Title: Amendment to the National Minimum Wage regulations 2014- increase in NMW rates **IA No: BISLM003** **Lead department or agency:** Department for Business Innovation and Skills (BIS) **Other departments or agencies:**	**Impact Assessment (IA)** **Date:** 2/05/2014 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Shilpa Patel: 0207 215 6160
Summary: Intervention and Options	**RPC Opinion:** RPC Opinion Status

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, One-Out?**	**Measure qualifies as**
£0.0m	-£496.76	£400.63	No	N/A

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

If there is exploitation in the labour market, employers may abuse unequal bargaining power to pay unacceptably low wages, particularly where workers have a lack of experience, skills, mobility or opportunities. The National Minimum Wage (NMW) is a statutory pay floor that provides protection to low-paid workers by; preventing potential exploitation; preventing businesses from undercuting other organisations by paying exploitatively low wages; and providing a greater incentive to work. The NMW came into force in April 1999 and since then the NMW rates have been reviewed by the Low Pay Commission annually.

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.

The Government stated in the Coalition Programme for Government (p23): "We support the NMW because of the protection it gives low-income workers and the incentives to work it provides.

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

The independent Low Pay Commission (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 2014 report.**

The Government has two options to consider:

1. Agree with all the LPC recommendations on NMW rates and implement the new rates
2. Reject all, or some of the LPC rates recommendations.

The Government has concluded that the LPC's recommendations are appropriate and therefore have agreed with all their recommendations.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 03/2015

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: Jo Swinson Date: 30/06/2014

Summary: Analysis & Evidence — Policy Option 1

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

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2014	Time Period Years 1	Net Benefit (Present Value (PV)) (£m)		
			Low: £0	**High:** £0	**Best Estimate:£0**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0.0			
High	0.0			
Best Estimate	0.0		£522.9m	**£522.9m**

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

As a result of increases in the adult and youth NMW rates, the wage bill for employers will increase by £444.6m and an increase in non-wage labour costs of £78.5m (a total increase in labour costs of £522.9m). Over 95% of these costs are direct costs to business but are out of scope of OITO.

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. 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			£522.9m	**£522.9m**

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

Employees – adults and young people benefit from higher wages (£444.6m) 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 (£78.5m).

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). This suggested that we should not expect a large fiscal impact from increasing the NMW, given the size of the recommended increase.

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

Main assumptions can be found in the impact assessment. As there is not sufficient new evidence to support changing the counterfactual, 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 2013.

The proposed 2014 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: £400.6m	**Benefits: 0**	**Net: -£400.6m**	No	NA

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 Low Pay Commission, annually to recommend the appropriate NMW rates. The final decision on whether to accept the Low Pay Commissions 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 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 vulnerable 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 therefore has more potential for negative employment effects for young people. The evidence shows that unemployment and employment rates are worse 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

BIS has worked closely with HM Treasury to provide oral and written evidence to the Low Pay Commission.[2]

Public consultation

The LPC consulted a range of stakeholders including employee and employer organisations to recommend the 2014 NMW rates. A full list of those consulted and a summary of responses can be found in Appendix 1 of the LPC report.

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[1] National Minimum Wage Low Pay Commission Report 2014 104

[2] https://www.gov.uk/government/publications/national-minimum-wage-final-government-evidence-for-the-low-pay-commission-2014-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.

Options identification

Options:

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 2013 to October 2014

Age band	October 2013 rate	LPC recommended rate for October 2014	Percent increase
Adult rate (for workers aged 21+)	£6.31	£6.50	3.0%
Development rate* (for workers aged 18-20)	£5.03	£5.13	2.0%
16-17 year old rate	£3.72	£3.79	2.0%
Apprentice rate	£2.68	£2.73	2.0%

Source: Low Pay Commission.

The Government's preferred option is to agree with the LPC recommendations.

Rationale for the Government's decision

The adult NMW rate

The LPC concluded that increasing the adult NMW rate by 19 pence (3.0%) in October 2014 is appropriate given the strength of the labour market, the more optimistic economic outlook and the NMW has fallen a little as a proportion of median earnings. They believe that this is the first step towards restoring the real value of the minimum wage. It is the biggest cash and percentage increase since 2008 and the first real increase since 2007. The LPC reported that they expect this to increase the number of jobs covered by the minimum wage by over a third to around one and a quarter million and it to lift NMW worker's pay relative to others' earning.

The LPC stated that because of the improved economic and labour market conditions employers will be able to respond in a way which supports employment.

The youth NMW rates

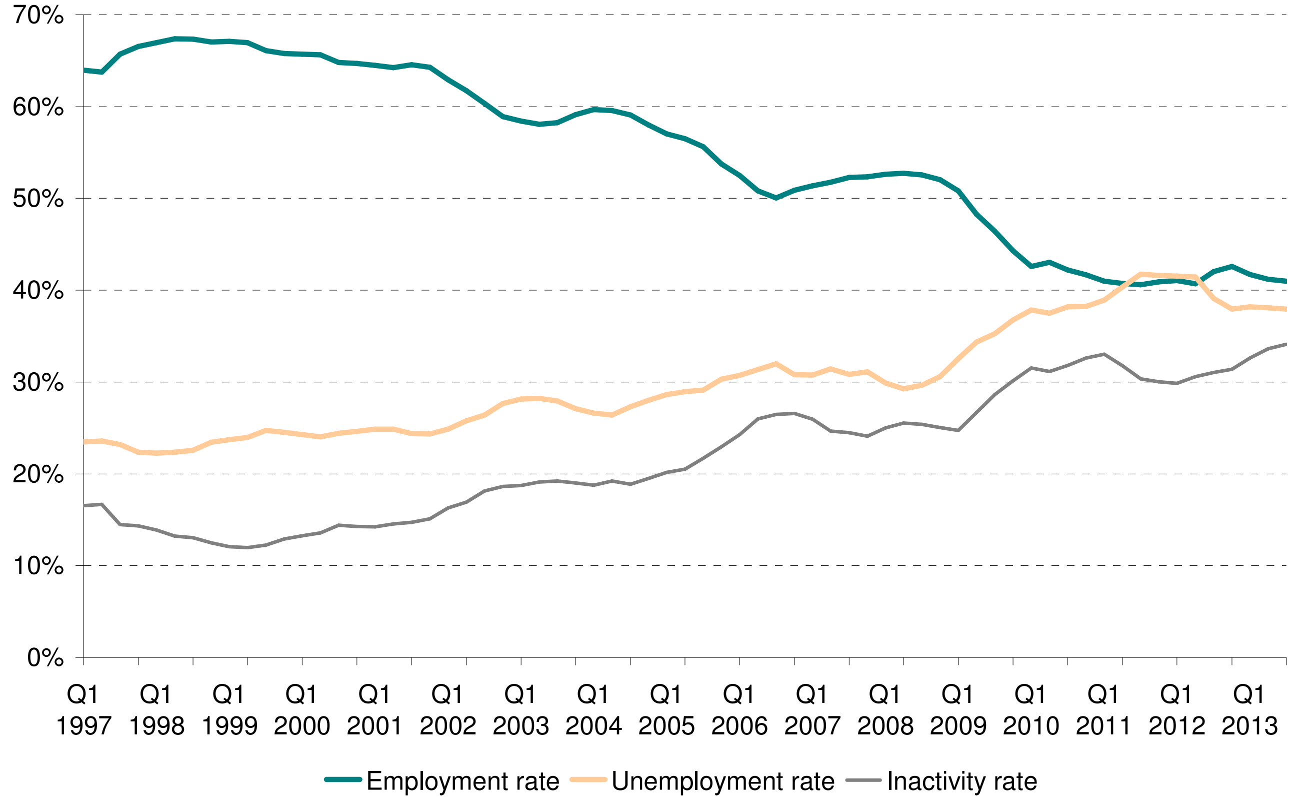
The LPC has recommended that the 16-17 year old rate should be increased by 7 pence (2%) and that the Development rate (18-20 year olds) should increase by 10 pence (2%) in October 2013.

This is a smaller increase than the adult, as has been the case in the last three years, as a result of the labour market position for young people remaining worse than for adults. The report stated that the labour market position has yet to improve to match that of adults, and, despite a fall in 2013, we continue to see greater use of the youth rates than in earlier years. The report found that the employment position of young people has stabilised and therefore, the LPC suggested that that this year, the increases should broadly protect the rates' real value (though less than the increase recommended for adults).

Chart 1 and 2 below show the employment, unemployment and inactivity rates of young people excluding full-time students and graduates.

Chart 1: Employment, unemployment and inactivity rates of 16-17 year olds, excluding full time students and graduates

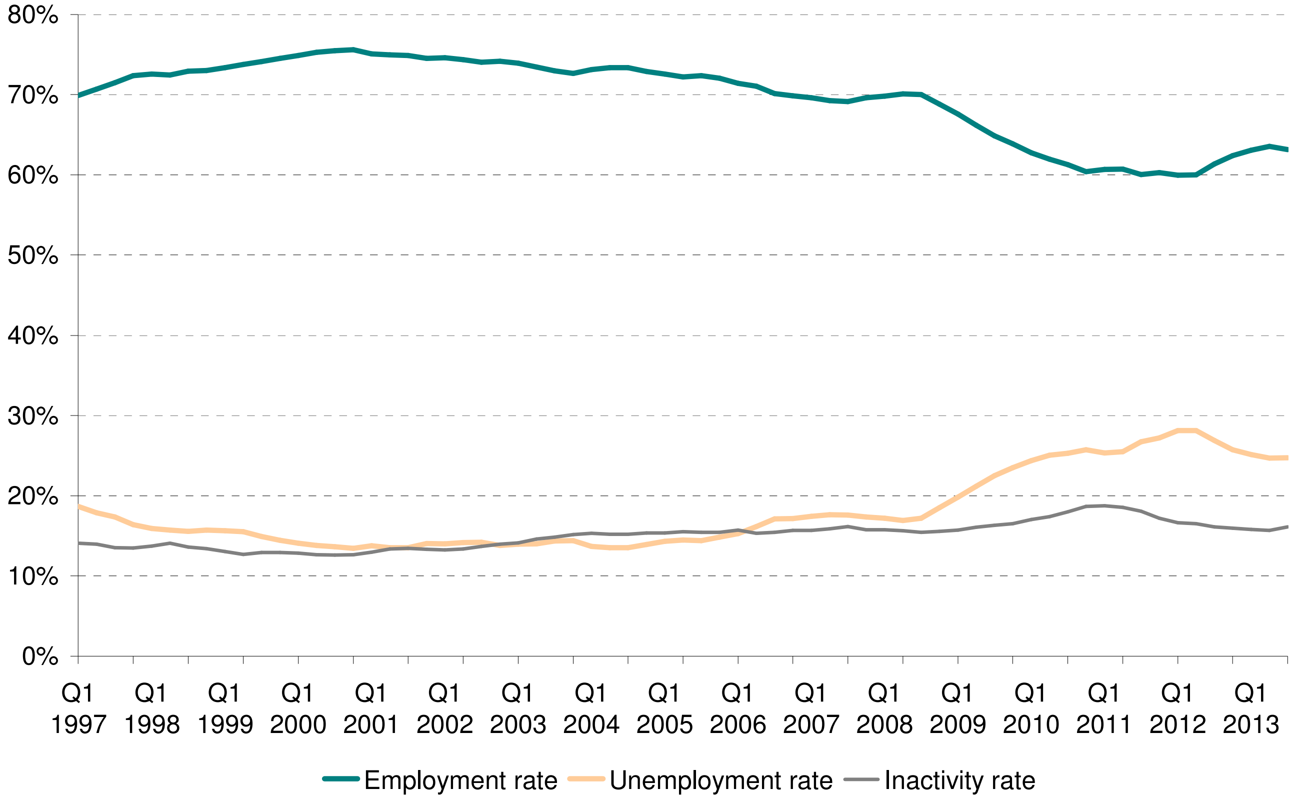
Per cent of age group, four quarter moving average



Source: BIS analysis of Office for National Statistics, Labour Force Survey. 4-quarter averages. Not seasonally adjusted.

Chart 2: Employment, unemployment and inactivity rates of 18-20 year olds, excluding full time students and graduates

Per cent of age group, four quarter moving average



Source: BIS analysis of Office for National Statistics, Labour Force Survey. 4-quarter averages. Not seasonally adjusted.

The Apprentice NMW (ANMW) rate

The LPC has recommended an increase in the Apprentice Rate which will protect its real value and maintain its position relative to the youth rates. From October 2014 the Apprentice rate will increase by 2 per cent or 5 pence, to £2.73.

The Accommodation Offset

In line with their recommendations from last year's 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 3.5 per cent, to £5.08 a day from 1 October 2014.

Analysis of options

Costs and Benefits

In assessing the impact of the 2014 NMW rates, we need to establish what might have happened in the absence of government intervention. As there is not sufficient new evidence to support changing the counterfactual, 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 9. However, the key points are that firstly, the policy rationale of preventing the potential for abuse resulting from unequal bargaining power between employers and employees still stands. Second, the conditions of the labour market have not changed significantly since last year and finally, the economic evidence presented on page 10 is supportive of this assumption,

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.[3]

[3] Due to the evidence base and inability to observe the true counterfactual we take these estimates as our best estimate.

Box 1: The real National Minimum Wage

The LPC has shown in their latest report that the real value of the NMW has fallen in recent years as the increase in the NMW rate has been lower than increases in Consumer Price Index (CPI) inflation. The real value of the NMW peaked in 2007 (at £6.95 in 2013 prices). Therefore in October 2013, the NMW was 34 pence lower than it was in October 2007. It should, however, be noted that over this period average earnings' growth has also been below inflation in recent years leading to a fall in real average earnings (see chart A1 in Annex 1).

It is important to note that employers and employees have different concerns over wages. Employers care about the real product wage that is the level of labour costs relative to the price of the products they sell that is typically proxyed by the GVA deflator. Employees care about the real consumption wage that is the level of labour income relative to the price of the goods and services they wish to consume, measured by the Consumer Prices Index (CPI). So the product wage includes 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 fall and real non-wage labour costs 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.

For 2014, the LPC have recommended a larger increase than in recent years following improved economic and labour market conditions. This is in line with the forecast for average earnings growth. The OBR expects whole economy wages to grow by around 2.5 in 2014 compared to a year earlier.

However, the LPC reported that it is too early to know how strong and sustained the recovery will turn out to be, or how far it will spread across all of the economy and the country. Therefore, they have had to balance the risk of recommending more than business and the economy can afford against the risk of doing too little to start to restore the real value of the earnings of the lowest paid.

Since the introduction of the adult NMW in April 1999 and October 2013, the NMW rate has increased by more than average earnings, CPI and RPI inflation over the whole period. Between April 1999 and October 2013, the adult NMW rate has increased by over 75 per cent whereas growth in average earning over the same period was around 60 per cent[4].

Since 2007 with the arrival of more uncertain economic conditions the LPC has taken a more cautious approach and increases have been much closer to average earnings which have fallen relative to prices. However over this period the adult NMW has got closer to median hourly earnings than ever before, improving the relative position of NMW workers.

This impact assessment measures the costs and benefits in nominal terms.

<u>The counterfactual</u>

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 2014. 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.

Evidence supports our assumption that the lowest paid workers would have received a pay freeze in the absence of a NMW rate review. In terms of the remainder of the earnings distribution, we assume that workers who are paid above the statutory minimum will receive different wage increases in 2014.

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

The purpose of the NMW is to prevent the potential for abuse resulting from unequal bargaining power between employers and employees (for example, this could occur in uncompetitive labour market situations (of which one example is monopsony labour markets), which are discussed in more detail in Annex 5). We consider it is reasonable to assume that an employer who enjoys unequal bargaining power would seek to maximise his profits and (in the absence of a statutory requirement to increase the wages of his employees), would not increase such wages.

Previous IAs have assumed that, in the absence of a NMW rate change, the lowest paid workers would have received an increase in wages in line with average earnings growth. The counterfactual used in this IA is the same as the one used last year for the October 2013 uprating of the NMW IA. There are a number of key reasons that support the use of this counterfactual. These are explored in more detail in Annex 1. However, the main arguments are briefly summarised below:

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' of the NMW has generally been increasing over time; NMW coverage has been increasing over time.
2. **The NMW is an established policy** - There is evidence that a number of employers track the NMW rate and may treat the NMW as the 'right' wage for the low paid; there is evidence that the NMW is influential in pay setting more generally. Recent evidence from the LPC shows that in economic recessions before the introduction of the minimum wage the wages of the lowest paid fell relative to the median. Since 1999 the picture has changed radically and the lowest paid have received larger increases than the median, due to the NMW.
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. If there was a binding wage floor in a competitive labour market, there would be an increase in unemployment because employers would want to pay less for labour than the wage floor – the LPC has found no strong evidence of negative employment effects of the NMW.
4. **The macroeconomy and the labour market** - The macroeconomic conditions in the UK, although improving, are not significantly different to last year; annual price inflation is currently above annual average earnings growth and has been over the last few years; the NMW rate has increased faster than average earnings and inflation since its introduction.

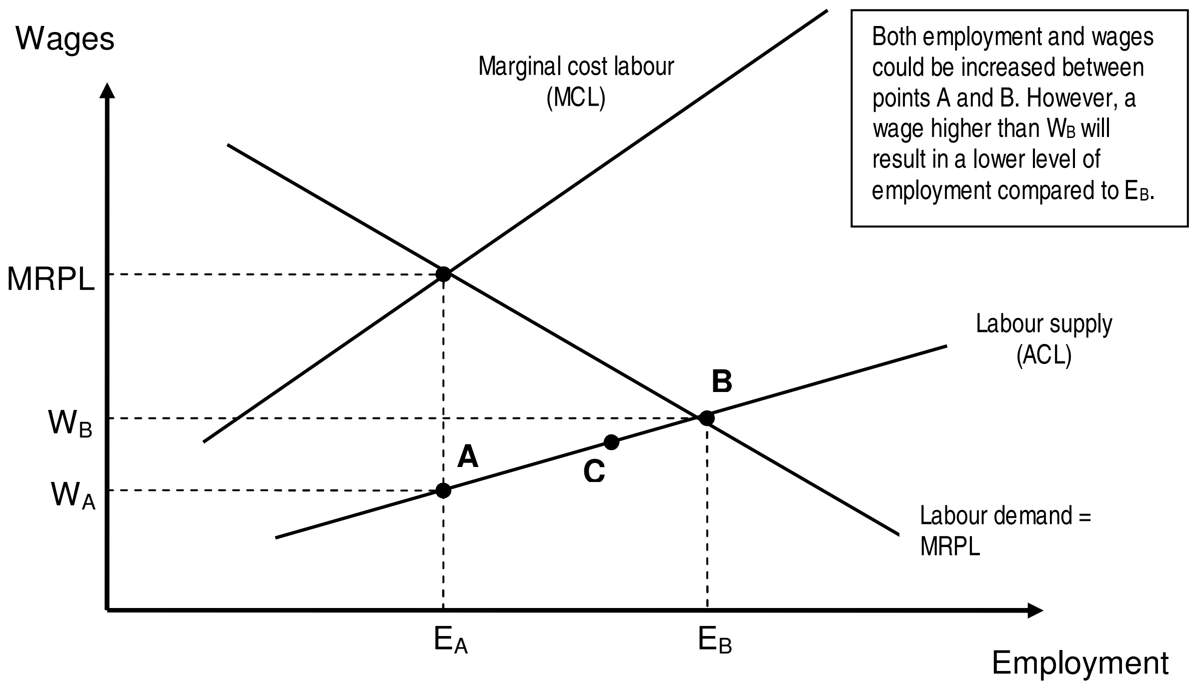
Economic Rationale

We assume that 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 (this is discussed in more detail below). The transfer from employers to workers is as a result of mitigating potential exploitation of workers from low wages through a wage floor.

Adults – 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 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 or 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



Young people – the argument is similar to adults although during the recession, it is more likely that the labour demand curve for young workers may have shifted inwards. If this happened to be the case, the distance between point C and B would become smaller. The LPC found that the labour market position of young people had stabilised over the last year following an increase of 1% in 2013 and a freeze in 2012 for both rates. The LPC also concludes that the research that they commissioned demonstrated little effect of the NMW on young people. However, some evidence showed that NMW upratings had a negative impact on hours worked, particularly for young people during the recession[5].

Apprentices – An increase in the ANMW rate could also have an impact on the employment and/or the training prospects for apprentices. Employers of Apprentices are faced with higher labour costs due to the provision of training and, in addition, may be faced with lower productivity while the individual is in training. As a result, an increase in the ANMW rate could mean that employers reduce employment or hours worked of apprentices and/or reduce the quantity or quality of their training to offset the increased wage costs.

Impact of the National Minimum Wage

The objective of the minimum wage is to maximise the wages of the low paid without damaging their employment prospects by setting it too high. The Commissions recommendations are shared judgements rather than the mechanistic products of an economic model. They are strongly based in evidence and involve careful assessments of, among other things the NMW relative to median earnings and the number of jobs covered by the minimum wage.

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[6]. The adult bite has broadly been stable between 2007 and 2010, reaching its highest level in October 2012 before falling back slightly in 2013. As mentioned above,

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[5] National Minimum Wage Low Pay Commission report 2014 page 72

[6] The 'bite' of a minimum wage is a relative measure of its importance for a particular sector or demographic. For instance, a high minimum wage compared with the median wage in the UK is good for the relative position of minimum wage workers however it is more likely to affect their employment outcomes than a low bite

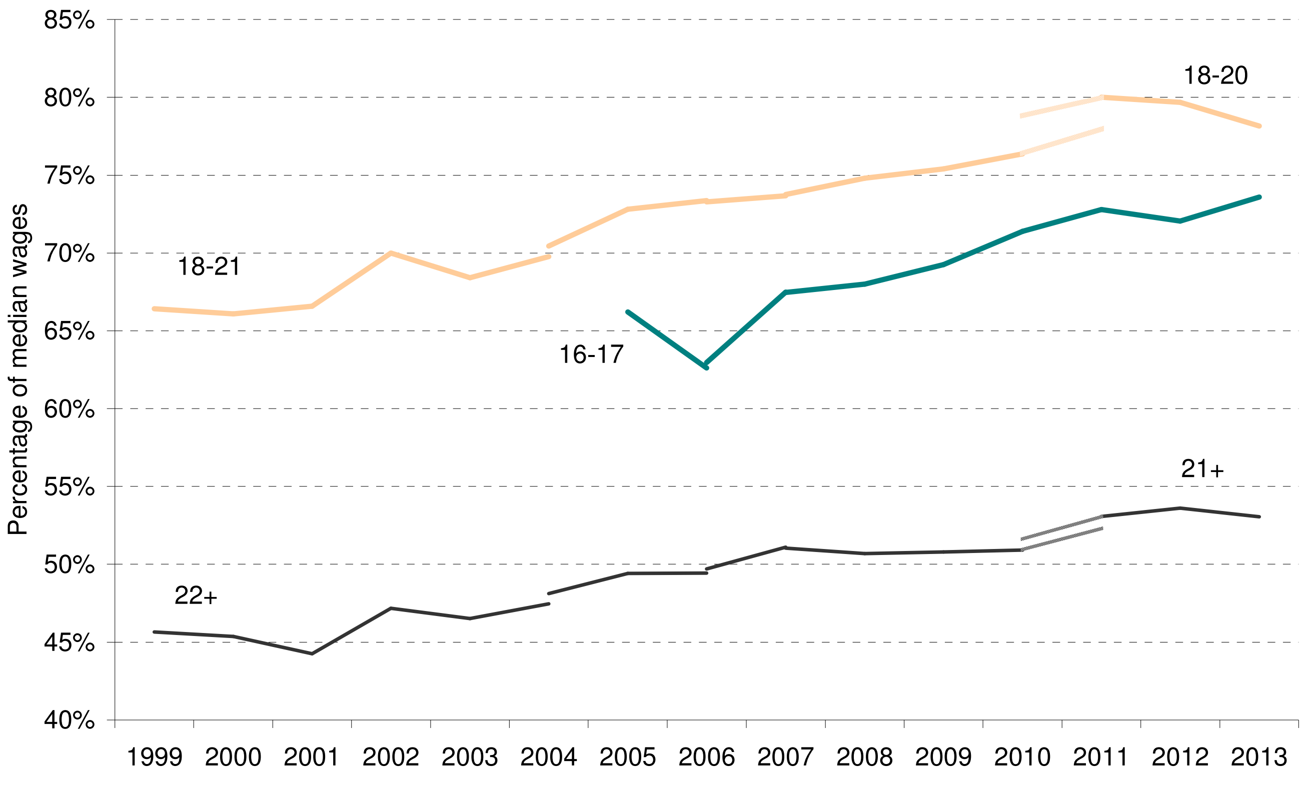
research for, and analysis by, the LPC has not found significant evidence of negative employment effects as a result of the adult NMW. The LPC concluded that an increase which would roughly maintain the position of the lowest paid and is the largest increase that employers would pay without cutting jobs.

The earnings of 18-20 year olds saw relatively strong growth in 2013 compared with the previous year and the bite of the Youth Development Rate fell, due in part to the freezing of the Youth Development Rate in October 2012. 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[7].

Apprenticeship starts in the UK on the other hand fell in 2012/13 for the first time since 2005/06 and the fall was greatest among 16-18 year olds. According to the findings from the 2012 Apprentice Pay Survey, median hourly earnings of under 19 year old apprentices in England were £3.00. This means that the bite of the ANMW on this age group was 88.3%. The bite varied considerably by sector and was found to be 98.1% in hairdressing[8]. However, caution is needed in interpreting information from the survey and the results should be seen as indicative.

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. 2006-2013 ASHE data - new methodology.

Number of jobs covered by October 2013 NMW rates as at April 2014

The methodology used by the LPC in previous reports to estimate coverage will only produce sensible estimates of coverage when the downrated value of the future minimum wage is at least its current

[7] The LPC reported a reduction in employers' use of the youth rates in the last twelve months; the 16-17 Year Old Rate fell in 2013. There was no change in the proportion of 18-20 year olds paid at the Youth Development Rate. The proportion paid at the Adult Rate fell slightly. We also noted a rise in the proportion of young people paid below their age-related NMW rate although this may be due to the increased number of apprentices and greater use being made of the Apprentice Rate

[8] Hairdressing is also found to have a high occurrence of non-compliance

value. That is, in other words, when the increase in the NMW is greater than the increase in wages suggested by the forecasts.

In order to estimate the coverage of the recommended upratings in April 2015, the LPC down rated the recommended rates using predicted wage growth to April 2013 (the date of the latest earnings data).

The table below presents the number of workers working at or below the NMW rates recommended for October 2014, in April 2013 from the LPC report[9]. These are based on ASHE 2013 data. Because of this change in the methodology, the estimates below are likely to be an overestimate of coverage.

Table 2. Number of employees paid at or below the October 2014 National Minimum Wage by age

Figures are based on the share of employees in the private sector from ASHE 2013.

Age group	October 2014 rates	Numbers covered
16-17 year old rate	£3.79	39,000
Development rate (for workers aged 18-20)	£5.13	183,000
Adult rate (for workers aged 21+)	£6.50	1,909,000
Total		**2,131,000**

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

Because the LPC recommendation for uprating the youth rates is lower than the adult rate, the LPC does not expect a large increase in the coverage of the youth rates.

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**[10] hourly pay for those 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 2013 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 2013 ASHE[11] to estimate potential workers affected.

To go from the total wage bill to total labour costs, we add 17.8 per cent to take account of the cost to employers of National Insurance and any other non-wage labour costs (such as pension contributions)[12].

The annual review of the NMW will be part of business as usual so therefore we do not envisage any transitional costs to employers as part of the rate change.

Impact on public finances: Analysis by HMT shows 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.[13]

[9] National Minimum Wage Low Pay Commission report 2014 page 183

[10] We use a weighted average as there will be some individuals that partially benefit by less than 19 pence (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 16 pence (this is lower than the 19 pence increase in the adult rate).

[11] The number earning at or below the proposed NMW in April 2013

[12] Source: Eurostat

[13] 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

Our calculations for all rates can be found in figures 2-5 below.

Total costs and benefits for all rates

Table 3. Summary costs and benefits of option 1*

Age band	October 2014 rate	Employers Higher labour costs	Employees Higher wages for employees (benefit)
Adult rate (aged 21+)	£6.50	£486.3m	£412.8m
Development rate (aged 18-20)	£5.13	£4.1m	£3.4m
16-17 year old rate	£3.79	£29.3m	£24.9m
Apprentice rate	£2.73	£3.4	£3.4

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.

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

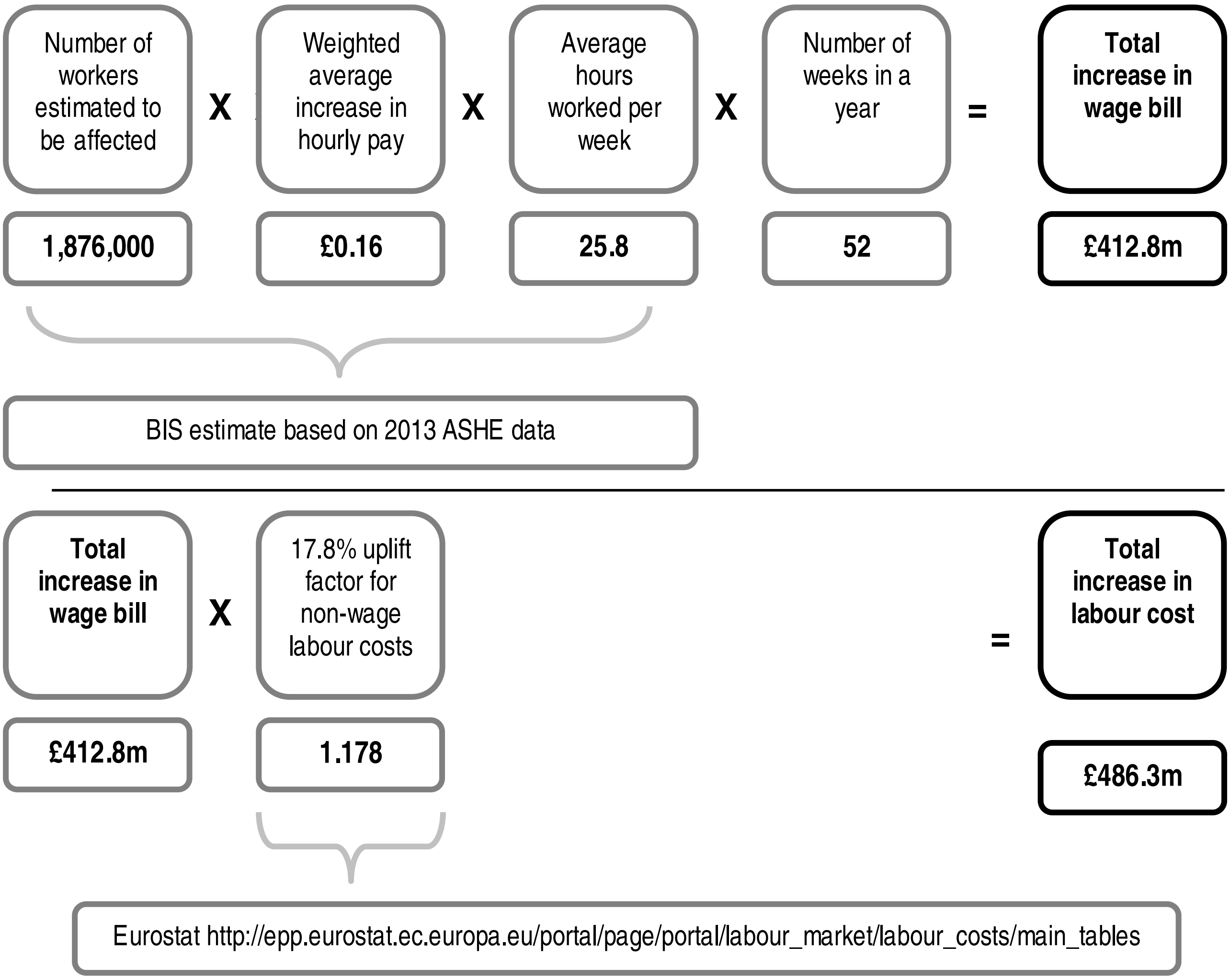
The proposed changes to the October 2014 rates represent an increase of 3.0% on the current rate for adults.

The total estimated cost impact of the 2014 adult rate is an increase in labour costs of **£486.2m for all employers (a direct impact on business of £463.4m).**

Adult employees benefit from increased wages (**£412.8m**) and non-wage labour costs will increase by (**£73.5m**).

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 £6.31 to £6.50 (figures have been rounded*)



Source: BIS calculations. * Individual parts may not sum to total due to rounding. The estimated number of workers affected in figure 2 is a BIS estimate and this differs to table 2 which is a LPC estimate. Differences are due to slight variations in methodology.

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

The proposed changes to the October 2014 rates represent an increase of 2.0% on the current rate for 16-17 year olds.

The estimated cost impact of the 2014 16-17 rate is an increase in labour costs of **£4.1 m for all employers (a direct impact on business of £3.7m).**

16-17 year old employees benefit from increased wages (**£3.4m**) and non-wage labour costs will increase by (**£0.6m**).

We have assumed that there will be no negative employment effects from uprating the 16-17 NMW rate.

Figure 3. Estimated increase in labour costs from increase in 16-17 NMW rate from £3.72 to £3.79 (figures have been rounded*)

Source: BIS calculations. * Individual parts may not sum to total due to rounding. The estimated number of workers affected in figure 2 is a BIS estimate and this differs to table 2 which is a LPC estimate. Differences are due to slight variations in methodology.

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

The proposed changes to the October 2014 rates represent an increase of 2.0% on the current rate for 18-20 year olds.

The estimated cost impact of the 2014 18-20 rate is an increase in labour costs of **£29.3 for all employers (a direct impact on business of £27.3m).**

18-20 year old employees benefit from increased wages (**£24.9m**) 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.

Figure 4. Estimated increase in labour costs from increase in 18-20 NMW rate from £5.03 to £5.13 (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**
185,000		**£0.09**		**27.5**		**52**		**£24.9m**

Total increase in wage bill	X	17.8% uplift factor for non-wage labour costs	=	**Total increase in labour cost**
£24.9m		**1.178**		**£29.3m**

Source: BIS calculations. * Individual parts may not sum to total due to rounding. The estimated number of workers affected in figure 2 is a BIS estimate and this differs to table 2 which is a LPC estimate. Differences are due to slight variations in methodology.

Cost and benefits of the apprentice rate

The proposed changes to the October 2014 apprentice rates represent an increase of 2.0% on the current rate for 18-20 year olds. BIS estimates that around 35,707 apprentices stand to benefit from the increase in the ANMW rate and that it will **cost employers £3.4m (a direct impact on business of £3.2m)** in increased wage bills. This represents a transfer and will **benefit apprentices by £3.4m** in the form of increased wages.

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

- Using ASHE 2013 data we estimate that around 35,707 individuals earn at or less than the £2.73 per hour ANMW rate. We assume that all these people are apprentices. Given these small numbers we assume all of the apprentices affected will benefit from a 5p pay rise per hour.
- We multiply the above by **37 hours** worked per week (the average hours contracted to work by apprentices on the ANMW in 2012[14]).
- Multiply by 52 weeks per year.

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.

[14] Source: Apprenticeship pay survey 2012 data

Figure 5. Estimated increase in wage bill from increase in ANMW rate from £2.68 to £2.73

Number of apprentices estimated to be affected	X	Average increase in hourly pay	X	Average hours worked per week	X	Number of weeks in a year	=	**Total increase in wage bill**
35,707		**£0.05**		**37**		**52**		**£3.4m**

BIS estimate based on 2013 ASHE data and 2012 BIS Apprenticeship Pay Survey

Source: BIS calculations. Figures have been rounded.

In order to make our coverage estimate of 35,707.we have assumed that all individuals counted by ASHE earning at or below £2.73 are apprentices. This is because, using ASHE, it is not possible to distinguish between whether an individual is an apprentice or not

As discussed above, there could be 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. However, due to the uncertainty associated with these impacts, we have not monetised them.

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 £4.91 in October 2013 to £5.08 in October 2014. This represents an increase of 3.5%. The Accommodation Offset is a benefit to employers as it allows them to offer a greater amount in benefits in kind to workers. 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 2014 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 2014. 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[15].

We have assumed that there are no negative employment effects of uprating the adult and youth NMW rates. The LPC reported that the minimum wage has done its job well. 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.

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 2014[16].

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 NOU 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 NOU.

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

Table 4 represents a summary of the LPC's recommendation.

[15] National Minimum Wage Low Pay Commission report 2013 page 91
[16] National Minimum Wage Low Pay Commission report 2014 page 185

Table 4. Summary costs and benefits of option 1*

Age band	October 2014 rate	Employers	Employees
Adult rate (aged 21+)	£6.50	Higher labour costs	Higher wages for employees (benefit)
Development rate (aged 18-20)	£5.13	Higher labour costs	Higher wages for employees (benefit)
16-17 year old rate	£3.79	Higher labour costs	Higher wages for employees (benefit)
Apprentice rate	£2.73	Higher labour costs	Higher wages for apprentices (benefit)

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.

Implementation

The changes to the NMW regulations would be made by secondary legislation and would be expected to come into force on 1 October 2014.

"One in, two out" rule

Implementation by the Government of LPC rate recommendations falls out of scope of the 'one-in two-out' (OITO) rule whereby no new regulation can be brought in without other regulations being removed. Therefore, under option 1 all direct costs to business are exempt from OITO (EANCB score £522.9m).

Annexes

Annex 1: Counterfactual discussion

Below are further details of the main arguments for selecting the counterfactual for this IA referred to on page 6.

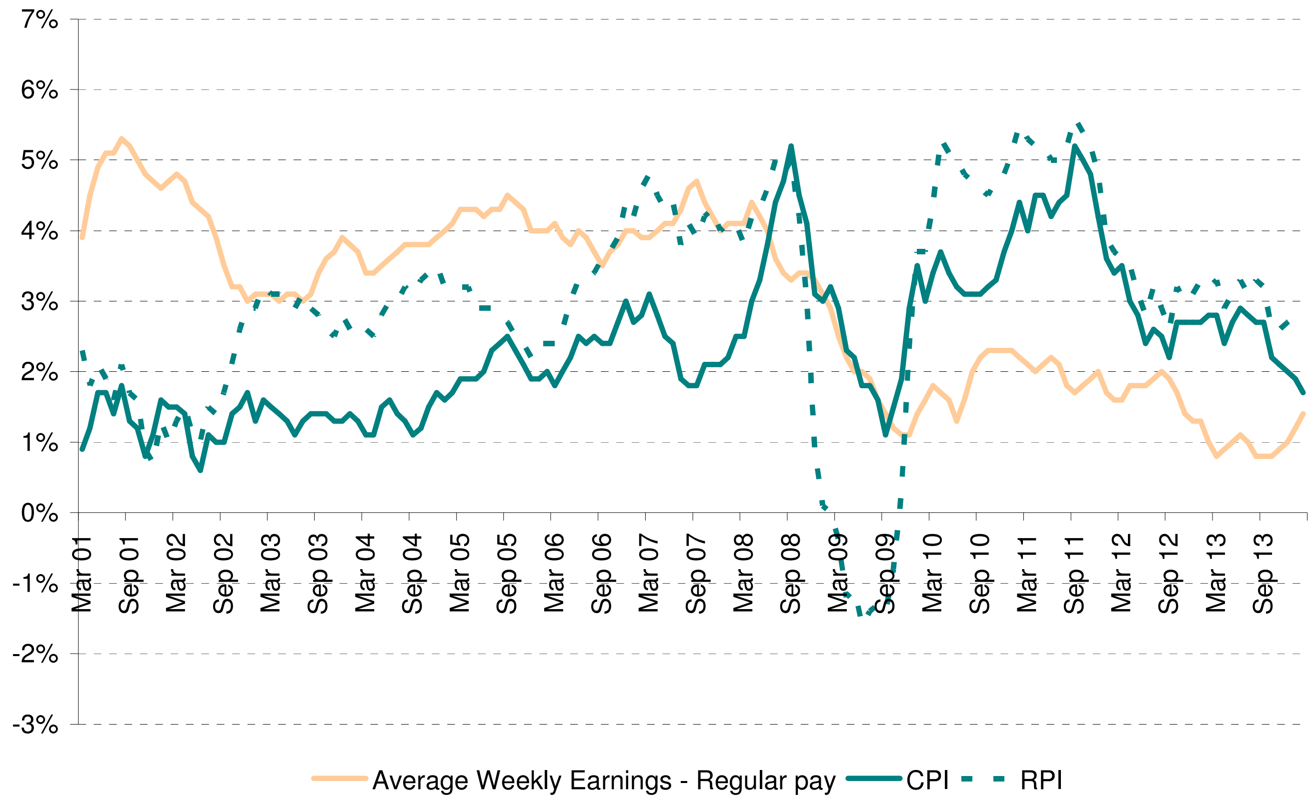
1) The macro economy and labour market

The macroeconomic conditions in the UK have improved somewhat since the 2013 rate recommendations. The recovery has taken hold with growth forecasts revised upward and improving labour market conditions with rising employment, falling unemployment and falling inactivity. However the state of the macroeconomy remains very different compared to the years that followed the introduction of the NMW. The latest GDP data for the fourth quarter of 2013 show growth of 0.7 per cent compared with Q3 2013 and growth over the year as a whole was 1.8 per cent compared to 2012. However the recession was one of the deepest with GDP falling by 7.2 per cent between its peak in Q1 2008 and its trough in Q2 2009. GDP remains 1.4 per cent below the pre-downturn peak. The OBR revised up its forecast for GDP growth in 2014 by 0.3 percentage points to 2.7 per cent, in line with the average of outside forecasts.[17]

Average earnings growth in the economy as measured by Average Weekly earnings (AWE) remained subdued throughout 2013 rising by 1.4 per cent in November 2013 to January 2014 compared to a year earlier, outstripped by CPI inflation of 2.0 per cent. Earnings growth has been consistently below inflation since the recession (see chart A1 below). With both average earnings growth being shocked downwards post recession and price inflation higher than wage growth; this casts some doubt over whether the very lowest paid workers in the economy would have received average earnings pay settlements in the absence of a NMW rate increase.

[17] http://cdn.budgetresponsibility.org.uk/13476-Exec_summary_March2014_EFO_web.pdf

Chart A1. Annual growth in average weekly earnings, consumer price inflation and retail price inflation



Source: National Statistics. Average weekly earnings (KAI9), CPI (D7G7), RPI (CZBH)

Prior to the introduction of the NMW, wages for the lowest paid grew at around the same rate as the CPI with those just above getting increases in line with RPI. However, these increases were considerably below average earnings increases.

Since its introduction, the adult NMW rate has risen faster than average earnings and price inflation over time (see box 1) and therefore the scope to increase it any further without incurring job losses is now more limited. Because of the limited scope to further substantially increase wages without the shedding of labour we strongly believe the appropriate counterfactual is a wage freeze.

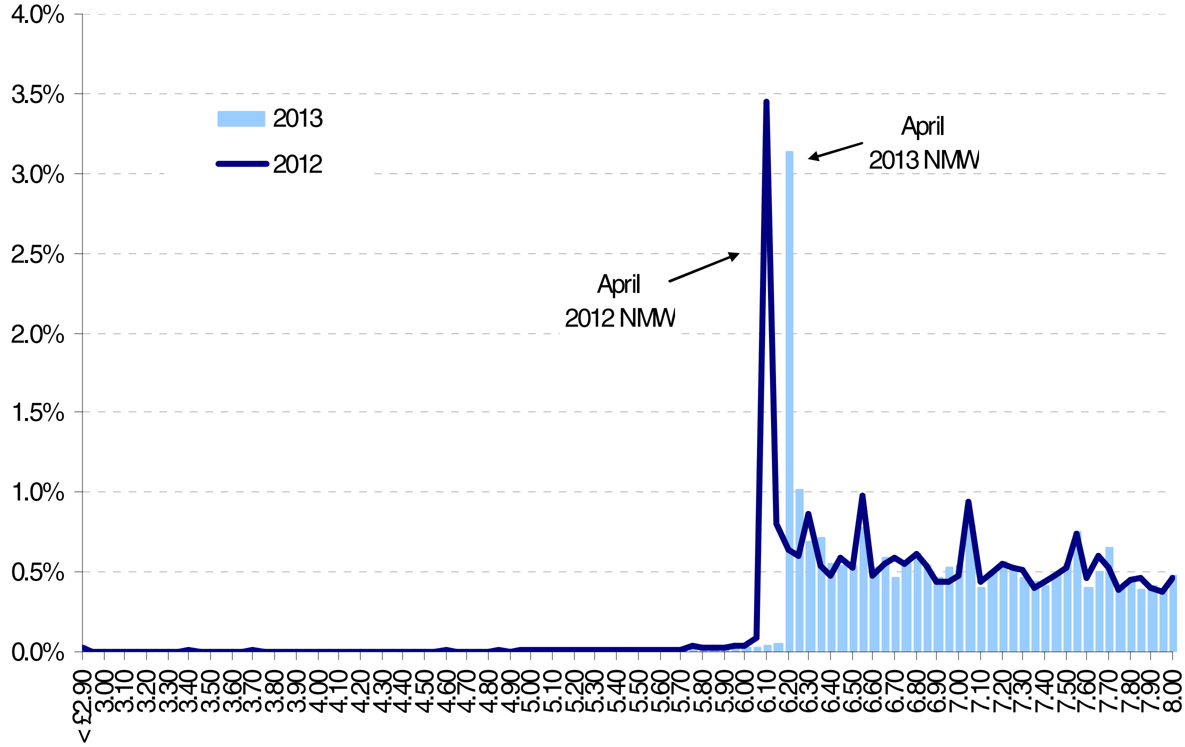
2) Evidence suggests that the NMW is binding on the labour market

Evidence from ASHE 2013 in Chart A2 clearly shows the impact of the NMW with a spike in the hourly earnings distribution at £6.19 in April 2013, the adult rate at the time. Around 929,000 employees aged 21 and over (3.8 per cent) were paid at the minimum wage.[18] This number is below that in April 2012 (around 961,000 or 3.9 per cent) but was substantially above that in April 2011 (about 737,000 or 3.0 per cent). The distribution just above the spike has remained largely unchanged as can be seen for 2013 and 2012. The 2013 uprating is slightly higher at 1.9 per cent and the recommended 2014 uprating is the largest increase in the NMW since 2008 at 3 per cent, however, we will not be able to assess their impact on the low pay distribution until further data is released.

[18] This is calculated including those paid 5 pence above the NMW.

Chart A2: Adult low-pay distribution, April 2013

Per cent of adult employee jobs for employees aged 21 years or older, by five pence band



Source: Office for National Statistics, Annual Survey of Hours and Earnings

We can also look at the NMW as a proportion of median earnings, or the 'bite' (see chart A3 below). Since its introduction, the bite of the adult NMW rate has steadily increased from 45.6 per cent of the median wage in 1999 to 53.1per cent in April 2013. Between April 2012 and April 2013, the adult bite decreased by 0.6 percentage points and now stands as the same level as in 2011, close to its highest level since the NMW was introduced. The most recent decrease indicates median earnings have increased faster than the NMW.[19]

The bite for 18-20 year olds fell slightly for the second consecutive year between April 2012 and April 2013 to 78.2 per cent of the median in 2013. 21 year olds moving out of scope of the development rate is likely to have contributed to the relatively large jump in the associated bite between April 2010 and April 2011. The impact of this change was greater for this age group than for adults.

The bite for 16-17 year olds on the other hand increased between April 2012 and April 2012 to 73.6 per cent, following a fall in the bite the previous year. The rise in the bite comes despite the freeze in the 16-17 year old and development rate in October 2012 Further discussion on youth earnings is presented in section four.

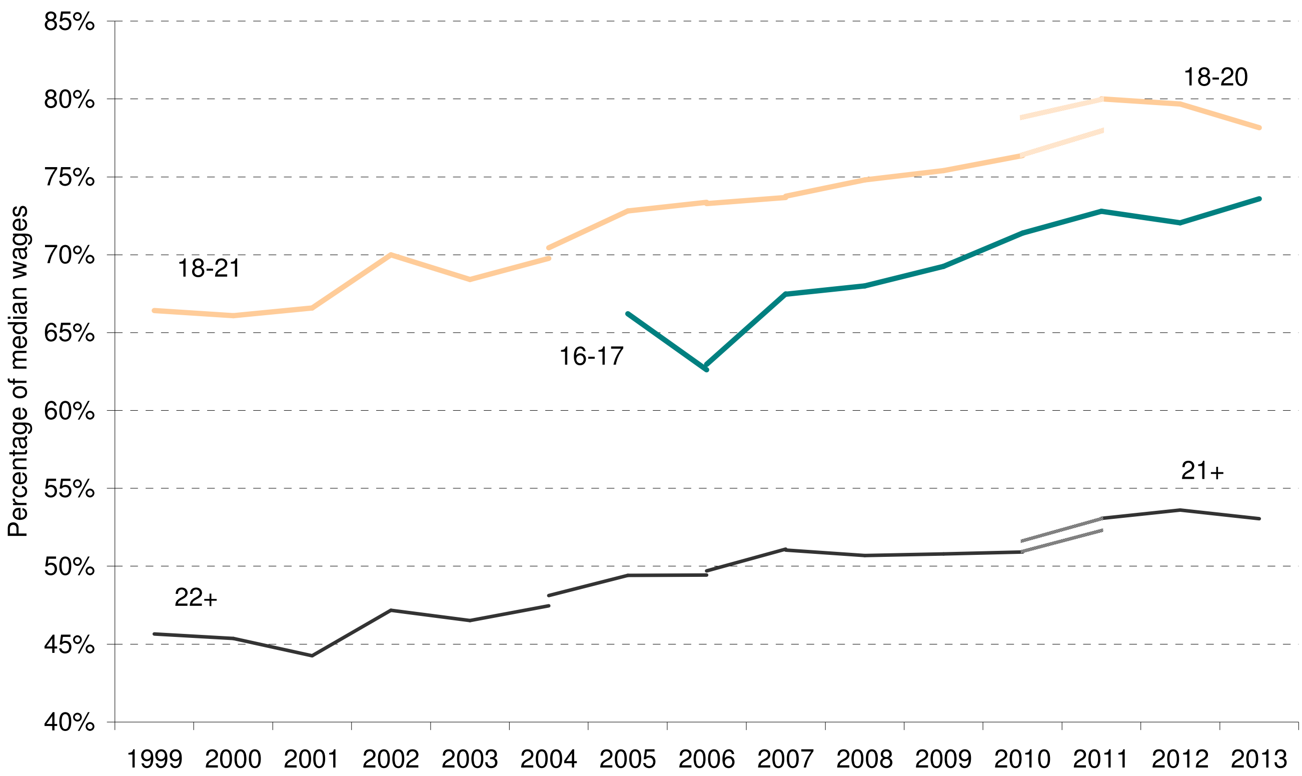
The bite has been steadily rising for adult workers in the low-paying industries, from 67.5 per cent in 1999 to 78.8 per cent in 2013. The bite for non low-paying sectors increased from 42.2 percent to 45.9 percent over the same period. The lower earning growth between 2007 and 2011 in the low-paying sectors resulted in the bites of the minimum wage in the low-paying sectors and the other sectors diverging. Annualised earnings growth in the low-paying sectors was, on average, 2.1 percentage points lower than the uprating in the NMW between 2007 and 2011.[20]

Chart A3: The bite of the NMW

[19] In this report we use earnings' data from the 2013 Annual Survey of Hours and Earnings and calculate bites based on the appropriate NMW rates for April 2013.

[20] National Minimum Wage Low Pay Commission report 2014 page 36

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. 2006-2013 ASHE data - new methodology.

3) The NMW has been established for fifteen years

In addition to the arguments above, it should also be noted that the adult NMW rate was introduced 15 years ago. The LPC has received evidence that some employers have tended to track the NMW rate each year[21]. For these employers if the NMW rates were not reviewed and were frozen they would be highly likely to freeze rates. It is also possible that over time, the NMW may have had an impact on the business behaviour of low paying firms such that these businesses may interpret the NMW rate as the 'appropriate' wage for the low paid. Low paying employers thus may interpret a wage freeze (achieved through no government intervention to review the rates) as a signal that the most appropriate wage settlement is a freeze.

Chart A2, based on ASHE 2013 shows that for workers on the adult NMW there is a 'spike' in the earnings distribution at the 2012 NMW rate in 2012. In 2013 this 'spike' moves to the April 2013 minimum wage rate. This trend of employers closely tracking the NMW rate has also been present in previous years. Based on this evidence, we assume that if NMW rates were not reviewed, employers would track this wage freeze.

The 2014 LPC report suggests that there is further evidence of the NMW having an influence on pay setting, citing the Workplace Employment Relations Study (WERS) 2013[22] which found that 31 per cent of private sector employers considered the NMW as an influence on pay settlements. Also, CIPD (2012) found that 7 per cent regarded the NMW as the most influential influence on increasing salaries[23]. Bryson and Lucchino (2014) found that the NMW played a stronger role in the private sector when the management set pay unilaterally, and where trade unions were absent or were not involved in pay-

[21] There is evidence that there is a spike in the earnings distribution at the NMW rates and that this spike jumps to the new NMW rate on an annual basis (see chart A2).

[22] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/68684/13-535-the-2011-workplace-employment-relations-study-first-findings.pdf

[23] National Minimum Wage Low Pay Commission report 2014 page 49

setting. The researchers conclude that this is important as it demonstrated that the NMW is 'providing a minimum standard of pay protection in pockets of the labour market where such protection would otherwise be absent'. Furthermore, research commissioned by the LPC found that there is clear evidence that the NMW has affected the timing of pay reviews in the low paying sectors.[24]

Recent evidence from the LPC shows that in economic recessions before the introduction of the minimum wage the wages of the lowest paid fell relative to the median. Since 1999 the picture has changed radically and the lowest paid have received larger increases than the median

4) Uncompetitive labour markets

For the purpose of this analysis, workers in the labour market can be broadly split into two groups – workers that have unequal bargaining power with their employer and could be exploited through low wages (for example uncompetitive labour markets) and workers employed in the competitive labour market (who are paid at the competitive labour market rate). Where there is presence of unequal bargaining power and potential exploitation of workers, both wages and employment can rise together. In a competitive labour market, employers are faced with a downward sloping demand curve and increases in wages correspond with less employment – assuming no change to the labour supply curve.

The NMW rates cover workers who could potentially be exploited by their employers (who have some form of labour market power) but are set at a level that is approaching the competitive labour market wage. Beyond this wage, the NMW will start affecting the competitive labour market and a further rise in the NMW would be followed by a fall in employment.

Research commissioned by the LPC for its 2014 report shows that though the lowest paid had received higher than average wage increases, there remains little evidence of significant adverse effects of the minimum wage on employment. For young people, there may be a greater risk that their NMW rate is very close to the competitive labour market wage given their poor labour market performance over the recession. The labour demand curve for young low paid workers may have shifted inwards (a fall in demand) and there is greater uncertainty over the level of the competitive labour market wage for young people. On balance, we have concluded that the current NMW rates are not yet greater than the competitive labour market wage although we recognise that there is great uncertainty.

With this discussion in mind, we consider it is reasonable to assume that an employer who enjoys unequal bargaining power would seek to maximise his profits and, in the absence of a statutory requirement to increase the wages of his employees, would not increase such wages. Furthermore, if hypothetically the NMW was a binding wage floor in a competitive labour market (above the market clearing level), as discussed above, this would be expected to reduce labour demand compared to a situation in which the market clearing wage prevailed – and thus reduce employment (given an unchanging labour supply curve). In addition, businesses would not increase wages in the absence of a wage floor, but reduce them, as there would be enough people willing to work at a lower wage to fill the number of positions that businesses wish to fill.

It is important to also note that the Low Pay Commission (LPC) provides NMW rate recommendations such that low paid workers are helped as much as possible, while making sure that their employment prospects are not damaged by setting it too high. The LPC monitors the level of the NMW and its employment effects primarily through examining the NMW bite (NMW as a percentage of hourly median earnings) and monitoring of employee jobs in low paid sectors. The LPC makes its recommendations based on the best available economic evidence as well as oral and written evidence from Government and other stakeholders.

[24] National Minimum Wage Low Pay Commission report 2013 page 53

Annex 2: 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. 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. It is therefore unlikely that the NMW creates significant barriers to entry.

We conclude that the 2013 NMW rates are unlikely to hinder the number or range of suppliers or the ability and incentive for businesses to compete.

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 around 19 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 13 per cent of jobs in micro firms[25].

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 to 67.0 per cent in 2012 and 66.0 per cent in 2013. Similarly, other small firms experienced an increase in the bite from 48.2 per cent in 2001 to 59.4 per cent in 2013. 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 and 2012, albeit then falling back a little in 2013.

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

- Full Exemption
- Partial exemption
- Extended transition period
- Temporary exemption
- Varying requirements by type and/or size of business
- Direct financial aid for smaller businesses
- Opt-in and voluntary solutions

[25] https://www.gov.uk/government/publications/national-minimum-wage-low-pay-commission-report-2014 page 23

- Specific information campaigns or user guides training and dedicated support for smaller businesses

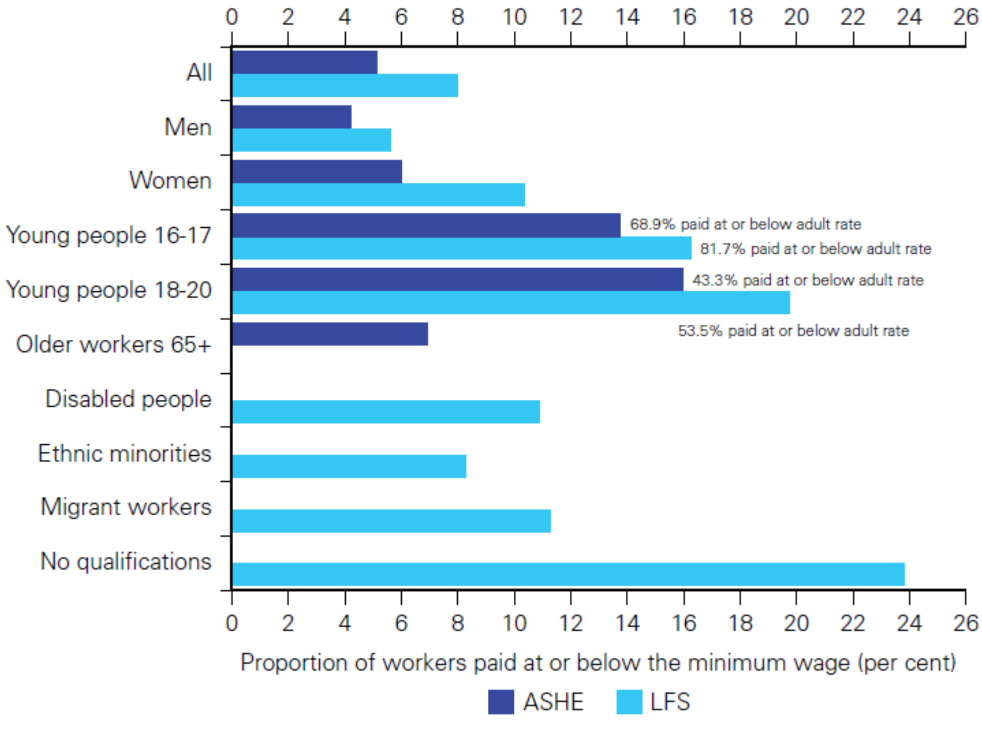
Following from the evidence above, allowing any exemptions targeted at small and micro business could have a negative impact on the primary objective of this policy, providing protection to low-paid workers by preventing exploitation, and providing incentives to work.

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 2014 report, these groups include women, young workers, older workers, people with disabilities, ethnic minorities, migrant workers, and those with no qualifications[26]. Chart A4 below shows the proportions of minimum wage workers of each of these groups compared to the general population.

Chart A4: Minimum Wage Workers, UK, 2013[27]



Source: LPC estimates based on ASHE 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013 and LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q2 2013.
Note: Minimum wage jobs defined as adults (aged 21 and over) earning less than £6.24, youths (aged 18-20) earning less than £5.03, and 16-17 year olds earning less than £3.73 in April 2013.

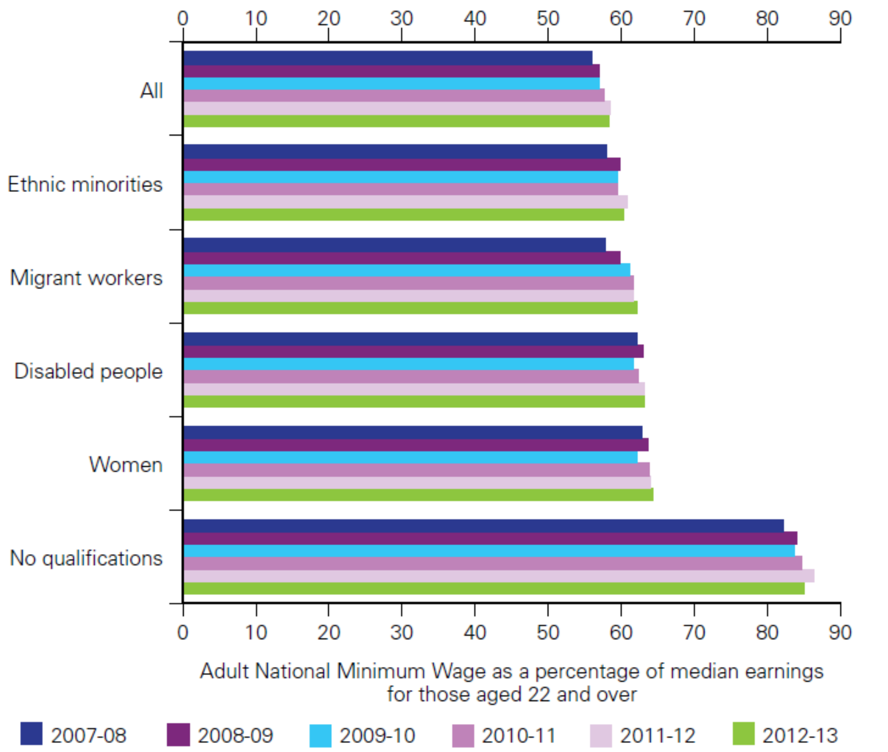
[26] National Minimum Wage Low Pay Commission report 2014 page 27
[27] National Minimum Wage Low Pay Commission report 2014 page 29

Gender

Chart A4 shows that a higher proportion of women than men were minimum wage workers in 2013. This is also reflected in the coverage estimates by gender of the October 2013 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[28]' of the adult NMW for women is slightly higher than for the general population (see chart A5).

The LPC notes that the median gender pay gap has increased over the last year from 8.5 per cent to 9.4 per cent. In 2013, the growth in male earnings has been higher than the growth in female earnings across the earnings distribution. This has resulted in increases in the gender pay gap at the lowest decile, the median and the upper decile. The gender pay gap at the lowest decile was 5.8 per cent in 2013, up from 5.0 per cent in 2011. Although the median gender pay gap in 2013 rose by nearly 1 percentage point to 9.4 per cent and the upper decile gender pay gap rose to 20.5 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[29].

Chart A5: Bite of the adult NMW at the median for those aged 22 and over, by groups of workers[30]



Source: LPC estimates based on LFS Microdata, income weights, quarterly, four-quarter averages, UK, Q4 2007-Q3 2013.
Note: Due to changes in the data series, the estimates from 2011/12 onwards are not directly comparable with estimates for earlier years.

28 NMW as a proportion of median earnings
29 Assuming no decrease in employment or substitution between men and women
30 National Minimum Wage Low Pay Commission report 2014 page 40

Age

The LPC identified that a higher proportion of young workers and older workers are minimum wage workers. They noted in their 2014 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 A4 are slightly higher (10.8%) than jobs held by the same group (10.1%) according to the LFS figures. Minimum wage jobs accounted for 8.3 per cent of jobs held by ethnic minorities as opposed to 7.7 per cent for White workers. 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 (5.4 per cent and 6.2 per cent respectively) were lower than that of white workers (7.7 per cent). In contrast, 15.3 per cent of Pakistani and Bangladeshi workers earned the minimum wage[31].

Chart A5 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 58.1 per cent) and those from ethnic minorities as a whole (from 57.9 per cent to 60.3 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 51.3 per cent in 2012/13. The increase in the bite for Bangladeshi people was similar albeit at a much higher level (from 74.0 to 76.0 per cent). The increase in the bite for black workers over the same period, from 56.9 per cent to 61.4per cent, was much larger. In contrast, the bite has fallen considerably for people of Pakistani origin from 73.5 per cent to 71.1 per cent. Over the last year, there was a fall in the bite for all ethnicities, except for Pakistani workers[32].

Disability

Chart A4 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 2013 NMW rates are unlikely to create any barriers to equality with regards to the protected groups.

[31] National Minimum Wage Low Pay Commission report 2013 page 24

[32] National Minimum Wage Low Pay Commission report 2013 page 41

Annex 3: Coverage estimates

As discussed above, the LPC has not made comprehensive forecasts of future coverage of their October 2014 NMW rate recommendations. In the same way that we have provided aggregate figures in table 2 using ASHE 2013 data, below are estimates of the number of people earning at or below the LPC's recommended NMW rates for October 2014. These estimates do not include apprentices because data is not reliable enough to do so.

Table A2. Estimated number of workers (excluding apprentices) that are covered by the October 2014 National Minimum Wage rates by age and sex

	Male	Female	Total
16-17	18,000	21,000	39,000
18-20	92,000	90,000	183,000
21 and over	706,000	1,203,000	1,909,000
Total	816,000	1,314,000	2,131,000

Source: BIS estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2013. **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 2014 National Minimum Wage rates by country and government office region

Country or region	Coverage estimate
Wales	116,000
Scotland	164,000
Northern Ireland	92,000
England	
North-East	121,000
North-West and Merseyside	262,000
Yorkshire & Humberside	207,000
East Midlands	184,000
West Midlands	223,000
Eastern	192,000
London	169,000
South East	210,000
South West	191,000
United Kingdom	**2,131,000**

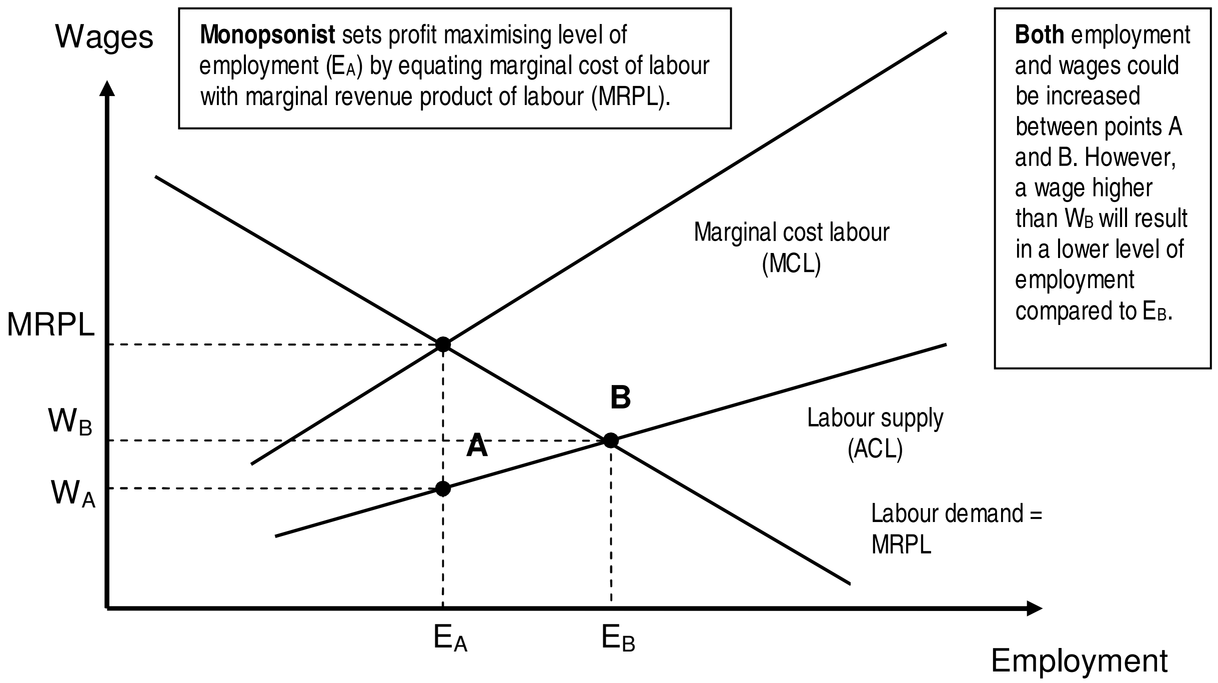
Source: A BIS breakdown of estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2012. **Figures have been rounded so totals may not sum up to individual parts.**

Annex 4: Uncompetitive labour markets monopsony example

A monopsony is a market dominated by a single buyer. A monopsonist has the market power to set the price of whatever it is buying (from raw materials to labour inputs). In a monopsony labour market a monopsonist sets profit maximising employment at the point which the marginal cost of labour is equal to the marginal revenue product of labour. A monopsonist faces an upward sloping marginal cost curve (it typically has to offer higher wages to the next marginal worker). However, wages are offered at the average cost of labour which is below the marginal cost of labour.

Figure 4 below shows that a monopsonist would set employment at E_A and offer wages W_A (point A). Point B represents the perfectly competitive labour market outcome where demand and supply equate. Between points A and B a higher wage can be associated with higher employment. However, a wage higher than W_B will result in a lower level of employment compared to E_B.

Figure 4: A monopsony labour market



Annex 5: 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 1: agree with all the LPC recommendations on the NMW rates and implement the new rates. All figures in £m. Best estimates.

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				
96%	YES	No	Wage bill adult rate (employer)	412.8	412.8	412.8	N/A
96%	YES	No	Non-wage labour cost adult rate (employer)	73.5	73.5	73.5	N/A
96%	YES	No	Wage bill 18-20 rate (employer)	24.8	24.8	24.8	N/A
96%	YES	No	Non-wage labour cost 18-20 (employer)	4.4	4.4	4.4	N/A
96%	YES	No	Wage bill 16-17 rate (employer)	3.4	3.4	3.4	N/A
96%	YES	No	Non-wage labour cost 16-17 (employer)	0.6	0.6	0.6	N/A
96%	YES	No	Wage bill apprentices (employer)	3.4	3.4	3.4	1.8
96%	YES	No	Non-wage labour cost apprentices (employer)	0.0	0.0	0.0	0.0
			Benefits				
0%	NO	NO	Wages adult rate (employee)	412.8	412.8	412.8	N/A
0%	NO	NO	Non-wage labour cost adult rate (Exchequer and employee)	73.5	73.5	73.5	N/A
0%	NO	NO	Wages 18-20 rate (employee)	24.8	24.8	24.8	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)	3.4	3.4	3.4	N/A
0%	NO	NO	Non-wage labour cost 16-17 (Exchequer and employee)	0.6	0.6	0.6	N/A
0%	NO	No	Wages apprentices (employee)	3.4	3.4	3.4	0.0
0%	NO	No	Non-wage labour cost apprentices (Exchequer and employee)	0.0	0.0	0.0	0.0
			Totals				
			Total cost	**522.9**			
			Present value total cost			**522.9**	
			OITO present value total cost				**0**
			Total benefit	**0**			
			Present value total benefit			**0**	
			OITO present value total benefit				**0.**

Source: BIS estimates. For the purposes of OITO, net cost to business on the front page are presented in 2009 prices. This IA has a 2012 price base year and the EANCB figures have been adjusted accordingly using HMT's GDP deflator. We have used the share of employees working in the private sector from ASHE 2013 to estimate percentage impact on business for costs and benefits.