DRAFT NATIONAL MINIMUM WAGE REGULATIONS 1999 (AMENDMENT)(No. 2) REGULATIONS 2004

EXPLANATORY MEMORANDUM

1. The draft National Minimum Wage Regulations 1999 (Amendment)(No. 2) Regulations 2004 ("the Regulations") are laid before Parliament in accordance with section 51(5) of the National Minimum Wage 1998 ("the Act") for approval by affirmative resolution of each House of Parliament.

2. The Regulations, which come into force on 1 October 2004, amend the National Minimum Wage Regulations 1999 ("the Principal Regulations") made pursuant to the Act. In summary, the Regulations increase the minimum hourly rates of the national minimum wage (both the adult and the development rate); introduce a new minimum hourly rate payable to those aged below 18; update the list of apprenticeship schemes where an exemption applies to workers aged below 19 and, during the first 12 months of participation in the scheme, to those aged 19 and above and below 26; introduce a complete exemption from the minimum wage for those on specified Government schemes at pre apprenticeship level; alter the provisions relating to the valuation of living accommodation; and introduce record-keeping requirements for employers paying output workers under the fair piece rates system. The Schedule contains a more detailed description of the changes (together with, where appropriate, commentary and a description of the current relevant law).

3. The Regulations have been prepared in the light of recommendations contained in a report made by the Low Pay Commission, the body which assisted with the introduction of the national minimum wage and has the function of reporting on matters relating to the national minimum wage that are referred to it by the Secretary of State. The Government made a written statement on 15 March 2004 on the recommendations put forward by the Low Pay Commission in the Commission's report. Copies of that statement, the report from the Low Pay Commission and the Government's regulatory impact assessment were placed in the Library of the House of Commons and the Library of House of Lords on that date.

4. In the opinion of the Secretary of State, the provisions of the Regulations are compatible with the Convention rights (as defined in section 1 of the Human Rights Act).

5. The Regulatory Impact Assessment prepared by the Department of Trade and Industry estimated that 1.6 million low paid workers stood to benefit from the rate increases and the new rate introduced by these Regulations, and that labour costs for employers stood to increase by around £344 million.

6. The Regulations extend to Great Britain and Northern Ireland.

Schedule

Regulation 1 provides for the Regulations to come into force on 1 October 2004. This will give employers sufficient time to prepare and plan for the rate increases. The commencement date of previous analogous regulations has been 1 October in each relevant year.

Regulation 2 amends the Principal Regulations by increasing the minimum hourly rate of the national minimum wage for adult workers from £4.50 to £4.85.

Regulation 3 amends the part of the Principal Regulations providing that certain workers do not qualify for the national minimum wage. It (1) removes the provision that workers who have not attained the age of 18 do not qualify for the national minimum wage, (2) updates the titles of certain schemes at apprenticeship level made under Government arrangements – workers on such schemes are treated as apprentices with the consequence that if aged under 19 they do not qualify for the national minimum wage, and that if aged 19 and above but under 26 they do not qualify during the first 12 months of participation in the scheme, and (3) secures that persons who are workers on certain specified schemes at a pre apprenticeship level made under Government arrangements do not qualify for the national minimum wage, whether they are employed by the employer or not.

Regulation 4 (a) and (c) amends the Principal Regulations by increasing, from £3.80 to £4.10, the rate to be paid to workers who qualify for the national minimum wage at a different rate, ie. those aged between 18 and 21 inclusive and, also, over 21-year olds who, in the first six months of a new job with a new employer, are doing certain training pursuant to an agreement with the employer.

Regulation 4(b) amends the Principal Regulations by introducing a new rate of the national minimum wage (£3.00) to be paid to workers that have reached compulsory school leaving age but are aged below 18.

Regulation 5 amends regulation 36(1) of the Principal Regulations by increasing the amount that is permitted to be taken into account (when determining whether the national minimum wage has been paid) in situations where a worker is provided with living accommodation by the employer. The amount is increased from £3.50 per day to £3.75 per day.

The rate increases introduced by Regulations 2 and 4 and the new rate introduced by Regulation 4(b) were recommended by the Low Pay Commission and agreed by the Government in March 2004. The increased daily amount for accommodation introduced by regulation 5 was recommended by the Low Pay Commission and agreed by the Government in March 2003.

Regulation 6 amends the record-keeping requirements contained in the Principal Regulations to provide that the employer of an output worker (ie one paid per piece produced or task performed) that is being paid under the fair piece rate system (described in what will become regulations 24 to 26A of the Principal Regulations on 1 October 2004) must, where relevant, keep a copy of the notice provided to the worker under that system and keep a copy of the data that he has used to set the fair piece rate under that system.

Regulation 7 contains transitional provisions. The first of these has the effect that the introduction of the national minimum wage for those who have not attained the age of 18 (but have ceased to be of compulsory school age) and the new record-keeping obligations described in the preceding paragraph only apply in relation to pay reference periods (a pay reference period is, broadly speaking, the period of work for which a worker is paid) beginning on or after 1st October 2004. The second ensures that any person who began participating in a pre apprenticeship level scheme mentioned in the third limb of the explanation of regulation 3 given above before the regulations come into force retains any right he has to the national minimum wage. The third maintains the obligation upon an employer of an output worker to retain a copy of any "fair estimate agreement" that he may have entered into with such worker prior to the introduction of the fair piece rate system mentioned above.

Regulation 8 is a revocation provision. Previous provisions increasing the hourly rate of the national minimum wage and the hourly rate required to be paid to those aged between 18 and 21 inclusive and the over 21-year olds are revoked.

Full Regulatory Impact Assessment
Employment Relations Directorate

Increase in National Minimum Wage rates

March 2004

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

This regulatory impact assessment (RIA) considers the impact of proposals to increase the adult and development rates for the National Minimum Wage (NMW). The proposed increases to the rate reflect the recommendations of the Low Pay Commission (LPC)'s fifth report into the NMW. The specific changes that the Government proposes to implement are that:

- The adult rate of the NMW increases from £4.50 an hour to £4.85 in October 2004, and the development rate for 18 to 21 year olds increases from £3.80 an hour to £4.10 in October 2004. Both these rises confirm provisional recommendations that were made by the Commission a year ago.
- There will be a new rate for 16 to 17 year olds, introduced in October 2004 at a rate of £3.00 an hour. Apprentices or workers on pre-apprentice schemes will not be covered by this new rate.

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 on the basis 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 2003.

4. The LPC's 4th report last Spring set out a staged increase in the minimum wage with initial increases in October 2003 and further increases in October 2004. In accepting the recommendations of the report, the Government agreed that the Commission should report back a year later on whether the economic conditions were consistent with the second-stage of the minimum wage increases provisionally proposed for October 2004. The Government also asked the Commission to consider the case for introducing a new minimum wage rate for 16 and 17 year olds.

Options

5. The LPC has recommended that the adult and development rates of the NMW should be increased to £4.85 and £4.10 in October 2004 as originally proposed a year ago. 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 alternative would have been to choose higher or lower rates.

6. The Government also accepts the LPC's recommendations on the new minimum wage rate for 16 and 17 year olds and the scope of the exemptions from this rate. The alternative options would have been to continue to leave all 16 and 17 year-old workers outside the scope of minimum wage legislation, to choose higher or lower rates, or to vary the scope of the exemptions that have been proposed by the Commission.

7. 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

8. 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

9. 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

(i) Increase in adult and development rates in October 2004

10. The latest official data on the prevalence of low paid jobs in the UK relates to spring 2003. At that time, it is estimated that around 2.2 million jobs held by those aged over 21 were paid below the proposed October 2004 adult rate of £4.85 and that 0.2 million jobs held by those aged 18-21 were paid below the proposed development rate of £4.10.

11. The numbers of jobs that actually stand to benefit from the proposed increases in October 2004 will depend upon what has happened, and is likely to happen, to the wages of workers in the period between spring 2003 and October 2004.

12. The adult and development rates of the NMW were increased to £4.50 and £3.80, respectively, in October 2003, 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 2003 rates).

13. In this RIA, our main assumption is that the hourly pay of all those earning less than the October 2004 rates increased in line with average earnings growth (measured by the Average Earnings Index) between spring 2003 and October 2004. This is based on an average increase using actual data for the period April 2003 to October 2003, and a forecast rate of increase thereafter derived from the HM Treasury comparison of independent economic forecasts.

14. On this assumption, the number of jobs that would potentially benefit from the proposed October 2004 increase is 1.6 million, made up of 0.1 million jobs held by 18-21 year olds and 1.5 million jobs held by those aged over 21[1].

15. An alternative assumption which is less likely is that the hourly pay of all those earning less than the October 2004 rates will have increased in line with RPI inflation between spring 2003 and October 2004. This is based on an average increase using actual data for the period April 2003 to October 2003, and a forecast rate of increase thereafter derived from the HM Treasury comparison of independent economic forecasts. On this assumption, the number of jobs that would potentially benefit from the

[1] This estimate is calculated by deflating the October 2004 proposed rates by actual and forecast average earnings growth, i.e. by 6.3 per cent over 18 months, producing equivalent spring 2003 rates of £4.56 and £3.86 for adult and development rates respectively. The numbers affected are then calculated from cumulative distributions of jobs by hourly pay based on the ONS low pay central estimates developed by the LPC.

proposed October 2004 increase is 1.9 million, made up of 0.1 million jobs held by 18-21 year olds and 1.8 million jobs held by those aged over 21[2].

(ii) New rate for 16 and 17 year olds

16. In analysing the position of 16-17 year olds, there are limitations to the data provided by the Office for National Statistics (ONS). Around 70 per cent of 16 and 17 year olds are in full-time education. As a result, the proportion of 16 and 17 year olds who are in work is much smaller than for 18-21 year olds and adults. Hence when data is extracted from general ONS surveys that cover the whole labour force, it is not surprising that sample sizes for 16-17 year old workers is small.

17. In addition, the number of eligible workers is reduced because the recommendation exempts workers on apprenticeship or pre-apprenticeship programmes. The Government believes this exemption is justified because of evidence that unemployment of young workers is detrimental to their future employment prospects and earnings potential. As a result, the Government agrees with the Commission that the employment position of such trainees should be protected by exempting them from the proposed 16-17 year old minimum wage rate.

18. Analysis of the ONS' low pay data (Central Estimate data) suggests that in Spring 2003 there were around 40,000 workers aged 16-17 earning below £2.90[3] an hour. Assuming that the pay of this group of workers rises in line with whole-economy average earnings, the same number of workers are expected to be earning below £3.00 an hour in October 2004 in the absence of any new rate being introduced. If one makes an assumption[4] about the ratio of apprentices to non-apprentices, we estimate that around 25,000 16-17 year old workers stand to benefit from the new NMW rate of £3.00 per hour in October 2004.

Impact on labour costs

(i) Impact of uprating

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[2] Calculated as above but using the actual and forecast increase in RPI rather than average earnings; so the October 2004 proposed rates are deflated by 3.0 per cent, producing equivalent spring 2003 rates of £4.71 and £3.98 for adult and development rates respectively.

[3] Below £2.90: Based on earnings growth between April 2003 and October 2004 (actual and the average of HM Treasury independent forecasts), the equivalent in the pay distribution of £3.00 in October is £2.82 in April 2003.

[4] Assumption is used because the available Labour Force Survey data on the number of apprentices earning below £2.90 an hour is below publishable quality. Analysis of LFS suggests that around 40 per cent of low-paid 16-17 year-old workers are apprentices and are not eligible. So, the number of expected beneficiaries is 60% of 40,000 which is around 25,000.

19. The impact of the uprating on wage and labour costs also depends upon the assumptions made about the likely path of wage increases between April 2003 and October 2004.

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

- We calculate the additional average hourly increase for those jobs paying less than the rates proposed for October 2004. It is assumed that there is full compliance with the October 2003 rates when calculating the average wage increase for the October 2004 uprating;
- Multiply this increase per hour by the average number of hours worked by those affected (taken to be around 26 hours)[5];
- Multiply by 52 weeks per year;
- Multiply by the number of potential beneficiaries (see above);
- The RIA only considers the direct impact of the uprating. We have therefore 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 2003 and October 2004. 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. Since our main assumption is that in the absence of any uprating low-paid earnings would have risen in line with average earnings, the table below shows the effect on the aggregate wage bill and labour costs under this assumption. The effect on wage and labour costs under the alternative assumption of low-paid earnings rising in line with the RPI is shown in the Annex.

Table 1: Impact of the 2004 uprating on aggregate wage and labour costs (assumes low-paid earnings rise in line with average earnings)

Increase in wage bill for proposed 2004 rates	£280 million
Percentage increase in wage bill	0.06%
Increase in labour costs for proposed 2004 rates	£310 million

Source: DTI

(ii) Impact of new 16-17 year old rate

[5] Source: 2003 grossed New Earnings Survey.

23. The methodology here is similar to that for the uprating. One differences is that since we are dealing with the introduction of a new rate rather than an uprating, we have to calculate an estimate for the average increase in pay required so that all those earning below the minimum wage rate receive the new rate of £3 an hour in October 2004[6]. We estimate that the average increase in pay required is around 90 pence an hour. Based on around 25,000 beneficiaries and multiplying by around 28 hours[7] a week and 52 weeks a year, the estimated cost to employers as shown in the table below is around £35 million.

24. The calculations for the introduction of the new 16-17 year old rate are based on the assumption that in the absence of the introduction of the new rate, the earnings of low-paid 16-17 year olds would have risen in line with average earnings. The estimates shown in the table below would not be significantly different if, alternatively, it were assumed that the earnings of low-paid 16-17 year old workers rise in line with prices.

Table 2: Impact of the new 16-17 year old rate on wage and labour costs for employers of 16-17 year olds

Increase in wage bill for proposed 2004 rates	£31 million
Increase in wage bill (as a %age of total 16-17 year old wage bill)	0.9%
Increase in labour costs for proposed 2004 rates	£34 million

Source: DTI

25. We think that the implementation costs and ongoing administrative costs associated with the introduction of the new 16-17 year old rate will be negligible. The NMW is a recognised part of employment practices and so implementation and ongoing costs associated with administering the new 16-17 year old rate will be minimal. Moreover, it is likely that employers affected by the new legislation for 16-17 year olds also employ other low-paid workers and so will already be familiar with existing minimum wage legislation.

Benefits

<u>(i) Increase in adult and development minimum wage rates in October 2004</u>

[6] DTI analysis of the 2003 grossed New Earnings Survey suggests that in April 2003 the average pay per hour of 16-17 year olds earning less than £2.90 an hour was £2.02. We have to assume that pay estimate for 16/17 year olds ex-apprentices would be the same as this estimate. The figure for ex-apprentices cannot be reliably estimated because sample sizes in the Labour Force Survey are too small.

[7] Based on the 2003 grossed NES, the weekly hours worked of all 16- 17 year olds is around 27.8 hours per week. We have to assume that the hours estimate for 16/17 year olds ex-apprentices would be the same as this estimate. The figure ex-apprentices cannot be reliably estimated because sample sizes in the Labour Force Survey are too small.

26. Based on the estimate calculated earlier of a £280 million increase in employers' wage bill for the year commencing October 2004, the estimated total benefit to workers on low pay is also expected to be around £280 million. This benefit is equivalent to an average pay rise per worker benefiting of around £180 per year before tax.

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 £530 million, equivalent to an average pay rise per worker benefiting of around £270 per year before tax.

28. For a low-paid adult working a 35-hour week, the minimum wage increase is worth a pay increase of around £640 per year before tax.

(ii) New minimum wage rate for 16 and 17 year olds

29. Assuming the increase in employers' wage bill in the year commencing October 2004 is around £30 million as calculated earlier, the estimated total benefit to 16-17 year-old workers on low pay is also expected to be around £30 million, equivalent to an average pay rise per worker benefiting of around £1,290 per year before tax.

30. For the average 16-17 year old who is expected to benefit from the new rate and is working a 35-hour week, the new 16-17 year old rate would be expected to deliver an increase in pay of around £1,780 per year before tax.

Costs for a typical business

31. The proposed changes to the October 2004 rates represent an increase of 7.8 per cent on the current rate for adults and 7.9 per cent for 18-21 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.

Equity and fairness

32. 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

33. 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

34. 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

35. 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

36. The Low Pay Commission has undertaken in both their fourth and fifth reports a thorough examination of the issues relating to the uprating of the existing minimum wage rates and the introduction of the new 16-17 year old rate.

Monitoring and review

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

38. 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 2005 on the operation of the minimum wage.

Declaration

39. I have read the Regulatory Impact Assessment and I am satisfied that the balance between cost and benefit is the right one in the circumstances.

Signed by the responsible Minister:

Date:

Contact point: Jonathan Gershlick

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Employment Market Analysis and Research

Employment Relations

Department of Trade and Industry

1 Victoria Street

London SW1P 0ET

020 7215 5799

Annex

Table A1: Impact of the 2004 uprating on aggregate wage and labour costs (assumes low-paid earnings rise in line with the RPI)

Increase in wage bill for proposed 2004 rates	£530 million
Percentage increase in wage bill	0.11%
Increase in labour costs for proposed 2004 rates	£580 million

Source: DTI