Title: Amendment to the National Minimum Wage regulations 2012-increase in NMW rates **IA No:** BIS0348 **Lead department or agency:** Department for Business Innovation and Skills (BIS) **Other departments or agencies:**	**Impact Assessment (IA)** **Date:** 20/06/2012 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Asad Ghani 020 215 1627

Summary: Intervention and Options

RPC Opinion: Amber

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	-£164.89m	£155.61m	No	NA

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

The aim of government intervention is to prevent employers from abusing unequal bargaining power to pay unacceptably low wages, particularly where workers have a lack of skills, mobility or opportunities. The National Minimum Wage (NMW) provides protection to low-income workers by avoiding potential exploitation of low paid workers; prevents businesses from being able to undercut by paying exploitatively low wages; and provides incentives to work. The NMW came into force in April 1999 and since then the NMW rates have been increased annually.

What are the policy objectives and the intended effects?

The NMW sets a wage floor below which pay cannot fall ensuring protection for low-income workers, while also providing incentives to work. The aim when setting the rates is to help the low paid through an increased NMW, while making sure that their employment prospects are not damaged by setting it too high.

The Government has stated in the Coalition Programme that it supports 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 by Government in 1999 to make recommendations on the main NMW rates to Government. 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 rate recommendations

In making its recommendations to Government, the LPC has consulted extensively and undertaken substantial analysis, details of which are contained in its 2012 report. The Government has carefully considered the LPC's report and has concluded that the LPC's rate recommendations are appropriate.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 03/2013

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 Minister: Date: 21 June 2012

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 2011	PV Base Year 2011	Time Period Years 1	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	**Best Estimate:** £0m

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate			£177.3m	**£177.3m***

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

Employers – as a result of increases in the adult NMW rate, the wage bill for employers will increase by **£150.6m** and an increase in non-wage labour costs of **£24.7m** (a total increase in labour costs of **£175.3m**).
Employers face an increase in wage bill from the apprentice rate of **£2.0m**
*Employers face a cost burden because Government wants to prevent some employers from paying unacceptably low level wages.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate			£177.3m	**£177.3m**

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

Employees – benefit from higher wages in respect of adults (**£150.6m**) as a result of these rates being higher than our counterfactual assumption of a wage freeze. Benefit to apprentices from higher wages **(£2.0m)** as a result of these rates also being higher than our counterfactual.
Exchequer and employees - benefits from increased non-wage labour costs as a result of increase in adult NMW rate **(£24.7m**).

Other key non-monetised benefits by 'main affected groups'

Employees - young workers benefit from employment prospects being protected and the youth 2012 NMW rates may draw more young people into employment as their relative attractiveness may increase to employers. Employers benefit from increased accommodation offset.
Exchequer – there will be benefits to the Exchequer from increased tax and National Insurance (from employees) and reduced benefit and tax credit payments as a result of changes in the adult rate.

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

Main assumptions can be found in the impact assessment. We assume that in the absence of changes to last year's NMW levels, the wages of the lowest paid would remain the same for the year beginning 1 October 2012. The proposed 2012 NMW rates involve transfers between employers, employees and the Exchequer. As this impact assessment involves an annual uprating the time period is one year.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: £155.6m	**Benefits: £0m**	**Net: -£155.6m**	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-income 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 uprated annually. The aim when setting the rates is to help the low paid through an increased NMW, while making sure that their employment prospects are not damaged by setting it too high.

Decisions on the NMW rates are made by the government following consideration of recommendations by the independent Low Pay Commission (LPC). The LPC reports contain a large body of evidence and analysis on the impact to date of the NMW. The LPC also consider 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. The evidence and data collected and produced by the LPC have been used to inform this IA[1].

The NMW varies by age band (16-17, 18-20 year olds, 21 years and older) primarily because the labour market position of younger workers is more vulnerable to potential negative employment effects associated with increases in labour costs (the evidence shows that young workers experience substantially worse unemployment and employment rates than adults)[2]. The Government's position is the same as that of the LPC who have consistently argued that young workers should be treated differently from their older counterparts in order to protect employment and at the same time reflect the training element attached to younger workers. The NMW structure therefore provides for lower NMW rates for workers aged below 21.

In October 2010, the Government introduced a new apprentice minimum wage which applies to those apprentices who were previously exempt from the NMW (that is, apprentices who are aged under 19, or aged 19 or over and in the first year of their apprenticeship). This was to ensure that these apprentices received the legal protection of the NMW. There are costs to the apprenticeship provider (of the training, the lower productivity during training and the opportunity cost of managing the apprentice at the workplace); and considerable gains to the individual apprentices through higher future earnings and increased employment prospects. The level of the apprentice minimum wage should provide a fair deal for apprentices which protects them from exploitation whilst at the same time not deterring businesses from taking them on.

Consultation

Within government

BIS has been working closely with HM Treasury

Public consultation

The LPC consulted a range of stakeholders including employee and employer organisations to recommend the 2012 NMW rates. A full list of those consulted and a summary of responses can be found in the LPC report.

---

[1] National Minimum Wage Low Pay Commission Report 2012
http://www.lowpay.gov.uk/lowpay/report/pdf/2012_Report.pdf

[2] National Minimum Wage Low Pay Commission Report 2012

Policy objectives

The NMW sets a wage floor below which pay cannot fall ensuring protection for low-income workers, while also providing incentives to work. The aim when setting the rates is to help the low paid through an increased minimum wage, 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 Government's preferred option is to agree with the LPC recommendations on NMW rates. The analysis contained within this impact assessment is based on option 1.

The LPC in their latest report to the Government have recommended the following NMW rates:

Table 1. NMW rates from October 2011

Age band	October 2011 rate	October 2012 rate
Adult rate (for workers aged 21+)	£6.08	£6.19
Development rate* (for workers aged 18-20)	£4.98	£4.98
16-17 year old rate	£3.68	£3.68
Apprentice rate	£2.60	£2.65

Source: Low Pay Commission.

The LPC has recommended rates for October 2012 after a wide ranging consultation and careful consideration of economic evidence and the impact on the employment prospects of low paid workers. The LPC's analysis is set out in their report.

The LPC concluded that the adult NMW rate should be increased by 11 pence (1.8%). The aim of the increase is to maintain the relative position of the lowest paid while ensuring a rate that business, including small business, will be able to afford[3].

The LPC found the labour market position of young people had continued to worsen in 2011. Employment of young people had continued to fall, and unemployment rise. However, there is debate about exactly how far pay is a factor. Minimum wage increases for young people have exceeded rises in average earnings of young people over several years and so the wages of the lowest paid young people relative to their peers is now higher than ever. Employment of young people is more sensitive than that of adults to the economic cycle. With this in mind the LPC recommended a freeze to the rates for young people, which may increase their relative attractiveness to employers[4].

The LPC examined the effect of last year's increase in the apprentice rate. In 2010/11, apprenticeship starts have increased for all age groups and LPC concluded there is room for a further, smaller increase. It therefore recommended that the Apprentice rate be increased by 5 pence (1.9%) to £2.65 an hour[5].

[3] National Minimum Wage Low Pay Commission report 2012 page 148 http://www.lowpay.gov.uk/lowpay/report/pdf/2012_Report.pdf
[4] National Minimum Wage Low Pay Commission report 2012 page 149 http://www.lowpay.gov.uk/lowpay/report/pdf/2012_Report.pdf
[5] National Minimum Wage Low Pay Commission report 2012 page 149 http://www.lowpay.gov.uk/lowpay/report/pdf/2012_Report.pdf

Box 1: real wage effects

Given the state of the economy and current labour market conditions, the LPC has adopted a cautious approach with the recommended increase below the forecast rate of inflation. It was concerned that employers might respond to increases in real wages by reducing employment in the current economic climate and thus made a recommendation that was unlikely to increase real wage costs. Further, average earnings growth forecasts are currently below inflation forecasts, suggesting continued downward real wage pressures for the rest of the workforce. However, the recommended increase in the minimum wage for adults is in line with forecasts of average earnings growth, which would maintain the relative earnings of the lowest paid. Indeed, the bite of the minimum wage (hourly minimum wage as a percentage of median hourly earnings) is currently higher than it has ever been. Therefore, although the recommended rise in the minimum wage is likely to lead to a small cut in the real wages of the lowest paid, it reflects what is happening to the broader labour market.

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

Analysis of options

Costs and Benefits

In assessing the impact of the 2012 NMW rates, we need to establish what might have happened in the absence of government intervention. 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 below. **This counterfactual will be reviewed annually to assess if emerging evidence supports a different counterfactual. There will always be uncertainty surrounding the counterfactual as once policy intervention takes place we can never observe the counterfactual (we can only make inferences using appropriate evidence). It should be noted that the cost impact on employers is maximised through a rate freeze counterfactual and that the estimates provided do represent an absolute upper bound estimate. Due to the evidence base and inability to observe the true counterfactual we also take these estimates as our best estimate.**

The counterfactual

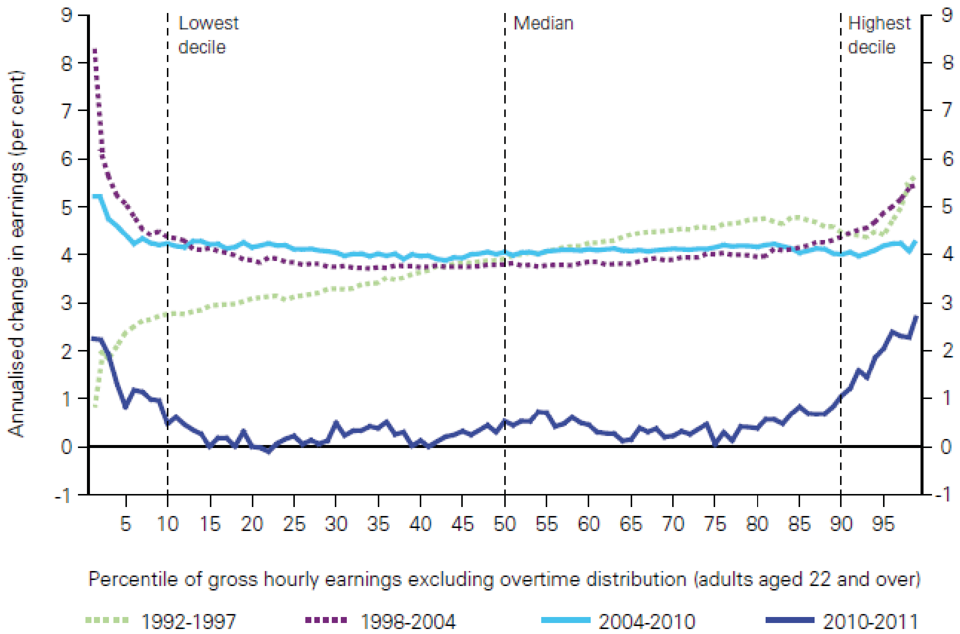
This impact assessment covers changes to the NMW regime through the proposed increases in the level of the adult and apprentice NMW rate from 1 October 2012. For the purposes of this impact assessment, the effect of the absence of government intervention would be no changes to the already existing NMW regime. There would still be a NMW (this impact assessment does not cover the overall policy of the NMW) but all the rates would be frozen at the level that is currently in force.

We assume 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 2012.

It is clear that the same average wage is not received by workers outside the lowest paid group. The earnings distribution (taken from the 2012 LPC report) shows that earnings growth varied across the earnings distribution between 2010 and 2011. The 2011 Annual Survey of Hours and Earnings (ASHE) shows that median hourly earnings growth was 0.4%. The chart below shows that the very lowest earners (those in the bottom '5th percentile', which includes those on NMW) received the NMW rate increase (around 2%) between 2010 and 2011. For the next lowest paid set of workers (up to the lowest decile), wage growth was lower at around 1%. Moving up the earnings distribution, the annual wage growth approaches 0% (with some workers even experiencing a pay cut). The earnings distribution for 2010-2011 provides evidence to support a counterfactual of 0% as low paid workers who were earning just above the NMW received an annualised pay increase of around 0% between 2010 and 2011.

Chart 1. Annualised growth in hourly earnings for employees aged 22 and over, by percentile, UK, 1992-2011

Figure 2.15: Annualised Growth in Hourly Earnings for Employees Aged 22 and Over, by Percentile, UK, 1992-2011



Source: LPC estimates based on New Earnings Survey (NES), April 1992-1997, and ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights (NES unweighted), including those not on adult rates of pay, UK.
Note: Direct comparisons before and after 1997, before and after 2004, and before and after 2006, should be made with care due to changes in the data series.

Source: LPC 2012 report, page 41 http://www.lowpay.gov.uk/lowpay/report/pdf/2012_Report.pdf

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 4). 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.

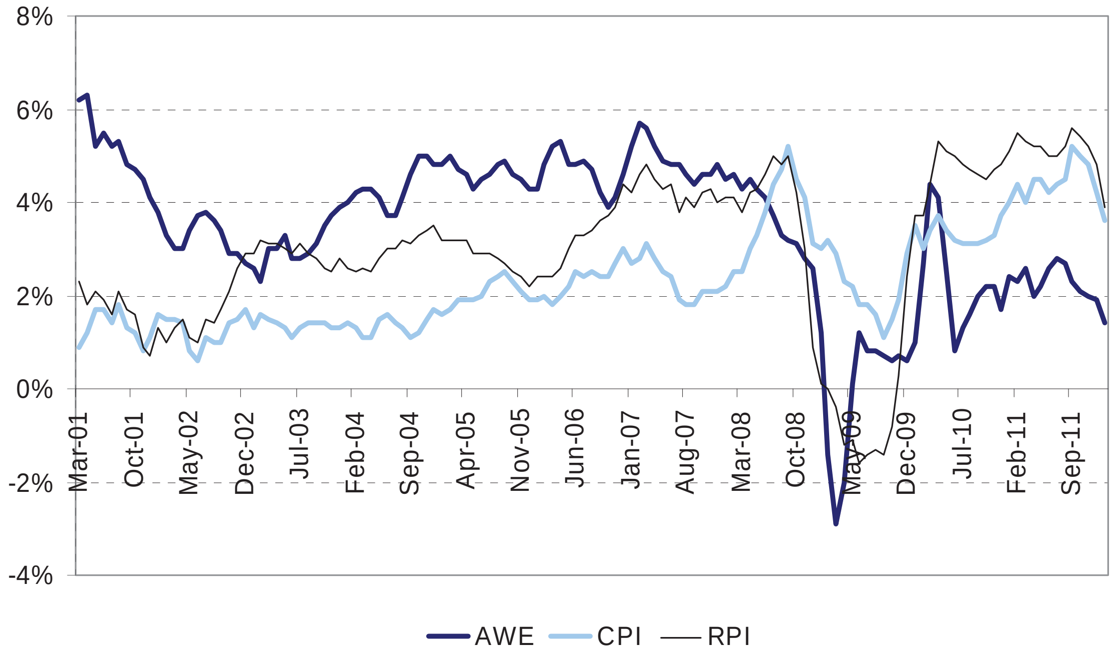
Previous impact assessments

In the past we 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. In this impact assessment we assume a counterfactual of a wage freeze. There are two key reasons why we have reviewed the counterfactual.

1) Changes to the macroeconomy and labour market

We feel it is appropriate to review the counterfactual as the state of the macroeconomy and labour market is now very different compared to the years that followed the introduction of the NMW. For example, post recession average earnings growth has fluctuated around 2%, whereas pre-recession average earnings growth was above 4% since the start of 2004. Also, pre-recession average earnings growth has tended to be above consumer and retail price inflation. Post-recession this has reversed with price inflation outstripping average earnings growth (see chart 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.

Chart 2. Annual growth in average weekly earnings, consumer price inflation and retail price inflation



Source: National Statistics. Average weekly earnings (KAC3), CPI (D7G7), RPI (CZBH)

There have also been changes observed in the earnings distribution which again cast doubt over whether average earnings is the appropriate counterfactual. Between 1999 and 2008, wage growth was similar across the earnings distribution for all age groups and all business sizes. The NMW grew faster but did not appear to have affected general growth across the distribution. However, it has become apparent with recent releases of Annual Survey of Hours and Earnings (ASHE) data that this general wage growth has not been maintained throughout the recession. The wage growth for young workers has been considerably lower than for older workers. It has also been lower for small firms compared with large firms, and for low-paying sectors compared with the rest of the economy.

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.

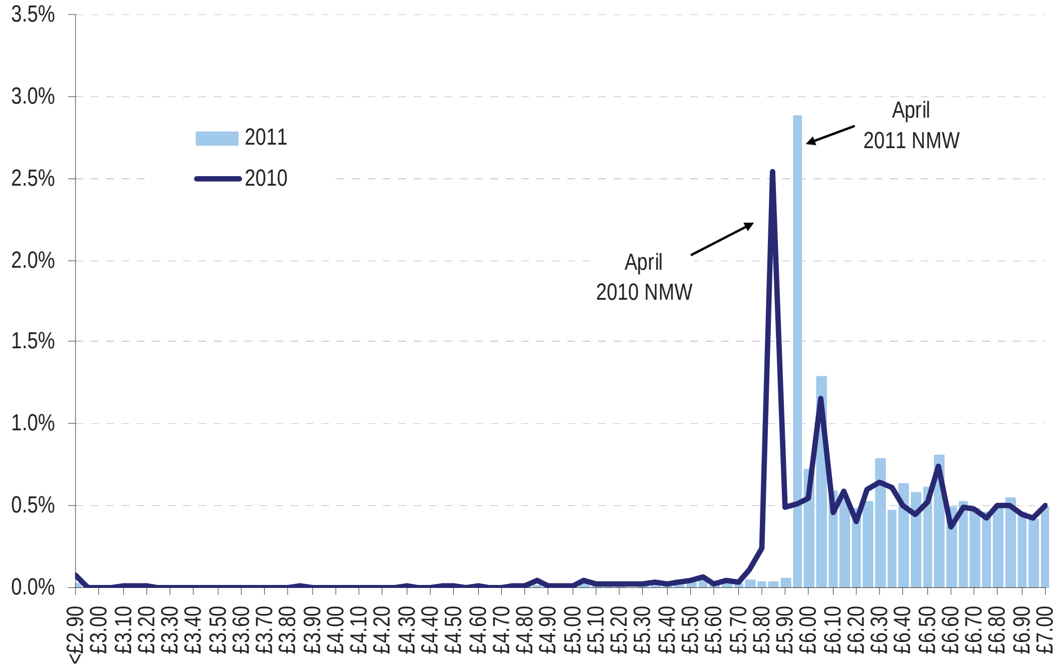
2) The NMW has been established for now over a decade

In addition to wider changes to the macroeconomy it should also be noted that the adult NMW rate was introduced 13 years ago. The LPC have received evidence that some employers have tended to track the NMW each year[6]. For these employers if the NMW rates were not reviewed and were frozen they would be highly likely to freeze rates. Also, more generally low paid employers 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.

This is supported by evidence from ASHE which also shows that employers track the NMW rate. Chart 3 shows that for workers on the adult NMW there is a ‘spike’ in the earnings distribution at the 2010 NMW rate in 2010. In 2011 this ‘spike’ moves to the 2011 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.

Chart 3: Adult low-pay distribution, April 2011

Per cent of adult jobs (21 years or older)



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

As the NMW has risen faster than average earnings and price inflation, the scope to increase it any further without incurring job losses is now more limited. This is discussed in greater depth below. **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.**

Discussion of uncompetitive labour markets

The Low Pay Commission (LPC) provide NMW rate recommendations such that low paid workers are helped through increases in the NMW, while making sure that their employment prospects are not damaged by setting it too high. The LPC monitor 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.

[6] The LPC evidence report shows 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.

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.

The NMW rates cover workers who could potentially be exploited by their employers (who have some form of labour market power). The adult NMW rate covers potentially exploited employees but is 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). For young people their NMW rate is very close to the competitive labour market wage. However, unlike adults the young people's NMW rate could possibly be at a rate higher than the competitive wage as 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 for young people the current NMW rate is not yet greater than the competitive labour market yet but we recognise that there is great uncertainty.

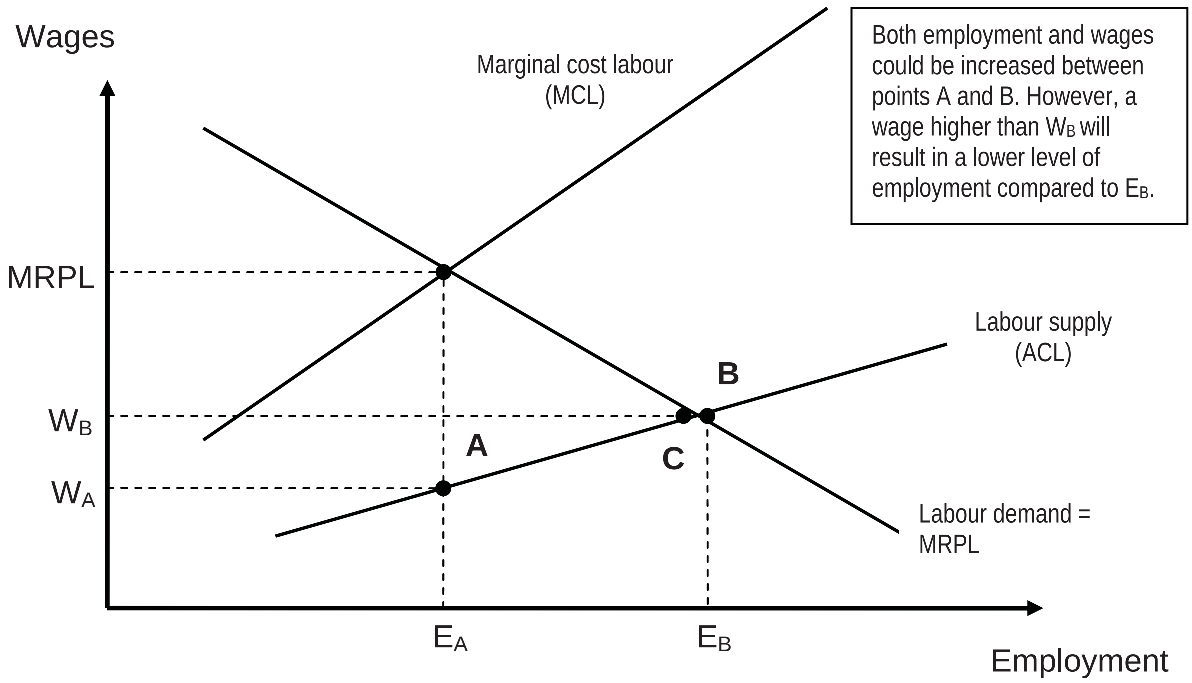
Costs and benefits

For the impact assessment we assume that the lowest paid workers (NMW paid workers) are in an employment situation where they 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). Taking 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 the complete absence of a NMW workers would receive a wage of W_A (see figure 1 below). Over time through the introduction of the NMW and subsequent increases we have moved to point C. We don't know the precise location of C. However, the LPC's judgement is that point C is now closer to B than it was in 1999. Taking a cautious approach in recent years, attempting to mitigate negative employment effects, the LPC has recommended increases in the adult NMW that have turned out in line with average earnings growth (i.e. the overall bite has been broadly constant since 2007).

Figure 1: A labour market characterised by market power for adult low paid workers



Young people – similar to adults although given the state of the economy the labour demand curve for young workers may have shifted inwards. The distance between point C and B would become smaller. Also, there is now greater uncertainty about the position of C relative to B, that is whether a NMW increase will result in a negative employment effect for young people.

Based on a counterfactual that wages of low paid workers would not increase, there would be a cost to employers from the proposed increases in the adult and apprentice rates. This represents a transfer from employers to employees as the employees would gain an equivalent benefit of obtaining a wage increase which they would otherwise not have received.

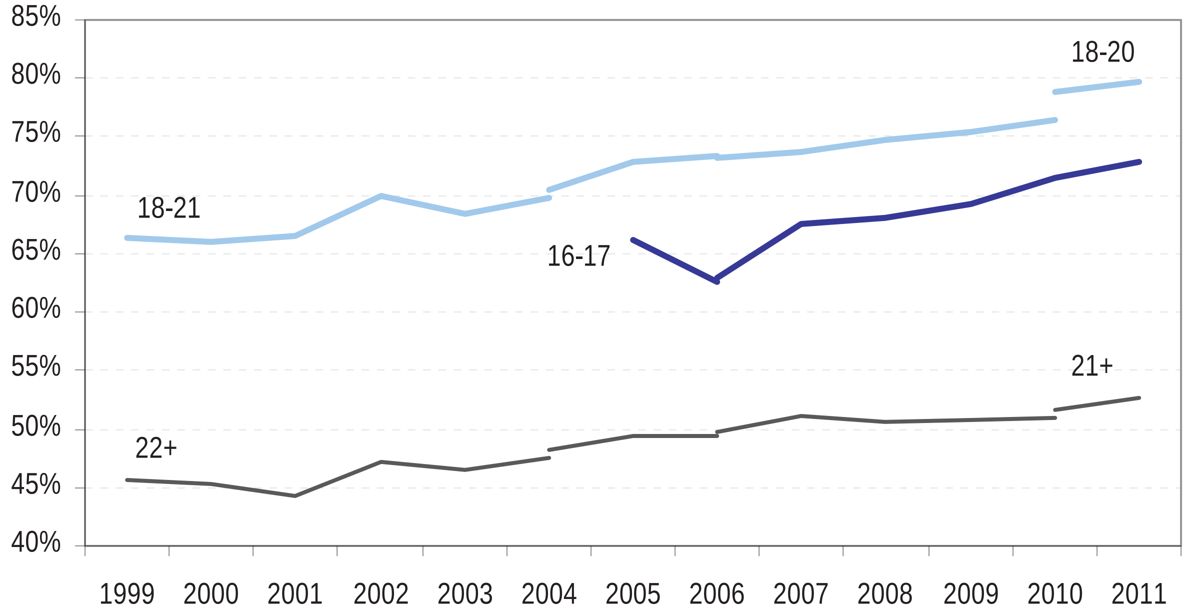
The aim of the LPC when recommending NMW rates is to have as high an increase in the minimum wage as possible without damaging low paid workers' employment prospects. In considering whether a particular NMW rate would have an impact on employment, the LPC consider the "bite" (that is, the NMW as a percentage of median earnings). The adult bite has broadly been stable between 2007 and 2010 (with a small increase observed in 2011). 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 (although it would slightly lower the bite) is the largest increase that employers would pay without cutting jobs.

Unlike adult workers, the bites of the youth rates relative to the median have continued to increase since 2007 as the wages of young people in general have increased at a slower pace than those of adults. The labour market position of young people continued to worsen in 2011, with employment of young people continuing to fall and unemployment to rise (although the extent to which pay is a factor is not clear). The evidence continues to show that young people are more vulnerable in the labour market and the threat of unemployment is greater for younger workers. The LPC concluded that it should act cautiously and recommended that the rates for young workers should be frozen.

Based on a counterfactual that wages of low paid workers would not increase, there would be no cost to employers from the freezing of the youth rates; nor would there be an equivalent monetary benefit for young workers. However, as the average earnings of young workers is expected to increase, the relative bite of the NMW for young workers is expected to reduce which may increase their relative attractiveness to employers.

Chart 4: The bite of the NMW

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. 2006-2010 ASHE data - new methodology.

Number of jobs covered by October 2012 NMW rates as at April 2013

LPC have estimated the number of jobs covered by the October 2012 NMW rates (estimates below exclude apprentices). Separately BIS estimate 20,000 apprentices stand to benefit from the proposed increase in the apprentice rate.

Table 2. Number of jobs that are covered by the October 2012 National Minimum Wage by age as at April 2013

Age group	October 2012 rates	Numbers covered
16-17 year old rate	£3.68	14,000
Development rate (for workers aged 18-20)	£4.98	40,000
Adult rate (for workers aged 21+)	£6.19	938,000
Total		992,000

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

Cost and benefits of the proposed uprating of the Adult rate (21+)

The proposed changes to the October 2012 rates represent an increase of 1.8% on the current rate for adults.

Thus under our assumption that low pay wages would been frozen for low paid workers aged 21 and over in the absence of an uprating the estimated cost impact of the 2012 adult rate is an increase in labour costs of **£175.3m for all employers (a direct impact on business of £163.0m).** Further details on direct impact on business estimates can be found in the OIOO section within this impact assessment and in Annex 5.

Adult employees benefit from increased wages (**£150.6m**). The Exchequer and employees will benefit from increased non-wage labour costs (**£24.7m**).

We have not monetised all the benefits to the Exchequer from increased tax and National Insurance revenues (from employees) and reduced benefit and tax credit payments as a result of changes in the adult rate.

Methodology for estimating the cost to employers – adult workers

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

- We calculate the additional **weighted average**[7] 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 2011 Annual Survey of Hours and Earnings (ASHE).

- Multiply by 52 weeks per year.

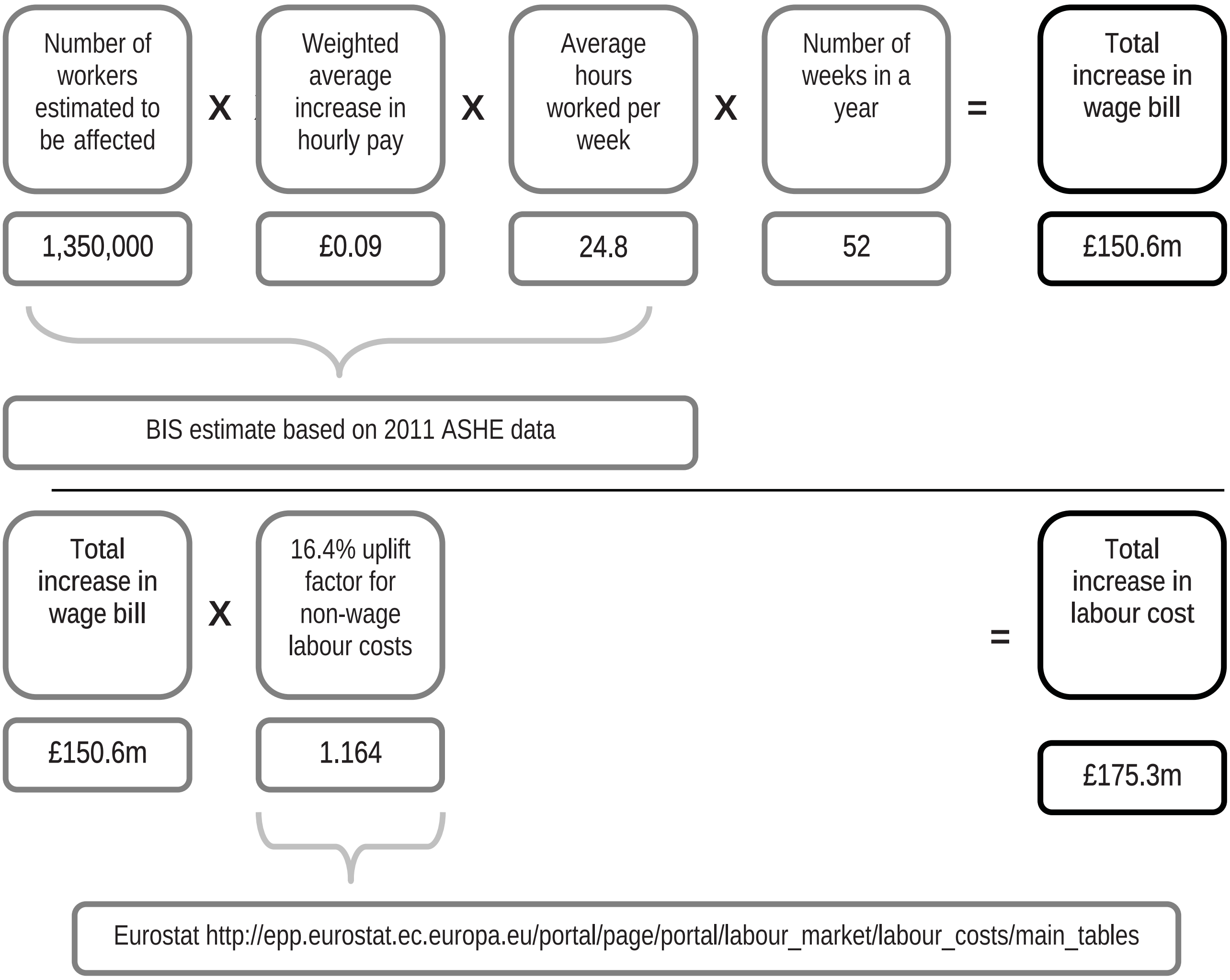
- Multiply by the number of potential workers between the proposed rate and the rate that would have prevailed under the counterfactual. We use 2011 ASHE to estimate potential workers affected.

To go from the total wage bill to total labour costs, we add 16.4 per cent to take account of the cost to employers of National Insurance and any other non-wage labour costs (such as pension contributions)[8].

Our calculations can be found in figure 2 below.

[7] We use a weighted average as there will be some individuals that partially benefit by less than 11 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 9 pence (this is lower than the 11 pence increase in the adult rate). Given the small number of apprentices affected we assume all apprentices affected benefit by a 5 pence increase in the apprentice rate.
[8] Source: Eurostat

Figure 2. Estimated increase in labour costs from increase in adult NMW rate from £6.08 to £6.19 (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 for young workers (16-17 and 18-20 year olds)

The LPC found the labour market position of young people had continued to worsen in 2011. Employment of young people had continued to fall, and unemployment rise. However, there is debate about exactly how far pay is a factor. Minimum wage increases for young people have exceeded rises in average earnings of young people over several years and so the wages of the lowest paid young people relative to their peers is now higher than ever. Employment of young people is more sensitive than that of adults to the economic cycle. With this in mind the LPC reluctantly recommended a freeze to the rates for young people, which may increase their relative attractiveness to employers. We agree with the LPC analysis and consider that its recommendations should protect the labour market position of younger workers[9].

The proposed changes to the October 2012 rate for workers aged 18-20 and 16-17 represent a 0% change which is in line with our counterfactual. **Thus there is no marginal impact of the rate freeze for young workers.**

[9] National Minimum Wage Low Pay Commission Report 2012

Cost and benefits of the proposed uprating of the Apprentice rate

An Apprentice minimum wage of £2.50 was introduced 1st October 2010. This applies to apprentices aged under 19 and those aged 19 and over in their first six months of apprenticeship. This rate was increased to £2.60 in October 2011.

The proposed changes to the October 2012 rates represent an increase of 1.9% on the current rate for apprentices. BIS estimates that around 20,000 apprentices stand to benefit from the increase in the apprentice rate and that it will **cost employers £2.0m (a direct impact on business of £1.9m)** in increased wage bills. This represents a transfer and will **benefit apprentices by £2.0m** in the form of increased wages.

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

- Using ASHE 2011 data we estimate that around 20,000 individuals earn less than the forthcoming £2.65 per hour apprentice 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.

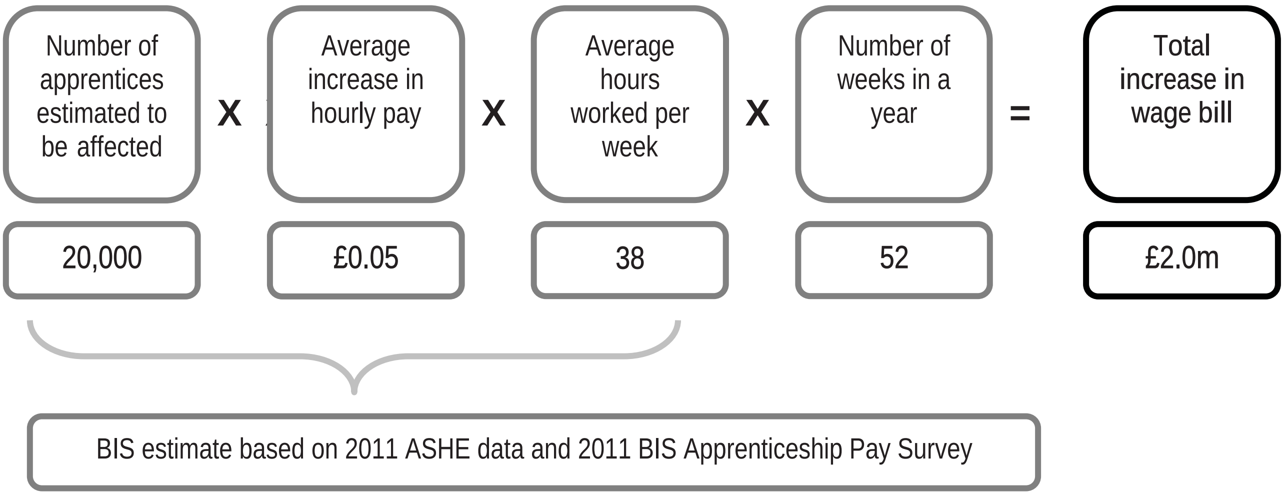
- We multiply the above by **38 hours** worked per week (the average hours contracted to work by apprentices on the apprentice minimum wage in 2011[10]).

- Multiply by 52 weeks per year.

Unlike adults we assume no change in non-wage labour costs as the total apprentice weekly pay is below the point at which employers start paying National Insurance contributions.

Our calculations can be found in figure 3 below.

Figure 3. Estimated increase in wage bill from increase in apprentice rate from £2.60 to £2.65



Source: BIS calculations. Figures have been rounded.

[10] Source: Apprenticeship pay survey 2011 data

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 LPC found no reason this year to adjust the offset relative to the minimum wage.**

The proposed change to the NMW accommodation offset is an increase from £4.73 in October 2011 to £4.82 in October 2012. This represents an increase of 1.9%. 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 evidence base available and a set of necessary assumptions which are subject to uncertainty.

In assessing the impact of the 2012 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 2012. 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 not 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. With the current evidence base any estimate would be subject to great uncertainty. However, the LPC have commissioned a project to investigate the substitution rate between low-pay workers and the NMW for their 2013 report.

Due to lack of available data that precisely estimates the number of apprentices covered by the October 2012 rate we have had to make a simplifying assumption. Using April 2011 ASHE data we make the assumption that everyone earning at or below the October 2012 apprentice rate is an apprentice.

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. For further info, please see LPC Report 2012[11].

Enforcement

The NMW is enforced by HM Revenue and Customs (HMRC). HMRC respond to complaints about situations where workers may not be being paid NMW. They also visit employers identified through risk assessment. Individuals may also make a complaint to an Employment Tribunal that their employer has not paid them the NMW. Employers found to have underpaid their workers NMW are required to pay arrears (at the current NMW rates) to their workers and may be subject to a penalty. **There is no change in cost of enforcement due to these upratings**.

[11] National Minimum Wage Low Pay Commission report 2012 page 152 http://www.lowpay.gov.uk/lowpay/report/pdf/2012_Report.pdf

Summary of preferred option

Table 3 represents a summary of option 1 (agree with all the LPC recommendations on the NMW rates and implement the new rates).

Table 3. Summary costs and benefits of option 1*

Age band	October 2012 rate	Employers	Employees
Adult rate (aged 21+)	£6.19	Higher labour costs	Higher wages for employees (benefit)
Apprentice rate	£2.65	Higher wage bill	Higher wages for some employees (benefit)
Development rate (aged 18-20)	£4.98	No marginal impact	No marginal impact
16-17 year old rate	£3.68	No marginal impact	No marginal impact

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

If Option 1 (agree with LPC recommendations on NMW rates and implement the new rate changes) were selected, the changes to the NMW regulations would be made by secondary legislation and would be expected to come into force on 1 October 2012.

“One in, one out” rule

Implementation by the Government of LPC rate recommendations falls within the ‘fees and charges’ exemption **(out of scope)** to the ‘one-in one-out’ rule whereby no new regulation can be brought in without other regulation being removed.

Using 2011 ASHE data, 93% of low paid workers (earning at or below the NMW) worked in the private sector. We take 93% as the percentage impact on business. The appraisal period has been set at one year as the NMW is reviewed annually and we have used 2011 prices. All of our workings related to OIOO and net present values can be found in Annex 5.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. If the policy is subject to a sunset clause, the review should be carried out sufficiently early that any renewal or amendment to legislation can be enacted before the expiry date. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), i.e. a sunset clause or a duty to review , or there could be a political commitment to review (PIR)];
Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]
Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]
Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured]
Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]
Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review]
Reasons for not planning a review: [If there is no plan to do a PIR please provide reasons here] BIS will not be planning a PIR for the amendments to the NMW regulations as the LPC extensively monitors and evaluates the NMW each year. The Government's remit to the LPC includes monitoring, evaluating and reviewing the NMW and its impact, with particular reference to the effect on pay, employment and competitiveness in the low paying sectors and small firms; the effect on different groups of workers, including different age groups, ethnic minorities, women and people with disabilities and migrant workers and the effect on pay structures.

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 have fully considered the questions posed in The Office of Fair Trading competition assessment test[12] and conclude that the 2012 NMW rates are unlikely to hinder the number or range of suppliers or the ability and incentive for businesses to compete.

Table A1. Competition assessment.

Question: *In any affected market, would the proposal..*	Answer
..directly limit the number or range of suppliers?	No
..indirectly limit the number or range of suppliers?	No
..limit the ability of suppliers to compete?	No
..reduce suppliers' incentives to compete vigorously?	No

Source: BIS

Small firms impact test

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 workers in large firms (250+ employees) are much less likely to be paid at or below the minimum wage than those in small firms (less than 50 employees), especially micro firms (those with 1-9 employees). Nearly 10 per cent of jobs in micro firms are paid at the minimum wage compared with around 3 per cent in large firms. Nevertheless, according to the Annual Survey of Hours and Earnings (ASHE), the majority of minimum wage workers work in large firms. Around 51 per cent of minimum wage workers work in large firms compared with around 17 per cent in micro firms and a further 17 per cent in other small firms (those with 10-49 employees). The remaining 15 per cent work in medium sized firms (50-249 employees).

In the LPC report they found the bite of the NMW for small sized firms (the adult NMW as a percentage of median earnings) is much greater across the earnings distribution for smaller firms. For example the bite for small firms is 58.7 per cent compared to medium sized firms at 53.1 per cent.

Micro-business Exemption Rule

Under the micro-business exemption rule whereby regulation exempts the organisations of 10 or fewer employees and start-ups, this measure is out of scope because it relates to the National Minimum Wage.

12 http://www.oft.gov.uk/shared_oft/reports/comp_policy/oft876.pdf

Equality impact assessment

In line with better regulation best practice and the Equalities Duties we have considered the impact of the NMW uprating on minority groups. Considering the impact of the 2012 NMW rates on minority groups is part of the Government's remit to the LPC which includes monitoring, evaluating and reviewing the NMW and its impact, with particular reference to the effect on pay, employment and competitiveness in the low paying sectors and small firms; the effect on different groups of workers, including different age groups, ethnic minorities, women and people with disabilities and migrant workers and the effect on pay structures.

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 gender, race or disability. Therefore the 2012 NMW rates are unlikely to create any barriers to equality in terms of gender, race, disability and religion.

Annex 3: LPC coverage estimates

Low Pay Commission coverage estimates of the 2012 NMW rates by sex

Table A2. Estimated number of workers (excluding apprentices) that are covered by the October 2012 National Minimum Wage rates by age and sex

	Male	Female	Total
16-17	8,000	6,000	14,000
18-20	26,000	14,000	40,000
21 and over	366,000	571,000	938,000
Total	400,000	591,000	992,000

Source: LPC estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2011. Figures have been rounded so totals may not sum up to individual parts.

BIS estimate that around 20,000 apprentices stand to benefit from the October 2012 apprentice NMW rate increase.

Coverage estimates of the 2012 NMW rates by country and Government Office region

Table A3. Estimated number of workers (excluding apprentices) that are covered by the October 2012 National Minimum Wage rates by country and government office region

Country or region	Coverage estimate
Wales	59,000
Scotland	81,000
Northern Ireland	50,000
England	
North-East	49,000
North-West and Merseyside	119,000
Yorkshire & Humberside	93,000
East Midlands	87,000
West Midlands	104,000
Eastern	85,000
London	83,000
South East	103,000
South West	79,000
United Kingdom	992,000

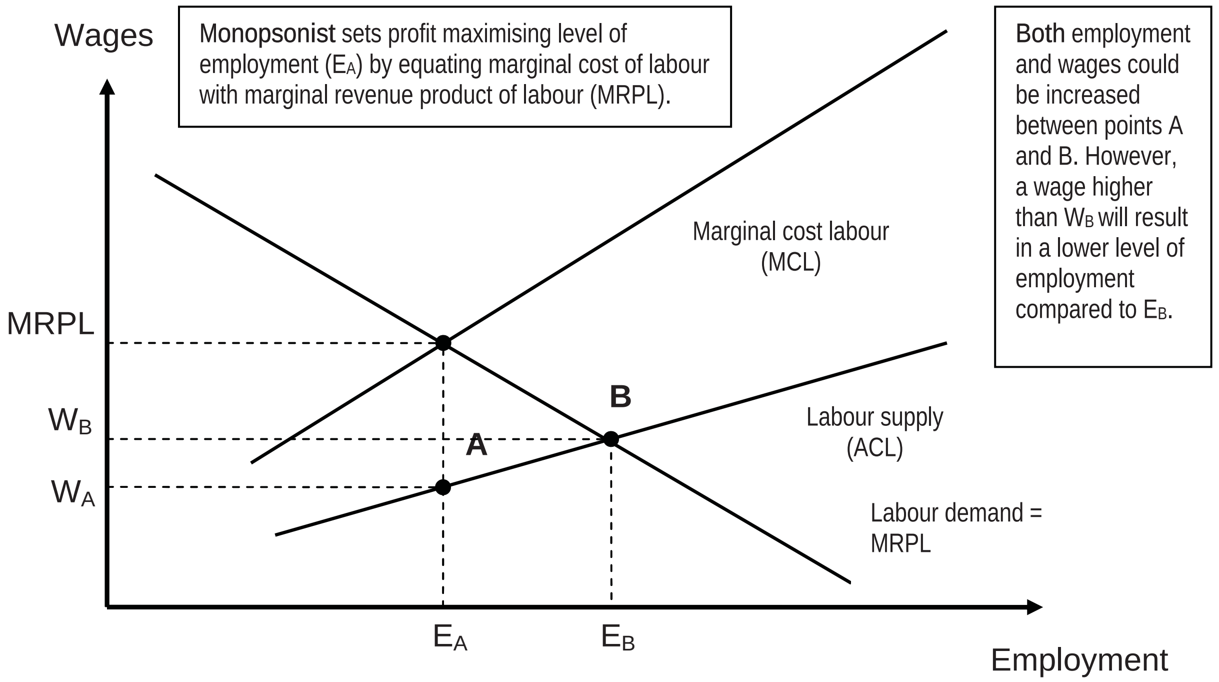
Source: A BIS breakdown of LPC estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2011. Figures have been rounded so totals may not sum up to individual parts.

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 One-in-one-out 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) scores for option 1.

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	Cost or benefit	Year 0	Nominal total	Present value total
		Costs			
93%	YES	Wage bill adult rate (employer)	150.6	150.6	150.6
93%	YES	Non-wage labour cost adult rate (employer)	24.7	24.7	24.7
93%	YES	Wage bill apprentice rate (employer)	2.0	2.0	2.0
		Benefits			
0%	NO	Wage bill adult rate (employee)	150.6	150.6	150.6
0%	NO	Non-wage labour cost (Exchequer and employee)	24.7	24.7	24.7
0%	NO	Wage bill apprentice rate (employee)	2.0	2.0	2.0
		Totals			
		Total cost	177.3		
		Present value total cost			177.3
		Total benefit	177.3		
		Present value total benefit			177.3

Source: BIS estimates. For the purposes of OIOO, net cost to business are presented in 2009 prices. This IA has a 2011 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 2011 to estimate percentage impact on business for costs and benefits.