

Briefing Paper 132

Accounting for the impact of the forthcoming “National Living Wage” on the third sector

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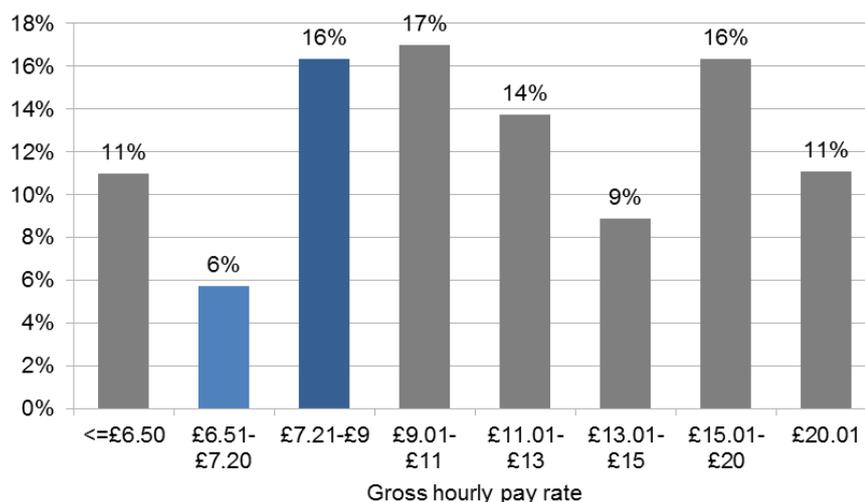
In the Summer Budget 2015 the Chancellor announced a new extension to the current National Minimum Wage (NMW) and its set of age-based rates, “*I am today introducing a new National Living Wage. We’ve set it to reach £9 an hour by 2020.*” The target was also described as being to reach 60% of median earnings by 2020, which could imply an even higher level (£9.35 an hour according to The Office for Budget Responsibility (OBR 2015)). As an initial step, a rate of £7.20 is to be implemented next year. The budget suggested that any employment effects would be relatively small. Moreover, the OBR analysis suggested a rather modest effect of the National Living Wage (NLW) from 2020, claiming that the effect would represent just 0.3% of the total paybill for the country, and 1% of corporate profits (though presumably the profit calculation is based only on the private sector), and which they quantified as being about £4billion in total.

These figures look relatively low because they build in the effects of anticipated increases in the NMW and in pay levels themselves, between 2015 and 2020. The OBR assumes that pay rates at all levels will grow with the average increase in wages (a surprising assumption with a public sector pay cap in force), and that the NMW will itself also grow in line with prevailing trends in wages, reaching about £8.25 by 2020. The effect of the National Living Wage (of say £9.35 at that point) is then compared with the new NMW at that time, rather than with the current level of wages, in the OBR analysis. The effect of the new policy, as estimated by the OBR, is thus only to increase wages from £8.25 to £9.35, rather than from the current minimum level of £6.50 (hence by £1.10 an hour rather than by £2.85). In strict policy evaluation terms, it is certainly arguable that this is the correct approach to take, in order to represent the ‘net’ effect of the new policy compared to what would have happened without it. However we tackle the somewhat larger issue of the total cost to organisations of moving from the current situation to having a National

Living Wage of £9.00 (as announced in the budget). In other words, we consider the costs of implementing that policy now.

We use the Annual Population Survey data from October 2014-March 2015 to run our calculations. This is a reliable, official source of data, but may tend to under-represent the sector compared with other information (though it may overstate numbers of lower paid workers, too). The data was adjusted so that everyone is paid at least the current minimum wage. Figure 1 shows the distribution of hourly paid rates in the third sector. The data includes October 2014, when a new NMW had just been enacted and, along with the inclusion of younger and apprentice workers ineligible for the NMW, this may help to explain the seemingly high proportion (11%) receiving the current NMW. There are then 6% of workers paid between £6.51 and £7.20, and a further 16% paid from £7.21 to £9 – the groups going to be directly affected by the new NLW.

Figure 1: Gross hourly pay rates of third sector workers of all ages



Source: calculations based on Annual Population Survey 2014-15.

In Table 1 we show the estimated effects of moving staff (aged 25+) from below the level of the NLW to reach the new mandated levels. (The proportions affected differ from those implied in Figure 1 as they relate only to those aged at least 25.)

Table 1 Changes in total amount of employee compensation as a result of the new NLW hourly rates

Sector	Rise to £7.20		Rise to £9.00		
	Change in earnings bill (%)	Change in earnings bill (£)	Change in earnings bill (%)	Change in earnings bill (£)	Proportion of staff affected (%)
Private	0.9%	£4.7bn	3.2%	£16.7bn	31%
Public (not local)	0.2%	£0.2bn	1.0%	£0.9bn	15%
Local Govt	0.5%	£0.4bn	2.0%	£1.4bn	26%
Third Sector	0.6%	£0.1bn	2.5%	£0.4bn	29%
Whole economy ¹	0.7%	£5.4n	2.7%	£19.6bn	28%

Source: calculations based on Annual Population Survey 2014-15.

So, within the Third Sector we calculate the cost of moving to £7.20 a hour (due next year) as being around £100m, or an extra 0.6% on the total earnings bill. However a move to £9 would mean a rise of £400m, or 2.5% on the total pay bill. The latter would also mean changing the earnings of almost 3 in every 10 of the third sector workforce (around 250,000 people) – and that ignores any compensating increases to those higher up the earnings distribution.

The OBR, on my reading, does not seem to have factored in any other costs of the NLW, beyond that of direct pay costs – but which would include such additions as employer National Insurance contributions, and employer contributions towards workplace pensions. An additional 13.8% of earnings is likely to be paid, in employer NI, for increases in earnings. Where an employee is in a workplace pension scheme, the rate of contribution will clearly vary with the scheme, but could be 3% in the case of the National Employer Savings Trust (NEST). The process of auto-enrollment into workplace pensions is currently incomplete, particularly for organisations with fewer than 50 workers, who are brought into the system from later this year, and beyond that for smaller companies. Hence there are likely to be further cash costs associated with the higher wage bill, beyond what is paid to workers as gross earnings.

¹ Including some workers with sector not known.

There are some offsetting changes – an NI reduction for the smallest organisations, and reductions in corporation tax for profit-making enterprises.

There may also be spillover effects if those just above the new wage level are given compensating amounts – which the OBR has modelled as doubling the numbers affected (i.e. many workers above the level of the new NLW also enjoy a pay increase, as part of preserving pay differentials between workers). However, we do not make these assumptions but instead look only at those below the likely level of the NLW. The effects will of course be larger for those organisations employing mostly those aged 25 or older, as the new NLW does not apply to people below that age, nor to certain categories of apprentices/trainees.

All in all, an increase in paying workers (including NI and pensions) of the order of £500m looks to be plausible for third sector organisations, comparing the National Living Wage with today's circumstances. This is clearly a large sum, although importantly that level of earnings is not anticipated as being reached until 2020, giving some time to plan.

Reference

OBR (2015) *Economic and Fiscal Outlook*, July 2015, Cm 9088.
<http://cdn.budgetresponsibility.independent.gov.uk/July-2015-EFO-234224.pdf>



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