

REGULATORY IMPACT STATEMENT

MINIMUM WAGE REVIEW 2011

AGENCY DISCLOSURE STATEMENT

- 1 This Regulatory Impact Statement has been prepared by the Department of Labour (the Department). It provides an analysis of options for the minimum wage for the Minister of Labour's annual minimum wage review in 2011.
- 2 The Department assessed the proposed options in light of the objective for the minimum wage, assessment criteria and related considerations. These considerations, and the limitations with some of the data, include:
 - a) The numbers and characteristics of workers directly affected. There is no robust data available on some types of workers who are more likely to be on the minimum wage, such as new migrants, temporary workers and disabled workers. Some of our estimates assume that all 16 and 17 year olds are eligible to earn (at least) the adult minimum wage because the Department is unable to estimate how many of them may be eligible for the new entrants' minimum wage. Estimates based on data from the New Zealand Income Survey do not include workers who report an hourly wage below the minimum¹.
 - b) Estimates of the impact on employment growth and wage earnings/costs. The estimates of impacts on job growth are based on a conventional model of firm decision-making, whereby firms operate in perfectly competitive markets that adjust outputs and inputs, including labour, in response to relative prices. This modelling approach does not adequately reflect the dynamic nature of employment responses to changes in minimum wages, and, in particular, any investments that employers may make to increase the productivity of low paid workers.
 - c) The types of industry sectors affected. Data limitations mean that more detailed, lower level (e.g. within sectors or at an individual firm level) analysis is not possible.
 - d) An assessment of the labour market conditions.
 - e) The views of submitters.
- 3 The Department is only able to estimate the direct impacts of minimum wage changes. We do not have adequate data to assess any flow-on effects of an increase in the minimum wage. There is inadequate information to assess the potential impact of the minimum wage options on labour participation and productivity.
- 4 Apart from the direct costs provided by some state agencies, the Department is unable to assess other fiscal impacts, such as changes to social assistance and taxation due to lack of information.

¹ In the 2011 New Zealand Income Survey, 4.4% of 18-64 year olds reported wages below the adult minimum wage.

- 5 The assessment is focused on the adult minimum wage rate. It is not proposed to change the relativity of the new entrants' minimum wage and the training minimum wage to the adult minimum wage and it remains at 80 percent throughout the assessment.
- 6 Policy options considered in this Regulatory Impact Statement that result in an increase in the minimum wage are likely to have an effect that will require a particularly strong case before regulation change is considered, as they may impose additional wage costs on businesses employing staff on the minimum wage and, possibly, those with workers earning near the minimum wage. The increased wage costs could be an obstacle to job creation in the current economic situation.

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1 February 2012

Note: The following table forms part of the Regulatory Impact Analysis. It is moved forward for formatting reasons.

Table 1: SUMMARY OF THE ASSESSMENT OF OPTIONS

Assessment criteria/ consideration	Option 1: \$13.00 (status quo)	Option 2: \$13.25 (in line with change in Labour Cost Index)	Option 3: \$13.30 (in line with forecasted change in CPI in the year to March 2012)	Option 4: \$13.50 (in line with the change in average wages from QES in September 2011)	Option 5: \$13.60 (increase in line with the change in the (CPI) in September 2011)	Option 6: \$15.00 (from consultation with stakeholders)
Percentage increase	-	1.9%	2.3%	3.8%	4.6%	15.4%
Workers directly affected - 18-64 years	56,400	67,500	73,300	81,100	108,800	248,600
Workers directly affected -16-17 years ²	7,600	8,100	9,000	9,500	11,200	16,200
Principle of fairness (comparison benchmark: average wage change from October 2010 to September 2011)	reduces	reduces	reduces	maintains	slightly improves	strongly improves
Principle of protection (comparison benchmark: collective agreement average wage change from July 2010 to June 2011)	reduces	reduces	reduces	maintains	improves	strongly improves
Principle of income distribution (comparison benchmark: change in average wage and median wage from October 2010 to September 2011)	income disparity increases	income disparity increases	income disparity increases	income disparity reduces	income disparity reduces	income disparity reduces strongly
Principle of work incentives (comparison benchmark: benefit levels which will be adjusted on 1 April in line with CPI change)	reduces	reduces	reduces	maintains	improves	strongly improves
Income benchmark - average total hourly earnings from QES in September 2011	49%	50%	50.1%	50.9%	51.3%	56.5%
Income benchmark - median total hourly earnings from Income Survey in June 2011	63.8%	65.1%	65.2%	66.2%	66.7%	73.6%
Income benchmark – minimum wage in collective agreements in June 2011	lower	lower	lower	lower	lower	equal
Economy-wide wage increase for the 2012/13 financial year(\$m)	N/A	22	27	50	66	477
Inflationary impact /GDP (percentage points)	N/A	0.01	0.01	0.02	0.03	0.24
Projected job growth (March 2012 to March 2013)	34,700 to 35,200	34,000 to 34,300	33,900 to 34,100	33,400	33,000 to 33,200	28,000 to 29,500
Potential constraint on job growth (absolute change) ³	-1,200 to -1,700	-600 to -800	-400 to -600	0 to 100	300 to 500	4,000 to 5,500
Affected industries	Hospitality and retail are most likely to be affected by a minimum wage increase as they employ more low wage employees. Under Option 6, there would be more industries affected.					
Additional wage costs to government ⁴ for the 2012/13 financial year(round to \$m)	N/A	10	11	16	17	55
Non-compliance	Increasing the minimum wage may increase non-compliance with the minimum wage legislation. However, it is not clear whether an increase in the number of workers reporting being paid below minimum wages is caused by measurement error or non-compliance.					

² Assuming that all 16 and 17 year olds are eligible for the adult minimum wage.

³ The negative numbers under Options 1, 2 and 3 mean that these options would promote job growth, rather than constrain it. Alternatively it could be understood that the constraint on job growth is zero.

⁴ These area high level estimates based on the information provided by the four agencies most likely to be affected.

OBJECTIVE OF THE MINIMUM WAGE

Statutory obligation to review

- 7 Minimum wage rates are set through an Order in Council made under Section 4 of the Minimum Wage Act 1983 (the Act). Under Section 5 of the Act, the Minister of Labour has a statutory obligation to review the minimum wage rates by 31 December each year.
- 8 Any change to the minimum wage rates would be implemented by making a new Order in Council.

Overarching objective and assessment criteria

- 9 The Government's agreed objective for the minimum wage [CAB Min (08) 28/24 refers] forms the basis of this review. The minimum wage objective is:

"to set a wage floor that balances the protection of the lowest paid with employment impacts, in the context of current and forecast labour market and economic conditions, and social impacts".

- 10 Cabinet also agreed that, in order to meet this objective through the minimum wage review, the following two assessment criteria must be considered:
 - 'the extent to which any change to the minimum wage would produce gains that are more significant than any losses',⁵ and
 - 'consideration of whether a change to the minimum wage would be the best way to protect the lowest paid in the context of the broader package of income and employment-related interventions, and would meet the broader objectives of government'.

STATUS QUO AND PROBLEM DEFINITION

Current minimum wage

- 11 The current minimum wage rates are as follows:
 - The adult minimum wage is \$13.00 an hour. It applies to all employees aged 16 years and over, who are not new entrants or trainees.
 - The new entrants' minimum wage is \$10.40 an hour.⁶ It applies to 16 and 17 year olds except for those employees: who have completed 200 hours or three months of employment, whichever is shorter; who are supervising or training other workers; or who are subject to the training minimum wage.

⁵ The Cabinet approved objective and assessment criteria also include a list of factors to be considered in relation to the first assessment criteria. These include consistency with the principles of fairness, protection, income distribution, and work incentives; comparison against other local and international benchmarks; and consideration of social and economic impacts. The assessment criteria and related factors to be considered are not weighted. Please see Appendix 1 for more detail.

⁶ By law, the new entrants' minimum wage cannot be set at less than 80 percent of the adult minimum wage.

- The training minimum wage is \$10.40 an hour. It applies to those employees aged 16 years and over who are undertaking at least 60 credits a year in a registered training programme.
- 12 The current rate for the adult minimum wage is a result of the 2010 annual review. The adult minimum wage was increased by 2 percent on April 2011. The increase was broadly in line with the change in the Consumers Price Index (CPI) in June 2010.⁷ However, the increase would not constitute an increase in the real cost to the employers, if this is calculated using the Producers Price Index–Outputs (PPI-O).⁸
- 13 By comparison, the current adult minimum wage of \$13.00 an hour is around 49.0 percent of average total hourly earnings (\$26.53 an hour in the Quarterly Employment Survey (QES), September 2011) and 63.8 percent of median total hourly earnings (\$20.38 an hour in the New Zealand Income Survey, June 2011).
- 14 Internationally, five other OECD countries have a higher minimum wage than New Zealand.⁹ The Australian Federal minimum wage increased by 3.4% from AU\$15.00 to AUS\$15.51 following the 2010/11 review. This equates to NZ\$19.74 on 12 September 2011.¹⁰ Table 2 shows if we compare the value of the minimum wage across countries using purchasing power parity (PPP),¹¹ New Zealand’s minimum wage also ranks sixth amongst these OECD countries.

Table 2: Comparison of minimum wage levels, by country

	Hourly rate in national currency	Hourly rate in NZ\$ *	In NZ\$ using PPPs	Date of last up rating	Applying Age
France	€8.86	\$15.00	\$15.04	Jan-10	18
Australia	Au\$15.51	\$19.52	\$16.71	Jul-11	21
Belgium	€8.17	\$13.83	\$14.01	Oct-09	21
Netherlands	€8.17	\$13.83	\$14.01	Jul-10	23
United Kingdom	£6.08	\$11.79	\$14.34	Oct-11	22
Ireland	€8.65	\$14.64	\$12.30	Jul-11	20
New Zealand	\$13.00	\$13.00	\$13.00	Apr-11	16
Canada	C\$9.16	\$11.25	\$10.55	Jan-10	16
United States	US\$7.25	\$8.91	\$10.21	Jul-09	20
Spain	€3.65	\$6.18	\$7.64	Jan-10	16
Japan	JPY730	\$11.66	\$7.05	Oct-10	15/18
Greece	€4.13	\$7.00	\$9.34	May-09	25
Portugal	€2.74	\$4.64	\$5.54	Jan-10	16

⁷ According to Statistics New Zealand, from June 2009 quarter to June 2010 quarter, the CPI increased by 1.8 percent.

⁸ This measures the average change in output (selling) prices of firms across the whole economy.

⁹ This is measured in New Zealand dollar using purchasing power parity. Five countries are: Australia, France, Ireland, Belgium, and the Netherlands.

¹⁰ Based on an exchange rate of 0.7858 from New Zealand Reserve Bank.

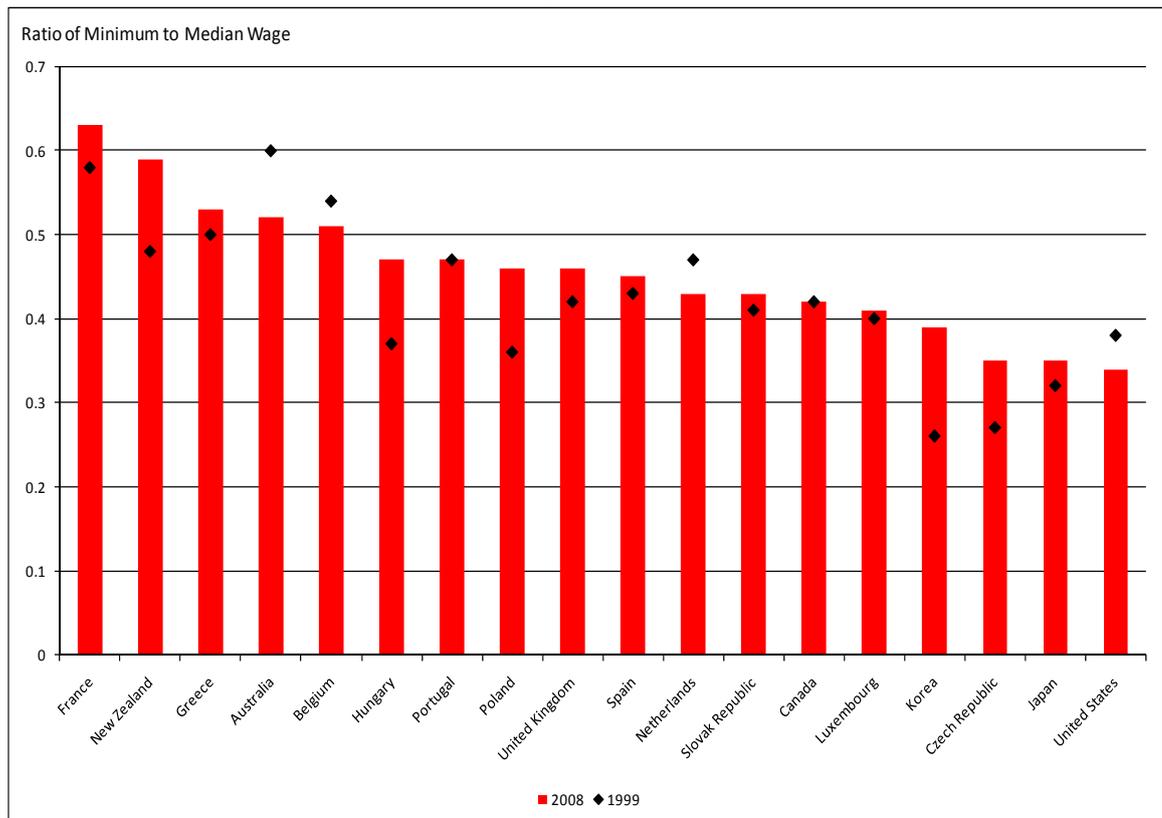
¹¹ PPP measures the monetary amount needed to buy the same representative basket of consumer goods and services in each country and allows a more accurate comparison of standards of living across countries than exchange rates.

Source: The UK Low Pay Commission Report on minimum wage 2011¹² used as a basis for updating

* Exchange rate source: Reserve Bank New Zealand average rates, September 2011

- 15 As a proportion of the median wage, New Zealand’s minimum wage is high compared to other OECD countries. As Figure 1 shows, as at 2008, New Zealand’s minimum wage, as a ratio to median wage indicated by the red bar, was the second highest of 21 OECD countries, second only to France. While in 1999, at least four countries had higher ratio of minimum to median wage than New Zealand.

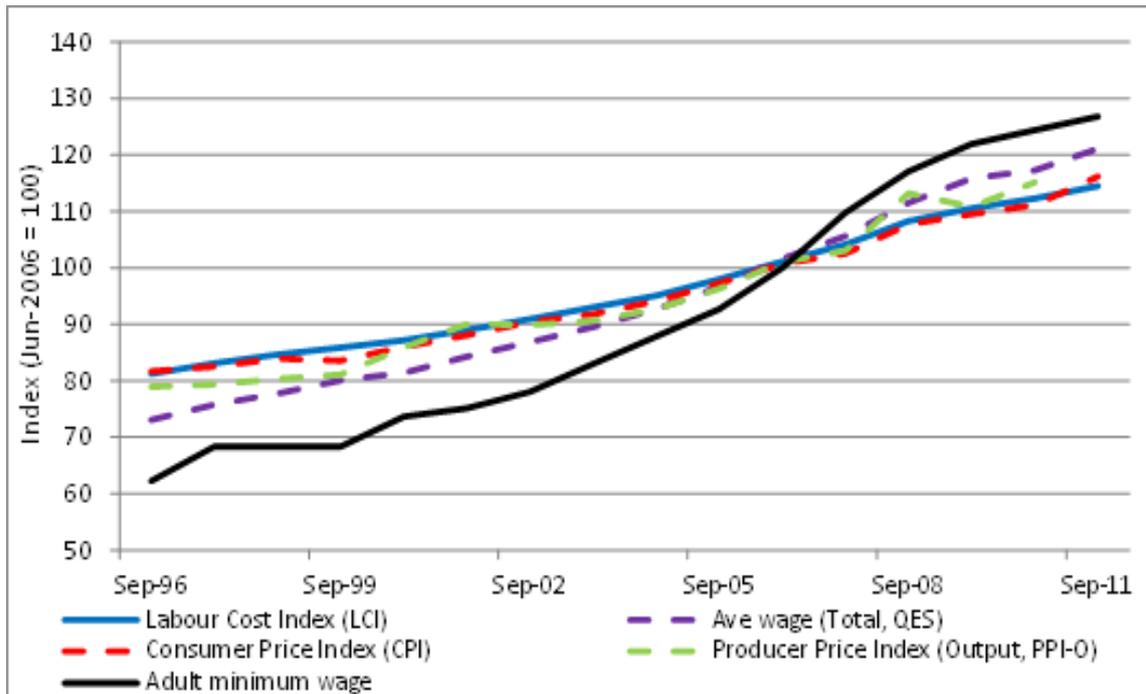
Figure1: Relative minimum wage levels (Gross earnings of full-time minimum wage earners as percentage of gross median wages)



- 16 Between 2000 and 2008, the minimum wage had been increasing at a faster rate than general wages (as measured by the Labour Cost Index (LCI)) and general prices (as measured by the CPI), but recent increases have been more in line with general price inflation. Figure 2 shows increases in the minimum wage compared with various measures of inflation over the last 15 years.

¹² Information can be accessed at <http://www.lowpay.gov.uk/>

Figure 2: Wage inflation and the minimum wage, 1996 – 2011



17 The modest and gradual increase to the minimum wage rate over the past three years reflects a balance between providing protection to the lowest paid by maintaining the purchasing power of the minimum wage and minimising the impact of minimum wages on employment, based on the most reliable economic and statistical indicators.

Current labour market conditions

- 18 The current review of the minimum wage takes place amid a slowly recovering economy and labour market following a five quarter recession in 2008-2009 and two major earthquakes in Canterbury.
- 19 New Zealand has a total labour force of 2,375,000 (2,218,000 employed and 157,000 unemployed).¹³ Employment growth after the recession has been sluggish. The unemployment rate is 6.6 percent as at September 2011. Youth (15-24 year olds) were severely affected by the 2008-2009 recession, with large falls in employment and rising unemployment. Since September 2010, the youth unemployment (for 15-24 year olds) rate has remained at 16.2 percent and youth employment has increased by 0.1 percent. Unemployment rate for the 15-19 year-olds is 23.4 percent (Statistics New Zealand Household Labour Force Survey data for the September 2011 quarter).
- 20 The recession slowed wage growth and general inflation. Statistics New Zealand records that wages and salaries rose by 2 percent in the year to September 2011.

¹³ Household Labour Force Survey (September 2011 quarter).

Problems associated with the status quo

- 21 In the year to September 2011, the CPI increased by 4.6 percent. The Unemployment Benefit will increase in the coming year as it is indexed to the CPI. The average wage, median wage and collective agreement average minimum wage increased, by 3 percent, 1.9 percent and 4 percent respectively.¹⁴ If the minimum wage stays unchanged, the existing levels of fairness, protection and work incentive would be reduced. Income inequality would increase.
- 22 Problems associated with the status quo, particularly how effective minimum wage increases are at achieving the government's objective of balancing protection with employment impacts, has been discussed by submitters during the consultation. Some submitters argue that the minimum wage needs to be significantly raised to address the needs of many low income workers, narrow the wage gap with Australia, encourage employers to invest in raising productivity, reduce income inequality (including gender inequality), and reducing poverty, especially in-work poverty. Others argue that the minimum wage should not be increased as it is already too high (as a proportion of the median wage). It should be reduced or maintained at the current level to avoid negative impacts on employment.
- 23 Youth unemployment remains a concern. The proportion of 15-24 year olds who are not engaged in employment, education or training (the NEET rate) serves as a measure of disengagement. The NEET rate started to rise from late 2008, peaking at 10.8 percent in the year to March 2010. In the year to September 2011, the NEET rate fell to 9.7 percent. Some commentators have suggested that youth have been priced out of the labour market by the lack of an effective sub-minimum wage rate for them.

REGULATORY IMPACT ANALYSIS

Assessment of the options

- 24 The Department has included six options for the adult minimum wage rates for the 2011 review. These options are:
- Option 1: Retaining the current adult minimum wage of \$13.00 an hour
 - Option 2: An increase to \$13.25 an hour in line with the change in the LCI in the year to September 2011
 - Option 3: An increase to \$13.30 an hour in line with the forecasted change in the CPI for the year to March 2012¹⁵
 - Option 4: An increase to \$13.50 an hour in line with the changes in average wages from the QES in September 2011
 - Option 5: An increase to \$13.60 an hour in line with the CPI in the year to September 2011, and

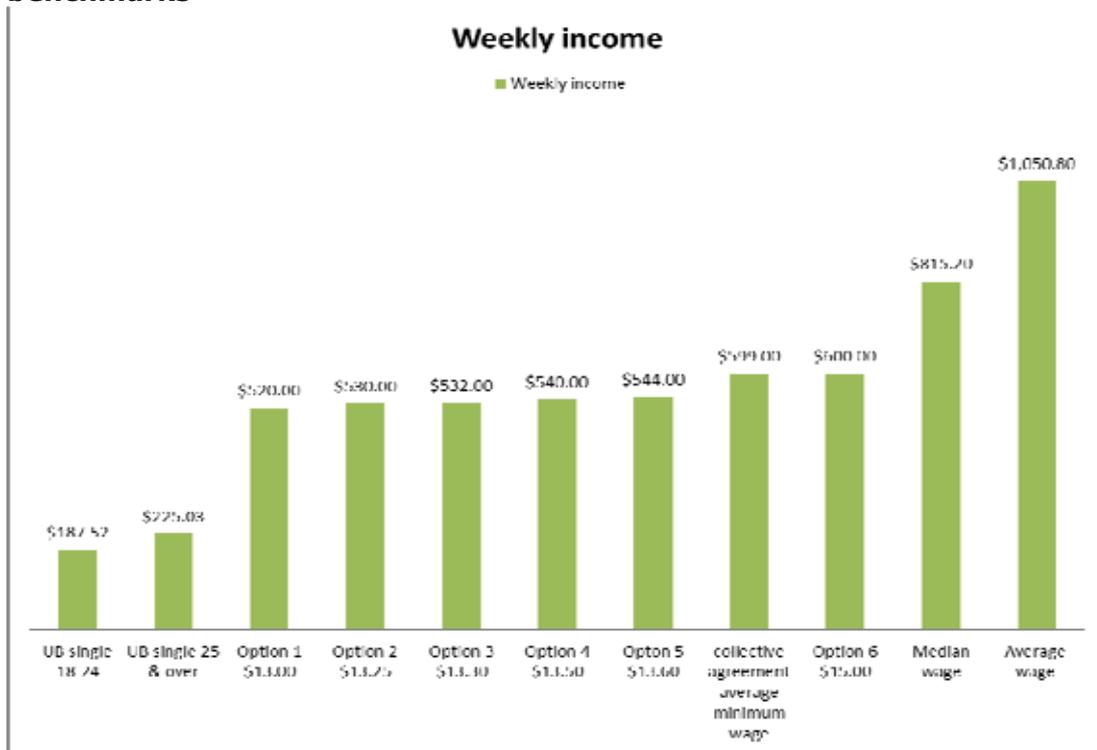
¹⁴ The increases of median wage and collective agreement average minimum wage are calculated by the year to June 2011.

¹⁵ This is based on NZIER Consensus Forecasts of CPI increase by 2.3% to the year ended March 2012. This option is in contrast to Option 5 (based on the change of CPI for the year to September 2011, which includes the change to the rate of the Goods and Services Tax) in October 2010 but does not reflect the offsetting adjustment to income tax rates.

Option 6: An increase to \$15.00 an hour.

- 25 Figure 3 provides a comparison of the minimum wage options against other income benchmarks. For the purpose of comparison, the weekly median wage and average wage are calculated on the basis of a 40-hour week.

Figure 3: Adult minimum wage options compared with other income benchmarks



Note: UB stands for Unemployment Benefit.

- 26 All six options are assessed against the minimum wage objective and the relevant criteria. The assessment is summarised in Table 1 at the beginning of the Statement. Some particular issues are discussed in more detail below. Overall, any increase in the minimum wage will increase the income for those paid at or near the current minimum wage. However, the impact on net income is affected by taxation and abatement for those receiving income support and tax credits.
- 27 Minimum wage increases may have employment impacts. However, only when there is an increase in the real value of the minimum wage (under Options 4, 5 and 6) does it potentially affect employment growth. Further, it is estimated that there would only be an impact on the unemployment rate under Option 6 (an increase of 0.2 percentage point).
- 28 An increase in the minimum wage will increase labour costs for employers, especially for those industries that employ a large proportion of minimum wage workers such as retail and hospitality, although evidence suggests the increase to the wage bill will be small. For example, the Department's estimate is that for Option 2 (\$13.25 an hour) the increase in economy wide weekly wage earnings will be 0.03 percent. It will also have a fiscal impact on the state sectors, particularly for the Ministries of Health, Social Development and Education, and for Accident Compensation Corporation (ACC).

Impact on employment and unemployment

Impact on employment growth

- 29 The Department has analysed employment impacts with respect to real minimum wage changes by using a range of employment adjustment factors (elasticities).¹⁶ Real changes in minimum wage rates are calculated using the Producers Price Index–Outputs (PPI-O).¹⁷ In terms of real cost to employers, Option 2 (\$13.25 an hour) does not constitute an increase; while Option 4 (\$13.50 an hour) would result in an increase of 0.2 percent.
- 30 The Department has used a benchmark to estimate the impact of various minimum wage options on job growth. The benchmark is an estimate of the number of extra jobs that would be created in the economy if the minimum wage stayed the same in real terms from April 2012 to March 2013 (e.g. increased by the same percentage as the PPI-O). The benchmark projected job growth is estimated at 1.5 percent or 33,500 jobs. Table 3 below sets out aggregate estimates of the potential constraint on job growth that may result from minimum wage increases.

Table 3: Summary of the impacts of minimum wage increases on employment levels (March 2012 – March 2013)¹⁸

Option	Projected job growth (% increase in parenthesis)	Potential constraint on job growth (absolute change)
\$13.00	34,700 to 35,200 (1.6%)	-1,200 to -1,700
\$13.25	34,000 to 34,300 (1.5%)	- 600 to -800
\$13.30	33,900 to 34,100 (1.5%)	-400 to -600
\$13.50	33,400 (1.5%)	0 to 100
\$13.60	33,000 to 33,200 (1.5%)	300 to 500
\$15.00	28,000 to 29,500 (1.3%)	4,000 to 5,500

Impact on unemployment

- 31 It is difficult to estimate the potential impact on unemployment of a minimum wage increase. Even if it is assumed that a minimum wage increase will result in fewer jobs in the economy than would otherwise have been the case, individuals affected by the reduction in jobs may not become officially unemployed (and thus counted as such). Some individuals may choose to study, look after children or other dependants, or simply exit the labour force (or not enter it).

¹⁶ More information on the adjustment factors used is available from the Department of Labour.

¹⁷ PPI-O measures the average change in output (selling) prices of firms across the whole economy. NZIER forecasts that the PPI-O will increase by 3.6% over the year to March 2013.

¹⁸ We have used single estimates for the wages of 16 and 17 year old workers, as the data suggest that the majority are earning the adult minimum wage or more and we are unable to estimate how many 16 and 17 year olds may be eligible for the new entrants' minimum wage. The calculations therefore assume that all 16 and 17 year olds are eligible to earn (at least) the adult minimum wage.

- 32 Based on the Reserve Bank forecasts of the unemployment rate of 5.7 percent for March 2012 and 5.2 percent for March 2013, it is estimated that the forecasted unemployment rate would not be affected by Options 1, 2, 3, 4 or 5 for the March 2013 quarter, but could increase to 5.4 percent for the same quarter under Option 6 (\$15.00 an hour).

Impacts on low paid workers

- 33 Women, Māori, Pacific peoples, disabled people, young people and the low-skilled are more likely to be minimum wage workers. A modest increase in the minimum wage could have a positive financial and social impact for low paid workers through an increase in their income. However, these workers may also be the first to experience any negative impacts that could result from a change in the minimum wage (e.g. reduced hours offered or substitution of some groups of workers for others). A significant rise in the level of the minimum wage may have the effect of employment losses and subsequently increased hardship for lower skilled workers.

Impact on young people

- 34 Over half of those earning the minimum wage are between 16 and 24 years of age. An increase in the minimum wage is likely to affect a very large number of young people already in work. On the one hand, those remaining in work will see an increase in their weekly income; on the other hand, some of them might lose employment due to the disemployment effect of the minimum wage.¹⁹
- 35 The minimum wage can either encourage young people to enter the workforce (rather than continuing in training or education) or encourage them to remain in training or education. These impact results depend on the level of the minimum wage, the cost of education or training, and job opportunities and prospects.
- 36 Previous research found that minimum wage increase had minor negative effects on education enrolments in New Zealand.²⁰ However, Hyslop and Stillman's study²¹ found that the policy change to abolish the youth minimum wage in 2008 increased the proportion of 16 and 17 year olds participating in study, but the proportion looking for work (unemployed) or inactive did not increase following the rise in minimum wages (inactivity actually fell).

¹⁹ Luttmer, E. (2007). Does the Minimum Wage Cause Inefficient Rationing? *The B.E. Journal of Economic Analysis & Policy*, 7(1)(Contributions), Article 49. Also see Quiggin, J. (2006). Does a higher minimum wage mean fewer jobs? *Australian Policy Online*. Available at <http://www.apo.org.au/commentary/does-higher-minimum-wage-mean-fewer-jobs>

²⁰ Hyslop, D. and S. Stillman (2004), *Young people Minimum Wage Reform and the Labour Market*. New Zealand Treasury Working Paper 04/03, Wellington, the Treasury. Available online at <http://www.treasury.govt.nz/workingpapers/2004/04-03.asp>. This research found a statistically significant fall in the fraction of 16 and 17 year olds studying of about 3-4 percent in each year after the minimum wage increases and a generally smaller drop in study rates for 18 and 19 year olds of 1-2 percent, which were statistically significant, in 2001 and 2002. Pacheco, G. and A. Cruickshank (2007) *Minimum Wage Effects on Educational Enrolments in New Zealand*. Economics of Education Review, also find a statistically significant negative effect on enrolment levels for 16 to 19 year olds over 1986-2004.

²¹ Hyslop, D and Steve, Stillman(2011), *The Impact of the 2008 Young people Minimum Wage Reform*, The Department of Labour, Wellington.

Impact on other groups

- 37 Similar conclusions about the impact of an increase in the minimum wage on young people can be drawn for other demographic groups. For example, Māori people may be adversely affected by a higher minimum wage. According to Pacheco,²² Māori people who face a binding minimum wage experienced significant falls in their employment propensity and usual total weekly hours worked. However, the impact on gender pay gap has been estimated to be negligible even under Option 6 (from 86.3 percent to 86.7 percent).

Impact on income distribution

- 38 Changes in the minimum wage affect wage distribution in the form of 'bite', which provides a measure of the extent to which the minimum wage compresses the wage distribution.²³ If the percentage rises in the minimum wage are greater than the rise in 'average' earnings, the minimum wage 'bite' increases. As the 'bite' increases, wage differentials are compressed at the lower end of the earnings distribution. This means less earnings inequality.
- 39 The higher the ratio, the better the relative position of minimum wage workers. The higher the minimum wage is relative to average wages (the greater the bite), the greater the proportion of workers that will be impacted (increased likelihood of disemployment effects).
- 40 Between 2000 and 2008, the minimum wage had generally risen faster than average earnings. As illustrated in Table 4, the relativity of the minimum wage to the average hourly wage has risen from 44 percent in 2001 to 50 percent in 2008 and has then remained at this level. The bite at the median has followed a similar pattern and increased from 52 percent in 2001 to 62 percent in 2008. The bite at the lower end of the distribution has remained at about 80 percent in the lowest quartile and around 95 percent in the lowest decile since 2007. This suggests that an increase in the minimum wage has led to some compression of earnings at the bottom of the distribution, and towards the median wage. However, the minimum wage increases since 2007 have not led to a further compression of wages.

²² Pacheco, G. (2011), *Estimating Employment Impacts with Binding Minimum Wage Constraints*. The Economic Record. VOL. 87, No. 279, December, 2011, 587-602.

²³ The 'bite' is a standard indicator used in the minimum wage literature, defined as the ratio of the nominal value of the minimum wage to the average wage.

Table 4: The minimum wage 'bite' at different points in the hourly earnings distribution, ages 20+, 2001-2011

Year	Adult minimum wage	10 th percentile	25 th percentile	Median	Mean	75 th percentile	90 th percentile
2001	\$7.70	79.4%	67.1%	52.1%	44.0%	39.8%	29.1%
2002	\$8.00	80.6%	69.0%	53.3%	41.8%	40.0%	29.4%
2003	\$8.50	85.0%	70.8%	55.4%	43.9%	41.2%	29.5%
2004	\$9.00	89.1%	73.2%	56.3%	47.1%	41.9%	30.4%
2005	\$9.50	88.4%	73.1%	55.9%	47.4%	41.5%	30.5%
2006	\$10.25	93.2%	75.0%	57.6%	48.9%	42.7%	30.7%
2007	\$11.25	93.8%	79.7%	59.4%	49.3%	44.0%	31.3%
2008	\$12.00	96.0%	80.0%	61.6%	50.2%	44.4%	31.3%
2009	\$12.50	96.2%	81.5%	62.4%	51.5%	44.9%	32.6%
2010	\$12.75	94.4%	79.7%	61.4%	51.2%	44.3%	31.9%
2011	\$13.00	94.5%	81.3%	61.1%	49.5%	43.6%	31.1%

- 41 Under Options 1, 2 and 3 there would be no compression of wages and earnings inequality will increase; under Options 4, 5 and 6, wage differentials would be compressed and earnings inequality be reduced to different degrees.

Impact on poverty reduction

- 42 While designed to be a protective measure for the low paid workers, the minimum wage as a broad lever is not the most effective tool for reducing poverty. The minimum wage applies to individual employees when those with the lowest incomes in society tend to be families with no employed workers.²⁴
- 43 Research suggests that minimum wages have little impact on net household incomes.²⁵ This is because 'most gainers lived in nonpoor families and most working poor already had wages above the proposed minimums'. This is also the case in New Zealand, where the minimum wage is earned across all family income deciles, rather than being predominantly compressed into the lower end of the distribution of family income. This is supported by Maloney and Pacheco's research²⁶ which finds that a 10 percent increase in the minimum wage would lower the poverty rate by less than one tenth of a percentage point. The small impact is due to the fact that many poor households do not

²⁴ Freeman (1996) "The Minimum Wage as a Redistributive Tool". *The Economic Journal*, 106 (436), 639-649.

²⁵ Burkhauser, R., & Sabia, J. (2006). The effectiveness of minimum-wage increases in reducing poverty: past, present and future. *Contemporary Economic Policy*, 25(2), 262-281. Retrieved electronically from Blackwell Publishing Limited. Formby, J., Bishop, J., & Kim, H. (2010). The redistributive effects and cost-effectiveness of increasing the minimum wage. *Public Finance Review*, 38(5), 585-618. Retrieved electronically from Sage Publications Academic Database.

²⁶ Maloney, T. & Pacheco, G. (2010) *The Efficacy of the Minimum Wage as an Antipoverty Tool*. Retrieved from <http://www.stats.govt.nz>.

contain working members who could take advantage of higher minimum wages to boost household income, and many minimum wage workers do not live in poor households.

- 44 While increases to the minimum wage rate will generally provide increased incomes for those on the minimum wage, the overall impact on net income is affected by taxation, and for those receiving income support,²⁷ the increase in wages received results in a reduction of benefit, also affecting the overall gain.
- 45 The Department recognises the minimum wage is often only part of the income of low income workers. Within the current policy context, a minimum wage increase will not be able to significantly increase the net gain for those on benefits. Therefore, by itself, it has limited effectiveness for incentivising this group of people into work or to work more hours. Other income and employment-related interventions should be explored to meet the broader objectives of government.

Impact on work incentives

- 46 Increasing minimum wage rate can make certain types of work more attractive. Generally, when the increase is greater than the increase to the CPI, it means further increase to work incentives. However, work incentives are dependent on many factors such as benefit level, and childcare and transport costs. A higher minimum wage can frustrate work incentives through economic effects that restrict job opportunities available to low skilled workers.
- 47 As it is further assessed in detail in Table 5, Options 1, 2, and 3 would reduce the current level of work incentives while Options 4, 5 and 6 would maintain or increase the work incentives.
- 48 An increase in the minimum wage would not be effective to increase work incentives in the current economic situation for the following reasons. Firstly, the current minimum wage is already significantly higher than the unemployment benefit rate. Secondly, New Zealand has very high labour force participation (68.4 percent according to the HLFS in September 2011, Statistics New Zealand). Thirdly, we have a much higher unemployment rate and the labour market (especially in the lower skilled labour market) is not as tight as before. This means people would be more discouraged to seek employment due to greater competition.

Impact on labour productivity

- 49 There is little existing empirical evidence on the impact of minimum wages on productivity. The OECD Employment Outlook for 2007 found that minimum wages were estimated to have a positive impact on labour productivity²⁸. The Department's examination of the literature has found the evidence to be mixed and still exploratory. If minimum wage increases encourage better workplace practices, including increased training or investment in technical innovations, it can lead to productivity improvements. There may be longer-

²⁷ 7,200 minimum wage earners also receive benefits.

²⁸ OECD (2007) *OECD Employment Outlook 2007*. Available at: http://www.oecd.org/document/0/0,3343,en_2649_33927_40774656_1_1_1_37457,00.html.

term negative impacts on labour productivity emanating from increases in the minimum wage if it encourages young workers to work more and study less.

- 50 The Department considers that macro labour productivity levels can be volatile when measured over a short period of time. There are also noted difficulties with productivity measurement in the long run. This makes it difficult to monitor on an annual basis to inform the minimum wage review. Furthermore, there is no micro labour productivity data available for us to assess the impact of minimum wage increase.
- 51 Irrespective of measurement and attribution difficulties, the Department does not consider that increases in the minimum wage are effective tools to drive economy-wide improvements in labour productivity.

Impact on employers and firms

- 52 An increase in minimum wage may affect employers in different ways. Dalziel found that employers responded in a number of ways to minimum wage increases.²⁹ The most common response was to reduce wage relativities across their staff. Other possible responses identified by employers included reducing the hours of work to staff, tightening employment policy, not replacing workers who resign, attempting to increase productivity, attempting to reduce costs, raising prices where possible, accepting a reduction in profits, and business closure.
- 53 Research from overseas suggests that increases in the minimum wage may have a small negative impact on firm profitability, but finds no evidence of this increasing the probability of firm closure.³⁰
- 54 In 2010, the Department of Labour conducted a survey on employers' attitudes and practices around the change to the minimum wage.³¹ The survey found that around three quarters of employers surveyed reported that they did not employ any workers on the minimum wage and their business was not affected by the changes. Another 12.7 percent of employers surveyed reported no effects on their business other than increasing the wages of those on the minimum wage.³² Of those who reported to be affected by the minimum wage increase, the majority absorbed the costs internally.

Impact on the state sectors

- 55 There are state sector employees and contractors paid low wages, particularly in the public health and compulsory education sectors. Increases in the minimum wage are therefore likely to have direct (and also indirect or 'flow-on') costs for some state sector employers.

²⁹ Dalziel, P et al (2006) *Firm Responses to Changes in the Minimum Wage*, Canterbury, AERU Research Unit, Lincoln University. This is available from the Department on request.

³⁰ Denvir A. and G. Loukas (2006) *The Impact of the National Minimum Wage: Pay Differentials*. Available at: www.lowpay.gov.uk/lowpay/rep_research_index.shtml. Draca M., S. Machin and J. Van Reenen (2008) *Minimum Wages and Firm Profitability*. NBER Working Paper 13966. Available at: www.nber.org/papers/w13996.

³¹ This survey had a total sample of 1,766 employers, with a weighted sample of 1,762 employers.

³² Please note this is because they replied "no" to the question: Did this rise have an effect on your business? In other words, it is the perceptions of the effect of the changes, not actual, verifiable changes.

56 The Ministries of Health, Social Development and Education and ACC have identified areas that are likely to be impacted by increases in the minimum wage. For these four agencies, total annual costs directly related to a minimum wage increase could increase by:

- \$10 million for Option 2 (\$13.25 an hour)
- \$11 million for Option 3 (\$13.30 an hour)
- \$16 million for Option 4 (\$13.50 an hour)
- \$17 million for Option 5 (\$13.60 an hour); and
- \$55 million for Option 6 (\$15.00 an hour).

Assessment against the principles

57 Table 5 shows the options assessed against the principles of fairness, protection, income distribution, and work incentives.³³

Table 5: Options assessed against the principles

	Fairness	Protection	Income distribution	Work incentives
\$13.00	Level of fairness would be eroded as the real value of the minimum wage decreases while average wages increase	Protection would be reduced as the increase is much lower than the increase in the minimum wages paid under collective agreements.	Income disparity would increase as the real value of the minimum wage decreases while both average wages and median wage increased	Incentives reduce as there is an erosion of the difference between the minimum wage rates and benefit levels (which are adjusted annually in line with the CPI change).
\$13.25	Level of fairness would be eroded to a smaller extent than above	Protection would be reduced but to a smaller extent than above	Income disparity would increase but to a smaller extent than above	Incentives reduce but to a smaller extent than above
\$13.30	Level of fairness would be eroded to a smaller extent than above	Protection would be reduced but to a smaller extent than above	Income disparity would increase but to a smaller extent than above	Incentives reduce but to a smaller extent than above
\$13.50	Level of fairness would be maintained as the increase is in line with the change in the	Protection would be maintained as the increase would keep current relativities with minimum wages paid under	Income distribution remains as the increase is in line with the changes in the average wage	Almost maintains as the increase is just slightly less than CPI change

³³ For a detailed explanation of the principles, please see Appendix 1.

	average wage	collective agreements	and median wage	
\$13.60	Level of fairness would slightly increase as the increase is higher than average wage increase	Protection improves as the increase is slightly higher than the increase in the minimum wages paid under collective agreements	Income disparity would decrease as the increase is higher than the increases in the average and median wage	Maintains as the increase is in line with CPI change
\$15.00	Levels of fairness would be strongly improved as the increase is much higher than average wage increase	Protection strongly improves as the increase is much higher than the increase in the minimum wages paid under collective agreements	Income disparity would further decrease as the increase is much higher than the increases in the average and median wage	Strongly increases as the increase is much higher than the CPI change

CONSULTATION

Feedback from submitters

58 The Minister of Labour invited written submissions from 51 stakeholders. Thirty-two submissions were received. These submissions have been summarised under the following themes.

Recommended rate for adult minimum wage

59 Submitters' recommendations for what they deem to be an appropriate setting for the minimum wage as at April 2012 are split between no increase, and an increase to \$15.00 or more, and recommended rates in between.

60 Submitters who recommend no change provided the following justifications:

- the economic challenges New Zealand is currently facing
- a period of consolidation is required after the large increases in recent years
- low interest rates
- the fact that the minimum wage is already 50 percent of the average wage
- the current minimum wage is too high so no further increases should be made until minimum wage falls below 25 percent of the average wage

61 Submitters who recommended a rate between \$13 and \$15 provided the following justifications:

- an increase is needed but the government should take account of the ability of businesses to recover the increase, which is very limited in the current economic environment

- a small increase would also close the gap between the minimum wage and market wage rates
 - Submitters who recommend \$15.00 or more provided the following justifications:
 - meets ILO recommendation to set minimum wage at two thirds of the average wage
 - an increased minimum wage level is needed as a contribution towards addressing the needs of many low income workers
 - compensating for rising costs and encouraging employers to invest in raising productivity
 - narrowing the wage gap with Australia and raising New Zealand's low general wage levels
 - ensuring the recommendations of the Welfare Working Group, if implemented, do not drive wages down further, creating more working poor employed under vulnerable and inferior conditions
 - maintaining domestic demand and hence employment levels
 - reducing New Zealand's high income inequality, reducing poverty, especially child poverty, and reducing gender inequality
 - increasing labour participation rates, particularly of disadvantaged groups including Māori and Pacific workers
- 62 Five submitters recommended an immediate rise in the minimum wage to 66 per cent of the average ordinary time wage (for April 2012 this was estimated to be \$17.66) to set a clear base. A possible alternative was suggested, as an interim step on the way to this level, to increase the minimum wage to \$15.00 from 1 April 2012 and move to the 66 per cent benchmark in April 2013.

Gains or positive impacts from a moderate increase

- 63 Nine submitters suggest that a moderate increase to the minimum wage would boost labour participation and people's desire to work. Fourteen submitters suggest it would improve people's standard of living, health, and wellbeing. Three submitters suggest it would send a positive message to minimum wage workers about their value in the community and two submitters state that an increase would reduce the gender pay gap.
- 64 Four submitters do not think 25 cents equates to a moderate increase, but recognise there would be positive effects from a larger (but still moderate) increase. One submitter said there would be no impact on their employees as they are paid above the minimum wage.

Costs or negative impacts from moderate increase

- 65 The majority of the submitters suggest that a moderate increase in the minimum wage rates would be inadequate for the people that they represent. Half of the total submitters submit that an increase would cause higher wage costs for employers, potentially resulting in reduced hours or downsizing of

the business. This could hinder productivity, lead to unemployment, and damage the economy.

- 66 One submitter notes that a moderate increase would not be in line with the rise in the cost of living. Two others note that with only moderate increases people may continue to struggle and living standards decline.

Agency comments

- 67 The Treasury, Ministry of Economic Development, Ministry of Pacific Island Affairs, Ministry of Women’s Affairs, Te Puni Kōkiri, Ministry of Youth Development, Office for Disability Issues, Ministry of Social Development, Ministry of Health, Tertiary Education Commission, Ministry of Education, Accident Compensation Corporation, Inland Revenue and Department of the Prime Minister and Cabinet were consulted in this review. However, Option 3 (\$13.30 an hour) was not in the original consultation paper
- 68 Comments from Ministry of Women’s Affairs (MWA), Ministry of Pacific Island Affairs (MPIA), Ministry of Social Development (MSD) Te Puni Kōkiri (TPK) and the Treasury (TSY) are summarised in Table 6.

Table 6: Summary of agency comments

	Preferred option	Reasons given	Other comments
TSY	\$13.00	<p>A continued deterioration in economic conditions abroad is likely to impact on the NZ economy (and consequently on employment growth, wage growth and inflation)</p> <p>New Zealand has the highest minimum wage relative to median wages in the OECD. Further increase could restrict employment growth</p> <p>Increases are unlikely to lead to substantial reductions in income inequality, because many minimum wage earners (particularly youth) come from higher income households</p> <p>A minimum wage of \$13.00 an hour aligns with broader labour market policies, particularly welfare reform</p>	<p>If Ministers wish to increase the minimum wage, Treasury suggests increasing it to \$13.25, in line with the (LCI) wage growth and closer to non-GST price increases.</p>
MWA	\$13.60	<p>The difference between Options 4 and 5 is minimal and the number of additional workers who would receive a wage increase (120,000 v. 90,600) outweighs the forecast constraint on job growth.</p>	<p>MWA agrees that an increase to \$15.00 an hour in the current climate is not viable.</p>

	Preferred option	Reasons given	Other comments
MSD	\$13.50	This option ensures that replacement rates (the extent to which wages "replace" benefit rates) are slightly improved when benefit rates rise in line with the CPI in April 2012	
MPIA	\$13.60	<p>Provides the most improved economic outcomes for Pacific people in relation to its potential negative impacts. Employment intentions are positive and wage growth is recovering</p> <p>There is an increasing proportion of Pacific people benefiting from minimum wage increases</p> <p>Pacific minimum wage earners will benefit from this increase in light of increases to the cost of food, increases in GST, and the hardship they are experiencing</p> <p>Supports MPIA's training and up-skilling programme for Pacific youth to improve their engagement and participation in the labour market</p>	<p>Pacific peoples incomes levels are amongst the lowest in comparison to other ethnic groups</p> <p>Global economic downturn has negatively impacted on the employment outcomes for Pacific people</p> <p>Pacific people employment has declined and unemployment remains high, especially youth</p> <p>Option 6 may be too ambitious in the current economic climate</p>
TPK	\$16.60	<p>Improve Māori household income</p> <p>Strengthen Māori workers' attachment to the labour force</p> <p>Limit the growth in numbers of discouraged workers disconnected from the labour market</p> <p>Be a catalyst for productivity gains of the low pay sector over time, especially as firms increase investment in training</p> <p>Improve social outcomes (such as housing, education, health, criminal justice etc) for Māori, as the labour market outcome is a key driver.</p>	<p>Minimum wage review provides a very important regulatory framework and nominal wage-setting instrument for Māori</p> <p>The review may be perceived as unbalanced because it does not sufficiently discuss the potential gains of raising minimum wage for low income workers and identify what is considered to be adequate for a worker to meet basic needs</p> <p>Increase the minimum wage to \$18.60 an hour over four years</p>

69 Submitters' and government agencies' comments have been carefully considered and their concerns have been addressed accordingly. No change has been made to the proposed minimum wage options as almost all submitters' and agencies' preferred options are within the range of examined options. TPK's preferred option of \$16.60 an hour is considered to be too risky

in terms of its impact on job growth. The submitters who suggested an increase to 66 percent of the average wage also accepted that an increase to \$15.00 an hour was an interim step for 2012.

CONCLUSIONS AND RECOMMENDATIONS

70 The Department's examination of the current labour market conditions suggests that the options for changes to the minimum wage could have the following effects:

- **Option 1 (\$13.00 an hour)** will erode the real value of the minimum wage. The current levels of protection, fairness and work incentives will be reduced. It is estimated that there would be no impact on annual economy-wide wage costs or inflation. It would not constrain job growth.
- **Option 2 (\$13.25 an hour)** will erode the real value of the minimum wage. The current level of protection, fairness and work incentives will be reduced. This option could directly affect up to 75,600 workers; it would not constrain job growth. It could increase annual economy-wide wages by \$22 million and inflation by 0.01 percentage points
- **Option 3 (\$13.30 an hour)** will erode the real value of the minimum wage. The current levels of protection, fairness and work incentives will be reduced. This option could directly affect up to 82,300 workers; it would not constrain job growth. It could increase annual economy-wide wages by \$27 million and inflation by 0.01 percentage points
- **Option 4 (\$13.50 an hour)** will slightly increase the real value of the minimum wage. It increases existing levels of fairness and income distribution and may increase or maintain protection and work incentives. This option could directly affect up to 90,600 workers. It may constrain employment growth by about 100 jobs. It could increase annual economy-wide wages by \$50 million and inflation by 0.02 percentage points
- **Option 5 (\$13.60 an hour)** will further increase the real value of the minimum wage and its relativity with other income benchmarks. It further improves relative levels of fairness, protection, income distribution and work incentives. It could directly affect up to 120,000 workers and constrain employment growth by between 300 and 500 jobs. It could increase annual economy-wide wages by \$66 million and inflation by 0.03 percentage points
- **Option 6 (\$15.00 an hour)** will significantly increase the real value of the minimum wage and its relativity with other income benchmarks. It could strongly improve relative levels of fairness, protection, income distribution and work incentives. It could directly affect up to 264,800 workers and constrain employment growth by between 4,000 and 5,500 jobs. It could increase annual economy-wide wages by \$477 million and inflation by 0.24 percentage points

71 The impacts of any of the options on labour participation, labour productivity, and poverty reduction are uncertain or insignificant.

- 72 Setting the minimum wage requires balancing the benefits of any changes, such as the protection of the lowest paid, against the costs that any changes might bring, such as employment impacts. The above analysis shows that under Option 6 the costs are likely to outweigh the benefits as employment growth could be constrained by between 4,000 and 5,500 jobs. However, under other options, the costs are less significant but it is uncertain if the benefits are likely to outweigh the costs.
- 73 The Department recommends that the adult minimum wage rate be increased to \$13.30 an hour and the new entrants and training minimum wage be increased to \$10.65 an hour. This modest increase in the minimum wage rates seeks to maintain the buying power of the minimum wage and minimise the risks of any negative employment impact.

IMPLEMENTATION

- 74 Changes to the minimum wage rates will be implemented through an Order in Council. Historically, any change in the minimum wage occurs on or before 1 April. This implementation date will provide consistency for employees and employers.
- 75 The Department will provide information through its website, call centre and other customer services to inform employers and employees of the changes before the changes take effect. No extra budget is required for the purpose of implementation.
- 76 Some employers may choose not to comply with minimum wage legislation or delay their compliance with increase in the minimum wage. Any complaints of non-compliance will be dealt with by labour inspectors of the Department. Labour inspectors are shifting their focus from individual complaints to workplace compliance to achieve a higher level of compliance of minimum employment standards (including minimum wage) in workplaces. There are no extra costs associated with implementation.

MONITORING, EVALUATION AND REVIEW

- 77 The Department will monitor uptake through the Labour and Immigration Research Centre's National Survey of Employers and the New Zealand Income Survey. It might take a long time for sufficient data to become available but the Department is examining ways to improve this information to fully evaluate the impact of the policy change.
- 78 It is a statutory obligation under Section 5 of the Minimum Wage Act 1983 for the Minister of Labour to review the minimum wage rates by 31 December each year. The Department will continue to collect relevant data to effectively evaluate impacts of minimum wage change and provide advice on whether the objectives of the minimum wage are met and whether further mechanism changes are needed to the Minister of Labour to fulfil the obligation.

APPENDIX 1: CABINET APPROVED OBJECTIVE AND ASSESSMENT CRITERIA

Overarching objective

In September 2008, Cabinet agreed to a new overarching objective for the annual minimum wage review [POL MIN (08) 16/21 refers].

“to set a wage floor that balances the protection of the lowest paid with employment impacts, in the context of current and forecasted labour market and economic conditions and social impacts”

Assessment criteria

‘the extent to which any change to the minimum wage would produce gains that are more significant than any losses’

‘consideration of whether a change to the minimum wage would be the best way to protect the lowest paid in the context of the broader package of income and employment-related interventions, and would meet the broader objectives of government’

Factors to be considered in relation to the first assessment criterion

consistency with the principles of fairness, protection, income distribution, and work incentives

comparison against international/OECD benchmarks

comparison of the level of the minimum wage, and any proposals to change that level, against other income benchmarks (benefit rates, the minimum rate of wage averaged across collective agreements, the producers price index, median wages, and average wages). This analysis can also provide a measure of any changes in income inequality

consideration of forecast social and economic impacts relevant to changing the level of the minimum wage including:

- a. the positive and negative impacts on those most likely to be low paid including: women, new migrants, Māori, Pacific people, part-time workers, temporary workers, those with a disability, and young people, including any (dis)incentive effects for young people to choose low paid employment or additional education and training
- b. the net effects after corresponding withdrawal of social assistance
- c. impacts on the gender pay gap

consideration of the forecast labour market/economic conditions and impacts (together with a range of possible economic conditions) relevant to changing the minimum wage including:

- a. earnings and the wage bill
- b. employment and unemployment

- c. labour productivity
- d. the number of employees and the hours they work
- e. industry sectors
- f. Gross Domestic Product and inflation

potential impacts on the rate of non-compliance

Explanation of the principles

Fairness

To ensure that wages paid are no lower than a socially acceptable minimum. There are two main views on what constitutes a socially acceptable minimum. The first option is to determine social acceptability as a proportion of how much other workers earn (e.g. average wages). The second option is to view social acceptability through determining the amount needed to maintain a set standard of living, adjusted for inflation. The first option is the measure used by the Department in the review. Benchmarks: average wages.

Protection

To offer wage protection to vulnerable workers so that workers are paid wages that reflect their worth or productivity. Workers may be 'underpaid' on this measure when they have a relative lack of bargaining power, such as when they have limited bargaining strength (e.g. are not collectivised and unable to bargain for higher wages), or face risks in leaving and finding another job (e.g. poor English, disability), or have poor income or employment alternatives (e.g. they do not qualify for unemployment benefits). Benchmarks: minimum wages paid under collective agreements.

Income distribution

To ensure that earnings of people on low incomes do not deteriorate relative to those of other workers. This is likely to reflect a preference that society has for the degree of wage (and income) equality, and this may promote greater social cohesion. The effectiveness of minimum wages to achieve this objective depends on whether employment effects occur, since the income of workers is significantly lowered where they may lose their jobs or have their work hours cut. The current minimum wage is about 50 percent of average total hourly earnings and 64 percent of median total hourly earnings (using the Quarterly Employment Survey). Benchmarks: changes in average and median wages.

Work incentives

To increase the incentives to work, for people considering work. Creating the correct incentives requires the minimum wage to be set at a level that makes work attractive compared to not working. The minimum wage needs to be above benefit levels (and associated employment costs such as childcare and transport costs that are payable by a worker). At some point, however, a higher minimum wage can frustrate work incentives through economic effects that restrict job opportunities available to low skilled workers. Benchmarks: benefit levels and costs associated with working.