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Department of Labour

TE TARI MAHI



Regulatory Impact Statement

Minimum wage review 2010

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by the Department of Labour (the Department). It provides an analysis of options for the Minister of Labour's annual statutory review of the minimum wage rates.

The Government's agreed objective for the minimum wage, assessment criteria and related considerations provides a framework for assessing the specific options considered. The Department provides Ministers with analysis based on available data, which can be limited.

The Department's analysis incorporates a number of factors, including:

- 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 workers with disabilities. Estimates using 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 the potential impacts on job growth use a range of employment adjustment factors (elasticities) that are broadly derived from econometric analysis conducted by the Department and elsewhere. The estimates of impacts on job growth are based on a conventional model of firm decision-making, whereby firms operating in perfectly competitive markets 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 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, and
- e the views of submitters.

We are only able to provide estimates of the direct impacts of minimum wage changes. Indirect impacts, such as changes to wage relativities or changes in consumer spending, are unable to be accurately estimated. The Department does not have adequate information to assess the potential impact of the minimum wage options on productivity.

Some of our estimates assume that all 16 and 17 year olds are eligible to earn (at least) the adult minimum wage. This assumption is made because the Department is unable to estimate how many 16 and 17 year olds may be eligible for the new entrants' minimum wage. The data suggests that the majority are on at least the adult minimum wage.

The Ministries of Health, Education, and Social Development and the Accident Compensation Corporation have provided estimates of the direct costs for some state sector employers and state sector-funded employers. The estimates do not include indirect costs (e.g. if other workers' wages are increased to maintain wage relativities). The Department is also unable

¹ In the 2010 New Zealand Income Survey, 5.5% of 18-64 year olds reported wages below the adult minimum wage.

to provide an estimate of other fiscal impacts, such as changes to social assistance and taxation. As the modelling sample is relatively small, the Department did not assess the impact on the Working for Families Scheme, which is targeted at low to middle income families with dependent children.

Data for the year ending June 2010 is used to calculate Option 2, which is in line with changes in the Consumers Price Index and average wages. It is possible that the actual change in consumer prices and average wages may be higher or lower on 1 April 2011. For example, the changes in the GST rate in October 2010 will not be included in the June 2010 CPI change.

The relativities for the new entrants' and training minimum wages have not been reviewed in this minimum wage review process. By law, the new entrants' minimum wage cannot be set at less than 80% of the adult minimum wage.

An increase in the minimum wage will impose additional wage costs on businesses employing staff on the minimum wage and, possibly, those with workers paid near the minimum wage.

SUMMARY OF THE ASSESSMENT OF OPTIONS

Assessment criteria/ consideration	Option 1: \$12.75	Option 2: \$13.00	Option 3: \$13.50	Option 4: \$15.00
Percentage increase in minimum wage	0%	2.0%	5.9%	17.6%
Workers directly affected (18-64 years)	34,600	41,300	92,000	252,800
Number of workers directly affected (16-17 years) ²	2.0%	2.4%	5.4%	14.8%
Assessment against the principles of				
- fairness ³	Erodes	Maintains	Improves	Strongly improves
- protection ⁴	Erodes	May erode	Improves	Strongly improves
- income distribution ⁵	Reduces	Maintains	Improves	Strongly improves
- work incentives ⁶	Reduces	Maintains	May increase	Strongly improves
Comparisons ⁷ :				
- International gross MW in NZ\$ using PPP (2009)	7th of 13 OECD, High among all 21 OECD	7th of 13 OECD, High among all 21 OECD	6th of 13 OECD, High among all 21 OECD	5th of 13 OECD, High among all 21 OECD
- International relative to Median Wage (2008)	2nd in OECD	Very high	Very high	Very high
Other income benchmarks – unemployment benefit	Significantly higher	Significantly higher	Significantly higher	Significantly higher
Other income benchmarks - average total hourly earnings	50%	50%	52%	58%
Other income benchmarks - median total hourly earnings	64%	65%	68%	75%
Other income benchmarks – minimum wage in collective agreements	Lower	Lower	Lower	Slightly higher

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

³ To ensure that wages paid are not lower than a socially acceptable minimum as a proportion of how much other workers earn or the amount needed to maintain a set standard of living, adjusted for inflation. Benchmarks: average wages, CPI.

⁴ To offer wage protection to workers who are disadvantaged in the labour market so that workers are paid wages that reflect their worth or productivity. Benchmarks: minimum wages paid under collective agreements.

⁵ To ensure that earnings of people on low incomes do not deteriorate relative to those of other workers. Benchmarks: changes in average and median wages.

⁶ To increase the incentives to work, for people considering work. Benchmarks: benefit levels and costs associated with working.

⁷ Note that this comparison uses figures as at 2009 and other countries may have, or be in the process of, changing their minimum wage rates so relativities may have changed.

Impact on low paid workers	Women, Māori, Pacific peoples, disabled people and youth are more likely to be low paid workers. A modest increase in the minimum wage can have a positive impact on low paid workers. However, low paid workers may also be the first to experience any negative impacts that could result from a change in the minimum wage.			
Gender pay gap	Increasing minimum wage rates is likely to have a small, positive outcome on the gender pay gap.			
Increase in economy-wide annual earnings (%)	N/A	0.02%	0.09%	0.62%
Annual Wage increase (millions)	N/A	\$15.0m	\$75.7m	\$517.7m
Increase in inflation (% points)	N/A	0.01	0.04	0.26
Projected job growth	23,510 - 24,100	22,910 - 23,230	21,490 - 21,690	16,260 - 18,040
Potential impact on job growth (absolute change)	1,360 - 1,960	760 - 1,080	-660 - -460	-5,890 - -4,100
Potential impact on job growth (relative change)	0.06% - 0.09%	0.03% - 0.05%	-0.03% - -0.02%	-0.27% - -0.19%
Industries	Hospitality and retail industries are most likely to be affected by a minimum wage increase.			
State Sector				
(fiscal impacts – direct wage costs rounded to million)	N/A	\$6m	\$30m	\$119m
Productivity	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 productivity ⁸ . If minimum wage increases encourage better workplace practices, including increased training or investment in technical innovations, it can lead to productivity improvements. There may also be longer-term negative impacts on labour productivity emanating from increases in the minimum wage if it encourages young workers to work more and study less ⁹ .			
Other government interventions – Taxation	The rates of tax on individual incomes recently decreased while the GST rate increased from October 2010. The net result from these two changes for those earning around the minimum wage is expected to be a small increase in disposable income ¹⁰ . There are also a range of tax credits for families to assist them to meet the costs of raising a family, or ensure that families in work are better off than comparable families receiving a social security benefit. Additionally, the independent earner tax credit is available to some people. A decrease in company tax rates (from 30% to 28%, effective from 1 April 2011) may improve companies' ability to cover an increase in the minimum wage. The Department recognises that these interventions and initiatives (including Working for Families) play an important role in supporting New Zealanders, especially those in need. However, the Department considers that because minimum wage increases benefit all minimum wage earners, irrespective of their family status, the minimum wage continues to usefully complement other instruments to improve the income levels of low income workers and households.			
Non-compliance	Increasing the minimum wage may increase non-compliance with the minimum wage legislation. However, it is not possible to identify whether an increase in the share of workers reporting below minimum wages is caused by an increase in exemptions from the minimum wage, measurement error or non-compliance.			

⁸ OECD (2007) *OECD Employment Outlook 2007*. Available at: www.oecd.org/document/0/0,3343,en_2649_33927_40774656_1_1_1_37457,00.html.

⁹ Hyslop, D. and S. Stillman (2004) *Youth Minimum Wage Reform and the Labour Market* New Zealand Treasury Working Paper 04/03, Wellington, the Treasury. Available online at 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.

¹⁰ There is a rough calculator at www.taxguide.govt.nz which could be used to run some scenarios. Someone on a minimum wage might be better off by around \$2 - \$6 a week depending on how much of their income is spent on rent.

STATUS QUO AND PROBLEM DEFINITION

The minimum wage is part of the Government's general responsibility to ensure socially acceptable employment standards that are prescribed and enforceable. It is a statutory requirement for the Minister of Labour to review the minimum wage rates by 31 December each year. The minimum wage objective seeks to balance the protection of the lowest paid with employment impacts, in the context of current and forecast labour market and economic conditions and social impacts.

There are formal international commitments that establish an explicit obligation on the Government to ensure an adequate minimum wage, including under the International Labour Organisation Convention 26. This Convention obliges the Government to create minimum wage-fixing machinery where "no arrangements exist for the effective regulation of wages...and wages are exceptionally low", and recommends that minimum wages should be set according to the "general level of wages prevailing in the country".

Current minimum wage rates

The current minimum wage rates are as follows:

- a The adult minimum wage is \$12.75 an hour. It applies to all employees aged 16 years and over who are not new entrants or trainees.
- b The new entrants' minimum wage is \$10.20 an hour. 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; or who are supervising or training other workers; or who are subject to the training minimum wage.
- c The training minimum wage is \$10.20 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.

Past minimum wage rates

Figure 1 shows that the adult minimum wage rate has been increasing steadily since 2003.

Figure 1: Adult minimum wage rates 2003 to 2010

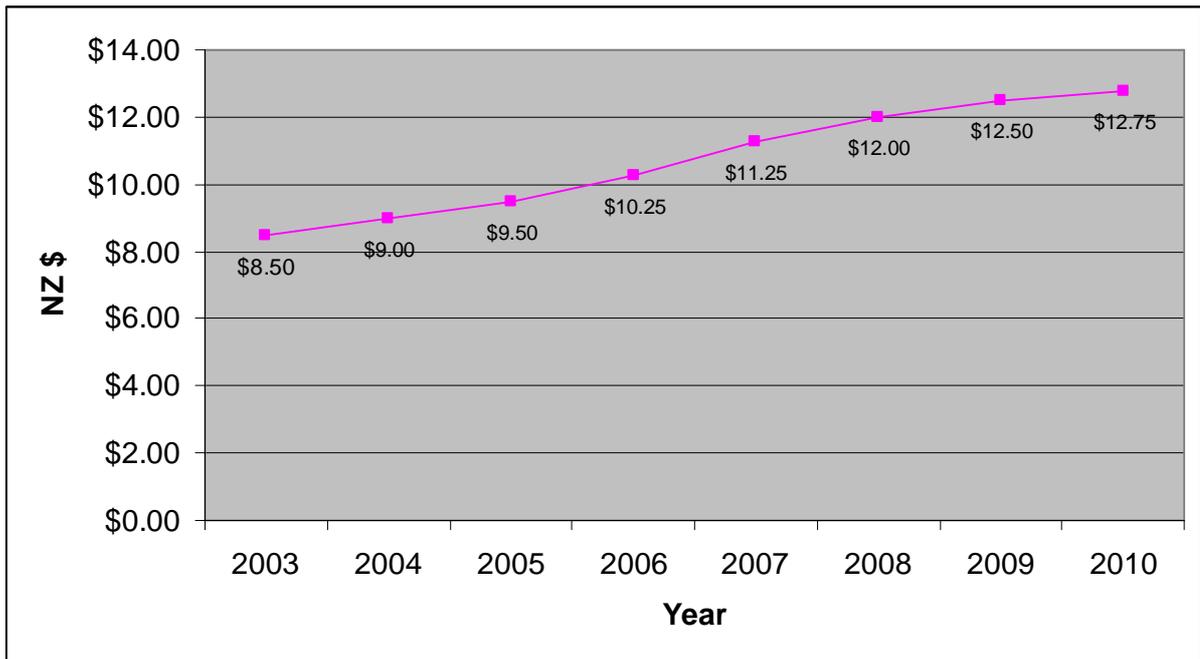
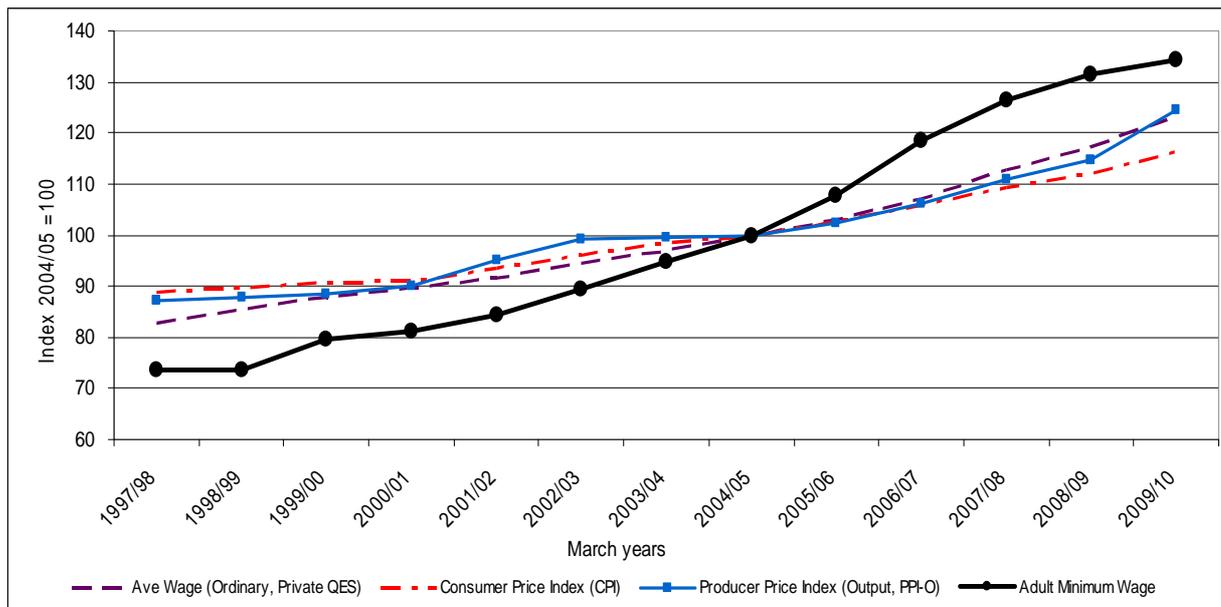


Figure 2 illustrates how changes in the adult minimum wage have been tracking since 1997/98 against three other benchmarks: average wages, the Producers Price Index (PPI) and the Consumers Price Index (CPI). The minimum wage had been increasing at a faster rate than those benchmarks until 2008. Since 2008, the minimum wage has increased in line with changes to the CPI. These increases have been smaller than increases in the average wage.

Figure 2: Average wage, Producers Price Index (output), Consumers Price Index and the adult minimum wage (2000/01=100)



Source: Statistics New Zealand

Comparisons with income benchmarks

The minimum wage was last increased on 1 April 2010 by 2%, based on the change in CPI. Since then, consumer prices have increased by 1.8% (from the June 2009 quarter to the June 2010 quarter). The median wage, average wage and the average minimum wage in collective agreements all increased (2.8%, 2.6% and 3.8% respectively) in the past year.

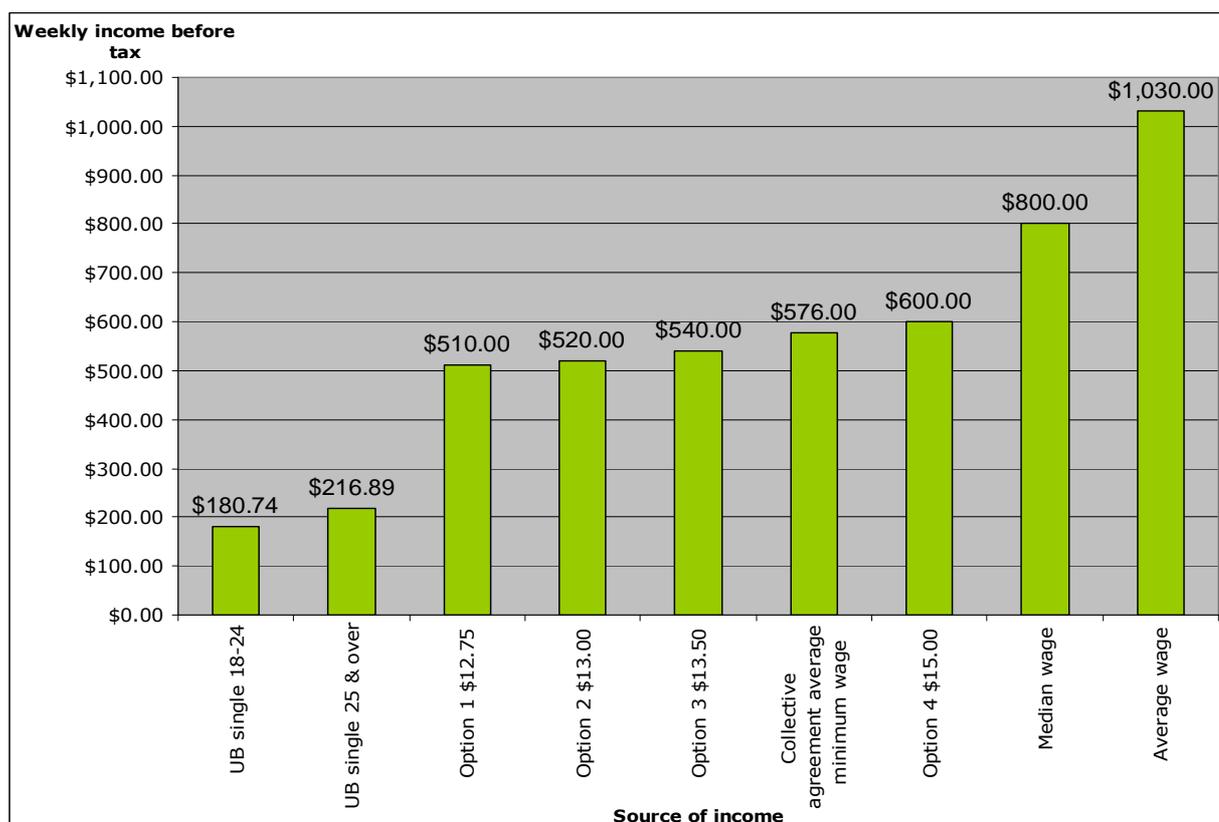
The current adult minimum wage of \$12.75 an hour is significantly higher than the unemployment benefit for a single adult aged 18 to 24 years. The adult minimum wage is around two times higher than the benefit for a single adult aged 25 years or over. These figures do not include any additional assistance such as the accommodation supplement¹¹ or temporary GST assistance. People on the minimum wage or low incomes may also receive an accommodation supplement. Benefit rates, which are indexed to the CPI, are likely to increase from 1 April 2011.

The current adult minimum wage is around 49.5% of average total hourly earnings (\$25.75 an hour in the Quarterly Employment Survey, September 2010) and 63.7% of median total hourly earnings (\$20.00 an hour in the New Zealand Income Survey, June 2010)¹².

¹¹ Those on the unemployment benefit may receive an accommodation supplement, the amount of which depends on the level of rent, board or mortgage they pay. Depending on location, some people will receive a significantly higher accommodation supplement than others.

¹² The Quarterly Employment Survey average and the New Zealand Income Survey (NZIS) average differ because of the relative weight given to part-time and full-time wages. The NZIS mean is an average of average wages over all workers and both part- and full-time workers (and their wages) carry equal weighting in that average. The QES is effectively the average of all wages paid over total hours worked, so full-time workers, who work more hours and are higher paid, are more heavily weighted in the average. The QES average also excludes the agriculture and fishing sectors that generally pay a lower than average wage, thereby lifting the average measured in that survey.

Figure 3: Comparison of current adult minimum wage options with other income benchmarks



International Comparisons

Internationally, minimum wage levels vary. In many countries, despite the economic crisis, minimum wages have continued to increase, either as the result of long-term adjustment plans or reviews of their domestic economic and labour market situations¹³.

New Zealand's gross minimum wage is in the middle of the 13 OECD countries compared in Table 1¹⁴, but high among all the OECD countries. Of the 21 OECD countries, seven countries (Australia, Belgium, France, Ireland, Luxembourg, Netherlands and the United Kingdom) have higher minimum wage rates than New Zealand¹⁵.

¹³ International Labour Organisation (2009) Global Wage Report Update 2009.

¹⁴ Information can be accessed at <http://www.lowpay.gov.uk/>

¹⁵ If exchange rates provided by the European Central Bank and the Reserve Bank of New Zealand on 15 November 2010 are used for calculation, the hourly minimum wage in US dollars for Belgium, France, Ireland, Luxembourg, Netherlands, the United Kingdom and New Zealand are \$12.24, \$13.05, \$12.74, \$14.30, \$11.88, \$10.05 and \$9.89, respectively.

Table 1: Comparison of minimum wage levels, by country, 2009

	Hourly rate in local currency	Hourly rate in NZ\$¹⁶	In NZ\$ using PPPs	Date of last up rating	Age full minimum wage usually applies
France	€ 8.82	\$19.44	\$15.90	Jul 09	18
Australia	AU\$14.31	\$17.85	\$15.63	Oct 08	21
Belgium	€ 8.41	\$18.54	\$15.16	Oct 09	21
Netherlands	€8.071	\$17.79	\$15.03	Jul 09	23
United Kingdom	£5.80	\$14.35	\$14.41	Oct 09	22
Ireland	€ 8.65	\$19.07	\$13.49	Jul 07	20
New Zealand	NZ\$12.50	\$12.50	\$12.50	Apr 09	16
Canada ¹⁷	C\$9.08	\$12.63	\$12.18		16
United States	US\$7.25	\$11.43	\$11.85	Jul 09	20
Spain	€ 4.89	\$10.78	\$10.14	Jan 09	16
Japan	JPY713	\$12.04	\$9.00	Oct 09	15/18
Greece	€ 4.13	\$9.10	\$8.65	May 09	15
Portugal	€ 2.59	\$5.71	\$5.91	Jan 09	16

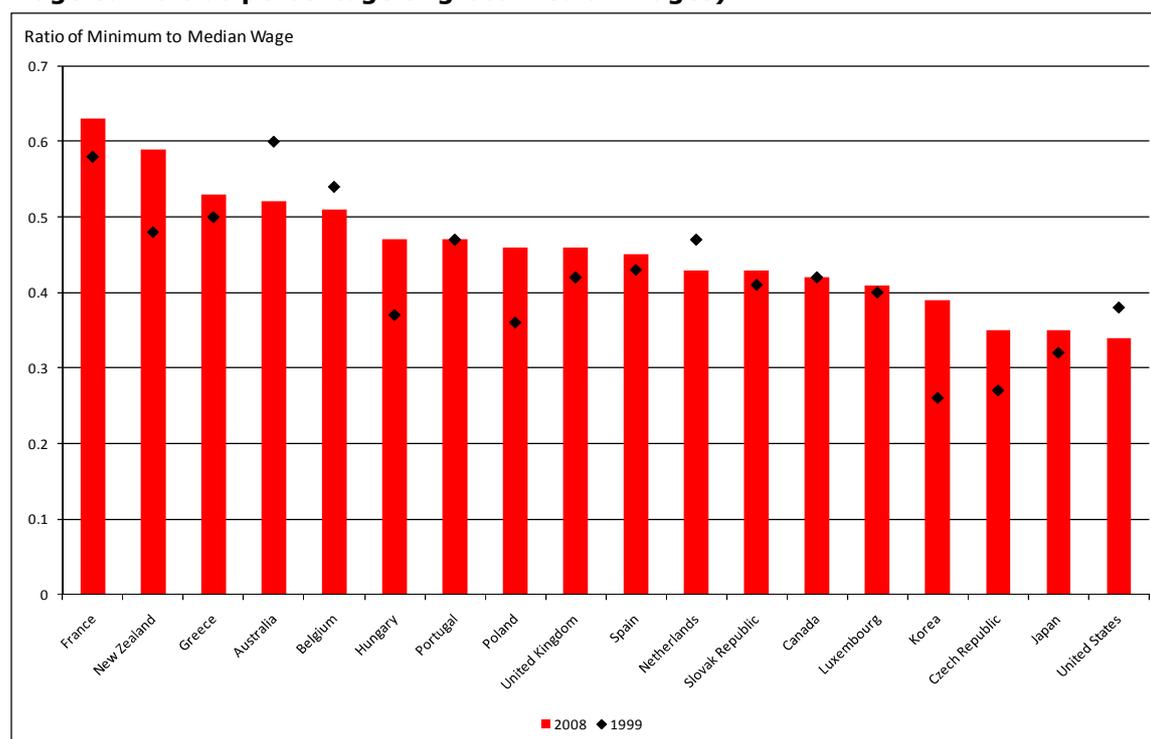
Source: The UK Low Pay Commission Report on the Minimum Wage 2010

As a proportion of the average wage, New Zealand's minimum wage is high compared to other OECD countries. As at 2008, New Zealand's minimum wage was the second highest of 21 OECD countries with available data.

¹⁶ Exchange rate source Reserve Bank of New Zealand average rate for 2009.

¹⁷ Operative date varies by province.

Figure 4: Relative minimum wage levels (Gross earnings of full-time minimum wage earners as percentage of gross median wages)



Source: OECD

A comparison with Australia is useful, due to its close economic connections to New Zealand and the free movement of labour between the two countries. The Australian federal minimum wage increased by 4.8% from AU\$14.31 to AU\$15.00 following the 2009/10 review. This equates to NZ\$19.31 on 1 November 2010¹⁸. According to the Australian Bureau of Statistics, the average wage in Australia in 2010 was AU\$64,641. The ratio of the minimum wage to the average wage is 45.2% in Australia and 49.5% in New Zealand.

It should be noted, however, that the federal minimum wage of Australia only applies to award/agreement-free employees. Minimum wages in the Australian national system are predominately set by modern awards (of which there are 122) and the wages set in these instruments vary according to the industry and occupation they apply to. Furthermore, the minimum wage in Australia only fully applies to those 21 years old and over, rather than 16 years old and over in New Zealand (except new entrants and trainees)¹⁹.

Economic context: the labour market conditions and outlook

The current review of the minimum wage takes place amid a slowly recovering labour market following five quarters of recession in 2008 and early 2009. This outlook is based on data available to the Department as at January 2011. The

¹⁸ Based on an exchange rate of 0.7769 from the Reserve Bank of New Zealand.

¹⁹ More information on the Australian system can be found here: www.fairwork.gov.au/resources/fact-sheets/conditions-of-employment/Pages/minimum-wages-fact-sheet.aspx

main sources of information are Statistics New Zealand, business surveys, and market views.

As a result of both domestic and global factors, the New Zealand economy contracted over the five quarters to March 2009, with real GDP falling by a total of 3.4%, making it the longest and deepest recession for thirty years. However, New Zealand's economy fared better than most other developed nations with the support of a sound financial system, growth in key trading partners (particularly China and Australia), high commodity prices, positive net migration, and significant monetary and fiscal stimulus. These factors also helped pull New Zealand out of recession in the June 2009 quarter.

The recovery has been led by the export sector aided by strong commodity prices, robust growth from Asia and a favourable exchange rate with Australia. The latter has contributed to stronger than expected performance by some manufacturing industries servicing the Australian market. However, the recovery has been patchy and mild, particularly compared to previous upturns. Although it has been six quarters since the recession ended, economic activity still remains 1.8% below its pre-recession peak and economic growth was essentially flat over the middle of 2010.

Domestic demand remains subdued. Households continue to be cautious with growth in consumer spending low and activity in the retail sector weak. Weakness in the housing market, low wage growth and many households choosing to repay debt, or save, is constraining economic activity in sectors such as retail and hospitality. The Department expects growth in these sectors to remain relatively modest with households likely to continue to be cautious over 2011.

The general view is that inflationary pressures in the economy are low and little pressure is expected from wage cost-push as the labour market remains relatively weak. However, GST and other one-off increases will temporarily boost domestic inflation (as measured by the CPI) towards 4.5% in mid-2011. It is not clear whether the one-off increases in headline inflation will affect price and wage setting behaviour. Pricing intentions in the December 2010 Quarterly Survey of Business Opinion however, suggest that underlying inflation pressures remain well contained.

The downturn in the New Zealand economy led to an easing in the labour market during 2008 and 2009 with employment falling by 2.4% from peak to trough and the unemployment rate rising to a ten year high of 7.1% in the December 2009 quarter. While the rise in unemployment was significant, it was from a 22-year low of 3.5% before the recession hit. Therefore, despite the unemployment rate more than doubling, it remained below the 7.9% peak recorded in the 1997/98 recession and the 11.2% peak recorded in the early 1990s.

The labour market turned a corner in late 2009/early 2010 and has slowly recovered over the past year. Although labour market data has been volatile recently, the unemployment rate has trended down from 7.1% in the December 2009 quarter to 6.4% in the September 2010 quarter. Employment, on the other

hand, has risen by 1.8% over the year to September 2010 and is up 39,000 since it reached a trough in the second half of 2009.

While the economic recovery lost some momentum during the middle of 2010, growing by only 0.1% in the June 2010 quarter and falling by 0.2% in the September 2010 quarter, economic growth prospects for 2011 are more positive. Economic activity is expected to pick up over 2011 on the back of robust trading partner growth, high commodity prices, and reconstruction activity in Canterbury. The 2011 Rugby World Cup will also support activity over the next year. These factors are expected to see the economy grow by more than 3% over 2011.

The increased economic activity is expected to see the labour market continue to slowly improve over the next year. Employment is forecast to continue trending upwards, in line with the Department of Labour's Leading Indicator of Employment and rising job vacancies. In addition, the December 2010 National Bank Business Outlook showed a net 12.5% of firms intend to increase staffing levels over the next year. This is above the long-term average of a net 6.0% and points to above average employment growth. As a result of continued increases in employment, the unemployment rate is expected to trend down gradually over the next year, falling to around 6.0% in mid-2011. An unemployment rate of below 6.0% is historically low and highlights that despite the rise in unemployment over recent years, the Department predicts there will be little spare capacity in the labour market by the end of 2011.

OBJECTIVE OF THE MINIMUM WAGE REVIEW

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”.

Two assessment criteria, and related considerations, have been identified to apply the minimum wage objective through minimum wage reviews.

The first assessment criterion is the extent to which any change to the minimum wage would produce gains that are more significant than any losses. The assessment criteria for this criterion include consideration of:

- consistency with the principles of fairness, protection, income distribution and work incentives;
- comparison with other income benchmarks and international benchmarks;
- consideration of the social and economic impacts of any change to the level of the minimum wage, including on groups likely to be low paid, the net effects of any corresponding withdrawal of social assistance and impacts on the gender pay gap; and
- consideration of the forecast labour and economic impacts of changing the minimum wage, including on earnings, employment and unemployment, labour productivity, the number of employees and the hours they work, industry sectors, nominal gross domestic product and inflation.

The second assessment criterion is the 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 the Government.

As per Cabinet's decision, the assessment criteria and considerations are not weighted. Their relative importance depends on the conditions at the time of the review and the Government's judgement. For instance, if adverse employment or economic impacts are the forecast result of a minimum wage rate change, this may be a risk for Ministers to consider. Employment opportunities may need to be protected as well as wages. Raising minimum wages can also encourage labour market participation and increase labour supply. The prudent and gradual increases in the minimum wage rate in the past two years have met this objective. The Department considers that a cautious approach to the minimum wage is still warranted.

ASSESSMENT OF THE OPTIONS

Four options have been considered and assessed for this year's review.

Table 2: Options for the minimum wage

Option	Adult minimum wage (an hour)	New entrants' minimum wage & Training minimum wage (an hour)
Option 1	\$12.75 (no change)	\$10.20
Option 2	\$13.00 (2.0% increase) ²⁰	\$10.40
Option 3	\$13.50 (5.9% increase)	\$10.80
Option 4	\$15.00 (17.6% increase)	\$12.00

All four options are assessed against the minimum wage objective and the relevant criteria. The assessment is summarised at the beginning of the RIS. The Department considers that the most significant factors for consideration in the 2010 review are the impact on:

- employment and unemployment;
- low paid workers, especially young people;
- industries and firms; and
- the state sector.

Impact on employment and unemployment

Research on the effects of the minimum wage

There is a mix of views on the effects of the minimum wage on employment levels. The ILO has found that whether a minimum wage has a negative or a positive effect on employment depends on many factors such as, its relative level, the structure of the labour market and the country concerned²¹.

Research finds that minimum wage laws raise pay at the bottom of the wage distribution and are generally associated with lower distribution of earnings. However, international research on the effects of minimum wage on other aggregate economic outcomes has provided differing views depending on local market conditions²². For example, research from the United Kingdom (UK)

²⁰ An increase in line with the change of the Consumers Price Index (CPI) and average wage change from the Quarterly Employment Survey (June 2010) (QES).

²¹ Youcef, Ghellab. (1998) "Minimum Wages and Youth Unemployment", ILO, p.58.

²² Freeman, R. (2007) *Labour Market Institutions around the World*, National Bureau of Economic Research, Cambridge.

concludes that if there is some adverse employment effect from minimum wage raises, it must be of a small and policy-irrelevant magnitude²³. Australian research indicates that the employment effects of minimum wages are not clear cut²⁴.

Impact on employment growth

With the mixed results from research elsewhere in mind, the Department has taken a cautious approach to modelling the impact on employment and unemployment. Moreover, we have only considered the relationship between the minimum wage and employment growth and calculated high and low scenarios for employment impacts, with the scenario based on higher and lower employment adjustment factors (i.e. that employment is more or less sensitive to changes in real minimum wage costs). This approach is also driven by the availability of data.

The model used to estimate the impact on employment growth considers how a firm that hires minimum wage workers will alter its hiring decisions based on changes in the minimum wage and the output price changes faced by the firm. The model is based on a conventional model of firm decision-making, whereby firms operating in a perfectly competitive market adjust outputs and inputs, including labour, in response to their relative prices.

The Department has modelled the impact of the minimum wage changes on job growth for the period 1 April 2011 to 31 March 2012, which implies a one year adjustment period. The estimates are based on a number of assumptions and preconditions (see agency disclosure statement). It is assumed that the Producers Price Index for Outputs (PPI-Output) tracks at the NZIER's forecast level and that no other economic events occur.

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 2011 to March 2012 (e.g. increased by the same percentage as the PPI-Output). The benchmark projected job growth is estimated at 1% or 22,100 jobs.

The evidence of the impact of increasing the minimum wage on job growth is not strong. Econometrically estimated adjustment factors of employment with respect to the minimum wage show only a mild negative effect. The Department therefore considers the impact on job growth to be minimal (less than 0.1% of job growth) for Options 1, 2 and 3.

²³ Doucouliagos, Hristos and Stanley, T.D. (2009) "Publication Selection Bias in Minimum-Wage Research? A Meta-Regression Analysis", *British Journal of Industrial relations*, 406-428.

²⁴ Nelms, Lucy and Dr Constantine Tsingas (2010) *Literature review on social inclusion and its relationship to minimum wages and workforce participation*, Research Report, Minimum Wage and Research Branch, Fair Work Australia.

Compared with the benchmark, Options 1 and 2 could mean additional jobs are created as increases in the real minimum wage costs are expected to be negative (given a 4.4% increase in the PPI-Output over the period). This means that the increase in the price of minimum wage labour costs is less than the forecasted increase in the price employers are receiving for their goods. However, this assumes that a potential erosion of income in terms of the CPI does not reduce incentives to work.

Under Option 3 (\$13.50 an hour), employment growth is estimated to be lower than the benchmark by between 460 and 660 jobs (which is small in terms of total employment), and reduced by between 4,100 and 5,890 jobs under Option 4 (\$15.00 an hour).

The estimate can be further broken down by age group. While the 18-19 year old group is not expected to be affected much, employment growth of the 16-17 year old group may be fewer by between 40 and 220 jobs under Option 3 (\$13.50 an hour), and fewer by between 370 and 1,980 jobs under Option 4 (\$15.00 an hour).

Table 3: Impact on job growth as at 31 March 2012

	Option 1: \$12.75	Option 2: \$13.00	Option 3: \$13.50	Option 4: \$15.00
Projected job growth	23,530 - 24,100	22,910 - 23,230	21,490 - 21,690	16,260 - 18,040
Potential impact on job growth (absolute change compared to the benchmark)	1,360 - 1,960	760 - 1,080	-660 - -460	-5,890 - -4,100
Potential impact on job growth (relative to the benchmark)	0.06% - 0.09%	0.03% - 0.05%	-0.03% - -0.02%	-0.27% - -0.19%
Potential impact on total jobs (relative to Option 1)	0%	0.03 - 0.04%	0.08 - 0.12%	0.24 - 0.35%

Impact on unemployment

It is not straightforward to estimate the impact on unemployment. There is no data on whether those who are unable to find a job due to the potential constraints on job growth from a minimum wage increase will decide to be in the labour force or not. Those who cease work and withdraw from the labour market

all together, for instance to study or look after children, are not counted as unemployed. To be counted as unemployed, a person must be actively seeking work. On the other hand, an increase in employment growth may attract people into the labour market. This may not alter the number of people who are unemployed as the increased number of jobs may be filled by people who are not currently in the labour force. The Department assumes that there are no changes to people's preferences to be in the labour market for these estimates.

Based on the Reserve Bank forecasts of the unemployment rate of 6% for March 2011 and 5.5% for March 2012, it is estimated that the unemployment rate would not rise under Option 1 (\$12.75 an hour), Option 2 (\$13.00 an hour) or Option 3 (\$13.50 an hour) for the March 2012 quarter but would increase to 5.7% for the same quarter for Option 4 (\$15.00 an hour).

Impact on low paid workers

Women, Māori, Pacific peoples, disabled people and youth are more likely to be low paid workers. It is estimated that of those currently earning the minimum wage, 20.8% are Māori and 5.6% are Pacific peoples. A modest increase in the minimum wage could have a positive economic and social impact for low paid workers through an increase in their income. However, low paid 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).

Impact on youth

Over half of those earning the minimum wage are between 18 and 24 years of age. A high proportion of 16 and 17 year olds are also paid at or near the minimum wage. Therefore, an increase in the minimum wage is likely to affect a very large number of young people already in work.

A survey by the Department shows that between a quarter to a third of businesses had at least one employee aged under 20 years in the past 3 months; while 10% employed at least one youth aged 16 to 17 years. Two thirds of the employers did not pay 16 and 17 year olds the new entrants' minimum wage. The most common reasons for not paying this wage was that the rate was too low or not fair, or that the job was skilled.

Ninety-seven percent of businesses reported that they had not changed their preferences for hiring 16 and 17 year olds as a result of the introduction of the new entrants' minimum wage. Employers gave a range of reasons for hiring youth. Of these:

- a nearly half did so to provide opportunities for young people;
- b just under a fifth employed youth because they were flexible in the time and types of work they would do; and

- c only 7.0% of those actively targeting youth reportedly did so for the lower cost of hiring²⁵.

Impact on industries and firms

The impact of minimum wage increases varies across industry sectors as some sectors, notably retail and hospitality, employ a large proportion of low paid workers. For example, if the minimum wage was increased to \$13.50 an hour (option 3) this could affect nearly 20% of workers in the hospitality sector.

The economy-wide wage cost is estimated to increase by 0.02% (\$15 million a year) for Option 2, 0.09% (\$76 million a year) for Option 3 and 0.62% (\$518 million a year) for Option 4.

Previous New Zealand research found that firms respond in a number of ways to minimum wage increases²⁶. The most common response was to reduce wage relativities across their staff. Other responses include reducing the number of hours of work offered to staff, tightening employment policy, not replacing workers who resign, attempting to increase productivity, attempting to reduce costs, raising prices where possible, reducing profits and business closure. More generally, firms' responses were based on supply and demand variables. The sectors most affected by minimum wage increases (the retail and hospitality sectors) had more scope to raise prices, as they supply non-tradable products to the domestic market²⁷.

The Department's survey in 2010 showed around 20% of employers paid someone at the minimum wage in the past year. Large businesses with more employees were much more likely to have hired someone at a minimum wage rate in the past year.

Of those employers who were aware of the April 2010 changes the likelihood of being affected by those changes varied by industry. Employers working in the hospitality sector appear to be more likely affected than other industry sectors with one third of employers reporting this to be the case. Nearly one fifth of retail and administrative and support services' employers also claim to have been affected by the changes. Some industries have very low rates of employers affected, namely financial and insurance services, education and training.

Research has been undertaken into the patterns of firm-level teenage (16 to 19 years) employment in New Zealand between 1999 and 2007²⁸. While teenage

²⁵ Department of Labour, (2010) *SPRE Omnibus Employers' Survey: Employers' Attitudes and Practices Surrounding Changes to Minimum Wage Rates and the Employment of Youth*.

²⁶ 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.

²⁷ Ibid

²⁸ Hyslop D., D. Maré, S. Stillman and J. Timmins (2008) *An Analysis of Teenage Employment by Firms 1999/00 -2006/07*. Statistics New Zealand.

Available at: <http://www.stats.govt.nz/leed/reports/default.html>

workers account for 7 - 8% of overall employment, they account for about twice that proportion in the four main teen employing industries: agriculture, forestry and fishing; construction; retail trade; and hospitality. The research finds that the average effect of minimum wage increases for young workers on the typical firms' wage costs is likely to be small (0.5%) and about 1.5% for firms in the main teen-employing industries. However, for firms with teen-employment shares of at least 30%, the estimated impact on their wage cost may be around 4 - 5%.

Impact on State Sector

There are a number of state sector employees and contractors on low wages, particularly in the public health and compulsory education sectors. Increases in the minimum wage are therefore likely to have direct (and possibly also indirect or 'flow-on') costs for some state sector employers. It is likely that organisations will seek additional funding for higher wage costs. It is possible that following a minimum wage increase state sector employees earning above the minimum wage may bargain with their employers to retain their relativities. This may also lead to increased costs for the Government.

The Ministries of Health, Social Development (MSD) and Education and the Accident Compensation Corporation (ACC) have identified areas which are more likely to be impacted by changes in the minimum wage. The following table provides an estimate of the direct financial impact of the increase in the minimum wage.

Table 4: Financial impact for four state agencies (\$m)

Option (\$ per hour)	Health	MSD	Education	ACC	Total impact (rounded up to \$m)
2. 13.00	3.53	0.108	0.032	2.3	6
3. 13.50	21.87	0.323	0.169	6.9	30
4. 15.00	92.85	0.968	4.463	20.7	119

The Department is not able to estimate the indirect impact of the options. There might also be other government agencies, crown entities or state sector organisations which may be affected by a change in the minimum wage, but we do not have data to estimate the impacts on them. As well as impacting on wage costs, increasing the minimum wage may have other fiscal impacts. Social assistance costs through benefit payments may rise, if an increase in the minimum wage increases unemployment. Alternatively, higher incomes can increase the amount of personal income tax received and lead to the abatement of social assistance, such as Working for Families tax credits. It is difficult, however, to assess the net effect of these impacts.

CONSULTATION

Feedback from submitters

In September 2010, the Minister of Labour invited written submissions from Business New Zealand, New Zealand Council of Trade Unions (NZCTU) and other stakeholders. The Minister received 12 written submissions. Of them:

- Three submitters, National Association of Retail Grocers and Supermarkets of New Zealand (NARGON), Federated Farmers of New Zealand and Hospitality Association of New Zealand, recommended no increase to the minimum wage (Option 1) in 2011.
- Five submitters, NZCTU, National Distribution Union, New Zealand Nurses Organisation, Service and Food Workers Union (SFWU) and Working Women's Resource Centre, recommended increasing the minimum wage to \$17.22 an hour²⁹.
- One submitter, Unite, recommended an increase to \$15.00 an hour (Option 4).
- Two submitters, National Advisory Council on the Employment of Women (NACEW) and Mayors Taskforce for Jobs, recommended an increase in the minimum wage, but did not recommend a specific figure.
- Small Business Advisory Group recommended a range of options from no change to \$13.00 an hour, with a strong preference to increase the minimum wage rate in line with the change in the CPI (Option 2).

Agency comments

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 have been consulted in this review.

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 the following table.

²⁹ This is based on 66.0% of the average ordinary time wage of \$25.45 an hour in the June 2010 Quarterly Employment Survey, plus a 2.5% increase to take it to the end of March 2011. NZCTU and SFWU also accepted increasing to \$15.00 an hour in 2011 as a stepped approach.

Table 5: Summary of agency comments

	Preferred option	Reasons given	Other comments
MWA	\$13.50	<p>To maintain relativity with average wage increase</p> <p>92,000 people will benefit</p> <p>Constraint on job growth is small</p>	<p>Decrease in company tax rates (from 30% to 28%, effective from 1 April 2011) should improve companies' ability to cover an increase in the minimum wage</p>
MPIA	\$13.50	<p>In line with average wage increases and the CPI</p> <p>Ensures that the minimum wage is set at a greater rate than that for the increase in benefits and incentivises employment over social assistance</p> <p>Benefit Pacific people by acting as a catalyst for an increase to wages in general</p> <p>Given the generally positive labour market and economic forecast, increasing the minimum wage to \$13.50 could easily be absorbed</p>	<p>Pacific peoples are the lowest income earners of all ethnicities</p> <p>Pacific peoples in lower wage bands have less bargaining power</p> <p>Aligns with policy objectives to improve economic development and the standard of living for Pacific people</p> <p>The Pacific workforce is more vulnerable to a prolonged recovery from the recession compared to other groups</p>
MSD	\$13.00	<p>To reflect the cost of living increase</p> <p>No increase would not preserve the real incomes and living standards of minimum wage workers</p> <p>Option 3 and 4 would entail great risk of loss of employment</p>	<p>Some disabled, young and older people on minimum wage would benefit from an increase in the minimum wage</p> <p>No impact on rate of New Zealand Superannuation expected by 2013/14</p>

	Preferred option	Reasons given	Other comments
TPK	\$13.50 or higher	<p>Job loss projection is small</p> <p>The increases in the minimum wage rate between 2009 and 2010 were the lowest over the past seven years. Another small increase would further erode the incomes of low-income workers</p> <p>A higher minimum wage rate would encourage Māori labour market attachment and encourage those on benefit to return to full-time employment</p>	<p>Māori detachment from the labour market reinforces social disconnection, which creates other problems that may include increased participation in the criminal justice system. This in turn increases long-term social and economic costs to government and society</p> <p>More sustainable long-term approach to raising the minimum wage needs to be developed that achieves a more equitable balance between the needs of employers and employees</p>
TSY	\$12.75	<p>The economic recovery is slow and the labour market remains volatile</p> <p>Overheating in China and commodity prices in Australia may increase vulnerabilities for New Zealand over the next 12 months</p> <p>Increasing the minimum wage in this environment could create wage pressures (both directly through increased wage costs and indirectly through pressure on wage relativities) for employers who retained their workforce during the recession, and employers who are expanding their workforce as the economy is recovering</p> <p>The Department of Labour estimates that keeping the minimum wage at \$12.75 may lead to an employment gain of between 1360 and 1960 jobs</p>	<p>As a proportion of the median wage, New Zealand's minimum wage is the second highest in the OECD (in 2008)</p> <p>The minimum wage has increased significantly since the late 1990s. In real terms by 63% for adults and 128% for 16 and 17 year olds since 1999 (the latter is largely likely to be due to the abolition of the youth minimum wage in 2008)</p>

CONCLUSIONS AND RECOMMENDATIONS

The prudent and gradual increases in the minimum wage rate in the past two years have met the minimum wage objective. The Department considers that a cautious approach to setting the minimum wage is still warranted.

IMPLEMENTATION

The Department recommends implementing any changes to the minimum wage rates on 1 April 2011. Historically, any change in the minimum wage occurs on or before 1 April, thus providing consistency for employees and employers. April 1 is also the date that the adjustments to benefit rates and Minimum Family Tax Credit become effective.

The Minister of Labour intends to make a media statement following Cabinet confirmation. The Regulatory Impact Statement and the Officials' report will be made publicly available through the Department's website (The Regulatory Impact Statement will also be on Treasury's website). If the minimum wage is increased, the Department will provide information through its website, call centre and other customer services to inform employers and employees of the changes.

MONITORING, EVALUATION AND REVIEW

It is possible that increasing the minimum wage may increase non-compliance with the minimum wage. However, using existing data sources, it is not possible to identify whether an increase in the share of workers reporting below minimum wages is caused by an increase in exemptions from the minimum wage, measurement error or non-compliance. The Department considers that growth in the proportion of below minimum wage workers appears to be short-lived and is related to when the minimum wage increase impacts a relatively large share of the workforce. The Department will continue monitoring the proportion of workers reporting to be paid below minimum wage to ensure that any growth in below minimum wage workers is not persistent.

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 undertakes informal monitoring of the minimum wage during the year.