

Regulatory Impact Statement

Minimum Wage Review 2007

Executive summary

The Minimum Wage Act 1983 requires that any minimum wage rates must be reviewed yearly by 31 December. Five options have been considered for the minimum wage, ranging from retaining the status quo (\$11.25 per hour) through to an increase to \$15.00 per hour. A minimum wage new entrants rate is also to be set this year, at 80% of the adult minimum wage. The minimum wage training rate for trainees is proposed to be set at 80% of the adult minimum wage.

Adequacy statement

The Ministry of Economic Development has reviewed this Regulatory Impact Statement and considers it to be adequate according to the adequacy criteria.

Status quo and problem

The minimum wage is part of the government's general responsibility to ensure socially acceptable employment standards that are prescribed and enforceable. Social acceptability is defined through the weighing and contribution of each of the minimum wage options to the government's agreed objectives. This is described further in paragraph 7 below.

In addition, there are formal international commitments that establish an explicit obligation on the government to ensure an adequate minimum wage, including under ILO Convention 26 which 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".

Subsection 5(1) of the Minimum Wage Act 1983 states that "The Minister of Labour shall, in each year ending on the 31st day of December, review any minimum rate prescribed pursuant to section 4 of this Act". The current specified minimum rate for people aged 18 years and over (the adult rate) is \$11.25 an hour and for those aged 16 or 17 years (the youth rate) and trainees it is 80% of the adult rate, or \$9.00 an hour. These rates need to be reviewed by 31 December 2007.

Changes to Minimum Wage Legislation

The Minimum Wage (New Entrants) Amendment Act was passed on 5 September 2007. This amended the Minimum Wage Act allowing for the setting of a new entrants minimum wage rate for 16-17 year olds that must not be less than 80% of the minimum wage. The qualifying criteria for the new entrants minimum wage rate are 200 hours or three months of employment. The effect of this Act is that youth rates will cease on 1 April 2008. The minimum wage review has considered the setting of a new entrants minimum wage rate.

Objectives

The government has previously agreed to objectives for the minimum wage (FIN (00) M 29/1 and CAB (00) M 33/1E refer) that form the basis of this minimum wage review. The objectives for the minimum wage, and associated benchmarks to help set the minimum wage are:

- fairness – to ensure that wages paid are no lower than a socially acceptable minimum;
- protection – to offer wage protection to vulnerable workers so that workers are paid wages that reflect their worth or productivity;
- income distribution – to ensure that earnings of people on low incomes do not deteriorate relative to those of other workers;
- work incentives – to increase the incentives to work, for people considering work. Benchmarks: benefit levels and costs associated with working.

Alternative options

Alternative option 1 – maintain the status quo \$11.25 per hour (or \$450 per week)

Under this option the minimum wage rate would stay at \$11.25 for adults. Maintaining the status quo could erode the real value of the minimum wage, and it is likely there would be no additional constraints on job growth or other impacts on employers and employees. It may also negatively impact on incentives to work through a reduction in the gap between the minimum wage and benefit levels. Currently, using the unemployment benefit (for a benchmark measure), a single adult aged 18-24 with no supplementary assistance receives \$174.98 per week as compared against the current minimum wage of \$450.00 per week (178.5% higher than the unemployment benefit). Benefit levels are adjusted every year in April and as such, the incentives to work would change. This option would not contribute to the government's current objectives for the minimum wage.

Alternative option 2 – increase the minimum wage in line with average wages to \$11.70 per hour (or \$468 per week)

This option would increase the minimum wage to maintain relativity with the increase in average wages (currently \$22.81 per hour or \$912.00 per week), and could preserve the real value of the minimum wage and maintain existing levels of fairness, protection, income distribution and work incentives. This option is likely to affect 82,800 workers. If this option were to be pursued it is likely there would be no additional constraints on job growth. The national weekly wage bill could however increase by 0.08% and it could have a potential inflationary impact of 0.03% on the CPI.

Alternative option 3 – increase the minimum wage to \$13.50 per hour (\$540.00 per week)

This option would strongly improve relative levels of fairness, protection, income distribution, and work incentives. This option could affect 311,100 workers. This option could however have a large impact on the economy-wide wage bill, inflation, and could potentially constrain employment growth to a large extent. If

this option were to be pursued there could be a potential constraint on job growth of up to 0.4%. The national weekly wage bill could increase by 1.45% and it could have a potential inflationary impact of 0.63% on the CPI.

Alternative option 4 – increase the minimum wage to \$15.00 per hour (or \$520 per week)

This option would very strongly improve relative levels of fairness, protection, income distribution and work incentives. This option is likely to affect 452,900 workers. This option could have a very large impact on the economy-wide wage bill, inflation, and could potentially constrain employment growth to a large extent. If it were to be pursued there could be a potential constraint on job growth of up to 0.6%. The national weekly wage bill could increase by 3.74%, or \$51,316,000.00, and it would have a potential inflationary impact of 1.63%.

Overall assessment of alternative options

The Department of Labour considers that \$11.25 an hour (alternative option 1) would see the minimum wage remaining at its current level and could see the minimum wage erode in real value, and decrease relative to benefit payments, which are indexed to the CPI. If the minimum wage was increased to \$11.70 an hour (alternative option 2) to maintain relativity with average wages this may not improve existing levels of fairness, protection, income distribution and work incentives as much as a larger increase in the minimum wage could. This may alter incentives to work. The Department considers that these two options would not contribute to the government’s agreed objectives to the minimum wage.

The Department of Labour also considers that a move to \$13.50 an hour (alternative option 3) or \$15.00 an hour (alternative option 4), could have a negative impact on the economy-wide wage bill and inflation, and could potentially constrain employment growth to a much larger extent than the \$12.00 an hour option.

A summary of the effects of the options for changes to minimum wage rates is set out in the table below. Specific effects of the preferred option follows the table.

Minimum Wage Hourly Rate	Projected Job Growth, Reflecting The Potential Level Of Constraint On Job Growth (% Increase In Parentheses)	Potential Level Of Constraint On Job Growth	Potential % Constraint On Job Growth
Option 1 \$11.25	27,200 (1.3%)	0	0.0%
Option 2 \$11.70	27,200 (1.3%)	0	0.0%
Preferred Option \$12.00	25,800 (1.2%) - 26,900 (1.2%)	300 - 1,400	0.0% - 0.1%
Option 3 \$13.50	17,900 (0.8%) - 25,100 (1.2%)	2,100 - 9,200	0.1% - 0.4%
Option 4 \$15.00	10,000 (0.5%) - 23,300 (1.1%)	3,800 - 17,100	0.2% - 0.8%

Preferred option

Increase the minimum wage to \$12.00 per hour

The preferred option is likely to improve levels of fairness, protection, income distribution, work incentives for workers. The option would also equate to an increase of 6.7% or \$0.75 to the minimum wage. This option delivers the government goal of \$12.00 per hour.

The option also has a number of impacts and benefits for specific groups of wage earners, as well as potential costs for the economy, including specific sectors such as retail and hospitality, and potential compliance costs. Overall, the option is likely to affect 120,000 workers. It could increase the weekly wage bill by \$2,319,000 and potentially increase inflation of 0.07%. An increase in the minimum wage is likely to benefit specific groups such as youth, women, those who do not have a post-school qualification, part-time workers, Maori, and Pacific, who are often over-represented amongst those earning less than \$12.00 per hour. The same groups could also be the first to experience any negative impacts. Negative impacts could include being offered reduced hours of work, or the substitution of some groups of workers by others.

An increase to \$12.00 per hour could, for instance, in the \$11.25-\$11.99 wage band affect 62.1% of female wage and salary workers, 13.6% of Maori wage and salary workers, and 8.5% of Pacific wage and salary workers. For 16 and 17 year olds who will be on the adult wage for the first time, an increase to \$12.00 would affect 68%, or 38,300 workers.

Similarly some sectors are more impacted by an increase in the minimum wage. The hospitality and retail sectors are the most exposed to minimum wage increases. In the hospitality sector 24.3% (21,800) of workers could be affected by an increase to \$12.00. They work 16.7% of the hours worked in hospitality sector. In the retail sector, 17.4% (38,300) of workers could be affected by an increase to \$12.00. They work 13.2% of hours worked in the retail sector.

Qualitative research of 34 New Zealand businesses conducted in 2006 showed that firms respond in a number of ways to increases in the minimum wage. The most common response was to reduce wage relativities across staff. Other responses included reducing the number of hours of work offered to staff, tightening employment policy, attempting to increase productivity, attempting to reduce costs, raising prices where possible, reducing profits and business closure.

From the impacts on sectors and firms and the possible responses discussed above there may be potential flow-on effects on consumers from a minimum wage increase. This may be in terms of increased prices of goods and services in either the short or long term.

As identified above this option could also affect other workers who earn more than the minimum wage. These effects would be from the reduction of relativities

between workers who earn either the minimum wage and close to it, or beyond the minimum wage. This might affect workers who are paid at a higher rate according to experience, level of responsibility and completion of training.

Overall, the Department considers that labour market conditions can support an increase of up to \$0.75 to \$12.00 per hour for this year's review. There is a risk that future adjustments to the minimum wage may need to be assessed in a less favourable labour market and economy. The Department considers that an increase up to and including \$12.00 an hour could be sustainable in the current economic conditions. This option could potentially constrain employment growth to some extent.

The preferred option could potentially impose compliance costs on employers, beyond the impacts already described, in adjusting payroll systems to meet the effects of an increase in the minimum wage.

This option would mean that a new minimum wage order would be made, specifying the minimum wage rates for 2008, replacing the current minimum wage order.

Setting the new entrants minimum wage and the training wage for 2007

For 2007 it is recommended that the new entrants minimum wage rate and the training rate be set at 80% of the minimum wage. Maintaining parity between new entrants and those on the training rate ensures that there is no incentive to employ one type of minimum wage worker over another.

Implementation and review

Changes to minimum wage rates are implemented by Order in Council. The process for authorisation by Cabinet, drafting and the 28 day waiting period for regulations mean that minimum wage changes generally come into force in March. I consider that an appropriate date for minimum wage increases recommended in this paper to come into force is 1 April 2007, to coincide with changes to Working for Families tax credits. This is to ensure that Working for Families recipients are not disadvantaged when inflation adjustments are made to Working for Families Tax Credits. This will ensure that the recipients' overall income will increase.

I intend to make a media statement following the cabinet confirmation. The Cabinet paper and the Officials' report will also be made publicly available through the Department's website. The Department will provide information through its website, call centre, and other customer services to give employers warning of changes to the minimum wage.

Consultation

The Department invited submissions from women's interests, employee interests, employer interests, and business interests. Submissions received from business interests included Business New Zealand, New Zealand Chambers of Commerce (Inc), Hospitality Association of New Zealand, Horticulture New Zealand, Motel

Association of New Zealand, National Association of Retail Grocers and Supermarkets Of New Zealand (Incorporated), New Zealand Hotel Council, Federated Farmers of New Zealand, New Zealand Kiwifruit Growers Incorporated, and the Small Business Advisory Group. The Department also received submissions from the Mayors' Taskforce for Jobs and the New Zealand Association of Registered Hairdressers Incorporated. Views expressed by submitters have, where possible, been incorporated in the Department's analysis.

Submissions received from employee interests included the New Zealand Council of Trade Unions, National Distribution Union, Service and Food Workers Union, Stand Up (Formerly Youth Union Movement). Women's interests include the National Advisory Council on the Employment of Women and Pacific Allied (Womens) Council Inspires Faith in Ideals Concerning All.

Submissions from business and employer interests sought no wage increases, opposed the introduction of a new objective, and emphasised tax cuts and training to help improve workers' incomes. Employee interests sought an increase to \$15.00 per hour and some suggested indexation to the CPI. Employee interests supported the introduction of the new objective. They also asked that differential between the training rate and the minimum wage be reduced to 90% and apply only for a year.

In addition, the Department met separately with the New Zealand Council of Trade Unions, Business New Zealand, and the New Zealand Chambers of Commerce to discuss some of the key issues relating to their submissions.

The following government organisations were consulted on the 2007 Minimum Wage Review: The Treasury; Ministries of Education, Women's Affairs, Pacific Island Affairs, Health, Social Development, Economic Development, Justice, Youth Development; State Services Commission, Te Puni Kōkiri; and the Tertiary Education Commission. The Department of the Prime Minister and Cabinet were provided with a copy of the Cabinet paper.

Treasury concurs that, based upon current projections, economic conditions will likely permit a rise in the minimum wage from \$11.25 to \$12.00 in 2008, although they note there are downside risks to the economic and labour market outlook. Treasury generally agree with the analysis of the potential economic impact of the options canvassed in terms of possible reductions in employment growth. Treasury note that the potential level of constraint on job growth increases with the level of the minimum wage and economic impacts are likely to be more significant if current buoyant economic and labour market conditions soften.

The total number of people aged over 18 whose wages would be directly affected by an increase in the minimum wage to \$12.00 would be similar to when the minimum wage was increased in 2006 and 2007. An increase to \$13.50 or \$15 per hour would affect a significantly larger number of people. The impact on younger workers of all three options is likely to be much greater than past increases given the changes to minimum wage legislation. Groups such as young

workers, women and Maori and Pacific people are the most likely to benefit, but would also likely be the first to feel the impact of any negative impacts.

Treasury does not support the proposal to introduce an objective to reduce the gender pay gap in the context of the 2008 Minimum Wage Review. Treasury note that formal decisions regarding the third phase of the Pay and Employment Equity Plan of Action (which includes the private sector and not-for-profit organisations) are yet to be taken.

The Ministry of Pacific Island Affairs supports the government's goal to increase the adult minimum wage to \$12.00 an hour by the end of 2008 if economic conditions permit and would also support option 4 of \$13.50 an hour as this improves the levels of fairness and protection for Pacific wage earners who are over-represented amongst those in lower wage brackets, particularly Pacific women who earn significantly less than other women. The Tertiary Education Commission supports parity being maintained between the minimum training rate and the new entrant's rate). The Ministry of Women's Affairs supports an increase in the minimum wage to \$12.00 an hour and the adoption of the pay and employment equity objective. The State Services Commission support the inclusion of a pay and employment equity objective as they see that as consistent with other government policy and with their role as sector leader to facilitate progress against the P&EE Plan of Action. Te Puni Kōkiri supports setting the minimum wage to at least \$12.00 per hour and preferably to \$13.50 per hour. Te Puni Kōkiri also supports linking the new entrant and training rate to the adult minimum rate and setting it at 80%. Te Puni Kōkiri supports the new objective "Reducing the Gender Pay Gap".