

REGULATORY IMPACT STATEMENT

Statement of the nature and magnitude of the problem and the need for government action

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 \$9.50 per hour and for those aged 16 or 17 years (the "youth" rate is 80% of the adult rate, or \$7.60 per hour) therefore need to be reviewed by 31 December 2005.

Minimum wage rates provide a minimum acceptable standard for pay rates, and therefore are particularly relevant to the low paid.

Women, Maori and Pacific Island people and young people are over-represented among minimum wage earners, and would expect to benefit from increases in the minimum wage. Changes in the minimum wage particularly affect the agricultural, accommodation and catering and retail trades sectors, and small and medium enterprises.

The training minimum wage was introduced in July 2003 and allows for a lower minimum wage (at 80% of the adult rate) to be paid if an employee is undertaking training of at least 60 credits annually towards a qualification registered by the National Qualifications Framework.

The minimum wage was last increased on 21 March 2005. Since then, consumer prices have increased by 2.8% and average hourly earnings have increased by 3.5% (for the year to June 2005) resulting in a decrease in the real value of the minimum wage. Benefit rates are indexed to the Consumer Price Index, (and have therefore increased at that rate) so the incentive for some people to work may have reduced. The current unemployment level is 3.4% for the overall population aged 18 years or over (September Quarter 2005).

Statement of the public policy objective(s)

The minimum wage is part of the government's general responsibility to ensure socially acceptable employment standards that are prescribed and enforceable. 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".

The government's objectives for the minimum wage are:

- A. to ensure that wages paid are no lower than a socially acceptable minimum (fairness). Changes to reflect average wages or inflation are relevant for maintaining this objective.

- B. to offer wage protection to vulnerable workers (protection)
- C. to ensure that incomes of people on low incomes do not deteriorate relative to those of other workers (income distribution)
- D. to increase the incentives to work for people considering work who are not currently in paid employment (work incentives).

The government has also announced an aspirational goal of reaching \$12 an hour (for adults) by the end of 2008, if economic conditions permit. The Minister of Labour will make an announcement about the path to reach the government's goal at the same time as an announcement is made about the outcome of this year's review. However, an identified path will be indicative only, and will be confirmed following further minimum wage reviews, if economic conditions permit. Changes will be announced in advance, however, to allow businesses time to adjust.

Changes would not come into effect until March to allow employers time to adjust to the change. Annual adjustments to reach the government's aspirational goal of \$12 an hour (adult rate) by the end of 2008, if economic conditions permit, will continue to be subject to an annual review.

Statement of feasible options (regulatory and/or non-regulatory) that may constitute viable means for achieving the desired objective(s) AND Statement of the net benefit of the proposal, including the total regulatory costs (administrative, compliance and economic costs) and benefits (including non-quantifiable benefits) of the proposal, and other feasible options.

Options for the 2006 adjustment (or first step towards the goal of \$12 an hour)

Seven options for the adult minimum wage have been considered. Tables 1 and 2 below indicate total numbers of adults and youth affected by each of the minimum wage options. Minimum wage changes would come into effect on Monday 27 March 2006.

Table 1: Impact of Adult (18 years and over) Minimum Wage

Option for 2006	Hourly rate	Weekly rate	Cumulative no. of people who would receive a wage rise and percentage of
1	\$9.50	\$380	0
2A	\$9.83	\$393	24,900 (1.6%)
2B	\$10.00	\$400	28,400 (1.8%)
3A	\$10.13	\$405	86,140 (5.6%)
3B	\$10.25	\$408	91,000 (5.7%)
3C	\$10.50	\$420	103,500 (6.5%)
4	\$12.00	\$480	246,600 (15.5%)

Table 2: Impact of Youth (16 and 17 years) Minimum Wage

Option for 2006	Hourly rate	Weekly rate	Cumulative no. of people who would receive a wage rise and percentage of youth workforce
1	\$7.60	\$304	0
2A	\$7.86	\$315	3,500 (5.8%)
2B	\$8.00	\$320	3,700 (6.3%)
3A	\$8.10	\$324	9,420 (18.6%)
3B	\$8.20	\$328	10,000 (16.9%)
3C	\$8.40	\$336	11,000 (18.7%)
4	\$9.60	\$384	24,700 (41.8%)

Status quo – Option 1: leaving the minimum wage unchanged at \$9.50 (\$7.60 for youth and trainees)

Leaving the minimum wage unchanged would not require any adjustment by employers. However, it would mean that the minimum wage would decrease in real terms, and relative to average wages. There would also be a reduction in the margin between benefit rates (which increase by the rate of inflation each April) and the minimum wage, which may reduce incentives for some people to work. The current minimum wage is 90.4% higher than the unemployment benefit (for a single adult with no supplementary assistance included).

Retaining the existing minimum wage (\$9.50 per hour) will erode the real value of these wages and would not further contribute to the government's objectives for the minimum wage.

Increasing the minimum wage by a relatively small amount (Option 2A by 3.5% to \$9.83, and option 2B by 5.3% to \$10.00)

A small increase equivalent to the increase in average wages (to around \$9.83), and an increase in line with recent annual fifty cent an hour increases (to \$10.00 an hour) would be consistent with the Government's concern that the minimum wage should not lose its value over time. It would also contribute to the fairness and income protection objectives of the minimum wage. An increase of at least the rate of inflation would also preserve the margin between benefit rates and the minimum wage (relevant to the work incentives objective). The slightly larger increase proposed in this option would increase the margin between benefit rates and wages, and also increase the ratio of the minimum wage to the average wage.

An increase in the minimum wage in 2006 to maintain relativity to average wages (\$9.83 per hour) will preserve the real value of the minimum wage and can be made with confidence in the current economic and labour market conditions. It would mean that larger increases would be required in future years to reach the government's aspirational goal of reach \$12 an hour by the end of 2008 (adult rate), if economic conditions permit.

Increasing the minimum wage by a larger amount, either Option 3A by 6.6% or \$10.13, or Option 3B: by 7.9% to \$10.25, Option 3C: by 10.5% to \$10.50, or Option 4: by 26.3% to \$12.00

Those on low incomes could expect larger increases in their earnings as a result of a larger increase in the minimum wage. This would help to narrow the earnings distribution, although it could also create 'flow on' effects for firms as employees further up the earnings distribution seek wage increases to preserve relativities. A larger increase in 2006 would require smaller increases in future years to reach the government's aspirational goal of \$12 an hour (adult rate) by the end of 2008, if economic conditions permit.

A larger increase in the minimum wage could also lead to business seeking to improve the productivity of lower wage workers. Evidence from the UK Low Pay Commission suggests that a significant proportion of businesses adjusted to the minimum wage by seeking to increase productivity of their workers. Firms also responded by exercising tighter control on labour costs (including reducing employment and hours worked), and some 'positive' adjustments such as changing work organisation, increasing investment in training and development, improved quality of service, and increased use of technology.

A rate over \$10 an hour (e.g. \$10.25 or \$10.50 an hour) would exceed the recent trends of fifty cents an hour increases and so would signal a stronger message in 2006 about a commitment to reach the government's aspirational goal. An increase over \$10.50 an hour could also mean a higher risk that the rate of growth of minimum wage jobs would slow, especially if there is a downturn in the economy or a further softening in economic conditions.

Youth and training minimum wage rates for 2006

The recommended option for 2006 is that the youth and training minimum wage rates retain their current relativity with the adult rate (at 80% of the adult rate). Young people report higher levels of non-compliance with the youth minimum wage and a large increase in the youth rate (irrespective of its relativity with the adult rate) may result in a corresponding rise in reported non-compliance for this group.

Overall net impacts of an increase in the minimum wage

Costs

Unless they are readily able to absorb the increased labour costs associated with an increased minimum wage, businesses will need to adjust to a minimum wage increase in some other way. The adjustment needed will be greater the larger the increase in the minimum wage. Those employees who would benefit from an increase in the minimum wage would also be the first to be affected by any costs, for example, through shortened working hours, the substitution of higher for lower skilled workers, delayed employment decisions, reduced non-wage terms and conditions, increased pressure on worker productivity, or reduced training. Sectors most likely to be affected will be agriculture, accommodation and catering, and retail sectors. Small firms are also more likely to be affected than larger firms.

The impact on costs to government is unclear, but likely to be small. There are a number of state sector employees (and contractors) that earn wages of \$12 per hour or less, particularly in the public health and compulsory education sectors. Future increases in the minimum wage are therefore likely to have direct (and possibly also indirect or 'flow-on') costs for some state sector employers. These costs and the likelihood that organisations will seek additional funding to compensate for them, will be higher for larger movements towards the aspirational goal of \$12 per hour.

Benefit payments may increase for people who have their hours of work reduced, but for those who receive wage increases; there may be some offsetting benefit abatement. There will also be a small increase in tax paid by people who receive pay rises. Overall, these factors mean the direct fiscal impacts are likely to be small however, detailed estimates of these costs and off-setting benefits have not been prepared.

If wage increases are contained to those moving up to the new minimum wage, the impact on prices is likely to be small. Businesses who are affected by minimum wage increases have suggested that they may adjust by passing on the cost of wage rises to customers by increases prices.

Compliance costs arising out of any increase in the minimum wage are detailed in the Business Compliance Cost Statement.

Benefits

Any increase in the minimum wage will mean that some low-wage workers will receive wage increases ensuring that their earnings do not deteriorate relative to other workers. There may also be flow-on effects to the wages of some workers above the minimum wage, as they seek to maintain wage relativities. If the margin between wages and benefit rates is increased through a minimum wage increase, the incentive to work relative to remaining on benefit is also increased.

The benefits of minimum wage increases are likely to be felt most strongly among women, younger workers, Maori, Pacific peoples, people with disabilities, recent migrants, the low skilled and people with non-English speaking backgrounds. These groups would, however also be more likely to experience any negative impacts that could result from a minimum wage increase, particularly if there was a big increase (for example, reduced hours worked, or substitution of some groups of workers by others).

Fifty percent of low wage workers work part-time. Because of this, any increase in weekly incomes will reflect the fewer hours worked by low wage workers and will reduce the absolute increase in income arising from minimum wage increases.

For some groups of women, an increase in the minimum wage is the only direct lever the government has to ensure an adequate earned income (they may be non-unionised and/or, have weak bargaining power). Increasing the minimum wage will also play a small role in reducing the gender pay gap. The objectives sought through the minimum wage of improving levels of fairness and protection are particularly relevant for these groups of more vulnerable women.

Increasing the minimum wage can make a small contribution to reducing the gender pay gap. For example an increase in the minimum wage from \$9.50 to \$10.50 will improve the gender pay ratio by three tenths of a percentage point (0.3) to 82.1%.

Of those receiving the youth minimum wage, the beneficiaries are likely to be youth who are working while still at school (75% of 16 and 17 year olds are still at school or in some form of study) and these workers are likely to be in the retail sector (64% of 16 and 17 year olds are employed in the retail industry). For youth, the increase in weekly income from an increase in the minimum wage is likely to be small, because the majority of young people work short hours.

There may be savings to government through abated income assistance as a result of increased earned income for people in receipt of such assistance (including Working for Families assistance). However, despite abated income assistance, people will still be better off as a result of the increases to their wages.

Statement of consultation undertaken

Submissions for the 2005 Minimum Wage Review were received from a number of organisations reflecting women's interests (the National Advisory Council on the Employment of Women) and worker (New Zealand Council of Trade Unions and Youth Union Movement) and business interests (Business New Zealand, the NZ Retailers Association, The Hospitality Association, the Federation of Farmers, and New Zealand Association of Retail Grocers and Supermarkets and the Small Business Advisory Group). In addition, the Department of Labour met separately with the New Zealand Council of Trade Unions, Business New Zealand and the Small Business Advisory Group to discuss some of the key issues relating to their submissions. Submissions representing employer interests, emphasised the costs of wage increases (refer above) and sought no or small increases in minimum wages. Employee representatives recommended large increases in the minimum wage, emphasising the benefits to low waged workers.

The Treasury, Ministries of Education, Women's Affairs, Pacific Island Affairs, Social Development, Economic Development, and Youth Development, Te Puni Kokiri, Tertiary Education Commission, the Office for Disability Issues, and the Department of the Prime Minister and Cabinet have been consulted on the 2005 Minimum Wage Review.

The Ministry of Social Development (MSD), the Treasury and the Ministry of Economic Development have raised concerns that larger increases in minimum wage rates, which would directly affect a considerably larger number of workers than have been affected by previous increases, involve risks of a significant reduction in employment opportunities, particularly for vulnerable groups, and of wider economic losses. The extent of these potential losses cannot be quantified, however, these negative effects will be exacerbated if current buoyant economic and labour market conditions soften.

These risks have been noted in the 2005 Minimum Wage Review. The Department of Labour considers that, given current economic and labour market conditions, an increase in the minimum wage above the rate needed to maintain

relativity to the average wage (e.g. \$10 an hour or more) could be made to reflect a stronger view of the contribution of the minimum wage to its objectives. An increase over \$10.50 an hour could, however, mean a higher risk that the rate of growth of minimum wage jobs would slow, especially if there is a downturn in the economy or a further softening in economic conditions.

MSD has also noted a concern that much of the re-distributional gains from gross increases in the minimum wage for low paid workers and low income families will be limited. MSD observes that in the current post-Working for Families environment raising the minimum wage is not a particularly effective way to improve the take home income of poor working families. The Department of Labour and MSD will undertake further research to better understand the interface between minimum wage increases and Working for Families.

Business compliance cost statement

This statement is based on the assumption that the minimum wage will be increased – there will be no incremental compliance costs if the minimum wage is left unchanged.

Changes to minimum wages require firms that currently pay less than the new minimum wage to their employees to raise those wages from the time that the new minimum wage rates come into force. This adjustment will require minor changes to data in payroll systems, but otherwise, the regulatory requirements remain unchanged by changing minimum wage rates. There may be compliance costs for employers adjusting to an increased minimum wage and these adjustments are likely to disproportionately affect small businesses because small businesses employ proportionally large numbers of minimum wage earners and tend to offer a narrow wage band (so flow on effects may occur). Early notice of an increase will reduce these costs. These costs may change depending on the particular path taken to achieve the government's goal of \$12 an hour.

Employers employing workers who are paid less than the new minimum wage rates will be affected. Information from the July 2004 to June 2005 Statistics New Zealand Household Labour Force Survey Income Supplement suggests that these employers are most likely to be in agriculture and agricultural services, parts of manufacturing (food, beverage and tobacco; textiles, clothing, footwear and leather), retail trades, restaurants and hotels, business services, education and health and community services.

The Minister of Labour will undertake a communications strategy to outline the changes to minimum wage rates. Changes would not come into effect until March to allow