

REGULATORY IMPACT STATEMENT - 2003 MINIMUM WAGE REVIEW

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

- 1 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 rates for people aged 18 years and over (the “adult” rate is \$8.50 per hour) and for those aged 16 or 17 years (the “youth” rate is 80% of the adult rate, or \$6.80 per hour) therefore need to be reviewed by 31 December 2003.
- 2 Minimum wage rates provide a minimum acceptable standard for pay rates, and therefore are particularly relevant to the low paid.
- 3 As at June 2003, it was estimated that 15,200 people (1.0 % of all employees) earn between \$8.50 and \$8.75, 4,700 people (0.3%) earn between \$8.75 and \$9.00, 35,000 people (2.4 %) earn between \$9.00 and \$9.50, 34,600 people (2.4%) earn between \$9.50 and \$10.00, and 92,300 (6.3%) earn between \$10.00 and \$10.50.
- 4 In relation to youth (aged 16 and 17 years old) it was estimated as at June 2003 that 7,000 people (14.5 % of youth employees) earn between \$6.80 and \$7.20, 6,100 (12.7%) earn between \$7.20 and \$7.88, 5,100 (10.7%) earn between \$7.88 and \$8.40, 4,800 (9.9%) earn between \$8.40 and \$9.00, and 4,300 (9.0%) earn between \$9.00 and \$9.45.
- 5 Since the minimum wage was last increased (on 1 April 2003), consumer prices have increased by 1.5% and average hourly earnings by 3.1% resulting in a decrease in the real value of the minimum wage. Benefit rates have increased by 2.72% since the minimum wage was last increased so the incentive for some people to work may have reduced. The current unemployment level is 4.4% for the overall population and 12.9% for youth (aged 16 and 17).

Statement of the public policy objective(s)

- 6 The Government’s objectives for the minimum wage are:
 - a to ensure that wages paid are no lower than a socially acceptable minimum (fairness)
 - 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 protection)
 - d to increase the incentives to work for people considering work who are not currently in paid employment (work incentives).

Statement of feasible options (regulatory and/or non-regulatory) that may constitute viable means for achieving the desired objectives(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.

Status quo – Option 1: leaving the minimum wage unchanged at \$8.50

- 7 The key features of the current minimum wage structure are:
 - a adult rate of \$8.50 per hour, youth rate of \$6.80 per hour (80% of adult rate).
- 8 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. The Government has an objective that the minimum wage should not lose its value over time. 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.
- 9 Five other options for the adult minimum wage have been considered.

Increasing the minimum wage by a relatively small amount (Option 2: \$8.75 or Option 3: \$9.00)

- 10 A small increase in line with the change in consumer prices or average wages (to around \$8.75) 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). A slightly larger increase (e.g. to \$9.00) would increase the margin between benefit rates and wages, and also increase the ratio of the minimum wage to the average wage.
- 11 For increases in the minimum wage to \$8.75 and \$9.00 the Department of Labour estimates that the effect would be a reduction in the numbers employed of 100 and 400 respectively (including 0 and 100 youth respectively).
- 12 In the current economic environment, with strong demand for labour, the result would probably be that employment grew by slightly less, rather than a reduction in employment.
- 13 Recent New Zealand research by Hyslop and Stillman¹ suggests that risks to youth employment posed by rising minimum wages have proved less significant than previous analysis suggested, although these results should be taken in the context of a buoyant economy and an increasing proportion of young people at or near the minimum.

¹ Hyslop D. and Stillman, S. (2003) Youth Minimum Wage Reform and the Labour Market. Preliminary draft May 2003.

- 14 As women, Maori, Pacific peoples and youth are over-represented amongst those earning between \$8.50 and \$10.50, any increase in incomes or reduction in employment opportunities from a relatively small increase in the minimum wage is likely to disproportionately affect them.

Increasing the minimum wage by a large amount (Option 4: to \$9.50, Option 5: to \$10.00 or Option 6: to \$10.50)

- 15 Those on low incomes who remain employed could expect large increases in their earnings as a result of a large increase in the minimum wage. This would help to narrow the earnings distribution, although it would also create pressure further up the earnings distribution for wage increases to preserve relativities. The Department of Labour estimates that the reduction in the numbers employed from large increases in the minimum wage would be in the order of 1,700 from an increase to \$9.50 (and a youth rate of \$7.60), 3,600 from an increase to \$10.00 (and a youth rate of \$8.00) and 8,800 from an increase to \$10.50 (and a youth rate of \$8.40).
- 16 As women, Maori, Pacific peoples and youth are over-represented amongst those earning between \$8.50 and \$10.50, any increase in incomes or reduction in employment opportunities from a large increase in the minimum wage is likely to disproportionately affect them.
- 17 A large increase in the minimum wage would also send a strong signal that commercial adjustment should occur through raising productivity (evidence that raising productivity is one way firms adjust to increased minimum wages is presented in the UK Low Pay Commission).

Overall net impacts of an increase in the minimum wage

Costs

- 18 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. These adjustments may occur via 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.
- 19 The impact on costs to government is unclear, but likely to be small. Benefit payments may increase for people who become unemployed or 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.
- 20 If wage increases are contained to those moving up to the new minimum wage, the impact on prices is likely to be small. Retailers, who employ a significant number of low-wage workers, have also suggested that it is difficult for them to pass on the cost of wage rises to customers.

Benefits

- 21 Any increase in the minimum wage will mean that some low-wage workers will receive wage increases (where there is compliance with the minimum wage), 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.
- 22 A higher minimum wage may emphasise the importance of competing on the basis of improved productivity, rather than lowest cost. 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.² 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.
- 23 Any change in the adult minimum wage will determine the level of the youth minimum wage as long as the youth minimum wage is set at 80% of the adult minimum wage. The impacts of an increased youth minimum wage are set out below.

Increasing the youth minimum wage to 90% of the adult minimum wage

- 24 Increasing the youth minimum wage from 80% to 90% of the adult minimum wage would send a strong signal about the value of youth in society and their rights to be protected from exploitation, while reflecting the increasing skill levels that youth have in some areas. It may also increase the incentives for youth to seek work.
- 25 On the other hand, a further large increase in the youth minimum wage may also encourage some youth to seek low-wage employment rather than continuing with training.
- 26 A large increase in the youth minimum wage could also be expected to reduce the employment prospects of youth when economic conditions and demand for labour weaken.

Statement of consultation undertaken

- 27 In the course of the review, the following government agencies have been consulted: The Treasury, Ministries of Women's Affairs, Education, Social Development, Pacific Island Affairs, Economic Development and Youth Development, Te Puni Kokiri, Tertiary Education Commission and the Department of Prime Minister and Cabinet.

² UK Low Pay Commission (2003) *The National Minimum Wage, Fourth Report of the Low Pay Commission, Building on Success*

- 28 The Department of Labour considers an increase in the minimum wage to \$8.75 or \$9.00 an hour as being the options most consistent with the multiple objectives of the minimum wage.
- 29 Treasury considers a case can be made for a small increase to the adult minimum wage (to \$8.75 an hour), as sufficient to meet the policy objectives agreed by Cabinet while minimising expected job losses. The Ministry of Social Development supports a small increase in the adult minimum wage to reflect the movement in the average wage. The Ministry of Social Development is of the view that this adjustment should continue to be used to ensure that the lowest paid receive a similar wage increase to the rest of the community.
- 30 The Ministry of Youth Development, Te Puni Kokiri and the Ministry of Pacific Island Affairs support an increase in the minimum wage to \$9.00. The Ministry of Pacific Island Affairs and Te Puni Kokiri noted that the minimum wage is one of many mechanisms that assist low income Pacific and Maori earners, who are currently over-represented amongst the low waged.
- 31 The Ministry of Youth Development, Te Puni Kokiri and the Ministry of Pacific Island Affairs support an increase of the youth minimum wage from 80% to 90% of the adult minimum wage. It is the view of the Ministry of Pacific Island Affairs that this increase would benefit Pacific youth.
- 32 The Ministry of Youth Development holds the view that there should be no differentiation on the basis of age in the minimum wage system and believe that the system needs to be examined in the context of international rights based arguments and instruments. A similar view was expressed in a submission from the National Advisory Council on the Employment of Women (NACEW) to this year's review.
- 33 Treasury notes that an increase in the minimum wage to 90% of the adult rate would affect over 40% of 16 and 17 year olds currently in employment (including those paid below the current minimum). Such a high level of coverage amongst a small but significant group in the labour market could overly constrain decisions around future increases in the minimum wage. Accordingly, Treasury supports the Minister of Labour's recommendation to retain the youth minimum rate at its current level of 80% of the adult minimum.
- 34 The Ministry of Women's Affairs supports an increase in the minimum wage to \$9.00 but considers that this should be a step in increasing the relativity of the minimum wage to above 50% of the average wage.
- 35 The Ministry of Education commented that an increase in the minimum wage may encourage young people to participate in the workforce rather than pursue educational opportunities. If there is an increase in the minimum wage, the development and promotion of industry training opportunities may be a way to ensure that young people develop the skills required for a knowledge society.
- 36 Selected non-government stakeholders were invited in late September to make written submissions to the review. Written submissions were received from the New Zealand Council of Trade Unions, Business New Zealand, Federated Farmers, the National Association of Retail Grocers and Supermarkets of New Zealand, the New Zealand Hairdressers Association, the National Advisory

Council on the Employment of Women, The Mayors Taskforce for Jobs and the Maori Women's Welfare League.

- 37 In general, employer groups supported leaving minimum wage rates unchanged (and in some cases, abolishing the youth minimum wage), while union groups favoured significantly increasing the adult minimum wage, and further reducing the gap between the youth and adult minimum wage rates.

Business compliance cost statement

- 38 This statement is based on the assumption that the minimum wage will be increased – There will be no compliance costs if the minimum wage is left unchanged.
- 39 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 will require minor changes to 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 (involving stress and time to strategize), and these adjustments compliance costs are likely to affect small business disproportionately.
- 40 Employers employing workers who are paid less than the new minimum wage rates will be affected. Information from the June 2003 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 trade, restaurants and hotels, business services, education and community services.
- 41 The Minister of Labour will undertake a communications strategy to outline the changes. Changes would not come into effect until March 2004, to allow employers time to adjust.