

Report Cover Sheet

Department of Labour
TE TARI MAHI



Date	2 December 2005
Subject	Minimum Wage Review 2005: officials' report
Minister(s)	Minister of Labour
Agencies consulted	List
Action sought	<p>Note that your consideration of this paper fulfils your statutory obligations to review the minimum wage.</p> <p>Direct officials on the option(s) for minimum wage rates you would like submitted to Cabinet Business Committee on 12 December, by Monday 5 December.</p> <p>Discuss timing issues raised in the attached cover note with officials on Monday 5 December.</p>
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Tracker Number	05/52910

2 December 2005

Minister of Labour

MINIMUM WAGE REVIEW 2005

Introduction

1. This report reviews the Minimum Wage for 2005 and seeks your advice on the options(s) for minimum wage rates you would like submitted to Cabinet Business Committee on Wednesday 14 December 2005.

Executive summary

2. This report reviews the minimum wage for 2005. There is a statutory requirement for the Minister of Labour to review minimum wage rates by 31 December each year. Your consideration of this report before 31 December 2005 fulfils your obligation to undertake the review.
3. If minimum wage rates are to be adjusted, such changes have generally taken effect before 1 April (following a decision in December the previous year).
4. Changes to the minimum wages are part of a wider mix of approaches to support higher quality working lives and productive workplaces. These approaches include work underway on workplace productivity, work life balance, the Working for Families package, initiatives around skill and labour shortage, work to promote pay and employment equity, and work to enhance parents' choices.
5. This review has been undertaken in the context of government's aspirational goal of achieving a minimum wage of \$12 an hour (for those aged 18 and older) by the end of 2008, economic conditions permitting.
6. The Department considers that there are benefits to be gained in identifying and signalling an intended pathway to reach the government's aspirational goal, including the level of increases and when they will happen. Each step would be checked annually against prevailing and forecast economic conditions and, if necessary, modified. The Department seeks your agreement to recommend to Cabinet that the intended pathway is communicated at the same time as announcements are made about any adjustment for 2006.
7. Identifying and signalling an intended goal:
 - a will allow greater certainty for businesses, employers and employees around minimum wage changes to 2009
 - b will allow a longer notice period to be provided to businesses

- c is consistent with the statutory requirement for an annual review, but will focus the review on whether the signalled increases remain appropriate.
8. The government's aspirational goal is dependent on economic conditions. The Department considers that the criteria for determining whether economic conditions permit the planned increase should be transparent. The Department is undertaking work to identify appropriate indicators and will use these in future reviews to assess prevailing economic conditions and whether the intended step should be modified.
 9. In addition to considerations around economic sustainability, the Department recommends that the annual review should continue to assess minimum wage levels against the government's agreed objectives and criteria (and corresponding benchmarks) for the minimum wage (FIN (00) M29/1 and CAB (00) M33/1E refers).
 10. In assessing the appropriate level of the minimum wage, this report considers the current political context in which agreements have been made around reaching an aspirational goal for the minimum wage, the current and projected economic and labour market conditions, the government's objectives for the minimum wage, the costs and benefits to employers and employees of an increase in the minimum wage, and the views of submitters.
 11. You received 9 submissions on the 2005 review (and 3 additional submissions in response to your invitation that submitters comment on their preferred progression towards achieving the government's aspirational goal). Submitters' views vary and are summarised in Appendix F, and are also referred to in various parts of the main body of the report.
 12. The review has considered a range of options for changes to minimum wages, from 'no change' (recommended by Business New Zealand, Federated Farmers, the Hospitality Association and the Small Business Advisory Group) through to an immediate increase to \$12 an hour (New Zealand Council of Trade Unions). The review has also considered three paths towards achieving the aspirational goal of \$12 an hour for adults by the end of 2008, if economic conditions permit (these paths are described in more detail in paragraphs 48 to 50, and involve increases following this review of between 63 cents and 75 cents).
 13. Based on assessing the factors outlined in paragraph 10 above, the Department considers that there is little difference at the macroeconomic level between the selected pathways identified to reach \$12 an hour by the end of 2008, although there may be some limited constraints on economic (job) growth and some inflationary pressures.
 14. There are different costs and benefits, however, at the sectoral and firm level for employers and employees associated with the different options and deciding on a preferred option at this time will involve a trade-offs between these costs and benefits. These trade-offs are primarily between the income and social benefits accruing to minimum wage earners by a large increase in hourly earnings early on in the timeframe (a 'frontloaded' increase) - which would see a higher weighting given to the government's objectives and criteria for the minimum wage - versus the reduced cost impacts for sectors and firms that would occur if a large increase was postponed until later in the timeframe (a 'backloaded' increase). An even ('smooth') progression would theoretically spread the different costs and benefits, but hourly rates needed to achieve a smooth progression would not make wage calculations easy, and so could exacerbate non-compliance with minimum wage rates. A progression that gave a larger increase at the front and the back of the series could also be seen to balance the various costs and benefits. Based on the Department's

view of current economic and labour market conditions (summarized in paragraphs 28 - 34), the Department considers that:

- a 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. There would, however, be no constraint on job growth or other impacts on employers and employees. No tangible movement would be made towards the aspirational goal
- b 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 could be made with confidence in the current economic and labour market conditions
- c 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. 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. The Department considers that the current economic and labour market conditions are likely to be able to accommodate an increase up to \$10.50 an hour (a \$1.00 increase) in 2006: an increase over \$10.50 an hour could 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.
- d that the 80% relativity between the adult minimum wage and the youth minimum wage and the training minimum wage should be retained and that the youth minimum wage should continue to apply for 16 and 17 year olds at this time.

15. Increases in minimum wages would particularly benefit women, younger workers, Maori and Pacific peoples, new migrants, people with disabilities, the low-skilled, and people with non-English speaking backgrounds who are over-represented among minimum wage earners.¹ Changes in the minimum wage also affect employees in the agriculture, retail and related trades, and accommodation and catering sectors, and small/medium enterprises due to the higher proportion of low wage employees in these sectors and SMEs. Correspondingly, employers in these sectors and SMEs are more likely to need to respond to increases in minimum wages. Currently the Department has a limited and theoretical understanding of how businesses actually respond to increases in minimum wages. Over the next year the Department intends to develop a programme of work (evaluation strategy) to better evaluate the impacts of minimum wage changes and businesses responses to these changes. The Department would also like to discuss further with you whether further work around relativities between the adult, youth and training rates and on reported non-compliance with minimum wage rates should be a priority in our research and evaluation programme in 2006.

¹ Detail on the impact of minimum wage changes on subgroups is contained in Appendix E.

SECTION A BACKGROUND AND CONTEXT

16. 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".
17. Minimum wages are set through an Order in Council made under Section 4 of the Minimum Wage Act 1983 (the Act). The minimum wage provides a floor for wages paid to employees, and it is an offence to pay wages below the prescribed hourly rate.
18. Where a minimum wage is set, the Minister of Labour has a statutory obligation under Section 5 of the Act to review the level of the minimum wage by 31 December each year (your consideration of this report fulfils this obligation). Following this review, the Minister has the discretion to make recommendations to the Governor General regarding any adjustments to be made to the minimum wage.
19. The process for reviewing the minimum wage involves the following steps:
- a ILO Convention 26 requires that consultation with employers and employees ("in equal numbers and on equal terms") occurs to inform the determination of minimum wage rates (as part of wage-fixing machinery)
 - b the Minister invites submissions from a range of identified parties²
 - c officials present options for reviewing the minimum wage to the Minister (this report)
 - d the Minister decides what recommendation(s) will be submitted to Cabinet for consideration
 - e regulations must be passed if the minimum wage is to change. These new regulations typically come into effect before 1 April.
20. The review process complies with ILO Convention 26 regarding minimum wage fixing machinery.
21. Since 2000 there have been a number of changes in the structure of minimum wages:
- a the age of eligibility for the adult minimum wage was lowered from 20 years to 18 years in 2001. This change provided consistency with the age for general eligibility to benefits and the UNCROC age for children, as well as providing a fairer wage to young people

² Submissions were received from Business New Zealand, the New Zealand Council of Trade Unions (NZCTU), the Youth Union Movement, National Association of Retail Grocers and Supermarkets of New Zealand (NARGON), Retailers Association, Federated Farmers, the Small Business Advisory Group, the Mayors Taskforce for Jobs, the National Advisory Council on the Employment of Women, and the Hospitality Association of New Zealand. NACEW, Federated Farmers and the NZCTU made additional submissions on the government's aspirational goal of \$12 an hour. See Appendix F for a summary of submissions.

- b the youth (16 and 17 year olds) minimum wage increased from 60% to 80% of the adult minimum wage, in two steps in 2001 and 2002, to provide a fairer wage for young people
- c a training minimum wage was introduced in June 2003 to replace an exemption from the minimum wage for employees enrolled in training. The training minimum wage was set at the youth minimum wage for 16 and 17 year olds, as their lower rate implicitly reflects extra training that the group usually requires.

22. Since 2002, the adult minimum wage rate has increased by \$0.50 a year, a rate which has slightly outpaced annual increases in the average wage. Changes in minimum wage rates are set out in a table in Appendix A.

Assessing options for changes to minimum wage rates

23. In assessing the appropriate level of the minimum wage, this report considers the current political context in which agreements have been made around reaching an aspirational goal for the minimum wage, the current and projected economic and labour market conditions, the government's objectives for the minimum wage (set out below, the costs and benefits to employers and employees of an increase in the minimum wage, and the views of submitters.

Political context - the government's aspirational goal

24. The 2005 pre-election Labour Party manifesto contained a commitment to continue to make annual adjustments to the minimum wage. Additionally, in the Labour-led government's Confidence and Supply Agreement with NZ First and the Co-operation Agreement with the Green Party, the government has committed to continue the practice of annually increasing the minimum wage, with a view to it being set at \$12.00 per hour by the end of 2008, if economic conditions permit.
25. In her address to the New Zealand Council of Trade Unions (NZCTU) on 18 October, the Prime Minister indicated that "*the aspiration over the next four adjustments is to see it move close to \$12 an hour for the adult rate*".
26. Section B identifies three possible paths for reaching the aspirational goal and for the first step in 2006. Section C assesses these options.
27. Paragraphs 30 - 33 below outline how the Department proposes to assess prevailing economic conditions for the purposes of future reviews.

Economic context - the labour market outlook to 2009

28. The current review of the minimum wage takes place against a background of a strong labour market. In the September 2005 quarter, the unemployment rate was the lowest in the OECD at 3.4%. The labour force participation rate rose to a record high of 68.2%, and labour shortage indicators fell but remained very high. This labour market performance has been supported by robust economic growth of 3.1% in the year to June 2005.
29. The past year's economic growth of 3.1% is, however, the lowest rate since 2001 and it is likely to slow further. In the Pre-Election Economic and Fiscal Update 2005, Treasury forecast a fall in economic growth to 2.2% in the year to March 2006,

followed by 2.6% growth the next year. A further lift to 3.5% and 3.1% is then forecast for the years to March 2008 and March 2009 respectively.

30. Based on consensus economic forecasting, the Department of Labour expects labour market conditions to ease slightly over the next two years. Four main factors underpin the Department's labour market outlook:

- a an easing of employment growth and skill shortages due to the recent and expected slowing of growth in the New Zealand economy
- b a small rise in the unemployment rate to around 4.0% in the March 2007 quarter
- c a continued high rate of participation and a stabilisation of net migration inflows
- d a gradual rise in labour productivity growth due to factors such as strong growth in business investment.

31. There are also risks to the labour market outlook. Major risk factors surround inflation, business confidence, oil prices, interest rates, the exchange rate, and the housing market. An additional risk factor is net migration (inflows of 6,000-8,000 people per annum are currently expected in the short-term), where a swing into outflows would affect the labour market directly.³

32. Currently the Department's assessment of economic conditions is based on an aggregate assessment of consensus opinion around prevailing and forecast economic and labour market conditions. The information contained in this aggregate assessment could be disaggregated to provide a richer understanding of prevailing economic conditions, and increase transparency around decision-making. The Department is currently exploring work around different indicators that would be appropriate to use in this case (known as 'leading indicators of employment') as a separate exercise, and intends to feed this work into future reviews to increase transparency around the assessment of prevailing economic conditions. To illustrate what leading indicators might include, indicators already identified by the Treasury as leading indicators of employment are:

- a aggregate economic activity
- b consumption demand
- c investment demand
- d trade indicators
- e financial and monetary indicators
- f consumer and business confidence indicators
- g labour market indicators, and
- h foreign indicators.

33. The Department's work will confirm the use of these, or other, indicators in future reviews.

³ DoL report "Labour Market Outlook – October 2005" refers, www.dol.govt.nz/publications/lmr/index.asp

34. While the interpretation of economic conditions is an art as well as a science and macroeconomic indicators cannot be used in a mechanistic way, significant changes in some or all of these (or other) indicators may suggest that the intended progression towards \$12 an hour should be modified (up or down).

Objectives and criteria for the minimum wage

35. Changes to the minimum wages are part of a wider mix of approaches to support higher quality working lives and productive workplaces. These approaches include work underway on workplace productivity, work life balance, the Working for Families package, initiatives around skill and labour shortage, work to promote pay and employment equity, and work to enhance parents' choices.

36. 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:

1. **Objective 1: Fairness – to ensure that wages paid are no lower than a socially acceptable minimum.** There are two main views on what constitutes a socially acceptable minimum. One option is to determine social acceptability as a proportion of how much other workers earn (e.g. average wages). A target of 2/3 of average wages is the long term target recommended by the NZCTU. Another option is to view social acceptability through determining the amount needed to maintain a set standard of living, adjusted for inflation. **Benchmarks:** average wages, CPI.
2. **Objective 2: Protection – to offer wage protection to vulnerable workers** so that workers are paid wages that reflect their worth or productivity. Workers may be "underpaid" on this measure when they have a relative lack of bargaining power, such as when they have limited bargaining strength (e.g. are not collectivised and unable to strike for higher wages), or face risks in leaving and finding another job (e.g. poor English, disability), or have poor income or employment alternatives (e.g. they do not qualify for unemployment benefits). **Benchmarks:** minimum wages paid under collective agreements.
3. **Objective 3: Income Distribution – to ensure that earnings of people on low incomes do not deteriorate relative to those of other workers.** This is likely to reflect a preference that society has for the degree of wage (and income) equality, and this may promote greater social cohesion. The effectiveness of minimum wages to achieve this objective depends on whether employment effects occur, since the income of workers is significantly lowered where they may lose their jobs or have their work hours cut. **Benchmarks:** changes in average and median wages.
4. **Objective 4: Work Incentives – to increase the incentives to work for people considering work.** Creating the correct incentives requires the minimum wage to be set at a level that makes work attractive compared to not working. This may be relevant if skill shortages exist for certain low pay occupations (see Appendix C for an initial investigation) The minimum wage needs

to be above benefit levels (and associated employment costs such as childcare and transport costs that are payable by a worker). At some point, however, a higher minimum wage can “frustrate” work incentives through economic effects that restrict job opportunities available to low skilled workers. **Benchmarks:** benefit levels and costs associated with working.

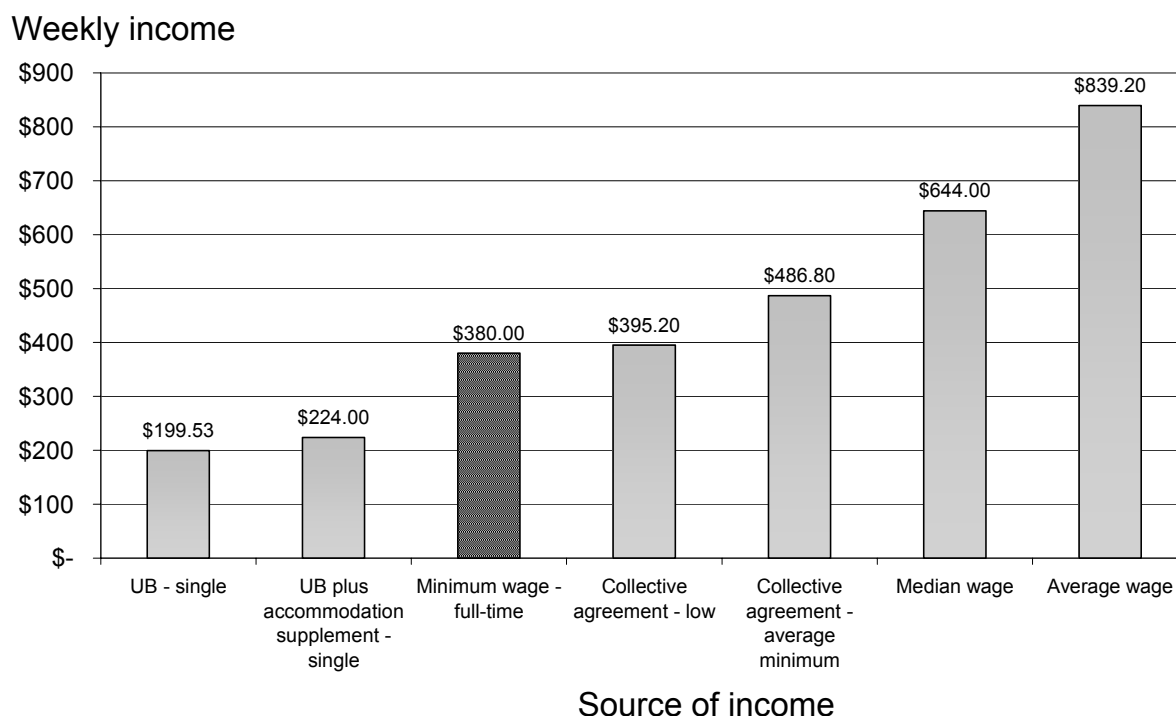
37. The agreed criteria for assessing changes to the minimum wage are:

- 1 do changes in the minimum wage produce gains that are more significant than any losses?
- 2 is the minimum wage the least cost way of implementing the objectives of the policy?
- 3 does the level of the minimum wage form part of the most appropriate mix of measures to meet the broader objectives of the government?

Benchmarks arising from the objectives

38. The following chart compares the current minimum wage, for a 40 hour week, to several other income benchmarks. It shows that the current minimum wage is 90.4% higher than the unemployment benefit (for a single adult with no supplementary assistance such as Accommodation Supplement, if the Accommodation Supplement is added; a single adult could receive an additional \$24 dollars a week on top of their main benefit). The current minimum wage is approximately 45.3% of average hourly earnings (using the Quarterly Employment Survey) and 59.0% of median hourly earnings (according to the HLFIS Income Supplement).

Figure 1: Comparison of current minimum wage with other weekly income benchmarks



International benchmarks

39. The most recent report of the UK Low Pay Commission (February 2005) suggests that the New Zealand minimum wage is slightly above average compared with other countries (as at June last year). Looking at the adult minimum wage relative to full-time median earnings, our minimum wage was 53.6% of the median wage.⁴ The Australian ratio is between 55.1%-58.8% (depending on what survey is used), the UK ratio was 43.2% and the US ratio was 32.2%. Out of the 13 countries surveyed, only France had a higher ratio at 56.6%. When comparing what a single unit of currency will buy across different countries ('purchasing power parity', or PPP ratings), however, a slightly different story is told. Australia has the highest rate at 5.37 PPP, the UK is next at 4.85, followed by NZ at 4.01, and the US is the lowest at 3.37 PPPs.

SECTION B OPTIONS FOR MINIMUM WAGE CHANGES TO ACHIEVE \$12 AN HOUR FOR ADULTS BY THE END OF 2008 AND OPTIONS FOR THE FIRST STEP IN 2006

Benefits of signalling future intended increases

40. There are many possible 'routes' for achieving the government's aspirational goal of \$12 an hour. The Department considers that there are benefits to be gained in identifying (and communicating publicly) an intended progression towards this goal at

⁴ "National Minimum Wage, Low Pay Commission Report 2005", p.237.

the outset. Such communication would, however, need to emphasize the provisional nature of the pathway, so that ministers retain the flexibility to modify the progression in response to economic circumstances. Communicating an intended path would enable affected sectors and firms to plan ahead for the adjustments they will need to make. For the same reasons, several submitters stated a preference to know from 2006 onwards how many steps there will be and what they will look like.

41. An intended pathway could be publicised at the same time as announcements are made on an adjustment for 2006, if you agree.
42. Possible pathways to achieve \$12 an hour are identified below.

Impacts on future reviews of signalling an aspirational goal

43. Setting an aspirational goal and signalling intended increases to achieve it are consistent with the statutory requirement to review the minimum wage each year and with ILO convention 26. The annual reviews would therefore be focused on whether prevailing and forecasted economic conditions mean it remains appropriate to make adjustments according to the signalled increases, or whether changes to those increases are appropriate.
44. In addition to these considerations around economic sustainability and consultation, the review process would continue to assess minimum wage levels against government's agreed objectives and criteria for the minimum wage (and corresponding benchmarks).

Possible steps to reach \$12 an hour by the end of 2008

45. Achieving \$12 an hour for adults would represent an increase of 26.3% from the current minimum wage rate for the adult, and youth and trainee rates if current relativities between the rates are maintained. As a point of comparison, the percentage increase over the past four years (2001-2005) was 23.7%.
46. The tables below identify three different routes to achieve \$12 an hour across four adjustment periods (economic conditions permitting in each case). The progressions vary according to the different incremental increases suggested across the timeframe. If shown in graph form, the resulting curves would respectively appear 'smooth', 'frontloaded' or 'double spiked', and are labelled accordingly.
47. The tables indicate four steps to reach \$12 an hour. Minimum wage changes are agreed by Cabinet in December and generally implemented in the following March, so the first step would take effect in March 2006. The rates shown assume the 80% relativity between the adult, youth and training minimum wages is retained.

"Smooth"

48. The progression set out in table 1 is as even as possible over four adjustment periods. If economic conditions remain fairly stable over four years, this progression would spread the impacts of the change evenly over the period.

Table 1: Smooth progression towards \$12 an hour by end 2008

Step	Adult minimum wage rate	Dollar Increase	40 hour week	Youth/trainee minimum wage rate
1	\$10.13	\$0.63	\$405.20	\$8.10*
2	\$10.75	\$0.62	\$430	\$8.60
3	\$11.38	\$0.63	\$455.20	\$9.10*
4	\$12	\$0.62	\$480	\$9.60

*numbers are rounded to nearest cent.

“Frontloaded”

49. Table 2 sets out two \$0.75 increases followed by two, \$0.50 increases. This ‘frontloading’ would send a strong signal about the government’s intention to achieving the aspirational goal by 2008.

Table 2: frontloaded progression

Step	Adult minimum wage rate	Dollar Increase	40 hour week	Youth/trainee minimum wage rate
1	\$10.25	\$0.75	\$410	\$8.20
2	\$11.00	\$0.75	\$440	\$8.80
3	\$11.50	\$0.50	\$460	\$9.20
4	\$12	\$0.50	\$480	\$9.60

“Double spiked”

50. Table 3 shows a \$0.75 increase in the first year and final years; with \$0.50 increases in the two middle years, if economic conditions permit.

Table 3: double spike progression

Step	Adult minimum wage rate	Dollar Increase	40 hour week	Youth/trainee minimum wage rate
1	\$10.25	\$0.75	\$410	\$8.20
2	\$10.75	\$0.50	\$430	\$8.60
3	\$11.25	\$0.50	\$450	\$9.00
4	\$12	\$0.75	\$480	\$9.60

Identification of options for the first step in 2006

51. Analysis of submissions on the review (see Appendix F), benchmarks arising from the government's agreed objectives for the minimum wage and incorporating possible first steps towards the government's aspirational goal based on the pathways outlined above suggests a range of options for the minimum wage for implementation in 2006.

52. **Option 1: retain the existing minimum wage (\$9.50 per hour or \$380 per week).** Leaving minimum wages at this level would see those wages erode in real value, and decrease relative to benefit payments (which are indexed to the CPI). This option is recommended by Business New Zealand, the Hospitality Association of New Zealand, the National Association of Retail Grocers and Supermarkets of New Zealand, the Small Business Advisory Group and Federated Farmers.

53. Option 2: maintaining relativity with average wages and recent trends

- a **Option 2A: Increase to \$9.83 or \$393.20 per week which reflects the movement in average wages.** This represents an increase of 33 cents an hour or an increase of 3.5% which equates to the movement in average hourly earnings as measured by the Quarterly Employment Survey, or QES. This option is considered 'fair' by the Retailers Association of New Zealand. This is also close to the lowest minimum pay rate in collective agreements (\$9.88).
- b **Option 2B: Increase to \$10.00 per hour (or \$400 per week) in line with trend set since 2000.** This is a 5.3% or 50 cents increase on the current rate, which is consistent with recent adjustments. This increase would also continue the accelerated rate of change (relative to the average wage) that has occurred since 2003 (i.e. minimum wage increases are outpacing average wage increases at a fairly constant pace⁵, e.g. a 1.8% increase compared with 1.2% last year).

54. **Option 3: increase above the rate needed to maintain relativity with average wages and recent trends,** in order to achieve the government's aspirational goal of \$12 an hour for adults by the end of 2008

- c **Option 3A: Increase to \$10.13 an hour (\$405 a week) as a step towards \$12 an hour.** This represents an increase a 63 cents per hour or a 6.6% increase on the current rate. This increase represents the first step in the "smooth" progression towards reach \$12 an hour.
- d **Option 3B: Increase to \$10.25 an hour (\$410 a week) as a step towards \$12 an hour.** This represents an increase of 75 cents per hour or a 7.9% increase on the current rate. This increase represents the first step in the "frontloaded" progression towards reaching \$12 an hour, with \$0.75 being the biggest increase in this progression.
- e **Option 3C: Increase to \$10.50 per hour or \$420 per week.** This represents an increase of \$1.00 per hour, which would be a 10.5% increase on the current rate.

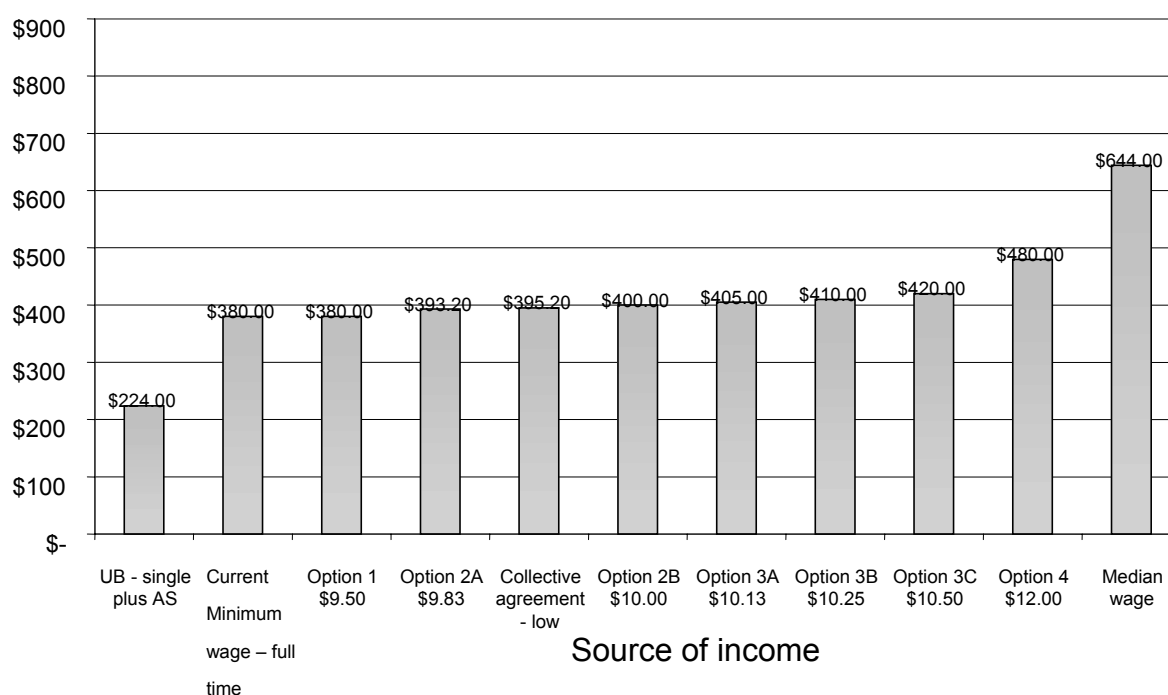
⁵ In 2004 the minimum wage increase outpaced the average wage increase by 1.08%. This present option would mean the minimum wage is outpacing the average wage by 1.2%.

55. Option 4: increase above the rate needed to maintain relativity with average wages and recent trends. Increase to \$12.00 per hour or \$480 per week. This represents an increase of \$2.50 per hour which would be a 26.3% increase on the current rate. This option is recommended by the New Zealand Council of Trade Unions (NZCTU).

56. The figure below shows how the various options given above compared with median wage, the unemployment benefit and the lowest wage in collective agreements (as at June 2005). These are among the key indicators we use to compare changes in the minimum wage.

Figure 2: Options compared with some key indicators

Weekly income



57. The table below indicates where the options for the first step are located in relation to the benchmarks. As points of comparison, the table also shows other benchmarks against which minimum wage changes can be measured, and the objectives associated with these benchmarks.

Table 4: options for first step assessed against benchmarks

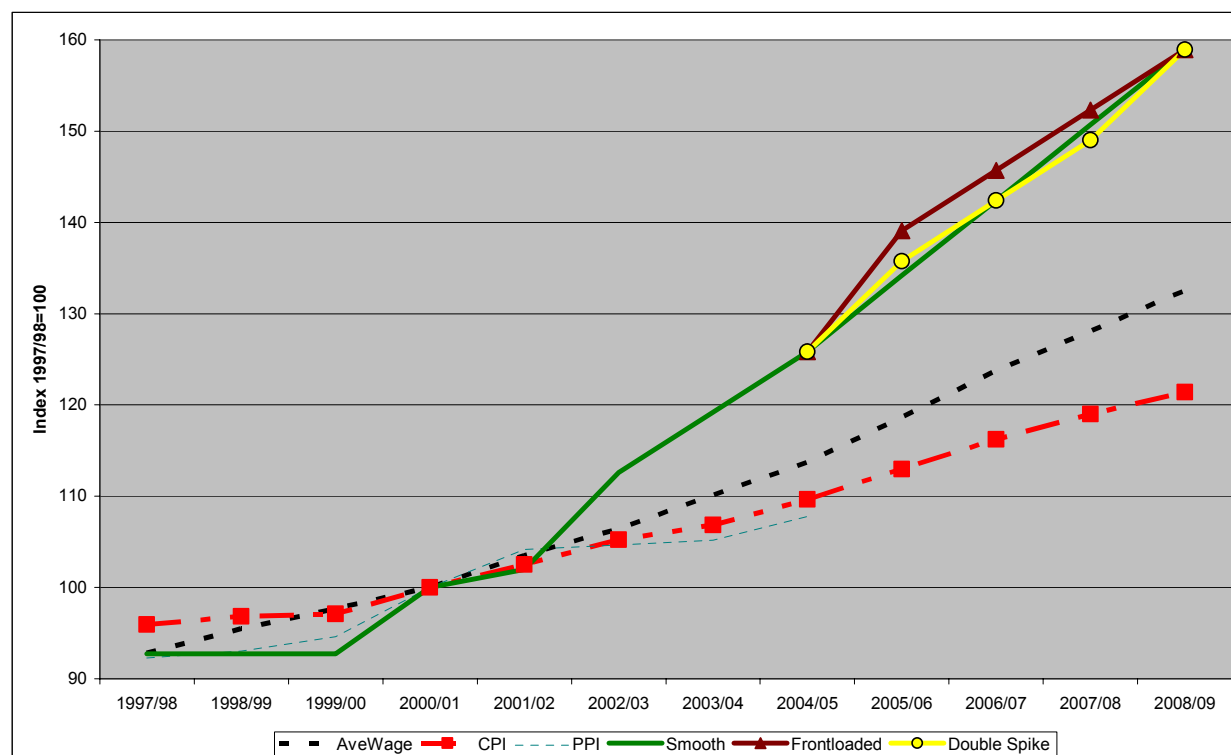
Option	Objective(s) prioritised through option	Per hour	40 hour week
1 - current minimum wage Recommended by Business NZ, Federated Farmers and Hospitality Association, SBAG first preference	Erodes existing levels of fairness, protection, income distribution and work incentives	\$9.50	\$380
2A – current minimum wage increased by average wage growth of 3.5%. SBAG third preference, considered 'fair' by Retailers Association	Maintains existing levels of fairness, protection, income distribution and work incentives	\$9.83	\$393
2B – maintain trend of fifty cents an hour increases	Protection	\$10.00	\$400
3A – first step in a "smooth" progression		\$9.63	\$405
3B – first step in a 'frontloaded' or 'double spiked' progressions	Protection, income distribution, work incentives	\$10.25	\$410
3C – a one dollar increase on current rate	Protection, income distribution, work incentives	\$10.50	\$420
4 – CTU recommendation	Fairness, protection, income distribution, work incentives (reflecting CTU's submission)	\$12.00	\$480
Benchmarks			
Unemployment Benefit – single person aged under 20	Work incentives		\$165
Unemployment Benefit – single person aged 25 years and over	Work incentives		\$200
Unemployment Benefit and Accommodation Supplement – single person aged 25 years +	Work incentives		\$224
Collective Agreements – lowest minimum wage	Protection	\$9.88	\$305
50% of average wage	Fairness	\$10.49	\$420
2/3 rd median wage	Fairness	\$10.73	\$430
Collective Agreements– average minimum wage	Protection	\$12.17*	\$487
66% of average wage – CTU recommendation	Fairness	\$13.85	\$554

Forecasted growth and the options to achieve \$12 an hour

58. The growth rate trajectories of the various minimum wage options to reach \$12 an hour are compared in the figure below. This figure illustrates how the options compare with each other and with the growth rates of the (private sector) average wage in the economy, the Producers Price Index (PPI) (output prices) and the Consumers Price Index (CPI).⁶ This figure shows that all selected pathways grow faster than the rate of growth of the average wage, CPI inflation, and the PPI, and that the rate of outpacing varies somewhat between them by year, but that the differences are essentially marginal.
59. The figure shows that since 2002, the rate of growth of the minimum wage has started to outpace the PPI, CPI and the average wage in the private sector. In the recent past, minimum wage rates have been either catching up with (i.e., in 2003) and/or kept up with average wage rate levels. Since 2003 minimum wage rates have outpaced the growth in average wage rates.
60. Given the aspirational goal of a \$12.00 minimum wage by the end of 2008, and expected growth rates of average wages, the minimum wage would continue to increase in relativity to average wages. The increase of the minimum wage in proportion to the average wage will increase the real value of the minimum wage, will raise the level of protection, improve income distribution levels and increase the incentives to work. The Department considers such an increase would have negligible risks of constraining job growth.

⁶ Actual data is used up to 2004/05, and NZIER forecasts are used to 2008/09 (for the years ending March). Data are derived and presented in index format (Base 2000=100) (in Figure 1) as well as in terms of annual % change (in Figure 2) for the years ending March.

Figure 3: Average Wage, PPI, CPI and various minimum wage options (2000=100)



Source: NZIER (Ave Wage in Private Sect, PPI, CPI), DoL (Minimum Wage Options)

SECTION C ASSESSMENT OF THE MINIMUM WAGE OPTIONS TO REACH \$12 AN HOUR AND OPTIONS FOR 2006

61. The assessment below attempts to identify and weigh different costs and benefits associated with each of the different pathways identified for delivering on the aspiration to reach \$12 an hour. At the macroeconomic level there is little difference between these options to achieve \$12 an hour. There may be some limited constraint on economic (job) growth and some inflationary pressures resulting from the increases. There are different costs and benefits, however, at the sector and firm level for employers and for employees that are associated with the options, and, in deciding on a preferred option at this time will essentially involve a trade-off between these different costs and benefits. Depending on the rate of change, there may also be some trade-offs between the government's social objectives (for example, if hours of work are reduced for minimum wage earners in firms unable to adjust quickly to increases). Given that the Department's analysis of prevailing economic and labour market conditions indicates that an increase to \$12 an hour by the end of 2008 appears sustainable, determining the most appropriate steps to achieve that goal will involve a political decision around the trade-offs between larger increments occurring earlier in the timeframe ('frontloading') or later ('backloading' the increase).

62. More income and social benefits will accrue to minimum wage and low paid workers from the frontloaded option, and this option also will also send a clear signal about the government's intention to reach the aspirational goal. If economic conditions

soften in the latter half of the timeframe, then relatively smaller increases in later years are more likely to be sustainable and less likely to represent a constraint on future economic growth.

63. Leaving a large increase until later, or last in the series of steps to \$12 may mean that less people are impacted by that change than if the large increase is introduced early on (this assumes people earning just over the minimum wage rates will move up the wage distribution scale as nominal base line wage changes occur during the period).
64. A larger increase early on will directly affect more people, and they would benefit for a longer period (from 2006 rather than, say, 2009). The need to manage costs increases will, however, be reduced for sectors and firms when larger increases occur later in the cycle, or are backloaded. This is because backloading the larger increases, as in the "double spiked" option, will reduce the overall real and proportional costs for employers. It will also give them more time to plan for the adjustments they might make, for example, by investing in skill development or other ways to increase productivity.
65. The "smooth" option would spread the different costs and benefits evenly over the timeframe. The "double spiked" option, which involves frontloading and backloading increases, could also be considered to balance the trade-offs with a strong signal of the intention to reach the aspirational goal of \$12 an hour, as well as providing an opportunity for employers to manage and respond to minimum wage increases.
66. As a secondary consideration (but a practical one), anecdotally employers prefer to pay wages in 'rounded up' amounts as this simplifies pay calculations and reduces compliance costs. Round number minimum wages are also advantageous for employees as it is easier to recall wages in round numbers, and this may aid compliance from both employee and employer perspectives. (Of course, employers can choose to round wages up to a rate above the minimum wage if they perceive the benefits arising from ease of wage calculation outweighs the cost of the additional wage bill). In this sense, the "smooth" option may impose higher compliance costs on employers, although a small amount of rounding of this progression would resolve this problem to some extent.
67. For the first step in 2006, an increase beyond that needed to retain relativity with average wages (e.g. beyond \$9.83) will increase the real value of the minimum wage, will raise the level of protection, improve income distribution levels and increase the incentives to work. The Department considers such an increase would have negligible risks of constraining job growth. The Department considers that an increase of up to one dollar in the hourly minimum wage rate can be made in the current economic and labour market conditions.
68. Arguably, a progression that implements an adjustment in the first year (2006) that is larger than the fifty cent an hour increase that has been the trend in recent years will send a clear signal about the intention to reach the aspirational goal. This reasoning would support an increase to beyond \$10.00 an hour i.e. an adjustment to \$10.13, \$10.25 or \$10.50 an hour in 2006 for adults. The Department considers that

such an adjustment could be made with confidence in the current economic and labour market environment, but that an adjustment beyond \$10.50 would create more risks of slowing job growth and increasing inflationary pressures, particularly if there is an economic downturn, or if economic conditions soften.

69. The numbers of people who would receive an hourly pay rise (number of people aged 18 and over 'directly affected' by the various options) jumps significantly after increases of more than 50 cents an hour. This is because comparatively large numbers of people earn exactly \$10 an hour, and these people wouldn't be directly affected by an increase to \$10 an hour but would be directly affected by an increase over \$10.
70. A fifty cent an hour increase will directly affect **28, 400** workers (or 1.8% of all 18+ employees), a seventy-five cent an hour increase will directly affect **91, 000** workers (5.9%), and a \$1.00 increase will directly affect **103,500** (6.7%), as at June 2005. If relativities between adult and youth rates remain the same, the corresponding numbers for youth are 3,500 (6.3% of 16-17 year employees), 10,000 (16.9%) and 11,000 (18.7%). If people who currently report non-compliance with the minimum wage rate (55,000 or 3.4% of adults) and people who are close to the wage bands also receive an increase in their hourly rate as a result of an increase in the wage band, more people will be affected by the increases (these numbers are difficult to quantify, however, because of uncertainties about the impacts on these groups). (Appendix E refers).
71. Departmental working papers which have informed the analysis summarised above are available to you at your request.

SECTION D POTENTIAL IMPACTS OF INCREASING THE MINIMUM WAGE

Who benefits?

72. The benefits of minimum wage increases are likely to be felt most strongly among women, younger workers, Maori, Pacific peoples, disabled people, recent migrants, the low skilled and people with non-English speaking backgrounds⁷, who are over-represented in earners on low wages. For example, 68% of workers paid between \$9.50 and \$10.50 per hour are female (c.f. 47% of all wage and salary earners are female), 12% are Maori (c.f. 10%), 7% are Pacific (c.f. 5%) and 39% are 18 to 24 years old (c.f. 15%).⁸ These groups would, however, also be the first 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 other).
73. Of this group, many work part-time (approximately 50% of low wage employees work part time (less than 30 hours per week) compared to 20% of higher paid workers).

⁷ See Appendix E for a breakdown of the subgroups affected by the options.

⁸ This is based on hours worked by those earning between \$9.50 and \$10.50.

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.

74. Many of the group who are likely to benefit from minimum wage increases live in low income working households. For example, the Department estimates that approximately 75% of low wage earners (between \$9.50 and \$10.50 per hour) live in households below the median gross equivalised household income for working households of \$660 per week.⁹
75. 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 retail workers (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 (32% work less than 10 hours per week, 33% work between 10 and 20 hours and 20% are working a fulltime 40-50 hour per week job).
76. As the youth minimum wage increases, the Department considers that it will be important to monitor the potential substitution of workers aged 16-17 with workers aged 15 (and continue monitoring and investigating levels of reported non-compliance).

More detail on impacts for women and the gender pay equity.

77. For some groups of women, an increase in the minimum wage is the only direct lever government has to ensure an adequate earned income – they may be in fairly non-unionised areas and/or have limited bargaining power, or may be in jobs in which pay equity strategies have little effect. The objectives sought through the minimum wage of improving levels of fairness and protection are particularly relevant for these groups of more vulnerable women.
78. Analysis of the June 2005 HLFS IS suggest that:
- a raising the minimum wage can make a small contribution towards reducing the gender pay gap (see below)
 - b more women than men report non-compliance with minimum wage rates (2.025 cf 1.33%)
 - c most working women are in jobs that pay over \$10.50 an hour, but women are more than twice as likely as men to be in low paid jobs (under \$10.50 an hour)

⁹ These categories are based on equivalised income and account for differences in numbers of adults and children in a household (e.g. a couple without children is effectively “richer” than a couple with children on the same level of income). A single individual has the base reference value of 1, and larger household groupings involve discounting actual gross income e.g. the adjustment value for a 2 adult 2 child family is 2.163. The median gross equivalised household income was calculated using the 2005 New Zealand Income Survey and includes income information for individuals aged 15 years and over.

- d women are employed in low paid jobs across all sectors rather than being concentrated in low paid sectors (except for young women) – although there is some ‘clumping’ in particular sectors)
- e most women are in full time employment (30 hours and more a week), but women are more likely than men to work part time (less than 30 hours a week), and are more likely than men to work part time for low wages
- f Maori and Pacific women, and women of ‘other’ ethnicities are over-represented amongst part time low waged women.

79. Increasing the minimum wage can make a small contribution to reducing the gender pay gap. This is because more women than men will have their wages increased as a result of an increase in the minimum wage (74% of minimum wage earners recorded in the June 2005 HLFS IS are women). For example, the Department estimates 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%.¹⁰

80. The Department considers that other policies that assist women into higher paid jobs in all sectors (e.g. childcare assistance, work life balance, policies to improve opportunities to acquire skills or to up-skill, or to train) will be more effective overall in reducing the gender pay gap than raising the minimum wage. This does not detract, however, from the impact that increases in the minimum wage may have for improving the incomes of the vulnerable groups of women.

The impacts of minimum wage increases on sectors and firms

Sectors

81. Some sectors will be impacted on more than others because they employ relatively large numbers of minimum wage workers and/or their wage bands are lower and relatively narrow. In these terms, the sectors most likely to be affected are agriculture and related services, retail, accommodation & catering, community services and textile and clothing. These sectors can expect higher than average increases in their wage bill when minimum wage increases are implemented.

82. While we cannot be sure how minimum wage increases in recent years have affected low pay sectors, we do know that that in general, these sectors are growing at the same average rate as other sectors in the economy (with the exception of business services which is growing at much higher rates as it includes high growth pockets, and the textile & manufacturing sector which is growing at much lower rate and is in a long term structural decline). Experiences overseas suggest that the effects of adjustment to minimum wages may vary across these sectors, ranging from reduced hours during off-peak times to substitution towards qualified staff, increased labour

¹⁰ The NZ Income Survey for the June 2005 quarter (Statistics New Zealand), shows that pay for full time men went up approximately 6.3% since the June 2004 quarter, compared with 3.2% for women. The rates for male part time workers increased by 8%, as compared to 2.8% for women. Overall, this means that the gender pay gap has increased – with women earning 82% on average of what men do, as compared to 85% in 2004. This increased gap is largely explained by increased hourly earnings in male-dominated occupations, for example, agricultural and fisheries workers, trades workers, and plant and machine operators and assemblers.

productivity and increased output prices. (The Department is proposing to research the range of responses made to minimum wage increases by New Zealand employers as part of an evaluation strategy, see below).

83. Overall, for small and medium sized enterprises (SMEs, which employ less than 19 people) employment growth is faster than for large firms. SMEs have recorded lower employment growth than for large firms in some low pay sectors, however, including in the food processing sector and the food and other retailing sector. The Department notes that SMEs in some low pay sectors are more vulnerable to minimum wage increases than large firms.
84. There are also 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 if Ministers wish to make large movements towards the minimum wage goal of \$12 per hour early in the 4 year period. At this stage officials have not prepared estimates of potential fiscal costs associated with the different options proposed.

Firms

85. Assessing the impacts of increases to the minimum wage on firms involves trying to isolate the nature of the employment impacts due to minimum wages from other employment changes occurring in the economy. It is difficult to do this with the level of certainty that would be preferable in a review of this type. Submitters' views on the impacts of increases to the minimum wage on firm behaviour vary according to whether they represent employer or employee perspectives, but they are nevertheless firmly held by the different groups.
86. Firms may invest in the skill development of low paid workers (and other ways of increasing firm productivity) to offset additional wage costs in anticipation of an increase in minimum wages to \$12 an hour.
87. The following section sets out themes common to submissions on the review made by employer groups.

Impacts on employers

88. Business submitters comment that raising minimum wages increases wage costs to employers. These costs may be passed onto consumers of goods and services that low wage workers produce, with resulting inflationary pressures. Alternatively they may result in negative impacts on employment levels (see below) and/or reduced production and/or reduced profits for businesses.
89. Business submitters also comment that there may be indirect impacts on workers paid above the minimum wage ('flow-on' effects) as these workers bargain to retain their wage relativity with minimum wage workers. It is likely that flow-on effects

would particularly affect small firms (as minimum wage changes are most likely to affect these firms and because of a generally narrow range of wages paid within small firms).

90. The Department notes that there is some evidence of flow-on effects, but that there is little evidence of the extent of these effects (Appendix C refers). Further research into wage profiles within firms and the flow on effects of minimum wages are required to accurately assess this effect. The Department is proposing to do some exploratory work in this area as part of its evaluation strategy (see below).
91. Submitters point out that these potential costs will be in addition to other employment related costs imposed by government in recent years, such as the Holidays Act requirement to pay time and a half on public holidays and implementation of four weeks' annual leave in 2007. The former cost is particularly likely to affect accommodation and retail sectors.

Impacts on employment and other firm responses to minimum wage increases

92. Business submitters argue that increases in the minimum wage (which make minimum wage workers more expensive) may also have effects on the levels of employment for minimum wage earners ("employment effects") such as reduced hours worked, firms dismissing workers (particularly young and/or unskilled workers), reduced hiring by a firm, potential new firms being dissuaded from entering business, or firms becoming unviable and going out of business.
93. There is no consistent or robust New Zealand evidence that such employment effects have been experienced over the last four years (which has seen a 23.7% increase in the minimum wage for adults during a period of strong economic growth). Quantitative evidence that exists for youth varies between weak positive effects and very small negative effects (Hyslop and Stillman, 2004, 2005). In its submission, however, SBAG has reported a perception amongst its members of reduced opportunities for young people in small/medium enterprises within that timeframe.
94. The OECD's view of the consensus on employment effects is "that statutory minimum wages at typical OECD levels do not have major negative effects on total employment, but a high minimum wage reduces the employment prospects of disadvantaged groups".¹¹ The latest report of the UK Low Pay Commission (February 2005) suggest that New Zealand's minimum wage (at June 2004) was slightly higher than average (but still within the 'typical' OECD range) when compared with the minimum wages of other OECD countries.

Assessing impacts on employment and job growth

95. All business submitters comment about a possible reduction in employment levels if minimum wages increase. How we think firms will respond to minimum wage changes depends on how we think firms make employment decisions. In most of its

¹¹ OECD Economic Survey: New Zealand, 2004, page 127.

analysis the Department has used a typical neo-classical model of firm decision-making, whereby firms operating in perfectly competitive markets adjust output and inputs, including labour, in response to relative prices, in order to evaluate these claims.

96. 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. With an increase in the minimum wage relative to the average wage, employers will have an increased incentive to invest in the productivity of workers.
97. The Department intends to work with firms in sectors most likely to be affected by changes in the minimum wage, and to develop case studies to investigate how firms respond in practice to minimum wage increases, as part of its evaluation strategy. This work would enable us to explore the anecdotal evidence (and our understanding of the theory) we have around such responses.
98. Important relative prices for considering minimum wage impacts are:
- a the relative price of labour to output¹², and
 - b the relative price of minimum wage labour (typically low skilled) to other labour.¹³
99. Minimum wages have a small effect on average wages because relatively few workers are directly affected (28,400 people would be directly affected by a %0.50 increase, while 103,500 would be affected by a \$1 increase). Accordingly minimum wage increases are likely to have a small impact on the relative price of labour to output in the total economy. This impact would be more intense, however, if significant 'flow-on' effects were experienced following a rise in the minimum wage.
100. An important consideration for the impact on the demand for low wage workers is how minimum wages change relative to average wages. If minimum wages keep pace with average wages then we would expect to see little change in the relative demand for low wage workers or low wage jobs. In recent times the minimum wage has been growing faster than the average wage, and is expected to grow faster still to reach \$12 an hour, and therefore the relative value of low wage workers and low wage jobs is changing (their 'price' is increasing relative to workers on average wages).
101. The frame of reference used by analysts is important for assessing potential employment impacts. In past reviews the Department has presented the change as occurring overnight (the difference in employment immediately before and after a change in the minimum wage). However, in practice, over a year the real value of the minimum wage declines relative to the average wage (which increases over the

¹² .This variable is important for determining how much labour is used by a firm to produce goods and services (relative to other inputs such as machinery). Indicators for this variable will often be based on average wages relative to producer output prices (often called real product wages).

¹³ This determines whether firms use low or higher skilled workers (skill mix) in their workforce (or how a new firm might choose to make its products or services). If the minimum wage accelerates relative to the average wage employers will tend to favour higher skilled workers who become relatively cheaper

year, while the minimum wage is fixed for the year). Theoretically there would be a reversal of the employment impact (minimum wage workers become cheaper and more attractive to employers). As long as the relative minimum wage remains constant from year to year, it can be argued that there will be no overall change in employment year on year relative to other labour that is paid above the minimum wage. If the reference point is taken as immediately before a change to minimum wages the impacts may appear larger than if the reference point is the same time last year. The Department considers that the longer (annual) timeframe is more appropriate for assessing the impacts of minimum wage changes.

102. The Department considers that when the following two factors are taken into account, a negative effect on employment levels from an increase in the minimum wage of between \$0.50 and \$1.00 is unlikely:

- a an annual frame of reference as described above which means that, as long as the relativity between the minimum wage and average wages remains fairly constant from year to year (which is more or less what the trend in NZ is) there should be little negative effects on employment levels relative to labour that is paid the average wage, and
- b the slight outpacing of the minimum wage relative to the average wage in recent years has apparently been offset by a growing economy which requires more labour.

103. It is possible, however, that increases in minimum wages could constrain projected increases in job growth, with larger increases more likely to act as a constraint. This effect becomes more significant for increases of over \$1.00 an hour.

104. The following table sets out estimates of level of job constraint that could result from minimum wage increases.¹⁴ The results show that baseline employment growth, estimated to be around 31,000 in the year to March 2006 could potentially be constrained by about 1,000 jobs if the minimum wage is increased to \$10.25. It is unclear which jobs would be forgone in the economy, but it is likely that these would be low wage jobs. The Department's planned case studies of firm responses to increases in the minimum wage will give us more insight into this question. Detail on the methodology used to derive these numbers is contained in Appendix E.

¹⁴ Projected job growth figures are from the Department's recent Labour Market Outlook, (October 2005). Estimates of the constraint on job growth potentially caused by increases in minimum wage rates are derived using the mean of the various wage bands, the numbers of people directly affected in each wage band, and a labour demand elasticity of 0.3.

Table 5: estimated potential level of constraint on job growth

	Minimum wage hourly rate	Projected job growth March 2006	Potential level of constraint on job growth *
Number of jobs	Current total no. of jobs is 2, 054,000	Projected to increase by 31,000 jobs to 2,086,000 jobs	
Option 1	\$9.50 (status quo)	31,000	0
Option2A	\$9.83	30,800	200
Option 2B	\$10.00	30,700	300
Option 3A	\$10.25	39,900	1,100
Option 3B	\$10.50	29,000	2,000
Option 4	\$12	20,100	10,900

*Using a demand elasticity of 0.3.

Working for Families assistance package

105. The interface between the minimum wage and In-work assistance to low and middle income working families ("Working for Families") is important for assessing the overall effectiveness and impacts of changes to the minimum wage. Working for Families is arguably better suited to meeting household income needs, and the needs of these families. However, not all minimum wage earners will be eligible for Working for Families, so the two policy mechanisms need to work together to ensure the government's overall income adequacy objectives are achieved.

106. This minimum wage review is the first review to seriously consider these interface issues between Working for Families and minimum wage increases. For people who are in receipt of family assistance that is abated against income (for example the Accommodation Supplement, Family Support and Childcare Subsidy), increases in income resulting from rises in the minimum wage will result in a decrease in the level of these forms of assistance for some people.

107. Preliminary Ministry of Social Development (MSD) modelling work indicates that much of the re-distributional gains from gross increases in the minimum wage for these employees and their families will be limited due to the impact of:

- a individual marginal tax rates (15 cents or 24 cents in the dollar)
- b abatement of first, second and third tier benefits (including the Accommodation Supplement), and
- c abatement of Family Assistance as the minimum wage increases.

108. Generally, however, the decrease in supplementary assistance will be less than the increase from the minimum wage and these families will therefore experience a net gain.

109. Minimum wages will however continue to raise incomes for individuals or families which do not receive Working for Families assistance. These are either people or couples in families without children, or people on low wage jobs living in well-off families. Increases in the minimum wage will also be continue to be important in raising the incomes of families that do not access their full entitlements under Working for Families.
110. More detail on MSD's indicative modelling is available at your request. This modelling sets out outcomes for four different family types, and the net distributional impacts on their Working for Families and other (tax/benefit) entitlements when the minimum wage is raised by either \$0.50 or \$1.00 an hour.
111. The Department will work with MSD to provide firmer modelling in the 2006 review around the impact of minimum wage increases on Working for Families recipients following the implementation of additional Working for Families assistance next year.

Youth Minimum Wage/Training Wage

112. Currently the youth minimum wage and the training wage are set at 80% of the adult minimum wage. This relativity was substantially considered in 2001 and increased from 60% through the 2001 and 2002 minimum wage reviews. The CTU and Youth Union Movement (YUM) both recommend eliminating the separate rate for 16 and 17 year olds.
113. At current minimum wage levels changes to the youth minimum wage (and to its relativity to the adult minimum wage) will have a greater proportional effect on young people than changes to the adult minimum wage will have on adults (as more young people than adults are on minimum rates and there is a narrower range of wages paid to young people, see the tables below for numbers of young people affected by each of the options).
114. Given where the youth minimum sits in relation to average youth wages (at 75%), as compared with the adult minimum rate relative to the average adult wage (49%) reflected by the percentage of people affected in each case, the Department recommends that the 80% relativity is maintained at this time.
115. New Zealand research on the impacts of increases in the minimum wage on youth employment have found, however, that no significant negative impacts on youth employment were experienced when there were large increases in the minimum wage.¹⁵ In their submission, SBAG, however, reports a perception among members of a reduction in work and work experience opportunities for young people in small/medium enterprises since the 2002 increases.
116. Researchers also estimates that minimum wage increases in the order of 5% may reduce the numbers of 16-17 year old students enrolled in formal study by

¹⁵ Hyslop and Stillman, 2004.

approximately 500 students each year (as these students substitute work for study, based on student choices following the 2003 increases).¹⁶

117. The CTU and YUM submissions have also recommended that the adult minimum wage rate should apply to employees under the age of 16 years (the CTU qualifies this to allow for some exceptions from the minimum wage). They argue that extending the coverage of the minimum wage to younger employees will reduce the risk of substitution of 14-15 year olds for 16-17 year olds as wages increase for the latter cohort. The Department is currently in the process of reviewing children's employment regulation as part of its assessment of ratification of ILO Convention 138 (minimum age for employment). The department recommends that the issue of minimum wages for young people under the age of 16 years be considered once government has reached a decision around the ratification of ILO Convention 138 (minimum age of employment). The Department recommends that the age the youth minimum wage applies to remains at 16 and 17 years while this work is being completed.
118. The level of the training wage was reviewed in 2004 a, and the Department recommends maintaining relativity of the training wage at 80% of the adult minimum wage at this time. The CTU submission recommended retaining the training rate, but raising it to 90% of the adult rate.

Evaluation strategy

119. The Department is proposing to do further work to examine the effect of minimum wage increases. This work would include:
- a case studies of adjustment to the change of particular firms in the sectors where most minimum wage workers are to be found
 - b an HLFS time series econometric study of employment rates of potentially vulnerable groups (women, youth, Maori and Pacific peoples, recent migrants, etc.) along the lines of previous Chapple (1997) and Maloney (1995) work, which is now well outdated
 - c examination of PAYE/LEED data to monitor pay changes
 - d examination of 'flow on' effects up the earnings distribution via looking at changes in the Income Supplement (IS) of the HLFS earnings distribution before and after increases, and
 - e further work to monitor and explain the high levels of non-compliance with the minimum wage that are reported in the income supplement to the HLFS, with a view to providing you with more advice on this matter in the Department's 2006 minimum wage review report.

¹⁶ Pachero and Cruikshank, 2005.

Consultation with government agencies

120. The Treasury, Ministry of Women's Affairs, Ministry of Pacific Island Affairs, Ministry of Social Development, the Office for Disability Issues, Ministry of Economic Development, and Ministry of Youth Development, Te Puni Kokiri, the Tertiary Education Commission, and the Department of the Prime Minister and Cabinet have been consulted in this review.
121. The Ministry of Social Development (MSD) supports the improvement in work incentives resulting from the move, but we note that the impact on work incentives, even from such a large rise, is comparatively small. MSD notes their concerns about the unknown disemployment effects of pushing minimum wages significantly above historic levels, especially for highly disadvantaged people, and the downside risks it may create for the government's sustainable employment goal
122. MSD also notes concern about extent to which extra pay resulting from the rise actually ends up with taxpayers, rather than taken home by low paid workers to low income families 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 In terms of transition paths, our judgement of possible risks/possible returns from the policy is that we would favour the slowest transitional pathway to \$12.00 per hour. The pathway should be preannounced.
123. Additionally MSD strongly advocate rigorous ongoing evaluation of possible disemployment & re-distributional impacts.
124. Treasury considers that the recommended increase in the minimum wage to \$10.25 per hour will directly affect the wage rates of a significantly larger number of people than have been affected by previous increases by increases in the minimum wage. The proportion of younger workers affected will be particularly high. Additional increases in the minimum wage to \$12 per hour by 2009 are likely to see the number of people affected by each successive adjustment rise even further.
125. Treasury also notes that as a consequence, there is greater potential for minimum wage settings to lead to employment and wider economic losses, particularly if current buoyant economic and labour market conditions soften.
126. The Ministries of Women's Affairs and of Pacific Island Affairs support increases in the minimum wage, and both agencies support a 'frontloaded' progression to reach the government's aspirational goal.

RECOMMENDATIONS

127. It is recommended that you:

- 1 **note** that your statutory obligation as Minister of Labour to annually review minimum wage rates is discharged by your giving consideration to this paper

Options for reaching aspirational goal of \$12 per hour for adults

- 2 **note** that the Department considers that there are benefits to be gained in identifying and communicating an intended path to reach \$12 an hour for adults by the end of 2008, if economic conditions permit
- 3 **agree** to recommend to Cabinet that the steps and the timing of these steps for reaching \$12 an hour for adults are identified and publicised at the same time that announcements are made in the media about an adjustment to the minimum wage for 2006

agree / disagree

- 4 **agree** to recommend to Cabinet that progression towards an aspirational goal of \$12 an hour minimum wage rate for adults should aim to be achieved through the following four step adjustments to the minimum wage:

either

- 4.1 a \$0.63 increase to be implemented in March 2006 followed by a \$0.62 increase, a \$0.63 increase, and a \$0.62 increase, by the end of 2008, if economic conditions permit ('smooth' option)

or

- 4.2 a \$0.75 increase taking effect in 2006 followed by a second \$0.75 increase, a \$0.50 increase, and ending with a second \$0.50 increase, by the end of 2008, if economic conditions permit (a "frontloaded" progression]

or

- 4.3 a \$0.75 increase taking effect in 2006 followed by a \$0.50 increase, followed by a \$0.50 increase, and ending with a \$0.75 increase, by the end of 2008, if economic conditions permit ("double spiked" progression]

agree / disagree

- 5 **agree** to recommend to Cabinet that progression towards an aspirational goal of \$12 an hour minimum wage rate for adults should aim to be achieved through a three step adjustments to the minimum wage:

agree / disagree

- 6 **direct** officials to prepare advice around another path for reaching \$12 an hour (adult rate) by the end of 2008, if economic conditions permit

Options for the 2006 adjustment

- 7 **note** that the Department of Labour considers 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 could be made with confidence in the current economic and labour market conditions. Such an increase will provide benefits to an estimated 28,400 recipients with minimal likelihood of constraining job growth
- 8 **note** that the Department of Labour considers that an increase in the minimum wage in 2006 above the rate needed to maintain relativity to the average wage (e.g. a \$0.75 increase on the current rate) could be made with confidence in the current economic and labour market conditions, and to reflect a stronger view of the contribution of the minimum wage to its objectives and to communicate a stronger message about reaching the government's aspirational goal for the minimum wage. The current labour market and economic conditions are likely to be able to accommodate a larger increase now than in the coming years, if there is an economic downturn or the economy softens. Increases above \$1.00 would, however, involve increased likelihood of constraining potential job growth
- 9 **agree** to recommend that the adult minimum wage rate for 2006 should be:
- either
- 9.1 \$9.50 per hour or \$380 for a forty hour week (status quo – Business New Zealand, Federated Farmers, Hospitality Association position)
- or
- 9.2 \$9.83 per hour or \$393 for a forty hour week [same increase as the increase in average hourly earnings between June 2004 and June 2005 (Retailers Association position)]
- or
- 9.3 \$10.00 per hour or \$400 for a forty hour week
- or
- 9.4 \$10.13 per hour or \$405 for a forty hour week
- or
- 9.5 \$10.25 per hour or \$410 for a forty hour week
- or
- 9.6 \$10.50 per hour or \$420 for a forty hour week.
- or
- 9.7 \$12.00 per hour or \$480 for a forty hour week. [NZCTU position]
- 10 **agree** to recommend that the youth minimum wage rate should continue to apply for 16 and 17 years old employees and remain at 80% of the adult rate for 2006
- agree / disagree**
- 11 **agree** to recommend that the training minimum wage rate should remain at 80% of the adult rate for 2006
- agree / disagree**

- 12 **note** that the issue of minimum wages for young people under the age of 16 years may be considered once government has reached a decision around ratification of ILO Convention 138 (minimum age for employment)
- 13 **note** that women, younger workers, Maori, Pacific peoples, disabled people, recent migrants, the low skilled and people with non-English speaking backgrounds are over-represented amongst the low paid workforce, and that they would be expected to benefit from any resulting wage increases,

Future minimum wage reviews to the end of 2008

- 14 **note** that the ILO Convention 26 "Minimum Wage Fixing Machinery"; article 3 requires that consultation with employers and employees takes place in determining minimum wage rates as part of wage fixing machinery
- 15 **agree** that reviews to 2008 continue to assess minimum wage rates against government's agreed objectives and goals for the minimum wage (including an assessment against corresponding benchmarks, for example relativity with the average wage)

agree / disagree

- 16 **note** that the Department is undertaking work to identify leading indicators of employment, and that leading indicators could be used in future reviews to provide disaggregated information around economic conditions
- 17 **indicate** whether you wish officials to review the relativities between adult, youth and trainee minimum wages, with a view to providing you with more advice on this matter in the Department's 2006 minimum wage review report

yes / no

- 18 **note** that the Department will work with MSD to provide firmer modelling in the 2006 review around the impact of minimum wage increases on Working for Families recipients following the implementation of Working for Families phase 2.
- 19 **note** that the Department intends to undertake work to evaluate minimum wage increases, including:
- 19.1 case studies of adjustment to the change of particular firms in the sectors where most minimum wage workers are to be found
- 19.2 an HLFS time series econometric study of employment rates of potentially vulnerable groups (women, youth, Maori and Pacific peoples, recent migrants, etc.) along the lines of previous Chapple (1997) and Maloney (1995), work which is now outdated
- 19.3 examination of PAYE/LEED data to explore pay changes
- 19.4 examination of 'flow on' effects up the earnings distribution by looking at changes in the Income Supplement of the HLFS earnings distribution
- 19.5 further work to monitor and explain the high levels of non-compliance with the minimum wage that are reported in the income supplement to the HLFS,

with a view to providing you with more advice on this matter in the Department's 2006 minimum wage review report.

Shane Kinley
Policy Manager – Workplace Group
for Secretary of Labour

TABLE OF APPENDICES

A	Recent trends in minimum wage rates
B	Measuring average hourly wages
C	Selected economy-wide impacts of minimum wage increases
D	Sectors and minimum wage increases
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F	Summary of submissions

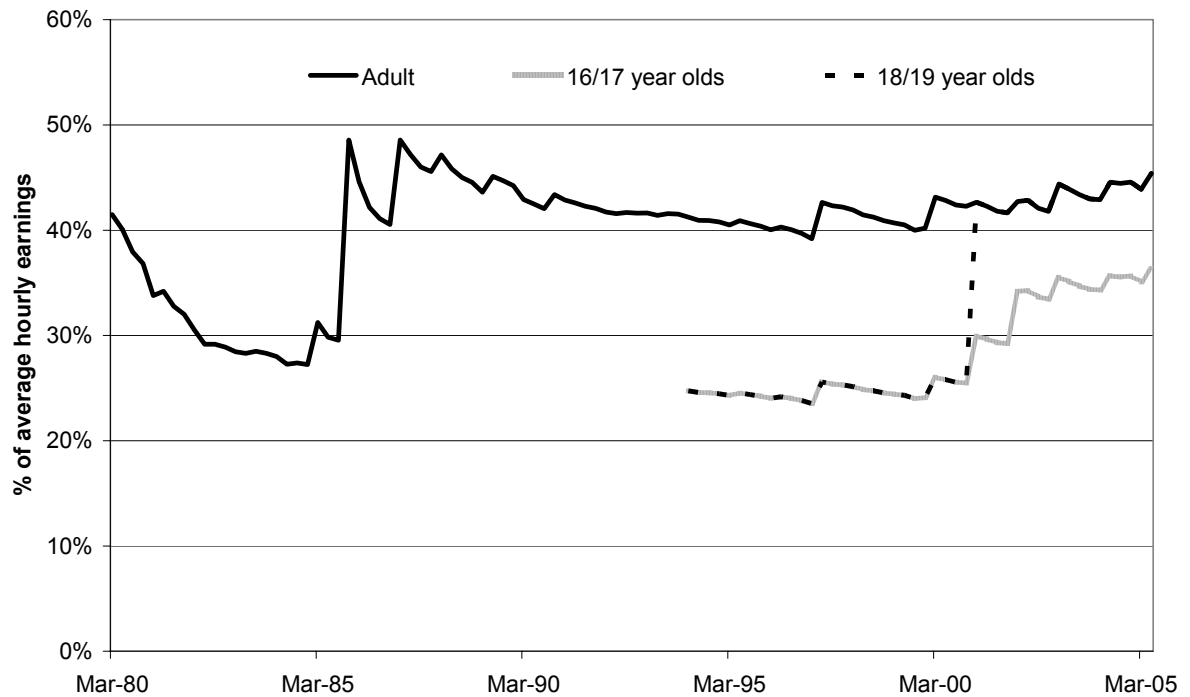
Appendices C, D, and E summarise Department of Labour working papers that have contributed to the 2005 review of the minimum wage. These papers are available on your request. A working paper on the gender analysis that underpins the report is also available on request.

APPENDIX A

RECENT CHANGES IN THE MINIMUM WAGE

- 1 Minimum wages have grown steadily as a percentage of average earnings since 2000. The following figure shows how minimum wages have tracked over time as a proportion of average earnings measured using the QES.¹⁷

Figure 1: Minimum wages as a proportion of average earnings¹⁸



¹⁷ Because QES average wages are higher than those in the NZIS these percentages will not match comparison with the NZIS average outlined in Figure 1.

¹⁸ The administration of the Quarterly Employment Survey changed from the Department of Labour to Statistics NZ in February 1989 resulting in slight changes in coverage. Youth minimum wages first came into effect in March 1994.

2 The following table sets out changes in minimum wage rates since 1999.

Table 1: Recent changes in minimum wage rates¹⁹

	Key changes in minimum wages	Minimum Wage Rates % increase % mean average (+ % median) wages		
		Adult	18/19 year olds	16/17 year olds
1997- 1999		\$7.00 42.6(56.0)	\$4.20	\$4.20
2000	All minimum wages increased to restore relativity to average wage in 1997, when minimum wages were last increased.	\$7.55 7.9% 43.0(56.3)	\$4.55 8.3%	\$4.55 8.3% ²⁰
2001	Adult wages raised by increase in average wages. Age of eligibility for adult minimum lowered from 20 to 18 years. Youth minimum wage rate raised from 60% of adult to 70% (target of 80% announced for next year).	\$7.70 2.0% 42.5(56.8)	\$7.70 69.2%	\$5.40 18.7%
2002	Adult minimum wage rate raised by increase in average wages. Youth minimum wage rate rose from 70% to 80% of adult rate.	\$8.00 3.9% 42.6(57.1)	\$8.00 3.9%	\$6.40 18.5%
2003	All minimum wages increased by 6.3% (\$0.50 increase for adult), higher than average wage increase of 2.7%. Training minimum wage set at youth rate comes into effect from 1 July 2003.	\$8.50 6.3% 43.8(56.7)	\$8.50 6.3%	\$6.80 6.3%
2004	All minimum wages increased by 5.9% (\$0.50 increase for adult), higher than average wage increase of 3.7%.	\$9.00 5.9% 44.4(58.7)	\$9.00 5.9%	\$7.20 5.9%
2005	The adult rate increased by 5.6% (\$0.50 increase) and by 5.5% for youth rate and for the trainee rate (\$0.40 increase for both rates), adult increase greater than average wage increase of 2.7%.	\$9.50 5.6% 45.3(59.0)	\$9.50 5.6%	\$7.60 5.5%

¹⁹ See Appendix A for a graph showing the minimum wage as a percentage of average hourly earnings since 1980.

²⁰ This number differs from 7.9% due to rounding of youth rate to nearest 5 cents.

MEASURING AVERAGE HOURLY WAGES

- 1 This appendix explains the differences between the various hourly wage measurements (average wage, median wage) used in this report, and why the Department uses the QES mean average wage as its benchmark against which to measure movement in hourly earnings.
- 2 Wage levels and wage growth are key indicators used in the review of the minimum wage. There are conceptual differences between average and median wages. The median is the wage for the “worker in the middle of the range”, while the average wage looks across all workers, including those on higher wages, and embodies the concept of all wage and salary income being shared among all workers.
- 3 Several measures of hourly wages exist and are set out in the following table (along with the CPI for comparison).

Table 1 Hourly wage measures

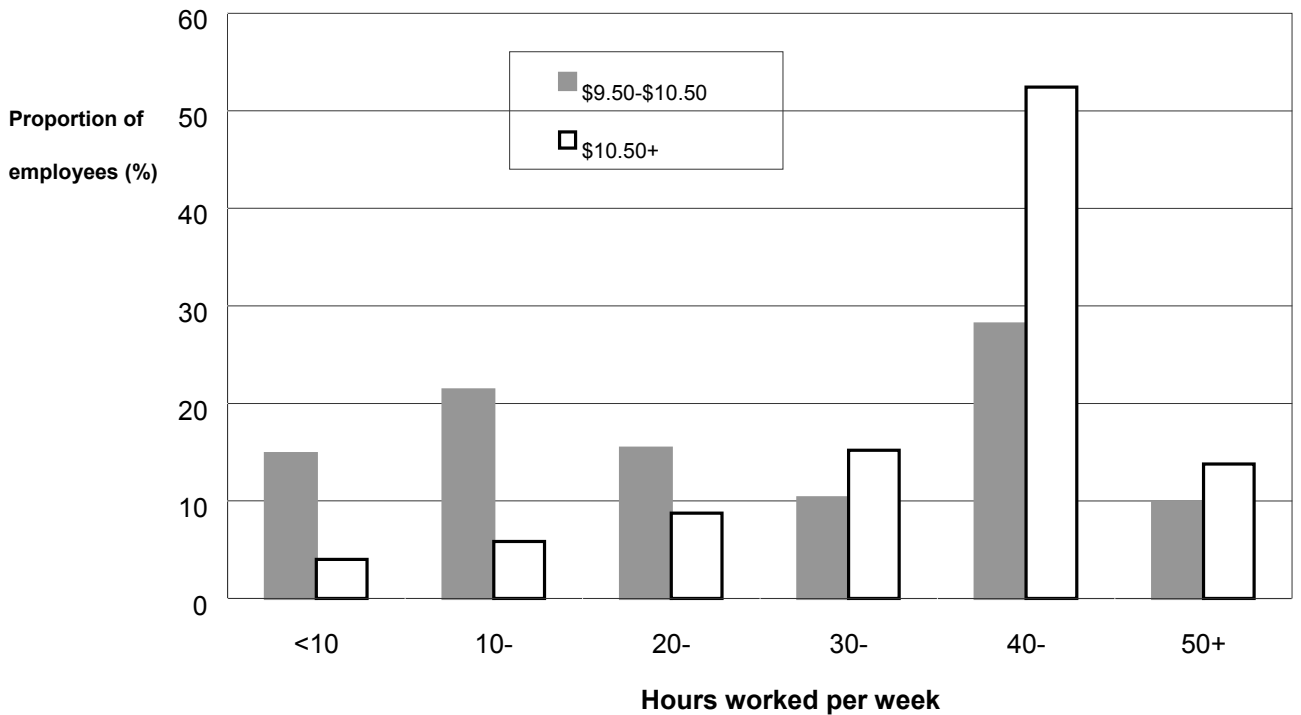
Hourly Wage Measure	June Qtr 2004	June Qtr 2005	% change
New Zealand Income Supplement [NZIS] (median)	\$15.34	\$16.10	5.0
New Zealand Income Supplement (mean)	\$18.24	\$19.30	5.8
Quarterly Employment Survey [QES] (average)	\$20.28	\$20.98	3.5
Labour Cost Index [LCI] (unadjusted index)	1130	1185	4.9
Average minimum wages in Collective Agreements (weekly wage)	475	487	2.5
Consumers Price Index (base: June 1999 quarter = 1,000)	1124	1156	2.8
Producers Price Index (Outputs)	1151	1186	3.0

- 4 Key points to emerge in relation to these indicators are:
 - a. The QES average and NZIS mean differ because of the relative weight given to part and full time wages. The NZIS mean is a measure 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 pay a lower than average wage, thereby lifting the average measured in that survey.

- b. There can be significant variances in the rate of change of different measures (as set out in Figure 2 below). For example, over the past eight years (since 1997 when the NZIS first started) average percentage changes in the three key measures have been very similar (at 3.2%, 3.5% and 3.0% respectively for the first three listed in the table above). For the year to June 2005 the NZIS measure of the mean was more aggressive than the QES at 5.8% growth in average wages compared to 3.5% for the QES measure.
- c. For the seven years 1997/98 – 2004/05, wages in the lower percentiles have grown as strongly as those in the upper percentiles. Accordingly measures of wage inequality between upper and the lower percentiles have not deteriorated. The increases in minimum wages over that time may have contributed to this change along with increased demand for low skilled labour arising in sectors such as construction.

Figure 1: Rates of change in hourly wage indicators



SELECTED ECONOMY-WIDE IMPACT OF MINIMUM WAGE INCREASES

Background

- 1 Previous minimum wage reviews have emphasised the impact of minimum wage increases in New Zealand on the recipient, in particular various vulnerable groups of society.
- 2 In addition, past reviews have employed a simple impact framework to examine the potential direct effects of raising the minimum wage on foregone employment growth.
- 3 For the 2005 review it was proposed to also cast a wider net and consider selected economy-wide impact channels of minimum wage increases in New Zealand.

Objectives

- 4 There are many dimensions to an evaluation of the economy-wide impact of minimum wage increases on the New Zealand economy. Without claiming to be exhaustive, this appendix deals with the potential impacts of minimum wage increases on:
 - employment growth using a simple partial adjustment model, as was used in previous years,
 - industry or sector level wage costs, so as to identify vulnerable sectors,
 - inflation, based on aggregate and an industry level approach, and
 - demand - output effects of a) and c) on GDP and employment using input-output analysis.
- 5 This analysis is by no means comprehensive and rather serves the modest purpose of explaining some of the impact channels that can be supported by evidence-based empirical analysis using a range of tools that could be applied at short notice.

Results

Employment growth

- a) As with previous reviews, a model is employed that is based on the traditional view of demand and supply in the labour market in which a higher minimum wage will lead lower employment growth.
- b) The relationship between price (wage) and quantity (demand for labour) is expressed in terms of an elasticity of employment demand.
- c) The values of the elasticities are based on empirical analysis carried out in New Zealand and in international literature.
- d) The results show that with an uprating to \$10.25 base line employment growth, expected to be around 31 000 for the year to

March 2006 will be less by between 100 and 1 900, depending on the assumptions adopted.

Sectoral Wage Bill Increases

- e) At the sectoral level, analysis show that agriculture, retail and accommodation activities can expect relatively high increases in their wage bill.
- f) In a worse case scenario, in which all subminimum workers earning more than \$5.00 are uprated, along with those workers who are currently on the minimum wage, the wage bill may increase by between 1% to 0.5% for these sectors.
- g) If only minimum wage workers are uprated, the highest wage bill increase is 0.2% in food retail.

Inflation

- h) A simple aggregate analysis of uprating workers who continue to share in baseline employment growth from the current minimum wage level to to \$10.25 suggests that inflation will increase by between 0.04% and 0.24% points.
 - i) The latter is a worst case scenario as it is based on a broader view of uprating subminimum workers, while the former is based on uprating only those workers who are currently on the minimum.
 - j) An alternative analysis based on sector level cost-push principals in which the burden of higher wage costs is shifted downstream the production chain yields similar estimates.
- 6 A number of **demand – output impacts** can be associated with the above mentioned price effects:
- 7 Given the increase in prices, household income will be eroded and expenditure declines. This is off-set by a (real) increase in consumer demand as a result of the initial uprating. However, expenditure will be lower than in the base line for those who do not share in job growth. Our challenge is to determine the net effect of these three forces on final demand as well as sectoral and economy-wide GDP. The results are summarised in the next table:

Table 1: Aggregate impact of minimum wage increases on demand and output, 2005

	Reason	Measure	High impact: including subminimum workers, low employment elasticity	Low impact: excluding subminimum workers, high employment elasticity
1	Real income erosion	Household demand	-0.18%	-0.03%
2	Loss of international competitiveness	Foreign demand	-0.21%	-0.03%
3	Uprating	Household demand	0.43%	0.11%
4	Losses in employment growth	Household demand	-0.00%	-0.10%
5	Net effect	Final demand	0.09%	-0.03%

6	Net effect	Value added	0.07%	-0.02%
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Source: IS of HLFS (earnings, various years), Stats NZ (IO table 1996) and own calculations

The following observations can be made:

- a) Rows 1 and 2 show the negative impact of the increases in prices, following the higher minimum wage, on household and foreign demand, assuming an income elasticity of demand of unity.
- b) The negative impact on foreign demand is based on the principle that New Zealand exporters will lose market share due to their higher pricing in world markets.
- c) Row 3, shows the positive impact of uprating those workers who remain employed but now enjoy a higher real wage income
- d) Row 4 shows the negative impact due to lower employment growth.
- e) The net effect on final demand is shown in row 5 to be slightly positive. Ignoring sub minimum workers in the uprating and assuming a relatively high employment output elasticity generates a very small negative impact.
- f) The net effect is mainly driven by higher demand emanating from the uprating.
- g) The direct and indirect (multiplier) impact on *value added* is shown in the last row (6) to display a similar but slightly lower net effect. The results appear to vary between slightly positive and very small negative impacts, which suggests on balance a somewhat **positive to neutral impact on GDP**.
- h) The results will vary across sectors, with some benefiting and others losing out. The winners are typically service industries which have a higher weight in household expenditure, even though they may be low pay sectors. Primary industries, such as agriculture, which rely less on household expenditure and relatively more on exports, suffer.
- i) The associated impact on **employment** depends on how the various sectors affected by these changes in their output adapt their workforce.
 - As a starting point, one could use fixed employment output ratios at the sectoral level to get a first glimpse. This implies that the proportional change in employment is the same as that of value added (see row 6 of the table above).
 - With about 1.5 million employees, the potential demand impact ranges between 1 000 additional workers and 300 fewer workers required.
 - This approach typically ignores the possibility that, at the margin, employers may decide to keep their workforce in tact during downturns, in order to avoid rehiring and training costs in upswings.
- j) Net employment effect: A slightly positive demand impact on employment of 1 000 would outweigh the initial negative impact on employment of the same scenario calculated in 1d) above to be about 100. The negative demand impact of about 300 workers would amplify the negative initial impact calculated to be about 1 600²¹.

Effects not covered

8 The following important channels have been ignored:

1. Additional rounds of spending: One could go a step further and argue that a positive demand impact on GDP in itself may lead to higher

²¹ This calculation is not entirely consistent in that the demand impact on employment is measured in full time equivalents, while the initial negative impact on employment also includes those working less than 30 hours per week.

inflation, especially if the economy is running at a high level of capacity utilisation. This could erode real household income and dampen the impacts that we have computed so far.

2. Knock-on or spill over effects that may lead to increases in wages (just) above the minimum level, so as to preserve wage differentials. This could amplify the results mentioned above.
 3. Differential expenditure by low income and high income households, which could change the composition of the demand effects.
 4. Impact on savings and therefore investment which may have long term growth effects
 5. savings.
 6. Imperfect competition in some segments of the labour market which may give rise to monopsonistic behaviour by employers could mute the negative direct employment effects.
 7. Productivity changes and efficiency wage arguments, which, according to some literature, may have a positive impact on economic activity and employment.
- 9 A *comprehensive* macro-micro simulation model is required in order to examine more complex issues. Our analysis is therefore by no means all inclusive and rather serves the very modest purpose to take policy makers through some of the impact channels that can be supported by evidence-based empirical analysis using a range of tools that can be applied at short notice, are loosely connected but do not achieve full internal consistency. Below we discuss topics 1-4 in turn while making occasional and casual remarks to the other issues as we proceed.

APPENDIX D

SECTORS AND THE MINIMUM WAGE

- 1 Previous minimum wage reviews in New Zealand paid little attention to sector level responses. It is not possible to conduct extensive sector level analysis given the time constraints. This appendix presents a top-down bird eye's view as a first step to fill this gap in understanding.

Identifying Low Pay Sectors

- 2 Household Labour Force Survey (HLFS) - Income Supplement (IS) data allows sectors with relatively high incidence of low pay workers to be identified (< \$10.00 in 2003 prices). They include the following sectors:
 - a. Agriculture
 - b. Food processing
 - c. Textile & wearing
 - d. Retail
 - e. Accommodation
 - f. Business services (including cleaning)
 - g. Education (including preschool)
 - h. Community services (including child and age care)
 - i. Personal services (including hair dressing)
- 3 These sectors are broadly defined and further breakdown is required, as a number of the above sectors are also known for their relatively high pay.

Growth Performance of Low Pay Sectors

- 4 Business Demographic Statistics of Stats NZ is employed to compute employment growth rates at 2 digit level sectors. We combine employment growth rates and low pay characteristics. Most low pay sectors record employment growth rates that are very close to the economy-wide average. The exceptions are Business services: growing at much higher rates as it includes high growth pockets, and Textile & manufacturing: growing at much lower rates but is in a long term structural decline.
- 5 Conclusion: Low pay sectors are more vulnerable to minimum wage increases but have not necessarily performed worse than average in terms of employment growth

Small/Medium Enterprises Growth Performance of Low Pay Sectors

- 6 Business Demographic Statistics of StatsNZ is employed to compute employment growth rates for large firms and SMEs (>19 employees) at 2 digit level sectors. Overall: SME's employment growth is faster than for large firms. SMEs have recorded lower employment growth than for large firms in some low pay sectors including:
 - a. Food processing.
 - b. Food and other retailing.

- 7 SMEs in accommodation have recorded higher employment growth rates than large firms
- 8 Conclusion: SMEs in some low pay sectors are more vulnerable to minimum wage increases than large firms.

Low pay occupations groups and supply shortages

- 9 IS data is employed to identify low pay *occupation groups*. The following occupation groups have a relatively high incidence of low pay:
 - a. Sales workers
 - b. Personal service workers
 - c. Worker in agriculture and fishery
 - d. Elementary occupations
 - e. Machine operators
 - f. CS clerks
 - g. Building trades and workers
- 10 The hypothesis is that: if a low pay occupation group is in short supply, minimum wage increases may solve potential bottlenecks by encouraging more workers to take up jobs. Based on a measure of change in vacancies (year ending July 2005), the following occupations show signs of supply shortages.
 - a. Workers in agriculture and fishery
 - b. Elementary occupations
 - c. Machine operators
- 11 Based on Departmental vacancy rates (vacancies / employment) we identify:
 - a. CS clerks
 - b. Elementary occupationsin short supply but not: machine operators and agriculture and fishery workers.
- 12 The findings with regard to low pay occupations are somewhat inconclusive and requires further analysis.

APPENDIX E

NUMBERS OF PEOPLE AND SUBGROUPS AFFECTED BY OPTIONS

- 1 The tables below provide details on the numbers of people (by age group) who should receive wage increases as a result of an increase in minimum wage rates (are 'directly affected' by changes in the minimum wage).

Table 1: Impact of minimum wage options - adults (18 years and over)

Option for 2006	Hourly rate	Weekly rate	No. of people who would receive a wage rise and percentage of employees
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 minimum wage options - those aged 25 years and over

Option for 2006	Hourly rate	Weekly rate	No. of people who would receive a wage rise and percentage of adult workforce cohort
1	\$9.50	\$380	0
2A	\$9.83	\$393	13,300 (1%)
2B	\$10.00	\$400	16,000 (1.2%)
3A	\$10.13	\$405	49,906 (2.6%)
3B	\$10.25	\$408	53,600 (3.9%)
3C	\$10.50	\$420	63,100 (4.7%)
4	\$12.00	\$480	169,400 (12.5%)

Table 2: Impact of minimum wage option - 20-24 years

Option for 2006	Hourly rate	Weekly rate	No. of people who would receive a wage rise and percentage of adult workforce
1	\$9.50	\$380	0
2A	\$9.83	\$393	4,400 (2.4%)
2B	\$10.00	\$400	5,200 (2,8%)
3A	\$10.13	\$405	21,223 (12.1%)
3B	\$10.25	\$408	21,600 (11.8%)
3C	\$10.50	\$420	24,000 (13.1%)
4	\$12.00	\$480	49,200 (26.9%)

Table34: Impact of minimum wage option - 18-19 year old

Option for 2006	Hourly rate	Weekly rate	No. of people who would receive a wage rise and percentage of adult workforce cohort
1	\$9.50	\$380	0
2A	\$9.83	\$393	7,200 (11.7%)
2B	\$10.00	\$400	7,200 (11.7%)
3A	\$10.13	\$405	15,011 (30.8%)
3B	\$10.25	\$408	15,900 (25.8%)
3C	\$10.50	\$420	16,400 (26.7%)
4	\$12.00	\$480	28,000 (45.5%)

Table 4: Impact of Youth (16 and 17 years) Minimum Wage Options

Option for 2006	Hourly rate	Weekly rate	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	\$405	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%)

Subgroups affected

2 The following provides further information on the extent to which various sub-groups are affected by minimum wage changes.

Table 5: Sub-groups affected by analysed option*

Option for Adult Minimum Wage (per week) % increase (% average ¹)	No of adults directly affected (% total) Subgroups (% of wage group)	Youth Minimum Wage (80% of Adult)	No of youth directly affected (% total)
Reported below \$9.50	Total (3.4%) 54,800	<\$7.60	8,500 (14.4%)
	Female (58%) Maori (12%) Pacific (4%)		
Option 1 - \$9.50 (\$380) No increase (48.0%)		\$7.60 (\$304)	
Option 2A - \$9.83 (\$393)	Total (1.6%) 24,900	\$7.86 (\$315)	3,500 (5.8%)
3.5% (49.7%)	Female (2%) Maori (3%) Pacific (2%)		
Option 2B - \$10.00 (\$400)	Total (1.8%) 28,400	\$8.00 (\$320)	3,700 (6.3%)
5.2% (50.5%)	Female (3%) Maori (3%) Pacific (6%) ²		
Option 3A - \$10.13 (\$405)	Total (5%) 86,140	\$8.10 (\$324)	
	Female (8%) Maori (7%) Pacific (9%)		
Option 3B - \$10.25 (\$410)	Total (5.9%) 91,000	\$8.20 (\$326)	10,000 (16.9%)
7.3% (51.5%)	Female (8%) Maori (7%) Pacific (9%)		

Option 3C - \$10.50 (\$420)	Total (6.5%)	103,500	\$8.40 (\$338)	11,000 (18.7%)
10.6% (53.1%)	Female (9%) Maori (12%) Pacific (11%)	60,961 12,000 7,600		
Option 4 - \$12.00 (\$480) 26.3% (60.6%)	Total (15.5%)	246,600	\$9.60 (\$384)	24,700 (41.8%)
	Female (22%) Maori (21%) Pacific (20%)	162,200 31,500 21,500		
Total	Total (100%)	1,593,900	Total	59,100 (100%)
(includes those reporting below minimum wage)	Female (47%) Maori (10%) Pacific (5%)	750,100 154,300 74,400		

* (this table excludes the numbers of people who report earnings under the minimum wage)

¹ The average hourly wage rate is calculated from reported earnings for all individuals and includes those earning less than the minimum wage. The average hourly wage rate for adults (aged 18 and over) is \$19.79 and \$9.56 for young people (aged 16 to 17 years).

² There are no Pacific adults in the Income Survey with an hourly wage rate between \$9.83 and (less than) \$10.

Population counts have been rounded to the nearest hundred.

Source: 2005 New Zealand Income Survey, Statistics New Zealand;

3 The following table provides more detail on the numbers of people who directly affected by a minimum wage increase, using HLFS Income Supplement data for June 2005 and mid-point, mean and median points of the wage band options as reference points. The table also provides a hypothetical estimates of the effect of raising the minimum wage on job growth ('employment effects'), using low (0.04), medium (0.3) and high (0.5) labour demand elasticities.

APPENDIX F

SUMMARY OF SUBMISSIONS

- 1 Submissions were received from the New Zealand Council of Trade Unions, the Youth Union Movement, Business New Zealand, Federated Farmers, Small Business Advisory Group, the National Association of Retail Grocers and Supermarkets of New Zealand (NARGON), the New Zealand Association of Retailers, the Small Business Advisory Group (SBAG), the Mayors Taskforce for Jobs, the Hospitality Association of New Zealand (HANZ), and the National Advisory Council on the Employment of Women (NACEW).
- 2 The main points made in each submissions are outlined in the table over the page.

Table 1: Summary of Submissions by Organisation

<p>Federated Farmers</p>	<p>Federated Farmers broadly agrees with the government’s goals for the minimum wage and accepts the need for a statutory requirement to protect the most vulnerable.</p> <p>Substantially increasing minimum wages is neither a credible nor sustainable policy tool to achieve higher wages. An artificial, centrally imposed intervention can never reflect neither competitiveness nor productivity but will squeeze already tight business margins and discourage employment and increase inflationary pressures.</p> <p>Two impacts of recent increases – harmed the employment and training prospects for youth, and led to increased costs for businesses, eroding competitiveness with no increases in productivity.</p> <p>There should be no increase in the minimum wage. Govt policies should focus on improving skills, improving incentives to work, improving the business environment, and so lead to better competition and productivity, and so to higher wages.</p> <p>Union movement’s focus on across the board wage increases (including minimum wage increases) is inconsistent with its support for increasing productivity.</p> <p>Federated Farmers had input into and endorses the submission from Business NZ.</p> <p>Govt’s social objectives around the minimum wage would be better delivered through social welfare and taxation policies.</p> <p>An increase to \$12 an hour would have wide impacts across the labour market, especially at a time when many businesses are facing cost pressures.</p>
<p>Mayors Taskforce for Jobs</p>	<p>Notes that recent minimum wage Increases have not resulted in constraints or fewer jobs for young people.</p> <p>Lifting the minimum wage could lead to investment in skill training and increases in productivity.</p> <p>Minimum wage protection is necessary for young people , to encourage employers to invest in skill development and trade and to avoid increasing wage disparities between Australila and NZ.</p> <p>2004 concerns around skills and labour shortages remain.</p> <p>Lifting minimum wages will help address skills and labour shortages, industries’ ability to attract and retain young people, and staff retention.</p>

<p>Business New Zealand</p>	<p>Recommends that:</p> <p>There be no further increases in either the youth or adult minimum wage rates, or extensions in coverage.</p> <p>The Government should focus on increased access to training and employment for young people, and that the youth minimum wage rate be abolished so that this restriction on the employment of young people is removed</p> <p>The Government should considers tax cuts rather than increases in the minimum wage rates as a more effective way of increasing real wages for relatively low paid workers</p> <p>Statistics New Zealand is provided with funding for the development of a Cost of Living indices (or real disposable income indices), as a guide for increases to the minimum wage.</p> <p>Also:</p> <p>Government focus should be on increased access to training and employment to achieve higher productivity and real earnings over time.</p> <p>Legislatively set minimum wages create employment obstacles for the young and unskilled.</p> <p>Concerned about inflationary pressures due to flow-on effects. Youth minimum wage has distortionary effect on the labour market.</p> <p>Business NZ provides survey information that shows that 65% of employers are generally prepared to accept increases about the level of the rate of inflation only. Around 20% were prepared to accept an increase to \$12 an hour for adults.</p> <p>Economic indicators suggest increases may not continue to be sustainable, especially for the Manufacturing, Accommodation, cafés and restaurants, Retail Trades, and Construction industries. Recent increases that have been greater than the rate of inflation may have negative impacts on employment in these industries when economic growth slows, especially for young/unskilled.</p>
<p>Small Business Advisory Group SBAG</p>	<p>Note that minimum wage increases are most likely to affect small firms</p> <p>SBAG believe the case for an increase from present rates is not strong, and should stay at present rates for at least next 12 months, and also perceives SMEs to be struggling with impacts of workers above minimum wage seeking to retain wage relativities with minimum wage workers.</p> <p>Youth minimum wage should retain existing relativity with adult rate.</p> <p>SBAG members perceive a reduction in work and work opportunities in SMEs for younger people as a result of increases to youth rate.</p> <p>SBAG considers that significant econometric modelling should be undertaken before increases [to \$12 an hour] are contemplated.</p>

<p>National Association of Retail Grocers and Supermarkets of New Zealand NARGON</p>	<p>Recommends that there is no increase in minimum wages and that there is an increased focus on youth training.</p> <p>Grocery retail is a fast growing sector and large employer, particularly of casual, part-time and young workers.</p> <p>Grocery is a low margin industry selling essential foodstuffs in which increased wages directly affect business viability, hence service and employment levels..</p> <p>Minimum wages are important in setting wage rates and any increases may have flow on effects (wage costs – via relativity) and hence inflationary effects.</p> <p>Costs of training to lift the productivity of young and unskilled workers are significant. NARGON outlines anecdotal evidence from members that opportunities for 18 and 19 year olds have been adversely affected by increasing their minimum wage to the adult rate (as employers substitute older people for 18 and 19 year olds).</p> <p>'After-school' workers may lose opportunities for skill development and work, while they receive message that further training/education is unwarranted.</p> <p>Significant increases only sustainable if based on increases in productivity. Without this it conflicts with promoting productivity and economic growth.</p>
<p>Retailers Association</p>	<p>Concerned that minimum wages are becoming a barrier to employment in the retail industry and the development of industry training programmes.</p> <p>Modest increases in minimum wage in line with average wage growth is fair.</p> <p>Businesses find it hard to absorb increases that are higher than general wage increases.</p> <p>Employers may delay or abandon their recruitment decisions or focus on experienced staff only.</p> <p>Previous increases in youth rate had flow-on effects for other workers to maintain relativities, and further increases would probably have flow-on effects through the whole hierarchy.</p> <p>Recommend no increase in training minimum rates.</p> <p>Association has seen an increase in numbers training and consider training minimum wage has contributed to this.</p> <p>The artificial relativity between the youth and adult rates is neither rational nor sustainable and alternative solutions should be explored, e.g. training incentives, tax rebates.</p> <p>Movement to \$12 an hour would cost the industry an additional \$760m p.a. Would lead to increased costs for consumers, loss in job opportunities (esp. part time work) and unnecessary economic impacts, e.g. inflationary pressures.</p> <p>Recommend that the youth minimum wage is not increased, and its relativity to the adult rate is dropped.</p> <p>Recommends increase to the adult rate no greater than general wage increase, and robust economic consideration is applied to subsequent increases.</p> <p>These two recommendations would deliver on government's stated minimum wage objectives.</p>

<p>Youth Union Movement YUM</p>	<p>The Youth Union Movement calls for the elimination of discrimination on the grounds of age in the minimum wage provisions.</p> <p>Recommends that the minimum wage for those 16-17 should be immediately lifted to the adult rate, and that a minimum wage at the adult rate should be instituted for those under 16.</p>
<p>New Zealand Council of Trade Unions (NZCTU)</p>	<p>The recommendation is that the minimum wage should initially be raised to \$12.00 per hour or \$480 per week. This is equivalent to 56.7% of the average ordinary time hourly rate.</p> <p>Supports an indexation of the minimum wage to the average wage but only once there is a commitment to lift the ratio to two-thirds.</p> <p>For those aged below 18 years, the CTU submits that the lower rate based on age should be removed. We support the continuation of an exemption for trainees but submit that this rate should be at 90% of the minimum wage which would be \$10.80 an hour.</p> <p>Supports the minimum wage applying regardless of age and this includes (with some exceptions) those aged under 16 years of age.</p> <p>The 2005 Minimum Wage Review needs to take account of the recommendations of the Pay and Employment Equity Taskforce. An increase in the minimum wage can make a small but important contribution to reducing the gender pay gap.</p> <p>Steps need to be taken to re-establish a reliable database on low pay, so that the impacts of the minimum wage on the lower rates in the pay structure, and on young workers, can be considerations in subsequent reviews.</p> <p>Resources allocated to policing the minimum must be increased, the inspectorate should commence inspection on its own motion, and the inspectorate should instigate a policy of prosecuting employers who breach the minimum wage.</p> <p>The government should amend the law so that in the event of an employer being found to be paying less than the minimum wage, the penalty is twice the amount of underpayment, payable to the victim of the underpayment (the worker).</p>

<p>NZCTU cont'd</p>	<p>The submission reviews local and international evidence on the impact of the minimum wage on employment levels and concludes that at least within the range of adjustment being sought here, the case for raising the minimum can be judged on equity grounds, since it is not likely to have a detrimental effect on employment.</p> <p>The Government must acknowledge the devastating effect on workers of the removal of the award system. The Government needs to properly address the plight of low wage workers by ensuring that the minimum wage is significantly increased. This may require a Low Pay Commission. But, the crucial issue is to build on the acceptance by most (even in business) that our pay rates are too low by ensuring that there is a concerted range of measures that can lift pay rates.</p> <p>The NZCTU notes the inclusion in the Confidence and Supply Agreement with NZ First and the Co-operation Agreement with the Green Party that the Government will "continue the practice of annually increasing the minimum wage, with a view to it being set at \$12.00 per hour by the end of 2008 if economic conditions" permit.</p> <p>The NZCTU view is to welcome the commitment to an initial target of \$12.00 an hour. However, we are submitting that there should be an immediate increase to \$12.00 an hour and the issue of removing the youth rate also needs to be addressed. We note also that the Government target of \$12.00 an hour also is subject to the qualification of whether economic circumstances would permit such an increase. We anticipate that some employer groups will continue to argue that economic conditions would not allow such a move. In addition, they will argue that a significant increase in the minimum wage at the same time as the fourth week's annual leave will be too great a burden. The Government needs to be resolute in the face of such arguments.</p> <p>This means that it is imperative that the Government takes the initiative in this review for a significant increase rather than wait until 2007 or 2008.</p>
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<p>National Advisory Council on the Employment of Women (NACEW)</p>	<p>It is still the view of the Council that, on balance, moderate increases in the minimum wage are likely to have a positive effect on the employment experiences of women. The minimum wage is recognised as one of a range of mechanisms that can increase the likelihood of women receiving equal pay for work of equal value.</p> <p>Cites Pay and Employment Equity Taskforce 2004 finding that there is positive evidence that raising the minimum wage would have a positive effect on closing the gender pay gap.</p> <p>An increase in the minimum wage could stimulate women to increase their labour market participation, as well as helping to as well as helping to address pay and employment equity issues for women.</p> <p>Raising the minimum wage is also likely to have positive, implications for the work-life balance of people on low-incomes and/or in precarious employment.</p> <p>For example, enabling families to better balance work and caring responsibilities by raising income (e.g. to afford childcare)...will benefit business and labour force participation.</p> <p>Calls for better monitoring and evaluation of income distribution by gender and ethnicity, esp. important as population is ageing.</p> <p>Calls for more research into impacts of minimum wage increases on SMEs, and on productivity.</p> <p>Calls for research into impacts of moving to \$12 an hour on low-wage earners, businesses (esp. SMEs), productivity and the economy.</p> <p>Asks Minister to note the research NACEW will be doing on the motivations behind the decision-making of people with caring responsibilities and their labour force participation.</p>
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<p>The Hospitality Association of New Zealand</p>	<p>The Association supports the submission by Business NZ. Recommends no further increase in youth or adult rates. Further changes to the rates and eligibility for adult and youth rates will severely impact on the ability of the hospitality and tourism industries to provide jobs and training opportunities for less skilled workers.</p> <p>Govt should focus on increasing training and employment to achieve higher productivity and increased real earnings over time.</p> <p>The minimum wage places additional obstacles on particular workers.</p> <p>When minimum wage rates reach market rates it can have significant negative impact at the micro level on the employment opportunities for young and unskilled workers in industries that pay minimum rates.</p> <p>The industry employs many entry level people. The minimum wage is a benchmark for other wages in the industry; therefore increases in the minimum wage reduce industry profitability, and place businesses/employment levels in the industry at risk.</p> <p>The majority of members are affected by minimum wage changes.</p> <p>Concerned about increased labour costs caused by other workers seeking to maintain wage relativities with minimum wage workers.</p> <p>Minimum wage increases may reduce employers' flexibility to reward higher-performing workers.</p> <p>Inflationary pressures caused by increased wages may lead to higher interest rates and reduced investment and job availability.</p> <p>Training minimum wage deters employers from offering training, and so conflicts with government's objectives around life-long learning, development of a skilled workforce and investment in vocational training.</p> <p>Youth minimum wage could incentivises young people to substitute work for education.</p> <p>A two-fold unemployment effect may occur when labour force participation increases at the same time that job opportunities are reduced.</p> <p>A rise in the minimum wage may compromise job opportunities for beneficiaries through the industry's programme with MSD.</p>
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Views on achieving \$12 an hour

- Key submitters were invited to provide additional submissions on the government's aspirational goal to reach \$12 an hour for adults by the end of 2008, if economic conditions permit. Three submitters provided additional material on this matter, and their views are summarised below.

NACEW

- 4 NACEW recommend that research is conducted as to the impact of such an adjustment on the gender pay gap, low income earners, business, workplace productivity, and the wider economy. NZCEW also recommends that the number, level and timing of increases is signalled early on to employers.

Federated Farmers

- 5 Federated Farmers does not believe economic conditions will sustain a \$2.50 increase over the next three years. The Reserve Bank is clearly concerned about inflationary pressures, and there is a need for tighter monetary policy. Increasing the minimum wage will squeeze already tight business margins, discourage employment and increase inflationary pressures. Market forces appear to be working in the sector as wages and salaries experienced a large increase between June 2004 and June 2005: there is no need to artificially increase minimum wages. The impact on the agricultural sector would be particularly severe (which is the largest contributor to productivity, exports and sustainable economic growth in NZ) – an increase in the minimum wage could reduce the standard of living for all New Zealanders.

NZCTU

- 6 NZCTU's first preference is for an immediate move to \$12 an hour. If the government's view is to move to the goal over three years, then NZCTU supports a significant move being made in 2006, rather than three even moves, or a significant increase being made in 2008. While some businesses may want certainty around the steps, NZCTU values the annual review process, and does not support a decision that supplants the annual review.

Other issues raised in discussion

- 7 The Department of Labour met separately with the New Zealand Council of Trade Unions, the Small Business Advisory Group and Business New Zealand to discuss some of the key issues relating to their submissions. Additional issues raised in these discussions are set out below.
- 8 Business New Zealand continues to supported the development of cost of living indices to assist in setting changes to minimum wages (relevant to objective 1). The Business NZ submission is also supported by Federated Farmers. Statistics NZ is preparing a possible budget bid for 2006/07 to develop such indices.
- 9 Business NZ argues that the international cost of labour is zero, and that government needs to give careful consideration to the potential impacts of raising the minimum wage for vulnerable and disadvantaged workers. These impacts take 10/15 years to work through (and can include the substitution of capital and technology for labour).

10 With respect to the youth and the training rates, the NZCTU submit that using age as a proxy for productivity is flawed (and discriminatory), and that, if employers are genuinely investing in training junior staff, it should be done formally (and so warrant a training rate). CTU submit that this policy would act as an incentive for employers to invest in industry training.