



COVERSHEET

Minister	Hon Iain Lees-Galloway	Portfolio	Workplace Relations and Safety
Title of Cabinet paper	Minimum Wage Review 2019	Date to be published	21 February 2020

List of documents that have been proactively released

Date	Title	Author
5 December 2019	Minimum Wage Review 2019	Office of Hon Iain Lees-Galloway
11 December 2019	DEV-19-MIN-0353 Minute	Cabinet Economic Development Committee
5 December 2019	RIA: Increasing the minimum wage 2019	MBIE

Information redacted

YES / NO [select one]

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Some information has been withheld to maintain the confidentiality of advice tendered by Ministers of the Crown and officials.

Coversheet: Increasing the minimum wage

Advising agencies	<i>Ministry of Business, Innovation and Employment</i>
Decision sought	<i>Increasing the Minimum Wage</i>
Proposing Ministers	<i>Minister for Workplace Relations and Safety</i>

Summary: Problem and Proposed Approach

Problem Definition

What problem or opportunity does this proposal seek to address? Why is Government intervention required?

This proposal seeks to increase the adult minimum wage to \$18.90 from 1 April 2020 in order to make progress on the Coalition Agreement commitment to increase the minimum wage to \$20 by 1 April 2021.

Proposed Approach

How will Government intervention work to bring about the desired change? How is this the best option?

An increase to the minimum wage of \$1.20 (to \$18.90) will provide a significant income boost to New Zealand's lowest paid workers. It enables employers and employees to plan ahead for the current proposed rate, and also gives them confidence that next year's review will result in the Government's commitment to a \$20 rate by 1 April 2021. It aligns exactly with the 'pathway' to \$20 that was preferred almost universally by employers and employees consulted in 2018, as the lowest risk and least disruptive option.

The key factors that make this annual review different from previous annual reviews are:

- Focus of review on a specific rate - this review focused particularly on the specific rate (\$18.90) that was published as the indicative rate for this review, as well as considering other potential rates. Previous reviews have not tended to focus more on one rate than others. However, the modelling and evidence used in this review aligns with previous reviews (for a range of potential rates, estimating impacts such as wage growth, disemployment effects etc), and as with previous reviews, all potential minimum wage rates have been tested, modelled, and considered.
- Additional consideration on stakeholder confidence and certainty - the indicative rates through to 2021 were developed after consultation with employers and employees, who overwhelmingly considered those rates as the preferred pathway to achieve the \$20 commitment. This means that this review needed to consider the impact on stakeholder confidence and certainty if a different rate is chosen without a clear justification, or if a rate was chosen that resulted in stakeholders losing confidence that the Government will achieve the \$20 rate next year.
- Understanding the impacts of historically high minimum wage increases - this proposed increase to the rate (\$1.20) is historically high, and also follows a \$1.20 increase that occurred last year. Our ability to estimate the impacts of larger increases carries some risk, primarily because our understanding of changes to the minimum wage is based on smaller 50c increases from previous years. The effects of this year's increase may be harder to estimate, compared to last year, because of the greater number of workers currently at or near the minimum wage (as a result of last year's increase). This number will only grow larger as a result of the

number of employees whose wages are captured by this year's minimum wage increase.

The first two factors above provide a clear basis for the recommendation to adjust the rate to \$18.90. In addition, the proposed rate of \$18.90 achieves a large increase to the wages of our lowest paid workers, and has estimated disemployment and inflationary impacts reasonably in line with what previous reviews have reported. In other words, the estimated 'negative' effects of a minimum wage increase to \$18.90 are not disproportionately large.

The disemployment impacts of the proposed rate do not raise concerns that would require a different rate to be considered, especially when considered alongside the current economic context and forecast employment growth of 43,600 in 2020. Put differently, the ratio between the forecast employment growth for 2020 and the disemployment effects of the preferred rate indicate that a minimum wage of \$18.90 will have a relatively minor impact on the economy.

The impact of a minimum wage increase on various sectors depends on the number of employees earning the minimum wage and those earning close to it. In New Zealand (and in many countries), employers in the hospitality, retail and administrative services sectors are more likely to have staff paid at, or close to, the minimum wage than employers in the professional, technical, or health sectors.

Workers who are female, Māori, part-time employees, without formal qualifications, or working in the retail and hospitality industries are more likely to be paid at the minimum wage rate. These workers are therefore generally more likely to benefit from an increase to the minimum wage. However, they may be the first to experience the negative impacts that could result from an increased minimum wage (such as reduced work hours or the substitution of some groups of workers for others).

The rate options under consideration for this year's review are:

- \$17.70 (status quo)
- \$18.20
- \$18.70
- **\$18.90** (published indicative rate for 2020 and MBIE's preferred rate)
- \$19.40
- \$19.90
- \$20.55
- \$21.15 (proposed by Living Wage Aotearoa as a 'living wage')

In addition to the adult minimum wage, the starting out and training minimum wages will remain pegged at 80 per cent of the adult minimum wage.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?

Up to 242,400 workers (those currently earning from \$17.70 to \$18.90 per hour) are estimated to receive an increase up to the new minimum wage, along with an estimated economy wide increase in wages of 306 million. Many of those earning above the new minimum wage can also expect an increase over time as relative wage rates between different roles are addressed, and new entrants to employment can expect to start employment at a higher wage rate than if this increase did not occur. This represents an increase in hourly wages and overall income for many workers, although outcomes may differ for employers who reduce their employees' work hours (or for employees who choose to reduce work hours as a result of a wage increase). MBIE's model does not discount work hours in its calculations, instead assuming full-time employment of 40 hours per week or part-time employment of 20 hours per week across different scenarios.

The minimum wage provides a wage floor for workers, to ensure that they receive an adequate wage for their employment. One of the Government's objectives is to lift the wages of low-paid workers, and increasing the minimum wage is one part of this policy objective.

Increasing the overall income for low wage earners may result in more people having disposable income, which could then lead to an increase in spending and consumption levels, benefitting local businesses and economies.

Minimum wage increases may also have a small impact on poverty rates. This is particularly the case for households without children, as these households are more likely to be on the lowest wages and receive less government-provided income support to supplement their earnings. In other words, low income households without children are likely to realise greater net gains from a minimum wage increase.

Where do the costs fall?

MBIE's modelling estimates the costs of any minimum wage increase fall initially to employers who will experience an economy-wide labour cost increase (of approximately \$306 million annually in this case). The increased cost of labour may then be passed on to customers through rising prices of goods and services, as employers seek to maintain a profit. However, for most businesses and sectors, workers on the minimum wage represent a small fraction of total labour costs so any increase in the minimum wage should not significantly impact overall operation costs. In contrast, sectors that will experience an impact from a minimum wage increase include hospitality, retail, and administrative services. Increasing the minimum wage is expected to create some inflationary pressure on gross domestic product (GDP), and MBIE's minimum wage model suggests a small impact (0.1 per cent).

Increasing the adult minimum wage to \$18.90 is expected to have a direct annual fiscal cost of \$61.6 million to government. Although increases to the minimum wage are predicted to increase wage costs for government, it is likely that they would also impact on the tax and transfers system and other social policy programmes, in effect partially mitigating the costs of the minimum wage increase. It is worth noting, however, that MBIE's modelling is unable to quantify these estimated reductions in government

expenditures, which means the anticipated annual fiscal cost of \$61.6 million is not net of these savings.

MBIE's model uses economic and employment data to predict the employment impacts of different increases to the minimum wage. The model provides estimates for three groups:

- **Groups most affected:** The model produces predicted employment impacts for aggregate groups most affected by minimum wage changes (16-17 year olds, 18-19 year olds, females, Māori, Pacific peoples)
- **16-64 year olds (relative impact):** All workers aged between 16 and 64 years old are included and the impact of the change to the minimum wage relative to the average wage is used to assess the employment impacts
- **16-64 year olds (direct impact):** All workers aged between 16 and 64 years old are included and the model captures the direct employment effect of the proposed minimum wage increase as well as the increase to the average wage separately rather than relative to each other.

Table 1 shows the estimated employment effects that result from the rate options under consideration.

Table 1: Summary of employment impacts¹

Option	Potential restraint on employment growth		
	Groups most affected	16-64 year olds (relative impact)	16-64 year olds (direct impact)
\$17.70	N/A	N/A	N/A
\$18.20	N/A	N/A	N/A
\$18.70	-2,500	-4,500	-5,000
\$18.90	-4,000	-6,500	-7,500
\$19.40	-7,000	-11,500	-13,000
\$19.90	-10,000	-17,000	-19,000
\$20.55	-14,500	-23,500	-26,500
\$21.15	-18,000	-30,000	-33,500

Of the three groups above, MBIE uses the figures modelled for the 16 to 64 year olds 'relative impact' since MBIE judges it to be the best estimate of the impacts. This group assesses the impact across the working age of 16 to 64 year olds and evaluates the impact of minimum wage changes in relation to the forecast average wage change. It also produces the employment restraint, which is more central, with the other two groups providing a lower and upper range. As shown in table 1, the modelling suggests that increases above \$18.90 would significantly restrain employment growth.

MBIE's model does not produce negative employment effects when the rate of change in the minimum wage is smaller than the rate of change in the average wage. For example, an increase in the current minimum wage rate of \$17.70 to \$18.20 represents a 2.8 per cent increase, which is less than the forecast 3.2 per cent increase in the average wage in

¹ These figures are based on the Treasury's wage growth forecasts contained in the Treasury's Budget Economic and Fiscal Update 2019. They differ from the New Zealand Institute of Economic Research's (NZIER) wage growth forecasts, found in their Quarterly Predictions, that were used in previous minimum wage reviews. NZIER's figures predict smaller disemployment effects of -3,000 (low), -4,500 (mid), and -5,000 (high).

2020.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?

Any increase to the minimum wage has the potential to affect employment levels as the rising cost of labour may mean that employers choose to substitute capital for labour, or for higher-wage/higher-skill labour. Employers and employees may also respond to a minimum wage increase by reducing worker hours. MBIE's model for the \$18.90 option predicts a possible negative employment effect (disemployment) of 6,500 (low estimate of 4,000 and a high estimate of 7,500), compared to forecast employment growth of 43,600 in 2020². Evidence indicates that minimum wage increases are more likely to impact certain demographic groups, such as young people, Māori, and low-skilled workers.

Rate options higher than \$18.90 produce greater employment effects. For example, a rate increase to \$19.40 would result in an estimated disemployment effect of 11,500 for 16 to 64 year olds (relative impact). Rates higher or lower than the proposed rate will also result in reduced levels of confidence and certainty for business as well as workers. The \$18.90 rate was published as an indicative rate to be confirmed through this review, and follows the pathway to a \$20 minimum wage rate in 2021, which employers and employees preferred and which they expect will be followed.

Increasing the minimum wage may also lead to relative adjustments to wages above the new minimum wage, as workers seek to maintain a wage that reinstates the wage differential that existed prior to a rate change (compared with workers that may be or are considered to be less qualified or experienced).

In some situations a rate change could potentially drive downward pressure on wages in some businesses or sectors where there is little ability to fund the legally required rate increase other than through reductions in other parts of the payroll. This is more likely to occur through lower wage offers to prospective employees rather than current employees receiving reductions.

These consequential adjustments are an expected result of minimum wage rate increases, but are not as predictable as adjustments up to the new rate. This is because they are more complex than the legal requirement to shift to at least the required rate. These types of employer responses depend on factors such as recruitment and retention issues, business considerations, and the quality of employment relationships.

Identify any significant incompatibility with the Government's 'expectations for the design of regulatory systems'.

There is no incompatibility with the Government's expectations for the design of regulatory systems as the minimum wage review delivers net benefits to New Zealanders and meets the criteria outlined in the 'Government Expectations for Good Regulatory Practice' document.

² MBIE. (2018). *Short-term Employment Forecasts: 2017-2020*. This indicates that employment impacts may be partially absorbed by wider employment growth. However, the two figures are not directly comparable as the time periods they cover are not fully aligned.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?

The minimum wage model used by MBIE has a medium level of confidence. It was reviewed and updated in 2018 to better predict the impact of minimum wage changes on employment. More specifically, the elasticities used in the model to estimate the impact of minimum wage changes on employment have been updated using a simpler set of explanatory terms, more recent employment data, and addressing some technical issues with the earlier model. However, the model contains inherent limitations in its ability to predict the effects of minimum wage increases (especially larger increases). These include a lack of evidence on the effects of successive increases across multiple years, no direct evidence of the degree of pay relativity adjustments, and no consensus in the international literature on the impact of the disemployment effects of minimum wage increases. Despite these limitations, the model provides sufficient information to allow Ministers to make an informed decision on whether to raise the minimum wage.

The model does not provide estimates on the flow-on economic impacts aside from inflation. MBIE is only able to estimate the direct impacts of minimum wage changes.

The model is also based on a number of assumptions about how a single change to the minimum wage will impact the labour market and wider economy. The impacts of a series of successive minimum wage changes are not captured in MBIE's minimum wage model, or the review. This is largely because there is little international or domestic evidence of the impact of these types of successive increases signalled well ahead and across multiple years. MBIE's model predicts the impact of a single change as a one-off event, which is consistent with the *Minimum Wage Act 1983* (the Act) and the requirement that the minimum wage is reviewed annually.

International evidence of the impacts of minimum wage changes – particularly any impacts on employment – is by its nature context-specific and based on local labour market and economic conditions of the time. As such, there is always some uncertainty in predictions and how a specific minimum wage change will impact the New Zealand economy. This uncertainty increases as the size of the minimum wage change being modelled increases. Most historic minimum wage changes, both domestically and internationally, are relatively modest (eg most increases are lower than 5%). Therefore, modelling the impact of larger increases is inherently more uncertain.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:

The Treasury and Ministry for Business, Innovation and Employment

Quality Assurance Assessment:

A Quality Assurance Panel with representatives from Ministry of Business, Innovation and Employment and the Treasury Regulatory Quality Team has reviewed the Regulatory Impact Assessment "Increasing the minimum wage" produced by the Ministry of Business, Innovation and Employment and dated 03 December 2019.

The Panel considers that it meets the Quality Assurance criteria.

Reviewer Comments and Recommendations:

The modelling supporting the RIA is comprehensive and provides the supporting information required by Cabinet. It is clear about the limitations of the modelling in estimating the impact of a more a significant increase in minimum wage relative to previous reviews. Given these limitations the RIA outlines an ongoing monitoring of

anticipated impacts while acknowledging the difficulty of monitoring in the current environment with a range of factors impacting on pay rates for those on or near the minimum wage.

While disemployment effects (the main measurable 'negative' effect along with inflationary impacts), are expected to have a 'relatively minor impact on the economy' in aggregate (the restraint on employment is estimated at 6,500), the RIA acknowledges that groups that will most benefit from the increase in minimum wage (i.e. female, Maori, part-time, without formal qualifications) may be the first to experience this effect.

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Impact Assessment: Increasing the minimum wage

Section 1: General information

Purpose
MBIE is solely responsible for the analysis and advice set out in this RIA, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing Cabinet's decision on whether to raise the adult minimum wage to \$18.90 from 1 April 2020.
Key Limitations or Constraints on Analysis
<ul style="list-style-type: none">• This year's review occurs within the context of the Coalition Agreement commitment between the New Zealand Labour Party and New Zealand First Party to increase the minimum wage to \$20 by 1 April 2021. Cabinet has also published an indicative rate of \$18.90 to come into force from 1 April 2020.• MBIE is only able to estimate the direct impacts of minimum wage changes. We do not have adequate data to assess any flow-on effects of any increase in the minimum wage rate. While MBIE's model provides estimates based on publicly available figures from Stats NZ, the direct impacts or the degree of those impacts of changes to the minimum wage are difficult to assess.• The extent to which the minimum wage has an employment effect, particularly for larger increases, is heavily debated in economic literature. There is no clear consensus, and the results of empirical studies are subject to economic and labour market contexts.• The economic literature indicates that minimum wage increases can result in fewer hours worked for some employees. MBIE's minimum wage model is not able to provide estimates on the impact of hours worked for employees at an aggregate level. MBIE's model does not discount work hours in its calculations, instead assuming full-time employment of 40 hours per week or part-time employment of 20 hours per week across different scenarios.• There is little evidence of the specific uptake of the starting-out wage and training minimum wage. Recent survey data suggest that 4.5 per cent of employers use the starting-out wage, and less than one per cent of employers use the training minimum wage. These figures are unlikely to accurately represent the total number of employees that are paid less than \$17.70 (in 2019) by using the starting-out and training minimum wages. This is because the survey data does not capture the number of employers who hire these minimum wage workers through industry training organizations, i.e. not directly remunerated through the employer's payroll.
Responsible Manager (signature and date):
Gerard Clark Employment Standards Policy Labour and Immigration Policy Ministry of Business, Innovation and Employment

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

The Act authorises the Governor General to prescribe minimum wage rates and requires the responsible Minister to review the rates by 31 December each year. The responsible Minister is the Minister for Workplace Relations and Safety.

There are currently three minimum wage rates:

- the adult minimum wage rate at \$17.70 per hour
- the starting-out minimum wage rate at \$14.16 per hour
- the training minimum wage rate at \$14.16 per hour.

The adult minimum wage is paid to an estimated 85,400 employees. Some sectors and demographics are more likely than others to be paid the minimum wage. The table below provides a summary of who is paid the minimum wage currently (at \$17.70) based on MBIE's modelled data and survey data from the Labour Market Statistics (Income – June 2019).

Table 2: Demographics of workers paid \$17.70 per hour

Demographic	% of minimum wage earners			% of total wage earners
	16-24	25-64	16-64	16-64
Aged 16-24 years	100%	0%	55%	17%
Female	55%	73%	63%	50%
European/Pākehā	60%	42%	52%	61%
Māori	17%	15%	16%	13%
Pacific	6%	5%	6%	6%
Part-time	72%	46%	60%	17%
Studying	33%	10%	23%	12%
Total	47,200	38,200	85,400	2,010,900

Table 2 shows that workers aged 16 to 24 make up 55% of minimum wage earners (this same demographic make up 17% of all wage earners). Table 2 shows that young people, Māori and women are disproportionately paid the minimum wage than other groups.

This year's review takes place in a cooling economic climate that is tempered by a strong labour market. Despite a slowing annual GDP growth rate of 2.4 per cent, low business confidence and international trade tensions, Stats NZ's labour market statistics for the September 2019 quarter reveal mostly positive figures. Although the unemployment rate rose slightly from 3.9 per cent to 4.2 per cent for the quarter, this remains at a very low level and the total employment rate has remained steady at 67.5 per cent (2,641,000 individuals), with the economy adding 6,000 employed people during the quarter. Wage rates also increased 2.4 per cent in the year to September 2019.

MBIE considers that the current economic context, including forecast employment growth of 43,600 in 2020, enables an increase to the proposed rate of \$18.90 with relatively low risk, and resulting in relatively minor impacts to factors such as disemployment, compared with the benefits the increase will generate.

In general, a stronger economic outlook is unlikely to impact on MBIE's preferred rate of \$18.90, given it is the published indicative rate for 2020 and a well-publicised step towards the \$20 goal of 2021. On the other hand, a worsening economic context could have resulted

in different estimated impacts that then meant either a lower increase would need to be considered to mitigate against disemployment or other impacts this year, or (if conditions were expected to be stable but then decline sharply in a year or so) it could have resulted in a recommendation for a higher rate than \$18.90 from this review, followed by a lower increase being needed to achieve the commitment of a \$20 rate by 2020.

2.2 What regulatory system, or systems, are already in place?

The minimum wage sets a price floor for all employees, below which employers are not allowed to set or pay wages.

The minimum wage assists employees that do not have the bargaining power to negotiate wage increases, ensures that workers are paid an appropriate wage in compensation for their time working, and prevents businesses from 'undercutting' their competition by paying less for their labour. Reviewing the minimum wage ensures that it maintains relativity to inflation and/or wage growth, so that minimum wage workers' real earnings are not eroded over time (assuming they continue to earn the minimum wage).

The Minister responsible for the minimum wage (the Minister for Workplace Relations and Safety) is required to review the minimum wage each year by 31 December, although the criteria for the review are not specified in legislation.

2.3 What is the policy problem or opportunity?

It is the government's priority to improve the well-being and living standards of all New Zealanders through productive, sustainable and inclusive economic growth. To help achieve this goal, the Government has committed to increasing the minimum wage to \$20 per hour by 2021.

There are strong rationales for having a minimum wage and for reviewing the rate on a periodic basis. These include protecting real incomes for minimum wage earners (for example, using the consumer price index (CPI) as an indicator), maintaining relativity to median or average earnings, and lifting the incomes of low-income households. In addition, some employees do not have the bargaining power or capability to negotiate wage increases that reflect the value of their work. In the absence of annual increases to the minimum wage, these workers would likely receive no annual increase, or an increase lower than inflation. Over time, workers would receive lower pay for the same work, which may increase income inequality.

MBIE's analysis for this proposal does not include examining the merits of the underlying rationale for the minimum wage. Nevertheless, it is worth noting that the minimum wage is a well-established and accepted feature of New Zealand employment law.

Employers and employees expect the minimum wage to increase in light of the Government's commitment to raise the minimum wage to \$20 by 2021. The proposal to increase the minimum wage to \$18.90 (the indicative rate for 2020), which is the mid-point between the current rate of \$17.70 and the indicative rate of \$20, provides a balanced (i.e. gradual) approach toward meeting the Government's commitment. Front- and back-loaded approaches, which include larger increases in some years, are associated with higher risks and levels of uncertainty. In other words, the larger the increase to the minimum wage, the harder it becomes to predict the possible range of responses from employers and

employees. A lack of statistically relevant data on large increases to the minimum wage, both in New Zealand and other economies, contributes to the analytical uncertainty.

2.4 Are there any constraints on the scope for decision making?

This year's review occurs within the context of the Coalition Agreement commitment between the New Zealand Labour Party and New Zealand First Party to 'progressively increase the Minimum Wage to \$20 per hour by 2020, with the final increase to take effect in April 2021'. Cabinet also published an indicative rate of \$18.90 from 1 April 2020, although the indicative rate is not binding on the Minister. The purpose of this impact assessment is to review and analyse the options that lead toward the Government's objective, as well as to contextualise any impacts through comparisons to other minimum wage rates.

2.5 What do stakeholders think?

The published indicative rates were determined in consultation with stakeholders during the 2018 annual review. The majority of stakeholders expressed a preference to reach the \$20 target through even annual increases, as opposed to front-loaded or back loaded increases. This resulted in the indicative rates of \$17.70 from 2019, \$18.90 from 2020 and \$20 from 2021.

In 2019, consultation was again carried out with BusinessNZ and the New Zealand Council of Trade Unions (NZCTU). Both organisations expressed a preference for a minimum wage rate other than the indicative rate of \$18.90. BusinessNZ suggests the minimum wage should be set as a percentage of the median wage, with the percentage determined by a review and limited by inflation as measured by CPI. The NZCTU proposed an increase to \$21.80 (preferred step for 1 April 2020), \$19.41 (suggested alternative step for 1 April 2020) or \$19.00 (suggested approach to the \$20 target).

While it is not either agency's preferred rate, the increase to \$18.90 is supported as the best pathway to achieve the rate of \$20 by 2021 the Government committed to. Both organisations preferred the increase to occur through a gradual approach, namely through the indicative rates of \$17.70 from 2019 and \$18.90 from 2020.

In accordance with the four-year cyclical comprehensive review prescribed by Cabinet in 2012 (CAB Min (12) 41/5B), MBIE sought feedback from additional stakeholders beyond the social partners. Specifically, Living Wage Aotearoa New Zealand and J R McKenzie Trust were invited to share their views, respectively, about the impact the living wage has had on businesses and workers and how minimum wage increases are likely to impact child poverty and poverty in general. Living Wage Aotearoa was invited to comment on the differences between the living wage and the minimum wage as well as highlight the effects on employers and employees that have adopted the living wage. J R McKenzie Trust was invited to provide feedback about the possible effects of minimum wage increases in the fight against poverty because of their direct insight into households living under the poverty line.

Living Wage Aotearoa New Zealand emphasised the positive benefits the organization has noted from employers who have adopted the living wage, including how some employees are able to choose to reduce their work hours to spend more time with family. J R McKenzie Trust highlighted the importance of the minimum wage in the fight against poverty, while noting that the minimum wage is only one element in addressing poverty levels. J R McKenzie Trust encourages the Government to continue to increase the minimum wage even if the effects of the increase are difficult to measure, citing mostly positive results from

its own research.

A number of agencies were requested to provide their estimated costs from increases to the minimum wage. The agencies that provided detailed costs information were the Ministry of Health, Accident Compensation Corporation, Ministry of Social Development, Ministry of Education, Oranga Tamariki, and the New Zealand Defence Force. Their costs are included in MBIE's assessment of minimum wage options.

The Treasury, Accident Compensation Corporation, Department of the Prime Minister and Cabinet (Policy Advisory Group and Child Poverty Unit), Inland Revenue, Ministry of Justice, Ministry for Pacific Peoples, Ministry for Women, Te Puni Kōkiri, the Reserve Bank of New Zealand and the State Services Commission have also been consulted in this review.

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Section 3: Options identification

3.1 What options are available to address the problem?

A range of options were developed to analyse and model the impacts of increasing the minimum wage. MBIE's model assesses the effects of minimum wage changes across three 'modelling approaches' that comprise high, middle and low estimates. The 'modelling approaches' are: 'groups most affected' (low), '16-64 year olds – Relative Impact' (middle) and '16-64 year olds – Direct Impact' (high).

As stated above, the options selected for consideration in this year's report are:

- \$17.70 (status quo)
- \$18.20
- \$18.70
- \$18.90 (published indicative rate for 2020 and MBIE's preferred rate)
- \$19.40
- \$19.90
- \$20.55
- \$21.15 (proposed by Living Wage Aotearoa as a 'living wage')

The options were agreed to by the Minister of Workplace Relations and Safety. The fifty cent increments between most of the options are designed to enable agencies that provide fiscal impacts with the ability to submit useful estimates. Specific options for rates are needed to be provided in order for the agencies to interrogate their payroll in order to determine the impacts at each rate.

Setting the starting-out wage and training minimum wage

The Minimum Wage Order 2020, which will set the adult minimum wage, will also set the starting-out wage and training minimum wage. These wage rates are available to some workers who meet appropriate criteria.

The Act requires these other minimum wages to be no less than 80 per cent of the adult minimum wage, which means that they would be set at \$15.12 per hour. MBIE has not considered other options for the starting-out wage and training minimum wage because:

- a differential between these rates and the adult minimum wage rates may support the transition of youth into employment
- employers expect these minimum wages to be 80 per cent of the adult minimum wage
- maintaining the training minimum wage rate at 80 per cent of the adult minimum wage helps further the policy objective of incentivising employers to take on and support trainees
- legislation does not allow a rate lower than 80 per cent and anything substantially higher than 80 per cent might reduce incentives for employers to take on trainees
- it is important that the starting-out and training minimum wages are the same, as they are often used interchangeably.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The criteria used to assess the impacts of the proposed minimum wage are consistent with MBIE's assessments in previous reviews of the minimum wage. The criteria includes those prescribed by Cabinet in 2012 (CAB Min (12) 41/5B) and other additional factors, and are used here to indicate likely impacts or trade-offs, rather than for directly comparing options. An overview of MBIE's analysis of each criterion is provided in the following section.

The mandated criteria prescribed by Cabinet are:

- inflation, using the Consumer Price Index (CPI) as the indicator
- wage growth, using the median wage as the indicator
- restraint on employment growth
- fiscal impacts.

Additional factors in this year's review are:

- living costs and financial needs of workers and their families
- actual income of workers and households after tax and social transfers
- relativity of minimum wages to welfare benefits and the average and median wages
- distributional impact of any minimum wage change
- the impact on employer and employee confidence and certainty if there is a departure from the published indicative rate of \$18.90 by 1 April 2020
- increasing the minimum wage to \$20 by 1 April 2021
- impact on workers
- impact on employers
- impact on poverty
- the Government's goals for the economy.

Of the criteria above, MBIE prioritises achieving a balance between increasing the real incomes of minimum wage workers and reducing employment effects, within the context of a Government commitment to raise the minimum wage to \$20 by 1 April 2021. A different set of factors or prioritisation, such as favouring maximum wage growth regardless of employment effects, would likely result in very different preferred options and recommendations.

3.3 What other options have been ruled out of scope, or not considered, and why?

Options greater than \$21.15 have not been considered. This is because the Government's commitment is to reach \$20 by 2021 and increases larger than \$21.15 are unlikely to be adopted due to the significant employment and inflation impacts.

Options less than the status quo have not been considered as no increase would erode the real incomes of the lowest paid workers compared to wage growth and inflation.

Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

Table 2: Summary of impacts of minimum wage options

Minimum wage rate impact measures	Option 1	Option 2	Option 3	Option 4	Option 5	Option 6	Option 7	Option 8
Adult minimum wage (hourly rate)	\$17.70	\$18.20	\$18.70	\$18.90	\$19.40	\$19.90	\$20.55	\$21.15
Adult minimum wage (gross weekly income) ³	\$708.00	\$728.00	\$748.00	\$756.00	\$776.00	\$796.00	\$822.00	\$846.00
Percentage increase	-	2.82%	5.65%	6.78%	9.60%	12.43%	16.10%	19.49%
Relativity to median wage ⁴	69.4%	71.4%	73.3%	74.1%	76.1%	78.0%	80.6%	82.9%
Relativity to Job Seeker support ⁵	289%	297%	306%	309%	317%	325%	336%	346%
Number of people directly impacted (rounded up to nearest 100)	85,400	176,200	222,000	242,400	311,400	347,400	449,900	518,500
Estimated restraint on employment ⁶	N/A ⁷	N/A	-4,500	-6,500	-11,500	-17,000	-23,500	-30,000
Estimated economy-wide increase in wages (\$m, annual)	-	88	235	306	532	800	1,251	1,731
Estimated inflationary impact/GDP (percentage points)	-	-	0.10%	0.10%	0.20%	0.30%	0.40%	0.60%
Additional annual costs to the government (\$m) ⁸	-	\$20.6	47.6	\$61.6	89	126	171	220

³ This is calculated on a 40 hour week basis.

⁴ The median hourly earnings are \$25.50 per hour (Labour Market Statistics (Income), June 2019).

⁵ For a single adult, aged 25 or over, receiving \$244.67 (gross) per week.

⁶ The employment effects for '16-64 year olds' are represented. Figures rounded to the 500s.

⁷ MBIE's model does not produce negative employment effects when the rate of change in the minimum wage is smaller than the rate of change in the average wage.

⁸ This is a high level estimate based on the additional costs to the Ministries of Health, Accident Compensation Corporation, Social Development, Education, Oranga Tamariki and the New Zealand Defence Force. It does not include potential transfer savings.

4.1 Analysis of criteria and objectives

MBIE has modelled all the options in Table 2 against the criteria in section 3.2. The analysis below demonstrates how MBIE's preferred option of \$18.90 is assessed against the factors for consideration.

Relativity to median and average wages

MBIE has assessed the relativity of minimum wage options to both median and average wages. The median wage is currently \$25.50 per hour (June 2019 Labour Market Statistics (income)) and the average wage is \$32.65 per hour (September 2019 Labour Market Statistics). If these same rates were used to assess an increase to \$18.90 on 1 April 2020, the proposed minimum wage would lift relativity from 70.8 per cent to 74.1 per cent of the median wage and from 56.5 per cent to 57.9 per cent of the average wage – which would be an historic high (these figures could change by the time the new minimum wage is introduced on 1 April 2020). The implication is that the closer the minimum wage is to the median wage, the greater its potential to raise the income of many New Zealanders (assuming there is no significant reduction in work hours) and to contribute to positive economic growth. This especially applies to young people, although they risk experiencing greater disemployment effects and labour substitution for slightly older or higher skilled workers.

Number impacted

MBIE's model estimates the number of people who are likely to be paid each option for the minimum wage. The number of people impacted provides an estimate of how many employees will receive a pay increase, which is also related to restraint on employment.

A minimum wage of \$18.90 will impact an estimated 242,400 workers – many of whom will receive an increased wage as they are paid between the current minimum wage of \$17.70 and the proposed minimum wage of \$18.90. The predicted number of workers is larger than in previous years (209,200 in 2018 and 164,100 in 2017).

Each review estimates the number of workers earning below the proposed new rate, and estimates the direct costs of increasing their wages to that proposed new rate. However, in reality many of these workers will not receive one single increase that year to adjust their rate to the new minimum wage rate. For instance, some will receive a higher increase on 1 April, while others will receive the required adjustment to the new rate, but then also receive further increases during the year such as to reward performance, or as a result of promotion, or through a collective agreement renegotiation. This is why the number of people estimated to shift up to the new minimum wage rate in any year does not provide an estimate of the number of people we expect to be being paid that rate a year later. For instance, the 2017 review estimated that 164,100 people would receive an increase to earn the proposed minimum wage of \$16.50. However the 2018 review estimated the number of workers actually earning the minimum wage to be 71,500. Likewise, the 2018 review estimated that 209,200 people would receive an increase to earn the proposed minimum wage of \$17.70. In this year's review the number of workers earning the minimum wage is 85,400.

These figures, taken together with other statistics such as the current low unemployment rate, provide insight into the impacts of minimum wage increases. They tell us that the low paid workforce is dynamic and that many workers shift out of the range close to the minimum wage rate. Potentially many move both in and out of the range regularly. In regard to the

group impacted directly by last year's review the data shows:

- 209,200 workers were receiving less than \$17.70 when the review occurred and therefore this was the group that would be directly affected by the change to that rate
- The number of workers receiving \$17.70 at the time of the current review is 85,400 – much lower than the number estimated to have had an increase up to that rate.
- The difference in these figures is likely because of a combination of the following factors:
 - Some of the 85,400 were never actually part of the 209,200 identified in 2019 – there will be new or returning entrants to the labour market, and workers that have taken a job at the minimum wage rate but previously received a higher rate in a different job
 - Many of the 209,200 will have received an increase or increases during the year to take them beyond the minimum wage rate to reflect competence, productivity, experience or training levels
 - Many will have changed jobs, receiving higher pay, etc.

Given the low unemployment rate (4.2 per cent) and reports of difficulty finding employees that have skills required in many sectors, it is not surprising that there are indications such as these that many low paid workers have received increases larger than the statutory minimum, during the year, or been placed in jobs paying a higher rate than the minimum wage.

Restraint on employment

MBIE's model estimates the effects on employment due to an increased minimum wage. Restraint on employment can be defined as the number of individuals not in employment that would have been if the minimum wage had not increased. Estimates on restraint on employment are based on historic elasticities for various groups of minimum wage earners. Restraint on employment can be due to labour-capital substitution (where employers swap low-wage labour for capital investment), or labour-labour substitution (where employers hire higher-wage workers due to better returns on the cost of labour), or through marginal firms exiting the market because of higher costs. Restraint on employment is a mandated criterion.

The estimated restraint on employment for a minimum wage of \$18.90 is 6,500 (low estimate of 4,000 and high estimate of 7,500), compared to forecast employment growth of 43,600 in 2020. MBIE judges the 6,500 figure to be the best predictor of employment effects, when considering all iterations of the model. This is a net figure, and it includes both positive and negative effects for different groups. MBIE's approach to the minimum wage has been to recommend options that balance potential employment effects against anticipated benefits to workers from increased wages. This year's preferred rate of \$18.90 accomplishes this by creating higher wage growth than the first three options but lower disemployment than the other four options under consideration.

This year's estimates are based on the Treasury's official wage growth forecasts contained in the Treasury's Budget Economic and Fiscal Update 2019. In contrast, the restraints on employment estimates from the Minimum Wage Review 2018 were based on NZIER's wage forecasts, found in their Quarterly Predictions. For comparative purposes, restraint on employment estimates for the \$18.90 indicative rate based on NZIER's September 2019 quarterly predictions is 4,500 (low estimate of 3,000 and high estimate of 5,000).

Labour market statistics for the September 2019 quarter indicate that the unemployment rate rose slightly from 3.9 per cent to 4.2 per cent, which remains at a very low level. The employment rate has remained steady at 67.5 per cent (2,641,000 individuals) and 6,000 additional people were employed during the quarter. Wage rates also increased 2.4 per cent annually. As mentioned, employment growth of 43,600 jobs is forecast in 2020. The indicative minimum wage increases of \$18.90 from 1 April 2020 and \$20 from 1 April 2021 have also been widely publicised. In light of the above, MBIE considers that the current economic context, including forecast employment growth of 43,600 in 2020, provides a sufficient basis to support the proposed increase to \$18.90 with relatively minor impacts.

Economy-wide wage increase

MBIE's model provides an estimate of the total increased cost of labour across the entire economy. It does not include any ripple effect for workers whose wages above the minimum wage are increased for reasons of relativity, as these are a result of individual decisions made by employers. Wage growth is a mandated criterion.

The estimated economy-wide impact of \$306m is greater than previous years' estimates for the option that was chosen (\$231m in 2018, \$129m in 2017 and \$65m in 2016). While the increase to the minimum wage rate is the same as occurred last year (\$1.20), the economy wide increase is larger because more workers are expected to receive an increase.

While the minimum wage increase raises the concern of wage compression at the bottom of the wage scale, previous reviews have not shown this to occur in a significant way. As mentioned, the number of workers earning the minimum wage is generally lower than the figure estimated in the previous annual minimum wage review.

Inflationary impact

MBIE's model estimates the possible impact on general price inflation as a result of proposed increases to the minimum wage. Inflation is a mandated criterion.

MBIE's model estimates that there will be a minor direct inflationary impact (0.1 per cent) to the price levels in the economy of increasing the minimum wage to \$18.90. There is also uncertainty around the impact that wage inflation might have on consumer price inflation. In addition, MBIE is unable to quantify the ripple effects to wages above the minimum wage and any corresponding wage inflationary pressure, which could have flow-on effects to general price inflation and interest rates. The Government's signalled increase to \$20 by 1 April 2021 may also have an effect on inflation, but the extent to which this might occur is not possible to quantify.

Stats NZ reports that the CPI increased 1.5 per cent for the year to September 2019 and that wage rates increased 2.4 percent annually. These figures indicate that last year's minimum wage increase of \$1.20 did not disproportionately affect both the CPI and wage inflation rates.

Costs to government

The costs to government of an increased minimum wage are estimated based on modelled costs for a number of agencies and ministries at each minimum wage option. MBIE received fiscal impact estimates from the Ministry of Health, the Ministry of Education, the Ministry of Social Development, Oranga Tamariki, Accident Compensation Corporation, and the New Zealand Defence Force.

The estimated additional costs to government (based on agencies' feedback) are higher than in 2018, largely due to the increased percentage of workers captured by the proposed minimum wage. This year, a \$1.20 increase is estimated to cost government \$61.6 million annually.

The estimated costs to government of \$61.6 million are lower than last year's estimated costs of \$93.1 million (for an increase of the same amount - \$1.20). This is primarily due to the removal of the Accident Compensation Corporation's outstanding claims liability (OCL) figures from the estimate of fiscal impacts. The OCL estimate has been removed because it is not a direct cost that the agency must pay during the year. Rather, it is an actuarial estimate of the funds that would be required now to meet the future cost of all existing claims. This cannot be compared to the other costs, and has a distorting effect on the cost estimates.

Although increases to the minimum wage are predicted to increase costs for government, they are also expected to impact the tax and transfers system and other social policy programmes. While it is not possible to quantify the exact impacts, MBIE expects the following outcomes:

- a minimum wage increase could lead to decreased spending as a result of lower entitlements being paid out due to higher abatement rates of welfare benefits and other social assistance (eg Working for Families Tax Credits)
- the number of people required to make student loan repayments could increase, as well as the repayment rates attached to the loans
- the amount of KiwiSaver contributions could rise, which could increase costs if more people receive their full member tax credit entitlement
- it is expected that PAYE tax paid by employees will increase, but government revenue is likely to be offset by a decrease in corporate tax paid by employers (as wages are a line item expense, i.e. deductible from employer gross revenue)
- an increase in the minimum wage may lead to more people having more disposable income, which could result in greater consumer spending and the collection of more GST.

Impact on workers

MBIE has considered the impacts of minimum wage increases on workers. Workers who are female, Māori, part-time employees, without formal qualifications, or working in the retail and hospitality industries are more likely to be paid at the minimum wage rate. These workers are therefore generally more likely to benefit from an increase to the minimum wage. However, they may be the first to experience the negative impacts that could result from an increased minimum wage (such as reduced work hours or the substitution of some groups of workers for others).

Table 3 shows the demographics of minimum wage earners if the minimum wage is increased to \$18.90.

Table 3: Demographics of wage earners at \$18.90

Demographic	% of minimum wage earners	% of total wage earners
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	16-24 year olds	25-64 year olds	16-64 year olds	16-64 year olds
Aged 16-24 years	100%	0%	45%	17%
Female	53%	66%	60%	50%
European/Pakeha	58%	45%	51%	61%
Māori	18%	15%	17%	13%
Pacific	8%	8%	8%	6%
Part-time	57%	34%	45%	17%
Studying	29%	9%	18%	12%
Total	109,800	132,600	242,400	2,010,900

Wages often make up only a portion of the income of minimum wage earners. There are a range of government interventions and initiatives aimed at protecting employment and increasing incomes. These interventions encompass labour market policies, the social assistance system, the taxation system, and education and training policies.

Tables 4 and 5 set out the anticipated increase in weekly income (at a minimum wage rate of \$18.90) for two family types in various regions that are eligible for different rates of government transfers, including Working for Families and the Accommodation Supplement.

Table 4: A couple working a combined 60 hours per week at \$18.90 per hour with two dependent children living in various regions across New Zealand

Minimum wage		Auckland	Ashburton	Whakatane
\$18.90 (+6.78%) from current minimum wage	Combined household net earnings	\$49,788.94	\$49,788.94	\$49,788.94
	Government transfers after abatements	\$19,751.00	\$11,680.60	\$12,211.00
	Total annual household earnings	\$69,539.94	\$61,469.54	\$61,999.94
	Per cent increase in annual earnings	1.70%	1.93%	2.11%

Table 5: A solo parent working 40 hours per week at \$18.90 per hour with two dependent children living in various regions across New Zealand

Minimum wage		Auckland	Ashburton	Whakatane
\$18.90 (+6.78%) from current minimum wage	Combined household net earnings	\$32,865.96	\$32,865.96	\$32,865.96
	Government transfers after abatements	\$27,783.00	\$20,185.80	\$16,967.00
	Total annual household earnings	\$60,648.96	\$53,051.76	\$53,004.96
	Per cent increase in annual earnings	2.36%	2.71%	2.51%

Impact on employers by sector

The impact of a minimum wage increase on various sectors depends on the number of employees earning the minimum wage and those earning close to it. In New Zealand (and in many countries), employers in the hospitality, retail and administrative services sectors are more likely to have staff paid at, or close to, the minimum wage than employers in the professional, technical, or health sectors.

Table 6 provides an overview of the number of minimum wage earners in different sectors.

Table 6: Minimum wage workers by sector at \$18.90

Sector	Workers		Working Hours	Their Earnings
	% of total workers	Number	% of total hours	% of total earnings
Agriculture	14.6%	11,500	13.8%	10.0%
Mining	S ⁹	S	S	S
Manufacturing	10.2%	19,400	9.1%	5.4%
Utilities	6.0%	1,200	6.5%	3.3%
Construction	6.4%	9,900	5.5%	3.3%
Wholesale	7.9%	7,000	6.8%	3.7%
Retail	29.0%	60,600	23.5%	17.3%
Hospitality	42.5%	49,400	32.8%	28.0%
Transport and Storage	9.8%	9,100	8.0%	4.9%
Information and Telecommunications	6.6%	2,100	6.2%	3.2%
Finance	1.9%	1,300	1.5%	0.6%
Real Estate	10.1%	3,400	7.3%	3.6%
Professional Services	3.2%	5,700	2.7%	1.2%
Administrative Services	21.5%	13,400	17.9%	11.2%
Public Administration	3.4%	4,700	3.2%	1.6%
Education	7.9%	14,900	5.6%	3.3%
Health	5.7%	12,600	4.3%	2.5%
Arts and Recreation	13.6%	4,500	8.7%	5.1%
Other Services	11.1%	8,200	9.0%	6.0%
Total	12.1%	242,400	9.3%	5.4%

The impact of the minimum wage in the regions is determined, in part, by understanding both the number and proportion of minimum wage earners in that region. At the rate of \$18.90, Northland would have a higher proportion of its workers earning the minimum wage than other regions, making up 17.4 per cent of all workers in Northland.

Table 7: Minimum wage earners by region at \$18.90

Region	Number (%)
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⁹ The values are suppressed if a cell value is lower than 1,000.

Northland	10,100 (17.4%)
Auckland	73,400 (10.2%)
Waikato	22,800 (12.4%)
Bay of Plenty	14,300 (12%)
Gisborne/ Hawke's Bay	12,000 (15%)
Taranaki	7,500 (15.6%)
Manawatu-Wanganui	15,000 (15.7%)
Wellington	24,000 (9.9%)
Nelson/Tasman/Marlborough/ West Coast	9,000 (12.8%)
Canterbury	34,400 (13.5%)
Otago	13,300 (13.6%)
Southland	6,600 (15.5%)

Impact on poverty

Analysis conducted by the Child Poverty Unit and Ministry of Social Development indicates that minimum wage increases, on their own, are likely to have a limited impact on measured income poverty for those with children. There are a number of reasons for this: minimum wage earners can be found in households across the income distribution; a relatively small proportion of people earning the minimum wage are parents living with dependent children; and in-work income support (such as Family Tax Credits and supplementary assistance like the Accommodation Supplement) 'tops up' the earned income of most low income families to a level that is above standard poverty lines. It is important to note that this conclusion relies on households fully receiving the in-work income support to which they are entitled. Available evidence suggests there are take-up issues with both the Accommodation Supplement and the Minimum Family Tax Credit (MFTC).

It is more difficult to assess the impact of minimum wage increases on material hardship as this is experienced across the household income distribution, and is influenced by a broad range of factors, of which income is only one.

Minimum wage increases are more likely to have an impact on poverty rates for households without children. This is because they are more likely to be on the lowest wages and are not subject to abatements on government support that occur for households with children when the family's income rises.

Section 5: Conclusions

5.1 What option, or combination of options, is likely to best address the problem, meet the policy objectives and deliver the highest net benefits?

MBIE's analysis of the Government's proposed minimum wage is that there are positive benefits for workers of increased incomes, as well as potential negative impacts (such as a restraint on employment or the risk of increased inflationary pressure). Taking the best available knowledge into consideration, and for the reasons set out below, MBIE recommends increasing the adult minimum wage to the Government's indicative rate of \$18.90 by 1 April 2020.

The increase of \$1.20 (to \$18.90) represents a steady, predictable and balanced approach to increasing the minimum wage to \$20 by 1 April 2021, in line with the Government's Coalition Agreement commitment. Front- and back-loaded approaches, which include larger increases in some years, are associated with higher risks and levels of uncertainty. In light of the Government's published indicative rates for minimum wage increases, many employers and workers are expecting a \$1.20 increase in 2020.

MBIE considers that the current economic context is able to support this increase with relatively minor impacts. As stated, the unemployment rate has inched up to 4.2 per cent but remains at a very low level and the employment rate remains steady at 67.5 per cent for the September 2019 quarter. The published indicative rates of \$18.90 for 1 April 2020 and \$20 for 1 April 2021 have been widely publicised.

The rate increase will have positive impacts for low-paid workers by raising their income. Up to 242,400 workers (those currently earning up to \$18.90) are estimated to receive an increase up to the new minimum wage. Many of those earning above the new minimum wage can also expect an increase over time as relative wage rates between different roles are addressed. New entrants to employment can also expect to start employment at a higher wage rate, all of which represents an increase in hourly wages and overall income for many workers. A minimum wage of \$18.90 will result in historically high relativities to the median and average wages (which is already high in New Zealand compared to other OECD countries), which furthers the goal of lifting more individuals out of low wages.

The estimated restraint on employment for this year's proposed minimum wage increase to \$18.90 is 6,500, compared to the forecast employment growth of 43,600 in 2020. The estimated restraint on employment would be lower, at 4,500, if the model had used NZIER's figures instead of the Treasury's wage growth forecasts. Both figures are lower than last year's estimated restraint of 8,000, indicating that minimum wage workers will be better off through increased incomes compared to relatively minor negative employment effects.

The preferred rate of \$18.90 will increase the real income of minimum wage workers more than the first three rate options (\$17.70, \$18.20, and \$18.70) and limit disemployment effects more than the higher four options (\$19.40, \$19.90, \$20.55 and \$21.15).

The minimum wage model identifies a small direct inflationary impact (0.1 per cent) to the general price level from increasing the minimum wage to \$18.90. MBIE also acknowledges the risk of inflationary pressure on wages due to relative pay adjustments for wages above the minimum wage as well as the risk of wage compression at the lower end of the wage distribution scale.

The estimated additional annual cost to government of a minimum wage increase to \$18.90 is \$61.6 million. The increase would also affect the tax and transfer system and other social policy programmes. Last year's increase to \$17.70 was estimated to cost the Government approximately \$93 million a year. The reduced costs for this year's estimate are due to the removal of the Accident Compensation Corporation's outstanding OCL figures from the equation.

5.3 What other impacts is this approach likely to have?

Despite well-publicised indicative rates for the minimum wage, worker representatives may continue to advocate for higher minimum wage rates. The adoption of the Living Wage by core government agencies may also place additional pressure on the perceived appropriateness of the proposed minimum wage rate. In contrast, business representatives may argue that the minimum wage increase raises the costs of work without changing its value, resulting in job losses.

The target rate of \$20 from 1 April 2021 allows businesses to prepare for future minimum wages, but may also trigger a number of responses from employers, such as an increase in the prices of goods or services, reduced hours, capital investments, or substitution of some groups of workers for others. To date, MBIE has not found any evidence of such responses occurring on a large scale, despite the relative large increase of \$1.20 in last year's minimum wage. The flow-on effects of relative pay adjustments are also difficult to quantify.

In many households, the total income will increase along with the higher minimum wage, which will make it easier for minimum wage earners and their families to meet living costs. However, some households with a minimum wage earner will not receive the full financial gains of a minimum wage increase because their higher level of income may reduce the amount of financial assistance they are entitled to receive through Government transfers such as Working for Families and the Accommodation Supplement. This occurs as the amount of government assistance someone is eligible to receive abates as the income of the recipient increases. The reduction in assistance paid out will slightly offset the costs to Government of the minimum wage increase, although the extent of this cannot be quantified.

Individuals most likely to benefit from minimum wage increases, including youth, females, and Māori working in the hospitality, retail, and administrative service sectors are also the most likely to be impacted by reduced hours or lower jobs growth. Nevertheless, the minimum wage increase to \$18.90 is estimated to affect up to 242,400 workers who will benefit from higher wages.

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

The preferred option is compatible with the Government's expectations for the design of regulatory systems as the preferred option delivers net benefits to New Zealanders and meets the criteria outlined in the 'Government Expectations for Good Regulatory Practice' document.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

Any increase to the minimum wage is made by Order in Council under the Act. The new minimum wage (and training minimum wage and starting-out wage) traditionally take effect the following 1 April. This convention provides the greatest certainty for employers and businesses and, importantly, aligns with the tax year. Press releases and media statements will be used to communicate the increase in a way that ensures clear messaging.

Once implemented, all employers will be required to pay their workers at least the adult minimum wage (or the applicable training wage or starting-out wage). Failure to provide this minimum pay would mean that the employer is in breach of the Act, and liable for penalties and recovery of wages.

6.2 What are the implementation risks?

Increasing the minimum wage is straightforward and requires no significant process or procedural change. Effective communication and signalling is required.

Increased minimum wages present the risk that some employers may attempt to avoid paying the minimum wage. For example, employers may make decisions about their business practices that are designed to avoid paying the new minimum wage, such as shifting work to independent contractors. Other employers may simply fail to comply with the Act by paying wages that are lower than what the Act allows.

As with any minimum wage increase, there is a risk of changing economic, labour market, or other factors that could result in the effects of the minimum wage increase being different from those modelled.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

MBIE has ongoing responsibilities to support the Minister in their annual review of the minimum wage. The effects of minimum wage increases are monitored by analysing a range of labour market and economic statistics regularly published by Stats NZ and other organisations. The outcome of the statistical analysis will inform future recommendations on the minimum wage rate.

7.2 When and how will the new arrangements be reviewed?

There is a statutory requirement to review the minimum wage on an annual basis.

In light of the Government's intention to increase the minimum wage every year, MBIE will continue to monitor the long-term impacts of minimum wage increases, paying particular attention to potential employment effects. The effects of minimum wage increases are monitored by analysing quarterly labour market statistics published by Stats NZ and other organizations, through other economic indicators, and through feedback provided to Government from surveys and letters to Ministers. The results of the analysis will feed into MBIE's future reviews of the minimum wage.

There are several current initiatives aimed at improving outcomes for New Zealand's lowest paid workers, such as work to address pay inequity, and changes that have increased wage rates for the lowest paid public sector workers. These and other initiatives create additional complexity when attempting to determine the impact of minimum wage changes. However each initiative also provides additional evidence and understanding of the impacts of policy on employees paid close to or near the minimum wage, and on their employers, and how these impacts can have flow on effects for the rest of the labour market. There will be ongoing monitoring and consideration of the impacts on the labour market from these initiatives, as well as in light of this year's minimum wage increase.