

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

<p>Problem Definition</p> <p>What problem or opportunity does this proposal seek to address? Why is Government intervention required?</p>
<p>This proposal implements the Government’s commitment contained in the coalition agreement to increase the minimum wage to \$16.50 from 1 April 2018.</p>

Section B: Summary Impacts: Benefits and costs

<p>Who are the main expected beneficiaries and what is the nature of the expected benefit?</p>
<p>The proposed minimum wage is expected to apply to approximately 164,100 workers, who are currently paid between \$15.75 and the increased minimum wage of \$16.50. Many of these will receive an increased pay, with 76,400 paid the current minimum wage of \$15.75. The increase of 4.8 per cent since 1 April 2017 means that the minimum wage remains above the rate of inflation (1.9 per cent annual increase in the third quarter of 2017). The minimum wage provides a wage floor for workers, to ensure that they receive a high enough wage for their employment. The Government has confirmed its objective of lifting wages for low-paid workers, and increasing the minimum wage is one part of this policy objective.</p>

<p>Where do the costs fall?</p>
<p>The costs of any minimum wage increase fall firstly to employers who will experience an economy-wide labour cost increase (of approximately \$129m in this case). The increased cost of labour may then be passed on to employers’ customers through rising prices of goods and services, as employers seek to maintain a profit. Increasing the minimum wage will inevitably create some wage inflationary pressure, but MBIE’s minimum wage model does not suggest any discernible impact. MBIE acknowledges that there is some uncertainty around the extent to which wage inflation might occur, and how this will impact on headline consumer price inflation.</p>

<p>What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?</p>
<p>Any increase to the minimum wage has the potential for affecting employment levels as the rising cost of labour may mean that employers choose to substitute labour for capital,</p>

or for higher-wage/higher-skill labour. MBIE's model predicts a possible negative employment effect (disemployment) of 3,000.

There is also a risk of a 'ripple effect' due to wages above the minimum wage also increasing faster than expected income growth. This has the potential to have a larger impact on employment, and the economy-wide wage bill.

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

None.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?

The minimum wage model used by MBIE has a relatively high level of confidence. International evidence for the impacts of the minimum wage – particularly any employment effects – is always context-specific and based on local labour market and economic conditions so it may be difficult to make accurate predictions for the New Zealand experience. The model is based on a number of assumptions, and was last reviewed in 2012. Longer-term effects of the minimum wage (such as for multi-year increases) are not captured in MBIE's review.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:

MBIE

Quality Assurance Assessment:

Not applicable for 100 Day Plan priorities.

Reviewer Comments and Recommendations:

These comments by MBIE's Regulatory Impact Analysis Review Panel are based on revised expectations for Impact Analyses covering 100 Day Plan priorities. Given the constraints that have been highlighted in the Impact Statement, the Impact Statement appropriately reflects the analysis and consultation that has been able to be completed. The potential impacts of the proposed approach have been broadly identified, and the analysis is methodical and thorough. Gaps in evidence, risks and downsides are acknowledged. Where stakeholders have provided views these have been summarised. It will be important to ensure monitoring and evaluation processes for the increase in the minimum wage are undertaken in a timely way to inform discussion about the potential effects of future increases.

Impact Statement: Increasing the Minimum Wage

Section 1: General information

Purpose

The Ministry of Business, Innovation and Employment is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to raise the minimum wage to \$16.50 to be taken by or on behalf of Cabinet

Key Limitations or Constraints on Analysis

- The Government has committed to increase the minimum wage to \$16.50 as part of its 100 Day Plan for manifesto and coalition policy priorities.
- MBIE’s model has been used for a number of years, and has provided labour market analysis for increases. Like all economic models, it is based on a series of assumptions. The model was last reviewed in 2012, and a number of stakeholders have previously indicated to MBIE that the model should be again reviewed.
- There is little evidence of the specific uptake of the starting-out wage and training minimum wage, but the evidence that does exist suggests that relatively few workers are paid the starting-out wage, while some trainees are paid the training minimum wage. Recent survey data suggests that 4 per cent of employers use the starting-out wage, and 1 per cent of employers use the training minimum wage. These figures are unlikely to accurately represent the number of employees that are paid less than \$15.75 using these other minimum wages. For example, some of the employers using the training minimum wage are likely to be industry training organisations and have many employees earning the training minimum wage.
- The extent to which the minimum wage has an employment effect 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.

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 current minimum wage is \$15.75, and is paid to an estimated 76,400 employees. Some sectors and demographics are more likely than others to be paid the minimum wage. The below table provides a summary of who is paid the minimum wage currently (at \$15.75) based on MBIE’s modelled data and survey data from the Labour Market Statistics (Income).

Table 1: Demographics of workers paid \$15.75 per hour

Demographic	% of minimum wage earners			% of total wage earners
	16-24	25-64	16-64	
Aged 16-24	100.0%	0.0%	55.7%	17.1%
Female	57.3%	64.0%	60.3%	49.2%
European/Pākehā	56.3%	33.9%	46.4%	64.4%
Māori	20.0%	18.2%	19.2%	13.0%
Pacific	7.4%	9.5%	8.3%	6.1%
Part-time	71.0%	46.7%	60.2%	18.7%
Studying	30.4%	13.4%	22.9%	12.0%
Total	42,500	33,900	76,400	1,965,312

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

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

This ensures that workers are paid an appropriate wage in compensation for their time, and that businesses are unable to ‘undercut’ their competition by paying less for their labour. Reviewing the minimum wage is one way to ensure that it maintains relativity to inflation and/or wage growth, so that minimum wage workers’ financial positions are not eroded over time if 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 wage each year, although the criteria are not specified in legislation. This year, the Minister’s review confirmed the Government’s commitment to increase the minimum wage to \$16.50 from 1 April 2018.

2.3 What is the policy problem or opportunity?

The minimum wage has, for the last 18 years, been incrementally increased by a rate of between 15c and \$1.00. There are many reasons to increase the minimum wage, a number of which are used for assessing possible minimum wages. These reasons include protecting real incomes for minimum wage earners (for example, using CPI as an indicator), maintaining relativity to median or average earnings, and lifting the incomes of low-income households.

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

Both employers and employees have expectations of the minimum wage increasing on a regular basis. This year, increasing the minimum wage is a key commitment in the Government's coalition agreement, and this proposal will deliver on this policy. The proposed increase to \$16.50 has been better signalled than most previous increases, as it was a pre-election policy that was also included in the Government's coalition agreement.

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

The Government has confirmed its commitment to increase the minimum wage to \$16.50 as part of its 100 Day Plan for manifesto and coalition policy priorities. The purpose of this impact statement is to provide an assessment and analysis of the proposed increase, as well as contextualising any impacts with comparisons to other minimum wage rates.

2.5 What do stakeholders think?

Consultation was carried out with BusinessNZ and the New Zealand Council of Trade Unions, but neither organisation provided submissions on what the minimum wage rate should be

A number of agencies were also consulted to gain information about their estimated costs for increases to the minimum wage. The agencies that provided costs information were the Ministries of Health, Social Development, Vulnerable Children Oranga Tamariki, Education and the Accident Compensation Corporation. Their costs are included in MBIE's assessment of minimum wage options.

The Treasury, Department of the Prime Minister and Cabinet, Inland Revenue, Ministry for Pacific Peoples, Te Puni Kōkiri, the Reserve Bank of New Zealand and the State Services Commission have also been consulted in this review.

Comments made by agencies have been included or reflected in this regulatory impact analysis, but specific comments include:

- The Treasury has commented that it is their expectation that government agencies manage any increases within baselines.
- The Reserve Bank of New Zealand raised the risk of wage inflation due to this increase having a larger-than-usual effect on price and wage expectations (generating a ripple effect to other wages above the minimum wage). If this was to occur, this may have implications for interest rates in order to maintain CPI inflation targets.

- The Accident Compensation Corporation noted the effect that minimum wage increases have for the scheme's Outstanding Claims Liability, which is recovered over a ten-year period through levies and appropriations.

Section 3: Options identification

3.1 What options are available to address the problem?

This analysis provides an assessment of the Government's coalition agreement to increase the adult minimum wage to \$16.50 per hour from 1 April 2018. The increase of 4.8 per cent is slightly higher than the compound annual increase of 3.4 per cent over the last 10 years. A number of other minimum wages have also been assessed for comparative purposes, and to contextualise the assessment of the impacts:

- Status quo: \$15.75
- \$16.00
- \$16.25 (a 50c increase, the same as the last four increases)
- \$16.50 (recommended option and Government commitment)
- \$16.95 (reflects the figure proposed by the Council of Trade Unions in their submission to last year's review)
- \$18.00
- \$19.00
- \$19.85 (66 per cent of the average ordinary time hourly earnings for the June 2017 quarter)
- \$20.20 (the current hourly wage proposed by Living Wage Aotearoa New Zealand)

Setting the starting-out wage and training minimum wage

The Minimum Wage Order 2018 which will set the adult minimum wage will also set the starting-out wage and training minimum wage, which are available to some workers who meet appropriate criteria. The *Minimum Wage Act 1983* 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 \$13.20 per hour. MBIE has not considered other options for the starting-out wage and training minimum wage at this stage because:

- the starting-out wage is likely to be removed in 2018, as per the Government's commitment to abolish youth rates
- the training minimum wage will be reviewed as part of this process
- 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 is necessary to achieve 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 would create a lowered incentive for employers to take on trainees
- although the starting-out wage is likely to be abolished, it is important that while it exists it is the same as the training minimum wage, as they are used interchangeably in some cases.

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 here include those prescribed by Cabinet in 2012 (CAB Min (12) 41/5B), and are used here to indicate likely impacts or tradeoffs, rather than for directly comparing options. An overview of MBIE's analysis of each criteria is provided in the following section.

Relativity to median and average wages

The median wage, as at June 2017, was \$24.00 per hour. The average wage was \$30.36.

Number impacted

MBIE's model estimates the number of people who are likely to be paid each option for the minimum wage. The figure for the status quo is the estimated number of people currently paid the minimum wage.

Restraint on employment

MBIE's model makes an estimate for impact on employment due to the increased minimum wage (or where the hours workers might reduce). This is based on historic elasticities for various groups of minimum wage earners. Jobs can be lost 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 return on the cost of labour), or through marginal firms exiting the market because of higher costs.

Economy-wide wage increase

This is 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 due to individual decisions made by employers.

Inflationary impact

MBIE's model estimates the possible impact on general price inflation an increased minimum wage might have.

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 that employ a large number of workers at each minimum wage option. We received costings from the Ministry of Health, the Ministry of Education, the Ministry for Social Development, the Ministry for Vulnerable Children Oranga Tamariki, and the Accident Compensation Corporation.

Section 4: Impact Analysis

Table 2: Analysis of minimum wages against each of the criteria in section 3.2

	Status quo	\$16.00	\$16.25	\$16.50	\$16.95	\$18.00	\$19.00	\$19.85	\$20.20
Weekly income based on 40 hours at Minimum Wage	\$630.00	\$640.00	\$650.00	\$660.00	\$678.00	\$720.00	\$760.00	\$794.00	\$808.00
Relativity to median wage (\$24.00, June 2017)	65.6%	66.7%	67.7%	68.8%	70.6%	75.0%	79.2%	82.7%	84.2%
Relativity to average wage (\$30.36, June 2017)	51.9%	52.7%	53.5%	54.3%	55.8%	59.3%	62.6%	65.4%	66.5%
Number impacted	76,400	92,300	142,400	164,100	210,800	319,600	421,000	502,600	568,200
Estimated restraint on employment	N/C	N/C	-1,000	-3,000	-6,500	-14,000	-21,500	-28,000	-30,500
Economy-wide wage increase	N/C	\$27m	\$74m	\$129m	\$255m	\$708m	\$1,338m	\$2,014m	\$2,333m
Estimated inflationary impact (CPI)	N/C	N/C	N/C	N/C	0.1%	0.2%	0.4%	0.6%	0.7%
Additional annual costs to government	N/C	\$6,326,046	\$12,823,552	\$19,584,248	\$34,679,015	\$73,834,484	\$124,593,606	\$198,240,216	\$239,804,439

Analysis of criteria and objectives

This section outlines MBIE's assessment of how the Government's preferred option of \$16.50 per hour meets each of the criteria described in section 3.2.

Relativity to median and average wages

In previous years, MBIE has assessed minimum wage options against the median wage, and has taken the approach that minimum wages should not be out of step with median wages. In this analysis, MBIE has assessed relativity to both median and average wages. The latest figures for income from Statistics New Zealand are for the June 2017 quarter, so are somewhat out of date for this analysis. If these same rates were used to assess an increase to \$16.50 on 1 April 2018, the proposed minimum wage would lift relativity to 68.8 per cent of the median wage and 54.3 per cent of the average wage – which would be an historic high. However, the NZIER consensus forecasts and Treasury's Pre-Election Fiscal Update forecast slightly higher wage growth than expected, so the exact relativity of the minimum wage to the median and average wages could change as these wages change.

Number impacted

A minimum wage of \$16.50 will apply to an estimated 164,100 workers – many of whom will receive an increased wage as they are paid between the current minimum wage of \$15.75 and the proposed minimum wage of \$16.50. The tables below show the demographics of minimum wage earners if the minimum wage is \$16.50, and also the sectors employing minimum wage workers at \$16.50. These tables look broadly similar to those in previous years.

Table 3: Demographics of workers paid \$16.50 per hour

Demographic	% of minimum wage earners			% of total wage earners
	16-24	25-64	16-64	
Aged 16-24	100.0%	0.0%	48.4%	17.1%
Female	53.5%	67.4%	60.6%	49.2%
European/Pākehā	57.6%	43.7%	50.5%	64.4%
Māori	19.1%	15.0%	17.1%	13.0%
Pacific	8.7%	10.6%	9.7%	6.1%
Part-time	64.1%	39.2%	51.4%	18.7%
Studying	29.5%	10.5%	19.9%	12.0%
Total	81,000	83,100	164,100	1,965,312

Table 4: Sectors employing workers at \$16.50

Sector	Minimum Wage workers		% of total Working Hours	% of total earnings
	% of total workers	Number		
Agriculture	7	5,400	7.2	4.9
Mining	Suppressed as less than 1,000			
Manufacturing	6	12,800	5.3	3
Utilities	1.8	400	1	0.4
Construction	3.7	5,600	3.4	1.9
Wholesale	4.8	4,700	4	1.9
Retail	18.1	34,700	14.5	10.2
Hospitality	35.2	42,000	28.1	23.2
Transport and Storage	3.9	3,300	3.6	2.1
Information and Telecommunications	5.3	1,900	3.3	1.4
Finance	Suppressed as less than 1,000			
Real Estate	5.3	1,400	4.2	2.2
Professional Services	2.4	3,800	1.8	0.8
Administrative Services	16.1	9,000	13.1	8.1
Public Administration	2.1	2,700	1.8	0.8
Education	3.1	6,200	2.3	1.3
Health	8.5	17,800	6.4	3.4
Arts and Recreation	13.9	4,600	9.1	4.9
Other Services	6.6	4,500	5.7	3.8
Total	8.3	164,100	6.2	3.3

Restraint on employment

An increase to the minimum wage may have negative employment impacts which include lower job growth and reduced work hours. MBIE's model estimates the effects that an increase to the minimum wage rate may have on employment growth. The estimated restraint on employment for a minimum wage of \$16.50 is 3,000. This is a net figure, and

includes both positive and negative effects for different groups. MBIE's approach to the minimum wage in previous years has been to recommend options based on minimising negative employment effects as much as possible. Given recent and forecast job growth, MBIE expects that the possible employment effect of the Government's preferred wage will be at least partially absorbed.

Economy-wide wage increase

The estimated economy-wide impact of \$129m is greater than previous years' estimates for the option that was chosen (\$65m in 2016, \$75m in 2015, and \$60m in 2014). This is in line with the fact that a large number of people are expected to be affected by the new minimum wage.

While this 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. In general, the number of people estimated to be earning a new minimum wage is higher than the actual number earning the minimum wage by the time of the next year's review.

For instance, in the 2016 review, 119,500 people were expected to be earning the new minimum wage of \$15.75. This year's model, however, estimated only 76,400 people are actually earning \$15.75. This is not because the model is incorrect, but because the structure of the labour market changes between each review of the minimum wage, and is captured in the June Labour Market Statistics (Income) survey.

Inflationary impact

MBIE's model estimates that there will be no discernible direct inflationary impact to the consumer price index of increasing the minimum wage to \$16.50. The model does not assess wage inflation, and there is uncertainty around the impact that wage inflation might have on consumer price inflation. MBIE also acknowledges that there is a risk that significant ripple effects to wages above the minimum wage could lead to much greater wage inflationary pressure, which could have flow-on impacts to general price inflation and interest rates. Expectations for wage growth due to the Government's signalled increase to \$20 by 2021 may also have an effect, but the extent to which this might occur is not possible to quantify.

Costs to government

The estimated additional costs to government (based on agencies' costings) are lower than in previous years, due in part to recent pay equity settlements in the health sector. For the purposes of comparison, in 2016 a 50c increase was estimated to cost \$29.38m and a 75c increase was estimated to cost \$40.44m. This year, a 50c increase is estimated to cost only \$19.58m.

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to 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 both positive benefits for workers of increased incomes, as well as potential negative impacts (such as restraint on employment or the risk of increased inflationary pressure).

Employers and workers already expect an increase to \$16.50, as this increase has been better signalled than previous increases.

The increase of 75c (to \$16.50) is broadly consistent with recent increases (of 50c) and most businesses and workers expect incremental changes to the minimum wage each year. While it is higher than the most recent minimum wage increases, the labour market and economic context is currently well placed to support this increase with relatively little impacts. A minimum wage of \$16.50 results in historically high relativities to the median and average wages.

This moderate increase will have positive impacts for low-paid workers through increasing their income. An estimated 164,100 people are currently earning wages between the minimum wage and the proposed minimum wage of \$16.50, so will benefit from the change.

The estimated restraint on employment for this minimum wage is 3,000. This is higher than last year's estimated restraint of 1,500, however the larger increase also benefits significantly more workers (164,100 compared to 119,500 last year). This indicates that minimum wage workers will be better off through increased incomes, compared to relatively minor negative employment effects. Further, the current strong labour market is expected to be able to absorb some of this impact.

The minimum wage model identifies no discernible direct inflationary impact of increasing the minimum wage to \$16.50, although MBIE acknowledges that there is the risk of greater inflationary pressure on wages due to a ripple effect for wages above the minimum wage.

There is also the possibility that minimum wage increases could lead to compression of wages at the lower end of the wage distribution. In the past this has been a concern raised, but there has been little evidence of this occurring. Previous reviews of the minimum wage estimate relatively similar numbers of people earning the minimum wage each year. However, the larger increases that may occur in the future (up to \$20 by 2021) could lead to wage compression. The possibility of either a ripple effect or wage compression caused by the increased minimum wage are, to some extent, also subject to market conditions.

The estimated additional cost to government (based on agencies' costings) are lower than in previous years, due in part to recent pay equity settlements in the health sector.

5.3 What other impacts is this approach likely to have?

Given the publicity surrounding the Government's commitments to increase the minimum wage to \$16.50 and then to \$20 by 2021, and policies such as paying the living wage to core government workers, there is the possibility that workers and unions will have higher than usual wage expectations for wages above the minimum wage. This could make the impact on wage inflation greater and, as explained above, there is uncertainty over the extent to which wage inflation might have an impact on general price inflation (CPI).

Likewise, signalling of future increases will allow businesses to prepare for future minimum wages, but may trigger some of the effects that would be expected of a larger increase before the new minimum wages are adopted. For example, businesses may start to make decisions about investing in staff and capital based on their expectations of higher minimum wages in the coming years. It is not possible to quantify or estimate the extent to which this may occur, but consultation for future increases may offer insights into businesses' expectations for minimum wages.

Increasing the minimum wage will, for many households, interface with in-work tax credits. Workers in low-income households whose incomes are currently supplemented by tax credits may not receive the full benefit of the wage increase due to abatement of their tax credits if their total income is over the abatement threshold. This will have an offsetting effect for fiscal impacts to Government, although the extent of this cannot be quantified.

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 *Minimum Wage Act 1983*. 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. Publicity and media statements will be used to communicate the increase in a way to ensure 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 *Minimum Wage 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, but MBIE considers that this increase to \$16.50 is better signalled than recent increases, due to its prominence in pre- and post-election publicity.

Increased minimum wages also present the risk that some employers may attempt not to comply and avoid paying the minimum wage. Likewise, employers may make decisions about their business practice in order to avoid the increased minimum wage for employees, such as increasing the use of contracted workers.

Section 7: Monitoring, evaluation and review

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

Monitoring the effects of the minimum wage increase is done by analysing a range of labour market and economic statistics that are collected and regularly published by Statistics New Zealand.

As MBIE has ongoing responsibilities to support the Minister to review the minimum wage annually, the monitoring of the minimum wage increase will be built into future assessments of any potential increase.

7.2 When and how will the new arrangements be reviewed?

The minimum wage is required to be reviewed each year.

Given the Government's intention for the minimum wage to increase to \$20 by 2021, the longer-term impacts of the minimum wage (especially regarding potential employment effects) will be of interest to MBIE, will continue to be monitored, and will feed into future reviews of the minimum wage.