

Submission

by

Business|NZ

to the

**Labour Market Policy Group, Department
of Labour**

on the

Annual Review of the Minimum Wage

21 October 2005

PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

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1. Introduction

- 1.2 Business New Zealand welcomes the invitation by the Minister of Labour to submit on the 2005 minimum wage review consultation. Business New Zealand regularly takes the opportunity to comment on this issue, given the effect minimum wages can have on levels of employment for particular groups.
- 1.3 We believe that increased access to training and employment is one way to achieve higher productivity and economic growth. However, increases in the minimum wage rate and/or extensions to its coverage may limit this access, as businesses no longer find it economically viable to hire workers at an increased minimum rate. Increases can be particularly severe on those earning the youth minimum wage rate, as opportunities for valuable work-place learning and skill development become increasingly harder to obtain.
- 1.4 There have already been extensive changes to the rates and eligibility of both the adult and youth minimum wage rates since 1999. Because of these changes (particularly to the youth rate) Business New Zealand is concerned that any further rises will severely impact on the ability of businesses to provide jobs and training opportunities for those less skilled. We believe that Government focus should instead be on increased access to training and employment to achieve higher productivity and hence increased real earnings over time.

2. Recommendations

- 2.1. Business New Zealand recommends that:
 - (a) There be no further increases in either the youth or adult minimum wage rate (see page 9);
 - (b) The Government should focus on increased access to training and employment for young people, and that the youth minimum wage rate be abolished so that this restriction on the employment of young persons is removed (see page 10);
 - (c) The Government seriously considers tax cuts rather than increases in the minimum wage rates as a more effective way of increasing real wages for relatively low paid workers (see page 12); and
 - (d) Statistics New Zealand is provided with funding for the development of a Cost of Living index (see page 13).

3. Business New Zealand's Core Position

- 3.1. The Government has outlined four main objectives for the minimum wage, namely fairness, protection, income protection and work incentives. On one level, some may consider them to be admirable motives for continuing to have minimum wage rates. However, neither laudable intentions nor

widespread support can alter one simple fact: although minimum wage laws can set wages, they cannot guarantee jobs. It is Business New Zealand's view that minimum wage laws place additional obstacles in the path of particular workers (particularly those who are young and unskilled) who are towards the bottom end of the economic ladder.

- 3.2. Although there have been publications from time to time (both domestically and internationally) that have shown there to be perhaps neutral or positive effects on employment of increasing minimum wage rates¹, the great weight of evidence (both at a theoretical and empirical level) over time suggests that a 10% increase in the minimum wage rate has a negative outcome on employment, typically ranging somewhere in the vicinity of a 3-5% rise in unemployment on groups which are usually young and/or unskilled.
- 3.3. Business New Zealand has previously outlined in prior minimum wage review submissions specific reasons why increases in the minimum wage rates (particularly the youth rate) negatively affect employment. These include:
- Most receiving the youth minimum wage are not in a vulnerable position and do not rely on the minimum wage as a long term source of income;
 - Businesses have indicated to Business New Zealand that many of those receiving the youth minimum wage rate are 'after-school' workers, who are generally employed from a goodwill or social standpoint. This type of work provides young workers with the opportunity to learn fiscal responsibility and to develop a work ethic, as well as providing additional pocket money and work experience that may be added to a CV;
 - Increases in minimum wage rates reduce job and training opportunities for youth, as does the extension of the youth minimum wage to employees on training agreements. Raising and/or extending minimum wage rates may well mean many workers receiving such rates would find their jobs no longer sustainable, as their productivity is below their comparable wage level;
 - It is likely that continued increases and extensions of coverage to the minimum wage rate may instead send a signal to younger people that further education and training is not warranted;
 - Business New Zealand is concerned about inflationary pressures due to increases in the minimum wage rate. Any increase will lead to higher skilled workers who earn slightly higher pay rates than those in the same firm on the minimum wage rate seeing their relative advantage eroded and consequently expecting a corresponding increase in their own wage rate; and
 - Raising the minimum wage rate may lead to a two-fold unemployment effect, whereby unemployment may rise due to employers finding the jobs

¹ For instance, the much cited research by Card and Kruger "Myth and Measurement: the New Economics of the Minimum Wage", 1997.

and minimum wage recipients no longer sustainable, and because some individuals who were previously not part of the labour force seek to enter it as they know they are guaranteed a higher minimum wage rate.

- 3.4. Overall, Business New Zealand believes the existence of a youth minimum wage rate clearly has a distortionary effect on the labour market, which reduces the opportunity for youth employment, as well as stifling the prospect of enhanced productivity.
- 3.5. However, it is reasonable to assume that in the short-medium term at least, minimum wage rates such as those aimed at youth will continue to exist in New Zealand. Therefore, the key question then becomes *at what level should a minimum wage be set at?* Business New Zealand wishes to focus the rest of this submission on examining this question in light of the 2005 review.

4. Recent Reviews of the Minimum Wage

- 4.1. Business New Zealand considers the aim of the Government for minimum wage rates seems to be more politically driven, rather than by economic rationale and what is best for New Zealand's long-term productivity and growth. Given statements made in the past by previous Ministers of Labour under the current Government, it appears that the short-term aim for the adult minimum rate is to reach \$10 and the youth minimum rate to reach \$8 (80% of the adult minimum rate).
- 4.2. Table 1 below shows a summary of the increases in both the adult and youth minimum wage since the current Government took office, as well as a change in the criteria for youth workers. During that time there have been extensive increases in both the minimum wage rates for adults and youth workers. Over a five-year period, the adult minimum wage has increased 35.7%, while the youth rate has increased at a much stronger rate of 81%. In addition, the age criterion for receiving the adult minimum wage rate has dropped from 20 to 18 years, while those doing at least 60 points or more towards a qualification from the National Qualifications Framework are paid the youth minimum wage level. Collectively this represents a substantial cost increase for employers over a relatively short period of time.

Table 1: Adult and Youth Minimum Wage Rates and Changes (1999-2005)

Time Period	Youth Minimum Wage Rate	% Change from Previous Year	Adult Minimum Wage Rate	% Change from Previous Year
March 1999	\$4.20	-	\$7.00	-
March 2000	\$4.55	8.3%	\$7.55	7.9%
March 2001	\$5.40	18.7%	\$7.70	2.0%
March 2002	\$6.40	18.5%	\$8.00	3.9%
March 2003	\$6.80	6.25%	\$8.50	6.25%
April 2004	\$7.20	5.9%	\$9.00	5.9%
March 2005	\$7.60	5.6%	\$9.50	5.6%
% Change from March 1999-April 2005		81%		35.7%

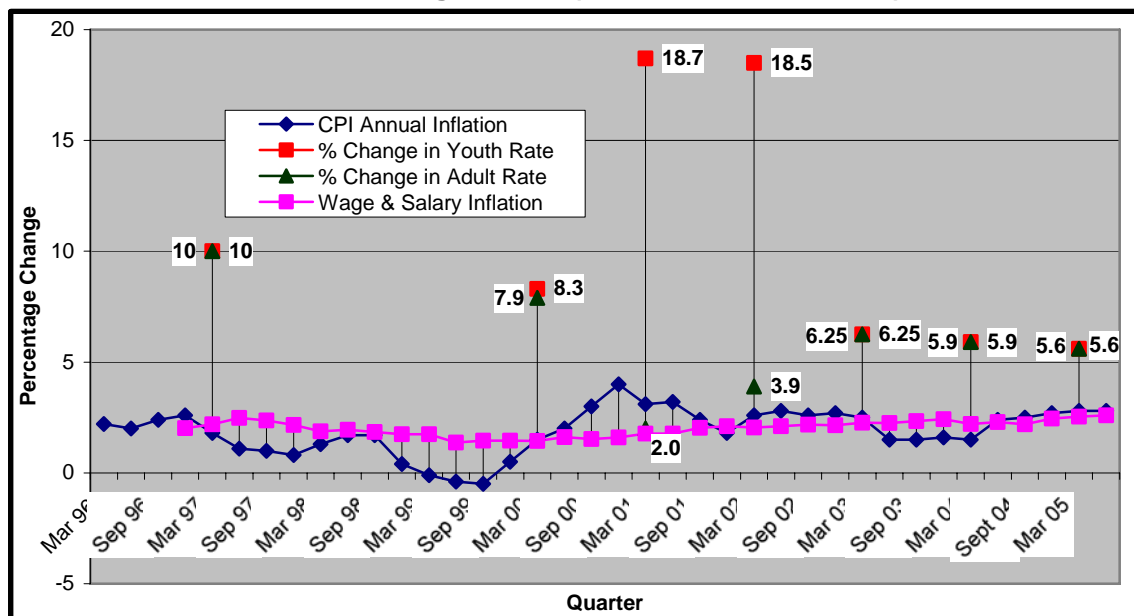
Other Changes

- 2002: The age criterion for receiving the adult minimum wage rate dropped from 20 to 18 years.
- 2003: The training exemption from the minimum wage was removed, which meant those doing 60 credits or more towards a qualification from the National Qualifications Framework would be paid a training minimum wage, set at the youth minimum wage level.

- 4.3. As well as the recent increases, discussions by political parties post the 2005 General Election have led to agreement amongst the new Government of the adult minimum wage rate increasing to \$12 by the end of 2008 if economic conditions permit. This would represent an increase of 26.3% from the current standing for both the adult and youth rates, if relativities are kept with the youth rate remaining at 80% of the adult rate. Plans at this stage seem to involve a phase-in period of three years, which would represent a 71.4% increase in the adult rate and a 128.6% rise in the youth rate over nine years from 1999.
- 4.4. One of Business New Zealand's Regional Associations, Employers and Manufacturers Association (Northern), recently undertook a survey to gauge the reactions of employers regarding their acceptance of possible future minimum wage increases. The results showed that a proportion of employers are generally prepared to accept increases that are around the high level of general inflation, but do not support significant rises that do not bear any relation to economic rationale.
- 4.5. Specifically, around 65% of employers were prepared to accept an increase in the adult and youth minimum wage rate of 3%, which is around the current level of inflation. At around a 5% rise, employers were less enthusiastic, with 58.6% prepared to accept the increase. Once the adult rate moves beyond \$10, acceptance of minimum wage rate increases takes a significant drop. Less than one-third of employers were willing to accept an increase of around 10% from the current rate, equating to a \$10.50 minimum adult rate and an \$8.40 youth rate. Moves towards a \$12 adult minimum wage rate led to strong opposition by employers. A 15% or 25% increase (the latter meaning the adult rate would be almost \$12) in minimum wage rates were only accepted by around one-fifth of employers, with the largest proportion of employers strongly opposed.
- 4.6. The quantitative results as well as comments received from employers (see section 6 below) highlight the fact that the vast majority of employers believe that a fair wage should be paid for fair work carried out. However, large increases that simply cannot be justified on more substantial grounds such as inflation, upskilling or productivity leave many employees on minimum wage rates in a precarious employment position.
- 4.7. Figure 1 shows that increases in the minimum wage rates over the last ten years have almost always been far above general levels of inflation, as well as salary & wage inflation (the latter being broadly constant over time). While the increases in minimum wage rates in 1997 and 2000 could be argued to be based on adjusting minimum wage rates to keep up with general inflation

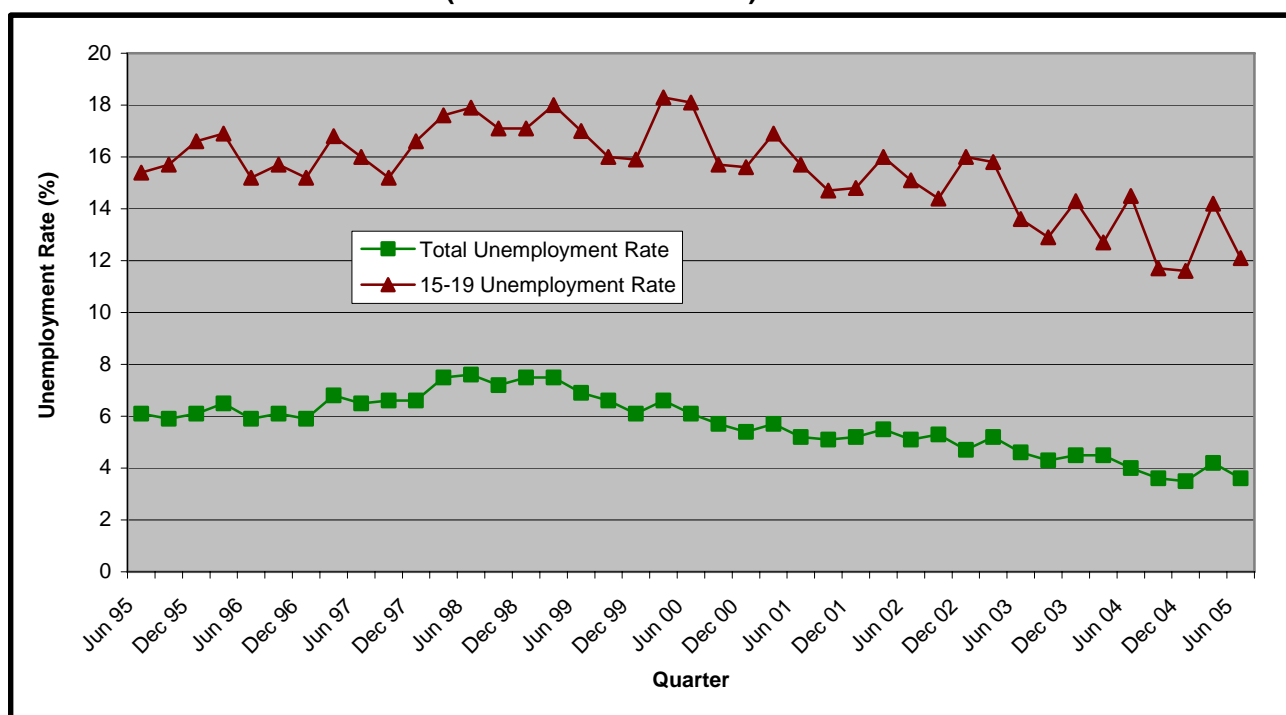
movements, the increases from 2001 onwards have mostly been well above other inflation levels, with the only exception being the 2% increase in the adult rate in 2001.

Figure 1: Annual Inflation Rate Compared with Changes to the Adult and Youth Minimum Wage Rates (March 1996-June 2005)



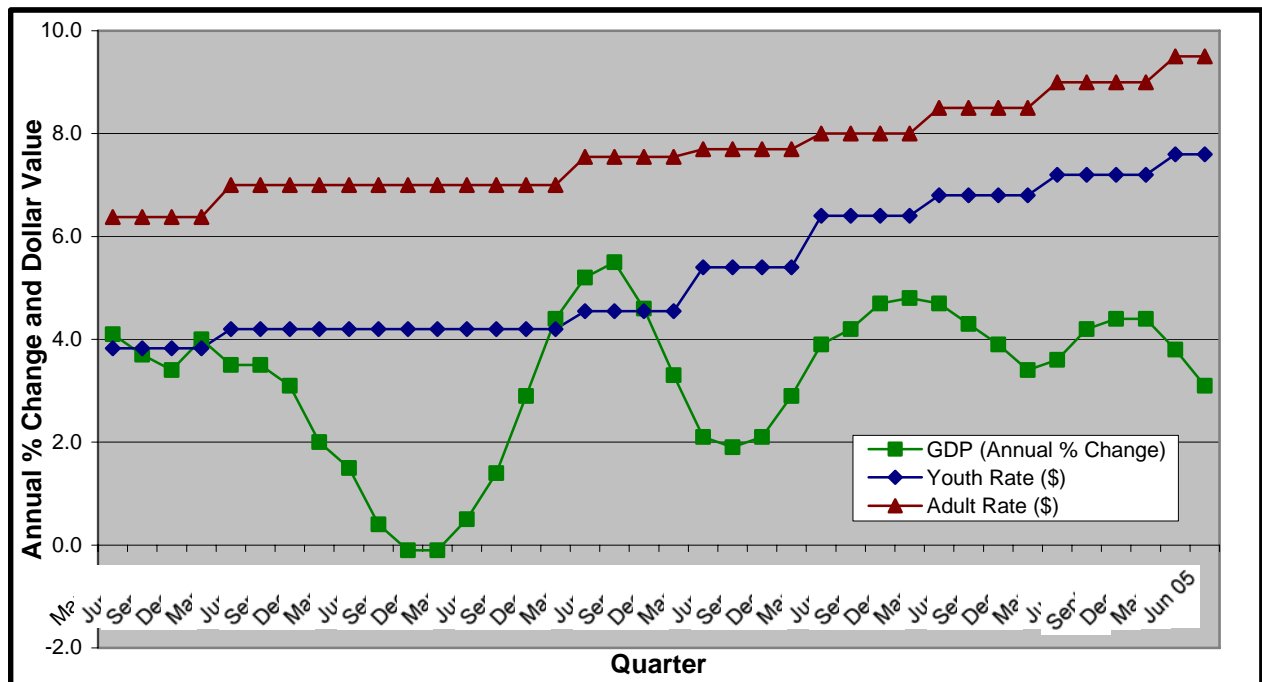
- 4.8. Figure 2 compares the unemployment rate for the 15-19 year age group with the overall New Zealand unemployment rate. The differences between the two rates have stayed relatively the same, but both have trended downwards since 2000. Proponents of minimum wage increases could argue that this shows that increases in minimum wage rates have little if any effect on employment. However, substantial increases of this magnitude over such a short time period will undoubtedly lead to effects on levels of employment at some point in time.
- 4.9. Business New Zealand believes the Government has taken a very short-term view of the effects of increases in the minimum wage. The fact that an employer may be able to sustain the increase in labour costs today does not automatically mean they can tomorrow, which is often dependant on the general economic conditions of the time. Much of the 'cushioning' of substantial increases in minimum wage rates has been due to the status of the New Zealand economy over recent years.

**Figure 2: Total New Zealand & 15-19 Age Group Unemployment Rates
(June 1995-June 2005)**



- 4.10. Over the past 4-5 years, New Zealand has experienced one of the strongest and most prolonged periods of economic growth for decades, often outperforming countries we typically compare ourselves with. Combinations of factors such as terrorism threats abroad, strong net migration, high world commodity prices, low unemployment and a booming property market have all contributed to growth rates near or in excess of 4% since 2000 (as figure 3 shows). The graph also shows that during the same time, both the adult and youth minimum wage rates have continued upwards.
- 4.11. However, recent economic indicators tend to show that the economy is slowing, exemplified by the recent downwards trend of annual GDP growth in figure 3. Economic commentators have predicted that the economy will drop to growth rates around 2-2.5% over the next two years (perhaps even lower), which at that level would not be enough for the Government's goal of moving New Zealand into the top half of the OECD rankings.
- 4.12. The recent trends of certain economic indicators are a cause for concern. New Zealand's merchandise trade deficit is now at record highs, while net gains in migration have plummeted. Interest rates are rising, as are general inflation levels. The continued high value of the New Zealand dollar has led to a loss of competitiveness in the global market, while the property market "bubble" continues to grow. Stagflation in the near future is not beyond the realms of possibility.

Figure 3: Annual Change in GDP Compared with Adult and Youth Minimum Wage Rate (June 1995-June 2005)



- 4.13. The sustained high value of the New Zealand dollar over recent times (especially against the U.S dollar) has caused problems for certain sectors, such as export-orientated manufacturers. The Business New Zealand Performance of Manufacturing Index (PMI) shows that on a month by month basis, the strong value of the New Zealand dollar has led to falling international orders as well as constraining expansion. This has obvious flow-on effects for growth and capacity for retaining jobs in the sector. Further increases in minimum wage rates can exacerbate the problem, leading to further redundancies that might not have been the case if minimum wage rates had previously not increased at levels far exceeding that of general inflation.
- 4.14. Manufacturing is not the only sector to feel the early effects of an economic slowdown, nor the only one affected by changes to minimum wage rates. There are other industries that are more likely to have minimum wage recipients, given the nature of the work and the training and qualifications involved. When looking at total average hourly earnings², in addition to Manufacturing the lowest wages tend to be in sectors such as Accommodation, Cafes & Restaurants, Retail Trade and Construction. These industries are also more likely to suffer a more sustained period of downturn compared with other sectors of the economy.
- 4.15. Business New Zealand believes that recent increases in minimum wage rates (particularly for the youth rate) will lead to a much stronger negative impact on employment in these groups once the economy slows or goes into

² Quarterly Employment Survey - June 2005, Statistics New Zealand.

a recession, compared with previous increases that were adjusted for general inflation levels. Any further increases in either the adult or youth rate will continue to exacerbate the problem, which will deny many youth workers the opportunity to gain relevant skills and work experience.

Recommendation: There are no further increases in either the youth or adult minimum wage rate.

5. Minimum Wage Rates and Productivity

- 5.1. While Business New Zealand believes further increases to minimum wage rates are effectively increasing the chances of job losses for those who are young and/or unskilled, we also believe continued minimum wage increases are inconsistent with the Government's priority placed on raising productivity and growth.
- 5.2. Business New Zealand is pleased to see that the Government has decided to seriously examine ways in which New Zealand's productivity could be lifted. Business New Zealand has long advocated that any gains in productivity (particularly in the workplace) are the key to lifting New Zealand's living standards and wealth. However, continued substantial increases in the minimum wage rates are at odds with how to raise productivity growth.
- 5.3. Data shows action on labour productivity is needed sooner rather than later. New Zealand's labour productivity growth has been consistently less than the OECD average from the late 1970s. In fact, New Zealand's labour productivity growth has only grown at around 70% of the OECD average over the period 1978-2006 (projected). Comparing New Zealand with our closest economic neighbours shows that Australia's average annual productivity growth rate over the period 1998-2006 is 1.9%, compared with 1.6% for New Zealand. Clearly, New Zealand has to do better to compete on an international setting.
- 5.4. Remuneration is a key factor in getting higher productivity, but only where it can be linked to specific individual or team outcomes, such as throughput at a freezing works. Increases in minimum wage rates are an artificial way of boosting wages, with no increases in productivity to justify the rise in wage rates.
- 5.5. Also, the argument that increasing the wages of employees makes them more productive is in most cases simply not true. For many workers, pay is not the biggest motivator in their jobs. Studies both in New Zealand and overseas have generally shown that factors such as work satisfaction, self-image in work role, connection with co-workers and opportunities to help customers are more important motivators.
- 5.6. Because of these inherent differences, any Government policies aimed towards those in the younger age bracket should primarily focus on providing employment opportunities and training schemes, so young people have a higher level of skills when fully committed to the workforce, and can provide employers with a signal of their productivity.

Recommendation: The Government should focus on increased access to training and employment for young people, and that the youth minimum wage rate be abolished so that this restriction on the employment of young persons is removed.

6. Comments from Members of Business New Zealand

- 6.1. Business New Zealand regularly consults with its members regarding impacts of changes to legislation on their day-to-day business activities. Consistent increases in the minimum wage rates over recent years have seen many employers experiencing significant increases in payments to workers. The following are a selection of comments that we have received from recent member surveys carried out so that the Government is aware of the general sentiment towards recent and possible future changes to minimum wage laws:

On General Increases

“Most min rates are there to allow entry into the workplace for inexperienced people. Anyone who quickly learns and becomes productive can be moved from these low bases once proven. There needs to remain incentive to improve. By moving the base rate up the incentive is missing.”

“My industry is already suffering from very low margins and adding this extra expense with the four week holidays would close our doors.”

“Our real issue is with having to pay a higher rate to inexperienced workers particularly the young adults, this will have an impact on the number and the age of staff we will employ. It will also have an impact on our operating costs, which is already running high.”

“Our youth workers are usually the children of staff or friends who ask to work for the experience. We would not be prepared to increase the youth rate significantly because they require too much supervision for that to be viable.”

“The biggest concern will be the flow-on effect of staff currently receiving above the minimum wage wanting to maintain parity so any increase will impact further along the pay curve.”

“We are a service station still providing service on the forecourt. We do this on a fixed margin of 4.5cents per litre of petrol and 3.25cents per litre of diesel. Any substantial increase in wages without increase in margin will mean a reduction in staff.”

“We are employing low to no skill employees in manual labour roles with high staff turnover in South Auckland e.g. tomato picking, greenhouse jobs in a low margin industry. Any significant rate change will mean we will be less open to giving work to first time workers”

"We are in the horticulture industry and would have to pass on most of the increase to the minimum wage on to growers who are presently suffering from much lower returns for their product."

"While we will not be directly affected, I strongly believe the individuals that are currently earning these rates will be most harmed. There will be fewer opportunities for them to enter the job market, more unemployment, more dole, less productivity!"

"Would mean we have to give everybody a pay rise so that there are pay differences between more experienced and qualified staff"

On a \$12 Adult Minimum Wage Rate

"A increase in the minimum wage to \$12.00 would force wages up overall with no increase in productivity. Would add to our wage bill significantly and we would be forced to look at staff numbers."

"Although 90% of my employees are currently paid more than \$12/hour, the effect of raising the minimum wage will place upward pressure on pay rates within my company as my employees have an expectation, given their skill sets, of being paid a premium over those on minimum wage rates."

"An increase to \$12 per hour would make it unlikely that we would employ an inexperienced 18 year old."

"Any move to \$12.00 minimum adult wage would probably cause me to consider 'contractor arrangements' rather than 'hourly rate' arrangements."

"At \$12 per hour very little room left give increases as new staff learn the trade. At this rate all existing staff would expect raises of same value to maintain their pay margins this would increase our payroll by \$1400.00 per week."

"If minimum adult rate raised to \$12 per hour 1) We could no longer afford to train staff 2) Need to increase fully trained staff to \$2-\$3 per hour above minimum. 3) Source some manufacturing options off shore 4) Employ less staff or increase prices."

"If we had to give any over 18year old a minimum of \$12 / hour starting wage - we would have to reconsider 'new employment' options. There is a big difference between an 18year old (with very little job experience) and say a 25 year old with several years experience."

"It's not so much that it would significantly affect our profit. I feel it would more affect people looking for jobs. I could employ someone with 2 years experience for \$12 so why would I employ someone with no experience for \$12?"

“My wage bill is set to increase \$30,000 at the end of this year because of qualification changes. If the minimum went to \$12 I would have to find another \$60,000. I don't have that spare cash in my budget.”

7. A Better Approach – Reducing Tax Rates

- 7.1. Business New Zealand believes there is a more viable alternative to raises in the minimum wage rates to ensure a highly productive and high wage economy – the reduction of taxes on both individuals and businesses.
- 7.2. If the Government is focused on raising New Zealand's productivity and growth rate, as well as raising the standard of savings which is found to be lower when compared with other countries³, we believe a better way in which to provide all New Zealanders with the opportunity to save and invest more is through personal and company tax rate cuts.
- 7.3. Business New Zealand's recently published *Tax Perspectives*⁴ outlines a direction in which both personal and company tax rates can be lowered without having to limit funding for core Government expenditure. For instance, current projections show that two personal tax rates of 15% and 25%, combined with a company tax rate at 25% by 2010 are easily achievable. This would substantially change the take home pay of a significant proportion of the working population. By instigating a broad-base, low rate approach to taxes while containing Government spending to levels around 30% of GDP, most New Zealanders will have more cash in hand in which to repay debt, save for a house deposit or invest for retirement savings.
- 7.4. For example, consider a person working a typical 40-hour week at the current adult minimum wage of \$9.50. After tax of 19.5% (excluding any rebates and ACC payments that may come into account), the person ends up with \$15,907 cash in hand. With a low personal tax rate of 15%, cash in hand would rise to \$16,796 a year - an increase of \$889. This raises the hourly rate from \$9.50 to \$9.93 an hour.
- 7.5. The advantages of a tax cut over an increase in the minimum wage rates for low paid workers are numerous. Firstly, the rise in the hourly rate through a tax cut does not increase the wage costs for the business. Therefore, there is no likelihood of the position being made redundant, and less likelihood of the position being withdrawn once the current employee takes on another position. Secondly, the relativity of those earning slightly more than those on the minimum wage because of extra responsibilities or qualifications is kept as their wages also experience an increase.

Recommendation: That the Government seriously considers tax cuts rather than increases in the minimum wage rates as a more effective way of increasing wages for relatively low paid workers.

³ Whether this is a fundamental problem for New Zealand is debatable, as Business New Zealand has raised this issue in previous submissions and consultations relating to other issues.

⁴ See <http://www.businessnz.org.nz/doc/934/TAXPERSPECTIVES>

8. Minimum Wage Rates and the Consumers Price Index

- 8.1. Business New Zealand notes that the report by the Consumer Price Index (CPI) Revision Advisory Committee (2004)⁵ contains a recommendation that another index be developed alongside the CPI to better measure changes in the cost of living. This would perhaps be an annual index (or indexes), taking into account cost of living for various subgroups. This recommendation is similar to a more accurate index that Business New Zealand has been advocating during recent years through a Real Disposable Income measure that was recommended by the CPI Revision Advisory Committee in 1997.
- 8.2. The CPI has traditionally been used as a key indicator for adjustments of the minimum wage rate on an annual basis. Notwithstanding recent evidence that suggests this has not been the case with recent minimum wage hikes, we have concerns about the use of the CPI for this purpose. The CPI measures changes in prices affecting the average household, but does not provide information on what has been happening with incomes and does not cover all household expenditure. Because Government policy changes have had a much stronger impact on the CPI than other inflation measures, this has resulted in a higher level of average annual movement than most other broader measures of inflation.
- 8.3. The 2004 report notes that the CPI Revision Advisory Committee has ranked the production of a cost of living index as the number one non-essential recommendation (i.e. those recommendations that are not required to be implemented in order for the revised CPI to be introduced in 2006). However, Statistics New Zealand have stated that while they support the additional measure(s), current resources do not allow for the development of such indexes, and a case for further funding will be made once additional costs have been assessed⁶. Business New Zealand strongly recommends that the Government through additional funding supports the recommendation put forward by the CPI Revision Advisory Committee in 2004 relating to the development of a cost of living index.

Recommendation: That Statistics New Zealand is provided with funding for the development of a Cost of Living index.

9. Conclusion

- 9.1. Business New Zealand strongly supports the policy of providing workers with every opportunity to raise their skill levels. Any increases or extensions of the minimum wage rate distort the labour market by reducing jobs, and directly conflict with promoting productivity and economic growth. With an economy that is rapidly slowing, further increases in minimum wage rates will only exacerbate any loss of jobs, particularly for those who are young and/or unskilled. Therefore, we strongly support the reduction of tax rates as a better alternative to raising minimum wage rates.

⁵ Statistics New Zealand.

⁶ "Review Committee Endorse CPI Methodology, Statistics New Zealand, 2004.

10. Appendix

- 10.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 57-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.
- 10.2 In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.
- 10.3 Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.