Submission by

BusinessNZ

GROWING PROSPERITY AND POTENTIAL

to the

Ministry of Business Innovation and Employment

on the

2020 Review of the Minimum Wage

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ANNUAL REVIEW OF THE MINIMUM WAGE 2020

INTRODUCTION

1. BusinessNZ welcomes the invitation by the Minister of Workplace Relations and Safety to submit on the 2020 Minimum Wage review. This submission largely repeats arguments made in previous years, however the effects highlighted are now multiplied by the recessionary consequences of Covid-19.

2. We recommend that:

a. A moratorium be placed on increases to the minimum wage at least until such time as Covid related restrictions are removed from international travel and trade and preferably until NZ is out of recession.

b. In the interim, a review be undertaken of the role and effect of the minimum wage (not just its level) in light of the very significant movements and events affecting it since its creation in 1945[1], the diverse and dynamic working conditions prevalent today, and in particular, the impacts of Covid-19.

c. Account should also be taken of the effects of the Working for Families Scheme and other transfer payments on the incomes of those on the Minimum Wage.

d. The minimum wage ultimately be set as a percentage of the median wage. The percentage should be determined taking account of the results of (b) and (c) above.

e. The Minimum Wage Act be amended to require that a worker's average wage not fall below the minimum wage set by the Act, rather than, as at present, requiring that every hour worked be paid at the minimum wage rate.

f. Pending the outcome of the review in (b) above, future increases to the minimum wage be no greater than inflation as measured by the CPI in the preceding period.

g. The Government continues to emphasise the need for increased access to training and employment opportunities, particularly for young people.

h. The Government seriously considers the use of further tax cuts, rather than increases in minimum wage rates, as a more effective way of increasing real wages for relatively low paid workers.

[1] It has not changed materially since.

DISCUSSION

3. There will always be work that is the lowest paid in any economy. Often this is because it is "undesirable" work; typically, it is relatively low-skilled and/or is often performed at unsociable times of day or in physically demanding environments. Historically this work is undertaken by the least experienced and educated, migrant workers, part-time workers, and people supplementing other incomes.

4. Raising wages for these groups may briefly improve their standard of living but may also stimulate competition from more qualified and experienced workers, thus disenfranchising the very vulnerable workers the wage increase was designed to protect. Overseas experience, for instance in the UK, suggests that rises in the minimum wage correlate with increases in unemployment for young people and minority groups.

5. For low paid jobs, raising wages may have no effect at all, as they remain sufficiently unattractive that only those with no alternative are likely to compete for them. Migrant workers increasingly are filling these roles, which ultimately reduces the number of jobs available for New Zealanders who might seek to enter the workforce at some future date.

6. Furthermore, increasing low pay levels eventually forces up all pay rates – the "compression effect". This is because employees in jobs requiring higher levels of skill and knowledge rightly expect a higher rate of pay than a worker in a job requiring relatively little skill and/or knowledge.

7. Diminished recognition of the responsibilities of senior roles is demotivating for those in such positions because there is little incentive to take on responsibilities paid at levels close to the lowest paid. Difficulties in recruiting senior staff inhibit the ability of businesses to innovate and grow, thus placing at risk a sector's contribution to economic growth in the long term and, in the short term, its recovery

8. At its present level (59% of the average wage and 70% of the median wage), the minimum wage now influences wage levels generally, particularly those covered by collective bargaining. This is more marked in sectors with relatively higher proportions of the lowest paid workers (e.g., hospitality, retail and tourism).

9. Pressure on wage levels above the minimum wage also adds to inflationary pressures, ultimately resulting in increased costs and interest rates, both of which ironically impact most on the lowest paid. Artificially high increases (i.e. well above inflation) in the minimum wage simply increase this pressure, particularly now at a time when the capacity to absorb cost increases is at an all-time low.

10. The increasing inability to fully compensate for the compression effect ultimately means that *as the minimum wage rate rises so too does the number of people paid the minimum wage*. Put another way, imposing above inflation additional costs on to wages drives more and more workers to the lowest end of the wage spectrum. This is scarcely consistent with the oft-stated objective of a high skill, high wage and highly productive economy.

11. It is generally accepted that increases in the minimum wage cost jobs, which are not replaced in the short to medium term. These losses shrink the pool of work available to the least skilled and educated. Therefore, unless all the effects are managed, *simply increasing the minimum wage can also marginalise the very people the increase is designed to assist, low paid New Zealanders*.

12. The pressures caused by wage compression and job losses are set to increase even more significantly if the government remains committed to raising the minimum wage to $20 per hour by 2021. These pressures will be further exacerbated by pressure to adopt the so called "living wage" in the coming parliamentary term.

13. For these reasons, BusinessNZ has consistently advocated a period of consolidation before further increases in real terms are contemplated. That view remains unchanged.

KEY FACTORS

14. BusinessNZ has outlined in previous years' submissions a number of reasons why increases in the minimum wage rate (particularly the youth rate) negatively affect employment.

15. BusinessNZ members have indicated that many if not most, under 18-year-old workers working for them are "after-school" workers, who are generally employed from a goodwill or social standpoint. This type of work provides young people with an opportunity to develop a work ethic, learn fiscal responsibility and gain work experience to build a CV. Typically these young workers live with their parents, are not in a vulnerable position and do not rely on the minimum wage as a long-term source of income. However, as outlined in this submission, increases in minimum wage rates usually reduce job and training opportunities for youth.

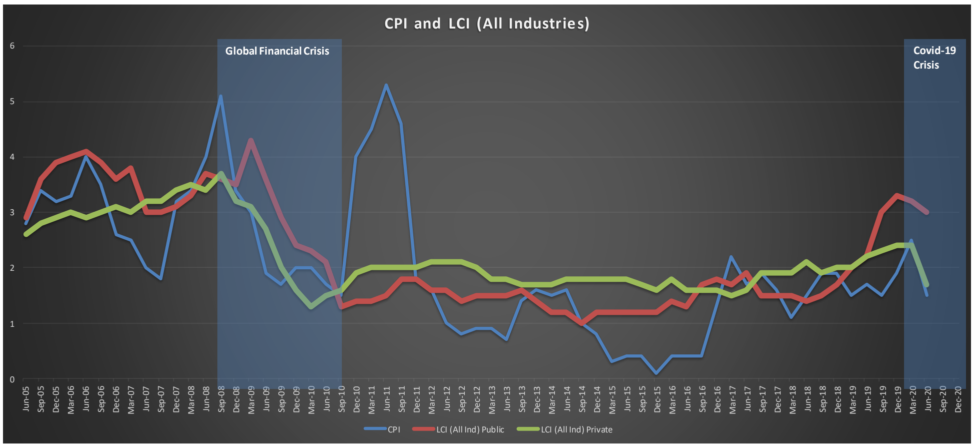
16. This creates a risk that continued increases and extensions of coverage to the minimum wage rate and a corresponding reduction in job opportunities will signal to younger people that further education and training are not going to be beneficial. Ultimately, raising and/or extending minimum wage rates may mean many minimum wage workers will find their jobs no longer sustainable once their productive value falls below their comparable wage level. On the other hand, a too high minimum wage rate can discourage young people from further expanding their horizons.

17. These general effects are being reported to BusinessNZ by a growing number of businesses, particularly smaller businesses and those with a relatively high proportion of lower waged employees.

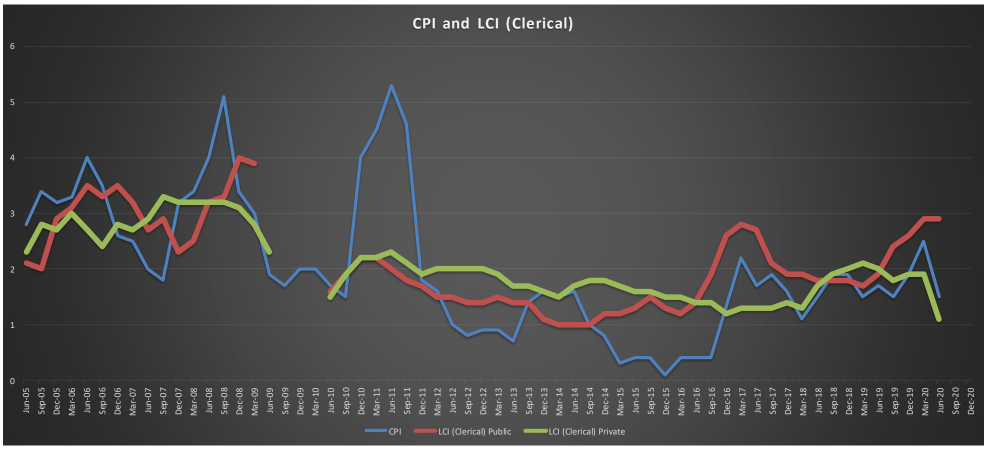
18. Inflationary pressures will of course be exacerbated by the pressure from some quarters to introduce a "living wage", which has less to do with the productive value of a worker than it does with that worker's costs of living. Research by the NZ Treasury has shown this concept to be poorly targeted as it would benefit mainly low paid single people but will also impose significant pressure on wage rates generally. While this may be socially well intentioned it is economically deleterious because it in fact creates outcomes in excess of the level being aimed at due to the effects of transfer payments, in particular Working for Families payments.

Growing gap between private and public sectors

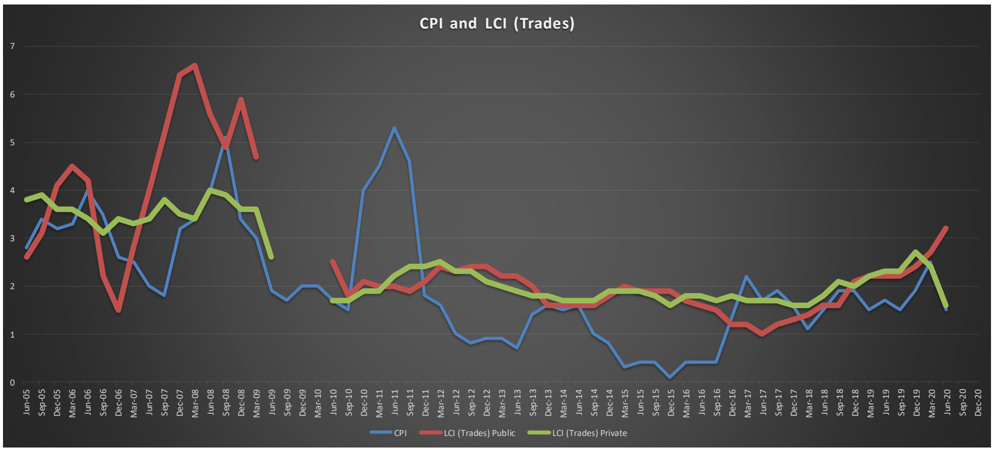
19. During 2020, particularly under the influence of Covid-19, we have seen a widening gap in the rate of wage increases between the private and public sectors.



20. While wages overall have clearly been affected by the advent of Covid-19, this impact has not been evenly felt. Clerical workers, many of whom fall into the lower paid categories affected by the minimum wage, are receiving disproportionately higher increases in the public sector than in the private sector.



21. The public/sector gap is even greater when looking at trade-related occupations.



22. This private/public sector gap highlights a need for a more targeted response to wages than simply increasing them across the board.

23. Here it is instructive to compare the positions of the public and private sectors going into the Global Financial Crisis in 2008 with their relative positions today (see paragraph 19 above). In the lead up to both, the public sector was significantly ahead of the private sector.

24. The prevailing economic view is that New Zealand will head further into recession in the foreseeable future. As is indicated by the graph in paragraph 19, a private sector led economic recovery after the GFC generated relatively higher wage increases in the private sector. This is off the back of increased economic activity, the prerequisite for any sustainable growth in wages. However, all current signals from the private sector suggest that increasing costs now, at the very time that economic conditions are predicted to get worse, will deepen future recessionary impacts.

25. Now is the time for the Government to signal restraint on core costs such as wages. Any later may be too late.

26. It should be recognised here that the private sector response to wages is dictated by prevailing economic conditions. On the other hand, the public sector response is guided more by government policy priorities. These priorities have over time become less and less connected to economic realities.

27. This scenario will only be made worse if the next government continues with the Labour Party's election commitment to embed the living wage throughout the state sector. This commitment, to pay a living wage to state employers and contractors to the state, is an example of detachment from economic reality. So too is the lack of recognition of the role played by government income assistance, e.g Working for Families.

Working for families adds additional value that is not being counted

28. The Working for Families (WFF) scheme benefits a large proportion of those on the minimum wage.

29. It comprises two main payments:

a. *Family Tax Credit* – paid irrespective of source of income
b. *In Work Tax Credit* – for families working a specified minimum number of hours per week (20 hours for a 1 parent family and 30 hours for a 2-parent family)

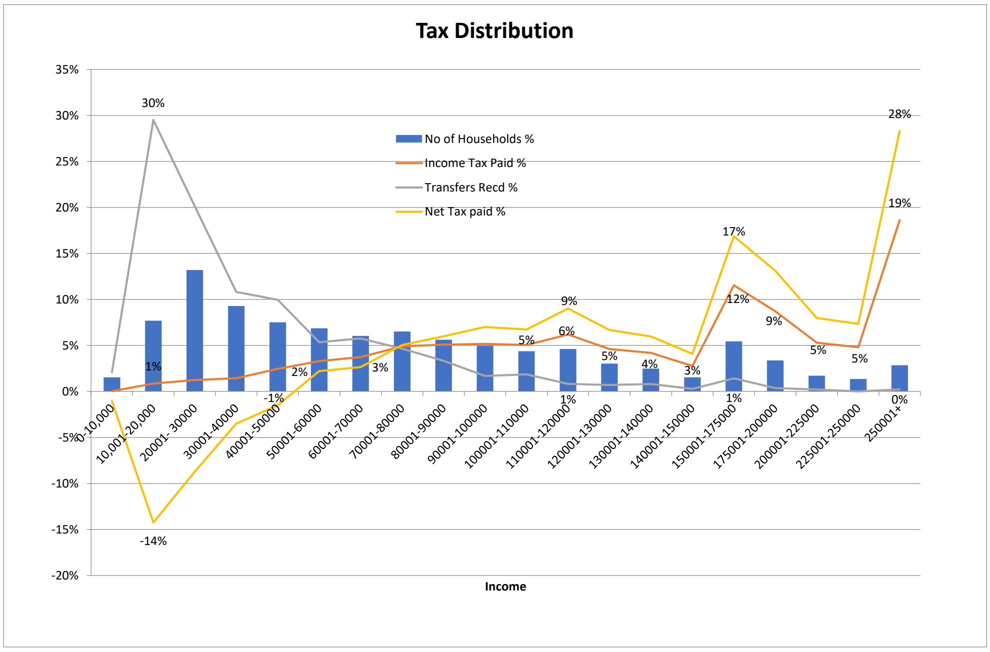
30. The table below illustrates the effect of WFF payments on the minimum wage. The rates used are the combined value of the Family Tax Credit and the In-Work Tax Credit.

		Min Wage	Working for Families Family Tax Credit					
			1 child	2 children	3 children	4 children	5 children	6 children
Weekly		$756	$185	$276	$367	$473	$580	$686
Cumulative Total			$941	$1,032	$1,123	$1,229	$1,336	$1,442
Annual		$39,420	$9,646	$14,391	$19,136	$24,664	$30,243	$35,770
Cumulative Total			$49,067	$53,812	$58,557	$64,084	$69,663	$75,190
Hourly equivalent		**$18.90**	**$23.53**	**$25.80**	**$28.08**	**$30.73**	**$33.40**	**$36.05**

31. With the exception of single workers and couples with no children, workers on the minimum wage typically actually earn in excess of the so-called Living Wage which is currently calculated at $22.10 per hour for a family of four. Single persons and couples with no children attract only the minimum wage as they are not eligible for Working for Families payments.

32. Based on this, it is arguable that current minimum wage settings coupled with transfer payment regimes constitute adequate minimum incomes already, without the need for the scale of proposed future increases.

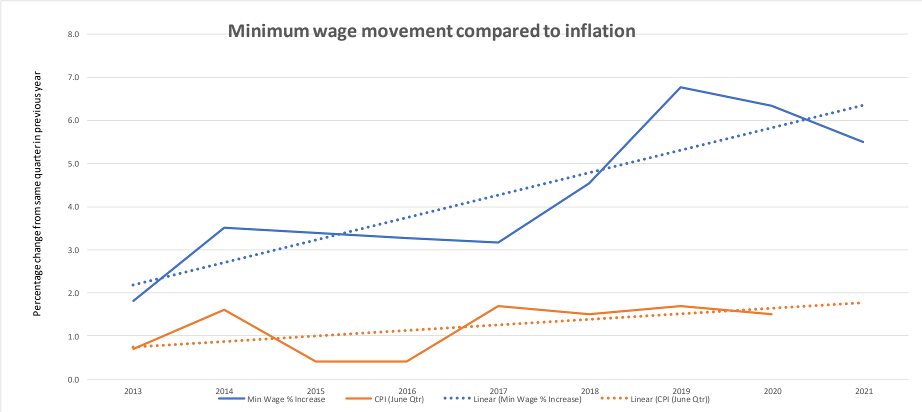
33. Added to this is the fact that, on average, those on the minimum wage are paying net negative tax. The graph below illustrates the net effect of income versus transfer payments (including WFF).



34. At the very least, consideration needs to be given to the effects of transfer payments when contemplating future adjustments to minimum wage rates. This has not been a feature of previous reviews.

Relationship between minimum wage and average and median wages

35. The ratio of the minimum wage to the median wage and average wage did not change materially between 2008 and 2017. It has jumped up significantly since the current government came to power. Moreover, increases are also accelerating in relation to inflation, as illustrated by the graph below.



36. This brings into question the whole role of the minimum wage in today's context. Historically it was a "floor" that generally followed, but was not formally indexed to, the rate of inflation. The fact it is now running at over three times the rate of inflation suggests it is now more a tool for "socially engineering" the politically acceptable value of work. This apparent departure from an economically balanced approach to the minimum wage runs the risk of the effects becoming less manageable over time as, other than impacts on jobs, they are hard to measure.

37. The table below sets out changes to the minimum wage since 1998.

Year	Average Hourly Earnings	Median Hourly Earnings	Minimum Wage	Minimum Wage $ increase	Minimum Wage % Increase	Minimum Wage as % of Average Hourly Wage	Minimum Wage as % of Median Hourly Wage
1998	$15.02	$13.21					
1999	$15.34	$13.38	$7.00			45.6%	
2000	$15.62	$13.55	$7.55	$0.55	7.3	48.3%	55.7%
2001	$16.30	$14.00	$7.70	$0.15	1.9	47.2%	55.0%
2002	$16.66	$14.50	$8.00	$0.30	3.8	48.0%	55.2%
2003	$17.87	$15.00	$8.50	$0.50	5.9	47.6%	56.7%
2004	$18.23	$15.34	$9.00	$0.50	5.6	49.4%	58.7%
2005	$19.23	$16.03	$9.50	$0.50	5.3	49.4%	59.3%
2006	$19.99	$17.00	$10.25	$0.75	7.3	51.3%	60.3%
2007	$21.34	$18.00	$11.25	$1.00	8.9	52.7%	62.5%
2008	$22.33	$18.75	$12.00	$0.75	6.3	53.7%	64.0%
2009	$23.04	$19.56	$12.50	$0.50	4.0	54.3%	63.9%
2010	$23.97	$20.00	$12.75	$0.25	2.0	53.2%	63.8%
2011	$24.89	$20.46	$13.00	$0.25	1.9	52.2%	63.5%
2012	$25.19	$21.00	$13.50	$0.50	3.7	53.6%	64.3%
2013	$26.08	$21.58	$13.75	$0.25	1.8	52.7%	63.7%
2014	$26.87	$22.00	$14.25	$0.50	3.5	53.0%	64.8%
2015	$27.46	$22.83	$14.75	$0.50	3.4	53.7%	64.6%
2016	$28.14	$23.49	$15.25	$0.50	3.3	54.2%	64.9%
2017	$28.78	$24.29	$15.75	$0.50	3.2	54.7%	64.8%
2018	$29.66	$25.00	$16.50	$0.75	4.5	55.6%	66.0%
2019	$30.53	$25.50	$17.70	$1.20	6.8	58.0%	69.4%
2020	$32.03	$27.00	$18.90	$1.20	6.3	59.0%	70.0%

38. Movements in average wages primarily reflect movements at the top end of the earnings spectrum, whereas increases to the median are more reflective of the broader economic situation. This arguably makes the median wage a relatively more balanced point of comparison than the average wage.

ECONOMIC IMPACTS

General

39. Increases in minimum wage rates boost wages but of themselves do not boost productivity. Furthermore, increased costs that are not offset by increased productivity typically flow through either into increased prices or, if the market cannot sustain higher prices, cost cutting and, often, job losses. In other words, increasing wages needs to be paid for by productivity. Anything else is effectively borrowing to pay wages. This is unsustainable by any measure.

40. As can be seen in the table above, the increases in 2019 and 2020, and that proposed for 2021, are roughly double those in previous years. The potential for relativity-based pressure on wages above the minimum wage is inescapable.

41. This in turn impacts on the ability of employers to provide other enhancements to conditions of employment, as the capacity to accommodate compulsory increases to wages diminishes their ability to do so . Instances are being reported of employers reducing employer subsidised health care, health status checks, gym memberships and other well-being related benefits to compensate for increases in the minimum wage. In other instances, young people not able to get jobs are resorting to unpaid volunteer work to obtain work experience with a view to being more competitive in the job market.

Sector related impacts

42. Impacts are not evenly spread across the economy. Jobs in the manufacturing, primary produce, retail, hospitality, services and tourism sectors (the very jobs that will be the backbone of economic recovery in the short and medium term) will be impacted more significantly than jobs in other sectors. This is mainly because there are higher proportions of lower paid workers in these sectors than in, for instance, the finance sector. Automation is one of the emerging responses, as evidenced by the rise of staffless outlets e.g. Gull and Waitomo with respect to fuel and self-service checkouts in supermarkets.

43. These sectors also contain a significant number of entry level jobs (e.g. supermarkets) making them important as a gateway to long-term employment for young people in particular. Business responses to increased costs, automation in particular, will likely disenfranchise many young people as a result.

44. Emerging evidence also suggests that past and planned minimum wage increases have sped up the shift of food manufacturing from New Zealand to Asia. While this has been happening for some time, the Government's 2017 announcement that it was aiming for $20 by 2020 sent a strong message about cost trends in manufacturing. The Labour Party's reiteration of this commitment in 2020 will do little to influence a change in business approach.

45. While it is expected that processing of fresh commodity produce will stay in New Zealand for the foreseeable future, many grocery producers can, and are expected to, move manufacturing elsewhere. This sentiment appears to be true of manufacturing and exporting generally, as illustrated by the survey conducted in 2020 by Manufacturing New Zealand, a division of BusinessNZ.

> "We cannot do any more than we have done continuously for the last ten years as local compliance and other costs rise and international margins drop - try displacing as many people as we can with automation and robotics and limit capital-based expansion."
>
> Manufacturer

46. In that survey 73.2% of respondents predicted a negative impact on business as a direct result of proposed increases to the minimum wage[2]. A further 21.1% were neutral, while 4.7% were positive and the remainder didn't have a view.

47. A majority reported that simply increasing prices was not an option as they sold into competitive international markets which would turn to other sources.

48. A number of neutral responses reported not having staff on the minimum wage, thus having no flow on effects. Others tended to take a neutral stance based on the fact they could (and probably would) accommodate the increase by

- increasing hours (and therefore production) of existing staff and not taking on new staff.
- Increasing automation and taking out jobs

49. By and large neutral responses mirrored those taking a negative view. The vast majority of survey respondents indicated that they would be looking at one of more of:

- reducing staffing (layoffs and stopping recruitment)
- reducing hours, including overtime, for existing staff (and reduced production)
- shifting production offshore, and
- increasing automation

50. None of these responses assists the Government's oft-stated objective of growing employment and wages.

Hospitality

51. While automation is an increasing response to increased domestic costs, it is not the only flow on effect. In some cases, increased wage rates are leading to less take home pay.

52. Hospitality businesses typically operate on small margins. Most employ at least some staff (often students) on the minimum wage. Simply increasing prices as a response

[2] Similarly, a recent survey of viticulture industry remuneration practices reported that 76% of survey participants predicted a negative impact on organisational culture, wage costs and employee retention as a direct consequence of increases in the minimum wage.

to enforced increases in wage rates is not always an option however, as this tends to drive customers away and therefore reduce revenue.

53. Typically, affected business owners (often couples) increase their own work hours and reduce those of their staff in order to avoid imposing price increases on customers. This removes income from workers, negating the value of the increase in the minimum wage and often also reducing their total take home pay. Even with these measures, price increases often cannot be avoided.

54. Furthermore, increased wage costs are often followed in short order by increased supply and transport costs, because supply and transport businesses have had to increase prices to accommodate increased wage costs. The net result is often less income for everyone.

Accommodation

55. The accommodation sector has suffered greatly as a result of the Covid-19 related closing of New Zealand's borders, particularly those not participating in the Ministry of Health funded managed isolation programme. For the accommodation sector, management of staff through this period has been very difficult.

56. Accommodation businesses form a significant part of the tourism industry as well as being an intrinsic part of the hospitality sector. Pre-Covid, tourism was a major contributor to New Zealand's GDP, at just under 6%. It also employed approximately 8.5% of New Zealand's workforce. However, reduced occupancy rates and demand for services has driven cost saving measures across the sector. Most businesses have had to restructure and, in many cases, reduce staffing levels.

57. The closure of New Zealand's borders has also created significant pressure to keep domestic prices as low as possible, to stimulate demand and sustain the industry until the return of international tourism. Accommodation businesses cannot easily pass on increased payroll costs via increased prices to consumers, particularly as they are now more cost-sensitive than ever before.

58. As with hospitality, minimum wage increases also impact the cost of other services, such as transport and food, which flow through to the accommodation sector in the form of yet more cost increases, imposing further cost pressure on businesses and their employees alike. The net result may be no actual increase in disposable income as the cost of living will have risen commensurate with the increased wages earnt.

59. Wage affordability therefore is a significant issue for the accommodation sector. Currently, many businesses are financially unable to review wages and salaries for staff (beyond any legal requirement to do so). Faced with such conditions, the proposed increase to the minimum wage is predicted to lead to further job cuts and/or an increasing prevalence of part-time/casual work. This is in direct contrast to the Government's stated objective of improving job prospects and conditions for workers.

Horticulture

60. Horticulture is vital to New Zealand's domestic food supply as well as being a major export earner. As such, it will be a major contributor to post-Covid economic

recovery, and all efforts should be made to ensure its value to the economy is not diminished as a consequence of government decision-making.

61. For many horticultural businesses, wage costs are the largest single cost component. For some, wage costs have increased from around 20% to over 40% of business costs in recent years. However, businesses cannot simply increase prices to accommodate imposed extra costs. This is because prices obtainable for produce are significantly influenced domestically by large buyers, such as supermarket chains and in export markets, by the presence of international competition.

62. Consequently, horticulturalists are constrained in the amount of wage-related cost they can load into a unit of produce. Faced with imposed cost increases, they therefore must find alternatives to price increases to make up the shortfall. A recent survey of over 3000 horticultural businesses reported increasing intentions to invest in automation which, while reducing operational costs, will also significantly reduce the number of available jobs. However, not all businesses can automate to the degree necessary to offset cost increases, in part because margins are already so tight there is little extra capacity to invest in research, development and new technology.

63. Ultimately, increasing productivity is the only sustainable means of absorbing extra costs but increasing wages does not of itself increase worker productivity, i.e. the rate at which produce is picked and processed. This is incentivising some employers to introduce alternative means of paying workers, e.g., piece rates, which focus on the volume of produce gathered rather than on the time taken to gather it. Further increases to the time-based minimum wage rate will inevitably further increase the use of piece rates.

64. Cost pressures created by wage increases are exacerbated by housing availability issues. Many businesses in the horticultural sector, particularly those employing seasonal workers, are required to provide worker accommodation for the significant number of migrant workers employed each season. Few, if any, other industries are required to do this, let alone on the scale required of the horticultural sector.

65. Housing is an extra cost that must be absorbed, making the absorption of imposed increases in wages even more challenging. National housing shortages exacerbate this issue further. All these cost pressures limit options for growth-oriented investment in the business.

WHAT CAN BE DONE?

The Minimum Wage Act itself needs amendment

66. In light of the effects discussed above, BusinessNZ believes further, above inflation, increases to the current minimum wage will not bring hoped for benefits and should be minimised in favour of approaches that generate higher skills and greater productivity, the key ingredients of sustainable income increases.

67. These concerns are exacerbated by the fact that the minimum wage is set as an hourly rate. The courts have determined that the minimum rate must be paid for every hour worked, even when that work is minimal, e.g. sleeping and travelling. This approach effectively increases the cost of the job, without changing its value.

This in turn is a disincentive to employers who would otherwise offer development opportunities to employees, particularly youth.

68. BusinessNZ advocates changing the approach to the minimum wage away from a rate per hour to that of averaging income over hours worked. This would allow different aspects of work to be "priced" according to their relative value, at the same time as protecting employees from exploitation by ensuring that their average income did not fall below the specified rate.

Reduce wage compression

69. To improve the relative ratios between those paid above the minimum wage and those on it, government ideally should focus on enabling and encouraging increased access to training and employment to achieve higher productivity and hence increased real earnings over time. Relying on increased minimum wages alone we believe is likely to have the opposite effect.

70. The key challenge is to increase the value (as opposed to the cost) of low paid work. Put another way, low wages need to be dragged up by improvements in the performance of the economy, not pushed up, affecting the rest of the economy.

71. However, it also needs to be recognised that all markets, including labour markets, typically respond faster to reality than a government can respond through intervention. Thus, many interventions run the risk of being rendered ineffective by the time taken to implement them.

Reducing Tax Rates

72. BusinessNZ believes there is a more viable alternative to rises in minimum wage rates to ensure a highly productive and high wage economy – the reduction of taxes on both individuals and businesses. Economic conditions are good for this option at the moment.

73. If government is focused on raising New Zealand's productivity and growth rate, as well as raising the standard of savings, we believe a better means of providing all New Zealanders with the opportunity to save and invest more is through restructured personal and company tax rates.

74. Instigating a broad-based, low rate approach to taxes, while containing government spending to levels around 30% of GDP, will leave most New Zealanders with more cash in hand with which to repay debt, save for a house deposit or invest for retirement savings.

75. The advantages of a tax cut over an increase in the minimum wage rate for low-paid workers are numerous and include the facts that a rise in the hourly rate through a tax cut does not increase the wage costs for the business, and the relativity of those earning slightly more than minimum wage workers, because of extra responsibilities or qualifications, is maintained as their wages also experience an increase.

76. There is also a need to account for the effects of transfer payment schemes, such as Working for Families, on low wage rates. The challenge here is to avoid the

complications of abatement regimes in the first place. If it is determined that government should subsidise incomes, it should do so in a way that is effective in areas of need, is administratively simple, and does not create perverse incentives that contradict other policy initiatives. Currently the administration of state social assistance programmes requires monolithic government infrastructure and complex and cumbersome administrative processes, resulting in ever-increasing costs.

77. An obvious means of addressing these issues is to leave the value of government assistance in people's pockets in the first place. This means adjusting tax rates and thresholds rather than introducing new ways of distributing welfare. Except for those genuinely unable to work, this would act as an incentive to find work; it would also mean that increases in net income would need to be achieved through effort and productivity.

78. Taking a tax adjustment approach would simplify administrative issues and reduce government social spending (and its associated administration and compliance costs). It would largely remove the disincentives attached to WFF or the cross over effects into other assistance programmes.

Ends