

NEW ZEALAND BUSINESS ROUNDTABLE

**SUBMISSION ON THE 2000 REVIEW OF THE
MINIMUM WAGE**

OCTOBER 2000

THE 2000 REVIEW OF THE MINIMUM WAGE

Introduction

- 1.1 This submission on the annual review of the minimum wage is made by the New Zealand Business Roundtable, an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall national interests.
- 1.2 The Minimum Wage Act 1983 (the Act) states that the governor-general may prescribe by order in council minimum rates of wages payable to any class or classes of workers. The class or classes of workers are to be defined by reference to their ages. It is not mandatory to prescribe such wage rates. The minister of labour is required to review any minimum wage rates prescribed under the Act before 31 December of each year but is not required to recommend that such rates be adjusted. The Act is silent on both the objectives of minimum wages and the criteria that are to be applied in setting or reviewing minimum wages. The Act does not apply to apprentices, certain classes of people engaged in training and inmates of charitable institutions.
- 1.3 The balance of this submission is presented in four sections. The next section (section 2) provides background information on minimum wages and reviews key employment trends. Section 3 examines the objectives of statutory minimum wages. The economic effects of minimum wages are discussed in section 4. Our conclusions and recommendations on the review are presented in section 5.

2. Background

- 2.1 The 2000 review takes place in the context of continuing high unemployment particularly among the young, those with few skills, and Maori and Pacific Island peoples. According to the Household Labour Force Survey, 18.1 percent of people aged 15-19 years and 9.3 percent of those aged 20-24 years were unemployed in the June quarter of 2000 compared with 6.1 percent for all age and ethnic groups. Thirteen percent of Maori and 10.8 percent of Pacific Island people are reported to be unemployed. They are disproportionately represented among the young

unemployed. Such unemployment should be of the utmost concern to the government and the prime consideration in the 2000 annual review.

- 2.2 Statutory minimum wages have been prescribed for people aged over 16 years and under 20 years of age (youth) and for adults (aged 20 years and over). The present minimum weekly wages of \$182 for youth and \$302 for adults have applied since 1 March 2000.¹ Those wages were 8.3 percent and 7.9 percent higher than the minimum youth and adult wages respectively that applied in February 2000.
- 2.3 As could be expected in these circumstances, labour market outcomes for youth and young adults, the groups most affected by minimum wages, are inferior to those for the population as a whole.
- 2.4 The unemployment rate among 15-19 year olds remained at 18.1 percent between the March quarter of 1999 and the June quarter of 2000 whereas the unemployment rate for the population as a whole has decreased from 7.5 percent to 6.1 percent. Although this is a comparison between the period before the increase and the latest period for which statistics are available, it may be affected by seasonal factors. However, on a June quarter to June quarter basis, the labour market outcome for youth is even more adverse. On this basis the unemployment rate for 15-19 year olds increased by 1 percentage point while the overall unemployment rate fell by 0.9 percentage points.
- 2.5 The unemployment rate for 20-24 year olds has fallen from 13.1 in the March quarter of 1999 to 9.3 percent in the June quarter of 2000. A smaller reduction occurred on a June quarter of 1999 to June quarter of 2000 basis. However, there has been an equally pronounced decline in labour market participation by the 20-24 age group. Between the March quarter of 1999 and the June quarter of 2000 it fell substantially from 78.3 percent to 70.2 percent. This may well indicate that young adults are being discouraged from looking for employment. Such an outcome is consistent with a rise in the adult minimum wage.
- 2.6 The labour market outcomes for youth and young adults should also be examined in the broader context of recent changes in minimum wages and medium-term trends in employment. The increase in minimum wages approved in the 1999

review followed a massive 10 percent increase that was implemented on 1 March 1997. Reviews conducted in 1997 and 1998 left the level of minimum wages unchanged. Even so, minimum adult and youth wages in March 2001 are expected to be between 9 and 15 percent higher in real terms on both a before- and an after-tax basis than they were in 1996. Not surprisingly, labour market outcomes for youth and young adults since then have been substantially worse than for the labour force generally (see table below).

- 2.7 The number of 15-19 year olds and 20-24 year olds in employment has fallen by a substantial 7 and 17 percent respectively since June 1996 whereas total employment has increased by 4 percent. The level of unemployment has increased by 18 percent for 15-19 year olds compared with 8 percent for the population generally. In contrast, the level of unemployment of 20-24 year olds has declined by 4 percent. More significantly, the labour force participation rates for youth and young adults have declined by 3 and 7 percentage points respectively compared with a decline of 1 percentage point for the population as a whole. The unemployment rate for youth and young adults has increased relative to that of the population as a whole.

**Labour Market Performance for Youth and Young Adults
June Quarter 1996 to June Quarter 2000**

	June Quarter 2000	June Quarter 1996	Change	
			000s	Percent
<i>Employment</i>	000s	000s	000s	Percent
15-19 year olds	115.8	124.7	-8.9	-7.1
20-24 year olds	161.7	193.9	-32.3	-16.6
All age groups	1,753.2	1,683.5	69.7	4.1
<i>Unemployment</i>				
15-19 year olds	25.7	21.8	3.9	17.9
20-24 year olds	16.6	17.3	-0.7	-4.0
All age groups	114.3	105.9	8.4	7.9
<i>Unemployment rate</i>	Percent	Percent	Percentage Points	
15-19 year olds	18.1	14.9	3.2	
20-24 year olds	9.3	8.2	1.1	
All age groups	6.1	5.9	0.2	

¹ These rates reflect a forty-hour week. Equivalent rates are prescribed where workers are paid on an hourly or daily basis, or work for more than 40 hours in a week.

<i>Participation rate</i>	Percent	Percent	Percentage Points
15-19 year olds	51.9	55.3	-3.4
20-24 year olds	70.2	77.4	-7.2
All age groups	64.6	65.6	-1.0

Source: Statistics New Zealand (2000), Household Labour Force Survey, Statistics New Zealand, Wellington.

2.8 While factors other than the change in minimum wages will have contributed to these outcomes, minimum wages can be expected to have played an important part. Although the government predicted modest economic growth through to 2003/04 in the budget, little improvement in the rate of unemployment is projected. The overall rate of unemployment is forecast to be 5.7 in the March quarter of 2001 and 5.6 percent in the March quarter of 2004. These forecasts are likely to prove optimistic given the massive deterioration in the quality of economic policy over the past few years and the consequent slump in business and consumer confidence.

3. Objectives of statutory minimum wages

3.1 The Department of Labour reported in 1999 that there are two commonly cited objectives for a minimum wage:

- a income redistribution, reflecting the view that, without intervention by a minimum wage, the income of a person or household may be insufficient; and
- b the protection of vulnerable employees, reflecting the view that a minimum wage ensures that employers are not able to exercise a disproportionate influence over wages in a particular industry or location when workers lack the necessary information and skills to bargain effectively.²

These objects are reflected in the minister of labour's request for submissions which states that:

The minimum wage rates that are set attempt to make work pay, and to protect vulnerable workers, while at the same time being set at a level that businesses can afford.³

² MacPherson, Elizabeth (1999), "Minimum Wage Review 1999", Unpublished report to the Minister for Enterprise and Commerce, 25 November, Department of Labour, Wellington, p 7.

³ Wilson, Margaret (2000), Annual Review of the Minimum Wage, personal correspondence, 8 September.

- 3.2 Statutory minimum wages are an inappropriate instrument for achieving these equity objectives. As noted by the Department of Labour, they are "poorly targeted" and are "unlikely to reach many of those who may need assistance".⁴ The Department concluded that "an increase in the minimum wage is not an effective means of targeting income assistance."⁵ Most people on low wages are in households on middle to upper incomes with income deciles 4 to 7 inclusive accounting for 56 percent of all minimum wage workers.⁶ A low wage is often a second or subsequent market income of a household. Moreover, many people on low wages also receive other government assistance. Tenants in state houses, for instance, will receive higher housing subsidies following the reintroduction of income-related rents.
- 3.3 Professor Lawrence Mead, drawing on research conducted in the United States, observes that the vast majority of poor workers are mainly poor because of their low hours of work. In his view "Poverty ... has little connection to low wages in general" because "few steady workers at any wage are poor."⁷ Moreover, income is often a poor measure of individual welfare. For that reason, poverty studies usually focus on household consumption which tends to be less closely related to income at the bottom end of the income distribution than elsewhere.
- 3.4 Welfare and tax systems are better instruments than minimum wages for addressing valid income distribution concerns. The level of benefits reflects society's assessment of the minimum acceptable income that should be available to residents. Over recent years governments have taken some helpful steps to encourage beneficiaries of working age to engage in employment where feasible. A minimum wage in excess of the community wage is inconsistent with such policies and an increase in minimum wages would be a step in the wrong direction. It makes no sense, for example, to deny a person a job at a wage that would provide a higher income than the community wage.
- 3.5 The proposition that minimum wages are an effective means of protecting

⁴ MacPherson (1999), p 2.

⁵ *Ibid* p 12.

⁶ *Ibid* p 8.

⁷ Mead, Lawrence (1997), "Raising Work Levels Among the Poor", *Social Policy Journal of New Zealand*, Issue eight, March, pp 1-28, at p 7. Note that minimum wages in the United States are generally set at a lower proportion of mean wages than in New Zealand.

vulnerable employees is also mistaken. It reflects an outmoded view that employees are powerless in bargaining with employers. As Alchian and Allen observed in relation to collective bargaining:

... employers compete against other employers, and employees against other employees – not employees against employers, as folklore says. It is the availability of higher-valued alternatives ... that increases bargaining power.⁸

The best protections that workers have are the ability to change jobs and the normal legal sanctions that apply in the event of offences such as fraud or civil disputes. The objective of protecting vulnerable workers makes no sense at all in the vast majority of centres where there is a wide choice of employers. Furthermore, employees who are unhappy with their pay and conditions in a locality with few employers may be able to move to another town or city. It is not necessary for all, or even most, employees to transfer as it is decisions at the margin that affect wages and conditions. Employees who choose to remain can free ride on the actions taken by those employees who are prepared to act.

- 3.6 If government action is justified on information grounds, the government should arrange for information to be made available to affected employees. Those grounds do not justify statutory minimum wages.
- 3.7 The government promoted the Employment Relations Act 2000 (ERA) on the mistaken grounds that it was required to protect vulnerable workers. However, if the government is confident that the ERA will achieve this objective, the minimum wages legislation is redundant. Its retention would indicate the government's limited confidence in the efficacy of the ERA.

4. Employment and other effects of statutory minimum wages

- 4.1 A conventional economic analysis and the weight of empirical evidence show that binding statutory minimum wages result in lower levels of employment than otherwise. The grounds for this view and recent challenges to it were reviewed in detail in the Business Roundtable's previous submissions and in a 1994 report

⁸ Alchian, Armen and Allen, William R (1983), *Exchange & Production: Competition, Coordination & Control*, Wadsworth Publishing Company, Belmont, p 328.

prepared by ACIL, and are summarised below.⁹

- 4.2 As is well known, orthodox economic theory predicts that an increase in the statutory minimum wage above the market-determined minimum wage will reduce numbers employed and aggregate hours of employment. Those people who retain their jobs and were previously employed at a wage below the new minimum gain a pay increase. However, the market incomes of those who lose their jobs fall dramatically to zero. The main claim of those who oppose rises in minimum wages (and, indeed favour their abolition) is that the losses imposed on the latter outweigh the benefits accruing to the former and that overall economic efficiency and national income are reduced through disemployment and other effects.
- 4.3 An increase in the minimum wage tends to increase the costs of goods and services that are produced by unskilled labour. The producers of unskilled-labour intensive traded goods and services (eg shoes and clothing) are unable to put up their prices. The production of such goods and services therefore tends to decline because they are less profitable to produce. Imported products would tend to increase. Both effects can be expected to reduce the quantity of unskilled labour that is employed. In the case of non-traded goods and services which are unskilled-labour intensive (eg fast food products) producers tend to raise their prices relative to the prices of other goods, thereby reducing the quantities consumed and the quantity of unskilled labour hired to produce such goods. Moreover, the producers of traded and non-traded goods tend to substitute other inputs for unskilled labour in their production processes.
- 4.4 On the basis of recent statistical studies, some researchers have suggested that the effect on employment of statutory minimum wages may be close to zero or even

⁹ New Zealand Business Roundtable (1996), "Review of the Statutory Minimum Wage", Unpublished submission, New Zealand Business Roundtable, Wellington; Sloan, Judith (1997), "Annual Review of the Minimum Wage", Unpublished submission, New Zealand Business Roundtable, Wellington; New Zealand Business Roundtable (1998), "Submission on the 1998 Review of the Statutory Minimum Wage", Unpublished submission, New Zealand Business Roundtable, Wellington; New Zealand Business Roundtable (1999), "Submission on the 1999 Review of the Minimum Wage", Unpublished submission, New Zealand Business Roundtable, Wellington; and ACIL Economics and Policy Pty Ltd (1994), *What Future for New Zealand's Minimum Wage Law?*, New Zealand Business Roundtable, Wellington. Copies of these submissions and the ACIL report are available on request.

positive.¹⁰ One argument for this view is that, within a certain range, a minimum wage will induce a monopsonist to increase the quantity of a given type of labour that is hired.¹¹ While this proposition rests on conventional theory, genuine monopsony is rare and is not a sound basis for expecting an increase in the minimum wage to raise employment. A further argument is that the 'shock' of an increase in the minimum wage induces employers to find ways of improving labour productivity to an extent that enables them to profit by increasing the quantities of labour hired. This is essentially an *ad hoc* explanation which is, at best, barely plausible. It is tantamount to assuming that previously employers persistently failed to perceive and exploit opportunities to increase profits.

- 4.5 The theoretical underpinnings of these views are both contrived and unconvincing and there are serious methodological problems with the Card and Krueger study which propounded them. This contrasts with the commonsense propositions that underlie the conventional view. Similar findings to these conclusions are found in the literature.¹² Furthermore, 87 percent of labour economists in the United States who participated in a random survey agreed that a minimum wage increases unemployment among young and unskilled workers.¹³ Consistent with this conventional view, Officials concluded that:

... the minimum wage has some negative impact upon employment, leads to increased unemployment, results in reduced skill formation, may have a slight [upward] impact on inflation and has a variety of fiscal consequences.¹⁴

- 4.6 The conventional view, based on empirical studies over many decades (predominantly from the United States), is that a 10 percent increase in the

¹⁰ Card, David E and Krueger, Alan B (1995), *Myth and Measurement: The New Economics of the Minimum Wage*, Princeton University Press, Princeton and Chapple, Simon (1997), "Do Minimum Wages Have an Adverse Impact on Employment? Evidence from New Zealand", *Labour Market Bulletin*, No 2, pp 25-50.

¹¹ A monopsonist is defined as the sole hirer of a given class of labour in a given market. An example might be a country hospital that hires nurses living in the surrounding area.

¹² Hamermesh, Daniel S (1995), "Comment", *Industrial and Labour Relations Review*, Vol 48, No 4, pp 835-838; and Lewis, Philip (1997), "The Economics of the Minimum Wage", *Australian Economic Review*, Vol 30, No 2, pp 4-7. Also see references contained in Sloan (1997).

¹³ Whaples, Robert (1996), "Is There Consensus Among American Labour Economists? Survey Results on 40 Propositions", *Journal of Labor Research*, Vol 17, No 4, pp 725-734.

¹⁴ Compton, Jan (1997), "Officials Paper: Minimum Wage Review 1997", Unpublished report to the Minister of Labour, 2 December, Department of Labour, Wellington, p 3.

¹⁴ Compton (1997), pp 7-9.

minimum wage can be expected to reduce employment of low-wage workers by something in the order of 1 to 3 percent.¹⁵ On this basis a 'ballpark' estimate is that the number of youths and young adults employed could decline by perhaps 550 to 1,650, depending on the number in these groups with jobs at the bottom of the wage spectrum, if minimum wages were increased by, say, 2 percent. Additional job losses could be expected in other adult age groups.

- 4.7 The adverse effects of higher minimum wages extend beyond job losses. When the price of labour is artificially increased by statute, employers tend to adjust non-price attributes of the job in an attempt to retain their lower-skilled staff. In net terms even employees who are retained may end up worse off. On-the-job training is often cut back and other job attributes, relating to factors such as management supervision, the pace of work, safety, hours of work, recreation facilities and health and retirement benefits may become less favourable to employees. Fringe benefits including, where relevant, holiday pay, sick leave, health insurance, subsidised food and accommodation, time off for study, year-end bonuses and commission payments tend to become more difficult to obtain or maintain. Furthermore, bargaining agents will seek to preserve or restore non-wage conditions that are eroded by increases in minimum wages.
- 4.8 While an increase in statutory wages would increase the incomes of people who currently earn an income below the minimum wage and who retain their jobs, those benefits do not, in our opinion, outweigh the adverse consequences for those who would be precluded from employment. If the incomes of low-wage employees are judged to be inadequate, the appropriate remedy is to provide some form of income transfer which does not create undue obstacles to welfare-enhancing employment contracts through the labour market.

5. Concluding comment

- 5.1 The inescapable conclusion is that binding statutory minimum wages destroy jobs and are a poor policy instrument for advancing equity objectives. For this reason, the Business Roundtable submits that a fundamental review of the minimum wage

¹⁵ The relevant research is summarised in Sloan (1997) and New Zealand Business Roundtable (1998).

legislation should be undertaken with a view to its abolition. This approach is consistent with the government's policy of 'closing the gaps' since paid work is the key means by which most people can earn an income and advance up the income ladder.

- 5.2 Pending a review of the Minimum Wage Act 1983, the Business Roundtable is opposed to any increase in statutory minimum wages; rather they should be reduced, desirably to the level of the community wage with income support providing the safety net. There is no logical reason for denying people an opportunity to work for a higher income than that provided by the government if they are unemployed and dependent on the community wage. Higher minimum wages would reduce the number of jobs available and deny people the opportunity to take up employment that would be attractive to them. A disproportionate number of such people are likely to have no formal educational qualifications, few workplace skills and low productivity. The combined effects of forgone income and training opportunities and lower self-esteem may have serious consequences for already disadvantaged people over their entire working lives.
- 5.3 Greater opportunity should be provided for people to opt out of the provisions of the Minimum Wage Act 1983 whether or not minimum wages are raised. Exemptions should be provided for all jobs that contain a training component, new entrants to the labour market, people unemployed continuously for more than six months and people who have been convicted of serious criminal offences. It may be possible to implement such a strategy by encouraging affected people to apply for exemption permits that may be issued under the Act, although a less burdensome approach is clearly preferable.