POLICY POINT

Minimum wages to the maximum: The risks of lifting the minimum wage

Dr David Law

3 December 2020

Introduction

On 24 November, the Helen Clark Foundation and the New Zealand Institute of Economic Research released a joint report (the HCF&NZIER report) outlining an inclusive growth agenda for New Zealand.[1] Its recommendation on the minimum wage is concerning and risks hurting the most vulnerable.

The report argues for a much higher minimum wage to help reduce inequality and lift productivity. This is despite the fact that the minimum wage was already increased from $17.70 to $18.90 in April of this year. In particular, the report recommends a "living wage" of $22.10 per hour.

The report argues that any potential benefits of higher minimum wages would not come at the expense of significantly fewer jobs, according to studies conducted overseas. But, there is good reason to be sceptical about the applicability to New Zealand of the most common results from the minimum wage literature overseas.

In fact, relative to the median wage, minimum wages vary widely across developed countries. In the OECD, for example, the rate ranges from 32-90% of the median wage. Estimates of employment effects of minimum wages also vary widely. New Zealand already has one of the highest relative minimum wage rates in the OECD which means jobs are likely to be at greater risk from further increases than in other places.

Analysis

Most OECD countries have some form of statutory minimum wage, which is the lowest wage permitted by law. However, minimum wage levels and setting mechanisms differ across countries, as do their coverage and level of employer compliance.

During the 2008 global financial crisis and recovery, countries relied heavily on the minimum wage either to boost (or sustain) the wages of the (working) poor and other low-paid workers, or to cut labour costs to deal with the crisis.

A minimum wage has potential advantages and disadvantages. It can improve equity by lifting the incomes of lower-paid workers and encourage those on the edge of the labour market, such as the low-skilled, to seek work. If set too low, it loses this usefulness. If set too high, the minimum wage will stop employers from hiring low-skilled workers and may end up protecting the "insiders" who already have the jobs. For some firms, the cost of hiring

[1] Krieble, T. (2020). Gains for everyone: Towards an inclusive growth agenda for Aotearoa New Zealand (NZIER Discussion Paper). Wellington: The New Zealand Institute of Economic Research. https://nzier.org.nz/publication/gains-for-everyone-towards-an-inclusive-growth-agenda-for-aotearoa-new-zealand

David Law is a Senior Fellow with The New Zealand Initiative.

extra staff can be a hurdle, even at the minimum wage.

A key reason the HCF&NZIER report advocates lifting the minimum wage is to help reduce inequality. This benefit may be lost if higher minimum wages reduced jobs significantly. Yet even without job losses, minimum wages are a relatively blunt tool for tackling poverty and inequality.

Some poor families have no working member. At the same time, many workers on the minimum wage live in households with above-average incomes. Also, minimum wages do not guarantee people can work enough hours to escape from poverty.

For instance, a study using New Zealand data and previous minimum wage changes estimated that a 10% increase in the minimum wage, even without a loss in employment or work hours, would only lower the relative poverty rate by less than one-tenth of a percentage point.[2] For this reason, in-work transfers are likely to be a better way to reduce poverty.

The HCF&NZIER report suggests lifting the minimum wage would have little adverse effect on overall employment based on an International Labour Organisation (ILO) report.[3] They note that while there is a wide range of effects of lifting the minimum wage across high-income countries, the most frequent finding is that there is little or no adverse effect on employment.

The OECD's reading of the evidence[4] is more nuanced. The OECD concludes that small increases in the minimum wage at reasonable levels are unlikely to cause substantial job losses. However, the evidence also shows that the prospects of the young and low-skilled are often hurt by such increases. Furthermore, what constitutes a "reasonable" minimum wage is inevitably country-specific and depends on how the minimum wage interacts with other policies, legislation, compliance, and macro-economic and labour market conditions.

Crucially, the OECD highlights the importance of the initial level of, and expected increase in, the minimum wage when assessing potential employment effects. That is, how binding the minimum wage is and will be.

So, how does New Zealand's minimum wage compare with its OECD peers?

In 2019, New Zealand's minimum wage was among the highest in the OECD, at 66% of the median wage for full-time workers (Figure 1). The OECD average was 54%. Only Costa Rica, Chile, Turkey and Colombia had higher relative minimum wages than New Zealand.

Since the 2019 OECD comparison was undertaken, the minimum wage in New Zealand has risen to 70% of the median wage. During the 2020 election campaign the Labour Party promised to lift it even further to $20 per hour in 2021 – to about 74% of the median wage, near Turkey's rate.

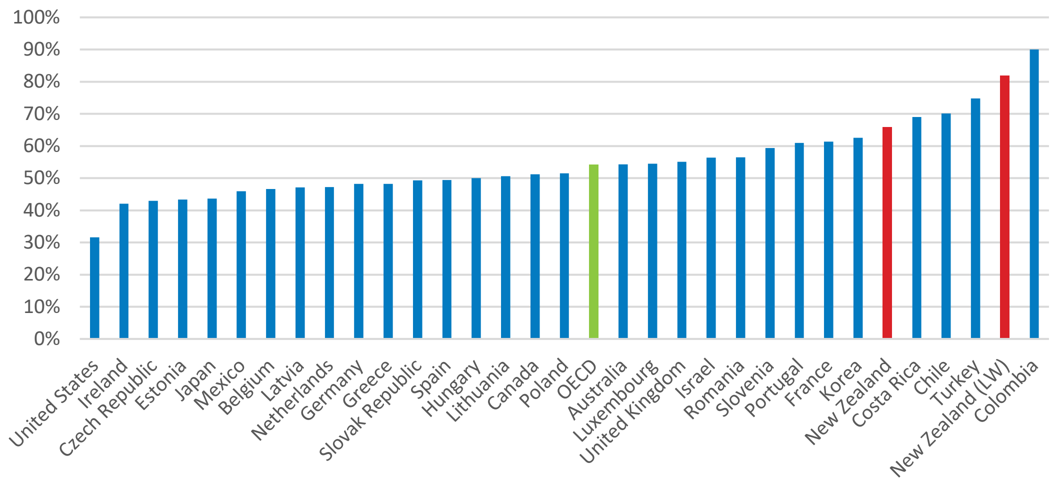
Figure 1 includes a bar for New Zealand showing the effect of a "living wage" ($22.10), as advocated by the HCF&NZIER report. If this is implemented, the minimum wage would rise to about 82% of the median wage and become second highest in the OECD behind only Colombia.

---

[2] Tim Maloney and Gail Pacheco, "Assessing the Possible Antipoverty Effects of Recent Rises in Age-Specific Minimum Wages in New Zealand," *The Review of Income and Wealth* 58:4 (2012), 648–674.
[3] ILO. 2016. "Monitoring the Effects of Minimum Wages." In Minimum Wage Policy Guide. https://www.ilo.org/wcmsp5/groups/public/---ed_protect/---protrav/---travail/documents/genericdocument/wcms_508532.pdf.
[4] OECD. "Employment Outlook 2015," Website.

Most empirical literature on the effects of minimum wage increases on employment comes from countries with relative minimum wage rates well below New Zealand's current level, such as the US, let alone that proposed by the HCF&NZIER report. Where relative minimum wages are high and potential hikes substantial, greater job losses can be expected. It matters little that average wages in New Zealand are slightly below the OECD average, as is the level of GDP per capita. Employment decisions are made at the margin.

Figure 1: Minimum wage as a share of median wage in 2019



Source: OECD and New Zealand Initiative calculations

Additionally, today's macro-economic and labour market conditions are far from ideal to absorb fresh hikes. Indeed, the country is in the middle of a recession and unemployment is already rising. In a market where margins are being squeezed, risks are clearly on the downside. Employers are more likely to respond to increases in the minimum wage by reducing employment than by investing in training to raise productivity. A policy stance of aggressively raising the minimum wage is thus not to be recommended at this stage of the economic cycle.

In fact, as part of its 2019 annual minimum wage review, the Ministry of Business Innovation and Employment (MBIE) forecast that the 2020 increase to $18.90 may cost 7500 jobs. A total of 19,000 jobs could be lost if the rate rose by dollar to $19.90 – more-or-less the level proposed by the Labour Party for 2021. MBIE's analysis never considered a rate as high as the "living wage" ($22.10) but said a rate of $21.15 might cost 33,500 jobs.[5]

These predictions assume "limited, but steady" overall employment growth which is now redundant due to the Covid-19 pandemic. Indeed, the latest available employment data from Statistics New Zealand shows employment down by 22,000 in the September quarter. That follows an 11,000 reduction in the June quarter. MBIE's predictions of the costs to employment from minimum wage increases now seem optimistic.

Finally, the HCF&NZIER report argues productivity will jump if the rate increases. It suggests firms will choose to upskill their workers to get the most value from them and that weak firms would be replaced by stronger firms.

Economists usually expect wage rises to follow productivity, not the other way around. It is true that New Zealand has had a long-standing issue with productivity performance. Unfortunately, legislating higher wages is not the answer. If simply implementing higher

[5] Ministry of Business, Innovation & Employment (MBIE), "Minimum Wage Review 2019" (Wellington: New Zealand Government, 2019).

wages would generate better outcomes, firms would do it already (and a policy analyst in Wellington would have found this solution decades ago). Indeed, firms already do pay most employees more than the minimum wage. Even if this argument had some merit at some minimum wage levels it is not clear why the optimal level would be $22.10.

Conclusion

Relative minimum wage rates in New Zealand are high compared with its OECD peers. Given the current economic climate, it is terrible timing to consider lifting them now.

Chasing, at best, marginal reductions in inequality or increases in productivity with a minimum wage rate increase would likely lead to significantly fewer Kiwis employed than would otherwise be the case.

Job growth and keeping people employed should be of primary policy concern, rather than differences between those who are lucky enough to be employed at this time. To ensure employment levels remain as high as possible during the Covid-19 crisis and recovery, the minimum wage increase earlier this year should be rolled back. Any further increases should be avoided.