The Treasury

Living Wage Information Release

November 2013

Release Document

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(g)(i) - maintain the effective conduct of public affairs through the free and frank expression of opinions

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

28 February 2014 update: Please note that none of the statistics is this report are based on the dataset which contained the disposable income miscalculations reported by the Treasury and Statistics New Zealand on 26 February 2014 at http://www.treasury.govt.nz/publications/informationreleases/disposableincome.

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Analysis of the Proposed $18.40 Living Wage

Date:	30 September 2013	**Report No:**	T2013/2346

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Read** the contents of this report. **Refer** a copy of the report to the Ministers of Labour, Health, Social Development and State Services and the Ministerial Committee on Poverty.	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Margaret Galt	Principal Advisor, Labour Market and Welfare	04 917 6986 (wk)	[1]	✓
[2]				
Carolyn Palmer	Acting Manager, Labour Market and Welfare	04 917 7021 (wk)		

Actions for the Minister's Office Staff (if required)

If the Minister agrees, **refer** this report to the Ministers of Labour, Health, Social Development, and State Services and the Ministerial Committee on Poverty

Return the signed report to Treasury.

Enclosure: None

Treasury Report: Analysis of the Proposed $18.40 Living Wage

Executive Summary

The Living Wage Aotearoa New Zealand Campaign (the Living Wage Campaign) launched in May 2012 with a focus on the income of workers with families. It calls for all New Zealanders to be paid a 'living wage', defined as $18.40 per hour. This is their calculation of the wage required by a family of two adults and two children. While there has been significant research dedicated to the economic and social impacts of the minimum wage, there is less evidence available on the Living Wage, or setting a minimum wage as high as the Living Wage.

This report therefore provides you with information on who earns wages below $18.40 in New Zealand.

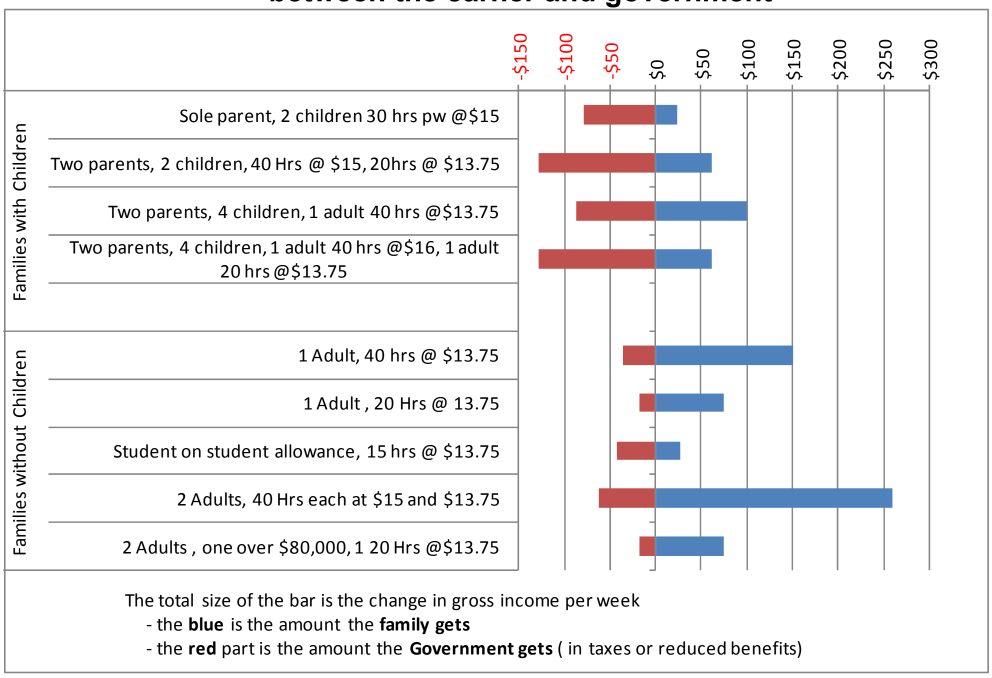
The group who earn a wage between $13.75 and $18.40 is diverse ...

- Almost all teenagers and the majority of people in their twenties earn below $18.40.
- 63 percent of households earning below $18.40 are single adults without dependants.
- About 30 percent of households with dependants earn below $18.40.

... and those who would benefit most are the families that do not receive supplementary assistance that abates.

- Families that receive means-tested income payments would benefit less the more those payments are abated.
- Families without dependants would see the biggest increase in incomes in their hands.

Total additional income from a Living Wage, and how that is distributed between the earner and government



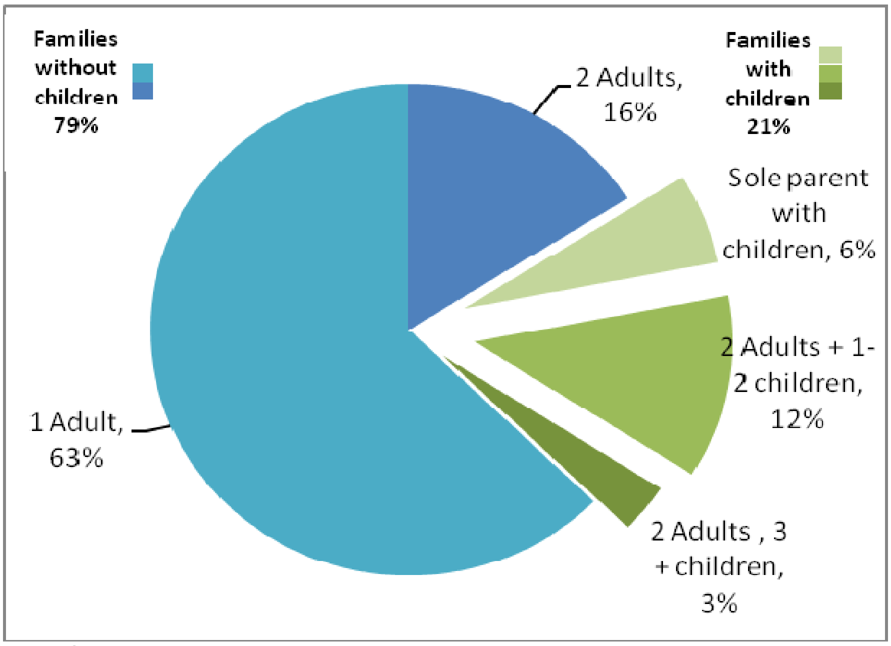
Source: Treasury, IRD and MSD calculations

A Living Wage is therefore not well targeted at low income families with children ...

- In 2012 benefits were the main income source for 44% of households with the bottom 20% of household incomes. A Living Wage would not improve the living standards of those without employment.

- Sole parents are overrepresented in the $13.75-$15.00 wage bracket, but would benefit least from a Living Wage in terms of lifting household income because of steep abatement rates.

Distribution of families earning below the Living Wage



Source: Taxwell

... and is likely to have negative economic impacts on employment and inflation.

- Negative employment effects are likely to be felt strongest by those with weak labour market attachment, such as teenagers and young adults.

The Living Wage figure of $18.40 is a relative measure and not based on a calculation of need.

- A number of calculations are made in the Living Wage report, each resulting in different figures. The $18.40 figure, however, is only a relative measure.

Adoption of the Living Wage as a minimum wage would have greater impact on some industries ...

- Over 70 percent of the Accommodation and Food Services industry earn below $18.40.

- Adoption of the Living Wage would be likely to put some industries, such as Retail Trade, at a disadvantage compared to overseas competitors.

... and we do not think increasing the minimum wage to this extent would lead to higher average wages.

- The minimum wage has grown much faster than average wages over the last decade, and this has not led New Zealand becoming a higher wage economy.

Recommended Action

We recommend that you:

a **note** the contents of this report

refer this report to the Minister of Labour, the Minister of Health, the Minister of Social Development and the Minister of State Services, and

Refer/not referred

b **refer** this report to the Ministerial Committee on Poverty.

Refer/not referred.

Carolyn Palmer
Acting Manager, Labour Market & Welfare

Hon Bill English
Minister of Finance

Purpose and Structure of this Report

1. This report provides you with information on the likely impact of the proposed Living Wage of $18.40 being widely adopted.

2. We first provide evidence on whether the proposed Living Wage would be an effective means of reducing inequality and poverty particularly amongst families, by considering:

   - Who works for a wage between the current minimum wage of $13.75 per hour and $18.40

   - What extra income different types of households would receive in the hand after considering the impact of taxes and benefits, and

   - The robustness of the research around the calculation of the $18.40 level.

3. Then we provide evidence on whether a higher minimum wage would be a useful approach for lifting New Zealand to a high wage economy, by considering:

   - The impact on different industries should the minimum wage rise to $18.40 and

   - The evidence on whether a higher wage rate “floor” is likely to move the economy to a higher average income level.

Background to the Living Wage proposal

The argument for the Living Wage is focused on reducing poverty ...

4. The Living Wage has been promoted by Living Wage Aotearoa New Zealand (a coalition of NGOs, unions and other interested people) “as a necessary step in reducing inequality and poverty in our society”[1]. As has happened overseas, the focus of their campaign has been on workers with families earning below $18.40 per hour, and on persuading local and national governments, NGO’s and other non-market employers to adopt the Living Wage.

5. The goal of the campaign is for every worker to earn a wage of at least $18.40, while acknowledging that only businesses that are able and willing to opt in will do so. This distinguishes the Living Wage from the legislatively prescribed Minimum Wage. Over time, and if the Living Wage campaign gathers momentum, there is a risk that it gathers increasing recognition as a benchmark, magnifying the associated benefits and costs. However, for the purposes of exploring the data, this report assumes that the Living Wage is universally adopted.

... but this is a departure from the approach to the minimum wage and targeted assistance.

6. Using a Living Wage as a way to reduce poverty and improve living standards for low wage earners is a departure from the current policy approach, which uses a number of instruments targeted mostly at lower income families.

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[1] From their website www.livingwagenz.org.nz

7. The current objective of the minimum wage is to protect the real incomes of low wage earners, while minimising job losses. It is not an effective mechanism for reducing poverty on its own, nor is it intended to be. Instead, there are other measures, like income transfers, subsidised access to health and education services, and childcare assistance, to improve the wellbeing of families with low incomes.

8. A legislated Living Wage would put the regulation of wages at the centre of policies which are aimed to achieve higher living standards for families. In many cases, the reliance on other public assistance would reduce significantly or abate entirely (see Figure 4).

Who would benefit from a Living Wage

9. Treasury has used the Household Economic Survey (HES) data used in the Taxwell model to analyse who earns wages below $18.40. We have not considered people on low incomes who are self-employed, solely supported by benefits, or have other forms of income (e.g. paid parental leave, ACC payments etc) as these people would not be affected by the adoption of the Living Wage.

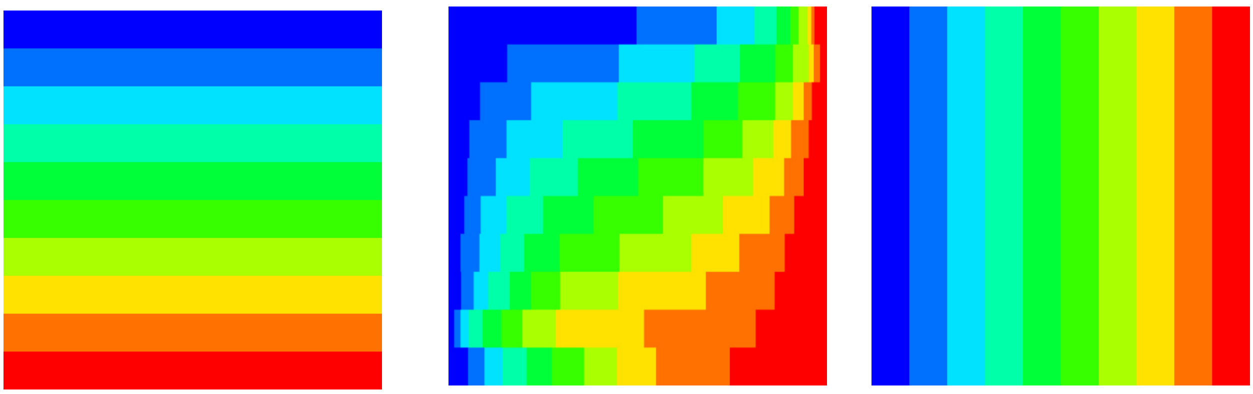
10. Appendix 1 contains a set of standard qualifiers and modelling assumptions used, while we have listed some significant limitations in using the HES data below:

- It only covers one time period so it will miss any changes over time. Last year we reported to you (T2012/866 refers) on research using the SoFIE database which showed that while a significant proportion of low income earners persist in low income, there is also substantial movement over relatively short periods of time, as shown in figure 1. The Living Wage campaign has focused on those that persist in low income for many years, but in fact only 24% of those in the bottom decile of income in 2002 were still in that decile in 2009.[2]

Figure 1: Short term income mobility in New Zealand

Starting point & No mobility | **New Zealand's mobility after seven years** | **Complete mobility**

Top 10%



Bottom 10%

- We had to decide how to treat people who have more than one job. For this analysis we used the job with the most hours recorded.

2 This mobility was not caused by young people entering the labour market and retirements but rather is a pervasive feature of both labour markets both here and overseas.

- The HES wage rate is calculated by dividing income by the number of hours worked. In a significant number of cases this showed an unreasonably low hourly wage, either because one of the two numbers was recorded incorrectly, or the person's remuneration package includes other benefits, such as commission or accommodation. Rather than ignore these people, we have included them in the analysis describing their income as "low" because we think that most are likely to earn below $18.40 per hour.

Almost half of wage workers earn below $18.40 ...

11. The proposed Living Wage is nearly at the median hourly earnings in New Zealand, so just under half (45%) of the wage earners currently earn less than it.

    - Over half of this group (56%) earn between $13.75 and $15 per hour, with the rest earning between $15 and $18.40 per hour.

    - Men and women are equally likely to be earning between $15 and $18.40, but women are rather more likely to be in the $13.75 to $15 band (56% of these workers), and less likely to earn above $18.40 (46% of these workers).

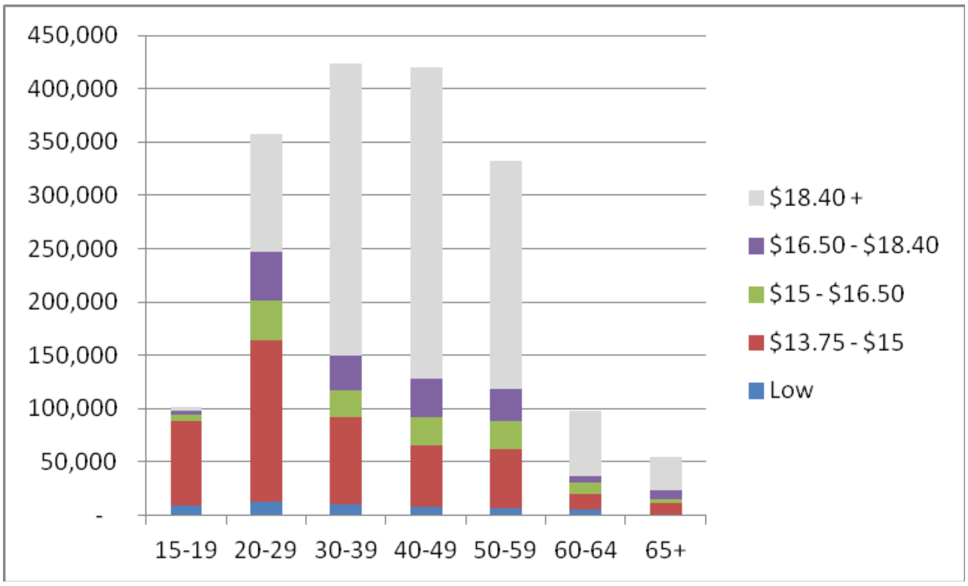
    - About 60% of Māori and Pacific wage earners earn below the Living wage compared to 40% of New Zealand European.

... but it is particularly common amongst young people.

12. Figure 2 shows that people are most likely to earn below the Living Wage when they are aged below 30. Almost all teenagers work for less than $18.40 per hour, as do about 70% of those in their twenties. Together these two groups make up 43% of the people below the Living Wage. About a third of people aged between 30 and 65 earn below $18.40.

13. The high proportion of young people reflects the life-cycle pattern of earnings, where on average people earn less when they are young and more as they gain experience, peaking at about age 45 to 50. Raising the floor on wages will, therefore, always provide greatest benefit to younger people, and especially to those in the teens and early 20s.

Figure 2: The wage rates of people of different ages

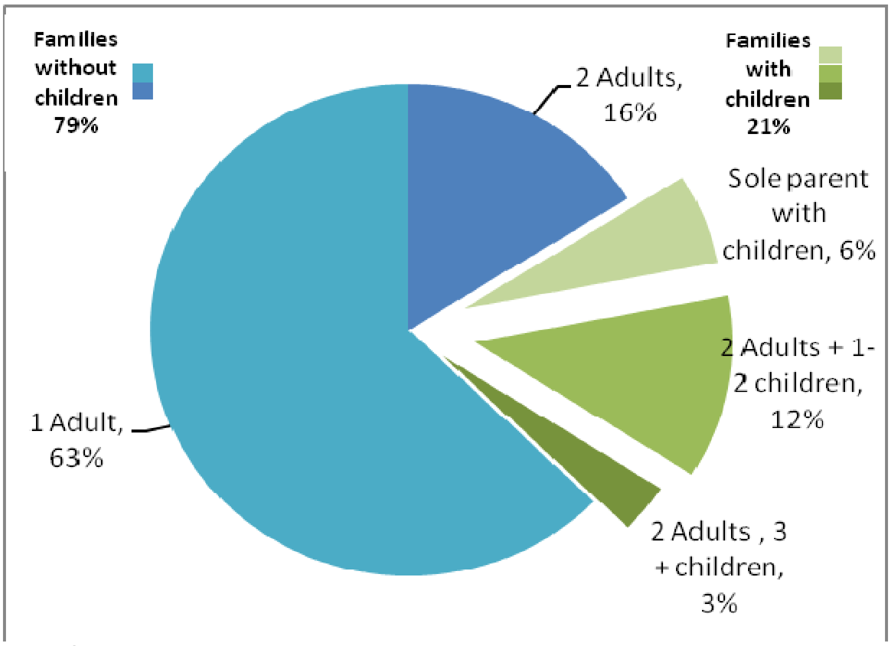


Source: Taxwell

Wage workers earning under $18.40 are also commonly single adults and two adult families without children. Only a minority are families with children.

14. As shown in Figure 3, single adults without dependants represent 63% of the families earning below the Living Wage. Some of these will still be living with their parents, as the HES counts every child over 18 as a separate "family". 16% of families are two adults with no dependent children.

Figure 3: Distribution of families earning below the Living Wage



Source: Taxwell

15. About 21% of families earning below the Living Wage rate have dependants. In particular:

- Over half of the sole parents with dependants who are working have wage rates below the Living Wage, and most of these earn less than $15 per hour.

- In 25% of households with two adults and dependants, the principal earner of the household is on a wage rate below the Living Wage. This earner may also have income from other sources, but generally the partner and dependants will have an even lower wage rate if they are earning wages or a salary.

In some cases workers have other sources of income in addition to their wages.

16. Some low income earners have other income sources which moderate the impact of their personal low wage rate on their living standards.[3]

- **31% are secondary earners or dependants living with another earner.** The distribution of low wage earners across family incomes detailed below suggests that some of these people are in high income families.

[3] The different groups cannot be added together as a person may be in more than one of these categories e.g. part-time and a secondary earner or dependent

- **Many, particularly those on the lowest wages, also receive a core benefit.**[4] 20% of those on incomes under $16.50 receive a core benefit, but this drops to 5% for those above $16.50, and 3% for those earning over $18.40.

- **About 20% of those earning under $18.40 are full or part-time students.**

- **3% are over 65 and will be receiving New Zealand Superannuation.**

Or workers may live in households where other people earn high incomes.

17. The proportion of people who share incomes with other family members will be underestimated by the fact that young adults over 18 who live with parents are classified as separate "families". Even so, 29% of low income workers are classified as living in families where the family income exceeds $60,000 (the Living Wage would provide gross $57,432 for a family with one full-time and one part-time worker).

18. If we look at families which earn over $20,000 (so may be working more than 30 hours a week on the minimum wage) then 18% of the individuals which would benefit from the Living Wage already have a family income of over $80,000. For those earning the lowest wage rates, 15% have a family income over $80,000.

Family Income	Proportion earning under $18.40 per hour	Proportion earning $13.75 to $15 per hour
$20,000 to $40,000	41%	46%
$40,000 to $80,000	41%	39%
$80,000 to $100,000	7%	5%
$100,000 to $150,000	8%	8%
over $150,000	3%	2%

Source: Taxwell

For those receiving supplementary assistance government would gain most from higher wages ...

19. Because supplementary payments abate and income taxes rise as incomes increase, not all of the extra income provided by lifting wage rates would end up in wage earners' take home pay.

20. The people who would benefit most would be those who currently receive no means tested support from government, i.e. teenagers and young single people, older single adults, and those over 65. Those who would receive the lowest additional assistance would be those who receive welfare support that abates as incomes rise.

... which means individuals who benefit most are those without children, including teenagers and young adults.

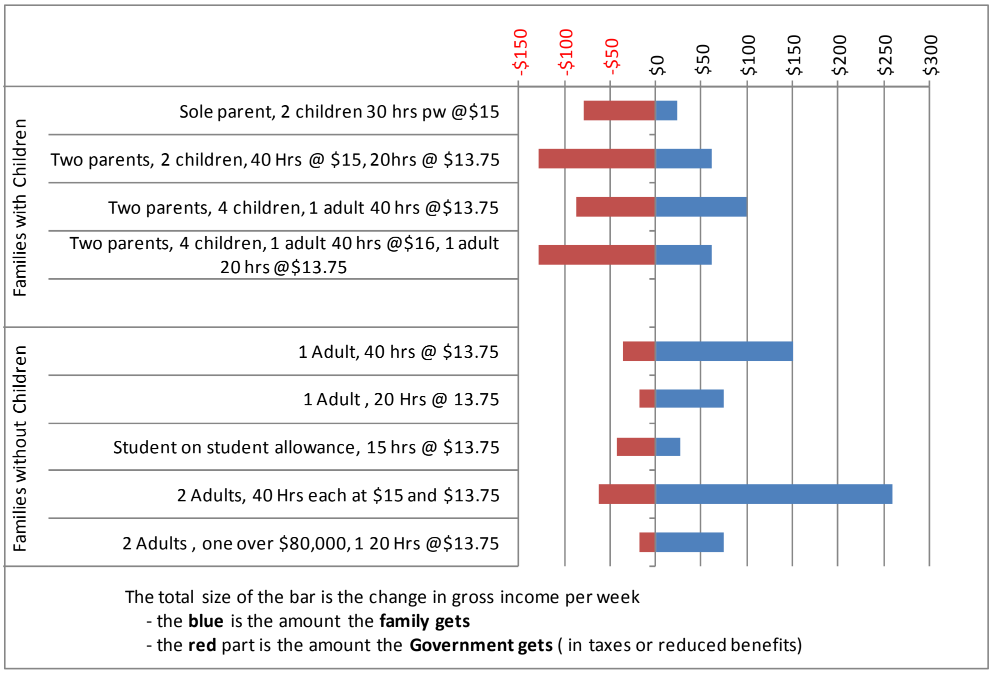
21. To assess the income gain for different households, MSD and IRD provided us with advice on what the results would be for particular family types in terms of the gross income that would be earned, and how this would be split between higher income for the person and either higher taxes or reduced transfer payments for government. The details of these calculations are in Appendix 2, and graphically represented in Figure 4. The calculations show:

- The amount of gross earnings depends on the hours worked (it is higher for full time workers) and the difference between the current wage rate and $18.40.

[4] i.e. Jobseeker, Sole Parent, or Supported Living payments

- Everyone gains some extra money in the hand, but for some family types the amount they keep is a small proportion of the total earned.
- For families with children, in most cases government receives more in tax and abated transfers.
- The proportion kept by the earner is particularly low for sole parent families, and our earlier analysis of short-term income dynamics showed this family type had the highest level of persistence in low income (T2012/866 refers).
- Students on student allowances also keep only a very small portion of the increase.
- Households without children see the biggest increase in weekly income, and in part this is because government only receives a small share of the change in income.

Figure 4: Total additional income, and how that is distributed between the earner and government



Source: Treasury, IRD and MSD calculations

Adopting the Living Wage approach implies a change in focus from support for young children to adults ...

22. Assuming those in work remain employed with the same hours, adopting a Living Wage would rebalance the role of the employer and the welfare system towards work being the primary mechanism for people to support themselves. It would however, also move the focus of support from young children to adults, particularly young adults. It would not change the income for those families that are solely dependent on welfare payments.[5]

... though young adults are also likely to face more difficulty in finding a job.

23. It is likely that introducing the Living Wage would impact on employment levels. MBIE has estimated that forecast employment would reduce by 25,000 if the minimum wage was lifted to the Living Wage. A study of seven workplaces in London which adopted their Living Wage found that while wages increased by 26% on average, overall costs increased by only 6% because the cost was mitigated by reviewing work practices,

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5 In 2012, welfare payments were the main income source for 44% of households with the bottom 20% of household incomes. Source: Bryan Perry, Household Incomes in New Zealand 1982-2012, Table B.6

reducing management overheads and in some cases reducing work hours and/or the number of people employed. Staff benefits and differentials were also reviewed, for example, staff bonuses.[6] Reduced employment or hours is likely to disproportionately impact young people (as jobs move to those with more maturity and experience) with the risk that they would face longer bouts of unemployment with the consequential risk of ongoing scarring, i.e., the permanent effects of detachment from the labour market.

24. It is likely that a similar pattern would be found here, and that one of the consequences of a universal Living Wage would be a reduction in other benefits, and a reduction in working hours or the number of jobs overall. Research by the former Department of Labour found that employers in New Zealand had similar responses to increases in the minimum wage.[7]

Lifting low wages has relatively little impact on inequality measures ...

25. Research on increases in the minimum wage between 1999 and 2008 estimated that a 10 percent increase in minimum wages, even without a loss in employment or hours of work, would lower the relative poverty rate by less than one-tenth of a percentage point.[8] While this ratio is only indicative, it does suggest that if the minimum wage was lifted by 34% to the Living Wage it would have only a very small impact on the relative poverty rate (say around 0.3 percentage points).

... and some of the income gain may be eroded by inflation.

26. A crucial assumption in all of this work is that imposing a Living Wage has no impact on prices. However, a Living Wage would enable those on lower wages to buy more, and this would only have no impact on prices if people buy the same goods whatever their income, both the short and long run aggregate supply curve is horizontal, and this is paid for solely by redistribution of income or job losses. None of these conditions are likely but the extent of the impact depends on which of these is more important.

27. The income effect of higher wages could be eroded by higher prices, particularly for the goods bought by people with lower incomes. It is very difficult to assess the one-off increase in prices. MBIE has calculated a figure of 1.3%, but this does not take into account some of the dynamic adjustments that employers are likely to use to minimize the impact. We would therefore expect the actual figure to be lower than this. Further, this estimate does not include any impact on interest rates or from increased taxation to fund the public sector component of the increased pay.

28. As the minimum wage applies to a smaller proportion of the workforce (less than 4%) it is unlikely to have a large inflationary impact. By contrast the Living Wage would impact on a significant proportion of the workforce.

A set of more focused and integrated interventions for low income families is likely to achieve improvements to living standards, without having large unintended impacts.

29. The Living Wage is not well targeted at the intended demographic of low income families. However, as previously mentioned, government has a range of interventions and services set up across the major sectors of health, education and welfare that are intended to assist families and individuals with low income. If government were to improve those interventions to lift the living standards of low income families, there a number of possibilities, including:

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6 Queen Mary University and Trust for London, Costs and Benefits of a Living Wage p.1

7 Department of Labour: Employers' Perspectives – Part Two: The Minimum Wage System

Tim Maloney & Gail Pacheco, 2012. "Assessing the Possible Antipoverty Effects of Recent Rises in Age-Specific Minimum Wages in New Zealand, "Review of Income and Wealth, International Association for Research in Income and Wealth, vol. 58(4), pages 648-674

- Shifting Working for Families towards parents with younger children
- Targeting Early Childhood Education subsidies more strongly
- Shifting the benefit abatement regime to incentivise 3-5 days of work, and
- Making our system of service interventions for children aged 0-5 years more focused and integrated.

How $18.40 per hour was determined

30. The amount of $18.40 per hour was developed by the Family Centre Social Policy Research unit at the request of the Living Wage Campaign.[9] The researchers were asked to provide a headline wage level for the campaign.

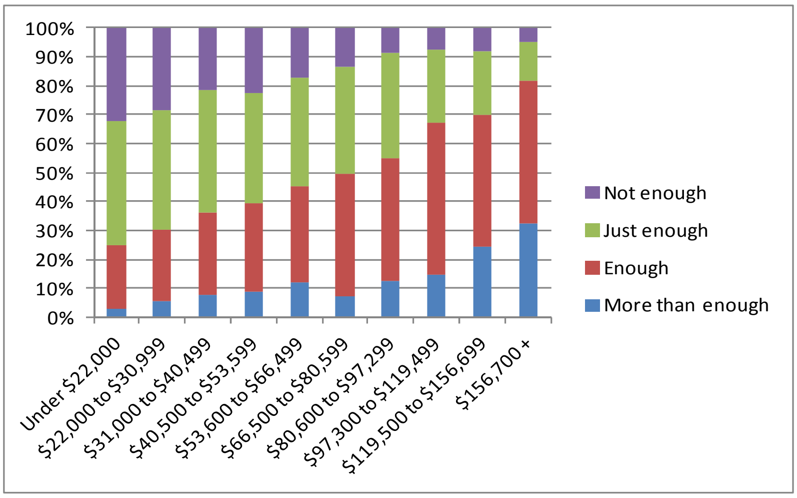
31. Treasury questions whether the methodology used to arrive at $18.40 is robust, for the following reasons (A more detailed explanation is provided in Appendix 3):

    - The research is based on a family composition of two adults and two children. The research acknowledges that while it is possible in principle to identify different wage levels for different numbers of dependants, this is not done because it would make the Living Wage estimate unhelpful as a communication tool.
    - Families comprising two adults and two children represent only 6% of families earning below the Living Wage. Those who have the highest deprivation level (i.e. absolute, not relative) are sole parents and this analysis generally does not apply to them.
    - As indicated above, around three quarters of families earning below the Living Wage have no children. Thus, the majority of these people have considerably lower necessary expenditure levels.
    - There are regional variations in living costs, notably for housing. Thus, a nationally set Living Wage will be too high in low cost regions, eroding the cost competitiveness of industry in those regions; and too low in high cost regions, so failing to address any concerns about the adequacy of work income.
    - Finally, the research reported a number of approaches, which resulted in a range of options from $38.19 to $18.40. The figure chosen is essentially an average of the estimated current expenditure of the lowest half of the income distribution, and close to two thirds of the national average expenditure of two adult, two child households. Thus it is a relative measure of income and not one based on estimating need.

32. The research is inconsistent with Household Economic Survey which finds that at least 70% of people in even the lowest income band say that their current income is either just enough or better.

9 Peter King and Charles Waldegrave, *Report of an investigation into defining a living wage for New Zealand,* Family Centre Social Policy Research, September 2013.

Figure 5: Perceived household income adequacy



Source: Household Economic Survey, June 2012, table 8

Would raising the minimum wage move NZ to a high wage economy?

An $18.40 minimum wage would impact on some industries more than others ...

33. The analysis provided in this section considers the impact if the current minimum wage was lifted to $18.40. We acknowledge that the campaign has focused on voluntary adoption by industry, and that the impact of a partial adoption is likely to be lower.

34. There are large differences between industries in the number of workers earning above and below $18.40. There are also concentrations of low wages ($13.75 to $15) in some industries, and it is these differences that matter most. However, the share of the workforce earning between $15 and $16.50 or $16.50 and $18.40 is small.[10]

... and the most affected industries would be accommodation and food, wholesale and retail trade and health care.

35. Because of this, the impact of a universal adoption of the Living Wage of $18.40 would be different between industries, as shown in Figure 6[11]:

- The Accommodation and Food industry would be most affected, with 54 percent of its workforce earning between $13.75 and $15, and only 10 percent earning above $18.40.

- Wholesale and Retail Trade would likewise face a high transition cost, with 38.4 percent of its workforce earning between $13.75 and $15, and also the largest number of workers in that category. 32 percent of the workforce earn above $18.40.

- Health Care and Social Assistance have the third highest number of workers earning between $13.75 and $15, who make up 25 percent of the workforce. However, 50.4 percent earn above $18.40.

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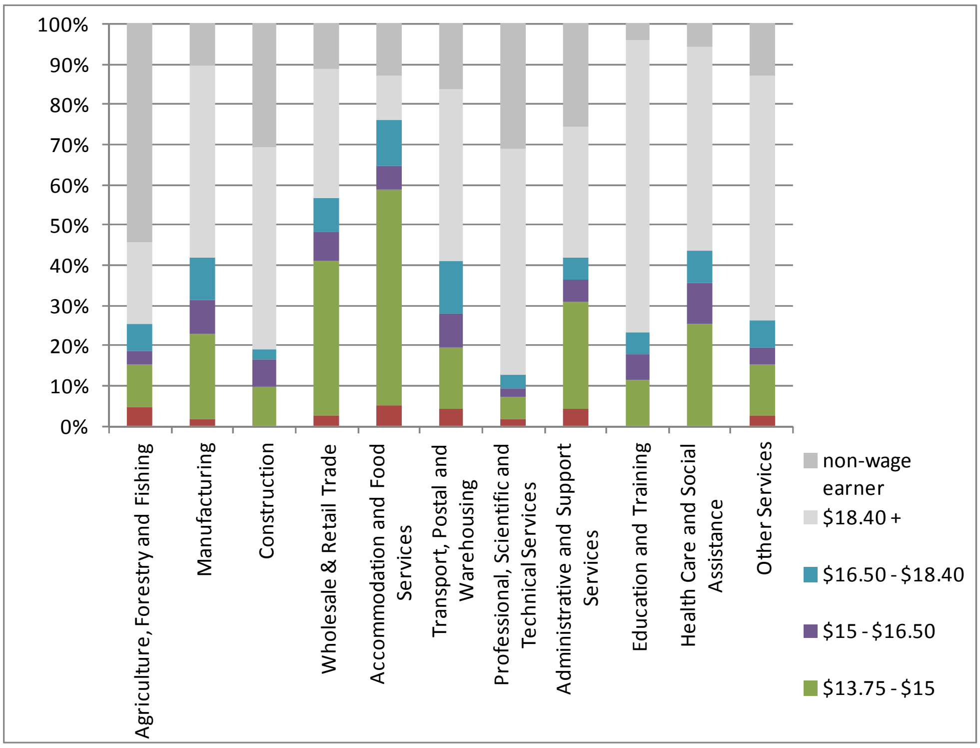
10 Only one industry out of twelve, Health Care and Social Assistance, has at least 10 percent of its workforce earning between $15.00 and $16.50. Three industries have at least 10 percent of its workforce earning between $16.50 and $18.40: Manufacturing; Transport, Postal and Warehousing; and Accommodation and Food Services.

11 Although this is unlikely to happen unless it is legislatively enforced, it is useful to explore the differences between industries.

- The Professional, Scientific and Technical Services industry would be least affected with only 5.4 percent earning between $13.75 and $15, and 56 percent earning above $18.40.

- Likewise, the Construction and the Education and Training industries have low proportions of the workforce earning between $13.75 and $15 (9.6 and 11.5 percent respectively), and high proportions earning above $18.40 (50 and 72.4 percent respectively).

Figure 6: The distribution of wages by industry



Non-wage earners is mainly self employed.
Source: Taxwell

A Living Wage would be likely to reinforce the slow growth path of some industries.

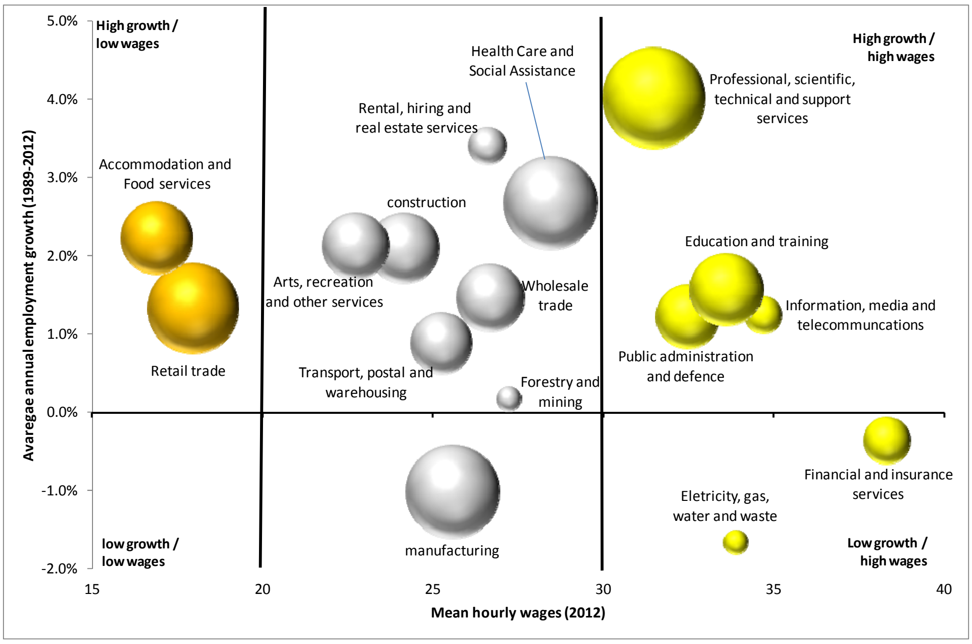
36. We looked at recent and historical trends in employment and wage growth across industries to make a judgement on the impact that a Living Wage might have on those industries most affected.

- Accommodation and Food Services, and Retail Trade experienced low-to-moderate employment growth over the period from 1989 to 2012. These two industries also had the lowest rates of hourly wage growth over the same period.[12] Adoption of the Living Wage would represent a significant shift away from the average wage trends and would risk reinforcing the slow employment growth.

- Manufacturing is the biggest industry to have experienced negative employment growth over the period. With 40 percent of its workforce earning below $18.40, adoption of the Living Wage could be expected to put further downward pressure on the industry's growth.

12 Source: Statistics New Zealand – Quarterly Employment Survey.

Figure 7: Industry employment growth (1989-2012)

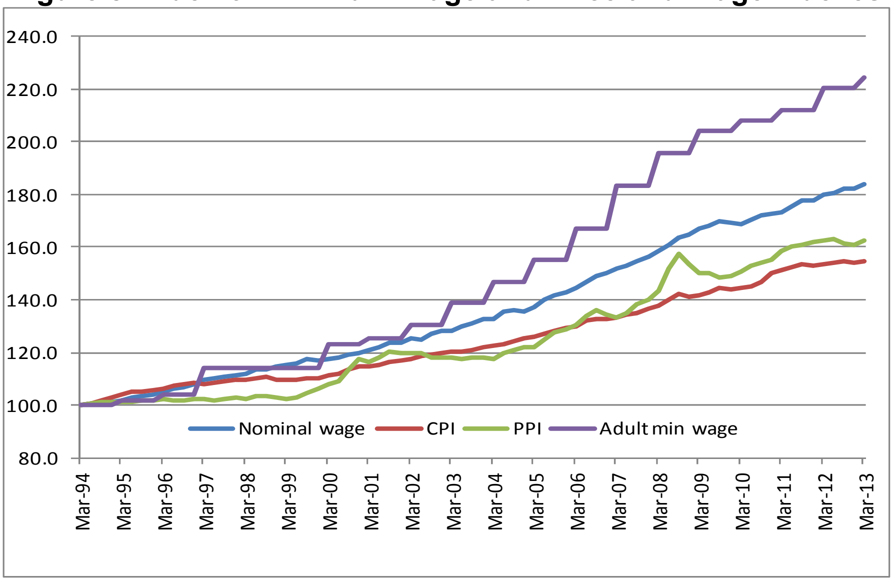


Source: Statistics New Zealand – Quarterly Employment Survey.

Minimum wage rates have been rising faster than inflation ...

37. New Zealand's minimum wage has grown at a much faster rate than our median or average wage over the past decade, and also at a higher rate than inflation.

Figure 8: Index of Minimum Wage and Price and Wage Indexes



Source: Statistics New Zealand

... but it has not pushed up our average wages.

38. Empirical evidence suggests that increases in the minimum wage have some spill over effects on lower income deciles through increases in wages just above the minimum.[13] This effect tapers off relatively quickly, resulting in the ratio of our minimum wage to our average or median wage increasing. This suggests that, over the last decade, the minimum wage has not played a large role in increasing New Zealand wages in

13 Treasury presentation 2011.

general, and in particular has not increased our average incomes relative to other countries. [14]

The $18.40 rate would put us well above our trading partners ...

39. In 2011 our minimum wage was 60% of the median earnings for full-time workers. This was amongst the highest ratios in the OECD, and well above the level found in most countries which is typically around 45%. For instance, the ratio was 45% in Australia, 38% in the United Kingdom, 40% in Canada, and 28% in the United States.[15] Increasing the rate still higher to 88% of the median wage would take the minimum wage well outside the normal range. This is likely to make employment for people with low skills difficult in an internationally focused economy.

Figure 9: International distribution of minimum wages in 19 OECD countries

Source: The OECD dataset: minimum relative to average and median wages of full-time workers.

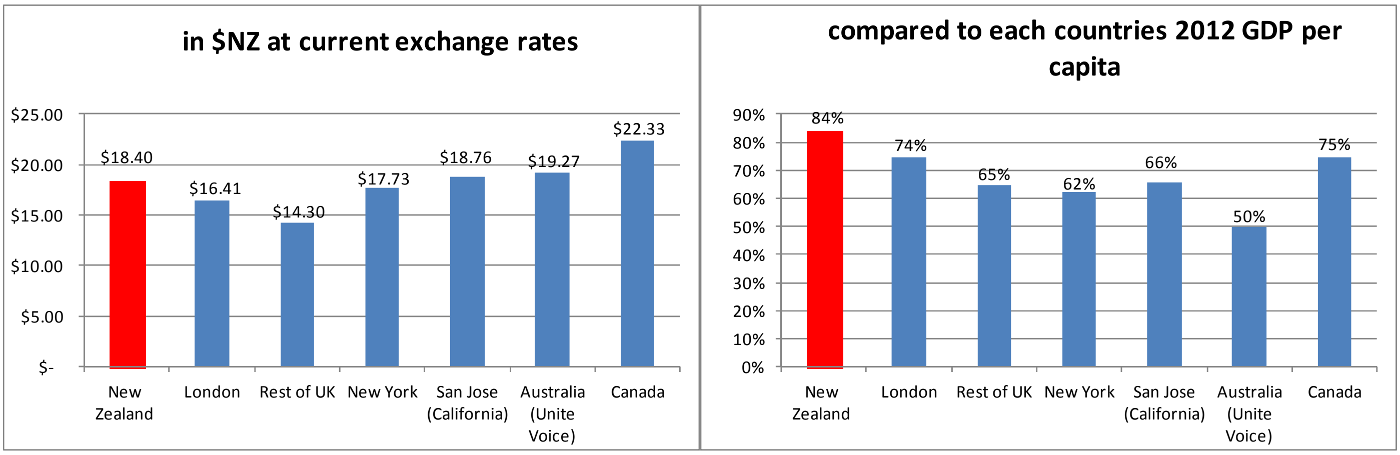
... and $18.40 is high compared to other countries' Living Wage campaign rates.

40. The proposed $18.40 Living Wage is also high compared to the other Living Wage rates being proposed by similar groups overseas. Compared to Australia, Canada, USA, and the UK, it is the highest proposed Living Wage relative to GDP per capita and, when converted using current exchange rates, it is higher than the amount recommended for London, the rest of the UK, and New York, but below the proposed rates for Canada, Australia or California.

14 This is in part because the proportion of the population earning the minimum wage has been traditionally low. It is less certain how average wages would be impacted if this proportion rose significantly.

15 2011 was the most recent date on which comparisons were available from the OECD.

Figure 10: NZ's proposed Living Wage compared to other Living Wage proposals

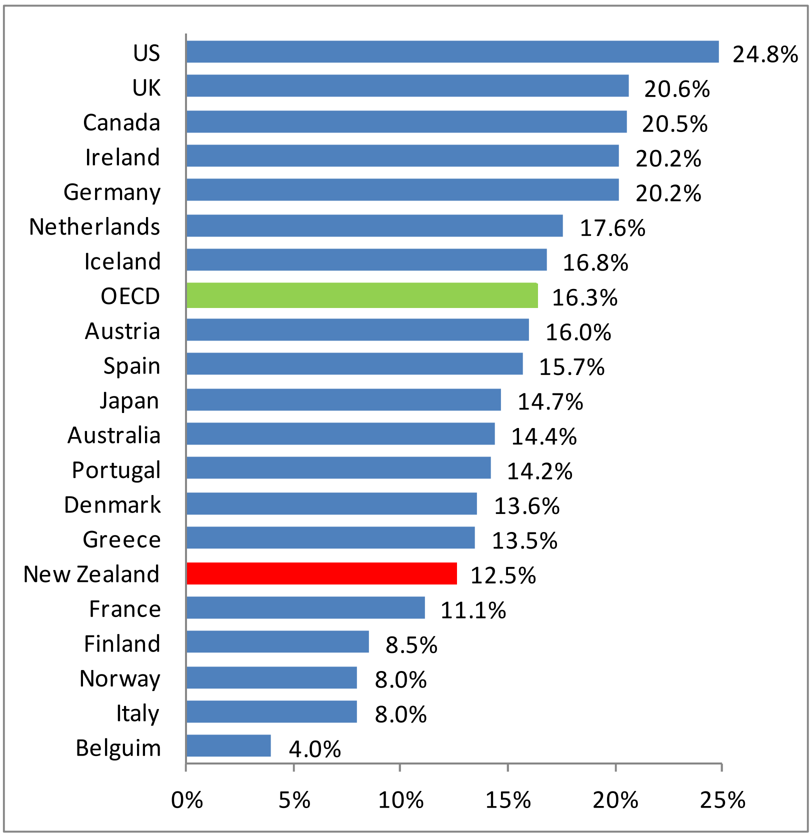


Source: Living Wage campaign websites, and exchange rates as at 20 September 2013.

New Zealand does not have a particularly high proportion of low wage workers ...

41. By international standards, New Zealand already has a relatively low proportion of full-time workers in low-paid work, and in particular the rate is well below that in the United States, where the Living Wage Campaign originated, and the United Kingdom, where it has had significant prominence. This could partly be because our minimum wage is high relative to our average wage. This suggests that low wages are not as significant a source of inequality in New Zealand as in those other countries, and that there is not a strong case for suggesting that New Zealand requires a major structural adjustment to reduce the level of low paid work.

Figure 11: Share of full-time employees in low paid work in selected OECD countries, 2009

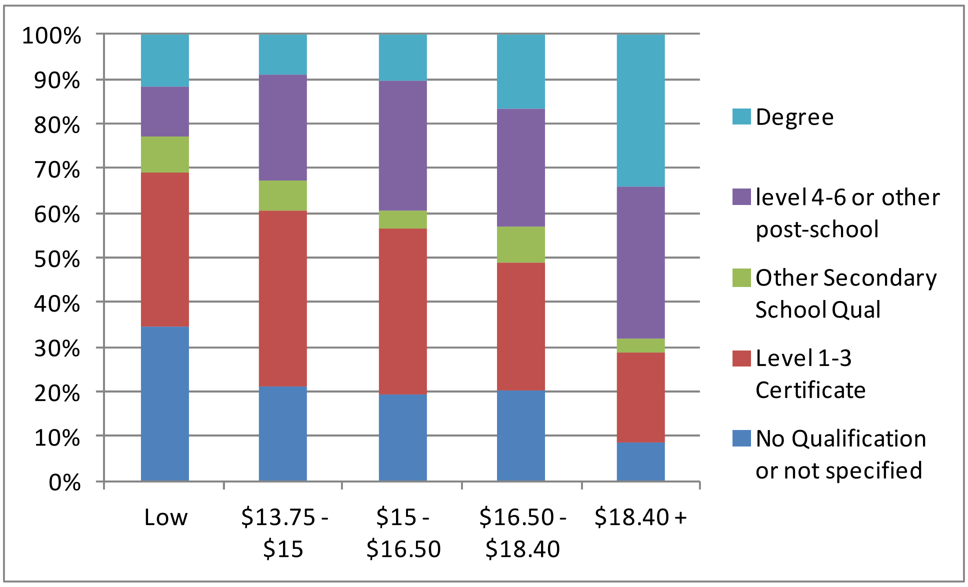


Note: Low paid is defined by the OECD as earning less than two-thirds of the gross median hourly full time wage.
Source: Data from K Lawton and M Pennycook, Beyond the Bottom Line, Resolution Foundation, 2013

We have a relatively low return to skills which a higher minimum wage would reduce further.

42. Our low average wages appears to be a result of the fact that we have fewer very highly paid workers, partly because the return to tertiary education is comparatively low, even after the measurement differences that act to reduce our skills premium are taken into account.[16] Lifting low wages without adjusting top wages risks reducing the premium for skills even further, and so reducing the incentive on young people to stay at school and progress to tertiary education for further training. In the short-term, however, younger people may choose to stay in education longer as employers substitute toward older and more experienced workers.[17] As those with low wages are disproportionately those with low skills, there is a risk that larger parts of New Zealand's economy may be dominated by low skills.

Figure 13: Impact of education on the level of low paid work



Source: Taxwell

Next steps

43. We intend to circulate a copy of this report to the Ministry of Social Development, the Ministry of Business, Innovation and Employment and the State Services Commission. If you agree, we recommend you refer a copy to the Ministers of Health, Social Development, Labour and States Services, and the Ministerial Committee on Poverty.

[16] NZIER, Private Returns to Tertiary Education, 2012.

[17] Hyslop and Stillman, The Impact of the 2008 Youth Minimum Wage Reform, Department of Labour, 2011.

Appendix 1: Key information on the Household Economic Survey data

- All numbers estimated from HES 2010/11 database, inflated using Taxwell to year ending 31 March 2014.
- All results are rounded to the nearest 1000, and due to this rounding may not sum to totals.
- Access to the Household Economic Survey data was provided by Statistics New Zealand under conditions designed to give effect to the security and confidentiality provisions of the Statistics Act 1975.
- The results presented here are the work of Treasury, not Statistics New Zealand.
- Only wage and salary income for the current job with the most hours worked is used to calculate wage rates.
- For families, the wage rate of the highest income earner is used for the family.
- All people whose wage is calculated between $9/hr and $13.75/hr are assumed to be on minimum wage.
- All people whose wage is calculated below $9/hr are included in the "Low" category; where data problems appear to impact the wage calculation. These people are likely to have low incomes, but their actual incomes cannot be calculated meaningfully from the data.
- Unwaged includes self-employed people.

Appendix 2 : Changes in After tax wages

								Overall impact		
	Family type	**Paid employment**	**Current hourly rate**	**Accommodation (for calculation of AS)**	**Increase in before-tax wages pw**	**Increase in after-tax-wages pw**	**Decrease in supplementary support pw**	**On take-home pay $**	**% increase of after-tax**	**Change in Govt position** ie increase in tax plus reduction in benefits
Families with Children	Sole parent, 2 children	30 hrs pw	$15.00 per hr	3 bedroom, $380 pw	$102	$82	$58	$24	30%	$78
	Two parents, 2 children	40 hrs pw (adult #1) 20 hrs pw (adult #2)	$16.00 per hr $13.75 per hr	3 bedroom, $380 pw	$189	$153	$88	$63	42%	$126
	Two parents, 4 children One employed	40 hrs pw (adult #1) 0 hrs pw (adult #2)	$13.75 per hr n/a	4 bedroom, $477 pw	$186	$150	$51	$99	66%	$87
	Two parents, 4 children Both employed	40 hrs pw (adult #1) 20 hrs pw (adult #2)	$16.00 per hr $13.75 per hr	4 bedroom, $477 pw	$189	$153	$88	$63	42%	$126
Families without Children	1 Adult	40 hours pw	$13.75	No AS support	$186	$150	0	150	32%	$36
	1 Adult	20 hours pw	13.75 per hr	No AS support	$93	$75	0	75	32%	$18
	Student on student allowance	15 hours pw	13.75 per hr	No AS support	$70	$61	$34	$27	13%	$43
	2 Adults	40 hours each pw	$15 and $13,75 per hr	No AS support	$322	260	0	260	52%	$62
	2 Adults	One on low income for 20 hours, the other on income over $80,000	$13.75 per hr	No AS support	$93	75	0	75	32%	$18

Source: Figures provided by IRD and MSD

Appendix 3: The origin of the $18.40 number

The $18.40 per hour rate was developed for the Living Wage campaign ...

1. The amount of $18.40 per week was developed at the request of the Living Wage Campaign.[18] The research was aimed at finding a wage that:

   ... is the income necessary to provide workers and their families with the basic necessities of life. A living wage will enable workers to live with dignity and to participate as active citizens in society.

... as the wage needed for two adults and two children.

2. The research was focused on simplicity: "while it is possible, in principle, to define different wage levels for different numbers of dependants, doing so would introduce a degree of complexity that would be unhelpful for a campaign to support the adoption of a Living Wage" (p18). As a result it was decided to focus on a single family size of two adults and two school age children (with one adult working full-time and one working half-time) on the basis that it is the family required for population replacement (p5). However, most families earning below the Living Wage have no children, and the chosen family type of two adults and two children represent only 6% of families earning below the Living Wage.

The first estimate was generated by focus groups ...

3. Five focus groups were held in Wellington and Auckland where

   ...to avoid the groups feeling limited in the estimates they could arrive at, they were encouraged to be realistic while at the same time being aspirational and they often had to consider estimates for things they did not necessarily spend money on themselves (p7).

4. The focus groups were then asked to estimate the income needed by a two adult and two child family. The focus groups were held in areas of Auckland and Wellington which have lower incomes and were "low to medium income householders" (p17).

5. The focus groups provided an estimate of $38.89 per hour for a family of two adult and two children. This equates to households in deciles nine to ten of income (p8) and had it been adopted it would have implied that 80% of families in New Zealand have an income below what was needed for "*the basic necessities of life".*

... which was then modified to lower the rate.

6. Because the focus groups produced a high wage rate, a new value was created by substituting Otago University's estimate of "basic food costs" (p8), changing the childcare assumptions (p9) and removing any saving because estimates were "difficult for the groups and produced considerable variation" (p8). This produced a Living Wage of $31.05 which "is still on the high side for our purposes" (p10) and only slightly lower than the initial figure.

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[18] Peter King and Charles Waldegrave, *Report of an investigation into defining a living wage for New Zealand,* Family Centre Social Policy Research, September 2013. All page references in this appendix are from this paper.

The Household Economic Survey data was then used to modify the rate further.

7. A third approach was then undertaken using the expenditure data from the 2010 Household Economic Survey and adjusting it so the categories are the same as those used by the focus groups (p10) but substituting the Otago study estimate for food costs. The researchers assumed the people would be renting “because renting is the most likely housing tenure to be available to those reliant on a living wage” (p20/1). This means the wage rate would overstate the income needed for those who do own their property with low debt levels (as shown by the low rates of deprivation for superannuation recipients).

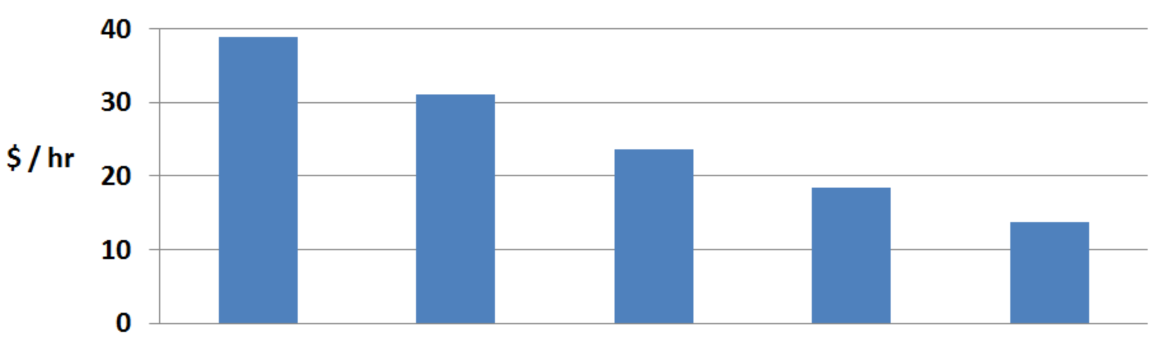
8. This approach produced three estimates which are felt to have considerable evidence to support them because they are based on data from reputable sources (p12):

   - an estimate for the whole population ($23.65);
   - an estimate for the average of expenditure by the bottom half of the income distribution with a national average of rental costs ($18.41); and
   - an estimate for the national average of expenditure by the bottom half of the income distribution with average Auckland rental costs ($24.11).

9. The report does not explain why the lowest of these estimates is chosen, though it does state that the result is not generous because $18.41 would produce a disposable income of 76.78% of the median disposable income and 63.78% of the mean disposable income for households with two adults and two children (p13).

The range of estimates produced by the research

	Estimate 1 (Absolute)	Estimate 2 (Absolute)	Estimate 3 (Relative)	Estimate 4 (Relative / Mixed)	Minimum wage (Historical)
Data	*Focus groups*	*Focus groups, childcare costs, UoO study, DBH and HES*	*HES*	*Childcare costs, UoO study, DBH and HES*	*Household Labour Force Survey, HES, New Zealand Income Survey, and other sources*
Rationale	*Income that is “realistic while at the same time aspirational”*	*“moderated” estimate 1*	*Average income from HES*	*77% median income / 64% mean income*	*“… to protect the real incomes of low wage earners, while minimising job losses”*



Summary of our analysis

10. In summary the research behind the Living Wage proposed four estimates, the highest two of which were calculated on the basis of perceived absolute need, and the lower two, primarily on the relative spending of those with below median incomes.

11. Our review suggests:

- There is no link between the focus group evidence and the estimate produced. The final choice of $18.40 is an averaging of expenditure for those in the lower half of the income distribution using DBH data for accommodation expenditure.
- $18.40 is chosen because it is close to two thirds of the national average expenditure of two adult, two child households. i.e. it is relative measure not one based on a calculation of need.
- As a measure it has a number of problems:
    - The Living Wage is only 47% of the wage needed to meet the focus group's results.
    - The majority of those who earn less than $18.40 an hour have considerably lower necessary expenditure (because they are single or in a childless couple).
    - There are regional variations in living costs (notably for housing) so there are issues in a national Living Wage as it will either over-compensate in low cost regions (so creating unnecessary additional costs for industry in those regions) or under-compensate in the high cost regions (so failing to address the basic concerns of providing an adequate income).
    - Those who have the highest deprivation level (i.e. absolute, not relative) are sole parents and this analysis generally does not apply to them.