Small Firms Association

Submission on the National Minimum Wage

Presented to:

Low Pay Commission

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Introduction

The Small Firms Association (SFA) is the trusted partner of small businesses in Ireland, with 8,500 members and four affiliated organisations in all sectors and parts of the country. Its mission is to deliver business-focused advice and insights to member companies, influence government policy to the benefit of small businesses and connect its members in a thriving community.

The SFA has a vision of Ireland as the most vibrant small business community in the world – supporting entrepreneurship, valuing small business and rewarding risk takers. In this context, the SFA welcomes the opportunity to make a submission to the Low Pay Commission on the National Minimum Wage (NMW) rate based on our knowledge and experience of the small business community, which comprises over 235,000 businesses and employs half of the private sector workforce.

Overview

The economic, social and business environment has changed substantially since the SFA made its submission to the Low Pay Commission in early 2016. The UK has voted to leave the EU; this is already creating serious challenges for business and will continue to do so over the coming months and years. The impact will be felt throughout the country, with certain regions and sectors particularly exposed. Domestic economic growth is slowing and the outlook for the coming year is mixed at best.

In the labour market, unemployment is declining but those that remain on the Live Register face challenges to entering employment due to their circumstances (low skilled, young people and the long term unemployed). It is important that no additional barriers are created. Wages in general are climbing, with 60% of SFA members in a position to award pay increases this year, but a significant minority of 40% will not be able to do so. This takes place in a context of zero inflation.

Taking these factors into account, it is clear that an assessment of the NMW must take account of the varied circumstances and prospects of businesses and communities in Ireland in 2017. Across the board pay increases are not appropriate at this time and there is no evidence basis for a change in the minimum wage. The SFA is calling, therefore, for the NMW to remain unchanged at €9.25 per hour. This is the preference of two thirds of SFA members, with the other one third split almost evenly between those that think it should go up and those that think it should be reduced.

The submission that follows provides essential information for consideration by the Low Pay Commission in a number of areas:

- Evidence-based policy
- Recent developments in the NMW
- Interaction with the tax system
- International developments

- Domestic economic context
- Labour market issues
- Wage levels in Ireland
- Breakdown of impact on specific sectors and regions

Evidence-based policy

The SFA welcomed the concept of an independent evidence-based assessment of the National Minimum Wage. However, further development of the operation and methodology of the Low Pay Commission is required to fulfil this mandate.

There was insufficient indication in the Low Pay Commission's 2015 and 2016 reports that its recommendations were evidence-based. The reports present detailed analysis of a range of factors that the Commission considered in the course of its work. There is a gap, however, between this analysis and the figure ultimately presented as the Commission's recommendation for the NMW. In order to constitute real evidence-based decision-making, stakeholders such as SFA members need to see the calculations that were used to arrive at the recommended NMW rate. This is vital to give the small business community confidence in the Low Pay Commission as an independent body.

Clearly, to date, the shortage of detailed data specific to Ireland has posed challenges to all parties with an interest in the National Minimum Wage. A number of important steps were taken in 2016 to address this information vacuum, namely the Low Pay Commission's research partnership with the ESRI and the pilot programme to include a set of questions in the Quarterly National Household Survey starting in Q2 2016. The SFA has not had access to this QNHS data to inform its submission and we would encourage the Commission to make it available as part of the main QNHS publications/releases as a matter of course.

In the absence of data collected by the CSO, the SFA conducted a survey of its members to collect up-to-date input on the impact of changes to the minimum wage on their businesses. Of the members that have come forward to respond to the survey or otherwise share their views on the NMW, the cohort is fairly evenly split between those that employ people on the NMW (36%), those whose businesses are impacted indirectly (34%) and those that do not see a connection between their own business and the NMW (30%). This highlights an important point to be borne in mind when analysing the CSO QNHS data – in addition to those workers on the minimum wage and their employers, there is a much wider cohort that are impacted (often significantly) despite not paying/receiving the minimum wage.

Recent developments in the NMW

The Small Firms Association argued last year that time was needed to assess the impact of the 5.7% increase in the NMW from €8.65 to €9.15 on 1 January 2016. Before such an assessment could take place, however, another 10c increase in the NMW was announced, effective from 1 January 2017. Feedback from SFA members indicates a range of changes that has resulted from these successive increases.

The most frequently cited impact is a reduction in the profitability of small businesses. In a zero inflation environment, when it is very difficult to get price increases in the market, a rising cost base in the form of a higher minimum wage squeezes the profitability of the business. As articulated by one SFA member:

"High street customers do no want to see pricing changes and any change would have a negative effect on customers. Therefore any wage change would have an effect on profitability."

However, from an examination of the 2012 average pre-tax profits (most recent data available from CSO) in small businesses in the sectors with the majority of NMW workers, it is clear that many would not be able to offset NMW increases against profits. In micro firms (1-10 employees), which are 92% of all businesses in Ireland, average pre-tax profits in accommodation and food businesses were €14,549; in retail were €21,470 and other services were €16,582. This means that they are not capable of absorbing labour cost increases without productivity gain and would have no choice but to offset NMW increases against reductions in hours, jobs or capital and skills investment.

Indeed, the second impact reported by members in our survey is a reduction in hours worked by employees, often offset by more hours worked by the owner-manager themselves or their family members. If the NMW continues to rise this effect is expected to accelerate, along with a move towards greater automation, in particular in the retail sector. According to one SFA member:

"I've had to reduce employee hours as I cannot afford to pay. I have one assistant who is under 18. She turns 18 in April so I will have to reduce her hours as I won't be able to afford to pay her full pay on the same hours."

Reduced head count in some small businesses has also been attributed to recent increases in the NMW.

A number of SFA members have also reported increasing pressure for knock-on pay rises for those earning above the new NMW rate, in order to maintain their relative position. This occurs even in companies that do not employ anyone on the NMW. Repercussive claims are specifically ruled out by the National Minimum Wage Act 2000, but this does not alter the reality that employers are facing on the ground. A recent SFA survey found that 40% of small businesses cannot afford to give pay increases in 2017. This leaves employers who cannot afford broad-sweeping pay rises at risk of damaging relations with their employees.

In surveying our members we also tried to identify any positive impacts of the 2016 and 2017 increases in the NMW, as these are often cited by proponents of further increases. 5% of SFA members reported increased employee engagement. When asked, no respondents reported higher productivity as a result of the NMW increases.

Interaction with the tax system

The Low Pay Commission's 2015 report states "A moderate increase in the current minimum wage rate without an appropriate adjustment in employer PRSI will have a major impact, particularly on small business costs." It also states "…it is clear that any recommended increase in the NW must be accompanied by an appropriate adjustment to the PRSI system, to ensure that the entire burden of any adjustment should not fall solely, and unreasonably, on the employer".

Budget 2016 introduced certain PRSI changes, effectively ending the step effect from an employee perspective and shifting the step effect for employers. However, the changes to employer PRSI cannot be considered an 'appropriate adjustment' as called for by the Low Pay Commission. The changes offset less than 10% of the increased labour costs as a result of the 2016 NMW increase. The minimal level of the offset has resulted in even greater pressure on companies in labour intensive, low margin sectors, who have very limited scope to either absorb the cost increases or pass them on to customers. Therefore the poor alignment of the minimum wage and the tax system has increased the likelihood of the minimum wage increase costing jobs.

In its 2016 report, the Low Pay Commission provided further comment on this issue, stating "…[the employer PRSI step effect] remains as a possible barrier to adjustment to the NMW in future years, and a potential disincentive to employers to offer overtime or additional hours to workers where this might push earnings above the threshold". No attempt to address this issue was made by the Minister for Finance in Budget 2017 and the problem has been exacerbated by the further increase in the NMW on 1 January 2017.

As previously argued by the SFA, this demonstrates a problem in terms of the Low Pay Commission making recommendations that are contingent on one another and these recommendations being implemented only in part by the Government of the day. The Low Pay Commission must be cautious about recommending any change in the NMW that would produce distortions in the tax system or elsewhere, as its remit to recommend accompanying tax policy changes to resolve these distortions is limited, as we have seen.

International developments

The context in which small businesses operate in Ireland has changed dramatically over the past year. The slowdown in global economic growth is a cause for concern for a small open economy like Ireland's, as our growth rate has been shown to decline by 1% for every 1% fall in global growth. President Trump's protectionist declarations have created uncertainty about the future of our international trade and investment environment.

Chief among the external changes, however, is the UK's vote to leave the EU, the impact of which the Low Pay Commission has described as "significant and unquantifiable". This may prove to be the biggest change in Ireland's trading conditions since EU accession in 1973. Crucially, its impact has not been and will not be limited to exporting companies, but felt right throughout the Irish economy, with the effects most pronounced in many of the same sectors and regions where the minimum wage is most prevalent.

Exchange rates suffered considerable shocks in the lead up to and aftermath of the UK vote. Over the past year we have seen a rapid and volatile weakening of Sterling. It is now 15% weaker than it was at the beginning of 2016, leaving Irish products 15% less competitive. These exchange rate trends are not temporary but rather the depreciation now structural and Irish businesses face a painful period of adapting to this new normal.

The negative effects of the Brexit vote on exports can already be seen. 2016 exports to the UK were down 6.3% annually. While small firms are shown to be poor at exporting, when they do trade internationally they rely heavily on the UK. This can be seen in some related figures, such as the fact that 43% of exports from indigenous companies are destined for the UK. Furthermore, exports to the UK account for 10% of total exports but 50% of jobs generated by exports. The challenging export situation is particularly difficult for small, indigenous firms as often they do not have the same degree of mobility and diversification as multi-national companies. This makes it difficult for them to renegotiate contracts, shift operations and review sourcing in response to shocks such as Brexit.

The effects of these developments and the knock-on effects across the small business community can be seen in the sentiment of SFA member companies. At the end of 2016, 50% felt that the business environment was improving (down from 77% at the beginning of the year and 66% immediately before the Brexit vote). Meanwhile, 18% felt that the business environment was disimproving (up from 4% at the beginning of 2016 and 3% immediately before the Brexit vote). 41% of companies reported that the Brexit vote has already had a negative impact on their business, including through postponement of investment decisions, loss of business in the UK market, loss of business in the Irish market and increased sourcing of inputs in the UK market. Some members have already moved their operations to the UK and there have been redundancies in some member companies. Furthermore, 68% of member companies expect to feel the negative effects of Brexit on their business in the first half of 2017, so the worst is yet to come in many cases. This serves to demonstrate the scale of the impact on small Irish businesses and the uncertainties and challenges that they face.

In light of Brexit and the other international factors referenced above, businesses more than ever require certainty over costs and cannot withstand cost increases imposed on them that are unconnected to the performance and profitability of their business.

Domestic economic context

At the current juncture, small businesses are cautious about the performance of the Irish economy in 2017. The growth forecast by Ibec for the coming year is 2.8%, significantly lower than the rates we have experienced in recent years. The major economic indicators show a varied picture, with employment continuing to fall but retail sales, industrial production, exports and tax receipts all pointing towards weakening economic performance. At best, 2017 is likely to hold mixed fortunes for Irish businesses. It is important that the Low Pay Commission is cognisant of this and calibrates the NMW as an absolute floor that is achievable by even those businesses in vulnerable sectors and regions. Policy should take the path of least harm as the economy navigates this volatile period.

In this context, it is vital that Ireland does not allow its underlying competitiveness to be eroded. All businesses compete internationally on costs, whether they export or not and the reality is that Ireland remains a high cost location. The cost of labour is the most significant driver of business costs in many sectors. Ireland currently has the second highest nominal NMW in the EU and the sixth highest in terms of purchasing power. The additional burden of other employment legislation is significant and businesses are fearful of draft legislation limiting flexible working conditions. If the cost of employment in Ireland is significantly higher than our export markets and competitor economies, it puts Irish companies at a distinct disadvantage when it comes to winning and maintaining market share.

Productivity is a key consideration that has been highlighted by the National Competitiveness Council in recent weeks. While the headline figures for productivity in Ireland look positive, more detailed analysis uncovers some worrying trends. While GDP per hour worked is strong, Ireland's relative position declines significantly if we look at GNP per hour worked. This demonstrates that highly productive multinational businesses conceal poor productivity in indigenous companies. Examining productivity in those sectors where the NMW is most prevalent, the picture is particularly stark. While a small improvement was made in accommodation, wholesale, retail, transport and food in 2014 and 2015, it is still 37% lower than it was in 1998. From a small business perspective, the SFA is also concerned about the productivity gap between micro/small firms and larger businesses. The Low Pay Commission stated in its 2016 report that higher wages can lead to improved productivity, but this is not borne out by the NCC research or by feedback from SFA members, none of whom identified increased productivity on foot of the 2016 and 2017 NMW increases.

The SFA's argument for a freeze in the NMW is also justified by the context of zero inflation. While the costs of some services are rising, this is offset by a reduction in goods prices, leaving prices in general flat over the last three years. Overall prices are still at 2008 levels and forecasts of inflation for 2017 are very low at 0.6%. The real value of the NMW is considerably higher today compared with when it was introduced and it would be 28% lower if it was pegged to the harmonised index of consumer prices (HICP). There has been considerable public focus on certain price increases, for example the rising cost of motor insurance and hotel prices, but there is no evidence that minimum wage workers are disproportionately affected by these isolated movements. Public policy measures to address specific cost issues around rent would be welcome but, as only one third of minimum wage workers live in private rented accommodation, the issues in relation to the rental market do not justify economy-wide wage hikes. Indeed, such a measure would likely serve to further increase rents as supply is limited. As such, there is little evidence for an increase in the NMW based on the cost of living.

Labour market issues

The labour market in Ireland has changed significantly since previous submissions to the Low Pay Commission. Unemployment has continued to fall and currently stands at 7.2%. The labour market is returning to full employment and skills gaps are emerging in some sectors. In this context, those that remain on the live register are predominantly those who are experiencing or are at risk of long term exclusion from employment – the long term unemployed, low skilled workers and young people with minimal work experience for example. This cohort face particular challenges to entering employment and it is vital that they do not get 'left behind' due to increased barriers to employment.

Getting people into employment is the best way to tackle poverty, spread the gains from the recovery and reduce income inequality. This is particularly true in Ireland where the link between work and poverty is the weakest in Europe, i.e. people in work are much less likely to be in poverty. Finding routes into work for the cohorts mentioned above and in particular those from jobless households and those not in employment, education or training (NEET) – which are both particularly pronounced problems in Ireland – is vital. Increasing the NMW acts as a barrier to job creation and, in particular, to helping low skilled and young workers to enter the workforce, as it becomes unaffordable to train them up. Small businesses have the capacity to continue to generate employment but any increase in the entry level of wages will prevent them from doing so.

In its mandate to take into account the need for job creation when making a recommendation for the level of the minimum wage, the Low Pay Commission must appreciate the particular challenges involved in reducing the unemployment rate from its currently relatively low level. Increasing the NMW is a blunt tool that is ineffective at combatting poverty and inequality and that generates undesirable side effects such as locking the long-term unemployed out of work. The labour market itself should be used to arrive at a rate that is realistic for both the employer and the employee.

Wage levels in Ireland

The minimum wage in Ireland is already high by international standards. It is the second highest in the EU in nominal terms and sixth highest by purchasing power. Comparing the Irish minimum wage rate with that in Northern Ireland/UK, which the Low Pay Commission is mandated to take account of, the Irish rate is 9.6% higher than the current UK rate and will still be 5.2% ahead after the new higher UK rate comes into force on 1 April.

Despite a severe productivity problem in domestic-facing sectors, the NMW is over 70% of median earnings in the accommodation and food sector and 57% of median earnings in retail (compared with 45% of median earnings in the overall economy). The closer the minimum wage is to the median wage, the greater the probability that the employer will have to offset additional increased wages with job losses or non-creation of new jobs, as the effect on their overall wage bill is greater.

Just over 60% of SFA member companies intend to award pay increases to staff in 2017. Where this is the case, the increases are in the order of 2%. This demonstrates that, where the performance of the business allows, pay will rise. In 40% of businesses, however, this will not be possible in 2017. Small business owner-managers are close to their businesses and their employees. They recognise the value of employee contribution and generally display much lower employee turnover when compared to large business. Small businesses will respond to market trends in wages but they cannot generate employment where unjustified business cost increases are imposed upon them by Government.

In the current Irish context, where Ireland's economic prospects for 2017 are uncertain and the trends in different parts of the labour market are so different, the SFA believes that wage increases cannot be enforced across the board. Voluntary increases are the most practical, taking account of the businesses' ability to pay and thereby maximising job creation and retention.

Breakdown of impact on specific sectors and regions

Over the past number of years, the recovery has been slow to reach some sectors and parts of the country, especially for small firms. Overall employment is still below pre-crisis peak levels and the situation in the sectors that employ the bulk of minimum wage workers (retail, hospitality and support services) is much more sobering than the positive headline figures would indicate.

In retail, there has been no significant year-on-year growth in employment since 2007. Growth in the sector has been half the rate seen in the rest of the economy. While sales volumes have recovered since the crisis, sales values have lagged behind and margins much lower than they once were. The sector faces significant threats from Brexit and the resulting fall in Sterling by 15% in the past year. Irish retailers are losing out as shoppers go North – the percentage of cars with ROI registrations in Northern Ireland shopping centre car parks rose from 30% in Q2 2016 to 58% in Q3 2016. They face stiff competition online also – Central Bank data indicated that online purchases rose by 20% in Q3 2016 but that 70% of Irish ecommerce spend goes to the UK.

The hospitality sector had a strong year immediately before Brexit and was showing good signs of recovery. However, the shadow of Brexit looms large over this sector also. 41% of visitors to Ireland come from the UK and their spend in the Irish economy is estimated at €1bm. Weakening Sterling makes holidaying in Ireland more expensive for visitors coming from the UK, meaning they are less likely to come and will spend less if they do. The sector is vulnerable, therefore, and faces considerable challenges over the years ahead.

Economic performance and outlook varies significantly between regions also. Dublin is faring best in terms of employment, just 3% off the pre-crisis peak. The Border and West, however, are still more than 10% off peak employment. In the context of Brexit, the Border region showed by far the largest proportion of businesses in decline, feeling the business environment is disimproving and planning to cut wages in the latest SFA survey. The Low Pay Commission stated in its 2016 report that the introduction of regional minimum wage rates would be unduly complex and could not be targeted sufficiently. The National Minimum Wage rate, therefore, must take account of the situation in the most fragile regions and it is vital that the Low Pay Commission makes sure the rate is appropriate to these parts of our country.

Conclusion

The NMW is an absolute wage floor and as such must take account of the weakest and most vulnerable companies, if it is not to cost jobs and jeopardise local economies. In a challenging domestic and international economic environment, it is not realistic to continually increase the minimum wage and still be competitive. Given that 2017 is going to be a difficult year for particular sections of our economy, as outlined above, any pay increases should be kept on a voluntary basis.

The SFA believes that, based on the evidence available, the Low Pay Commission should recommend that the NMW be maintained at its current rate of €9.25 per hour. This would give small businesses, especially those most exposed to Brexit, certainty over labour costs. Maintaining the NMW rate would also ensure that job creation efforts are realisable for low-skilled workers and others at risk of being 'left behind' on the Live Register. It would give them an entry point into work and upskilling from where they can develop their skills and increase their wages relative to their productivity levels.

As the country works to navigate Brexit, it is crucial that all public policy is aligned to support this national effort. 2017 may be the most challenging year for Ireland since 2008. Small companies employ half the private sector workforce and are essential to the vibrancy of towns and villages around the country. At this juncture, they cannot withstand cost increases imposed by Government, unrelated to the performance of their business. They must be allowed to compete and survive, and in the process to continue to provide hundreds of thousands of jobs.

For further information on any of the issues raised in this submission, or to arrange a meeting on the basis of this submission, please contact Patricia Callan, SFA Director, on 01-6051602 or patricia.callan@sfa.ie

More information about the SFA is available on www.sfa.ie and on Twitter @SFA_Irl