The minimum wage in Ireland

An Ibec submission to the Low Pay Commission

February 2018

Key Messages

1. **Recent increases in the minimum wage outstripped the fundamentals of the economy**

Since 2015 the minimum wage increased by 10.4%. Inflation over the same period was only 0.4% and total hourly wages only grew by 2.5%. Despite having the second highest minimum wage in the EU, over the past 3 years Ireland experienced the largest increase in real terms in the EU-15. These increases were unjustified and undermined our competitiveness and as a result there should be no additional increase in 2018.

2. **Previous changes to the minimum wage did not take the challenges faced by the main minimum wage sectors into account**

The retail and hospitality sectors account for more than 50% of minimum wage workers. The retail sector faced many challenges in recent years and employment in the sector is still 7% below 2007 levels. Both the retail and hospitality sectors were adversely impacted by the depreciation in the euro-sterling exchange rate. In the first nine months of 2017 the number of tourists from Great Britain fell by 7% and there was also a sharp increase in cross border shopping. These factors must be taken into account given the disproportional impact a rise in the minimum wage would have on these two sectors.

3. **Labour costs are central to our international competitiveness**

International competitiveness is essential for a small exporting country like Ireland. Recent movements in the euro-sterling exchange rate caused Ireland's competitiveness to deteriorate relative to our trading partners. It is now very important that other costs are kept in line to avoid a further decline. Ireland's minimum wage is now the second highest in the EU. The CSO found that one in ten employees were on the minimum wage in 2016. This suggests that further increases in the minimum wage will have a big impact on overall labour costs in the economy.

4. **The cost of living is still the same as 2008**

Over the past few years inflation in Ireland was extremely low and the overall cost of living is the same as it was in 2008. The cost of certain items such as rents did increase but only 35.7% of minimum wage workers are renting from a private landlord. Furthermore, roughly 12% of minimum wage workers are renting in Dublin where rental costs increased most. As minimum wage workers are not alone in rental challenges, it is better to target the cost at source through public policy intervention. Given that these costs are driven by a limited supply, it is likely that raising incomes to increase affordability would just drive up prices further.

5. **Minimum wage is a poor instrument to tackle household poverty and Income inequality**

The OECD noted (2015) that the minimum wage is a "blunt instrument" for reducing poverty. This is because many low income households don't have any member who is working. The ESRI has provided evidence that supports this as they found that while minimum wage workers are the lowest earners, they usually don't live in low income households. Minimum wage workers are typically found in average or high income households as they typically aren't the primary earner. Increasing the minimum wage is therefore very unlikely to have any meaningful impact on reducing poverty in Ireland.

Introduction

Ibec supports the minimum wage as a principle and recognises that the wage floor should increase as economic circumstances improve. It is vital, however, that the minimum wage is appropriate, competitive and affordable whilst also considering the cost of living.

The economy is currently experiencing a steady phase of growth and one could argue that now is an appropriate time to increase the minimum wage. However, over the past three years the minimum wage increased significantly which was unjustified and above the fundamentals of the economy. It was the largest real increase (adjusted for inflation) in the EU-15 and Ireland now has the second highest minimum wage in the EU.

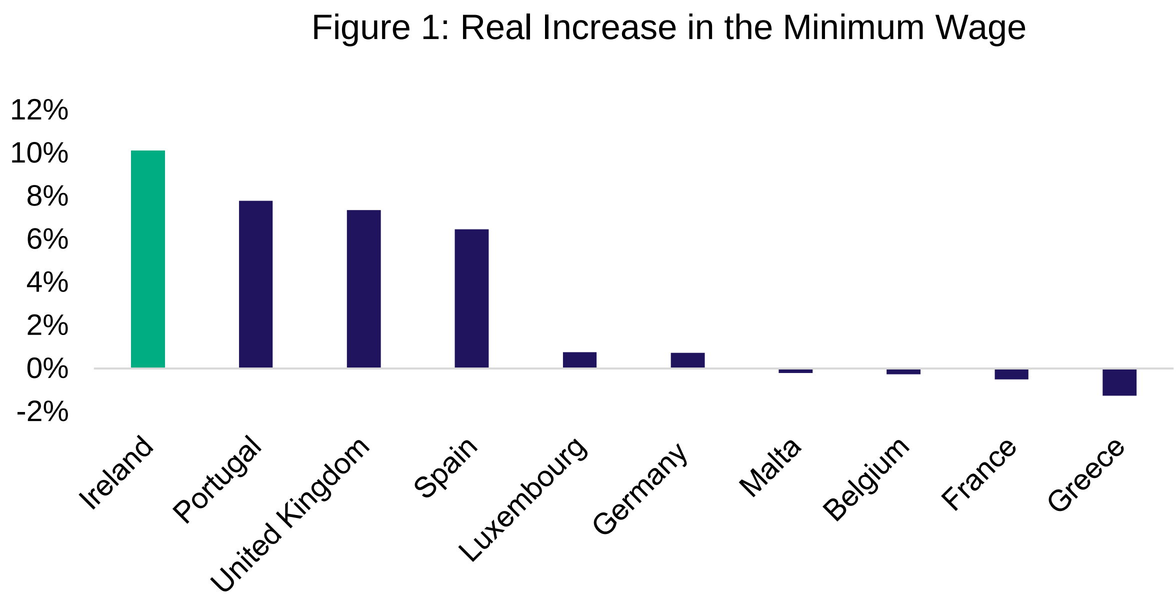
These increases failed to take overall competitiveness and the challenges faced by certain sectors into account. The depreciation in the euro-sterling exchange rate undermined Ireland's international competitiveness relative to our largest trading partners. It also created new challenges for both the retail and hospitality sectors which are the two sectors that are most likely to pay the minimum wage.

Ibec strongly encourages that these factors will be taken into account when the Low Pay Commission makes its decision. Given the difficulties that certain firms will face this year and the significant rise since 2015, Ibec believes that there is little justification for increasing the minimum wage.

Ibec's position is that any changes to the minimum wage should be strongly evidence-based and linked to the following factors:

Minimum Wage over time

Over the past three years the minimum wage increased by 10.4%. This was well above inflation over the same period, which was only 0.4 %. This is not a recent trend. Since its introduction in 2004, the minimum wage has outstripped inflation. If the minimum wage had been pegged to inflation over this period, it would only be €7.45, which is 28% lower than the current rate. As a result of these large increases, Ireland now has the second highest minimum wage in the EU after Luxembourg. At the same time, we are also experiencing the strongest real increase (accounting for inflation) in the minimum wage in the EU-15. Other Eastern European countries are experiencing larger increases but this is coming from a very low base.



Source: Eurostat

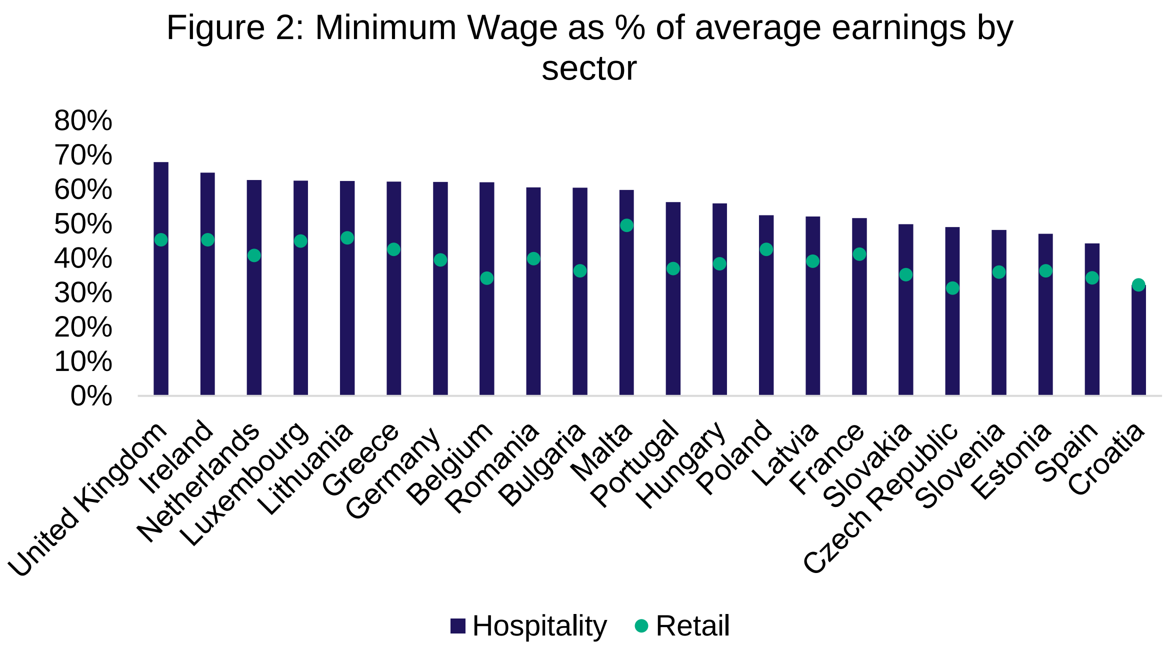
New research by the CSO showed that in 2016 10.1% of employees were on the minimum wage. As the minimum wage is now 4% higher, it is likely that an even greater share of employees are on this rate. This suggests that future increases in the minimum wage will have a bigger impact on labour costs. It will also have wider knock on effects as it impacts the wages of those who are paid a premium above the minimum wage e.g. paid an hourly rate of €1 above the minimum wage. The higher the number of people who are on the minimum wage or who are paid a premium above it, the bigger the impact an increase in the minimum wage will have on business costs.

Any rise in the minimum wage not only affects employers through its direct impact on wages but also through employers' PSRI. Like the minimum wage, employers' PSRI for a minimum wage worker increased by 10.4% since 2015 (€156 euro per year). Currently, a minimum wage worker's weekly earnings are just below the threshold for the higher rate of employers' PSRI if they work 39 hours a week (€372 vs threshold of €376). If they work any additional hours they are pushed onto the higher rate. Any further increase in the minimum wage will see a dramatic rise in numbers going onto the higher rate of employers' PSRI and this will put increased pressures on business.

Competitiveness

The increase in the minimum wage over recent years pushed Ireland's minimum wage from the 5th to the 2nd highest in the EU. In purchasing power parity (PPP) terms, Ireland's ranking is slightly lower (6th) due to the higher cost of living in Ireland. While the higher cost of living may warrant a higher wage floor, it is important to keep in mind that in terms of competitiveness, it is the nominal rate that matters. The National Competitiveness Council noted in its "Cost of Doing Business 2017" report that labour accounts for 75%-90% of location sensitive costs. This makes labour costs central to our overall competitiveness, particularly for a small country like Ireland that relies heavily on exports. Compared to the UK, the minimum wage in Ireland is now 12% higher. In April 2018, the UK will increase its minimum wage further, but the Irish rate will still be 7% higher.

The Low Pay Commission noted in its submission last year that as a share of median earnings, the minimum wage is relatively low in Ireland. This is because Ireland has the second highest median wage in the EU, that is driven by specific sectors of the economy that are dominated by multinational companies. Looking at the minimum wage as a proportion of average earnings in the two largest minimum wage sectors (retail and hospitality), Ireland had the 3rd highest in retail and the 2nd highest in hospitality.

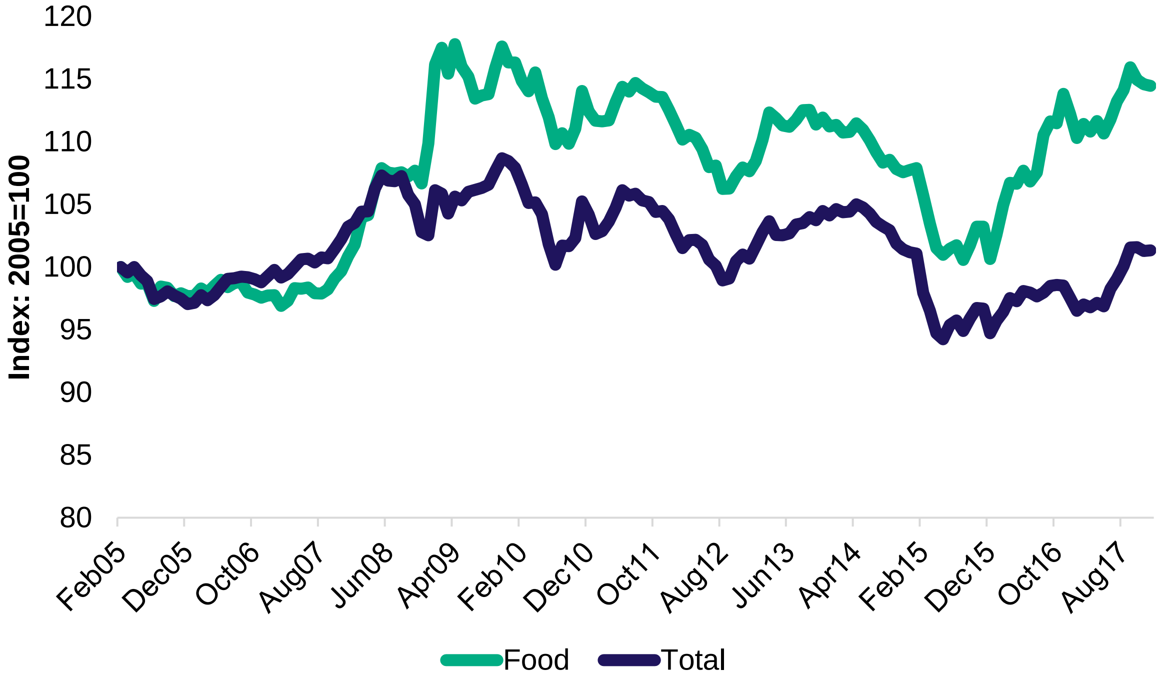


Source: Eurostat

Ireland's competitiveness made huge gains from 2010 to 2015 due to favourable exchange rates but since 2016 these gains diminished. The Effective Exchange Rate (EER) measures international cost competitiveness and depends on exchange rate movements between trading partners. The EER was calculated for Ireland using 41 trading partners. It is calculated by taking a weighted average of a country's exchange rate with its trading partners. The weight for each exchange rate is equal to its trade share. If the index rises, there has been a loss in competitiveness, as the euro has appreciated relative to its trading partners. This increases purchasing power (imports become cheaper) but exports become more expensive which undermines competitiveness. As Ireland exports a significant amount to non-eurozone countries, our EER is more volatile than other EU countries.

Since 2016 the EER for Irish goods exports increased (lost competitiveness) as sterling depreciated. The euro appreciated by 6% relative to its trading partners since 2016. However, this relative appreciation was larger for sectors that are more reliant on the UK. The EER was also calculated for the food sector, which is another minimum wage employer. The EER for food appreciated by 11.6% compared to its trading partners. The reason for this divergence relates to the fact that the destination of food exports differs significantly to that of total goods exports. The UK accounts for a greater share of food exports (41%). At the same time, the US plays a much greater role in total goods exports accounting for 27% compared to only 4% of food exports. Given the significance of these losses, it is very important that we keep other costs in line particularly in the areas that comprise a significant share of costs.

Figure 3: Effective Exchange Rate



Source: Ibec calculations

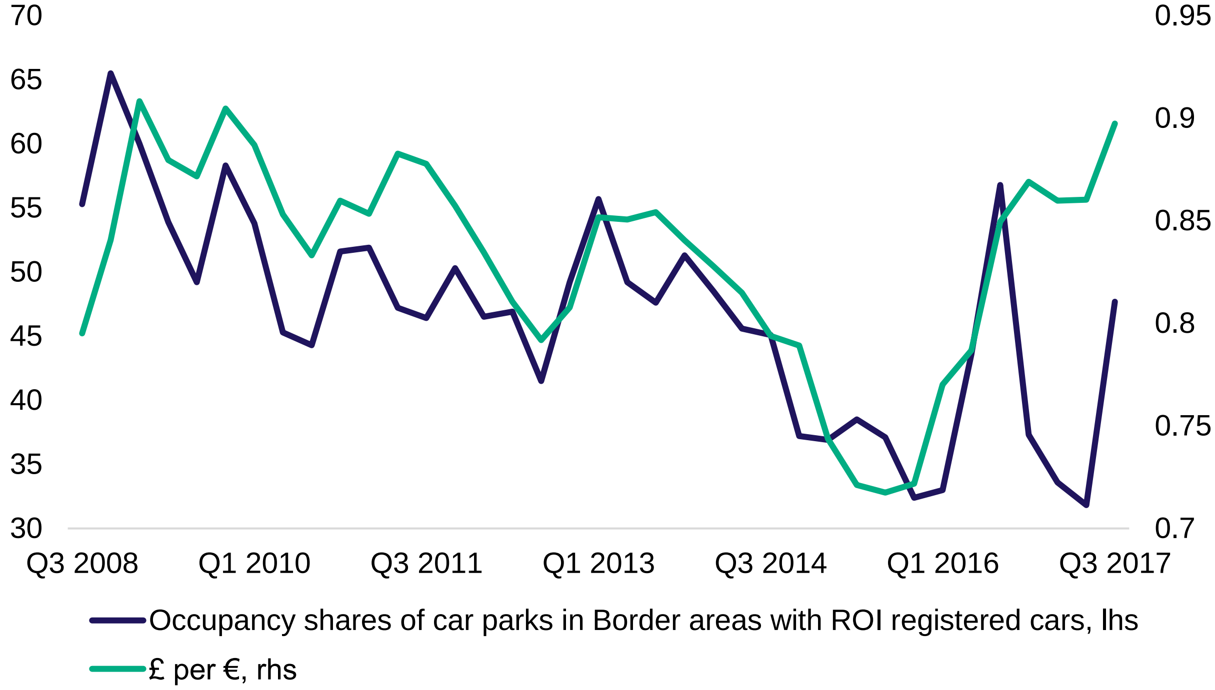
Sectoral analysis

The Irish economy continues to perform exceptionally well. However, certain sectors, particularly minimum wage sectors struggled and were adversely impacted by exchange rate movements. Also, minimum wage workers account for a greater share of employment in certain regions, which have also suffered more than other regions in recent years.

The CSO found that 26% of minimum wage workers are in retail. This is a sector that experienced significant changes in recent years. Turnover is still below peak levels while volumes are above. This divergence is due to significant discounting in the retail sector. The price of goods continues to fall (down 2.1% in 2017) and the overall price of goods is lower than in 2000. As a result, of this weak performance, the recovery in retail employment was not as strong as other sectors. Since 2012, total employment grew by 17% while in retail it only increased by 10%.

The retail sector was also affected by the recent depreciation in the euro-sterling exchange rate. Between Q2 and Q3 of 2017 the number of cars parked in Northern Ireland shopping centres with an Irish registration increased from 32% to 48%. Before it was typically the Border counties that were affected by cross border shopping however, with the sharp increase in online shopping, other parts of the country are now affected by the sterling depreciation.

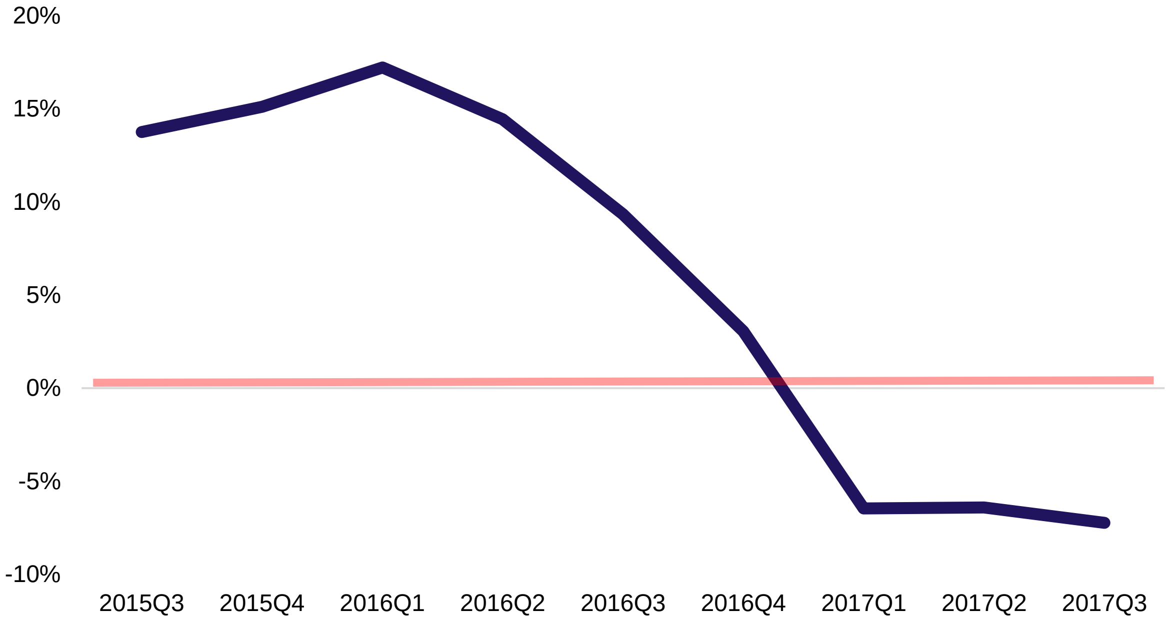
Figure 4:Cross border shopping and sterling



Source: Intertrade Ireland

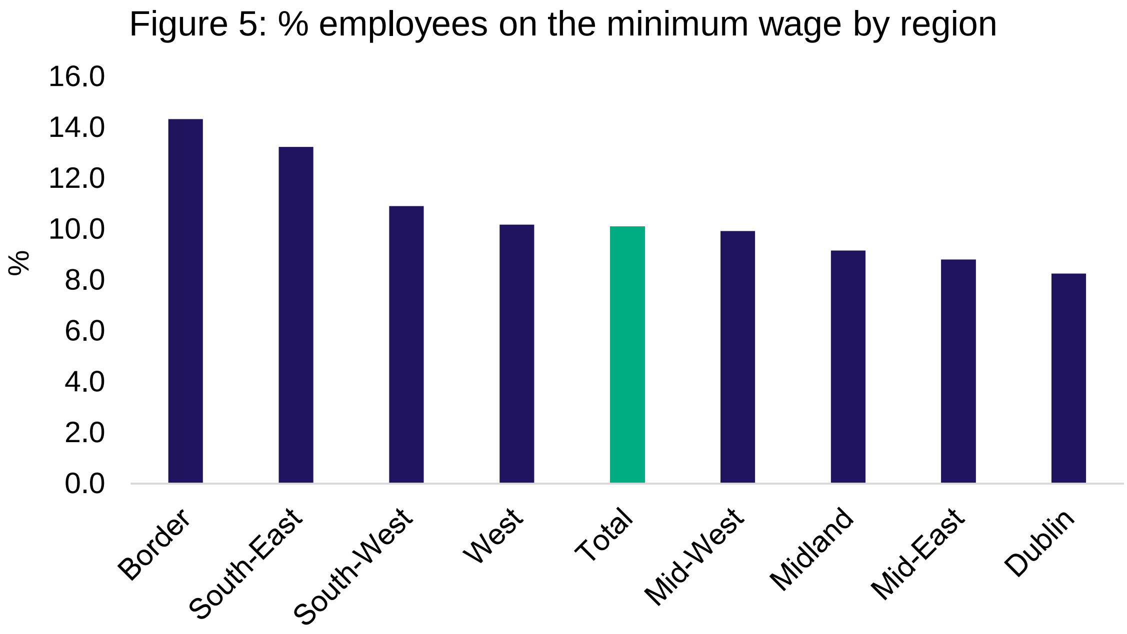
The hospitality sector, which is the other major minimum wage employer, was also affected by the depreciation in sterling. Great Britain accounts for 41% of tourists to Ireland from overseas. In the first three quarters of 2017 the number of tourists from GB fell by 7%. These losses will hit certain regions of the country more than others. Tourists from the UK account for 70% of tourists to the Border region and 60% of tourists to the Midlands.

Figure 4: Annual % change in tourists from GB



Source: CSO

Changes to the minimum wage have a bigger impact in certain regions. The economic recovery from 2012-2016 was heavily concentrated in Dublin. The rest of the country is now experiencing strong growth but some regions are still struggling. In Q2 2017, employment in the Border area was 11% below its peak. In the second quarter of 2017 both the Border and the South-East experienced the weakest employment growth. These are also the two regions with the largest proportion of employees on the minimum wage. In the Border region 14.3% and in the South East 13.2% of employees were on the minimum wage. This is substantially higher than Dublin where only 8.3% of employees are on the minimum wage.



Source: CSO

Cost of Living

There is little evidence that the cost of living justifies increasing the minimum wage. Prices have remained flat for the past four years. Inflation was only 0.4% last year and the overall cost of living is the same as it was in 2008. There are however, two differing trends underlying this. The price of services continues to rise while the price of goods continues to fall. However, as some prices are rising while others are falling, the cost of living for some people may have increased more than others if they consume more of the items that are experiencing inflation.

One item that increased significantly is rents. Rents grew substantially over the past three years and are now above pre-crisis levels. Given that housing costs make up a large proportion of a person's budget, those who are renting their accommodation saw their cost of living rise substantially over the past few years.

Many arguments have been made that while there has been no change in the overall cost of living, these rental increases had a disproportionate impact on minimum wage workers and therefore their wages should rise accordingly. The Low Pay Commission noted in its report last year that 35.7% of minimum wage workers were renting from a private landlord. This is not considerably higher than the proportion of workers earning more than the minimum wage who are renting (22%). Furthermore, assuming that minimum wage workers in Dublin are as likely to rent as their counterparts in the rest of the country, only 12% of minimum wage workers are actually renting in Dublin where the cost of renting has increased the most. This is not high enough to justify pay increases for the entire cohort. As minimum wage workers are not alone in rental challenges, it is better to target the cost at source through public policy intervention. Given that these costs are driven by a limited supply, it is likely that raising incomes to increase affordability would just drive up prices further.

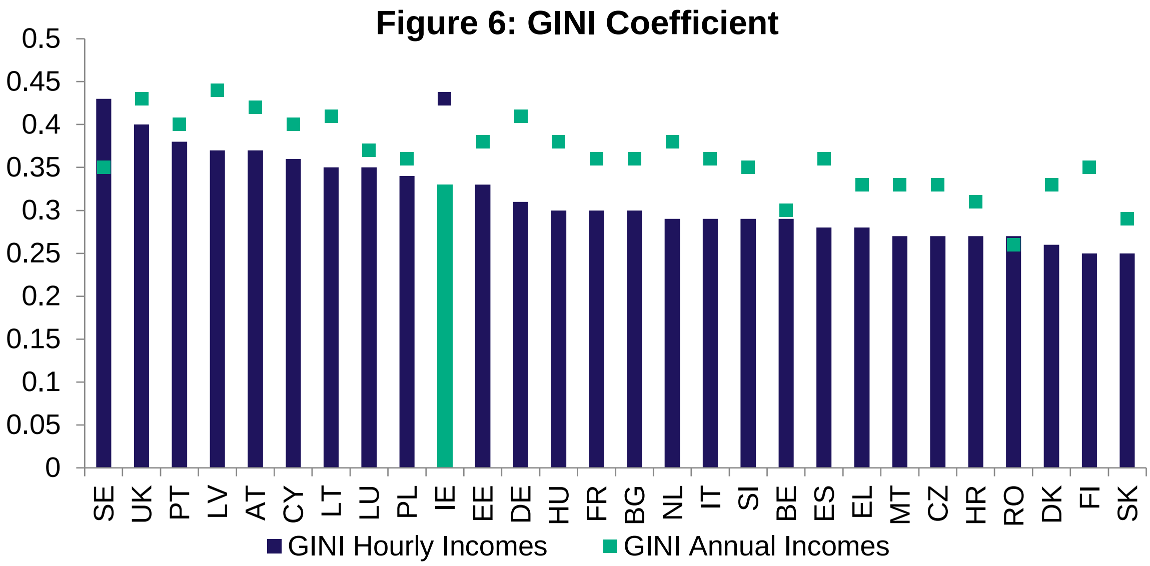
Low Pay and Income Inequality

The Gini coefficient is the most popular indicator to measure inequality in the distribution of household income. It compares the cumulative proportions of the population against the cumulative proportions of income they receive. It ranges between 0 and 100. It is 0 if income is equally distributed among households and it is 100 if only one household holds all the income. It is important to distinguish between the "Market Gini", which does not account for transfers and taxes, and the "Gini in disposable income" which takes welfare policies into account. The difference between these two indicators is the level of redistribution adopted by the State.

With a market Gini of 41.9, Ireland has the highest market income inequality in the EU. When the welfare system is taken into account, income inequality falls dramatically to 29.5, which is below the EU average.

More importantly, the most common Gini Coefficient focuses on annual earnings (rates x hours worked). This can mask the fact high levels of income inequality can be related to low work intensity as opposed to low hourly wages. If this were the case the minimum wage would not be an optimal policy tool to improve income equality.

An analysis of the Gini for hourly earnings shows that inequality levels are much lower than expected if people are in employment. Ireland is placed in the middle of the ranking with the 10thhighest hourly Gini in the EU. This indicates that incomes at the lower of the end of the distribution for Irish people in employment are not low compared to other countries.



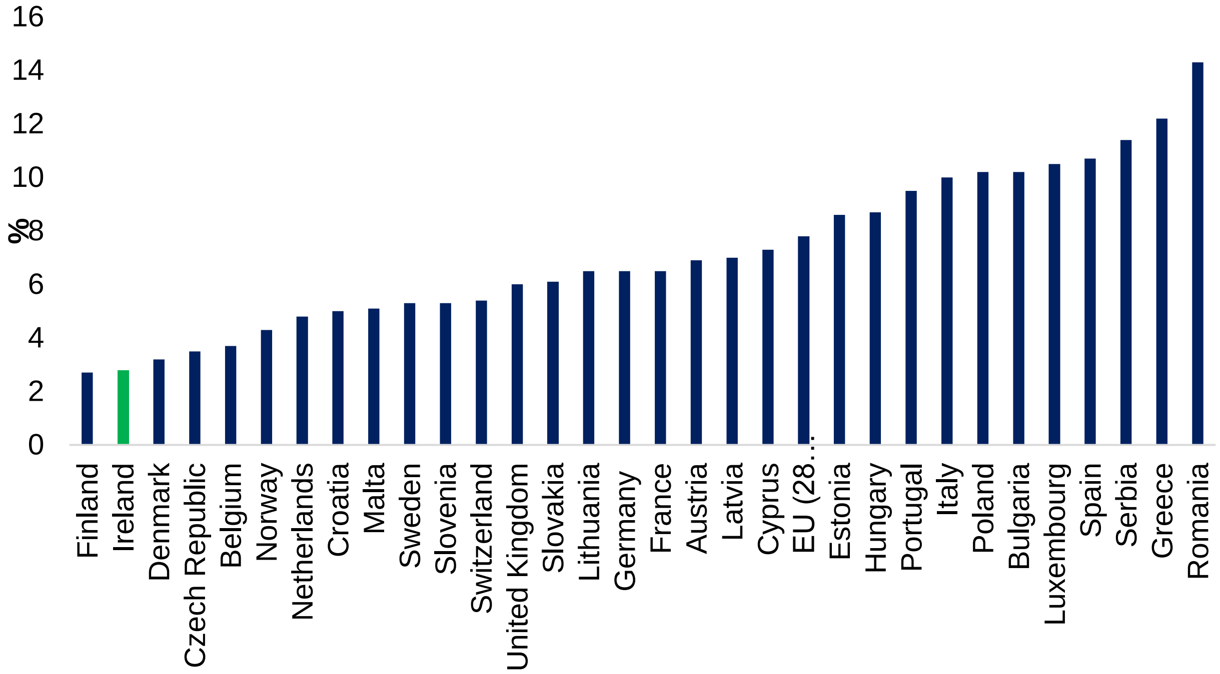
Source: Eurostat

In addition, it is worth keeping in mind that the Gini is a measure of the dispersion of income in a society. To assess the standard of living for people on low incomes, it is more accurate to consider poverty rates or at risk of poverty metrics. There are countries such as the UK that have relatively high inequality but lower than average poverty rates.

Minimum wage and poverty

Common arguments in favour of increasing the minimum wage focus on the low standard of living experienced by those earning these rates. However, as shown in figure X below, Eurostat data indicates that for Irish workers the risk of being in poverty is one of the lowest in the EU. The in-work at-risk-of-poverty rate (% of persons at work and have a disposable income below 60 % of the national median disposable income) for full time workers was the 2nd lowest (2.9%) in EU in 2016. The EU-28 average(7.7%) was more than twice as high as the Irish rate. A similar picture is depicted for Irish part-time workers. Their risk at being on poverty was the 4th the lowest in the EU in 2016 (9.5% in IE vs 15.8% in EU-28).

Figure 7: In-work at-risk-of-poverty rate by full-time work



Source: Eurostat

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Furthermore, to quantify the "depth" of poverty, Eurostat calculates the relative median at-risk-of-poverty gap. This is the distance between the median income of people living below the poverty threshold and the threshold itself. It helps understand how far people are from the poverty line. For this metric, Ireland had the 7th lowest poverty gap in 2016 (18.1% vs 25% in the EU-28).

It is not clear the extent to which poverty can be addressed using the minimum wage. The OECD (2015) noted that minimum wage is a “blunt instrument” for achieving this goal and lowering poverty. This is because: i) households on low incomes have members who are not in employment and cannot benefit from an increase in the minimum wage; ii) many minimum wage workers are not the primary earner and live in a household with earnings that are above average. In this regard, the ESRI’s post-budget distributional analysis found that the main beneficiaries of the minimum wage were in deciles 4-8 in proportional terms. This means that households in the middle or upper half of the income deciles received more from the increase than those in lower income deciles. This in turn highlights the limited capacity of the minimum wage to target people experiencing poverty efficiently.