



Small Firms Association

Submission on the National Minimum Wage

Presented to:

Low Pay Commission

February 2018

Introduction

The Small Firms Association (SFA) is the trusted partner of small businesses with less than 50 employees 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 245,000 businesses and employs half of the private sector workforce.

Overview

The National Minimum Wage has increased by 10.4% since 2015, outstripping average wage increases across the economy and well ahead of inflation, which has been minimal over the period. At the current economic juncture, cost competitiveness is of upmost importance if Ireland is to avoid repeating the mistakes of its recent past. Policy should take the path of least harm as the economy navigates this critical period.

The CSO and Revenue data published in the 2017 Low Pay Commission report has given all stakeholders a much clearer picture of the prevalence of the NMW in Ireland and the main profiles of the people and the roles involved. The research has demonstrated that minimum wage workers are predominantly young workers, carrying out basic tasks on a part-time basis.

In the labour market as a whole, 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 to employment are created.

SFA data and an examination of economic activity in certain sectors and regions demonstrates the varied circumstances and prospects of businesses. Our members have identified wage pressures as the biggest threat to their businesses in 2018. It is important that the Low Pay Commission calibrates the NMW as an absolute floor that is achievable by even those businesses in vulnerable sectors and regions.

Taking these factors into account, it is clear that across the board pay increases are not appropriate at this time. Firm level negotiation remains the most appropriate method for setting wages, taking into account the performance of the business and of the individual employee. The SFA is calling, therefore, for the NMW to remain unchanged at €9.55 per hour. This is the preference of two thirds of SFA members.

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
- International developments
- Domestic economic context
- Labour market issues
- Wage levels in Ireland
- Interaction between the NMW and the tax system
- Breakdown of impact on specific sectors and regions

Evidence-based policy

The SFA strongly believes that any recommendation by the Low Pay Commission must be evidence-based. This is vital to give the small business community confidence in the Low Pay Commission as an independent body.

This is the first submission to the Commission by the SFA since the publication of the NMW data gathered by the CSO as part of the Quarterly National Household Survey in Q2-4 2016. This data provides evidence of a number of notable points. The number of employees earning the minimum wage or less declined in each quarter covered by the survey. The period examined was very short, so it would be useful to be able to monitor if the decline has continued since Q4 2016 as the economy has continued to grow and the labour market has continued to tighten. From the 2016 data, only one in twenty full time employees reported earning the minimum wage or less.

In terms of the sectors where the minimum wage is most prevalent, retail (26%) and accommodation and food services (25%) make up over half of minimum wage workers. It is striking that these are also among the sectors most exposed to Brexit, the outcome of which is as uncertain as ever from a business perspective.

Examining the type of roles carried out by minimum wage workers, 35% were 'elementary' occupations, i.e. carrying out simple and routine tasks. An additional 23% were sales and customer service roles. Minimum wage workers tend to have a lower level of education (primary or below 19%, lower secondary 19%, higher secondary 17%). In addition, 38% of minimum wage workers were found to be between the ages of 15 and 24, with 55% under the age of 34. 40% of minimum wage workers have been on the minimum wage for one year or less.

This statistical evidence, gathered by the CSO, demonstrates that minimum wage workers are predominantly young workers, carrying out basic tasks on a part-time basis. This indicates that with experience, education and upskilling, workers are in a position to transition from the minimum wage and move up the income scale. This is supported by the findings of the Revenue Commissioners that; "Based on an analysis of income mobility, lower paid taxpayers working in low paid sectors have a higher chance of increasing their incomes in future years relative to others within the same sector. For example, in the accommodation and food sector almost half moved upwards from the bottom quintile between 2013 and 2014."

The SFA also 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 feel that their business is impacted by the level of the National Minimum Wage, the cohort is evenly split between those that employ people on the NMW and those whose businesses are impacted indirectly. This highlights an important point to be borne in mind when analysing the 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 NMW has increased rapidly since the establishment of the Low Pay Commission. The 10.4% increase in the rate since 1 January 2016 represents the fastest real increase in the EU-15. For a small firm with 10 employees on the minimum wage, its annual wage bill is over €18,000 higher compared with 2015. The Low Pay Commission's 2017 report concedes that "Data is not yet available to assess the impact of previous increases recommended by the Commission in 2015 and 2016". The Small Firms Association believes that time is needed to assess the impact of successive increases and that the NMW should be frozen for a period to allow this assessment to take place.

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. Among SFA members, the most frequently cited impact of the increases in the minimum wage since 2015 is a reduction in profitability.

From the Revenue Commissioners' examination of 2014 median profits, however, it is clear that many micro-enterprises (less than 10 employees, making up 92% of all businesses) in low pay sectors would not be able to offset NMW increases against profits. In the accommodation and food services sector, for example, the average profit of a micro-enterprise is only €13,324. This means that many firms 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.

The second most common impact reported by members in our survey is a transfer of hours worked from employees to the business owner 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 the retail sector in particular. 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 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 sample of comments from SFA members:

- *“There is a knock on effect from other staff asking to be reviewed for no other reason than the NMW increase.”*
- *“High minimum wage in my opinion sets unrealistic expectations of some skilled workers’ wages in comparison.”*
- *“The amount of the minimum wage in itself is not an issue in my business, it is the knock on effect it has on wages up the line.”*

In surveying our members we also tried to identify any positive impacts of the 2016-2018 increases in the NMW, as these are often cited by proponents of further increases. Only one SFA member reported increased employee engagement. When asked, no respondents reported higher productivity as a result of the NMW increases.

International developments

Much was written in previous SFA submissions about the international economic context. Chief among the external changes currently facing Irish businesses is Brexit.

In the immediate aftermath of the UK’s vote to leave the EU, the Low Pay Commission described the likely impact on Ireland as “significant and unquantifiable”. While the process has advanced since summer 2016, the reality is that range of possible outcomes is as broad as ever and great uncertainty persists.

One aspect that has crystallised in the period since the vote is the understanding that the fallout from Brexit is not limited to exporting companies. It is 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, such as tourism, retail, food production and the border region. Movements in the euro-sterling exchange rate have caused Ireland’s competitiveness to deteriorate relative to our trading partners, and this would appear to be a structural shift as opposed to a temporary one.

In light of Brexit, businesses more than ever require certainty over costs. The State must trust that owner-managers are best placed to manage their own cost bases and government should minimise the imposition of increases that are unconnected to the activity and performance of their business. In the context of Brexit and other international developments, there are many elements that are outside of our domestic control; this makes it all the more important to control those costs that we can.

Domestic economic context

There is no doubt that the Irish economy is strong, with Ibec forecasting GDP growth of 4.2% for 2018. 55,000 net new jobs were created in 2017. Over 60% of SFA members feel that the business environment is improving, up from 50% a year ago.

The economy now faces very different challenges to those present over the last decade. Maintaining competitiveness is chief among these new challenges. As stated by the National Competitiveness Council “A significant challenge for policy is whether, in one of the world’s

most globalised economics, Ireland can avoid another boom-bust cycle of fast growth followed by recession by putting competitiveness at the centre of our economic model, thereby achieving a stable and sustainable economic growth rate.”

Furthermore, the government’s National Risk Assessment 2017 states: “As a peripheral trading economy in a single currency area, Ireland is vulnerable to losses of competitiveness through wage and/or productivity developments that are out of line with our competitors in the euro area, the UK and beyond.”

It is vital that Ireland does not allow its 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 in which to do business. 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. 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.

A sample of comments from SFA members:

- *“Our main competitors are from Chile where the minimum wage is a fraction of the Irish minimum wage.”*
- *“In a digital business we are competing against low cost economies and it is getting harder to compete.”*

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 inflation for 2017 was very low at 0.4%. This subdued inflation is due to continue in 2018 with less than 1% inflation forecast.

Due to these trends, the real value of the NMW is considerably higher today compared with when it was introduced. It would be 28% lower (€7.45) if it was pegged to the harmonised index of consumer prices (HICP). 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 the Low Pay Commission was established. Unemployment has continued to fall and currently stands at 6.1%. Ireland is on track to reach full employment, perhaps even by the end of 2018. As the labour market tightens skills gaps and recruitment difficulties are emerging.

In this context, people 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 second weakest in Europe, i.e. people in work are much less likely to be in poverty (2.9% compared with the EU average of 7.7%). 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.

In the words of one SFA member company:

“We take unskilled employees and train them in house. The rate per hour increases significantly when trained. If the increase is not large enough we see a big impact on the desire to take on the skills training.”

In this case, if the minimum wage for unskilled workers is set too high, the incentive to undergo training is reduced.

The OECD Employment Outlook has suggested that minimum wages can help underpin the income of low-paid workers but adds that this is conditional on the rate not being set too high, otherwise it can lead to job loss and a loss of income for low-paid workers.

In its mandate to take account of 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 obliged to take account of, the Irish rate is 12% higher than the current UK rate and will still be 7% ahead after the new higher UK rate comes into force in 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.

Around three quarters of SFA member companies expect to award pay increases to staff in 2018. 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 over 20% 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.

Irish workers are on course to have experienced the strongest real earnings growth in the EU during 2017. The greatest gains from increased incomes have accrued to the bottom deciles in proportional terms. It is clear that wages are rising across the economy where business performance allows. There is therefore no justification for state intervention in the setting of wages at this time.

Interaction between the NMW and the tax system

The Low Pay Commission's first report in 2015 report stated "...it is clear that any recommended increase in the NMW 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, shifting the so-called 'step effect' for employees and employers. However, from an employer perspective, the changes offset less than 10% of the increased labour costs as a result of the 2016 NMW increase.

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 or 2018 and the problem was exacerbated by the further increases in the NMW on 1 January 2017 and again in 2018.

The employer representatives on the Low Pay Commission highlighted the shortcomings in this area in their Minority Report attached to the Commission's 2017 recommendations. The Minority Report stated: "An expectation emerged around the time of the publication of the first Low Pay Commission Report that the Government would take the necessary steps to address the anomaly highlighted in it whereby "a moderate increase in the current Minimum Wage rate without an appropriate adjustment in employer PRSI would have a major impact, particularly on small business costs." Unfortunately, this aspect has never been adequately addressed and remains a very serious concern for us and for employers generally."

Any further increase in the NMW would bring this issue to the fore yet again. Currently a minimum wage worker working a 39-hour week earns €372, just below the level where employees' PRSI jumps from 0% to 4% and employers' PRSI jumps from 8.6% to 10.85% on all wages earned. Past experience leads employers to believe that the employee step effect

would be offset in full in the case of any further changes in the NMW but the employer step effect will likely be inadequately addressed.

This would create additional PRSI costs for employers, beyond just the basic increase proportionate to the NMW change. Yet again this would result 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 increases the likelihood of changes to the minimum wage costing jobs.

As argued by the SFA in its last three submissions to the Low Pay Commission, this highlights the major problem of the Commission making recommendations that are contingent on other policy changes over which it has little influence. The Low Pay Commission must be extremely cautious about recommending any change in the NMW that would produce distortions in the tax system or elsewhere, as its remit to recommend accompanying policy changes to resolve these distortions is limited, as we have seen.

Breakdown of impact on specific sectors and regions

As discussed earlier in this submission, the Irish economy is performing well. The situation is not uniform across all sectors and regions, however, especially for small firms. A real manifestation of this is the fact that redundancy queries were still in the top five queries received from SFA members in January 2018.

Looking in particular at the sectors that employ the bulk of minimum wage workers (retail, hospitality and support services) the situation is much more sobering than the positive headline figures would indicate.

In retail, 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. Good prices fell by 2.1% in 2017 and are down almost 9% on three years ago. Employment in the sector is 7% below 2007 levels. The sector faces significant threats from Brexit and the resulting fall in Sterling has prompted many shoppers to cross the border to Northern Ireland. Irish retailers face stiff competition online also; €16 billion was spent online by Irish consumers in 2017 but an estimated three-quarters of this spend goes outside the country.

The hospitality sector had a strong year immediately before the Brexit vote 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 €1bn. 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. In the first nine months of 2017, the number of visitors from the UK fell by 7%. The sector is vulnerable, therefore, and faces considerable challenges over the years ahead.

Economic performance and outlook varies significantly between regions also. The Border region is still more than 10% off peak employment. The Border and the South-East regions

experienced the weakest employment growth in the country in Q2 2017. These are the regions that have the highest proportion of people on the NMW. The Low Pay Commission reiterated in its 2017 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 should be appropriate, competitive and affordable at national and firm level. In the current Irish context, where 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.

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 €9.55 per hour. This would give small businesses, especially those most exposed to Brexit and rising business costs in other areas, 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.

The NMW is a blunt instrument and the State must weigh up the other instruments at its disposal for achieving desired economic and social outcomes. The cost of housing, both rental and purchase, cannot be effectively addressed via the NMW and must be tackled at source. Further income tax changes can be deployed to increase the take home pay of employees without an additional burden on the employer.

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 an economic context where competitiveness is paramount, it is not realistic to continually increase the minimum wage ahead of average wage growth, minimum wage growth in competitor economies and far ahead of domestic inflation. The SFA therefore urges the Low Pay Commission to recommend no change to the National Minimum Wage for 2019.

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 Linda Barry, SFA Assistant Director, on 01-6051626 or linda.barry@sfa.ie.

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