TASC Submission to the Independent Review of ERO and REA Wage Setting Mechanisms

Introduction

TASC is an independent think tank dedicated to combating Ireland's high level of economic inequality and ensuring that public policy has equality at its core. In making this submission, TASC presents independent external economic and labour market evidence in support of the need for wage floors and makes a number of recommendations in this regard.

Main Points

1. The empirical evidence on the employment effect of wage floors is ambiguous. Numerous econometric studies in the literature have shown no net employment effect. It is not possible to conclude that reducing the earnings of low-wage workers will generate increased employment.
2. It is anticipated that reducing the wages of low income earners will depress aggregate demand and therefore economic growth. This has implications for Ireland's ability to achieve debt sustainability.
3. Most EU countries have raised their national minimum wage during the current crisis. Ireland is a unique exception in having decreased its national minimum wage
4. OECD data shows that labour costs in Ireland in the low-wage sectors are not high by European Union standards. The most recent EU Klems data finds that hourly labour costs in the hospitality sector (the largest low-pay sector) are the third lowest in the EU-15.
5. For an employee working a thirty nine hour week it is estimated that the annual **direct** cost to the exchequer of reducing a JLC rate set at €9.27 per hour down to the current national minimum wage rate of €7.65, will be €1,865 per annum per worker. This figure does not include the indirect costs to the public finances from lost VAT and other receipts and from increased social protection spending on measures such as Family Income Supplement.

6. The ERO and REA wage-setting mechanisms are about more than the setting of minimum wages. They also safeguard the minimum conditions within particular sectors and therefore safeguard a minimum standard of living.
7. The vast majority of OECD economies have already implemented the right to collective bargaining as established by article 11 of the European Convention for the Protection of Human Rights and Fundamental Freedoms. Ireland is unusual in having failed to do so. The wage setting mechanisms perform some of the same functions in Ireland.

Main Recommendations

8. The minimum wage cut should be reversed to support aggregate demand in the economy, protect vulnerable workers and reduce income inequality.
9. In the medium-term, an independent commission for wage setting in low paying sectors should be established. This commission should be constituted along similar lines as the Low Pay Commission in the United Kingdom (modified to Ireland's needs) to monitor, evaluate and review the low paying sectors and annually recommend to Government on:
    i. The labour market impacts of the various wage floors
    ii. The competitiveness impacts of the various wage floors
    iii. The equality impact of the various wage floors
    iv. The poverty impact of the various wage floors

    While employers and unions are represented on the UK Low Pay Commission, this does not replace local/sectoral collective bargaining processes, which are used to negotiate the conditions of employment.

10. There should be no change to the current structure of wage floors until an independent economic assessment has been undertaken to quantify the macroeconomic effects of changing the levels of these wage floors.
11. The ERO and REA wage setting mechanisms should continue to be retained but the system streamlined and modernised. A number of Joint Labour Committees (JLCs) have gone through this process, which could be applied to all EROs and REAs.

Minimum Standard of Living

12. The national minimum wage and the system of minimum wage floors set by the JLC agreements are not end-goals in themselves. The primary end-goal is a minimum standard of living, and dignity, for everybody in society.
13. Of course there are other important considerations such as the need to avoid creating perverse labour market incentives, the need to foster improved productivity and output and the need to promote social solidarity. Understanding the complex interactions between wage rates and other fiscal and social policies is crucial to this debate.
14. TASC argues for a minimum annual income approach, with an integrated tax and welfare system that pays everyone a decent minimum through an integrated tax credit/transfer payment system. TASC's Pension Policy '*Making Pensions Work for People'* (2008) also sets out a model of pension provision that provides a guaranteed minimum income for people in retirement.
15. The long-term goal must be an integrated system that provides a sufficient minimum income for everybody. In the absence of such an integrated system the minimum wage was introduced in recognition of the vulnerability of low income workers. That vulnerability has not decreased in the intervening period.
16. Minimum wage laws also help boost overall income equality between women and men as the majority of minimum wage workers are women. Minimum wage floors also act as bulwarks protecting migrant and other vulnerable groups against exploitation by employers. Reducing or eliminating the wage floors will simply add to the vulnerability of low income groups and exacerbate income inequality. TASC therefore calls for the recent cut in the minimum wage be reversed.
17. Individual and household welfare is not just determined by wages and minimum wage floors should be seen as just one of many tools available to policymakers. However minimum wage floors can be an important defence against discriminatory practices and a legal protection for vulnerable groups.
18. The economically vulnerable are not just those people living on the minimum wage. The economically vulnerable group also includes those people living on rates just above the minimum wage. What is needed is not a system of minimum wage floors *per se*, but a minimum income, capable of supporting a minimum acceptable standard of living. The Vincentian Partnership has quantified the 'minimum essential budgets' for a range of household types required to provide a minimum standard of living.

19. An individual's job conditions are an important factor impacting on his or her minimum standard of living. The ERO and REA wage-setting mechanisms are about more than the setting of minimum wages. They also safeguard the minimum conditions within particular sectors and therefore safeguard a minimum standard of living. This setting of minimum conditions is a key differentiator with the national minimum wage.
20. In the medium terms, TASC is recommending the establishment of a Low Pay Commission constituted along similar lines as the Low Pay Commission in the United Kingdom to monitor, evaluate and review the low paying sectors. Some changes to the UK model will be needed to fit Ireland's current needs.

Employment Effects of Wage Floors: Empirical Evidence

21. As an equality think tank, TASC is concerned by the increasing levels of inequality that were experienced in the developed world in the quarter century leading up to the economic crisis in 2008. However there is also evidence that inequality may have contributed to the current crisis. For example, Kumhof and Ranciére (2010) of the IMF argue that both of the major economic crises of the past century were preceded by a sharp increase in income and wealth inequality, and by a similarly sharp increase in debt-to-income ratios among lower and middle income households. The authors find that the financial crisis was the ultimate result of increasing inequality driving a sharp increase in debt-to-income ratios. They conclude that redistribution policies that prevent excessive household indebtedness can reduce the probability of a crisis and therefore promote macroeconomic stability.
22. The OECD has conducted comparative research on international levels of earnings inequality and found that in 2008, Ireland had the highest level of earnings inequality in the original EU 15 (OECD, 2008).
23. Simple theoretical models of supply and demand can be used to show that minimum wage laws should cause unemployment for those with the weakest skill sets. However Fields (1994) shows that in a two-sector economy the employment effects of wage floors are ambiguous and the predictions of orthodox models cannot be relied on. On the other hand, under certain conditions, for example those of monopsony, a wage floor can theoretically boost employment. A monopsony is a market form in which only one buyer (in this case a buyer of labour) faces many sellers. It is an example of imperfect competition, similar to a monopoly.

24. Higher wages, particularly for those on low income, stimulates aggregate demand and through this mechanism can protect existing jobs.
25. The actual empirical evidence is very mixed on the minimum wage and there is conflicting evidence surrounding employment, productivity and equality outcomes.
26. The Low Pay Commission (Metcalf, 2007) and the London School of Economics (CEP, 2008) in the United Kingdom have found no impact on employment levels, and the Fiscal Policy Institute (2006) in a study of American states actually found a positive correlation between employment growth and the minimum wage.
27. New Jersey changed its state minimum wage in 1992 and eastern Pennsylvania just across the Delaware River maintained its existing rate. In a seminal econometric study Card and Krueger (1994) computed differences-in-differences estimates of the effects of the New Jersey minimum wage increase on employment and found that the effects of minimal wage laws were essentially non-existent.
28. Although Neumark and Wascher (2008) in a meta-analysis of minimum wage studies did find an employment impact, other meta-analyses of the employment effect (e.g. Doucouliagos and Stanley, 2008) found little or no evidence of a negative association.
29. Finally, in a wide reaching study, Dube, William and Reich (2010) use policy discontinuities at state borders to identify the effects (including long term effects) of minimum wages on earnings and employment in restaurants and other low-wage sectors. They find that traditional approaches that do not account for local economic conditions, such as those advanced by Neumark and Wascher, tend to produce spurious negative effects due to spatial heterogeneities in employment trends that are unrelated to minimum wage policies. They find strong earnings effects and no employment effects of minimum wage increases.
30. TASC is recommending that there should be no change to the current structure of wage floors until an independent economic assessment has been undertaken to quantify the macroeconomic effects of changing the levels of these wage floors.

The Impact on Aggregate Demand and Jobs

31. Reducing wage rates will disincentivise work and further contract domestic demand. Low income earners, out of necessity, spend almost all of their income. Reducing wage rates, particularly for those already on low incomes, will further dampen aggregate demand through reduced consumption. The reduced spending in the economy will

create further pressure for existing businesses and will ultimately lead to job losses and lower economic growth.

32. The great majority of advanced economies increased their minimum wage rates during the current crisis; they did this precisely because they understood the need to maintain demand. Low paid workers are almost pure transmitters of demand. These are people who already spend all or almost all of their money. Reducing the wage floors would result in a lower level of spending throughout the economy. This reduced spending will hit all firms including those that employ low income workers.
33. Another very important consideration is for those firms that do not employ minimum wage rate workers or JLC rate workers. These firms will experience no upside to the reductions; they will have reduced income, without a corresponding significant reduction in their cost base. This will distort the economy in favour of low paying sectors and exacerbate the job crisis in all non low-wage sectors.

The Impact on the Exchequer Finances

34. The reduction in wages and in consumption will create further pressure on the public finances through the direct and indirect loss of tax receipts and through increased government expenditure on social protection measures such as Family Income Supplement. The reduction in economic growth caused by the fall in consumption will ultimately make the Irish State's debt burden more unstable.
35. Table 1 shows the direct cost to the exchequer from reducing the JLC rate from €9.27 down to the new minimum wage rate of €7.65. The cost is €1,865.24 per worker. This is €1,163 in employee payments with the rest (€702) coming from employer's PRSI. The employee will see a reduction in annual **net** income of €2,123.
36. Table 1 also shows the direct cost to the exchequer from reducing the minimum wage rate from €8.65 down to €7.65. The cost is €507 per worker. This is €335 in employee payments with €172 coming from employer's PRSI. The employee will see a reduction in annual **net** income of €1,693.
37. There will also be an additional cost to the exchequer through an increase in Family Income Supplement (FIS) payments, whereby increasing numbers of low paid workers will be eligible for this supplementary payment. This will lead to tax payers effectively subsidising the employers of very low paid workers. In the UK, the increased burden on the exchequer (providing in-work benefits) was one of the main reasons why

government policy in the 1990s changed to focus on putting in place mechanisms to support the creation and enforcement of wage floors through the establishment of the Low Pay Commission.

Table 1

Direct cost to the exchequer from changes to wage floors

	A	B	C
Hourly rate	**€7.65**	**€8.65**	**€9.27**
Weekly rate	€298.35	€337.35	€361.53
Hours	39	39	39
Weeks	52	52	52
Gross annual income	€15,514.20	€17,542.20	€18,799.56
20% income tax	€3,103	€3,508	€3,760
Tax credits, relief, etc	€3,300	€3,300	€3,300
Income tax payable	€ -	€208	€460
Universal levy	€ 420	€547	€635
Employee's PRSI	€ -	€0	€488
Annual net income	€15,094	€16,787	€17,217
Employer's PRSI - 8.5%	€1,318.71	€1,491.09	
Employer’s PRSI - 10.75%			€2,020.95
Total cost to employer	€16,833	€19,033	€20,821
Exchequer gain	**€1,738.71**	**€2,246.09**	**€3,603.95**

Direct Impact on the Exchequer = Income Tax + Universal Levy + Employee’s PRSI + Employer’s PRSI (1)

Direct benefit to the exchequer at €7.65 per hour = €0 + €420 + €0 + €1,318.71 = **€1,738.71**

Direct benefit to the exchequer at €8.65 per hour = €208 + €547 + €0 + €1,491.09 = **€2,246.09**

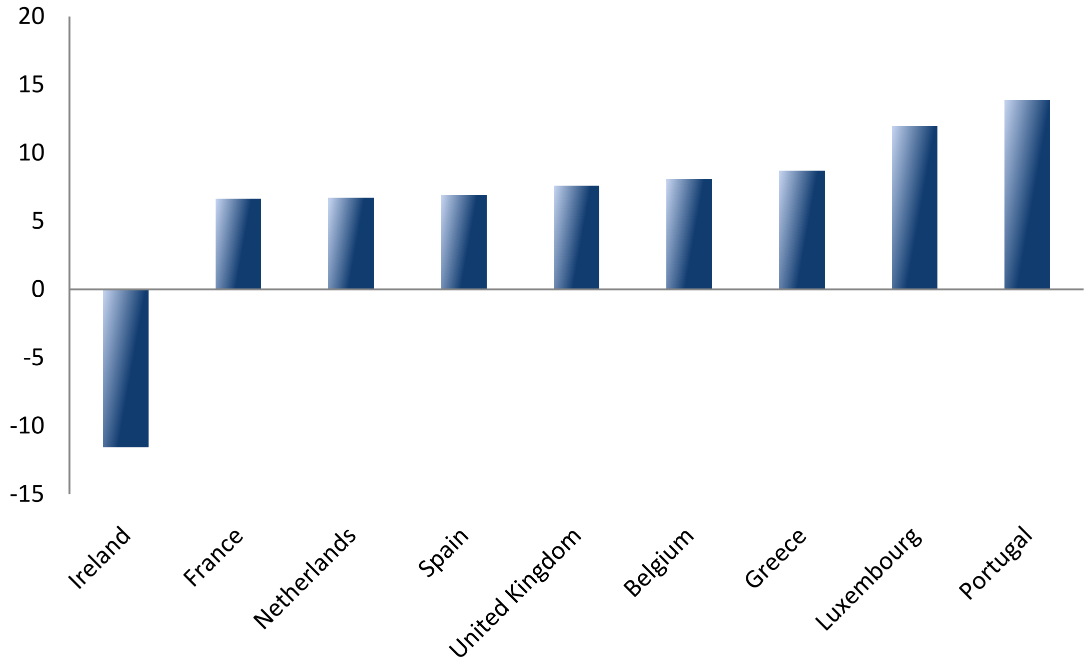
Direct benefit to the exchequer at €9.27 per hour = €460 + €635 + €488 + €2,020.95 **= €3,603.95**

Minimum Wage and Labour Costs: International Comparisons

38. The myth that Ireland had, until recently, the second most generous national minimum wage has been widely promulgated in the Dáil and by various interest groups.
39. However to accurately compare minimum wage rates across countries we must first adjust the rates for Purchasing Power Parity. This is done by expressing the minimum wage in terms of a common unit called the Purchasing Power Standard (PPS).
40. When expressed in PPS terms (Eurostat, 2010), the official data from Eurostat (2011) shows that Ireland's ranking drops from second to sixth place, reflecting our higher cost of living. Ireland's monthly minimum wage at the start of the year was €1,152 in PPS. The UK was in fifth place with a monthly minimum wage of €1,154 (in PPS) and France in fourth place with a monthly minimum wage of €1,189 (in PPS). The United Kingdom's Low Pay Commission (2010) found that Ireland's national minimum wage was (in real terms) the fifth highest of eight surveyed EU-15 countries.
41. The Eurostat data calculates wages per month. Ireland's monthly rates are calculated on the basis of a 39 hour week, France on the basis of a 35 hour week and the UK on the basis of the 38.1 hour week. If we differentiate for the number of hours worked in the three countries we find that the hourly minimum wage was €7.84 (PPS) in France; €6.99 (PPS) in the UK and €6.82 (PPS) in Ireland **before** the recent 11.6 per cent cut.

Figure 1:

Percentage change to NMW rates (2008 and 2011) in the EU 15 countries operating an NMW.



Source: Eurostat (2011).

42. The Eurostat data only refers to those European Members that have statutory minimum wages. This means that the dataset does not include Germany, Sweden, Denmark and Finland. Collective bargaining is used to set minimum wages in these countries and an October 2008 study by Swedish economists showed that Sweden, Finland and Denmark all had higher hourly minimum wages in 2006 than Ireland, as did Norway which is not a member of the EU.
43. Eurostat also calculates the minimum wage as a per cent of average monthly earnings. The minimum wage in Ireland was 42 per cent of average industrial earnings in 2008, which puts Ireland in ninth place in the EU, or in twelfth place if we include the corresponding 2006 percentages for the Scandinavian countries.
44. When calculating the cost of employing a person, it is more accurate to look at the overall cost of labour which is made up of labour and payroll taxes (PRSI). Ireland has one of the lowest levels of employers' social protection contribution in the OECD. The Irish rate (10.8 per cent) is significantly lower than the OECD average (15.2 per cent) and the euro area average (27 per cent), which means that the **total cost** of employing workers in Ireland is not as high as is often assumed.

45. The hospitality sector is the largest employer of low wage workers and OECD data shows that labour costs in Ireland in this sector are the third lowest in the EU 15 (TASC, 2010). The EU Klems (2009) database shows labour costs per hour for hospitality workers in 2007 (the last year the minimum wage was increased in Ireland). These were:
    - €12.84 in Ireland;
    - €14.85 in the United Kingdom;
    - Labour costs averaged €15.56 in the EU-15 as a whole;
    - Only Greece and Portugal had lower labour costs per employee than Ireland.

The Wage Setting Mechanisms

46. The terms of reference asks whether and to what extent EROs and REAs contribute to nominal wage rigidity in the covered sectors and occupations, with potentially relevant effects on employment during weak economic conditions and on the adjustment of labour markets across sectors, occupations, and geographical areas.
47. The British Conservative government of the 1980s argued that Wages Councils (equivalent body to JLCs) interfered with market forces and that their removal would help to 'price people back into jobs'. However, Machin and Manning (1994) found no evidence to support the claim that Wages Councils restrained employment in the 1980s.
48. Research by O'Sullivan and Wallace (2011) indicated that one third of employer representatives on the JLCs believed they were necessary because they prevent employer undercutting and because they tailor minimum pay and conditions to the specific industry/employment covered. This latter reason offers a bargaining advantage to unions and employers because they have the ability to help determine minimum pay and conditions in their industry - something which they cannot do with the national minimum wage or employment law.
49. TASC therefore recommends that ERO and REA wage setting mechanisms should continue to be retained but the system streamlined and modernised. A number of Joint Labour Committees (JLCs) have gone through this process, which could be applied to all EROs and REAs.

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