

## Note on the National Minimum Wage for Tax Strategy Group

September 2010

### Introduction

1. The National Minimum Wage Act 2000 was enacted in April 2000, introducing an hourly rate of £4.40 (€5.59). Since then, the value of the minimum wage has been increased six times, by about 55% in all<sup>1</sup>. The last increase, in July 2007, raised the minimum wage from €8.30 to €8.65 per hour. Similarly, between Q2 2000 and Q2 2008 the average industrial wage increased from €10.60/hr to €16.74/hr, which represents an increase of 58%. Ireland's Consumer Price Index increased by 37% over the same period.

2. On an annualised basis, the minimum wage is equivalent to €17,542. In Ireland, all income earners who earn less than €18,304 pay no income tax, PRSI or health levy but do pay the income levy. In 2009, 4.9% of employees were on the minimum wage. However, about 31% of employees earn below 1.5 times the minimum wage (€12.97 per hour).

3. Sectors that are particularly reliant on low wage workers include Wholesale and Retail Trade and Accommodation and Food Services. These sectors experienced decreases in employment of -12.8% and -14.2% respectively in the year to Q4 2009. In the current economic circumstances, these sectors are particularly at risk as they are predominantly labour intensive with low value added, leaving them exposed to low cost competitors.

4. The mechanism for reviewing the National Minimum Wage is through the Labour Court. After taking into account any submissions from interested parties, the Labour Court makes a recommendation to the Minister for Labour Affairs (this process is outlined in more detail below).

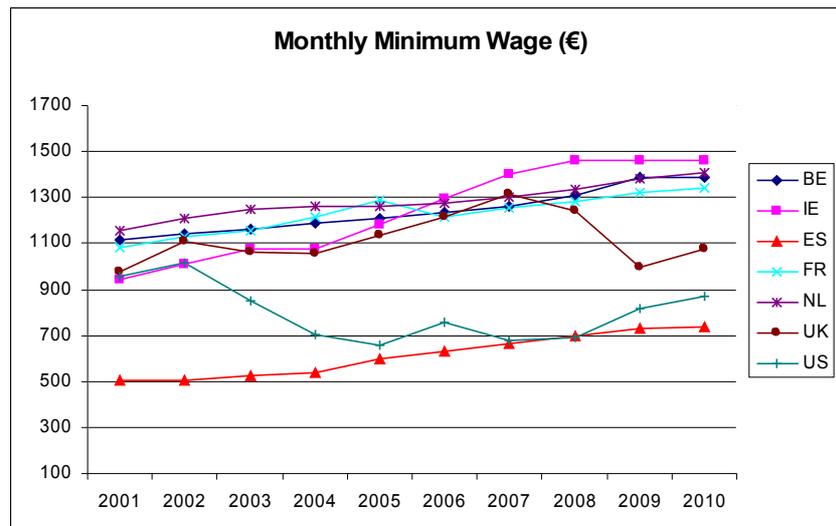
### International Comparisons

5. Out of the 20 EU Member States with a statutory minimum wage, Ireland had the second highest EU monthly minimum wage in 2009, at €1,462. When considered in the context of purchasing power, Ireland's minimum wage slips to 6<sup>th</sup> place. While this is a useful measure in terms of ranking the purchasing power of Ireland's minimum wage earners, it is of limited use in the context of our ongoing international cost competitiveness. The average EU monthly minimum wage is approximately €700, reflecting the particularly low minimum wage rates in the 2004 accession states. Among the nine EU15 countries data is available for, the average monthly minimum wage was €1,168<sup>2</sup>. The UK average monthly minimum wage is approximately €1,010 based on 2009 exchange rates<sup>3</sup>.

<sup>1</sup> By comparison, the UK minimum wage, while lower than Ireland's, has increased by 61% between 1999 and 2009 and is due to increase again in October 2010 by approximately 2.2%.

<sup>2</sup> This excludes several Nordic countries with traditionally high wage levels but with *sectoral* minimum wage levels rather than a single national minimum wage.

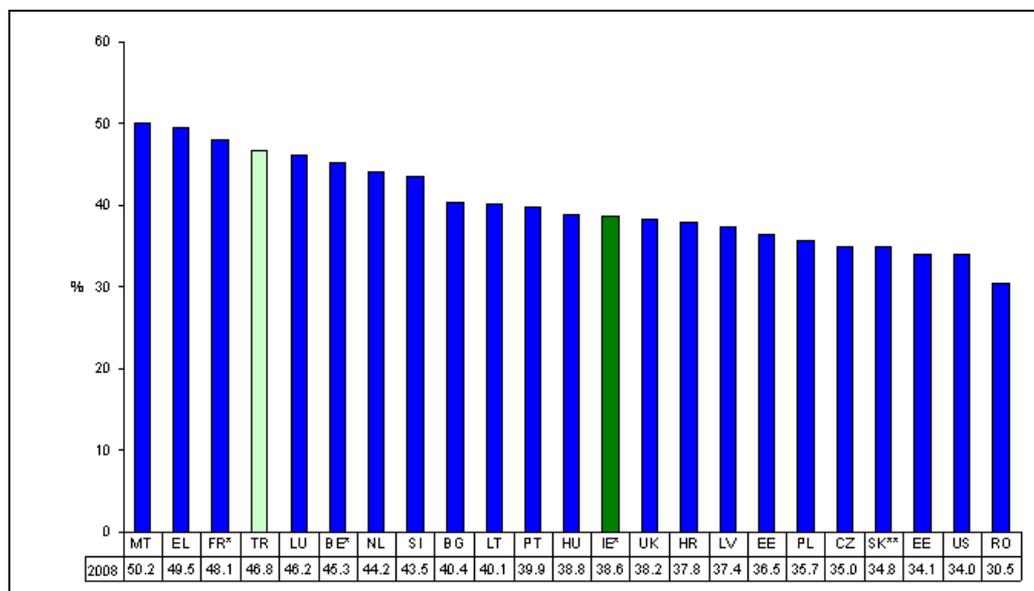
<sup>3</sup> Since this 2009 Eurostat data was published, the UK minimum wage has been increased and will increase again in October 2010, to £5.93. This equates to £961.68 per month or €1,190 (as per September 2010 exchange rates) – still significantly lower than the Irish monthly rate of €1,462.



Selected Monthly Minimum Wage Rates in EU Member States (2000-2010)

Source: Eurostat

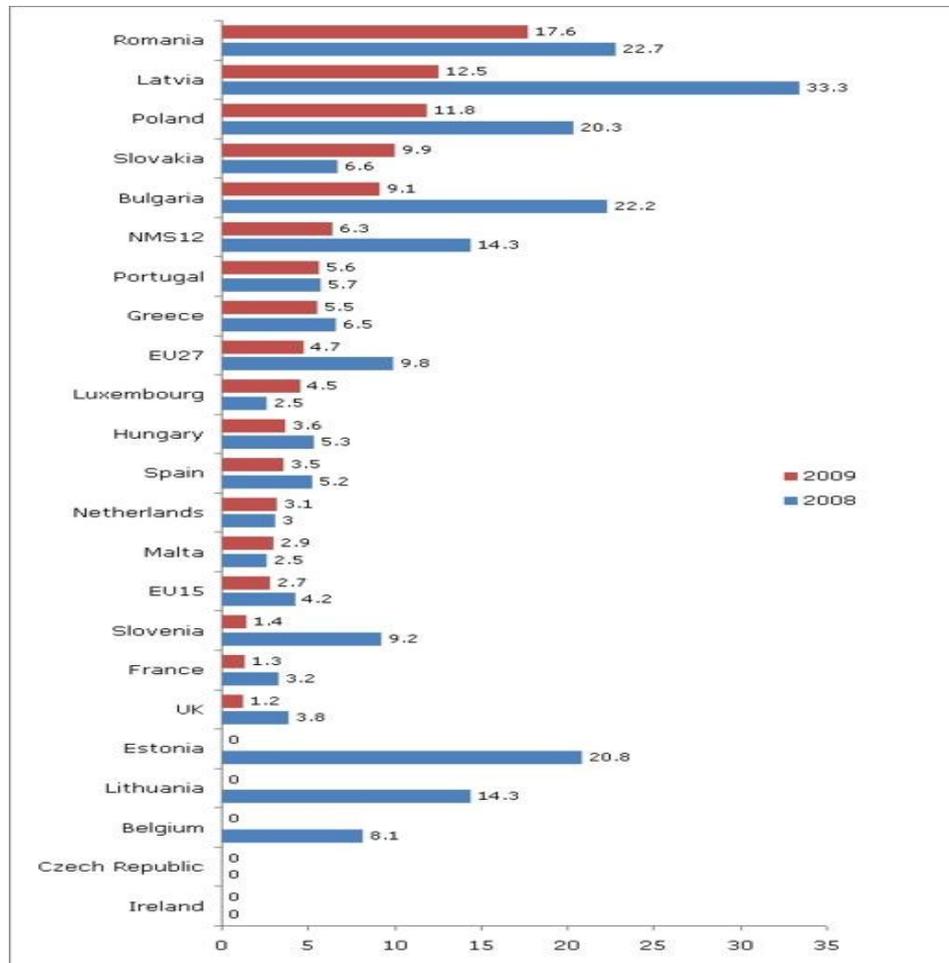
6. In 2008, Ireland's minimum wage was measured at 42% of average EU15 earnings in industry and services, down from 51% in 2006, just slightly above an average of 15 EU Member States (41%). This reflects that, while Ireland's minimum wage rate is high by EU standards, it is not disproportionately high when compared with overall earnings in the Irish economy. However, the dual nature of Ireland's economy should be considered. Outside the Ireland's highly productive foreign-owned export sector, minimum wages are a considerably higher proportion of average earnings.



Minimum wages as percentage of average gross monthly earnings in industry and services in EU Member States and the United States, 2008 (Ireland figure is for 2007) Source: Eurostat

7. Ireland's minimum wage has remained unchanged since July 2007, making Ireland just one of two EU Member States with a statutory minimum wage without any

increases in either 2008 or 2009<sup>4</sup>. Average EU15 minimum wage increases in 2008 and 2009 were 2.7% and 4.2% respectively. It should be noted that Ireland experienced significant and prolonged deflation though 2009 and much of 2010 which increased the purchasing power of existing minimum wage levels. No EU member state experienced comparable deflation.



Growth in Minimum Wage Rates, 2008-09. Source: Eurofound

## **Youth Unemployment**

**8.** Younger workers are typically more likely to be on the minimum wage. Arguments for decreasing the minimum wage frequently suggest a lower minimum wage will increase youth employment, or, at the very least, help preserve existing youth employment.

**9.** In August 2010, there were 94,550 people under 25 on the Live Register, or just over 20% of the total. The most recent Eurostat data (July 2010), gives an unemployment rate for Ireland of 13.6% with a youth unemployment rate of 28.9%. Both figures are significantly about EU27 averages, though by broadly similar proportions.

**10.** While the 2003 Neumark & Wascher study of the effect of the minimum wage on youth unemployment in 17 OECD countries did include Ireland, the historical data series was insufficient. They did however, note, that, as is the case in Ireland, the

<sup>4</sup> Similarly, Ireland was one of only two OECD countries – the other being Australia – to freeze its minimum wage in 2009.

“disemployment effects of minimum wages appear to be smaller in countries that have subminimum wage provisions for youths” – i.e. a lower minimum wages for younger workers ease any negative employment effects of a minimum wage rate.

### **Recent Developments**

11. In November 2008, the Irish Congress of Trade Unions requested the Labour Court to review the National Minimum Wage and to make a recommendation to the Minister for Labour Affairs concerning its adjustment. The Labour Court subsequently invited submissions on the issue. Various submissions were received, including from IBEC, ICTU and the Department of Finance. The Department of Finance also made a presentation before the Labour Court in January 2009.

12. Under the National Minimum Wage Act, 2000, the Labour Court can seek to establish, in the context of such consultations, whether a general agreement can be reached between the parties. If, however, the Labour Court is satisfied that such a general agreement cannot be reached, it may still make a recommendation to the Minister of State for Labour Affairs. **The Minister has not yet, as of September 2010, received any recommendation from the Labour Court in relation to the application made under the National Minimum Wage Act.**

13. The submission to the Labour Court by the Department of Finance argued against increasing the National Minimum Wage in the prevailing economic climate. In particular, the Department cited a significant loss of international price competitiveness due to appreciation of the euro, inflation and wage increases in excess of productivity as significant reasons against revising the minimum wage upwards.

14. The Department also argued that increases in the minimum wage reduce the ability of exposed lower wage sectors to respond, through wage and price adjustment, to changing economic circumstances. This could have detrimental effects in the form of increased unemployment among lower-skilled workers.

15. In some instances, wage increases may be passed to consumers in the form of higher prices. Any increase in input costs (including wage costs) would have a detrimental effect on Ireland’s ability to secure sustainable export-led growth.

16. In July 2010, the Joint Oireachtas Committee on Enterprise, Trade and Innovation held hearings on the minimum wage with varying views on the issue from TASC, IBEC and others.

### **Recent Research**

17. While Irish wage growth has exceeded that of our trading partners for much of the last decade, the implications for the minimum wage are mixed. Recent research from the European Central Bank suggests that “firms with a higher incidence of minimum wage earners are more vulnerable to adverse shocks due to their inability to adjust wages downward. Indeed, minimum wage restrictions were seen to increase the failure rates”<sup>5</sup>. Firm-level research on behalf of the Irish Central Bank suggests that Irish firms did “not regard themselves as facing significant structural or institutional

<sup>5</sup> *Wage and the Risk of Displacement*, European Central Bank Working Paper Series No. 1159, February 2010.

obstacles to wage reductions”<sup>6</sup>. It should, however, be pointed out that this research was undertaken prior to the economic downturn in Ireland.

**18.** While there is a wide literature suggesting a national minimum wage may exacerbate youth unemployment, in Ireland this potential effect alleviated the long-standing provision whereby younger, less skilled, staff may earn just 75% of the total minimum wage.

**19.** Forfás (2009) have argued that the likely impact on employment of any change (increase or decrease) in the National Minimum Wage is not predictable, based on current historical Irish data and that the international empirical evidence is ‘not very consistent’.

**20.** The ESRI’s 1999 study<sup>7</sup> on the effects of the introduction of a minimum wage suggested that, as well as increasing upward pressure on prices and wages, the minimum wage could dampen employment growth marginally (by approximately -0.9%), resulting in slightly greater unemployment concentrated in low-skilled workers. On the other hand, productivity levels and employee turnover levels were likely to improve. Subsequent ESRI follow up studies commissioned by the then Department of Enterprise, Trade and Employment, in 2002 and 2006<sup>8</sup>, while useful and insightful in their own right, were not aimed at examining the effects of the National Minimum Wage on employment growth or competitiveness.

### **Wider issues: Employment Regulation Orders and Registered Employment Agreements**

**21.** Minimum rates of pay and other conditions of work, for workers in certain sectors (such as agricultural workers and catering) are determined by **Joint Labour Committees (JLCs)**, established under the Industrial Relations Act, 1946. Currently, there are 13 JLCs in existence. Each JLC is composed of representatives of workers and employers in the sector concerned. In recent years, agreements by the social partners have seen the amalgamation or abolition of some of the JLCs.

**22.** While JLCs are established by means of a statutory order made by the Labour Court, they are independent bodies which determine minimum rates of pay and conditions of employment for workers in their respective sectors. The pay and conditions agreed by the JLCs are given the force of law in **Employment Regulation Orders (EROs)** made by the Labour Court on foot of proposals made to the Court by the JLCs.

**23.** The average hourly rate under the EROs is €9.15 (105.4% of the national Minimum Wage). The most recent ERO, from April 2010, for agriculture workers, temporarily reduced their hourly pay and increased flexibility provisions<sup>9</sup>.

<sup>6</sup> *Wage Setting and Wage Flexibility in Ireland: Results from a Firm-level Survey*, Central Bank and Financial Services Authority Research Technical Paper, February 2010.

<sup>7</sup> ESRI, May 1999: ‘Final Report of the Inter-Departmental Group on Implementation of a National Minimum Wage’

<sup>8</sup> ESRI, 2002: ‘The Impact of the Minimum Wage on Irish Firms: results from a follow-up Survey in 2002’ & 2006: ‘The Minimum Wage and Irish Firms in 2005’

<sup>9</sup> Statutory Instrument 146 of 2010, Employment Regulations Order (Agricultural Workers Joint Labour Committee) 2010

**24. Registered Employment Agreements (REAs):** Employers and workers in any sector or enterprise can agree minimum rates of pay and conditions of employment and can then have that agreement registered with the Labour Court. When registered with the Court, these agreements are legally binding on the parties to the agreement as well as others who are in the class, type or group to which the agreements are expressed to apply. There are 68 Registered Employment Agreements, in areas such as construction and electrical contracting, on the Register maintained by the Labour Court.

**25.** While EROs and REAs are most common in sectors traditionally known for low-paid labour (retail, accommodation, etc.) data on the number of employees covered by these agreements are not available. Forfás suggest that the impact of any cut in the minimum wage would be reduced by the rigidities of the EROs.

**26.** The **Industrial Relations (Amendment) Bill 2009**<sup>10</sup> aims to strengthen the existing system for the ongoing functioning of both Employment Regulation Orders and Registered Employment Agreements and to provide for their continued effective operation. In the context of the *Towards 2016* review and transitional agreement, the Government and the social partners had agreed to the implementation of a series of measures on aspects of employment rights and compliance.

**27.** The JLC and REA systems have been the subject of a number of recent legal challenges that have come before the High Court. The current draft legislation aims to remedy some of the legal issues raised in these court challenges. Recently, the Labour Court, after considering a request by the Construction Industry Federation to reduce wage rates in the construction sector under the REA by 20%, consented to a 7.5% cut. The CIF's previous request to the Labour Court for a 10 per cent cut was rejected in March 2009.

## Options

### **Option 1 – Freezing the Minimum Wage**

**28.** With the minimum wage rate unaltered, in nominal terms, since July 2007, a minimum wage freeze is, *de facto*, the current approach. As noted above, Ireland is only one of two EU member states not to have increased its minimum wage in either 2008 or 2009, and, while Ireland's minimum wage is still high by EU standards, there has been convergence in recent years. Maintaining the current *de facto* minimum wage freeze should result in greater convergence. However, it should be noted that after some eighteen months of significant deflation in Ireland, the purchasing power of an unchanged minimum wage has been enhanced.

### **Option 2 – Reducing the Minimum Wage**

**29.** There are few international examples of reducing the statutory minimum wage. However, many countries have increased statutory minimum wage rates at levels below inflation, thereby reducing them in real, if not nominal, terms. While the OECD<sup>11</sup> have suggested a cut in Ireland's minimum wage may be necessary, in the absence of significant decreases in the *rates* of private sector pay (private sector

<sup>10</sup> As of September 2010, this Bill is at the Committee Stage in Dáil Éireann after passage through the Seanad

<sup>11</sup> OECD Economic Survey of Ireland, 2009, p.90

payroll has primarily been reduced through redundancies and shorter working hours), it may be difficult to make a strong case for a cut in the minimum wage. Any cut would reduce the minimum wage as a percentage of average earnings, which, as we have seen, is not excessive by EU standards. A reduction in the minimum wage rate may also require amending primary legislation and incur significant resistance through the current industrial relations machinery so central in setting minimum wage levels in Ireland. There may also be significant implications with regards to replacement rates, dealt with in a separate paper.

### **Option 3 – Enhancing and expanding existing age and trainee-specific Minimum Wage rates**

**30.** This approach would enhance the current *de facto* freeze in the minimum wage, with greater utilisation of current flexibilities in the present minimum wage legislation regarding discount rates for younger employees and trainees. Revised minimum wage rates, for example, for under-25s would reflect recent social welfare adjustments in Budget 2010 for that age group. This option may also require primary legislation.

### **Conclusion**

**31.** There are mixed views of the effect of a minimum wage on employment, although the majority of research suggests that, in a poorer labour market in particular, the minimum wage has a negative impact on employment. While Ireland's National Minimum Wage did little to hinder employment growth prior to 2007, more recently, as the labour market weakened and the private sector looked to reduce costs, including labour costs, the Minimum Wage, at its current level, became open to increasing scrutiny. Indigenous, low-margin, enterprises, with their disproportionate reliance on minimum wage labour have, in the current economic climate, a particularly strong case for a reduction in the minimum wage to help restore cost competitiveness.

**32.** Previous research by the ESRI (2002) on the effects of the minimum wage on the Irish economy were undertaken in better economic circumstances, when any potential detrimental effects may have been mitigated by a strong labour market with significant upward wage pressures. While the UK minimum wage and its effects are monitored closely by the Low Pay Commission, such timely research is largely absent in Ireland. Fresh research in this area, given the current economic climate, would provide greater insight on this issue.

The TSG is invited to discuss this paper.

**Interdivisional Group on Growth and Employment  
Department of Finance  
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