

# Low Pay Commission

## Submission on the National Minimum Wage



**April 2015**

*“Recent research suggests that ... there is either no trade-off between increased minimum wages and employment levels or that such increases have very limited effects on employment, which can be either positive or negative. On the other hand, it shows that minimum wages do contribute effectively to reducing wage inequality.”*

International Labour Organisation, 2014<sup>1</sup>

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## Summary

Economic Inequality is now recognised internationally as one of the greatest challenges facing modern economies and societies. While there are many causes of inequality, it is acknowledged that low pay is at its root.

In Ireland, wage and salary earners have higher out of pocket expenses due to:

- fewer universal public services
- more charges for public services
- a higher cost of living

Income levels are therefore an even greater determinant of inequality in Ireland than in other advanced economies. A Commission dedicated to annual recommendations on the appropriate levels of minimum wage is very welcome.

Income inequality is rising in Ireland, and when it comes to how the market distributes income we are the most unequal country in the OECD. This is caused by:

- **Low Employment levels:** 65% of the working age population are in employment, which is below the EU average.
- **High Earnings Inequality:** the distribution of incomes for those in work is amongst the more unequal in the OECD.
- **High Incidence of low pay:** More than 20% of people in employment earn less than 2/3rds of the average wage, one of the highest rates in Europe.

While taxes and social welfare play a major role in reducing market inequality, this high dependence on tax and social welfare to make up for low market incomes diverts resources from key public services and is unsustainable in the longer term.

Therefore reducing inequality of earnings and stemming a rising incidence of low pay are key challenges to be addressed to avoid the negative societal impact of economic inequality and to enable greater resources to be invested in key public social services.

The minimum wage is an important tool in addressing market inequality. In order to be effective it must be close to a Living Wage and the Low Pay threshold. TASC's research, based on the best available data both nationally and internationally, finds that as it currently stands the Irish Minimum wage is well below both of these targets.

If Ireland had a minimum wage that was equal to a Living Wage there would be close to an additional €1 billion spending in the local economy by people currently on low incomes.

TASC recommends that the Minimum Wage be tracked against median earnings and the cost of living. We urge the Commission to consider the findings of the Irish Living Wage Technical Group, and to find ways to bring the Minimum Wage incrementally into line with the a calculated Living Wage over the course of a number of years.

## **Introduction**

Real economic development has occurred in Ireland in the last three decades which, along with technological advancements, has helped bring a higher standard of living across society.

However, not everyone has benefited to the same extent from economic advancement. Along with economic growth we have seen a rise in economic inequality in Ireland. Addressing economic inequality is important because it has been demonstrated that more equal societies perform better on a whole range of social indicators such as crime, health and educational attainment<sup>2</sup>. There is also increasing evidence that more equal societies are economically more stable and have better chances of stronger and more sustained economic growth.

Economic growth has long been presented as a solution to all economic problems. Yet the unequal distribution of the benefits of growth and the negative impact of rising inequality suggest that growth alone is not sufficient to ensure prosperity for all.

The necessity for a minimum wage in most advanced economies is a recognition that a 'free market' for wages does not result in an optimal outcome for the economy or for society.

Reducing economic inequality takes account of new thinking in economics that is focused more on the distribution of resources, and less on measurements of growth like Gross Domestic Product (GDP). The Organisation for Economic Co-operation and Development (OECD), World Bank, International Monetary Fund (IMF), International Labour Organization (ILO), World Economic Forum (WEF) and other international bodies have all recognised the rise of economic inequality as a challenge to be addressed.

All advanced economies are experiencing the same pressures that lead to growing inequality. These include: widening wage gaps, technological change, changes in household structure and increased international financial flows.<sup>3</sup>

However, inequality is not inevitable and levels of inequality are not the same in every developed country. Economic and social policy choices, including income policies, those relating to taxation and the provision of public services, can produce better outcomes.

Nor is there a trade-off between reducing inequality and achieving better economic growth. Indeed there are strong arguments to show that more equal societies have stronger and more sustainable economies. The minimum wage therefore is a significant tool if we wish to address economic inequality and if we wish to ensure the ongoing sustainability and public confidence in the market system.

## **Low pay and economic inequality in Ireland**

One of the key drivers of rising economic inequality is low pay. As TASC has shown through its recent publication "*Cherishing All Equally: Economic Inequality in Ireland*"<sup>4</sup> low pay is particularly relevant in Ireland where the inadequacy of universal public services and the high charges for services (such as GP visits, childcare and eldercare), along with a cost of living that is 20% higher than the EU average<sup>5</sup> means that cash income is even more important in Ireland than it would be in other countries.

## **The Problem of Economic Inequality**

### ***Economic instability***

Economic inequality has been identified by many political and economic leaders as among the most pressing problems facing advanced economies. There is growing awareness that inequality undermines economic performance, and was one of the causes of the financial crisis.

The World Bank has stated: “We now know that nations with a widening gap between those who can and cannot access opportunities in life have difficulty sustaining economic growth and social stability over time. To date, no country has managed to transition beyond a middle-income status while maintaining high levels of inequality.” The CEO of Goldman Sachs, Lloyd Blankfein has warned that economic inequality is “destabilizing” and has undermined the ability of the USA to legislate to deal with problems. He has stated that “Too much of the GDP over the last generation has gone to too few of the people.”

### ***Political power imbalance***

Thomas Piketty’s research (amongst others) shows that those in the top one in ten earners are taking an ever greater share of income, even while wages overall are in decline compared to the profits of investors and financiers. The Top 10%, and in particular the Top 1%, have the political power to fight against economic policies that will require them to pay more. This power can be used against attempts to increase the level of tax for those on high incomes, or to reduce their income share.

### ***Pressure on social welfare system***

In order to redress the worst effects of high market inequality, Governments use tax revenue to pay for social welfare payments, including for people who are at work. These are resources that would otherwise be available for improving vital public services and investing in productive activity. Such public investments in infrastructure, spending on health and education, and social insurance provision could reduce inequality and increase growth.

### ***Lack of demand***

Those on low and middle incomes spend proportionately more of their money, which drives the economy and creates jobs. With a declining share going to them (and a greater share going to the Top 10%) we have a problem of a lack of consumption. Globally, the OECD has shown that inequality has led to a fall in the share of economic growth that goes to people at work; for many reasons, from new technologies to the bigger role of finance in the economy. In this way, inequality leads to poverty and social exclusion. But it also lowers demand in the economy in a downward spiral of lost spending.

## Income Inequality in Ireland

Low pay is a feature of rising income inequality. One way of demonstrating the rise of income inequality is to look at the distribution of incomes from the market - including wages, self-employed incomes and investments. When we look these incomes in Ireland over a period of time we see a growing concentration of income in the Top 10%, and in particular the Top 1%.

While average incomes in Ireland have more than doubled since the 1970s in real terms, the average for the Top 10% has tripled and the average for the Top 1% has gone up five-fold (See Chart 1).

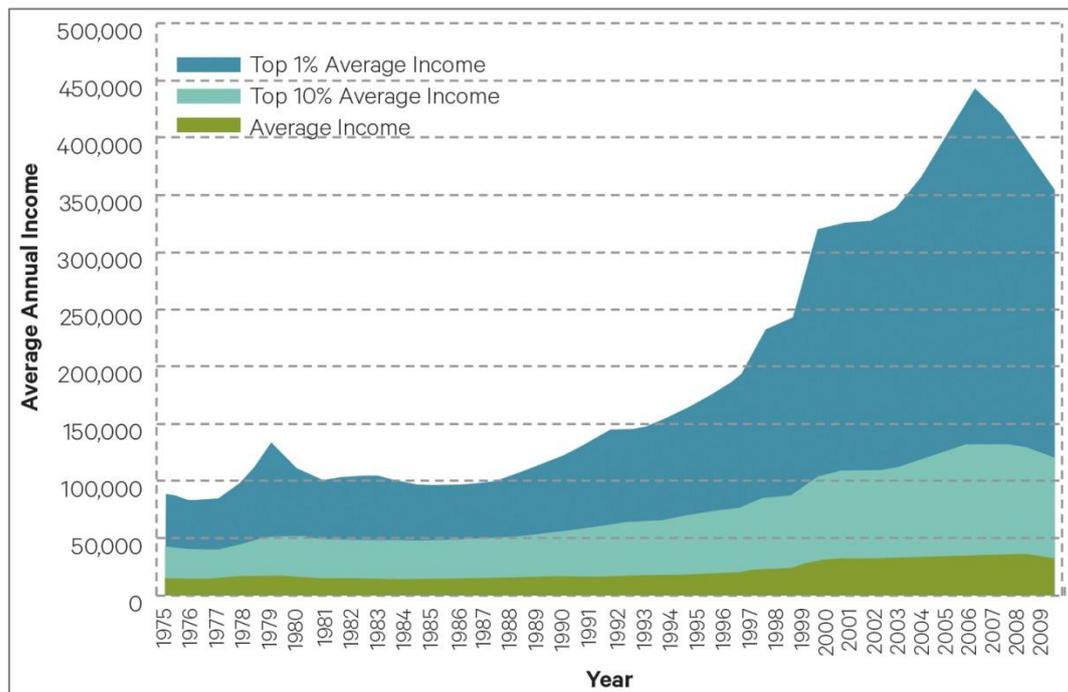


Chart 1: Rising Average Incomes by Tax Unit in Ireland (Source: World Top Incomes Database: WTID<sup>6</sup>)

Those at the top of the income distribution are now getting an ever greater share of the national income. During the period of economic growth from the early 1990s, the share of income earned by the Top 10% in Ireland rose, meaning that the vast majority of people, the 'Bottom 90%' of the population, lost a proportional share of the national income.

The Top 10% in Ireland take a third (34%) of all income, up from 27% of national income in the 1970's. They represent only 12% of the working age population. Correspondingly, the share of income going to the majority of people - the 'Bottom 90%' – has fallen to 66% of all income, down from 72% in the 1970's. (See Chart 2, Green area)

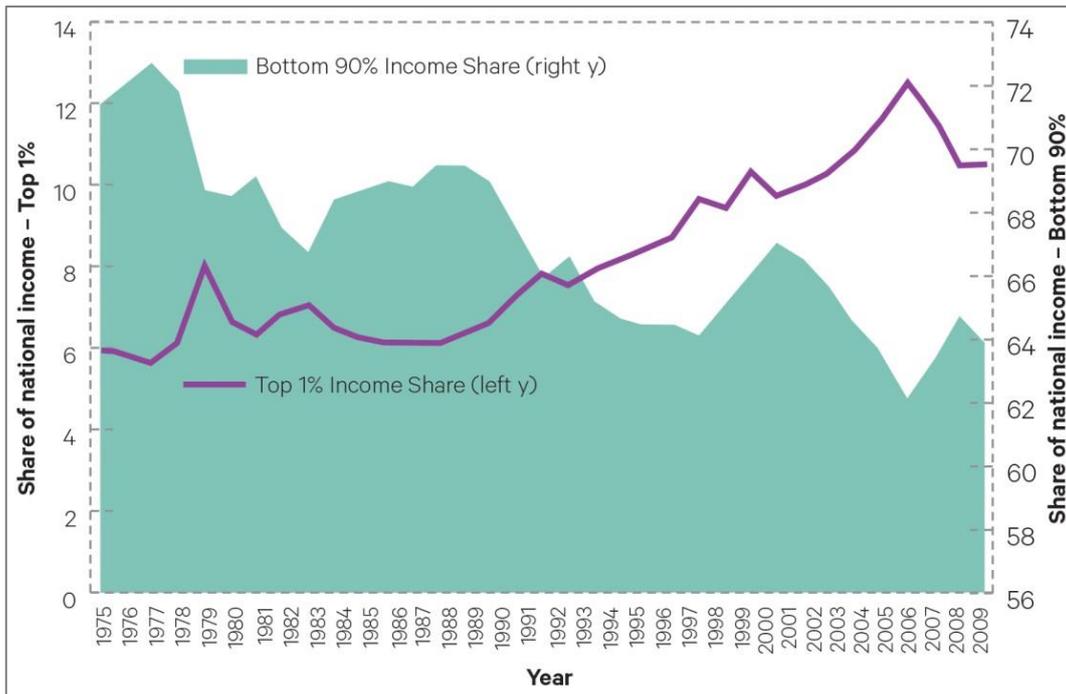


Chart 2: Top 1% Income and Bottom 90% Income in Ireland 1975-2010 (Source: WTID<sup>7</sup>)

At the same time, the Top 1% doubled their share from 6% in 1975 to 12% by 2006 (Chart 2, Purple line).

Ireland is now the most unequal country in the OECD when it comes to market income inequality. This is shown by the Gini Coefficient (a measure of overall inequality) of incomes prior to taxes and transfers (Chart 3).

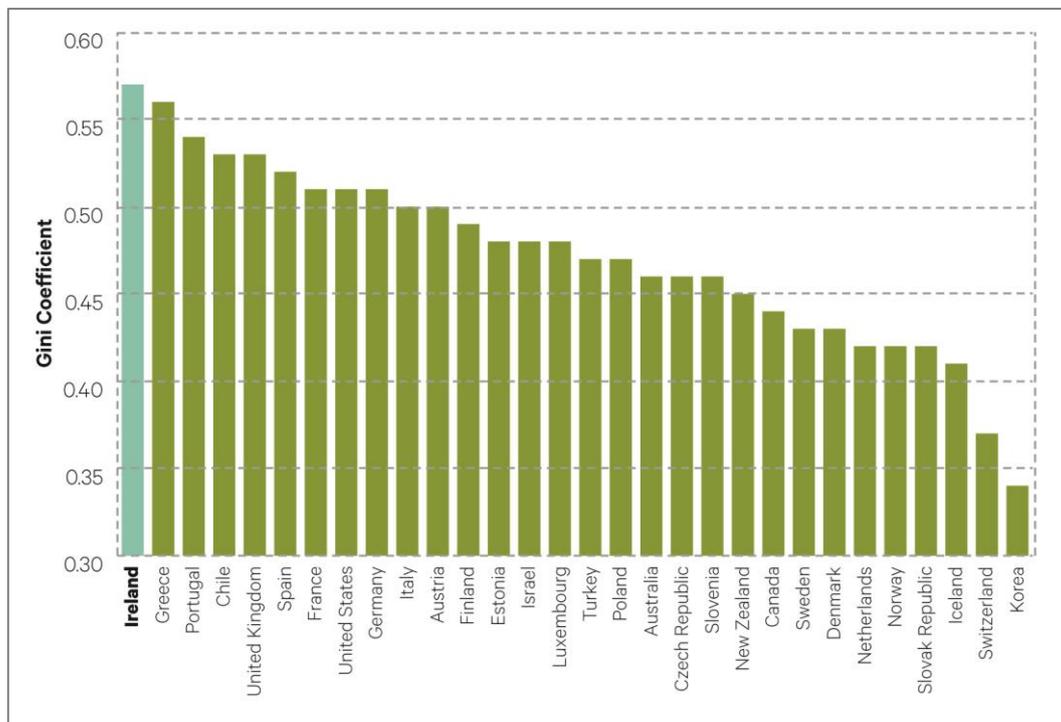


Chart 3: Market Income Inequality (Source: OECD)

## Addressing Inequality

Inequality is not inevitable. The forces that lead to rising inequality are similar for all advanced economies, but inequality does not manifest in the same way in every developed country. This is because countries implement specific policies to address inequality.

As Chart 4 shows, Ireland, Denmark and the USA had similar levels of gross income inequality in the period from 1945 up to about 1980 (as measured by the share of the Top 10%). Since then the three have diverged: in the USA inequality has risen dramatically, while it has fallen in Denmark. Ireland also had rising inequality in that period, though not to the same extent as the USA.

Addressing low pay is one of the key tools for addressing rising market income inequalities.

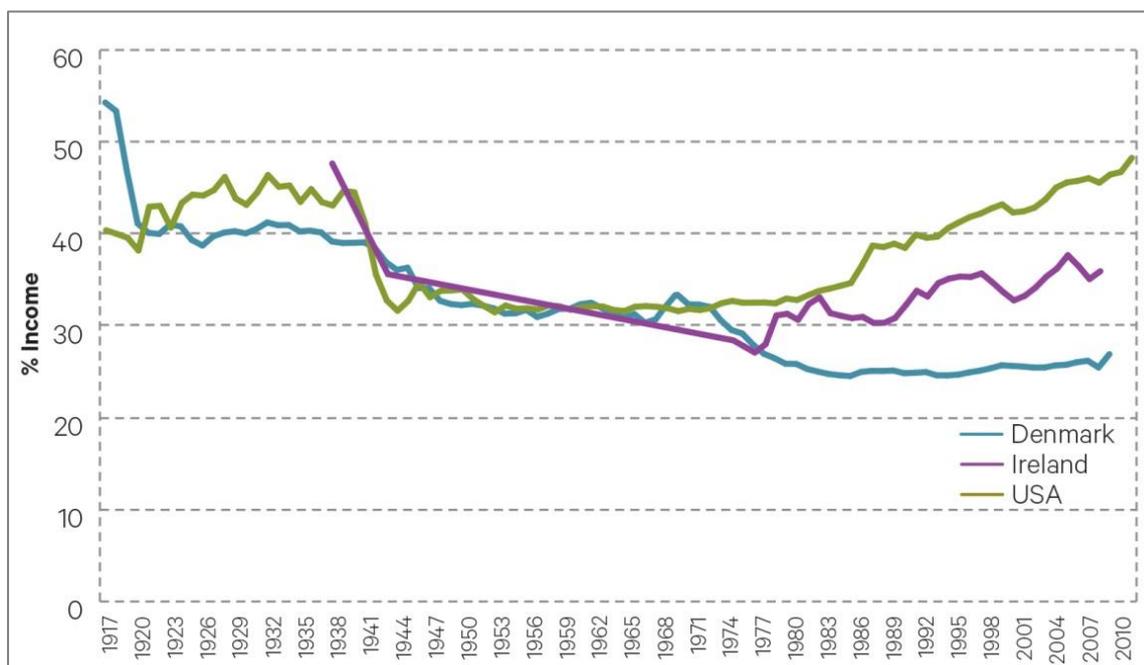


Chart 4: The share of income held by Top 10% in the USA, Ireland and Denmark (Source: WTID<sup>8</sup>)

One of the ways in which Ireland currently addresses high levels of income inequality is through social protection payments. Looking again at the Gini Coefficient, we see that social protection payments bring Ireland from being the most unequal country in the OECD (before taxes and transfers) to around the average when taxes and transfers are included (see Table 1). Note it is the impact of social welfare, rather than taxes, which does most to reduce inequality.

If Ireland confines itself to this model, allowing income inequality to rise, then more has to be spent in social protection payments to bridge the gap.

	Source	Value (Ireland)	Year
<b>Gini before taxes and transfers</b>	OECD	56.8	2011
<b>Gini coefficient before social transfers (pensions included)</b>	Eurostat	53.5	2012
<b>Gini coefficient before social transfers (pensions excluded)</b>	Eurostat	46.0	2012
<b>Gini Coefficient (post taxes and transfers)</b>	CSO	31.2	2012
<b>Gini Coefficient (post taxes and transfers)</b>	OECD	30.2	2011
<b>Gini Coefficient (post taxes and transfers)</b>	Eurostat	29.9	2012

Table 1: Gini Coefficients in Ireland before and after taxes and transfers

The important thing to note is what we are measuring is how hard our social protection system has to work given how unequal our market system is. As an IMF staff paper puts it: “More unequal countries tend to redistribute more”<sup>9</sup>. As inequality rises it gets harder to address inequality in this way and the system become unsustainable.

To really tackle inequality it is important that we address market inequality. To understand the role that low pay plays in perpetuating inequality, we need to look at the reasons why market inequality in Ireland is so high.

### Why is Ireland so unequal?

The reason why Ireland has high levels of market inequality are not widely researched or understood. Here we look at three of the determinants of market income inequality. They are:

- **Employment levels:** the total number of people in employment as a percentage of the adult population. Low numbers in the labour market will lead to higher levels of market inequality.
- **Earnings inequality:** the distribution of incomes for those in work. If these incomes are highly skewed then market inequality will be higher.
- **Incidence of low pay:** Commonly referred to as the number of people in employment who earn less than 2/3rds of the average. If this number is high then market inequality will be high.

### Employment level

The first factor to explain high market inequality in Ireland is Ireland’s low employment levels relative to other countries. With a low employment level, many people have zero market income which leads to high levels of market inequality.

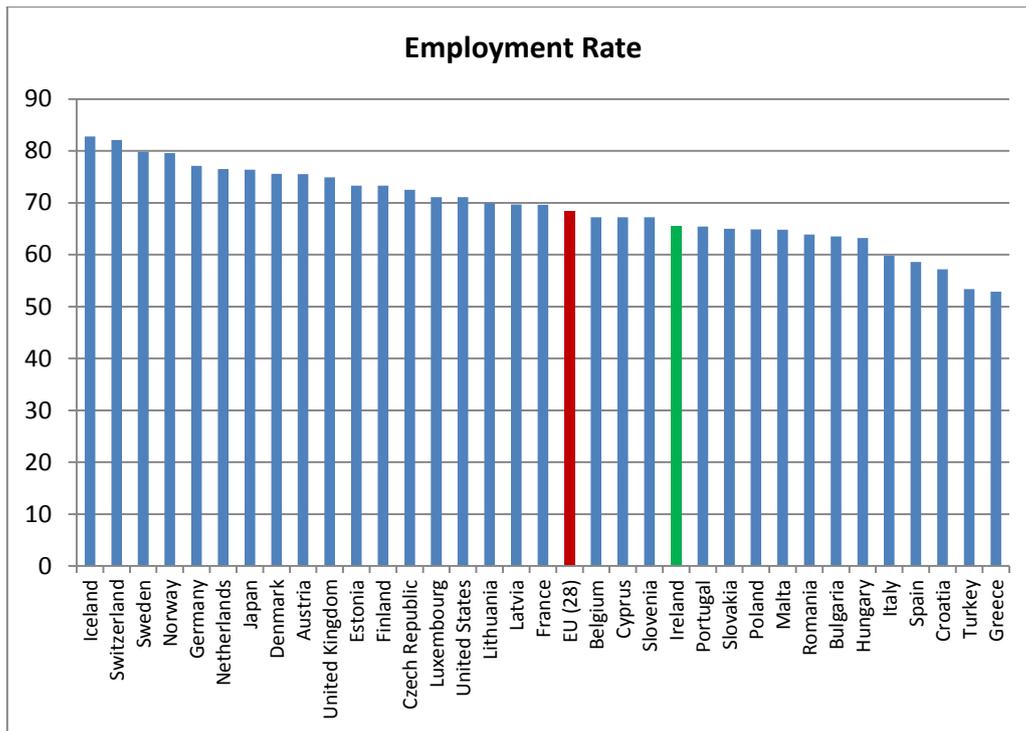


Chart 5: Employment rate in Europe (source: Eurostat)<sup>10</sup>

In total, about two-thirds (65%) of ‘working age’ adults in Ireland are in employment (70% of men/60% of women), below the EU average of 68%, and well below countries like the UK/Netherlands/Denmark (76%) or Sweden (80%).

65% of working age adults equates to just over half (55%) of all adults.

### Earnings Inequality

A second component of market income inequality is earnings inequality, which looks at the distribution of incomes from work (only those who are working are counted). Using data from OECD<sup>11</sup> on earnings we see that Ireland is again among the more unequal countries.

The three measures used in these graphs are the ratios between

- Those at the top (also known as the 90<sup>th</sup> percentile, i.e. the person ranked 90 out of 100),
- Those in the middle (the median, or the 50<sup>th</sup> percentile, i.e. the person ranked 50 out of 100)
- Those at the bottom (also known as the ‘10<sup>th</sup> percentile’, i.e. ranked 10 out of 100)

### The 90/10 ratio (top to bottom)

Those at the Top (90th) earn almost four times those at the bottom (10th), which makes Ireland 7<sup>th</sup> most unequal out of 23 OECD countries<sup>1</sup>.

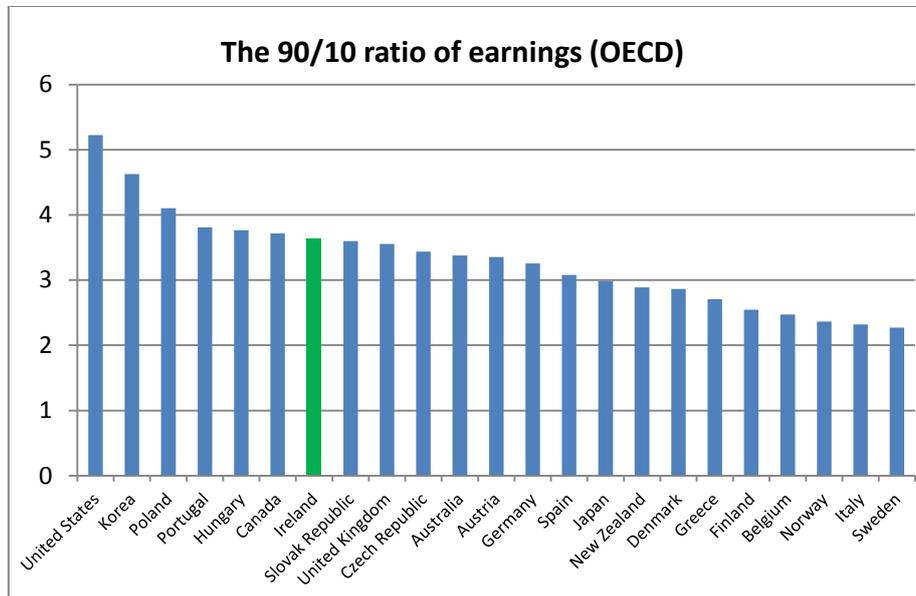


Chart 6: Employment rate in Europe (source: Eurostat)<sup>12</sup>

### The 50/10 ratio (middle to bottom)

Those in the middle (50) earn twice (1.99) what those at the bottom (10) earn. On this measure Ireland ranks 6<sup>th</sup> most unequal out of 23 countries.

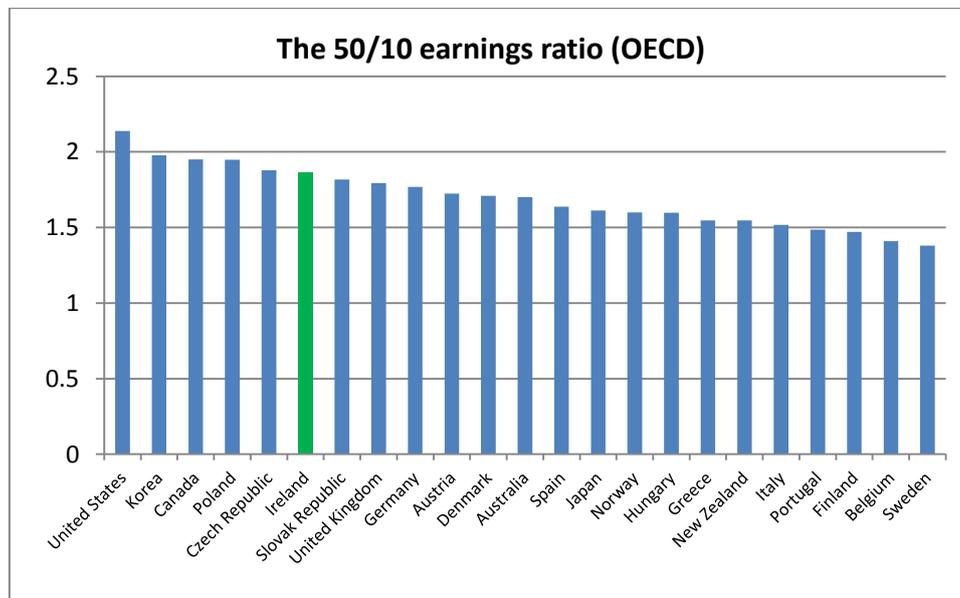


Chart 7: The 50/10 ratio of earnings: This measures the gap between those in the middle and those at the bottom of the earnings distribution (source OECD)

<sup>1</sup> Only 23 of the 33 OECD countries have data on these measures

### The 90/50 ratio (top to middle)

Ireland is slightly more equal when it comes to the gap between the middle and the top (90/50), where we rank in 9<sup>th</sup> place.

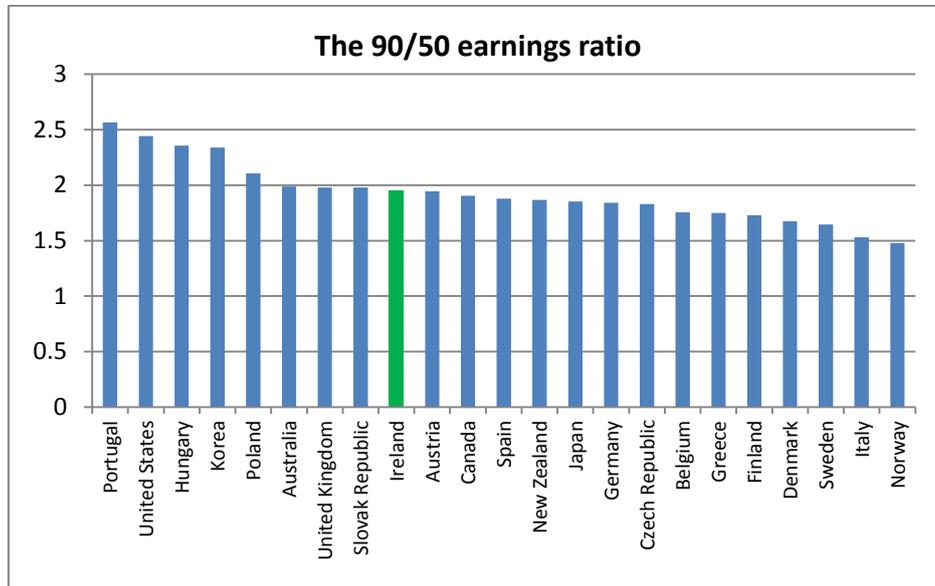


Chart 8: The 90/50 ratio of earnings: This measures the gap between those those at the top and those in the middle of the earnings distribution (source OECD)

### How earnings ratios have changed

Since 2000, the gap between the top and the bottom in Ireland has widened – from a ratio of 3.3 to 3.9 in 2013. The gap between the middle and the bottom has also widened from 1.7 to 2. The gap between the middle and the top however has stayed relatively stable at around 2.



Chart 9: Earnings ratios in Ireland 2000 and 2013 (source OECD)

This would seem to suggest that the rising earnings inequality in Ireland is caused by those in the middle and at the top of the earnings distribution pulling away from those at the bottom.

### Low Pay

Linked to this rising disparity between those at the bottom and those in the middle and at the top is the incidence of 'low pay' in Ireland. Ireland has one of the highest rates of low pay in the EU and the OECD, with more than 20% officially classified as being on low pay. Low pay is calculated as the percentage of full-time workers earning less than  $\frac{2}{3}$ <sup>rd</sup>s of median earnings for full-time workers. The threshold for low pay in Ireland is €12.20 per hour.

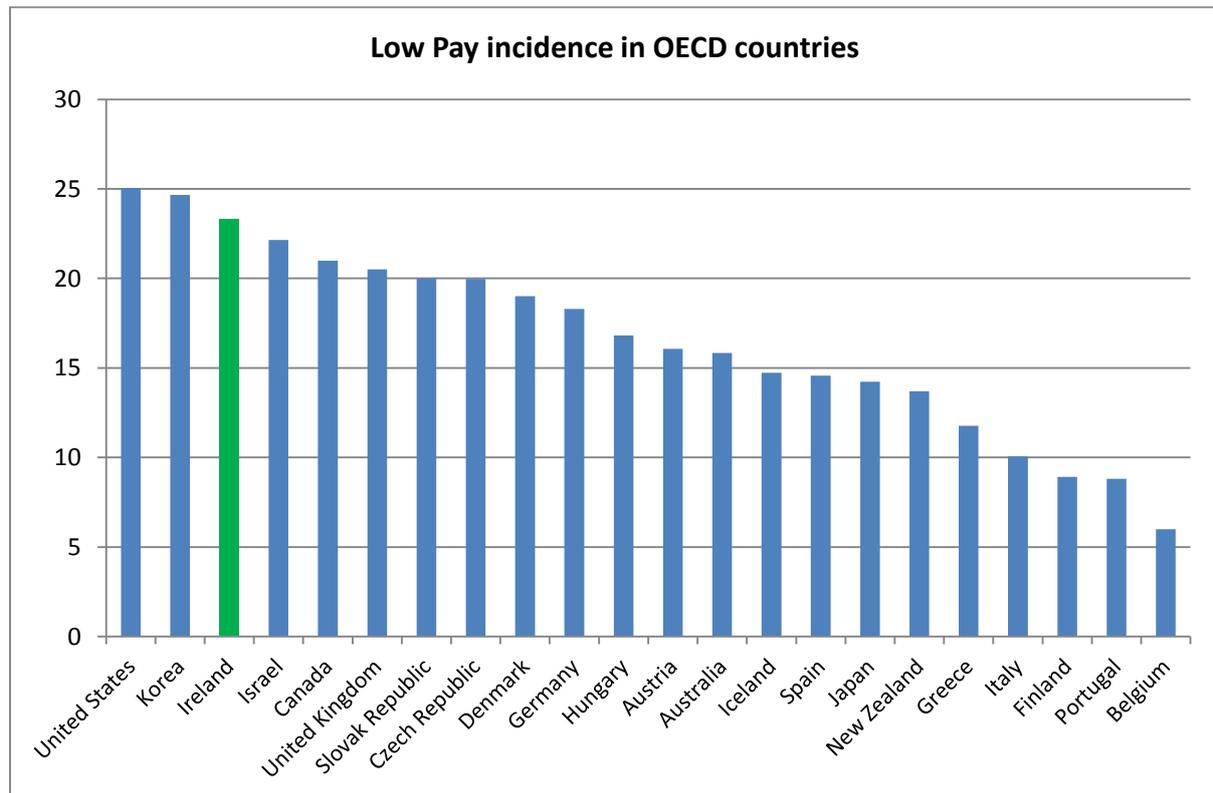


Chart 10: Low Pay incidence in OECD countries (source OECD)

Along with rising inequality, we can also observe that the incidence of low pay is rising more quickly in Ireland compared to other OECD countries, climbing almost continuously since the year 2000.

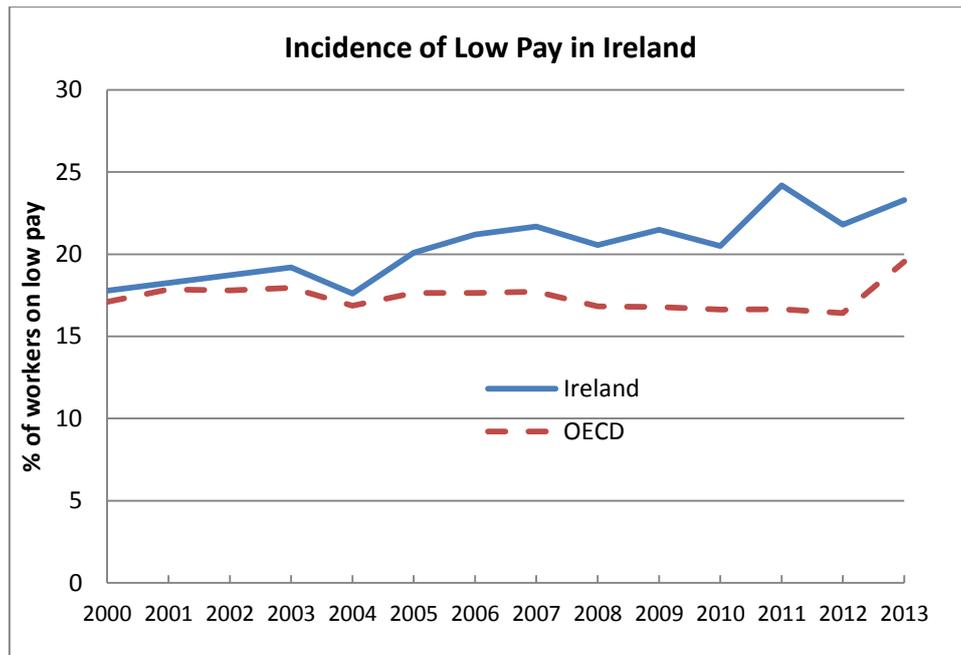


Chart 11: Low pay in Ireland and OECD 2000-2013<sup>2</sup>

### The role of minimum wages in addressing inequality

Minimum wages can play an important role in reducing inequality and in supporting the wages of low-paid workers. In particular, the minimum wage is important in order to address the gap between those on low incomes and those on middle and high incomes<sup>13</sup>.

It has been claimed by some that raising the minimum wage would lead to a loss of employment. However, recent research, new studies and meta-analyses of earlier studies from both the UK<sup>14</sup> and the US<sup>15</sup> show minimum wages either have no negative effects on employment levels or have very small effects.

As the international Labour Organisation (ILO) puts it:

*“With 64 studies containing approximately 1,500 estimates, we have reason to believe that if there is some adverse employment effect from minimum-wage raises, it must be of a small and policy irrelevant magnitude.”<sup>16</sup>*

Increasing the minimum wage can also lead to a significant boost to consumption, one of the key drivers of the economy. There is significant research to suggest that increasing wages at the bottom boosts consumption and has a positive impact on economic growth and further employment<sup>17</sup>.

It is possible to estimate the effect of raising the minimum wage on consumption in Ireland by looking at the difference between the minimum wage and a calculated ‘Living Wage’.

<sup>2</sup> Note: The OECD figure is calculated as an average of countries where data is available. It is not adjusted to reflect the size of the countries, and as such is not an average for the OECD as a whole.

## **The Living Wage in Ireland**

A 'Living Wage' is based on the idea that work should provide people with the means to afford a socially acceptable standard of living. In Ireland there is no officially acknowledged living wage. However through focus group research it is possible to establish a consensual 'Minimum Essential Standard of Living'.<sup>18</sup>

On this basis the Vincentian Partnership for Social Justice (VPSJ), have calculated that for a single person to meet this standard they would need to earn between €390 and €480 per week (depending on location).

Consequently, the Living Wage Technical Group, which includes TASC, NERI, Social Justice Ireland, UNITE and VPSJ, calculate that a national living wage for a single person is €11.45 per hour based on a full-time job. This is €2.80 (or 32%) higher than the current minimum wage of €8.65.

Because it is based on the cost of living, incorporating the actual cost of goods of agreed upon items, it shows the extent to which those earning below a Living Wage are going without essential goods. This reduces the quality of their lives and is spending lost to the economy, as it can be assumed that any increase in money will lead to consumption to meet those essentials.

This gives an indication of the potential lost spending. It is estimated that 345,000 employees in Ireland earn less than a Living Wage.<sup>19</sup> Assuming that the average increase to reach the living wage was €1.40 per hour (€280/2), this equates to €2,730 per employee per year.

For all employees below the Living Wage that is €942m per year in lost spending power, money that would be spent in the local economy to drive consumption and employment.

## **The minimum wage, living wage and average wages**

Chart 12 shows the highly skewed nature of incomes in Ireland.

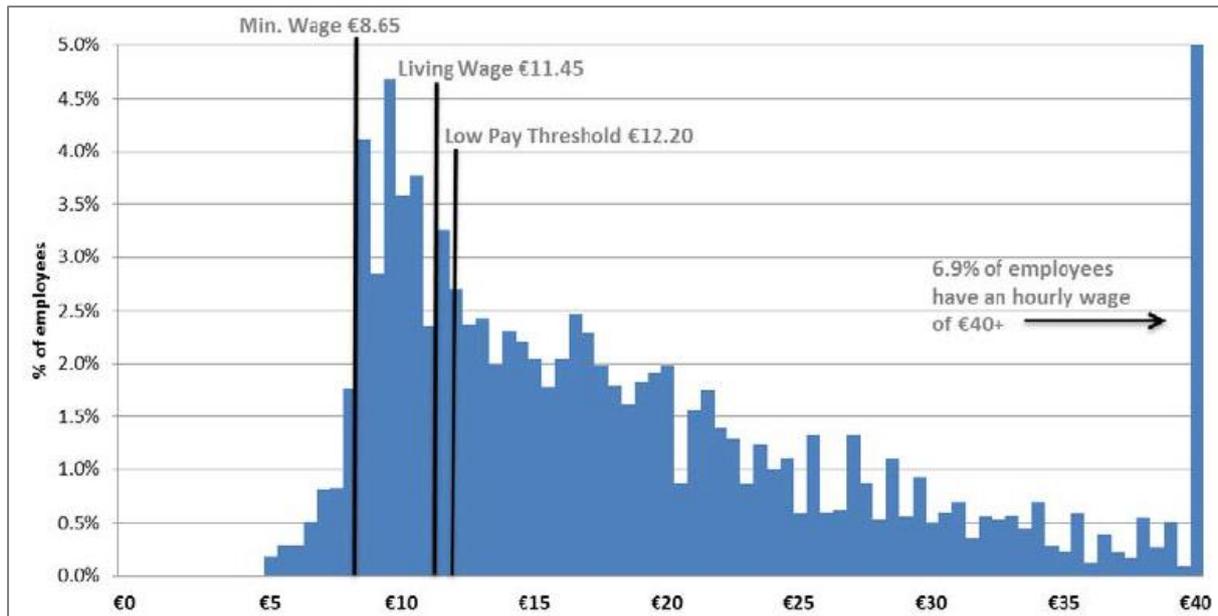


Chart 12: The Distribution of Earnings in Ireland (Source: NERI<sup>20</sup>)

While the ‘average’ employee earns €20.63 per hour, half of employees earn less than €16.62 per hour<sup>21</sup>.

The minimum wage provides an effective floor under which very few workers can fall. Yet the high numbers of people immediately above the minimum wage threshold but below a ‘Living Wage’ or a ‘Low Pay’ threshold shows that the minimum wage needs to rise in order for the minimum wage to reduce inequality and promote economic growth.

### Working Conditions

Many countries have seen a growth in jobs where workers are badly paid, subject to arbitrary discipline and have little job security. The rising number of the ‘working poor’ (particularly in the UK and the USA) has undermined the belief that employment of any kind is always the best cure for poverty.

What appears to be happening in many countries is a growing polarisation of employment: the middle is ‘hollowed out’, while the number of jobs grows at the top and the bottom of the occupational structure.

The issue of ‘Low Pay’ goes further than just the remuneration that people receive. It is also important that we understand the nature of the work that people are undertaking and the conditions of work.

There is a growing concern at the prevalence of ‘zero-hours’ contracts, where employees are required to be available for work, but are not given specified or guaranteed hours of work. The Department of Jobs Enterprise and Employment have launched a study (to be carried out by researchers at Kemmy Business School, University of Limerick) to investigate the prevalence of such contracts in Ireland.

TASC is currently conducting research looking at the changing nature of work in Ireland, particularly at the extent that Ireland is experiencing a 'hollowing out' of the occupational structure. In addition, the research project will look at what is happening 'inside' jobs: the extent to which jobs have become more insecure and workers more subject to arbitrary management decision.

The project will use a version of the 'job quality index' comprising six dimensions: wages, non-standard employment, working time and work-life balance, working conditions and job security, skills and career development, and collective interest representation.

This work will be carried out in 2015 under the leadership of Prof. James Wickham. The findings will be made available to the Low Pay Commission for consideration upon completion in early 2016.

## **Recommendation**

Economic inequality is a real and growing threat to Ireland's economy and the quality of life of hundreds of thousands of people. Ireland has large income disparities and a high instance of low pay. This is coupled with the absence of some vital universal services, high charges for public services, and a cost of living that is 20% higher than the EU average. It is vital that Ireland has policies that address this threat.

Research shows that low pay is one key driver of economic inequality in Ireland. Earnings inequality is amongst the highest in the OECD, with those in the middle and at the top pulling away from those at the bottom. As a result, Ireland has one of the highest rates of low pay, a rate that has been rising steadily since the turn of the century.

The minimum wage can be an important tool in addressing low pay and market inequality, while improving the quality of life for significant portion of the population. But in order to be effective it must be close to a Living Wage and the Low Pay threshold. Our research finds that as it currently stands the Irish Minimum wage is well below both of these targets. The current Minimum Wage is 75% of a calculated Living Wage.

Therefore the current Minimum Wage is not sufficient to meet a minimum living standard, and we recommend that it should rise to meet the Living Wage over time.

We find that moving towards a Living Wage would increase spending by those on low incomes by €942m per year. This would have positive effects on the economy, which will in turn boost consumption, employment and tax revenue, while addressing one of the root causes of rising economic inequality.

## Notes and Sources

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- <sup>1</sup> International Labour Organisation (ILO) [http://www.ilo.org/global/publications/books/WCMS\\_324678/lang--en/index.htm](http://www.ilo.org/global/publications/books/WCMS_324678/lang--en/index.htm)
- <sup>2</sup> Pickett and Wilkinson (2009) *The Spirit Level* <http://www.equalitytrust.org.uk/about-inequality/spirit-level>
- <sup>3</sup> The Organisation for Economic Co-operation and Development (OECD) <http://www.oecd.org/social/soc/dividedwestandwhyinequalitykeepsrising.htm>
- <sup>4</sup> TASC 2015 *Cherishing All Equally* <http://www.tasc.ie/researchpolicy/projects/cherishing-all-equally/>
- <sup>5</sup> [http://ec.europa.eu/eurostat/statistics-explained/index.php/Comparative\\_price\\_levels\\_of\\_consumer\\_goods\\_and\\_services](http://ec.europa.eu/eurostat/statistics-explained/index.php/Comparative_price_levels_of_consumer_goods_and_services)
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