Who really pays?

Why increasing Newfoundland and Labrador's minimum wage could do more harm than good

NEWFOUNDLAND & LABRADOR EMPLOYERS' COUNCIL

SUBMISSION TO THE 2012 NEWFOUNDLAND & LABRADOR MINIMUM WAGE ADVISORY COMMITTEE

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About the NLEC

The Newfoundland and Labrador Employers' Council (NLEC) advocates on behalf of employers on matters that enhance their ability to contribute to the economic growth and prosperity of Newfoundland and Labrador. Our membership employs more than 50% of the private sector workforce in this province. The organization is widely recognized as the lead business advocate on employment legislation in the province.

The NLEC is pleased to have the opportunity to offer recommendations to the minimum wage advisory committee.

INTRODUCTION

Historically, increases in minimum wage, in both Newfoundland & Labrador and in other jurisdictions, have been portrayed by government as a positive move for their constituency – a way to address poverty or look out for the "little guy", with little to no negative consequences. Advocates for minimum wage increases profess that such increases are beneficial to the labour market and have a positive impact on the economy.

This is simply not the case.

While the negative impacts of minimum wage increases may not be immediately visible to the public, over the medium to long term those negative impacts are unmistakable. As labour costs increase, it becomes more and more economical for the employer to shift from using labour to using more capital. Employers automate functions of the business or implement administrative changes to save costs. This shift from labour to capital happens gradually and over a longer time frame. It becomes more economical to implement self serve gas pumps and checkouts, for consumers to bus their own tables at fast food restaurants and fill their own drinks at machine, and for computerized machinery to do a thousand different functions such as stuffing newspapers or sending faxes, than it is to hire a person to do the same job.

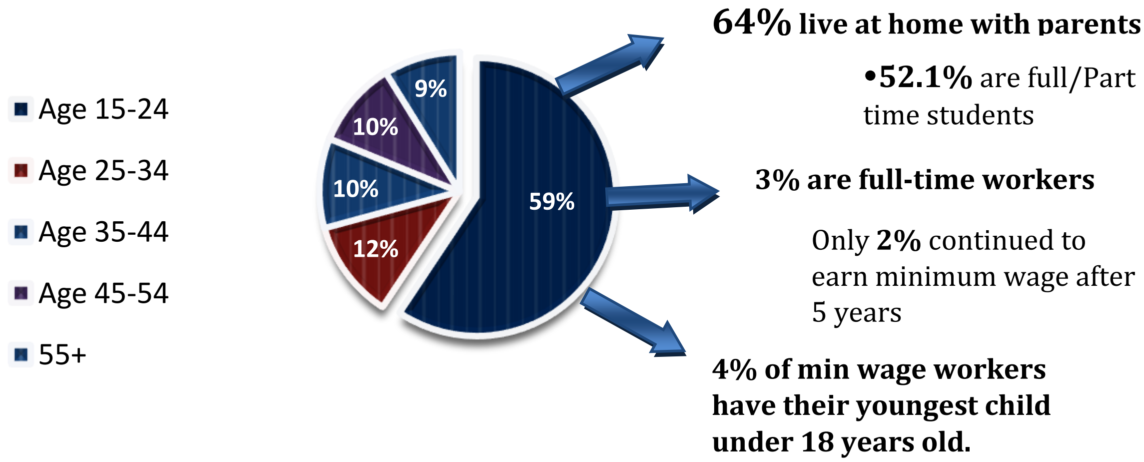
These negative impacts are intensified by large increases over short periods of time like the one recently implemented by the Government of Newfoundland and Labrador. Over a five year period the minimum wage was raised by an astounding 67%. Employers were forced to absorb this significant increase in wages and the accompanying increased payroll taxes in any way they could. The employer community has seen the negative impacts first hand. The impacts of this rapid and significant increase are still being felt and are reflected in the province's dismal youth unemployment rate, the highest of any province in Canada.

Moving forward, our province needs to base its minimum wage public policy more on fact and research and less on public perception. Short of government doing this, employers need some protection from the extremes of minimum wage increases like the 67% just experienced. Such an increase is extreme by any standard; therefore, some additional safeguards must be put in place to protect jobs and the economy from similar decisions.

WHO IS THE TYPICAL MINIMUM WAGE EARNER?

According to Statistics Canada, minimum wage earners in Newfoundland and Labrador represent a small portion of the total workforce, approximately 9.3%. The actual composition of this group of workers differs significantly from the rest of the workforce (Figure 1).

Figure 1: Minimum Wage Workers By Age Group



Source: Statistics Canada, Perspectives on Labour and Income (2010)

The typical minimum wage earner is a student living at home. The liklihood that he or she has a child at home is only 4%. As a student earning minmum wage, they work part time hours and this job is likely to be one of their first jobs. This employment is used to gain valuable work experience and skill development that will enable him or her to demand a higher wage. The likelihood that he or she will still be earning minimum wage after five years of employment is only 2%.

Minimum wage positions are entry-level stepping stone positions. They are offered by employers as opportunites for unskilled or low skilled workers, who otherwise wouldn't get that employment opportunity. Minimum wage positions offer these low / unskilled individuals the opportunity to gain valuable work experieince, development of skills and the opportunity to move on to higher paying jobs. They are doorways to higher incomes.

As the next section will demonstrate, legislated increases in the wage rates for this group limits the number of these valuable opportunities for this unique subset of the workforce.

WHO PAYS FOR THAT MINIMUM WAGE INCREASE?

The impact of an artificial increase in the wages paid to workers will have short, medium and long-term negative impacts. The consequences of that legislated wage rate are often larger than anticipated, unintended and impact groups not part of the employment relationship.

A. Minimum wage earners pay for that increase

The economic impact of minimum wage increases is one of the most studied of all public policy issues. The preponderance of evidence clearly demonstrates that increases in minimum wage reduce employment levels among those who earn minimum wage. The only question is the extent of that employment reduction.

Gunderson 2005

In Morley Gunderson's 2005 report to the Federal Labour Standards Review Commission, he analyzed 23 Canadian studies on the effects of minimum wage increases. Gunderson found an overall adverse affect of minimum wage increases. He indicated that a 10% increase in the minimum wage leads to a 3%–6% reduction in the employment of teens.

Baker 1999/ Baker 2005

In Bakers 1999 study, they analyzed data subsets across all provinces from 1975–1993. Their findings concluded a 10% increase in the minimum wage would decrease employment for teenagers (age 15-19) by 2.4%–4.4%
In an expansion of their previous study, they added the subset of young adults (age 20-24) & used all provinces from 1983-2000. Their results found that a 10% increase would decrease employment for teenagers by 3.23%-5.72% and 0.92%-1.95% for young adults.

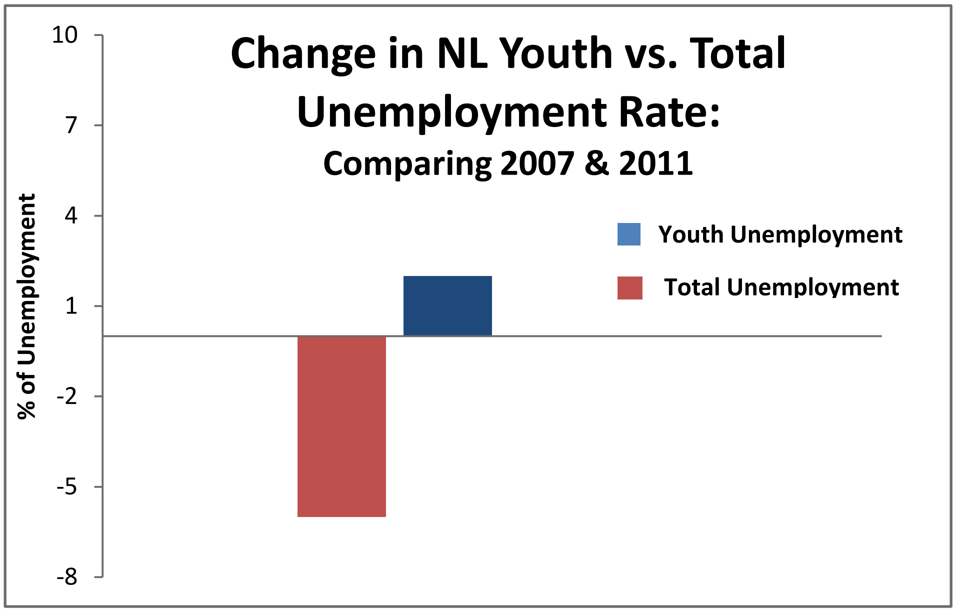
Capolieti et al 2006

Building on their previous study in 2005, they analyzed data from all provinces from 1981–1997. They found that increasing the minimum wage by 10%, would decrease employment in teenagers (age 16-19) by 2.5%-4.2%, in youth (age 20-24) by 1.4%-2.7%, resulting in a combined decrease of 2.6%-4.4%.

As Gunderson noted, "More recent studies using different and more sophisticated methodologies as well as more recent data find larger adverse employment effects at the higher end and beyond the consensus range." He solidified this notion stating, "[The] fact they use different data sets and methodologies suggest that these results are robust." (Gunderson 2005:44)

An examination of our provincial unemployment rates for youth (our typical minimum wage earner) and the unemployment rate for our population overall supports the conclusions of minimum wage economic theory.

Figure 2: Change in youth unemployment rate vs. overall unemployment rate 2007 – 2011



As of April 2012, our province's youth unemployment rate is at 20.2%, startlingly higher than any other province in Canada. At a time when the unemployment rate in Newfoundland and Labrador is at an all time low and has been dropping steadily for the last number of years, our youth unemployment rate is bucking this trend (figure 2). Between 2007 and 2011, total unemployment in our province decreased by 6% but youth unemployment actually **increased** 2%.

Economic theory and evidence both support decreasing employment opportunities for Newfoundland and Labrador's youth as a result of minimum wage increases in our province.

B. Those living below the poverty line pay for the increase

The most commonly cited reason for increasing minimum wage is poverty reduction. Unfortunately addressing the important goal of eliminating poverty by forcing employers to pay higher wages is much too simplistic a solution and ignores the fact that employers can and will adjust to such artificial wage increases. That adjustment often leaves fewer employment opportunities for those living in poverty, as is the case for students.

Sen et al 2011

In "Teen Employment, Poverty and the Minimum Wage: Evidence from Canada," a study of all the Canadian provinces was conducted using data spanning 1981-2004. Further, a 10% increase in the minimum wage will also increase the poverty gap, with a 4%-6% increase in the percentage of families living under Low Income Cut Offs.

Gunderson 2005

Morley Gunderson's 2005 report concluded that minimum wage is ineffective in alleviating poverty and in specific instances can increase poverty. Gunderson noted that minimum wage does not target the needs of the poor efficiently because many of them are not actively employed and those that are, often work only a few hours.

Minimum wage as public policy tool to address the issue of poverty in Newfoundland and Labrador is, at best, a blunt instrument. In most cases, minimum wage increases do more to limit employment opportunities than to provide ladders out of poverty. If the true goal is poverty reduction, then other, more direct policy initiatives are more effective in achieving positive results.

C. Consumers pay for that increase

Another impact of legislated increases in minimum wage is inflationary pressure on goods and services. This occurs as employers attempt to pass the wage increase on to customers. Those, whom the minimum wage is intended to help, end up having to spend more on goods and services as a result of the increase. Harder hit still are those on fixed incomes, specifically the elderly, pensioners, and individuals on social assistance who cannot negotiate higher levels of income.

Deere 1998

American economist Donald Deere indicates that increases to the minimum wage can adversely affect low income families because of the inflated costs of goods and services.

"To add insult to injury for low-income families, the minimum wage increases the cost of the goods and services produced with low-wage labour - goods and services that are purchased disproportionately by low income families. Almost one-half of all low-wage workers are employed in the retail sector, which means, for example, that part of what an increase in the minimum wage does is take money from the pockets of the people in front of the McDonald's counter to put in the pockets of the people behind the McDonald's counter." (Deere 1998:2)

D. Our economy pays for that increase

Minimum wage increases make no distinction between businesses that are profitable and business that are not. The ability of a business to deal with the negative impacts of a minimum wage increase can be quite varied and depending on the individual situation, may even contribute significantly to a business's demise.

Loss of sales – inability to increase prices

As demonstrated earlier, increases in minimum wage cause employers to attempt to pass on the cost of the increase to consumers; however, this is not always possible. Products and services purchased with disposable incomes like fast food and retail (industries with minimum wage employment opportunities) are very sensitive to price increases. Customers will not readily accept price increases and will either do without the item or substitute a lower cost item (economic theory of elasticity of demand).

The three top selling products in convenience retail for the province are alcohol, lottery, and tobacco, all of which have regulated prices. These business owners have no way to pass on increased labour costs on these highest volume items resulting in a direct negative impact on the success of those businesses.

Fixed term contracts

Past increases in minimum wage had unavoidable impacts on businesses involved in servicing fixed term contracts. No company in the province could have anticipated that minimum wage would increase 67% over a five year period and as a result, many contracts did not reflect these rapid increases. These firms were legally bound by these contracts (many with government) regardless of their impact.

Many businesses are currently projecting labour costs in order to bid on future projects. Even if government announces a schedule of minimum wage increases, firms with contracts of 3-5 years have no ability to adjust over the duration of the contract.

Minimum wage is more than a minimum – it's a benchmark

Minimum wage impacts a significant portion of wage earners in the province who earn above the minimum. Minimum wage is used, intentionally or unintentionally, as a benchmark for many wages in the province. Increases in minimum wage place pressure on employers to maintain the separation between minimum wage and wages paid above that minimum. An example of this effect is evidenced by a February 16th, 2007 front-page story in the Telegram entitled, ***"They're cheating me"*** where an employee complains of his employer not maintaining his separation with the minimum wage benchmark. The NLEC estimates that 27% of the provincial workforce has a wage tied to minimum wage although other estimates put this figure much higher. The benchmarking effect is intensified the higher the minimum wage is set and the faster it is increased.

Few people in the general public expect minimum wage legislation to be used as a tool for higher wages in unionized environments but it is. Rapid increases in minimum wage enhance expectations of wage separation when collective agreements come up for renegotiation every 3 – 4 years. Unions and their members expect, and use, minimum wage increases over the term of the agreement to negotiate similar wage increases for all union members. It is cited as a time to "catch up" with the percentage increases experienced by minimum wage earners. An example of this is the last contract negotiation between NAPE and Marble Mountain Corporation.

The NLEC submits that minimum wage increases under the Labour Standards Act were never intended to have such far-reaching impacts, especially in unionized environments.

Government as an employer

Government, as an employer, is also impacted by minimum wage increases. As an example, the Home Support sector, which is funded in large part by government, consists of a large workforce being paid minimum wage or close to minimum wage. Increases in minimum wage put direct pressure on government's ability to pay for these types of public services.

Increasing payroll taxes

An increase in minimum wage is not just an increase in the hourly rate. Increases in the minimum wage also mean increases in government payroll taxes including WHSCC employer insurance premiums, employer contributions to EI, CPP, and the Health and Post Secondary Education Tax (HAPSET).

In addition, because the HAPSET is only applied to payrolls above $1.2 Million, increases in minimum wage could push some employers above that threshold and make them susceptible to a tax they didn't previously pay.

E. Rural communities pay for that increase

The impact of an artificial increase in the wages paid to workers (minimum wage legislation) will have different negative impacts in areas with high and low unemployment. According to Morley Gunderson's 2005 report to the Federal Labour Standards Review, the impact in urban areas with low unemployment rates is typically a reduction in the **rate of growth** of employment for minimum wage earners. In rural areas with high unemployment rates, the impact is likely a decrease in the **current jobs** available for minimum wage earners.

Government's consideration of the impact of minimum wage must recognize that such legislation is applied equally to all areas of the province – those with strong economic activity and those with poor economic activity. Any minimum wage increase will have a greater negative impact on rural communities than it will on urban communities. Both areas will be negatively impacted but the impact will be much more severe in rural parts of the province.

THE NLEC FUNDAMENTAL POSITION:

Given the overwhelming weight of economic evidence indicating minimum wage increases have significant negative impacts on jobs and the economy, the NLEC is fundamentally opposed to any increase in minimum wage.

THE NEED FOR LEGISLATIVE SAFEGUARDS TO PROTECT JOBS AND THE ECONOMY

To the NLEC's knowledge there was no assessment of what government's recent 67% increase in minimum wage would do to jobs and the economy of the province. Implementing a 67% forced wage increase over a five year period without a detailed analysis of the micro and macro economic impacts was a dangerous public policy decision.

The current system of reviewing minimum wage every two years after the last minimum wage increase, is problematic for business and creates uncertainty among the employer community. With no consistent method of determining minimum wage, employers are unable to plan for or forecast payroll costs in the near to medium term. No increase in minimum wage followed by a rapid 67% increase, is much more detrimental than smaller increases over a much longer period of time and more reflective of the economic environment.

If government insists on minimum wage increases then the NLEC recommends legislative mechanisms to make increases gradual, realistic, and preceded by adequate warning.

Recommendation A: If government ignores the negative economic impacts of minimum wage increases and chooses to increase the minimum wage rate, then that increase must be gradual, based upon economic conditions, and preceded by a significant notice period for employers.

The need for a ceiling

Some jurisdictions have attempted to create legislative safeguards against extreme increases in minimum wage by linking minimum wage public policy to an economic indicator such as the Consumer Price Index (CPI). However, there is significant risk in utilizing CPI increases as a ceiling for minimum wage increases. Many of the components of CPI are considered volatile and fluctuate wildly based on short-term environmental impacts. To be useful, inflationary measures need to be considered over a period of several years or at a minimum, volatile indicators need to be removed from the measurement. A ceiling established based on CPI would likely be above core inflation. Indicators like the Bank of Canada's Canadian Core Index (CPIX) would provide a much more realistic and accurate tool in establishing a minimum wage ceiling.

Extensive review has proven that the CPIX model demonstrates "superiority on both empirical and theoretical grounds" (Murray, 2008). This model proves advantageous over generic CPI calculations for many reasons. The CPIX is a more accurate model for underlying inflationary pressures, it provides for a more stable operating guide for regulating monetary policy and is easier for clearly communicating data to the general public (Laflèche and Armour, 2010).

Recommendation A.1: ***To ensure that increases are gradual, the NLEC recommends that government's ability to increase minimum wage under the Labour Standards Act be restricted to a ceiling established by the provincial equivalent of the Bank of Canada's Canadian Core Index (CPIX).***

Increases must not be automatic

Government must never view the calculation of a minimum wage ceiling as the amount of a minimum wage increase, only the maximum amount of an increase, if any. Using the provincial equivalent of the CPIX to increase minimum wage at any time but particularly during adverse economic conditions could be disastrous for the province. This is why many provinces, including British Columbia and New Brunswick, deferred planned minimum wage increases during the last economic recession. It is imperative that if government creates a ceiling for minimum wage, that government retain the ability in legislation to implement increases less than the ceiling or forgo any increases at all.

For this reason, minimum wage increases should **never** be automatic in legislation.

Recommendation A.2: ***To protect jobs and the economy, especially during adverse economic conditions, government must maintain the ability in regulation to implement minimum wage increases less than the established maximum ceiling or no increase at all.***

Adequate notice for employers is imperative

Employers must be afforded the opportunity to develop a strategy to deal with any increases in minimum wage. As was stated earlier, the negative impacts of minimum wage are mostly medium to long-term. The earlier the warning to employers that wages will be increased through legislation, the better chance the employer has of mitigating the negative impacts. A long notice period will provide employers the opportunity to gradually increase costs on goods and services to consumers (if possible) and make accurate projections on wages for future expansions, contracts and activities. Long notice periods do not prevent negative impacts, they just permit the employer time to attempt to mitigate their impacts.

Recommendation A3: ***To provide employers time to attempt to mitigate the negative economic impacts of minimum wage increases, the Labour Standards Act must be amended to include a provision for a minimum one year notification period before any minimum wage increase.***

CONCLUSION

The average person, regardless of how much they currently earn, would like to earn more. With no understanding of the impact of legislating wage increases, the general public will perceive increases in minimum wage as a positive, or at best innocuous, public policy move. However, the role of government is to make educated, informed, legislative changes that are in the best long term interest of our province, its economy and its people.

To our knowledge, government undertook no research into what the impact would be on employment opportunities for minimum wage earners, hours of work, costs of goods and services to the public, and overall economic activity in the province prior to its dramatic 67% increase in the minimum wage over five years. The NLEC finds it very disappointing that this analysis would not be conducted when the weight of current economic opinion on minimum wage increases is solidly behind the position that such increases do more harm than good.

A 67% forced increase in wages, together with the accompanying increases in government payroll taxes, is much too drastic a jump by any standard. Given government's past behavior of these extreme increases without study, the employer community is asking for future minimum wage decisions to be based on economic fact or, failing this, greater protection at law from minimum wage increases of such magnitude and in such short time frames.

SUMMARY OF RECOMMENDATIONS

The NLEC Fundamental Position:

Given the overwhelming weight of economic evidence indicates minimum wage increases have significant negative impacts on jobs and the economy, the NLEC is fundamentally opposed to any increase in minimum wage.

Recommendation A: ***If government ignores the negative economic impacts of minimum wage increases and chooses to increase the minimum wage rate, then that increase must be gradual, based upon economic conditions, and preceded by a significant notice period for employers.***

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> **Recommendation A2:** ***To protect jobs and the economy, especially during adverse economic conditions, government must maintain the ability in regulation to implement minimum wage increases less than the established maximum ceiling or no increase at all.***
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> **Recommendation A3:** ***To provide employers time to attempt to mitigate the negative economic impacts of minimum wage increases, the Labour Standards Act must be amended to include a provision for a minimum one year notification period before any minimum wage increase.***

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