



***“ADVERSE CONSEQUENCES OF PROPOSED INCREASES  
IN MINIMUM WAGE”***

**JANUARY 29, 2008**

## **I. INTRODUCTION**

The Newfoundland and Labrador Employers' Council (Council) is the lead business association in the province on matters affecting the employment relationship. Our membership employs more than 50% of the workforce in this province (notably exempt from this group is government who is not eligible for membership in Council). Council is pleased to have this opportunity to provide input into government's consideration of a \$2 increase in the minimum wage to \$10 per hour by 2010.

The Employers' Council prides itself on promoting responsible positions with regard to labour and employment issues – positions that promote not only the good of the individual employer but also the good of the employment relationship as a whole.

Council has serious concerns regarding the proposed increase of \$2 over 2 years. Council is not opposed in principle to increases in the minimum wage. Our concerns involve the substantial rate of increase over too short a period of time, in addition to policy issues associated with this overly aggressive target.

If government is determined to move in this direction, significant steps must be taken to remove and/or mitigate the many significant negative impacts of this policy. The following represents some of the key areas of concern for Council and its membership with government's proposal.

## **II. FORCING MARGINAL BUSINESSES BEYOND PROFITABILITY**

### **a. Two dollars in two years represents significant payroll cost increases**

Employment related costs typically constitute the largest component of a firm's total cost of production. Although wages represent, on average, somewhere around 50% of a firm's total cost, it is not unheard of to have firms with as much as 90% of their total costs attributable to wages. Increases in the minimum wage together with the associated increases in related employment costs such as workers compensation premiums, employer contributions to employment insurance, Canadian Pension Plan, short and long term disability insurance, pension and/or RRSP plan contributions will increase total payroll cost of many firms in this province significantly and will, in some cases, make marginal businesses unprofitable. Although wages are not the only factor that determines the profitability of a firm and whether or not that firm will survive, payroll costs do represent its largest cost.

Government should not underestimate the increased payroll costs that will occur as a result of minimum wage increases. Based on a 25% increase in minimum wage (as is proposed over the next two years) there is likely to be a payroll increase of approximately 9.6% to 13% for workers earning minimum wage. As is to be expected, payroll cost increases for small firms will be much higher than for large firms, with estimates

indicating payroll costs increases for small firms almost three times higher than for large firms.

A survey of the Employers' Council membership regarding minimum wage, indicated a significant number of firms would not be able to bear this increased payroll cost. As expected, these firms tend to be small to medium sized businesses, service based with operations focused in areas outside the northeast Avalon (although some do operate in the St. John's area).

#### **b. Passing payroll increases on to consumers**

One of the often-cited ways that employers can maintain margins and profitability while increasing wages is to pass those increased payroll costs, which we have shown as significant, onto consumers through product and service price increases. This is too simplistic a solution and ignores the reaction of customers to such price increases and the basics of economic theory around price elasticity of demand. Depending on the product or service, consumers will substitute away or toward that product as price changes. Research conducted by some of Canada's most respected economists has shown the effect that increasing prices of goods and services can have on demand.

From a lay person's point of view, there are several factors that contribute to a firm's inability to pass on these additional payroll costs to consumers.

#### **c. Continual price increases**

Many firms have already implemented two price increases to deal with jumps in the minimum wage over the past three years. Some Council members are fearful of customer reaction if prices are increased two more times to reach the minimum wage target set for 2010. They predict that their customer base will lose tolerance for such price increases and will begin to substitute away from their products and services.

#### **d. Fixed prices on high volume goods**

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 through these highest volume items.

#### **e. Fixed term contracts**

Many firms are servicing contracts, the bidding process of which was based on projected labour costs. No firm in the province could have expected that minimum wage would increase 58% (33% since 2005 followed by an additional 25% in the next two years). These contracts do not reflect these rapid and sometimes un-announced increases in minimum wage. These firms have to honour these contracts (many with government) regardless of the impact on profits. Such contracts can be for terms as long as 4-5 years.

Even if government announces a schedule of increases, firms on contract have no ability to adjust over the short to medium term.

**f. Inflationary pressures**

Even with some firms being able to pass on these increased labour costs to the consumer, price increases create inflationary pressure. Those whom the minimum wage increase is intended to help, end up having to spend more on the goods and services as a result of the increase. Harder hit still are those in our population on fixed incomes, specifically the elderly, pensioners, and individuals on social assistance who have no ability to negotiate higher levels of income and are left further behind in terms of their disposable income relative to the rest of society.

**g. Slowing economic growth**

It is easy to look at recent rates of growth for the Newfoundland and Labrador economy and believe that these historic growth rates will continue. Most recently the Royal Bank of Canada predicted that Newfoundland and Labrador's economic growth rate would slow to a "barely noticeable" 0.5 per cent in 2008 and one per cent in 2009. In essence, scheduling minimum wage increases so far into the future is banking on future success in the economy, when that success is not guaranteed. There is no guarantee that firms in this province will be in a financial position to pay higher wages in 2010.

**III. REDUCED EMPLOYMENT**

On the labour supply side of the minimum wage issue is the impact artificially high wage rates have on the willingness of employers to hire additional labour. This is a well-documented fact cited by many respected economists including University of Toronto's Dr. Morley Gunderson who was recently commissioned to study the impact of minimum wage in the Province of Ontario.

**a. Student employment is reduced**

One of the conclusions from research completed by Dr. Gunderson is that the group most often impacted negatively by minimum wage increases are students.

According to Dr. Gunderson's report to the Ontario Government in 2007, Canadian evidence suggests that a 10% increase in the minimum wage is likely to reduce the employment of teens by 3% to 6% and by a slightly lower percentage for young adults. This implies that a 25% increase (as is proposed by the Newfoundland and Labrador government) in the minimum wage could lead to a 7.5% to 15% reduction in teen employment. This impact does not necessarily mean a decline in actual employment, but a slowing of employment growth relative to what would have occurred in the absence of a minimum wage increase. There is strong evidence that increases in the minimum wage, as proposed by the provincial government will limit opportunities for youth and students.

### **b. Students and minimum wage in Newfoundland and Labrador**

Figures from Statistics Canada addressing minimum wage earners in this province show similar characteristics as is found elsewhere in the country. In 2006, Statistics Canada reported that 36.9% of minimum wage earners were students and nearly 46% of minimum wage earners still live at home. Students represent a significant portion of minimum wage earners in this province.

The impact of minimum wage increases on this group in this province is clear -- an increased minimum wage may benefit some students individually, but collectively, the opportunities for employment are reduced.

### **c. Reductions in other benefits**

The adverse affects of minimum wage increases extend beyond employment losses. Research finds that employers often respond to such increases by reducing other benefits and on-the-job training. Even if minimum wage workers are fortunate enough to keep their jobs and maintain the number of hours worked, they may still not be better off due to reduced benefits and training.

## **IV. THE BENCHMARKING EFFECT & COLLECTIVE AGREEMENTS**

One of the biggest unintended consequences of minimum wage increases is the impact such increases have on higher wage earners and those covered by collective agreements. Few in the general public would expect that minimum wage increases impact higher wage earners and unionized workplaces; however, this impact is well documented.

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

Minimum wage is used, intentionally or unintentionally, as a benchmark for many wages in the province. Increases in minimum wage place pressure on employers (whether unionized or not) to maintain the separation between minimum wage and wages paid above minimum. An example of this effect is evidenced by a February 16<sup>th</sup>, 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. Minimum wage impacts a significant portion of wage earners in the province who earn above the minimum. Council 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. Both of these compounding factors are occurring in Newfoundland and Labrador right now.

## **b. Benchmarking in contract negotiations**

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.

## **c. Government as an employer**

Government, as an employer, is impacted by this reality even more so than private employers. As an example, the home support sector, which is funded in large part by government, consists of a large workforce being paid minimum wage. This workforce has also recently been heavily unionized by NAPE. These NAPE members in the home support sector will receive a 25% increase (as is planned by government over the next two years) in their wages irrespective of what is negotiated in their collective agreements. The NAPE membership outside of home support will feel entitled to similar percentage increases. It is likely that this negotiating strategy will be employed by NAPE during the upcoming round of contract negotiations with government. At the very least, its membership will claim entitlement to the same treatment – “parity” as they say.

In turn, the percentage increases eventually negotiated by government resulting from minimum wage increases will even impact union negotiations outside of government for the next several years.

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

# **V. POLICY ISSUES**

## **a. Too blunt an instrument**

While Council believes that minimum wage increases can provide some minor benefits to low-income families and other individuals living below the poverty line, a vast amount of research indicates that such increases are an exceedingly blunt instrument for dealing with the poverty issue. Minimum wage increases have many significant unintended negative consequences that will affect the labour market and the economy of this province.

Council’s position is that government, with this announcement, is moving away from the intent of the Labour Standards Act (that being the setting of minimum standards of employment in the province) and moving toward using the *ACT* as a tool to influence wages paid to others well above the poverty line. Wages that are traditionally determined in our economy by free-market forces. Evidence of this change in policy comes from the fact that the minimum wage rate being proposed for 2010 is well beyond what other provinces with comparable economies believe to be an acceptable minimum standard.

## **b. Differing economic realities**

Just as there are two economies in Newfoundland and Labrador, the urban and the rural, each with drastically different realities, so too are there differences between the economies of Newfoundland and Labrador and other regions of Canada. Council suggests that this province is not able to support the same wage rates as are achieved by workers in the larger economies of other jurisdictions in Canada. The proposed minimum wage for 2010 will place this province close to the same planned minimum wage as the province of Ontario by the year 2010. Council submits that before government proceeds in this direction, it must first ask, “Does Newfoundland and Labrador need a minimum wage on par with Ontario in 2010 and does a minimum wage on par with the economic giant of Ontario represent realistic similarities in the labour markets of both provinces?” Council’s position is it does not.

In the same context, given the many negative side effects increases in the minimum wage can have on the economy, Council submits that the alacrity of the proposed increase in minimum wage (58% over a period of five years) will compound these negative effects and make them difficult to mitigate.

## **VI. MITIGATING THE IMPACTS**

The following are some potential ways government could attempt to mitigate, at least partially, some of the negative consequences of their proposal.

### **a. Payroll Tax Threshold**

There are firms who, because of proposed minimum wage increases, will have their payroll levels bumped up above the threshold for payroll tax (\$600,000 in total payroll) and will then be required to pay an additional tax of 2% on that total payroll not previously required before the minimum wage increase. This is a direct negative impact on these firms. To offset this, government could potentially increase the threshold for the payroll tax by the appropriate amount. Estimates are a \$10 minimum wage increase would increase payroll costs by 13% or more depending on the firm. This is only for firms paying minimum wage, however, it is important to remember that, because of the benchmarking effect, many other firm will break this threshold. All firms should be considered in the setting of the threshold for payroll tax.

### **b. Tax Relief**

Because the negative consequences of minimum wage increases are not confined to small employers who pay minimum wage but extend though almost the entire workforce, other taxes may provide opportunities for mitigating the impacts. Insurance tax elimination/reduction and corporate tax reductions represent the most obvious options for government to reduce the impact of this policy.

## VII. CONCLUSION

The negative side effects of minimum wage increases are well documented. As was stated before, the Ontario government contracted renowned University of Toronto Professor Morley Gunderson to examine the impact of minimum wage increases in Ontario. In his report, released alongside the provincial budget, Professor Gunderson found that the consequences of the proposed minimum wage increase would be enormously negative. He concluded that a 25 per cent increase in the minimum wage could reduce employment by as much as 15 per cent or approximately 180,000 lost jobs, even if phased in gradually as proposed by the Ontario government. As Professor Morley Gunderson stated in his report: “Minimum wages are, at best, an exceedingly blunt instrument for curbing poverty and the evidence suggests they essentially have no effect on reducing overall poverty”.

There are significant trade offs for increasing the minimum wage. It is true that there will be individuals currently earning below the poverty line that will, individually, benefit from the proposed increases in minimum wage, but others, not typically considered in minimum wage discussions, will be asked to pay for those increases.

The solution? The target of \$2 in 2 years should be reduced and expanded over a longer time. In addition, government should implement necessary relief to businesses operating at all levels in the economy to offset the adverse consequences of a minimum wage increase.