

LABOUR MARKET
COMPETITIVENESS
2013

Executive Summary	3
1. Background	13
1.1 Action Plan for Jobs 2013	13
1.2 Importance of Labour Costs to Enterprise	15
1.3 Structure of Report	15
2. Labour Market Context	16
2.1 Introduction	17
2.2 Overview of Labour Market Trends	17
2.3 Focus on Unemployed	18
2.4 Focus on Labour Market Participation	21
3. Labour Costs and Earnings Data Analysis	22
3.1 Impact of high costs	22
3.2 Overview of Labour Costs Data	23
3.3 Focus on Unit Labour Costs	27
3.4 Recent Developments in Earnings in Ireland	28
4. Social Welfare and Replacement Rates	37
4.1 Introduction to Replacement Rates	38
4.2 Overview of Replacement Rate Data	39
4.3 Policy Considerations	43
4.4 Labour Market Activation	48
5. Sectoral Wage Setting Mechanisms	51
5.1 Introduction to Sectoral Wage Setting Mechanisms	51
5.2 Reform of the Sectoral Wage Setting Mechanisms	53
5.3 Impact of Reforms	55
5.4 Focus on Key Sectors	60
5.5 Conclusions on Reform Agenda	68
6. National Minimum Wage	70
6.1 Introduction to the National Minimum Wage	70
6.2 Overview of Minimum Wage Data	74
6.3 Policy Considerations	76

7. Labour Tax Competitiveness	81
7.1 Introduction to Labour Taxes	81
7.2 Labour Taxes in Context	84
7.3 Policy Considerations	90
Appendix One: Forfás Board Members	94
Appendix Two: Recent Forfás Publications	95

Executive Summary

Building on the Forfás review of the Costs of Doing Business in Ireland¹, this paper focuses on labour costs. As one of the major cost components for firms, labour costs are a key determinant of both firm-level and national competitiveness. In the absence of exchange rate policy, in order to enhance Ireland's international competitiveness and job creation, it is necessary to achieve an internal devaluation and to maximise productivity growth. Of course, since international competitiveness is a relative measure, improved cost competitiveness can also be achieved by maintaining lower wage growth than our competitors.

The OECD have pointed out that continued wage restraint over the medium term is required and is of particular importance for traditional, labour intensive sectors whose exports tend to be more labour intensive than MNC-dominated sectors². The ESRI's Medium Term review also outlines the negative impact of a loss of labour cost competitiveness on economic activity, employment and the public finances in the medium term³.

Despite some evidence of reductions in Irish labour costs being recorded over recent years, wage rates have proven relatively sticky⁴. Indeed, despite the reductions, labour costs in Ireland remain above both the OECD and euro area averages. Further, Irish labour costs are once again on an upward trajectory - in the last two quarters of 2012, Irish labour costs increased by more than both the EU27 and the euro area-16 averages. These increases are occurring in the context of an unemployment rate of 13.7 per cent in Q1 2013.

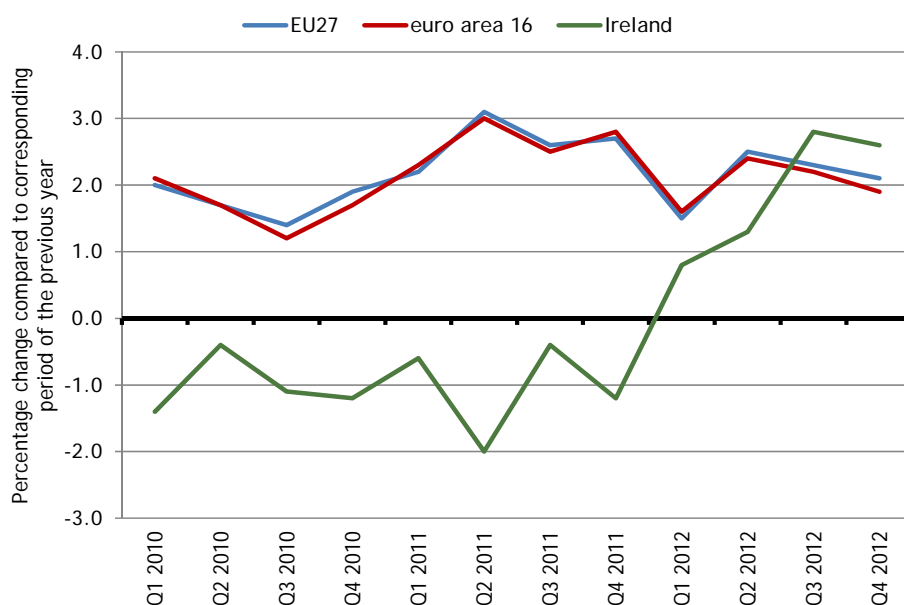
1 Forfás, Costs of Doing Business in Ireland 2012, April 2012

2 Pina, Á., Structural Reforms to Reduce Unemployment and Restore Competitiveness in Ireland, OECD Economics Department Working Papers No. 910, December 2011

3 FitzGerald, J. and Kearney, I. (Editors), Medium-Term Review 2013-2020 ESRI July 2013

4 Based on Irish data from the National Employment Survey (2006-2009), the ESRI have found that despite an unprecedented fall in output and rise in unemployment, average earnings and average labour costs increased marginally over the period. See Bergin, A., Kelly, E., & McGuinness, S., Explaining Changes in Earnings and Labour Costs During the Recession, Renewal Series Paper 9, ESRI, April 2012

Quarterly Change in Labour Costs, Q1 2010 - Q4 2012



Source: Eurostat

OECD research finds that labour market reform can support labour cost competitiveness and employment growth. For example, Germany, having implemented significant labour market reforms in the years preceding the current crisis, has weathered the unemployment crisis relatively well⁵.

To this end, APJ 2013 commits the Government to taking further steps to address labour cost competitiveness in 2013. A range of important initiatives are also underway to enhance individuals skills and competencies and to support people to find work. Two specific actions are outlined in APJ 2013, namely⁶:

115	Assess the impact of reforms to sectorial wage-setting mechanisms (Industrial Relations (Amendment) Act 2012) in terms of promoting labour market competitiveness. (Forfás/DJEI)
117	Assess the potential for further actions to support improvements in labour market competitiveness. (Forfás, DJEI, DSP, D/Finance)

⁵ Hüfner, F. and C. Klein, The German Labour Market: Preparing for the Future, OECD Economics Department Working Papers, No. 983

⁶ Action 115 is also required as part of the EU/IMF Programme for Ireland.

Ultimately, this report aims to ensure that labour market policy and regulation, and the taxation and social welfare systems support competitive labour costs and job creation. Following a broader review of labour market costs by Forfás in 2010, this paper focuses on a number of key issues, specifically:

- Social welfare and replacement rates;
- Sectoral employment agreements;
- National minimum wage (NMW);
- Labour taxes.

The bulk of the State's interventions in the labour market affect those who are either unemployed or on low or average incomes. Each of the policy areas listed above represents a lever through which the State can influence labour costs. Of course, these policy areas also have other important goals - in particular, ensuring that people have a basic level of income. It is important to note, however, that despite these levers the State has limited influence over wage levels. In most of the economy, wage levels are set by the market and through a wage bargaining process between employers and employees.

Labour Market and Earnings Context

Price and wage competitiveness can be defined as 'a state in which medium term full employment is achieved and the return on capital matches the global risk-adjusted cost of capital'. Despite significant improvement, the need for further gains in cost competitiveness is still evident through high levels of unemployment and low levels of investment. While a range of factors influence employment and unemployment levels and trends, an analysis of the labour market provides an important assessment of where cost competitiveness may be out of line.

There was an increase in employment of 1.1 per cent or 20,500 in the year to the first quarter of 2013, bringing total employment to 1,845,600. While full-time employment fell by 3,700 (-0.3%), this decrease was offset by an increase in part-time employment of 24,200 (+5.6%). Over the course of the recession, the incidence of both temporary and casual employment has increased significantly.

Unemployment decreased by 29,900 (-13.1%) in the year to Q1 2013 bringing the total number of persons unemployed to 292,000. The long-term unemployment rate (more than 1 year) decreased from 9.5 per cent to 8.4 per cent over the year to Q1 2013. All of this however, must be set against the backdrop of falling labour participation rates.

Labour costs represent the single largest location sensitive cost for most firms and sectors. High costs in general, and high labour costs specifically, damage enterprise development and employment creation.

Looking at earnings data, Ireland has the 17th highest total labour costs level in the OECD-32 and the 11th highest net wage level in the OECD-32. Following three years of competitiveness gains vis-à-vis our key competitors, in the two most recent quarters of 2012, Irish labour costs increased by more than both the EU27 and the euro area average.

At a sectoral level, in 2010 and 2011, average growth rates in labour costs fell across most sectors in Ireland. The biggest declines occurred in construction (-5.9%), finance (-2.2%) and

manufacturing (-1.1%). In 2012, however, growth in labour costs resumed, particularly in manufacturing (+2.6%) and wholesale and retail trade (+1.8%).

On a more positive note, real Irish unit labour costs (ULCs) fell by 4.3 per cent in 2010 and 3.4 per cent in 2011. The European Commission expect this trend to continue out to 2014, driven by Irish productivity improvements. By comparison, moderate increases (or smaller decreases) are forecast for the EU and euro area. The improvement in overall ULCs, however, is primarily driven by a small number of high productivity exporting sectors and employment losses in lower productivity sectors.

Firms can control labour costs in a number of ways - through reductions in employment, changes in hours worked or through reductions in hourly wages. Where they have occurred, observed decreases in hourly rates are relatively modest. Instead, many firms have continued to reduce numbers employed and/or contracted hours worked, more consistently and to a greater extent, than adjusting pay rates.

Firms are generally very reluctant to cut hourly wages given the impact of reductions on morale and productivity. It is not surprising, therefore, that there is little evidence of wage reductions either in the general economy or in the sectors most impacted by the reforms to the sectoral wage setting mechanisms (e.g. parts of the retail, accommodation and construction sectors).

This paper focuses primarily on the financial costs related to employment. Other factors such as ease of hiring and other labour market regulations are not considered. In this regard, the four policy areas covered relate to social welfare and replacement rates; sectoral wage-setting mechanisms; the national minimum wage; and labour taxes. Each of these topics is addressed below.

Social Welfare and Replacement Rates

The replacement rate measures the proportion of out-of-work benefits received when unemployed against take home pay if in work. In general, a replacement rate in excess of 70 per cent is considered to act as a disincentive to work (i.e. if an individual can receive more than 70 per cent of in-work income in benefits, they will demand a higher wage in the market to retain a monetary incentive to work).

Replacement rates vary significantly by individual and family circumstances. For example, a couple with two children and one earner on the average industrial wage has a replacement rate of 66 per cent compared with a replacement rate of 37 per cent for a single individual earning the same amount. While some Irish replacement rates appear high relative to those in other countries, it is important to note that there are relatively small numbers of people with replacement rates significantly above 70 per cent and that where high replacement rates are recorded they are generally a result of either family size and/or entitlements to secondary benefits such as housing support. It is also important to note that factors such as the cost of travelling to work and the cost of childcare increase replacement rates further.

Under a planned new Housing Assistance Payment, the contribution that the tenant will make towards their rent will be based on a means test that links the level of contribution to the household income, rather than employment status (i.e., it will not penalise those working).

There is a need to ensure that the social welfare system as a whole supports employment creation, that replacement rates do not increase overtime and that secondary benefits do not create barriers to the take up of employment.

Recommendation: Reform the social welfare system so that unemployment benefits (and consequently replacement rates) decline in line with the length of time a person is out of work.

Responsibility: Department of Social Protection

Recommendation: Undertake a comprehensive review of secondary benefits retention arrangements for those in receipt of Jobseekers Benefit or Jobseekers Assistance, with a view to establishing whether or not they are effective in the long term in removing barriers to the take up of employment.

Responsibility: Department of Social Protection

Recommendation: The rollout of the Housing Assistance Payment (i.e. decoupling housing support from social welfare payments) is an essential element in removing barriers to employment and reducing replacement rates. Once fully implemented, the impact of HAP on replacement rates should be monitored to ensure that the payment successfully reduces barriers to employment, whilst protecting living standards.

Responsibility: Department of Environment, Community and Local Government

Recommendation: Review social welfare supports for part time workers to ensure that they have a significant financial incentive to avail of an employment opportunity.

Responsibility: Department of Social Protection

Continued action on ensuring that replacement rates do not create impediments to the take up of employment must occur in tandem with improved activation and up-skilling.

Recommendation: There should be wider adoption of activation programmes which are linked directly to identified enterprise needs; have significant employer engagement in course development, selection of candidates, and programme delivery; and which offer internships to participants.

Responsibility: Department of Education and Skills / Department of Social Protection

Given the collapse in demand for labour over the course of the recession, a series of incentives have been put in place to encourage job creation. The planned JobsPlus Initiative will replace existing employment support schemes that had relatively low take-up due to a number of reasons including the multiplicity of schemes which caused confusion, poor marketing of the schemes and administrative burdens. If the initiative is to be successful, it will be essential that lessons are learned from the administration of the earlier schemes.

Recommendation: The design of the JobsPlus programme should enable clear communication of the benefits of the initiative, be easily accessible and create limited administrative burden for business. This will require a well-resourced media campaign to provide information and support take-up.

Responsibility: Department of Social Protection

Sectoral Wage Setting Mechanisms

Sectoral wage setting mechanisms (Employment Regulation Orders and Registered Employment Agreements) deal with the pay and working conditions of the employees concerned and may be included in an employee's contract of employment. Employers of workers covered by EROs and REAs are obliged to pay the wage rates and provide the conditions of employment prescribed by the collective agreement. In 2009, it was estimated that between 212,000 and 284,000 workers were covered by either EROs or REAs.

Following the introduction of the Industrial Relations (Amendment) Act, Ireland agreed to "report to the staff of the European Commission, the IMF, and the ECB on the impact on the labour market of reforms to sectoral wage-setting mechanisms" by the end of the second quarter of 2013. This action was subsequently included in the Action Plan for Jobs 2013 (Action 115) and was assigned to DJEI/ Forfás. A report was submitted to the Minister in June.

Separately, a series of legal actions to test the constitutionality of EROs and REAs have been brought forward over recent years. From July 2011, following a High Court ruling, all Employment Regulation Orders ceased to have statutory effect. In a similar case, REAs were struck down by the Supreme Court in May 2013. The Government is currently studying the rationale and implications of the latter decision.

Within the sectors where sectoral employment agreements operate, Employment Regulation Orders collapsed as a result of the High Court ruling of July 2011. Therefore, the pay and conditions of employees who started work after 7th July 2011 were governed by employment legislation such as the minimum wage. Existing employees who were covered by an ERO had existing contracts of employment, which governed their pay and conditions of work. There is little evidence that hourly wages in the sectors covered by EROs have declined as a result of their abolition. Given that we have less than three quarters of data since the commencement of the Industrial Relations (Amendment) Act, it is not possible to determine what influence, if any, the new Act has had from the available data.

A further factor militating against any major impact from the reform process on wage levels is the fact that much of the reform agenda has not yet been fully implemented or utilised. While the legislative underpinning for sectoral agreements has now changed, new Joint Labour Committees have yet to be established. It is only as the various parties come together under the new JLC arrangements to negotiate and agree new Employment Regulation Orders that we can expect to see an impact on labour competitiveness. Likewise, other elements of the reform agenda (e.g. the finalisation of the overtime and Sunday working codes of practice) could have an impact upon labour competitiveness once completed.

Given the lack of data currently available and the number of outstanding elements of the reform agenda, more time is needed to definitively test the impact of the new wage setting framework.

Recommendation: The analysis of the impact of the reforms to the sectoral wage setting mechanisms should be repeated in due course when sufficient data is available for analysis (i.e. approximately 18 months after all elements of the reform process have been completed).

Responsibility: Department of Jobs, Enterprise and Innovation

Recommendation: The remaining elements of the wage setting mechanisms reform programme need to be agreed and implemented. Specifically:

- The recommendations contained in the Labour Courts' review of JLCs should be implemented with a view to minimising administrative costs for enterprise;
- Outstanding reforms to overtime, Sunday working and the derogation for financial difficulty need to be concluded quickly with a strong emphasis on enhancing labour cost competitiveness;
- Utilisation of the new wage setting mechanisms needs to be progressed quickly given on-going labour cost concerns and Ireland's unemployment crisis. Renegotiation of agreed rates offers the most impactful method of achieving improved wage competitiveness.

Responsibility: Department of Jobs, Enterprise and Innovation, Labour Relations Commission

National Minimum Wage

The minimum wage is intended to deliver a socially preferable distribution of income than would occur through a free market solution. In general, therefore, the success or otherwise of minimum wage policy is usually measured against its impact on poverty levels. It is important to note that the imposition of a minimum wage can have significant impacts on income and employment levels as well as poverty, and impacts on both firm level and national competitiveness.

Overall, relatively few employees earn the minimum wage in Ireland - the NMW is most prevalent (in terms of the number of employees earning less than €8.65) in sectors such as hotels and restaurants; wholesale and retail; construction; and other services. Employees earning the NMW are more likely to be employed in sales, craft, personal service or other occupations; are most likely to be between the ages of 15 and 24 years; tend to be female; have relatively low levels of educational attainment (i.e. less than upper secondary); and are more likely to be nationals from the EU Accession States.

In both euro and purchasing power standard terms, the monthly minimum wage in Ireland is relatively high: of the 21 countries for which data is available, Ireland had the 5th highest minimum wage in PPS terms and 4th highest in euro terms, When expressed as a percentage of average wages (44.5%), Ireland has the 8th highest minimum wage out of 20 EU countries examined.

Despite the lack of consensus on the exact effects of the NMW, there is broad agreement that a national minimum wage of circa 30-40 per cent of median wages can have a positive effect on equality and will have a limited effect on lowering employment rates for low skilled

workers. There is a somewhat stronger consensus that NMW can impact on employment levels of young and inexperienced workers, which is reflected in differentiated minimum wage rates in Ireland and elsewhere.

It is recommended that the main NMW rate of €8.65 is maintained at the existing level until there is a significant improvement in the labour market. Consideration should be given to amending the NMW rate for younger cohorts, given the high levels of youth unemployment and evidence that this cohort is most affected by a higher NMW. Currently a rate of €6.06 exists for workers less than 18 years of age. Consideration should be given to introducing a rate lower than €8.65 for all workers aged over 18 and under 21 or 25 years of age. This would:

- Reflect current rules governing the payment of Jobseekers Assistance which provide for lower weekly payments to those under the age of 25 years.
- Target a cohort of the labour market where the negative consequences of long term unemployment are most pronounced (in terms of future earnings and likelihood of finding employment).
- Increase the attractiveness to employers of hiring additional workers.

Recommendation: Consideration should be given to extending the lower NMW rate for younger workers. Currently a rate of €6.06 exists for workers less than 18 years of age. Recognising high levels of youth unemployment, and to enhance employability, consideration might be given to introducing a rate lower than €8.65 for all workers aged over 18 and under 21 or 25 years of age.

Responsibility: Department of Jobs, Enterprise and Innovation

At present, while the National Minimum Wage Act 2000 provides a range of conditions under which the NMW may be reviewed, it does not mandate that a review should occur at particular fixed intervals - if such a timeline was in place, this would provide greater certainty for both employers and employees.

Recommendation: Consideration should be given to requiring that a comprehensive review of the NMW be completed every four to five years, with the other years requiring a streamlined process.

To ensure that any revisions to the NMW are reflective of economic circumstances, and to provide certainty to workers and employers, potential exists to set out a methodology to calculate changes to the NMW (e.g. NMW should reflect changes in monthly median wages, youth unemployment, productivity etc.)

Responsibility: Department of Jobs, Enterprise and Innovation

The National Employment Rights Authority (NERA) carries out workplace inspections to ensure compliance with employment rights legislation. NERA's latest quarterly report highlights high

rates of non-compliance with National Wage legislation⁷ in the businesses that were selected for inspection. Of the 969 inspections conducted with respect to the NMW over the period January to September 2012, there was a compliance rate of 50 per cent.

From an enforcement perspective, ensuring adherence to employment legislation can be seen as a complementary to the control and activation measures built into the social welfare system - both serve to minimise disincentives to the take up of employment offers.

Recommendation: Continued efforts are required to monitor and enforce compliance with all aspects of employment law.

Responsibility: Department of Jobs, Enterprise and Innovation / National Employment Rights Authority

Labour Tax Competitiveness

The tax wedge⁸ increases labour costs which can have a negative influence on the employer's decision to retain or hire individuals. A higher tax wedge can also reduce the take-home pay of workers. As a result, workers increase the pre-tax wage they bargain for in wage negotiations. Higher labour taxes also increase replacement rates (i.e. make work less attractive vis-à-vis social welfare), reduce take home pay, weaken domestic demand and risk stimulating the informal economy. A competitive tax wedge is vital to encourage employment growth across all income categories and is a key factor in attracting and retaining highly skilled and internationally mobile workers.

In general, the Irish taxation system has been broadly supportive of labour market efficiency. Since the onset of the recession while measures were introduced in successive Budgets to widen the tax base and improve the yield while still seeking to maintain progressivity and support employment. There has also been an increase in levels of personal taxation which has eroded cost competitiveness and the incentive to work. As a result, while Ireland's tax wedge is still relatively low for many lower paid workers, the wedge is much less competitive for higher earners (e.g. earning 167 per cent of the average wage), although not out of line with the OECD average.

To support job creation and enterprise growth, labour taxes should be shielded from any further increases. In this context, the OECD's hierarchy of taxation provides an essential guide to policymakers. There is also considerable room to raise revenues without increasing the already elevated marginal tax rates (i.e. through reductions in the entry point for income tax).

Recommendation: While recognising the need for fiscal consolidation, in order to support job creation and enterprise growth, labour taxes should be shielded from any further increases to the extent possible. Efforts to increase Government revenue should focus on alternative sources. Revenues from alternative tax-streams such as the property tax should be used to

⁷ National Employment Rights Authority, Quarterly Update, Issue 3 2012

⁸ The difference between the employers' cost of hiring an individual and the individual's actual take home pay, due to income taxes and payroll taxes, is known as the tax wedge.

support a tax strategy which circumvents the need for further increases in the labour tax wedge and the marginal rates.

Responsibility: Department of Finance

The level at which individuals start paying the higher rate of tax in Ireland (€32,800 for single individuals) is low relative to other countries. The higher rate of tax actually impacts on individuals earning less than the average wage, meaning that marginal tax rates (i.e. the tax paid on an individual's last euro of income) are now in excess of 50 per cent for single individuals earning €32,800 per annum. High marginal tax rates create a disincentive for workers already in employment to work longer hours. High marginal tax rates also discourage entry into the Irish labour market and may also act as a disincentive for entrepreneurship and risk-taking - the effective marginal rate is 55 per cent for individuals with non-PAYE income over €100,000.

Recommendation: As well as ensuring that, to the extent possible, there are no further increases in marginal tax rates, it would be beneficial to provide certainty regarding future marginal labour tax rates. Consideration should also be given to flagging when it will be feasible to reduce marginal labour rates below 50 per cent.

Responsibility: Department of Finance/ Department of Social Protection

In addition to direct taxes, other factors add to the costs of employment.

Recommendation: The introduction of further costs on employment (e.g. changes to sick pay policy, pensions policy, health insurance, etc.) should be considered carefully from a labour cost competitiveness perspective given the scale of our unemployment crisis.

Responsibility: Department of Finance/ Department of Social Protection

1. Background

1.1 Action Plan for Jobs 2013

The Action Plan for Jobs (APJ) 2013 notes that in order to generate sustainable, broad-based export-led growth, Ireland's international competitiveness needs to continue to improve. Cost competitiveness is a critical foundation of international competitiveness. Labour costs represent the single biggest location sensitive cost for most employers. In the absence of exchange rate policy, wage restraint represents one of the key domestic strategies to enhance cost competitiveness. To this end, APJ 2013 commits the Government to taking further steps to address labour and broader cost competitiveness in 2013. A range of important initiatives are also underway to enhance individuals skills and competencies and to support people to find work.

Two specific actions are outlined in APJ 2013, namely⁹:

115	Assess the impact of reforms to sectorial wage-setting mechanisms (Industrial Relations (Amendment) Act 2012) in terms of promoting labour market competitiveness. (Forfás/DJEI)
117	Assess the potential for further actions to support improvements in labour market competitiveness. (Forfás, DJEI, DSP, D/Finance)

Such reforms are not unique to Ireland. The OECD¹⁰ has noted that OECD countries have sought to raise labour utilisation especially by cutting labour taxes, delaying effective retirement ages, reforming disability schemes and strengthening active labour market policies.

At the onset of the recession, most OECD countries sought to improve the safety net for job losers by boosting unemployment benefit generosity and expanding coverage to new groups of workers. At the same time, more than two-thirds of OECD countries raised resources for job-search assistance and training programmes in order to facilitate re-employment and re-deployment. To stimulate labour demand, work-sharing arrangements were introduced or expanded in two-thirds of OECD countries, labour taxes were cut and new job or hiring subsidy schemes were introduced, often targeting marginal job seekers such as youth, older workers, or the long-term unemployed. Some temporary measures were subsequently phased out, and difficult labour market reforms were implemented in the areas of retirement schemes, job protection, minimum wages and wage bargaining systems, especially in the context of the European debt crisis.

⁹ Action 115 is also required as part of the EU/IMF Programme for Ireland.

¹⁰ OECD, Economic Policy Reforms 2012, Going for Growth, 2012

Objectives

Ultimately, this project aims to ensure that labour market policy and regulation, and the taxation and social welfare systems support competitive labour costs and job creation. In undertaking these actions, a number of questions/issues need to be considered, including:

- How do Irish wage levels compare internationally;
- How have wage levels in Ireland evolved over the last 5 years?
- Has the recession led to reductions in wage rates?
- What impact do wage rates have on economic growth and international competitiveness?
- How does the social welfare system / replacement rates impact upon labour supply;
- What (if any) impact has ERO/JLC reform had on sectoral wages and employment?
- What impact does the national minimum wage (NMW) have on labour costs and employment creation?
- What impact does taxation have on the labour market - both in terms of impact on cost and in terms of the incentive effect on labour supply;
- Are there other barriers preventing labour costs from adjusting, are these barriers damaging employment creation and what steps are required to address these issues?

The bulk of the State's interventions in the labour market affect those who are either unemployed or on low or average incomes. The policy recommendations herein, therefore, largely focus on these areas. However, it is important to bear in mind that to the greatest extent possible the market should set wage levels, and interventions should be designed with this in mind¹¹.

Labour market expectations and wage demands are not divorced from happenings elsewhere in the economy. A study to assess the costs of living in Ireland and its impact on wage expectations is currently underway¹².

The paper also focuses primarily on the direct financial costs related to employment. Additional factors such as the cost of childcare are not considered but obviously impact upon individual replacement rates and decisions relating to the take up of employment. Other factors such as ease of hiring and other labour market regulations are not considered. Publications such as the World Bank's Doing Business 2013 and the IMD's World Competitiveness Yearbook benchmark consider many of these regulations.

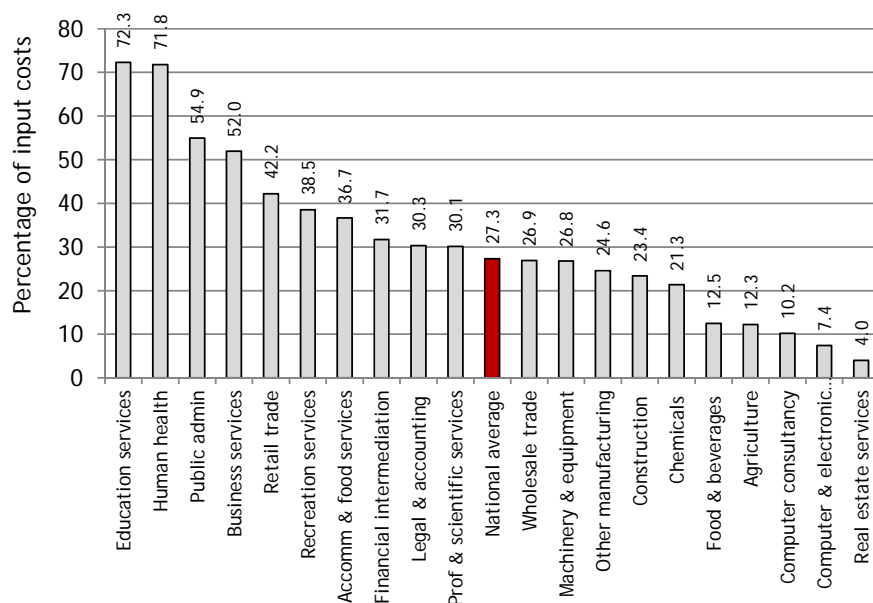
11 The IMF have pointed out that the State's role in employment creation is somewhat limited and that the vast majority of jobs are created in the private sector. In addition to supporting fundamentals for job creation (through macroeconomic stability and policies to enhance the general business environment), they note that one of the primary goals of labour policy should be to "not undermine job creation and instead enhance the development payoffs from jobs". The State also has a role in identifying selected policy interventions that remove barriers to private sector job creation (e.g. through taxation, spending on social welfare etc.). For further details see International Monetary Fund, Jobs and Growth: Analytical and Operational Considerations for the Fund, March 2013

12 Action 126 in the Action Plan for Jobs requires Forfás to compare consumer price levels and consumer price inflation in Ireland with prices in our key competitors; identify the primary drivers of price and inflation differentials; and assess the impacts of cost of living on labour costs and other business costs.

1.2 Importance of Labour Costs to Enterprise

Figure 1 highlights that labour costs represent a relatively high proportion of total input costs across a range of sectors.

Figure 1: Labour Costs as a Percentage of Total Input Costs by Sector, 2009¹³



Depending on the labour intensity of individual sectors, the proportion of total costs accounted for by labour varies. The importance of a range of location sensitive costs for a range of sectors (with a particular focus on exporting sectors) is explored in more detail in the recent Forfás report on the Costs of Doing Business¹⁴.

Source: CSO, Supply and Use Tables 2009

1.3 Structure of Report

Chapter 2 provides an analysis of labour market trends, Chapter 3 focuses on labour costs, while Chapters 3-7 examine some of the key factors which influence labour competitiveness, and set out a series of policy recommendations to improve labour market efficiency. While there are a variety of drivers of labour competitiveness (as assessed in Forfás' 2010 review of labour costs¹⁵), this paper focuses on a number of key issues, specifically:

- Reductions in high replacement rates;
- Reform of the sectoral employment agreements;
- Modifications to the national minimum wage (NMW);
- Labour tax competitiveness.

In addition, other issues such as activation and training policies are briefly considered - these are dealt with in greater detail in Pathways to Work, the Action Plan for Jobs 2013, etc.

¹³ Chart is derived from Table 2 in the CSO's Supply and Use Tables for Ireland. Inputs are composed of 'total intermediate consumption of goods and services at purchasers prices' plus 'compensation of employees'.

¹⁴ Forfás, Costs of Doing Business in Ireland 2012, April 2012

¹⁵ In 2010, Forfás conducted a review of labour cost competitiveness - this paper builds upon the existing knowledge base. See Forfás, Review of Labour Cost Competitiveness, October 2010

2. Labour Market Context

Key Findings

- Price and wage competitiveness can be defined as “a state in which medium term full employment is achieved and the return on capital matches the global risk-adjusted cost of capital”
- An economy is under-competitive, if the levels of prices and wages are sufficiently high to generate an increase in the current or future unemployment rate and/or capital disinvestment - the need for further improvements in Ireland’s cost competitiveness is evident through high levels of unemployment and low levels of investment. In Q4 2012 the broad unemployment rate, which includes part-time underemployed, discouraged workers, passive job seekers and other marginally attached remained high at 23 per cent
- There was an increase in employment of 1.1 per cent or 20,500 in the year to the first quarter of 2013, bringing total employment to 1,845,600. Full-time employment fell by 3,700 (-0.3%) but this decrease was offset by an increase in part-time employment of 24,200 (+5.6%). The incidence of temporary employment has also increased significantly
- Unemployment decreased by 29,900 (-13.1%) in the year to Q1 2013 bringing the total number of persons unemployed to 292,000. The long-term unemployment rate (more than 1 year) decreased from 9.5 per cent to 8.4 per cent over the year to Q1 2013
- Younger workers, particularly those with lower levels of educational attainment are most likely to be unemployed. In more detail:
 - The unemployment rate in Q1 2013 for those with primary education or below is 26.5 per cent; for those with lower secondary is 22 per cent; and for those with a third level honours degree or above is 6.3 per cent
 - The under-25’s account for 18.4 per cent of total unemployment even though they represent less than 10 per cent of the total labour force
 - Males (15.9%) are more likely to be unemployed than females (11%)
- In Q1 2013 almost 62 per cent of those classified as unemployed were unemployed for more than 12 months. Those most vulnerable to long-term unemployment are those who have: a recent history of long-term unemployment; previous participation on the Community Employment (CE) scheme; advanced age; relatively high number of children; relatively low education; literacy/numeracy problems; are located in urban areas; a lack of personal transport; and low rates of recent labour market engagement
- Labour participation rates are also falling
- Notwithstanding continued weak demand for labour and significant challenges in employment intensive sectors, high levels of unemployment - in particular youth unemployment and long-term unemployment - indicate that price and wage competitiveness remains an issue

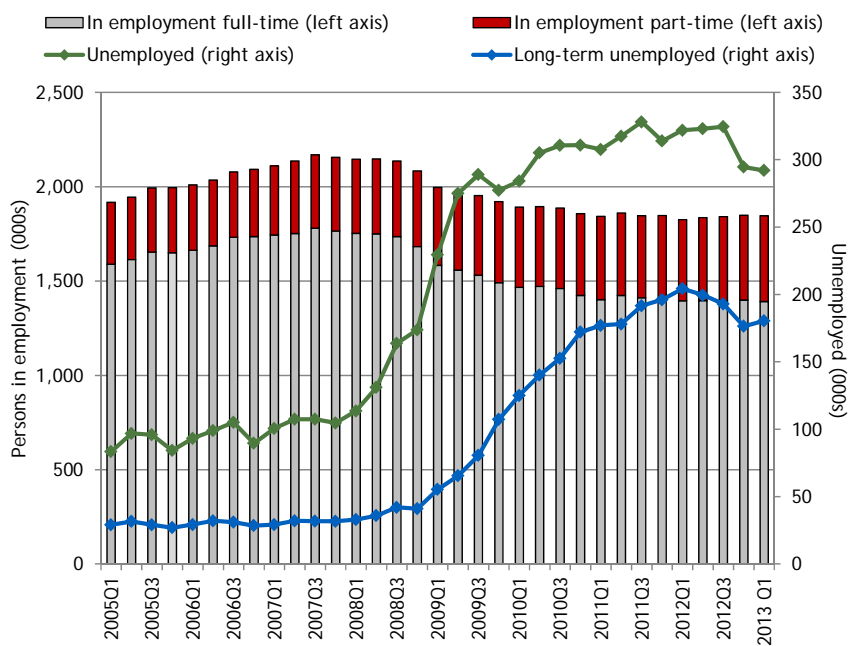
2.1 Introduction

Price and wage competitiveness can be defined as ‘a state in which medium term full employment is achieved and the return on capital matches the global risk-adjusted cost of capital’. An economy is under-competitive in cost terms, if the levels of prices and wages are sufficiently high to generate an increase in the unemployment rate and/or capital disinvestment¹⁶. While a range of factors influence employment levels and trends, an analysis of the labour market provides an important assessment of where cost competitiveness may be out of line.

2.2 Overview of Labour Market Trends

The analysis in this section draws on the most recent data available from the CSO’s Quarterly National Household Survey (i.e. Quarter 1 2013)¹⁷.

Figure 2: Labour Market Overview, 2005-2013



There was an increase in employment of 1.1% or 20,500 in the year to the first quarter of 2013, bringing total employment to 1,845,600. As a result, the seasonally adjusted unemployment rate has decreased to 13.7% - the number of persons unemployed fell by 29,900 also on a seasonally adjusted basis.

Source: CSO, Quarterly National Household Survey

16 By this definition, an economy is over-competitive if prices and wages are so low that the economy is in overheating territory and employment growth is only achievable via significant levels of net immigration. See Lane, P., *Assessing Ireland’s Price and Wage Competitiveness*, National Competitiveness Council, 2004

17 Once the results from the 2011 Census of Population became available, the CSO began to revise the QNHS population estimates from Q3 2006 on, based on the new benchmark population totals for 2011. This process will be fully in effect as of Q4 2013. The original population estimate for the second quarter of 2011 for the working age population was 3,502,700. The revised benchmark population estimate for the same period is now 3,599,100, a difference of 2.8 per cent. This difference was not split evenly across all sub-groups within the population. In addition to the updated population estimates, the CSO has introduced some changes to the processes, definitions and weightings.

Full-time employment fell by 3,700 (-0.3%) over the year but this decrease was offset by an increase in part-time employment of 24,200 (+5.6%). There has been a notable increase in the incidence of part-time employment over the course of the recession compared with the employment peak of Q3 2007 - overall, part-time employment has increased from 18 per cent of total employment to 24.6 per cent; the increase for males (from 7.4 per cent to 14.8 per cent) has been particularly significant.

The incidence of temporary employment has also increased and this has primarily impacted upon younger cohorts¹⁸. In Q1 2007, 13.8 per cent of those aged 15-24 years and in employment where classified as temporary workers, compared with 5.5 per cent of those aged 15-64 years. By Q1 2013 over 32 per cent of the 15-24 years of age cohort were engaged in temporary employment, compared with 9.6 per cent of those aged 15-64 years. The incidence of temporary working in Ireland, however, remains below the euro area average for all age cohorts.

2.3 Focus on Unemployed

While the rise in unemployment is primarily a result of the collapse in demand, both domestically and internationally, demand for labour is intricately linked with the cost of labour.

Unemployment decreased by 29,900 (-13.1%) in the year to Q1 2013 bringing the total number of persons unemployed to 292,000. The long-term unemployment rate decreased from 9.5 per cent to 8.4 per cent over the year.

¹⁸ According to Eurostat, a job may be regarded as temporary if it is understood by both employer and the employee that the termination of the job is determined by objective conditions such as reaching a certain date, completion of an assignment or return of another employee who has been temporarily replaced. The data referenced herein is taken from the European Labour Force Survey.

Figure 3: Change in Employment by Sector, Q3 2007 - Q4 2012

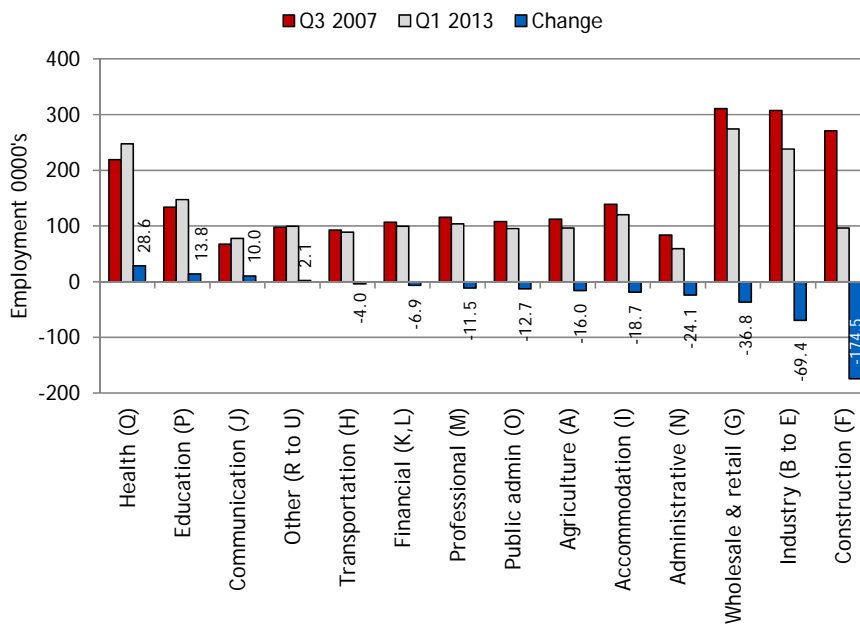


Figure 3 examines the change in employment by sector. Since the peak, the greatest reductions in employment have occurred in construction, industry and the wholesale and retail sector.

Source: CSO, Quarterly National Household Survey

Looking at the most recent CSO data, employment fell in six of the fourteen economic sectors over the year to Q1 2013. The greatest rates of decline were recorded in construction (-6.7% or -7,000); administration and support services (-4.8% or 3,000); and public administration and defence and compulsory social security (-4.3% or -4,300), and transportation and storage (-4.0% or -3,700) sectors. Employment grew in eight of the fourteen sectors - the largest rate of increase was recorded in agriculture, forestry and fishing (+19.5% or +15,700).

Looking in more detail at the unemployment data, males (15.9%) are more likely to be unemployed than females (11%). The construction sector, which is a male dominated sector in employment terms, was the first to be hit by the effects of the recession. Female unemployment remained relatively constant until early 2009 - thereafter it increased rapidly. As with male unemployment, there is a strong sectoral dimension to female unemployment - reductions in female employment account for the majority of employment reductions in sectors such as accommodation, wholesale and retail trade and administration.

Educational attainment is highly linked to current prospects in the labour market; the unemployment rate in Q1 2013 for those with primary education or below is 26.5 per cent while the rate for those with lower secondary is 22 per cent, compared with a rate of 6.3 per cent for those with a third level honours degree or above.

Age is also a strong determinant of unemployment. The under-25's accounts for 18.4 per cent (53,800) of total unemployment even though this cohort only represents less than 10 per cent of the total labour force.

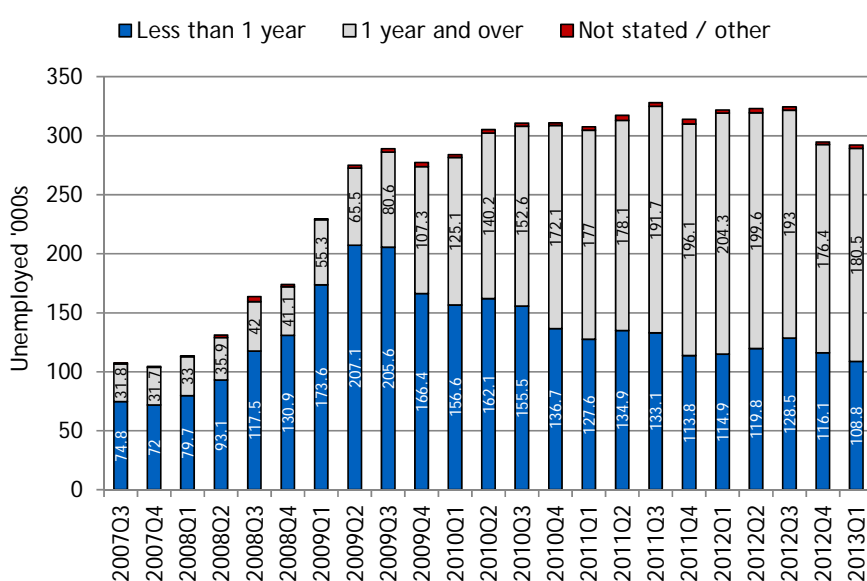
However, further analysis shows that the unemployment profile is more nuanced than single characteristics such as age, gender, or qualifications. Previous analysis by Forfás identified four key cohorts of the labour market with particular and specific characteristics¹⁹:

- 20-54 year olds with no formal/primary level of educational attainment.
- 15-19 year olds with lower secondary/upper secondary/ PLC educational attainment.
- 20-24 year olds with PLC, Third Level Non-Degree and Third Level Degree and above Educational Attainment.
- 20-24 year olds with Lower and Upper Secondary, 25-34 year olds with Lower Secondary, Upper Secondary and PLC, 35-44 year olds with Lower Secondary and PLC, 45-54 with Lower Secondary.

2.2.1 Focus on Long-term Unemployment

Notwithstanding recent reductions, long-term unemployment (more than 1 year) continues to be a cause for concern - and is likely to persist well into the future given (a) the lack of demand for labour and (b) the difficulty experienced by long term unemployed in returning to work.

Figure 4: Duration of Unemployment in Ireland, Q3 2007 - Q4 2012



This chart shows the increase in long term unemployment over the course of the recession - both in terms of absolute numbers and as a proportion of total unemployment. In Q1 2013 almost 62% of those classified as unemployed were unemployed for more than 12 months.

Source: CSO, Quarterly National Household Survey

Those most vulnerable to long-term unemployment have been identified by the ESRI as those with a recent history of long-term unemployment, previous participation on the Community Employment (CE) scheme, advanced age, relatively high number of children, relatively low

19 Forfás, Profile of Employment and Unemployment, February 2010

education, literacy/numeracy problems, located in urban areas, lack of personal transport, low rates of recent labour market engagement, and spousal earnings²⁰.

Long-term unemployment is, therefore, determined by a number of variables which can be addressed through appropriate labour market interventions (for example, upskilling, literacy/numeracy interventions, job search supports, traineeships, work placements, specific skills training).

2.4 Focus on Labour Market Participation

The total number of persons in the labour force in the first quarter of 2013 was 2,137,500. This represents a decrease of 9,400 (-0.4%) over the year. The number of persons not in the labour force in Q1 2013 was 1,457,000, an increase of 10,100 (+0.7%) over the year.

The number of persons in the labour force is influenced by changes in the size of the working age population (demographic effect) and by the labour force participation rate.

Up to the start of 2008, the demographic effect had been adding 65,000 or more to the labour force on an annual basis, primarily driven by net inward migration. With the decline in inward migration the positive demographic effect started to fall in the second half of 2007 and continued to decline throughout 2008 and 2009 before becoming negative in Q4 2009. In Q1 2013 this negative demographic effect contributed 12,000 to the overall decline in the labour force and is almost exclusively concentrated in the 20-24 and 25-34 age groups.

As mentioned, the size of the labour force is also impacted by changes in participation. While a relatively low decrease in the participation rate was recorded overall (falling by 0.3 per cent over to year to 59.5 per cent), participation rates differ according to age category - decreases were recorded for the 25-34, 15-19 and 20-24 age groups while the greatest increases were recorded for the 60-64 and 55-59 age groups.

In an international context, the Irish participation rate in Q4 2012 (59.6%) is slightly above EU27 (57.8%) and euro area (57.2%) averages. However, the declining trend is of concern.

High levels of unemployment, youth unemployment and long-term unemployment allied to falling participation rates pose a significant challenge to society, to Government and to enterprise.

²⁰ The ESRI have analysed Department of Social Protection data and on the Live Register and have found that for co-habiting individuals, spousal income appears, at first glance, to exert little influence on their ability to exit the Live Register. More distinct patterns emerge, however, when the data is disaggregated by gender. While males with a spouse earning above €350 per week appear much more likely to exit to employment, the opposite appears to be the case for females. These patterns may, in part, potentially reflect social norms whereby it is less socially acceptable for a male to be supported by a higher earning spouse. However, it may also be picking up unobserved characteristic differences between males and females that are related to spousal income. See ESRI, National Profiling of the Unemployed in Ireland, June 2009

3. Labour Costs and Earnings Data Analysis

Key Findings

- This section examines labour costs across countries, trends in labour costs and unit wage costs to determine whether Irish pay rates are out of line with pay rates in our key competitors
- Ireland has the 17th highest total labour costs level in the OECD-32. Ireland has the 11th highest net wage level in the OECD-32 (almost 12 per cent above the OECD average), partly a result of the relatively small gap between before and after-tax wages in Ireland. In terms of hourly compensation costs in manufacturing in 2011, Ireland (\$39.83) was more expensive than the OECD average (\$33.58), the euro area-13 average (€33.57) and the US (€35.53)
- Following 3 years of competitiveness gains versus the euro area, in 2012 labour costs rose by 1.9 per cent in Ireland - close to the EU and euro area averages. In Q3 and Q4 of 2012, Irish labour costs increased by more than both the EU27 and the euro area 16 average
- Unit labour costs (ULC) measure the average cost of labour per unit of output. The reduction in Irish ULCs relative to ULC's in our key competitors in recent years represents a significant competitiveness gain for Ireland. The European Commission expect this trend to continue out to 2014. However, improvements in overall ULCs are primarily driven by a small number of high productivity exporting sectors and employment losses in lower productivity sectors
- Firms can control labour costs in a number of ways - through reductions in employment, changes in hours worked or through reductions in hourly wages. Since 2008, levels of employment have declined dramatically. As of Q1 2013, earnings per week have declined by 1.1 per cent and the average number of weekly hours worked has fallen by 4.6 per cent. Average hourly earnings have increased by 3.6 per cent
- Where they have occurred, observed decreases in hourly rates are relatively modest. Instead, many firms have continued to reduce numbers employed and/or contracted hours worked, more consistently and to a greater extent, than adjusting pay rates
- This finding is not surprising - there is a body of research which indicates that firms are reluctant to introduce nominal hourly wage reductions. It is more likely that new firms will take advantage of current market conditions. However, given weak domestic demand and low rates of entrepreneurship, it will take time for this cohort to impact on aggregate labour costs and employment growth

3.1 Impact of high costs

High costs damage enterprise development and employment creation. A high cost environment impacts on enterprise development across a range of areas:

- FDI Enterprise Base: A wide range of factors, including cost competitiveness contribute to our attractiveness in winning and retaining overseas investment. The intensification of competition from low cost locations for new FDI investment has coincided with, and exposed, the sharp rise in Ireland's cost base in recent years. Despite relatively strong

productivity growth in these sectors and the containment of unit labour costs, the profile of FDI projects that Ireland has traditionally won has changed (e.g. the labour intensity of investment projects). For the existing FDI base, as some product markets are becoming increasingly commoditised (e.g. electronics in the past decade, pharmaceuticals as products are coming off patent), it is becoming more challenging to sustain value added (i.e. productivity) and cost competitiveness. That fact that Ireland has priced itself back in the market for previously unattainable FDI projects is only in part a result of reductions in wage costs. Perhaps of more relevance to prospective employers is the confidence that they will not be facing significant earnings growth over the medium term. This more positive outlook relating to future labour costs, allied to falling property costs, the availability of skilled workers, reductions in employee churn and the spill over effects resulting from the international economic recovery makes investment in Ireland a more attractive proposition.

- **Indigenous Enterprise Base:** The performance of our indigenous exports remains closely tied to the UK where labour costs are generally lower. For example, this is evidenced by a very strong trading relationship with Ireland exporting 44 per cent of its estimated €7.12 billion food and drink exports to the UK and importing €2.3 billion or 52 per cent of its total food and live animal imports from the UK. Ireland's higher cost base and the appreciation of the euro against sterling places the food and drink sector under pressure both at home, in the UK and in third markets where Irish produce competes with UK produce.
- **Sub-Supply Base to Exporters:** While internationally trading sectors account for a significant share of national value added, they represent a much smaller share of national employment. The more employment intensive locally trading sectors have generally faced a significant rise in unit labour costs - pay costs adjusted for improvements in productivity. Increases in the broader cost environment damage the costs competitiveness of exporting firms as they source essential goods and services. High local costs reduce the multiplier benefits of export driven growth if international trading firms are driven to source a higher proportion of their raw materials and services overseas.
- **At a firm level,** high costs encourage companies to minimise the use of expensive resources such as labour. This can make marginal business opportunities unviable which results in lost output and employment. In cases where high prices are a genuine reflection of market demand and supply (e.g. scarcity), prices serve an important role in ensuring the best use of scarce resources. However, if prices remain high (despite the potential availability of resources - labour, property, etc.), enterprise development and broader economic development (tackling unemployment, building vacancy rates, etc.) is impeded. If firms seek to reduce numbers employed and and/or hours worked as a means of managing high labour costs, the loss of human capital may impede their ability to compete for additional business when demand improves.

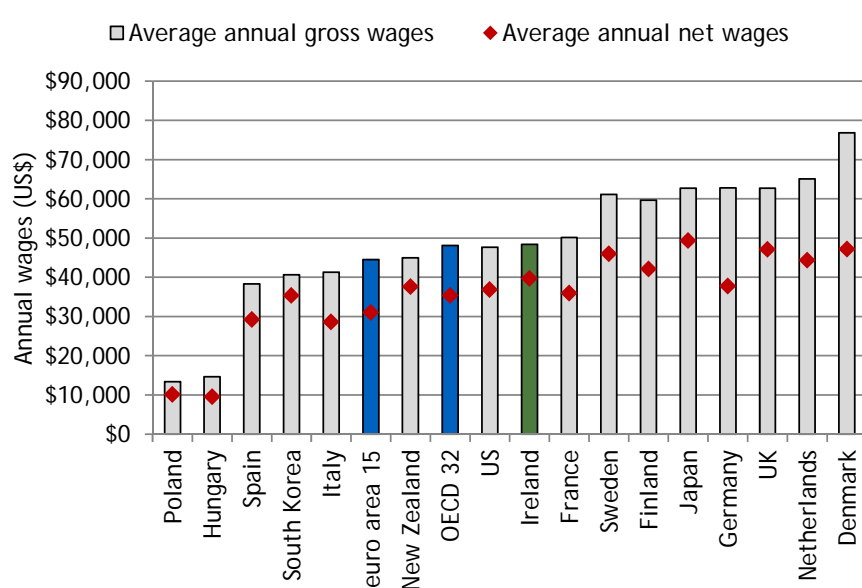
3.2 Overview of Labour Costs Data

This section examines labour costs across countries, trends in labour costs and unit wage costs to determine whether Irish pay rates are out of line with pay rates in our key competitors. A variety of metrics are analysed below. In comparing the trends evident in each chart it is important to be cognisant of the definitional issues.

In general, total labour costs relate to the cost to the employer of hiring an employee. Eurostat define labour costs as core expenditure borne by employers for the purpose of employing staff. This includes employee compensation, with wages and salaries in cash and in kind, employers' social security contributions and employment taxes regarded as labour costs minus any subsidies received.

Also in terms of methodological issues, it is necessary to note that the changing composition of the labour market impacts on wage data - for example, if relatively more low-paid workers have lost their jobs than high paid workers, then this would serve to force average wage levels up.

Figure 5: Average Total Labour Costs and Net Wages, 2012

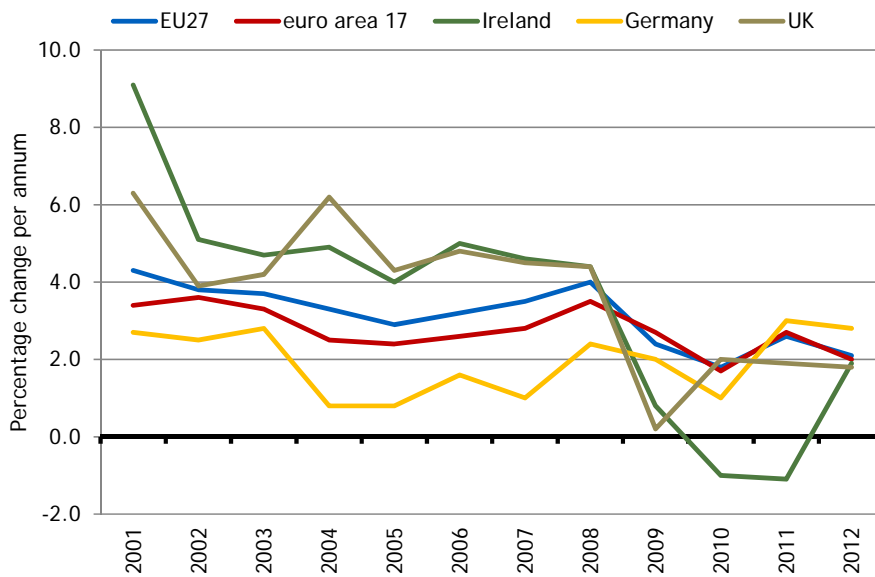


Ireland has the 17th highest total labour costs level in the OECD-32²¹. The chart also shows average net wage levels. Ireland has the 11th highest net wage level in the OECD-32 (almost 12% above the OECD average), partly a result of the relatively small gap between before and after-tax wages in Ireland.

OECD, Taxing Wages 2013

21 Total labour costs include wages, taxes on income and employer and employee social security contributions (and in Ireland, the Universal Social Charge which came into effect on 1st January 2011).

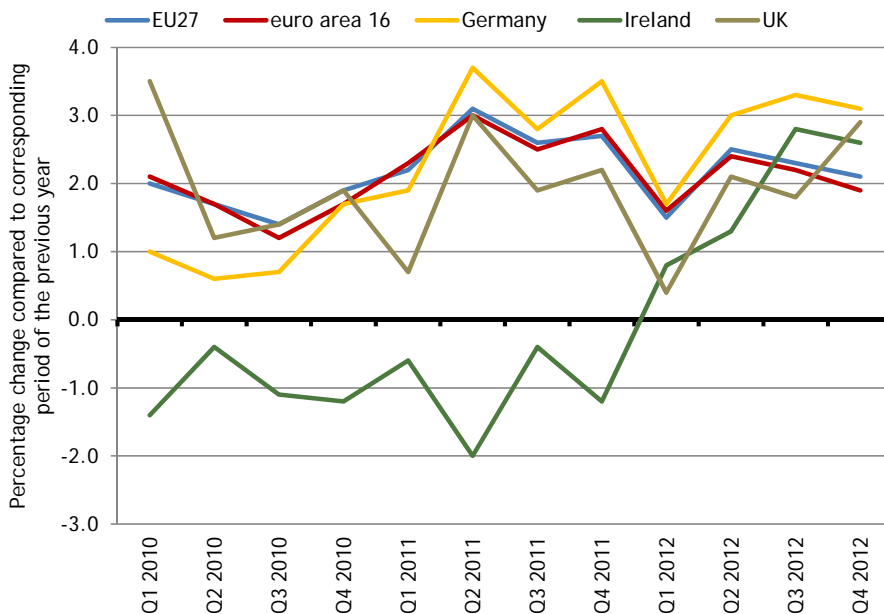
Figure 6: Annual Change in Labour Costs, 2001-2012



This indicator shows the trend in labour cost growth in Ireland compared with the euro area-16 and EU-27. From a high of 9.1% growth in 2001, Irish labour costs have fallen in both 2010 (-1%) and 2011 (-1.1%). This represents a gain in competitiveness as labour costs rose in the EU and euro area. In 2012, labour costs rose by 1.9% in Ireland - close to the EU and euro area averages.

Source: Eurostat

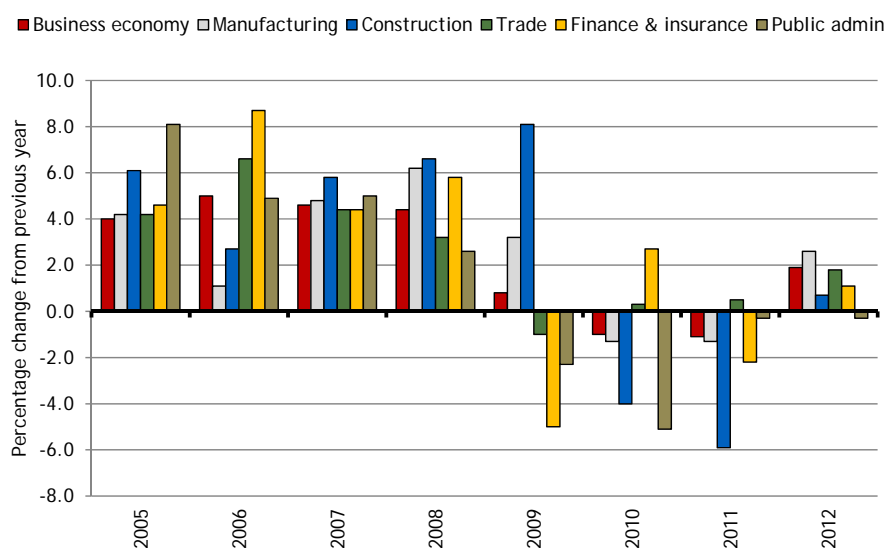
Figure 7: Quarterly Change in Labour Costs, Q1 2010 - Q4 2012



Looking at more recent quarterly data, it is clear that Irish labour costs are once again on an upward trajectory. In the last 2 quarters of 2012, Irish labour costs increased by more than both the EU27 and the euro area-16. Due to methodological differences, the quarterly and annual data do not match up exactly.

Source: Eurostat

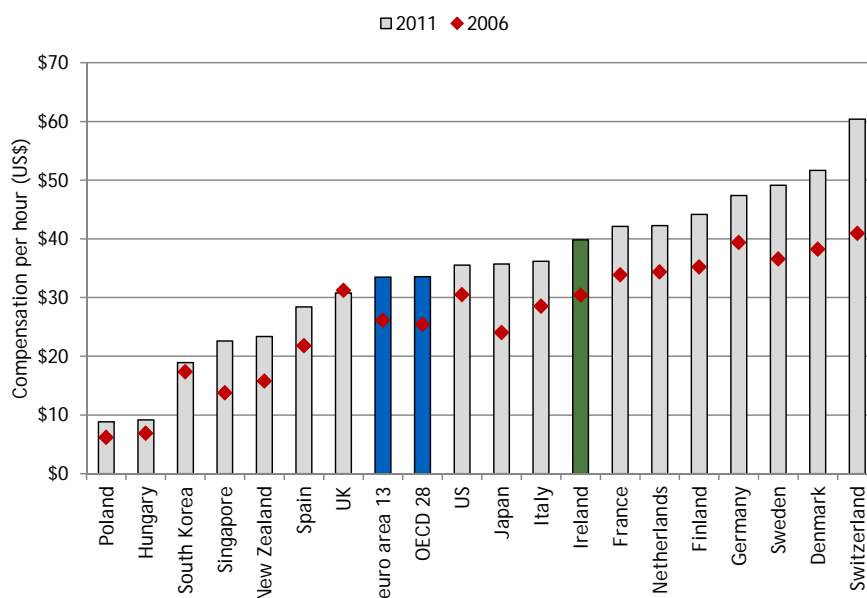
Figure 8: Average Growth Rate in Labour Costs in Ireland²² by Sector, 2005-2012



In 2010 and 2011, average growth rates in labour costs fell across most sectors in Ireland. The biggest declines occurred in construction (-5.9%), finance (-2.2%) and manufacturing (-1.1%). In 2012, however, growth in labour costs resumed, particularly in the manufacturing (+2.6%) and trade sectors (+1.8%).

Source: Eurostat

Figure 9: Hourly Compensation Costs in Manufacturing²² (US\$), 2011



In terms of hourly compensation costs in manufacturing in 2011, Ireland (\$39.83) was more expensive than the OECD average (\$33.58), the euro area-13 average (€33.57) and the US (€35.53). Compensations costs, however, were lower in Ireland than in the Netherlands, Germany, and the Scandinavian countries.

Source: U.S. Bureau of Labor Statistics

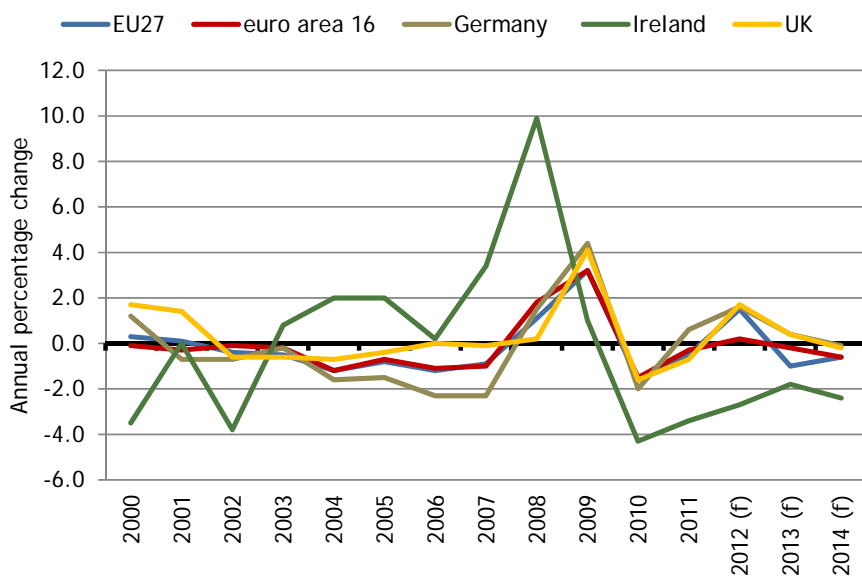
²² Compensation costs relate to all employees in manufacturing and include (1) direct pay, (2) employer social insurance expenditures and (3) labour-related taxes. OECD 28 excludes Chile, Iceland, Luxembourg, Mexico, Slovenia and Turkey; euro area 13 excludes Cyprus, Luxembourg, Malta and Slovenia.

3.3 Focus on Unit Labour Costs

Unit labour costs (ULC) measure the average cost of labour per unit of output²³. ULCs represent a direct link between productivity and the cost of labour used in generating output. Increasing labour costs driven by increases in productivity drive higher national living standards. However, a rise in labour costs higher than the rise in labour productivity may be a threat to an economy's cost competitiveness, if other costs are not adjusted in compensation. ULCs should not be interpreted as a comprehensive measure of competitiveness, but as a reflection of cost competitiveness. ULC measures deal exclusively with the cost of labour, which though important, should also be considered in relation to changes in the cost of capital, especially in advanced economies.

Cross-country evidence suggests that strong growth in unit labour costs in the years leading up to the crisis is related to employment losses during the crisis. German ULCs fell from 2000 to 2007 - having implemented significant labour market reforms in the years preceding the current crisis, Germany has weathered the unemployment crisis relatively well²⁴.

Figure 10: Annual Change in Real Unit Labour Costs, 2001-2014 (f)



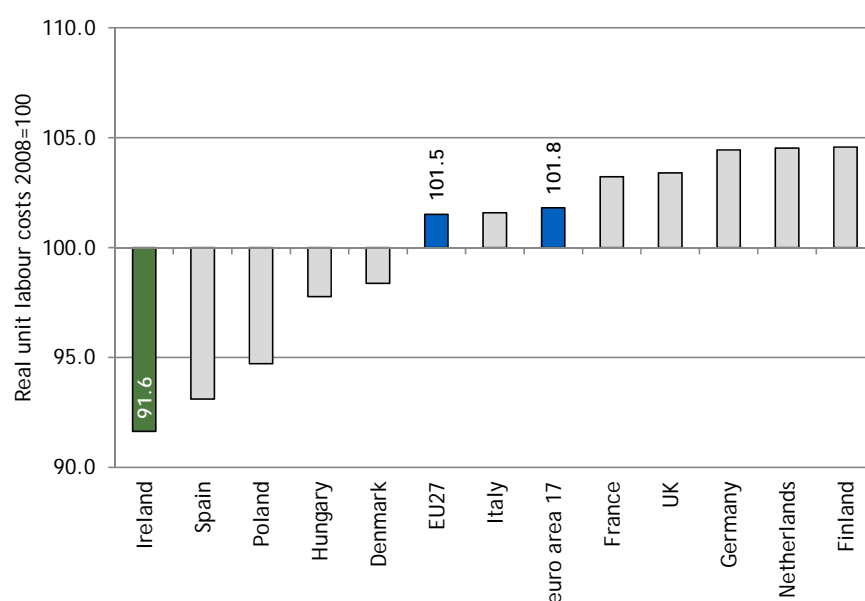
Up to and including 2008, significant annual increases (i.e. deterioration) in Irish ULC's were recorded compared with EU and euro area averages. Conversely, real Irish ULC's fell by 4.3% in 2010 and 3.4% in 2011. The European Commission expect this trend to continue out to 2014, driven by Irish productivity improvements. By comparison, moderate increases (or smaller decreases) are forecast for the EU and euro area.

Source: Eurostat, Unit Labour Costs Annual Data

²³ Nominal unit labour costs are defined as total wage compensation per unit of output. This is equal to the nominal wage rate per worker divided by labour productivity. Real unit labour costs are dividing nominal unit labour costs by the price level and are therefore identical with the wage share in GDP.

²⁴ Hüfner, F. and C. Klein, The German Labour Market: Preparing for the Future, OECD Economics Department Working Papers, No. 983, 2012

Figure 11: Real Unit Labour Costs Index, 2012(f) (2008 = 100)



The reduction in Irish ULCs relative to ULCs in our key competitors represents a significant competitiveness gain for Ireland. Figure 11 shows the scale of this gain - relative to 2008 levels, Irish ULCs have declined by over 8% while ULCs in both the euro area and EU27 have marginally increased over the same period.

Source: Eurostat, Unit Labour Costs Annual Data

As outlined in Forfás' Review of Ireland's Competitiveness Performance²⁵, improvements in overall ULCs have primarily been driven by a small number of high productivity exporting sectors²⁶. Further, the real improvement in Irish ULCs is likely to be weaker than those reported due to sectoral changes in the economy (i.e. as lower productivity sectors contract as a result of the impact of the recession). A number of sectors experienced decreases in ULCs from 2009 to Q1 2011 (the most up-to-date data available) with decreases in manufacturing the most significant. However, ULCs in both the construction and financial services sectors increased during this period indicating a loss of cost competitiveness.

3.4 Recent Developments in Earnings in Ireland

This section examines recent earnings trends in Ireland and relies upon data from the CSO's Earnings, Hours and Employment Costs Survey (EHECS)²⁷ - the most comprehensive and timely

²⁵ See Forfás, Review of Ireland's Competitiveness Performance 2013, May 2013

²⁶ The ESRI, analysing Irish data from 2006-2009 based on the National Employment Survey, have found that despite an unprecedented fall in output and rise in unemployment, both average earnings and average labour costs increased marginally over the period. Their analysis suggests that a good deal of the downward wage rigidity observed within Irish private sector employment has been driven by factors consistent with continued productivity growth. See Bergin, A., Kelly, E., & McGuinness, S., Explaining Changes in Earnings and Labour Costs During the Recession, Renewal Series Paper 9, ESRI, April 2012

²⁷ The Earnings, Hours and Employment Costs Survey (EHECS) replaced the four-yearly Labour Cost Survey, and also replaced all other CSO short-term earnings inquiries. The EHECS results are comparable across sectors and include more detail on components of earnings and labour costs than was previously available.

earnings data available. It is important to note that firms can control labour costs in a number of ways - through reductions in employment, changes in hours worked or through reductions in hourly wages.

While the rapid increase in unemployment has garnered most attention, over the course of the recession there has been much anecdotal news of significant downward adjustment in earnings and rates of pay. However, the observed decreases in hourly rates and weekly rates, based on CSO data are relatively modest, as illustrated in Table 1 below and the subsequent charts, which focus on aggregate data (i.e. for the entire economy). The analysis does not take account of the impact of compositional changes in employment (i.e. changes in the proportions of high and low paid workers in employment)²⁸.

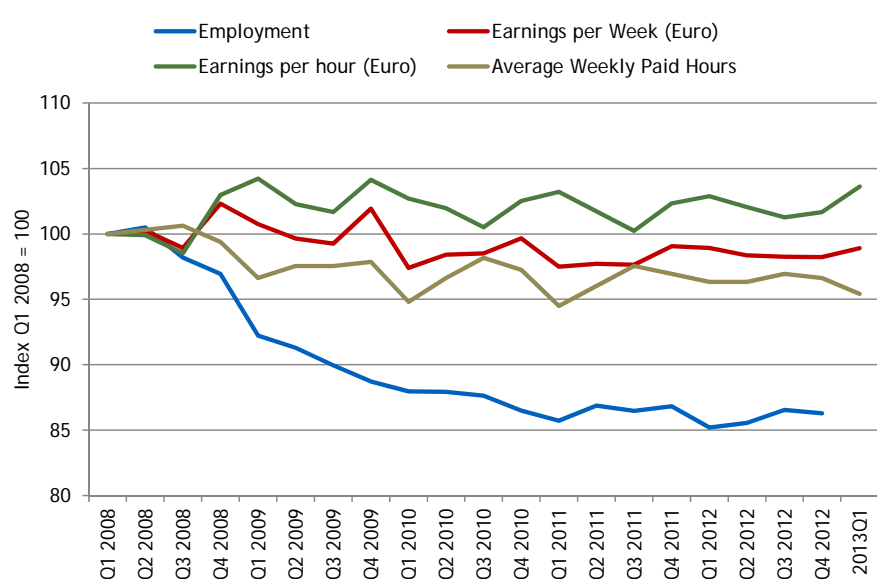
Table 1: Summary of Earnings Data, Q1 2008 - Q1 2013

	Hourly Earnings excluding irregular bonuses	Hourly earnings including irregular bonuses	Earnings per week	Hours per week
Quarterly Change to Q1 2013	1.1	1.9	0.7	-1.3
Annual Change to Q1 2013	1.2	0.7	0.0	-1.0
Change Q1 2008 to Q1 2013	4.5	3.6	-1.1	-4.6

Source: CSO, EHECS Earnings Hours and Employment Costs Survey

28 In their 2009 analysis of composition effects, the CSO noted that “one difficulty typically faced in analysis of short-term earnings data is that the lack of data on the composition of employment within an organisation does not allow the effect of changes in the composition of employment to be estimated. For example, if within an enterprise a group of high paid workers were hired at a point in time then the average earnings for that enterprise will rise, not because of any change in pay-rates but solely due to the compositional effect of having a greater proportion of workers on higher pay scales”. In the period Q3 2008 to Q3 2009 the compositional effect was +1 per cent (i.e. changes in composition of employment added 1 per cent to average hourly earnings). Between 2009 and 2010 the compositional effect (+1%) exactly matched and cancelled out the change in hourly earnings (-1%). Between 2010 and 2011 no compositional effect was measured. For further details see CSO, Analysis of Wage Bill Change in Enterprises and Components of Change, Quarter 3 2008 to Quarter 3 2009, 2010 and Walsh, L., Wage Bill Change in Ireland During Recession - How Have Employers Reacted to the Downturn, Journal of the Statistical and Social Inquiry Society of Ireland, Vol. 41, 2011-2012

Figure 12: Earnings per Week, Earnings per Hour and Hours Worked, Q1 2008 - Q1 2013



This chart tracks average earnings and hours worked, as well as total employment since 2008. Since 2008, levels of employment have declined dramatically. As of Q1 2013, earnings per week have declined by 1.1% and the average number of weekly hours worked has fallen by 4.6%. Average hourly earnings have increased by 3.6%.

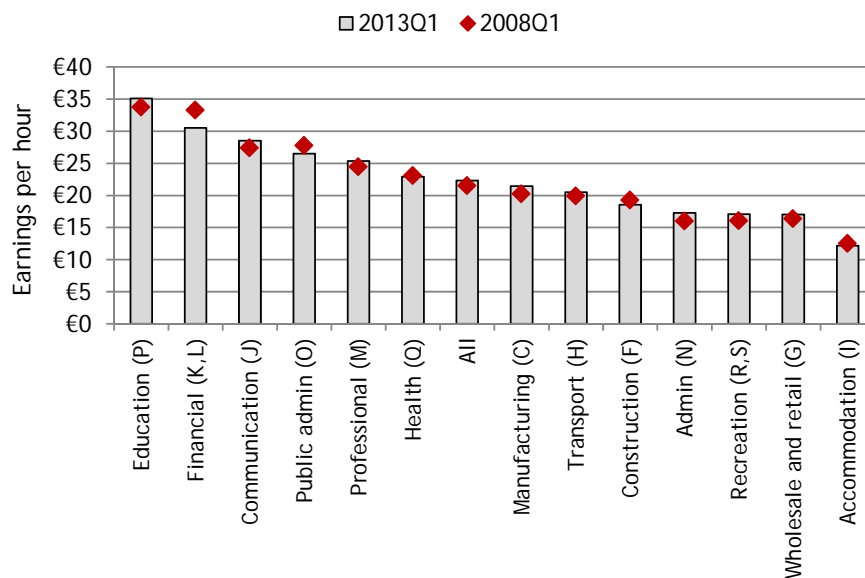
Source: CSO, EHECS Earnings Hours and Employment Costs Survey

As well as weekly and hourly measurements, it is possible to examine earnings data according to economic sector, occupational grouping, and firm size, as well as differentiating between public and private sector earnings. The main hourly and weekly trends are summarised below.

3.4.1 Hourly Earnings Trends

Over the last year, hourly earnings rose in 6 of 13 sectors, with the largest increases in administrative and support services (+9.4%). The largest decline was recorded in the professional sector (-3.1%). Figure 14, however examines sectoral data over a longer time horizon.

Figure 13: Average Hourly Earnings, Industry Sector, Q1 2008 - Q1 2013



As highlighted in Table 1, aggregate hourly earnings in Q1 2013 were 3.6 per cent above their Q1 2008 level. Since Q1 2008, hourly wages increased in the majority of sectors. Notable exceptions are electricity (-11.1%), finance (-8.4%), public admin (-4.5%) and construction (-3.8%).

Source: CSO, EHECS Earnings Hours and Employment Costs Survey

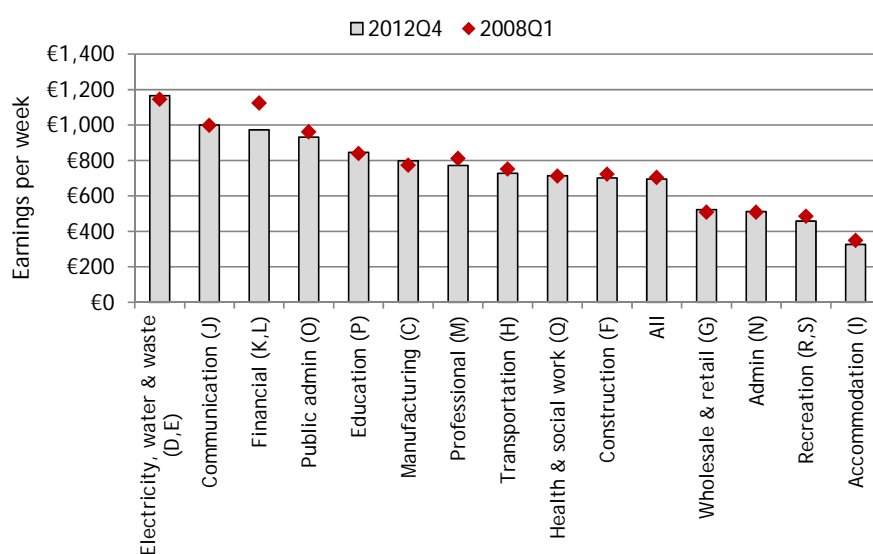
Looking at firm size, hourly earnings increased across all firm categories since Q1 2008²⁹. Hourly earnings increased by 2.6 per cent in small firms, by 4.0 per cent in medium sized firms and by 3.0 per cent in large firms. There was, however, significant variation between sectors. In sectors such as financial services where a significant proportion of hourly wages were accounted for by irregular bonuses, much of the hourly decline arose as a result of significant reductions in these payments - financial service bonuses fell by over 50 per cent since their peak.

3.4.2 Weekly Earnings Trends

At an aggregate level, average weekly earnings (average hourly wages * average hours worked per week) were virtually unchanged in the year to Q1 2013. Across the economic sectors average weekly earnings increased in 6 of the 13 sectors in the year to Q1 2013, with the largest percentage increase in the administrative and support services sector (+3.3%). The largest percentage sectoral decrease in weekly earnings was recorded in the professional, scientific and technical sector (-3.7%). Figure 14 looks at the change in weekly earnings over the course of the recession.

²⁹ EHECS breaks firms into three categories: under 50 employees, 50-250 employees and above 250 employees. Data on earnings by occupations were discontinued after Q1 2010.

Figure 14: Earnings per Week (Euro), Industry Sector, Q1 2008 - Q1 2013



Primarily driven by changes in hours worked, reductions in weekly wages were recorded in 11 out of the 15 sectors analysed. The largest reductions were recorded in accommodation (-16.4%), electricity (-12.1%), construction (-9.6%) and financial services (-7.6%). Increases were recorded in a number of other sectors including communications (+5%) and manufacturing (+3.6%).

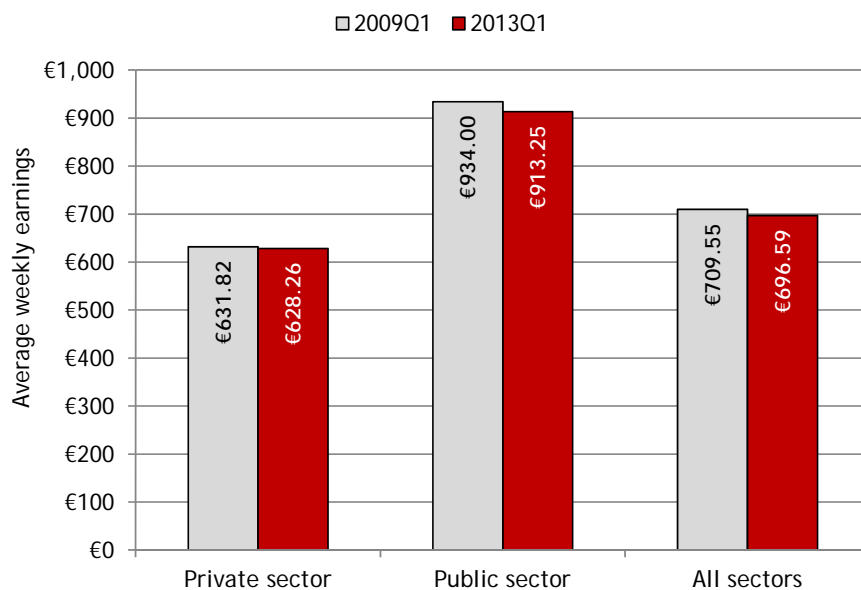
Source: CSO, EHECS Earnings Hours and Employment Costs Survey

In terms of firm size, weekly earnings in small firms declined by 5 per cent between Q1 2008 and Q4 2012. Reductions of 3.1 per cent were recorded in medium sized firms while weekly earnings in large firms increased by 1.5 per cent over the same period.

3.4.3 Public and Private Sector Wage Developments

Employment in the public sector declined by 1.3 per cent over the year to Q1 2013 bringing the total to 383,500 (including semi-state bodies). The reduction in numbers in the public sector over the four years from Q1 2009 to Q1 2013 now stands at 37,500 (-8.9%). In the year to Q1 2013 numbers fell in all areas across the public sector with the largest percentage decrease recorded in the Health sector (-6.3%).

Figure 15: Average Weekly Public and Private Sector Earnings, Q1 2009 - Q1 2013



Weekly earnings the public sector declined by 0.5% in the year to Q1 2013 compared with a private sector increase of 0.7%. In the four years to Q1 2013 average weekly public sector earnings have fallen by -2.2%, compared with a decrease of -0.6% in private sector earnings.

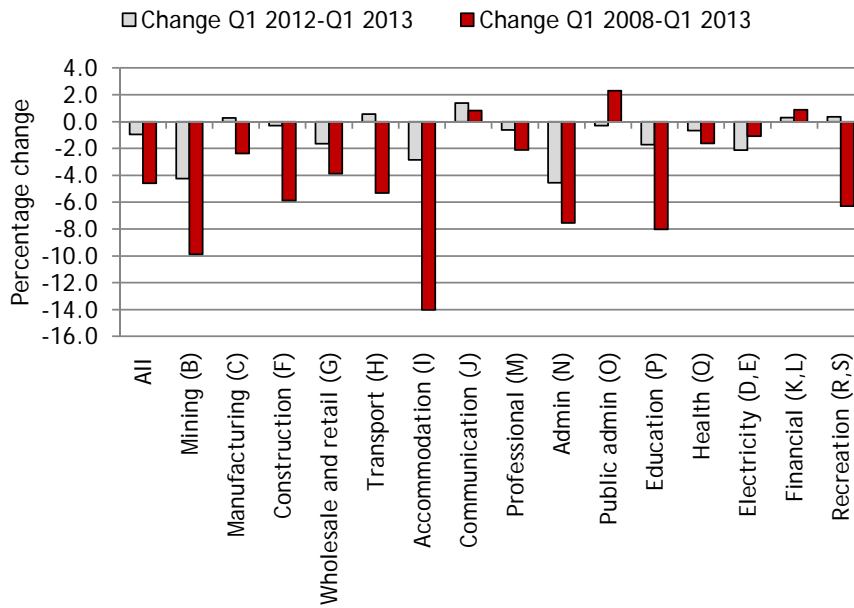
Source: CSO, EHECS Earnings Hours and Employment Costs Survey

3.4.4 Trends in Weekly Paid Hours

Average weekly paid hours were 31.2 in Q1 2013, down by 1 per cent over the year. This represented a 4.6 per cent decline on weekly paid hours in Q1 2008. In the public sector average weekly paid hours decreased by 0.6 per cent over the year to Q1 2013, from 31.7 hours to 31.5 hours.

Looking at a longer time horizon, since Q1 2008, public sector hours have decreased marginally (-0.3%) while paid hours in the private sector have fallen by 6 per cent.

Figure 16: Change in Weekly Paid Hours, Q1 2008 - Q1 2013



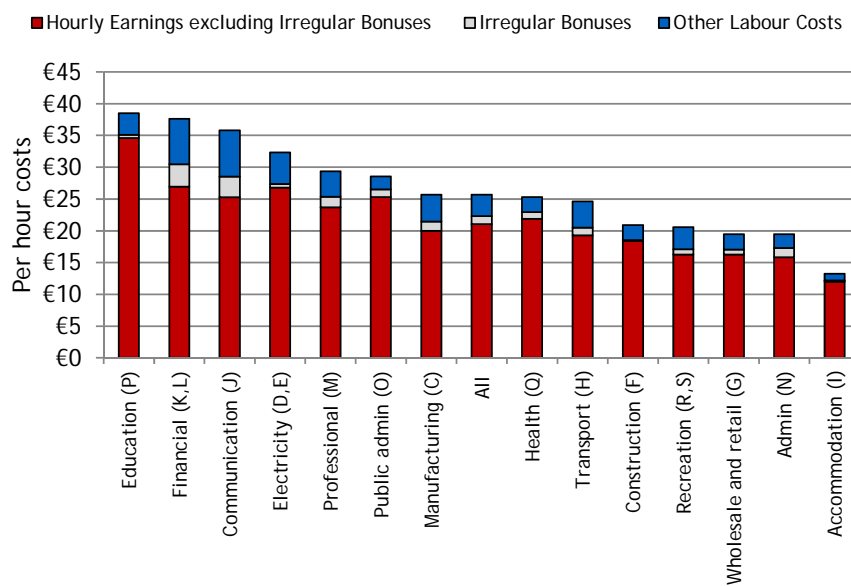
The largest annual percentage increase in average weekly paid hours in Q1 2013 was recorded in information and communications (+1.4%), while the largest percentage decrease over the same period was seen in the administrative service sector (-4.5%).

Source: CSO, EHECS Earnings Hours and Employment Costs Survey

3.4.5 Labour Costs

Figure 17 examines labour costs as opposed to earnings. Labour costs are a particularly important metric from a competitiveness perspective and include regular hourly earnings, irregular bonuses and other labour costs. Other costs encompass statutory employers' PRSI including the social security contributions for apprentices; other social costs (e.g. pension fund contributions, life assurance premiums, income continuance insurance; benefits in kind; redundancy payments).

Figure 17: Labour Costs by Sector, Q1 2013



Between 2008 and 2012, labour costs increased by 2.6%. Reductions in labour costs were recorded in a number of sectors including finance (-8.2%), construction (-7.6%), accommodation (-6.7%) and public administration (-4.9%). Increases were recorded for recreation (11.5%), manufacturing (6.2%) and communications (4.9%).

Source: CSO, EHECS Earnings Hours and Employment Costs Survey

3.4.6 Conclusions on Earnings Trends in Ireland

Economy-wide hourly wages have remained relatively stable in recent years. Despite the effects of the recession, this is not unexpected - there is a body of research which suggests that, even when there are no external constraints such as sectoral wage agreements, firms are reluctant to introduce nominal hourly wage reductions.

- EU and US based research suggests that employers resist reductions in hourly wages largely because the savings from lower wages are usually outweighed by the cost of denting workers' morale: pay cuts hit workers' standard of living and lower their self-esteem^{30,31}. Falling morale raises staff turnover and reduces productivity. Employers are also concerned about the impact that pay cuts may have on staff retention.
- Firms also generally prefer layoffs to pay cuts because they are less harmful to morale. Although layoffs negatively impact upon morale, their effects are less severe and are shorter than those of wage reductions.
- Firms similarly do not generally seek to take advantage of changes in circumstances (i.e. by hiring additional, equally qualified staff at significantly lower wage rates than existing employees) as this too can damage morale and ultimately productivity.

30 Du Caju, P, Theodora, K., Lawless, M, Messina, J. and Room, T., Why Firms Avoid Cutting Wages: Survey Evidence from European Firms, Central Bank of Ireland, Research Technical Paper, 3/RT/13

31 Bewley, T.F., Why Wages Don't Fall During a Recession, 1999, Harvard University Press.

It is more likely that new firms will take advantage of current market conditions. However, given weak domestic demand and low rates of entrepreneurship³², it will take time for this cohort to impact on aggregate labour costs and employment growth.

32 Global Entrepreneurship Monitor (GEM) data indicates Irish entrepreneurial activity levels (new business ownership rate) have fallen in recent years, with 2.3 per cent opening and managing a business in 2012 compared to 4.3 per cent in 2008. For further details, see GEM, Global Report 2012, January 2013

4. Social Welfare and Replacement Rates

Key Findings

- Jobseekers' Benefit and Jobseekers Assistance are designed to offer income maintenance during periods of frictional or cyclical involuntary unemployment, rather than to serve as an alternative long term source of income. The challenge is to provide income support to those who become unemployed while ensuring that incentives exist to find new employment
- The replacement rate measures the proportion of out-of-work benefits received when unemployed against take home pay if in work. In general, a replacement rate in excess of 70 per cent is considered to act as a disincentive to work (i.e. if an individual can receive more than 70 per cent of in-work income in benefits, they will demand a higher wage in the market to retain a monetary incentive to work)
- Replacement rates vary significantly by individual and family circumstances. For example, a couple with two children and one earner on the average industrial wage has a replacement rate of 66 per cent compared with a replacement rate of 37 per cent for a single individual earning the same amount
- The ESRI, using micro simulation models and nationally representative survey data, have estimated that approximately 28.6 per cent of unemployed persons in receipt of either Jobseekers Benefit or Jobseekers Allowance have replacement rates in excess of 70 per cent
- Irish replacement rates for married couples with child dependents appear high relative to those in other countries
- Secondary benefits, and specifically housing entitlements, are a major influencing factor on replacement rates for those who avail of these supports. Under a planned new Housing Assistance Payment, the contribution that the tenant will make towards their rent will be based on a means test that links the level of contribution to the household income, rather than employment status (i.e., it will not penalise those working)
- The rollout of the Housing Assistance Payment (i.e. decoupling housing support from social welfare payments) is an essential element in removing barriers to employment and reducing replacement rates. Once implemented, the impact of HAP on replacement rates should be monitored to ensure that the payment successfully reduces barriers to employment, whilst protecting living standards
- Further reforms are recommended:
 - Reform the social welfare system so that unemployment benefits (and consequently replacement rates) decline in line with the length of time a person is out of work.
 - Undertake a comprehensive review of Secondary Benefits Retention arrangements, with a view to establishing whether or not they are effective in the long term in removing barriers to the take up of employment
 - Review social welfare supports for part time workers to ensure that they have a significant financial incentive to avail of an employment opportunity

- In terms of activation, there should be wider adoption of activation programmes which are linked directly to enterprise needs, have significant employer engagement in course development, selection of candidates, and programme delivery, and which offer internships to participants

4.1 Introduction to Replacement Rates

Jobseekers' Benefit (JB) and Jobseekers Assistance (JA) are designed to offer income maintenance during periods of frictional or cyclical unemployment, rather than to serve as an alternative long term source of income. The replacement rate measures the proportion of out-of-work benefits received when unemployed against take home pay if in work. Higher replacement rates increase the disincentive to take up offers of employment. As such, it sets a de facto rather than legal minimum wage.

In general, a replacement rate in excess of 70 per cent is considered to act as a disincentive to work (i.e. if an individual can receive more than 70 per cent of in-work income in benefits, they will demand a higher wage in the market to retain a monetary incentive to work³³).

In addition to Jobseekers' Benefit or Jobseekers Assistance support, secondary benefits, and specifically housing entitlements, are a major influencing factor on replacement rates.

It is important to note, however, that replacement rates are not the sole determinant of the decision to take-up employment: for instance, the impact of the decision to accept or reject employment on future earnings has an impact. It should also be noted that replacement rates do not generally take account of the cost of working (e.g. travel, childcare, potential loss of medical card, etc.) which can be significant. Similarly, the less tangible, non-financial rewards from taking up employment also influence the decision making process³⁴. Such factors partially explain why some people in employment have replacement rates in excess of 100 per cent.

4.1.1 Steps take that have Reduced Replacement Rates

A range of actions have been taken in recent budgets to reduce replacement rates, including:

- Reductions in the personal rate of payment for new JA claimants aged 18 and 19 years of age (2009);
- Reductions of at least 4.1 per cent in all social welfare payments made to those of working age and larger reductions in JA rates for claimants under the age of 25 (2010)³⁵;
- Increases in the lower threshold for payment of the universal social charge (2012);

33 It is important to note the interaction between replacement rates, and control and activation measures - the more efficient the control and activation measures a country has in place, the higher the replacement rate it can sustain without creating unemployment traps. For more information on the 70 per cent threshold, see: Department of Finance, Replacement Rates and Unemployment, 2009 and Department of Finance, Tax Strategy Group 11/14, Replacement Rates 2011, September 2012.

34 Callan, T., Walsh, J.R., and Coleman, K., Work Incentives, Poverty and Welfare in Ireland, The Economic and Social Research Institute Policy Research Series No. 60, 2007

35 See Department of Finance, Financial Statement of the Minister for Finance, 9th December 2009

- Entitlement to jobseekers benefit is now based on a five day rather than a six day week where a person is working for part of a week (2012);
- Inclusion of Sunday working in the calculation of JB and JA payments for those engaged in casual or part time working (2013).

According to the ESRI, the reforms are having an impact - high replacement rates were more common in 2005 than in 2012³⁶.

Some steps have already been taken to address the impact of housing entitlements upon replacement rates³⁷. Arising out of commitments in the Programme for Government to review the operation of the Rent Supplement Scheme, proposals to integrate the systems for providing rent supplement and social housing support have been advanced³⁸. The Government has decided, in principle, to transfer responsibility for the provision of rental assistance to persons with a long term housing need from the Department of Social Protection (currently provided through Rent Supplement) to housing authorities using a new Housing Assistance Payment (HAP)³⁹.

The effect of this transfer and the introduction of a new form of Housing Assistance Payment will be to remove a barrier to accessing full-time employment that exists under the Rent Supplement scheme. Under the new Housing Assistance Payment, the contribution that the tenant makes towards the rent will be based on a means test that links the level of contribution to the household income, rather than employment status.

4.2 Overview of Replacement Rate Data

The following charts examine Irish replacement rates (based on data from the Department of Social Protection). Irish replacement rates are then placed in an international context. It is important to note, however, that the replacement rates displayed for various examples of family types shown in the charts should be used for indicative purposes only as family circumstances can vary substantially.

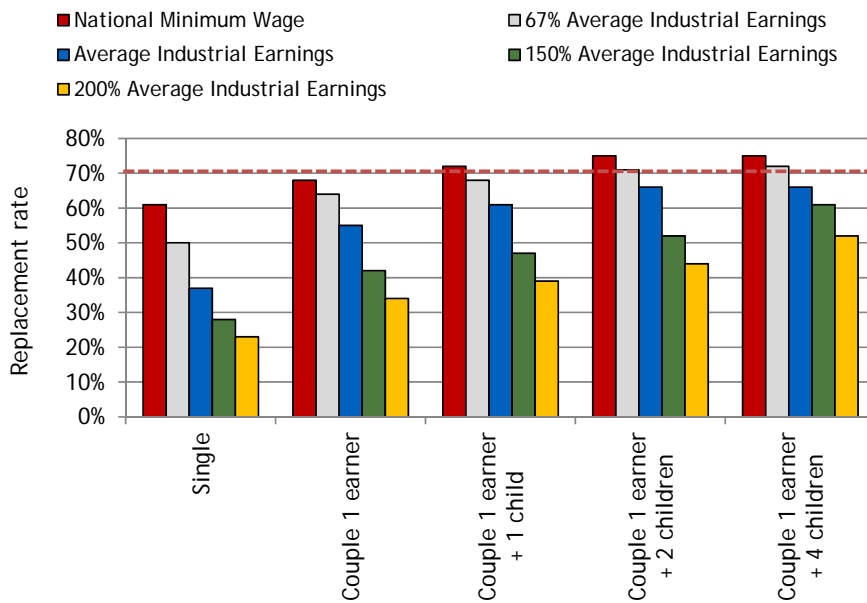
36 Callan, T., Keane, C., Savage, M., Walsh, J.R. and Timoney, K., Work Incentives: New Evidence for Ireland, published in ESRI, Budget Perspectives 2013, Research Series No. 28, September 2012

37 It was announced in Budget 2012 that the minimum contribution an individual in receipt of Rent Supplement must pay towards rent would increase.

38 Rent Supplement is paid to people living in private rented accommodation who cannot provide for the cost of their accommodation from their own resources. In general, individuals qualify for a Rent Supplement, if their only income is a social welfare payment and they satisfy a range of other conditions.

39 At present there are around 70 rent schemes in the country operated by individual housing authorities. Under the Housing (Miscellaneous Provisions) Act, 2009, a new regulatory framework will be put in place that will set national parameters for local rent schemes. This new model will be progressive and will allow for a gradual increase in rent contribution as the household income rises.

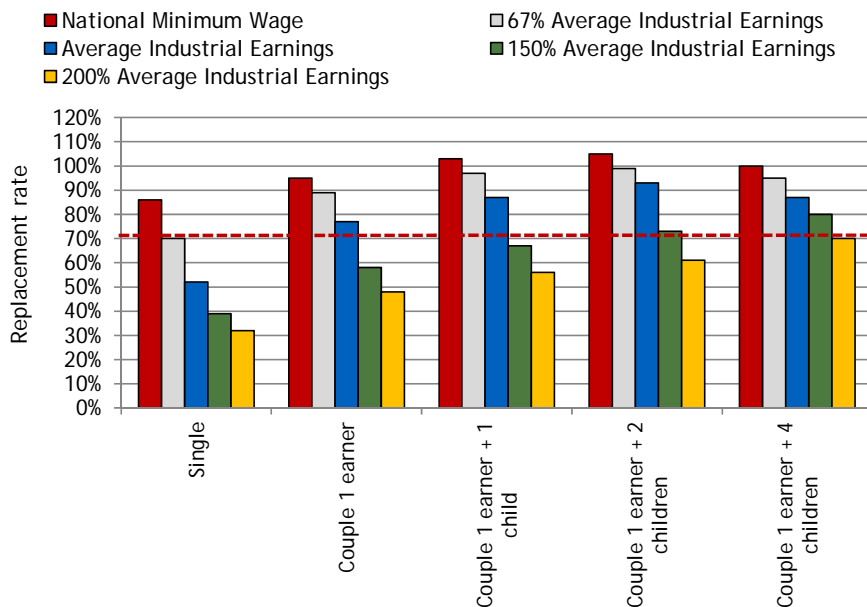
Figure 18: Replacement Rates in Ireland, 2013



Replacement rates tend to be lower for single people compared with married couples - for example a couple with two children and one earner on the average industrial wage has a replacement rate of 66% compared with a replacement rate of 37% for a single individual earning the same amount.

Source: Department of Social Protection

Figure 19: Replacement Rates including Dublin Rent Supplement in Ireland, 2013



The inclusion of existing housing benefits in the replacement rate calculation has a significant adverse effect on results - pushing several recipient types above the 70 per cent threshold, particularly those earning less than the average wage.

Source: Department of Social Protection

In considering the implications of these replacement rate data, one must acknowledge that these measurements do not reflect the incidence of replacement rates (i.e. the proportion of people that fall into each category). Using Live Register data, the Department of Social Welfare have concluded that of the 425,088 claimants analysed in March 2013⁴⁰:

- 73 per cent (311,190) were claiming for themselves only (i.e. no dependents)'
- 5 per cent (21,500) are couples with no children;
- 4 per cent (18,000) are couples with one child;
- 9 per cent (37,500) are couples with two or more children;
- 5 per cent (19,800) are claiming a personal rate (i.e. one adult) plus two or more children;
- 4 per cent (15,500) are claiming personal rate plus one child.

In terms of housing entitlements, the numbers in receipt of either rent supplement or local authority/mortgage interest supplement are also relatively low: 9.1 per cent (38,664) are entitled to rent supplement, while 1.7 per cent (7,325) are getting Mortgage Interest Supplement.

The importance of understanding the actual numbers of people with high replacement rates has been consistently reiterated by the ESRI - using micro simulation models (and nationally representative survey data) they have estimated that approximately 28.7 per cent of unemployed persons in receipt of either Jobseekers Benefit or Jobseekers Allowance have replacement rates in excess of 70 per cent⁴¹. The same study, however, found that the average (mean) replacement rate facing unemployed people in receipt of Jobseeker payments is 56 per cent (with the median replacement rate at 53 per cent).

4.2.1 International Comparisons

International replacement rates are presented for the initial period of unemployment, and for those unemployed for longer than 60 months (a particularly important measure given the recognised difficulty of long term unemployed individuals exiting the Live Register)⁴².

A degree of caution is required when analysing this data. The ESRI have pointed out that while the calculations regarding the individual cases are accurate, "some interpretations of the results do not take into account the composition of actual unemployment, and the extent

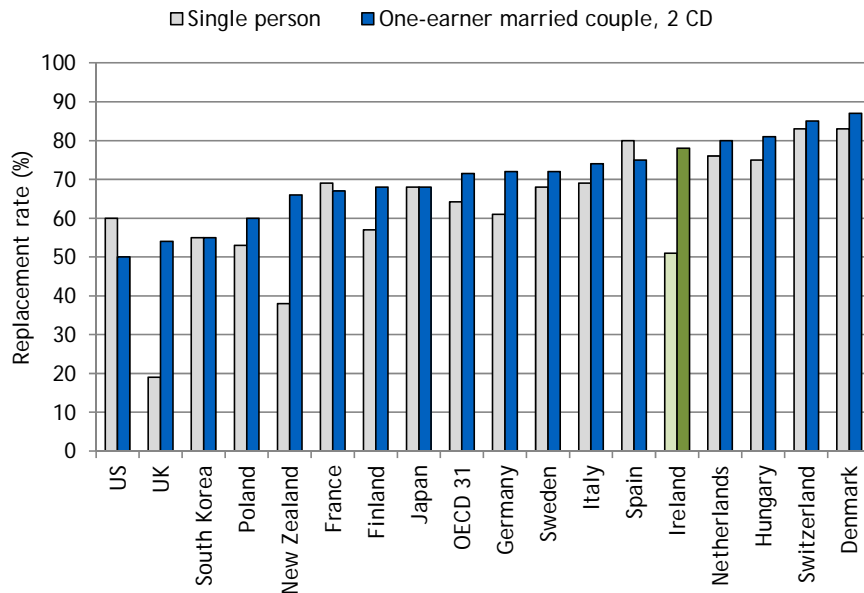
40 These figures are calculated using differing metrics to those used in replacement rate calculations. Therefore they provide only a general indication of the numbers in various replacement rate categories.

41 Callan, T., Keane, C., Savage, M., Walsh, J.R. and Timoney, K., Work Incentives: New Evidence for Ireland, published in ESRI, Budget Perspectives 2013, Research Series No. 28, September 2012

42 The data relates to 2010 - given recent initiatives in Ireland to reduce replacement rates, it is likely that Irish rates have since declined. Of course, other countries may have since implemented reforms. Note that due to the OECD methodology, Figure 20 which illustrates the replacement rate for the initial phase of unemployment does not include entitlement to housing assistance while Figure 21 dealing with replacement rates for the long term unemployment does include entitlement to housing assistance.

to which 'add-on' payments are or are not received by the unemployed population. These factors...can have a substantial impact on how benefit regimes compare in practice"⁴³.

Figure 20: Net Replacement Rates - Initial Phase of Unemployment (67% of Average Wage), 2010

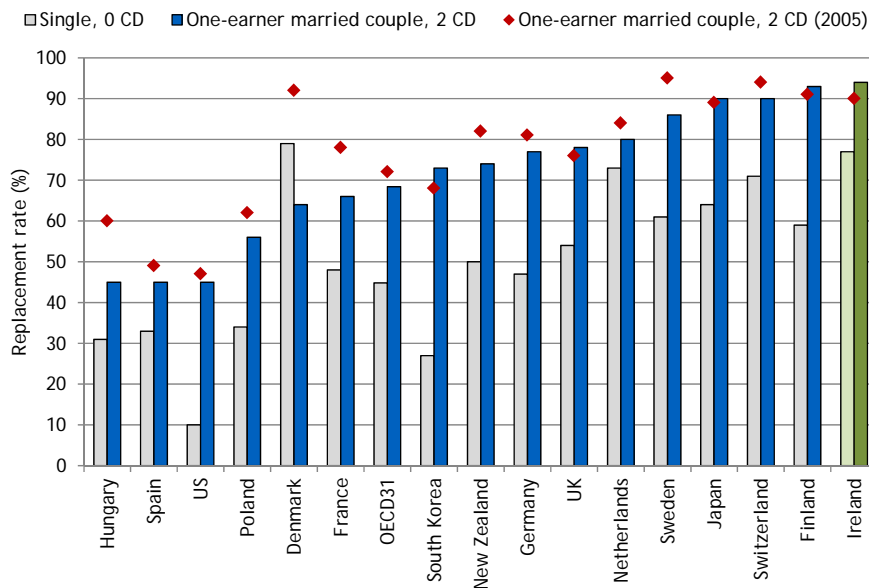


This chart illustrates replacement rates for the initial phase of unemployment for both a single person and a one-earner married couple with 2 children (neither qualifies for housing assistance). While the Irish replacement rate is amongst the lowest in the OECD for single people, it exceeds the OECD average for the couple with two children.

Source: Source: OECD, Tax-Benefit Models, Online Database

43 Further, the ESRI contend that results from the OECD database have been misinterpreted by both the OECD and the IMF, each of which maintains that Ireland's long-run replacement rates are high by international standards. The ESRI find that replacement rates for Ireland are close to typical values for EU15 countries. For more information, see Callan, T., Keane, C., Savage, M., Walsh, J.R. and Timoney, K., Work Incentives: New Evidence for Ireland, published in ESRI, Budget Perspectives 2013, Research Series No. 28, September 2012

Figure 21: Net Replacement Rates for Long Term Unemployment (67% of Average Wage), 2010



Irish replacement rates for the long term unemployed - which include housing benefits - were significantly higher than the OECD average for both single earners and one-earner married couples with 2 children (earning 67% of the average wage). These replacement rates apply to a small subset of those in receipt of jobseekers supports in Ireland (i.e. those who are long term unemployed who also receive Rent Supplement).

Source: OECD, Tax-Benefit Models, Online Database

4.3 Policy Considerations

The issue of replacement rates and the need for structural reform of the social welfare system has been recognised and acted upon over recent years. A system which had developed on an incremental basis over the years has seen a series of positive changes and reforms recently (some of which are on-going), including but not limited to:

- The establishment of a new further education and training authority SOLAS (Seirbhísí Oideachais Leanúnaigh agus Scileanna) to oversee funding and policy direction for the Further Education and Training sector. SOLAS will co-ordinate education and training activities delivered by the VEC and FÁS to date⁴⁴.
- The establishment of 16 Education and Training Boards (ETBs) to replace the 33 Vocational Education Committees (VECs)^{45,46}.

44 In January 2013, the Minister for Education and Skills published the Further Education and Training Bill 2013 which provides for the establishment of SOLAS.

45 The Education and Training Boards Bill 2012 was published by the Minister for Education and Skills in October 2012. The enactment of the Education and Training Boards Bill allows for the formal establishment of the 16 new Education and Training Boards. Six FÁS Training Centres will move to the relevant Education and Training Boards by the end of 2013.

- The development of Intreo as a single point of contact for all employment and income supports (i.e. the integration of employment services and benefit payment services). Nine Intreo centres are operational around the country with the service expected to be available nationwide in 2014.
- On-going reform of Working Age payments to facilitate activation.
- Reform of Child Income Supports to facilitate the move from welfare to work.

When determining the scope for further reform to support labour competitiveness, a number of other objectives must also be considered. For example, the adequacy and sustainability of the welfare system must be maintained in light of both fiscal and demographic challenges⁴⁷. A key goal here is that “work pays for welfare recipients”. The system must also continue to provide targeted support to those who are most at risk of poverty whilst facilitating and encouraging the transition of individuals from welfare to work⁴⁸.

In their September 2012 report, the IMF noted that in Ireland (in contrast to most other EU members), unemployment benefits do not vary with the duration of unemployment⁴⁹. It was further noted that such a flat structure of unemployment payments can lead to disincentives for a minority of job seekers (e.g. through the creation of poverty traps) and as a consequence could contribute to lower exit rates from the Live Register⁵⁰.

While welfare payments remain flat (and can increase) over employment duration, it is likely that the individuals earning potential will decline over time. Research using the International Adult Literacy Survey has found an economically significant negative relationship between work interruptions and skills⁵¹. A full year of non-employment is associated with skills losses that are equivalent to moving 5 percentiles down the skill distribution. Moreover the loss is more severe for those with longer durations of unemployment. In addition the long term

46 The June 2013 EU/IMF Memorandum of Economic and Financial Policies requires the authorities to “conduct by September 2013 a strategic review of the training and education provision offered by Education and Training Boards (ETBs) to guide the strategic work of SOLAS and the FET provision by ETBs. The review will evaluate the FET provision in terms of its relevance for labour activation purposes. The review will provide an assessment of the existing provision as well as recommendations to enhance their relevance for activation purposes”.

47 In 2013 Jobseeker’s Benefit duration was reduced from twelve months to nine months for recipients with 260 or more contributions paid and from nine months to six months for recipients with less than 260 contributions paid. Payments under Jobseekers Benefit in January 2013 were 50 per cent lower than in January 2010. However, expenditure on Jobseekers Allowance (a payment to those who are not eligible for Jobseekers Benefit or who have already exhausted their Jobseekers Benefit entitlements but who satisfy a means test in order to qualify) continues to increase. See Department of Public Expenditure, Labour Market Synopsis Issue 3, March 2013

48 The merits of introducing a single payment for people of working age as a tool to improve both income and employment outcomes for individuals have already been considered in depth by the Department of Social Protection. For further details, see Department of Social Protection Report on the desirability and feasibility of introducing a single social assistance payment for people of working age November 2010

49 IMF, Country Report No. 12265, Ireland: Selected Issues, September 2012

50 IMF, 2012 Article IV Consultation with Ireland - Concluding Statement of the IMF Mission, 18 July 2012

51 Edin, P. and Gustavsson, M., Time Out of Work and Skill Depreciation, Uppsala University Department of Economics, Working Paper 2004:14, 2004

unemployed also have to overcome employer bias, where employers will tend to select job seekers more recent job history. A long period of unemployment is likely to lower earnings potential which contributes to increasing replacement rates over time.

Recommendation: Reform the social welfare system so that unemployment benefits (and consequently replacement rates) decline in line with the length of time a person is out of work.

Responsibility: Department of Social Protection

The Advisory Group on Tax and Social Welfare is currently analysing working age income supports with a particular focus on addressing anomalies in the interaction of the tax and social welfare codes.

The issue of secondary benefits⁵² and their impact upon an individual's incentive to take up an offer of employment merits specific consideration (i.e. secondary benefits increase replacement rates, and their loss upon the take up of employment may create employment disincentives). At the same time, the impact of withdrawing secondary benefits on in-work poverty needs to be borne in mind. As pointed out by Watson et al., the rate at which such benefits are withdrawn as someone begins to work in what may be an insecure job needs to be carefully planned⁵³.

Recommendation: Undertake a comprehensive review of secondary benefits retention arrangements for those in receipt of Jobseekers Benefit or Jobseekers Assistance, with a view to establishing whether or not they are effective in the long term in removing barriers to the take up of employment.

Responsibility: Department of Social Protection

The issue of housing entitlements is especially important in relation to replacement rates. In particular, those in receipt of Rent and Mortgage Supplement tend to have higher than average replacement rates - this payment creates particularly high replacement rates because while it is available to those who are not in employment, in effect, it is not available to those who are in employment. The same ESRI report previously referenced has found that about 7 out of 10 of the unemployed recipients of Rent and Mortgage Supplement face replacement rates of over 80 per cent.

52 Secondary benefits for those in receipt of Jobseekers Benefits and Jobseekers Assistance may include: Rent Supplement, Mortgage Interest Supplement, Fuel Allowance, Rental Accommodation Scheme (RAS), Medical Card and GP Visit Card, Back to School Clothing and Footwear Allowance, School Books Grant Scheme

53 Watson, D, Maître, B., and Whelan, C.T., Work and Poverty in Ireland: An Analysis of the CSO Survey on Income and Living Conditions 2004-2010, Department of Social Protection, 2012

Some steps have already been taken to minimise the adverse impact of such supports on employment decisions⁵⁴. Proposals to integrate the systems for providing rent supplement and social housing support have been advanced⁵⁵. The Government has decided, in principle, to transfer responsibility for the provision of rental assistance to persons with a long term housing need from the Department of Social Protection (currently provided through Rent Supplement) to housing authorities using a new Housing Assistance Payment (HAP)⁵⁶.

The effect of this transfer and the introduction of HAPs will be to remove a barrier to accessing full-time employment that exists under the Rent Supplement scheme. Under HAPs, the contribution that the tenant makes towards the rent will be based on a means test that links the level of contribution to the household income, rather than employment status.

Recommendation: The rollout of the Housing Assistance Payment (i.e. decoupling housing support from social welfare payments) is an essential element in removing barriers to employment and reducing replacement rates. Once fully implemented, the impact of HAP on replacement rates should be monitored to ensure that the payment successfully reduces barriers to employment, whilst protecting living standards.

Responsibility: Department of Environment, Community and Local Government

The ESRI has also assessed the costs of working and have built these costs into their analysis of replacement rates⁵⁷. As would be expected, including the costs of working (e.g., travelling to work, childcare while working, etc.) increases the replacement rate for relevant groups. The analysis found that 12.2 per cent of the unemployed population would earn more income on welfare than in work, when the costs of working are included. They also find that 34.6 per cent of the unemployed population face replacement rates higher than 70 per cent, when factoring in the extra costs of working. However, they also note that most of the cohort while face high replacement rates are actually in work. Better and more cost effective transport and childcare services would reduce the costs of working.

It was noted earlier that there has been a significant increase in the number of casual workers in the economy. The number of casual workers in receipt of a jobseeker's payment

54 It was announced in Budget 2012 that the minimum contribution an individual in receipt of Rent Supplement must pay towards rent would increase.

55 Rent Supplement is paid to people living in private rented accommodation who cannot provide for the cost of their accommodation from their own resources. In general, individuals qualify for a Rent Supplement, if their only income is a social welfare payment and they satisfy a range of other conditions. The reason that these payments create particularly high replacement rates is that they are available to those who are not in employment, but, in effect, are not available to those who are in employment.

56 At present there are around 70 rent schemes in the country operated by individual housing authorities. Under the Housing (Miscellaneous Provisions) Act, 2009, a new regulatory framework will be put in place that will set national parameters for local rent schemes. This new model will be progressive and will allow for a gradual increase in rent contribution as the household income rises.

57 Callan, T., Keane, C., Savage, M., Walsh, J.R. and Timoney, K., Work Incentives: New Evidence for Ireland, ESRI Budget Perspectives 2013

has increased more than four-fold over the last seven years⁵⁸, and in 2012, it was estimated that 20 per cent of the Live Register was made up of people who are either casual or part-time claimants receiving a payment due to a loss of working hours as opposed to facing full time unemployment⁵⁹.

The OECD has also stated that Ireland also stands out internationally due to its very high number of unemployment benefit recipients, far above the number of unemployed according to the standard ILO definition used in labour force surveys⁶⁰. They note that close to one fifth of recipients have casual or part-time jobs, due to a loss of working hours as opposed to facing full-time unemployment. The OECD suggests that these workers enjoy generous work income disregards in the determination of benefit amounts.

The OECD goes on to note that besides being costly, this can add to work disincentive effects. While this system provides strong incentives for jobseekers to take up part-time jobs, part time workers face high marginal effective tax rates when moving to a full-time job and will also lose benefit eligibility. The OECD recommends that for part-time workers, work income disregards in the determination of benefits should be made less generous. Recognising this trend, the Department of Social Protection is considering the future structure of the jobseeker schemes. It is important that there are no disincentives in place which would discourage a move from part time to full time employment.

Recommendation: Review social welfare supports for part time workers to ensure that they have a significant financial incentive to avail of an employment opportunity.

Responsibility: Department of Social Protection

Finally, the enforcement of the existing rules continues to be important. Part-time workers in receipt of Jobseekers Benefit / Jobseekers Assistance must continue to look for full-time employment (i.e. must be available for work and actively looking for work to qualify). There is a responsibility on employers, therefore, to report instances where an individual refuses to return to full time employment (following a temporary reduction in hours) in order to maintain their social welfare payments⁶¹.

Continued action on ensuring that replacement rates do not create impediments to the take up of employment must occur in tandem with improved activation and up-skilling⁶². Similarly,

58 PQ 14772/13, Tuesday, 26 March 2013

59 Department of Public Expenditure, Labour Market Synopsis Issue 3, March 2013

60 Pina, Á., Structural Reforms to Reduce Unemployment and Restore Competitiveness in Ireland, OECD Economics Department Working Papers, No. 910, OECD, 2011

61 The Social Welfare Act 2010 provides that payments can be reduced if an individual refuses an appropriate offer of training by an officer of the Department of Social Protection or FÁS, or declines an intervention under the Employment Action Plan (EAP), does not attend EAP meetings with a FÁS officer under the EAP or drops out of the EAP process. More proactive engagement and adherence to existing rules is already evident – as of August 2012, some 1,275 jobseekers' payments have been reduced.

62 As part of the requirements of the EU/IMF programme, a Review of Employment Support Schemes under the Department of Social Protection has been completed and an action plan aimed at increasing the effectiveness of training and activation support schemes is due shortly. Further, it is intended to

any reforms should be considered in the context of the level of employment opportunities available.

4.4 Labour Market Activation

Structural imbalances in the labour market arising from the past dominance of the construction sector remain. At the same time, concerns persist about the availability of enterprise relevant skills despite the unemployment crisis. At present, skills shortages are currently limited to specialised positions in the information and communications sector (e.g. designers and developers with specific skill sets such as sophisticated database architecture, JAVA related applications etc.), in high tech manufacturing (mostly in the biopharma sector), in the financial services sector (e.g. risk analysts, credit specialists, actuaries), and in the health sector (e.g. medical doctors, radiographers, and advanced nursing practitioners)⁶³.

However, the reality is that many unemployed workers are ill-equipped to work in those sectors most likely to experience employment growth. A major programme of up-skilling and re-skilling is essential to support growth in employment and to support labour cost competitiveness.

In the longer term, Ireland must address long standing participation bottlenecks - historically, Ireland has had relatively low rates of labour market participation and employment among certain groups (e.g. females; lone parents; persons with a disability; older workers and people dependent on welfare).

A number of programmes have been introduced recently, designed to up-skill unemployed workers, and provide them with practical work based experience. The greater emphasis on evaluation, targeting, and accreditation which has accompanied the development of recent programmes (e.g. Jobbridge⁶⁴ and Springboard⁶⁵) is to be welcomed. Similarly, the proactive nature of engagement between State agencies and the unemployed set out in Pathways to Work is an important development⁶⁶.

Activation measures should primarily aim to improve employability and should be characterised by:

- Identifiable labour market/ enterprise needs;
- Ability to target candidates appropriately to programmes based on their abilities, skills and learning requirements;

improve the targeting of these schemes by ensuring that participation by jobseekers is increasingly guided by case workers and that priority is given to the long term unemployed.

63 A skills shortage refers to a situation whereby there are an insufficient number of individuals who have the required qualifications, skills set and/or experience to fill a particular post. For further detail, see Expert Group on Future Skills Needs, National Skills Bulletin 2012, July 2012

64 Jobbridge is a national internship scheme, which provides up to 5,000 work experience placements for interns for a 6 or 9 month period.

65 Springboard is a series of educational courses aimed at areas where there are current or future opportunities (e.g. in finance, green energy, ICT, science and environment, sales and marketing).

66 Department of Social Protection, Pathways to Work: Government Policy Statement on Labour Market Activation, March 2012

- Emphasis on quality assurance and demonstrated progression pathways for the learner - to employment/self-employment, further/higher education and training;
- Structured internship / opportunities providing work experience opportunities within enterprise.

There has been some progress in this regard through the rollout of the Springboard programme and to an even greater extent, with the development of a Higher Diploma Level 8 Conversion Programme in Computing. Such programmes directly link higher education places with identified enterprise needs and have significant employer engagement in course development. In the case of the Conversion Programme, companies were involved in the selection of candidates for entry to the courses, delivery of aspects of the programme and the provision of internship placements during the programme. This close education/ industry engagement increases the prospects of progression to employment on completion of such programmes and also encourages better engagement of jobseekers in up-skilling and conversion where the progress paths are clearer. Wider adoption of models such as this should be considered where evaluations have found positive outcomes. There is also more scope to align broader education and training provision with the needs of the labour market.

Research from the Department of Public Expenditure and Reform⁶⁷ indicates that of the €1,346 million spent on labour market activation, over 60 per cent is spent on programmes with 'weak' linkages to the labour market. The Department of Social Protection have recently reviewed their suite of activation programmes and recommendations are being implemented. On the Further Education and Training side, a Strategic Review of existing provision based on the skills needs of the economy and the capabilities of the unemployed, particularly the long term unemployed, is underway. Further potential exists to prioritise spending towards more effective provision (i.e. supporting people to enter/re-enter employment).

Recommendation: There should be wider adoption of activation programmes which are linked directly to identified enterprise needs; have significant employer engagement in course development; selection of candidates, and programme delivery; and which offer internships to participants.

Responsibility: Department of Education and Skills / Department of Social Protection

Incentivising Employment Creation

Given the collapse in demand for labour over the course of the recession, a series of incentives have been put in place to encourage job creation. Under the Action Plan for Jobs 2013, it is planned to introduce a cash-flow benefit for employers to recruit individuals that are long-term unemployed. Under this scheme the State will pay circa €1 of every €4 it costs the employer to recruit a person off the Live Register.

The JobsPlus Initiative will replace existing employment support schemes that had relatively low take-up due to a number of reasons including the multiplicity of schemes which caused confusion, poor marketing of the schemes and administrative burdens. If the initiative is to be

⁶⁷ Sourced from draft DPER Paper 'Labour Market and Labour Market Activation', June 2013

successful, it will be essential that lessons are learned from the administration of the earlier schemes.

Recommendation: The design of the JobsPlus programme should enable clear communication of the benefits of the initiative, be easily accessible and create limited administrative burden for business. This will require a well-resourced media campaign to provide information and support take-up.

Responsibility: Department of Social Protection

5. Sectoral Wage Setting Mechanisms

Key Findings

- Hourly wage rates are sticky
- Even in sectors of the economy where there are not external constraints on setting wages (such as sectoral wage agreements), firms are very reluctant to cut hourly wages given its impact on morale and productivity
- There is no evidence that hourly wages in the sectors covered by JLCs/REAs have declined as a result of the High Court decision in July 2011 - in fact, since July 2011 hourly earnings have increased marginally in most sectors and have increased overall by 1.9% since Q2 2011
- It is too early to assess the impact on earnings and employment of the Industrial Relations (Amendment) Act in August 2012
- While the legislative underpinning for sectoral agreements has now changed, new Joint Labour Committees have yet to be established. It is only as the various parties come together under the new JLC arrangements to negotiate and agree hourly new Employment Regulation Orders that we can expect to see an impact on labour competitiveness
- The reforms introduced in the Industrial Relations Amendment Act are expected to bring about a simplification in the compliance requirements for enterprise which arise from managing and implementing the agreements
- The finalisation of the overtime and Sunday working codes of practice will also have an impact upon labour competitiveness
- The impact of the recent Supreme Court decision (9th May 2013) striking down Registered Employment Agreements put in place under the 1946 Industrial Relations Act is unclear at this point

5.1 Introduction to Sectoral Wage Setting Mechanisms

The Memorandum of Understanding, agreed between Ireland, the IMF, the European Central Bank and the European Commission, sets out a series of reforms which Ireland must implement as part of the deal to secure continued fiscal support. More specifically in relation to the labour market, Ireland is required to “report to the staff of the European Commission, the IMF, and the ECB on the impact on the labour market of reforms to sectoral wage-setting mechanisms”. This is required by the end of the second quarter of 2013⁶⁸. This action was subsequently reiterated in the Action Plan for Jobs 2013.

In response to this requirement, Forfás has undertaken a literature review, analysed the relevant earnings data from the CSO and engaged in a series of consultations with key stakeholders from the sectors most impacted by the sectoral wage agreements system. We have also held a series of meeting with DJEI officials.

⁶⁸ International Monetary Fund, IMF Country Report No. 13/93 - Ireland: Ninth Review Under the Extended Agreement, April 2013.

5.1.1 What are Sectoral Wage Setting Mechanisms?

Sectoral wage-setting mechanisms are sectoral agreements dealing with the pay and working conditions of employees. The terms of these agreements may also be included in an employee's contract of employment. Employers of workers covered by EROs and REAs are obliged to pay the wage rates and provide the conditions of employment prescribed by the collective agreement.

Joint Labour Committees (JLCs) are statutory bodies to provide the machinery for the fixing of minimum rates of pay and the regulation of conditions of employment. They are composed of representatives of employers and workers in a particular sector. JLCs are established by order of the Labour Court. The various agreements on pay and conditions made by Joint Labour Committees (JLCs) are known as Employment Regulation Orders (EROs).

Agreements which result from negotiations between trade unions and employers are called Collective Agreements. If a Collective Agreement has been registered with the Labour Court (i.e. if the Labour Court is satisfied that the agreement meets the statutory requirements), it is known as a Registered Employment Agreement (REA).

Prior to the introduction of the Industrial Relations (Amendment) Act 2012, registration had the effect of making the provisions of the agreement legally enforceable in respect of every worker of the class, type or group to which it is expressed to apply and to his or her employer, even if such worker or employer is not a party to the agreement. The 2012 Act introduced new provisions requiring a Ministerial order to give legally binding effect to an REA.

5.1.2 Scope of Agreements

In 2009, it was estimated that between 212,000 and 284,000 workers⁶⁹ were covered by either EROs or REAs. At present (prior to the conclusion of the on-going reform agenda), Joint Labour Committees exist for the sectors outlined in Table 1.

There are 75 REAs on the Register maintained by the Labour Court. Prior to the recent Supreme Court judgment, there were 6 existing sectoral REAs registered or varied by the Labour Court in recent years. It is estimated that between 70,000 and 80,000 workers were covered by these sectoral agreements. In addition, there were over 50 employment agreements covering individual enterprises that had been registered since 1946.

Table 2: List of JLCs and REAs

Joint Labour Committees	Registered Employment Agreements
<ul style="list-style-type: none">▪ Agricultural Workers▪ Catering (Dublin and Dun Laoghaire)	<ul style="list-style-type: none">▪ Construction Industry▪ Contract Cleaning Industry

⁶⁹ Duffy, K. & Walsh, F., Report of Independent Review of Employment Regulation Orders and Registered Employment Agreement Wage Setting Mechanisms, Department of Jobs, Enterprise and Innovation, April 2011.

- | | |
|--|---|
| <ul style="list-style-type: none"> ▪ Catering (Other) ▪ Contract Cleaning ▪ Hairdressing ▪ Hotels (Dublin and Dun Laoghaire) ▪ Hotels (Other excluding Cork) ▪ Law Clerks ▪ Retail Grocery and Allied Trades ▪ Security Industry | <ul style="list-style-type: none"> ▪ Drapery, Footwear and Allied Trades ▪ Electrical Contracting Industry ▪ Overhead Powerline Contractors ▪ Printing Industry |
|--|---|

An examination of the hourly rates guaranteed by EROs suggests that these agreements are offering a premium of approximately nine per cent over the national minimum wage (NMW) rate⁷⁰. Current REAs can provide for a wage rate multiple times that of the NMW.

5.2 Reform of the Sectoral Wage Setting Mechanisms

5.2.1 Reforms undertaken

Following a High Court ruling, all EROs ceased to have statutory effect from 7th July 2011⁷¹. As a result, the pay and conditions of employees who started work after 7th July 2011 were governed by employment legislation such as the minimum wage. Existing employees who were covered by an ERO had existing contracts of employment, which governed their pay and conditions of work.

In response, the Industrial Relations (Amendment) (No. 3) Bill was enacted on 24th July 2012 and commenced on 1st August 2012. The Act sought to provide more comprehensive measures to strengthen the legal framework for the ERO and REA sectoral wage setting mechanisms, in the light of deficiencies in the original legislation identified in the High Court judgment.

The Act also seeks to make the system more responsive to changing economic circumstances and labour market conditions - issues raised in the Independent Review of Wage Setting Mechanisms, undertaken in 2011 as part of commitments made under the EU/IMF Economic Adjustment Programme for Ireland.

The principal measures in the legislation include:

⁷⁰ The difference between the employment weighted average of the JLC minimum wages and the national minimum wage suggests a positive differential of about 10 per cent for the average JLC rates. For further details, see Duffy & Walsh (2011).

⁷¹ For details, see John Grace Fried Chicken and others v The Catering Joint Labour Committee, The Labour Court, Ireland and the Attorney General. Also background to the various challenges to EROs and applications for judicial review can be found in Department of Jobs, Enterprise and Innovation, Industrial Relations (Amendment) (No. 3) Bill - Regulatory Impact Assessment, December 2011.

In 2008 the High Court also granted leave to a number of electrical contractors to seek Judicial Review of the REA in the electrical contracting industry. While the Judicial Review focused primarily on challenging compliance with the existing legislative requirements, constitutional issues similar to those in the ERO challenge were raised. On 9 May 2013 the Supreme Court declared the system of making Registered Employment Agreements (REAs) to be unconstitutional.

- The restoration of the constitutionality of EROs and REAs through inclusion of more robust principles and policies.
- Provision for Ministerial and Oireachtas oversight in the making of EROs and Orders relating to REAs.
- JLCs will have the power to set a basic adult rate and two additional higher rates, based on length of service in the sector or enterprise concerned as well as the standards and skills recognised for the sector concerned.
- In setting rates, JLCs will have to take into account a series of economic (e.g., level of employment and unemployment, the general level of wages in comparable sectors, including wage trends in comparable competing sectors in other relevant jurisdictions) and industrial relations factors.
- JLCs will no longer set Sunday premium rates⁷².
- Companies will be able to derogate from EROs and REAs in cases of financial difficulty. Such derogation will be granted, for a limited period, in cases of proven economic difficulty, following consultation with the employees.
- The burden of compliance and record-keeping requirements for employers will be reduced.
- Provision for use of civil remedies rather than an exclusive reliance on criminal sanctions.
- Changes in the decision making process of JLCs, including changes which oblige the Chairman to have regard to a relevant Labour Court recommendation in the event of a casting vote being exercised.
- The introduction of a time-bound process by which the terms of an REA may be varied by the Labour Court in certain circumstances without necessarily obtaining the consent of all parties to the REA.

5.2.2 Reforms Outstanding

A number of outstanding initiatives related to sectoral wage agreements, which could have an impact upon labour costs, are still being finalised. Specifically, the Minister has asked the Labour Relations Commission (LRC) to develop two Codes of Practice which will provide guidance to employers and employees in complying with the Organisation of Working Time Act.

- The first, on Sunday working, will be prepared by the LRC following submissions from employers and trade unions. This Code will provide guidance to both parties in the sectors covering EROs on the compensatory arrangements, including such additional amounts as are reasonable, for Sunday working and on the procedure to apply in the event of disputes concerning the varying entitlements to Sunday working.

⁷² Instead, Sunday working in these sectors will be governed by existing employment legislation, which currently provides protection for Sunday working across the entire workforce. The Organisation of Working Time Act 1997, which will continue in force, requires that employers recognise Sunday working in one of three ways: Sunday premium payment; increased hourly rate across the whole week; time off in lieu.

- The second will address the standardisation of benefits in the nature of pay - including overtime and the conditions under which it becomes payable - across sectors covered by JLCs. Consultations between the LRC and the social partners are currently underway.
- Under the Action Plan for Jobs 2013 (Action 116), both Codes are due to be agreed and given effect through a Ministerial Order by Q3 2013⁷³.

Third, the impact of the newly developed derogation in cases of financial difficulty remains to be determined - use of derogation will not occur until after new Employment Regulation Orders are made and Collective Agreements are registered.

Finally, while the legislative underpinning for sectoral agreements has been reformed, new Joint Labour Committees have yet to be established and the new framework has not been utilised. It is only as the various parties come together under the new JLC arrangements to negotiate and agree new Employment Regulation Orders that we can expect to see an impact on labour competitiveness. Whether this occurs, will be a matter for the relevant parties to decide.

5.3 Impact of Reforms

As previously noted, the purpose of this section is to analyse and report on the impact on the labour market of reforms to sectoral wage-setting mechanisms. Specifically, the Action Plan for Jobs 2013 commits Forfás and DJEI to “review wage developments and labour cost competitiveness in relevant sectors”.

This section assesses labour cost and employment trends across the entire economy, before assessing key sectors, where sectoral agreements are prevalent, in more detail. The analysis focuses primarily on those sectors covered by either JLCs or REAs and which account for significant employment numbers. The sectors addressed are:

- Wholesale and Retail;
- Accommodation and Food; and
- Construction.

Important Data and Methodological Issues

- Given that the Industrial Relations (Amendment) (No. 3) Act commenced on 1st August 2012, very limited employment and earnings data is available with which to assess the impact of the reform of sectoral agreements. In terms of the time periods analysed, the analysis compares wage and employment levels prior to the High Court ruling (Q2 2011) with subsequent wage and employment levels - with a particular focus on the

⁷³ In some sectors, the impact of the Codes may be limited as sectoral level agreements have already addressed the issue of Sunday working. For example, through engagement at JLC level, the Sunday Premium in both the Catering JLCs and the Hotel JLC were re-negotiated in 2009. Employer and worker representatives on both the catering and hotels JLC agreed to reduce the Sunday premium rate from double time to time and a third. Note, however, that under the provisions of the Industrial Relations (Amendment) Act, JLCs will no longer set Sunday premia payments.

impact of new Act which came into effect on 1 August 2012. The analysis draws on CSO's Earnings and Labour Costs publication which captures salary data up to Q1 2013 and employment data up as far as Q4 2012.

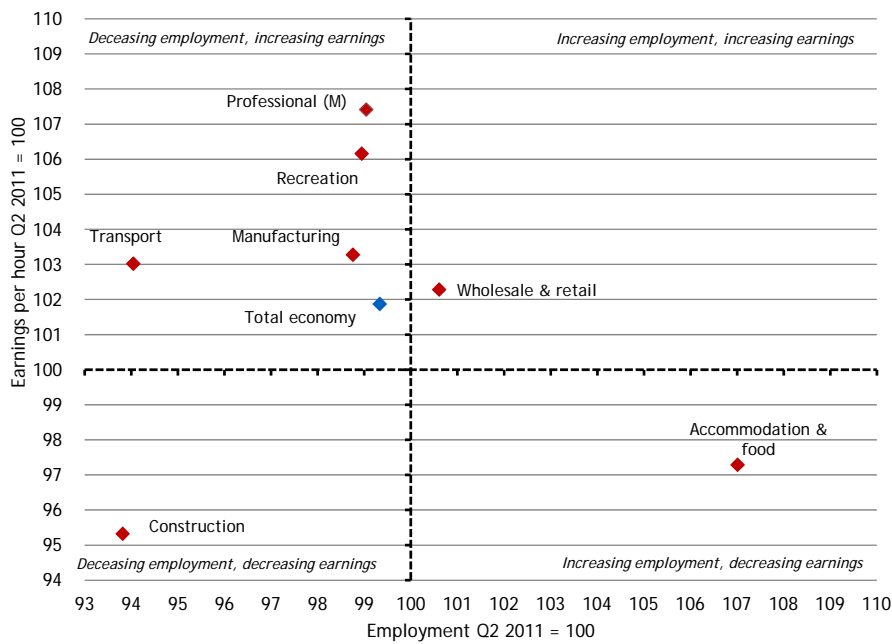
- We do not have precise data on who is covered by sectoral wage agreements and what sectors they work in. For the purposes of this analysis, we have taken three key sectors where EROs/REAs are prevalent and have analysed these using CSO data which is based on NACE codes. The NACE classifications should be seen as broad proxies for wage and employment developments in the related sectoral wage agreement.
- Any assessment of the impact of reform must take account of the depressed economic climate. As the IMF recently noted, the level of demand for goods and services in Ireland is explicitly linked to and dependent upon the economic wellbeing of our key trading partners - weak global demand impacts directly upon demand in Ireland with knock-on effects on employment creation. In the absence of a global upswing in economic growth, domestic reform will only have limited employment impact in the immediate term. On the other hand, it could be expected that wage growth in Ireland would be depressed regardless of the impact of any structural changes.
- It is worth noting that other factors are constantly at play in the labour market and changes in the status of JLCs and REAs did not occur in isolation. For instance, the Employer Job (PRSI) Incentive Scheme⁷⁴ has been in place for much of the period under consideration and is a complicating factor when considering the impact of either the High Court decision or the commencement of the Act on employment (i.e. it is not possible to isolate the effect of individual schemes and decisions on employment growth or earnings at this point).
- The level of compliance with sectoral wage agreements has in the past been a cause for concern as highlighted in annual and quarterly reports by the National Employment Rights Authority (NERA).

5.3.1 Economy-wide Earnings and Employment Trends

Figure 22 shows the change in employment (x-axis) and hourly earnings (y-axis) across a range of relevant sectors since the High Court ruling of July 2011. Over the 18 month period, most sectors experienced increases in earnings per hour alongside reductions in employment levels.

74 A series of exemptions allowing employers to be exempt from paying employer PRSI contributions for new eligible employees for 12 months, providing certain conditions are met, were first introduced in 2010. Further, in May 2011 it was announced that the lower rate of employer PRSI would be halved for all jobs that pay up to €356 per week from 1st July 2011.

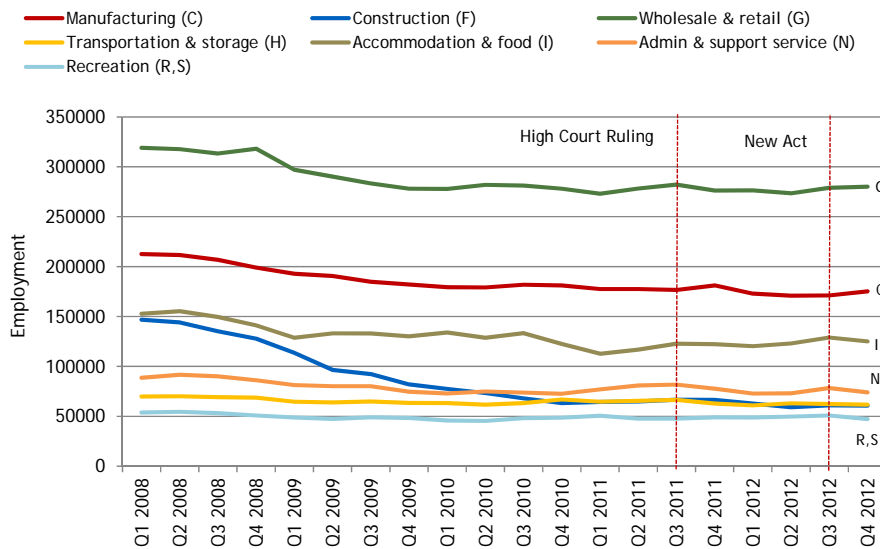
Figure 22: Index of Employment and Earnings Growth, Q2 2011 - Q1 2013⁷⁵



The accommodation and food sector is a notable exception, recording both increases in employment and reductions in hourly earnings over the period. Percentage changes in employment have generally been more significant than changes in hourly earnings.

Source: CSO, Earnings and Labour Costs

Figure 23: Change in Employment by Sector, Q1 2008 - Q1 2013



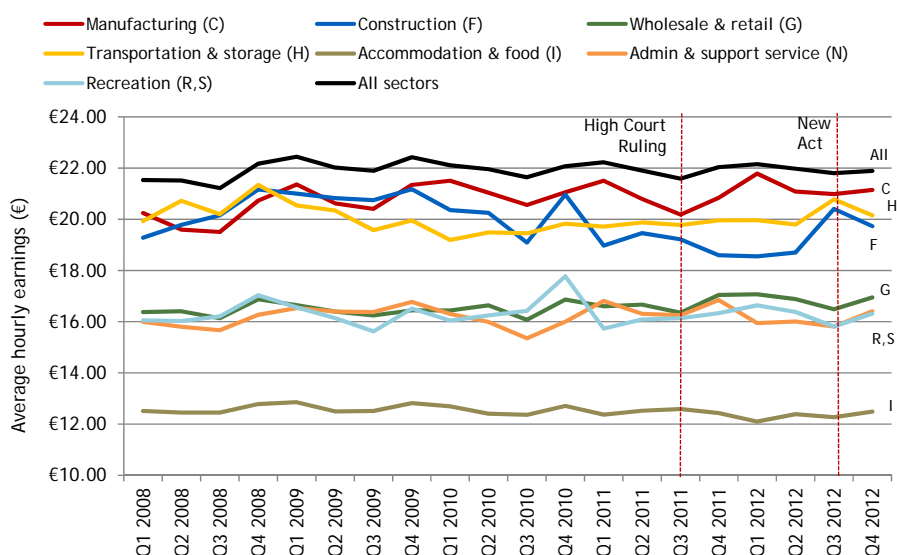
As can be seen in Figure 23, a clear downward trend in employment is evident across all sectors since 2008 with the sharpest losses occurring earlier in the period. Employment levels have grown in wholesale and retail, and accommodation and food since Q2 2011.

Source: CSO, Earnings and Labour Costs

⁷⁵ Note that based on the CSO's Earnings and Labour Costs Survey, the most recent earnings data refers to Q1 2013 while the most recent employment data refers to Q4 2012.

Figure 24 examines trends in hourly earnings data for a range of sectors since Q1 2008.

Figure 24: Change in Hourly Earnings by Sector, Q1 2008 - Q1 2013



As with the employment data, a degree of seasonal volatility is evident in the hourly earnings data. Most sectors shown recorded increased hourly earnings between Q2 2011 and Q1 2013 - the only exceptions were the construction and the accommodation and food sectors.

Source: CSO, Earnings and Labour Costs

5.3.2 Impact of the Act on Wages

At an economy wide level, the full impact of the 2012 Act is not yet evident in terms of improving labour cost competitiveness or significant increases in employment. Changes in wage rates often take time to permeate through the wider labour market and to be captured in official data. Nevertheless, at this point there do not appear to be any significant employment or wage impacts arising from either the High Court decision or the subsequent legislative reform. This is not particularly surprising for a number of reasons:

- Despite the High Court decision, employee terms and conditions are generally set out in contracts of employment which remained in place and limited the scope of employers to impose wage reductions.
- Furthermore, the Government made it clear shortly after the High Court decision that they would quickly bring forward legislation to re-institute the statutory basis of sectoral wage agreements. This reduced the incentive to introduce short term pay reductions.

While the legislative underpinning for Employment Regulation Orders has now changed, new Joint Labour Committees have yet to be established. It is only as the various parties come together under the revised JLC arrangements to negotiate and agree new Employment Regulation Orders that any impact on hourly wage rates and labour competitiveness may occur. How these negotiations will impact on labour costs is unclear.

The new Act requires the parties to consider broader competitiveness factors and Section 42.6 of the Act requires the JLC to have regard, amongst other factors, to the national minimum wage rate when setting hourly rates.

In relation to REAs, a number of developments are worth noting. In contract cleaning a new REA was proposed under the 2012 Act. This has now been approved for registration by the Labour Court, pending the approval of the Minister for Jobs, Enterprise and Innovation⁷⁶. For the most part, the proposal replicates the old ERO that existed in this sector, retaining the €9.50 per hour single pay rate. The key changes are in overtime, which is now paid after 40 hours, instead of 39 hours previously, with Saturday overtime now at the same rate as Monday to Friday rather than being counted separately. The definition of the cleaning industry has also been widened in the proposed new REA.

The security sector, which had previously been subject to an ERO is also currently in the process of migrating to an REA. A document is currently being considered by the Labour Court. The proposed new security sector deal provides for increases in the previous starter pay rate of €10.01 per hour, bringing all workers up to the main €10.75 per hour rate. Overtime premiums are not to be paid until 48 hours have been worked per week in the roster cycle, as opposed to 39 hours previously. Changes are also proposed in relation to Sunday premium and Public holiday entitlements, while the unsocial hours' premium will be discontinued.

5.3.3 Impact of the Act on Administrative Costs (Non-Wage Impacts)

Based on our consultations, firms have identified two main channels through which administrative costs arise:

- The management time required to understand JLC provisions, keep up-to-date with complex provisions, and planning staff rosters to ensure compliance with the JLC requirements; and
- The time taken to monitor staff working hours to ensure that they are in compliance with JLC conditions and to minimise overtime pay.

According to the Regulatory Impact Analysis conducted in advance of the passing of the Act⁷⁷, the reform of the JLC and REA systems is expected to bring about a significant simplification of compliance requirements as a result of the reduction in the number of JLCs and through the reviews conducted to ensure the on-going validity of the remaining JLCs.

When the planned reforms are fully implemented, EROs should reflect a standardised approach to the determination of benefits in the nature of pay - including overtime which will also reduce complexity. Record-keeping requirements for employers in the sectors covered will also be reduced, while the burdensome requirement for the posting of notices in workplaces will be reduced and replaced by placing an obligation on employers to provide employees with clearer details of employment terms and conditions.

Reforms are in train to realise these administrative savings.

76 This is an additional stage introduced under the Industrial Relations (Amendment) Act, 2012, which also stipulates that if the order is signed by the Minister, it must then be laid before each House of the Oireachtas, each of whom has the power to rescind the order by passing a resolution against it within 21 sitting days. Both of these restrictions are aimed at providing parliamentary oversight, which had been a constitutional weakness of the old REA system.

77 For further details see Department of Jobs, Enterprise and Innovation, Industrial Relations (Amendment) (No. 3) Bill - Regulatory Impact Assessment, December 2011.

- Following a request from the Minister for Jobs, Enterprise and Innovation, the Labour Court in exercise of the powers conferred on it by Section 40 of the Industrial Relations Act 1946 has announced the abolition of three JLCs (the Aerated Waters and Wholesale Bottling; Provender Milling and Clothing JLCs), on the basis that these sectors have declined considerably in terms of numbers employed, or have effectively ceased to function as wage fixing bodies. The abolition was effective from 12th October 2012.
- The 2012 Act provides for a review of all JLCs to be carried out by the Labour Court. This review was completed in April 2013 and is currently being considered by the Minister for Jobs, Enterprise and Innovation. The outcome of this review will inform the Labour Court as to whether any further JLCs should be abolished, maintained in their current form, amalgamated with other JLCs or have their establishment orders amended. The outcomes arising are likely to simplify the regulatory landscape in the labour market. The review itself will not, however, result in a change to wage rates in any of the sectors affected. As noted previously the establishment of new JLCs will require employers and employees to negotiate new Employment Regulation Orders (i.e. agree hourly wage rates). This process may potentially result in a change in the hourly wage rates in the sectors covered. Negotiations, however, will not necessarily result in hourly wage reductions - they may focus on other related terms and conditions such as overtime, as is the case in the security sector.
- The 2012 Act also introduces reforms which will expedite the decision making process and which clarify the role of the JLC chairman⁷⁸.
- In relation to Registered Employment Agreements, the 2012 Act introduces a time-bound process by which the terms of an REA may be varied by the Labour Court in certain circumstances without obtaining the consent of all parties to the agreement - this can be expected to expedite the decision making process.

The impact of the Act on industrial relations has not been considered. The next sections assess employment and hourly wage developments in the sectors where sectoral wage agreements are most prevalent, namely Wholesale and Retail, Accommodation and Food, and Construction.

5.4 Focus on Key Sectors

5.4.1 Wholesale and Retail Trade

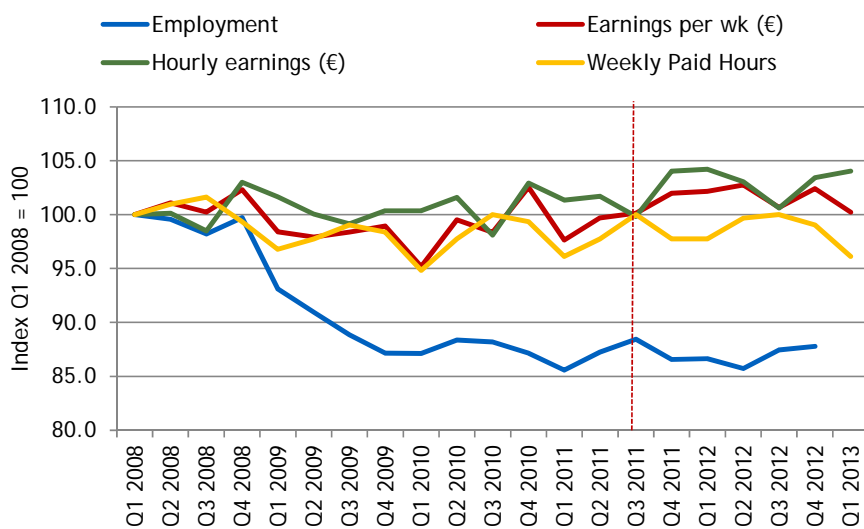
In analysing the impact of various reforms on the sector, it is important to note that relevant ERO relates to particular categories of employees in the grocery and allied trades; CSO earnings data captures data for all employees in the retail and wholesale sector as defined under NACE Rev.2.

⁷⁸ According to section 42(B) of the Act, where the chairman is satisfied that no further efforts on his or her part will advance a JLC in reaching agreement, the chairman may submit the outstanding issues to the Labour Court for its recommendation. Once the Court has considered the matter and made a recommendation (within a prescribed time period), and if there is an equal division of votes amongst JLC members, the chairman shall cast his or her vote having regard to the recommendation of the Court.

Consumer demand has reduced substantially as a result of the recession - in volume terms, the retail sales index (excluding motor trades) is back at 2005 levels⁷⁹. Employment in the sector, based on QNHS data, is also at approximate 2005 levels.

There has been a steady decline in employment in the wholesale and retail sector over the course of the recession - from 319,000 in Q1 2008 to 280,000 in Q4 2012, a reduction of over 12 per cent. Virtually the entire employment reduction in the sector occurred between 2008 and 2009. Since Q4 2009, employment has remained relatively constant (notwithstanding seasonal fluctuations).

Figure 25: Earnings and Employment in Wholesale and Retail, Q1 2008 - Q1 2013



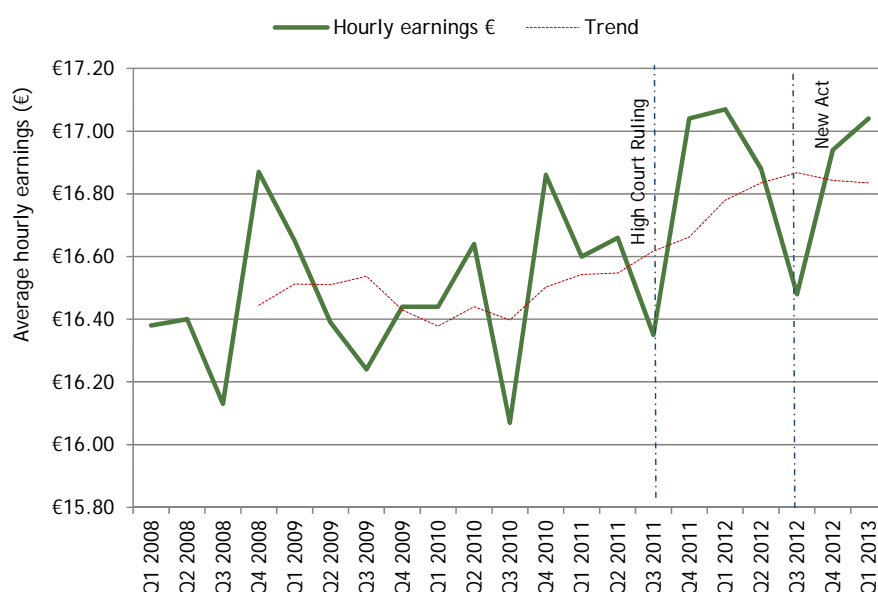
Following an initial drop in hours worked (particularly in Q1 2010) weekly paid hours have stabilised and at 29.8 hours per week in Q1 2013 are slightly less than average weekly paid hours in Q1 2008 (31.0 hours). Hourly earnings have increased by approximately 4 per cent over the Q1 2008 to Q1 2013 period.

Source: CSO, Earnings and Labour Costs

Figure 26 shows the evolution in hourly wages over recent quarters in more detail. The dashed red line presents a four quarter moving average to strip out seasonal changes. An upward trend is evident.

⁷⁹ In terms of the value of sales, the index (2005=100) has fallen from a peak of 114.9 in 2008 to 96.4 in 2012. For further details, see CSO, Retail Sales Index, March 2013

Figure 26: Hourly Earnings in Wholesale and Retail, Q1 2008 - Q1 2013



Despite the collapse of the Retail Grocery and Allied Trades JLC, hourly wages continued to increase marginally post the High Court decision on sectoral wage agreements in July 2011. Discounting seasonal trends, wage growth seems to have moderated since August 2012.

Source: CSO, Earnings and Labour Costs

Given that we have less than three quarters of data since the commencement of the new Industrial Relations Act, it is not possible to determine what influence, if any, the new Act has had from the available data.

Finally as illustrated in Table 3 below, average hourly earnings in the wholesale and retail sector in 2012 exceeded the minimum wage provided for under the relevant ERO by a significant amount. Of course, the CSO data reflects average earnings for all employees and does not differentiate between the levels of experience or qualifications different employees might have. Given previously highlighted caveats about the coverage of the various data sources, the table below should, therefore, be used for illustrative purposes only. Nevertheless, it would appear logical to conclude, that macroeconomic conditions are a significant driver of employment and earnings trends in this sector.

Table 3: Comparison of JLC Rates and CSO Data for Wholesale and Retail, 2012

	JLC weekly statutory minimum rate	JLC hourly rate (based on 39 hour week)	CSO average hourly earnings 2012**	CSO average hourly earnings (excluding irregular earnings)**
General sales assistant/clerical worker	€374.40	€9.60	€16.84	€16.04
Post of responsibility	€414.96	€10.64		

*Note: Other rates apply to other categories of workers including younger workers, trainees and more senior employees

**Note: CSO data is based on an average of Q1-Q4 data for 2012

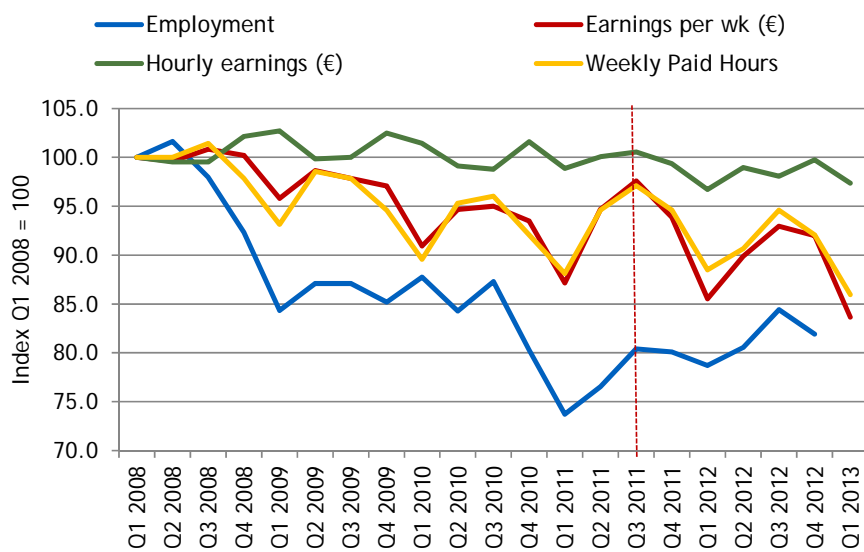
Source: CSO, Earnings and Labour Costs / Retail Grocery and Allied Trades JLC (R.G.A.T. (2011 No.2))

5.4.2 Accommodation and Food

At the beginning of the recessionary period, both employment and hours worked declined in the accommodation and food service sector in Ireland. Employment fell from 152,700 in Q1 2008 to 112,600 in Q1 2011 before subsequently increasing to 125,100 in Q4 2012.

Weekly paid hours have not rebounded, however, and continue to exhibit a downward trend - suggesting a growing incidence of part-time working in the sector (part-time working was already a feature of the sector prior to the recession). In Q1 2013, employees in the sector worked an average of 23.9 weekly paid hours compared with 27.8 hours in Q1 2008.

Figure 27: Earnings and Employment in Accommodation and Food, Q1 2008 - Q1 2013



Hourly earnings have remained relatively stable (declining from €12.51 in Q1 2008 to €12.18 in Q1 2013). In terms of earnings, the greatest change has occurred in weekly earnings which have declined from €347.52 at the beginning of the period to €290.68 in Q1 2013 reflecting, primarily, the decline in weekly paid hours.

Source: CSO, Earnings and Labour Costs

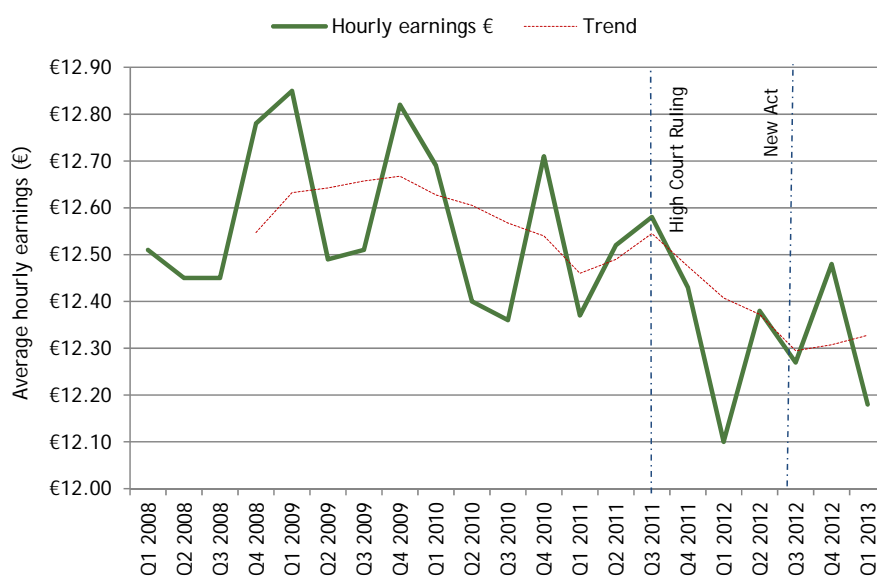
Employment levels in the accommodation and food sector mirror trends in tourist numbers - in 2008 over 7.8 million trips to Ireland were recorded. This fell to 6 million in 2010 (the bottom of the employment cycle in the accommodation sector) reflecting the global economic downturn before rebounding to 6.5 million in both 2011 and 2012 (coinciding with the upswing in employment)⁸⁰. Total tourism and travel earnings from overseas travellers to

80 CSO, Overseas Travel, December 2012 - February 2013, March 2013.

Ireland have also increased over recent years (from €3,525 million in 2011 to €3,683 million in 2012)⁸¹.

Wages in the sector tend to peak in the fourth quarter of each year. The dashed red line in Figure 28 presents a four quarter moving average to strip out seasonal changes.

Figure 28: Hourly Earnings in Accommodation and Food, Q1 2008 - Q1 2013



There is a clear (albeit marginal) downward trend evident in average hourly wages in the sector. Since Q3 2012, annual hourly earnings have turned positive - again the gain is marginal. Given that we have less than three full quarters of data since the commencement of the Act, it is not possible to determine what impact, if any, the new Act has had from the available data.

Source: CSO, Earnings and Labour Costs

During our consultations, the industry highlighted the positive impact on labour costs of the reduction in premium for Sunday working from double time to time and a third in both the Hotels and the Catering JLCs in 2009. It was noted, however, that as hospitality is a seven-day week business, and indeed for many premises Sunday is a key day, the payment of a premium for Sunday working remains a cause for concern. From an existing worker perspective, the reduction in hourly wages and secondary benefits is a concern, particularly in a sector with relatively low pay rates.

Finally, despite the reductions highlighted above, average hourly earnings still exceed the average hourly rate provided for in the Hotels Joint Labour Committee Employment Regulation Order (illustrated in Table 4), even when irregular earnings (bonuses) are excluded. As noted earlier, the cohort captured in both sets of data might differ somewhat. While the gap is not as significant as that in the Wholesale and Retail sector, the data suggests that economy wide factors are a driver of labour market costs in the accommodation and food sector.

81 CSO, Tourism and Travel 2012, March 2013.

Table 4: Comparison of JLC Rates and CSO Data in Accommodation and Food, 2012

	JLC weekly statutory minimum rate	JLC hourly rate (39 hour week)	CSO average hourly earnings 2012**	CSO average hourly earnings (excluding irregular earnings)**
Hotel JLC - Trained cook/ barperson/ waiter/ porter*	€354.43	€9.09	€12.34	€12.14
Catering JLC - Waiter/ clerical worker /counter assistant /short order cook*	€363.28	€9.31		
*Note: Other rates apply to other categories of workers including younger workers, trainees and more senior employees (e.g. head chef, head barperson etc.)				
**Note: CSO data is based on an average of Q1-Q4 data for 2012				

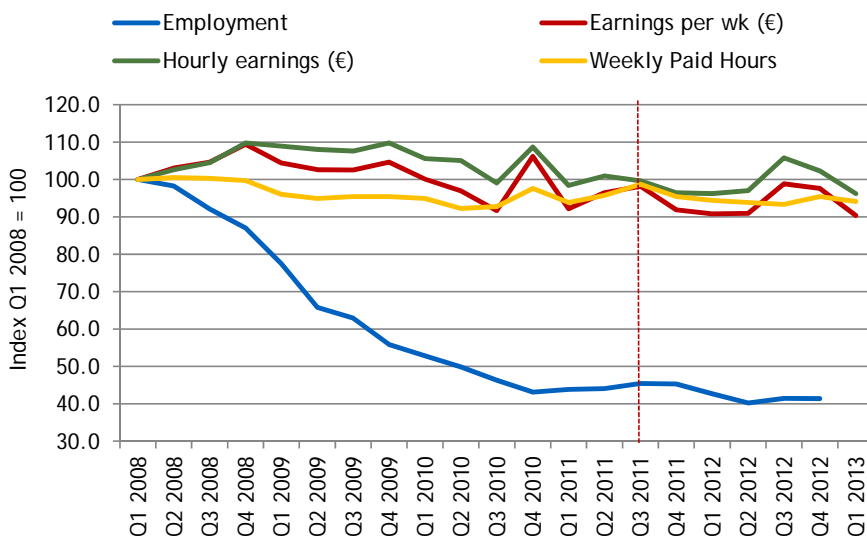
Source: CSO, Earnings and Labour Costs / Hotels Joint Labour Committee (H. (2009 No. 2)) / Catering Joint Labour Committee (C. (D) (2009 No. 2))

5.4.3 Construction Sector (REA)

The reduction in construction employment following the bursting of the property bubble is one of the most visible effects of the recession - based on CSO QNHS data, employment declined from 276,000 in Q2 2007 to just over 96,000 people in Q1 2013⁸².

⁸² Note: Construction employment figures in the Earnings and Labour Costs survey differ substantially from construction employment figures in the Quarterly national Household Survey. See CSO, Quarterly National Household Survey Q1 2013, May 2013

Figure 29: Earnings and Employment Trends in Construction, Q1 2008 - Q1 2013

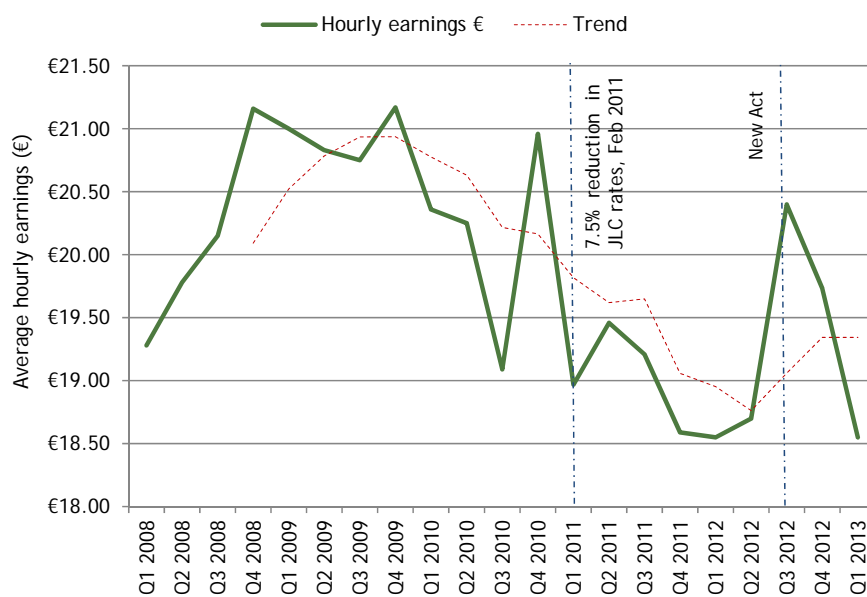


Looking at EHECS data, hourly earnings have decreased since Q1 2008 (from €19.28 to €18.55). However, there has been a more substantial decline in weekly paid hours (down from 37.4 hours to 35.2 hours) resulting in a more significant reduction in weekly earnings (from €721.54 per week to €651.98).

Source: CSO, Earnings and Labour Costs

The data in Figure 30 suggests that reported hourly wage rates in construction have been somewhat volatile over the course of the recession but do exhibit a general downward trend.

Figure 30: Hourly Earnings in Construction, Q1 2008 - Q4 2012



The dashed red line presents a four quarter moving average to strip out seasonal changes. Comparing the Q4 2009 peak with Q4 2012, hourly wages have declined by 6.85 per cent.

Source: CSO, Earnings and Labour Costs

The July 2011 High Court ruling did not impact on the legal standing of REAs and so had no effect on construction wages. Changes in REA rates, however, were introduced in February 2011 when the statutory hourly rate was reduced by 7.5 per cent. Between Q4 2010 and Q1 2011 (i.e. the quarters immediately before and after the reduction was agreed), the EHECS data demonstrates a visible reduction in hourly wage rates. It is not possible at this point to ascertain whether this reduction is directly related to the amended REA rates, particularly given the data fluctuations in the periods just before and just after the official REA reduction.

Since the commencement of the Act, hourly wages have rebounded somewhat (i.e. since Q2 2012). Given that we have less than three full quarters of data since the commencement of the new Industrial Relations Act, it is not possible to determine what influence, if any, the new Act has had from the available data.

As illustrated in Table 5 below, there appears to be a relatively narrow gap between the average hourly wages and the hourly rates set out in the construction sector registered employment agreement. The impact of the negotiated reduction in REA rates in February 2011 seems to have had an impact on wage rates, although it is impossible to determine the extent of causality - other factors may also have impacted upon wage rates.

Table 5: Comparison of REA Rates and CSO Data for Construction, 2012

	JLC hourly rate (based on 39 hour week)	CSO average hourly earnings 2012**	CSO average hourly earnings (excluding irregular earnings)**
Craftsmen*	€17.21	€19.37	€18.97
*Note: Other rates apply to other categories of workers including younger workers, trainees and more senior employees (e.g. head chef, head barperson etc.)			
**Note: CSO data is based on an average of Q1-Q4 data for 2012			

Source: CSO, Earnings and Labour Costs / Registered Employment Agreement (Construction Industry Wages and Conditions of Employment) Variation Order, 2011

There have been a number of developments in relation to REAs over recent months.

- The Labour Court Recommendation (LCR 20417) in response to the Construction Industry Federation claim for further cost reductions was received on the 20th November 2012 and recommended a further 2.5 per cent reduction on top of the 7.5 per cent received in 2011 on the basic hourly rate of €18.60. This would bring it to €16.74 per hour; with corresponding reductions in general operative rates; the entry rate would be reduced to €12 per hour from €13.77. This recommendation is still being considered by the employer and trade union parties. In the event that the recommendation is accepted, the changes to the pay and conditions for the sector will be progressed by means of an application to vary the REA under the 2012 Act.
- A High Court challenge to the validity of the Electrical Contracting Registered Employment Agreement (REA), as well as the constitutionality of the 1946 Act, was

successfully defended in 2010 by the State but was appealed to the Supreme Court. On 9th May, the Supreme Court held⁸³ that Part III of the Industrial Relations Act 1946 was invalid having regard to Article 15.2.1° of the Constitution. The effect of this decision is to invalidate the REA agreements previously registered under Part III of the 1946 Act. As a consequence, the Labour Court no longer has jurisdiction to enforce, interpret or otherwise apply these agreements (similar to the 2011 decision on EROs). However, contracts of employment will remain in force. The Attorney General has been asked to supply advice on any potential implications of the judgment for the 1946 Act as amended by the 2012 Industrial Relations Act⁸⁴. Subject to this advice, it is expected that the affected REAs will need to be reconstituted under the 2012 Act. The 2012 Act allows for the new agreements to reflect the competitiveness concerns and the current economic environment.

5.5 Conclusions on Reform Agenda

Given the lack of data currently available and the number of outstanding elements of the reform agenda, more time is needed to definitively test the impact of the new wage setting framework.

Recommendation: The examination of the impact of reforms to the sectoral wage setting mechanisms should be repeated in due course when sufficient data is available for analysis (i.e. approximately 18 months after all elements of the reform process have been completed).

Responsibility: Department of Jobs, Enterprise and Innovation

Equally, the reform agenda must be completed as quickly as possible. Putting in place a labour market regime that is flexible to changing economic circumstances can aid recovery and, as the economy picks up, ensure that recent competitiveness gains are not eroded as job creation returns and the labour market tightens.

Recommendation: The remaining elements of the wage setting mechanisms reform programme need to be agreed and implemented. Specifically:

- The recommendations contained in the Labour Courts' review of JLCs should be implemented with a view to minimising administrative costs for enterprise;
- Outstanding reforms to overtime, Sunday working and the derogation for financial difficulty need to be concluded quickly with a strong emphasis on enhancing labour cost competitiveness;
- Utilisation of the new wage setting mechanisms needs to be progressed quickly given on-going labour cost concerns and Ireland's unemployment crisis. Renegotiation of

83 McGowan and others v. the Labour Court, Ireland and the Attorney General

84 Written answers, Thursday, 16 May 2013, Department of Jobs, Enterprise and Innovation, Registered Employment Agreements

agreed rates offers the most impactful method of achieving improved wage competitiveness.

Responsibility: Department of Jobs, Enterprise and Innovation, Labour Relations Commission

6. National Minimum Wage

Key Findings

- Relatively few employees earn the minimum wage in Ireland
- The NMW is most prevalent (in terms of the number of employees earning less than €8.65) in sectors such as hotels and restaurants; wholesale and retail; construction; and other services
- In both euro and purchasing power standard terms, the monthly minimum wage in Ireland is relatively high: of the 21 countries for which data was available, Ireland had the 5th highest minimum wage in PPS terms and 4th highest in euro terms
- When expressed as a percentage of average wages (44.5%), Ireland has the 8th highest minimum wage out of 20 countries
- Despite the lack of consensus on the exact effects of the NMW, there is broad agreement that a national minimum wage of circa 30-40 per cent of median wages can have a positive effect on equality and will have a limited effect on lowering employment rates for low skilled workers
- Replacement rates and sectoral agreements represent the primary barriers to labour cost adjustments. Only once these issues are addressed should other measures such as changes to the National Minimum Wage be considered
- It is recommended that the main NMW rate is maintained at the existing level until there is a significant improvement in the labour market.
- Consideration should be given to extending the lower NMW rate for younger workers. Currently a rate of €6.06 exists for workers less than 18 years of age and reduced rates for inexperienced workers and trainees aged over 18. Recognising high levels of youth unemployment and evidence that this cohort is most affected by higher NMW, consideration should be given to introducing a rate lower than €8.65 for all workers aged under 21 or 25 years of age
- Consideration should be given to requiring that a comprehensive review of the NMW be completed every four to five years, with the other years requiring a streamlined process

6.1 Introduction to the National Minimum Wage

The minimum wage is intended to deliver a socially preferable distribution of income than would occur through a free market solution. In general, therefore, the success or otherwise of minimum wage policy is usually measured against its impact on poverty levels. It is important to note that the imposition of a minimum wage can have significant impacts on income and employment levels as well as poverty, and impacts on both firm level and national competitiveness.

A National Minimum Wage (NMW) was first introduced in Ireland in 2000 through the National Minimum Wage Act, 2000. Since 1st July 2011 under SI 331 of 2011, the national minimum

wage for an experienced adult employee is €8.65 per hour⁸⁵. As illustrated in Table 6 (below) certain exemptions to the €8.65 rate exist - these exemptions provide for lower rates of hourly pay for certain categories of workers (including trainees and inexperienced employees).

Table 6: National Minimum Wage Rates, 2013

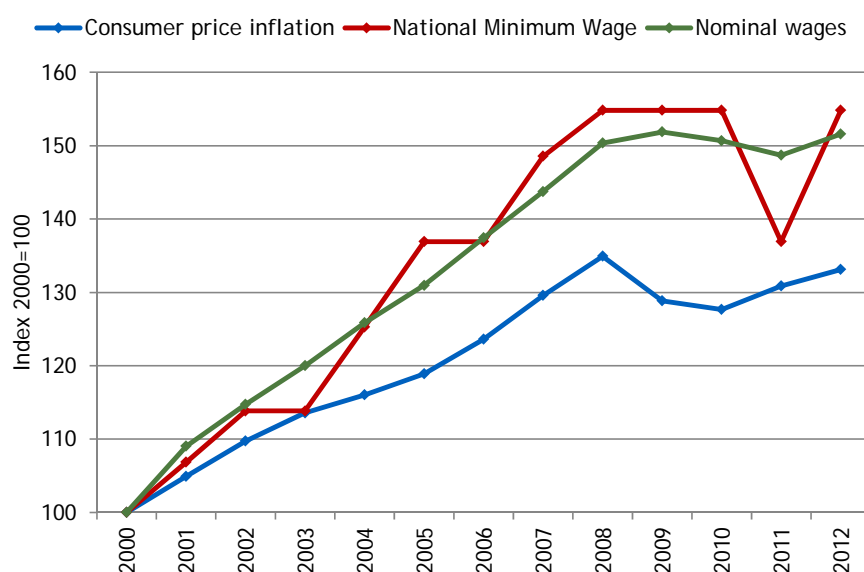
	Minimum hourly rate of pay	% of minimum wage
Experienced adult worker	€8.65	100%
Aged under 18	€6.06	70%
First year from date of first employment aged over 18	€6.92	80%
Second year from date of first employment aged over 18	€7.79	90%
Employee aged over 18, in structured training during working hours		
1st one third period	€6.49	75%
2nd one third period	€6.92	80%
3rd one third period	€7.79	90%

Source: National Employment Rights Authority

The evolution over time in the adult and under-18 NMW rates vis-à-vis consumer price inflation and nominal wages across the business economy is shown for Ireland in Figure 31.

⁸⁵ An experienced adult employee for the purposes of the National Minimum Wage Act is an employee who has an employment of any kind in any 2 years over the age of 18

Figure 31: Change in NMW Rates, 2000-2012



The NMW has increased at irregular intervals since 2000. The NMW was reduced from €8.65 per hour to €7.65 per hour as of 1st February 2011 and was subsequently changed back to €8.65 from 1st July 2011. The under-18 rate (not shown) has moved in tandem with the headline rate over recent years.

Source: CSO / National Employment Rights Authority

A number of factors emerge from Figure 31:

- The rate of increase in the NMW has generally mirrored the growth rate in nominal wages.
- The rate of increase in the NMW significantly exceeded the rate of inflation in the period 2000 to 2007/08. The NMW increased in real terms between 2008 and 2010 as consumer prices fell. These gains, however, have diminished somewhat as consumer price growth resumed from 2010.
- Nominal wages, NMW and consumer price inflation are now at broadly similar levels as experienced in 2007/08.

In determining the rate at which the minimum wage is set, the Minister for Jobs, Enterprise and Innovation must be cognisant of a number of factors⁸⁶, namely:

- Changes in earnings during the period since the most recent making of an order;
- Changes in currency exchange rates during that period;
- Changes in both employment and unemployment; and

86 For further detail see National Minimum Wage Act, 2000. The Law Reform Commission has been engaged in a programme of 're-stating' legislation (i.e. a process for making legislation more accessible by updating existing Acts to incorporate all amendments which have occurred since their original enactment and to form a single text which is certified by the Attorney General). Restatements do not alter the text or the provisions of the legislation in anyway. The National Minimum Wage Act 2000 has been restated by the Law Reform Commission, and although this restatement has not yet been certified by the Attorney General, it is a useful resource which provides the up-to-date position of the Act.

- The likely effect that the proposed order will have on levels of employment and unemployment; the cost of living, and national competitiveness.

6.1.1 Who Earns the Minimum Wage?

There is relatively little data available focusing on minimum wage earners in Ireland. It is clear, however, that there is a relatively low percentage of the workforce earning the national minimum wage. Data from the CSO suggests that 4 per cent of employees in Q3 2012 were earning the NMW or less⁸⁷. This finding is not substantially different from a recent study by the UK's Low Pay Commission which found that 5.3 per cent of UK employment in April 2012 was accounted for by minimum wage jobs⁸⁸.

Irish data also showed that the NMW was most prevalent (in terms of the number of employees earning less than €8.65) in a number of specific sectors, notably:

- Hotels and restaurants;
- Other services;
- Wholesale and retail; and
- Construction.

The now discontinued National Employment Survey provided information about a range of characteristics for those earning the NMW. It demonstrates that those earning €8.65 per hour or less are more likely to be employed in sales, craft, personal service or other occupations; are most likely to be between the ages of 15 and 24 years; tend to be female; have relatively low levels of educational attainment (i.e. less than upper secondary); and are more likely to be nationals from the EU Accession States. These findings mirror the findings of the UK's Low Pay Commission referenced above.

The impact of national minimum wages on in-work poverty is complex. Marx et al⁸⁹ note that 'various studies have demonstrated that the overlap between low pay and poverty is weak - in the order of five to ten per cent in most industrialized economies. This is because poor households generally do not contain an employee, whether low-paid or not, while most low-paid workers live in households with more than one earner. A crucial influence is thus the extent to which the household relies on the earnings of this low-paid worker. Particularly for low-paid women and young people, their earnings most often constitute a secondary or even tertiary source of income for the household. In some cases, accepting a low-paid job helps to lift household income above the poverty threshold. Low-paid workers who are not primary earners are often reasonably high up the household income distribution.'

They also note that 'the core of the working poor consists of workers who are sole earners - generally with a low earned income - and have a family to support. Even a job paid well

87 This is based on data from CSO, Earnings and Labour Costs, February 2013. Previous work undertaken by Forfás in 2009 found that 4.9 per cent of employees in Ireland earned €8.65 per hour or less. Due to methodological difficulties it was not possible to estimate precisely the number earning exactly the €8.65 rate at this time. This data was based on the discontinued National Employment Survey. The most recent NES was conducted for 2009.

88 Low Pay Commission, National Minimum Wage Low Pay Commission Report 2013, April 2013

89 Marx, I., Marchal, S., and Nolan, B., Mind the Gap: Net Incomes of Minimum Wage Workers in the EU and the US, Working Paper 2012.05, European Trade Union Institute

above the minimum wage may not suffice to meet household income needs, depending on the extent of those needs and the other sources of income available to the household'. They conclude that in tandem with the NMW, the tax (low or negative taxes on low earners) and social welfare systems (e.g. child benefit, etc.) have a key role in supporting working people who are at risk of poverty.

From a competitiveness perspective, the NMW also sets a baseline for wage negotiations. It is likely that the presence of the minimum wage influences wage levels for those who earn close to the NMW rate (and also impacts upon wage rates set under the various sectoral wage setting mechanisms). For example, the earnings of another 26 per cent of the labour force, for instance are within 1.5 times the NMW⁹⁰. In terms of sectoral impact, we concluded that:

- On the basis of the proportion of employees earning less than 1.5 times the NMW and the proportion of their output which relates to labour costs, the wholesale and retail, hotels and restaurants, other services, and traditional manufacturing sectors are the most impacted by the existence of the NMW.
- On the basis of reliance on NMW sectors for intermediary goods and services, the hotels and restaurants, business services, and other services sectors are most impacted.
- Exporting sectors such as food and beverages, pharmaceuticals, medical devices, ICT, and financial services are not generally impacted directly by the national minimum wage given relatively high average salaries in these sectors. High wage costs weaken Ireland's ability to compete for FDI in some sectors that require lower skill levels.
- At a macro level, the NMW affects the broader costs of doing businesses as exporter's source goods and services in the local economy.

6.2 Overview of Minimum Wage Data

Minimum wage statistics published by Eurostat refer to monthly national minimum wages⁹¹. The national minimum wage usually applies to all employees, or at least to a large majority of employees in the country. Minimum wages are gross amounts (i.e. before deduction of income tax and social security contributions, which vary from country to country). It is worth noting that in Ireland a low rate of income tax is imposed on low rates of income.

In January 2013, 20 of the EU's 27 Member States (Belgium, Bulgaria, the Czech Republic, Estonia, Ireland, Greece, Spain, France, Latvia, Lithuania, Luxembourg, Hungary, Malta, the Netherlands, Poland, Portugal, Romania, Slovenia, Slovakia, and the United Kingdom), had

⁹⁰ Assuming that wages up to 1.5 times the NMW (€12.97) are impacted by changes in the NMW rate, Forfás previously estimated that wage rates for 31 per cent of employees may be affected by a change in the NMW. Based on National Employment Survey data, 4.9 percent of employees were earning less than €8.66 per hour, another 9.8 per cent were earning between €8.66 and €10.00 per hour, while 16.5 per cent were earning between €10.01 and €12.97 an hour (i.e. 1.5 times the NMW).

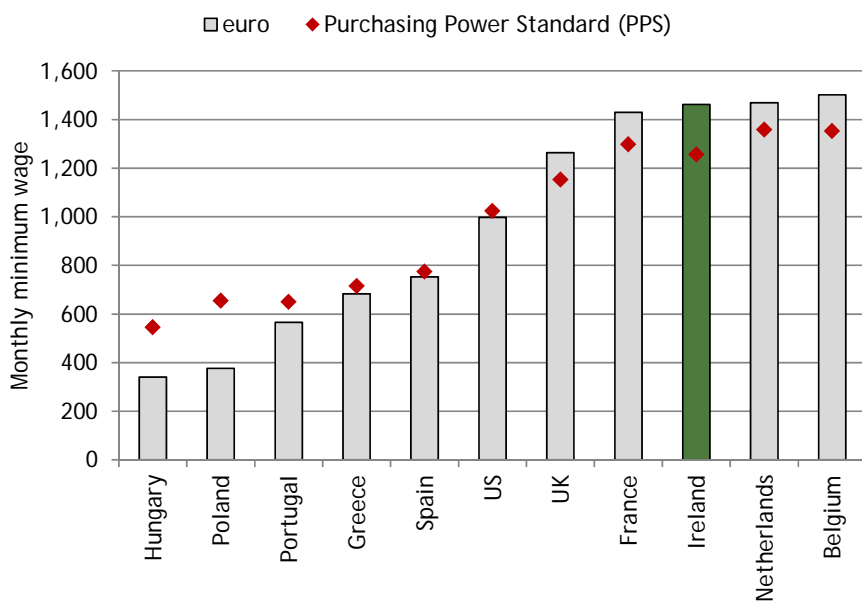
⁹¹ For most countries, the minimum wage is agreed in terms of a monthly rate. For some countries (e.g. France, Ireland, UK, US) the minimum wage is fixed at an hourly rate. For purposes of comparison, the hourly rates for these countries have been converted to a monthly rate. The Eurostat methodology takes account of the different number of average hours worked per week in each country (e.g. 39 hours per week in Ireland, 40 hours in the US, 35 hours in France, 38.1 hours in the UK). For notes on the calculation of the monthly minimum wage in each country see

http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-QA-09-029/EN/KS-QA-09-029-EN.PDF

national legislation setting a minimum wage by statute or by national inter-sectoral agreement.

Figure 32 illustrates the range of monthly minimum wage rates across a range of countries. Monthly minimum wages varied widely, from €157 in Romania to €1,874 in Luxembourg. However, it should be noted that for non-euro area countries the levels and ranking of minimum wages expressed in euro are affected both by the values of the minimum wages in national currencies and by exchange rates. Therefore, minimum wage data is also displayed in purchasing power standard terms⁹².

Figure 32: Monthly Minimum Wages, 2013



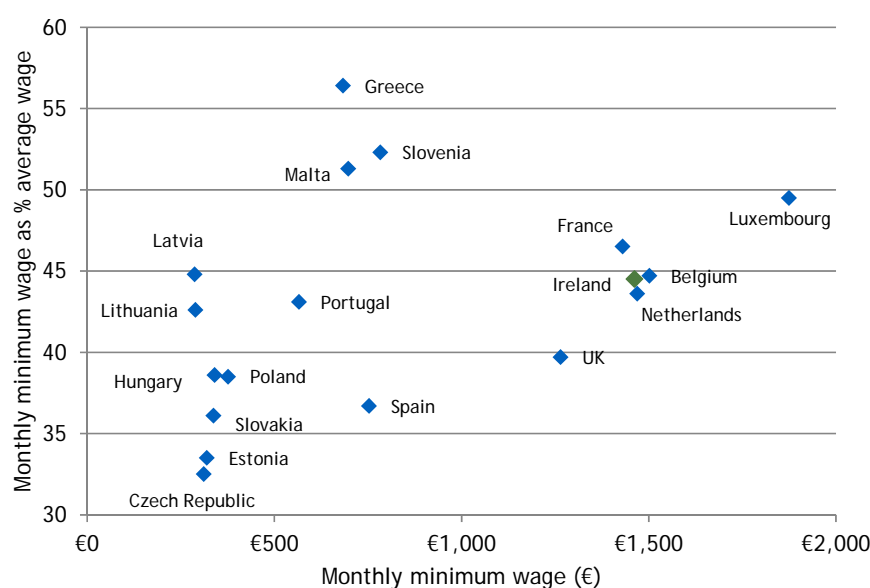
In both euro and purchasing power standard terms, the monthly minimum wage in Ireland is relatively high. Of the 21 countries for which data was available, Ireland had the 5th highest minimum wage in PPS terms and 4th highest in euro terms.

Source: Eurostat

Figure 33 illustrates the statutory monthly minimum wage levels and also displays the minimum wage as a percentage of the average monthly wage in each country.

⁹² PPS is the technical term used by Eurostat for the common currency in which national accounts aggregates are expressed when adjusted for price level differences using PPPs. Thus, PPPs can be interpreted as the exchange rate of the PPS against the euro.

Figure 33: Monthly Minimum Wage and Minimum Wage as a % of Average Wage, 2013⁹³



In 2011 the minimum wage level varied between 32.5 per cent (Czech Republic) and 56.4 per cent (Greece which was substantially reduced in mid-2012) of average gross monthly earnings. When expressed as a percentage of average wages, Ireland has the 8th highest minimum wage (out of 20 countries).

Source: Eurostat

6.3 Policy Considerations

To date, economists have not reached a consensus on the employment effects of a minimum wage. For instance, Dube et al have found that higher minimum wages had no negative employment effects (based on a comparison of restaurants across all contiguous countries with different minimum wage rates between 1990 and 2006)⁹⁴. Neumark and Wascher, however, reviewed a sample of international studies and concluded that these studies provided a relatively consistent (although not always statistically significant) indication of negative employment effects of minimum wages. Of the studies which find a negative relationship between minimum wages and employment, a 10 per cent increase in the minimum wage typically reduces employment in the cohort studied by between zero and five per cent⁹⁵.

There is, however, broad agreement that a moderate national minimum wage (e.g. 30-40 per cent of median wages) can have a positive effect on equality and will have a limited effect on lowering employment rates for low skilled workers⁹⁶. Martin and Immervoll⁹⁷ also note that

93 Data relating to the minimum wage as a percentage of average wages is based on the latest year available between 2010 and 2012.

94 Dube, A., Lester, T.W, and Reich, M., Minimum Wage Effects Across State Borders: Estimates Using Contiguous Counties, *The Review of Economics and Statistics*, November 2010, 92(4): 945-964

95 Neumark, D. and Wascher, W., Minimum Wages and Employment, Institute for the Study of Labor, Discussion Paper Series IZA DP No. 2570, January 2007

96 Generally, it appears that the employment effects one might expect in a perfectly competitive labour market do not emerge from empirical studies. The 'dynamic monopsony' model may explain this result - this approach suggests that minimum wages and other wage floors can reduce the costs of

“on balance, the evidence shows that an appropriately-set minimum wage need not have large negative effects on job prospects, especially if wage floors are properly differentiated (e.g. lower rates for young workers) and non-wage labour costs are kept in check.”

Forfás’ previous work argued that replacement rates and sectoral agreements represent the primary barriers to labour cost adjustments⁹⁸. Thereafter, other measures such as changes to the National Minimum Wage should be considered. It is recommended that the main NMW rate is maintained at the existing level until there is a significant improvement in the labour market.

However, we recommend that consideration should be given to amending the NMW rate for younger cohorts, given the very high levels of youth unemployment in Ireland (Figure 34). Neumark and Wascher have previously noted that the “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)⁹⁹. This also reflects evidence from the IMF which finds that while minimum wages have either small negative or no effects on aggregate employment, negative employment effects exist for youth workers¹⁰⁰.

This is particularly important given the recognised long term consequences arising from youth unemployment - decreased earnings over their entire lifetime for those who are unemployed in youth¹⁰¹ and increased likelihood of future unemployment later in life¹⁰². A differentiated youth rate also takes account of productivity differentials amongst workers, depending on their age and experience. Research from the European Trade Union Institute also indicates that the longer the work experience in the labour market, the lower is the odds of receiving minimum wages in Ireland¹⁰³.

employee turnover to low-wage employers. A higher wage floor makes it easier to recruit and retain employees, and this lowers turnover costs, which in turn frees up resources to maintain employment levels. In this way the monopsony models predict that higher wage floors will have minimal or no effect on overall employment. For further details, see Economist, *The Argument in the Floor - Evidence is Mounting that Moderate Minimum Wages can do More Good than Harm*, 24th November 2012 (print edition)

97 Martin, J. P., and Immervoll, H., *The Minimum Wage: Making it Pay*, OECD Observer, 261, 2007

98 Forfás, *Review of Labour Cost Competitiveness*, October 2010

99 Neumark, D., and Wascher, W., *Minimum Wages, Labor Institutions and Youth Unemployment: A Cross-National Analysis*, March 2003

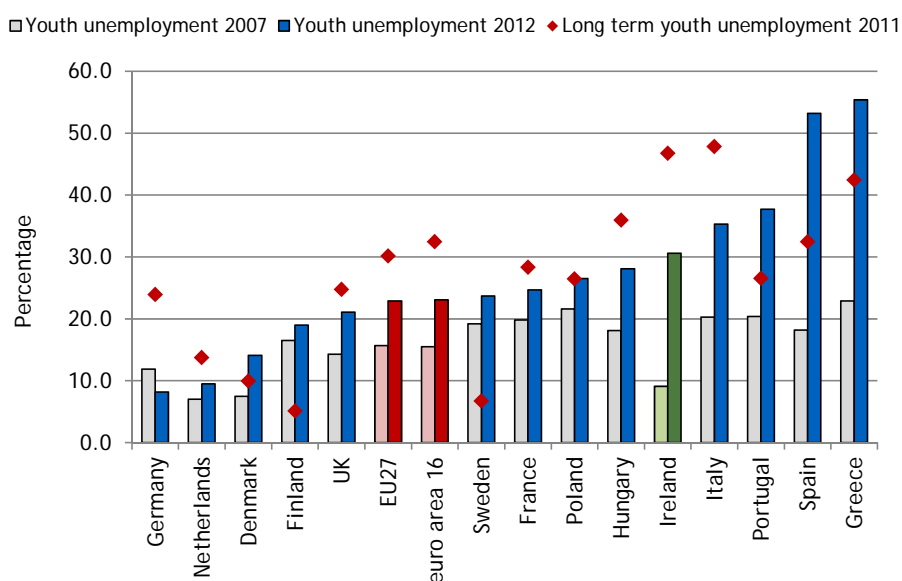
100 International Monetary Fund, *Jobs and Growth: Analytical and Operational Considerations for the Fund*, March 2013

101 Kahn, L.B., *The Long-Term Labor Market Consequences of Graduating from College in a Bad Economy*, *Labour Economics*, Vol. 17, No. 2, pp. 303-16, 2010

102 Mroz, T.A, and Savage, T.H, *The Long-Term Effects of Youth Unemployment*, *Employment Policies Institute*, October 2001

¹⁰³ Rycx, F. and Kampelmann, S., *Who Earns Minimum Wages in Europe - New Evidence based on Household Surveys*, Report 124 *European Trade Union Institute*

Figure 34: Youth Unemployment, 2012



In Ireland, almost one third of those aged 25 years or under (and in the labour market) were unemployed in 2012. Of these, 47 per cent were deemed to be long term unemployed. In both cases, the figures for Ireland are significantly higher than the EU average.

Source: Eurostat

Currently a rate of €6.06 exists for workers less than 18 years of age. Recognising high levels of youth unemployment, consideration should be given to introducing a rate lower than €8.65 for all workers aged over 18 and under 21 or 25 years of age.

This would reflect current rules governing the payment of Jobseekers Assistance which provide for lower weekly payments to those under the age of 25 years - the maximum weekly rate for those aged between 18 and 21 years is €100 and the maximum for those aged between 22 and 24 years is €144, compared with a rate of €188 for those aged 25 years or over. The 2009 National Employment Survey indicated that 38.4 per cent of those on the NMW total were aged under 25 years¹⁰⁴.

Such a differentiated approach would also reflect the experience in the UK where it is recognised that employment of young people is more sensitive than that of adults to the economic cycle. The most recent Low Pay Commission report notes that some, but by no means all, of their commissioned research found evidence of statistically significant negative effects of the minimum wage on the employment and hours of young people. Further, they note that more employers are making use of both the youth rates and the adult rate of the minimum wage to pay young people, suggesting that there are potential employment benefits to young people from differentiated wage rates. In their latest review of minimum wages, the UK youth minimum wage has remained frozen while the other rates have increased by less than inflation¹⁰⁵.

104 See PQ 53942/12

105 For comparison purposes, the differences between the various minimum wage rates in the UK are significantly larger. The UK rates are: £6.08 per hour for those aged 21+; £4.98 per hour for those aged 18-20; £3.68 per hour for those aged 16-17; £2.60 per hour for apprentices.

It is important that any change to the NMW for particular cohorts of workers do not conflict with the other provisions in the National Minimum Wage Act allowing for differentiated training rates.

Recommendation: Consideration should be given to extending the lower NMW rate for younger workers. Currently a rate of €6.06 exists for workers less than 18 years of age. Recognising high levels of youth unemployment and to enhance employability, consideration might be given to introducing a rate lower than €8.65 for all workers aged over 18 and under 21 or 25 years of age.

Responsibility: Department of Jobs, Enterprise and Innovation

At present, while the National Minimum Wage Act 2000 provides a range of conditions under which the NMW may be reviewed, it does not mandate that a review should occur at particular fixed intervals - if such a timeline was in place, this would provide greater certainty for both employers and employees. Greater clarity both in terms of the objectives of the NMW and the process for setting it (i.e. methodology, factors to be considered) are also required. The operation of the Low Pay Commission in the UK and processes used elsewhere may provide guidance in this regard.

Recommendation: Consideration should be given to requiring that a comprehensive review of the NMW be completed every four to five years, with the other years requiring a streamlined process.

To ensure that any revisions to the NMW are reflective of economic circumstances, and to provide certainty to workers and employers, potential exists to set out a methodology to calculate changes to the NMW (e.g. NMW should reflect changes in monthly median wages, youth unemployment, productivity, etc.)

Responsibility: Department of Jobs, Enterprise and Innovation

The National Employment Rights Authority (NERA) carries out workplace inspections to ensure compliance with employment rights legislation. NERA's latest quarterly report highlights high rates of non-compliance with National Wage legislation¹⁰⁶. Of the 1,316 inspections conducted with respect to the NMW in 2012, there was a compliance rate of 51 per cent. The vast majority of breaches related to record keeping with only a small minority (9%) being instances where the minimum wage was not being paid¹⁰⁷.

From an enforcement perspective, ensuring adherence to employment legislation can be seen as a complementary to the control and activation measures built into the social welfare system - both serve to minimise disincentives to the take up of employment offers.

¹⁰⁶ National Employment Rights Authority, Quarterly Update, Issue 3 2012

¹⁰⁷ This does not imply that 49 per cent of all firms are in breach of NMW legislation - just that 49 per cent of firms selected for inspection were in breach.

Recommendation: Continued efforts are required to monitor and enforce compliance with all aspects of employment law.

Responsibility: Department of Jobs, Enterprise and Innovation / National Employment Rights Authority

7. Labour Tax Competitiveness

Key Findings

- A competitive tax wedge is vital to encourage employment growth across all income categories and is a key factor in attracting and retaining highly skilled and internationally mobile workers
- In general, the Irish taxation system has been broadly supportive of labour market efficiency
- Since the onset of the recession, measures were introduced in successive Budgets to widen the tax base and improve the yield while still seeking to maintain progressivity and support employment
- Ireland's tax wedge is still relatively low for many lower paid workers. However, the wedge is much less competitive for higher earners (e.g. 167 per cent of the average wage) although not out of line with the OECD average
- Increases in personal taxation over recent years, however, have eroded cost competitiveness and the incentive to work
- While recognising the need for fiscal consolidation, in order to support job creation and enterprise growth, labour taxes should be shielded from any further
- There is considerable room to raise revenues without increasing the already elevated marginal tax rates (i.e. through reductions in the entry point for income tax)
- The level at which individuals start paying the higher rate of tax in Ireland (€32,800 for single individuals) is low relative to other countries and a cause for concern
- The higher rate of tax actually impacts on individuals earning less than the average wage, meaning that marginal tax rates (i.e. the tax paid on an individual's last euro of income) are now 52 per cent for single individuals earning €32,800 per annum
- It would be beneficial to provide certainty regarding future marginal tax rates. Consideration should be given to flagging when it will be feasible to reduce marginal labour rates below 50 per cent
- The design of the JobsPlus programme should enable clear communication of the benefits of the initiative, be easily accessible and create limited administrative burden for business

7.1 Introduction to Labour Taxes

The tax wedge¹⁰⁸ increases labour costs which can have a negative influence on the employer's decision to retain or hire individuals. It can also reduce the take-home pay of workers. As a result, workers increase the pre-tax wage they bargain for in wage negotiations. Higher labour taxes also increase replacement rates (i.e. make work less attractive vis-à-vis social welfare), reduce take home pay, weaken domestic demand and risk stimulating the informal economy. Further, anecdotal evidence suggests that recent tax

¹⁰⁸ The difference between the employers' cost of hiring an individual and the individual's actual take home pay, due to income taxes and payroll taxes, is known as the tax wedge.

increases have weakened the ability of employers to cut wages - employees have already suffered an effective wage cut through the increased taxes. This reduces the scope to achieve reductions in labour costs across all sectors of the economy.

The OECD has shown a direct link between the tax wedge and job creation and estimated that a ten percentage-point reduction of the tax wedge in an average OECD country would increase the employment rate by 3.7 per cent¹⁰⁹. A competitive tax regime, therefore, is essential in stimulating employment and economic growth, attracting and retaining individuals in Ireland and encouraging people to remain in or return to the labour market.

At the same time, it must be recognised that tax revenues fell by over 30 per cent between 2007 and 2009. Consequently, increased labour taxation has played an essential role in tackling the fiscal imbalance which emerged. Ultimately stable public finances are an essential element of international competitiveness.

7.1.1 Recent Developments

In general, the Irish taxation system has been broadly supportive of labour market efficiency. Between 2000 and 2008, tax rates were reduced, the standard rate band widened and tax credits introduced. The result was that a large number of taxpayers were exempt from income tax with, for example, single income earners earning at or below the minimum wage outside the income tax net. Marginal rates also reduced - to zero in the case of those on the minimum wage and from 28.5 per cent to 26 per cent for those on the average wage. While this structure was conducive to incentivising labour market participation, it had the effect of reducing the tax-base to an unsustainable level whereby 45 per cent of tax units were exempt from income tax in 2010, compared with 34 per cent in 2004.

Since the onset of the crisis, measures were introduced in successive Budgets to widen the tax base and improve the yield while still seeking to maintain progressivity and support employment. In particular, we have seen a move away from excessive reliance on property related transactional taxes, and the proportion of total tax revenue accounted for by taxes on labour has increased as a result.

109 OECD, Going for Growth, 2009

Figure 35: Income Levels and Tax Entry Point (Single Individual) , 2001 - 2012

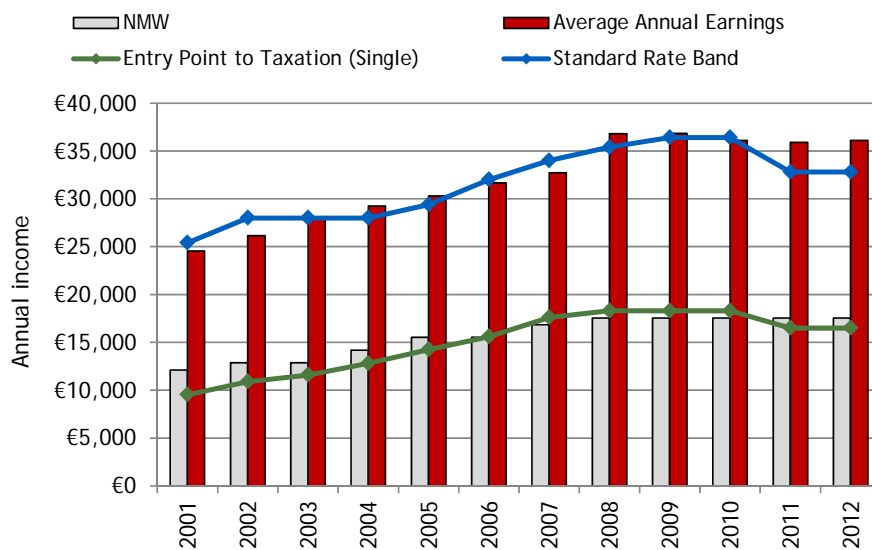


Figure 35 demonstrates the impact of various changes to tax credits and bands upon those earning the national minimum wage and the average annual wage. In rebuilding the tax-base, these changes, in effect, returned credits and bands to 2006/2007 levels and reduced the numbers exempt from income tax. The standard rate refers to the entry point to the higher rate of tax.

Source: Department of Finance / Tax Strategy Group

Budget 2012 did not increase taxes on labour. Increases in personal taxation in 2010 and 2011, however, have eroded cost competitiveness and the incentive to work. Budget 2013 abolished the weekly PRSI allowance for employees. As a result, the difference between the employers' cost of hiring an individual and the individual's actual average take home pay, has widened for all income categories. The difference is wider for higher paid workers in Ireland, which is of concern as Ireland competes internationally for mobile talent. Table 3 below illustrates the development of average tax rates across various income levels since 2000.

Table 3: Average Tax Rates on Annual Earnings (%), Full Rate PRSI, 2001 - 2013¹¹⁰

Gross Income	Single			Married, 1 Income, 2 Children		
	2001	2008	2013	2001	2008	2013
€15,000	9.5%	0.0%	2.7%	2.2%	0.0%	2.7%
€20,000	15.2%	4.4%	11.1%	4.7%	2.7%	7.6%

110 Average Tax Rates 2001 and 2008: Total of Income Tax, Levies (Income and Health) and PRSI as a proportion of gross income. Average Tax Rates 2013: Total of Income Tax, PRSI and Universal Social Charge as a proportion of gross income. Table includes only the standard employee credit, personal income tax credit and home carer credit, where relevant.

€25,000	17.3%	8.3%	15.1%	8.7%	2.9%	8.3%
€30,000	22.2%	12.9%	17.7%	11.6%	5.1%	9.5%
€40,000	28.3%	18.6%	24.8%	16.6%	9.4%	14.9%
€60,000	33.6%	27.5%	33.9%	25.9%	19.8%	26.6%
€100,000	37.9%	33.8%	41.1%	33.2%	29.2%	36.8%
€120,000	38.9%	35.4%	42.9%	35.0%	31.6%	39.3%

Source: Department of Finance, Taxation Annexes to the Summary of 2013 Budget Measures

The marginal tax rate is described as the tax rate that applies to the last euro of income earned. Marginal tax rates are important because they influence individual decisions to work more or indeed to work at all. Having a low and competitive top marginal tax rate is viewed as one of the major drivers in promoting labour force participation. Measures introduced over recent Budgets have had a substantial adverse impact upon marginal tax rates in Ireland (Table 4).

Table 4: Marginal Tax Rates for PAYE Employees, 2008 - 2011

Income Level	2008	2012
National Minimum Wage	0%	27%
Average Wage	26%	31%
Average Wage x2	43%	52%
€100,000	43.5%	52%

Source: Department of Finance

7.2 Labour Taxes in Context

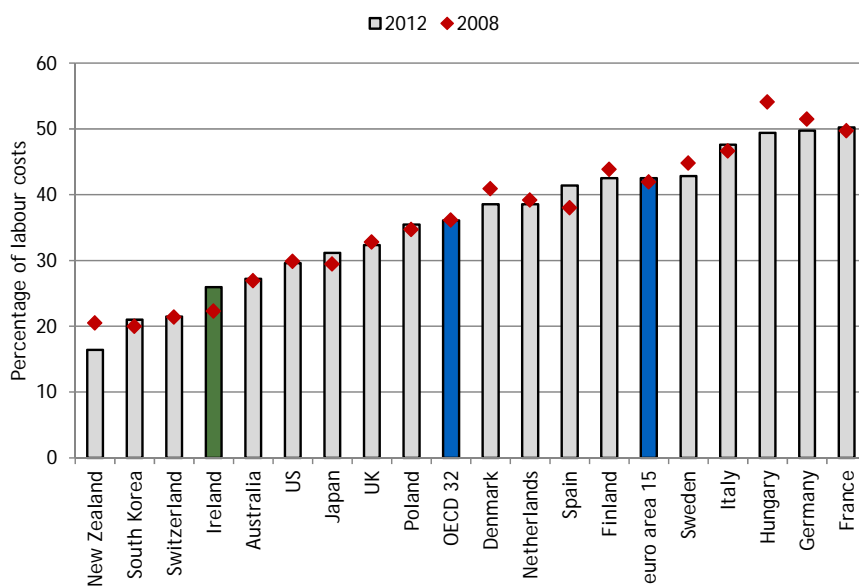
The following sections use internationally available data from the OECD to compare the tax wedge, average and marginal tax rates in Ireland with rates in our key competitors¹¹¹.

¹¹¹ Unless otherwise noted, in all of the following charts, euro area 15 excludes Cyprus and Malta.

7.2.1 The Tax Wedge

The tax wedge is a measure of the difference between labour costs to the employer and the corresponding net take-home pay of the employee - which is calculated by expressing the sum of personal income tax, employee plus employer social security contributions together with any payroll tax, minus benefits as a percentage of labour costs.

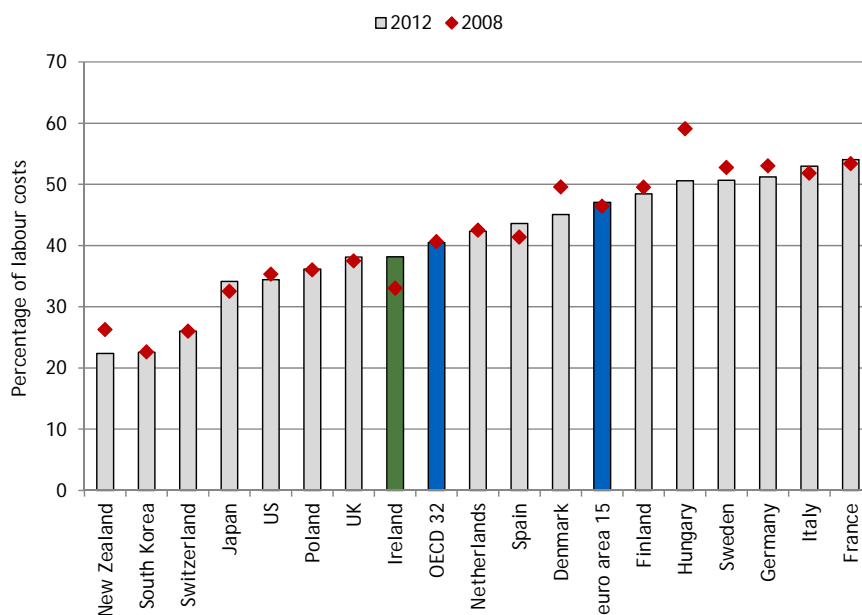
Figure 36: Average Income, tax plus employees' and employers' social security contributions: Single individual without children, 100% of average earnings, 2012



For a single person with no children on 100% of the average wage, the total tax on labour (the gap between what the employer pays and what the employee receives) is the 6th lowest in the OECD. At 25.9% it remains well below the OECD average of 36.1%, despite the recent upward trend.

Source: OECD, Taxing Wages, 2013

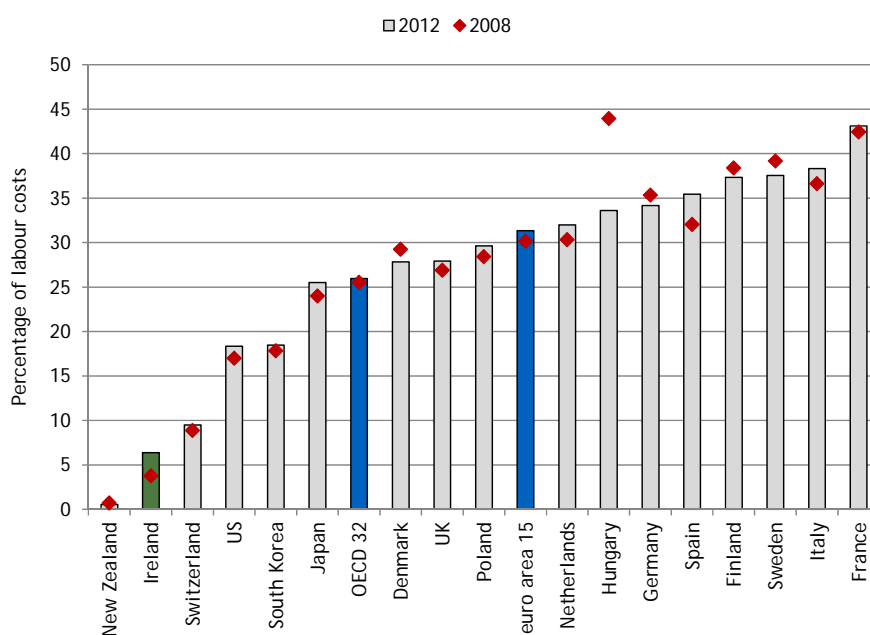
Figure 37: Average Income, tax plus employees' and employers' social security contributions: Single individual without children, 167% of average earnings, 2012



The total tax on labour is the 12th lowest in the OECD for single individuals with no children earning 167% of average earnings, down from 9th lowest in 2008. For this higher income cohort, the total tax on labour in Ireland (38.2%) is much closer to the OECD average (40.5%).

Source: OECD, Taxing Wages, 2013

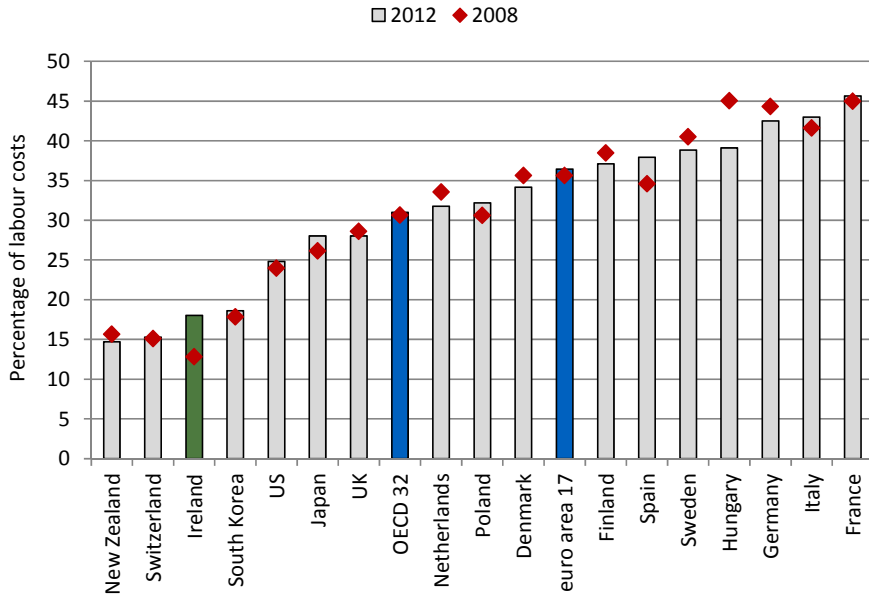
Figure 38: Average Income, tax plus employees' and employers' social security contributions: Married Couple with two children, 100% of average earnings, 2012



For married couples with two children, the total tax on labour is much less pronounced at 6.4%. At this level, Ireland had the second lowest tax imposition on labour in the OECD for this family cohort. This ranking remained unchanged relative to 2008, although the rate has increased from 3.8%.

Source: OECD, Taxing Wages, 2013

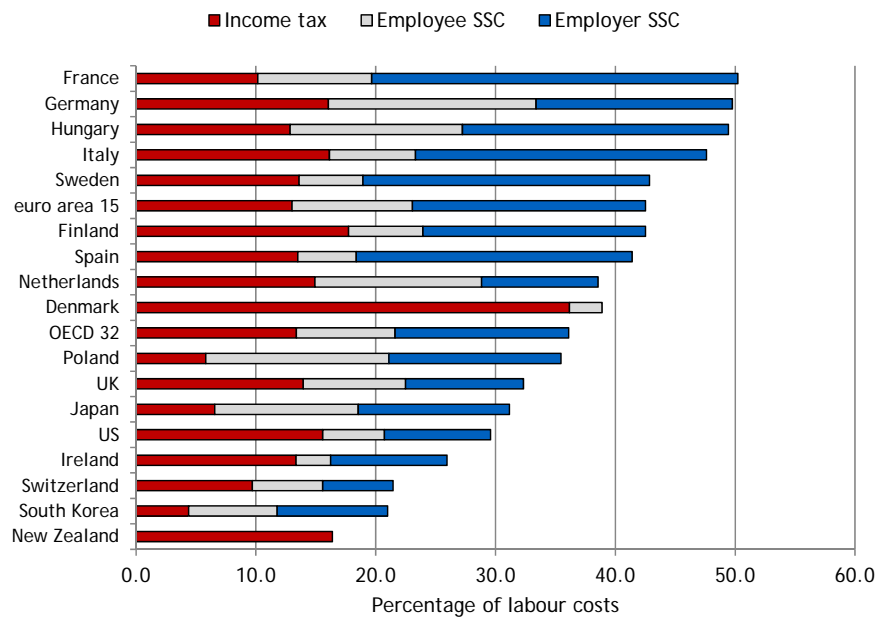
Figure 39: Average Income, tax plus employees' and employers' social security contributions: Married Couple with two children, 100-67% of average earnings, 2012



18% of total labour costs for a married couple with two children earning 167% of average earnings (i.e. the first earning 100% and the second earning 67% of average earnings) went towards tax, up from 12.8% in 2008. This is below the OECD average of 31%. As a result, the tax wedge is now the 5th lowest in the OECD 32 (down from 2nd lowest in 2008).

Source: OECD, Taxing Wages, 2013

Figure 40: Income tax plus employees' and employers' social security contributions (% of labour costs), 2012



This chart breaks out income tax and social contributions paid by both employees and employers as a percentage of labour costs. Data relates to a single individual without children at the income level of the average worker.

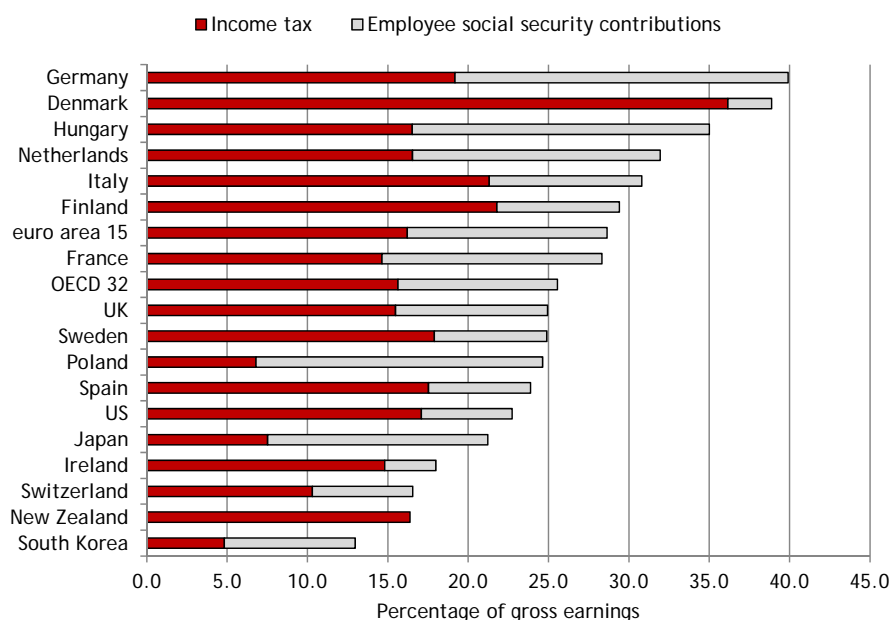
Source: OECD, Taxing Wages, 2013

Ireland has the 8th lowest rate of social security contributions in the OECD. Employer's SSCs are the 10th lowest, while employee contributions are the 6th lowest. In many countries, there is either a cap on employer social security or a reduced rate above a certain income threshold. In Ireland, a flat rate is charged on the full salary - as salaries increase, our competitiveness is quickly eroded.

7.2.2 Average Personal Tax Rates

Figure 41 examines net personal average tax rate across a range of countries. The personal average tax rate is defined as income tax plus employee social security contributions as a percentage of gross wage earnings.

Figure 41: Income tax plus employee social security contributions, 2012 (% gross wage earnings)



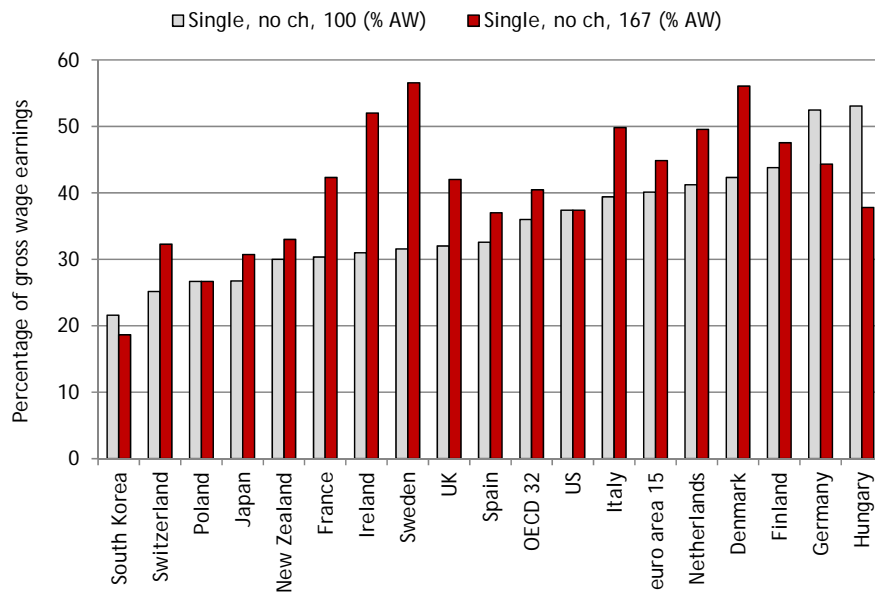
The average personal tax rate in the OECD 32 is 28.6 per cent compared with 18 per cent in Ireland. According to this measure, Ireland is the 6th most competitive location in the OECD 32.

Source: OECD, Taxing Wages, 2013

7.2.3 Marginal Tax Rates

The following two charts show the incremental change to personal income tax and employee social security contributions less cash benefits when gross wage earnings rise marginally. In most cases personal income tax and employee social security contributions absorb 25-55 per cent of a worker's pay rise for single individuals without children at 100 per cent of the average wage level.

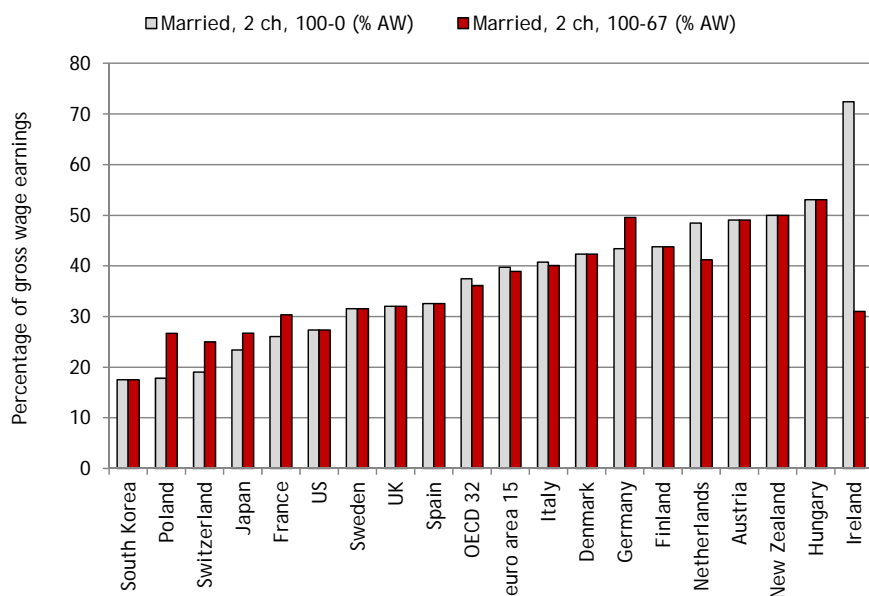
Figure 42: Marginal rate of income tax plus employee contributions less cash benefits (% of gross wage earnings), Single, 2011



The marginal tax rate in Ireland (31%) for a single individual earning 100% of the average wage is lower than the equivalent OECD average. A rate of 52% applies in Ireland, however for an individual earning 167% of the average wage and as a result, the marginal rate is amongst the highest in the OECD.

Source: OECD, Taxing Wages, 2013

Figure 43: Marginal rate of income tax plus employee contributions less cash benefits (% of gross wage earnings), Married, 2011



At 72.4%, the marginal rate of income tax (plus employee and employer contributions) in Ireland is particularly high for a married couple with 2 children and one income (earning 100% of the average wage). For a married couple with two children and two earners (earning 167% of the average wage) the marginal rate is more competitive (31%) and is below the OECD average.

Source: OECD, Taxing Wages, 2013

The 72.4 per cent marginal tax rate (in Figure 43) appears to be a result of the interaction between the taxation system (the transition between lower and higher income tax rates) and the treatment of social welfare entitlements. Based on the OECD data, this rate applies to those earning between 89 per cent and 100 per cent of average earnings in Ireland. For those earning 101 per cent and 102 per cent of average wages, the marginal rate drops back to 54.5 per cent and 31 per cent respectively. For further details, see <http://www.oecd.org/ctp/tax-policy/taxingwages-ireland.htm>.

7.3 Policy Considerations

7.3.1 Taxation to Support Enterprise Development

Maintaining a pro-enterprise taxation system, while simultaneously broadening the tax base, is critical to maintaining employment levels and incomes in Ireland and repairing the public finances.

In this context, the OECD's hierarchy of taxation provides an essential guide to policymakers. The hierarchy establishes a tax and economic growth ranking order according to which corporation taxes are the most harmful to growth, followed by personal income taxes and then consumption taxes with recurrent taxes on immovable property being the least harmful tax.

In this regard, the introduction of the annual value based tax on property is a welcome development - achieving a significant revenue stream from property taxes should act as part of a wider strategy to identify alternative revenue sources in order to avoid any further increases in income tax, social security and other charges on labour.

Recommendation: While recognising the need for fiscal consolidation, in order to support job creation and enterprise growth, labour taxes should be shielded from any further increases to the extent possible. Efforts to increase Government revenue should focus on alternative sources. Revenues from alternative tax-streams such as the property tax should be used to support a tax strategy which circumvents the need for further increases in the labour tax wedge and the marginal rates.

Responsibility: Department of Finance

7.3.2 Addressing High Marginal Tax Rates

Overall, analysis conducted by the Department of Finance, ESRI, and the OECD (amongst others) has found that Ireland's income tax system is one of the most progressive in the world¹¹² and the overall fiscal adjustment to date has been progressive in nature¹¹³.

112 A progressive tax is one where the revenue collected increases by proportionally more than the taxable amount (e.g. income). The European Commission measures progressivity by comparing the OECD tax wedge on 167 per cent of average income as a proportion of the tax wedge on 67 per cent of average income. On a rating system where less than 100 is regressive and above 100 is progressive, most EU countries had a progressivity rate of between 120 and 140. Ireland, in comparison, had a progressivity rate of 190.

According to figures from the Department of Finance, the richest 23 per cent of tax units (with income in excess of €50,000 per annum) pay 77 per cent of total income tax and Universal Social Contribution (USC) revenue¹¹⁴.

Despite recent changes, the average tax rate on lower levels of income remains competitive. As illustrated in Figure 35 previously, the entry point to income tax in Ireland is €16,500 per annum which is the highest entry point relative to average wages in the OECD (i.e. in Ireland those earning less than 51 per cent of the average wage do not pay income tax; on average in the OECD, those earning 9 per cent of the average wage pay income tax)¹¹⁵.

Even accounting for the USC, the entry point for which is €10,036, the entry point for tax is about 33 per cent of the average wage, still significantly above the OECD average. This ensures that effective tax rates are very low in Ireland at the lower end of the income distribution. As a consequence, the IMF has already suggested that there is considerable room to raise revenues without increasing the already elevated marginal tax rates¹¹⁶.

The ESRI have recently noted that the structure of Irish income tax “necessarily limits the revenue generated by the income tax system, because the low marginal tax rates at low income levels apply also to the relevant ‘slice’ of income of those with higher incomes. Thus, if Irish income taxes were to approach European levels, it is likely that marginal tax rates in low to middle income ranges would have to rise”¹¹⁷.

Despite the aforementioned progressivity, other concerns persist. In particular, the level at which individuals start paying the higher rate of tax in Ireland (€32,800 for single individuals) is low relative to other countries¹¹⁸. Table 4 illustrates the proportion of income earners at each tax rate, while Table 5 summarises data on the entry point to the top rate of income tax in a range of countries.

113 According to the ESRI, while Budget 2012 involved greater proportionate losses for those on low incomes, the overall distributional pattern of Irish austerity measures (taken between October 2008 and Budget 2012) is among the most progressive in 6 EU countries examined. For further details, see Callan, T., Keane, C., Savage, M., and Walsh, J.R., *Distributional Impact of Tax, Welfare and Public Sector Pay Policies: 2009-2012* in ESRI, *Quarterly Economic Commentary*, Winter 2011/Spring 2012, February 2012

114 O'Connor, B., *Fairness and Progressivity in the Irish Tax System*, Department of Finance Presentation, 3rd May 2013

115 This entry level was described by the IMF as very high in its Article IV report on Ireland. See IMF, *Ireland - Staff Report for the 2012 Article IV Consultation - Policy Discussion B - Growth-Friendly Consolidation that Protects the Vulnerable*, 2012

116 A reduction in the entry point for income tax generally means reducing credits, which increases average tax rates for all. This could result in higher replacement rates for lower-paid workers, i.e. those currently below the current threshold.

117 The ESRI also note that higher marginal tax rates on low and middle income earners would raise extra revenue not just from those at such income levels, but also from those at higher income levels. Changes to top tax rates at very high income levels would have little impact on the gap in income-related taxes collected in Ireland. See Callan, T., Keane, C., Savage, M., and Walsh, J.R., *Taxes on Income: Ireland in Comparative Perspective*, ESRI, *Budget Perspectives 2014*, June 2013

118 For instance, in the case of the US, the threshold at which the marginal rate takes effect is at a much higher earnings level (approximately €310,000). In the case of Germany the marginal takes effect at a much higher wage level of approximately €253,000.

Table 4: Distribution of Income Earners on the Income Tax File for 2013 (Pre-Budget Basis)

	Exempt (standard rate liability fully covered by credits or age exemption limits)	Exempt (standard rate liability fully covered by credits or age exemption limits)	Higher rate liability NOT fully offset by credits	Total
Number of Income Earners	841,002	953,066	379,362	2,156,830
Proportion	39.69%	42.85%	17.46%	100.00%

Source: Department of Finance, Taxation Annexes to the Summary of 2013 Budget Measures

Table 5: Entry Point to Top Income Tax Rate, 2012

	Threshold for top income tax rate	Personal income tax & employee social security contributions	Threshold (expressed as a multiple of the average wage)
Finland	€70,300	55.5%	1.8
France	€150,000	51.2%	5.1
Germany	€250,731	44.3%	5.8
Ireland	€32,841	52.0%	1
Netherlands	€56,491	49.3%	1.2
UK	€150,000	52.0%	4.2
US	€388,350	40.2%	8.4

Source: OECD Tax Database

The higher rate of tax actually impacts on individuals earning less than the average wage (€36,000)¹¹⁹, meaning that marginal tax rates (i.e. the tax paid on an individual's last euro of income) are now in excess of 50 per cent for single individuals earning €32,800 per annum¹²⁰.

119 The CSO, Earnings and Labour Costs Survey for Q4 2012 show that average weekly earnings are € 695.80. The average annual salary in the economy, therefore, is approximately €36,000.

120 The following example illustrates the effect of recent changes in taxation on individuals. For a single worker earning €40,000 per annum the average rate of tax has increased from 18.6 per cent in 2008 to 24.8 per cent in 2013, while the marginal rate has increased from 47 per cent to 52 per cent. At the higher income levels, a single worker earning €100,000 per annum, the average rate of tax has

Apart from Belgium, Ireland is the only State in the EU15 where the highest marginal rates kick in at average income levels – in the UK, for example, the highest rate applies only when income is more than four times the average¹²¹.

High marginal tax rates create a disincentive for workers already in employment to work longer hours. High marginal tax rates also discourage entry into the Irish labour market and may also act as a disincentive for entrepreneurship and risk-taking.

The OECD have raised the possibility that “high top marginal rates will increase the average tax rates paid by high-skilled and high-income earners so much that they will migrate to countries with lower rates resulting in a brain drain which may lower innovation activity and productivity”¹²². This is a particular concern, given our need to retain high skilled individuals.

Recommendation: As well as ensuring that, to the extent possible, there are no further increases in labour taxes, it would be beneficial to provide certainty regarding future marginal labour tax rates. Consideration should be given to flagging when it will be feasible to reduce marginal labour rates below 50 per cent. The introduction of further costs on employment (e.g. changes to sick pay policy, pensions policy, etc.) should be considered carefully from a labour cost competitiveness perspective given the scale of our unemployment crisis.

Responsibility: Department of Finance/ Department of Social Protection

increased from 33.8 per cent in 2008 to 41.1 per cent in 2013, while the marginal income tax has increased 43.5 per cent in 2008 to 52 per cent in 2011. Department of Finance, Budget 2012, Annex

121 Callan, T., Keane, C., Savage, M., and Walsh, J.R., Taxes on Income: Ireland in Comparative Perspective, ESRI, Budget Perspectives 2014, June 2013

122 Johansson, Å., Heady, C., Arnold, J., Brys, B., and Vartia, L., Tax and Economic Growth, OECD Economics Department Working Paper No. 620, ECO/WKP(2008)28, July 2008

Appendix One: Forfás Board Members

Eoin O’Driscoll (Chairman)

Chairman, Southwestern

Martin Shanahan

Chief Executive, Forfás

Mark Ferguson

Director General, Science Foundation Ireland

John Murphy

Secretary General, Department of Jobs, Enterprise and Innovation

Barry O’Leary

Chief Executive, IDA Ireland

Frank Ryan

Chief Executive Officer, Enterprise Ireland

Michael O’Leary

Secretary to the Board, Forfás

Appendix Two: Recent Forfás Publications

Addressing Future Demand for High-Level ICT Skills Forfás, EGFSN	November 2013
State Investment in Research & Development 2011 - 2012 Forfás	August 2013
Business Expenditure in Research & Development (BERD) 2011/2012 Forfás	August 2013
Social Enterprise in Ireland - Sectoral Opportunities and Policy Issues Forfás	July 2013
Ireland's Construction Sector - Outlook and Strategic Plan to 2015 Forfás	July 2013
Forfás Annual Report Forfás	July 2013
Research Prioritisation: Framework for Monitoring Public Investment in Science, Technology and Innovation and 14 Action Plans DJEI	July 2013
National Skills Bulletin 2013 EGFSN	July 2013
Monitoring Ireland's Skills Supply: Trends in Education and Training Outputs 2013 EGFSN	July 2013
Annual Business Survey of Economic Impact 2011 Forfás	July 2013
Global Entrepreneurship Monitor (GEM) 2012 Global Entrepreneurship Monitor	July 2013
Annual Employment Survey 2012 Forfás	July 2013
Ireland's Competitiveness Performance 2013 Forfás	May 2013
Making it in Ireland: Manufacturing 2020 Forfás	April 2013

Future Skills Requirements of the Manufacturing Sector to 2020 EGFSN	April 2013
Sectoral Regulation Forfás	April 2013
EGFSN Statement of Activity EGFSN	March 2013
Costs of Doing Business in Ireland 2012 Forfás	March 2013
Vacancy Overview 2012 EGFSN	February 2013
Action Plan for Jobs 2013 Forfás, DJEI	February 2013
A Review of the Equity Investment Landscape In Ireland Forfás	January 2013
Regional Labour Markets Bulletin 2012 EGFSN	January 2013
A Review and Audit of Licences Across Key Sectors of the Irish Economy Forfás	December 2012
Global Entrepreneurship Monitor (GEM) 2011 Global Entrepreneurship Monitor	September 2012
Annual Employment Survey 2011 Forfás	August 2012
National Skills Bulletin 2012 NCC	July 2012
Monitoring Ireland's Skills Supply - Trends in Education and Training Outputs 2012 EGFSN	July 2012
Ireland's Competitiveness Scorecard 2012 NCC	July 2012



The publications of Forfás and the advisory groups to which it provides research support are available at www.forfas.ie

To sign up for our email alerts contact us at info@forfas.ie or through the website.

July 2013

Forfás
Wilton Park House
Wilton Place
Dublin 2

Tel: +353 1 607 3000
Fax: +353 1 607 3030

www.forfas.ie