Organisation for Economic Co-operation and Development

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The minimum wage and the tax and benefit system in Ireland

A note for the Irish Low Pay Commission

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Key messages

- A good coordination between minimum wages and the tax and benefits system is key to maximise the beneficial effects of wage floors on worker incomes, and to limit potential adverse effects on employment. It is also needed to enhance the effectiveness and affordability of in-work benefits and tax credits.
- In Ireland, the tax burden at the minimum wage is relatively low while two types of in-work benefits provide support to people on low pay. Moreover, given comparatively generous social-benefit provisions for low-income groups, even short working hours at the minimum wage can be enough to avoid income poverty. In some household circumstances, families can escape income poverty also when out of work, although poverty does remain a risk for others.
- However, interactions between the minimum wage and tax and benefit policies are complex and require careful consideration. In particular, in Ireland lone parents relying on means-tested benefits while in work would benefit from tighter co-ordination between the minimum-wage policy and the tax and benefit system. In particular, results in this note show that:
    - Without any accompanying measures, such as raising means-tested benefits in line with the minimum wage, only a small share (just over 10%) of a minimum-wage increase of 5% may end up in the pockets of a lone parent earning the minimum.
    - The financial incentives to move from part-time to full-time minimum-wage employment are comparatively weak for lone parents. In particular, the combined increase in tax burdens and loss in social benefits is significantly higher than in most OECD countries. By contrast, incentives to start employment are stronger for lone parents than in the OECD on average. However, these results do not account for the costs of childcare, which are high in Ireland and can make low-paid work “unaffordable” to for low-paid parents.
- Housing benefits play a major role in supporting low-income households in Ireland. However, in some cases current housing-benefit rules risk generating perverse incentives for low-paid workers. The analysis in this note suggests that a minimum-wage increase could actually make some families, such as low-paid two-earner couples, worse off, as housing-benefit reductions outweigh higher employment incomes.

Introduction

1. Currently, 28 out of 36 OECD countries have statutory minimum wages in place. Minimum wages also exist in most non-OECD emerging economies. In the eight OECD countries without statutory minimum wages (Austria, Denmark, Finland, Iceland, Italy, Norway, Sweden and Switzerland), a large part of the workforce is, at least formally, covered by wage floors specified in sector- or occupation-level collective agreements.

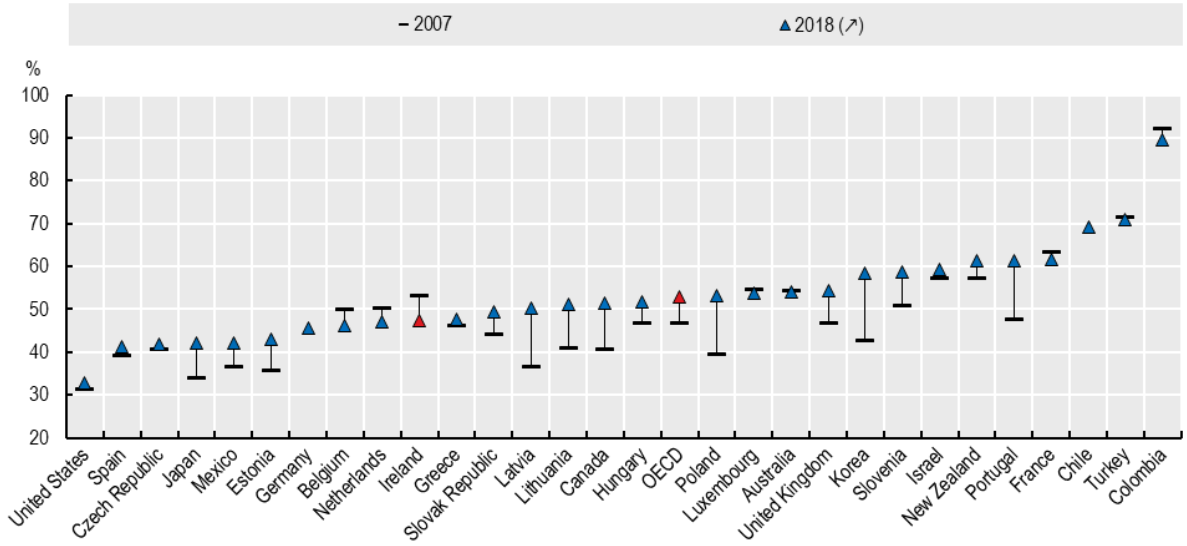
2. Statutory wage floors are the most direct policy lever governments have for influencing wage levels, especially at the bottom of the distribution. More specifically, minimum wages have been justified for: i) ensuring fair pay and curbing worker exploitation; ii) making work pay; iii) boosting tax revenue and/or tax compliance by limiting the scope of wage under-reporting; and iv) anchoring wage bargaining,

particularly for vulnerable workers with a weak bargaining position. Recently minimum wages have attracted renewed interest as a tool to tackle inequality and strengthen workers' bargaining power.

3. Gross minimum-wage levels expressed as a share of median wages vary significantly across OECD countries and emerging economies (Figure 1). In the OECD area, they are on average 53% of the median wages, ranging from below 40% of median wages in the United States to 60% and over in Colombia, Turkey, Chile and France. At 47.5%, the ratio of the minimum to the median wage in Ireland was below the OECD average in 2018.

Figure 1. Minimum wage levels pre- and post-crisis, OECD countries

Minimum wages as a percentage of median wages of full-time employees (in gross terms)



Note: OECD is the unweighted mean of OECD countries shown (not including Colombia).
Source: OECD Minimum Wages Database.

4. There have been sizeable differences between countries in how the value of minimum wage has changed over the crisis and recovery period. Figure 1 shows that the minimum-to-median ratio has increased substantially between 2007 and 2018 in about half of OECD countries, in particular in Central and Eastern European countries. Ireland is one of only a few countries where the minimum-to-median ratio in 2018 was significantly below 2007 levels. In addition to Ireland (-10.5%), the minimum-to-median ratio also fell in Belgium (-7.5%), the Netherlands (-6.8%), Colombia (-3.0%), France (-2.7%) and Luxembourg (-1.2%). In most cases, this reflected a freeze in the nominal value of the minimum, or by keeping adjustments below inflation.[1] In Ireland, the nominal value of the minimum wage remained constant between 2008 and 2016 – apart from a temporary reduction in 2011.[2] The only OECD country where the minimum wage fell in nominal terms during this period was Greece, where the minimum wage was cut by

[1] There is also a compositional effect at play. As job losses during the crisis were concentrated among the workers with the lowest pay, median wages rose mechanically, thereby eroding the value of minimum wages relative to the median. Such compositional effects were at play in Spain, for example.

[2] The minimum wage was reduced to EUR 7.65 effective February 2011 but this was reversed in July 2011 when the minimum wage was restored to EUR 8.65.

22% in nominal terms between 2011 and 2012[3] and frozen until February 2019 when it was increased by 11%.

The interaction with the tax and benefit system

5. Gross values of the minimum wage do not give an accurate picture of workers' take-home pay, nor of the costs of employing minimum-wage workers for firms due to the role of taxes and transfers.

6. While minimum wages are intended to support low-wage workers, the cost of employing them can be at the heart of concerns that legal minima might reduce employment, or damage the international competitiveness of firms relying on low-skilled labour. Even at the very bottom of the wage ladder, taxes and social levies can strongly reduce take-home pay. At the same time, taxes and other mandatory non-wage labour costs also push up the cost of employing minimum wage workers. By driving a wedge between labour costs and workers' take-home pay, the size of the overall tax burden has implications for how well minimum wages perform at supporting low-wage workers and low-income families, while avoiding significant job losses.

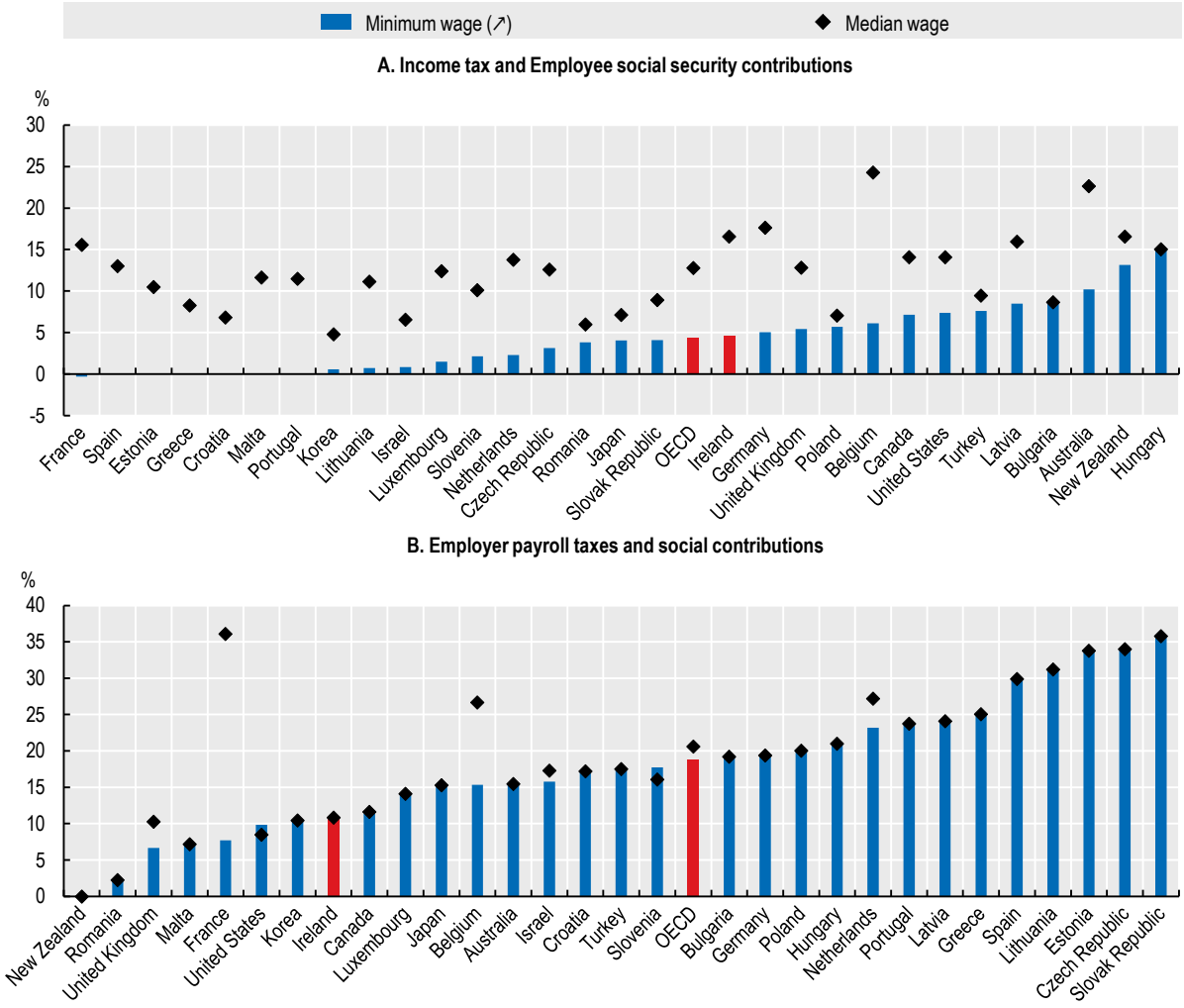
7. On average across the OECD, the total burden from income taxes, social contributions and related mandatory payments amounts to one third of gross earnings at the full-time wage, with approximately equal shares paid by employer and employee (Figure 2).[4] To lower employers' costs and the risk of employment losses, some countries have introduced sizeable reductions in employer social security contributions for workers at around the minimum wage, thereby lowering the ratio of minimum-to-median labour costs below that of the minimum-to-median wage. The most notable case is the one of France: since 1995, social security contributions for firms employing workers at the minimum wage have been reduced and are now almost zero. Other countries have attempted to increase the effectiveness of the minimum wage to "make work pay" using targeted reductions in income taxes and/or employee social contributions for low-wage workers. Some countries offer tax credits or in-work benefits targeted at low-wage workers (e.g. Belgium, France, Mexico, United Kingdom, United States), while others rely on progressive income taxes to keep the tax burdens of low-wage earners well below those applicable to the typical worker (e.g. New Zealand).

[3] The minimum wage for employees aged above 25 was cut by 22% between July 2011 and March 2012, while the minimum wage for those aged below 25 was lowered by 32%.

[4] However, in some countries, the total "tax wedge" can be 45% or more (Czech Republic, Germany, Poland, Estonia, Slovak Republic, Latvia and Hungary). In these cases, tax policy may be as important a driver of net wages and labour costs as "headline" minimum wage levels.

Figure 2. Employer and employee taxes and social contributions on minimum wage earners

Percentage of gross earnings, OECD and EU countries, 2018



Note: Tax burdens are calculated for a full-time worker in a single-person household earning a minimum wage at the standard (adult) rate. Full-time refers to usual full-time hours in each country. Employer and employee social contributions also include any mandatory payments to private insurance for health, retirement pensions, etc. Countries are ordered in ascending order of the minimum-to-median ratio before taxes. OECD is the unweighted average of OECD countries shown (not including Bulgaria, Croatia, Malta and Romania).
Source: OECD Tax-Benefit Model TaxBEN. For details on the model, see oe.cd/taxben. Underlying wage data are at https://taxben.oecd.org/docs/TaxBen_wages.xlsx.

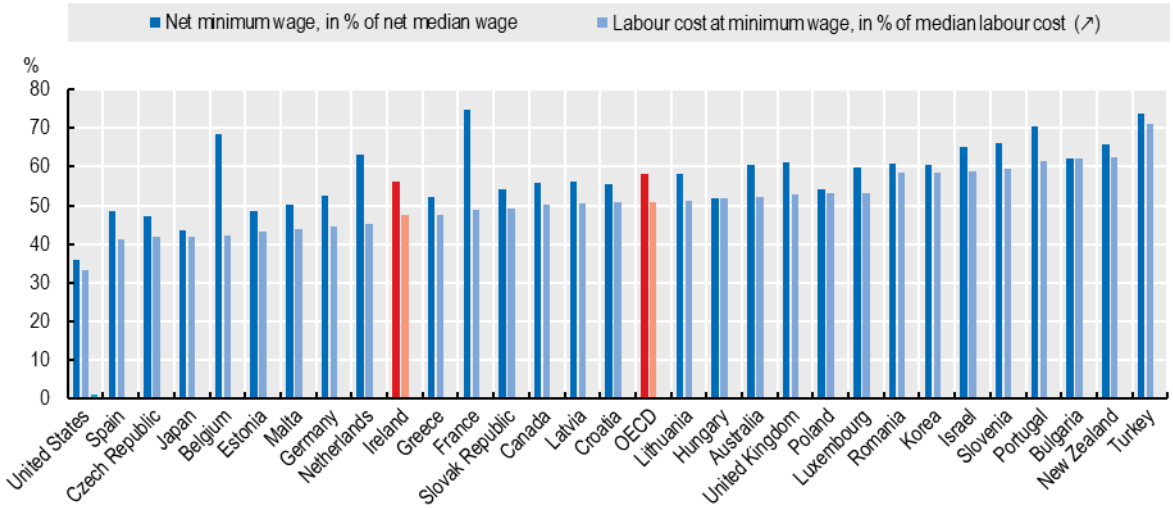
8. The overall labour tax burden for minimum-wage earners in Ireland is relatively low: employers pay 11% of gross earnings in payroll taxes and social security contributions while employees pay 4.5% in income taxes and social security contributions.[5] Moreover, employers' payroll taxes and social security contributions are the same at the minimum and at the median wage. Therefore, in Ireland, the labour cost of employing someone at the minimum wage, relative to the cost of employing someone at the median wage, remains below the OECD average (Figure 3) as shown in Figure 1 for the gross minimum wage. By contrast, Figure 3 shows that France, despite one of the highest gross minimum wages compared to the gross median wage, has a significantly lower labour cost at the minimum wage relative to the median

[5] For more info, see http://www.oecd.org/els/soc/TaxBEN-Ireland-2018.pdf

labour cost than the OECD average. Ireland's comparatively smaller tax burdens also mean that the scope for reducing taxes, e.g. to offset the effect of future minimum-wage increases on labour costs as other countries have done in the past, is more limited in Ireland.

Figure 3. Net minimum wages and minimum labour costs

Percentage of net median wage and median labour cost respectively, OECD and EU countries, 2018



Note: Labour cost is calculated as the gross minimum wage + employer social security contributions and payroll taxes, including any other mandatory payments to private insurance for health, retirement pensions, etc.. Data refer to a single person without children aged 40 and working full-time and the full year. Countries are ordered in ascending order of the labour cost at the minimum wage. Net minimum wages and labour costs are not provided for Colombia and Mexico as these countries are not currently included in OECD TaxBEN. OECD is the unweighted average of OECD countries shown (not including Bulgaria, Croatia, Malta and Romania).
Source: OECD Database on Minimum Wages (https://stats.oecd.org/Index.aspx?DataSetCode=MIN2AVE) and OECD Tax-Benefit Model TaxBEN. For details on the model, see oe.cd/taxben. Underlying wage data are at https://taxben.oecd.org/docs/TaxBen_wages.xlsx..

9. In addition to taxes and social security contributions, the benefit system also has a significant impact on the net incomes of minimum-wage workers. Ireland operates two types of in-work benefits, the Working Family Payment (WFP)[6] and the Back to Work Family Dividend (BTWFD)[7]. The WFP, formerly known as Family Income Supplement (FIS), is a weekly tax-free payment available to employees with children and gives extra financial support to people on low pay. The BTWFD provides income support to people with qualified children who are in or take up employment or self-employment and, as a result, stop claiming a jobseeker's payment. The BTWFD and the WFP can be paid together and the BTWFD will not be taken into account in the income test for WFP. Thanks to these in-work benefits, Figure 3 shows that, when looking at the net minimum wage relative to the net median wage, Ireland gains positions in the ranking, ending just below the OECD average.

[6] For more info on eligibility criteria, amounts, duration, income test, see https://www.citizensinformation.ie/en/social_welfare/social_welfare_payments/social_welfare_payments_to_families_and_children/family_income_supplement.html

[7] For more info on eligibility criteria, amounts, duration, income test, see https://www.citizensinformation.ie/en/social_welfare/social_welfare_payments/social_welfare_payments_to_families_and_children/back_to_work_family_dividend.html

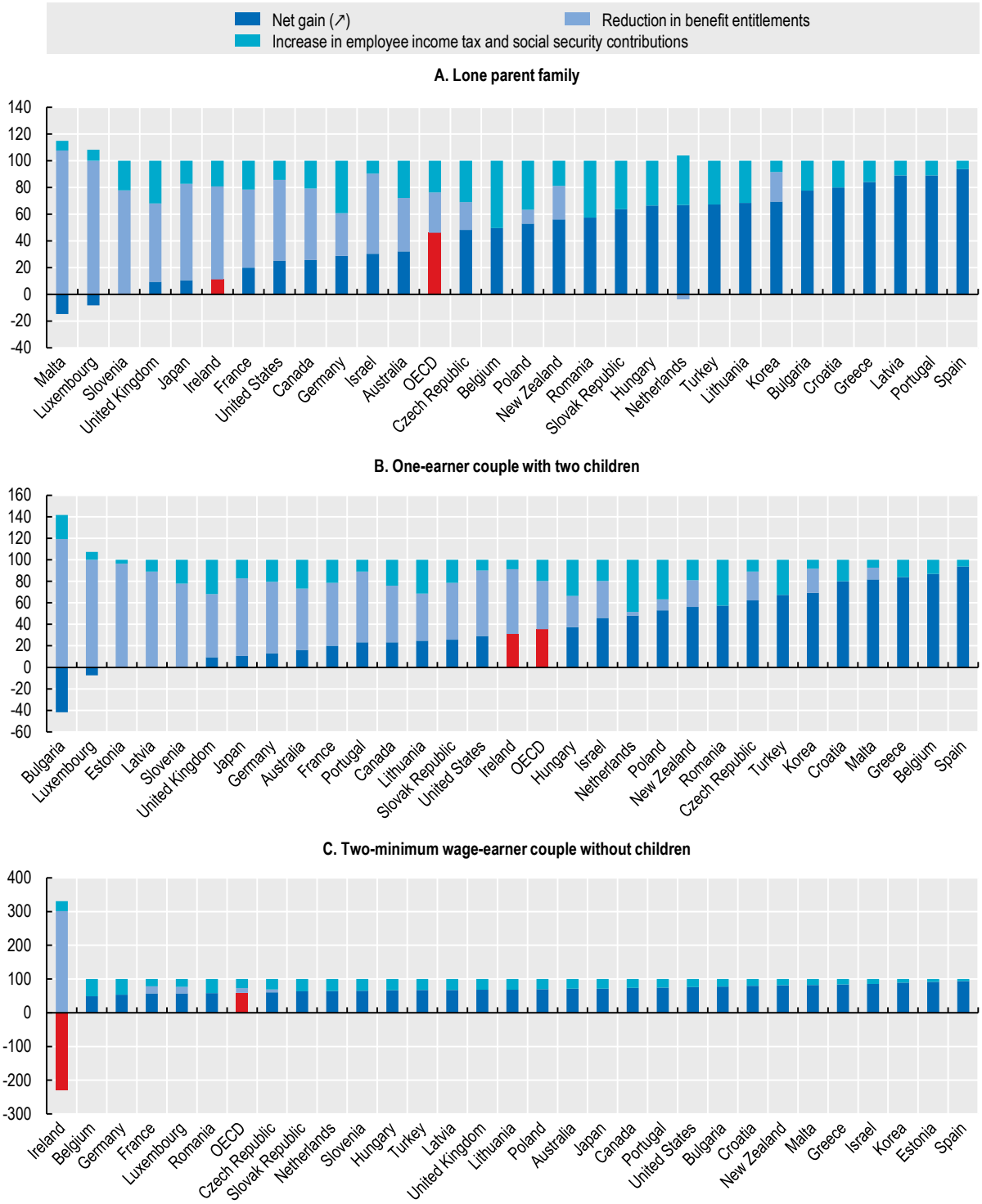
10. Effective coordination between minimum wage policy and tax and benefit provisions is not only key to limit potential adverse effects on employment and ensure that work pays, but also to enhance the effectiveness and affordability of in-work benefits and tax credits in supporting the incomes of workers and their families. By imposing a wage floor, statutory minima limit the risk that employers lower wages in an effort to "pocket" in-work benefits and tax credits, thereby neutralising their impact on the take-home pay of workers.[8] At the same time, to keep tax concession aimed at reducing the labour cost affordable, the minimum wage should be set at moderate levels. Moreover, for in-work benefits or tax concessions to remain well targeted, reliable information on wages and working time should be available to the authorities for means-testing.

11. Tax and transfer policies can in some cases undermine the efficacy of the minimum wage in raising the living standards of low-wage workers. Without policy coordination, higher taxes and reduced benefit entitlements can consume large parts of a minimum wage increase, reducing the part that adds to net incomes of the intended beneficiaries. Panels A to C of Figure 4 show the share of a 5% minimum wage increase that is left after taxes and benefit reductions for three different family types. Simulations for other family types (single, one-earner couple 2-minimum wage-earner couple with and without children) can be found in Annex A and Annex B.

12. The results show that in Ireland, without any accompanying measures such as raising means-tested benefits in line with the minimum wage, less than 12% of a minimum wage increase would end up in the pockets of single-parent minimum wage earners (Figure 4, Panel A) as a result of higher income taxes and social security contributions as well as lower benefits. In the case of one-earner couple with two children, the net increases in only around a third of the gross increase (Figure 4, Panel B). As an extreme, but informative, case, a minimum-wage increase could actually make a two-earner couple without children worse off (Figure 4, Panel C), if housing benefit reductions more than outweigh the minimum wage increase.

[8] For instance, one of the stated aims of introducing the UK National Minimum Wage was to ensure that in-work benefits would actually increase incomes of workers (rather than being "pocketed" by employers who might reduce wages by a similar amount).

Figure 4. Share of minimum wage increase that is left after taxes and benefit reductions, 2018



Note: Calculations refer to a 5% minimum-wage increase and a single-adult household with two children. They assume that all tax and benefit provisions remain as they were before the increase, and account for minimum-income and other means-tested benefits that are primarily income related and are typically accessible for low-income families. For Japan, calculations reported in this figure use minimum wages for Tokyo and social assistance rates for Tokyo grade 1-1. OECD is the unweighted average of OECD countries shown (not including Bulgaria, Croatia, Malta and Romania).

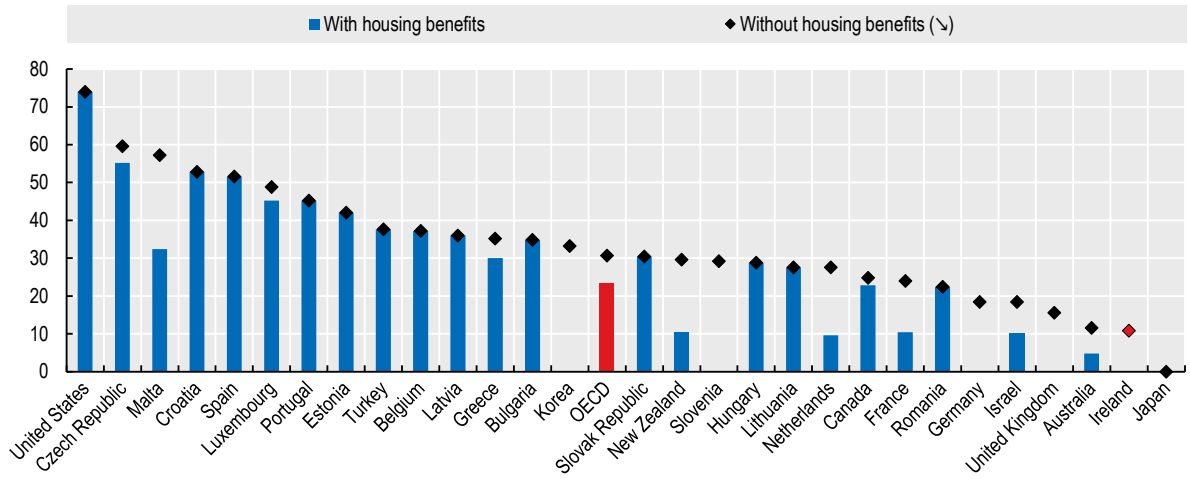
Source: OECD Database on Minimum Wages (https://stats.oecd.org/Index.aspx?DataSetCode=MIN2AVE) and OECD Tax-Benefit Model TaxBEN. For details on the model, see oe.cd/taxben. Underlying wage data are at https://taxben.oecd.org/docs/TaxBen_wages.xlsx.

Minimum wages and income poverty

13. Wage floors can be an important element in an overall strategy to tackle inequality. But, even in the absence of any negative effect on employment, they are only a blunt instrument for fighting income poverty. Many poor families have no one working. Moreover, many workers at the minimum wage live in households with above average incomes (for instance, around 81% of minimum wage earners in France are not poor)[9]. Minimum wages also do not guarantee that workers will be able to work a sufficient number of hours to lift them out of poverty. And in some countries, minimum wages may simply be too low to have any discernible effect on poverty as conventionally measured. Weak co-ordination between minimum-wage policy and social benefit provisions is another reason why low-wage workers may be "in-work poor".

14. Figure 5 shows that in some countries with low minimum wages, even working very long hours may not enable families to escape income poverty (50% of median net household income). In a country such as the United States, for instance, the working hours required to escape poverty on a minimum wage are unrealistic and more generous income support or wages significantly above the (federal) minimum wage can be needed in these cases to provide a viable route out of poverty. In other countries, the welfare system is generous enough to put family incomes close to or above the poverty line even when out of work. In Ireland, non-working lone parents can escape poverty if they qualify for family and housing benefits that are typically available for those meeting low-income and other relevant requirements. Without housing benefits, lone parents need to work at least 10 hours per week to escape poverty.

Figure 5. Weekly working hours needed for a lone parent working at the minimum wage to move above the relative poverty line, 2018



Note: The poverty line is 50% of median net household income. Net incomes ae calculated by subtracting income taxes and mandatory social or private contributions payable by workers, and adding family and housing benefits, as well as minimum-income and other means-tested benefits that are primarily income related and are typically accessible for low-income families. For Japan, calculations reported in this figure use minimum wages for Tokyo and social assistance rates for Tokyo grade 1-1. OECD is the unweighted average of OECD countries shown (not including Bulgaria, Croatia, Malta and Romania).
Source: OECD Database on Minimum Wages (https://stats.oecd.org/Index.aspx?DataSetCode=MIN2AVE) and OECD Tax-Benefit Models (http://www.oecd.org/social/benefits-and-wages.htm).

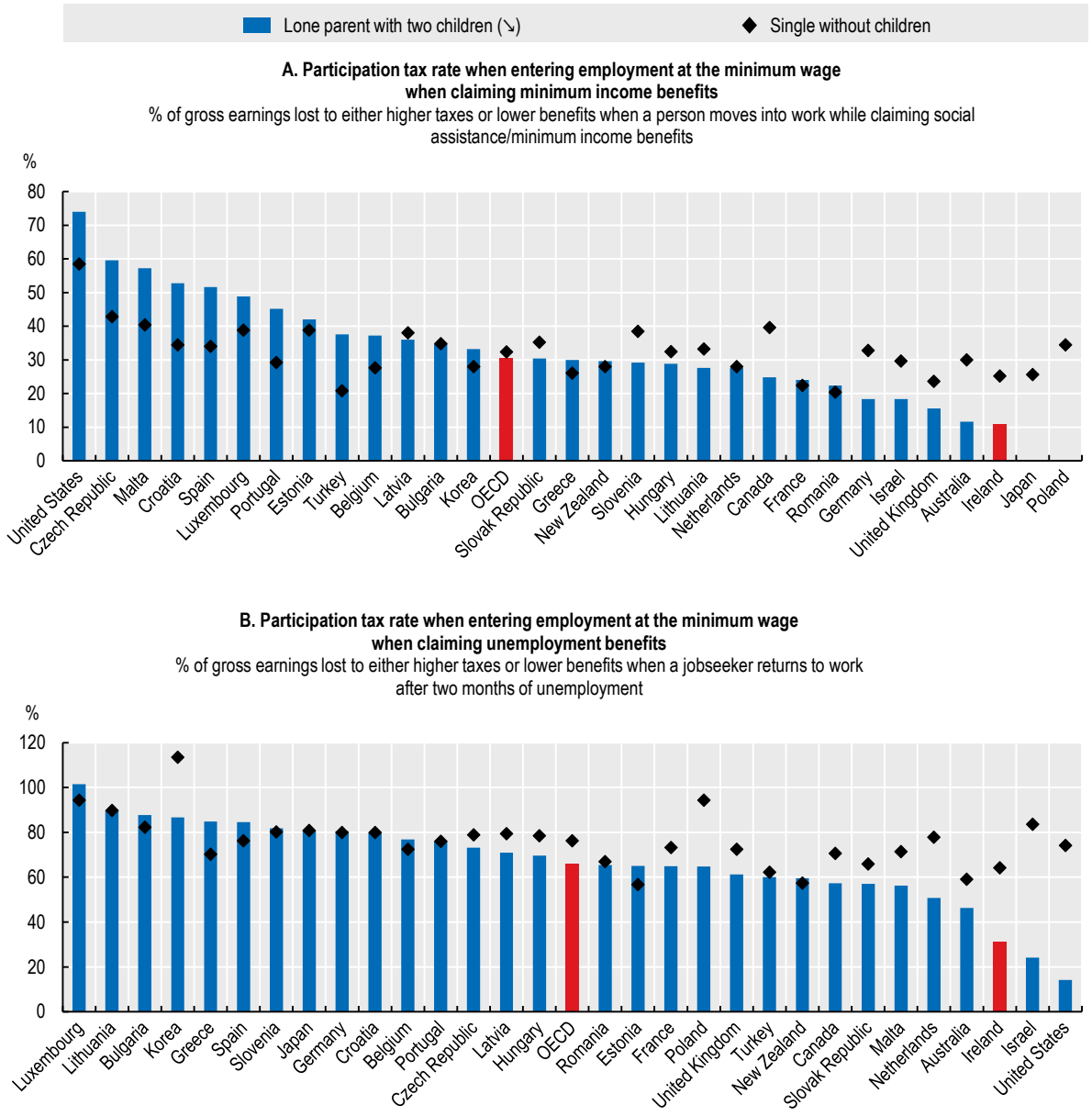
[9] Source: *Salaire Minimum Interprofessionel de Croissance: Rapport du Groupe d'Experts 2018*.

Work incentives

15. Finally, the interaction between taxes and benefits also determines the financial incentives of those with low earnings potential to take up employment or increase earnings by working longer hours. One metric of the disincentives resulting from taxes and reduced benefit entitlements is the effective tax rate. This is commonly referred to as "participation tax rate" (PTR, for someone moving from unemployment or inactivity into a job) or "marginal effective tax rate" (METR, for somebody who is already in work but increases his or her earnings).

16. Figure 6 shows that in Ireland the PTR for a recipient of social assistance (Panel A) or unemployment benefits (Panel B) is lower than in several OECD countries for lone parents and closer to the OECD average for single persons thanks to relatively generous in-work benefits.

Figure 6. Participation tax rates when entering employment at the minimum wage

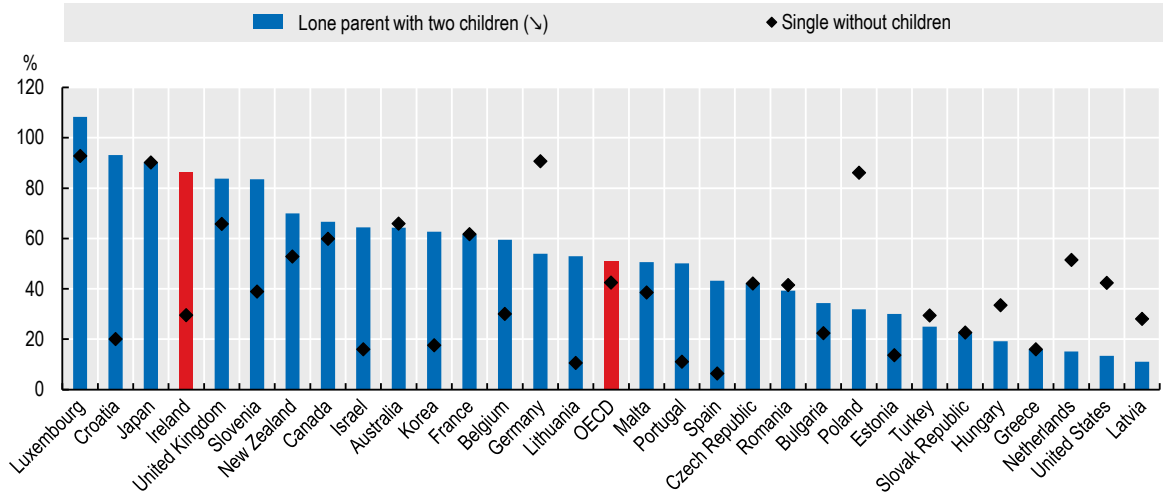


Note: Tax burdens are calculated for a full-time worker in a single-person household earning a minimum wage at the standard (adult) rate. Full-time refers to usual full-time hours in each country. Employer and employee social contributions also include any mandatory payments to private insurance for health, retirement pensions, etc. OECD is the unweighted average of OECD countries shown (not including Bulgaria, Croatia, Malta and Romania).
Source: OECD Tax-Benefit Model TaxBEN. For details on the model, see oe.cd/taxben. Underlying wage data are at https://taxben.oecd.org/docs/TaxBen_wages.xlsx.

17. By contrast, the marginal effective tax rate for lone parents working at the minimum wage and going from part-time to full-time is particularly high (86.5%, i.e. for 10 euros more of gross earnings earned, a worker would pocket only 1.35 euros in net terms), well above the OECD average (Figure 7), as workers earning the minimum wage start paying income taxes and social security contributions and, most importantly, see family and in-work benefits reduced.

Figure 7. Effective tax rates when going full time

Percentage of gross earnings lost to either higher taxes or lower benefits when an employee increases working hours from part time (20 hours per week) to full time (40 hours per week) at the minimum wage



Note: OECD is the unweighted average of OECD countries shown (not including Bulgaria, Croatia, Malta and Romania).
Source: OECD Tax-Benefit Models (http://www.oecd.org/social/benefits-and-wages.htm).

Concluding remarks

18. Minimum wages can have a strong impact on wages at the bottom of the distribution – which is why countries have heavily relied on them throughout the recession and the recovery, either to boost the wages of the (working) poor, or to cut labour costs as a crisis-related measure (depending on what was the most pressing issue). However, minimum wages can only make a limited contribution to tackling wider poverty (both in and out of work) when treated as a stand-alone policy. To be more effective, it is essential that minimum wage policy be co-ordinated with tax-benefit policies in order to ensure that increases in the headline value of the minimum wage translate into higher take-home pay while limiting the rise in labour costs for employers.

19. For instance, welfare and social security benefits in the Netherlands are closely linked to minimum-wage levels, while the Minimum Wage Act in Japan requires authorities to maintain consistency between minimum wages and public assistance. Without effective co-ordination, minimum wage hikes may not

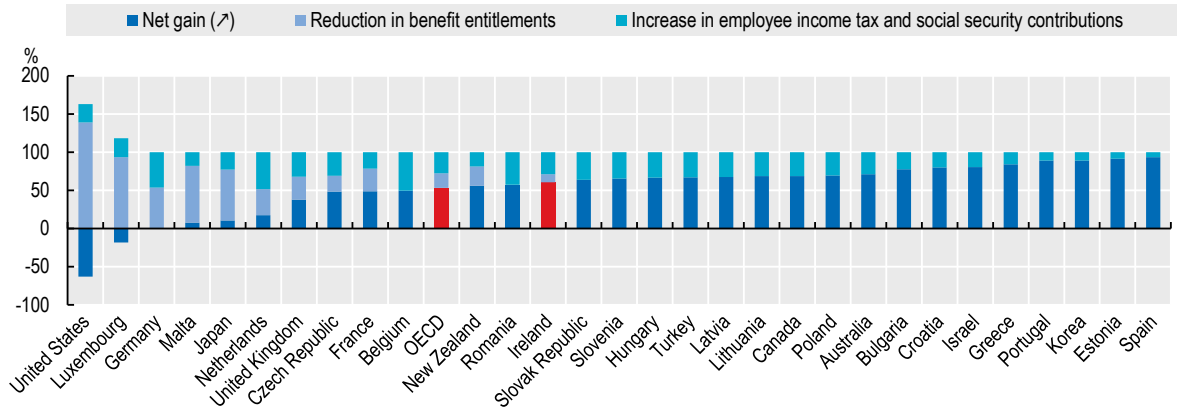
result in significant income gains for the targeted individuals, especially in countries where tax burdens on low-wage earners are sizeable, or where means-tested out-of-work transfers provide a comprehensive income safety net.

20. In particular, the analysis in this note suggests that in Ireland lone parents are relatively well protected when out of work, but they benefit relatively little from minimum wage increases or from increasing their working hours. Adaptations to the tax and benefit system could be considered in order to ensure that gross pay increases for this particularly vulnerable type of household effectively result in increases of their net income.

21. Co-ordinating the minimum wage with the tax and benefit system may require some trade-offs. Tax concessions or benefits that are tightly targeted to low-wage earners (and are therefore phased quickly out when wages increase above the minimum), make it less attractive for workers to progress to higher-paid jobs. They also create incentives for wage underreporting. By contrast, weakly targeted benefits, that are available over a wider wage range or in-work benefits that top up earnings compensating for the loss of other forms of income support, avoid these adverse incentives. But because they are available to large numbers of workers, they can be very expensive for governments – and these costs will rise further when the minimum wage is increased. The difficulties of targeting are most pronounced when very large shares of workers are within or close to the targeted wage range. As a result, in-work benefits or targeted tax concessions generally work best when minimum wages are set at moderate levels, when the share of minimum wage earners is relatively low, and when authorities have access to reliable information on wages and working time.

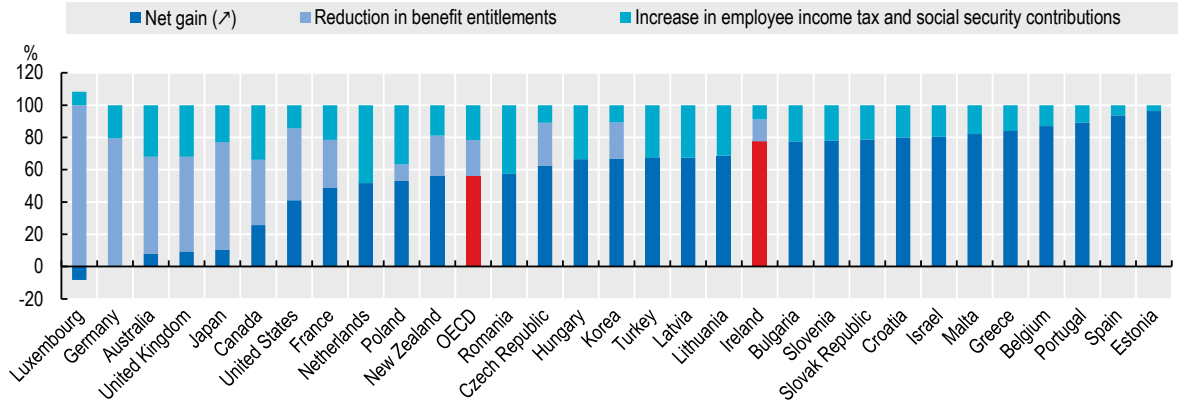
Annex A. Other charts including housing benefits

Figure A.1. Share of a minimum wage increase that is left after taxes and benefit reductions, single without children, 2018



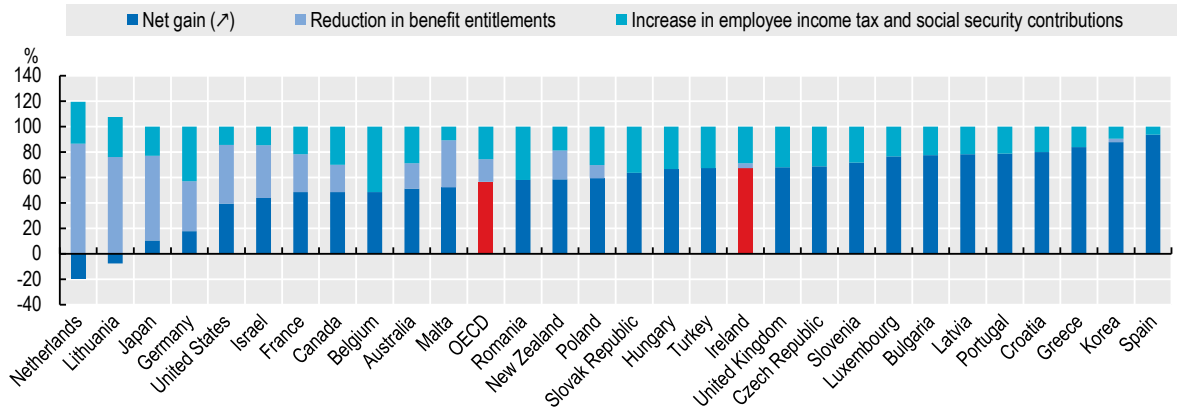
Note and Source: See Figure 4.

Figure A.2. Share of a minimum wage increase that is left after taxes and benefit reductions, one-earner couple without children, 2018



Note and Source: See Figure 4.

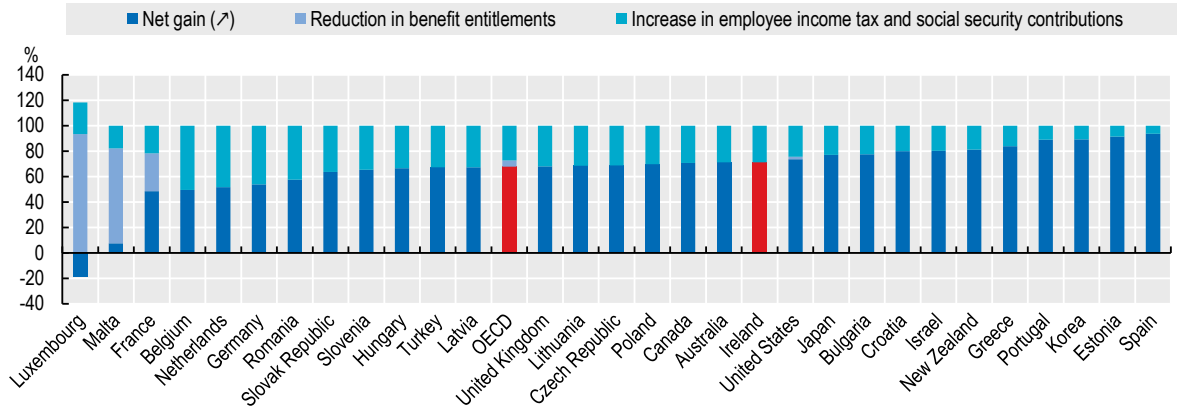
Figure A.3. Share of a minimum wage increase that is left after taxes and benefit reductions, two-minimum wage earner couple with two children, 2018



Note and Source: See Figure 4.

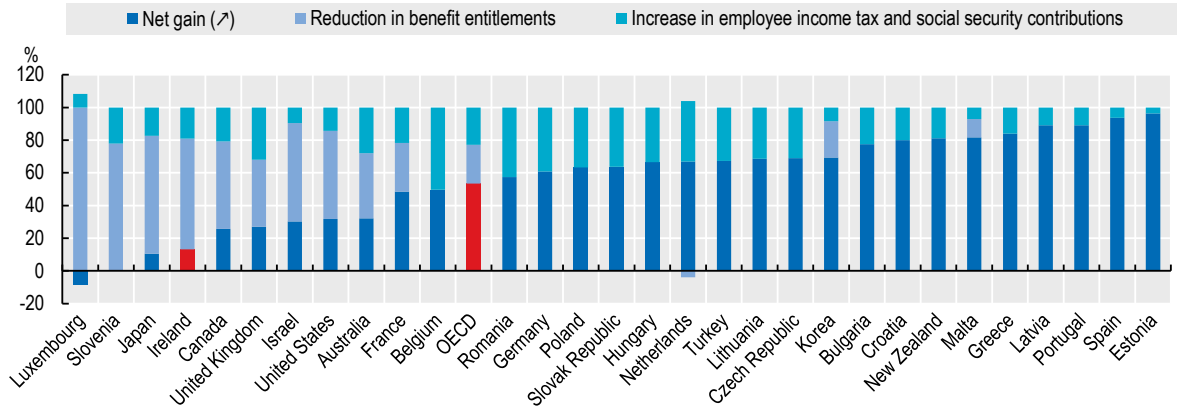
Annex B. Charts excluding housing benefits

Figure B.1. Share of a minimum wage increase that is left after taxes and benefit reductions, single without children, 2018



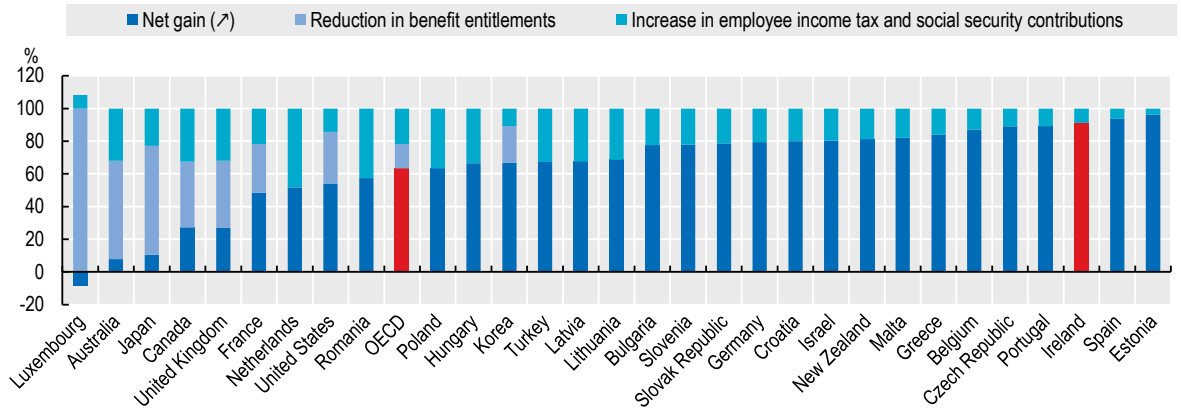
Note and Source: See Figure 4.

Figure B.2. Share of a minimum wage increase that is left after taxes and benefit reductions, single with two children, 2018



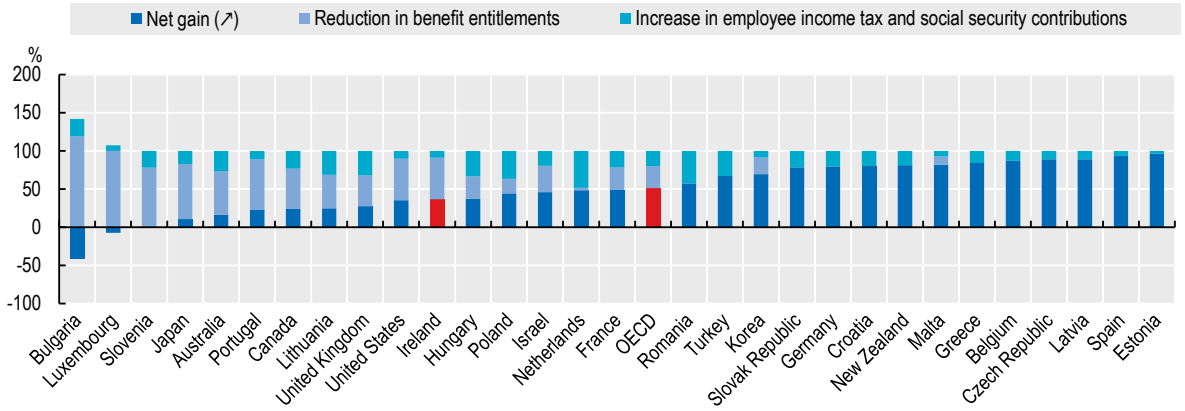
Note and Source: See Figure 4.

Figure B.3. Share of a minimum wage increase that is left after taxes and benefit reductions, one-earner couple without children, 2018



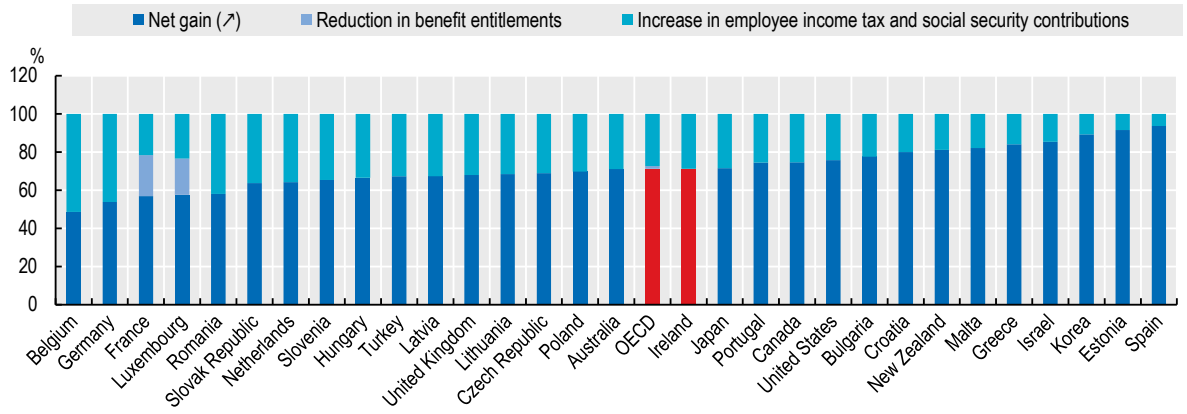
Note and Source: See Figure 4.

Figure B.4. Share of a minimum wage increase that is left after taxes and benefit reductions, one-earner couple with two children, 2018



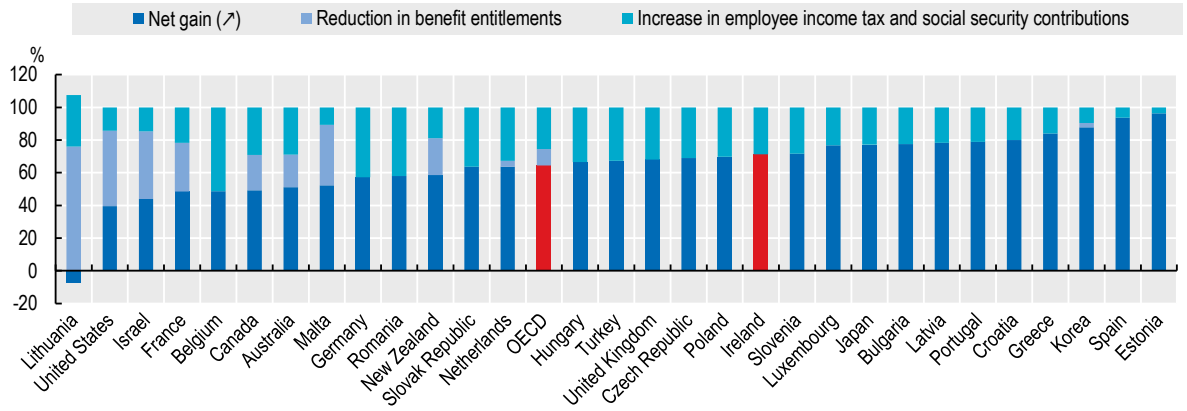
Note and Source: See Figure 4.

Figure B.5. Share of a minimum wage increase that is left after taxes and benefit reductions, two-minimum wage earner couple without children, 2018



Note and Source: See Figure 4.

Figure B.6. Share of a minimum wage increase that is left after taxes and benefit reductions, two-minimum wage earner couple with two children, 2018



Note and Source: See Figure 4.