

# Ontario's Proposed Minimum Wage Hike: An Economic Assessment

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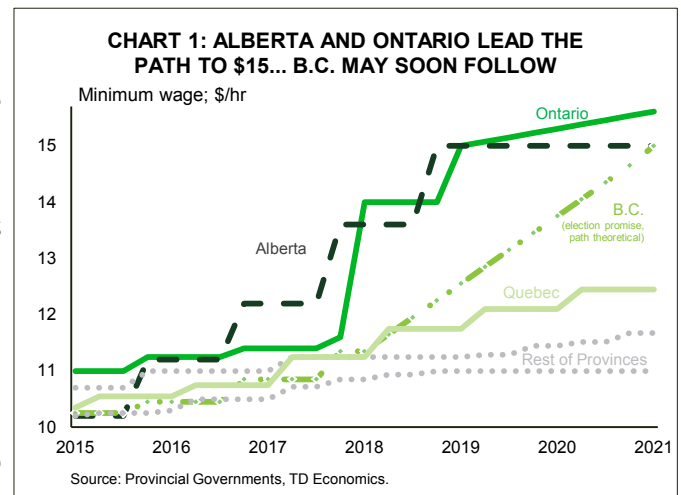
## Highlights

- Ontario's bold plan to raise the minimum wage by one-third over the next 18 months has fueled much debate about its potential impact on Canada's largest economy, with commentary deeply divided on the issue. For the economic forecasting community, the challenge at hand will be to quantify the potential effects for the purposes of their medium-term projections.
- Raising the minimum wage can potentially generate more benefits to society than costs in terms of any resulting job loss. However, the relatively rapid speed of the implementation and its timing within the economic cycle are two factors that will likely accentuate the negative hit to Ontario employment.
- Our baseline job forecast builds in a net reduction in jobs of around 80-90k positions by the end of the decade and a 0.3% increase in Ontario's CPI (relative to business as usual levels). The estimated job impacts would still leave employment expanding over the next few years, but at a tepid clip of around 0.5% annually.
- These estimated job impacts could be mitigated by extending the implementation timeline. Reforms should also be considered to the wage-setting process in the province, including allowing minimum wage levels to vary regionally based on relative CPI and/or overall wage levels.

The steep increase in the minimum wage planned by the Ontario government has fueled significant debate about its potential impact on Canada's largest provincial economy (40% of national GDP), particularly in the midst of a weakening housing market. This report aims to address many of the key questions around the policy.

## What is the Ontario government's plan?

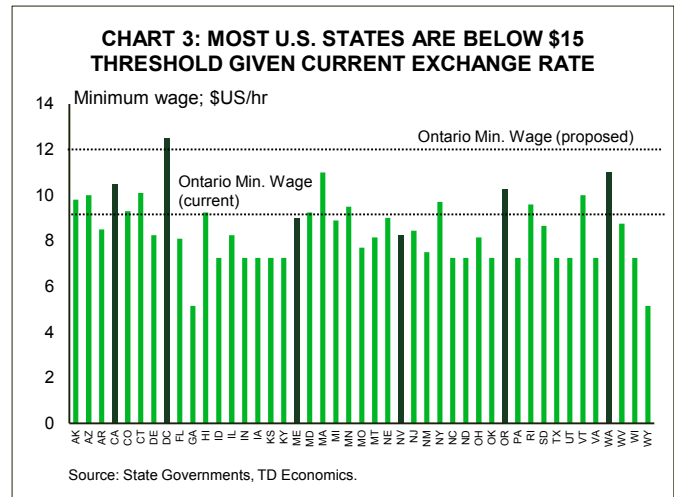
- The planned hike in the minimum wage is the centerpiece of the Ontario government's plan to reform the provincial labour market:
  - The general minimum wage is poised to rise from its current level of \$11.40 per hour to \$14 on January 1, 2018 and then to \$15 in early 2019. Thereafter, annual increases would be at the rate of inflation.
  - Students under 18 and liquor servers will see a parallel percentage point jump in their lower minimum wage rates rise by 2019 (from \$10.90/\$10.10 to \$14.10/\$13.05).



- Among a host of other proposed changes in the reform bill include mandating equal pay for part-time, temporary, casual and seasonal employees doing the same job as full-time employees, increasing vacation entitlements (to at least 3 weeks of vacation after 5 years) and expanding personal emergency leave.
- An all-party committee is currently studying the legislation. No significant changes were made after the first reading in August. There will be a second reading in September, after which time the bill is expected to become law (likely this autumn).

### Are there other provinces moving to \$15?

- The minimum wage in Ontario has largely followed provincial trends over the past three decades.
  - Rates were increased steadily in the 1970s and 1980s, before being held flat throughout the 1990s.
  - Over the past decade, the rate has been increased steadily in Ontario – from \$8 in 2007 to \$11.40 in 2017.
- Ontario’s proposed path would essentially match a 2-year plan being implemented by Alberta that will see its minimum wage reach \$15 by October 2018.
  - A third province – British Columbia – has promised to hike its minimum wage from \$11.35 to \$15, though a timetable has not yet been set.
  - Rates in other provinces currently range from



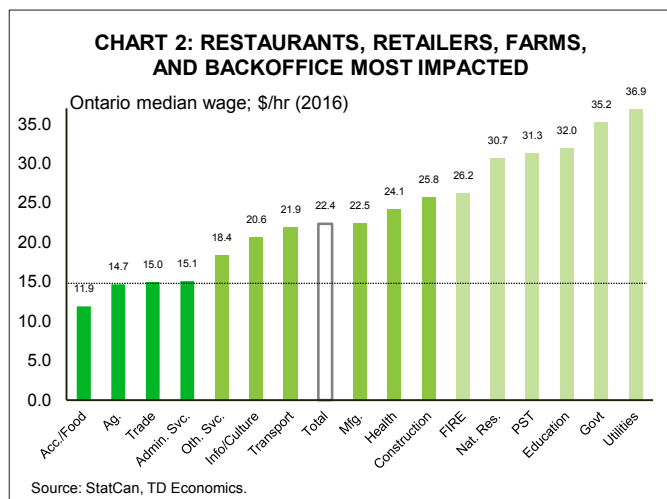
a low of \$10.75 in Saskatchewan, Nova Scotia and N&L to \$13 in the territories.

### How will Ontario stack up to U.S. states?

- Across U.S. states, the variance in the minimum wage is wider, with rates running from US\$5.20-US\$12.50 (C\$6.40-\$15.60).
  - A number of states (California, Maine, New York, Oregon, and Washington) and the District of Columbia plan significant increases in their respective rates in the coming years to US\$12 (C\$15) or higher.
  - D.C. and California plan to raise their rates to US\$15 (C\$18.75) by 2020 and 2022, respectively. In New York, the rate is set to rise to US\$12.50 by 2021, and then adjusted annually by inflation until it reaches US\$15.
  - In the U.S., a number of cities have adopted their own minimum wages, with New York, San Francisco, Seattle, and Los Angeles either at – or moving towards – the US\$15 level (C\$18.75).
  - By 2022, it is estimated that about 63% of Canadians and 25% of Americans will live in a state or city with a US\$12 (C\$15) minimum wage.

### Who earns the minimum wage in Ontario?

- Among Canadian provinces, Ontario has the highest share of employees who earn the minimum wage:



- A steady but gradual increase in the number of minimum wage workers since the 1990s has brought the share of total employees in Ontario to 9% (or 7% of total jobs if self-employed workers are included).
- In the other provinces, minimum wage shares of total employees run from about 2% in Alberta to 8% in the Atlantic region.
- About 40% of minimum wage workers are teens (15-19), 20% are of post-secondary age (20-24) and 40% are adults.
- About 60% live with family, while 20% live with a spouse who is also employed;
- Half of minimum wage workers are employed by businesses with less than 100 employees;
- In terms of sectors, the prevalence of minimum wage workers is heavily skewed towards private services industries such as retail trade, food & accommodation, and administrative services. In contrast, most of the tradeable industries (i.e., manufacturing and mining) have a relatively low incidence.

### How would the demographic change under a \$15 minimum wage?

- As the \$15 plan is implemented, the share of those earning the wage floor would likely rise sharply (to around 30% of total employees).
- The mix would also swing away from teens to adult workers. According to the Financial Accountability Office of Ontario (FAO), almost 60% of workers would be adults, while the teen share would fall to about 20%.

### What is the core issue being debated?

- Raising the minimum wage represents a direct transfer of income from businesses to low-wage earners.
  - Positive household income effect – a hike in the minimum wage delivers a direct (and immediate) income boost to low wage workers.
  - Negative employment effect – businesses will

look to defray the higher labour cost by hiring fewer workers, cutting less productive positions and increasing the use of automation.

- Negative price effect – to the extent that market conditions allow, businesses might aim to pass along the higher cost to customers in the form of higher prices, reducing household purchasing power.
- The key question is which side of the ledger wins out? Proponents of higher minimum wages recognize that jobs will be lost, but still see the policy as being an overall net positive. They see minimum wage as a key tool to addressing the challenges of income inequality and poverty. In contrast, opponents argue that while well intentioned, minimum wage hikes hurt the lower wage individuals they are intended to help and represent a net cost to society. They make the case that other programs and tools are better suited to address the low-income challenge.

### What are other economic considerations?

- Magnitude, speed of changes and timing:
  - While it is customary to compare jurisdictions in terms of the level of the minimum wage, a more relevant benchmark is how minimum wages stack up in terms of average or median wages offered within the respective marketplace. For example, a move to \$15 in a higher-cost centre like Toronto is less economically impactful than in a lower-cost market in southwestern Ontario.
  - Changes implemented over longer time frames tend to reduce the adjustment costs faced by firms, especially smaller businesses.
  - The stage of the business cycle matters. For example, if minimum wage hikes take place during a period of economic strength, the negative effects on labour markets tend to be lessened and/or less visible.
- Knock on effects to higher wages – a hike in the minimum wage can exert upward pressure on wages just above the threshold, thus amplifying the impacts of the policy. An industry may have no or few employees

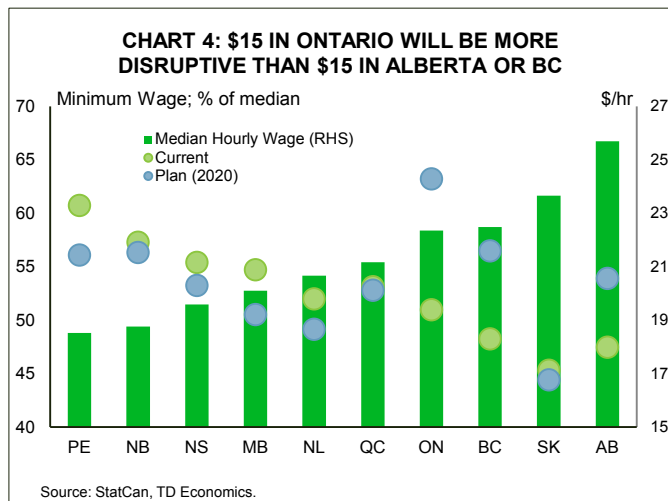
earning the minimum wage, but wages at the lower end of the scale may need to be adjusted upward in order to remain competitive.

- Direct impact on consumption – there is a common view that the personal income gains generated by higher minimum wages will be near-term growth enhancing, as low-wage individuals typically spend virtually each dollar of earned income (i.e., a marginal propensity to consume of close to 1.) However, many of the individuals who earn minimum wage do not live in low income households. Moreover, many low income households do not have minimum wage earners. Accordingly, only a portion of the direct income gain will likely make its way into the economy. To the extent that jobs and purchasing power decline, the real consumption benefits would also be eroded.
- Business investment effects – investment would face countervailing forces. Businesses would likely prioritize investments in labour-saving automation. And to the degree that this investment results in labour productivity increases, there could be a positive spill-over to wages over the longer run. However, downward pressure on profits in the near term could lead to offsetting cuts to business spending and capital investment.
- Labour force impacts – advocates argue that higher minimum wages result in increased labour supply and reduced turnover. Since firms would anticipate a more stable workforce, they would be inclined to increase training expenditures. The counter-argument is the “scarring” impact on youth of lost employment opportunities. Lower-wage jobs generally represent a stepping stone for young workers where they first gain valuable experience. Moreover, opponents argue that weaker profits will mean lower, not higher, training budgets.

### What has empirical research concluded?

- Many of these considerations are not clear cut, so it is perhaps not surprising that empirical studies on the economic impacts of minimum wage hikes reach conclusions that are all over the map:
  - Much of the research has been focused on isolating net employment and price effects.

- Methodological differences alone can yield strikingly different results. An example relates to Seattle’s recent experience on lifting its minimum wage. Research carried out by the University of Washington concluded that the higher minimum wage resulted in a significant net drop in hours worked in the city. Yet another study came to the opposite result: that the wage hike actually led to higher pay without negatively affecting employment. That study focused on the restaurant industry, where low wage workers tend to be particularly prevalent.<sup>1</sup>
- Despite this ambiguity, on balance, studies undertaken since the 1990s have generally found net negative job effects from minimum wage hikes:
  - In U.S. and international research, employment elasticities (EE) have been traditionally found to run in the range of a negative but modest -0.1 to a higher -0.3%.<sup>2</sup> In other words, each 10% hike in the minimum wage has reduced payrolls among affected workers by 1-3% relative to business as usual levels.
  - The most affected workers are inexperienced workers, notably teens and young adults.
  - Researchers have generally found a stronger relationship between minimum wages and employment in Canada than in the U.S..<sup>3</sup> Canadian studies have determined that a 10% increase in the minimum wage has historically reduced teen employment by as much as 3-6%.<sup>4</sup> The impact on young adult jobs is generally estimated to be about one-third of the impact on teen employment.<sup>5</sup>
- There has been a growing consensus, particularly in recent years, that the level of the minimum wage is a key determinant of the magnitude of adjustment<sup>6</sup>:
  - At low levels, minimum wage hikes have little, if any, depressing effects on employment. In this case, the benefits of a higher minimum wage, including reduced income inequality, may outweigh the costs.
- Few empirical studies have addressed the question of an “appropriate” level of the minimum wage head



on, but those that do tend to place it somewhere between 25-50% of the average or median wage.<sup>7</sup> Within the OECD countries, a ratio is commonly close to half, while some countries (i.e., France and some southern European countries) record a level of around 60%.

### What can we say then about the potential employment adjustment in Ontario?

- The burning question faced by forecasters is how to account for minimum wage plan in their medium term Ontario economic projections. Given all the various considerations and cross-currents, this is no easy task.
- Applying the empirical results from the Canadian and U.S. literature yields an estimated net job reduction in Ontario of 50,000 to 150,000 by the end of the decade – or between 0.7% and 2.1% of total employment. These impacts are relative to business as usual levels.
- Moreover, based on studies of typical pass-through effects of wages to prices, inflation in Ontario could be lifted by 0.3 ppts over the next few years.
- These rough estimates are consistent with those that have been released publicly in recent weeks.
  - The FAO predicted a net job loss in Ontario of 50,000 (low end of the range cited above) and a 0.5% increase in the CPI.<sup>8</sup>
  - According to the FAO analysis, the boost to per-

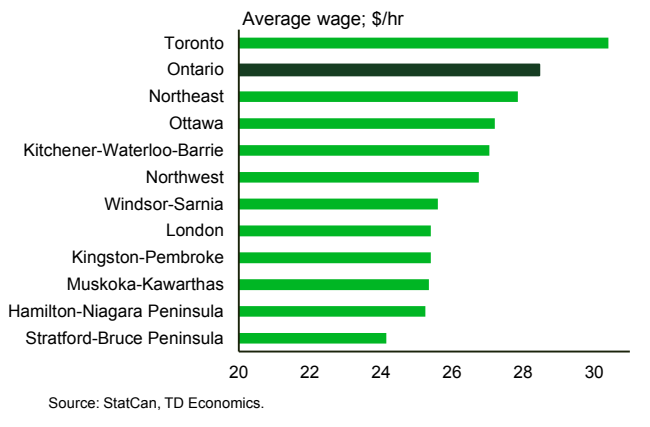
sonal income would still outweigh the drag from the job cut, leaving real personal income about 1.3% higher.

- In contrast, the Canadian Centre for Economic Analysis estimated that the combined impact of Ontario’s minimum wage increase and other labour forms place 185,000 jobs “at risk”.<sup>9</sup>

### What could accentuate the adverse impacts?

- Given the boldness of Ontario’s plan, the negative adjustment in job markets is likely to be exacerbated by the speed, magnitude and timing of the wage hikes:
  - It is difficult to find experiences in North America where the wage has been increased as sharply over such a compressed period of time.
  - At 34%, Alberta’s two-year minimum wage hike is in the same ballpark. But the key distinction is that Alberta has the highest median wage among the provinces. As such, measured as a share of the median wage, its minimum wage floor still stands at a relatively moderate 45%. Even with the planned hikes, the share is projected to rise to 54%, a level that is still quite manageable.
  - In contrast, Ontario’s minimum wage floor is set to jump from a current level of about 53% to an elevated 63% by early 2019.
- As importantly, the timing of Ontario’s plan could coincide with significantly slower economic growth:
  - At almost 3% per year, Ontario’s economy has enjoyed well above trend growth over the past 5 years.
  - With the economy likely to endure a cyclical slowdown in both housing activity and household leverage, economic growth will likely slow sharply in the province.
  - Cyclically slower growth will complicate the adjustment for Ontario companies.
  - What’s more, the hikes will coincide with other cost pressures, including rising interest rates, higher CPP premiums, carbon pricing and elevated electricity costs.

**CHART 5: PROVINCE-WIDE THRESHOLD IGNORES DIFFERENCES WITHIN ONTARIO**



- As such, we believe that the net reduction in employment is likely to exceed the lower-end job estimate cited by the FAO. In our Ontario employment forecast, we have factored in a reduction from business as usual levels of around 80-90k by the end of the decade.
- Under this scenario, we still anticipate net job creation over the 2018-20 period, but at a relatively anemic annual average pace of 0.5%.

### Are businesses already preparing?

- A number of Ontario businesses and other entities are already warning of the negative impact on operations from the planned changes. For example:
  - Metro Inc. estimates the wage increase will cost about \$50 million next year and is accelerating its study of automation.
  - Loblaw's companies has estimated a \$190 million hit in 2018 from the higher minimum wages in Ontario and Alberta.
  - Magna has warned that the higher cost under the plan could affect its business investment in the province.

### Which regions stand to be most affected?

- Cities where wages are generally higher will be able to absorb the impacts of the minimum wage hike most easily.
- This is because low wage industries typically make up a smaller part of these economies, or the low

wage industries in these areas generally pay more to begin with.

- Wage metrics suggest that the centres of Hamilton, London, Kingston, and Windsor will be more severely impacted than average.
- On the other hand, Toronto, Ottawa, and Northeast Ontario are most likely to experience relatively modest impacts.

### What changes should be considered?

- In order to better balance the benefits and costs of minimum wage policy, TD Economics encourages the Ontario government to consider the following changes to its plan:
  - Extend the implementation period by at least two years, to 2021.
  - Consider moving to a process that depoliticizes the setting of the rate. The government's own Minimum Wage Advisory Panel had recommended in 2014 that a committee of independent experts from business, community and labour be established to make regular non-binding suggestions to the ministry on the wage floor contingent on factors such as the timing of the economic cycle.
  - Introduce differentiated minimum wages across Ontario in order to alleviate adverse side effects. A province-wide minimum wage fails to factor in the large divergence in median wage rates across the regions. As such, Ontario could consider the model used in a number of U.S. states that allows minimum wages to be established at the city level. For example, in Toronto region, a minimum wage of \$15 would maintain a ratio relative to average income in the 50-60% range. However, in Windsor, a \$11-\$12 level would be more appropriate.

### Is this the best way to address poverty?

- Through its public policy research in areas such as welfare reform and affordable housing, TD Economics has been active in helping to find solutions to challenges faced by low-income Ontarians.

- Raising the minimum wage will benefit many individuals in low income and narrow the gap between a so-called “living wage” and the prevailing wage. However, as a poverty reduction tool, it is not particularly well targeted, since a significant share of those who earn the minimum wage are in non-poor households and many who are poor are not employed. Indeed, the FAO report found that just one quarter of the higher labour income would directly benefit low-income families.
- Most economists agree that other mechanisms funded through the income tax system – such as the federal Working Income Tax Benefit (WITB) and its American counterpart, the Earned Income Tax Credit – are preferred to more directly tackle poverty reduction.
- For the government, the benefit of legislating a higher minimum wage as a key tool in addressing poverty reduction is that (unlike other mechanisms funded through the tax system) it has no direct impact on the provincial budget. However, the government will ultimately face pressure to address the negative unintended consequences. For example, given the concerns about the impacts of its plan on small businesses, the government has already committed to unveiling a series of measures this fall to cushion the blow.
- Ontario has a well-established poverty strategy, and is currently piloting a guaranteed minimum income program. With the province moving into a budget surplus position, it could have some increased resources to direct towards poverty reduction and/or designing a made in Ontario working income tax benefit.

## END NOTES

1. The first by researchers at the University of Washington (Jardim, Plotnick, van Inwegen, Vigdor, Minimum Wage Increases, Wages and Low Wage Employment: Evidence from Seattle, NBER, June 2017), which found adverse impacts on labor and hours worked. This contrasts with results from a study at the University of California, Berkeley (Reich, Allegretto and Godoey, Seattle’s Minimum Wage Experience 2015-16, June 2017) which found little impact on jobs in the restaurant industry.

2. The range of estimates are cited in various survey research. This includes the International Monetary Fund, Cross-Country Report on Minimum Wages, 2016 as well as David Newmark, Employment Effects of Minimum Wages: IZA World of Labor Essay, 2014.

3,4,5. Gunderson: Minimum Wages: Issues and Options for Ontario, Prepared for the Ontario Ministry of Finance, 2007, and Gunderson: Minimum Wages in Canada: Theory, Evidence and Policy, 2005.

6,7. Op Cit, International Monetary Fund, Cross-Country Report on Minimum Wages, June 2016.

8. Financial Accountability Board of Ontario Commentary: Assessing the Impacts of Ontario’s Proposed Minimum Wage Plan, September 12, 2017

9. Canadian Centre for Economic Analysis: Measuring the Potential Economic Impact of the Fair Workplaces, Better Jobs Act, 2017: A Risk Assessment for Ontarians.

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