A Macdonald-Laurier Institute Publication

True North in Canadian public policy

Commentary

October 2018

MLI Labour Market Report for Q3, 2018

A Counterproductive Outcome: Income Growth Slows Following Minimum Wage Hikes

Philip Cross

While Canadians have traditionally focused intensely on the unemployment rate as an indicator of economic health, in recent years it has become an increasingly incomplete and misleading reflection of how the labour market and the economy are faring. In this series of commentaries, MLI Munk Senior Fellow Philip Cross dives into the data to reveal what's really going on with jobs and wages in Canada, so policy-makers can better understand who is gaining and who is losing, and what it means for the economy as a whole.

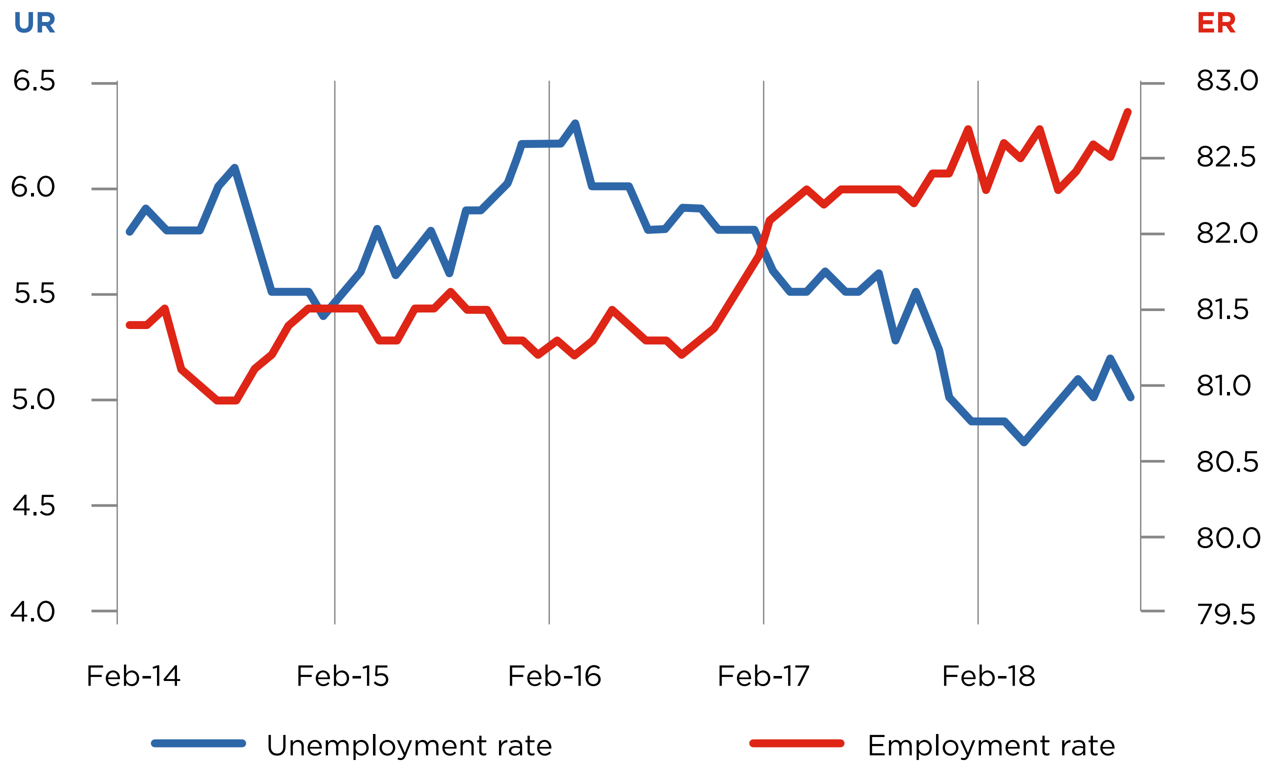
Overview

After labour market conditions weakened in the first half of 2018, they were mixed in the third quarter. Em-ployment edged up enough to stabilize the share of adult Canadians holding a job and the unemployment rate was unchanged. However, new claims for employment insurance rose steadily. With wages decelerating and consumer prices rising, real income growth has decelerated so far this year. This is the opposite of what govern-ments intended when they raised minimum wages this year, especially in Ontario.

Labour market conditions stabilize

The Canadian economy continues to struggle to create more jobs and higher incomes in 2018. Employment rose by 0.4 percent in the third quarter, after no growth in the first two quarters of the year. Compared with a year ago, employment was up 0.5 percent in the third quarter. More significantly, the employment rate among adult Canadians edged up from 82.5 percent to 82.6 percent in the third quarter after falling slightly over the first half of the year, while the unemployment rate also rose slightly to 5.2 percent (see chart 1).

Chart 1: Unemployment and employment rate, 25-54



Source: Statistics Canada CANSIM Table 14-10-0287-01

The third-quarter gain in employment does not signify that a new upward trend has begun. Employment was quite volatile over the summer, rising by 54,000 in July, receding by 51,000 in August and then recovering by 63,000 in September. Such volatility is not unusual because of the difficulty of seasonally adjusting employment during the summer months. Moreover, much of the gain in employment over the summer originated in government, notably education in Ontario and a hiring binge by the BC government.

The tepid outlook for growth is reflected in the Macdonald-Laurier Institute's Leading Economic Indicator (LEI), which eked out only a 0.1 percent gain in August. It is noteworthy that much of the weakness in the overall index originated in widespread declines in the components based on household spending and confidence. In particular, the Bloomberg-Nanos index of consumer confidence continued to trend down for the sixth month in a row. This is consistent with the assessment that labour market conditions remain sluggish as new claims for employment insurance have risen steadily since February. As well, the housing market so far this year continues to soften from its frothy condition in 2017. The downcast state of household spending and sentiment in Canada contrasts with the buoyancy of households in the US, where employment and income growth remains strong and the University of Michigan index of consumer sentiment is near record highs.

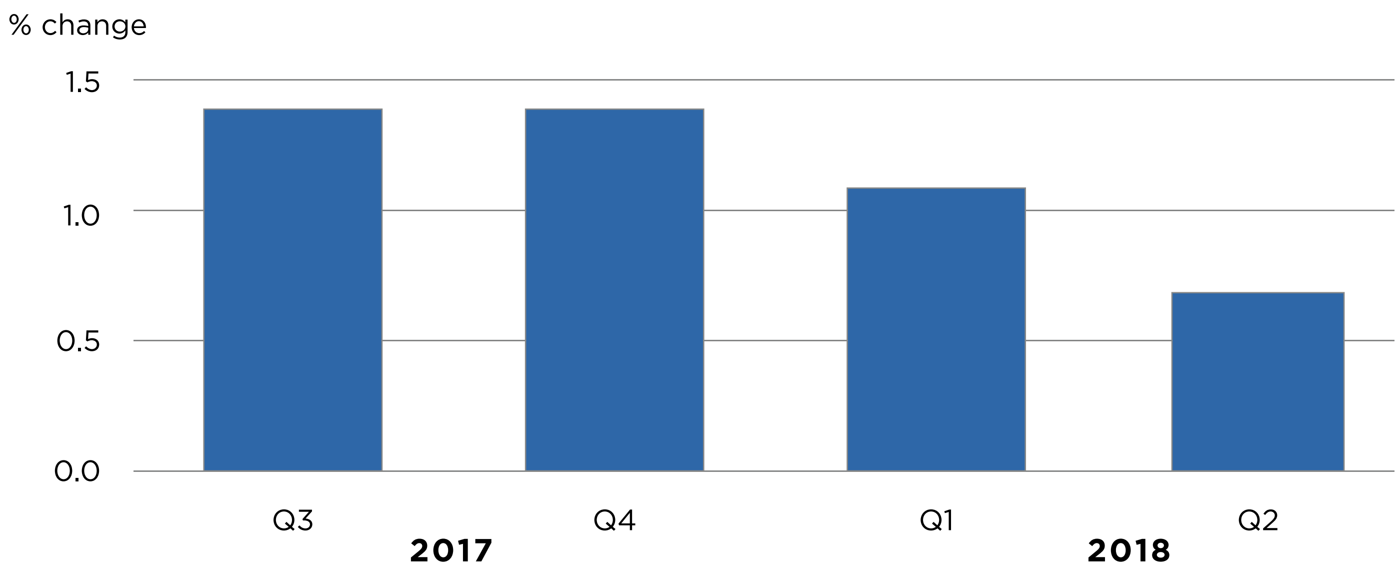
The focus of this quarterly update on Canada's labour market conditions is the impact of higher minimum wages, notably the 20 percent hike in Ontario on January 1. Overall the hoped-for boost to household incomes did not materialize for several reasons. The number of people affected was relatively small, the increase in wages was confined to those earning the minimum, and employment softened so far this year. This disappointing outcome may be a precursor to Alberta's experience after it sharply raised its minimum wage to $15 an hour on October 1.

Higher minimum wages did not raise total incomes

Wages rose by a paltry 2.2 percent, despite several attempts by the provinces to legislate higher minimum wages. The sharp increase in the minimum wage in multiple provincial jurisdictions – to $14 an hour on January 1 in Ontario and to $15 an hour on October 1 in Alberta – are the most dramatic examples of governments attempting to accelerate the long-hoped for upturn in incomes coming out of the Great Financial Crisis. Usually, governments rely on the Phillips Curve relationship between low unemployment and higher wages to boost incomes. However, since the Phillips Curve has been a poor guide to wage growth (Cross 2018), governments are trying to legislate this outcome.

Predictably, the results have been disappointing. Sharply raising minimum wages, with little advance warning in Ontario's case, had the inevitable effect of slowing job growth as firms concentrated on controlling their overall wage bill at a time of falling competitiveness and uncertainty in trade with the US. As a result, the impact of a higher minimum wage on the incomes of other workers has been limited. With job growth slowing and wages stagnant, overall labour income growth in Canada has slowed steadily so far in 2018. After rising by a peak quarterly rate of 1.7 percent in mid-2017, labour income growth slowed to 1.1 percent in the first quarter of this year and to 0.7 percent in the second (see chart 2).

Chart 2: Quarterly growth of total wages and salaries



This slowdown is in marked contrast with the United States, where labour income has strengthened over the past year. Rather than using government fiat in an attempt to raise incomes, the US relied on strong employment growth and corporate tax cuts to gradually bid up wages. With incomes rising faster than taxes in the US, disposable income has risen 5.1 percent in the past year, compared with 3.9 percent in Canada. Amazon is the latest example of a company responding to tight labour market conditions by voluntarily raising its own internal minimum wage to $15 an hour.

To be clear, the higher minimum wage did raise the earnings of workers earning low wages who kept their jobs. A detailed analysis by Statistics Canada showed that the number of people in Canada earning the minimum wage soared from 953,00 in the first quarter of 2017 to 1.57 million in the first quarter of 2018 (Morissette and Simard 2018, 3). This large increase reflects that all those workers earning the old minimum wage plus all those earning less than the new minimum ($14 an hour in Ontario) automatically began earning the new, higher minimum wage.

> “While wages rose in low-paying industries such as retail trade, accommodation and food, earnings in other industries were little changed.

So why did total labour income growth decelerate in 2018 despite higher minimum wages? First of all, the number of workers in the Canadian economy earning a minimum wage was relatively small; in 2017, the 1.018 million workers paid minimum wage represent less than 6 percent of the total employment pool of over 18 million. Second, the number of people employed fell slightly in the first half of the year. Third, the hoped-for ripple effect that higher minimum wages would induce employers to maintain the existing gap between minimum wages and other wages did not materialize.

While wages rose in low-paying industries such as retail trade, accommodation and food, earnings in other industries were little changed. For example, while average earnings in retail, accommodation and food rose significantly (by 8.6 percent and 6.6 percent, respectively), overall earnings in Canada in the year ending in September 2018 increased by 2.4 percent, not much different from the 2.2 percent growth between September 2016 and September 2017 (Statistics Canada 2018).

Similarly, earnings in Ontario did accelerate from 1.8 percent to 3.1 percent from 2017 to 2018, but this increase was less than in provinces that did not boost minimum wages (notably from 1.5 percent to 3.8 percent in BC and from 2.8 percent to 4.3 percent in Alberta). Meanwhile, the number of people in Ontario holding a job fell in the first half of the year. Ontario’s economy did show signs of improving in the third quarter with a small gain in jobs. This may partly reflect the election of a new government, which cancelled a planned second hike in the minimum wage to $15 an hour on January 1 and a number of labour regulations introduced by the outgoing Wynne government. However, as noted, the jobs data can be misleading over the summer months and it remains to be seen if these new measures will significantly boost investment in Ontario. A healthy economy is still the better way to raise incomes than governments dictating to employers what they should pay employees.

More broadly, a higher minimum wage is not an efficient way of reducing the number of families living in low income. In the first quarter of 2017, just over half (50.5 percent) of all Canadians earning the minimum wage were either students or youths between 15 and 24 years old still living with their parents (Morissette and Simard 2018, 2). Students or youths living at home and earning the minimum wage were part of families earning an average weekly wage of a healthy $924 (or $48,048 a year). While the higher minimum wage did boost the wages earned by single-parent families, this group accounted for only 15.3 percent of all minimum wage workers (Morissette and Simard 2018, 4). There are more effective ways of targeting incomes in this group, such as the Canada Child Benefit, without harming the job prospects of other people, notably youths.

Nor has a higher minimum wage incited more people to enter the labour force on the promise of earning more income. In Ontario, the labour force rose by 1.4 percent in the year to September 2018, not materially different from 1.3 growth in the rest of Canada outside of Quebec (Quebec's labour force shrank by 0.3 percent over the same period, partly because its older population is reaching retirement age faster than most of Canada – this rapid aging of the population and rising number of workers retiring from the labour force is a key reason why the employment rate has become a better indicator of the labour market than the number of people employed). So instead of expanding the pool of available workers for employers to hire, the job vacancy rate in Ontario rose over the past year to 3.3 percent.

New governments in Central Canada promise change

The shrinking of the labour force in Quebec is reflected in growing reports from firms of labour shortages in the province, notably the Bank of Canada's quarterly outlook survey (Bank of Canada 2018, 5). The difficulty of finding workers increases the incentive for firms to invest more. Investment in Quebec may also receive a boost from the election of the new Quebec government under the Coalition pour l'Avenir du Quebec (CAQ), led by Francois Legault. Over half of the CAQ's newly elected members are drawn from the business community (Legault himself is the former head of the discount airline Air Transat), a marked contrast from the usual coterie of lawyers and academics that have dominated recent Quebec governments.

Beyond their commitment to controlling government spending and reducing taxes, the new government may adopt other policies to encourage business development. Together with the election of a more business-oriented government in Ontario, this lays the foundation for an improved environment for firms operating in Central Canada as governments shift their focus from the redistribution of incomes (including policies such as raising the minimum wage) to raising economic growth.

Initial claims for EI continue to increase

There are 243,180 new claimants for EI benefits in Canada in July, up 1.8 percent from June and continuing the upward trend that began in the spring. This is significant; new claims for EI are one of the ten components of the Macdonald-Laurier Institute's LEI, which indicates where the economy is headed. As well, it is noteworthy that unemployment insurance claims in the US have fallen to a 40-year low of 400,000, less than twice as high as Canada despite the US having a population 10 times as large.

The much higher percentage of the population in Canada applying and receiving EI benefits reflects how the program in Canada covers a range of social benefits unrelated to unemployment, such as parental leave. As a result, the level of US claims for unemployment benefits is much lower. However, since social benefits vary little with the business cycle, short-term fluctuations in new claims are a good barometer of labour market conditions in both countries.

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About the Author

Philip Cross is a Munk Senior Fellow at the Macdonald-Laurier Institute. Prior to joining MLI, Mr. Cross spent 36 years at Statistics Canada specializing in macroeconomics. He was appointed Chief Economic Analyst in 2008 and was responsible for ensuring quality and coherency of all major economic statistics. During his career, he also wrote the "Current Economic Conditions" section of the Canadian Economic Observer, which provides Statistics Canada's view of the economy. He is a frequent commentator on the economy and interpreter of Statistics Canada reports for the media and general public. He is also a member of the CD Howe Business Cycle Dating Committee.

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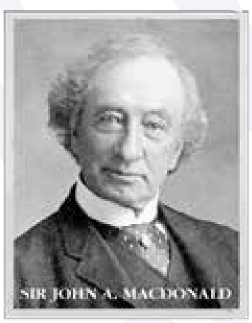
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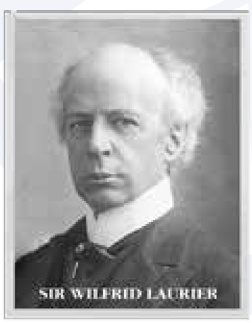
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