

NEW ZEALAND BUSINESS ROUNDTABLE

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Submission on the Minimum Wage (Abolition of Age  
Discrimination) Amendment Bill

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April 2006

## **Executive Summary**

- The proposal to extend the adult minimum wage to 16 and 17 year-olds may be well-intentioned, but it is likely to adversely affect the employment and training of young workers.
- The proposed policy change would raise the cost of hiring young workers, but would do nothing to increase their productivity. Employers may respond to an increase in minimum wage applicable to 16 and 17 year-olds in a number of ways, including cutting jobs, hiring more highly skilled workers or making 'compensating' reductions in training, allowances and other employment benefits for young workers.
- Reduced job opportunities would have a near-term impact on young workers, who have little work or life experience and few skills. In addition, the loss of valuable work experience and training opportunities could have a longer-term, and potentially more significant, effect on these workers.
- In our view, the bill should be assessed on its impact, not on its intentions. We recommend that the bill not proceed. If it is to proceed, we recommend that it be modified to limit its impact, either by excluding small employers or by making it apply to young workers only after a certain time in employment (eg one year). At a minimum, the ability to set a lower youth rate should be left in the Minimum Wage Act 1983, even if the youth and adult rates are aligned.

## **1. Introduction**

- 1.1 This submission on the Minimum Wage (Abolition of Age Discrimination) Amendment Bill (the bill) is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests.

## **2. Background**

2.1 Under the provisions of the Minimum Wage Act 1983, all employees aged 16 years or more must be paid the statutory minimum wage. There are several different minimum wage rates payable:

- the adult rate, which applies to individuals aged 18 or more, is currently set at \$10.25;
- the youth rate, which applies to individuals aged 16 and 17, is currently set at \$8.20 – 80 percent of the adult rate; and
- the training rate, which applies to people doing recognised industry training, is currently set at \$8.20 – 80 percent of the adult rate.

2.2 Individuals may also be exempted from the minimum wage if they have a recognised disability that significantly slows their work and makes them incapable of earning the minimum wage.

2.3 Under section 5 of the Minimum Wage Act 1983, the minimum wage must be reviewed each year by the minister of labour, who may recommend to the governor-general that the minimum rates be adjusted.

## **3. Proposed Changes**

3.1 The bill seeks to amend section 4 of the Minimum Wage Act 1983 to remove the ability for the governor-general in Council to prescribe age-based minimum wage rates. It also consequentially amends the Minimum Wage Order 2005 to remove such provisions.

3.2 The bill would still allow some workers to be paid less than the adult minimum wage, namely those whose employment includes a significant training component and those whose disability prevents them from earning the minimum wage.

#### **4. Assessment of the Bill**

- 4.1 Although opponents of minimum wages are often criticised for showing a lack of sympathy towards those on low incomes, this is not the case. Rather, those who oppose the minimum wage do so on the basis of the significant evidence that minimum wages harm the poor and vulnerable – the very people who are the intended beneficiaries.
- 4.2 While the regulation of minimum wages, including those applicable to young people, may be well-intentioned, such regulation is harmful. In the end, policies must be judged on their real world effects, not on their intent. On this count, as this submission will argue, minimum wages fail the test.
- 4.3 There is no valid rationale for extending the adult minimum wage to 16 and 17 year old workers. The interests of employees and employers are best served by a system where both parties are free to negotiate mutually beneficial employment arrangements – wages and non-wage benefits. A free contracting model best recognises the differing attributes, circumstances and preferences of employees and firms and would be most conducive to a growing and prosperous economy and increasing job opportunities.
- 4.4 Under this system, pay is determined largely by the amount a worker contributes to the firm's outputs. Hence, a 16 year old would generally be paid at the same rate as a 20, 30 or 40 year old if the young worker made the same contribution to output as older workers. On the other hand, if the inexperience and personal attributes of a 16 year old are such that their productivity is lower, their pay would also be lower.
- 4.5 Such a system is fair to workers of all ages, despite claims to the contrary by those seeking to extend the adult minimum wage to younger workers. Younger people tend to be paid at a lower rate than older workers because age is a proxy for experience and performance on the job, just as the age of 15 is a proxy for the

minimum capacity and maturity required to begin learning to drive a car on our roads.

- 4.6 Although supporters often assert that minimum wages are necessary to offset the unequal bargaining power that is said to be inherent in the labour market, there is little evidence to support this and much that contradicts it.
- 4.7 In a recent report, Hogbin (2006) notes that there is little evidence that employees in more heavily regulated labour markets receive 'fairer' shares of national income than those in less regulated labour markets. Indeed, he presents data showing that labour's share of income in lightly regulated economies such as the United States has been consistently higher than in most of the more heavily regulated labour markets of continental Europe.<sup>1</sup>
- 4.8 The imbalance of power hypothesis is even less credible in a New Zealand context, where the labour market is characterised by low unemployment, significant labour shortages and a large number of small employers – factors that would mitigate any imbalance that could be said to exist.
- 4.9 Our main reason for opposing the extension of the minimum wage to younger workers is that it is likely to have an adverse impact on the employment and training opportunities available to young people. An increase in the minimum wage for 16 and 17 year olds would raise the cost of employing these workers without increasing their productivity.
- 4.10 The economic argument against minimum wages is based on the simple fact that the quantity of labour demanded falls as its price rises. While some object to analysing labour markets within an economic framework, that does not change the fact that the 'law of demand' applies just as much to labour services as it does to other goods and services.

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<sup>1</sup> Hogbin, Geoff (2006) *Power in Employment Relationships: Is There an Imbalance?*, New Zealand Business Roundtable, Wellington, p 5.

- 4.11 A legislated increase in the minimum wage, if it is not accompanied by a corresponding increase in worker productivity, will mean that some workers – those with fewer skills and who are the least productive – will be priced out of a job. This occurs because employers, faced with higher wage costs, seek lower-priced alternatives – whether job cuts, substituting technology for workers or replacing low-skilled workers with more productive ones.
- 4.12 A higher minimum wage also makes employment more attractive for workers and leads to an increase in the number of individuals competing for these jobs. This increased labour supply, combined with wages that are slow to adjust, results in lower productivity/lower skill workers being ‘crowded out’ of jobs by higher productivity/higher skilled workers.
- 4.13 While the short-term impact on the job market of a minimum wage is of concern, the longer-run adverse impacts on young people who are displaced may be of greater concern from a policy perspective. This is because these effects are persistent and fall on older individuals who are likely to be primary breadwinners in their families. These long-run effects include reduced human capital formation, which may arise because of decreased work experience, training and skill formation (including schooling).<sup>2</sup>
- 4.14 A large number of studies support the view that minimum wages reduce employment, especially for younger workers and those with fewer skills. The attached Annex summarises some of the relevant studies on the labour market impact of minimum wages. An important finding is that job losses among youth seem to be smaller in countries with lower minimum rates for youth.<sup>3</sup>

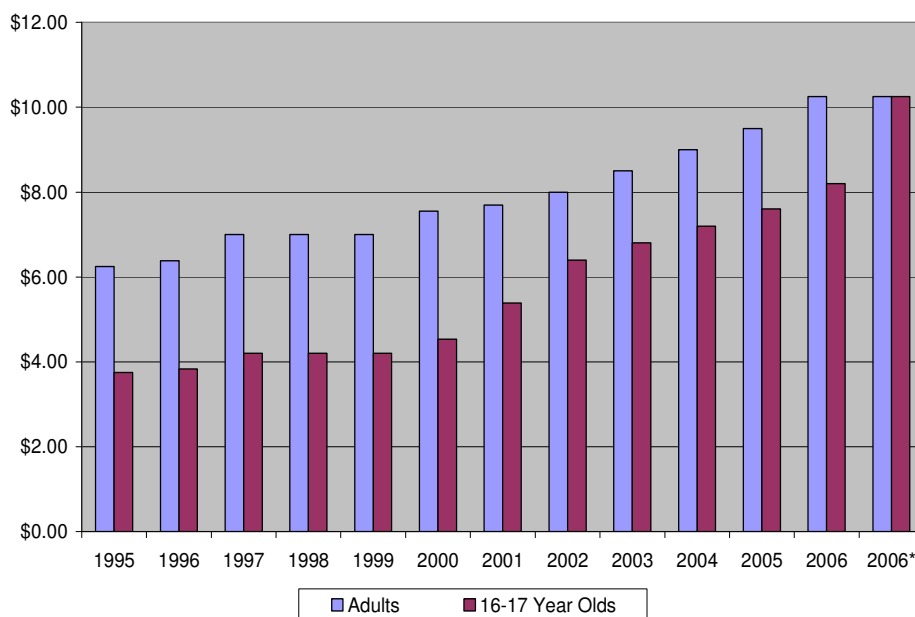
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<sup>2</sup> See Mroz, Thomas A and Timothy H Savage (2001) *The Long-Term Effects of Youth Unemployment*, Employment Policies Institute, Washington, DC; and Neumark, David and Olena Nizalova (2004) *Minimum Wage Effects in the Longer Run*, IZA Discussion Paper No 1428, IZA Institute for the Study of Labor, Bonn.

<sup>3</sup> Neumark, David and William Wascher (2003) *Minimum Wages, Labor Market Institutions and Youth employment: A Cross-National Analysis*, Finance and Economics Discussion Series 2003-23, Federal Reserve Board, Washington, DC.

4.15 A small number of studies have found either no impact or a positive impact from increases in minimum wages.<sup>4</sup> However, even these authors note that their results may not hold in the case of significant increases in the minimum wage. This caveat is of particular importance in a New Zealand context, where increases have been significant in recent years. As can be seen from Figure 1, the minimum wage for 16-17 year olds has increased from just over \$4.00 per hour to more than \$8 per hour since 1999.

Figure 1: Minimum wage levels for adults and 16-17 year-olds, 1995-2006



Note: \* Figure for 2006 shows the level of the minimum wage for 16-17 year olds if the adult minimum wage were extended to 16 and 17 year olds.

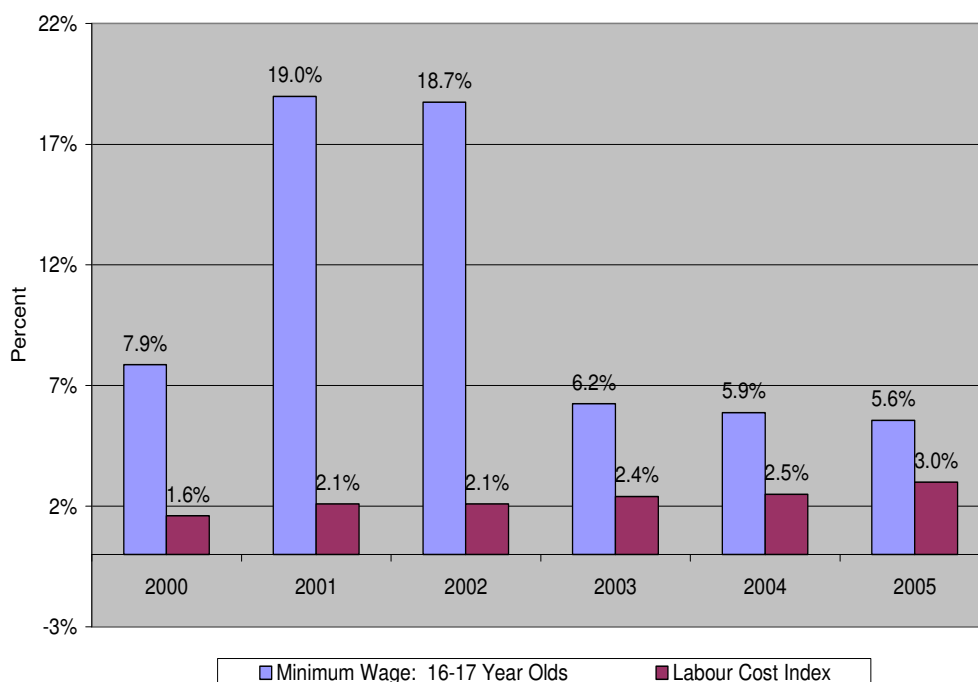
Source: Data from Hyslop and Stillman (2004)

4.16 These increases have been driven by both annual increases in minimum wage levels and extensions of minimum wage coverage such as the introduction of a training minimum wage, a reduction in the age of eligibility for the adult minimum wage to 18 and an increase in the youth rate from 60 to 80 percent of the adult rate.

<sup>4</sup> See Card, David and Alan B Krueger (1995) *Myth and Measurement: The New Economics of the Minimum Wage*, Princeton University Press, Princeton, New Jersey; and Hyslop, Dean and Steven Stillman (2004) *Youth Minimum Wage Reform and the Labour Market*, New Zealand Treasury Working Paper 04/03, Wellington, March 2004.

4.17 Not only have increases in the minimum wage been significant in absolute terms, but they have also been high relative to wage increases generally. As shown in Figure 2, annual increases in the minimum wage for 16-17 year olds have significantly exceeded annual increases in Statistics New Zealand's Labour Cost Index in every year since 2000.

Figure 2: Percentage change in minimum wage for 16-17 year-olds and Labour Cost Index, 2000-2005



Source: Data from Hyslop and Stillman (2004) and Department of Labour (2006) Labour Market Reports, [www.dol.govt.nz/publications/lmr/lmr-qes-lci.asp](http://www.dol.govt.nz/publications/lmr/lmr-qes-lci.asp).

4.18 The current adult minimum wage in New Zealand represents around 48 percent of the average wage – up from 46 percent in 2000.<sup>5</sup>

4.19 Further increases in the minimum wage appear to be on the cards, given the government's stated goal of an adult minimum wage of \$12 per hour by the end of 2008, if economic conditions permit.<sup>6</sup>

<sup>5</sup> Figure for 2000 from Neumark and Wascher (2003), p 30.

<sup>6</sup> Dyson, Ruth (2005) *Minimum wage to increase*, Press Release, New Zealand Government, 21 December.



- 4.20 The abolition of the youth rate would push the minimum wage beyond the average wage of \$8.56 paid to 16-17 year olds in the retail sector – the most common industry in which young workers are employed.<sup>7</sup>
- 4.21 Studies on the impact of minimum wage changes are always subject to debate on methodological or other grounds, and cannot be definitive. For a start, labour markets are complex and it is not always easy to disentangle the impact of policy changes from other factors such as economic growth, other policy changes (eg education policy changes) or external factors on labour market outcomes.
- 4.22 An increase in the minimum wage may not lead to immediate job losses. Employers may adopt different strategies in response to an increase in the minimum wage – for example reducing allowances, increasing monitoring to raise productivity, cutting back on training or reducing other benefits.<sup>8</sup> All of these can act to reduce the ‘first-round’ labour market benefits of a minimum wage increase. If employers do respond by cutting back on training (whether formal or informal), younger workers may be worse off because of reduced investment in human capital.
- 4.23 On the whole, the theory and empirical evidence underlying economists’ near-unanimous opposition to minimum wages, the significant increases in minimum wages in recent years in New Zealand and the potential long-term costs of decreased youth employment suggest that it would be risky to extend the adult minimum wage to 16 and 17 year olds.
- 4.24 It would be particularly risky to ignore the significant body of evidence against minimum wages and focus solely on one study that shows little adverse impact on employment. Yet this is exactly what the Greens have done in communications aimed at garnering support for the bill.<sup>9</sup> As discussed above, there could be any number of reasons

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<sup>7</sup> New Zealand Retailers Association (2005) *Submission to the Minister of Labour on the 2005 Review of the Minimum Wage*, Wellington, 21 October.

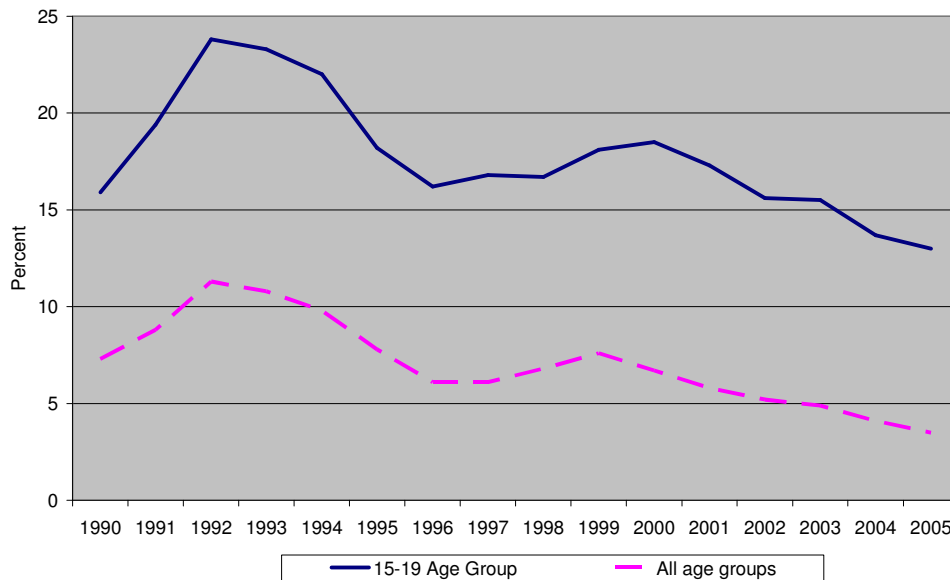
<sup>8</sup> ‘Allowances stripped after minimum wage raised, Greens say’, *New Zealand Herald*, 7 April 2006, [www.nzherald.co.nz](http://www.nzherald.co.nz).

<sup>9</sup> Bradford, Sue (2006) *Action Alert! – Submission Guide for Minimum Wage (Abolition of Age Discrimination) Amendment Bill*, Green Party, 15 March.

for the Hyslop and Stillman (2004) finding that the minimum wage increase had little impact on young workers, including lags in employers' adjustments to the higher rates and offsetting reductions in non-wage benefits.

4.25 The potential adverse impact on employment of an extension of the minimum wage to 16 and 17 year olds should also be seen in the context of a slowing economy and the (still) high unemployment rate among youth in New Zealand. As shown in Figure 3, the unemployment rate for 15-19 year-olds in 2005 stood at 13 percent.

Figure 3: Unemployment rate, 15-19 year-olds versus all age groups, 1990-2005



Source: *Labour Force Statistics 2005, Statistics New Zealand.*

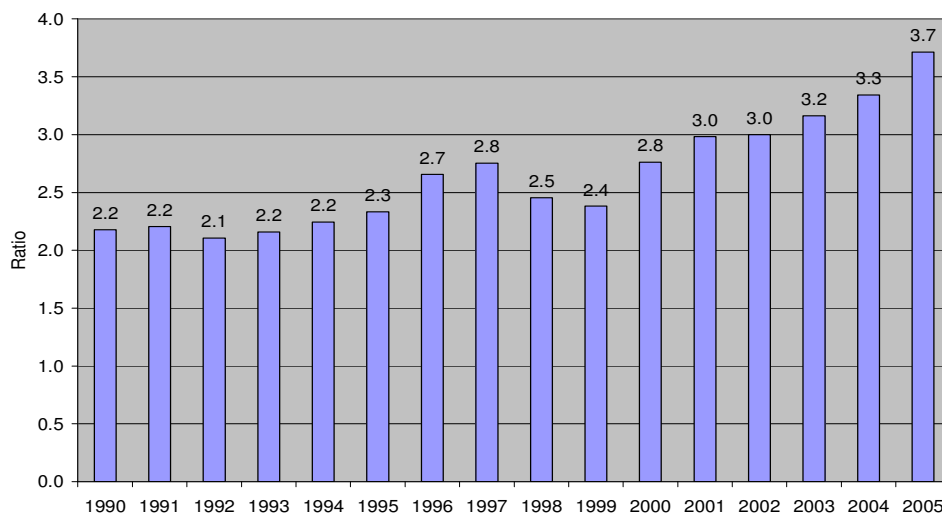
4.26 Although this is down considerably from its peak in the early 1990s, it remains well above the 3.5 percent unemployment rate for all age groups and is almost 2 percentage points higher than the peak unemployment rate for all age groups experienced during the recession of the early 1990s (11.3 percent).

4.27 Indeed, given the current youth unemployment rate, the government ought to be examining initiatives that have a significant prospect of improving the labour market position of youth, not ones with significant downside risks – such as minimum wages.

4.28 Minimum youth wages are likely to be binding in far fewer cases when the economy is growing solidly than in a downturn. When economic growth stalls, as appears to be the case at present, higher youth unemployment than otherwise may arise. The Department of Labour is understood to believe that there are up to 5,000 fewer jobs than would otherwise be the case because of our minimum wage laws. The number of jobs lost might increase by up to a further 5,000 in a downturn. Marginal workers are likely to be most affected.

4.29 Reduced job opportunities would also come at a time when the relative labour market position of young workers is deteriorating. As shown in Figure 4, the unemployment rate for 15-19 year olds in 2005 was 3.7 times that of all age groups (including 15-19 year-olds).

Figure 4: Ratio of unemployment rate for 15-19 year-olds and unemployment rate for all age groups, 1990-2005



Source: *Labour Force Statistics 2005, Statistics New Zealand.*

4.30 This ratio is well above the range of 2.2 to 2.8 times that prevailed during the 1990s, and has increased since the government began a series of significant increases in the minimum wage applying to 16 and 17 year olds.

## 5. Conclusion

5.1 Minimum wages and other forms of labour market regulation are often said to be in the interests of the poor or those who are 'powerless' in the labour market. The government has passed a raft of legislation in recent years that is predicated on this mistaken belief, including the Employment Relations Act.

5.2 The reality is that such regulation, while it may be well-intentioned, often works against the interests of the poor and the so-called 'powerless'. This is certainly the case with the proposed extension of the adult minimum wage to 16 and 17 year olds, the cost of which would be borne predominantly by those with few skills. As Nobel Prize winning economist Paul Samuelson stated in the 1960s:

What good does it do a black youth to know that an employer must pay him \$2 per hour if the fact that he must be paid that amount is what keeps him from getting a job?<sup>10</sup>

5.3 The interests of young people with few skills, including many Maori and Pacific Peoples, are more likely to be promoted through the introduction of policies that open up opportunities and enhance the prospects for economic growth. The abolition of the minimum wage for 16-17 year olds will do neither. By preventing 16 and 17 year olds from gaining a foothold in the labour market, the change would limit their opportunities to gain work experience and on-the-job training.

5.4 A more flexible system – indeed one without a minimum wage at all – would better allow firms to 'take a chance' on those with fewer skills, less developed work habits and who are less productive. The need to recognise special circumstances through differential minimum wages is explicitly recognised in the bill since it does not seek to abolish the lower rate applicable to apprentices or those with a disability.

5.5 It is not clear why the bill does not recognise the differing circumstances of youth with low skills or the beneficial effects of 'non-formal' or general 'on-the-job' training for younger workers – which

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<sup>10</sup> Quoted in Henderson, David R (2006) 'Minimum Wage, Minimum Sense', *Wall Street Journal*, 25 February, p A11.

may in fact be more valuable than skill training at such an early stage of an individual's work career.

- 5.6 Employees and employers are best placed to decide whether to pay differential rates based on age. Some would argue that the recent decision by Restaurant Brands to move away from paying youth rates represents tacit support for this bill.<sup>11</sup> In our view, this decision is not an argument for centrally mandating minimum wages. Rather, it is further evidence that employees and employers are in the best position to make decisions about overall worker compensation.
- 5.7 An increase in the minimum wage for 16-17 year olds would adversely affect the profitability of firms in the short-term – especially those in the retail and service sector. The change would come on top of a slowing economy and recent anti-business reforms such as successive increases in the minimum wage more generally, the changes to the Holidays Act, paid parental leave and the introduction of the Employment Relations Act and subsequent amendments.
- 5.8 The continuing deterioration in the New Zealand policy environment is borne out by the Economic Freedom of the World (EFW) index. It showed that, in 2003, New Zealand scored only 5.7 out of 10 and ranked only 38<sup>th</sup> for the regulation of labour markets (which includes minimum wages) in the EFW index. This was below the rankings for Hong Kong (5<sup>th</sup>), the United States (10<sup>th</sup>), the United Kingdom (19<sup>th</sup>) and Australia (32<sup>nd</sup>).
- 5.9 New Zealand's ranking is down from 21<sup>st</sup> in 2001 and its score on the minimum wage element of the EFW Index is even lower than for labour market regulation as a whole – only 3.6 in 2003. This is down from 6.5 in 1995.<sup>12</sup>
- 5.10 The OECD has, in recent years, voiced concerns about the direction of New Zealand labour market policies, noting in 2005 that:

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<sup>11</sup> Stokes, Jon (2006) 'Food firm to end youth rates', *Weekend Herald*, 25 March.

<sup>12</sup> Gwartney, James, Robert Lawson and Erik Gartzke (2005) *Economic Freedom of the World: 2004 Annual Report*, Fraser Institute, Vancouver, pp 13-16.

New Zealand has one of the most flexible labour markets in the OECD and is one of the countries where performance has improved the most over the last few years... However, legislative changes since the beginning of the decade have been in the direction of increasing rigidities in the market...<sup>13</sup>

- 5.11 The cost of the minimum wage seems likely to be borne disproportionately by those with few skills and low productivity, with little offsetting benefit in terms of reduced poverty.<sup>14</sup> It is simply not possible for the government to transfer more money to some people without imposing costs on others. If the minimum wage were truly costless, as some appear to believe, it would be a simple matter to eliminate poverty by legislating higher wages for all.
- 5.12 Given the evidence suggesting that the costs of the minimum wage outweigh the benefits, that the distributional impacts may be inequitable and that this is a poor instrument for targeted poverty assistance, we recommend that the bill not proceed and policy makers should consider alternatives.
- 5.13 A better approach may be to focus on targeted income supplements through the tax and welfare system to advance the government's income adequacy objectives.
- 5.14 To minimise the adverse labour market effects of an increase in the youth minimum wage, the government could exempt 'small' employers from the requirement to pay the minimum wage and/or exempt youth from the minimum wage for a certain period (eg one year).
- 5.15 As a last resort, if the youth minimum wage rate is to be raised, this should be done solely via a policy change, rather than through legislative change. Retaining the ability to set age-based rates in the Minimum Wage Act 1983 would allow a youth rate to be more easily re-introduced if it becomes apparent that the policy is having an excessively deleterious impact on youth labour market outcomes.

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<sup>13</sup> OECD (2005) *OECD Economic Surveys – New Zealand 2005*, Paris, July, pp 89-90.

<sup>14</sup> Raman, Venkat (2006) 'The harmful effects of lifting minimum wage', *National Business Review*, March 24, p 48.

- 5.16 The introduction of a probationary period for new employees could provide some protection for employers who take a risk on new employees and provide workers with time to acquire the skills and experience necessary to lift their productivity and 'justify' a higher minimum wage.

## Annex

### Labour Market Impact of Minimum Wages: A Brief Overview

There is a large body of evidence that is consistent with the 'conventional' view that increases in the minimum wage reduce youth employment, and only limited empirical support for the view that higher minimum wages have no adverse effects on youth employment and very little support for the view that they have a positive impact. For example:

- Turner and Demiralp (2000) show that increases in the US minimum wage attracted higher-skilled teenagers into the labour market, and teens with fewer skills were displaced. Vulnerable groups such as African Americans and Hispanics were more likely to be adversely affected;<sup>15</sup>
- Neumark and Wascher (2003) estimate the employment effects of changes in national minimum wages in 17 OECD countries and find that the average minimum wage effects are consistent with the view that minimum wages cause employment losses among youth. Importantly, they find that the disemployment effects of minimum wages appear to be smaller in countries that have lower minimum rates for youth;<sup>16</sup> and
- Bazen and Marimoutou (2002) examine time series data on the relationship between the minimum wage and teenage employment in the United States. They find that the minimum wage has a significant, negative effect on teenage employment and that the size of this impact has remained constant.<sup>17</sup>

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<sup>15</sup> Turner, Mark and Berna Demiralp (2000) *Higher Minimum Wages Harm Minority and Inner-City Teens*, Employment Policies Institute, Washington DC.

<sup>16</sup> Neumark, David and William Wascher (2003) *Minimum Wages, Labor Market Institutions and Youth Employment: A Cross-National Analysis*, Finance and Economics Discussion Series 2003-23, Federal Reserve Board, Washington, DC.

<sup>17</sup> Bazen, Stephen and Velayoudom Marimoutou (2002) *Looking for a Needle in a Haystack? A Re-examination of the Time Series Relationship between Teenage Employment and Minimum Wages in the United States*, Oxford Bulletin of Economics and Statistics, vol 64, pp 699-725.



Moore (2002) cites two surveys on the effects of minimum wages on employment that were prepared for the Department of Employment and Workplace Relations in Australia:

- the first survey covers the results of 19 academic studies relating to the United States that were prepared in the 1990s. Of these, 14 studies found a negative effect of minimum wages on employment and a number of other studies with similar findings were excluded from the survey; and
- the second survey covers the results of 25 studies based either on data from other countries or international data. Of these, 17 find a significant negative relationship, with the other eight ranging from “neutral to marginally positive”, through “no significant effect”, to “no clear relationship”, to “varied but generally consistent with the view that minimum wages cause employment losses among youth”.<sup>18</sup>

Some US studies – in particular those carried out by Card and Krueger (1995) – suggest that an increase in the minimum wage may have a limited negative impact on employment and one study showed it actually had a positive impact.<sup>19</sup> Their analysis provided a challenge to orthodox economics and has been subject to considerable criticism by peers.<sup>20</sup> Subsequent work using similar techniques has confirmed the traditional view that increases in the minimum wage reduce employment.

New Zealand evidence on the impact of minimum wages on employment is more limited:

- Maloney (1995) found that a 10 percent increase in the adult minimum wage produced a decline of 3.8 percent in the employment of young adults, a figure that is broadly consistent with evidence from the United States;

<sup>18</sup> Moore, Des (2002) *Minimum Wages: Employment and Welfare Effects, or why Card and Krueger Were Wrong*, Paper presented to the HR Nicholls Society XXIII Conference, Melbourne.

<sup>19</sup> Card, David and Alan B Krueger (1995) *Myth and Measurement: The New Economics of the Minimum Wage*, Princeton University Press, Princeton, New Jersey.

<sup>20</sup> See for example Neumark and Wascher (2000), ‘Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Comment’, *American Economic Review*, December, pp 1362-1396 and Moore (2002), *op cit*.

- Chapple (1997) found some evidence that was consistent with Maloney's estimates, but his overall assessment was that increases in the real minimum wage showed minimal impact on employment rates; and
- Pacheco and Maloney (1999) found no consistent evidence that a minimum wage reduced the employment prospects of females without qualifications.

More recently, Hyslop and Stillman (2004) studied the large significant increases in minimum wages that occurred in the early 2000s and, like Card and Krueger (1995) in respect of the United States, found no consistent and robust evidence of any adverse effects of the changes on teenage unemployment. Indeed, their only statistically significant estimates imply positive employment responses.<sup>21</sup>

Gail Pacheco, a senior economics lecturer at the Auckland University of Technology, has investigated the issue of minimum wages in a New Zealand context and has expressed concerns about its impact on unskilled workers and on Maori and Pacific Island workers in particular.<sup>22</sup>

Even those authors who find results that are inconsistent with the traditional view acknowledge a significant caveat to their findings. For example, Card and Krueger (1995) argue that their findings may only be relevant for a moderate range of minimum wages and that this does not mean that employment losses from a much higher minimum wage would be small.<sup>23</sup> Similarly, Hyslop and Stillman (2004) note: "However, given recent increases, whether such benign effects continue going forward is a moot point".<sup>24</sup>

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<sup>21</sup> Hyslop and Stillman (2004).

<sup>22</sup> Raman, Venkat (2006), p 48.

<sup>23</sup> Card and Krueger (1995)

<sup>24</sup> Hyslop and Stillman (2004), p 17.