

## Section 4 4. Providing a safety net for the low paid

The Australian Fair Pay Commission (Commission) considers that the Australian income safety net comprises minimum wages, tax benefits and income support payments. While the Commission is responsible for setting and adjusting the first of these components, the Australian Government is responsible for the remainder.

Many of the submissions to the 2008 Minimum Wage Review accept this view of the safety net:

'The living standards of low income households rest on three foundations: jobs, minimum wage levels, and income support payments. All three play a vital role in preventing poverty.'<sup>88</sup>

'A wages safety net provides incomes that are sufficient to meet the basic needs of workers and their dependants, having regard to general living standards in the community. A wages safety net has to take into account the tax paid by workers and government transfers paid to them and to their families.'<sup>89</sup>

'One [of] the key advances in Australian minimum wage setting...has been the recognition that real incomes and purchasing power for employees working on minimum wages are not delivered by minimum wages alone, but also by the interaction between minimum wages, taxation settings, and the social security/transfer payments system.'<sup>90</sup>

'Ai Group recognises the extent to which the Fair Pay Commission has incorporated a formal consideration of income tax and income support arrangements into its deliberations of the safety net role of minimum wages. Ai Group applauds this as an important advance and one that carries with it the potential for achieving better social and economic outcomes through closer coordination of the different elements of the broader social safety net.'<sup>91</sup>

Because many Australian households rely on a combination of wages and income transfers for their income, the Commission monitors the effects of its decisions on household disposable income, taking account of other elements of the tax and transfer systems.

By definition, the safety net concept is primarily concerned with the living standards of people at the lower end of the income distribution. The Commission therefore focuses its attention mainly on those households that rely most heavily on minimum wages, either alone or in combination with income transfers.

The Commission's modelling assumes that households choose to take up all available income transfers. The Australian Catholic Council for Employment Relations (ACCER) is concerned that this has the effect of overstating the disposable income of some low-wage households, namely those who choose for one parent to remain outside the workforce.<sup>92</sup>

<sup>88</sup> ACOSS, *Submission to the Fair Pay Commission on minimum wages*, 2008, p. 8.

<sup>89</sup> ACCER, *Submission by the Australian Catholic Council for Employment Relations to the Australian Fair Pay Commission, Workplace Relations Act 1996, Minimum Wages Review 2008*, 14 March 2008, p. 2.

<sup>90</sup> ACCI, *2008 Minimum Wage Review: ACCI Submission*, March 2008, p. 115, para. 6.1.

<sup>91</sup> Ai Group, *Australian Fair Pay Commission – 2008 Minimum Wage Review*, March 2008, p. 34, para. 113.

<sup>92</sup> Under the rules applying to receipt of Parenting Payment (Single) and Newstart Allowance, a 'primary caregiver' generally does not qualify for payment after their youngest child turns six unless they agree to seek suitable work of at least 15 hours a week. There are some exceptions to this – for example, if the parent is caring for a child with significant disability or has four children under the age of 16, or undertakes home schooling.

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...the decision by the AFPC in 2007 to *assume* that the second parent family [sic] in this family is in receipt of the Newstart allowance...has had the effect of discriminating against families...this kind of reasoning would lock wage-setting into a position that would continually prejudice single income families, by assuming that they were receiving income to which they were not legally entitled.<sup>93</sup>

In response to ACCER's concerns, the Commission's modelling (for example, as presented in Table 4.2) includes disposable income estimates for a couple family which chooses not to claim income support, as well as for a single parent who is not entitled to receive Parenting Payment (Single).<sup>94</sup>

### 4.1. The complementary roles of wages and the tax/transfer system

While many submissions acknowledge that wages are not the only factor that determines disposable income, and that taxation and income transfers have an important role to play, they are divided on the relative importance that should be accorded to one factor over another. For example, the Australian Chamber of Commerce and Industry (ACCI) and the Australian Industry Group (Ai Group) argue that the Commission should explicitly take account of the effect of changes in the taxation and transfer systems when making its decisions:

'The combination of a minimum wage rise in the terms ACCI commends to you...plus tax cuts, will ensure that the lower paid working on minimum wages will see their real incomes maintained or marginally increased.'<sup>95</sup>

'Ai Group urges that these changes in the broader social safety net be taken into account by the Commission in determining the extent of changes in minimum wage levels.'<sup>96</sup>

Ai Group further recommends that:

...improve[d]...coordination between different elements of the safety net...could be achieved if the Commission gave more explicit guidance of how it takes changes in income tax and income support arrangements into account when determining changes in minimum wages.<sup>97</sup>

On the other hand, the Australian Council of Trade Unions (ACTU) and ACCER reject the idea that the respective contributions of tax cuts and minimum wages should be considered together by the Commission:

'The ACTU presumes that the decision to provide tax cuts and welfare benefit changes have not been made in the knowledge that the Government can give with one hand while the AFPC will take with the other.'<sup>98</sup>

'ACCER submits that there is no basis for discounting the 2008 safety net wage increases on the basis of the Commonwealth's proposed tax changes.'<sup>99</sup>

<sup>93</sup> ACCER, 14 March 2008, pp. 2 and 13, para. 32.

<sup>94</sup> Since July 2006, Parenting Payment (Single), a pension-level payment, has not been available to new income support claimants with a youngest child aged eight or over. Single parents with older children must therefore qualify for alternative income support, most commonly Newstart Allowance, which is usually payable at a lower maximum rate than Parenting Payment and subject to stricter means-testing.

<sup>95</sup> ACCI, March 2008, p. 119, para. 6.24.

<sup>96</sup> Ai Group, March 2008, p. 27, para. 95.

<sup>97</sup> Ai Group, March 2008, p. 27, para. 97.

<sup>98</sup> ACTU, *Australian Council of Trade Unions Submission to the Australian Fair Pay Commission*, March 2008, p. 127, para. 10.62.

<sup>99</sup> ACCER, 14 March 2008, p. 35, para. 103.

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In favouring a heavier emphasis on tax/transfer provisions to deliver increases in disposable income, employer submissions emphasise the trade-offs between income for workers, costs to employers and effects on the broader economy:

'Ai Group estimates that, as a rule of thumb, when minimum wages are increased, employees receive a benefit in the form of extra disposable income that is roughly half of the additional costs faced by employers.'<sup>100</sup>

'ACCI believes that tax cuts are necessary for the long term performance of the Australian economy and obviate the need for large nominal wage increases.'<sup>101</sup>

By contrast, ACCER does not accept that the Commission's wage-setting criteria should be balanced against each other:

ACCER submits that the AFPC is under a statutory obligation to determine, as best it can, the requirements of a safety net. This determination must proceed as a separate step to the consideration of other statutory wage-setting criteria, such as economic factors, because the AFPC is bound to have regard to all of the criteria, including the safety net criterion.<sup>102</sup>

Gross wages, tax liabilities and income transfers all contribute to the final disposable income of low wage-earners and their households. A recent study from the Organisation for Economic Co-operation and Development (OECD) found that in 2006, Australia ranked fourth among OECD countries for the value, in US dollar purchasing power parity, of its net (after-tax) minimum wage. The study also found that countries with higher minimum wages tended to levy higher taxes and vice versa.<sup>103</sup> This means that the differences between countries in the level of minimum wages are smaller for net wages than for gross wages. (More information on international comparisons of gross and net minimum wages can be found in Appendix D.)

The Commission does not favour a formulaic approach to balancing the respective contributions of tax/transfer changes and wage increases to disposable income. Nor does it believe that tax/transfer changes should be completely ignored, since their effect on disposable income can be significant. The Commission will continue, therefore, to monitor the effects of tax/transfer changes on the disposable incomes of low wage-earning households as part of its decision-making processes.

### 4.2. 2008-09 income tax changes

Recently legislated changes to income tax for the 2008-09 financial year will benefit lower-income Australians in a number of ways. They include:

- an increase in the income threshold for the 30 per cent tax rate from \$30 001 to \$34 001 per annum;
- an increase in the Low Income Tax Offset (LITO) from \$750 to \$1200 per annum (this increases the effective tax-free threshold from \$11 000 to \$14 000 per annum); and
- the availability of half the LITO throughout the year as reduced income tax withholding.

<sup>100</sup> Ai Group, March 2008, pp. 34-35, para. 114.

<sup>101</sup> ACCI, March 2008, p. 128, para. 6.55.

<sup>102</sup> ACCER, 14 March 2008, p. 6, para. 8.

<sup>103</sup> OECD, *Taxing Wages 2005-2006: The Tax Treatment of Minimum Wages*, Paris, OECD, 2007, pp. 22-28.

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As a result of these changes, the majority of employees receiving wages at or around the standard Federal Minimum Wage (FMW) will receive a tax cut equivalent to \$8.65 per week. Pensioner single parents on the standard FMW (those with a youngest child under the age of 8) will receive a larger tax cut of almost \$15 per week because their taxable income is higher due to their eligibility for a part-rate pension. At the level of 150 per cent of the standard FMW, the tax reduction will be just over \$20 per week.

The Australian Government emphasises that these changes in taxation will assist low-income earners, including part-time workers, by allowing them to retain a greater proportion of their earnings and maintain their disposable income, as well as providing further incentives for people to enter the workforce or increase their working hours.<sup>104</sup> Submissions from both the ACTU and ACCI similarly point to the tax cuts as creating greater incentives for workforce participation.

This is in contrast to ACCER's view that:

...first, the proposed taxation reductions are not specifically targeted at low paid workers, but are part of an overall realignment of income taxation rates; and, second, they were not put forward as a basis for the [sic] discounting safety net wage increases that may be awarded to low paid workers.<sup>105</sup>

The Australian Government submission also highlights the continuing effect of current and future planned tax cuts on the disposable incomes of low wage earners. Over the three years from 2007-08 to 2010-11, the Low Income Tax Offset (LITO) will double from \$750 to \$1500. This change means that workers who earn less than \$16 000 will pay no tax in 2010-11, compared with the current effective tax-free threshold of \$11 000:

Compared with their income tax liability for 2007-08 and excluding the Medicare levy, a person on \$20,000 will have an income tax reduction of around 56 per cent and a person on \$50,000 will have an income tax reduction of around 18 per cent by 2010-11.<sup>106</sup>

### 4.3. Effective marginal tax rates

Effective marginal tax rates (EMTRs) measure the proportion of extra labour earnings effectively lost to the joint effects of taxation paid and reductions in income transfers. High EMTRs create work disincentives and limit the income retained by workers following an increase in minimum wages.

A number of submissions, including from the ACTU, refer to the Commission's internal and commissioned research on EMTRs, and support the conclusions reached:

Modelling undertaken for the Commission confirms that most low-income earners face relatively low effective marginal tax rates (EMTRs) and would therefore retain most of any pay rise.<sup>107</sup>

Table 4.1 summarises the effect of tax and transfer changes on the EMTRs of various categories of household receiving 100, 120 or 150 per cent of the standard FMW. This analysis indicates that households with a taxable income below \$30 000

<sup>104</sup> Australian Government, *Submission to the Australian Fair Pay Commission Minimum Wage Review 2008*, 14 March 2008, p. 39, para. 4.27.

<sup>105</sup> ACCER, 14 March 2008, p. 35, para. 103.

<sup>106</sup> Australian Government, 14 March 2008, p. 39, para. 4.28.

<sup>107</sup> ACTU, March 2008, p. 110, para. 10.18. ACTU cites A Harding, A Payne, Q Ngu Vu and R Percival, *Interactions between wages and the tax/transfer system*, National Centre for Social and Economic Modelling, report commissioned by AFPC, 2006.

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(that is, all households with one wage-earner on 100 per cent of the standard FMW, except for a pensioner single parent) will face very similar EMTRs in 2008-09 as they did in 2007-08.

Households with a taxable income between \$30 000 and \$34 000 (most of those households with one wage-earner on 120 per cent of the standard FMW, plus pensioner single parents on 100 per cent of the standard FMW) will experience a reduction in EMTRs of up to 15 percentage points. For households with one earner on 150 per cent of the FMW, EMTRs will be unchanged.

**Table 4.1: Effective marginal tax rates (EMTRs) at 100, 120 and 150 per cent of the standard FMW for selected low-income households, 2007-08 and 2008-09**

Employee Household Type	EMTR @ 100% FMW		EMTR @ 120% FMW		EMTR @ 150% FMW	
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
Single, no children	16.5	16.5	35.5	20.5	35.5	35.5
Single-earner couple, no children	64.9	64.9	80.5	65.5	95.5*	95.5*
Single-earner couple, two children aged 6-12	63.0	63.0	98.9	83.9	35.5	35.5
Single parent, one child aged 7	73.9	64.9	73.9	73.9	35.5	35.5
Single parent, one child aged 8-12	15.0	15.0	44.0	29.0	35.5	35.5

Note: \* These high EMTRs reflect the modelling assumption that all transfer entitlements are taken up. In these couples, the non-earning partner is entitled to only a small amount of income support, and that only if the couple qualifies for rent assistance. Couples not paying private rent or choosing not to take up this small entitlement would have the same EMTR as the other cases modelled.

Source: AFPC modelling

Assumptions: FMW= \$522.12 per week; 120% FMW = 626.54; 150% FMW = \$783.18.

Tax/transfer parameters as at 1 July 2007 (2007-08 EMTRs) and 1 July 2008 (2008-09 EMTRs). Single parent with child under 8 years old receives Parenting Payment (Single). Households are paying sufficient private rent to receive maximum rent assistance, where applicable.

This analysis shows that low-paid workers will retain a proportion of the increase in minimum wages granted by the Commission in this Decision at least as high as, and in some cases higher than, last year's.

### 4.4. The effects of recent wage increases and tax/transfer changes on disposable income

Table 4.2 summarises the effects of the Commission's general Wage-Setting Decisions 2006 and 2007 and recent tax/transfer changes on the disposable incomes of households earning various proportions of the standard FMW. While the primary focus is on households with one earner on the standard FMW, the modelling also includes cases where a single parent or secondary earner works part-time for 50 per cent of the FMW.

Between July 2006 and July 2008, increases in nominal disposable income range from around 8 per cent for couples with one earner on the standard Federal Minimum Wage (FMW) to more than 11 per cent for a single parent on the standard FMW who is also eligible to receive Parenting Payment (Single). Relative to estimated consumer price inflation of between 6.2 and 6.5 per cent, these represent real increases in the value of the income safety net.

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It is worth noting also that these real increases in disposable income follow real increases in the year to July 2006, as detailed in the Commission's previous decisions.<sup>108</sup>

**Table 4.2: Disposable incomes of illustrative low-paid households, July 2006 to July 2008**

Family type	Disposable income			Increase		
	July 06 \$pw	July 07 \$pw	July 08 \$pw	06-07 \$pw	07-08 \$pw	06-08 %
Single person earning 100% FMW	432.69	459.13	476.35	26.44	17.22	10.1
Couple without children, one earning 100% FMW	592.02	617.60	641.53	25.58	23.93	8.4
Couple without children, one earning 100% FMW, one earning 50% FMW	708.45	735.83	768.51	27.38	32.68	8.5
Couple with two children aged 6-12, one earning 100% FMW	815.47	848.74	880.89	33.27	32.15	8.0
Couple with two children aged 6-12, one earning 100% FMW (no Newstart Allowance)	712.89	748.77	776.09	35.88	27.32	8.9
Couple with two children aged 6-12, one earning 100% FMW, one earning 50% FMW	910.83	956.12	994.61	45.29	38.49	9.2
Single parent with one child aged 7, earning 50% FMW	614.15	641.98	668.53	27.83	26.55	8.9
Single parent with one child aged 7, earning 100% FMW	702.37	748.18	784.47	45.81	36.29	11.7
Single parent with one child aged 12, earning 50% FMW	516.82	536.90	559.86	20.08	22.96	8.3
Single parent with one child aged 12, earning 100% FMW	630.08	663.23	687.26	33.15	24.03	9.1

Source: AFPC modelling.

Assumptions: FMW = \$484.50 pw in July 06, \$511.86 pw in July 07 and \$522.12 in July 08. Tax/transfer parameters as at July in each year.

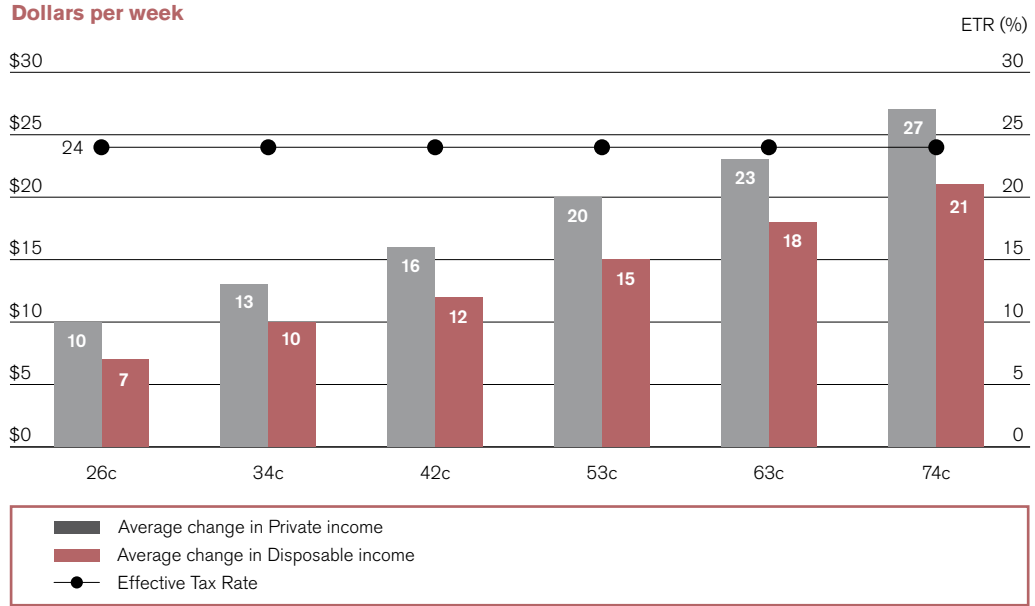
Households paying sufficient private rent to receive maximum rent assistance, where applicable. Disposable income includes all available income transfers, unless otherwise specified.

As in previous years, the Commission has asked the National Centre for Social and Economic Modelling (NATSEM) to estimate the average effective tax rates experienced by Australian low-wage employees (defined as those earning less than \$16.50 an hour, or about 120 per cent of the standard FMW), as at July 2008. NATSEM has also modelled the average effect on gross and disposable income for the same employees of a variety of possible wage rises, ranging from 26 cents an hour to 74 cents an hour.

<sup>108</sup> See, for example, AFPC, *Wage-Setting Decision and Reasons for Decision*, Commonwealth of Australia, October 2006, Table 5.1, p. 93; and AFPC, *Wage-Setting Decisions and Reasons for Decisions*, Commonwealth of Australia, July 2007, Table 1.8, p. 65.

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**Figure 4.1: Average effect of various increases in hourly pay for Australian employees earning less than \$16.50 an hour, July 2008**



Source: NATSEM modelling.

Figure 4.1 shows that, on average, low-paid Australians face an effective tax rate of around 24 per cent on additional earnings (a decline of 2 percentage points relative to the situation in July 2007).<sup>109</sup> This means that low-paid employees who benefit from the Commission’s general Wage-Setting Decision 2008 will retain, on average, more than three-quarters of their gross pay increase.

In reaching this year’s Decision, the Commission also considered a wide range of disposable income modelling. The modelled scenarios covered a range of family types, with one or two earners, earning wages at various points in the Pay Scale distribution. Two different inflation scenarios, corresponding with Australian Government and Reserve Bank of Australia (RBA) forecasts, were also used to predict future values of income transfers.

Whether eventual inflation is at the lower (Australian Government) estimate or at the higher (RBA) estimate, all household types modelled will experience a real increase in disposable income in October 2008 when the Commission’s minimum wage increase comes into effect, relative to their income one year previously (see Table 4.3).

At the higher inflation estimate a single-earner couple with two children earning the FMW will experience a 4.8 per cent increase in disposable income. A single-earner couple with two school-aged children, where one partner chooses not to look for work and the other works full-time at the FMW, will experience a 5.0 per cent increase in disposable income. A dual-earner couple with no children will experience an increase of 5.9 per cent over the same period.

<sup>109</sup> AFPC, July 2007, Figure 1.2, p. 67.

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**Table 4.3: Estimated impact of general Wage-Setting Decision 2008 and tax/transfer changes on disposable income between October 2007 and October 2008, various Pay Scale classifications and household types**

Household type	% increase in disposable income					
	Lower CPI			Higher CPI		
	FMW	C10	C4	FMW	C10	C4
Single, no children	5.7	5.9	5.5	5.7	5.9	5.5
Single, one child (non-pensioner)	5.1	5.3	5.1	5.1	5.3	5.1
Single, one child (pensioner)	5.5	5.7	5.3	5.7	5.8	5.4
Single-earner couple, no children	5.0	5.6	5.7	5.1	5.7	5.9
Single-earner couple, two children	4.7	5.2	5.0	4.8	5.3	5.0
Single-earner couple, two children (no income support)	5.0	5.1	5.0	5.0	5.2	5.0
Dual-earner couple, no children	5.7	6.0	5.4	5.9	6.0	5.4
Dual-earner couple, two children	5.5	5.4	5.2	5.5	5.4	5.2

Source: AFPC modelling.

Assumptions: October 2007 wage parameters: FMW = \$522.12 pw, C10 wage = \$615.98 pw, C4 wage = \$749.74 pw. October 2008 wage parameters: FMW = \$543.78 pw, C10 wage = \$637.64 pw, C4 wage = \$771.40 pw. Second earner in dual-earner household earns 50 per cent of the primary earner's wage. Tax/transfer parameters as at October in each year, assuming either 2.3 per cent or 2.6 per cent CPI increase between December 2007 and June 2008. Children aged 6-12. Households paying sufficient private rent to receive maximum rent assistance, where applicable. Disposable income includes all available income transfers, unless otherwise specified.

The Commission is confident that the minimum wage increase of \$21.66 per week, in combination with the 2008-09 tax cuts and regular indexation of transfer payments, will provide the great majority of workers earning Pay Scale wages with household disposable incomes in October 2008 that are higher in real terms than in October 2007.

### 4.5. Living standards of low-wage households

Several submissions express concern about increases in living costs for low-paid working households. They highlight the rising costs of mortgage repayments, rents and transportation (including petrol). Prices for other basic expenses, such as milk and bread, have also been rising strongly:

'...low paid employees and their families have been disproportionately affected by sharp increase in rents over the past year (since they are more likely to rent) and higher fuel prices (since they are more likely to live in outer urban and rural areas). The average increase in rents across capital cities from December 2006 to December 2007 was 6.4% and the corresponding increase in petrol costs was 14.3%<sup>110</sup>

'Successive interest rate increases, rent increases, rising personal debt, and spiraling costs of petrol, childcare, health care and education mean that low paid working Australians are struggling to meet their day to day costs of living.<sup>111</sup>

'Higher inflation impacts on low paid workers, including those who are Pay Scale-reliant. It is clear that some low paid workers continue to experience financial stress. These workers are least able to maintain their standard of living in the face of higher prices and mortgage repayments or rents.<sup>112</sup>

<sup>110</sup> ACOSS, March 2008, p. 28.

<sup>111</sup> ACTU, March 2008, p. 105, para. 10.1.

<sup>112</sup> Australian Government, 14 March 2008, p. 1, para. 1.8.

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Participants in the Commission's focus groups also raised the effect of recent price increases on their standard of living:

Cost of living pressures were mentioned with greater strength and emphasis in the 2008 consultations. While participants commented on cost of living pressures in the 2007 consultation... moderators noticed both an increase in the frequency and intensity of such comments in 2008, as well as strong articulation of the perceived erosion of wages due to increases in the cost of living.<sup>113</sup>

### Consumer price inflation and living costs

Each quarter, the Australian Bureau of Statistics (ABS) monitors the prices for a 'basket' of items that reflects the expenditure patterns of Australian households as a whole. In any given period, the prices for some items will be increasing faster than those for other items. The Consumer Price Index (CPI) is able to take these variations into account by weighting the items according to household expenditure patterns.

As an example, the price of milk has increased by 12 per cent over the past year to March 2008 and this is reflected in the CPI at a detailed level. However, that item has a weighting in the CPI of just 0.6 per cent, reflecting the fact that it does not form a large percentage of Australian household expenditure. As a result, its effect on the overall price of the total basket is very low. Equally, price changes for items that have higher weights, such as rent and fuel, are more likely to have a larger effect.

The CPI increased by 4.2 per cent in the year to March 2008. To illustrate the diversity within the CPI, prices for the food component increased by 5.7 per cent; housing by 5.7 per cent; and transportation by 6.8 per cent. Clothing and footwear prices decreased by 0.5 per cent.

As noted earlier, many submissions express a concern that low-income employee households spend a higher percentage of their income on items experiencing higher inflation, than other households. Preliminary analysis by the Commission indicates that there would be, on average, only minor differences between expenditure-weighted CPIs for low-income employee households and all households.

The ACTU's submission to the 2006 Minimum Wage Review showed that in 2003-04 low-income employee households spent an estimated 52 per cent of their total goods and services expenditure on current housing costs, food and non-alcoholic beverages, and transport.<sup>114</sup> The equivalent percentage for all households was 49 per cent.<sup>115</sup> Therefore, rising costs for items such as rents and fuel are not likely to have a significantly greater effect on what might be termed a CPI for low-income employee households than on the All Groups CPI.

The Commission notes that the general CPI has increased over the past year at a rate above the RBA's medium-term target. The actual increase in living costs experienced by different households may vary widely. Minimum wage adjustments have some capacity to address these individualised pressures but governments also act to help ease cost of living pressures through budgetary and other initiatives.

<sup>113</sup> TNS Social Research, *Report on Public Consultations for the Australian Fair Pay Commission's 2008 Minimum Wage Review*, report commissioned by AFPC, 2008, p. 47.

<sup>114</sup> ACTU, *Australian Council of Trade Unions Submission to the Australian Fair Pay Commission*, July 2006, p. 71. The reference group in this case is the bottom 20 per cent by gross household income of households in which the principal source of income is wages and salaries. This covers employee households with gross household income of up to \$850 per week.

<sup>115</sup> ABS, *Household Expenditure Survey and Survey of Income and Housing – Confidentialised Unit Record Files, Technical Manual, 2003-04 (Third Edition)*, Catalogue No. 6540.0.00.001, Canberra, 2008.

## Section 4 Financial stress

Submissions from the ACTU, ACOSS and the Australian Government assert that one outcome of increased cost pressures on families is higher levels of financial stress:

In determining the level of minimum wages, the Government submits that the Commission should take into consideration the degree of financial stress reported by the low paid. At a time of rising prices and with recent increases in interest rates, it is important to consider the number of low paid households experiencing financial stress.<sup>116</sup>

The Australian Government cites recent research by the Australian Housing and Urban Research Institute, which finds significant levels of reported financial stress among low income earners who were paying more than 30 per cent of their income on rent (the common definition of 'housing stress').<sup>117</sup> The ACTU draws attention to other research commissioned by the Government which 'concludes that housing stress is a particularly serious problem for low and middle income earners - those in the bottom 40 per cent of all earners in Australia'.<sup>118</sup>

On the other hand, the Australian Government also cites research which shows that only six per cent of households containing low-paid adults consider themselves 'poor or very poor', despite the fact that around one third of all such households report one or more episodes of financial hardship during the previous year.<sup>119</sup>

In order to improve its understanding of the living standards and financial pressures facing low-paid workers, the Commission has contracted external research into the household incomes, assets and consumption patterns of low-paid employees. This research, which is due to be completed in the latter half of 2008, will also analyse longitudinal data to determine the extent to which low-paid households face persistently low living standards over time.

In this Decision, the Commission has been especially cognisant of the financial pressures on low-income households at this time. Movements in consumer prices, in particular, have put many low-income households under considerable financial stress. While most submissions to the Commission raise this issue, there is no agreement on forecasts of inflation nor on the quantum of increase in minimum wages the Commission should award.

### 4.6. Comparisons with low-income benchmarks

In its previous decisions and recent monitoring report, the Commission has used the Henderson Poverty Line (HPL) as its primary benchmark for measuring trends in the value of the disposable incomes of FMW-reliant households.<sup>120</sup>

ACCER is concerned about the Commission's apparent endorsement of the HPL as an appropriate benchmark for the disposable incomes of low-wage households. It states that it prefers the household relativities embodied in the modified OECD equivalence

<sup>116</sup> Australian Government, 14 March 2008, p. 33, para. 4.4.

<sup>117</sup> Australian Government, 14 March 2008, pp. 35-36. The Australian Government cites T Burke, S Pinnegar, P Phibbs, C Neske, M Gabriel, L Ralston and K Ruming, *Experiencing the housing affordability problem: blocked aspirations, trade-offs and financial hardships*, The Australian Housing and Urban Research Institute Research Paper No.9, December 2007.

<sup>118</sup> ACTU, March 2008, p. 115, para. 10.32. ACTU cites Australian Government, *Making housing affordable again*, 4 March 2008, <[http://www.tanyaplibersek.fahcsia.gov.au/internet/facsinternet.nsf/vIA/housing\\_affordable/\\$File/making\\_housing\\_affordable\\_again.pdf](http://www.tanyaplibersek.fahcsia.gov.au/internet/facsinternet.nsf/vIA/housing_affordable/$File/making_housing_affordable_again.pdf)>.

<sup>119</sup> Australian Government, 14 March 2008, pp. 34-35. The Australian Government cites I Watson, *Low paid workers in Australia: insights from HILDA*, A report for IR Victoria, March 2007.

<sup>120</sup> AFPC, October 2006, p. 96; AFPC, July 2007, pp. 69-70; and AFPC, *Economic and Social Indicators – Monitoring Report*, Issue 01, Commonwealth of Australia, July to December 2007, pp. 27-28.

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scale to those of the HPL, which it argues are not credible (especially in relation to single-income couple and single parent families).<sup>121</sup> ACCER argues further that the HPL does not allow adequately for the housing costs likely to be incurred by low-income households, or for childcare costs.<sup>122</sup>

While preferring OECD-style relative poverty lines to the HPL, ACCER also suggests that more appropriate indications of minimum living standards could be obtained through a 'budget standards' approach. In support of this position, it cites a variety of benchmark disposable income figures derived by the Social Policy Research Centre, all of which are significantly higher than the comparable HPL:

ACCER has participated in wage review cases...for a number of years and has argued that the Federal Minimum Wage and the wage rates of other low paid classifications, together with transfer payments, are manifestly inadequate to support a family at a decent standard of living.<sup>123</sup>

The Commission has two main reasons for comparing disposable incomes of the lowest wage-earning households against accepted poverty lines or other benchmarks for the population as a whole. First, it can assess how those incomes compare at a point in time to the set of indicators chosen. Second, it can assess how those relativities move over time, as was recently done in the Commission's February 2008 *Economic and Social Indicators – Monitoring Report*.<sup>124</sup>

A theoretically ideal low-income benchmark (or set of benchmarks) would have the following properties:

- it would be derived using a transparent methodology that was easily accessible to the general public, at least in concept;
- it would be regularly updated so that current (or at least recent) comparisons could be made with a degree of confidence;
- it would take account of important factors that affect the level of income that different households need to achieve similar standards of living – for example, the size and age composition of a household and factors that give rise to additional costs, such as presence of disability, workforce participation, location of housing, etc; and
- it would have a high degree of visibility and credibility within the general population.

Unfortunately, there are no such ideal benchmarks of low income. The different kinds of poverty line in existence all have advantages and disadvantages. All involve making arbitrary assumptions of one kind or another – for example, how much income a child needs relative to an adult, which items are necessary for a minimum acceptable level of consumption or how much incomes and/or costs have changed since relevant data were originally collected.

The Commission acknowledges that it is appropriate to use a variety of benchmarks when assessing the relative value of disposable incomes in low-wage households. Tables 4.4 and 4.5 compare the disposable incomes of a variety of low-wage households as at December 2007 against both the HPLs (Table 4.4) and a set of relative poverty lines that represent 60 per cent of median income (Table 4.5). The latter is the most generous definition of relative poverty commonly used by the OECD and academic researchers, the others being 50 per cent of median income and 50 per cent of mean income. The poverty lines in Table 4.5 have been derived

<sup>121</sup> ACCER, 14 March 2008, pp. 19-20.

<sup>122</sup> ACCER, 14 March 2008, pp. 22-27.

<sup>123</sup> ACCER, 14 March 2008, p. 38, para. 112.

<sup>124</sup> AFPC, July to December 2007, pp. 27-28.

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by applying the modified OECD equivalence scale to 60 per cent of the estimated median equivalised disposable household income as at December 2007.<sup>125</sup>

From these tables, it is clear that poverty lines based on 60 per cent median income are higher than the HPLs, although the differences for dual-earner couples are smaller than for other household types.

Nevertheless, households with one earner on the standard FMW have income in excess of both Henderson and relative poverty lines, when available income support entitlements are included. Results for single people, with and without children, are comfortably above both measures, with couples faring less well by comparison, especially under the relative poverty lines. The only family type with income below the relative poverty line (when receiving the standard FMW) is a single-earner couple with two children that chooses to forgo access to Newstart Allowance.

The disposable incomes of households working part-time for 50 per cent of the FMW are generally above the HPL but below the relative poverty line, with the exception of the two single-parent households modelled.

**Table 4.4: Comparison of Henderson Poverty Lines (HPLs) with disposable income (DI) of households earning varying proportions of the FMW, December 2007**

Household type	Henderson Poverty Line (HPL) Dec 07 (\$pw)	Disposable income (DI) (\$pw)			DI as proportion of HPL		
		50% FMW	100% FMW	150% FMW	50% FMW	100% FMW	150% FMW
Single adult, no children	374.11	377.12	467.70	646.50	1.01	1.25	1.73
Single parent, one child	480.28	541.96	672.72	843.69	1.13	1.40	1.76
Single parent, two children	581.33	627.50	758.26	929.23	1.08	1.30	1.60
Single-earner couple, no children	500.45	552.71	624.90	686.88	1.10	1.25	1.37
Single-earner couple, one child	601.56	678.32	770.06	843.69	1.13	1.28	1.40
Single-earner couple, two children	702.68	763.86	857.22	929.23	1.09	1.22	1.32
Single-earner couple, two children (no Newstart Allowance)	702.68	591.84	758.26	929.23	0.84	1.08	1.32
Dual-earner couple, no children	571.21	nm	667.03	745.02	nm	1.17	1.30
Dual-earner couple, one child	672.32	nm	767.12	883.25	nm	1.14	1.31
Dual-earner couple, two children	773.44	nm	852.66	968.79	nm	1.10	1.25

Notes: nm = not modelled.

Sources: AFPC modelling; Melbourne Institute of Applied Economic and Social Research, *Poverty Lines: Australia December Quarter 2007*, University of Melbourne, 11 April 2008

Assumptions: HPLs include housing costs and dual-earner figures include additional 'cost of work' component of \$70.76 pw. FMW = \$522.12 pw. Tax/transfer parameters as at 31 December 2007. Children aged 8-12. Households paying sufficient rent to receive maximum rent assistance, where applicable. Singles on 50% FMW and couples on 50% and 100% FMW eligible to receive Newstart Allowance, unless otherwise specified. Dual-earner examples assume income is split 2:1.

<sup>125</sup> The modified OECD equivalence scale is used to adjust household income for household size, in order to enable more meaningful comparisons between households. Household income is divided by an equivalence factor which is derived by giving the first person aged 15 or over a value of 1.0, every other person aged 15 or over a value of 0.5 and each person under the age of 15 a value of 0.3.

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**Table 4.5: Comparison of 60% median income poverty lines (PLs) with disposable income (DI) of households earning varying proportions of the FMW, December 2007**

Household type	60% Median Income Poverty Line (PL) Dec 07 (\$pw)	DI as proportion of PL		
		50% FMW	100% FMW	150% FMW
Single adult, no children	387.48	0.97	1.21	1.67
Single parent, one child	503.73	1.08	1.34	1.67
Single parent, two children	619.97	1.01	1.22	1.50
Single-earner couple, no children	581.22	0.95	1.08	1.18
Single-earner couple, one child	697.47	0.97	1.10	1.21
Single-earner couple, two children	813.71	0.94	1.05	1.14
Single-earner couple, two children (no Newstart Allowance)	813.71	0.73	0.93	1.14
Dual-earner couple, no children	581.22	nm	1.15	1.28
Dual-earner couple, one child	697.47	nm	1.10	1.27
Dual-earner couple, two children	813.71	nm	1.05	1.19

Notes: nm = not modelled.

Sources: AFPC modelling; ABS, *Household Income and Income Distribution, Australia, 2005-06*, Catalogue No. 6523.0; Melbourne Institute of Applied Economic and Social Research (MIAESR), *Poverty Lines: Australia December Quarter 2007*, University of Melbourne, 11 April 2008

Assumptions: PLs are based on estimates of median equivalised disposable household income for 2005-06, updated for movements in household disposable income per head as calculated by MIAESR, and adjusted for household composition using modified OECD equivalence scale. FMW = \$522.12 pw. Tax/transfer parameters as at 31 December 2007. Children aged 8-12. Households paying sufficient rent to receive maximum rent assistance, where applicable. Singles on 50% FMW and couples on 50% and 100% FMW eligible to receive Newstart Allowance, unless otherwise specified. Dual-earner examples assume income split 2:1.

The results of the Commission's modelling are consistent with those of the OECD, which recently found that the disposable incomes of Australian households earning the full-time FMW in 2005 were above 60 per cent of median equivalised disposable household income. According to that study, only one country (Great Britain) consistently provided minimum wage-earners with a higher level of disposable income relative to the median.<sup>126</sup> (For more detail on country rankings, see Table D.4 in Appendix D.)

Both ACCER and ACOSS repeat their previous calls for new research into minimum living costs of low-income households:

'Relevant research on living costs is just as relevant to the AFPC's work as research on macroeconomic issues. Knowing what it costs to live is vital to the proper exercise of the AFPC's statutory obligation to have regard to the desirability of providing a safety net for the low paid.'<sup>127</sup>

'...ACOSS recommends that research be commissioned to assist the Commission to assess the minimum income needs of low paid employees. It is desirable that the Commission work with stakeholders towards a common understanding of how minimum wages should be benchmarked, not to set a 'target' for the minimum wage but to be clear about the 'adequacy objective' of minimum wage fixation in Australia. A good starting point would be a review of the available research in this area including budget standards, deprivation research and income poverty research.'<sup>128</sup>

<sup>126</sup> OECD, *Benefits and Wages 2007: OECD Indicators*, OECD, 2007, pp. 80-84.

<sup>127</sup> ACCER, 14 March 2008, p. 27, para. 77.

<sup>128</sup> ACOSS, March 2008, p. 3

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In the Commission's opinion it is not possible to reach a single 'right' answer as to how much income a wage earning household needs to achieve a minimum acceptable standard of living. It will continue to monitor relevant Australian and international research, including that published by the OECD.

Of the household types whose disposable incomes the Commission has modelled, a single person without children is the only one whose disposable income does not depend on income transfers. These wage-earners have disposable income that is 25 per cent above the relevant HPL and 21 per cent above a poverty line based on 60 per cent of median equivalised disposable income. In the Commission's view, this is a reasonable margin above poverty for a person earning the lowest adult full time wage in the regulated labour market.

