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1. Framework for wage-setting decision

The Australian Fair Pay Commission (the Commission) is established by s. 20 of the *Workplace Relations Act 1996* as amended by the *Workplace Relations Amendment (Work Choices) Act 2005* (WR Act), and consists of the Chair and four Commissioners.

The Commission's functions are set out in s. 21 and include its wage-setting function, as set out in s. 22(1), and any other functions conferred on the Commission under the WR Act or any other Act or by regulations made under the WR Act or any other Act.

The Commission also has the function of undertaking activities to promote public understanding of matters relevant to its wage-setting and other functions.

1.1 Wage-setting function

The Commission's wage-setting function is set out in s. 22(1) of the WR Act:

- (1) The Commission's wage-setting function is to:
 - (a) conduct wage reviews; and
 - (b) exercise its wage-setting powers as necessary depending on the outcomes of wage reviews.

A 'wage review' is a review conducted by the Commission to determine whether it should exercise any of its wage-setting powers. The Commission's 'wage-setting powers' are those conferred by Division 2 of Part 7 of the WR Act. A 'wage-setting decision' is a decision made by the Commission in the exercise of its wage-setting powers (s.19).

The footnote to s. 22(1) notes that the *main* wage-setting powers of the Commission are:

- adjusting the standard Federal Minimum Wage (standard FMW);
- determining or adjusting special Federal Minimum Wages (special FMWs);
- determining or adjusting basic periodic rates of pay and basic piece rates of pay; and
- determining or adjusting casual loadings.

The WR Act assigns the Commission an over-arching objective 'to promote the economic prosperity of the people of Australia'.

More specifically, in performing its wage-setting function, the Commission must have regard to:

- the capacity of the unemployed and the low paid to obtain and remain in employment;
- employment and competitiveness across the economy;
- providing a safety net for the low paid; and
- providing minimum wages for junior employees, employees to whom training arrangements apply and employees with disabilities that ensure those employees are competitive in the labour market.

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These criteria have guided the Commission in making its first wage-setting decision. The Commission directed all parties making submissions to the Commission or undertaking research on its behalf to be similarly guided by the criteria laid down for the Commission in the WR Act. In addition, these criteria guided the consultations undertaken by the Commission with stakeholders and the Australian public.

1.2 Promoting economic prosperity

Promoting the economic prosperity of the Australian people is a very broad objective. In submissions and consultations, some people express concern that the Commission would interpret economic prosperity too narrowly. The Australian Council of Social Service (ACOSS) in its submission, for example, states that:

... the 'economic prosperity of the people of Australia' has a much wider meaning than growth in Gross Domestic Product.¹

At the broadest level, the Commission understands its role as balancing a desire for minimum wages to promote employment opportunities for unemployed and low-paid Australians with the need for minimum wages to play their part in maintaining a safety net. The Commission therefore interprets economic prosperity broadly rather than narrowly. An economically prosperous Australia is one where those seeking work have ample opportunity to find it and where a safety net mitigates hardship.

Many factors contribute to economic prosperity, including efficient industry, a skilled workforce, effective regulation, and sound macroeconomic policies. The level of minimum wages also contributes to economic prosperity. Setting minimum wages 'too high' will have a detrimental effect on employment growth and could even cause unemployment to rise. On the other hand, minimum wages form part of the safety net and help to sustain the living standards of the low paid. Minimum wages influence the extent to which unemployed and low-paid Australians share the economic prosperity of the wider community.

While many factors bear upon the economic prosperity of all Australians, including the level of minimum wages, the Commission has responsibility only for setting and adjusting minimum wages for employees within its jurisdiction. The Commission is mindful that its determinations are only one factor likely to influence the economic prosperity of all Australians but that unemployed and low-paid Australians are among those most directly affected by its wage-setting decision.

The Australian economy is enjoying its fifteenth consecutive year of economic expansion. Unemployment is low by recent historic standards and inflation, while strengthening recently, is still within the Reserve Bank of Australia's target range of 2-3 per cent per annum over the medium term.

The Commission believes that, as far as possible, its decision should not exacerbate unemployment or inflation. The international competitiveness of the Australian economy, ultimately reflecting its productivity, is also an important determinant of economic prosperity. Both are potentially affected by the Commission's decision in relation to minimum wages.

¹ ACOSS, *Submission to the Fair Pay Commission on Minimum Wages*, July 2006, p. 8.

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The Commission is well aware of the potential for its decision to do more harm than good, especially to some of Australia's most vulnerable citizens.

1.3 Decision

The Commission has conducted a wage review and now exercises its wage-setting function as set out in s. 22(1) of the WR Act.

The Commission consulted widely, both with key stakeholders and a broad range of representative organisations with an interest in the setting of minimum wages in Australia. Interested parties were invited to make submissions and the views of the Australian people were sought directly through an extensive consultation process.

Research was commissioned on a range of issues, including:

- the characteristics of low-paid employees and employers of the low paid;
- the broader tax-transfer and wage context; and
- the academic literature analysing labour demand and supply issues.

The Commission also drew on existing academic literature and research findings summarised in the submissions.

Having undertaken this review, the Commission exercises its wage-setting powers under Division 2 of Part 7 of the WR Act. In exercising this power the Commission:

- adjusts the standard FMW;
- adjusts basic periodic rates of pay contained in the Australian Pay and Classification Scales (Pay Scales) derived from pre-reform wage instruments;
- adjusts basic piece rates of pay;
- adjusts junior and trainee wages; and
- determines new special FMWs and special Pay Scales for employees with a disability.

The Commission has given due consideration to its over-arching objective 'to promote the economic prosperity of the people of Australia'. More specifically, in performing its wage-setting function, the Commission has considered the impact of its decision on:

- the capacity of the unemployed and the low paid to obtain and remain in employment;
- employment and competitiveness across the economy;
- providing a safety net for the low paid; and
- providing minimum wages for junior employees, employees to whom training arrangements apply and employees with disabilities that ensure those employees are competitive in the labour market.

The Commission has weighed up a number of considerations in determining the level of increase (if any) that should apply to the standard FMW; how this increase should be expressed; and the extent to which an increase should apply to workers on preserved Pay Scales. At heart, this is a balancing exercise. In arriving at the decision outlined below, the Commission has taken into account:

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- the close to 18 month period since the last pay increase for Pay Scale reliant employees;
- the sensitivity of low-paid employment to changes in wage levels, as well as the incentives for individuals to seek and remain in paid employment;
- the fact that the economy and labour market have continued to perform strongly, although not uniformly;
- movements in consumer prices, as well as incipient inflationary pressures, (including on interest rates); and
- the requirement to provide a safety net for the low paid.

While the Commission awards an increase to the standard FMW and preserved Pay Scales, it has determined a differential increase which recognises the low paid as being more reliant on minimum wages than higher-paid workers. The Commission considers that this is consistent with research, including that conducted by the Award Review Taskforce regarding award reliance, which shows that workers in low-paid employment are more likely to be award reliant. The Commission also considers that its decision is consistent with providing a safety net for the low paid, as well as the principal object of the WR Act.

As discussed in the following sections, there are many definitions of low paid. An approach commonly used by researchers is to adopt a relative definition of low pay. While the Commission has not sought to define low paid, it has used a range of minimum wage rates up to \$700 per week² as the indicative low-paid range. This equates to approximately two-thirds of Average Weekly Ordinary Time Earnings (AWOTE) and is a broader definition of low paid than many submissions advanced. Wage increases for those on minimum wage rates above \$700³ are also awarded but at a lower level than for those in the low-paid range.

Decision

The Commission grants a general pay increase that will adjust the standard FMW and preserved Pay Scales.

The standard FMW increases by \$27.36 per week, bringing the weekly rate to \$511.86. The standard FMW increases from \$12.75 to \$13.47 per hour.

Preserved adult⁴ Pay Scales that currently provide for a basic periodic rate of pay up to, and including, the level of \$700.00 per week increase by \$27.36 per week.

Preserved adult⁵ Pay Scales that currently provide for a basic periodic rate of pay of over \$700.00 per week increase by \$22.04 per week.

Minimum wages for junior employees, employees to whom training arrangements apply and employees with disabilities, basic piece rates of pay and casual loadings

The Commission intends that the general pay increase flow on to junior employees, employees to whom training arrangements apply and employees with disabilities in ways that preserve existing relativities to the extent this is possible.

² \$18.42 per hour x 38 hours equals \$699.96 per week. Therefore the hourly increase of \$0.72 is granted to Pay Scales providing weekly rates of pay up to and including \$699.96 per week.

³ \$18.42 per hour x 38 hours equals \$699.96 per week. Therefore the hourly increase of \$0.58 is granted to Pay Scales providing weekly rates of pay above \$699.96 per week.

⁴ Where adult means a basic periodic rate of pay that does not explicitly apply to a class of employees with a disability or employees to whom a training arrangement applies or junior employees.

⁵ Where adult means a basic periodic rate of pay that does not explicitly apply to a class of employees with a disability or employees to whom a training arrangement applies or junior employees.

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Basic piece rates of pay pose unique issues in translating the general increase. In the majority of cases, the general wage increase flows automatically to casual employees. In some limited circumstances however, specific adjustment is necessary to flow on the increase.

There is considerable diversity in how wage arrangements for these employees are expressed in pre-reform wage instruments. Historically, there have been a variety of methods adopted by state, territory and federal institutions to flow on general wage increases to these groups. Sections 6 to 10 outline in detail how the general increase will flow on to each of these wage categories.

Date of effect

All parts of this decision that adjust or establish a rate of pay, however defined in this decision, will have effect from 1 December 2006. For the purposes of calculating the date of effect, 1 December 2006 commences at midnight on 30 November 2006.

Australian Industrial Relations Commission (AIRC) 2005 Safety Net Review decision

The Commission, as part of the first exercise of its wage-setting powers, will adjust wage rate provisions within a preserved Pay Scale derived from pre-reform wage instruments, that were not adjusted for the AIRC's 2005 Safety Net Review decision where:

- the wage rates were adjusted in accordance with the AIRC's 2004 Safety Net Review decision (whether by the AIRC or by a state industrial authority); or
- the wage rates were not adjusted in accordance with the AIRC's 2004 Safety Net Review decision (whether by the AIRC or by a state industrial authority) but received a safety net adjustment during the 12 months to 27 March 2006; or
- the instrument took effect after the AIRC's 2004 Safety Net Review decision.

These pre-reform wage instruments will be increased by \$17 per week expressed as an hourly rate.

Award Review Taskforce Recommendations

The Commission has had regard to the recommendations of the Award Review Taskforce in making this decision.

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1.4 Reasons for decision and future directions

Subsection 24(4) of the WR Act provides that the Commission's wage-setting decisions must:

be in writing; and

- be expressed as decisions of the Commission as a body; and
- include reasons for the decisions, expressed as reasons of the Commission as a body.

The reasons for decision are outlined in the following sections of this document. They are based on the Commission's analysis of information received through submissions, research and consultations.

In addition, this document outlines the Commission's future directions and highlights particular matters which will be addressed in future wage reviews.

The Commission will commence a wage-setting review on minimum wages for junior employees and employees to whom training arrangements apply in early 2007.

The Commission will also deliver its second general wage-setting decision in mid 2007.

The Commission intends to undertake further research and consultations in respect to the recommendations of the Award Review Taskforce in 2007.

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2. Characteristics of the low paid

In determining the level of minimum wages, the Australian Fair Pay Commission (Commission) is required to take into account the impact of its decision on the capacity of low-paid Australians to remain employed and on the opportunities for unemployed Australians to find work.

2.1 Definitions of low pay

There are various ways of defining low-paid workers. Some employees work only relatively few hours per week and therefore earn relatively little. In terms of hourly rates of pay, however, these workers are not necessarily low-paid. At the other end of the spectrum, there are workers who work very long hours each week. Notwithstanding relatively high weekly earnings, they may earn relatively low rates of hourly pay.

The question remains as to where to draw the line on low pay. Above which level (in either weekly or hourly terms) should a worker no longer be considered low-paid? Again, there is a wide diversity of approaches to defining a specific monetary point above which an employee can no longer be said to be low-paid.

One approach is to select a benchmark classification from an award. The Australian Catholic Council for Employment Relations (ACCER) in its submission suggests that:

the term low paid...extend[s] to cover at least workers on the base general trade rate [Classification C10 of the Federal Metal Industry Award] of \$578.20 per week.¹

Another approach commonly used by researchers is to adopt a relative definition of low pay. A definition used for cross-national comparisons (for example by the Organisation for Economic Co-operation and Development (OECD)) is two-thirds of median earnings for full-time workers. This can be converted into an hourly rate for the purposes of defining low-paid part-time workers.

The evidence on low pay presented in submissions and in the findings of researchers reflects a variety of opinions and approaches as how best to define the low paid.

The Commission has determined that, for the purposes of making a differential increase, minimum wage rates of up to \$700 per week² will be adopted as the range over which a larger increase will be awarded. A smaller increase is awarded to minimum wage rates above \$700 per week.³

While there are diverse views on how low-paid might be defined, there is some consensus on the characteristics of those who are regarded as falling within the spectrum of low-paid employees.

¹ ACCER, *Minimum Wages Review 2006, Submission by the Australian Catholic Council for Employment Relations*, 28 July 2006, p. 17, para. 45.

² \$18.42 per hour x 38 hours equals \$699.96 per week. Therefore the hourly increase of \$0.72 is granted to Pay Scales providing weekly rates of pay up to and including \$699.96 per week.

³ \$18.42 per hour x 38 hours equals \$699.96 per week. Therefore the hourly increase of \$0.58 is granted to Pay Scales providing weekly rates of pay above \$699.96 per week.

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2.2 Individual characteristics of the low paid

While the majority of submissions do not specify a precise definition of low pay, many outline a number of characteristics typically associated with receipt of low pay.

These characteristics include:

- employment in relatively low-skilled service occupations;
- low levels of formal education;
- being 21 years of age or younger;
- being female;
- living in a rural or remote location; and
- being a migrant from a non-English speaking background.

Submissions identify many of these characteristics as common to those groups susceptible to low pay and the risk of financial hardship. Frequent mention is also made of people in part-time and casual employment who were seen to be over-represented among the low paid.

Commissioned research undertaken by the Melbourne Institute of Applied Economic and Social Research (Melbourne Institute) using data from the Australian Bureau of Statistics (ABS) and the Household Income and Labour Dynamics in Australia Survey (HILDA) confirms that workers are significantly more likely to be low-paid if they are:

- employed casually;
- female (especially if a single parent or partnered secondary earner);
- single;
- educated to year 9 or less;
- in the 21-30 years or older than 60 years age groups;
- working in smaller firms (firms with fewer than 50 employees);
- migrants from non-English speaking countries;
- living in rural locations;
- employed on short-term contracts; and
- not members of a union.⁴

The researchers find, however, that the increased incidence of low pay for women is primarily the result of their over-representation among part-time workers who, in turn, have a higher incidence of low pay. Among part-time workers in general, women are no more likely to be low-paid than men.⁵

Further commissioned research from the National Institute of Labour Studies (NILS) supports some of these findings.⁶ Data from both the HILDA Survey and the ABS Survey of Income and Housing show that low-paid workers (defined as those paid up to or slightly above the Federal Minimum Wage) are roughly evenly divided between men and women. Around half are aged 25-44 years and most are partnered (about 40 per cent with dependent children). Most are Australian-born, live in metropolitan areas and work full-time in a permanent relatively low-skilled job. Just over half have no post-school qualifications.⁷

⁴ S McGuinness, J Freebairn & K Mavromaras, *Characteristics of minimum wage employees*, Melbourne Institute of Applied Economic and Social Research, report commissioned by AFPC, 2006, pp. 25-26.

⁵ McGuinness et al, *Characteristics of minimum wage employees*, 2006, p. 26.

⁶ J Healy & S Richardson, *An Updated Profile of The Minimum Wage Workforce in Australia*, National Institute of Labour Studies, report commissioned by AFPC, 2006.

⁷ Healy & Richardson, 2006, pp. 7-10.

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Compared with all adult employees however, these low-paid workers are significantly more likely than average to be female, young (21-24 years), without post-school qualifications (about 40 per cent had not studied past Year 11) and working in part-time casual jobs. They are no more likely than higher-paid employees to be mature-aged (55 years or over) or born overseas.⁸

While almost 60 per cent of low-wage earners live in couple relationships, they are less likely than other wage earners to do so, particularly if they have children. They are significantly more likely to be lone parents or non-dependent children living with a parent or parents. They are also twice as likely as their higher-paid counterparts to live in outer-regional locations.⁹

This research also finds that minimum wage workers are over-represented in service based occupations and industries such as child care, aged care, labouring, clerical services, the retail and hospitality sectors and agriculture.¹⁰ Research by the Melbourne Institute on the characteristics of employers of the low paid also shows that industries with the highest average concentrations of low-paid employees include:

- Retail trade;
- Construction;
- Manufacturing; and
- Accommodation, cafes and restaurants.¹¹

Compared with other adult employees the low paid are less satisfied with their pay but no less satisfied with other aspects of their work or with their lives more generally.¹²

2.3 Household characteristics of the low paid

Previous research¹³ on the household income status of low-paid employees has consistently found that, rather than being concentrated in low-income households, low-paid employees can be found across the whole household income distribution. This suggests that, for many of the low paid, their wage is not the sole or even primary source of family income.

As much of this research is based on data from the 1990s, and in light of the considerable changes that have occurred over the past decade in the labour market and in the Australian social security system, new research was commissioned to explore this issue using data from the period 2001-04.

The Melbourne Institute research finds that data from the HILDA survey largely confirm the earlier picture.¹⁴ It shows that full-time workers earning around or below the minimum wage are concentrated in middle-income households (being over-represented in the third to seventh deciles of equivalised household income), while part-time workers on similar wages are more highly concentrated at the lower end of the distribution (over-represented in the second to fourth deciles).

⁸ Healy & Richardson, 2006, pp. 7-8.

⁹ Healy & Richardson, 2006, pp. 7-8.

¹⁰ Healy & Richardson, 2006, pp. 9-10.

¹¹ S McGuinness, E Webster, K Mavromaras, *What are the characteristics of the employers of the low paid in Australia?* Melbourne Institute of Applied Economic and Social Research, report commissioned by AFPC, 2006.

¹² Healy & Richardson, 2006, p. 11.

¹³ S Richardson & A Harding, 'Poor workers? The link between low wages, low family income and the tax and transfer systems' in S Richardson (ed), *Reshaping the Labour Market*, Cambridge University Press, Cambridge, 1999; also A Leigh, *Does Raising the Minimum Wage Help the Poor?*, CEPR Discussion Paper No. 501, Centre for Economic Policy Research, Australian National University, Canberra, 2005.

¹⁴ McGuinness et al, *Characteristics of minimum wage employees*, 2006, pp. 19-21.

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Lower-paid workers as a group (both full-time and part-time) are relatively concentrated in lower-income households. However, 20 per cent of both full-time and part-time workers on or below the minimum wage live in households in the top three deciles of the income distribution. This suggests that many low-paid workers are either partnered to people on above minimum wages or single people living with other employed people (for example, young people living at home with parents). This is consistent with findings of a higher incidence of low pay among partnered secondary earners.

Using the same data, the NLS commissioned research compares the household income of low-paid employees with the household income distribution of a variety of populations.¹⁵ It finds that relative to the adult population as a whole, employees earning below, around or slightly above the minimum wage are concentrated in the middle of the overall household income distribution. However, comparing the household income of low-paid employees with that of two sub-populations that more closely resemble them (adults in the labour force [i.e. employed or looking for work] and all adult employees), there is greater concentration in low-income households.

Compared with other workers, the majority of low-paid employees are found to live in households with equivalised income in the bottom three deciles. However, while this is not a surprising finding in itself, it is notable that even when the comparison population is restricted in this way, around one-third of low-paid employees live in households in the top half of the income distribution of all employees.¹⁶

The Commission finds the research useful in updating knowledge about the groups most affected by its decision, especially vulnerable groups who are more likely to be Pay Scale¹⁷ reliant.

¹⁵ Healy & Richardson, 2006, pp. 13-16.

¹⁶ Healy & Richardson, 2006, p. 16.

¹⁷ Australian Pay and Classification Scale

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3. Capacity for the unemployed and low paid to obtain and remain in employment

The Australian Fair Pay Commission (Commission) is required to have regard to the capacity for the unemployed and low paid to obtain and remain in employment when conducting wage reviews and exercising its wage-setting powers.

3.1 Minimum wages and labour demand

The employment impact of adjustments to the minimum wage is an issue that has been of interest to researchers and academics in Australia and overseas for some time. Much of the influential research into the elasticity of demand for labour is cited in submissions received by the Commission.¹ The different viewpoints expressed reflect the diverse findings of the research.

Essentially, submissions either support the conventional (neoclassical) theory and associated empirical evidence that increases in minimum wages reduce employment opportunities² or argue that this is not always the case, citing alternative theories and empirical evidence.³ For example, the Victorian and Northern Territory Governments submit:

The inadequacy of the fundamental assumptions behind the neo-classical employment model has resulted in the development of a number of labour market models designed to overcome these limitations.⁴

The proposition that setting minimum wages 'too high' can have an adverse impact on employment opportunities is generally accepted in all of the research and studies considered by the Commission. As noted in the Employers First submission:

There has been a long-running debate on the relative merits of perfect competition or monopsony as models to explain the effects of minimum wages on employment. However, all models of the labour market predict that a high enough minimum wage will reduce employment.⁵

Most of the submissions recommend that the Commission should award a 'moderate' increase. For example, the Tasmanian Government submits:

... that moderate and predictable increases in the minimum wage will not have a significant negative impact on the employment of the low paid or the ability for the unemployed to gain employment⁶

Key questions raised in submissions were: 'What is moderate in the Australian situation?' and 'How high is too high?'

¹ The elasticity of demand for labour is the percentage change in employment resulting from a 1 per cent increase in minimum wages.

² e.g. Australian Government, *Submission to the Australian Fair Pay Commission 2006*, 28 July 2006, pp. 49-65, paras 3.1-3.59; AiG, *2006 Review of Minimum Wages: Submission to the Australian Fair Pay Commission*, July 2006, pp. 48-55, paras 119-141.

³ e.g. ACTU, *Australian Council of Trade Unions Submission to the Australian Fair Pay Commission*, July 2006, pp. 107-116; ACROSS, *Submission to the Fair Pay Commission on Minimum Wages*, July 2006, pp. 25-30; ACT Government, *ACT Government Submission to the Australian Fair Pay Commission*, July 2006, pp. 10-12, paras 34-9.

⁴ Vic & NT Governments, *Joint Submission by the Victorian and Northern Territory Governments in response to: Australian Fair Pay Commission*, 28 July 2006, p. 17, para.2.10.

⁵ Employers First, *Submission to the Australian Fair Pay Commission*, July 2006, p. 7, para 2.4.

⁶ Tas. Government, *Tasmanian State Government Submission to the Australian Fair Pay Commission: Federal Minimum Wage Determination*, July 2006, p. 13.

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The Australian Government submission lists more than 50 international studies on the relationship between minimum wages and employment, more than two-thirds of which find a statistically significant negative relationship.⁷ The Australian Council of Trade Unions (ACTU), on the other hand, cites recent Organisation for Economic Co-operation and Development (OECD) work which finds that:

Simple economic reasoning indicates that a statutory minimum wage or labour costs set at too high a level will become a barrier to employment for low-productivity workers, reducing national output while also frustrating the equity goals motivating these measures. However, pinning down the size of the employment losses that result from minimum wages has proven to be difficult and there is considerable uncertainty concerning how many jobs might be lost due to minimum wages set at the levels actually observed in different countries.⁸

A number of studies have cast doubt on the neoclassical view that increasing minimum wages will result in employment losses, starting with the work of Card and Krueger in the 1990s in the United States.⁹ Their study found that an increase in minimum wages had no negative impact on employment and may have even raised employment.

While subsequent studies by Card and Krueger and other researchers have demonstrated similar results for the United States and other countries, Card and Krueger's work has attracted considerable criticism. The Australian Government submission notes that Card and Krueger's work has been 'heavily criticised and discredited' and that re-estimation using their data by other researchers finds a long run negative relationship between employment and the minimum wage.¹⁰

The impact of minimum wage increases is difficult to estimate. This difficulty is partly explained by the fact that, in most countries, only a small proportion of the workforce is subject to the minimum wage. As a result, increasing the minimum wage usually has a very small impact on average wages, and therefore, on total employment. The problem centres on identifying those people directly affected by an increase in the minimum wage, as the extent of any effect will be more noticeable amongst them.

This measurement difficulty can be exacerbated by the extent to which substitution occurs as a result of minimum wage increases, as discussed in the Australian Chamber of Commerce and Industry (ACCI) submission. That is, an increase in minimum wages encourages employers to substitute more productive workers on higher pay for less productive minimum wage workers, whose labour cost per unit of output has increased.¹¹ According to this model, the loss of low-skilled jobs can be significantly higher than the aggregate reduction in employment.¹²

There are other problems confronting those trying to estimate the effects of minimum wages on employment, as indicated by the extensive criticisms of various studies in the literature. Even if there were conclusive international evidence one way or the other as to the relationship between minimum wages and employment, it may not be of relevance to Australia, given the unique structure of our minimum wages system. Compared with other OECD countries:

⁷ Australian Government, 2006, p. 53, table 3.2.

⁸ OECD, Employment Outlook No. 79, May 2006, p. 86.

⁹ D Card and A Krueger, *Myth and Measurement: The New Economics of the Minimum Wage*, Princeton, Princeton University Press, 1995. The OECD also noted that, given the ambiguous evidence concerning the impact of minimum wages on employment, it is important for governments making use of statutory minimum wages to monitor closely whether they are resulting in significant job losses: OECD, 2006, p. 86.

¹⁰ Australian Government, 2006, p. 62, para. 3.45.

¹¹ ACCI, *2006 Minimum Wage Review: ACCI Submission*, July 2006, p.142, para. 8.16.

¹² ACCI, 2006, p. 142, para. 8.5.

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- Australia's minimum wage system prescribes not one minimum wage but a series of minimum wages at higher levels through the wages distribution;
- Australia's minimum wage is higher in relative terms; and
- Australia's minimum wage system covers a higher proportion of employees than other countries (20 per cent in May 2004).¹³

The commissioned paper 'Minimum Wages and Employment', prepared by the Centre for Labour Market Research (CLMR) at the University of Canberra, provides an overview of both international and Australian research, as well as the theoretical debate and areas for future research.¹⁴ Estimates of average wage elasticities of demand for labour for Australia range from -0.2 to -0.8 (the latter, for example, indicating that an average wage increase of 1 per cent would decrease employment by 0.8 per cent).

ACCI and the Australian Government cite two recent studies on the impact of minimum wages in Australia.¹⁵ In a 2003 study, Leigh examined the effect of increases in minimum wages in Western Australia, compared with the rest of Australia where the minimum wage was not changed. Leigh found that the elasticity of demand for labour with respect to changes in the minimum wage was -0.15.¹⁶ Harding and Harding (2004) estimate the short run elasticity of employment demand with respect to the minimum award rate to be -0.21, based on a survey of small and medium size employers.¹⁷

Both these studies have been extensively criticised. ACCI consider that Leigh successfully defended his findings in a 2004 correction to his 2003 paper, in which he also revised the estimated elasticity to -0.29.¹⁸

In concluding their paper, CLMR note that there might appear to be:

...a somewhat bewildering array of contradictory theory, evidence and heated argument on the employment effects of minimum wages...However, the Australian and international evidence is very clear on one thing - rises in real wages reduce demand for labour.¹⁹

The Australian Government also cites the work of Card and Krueger²⁰ supporting the view that minimum wage increases are likely to adversely affect employment because of Australia's relatively high minimum wage. Card and Krueger emphasise that employment losses can result from increases to a minimum wage already set at a high level, arguing "if the minimum wage is raised too much, we will see job losses; there is a tipping point".²¹

Subsequent to the release of the OECD Employment Outlook 2006 cited above, the OECD released its 2006 economic survey of Australia. The OECD questions the rationale for maintaining the award system after the implementation of the *Workplace Relations Amendment (Work Choices) Act 2005*, and states that:

The minimum wage is high in international comparison and the number of low skilled who are long-term unemployed or disabled is also high, thus raising concerns about the adverse effects of the minimum wage on labour demand for the low skilled.²²

¹³ ABS, 'Employee Earnings and Hours, Australia, May 2004', Catalogue No.6306.0, p. 25, table 12.

¹⁴ P Lewis, *Minimum Wages and Employment*, Centre for Labour Market Research, report commissioned by AFPC, 2006.

¹⁵ ACCI, 2006, pp. 155-161, figure 1 and paras 8.71-8.99; Australian Government, 2006, p. 57, table 3.4.

¹⁶ A Leigh, 'Employment Effects of Minimum Wages: Evidence from a Quasi-Experiment' *Australian Economic Review* vol. 36, no. 4, 2003, p. 370-371. In this article Leigh finds an elasticity figure of -0.13 which is subsequently revised to -0.15 in A Leigh, 'Employment Effects of Minimum Wages: Evidence from a Quasi-Experiment Erratum', *Australian Economic Review* vol. 37, no.1, 2004, pp. 102-4.

¹⁷ D Harding and G Harding, 'Minimum Wages in Australia: an Analysis of the Impact on Small and Medium Sized Businesses - A report to the Department of Employment and Workplace Relations; Turning Point Research Pty Ltd, 2004, p. 49, table 3.3 & para. 3.8.

¹⁸ ACCI, 2006, p. 156, para. 8.74. ACCI cites A Leigh 'Minimum Wages and Employment: Reply' *Australian Economic Review* vol. 37, no. 2, 2004, p. 177.

¹⁹ P Lewis, 2006, p. 27.

²⁰ D Card and A Krueger, *Unemployment Chimera*, Washington Post, 6 March 1998.

²¹ Australian Government, 2006, p. 62, para 3.48.

²² OECD, *Economic Surveys: Australia*, 31 July 2006, p. 18.

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The OECD appears to recommend caution in adjusting the Australian minimum wage. On the other hand, the ACTU does not accept that there is a negative relationship between wages and employment and argues that there is no evidence that past safety net adjustments have had any significant adverse impact on employment, a view shared by the state and territory Governments.²³

In addition to the evidence already discussed, the Australian Government also submits modelling work on the impact of minimum wage increases on employment prepared by Econtech and the Centre of Policy Studies (CoPS) at Monash University.²⁴ For example, CoPS estimates a loss of 74,000 jobs from an increase of \$26.60 to all award reliant employees in 2005.²⁵

These models provide more scope for capturing the flow-on effects of wage increases throughout the economy, but their results also depend on the values of certain parameters and structural relationships determined outside of the models. For example, in both models, the wages of non-award workers increase on average by 20 per cent of the increase in award wages as a result of flow-on effects. This issue has been disputed in previous Australian Industrial Relations Commission (AIRC) Safety Net Reviews,²⁶ although the ACTU submission concedes there is some flow on:

With many rates of pay and conditions found within AWAs being directly linked to minimum pay and condition standards the AFPC should be aware that the implications of its decisions are wider than those employees who are award reliant.²⁷

The Commission notes that the flow-on effects from its first decision may be influenced by the fact that approximately one-third of award employees have already received pay increases following various state wage decisions.

On the basis of the evidence available, the Commission considers that there is a negative relationship between the level of minimum wage increases and employment in Australia. The basis for any disagreement seems to involve the magnitude of the relationship rather than its existence.

3.2 Employment impact of safety net adjustments

The Australian Industry Group (AIG) submission discusses the findings from a June 2006 survey of predominantly manufacturing businesses on the impacts of the \$17 safety net adjustment in 2005. Of the total employees in respondent businesses, around 11 per cent were on minimum wages. The safety net adjustment resulted in 134 redundancies (0.26 per cent of total employment) and a reduction in additional employment of 230 employees (0.44 per cent of total employment).²⁸ Thus total employment across all of these businesses was estimated to be 0.7 per cent lower than it would have been without the minimum wage increase.

²³ ACTU, 2006, p. 17. NSW Government, *Submission to the Australian Fair Pay Commission on behalf of the New South Wales Government*, 28 July 2006, p. 25, paras 98-9, pp. 30-1, paras 124-8.

²⁴ Econtech, 'Modelling the Economic and Employment Impacts of Various Scenarios for Increases in Minimum Wages', research commissioned by the Department of Employment and Workplace Relations, Canberra, 16 July 2006; P B Dixon, J R Madden and M T Rimmer, 'The Effects on the Australian Economy of a Sustained Increase in Award Wage Rates: Results from the MONASH Model', Centre of Policy Studies, Monash University, 11 March 2005.

²⁵ Australian Government, 2006, p. 58, para.3.25.

²⁶ e.g. AIRC, *Safety Net Review 2005*, Decision, [PR 002005], pp. 63-64, paras 212-220.

²⁷ ACTU, 2006, p. 20.

²⁸ AIG, 2006, pp. 119-120.

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The survey response rate was just 22 per cent and, of those that did respond, some did not answer all questions.²⁹ Such a relatively low response rate does raise questions about the reliability of the survey's findings and, in particular, the possibility of non-response bias. It is also not clear how well respondents would have been able to isolate the effects of the safety net adjustment from other cost pressures, particularly in a sector which has faced a significant increase in international competition over recent years.

Many submissions claim that minimum wage increases through safety net adjustments over recent years have not affected employment growth given the strong employment growth over the same period. The AIRC also highlighted this fact in its 2005 decision, saying: "[i]n light of the growth in employment over the last eight years...it would be difficult to accept that the Commission's safety net adjustments have been excessive...".³⁰

The ACTU and ACCI both concentrate on employment growth in award reliant (state and federal) industries in support of their different positions. The most award reliant industries are Accommodation, cafes and restaurants, Retail trade and Health and community services. Based on the latest data available (May 2004), only Accommodation, cafes and restaurants had a majority of employees on awards (60.1 per cent), compared with 31.3 per cent for Retail trade and 26.6 per cent for Health and community services.³¹

The ACTU states:

In the last five years to February 2006 there have been 169 800 additional jobs created in retail trade and 155 300 additional jobs in health and community services.

The Department of Employment and Workplace Relations (DEWR) predicts that 9,000 additional jobs will be created each year to 2010-11 in the accommodation, cafes and restaurant sector; a massive 31,600 additional jobs created each year in the health and community services industry and a staggering 30,700 additional jobs each year in the retail trade industry.³²

On the other hand, ACCI argue that employment growth over May 2005 to May 2006 was negatively correlated with award coverage, although employment growth over the previous twelve months had been positively correlated with award coverage.³³ Over the period since the first Safety Net Review, growth in the number of employees has been lower than average in Accommodation, cafes and restaurants, but higher in Retail trade and Health and community services.

The Queensland Government submission points out the dangers of positing:

...a direct causal link between those economic outcomes and the level of wage increases awarded, to the exclusion of all other potential causal factors.³⁴

The range of factors other than wages that can affect employment growth makes it difficult to isolate the effects of minimum wage increases. Yet it is this isolated effect that studies of the relationship between minimum wages and employment typically try to measure. Models such as those used by Econtech and CoPs do allow for most, if not all, of the significant factors likely to affect employment including wages but are open to criticism on account of their underlying assumptions.

²⁹ AIG, 2006, p. 154, para. 60.

³⁰ AIRC, 2005, p. 110, para. 410.

³¹ ABS, Catalogue No 6306.0, p. 29, table 15.

³² ACTU, 2006, p. 16.

³³ ACCI, 2006, p. 135, para. 7.111.

³⁴ Qld Government, *Australian Fair Pay Commission: Queensland Government Submission*, 28 July 2006, p. 19.

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3.3 Do low paid jobs act as a stepping stone to better paid jobs?

Many submissions address the extent to which low-paid employees experience upward mobility in their level of earnings. The facts tend to be interpreted in a positive or negative light depending upon the perspective of the observer:

‘Those on lower wages in any one year may not be the same group as those on lower wages in another year. Indeed it should be expected that as labour market experience and skills develop wages will rise in recognition of these advances.’³⁵

‘Low paid jobs are transitional for many workers and can act as important stepping stones to higher paying jobs. In many cases, this transition may only take a year or two. Low paid jobs often act as an entry point to the workforce - particularly for school leavers, people returning to the labour market following child caring duties, and less skilled unemployed job seekers.’³⁶

‘...people who were formerly jobless who obtain a low paid or casual job have about an equal chance of moving up in the next year to a higher paying or permanent job, or falling back into joblessness. Their chances of moving up are much lower than those of low paid or casual employees who were not recently unemployed...[and a] substantial minority remain in low paid or casual employment from year to year.’³⁷

Not surprisingly, the research finds that some people progress from low-paid jobs to higher-paid jobs while others do not and a significant minority cycle between non-employment and low-paid work. A number of submissions cite research undertaken by Dunlop using data from the Australian Bureau of Statistic (ABS) Survey of Employment and Unemployment Patterns.³⁸ This finds that close to half of a sample of low-paid adult wage and salary earners moved to higher-paid work within a year, about 40 per cent remained in low-paid work and approximately one in eight experienced a period of joblessness. Dunlop also finds that having recently been jobless and the duration of previous joblessness were predictors of receiving low pay.³⁹

However, as the Australian Government points out in its submission, low-paid jobs provide an important (re-) entry point to the labour market. Longitudinal data from the Household Income and Labour Dynamics in Australia Survey (HILDA) indicate that, of unemployed people who found a job between 2002 and 2004, around 57 per cent found a low-paid job. Moreover, around one-fifth of low-paid workers at any point in time had been jobless in the previous year.⁴⁰

³⁵ ACCI, 2006, p. 229, para. 9.41.

³⁶ Australian Government, 2006, p. 118, para. 7.5.

³⁷ ACOSS, 2006, p. 33.

³⁸ ACTU, 2006, pp. 77-78; ACOSS, 2006, pp. 5, 53; ACCI, 2006, pp. 229-230, para. 9.44; Queensland Commission for Children and Young People and the Child Guardian, *Submission to the Australian Fair Pay Commission on the Federal Minimum Wage*, 28 July 2006, pp. 4-5.

³⁹ Y Dunlop, *Labour Market Outcomes of Low Paid Australian Workers*, Australian Bureau of Statistics Catalogue No. 6293.0.00.005, 2000; Y Dunlop, ‘Low-paid employment in the Australian labour market, 1995-97’ in J Borland, B Gregory and P Sheehan (eds) *Work Rich, Work Poor: Inequality and economic change in Australia*, Centre for Strategic Economic Studies, Victoria University, Melbourne, 2001; Y Dunlop, *Low Paid Employment in Australia*, PhD Thesis, Centre for Strategic Economic Studies, Victoria University, 2002.

⁴⁰ Australian Government, 2006, p. 118-121.

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The same data show that some 44 per cent of employees defined as low paid in 2001 (earning between the Federal Minimum Wage) and two-thirds of median hourly earnings had moved completely out of this pay range by 2004, 38 per cent were still in low-paid jobs (though they may have had a pay increase), 2 per cent had become unemployed and 12 per cent had left the labour force.⁴¹

Using a slightly different categorisation of low pay but the same data, the Melbourne Institute of Applied Economic and Social Research (Melbourne Institute) finds that 58 per cent of people earning minimum or below minimum full-time wages in 2001 had moved into above minimum wages by 2004 (though some had moved from full-time to part-time work), whereas movement of low-paid part-time workers into higher paid jobs was somewhat less common (around 43 per cent).⁴² Furthermore, around 30 per cent of people in low-paid part-time work in 2001 were either unemployed or outside the labour force in 2004.⁴³

International comparisons indicate that low-paid Australians have a higher probability of moving to a better paid job than in most other English-speaking countries (for example, in the UK or the USA) but a lower probability than in some European countries (for example, Denmark).⁴⁴ Workers are more likely to experience upward earnings mobility if they are young, better educated and/or male.⁴⁵

Ultimately, there may be limited scope for wages policies to influence the extent of upward earnings mobility among those already in stable employment. For many people, the route to higher incomes will continue to lie in improving their skills, and hence their attractiveness to employers, or in moving to a location with more and better paid jobs.

3.4 Minimum wages, income support and work incentives

In setting minimum wages, the Commission is required to consider how the level of minimum wages affects the capacity of the unemployed and low paid to obtain and remain in employment. This consideration bears on labour supply as well as labour demand. In other words, is there sufficient incentive for people who are otherwise jobless or underemployed to take up, or increase their hours of, low-paid work?

An individual's workforce decisions are a result of the complex interplay of factors, some financial and others non-financial. While one of the primary reasons for working is to earn sufficient money to support a household and standard of living, submissions to the Commission and research carried out on behalf of the Commission confirm that people engage in paid work for a wide variety of reasons, including identity, self-esteem, job satisfaction, and the desire to be self-reliant.⁴⁶

For some people, these other factors may be sufficient to induce them to work even when doing so appears to offer relatively little financial benefit. Others may be prepared to work for little short-term gain in the expectation that financial benefits will be more substantial in the longer term (for example, after career progression or when work-related costs such as the cost of child care diminish). On the other hand, people who place a high value on activities such as caring for their own children may choose not to work even if they could increase their disposable income substantially by doing so.

⁴¹ Australian Government, 2006, pp. 118-9.

⁴² S McGuinness, J Freebairn and K Mavromaras, *Characteristics of minimum wage employees*, Melbourne Institute of Applied Economic and Social Research, report commissioned by AFPC, 2006, pp. 28-30.

⁴³ See footnote above.

⁴⁴ ACOSS, 2006, p. 34.

⁴⁵ Dunlop, 2002, pp. 80-2; Australian Government, 2006, p. 119, paras 7.11-7.13.

⁴⁶ ACOSS, 2006, p. 42; Colmar Brunton Social Research, *Work Decisions and the tax/transfer system*, report commissioned by the AFPC, 2006, pp. 11-12, 14-16, 18-19, 21, 24, 27 & 30.

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While acknowledging the wide variety of factors that may influence people's decisions to participate in the workforce, non-financial issues are beyond the remit of the Commission. For this reason, the following discussion of incentives focuses primarily on the effect of financial factors. Within the arena of financial incentives, the Commission has only one lever of adjustment - namely to adjust minimum wages.

3.4.1 Financial incentives and disincentives

The Australian social security system supports low-income workers and their families through a variety of programs such as income support and family assistance benefits. These payments are means tested. Consequently, recipients can be faced with high 'effective marginal tax rates' (EMTRs) as their payments decline as a result of rises in income received through employment. The EMTR at a particular income point refers to the proportion of an additional unit of income (typically \$1) that is not received by the person as a result of changes in income tax and reductions in cash benefits.

While people would normally be considered to have an incentive to work if they were better off financially having taken a job, incentives may be compromised by the following factors:

- high EMTRs resulting in low financial gains overall; and/or
- associated costs of employment (for example, transport and childcare costs).

Effective marginal tax rates

Submissions from welfare organisations, religious and community groups tend to focus upon the detrimental impact of high EMTRs.⁴⁷ The Australian Government emphasises that most households are better off financially with one or more members working, notwithstanding potentially high EMTRs.⁴⁸

The Australian Council of Social Service, in its submission, argues that the evidence suggests that financial work disincentives bear more heavily on decisions to enter the workforce than on decisions to increase working hours.⁴⁹ This is despite the fact that EMTRs are often higher for people already in low-paid work than for people who are wholly reliant on income support.

The pattern of EMTRs varies by family type. The more income support and family payments an individual or family receives, the further extended the income range over which that assistance is withdrawn and EMTRs become relatively high.⁵⁰

Extent of high EMTRs

The effect of high EMTRs is qualified by the fact that they are faced by only a small minority of employees.

⁴⁷ e.g. ACOSS, pp. 41-43; ACCER, *Minimum Wages Review 2006: Submission by the Australian Catholic Council for Employment Relations*, 28 July 2006, p.24, para. 62.

⁴⁸ Australian Government, 2006, pp. 126-8, paras 7.43-7.45.

⁴⁹ ACOSS, 2006, p. 42.

⁵⁰ A Harding, A Payne, Q Ngu Vu & 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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Commissioned research undertaken by the National Centre for Social and Economic Modelling (NATSEM) finds that of the estimated 8 million wage and salary earners in Australia in 2006-07, the majority (68 per cent or around 5.4 million) face moderate EMTRs of between 30 and 40 per cent. The proportion facing EMTRs of greater than 50 per cent was 9 per cent (around 714,000).⁵¹

NATSEM estimates that of the 1.9 million lower-paid employees (i.e. those earning less than \$15.50 per hour or working full-time for less than \$589 per week), 10 per cent (around 200,000) face EMTRs of more than 50 per cent.⁵²

Those facing EMTRs of 70 per cent or more make up 2.5 per cent of the low-paid group or 0.6 per cent of all wage and salary earners in Australia (around 50,000).⁵³

Net financial returns from taking up employment

EMTRs tell only part of the work incentives story. A different perspective can be gained by focusing on the net financial gains that people experience from taking up low-paid work. These gains vary according to individual circumstances of households prior to taking up low-paid work: for example, whether, and to what extent, the household relies on income support; the type of housing tenure; and whether one or both partners in a couple are in paid work.

Figure 3.1 illustrates, for a variety of family types paying rent, the difference in disposable income between those without paid work (that is, totally reliant on income support) and those with one person entering a low-paid job (earning either 100 per cent or 150 per cent of the current standard FMW).

The gains in dollar terms are fairly similar (regardless of whether families are single with no children, single with two children or a couple with two children) when moving from complete income support reliance to a job paying the standard FMW. All the family types illustrated gain between \$170 and \$210 a week in disposable income.

⁵¹ Harding et al, 2006, p. 5.

⁵² Harding et al, 2006, p. 23.

⁵³ Harding et al, 2006, p. 23.

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Figure 3.1: Disposable incomes out of work and at 100 per cent and 150 per cent of the standard Federal Minimum Wage (FMW), September 2006

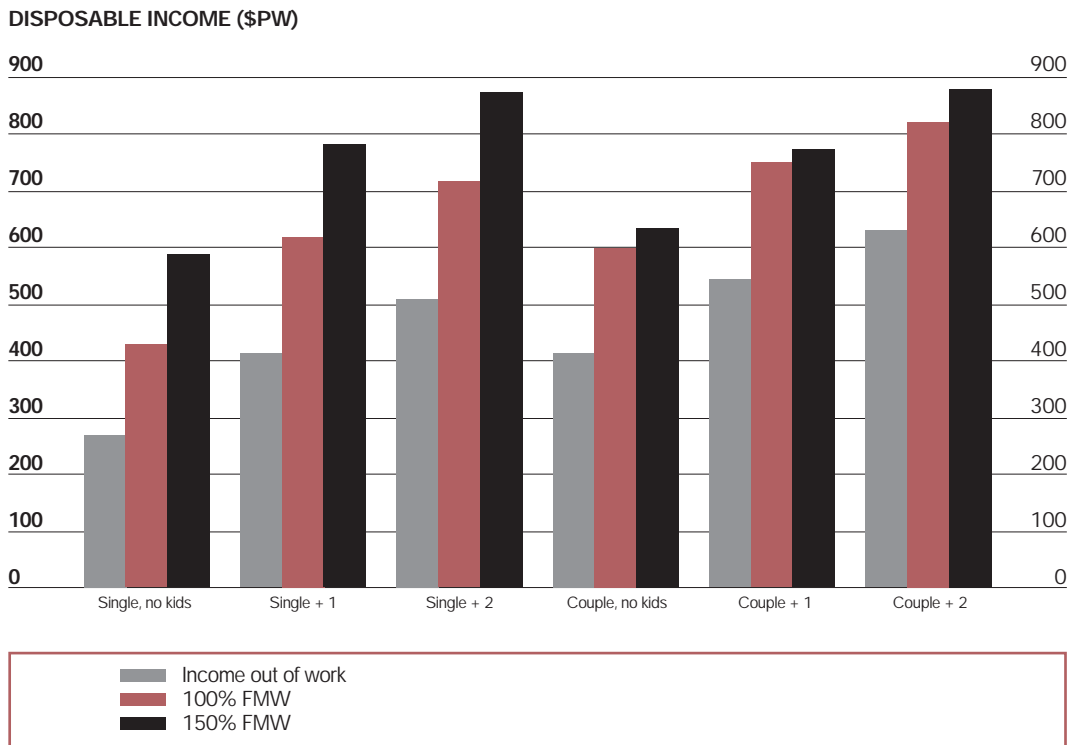


Figure 3.1 also shows the effect of higher EMTRs at the higher income level of 150 per cent of the standard FMW versus 100 per cent of the standard FMW.

For single people with and without children, moving into a job paying 150 per cent of the standard FMW delivers a substantial additional financial benefit. These family types are between \$326 and \$360 per week better off than when totally reliant on income support.

For single earner couples, however, the financial outcome is similar when earning one and a half times the standard FMW as when earning the standard FMW, an additional \$37 to \$40 per week more than at the standard FMW.

While the improvement in disposable income for single earner couples earning one and a half times the standard FMW when compared with earning the standard FMW is relatively small, they are substantially better off earning one and a half times the standard FMW when compared to income support (between \$209 and \$231 per week).

Modelling presented to the Commission by the Australian Government tells a similar, if slightly more optimistic, story.⁵⁴ It shows a single unemployed adult as \$257 per week (125 per cent) better off financially when taking a job paying \$530 per week.

For a couple household with one child aged seven in which neither parent is in paid work the net gain from a job paying \$530 per week is just under \$200 per week (41 per cent). If the second partner enters a similar low-paid job, household disposable income increases by a further \$280 per week (again 41 per cent better off).

⁵⁴ Australian Government, 2006, pp. 126-129. The examples appear to assume that the individuals in question either own or are purchasing their own homes. In the more likely situation that a person is renting either privately or from a public housing authority, net financial gains are somewhat more modest.

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While acknowledging that financial incentives for jobless people to move into employment are reasonably strong, a number of submissions draw attention to the fact that associated costs such as for child care and transport may reduce or even eliminate any financial benefit.⁵⁵ The smaller the difference or gap between the level of government benefits for those who are unemployed and the minimum wage of the low paid, the lower the incentive for the jobless to seek low-paid work and to remain in low-paid work. By and large, the size of this gap would appear to offer an adequate incentive for most to participate actively in the labour market - either by seeking employment or working in a low-paid job.

When considering the capacity of the unemployed and low paid to obtain and remain in employment, the Commission has taken into account both the demand for and the supply of labour.

The Commission acknowledges that high minimum wages may induce employers to reduce the number of employees they hire and/or retain, as well as adjust the number of hours they offer to their employees. The size of these effects will in part depend on the magnitude of the rise.

By the same token, those without jobs and those in low-paid employment, particularly part-time, will weigh up the net benefits of work relative to the net benefits of being without work.

⁵⁵ e.g. Caxton Legal Centre, *Fair Pay Commission - Review of Minimum Wages*, July 2006, pp. 9-13; PWD/DDLC, *Minimum Wage Determinations: Spring 2006*, pp. 7-8.

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4. Employment and competitiveness

The Australian Fair Pay Commission (Commission) is required to have regard to employment and competitiveness across the economy.

4.1 Labour market trends

Conditions in the Australian labour market remain positive:

- after a period of weakness in late 2005, employment has grown at an annualised rate of around 3.4 per cent thus far in 2006, with over 75 per cent of the additional jobs being full-time;
- the participation rate was 65.1 per cent in August 2006, its highest level ever;
- the unemployment rate fell below five per cent for the first time in 30 years in May 2006, and has remained below five per cent since then; and
- the Australian Bureau of Statistics (ABS) measure of job vacancies showed that the job vacancy rate (vacancies as a percentage of the labour force) was close to its highest rate in over 30 years in the September quarter 2006.

Over the year to August 2006, unemployment fell in Victoria, Queensland, Western Australia and both territories. There remain considerable differences in the labour market performance across states and territories. The largest labour market, New South Wales, has demonstrated weakness and along with Tasmania, has experienced the slowest employment growth over the year to August 2006.

Table 4.1: Labour market developments by state/territory: year to August 2006

	EMPLOYMENT	UNEMPLOYMENT	UNEMPLOYMENT RATE		PARTICIPATION RATE	
	Annual % change		%	Annual ppt change	%	Annual ppt change
Metropolitan*	1.5	1.0	4.3	0.0	65.2	0.1
Non-metropolitan*	2.7	-5.5	5.1	-0.4	62.9	0.5
NSW	0.7	15.7	5.7	0.7	63.3	0.3
Vic	2.2	-11.9	4.6	-0.7	64.8	0.1
Qld	3.7	-10.6	4.5	-0.7	67.2	0.4
SA	1.8	0.8	4.8	-0.1	62.4	0.5
WA	1.7	-16.9	3.6	-0.7	67.6	-0.7
Tas	0.7	2.9	6.0	0.1	60.4	0.1
NT**	7.2	-2.1	4.3	-0.5	71.3	2.5
ACT**	4.8	-10.0	2.8	-0.4	74.2	2.3
Australia	2.0	-1.6	4.9	-0.1	65.1	0.3

* Data are not seasonally adjusted.

** Data are trend estimates.

Sources: ABS, Labour Force Australia, Catalogue No. 6202.0 and Catalogue No. 6291.0, 55.01, August 2006.

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The generally tight labour market conditions currently being experienced follow a period of sustained improvement over more than a decade. Since December 1992, the unemployment rate has fallen by over 6 percentage points, employment has increased at an average annualised rate of 2.2 per cent, and the numbers of unemployed have decreased at an average annualised rate of 4.1 per cent. The participation rate has increased by approximately 2.5 percentage points over this period and by over 1 percentage point since the end of 2004.

The Australian Chamber of Commerce and Industry (ACCI) cites broader measures of labour under-utilisation than the unemployment rate, noting that "Employment growth has been good though there still remains a significant amount of unemployment and underemployment".¹

The Commission is open to considering broader definitions of labour under-utilisation and notes that there is still a pool of under-utilised labour in Australia. The unemployment rate is, however, a widely understood and useful indicator of conditions in the labour market.

4.2 Trends in wage growth

Aggregate wage growth has been solid recently, an outcome that is consistent with strong labour market conditions.

Table 4.2: Growth in various labour cost measures

	WPI	AWOTE	AWE
Year-ended growth to 2006:Q2	4.1	3.5	4.7
Average annualised growth from 1997: Q3 to 2005:Q2	3.4	4.7	4.1

Sources: ABS, Average Weekly Earnings, Catalogue No. 6302.0; ABS, Labour Price Index, Catalogue No. 6345.0

While submissions present a range of measures there is wide agreement that the WPI is the most appropriate measure of wage growth.² It is designed to measure changes in the cost of employing a constant quantity and quality of labour. As the Australian Council of Trade Unions (ACTU) notes in its submission:

The advantage of the WPI over most of the other measures of wage growth... is that it does not incorporate compositional change [in the labour force].³

Unlike other measures, the WPI is not affected by changes in the shares of full-time and part-time workers or changes in the shares of employees in high-paid and low-paid occupations.

Growth in total labour costs is expected to remain firm over the next year.

¹ ACCI, *2006 Minimum Wage Review: ACCI Submission*, July 2006, p. 105, para. 7.

² There is a range of different labour cost and earnings measures in Australia, designed to measure different concepts. The main measures put to the Commission were the Wage Price Index (WPI), Average Weekly Ordinary-Time Earnings (AWOTE), Average Weekly Earnings (AWE), Average Earnings from the National Accounts (AENA), Average Annualised Wage Increases (AAWI), new federal enterprise bargaining agreements (EBAs), and unit labour costs.

³ ACTU, *Australian Council of Trade Unions Submission to the Australian Fair Pay Commission*, July 2006, p. 57.

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4.3 Inflation

While wage growth is not expected to moderate in the near future, the Australian Government submission notes that “the cyclical upswing in [labour] productivity ... [should] have a moderating influence on inflation”.⁴

The Reserve Bank of Australia (RBA) aims to keep consumer price inflation between 2 and 3 per cent, on average, over the medium term. The Consumer Price Index (CPI) increased by 4.0 per cent over the year to the June quarter 2006, above its average level of 2.5 per cent over recent years and also above the RBA's target band.

The CPI rise reflects large increases in fuel and fruit prices. Fuel prices are expected to stabilise and the fruit price increase should be reversed over coming quarters. In the RBA's assessment, underlying inflation (which broadly captures the trend growth in prices) edged up to a little below 3 per cent in year-end terms in the June quarter 2006.

Wage growth has not yet been identified as contributing to the recent higher headline inflation. The RBA has indicated, however, that labour cost pressure is one of a number of factors contributing to the upward shift in underlying inflation:

Total labour cost pressures therefore appear to be stronger than is recorded in those official wage measures which do not capture these non-wage incentives. This is especially apparent in resource-related and non-residential construction industries, particularly in Western Australia, but solid labour cost growth is evident in most industries.

... measures of underlying inflation picked up, confirming the upward shift in underlying inflation that was apparent in the March quarter data. The pick-up appears to reflect a number of factors, including higher input cost pressures, ongoing solid growth in total labour costs, and the strengthening in consumer demand that was apparent in the March quarter national accounts and seems to have been maintained in the June quarter.⁵

In making its decision, the Commission has had regard to possible implications for underlying and headline inflation.

4.4 Competitiveness

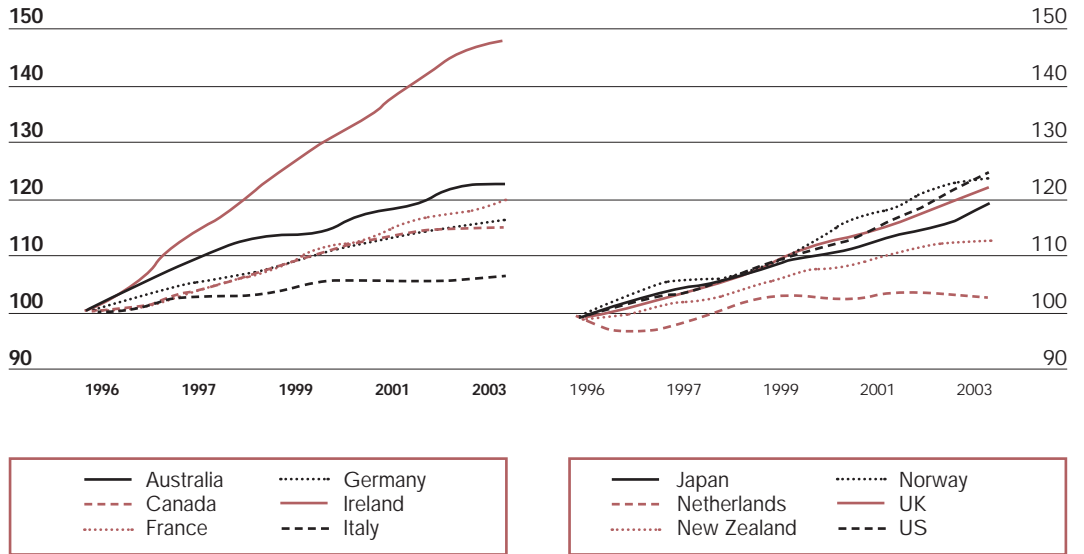
Figure 4.1 below compares growth in labour productivity for Australia and other more advanced Organisation for Economic Co-operation and Development countries with which Australia is often compared. Australia outperformed all other countries shown except Ireland over the period and was ranked twelfth out of thirty countries overall.

⁴ Australian Government, *Submission to the Australian Fair Pay Commission 2006*, 28 July 2006, p. 32, para. 2.22.

⁵ RBA, *Statement on Monetary Policy - August 2006*, 2 August 2006, pp. 49-51.

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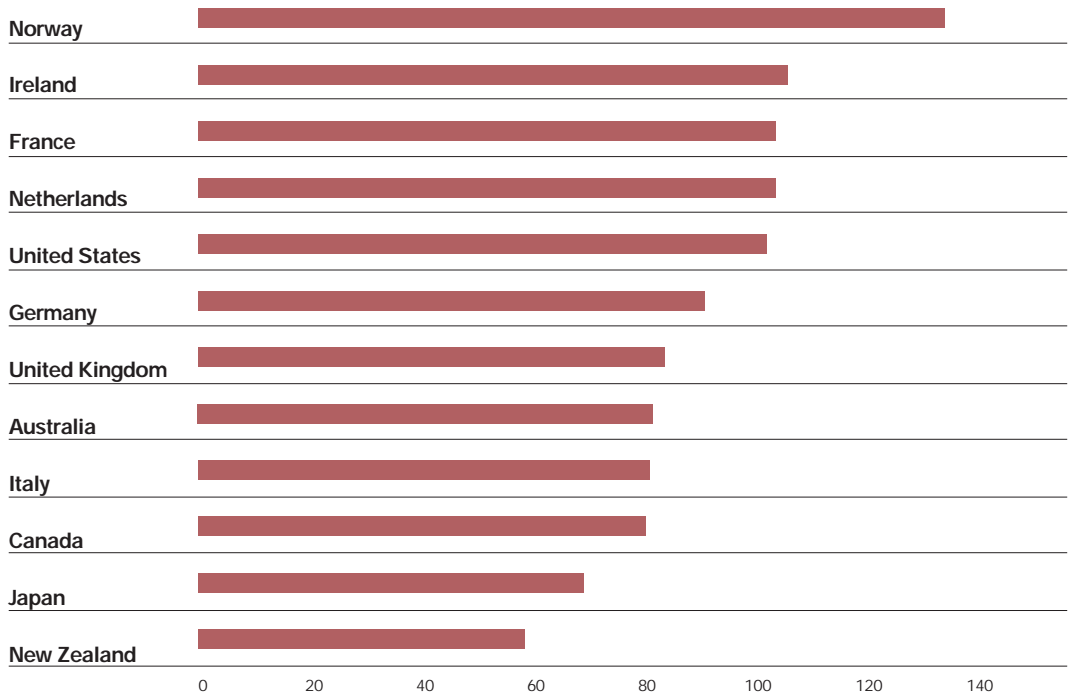
Figure 4.1 - GDP per hour worked, each country indexed to 100 in 1995



Source: OECD Productivity Database, January 2006

While stronger relative productivity growth is encouraging, Figure 4.2 shows there are still considerable gaps between Australia's level of labour productivity and those of other advanced countries. Australia ranked fifteenth of the thirty countries but was behind most of the more advanced OECD economies, suggesting there is considerable scope for continuing improvements in Australia's productivity.

Figure 4.2 - GDP per hour worked in 2004, indexed to US = 100



Source: OECD Productivity Database, January 2006

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The Commission notes the importance of productivity to the future competitiveness of the Australian economy.

4.5 Economic outlook

The Australian economy has grown at a moderate pace recently, with Gross Domestic Product (GDP) growing at 1.9 per cent over the year to the June quarter 2006. International economic conditions are favourable, with the world economy now in its fourth successive year of above-average growth. This has led to an increase in commodity prices over the past two and a half years, which has provided a significant boost to national income in Australia.

ACCI submits that economic growth in recent quarters is well below the growth rates observed earlier in the current economic expansion, and therefore:

the economy as a whole cannot sustain the rapid growth in award wages that were given when the economy was growing more strongly.⁶

The former Governor of the RBA, Mr Ian Macfarlane, has argued that the current period of slower growth should not necessarily be taken as a sign of general economic weakness.⁷ It is likely to be at least partly due to the economy reaching capacity constraints after 15 years of economic expansion. Mr Macfarlane states that:

we should get used to GDP growth with a 2 or a 3 in front of the decimal point, rather than a 3 or a 4 as we had become accustomed to throughout most of the expansion.⁸

The RBA has emphasised that strong demand coupled with limited spare capacity adds to the risk of higher inflation.

Table 4.3: Outlook for main economic indicators

	FORECASTS*		
	2005-06 year average	2006-07 year average	Four quarters to June 2007
GDP	2 ¾	3 ¼	3 ¼
Employment	2 ¼	1	1 ¼
Unemployment rate (ppts)	5	5 ¼	5 ¼
CPI	3 ¼	2 ¾	2 ½
WPI	4	4	3 ¾

* Percentage change on preceding year unless otherwise indicated
Forecasts are from 2006-07 Budget.

The 2006-07 Budget in May forecast that the WPI would increase by 4 per cent over 2006-07, supported by continuing tight conditions in segments of the labour market, and that employment growth would moderate to 1 ¼ per cent over the year.⁹ Since then, employment growth has been somewhat stronger than generally expected. Barring deterioration in the labour market, employment growth should exceed the May forecasts.

⁶ ACCI, 2006, p. 106, para. 7.3

⁷ I Macfarlane, *Opening Statement to the House of Representatives Standing Committee on Economics, Finance and Public Administration*, 18 August 2006.

⁸ See footnote above.

⁹ Treasury, *Budget Strategy and Outlook 2006-07: Budget Paper No. 1*, 9 May 2006.

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In its August *Statement on Monetary Policy*, the RBA forecast that GDP growth over the next year or so will be approximately 3½ per cent, one quarter of a percentage point higher than forecast in the Budget.¹⁰ Underlying inflation is forecast to remain broadly stable, at around 3 per cent over the next two years, with CPI inflation hovering around 4 per cent in the short term before declining.

In summary, the available evidence suggests that GDP growth should be stronger in 2006-07 at around 3½ per cent and underlying inflation should remain within the RBA's target range, although towards its upper limit. Employment growth remains strong, but is expected to moderate.

4.6 Industry differences

Much of the industry analysis provided in submissions is of a partial nature and therefore of limited use. Different submissions present different data on the same issue to show that award reliant industries performed better or worse than other industries in response to safety net adjustments.

Table 4.4 below shows that the industries with significant proportions of employees on Australian Pay and Classification Scales (Pay Scales) are: Accommodation, cafes and restaurants (43.2 per cent), Retail trade (20.9 per cent) and Property and business services (14.5 per cent).¹¹

More than 10 per cent of employees are also Pay Scale reliant in:

- Health and community services;
- Manufacturing;
- Construction;
- Transport and storage;
- Wholesale trade;
- Personal and other services; and
- Cultural and recreational services.

It is possible that Pay Scale reliant employees dominate particular segments within these broader industries which could therefore be more significantly affected by the Commission's decision.

¹⁰ RBA, *Statement on Monetary Policy - August 2006*, 2 August 2006.

¹¹ The most recent data available that can provide estimates of Pay Scale reliance in the federal jurisdiction are contained in the ABS Employee Earnings and Hours (EEH) 2004 survey. Undertaken in 2004, the data collected from this survey reflect award reliance (federal and state) rather than Pay Scale reliance. Award reliance, however, is a robust indicator of Pay Scale reliance. The EEH allows for the data for award reliant employees to be disaggregated by employees: working for incorporated businesses who are on awards; working for incorporated businesses who are not on awards, and who earn at or below the standard FMW; and in Vic, the NT or the ACT who work for non-incorporated businesses and are on awards. This allows for an estimation of those award reliant employees who would now fall within the federal jurisdiction.

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Table 4.4: Employees on awards as at May 2004 by jurisdiction

INDUSTRY	AUSTRALIAN PAY AND CLASSIFICATION SCALE (PAY SCALE)			OTHER AWARDS
	Number ('000)	% Pay Scale Employees	% Total Employees	% Total Employees
Mining	0.8	0.1%	1.1%	0.8%
Manufacturing	107.4	10.7%	12.2%	2.7%
Electricity, gas and water supply	0.5	0.1%	1.2%	0.5%
Construction	50.1	5.0%	12.0%	3.2%
Wholesale trade	48.2	4.8%	11.7%	3.2%
Retail trade	238.2	23.6%	20.9%	10.4%
Accommodation, cafes and restaurants	185.5	18.4%	43.2%	16.9%
Transport and storage	34.4	3.4%	11.8%	2.6%
Communication services	0.4	0.0%	0.4%	1.7%
Finance and insurance	8.4	0.8%	2.5%	2.0%
Property and business services	146.9	14.6%	14.5%	5.2%
Government Administration and Defence	0.0	0.0%	0.0%	0.8%
Education	22.6	2.2%	3.1%	5.8%
Health and community services	115.2	11.4%	12.9%	13.7%
Cultural and recreational services	17.9	1.8%	10.0%	7.7%
Personal and other services	30.7	3.0%	10.3%	13.2%
Total	1,007.2	100.0%	13.1%	6.9%

Source: ABS, Unpublished EEH data. Data are not collected for Agriculture, forestry and fishing.

ACCI calls for a process to assist industries or regions facing particular hardships arguing that "the AFPC should not grant increases, in whole or in part, where circumstances of an industry ... do not warrant such increases."¹²

Furthermore, ACCI argues that moving to the highest industry level may still mask significant differences within the industry. For example, in agriculture, different commodities perform quite differently at the same time and droughts can occur in some regions while conditions are excellent in others.

According to the National Farmers Federation (NFF), however, this approach is cumbersome and involves difficulty in determining eligibility for deferral, and when special circumstances would apply. The NFF favours an alternative approach whereby:

... if any increase to the minimum wage is deemed appropriate then it should be set at a level that ensures that all industries have the capacity to pay rather than using an averaging approach.¹³

Some submissions point to Australia's relatively high minimum wage compared with other OECD countries, which is of particular concern in trade-exposed sectors. ACCI notes that:

¹² ACCI, 2006, p. 32, para. 2.81.

¹³ NFF, *Submission to the Australian Fair Pay Commission*, 28 July 2006, p. 9, para. 21.

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It is not about trying to compete with Asia (particularly China) by lowering wages. We cannot, and should not, try to compete with Asia on wages. Instead we can (and should) compete by having higher productivity - a key goal of labour market reform.¹⁴

The ACTU states that "A race to the bottom does nothing to further Australia's competitive advantage."¹⁵

ACCI and Australian Industry Group (AiG) support minimum wage systems and levels that are comparable with those of other 'established' economies with whom Australian businesses are in competition, rather than low-wage countries.

Nevertheless, the competitive pressures facing Australian manufacturing due to competition from China are well documented. AiG notes that manufacturing wages growth has been subdued in other OECD countries, and states that:

If administered wages such as Australian minimum wages do not echo the moderation in growth that appears to be occurring in labour market outcomes in trade exposed sectors such as manufacturing:

- domestic producers in trade exposed sectors will suffer a greater loss of comparative cost competitiveness than would otherwise be the case: and
- there are likely to be fewer employment opportunities in these trade exposed sectors for employees whose wages are impacted by the minimum wage decision.¹⁶

The Commission notes that its decision may have different effects on industries, and have a larger impact on those industries with greater Pay Scale reliance. However, the Commission does not consider that the possibility of disparate effects warrants different wage-setting decisions for different industries.

4.7 Regional considerations

Employment growth in non-metropolitan regions over the past year was around twice that in metropolitan regions, in percentage terms. Non-metropolitan areas have also experienced a larger fall in the unemployment rate and a larger rise in the participation rate over this period. The unemployment rate remains somewhat higher and the participation rate somewhat lower in non-metropolitan areas. Employment increased in 38 out of 59 labour force regions over the year to August 2006, while 33 regions recorded a reduction in their unemployment rate.

The New South Wales Government notes that unemployment rates are higher in regional New South Wales than they are in Sydney. It states that:

Higher unemployment rates mean that workers in regional areas often have less bargaining power than workers in metropolitan labour markets. It is the view of the New South Wales Government that workers with less bargaining power benefit from minimum wage increases.¹⁷

¹⁴ ACCI, 2006, p. 17, para. 2.9

¹⁵ ACTU, 2006, p. 15

¹⁶ AiG, 2006 *Review of Minimum Wages: Submission to the Australian Fair Pay Commission*, July 2006, pp. 58-9, para. 149.

¹⁷ NSW Government, *Submission to the Australian Fair Pay Commission on behalf of the New South Wales Government*, 28 July 2006, p. 22, para. 87.

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By contrast, the Australian Government and particular employer groups express concern that regional towns may not have the capacity to support a rise in the minimum wage. Consistent with this, ACCI claims that “the AFPC should not grant increases, in whole or in part, where circumstances of [a]... region do not warrant such increases”.¹⁸

Based on a survey, AiG finds that minimum wage increases have a larger impact on firms that are located in regional towns relative to metropolitan centres and regional cities, and firms in regional towns are more likely to “lift selling prices and implement redundancies”, particularly of low-skilled labour.¹⁹

On the other hand, the Econtech modelling submitted by the Australian Government estimates that award reliant industries are concentrated in metropolitan areas, and capital cities are therefore subject to greater percentage employment losses from increases in minimum wages. The Australian Government presents disaggregated data which suggest that:

there are regions across Australia which perform substantially worse than others. These regions take longer to recover from slowdowns in economic activity and remain highly vulnerable to cyclical or other shocks that can impact negatively on their regional economies.²⁰

The Australian Council of Social Service (ACOSS) suggests that wages are generally lower in rural and regional areas than in capital cities, and policies that address the causes of high unemployment in these areas are likely to be fairer and more effective than reducing minimum wages.²¹

While the Commission notes the comments in submissions regarding regional differences, it is required to eliminate pay differentials based purely on state or territory locations over a three-year period.

4.8 Bargaining

The Commission is aware that the principal object of the WR Act is to provide a framework for cooperative workplace relations which promotes the economic prosperity and welfare of the people of Australia by:

(a) encouraging the pursuit of high employment, improved living standards, low inflation and international competitiveness through higher productivity and a flexible and fair labour market; and

...

(d) ensuring that, as far as possible, the primary responsibility for determining matters affecting the employment relationship rests with the employer and employees at the workplace or enterprise level; and

(e) enabling employers and employees to choose the most appropriate form of agreement for their particular circumstances; and

...

¹⁸ ACCI, 2006, p. 32, para. 2.81.

¹⁹ AiG, 2006, p. 115.

²⁰ Australian Government, 2006, p. 79, para. 5.16.

²¹ ACOSS, *Submission to the Fair Pay Commission on Minimum Wages 2006, July 2006*, p. 7. ACOSS cites: OECD, *Employment Outlooks*, 2006, 2003 and 1998; Kennedy & Borland 1997, *A Wage Curve for Australia?*, ANU CEPR Discussion Paper No. 372; Leigh 2005, *Does the minimum wage help the poor?*, ANU Centre for Economic Policy Research Discussion Paper 501.

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(g) ensuring that awards provide minimum safety net entitlements for award-reliant employees which are consistent with Australian Fair Pay Commission decisions and which avoid creating disincentives to bargain at the workplace level; ...²²

The Australian Government, ACCI and AiG all contend that minimum wage rises can limit enterprise bargaining by removing the incentive for employees to bargain. ACCI notes that a minimum wage rise may reduce the capacity of a business to pay a wage premium over its competitors, reducing the ability of individual firms to use higher wages to reduce turnover or increase efficiency. AiG states that:

Minimum wage increases need to be positioned at a level below average enterprise agreement wage outcomes in order to avoid diminishing the primacy which is given to workplace agreement making under the Act.²³

The ACTU considers that the significant gap between minimum wages and the outcomes from bargaining agreements provides a real incentive for employees to bargain. It submits that:

The considerable gap between minimum rates of pay and those obtained through collective bargaining is currently more than a sufficient incentive for minimum wages workers to agitate for enterprise agreements and for this to be resisted by employers.

In most cases the market rates are 30 to 50 per cent in excess of the statutory minimum rates of pay found in awards. It is not uncommon to find rates of pay in collective agreements that are more than double the statutory minima within the award.²⁴

The ACTU claims it is often employers who are not interested in bargaining, and not the employees who have little bargaining power themselves and will only get mandated pay rises.²⁵

It is generally true that award reliant employees have significantly lower average hourly ordinary time earnings than non-award employees overall. The gaps, however, between award and non-award wage rates for Accommodation, cafes and restaurants and Retail trade, the industries with the highest proportions of Pay Scale reliant employees, were among the lowest for all industries.²⁶

It is not only the percentage increase that might affect the incentive to bargain but also the amount of any increase and the pattern of increases over time. There may also be different employment conditions associated with workplace agreements contributing to the overall attractiveness of working arrangements.

The ACTU also argues that, in some cases where agreements operate, they do not involve bargaining between two equal parties at all but are offered to employees on a take it or leave it basis.²⁷ Such agreements can have their pay linked to the Pay Scale, in which case they would only get a pay rise through the Commission. This is at odds with the ACTU's costing of its claim, in which it assumed that there was no flow on to non-award employees.²⁸

²² WR Act, s.3

²³ AiG, 2006, p. 69, para. 173.

²⁴ ACTU, 2006, p. 18.

²⁵ ACTU, 2006, p. 21.

²⁶ Unpublished EEH data, based on average hourly ordinary time earnings for adults by sex and employment status.

²⁷ ACTU, 2006, pp. 19-20.

²⁸ ACTU, 2006, pp. 44-5.

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As noted above, ACCI state that the Commission should, if possible, actively encourage enterprise bargaining, and not simply “avoid creating disincentives to bargain at the workplace level”.²⁹

In making its decision, the Commission notes its obligation to avoid creating disincentives to bargain at the workplace level as far as possible. In particular, the decision to award a smaller increase to those employees earning above \$700 per week is partly based on the proposition that these employees are better equipped to reach workplace agreements themselves and should be encouraged to do so.

²⁹ ACCI, 2006, p. 85, para. 5.51 & p. 253, para. 11.21. ACCI cite WR Act, s. 3(g).

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5. Providing a safety net for the low paid

The Australian Fair Pay Commission (Commission) is required to have regard to providing a safety net for the low paid. A number of factors contribute to the financial situation of the low paid including wages, other income, government benefits and pensions and income transfers.

5.1 Income transfers for people in low-paid work

The income safety net for many low-paid Australians consists of a combination of wages and income transfers. Any assessment of the adequacy or otherwise of the safety net must take account of the contribution that income transfers make to disposable income.

The Australian social security system provides additional income for low-income individuals (in a range of circumstances) and families. Since the introduction of Family Income Supplement in 1983, Australia has provided income transfers specifically targeted to low-paid working families with children. Over the years, this system of family assistance has been expanded progressively to supplement the disposable incomes of low-income families, both in-work and out-of-work.

At the same time, the system of income support for individual Australians has also come to provide additional income for increasing numbers of people who are either in part-time low-paid work themselves or partnered to people in low-paid work.

In its submission to the Commission, the Australian Government illustrates the extent of the income supplementation provided by current transfers.¹ It shows that for households containing one worker earning the full-time standard Federal Minimum Wage (standard FMW) of \$484.40 per week, the amount and proportion of disposable income coming from government transfers is:

- \$239 per week (36 per cent) for a single parent with one child aged 4; and
- \$335 per week (43 per cent) for a couple with two children aged 4 and 7.

Even at median full-time earnings (\$843 per week), income supplementation is occurring, albeit at a reduced level. At this wage, transfers amount to:

- \$135 per week (17 per cent of disposable income) for an equivalent single parent; and
- \$217 per week (25 per cent of disposable income) for an equivalent couple.

5.2 The relative roles of wages and the tax/transfer system

Wage increases are not the only source of increases in disposable income. Disposable income can also increase because of reductions in income tax, such as occurred most recently in July 2006. Where individuals or families are also receiving cash transfers, disposable income can increase because of:

¹ Australian Government, *Submission to the Australian Fair Pay Commission 2006*, 28 July 2006, p. 113.

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- regular indexation of income support payments (once or twice a year) and/or family assistance (once a year); and/or
- ad hoc changes to rates or to income test arrangements, such as occurred in July 2006 when the income test taper was relaxed for people receiving unemployment and related payments.

Some individuals and families may therefore be more reliant on changes to transfer payments to maintain or improve their standard of living than on increases in wages. Table 5.1 illustrates how the disposable incomes of a variety of family types earning various proportions of the standard FMW of \$484.40 per week changed between July 2005 and October 2006 solely as a result of the most recent tax cuts and changes to transfer payments.

Table 5.1: Disposable incomes of various family types earning 50 to 150 per cent of the weekly standard FMW, July 2005 and October 2006.

Family type	DISPOSABLE INCOME (\$PW)		CHANGE	
	July '05	October '06	\$pw	%
A. Single person earning 100% FMW	413.19	432.63	19.44	4.7
B. Couple without children, one earning 100% FMW	490.43	555.53	65.10	13.3
C. Couple without children, one earning 100% FMW, one earning 50% FMW	640.88	667.38	26.50	4.1
D. Couple with 2 children aged 6-12, one earning 100% FMW	679.56	763.87	84.31	12.4
E. Couple with 2 children aged 6-12, one earning 100% FMW, one earning 50% FMW	799.34	849.87	50.53	6.3
F. Single parent with 1 child aged 7, earning 50% FMW	531.62	561.17	29.55	5.6
G. Single parent with 1 child aged 7, earning 100% FMW	610.99	648.18	37.19	6.1

For those family types wholly reliant on wages (cases A and C), the tax cuts alone have been roughly sufficient to compensate for the effects of inflation on the real value of their disposable income. These two family types also benefit the most from any increase in the minimum wage because of their relatively low Effective Marginal Tax Rates (EMTRs).²

In the other cases illustrated, wages are combined with income support and/or Family Tax Benefit (FTB). Increases in these payments as a result of regular indexation and the July 2006 income test changes have combined with the tax cuts to deliver more substantial real increases in disposable income.

Some submissions raise the issue of the targeting of recent tax cuts to low-income earners and the changes to family assistance, and argue that these should be explicitly taken into account in the Commission's wage decision.³

While the Commission is not persuaded that an explicit discount is warranted, it considers that the proposed wage rise, in combination with recent tax cuts and increases in income transfers, will deliver a real increase in the living standards of low-paid employees and their families.

² See Section 3.

³ AIG, 2006 *Review of Minimum Wages: Submission to the Australian Fair Pay Commission*, July 2006, pp. 27-42, 80; ACCI, 2006 *Minimum Wage Review: ACCI Submission*, July 2006, pp. 243-8.

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5.3 The effect of wage rises on disposable income

The Australian Council of Social Service (ACOSS) quotes both Australian Bureau of Statistics (ABS) data and National Centre for Social and Economic Modelling (NATSEM) analysis to support arguments relating to moderate increased inequality in disposable income:

Since the mid 1980s, income inequality among households has increased modestly in Australia, though the rate of increase may have slowed in recent years. This modest rise in inequality is the result of two forces pushing in opposite directions - substantially greater inequality in market incomes (jobs and wages) and greater effort by Governments to reduce it.

According to the ABS household income surveys, between 1994 and 2003, household disposable incomes have increased by:

- 8.5% at the tenth percentile (top of the bottom 10% of all households)
- 13.7% at the 50th percentile (median) household
- 14.9% at the 90th percentile (bottom of the top 10%).

According to analysis by NATSEM of ABS Household Expenditure Surveys, income inequality had already increased between the mid 1980s and mid 1990s.⁴

A number of submissions argue that wage increases are not an effective way to increase the disposable income of low-paid workers. Australian Chamber of Commerce and Industry states that:

The less well off do not receive much from increases in minimum wages. They receive most of their income from government payments, and the effective tax rates on wages mean they can lose a significant amount of their extra wages.⁵

The Australian Council of Trade Unions (ACTU) points out that:

The worst case EMTR scenario...involves the minimum wages earner who, on receiving a minimum wages increase, loses [sic] 30 cent[s] in the dollar to tax, 4 cents in the dollar to [the] withdrawal of the Low Income Tax Offset and whose partner loses [sic] 60 cents to Parenting Payment (Partnered) withdrawal.⁶

The ACTU notes, however, that the number of wage earners in this particular situation, facing high EMTRs, is relatively small.⁷

Modelling undertaken for the Commission by NATSEM confirms that most low-income earners face relatively low EMTRs⁸ and would therefore retain most of any pay rise.

Figure 5.1 shows that the average EMTR experienced by low-paid employees (defined as those earning less than \$15.50 per hour – around 1.9 million employees) is around 30 per cent. On average, such an employee would retain around 70 per cent of any pay rise.

⁴ ACOSS, *Submission to the Fair Pay Commission on Minimum Wages 2006*, July 2006, p. 15.

⁵ ACCI, *2006 Minimum Wage Review: ACCI Submission*, July 2006, p. 241, para. 9.97.

⁶ ACTU, *Australian Council of Trade Unions Submission to the Australian Fair Pay Commission*, July 2006, p. 83.

⁷ ACTU, 2006, p. 83.

⁸ A Harding, A Payne, Q Ngu Vu & R Percival, *Interactions between wages and the tax/transfer system*, National Centre for Social and Economic Modelling, report commissioned by AFPC, 2006. In this report, the researchers use the term 'effective tax rate' (ETR) in preference to the more commonly used 'effective marginal tax rate' (EMTR). For consistency with our previous discussion, we continue to use the term EMTR.

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For example, a pay increase of 39 cents per hour results in an average increase in earnings of around \$14 per week. After income tax and reductions in income-tested transfer payments, a low-paid employee would receive on average an increase in disposable income of around \$10 per week. This results in an average EMTR of 30 per cent.

Figure 5.1: Average effect of various increases in hourly pay for Australian employees earning less than \$15.50 per hour

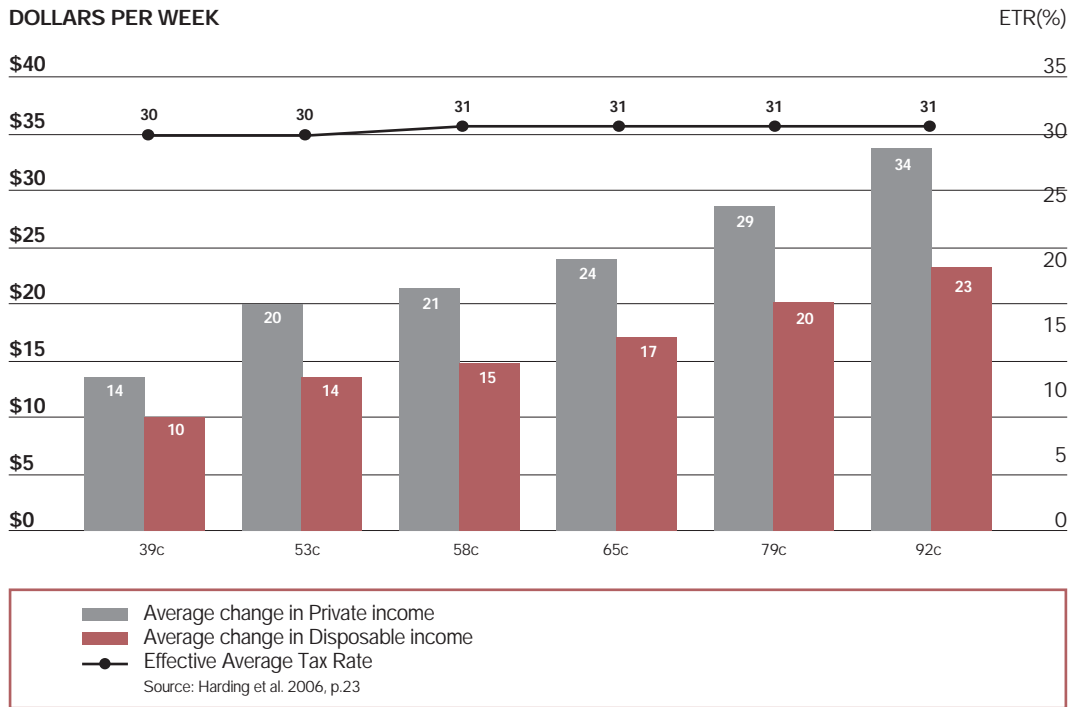


Figure 5.1 also shows that the average EMTR remains approximately 30 per cent across the range of modelled increases from 39 cents per hour to 92 cents per hour, implying that the disposable incomes of low-paid employees will rise by 70 cents in the dollar on average for a wide range of possible wage rises.

While the average EMTR remains around 30 per cent, 90 per cent of low-wage workers have an EMTR of less than 50 per cent. The remaining 200,000 low-wage workers face EMTRs of at least 50 per cent. Of these, about 50,000 (2.5 per cent of all low-paid employees) have EMTRs of 70 per cent or more.

5.4 Approaches to the safety net

5.4.1 What is a fair wage?

Fairness is a consistent theme in submissions to the Commission and in the public consultations. Fairness is seen to embody attributes of:

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- adequacy (ability to enjoy a reasonable or 'decent' standard of living);
- equity (relativity with higher-paid workers); and
- incentive (gap between in-work and out-of-work disposable income).

5.4.2 Adequacy

Submissions from community organisations consistently argue that many people currently reliant on minimum wages suffer financial hardship, which would be exacerbated if the minimum wage (or the combination of minimum wage and income transfers) did not to keep pace with increases in the cost of living.

While the majority of submissions accept that wages can no longer be based on the needs of an entire family, a minority argue in favour of a family-based minimum wage⁹ Others point out that wages are insufficient to enable some workers to support their families and also present evidence comparing wages with total household expenditures.¹⁰

The income support and family assistance safety net, and its continued improvement over recent years, allows people with family responsibilities to rely solely on a single wage to support their families. This means that they are able to compete for jobs on a more equal footing with people who do not have such additional responsibilities.

While many submissions indicate that current arrangements do not always provide an adequate income, there is little consensus as to an appropriate benchmark of adequacy. There is general agreement that minimum wages should, in combination with cash transfers, provide an income 'well above poverty'. The Commission's modelling shows that this is indeed the case, for a variety of family types and commonly used definitions of poverty.

Table 5.2: Comparison of Henderson Poverty Lines with disposable income of income units earning varying proportions of Federal Minimum Wage (FMW), July 2006

Family type	Henderson poverty line (HPL)	DISPOSABLE INCOME (DI)			DI AS PROPORTION OF HPL		
		50% FMW	100% FMW	150% FMW	50% FMW	100% FMW	150% FMW
Single adult, no children	330.77	358.10	432.63	588.85	1.08	1.31	1.78
Single parent, one child	424.65	516.80	630.02	778.97	1.22	1.48	1.83
Single parent, two children	513.99	599.61	712.83	862.57	1.17	1.39	1.68
Single earner couple, no children	442.48	525.21	590.54	629.60	1.19	1.33	1.42
Single earner couple, one child	531.89	647.12	732.64	778.97	1.22	1.38	1.46
Single earner couple, two children	621.29	729.93	815.46	862.57	1.17	1.31	1.39
Dual earner couple, no children	505.04	nm	629.76	705.44	nm	1.25	1.40
Dual earner couple, one child	594.45	nm	736.01	825.40	nm	1.24	1.39
Dual earner couple, two children	683.85	nm	818.82	909.00	nm	1.20	1.33

Notes:

Henderson poverty lines as at March 2006 (Melbourne Institute of Applied Economic and Social Research 2006), including housing costs and 'cost of work' component of \$62.56 pw for each person in workforce. Federal minimum wage (FMW) = \$484.40 pw. Tax and transfer parameters as at July 2006. Children aged 8-12. Households paying sufficient private rent to receive maximum rent assistance, where applicable. Singles on 50% FMW and couples on 50% and 100% FMW eligible to receive Newstart Allowance. Dual earner examples assume income split 67:33. nm, not modelled.

⁹ e.g. ACCER, *Minimum Wage Review 2006 Submission by the Australian Catholic Council of Employee Relations*, 28 July 2006, pp. 18-22; Anglican Church of Tasmania, *Submission by the Bishop of Tasmania to the Australian Fair Pay Commission*, 27 July 2006, p. 2.

¹⁰ e.g. Uniting Church of Australia, *Submission*, 27 July 2006, p. 2; SDA Qld, *Australian Fair Pay Commission Minimum Wage Submission*, July 2006, pp. 10-11.

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Analysis of government benefits and wages policies by the Organisation for Economic Co-operation and Development (OECD) confirms that the combination of minimum wages and income transfers in Australia provides a higher level of protection for low-paid workers and their families from poverty than in other countries surveyed. This analysis finds that:

- full-time minimum wage households in Australia had higher disposable incomes relative to a poverty line based on 60 per cent of median household income than in any of 14 other countries surveyed; and
- the amount of income that income support recipients with children need to earn to reach such a poverty line is less in Australia than in other countries surveyed.¹¹

5.4.3 Equity with other wage earners

Another common theme in submissions is that low-wage earners should not be allowed to fall too far behind other Australians in their standard of living or their capacity to participate in the community. This was often interpreted as requiring a wage increase “in line with general wage movements”¹² or that it is appropriate that “in good economic times award dependent workers should receive real increases in their wages”.¹³

The Australian Government’s modelling has shown that, once tax liabilities and cash transfers are taken into account, minimum wage earners with families have disposable incomes much closer to those of equivalent families on median wages that would be possible if they were entirely dependent on their wage. For example, the median full-time wage is 74 per cent higher than the standard FMW, yet a median earner couple with two children typically has a disposable income no more than 15 per cent higher than a similar family on the standard FMW.¹⁴

This example illustrates how the broader tax/transfer system exerts an equalising effect on the disposable incomes of wage-earners, an effect which has probably become more significant over time as the coverage of the tax/transfer taper has extended further up the income distribution. Indeed, as ACOSS points out, growing inequality in the distribution of market incomes across Australian households has been effectively neutralised by the tax/transfer system over the last decade.¹⁵

5.4.4 Incentive to work

There is general agreement across all the submissions that minimum wages should provide sufficient financial incentive for unemployed people to take up paid work. Some community organisations also express concern that EMTRs (especially for people already working part-time) could deter some people from moving into low-paid full-time work or that the costs of work might be so large as to extinguish the likely financial gains.¹⁶

The Australian Government argues that a simple comparison of disposable incomes in and out-of-work is sufficient to demonstrate that there is adequate incentive for unemployed people to take a low-paid job.¹⁷ In all cases modelled by the Australian Government, a low-paid job paying \$530 per week delivers an increase in disposable income of at least \$170 per week compared with being unemployed and, in some cases, considerably more.

¹¹ OECD, *Benefits and Wages: OECD Indicators*, OECD, 2004, pp. 86-89.

¹² ACOSS, 2006, p. 1; SACOSS, 2006, p. 2.

¹³ ACCER, 2006, p. 29.

¹⁴ Australian Government, 2006, p. 113, Appendix A6.

¹⁵ ACOSS, 2006, p. 2.

¹⁶ ACOSS, 2006, p. 42; Caxton Legal Centre, *Fair Pay Commission Review of Minimum Wages*, July 2006, p. 12; Women’s Electoral Lobby Australia and National Pay Equity Coalition, *Submission to the Australian Fair Pay Commission*, 2006, p. 8.

¹⁷ Australian Government, 2006, pp. 126-9.

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The Commission is persuaded that there is sufficient incentive for a person to move from unemployment to a low-paid full-time job, especially if the costs associated with working are not large.

The incentives for lower-paid employees in part-time work to move to full-time work are not as strong. However, this is essentially the consequence of changes that have been made over time to income tests in order to improve the attractiveness of part-time work. The trade-off for these improvements has been some diminution in the relative incentive once in part-time work to take the further step of moving to full-time work.

In having regard to the role minimum wages play in providing a safety net for the low paid, the Commission has been mindful of different definitions of low pay, the support provided to low-paid workers by the tax/transfer system and the fact that low-paid workers can be found in high as well as low-income households.

