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Wage-setting decision

This is the first wage-setting decision of the Australian Fair Pay Commission (Commission).

The Commission is created by s. 20 of the *Workplace Relations Act 1996*, as amended by the *Workplace Relations Amendment (Work Choices) Act 2005* (WR Act).

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 legislation 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 for 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.

These criteria have guided the Commission in making its first wage-setting decision.

The Commission sought information from a range of sources in making its decision. It consulted widely with key stakeholders and received submissions from a broad range of representative organisations with an interest in the setting of minimum wages in Australia. Public consultations enabled ordinary Australians, particularly those most affected by minimum wage decisions, to place their views before the Commission. In addition, commissioned research added to the Commission's base of specialist knowledge.

The Commission's first wage-setting decision has three elements:

- an **increase** of \$27.36 per week in the standard Federal Minimum Wage;
- an **increase** of \$27.36 per week in all Pay Scales up to and including \$700 per week¹; and
- an **increase** of \$22.04 per week in all Pay Scales above \$700 per week².

These increases flow on to junior employees, employees to whom training arrangements apply and employees with disabilities. They all take effect from **1 December 2006**.

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

¹ \$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.

² \$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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Promoting economic prosperity

The Commission 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.

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 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.

The Commission has weighed a number of factors in determining how much to increase the standard FMW on this occasion; how this increase should be expressed; and the extent to which it should apply to other workers on preserved Pay Scales.

The Commission has taken into account:

- 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 pressure (and its effect on interest rates); and
- the requirement to provide a safety net for the low paid.

While the Commission's decision increases the standard FMW and preserved Pay Scales, the increase is higher for lower-paid workers than for higher-paid workers. This difference recognises that lower-paid workers are more reliant on minimum wages than higher-paid workers.

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Characteristics of the low paid

In determining the level of minimum wages, the Commission considers the impact of its determination for the capacity of low-paid Australians to remain in employment and for the unemployed to find a job.

The evidence on low pay in submissions and in the research findings reflects a variety of opinions and approaches as to how best to define the low paid. Research 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.³

Lower paid workers 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.

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 Scale reliant.

Capacity of the unemployed and the low paid to obtain and remain in employment

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. Most of the submissions recommend that the Commission should award a 'moderate' increase.

The impact of minimum wage increases is difficult to estimate. This is because in most countries, only a small proportion of the workforce is subject to the minimum wage.

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 relevant to Australia, given the unique structure of our minimum wage system. Compared with other OECD countries:

- Australia's minimum wage system prescribes not only minimum wages but other 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).

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

³ J Healy & S Richardson, *An Updated Profile of The Minimum Wage Workforce in Australia*, National Institute of Labour Studies, report commissioned by AFPC, 2006, pp. 9-10.

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Many submissions address the issue of the extent to which low-paid employees experience upward mobility in their level of earnings. The discussion suggests that some people progress from low-paid jobs to higher-paid jobs while others do not, while a significant minority cycle between non-employment and low-paid work.

Ultimately, there may be little scope for wages policies to influence the extent of upward earnings mobility. 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.

Assessing how the level of minimum wages affects the capacity of the unemployed and low paid to obtain and remain in employment involves labour supply as well as labour demand considerations.

People's workforce decisions reflect a 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.

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 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.

The Australian social security system supports low-income workers and their families through a variety of programs such as income support and family assistance and benefits. These payments are means tested and, consequently, recipients can be faced with high 'effective marginal tax rates' (EMTRs) when their payments decline as a result of income received through employment.

While people would normally be considered to have an incentive to work if they were better off financially after taking 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).

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.

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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.

Employment and competitiveness across the economy

The Commission is required to have regard to employment and competitiveness across the economy.

Conditions in the Australian labour market remain positive. 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.

Aggregate wages growth has been solid recently, an outcome that is consistent with strong labour market conditions. Growth in total labour costs is expected to remain firm over the next year.

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 the RBA's target band.

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

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

In recent years, Australia's productivity growth has outperformed all other advanced OECD countries except Ireland and was ranked twelfth out of thirty countries overall.

While stronger productivity growth is encouraging, 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 level.

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

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Some submissions to the Commission highlighted differences in industries and occupations. Much of the industry analysis provided presents different data to show that award reliant industries performed better or worse than other industries in response to safety net adjustments.

The industries with significant proportions of employees on Pay Scales were Accommodation, cafes and restaurants (43.2 per cent), Retail (20.9 per cent) and Property and business services (14.5 per cent).⁴

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.

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.

A number of submissions ask the Commission to take into account regional differences. 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.

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.

A number of submissions contend that minimum wage rises can limit enterprise bargaining by removing the incentive for employees to bargain. They argue that a minimum wage rise may reduce the capacity of businesses to pay a wage premium over competitors, reducing their ability to use higher wages to reduce turnover or increase efficiency.

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.

⁴ 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, state and territory) 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 federal minimum wage; in Vic, the NT or the ACT who work for non-incorporated businesses and are on awards; and in Vic, the NT or the ACT who work for non-incorporated businesses, are not on awards, and earn at or below the federal minimum wage. This allows for an estimation of those award reliant employees who would now fall within the federal jurisdiction.

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Providing a safety net for the low paid

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 that safety net must take account of the contribution that income transfers make to disposable income.

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.

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 the Commission should take these into account in its wage-setting decision.⁵

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.

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

There is general agreement across all submissions that minimum wages should provide sufficient financial incentive for unemployed people to take up paid work. Some community organisations also express a concern that EMTRs (especially for people already working part-time) could deter some people from moving into low-paid full-time work⁶ or that the costs of work might be so large as to extinguish the likely financial gains.⁷

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.

5 Australian Industry Group, (AIG) pp 27-42, 80; Australian Chamber of Commerce and Industry (ACCI), 2006, pp 243-248.

6 ACOSS, 2006, p 42.

7 Caxton Legal Centre, 2006, p 12; ACOSS, 2006, p 42; Women's Electoral Lobby Australia and National Pay Equity Coalition, 2006, p 8.

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Junior employees, employees to whom training arrangements apply and employees with a disability

There is a broad consensus in submissions that the Commission exercise caution in implementing changes to the current structure of junior wage arrangements.

The Commission is aware that junior wage arrangements present some complex issues and will initiate a wage review in early 2007 on junior wage arrangements to gather further information on these issues.

There is also a broad consensus in submissions regarding the need to retain concessionary wage rates for apprentices and trainees. The submissions vary in the approach recommended towards the setting of a special FMW for this group.

The Commission considered whether there should be a new Pay Scale that applies to all, or a class of, employees to whom training arrangements apply, including in relation to the issues raised in submissions such as gaps in part-time apprenticeship arrangements, competency-based provisions, and adult apprenticeship Pay Scales.

Given the complexity of the issues and divergent views amongst those that would be affected by change, the Commission has decided that establishment of new Pay Scales at this stage would be premature and may have unforeseen consequences.

The Commission will initiate a wage review in 2007 of Pay Scales for employees to whom training arrangements apply to inform itself more fully on these issues.

The Commission's decision in relation to the adjustment of minimum wages for employees with a disability⁸ fills the gaps in coverage discussed in submissions and is based upon a general consensus of key stakeholders.

The Commission will establish a new special FMW - equal to the standard FMW - for employees with a disability as defined by the legislation who are able to earn full adult, junior or trainee wages as the effects of their disability do not impair their productive capacity.

This will be a default statutory minimum for employees with a disability as defined by the legislation. This special FMW will not apply to workers with a disability who are juniors, covered by training arrangements or who are otherwise covered by a Pay Scale or other special FMW.

The Commission will establish a new special Pay Scale that extends coverage of the Supported Wage System (SWS) pro rata wages to preserved Pay Scales that do not currently provide for pro rata wage arrangements.

Coverage will be limited to those employees working in open employment who would otherwise be covered by Pay Scales that do not provide for the SWS arrangements. Specifically, the special Pay Scale will cover employees with a disability who are unable to perform the range of duties to the competence level required within the class of work

⁸ Employees with a disability are defined in Section 8

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for which they are engaged because of the effects of their disability on their productive capacity and who:

- work in open employment;
- are covered by a preserved Pay Scale; and
- are not otherwise covered by a SWS Pay Scale.

The supported wage minimum weekly payment for the new special FMW and the new special Pay Scale will be \$64.00 per week. Where preserved Pay Scales specify a supported wage minimum weekly payment, this will be increased to \$64.00 per week.

The Commission will establish a new special Pay Scale under s. 220 of the WR Act that provides pro rata wages to employees with a disability employed in the business services sector and who are not otherwise covered by preserved Pay Scales.

The Commission will consult further with key stakeholders regarding the future operation of arrangements for employees with a disability.

Casual loadings and piece rates

Given the level of diversity and complexity of the current casual loadings provided for in the Pay Scales, the Commission has decided that further consideration of any casual loading adjustments should be undertaken in the context of the rationalisation of the wages and classification structures.

The Commission will not make any adjustments to the casual loadings expressed as a percentage contained in preserved Pay Scales or the default casual loading at this time

The majority of submissions do not address the issue of piece rates and piece workers. The Commission would prefer to distinguish between piece rates and incentive based payments.

As part of its future inquiries, the Commission will further consider the option of new basic piece rate Pay Scales.

Discrimination

The Commission received a number of submissions dealing with discrimination matters, focussed mainly on the following vulnerable groups of employees (vulnerable groups):

- female employees;
- employees with disabilities;
- people from culturally and linguistically diverse (CALD) backgrounds; and
- indigenous Australians.

Submissions identify a range of contributory factors to gender pay inequity; however, submissions differ with regard to the approach the Commission should adopt.

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Submissions argue strongly that women are over-represented among the low paid. A number of submissions argue that employees with a disability, workers from CALD backgrounds and Indigenous Australians are also disproportionately represented among the low paid.

The Commission places considerable emphasis on who the low paid are and the importance of its decision for all low-paid Australians. The Commission recognises that vulnerable groups are over-represented among the low paid.

Future directions

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

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

Award Review Taskforce

The Commission was presented with a copy of the *Award Review Taskforce Final Report on Rationalisation of Wage and Classification Structures, July 2006* (Report) on 1 September 2006.

The three major issues identified are:

- definitional issues, where award classifications were unclear or uncertain;
- wage diversity in basic rates of pay and casual loadings; and
- transitional issues, regarding access to and identification of wages drawn from pre-reform wage instruments now forming the preserved Pay Scales.

The Commission's decision has regard to the Task Force's recommendations regarding the rationalisation of wage and classification structures. In particular, the Commission's decision gives effect to Recommendation 10 in relation to employees with a disability through the creation of new special Pay Scales and new special FMW that fill gaps in coverage.

The Commission intends to undertake further research and consultations regarding the recommendations of the Award Review Taskforce and will commence this in 2007.

Research

A number of submissions suggested topics for further research and/or analysis. These proposals are summarised in Appendix F.

The Secretariat will undertake further consultation with stakeholders and seek advice on priority areas of research to assist the Commission in future wage-setting decisions.