

Section 3 3. Employment and competitiveness across the economy

The Australian economy performed strongly over the past year, recording solid growth in economic activity and employment. Wage pressures have generally been contained to date. However, inflation accelerated through 2007, prompting the Australian Government and the Reserve Bank of Australia (RBA) to act to restrain aggregate demand.

3.1. Employment

The labour market performed solidly over the year to May 2008 (see Table 3.1):

- total employment increased by 2.2 per cent, with full-time and part-time employment increasing by 1.6 per cent and 3.7 per cent, respectively;
- the participation rate increased slightly, to 65.2 per cent of the working-age population;
- the employment-to-population ratio increased by 0.3 percentage points; and
- the unemployment rate remained at 4.3 per cent.

Unemployment fell in most states and territories, with the exception of Queensland and Western Australia which already had comparatively low unemployment rates, and South Australia.

The improvement in labour market performance has been relatively uniform throughout Australia's regions, with the majority of small area labour markets recording unemployment rates below 5 per cent.⁴⁶

Table 3.1: Labour market developments by State/Territory, year to May 2008

	Employment growth	Unemployment Rate		Participation Rate	
	Percentage change	Per cent	Percentage point change	Per cent	Percentage point change
NSW	2.0	4.7	-0.1	63.7	0.4
Vic	1.9	4.3	-0.4	64.8	-0.2
Qld	2.4	3.8	0.4	67.2	0.1
SA	2.1	5.0	0.4	63.0	0.8
WA	2.3	3.7	0.5	68.1	0.1
Tas	3.9	4.4	-0.1	61.7	1.7
NT	4.8	3.6	-1.0	72.3	0.7
ACT	2.5	2.7	-0.3	73.1	0.0
Australia	2.2	4.3	0.0	65.2	0.2

Note: Data are seasonally adjusted, except for NT and ACT, where trend estimates are shown.
Source: ABS, *Labour Force, Australia, May 2008*, Catalogue No. 6202.0, Canberra, ABS, 2008.

Broader measures of labour underutilisation also point to an improvement in labour market performance. One such estimate declined from 9.9 per cent in late 2004 to 7.9 per cent in early 2008.⁴⁷

⁴⁶ AFPC, *Economic and Social Indicators – Monitoring Report*, Issue 01, Commonwealth of Australia, July to December 2007, p. 9.

⁴⁷ Centre of Full Employment and Equity, *CoFEE Labour Market Indicators*, Newcastle, February quarter 2008.

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In the short-term, the level of demand for labour remains high, as reflected in job vacancy rates across a broad range of occupations and skill levels.⁴⁸ Businesses have indicated that the availability of labour is one of the more significant constraints they face.⁴⁹

3.2. Wage growth

Assessments of the underlying trends in labour costs vary in submissions to the 2008 Minimum Wage Review. Some consider that wage growth has been generally steady, while others are concerned by a gradual acceleration in wages since early 2007.

Most submissions regard the Wage Price Index (WPI) as the most accurate measure of underlying wage growth.⁵⁰ The WPI increased by 4.1 per cent over the year to March 2008, similar to the annual rates recorded over the previous two years.⁵¹ Higher wage growth appears to have been contained to those segments of the economy with skill shortages or already low unemployment rates.⁵²

Wage growth in collective agreements reached in each quarter over the past three years has been steady. The most recent data indicate that the average annualised wage increase (AAWI) in all wage agreements current in the December quarter 2007 was 4.0 per cent, while the AAWI for new agreements was 3.8 per cent.⁵³

Businesses expect labour costs to increase, and identify wage growth as a significant impediment to further employment.⁵⁴ Employer groups and governments are also concerned about wage growth increasing if the labour market remains tight. Wage growth has generally been highest in Western Australia and Queensland, where unemployment rates are lowest. Therefore, there is an expectation that economy-wide wage growth may increase if unemployment rates in other states were to decline.⁵⁵

3.3. Competitiveness

Wages are one factor affecting the competitiveness of businesses and industries. Other relevant factors include productivity and business profitability. Higher productivity enables businesses to better confront competition and support increased wages, while a healthy level of profitability enables businesses to be more resilient to adverse economic conditions.

Many submissions highlight that productivity growth rates have slowed since the late 1990s. While the data can be volatile and there are wide variations between industries,

⁴⁸ DEEWR, *Vacancy Report*, May 2008, <<http://www.workplace.gov.au/workplace/Publications/LabourMarketAnalysis/VacancyReports/>> at 3 June 2008.

⁴⁹ TNS Social Research, *Report on Public Consultations for the Australian Fair Pay Commission's 2008 Minimum Wage Review*, report commissioned by AFPC, 2008, p. 38; National Australia Bank, *Quarterly Business Survey 2008*, March Quarter 2008, p. 9, <http://www.nab.com.au/Business_Solutions/0,,93755,00.html> at 28 May 2008; and ACCI and Westpac Banking Corporation, *ACCI-Westpac Survey of Industrial Trends*, March Quarter 2008, <http://www.acci.asn.au/text_files/surveys/Westpac_Survey/2008/MarchACCI2008.pdf> at 28 May 2008.

⁵⁰ For example, ACTU, *Australian Council of Trade Unions Submission to the Australian Fair Pay Commission*, March 2008, p. 37; and ACCI, *2008 Minimum Wage Review: ACCI Submission*, March 2008, p. 58, para. 2.94.

⁵¹ ABS, *Labour Price Index, Australia*, Catalogue No. 6345.0, Canberra, March 2008.

⁵² Australian Government, *Submission to the Australian Fair Pay Commission Minimum Wage Review 2008*, 14 March 2008, p. 6, para. 2.7.

⁵³ DEEWR, *Trends in Federal Enterprise Bargaining*, December Quarter 2007, <<http://www.workplace.gov.au/workplace/Publications/ResearchStats/Agreement/TrendsInFederalEnterpriseBargaining.htm>>, at 6 June 2008.

⁵⁴ ACCI, March 2008, pp. 58-59, paras. 2.95-2.96.

⁵⁵ Further analysis of this issue is contained in S Kennedy, *Full Employment in Australia and the Implications for Policy*, speech to the NSW Economic Society, 11 December 2007, <<http://www.treasury.gov.au/documents/1328/PDF/Address%20by%20Steven%20Kennedy%20to%20the%20NSW%20Economic%20Society.pdf>> at 29 April 2008.

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this trend appears to be borne out by evidence.⁵⁶ Slower productivity growth, combined with a steady rate of wage growth, will result in higher growth in unit labour costs and potentially higher inflation.

In year-average terms, real gross domestic product (GDP) per hour worked in the market sector increased by 2.0 per cent in the year to March 2008. Slow productivity growth may be consistent with the view, expressed by the Australian Chamber of Commerce and Industry (ACCI), that 'capacity constraints are being reached'.⁵⁷ However, an alternative view is that productivity growth in 2007 was held down by a fall in farm GDP, while productivity growth in the non-farm economy may have 'picked up to a more normal pace'.⁵⁸

Another set of indicators of competitiveness relates to business profitability. While there is considerable diversity among businesses, aggregate profit remained solid in recent years:

- the profit share of total factor income rose to a historic high of 27 per cent in March 2008;⁵⁹
- company gross operating profit increased by 7 per cent over the year to March 2008;⁶⁰ and
- gross profit margins on sales increased steadily over the five years to 2005-06, with average margins for all industries during this period between 8 and 11 per cent.⁶¹

Business surveys and submissions from employer groups suggest that business profitability has declined recently.⁶² On the available data, any such decline would be occurring from what appear to be relatively high rates of profitability in most industries on average.

3.4. Industry conditions

Industries with the largest proportion of Pay Scale reliant employees (Pay Scale reliant industries) performed generally well in 2007.⁶³ Output and employment in these industries appear to have grown at a steady rate relative to other industries since 2003.⁶⁴

There are, however, variations across and within industries. Over the past three years, for example, aggregate employment grew at a moderate but steady rate, while employment growth in Pay Scale reliant industries was more volatile.⁶⁵ Estimates of job vacancies are at record levels for all industries.

Recent data indicate that wage growth has been firm across most industries. However, there are some variations around the aggregate trend, with some Pay Scale reliant industries experiencing high rates of wage growth and others recording slower growth.

⁵⁶ AFPC, July to December 2007, p. 11; and Ai Group, *2008 Minimum Wage Review: Submission to the Australian Fair Pay Commission*, March 2008, pp. 19-21, paras. 68-74.

⁵⁷ ACCI, March 2008, p. 61, para. 2.100.

⁵⁸ ACTU, March 2008, p. 86, para. 7.24.

⁵⁹ ABS, *Australian National Accounts: National Income, Expenditure and Product*, March 2008, Catalogue No. 5206.0, Canberra, 2008.

⁶⁰ ABS, Catalogue No. 5206.0, 2008.

⁶¹ ABS, *Australia Industry, 2005-06*, Catalogue No. 8155.0, Canberra, 2007.

⁶² ACCI, March 2008, p. 46, para. 2.59.

⁶³ The Commission estimates that around 70 per cent of Pay Scale reliant employees are employed in Retail trade, Property and business services, Accommodation, cafes and restaurants, or Health and community services. For a more detailed breakdown of Pay Scale reliance by industry, see Table 1.7 in AFPC, *Wage-Setting Decisions and Reasons for Decisions*, Commonwealth of Australia, July 2007, p. 62.

⁶⁴ AFPC, July to December 2007, pp. 19 and 22.

⁶⁵ AFPC, July to December 2007, p. 20.

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For example, wage growth in Retail trade (as measured by the WPI) appears to have accelerated to 4.5 per cent over the year to the March quarter 2008. The increase in minimum wages which came into effect in the December quarter of 2007 is unlikely to have been a significant driver of this increase, as other Pay Scale reliant industries simultaneously recorded more modest and stable growth in wages.⁶⁶

Econtech forecasts that conditions in industries most affected by the Commission's decisions will be moderate in 2008-09.⁶⁷ In particular, output growth is expected to slow markedly in 2008-09 for Manufacturing, Personal and other services, and Retail trade, and is predicted to remain weak in Accommodation, cafes and restaurants. Employment is expected to decline slightly in 2008-09 in Accommodation, cafes and restaurants, Health and community services and Manufacturing, while employment growth is expected to moderate in most other Pay Scale reliant industries.

The Commission will continue to monitor the effects of minimum wages on particular industries, since minimum wages are one factor of a number which can influence changes in employment in a given industry. As part of this monitoring, the Commission will undertake a series of detailed industry profiles. At this stage, research is underway into the Retail trade, Health and community services, and Accommodation, cafes and restaurants industries.

3.5. Economic outlook and macroeconomic policy

Most submissions acknowledge the solid performance of the economy. However, views expressed on the economic outlook vary across submissions.

The Australian Council of Trade Unions (ACTU) considers that the 'Australian economy continues to be strong with employment continuing to grow with unemployment at historically low levels'.⁶⁸

Both ACCI and Australian Industry Group (Ai Group) emphasise the uncertainty in the economic outlook. They argue that this supports a cautious approach to adjusting minimum wages in the near term. Ai Group identifies two main categories of uncertainty:

The global economy is slowing to an, as yet, uncertain extent while at the same time inflation appears to be moving higher in most of the developed economies.⁶⁹

and

Domestically, inflation has accelerated and there is significant uncertainty around the extent to which the Reserve Bank will need to slow the economy in order to reel in rising inflationary expectations.⁷⁰

The Australian Government updated its view on the economic outlook in May 2008 (see Table 3.2). The Government forecasts that economic activity will slow to a moderate pace, with employment growth slowing quickly over the next year. The unemployment rate is expected to increase to 4¾ per cent by mid 2009.⁷¹

⁶⁶ ABS, *Labour Price Index Australia*, March 2008, Catalogue No. 6345.0, Canberra, 2008.

⁶⁷ Econtech, *Econtech's Australian National, State and Industry Outlook*, 18 April 2008.

⁶⁸ ACTU, *Australian Council of Trade Unions Submission to the Australian Fair Pay Commission*, May 2008, p. 1.

⁶⁹ Ai Group, March 2008, p. 3, para. 2.

⁷⁰ Ai Group, March 2008, p. 12, paras. 35-36.

⁷¹ Commonwealth of Australia, *Budget Paper No. 1: Budget Strategy and Outlook 2008-09*, Canberra, AGPS, 2008, p. 2-6.

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Table 3.2: 2008-09 Budget economic forecasts*

	2007-08 Year average	2008-09 Year average	Four quarters to June 2009
Real GDP	3½	2¾	2¾
Employment	2½	1¼	¾
Unemployment rate (%)	4¼	4½	4¾
Consumer Price Index	4	3½	3¼
Wage Price Index	4¼	4¼	4¼

Note: The Consumer Price Index for 2007-08 is calculated on a through-the-year basis.

* Percentage change on preceding year unless otherwise indicated.

Source: Commonwealth of Australia, *Budget Paper No. 1: Budget Strategy and Outlook 2008-09*, Canberra, AGPS, 2008, p. 1-3 and 2-6.

The headline Consumer Price Index (CPI) demonstrated some volatility over the past eighteen months, ranging from a year-ended increase of 1.9 per cent in the September quarter 2007 to 4.2 per cent in the March quarter 2008. The RBA's measures of underlying consumer price inflation discount extreme changes in prices. Even so, this measure increased by an average of 4.3 per cent over the year to the March quarter 2008, which was well above the RBA's medium-term inflation target band of 2 to 3 per cent per annum.

The RBA forecasts that the inflation rate will peak at 4½ per cent through the year to December 2008, before declining to 3¼ per cent by December 2009.⁷² By comparison, the Australian Government considers that inflation will have peaked in the March quarter 2008, before steadily declining.

The RBA has been acting to slow the rate of growth in aggregate demand. In its view:

...there is now evidence that demand growth has slowed, but it will take time for this to have a substantial impact on inflation.⁷³

However, both the RBA and the Australian Government highlight the opposing influences on future growth and inflation, and the uncertainty that remains. On the one hand, slower global growth and tighter credit conditions are expected to reduce domestic activity, while on the other hand, large rises in Australia's terms of trade will boost national income.⁷⁴ The RBA is also concerned that:

...the persistence of inflation at relatively high rates for some time could result in inflation expectations becoming entrenched at higher than acceptable levels, which could feed back into wage- and price-setting behaviour.⁷⁵

The Australian Government warns that:

In the current tight labour market, employers are more likely to agree to wage rises in excess of the relative increase in minimum wages in order to attract labour. In other words, a higher minimum wage increase is likely to encourage higher wage outcomes in workplace bargaining negotiations.⁷⁶

⁷² RBA, *Statement on Monetary Policy*, 9 May 2008, p. 68, <<http://www.rba.gov.au/PublicationsAndResearch/StatementsOnMonetaryPolicy/index.html>> at 12 May 2008.

⁷³ RBA, *May 2008*, p. 67.

⁷⁴ Commonwealth of Australia, 2008, p. 2-3; and RBA, *May 2008*, p. 68.

⁷⁵ RBA, *May 2008*, p. 68.

⁷⁶ Australian Government, 14 March 2008, p. 9, para. 2.17.

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It suggests that this risk is particularly high at present, with almost half of all federally registered collective agreements due to expire in 2008.⁷⁷

Submissions agree on the objective of lowering price inflation. For example, ACCI notes the adverse effects of high inflation:

Higher interest rates slowing demand growth and the economy in response to inflation would mean that unemployment may be higher than it otherwise would be...Higher inflation through the economy also means that interest rates will be higher than they otherwise may be and that economic growth will be slowed in turn...The fact that the economy has low unemployment relative to the recent past makes the inflationary dangers from wages even greater.⁷⁸

Focus group research for the Commission has also found a greater awareness of the challenges facing the economy at present and the risk of wage push inflation.⁷⁹

The Commission notes that there is general agreement that inflation will decline over the period to October 2009. However, there is disagreement over when and at what level inflation will peak. The Commission has taken into account the range of estimates and the uncertainty surrounding the outlook for inflation in making its Decision.

The Commission acknowledges that minimum wage increases may affect wider wage growth in the economy and therefore inflation. However, the extent to which this occurs is influenced by many factors and there is considerable uncertainty over this effect.

Increases in minimum wages add directly to the wages bill of the economy. They could also create a disincentive to agreement making, as well as providing a floor to outcomes negotiated through workplace agreements.

From an inflation and competitiveness perspective, it is desirable for agreement making to be closely based on productivity.

The direct effect of a moderate increase in minimum wages on aggregate inflation is likely to be minor. Wages paid to employees who are directly reliant on the Commission's decision comprise only a small percentage of the economy's total wage bill.

According to the Australian Bureau of Statistics (ABS) Employee Earnings and Hours survey, 19 per cent of (non-farm) employees earned the rate of pay specified in the relevant award or Pay Scale as of May 2006. However, their share of total labour costs is somewhat lower, since on average they earn less than other employees.⁸⁰

The flow-through of growth in labour costs to price inflation will depend upon factors such as the cost structure of firms, employment effects and market competitiveness. The ACTU estimates that a one per cent increase in average earnings (with no productivity adjustments) raises the CPI by 0.54 per cent.⁸¹ Other estimates of this effect vary, but it is reasonable to assume that the effect on inflation is less than the wage growth figure and that it is spread over several years.⁸²

⁷⁷ Australian Government, 14 March 2008, p. 9, para. 2.18.

⁷⁸ ACCI, March 2008, pp. 91-92, paras. 4.9, 4.16 and 4.19.

⁷⁹ TNS Social Research, 2008, p. 36.

⁸⁰ ABS, *Employees Earnings and Hours*, May 2006, Catalogue No. 6306.0, Canberra, 2007. Unpublished estimates from the ABS indicate that at least three quarters of these employees are in the federal jurisdiction. See M Gerrity, 'Jurisdictional Coverage of Pay-Setting Arrangements' in ABS, *Australian Labour Market Statistics*, January 2008, Catalogue No. 6105.0, Canberra, 2008, pp. 11-14 for an explanation of the methodology.

⁸¹ ACTU, March 2008, p. 103.

⁸² A Stone, T Wheatley and L Wilkinson, *A Small Model of the Australian Macroeconomy: An Update*, Reserve Bank of Australia Research Discussion Paper 2005-11, 2005, p. 26.

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There can also be indirect effects from minimum wage adjustments, as they flow on (in one form or another) from minimum wage decisions to wages set under other instruments. However, the available evidence on the size of these effects is limited.

The Australian Government provides data on the extent of a flow on of minimum wage adjustments to wage outcomes under collective agreements, drawing on its census database of federal certified collective agreements. These data suggest that the strict flow on is very limited, while the potential flow on is imprecise:

According to the Department of Education, Employment and Workplace Relations' Workplace Agreements Database, 11 per cent of collective agreements, covering less than 4 per cent of employees in the federal workplace relations system, automatically flow on the Commission's decision. An additional 22 per cent of current collective agreements, covering a further 11 per cent of federal system employees are linked in some form to the Commission's minimum wage outcomes, however, conditions and/or qualifications of some type apply.⁸³

ACCI provides an estimate of the flow-on effects to wages under other forms of agreements, based on assumptions regarding how many workers are earning close to the rate of pay specified in the relevant award or Pay Scale. ACCI estimates that there are indirect flow-on effects to a further 2.3 per cent of employed persons, although it notes that it is difficult to estimate these effects.⁸⁴

The extent of further informal flow-ons from the Commission's decisions to wages determined under collective agreements, through the setting of claims and expectations, is also uncertain. Regarding these effects, the Australian Government cautions that:

In the current tight labour market, employers are more likely to agree to wage rises in excess of the relative increase in minimum wages in order to attract labour. In other words, a higher minimum wage increase is likely to encourage higher wage outcomes in workplace bargaining negotiations.⁸⁵

Recent wage increases for employees covered by federal enterprise agreements have been broadly in line with increases in the standard Federal Minimum Wage.

Including both direct and indirect effects, and considering historical wage price relationships, the Commission estimates that the 2008 minimum wage adjustment may increase prices by up to 0.4 per cent over the medium-term.

The Australian Government indicates that addressing inflation is its most significant policy challenge.⁸⁶ A broad range of strategies is being pursued to this end, including measures to moderate demand through the budget, foster greater competition in particular markets, and relieve capacity constraints.

Employment growth is expected to slow in the foreseeable future and the unemployment rate is expected to increase slightly. Aggregate wages have been growing at moderate rates to date. However, there are some risks to unit labour costs as a result of slower productivity growth. There is considerable uncertainty in the outlook for inflation and demand growth.

⁸³ Australian Government, 14 March 2008, p. 8, para. 2.16.

⁸⁴ ACCI, *ACCI Minimum Wage Submission – Additional Information*, Attachment A, letter dated 20 May 2008, p. 4.

⁸⁵ Australian Government, 14 March 2008, p. 9, para. 2.17.

⁸⁶ Commonwealth of Australia, *Budget Paper No. 1: Budget Strategy and Outlook 2008-09*, Canberra, AGPS, 2008.

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Given the increased flexibility of the labour market and the diversity of wage setting arrangements, the effect of changes in minimum wages on aggregate wages, prices and employment is somewhat less than it has been historically. However, the current economic environment highlights the importance of measured adjustments to policy settings, including minimum wages. A number of government submissions argue for an increase in minimum wages that is sustainable and predictable.⁸⁷ Such an approach to the adjustment of minimum wages can help to anchor expectations and act as a stabilising influence, both in dampening overly large variations in the economy and addressing a period of increased uncertainty.

On balance, the Commission believes that its general Wage-Setting Decision 2008 to increase minimum wages by \$21.66 per week will have only a minor impact upon aggregate wage and inflation outcomes in the economy as a whole. However, the Commission will continue to monitor the impacts of its Decision closely.

⁸⁷ For example, NSW Government, *Submission to the Australian Fair Pay Commission on behalf of the New South Wales Government*, 18 March 2008, p. 28, para. 87; and Tasmania, Department of Justice, Industrial Relations (Private Sector), *Australian Fair Pay Commission 2008 Minimum Wage Review*, letter dated 4 March 2008.