





## **Australian Fair Pay Commission**

### **Executive Summary**

July 2009

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The Australian Fair Pay Commission (Commission) is responsible for setting minimum rates of pay, with the overarching objective of promoting the economic prosperity of the people of Australia. In undertaking this task, the Commission is required by the *Workplace Relations Act 1996* to 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.

As in previous reviews, the Commission invited submissions to its 2009 Minimum Wage Review to address some or all of these criteria. The criteria also informed the Commission's consultations in each state and territory, and the ongoing research program.

With the economy in transition, these complementary processes and information sources have been particularly valuable, enabling the Commission to analyse the effects of minimum wages from a variety of perspectives.

In its 2008 general Wage-Setting Decision, the Commission was especially cognisant of the financial pressures on low-income households at that time of increasing consumer prices. The Commission therefore placed emphasis on the role minimum wages play in maintaining the safety net for low-paid workers. The Commission considered that the impact of the 2008 Decision on employment and unemployment would be minimal, given the strength of the labour market and employment growth at the time the decision was reached.

Since the 2008 Decision, the economic outlook has changed markedly. Employment growth is slowing, average working hours are falling, and the unemployment rate is expected to rise to 8.5 per cent. As in previous downturns, the impact of these changes in the labour market will be felt most acutely by low-paid, low-skilled workers.

These are challenging times for the Australian labour market, and caution is warranted in the setting of minimum wages. In the current environment, the ability of employers to offer sufficient work has been curtailed and there is a heightened risk that an increase in regulated minimum wages would reduce employment and working hours. One consequence of increased job losses and fewer hours of work would be significantly lower living standards for many Australians.

The Commission recognises that consumer prices continue to increase, putting some pressure on household disposable income. However, the Australian Government's changes to the tax/transfer system and its recent fiscal stimulus packages have provided real increases to disposable income for most households and have thus enabled the safety net to be maintained without the risk of increasing unemployment.



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For most people, an adequate living standard depends on having sufficient paid work. Unemployment is the chief cause of relative poverty and social exclusion in Australia. Economic downturns magnify the consequences of unemployment for low-paid, low-skilled workers, with many remaining jobless for extended periods of time and some leaving the labour market altogether. The social consequences of extended joblessness, especially for families, are considerable and well-known. The Commission considers that its decisions should not exacerbate the risk of unemployment for the most vulnerable groups of workers.

The Commission has therefore decided, following its 2009 Minimum Wage Review, that minimum wages will **remain at their current levels** and not be increased. In making this decision, the Commission has focused on protecting jobs and supporting a stronger recovery in employment as the economy improves.

The Commission notes that the next minimum wage review will be conducted by Fair Work Australia. The Commission considers that, by the next review, the outlook for the economy, and especially the labour market, will be more certain.

### The economic and labour market outlook

The Commission has looked ahead to the period when its decision would come into effect. The economic and labour market environment in 2009–10 will be very different from the environment of the Commission's previous decisions. After the unemployment rate reached a low of 3.9 per cent in early 2008, employment growth slowed rapidly in response to the sharp weakening of the global economy.

While opinions vary, most analysts expect employment to continue to fall through 2009–10, with unemployment rising towards 8.5 per cent of the labour force. In previous downturns, the increases in unemployment have taken many years to reverse, and the Australian Government now projects that unemployment will not return to current levels for approximately six years.

The scarring effects of unemployment magnify the costs associated with this downside risk. Unemployment tends to affect more severely those people who are already vulnerable – low-paid and low-skilled workers. Many people who become unemployed during a recession do not re-enter paid employment and instead become long-term unemployed or leave the labour force. Therefore, the Commission considers that its main priority in this decision is to protect jobs in the short term and help job seekers to be competitive in the labour market.

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### Employment and competitiveness across the economy

The 2008 general Wage-Setting Decision was made in the context of high price inflation and robust economic conditions. Employment was growing at moderate but slowing rates, with aggregate profits at record high levels. Wages were growing steadily overall but more strongly in some parts of the labour market.

The economic environment changed sharply in late 2008, following a shock to the global financial system. This has resulted in much slower employment growth and unemployment rising faster than expected, with the labour market forecast to weaken further in 2009–10.

The Commission reviewed the empirical evidence on the use of minimum wages to increase aggregate demand and thereby employment. Modelling commissioned for the 2009 Minimum Wage Review finds that an increase in household consumption in the short term, in response to higher minimum wages, would be offset by a fall in consumption as a result of lower employment, with other forms of demand such as business investment also decreasing.<sup>1</sup>

Looking further afield, an empirical study of the likelihood of a wage-led mechanism in several major economies comparable with Australia<sup>2</sup> found that the evidence for wage-led or profit-led recovery is mixed. While possible, there is “little support for the existence of a wage-led employment regime, at least under existing conditions of substantially open economies.”<sup>3</sup>

Recent modelling undertaken for the Commission finds that the disemployment effect of increases in minimum wages becomes larger during a recession. This research finds that the minimum wage adjustments from 2005 to 2008 had only small short-term effects in the context of a strong labour market. However, during a downturn, as aggregate wage growth slows and new job opportunities diminish, minimum wage increases are estimated to have a magnified negative effect on employment.<sup>4</sup>

In previous economic cycles, while the recession itself may have been short, the recovery in employment has tended to be weak and it has taken a long time for unemployment to return to its initial low rate. A lesson from this previous experience is that decision-makers should act early to limit the increase in unemployment and to lend greater support to employment.

While the extent of weakness in the economic outlook remains uncertain, the Commission emphasises the need for caution at this time, when there is greater risk that a minimum wage increase may further reduce employment and competitiveness.

<sup>1</sup> Centre for International Economics, *Modelling the macroeconomic impact of the Fair Pay Commission's minimum wage decisions*, report commissioned by AFPC, 2009, forthcoming.

<sup>2</sup> France, Germany, Japan, UK and USA.

<sup>3</sup> S Bowles and R Boyer, 'Wages, aggregate demand, and employment in an open economy: an empirical investigation' in G A Epstein and H M Gintis (eds), *Macroeconomic Policy After the Conservative Era*, Cambridge, Cambridge University Press, 1995, p. 165.

<sup>4</sup> Centre for International Economics, 2009, forthcoming.

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### The capacity for the unemployed and low paid to obtain and remain in employment

Economic downturns are associated with significant changes in the composition of employment and unemployment. These changes vary by age, gender, skill, education, location, household type, form of employment, industry and occupation. Extensive research on previous cycles in the Australian labour market demonstrates that unemployment has significant costs. This suggests that strategies are needed to minimise the emergence and duration of unemployment wherever possible.

The Australian labour market can expect to experience further compositional changes through 2009–10, with total employment forecast to decrease. The Commission is conscious that minimum wages affect some industries (for example, Accommodation and food services) and occupations (for example, Elementary clerical, sales and service workers) more than others. Changes in minimum wage rates are therefore likely to affect levels of continued employment and the potential for further jobs to be offered in these industries and occupations.

Lower-skilled workers also become less competitive in the labour market as higher-skilled workers who become unemployed accept lower-skilled jobs.<sup>5</sup> This ‘crowding out’ effect is greater during downturns, when unemployment rates for higher-skilled people tend not to increase to the same degree as those for lower-skilled people. Low-skilled workers are less likely to regain employment and more likely to leave the labour force.<sup>6</sup>

Australian evidence indicates that the burden of increased unemployment falls disproportionately on identifiable demographic groups, especially those attempting to gain a foothold in the labour market and to maintain that position. These groups include young people, low-skilled workers, and migrants from non-English speaking backgrounds. All these demographic groups have been identified as both more heavily reliant on minimum wages and at higher risk of unemployment.<sup>7</sup>

Empirical evidence points to long-term consequences or scarring for individuals who experience prolonged joblessness.<sup>8</sup> As lower levels of employment persist, many people who have become unemployed remain jobless and find it increasingly difficult to regain employment.<sup>9</sup> Given diminished demand for their labour, some react to the adverse labour market conditions by withdrawing from active job search and possibly leaving the labour force altogether. This has been the experience of many older workers, for whom loss of employment is more likely to lead to long-term unemployment.

<sup>5</sup> I Linsley, *Causes of overeducation in the Australian labour market*, Department of Economics, University of Melbourne, Research Paper Number 940, June 2005.

<sup>6</sup> P Frijters and R Gregory, ‘From golden age to golden age: Australia’s ‘Great Leap Forward’?’, *The Economic Record*, Vol. 82, No. 257, June 2006, pp. 207–224.

<sup>7</sup> J Healy and S Richardson, *A Strategy for Monitoring the Micro-Economic and Social Impacts of the Australian Fair Pay Commission*, Research report No. 4/07, National Institute of Labour Studies, report commissioned by AFPC, 2006, p. 12.

<sup>8</sup> A T Le and P W Miller, *A Risk Index Approach to Unemployment: An Application Using the Survey of Employment and Unemployment Patterns*, ABS Occasional Paper, 1999, Catalogue No. 6293.0.00.01, Canberra, ABS, Synopsis; D Doiron and T Gorgens, ‘State dependence in youth labour market experiences, and the evaluation of policy interventions’, *Journal of Econometrics*, Vol. 145, Issues 1–2, 2008, pp. 81–97; M Gray, *The Effects of Unemployment on the Earnings of Young Australians*, ANU Centre for Economic Policy Research, Discussion Paper 419, September 2000, p. 1; and B Chapman and M Gray, *Youth Unemployment: Aggregate Incidence and Consequences for Individuals*, ANU Centre for Economic Policy Research, Discussion Paper 459, December 2002.

<sup>9</sup> B Chapman and C Kapuscinski, *Avoiding Recessions and Australian Long-Term Unemployment*, ANU Centre for Economic Policy Research, Discussion Paper 418, July 2000.

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Periods of unemployment also restrict subsequent earnings in a number of ways, such as by reducing hourly wages or the number of hours worked. Minimising cyclical unemployment therefore helps to minimise ongoing underemployment and reduced earnings.

The Commission notes that the Australian Government has introduced a range of measures to assist job seekers back into employment, including greater access to employment services and training for vulnerable young job seekers, retrenched workers and apprentices. These measures are in addition to those which encourage greater demand for workers.

On balance, the economic downturn has reduced the capacity of the unemployed and low paid to obtain and remain in employment. The Commission considers that its decision will both protect jobs in the short term and better support a speedy recovery in employment in the medium term. As the effects of downturns tend to be concentrated on the most disadvantaged segments of the labour force and have longer-term implications, the Commission's chief concern is that an increase in minimum wages may exacerbate the forecast increase in unemployment.

### Providing a safety net for the low paid

The Australian Government submits that economic conditions are “extremely volatile and uncertain”, but maintains that its priorities are to both “support jobs so as to minimise job losses during the economic downturn and to maintain a fair minimum safety net”, and urges the Commission to “align its decision with these aims”.<sup>10</sup>

The Commission maintains its view that the income safety net is provided by the combination of minimum wages and the tax/transfer system, with the Australian Government responsible for the latter. This is consistent with Article 3 of the International Labour Organisation C131 *Minimum Wage Fixing Convention, 1970* (ratified by Australia in 1973), which lists social security benefits among the range of factors to be considered in determining minimum wage levels.<sup>11</sup>

The Commission considers that information on recent trends in the disposable incomes of households reliant on minimum wages, either solely or in combination with income transfers, is relevant to its deliberations. This is especially so at a time when wage increases are more likely to have an adverse impact on employment.

Over the past year, weekly disposable incomes of a range of illustrative households with one or two earners on the standard Federal Minimum Wage (FMW) increased by more than the current rate of inflation. Taking a longer-term view, since July 2006, the Commission's first three general Wage-Setting Decisions, in conjunction with tax/transfer changes, have increased the disposable incomes of all household types modelled, by around one and a half to two times the rate of inflation.

<sup>10</sup> Australian Government, *Submission to the Australian Fair Pay Commission Minimum Wage Review 2009*, 20 March 2009, p. 2, para. 1.13.

<sup>11</sup> ILO, *C131 Minimum Wage Fixing Convention, 1970*, 2006a, <<http://www.ilo.org/ilolex/cgi-lex/convde.pl?C131>> at 24 April 2009; and ILO, *C131 Minimum Wage Fixing Convention, 1970*, 2006b, <<http://www.ilo.org/ilolex/cgi-lex/ratifce.pl?C131>> at 24 April 2009.

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Wage-earning households, especially those with children, also received a considerable boost to their disposable income during the 2008–09 financial year as a result of the Australian Government's economic stimulus packages. These payments should have helped to mitigate financial pressures for many families. The additional support provided by them has enabled the Commission to make a cautious decision designed to protect employment in the short term, pending the next wage review in 2010.

These increases in real disposable income for low-paid employee households contrast with the situation of unemployed people, whose incomes are increased only for movements in the Consumer Price Index and who received no payments under the recent economic stimulus packages. As of July 2009, the maximum disposable income of an unemployed single person receiving Newstart Allowance is less than 57 per cent of the disposable income of a single person earning the standard FMW.

The Commission accepts that prices of different expenditure items have moved differently in recent times and that changes in overall living costs will vary for different households, according to the proportion of their overall expenditure they spend on particular items. However, on the basis of its analysis of ABS expenditure data<sup>12</sup>, the Commission believes it is likely that, on average, changes in living costs of low-income employee households in recent months are similar to those of all employee households.

This conclusion is strengthened by analysis showing that low-paid employees, including those who live in low-income households, have a similar pattern of housing tenure to that of all employee households. They also have lower average housing costs. The housing situation of low-paid employees is much more favourable than that of unemployed people, who are more than twice as likely to pay rent and much less likely to be home-owners or purchasers.<sup>13</sup>

The available evidence on the living standards of low-paid workers indicates that a small proportion (around one in five) has low living standards overall. The evidence also indicates that unemployed people have considerably lower levels of household income and are much more likely to experience financial stress.

The Commission expects that, while increases in living costs will vary widely across individual households, for many households containing low-wage earners, recent increases in disposable income have outpaced increases in living costs. This is not true for many households whose members are unemployed. By emphasising the protection of jobs when household disposable incomes have kept pace with inflation, the Commission regards its decision as reaching an appropriate balance between helping to maintain the safety net for low-paid workers and safeguarding employment during the economic downturn.

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<sup>12</sup> AFPC, *Economic and Social Indicators – Monitoring Report*, Issue 02, Commonwealth of Australia, January to June 2008, pp. 28–29.

<sup>13</sup> ABS, *Survey of Income and Housing: Confidentialised Unit Record File on CD-ROM/RADL*, 2005–06 (second edition), Catalogue No. 6541.0.30.001, Canberra, ABS, unpublished data.

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### Employees with disability

The Commission has decided to adjust the minimum weekly amount payable to employees with disability under the Supported Wage System (SWS) to maintain its nexus with the income test free threshold for the Disability Support Pension increasing this from \$69 to \$71 per week.

In order to improve its understanding of the employment of people with disability, the Commission has undertaken a variety of monitoring and research projects to provide a profile of the Australian Disability Enterprises employment sector. Projects include a statistical study using published and unpublished administrative data, an audit of wage assessment tools (WATs), a survey of employers in the sector and qualitative research with employees.

Key findings from the research include:

- Disability Enterprise employees are engaged in a number of different industries and occupations;
- just over half (55 per cent) of Disability Enterprises source their rates of pay from the Pay Scale derived from the Liquor, Hospitality and Miscellaneous Union 2005 Award (LHMU Pay Scale) and the Special Business Services Pay Scale, with the remainder sourcing their classifications and wage rates from alternative wage instruments;
- the Pay Scale level used to calculate minimum rates of pay that is most frequently cited by employers is Grade 1 of the LHMU Pay Scale;
- there are a number of WATs approved for use in the sector, but the majority of organisations use only four – the Business Services WAT (BSWAT); SkillsMaster WAT; SWS WAT; and the Greenacres WAT. With the exception of the Greenacres WAT, all of these are designed to be adaptable for general use; and
- Disability Enterprise employees vary in their understanding of how their wages are determined.

### Discrimination

Recent research undertaken for the Commission into the role that minimum wages play in relation to pay equity finds that:

- gender pay differentials persist, even after controlling for a variety of employee and job characteristics;
- the pay gap between men and women is lowest for those employees most directly affected by the Commission's decisions, with little or no gender pay differential among employees paid only an award rate of pay; and
- the minimum wage adjustments over the period from 1995–96 to 2005–06 are estimated to have decreased the overall gender pay gap in hourly wages by around 1.2 percentage points.

While the Commission is required to apply the principle that men and women should receive equal remuneration for work of equal value, no submissions to the Commission's 2009 Minimum Wage Review raise a specific claim that a Pay Scale discriminates on the basis of gender.

