

Section 2 2. Employment and competitiveness across the economy

Australia experienced an extended period of growth in economic activity, employment and real wages from the early 1990s to 2008. The economy grew by 81 per cent in real terms between 1991 and 2008, with the number of people employed increasing by 3.1 million or 41 per cent. The unemployment rate decreased from a peak of 10.7 per cent in 1993 to a low of 3.9 per cent in February 2008, when labour force participation and employment rates were also at record highs.⁶

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 resulted in much slower employment growth and unemployment rising faster than expected, with the labour market forecast to weaken further in 2009–10.

Most submissions to the Commission highlight this significant change in circumstances, indicating that the 2009 Minimum Wage Review takes place in a very different climate to the previous review. Indeed, the Australian Government describes the climate as the “most severe faced by Australian policy makers for a considerable period of time”.⁷

2.1. Employment and unemployment

From early 2008, employment growth began to slow in response to tighter monetary policy settings and, later in the year, the sharp fall in global confidence and activity (Figure 1). Initially, the lower demand for labour was reflected in fewer job vacancies, reduced overtime and, increasingly, a shift toward part-time employment (Figure 2). Business surveys indicate that increasing numbers of businesses have reduced, or are planning to reduce, their workforce over the next twelve months.⁸

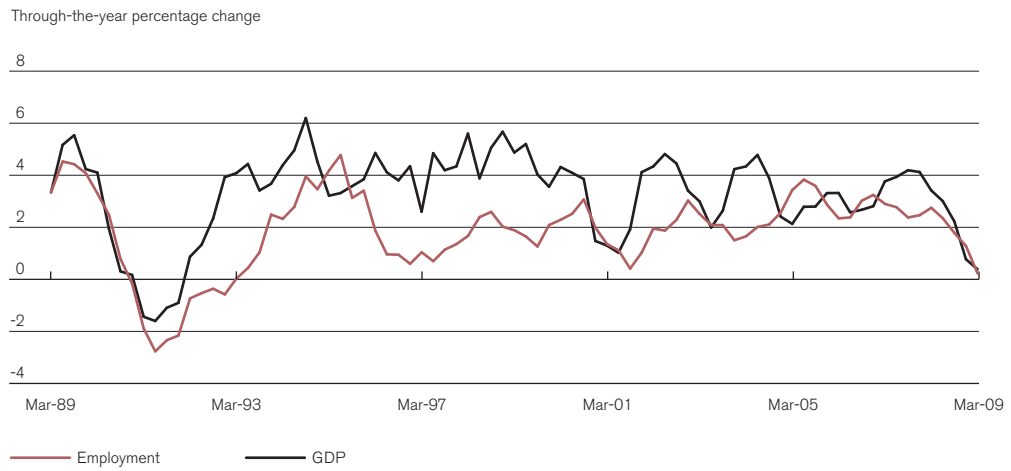
⁶ ABS, *Australian National Accounts: National Income, Expenditure and Product*, March 2009, Catalogue No. 5206.0, Canberra, ABS, 2009; and ABS, *Labour Force, Australia*, April 2009, Catalogue No. 6202.0, Canberra, ABS, 2009.

⁷ Australian Government, *Submission to the Australian Fair Pay Commission Minimum Wage Review 2009*, 20 March 2009, p. 5, para. 2.2.

⁸ For example, Dun and Bradstreet, *D & B National Business Expectations Survey*, April 2009, <<http://dnb.com.au>> at 30 April 2009.

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Figure 1: Growth in employment and GDP, March 1989 to March 2009



Note: The data are presented on a quarterly basis and seasonally adjusted.

Source: ABS, *Australian National Accounts: National Income, Expenditure and Product*, March 2009, Catalogue No. 5206.0, Canberra, ABS, 2009; and ABS, *Labour Force, Australia*, April 2009, Catalogue No. 6202.0, Canberra, ABS, 2009.

Figure 2: Growth in part-time and full-time employment, April 2007 to April 2009



Note: The data are presented on a monthly basis and seasonally adjusted.

Source: ABS, *Labour Force, Australia*, April 2009, Catalogue No. 6202.0, Canberra, ABS, 2009.

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The total number of people employed began to decrease in early 2009. Between its peak in October 2008 and April 2009, the number of people employed decreased by 0.2 per cent, with full-time employment decreasing by 0.6 per cent and part-time employment increasing by 0.9 per cent.⁹ When measured in terms of total hours worked, employment peaked in January 2008 and has decreased by 7.9 per cent since then, indicating a substantially weaker labour market.¹⁰ While these different trends in numbers employed and total hours worked indicate a degree of labour market flexibility, this has also meant an increase in underemployment.¹¹

The Australian Chamber of Commerce and Industry (ACCI) submits that businesses prefer the flexibility of working arrangements associated with part-time employment and are less willing to take on full-time employees in an uncertain economy.¹²

As the number of people employed has remained broadly unchanged over the past year, employment growth has been insufficient to meet continued growth in the labour force. As a result, the unemployment rate increased from a low of 3.9 per cent in February 2008 to 5.5 per cent in April 2009.¹³

2.2. Wage growth, inflation and competitiveness

Wage growth and inflation

The Australian Council of Trade Unions (ACTU) notes that there has been “steady but moderate real growth in wages in the general economy” in recent years.¹⁴ Both the ACTU and the Australian Catholic Council for Employment Relations (ACCER) argue that the current economic climate has not been caused by high or rising wage levels, with ACCER indicating that “Australia is not threatened by a wage-inflation recession of the kind experienced at times in recent decades”.¹⁵

The Wage Price Index (WPI) increased by 4.3 per cent in 2008 and there have been some early signs of slower wage growth in early 2009.¹⁶ Similarly, the average annualised wage increase in new federal collective agreements has changed little over most of the past five years, remaining at just over 4 per cent per annum.¹⁷ While there has been steady growth in nominal terms, real average wages have been generally declining since early 2008 due to higher inflation.¹⁸

⁹ ABS, *Labour Force, Australia*, April 2009, Catalogue No. 6202.0, Canberra, ABS, 2009.

¹⁰ ABS, *Labour Force, Australia, Detailed – Electronic Delivery*, April 2009, Catalogue No. 6291.0.55.001, Canberra, ABS, 2009. Data seasonally adjusted by AFPCS.

¹¹ ABS, *Australian Labour Market Statistics*, April 2009, Catalogue No. 6105.0, Canberra, ABS, 2009.

¹² ACCI, March 2009, p. 82, para. 235.

¹³ ABS, *Labour Force, Australia*, May 2009, Catalogue No. 6202.0, Canberra, ABS, 2009.

¹⁴ ACTU, March 2009, p. 72, para. 6.22.

¹⁵ ACTU, March 2009; and ACCER, *Submission by the Australian Catholic Council for Employment Relations*, 20 March 2009, p. 8, para. 15.

¹⁶ ABS, *Labour Price Index, Australia*, March 2009, Catalogue No. 6345.0, Canberra, ABS, 2009.

¹⁷ DEEWR, *Trends in Federal Enterprise Bargaining*, March quarter 2009, <<http://www.workplace.gov.au/workplace/Publications/ResearchStats/Agreement/TrendsInFederalEnterpriseBargaining.htm>> at 10 June 2009.

¹⁸ Real average wages are deflated using the GDP price deflator rather than the CPI because it is a better representation of labour costs for employers.

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Consumer price inflation increased to 5.0 per cent in the year to the September quarter 2008, as measured using the All Groups Consumer Price Index (CPI).¹⁹ While the Reserve Bank of Australia (RBA) reported that this inflation was increasingly broadly-based across product categories, the dominant influences were housing- and fuel-related.²⁰ Consumer price inflation has slowed sharply since late 2008, to 2.5 per cent over the year to the March quarter 2009. However, underlying inflation is yet to slow substantially, with the average of the RBA measures of underlying inflation at 4.2 per cent over the year to the March quarter 2009.

These trends, which suggest that wage growth has generally been less of a constraint to economic growth, may be due in part to the decentralisation of Australian wage determination. In 2008, an estimated 17.8 per cent of employees relied directly on awards or Pay Scales as their method of setting pay.²¹ Recent research indicates that estimates of the reach of minimum wages into the wage structure are imprecise, since many employees on individual arrangements and collective agreements are also affected by changes in minimum wages.²² On the other hand, modelling for the Commission finds that minimum wages have had a declining effect on aggregate wage outcomes in recent years.²³

Competitiveness

Real unit labour costs have shown a declining trend over the last decade, to levels that are lower than those leading into the 1990s recession. Therefore, in contrast with previous recessions, the current economic downturn in Australia appears not to have been associated with rapid wage growth above the rate of price inflation plus the rate of productivity growth.²⁴

There is an emerging consensus that productivity growth slowed in the last decade compared with the late 1990s. ABS data suggest that this trend has continued over the last year, with real Gross Domestic Product (GDP) per hour worked increasing by 1.5 per cent over the year to the March quarter 2009 and real GDP per hour worked in the market sector decreasing by 0.1 per cent.²⁵

¹⁹ ABS, *Consumer Price Inflation, Australia*, March 2009, Catalogue No. 6401.0, Canberra, ABS, 2009.

²⁰ RBA, *Statement on Monetary Policy*, May 2009, Sydney, RBA, pp. 61–62.

²¹ ABS, *Employee Earnings and Hours, Australia, Preliminary*, May 2008, Catalogue No. 6305.0.55.001, Canberra, ABS, 2009.

²² J Buchanan and G Considine, 'The significance of minimum wages for the broader wage-setting environment: understanding the role and reach of Australian awards' in Australian Fair Pay Commission, *2008 Minimum Wage Research Forum Proceedings, Volume 1*, Research Report No. 4a/08, report commissioned by AFPC, 2008, pp. 47–62.

²³ Centre for International Economics, *Modelling of the macroeconomic impact of the Fair Pay Commission's minimum wage decisions*, report commissioned by AFPC, 2009, forthcoming.

²⁴ R Green, W Mitchell and M Watts, 'The Accord, trade unions and the Australian labour market' in P Kriesler (ed), *The Australian Economy 2*, Sydney, Allen and Unwin, 1997, pp. 163–165.

²⁵ ABS, *Australian National Accounts: National Income, Expenditure and Product*, March 2009, Catalogue No. 5206.0, Canberra, ABS, 2009.

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Looking ahead, ACCI is concerned that a decline in productivity, combined with lower inflation, may lead to an increase in real unit labour costs and thus reduce competitiveness:

Given nominal wages tend [to] exhibit little downward flexibility, there is a risk that falling productivity and easing prices will cause an increase in real unit labour costs that will...have a negative impact on employment growth. That risk is magnified with nominal wages running at presently high levels and inflation slowing rapidly.²⁶

ACCI further warns that increases in labour costs that are not contingent upon additional productivity or customer demand may threaten the viability of businesses:

ACCI believes it is imperative that the Commission take into consideration falling productivity in its wage determination decision and continue to monitor the incoming data closely. Declining productivity reduces the capacity of Australian businesses to bear the cost of any increase in the award rates of pay.

Maintaining and encouraging productivity becomes more important in light of the economic adversity facing, in particular, minimum wage reliant businesses, and it is crucial to business survival, capacity to retain employment and capacity to take on new staff in the recovery from the current crisis.²⁷

On the other hand, the ACTU emphasises that the profit share of total factor income has increased to record levels and is at a higher rate than that leading into the last two recessions, with real labour costs correspondingly lower than they were at similar points in the business cycle.²⁸

Company gross operating profits increased by 19 per cent in the first half of 2008, but were largely unchanged during the second half of the year.²⁹ These movements may be attributed in part to variations in mining industry profits. However, recent surveys indicate that profitability has been declining for a large proportion of businesses across a range of industries.³⁰

The ACTU notes that any fall in corporate profits would occur from a record high base and suggests that profits would be cushioned in 2009 and 2010 as macroeconomic policy settings act to stimulate the economy.³¹ Indeed, the Australian Federation of Employers and Industry (AFEI) suggests that the relatively high share of profits to wages has helped to cushion employment from the recent downturn in economic activity:

In this downturn the share of profits to wages was still at 26 per cent of GDP in the last quarter of 2008. It was 21 per cent at the start of the 1991 recession, for example. This may in part explain the long time it took for employment to begin to fall as employers were able to hold onto labour as they were better placed than in the past. However, as profits are eroded this situation can quickly change.³²

²⁶ ACCI, March 2009, p. 118, para. 305.

²⁷ ACCI, March 2009, p. 117, paras. 301–302.

²⁸ ACTU, March 2009, pp. 26–27, paras. 2.44–2.45; and ABS, *Australian National Accounts: National Income, Expenditure and Product*, March 2009, Catalogue No. 5206.0, Canberra, ABS, 2009.

²⁹ ABS, *Business Indicators, Australia*, December 2008, Catalogue No. 5676.0, Canberra, ABS, 2009.

³⁰ For example, National Australia Bank, *NAB Monthly Business Survey and Economic Outlook*, March 2009, <<http://www.nab.com.au>> at 30 April 2009.

³¹ ACTU, March 2009, p. 105, para. 8.34.

³² AFEI, *Submission to the Fair Pay Commission*, March 2009, p. 17, para. 25.

Section 2 **2.3. Business conditions**

For many businesses, the decline in aggregate demand has led to significantly lower profitability and changes in business practices. This has been observed in consultations with individual employees, job seekers and businesses undertaken on behalf of the Commission.³³ These consultations involved a series of focus groups and in-depth interviews in late 2008, followed in February to April 2009 by discussions with the same participants. This approach has enabled observation of changes in economic behaviour and/or attitudes over time.

In stage one of the consultations, most employees, job seekers and employers were uncertain that the weaker global environment would translate to Australia. However, by stage two, all groups were convinced that the downturn was evident. Nonetheless, participants reported varying attitudes and actions in response to the downturn, depending largely on their personal experience.

Many employers reported that they were seeking to balance the retention of experienced staff by accepting a reduction in profits, with protecting their profit levels by reducing their labour costs. Reported actions to reduce labour costs included reducing work hours among casual employees, freezing recruitment, seeking improvements in workplace productivity, and lowering staff numbers.

Measures to reduce the total wage bill were among the first to be implemented by employers in Accommodation and food services and Retail trade.³⁴ Some businesses reported deferring scheduled wage increases, often only after other labour and non-labour related options had been pursued. Most employers considered price increases to be a less feasible option.

Looking ahead, employers had become more speculative about the outlook for their businesses, revising expectations and generally reducing the degree to which they planned ahead. While some had been adversely affected by the general economic downturn, others expressed confidence about future business prospects.

2.4. Economic and labour market outlook

Forecasts

As would be expected at this stage in the economic cycle, the economic outlook is uncertain as events continue to unfold at a fast pace. On balance, submissions to the Commission generally expect the economy to contract in 2009 and to recover weakly from early 2010. Employment is expected to decrease in 2009–10, with wage growth and price inflation forecast to slow to moderate or low rates.

³³ A Southwell, S Elliott, R Zappelli and G French, *Report on Public Consultations for the Australian Fair Pay Commission's 2009 Minimum Wage Review*, Research Report No. 8/09, TNS Social Research, report commissioned by AFPC, 2009, forthcoming.

³⁴ In this document, industry data are, wherever possible, classified according to the current Australian and New Zealand Standard Industry Classification (ANZSIC 2006). In some cases, especially in earlier research reported in later chapters, the earlier ANZSIC 1993 classification has been used. However, the text uses only the more recent terminology for industry divisions (for example, Accommodation and food services (ANZSIC 2006), rather than Accommodation, cafes and restaurants (ANZSIC 1993)).

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The Australian Government's forecasts are summarised in Table 1. These forecasts account for the effects of the measures that the Government and the RBA have taken to support the economy and labour market.

Strong and rapid policy action from the Australian Government and the Reserve Bank of Australia is helping to cushion the severe impact of the global recession on the Australian economy and employment. This action is one reason Australia is expected to experience a milder contraction than virtually all other advanced economies. Supported by policy, a recovery in the Australian economy is expected to gather pace over 2010.³⁵

Table 1: Australian Government forecasts

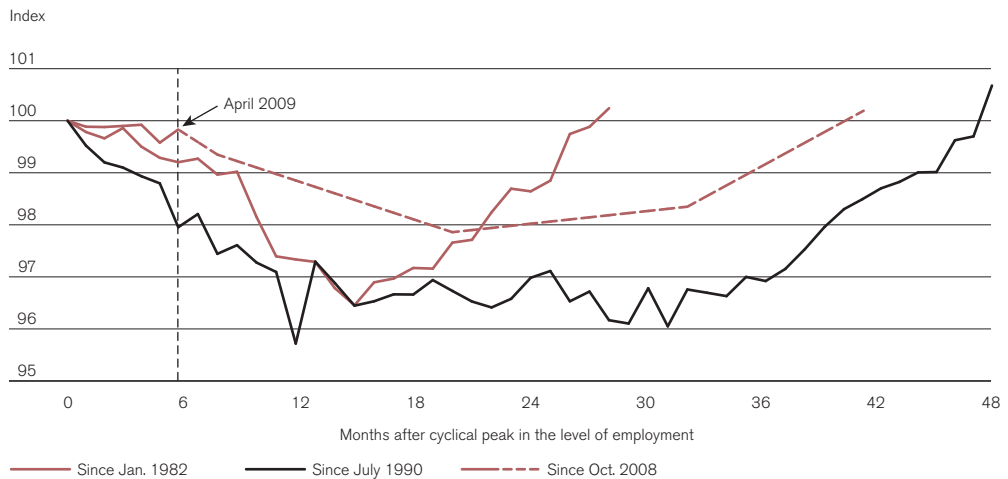
	2008-09 (e)	2009-10 (f)	2010-11 (f)
Real GDP growth	0	-1/2	2 1/4
Employment growth	-1/4	-1 1/2	1/2
Unemployment rate	6	8 1/4	8 1/2
Growth in the Wage Price Index	4 1/4	3 1/4	3 1/4
Consumer price inflation	1 3/4	1 3/4	1 1/2

Note: Data are reported as percentage changes over the year to the June quarter, except in the case of the unemployment rate, which is the estimate for the June quarter, and real GDP growth, which is the percentage change on the previous year. (e) represents estimate while (f) represents forecast.

Source: Commonwealth of Australia, *Budget Paper No. 1: Budget Strategy and Outlook 2009-10*, Canberra, Canprint Communications, 2009, p. 4-4.

The Australian Government forecasts that employment will not decline to the same extent as in the recession of the early 1990s and that the recovery will not be as slow. Employment is expected to decrease by 1 1/2 per cent in the year to the June quarter 2010, returning to its previous level in 2012 (Figure 3).

Figure 3: The level of employment during recession and recovery



Note: The data are presented on a monthly basis and seasonally adjusted.

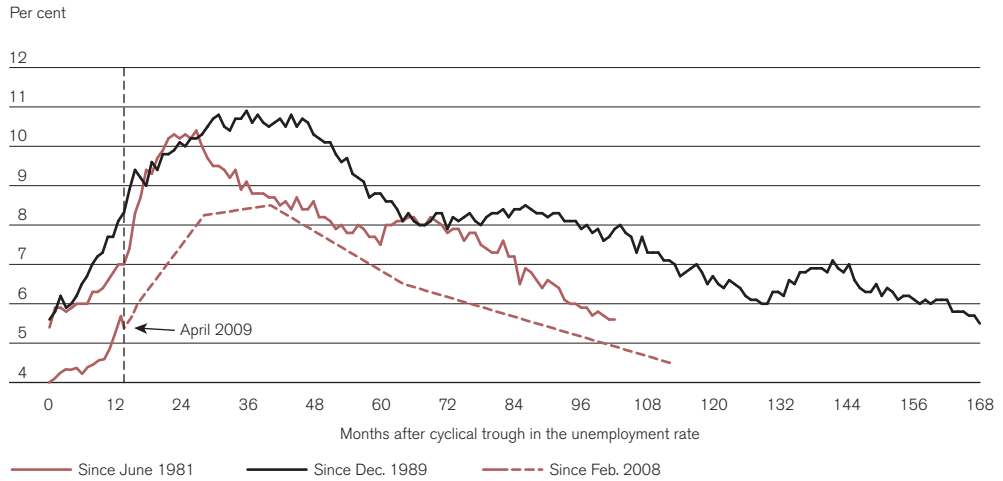
Source: ABS, *Labour Force, Australia*, April 2009, Catalogue No. 6202.0, Canberra, ABS, 2009; AFPCS estimates based on Commonwealth of Australia, *Budget Paper No. 1: Budget Strategy and Outlook 2009-10*, Canberra, Canprint Communications, 2009, p. 4-4, and K Henry, Secretary to Treasury, *Contemporary Challenges in Fiscal Policy*, speech to the Australian Business Economists, Sydney, 19 May 2009, <<http://www.treasury.gov.au>> at 20 May 2009.

³⁵ Commonwealth of Australia, *Budget Paper No. 1: Budget Strategy and Outlook 2009-10*, Canberra, Canprint Communications, 2009, p. 2-3.

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The Australian Government forecasts the unemployment rate to increase from 6 per cent of the labour force in the June quarter 2009 to 8¼ per cent by the June quarter 2010 and to remain broadly unchanged the following year, partly due to a cyclical decrease in labour force participation. This pattern is broadly comparable with earlier economic history, with unemployment tending to increase sharply during recessionary periods and to decrease only slowly once it has developed, as shown in Figure 4.

Figure 4: The unemployment rate during recession and recovery

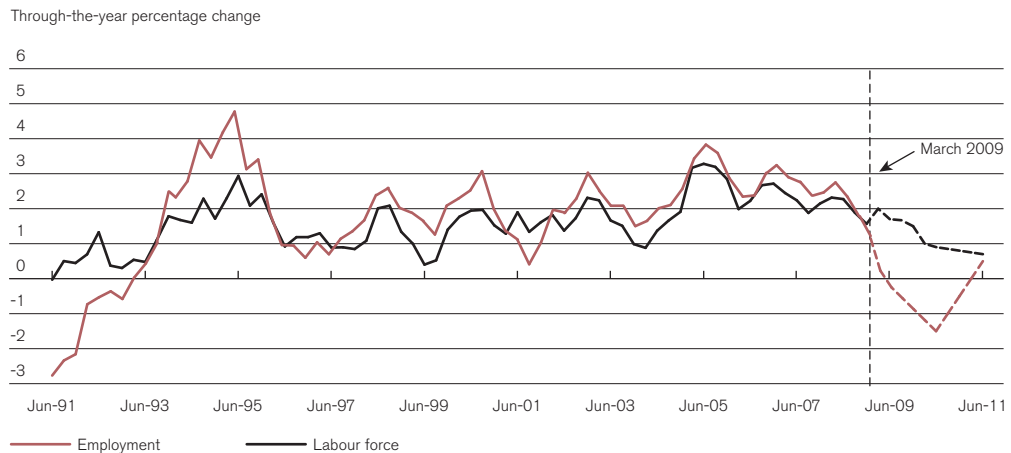


Note: The data are presented on a monthly basis and seasonally adjusted.

Source: ABS, *Labour Force, Australia*, April 2009, Catalogue No. 6202.0, Canberra, ABS, 2009; and AFPCS estimates based on Commonwealth of Australia, *Budget Paper No. 1: Budget Strategy and Outlook 2009–10*, Canberra, Canprint Communications, 2009, p. 4–4, and K Henry, Secretary to Treasury, *Contemporary Challenges in Fiscal Policy*, speech to the Australian Business Economists, Sydney, 19 May 2009, <<http://www.treasury.gov.au>> at 20 May 2009.

As illustrated in Figure 5, employment growth is expected to be insufficient to start reducing unemployment until 2011, with the unemployment rate projected to return to 5 per cent by around 2016 (Figure 4).³⁶

Figure 5: Employment and labour force growth, 1991 to 2011



Note: The data are presented on a quarterly basis and seasonally adjusted.

Source: ABS, *Labour Force, Australia*, April 2009, Catalogue No. 6202.0, Canberra, ABS, 2009; AFPCS estimates based on Commonwealth of Australia, *Budget Paper No. 1: Budget Strategy and Outlook 2009–10*, Canberra, Canprint Communications, 2009, p. 4–4.

³⁶ K Henry, Secretary to the Treasury, *Contemporary Challenges in Fiscal Policy*, speech to the Australian Business Economists, Sydney, 19 May 2009, <<http://www.treasury.gov.au>> at 20 May 2009, p. 15.

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The four major Australian banks broadly agree with the profile of the Government's forecasts for economic growth and the labour market. However, each is cautious, pointing to risks that the recovery may be weaker than expected as a result of the global environment. The International Monetary Fund (IMF) indicates that "down side risks to the [global] outlook remain substantial",³⁷ while the Australian Government warns that, "if the global recession is deeper and more protracted than expected, this would inevitably cause a more severe slowdown in Australia".³⁸

However, some of the banks also refer to the potential for a less pronounced downturn and a stronger recovery, encouraged in part by some recent leading indicators of activity. While the ACTU expects the Australian economy to be subdued over the next year, it cites the large policy stimulus to the economy as the source of a potential upside to the economic outlook. The ACTU also refers to the RBA's assessment that "firms may have identified the slowing in demand at an earlier stage than in past cycles...if so, when demand returns, production will pick up more quickly than in past cycles".³⁹

Business surveys

Business surveys offer complementary perspectives on current and future economic conditions. Most major surveys point to a continued weakening in business conditions, profitability, investment, wage growth and employment in the year ahead. However, while some measures of conditions and confidence have continued to decrease, a number of surveys hint at possible stabilisation in confidence, although at low levels.⁴⁰

These surveys often reveal the diversity of individual business experience of the current economic environment. For example, the *CBA-ACCI Business Expectations Survey* finds that 13 per cent of businesses expect their level of employment to increase over the next quarter; while 52 per cent expect no change and 35 per cent expect a decrease in employment.⁴¹ The National Australia Bank's *March 2009 Quarterly Business Survey and Forecasts* indicates that employment intentions for the next twelve months remain low.⁴²

2.5. Minimum wages and labour demand

While there appears to be broad consensus on labour market conditions over the next year or two, stakeholders continue to express widely varying views on the effect of minimum wages on employment outcomes.

Current labour market conditions are significantly less favourable than those around past wage-setting decisions, which were made against the backdrop of a strong labour market. The potential effects of minimum wage increases on employment in the near term may therefore be quite different from those observed in a more benign economic environment.

³⁷ ACCI, March 2009, p. 24, para. 90. ACCI cites International Monetary Fund, Group of Twenty Meeting of the Deputies, January 31 – February 1: Note by the Staff of the International Monetary Fund, 2009 <<http://IMF.org.au>> at 11 May 2009.

³⁸ Australian Government, March 2009, p. 8, para. 2.19.

³⁹ ACTU, March 2009, pp. 17–18, para. 2.22. ACTU cites RBA, *Statement on Monetary Policy*, February 2009, Sydney, RBA, p. 67.

⁴⁰ For example, National Australia Bank, *NAB Monthly Business Survey and Economic Outlook*, April 2009, <<http://www.nab.com.au>> at 11 May 2009.

⁴¹ CBA-ACCI, *Commonwealth Bank-ACCI Business Expectations Survey*, May 2009, <<http://www.acci.asn.au/SurveysMain.htm>> at 5 May 2009.

⁴² National Australia Bank, *NAB's Quarterly Business Survey and Forecasts*, March 2009, <<http://www.nab.com.au>> at 30 April 2009.

Section 2 Prospects for a wage-led recovery

The ACTU considers that excessive wages were not the cause of the recent increase in unemployment, as the profit share is very high and real wages are lower than they were leading into previous recessions.⁴³ The ACTU, ACROSS, Australian Youth Affairs Coalition (AYAC) and various state governments also advise that there is no evidence to suggest that a moderate increase in minimum wages would lead to higher unemployment.⁴⁴

The evidence provided by the ACTU to the AFPC over the past four years provides strong support for the proposition that moderate, predictable and regular increases in minimum wages do not cause a net contraction in employment growth or increases in unemployment. On the contrary such increases are often associated with improvements in the functioning of labour markets including through their positive effects on recruitment-retention. Such pay increases really make a difference to the well being of low paid workers, their families and communities.⁴⁵

The ACTU argues that insufficient demand was the primary reason for the recent increase in unemployment⁴⁶ and that increased minimum wages should be part of the defence against higher unemployment, as increased minimum wages raise household consumption expenditure.⁴⁷

The Commission reviewed the empirical evidence on the use of minimum wages to increase aggregate demand and thereby employment. There has been little previous Australian research undertaken to demonstrate this effect. However, 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.⁴⁸

Looking further afield, an empirical study of the likelihood of a wage-led mechanism in several major economies comparable with Australia⁴⁹ 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".⁵⁰ These researchers suggested that:

...it would be best to conclude not that particular nations' aggregate demand structures are profit led or wage led, but rather that the effects on aggregate demand of an economy-wide change in the real wage are likely to be quite small.⁵¹

The Australian Government also concludes that discretionary fiscal stimulus and monetary policy are more effective in stimulating aggregate demand in the current economic climate than increases to minimum wages.⁵²

⁴³ ACTU, March 2009, pp. 26–30.

⁴⁴ ACROSS, March 2009, p. 4; AYAC, *Australian Fair Pay Commission's Minimum Wage Review 2009 – AYAC's response*, March 2009, p. 4; and NSW Government, *Submission to the Australian Fair Pay Commission*, 20 March 2009, p. 24, para. 65.

⁴⁵ ACTU, March 2009, p. 8, para. 1.7.

⁴⁶ ACTU, March 2009, p. 105, para. 8.36.

⁴⁷ ACTU, March 2009, p. 32, para. 2.51.

⁴⁸ Centre for International Economics, 2009, forthcoming.

⁴⁹ France, Germany, Japan, UK and USA.

⁵⁰ S Bowles and R Boyer, 'Wages, aggregate demand, and employment in an open economy: a theoretical and empirical investigation' in G A Epstein and H M Gintis (eds), *Macroeconomic Policy After the Conservative Era*, Cambridge, Cambridge University Press, 1995, p. 165.

⁵¹ S Bowles and R Boyer, 1995, p. 164.

⁵² Australian Government, March 2009, p. 30, para. 5.27.

Section 2 Other views on the setting of minimum wages

The ACTU, NSW Government and AYAC support the view that an increase in minimum wages would have only a modest effect on overall wage growth and employment.⁵³ Several of the submissions indicate that the research evidence on the effects of minimum wages on employment is inconclusive, particularly when there is a deficiency in aggregate demand. The Victorian Government argues that:

The updated employment data presented...reinforces the conclusion...that the link between minimum and award wage increases and employment is difficult to determine and there is no conclusive evidence in the Australian case that minimum wage increases are affecting the level of employment.⁵⁴

While the Victorian Government agrees that economic growth is expected to decline along with consumer and business confidence, it argues that the economy has the capacity to afford a sustainable increase in minimum wages:

...downside risks to the economy dominate the economic outlook, such as the instability in global credit markets, a deeper than expected slowing in global growth (particularly China) and poor consumer and business confidence. These downside risks have not yet flowed through to employment and unemployment levels at the moment. This indicates that a sustainable increase, taking into account current and future economic climate moderate and sustainable increase in minimum wages will be absorbed in the current economic climate.⁵⁵

The NSW Government submits that the Commission should take account of confidence effects in the current economic climate:

In the short term, low levels of business confidence and the softer outlook for economic growth pose a significant risk to the outlook for employment in NSW and Australia...

The Commission should hand down a decision that goes towards maintaining the real value of all wage classifications contained within the Pay Scales taking into account the scope for employers to meet higher wage costs in the current economic climate and the need to minimise unemployment.⁵⁶

While ACOSS suggests the need for overall wage restraint, it nevertheless supports an increase in Pay Scale wages:

While in these circumstances overall restraint in wage increases is needed to support employment growth it would be unreasonable, and ineffective, to impose the burden of wage restraint on those employees who rely on Pay Scales. The Federal Minimum Wage and associated Pay Scales make only a very modest contribution to overall wages growth since only 20% of employees rely on the Pay Scales for their wage increases.⁵⁷

⁵³ AYAC, March 2009, p. 6; ACTU, March 2009, p. 8, para. 1.7; and NSW Government, March 2009, p. 24, para. 65.

⁵⁴ Victorian Government, *The Victorian Government's submission to the: Australian Fair Pay Commission*, 20 March 2009, p. 27, para. 2.14.1.

⁵⁵ Victorian Government, March 2009, p. 27, para. 2.14.4.

⁵⁶ NSW Government, March 2009, pp. 21–22, para. 54 and p. 5, para. 10.

⁵⁷ ACOSS, March 2009, p. 2.

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The Australian Government supports maintaining the real value of the minimum wage:

During this period of weaker labour demand, the Government's primary focus is on supporting jobs. At the same time, the Government has publicly supported a considered rise in the low-income safety net, mindful of significant challenges facing the domestic economy. The Government does not support a reduction in the real minimum wage. Given that weakness in aggregate demand is currently the primary constraint on demand for labour, a reduction in the real minimum wage is unlikely to be effective in stimulating employment as demand for labour is likely to remain subdued to macro-economic factors. Moreover, any decreases in the real minimum wage would tend to further dampen aggregate demand.⁵⁸

However, the Australian Government also considers that:

The majority of empirical research, as previously recognised by the Commission suggests that there is a negative relationship between minimum wage increases and employment. While this relationship has been relatively weak in recent years given that rises in the minimum wage have co-existed with strong employment outcomes for the low paid, the Government cautions the Commission that expected negative impacts on employment of minimum wage increases could be stronger in a slowing economy.⁵⁹

The Commission has examined the available evidence on the relationship between minimum wages and employment in its previous Minimum Wage Reviews⁶⁰ and again for the 2009 review. Its assessment is that, on balance, most experts consider that excessive wage growth can harm employment growth. As research by the Organisation for Economic Co-operation and Development (OECD) and Card and Krueger has indicated, the potential for a negative employment effect is higher when the labour market has a relatively high basic minimum wage, as in Australia.⁶¹

The Commission considers that these risks to employment are accentuated during downturns, when there is less flexibility for businesses to absorb an increase in minimum wages. This is confirmed by consultation with small businesses undertaken on behalf of the Commission at different times as the economy weakened during 2008–09.⁶²

Recent modelling undertaken for the Commission by the Centre for International Economics (CIE) finds that the disemployment effect of increases in minimum wages becomes larger during a recession. This research finds that minimum wage adjustments from 2005 to 2008 had only small effects on unemployment in the short term, 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 effect on unemployment, as shown in Figure 6.⁶³

⁵⁸ Australian Government, May 2009, p. 2, para. 11.

⁵⁹ Australian Government, March 2009, p. 30, para. 5.25.

⁶⁰ For example, AFPC, *Wage-Setting Decision and Reasons for Decision*, Commonwealth of Australia, October 2006, p. 70; AFPC, *Wage-Setting Decisions and Reasons for Decisions*, Commonwealth of Australia, July 2007, p. 51; and AFPC, *Wage-Setting Decision and Reasons for Decision*, Commonwealth of Australia, July 2008, p. 39.

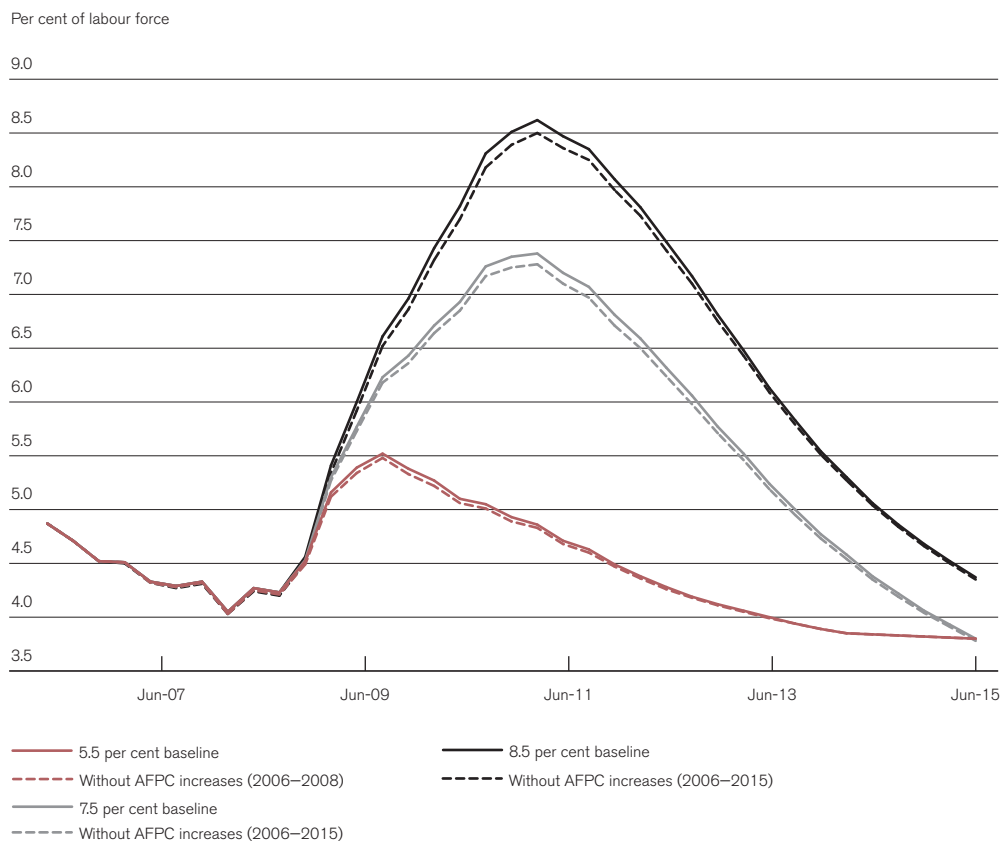
⁶¹ OECD, *Economic Surveys: Australia*, No. 12, Paris, OECD Publishing, July 2006, p. 18; and D Card and A Krueger, *Myth and Measurement: The New Economics of the Minimum Wage*, Princeton, Princeton University Press, 1995, p. 393.

⁶² Southwell et al, 2009, forthcoming.

⁶³ Centre for International Economics, 2009, forthcoming.

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Figure 6: Effect of minimum wage changes at low and high rates of unemployment



Source: Centre for International Economics, 2009, forthcoming.

The CIE estimates that if minimum wages were to continue increasing into the future at the rate that they did in 2008, the effects on employment and unemployment would be larger. Instead of the average increase of around 0.05 of a percentage point in unemployment during the period 2005 to 2008, the effects would be: around 0.1 of a percentage point increase if the unemployment rate were to rise to 7.5 per cent in 2009–10; and 0.12 of a percentage point increase if the unemployment rate were to rise to 8.5 per cent. The respective reductions in employment would be 17 000 and 20 000, compared with an average of 8000 in the earlier period.⁶⁴ That is, the effects on employment and unemployment of a minimum wage increase would be approximately two and a half times as high as in the 2005 to 2008 period.

It is useful to look back on the performance of the Australian labour market in the early 1990s. Despite consistently strong economic growth, the recovery in employment occurred at a relatively slow and inconsistent rate, leading to concerns about 'jobless growth'. The Committee on Employment Opportunities concluded that both output growth and wage restraint are important for generating sufficient employment growth.⁶⁵

⁶⁴ Centre for International Economics, 2009, forthcoming.

⁶⁵ Committee on Employment Opportunities, *Restoring Full Employment: a discussion paper*, Canberra, AGPS, 1993, p. 43.

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This view is supported by recent modelling undertaken by Dixon and Rimmer, who find that only a small proportion of the increase in unemployment is likely to be recovered by increases in aggregate demand, with wage moderation also necessary to offset the increase in unemployment.⁶⁶

Business behaviour

In its 2008 report, the UK Low Pay Commission notes that:

Two things are clear from economic theory. The first is that, in the presence of a wage effect from a minimum wage, employers will need to adjust on some margin. Something has to give. Raising the wages of low-paid workers can affect a number of economic variables, principal among which are: employment, prices, productivity and profits. The second implication is that the level at which the minimum wage is set is crucial to the magnitude of those economic effects and to the scale of any negative impact.⁶⁷

Economists emphasise that prices, such as wages, are often slow to adjust to imbalances in demand and supply, with changes in quantities occurring more readily in response to demand shocks.

The sluggishness in the response of prices and wages to imbalances in supply and demand accentuates fluctuations in output and employment. Because prices do not carry the main burden of adjustments, quantities are obliged to carry the load.⁶⁸

Behaviour of this kind was reported by employer participants in the public consultations undertaken on behalf of the Commission. Businesses tend to follow a broad sequence of adjustments to employment and wages in response to a fall in sales and profitability. Adjustment to hours worked tends to occur earlier in the process, followed by reduction in the number of employees, followed by reduction or deferral of planned wage increases. In some cases, where the viability of a business is threatened and other measures have been unsuccessful, reduction in wage rates may occur.⁶⁹

In its post-Budget submission, the ACTU refers to the confidence effects of minimum wage adjustments, arguing that "It is precisely by ensuring moderate, regular and predictable minimum wages increases through the cycle that confidence is sustained."⁷⁰

However, increases in minimum wages would reduce the flexibility that some employers may have to adjust their business practices to respond to an unexpected change in their business fortunes. They would also reduce the capacity of businesses to support the higher rates of employment growth needed to quickly reduce unemployment when the Australian economy begins to recover. When that occurs, it will be important for the level of minimum wages to help accelerate the recovery in employment.

⁶⁶ P Dixon and M Rimmer, 'We need wage moderation, not just demand stimulation', *Economic Papers*, Vol. 28, No. 1, March 2009, pp. 63–64.

⁶⁷ Low Pay Commission, *National Minimum Wage: Low Pay Commission Report 2008*, Cm7333, <<http://www.lowpay.gov.uk>> at 25 May 2009, p. 5, para. 2.2.

⁶⁸ A Okun, *Prices and Quantities*, Washington, Brookings Institution Press, 1981, p. 4.

⁶⁹ These stages of behaviour have also been reviewed by T Bewley, *Why Don't Wages Fall During a Recession?*, Cambridge, Harvard University Press, 1999, p. 1.

⁷⁰ ACTU, *Australian Council of Trade Unions Submission to the Australian Fair Pay Commission*, May 2009, p. 36, para. 5.4.

Section 2 2.6. Summary

The consensus among submissions is for a decline in employment and a significant increase in unemployment in 2009–10. 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 across the economy.