

## Section 2      2. The capacity for the unemployed and low paid to obtain and remain in employment

To date, strong growth in the economy has delivered solid employment outcomes to a broad cross section of the working-age population. Unemployment has continued to decline for most groups, including those identified as more disadvantaged in the labour market.

### 2.1. Minimum wages and labour demand

Submissions to the 2008 Minimum Wage Review indicate that the relationship between employment and minimum wages continues to be contentious.

As in previous minimum wage reviews, several submissions refer to the international literature review by economists David Neumark and William Wascher as providing evidence that minimum wage increases can have a negative effect on employment.<sup>6</sup>

The Australian Chamber of Commerce and Industry (ACCI), the Australian Council of Trade Unions (ACTU), the Australian Council of Social Services (ACOSS) and the Queensland Government caution that this international evidence cannot be fully relied upon, owing to the unique structure of the Australian minimum wage system. However, they cite quite different reasons for reaching this conclusion.

ACCI stresses that Australia's minimum wage is higher and affects a larger proportion of employees than in other countries.<sup>7</sup> Furthermore, Australia's minimum wage framework comprises not only the standard Federal Minimum Wage (FMW) but also minimum wages at higher levels in the wage distribution. In light of this, ACCI argues that:

When one stops to consider those [preceding] factors, then the only valid conclusion is that Australia potentially, if not in all probability, has a higher negative impact of wage increases on employment than the international literature and research would suggest.<sup>8</sup>

In contrast, the ACTU, ACOSS and the Queensland Government argue that the international evidence is ambiguous and that there are no significant disemployment effects in Australia.<sup>9</sup> The Queensland Government summarises this view by noting that 'under conditions of strong [economic] growth, modest wage increases are compatible with continued employment growth.'<sup>10</sup>

While this may be the case, this view downplays evidence that a slower rate of growth in real wages may result in even better employment outcomes. It also overlooks the possibility that, while aggregate employment may be affected only slightly by increases in minimum wages, employment of low-paid workers may be disproportionately harmed.

<sup>6</sup> D Neumark and W Wascher, *Minimum Wages and Employment: A Review of Evidence from the Minimum Wage Research*, National Bureau of Economic Research Working Paper No. 12663, November 2006.

<sup>7</sup> ACCI, *2008 Minimum Wage Review: ACCI Submission*, March 2008, pp. 6-7, para. 1.28. ACCI cites AFPC, *Wage-Setting Decision and Reasons for Decision*, Commonwealth of Australia, October 2006, p. 8.

<sup>8</sup> ACCI, March 2008, p. 7, para. 1.29.

<sup>9</sup> ACTU, *Australian Council of Trade Unions Submission to the Australian Fair Pay Commission*, March 2008, p. 71, para. 5.44; and ACOSS, *Submission to the Fair Pay Commission on minimum wages*, March 2008, p. 3.

<sup>10</sup> Queensland Government, *Queensland Government Submission, Australian Fair Pay Commission, 2008 Wage Review*, 14 March 2008, p. 25, para. 97.

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The Victorian Government presents the results of a modelling exercise in its submission. Its findings are that there would be a moderate boost to employment in the short-term in response to slower growth in minimum wages.<sup>11</sup> The effects of the one off change in minimum wages were estimated to be insignificant by the second year of the simulations. However, no results were reported for a cumulative adjustment to minimum wages and whether such adjustments might have a sustained effect.

Evidence for a sustained effect may be found in Australia's experience during the 1980s. An objective of the Prices and Incomes Accords during that time was to restrain growth in real wages and real unit labour costs. The Accords were found to have boosted employment during that time to levels that would not otherwise have been achieved.<sup>12</sup>

While the regulatory environment has changed since the 1980s, a further thread of empirical research has compared the expansion of the economy at that time with the period since the early 1990s. That research suggests that, in the latter period, the benefits of economic growth have accrued more through increased wages and incomes than through increased employment. For example, Professor Bob Gregory has observed that:

The new labour market [since the early 1990s] is delivering the gains from a faster rate of technological change to those that are employed rather than creating new jobs for the unemployed.<sup>13</sup>

ACOSS points to the relevance of the business cycle in considering the extent to which unemployment can be further reduced at this point in time. They argue that those people who remain unemployed at this advanced point in the current economic cycle are generally drawn from the most disadvantaged groups in society. This, they suggest, may reduce the potential for minimum wages to be adjusted in a way which provides further stimulus to employment.<sup>14</sup>

However, the Australian Fair Pay Commission (Commission) notes that the economic outlook is uncertain. Economic activity and employment growth are forecast to slow in the near term, while unemployment is expected to increase.

### 2.2. Employment trends for low-skilled workers

While many submissions analyse the trends in employment of low-skilled workers over recent years, they reach a variety of conclusions. The ACTU observes that employment growth across industries with a high proportion of low-paid employment (such as Retail trade, Manufacturing and Health and community services) was strong over the year to the December 2007 quarter, stating that:

Demand remains high for labour, including minimum wage occupations. There is no evidence that the level of minimum wages is having a negative impact on employment or participation rates.<sup>15</sup>

<sup>11</sup> Victorian Government, *The Victorian Government's submission to the: Australian Fair Pay Commission*, 14 March 2008, pp. 23-28.

<sup>12</sup> P Dawkins, 'The Australian Labour Market in the 1990s', in D Gruen and S Shrestha (eds), *The Australian Economy in the 1990s*, Sydney, RBA, July 2000, p. 325.

<sup>13</sup> R G Gregory, 'A Longer Run Perspective on Australian Unemployment' in J Mangan (ed) *Understanding and Reducing Unemployment: National and State Perspectives*, Office of Economic and Statistical Research, Queensland Treasury, 2000, p. 11.

<sup>14</sup> ACOSS, March 2008, pp. 7 and 30.

<sup>15</sup> ACTU, March 2008, p. 71, para. 5.44.

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On the other hand, the Australian Federation of Employers and Industry (AFEI) indicates that, in the past two years, the rate of employment growth in low-skilled occupations (such as Elementary, clerical and sales service workers and Labourers and related workers) has slowed compared with that in higher-skilled occupations.<sup>16</sup> Australian Bureau of Statistics (ABS) data indicate that the level of unskilled employment has been broadly steady over the past decade, with growth skewed towards skilled occupations.<sup>17</sup>

Movements by industry and occupation are reflected in Table 2.1.

**Table 2.1: Employment growth in Pay Scale reliant industries, to May 2008**

Industry	Percentage of total Pay Scale reliant employees across all industries	Annualised growth rates			
		1-year	3-year	5-year	10-year
Accommodation, cafes and restaurants	14.0	-2.4	0.5	2.3	2.1
Low-skilled occupations*		0.0	0.0	4.1	2.0
Health and community services	12.1	2.4	3.9	3.9	3.2
Low-skilled occupations		-3.2	-1.7	-0.2	-0.2
Property and business services	21.1	0.1	2.8	2.5	3.1
Low-skilled occupations		-1.8	0.1	0.2	1.4
Retail trade	22.2	4.6	0.6	1.0	2.2
Low-skilled occupations		6.3	-0.4	-0.3	1.6
<b>All industries</b>	<b>100.0</b>	<b>2.2</b>	<b>2.4</b>	<b>2.5</b>	<b>2.2</b>
<b>Low-skilled occupations</b>		<b>2.3</b>	<b>-0.1</b>	<b>0.6</b>	<b>0.7</b>

\*Low-skilled occupations include Elementary clerical, sales and service workers and Labourers and related workers.  
Source: ABS, *Labour Force, Detailed, Quarterly*, May 2008, Cat. 6291.0.55.003.

In the medium-term, therefore, employment growth in low-skilled occupations has been weaker than that in all other occupations. However, ACOSS suggests that the labour market remains broadly favourable for low-skilled workers, despite growth in the overall number of low-skilled jobs levelling off over the last four years.<sup>18</sup>

The ACOSS view is supported by the results of focus group research for the Commission, which confirms that the demand for unskilled labour remains high. Some low-paid occupations attract fewer workers and exacerbate labour shortages for employers. Potential employees consider the wage rates being offered in these parts of the labour market to be insufficient to outweigh the negative aspects of these jobs, particularly when employment prospects are abundant.<sup>19</sup> As a result, employers describe feeling the pressure of an 'employee's market', with job vacancies being hard to fill.<sup>20</sup> The focus group research indicates that employers' wage and employment strategies are being challenged by tighter labour market conditions, with diverse outcomes emerging.

<sup>16</sup> AFEI, *Submission to the Fair Pay Commission*, March 2008, p. 20, para. 4.2.

<sup>17</sup> AFPC, July to December 2007, p. 17.

<sup>18</sup> ACOSS, March 2008, p. 8.

<sup>19</sup> TNS Social Research, *Report on Public Consultations for the Australian Fair Pay Commission's 2008 Minimum Wage Review*, report commissioned by AFPC, 2008, p. 43.

<sup>20</sup> TNS Social Research, 2008, p. 38.

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While growth in aggregate levels of unskilled labour appears to be steady, employment outcomes for a range of lower-skilled demographic groups have improved over the past few years. Unemployment rates have continued to decline for many of these demographic groups.<sup>21</sup>

However, as the Australian Government notes, 'a number of groups, including teenagers, the long-term unemployed, lone parents and lower skilled workers continue to face significant labour market disadvantage'.<sup>22</sup> It also notes that these groups are most likely to be reliant on minimum wages:

Members of these groups are more likely to be employed, or to seek employment in low skilled, low paid jobs and therefore be most affected by the Commission's decisions. Any adverse labour market effects of the Commission's decisions could therefore be expected to be more noticeable amongst these groups. However there is no indication that this has so far been the case.<sup>23</sup>

The ACTU shares the Australian Government's assessment of improving labour market outcomes for low-skilled workers, pointing out that the unemployment rate for Labourers and related workers has declined over time.<sup>24</sup> However, AFEI argues that unemployment rates should be compared across all occupational groups, rather than just focusing on changes affecting a single group. AFEI suggests that such an examination is needed to demonstrate how 'difficult employment prospects [are] for the lower skilled'.<sup>25</sup>

The Australian Government reports that:

Notwithstanding the fall in unemployment and increase in participation rate for the low skilled, it remains the case that those groups most likely to be reliant on minimum wages have considerably higher unemployment rates than the rest of the labour force.<sup>26</sup>

The Commission will continue to monitor trends in employment of low-skilled workers and labour force participation rates of groups that are disproportionately represented in low-paid employment. These groups are at greater risk from adverse changes in the economy.

### 2.3. Transitions into and out of low-paid employment

In monitoring labour market outcomes for low skilled people and the relevance of minimum wages, the Commission examines transitions into and out of low paid employment.

The Australian Government provides further evidence on the nature of low paid employment drawing on the *Household, Income and Labour Dynamics in Australia* (HILDA) Survey. The Government reports that the prevalence of low-paid employment declined by one percentage point over the period 2001 to 2005, to nine per cent. It also finds that, in relation to the labour market transitions of low-paid people:

<sup>21</sup> AFPC, July to December 2007, p. 17.

<sup>22</sup> Australian Government, *Submission to the Australian Fair Pay Commission Minimum Wage Review 2008*, 14 March 2008, p. 13, para. 2.36.

<sup>23</sup> Australian Government, 14 March 2008, p. 13, para. 2.36.

<sup>24</sup> ACTU, March 2008, p. 69, para. 5.40.

<sup>25</sup> AFEI, March 2008, p. 21, para. 4.4.

<sup>26</sup> Australian Government, 14 March 2008, p. 15, para. 2.48.

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...around half of the low paid end up in higher paid job [sic] in both the short and long term. However, the remaining low paid employees do not make that transition.<sup>27</sup>

and

Low paid employees have a much higher likelihood of exiting the labour force or becoming unemployed compared with medium and higher paid employees. However, those people who 'churn' between low paid jobs and unemployment or remain persistently low paid are considerably better off financially than they would be without a job at all.<sup>28</sup>

The ACTU refers to research by Dr Ian Watson which examined changes in the median wage rate for employees in the bottom quintile of earnings, as well as the movement of job seekers from unemployment to the bottom quintile of earnings between 2001 and 2005. Based on Watson's study, the ACTU submits that:

...while there is growth in rates of pay in the bottom quintile right through the period there is also strong growth in rates of entry into employment for the unemployed.<sup>29</sup>

Watson also found evidence of upwards earning mobility for some of those unemployed who enter employment at the bottom quintile of earnings. However, he cautioned that there 'are a large number of formerly unemployed people—nearly 160,000—who are in work, but still reliant on AFPC decisions'.<sup>30</sup> Furthermore, Watson observed that, compared with their counterparts further up the wage distribution, employees earning at or below the standard FMW experience longer periods out of the labour force or unemployed.

Although the analysis submitted by the Victorian Government in 2008 is restricted to Victoria, the results are qualitatively similar to those obtained in Watson's study of the whole Australian population. The Victorian Government notes:

This research supports the conclusion that low pay work acts as a stepping stone for workers, in particular those from unemployment. However, while it is true that a substantial proportion of unemployed and low paid workers progress to jobs with higher income levels over this period, a considerable proportion of workers remain at the bottom level of the income distribution.<sup>31</sup>

ACOSS also finds that the evidence concerning the job mobility of low-paid employees is mixed, stating that:

Jobless people are more likely to be able to secure low paid jobs – especially casual jobs – than they are to move straight into higher paid, more secure jobs. There is also some evidence to suggest that these low paid or casual jobs can lead to better paid, or more secure employment, including for people who were previously jobless. But many return to joblessness, and many others remain in low paid work over the long term – especially if they were previously unemployed or have major work barriers such as a disability.<sup>32</sup>

Expressing a similar concern for workers who enter the labour force through casual

<sup>27</sup> Australian Government, 14 March 2008, p. 29, para. 3.36.

<sup>28</sup> Australian Government, 14 March 2008, p. 29, para. 3.37.

<sup>29</sup> ACTU, March 2008, p. 53, para. 5.11.

<sup>30</sup> I Watson, *Low Paid Workers in Australia: insights from HILDA*, a report for IR Victoria, March 2007, p. 31.

<sup>31</sup> Victorian Government, 14 March 2008, p. 29.

<sup>32</sup> ACOSS, March 2008, p. 38.

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employment, the Victorian Government submits that:

Adult workers who enter ongoing work are far more likely to remain in that employment and improve their position; in contrast, workers who enter casual employment have a lower likelihood of remaining employed and a higher likelihood of leaving the labour market. It is for this group of workers that the AFPC should be concerned with raising incomes over time.<sup>33</sup>

In summary, while there is evidence of upward earnings mobility for both unemployed people and low-paid employees, a sizeable proportion of low-paid employees is likely to 'churn' between low-paid jobs and unemployment, or out of the labour force, or remain in low-paid employment over time. The Australian Government cautions that:

...these workers are also at risk that any increase in the minimum wage which is too large will be counterproductive if it leads to a reduction in hours of work (including the loss of jobs) for these workers...<sup>34</sup>

The Commission regards labour market transitions as an important dimension of the experiences of low-paid and unemployed people. Setting minimum wages too high could exacerbate churning between low-paid employment and unemployment, reducing the chances of people moving into better-paid jobs.

### 2.4. Unmet demand for and supply of low-skilled workers

Various business and job vacancy surveys indicate that unmet demand for labour remains high. For example, the total number of job vacancies recorded on the Australian JobSearch website was around 87 000 in mid May 2008,<sup>35</sup> with around half of those vacancies appearing to be low skilled.

Estimating the level of unmet demand for labour with any accuracy is a difficult task. The number of unskilled vacancies may be overstated because of turnover and churning. For example, Restaurant and Catering Australia expresses concern that the hospitality industry experiences a high turnover of staff, as low-paid employees tend to move rapidly out of the industry to progress to higher pay:

While low skilled jobs traditionally have had the highest rates of staff turnover, reflecting individuals moving along the career path from lower skilled to higher skilled jobs, in the hospitality industry the change in occupation is often unrelated to the area of work. The industry is often used to provide casual income for students, who then go on to other careers on completion of their study...One of the immediate challenges for the industry is addressing the need for skilled staff in order to realise the full economic potential of the industry.<sup>36</sup>

Conversely, the level of demand for unskilled labour may also be underestimated by vacancy surveys, in part as vacancies are often 'advertised' informally or postponed due to a perception of labour shortages.

While estimates of unmet demand for labour are high, unmet supply may be far greater. One estimate is that 7.9 per cent of hours of work are lost due to unemployment, underemployment or discouragement from the labour force.<sup>37</sup>

<sup>33</sup> Victorian Government, 14 March 2008, p. 37.

<sup>34</sup> Australian Government, 14 March 2008, p. 19, para. 3.4.

<sup>35</sup> DEEWR, *Vacancy Report*, May 2008 <<http://www.workplace.gov.au/workplace/Publications/LabourMarketAnalysis/VacancyReports/>>, at 2 June 2008.

<sup>36</sup> Restaurant & Catering Australia, *Australian Fair Pay Commission Submission – R&CA 2008*, 2008, pp. 9-10.

<sup>37</sup> Centre of Full Employment and Equity, *CoFFEE Labour Market Indicators*, Newcastle, February quarter 2008.

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In response to these statistics, the Australian Industry Group (Ai Group) urges the Commission to:

...fully integrate underemployment and marginal attachment to the labour force as well as unemployment in its considerations on the full impacts of changes in minimum wage levels on the labour market.<sup>38</sup>

A complementary indication of the underutilised pool of labour can be found in the number of working-age income support recipients. With the exception of those on the Disability Support Pension (DSP), the number of working-age income support recipients has declined over the past four years. However, there were still more than 1.5 million people receiving working-age income support in 2006-07.<sup>39</sup>

The labour market appears to have capacity to absorb some lower-skilled income support recipients into low-paid employment, given estimates of unmet demand. However, the level of unmet demand for low-skilled labour could be significantly lower than the level of potential supply in both the short and longer terms.

Analysing the job search experience of the unemployed using ABS data, AFEI observes that the reasons most cited for not finding employment were insufficient skills or lack of experience. AFEI concludes that:

Regulated wage increases have a direct, negative effect on the demand for low paid workers in industries with high relative labour costs. Employers will only offer jobs if wages, labour on costs and return on output make economic sense. Even in an economy operating at near full employment, at the current minimum wage employers are not creating or retaining enough jobs suited to low skill/low wage workers.<sup>40</sup>

This reflects concerns that the employment prospects of the unemployed, and those people who are marginally attached to the labour force, may be adversely affected by the Commission's decision.

Focus group research indicates that many participants considered it easy to get a job if they wanted one. While they found it was easy to get 'any job', finding 'the' [preferred] job proved more time consuming. However, not all participants found that it was easy to get 'any job', particularly those people located in less buoyant labour markets or who encountered barriers to employment.<sup>41</sup>

In summary, the labour market remains tight with the unemployment rate remaining low. Vacancy rates indicate that there is a high level of unmet demand for unskilled labour. However, at the same time, a significant number of people are underemployed or disengaged from the labour force, and weaker economic conditions may place low-paid workers in a more vulnerable position.

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38 Ai Group, *Australian Fair Pay Commission – 2008 Minimum Wage Review*, March 2008, p. 38, para. 126.

39 ABS, *Year Book Australia, 2008*, Catalogue No. 1301.0, Canberra, 2008.

40 AFEI, March 2008, p. 24, para. 4.11.

41 TNS Social Research, 2008, p. 37.

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### 2.5. Work incentives

The issue of minimum wages and work incentives is addressed in a number of submissions to the 2008 Minimum Wage Review. Several submissions (for example, from the NSW Government, the ACTU, ACOSS and the Federation of Ethnic Communities' Councils of Australia) argue that higher minimum wages encourage workforce participation, by creating an incentive 'gap' between in-work and out-of-work disposable income which encourages jobless people to join the labour force.<sup>42</sup>

However, employer groups advocate caution in focusing on the creation of work incentives through minimum wages. For example the Ai Group emphasises that, in general, employers themselves already have strong incentives to offer wages at a level that will encourage workforce participation:

In light of the existence of adequate market-based incentives for employers to induce labour force supply, Ai Group does not think there is a strong reason for the minimum wage review decision to be complicated by the need to assess whether minimum wage levels will be sufficient to induce adequate labour market supply.<sup>43</sup>

ACCI refers to the Commission's *Economic and Social Indicators - Monitoring Report*, arguing that its analysis of work incentives highlights the central influence that tax and social security measures have on such work incentives:

This underscores the need to be cautious in seeking to secure a particular policy outcome through the crude single lever of minimum wage increases.<sup>44</sup>

In considering the capacity of unemployed and low-paid people to obtain and remain in employment, the Commission notes the effect of minimum wages on labour supply. It is important that unemployed people have adequate incentives to take up low-paid work and that people in low-paid work are encouraged to maintain their employment.

The Commission's monitoring of a range of work incentive indicators shows that financial incentives for unemployed people to move into work have either remained stable or improved in recent years.<sup>45</sup>

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<sup>42</sup> ACOSS, March 2008, p. 9.

<sup>43</sup> Ai Group, March 2008, p. 40, para. 132.

<sup>44</sup> ACCI, March 2008, p. 142, para. 7.63.

<sup>45</sup> AFPC, July to December 2007, pp. 29-32.