

5. Exploding the Myth of Moderation: The Cost of the ACTU Claim

Introduction

[5.1] The ACTU claim seeks an increase in award wages which it states will not add significantly to costs. This is an incorrect assertion. The ACTU claim, if granted, would add substantially to the costs of production and would slow the rate of improvement in the labour market and diminish the growth rate in the level of investment. It would make Australia less internationally competitive since we would be adding pressures across the entire awards structure at a time when it is a virtually certainty that none of the nations against which we compete would contemplate raising the minimum wages of their own workforce in this manner, if at all. Since the Commission is being asked to raise all award minima, and not just the minimum wage, we will be adding to costs in a much more comprehensive way than any of our competitors would remotely consider.

[5.2] The ACTU's minimum wage claim amounts to a 6.0% increase which is clearly in excess of productivity gains. As much as the ACTU attempts to hide the impact of increasing the wages of the lowest paid workers by arguing that, according to its own estimates, on average wages will only rise by 0.4 percent, the straightforward and undeniable fact is that individuals on the minimum wage would get an increase of 6.0%. There is no sense in which individuals get the average increase; therefore, there is no sense in applying the average increase to any given employee. There is no denying that individuals on the minimum wage would now cost 6.0% more to employ.

[5.3] The rise by 6.0 % to 4.9 % for the C14 through to the C10 level can only result in significant hardships for those that will:

- not be employed for as many hours as they previously were, or
- find themselves out of work when they previously had jobs, or
- not be able to enter into paid employment.

[5.4] It must be productivity that drives wages for a business to be able to afford wage increases without serious consequences for employment, investment and inflation. The ACTU has presented a claim that if granted would cost jobs amongst those that can least afford it.

The GST and the Safety Net

[5.5] The ACTU at paragraph 3.37 of its submission and in Table 3.10 stresses that real incomes fell when increases in the cost of living are considered. What the ACTU ignores is that in spite of there being some debate over the actual impact of the GST on inflation, coinciding with the introduction of the GST were personal income tax cuts. Therefore, although there was an unusually large rise in the CPI due to the introduction of the GST, this rise in the price level was offset by reductions in income tax payments so that there was no loss of real disposable income.

[5.6] ACCI has calculated the benefit of tax cuts and the real increases in wages focusing on the examples provided by the ACTU, the C10 and C14 categories. The table is presented below.

[5.7] The personal tax reductions were the equivalent of a wage increase of 3.0% on average, which is identical to the estimated increase in the CPI due to the introduction of the GST. What is evident is that despite the real wages impact of the GST on the CPI, the actual GST impact was significantly reduced over the year due to reductions in the income tax burden on the low paid.

Benefit From Reduction in Personal Tax
- 2000-2001 Financial Year

Award Classification	2000 After Tax Income per Week (\$)	2000 Post GST After Tax Income per Week (\$)	Personal Tax Cuts (\$)	After Tax Benefit of Lower Personal Tax rates (%)
C14	337.03	346.38	9.35	2.8
C13	347.83	357.85	10.02	2.9
C12	362.38	373.30	10.92	3.0
C11	375.90	387.66	11.76	3.1
C10	396.40	409.43	13.03	3.3
Average				3.0

[5.8] Given that there were other benefits provided beyond just the personal tax cuts should mean that this aspect of ACTU submissions should now be closed off. The increases granted last year in combination with the personal tax cuts mean there should be nothing further to say. The introduction of the GST should have no further relevance to this or any future Safety Net decision.

Costing the Claim

[5.9] The methodology used by the ACTU to cost the claim results in a figure to be added to Average Weekly Ordinary Time Earnings of 0.68%. The ACTU then attempts to say that because not all award employees get the increase this figures then shrinks down to 0.49%. The ACTU then assumes that the award wage increase would not flow-on to overawards or non-award employees.

[5.10] ACCI evidence, however, suggests that this is an incorrect assumption to make. The evidence suggests that in contrast to the ACTU position, there is a very real flow-on effect. ACCI's survey on the Safety Net is presented in Tag 6.

[5.11] It is unrealistic for the ACTU in developing its costing estimates to assume that a worker who through experience or improved productivity has earned an overaward payment would think it fair and acceptable that a less experienced or less productive worker should be granted a raise while the overaward employee is not. There would be the expectation in the workplace that the relativity between the two wage earners would remain.

[5.12] We note that the ACTU in its submission is well aware of the problems associated with compression of relativities between and within awards. On page 11 of its written submission in 2001 it states the following:

“It (wage compression) undermines fairness by diminishing the extent to which award rates properly reflect the relative skills, responsibilities, etc of jobs covered by awards. This phenomenon occurs both between awards and within awards.”

[5.13] The assumption of no flow-on of any increase in wages to overaward wage earners clearly goes against the ACTU's objective of retaining wage relativities within awards. Even to propose that the cost of the claim on average be quarantined within awards provides no indication of the true impact and ignores what happens at the workplace level.

[5.14] ACCI's survey results allow us to produce the illustrative tables below that show more realistically the full impact of the ACTU claim and an example of the cost of a \$10 increase. The tables are for the private sector only. We have, despite the inadequacies of doing so (again since the average full-time employee receives much more than \$19.95), employed the ACTU's process of weighting

the \$25 increase and scaling down the increase as it has done in its own submission.

[5.15] The first column in the table shows how the private sector is divided into award, overaward and non-award employees as a proportion of the total private sector labour force. These figures are provided by the ABS.

[5.16] The next column gives the proportion of private sector employees who would be given an increase in wages based on the Safety Net decision in each of the award, overaward and non-award categories. The figures for those on overawards and for non-award employees are taken from ACCI's survey on the effects of last year's decision. The aim is to determine what proportion of employees in the private sector would receive an increase directly as a result of Safety Net Adjustments. Although there is some approximation in the data, since the proportion of firms is not identical with the proportion of employees, it is a reasonable estimate of an unknown parameter.

[5.17] The proportion of employees who would be paid the Safety Net directly is calculated by taking the proportion of employees on each form of payment in Column 1 and multiplying it by the proportion who received the Safety Net increase in Column 2. This calculation is shown in Column 3.

[5.18] What we find once we take into account the flow-on effects of the decision, is that nearly 46.3% of private sector employees are given a wage increase as a direct consequence of Safety Net adjustments. This is a crucial point. The award increases are not constrained only to award employees but are passed on to a large proportion of the labour market.

[5.19] It may also be noted that the calculated result of 46.3% of private sector employees that are given a wage increase as a direct consequence of Safety Net adjustments sits very well with the ACCI survey data where the proportion was 42.2%.

[5.20] Continuing across the Tables, in Column 4 we have used the ACTU weighted average increase in wages for award employees. For simplicity we have also used these figures for the overaward and non-award categories. This weighted increase multiplied by the proportion of employees granted the increase gives us a figure for the addition to weekly earnings in dollar terms. This is shown in Column 5.

[5.21] Column 6 then gives the ABS data on Weekly Earnings for the Private Sector. Dividing the dollar increase by the weekly earnings data gives the addition to wages growth in percentage terms.

The Addition to Private Sector Total Earnings From a Flat \$25 Increase

Column	1	2	3	4	5	6	7
Data Source or Calculation	ABS	ACCI	1*2	ACTU	3*4	ABS	5/6
Private Sector Award Dependent Employees	26.8	100.0	26.8	19.95	5.35	642.60	0.8
Over-Award Employees	49.3	30.4	15.0	19.95	2.99	642.60	0.5
Non-Award Employees	23.8	18.8	4.5	19.95	0.89	642.60	0.1
Total			46.3				1.4
	Proportion of Total Private Sector Employees (%)	Proportion of Employees per Category Receiving Increases Directly Through Safety Net Decision (%)	Proportion of Private Sector Employees Receiving Increases Directly Through Safety Net (%)	Weighted Increase Sought by the ACTU (\$)	Addition to Earnings Growth (\$)	Private Sector Total Earnings (\$)	Addition to Private Sector Earnings (%)

The Addition to Private Sector Total Earnings From a Flat \$10 Increase

Column	1	2	3	4	5	6	7
Data Source or Calculation	ABS	ACCI	1*2	ACTU	3*4	ABS	5/6
Private Sector Award Dependent Employees	26.8	100.0	26.8	7.99	2.14	642.60	0.3
Over-Award Employees	49.3	30.4	15.0	7.99	1.20	642.60	0.2
Non-Award Employees	23.8	18.8	4.5	7.99	0.36	642.60	0.1
Total			46.3				0.6

[5.22] What these tables demonstrate is that when consideration is made for the flow-on effects the ACTU claim is even less reasonable in terms of the impact on average wages than it would like to portray. The data in the table show that granting the \$25 increase sought by the ACTU would lead to an increase in earnings of 1.4 percentage points. This is the figure shown in the bottom right hand corner of the table.

[5.23] This is money granted in return for no improvements in productivity. It therefore builds straight into the inflation rate since it is a cost increase that is difficult to finance in any other way. We have already noted that the CPI is pressing upwards, and has even now exceeded, the RBA's upper limit. This kind of increase provides an explanation for why the Australian inflation rate is above that of other major industrialised economies. We are building in this higher cost structure and are bringing the day forward when the official cash rate is next pushed up.

[5.24] The second table shows the effect of granting an increase of \$10 rather than \$25. The methodology is exactly the same but in this case the estimated increase in earnings growth is 0.6 percentage points. While this is a lower figure, it is by no means a benign number. It is an increase that presses on the cost structure of industry in a way that occurs in no other developed economy.

[5.25] The ACTU continuously draws attention to the minimum wage adjustments which occur in other economies and stresses how little damage such increases do while providing an important safety net for the low paid. We are attempting to compete with such economies in a low inflation environment by not only raising the minimum wage, but by increasing minimum award wages across the entire awards structure. Thus, if we granted the flat \$10 increase, there would be an increase in Australia's cost

structure of 0.6 percentage points relative to the costs in other economies which would be an increase larger than the effects of a minimum wage adjustment which only applies at the bottom of the pay scale.

[5.26] Moreover, in economies in which only the minimum wage is adjusted, it is not normally adjusted annually which appears to be becoming the established practice here in Australia. The adjustment of the minimum wage is done on an occasional basis when it appears that the rate may need an adjustment and then only after serious consideration of all of the consequences over a substantial period of the economic cycle or cycles. There is no doubting in any of these economies that it is well understood that raising the minimum too rapidly will cost jobs so that the essential matter is that minimum wage increases are only granted when there is real evidence that the effects will be extremely limited.

[5.27] One may take it as a near certainty that no economy in the world today would be raising its minimum wage while the uncertainties are as massive as they are. Yet we are seriously debating whether to adjust, not just the minimum wage, but all award rates by an amount that would make the Australian economy less competitive and more vulnerable in a world economy whose final direction is simply anyone's guess.

[5.28] **Confining the increases to the bottom of the wages structure does the most good with the least amount of damage.** It is also consistent with the statutory purposes of the *Workplace Relations Act 1996*. This is the approach that the Commission ought to take. It should recognise the risks that we will run by raising costs by such a large amount at a time like this, and it will not only reject the ACTU claim, but will reject the methodology of raising all award minima at one and the same time, from the minimum wage right up through award wages of over \$1000 per week.

Proper Basis for Estimating the Cost of the ACTU Claim

[5.29] One useful function the ACTU’s figures do provide is that they are a sharp reminder that the average wage increase across the economy does not provide an adequate estimate of the impact of the claim on employment. To go about making estimates of the average increase in the average wage diverts attention from what is actually the important issue: what will be the effect on specific employees in their specific jobs?

[5.30] Take, for example, an employee paid the minimum wage. If the ACTU claim were to be granted, the minimum wage would rise by \$25 on a wage level of \$413.40. That is, it would represent an increase of 6.0% for any such employee.

[5.31] The increase does not go to an average employee at the average level of the increase in wages. The increase goes to particular employees at particular rates of pay and the effect is on individual employees and their employers.

**Cost of ACTU Claim for \$25
on the Low Paid**

	2001 Award Wages (\$)	Award With ACTU Claim for \$25	Percentage Demand (%)
C14	413.40	438.40	6.0
C13	430.10	455.10	5.8
C12	452.60	477.60	5.5
C11	473.50	498.50	5.3
C10	507.20	532.20	4.9

[5.32] The manner in which the ACTU estimates the cost of the claim is to look at the average impact across some estimate of the average cost of

employing labour. Calculating the cost of the claim in terms of the so-called average wage earner misses the point.

[5.33] The ACTU give us a figure of 23.2% as the proportion of employees on award rates of pay only. It then assumes that simply because 23.2% percent of the workforce is on awards that only 23.2% of the increase counts. This ignores the fact that the ACTU's claim will have varying impacts across different firms in different industries and the employees within these firms.

The Fallacy of the Inflated Denominator

[5.34] The issues raised by ACCI in this case in regard to the manner in which the ACTU uses the entire workforce as the base on which to estimate the increases in the cost of labour have been drawn to the Commission's attention since the start of the Safety Net process. The cost of employing an individual will rise by \$25, and on the minimum wage this will represent an increase of 6.0%. At \$500 per week the increase will still be a very significant 5.0% and at \$600 the increase will be 4.2%. What the ACTU does is scale the increase down by weighting it so that it is cut by a quarter so that it will only apply to those on minimum award rates and then uses the figure for Average Weekly Ordinary Time Earnings, which includes the full-time wages of every employee in Australia as the denominator to calculate the effect on costs. The answer it comes up with ends up being much smaller than the cost increase that would be applied in any individual instance where someone who is genuinely low paid is involved.

[5.35] As we have argued in the past, this is an invalid approach. It turns out that our criticisms have been recognised in the economic literature in regard to the minimum wage controversy and is referred to as "the fallacy

of the inflated denominator”. In a discussion of this issue by Matthew James, Mark Wooden and Peter Dawkins in the *Economic Papers* for September 2001 [hereafter referred to as JWD and found in Tag 7] there is a discussion on the manner in which the impact of minimum wages on teenage unemployment is diminished because many such studies look at the entire teenage workforce, many of whom do not receive increases when the minimum wage is increased, so that the impact of the rise in the minimum wage on teenage employment in such studies is understated. The inclusion of all teenagers and not just those teenagers paid the minimum wage invalidates the conclusions drawn from such studies because the denominator is inflated and the estimated effect is diminished.

[5.36] This is the same problem writ large in regard to the cost estimates of its claims that have been used by the ACTU. The denominator it chooses, which is AWOTE, is completely unrepresentative of the employees affected. It provides little guidance in regard to the actual cost impact because the denominator is invalid. The cost calculations are near meaningless as an estimator of the impact of the claim on the demand for labour. As the paper states:

“The key question for policy makers regarding minimum wages, however, is not their aggregate impact but their impact on those who will actually be affected by that wage” (page 67).

[5.37] This is the point we have ourselves been trying to make in regard to this issue since the Safety Net hearings began.

[5.38] A number of other matters raised in the paper are also of significance. Firstly, in regard to the Card and Kreuger material that the

ACTU has relied on in the past, the JWD paper notes that they have themselves disclaimed any relevance for an economy such as Australia's:

“Card and Kreuger (1995, p. 393) have argued that their results only apply to the moderate range of minimum wages that has existed in the US in recent decades.” (page 59)

[5.39] We do not only apply increases to the minimum wage, but even if we did, given the relatively high minimum wage in Australia relative to the median, the results would anyway have no application.

[5.40] More generally, the paper is a reminder that many such minimum wage studies are inadequate to the task they set out to do. They do not provide a proper basis for comparison so that the conclusions apparently reached are misleading in regard to the impact of increases in the minimum wage. This is of particular relevance to the frequently cited OECD study on the minimum wage, about which JWD state:

“The OECD's findings thus do not imply that minimum wages have no impact on the employment of those who are affected by that minimum wage nor do they imply that the elasticity of demand for these workers is very low.” (page 67)

[5.41] But the major value in the JWD paper is its discussion of the importance of ensuring that when calculations are made of the impact of an increase in the cost of labour, the focus must be on what happens to those who receive those increases if we are to identify the labour market consequences of the increases granted.

[5.42] We have also included the reply to the JWD article written by John Nevile who does not dispute the issues raised in regard to the inflated

denominator but accepts that this is a valid point. He only believes that the issue of the inflated denominator was not important to the issues he had himself raised. His issue is about the structure of wage setting in Australia and in particular the recommendations made by the “five economists” for a four year award wage freeze. It does not disturb the central point of the JWD article on the importance of choosing the right denominator when making such calculations.

Illustrative Examples

[5.43] To illustrate why using an average award wage earner is fundamentally misleading in regard to the impact of the claim the ABS *Employee Earnings and Hours* 6305.0 from May 2000 provide statistics on the proportion of employees by industry and occupation on awards. An extract of this data is set out in the tables below.

Award Employees by Industry

Industry	Proportion of employees (%)
Construction	14.8
Wholesale trade	12.4
Retail trade	35.0
Accommodation, cafes and restaurants	65.2
Transport and storage	19.2
Property and business services	18.9
Education	25.3
Health and community services	37.1
Cultural and recreational services	19.1
Personal and other services	27.9
All industries	24.1

Source: ABS Employee Earnings and Hours, Preliminary - 6305.0 - May 2000

Award Employees by Occupation

Occupation	Proportion of employees (%)
Managers and administrators	3.3
Professional	13.2
Associate Professionals	12.2
Tradespersons and related workers	23.1
Advanced clerical and service workers	14.2
Intermediate clerical, sales and service workers	29.9
Elementary clerical, sales and service workers	42.0
Labourers and related workers	36.9
All industries	23.2

Source: ABS Employee Earnings and Hours, Preliminary - 6305.0 - May 2000

[5.44] In addition to the variations of the relative importance of awards by industry and occupation, there are also distinctions to be made between full-time and part-time employment as well as the division between males and females. For example, women are more likely to be paid award rates than males, with 31.2% of women on the award compared with 17.2% for male employees. Clearly, the granting of a 6.0 % increase in wages would have a much larger impact on the industry sectors and occupations most reliant on award rates of pay.

[5.45] Particularly vulnerable to cost increases in the price of labour is the community sector who as the tables show above have a fairly high concentration of award based employees and work on very limited budgets. The attached article in tag 4 from the September 2001 *Canberra Times* highlights the particular impact of increasing wages through the award system. The article entitled *Pay rise set to bite community sector: Tucker* states:

“Local community organisations have warned a recent increase in their staff award rates could slash jobs and services in the community sector.”

[5.46] This is just one instance of how award rate increases can have significant effects on organisations that operate on the margin. The use of aggregate data does not show the true effects of wage increases and thinking of wage increases as an aggregate increase to the wages bill for the economy as a whole has no application in any individual case.

[5.47] In addition, we must not lose sight of the fact that we are discussing a claim to increase costs against a backdrop in which the economy is not yet performing adequately, when we have a high structural rate of unemployment and where employment growth remains poor, particularly full-time employment.

[5.48] An increase of the amount claimed by the ACTU would put at risk the continued employment of thousands of Australians who are now working and would condemn thousands of other Australians, who do not now have jobs, to a further period of unemployment.

[5.49] Given current circumstances wages growth must remain moderate and should only be increased to the extent permitted by productivity growth. To increase wage rates by the amount currently claimed by the ACTU would have an immediate and significant impact on the Australian price level. Any rise in the CPI would be a major concern given the high CPI figures recorded in December. While the RBA has been seeking to downplay this number, we should not expect the same complacency from the RBA if the CPI remains high. It must be expected that if the CPI persists above the upper bound of its target range that it will not hesitate to

begin to raise interest rates once again. It should be said that a high CPI works substantially to erode the purchasing power and living standards of employees, especially the award based workforce, who the ACTU seek to assist.

[5.50] Increasing rates of interest constrain both the affordability of wage increases and will serve to slow growth. Both of which are not conducive to reducing unemployment nor fostering strong rates of wages growth over the longer term.

Conclusion

[5.51] The ACTU's wage claim is extravagant and unaffordable. The costing methodology utilised does not provide a realistic estimate of the cost of its claim to the economy. The manner in which the ACTU estimates the cost of the claim is to look at the average impact across some estimate of the average cost of employing labour when there is no such thing as an "average" employee receiving an "average" wage. The ACTU methodology continues to ignore the individual impact on individual employees and their employers. Moreover, the ACTU methodology fails to provide a realistic picture of the full cost of its claim because it continues to assume that the increase will be fully absorbed into existing overaward payments, which we have been able to demonstrate is clearly not the case.

[5.52] The ACTU costing of its claim cannot be relied upon to provide proper guidance to the actual effect on employment, prices and investment of granting the ACTU claim.