Safety Net Review – Wages

2001-2002

Commonwealth Submission

1 March 2002

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CHAPTER 1: THE COMMONWEALTH'S POSITION

Introduction

1.1 In this case, the Commonwealth will vigorously oppose what it regards as an ambit claim by the Australian Council of Trade Unions (ACTU) for a $25 per week increase in all award rates. Once again the ACTU's claim is inconsistent with the requirements of the *Workplace Relations Act 1996* (WR Act); is economically unsustainable; and will benefit many high income earners rather than focus on the needs of the low paid.

1.2 In this Safety Net Review the Commonwealth will argue for an affordable increase of $10 per week to award rates of the low paid on the following basis:

- to be available only to award rates up to and including the equivalent of the tradesperson's rate - C10 in the Metal Industries Award (currently $507.20 per week);
- to apply until the next Safety Net Review;
- to be fully absorbed into all above award payments including from enterprise agreements and informal overawards; and
- that there is a 12 month gap between the increases provided for by the Australian Industrial Relations Commission (AIRC) in its 2001 decision and any increases decided in this case.

1.3 In addition, the Commonwealth proposes amendments to the wage fixing principles to reaffirm the intent of the WR Act and to ensure that the principles continue to provide guidance and consistency in the

exercise of the Commission's powers under the WR Act. There are three areas of particular concern to the Commonwealth. The first is ensuring that enterprises, particularly small businesses and those in industries and sectors facing particular difficulties, can have a readily available avenue to seek temporary relief from an increase in wage costs. The second is removing ambiguity in the determination of changes to awards that may be considered *above or below the safety net* and/or referred to the President of the AIRC as *special case* applications. The third is to reaffirm in the wage fixing principles the emphasis the WR Act gives to agreement making at the workplace or enterprise level.

1.4 The evidence presented in this submission will demonstrate that in the light of uncertainties in the economic outlook, an increase to all award rates of the magnitude proposed by the ACTU will be damaging to the national economy and cause particular hardship for enterprises in certain industries, sectors and regions of Australia.

1.5 This submission will demonstrate conclusively that, if granted, the ACTU's claim would result in people, low skilled workers in particular, being pushed into unemployment. The consequences for the living standards of these people would be devastating. It is the Commonwealth's firm belief that unemployment is the main cause of poverty and disadvantage in the Australian community and that the decision that the Commission reaches in this case needs to be framed with this in mind.

1.6 There can be no doubt that the ACTU's claim overstates the capacity for the wages system to meet social equity goals. Safety Net Adjustments (SNAs) are a blunt instrument when is comes to improving

the position of low income families. The needs of these families can be more effectively targeted though the tax-transfer system.

1.7 The WR Act stresses the role of awards as a safety net of minimum wages and conditions focused on the low paid. Earnings of low paid workers have grown in real terms since 1996. Adjustment of the safety net should not be linked to market rates or bargained outcomes as the ACTU seeks to do in making comparisons to 'community wage movements'.[1] The WR Act does not intend that the award safety net should be adjusted on the basis of market rates and these arguments have been fully articulated in previous wage cases and accepted by the Full Bench in the Paid Rates Review.[2,3]

The 2001 Safety Net Review – Wages Decision

1.8 The Commonwealth does not believe the 'flared' adjustment provided in the 2001 safety net decision was appropriate in view of the legislated role of the award safety net focussing on the low paid and those unable to enter into agreement making.

1.9 It is clear from the very nature of the ACTU's claim before the Commission, and from public statements[4], that for its part the ACTU considered the 2001 outcome as being far from satisfactory. We note, however, that by seeking a 5.7 per cent increase in award rates above C10 in last year's case, the outcome in the 2001 case was, to some extent, of the ACTU's own making.

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[1] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 1.13.
[2] See for example, Joint Governments' Submission, 1998-1999 Safety Net Review-Wages (printed version), pages 239-240.
[3] Print Q7661.
[4] See for example, *Business Review Weekly*, 'The Pain of the Wage Claim', 31 January 2002, page 32.

1.10 Giving larger increases to higher paid employees also fails to provide an appropriate incentive for these employees to enter agreements. The 2001 decision suggests the Commission sees a role for the award system to determine the wages and salaries of middle and high wage earners, who are shown to be increasingly entering into wage agreements with their employers, and are less reliant on award based wage increases. The wage fixing principles are explicit in limiting the safety net role of awards to employees *unable* to make agreements;[5] that is, employees in low skilled occupations and at the lower classifications in the award system.

1.11 We note that this year's claim by the ACTU, which seeks a flat dollar adjustment only, is structured to give a larger proportional increase for low paid employees. This shows at least some degree of intersection with the Commonwealth's position in that SNAs should be directed towards the low paid. It is also noted that there is no request for a repeat of the 'flared' approach in last year's decision or a percentage increase for employees paid at higher award rates.

1.12 The ACTU accepts that internal award relativities are not a primary concern in the Safety Net Review. While the Commonwealth agrees with the ACTU submission on this point, it does not accept that the matter should be pursued elsewhere. The Commonwealth remains committed to focussing SNAs on the low paid and is not dissuaded from this view by the 2001 decision.[6] Indeed, the Commonwealth welcomes the opportunity to restate its policy position that any SNA should be targeted at low paid employees and that the setting of relativities is a matter for resolution through agreement making at the enterprise level.

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[5] Print PR002001, page 51.
[6] Print PR002001, paragraph 137

The Safety Net Role of Awards – Policy Position

1.13 Under the WR Act, the Commission is responsible for establishing and maintaining an effective award safety net in a manner that furthers the objectives of the Act.

1.14 Subsection 88B(2) of the WR Act states that, in performing its functions under Part VI of the Act, the Commission must ensure that a safety net of fair minimum wages and conditions of employment is established and maintained, having regard to:

> *(a) the need to provide fair minimum standards for employees in the context of living standards generally prevailing in the Australian community;*
>
> *(b) economic factors, including levels of productivity and inflation, and the desirability of attaining a high level of employment;*
>
> *(c) when adjusting the safety net, the needs of the low paid.*

1.15 A key part of the principle object of the WR Act is that actual wages should as far as possible be determined by bargaining at the workplace or enterprise level without uninvited third party intervention. A central feature of the legislative framework is the Commission's role to encourage such bargaining.

1.16 Decisions of the Commission on the adjustment of rates of pay in awards need to be consistent with and reinforce the safety net role of awards. This is important for the integrity of the system introduced by the 1996 changes to the WR Act - in ensuring its capacity to provide genuine safety net standards, to encourage agreement making and to meet overall economic objectives.

1.17 Changes to the WR Act in 1996 brought about a significant change in direction for the award system, refocussing it as a genuine safety net. New objects inserted in Part VI (covering dispute settlement and prevention) indicate that a fundamental statutory role of awards is to 'act as a safety net of fair minimum wages and conditions of employment'. The new objects also indicate that awards, while offering an enforceable system of statutory protections, are not intended to act as a disincentive to agreement making which should as far as possible be determined workplace pay and working arrangements and conditions.

1.18 Consistent with the WR Act's focus on the provision of safety net minimum wages and conditions in awards, the Commission's arbitral powers are limited to clearly defined circumstances. The WR Act generally confines the Commission's arbitral powers to the list of allowable matters specified in s. 89A(2). Other than in exceptional circumstances, awards and variations to awards may only deal with these allowable matters, and matters which are incidental to an allowable matter and necessary for the effective operation of the award. All other matters are now generally determined at the enterprise or workplace level, whether in formal agreements or informally.

1.19 The Act has also provided for pre-existing awards to be simplified so as to provide only for allowable award matters. The intention has been to ensure that minimum safety net standards continue to be provided without acting as barriers to greater workplace efficiency and flexibility and employment growth.

1.20 The WR Act emphasises the clear separation between the minimum protections afforded by the award system and actual outcomes achieved by workplace bargaining above the safety net. The objective is

to counteract the inflationary pressures and instability which arose from their interaction in the past. Importantly, the previous requirements that awards be maintained at a relevant level (s. 88A) and that 'secure, relevant and consistent' minimum award wages be maintained (s. 90AA) were removed in 1996 as part of the objective of refocussing awards more directly on setting minimum standards and acting as a safety net.

1.21 Consistent with the emphasis on awards as a minimum safety net focussed on the low paid, the WR Act when specifying matters to which the Commission must have regard in performing its functions under Part VI, refers to alterations to wage relativities between awards (s. 88B(3)(a)) but makes no reference to any need for alterations to wage relativities *within* awards. Maintenance of internal or vertical relativities within awards is not expected to be a consideration. To attempt to maintain such relativities would act to prevent safety net adjustments specifically targeted at the needs of the low paid.

Current reform agenda and the safety net focus

1.22 At the federal election of 10 November 2001 the Australian people returned a Government with a mandate to continue with further workplace reforms. The Government's position is contained in the policy statement, *Choice and Reward in a Changing Workplace*.[7]

1.23 The Government's workplace relations policy statement contains a commitment to provide an effective safety net of minimum wages and conditions of employment that can be relied on by low paid employees while contributing to workplace bargaining above the award safety net.

[7] Policy Statement released by the Coalition prior to the 2001 election.

1.24 At the outset of its third term the Government remains committed to the WR Act's employment safety net provisions by in particular:

- maintaining the minimum wage safety net made by the AIRC;
- retaining and, through further reform, continuing to simplify the minimum safety net industrial awards made by the Commission; and
- increasing, without significantly adding to employer costs, the minimum safety net for Victorian employees not employed under federal awards or federal agreements.

Conclusion

1.25 The WR Act places an onus on the Commission to have regard to economic factors in its deliberations in the Safety Net Review (in particular, s. 3(a) and s. 88B(2)(b)). This submission will show the adverse impacts on the labour market and the economy generally if the ACTU's claim were to be accepted in full.

1.26 The ACTU seriously underestimates the impact of its claim on aggregate wage growth and on employment levels. Its assertion that the claim would add 0.2 per cent to annual growth in average earnings actually refers to the amount over and above the cost of last year's decision. The full cost of the ACTU's claim is actually much larger – 0.59 per cent. If awarded in full, it will have a significant impact on the economy. Compared to the Commonwealth's position, for example, the ACTU's claim could push out of work up to 37 000 employees. This would come at a time when the one percentage point increase in the Superannuation Guarantee Levy will add an additional labour cost burden to employers.

1.27 Regional, industry and sectoral data presented in this submission highlight the dangers of an excessive safety net increase. A deterioration in the world economy has already impacted on some export-orientated and tourism related industries and occupations, although the very competitive level of the Australian dollar has provided a partial buffer for these sectors. Regions with high concentrations of these industries remain vulnerable and will face great difficulty in absorbing the shock of the ACTU's wage claim without further employment losses.

1.28 The Commonwealth will argue that the wages system has limited capacity to address and meet social equity goals. In the submission we stress that it is the overall level of income rather than its source that is most important in determining a person's living standards in the community. The tax-transfer system is the most effective way of helping low income earners and addressing poverty in Australia. While the ACTU's claim represents a relatively higher increase for the low paid than for higher paid employees, the across-the-board nature of the proposed increase is, in the Commonwealth's view, inconsistent with the intention of s. 88B(2)(c) of the WR Act. To this end, the Commonwealth will argue for the SNA to be capped at the C10 rate in the Metal Industries Award.

1.29 A capped safety net is consistent with the intent of the WR Act on two main fronts. First, it will help to contain the negative impact of wage increases on the labour market and the economy. Second, it addresses a fundamental (and somewhat overlooked) requirement in the WR Act that the Commission exercise its powers in ways consistent with the objectives that wages and conditions are determined as far as possible by agreement at the workplace or enterprise level, that awards act as an

effective safety net and that arbitrated adjustments to award rates do not act as a disincentive to agreement making.

CHAPTER 2: THE ECONOMY: DEVELOPMENTS, OUTLOOK AND POLICY

Introduction

2.1 In the current financial year, growth in the Australian economy is expected to be below the long-term average. Growth is expected to strengthen somewhat in 2002-03, although there are significant uncertainties to the outlook. The labour market, however, is expected to remain subdued.

2.2 Official forecasts for the economy are released twice a year, in the Budget documents and in the Mid-Year Economic and Fiscal Outlook (MYEFO).[1] Forecasts presented in this Chapter are from the latest MYEFO, which was released in October 2001. These forecasts were prepared in the immediate wake of the 11 September terrorist attacks, which came on top of an already sharply weakening world economy, and the collapse of Ansett. Additional data released since the finalisation of the MYEFO forecasts, which may impact on the economy, are outlined in the commentary. Chapter 4 presents an evaluation of the likely effect of the ACTU's claim based on the economic outlook presented here.

2.3 The key features of the outlook are:

- World growth is expected to have been around 2¼ per cent in 2001, with growth in major trading partners likely to have been less than 1 per cent. Global economic growth is likely to remain subdued in

[1] The MYEFO forecasts were also used in the Pre-Election Fiscal Outlook (PEFO).

early 2002, but is expected to gather momentum by the middle of 2002 as the US economy picks up. Inflation is expected to remain low.

- In its weakened state, the world economy is vulnerable to further shocks. There is a risk that sustained consumer and business uncertainty will result in a deeper and more protracted period of lower growth in the world economy than is currently forecast.

- The MYEFO forecasts Australian economic growth to be around 3 per cent in 2001-02 in year-average terms. More recent data, including strong growth in the September quarter 2001, an upward revision to growth in the June quarter (contained in the September quarter release), firm retail sales and rising consumer and business confidence suggest that this forecast growth rate is well within reach. However, risks remain from the very weak and uncertain world economic outlook.

- The MYEFO forecasts domestic demand to grow by a solid 3¾ per cent in 2001-02, with net exports expected to subtract around ¾ of a percentage point from overall economic growth.

- To some extent, short-term volatility is masking the subdued state of the labour market. Employment growth is forecast to be ¾ per cent in 2001-02 in year average terms, with the unemployment rate expected to be unchanged from the Budget forecast of 7 per cent for the June quarter 2002.

- Wages are expected to grow at a moderate rate in 2001-02 and 2002-03. Average earnings, on a national accounts basis, were forecast in the MYEFO to rise by 4¼ per cent in 2001-02, compared to a rise

of 4 per cent in 2000-01. Data released since the MYEFO was finalised suggest that overall wage increases may be less than earlier expected.

- The headline Consumer Price Index (CPI) is expected to increase by around 2¾ per cent in 2001-02.
- The MYEFO forecast for 2002-03 is for a strengthening in economic growth in Australia to around 3½ per cent. Employment growth is forecast to be slightly stronger than in 2001-02 and the CPI is forecast to increase by around 2½ per cent.

2.4 This chapter also provides specific criticism of the ACTU's analysis of the economic affordability of the claim. As the ACTU notes, Australia's economic growth prospects are stronger than in most other industrialised economies. However, the rate of growth relevant to the growth potential is more relevant from a labour market perspective. And on this score, it is of little comfort that economic growth is currently below trend and is forecast to remain below trend until 2002-03. The ACTU also highlights that productivity growth and the profits share are at relatively high levels. However, these aggregate measures fail to account for industry differences; as highlighted in Chapter 5, award dominated industries have had relatively poor productivity growth and relatively lower profit margins. The ACTU's claims that the profit share has increased at the expense of the wages share is also considered and found to be without substance.

2.5 The ACTU asserts that the wage rates and earnings of award dependent employees are falling behind the rest of the workforce. However, this claim founders on methodological questions about the suitability of earnings data for making such comparisons. In fact, award

wages have kept pace with other wage measures, as distinct from earnings measures. The ACTU's arguments also ignore the major institutional changes that have made average measures much less relevant for safety net reviews, whether these measures are of earnings or wages.

Developments and outlook

International economy

Economic growth

2.6 The world economy deteriorated in 2001 with a pronounced and synchronised reduction in growth in the US, Europe, Japan and in developing countries. The slowdown was particularly evident in Australia's major trading partners. The US economy moved into recession, as inventory levels were wound down and investment spending was pared back in line with weaker demand and overcapacity, particularly in the manufacturing and high technology sectors. The weakness was exacerbated by the terrorist attacks in September. It spread to Europe, where growth was already slowing following earlier tightening of monetary policy in response to inflationary pressures. The Japanese economy slipped back into recession and growth slowed sharply in other East Asian economies, with some of Australia's major trading partners in the region also going into recession. World growth is expected to have been around 2¼ per cent in 2001, with major trading partner growth likely to have been less than 1 per cent. This is significantly below the long run average of around 5 per cent.

2.7 Global economic growth is likely to remain subdued in early 2002. The world economy is expected to gather momentum by the middle of 2002 as the economic cycle in the US turns around. By this time, it is

expected that uncertainty will have decreased, the inventory adjustment will be completed, excess capacity worked off and the substantial stimulus from monetary and fiscal policy will be taking effect. Some recent data from the US are supportive of this pattern of recovery. Recovery in the US is likely to see stronger economic growth in Europe and East Asia. However, the Japanese economy may remain weak for some time due to ongoing problems in the corporate and financial sectors. Growth in Australia's major trading partners is expected to pick up in 2002. However, notwithstanding the improved outlook, cumulative growth in 2001 and 2002 in Australia's major trading partners is expected to be the weakest in any two-year period in the last three decades.

Inflation

2.8 Global inflation remained low in 2001 and is expected to remain low over the next year. Inflation fell in 2001 in line with sharply weaker economic activity and lower oil prices. Weak demand and strong competition helped contain price pressures.

2.9 With global growth expected to remain moderate over the next year, inflation is likely to fall further. The International Monetary Fund forecasts that inflation in advanced countries will be 2.3 per cent in 2001, falling to 1.3 per cent in 2002.

Risks to the international outlook

2.10 There are a number of uncertainties surrounding the world outlook. With the global economy already weak, it is vulnerable to further shocks. There is also a risk that sustained consumer and business uncertainty will result in a deeper and more protracted period of low growth than currently expected. The possibility of deteriorating financial

market conditions, particularly in emerging market economies, would reinforce the current weakness in economic conditions.

2.11 On the upside, there is a possibility that US and world growth could recover more quickly and at a faster pace than forecast, particularly given that the adjustment process in the US economy is well advanced and that there is a substantial monetary and fiscal stimulus in train. A stronger than expected recovery in the US would also improve prospects for a quicker global recovery and underpin an upswing in global activity.

Domestic Economy

2.12 Following economic growth of around 2 per cent in 2000-01, the MYEFO forecast is for the Australian economy to grow by around 3 per cent in 2001-02 in year-average terms. In through-the-year terms to the June quarter 2002, GDP is forecast to grow by 3¼ per cent. These forecast growth rates are below Australia's long-term average, mainly reflecting the expected impact of a much weaker international economic environment.

2.13 Post-MYEFO, the most significant developments affecting the forecasts are lower than expected petrol prices and two further 25 basis point cuts in official interest rates. However, risks remain from the very weak and uncertain world economic outlook. The key domestic macroeconomic forecasts for 2001-02 are summarised in Table 2.1.

Economic outlook for 2001-02 and 2002-03

2.14 The MYEFO forecasts anticipate 3 per cent GDP growth in 2001-02 in year-average terms. More recent data, including strong growth in the September quarter 2001, an upward revision to growth in the June quarter (contained in the September quarter release), firm retail sales

and rising consumer and business confidence suggest that this forecast growth rate is well within reach.

2.15 Domestic demand is forecast to grow by a solid 3¾ per cent in 2001-02, with net exports expected to subtract around ¾ of a percentage point from overall domestic economic growth. Reflecting the international downturn and the recovery in the housing sector, the MYEFO forecast significant changes to the expected mix of growth from 2000-01, when the contribution from net exports to GDP growth substantially outweighed that of domestic demand.

2.16 The MYEFO forecast a gradual recovery in world economic growth as 2002 proceeds and a return to around trend rates of world growth in 2003. A gradual strengthening in economic growth is forecast for Australia in 2002-03. GDP growth in Australia is expected to increase to around 3½ per cent in 2002-03 in year-average terms facilitated by accommodative monetary and fiscal policies. However, substantial uncertainties remain surrounding the international economic outlook.

Table 2.1: Domestic economy forecasts[(a)]

	Outcomes(b)	2001-02 Budget	2001-02 MYEFO
	2000-01 Year Average	Forecasts Year Average	Forecasts Year Average
Panel A - Demand and Output(c)			
Household consumption	2.7	3	3 1/4
Private investment			
Dwellings	-20.5	5	20
Total business investment(d)	-2.6	5	-1
Other buildings and structures(d)	-19.8	6	5
Machinery and equipment(d)	1.3	3	-5
Private final demand(d)	0.0	3 1/2	4
Public final demand(d)	1.1	2 1/4	3 1/2
Total final demand	0.3	3 1/4	3 3/4
Change in inventories(e)			
Private non-farm	0.0	- 1/4	- 1/4
Farm and public authorities	-0.1	0	0
Gross national expenditure	0.2	3	3 3/4
Exports of goods and services	7.1	5	0
Imports of goods and services	-1.4	4	3
Net exports(e)	1.7	1/4	- 3/4
Gross domestic product	1.9	3 1/4	3
Non-farm product	2.1	3	3
Farm product(f)	-4.8	7	3
Panel B - Other Selected Economic Measures			
External accounts			
Terms of trade	3.1	- 3/4	-1 1/4
Current account balance			
$billion	-18.7	-20	-26
Percentage of GDP	-2.8	-3	-3 3/4
Labour market			
Employment (Labour Force Survey basis)	2.1	1	3/4
Unemployment rate (per cent)	6.4	7	7
Unemployment rate (per cent)(g)	6.9	7	7
Participation rate (per cent)	63.7	63 3/4	63 3/4
Prices and wages			
Consumer Price Index	6.0	2	2 3/4
Gross non-farm product deflator	4.3	1 1/2	1 3/4
Average earnings(h)	3.9	3 3/4	4 1/4

Notes:
(a) Percentage change on preceding year unless otherwise indicated.
(b) Calculated using original data.
(c) Chain volume measure.
(d) Excluding transfers of second-hand asset sales from the public sector to the private sector.
(e) Percentage point contribution to growth in GDP.
(f) Calculated at basic prices.
(g) The level in the June quarter of each year, seasonally adjusted.
(h) Average non-farm compensation of employees (national accounts basis).

Household consumption

2.17 Growth in private consumption is expected to be around 3¼ per cent in 2001-02, a little below the long-term average and well down on the very strong growth rates recorded in the late 1990s. In response to international developments and some domestic business failures, the relatively subdued outlook for private consumption growth at MYEFO incorporated an allowance for a significant decline in consumer confidence.

2.18 Private consumption grew by a robust 0.8 per cent in the September quarter and initial partial data suggest that consumer spending in the December quarter was solid. Other factors supportive of consumption growth include a rebound in consumer confidence, the decline in petrol prices over recent months and low official interest rates. Strong growth in dwelling construction is also likely to support spending on durable items over the second half of 2001-02.

2.19 At the same time, two factors are likely to restrain consumer spending. Growth in real household income in 2001-02 is expected to be below recent averages, primarily reflecting the softer outlook for employment growth. Growth in real wealth is also expected to moderate, with the growth in house prices likely to be subdued.

Dwelling investment

2.20 Dwelling investment has rebounded sharply from the slump in the second half of 2000 and is expected to grow by around 20 per cent in 2001-02. The forecast for strong growth in the housing sector in 2001-02 reflects a combination of the Government's enhanced First Home Owners' Scheme (FHOS) for new home buyers, together with historically

low housing interest rates. The forecast strong growth in total dwelling investment in 2001-02 is expected to be unwound somewhat in 2002-03, reflecting a weakening in the building of new dwellings, although alterations and additions are expected to continue to grow strongly, supported by low interest rates.

2.21 The September quarter National Accounts released in December 2001 recorded a 13.7 per cent rise in total dwelling investment, driven by a strong 22.6 per cent rise in new dwelling investment and supported by a 3.8 per cent increase in alterations and additions. However, forward indicators of dwelling investment have declined in recent months, albeit from very high levels, although significant levels of incomplete work should support activity in the first half of 2002.

2.22 The expected easing in 2002-03 reflects a combination of oversupply in some segments of the market following a year of strong growth in residential construction activity in 2001-02, and the expectation that some FHOS-related activity will be unwound as the enhanced grant is phased out. The expected easing in the residential construction sector, which is labour intensive in nature, is expected to constrain employment growth in the first half of 2002-03.

Business investment

2.23 The MYEFO forecast is for private business investment (abstracting from the purchase of second-hand assets from the public sector) to decline by around 1 per cent in 2001-02. This reflects the impact of the much weaker world outlook and an allowance for some decline in business confidence in Australia arising from the terrorist attacks in the United States.

2.24 New machinery and equipment investment is expected to fall by around 5 per cent in 2001-02. At MYEFO, the most recent data on firms' equipment expenditure expectations (from the June quarter) suggested intentions slightly below the equivalent estimates for 2000-01. Given the deterioration in the global outlook since this survey was conducted, the forecasts were based on a conservative realisation ratio (that is, the ratio of actual to intended investment) broadly comparable to that experienced during the Asian crisis period.

2.25 The September quarter 2001 ABS Capital Expenditure Intentions Survey, taken soon after the events of 11 September and released after MYEFO, held up relatively well and suggested that the level of investment could be similar to that recorded in 2001-02.

2.26 The outlook for non-residential construction also appears to have consolidated since the MYEFO forecasts were prepared. Private engineering construction is expected to lead the recovery in non-residential construction, with investment intentions remaining very strong in the mining sector.

2.27 Private new business investment (second-hand assets abstracted) grew by 1.9 per cent in the September quarter 2001, to be 3.7 per cent lower than a year earlier. The quarterly growth in private new business investment was driven by a 2.8 per cent rise in new equipment investment and a 2.2 per cent rise in new non-dwelling construction.

External trade

2.28 The MYEFO forecast is for net exports to subtract around ¾ of a percentage point from GDP growth in 2001-02, following a large increase of 1.7 percentage points in 2000-01.

2.29 Reflecting the weaker outlook for the world economy, and notwithstanding a supportive exchange rate, growth in export volumes is forecast to be around zero in 2001-02. This comes on the back of two years of strong export growth.

2.30 The subdued outlook for export volumes largely reflects a significant expected fall in services exports and very muted growth in exports of Elaborately Transformed Manufactures (ETMs). Both categories of exports are very sensitive to economic conditions in the importing country and are more difficult to divert to other markets than are commodity exports. This difficulty is likely to be exacerbated by the synchronised slowing of growth in the US, Europe, Japan and in developing countries, including Australia's major trading partners in East Asia. With Asia being an important destination for both ETMs and services, the very weak outlook for that region will put significant downward pressure on exports.

2.31 Concerns about terrorist attacks involving airlines resulted in a sharp decline in international air travel, adversely affecting Australia's tourism industry, coming off the Olympics-related highs in 2000-01. Inbound tourist arrivals to Australia dropped sharply in the December quarter 2001. That said, the very competitive level of the Australian dollar provides some support for these sectors.

2.32 In contrast, commodity export volumes are much less affected by international conditions in the short term. In Australian dollar terms, most rural and non-rural commodity prices remain relatively profitable. Modest growth is expected in export volumes of non-rural commodities, with rural export volumes largely unchanged relative to 2000-01.

2.33 Growth in import volumes was revised down to 3 per cent in 2001-02 at MYEFO, reflecting the impact of higher prices due to a lower exchange rate and the downward revision to the forecast for machinery and equipment investment in 2001-02.

2.34 Following large rises in the last two years, the terms of trade is expected to decline by 1¼ per cent in 2001-02, but to remain above pre-Asian crisis levels. The relatively small overall decline in the terms of trade reflects the net impact of continuing firm world prices for several of Australia's key export items such as beef, grains and bulk commodities. These firm prices are helping to buffer the impact of substantial falls in world prices of base metals. Subdued world prices of some imports (especially Information Communication Technology), reflecting weak world growth and very competitive market conditions, should also help to minimise the fall in Australia's terms of trade.

2.35 Consistent with lower net exports and lower terms of trade, the current account deficit (CAD) as a share of GDP is expected to rise somewhat, to 3¾ per cent, in 2001-02, after reaching the lowest annual level in 20 years in the previous year. The CAD is expected to remain below its long-term average and well below its earlier highs as a share of GDP, despite the severity of the international downturn.

Labour market

2.36 Reflecting subdued economic growth over the latter half of 2000, employment growth is expected to be around ¾ of one per cent in 2001-02 in year-average terms. The expected strong recovery in the labour intensive construction sector is likely to be reflected in employment growth in 2001-02, particularly in male full-time

employment, the component of the labour market which has experienced the most marked weakness over the past 12 months.

2.37 The MYEFO forecast is for the unemployment rate to average around 7 per cent in 2001-02 and in the June quarter of 2002.

2.38 During the current financial year, periods of high volatility in labour force survey outcomes have been recorded, particularly some large monthly movements in the total number of employed persons, along with substantial monthly movements between the full-time and part-time categories. Some of the movement in total persons employed, and between the full-time and part-time categories, may be attributed to the Census (conducted in August 2001) and the Federal Election (held in November 2001).

2.39 Looking through this volatility, since the MYEFO forecasts were prepared, labour force survey outcomes and leading indicators of the labour market have been supportive of the MYEFO forecasts of subdued employment growth and a relatively steady unemployment rate of around 7 per cent over coming quarters.

2.40 The recent volatility in labour force outcomes has also been reflected in month-to-month movements in the participation rate, and hence the unemployment rate.

Labour productivity

2.41 Labour productivity growth was strong at 3 per cent through-the-year to September 2001, which mainly reflected an unwinding of the cyclical slowdown of productivity growth in 2000. In year-average terms, productivity grew by 1.5 per cent in the year to September 2001. The fall in productivity in 2000 reflected a slowdown in GDP growth and

year-average employment growth of 3 per cent. Robust GDP growth in the first three quarters of 2001 together with subdued employment growth resulted in a strong increase in productivity. As such, the high productivity outcome for 2001 is the result of cyclical patterns which will moderate when the impact of robust GDP growth flows through more strongly into job creation.

2.42 Productivity estimates exhibit substantial volatility and can be significantly affected by changes in industry and educational compositions. This implies that caution must be exercised when using aggregate productivity growth measures as a basis for changing awards. Productivity analysis by industry is presented in Chapter 5.

2.43 In recent years, the Commission has often made reference to Australia's high levels of productivity growth in assessing the economic impacts of safety net adjustments.[2] In interpreting the relevance of this productivity growth for award wages, a distinction needs to be drawn between trends in the private and the public sector, and trends in the industries to which the award increases apply.

[2] S5000, pages 19 and 70; R1999, pages 25 and 32.

Table 2.2: Productivity growth

	Labour (a) (Market Sector)	Capital (a) (Market Sector)	Multi-factor (a) (Market Sector)	Private sector enterprises	Public sector enterprises
Year-average growth					
1998-99	3.8	-0.1	2.3	3.4	14.5
1999-00	2.1	0.6	1.5	0.5	12.0
2000-01	0.3	-3.2	-1.1	-0.9	8.6
Average growth, decade to:					
1980-81	2.6	-1.0	1.3	2.4	v4.5
1990-91	1.6	-1.3	0.5	0.9	1.1
2000-01	2.6	-0.4	1.4	1.8	11.3
Quarterly growth					
GDP per hour worked (market sector) (b)					
Dec-00	0.0				
Mar-01	0.9				
Jun-01	1.4				
Sep-01	1.3				

Source: ABS Cat. No. 5204.0, 5206.0 & 1364.0.15.003.
Notes:
(a) Annual national accounts
(b) Quarterly national accounts

2.44 As shown in Chapter 5, two of the three strongest productivity growth industries are dominated by public enterprises, namely communication services and electricity, gas and water. These sectors have been subjected to substantial micro-economic reform and are dominated by enterprise bargaining. In contrast, the productivity trends in private sector industries have been lower. High productivity growth lowers input costs and benefits consumers.

2.45 The fall in labour productivity in 2000-01 was associated with the cyclical downturn in economic growth and is not believed to portend any structural deterioration in productivity performance. That said, it is difficult to identify the true extent of the structural improvement, particularly at an aggregate level.

Profits

2.46 As noted in previous submissions, profitability as represented by gross operating surplus (GOS) of private non-financial corporations should be expressed as a share of factor income for the same sector. This is explained in further detail later in this chapter.

2.47 Recent business surveys show mixed results for near-term profitability, but suggest that profits are likely to improve over the next year or so.

2.48 The ABS Company Profits Survey for the September quarter 2001 showed a contraction in company profits (before income tax) and company profits (before income tax, net interest and depreciation) of 7 per cent and 6 per cent respectively in the September quarter 2001. All industries recorded a decline in profits (before income tax) in the September quarter 2001, except manufacturing and other services.

2.49 The latest ABS Australian Business Expectations survey reported that profits are expected to decrease by 15 per cent (seasonally adjusted) in the March quarter 2002. Small, medium and large businesses expect profits to decline by 23 per cent, 40 per cent and 26 per cent respectively. The electricity, gas and water industry is the only industry expecting a rise in profits.

2.50 In the medium term, the ABS Australian Business Expectations survey found that profits are expected to increase by 8 per cent in the December quarter 2002. Small and large businesses expect profits to rise by 2 per cent and 27 per cent respectively, while medium businesses expect profits to decline by 3 per cent. The wholesale industry expects the largest increase in profits.

2.51 The latest ACCI Westpac Survey of Industrial Trends reported solid profit expectations for the next 12 months. This reflected about 43 per cent of the respondents expecting higher profits and around 21 per cent of respondents expecting lower profits in the next twelve months.

2.52 The ACCI National Survey of Business Expectations reported that a further slight improvement in profits is expected for the March quarter 2002. This reflected about 29 per cent of respondents expecting higher profits and around 26 per cent of respondents expecting lower profits in the March quarter.

Prices

2.53 The MYEFO forecast is for the CPI to increase by 2¾ per cent in 2001-02 in year-average terms and by 2½ per cent through-the-year to the June quarter 2002. The slight upward revision to the CPI relative to the Budget forecast mainly reflects the expected impact of a number of one-off or temporary factors, rather than representing any significant increase in ongoing inflationary pressures. In particular, higher insurance premiums, electricity prices, meat prices and domestic airfares are expected to put upward pressure on the CPI relative to earlier expectations.

2.54 In 2002-03, the headline CPI is forecast to increase by 2½ per cent in year-average terms, comfortably within the Reserve Bank's medium-term inflation target band of 2-3 per cent.

2.55 There are several key uncertainties surrounding the inflation outlook. The most significant of these relate to the external sector – notably the effects of world growth, oil prices, and the exchange rate.

The New Tax System and the CPI

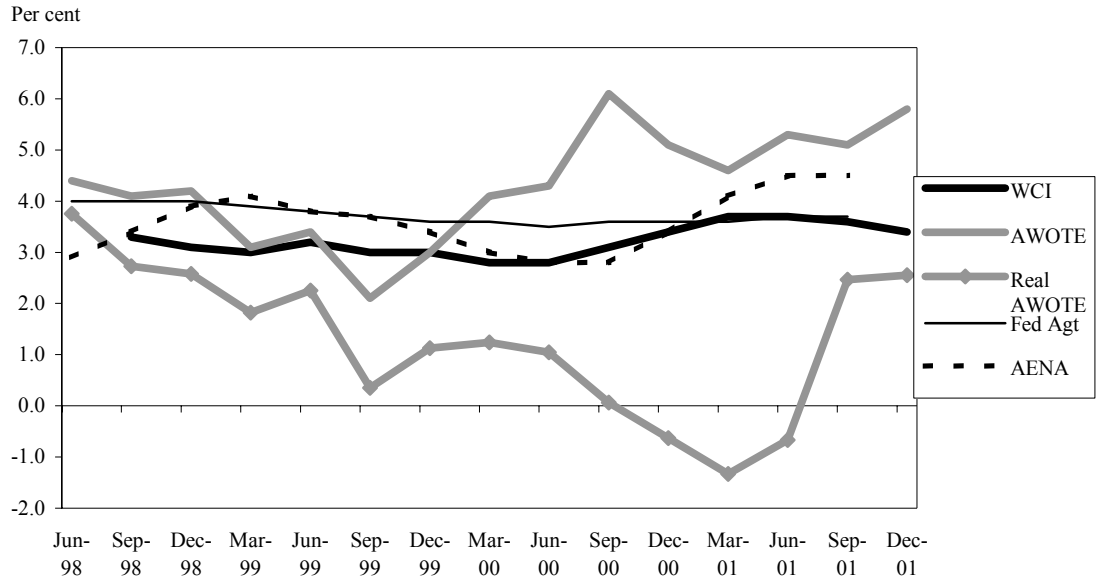
2.56 Through-the-year to the June quarter 2001, it is estimated that *The New Tax System* (TNTS) contributed around 2½ percentage points to the headline CPI increase of 6.0 per cent. This is in line with the 2001-02 Budget forecasts. Most of the impact on prices occurred in the September quarter 2000. In that quarter, the CPI increased by 3.7 per cent – TNTS is likely to have contributed a little less than 3 percentage points to that increase in the CPI.

2.57 In 2001-02, TNTS is expected to reduce the headline CPI slightly, reflecting the abolition of Financial Institutions Duty (FID) and stamp duty on marketable securities as well as the early introduction of full input tax credits for motor vehicles. These measures will have an indirect effect on the CPI by lowering business costs. The reduction in the CPI is estimated to be in the order of ¼ to ½ of a percentage point through-the-year to the June quarter 2002, other factors unchanged.

Wages

2.58 Data from the main indicators suggest that overall, growth in wages and earnings stabilised in 2001, after a slight pick up in late 2000. Over the longer term, the pace of annual growth has remained moderate, as can be seen in Chart 2.1 below.

Chart 2.1: Annual wages & earnings growth – main indicators



Source: ABS Cat. Nos. 6345.0, 6302.0, 6401.0 and 5206.0, DEWR's Workplace Agreements Database.

Nominal wages growth

Wage Cost Index[3]

2.59 As Chart 2.2 shows, the Wage Cost Index (WCI) measure of total hourly rates of pay excluding bonuses rose by 3.4 per cent over the year to December 2001, down slightly from the 3.6 per cent growth over the year to the September quarter and the 3.7 per cent growth over the year to the June and March quarters 2001. Prior to the December 2000 quarter, total hourly pay rates grew at approximately 3.0 per cent per year.

2.60 In the private sector, total hourly rates of pay excluding bonuses rose by 3.4 per cent over the year to the December quarter 2001, after

[3] The WCI measures changes in wage costs for a fixed 'basket' of wage and salary earner jobs. As the WCI was only introduced in September 1997, the data are not currently seasonally adjusted. However, a strong seasonal pattern in the quarterly data is evident; consistently high September quarter figures reflect the timing of safety net increases in State jurisdictions and increases under federal enterprise agreements. Consequently, annual, rather than quarterly, estimates of growth are probably more accurate in ascertaining wage trends.

rising by 3.6 per cent over the year to the September quarter. Public sector total hourly rates of pay excluding bonuses rose by 3.5 per cent over the year to the December quarter, after rising by 3.7 per cent over the year to the September quarter.

Average Weekly Earnings[4]

2.61 The most recent data show (in seasonally adjusted terms) that AWOTE for full-time adult employees grew by 5.8 per cent in the year to November 2001, following growth of 5.1 per cent and 5.3 per cent over the year to the August quarter and May quarter 2001, respectively. The AWOTE series has shown considerable volatility in the period since November 1998, peaking at 6.1 per cent over the year to the September quarter 2000, after reaching a low of 2.1 per cent over the year to August 1999. This makes it difficult to ascertain trends in earnings growth.

Federal Agreements

2.62 Recent trends in wage outcomes from federal enterprise agreements are consistent with trends in the WCI.

2.63 The average annualised wage increase (AAWI) for employees covered by formal federal agreements that were certified in the September quarter 2001 was 3.9 per cent, unchanged from the June quarter 2001. AAWIs for agreements certified in the four quarters to 30 September 2001 have been higher than the all quarters in the year to

[4] The Average Weekly Earnings Survey measures average weekly earnings (AWE) for all employees and average weekly ordinary time earnings (AWOTE) for full-time adult employees. Both AWE and AWOTE are influenced by changes in the composition of the labour market and are subject to significant volatility, making interpretation and analysis difficult and potentially unreliable. The ABS claims that the AWE is "significantly affected by changes in the composition of the work force which undermine their use as indicators of changes in wage rates", and believes the WCI series is a "far superior" measurement of wages growth.

30 September 2000 with the exception of September quarter 2000 itself which had an AAWI of 4.2 per cent per employee.

2.64 All agreements current at 30 September 2001 paid an AAWI of 3.7 per cent, unchanged from agreements that were current at 30 June 2001. (See Appendix A for more detail on developments in the wages system.)

National Accounts

2.65 Average earnings on a national accounts basis (AENA)[5] grew by 4.5 per cent in the year to the September quarter 2001 in trend terms, after growing at the same rate over the year to the June quarter 2001, and by 4.1 per cent over the year to the March quarter 2001. In the MYEFO, AENA is forecast to grow by 4¼ per cent (in seasonally adjusted terms) in 2001–02, marginally above the outcome in 2000–01.

Executive remuneration[6]

2.66 Over the year to the December quarter 2001, senior management base salaries rose by 5.0 per cent (up from 4.7 per cent in the year to September 2001). Total remuneration rose by 4.9 per cent (similar to growth of 4.8 per cent in the year to the September quarter).

2.67 Since the September quarter 1998, executive salaries have grown at a steady pace, between 4.6 per cent and 5.0 per cent per year. The large gap, which existed during the 1980s and early 1990s, between growth in base salaries of senior managers and general wages growth for full-time

[5] AENA is defined as average non-farm compensation per employee, and is a broad measure of earnings which includes fringe benefits, workers' compensation, employer superannuation contributions and termination, severance and redundancy payments.

[6] Executive salaries data is sourced from Mercer Cullen Egan Dell's (MCED) *Quarterly Salary Review.*

adults, has narrowed considerably. Since June 2000, growth in base salaries for senior management has been outpaced by growth in AWOTE for full-time adult employees.

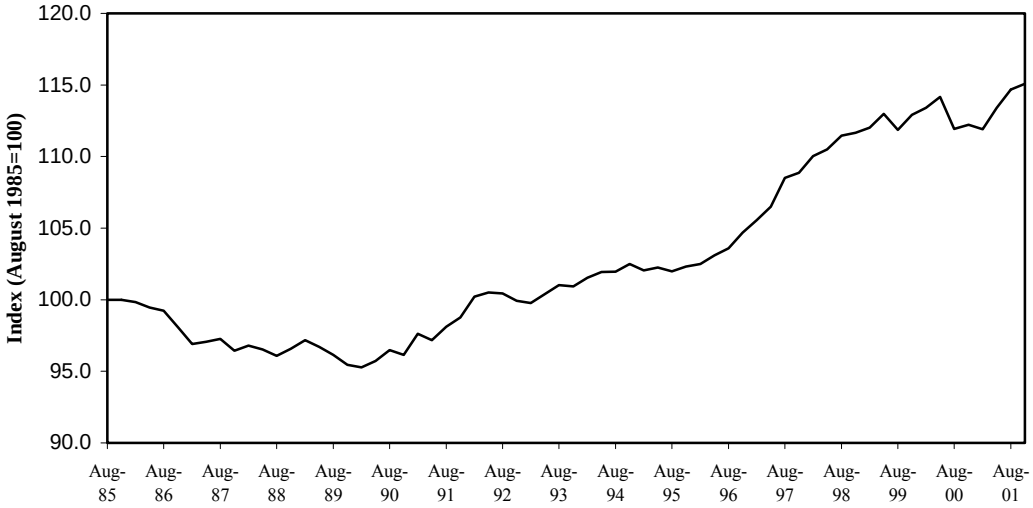
2.68 MCED data also show that average base salaries for Chief Executive Officers (CEOs) increased by 3.4 per cent over the year to the December quarter 2001, compared to 9.3 per cent the previous year, whilst total remuneration increased by 1.9 per cent, compared to 8.0 per cent over the year to the December quarter 2000.

Real wages growth

2.69 Using the headline CPI as the price deflator and seasonally adjusted earnings data, it is estimated that real AWOTE for full-time adult employees grew by 2.6 per cent over the year to the November 2001 quarter, compared to real increases of 2.5 per cent and –0.7 per cent over the year to the August and May 2001 quarters, respectively.

2.70 Real earnings have grown almost without interruption since the early 1990s (see Chart 2.2 below).

Chart 2.2: Index of real AWOTE growth



Source: ABS, Cat. Nos. 6302.0, 6401.0

2.71 A table showing the various measures of wages and earnings growth over time can be found at Appendix C: Wages Growth.

Economic policy context

Macroeconomic policies

2.72 The Government's fiscal strategy is conducted within a medium-term framework with the primary objective of maintaining budget balance, on average, over the cycle. This framework assists in creating the conditions which maximise sustainable growth and contribute to sustained progress towards full employment.

2.73 For monetary policy, the Government and the RBA have agreed on the objective of keeping inflation between 2 and 3 per cent, on average, over the cycle. Price stability is considered to be a crucial precondition for stable and sustainable growth in economic activity and employment.

- In order to meet its objectives, the RBA continually assesses the outlook for inflation and activity and the risks surrounding the outlook.

- Given the RBA's commitment to the inflation target, any increase in inflation due to wage rises in excess of that justified by underlying productivity risks higher interest rates than otherwise might be the case, with negative consequences for the level of employment and unemployment. Likewise, if a downturn in activity was to occur and there was no wage restraint in response to the resultant higher unemployment, the ability of the RBA to respond to the downturn with lower interest rates would be reduced.

Taxation Reform

2.74 On 1 July 2000, the goods and services tax (GST) was introduced to replace the wholesale sales tax (WST) and a range of State and Territory government taxes. The WST and bed taxes were abolished from 1 July 2001. The removal of these taxes significantly offset the price impact of the GST and further offsets can be expected as the effect of lower business input costs flows through production chains and into lower capital costs and as the remaining elements of the tax reforms are implemented.

- In addition, the Government's tax reform package included significant reductions in personal income tax rates, including an increase in the tax-free threshold and decreases in all marginal tax rates except the top rate. The tax cuts more than compensated for the one off increase in the cost of living associated with the new tax system, and ensure that low and middle income earners, in particular, keep a higher proportion

of the earnings they receive after tax, providing them with greater incentive to work and save.

Response to ACTU's submission

Performance of the Australian Economy

2.75 The ACTU frequently cites in its submission that the Australian economy has outpaced most of the other developed countries[7]. However, the absolute performance of the Australian economy is more relevant to this case than relative performance, as the absolute performance of the economy is the key factor in determining economic outcomes. In an absolute sense, Australia's economic growth remains below trend growth and is forecast to remain below trend until 2002-03. As noted in this submission, there are risks to expected domestic activity and employment emanating from the international and housing sectors.

2.76 The ACTU compares employment growth outcomes for Australia and other industrialised regions. Although employment growth in Australia has outperformed these regions over the last few years, Australia's employment performance over 2001 was subdued, and the unemployment rate increased. Hiring intentions have been significantly affected by the weak world economy which, along with cost cutting strategies via staff shedding, has resulted in a subdued outlook for the labour market in the first half of 2002.

2.77 The ACTU submission[8] casts the labour market in a favourable light by referring to the large January increase in the ANZ Job Advertisements survey, and other forward indicators of labour market and

[7] ACTU Written Submission, Living Wage Case, 8 February 2002, Chapter 4, pages 55-101.

economic activity. Too much emphasis should not be placed, however, on a single increase in the seasonally adjusted ANZ series. The ANZ Job Advertisements count has shown only a mild increase in trend terms over recent months. The DEWR Skilled Vacancy Series has fallen slightly since November 2001. Both of these vacancies measures are at levels significantly lower than a year ago.

2.78 In general, the leading indicators are pointing to continued solid growth in the economy which is gradually feeding through to labour market. Growth in employment is likely to be sufficient to meet the modest forecast in MYEFO of approximately ¾ of one per cent in 2001-02 in year-average terms. Should the downside risks that are identified earlier in this chapter actually occur, however, the labour market may be weaker than expected, possibly putting upward pressure on the unemployment rate.

2.79 The ACTU comments that labour productivity growth has been high relative to similar periods in Australia's recorded history. Although trend labour productivity has improved, the extent of the improvement is still uncertain. As noted previously, the strong labour productivity growth recorded over the year to September 2001 mainly reflects cyclical factors and is likely to be moderated when the impact of the strong GDP growth begins to flow through to job creation. It is particularly important for the case to focus on expected labour productivity corresponding to the case's reference period, instead of relying on past estimates.

2.80 Moreover, the above information relates to aggregate productivity growth which should not be solely relied upon when attempting to analyse the likely effects of a wage increase as productivity growth varies

[8] Written Submission, Living Wage Case, 8 February 2002, page 75.

significantly between industries. As Chapter 5 of this submission explains, caution needs to be exercised in interpreting aggregate productivity measures due to educational and industry compositional effects. Award-dominated industries have recorded low labour productivity growth rates. This implies that those industries are less able to absorb wage increases without adverse effects on their price inflation and employment.

2.81 Analysis in Chapter 5 also shows that the profit margins of award-dominated industries have been declining, partly as a result of rising unit labour costs in these industries. The relatively low profit margins for these industries imply that those industries are less able to absorb wage increases without adverse effects on employment.

Wages and Profit Share

2.82 There are a number of ways of measuring the profit share. The method used by the ACTU in its submission is the ratio of gross operating surplus (GOS) of private non-financial incorporated businesses to Total Factor Income (TFI). This measure shows an upward trend in the profit share of TFI since the mid 1970s, but this trend is heavily influenced by a large proportion of unincorporated businesses becoming incorporated over this period.

2.83 In its decision in the 2000-2001 Safety Net Review - Wages, the AIRC appeared to use the National Accounts measure - that is, the ratio of GOS of all non-financial and financial corporations to TFI[9]. This measure is also not ideal because it includes the 'profit' of public sector corporations.

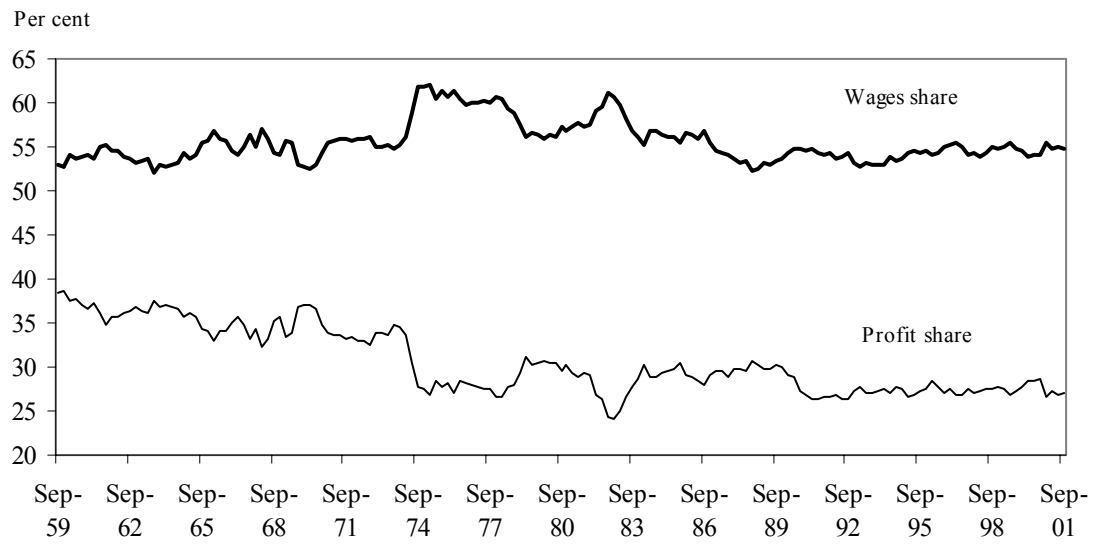
[9] Print PR002001, page 72.

2.84 A more accurate measure, used in Chart 2.3 below, restricts profits to the private sector but includes the profit share of unincorporated businesses. When the profits of unincorporated businesses are included in the profit share a much flatter trend in the profit share can be seen.

2.85 The ACTU's claim that the 'the profit share of national income continues to fluctuate around its recent historical highs'[10] is misleading as Chart 2.3 clearly shows. In fact, profit shares have hovered around 27 per cent in the 1990s, compared to being around 35 per cent in the 1960s. The only time that the profit share has been lower, since the series began, was in the recession of the early 1980s.

2.86 The ACTU goes on to claim that 'the wages share of total factor incomes remains at near record low levels'.[11] However, the wages share has increased fairly steadily over the 1990s from 52.3 per cent in September 1988 to 54.7 per cent in September 2001.

Chart 2.3: Movements in profit and wages share of total factor income



Source: ABS Cat No 5206.0

[10] ACTU Written Submission, Living Wage Case, 8 February 2002, page 71.
[11] ACTU Written Submission, Living Wage Case, 8 February 2002, page 71.

Earnings and Wages

Indicators of wage movements

2.87 The ACTU Submission compares at some length, changes in award rates with changes to average earnings prevailing in the community. It focuses heavily on the differences in growth between the C10 and C14 award rates on one hand, with AWOTE and AWE on the other. The ACTU's analysis, however, paints a misleading picture of the relative position of award paid workers. AWOTE and AWE data should not be compared with growth in award rates as they measure average earnings across all employees, regardless of changes to individual jobs, or in occupations or industries, whilst award rates measure actual wage rates.

- For example, if an individual employee moved from the award rate C14 to C13, this promotion would be reflected in AWE measures. AWE cannot, however, differentiate this from a change to actual wage rates for an existing job, such as a wage increase in the C14 award classification.

2.88 The WCI is a far superior measure for making comparisons between award increases and general wage rate increases. As a price index, the WCI specifically controls for changes in the number of hours or the quality of the work. This is analogous to analysing a particular award rate over time.

2.89 The ACTU recognises the critical difference between earnings and wage measures, although it mis-labels the former as the latter when it asserts that 'the wages bill measures (AWOTE, AENA and AWE)

provide the best indicator of movements in *living standards* (i.e. of wages as earnings)'[12] (original emphasis).

- It is therefore erroneous for the ACTU to compare earnings measures with award rates, and to conclude that award workers are experiencing declining living standards.
  - Chapter 6 of this submission discusses issues relating to living standards of Australian families.

2.90 The Commonwealth acknowledges that the WCI series does not allow long-term analysis as it has been produced only since September 1997. However, the ACTU's main concern appears to be that award rates have declined relative to average earnings in general over recent years. Chapters 2 and 3 of the ACTU Submission focus heavily on wage developments from 1999 to 2002, and on last year's Safety Net Review decision in particular. In this context, the limited time series of the WCI is not such a significant problem.

Recent trends in award rates

2.91 The ACTU Submission argues that award rates increased by a maximum of 3.2 per cent as a result of the 2001 decision, whilst "the rest of the community fared far better"[13]. This claim is based on comparing award increases with a variety of wages and earnings measures, including AWOTE and senior management.

2.92 However, when using the WCI (the most directly comparable measure) to compare 'community' wage increases with award increases,

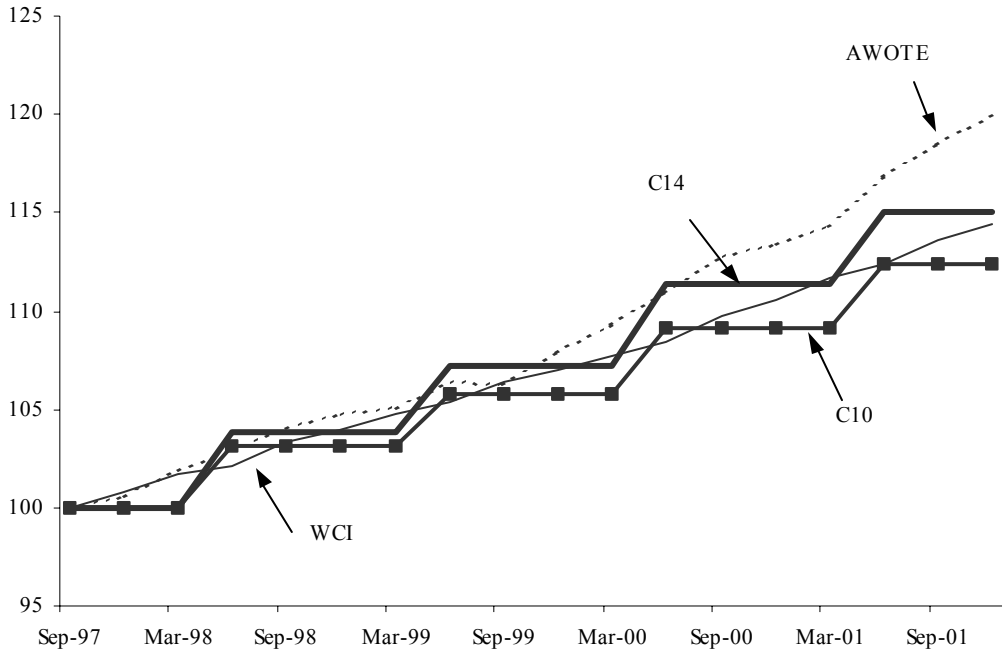
[12] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 2.3, p12.

it is clear that those on lower award rates received increases in 2001 which were not dissimilar to general wage increases. Contrary to the ACTU's argument, the 3.2 per cent increase in the C14 rate and the 3.0 per cent increase in the C10 rate are only slightly lower than the latest WCI figure of 3.4 per cent over the year to the December quarter 2001.

2.93 Chart 2.4 shows the changes in the WCI against changes in nominal C14 and C10 as well as nominal AWOTE, since September 1997. Although growth in the C14 and C10 award rates has diverged marginally from that of AWOTE in the last two years, this is not a cause for concern as growth in these award rates has tracked the WCI very closely.

[13] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 2.47, p28.

Chart 2.4: C14, C10, WCI and AWOTE (index September 1997=100)



Source: ABS Cat. Nos. 6345.0 and 6302.0

The effect of the ACTU's claim on relative growth of key award rates

2.94 In its submission, the ACTU argues that its claim 'delivers a wage increase for award workers consistent with the level of wage increases for others in the community'.[14]

2.95 However, a $25 per week increase across all award rates would deliver wage outcomes in excess of those received by the general community. Workers on the C14 classification would receive a wage increase of 6.0 per cent, whilst those on the C10 rate would receive 4.9 per cent.

- These increases would be much larger than the 3.4 per cent over the year to the December quarter 2001, as measured by the WCI.

[14] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 3.28, p47.

  - Only the C1 and C2 classification rates would receive less than average increases in the WCI.

- The increases would also be in excess of the 3.9 per cent AAWI for employees covered by formal federal agreements certified in the September quarter 2001.

  - Again, only those award employees on high classification rates (C1 to C4) would receive lower increases.

Longer term developments – changes in the role of SNAs

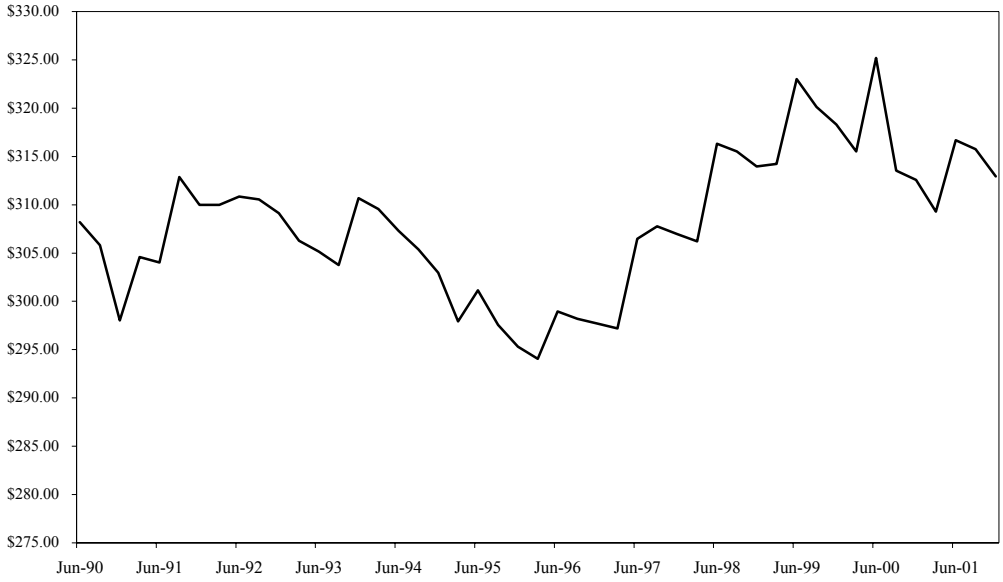
2.96 Over long periods, compositional change in the labour market becomes very important. In this context, the ACTU's comparisons of C14 and C10 award rates with AWOTE, made back as far as 1983[15], are even more problematic. Since 1983, there has been sweeping structural change in the labour market and in the broader economy and society.

2.97 Furthermore, long-term trends in award rates and in earnings should be understood in the context of the significant institutional changes in wage setting arrangements which have occurred over the last decade. The spread of enterprise bargaining means that award wages should now act as a genuine 'safety net'. Contrary to the ACTU's argument, the Commission is *not* required to adjust award rates to match growth in average earnings over time. Rather, the Commission is directed by the WR Act to adjust award rates having regard to the 'need to provide fair minimum standards for employees in the context of living standards generally prevailing in the Australian community' (s. 88B(2)(a)).

[15] See Figure 2.10, ACTU Written Submission, Living Wage Case, 8 February 2002, page 32.

- Safety net increases have already helped to lift the real value of the lowest award rates since June 1996, making the Federal Minimum Wage (C14) now significantly higher than it was in June 1990 (Chart 2.5).

Chart 2.5: The real value of C14 – June 1990 to June 2001*



Source: Department of Employment and Workplace Relations
* Using June 1990 dollars, based on the all groups CPI

Conclusion

2.98 In summary, the MYEFO forecasts released in October 2001 point to the likelihood of solid economic performance in Australia in 2001-02 and 2002-03, although growth rates are expected to be significantly below the very strong rates recorded in the late 1990s, and employment growth is expected to be subdued in the near term. Information released since the MYEFO forecasts were finalised reinforces this view, although the international outlook remains weak and uncertain. As at MYEFO, the main risks on the outlook for activity and employment continue to be the international outlook and the extent of the moderation in the housing sector in late 2002. Given this uncertainty, a restrained approach to this case should be adopted.

2.99 This Chapter has also shown that, contrary to the ACTU claims, the wages share of national income has increased fairly steadily for over a decade. Regarding actual wage rates, those award rates that ought to be the key focus of this safety net review (that is in the range from C14 to C10) have kept pace with general wage growth, as reflected in the WCI and AAWIs for federal agreements. The ACTU's claim of $25 per week is irresponsible. It would deliver wage outcomes in excess of the wage increases prevailing in the rest of the community. As the next three chapters demonstrate, if the ACTU's claim were successful, it would have significant impacts on employment and the broader economy.

CHAPTER 3: THE RELATIONSHIP BETWEEN MINIMUM WAGES AND EMPLOYMENT

Introduction

3.1 It is the Commonwealth's strong view that a $25 per week SNA would have adverse employment effects on low-paid workers and on the job prospects of the unemployed. In this chapter, the focus is on the likely employment effects of minimum wage increases. The majority of the academic literature shows that rises in the real value of minimum wages have an adverse impact on employment.

3.2 The Commonwealth first identifies the high level of the 'bite' (the ratio of minimum to median wages) of the minimum wage in Australia. Then it provides an update of the summary of empirical studies on the relationship between minimum wages and employment including a more detailed look at the studies that have been released since the joint Governments' submission to last year's Safety Net Review – Wages. Finally we include a critique of the ACTU's approach to this topic.

3.3 Chapter 4 goes on to investigate the macroeconomic consequences if the ACTU's claim were to be adopted and Chapter 5 examines the labour market consequences in specific areas of the economy.

The 'bite' of minimum wages

3.4 When examining the results of minimum wage studies, it is important to consider the relative value (or the 'bite') of the minimum wage in the country where the study was conducted. The 'bite' is usually measured as a proportion of the minimum wage to the median wage.

Compared to other OECD countries, Australia's FMW is set at a higher proportion of median earnings as Table 3.1 shows.

Table 3.1: Ratio of minimum to median wages in Australia and other OECD countries

Country	per cent	Country	per cent
France	60.8	Portugal	38.2
Australia	57.9	United States	36.4
Ireland	55.5	Hungary	35.6
Greece	51.3	Poland	35.5
Belgium	49.2	Turkey	34.7
Luxembourg	48.9	Japan	32.9
Netherlands	46.7	Spain	31.8
New Zealand	46.3	Czech Republic	30.4
Canada	42.5	Korea	23.8
United Kingdom	41.7	Mexico	21.1

Source: M Keese and A Puymoyen, 'Changes in Earnings Structure: Some International Comparisons Using the OECD Structure of Earnings Database', *OECD Labour Market and Social Policy Occasional Papers*, 2001. Data are for 2000 except for Hungary (1999), Poland (1999) and Turkey (1998).

3.5 In Australia, the FMW is 49.3 per cent of full-time adult ordinary time earnings.[1] In the United Kingdom, the National Minimum Wage is 36.7 per cent of full-time average gross earnings.[2] If the UK National Minimum Wage were to be set as the same proportion of average earnings as the Australian minimum wage, it would be £5.51 per hour, over 30 per cent higher than it is now.

3.6 Another broad indication of Australia's relative position was reported in the Low Pay Commission's third report - Australia's minimum wage was found by the OECD to be the highest in any OECD

[1] ABS Average Weekly Earnings, August 2001 (Cat No 6301.0), seasonally adjusted data.
[2] New Earnings Survey 2001, National Statistics, United Kingdom, April 2001 (latest available data).

country in terms of purchasing power parity.[3] This means that the value of the Australian minimum wage, in terms of what it can buy, is the highest in the OECD.

3.7 The fact that most overseas studies find a small (albeit statistically significant) negative relationship between minimum wages and employment, is partly a result of the relatively small 'bite' of the minimum wage in the countries pertaining to those studies. Given the relatively large 'bite' of minimum wages in Australia, the adjustment of the safety net is likely to have a much larger effect in this country. This should be kept in mind when considering the studies described in the following section.

3.8 The uniqueness of Australia's award system also needs to be considered when interpreting minimum wage studies from other countries. In other countries, the minimum wage is set at one basic rate whereas Australia has a whole range of award rates which are subject to SNAs. The employment effects found in minimum wage studies, therefore, only relate to an increase in a single minimum wage. If an empirical study could be conducted in Australia to determine the employment effects of adjusting all award rates, including those above the FMW, the employment effect would be much larger than in countries with a single rate. Indeed, aggregate wage studies in Australia find an employment effect of –0.7 to –0.8 per cent (that is a 1 per cent increase in real wages results in a 0.7 to 0.8 per cent reduction in employment)[4]. In

[3] UK Low Pay Commission, *The National Minimum Wage – Making a Difference*, Third Report, Vol 1, March 2001, page 133.
[4] For details of these studies see Joint Governments' Submission, 1997-1998 Safety Net Review – Wages (printed version), pages 159-160, and Committee on Employment Opportunities 1993, *Restoring Full Employment: A Discussion Paper*, AGPS, Canberra.

comparison, overseas minimum wage studies usually find much smaller employment effects.

Summary of minimum wage studies

3.9 The weight of academic evidence is clearly in favour of the Commonwealth's position that there is a significant negative relationship between minimum wages and employment. This is the case for studies conducted in the US, as well as in other countries. The Commission has recognised this and despite concluding in last year's decision that 'moderate wage increases in the wages of the low paid, of themselves, do little or nothing to diminish job prospects', it also recognised 'that in the context of recent weaker labour market performance, some caution is required in adjusting minimum safety net wage levels'.[5]

3.10 Table 3.2 summarises the results of the key empirical studies conducted in the US since 1990 which investigate the relationship between minimum wages and employment.[6] The table clearly shows that over two thirds of the studies by academics (14 out of the 19 studies listed) are suggestive of an inverse relationship between increases in minimum wages and employment.

[5] Print PR002001, paragraph 98.
[6] These studies have all been referenced elsewhere in this submission, or in previous joint Governments' submissions to the Safety Net Review.

Table 3.2: Summary of results of published US minimum wage studies by academics

Author/s	Year Published	Findings
Keil, Robertson and Symons	2001	**Significant negative** relationship.
Williams and Mills	2001	**Significant negative** relationship on teenage employment.
Burkhauser, Couch and Wittenburg	2000	**Significant negative** relationship.
Burkhauser, Couch and Wittenburg	2000	**Significant negative** relationship.
Neumark, Schweitzer and Wascher	2000	**Significant negative** relationship.
Hsing	2000	**Significant negative** relationship on ratio of part-time to full-time employment.
Partridge and Partridge	1999	**Significant negative** long-term relationship.
Card and Krueger	1999	'Little evidence' of a negative relationship.
Neumark	1999	**Significant negative** relationship.
Belman and Wolfson	1999	'No evidence' of a negative relationship.
Mills, Roy and Williams	1999	No significant evidence using 'natural experiments' but a '**large and negative** effect' using time series analysis.
Bernstein and Schmitt	1998	Mixed results.
Bazen and Marimoutou	1997	**Significant negative** relationship.
Currie and Fallick	1996	**Significant negative** relationship on probability of remaining employed.
Card and Krueger	1995	No negative and a possibly positive relationship.
Klerman	1992	**Significant negative** relationship.
Card	1992	Positive relationship.
Neumark and Wascher	1992	**Significant negative** relationship.
Wellington	1991	**Significant negative** relationship.

3.11 Since the publication of Card and Krueger's *Myth and Measurement* in 1995, no less than eleven US studies have found a significant negative relationship between increases in minimum wages and employment. This is despite proponents of the 'new economics of the minimum wage' making claims that increases in the minimum wage do not cause reductions in employment.

3.12 Table 3.3 shows that the majority of (17 out of 25) empirical studies in countries other than the US have also found a statistically significant negative relationship between employment and minimum wages.[7]

[7] These studies have all been referenced elsewhere in this submission, or in previous joint Governments' submissions to the Safety Net Review.

Table 3.3: Summary of results of minimum wage studies from countries other than the US

Country	Author/s	Year Published	Findings
UK	Stewart	2002	Overall neutral effect, marginally positive relationship for adult male and young workers.
Selected Developing Countries	Saget	2001	No significant effect.
France	Kramarz and Philippon	1999	**Significant negative** relationship.
US and France	Abowd, Kramarz and Margolis	1999	**Significant negative** relationship.
Cross-Country	Neumark and Wascher	1999	Results varied but were 'generally … consistent with the view that minimum wages cause employment losses among youth.'
Cross-Country	OECD	1998	**Significant negative** relationship.
Spain	Dolado, Fergueroso and Jimeno	1998	**Significant negative** relationship.
NZ	Maloney	1994	**Significant negative** relationship.
NZ	Chapple	1997	Inconclusive results.
Canada	Baker, Benjamin and Stanger	1997	**Significant negative** relationship.
France	OECD	1997	**Significant negative** relationship.
France	Abowd, Kramarz, Lemieux and Margolis	1997	**Significant negative** relationship.
France	Bazen and Skourias	1997	**Significant negative** relationship.
Columbia	Bell	1997	**Significant negative** relationship.
Mexico	Bell	1997	No clear relationship.
France	Dolado, Kramarz, Machin, Manning, Margolis and Tuelings	1996	Negative relationship with qualification that analysis could be affected by different business cycles.
Spain	Dolado, Kramarz, Machin, Manning, Margolis and Tuelings	1996	**Significant negative** relationship.
Canada	Kan and Sharir	1996	Small or negligibly negative relationship.
UK	Machin and Manning	1994	No negative relationship.
France	Benhayoun	1994	**Significant negative** relationship.
Netherlands	van Soest	1994	**Significant negative** relationship.
Greece	Koutsogeorpoulou	1994	**Significant negative** relationship.
France	Bazen and Martin	1991	**Significant negative** relationship.
UK	Bazen	1990	**Significant negative** relationship.
Netherlands	van Soest and Kapteyn	1990	**Significant negative** relationship.

New minimum wage studies

3.13 The Commonwealth is aware of four new empirical minimum wage studies, published since last year's Safety Net Review, which examine the relationship between minimum wages and employment. Clearly there is now a sound and growing body of evidence for the

existence of a negative relationship between minimum wage increases and employment. Three of these studies give results for OECD countries, which are detailed below. The fourth, by Saget, gives results for developing countries and is dealt with later in this chapter.

Keil et al

3.14 Keil, Robertson and Symons looked at the effect of minimum wages on aggregate employment rates in the US. This study was conducted for both adult and young workers in 48 US states for the period 1977–1995. It found that a one percent increase in minimum wages leads to a –0.11 per cent decrease in total employment and a –0.37 per cent decrease in youth employment in the short term, with long-run effects of –0.19 per cent and –0.69 per cent respectively. Keil et al concluded that, 'the cost of minimum wage legislation, far from being negligible as claimed by its apologists, may be higher still than even the minimum wage hawks have argued.'[8]

Williams and Mills

3.15 Williams and Mills revisited several time-series studies, which investigated the effect of an increase in the minimum wage on teenage employment in the US. After respecifying previous time-series models, they found a significant negative relationship between the minimum wage and teenage employment, with fairly robust results.

3.16 The authors found that the response of the teenage employment rate to a 10 per cent increase in the minimum wage is negative and ranges between 3 per cent and 5 per cent, increasing in strength over the first

[8] M Keil, D Robertson and J Symons, 'Minimum wages and employment', *Centre for Economic Performance Discussion Paper 497*, June 2001, page 12.

year or so before the effect begins to decrease.[9] The 10 per cent increase in the minimum wage was chosen as a convenient level for explanatory purposes, rather than as a threshold below which increases in minimum wages will have no impact on employment. The Department of Employment and Workplace Relations sought confirmation of this from the authors and received the following response from Mills via email:

> *The results imply that a 1% increase in the minimum wage would lead to a drop in teen employment of between 0.3% and 0.5% over the course of the first year or two.*[10]

3.17 Similarly the results of the Tulip paper[11] referred to in last year's joint Governments' submission were intended as an illustration of the impact that increases in the minimum wage would have on the non-accelerating inflation rate of unemployment (NAIRU), rather than the threshold below which such increases will have no impact.

3.18 Last year the Commission appeared to misinterpret Tulip's results when it stated:

> *The Tulip paper examines the impact of a 10% increase in the Minimum Wage relative to wages generally on the Non-Accelerating Inflation Rate of Unemployment in the United States. The ACTU claim does not entail a wage shock of that nature. As such, the Tulip paper is of limited assistance.*[12]

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[9] N Williams and J Mills, The minimum wage and teenage employment: evidence from time series', *Applied Economics*, v 33, i3, Feb 20, 2001, page 14.
[10] Email correspondence from Jeffrey Mills, 8 February 2002 (email: Jeffrey.Mills@UC.Edu)
[11] P Tulip, *The Effect of Minimum Wages on the NAIRU*, PhD Dissertation, University of Pennsylvania, 2000.
[12] Print PR002001, paragraph 94.

3.19 The Department of Employment and Workplace Relations has also contacted Peter Tulip and has received the following explanation of his choice of 10 per cent via email:

> *My figure of 10% is illustrative, not a threshold. I picked 10% because it is a round number and the conventional benchmark within the literature. The effect is log-linear (ie, proportionate) … It would be just as valid to refer to a 6% increase – which would increase the NAIRU by about a quarter of a percentage point.*[13]

3.20 The Commission's misinterpretation is unfortunate, because the Tulip paper indicates that minimum wage increases can have a long-term adverse impact on the structural health of the economy. This would render it less capable of sustaining vigorous economic growth, more susceptible to inflation, and less able to reduce unemployment as much as would otherwise be possible.

Stewart

3.21 Stewart used a 'difference in differences' approach to determine the effect that the introduction of the minimum wage in the UK had on employment. This approach attempted to discover whether a person who had gained a wage increase as a result of the minimum wage's introduction would have a higher probability of losing their job than an employee who earns slightly more than the minimum wage but did not receive an increase.

3.22 The Commonwealth notes that the UK evidently has been able to introduce a minimum wage with seemingly negligible adverse employment effects (according to Stewart's paper and the UK Low Pay

[13] Email correspondence from Peter Tulip, 12 Feburary 2002 (email: ptulip@frb.gov)

Commission's reports). However, it is important to remember that the case of the introduction of a single minimum wage in the UK is vastly different to an increase in all award levels of the size advocated by the ACTU. Firstly, the Low Pay Commission estimates that only 6.4 per cent of UK employees were entitled to a wage increase as a result of its introduction.[14] Secondly, as Stewart emphasised in the conclusion of his paper, the lack of a negative relationship between the minimum wage and employment is likely to be a result of it being set at such a low level:

> *Using a similar approach to that used here, Abowd et al. (2000) find significant negative effects for France, but insignificant effects for the US. The results in this paper for the UK are therefore closer to those for the US. This seems likely to partly reflect the differing levels at which minimum wages have been set in the three countries.*

3.23 Stewart correctly pointed out that the 'bite' of the minimum wage in the US and the UK (38 per cent and 46 per cent respectively) are much lower than the bite in France (70 per cent):

> *… the UK minimum wage has been set between the two [both the level and the bite of minimum wages in the US and France], but closer to that in the US than that in France. The results in this paper suggest that the estimated employment effects for the UK are also closer to those found for the US.*[15]

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[14] M Stewart, 'The Impact of the Introduction of the UK Minimum Wage on the Employment Probabilities of Low Wage Workers', January 2002, page 29.

[15] M Stewart, 'The Impact of the Introduction of the UK Minimum Wage on the Employment Probabilities of Low Wage Workers', January 2002, page 29. These figures differ from those in Table 3.1 because the median earnings figures used here exclude overtime, bonuses, and other supplementary bonuses, whereas these are included in Table 3.1.

3.24 The bite in Australia is close to 60 per cent (and would be higher if overtime was excluded from median earnings), so if such a study could be conducted in this country the results would likely be significantly negative.

3.25 Because of the differences between the minimum wage situations in the UK and Australia, that is, the unique structure of Australia's award wage system compared to the UK's single minimum wage, and differences in the 'bite' of the minimum wage, Stewart's results should not be emphasised when considering the employment effects of the ACTU's claim.

Response to ACTU's position on minimum wages and employment

3.26 The ACTU claims there is an 'extensive body of research [that] points to a firming international consensus that moderate rises in minimum wages do not cause unemployment, or harm the job prospects of the unemployed'[16]. It is the Commonwealth's submission that such evidence, a key part of which is the work of Card and Krueger, is in a minority. In addition, Card and Krueger's analysis has come under increasing challenge in recent years, especially from commentators who argue that Card and Krueger's natural experiments were based on a short time frame and so failed to capture the longer run impact of minimum wages on employment.[17]

3.27 As noted above, the ACTU states at paragraph 5.9 that there is a 'firming international consensus' that moderate rises in minimum wages

[16] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 5.9.
[17] Joint Governments' Submission, 2000-2001 Safety Net Review - Wages (print version), pages 215-216.

do not cause unemployment, or harm the job prospects of the unemployed. Rather than look at the literature overall as the Commonwealth has done, the ACTU selectively refers to just two papers which support its view that increases in minimum wages do not have a significantly negative impact on employment. By doing this, the ACTU once again ignores the majority of the literature that finds a significant negative relationship between minimum wage increases and employment.

3.28 Not only has the ACTU been selective in only including references to studies whose results suit it, the studies it has chosen relate to vastly different situations from the one we are dealing with. The first study, by Stewart, is considered at length above.

Saget

3.29 Saget's paper (at Tag 10) examines the employment effects of increasing minimum wages in developing countries including in Africa and Latin America. The 'bite' of minimum wages in these countries is tiny compared with that of Australia as Table 1 on page 14 of the Saget paper shows. For example, the ratio of the minimum wage to the average wage is around 20 per cent in Bolivia and Mexico, Chile and Brazil, whereas the ratio of the FMW to full-time adult average weekly ordinary time earnings in Australia is almost 50 per cent.[18]

3.30 In addition, Saget pointed out that compliance rates in developing countries tend to be poor:

> *The extent of non-compliance practices may contradict the objective of equality and fairness of the minimum wage. As documented by*

[18] ABS, Average Weekly Earnings Survey (Cat No 6302.0). It should be noted that the preferred measure of the bite is the ratio of minimum to median wages. We have used average wages here for ease of comparison.

> *several studies, most [developing country] governments appear not to enforce strict compliance with minimum wages.*[19]

3.31 The lack of significant negative results between minimum wage increases and employment in this study is probably partly due to this lack of compliance as Saget suggested:

> *The extent of non-compliance practises in developing countries … is expected to reduce the employment effects of minimum wages and may explain part of our results.*[20]

3.32 In summary, it is safe to conclude that Saget's results stem overwhelmingly from a combination of the small size of minimum wages compared with average wages and the practice of non-compliance with minimum wages in these countries. The results of this study are clearly not relevant to minimum wage increases in Australia.

Response to Joint Labor State's position on minimum wages and employment

3.33 The Joint Labor States only make the briefest mention in their submission of the impact that the ACTU's claim will have on employment. This consists of just two paragraphs, one repeating and supporting the Commission's decision of last year, and the second correctly pointing out that:

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[19] C Saget, 'Is the Minimum Wage an Effective Tool to Promote Decent Work and Reduce Poverty? The Experience of Selected Developing Countries', International Labour Office, *Employment Paper*, No.13, 2001, page 8.

[20] C Saget, 'Is the Minimum Wage an Effective Tool to Promote Decent Work and Reduce Poverty? The Experience of Selected Developing Countries', International Labour Office, *Employment Paper*, No.13, 2001, page 17.

> *… factors including monetary and fiscal policy responses play an important role in the overall economic effect of safety net adjustments.*[21]

3.34 The Commonwealth agrees that monetary and fiscal policy responses should be included in the analysis of the employment effect of minimum wages and these responses are included in our TRYM modelling in Chapter 4. The results of the TRYM modelling also show a significant negative effect on employment after second-round effects are taken into account.

Conclusion

3.35 When read as a whole, the literature on the relationship between increases in minimum wages and employment finds that the relationship is significant and negative.

3.36 Given the difficulty involved in conducting minimum wage studies in Australia, and the fact that the vast majority of employees paid at an award rate are paid more than the FMW, aggregate wage studies have the most relevance to Australia. Australian aggregate wage studies have found significant negative elasticities mostly around –0.7 or –0.8. These elasticities would be higher if the results were restricted to award dependent employees.

3.37 The ACTU's denial of these facts is insupportable. Its claim, if granted, would cause a significant increase in unemployment, particularly amongst low-paid workers, and would create a further impediment to employment for those already unemployed. The implications of the

[21] Joint Submission of the Labor Governments, ACTU Living Wage Claim 2001-2002, 8 February 2002, paragraphs 276-277.

literature are that increases should be kept small and limited to those on lower pay rates so that deleterious effects are minimised.

CHAPTER 4: THE COST OF THE ACTU'S CLAIM AND ITS MACROECONOMIC EFFECTS

Introduction

4.1 As well as having a significant impact on employment, the ACTU's claim, if successful, would have a considerable impact on labour costs and would impact negatively on the wider economy.

4.2 The ACTU has estimated the aggregate wage cost impact of the claim at 0.17 per cent. This is a serious underestimation of the aggregate impact. The Commonwealth has estimated that, if granted, the claim will add directly 0.59 percentage points to annual growth in hourly earnings across the economy. The Commonwealth's position is estimated to add 0.11 per cent to aggregate wages growth.

4.3 The Treasury Macroeconomic Model (TRYM) indicates that there would be significant impacts on the overall economy from the ACTU's claim compared to the Commonwealth's position. In particular, by 2003-04, employment levels would be around 37 000 lower and national income would be around $4.0 billion lower in real terms.

The direct wage cost impact of the ACTU's claim

4.4 The ACTU's claim is much higher than the current pace of wages growth. Table 4.1 provides data detailing the claim as a percentage increase for each of the classification rates in the Metal Industries Award relative to the annual growth in the Wage Cost Index (WCI). It clearly shows that the increase is much higher than the pace of wages growth in general. Moreover, as the Commonwealth demonstrates later in this

chapter, the increase is higher than those received by almost all employees under currently operating enterprise agreements.

4.5 In addition to the overall impact of the claim, it is important not to lose sight of the impact of the claim at the micro level. The number of award-reliant employees varies significantly between organisations depending on their size, region, occupational profile and the industry in which they operate. In organisations where the proportion of employees paid at award rates only is higher than the average for all employees (23.2 per cent), the wage cost impact will be significantly higher than the estimates presented in this chapter. The Commonwealth focuses more closely on the impact of the SNA at the micro level in Chapter 5 of this submission.

Table 4.1: ACTU's claim as a percentage increase, and relative to the annual growth in the Wage Cost Index

Metal Industries Award classification	Current wage rate $ per week	Nominal increase $ per week	Percentage increase from the ACTU's claim	WCI percentage increase in total hourly rates of pay excluding bonuses [1]	ACTU's claim relative to the WCI (%)
C14	413.40	25	6.0	3.4	176.5
C13	430.10	25	5.8	3.4	170.6
C12	452.60	25	5.5	3.4	161.8
C11	473.50	25	5.3	3.4	155.9
C10	507.20	25	4.9	3.4	144.1
C9	528.10	25	4.7	3.4	138.2
C8	548.90	25	4.6	3.4	135.3
C7	567.80	25	4.4	3.4	129.4
C6	609.50	25	4.1	3.4	120.6
C5	630.40	25	4.0	3.4	117.6
C4	651.20	25	3.8	3.4	111.8
C3	692.90	25	3.6	3.4	105.9
Level C2 (a)	713.80	25	3.5	3.4	102.9
Level C2 (b)	753.50	25	3.3	3.4	97.1
Level C1 (a)	837.00	25	3.0	3.4	88.2
Level C1 (b)	962.10	25	2.6	3.4	76.5

[1] Annual growth in the WCI over the year to December 2001. The WCI is a better measure of growth in wage rates that AWOTE and unlike AWOTE it is not affected by compositional change.

4.6 The ACTU estimates that its claim, if granted, would add 0.17 percentage points to economy-wide earnings**.** In the Commonwealth's view, this is a significant underestimate of the true cost of the claim, as explained in detail later in this chapter. The Commonwealth estimates that if granted the claim would directly add 0.59 percentage points to aggregate wages growth. In contrast, the Commonwealth's position would add 0.11 per cent to aggregate wages growth.

4.7 Table 4.2 presents the Commonwealth's estimates of the direct impact of the ACTU's claim on aggregate wages growth, net of the Commonwealth's position. The key point shown in Table 4.2 is that the ACTU's claim would add almost 0.48 percentage points to aggregate wages growth over 2001–02 to 2002–03, over and above the Commonwealth's proposed SNA, other factors unchanged. Focusing the analysis on this figure enables a clearer understanding of its economic consequences beyond those incorporated in the safety net increase proposed by the Commonwealth. It is this figure that is fed into the TRYM model.

Table 4.2: Additional impact of the ACTU's claim over the Commonwealth's proposal (percentage point contribution to wages growth)

2001-02		2002-03		
Year Average	Through the year	Year Average	Through the year	Total Impact (Through the year)
0.02	0.10	0.43	0.38	0.48

Notes:
The estimates are based on a number of assumptions including:

- the proportion of employees directly affected by the ACTU's claim is estimated to be around one quarter of all employees — based on data from the ABS May 2000 Survey of Employee Earnings and Hours (EEH) (Cat No 6306.0);
- the claim would not take effect until May 2002, and the impact of the claim would have a similar distribution to the previous safety net adjustment; and

- no award wage increases are assumed beyond the current claim.

'Year average' is the difference between the average in the financial year to the average in the previous financial year.

'Through the year' is the difference between the June quarter of the financial year and the June quarter of the previous financial year.

4.8 As noted in last year's proceedings the difference in the cost estimates appears to relate, primarily, to our inclusion of public sector employees in estimating the proportion of all employees paid at award rates. The ACTU argued that this was inappropriate and resulted in a substantial overstatement of the claim's macroeconomic and microeconomic effects.[1] It asserted, in particular, that due to residual amounts above properly fixed minimum rates in some awards and the existence of some s.170MX awards, public sector employees do not stand to benefit from SNAs.

4.9 The ACTU further argued that its cost estimate and that of the joint Governments were both overstated because they were based on the proportion of employees paid at an award rate rather than on the number of award reliant employees eligible for SNAs. The Commission appeared to concur with this view, noting:

> *Data previously relied on by the Joint Coalition Governments, from the 1999* Award and Agreement Coverage Survey *and the 1995* Australian Workplace Industrial Relations Survey *suggest that not all employees classified by survey respondents as award dependent benefit from safety net increases. This is most likely to reflect the absorption by residual amounts of safety net increases in some formerly paid rates awards, and to some degree reliance on s.170MX awards, together with some reporting errors by survey respondents who are unable to identify the award rate. As a*

[1] ACTU, Living Wage Case Submission 2001, ACTU Reply Submission, 13 March 2001, pages 33-37.

consequence data for award reliant employees might be better described as showing the potential cost impact, rather than the actual impact.[2]

4.10 While the Commonwealth acknowledges these comments, it does not agree that it overstates the cost of the claim. On the contrary, there are sound arguments for believing it is a conservative estimate. As noted in the joint Governments' supplementary submission last year, evidence suggests there are, in fact, public sector employees who do benefit from SNAs.[3] In addition, excluding the public sector from the analysis would actually result in a slightly greater proportional cost to earnings.[4]

4.11 With regard to the data used to estimate the cost of the claim, the Commonwealth accepts that it would be more appropriate, at least in principle, to use data on the flow of SNAs rather than the proportion of employees paid at award rates. Unfortunately the only data currently available on the flow of SNAs, relate to the number of awards affected, not employees, and so are not conducive to deriving estimates of the direct wage cost impact.[5]

4.12 In any case, as the Commonwealth has consistently argued in previous submissions, data on award-reliance can by no means be regarded as an upper boundary for the impact of SNAs. There are at least two reasons for this. First, the Commonwealth's estimate takes no

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[2] Print PR002001, paragraph 81.
[3] Joint Governments' Submission, 2000-2001 Safety Net Review - Wages (printed version), pages 293-295.
[4] Joint Governments' Submission, 2000-2001 Safety Net Review - Wages (printed version), page 294 and page 298.
[5] The ABS is investigating the possibility of collecting data on the flow of SNAs in future surveys of EEH. If the information is collected and made available the Commonwealth will endeavour to use the data in costing any future claim.

account of an important component of direct costs, namely the partial increases received by employees on informal overaward payments.[6]

4.13 Second, our estimate takes no account of the indirect effects of the claim. The joint Governments have provided evidence on the existence of these effects in previous submissions.[7] The Commonwealth now adds to this evidence detailing recent data from DEWR's Workplace Agreements Database (WAD). The data indicate that, at least with regard to federal enterprise agreements, the spillover of the ACTU's present claim is likely to be significant. It thus reinforces the fact that the Commonwealth's estimate is conservative and one that is likely to underestimate the full impact of the ACTU's claim.

The indirect wage cost impact of the ACTU's claim: evidence from the WAD on no extra claims clauses in agreements

4.14 Data from the WAD indicate that safety net increases could potentially flow on to around half a million employees covered by federal enterprise agreements.

4.15 A total of 176 500 employees are covered by current federal wage agreements which specify how safety net increases will be passed on (see Table 4.3) This total is composed of: 14 500 employees covered by agreements who receive automatic safety net increases; 69 500 who

[6] The Commonwealth's estimate is based on the proportion of employees paid by awards only. The EEH Survey includes employees paid by overawards in the category 'unregistered individual agreements' but unfortunately this proportion of employees is not separately identified. However, data from the DEWRSB Award and Agreement Coverage Survey (AACS) of 1999 suggest 22 per cent of employees paid overawards/ unregistered agreements in organisations with five or more employees would be eligible for an increase under the ACTU's claim.

[7] See, for example, Joint Governments' Submission, 2000-2001 Safety Net Review - Wages (printed version), pages 91-93 and Joint Governments' Submission, 1999-2000 Safety Net Review - Wages (printed version), pages 107-123 and 436-437.

receive safety net based increases where consistent with Safety Net Review decisions or principles as determined by the Commission; and, 92 500 who may receive a safety net based increase depending on the level of changes in award rates. The majority of this last group of employees received agreement increases well below the level represented by the ACTU claim making it likely that flow-on would result from safety net increases at that level.

4.16 A further group of employees are covered by agreements that do not specify the handling of safety net increases but which also do not rule out wage claims based on safety net increases. These agreements leave open the possibility of wage claims based on safety net increases during the life of the agreement. Over 302 300 employees were covered by such current wage agreements at the end of September 2001.

Table 4.3: Extent of safety net flow-on provisions for all wage agreements current at 30 September 2001

No extra claims commitment	No. of agreements	No. of employees	Percent of agreements	Percent of employees
Closed to safety net increases	8 279	883 300	70	65
Where consistent with Safety Net Review	797	69 500	7	5
Safety net increases conditional (may be open)	867	92 500	7	7
Safety net increases automatically passed on	217	14 500	2	1
Unspecified	1 595	302 300	14	22
Total	11 755	1 362 100	100	100

Source: DEWR, Workplace Agreements Database.

4.17 For the remaining group of over 880 000 employees covered by current federal wage agreements at the end of September 2001, safety net increases and wage claims were excluded.

Increases in the Superannuation Guarantee

4.18 The Commission needs to take account of the legislated increase in Superannuation Guarantee (SG) contributions, which will rise by 1 per cent to 9 per cent of earnings on 1 July 2002. The increase in SG will increase the future incomes of employees while adding costs to businesses unless offset by relatively lower wage increases.

4.19 It has been the policy of successive Commonwealth Governments since the inception of award superannuation in the mid-1980s that the SG results in a change in the mix of employee remuneration and not in an increase in overall remuneration or in business costs, which would have a negative impact on employment. In return, the Government provides tax concessions for retirement savings.

4.20 When the SG was introduced in 1992, the former Government amended the *Industrial Relations Act 1988* to require the Commission to take into account additional superannuation burdens for employers under the SG in determining future National Wage Case decisions (section 90A). The objective of introducing section 90A was full absorption of the SG over time and hence minimal, and purely transitional, employment effects. Section 90A has been retained in the WR Act by the current Government, requiring the Commission to take into account additional superannuation burdens for employers under the SG in determining the quantum of the SNA. In our submission, the rise in the SG from 1 July 2002 is a further consideration favouring a moderate SNA in this case.

4.21 So far in this chapter, the Commonwealth has examined the likely impact of the ACTU's claim on aggregate wages growth. The claim will have a significant impact on labour costs, not simply for those organisations where employees are paid at award rates, but also for those

that have alternative or combined pay setting methods. The significance of the increase in labour costs is its impact on employment and the overall economy.

Critique of the ACTU's Costing Methodology

4.22 The ACTU's claim that 'the Australian economy can afford a 0.2 per cent increase in its wages bill to give award workers a living wage'[8] is highly misleading. The ACTU's claim will not add 0.2 per cent to Australia's wages bill. The 0.2 per cent figure is the estimated cost of its claim less the estimated cost of the amount the Commission is likely to grant based on last year's decision. This 'net impact' analysis is next to meaningless as explained in more detail below. The other main flaw with the ACTU's costings methodology is its calculation of a 'maximum addition' as well as an 'estimated increase'.

The 'net impact' of the ACTU's claim

4.23 The 0.2 per cent costings figure the ACTU provides refers to the 'net impact' of its claim. That is, the estimated cost of its claim less the amount awarded in last year's decision. So the 'costings' figure of 0.2 per cent does not refer to what the ACTU's claim, if successful, would cost the economy. It is actually the cost of the ACTU's claim over and above the amount awarded in last year's case. Therefore the ACTU's assertion that its claim will add 0.2 per cent to wages growth is misleading.

4.24 By calculating the 'net impact' using the increase that the Commission granted last year, the ACTU is assuming that the Commission is likely to grant a similar increase this year. There is no

[8] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 1.32.

reason to make this assumption. If the Commission grants a smaller increase than last year, the ACTU's 'net impact' will be larger than estimated in its submission. The converse is also true.

4.25 The ACTU itself admits that 'the Commission must pay regard to the absolute impact of the ACTU claim not just the net impact'[9]. The ACTU's submission, then, is misleading the Commission when it asserts that its claim would lead to an increase in the WCI from 3.6 per cent to 3.8 per cent[10]. Its press release of 24 October 2001 is similarly misleading:

> *Mr Combet said the ACTU's $25 claim was economically affordable, representing an average annual pay rise of 3.8%…*[11]

Technical Issues - 'Maximum addition' versus 'estimated increase'

4.26 There are a number of technical matters that need to be explained in the context of understanding the problems with the ACTU's methodology. The 'maximum addition' to total ordinary time earnings applies the weighted increase of the claim to the total proportion of employees who are on awards. This figure should be fairly close to the Commonwealth's estimate, the only difference being caused by the differences in the construction of the weightings across the cohorts.

4.27 In contrast, the 'estimated increase' applies the weighted increase of the claim to the proportion of employees who receive SNAs as estimated by DEWRSB's 1999 Award and Agreement Coverage Survey (AACS), adjusted for the more recent results on award coverage from the EEH survey.

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[9] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 3.21.
[10] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 1.3.
[11] ACTU Media Release, '$25 Living Wage Claim For GST Rises', 24 October 2001 http://www.actu.asn.au/vunions/actu/news_room.cfm (accessed 14 February 2002)

4.28 As the joint Governments have noted in past safety net reviews, it is not valid to use the results from the AACS to construct costings in this manner. The reasons include the fact that the AACS estimate does not include some recently employed employees who, while not having been granted the SNA themselves during their period of employment, will be paid at the level determined by the most recent SNA. (This is an important consideration as 23.6 per cent of employees working in February 2000 had been in their current job for less than one year.[12]) Also, the results from the AACS survey are only relevant to SNAs available in the year to June 1999. The flow of SNAs in future reviews may differ greatly depending on the amount granted and the approach taken by State tribunals (for example, application versus general order).

Inclusion of the public sector

4.29 Once again, the ACTU has omitted the public sector from the first part of its costings calculations. However, it appears to have conceded the importance of public sector safety net increases as it has also included a set of costings that includes both public and private sectors.

4.30 The Commonwealth is unable to replicate the table at page 50 of ACTU Tag 4 with data from the EEH survey. In particular, it is not clear where the data underpinning the proportions in the first row come from. The ACTU claims that the proportion of award-dependent employees who are full-time permanent jumps from 30.3 per cent to 47.4 per cent when public sector employees are included. This is mathematically impossible, given that only 8.9 per cent of award employees are employed in the public sector. Even if all public sector award-employees were adult full-time permanents, the figure would only be able to increase

[12] ABS, Labour Mobility, February 2000 (Cat No 6209.0)

to 36.0 per cent. Our calculation using the EEH data is that this figure is 32.8 per cent.

4.31 Using the correct EEH figures, the ACTU's figure for 'maximum addition to total ordinary time earnings' drops from 0.68 per cent to 0.62 per cent, which is much closer to its costings when public sector award employees are excluded. Similarly, the ACTU's 'estimated increase in ordinary time earnings' drops from 0.49 per cent to 0.45 per cent when the correct figures are used. The Commonwealth trusts that the ACTU has not inflated these figures to try to indicate that including public sector employees grossly overestimates the costings. As the Commonwealth has shown, this is not the case.

4.32 In summary, the ACTU submission has grossly misled the Commission as to the impact its claim, if successful, would have on wages growth.

The macroeconomic impact of the ACTU's claim

4.33 In this section the Commonwealth assesses the potential impact of the ACTU claim in the context of the economic outlook discussed in Chapter 2. Using the TRYM model, the Commonwealth provides the Commission with estimates of the impact of the ACTU's current claim on key macroeconomic aggregates. In addition, we analyse the impact of previous decisions and respond to key issues raised in previous decisions.

Treasury Modelling Results

4.34 The assessment of the macroeconomic impacts of the direct wage effects of the ACTU claim are made relative to the Mid Year Economic and Fiscal Outlook (MYEFO) forecasts and projections outlined in Chapter 2. The wage forecasts in this baseline incorporate the effects on

the economy of Commonwealth's position. In other words, for the purposes of discussing the macroeconomic modelling in this review, the MYEFO baseline encompasses the effect of the Governments' proposal of a $10 per week increase capped at C10.

4.35 The modelling results are partly dependent upon the assumptions made in regard to the way the Reserve Bank and financial markets respond to the inflationary effects of the wage increase. For example, monetary policy could be modelled such that official interest rates increase to ensure that inflation remains low in the face of wage pressure. In view of the sensitivity of the results to different policy responses, two simulations are included:

- first, the Reserve Bank and financial markets do not respond to the higher inflation generated by the wage claim (that is, where the inflation effects are not counteracted); and
- second, the Reserve Bank and financial markets operate to counteract some of the additional inflation (that is, where the additional inflation is not allowed fully to flow through, but at the cost of lower growth and employment). This simulation extends the previous simulation to capture 'real world' interest rate responses and feedbacks.
  - Under this scenario, interest rates are adjusted in a forward looking manner which is intended to broadly mimic the way interest rates have moved in history. As such, the response is not arbitrarily imposed, but is based on historical experience.
    - This simulation uses an optimal control procedure where the short-term interest rate is adjusted so as to minimise a loss function. The loss function is specified such that it targets the

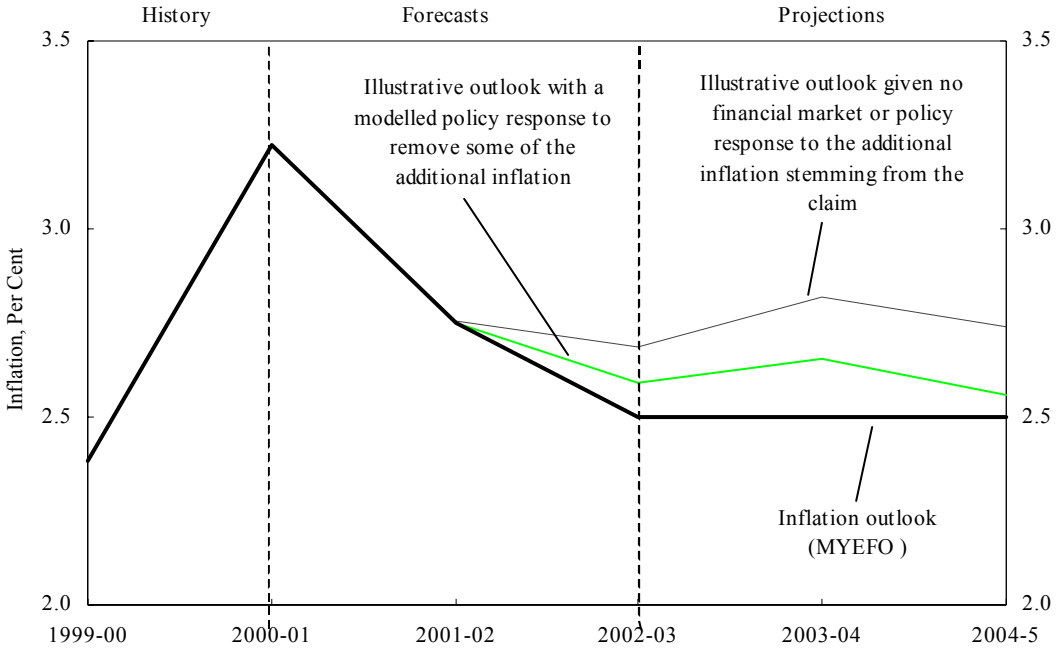
rate of inflation, the rate of unemployment and changes in the rate of interest.[13]

4.36 The first simulation provides an illustration of the potential inflationary impact of the claim in the absence of the Reserve Bank responding to higher inflation. The second simulation provides an illustration of the economy-wide consequences once monetary policy and financial markets react to bring inflation back towards where it would otherwise have been.

4.37 Charts 4.1 and 4.2 show the expected impact of the ACTU's claim on inflation and employment vis-à-vis the outlook presented in the MYEFO, with and without a monetary policy or financial market response.

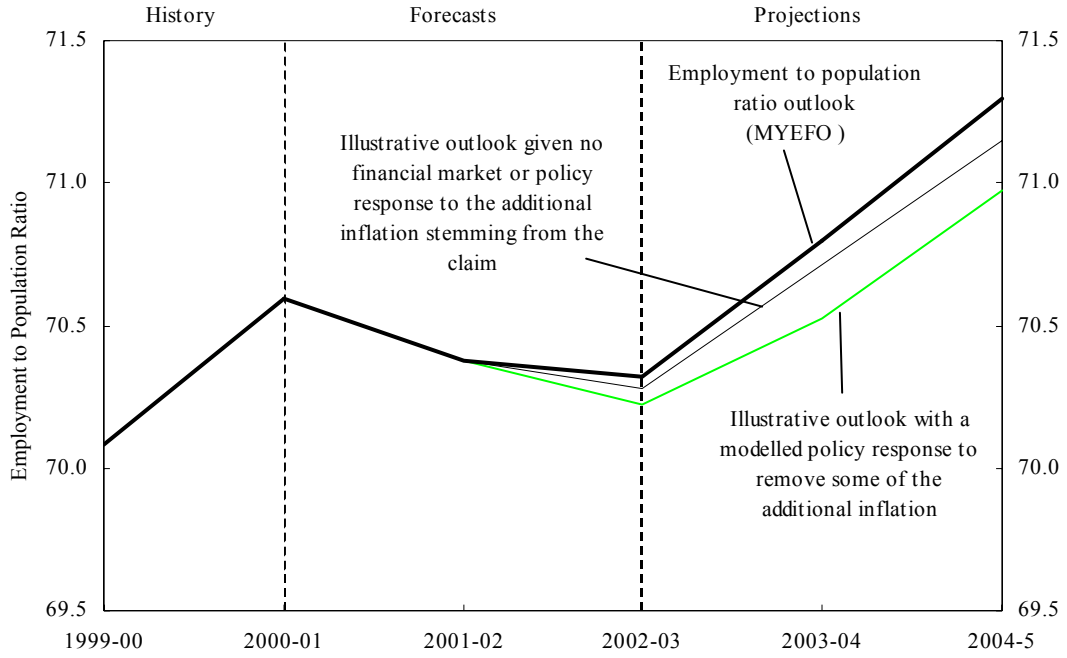
[13] The nature of the interest rate response has been discussed in detail in previous submissions. The methodology used and a comparison with other research, including that by the Reserve Bank, is contained in Section 6 of P Downes and K Nernie, 'The Macroeconomics of Unemployment in the Treasury Macroeconomic (TRYM) Model', *TRYM Related Paper No 20*, Commonwealth Treasury, Canberra, 1999 (Exhibit JG5 in 1999-2000 submission) .

Chart 4.1: Potential impact of the ACTU's 2001-02 'living wage' claim on year-average inflation [(a)(b)]



Notes:
(a) Inflation data prior to 1998-99 is 12th series headline inflation less mortgage interest charges and consumer credit charges. These adjustments have been made to bring the data into closer alignment with the 13th and 14th series definitions of headline inflation adopted by the ABS from the September quarter 1998 and the September quarter 2000 respectively.
(b) Inflation data here abstracts from the one-off impact in 2000-01 of the introduction of the federal Government's tax package on 1 July 2000.

Chart 4.2: Potential impact of the ACTU's 2001-02 'living wage' claim on the employment to population ratio [(a)]



Notes:
(a) The employment-to-population ratio is the ratio of total employment to the population aged 15-64 years, and therefore reflects employment relative to the pool of persons potentially in the work force.

4.38 The remainder of this chapter focuses on the second simulation as it captures more real world impacts by allowing the Reserve Bank and financial market to react to the increase in wages.

4.39 The potential impact of the ACTU claim with the modelled Reserve Bank and financial market responses is summarised in Table 4.4, where results are presented as deviations from the profiles underpinning MYEFO.

Table 4.4: Macroeconomic impact of the ACTU's 2001-2002 'living wage' claim – with Reserve Bank and financial market response [(a)]

	2002-03	2003-04
GDP Level (b)	-0.2	-0.6
Inflation (c)	0.2	0.1
Employment Level (b)	-0.1	-0.4
Employment ('000)	-13	-37
Unemployment Rate (d)	0.1	0.2
90 Day Bill Rate	0.5	0.3
Wages Growth (c)	0.3	0.0

(a) The impacts are given in percentage point deviations from official outlook unless otherwise stated.
(b) Per cent of baseline.
(c) Through-the-year (June) figures and after the monetary policy response.
(d) June quarter.

4.40 The key conclusion from the simulation is that if the ACTU's claim was accepted, then there are likely to be adverse impacts on the labour market and the economy more generally.[14]

- In 2003-04, the GDP level would be more than ½ per cent lower than would otherwise be the case. This equates to annual national income being $4 billion lower than would otherwise be the case by 2003-04.
  - Due to lags, it takes until 2003-04 for the significant contraction in GDP to occur.
- In addition, the number of people in employment would be around ½ per cent lower than otherwise would be the case by the June quarter 2004, which translates to around 37 000 fewer persons employed.
  - The unemployment rate would be around ¼ of a percentage point higher by the June quarter 2004, stemming both from the

[14] In Simulation 1 (not including the Reserve Bank and financial market reaction function), ACTU award increases will result in higher inflation, lower employment and lower GDP growth. Including the Reserve Bank and financial market reactions (Simulation 2), reduces but does not eliminate the inflationary impact at the expense of a further slight reduction in GDP and employment growth.

slowdown in GDP growth and from business substituting away from labour in favour of capital.

The macroeconomic impact of successive wage decisions – 1997 to 2001

4.41 Successive seemingly-moderate wage increases granted by the Commission over time can have significant impacts on the labour market and economy more generally. The economic impacts of decisions accumulate over time.

4.42 To illustrate the potential economic impact, TRYM has been used to examine the cumulative economic impact of the last five AIRC Safety Net Reviews decisions. Between 1997 and 2000, the joint Governments' advocated a capped safety net wage increase of $8 per week and in 2001 advocated a capped safety net wage increase of $10 per week. In the event, in each year the Commission has awarded larger uncapped increases which have added considerably to nominal wage growth over this period.

4.43 The impact on wage growth of these decisions since 1997, relative to the joint Governments' position, is shown in Table 4.5 below. The contribution to wage growth of the decisions has varied between a quarter and a third of a percentage point above that of the joint Governments' position.

- The cumulative direct impact of the decisions over the full period is additional wages growth of over 1¼ per cent above the joint Governments' position.

Table 4.5: Direct impact of decisions on aggregate wage growth: 1997 to 2001 (per cent change)

	1997		1998		1999		2000		2001	
	Year average	Through the year	Year average	Through the year	Year average	Through the year	Year average	Through the year	Year average	Through the year
Impact of safety net decisions relative to joint Governments' position	0.11	0.24	0.32	0.37	0.32	0.27	0.30	0.33	0.30	0.26

4.44 It is worth emphasising that these figures exclude the effect of the superannuation contribution. As such, the figures understate the total remuneration growth for employees (and total cost to employers) in these years. This is particularly the case as the higher decisions in 1998 and 2000 coincided with legislated increases in the minimum employer superannuation contribution.

4.45 The estimated effect on the economy if the joint Governments' position had been accepted rather than the actual outcome is determined by conducting a counterfactual simulation against history using the TRYM model. That is, the simulation takes history as the baseline (starting point) and then asks how would the past have been different if the joint Governments' position had been accepted in each year (rather than the actual decision).

- To simulate the effect of the difference between the joint Governments' position and the AIRC decisions, the historical baseline is subjected to a negative wage shock of the magnitudes shown in Table 4.5. The results of the counterfactual simulation are then compared to the historical baseline.

4.46 There are two main constraints in running the counterfactual simulation. First, the counterfactual simulation needs to be run continuously, starting at the time of the first decision which is the

June quarter 1997.[15] That is, the results relate to all the decisions taken together rather than for each individual decision in isolation. Second, under present monetary policy arrangements, the interest rate response needs to be treated as forward looking. That is, since the move to an explicit inflation targeting framework the Reserve Bank has conducted monetary policy in a forward looking manner. It sets interest rates with regard to the inflation outlook rather than according to past inflation.

4.47 This behaviour means that the Reserve Bank tends to take pre-emptive action in order to prevent inflation and unemployment from moving too far away from where they would have been without the wage shock. This also has implications for inflation, employment and the economy more generally.

- In this instance, as the Reserve Bank is treated as being forward looking, it is assumed to be able to perfectly foresee the implications of the new wage profile and its inflationary impact. Thus with the negative wage shock outlined in Table 4.2, the model generated lower interest rates for the first three years than occurred in history.

4.48 Table 4.6 summarises the results of the counterfactual simulation. The figures in each year incorporate the initial effect of the decision in that year, in combination with the lagged effects of the decisions from previous years. This lagged effect is partly dependent on the timing and degree of the monetary policy response to those previous decisions. The

[15] One critical factor when analysing results of the counterfactual simulation is the length over which the shock is imposed. The simulation in this year's submission commences in April 1997, the same as in last year's joint Government Submission. Consequently, there are five years of wage shocks in this submission, compared to only four in last year's submission.

monetary policy response gradually unwinds the impacts of the decisions (taken as a series) on inflation. [16]

Table 4.6: Estimated impact of the counterfactual simulation (deviations from history) - with financial market and monetary policy reaction

(Percentage point deviations unless otherwise stated)

	1997-98	1998-99	1999-00	2000-01	2001-02
GDP Level (a)	0.2	0.7	0.9	0.7	0.3
Inflation (b)	0.0	0.0	0.1	0.0	-0.2
Employment Level (a)	0.1	0.5	0.8	0.8	0.6
Employment ('000)	9.5	39.9	69.7	73.8	52.9
Unemployment Rate (c)	-0.1	-0.3	-0.4	-0.4	-0.2
90 Day Bill Rate	-0.7	-0.6	-0.1	0.3	0.2
Wages Growth (b)	-0.1	0.0	0.2	0.0	-0.2

(a) Per cent of baseline.
(b) Through-the-year (June) figures and after the monetary policy response.
(c) June quarter.

4.49 The key conclusion from the scenario outlined in Table 4.6 is that if, instead of the actual decisions taken, the joint Governments' positions had been accepted, there would have been a positive impact on the labour market and the economy more generally.[17] This is especially the case in the short term. In the medium term, the decrease in nominal wages is offset by the fall in interest rates, which leads to stronger employment and output growth. Thus as the impact of wage shock is eroded, real wages, unemployment and output will gradually revert back to the

[16] The general result for monetary policy is that it affects the timing of, rather than the level of, activity over a run of years. In other words, no hysteresis feedbacks are included where for example higher unemployment leads to a loss of skills and morale making unemployment harder to reduce. If these were included the employment effects in the sensitivity analysis would be larger. See TRYM Related Paper No 16, Sections 2.2.2 and 4.1 for a brief discussion of the monetary policy timing versus level issues.

[17] The result from the counterfactual simulation conducted for the Commonwealth's submission is broadly similar to those presented in last year's submission. The conclusion that there would potentially have been a positive impact on the labour market and the economy more generally remains. However, in this year's simulation, rather than responding to four years of different wage outcomes, they are responding to five years. As such, interest rates will be adjusted in a slightly different way. This

baseline scenario. In other words, the impact of the nominal wage shock on the real economy becomes more muted over time.

- By the end of the counterfactual period, the level of GDP would have been 0.3 per cent higher. Over the entire period of the counterfactual, GDP could have been as much as 0.9 per cent higher as interest rates could have been lower early in the counterfactual period.
- In 2001-02, employment would have been higher by 53 000 persons and the unemployment rate around ¼ of a percentage point lower. Over the entire period of the counterfactual, employment would have been up to 74 000 persons higher and the unemployment rate up to ½ of a percentage point lower.

4.50 The results of the counterfactual illustrate that a series of more moderate wage increases such as consistently advocated by the Commonwealth can have significantly positive impacts on the economy, especially in the short term.

Technical Note: Modelling Issues

4.51 The Treasury analysis is undertaken using the TRYM model. TRYM is a structural dynamic economic model based on historical time series data and developed over the last twelve years in the Commonwealth Treasury. The design and estimation of TRYM has been guided by a desire to ensure that the model is as useful as possible for macroeconomic forecasting and policy analysis.

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difference in the interest rate response then affects the timing of the employment and inflation responses.

- Extensive documentation of TRYM and explanation of the labour market linkages in the model have been tendered in previous cases.[18]

4.52 TRYM has been subject to substantial comparison with other models and systems over the years in regard to a wide variety of impacts. The model has many similar properties to other time series macroeconomic models such as the Murphy Model (MM2) maintained by the economic consultancy firm Econtech, the Access Economics Macroeconomic (AEM) Model, the Australian component of the McKibbin Sachs Global (MSG) model and other systems.

- It also has similar properties to much smaller and simpler systems. The model response to interest rate changes is very close to the assessment of the lags and magnitude of interest rate effects on the basis of single equation research by the Reserve Bank (Gruen et al (1997)) or the simple 6 equation system used by the Reserve Bank in a number of studies (such as Debelle and Stevens (1995))[19].

4.53 The fact that the properties of these different systems is similar in many respects is perhaps not surprising given that they are all estimated on the same historical time series data and necessarily reflect the historical regularities in that data. Importantly, TRYM produces results that are similar to the results obtained from a range of other models and modelling techniques.

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[18] See Commonwealth Treasury, *Documentation of the Treasury Macroeconomic (TRYM) Model,* AGPS Canberra, 1996, and P Downes and K Nernie, 'The Macroeconomics of Unemployment in the Treasury Macroeconomic (TRYM) Model', *TRYM Related Paper No 20*, Commonwealth Treasury, Canberra, 1999.
[19] D Gruen, J Romalis and N Chandra 'The Lags of Monetary Policy' Reserve Bank of Australia *Research Discussion Paper No 9702*, June 1997, and G Debelle and G Stevens 'Monetary Policy Goals for Inflation in Australia' Reserve Bank of Australia *Research Discussion Paper No 9503*, March 1995.

4.54 While all model results are subject to some degree of uncertainty and require the application of judgement, the use of a macroeconomic model provides the most comprehensive analysis of the economic impacts of a change in wages. The TRYM model is designed to reflect mainstream economic theory, is fully documented, and is the appropriate vehicle for providing such a benchmark in terms of the effect on the official outlook.

Response to Modelling Issues raised in last year's decision

4.55 In last year's decision, there were a number of comments made regarding the modelling exercise in general and TRYM in particular. These comments included:

- doubts about the usefulness of magnitudes of the impacts suggested by modelling, particularly in light of the different modelling results presented to the Commission; and
- a misunderstanding of where TRYM fits in the taxonomy of macroeconomic models.

4.56 With respect to the differences between the Treasury's TRYM model and the Access Economics modelling, the Commonwealth sees those differences as minor.

- First, TRYM's use of forward looking financial markets, designed to mirror the actual behaviour of markets, sees a more rapid interest rate reaction to a safety net rise, and therefore an earlier reduction in employment. Access Economics attributed the speed of TRYM's reaction to forward looking financial markets.

- Second, different shocks were applied to the two models, with TRYM allowing for the full effects on the economy of the safety net decision, including the possibility that resultant higher prices might induce wage rises elsewhere in the economy, whilst Access Economics focussed solely on first round wage impacts.

4.57 However, these differences are rather less important than are the points of agreement in the models. The main point is that both models find that there are significant negative employment effects from safety net wage increases. The Commonwealth sees that point of agreement as more important than the differences noted by the Commission.[20]

4.58 The decision reported that TRYM is a neoclassical model. This is not the case. In fact, the model could be described as broadly new Keynesian in its dynamic structure but with an equilibrating long run. Activity is demand determined in the short run but supply determined in the long run (see Section 2.3 of the Macroeconomics of TRYM).[21] The model will eventually return to a supply determined equilibrium growth path in the absence of demand or other shocks.

Conclusion

4.59 The ACTU's claim, if successful, would lead to a significant increase in labour costs in the short term, leading to detrimental effects on employment and the broader economy more generally. The Commission should be mindful of these effects when making its decision. In addition to considering the costs on the aggregate economy, it should be

[20] Print PR002001, paragraph 93.
[21] http://www.treasury.gov.au/publications/TreasuryMacroeconomic(TRYM)Model/macroeconomics/default.asp

remembered that the effects of the claim are likely to be larger in particular sectors and regions as discussed in the following chapter.

CHAPTER 5: THE MICROECONOMIC IMPACT OF THE CLAIM

Introduction

5.1 In Chapter 4 of this Submission, the Commonwealth provides an assessment of the aggregate economic impact of the ACTU's claim, demonstrating that it will lead to weaker employment growth. Many firms and regions will suffer significant negative effects if the ACTU's claim is granted. Regions and industries that are struggling are likely to experience a disproportionately large effect in terms of reduced activity and employment opportunities.

5.2 One of the conditions necessary for an improvement in employment opportunities is for labour productivity to keep pace with growth in real wages. Safety net increases have their main impact in low productivity growth service sector industries such as cultural and recreational services; and accommodation, cafes and restaurants. Award reliance remains high in such industries, many of which provide part-time and lower skilled work. Employment growth in lower skilled occupations has been weak for several years.

5.3 The ACTU's claim could lead to a significant reduction in employment opportunities in regions that depend on vulnerable industries. Many of these regions are already struggling as a result of the decline in inbound tourism and the Ansett collapse.

5.4 The small business sector is adjusting to a still uncertain economic environment.

5.5 In the 2000-01 Safety Net Review, the Commission noted the importance of sectoral considerations. In particular, it stressed 'the fact that a safety net increase will impact differently across sectors is a relevant consideration, amongst others, to be taken into account in determining the level of SNAs to be awarded'.[1]

5.6 The problems of sectoral and regional unemployment are also important matters for this case. Unemployment is directly related to the state of the economy, levels of employment, and general living standards, all factors specified for consideration under s. 88B(2).

The occupational dimension of the claim

5.7 Relatively poor long-term employment growth prospects in many occupations with lower pay rates and generally lower skill levels reinforce the view that any safety net increase should be of modest size if its effect on employment is to be minimised. Growth in hours worked in Australia over the last five years has been strongest in high paid occupations and weakest in low paid occupations where the claim is likely to have most effect.

5.8 The concentration of employees paid by the award only in particular occupational groups highlights the adverse potential impact of the ACTU's claim in particular segments of the labour market. For example, according to EEH Survey data as shown in Table A.1 (in Appendix A), labourers and related workers and elementary clerical, sales and service workers (36.9 per cent and 42.0 per cent, respectively) are significantly more likely to be paid at the award rate than managers and administrators (3.3 per cent) or professional employees (13.2 per cent).

[1] Australian Industrial Relations Commission, *Safety Net Review Decision 2000-2001*, paragraph 97.

The granting of the ACTU's claim for a $25 per week pay increase would clearly jeopardise the employment prospects for labourers and related workers and elementary clerical, sales and service workers.[2]

5.9 As can be seen in Chart 5.1, growth in hours worked has been strongest amongst high paid occupations and weakest amongst low paid occupations. This has been especially evident over the past two years where the softening in the labour market appears to have weakened labour demand in middle and low paid occupations while hours worked in high paid occupations have continued to grow strongly.[3] These results suggest that a very large proportion of the labour market (i.e. both the moderate and low paid sectors) may be harmed by a large safety net increase.

5.10 Declines in hours worked in low paid occupations have occurred amongst hospitality workers; textile, clothing and other machine operators; elementary clerks; and factory labourers. In middle paid occupations, electrical and electronics tradespersons; intermediate stationary plant operators; and intermediate numerical clerks have been among the hardest hit.

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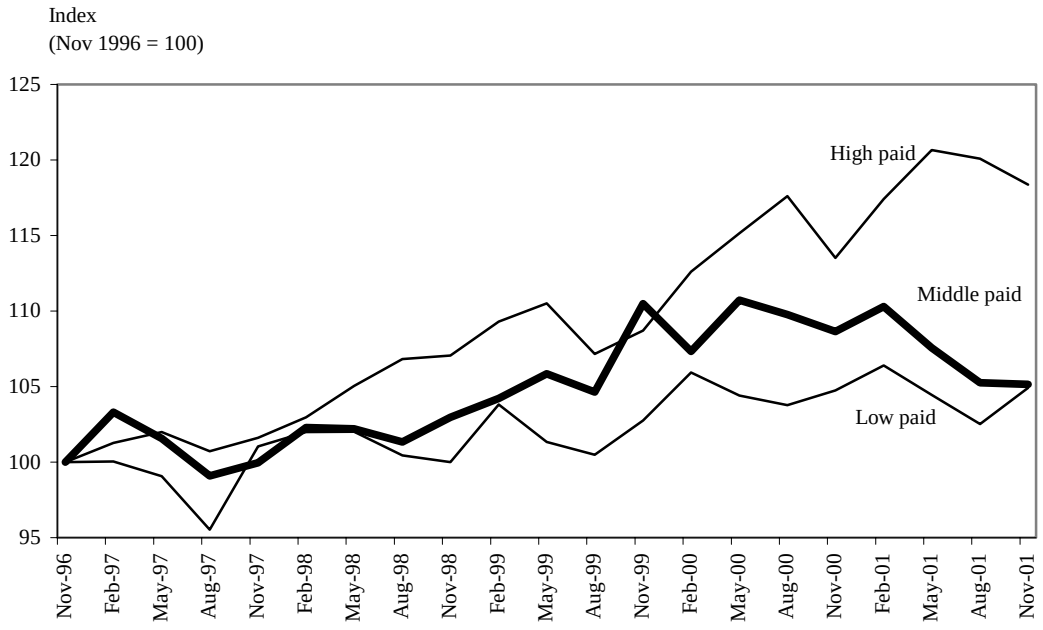
[2] The following section updates the analysis provided in Appendix G of our submission to the Safety Net Review – Wages 2000-2001 using the latest available data for November 2001. For a detailed description of the methodology employed in this analysis, and of related literature, refer to Appendix G of last year's submission (Joint Governments' Submission, 2000-2001 Safety Net Review – Wages (printed version), pages 223 to 244).

[3] As noted in last year's submission, it is important to take account of differences in the business cycle between the start and end periods when conducting this sort of analysis. This is because lower skilled occupations tend to be more adversely affected by downturns in the economy. The business cycle improved between November 1996 and November 2001. The trend unemployment rate was 8.4 per cent in November 1996 compared to 6.8 per cent in November 2001 while the trend employment to population ratio was 58.2 per cent and 59.3 per cent respectively. So the relatively weak performance of low and middle paid occupations compared to high paid occupations over this period cannot be attributed to a labour market downturn.

Occupations to experience the strongest growth among high paid occupations included general managers and administrators, specialist managers and project and program administrators.

5.11 As Table 5.1 shows, growth in hours worked in high paid occupations accounted for 65 per cent of the total growth in hours worked by adult employees while growth in middle and low paid occupations each accounted for just 18 per cent of growth. Chart 5.1: Growth in hours worked by adult employees from November 1996 to November 2001.

Chart 5.1: Growth in hours worked by adult employees from November 1996 to November 2001



Source: ABS, unpublished data, Labour Force Survey (Cat No 6203.0)

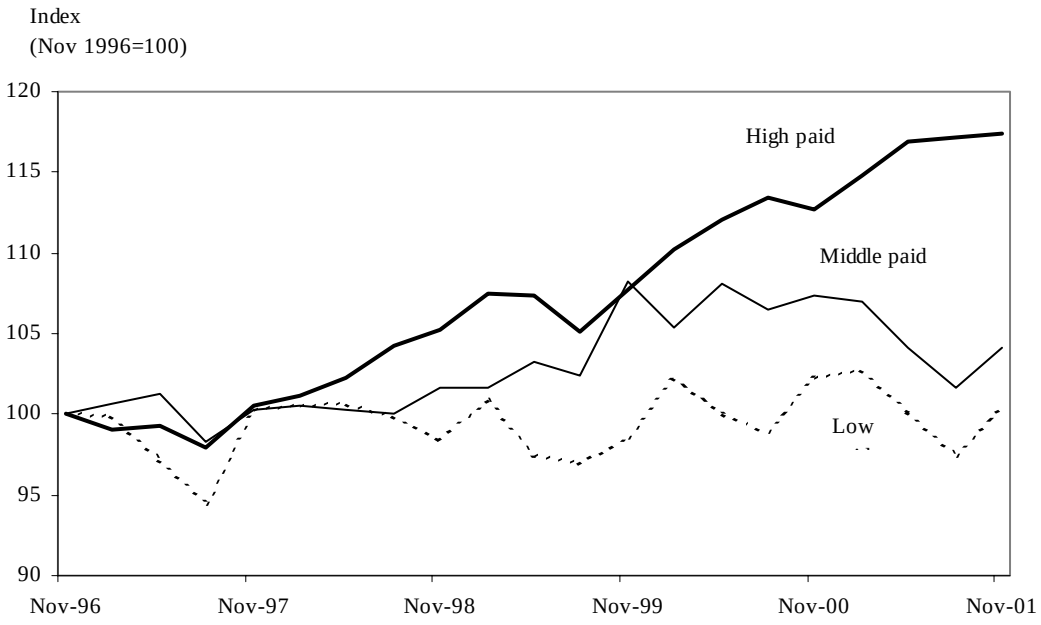
Table 5.1: Growth in hours worked by adult employees in low, middle and high paid occupations from November 1996 to November 2001

Occupation category	Initial share of hours worked (Nov 1996)	Proportion of total growth in hours worked from Nov 1996 to Nov 2001	Percentage growth from Nov 1996 to Nov 2001
	%	%	%
Low paid	34.2	17.7	4.9
Middle paid	32.5	17.6	5.2
High paid	33.4	64.7	18.4
Total	100.0	100.0	9.5

Source: ABS, unpublished data, Labour Force Survey (Cat No 6203.0)

5.12 The above results do not appear to be influenced by changes in average hours worked as repeating the analysis for adult full-time employees tells a very similar story. Table 5.2 shows that growth in full-time employment has been concentrated in high paid occupations with 80 per cent of employment growth for full-time adult employees occurring in high paid occupations while less than 2 per cent of the growth occurred in low paid occupations.

Chart 5.2: Growth in employment of adult full-time employees from November 1996 to November 2001



Source: ABS, unpublished data, Labour Force Survey (Cat No 6203.0)

Table 5.2: Growth in employment of full-time adult employees in low, middle and high paid occupations from November 1996 to November 2001

Occupation category	Initial share of full-time employment (Nov 1996)	Proportion of total growth in full-time employment from Nov 1996 to Nov 2001	Percentage growth from Nov 1996 to Nov 2001
	%	%	%
Low paid	32.5	1.7	0.4
Middle paid	33.5	18.5	4.1
High paid	34.0	79.7	17.4
Total	100.0	100.0	7.4

Source: ABS, unpublished data, Labour Force Survey (Cat No 6203.0)

5.13 The recent declines in the hour measures of employment for both low paid and middle paid occupations are probably due to subdued conditions in the labour market generally. However, Charts 5.1 and 5.2 show that the lower paid occupations in particular were unable to sustain more rapid employment growth for any significant period in the five years between 1996 and 2001. The sustained weakness highlights the inability of the sector to withstand a $25 per week increase in award rates. Such an increase would undermine the position of low paid workers and weaken the job prospects of unemployed people.

The industry dimension of the claim

5.14 The effect of any future SNA will also vary across industries. A number of industries shown in Table A.1 (Appendix A) have particularly high proportions of employees under award-based pay setting. For example, accommodation, cafes and restaurants; and retail trade had 64.7 per cent and 34.9 per cent, respectively, of employees paid by award rates only compared to the average for all industries of 23.2 per cent. Compare this with electricity, gas and water, which had just 1.4 per cent of employees paid at award rates only (76.5 per cent of employees in the industry were paid by collective agreements) and finance and insurance, where just 5.6 per cent of employees were paid at award rates (the

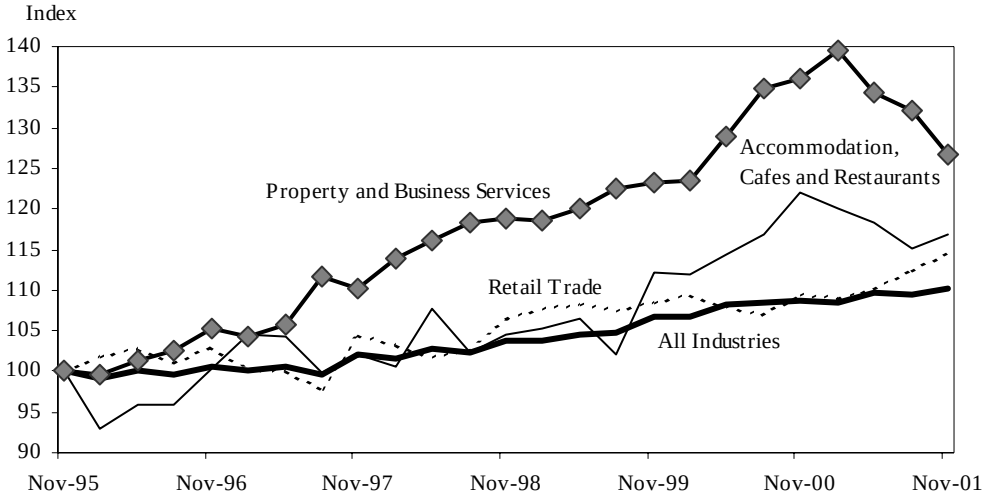
remaining employees in the industry were split evenly between collective agreements and individual agreements).

5.15 Of the industries in which award-based pay setting is prevalent, some are facing adverse operating conditions and some have a workforce which is characterised by low skill levels. For instance, the current problems in the tourism industry, which are examined later in the chapter, could have a significant adverse impact on some parts of the accommodation, cafes and restaurant industry.

5.16 Chart 5.3 compares employment growth in industries which have a relatively high degree of reliance on award-based pay setting[4] with that of all industries. It shows that accommodation, cafes and restaurants (where approximately two-thirds of employees are covered by awards) and property and business services have both experienced a general downturn in employment growth since the beginning of 2001. Between November 2000 and November 2001, employment in these two industries declined by 4.4 per cent and 6.9 per cent respectively. By contrast, employment in all industries increased by 1.3 per cent over this one-year period. Employment growth in retail trade has been quite similar to the rate of growth for all industries, however, it has picked up in the last year.

[4] An ‘award reliant industry’ is an industry in which over 20 per cent of employees have their pay set by an award.

Chart 5.3: Employment growth in award reliant industries, 1995 to 2001



Source: ABS Labour Force data, Cat No. 6203.0

5.17 It is also worth noting that two of the most award reliant industries - accommodation, cafes and restaurants; and retail trade - are also the two industries characterised by the highest proportion of part-time employees. As at November 2001, 49 per cent of accommodation, cafés and restaurant employees and 46 per cent of retail trade employees were employed on a part-time basis. According to ABS labour market flows data[5], the probability of losing employment and becoming unemployed in a month is twice as high for part-time workers (approximately 1.7 per cent) as it is for full-time workers (0.7 per cent). While these might seem like small figures, the cumulative effect is quite large.[6]

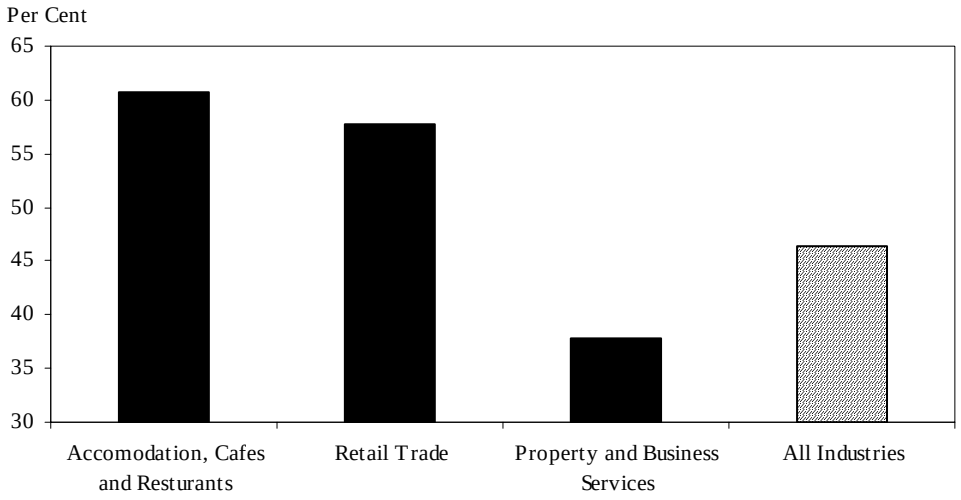
5.18 Employees of a lower skill level are also more likely to have their pay set by an award. Chart 5.4 shows that 61 per cent of employees in

[5] ABS Gross flows data are published in Catalogue Number 6203.0, Labour Force Australia.

[6] For example, over the year to December 2001, a total of 512 200 part-time employees became unemployed. Of course, not all of these workers remained unemployed. Some found new work and others left the labour force altogether.

accommodation, cafes and restaurants and 58 per cent of employees in retail trade do not have any post-school qualifications, compared to 46 per cent of employees in all industries.[7] The prevalence of part-time and lower skilled workers in award reliant industries suggests that the ACTU's claim will particularly impact on those in less secure, low income employment.

Chart 5.4: Proportion of employees in award reliant industries without post-school qualifications, May 2000



Source: ABS Transition from Education to Work, Australia, May 2000 (Cat No.6227.0)

Labour productivity and profits

Labour productivity

5.19 In recent years, the Commission has made reference to Australia's high levels of productivity growth in assessing the economic impacts of

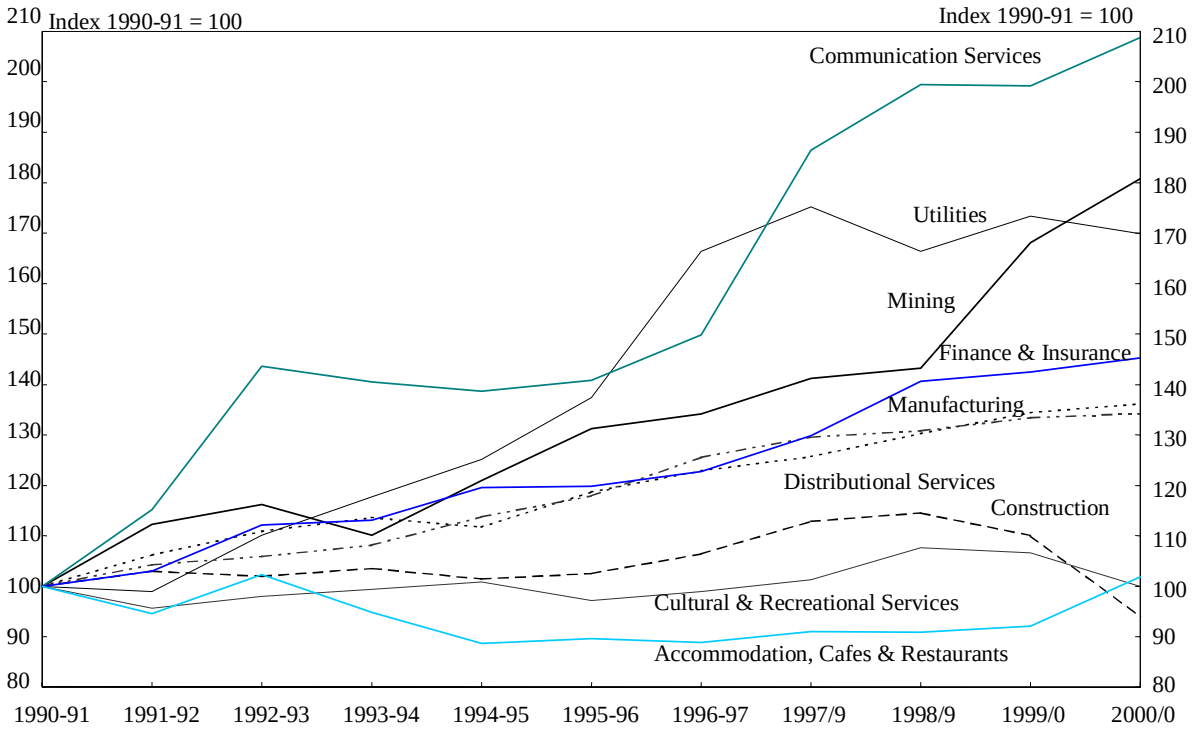
[7] A significant proportion of part-time employees in accommodation, cafes and restaurants and the retail trade industry may be students, whose long-term employment prospects may be better than many other part-time employees. DEWR does not have the data on educational attainment broken down by industry for both full-time and part-time employees required to fully examine this issue. Nevertheless, the high overall proportion of employees without post-school qualifications in these industries suggests its employees are more vulnerable than employees in other industries.

SNAs.[8] However, as noted in Chapter 2, measures of aggregate productivity provide little guidance in considering wage setting considerations.

5.20 In considering increases to award wages, it is important to consider the distribution of productivity growth by industry. Safety net increases have their main impact in low productivity growth service sector industries. Only 0.4 per cent of all award employees are employed in the three highest productivity growth industries (see Chart 5.5), namely communication services; mining; and electricity, gas and water. In comparison, 21.9 per cent are employed in the three lowest productivity growth industries, namely construction; cultural and recreational services; and accommodation, cafes and restaurants. Another 39.5 per cent are employed in sectors where productivity is not measured by the ABS. These sectors consist of personal and other services; property and business services; government administration and defence; education; and health and community services, in which the ABS makes the assumption that labour productivity growth is unchanged over time.

[8] Print S5000, pages 19 and 70; Print R1999, pages 25 and 32.

Chart 5.5: Gross product per hour worked by industry



Source: ABS Cat. No. 5204.0
Note: Distributional Services consists of wholesale trade, retail trade, and transport and storage.

5.21 If the high productivity growth in industries subject to micro-economic reform and enterprise bargaining is passed onto employees in low productivity growth industries in the form of higher wages, then real unit labour costs in the low productivity industries would increase as a consequence. In the present competitive environment, the rising real unit labour costs would manifest as diminishing profit margins. The decrease in the profit share in the award dominated service industries can be seen in Chart 5.6 below. The four industries with the largest increases in real unit labour costs in the 1990s account for 60 per cent of award employees.

5.22 It is important to consider the extent to which measured productivity growth is generated from changes in the occupational or industry composition over time. As noted in previous submissions, a

significant part of productivity growth over time is due to changing occupational structures and educational levels.[9,10]

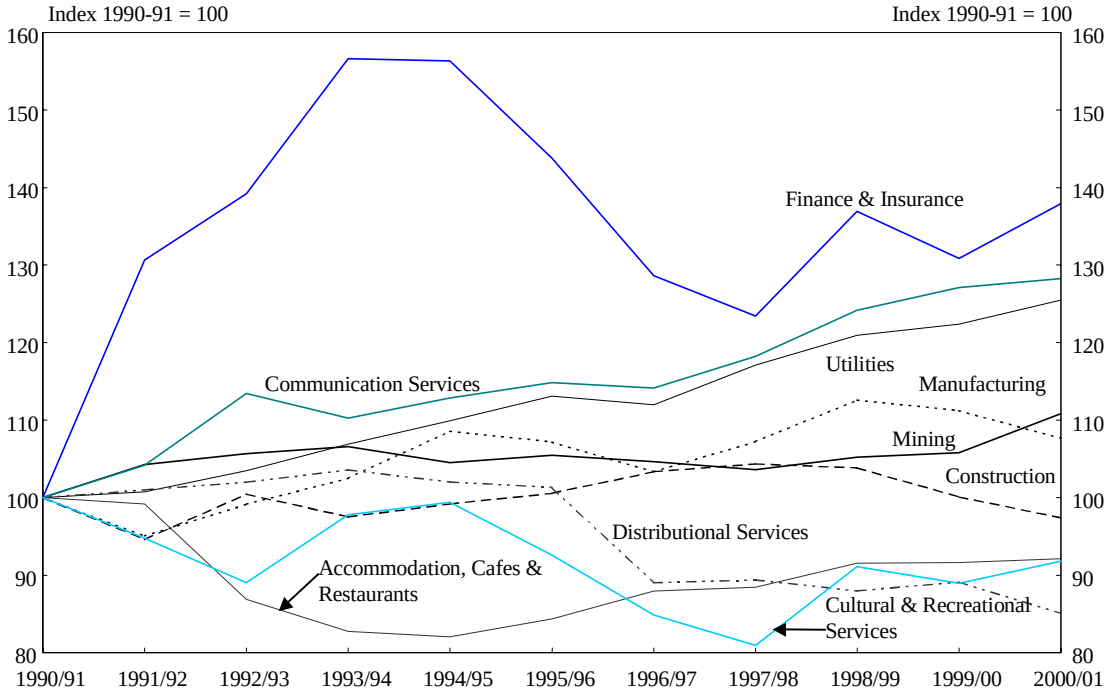
5.23 The industry composition of employment growth can have significant effects on measured productivity growth at particular points in time, thereby compounding the occupational composition problem. This implies that caution must be exercised when using productivity growth measures for appropriating award increments, unless the compositional effects from occupation and industry are factored in.

Profits

5.24 The greatest decrease in profit shares has been in the services sectors: distributional services; cultural and recreational services; and accommodation, cafes and restaurants. These industries have a relatively high proportion of award employees. Therefore, the safety net increases should be moderated given their higher proportional impact on these industries.

[9] Joint Governments' Submission to 1998-99 Safety Net Review – Wages, page 357.
[10] See Joint Governments' Submission to 2000-2001 Safety Net Review – Wages, page 33 for estimates of education compositional effect.

Chart 5.6: Movements in GOS share by industry indices



Source: ABS Cat. No. 5204.0
Note: Distributional Services consists of wholesale trade, retail trade, and transport and storage.

The tourism downturn

5.25 By the nature of its workforce, tourism is likely to be more affected than many industries by safety net increases. It is largely composed of industries which depend relatively heavily on awards to set pay rates.

> *About 26 per cent of those employed in tourism-related activities were in retail trade. The next most important tourism-related activities in terms of employment were the accommodation (18 per cent) and cafes and restaurants (9 per cent) industries.*[11]

5.26 As shown in Table A.1 in Appendix A, the abovementioned industries as well as the cultural and recreation services; and transport

[11] Econtech, 'Economic Effects of the Recent Tourism-Related Events on the Tourism Sector and the Economy', report prepared for the Department of Industry, Science and Resources, 10 October, 2001, page 4.

industries, have a relatively high proportion of workers dependent on award-based pay setting. Hence, a large award wage increase is likely to have a significant detrimental effect upon many tourism operators and their employees, with further flow on effects in particular regions.

5.27 Tourism is one of Australia's key industries in terms of export revenue, employment and economic growth. It generates six per cent of total employment directly,[12] and another four per cent of total employment through indirect channels.[13] Tourism's share of total export earnings has risen from 4.8 per cent in 1984-85 to 11.2 per cent in 1997-98.[14]

5.28 In the wake of the 11 September terrorist attacks, the Australian tourism industry has been hit particularly hard by the drop in international arrivals, especially of passengers from the US. Even before the attacks, visitor numbers from the key Japanese and New Zealand markets had fallen significantly. This negative shock has been exacerbated by the impact of Ansett's collapse on the domestic airline industry.

5.29 Modelling by two research organisations, Econtech[15] and the Centre of Policy Studies,[16] indicates that the long-term effects of the two events could hamper economic and labour market activity for another two

[12] Econtech, 'Economic Effects of the Recent Tourism-Related Events on the Tourism Sector and the Economy' report prepared for the Department of Industry, Science and Resources, 10 October, 2001, page i.
[13] Department of Industry, Tourism and Resources, 'Latest Inbound Visitor Movements', *Impact: A monthly fact sheet on the economic impact of tourism and the latest visitor arrival trends*, December 2001, page 2.
[14] ABS, Australian National Accounts: Tourism Satellite Account 1997-98, Cat No. 5249.
[15] Econtech, 'Economic Effects of the Recent Tourism-Related Events on the Tourism Sector and the Economy' report prepared for the Department of Industry, Science and Resources, 10 October, 2001.

to five years. Both reports state that though the impact of these events on aggregate activity is small, industry and region specific effects are, and will continue to be, much more significant.

The magnitude of the negative shock

5.30 The two studies have based their analysis on an expected 15 per cent reduction in tourism exports for the December 2001 quarter, worth around $500 million. Both studies also concluded that aggregate employment would decline about 0.3 per cent in the same quarter as a consequence, costing about 27 000 jobs.

5.31 Econtech estimated that overall GDP would fall by about 0.6 per cent or $1.0 billion in the December quarter 2001. Two surveys of 5 000 tourism operators conducted in late September 2001 in conjunction with the study, found that there had already been a loss in tourism jobs of about 4.5 per cent to date, with an expected decline in tourism revenue of 10 per cent for the December quarter 2001.

5.32 Econtech's conclusion that the effects of the two events will be felt over a period of two years, is based on the assumption that terrorism will be kept in check and the domestic aviation market will regain its competitiveness.

5.33 In the second study, the Centre of Policy Studies forecasts that the 11 September events will lead to an initial 16 per cent reduction in tourism demand. This will cause declines in real GDP, aggregate consumption, and aggregate imports. The Centre also argues that in the June quarter 2002, aggregate employment will be 0.4 per cent (or 37 000

[16] P D Adams, P B Dixon and M T Rimmer, 'The September 11 Shock to Tourism and the Australian Economy from 2001-02 to 2003-04', *Australian Bulletin of Labour*, Vol. 27, No. 4, December, 2001.

jobs) less than the level it would have reached had the 11 September events not occurred. One potential risk identified is that a drop in investor confidence would significantly magnify the effects of a decline in international tourism demand. Unlike the Econtech forecast, the Centre predicts that foreign demand will resume its pre-11 September level in five years time, rather than in two years.

Actual developments

5.34 The actual decline in international arrivals recorded for the December 2001 quarter is in line with estimates used by the studies to model the impacts. ABS data show that in the December 2001 quarter, the number of overseas visitors to Australia was 15.4 per cent lower than for the December 2000 quarter. In the month of December 2001, there were 10.7 per cent less visitors over the year than for the year to December 2000 (see Table 5.3).

5.35 The ABS data indicate that while the worst of the decline in international visitor arrivals may be over, arrivals are still very low compared to the previous year.

Table 5.3: Annual percentage change in short term overseas arrivals by month, August to December 2001

Short-term arrivals - Overseas visitors:	Annual change for month ending:				
	Aug-01 %	Sep-01 %	Oct-01 %	Nov-01 %	Dec-01 %
Original	3.1	-11.9	-16.2	-20.5	-10.7
Seasonally adjusted	4.1	-12.9	-16.3	-21.2	-12.3

Source: ABS, Overseas Arrivals and Departures (Cat No 3401.0)

5.36 Retail trade figures also point to a decline in tourism, as turnover in the hospitality and services sector fell by 4.4 per cent, in seasonally adjusted terms, in the four months after August last year.

5.37 The joint submission of the Labor Governments also points to the decline in overseas visitor arrivals, which fell by 1.6 per cent in the September quarter 2001 compared to the same quarter last year, and by 11.9 per cent over the year to the month of September 2001 (the latter figure corresponds to data provided in Table 5.3). Their analysis does not incorporate more recent information since the 11 September terrorist attacks, but it is pertinent that they acknowledge that the tourism sector was experiencing some difficulty even prior to the events of 11 September.[17]

5.38 In New South Wales, the Labor Governments' submission acknowledges that '[s]ince the Olympics… the State's tourism industry has struggled'.[18] New South Wales experienced large falls in hotel revenue and occupancy rates in annual terms to the September 2001 quarter. Moreover, '[t]he picture became gloomier', according to the Labor Governments during the recent bush fires in what is typically the peak tourism season.

Regional implications

5.39 Clearly, the geographical distribution of tourism activity means that some regions will be more severely affected than others. Econtech reports that the combined effect of the international and domestic problems varies widely.

[17] Joint Submission of the Labor Governments, ACTU Living Wage Claim 2001-2002, 8 February 2002, paragraph 130, page 30.
[18] Joint Submission of the Labor Governments, ACTU Living Wage Claim 2001-2002, 8 February 2002, paragraph 134, page 31.

> *At one extreme, around one-half of tourism operators report no impact from the two events in their answers to most questions. At the other extreme, some operators, covering a few percentage points of industry revenue, are severely impacted with revenue losses of over 50 per cent.*[19]

5.40 The Centre for Policy Studies also noted the regional consequences of the terrorist induced decline in international travel.

> *While in aggregate we expect the loss of jobs in Australia associated with the tourism downturn to peak at 0.4 per cent, the effects in some regions could be much more severe. Employment losses of up to 10 per cent could be experienced by heavily tourism-dependent regions.*[20]

5.41 At this early stage, a lack of detailed and comprehensive data on both domestic and international tourism makes it difficult to paint a full picture of the regional implications of the downturn. However, a range of partial information points to serious problems in some sectors and areas. It appears that more distant tourist destinations are suffering markedly while those within driving distance of major population centres have fared better.[21]

5.42 Surveys carried out by Econtech and anecdotal evidence available to the Department of Industry, Tourism and Resources at the time this submission was prepared suggest that the sectors most affected include:

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[19] Econtech, 'Economic Effects of the Recent Tourism-Related Events on the Tourism Sector and the Economy' report prepared for the Department of Industry, Science and Resources, 10 October, 2001, page ii.

[20] P D Adams, P B Dixon and M T Rimmer, 'The 11 September Shock to Tourism and the Australian Economy from 2001-02 to 2003-04', *Australian Bulletin of Labour*, Vol 27, No 4, December, 2001, page 241.

- businesses providing premium accommodation in metropolitan areas;
- travel agents (such as those in South East Queensland, and the north coast of New South Wales);
- North Queensland destinations (including the Townsville region);
- remote destinations in Western Australia (especially Broome); and
- central Australia.

5.43 The Centre of Policy Studies also found that one of the regions most likely to be affected is Far North Queensland. This is due to it having the highest dependence on international tourism of all the regions studied in terms of employment, with multiplier effects on total employment in the region. Other regions which the Centre argued would be affected are the Northern Territory, the Snowy River in NSW, Lord Howe and Kangaroo Islands in South Australia, the Tasman Peninsula, Port Douglas, and Cairns and Magnetic Island in Queensland.

5.44 A number of issues are compounding the impact of the downturn in tourism for small business operators in the industry:

- the outlook described in a small business survey[22] for the Northern Territory is especially depressed, with small businesses there exhibiting low confidence. This implies that the Northern Territory may find it particularly difficult to cope with the flow on effects of a decline in its international tourism sector;

[21] It remains to be seen whether the recent scarring by forest fire of bushland in areas adjacent to Sydney will complicate this pattern.
[22] Pacific Access, *Yellow Pages Business Index for Small and Medium Enterprises (SME)*, November 2001, page 7.

- the travel agency sector appears to be going through some restructuring since the Ansett collapse and Traveland's demise. Reports suggest that consumer sentiment has moved away from small independent travel agencies to nationally branded agencies. Regional travel agencies are likely to be caught in this adjustment in the wider market; and

- public liability insurance premium increases are becoming a pressing issue for the viability of many small adventure tourism operators involved in activities such as horse riding, canoeing and white water rafting.

5.45 The problem for a number of regions dependent on international tourism is further amplified by their weak labour markets.[23]

- The Northern Territory has had relatively low employment growth (1.6 per cent per annum) over the period 1998-2001, and an unemployment rate of 6.7 per cent over 2001. This unemployment rate may not be one of the highest in Australia, yet it increased by 1.9 percentage points from 2000 to 2001.[24]

- The region of Greater Hobart has also had poor labour market conditions, with a yearly decline in employment of 0.5 per cent from 1998-2001, and an unemployment rate of 9.1 per cent.[25]

[23] All data listed in paragraph 5.45 are sourced from the ABS Labour Force Survey (Cat. No. 6203.0).
[24] The Northern Territory has had an average employment growth of 1.6 per cent a year from 1998-2001, an unemployment rate of 6.7 per cent averaged over the year to November 2001. The unemployment rate for the year to November 2001 was 1.9 percentage points higher than for the year to November 2000.
[25] Greater Hobart has had an average annual decline in employment of 0.5 per cent from 1998-2001, and a 9.1 per cent unemployment rate averaged over the year to November 2001.

- Far North Queensland has had strong positive employment growth, but an unemployment rate of 7.3 per cent, that has worsened by 0.3 percentage points from 2000 to 2001.[26]

5.46 Some regions will be affected adversely by a large safety net increase that will flow to a relatively large proportion of the regional workforces because of industry composition and award dependence in key industries.

- For example, the Wide-Bay Burnett region in Queensland has a significant proportion of the workforce in accommodation, cafes and restaurants (6.2 per cent); transport and storage (5.1 per cent); and retail trade (16.5 per cent). It has declining employment growth (of 6.6 per cent over 2000-2001), and a high unemployment rate (12.5 per cent for the year to November 2001).

- The Richmond-Tweed and Mid-North Coast of New South Wales provides another case of a region with an above average proportion of the workforce employed in accommodation, cafes and restaurants (8.1 per cent); retail trade (17.8 per cent); and cultural and recreational services (3.0 per cent), with a high unemployment rate (10.4 per cent over the year to November 2001).[27]

5.47 Although necessarily based on somewhat incomplete data, the above analysis suggests that important sectors of the tourism industry are

[26] Far North Queensland has had an average employment growth rate each year from 1998-2001 of 7.2 per cent. It has had an average unemployment rate of 7.3 per cent over to November 2001, which was 0.3 percentage points higher than the average unemployment rate for the year to November 2000 (7.0 per cent).

[27] All data in this paragraph is from the ABS Labour Force Survey (Cat No 6203.0). Employment growth for the Wide Bay-Burnett region declined by 6.6 percentage points in annual terms from November 2000 to November 2001. Unemployment rates were averaged over the year to November 2001, and industry composition likewise is averaged over to November 2001.

in a fragile condition. While recovery and adjustment may occur over coming months, a safety net increase could hamper this, causing serious harm to tourism and hospitality operators and their employees.

Small business

5.48 Another sector of the economy that is likely to have trouble adjusting to a large SNA is small business.[28] There are two surveys which provide reason for concern.

5.49 The ACCI 'Survey of Small Business' for February 2002 summarises small business conditions as being 'stable during the last quarter, with neither strong growth nor the large declines from the first half of last year apparent.'[29]

5.50 The survey found that though there had been a modest improvement in overall small business conditions, they still remain well below the peak in conditions registered two years ago. Actual results for the November 2001 quarter show that there were improvements recorded in sales revenue, selling prices and investment in buildings for small business. Expectations for the key indicators in the coming quarter were reserved but optimistic on the whole.

5.51 However, continuing flat profitability, poor investment in plant and equipment, sluggish employment growth and declining overtime utilisation indicate that the small business sector is still experiencing economic weakness, despite showing some resilience. Economic difficulties appear to be greater for small business in comparison with medium and large businesses.

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[28] Small business is defined in this submission as an enterprise with up to nineteen employees.

[29] ACCI, *Survey of Small Business*, Issue 10, February 2002, page 1

5.52 The Yellow Pages *Business Index* for small and medium enterprises shows a substantial improvement in this sector's and perceptions of the Australia economy.[30] However, it is important to note that there are still significant differences between the performance of small and medium businesses. Over the February quarter 2002, small businesses were more likely than medium businesses to express markedly lower confidence levels in their own business prospects. The 'net balance'[31] of more confident over less confident small businesses is 49 per cent, much lower than the net balance of 67 per cent recorded for medium businesses.

5.53 Although the Yellow Pages survey shows significant improvement in many aspects of small and medium business activity, both expectations and actual experience relating to the workforce are less favourable. When compared to other key indicators, the net balance for the size of the workforce, at 20 per cent, is much lower than for value of sales (54 per cent), price charges (48 per cent), profitability (47 per cent) and wages bill (36 per cent). For the small business sector specifically, expectations concerning a rise in the workforce are still significantly lower (with a net balance of approximately 8 per cent) than they were during the course of 1999 (when the net balance often exceeded 10 per cent).

5.54 Another important fact to note is that actual employment performance has traditionally been weaker than expected by small businesses. This is reflected in the survey's results, which show that over

[30] Pacific Access, *Yellow Pages Business Index – Small and Medium Enterprises*, February 2002.
[31] Net balance refers to the balance between businesses which have experienced or expect an increase and those which have experienced or expect a decrease. Those who have expressed no change or a neutral stance do not affect the net balance.

the February quarter 2002 as many small businesses have increased their workforce as have decreased it, giving a net balance of 0 per cent. This net balance figure has been at or below zero for the last year.

5.55 Taken together, the surveys show that although conditions in general for small and medium businesses have improved over the last quarter and are projected to continue on this path, employment is responding more slowly. A moderate award wage increase would be less likely to jeopardise further improvement.

The Regional Dimensions of the Claim

5.56 As might be expected, the performance of labour markets across Australia varies over time because of factors such as international economic conditions, climatic conditions, technological change and changes in consumer preferences. Appendix F discusses these factors in more detail.

5.57 It is important to note here, however, the role which an excessive safety net increase could play in exacerbating regional problems. A large safety net increase would be likely to lead to reduced demand for labour and greater risk of business closure. If population and capital losses follow, this can intensify entrenched problems associated with structural change, which are occurring in some regions. According to some economists and geographers[32] it is possible for such losses to form part of a self reinforcing process of regional decline. Clearly, these are matters that are relevant to living standards, and so warrant the Commission's consideration under s. 88B(2) of the WR Act.

[32] These views are surveyed in OECD 'Disparities in Regional Labour Markets' OECD *Employment Outlook*, Paris, 2000.

5.58 There are several ways to gauge the performance of a particular regional labour market, including by employment growth, the unemployment rate, and the incidence of long-term unemployment (LTU). These measures are used in this submission to highlight the variation in the performance of the labour markets across Australia.

5.59 There are also various ways of classifying regions across the country. This chapter categorises labour markets by metropolitan and non-metropolitan regions, capital cities, other metropolitan (regional) and rural regions. For the purpose of this analysis, the Australian labour market has been divided into *capital cities* (ie the six State capitals plus the ACT), *other metropolitan* (which incorporates the Northern Territory and the major urban centres of Newcastle, Wollongong, Geelong, the Gold Coast and the Sunshine Coast), and *rural* areas.

The labour market performance of various regions

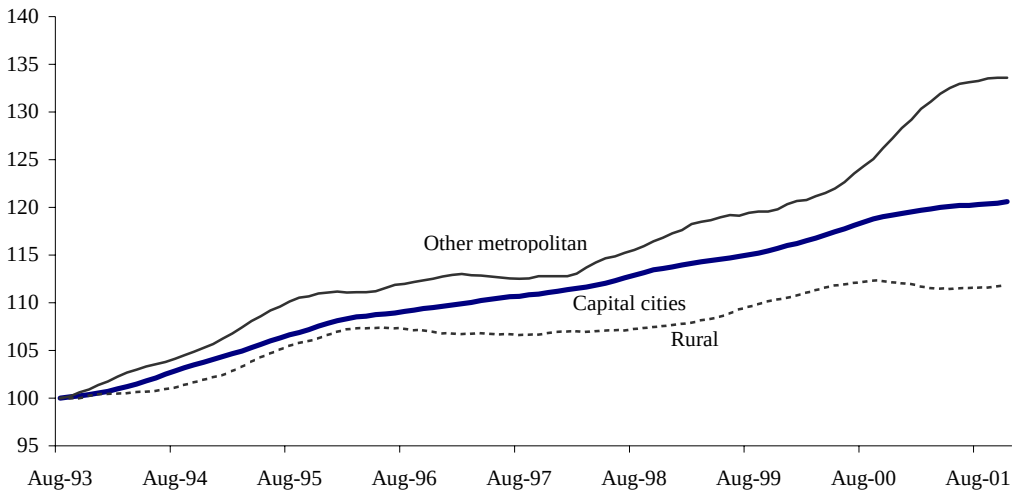
Employment

5.60 Regions with low rates of employment growth are less able to provide job opportunities for job seekers. Even regions with strong employment growth rates may have high rates of unemployment due to a large interstate or intrastate net inflow (especially in 'lifestyle' areas such as the Wide-Bay Burnett and Moreton regions).[33] Large SNAs, by increasing labour costs, will affect employment growth and migratory movements of an area. Areas already experiencing low employment growth or struggling to cope with changing demographics, may find that this creates significant additional pressure on their labour market.

[33] See for example McGuire's study of regional unemployment and regional decline in Queensland – P McGuire, 'Regional Unemployment in Queensland: Dimensions and Policy Issues' *Australian Bulletin of Labour*, Vol 27, No 4, December, 2001.

5.61 Chart 5.7 below presents an index of employment growth over time on a capital city, other metropolitan and rural area basis. The chart shows that in recent years the fastest rate of employment growth has occurred in other metropolitan areas, although growth has slowed considerably in all areas over the last 12 months, reflecting weaker economic conditions in 2000–01. Importantly, however, labour market conditions have been most subdued in rural areas, particularly over the last 12 months. The potential negative employment effects of a high SNA, therefore, could well be more marked in rural areas that can least afford it.

Chart 5.7: Employment Index for capital city, other metropolitan and rural labour markets, September 1992 to November 2001 (12 month averages)

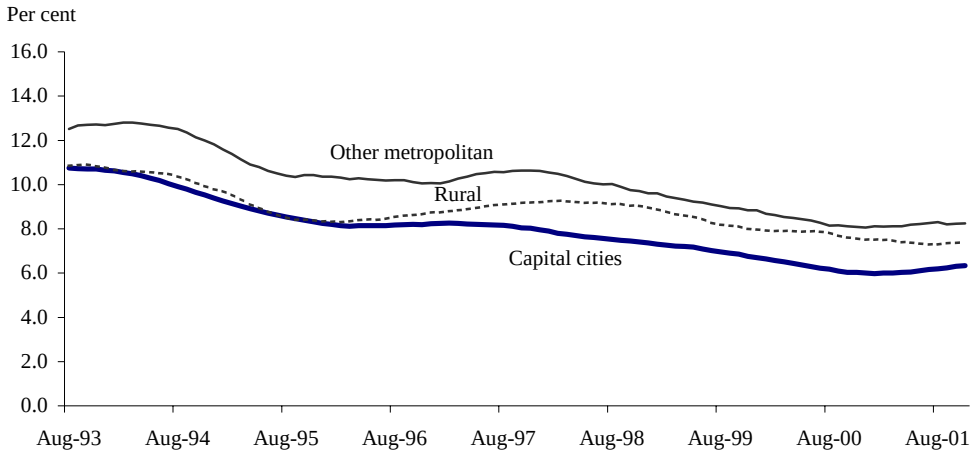


Source: ABS Labour Force (Cat No 6291.0)

Unemployment

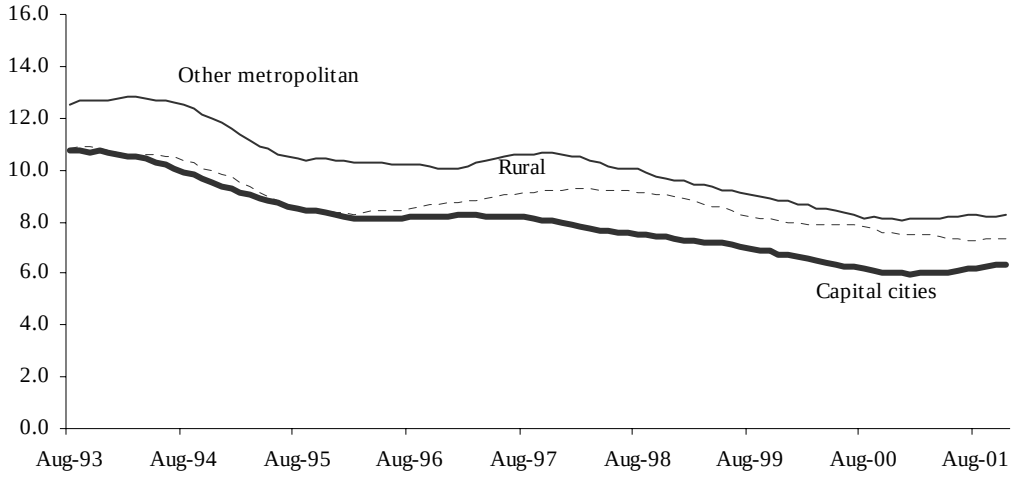
5.62 Capital cities usually have significantly lower unemployment rates than regional and rural areas (see Chart 5.8). This pattern is repeated to a similar extent in the incidence of LTU (those employed for 12 months or more as a proportion of the civilian population) (see Chart 5.9). Nevertheless, Charts 5.8 and 5.9 point to increasing unemployment and long-term unemployment in capital cities as well as other metropolitan areas.

Chart 5.8: Unemployment rates for capital city, other metropolitan and rural labour markets*



Source: ABS, Labour Force Survey (Cat No 6291.0)
* 12 month moving average

Chart 5.9: Long-term unemployment incidence (as a proportion of total unemployment) by region



Source: ABS Labour Force (Cat No. 6202.0)

5.63 Often employment opportunities for long-term unemployed persons are more likely to be entry level and low skilled in nature, offering relatively low rates of pay. Given that there is a proportionately greater reliance on SNAs among employees in lower skilled occupations,[34] a high SNA would reduce the level of demand for employees in these occupations. Such adjustments are therefore likely to have a more significant impact on the job prospects of this group than those who are not at risk of becoming long-term unemployed and have a larger impact on regions with relatively high incidences of long-term unemployment.

[34] Joint Governments' Submission, 1998-99 Safety Net Review – Wages (printed version), Table 8.5, page 131.

Specific Regions

5.64 A comparison of specific regions reveals even greater discrepancies between the performance of labour markets across Australia. As shown in Charts 5.10 and 5.11 below, some regions have an unemployment rate or an incidence of long-term unemployment which are significantly above or below the Australian average. This wide dispersion shows that employment conditions in some areas remain particularly difficult – helping to explain why the national unemployment rate has risen to over 7 per cent over the last 12 months.

5.65 There is also a significantly wider divergence in the incidence of long-term unemployment across regions than with unemployment rates. This is particularly relevant given that SNAs are likely to have a greater effect on those firms which are more likely to offer employment to the long-term unemployed. The effect of the SNAs on employment is therefore likely to also vary substantially across regions.

5.66 Large SNAs, by increasing labour costs, will affect employment growth and migratory movements of an area. For example, on the supply side, large SNAs will tend to depress employment growth but on the demand side, a large SNA will attract additional workers to an area. Collectively, this may have an intensely negative impact on a region. Areas already experiencing low employment growth or struggling to cope with changing demographics may find that this creates significant additional pressure on their labour market.

Chart 5.10: Regions with high unemployment rates, November 2001

Source: ABS, Labour Force (Cat No 6203.0)

Chart 5.11: Regions with a high incidence of long-term unemployment, November 2001[35]

Source: ABS, Labour Force (6203.0)

Conclusion

5.67 By identifying weak labour market conditions and a reliance on award-based pay setting, this chapter's survey of regional and sectoral developments highlights the danger that a large safety net increase could lead to weak employment growth, job losses and prolonged

[35] Chart 5.11 defines the incidence of long-term unemployment as those unemployed for 12 months or more as a proportion of total unemployment in each area

unemployment in certain sections of the economy. Employees most likely to be affected by a large SNA are in lower skilled occupations which have seen relatively slow employment growth over recent years.

5.68 Any safety net increase should be set at a level that does not compound existing problems in a significant number of both rural and metropolitan regions. Regions with low employment growth and/or high unemployment, or with a high reliance on tourism related activities could face depressed economic conditions and even job losses, with few compensating forces at least in the medium term. If unsustainable wage rises lead to, or accelerate, population loss or capital outflow from regions, the erosion of living standards could be very difficult to reverse.

CHAPTER 6: LIVING STANDARDS

Introduction

6.1 This chapter provides an overview of the living standards of Australian families. The chapter is intended to assist the Commission to give due consideration to the 'need to provide fair minimum standards for employees *in the context of living standards generally prevailing in the Australian community*'[1][emphasis added] in its assessment of the appropriate SNA in this case.

6.2 It is important that the Commission adopts a balanced approach in considering the need for a SNA. We note in this regard that the $13 per week increase provided last year to workers on award rates of less than $490 was closer to the joint Governments' position than the ACTU's larger claim. Indeed, it has been a combination of moderate pay increases and strong productivity growth in some sectors of the workforce that has enabled very strong economic growth together with low inflation and falling unemployment in Australia since the mid 1990s. This has led to higher living standards for the community including workers on low pay.

6.3 If ongoing improvements in living standards are not to be jeopardised, the Commission must exercise restraint in both the size and scope of any safety net increase that it awards.

6.4 The chapter starts by assessing the s. 88B(2) requirements – to the extent to which that requirement applies – under the WR Act. In the

[1] As prescribed in s. 88B(2) of the WR Act.

Commonwealth's view, the ACTU submission overlooks the requirement under the Act for the Commission to consider living standards 'generally prevailing in the Australian community'. The ACTU confines its analysis to those in paid employment. The ACTU's bias does not, however, release the Commission from its duty to consider general living standards in Australia. This chapter demonstrates that there is no evidence to support the claim that there has been a decline in living standards in recent times in Australia.

Social policy considerations for the case

6.5 Subsection 88B(2) of the WR Act states that, in performing its functions under Part VI of the Act, the Commission must ensure that a safety net of fair minimum wages and conditions of employment is established and maintained, having regard to:

> *(a) the need to provide fair minimum standards for employees in the context of living standards generally prevailing in the Australian community;*
>
> *(b) economic factors, including levels of productivity and inflation, and the desirability of attaining a high level of employment;*
>
> *(c) when adjusting the safety net, the needs of the low paid.*

6.6 The economic factors relevant to this case are discussed in Chapters 2 to 5. This chapter focuses on the social policy context for the case and its implications for the Commission's decision in this case. Consistent with its claims in previous years, the ACTU has placed heavy emphasis in its submission on the requirement for the Commission to have regard to the needs of the low paid. It largely ignores, however, the living standards of other members of the community including those

outside the workforce as well as those in paid employment. The previous three chapters have presented compelling evidence that a large safety net increase will restrain employment growth and increase the risk of unemployment, particularly for low paid workers who tend to have lower skill levels and work in less secure jobs. It will also weaken the job prospects of those who are already unemployed.

Evaluating the needs of the low paid using financial stress data

6.7 The ABS article 'Household Income, Living Standards and Financial Stress' provides a preliminary analysis of the extent of financial stress in Australian households.[2] The article is based on data from the ABS Household Expenditure Survey 1998-1999 (HES), which examines two levels of stress.[3]

6.8 The HES data reinforce the fact that unemployment (and limited access to paid employment) is the main cause of financial stress, not low pay. As the ABS article makes clear, the jobless are nearly six times as likely to be categorised as having a 'higher level of financial stress' than wage and salary earners. Some 72 per cent of wage and salary earners were reported as having 'no stress', compared to just 24 per cent of those whose principal source of income is an unemployment, education or sickness allowance. This finding is consistent with the NATSEM report

[2] The Commonwealth, the ACTU and most analysts of trends in earnings and income, focus on families because it is accepted that families share resources.

[3] The ABS uses 15 specific indicators of deprivation as the basis of their analysis. Indicators used range from 'basics of life' such as 'could not afford a night out once a fortnight' to more serious issues of deprivation, such as 'could not afford to heat home'. Households that report between two and four indicators are labelled as being under 'moderate financial stress', while households that report five or more indicators are deemed to be under 'higher financial stress'.

titled 'Financial Disadvantage in Australia',[4] which found that 19 per cent of Australians living in poverty were part of a family for which a wage or salary was their main source of income.

6.9 Nevertheless, the ACTU has commissioned the ABS to produce HES data that focus only on households whose principal source of income is employee income. It presents a series of tables in Tag 13 that show the lowest income quintile has a greater incidence of both higher and moderate financial stress levels than the second, third, fourth and highest quintiles. The ACTU argues that '[b]ecause award dependant workers predominate in the bottom of the earnings distribution, the benefit of the Commission's decision in this case is greater for those who need it most'.[5]

6.10 The Commonwealth acknowledges that the level of financial stress is likely to be higher among those with a lower level of income. It is for this reason that the Commonwealth supports a moderate safety net increase for low paid workers. However, the HES findings and the ABS article need to be kept in perspective. The ACTU has exaggerated the disadvantage of the lowest income quintile and understated the extent of financial stress among higher income quintiles in their interpretation of the HES data. For instance, the following revelations from the HES data were ignored by the ACTU:

- Comparing financial stress levels with income measured in disposable rather than gross terms reveals very little difference between the lowest and second quintiles. Some 42 per cent of households that earn

[4] A Harding and A Szukalska, 'Financial Disadvantage in Australia – 1999: The Unlucky Australians?' Report Commissioned by The Smith Family, 15 November 2000

up to $572.59 net per week (which constitute the lowest income quintile) were found to be under financial stress, compared to 41 per cent of households that earn up to $757.87 per week (the second income quintile).

- According to measures of both gross and disposable income, the majority of households in the lowest income quintile have experienced no financial stress.

- Only 29 per cent of those experiencing either moderate or higher levels of financial stress were in the lowest income quintile. By contrast, 42 per cent of those deemed to be under financial stress were in the three highest income quintiles.[6] In fact, over 20 per cent of the financially stressed category were reported to earn over $976.31 net per week. This raises the issue of whether some of the financial stress indicators used in the survey reflect issues of factors other than an absolute incapacity to pay, such as issues related to management of resources and consumption preferences of households.

Methodological limitations

6.11 This last point highlights the methodological limitations of the HES data. While the survey attempts to ascertain the extent of cash flow problems in Australian households, such problems are not necessarily evidence of genuine long-term financial hardship.

6.12 There are many other reasons why, at some point, a household may not be able to afford a basic good or service or need to seek financial assistance. Resources may be adequate but managed in such a way that

[5] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 6.109, page 147

[6] Income measured as disposable income.

cash flow problems arise. Alternatively, income may fluctuate over the course of the year, meaning that households experience financial difficulties for only a short period. Also, certain goods and activities (such as a special meal or a night out) may be voluntarily sacrificed in favour of other wants or priorities. It is for these reasons that a high proportion of households deemed to be under financial stress are among the upper bracket of income earners.

6.13 A related methodological problem with the ABS article is that each of the fifteen indicators are weighted equally in the assessment of the level of financial stress in Australian households. The ABS acknowledges, however, that some of the response items in the HES refer to more serious difficulties than others. For instance, the level of hardship associated with 'could not afford to heat home' and 'sought assistance from welfare/community organisations' seems much greater than that recorded by items like 'could not afford a night out once a fortnight' or 'could not afford leisure or hobby activities'. Admittedly, the criterion devised by the ABS to identify the higher level of stress among individual respondents (five or more of the indicators) does raise the chances of detecting more severe instances of hardship. It may be difficult to weight or rank the individual indicators, as the ABS paper does not describe the specific techniques which were employed to develop weights or ranks. If important but undetected similarities and/or differences between the indicators exist, however, the ABS analysis may not fully reflect the actual relationship between financial stress and income or other important factors.

Changes since the Household Expenditure Survey 1998-1999

6.14 The HES was undertaken over the twelve months between June 1998 and June 1999. The financial position of low income earners has changed since this time. For example, the real value of the Federal Minimum Wage increased by 2.6 per cent between June 1998 and June 2001. Real Average Weekly Ordinary Time Earnings (AWOTE) has also increased by 2.6 per cent over this time.

6.15 Furthermore, the implementation of the New Tax System has resulted in many substantial changes to taxation and income support, including increased assistance to families and lower income tax rates. This easing of the tax burden, along with increases in real wages, has enhanced the purchasing power of lower and middle income persons. It would therefore be reasonable to assume that such households are now less likely to experience cash flow difficulties.

6.16 In summary, the HES data confirm that unemployment and limited access to employment are the main causes of financial stress. This is ignored by the ACTU who examine stress amongst workers. In doing so, the ACTU is in fact asking the Commission to neglect its duty under s. 88 of the WR Act to take into account conditions generally prevailing in the community. Indeed, people outside the work force are part of the community and the Commission is required under the WR Act to take into account the impact of its decisions on those outside the workforce as well as those in paid employment.

6.17 The ACTU has also ignored the methodological limitations of the ABS article analysing HES. It has failed to properly acknowledge the role of choice, financial management and other factors, which may contribute

to the inability of families to meet their needs. As a result, the ACTU has overstated the extent of long-term deprivation amongst the low paid.

ACTU witness evidence

6.18 The ACTU has relied on evidence from low paid witnesses in the last four Safety Net Reviews, and continues to do so in its current submission. However, while this material is relevant, the ACTU's witnesses were not randomly selected, and the number of employees involved each year is very small (24 in 1997–98, 15 in 1998–99, 7 in 1999–2000, 10 in 2000–01, and 11 in 2001–02). It is important that the Commission is cognisant of the fact that the evidence is in no way representative of all low paid employees, but rather is a small subset chosen by the ACTU for their purposes.

6.19 To demonstrate this, we have compared the characteristics of the low paid witnesses chosen by the ACTU in previous Safety Net Reviews with the summary characteristics of low paid workers from a study by Harding and Richardson based on a statistically representative ABS survey.[7] For example, based on all witnesses provided in the last four ACTU submissions:

- Relatively few (four persons or 6 per cent) of the low paid witnesses were young (that is, aged 15–24).
  - Harding and Richardson find that around a third of all low paid employees are young.

[7] A Harding and S Richardson, 'The Lowly Paid, the Unemployed and Family Incomes', *Australian Journal of Labour Economics,* March 1999, Vol 3, No 1, pages 29-30. The study relied on the ABS Survey of Income and Housing Costs.

- The ACTU has selected very few part-time employees (only six of the 67 witnesses in the last five years were part-time).
  - Harding and Richardson found that 34 per cent of all low wage earners were part-time and 48 per cent of all female low wage earners were part-time. The Employee Earnings and Hours (EEH) survey indicates that of all employees paid at award rates, just over half were part-time workers in May 2000 and of all female employees paid at award rates, 65 per cent were employed on a part-time basis.
- A significant proportion of the ACTU witnesses (22 per cent) lived alone:
  - Harding and Richardson found that only 9 per cent of all low paid persons lived alone in 1994–96.
- A high proportion of the ACTU witnesses (64 per cent) were the sole source of income for the household;
  - We have shown in previous submissions that in the lowest decile of the wage distribution, the wage and salary income of low paid workers does not represent the main source of income.
- A significant proportion of the ACTU witnesses (54 per cent) were renting.
  - As was shown in the Joint Governments' Submission 1999–2000, only 36 per cent of low paid wage and salary earners are renters.

6.20 These are important biases; they could give the misleading impression that the low paid are overwhelmingly full-time; often single; renting; and are in income units where they are the main bread-winners.

In fact, many low wage earners are part-time and so do not benefit substantially from SNAs. Many low paid persons are also in families where there are multiple income earners or they own or are purchasing a home suggesting they are not financially disadvantaged.

6.21 Given the problems noted above with the ACTU's evidence, the Commonwealth believes that the ACTU has failed to establish the basis for granting large across-the-board award increases. However, the Commonwealth accepts that lower income earners face genuine financial stress and we do not object to a moderate SNA capped at C10 to assist them.

Household expenditure among the low paid

6.22 The joint Labor Governments have also attempted to analyse the needs of the low paid by comparing the amount households on the minimum wage earn with average weekly household expenditure. In particular, Table 5.1 of the Joint Submission of the Labor Governments[8] suggests shows that there is a shortfall between the disposable income of household earning the minimum wage and average weekly expenditure for lone household, and for couples with one child and couples with two children.

6.23 Such a comparison is inappropriate. Average weekly expenditure is inflated by a small group of big spending, high income earners. It therefore cannot be used a basis for determining 'fair minimum standards for employees in the context of living standards generally prevailing in the Australian community', as the joint Labor Governments claim in their submission.

[8] Joint Submission of the Labor Governments, ACTU Living Wage Claim 2001-2002 8 February 2002, page 54.

Living standards

The role of the tax-transfer system in reducing inequality

6.24 We have noted in previous submissions that the source of income is less important to a person's living standards than its overall level. The importance of the tax-transfer system in alleviating income inequality was clearly demonstrated in the ABS Survey of Income and Housing Costs (SIHC) for 1999-2000[9]. In this survey, the ABS compares trends in income over the period 1994-95 to 1999-2000. Using a broad definition of income encompassing both market (that is, wages) and non-market forms (that is, income support payments, investment income and rent), the ABS shows that there has in fact been no significant change in income inequality since 1994-95. In relation to data on gross income (total cash income before income tax) the ABS summarises its findings as:

> *The income shares in 1999–2000 were virtually unchanged from the shares in 1997–98, and there has not been any significant change in them in the period since 1994–95.*
>
> *The Gini-coefficient is a single statistic that summarises the degree of inequality and it also has not changed significantly since 1994–95 (page 4).*

6.25 These findings appear to be robust. For example, the ABS also shows that there has also been no significant change over the period in income measures that control for family size and that are net of tax – the so-called equivalised disposable income measures. The ABS notes, for example:

> *While the alternative [equivalised disposable] measures show a significant difference in the extent of inequality in the income distribution when compared to gross income, they give the same picture of no significant change in the level of inequality in the period since 1994–95 (page 6).*

6.26 Concerns are often expressed about whether income provides the best measure of the economic resources available to a household. NATSEM recently showed that if spending on goods and services was used as the measure of resources, then the degree of inequality had not changed during the 1990s.[10]

6.27 The ABS finding that there has been no change in income inequality since the mid-1990s has also been corroborated by Professor Peter Saunders of the Social Policy Research Centre[11]. Saunders reports that while there had been some increase in inequality between 1990 and 1999–2000 that there had been no statistically significant changes in the second half of the decade. The only statistically significant five yearly change identified by him was in wage and salary income for full-time employees between 1990 and 1994–95.

6.28 The Commonwealth notes that the ACTU has cited quite selectively from the Saunder's paper to provide evidence that 'in international terms in 1995 Australia was amongst the most unequal countries in the inequality ranking of countries participating in the

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[9] Other Australian research confirms that tax/transfers have offset the growth in earnings inequality and seem to be targeting those families most in need.

[10] A Harding and H Greenwell, 'Trends in Income and Expenditure Inequality in the 1980s and 1990s', NATSEM paper presented to the 30th Annual Conference of Economists, 24 December 2001.

[11] P Saunders, 'Household Income and its Distribution', *Australian Economic Indicators*, June 2001.

Luxembourg Income Studies (LIS) and was one of the seven countries where inequality increased by more than 5 per cent over the period'.

6.29 It is important for the Commission to recognise that the LIS study is dated and therefore should have no bearing on the outcome in this case. In addition, there is no evidence that the LIS finding stands today; and

6.30 Finally, the Commonwealth questions the ACTU's purported citing from the paper saying that 'increasing inequality is not inevitable, it is the result of clear policy choices'.[12] This appears to be a strange interpretation given that what the paper actually says is:

> …how much inequality a society is prepared to accept is something over which it has a choice. This does not mean that Australia should necessarily select a more equal distribution. The choices made on such matters reflect factors other than moral views about justice and inequality including incentive structures and how these affect entrepreneurship, competitiveness and productivity and ultimately, economic growth. (p54)

6.31 Indeed, the Commonwealth questions the basis for the ACTU's claim that there has been increasing inequality in Australia. In particular, evidence presented by the ACTU on trends in wealth[13] shows that overall family wealth increased at a rate of 8.6 per cent per annum over the period 1986 to 1998[14] but there has been no change in the distribution of wealth.

6.32 The following discussion considers how the tax transfer system reduces inequality among employees and their families – addressing the ACTU's concerns about low paid workers. The tables presented below are the most recent estimates of the way these cash and non-cash incomes

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[12] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 7.5, page 152.
[13] S Kelly, 'Trends in Australian Wealth – New Estimates for the 1990s', NATSEM, September 2001 (Tag 15).
[14] [14] S Kelly, 'Trends in Australian Wealth – New Estimates for the 1990s', NATSEM, September 2001 (Tag 15), page 11.

are distributed amongst wage and salary earners for December 2001, based on the STINMOD microsimulation model from NATSEM.[15] These are updated versions of tables presented in previous joint Government submissions and incorporate the impact of *The New Tax System* (TNTS) on marginal tax rates.

6.33 Table 6.1 shows that wage and salary earning families in the bottom quintile of wage and salary earner families received on average $178.24 (or 26.9 per cent of their total cash income) per week in cash transfer income in December 2001. In contrast those in the top quintile of the distribution receive only $2.88 per week (or 0.1 per cent of their total cash income) in cash benefits. The income tax system is also progressive. Tax represents an average of only 12 per cent of total cash income for those in the lowest quintile, compared to an average of 29.7 per cent for those in the top quintile.

Table 6.1: The estimated composition of weekly cash incomes of persons in income units with at least one adult employed full or part-time as a wage and salary earner - average income components, by quintile, December 2001

Dollars ($)	Private Income	Cash transfer income	Total Cash Income	Income Tax	Disposable Income	Equivalent Disposable Income
First (Bottom)	485.09	178.24	663.34	81.81	581.53	482.50
Second	847.50	79.55	927.05	175.76	751.29	661.97
Third	1114.19	36.25	1150.44	256.53	893.91	845.56
Fourth	1353.58	10.12	1363.70	332.49	1031.21	1082.78
Fifth (Top)	2117.90	2.88	2120.77	630.40	1490.38	1675.39
All	**1183.75**	**61.39**	**1245.15**	**295.43**	**949.72**	**949.72**

Source: Commissioned STINMOD microsimulation, as at December 2001, based on the ABS, 1996–97 and 1997–98 Continuous Income and Housing Survey, NATSEM.

[15] See, for example, Tables 4.1 and 4.2, Joint Governments' Submission, 2000-2001 Safety Net Review- Wages (printed version), pages 191-192. The version of STINMOD utilised for the generation of the tables in the current submission incorporates the changes made to government programs and the marginal tax rates as a result of the new tax system (ANTS package) that came into effect in July 2000.

6.34 Table 6.2 shows the impact of specific non-cash benefits as health, housing and education on the incomes of wage and salary earners. These non-cash benefits provide assistance to families by increasing the proportion of income available for other consumption and thereby increase their effective command over resources. For example, non-cash benefits provide value of around $248.16 per week for the lowest quintile of all wage and salary earners. This is almost double the amount available for those at the top quintile. In other words, all income groups have shared in improvements in the economy during the 1990s – but through different means. Some have benefited through increased real wages while others have benefited through increased government assistance, and some have benefited through a combination of these income sources[16].

Table 6.2: The estimated composition of weekly non-cash incomes of persons in income units with at least one adult employed full or part-time as a wage and salary earner - average income components, by quintile, December 2001

	Disposable Income ($)	Non-cash Benefits ($)	Final Income ($)	Equivalent final Income ($)
First (Bottom)	581.53	248.16	829.69	619.28
Second	751.29	228.44	979.73	822.97
Third	893.91	197.78	1091.69	1025.74
Fourth	1031.21	162.35	1193.56	1290.28
Fifth (Top)	1490.38	129.64	1620.02	1956.22
All	**949.72**	**193.26**	**1142.98**	**1142.98**

Source: Commissioned STINMOD Microsimulation for Dec 2000 based on the ABS, 1996-97 and 1996-97 Continuous Income and Housing Survey, NATSEM.

6.35 The results presented here highlight, in a simple way, the impact the taxation system and cash transfer system have on wage and salary earner households. The multiple and detailed means by which the various levels of government in Australia direct policies to assist the low paid

[16] The point is that higher income, however it is financed, means increased consumption choices and so higher living standards for everyone in the community. Importantly, low paid workers have experienced significant real increases in their

have a large impact on people's living standards. Focussing only on wage earnings – as the ACTU does – as the main determinant of a person's living standards will therefore tend to overstate the incidence of poverty or financial distress in the community.

6.36 In summary, the ACTU has not substantiated its claim that income inequality has increased in recent years. On the contrary, the Commonwealth has demonstrated that there is no evidence that income inequality has increased over the last five years. Importantly, we show – using a study cited by the ACTU itself – that wealth in Australia has increased and that growing wealth has not led to increasingly inequality. Importantly, government transfers and cash payments have made a major contribution to the living standards of wage and salary earners – particularly those on low incomes.

Growth in Real Wages

6.37 The Commonwealth does not dispute ACTU claims that earnings inequality has increased[17]. This has been a phenomenon for the past 30 years and reflects, inter alia, market forces at work[18]. The important point

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living standards in the 1990s both through rises in real wages (real wages have grown across the distribution in the 1990s) and increases in the real value of cash transfers.

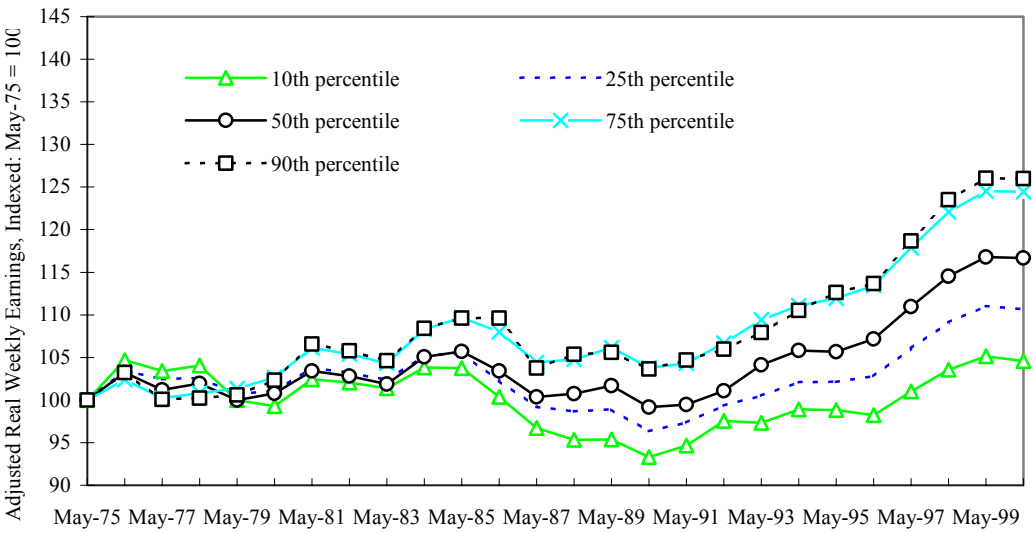
[17] The factors behind the trend of increasing earnings inequality are complex, however, they appear to associated with changes in the labour market since the early 1970's, including growth in unemployment, an increase in female employment and in the prevalence of part-time and casual jobs, and changes in the occupation and industry structure of employment and in the skill profile of work.

[18] The experience of industrialized countries, including Australia, with growing earnings inequality has spawned a great deal of research on the functioning of labour markets, on the sources of shifts in the demand for various types of skills, on the supply responses of workers, and on the efficacy of government efforts to intervene in the operation of labour markets. One story that has emerged from that body of research is now familiar: Rising demand for those workers who have the skills to effectively harness new technologies has been outpacing supply, and, thus, the compensation of those workers has been increasing more rapidly than for the lesser skilled segment of the workforce.

here is tax/transfers have offset the growth in earnings inequality and seem to be targeting those families most in need.[19, 20]

6.38 Additionally real wages have risen for all parts of the earnings distribution, including the low paid, as Chart 6.1 shows. This real growth in wages (plus the effect of the tax transfer system) has helped to lift the overall income of low paid people.[21]

Chart 6.1: Australian real weekly earnings, by percentile from 1975 to 2000 for full-time adult non-managerial employees



Source: Published and unpublished data from the ABS Survey of Employee Earnings and Hours (EEH Survey), ABS Cat no 6306.0. The EEH Survey was not conducted in 1982, 1984, 1997 and 1999. Results for these years have been obtained through linear interpolation. All series deflated by the all groups CPI.

[19] N Pappas, 'Earnings Inequality and Skill', *Work Rich, work poor: Inequality and economic change in Australia*, eds J. Borland, B. Gregory and P. Sheehan, Centre for Strategic Economic Studies, Victoria University, 2001, pp 196-218.

[20] As a result, growing earnings inequality at the bottom of the labour market has been accompanied by a lessening of household income inequality.

[21] It is important to note too that low hourly wages may not necessarily cause working poverty. As Richardson argues in *Inequality: Challenges for the Social Sciences and Australia*, many people live in multiple earner households: the household does not rely on the earnings of the low wage worker for its income. A second reason is that even a low wage may leave single people relatively well off, since they have to support only themselves on this income.

The limited role of the wages safety net

6.39 Even though the statistical evidence indicates that households have had marked increases in the resources available to them in recent times, the Government remains committed to ongoing improvements in living standards. However, it is by no means clear that the large safety net increases proposed by the ACTU will have their desired effect of improving social equity – particularly for the lower paid. Attempts to achieve large increases in minimum wages will be largely self-defeating for many low skilled employees and for new workforce entrants. Higher minimum wages will reduce the number of jobs offered. And, for many new entrants to the workforce and unemployed persons, low initial wages permit entry into employment where job skills are acquired so that higher wages are earned in future years.

6.40 Secondly, it is important to recognise that the wage system does not operate in isolation. It interacts with both the social security and taxation system. This means that large increases in wages – as proposed by the ACTU – will be to a certain extent offset by higher taxes and/or lower social security payments.

6.41 Indeed, safety net adjustments are a blunt instrument for improving the position of low-income families and, with increasing polarisation of households into multi-wage and no-wage households, may become blunter still. For example, research by Richardson and Harding (1998)[22] demonstrates that many low-income families receive little or no wages at all and many families with minimum wage workers lie in the

[22] S Richardson and A Harding, 'Low wages and the Distribution of Family Income in Australia', Paper for Conference of the International Association for Research on Income and Wealth, Cambridge, 1998.

middle or high-income bands.[23] By definition a wage increase will not benefit households where no one works. An unnecessarily large wage increase could, however, act to reduce the job prospects of no-work households even more by reducing the demand for low skilled employment. No pay is a far greater contributor to Australian poverty than low pay.[24]

6.42 In fact, the combination of the inefficiency of wages policy as an anti-poverty device and the efficiency of unemployment in increasing poverty means that an increase in wages need cause only a modest reduction in labour demand in order to worsen poverty.

Conclusion

6.43 This chapter has demonstrated that, despite a widening dispersion of earnings, real household incomes and hence living standards have improved. The Commonwealth remains committed to ongoing improvements in living standards in the community but has demonstrated the limited capacity of the wages system to meet social equity goals. In this regard, it is the overall level of income rather than its source that is most important in determining a person's living standards in the community i.e. the tax-transfer system is a more effective tool for containing inequality and eliminating poverty.

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[23] As Ann Harding noted on the 7.30 report on 16/01/02, 'one of the most startling findings of the (NATSEM report prepared for the Smith Family) for me was that six in every 10 unemployed people were in poverty'.

[24] R Lloyd, A Harding and H Greenwell, 'Worlds Apart: Postcodes with the Highest and Lowest Poverty Rates in Today's Australia', NATSEM report presented to the National Social Policy Conference, July 2001, page 26. The study confirms previous findings that the main cause of income poverty is non-employment rather than low paid work. The study found that regions with the highest rates of poverty had an above average proportion of household heads who were unemployed, not in the labour force, young people, renters (especially public housing tenants), or people whose major source of income is government cash benefits.

6.44 The Commonwealth notes the ACTU's heavy emphasis on the requirement for the Commission to have regard to the needs of the low paid. However, the Commonwealth has argued under s. 88B(2) of the WR Act, that the Commission is also required to consider the impact of its decision on conditions faced by the general community – including those outside the workforce. In particular, the Commonwealth has argued that, in terms of the context of 'living standards generally prevailing' referred to in s. 88B(2) of the WR Act, the Commission is required to consider the impact of its decisions under Part VI, including in safety net review cases, on those in employment and those presently, or at any time, without work and hence outside the workplace relations system.

CHAPTER 7: CAPPING SAFETY NET ADJUSTMENTS: IMPACT ON FAMILY INCOME

Introduction

7.1 The Commonwealth's main objective in advancing its 1996 legislative proposals in relation to the award safety net was to help to protect employees who are less skilled and therefore less mobile in the workforce. A cap at the C10 level would allow safety net increases to help ease financial pressure on low paid workers while minimising the negative impact of increases on the overall labour market and the economy.

7.2 Furthermore, a capped increase would address an essential requirement under s. 3 of the WR Act, by encouraging the continued spread of agreement making at the workplace or enterprise level. The Commonwealth believes that the application of a cap for employees above C10, who are a more skilled and mobile component of the labour market, is appropriate in order to maintain the incentive to bargain for these employees. Chapter 8 discusses issues relating to the incentive to bargain.

7.3 This Chapter focuses heavily on the Commission's concerns about controlling the extent of 'spillage' which occurs when awarding SNAs. The wage system cannot be as precise as the tax and transfer system in redistributing income across families. The Commonwealth demonstrates, nevertheless, that the application of a cap at lower classification rates more efficiently targets the low paid and minimises the 'spillage' problem.

Minimum wages

7.4 There is a general acceptance amongst economists that, in the absence of minimum wages, some low paid employees may receive less in wages than is warranted by the value of their marginal product. The Commonwealth agrees that there is a danger that those workers below the C10 rate may have a limited ability to bargain. This is unlikely to be generally true, however, for those earning above C10, who are more likely to be better skilled and have greater mobility.

7.5 In the United Kingdom, the National Minimum Wage was introduced to protect workers on the lowest rung of the labour market. The latest report from the United Kingdom's Low Pay Commission[1] states that the introduction of the minimum wage was followed by increases in both earnings and income of low paid persons while having only small impacts on employment (positive or negative, according to the demographic groups and industry sectors examined).

7.6 The UK Low Pay Commission considers that an important reason for these benign results is the modest level of the minimum wage. It is important to note, however, that the Low Pay Commission did find evidence of employment losses in sectors where firms were not able to raise prices to compensate for the wage increase, a conclusion which is consistent with concerns about particular sectors raised in Chapter 5 of this submission. In Chapter 9, the Commonwealth argues that some employers need more ready access to the economic incapacity principle if employment losses and additional unemployment arising from a safety net increase are to be avoided as much as possible.

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[1] The Low Pay Commission *The National Minimum Wage Making a Difference*, Third Report, March 2001.

7.7 However, as Table 3.1 of this submission makes clear, the 'bite' of the minimum wage in the UK and the USA is very much smaller than the bite in Australia. This means that the potential impact of a safety net increase in Australia is much larger and the potential for adverse effects on employment is much greater. This reinforces the importance of restraining the size of any such increase, even if it is capped.

7.8 There is considerable debate about whether minimum wages can play a role in reducing financial hardship by raising the incomes of low paid workers without nullifying these income gains through higher unemployment. The joint Governments provided substantial evidence in past Submissions relating to this issue. The literature presents mixed results about the extent to which poverty is ameliorated by minimum wages.

7.9 Despite extensive literature searches, the Commonwealth continues to believe that there is no compelling evidence demonstrating that minimum wages are as efficient as the tax-transfer system in reducing poverty or assisting low income working families.

- Stevans & Sessions (2001) find that 'while raising the minimum wage does reduce poverty, it is not as effective as other policies.'[2] Addressing the problem of poverty in the US, they suggest a diverse policy response, including expanding minimum wage coverage and increasing labour force participation (through a variety of tax-transfer mechanisms).
  - Their emphasis on increased participation is compatible with the Commonwealth Government's program of welfare reform which is

[2] L Stevans and D Sessions, 'Minimum Wage Policy and Poverty in the United States', *International Review of Applied Economics*, Vol 15, No 1, 2001, page 74.

designed to encourage more active and effective participation in the labour market.

- Even strong advocates of minimum wage increases acknowledge the value of other policies which target assistance more precisely. For instance, Bernstein argues that 'the minimum wage is a useful, though limited, anti-poverty tool … It cannot and should not, however, be viewed as a sole solution against poverty.'[3]

The requirements of the Workplace Relations Act

7.10 A cap is relevant to two aspects of the WR Act.

7.11 A moderate increase with a tightly targeted cap is the best way to address the needs of the low paid in a way that is consistent with other key requirements of the WR Act.

- Section 3, in setting out the principal object of the Act, refers to high employment, low inflation and higher productivity.
- Subsection 88B(2) draws attention to the relevance of economic factors including levels of productivity, inflation and employment.
- Paragraph 90(b) refers to the 'likely effects on the state of the national economy of any award or order that the Commission is considering'.

7.12 Chapter 2 of this Submission shows that although Australia is now experiencing moderate economic growth and most indicators, including inflation, remain favourable, the labour market has yet to respond to the pick up in the economy. In addition, there are considerable downside risks, posed primarily by the world economic situation.

[3] J Bernstein, 'Minimum Wages and Poverty', Testimony before the House Education and the Workforce Committee, 27 April 1999,

Chapters 3 and 4 present a wide range of strong evidence showing that if the ACTU's claim were granted, it would exert cost pressure on employers, thereby weakening employment growth and raising both unemployment and inflationary pressures.

7.13 In contrast, a tightly capped adjustment would lift the income of low paid workers while minimising the adverse consequences for the economy and labour market, provided of course that the quantum itself is modest.

7.14 In addition, the C10 cap is essential in order to further encourage the spread of agreement making, a major factor underpinning the strong productivity improvements which have contributed to the resilience of the Australian economy in a difficult international economic environment. Section 3 of the WR expresses that the principal object of the Act is to provide a framework for cooperative workplace relations which achieves its benefits by:

> *(c) ensuring that the primary responsibility for determining matters … rests with the employer and employees at the workplace or enterprise level; and*
>
> *(d) providing the means:*
>
> > *(i) for wages and conditions of employment to be determined as far as possible by the agreement of employers and employees at the workplace or enterprise level, upon a foundation of minimum standards…*

7.15 By adjusting all award rates of pay or adopting a high cap, the Commission would be failing to give due weight to the legislative

requirement to encourage agreement making and promote enterprise level workplace relations. As Chapter 8 stresses, agreement making is the appropriate mechanism for determining the wages and conditions of higher paid employees.

Safety Net Increases and the Distribution of Earnings and Income

The Distribution of Award Rates of Pay

7.16 The Commission, in its May 2001 decision[4], referred to the joint Governments' position as being that 'any increase to award wages would benefit mainly middle to high income families, not families in poverty'. These comments referred to SNAs 'as they currently operate'.[5] The Commonwealth emphasises that it does not oppose moderate increases that are limited to genuinely low paid workers. It is strongly concerned however, that too much of the benefit of uncapped adjustments flows unnecessarily to middle and high income families.

7.17 An uncapped increase in award rates will go directly to workers with relatively large earned incomes. This was demonstrated in last year's joint Governments' Submission[6] by referring to the distribution of AWOTE for employees paid at award rates. These tables were based on preliminary EEH data for 2000, but are re-presented below with final data as Tables 7.1 and 7.2. Table 7.1 shows the AWOTE distribution for various categories of full time employees. Table 7.2 covers part time workers who constitute over half (56.5 per cent) of the group of

[4] PR002001, paragraph 113.
[5] Joint Governments' Submission 2000-2001 Safety Net Review - Wages (printed version) page 71
[6] Joint Governments' Submission 2000-2001 Safety Net Review - Wages (printed version) page 77, Tables 5.1 and 5.2.

employees who are paid at award wage rates. The final EEH data have not led to marked changes in the tables.

Table 7.1: AWOTE for full-time adult employees paid at award wage rates, May 2000

	Permanent	Temporary	Casual	Casual Adjusted [(a)]	Total
10th percentile	$416.00	$460.00	$459.00	$382.50	$421.00
20th percentile	$447.00	$514.00	$484.00	$403.33	$454.00
25th percentile	$464.00	$582.00	$500.00	$416.67	$470.00
30th percentile	$477.00	$582.00	$515.00	$429.17	$480.00
40th percentile	$500.00	$600.00	$546.00	$455.00	$509.00
50th percentile	$532.00	$685.00	$565.00	$470.83	$543.00
60th percentile	$576.00	$739.00	$600.00	$500.00	$582.00
70th percentile	$630.00	$769.00	$626.00	$521.67	$638.00
75th percentile	$677.00	$854.00	$648.00	$540.00	$678.00
80th percentile	$725.00	$873.00	$675.00	$562.50	$726.00
90th percentile	$915.00	$903.00	$782.00	$651.67	$899.00

Source: ABS Survey of Employee Earnings and Hours (Final), 2000 (Cat No 6305.0)
(a) The casual loading has been removed by dividing the earnings of casual employees by 1.2.

7.18 As Table A.2 in Appendix A indicates, the average earnings of award paid employees (at least full time non-managerial employees) are lower than those of all employees. It is clear from Tables 7.1 and 7.2, however, that award based earnings extend well above the C10 level which was $477.20 per week for full time employees and approximately $12.56 per hour for part time employees[7]. As the ACTU submission notes, less than half (40 per cent) of award-paid employees receive less than the C10 rate[8].

[7] These amounts do not include the $15 per week Safety Net increase awarded by the Commission in May 2000.
[8] ACTU Written Submission, Living Wage Case, 8 February 2002, paragraph 7.29.

Table 7.2: Average hourly ordinary time earnings (in dollars) for adult part-time non-managerial employees paid at award rates, May 2000

	Permanent	Temporary	Casual	Casual Adjusted [(a)]	Total
10th percentile	$11.20	$11.40	$8.60	$7.17	$9.10
20th percentile	$12.00	$12.80	$11.00	$9.17	$11.70
25th percentile	$12.40	$13.10	$12.20	$10.17	$12.30
30th percentile	$12.50	$13.40	$12.80	$10.67	$12.70
40th percentile	$13.60	$14.60	$13.50	$11.25	$13.50
50th percentile	$14.40	$15.00	$14.30	$11.92	$14.30
60th percentile	$15.20	$15.90	$14.80	$12.33	$15.00
70th percentile	$16.70	$18.30	$15.60	$13.00	$15.80
75th percentile	$17.60	$21.00	$16.10	$13.42	$16.40
80th percentile	$18.80	$21.40	$16.60	$13.83	$17.20
90th percentile	$23.50	$28.30	$19.40	$16.17	$20.40

Source: ABS Survey of Employee Earnings and Hours (Final), 2000 (Cat No 6305.0)
(a) The casual loading has been removed by dividing the earnings of casual employees by 1.2.

The Distribution of Safety Net Increases According to Family Income

7.19 Past Safety Net Reviews have examined closely the effect of safety net increases on the distribution of family income.[9] This has demonstrated that a capped increase will benefit families at all income levels, to varying degrees. A major reason for this is that some workers on low award rates are members of families with higher incomes. In its 1999-2000 and 2000-2001 decisions, the Commission pointed to the problem of 'spillage' and stated that:

> The joint Governments submitted that limiting safety net increases to at or below the C10 classification rate would better target those in need. We are not convinced on the material before us that providing a cut-off at C10 would prevent spillage of some benefit of safety net

[9] As in all joint Governments' Submissions to Safety Net Reviews in previous years, the term 'family' encompasses single individuals in this Submission.

adjustments to those not in need. Indeed we are not sure where any such cut-off could be set in order to better target the benefit of safety net adjustments.[10]

7.20 The Commonwealth acknowledges the difficulty of determining the cap level that would strike the right balance between addressing the needs of low paid workers on one hand and limiting spillage to higher income sector on the other. Indeed, striking the best balance would require wide-ranging consideration of all the benefits and costs resulting from caps of different levels, including secondary changes in the broader economy.

7.21 The Commonwealth believes that while the targeting of low income families through capped increases will never be perfect, the application of a cap can strongly influence the distribution of the benefits of a safety net increase.

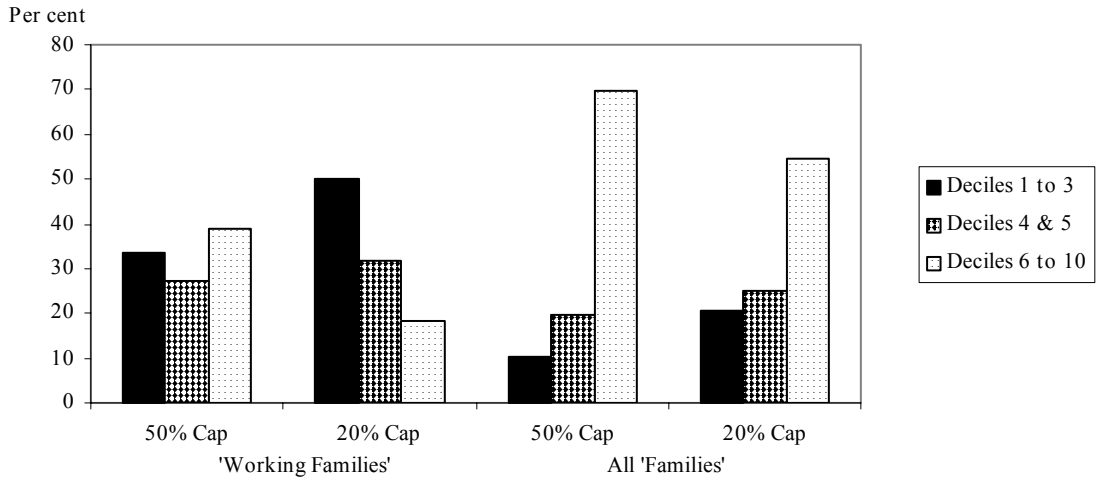
7.22 Chart 7.1 illustrates the positive effect of a cap. It shows how much of the total dollar benefit of a $10 wage increase would be distributed across families according to their varying position in the income distribution, after making allowance for the tax and transfer systems and family size. The different caps are based on the earnings distribution derived from the 2000 EEH survey, not the distribution of family income shown in the tables[11]. In the wage distribution used for this analysis, the C10 level sits at the 23rd percentile. However, this

[10] PR002001, paragraph 127.
[11] As noted in Joint Governments' Submission, 2000 –2001 Safety Net Review – Wages, page 76, there is a matched data set that allows the distribution of award-based wages to be estimated. As in last year's joint Governments' Submission, however, the data set has not been used, in order to avoid unnecessary debate. Consequently, the level of the cap is varied within the wage distribution of all employees.

illustration focuses on the 20th and 50th percentiles for ease of exposition[12].

7.23 The chart demonstrates that caps can limit the degree of spillage and direct more of the benefit of an increase to low paid families. More detailed data on which Figure 7.1 is based are presented in Appendix G.

Chart 7.1: The effect of different caps on the distribution of a $10 award increase across families with differing disposable income



Source: STINMOD (STIN01b) See Appendix G

7.24 In the case of working families (that is, wage and salary income units), if a $10 per week increase were to be limited to workers in the bottom 50 per cent of the wage distribution, then the top half of the families' income distribution would receive 39.0 per cent of the total dollar benefit and those in the bottom three deciles would receive 33.6 per cent. If the increase were to be restricted to the bottom 20 per cent of the wage distribution, then the top half of families would gain a much smaller proportion (18.5 per cent) while the share for families in the bottom three deciles would increase to 49.9 per cent. A tighter cap would restrict the distribution of the benefit even more strictly.

[12] Appendix G also presents data to illustrate the impact of a cap at the 30th percentile.

7.25 By focussing on all income units, Chart 7.1 also illustrates how a wage increase would be distributed across the wider community, not just working families. This issue is relevant to the Commission's responsibility under s. 88B(2)(a) of the Act, when having regard to fair minimum standards for employees, to consider those standards 'in the context of living standards generally prevailing in the Australian community'. When the focus is broadened in this way, the caps are not as effective in preventing spillage. A 50 per cent cap would allow almost 70 per cent of the benefit of a $10 per week increase to reach families in the top half of the income distribution. Families in the bottom three deciles would receive 10.4 per cent.

7.26 The greater degree of spillage is due, to a large extent, to the presence in the bottom decile of families who are outside the workforce or employed only for relatively few hours and so gain little or no benefit from the safety net increase.

7.27 Nevertheless, the level at which the cap is set clearly affects the share of the benefit from a safety net increase which is received by the low paid. When the cap is lowered from the middle point to the bottom 20 per cent of the wage distribution, the share received by families in the top half of the income distribution falls to 54.3 per cent and that received by the bottom one third of families is doubled, reaching 20.6 per cent.

7.28 The above analysis demonstrates that capped increases could help to reduce both earnings and income inequality. It is inconsistent therefore, for the ACTU not to support a capped SNA.

7.29 While a cap would help to direct SNAs to low income families, some of the benefit would still go to those with higher incomes. In

contrast, the tax and transfer system is more effective in reducing inequality, as the previous Chapter demonstrated.

Conclusion

7.30 The Commonwealth reiterates its view that the safety net increase should be targeted at those employees reliant on the safety net and less able to engage in agreement making. Wage increases for skilled employees are best delivered by ready and flexible access to market rates through agreement making. A low flat dollar increase, capped at the level of C10 will ensure that the award system operates to provide both an appropriate safety net and a strong incentive for agreement making.

CHAPTER 8: THE INCENTIVE TO BARGAIN

Introduction

8.1 The Commonwealth argues that a quantum of $10 per week and a cap at the level of C10 are consistent with the requirements of the WR Act and the wage fixing principles in regard to the Commission's responsibility to encourage agreement making at the workplace or enterprise level. On the other hand, the ACTU's claim would present a serious impediment, if granted, to the further spread of agreement making. The ACTU's proposed $25 per week increase represents a percentage increase of 4.9 per cent as a proportion of C10 and 6.0 per cent as a proportion of C14. This is well in excess of underlying wage movements achieved through agreement making.

8.2 The Commonwealth's view is that the incentive to bargain is fundamental to the effective operation of the workplace relations system supported by the WR Act. The incentive to bargain has been explicitly addressed in past Safety Net Review decisions and needs to be revisited in the current case.

Requirements of legislation and the wage fixing principles

8.3 The 1994 Review of the wage fixing principles highlighted the incentive to bargain as a fundamental principle in ensuring awards operate as a minimum safety net while 'encouraging and facilitating workplace and enterprise bargaining and agreements'[1]. In its decision the Commission noted the new legislation made a clear distinction between the award safety net and the bargaining stream.

[1] Print L4700, page 3.

8.4 The 1996 changes to the WR Act continued the requirement for the Commission to play an important and active role in encouraging agreement making. The arbitrated outcome of the Safety Net Reviews itself exerts an important influence in the decision making process for employers and employees considering making agreements. Both of these points were accepted by the Commission in handing down the 1997 Safety Net Review decision. The decision specifically addressed the incentive to bargain and referred to expected bargaining outcomes in the year ahead for employees at different classification and wage rate levels. The decision accepted the role of SNAs in this regard stating that:

> *...one of the factors which is relevant to the adjustment of the award safety net is the need to encourage the making of agreements between employers and employees at the workplace or enterprise level by maintaining an incentive to bargain.*[2]

8.5 Since 1997, and primarily since a change to the wage fixing principles in 1998, the Commission has appeared to give less priority to the legislative requirements in regard to the incentive to bargain. In the 1998 Safety Net Review decision the Commission rejected the joint Governments' proposed changes to the then *Principle 2 'Agreement Making'* which would have further prioritised bargaining for wages and conditions variations. In the decision the Commission stated there was no need to make the changes and in fact deleted the principle as:

[2] Print P1997, section 5.4.

> *...principles which do nothing more than paraphrase the relevant statutory provisions may do little to assist in the application of the legislation.*[3]

8.6 The Commonwealth believes it is incumbent on the Commission to reassert the priority the legislation gives to bargaining and this is addressed in our proposed changes to the wage fixing principles in Chapter 9. Chapter 9 details the priority accorded to the incentive to bargain in the first wage fixing principles articulated after the WR Act. We argue the emphasis of the current workplace relations system is on determining wages and conditions at the enterprise level and the wage fixing principles should reflect such an emphasis. The Commonwealth further believes the intent of the legislation requires the incentive to bargain be explicitly addressed in the 2002 Safety Net Review decision.

8.7 The Commonwealth submission for a cap at the level of C10 is an important factor in the further promotion of enterprise and workplace level bargaining and agreement making. A moderate increase to those earning less than the C10 rate is warranted as these employees are likely to be unskilled, are a less mobile workforce and may have more limited bargaining power. However, the concept of an award safety net focussing on the low paid (s. 88B(2)(c)), in a system where the emphasis is on agreement making at the enterprise or workplace level (s. 3(d)(i)), should inevitably require that those on higher classification rates are ineligible to receive safety net wage increases.

8.8 Agreement making between employers and employees at the workplace or enterprise level is the prime method of regulating wages and this has been widely accepted by the parties. Consequently, the award

[3] Print Q1998, section 11.5

safety net is intended only for those employees who cannot use agreement making to pursue claims for wages and conditions. The Commonwealth believes this is made explicit in the wage fixing principles. Principle 1, the *Role of Arbitration and the Award Safety Net*, states:

> *Existing wages and conditions in the relevant awards of the Commission constitute the safety net which protects employees who may be unable to reach an enterprise or workplace agreement.*[4]

The ACTU's claim

8.9 In its submission, the ACTU fails to acknowledge the primacy of agreement making in the workplace relations system and the Commission's role in encouraging agreement making. There are, however, two significant points in relation to the incentive to bargain that arise from the ACTU's claim. First, the quantum of the across the board increase the ACTU is seeking would reduce the incentive of employees currently dependent on awards to bargain for formal or informal agreements and many employees covered by agreements may find their rates of pay overtaken by increases in award rates.

8.10 Second, the claim suggests that employees reliant on awards should receive SNAs commensurate with increases achieved through other mechanisms. For awards to act as an effective safety net that promotes bargaining for actual wages and conditions in the workplace it is important that employees are able to appreciate that better wage outcomes are achievable through bargaining processes that allow wage increases to be linked to improvements in the workplace. Wage increases achieved through bargaining are able to be linked to productivity and

[4] Print PR002001, Statement of Principles

efficiency initiatives that ameliorate the cost impact of wage increases for employers. The system intended by the current legislation clearly separates the award and agreement making streams. The wage increases provided through SNAs and agreements arise through very different processes with SNA increases subject to statutory criteria and agreement increases left to the bargaining parties, within the bargaining framework provided by the Act.

8.11 Under the WR Act it is not intended that the safety net should be adjusted on the basis of market rates and this interpretation is effectively dealt with in the joint Governments' submission to the 1998-99 Safety Net Review – Wages.[5] In the 1998–99 submission, the joint Governments included in their arguments on this issue, the following extract from the landmark decision in the Paid Rates Review:

> *[Moreover], under the statutory scheme rates and conditions should only be adjusted for market considerations through certified agreements, pursuant to s.170MX or perhaps by exceptional matters pursuant to s.89A(7).*[6]

8.12 The environment most likely to encourage agreement making is one where employees benefit from a positive differential between agreement rates and award rates and employers benefit from positive changes to productivity and efficiency levels. This environment requires that SNAs be modest and nothing like the amount claimed by the ACTU.

[5] Joint Governments Submission, 1998-99 Safety Net Review (printed version), pages 239-240.
[6] Print Q7661, page 15.

Employees' incentive to bargain

Impact of the ACTU's claim on new agreement making

8.13 Charts 8.1 and 8.2 illustrate the potential impact of the ACTU's claim. Both charts provide a time series of the Average Annualised Wage Increase (AAWI) per employee for all federal agreements and for the highest and lowest quartiles of agreement covered employees.[7] Chart 8.1 also shows a time series of previous SNAs as a percentage of C10 and Chart 8.2 provides the same data as a proportion of C14. The charts plot the percentage increases that the ACTU's proposed $25 per week increase represents, which is 4.9 per cent as a proportion of C10 and 6.0 per cent as a proportion of C14. Both charts clearly demonstrate that the proposed increase by the ACTU outstrips the AAWI typically available for agreements at all levels and that actual SNAs from 1998 have generally provided higher percentage increases than AAWIs for the lower quartile of agreement covered employees. This may have provided a disincentive for low paid employees to enter the bargaining stream.

8.14 The Commonwealth accepts that the percentage increases obtained through agreement making will generally result in a higher equivalent monetary increase than if the same increases are applied to award rates of pay. However, a high SNA is likely to particularly affect agreement making in those industries where there is only a narrow margin between award rates of pay and those of agreement covered employees such as hospitality (accommodation, cafes and restaurants) and retail.[8]

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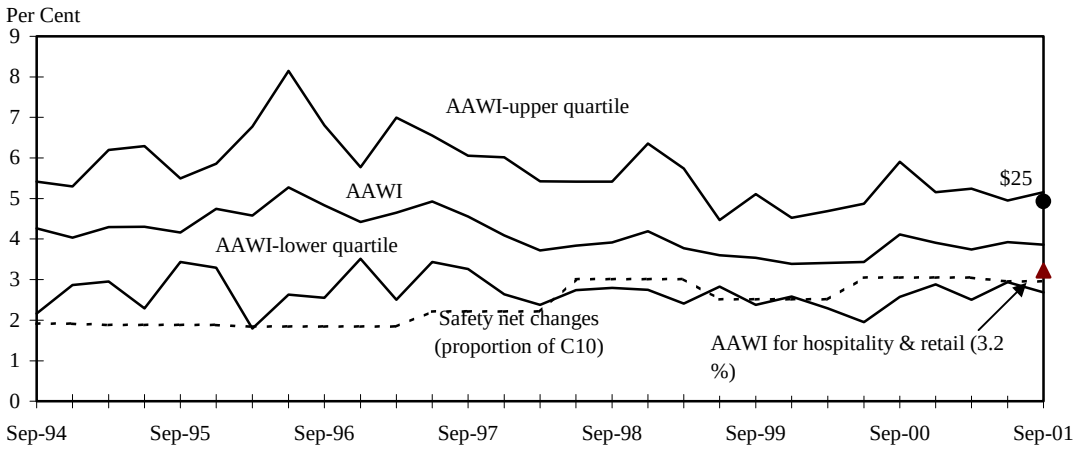
[7] These wage dispersion data in Charts 8.1 and 8.2 are based on federal certified quantifiable wage agreements that were certified during each quarter and employees covered by such agreements.

[8] See Table 2.3, Joint Governments' Submission, 2000–2001 Safety Net Review-Wages (printed version), page 14.

Furthermore, while the average wage rates for agreement covered employees within an industry may be considerably above those of the relevant award there will be industry sectors and many individual workplaces where this is not the case.

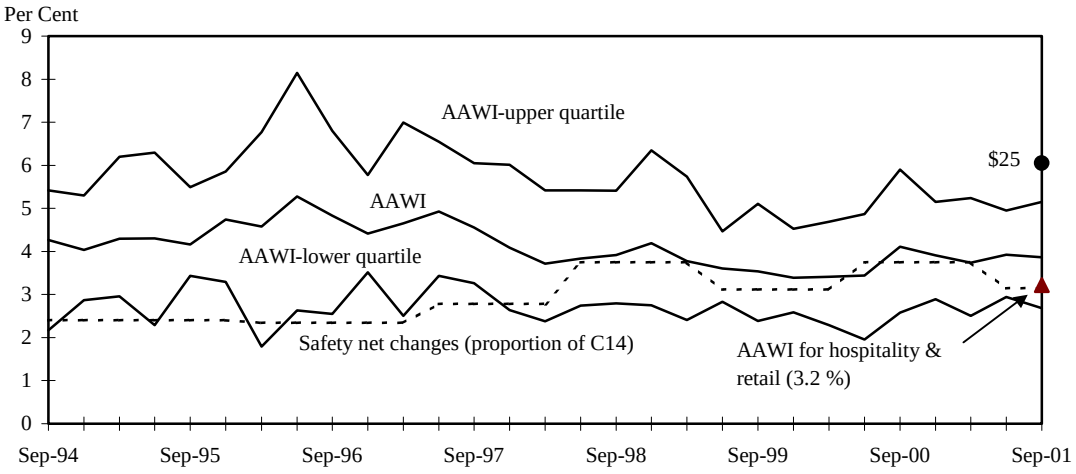
8.15 Charts 8.1 and 8.2 have additional points on the right hand vertical axis demonstrating the AAWI per employee from agreements in the retail and hospitality industries combined and it is clear the percentage increase of the ACTU's claim far outstrips the AAWIs for agreements in these industries.

Chart 8.1: A comparison of annual wage increases for federal wage agreements and SNAs and the ACTU's claim as a proportion of C10



Source: DEWR, Workplace Agreements Database

Chart 8.2: A comparison of annual wage increases for federal wage agreements and SNAs and the ACTU's claim as a proportion of C14



Source: DEWR, Workplace Agreements Database

8.16 The disincentive is still apparent at higher classification levels in awards and supports the Commonwealth's argument for a cap at C10, above which are higher skilled employees with marketable skills who are in a stronger position in the labour market. Agreement making is the most viable route to appropriate remuneration for employees paid at rates above the minimum and the evidence on agreement making supports this view.

8.17 We reiterate that the ACTU's claim represents a percentage increase of 4.9 per cent at the C10 level which could seriously impact on the incentive for employees at C10 or above to enter agreements. In the 1997 Safety Net Review Decision, the Commission considered the percentage increase of a $15 per week adjustment at the level of C6 and above as compared to the average percentage outcomes of increases through agreement making in determining the incentive to bargain. They commented:

> *An increase of $12 per week at the C14 level would represent an increase of 3.4 per cent; and $15 would be 4.3 per cent. There are*

significant risks, in our view, that such increases would (1) raise the levels of settlements in future workplace and enterprise bargains; (2) raise the growth rate of AWOTE to a level inconsistent with the Reserve Bank's inflation target; and (3) diminish the incentive for unions and employees to engage in bargaining.[9]

Agreement making in selected industries

8.18 Employee Earnings and Hours (EEH) Survey data show conclusively that award coverage has fallen dramatically since 1990 and agreement making is now the focus of Australia's workplace relations system. However, award coverage remains high in many of the service sectors including retail and hospitality (see Appendix A, Table A.1). In the retail industry, 34.9 per cent of employees are reliant on awards for pay setting arrangements while the proportion for hospitality employees was the highest of all industries at 64.7 per cent. The Commonwealth believes the high level of reliance on awards within these industries is, in itself, evidence of the continued need to encourage enterprise level bargaining.

8.19 Although other factors may be constraining bargaining in these industries the impact of SNAs is likely to be significant. The lack of agreement making in the hospitality industry has been attributed to the industry's highly casual and mobile workforce, low union density and a perception that the award system provides enough flexibility for organisations.[10] The Commonwealth does not believe however, that the

[9] Print P1997, page 74.

[10] N Timo and L Hort 'Missing in Action? A Decade of HRM and Enterprise Bargaining in the Australian Hotel Industry' *Ten Years of Enterprise Bargaining Conference Paper*, Newcastle, May 2001; J Buultjens and G Cairncross 'Ten years of Enterprise Bargaining and the Hospitality Sector' *Ten Years of Enterprise Bargaining Conference Paper*, Newcastle, May 2001.

lack of agreement making in hospitality reflects an entrenched inability to bargain within the industry. Nor should it be assumed that agreement making is not pursued because of perceptions that there are limited advantages to bargaining for either employees or employers. While Hort and Timo describe bargaining in the Australian hotel industry as minimal and reluctant, they also found that while some hotels use enterprise agreements to enhance cost minimisation strategies, others use agreements to improve the career paths, training and multi-skilling of employees.[11]

8.20 From the agreements recorded on the Department of Employment and Workplace Relation's Workplace Agreements Database (WAD), formal agreement making is mainly limited to particular sectors of the hospitality industry including casinos, large hotel chains such as Sheraton, All Seasons and Novotel, and to tourist resort complexes. Charts A.7 and A.9 in Appendix A suggest agreement coverage is growing in small (1–19 employees) and medium (20–99 employees) sized hospitality organisations, but not significantly.

8.21 In the retail industry agreement making is also more prevalent in large enterprises and chain organisations such as Coles Myer, OPSM, K-Mart and fast food stores.[12] Charts A.5 and A.6 at Appendix A show that within the retail industry the spread to smaller workplaces continues but slowly.

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[11] N Timo and L Hort 'Missing in Action? A Decade of HRM and Enterprise Bargaining in the Australian Hotel Industry' *Ten Years of Enterprise Bargaining Conference Paper*, Newcastle, May 2001, page 2.

[12] The ANZSIC classification structure includes take away stores as 'food retailing' under the retail industry division. Take away food stores are excluded from the hospitality (accommodation, cafes and restaurants) industry division which is categorised by 'consumption on the premises'.

8.22 The Commonwealth has identified retail and hospitality as industries with a particular vulnerability in regard to the incentive to bargain. However, the incentive to bargain is at issue for employees and employers of all industries. It is essential in this regard for the SNA as a percentage increase for award covered employees to not outstrip the wage increases likely to be sought through bargaining.

Employers' incentive to bargain

8.23 For agreement making to continue expanding, particularly into industries where award coverage remains high, there need to be recognisable benefits, over and above the award safety net for all parties. For employers, benefits lie in achieving flexible and productive workplaces with a committed workforce. In agreement making this can be realised, and is, through establishing new working arrangements such as new salary structures and flexible working patterns that can maximise returns on capital investment through increased productivity.

8.24 The WR Act has significantly reduced the complexity of agreement making and the Government is committed to further promoting agreement making through simplifying the administrative requirements for employers and employees wishing to negotiate and formalise agreements in the workplace.[13] The beneficial impact of this policy approach would be reduced within a context of unreasonably high SNAs creating a disincentive for the parties to agreement making.

8.25 Agreement making is a two way process with both sides seeking satisfactory outcomes including increased flexibility and productivity. For example, of federal collective agreements on the WAD current at 30

[13] See the Government's policy statement '*Choice and Reward in a Changing Workplace*' released by the Coalition prior to the 2001 election.

September 2001, 27.3 per cent had a provision for a new or revised classification structure, 32.8 per cent had provision for performance indicators or a commitment to introduce them during the life of the agreement and 67.7 per cent contained at least one flexible hours provision. These data for all agreements confirm the findings of a survey by ACIRRT in 2000 that reported the most popular reason for employers settling an agreement was the desire to increase the productivity or efficiency of the workplace.[14] The joint Governments' submission to the 2000–2001 Safety Net Review provided evidence that workplaces are taking advantage of the opportunity to use flexible approaches to classification structures and wage rates to suit the needs of employees and employers.[15]

8.26 Interestingly, the proportion of current, first round agreements with these provisions is lower than for all agreements. First round agreements are the first agreement recorded on the WAD for an enterprise and it is new entrants to agreement making that are of most concern to the Commonwealth in regard to the incentive to bargain.

8.27 Of first round agreements current at 30 September 2001, 21.7 per cent had a provision for a new or revised classification structure, 20.5 per cent had provision for performance indicators or a commitment to introduce them during the life of the agreement and 55.6 per cent contained at least one flexible hours provision. This may indicate that first round agreements are more closely aligned with awards in the terms

[14] R Hall and K van Barneveld 'Working it out? Why employers choose the agreements they do – a survey' *Final Report on the 1999 Workplace Agreements Survey - ACIRRT Working Paper*, No. 63, University of Sydney, 2000.
[15] Joint Governments' Submission, 2000–2001 Safety Net Review – Wages (printed version), pages 138–145.

and conditions they provide and are likely to be more susceptible to changes in relevant awards, including SNAs.

Bargaining practices in agreement making

8.28 The Commonwealth would like to address specific concerns, in regard to the incentive to bargain, raised in the oral proceedings in the 2001 Safety Net Review. The implication of some of the discussion in transcript appeared to be that there was a view that SNAs could be encouraging agreement making in particular ways including by providing a 'bargaining floor' and by the annual periodicity of Safety Net Review decisions to date. The Commonwealth does not support that argument.

8.29 There was some discussion in last year's proceedings about varying practices within formal and informal bargaining in the context of encouraging agreement making. Senior Deputy President Polites referred to the practice in agreement making, in the retail motor sector, of effectively paying an overaward rate that maintains some dependence on movements in awards as the bargaining platform.[16] Senior Deputy President Polites was referring to the practice within the context of informal workplace arrangements and it is unknown how widespread this practice is informally. It is not common in federal collective agreements for the practice to be explicitly outlined.

8.30 Data from the WAD shows that 1 per cent of agreement covered employees receive automatic flow-ons of SNAs through agreements (see Chapter 4, Table 4.2). First round agreements rely more on an automatic

[16] Transcript, 21 March 2001, paragraph 1564.

flow-on of SNAs with such provisions covering 3 per cent of employees under first round agreements.[17]

8.31 It may be that the use of SNAs as a bargaining platform is a developing trend. In addition to the automatic flow-on of SNAs, there is evidence from the WAD of an increasing number of agreements specifying that wage increases will be higher, by a set amount, than the wage increases of the relevant award. Some agreements state that for the life of the agreement employees will receive the award rate as varied plus a particular percentage or an agreement will specify that employees receive a particular dollar amount above the rates of the relevant award as varied for annual SNAs. While the number of agreements with these provisions is still low, the provisions are being increasingly found in particular sectors such as local government agreements.

8.32 As Chapter 4 shows, the indirect cost of SNA flow-on into agreements does warrant serious consideration. The practice of applying SNAs through agreements, whether formal or informal, is a further reason why caution is necessary in considering the SNA awarded in this case. Where agreements bind wage increases to SNAs there is an indirect cost impact from SNAs that is not factored into costings and the Commonwealth has consistently raised this concern in wage cases.

8.33 The Commission last year also suggested there may be an inbuilt incentive, through the application of annual award increases for employers to make agreements, particularly if the prospective SNAs were to be in the terms of the ACTU's claim. The concept discussed was that an employer can make an agreement for three years with differential wage increases providing an initial increase greater than the safety net

[17] WAD data, unpublished.

that is dissipated by leads and lags in further increases.[18] WAD data suggest that the practice of differential increases is uncommon and that where this does occur the first wage increase of a two year or three year agreement rarely outstrips the percentage increase proposed by the ACTU's claim.

8.34 Only 9.6 per cent of employees covered by quantifiable wage agreements, and 5.8 per cent of quantifiable wage agreements,[19] have a first wage increase that is more than one percentage point higher than the second wage increase of the agreement.[20] Where that first wage increase is comparable to the 2001 SNA in percentage terms (approximate wage increase of 3 per cent) the proportions fall further, and further still when compared to the percentage increase proposed by the ACTU's claim. Only 8.4 per cent of employees covered by quantifiable wage agreements receive a first wage increase that is both more than one percentage point higher than the second wage increase and provides an increase of more than 3.0 per cent. Only 4.9 per cent of employees covered by quantifiable wage agreements receive a first wage increase that is both more than 1 percentage point higher than the second wage increase and provides an increase of at least 4.9 per cent. Just 0.6 per cent of employees covered by quantifiable wage agreements receive a first wage increase that is both more than one percentage point higher than the second wage increase and provides an increase of at least 6.0 per cent.

8.35 The practice of differential increases (or 'front-loading') in agreements occurs predominantly in particular industries such as

[18] Transcript, 22 March 2001, paragraph 2230.
[19] WAD data, unpublished.
[20] For establishing whether a differential increase between first and later wage increases in an agreement is significant and likely to constitute 'front-loading' it was determined that the difference should be greater than 1 per cent.

manufacturing and construction although the employee coverage of these agreements is low in these industries. A small number of agreements in the government administration and defence industry also ‘front-load’ and impact on more substantial numbers of employees. Given that the data demonstrate the practice is uncommon and is limited to particular industries, it cannot be construed that the annual nature of the wage case provides an incentive for employers to pursue agreements with long durations.

Conclusion

8.36 The Commonwealth’s view is that the Commission is required by legislation to exercise its powers in ways consistent with the objectives that wages and conditions are determined as far as possible by agreement at the workplace or enterprise level, that awards act as an effective minimum safety net and that arbitrated SNAs do not act as a disincentive to agreement making.

8.37 The Commonwealth’s position is that recompense for skilled employees is best ensured by ready and flexible access to market rates for job types and classifications through agreement making. A moderate ($10 per week) increase, capped at the level of C10 ensures that the award system operates to provide both an appropriate safety net and a clear incentive for agreement making.

CHAPTER 9: THE WAGE FIXING PRINCIPLES

Introduction

9.1 This chapter presents the Commonwealth proposals for amending the Statement of Principles. The Commonwealth seeks three changes to the current principles and opposes the amendment proposed by the ACTU in regard to the timing of SNAs. The Commonwealth seeks to affirm the important role of the wage fixing principles in providing guidance and consistency in wage fixation and the application of the legislation.

9.2 As stated in Chapter 1, the principle for economic incapacity is essential to provide a readily available avenue for seeking temporary relief from increases in wage costs and the Commonwealth considers it an appropriate time to review the principle. We are not aware of any recent applications under this principle and believe this reflects the onerous requirements for a successful application. In light of the evidence presented in this submission on the economic and employment outlook, particularly for some sectors and regions and for small business, it is essential that the economic incapacity principle becomes more widely accessible. The Commonwealth also puts forward a particular proposal in regard to applications for economic incapacity from small business employers.

9.3 The Commonwealth is also seeking to amend the principles in relation to special case applications. The Commonwealth believes recent award determinations have highlighted some ambiguity in the referral of matters as special case applications. There is also a related concern over the identification of award variations that may be considered above or below the safety net.

9.4 The Commonwealth also seeks an amendment to Principle 1 to reinforce the incentive to bargain as a priority in Safety Net Reviews. This submission (see Chapter 8) has argued for promotion of the incentive to bargain to be given the emphasis and priority required by the legislation and the current workplace relations system.

9.5 Finally, the ACTU's proposed changes to Principle 8 'Arbitrated Safety Net Adjustments' are considered. The Commonwealth does not support the proposed amendments as they are inconsistent with legislative requirements including a general presumption against retrospectivity in awards of the Commission.

9.6 Technical amendments to Principle 8 'Arbitrated Safety Net Adjustments' and Principle 9 'Federal Minimum Wage' are required to reflect the Commonwealth's position of a $10 per week increase to award rates up to and including the equivalent of the tradesperson's rate – C10 in the Metal Industries Award.

Economic incapacity principle

History

9.7 The economic incapacity principle was introduced in the June 1986 National Wage Case in the context of a centralised wage fixing system. While raising the issue in submissions since then, the Commonwealth has not proposed any amendments to the economic incapacity principle since the 1998–99 Safety Net Review - Wages.

9.8 The Commonwealth welcomed the changes to the principle that occurred in 1998 and 1999. These changes included allowing for the phasing in/or postponing of labour cost increases and incorporating

references to the impact on employment at the enterprise level when assessing the merit of applications.

9.9 Changes to the economic incapacity principle have been proposed previously in an effort to make the principle more accessible and consistent with the prevailing legislative framework. In the April 1999 Safety Net Review decision, the Commission itself recognised that 'the operation of the principle may not be as well understood as it could be.'[1] As a result, an information sheet was produced by the AIR to assist parties to apply under this principle and was displayed on the AIRC website. The information sheet was also promoted by the (then) Department of Employment, Workplace Relations and Small Business on its website and through the Area Consultative Committee structure.

9.10 While these have been positive changes, the paucity of applications since then indicates that the economic incapacity principle may need to be reviewed to make it more accessible to applicants. There have been no applications, of which we are aware, to the AIRC since 1999.[2]

The Commonwealth's position

9.11 The proposed changes to the economic incapacity principle discussed and outlined in the following paragraphs seek to achieve three main objectives:

- to ease the administrative and procedural burden on enterprises seeking relief under the principle;

[1] Print R1999, page 50.
[2] From publicly available sources, it is difficult to determine whether employers are alternatively attempting to ease economic difficulties through reaching an agreement with employees.

- to ease the evidentiary burden on enterprises during cases; and
- to seek changes to the principle which acknowledge the particular needs of small businesses seeking relief under this principle.

9.12 The Commonwealth believes that the changes and approach advocated are consistent with the objective of the WR Act for an award safety net to operate while maintaining the focus of the system on the settlement of terms and conditions of employment at the level of the workplace or enterprise. The maintenance of an effective safety net of wages and conditions of employment for the low paid requires the provision, within the wage principles, of a readily accessible mechanism to provide relief from such adjustments for enterprises, regions or sectors facing financial difficulty.

9.13 Based on our understanding of industry perceptions and the experience of previous applicants under the economic incapacity principle,[3] it appears to the Commonwealth that the requirements for applications are so onerous they amount to a disincentive. For the safety net role of awards to be effective in maintaining and promoting employment there needs to be a relief valve for enterprises and organisations facing temporary hardship that does not *add* to that hardship. Adjustment to the principle and further promotion of its existence may encourage employers in need of temporary relief to make applications to the benefit of the jobs of their employees.

9.14 To this end the Commonwealth has proposed specific changes to the principle which reflect its concerns. In addition, we invite the Full Bench and other parties to consider the merits of the proposals and as

[3] See Appendix H for a history of cases related to claims for economic incapacity.

appropriate develop alternative approaches to address the same objectives.

Easing the Procedural Burden

Information Sheet

9.15 The Commonwealth would encourage the AIR to make available and promote an updated information sheet arising from these proceedings to assist applicants for economic incapacity as was previously available. The Commonwealth will also undertake to promote the information sheet.

Single member

9.16 Consistent with the application of the 'no disadvantage' test to certified agreements and AWAs referred to the Commission by the Employment Advocate, the Commonwealth proposes that economic incapacity claims on an enterprise basis should be able to be dealt with by a single member of the Commission without the need, as at present, to make out a case under s. 107. This will help minimise the administrative burden for the employer.

9.17 Where applications concern multiple enterprises or are of significant public interest it remains appropriate for such applications to be dealt with pursuant to s. 107 of the WR Act as at present.

Easing the evidentiary burden

9.18 The Commonwealth is particularly concerned about the weight the Commission gives to adverse economic conditions in a particular industry or region when considering incapacity applications by both individual and groups of businesses. The nature of evidentiary

requirements should have regard to the circumstances of the business(es) affected by the application.

9.19 The Commission has recognised that the differential impact of safety net increases across sectors and enterprises is a relevant factor in determining the level of safety net adjustments.[4]

9.20 The Commonwealth reaffirms arguments presented in both the 1997 and 1998 submissions from the Joint Governments that the Commission take a broader approach in dealing with enterprises presenting incapacity claims.[5] Evidence at the industry or regional level indicating that a significant number of enterprises in the relevant sector, industry or region are, or will be, experiencing adverse economic conditions and would be adversely affected by any further increase in labour costs, should be accorded significant weight in deciding an application. This should apply even for applications at the individual enterprise level. Examples include:

- an industry or regional area facing sudden deterioration in its export markets which is beyond its control; or
- where an industry sector in a particular region or nation wide suffers a severe contraction in sectoral demand; or
- where a regional area suffers as a result of a drought, major bushfires or other natural catastrophes.

9.21 Such a change of approach would add weight to the 1999 revision of the principle which incorporated the statement that: 'The impact on

[4] Print PR002001, paragraph 97.
[5] Joint Governments' Submission, 1996-97 Safety Net Review – Wages (printed version) pages 50-51, Joint Governments' Submission, 1997-98 Safety Net Review – Wages (printed version) pages 91-93.

employment at the enterprise level of the increase in labour costs is a significant factor to be taken into account in assessing the merit of the application.' Furthermore, this would be consistent with s. 88B and s. 3 of the WR Act where the Commission in considering whether a temporary reduction, postponement or phasing-in of an increase to labour costs is in the public interest, should give considerable weight to evidence relating to potential employment losses.

9.22 In addition, the Commonwealth is of the view that the evidentiary requirements for small businesses should be given special consideration. Small businesses invariably have fewer resources to devote to employee relations and it is the Commonwealth's view that the current rigorous evidentiary test constitutes a major disincentive for small businesses facing economic hardship to lodge a claim which is perceived as unlikely to succeed. The needs of small business in this regard are considered in more depth below.

Needs of small business

9.23 The Commonwealth proposes that special consideration be given by the Commission to applications for incapacity from small business employers. There are particular microeconomic concerns in regard to small business which are discussed in Chapter 5. Consideration also needs to be given to the impact of wage costs and employment losses for small businesses in regions with weak local economies and labour markets.

9.24 The Commonwealth would consider it appropriate in regard to employer claims under economic incapacity for small business to be defined as those enterprises with fewer than twenty employees.

9.25 The ACCI Survey of Small Business released in February 2002 found that while there had been a modest improvement in overall small business conditions, they still remain well below the peak conditions registered two years ago. From the survey, the indexes for profits, employment and investment report relatively flat results indicating little if any improvement.[6]

9.26 The survey also shows that labour costs remain one of the key constraints on investment among small and medium enterprises.[7] In the survey, the small business ranking of impediments to investment highlight the relative importance of wage and non-wage labour costs as limitations to economic growth. For these reasons it is important for the Commission to give special consideration to the impact that labour costs can have for small business.

9.27 Indeed, in its 2001 decision on the adjustment of Victorian minimum wage orders the Full Bench recognised the differential impact for small business of wage increases (and retrospectivity in particular) stating:

> *..we are concerned that retrospectivity would impose a significant administrative and financial burden on the employers bound by the Minimum wage orders. Such employers are predominantly small businesses.*[8]

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[6] ACCI, *Survey of Small Business*, Issue 10, February 2002, pages 4-6
[7] ACCI, *Survey of Small Business*, Issue 10, February 2002, page 7
[8] Print PR907793, paragraph 42.

Proposed alternative procedure for small business applications under economic incapacity

9.28 Small businesses as a result of their size and often the daily presence in the work place of the working proprietor, have advantages regarding ease of communications and consultations with their employees. Employees as a result are able to develop a close understanding of and affinity with the business and are generally well placed to be fully aware of when the business is performing strongly and conversely when it is experiencing trading or other difficulties that may be threatening the viability of the business.

9.29 In addition to providing the changes to the general incapacity principle discussed above, including recognition of the circumstances of small business, the Commonwealth's view is that it is important the Commission should provide an alternative avenue for incapacity to pay applications from small business which would take account of the particular features and distinguishing circumstances of these businesses.

9.30 Such an avenue would be available to small businesses as an alternative to the general procedure for accessing the incapacity to pay principle.

9.31 One form such an alternative process could take would allow for the Commission constituted by a single member to approve applications from small businesses for the deferred application of a SNA provided that the Commission is satisfied that such a deferral is appropriate having regard to the following criteria:

- The application is made within a reasonable time of the relevant award being varied for the SNA in question;

- The Commission is satisfied that the employer has demonstrated that the employees have been properly consulted regarding the difficulties facing the business, including by giving due consideration to any suggestions made by the employees regarding other possible changes or measures that could be taken to overcome those difficulties and thereby avoid the need to defer the SNA;
- The Commission is satisfied that there are genuine concerns that refusal of the application is likely to lead to loss of jobs in the business and/or threaten the viability of the business; and
- Supporting evidence if required could be presented to the Commission by affidavit.

9.32 At the Commission's discretion the matter could be dealt with on the papers. If oral hearings were considered necessary it would be expected that these would be brief. The employer could be ordered to serve notice of the listing of the matter on the employees in the business. Employees could participate through a representative of their choice, including by a union representative where there are union members employed in the business.

9.33 In the Commonwealth's view, such a procedure, or some alternative procedure developed by the Commission to address the same objectives, should be made available for a trial period in the first instance. If there were difficulties the trial could be suspended until the parties to the Safety Net Review were able to be reconvened to make further submissions. Otherwise the process could be reviewed at the next Safety Net Review.

Proposed changes to the text of Principle 12. 'Economic Incapacity'

9.34 The Commonwealth proposes the following replacement for the economic incapacity principle to give effect to the Commonwealth's position, with proposed changes in bold.

12. Economic Incapacity

Any respondents or group of respondents to an award may apply to temporarily or otherwise, reduce, postpone and/or phase-in the application of any increase in labour costs determined under the principles on the ground of very serious or extreme economic adversity. The merit of such application shall be determined in the light of the particular circumstances of each case and any material relating thereto shall be ***considered****. The impact on employment at the enterprise level of the increase in labour costs is a significant factor to be taken into account in assessing the merit of the application.*

Information on economic difficulties being experienced by an industry sector or region may be relevant to determining the adverse economic circumstances that affect the particular enterprise(s) which are the subject of an application. This information could include factors such as economic prospects, potential employment loss and labour costs. Particular regard will be given to the operational circumstances of small business in deciding on evidentiary requirements affecting them.

A single member of the Commission will deal with applications from individual businesses. Applications from multiple enterprises or at a sectoral, industry or regional level must be made and justified pursuant

to section 107. *It will then be a matter for the President to decide whether it should be dealt with by a Full Bench.*

Any decision to temporarily reduce or postpone an increase will be subject to a further review, the date of which will be determined by the Commission at the time it decides any application under this Principle.

Special case principle

Introduction

9.35 The Commonwealth is also seeking amendments to the principles to remove ambiguity in the determination of proposed award variations that may be considered *above or below the safety net* and/or referred to the President of the AIRC as *special case* applications.

9.36 The Commonwealth believes recent award determinations have highlighted some ambiguity in the referral of matters as special case applications and that there is a related concern over changes to awards that may be considered above or below the safety net. The Commonwealth seeks to affirm the role of the wage fixing principles in providing guidance and consistency in wage fixation and the application of the legislation.

Special case applications

Legislative intent of the WR Act and the wage fixing principles

9.37 The Statement of Principles has evolved over time to accommodate changing legislative requirements. The April 1997 Safety Net Review decision was the first to follow the major changes of the WR Act. The Commission's decision of 1997 stated that it will generally not

arbitrate above or below the award safety net except in the circumstances provided for in the Act. The relevant principle, 'Principle 2. Agreement Making' was intended to provide guidance in decisions regarding award variations that would be consistent with the WR Act's focus on agreement making as the most appropriate avenue for determining terms and conditions of employment within individual enterprises. The Commonwealth believes this emphasis needs to be reaffirmed and addressed in applications for award variations that are not otherwise prescribed in the principles.

History of special case provisions in the wage fixing principles

9.38 National wage fixing principles prior to the WR Act also contained special case principles and the principle evolved in 1994 to take into consideration the safety net role of awards and the focus on enterprise level bargaining for terms and conditions above the safety net.

- in 1991, the relevant principle read

  > *that any claim for increases in excess of those allowable in the August 1989 and 1991 national Wage case decisions must be processed as a special case before a Full Bench*[9]

- in September 1994 the matter of special case applications was tied directly to the concept of promoting bargaining. Under Principle 2, where the Commission considered no agreement could be reached on matters above or below the safety net

the matter shall be referred to the President for consideration as a special case....

[9] Print K0300

Current ambiguity

9.39 The wage fixing principles provide that the President may refer matters to a Full Bench or to a single Commissioner but are less clear in articulating the basis on which a matter referred back for handling by a single member should be dealt with. There may be a lack of clarity in these circumstances as to whether a single member may only determine an outcome above or below the safety net of the existing award if the member first decides that there is a special case.

9.40 The Commonwealth is seeking further clarity in the case of such referrals as to the nature of the award variation that may be made and whether it is to be treated as a special case matter. The Commonwealth is not seeking to fetter the discretion of the President to refer matters to a single member where there are no significant issues of public interest.

9.41 In the recent award variation to the Country Printing and Graphic Arts Awards (Print PR913088), the President refused an application to have the matter heard by a Full Bench. In a memorandum dated 9 July 2001, the President, in refusing the s. 107 application stated:

> *Having regard to the subject matter and the reasons for the applications pursuant to* section 107 *of the Act, I am not of the opinion that, in the public interest, a Full Bench should be constituted to deal with the matters.*

9.42 The employer bodies party to the case submitted that the variation sought was indeed a variation above the safety net and it was on this basis the application for a Full Bench hearing was made. It is unclear from the President's referral of the matter back to the single member whether it was to be dealt with as a claim above the safety net or not, and unclear

whether it was considered as a special case matter. Commissioner Cargill, at paragraph 25 of her decision, accepts the claim as one for a variation of an award above the safety net. The Commissioner then appears to infer, from the rejection of the s. 107 application, that she may proceed with the matter without reference to the nature of special cases or claims above the safety net, stating at Paragraph 26:

> *In the ordinary course of events the Principles would constrain my role as a single Member of the Commission in determining the applications. However, in the light of the rejection of the section 107 applications referred to earlier in this decision, it would appear that I am required to proceed to deal with the applications in accordance with industrial principles and the general industrial merits of the case.*

9.43 The Commonwealth does not believe the refusal to grant a s. 107 application in this instance appropriately indicates the way the single member should approach the matter. Other decisions demonstrate a similar ambiguity in the referral to single members for consideration in matters concerning award variations that are arguably above or below the safety net. In a number of decisions the President has refused s. 107 applications and referred matters back to a single member. It is not clear from the subsequent decisions by single members whether the applications have then been considered under the wage fixing principles as special cases.[10]

History of the application of the principle

9.44 There are precedents in special case applications, where the discretion for referral to a single Commissioner rather than a Full Bench

appeared to be applied with clearer reference to the nature of the matters. In two identified decisions (Prints F0576 and S0609) the President referred matters of award variations to single Commissioners for consideration but clearly identified them as 'special cases'.

- In Print F0576, the Chamber of Commerce and Industry of Western Australia (CCIWA) sought to vary a particular clause of the Forest and Building Products, Manufacturing and Merchandising (General) Award 1996. The parties to the award, the CCIWA and the CFMEU conferred and mutually agreed to the variation. The Commissioner referred the matter to the President for consideration as a special case as the variation could not be considered 'as a claim in respect of which an award may be varied without the claim being regarded as above or below the safety net' from Principle 2. In the decision, Senior Deputy President Watson stated 'the President referred the matter back to the Commission as presently constituted for hearing and determination as a special case'. The variation was subsequently approved.

- In Print S0609, union and employer parties to the Security Industry (New South Wales) Award 1994, sought to address the Commission on their (conflicting) understanding of certain matters that had been agreed between the parties through arbitration. At issue were matters of the absorption of wage increases and the operation of the award clause for a No Extra Claims commitment. The decision in Print S0609 was to order, for settling, changes to the award that were substantially agreed between the parties. In providing the background information in the decision, Senior Deputy President Harrison stated

[10] See three decisions: Print R4953, Print Q2204, Print PR904332

> *As it transpired the President, by way of a decision under section 107, decided that the constitution of a Full Bench was not necessary. Even though the matter was considered to be a special case it was referred back to me for determination.*

9.45 The Commonwealth believes that further guidance may be required in the referral of matters under the principle back to a single member, to clarify the nature of the matter to be determined. The Commonwealth proposes amendments to Principle 10 'Making or Varying an Award Above or Below the Safety Net' to remove ambiguity and uncertainty. The proposed amendments to the wording of the principle as set out in the May 2001 decision are highlighted in bold.

Proposed changes to the text of Principle 10. Making or Varying an Award Above or Below the Safety Net

An application to make or vary an award for wages and conditions above or below the safety net ***of wages and conditions prescribed by the award when the application is made*** *will be referred to the President for consideration as a special case. Applications involving a consideration of s. 89A(7) are subject to this Principle. Applications involving claims to incorporate agreements (expired or not) into awards (paid or minimum rates) ordinarily will not be considered to constitute a special case. A party seeking a special case must make an application pursuant to s.107 supported by material justifying the matter be dealt with as a special case.*

The further handling of the matter will then be for the President to consider.

Where the President is satisfied that a special case exists, the President will refer the matter to a Full Bench or to a single member, as appropriate, to determine any appropriate award variation to resolve the special case.

Alternatively the President may decide to refer the application to a Full Bench to itself determine whether it is satisfied that a special case exists, and any appropriate variation of the award to resolve such a special case.

Where the President is not satisfied that a special case exists, the President will refer the matter back to a single member for that member to deal with consistently within the limitations of the wage fixing principles, that is no 'special case' exemption from the principles.

The incentive to bargain

Agreement making under the WR Act

9.46 The WR Act requires a more positive application of the incentive to bargain through award variations than is suggested by Safety Net Review decisions in recent years. Changes to the wage fixing principles in 1994 and 1997 accepted and highlighted the priority accorded to enterprise level agreement making in the settlement of terms and conditions of employment. The Commonwealth is concerned that subsequent changes to the principles appear to have removed the emphasis on agreement making.

9.47 In the Statement of Principles in the Safety Net Review – Wages April 1997, Principle 1 described the changed employment relations system and gave particular emphasis to the promotion and encouragement

of agreement making.[11] The wording of Principle 1 emphasised that the priority in the system is on employers and employees taking responsibility for their own industrial relations and reaching agreements in relation to matters affecting their employment relationship. Principle 2, titled 'Agreement Making' detailed the ways the Commission would actually facilitate agreement making.

9.48 In the Safety Net Review – Wages 1998 decision, the Commission deleted the first two principles stating the text effectively paraphrased the objectives of the WR Act and summarised the Commissions' principal powers and functions in relation to awards. The Commission considered such a summary may have been useful in earlier years but was no longer needed.

9.49 However, the Commonwealth believes the priority the workplace relations system accords to enterprise-level agreement making is no longer adequately articulated in the Statement of Principles.

9.50 The Commonwealth proposes an amendment to Principle 1 to insert a direct reference to the incentive to bargain. The proposed amendments to the wording of the principle as set out in the May 2001 decision are highlighted in bold.

Proposed changes to the text of Principle 1. Role of Arbitration and the Award Safety Net

Existing wages and conditions in the relevant awards of the Commission constitute the safety net which protects employees who may be unable to reach an enterprise or workplace agreement ***while reinforcing an incentive to bargain for such agreements****. The award safety net also*

[11] See Appendix H for the text of the relevant principles.

provides the benchmark for the no-disadvantage test that the Workplace Relations Act 1996 (the Act) requires be applied before agreements are certified.

Timing of safety net adjustments

The ACTU submission

9.51 The ACTU's submission seeks an amendment to Principle 8 to overcome a perceived practical difficulty arising from the processes of the Commission. At paragraph 8.3 of the ACTU submission it is stated that safety net adjustment increases have been delayed even though the relevant unions have lodged applications in time for SNAs to fall on the 12-month anniversary of the previous SNA. Amendment is sought to Principle 8 'Arbitrated Safety Net Adjustments' which states that SNA variations are subject to the following:

> *a) The operative date will be no earlier than the date of the variation to the award.*
>
> *b) That at least twelve months have elapsed since the rates in the award were increased in accordance with the Safety Net Review – Wages may 2000 decision.*

9.52 The Commonwealth does not support the proposed amendment to Principle 8 which would be inconsistent with the operation of SNAs and the long established principles for the award variation in other than exceptional circumstances. Furthermore, such an amendment would allow for retrospective award variations that would be contrary to previous decisions of the Commission.

9.53 Unlike the variation to the twelve month rule made in the Safety Net Review – Wages 2001 decision, the ACTU's proposed amendment would permit award variations that:

- are not by the consent of all parties; and
- would impact on the wage and administrative costs for employers.

History of retrospectivity

9.54 In the first Safety Net Review case (1997) decided under the WR Act, the principle for arbitrated SNAs proscribed retrospective adjustments with the wording now in Principle 8 above. This effectively maintained principles determined in the National Wage Case of August 1988 where wage adjustments were subject to the following:

> *(d) The dates of operation of the first increase agreed by the parties will be the day the agreement is approved by the Commission.*
>
> *(e) Where increases in individual awards are arbitrated, retrospectivity will not be granted by the Commission.* [12]

9.55 Award variations in both federal and State jurisdictions are rarely granted retrospectively. There is a general presumption against retrospectivity in awards of the Commission as required by s. 146(2) of the WR Act which states that:

> *(1) An award shall be expressed to come into force on a specified day.*

[12] Print H4000

> *(2) Unless the Commission is satisfied that there are exceptional circumstances, the day specified in an award for the purposes of subsection (1) shall not be earlier than the date of the award.*

9.56 Decisions of the Commission have applied this requirement and provided illustration of what the Commission considers to be 'exceptional circumstances'. For example, a recent Full Bench decision in December 2001 on a proposed award variation discusses s. 146(2) stating:

> *For an award to operate retrospectively, therefore, the Commission must find "exceptional circumstances". Such circumstances must be "sufficiently rare and singular" to justify a conclusion that they are "exceptional".*[13]

9.57 Scheduling individual awards for safety net variations is a process for the Commission to determine. The Commonwealth believes it would create a context of uncertainty for all awards of the Commission if the SNA process were determined with a view to awarding retrospective variations. If there are, as in the ACTU's claim, procedural reasons for delayed SNAs, then the circumstances cannot be considered 'rare and singular'. The Commonwealth would suggest that the ACTU take up the matter in terms of the processes of the Commission and not seek changes through the principles.

Delayed safety net adjustments

9.58 The Commonwealth does not dispute that there may be some delay in some awards being varied for the SNA. Analysis of the length of time between annual SNAs over the last three years suggests that the

[13] Print PR912582, paragraph 48

operative dates for SNAs in individual awards do not consistently fall on the same date in consecutive years.

9.59 Seven of the respondent awards to the Safety Net Review application have had periods of more than twelve months between the operative dates for SNAs. For example, the Metal, Engineering and Associated Industries Award 1998 had an operative date in 1999 of 15 May and in 2000 of 1 June. Two awards, the Clerical and Administrative Employees (Victoria) Award 1999 and the Victorian Local Authorities Award 2001 had operative dates for the 2001 SNA that were thirteen months since the operative dates of their year 2000 SNAs. From data collated by DEWR, the Commonwealth found that of 575 awards that received the 2001 and 2000 SNA, 153 had a delay of more than five days from the twelve month anniversary of the 2000 SNA.

9.60 However, delays of this nature do not appear to be causing difficulties for the parties. On the publicly available documentation it appears that in many instances the ‘delayed’ adjustment has not been questioned and no party has sought retrospective adjustments. There are however instances where retrospective adjustments have been sought and the Commission’s decisions in this regard have upheld the principles as they are currently articulated.

9.61 The Commonwealth submits that there is sufficient scope within the current principles for parties to seek retrospective adjustments where there is a significant impact from a delay caused by exceptional circumstances. Under the legislation and the principles as currently drafted, parties are free to apply to have the issue of retrospective adjustments referred to a Full Bench as a special case. It is confirmed by recent decisions that there is sufficient scope within the principles as they

are currently articulated for parties to an award to seek a retrospective variation in exceptional circumstances.

- In June 2001, a retrospective SNA was awarded to two awards on application by the Shop, Distributive and Allied Employees Association. In his decision, Commissioner Lewin finds that consideration can be given to a departure from the strict application of Principle 8 (b) and individual cases must be decided on their particular facts and circumstances.[14] Commissioner Lewin describes the circumstances of the case as 'sufficiently extraordinary' in this regard.[15]

9.62 The Commonwealth does not believe that the timetable for the present case constitutes 'exceptional circumstances' that would warrant a departure from the prospective nature of SNAs. No parties in this Safety Net Review have caused, or sought, delays in the proceedings and the timetable for the case does not present a delay of great significance.

9.63 While the wage fixing principles determine a period of twelve months is necessary between SNAs, there is not universal conformity to an exact twelve month period between operative dates. The Commonwealth notes there is no specific requirement for awards to be varied on the twelve month anniversary of the previous adjustment.

[14] Print PR905754, paragraph 24.
[15] Print PR905754, paragraph 19.

CHAPTER 10: CONCLUSION

10.1 The Commission's decision in this case will be significant to the continuing transformation of the workplace relations and wages systems in Australia. The Commonwealth urges the Commission to reject the ACTU's claim of $25 per week across all award rates on the following grounds:

- In light of uncertainties in the economic outlook, the ACTU's claim is excessive and a moderate safety net adjustment of $10 per week capped at C10 is more affordable.
- The ACTU's claim, if awarded, would have a negative impact on levels of employment and, compared to the Commonwealth's position, could mean 37 000 less people in work by June 2004.
- It would have a severe impact on some industries already badly hit by external developments (for example, tourism).
- The rise in Superannuation Guarantee contributions from 1 July 2002 is a further consideration favouring a moderate safety net adjustment in this case.
- Across the board increases, such as those proposed by the ACTU, do not appropriately focus on the needs of the low paid as required by the WR Act.
- The proposed $25 per week increase in award wages would deliver wage outcomes in excess of those received in the community generally, regardless of which measure is used.

- The ACTU's claim does not recognise the limited capacity of the wages system to meet social equity goals. The needs of low income families can be more effectively targeted through the tax-transfer system.

10.2 We urge the Commission to adopt the Commonwealth's position for an affordable increase of $10 per week to award rates of the low paid on the following basis:

- to be available only to award rates up to and including the equivalent of the tradesperson's rate - C10 in the Metal Industries Award (currently $507.20 per week);
- to apply until the next Safety Net Review;
- to be fully absorbed into all above award payments including from enterprise agreements and informal overawards; and
- that there is a 12 month gap between the increases provided for by the AIRC in its 2001 decision and any increases decided in this case.

10.3 In this submission, the Commonwealth has continued to press a number of key arguments that have previously not been supported by the Full Bench and it has no hesitation in doing so. The workplace relations system is one where the primary focus is on wages and conditions being determined by bargaining between the parties at the workplace or enterprise level. The WR Act seeks to ensure that the role of the award system is confined to providing an effective safety net for those employees who are unable to bargain. Decisions of the Commission on the adjustment of the award safety net need to be consistent with and reinforce the safety net role for awards expressed in the WR Act.

10.4 The Commonwealth also urges the Commission to review the operation of the wage fixing principles in relation to economic incapacity, special case applications and the centrality of agreement making to the WR Act to ensure the principles continue to provide guidance and consistency in the exercise of the Commission's powers.

10.5 The Commonwealth urges the Commission to adopt its proposals in the 2001-2002 Safety Net Review – Wages.