

# **Safety Net Review – Wages**

**2001-2002**

## **Commonwealth Reply Submission**

28 March 2002

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## **CHAPTER 1: INTRODUCTION**

R1.1 In this reply submission, the Commonwealth welcomes the opportunity to respond to the ACTU's reply submission of 20 March 2002. However, there is nothing in that reply submission to dissuade the Commonwealth from the view that the ACTU claim is inconsistent with the requirements of the Workplace Relations Act 1996 (WR Act); is economically unsustainable; and will benefit many higher income earners rather than focus on the needs of the low paid.

R1.2 Statistical information released after the Commonwealth's original submission of 1 March 2002 (including the National Accounts – December Quarter 2001 and Labour Force Preliminary – February 2002) supports the Commonwealth's view that significant uncertainties are still evident in the economic outlook. This is particularly the case in relation to the international outlook and the extent of the moderation in the housing sector. While the labour market now shows some signs of improvement, a recovery in full-time employment has not yet begun. These are significant factors and the Commonwealth urges the Commission to take them into account when determining any increase in award rates in this case.

R1.3 Throughout this reply submission, the Commonwealth deals with specific statements, claims and assertions made in the ACTU's reply submission and addresses mistakes and misunderstandings. These include:

- the inappropriate use of wage and earnings measures to support claims that low paid workers are falling behind the rest of the community;

- the methodology adopted by the ACTU in estimating the effect of the bite of the minimum wage in Australia;
- ACTU criticisms of the MYEFO forecasts and TRYM modelling which appear to be based on misconceptions and a lack of understanding (in spite of the Commonwealth attempting to clarify issues with the ACTU) and as such have little credibility;
- the ACTU's inability to convincingly address the consequences of a \$25 per week increase in labour costs on employment, on sectors and industries already experiencing economic difficulties, on the small business sector, and on the incentive to bargain; and
- the ACTU's analysis of HES data on financial stress and its failure to recognise that joblessness and limited access to paid employment are the main causes of financial stress – which will only be made worse by a \$25 per week increase in labour costs for employers.

R1.4 The Commonwealth welcomes the ACTU's acknowledgement that minimum wages and the social wage are complementary mechanisms for addressing the needs of the low paid. However, the ACTU claim that the Commonwealth is doing nothing to improve assistance to low income earners is vigorously contested.

R1.5 The ACTU Reply Submission, in our view, contains nothing to detract from the force of the strong arguments and material in support of the Commonwealth's position as outlined in its original submissions. That is, 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.



## **CHAPTER 2: RECENT ECONOMIC DEVELOPMENTS AND WAGES**

R2.1 The evidence presented in the Commonwealth's original submission demonstrated 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. Statistical information released after the Commonwealth's original submission has shown that there is no reason for the Commonwealth to reassess its position. The major data releases since the finalisation of the Commonwealth's submission were the National Accounts – December Quarter 2001, and Labour Force Preliminary – February 2002. Appendix RA contains a statistical summary of the latest data releases. Notwithstanding the relatively strong December quarter National Accounts outcome, the main risks surrounding the outlook for activity and employment continue to be the international outlook and the extent of the moderation in the housing sector.

### **Domestic economy**

#### **GDP growth**

R2.2 Although economic growth according to the December quarter National Accounts became more broadly based, there were still pockets of weakness at the industry level. In particular, activity in industries like communication services; accommodation, cafes and restaurants; government administration and defence; and transport and storage declined in the December quarter. Accommodation, cafes and restaurants; government administration and defence; and transport and storage employ a significant proportion of award employees.

**Labour market**

R2.3 The Preliminary Labour Force Survey for February showed that employment by full time and part-time categories continued to display very different outcomes. The survey showed that of the 20 400 employment increase for February, part-time employment rose by 43 300, while full-time employment fell by 22 800. Over the year to February, part-time employment grew by 7.7 per cent, while full-time employment declined by 0.3 per cent.

**Productivity**

R2.4 The rebound in labour productivity outlined in the December quarter National Accounts mainly reflects a cyclical recovery following the low cyclical outcomes experienced over the last year or so. As robust GDP growth leads to higher job creation, the cyclical component of labour productivity is likely to fall.

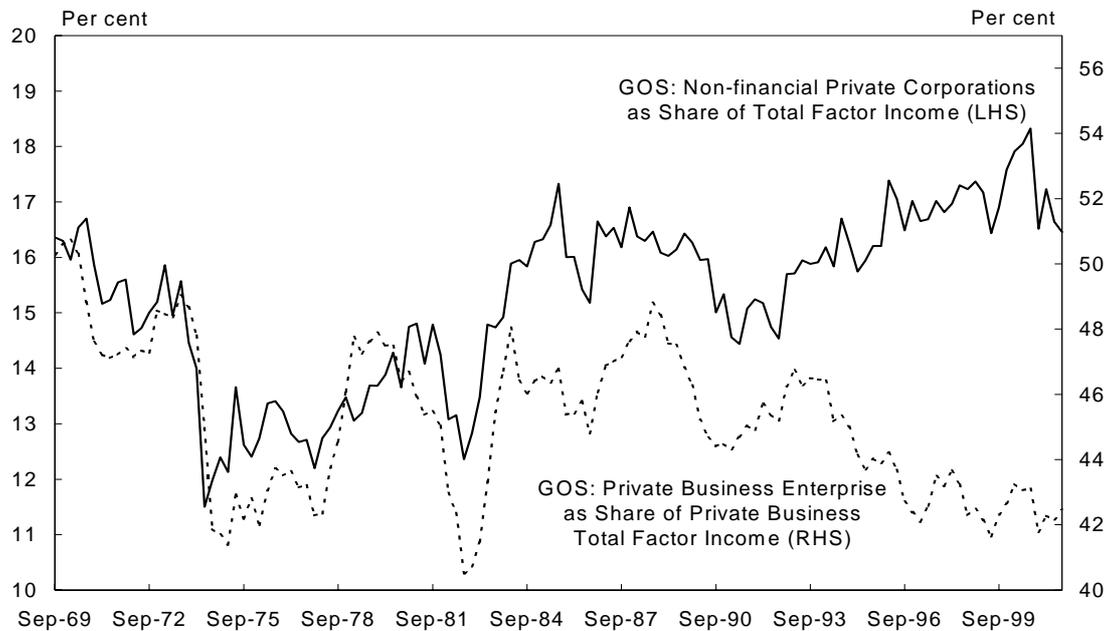
R2.5 The analysis of productivity by industry cannot be updated using the December quarter National Accounts on an equivalent basis as in Chart 5.5 of the Commonwealth submission (that is on a per hour worked basis). However, productivity on a per head basis shows that the three lowest award-intensive industries recorded the highest labour productivity growth, whilst the two of the three highest award-intensive industries actually recorded negative labour productivity growth.

**Profit share**

R2.6 As highlighted in paragraph 2.46 of the Commonwealth submission, the appropriate measure of profit share is gross operating surplus (GOS) of the private business sector as a share of factor income for that sector and not as a share of total factor income.

R2.7 As shown in Chart R.1, the GOS of the private business sector as a share of factor income for that sector has been declining over the past 10 years.

**Chart R2.1: Profit (a) shares for the corporate sector and private business sector (b) (Current prices, seasonally adjusted)**



Source: ABS Cat. No. 5206.0 & Treasury estimates.

Notes:

- (a) Gross Operating Surplus (GOS)
- (b) Total Factor Income (TFI) under SNA93

R2.8 While total profits increased in the December quarter according to the National Accounts, it is not possible to analyse profitability by industry. Caution must be exercised when using the aggregate profitability measure for determining appropriate award increases without factoring in composition at the industry level.

## Wages

R2.9 The Commonwealth notes that there are no material differences between the ACTU's broad conclusions about wages pressure, that is that wage pressure appears to be moderate at present. However, the

Commonwealth has some concerns about the ACTU's use of AWOTE and AWE as the basis for testing wage pressure at paragraph R2.7 of its reply submission. As we have noted in previous submissions, AWOTE is a particularly volatile statistical series since it is very sensitive to movements in the composition and size of the workforce. The Commonwealth is seriously concerned that the ACTU believes that s.88B(2) of the Act implies that AWOTE and AWE are 'appropriate indicators of living standards'. There is nothing in the explanatory memorandum underpinning the WR Act that implies such an analogy. In addition, the Commonwealth notes that living standards are determined by many things in addition to earnings that is tax-transfers, cost of living, infrastructure, etc.

R2.10 We also commented that the ACTU appears to be confusing changes in living standards with changes in community wage rates. We argue that living standards are a much broader concept, encompassing the tax and transfer system and other aspects of income and benefits. It is not appropriate to argue as the ACTU does that people on award rates have experienced a decline in their living standards in comparison with the rest of the community by sole reference to earnings and wages measures. The Commonwealth acknowledges the importance however of examining the position of award workers in comparison with the rest of the community, but there are better ways of doing this than the way the ACTU does (see Chapter 6 of the Commonwealth submission).

R2.11 The Commonwealth argues again that award wages have kept pace with community wage movements and reiterates that the ACTU's \$25 a week claim would result in increases to award rates in excess of wage outcomes received by the general community. As previously stated, AWOTE and AWE measures are average wages bill measures which

should not be used as the standard for community wage movements to compare with award wage rate changes. The Wage Cost Index is a better indicator of wage movements in the wider community, which can be used to compare with award wage rates.

R2.12 Once again, the Commonwealth also disputes the ACTU's selection of the time period and indicators used for their analysis. The ACTU focuses on growth in AWOTE, C14 and C10 since 1983. It is important to look at long-term trends, and the Commonwealth acknowledges that there is little alternative but to use the AWE series – or other earnings series – for this purpose. However, the regular nature of the Safety Net Reviews warrants closer attention be paid to more recent developments affecting award wage workers which makes the WCI an important indicator in the short term.

- It is worth noting that Chart 2.4 of the Commonwealth submission demonstrates that the C10 and C14 award rates, which represent the wage rates of the lowest paid award workers, have kept up with the wage rates as measured by the WCI, since September 1997.
- In response to the ACTU's comments at paragraph R2.7 of its reply submission, the ABS has indeed described the WCI as 'far superior' to AWE measures. In an ABS Media Release entitled 'Wage Cost Index replaces Average Weekly Earnings as ABS principal wages indicator'<sup>1</sup> statistician Dennis Trewin, states that 'the Wage Cost Index series (Catalogue No. 6345.0) provide[s] each quarter direct measures of change in wage and salary rates on a 'constant quality' basis and are, in his opinion, far superior measures of this change'.

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<sup>1</sup><<http://www.abs.gov.au/Ausstats/ABS%40.nsf/dddcf05472f88677ca2568b5007b8615/e9af758ca7aadd73ca2569e9007c2133!OpenDocument>>

R2.13 The ACTU states, at paragraph R2.5 of its reply submission, that “[t]he recent data confirms that wage cost pressures are moderate”, and indeed this is the case. Annual growth in the WCI increased by 3.4 per cent in the December 2001 quarter, down from 3.6 per cent in September 2001.

R2.14 Recent trends in wage outcomes from federal enterprise agreements are consistent with trends in the WCI. The average annualised wage increase (AAWI) per employee for employees covered by formal federal collective agreements that were certified in the December quarter 2001 was 3.8 per cent, unchanged from the revised AAWI for the September quarter 2001. AAWIs per employee for federal agreements certified in the two quarters to 30 June 2001 were higher than those paid twelve months earlier but AAWIs for the September and December quarters of 2001 were lower than the AAWIs per employee for the same quarters of 2000.

- All federal agreements current at 31 December 2001 paid an AAWI of 3.7 per cent, unchanged from the AAWI paid for agreements current at 30 September 2001, and from the AAWI paid for agreements current at 30 June 2001. (See Appendix RB for more details of wage outcomes in federal collective agreements contained in the December quarter 2001 edition of Trends in Federal Enterprise Bargaining.)

R2.15 The ACTU, at paragraph R2.8 of its reply submission, argues that:

*The Commonwealth’s criticism of the ACTU at paragraphs 2.87 to 2.90 rests on the alleged invalidity of comparing movements in award rates with movements in earnings. In this respect the Commonwealth simply fails to pay regard to the legislative requirements of the Act. The Commission is required by s.88B(2)(a)*

*to “provide fair minimum standards ... in the context of living standards generally prevailing in the Australian community.” As the Commonwealth submissions themselves demonstrate AWOTE and AWE are appropriate indicators of living standards. The comparison the ACTU makes between growth in award rates and growth in AWOTE and AWE is precisely the comparison contemplated by the Act.*

R2.16 The ACTU sidesteps the issue of the difference between living standards and measuring changes in earnings and wages. To examine living standards generally prevailing in the Australian community requires a broader approach than simply looking at earnings and wage rates. The Act does not specify how to measure living standards, let alone contemplate which earnings or wage rate measures to use, but simply states that living standards should inform the Commission’s decision to set fair minimum standards. The ACTU must pay heed to the importance of using the appropriate indicators to measure living standards, or changes in wage rates if that is what it is seeking to do. The ACTU cannot ignore the statements of various commentators on the AWE series. The Commonwealth, the ABS and the Reserve Bank have found that the AWE series is problematic because it is affected by compositional changes and exhibits considerable volatility. The picture it has been providing of wage and salary developments has departed significantly from other important wage data sources.

- Movements in AWOTE have been difficult to reconcile with movements in the WCI, AAWI, and AENA. AWOTE has consistently shown earnings growth much higher than WCI, AAWI and AENA, and often in the opposite direction, since March 2000 (see table in Appendix C of the Commonwealth submission). AWOTE, as noted by

both the ACTU and the Commonwealth, is affected by compositional change. This is an important consideration given the marked trend to longer working hours in recent decades and the fact that increases in real weekly earnings which merely reflect an increase in average working hours are not genuinely reflective, other things being equal, of either increased labour costs or employee living standards.

- The Reserve Bank in its quarterly Statements on Monetary Policy review developments in labour costs. In the most recent release for February 2002, the RBA notes that AWE is still difficult to interpret. ‘The average weekly earnings survey continues to be affected by compositional changes, which reduce its usefulness as an indicator of wages growth. The past couple of quarters have also been affected by a higher-than-usual sample rotation’<sup>2</sup>.

R2.17 Finally, the ACTU in para R2.21 claims again that:

*For the reasons already advanced in establishing a fair minimum standard by reference to generally prevailing living standards the more appropriate comparison is with those items which measure wages as earnings. We note that where the Commonwealth discusses real wages growth it refers to AWOTE (see paragraphs 2.69-2.71). Further, the Commission ought have regard to more than simply the C14 and C10 wage movements on which the Commonwealth’s submissions almost exclusively focus.*

R2.18 The Commonwealth has argued above that living standards is a much broader concept than just earnings or wages, so the ACTU’s arguments in this regard are misplaced. Comparing rates such as C14

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<sup>2</sup>[http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu\\_feb02/bu\\_0202\\_1.pdf](http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu_feb02/bu_0202_1.pdf) - page 52>

and C10 to wage rates in the community is better done with the WCI than AWOTE, given AWOTE's volatility and problems with compositional change. Although the AWOTE series exhibits problems, real AWOTE does provide a measure of real earnings growth, and the Commonwealth demonstrates in Chart 2.2 that real AWOTE growth has been strong particularly in the latter half of the 1990s. Whereas the ACTU considers the full array of award rates, the Commonwealth submission is particularly concerned with maintaining award rates up to C10, due to the Commonwealth's position that SNAs should be capped up to this award rate to establish fair minimum standards for award workers.



## **CHAPTER 3: THE RELATIONSHIP BETWEEN MINIMUM WAGES AND EMPLOYMENT**

R3.1 In the Commonwealth's original submission, Chapter 3 demonstrated that the greater part of the academic literature supports the notion that rises in the real value of minimum wages have an adverse impact on employment. There is nothing in the ACTU reply submission which leads us to change our view.

R3.2 The ACTU claims at paragraph R5.22 of its reply submission that the Commonwealth's argument that the bite of the minimum wage is higher in Australia than in the UK, is incorrect. The basis of its argument is that proportionately more employees are paid at the National Minimum Wage in the UK than at the Federal Minimum Wage in Australia. However, Australia has a number of minimum award rates, compared to the UK's single minimum wage. The impact of the ACTU's claim, if successful, would not be restricted to those on the minimum wage. Rather, it would affect all employees whose pay is determined by an award, that is 23.2 per cent of employees. Not only is the proportion of employees who will be affected by an SNA in Australia much larger than the proportion affected by the National Minimum Wage in the UK, the relative size of the award rates is much higher in Australia than are minimum wages rates in the UK.

R3.3 The ACTU's methodology in constructing an estimate of the bite in the Australian case (paragraph R5.25 of the reply submission) is seriously flawed. First, it is not really valid to compare the bite of award wages in Australia with the bite of minimum wages in other countries because Australia has a series of award rates rather than a single

minimum wage. Secondly, the ACTU's calculation is a ratio of the average hourly earnings of employees on award wages to median earnings. Clearly the ratio is not comparing like with like. An average earnings figure, even for those on awards, is likely to be considerably higher than a median earnings figure as there will be some employees at the top of the earnings distribution that will drag up the average.

- Indeed ABS EEH data shows that the median weekly earnings of award only employees was \$567.00 compared to average weekly earnings of \$626.80.

R3.4 A more appropriate way of estimating the bite of award wages is to use the ratio of median weekly earnings for award paid employees to median weekly earnings for all employees (79 per cent)<sup>1</sup>.

R3.5 At paragraph R5.25 of its reply submission, the ACTU correctly points out that given the high bite in Australia compared to other countries, one would expect to see large impacts from SNAs on employment in Australia compared to the impact that minimum wage increases have on employment in other countries. The ACTU argues that “these dramatic differences are simply not observed”. It provides no evidence for this assertion. As we noted in our submission and in past submissions, there have been no empirical studies that have examined the effect that SNAs have had on employment in Australia.

R3.6 It is true that Australia has experienced moderate employment growth in recent years although the situation has been more subdued in the last 12 months. Moderate growth has occurred despite the SNAs that have been granted, although the SNAs over this period of course have not

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<sup>1</sup> ABS Cat No 6306.0, May 2000.

been at levels comparable to the ACTU's excessive claims. This labour market situation has been primarily due to strong consumer demand, low interest rates, the low value of the Australian dollar, tax cuts and welfare reform underpinned by high productivity growth. Given this economic environment, if more moderate SNAs had been granted, employment growth may well have been higher, as demonstrated in our submission.

R3.7 The ACTU argues that the US elasticity of employment growth to wages growth reported in the Keil, Robertson and Symons paper imply that the level of employment in Australia should be 30 per cent lower than the level of employment in the US. This is a ludicrous conclusion. The elasticity published in the Keil, Robertson and Symons paper indicates the size of the effect on employment that would result from an increase in the minimum wage in the US. It can not be used to predict employment responses to wage changes in Australia or any country other than the US, or to explain differences between employment in different countries. There are countless variables that determine the differences between the employment to population ratios in the two countries – including the type of economy, nature of the labour market and productivity growth. These factors can vary significantly between countries – particularly economies as markedly different as the US and Australia.

R3.8 At paragraphs R5.27 - R.31, the ACTU tries to discredit the usefulness of the Keil et al and Williams and Mills papers due to problems it sees with aspects of the methodology of the respective authors. In fact, the Commonwealth does not ask the Commission to rely on the results of these papers alone. Rather they should be regarded in the context of the overwhelming evidence that there is a significant negative

relationship between increases in minimum wages and employment.<sup>2</sup>

The Commonwealth takes the view that the Commission should be aware of a wide range of the minimum wage literature in order to make a decision based on all of the available information regarding this subject.

R3.9 The Commonwealth includes a full version of the Williams and Mills paper at Appendix RC. At the time of publishing its initial submission a full copy was not available to it.

R3.10 As shown above, the ACTU has failed in its attempt to discredit our arguments about the bite of minimum wages in Australia and the relationship between minimum wages and employment. The evidence clearly shows that there are likely to be substantial adverse impacts on employment if the ACTU's claim is successful.

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<sup>2</sup> See Tables 3.2 and 3.3 of [Commonwealth Submission to 2001-2002 Safety Net Review – Wages](#).





## **CHAPTER 4: THE COST OF THE ACTU'S CLAIM AND ITS MACROECONOMIC IMPACT**

### **Overview**

R4.1 In its original submission, the Commonwealth argued that 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.

R4.2 Importantly, the ACTU's estimate of the aggregate wage cost impact of the claim seriously understates the effect of its proposed claim on the economy. 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 – which is larger than the ACTU's absolute estimate of 0.49 per cent and considerably larger than the ACTU's net impact estimate of 0.17. By contrast, the Commonwealth's position is estimated to add 0.11 per cent to aggregate wages growth.

### **Costing the claim**

R4.3 In paragraph R3.4 of its reply submission, the ACTU accuses the Commonwealth of 'obsfucation' (sic) in its criticism of the ACTU's costing methodology. On the contrary, the Commonwealth's criticisms are straightforward. The Commonwealth's methodology is similar in many ways to that of the ACTU. However, there remains a number of differences between the methodologies underlying the respective costings and it is these differences that we have problems with. Indeed, the Commonwealth went into great detail about the problems with the ACTU's costing methodology in our original submission.

R4.4 The ACTU remains critical of the Commonwealth's general approach. At paragraph R3.6 of the ACTU reply submission, the ACTU states that the Commonwealth is "eschewing the approach of calculating a net impact" but also that "its net estimate... is less than 0.2%". It is unclear how the ACTU can come to the conclusion that the Commonwealth possesses a net estimate of the cost of the ACTU claim while at the same time acknowledging that the Commonwealth has not calculated a net impact.

R4.5 When determining what the ACTU misleadingly describes as '[the Commonwealth's] estimate of the net impact of the ACTU claim', in paragraph R3.12, it uses figures that appear in Table 4.5 of the Commonwealth's submission. In fact, these estimates are constructed in order to calculate the economic impact of the decisions relative to the joint Governments' positions in this and previous cases (that is the 'counterfactuals' or what might have happened if the Government's proposals for previous safety net reviews had been granted by the Commission). These figures were not designed for use in estimating costings. The only way the Commonwealth examines the net impact of various positions is in the context of determining economic effects - of the ACTU's claim over and above the Commonwealth's claim or of the various AIRC decisions relative to what would happen in the absence of these decisions.

R4.6 The fact that the ACTU's estimate of 'net costs' based on the Commonwealth's costing methodology and TRYM results is similar to the ACTU's own estimate, as stated in paragraph R3.12 of the ACTU reply submission, is of no consequence. The ACTU's assumption underpinning its 'net impact' result is invalid. There is no reason to assume, as the ACTU does, that the Commission would grant the same or

similar amount in the 2001-2002 decision to that in the 2000-2001 decision.

R4.7 It is the Commonwealth's view that reliance on the ACTU's 'net impact' approach is not valid when determining the additional costs that will be faced by employers from SNAs. When making its decision, the Commission needs to be aware of the additional costs that will be faced by employers if the ACTU's claim is successful, regardless of what has happened in the past. An employer's knowledge that SNAs of certain sizes have been granted in the past will not diminish the additional costs that they will face after the next SNAs. Employers already face a wages bill. The granting of a SNA will increase this wages bill. The amount sought by the Commonwealth would increase labour costs by 0.11 per cent on average. The amount sought by the ACTU would increase labour costs by 0.59 per cent on average. The Commission needs to be aware of the additional costs that will be faced by employers.

R4.8 Paragraph R3.12 of the ACTU reply submission accuses the Commonwealth of avoiding providing evidence that shows that there are public sector award employees who benefit from SNAs and that our reference to pages 293-295 of the 2000-2001 Safety Net Review Submission 'contains no evidence'. This is not correct. Paragraph S.172 on page 295 of last year's joint Government submission clearly states that according to the DEWRSB Award and Agreement Coverage Survey, '7 per cent of all public sector employees received a safety net adjustment in the twelve months to June 1999'. The joint Governments also explained, in the same paragraph of last year's submission, that this is likely to be an understatement of the actual flow of safety net adjustments due to factors

such as staff turnover. It should also be noted that according to ABS EEH data, 9.8 per cent of public sector employees are paid by awards.<sup>1</sup>

R4.9 Paragraph R3.21 of the ACTU reply submission describes as unfounded, the Commonwealth's methodology that identifies agreement covered employees who could potentially receive safety net increases. However, the ACTU is being misleading in its criticism of the Commonwealth's methodology. Certainly many federal certified agreements that are categorised in the Commonwealth submission at Table 4.3 as 'Where consistent with Safety Net Review' or as 'Safety net increases conditional (may be open)', would be covered by the absorption principle. However, the ACTU takes an overly simplistic and dismissive view regarding the potential flow-on effect of safety net increases to agreements that allow for absorption.

R4.10 The ACTU reply submission reminds the Commission that the average differential between collective agreement rates and award rates is \$301.30. The use of this figure shrouds the fact that many employees covered by agreements do not earn a much higher wage than their counterparts under awards – for example, the differential in average weekly total earnings (the measure used for the ACTU's comparison above) is, for retail trade \$9.10 and for accommodation, cafes and restaurants minus \$5.90. The \$301.30 differential is constructed from a wide range of wage rates, within which many of the lower rates would be very close to award rates.<sup>2</sup>

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<sup>1</sup> ABS Cat No 3606.0

<sup>2</sup> These data are derived from Table 25, ABS Employee Earnings and Hours 6306.0, May 2000. The award category includes both federal and State awards and the collective agreement category includes both federal and State collective agreements.

R4.11 Over 25 per cent of federal wage agreements<sup>3</sup> in each of four industries contain provisions that allow for conditional safety net increases.<sup>4</sup> All four of these industries have agreement/award differentials in average weekly total earnings that are below the \$301.30 referred to by the ACTU and would therefore include rates close to comparative award rates at the lower end of the wages range.<sup>5</sup>

R4.12 The ACTU reply submission makes the assumption that such agreements would ‘overwhelmingly, not be entitled to receipt of any increase by reason of the absorption principle’. This assumption can only be made where safety net increases are granted at a very moderate level. Over 40 per cent of federal wage agreements are first time agreements.<sup>6</sup> When a first time agreement is made, moving employees directly from award pay rates, the agreement rate is likely to be relatively close to the award rate.

R4.13 First agreements often grant a percentage increase over the employees’ previous award rate. Many contain the proviso that if the award rate for any classification overtakes the agreement rate for the same classification, then the award rate will apply. For example, a health

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<sup>3</sup> Accommodation, cafes and restaurants 27%, cultural and recreational services 30%, government administration and defence 32%, and health and community services 37%.

<sup>4</sup> Defined as ‘Where consistent with Safety Net Review’ or as ‘Safety net increases conditional (may be open)’, in Table 4.3 of the Commonwealth submission 1 March 2002, covering a combined total of 176500 employees.

<sup>5</sup> Accommodation, cafes and restaurants -\$5.90, cultural and recreational services \$180.40, government administration and defence \$71.00 and health and community services \$255.40.

<sup>6</sup> 40.9 per cent of federal wage agreements that have been checked for replacements are first time agreements.

industry agreement<sup>7</sup> certified in early 2000 allowed for three consecutive annual increases of 3 per cent and contained this type of safety net increase provision. Table R4.1 shows the wage rates resulting from the partial absorption of the safety net increase in this agreement. This agreement is not atypical.

**Table R4.1: Example of wage rate changes in an agreement that allows for absorption of safety net increases.**

Skill Group 1	A 3 x 3 per cent p.a. increases	B Agreement with partial absorption of safety net increase flow- on	AWARD	Effect of flow- on Difference between A and B
Initial pay rate	459.20	459.20	459.20	
2000	472.98	474.20	474.20	1.22
2001	487.17	487.20	487.20	0.03
2002	501.79	501.79#	497.20#	0.00
2002	501.79	512.20*	512.20*	10.41

\* Rate if the ACTU claim of \$25 per week was granted

# Rate if the Safety Net decision grants a \$10 per week wage increase

R4.14 As this example illustrates, the ACTU can only assume that the flow on to agreements where absorption takes place would be moderate, in circumstances where the safety net increase itself is moderate. If the current ACTU claim of \$25 per week was to be granted, the flow on could be significant.

R4.15 In addition, agreements can, and do, override the absorption principle. Below are some typical examples of agreement provisions

<sup>7</sup> [C6647](#) Croft Health Care and Ellfam Nominees and Health Services Union of Australia (Victoria No. 1 Branch) Enterprise Agreement 2000 - parent award for this agreement is [AW783945](#) Health and Allied Services – Public Sector – Victoria Consolidated Award 1998.

which do so, and which would lead to significant flow-ons in the case of anything but a moderate safety net increase.

*‘Following certification of this Agreement by the Australian Industrial Relations Commission:*

*1. There will be a flat increase of \$7.50 per week applied to all employees as from the first full pay week on or after signing of this Agreement and such will be applicable to all employees covered by this Agreement.*

*2. During the Period of this Agreement all employees covered by this Agreement will receive safety review adjustments that are announced by the AIRC regardless of any requirement to absorb such increases.’<sup>8</sup>*

*‘Council agrees to pay all Federal Award officers:*

*(a) a 3% pay increase as at the 19 January 2001;*

*(b) a flat payment (or other payment basis) to a maximum of \$28 as determined by the Australian Industrial Relations Commission in the Living Wage Case as from the date of such decision; and*

*(c) a 3% wage increase as at the 19 January 2002.’<sup>9</sup>*

*‘i) The rates of pay for employees have been adjusted by \$15.00 per week and will take effect from 1st July 2000.*

*ii) Subsequent salary increases for all classifications during the life of this Agreement will be in accordance with the Safety Net*

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<sup>8</sup> AG771837 Berkle Limited Enterprise Agreement No. 2 (2000)

<sup>9</sup> [AG807332](#) Townsville City Council Enterprise Bargaining Agreement No. 4.

*Adjustment and Review decisions handed down by the Full Bench of the Australian Industrial Relations Commission for the years 2001 and 2002. The operative dates for the increases referred to in (ii) above, will be in accordance with the dates of ratification of the Parent Award during this period, but will be effected no later than 1st July each year.’<sup>10</sup>*

R4.16 An agreement certified only this year contained a wage clause in which the first wage increase is set at either \$15 or [\$7 plus the safety net increase] whichever is higher.<sup>11</sup> Clearly there would be a significant flow on in such a case if the ACTU claim were to be granted.

R4.17 Paragraph R3.21 of the ACTU reply submission states correctly, ‘the 302,300 employees covered by agreements which do not specify circumstances in relation to safety net increases would not be eligible for such increases merely because the agreement does not specify what is to occur in relation to them.’ However, the ACTU neglects to also point out that such agreements do not exclude the making of wage claims on the basis of a safety net increase. Such wage claims, may not have been a common occurrence in the past, where safety net increases have been fairly moderate. This should not lead to the assumption that such claims would not be made if excessive safety net increases (such as the ACTU’s current claim) were to be granted.

R4.18 The ACTU suggest in their reply submission at R3.18 that there is nothing in the evidence before the Commission to warrant a departure from the view in previous decisions that indirect costs are limited. The Commonwealth notes, in response, that the employer submissions to this

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<sup>10</sup> [C6530](#) CAS of SA Inc (2000) Enterprise Agreement.

<sup>11</sup> AG813845 English Style Confections Pty Ltd Certified Agreement 2001

year's SNR feature indirect costs from the flow-on of SNAs to non-award only reliant employees. The major employer groups focus on the indirect costs of SNA flow on to both formal and informal agreement covered employees to a degree not seen in previous SNRs. The issue is raised in the AiG submission ( paras 5.8 and 8.12); the ACCI submission report on the flow-on to agreement covered employees of SNAs (paras 2.82 and 4.9 – 4.11 and 5.9 – 5.21); the PIAA submission reports that despite the 'absorption clause' SNAs flow through to employees in the industry generally (page 2) and the Retail Motor Industry submission reports that their industry which pays above award rates is 'pressured to pass on similar increases regardless of the amount of over award payment' (section 7).

R4.19 It is clear there is a rising concern over the impact of safety net flow-ons that may be arising from the growing use of both formal and informal agreements. Clearly, from the evidence of employer group submissions and from the WAD, bargaining deals have already been struck that are going to pass on the SNA and if the SNA is other than moderate, and particularly if it is in the realm of the ACTU claim, there will be a significant cost impact for employers.

## **Macroeconomic impact of the claim**

### **General criticisms of the MYEFO and TRYM forecasts**

R4.20 The ACTU's criticism of the TRYM projections of the impact of its claim and of the Treasury's forecasting performance at R5.4 - R5.14 are based on a misconception that the TRYM model is the principal forecasting tool in producing forecasts for the Budget and Mid-Year Review. This is far from the true – lending little credibility to the

ACTU's comments about the Treasury costings or Treasury's forecasting performance.

R4.21 TRYM is an econometric model of the Australian economy, combining sound long-run properties with consideration of short-run dynamics. Treasury does not rely solely or even predominantly on TRYM in preparing MYEFO forecasts. TRYM is used as one input into the forecasting process, providing an independent source of analysis on some individual components of the forecasts and overall information on the internal consistency of the forecasts. TRYM is designed to assist with policy and sensitivity analysis, like the analysis on the macroeconomic impacts of ACTU's position in the Safety Net Review.

R4.22 Treasury does not rely solely or even predominantly on an econometric model or equations in preparing its economic forecasts. Instead, Treasury uses a range of inputs in deriving its forecasts, including the National Accounts data, all other available partial data, assessments of recent developments, views of other public sector forecasters, and business liaison; in addition to econometric techniques. Treasury forecasts also rely on the incorporation of informed judgement with the aim of converting estimated past relationships into more relevant forward-looking relationships.

R4.23 While TRYM's ability to provide overall economic forecasts can be questioned (in the same way that any forecasting methodology can be questioned), it provides a sound basis for examining changes in economic variables from a base case scenario. The ACTU's criticism of TRYM's overall forecasting ability is not relevant to TRYM's ability to measure the impact of controlled changes in an economic variable.

### **Magnitude of the ABS Labour Force Survey standard errors**

R4.24 At paragraph R5.9 of the ACTU reply submission, the ACTU dismisses the Commonwealth's estimated employment impact of the full ACTU claim (-37 000) on the basis that the estimate is of the same order of magnitude as the Labour Force standard errors as reported by the ABS. Contrary to a assertions in paragraph R5.9, the standard error on the Labour Force Survey is 18 200 not 37 400.

- In the February 2002 edition of the Labour Force Survey (ABS 6202.0) the ABS gives a 95 per cent confidence interval for its employment estimate of between minus 16 000 and plus 56 800. This is a span of 72 800 and given that there are 4 standard deviations under 95% of the double sided normal distribution, the standard error is therefore 18 200.

### **Criticism of TRYM's estimate of the employment impact**

R4.25 At paragraph R5.18 of the ACTU reply submission, the ACTU compares this year's estimate of the employment impact of the ACTU claim with last year's estimated impact for 2002-03. The comparison is incorrect. The ACTU claims that last year's estimate is 0.4 percentage points. It is in fact -0.3 percentage points (not reported in Table 4.4 of the Commonwealth submission). The ACTU incorrectly compares the employment growth effect for last year's scenario with the employment level for this year's scenario.

- In comparison to last year's simulation which used a 0.86 percentage point shock to aggregate wages growth<sup>12</sup>, this year's 0.48 percentage

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<sup>12</sup> This imposes a 0.86 percentage point increase in aggregate wages growth on the existing path of the economy (as projected by MYEFO).

point shock yields a nearly identical -0.3 percentage point impact on employment growth (actually -0.31 versus -0.28 percentage points). While this might seem anomalous, it is however explained by the fact that both history and the baseline MYEFO forecasts changed between the two years. (Additionally the model will have slightly changed due to refinements and revisions to the historical data.)

- For instance, in last year's simulation, the last year of history (2000-01) had employment growth of 3 per cent, while in this year's simulation, the last year of history (2001-02) had employment growth of  $\frac{3}{4}$  per cent. The CPI inflation history was also very different given that 2000 01 was the year in which the GST was implemented.
- The MYEFO forecast baseline was also quite different, especially in regard to employment growth. In the 2000-01 MYEFO the first year (2001-02) forecast was for 2 per cent employment growth, while in the 2001-02 MYEFO the first year (2002-03) forecast for employment is  $1\frac{1}{4}$  per cent.

### **Criticism of the role of monetary policy in TRYM**

R4.26 At paragraph R5.15 of the ACTU reply submission, the ACTU implies that the RBA is unlikely to respond to the small changes in inflation evident in the Commonwealth's modelling. Since 1993, the Reserve Bank has had the objective of keeping underlying consumer price inflation between 2 to 3 per cent on average over the course of the (economic) cycle a rate sufficiently low that it does not materially distort economic decisions in the community. The inflation target also acts to anchor private sector inflationary expectations.

R4.27 The Reserve Bank would be expected to respond to the higher inflationary pressures to ensure the credibility of monetary policy. The Reserve Bank would consider not only the implications of the current decision but also the kind of precedent it sets for future safety net increases and inflationary prospects.

R4.28 Wage increases add to business costs, which are often passed on in higher prices. These higher prices often lead to demands for higher wages. This interdependency gives considerable inertia to the inflation process. Once wages and prices start to accelerate they are hard to slow down, underlining the need for early policy action when inflationary pressures start to develop.

### **Criticism of the TRYM counterfactual simulation**

R4.29 At paragraph R5.19 and R5.20 of the ACTU reply submission, the ACTU refer to the ‘absurdity’ of the counterfactual modelling presented by the Commonwealth. In particular, the ACTU contends that the assumption that the Reserve Bank uses forward-looking behaviour is absurd. On the contrary, since the move to an explicit inflation-targeting regime, the Reserve Bank has conducted monetary policy in a forward looking manner. It sets interest rates according to the forecasts for inflation rather than according to past inflation. In a 1999 speech entitled ‘Economic Forecasting and Its Role in Making Monetary Policy’, Mr Glenn Stevens, at the time Assistant Governor of the Reserve Bank, said:

*...long lags associated with the full impact of monetary policy changes mean that policy changes today must be made with a view not just to what is happening now, but what is likely to be happening in a year's time and even beyond then.*

R4.30 He also commented that in respect to monetary policy:

*the lags in the full effects on inflation are probably somewhat longer than those to activity. This heightens the need to think ahead - to make a forecast - especially in the case where policy is centred, as in Australia, around a numerical inflation target.*

R4.31 The use of forward looking expectations in the counterfactual is designed to be illustrative of how the Reserve Bank may act, given full information about the outcomes of Safety Net Review decisions.

R4.32 It is possible to examine the impact of the Safety Net Review, relative to the Commonwealth's position, under the assumption of no change in monetary policy or financial market variables. The results are presented in Table R4.2 below:

**Table R4.2: Estimated impact of the counterfactual simulation (deviations from history) with no financial market or monetary policy reaction (Percentage point deviations unless otherwise stated)**

	1997-98	1998-99	1999-00	2000-01	2001-02
GDP Level (a)	0.0	0.1	0.2	0.4	0.7
Inflation (b)	-0.2	-0.4	-0.5	-0.7	-0.6
Employment Level (a)	0.0	0.1	0.2	0.4	0.7
Employment ('000)	2	8	18	36	60
Unemployment Rate (c)	0.0	-0.1	-0.1	-0.3	-0.4
90 Day Bill Rate	0.0	0.0	0.0	0.0	0.0
Wages Growth (b)	-0.4	-0.5	-0.6	-0.7	-0.5

(a) Per cent of baseline.

(b) Through the year (June).

(c) June quarter.

R4.33 As can be seen in Table 4.2, without financial market or monetary policy response, the positive impacts on employment and output are still

substantial. At the end of 2001-02 employment is higher by 60 000 persons and GDP is higher by around  $\frac{3}{4}$  of a percentage point.<sup>13</sup>

R4.34 The positive impacts associated with a lower wage outcome, whether or not the Reserve Bank adjusts monetary policy, are largely determined by the underlying properties of the economy. The influence the Reserve Bank asserts on the economy (via monetary policy decisions) is largely a shifting in timing of these impacts, such that an optimum path is taken (given an inflation target of 2-3 per cent over the course of the cycle).

R4.35 As mentioned last year<sup>14</sup>, the case shown in Table 4.2 where interest rates do not respond in fact involves a monetary tightening in response to the anticipated lower wage growth and lower inflation. Because inflation is lower, and nominal short term interest rates are unchanged, real interest rates rise. (In technical terms this implies a tighter stance for monetary policy - a strictly neutral stance would be one where nominal interest rates fell in line with inflation and real interest rate were unchanged.) The higher real interest rates stifle some of the positive impacts of the lower wage on investment and activity and hence employment. As a result, the economic effects come through with a longer lag.

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<sup>13</sup> 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. For a brief discussion of the monetary policy timing versus level issues see [TRYM Related Paper No 16](#), Sections 2.2.2 and 4.1.

<sup>14</sup> [Joint Government's Submission, 2000-2001 Safety Net Review – Wages](#) (printed version), page 359.



## **CHAPTER 5: MICROECONOMIC IMPACT OF THE CLAIM**

R5.1 Chapter 5 of the Commonwealth submission demonstrated that certain sectors and regions would be adversely affected by the ACTU claim for an increase of \$25 per week. In reply the ACTU asserts at paragraph R5.33 of its reply submission that this reflects the “differential impact” of the claim, which it argues the Commission has acknowledged in previous cases. The ACTU’s words, however, gloss the real consequences of the SNA which it is seeking.

R5.2 If the ACTU’s claim were to be granted its major impact would be decreased employed and increased joblessness, borne largely by those who would be least able to find alternative work. The Commonwealth submission expressed particular concern about sectors and regions that have shown long term weakness or are coping with major negative shocks or uncertainty. A large SNA would be harmful because:

- The pace of employment growth in low paid occupations remains very weak indicating that demand for lower skilled labour is relatively soft;
- Industries with a high proportion of award paid employees or which have not achieved significant productivity improvements will find it hard to cope with increased labour costs. Accommodation cafes and restaurants, retail and other service industries fall into one or both of these categories;
- The accommodation cafes and restaurants industry and the retail industry are also important parts of the tourism industry which is in the early stages of recovery from last year’s serious setbacks. A large

SNA could hamper this recovery and exacerbate regional problems associated with the tourism downturn;

- Optimism in the small business sector is returning but employment experience and expectations are not yet matching this improvement; and
- The ACTU claim could place extra pressure on regions with high unemployment rates, because of either weak employment growth or inward migration.

R5.3 None of the arguments advanced by the ACTU gives any grounds for dismissing these serious concerns.

### **Occupational dimension**

R5.4 At paragraph R5.34 of its reply submission, the ACTU argues that the Commonwealth's finding that employment growth has been weakest in low paid occupations is at odds with the results of Borland, Gregory and Sheehan. This is not the case. The aim and methodology of the two analyses are very different.

R5.5 Borland, Gregory and Sheehan examined the change in the proportion of employees falling within certain earnings bands. They found that the largest increase in the number of employees between 1980 and 1990, and 1990–2000 had occurred in low earnings bands. However, as Borland et al point out, this result was greatly influenced by the increase in part-time and casual work over these periods:

*It is important to note that, contrary to most studies of the distribution of earnings, we do not here confine our attention to particular type of jobs, such as full-time jobs, or attempt to correct*

*for hours worked. Our interest is precisely in the distribution of earnings from all jobs, irrespective of the reasons why those earnings are high or low.*<sup>1</sup>

R5.6 In contrast, the purpose of the Commonwealth's analysis is to see whether employment growth has been consistent across different types of occupations. The analysis found that although overall employment growth has been strong in recent years, low paid occupations have experienced lower employment growth. As noted in the Commonwealth's original submission, these occupations are the very ones that are likely to be affected by SNAs.

### **Industry employment and productivity**

R5.7 The ACTU argues at paragraph R5.35 of its reply submission that its position is supported by Chart 5.3 in the Commonwealth submission which shows that industries with a high level of dependence on award pay setting have demonstrated faster growth than the all industry average. The ACTU ignores, however, the more recent declines, particularly in the accommodation, cafes and restaurants industry (which shows heavy award dependence, with 64.7 per cent of employees paid award rates, as pointed out in paragraph 5.14 of the Commonwealth submission). More recent ABS Labour Force data point to stabilisation or growth in industry employment between November 2001 and February 2002, but this improvement should not be overemphasised. In seasonally adjusted terms, employment levels in accommodation, cafes and restaurants were almost exactly the same in February 2002 as they were in February 2001.

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<sup>1</sup> J Borland, B Gregory and P Sheehan, *Work Rich, Work Poor – Inequality and economic change in Australia*, Centre for Strategic Economic Studies, 2001, page 13.

Retail employment did not grow between November 2001 and February 2002.

R5.8 Regarding developments in labour productivity by industry, at paragraph R5.36 of its reply submission the ACTU utilises the Commonwealth's evidence for its own ends by asserting that 78.1 per cent of award dependent employees work in industries with medium, high or unmeasured productivity growth. This rosy re-interpretation is unwarranted, however, because the Commonwealth's evidence (paragraph 5.20) actually shows that a tiny 0.4 per cent of award employees work in high productivity industries. Another 39.5 per cent work in industries where productivity is not measured. This leaves just 38.2 per cent of award employees working in industries with only medium productivity growth.

R5.9 The AiG evidence is also portrayed by the ACTU, at paragraph R5.38 of its reply submission, as undermining the Commonwealth's case. More detailed examination of the paper 'How Fast Can Australia Grow?' reveals, however, that it does not particularly assist the ACTU's case. The key paragraph, which is only partially quoted by the ACTU is worth repeating in full (original emphasis):

*The labour productivity growth lift between the decades occurred primarily in a narrow range of industries sheltered from international trade (chart 5.3). While most industrial sectors displayed some improvement between the decades, the big lifts came from wholesale and retail trade, construction and to a lesser extent, the hospitality sector of accommodation, cafes and restaurants. These are all users of information technology, but it would be surprising if they alone were the major beneficiaries. A range of*

*industrial relations deregulation seems to be a more persuasive force.*<sup>2</sup>

R5.10 Three important points follow from the full paragraph and the chart to which it refers. First, deregulation of industrial relations is seen to be a major reason for ‘lifts’ in labour productivity, a view entirely compatible with the Commonwealth’s arguments about the importance of agreement making for productivity improvements. Second, the identified productivity lifts are identified by comparing the 1980s with the 1990s, whereas the Commonwealth focuses on the last 10 years, a period more relevant to this Safety Net Review.

R5.11 Third, Chart 5.3 in the AiG annexure reveals that the nature of the lift in labour productivity shown by the wholesale trade, retail trade and accommodation cafes and restaurants industries takes the form of a shift from significant negative growth (that is deterioration) in the 1980s to positive growth in the 1990s. The graph also shows that of the three cited service industries, only wholesale approaches the performance of electricity gas and water or communications which are identified as high labour productivity growth industries in the Commonwealth submission at paragraph 5.20. According to the top panel of Graph 5.3 in the AiG annexure, the accommodation, cafes and restaurants and retail industries achieved only mild productivity growth during the 1990s.

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<sup>2</sup> [2002 Safety Net Review Case](#), Submission to the Australian Industrial Relations Commission by The Australian Industry Group and the Engineering Employers’ Association South Australia, March 2002, Annexure E, page 9, chart 5.3 is located at page 18.

## **The tourism downturn**

R5.12 The Commonwealth argued in its submission at paragraphs 5.25 – 5.47 that while the tourism activity in coming months may show some recovery from the negative impact of the terrorism attacks in the US and the Ansett collapse in Australia, a large safety net increase could hamper this recovery and harm employers and employees in the industry, especially in particular areas, for example Far North Queensland or Greater Hobart.

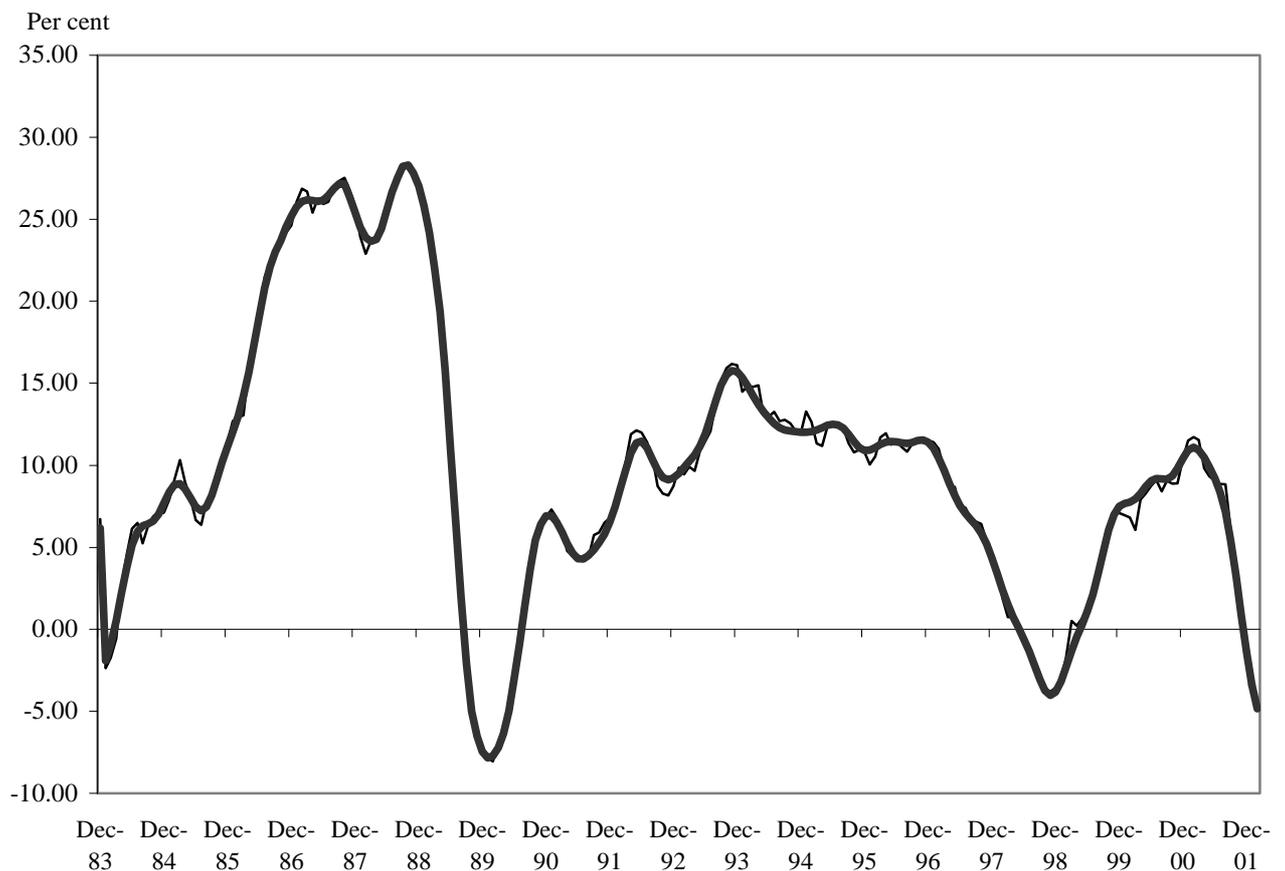
R5.13 At paragraph R5.39 of its reply submission, the ACTU addresses the Commonwealth's claims by referring to the reply at Tag 7 by the Australian Liquor, Hospitality and Miscellaneous Workers Union (LHMU) to the submissions concerning economic incapacity, from the Australian Hotel Association and the Motor Inn, Motel and Accommodation Association. The LHMU asserts that the tourism downturn was not as severe as expected and that international tourism is rebounding.

R5.14 ABS data show that numbers of short-term international visitors have increased in each of the last three months. Nevertheless, visitor numbers are still below the levels of a year ago. In February 2002, the seasonally adjusted number of short-term visitor arrivals was 4.8 per cent lower than in February 2001. Chart R5.1 shows that in terms of annual averages, short-term arrivals had fallen by almost five per cent in February 2002, a severe decline that is comparable to only two other downturns in the last 18 years, one of these being the pilot strike at the end of the 1980s.

R5.15 Furthermore, the current upswing in visitor numbers still seems to be fairly thinly based. Only four of the top ten source countries contributed to the increase recorded in February 2002.

R5.16 Current developments in inbound tourism are broadly consistent with the profile of the shock modelled by Econtech and the Centre of Policy Studies, as described in the Commonwealth submission. Both studies pointed to sudden but short-lived decline in the December quarter 2001, followed by gradual recovery.

**Chart R5.1: Change in annual average short term visitor arrivals (seasonally adjusted and trend)**



Source: ABS Cat No 3401, Overseas Arrivals and Departures, Australia

R5.17 In addition, the evidence provided in the LHMU submission confirms the existence of regional weakness in tourism activity. For

example, the Tourism Queensland survey<sup>3</sup> found that in January 2002 compared to January 2001, room occupancy rates were:

- down by 10.6 per cent in four star hotels in Cairns, and 4.2 per cent lower in hotels/motels and serviced apartments in the same city;
- down by 4.2 per cent in hotel/motels and serviced apartments in Port Douglas; and
- down by 12.2 per cent in the Whitsunday Islands.

R5.18 The Business Expectation Survey conducted by Tourism Tasmania (only the executive summary is provided in the LHMU submission<sup>4</sup>) shows little more than that tourism operators experienced an improvement in actual conditions between September and November 2001 and expected that improvement to continue in the new year. However, the material provided by the LHMU does not reveal whether the actual improvement reported between September and November is simply part of a normal seasonal upswing that is likely to occur every spring. It is possible that the upswing might not be strong enough to match the activity levels of a normal spring or summer period. Also, the survey does show evidence of regional weakness in that Tasmanian tourism operators are more pessimistic about the state of the Tasmanian economy than the national economy.

R5.19 While the conditions faced by individual tourist operators may vary according to the segment of the market and the region in which they are located, the industry as a whole is still dealing with a major downturn in tourism exports. In these circumstances, the Commonwealth urges the

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<sup>3</sup> ACTU Reply Submission, 20 March 2002, Tag 7, page 88 – 92.

<sup>4</sup> ACTU Reply Submission, 20 March 2002, Tag 7, page 84 – 88.

Commission to give due consideration to the potential impact of the ACTU's claims on the industry as a whole and in particular regions.

### **Small business**

R5.20 In responding briefly to the Commonwealth's close examination of the small business sector the ACTU, at paragraph R5.40 of its reply submission, only asserts that there is an "improved outlook for small business". It does not address the key points of the Commonwealth's analysis which are that:

- the Yellow Pages Business index shows that the small business sector is less optimistic than medium sized businesses (paragraph 5.52 of the Commonwealth submission) and
- the actual experience and expectations of small business relating to the workforce, remain much weaker than indicators of other aspects of business performance, and are also weaker than they have been in the past. (paragraphs 5.35, 5.54 of the Commonwealth submission).

### **Regional labour market performance**

R5.21 The ACTU at paragraph R5.43 of its reply submission correctly points out that there is a lack of regional data on award dependence. This prevents a precise assessment of the regional impacts of any SNA.

Nevertheless, the Commonwealth has presented a range of evidence pointing to serious labour market problems in a wide range of regions. It is highly likely that a large SNA would weaken employment growth in many of these regions, and exacerbate their existing problems of unemployment and low or lost earnings.



## CHAPTER 6: LIVING STANDARDS

### Overview

R6.1 In Chapter 6 of our original submission, the Commonwealth attempted to assist the Commission in its deliberations of setting ‘fair minimum standards for employees in the context of living standards generally prevailing in the Australian community’<sup>1</sup>. The Commonwealth demonstrated that since the Coalition government was elected in March 1996, real wages have increased for all full-time wage earners.

R6.2 However, the Commonwealth notes that part-time employees, some casual employees, as well as those outside the wage system have not benefited as much as full-time employees from economic growth or previous decisions from the Commission. This is because the wage system provides less assistance in dollar terms to part-time and casual employees and absolutely no assistance to the unemployed and those outside the wage system. In other words, the wage system provides less assistance, in dollar terms, to those in the greatest need. This highlights the inefficiency of the wage system in alleviating hardship. In view of this, there can be no doubt that the ACTU’s claim overstates the capacity for the wages system to meet social equity goals. SNAs are a blunt instrument when it comes to improving the position of low-income families. The needs of these families can be more effectively targeted through the tax-transfer system.

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<sup>1</sup>As prescribed in [s. 88B\(2\)](#) of the WR Act.

## **Trends in income distribution**

R6.3 In R7.1 of its submission, the ACTU criticises the Commonwealth for not disputing its claim that income inequality has increased over the last decade. The Commonwealth has instead focussed on trends in income since 1996-97 – and shown that income inequality has not increased during this time.

R6.4 The use of analysis relating to the second half of the 1990s is most appropriate for the purposes of this case.

- Data for the first half of the decade reflect the outcomes negotiated between the ACTU and the then government, and the ACTU cannot seek a second bite of the cherry on the trade-offs and deals it has made previously.

R6.5 It is also important to note that the 1994-95 and subsequent income surveys adopted somewhat different methodologies and definitions to earlier surveys. This means that some additional caution needs to be exercised in considering trends over the decade as a whole. As such slight changes, even if statistically significant<sup>2</sup>, may not be meaningful. Statistical significance refers only to issues of sampling, not to whether results are necessarily accurate due to other reasons.

## **Wealth**

R6.6 In R7.4, the ACTU criticises the Commonwealth for not challenging its proposition that ‘wealth inequality has increased if superannuation is excluded’. The reason for the Commonwealth’s

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<sup>2</sup> That is, there is a relatively high probability that the change observed is not simply random variability which may be expected from taking a survey of the sample of the population.

position is that such a statement is nonsensical and mistakes the idea of wealth with disposable income. The two concepts are not the same. From an economic perspective, wealth can be defined as ‘a store of spending power that can be carried into the future’ (Jones and Perkins 1986, p 150). Therefore, wealth can include a wide variety of assets, including financial assets, such as cash, shares, bonds, superannuation and non-financial assets such as dwellings, factories and other business assets that can be used to generate future income. By contrast, disposable income takes the form of income generating assets that can be accessed in cash terms now. Excluding superannuation from the definition of wealth makes as much sense as excluding eggs and flour from the other ingredients in a cake and still calling it ‘cake’.

### **ACTU witness evidence**

R6.7 The Commonwealth’s first submission provided an analysis of the ‘representative’ nature of the ACTU’s witness evidence, stating ‘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’.

R6.8 The ACTU’s reply submission is critical of the Commonwealth’s position, alleging it is faulty because it is based on Harding and Richardson’s definition of ‘low paid’ which – in the ACTU’s view is also not representative of the low paid in Australia.

R6.9 Harding and Richardson’s definition of low paid is restricted to adults earning \$10 per hour or less (in 1995-96). Harding and Richardson acknowledge the difficulty of choosing a ‘level of wages that is called

‘low’.<sup>3</sup> The \$10 benchmark represents the level at which (in 1995-96) was earned by the bottom 15 per cent of all wage earners.

R6.10 The ACTU suggests that the Harding and Richardson paper sets the benchmark of ‘low paid’ too low, excludes too many employees and does ‘not accept that employees [earning more than \$11.68 per hour] are not low paid’. However, the Commonwealth believes that the ACTU sets its definition of ‘low paid’ far too high, and includes employees who are clearly not low paid.

- For example, it is difficult to argue (using any measure of low paid, either relative or absolute) that those employees paid at the C1 or C2 classification rates<sup>4</sup> are low paid.

R6.11 The Commonwealth sees nothing in the ACTU reply submission that would change our original position. The Commonwealth acknowledges the difficulties of choosing a rate which clearly defines ‘low paid’, however, it believes that the Harding and Richardson paper remains an important reference. The Commonwealth notes that the ACTU has used research by Harding and NATSEM as evidence for their position – extensively in this proceedings and in previous reviews. We query, therefore, on what statistical basis the ACTU dismisses this particular piece of research by Harding.

R6.12 The ACTU witness evidence does indeed provide the Commission with a ‘misleading impression’ of the characteristics of low paid employees, and the Commonwealth reiterates to the Commission

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<sup>3</sup> Harding, A. & Richardson, S., *The Lowly Paid, the Unemployed and Family Incomes*, Australian Journal of Labour Economics, Vol 3, No 1, March 1999, p26.

<sup>4</sup> C2 and C1 rates range between \$696.80 per week and \$945.10 per week.

that this evidence, whilst useful, is not statistically representative of low paid employees in general.

### **Financial stress**

R6.13 One of the key themes of the Commonwealth submission is that the main cause of financial stress is unemployment (and limited access to paid employment), not low pay. This is based on data from ABS Household Expenditure Survey 1998-1999, which reveals that the majority of those deemed to be under financial stress were reliant on government assistance as their main source of income.

R6.14 The ACTU challenges this evidence in Chapter R6 of its reply submission based on unpublished data from HES 1998-99. These data, argues the ACTU, show that a greater number of households in the first income quintile whose main source of income is employee income experience a higher level of financial stress than households reliant on unemployment, education and sickness allowances. This statement is misleading. The HES study used by the ACTU has an extremely narrow sample of those outside the workforce. In addition to those on unemployment, education and sickness allowances, there are also a large number of people reliant on age and disability support pensions and other government pensions and allowance as their principal source of income that experience financial stress. While they are not categorised as unemployed, they can certainly be described as either jobless or having limited access to employment. Therefore comparisons of numbers of people within the workforce with the more narrow definition of people receiving government cash benefits will tend to exaggerate the relative importance of the former group.

R6.15 Indeed, according to the ACTU's own unpublished data (Table R6.3), 59 per cent of households experiencing higher financial stress are reliant on some form of government cash transfer as their principal source of income. However, only 36 per cent of the higher financial stress group are wage and salary earners. In fact, the ACTU neglects to advise the Commission that wage and salary earners constitute 62 per cent of the population who experience no financial stress. These data support our claim that joblessness and limited access to paid employment are the main causes of financial stress

- The reason that there is a greater number of wage and salary earners in the higher stress category than of those reliant on unemployment, education or sickness allowances is that there is a far greater number of households in the former category – over four million compared to just 260 000.

R6.16 In R6.26, the ACTU criticises the Commonwealth's argument that the financial stress reported by the highest quintiles 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 relating to management of resources and consumption.

R6.17 It is unclear what point the ACTU is specifically making here. If it rejects the contention that the responses to the 'financial stress' questions contain any component of choice or other household priorities, then based on data provided in Tag 13 of the ACTU submission, this carries with it the implication that over 15 per cent of employee income households in the 4th income quintiles (equivalised disposable) and 6 per cent of such households in the top quintile have insufficient income to avoid stress. Such an argument would appear bizarre since this implies that higher

income households experience financial stress because of priorities and lower income households do so simply from necessity.

R6.18 The other major argument made by the ACTU in R6.26 is that ‘questions of choice or voluntarily sacrificed and other factors are accommodated by the deprivation indicators’ since ‘the ABS provided for respondents to answer ‘don’t want it’ and ‘other reasons’ as well as ‘not applicable’ and ‘can’t afford it’.’ This implies that all of the responses to the questions took this form when in fact only six of the fifteen questions took this form.

R6.19 The Commonwealth notes that, as has been indicated previously, there is a need for considerable caution in associating the financial stress outcomes with what might be volatile household characteristics such as income levels. For example, on the issue of timing, besides the issue of the changes to earnings, tax and income support since the time of the HES, the reference does not fully reflect the situation of the financial stress questions. Seven of the questions specifically refer to events in the year prior to the survey, while others use terms such as ‘usually’. For example, the question on holidays asks if they usually have ‘a holiday away from home for at least one week a year’. In such a case it would be expected that the household response would need to be based on a number of years experience prior to the survey.

R6.20 In paragraph 6.31, the ACTU argues that it is considering the needs of the low paid through its use of the HES financial stress data. The ACTU again confuses the issue of low hourly rates of pay and low household income. The use of first quintile employee income households cannot be considered as being synonymous with low wage rates – many of the workers in these households will be part-timers.

R6.21 Notwithstanding these facts, the Commonwealth acknowledges that some wage and salary earners do experience financial stress, and that the level of financial stress is likely to be greater among low income households. The Commonwealth has argued that the best way of alleviating the financial stress experienced by the low paid is through the tax-transfer system. The rationale for this is simple. The main reason is that a material number of low-paid employees live in two income households – often in households in which at least one income earner is a high income earner. A safety net increase would not distinguish between such a household and one in which there was only one low paid income earner. The tax-transfer system would target the difference between the two households because it is means tested at the family unit level. The second reason that the wage system is a relatively blunt instrument in alleviating the impact of low pay is that higher wages will tend to dampen job creation resulting in less opportunities for the potentially low paid to get a job (given that the lack of a job is the major cause of poverty).

R6.22 The Commonwealth has already made submissions about the potential damage to the economy from awarding a large award increase – of the quantum proposed by the ACTU. Indeed, based on the ACTU’s own evidence, all of the 321,000 wage and salary earning families are experiencing higher financial stress.<sup>5</sup> Many more than these families would receive a safety net increase under the ACTU’s proposal because (a) safety net increases are awarded at the individual not the family unit and (b) the ACTU would award the increase to all individuals on the award – not just the low paid. The initial number of people receiving the SNA would therefore be much larger than under the Commonwealth’s proposal – which is capped at C10. The cost to the economy is also larger

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<sup>5</sup> See Table R6.3 of the ACTU’s reply submission

under the ACTU's proposal because of the size of the proposed SNA (\$25 per week versus \$10 per week) This suggests that a \$25 per week safety net adjustment will have a considerable effect on the economy, with wage pressure acting on wage costs and inflation and threatening job security in award reliant industries. Indeed, this analysis understates the potential damage to employment since it ignores the potential for the granting of the \$25 per week increase to flow on to employees who are not directly paid through awards.

R6.23 The ACTU also claims in RS6.10 of its submission that the Commonwealth presents data comparing the financial stress in different income quintiles that 'chooses the measures that emphasise the points it seeks to make' (paragraph R6.25).

R6.24 The Commonwealth has in fact been fully consistent. In each of our dot points in paragraph 6.10, we use the measurement of disposable net income. We believe that it is the most appropriate measurement, as it is a transparent, clearly defined representation of actual household purchasing power.

R6.25 The ACTU is distorting the true state of income inequality by quoting figures which compare gross income and equivalised gross income of the first and second quintiles. It is simply inappropriate to use gross income when net income is available. Given that the difference between the two is the amount of income tax which households have deducted from their income, disposable income is the measure which actually reflects the income a household actually has available to spend.

R6.26 In paragraph 6.10 of its submission, the Commonwealth points out that some indicators of financial stress in the 1998-1999 HES may reflect factors such as household consumption preferences rather than an

absolute incapacity to pay, especially given the significant number of high income earners deemed to be under financial stress by the ABS publication.

R6.27 The ACTU challenges this contention in paragraph R6.26 of its reply submission. In doing so, the ACTU seems to be implying that the 15 per cent of employee income households that earn in excess of \$976.31 (disposable income) per week have insufficient income to avoid stress.

R6.28 The ACTU claims in R6.26 that questions of choice and other factors are accommodated by the deprivation indicators, as the ABS provided for respondents to answer ‘don’t want it’ and ‘other reasons’ as well as ‘not applicable’ and ‘can’t afford it’. This is not correct, as only six of the fifteen indicators took this form.

R6.29 In paragraphs 6.14 and 6.15 of our submission, the Commonwealth argues that the financial position of low-income earners improved between June 1998 and June 2001, given that they have experienced real wage growth and benefited from the implementation of The New Tax System (TNTS).

R6.30 In paragraph R6.30 of its reply submission, the ACTU contends that ‘once the GST and bracket creep are taken into consideration, many low paid workers were worse off under TNTS. However, the ACTU has failed to consider the fact that low income earners were provided with a compensation package to offset the affect of indirect tax increases. Employees were compensated for the inflationary impact of TNTS through reductions in marginal income tax rates and increases in transfer payments.

R6.31 It is worth noting that the ACTU has previously accepted the argument that tax reform can be a substitute for wage increases as a mechanism for improving the living standards of low-income earners. Under the Accord, the ACTU agreed to sharp declines in real award wage rates, accepting that low income earners would benefit from a decrease in marginal income tax rates.

R6.32 The Commonwealth contends that, in focusing on stress among employees, the ACTU is in fact asking the Commission to neglect its duty under s.88B of the WR Act to take into account standards generally prevailing in the community.

R6.33 The ACTU responds to this contention in its reply submission by comparing financial stress levels of the first quintile of employee income households with that of the first quintile of all households (paragraph R6.31). This comparison reveals a similar level of financial stress.

R6.34 However, in making this comparison, the ACTU is again confusing the issue of low hourly rates of pay and low household income. The use of first quintile employee income households cannot be considered as being synonymous with low wage rates. Many of the workers in these families are part-time employees living in households with high incomes.

### **Part-time and casual employees**

R6.35 In its submission (R2.9), the ACTU criticizes the Commonwealth for its evidence that real wages have increase for all parts of the earnings distribution for full-time adult non-managerial employees. The Commonwealth accepts this criticism but justifies its focus on full-time adult non-managerial employees on the fact that part time and some

casual employees receive less assistance from SNAs, in dollar terms than their full time counterparts. For example a part-time employee who works 10 hours a week would only receive 26.3 per cent of the dollar benefit of any SNA compared to an equivalent full-time employee. In other words, the safety net component of the wages system would give lower paid part time and casual workers little relief.

R6.36 This does not mean that the Commonwealth does not care about the needs of part-time and casual employees. Indeed, poverty rates are considerably higher among part-time employees than full-time employees. Around 29 per cent of all poor Australians live in families where the head is employed full-time. However, in two-thirds of all such cases the head of the family is self-employed, so that relatively few poor Australians live in a family with a full-time wage and salary earner. This highlights the importance of the tax-transfer system for alleviating the hardship faced by such families.

### **The tax transfer system**

R6.37 The Commonwealth welcomes the ACTU's acknowledgement that minimum wages and the social wage are complementary mechanisms for addressing the needs of the low paid. However, in paragraph R6.35 the ACTU wrongly criticises the Commonwealth for not making any concrete proposal to improve assistance to low-income people.

R6.38 The Commonwealth is not asking the Commission to award a \$10 per week increase, rather than the ACTU's \$25 claim, on the basis that a shortfall exists and needs to be topped up through the social wage. To the

contrary, the internationally recognised<sup>6</sup> strength of the Australian social security system is that it effectively targets assistance to those most in need. Furthermore, the adequacy of the social security system is maintained by regular indexation of allowance and pension rates.

R6.39 The Commonwealth therefore does not agree with an implication that might be drawn from the AiG Submission, where it says ‘...employers would like to see the full \$10 going into the pay packets of the low paid...’, that social security rates are inadequate or need to be increased as part of a tradeoff in this year’s safety net review.

R6.40 The Commonwealth does ask the Commission to consider the important implications of the interaction of the social and industrial safety nets. The key point made in paragraphs 6.39 to 6.42 of the Commonwealth Submission is that because of the existing interaction between the social and industrial safety nets, the ACTU’s claim would provide only marginal increases in disposable income to low paid families that remained in work. That is, a wage increase of the order sought by the ACTU would not move anyone out of its definition of poverty, but would seriously disadvantage many families by significantly increasing unemployment.

R6.41 The ACTU fails to acknowledge that the approval of its claim would lead to the numbers of low paid workers being significantly reduced as disadvantaged people lose or are denied employment, thus becoming or remaining unemployed and unpaid. No pay is a far greater contributor to relative poverty than low pay.

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<sup>6</sup> See the following OECD reports: OECD (1998) "Income Distribution and Poverty in Selected OECD Countries", Economics Department Working Paper No. 189, Paris. OECD (2001) "Innovations in Labour Market Policies: The Australian Way", Paris

R6.42 The ACTU's criticism also confuses the respective roles of the Commission and the Commonwealth. The Commission is responsible for the industrial safety net that, as acknowledged by all parties, is complementary to and interacts with the social safety net. The Commonwealth's responsibilities include maintaining an adequate and effective social safety net. As discussed above, it does not agree that the social safety net is inadequate in terms of benefit levels.

R6.43 The Commonwealth accepts that any pay rise is likely to reduce employment and potential employment, and will lead to a greater call on the social safety net and reduced tax payments. However, a modest, carefully targeted, pay rise will provide some assistance to those in work without substantially damaging the job prospects of people out of work, or people seeking work.

R6.44 The Commonwealth also recognises the important contribution which clear financial incentives for paid work can make to improving the well being of those who are jobless or in a precarious position in the workforce, and their families. Indeed, the New Tax System delivered significant improvements in this regard. However, in its December 2000 response to the McClure Report, *Welfare Reform A Stronger, Fairer Australia*, the Commonwealth acknowledged that there were still some areas of concern. The Government's response also said that:

- clear financial incentives for paid work can contribute to people making the best choices in favour of participation - with the New Tax System reforms taking significant steps to improve work incentives, especially for families with children;
- people who work should receive a fair return for their work and have the incentive to increase their earnings; and

- as the necessary research base is developed, the Government will examine further ways to improve work incentives for people on income support.

R6.45 Furthermore, the Government's pre-election policy statement, *Our Future Action Plan, Stronger families and Communities*, included the following statements:

*'... We also want to remove existing disincentives to people moving from welfare dependence to paid work...'; and*

*'... We are also committed to making up-front investments that deliver future returns to taxpayers, as people move from welfare dependence to economic and social participation...'*

R6.46 The ACTU attempts to cast doubt on AiG's statement that '...the receipt of a safety net increase by an employee may result in the employee losing various family assistance and other social security benefits....' (R641). With regard to this issue, the Commonwealth notes that individuals and families in receipt of income tested government benefits will, in certain income ranges, have their benefits reduced when their income increases. Benefits can be completely lost once income exceeds certain cut out points. These features, of course, are part of a well-targeted regime of assistance which helps to ensure that the genuinely needy receive assistance.

R6.47 In attempting to support its view the ACTU refers to various aspects of the social security system. Several of these examples are incorrect or misleading.

R6.48 The ACTU states (R6.41) that '...singles without children and couples without children do not receive social security benefits...'. This

is incorrect. For example, in a childless couple, the unemployed spouse of someone on the FMW can receive unemployment benefits, subject to satisfying the activity test and other benefit requirements. Furthermore, single people working part-time on the FMW can, of course, receive unemployment benefits when their earnings are in the appropriate range and they meet the activity test and other requirements:

- under Section 595 of the Social Security Act 1991, people can be both unemployed and working. It is this section of the Act that allows people to stay on Newstart Allowance while undertaking work that is part-time, casual and/or of short duration; and
- part-time work can be used as one of the means for satisfying the Newstart activity test, with 30 hours per fortnight leading to a reduced job search requirement.

R6.49 The ACTU notes (R6.41) that Family Tax Benefit Part A (FTB A) is reduced at 30 cents in the dollar for incomes between \$29 857 and \$37 108<sup>7</sup>. The implication is that families on FMW rates cannot have incomes in the FTB A withdrawal range. This is also incorrect. For example, a couple where one earner works full-time and the other part-time, both on FMW rates, will have a family income in the FTB A withdrawal range quoted by the ACTU.

R6.50 The ACTU states (R6.41) that ‘...Rent Assistance is paid to people paying private rent and receiving more than the basic rate of FTB A...’ This statement is correct but is misleading by omission. People without dependent children (and therefore ineligible for FTB A) on

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<sup>7</sup> These figures relate to annual *family income* for families with one dependent child aged less than 13. The \$37,108 threshold refers to the income family at which the ‘more than base rate of FTB A’ cuts out for this family. The actual threshold faced by families will vary with the number and age of dependent children

pensions or allowances (but not the Austudy Payment), either single or partnered, also qualify for Rent Assistance, depending on individual circumstances and subject to satisfying benefit income tests and other requirements.

R6.51 The ACTU also states (R6.41) that ‘...Rent Assistance is not affected by the income test until income reaches \$37,108...’ As explained in footnote 7, this threshold applies for a family with one dependent child aged less than 13, and the actual threshold faced by families will vary with the number and age of dependent children.

### **The role of the tax-transfer system in reducing income inequality**

R6.52 We have noted in previous submissions that the source of income is less important to a person’s living standards than its overall level. At paragraph 6.32 of the Commonwealth submission, we demonstrated the effectiveness of the tax transfer system in reducing inequality among employees and their families – addressing the ACTU’s concerns about low paid workers using NATSEM’s latest estimates of the way these cash and non-cash incomes are distributed amongst wage and salary earners.

R6.53 Table 6.1 showed 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.

R6.54 Table 6.2 showed 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.<sup>8</sup>

R6.55 The ACTU criticised the Commonwealth’s analysis – and in particular Table 6.2 in R6.44 to R6.47 saying that ‘the table ... shows starkly the decline in non cash benefits for those on lower incomes ... (compared to Table 4.2 of last year’s submission), for the first quintile, the value of non cash benefits has declined by 15.6 per cent. In comparison, the top quintile non cash benefits have increased in value by 7.1 per cent’.

R6.56 The ACTU criticism is not valid since it presumes the tables presented this year and in the joint Government’s submission last year form part of a time series. They do not. NATSEM has advised us that it is not valid to compare this year’s tables on the split between cash and non-cash income because the data sources and methodology underpinning the

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<sup>8</sup> 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 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.

tables have changes since last year. There are differences in the methods and data used to estimate non-cash benefits, such as health and housing, and differences in the data used to estimate current incomes.

R6.57 The non-cash benefits used in last year's table had been estimated by NATSEM some years ago using a variety of data sources from 1993-94 and earlier. This year, NATSEM used the recently released ABS's estimates of non-cash benefits in 1998-99, which they estimated using the 1998-99 Household Expenditure Survey and a variety of other comparatively recent data sources.

R6.58 Apart from demographic changes and changes in public expenditures which have occurred over the period, there are likely to be some differences in the methods used by NATSEM and those used by the ABS. It should be noted that any differences in non cash benefits will flow into final incomes and into the composition of final income quintiles.

R6.59 There are also differences between the data sources used to estimate cash incomes. Last year, NATSEM used the 1995-96 and 1996-97 Survey of Income and Housing Costs (SIHC's) and this year, the 1996-97 and 1997-98 SIHC's.

R6.60 In summary, each table was NATSEM's best estimate of current incomes at the time. However, due to data limitations and the delays that always occur in receiving the most current data, the one year gap in time between the two tables is actually a much bigger gap when the data which underlies them is considered. Given the number and significance of the changes that have occurred between this year's tables and the tables in last year's submission, NATSEM advise that it would be best not to compare the two tables.

R6.61 This chapter has demonstrated that the ACTU has again not provided any convincing evidence that all award wages should be increased by \$25 per week. The key issue in this case is whether living standards for those directly affected by this Safety Net Review have deteriorated relative to the general community in recent years. The Commonwealth has demonstrated that living standards of low paid workers have not deteriorated since the Coalition took office in 1996 and it has reframed the award system as a wage safety net that complements the broader social safety net. It has shown that the tax-transfer system is a more effective tool than the wages system for containing inequality and eliminating poverty. Nevertheless, the Commonwealth remains concerned about the needs of low-paid workers. That is why it has supported a moderate capped increase of \$10 per week.





## **CHAPTER 7: CAPPING THE SAFETY NET ADJUSTMENTS: IMPACT ON FAMILY INCOME**

### **Overview**

R7.1 In its original submission, the Commonwealth argued that 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.

R7.2 The Commonwealth has argued that the ACTU's latest claim is neither economically sustainable nor consistent with the requirements of the WR Act relating to the adjustment of the award safety net.

R7.3 Beyond the size of the ACTU's claim, the Commonwealth's main objection to the claim is that it would, if granted, deliver wage increases to relatively high paid and skilled employees who we consider should be pursuing improvements in pay and conditions through agreement making.

R7.4 In this context, the Commonwealth has submitted that the Commission should move away from the practice of universal increases across classifications and move the award system decisively towards its intended role as a genuine safety net – through the means of a capped safety net increase.

R7.5 The ACTU criticises this position in its reply submission (paragraph R6.33) – arguing that the cap would mean that a worker earning \$26 500 per annum would receive nothing. Moreover, the ACTU argues that despite ten years of enterprise bargaining arrangements, low

paid workers lack the ability to bargain for increases in wages and conditions.

R7.6 Neither argument provides a basis for an across the board wage increase. While workers \$26 500 would not receive an SNA under the Commonwealth's proposal, many would generally receive assistance through the tax-transfer system, particularly if he or she is the sole family income earner. Second, the argument that low paid workers have not been able to bargain for increases in wages and conditions since the inception of enterprise bargaining arrangements ten years ago is not credible. The degree of earnings mobility amongst wage and salary earners is high – even among (initially) low income earners.

### **The effects of a capped safety net adjustment**

R7.7 There are compelling reasons which demonstrate why a capped increase is one of the most effective ways of maintaining a genuine safety net while at the same time encouraging agreement making. A cap would ensure that the increase is confined largely to low paid workers. On this point the Commonwealth wishes to correct the impression that it agrees with the ACTU's statement<sup>1</sup> that 40 per cent of award only employees earn less than the C10 rate. In referring to this statement in paragraph 7.18 of the Commonwealth submission, it wished to draw the Commission's attention to the fact that even the ACTU evidence shows that the majority of award employees earn more than the C10 rate. The Commonwealth is unable to directly verify the statement because it lacks data on the distribution of non-managerial adult hourly average earnings for award-paid workers, which are used by the ACTU. It has been able to

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<sup>1</sup> [ACTU Written Submission, Living Wage Case, 8 February 2002](#), paragraph 7.29

determine, however, that 43 per cent of adult award paid employees (both managers and non-managers) are paid at less than the C10 rate.

R7.8 Further, a capped increase would limit the flow on of award increases to the formal and informal sectors, again reinforcing the intended purpose of the safety net.

R7.9 In addition, a capped increase will ensure that incentives to bargain are maintained for workers on higher award rates. As the Commonwealth noted in Appendix A of its initial submission, the majority of employees no longer have their wage rates or wage increases determined through the award system. Rather their wages are increasingly provided through certified agreements, Australian Workplace Agreements (AWAs) and other individual agreements, or informal over award arrangements. At the same time, the number of employees benefiting directly from the decisions of the federal and State industrial tribunals in annual Safety Net Reviews is reducing over time. Consistent with the aims of the WR Act, the award system is increasingly becoming a safety net for a smaller (though still significant) number of employees.

R7.10 The Commonwealth's other concern with the ACTU claim is its size. Increased wages – particularly of the quantum proposed by the ACTU – may lead to weaker employment growth or actual job loss among the low paid, generally vulnerable sector of the workforce, particularly as many are employed in industries which are experiencing difficulties, as noted in Chapter 5.

R7.11 A \$10 capped increase would broadly maintain the real C10 level, but would help to minimise overall wage growth, thus reducing the potentially harmful impact of any SNA on the overall economy.

Importantly, it should not discourage employers or employees from entering into workplace agreements.

R7.12 The ACTU argues that a person earning \$26 500 is low paid, and cannot be assumed to have the capacity to bargain for increases through enterprise bargaining<sup>2</sup>. However, the ACTU also argues that ‘the tax-transfer system must complement fair minimum wages for low paid workers’<sup>3</sup>. The ACTU’s argument about the low paid ignores the fact that the tax-transfer system already acts in conjunction with the safety net of award rates.

R7.13 Tables 6.1 and 6.2 of the Commonwealth submission demonstrate that people in the lowest quintiles of the income distribution gain significantly from the cash and non-cash benefits redistributed through the taxation system. Therefore, although in paragraph R6.36 the ACTU argues that a person with earnings of \$26 500 a year may be considered ‘low paid’ by some criterion, earnings are not the only source of a person’s income. Final income depends upon a person’s income arrangements with other people (for example, with family or household members) and the operation of the taxation and social security system.

R7.14 The complementary roles of the wages safety net and the tax-transfer system will help to ensure that a capped SNA would form part of a genuinely progressive redistribution system which also supplements the income of those earning above the C10 rate, according to their circumstances. In addition, wage and salary earners above C10 are more likely to be in a stronger position to negotiate wage increases, and can

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<sup>2</sup> ACTU Living Wage Reply Submission 2002, 20 March 2002, paragraph R6.33.

<sup>3</sup> ACTU Living Wage Reply Submission 2002, 20 March 2002, paragraph R6.36.

benefit from enterprise bargaining rather than universal adjustment of award rates of pay.

R7.15 The second issue which the ACTU ignores is the fact that wage and salary earners do exhibit positive earnings mobility. The Commonwealth has presented evidence on this issue in previous Reviews, such as in the joint Governments' submission to the Safety Net Review 1999-2000, based on ABS Survey of Employment and Unemployment Patterns (SEUP), and also presented research based on this data undertaken by Yvonne Dunlop published by the ABS<sup>4</sup>. Dunlop showed that the majority (55 per cent) of employees who were low paid in September 1995 and who were still employed as a wage and salary earner in September 1996, had higher earnings compared to what they started on (and this appears to reflect promotions rather than just wage rises)<sup>5</sup>.

R7.16 The fact that the majority of low paid workers progress up the earnings distribution means that they are able to gain substantive promotions (if they remain employed). This means that, firstly, SNAs should be moderate so as not to jeopardise the employment prospects of the low paid and, secondly, SNAs do not need to be granted across the board, but are best restricted to those with the least ability to obtain bargained wage rate increases and promotions, that is, the employees on the lower award rates rather than all award dependent employees. Awarding a large across the board increase would diminish the prospects

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<sup>4</sup> [Joint Governments' Submission 1999-2000 Safety Net Review – Wages](#) (printed version), pages 198-202. For a summary and discussion of Yvonne Dunlop's paper see [Joint Governments' Submission 1999-2000 Safety Net Review – Wages](#) (printed version), Exhibit JG 6 Responses to Questions on Notice, Attachment A, pages 428-430.

<sup>5</sup> [Joint Governments' Submission 2000-2001 Safety Net Review – Wages](#) (printed version), pages 50-51.

of employees negotiating their own arrangements as they would be pre-empted by a large SNA.

R7.17 In view of the above arguments, the Commonwealth rejects the ACTU's proposal to extend SNAs to all award rates.





## **CHAPTER 8: THE INCENTIVE TO BARGAIN**

R8.1 A key factor in the Commonwealth submission on the incentive to bargain is that the issue has not been given due consideration in recent safety net review decisions. The lack of a significant response from the ACTU to our submission on this issue is symptomatic of this.

R8.2 The ACTU in its reply submission at R8.15–8.16 contends that there is no need to consider the incentive to bargain as agreement making continues to expand.<sup>1</sup>

R8.3 The continued expansion of agreement making is clear evidence of the success of the WR Act in focussing bargaining at the level of the enterprise. However, it is apparent that in some industries, agreement making has yet to dominate in the settlement of terms and conditions of employment. The Commonwealth reiterates that it is essential that SNAs do not provide a disincentive for the parties to enter into agreement making and that this is particularly of concern in those industries such as hospitality and retail where award reliance remains high.

R8.4 In its reply submission, at R3.1 the ACTU restates that the ACTU claim is consistent with the wage movements of others in the community. Again, the Commonwealth reiterates that it is not appropriate for SNAs to try to reflect the wage movements of others in the community which would, (a) impact severely on the incentive to bargain for employees and, (b) provide wage increases without the productivity or efficiency gains associated with non-safety net wage movements.

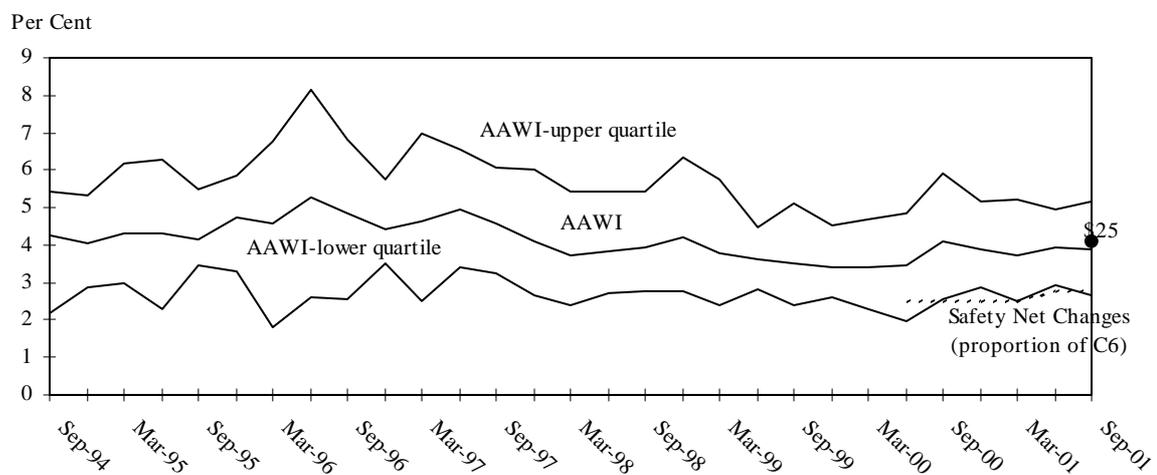
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<sup>1</sup> A second point made by the ACTU in this regard is addressed in Chapter 9 on the wage fixing principles.

R8.5 The ACTU suggests at paragraphs R3.34 and R3.35 of its reply submission that there is something lacking in the Commonwealth's use of C14 and C10 only as examples. In terms of the incentive to bargain, the magnitude of the increase proposed by the ACTU will outstrip the AAWI up to the award level C4 in the Metal Industries Award (currently \$651.20 per week). Below is a chart similar to Charts 8.1 and 8.2 of the Commonwealth submission, that demonstrates the continued impact of the ACTU claim on the incentive to bargain at C6 of the Metal Industries Award. Again, the Commonwealth restates its view that employees at high award rates, above C10 for example, are a well skilled workforce who should be encouraged into agreement making.

R8.6 At R6.33 of its reply submission the ACTU rightly points out that such employees at trade levels requiring skills and experience are receiving weekly wages well below their peers on agreements. The Commonwealth suggests this is all the more reason to ensure there is no disincentive through the SNA for such employees to seek better wage outcomes through agreement making.

**Chart R8.1 A comparison of annual wage increases for federal wage agreements and SNAs and the ACTU's claim as a proportion of C6.**



Source: Workplace Agreements Database





## **CHAPTER 9: THE WAGE FIXING PRINCIPLES**

R9.1 Chapter 9 of the Commonwealth submission presented proposals for three changes to the wage fixing principles and responded to the ACTU claim for retrospective SNAs where twelve months has elapsed since the previous SNA. This chapter will respond to the ACTU reply submission on all four issues.

### **Economic incapacity**

R9.2 At R8, the ACTU reply submission rejects the Commonwealth proposals for changes to the economic incapacity principles but appears to have misunderstood the purpose of the proposed changes.

R9.3 The Commonwealth rejects the interpretation the ACTU has made of the Commonwealth submission in regard to evidentiary requirements. The Commonwealth is not proposing a weakening of evidentiary requirements. The proposal is for evidence to be admissible on a broader scale than previously allowed. Individual employers, particularly small business employers, should be able to present evidence from their industry sector and not have to rely solely on individual business circumstances. Nothing in the Commonwealth proposals for changes to the economic incapacity principle would allow for ‘Special pleading based on bald assertion’ as claimed by the ACTU at paragraph R8.12.

R9.4 The ACTU makes no specific response to the Commonwealth call for small business employers to have an alternative process for economic incapacity applications and did not take up the invitation for a reasoned response to possible avenues of change for small business applications under the principle. The ACTU suggests in general that no change is warranted on the basis of material presented. However it is clearly an

issue of great concern for employer bodies and the particular circumstances of small business should be considered.

R9.5 At R8.9 of its reply submission the ACTU suggests the Commonwealth is making a “breathtaking leap of logic” in asserting the lack of economic incapacity applications indicates inadequacy in the principle as currently articulated. The Commonwealth’s assessment however finds support, for example, in ACCI’s indication that employers and employer associations are saying this is the case. It is also evident from the case histories presented by the Commonwealth (Appendix) and the AHA & MIMMA submissions that the current operation of the principle presents an insurmountable task for many employers, and particularly for small businesses.

### **Special Case applications**

R9.6 The Commonwealth rejects the suggestion by the ACTU at R8.18 of its reply submission that in proposing changes to the special case principles the Commonwealth is attempting to “create a back door route for the processing of economic incapacity arguments”. The Commonwealth proposals are specifically aimed at clarifying the processing of special case applications.

R9.7 In its reply submission, at paragraph R8.17, the ACTU states it is not opposed to the referral by the President of special case matters to a single member rather than a Full Bench. That appears to be the limit of the ACTU convergence with the Commonwealth’s view, noting however, that under the Commonwealth’s proposals a single member would not determine whether a special case exists in relation to any application. In this regard, the ACTU at paragraph R8.19 state they do not accept that there may be circumstances in which applications should be heard and

determined by a single member. The Commonwealth believes this may be a misunderstanding of our proposals. The Commonwealth proposal is intended to ensure there is a determination at some point in the hearing of applications as to whether or not the matter is a ‘special case’ and that this is best determined by the President or a Full Bench.

R9.8 At R8.20 of its reply submission the ACTU suggest the wording of the Commonwealth proposal will “have the consequence that every application for award variation would be referred to the President”. This is not an intended effect of the Commonwealth’s proposals for amending Principle 10. When Principle 10 is read within the context of the wage fixing principles as a whole, the principle would still operate within the limitations of the other principles, notably Principle 2: When an award may be varied or another award made without the claim being regarded as above or below the safety net. As is currently the case, where an application is arguably not within the prescription of Principle 2, or where a party considers the matter should be regarded as a special case, an application should proceed to the President. The Commonwealth is concerned that without further prescription of ‘special case’ applications, determinations on award variations may be inconsistent and unpredictable. The insertion of the wording “of wages and conditions prescribed by the award when the application is made” is to clarify the treatment of those award variations considered above or below the safety net by one party yet consistent with the award by another.

R9.9 The ACTU reply submission fails to address the Commonwealth’s concerns in this regard with any substantive arguments.

## **Incentive to bargain**

R9.10 The ACTU, in reply to the Commonwealth's proposal to reaffirm the 'incentive to bargain' in Principle 1 'Role of Arbitration and the Award Safety Net', contend that agreement making is expanding so there is no evidence of SNAs acting as a disincentive, and the obligations of the Commission in this regard are clear and do not need to be restated.

Chapter 8 of this reply submission deals with the first point made by the ACTU and this chapter responds to the second.

R9.11 The Commonwealth argues that the incentive to bargain has not received due consideration in recent safety net review decisions and this either results from, or reflects, the removal in 1998 of the reference to encouraging bargaining. It was certainly more explicit in the wage fixing principles as articulated in the first SNR to follow the introduction of the WR Act (Statement of principles – Safety net Review – Wages April 1997, Print [S5000](#)). In Chapter 8 of the Commonwealth submission the history of the importance of bargaining, and its development as a separate stream to award determinations was detailed. The ACTU does not respond to the Commonwealth's arguments in this regard except to dismiss them outright. Again, the Commonwealth asserts, this does not give agreement making the emphasis intended by the WR Act and reflected in the Principal Object s. 3(b), s. 3(c) and s. 3(d)(i).

## **ACTU 's proposed changes to Principle 8 'Arbitrated Safety Net Adjustments'**

R9.12 The ACTU reply submission does not provide any evidence of need for such a substantial change to the principles nor does it respond to

the issues in this regard raised by the Commonwealth in other than a limited way.

R9.13 Again, the Commonwealth suggests that if there are systemic delays between the lodging and the hearing of SNA applications, then the ACTU should seek to raise this as an administrative matter with the Commission. Moreover, where delays are the responsibility of individual unions the ACTU needs to take the issue up with those unions.

R9.14 The particular case cited by both the Commonwealth and the ACTU ([PR905754](#)) demonstrates that where delays are not ordinary and where there are substantial merits in determining a retrospective adjustment, the special case principle allows for such adjustments to be determined by the Commission. There is no need for a change to the principles in this regard. The proposed wording of the principle from the ACTU could allow for delays to be exacerbated with unions submitting applications ‘when they get around to it’. Employers would subsequently face significant costs where the SNA is made retrospectively.

R9.15 If the Commission were to seriously considering the ACTU proposal the Commonwealth believes the principle should contain a proviso that there be consent by the relevant parties. The ACTU claims its proposed principle is not dissimilar to that invoked last year to waive the requirement for twelve months to have elapsed between safety net adjustments in certain circumstances. However, the absence of a consent clause makes the proposal fundamentally different. It is also significantly different in that the decision last year to waive the twelve month rule was only in circumstances where no substantive effect flowed from the decision, that is there was no resultant wage increase for employees and

no costs to employers. The current ACTU proposal does not meet such criteria.