Safety Net Review – Wages

2002-2003

Commonwealth
Reply Submission

25 March 2003

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COMMONWEALTH POSITION

Introduction

R1.1 The Commonwealth welcomes the opportunity to respond to the statements, claims and assertions made in the reply submission by the Australian Council of Trade Unions (ACTU) of 17 March 2003.

R1.2 In this reply submission, the Commonwealth reinforces the position taken in its submission to the Safety Net Review – Wages 2002-2003 of 26 February 2003. The Commonwealth is unconvinced by the assertions made by the ACTU that a safety net wages claim for a $24.60 per week increase in all award wage rates is moderate and economically responsible.

R1.3 The Commonwealth's reply submission also provides updates for recent economic data to be taken into account in this case before the Australian Industrial Relations Commission (the Commission).

R1.4 The ACTU reply submission does not address the cumulative impact of safety net increases of the magnitude awarded by the Commission in recent years, including the impact of the current claim.

R1.5 The ACTU reply submission dismisses the evidence presented by the Commonwealth that the safety net wages claim by the ACTU will threaten the employment prospects of vulnerable groups in the labour market, such as the low paid and the unemployed.

R1.6 The Commonwealth submits that the ACTU fails to refute the evidence presented by the Commonwealth that higher minimum wages can lead to lower employment outcomes than otherwise would have been the case.

R1.7 The evidence presented by the ACTU in the paper produced by Dowrick and Quiggan fails to undermine the weight of academic literature that urges caution over both the relative value of the minimum wage and the rate at which it should be allowed to rise.

R1.8 The conclusion reached by the ACTU that the Commonwealth's macro-economic modelling shows that the claim will have no significant effect on the economy is contested. The ACTU conclusion is based on assumptions that the net impact measure expresses the full impact of the claim on wage costs and that the Reserve Bank will not respond if the large claim is granted. These assumptions are contested.

R1.9 The ACTU reply disregards the Commission's role in furthering the Objects of the *Workplace Relations Act 1996* (the WR Act) by attaining high levels of productivity and encouraging agreement-making. The Commonwealth does not support the argument presented by the ACTU that continued growth in bargaining is evidence that safety net adjustments have no impact of the spread of agreement making.

R1.10 The Commonwealth provides further evidence that while agreement making is spreading in award-reliant sectors, high minimum award wage outcomes will negatively impact on the incentive for workplace bargaining.

R1.11 The ACTU reply submission suggests that while the Commonwealth has introduced the Workplace Relations Amendment (Protecting the Low Paid) Bill 2003 (the PLP Bill) into the Parliament, the Commonwealth paid little regard to the needs of the low paid in its submission in this case.

R1.12 To the contrary, the Commonwealth submission dealt extensively with the potential employment impact of the claim by the ACTU for a $24.60 per week increase in all award wage rates and the capacity of employers to meet such an increase.

R1.13 The Commonwealth's position in this case remains that it will not oppose a moderate increase of up to $12 per week in the award rates of the low paid and the increase should apply on the following basis:

- in order to represent a genuine safety net adjustment, it must only be available to award rates up to and including the equivalent of the tradesperson's rate – C10 in the Metal Industries Award – currently $525.20 per week;
- it must apply until the next Safety Net Review and be fully absorbed into all above award payments including from enterprise and informal over-award agreements;
- there must be a twelve month gap between the increase awarded by the Commission in its 2002 decision and any increase decided in this case; and
- if the Commission were to consider awarding an increase of more than $12 per week in the award rates of the low paid, then such an increase should be phased-in over a period of no less than 18 months.

ECONOMIC OUTLOOK

Introduction

R2.1 The Commonwealth, in its submission, argues that although the outlook for the economy is generally bright, a number of downside risks are apparent for the coming months. Uncertainty in the international community resulting from the war on Iraq, uncertainty regarding oil prices and a generally weaker world economy, coupled with the effect of the drought on the domestic front, have the potential to adversely impact on the Australian economy.

Updates for recent economic data

R2.2 Statistical information released since the Commonwealth's submission is consistent with the 2002-03 MYEFO forecasts. The main risks surrounding the outlook for activity and employment continue to be the weak global economic and financial conditions, drought and the extent of moderation in the housing sector.

R2.3 The major ABS data releases since the finalisation of the Commonwealth's submission were the National Accounts — December Quarter 2002, and Labour Force Preliminary — February 2003.

GDP growth

R2.4 Australia's GDP rose by 0.4 per cent in the December quarter 2002, the lowest quarterly growth since December quarter 2000, and by 3.0 per cent over the year. The December quarter GDP growth outcome is consistent with a resilient non-farm economy notwithstanding the worst drought in a century and weak and uncertain global economic and

financial conditions, with the prospect of war and rising oil prices being prominent concerns.

R2.5 The non-farm economy grew by 0.8 per cent in the quarter and by 3.9 per cent over the year. Growth was underpinned by strong business investment and public final demand, with a moderation in the growth of household consumption and dwellings sector.

Productivity

R2.6 Aggregate labour productivity (GDP per hour worked) increased by 0.4 per cent in both the September and December quarters 2002, and by 1.6 per cent over the year to December 2002.[1] However, it is not possible to update the analysis of productivity by industry on a per hour worked basis.

R2.7 A statistical summary, which provides an overview of the key economic releases and the Treasurer's press release on the December Quarter 2002 National Accounts, are provided at Appendix RA and RB respectively.

Labour market

R2.8 In February 2003, employment fell by 12 300 to 9 563 500, partly offsetting the growth evident in preceding months. The unemployment rate was 6.0 per cent (seasonally adjusted data).

R2.9 The ACTU, in its reply submission, highlights the recent strength of the labour market, but it is important to note that employment growth is likely to ease in coming months.

[1] ABS, *National Income, Expenditure and Product*, Catalogue No. 5206.0, December 2002.

R2.10 Leading indicators of the labour market suggest that employment growth will slow around mid-2003. For example:

- the latest results for the DEWR Leading Indicator of Employment point to a possible slowdown in employment growth around that time;[2] and
- in releasing the latest ANZ Job Advertisements Series, ANZ Chief Economist, Saul Eslake, commented that:

  Ordinarily, we would expect reported employment growth to average around 8-10,000 over the next few months, consistent with a marginal rise in the unemployment rate to about 6¼ per cent.[3]

R2.11 The Commonwealth still expects that the labour market forecasts presented in MYEFO will be achieved. Given the uncertain economic situation and the expected slowing in employment growth, it is unlikely that the strong employment results recorded in recent months will continue.

Drought

R2.12 The ACTU cites a range of eminent and respected opinions on what might occur when the drought breaks. Of the six drought related quotes provided by the ACTU, however, only one provides any information as to the likely timing of the breaking of the drought. However, this is by no means certain. The drought has not yet broken and remains a downside risk to the economy.

International uncertainty

[2] DEWR Leading Indicator of Employment, March 2003, released on 12 March 2003.
[3] ANZ Job Advertisement Series, February 2003, released on 3 March 2003.

R2.13 In stating the international uncertainty facing the domestic economy, the ACTU focuses primarily on the risk surrounding a possible war in Iraq in its reply submission.[4]

R2.14 The broader international risks to the world outlook outlined in the Commonwealth submission remain. That is, on top of the international uncertainty associated with a war in Iraq, the risks exist from geo-political tensions, a weaker world economy, volatile global financial markets, vulnerable financial sectors and uncertainty surrounding oil prices.

R2.15 While the balance of the international risks remains on the downside, monetary and fiscal policy in the major economies is accommodative and could underpin a substantial global recovery, once uncertainty abates.

War in Iraq

R2.16 The ACTU argues in its reply submission that it is difficult to assess the impact of a war in Iraq on the Australian economy and implies that the impact of the war is likely to be benign, based on the latest *Economic Outlook* from BIS Shrapnel. The Treasurer is also cited, stating that Australia 'will be affected' but 'will continue to lead'. The implication is that the Australian economy could well be adversely affected by war with Iraq, but not as badly as other countries with less resilient economies.

R2.17 The Commonwealth agrees with the ACTU that it is very difficult to assess the impact of a war on the economy. While BIS Shrapnel might

[4] See, for example, the ACTU Reply Submission, Minimum Wages Case, March 2003, paragraphs R1.2, page 1; R1.3, page 2; and R5.1, page 41.

be quite relaxed about the possible impacts on Australia, many commentators are not. Apart from the fiscal implications, the costs of war are felt by the economy in many different ways, as an article in the *Australian Financial Review* indicates:

> *Higher oil prices, resulting from just the threat of conflict, soak up the discretionary income of households and add to business costs…*
>
> *The war can also have a large impact on consumers and businesses as they grow uncertain about the future. Measures of consumer and business sentiment have fallen sharply in recent months.* [5]

R2.18 While the Australian economy is better equipped than most countries to cope with the impact of the war, it would be irresponsible to ignore the potential for adverse economic circumstances arising from a war in Iraq.

Conclusion

R2.19 The range of uncertainties present in the current international and domestic environment warrant careful consideration in this case. An increase in all award rates of the magnitude proposed by the ACTU would be damaging to the national economy. On the other hand, a more moderate increase would better equip the Australian economy to weather the international and domestic uncertainties and help to sustain strong economic growth.

[5] C Murphy, 'Australia's bill tipped at $700m' *Australian Financial Review* , 24 March 2003, page 15.

WAGES AND EARNINGS DEVELOPMENTS

R3.1 The ACTU states it is significant for the case that growth in the Wage Cost Index (WCI) in the year to December 2002 was the same as for the year to December 2001 at 3.4 per cent.[1]

R3.2 It should be noted that wage growth decreased through 2001, with the WCI falling from 3.7 per cent in the year to March 2001 to 3.4 per cent in the year to December 2001.

R3.3 In 2002, wage pressures have been increasing, with growth in the WCI rising from 3.1 per cent in the year to March 2002 to 3.4 per cent in the year to December 2002.

R3.4 The Reserve Bank in its Statement on Monetary Policy for February 2003 commented:

> *Consistent with the recent tightening in the labour market, signs have emerged that the wage cycle has passed its trough, although most labour cost indicators suggest that wage pressures remain generally moderate.*[2]

R3.5 In Section 3 of its reply submission, entitled 'Wages Update', the ACTU repeats the same assertions contained in its submission in an attempt to justify the use of AWOTE as a benchmark for community wage movements.[3] The arguments in the Commonwealth's submission address the inadequacies of AWOTE and set out the case for using the

[1] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R1.14, page 4.
[2] Reserve Bank of Australia, *Statement on Monetary Policy*, February 2003, page 47.
[3] ACTU Written Submission, Minimum Wages Case, 5 February 2003, paragraph 3.49 to 3.63, pages 33-38.

WCI as an indicator of wage movements.[4] Advice from the ABS is repeated:

> *The Average Weekly Earnings series does not provide a reliable indicator of changes in wage rates, as it is significantly affected by compositional shifts in the workforce.*
>
> *Users who require a reliable measure of change in wage and salary rates should refer to the quarterly Wage Cost Index series (results published in Catalogue no. 6345.0), which directly measure changes in wage and salary rates each quarter.*[5]

R3.6 The ACTU also makes some claims in this part of its reply submission that should not go unchallenged. The Commonwealth does not go to great lengths to demonstrate that AWOTE is 'an inferior measure of community wage movements' because AWOTE is not a measure of wage movements. It is an earnings measure, subject to compositional changes as well as changes in wage rates, and is reported as such by the Commonwealth, along with AENA. Both these measures of earnings growth are volatile. To the extent that AWOTE is 'preferred', this only highlights the dearth of reliable measures of earnings growth, or the fact that there was no measure of wages growth prior to the introduction of the WCI.

R3.7 A major factor in the faster increase in AWOTE compared to C14 and C10 over recent years has been the increasing proportion of higher skilled, higher paid workers; which raises AWOTE without any change in relative pay rates. The C14 and C10 rates have kept pace with the WCI

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[4] Commonwealth Submission, Safety Net Review – Wages 2002-2003, paragraph 3.26 to 3.40, pages 18-19.

[5] ABS, *Average Weekly Earnings* (Preliminary), November 2000 (Cat. No. 6301.0).

over the last five years, which, like award rates, reflects the wage rates received for performing the same tasks at the same skill level. The relationship between C14 and AWOTE is therefore of little relevance.

R3.8 The ACTU seeks to make much of the decline in the relative earnings of the low paid since 1983. It should be noted that low paid workers have fared much better through the Safety Net Review process than they did in the preceding years. Full-time workers at the lowest 10th percentile experienced a 3.1 per cent real earnings decline between 1983 and 1996, compared to a 5.2 per cent real increase between 1996 and 2002. Award-reliant workers have also benefited over this period, particularly the lowest paid.

- Over the six years to December 2002 the C14 rate grew by 23.5 per cent in nominal terms and 6.0 per cent in real terms.

R3.9 The ACTU claims that the Commonwealth 'appear [sic] to be suggesting that the slight rise in the WCI measure during [the September and December quarters] has been solely the result of last year's Safety Net decision'.[6] This is not correct. The Commonwealth has simply quoted from the ABS, part of which the ACTU has also quoted, and made the following comment, which summarises the quotation:

> *[t]he last safety net adjustment has made an important contribution to wages growth in the December quarter of 2002, and, by implication, in the September quarter also.*[7]

R3.10 The Commonwealth contends that the aggregate increases in award rates over recent years have been unduly large, and have exerted a major cumulative negative impact on firms, as Section 6 of this

[6] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R3.7, page 18.

submission explains. This has resulted in lower employment levels than would have otherwise occurred. Ongoing wage restraint, with moderate increases in award wages in line with the Commonwealth's submission, coupled with the further spread of enterprise bargaining could contribute to further falls in the unemployment rate below its current level of 6.0 per cent.

[7] Commonwealth Submission, Safety Net Review – Wages 2002-03, paragraph 3.40, page 21.

WAGE AND EMPLOYMENT TRADE-OFF

R4.1 The substantive points raised by the ACTU concerning this topic relate to productivity issues. These points have therefore been addressed in Section 8.

MINIMUM WAGES AND EMPLOYMENT

Introduction

R5.1 Section 5 of the Commonwealth submission demonstrated that increasing award rates is likely to lead to employment losses. It established that the job security of the low paid is most at risk, as the minimum wage is already set at a comparatively high level in Australia.

R5.2 The Commonwealth made these points in highlighting the weaknesses and omissions in Dowrick and Quiggin's survey of the literature on minimum wages.

R5.3 It is therefore surprising that the ACTU claims, in its reply submission, that 'no opposing party has provided cogent evidence to counter the conclusions drawn by Professors Dowrick and Quiggin in their survey'.[1]

Survey of academic studies

R5.4 Dowrick and Quiggin in fact failed to draw any definitive conclusions from the vast body of economic literature surveyed on the link between employment and minimum wages. As the ACTU points out in its reply submission, Dowrick and Quiggin simply conclude that the econometric studies 'yield ambiguous results'.[2]

R5.5 It is true that no complete consensus has been reached by economists in regard to this debate. Indeed, an absolute consensus is rarely present in any discipline. However, the weight of evidence with respect to this issue clearly favours the Commonwealth's position. As the ACTU concedes in its reply submission, only '30 per cent of US and

[1] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.48, page 77.
[2] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.42, page 75.

other OECD studies do not find any significant negative relationship between employment and minimum wages'.[3] Therefore, the majority of academic studies (around 70 per cent) have found a statistically significant negative relationship.[4] The ACTU has not refuted this fact in its reply submission.

R5.6 In their paper, Dowrick and Quiggin also made the claim that 'the work of Card and Krueger, and subsequent studies using similar methods suggest that, in some cases, increases in minimum wages may have no effect, or even a positive effect, on unemployment'.[5]

R5.7 The Commonwealth demonstrated that Dowrick and Quiggin failed to consider the extensive body of formally published studies that identify shortcomings in Card and Krueger's analysis. Critics have challenged both the methodology underpinning Card and Krueger's analysis, as well as the applicability of their results to other countries. The ACTU response to these criticisms is to simply ignore them.

R5.8 The ACTU has also disregarded the caveats made by Card and Krueger in relation to their own findings. Card and Krueger acknowledge that their findings cannot be applied to countries with a substantially higher minimum wage than the United States. In fact, they emphasise the fact that employment losses can result from increases to a minimum wage already set at a high level.[6]

R5.9 As the Commonwealth established in Section 5 of its submission, Australia's minimum wage is amongst the highest in the OECD. This is

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[3] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.42, page 75.
[4] Commonwealth submission, Safety Net Review – Wages 2001-02 (printed version), pages 33-34.
[5] ACTU Composite Exhibit, Tag 8, page 103.
[6] D Card and A Krueger, *Myth and Measurement – The New Economics of the Minimum Wage*, Princeton University Press, Princeton, 1995, page 393.

acknowledged by Card and Krueger.[7] The 'bite' of Australia's minimum wage, that is, the relative value of the minimum wage to the median wage, is 57.9 per cent. This compares to a 'bite' of just 36.4 per cent in the United States. Therefore, Australia is not a country to which Card and Krueger's findings are applicable. This fact has not been disputed by the ACTU in its reply submission.

R5.10 In this context, it is also worth noting that the minority of recent international studies (around 30 per cent) which do not find a statistically significant negative relationship between employment and minimum wages were for countries with a lower 'bite' in their minimum wage than Australia. Therefore, the results of these studies can not be applied to the Australian context.

Australian studies

R5.11 Australian studies tend to focus on the link between aggregate real wages growth and employment. In this respect, they are more relevant to the Safety Net Review, which applies to award paid employees across the earnings distribution.

R5.12 However, Australian aggregate wage studies do have a key limitation, which is ignored by the ACTU in its reply submission. As Dowrick and Quiggin point out, Australian aggregate wage studies do not distinguish between the impacts on 'workers whose wages (or potential wages) are directly affected by the safety net increase and those workers whose pay is above the minimum'.[8] Given that a large proportion of award workers possess relatively few marketable skills, it is likely that elasticity figures would be more negative for workers who receive safety net increases.

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[7] D Card and A Krueger, *Myth and Measurement – The New Economics of the Minimum Wage*, Princeton University Press, Princeton, 1995, pages 240-241.
[8] ACTU Composite Exhibit, Tag 8, page 106.

R5.13 The Commonwealth submission refers to a paper by Lewis and MacDonald, which reviews a range of Australian studies into the link between employment and real wage growth in Australia.[9]

R5.14 Based on their review of these studies, Lewis and MacDonald conclude that 'the results for Australia suggest an employment elasticity with respect to real wages of approximately -0.6 to -0.8, at the higher end of the scale of elasticities for other countries'.[10]

R5.15 This conclusion was not disputed by Dowrick and Quiggin. However, in its reply submission, the ACTU claims that 'Lewis and MacDonald cite studies with estimates ranging between -0.4 and -0.8 with only a minority of [sic] the upper end of -0.8'.[11]

R5.16 The Commonwealth submission[12] also cited Lewis and MacDonald's own estimate of the employment elasticity with respect to real wages in Australia, which was -0.8 per cent over the period of 1959 to 1998. Referring to the Lewis and MacDonald paper in its reply submission, the ACTU claims that 'Dowrick and Quiggin comprehensively demonstrate [the Lewis and MacDonald paper] suffers significant and fundamental flaws'.[13]

R5.17 While Dowrick and Quiggin are noted Australian economists, so too are Lewis and MacDonald. The Lewis and MacDonald paper would have been formally refereed before publication in the Economic Record, and has been open to peer review and criticism. As far as we can ascertain there have been no follow-up papers addressing their work,

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[9] P Lewis and G MacDonald, 'The Elasticity of Demand for Labour in Australia', *The Economic Record*, March 2002, Vol 78, No 1.
[10] P Lewis and G MacDonald, 'The Elasticity of Demand for Labour in Australia', *The Economic Record*, March 2002, Vol 78, No 1, page 20.
[11] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.46, page 76.
[12] Commonwealth submission, Safety Net Review – Wages 2002-03, paragraph 5.29, page 41.
[13] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.43, page 75.

critical or otherwise. It appears that Dowrick and Quiggin's criticisms have not been aired in the academic literature.

R5.18 Dowrick and Quiggin's critique of Lewis and MacDonald has two main findings. Firstly, it is claimed that the Lewis and MacDonald elasticities apply to nominal wages, not real wages as stated in their paper. If this is correct, then the impact on employment would presumably be greater, because nominal wages growth will be higher than real wages growth, unless there is a period of deflation.

- The larger the increase in wages to which the elasticity is applied, the greater the resulting loss in employment will be.

R5.19 The second criticism relates to the interpretation of one of the regression coefficients from Lewis and MacDonald's estimated equations. Dowrick and Quiggin place a different interpretation than do Lewis and MacDonald on this estimated coefficient, and claim that as a result of this different interpretation, it is not possible to estimate the employment elasticity with respect to wages. They do not offer any opinion on whether the elasticity estimate is too high or too low.

R5.20 In its reply submission the ACTU claims that Lewis and MacDonald's results refer to 'real average wages', and say nothing about the impact of increases in the minimum wage.[14] This demonstrates a lack of understanding of Dowrick and Quiggin's analysis, which claims that Lewis and MacDonald's results do in fact apply to nominal, not real wages.

R5.21 As regards the use of average wages, both the Commonwealth and ACTU costings are based on estimating the impact of award increases on average wages, which will increase by 0.51 per cent according to the

[14] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.45, page 76.

Commonwealth submission.[15] Most of the ensuing reduction in employment opportunities will occur in low paid employment, where awards have most impact. [16]

R5.22 In addition, it is noted that 56 per cent of employees on youth wages are on awards, and the Productivity Commission has estimated that the employment elasticity with respect to wages for youth is 2 to 5 per cent[17], considerably higher than Lewis and MacDonald's estimate. It is therefore possible that an increase in award wages could have a greater negative impact on employment than an across the board increase in average wages.

R5.23 In summary, the ACTU has not established through Dowrick and Quiggin's review that wage increases will have less of a harmful effect on employment than that estimated by Lewis and MacDonald.

R5.24 Despite ignoring the range of evidence presented in the Commonwealth submission, the ACTU criticises the Commonwealth for not responding to 'the reference to Gregory and Duncan' contained in the Dowrick and Quiggin paper.[18] This 'reference to Gregory and Duncan' is actually contained within a quote from a separate author in the Dowrick and Quiggin paper.[19] It was not cited by Dowrick and Quiggin in their bibliography.

R5.25 The Gregory and Duncan paper was published 22 years ago. It studies the impact of the relative increase of female wages across the occupational spectrum in the early 1970s on the gender composition of employment. The Commonwealth in fact did respond to the findings of

[15] Commonwealth submission, Safety Net Review – Wages 2002-03 (printed version), page 45.
[16] See for example *The Economics of the Minimum Wage*, P Lewis, page 5.
[17] Productivity Commission, *Youth Wages and Employment*, 1998, page 65.
[18] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.43, pages 75-76.
[19] ACTU Composite Exhibit, Tag 8, page 105.

this paper, back in its 1996-97 submission, after the ACTU used the paper as evidence during the Safety Net Review case that year.

R5.26 The Commonwealth pointed out that the Gregory and Duncan findings suggest that the equal pay decision did have a small adverse impact on female employment.[20] Moreover, the findings reflected the particular characteristics of the female labour market at the time the equal pay decisions were made, in particular the high degree of occupational segmentation.[21] The study has limited relevance to this Safety Net Review, which is concerned with the employment impact of a sizable increase in award wages on low paid workers in the year 2003.

Conclusion

R5.27 The ACTU has failed to establish that a large safety net increase will have a benign effect on employment. This is reflected by its inability to respond to the two main conclusions of Section 5 of the Commonwealth submission. These two conclusions, which clearly can not be refuted, are as follows:

- Even the most strident advocates of raising the minimum wage acknowledge that there are adverse employment consequences if the minimum wage is set too high and/or allowed to rise too fast. In Australia, the federal minimum wage has grown strongly in recent years and is currently amongst the highest in the industrialised world.

- The group in receipt of a safety net increase are more likely to face unemployment than others in the labour force. As unemployment has dire consequences on the welfare of families, this is an important consideration in this Safety Net Review.

[20] Commonwealth submission, Safety Net Review – Wages 1996-97 (printed version), pages 148-149.
[21] Commonwealth submission, Safety Net Review – Wages 1996-97 (printed version), page 149.

ESTIMATED EMPLOYMENT IMPACT

Introduction

R6.1 In its reply submission, the ACTU has failed to adequately address the Commonwealth's position on several issues concerning the economic impacts of its claim for a $24.60 safety net adjustment.

R6.2 It has not addressed the Commonwealth's arguments concerning the validity of the gross estimates of the direct wage cost impact of the claim. It has wrongly dismissed the substantive evidence in relation to the likely significant indirect costs of the claim. It has misunderstood several key aspects in the modelling of the wider impacts on employment and economic growth.

R6.3 This section deals with the ACTU's comments on each of these issues.

The direct cost of the ACTU's claim

R6.4 The Commonwealth has estimated that the ACTU's claim, if granted, would lead to a very significant increase in average wage levels of 0.51 per cent. The ACTU's gross estimates are broadly similar.

R6.5 The ACTU defends its use of the much smaller net measure by reference to the Commission's decision in last year's Safety Net Review.[1] That decision stated that:

> *…in assessing the likely impact of the proposals currently before us against the present levels of relevant economic indicators, it is appropriate to consider the net impact on aggregate wages growth.* [2]

[1] ACTU Written Reply Submission, Minimum Wages Case, March 2003, paragraph R4.4, page 26.
[2] Safety Net Review- Wages, 2 May 2002, Print PR002002, paragraph 100.

R6.6 The Commonwealth is not challenging the ACTU's figure for the net impact, putting aside the issue of adjustment for the flow, which the Commonwealth maintains is not warranted.

R6.7 The Commonwealth disagrees strongly, however, with the view that the gross impact measure is not relevant to an assessment of the economic impact of the ACTU's claim.

R6.8 Simply referring to past decisions is not a sufficient response from the ACTU to the Commonwealth's arguments regarding this matter. The Commonwealth submission discussed the merits and the ramifications of both the gross and net measures to a much greater extent than has been done in past Safety Net Review decisions.

R6.9 In doing so, the Commonwealth provided a number of cogent reasons why gross increases in wage levels are likely to have an important influence on firms' decisions and employment levels.

R6.10 At this point it is worthwhile noting the ACTU's view that on-costs will increase in proportional terms,[3] with a wage increase. The Commonwealth was not arguing otherwise. Its concern is that additional on-costs will be added to the wage increase in firms' assessment of the higher cost of labour relative to the value of its product. Consequently, increases in on-costs are relevant to an assessment of the economic impact of the claim.

R6.11 The Commonwealth also pointed to the danger that past wage decisions may be viewed as a floor for future increases, creating expectations that may influence wage and price setting within and beyond those sectors where award reliance is important.

[3] ACTU Written Reply Submission, Minimum Wages Case, March 2003, paragraph R4.9, page 27

R6.12 The ACTU has not provided a genuine critique of these important points made by the Commonwealth. Rather, it appears to simply dismiss them as "introductory neo-classical economic theory".[4] In doing so, the ACTU completely ignores both the well-grounded status of these points within the discipline of economics and their importance for the Commission's decision in this case.

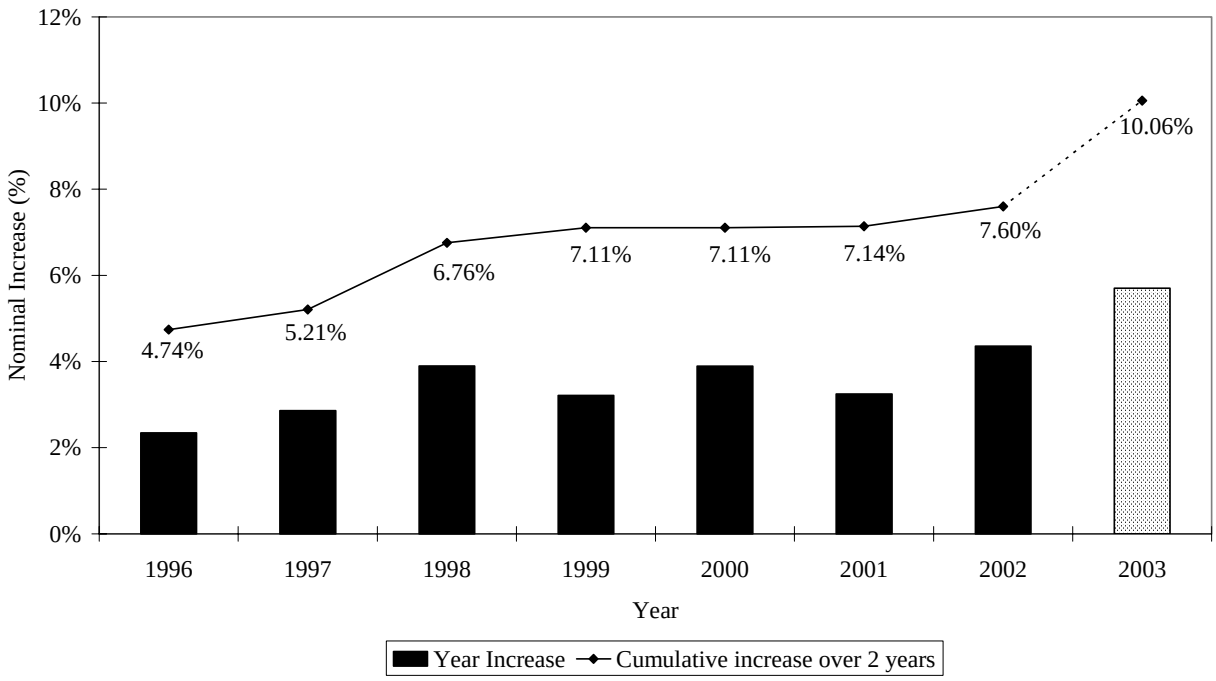
Cumulative impact of safety net increases

R6.13 The Commonwealth also argues that firms will find it especially difficult to absorb a succession of large increases. Figure R6.1 illustrates the cumulative impact of safety net increases. It shows, in nominal terms, both the annual increase in the FMW and the combined increase arising from each pair of successive safety net adjustments. It highlights two key features in the nature of safety net adjustments viewed over time.

R6.14 First, as the bold line in Figure R6.1 indicates, there has been a clear tendency for safety net adjustments to increase over time. However, as the columns in the graph suggest, this tendency has been moderated, to some extent, by smaller increases, following comparatively large ones. In 1999, for example, the Commission awarded an increase of $12, after awarding $14 in 1998. Similarly, in 2001, it granted a more moderate increase of $13, compared to the $15 granted in 2000.

[4] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R1.17, page 5.

Figure R6.1: Nominal yearly and two-year increases in the FMW due to safety net adjustments, 1996-2003



R6.15 In handing down each of these more moderate decisions, in 1999 and 2001, the Commission identified uncertainties surrounding global economic growth and recent falls in the growth of the domestic economy as influencing factors.[5] In its 1999 decision, it explicitly paid regard to the amount of the increase awarded the previous year.[6] The Commonwealth is of the view that it is similarly important to pay regard to the recent history of safety net adjustments. This should be reflected in the Commission's Safety Net Review decision this year.

R6.16 The $18 per week increase awarded in last year's decision was the largest increase since 1996. If the ACTU's claim of $24.60 per week in all award rates were to be granted in full, this year, it would represent a cumulative two year increase of 10.1 per cent or $42.60. The $18 claim

[5] Safety Net Review – Wages April 1999, Print R1999, paragraphs 20, 23, 29 and 87; Safety Net Review – Wages May 2001, Print PR002001, paragraphs 66, 67 and 128.
[6] Safety Net Review – Wages April 1999, Print R1999, paragraph 87.

submitted by the State and Territory Governments represents a cumulative two year impact of 8.72 per cent or $36.00. In each case the result would be a stark jump over previous cumulative rises. Such a large and unprecedented cumulative increase would have an adverse impact on the wages bill, and, in turn, the hiring and firing decisions of individual employers. Employers' capacity to accommodate a succession of large increases would be severely tested.

R6.17 Accordingly, the Commonwealth reiterates the view that the decision made in this year's proceedings must take into account the significant increase granted last year. This provides further compelling reasons for the Commission to exercise caution in responding to ACTU's claim.

Indirect cost of the claim

R6.18 The ACTU's reply submission, at R4.11 – R4.15, attempts to dismiss the impact of flow-on of safety net adjustments to agreement covered employees. While difficult to quantify, the flow-on into agreements does occur and deserves the Commission's consideration when assessing the economic impact of an increase. Regarding agreements that either automatically or conditionally provide increases in line with safety net increases, there is no reason to assume that the rate of their occurrence in federal certified agreements would not be reflected in the State jurisdictions.

R6.19 The ACTU attempts to quantify the 'minimum number of employees' that would almost certainly receive either a full or partial flow on of the safety net increase. This 'minimum number of employees' approach applies the proportion of employees under automatic safety net adjustment provisions (1.4 per cent) to the proportion of Australian employees whose pay method is a federal or State collective agreement.

This gives a figure of 0.5 per cent of non-farm Australian employees who would receive automatic safety net increases through agreements – almost 40 000 employees.

R6.20 This 'minimum number of employees' approach then obtains the sum (10.1 per cent) of the two groups of employees with any type of conditional safety net adjustment provision. It is then estimated that 14 per cent of these employees are on first time agreements and would be the most likely to have wage rates fairly close to award rates and be affected by a flow-on. This gives a further figure of 0.5 per cent of non-farm Australian employees who would be likely to receive safety net increases through conditional provisions in their agreements – a further estimated 40 000 employees.

R6.21 The Commonwealth emphasises that under this 'minimum number of employees' approach an estimated 80 000 employees would be extremely likely to receive safety net increases through their agreements. This excludes all other employees for whom such increases are possible but less likely. Many of these excluded employees, however, are on second or third agreements that have only just kept pace with award wage movements and are in industries where agreement wages are very close to award wages.[7] For such employees a large safety net increase may trigger a flow-on effect.

R6.22 At R4.29, the ACTU reply submission incorrectly seeks evidence of the safety net flow-on in the average annualised wage increases (AAWIs) for federal certified agreements. The increases that flow-on to employees covered by agreements will not be reflected in AAWI data. The AAWIs for quantifiable wage agreements are calculated when agreements are certified, at which time future safety net increases

[7] See, for example, R8.16 – R8.18 in Section 8 of this submission and Commonwealth submission, Safety Net Review – Wages 2001-2002, paragraphs R4.10 – R4.16, pages 206-209.

are not known. AAWIs are not calculated for agreements containing flow-on provisions, rather they are regarded as non-quantifiable wage agreements and do not contribute to estimated aggregate wage increases.

R6.23 It is clear from the employer submissions that there is a significant level of concern over the impact of safety net flow-ons that arise from formal and informal agreements. Bargaining agreements have been made that will pass on the safety net increase and if this increase is anything other than moderate there will be a significant further cost impact.

Macroeconomic Modelling

R6.24 More than once in its reply submission, the ACTU argues that the lack of a clear and adverse change in economic and labour market indicators shows that award wage increases are benign.[8] It is not possible, however, to draw such a conclusion from a simple observation of historical developments. The large number and wide range of diverse influences on specific economic indicators will usually obscure the impact of wage increases.

R6.25 The Commonwealth has presented the results of macro-economic modelling that isolates, in an illustrative way, the specific effects of the ACTU's claim.

R6.26 In its reply submission, the ACTU has made a number of comments on this modelling,[9] to which the Commonwealth now responds.

R6.27 The ACTU states that the Commonwealth's modelling shows that if the entire impact of the ACTU's claim is modelled then the results

[8] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraphs R1.16 and R6.48, pages 5 and 77.

imply the economic impact on GDP, employment and unemployment is negligible. The Commonwealth disagrees. The results of two models — the TRYM and the Murphy Model — suggest that the ACTU's claim would cost between 9 000 and 10 000 jobs by the June quarter of 2005, even with no interest rate response. With a modest interest rate response of 25 basis points, the employment loss would be between 16 000 and 17 000 jobs.

R6.28 The ACTU suggests that the results of the Commonwealth's modelling are influenced by 'unrealistic assumptions regarding the size and rapidity of feedback wage effects'.[10] In fact, the two models used by the Commonwealth make quite different assumptions about the feedback of wage effects. Nevertheless, both models provide similar estimates of the macroeconomic impact of the ACTU's claim on employment and economic growth.

R6.29 The ACTU suggests that there is an element of double counting in relation to the modelling in the Commonwealth's submission. This is not correct. The modelling compares the results from a baseline simulation corresponding to no safety net review increase, with the results from an alternative simulation corresponding to the ACTU's claim. If the modelling results were trying to forecast the state of the economy, the underlying wage assumptions under the baseline would be important. However, the modelling is trying to isolate the potential macroeconomic impact of the ACTU's claim. For this purpose, in models like the TRYM and the Murphy Model, that are close to linear, the exact baseline assumptions do not matter. Rather, the estimated impact depends only on the difference between the wages assumptions made in the two

[9] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraphs R6.2-R6.8, pages 66-67.
[10] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.6, page 67.

simulations. Consequently, the baseline simulation can be regarded as corresponding to no safety net increase.

R6.30 The modelling in the Commonwealth submission compares the impact of the ACTU's claim against a zero safety net adjustment outcome. In its reply submission, the ACTU implies that this change from the Commonwealth's approach in previous submissions of comparing the ACTU's claim against the Commonwealth's position is designed solely to increase the estimated macroeconomic impact. The different approach was not adopted for this reason.

R6.31 The nature of the difference that is being modelled reflects the inherent features of the Commonwealth's position. The Commonwealth is not supporting a particular dollar outcome for this Safety Net Review. The Commonwealth's position is that it will not oppose a moderate increase of up to $12 per week in the award rates of the low paid.

R6.32 At paragraph R6.8 the ACTU argues that its claim would lead to an increase in real wages that is below the average rate of productivity increase over the last decade (2.1 per cent). This overlooks the fact that, for individual firms, any nominal award wage increase in excess of productivity increases unit labour costs, and hence will have a negative impact on those firms, and therefore on employment and the economy more generally.

Conclusion

R6.33 The ACTU has clearly failed to address the Commonwealth's substantive arguments that the claim of $24.60, if granted, would add significantly to labour costs and have a detrimental effect on employment and economic growth.

R6.34 The adverse economic impacts of the ACTU's claim are especially stark when viewed in terms of the cumulative effect arising from the relatively large increase awarded last year.

R6.35 Given the current economic uncertainties, the likely adverse economic impacts of the ACTU's claim provide sound reasons for the Commission to take extra caution in this year's Safety Net Review.

SECTORAL IMPACT

Introduction

R7.1 In its reply submission, the ACTU claims that 'the Commonwealth has failed to demonstrate any impact on employment growth in award dependent sectors as a result of safety net review increases'.[1] The ACTU goes on to claim that the Commonwealth relies on 'neo-classical assumptions' to find that minimum wages have an adverse impact on employment, but this is 'not sustained by the evidence'.

R7.2 The Commonwealth has shown elsewhere[2] that virtually all of the studies into the relationship between minimum wages and employment that are applicable to Australia find that such a relationship exists, and that it is negative. This section builds on the Commonwealth submission to demonstrate a strong negative relationship between growth in award reliance and employment growth.

The industry dimension of the claim

R7.3 In its submission, the Commonwealth noted that the effect of the safety net adjustment would be expected to vary across industries subject to the award reliance of industries.[3] While the proportion of total employees covered by awards declined from May 2000 to May 2002, the proportion of employees covered by awards increased in seven of the sixteen industries, suggesting the incentive to bargain has diminished in these industries. Another large safety net increase similar to that granted last year could further reduce the incentive to bargain.

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[1] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.15, page 69.
[2] Commonwealth Reply Submission, Safety Net Review – Wages 2002-2003, paragraph R5.10, page 21.
[3] Commonwealth Submission, Safety Net Review – Wages 2002-2003, pages 63 to 67.

R7.4 The negative impact of award increases on employment by industry will not always be obvious because there are many other factors which impact on industry output and employment. These include productivity growth, consumer preferences, income levels, trade exposure and the speed with which industries can adjust to change.

R7.5 In its submission, the ACTU noted that over the period May 1996 to November 2002 the three highest award-reliant industries had above average employment growth and the three lowest award-reliant industries had below average employment growth. On this basis the ACTU claimed that 'there is clearly no identifiable impact of the decisions of the Commission on these employment growth figures'.[4]

R7.6 It should be noted that of the three highest award-reliant industries, only one (Accommodation, cafes and restaurants) has more than half its employees on awards, and could therefore be considered truly award-reliant. Of the other two most award-reliant industries, Retail trade has 35.8 per cent of employees on awards, and Health and community services, 31.1 per cent. These industries are therefore significantly impacted by collective and individual pay setting methods, as well as awards.

R7.7 The Commonwealth submission noted that part of the reason for the lower employment growth in the least award reliant industries was due to higher productivity growth. There is a trade-off between productivity growth and employment at the industry level, at least in the short term, but productivity growth is essential in order to make Australian industry internationally competitive.

[4] ACTU Written Submission, Minimum Wages Case, 5 February 2003, paragraph 6.14, page 94.

- This has also resulted in better quality, more affordable goods and services for Australians, and the freeing up of resources for other industries.

R7.8 Contrary to the ACTU's contention,[5] the Commonwealth is not claiming that productivity concerns should be elevated above those related to employment. Productivity is an issue, however, in determining the affordability of safety net increases.

R7.9 The Commonwealth also sought to explain how on the one hand employment could be negatively affected by large increases in award wages, while on the other hand employment could grow strongly in industries with the highest award reliance. It was shown that in two of the three most award reliant industries, employment increases were associated with declining numbers of employees on awards because award reliance in these industries declined.

- Between May 2000 and May 2002 the total number of employees in Accommodation, cafes and restaurants and Health and community services increased by 68 300, but the number covered by awards declined by 40 700.

R7.10 The ACTU states in its reply submission that 'this selective example establishes no causal link'.[6] While causality may be difficult to show, this decline in award employees offers no support for the ACTU position that award coverage has no negative impact on employment.

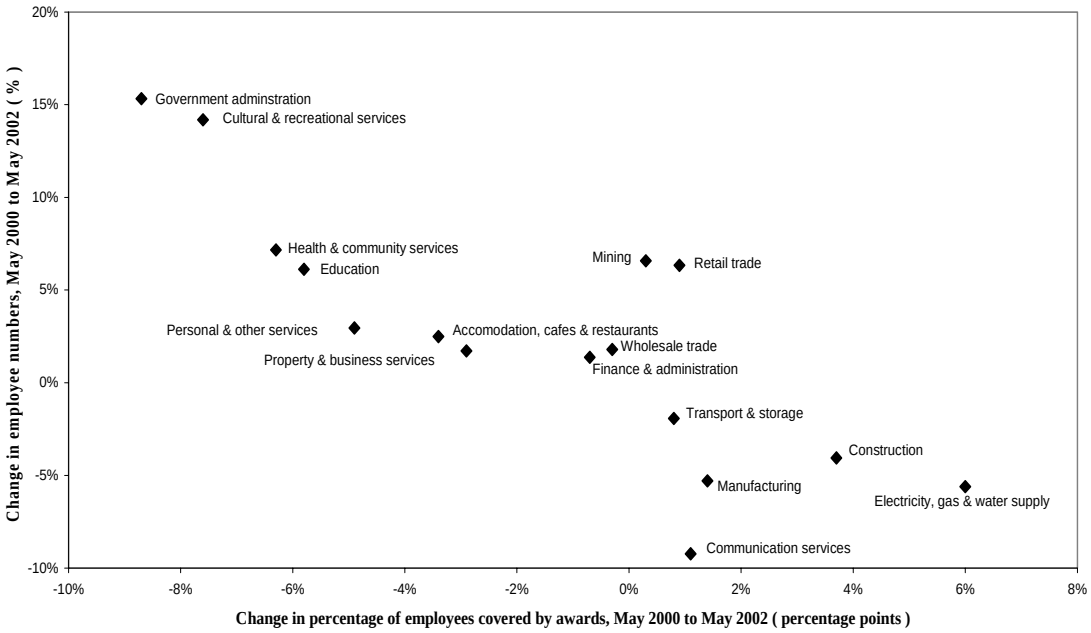
R7.11 In order to address the ACTU's point that this analysis is selective, it is extended below to cover the sixteen industries for which

[5] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.12, page 69.
[6] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.13, page 69.

award coverage data are available. The chart below plots the percentage point changes in award reliance against percentage changes in employment by industry over the period May 2000 and May 2002. This demonstrates a strong negative association between the two series:

- for those industries in which award reliance increased, and the impact of safety net adjustments consequently increased, employment growth was slower; and
- for those industries in which award reliance decreased, and the impact of safety net adjustments consequently decreased, employment growth was higher.

Figure 7.1: Comparison of changes in award coverage with changes in employment growth by industry, May 2000 to May 2002



R7.12 This negative relationship between changes in award reliance and employment growth has been quantified using regression analysis. This shows that the relationship is significant, with changes in award coverage accounting for 63 per cent of the observed changes in employment. A

one percentage point decrease in award coverage is associated with a 1.3 percentage point increase in employment growth.

R7.13 It is also noted that the increases in award reliance were not caused by the number of award employees staying constant while the numbers of non-award employees decreased. In all cases where award reliance increased, there was growth in the number of employees on awards. Thus it is the extension of award reliance and not just a reduction in non-award employment that is associated with slower employment growth.

R7.14 This demonstrates a strong correlation between declining award reliance and strong employment growth, and supports the Commonwealth contention that high safety net increases have a negative impact on employment growth.

Conclusion

R7.15 Building on the analysis provided in the Commonwealth's submission, this clearly demonstrates that there is a strong negative relationship between award reliance and employment growth. This is consistent with workers on awards attracting higher wages than are justified by their productivity.

R7.16 It should also be noted that this does not comprehend the effects of the record increase in award wages granted under the last Safety Net Review. Continuing large wage increases may exert even stronger downward pressure on employment in those industries where award employment is increasing.

R7.17 The Commission therefore needs to carefully consider the impact of this year's decision on both employment and the spread of enterprise bargaining.

WORKPLACE BARGAINING AND PRODUCTIVITY

Impact of agreement-making on productivity

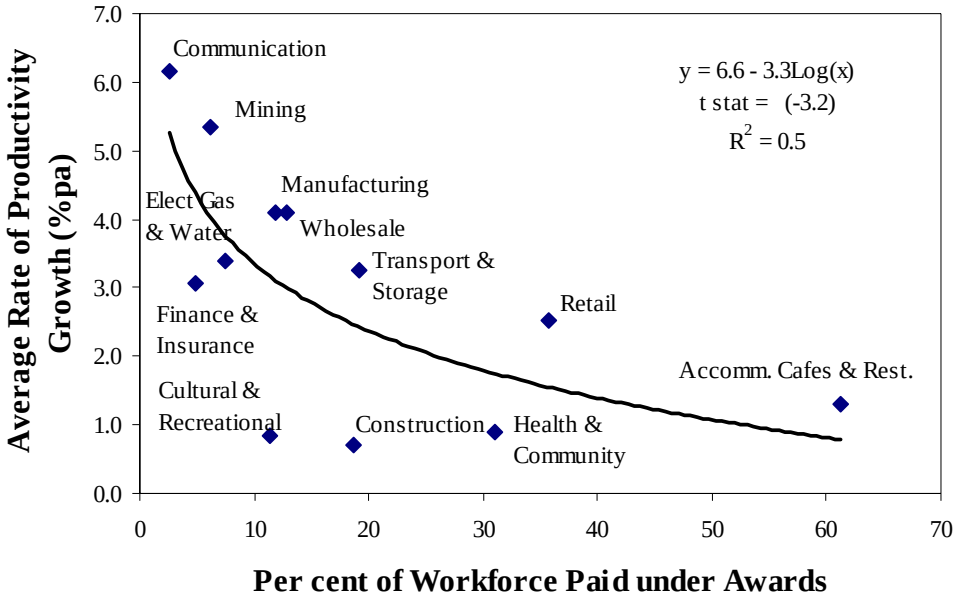
R8.1 In the Commonwealth submission, Section 8 demonstrated evidence both at the aggregate level and at the workplace level that workplace reform had a role to play in the improved productivity growth experienced by the Australian economy during the latter half of the 1990s.

R8.2 The ACTU in its reply submission (paragraph R6.17) does not contest the evidence presented at the workplace level but does argue that the evidence presented on differential industry productivity growth between 1990 and 2002 associated with award coverage (Figure 8.2 Commonwealth Submission) is 'without merit' and 'relies on a spurious causality generated by statistical coincidence'.[1]

R8.3 It is not a statistical coincidence when the same relationship appears in the data across numerous time periods during the 1990s when workplace bargaining has occurred. For example, the figure below shows the period 1995 to 2002 – the period during which the ACTU appears to accept as containing significant agreement-making. Multi-variate analysis indicates that variations in award coverage explain around half of the variation in industries' productivity growth.

[1] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.17, page 70.

Figure R8.1: Award coverage as at May 2002 and labour productivity growth by industry June 1995 to June 2002



Source: ABS Employee Earnings and Hours Survey, May 2002, (Preliminary), Table 25 (Cat. No. 6306.0); ABS AusStats, National Accounts (Cat. No. 5204.024).

R8.4 The same inverse relationship holds for most of the 1990s between industry productivity growth rates and award coverage as was shown in the Commonwealth submission for the period 1990 to 2002 and in Figure R8.1. The period towards the end of the 1990s becomes too short (that is, three or four years) for research to identify the longer term changes in productivity which result from structural changes due to workplace reform. Over such a short period the vagaries of cyclical and one-off factors dominate the longer term growth in productivity.

R8.5 The ACTU (paragraph R6.18) argues that the period 1990 to 1993 should not have been included in the Commonwealth analysis as enterprise bargaining did not exist in any significant way in the federal industrial relations system.[2] However, formal federal enterprise

[2] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R6.18, page 70.

bargaining has spread and evolved since 1991 when the Commission established the Enterprise Bargaining Principle.

R8.6 While the progress to workplace bargaining was slow in the early 1990s there were nonetheless over half a million employees (60% of whom were in the private sector) on federal enterprise agreements by the end of 1992. There were also an unknown number of workers on State agreements. The reason why 1990 was chosen as the base period was to provide a starting point for the analysis which was specifically outside the period that workplace bargaining commenced. This was done to include the entire period of workplace bargaining and not miss key bargaining outcomes that may have occurred early during its commencement and spread.

R8.7 At paragraphs R6.19 to R6.21 the ACTU compares the productivity growth for the periods 1990-93 (when agreement making was not prevalent) and 1993-2002 (during which time agreement making was spreading)[3]. The ACTU finds stronger productivity growth in the three award-reliant industries in the later period than in the earlier period. It should be noted in passing that Table R6.2 is unsourced and could not be reproduced using the relevant ABS data.[4] The ACTU's own analysis fails to point out, however, that while award reliance remains relatively high for these industries it did nonetheless fall considerably during the 1990s – by 39 per cent in Accommodation, cafes and restaurants, by 64 per cent in Retail trade and 69 per cent in Health and community services. This growth in workplace bargaining was associated with improvement in productivity growth in those industries. The ACTU's argument does not, therefore, undermine the Commonwealth's position.

[3] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraphs R6.19 – R6.21, page 71.
[4] ACTU Reply Submission, Minimum Wages Case, March 2003, Table R6.2, page 71.

R8.8 Fundamentally, the ACTU's approach ignores the difficulty of using productivity statistics over short durations of time such as the 3 years between 1990-93 when they are affected by short term and one-off factors. The specific period 1990-1993 was associated with the cyclical rebound from the recession of the early 1990s. This left its mark on the pattern of productivity growth of industries over the period. Comparisons of productivity growth over different time periods are thereby confounded. The Commonwealth has used a long time period of 12 years to moderate these cyclical and short term influences on productivity growth. This allows the better identification of the longer term structural changes to productivity as a consequence of workplace bargaining.

Unit labour costs

R8.9 The ACTU provides data on unit labour costs of the three most award-reliant industries of Accommodation, cafes and restaurants, Retail trade and Health and community services in paragraphs R6.22 – R6.25.[5] It is important to examine movements in nominal wages, given that these represent the actual wages paid by employers. Unit labour costs will increase in a given industry when wage increases are not matched by productivity growth.

R8.10 Unit labour costs are the ratio of nominal hourly wages to average hourly productivity. Thus, the increase in unit labour costs in an industry can be found by subtracting the percentage labour productivity growth from the nominal percentage increase in wages. Figure R8.2 shows that over the period 1996-2002, unit labour costs have increased substantially in the Accommodation, cafes and restaurants, Retail trade and Health and

[5] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraphs R6.22 – R6.25, pages 71-72.

community services industries based on C10 and C14 of the Metal Industries Award.

Figure R8.2: Increases in unit labour costs in the Accommodation, cafes and restaurants, Retail trade and Health and community services as a result of safety net adjustments over the period 1996-2002

Industry	C14 – FMW			C10		
	Nominal increase in wages	Productivity growth	Increase in unit labour costs	Nominal increase in wages	Productivity growth	Increase in unit labour costs
Accommodation, cafes and restaurants	23.5%	13.7%	9.8%	19.0%	13.7%	5.3%
Retail trade	23.5%	15.5%	8.0%	19.0%	15.5%	3.5%
Health and community services	23.5%	7.3%	16.2%	19.0%	7.3%	11.7%

Source: ABS AusStats, National Accounts (Cat. No. 5204.024).
Note: Labour productivity is measured as gross product per hour worked.

Impact of safety net adjustments on the incentive to bargain

R8.11 The Commonwealth notes that the ACTU has not disputed the relevance of the issue of the incentive to bargain to this case.

R8.12 At paragraphs R3.25 and R4.42 of its reply submission, the ACTU relies on the continued spread of bargaining to disprove any impact of safety net adjustments on the incentive to bargain.[6] This is flawed. The growth of bargaining continues and this expansion has included workplaces in the award-reliant industries. This demonstrates that bargaining is a real alternative for businesses in these industries, however, agreement-making in these industries remains relatively limited. This justifies the Commonwealth's concern about the effects of large

[6] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraphs R3.25 and R4.42, pages 22 and 37.

safety net adjustments on the incentive to bargain in award-reliant industries such as Retail trade, Accommodation, cafes and restaurants and Health and community services.

R8.13 In paragraphs R4.42 to R4.44, the ACTU has criticised the Commonwealth's comparison of AAWIs for federal wage agreements and safety net adjustments in various ways.[7] The Commonwealth submits that this is a useful and entirely appropriate analysis that reveals the potential impact that a large increase in award rates of pay could have on the incentive to bargain.

R8.14 The ACTU criticises the analysis on the grounds that it does not refer to employees paid by award rates of pay above C10 in the Metal Industries Award (paragraph R4.44).[8] The Commonwealth argues that the use of C10 and C14 as examples in the analysis is appropriate. The Commonwealth could have easily provided a figure on every single rate of the Metal Industries Award but this was seen to be unnecessary, particularly because award coverage is concentrated in occupations within the workforce at the tradesperson's level and below.

R8.15 The ACTU has also claimed that the analysis is misleading as it only involves percentage increases in rates of pay (paragraph R4.44).[9] It would be ideal, and no doubt very telling, to compare the ACTU's claim and the safety net adjustments with a time series of actual rates of pay for employees covered by federal wage agreements certified each quarter. Unfortunately, such data is not available. However, the comparison of percentage increases is relevant due to the similarity of rates of pay

[7] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraphs R4.42 – R4.44, pages 37-38.
[8] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R4.44, pages 37-38.
[9] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R4.44, pages 37-38.

between awards and collective agreements in the relatively award-reliant industries.

R8.16 In paragraph R4.44 of its reply submission, the ACTU has produced figures on the difference in earnings between employees paid by awards and those paid by collective agreements without clearly identifying the population group for this data.[10] It is not clear whether managerial employees are included, whether employees that are casual or under fixed term contracts are included, nor whether the figures are ordinary time earnings or total earnings. Given the limited May 2002 EEH Survey data available at the time of printing, the most appropriate data for this purpose is average weekly ordinary time earnings for all non-managerial full-time permanent employees, disaggregated by method of pay setting and industry.

R8.17 These data are displayed in Figure R8.3 and show that the gaps in earnings between employees paid by awards and those paid by collective agreements are generally not large in the services sector. As noted in the Commonwealth submission, the differences in earnings between the two groups are particularly marginal in Accommodation, cafes and restaurants and Retail trade.

[10] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R4.44, pages 37-38.

Figure R8.3: Average weekly ordinary time earnings for permanent full-time adult non-managerial employees disaggregated by industry by method of pay setting

Industry	Pay Setting Method	Earnings
Retail trade	Award Collective Agreement Difference	$546.17 $595.79 $49.62
Accommodation cafés and restaurants	Award Collective Agreement Difference	$593.05 $594.73 $1.68
Health and Community Services	Award Collective Agreement Difference	$633.20 $818.12 $184.92

Source: ABS Employee Earnings and Hours Survey, May 2002, (Preliminary), Table 25 (Cat No 6306.0).

R8.18 When examining these figures, it is important to remember that:

- the rates of pay in awards do not need to actually exceed rates of pay in agreements in order for there to be a disincentive to engage in agreement making (that is, a differential that is not substantial is also likely to have an impact); and

- there is dispersion around these averages, leading to even smaller margins between the two pay setting methods for some employees and even overlaps in certain industries. For instance, the small margin exhibited in the Accommodation, cafes and restaurants industry means that around half of permanent full-time adult employees covered by awards in this industry receive ordinary time earnings greater than the average weekly ordinary time earnings for collective agreements in the industry ($594.73).

R8.19 In paragraph R4.4, the ACTU refers to information provided by ACCI on factors – such as the transient or changeable nature of the workforce and the extent of casual and temporary employment – that may hinder bargaining, claiming that the Commonwealth's analysis should

take these factors into account.[11] The ACCI submission does not imply that safety net adjustments have no impact on the incentive to bargain. The Commonwealth is of the view that the factors raised by ACCI simply add greater weight to the argument that safety net adjustments must be moderate.

[11] ACTU Reply Submission, Minimum Wages Case, March 2003, paragraph R4.44, pages 37-38.

LIVING STANDARDS

Introduction

R9.1 The ACTU and other parties have not accurately addressed the key points which the Commission is required to take into consideration in making its safety net wage decision. These are prescribed in s88B(2) of the WR Act, which specifically requires the Commission to establish and maintain a safety net having regard to:

> *(a) the need to provide fair minimum standards for employees in the context of living standards generally prevailing in the Australian community;…*
>
> *(c) when adjusting the safety net, the needs of the low paid.*

R9.2 Firstly, in addressing 'the needs of the low paid' the Commonwealth argues that this must include giving regard to the employment prospects of the low paid. This emphasis is consistent with the proposed amendments in the PLP Bill. The Commission's decision in 2002 accepted that minimum wage increases have negative impacts on the employment prospects of those in award dependent sectors.[1] The loss of employment can have serious consequences on an individual's capacity to obtain future employment, as well as health and social repercussions.

R9.3 Secondly, the WR Act specifies that the 'living standards generally prevailing in the Australian community' are pertinent in the setting of the wages safety net. Therefore, the Commission cannot focus

[1] Full Bench Decision, Safety Net Review 2002, PR002002, paragraph 161.

on the living standards of wage and salary earners to the exclusion of the unemployed, retirees and other members of the Australian community.

R9.4 In terms of assessing the relative living standards of low paid employees, the Commonwealth has provided evidence in successive Safety Net Reviews that the low paid are not restricted to the bottom half of the family income distribution. The ACTU's claim will not necessarily lead to an improvement in the living standards of those on the lowest incomes who do not have wage and salary earners in their households.

R9.5 Finally, the Commonwealth does not see the need for an inquiry of the nature proposed by the Australian Catholic Commission for Employment Relations (ACCER) and the Australian Council of Social Services (ACOSS). Structural changes in society and the economy, the development of a comprehensive social security system, and changes to the workplace relations framework mean that minimum wages cannot operate as a 'living wage' for low paid workers in the same way as they did early last century.

The needs of the low paid

R9.6 The needs of the low paid includes the need for employment, which is the key source of financial security. In balancing the desire to award an increase and the need to protect the employment prospects of the low paid, the Commission must not give undue weight to the needs of those already in employment to the detriment of those on the margins of employment. Furthermore, these two aspects cannot be easily traded off against one another – the wider costs of unemployment on individuals, families and the community are of a different order to the simple income gains and losses which follow a safety net increase.

R9.7 The ACTU continues to assert that minimum wage increases are an effective means of addressing poverty, referring to material from the ACOSS.[2]

R9.8 ACOSS argues that minimum wages provide an important 'floor' for the incomes of low income households.

> *Without this floor, Governments would struggle to prevent widespread poverty among wage-earnings households.*[3]

R9.9 As the Commonwealth argued with reference to Neumark and Wascher's study (at paragraph 9.19 of the Commonwealth's submission), minimum wage increases may not improve the overall welfare of low income families.[4] Neumark and Wascher show that minimum wage increases are not an unproblematic solution to poverty, as they define it, because they affect the transitions of different families into and out of poverty.[5]

R9.10 Neumark and Wascher examined the statistically significant increases in poor and non-poor families, across US states and years in which minimum wage increases occurred. They found that although minimum wage increases raise the incomes of some low wage workers in poor families, disemployment effects also arise leading to considerable reductions in income among a subgroup of families that were initially above the poverty line. Neumark and Wascher explain how this arises:

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[2] ACTU Written Reply Submission, Minimum Wages Case, March 2003, paragraph R7.31, page 87.
[3] ACOSS Written Submission, National Wage Case, February 2003, page 4.
[4] D Neumark and W Wascher 'Do Minimum Wages Fight Poverty?' *Economic Inquiry*, July 2002, Vol 40, No 3.
[5] The definition of poverty in this article comes from the US Census Bureau. The Bureau uses a set of money income thresholds that vary by family size and composition to determine who is poor. If a family's total income is less than that family's threshold, then that family, and every individual in it, is considered poor. More information can be found at http://www.census.gov/hhes/poverty/povdef.html.

> *[M]inimum wages increase earnings per worker among families with workers both before and after the minimum wage increase. On the other hand, minimum wages cause the number of workers per family to decline; this effect is concentrated among the non-poor and results in some families falling into poverty.*[6]

R9.11 Neumark and Wascher conclude that 'we find no compelling evidence supporting the view that minimum wages help in the fight against poverty.'[7]

R9.12 The ACTU also refers to an issue raised by ACOSS about the status of families with low paid workers relative to all families in the working age population. ACOSS argues that it is better to look at the position of low paid workers within the household income distribution after excluding retired households. ACOSS refers to Harding and Richardson's research, which shows that this results in the proportion of low paid households in the labour force being more concentrated in lower income deciles than if the analysis includes all households.[8]

R9.13 The WR Act, however, specifically directs the Commission to look at 'the context of living standards generally prevailing in the Australian community'. The Australian community encompasses retired households and the unemployed amongst others. Focusing only on improving the living standards of households of workforce age or on wage and salary earner households to the detriment of the unemployed, for instance, would not fulfil the requirements of the Act.

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[6] D Neumark and W Wascher 'Do Minimum Wages Fight Poverty?' *Economic Inquiry*, July 2002, Vol 40, No 3, page 332.
[7] D Neumark and W Wascher 'Do Minimum Wages Fight Poverty?' *Economic Inquiry*, July 2002, Vol 40, No 3, page 332.
[8] S Richardson and A Harding 'Low wages and the distribution of family income in Australia' Paper prepared for the *25th General Conference of the International Association for Research in Income and Wealth*, Cambridge, England, 23-29 August 1998, page 11.

R9.14 Even so, when the analysis is restricted to wage and salary earning families there is evidence to suggest that a significant number of families with award-reliant workers are situated in the upper end of the income distribution. The Commonwealth has presented data which show that a strictly capped increase amongst wage and salary earning families concentrates much of the gain from a safety net increase on the bottom 30 per cent of families in the income distribution.[9]

Effective Marginal Tax Rates

R9.15 In its reply submission, the ACTU claims that the illustrative example used by the Commonwealth maximises social security payments, as well as the impact of taxation and social security withdrawal.[10] The Commonwealth has not been selective in choosing this realistic example (a single income couple with two children, with the earner on the Federal Minimum Wage), which presents an accurate illustration of how an increase in the Federal Minimum Wage can affect low income families.

An inquiry into minimum wages

R9.16 ACCER has submitted that the Commission should conduct an investigation or inquiry into the needs of the low paid and review the FMW, and establish a benchmark against which the FMW should be set.[11] ACOSS also proposes a similar inquiry 'to ascertain an appropriate benchmark for the adequacy of minimum wages'.[12]

R9.17 The Commonwealth does not see the need for an inquiry of this nature. The 'safety net' of award wages has evolved considerably since

[9] Commonwealth Submission, 2001-2002 Safety Net Review – Wages (printed version), page 94.
[10] ACTU Written Reply Submission, Minimum Wages Case, March 2003, paragraph R7.28, page 86.
[11] ACCER Written Submission, Safety Net Review – 2003, 25 February, page 3.

the 'basic wage' established in the Harvester judgement in 1907. Justice Higgins, in his decision, aimed to set 'fair and reasonable wages' for unskilled labourers living in a 'civilised community'. Justice Higgins looked to set the basic wage in line with the 'normal needs of the average employee' and his family.[13]

R9.18 However, the 'living wage' concept is not workable in today's society and economy. A minimum wage benchmark is particularly difficult to set given that family and household characteristics are diverse and changing.

R9.19 The tax and transfer system has gradually evolved over time to provide a range of comprehensive support which is targeted to help meet the specific needs of different individuals and families. The Commonwealth has shown in previous submissions that the cash and non-cash benefits distributed through the tax-transfer system significantly boost the private incomes of the lowest income earning families.[14]

R9.20 The award wage system is now a relatively small part of an economy that has undergone significant structural change since the Harvester decision. The spread of enterprise bargaining has meant that award wages now act as a 'safety net' of terms and conditions.

R9.21 The Commission is already required to have regard to the needs of the low paid and living standards generally prevailing in the Australian community. The amendments to the WR Act proposed in the Commonwealth's PLP Bill would underline that the primary focus of

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[12] ACOSS Written Submission, National Wage Case, February 2003, page 1.
[13] J O'Brien 'The Setting of Minimum Wages in Australia: From Harvester to Safety Net Adjustments' in R Harbridge, C Gadd and A Crawford, eds *Current Research in Industrial Relations: Proceedings of the 12th Association of Industrial Relations Academics of Australia and NZ Conference*, 3-5 February 1998, Wellington, New Zealand, page 274.

Safety Net Review decisions should be on the low paid, including their employment prospects in addition to those of the unemployed. This Bill is part of the Government's continuing efforts to improve the prospect of employment for the most vulnerable in the labour market.

R9.22 Further, the WR Act provides a legislative framework that recognises the need for increased flexibility and productivity in a market based global economy. The WR Act generally, and the PLP Bill in particular, will help to maintain the productivity and employment growth which has increased the standard of living for all Australians. Given the sustained real growth in earnings and the stability of the income distribution in recent years,[15] there is insufficient evidence to justify a benchmarking inquiry of the kind sought by ACOSS and ACCER.

Conclusion

R9.23 The Commission has the responsibility to balance a number of considerations, including the needs of the low paid within the context of living standards generally prevailing in the Australian community, when adjusting the award safety net. Given that the largest increase in the history of the Safety Net Review cases was awarded last year, this year there is a particularly compelling case to redress the imbalance in favour of those whose employment prospects have been diminished as a result.

[14] For example, in the Commonwealth Submission, 2001-2002 Safety Net Review – Wages (printed version), Tables 6.1 and 6.2, pages 84-85.
[15] As shown in the Commonwealth Submission, Safety Net Review – Wages 2002-2003, pages 85 to 88.

STATISTICAL SUMMARY

STATISTICAL SUMMARY (current as at 20 March 2003)

(Data seasonally adjusted unless otherwise stated)

GDP:

Real GDP grew by 0.4% in the December qtr 2002, to be 3.0% higher through the year. The quarterly National Accounts show that in 2001-02 GDP grew by 4.0%. MYEFO forecasts GDP growth of 3% in 2002-03 and 4% in 2003-04.

Nominal GDP (original) totalled $734.1 billion in the year to the December qtr 2002.

BUSINESS INVESTMENT:

Business investment rose by 7.4% in the December quarter 2002 to be 19.0% higher through the year. This represents 12.2% of GDP (in nominal terms). Non-residential construction investment declined 2.2% in the December quarter after rising 14.2% in the September quarter. Machinery and equipment investment rose by 12.8% in the December quarter.

Abstracting from second hand asset sales, new business investment rose by 10.0%, with investment in machinery and equipment rising by 14.1% and non-residential construction rising by 3.9% in the December quarter 2002.

HOUSING APPROVALS:

Total private dwelling commencements increased by 9.1% in the September quarter, following a 6.5% increase in the June quarter. Private building approvals fell by 2.0 per cent in January, following a 3.9 per cent increase in December and are now 2.1 per cent lower than a year ago. The number of housing finance commitments for the construction of owner occupied dwellings increased 7.8 per cent in January following a decline of 2.7 per cent in December to be 35.7 per cent lower than a year ago.

RETAIL TRADE:

Nominal retail trade (seasonally adjusted) rose by 0.2 per cent in the month of January, following a fall of 0.9 per cent in December, to be 5.4 per cent higher than a year ago. Retail trade volumes rose by 0.8 per cent in the December quarter.

UNEMPLOYMENT RATE:

6.0% in February 2003. Peak was 10.9% in December 1992. Low was 5.4% in June 1981.

EMPLOYMENT:

Declined by around 12 000 in February 2003 to be 3.1% higher than a year earlier. In trend terms, employment rose by 0.4% in February 2003.

LABOUR FORCE:

Around 10.2 million people in February 2003, of whom 609,737 were unemployed. The participation rate declined by 0.2 of a percentage point to 64.4% in February 2003.

ANZ JOB ADVERTISEMENTS:

Job advertisements (sa) rose by 3.2% in February 2003, following a 4.3% increase in January 2003, to be 1.5% higher than a year ago. Trend job advertisements fell by 1.2% in February 2003, and were 1.4 % lower than a year ago.

GROSS OPERATING SURPLUS (GOS):

The GOS of private non-financial corporations increased by 0.7% to $29.3b in the December qtr 2002, or 15.7% of GDP (in nominal terms). Gross mixed income was $16.4b in the December qtr 2002, or 8.8% of nominal GDP.

WAGES:

The Wage Cost Index (WCI) grew by 3.4 per cent over the year to December 2002, up from 3.3 per cent through the year to September 2002.

Full-time adult average weekly ordinary time earnings (AWOTE) rose by 1.1% in the December qtr 2002 and by 4.8% over the year to December.

REAL EARNINGS:

Real AWOTE (AWOTE adjusted for the headline CPI) grew by 0.4 % in the December qtr and grew by 1.8% over the year to December.

PRODUCTIVITY:

In trend terms, real GDP per hour worked market sector rose by 0.8% in the December qtr 2002, to be 3.8% higher through the year. This compares with the average rise of 1.4% in the 1980s and 2.7% in the 1990s.

CONSUMER PRICE INDEX:

Headline CPI increased by 0.7% in the December qtr 2002, to be 3.0% higher through the year.

EXTERNAL SECTOR:

The monthly balance on goods and services in January 2003 was a deficit of $1 365 million, down from $2 995 million recorded in December. Export values rose 5.6 per cent while imports declined 6.0 per cent.

COMMODITY PRICES:

In the month of February, the RBA Commodity Price Index fell by 1.2 per cent in $A terms but rose by 0.5 per cent in SDR terms. The largest increases recorded in February were for nickel, sugar and lead, while prices for coal and wool fell.

SURVEYS:

The latest **ACCI National Survey of Business Expectations** (released 3 February) indicated a fall in business confidence but the outlook for general business conditions in the March quarter 2003 remains positive. Expectations for the March quarter are for improvements in most categories, notably employment, sales revenue, profits and exports. Wage pressures are moderating, but wages are expected to continue to grow. Expectations for investment were mixed, with little movement from the previous quarter.

The latest **NAB Quarterly Business Survey** (released 30 Jan) indicated that business conditions remain resilient and are at their strongest levels for three years. According to the NAB, business conditions are consistent with growth in non-farm GDP of around 5 per cent for 2002-03. Within components of the composite index, trading conditions edged up slightly further, profitability moderately improved, while employment growth eased somewhat in the December quarter.

The latest Westpac-Melbourne Institute Survey of **Consumer Sentiment** (released 12 Mar) recorded a fall in the month of February. Consumer sentiment fell 2.1 per cent in March, following a fall of 7.8 per cent in February. Both components of the index relating to expected economic conditions increased.

The February 2003 **Yellow Pages Index** (released 15 February) showed that a net balance of 55 per cent of SMEs were confident in their business prospects over the next 12 months (69 per cent were confident and 14 per cent were worried). The February result is marginally higher than the 52 per cent net balance recorded in the November survey, largely due to significant rises in sales and profit performance recorded in the January to February 2003 period.

TREASURER’S PRESS RELEASE

TREASURER'S PRESS RELEASE

TREASURER www.treasurer.gov.au	**PRESS RELEASE**	**NO.**

NATIONAL ACCOUNTS: DECEMBER QUARTER 2002

Today's National Accounts show that Australia's GDP grew by 0.4 per cent in the December quarter 2002, and by 3.0 per cent over the year. Growth was underpinned by strong investment, particularly business investment in engineering, and machinery and equipment. Abstracting the direct impact of the drought, the non-farm economy remained solid, growing by 0.8 per cent in the quarter and 3.9 per cent over the year.

The good outcome in the December quarter National Accounts is against a backdrop of weak global economic conditions with the prospect of war and rising oil prices. During the quarter, Australia was in the grip of the worst drought in a century. Even so, the domestic economy has remained resilient.

Private business investment increased by 7.4 per cent in the December quarter, and was underpinned by a 14 per cent surge in new machinery and equipment investment. Strong investment by the business community reflects the favourable investment environment in Australia, with low interest rates, high levels of capacity utilisation and strong corporate profitability.

Household consumption increased by 0.6 per cent in the December quarter to be 4.1 per cent higher over the year, supported by strong growth in employment. Dwelling investment also contributed to GDP growth, rising 4.2 per cent in the quarter. Looking forward, residential construction is expected to ease in 2003-04, as activity in the sector passes its cyclical peak.

Total imports rose by 7.0 per cent in the December quarter, with strong business investment driving imports of capital goods up 16 per cent. Exports fell slightly, down 0.4 per cent, reflecting a large decline in agricultural exports partly offset by stronger growth in other exports.

The drought

The drought continued to depress agricultural production and farm income. Agricultural production fell by 14 per cent in the December quarter, and was more than 24 per cent lower than a year ago.

Rural exports fell by 3.3 per cent in the December quarter, following a decline of 5.0 per cent in the previous quarter. This was mainly due to grain exports falling 30.8 per cent in the December quarter. Employment in the farm sector fell by 19 700 persons in the December quarter, following a decline of 39 300 persons in the September quarter.

The attached table shows the profile of the impact of the drought. The next large detraction will occur in the June quarter. If the drought breaks (with signs already emerging), positive effects could emerge in the second half of 2003.

Incomes

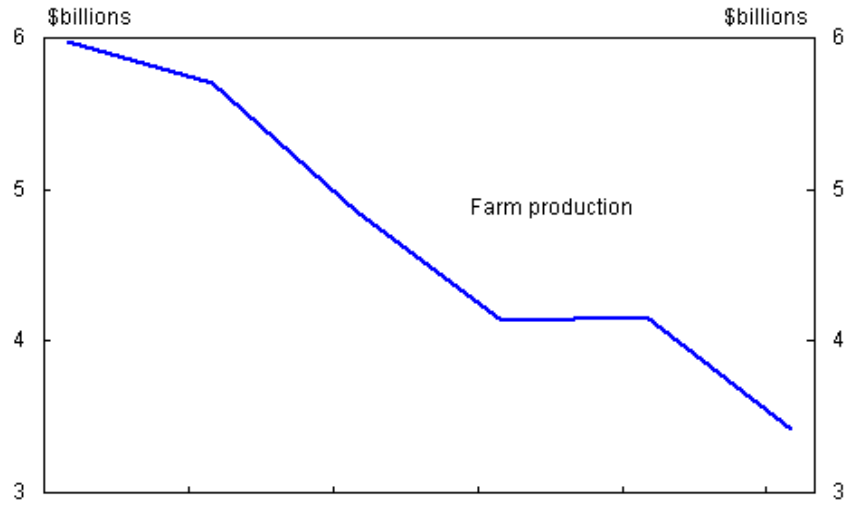
Income growth moderated in the December quarter following the very strong growth of the past year. Gross mixed income fell by 1.6 per cent in the quarter, primarily reflecting declines in farm income. Compensation of employees increased by 1.4 per cent in the quarter, while corporate profitability remained strong.

National Accounts measures of prices and wages confirm that inflationary pressures in the Australian economy remain moderate. The household consumption chain price index rose by 0.6 per cent in the quarter and 2.7 per cent through the year.

The Government's pursuit of a broad range of structural reforms and prudent macroeconomic policies has ensured that Australia is well placed to meet the challenges of a weak global economy. As the OECD noted when it judged the Australian economy "one of the best performers in the OECD", structural change has made Australia notably resilient to internal and external shocks.

CANBERRA
5 March 2003

Impact of the Drought on Agricultural Production - 2002-03



Quarterly Growth Rates