



ACOSS Submission | March 2008

Australian
Council of
Social Service

Submission to the Fair Pay Commission on minimum wages

ACOSS March 2008

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Summary and Recommendations

As the peak national organisation of the community sector and advocate for low income and disadvantaged Australians, ACOSS has a long standing interest in minimum wages and has made a number of submissions on this to the Australian Fair Pay Commission and previously to the Australian Industrial Relations Commission.

ACOSS is an interested party with expertise in poverty, employment policy and income support policy, rather than an advocate for union or employer positions. We have not advocated any specific wage increase in the past, and do not do so in this submission.

In July 2007, the Commission awarded an increase in the standard Federal Minimum Wage of \$10.26 per week, bringing this up to \$522.12. Adult Pay Scales of up to \$700 per week were also increased by that amount and those above \$700 were increased by \$5.30 per week. The increases were effective from 1 October 2007.

The Reasons for Decision contained welcome acknowledgement that minimum wages, along with the income support system, have an important role in preventing poverty and ensuring a decent standard of living for all.

Although poverty lines do not tell the 'whole story' of deprivation, they are a widely accepted benchmark for measuring disadvantage. New research on poverty in Australia found that in 2006:

- When a poverty line of 50% of median disposable income is used (a relatively low poverty benchmark used by the OECD), a total of 396,000 people in wage earning households, comprising 17% of all people in poverty, lived below this poverty line.
- When the higher poverty line of 60% of median disposable income (used in the UK and other European Union countries) is used, a total of 829,000 people in wage earning households, comprising 22% of all people in poverty, lived below this poverty line.
- Households living below these poverty lines mainly comprised families with children.¹

The real value of the Federal Minimum Wage (FMW) declined slightly (by 1%) from December 2006 to December 2007 after rising for a number of years.² The decline in the real value of Pay Scales above the FMW was greater because last year's increases in Pay Scales were capped at the same dollar value – and in many cases at 50% of the value - of the rise in the FMW.

In recent years the FMW has continued to fall behind wage movements in the community generally. Taking a longer view, the real value of minimum wages is about the same as it was 20 years ago.

A decline in real wages for many employees dependent on the Pay Scales is of particular concern within the non-government community services sector, which is having difficulty attracting and retaining skilled staff. The sector is often unable to pay above the standard Pay Scales due to the cumulative effects of growing demand for services, slow growth in agency incomes, and contractual arrangements linked to Government funding.

¹ Australia Fair 2007, *International Comparisons 2007*, [poverty estimates from Social Policy Research Centre, University of NSW].

² Based on an increase in the CPI of 3% over this 12 month period. See ABS 2008, *Consumer Price Index*.

Over the past year low income households have been disproportionately affected by sharp increases in rents, transport and other costs. Modest improvements in the real value of minimum wages are needed to assist people on the lowest incomes to share in the improvements in living standards that most Australians have enjoyed in recent years. While overall restraint in wage increases is critical to curb inflation and sustain economic growth it would be unreasonable, and ineffective, if the burden of restraint in wages fell disproportionately on low paid employees.

The Australian economy is running close to full capacity and there is a risk that higher levels of inflation will become entrenched. While it is important that overall growth in the real value of wages does not increase at this time, this cannot be achieved by restraining growth in minimum wages. The Federal Minimum Wage and associated Pay Scales make only a very modest contribution to overall wages growth since only 20% of employees rely on the Pay Scales for their wage increases.

Recommendations

ACOSS recommends that:

- Decisions on the level of minimum wages should be informed by 'benchmark' estimates of the cost of attaining a 'decent basic living standard' for a single adult according to contemporary Australian standards.³
- These benchmarks should be well above poverty levels, for two reasons. Australia has traditionally set wages well above poverty levels so that employees can live in dignity. Also, if social security payments for jobless people are set at poverty levels or higher, there is a need to set minimum wages at a higher level than this to preserve work incentives.
- Research should be commissioned to examine a range of possible benchmarks, including the updating and revision of 'Budget Standards' research.
- The effect of the minimum wage and family payments on the extent of poverty among families should also be taken into account in setting minimum wages.
- In its decision this year, the Commission should at least increase the Federal Minimum Wage in line with general wage movements, so that minimum wage earners do not fall behind.
- Minimum wage rates for young people, apprentices and trainees, and people with disabilities under the Supported Wage System, should continue to be increased in line with the rise in the federal minimum wage.

³ This should not be read to imply that a single 'target' should be set for minimum wages, since it is unlikely that any single benchmark will be broadly supported as robust and credible, and factors other than the needs and living costs of low wage earners and their families must also be taken into consideration. The benchmarks would be based on the needs of a single adult living alone since the social security and family payment systems should adequately supplement minimum wages in households that include jobless adults or children.

Evidence

Our recommendations are informed by our concerns about growing inequality of incomes, the incidence of income poverty among working families, concerns about the effect of any real decline in minimum wages on income support payments and work incentives, and the lack of convincing evidence that significant increases in minimum wages would lead to higher unemployment in Australia's present economic circumstances.

ACOSS welcomes the Commission's initiatives to fund research to inform its decisions. The evidence in most of last year's commissioned studies is broadly in accord with that presented in this submission, including:

- that low paid workers are found mainly in the bottom half of working-age households⁴
- that women, young people and people outside major cities are overrepresented among low paid employees;⁵
- that although various income support payments make a major contribution to the disposable income of low income families, most low paid employees still benefit substantially from increases in minimum wages, despite the high effective marginal tax rates faced by a minority of families;⁶
- that a slight majority of low paid employees progress to higher paid jobs within a few years, but those who were previously unemployed have a much lower chance of advancement and a greater risk of falling back into joblessness.⁷

As noted above, ACOSS recommends that research be commissioned to assist the Commission to assess the minimum income needs of low paid employees. It is desirable that the Commission work with stakeholders towards a common understanding of how minimum wages should be benchmarked, not to set a 'target' for the minimum wage but to be clear about the 'adequacy objective' of minimum wage fixation in Australia. A good starting point would be a review of the available research in this area including budget standards, deprivation research and income poverty research.

We understand the Commission plans to undertake or commission research to profile the community services workforce. This would be welcome, given that this is one of the major (and growing) employers of low paid and Pay Scale-dependent labour, and evidence of widespread difficulties recruiting skilled employees. ACOSS conducts a regular survey of the state of non government community services, the 'community sector survey'. In last year's survey, 58% of service provider respondents reported difficulty in recruiting qualified staff.⁸ Anecdotally, this problem is likely to worsen if the Pay Scales continue to be adjusted in flat dollar amounts, reducing rewards for skill in the sector. The reason for this is the high reliance on the Pay Scales across the sector, including in skilled occupations, due to Government funding restrictions.

The key evidence detailed in the body of this submission is summarised below.

⁴ Healy & Richardson 2006, *An updated profile of the minimum wage workforce in Australia*. National Institute of Labour Studies.

⁵ McGuinness et al 2006, *Characteristics of minimum wage employees*. Melbourne Institute.

⁶ Harding et al 2006, *Interactions between wages and the tax transfer system*, NATSEM.

⁷ McGuinness et al 2006, op cit; Dunlop Y, 2001, *Low paid employment in the Australian labour market*, in Borland et al, 2001, *Work rich, work poor*. Victoria University.

⁸ ACOSS 2007, *Australian Community Sector Survey*.

The federal minimum wage and low paid employees

The Federal Minimum Wage is currently \$522 per week for a fulltime employee, about the same level, after taking account of inflation, as it was in the mid 1980s. Increases in minimum wages in the 1980s and early 1990s were not sufficient to compensate for rises in the cost of living, though it has increased modestly in real terms since then.

Recent research undertaken for the Commission estimated that in 2004 there were around one and a half million adult employees (19% of all adult employees) earning below the FMW or up to \$2 per hour above it. About half of these employees earned less than the FMW.⁹

Although Australian minimum adult wages are high by wealthy country standards, the proportion of Australian employees who are 'low paid' (14%) is not much less than average for all OECD countries (15%). The likely reason for this discrepancy is that as research commissioned by the Fair Pay Commission indicates, a substantial proportion of adult employees earn less than the Federal Minimum Wage.¹⁰

The incidence of low pay is relatively high among young people, women, low skilled workers in service industries, and in rural and regional areas. A majority (52%) were women, who are overrepresented among low paid employees.¹¹ Most low paid employees fall within the bottom half (by disposable income) of households of workforce age.¹²

Trends in earnings and income inequality

Earnings inequality has increased in Australia since the 1980s. From 1986 to 2001, full time earnings increased by:

- 5% for tenth percentile (top of the bottom 10%) of full-time wage earners;
- 9.9% for the 50th percentile (median) full-time wage earner;
- 18.3% for the 90th percentile (bottom of the top 10%).¹³

Earnings inequality between men and women, as measured by gender pay equity ratios, dramatically declined in the 1970s and continued to decline more slowly between 1981 and 2002, but has increased since 2004.¹⁴

Although the effects of greater levels of earnings inequality and an increase in jobless households have been offset to a substantial degree by Government policies (such as family payments), income inequality among households also increased over this period.¹⁵

⁹ Healy & Richardson 2006, *Updated profile of the minimum wage workforce in Australia*, Report for Fair Pay Commission, National Institute of Labour Studies. The authors note that 45% of the workforce are women.

¹⁰ OECD 2006 *Employment Outlook*. In this study, 'low pay' means earning less than two thirds of the median wage. McGuinness et al 2006, op cit. Note that the lower incidence of 'low pay' in this study is due to the use of a different definition of 'low pay' (less than 2/3 of median earnings) to the above study.

¹¹ Healy & Richardson 2006, op cit. The authors note that 45% of the overall workforce are women.

¹² Leigh 2005, *Does the minimum wage help the poor?* ANU Centre for Economic Policy Research Discussion Paper 501. Healy & Richardson 2006, *An updated profile of the minimum wage workforce in Australia*. National Institute of Labour Studies.

¹³ Saunders 2005, *Reviewing recent trends in wage income inequality*. Social Policy Research Centre, University of NSW.

¹⁴ URCOT 2005, *Pay equity – how to address the gender pay gap*, Industrial Relations Victoria.

Household income distribution is relatively unequal in Australia and other Anglophone countries. Many other countries have avoided major increases in income inequality over the last two decades. This demonstrates that national policies and institutions do make a difference.¹⁶

Minimum wages and living standards

There are three ways to measure the living standards of households:

- to draft 'basic budgets' for different kinds of households,
- to use 'poverty lines',
- to survey actual living standards.

One possible benchmark for setting minimum wages is the 'modest but adequate budget standard' developed by the Social Policy Research Centre. When indexed to December 2006 using the CPI, the 'Modest but Adequate' Budget Standard for a single adult was \$512 per week. By comparison, the federal minimum wage is approximately \$475 per week after tax for a single adult without children.¹⁷

Although poverty lines do not tell the 'whole story' of deprivation, they are a widely accepted benchmark for measuring disadvantage. New research on poverty in Australia found that in 2006:

- When a poverty line of 50% of median disposable income is used (a relatively low poverty benchmark used by the OECD), a total of 396,000 people in wage earning households, comprising 17% of all people in poverty, lived below this poverty line. The 'risk' of income poverty was 6% for households with one wage earner and 1% for those with two or more wage earners.
- When the higher poverty line of 60% of median disposable income (used in the UK and other European Union countries) is used, a total of 829,000 people in wage earning households, comprising 22% of all people in poverty, lived below this poverty line. The 'risk' of income poverty was 15% for households with one wage earner and 4% for those with two or more wage earners.
- Households living below these poverty lines mainly comprised families with children.¹⁸

International evidence suggests that there is a link between levels of low pay and income poverty across nations. Broadly speaking, the greater the incidence of low pay the greater the incidence of income poverty, especially child poverty. It is not inevitable that the two indicators will be linked in this way, since low pay is a measure of individual income and income poverty is a measure of household income. The main reasons for this connection are likely to be the contribution of wages to the incomes of many low income families, and the

¹⁵ ABS 2007, *Household income and income distribution*; Harding & Greenwell 2001, *Trends in income and expenditure inequality in the 1980s and 90s*; Saunders 2003, *Examining recent changes in income distribution in Australia*, Social Policy Research Centre.

¹⁶ Forster & Ercole 2005, *Income distribution and poverty in OECD countries*, OECD.

¹⁷ Saunders 2003, *Updated budget standards estimates*. Social Policy Research Centre. The Budget Standards are a measure of expenditure, so they are equivalent to disposable (after tax) income rather than the gross wage. It might be argued that these Budget Standards are inflated by the use of Sydney rents as the benchmark for housing costs. On the other hand, since they are a decade old, the Budget Standards need uprating to take account of changes in living standards since 1996 when they were set.

¹⁸ Social Policy Research Centre 2007, *Poverty in Australia*, report for *Australia Fair*.

fact that countries with low minimum wages (such as the USA) usually also keep their social security payments for jobless people low to preserve work incentives. At 12%, the proportion of Australian children below the poverty line lies between the high levels of the US and UK (which have low minimum wages), and the low levels in European countries with higher minimum wages.¹⁹

Data on access to 'essential' items and services provide another useful measure of disadvantage. Recent research using focus groups of employees from low paid households suggests that budgeting on minimum wages is a struggle for these households. They must forego items that most wage earning households expect, such as dental care, annual holidays, a car, eating out with friends, and buying a home.²⁰

Many low paid employees and their families also find it difficult to afford to rent or buy housing in major capital cities. Research on 'housing stress' found that 407,000 working households, or 10% of all working households, devoted over 30% of their disposable incomes to rents or mortgages in 2001. Over one quarter of these households included employees in the low paid occupations of sales assistants, drivers, carers, cleaners, administrative workers, or hospitality workers. A clear majority of employees in these occupations who were in 'housing stress' had incomes below \$600 per week.²¹

The increases in minimum wages flowing from the Commission's decision last year, together with reductions in income tax that took effect from July 2007 (especially the increase in the Low Income Tax Offset from \$600 to \$750 per year), led to modest improvements in the disposable incomes of many low paid employees. However, low paid employees and their families have been disproportionately affected by sharp increase in rents over the past year (since they are more likely to rent) and higher fuel prices (since they are more likely to live in outer urban and rural areas). For example, the average increase in rents across capital cities from December 2006 to December 2007 was 6.4% and the corresponding increase in petrol costs was 14.3%.²²

Minimum wages and employment

Minimum wages can affect levels of employment and unemployment in two ways: by boosting or constraining overall economic growth, and potentially by raising the level of structural unemployment because more low skilled workers are excluded from jobs.

Recent research by the OECD on the effects of minimum wages on employment finds that they generally have little or no impact on employment among adults, though they may effect employment among young people in the absence of lower rates of pay within this group.²³

There is no convincing evidence to suggest that the modest increases in minimum wages over the last decade in Australia have constrained overall economic growth. From 1997 to

¹⁹ UNICEF 2006, *Overview of child wellbeing*. Innocenti Research Centre. Based on a poverty line set at 50% of household disposable income.

²⁰ Masterman-Smith, May, & Pocock 2006, *Living Low Paid: some Experiences of Australian childcare workers and cleaners*. Brotherhood of St Laurence.

²¹ Yates et al 2006, *Housing affordability, occupation and location*, Australian Housing and Urban Research Institute.

²² Australian Bureau of Statistics 2007, *Consumer Price Index* (December 2007).

²³ OECD 2006, *Employment Outlook*.

2007, real minimum wages rose by 9% (including the latest rise) while employment rose by 24%.²⁴

The large increases in minimum wages in Australia in the 1970s and early 1980s could have raised the level of unemployment among low skilled workers at that time, but again there is no evidence to suggest that the modest increases over the past decade have reduced their job prospects. Higher minimum wages do not automatically lead to higher unemployment levels among the low skilled. For example, despite the much lower level of minimum wages in the US (around three fifths of those in Australia), unemployment among low skilled workers is much higher there (at 9% in 2005) than in Australia (at 6.3%).²⁵

One of the main causes of structural unemployment in Australia today is that many jobless income support recipients are not yet competitive for low skilled jobs. Although the 'official' unemployment rate is low, those who remain jobless at this stage of the business cycle are generally drawn from the most disadvantaged groups in society.

For example, most workforce age income support recipients have been on payments (Newstart Allowance, Parenting Payment or Disability Support Pension) for over two years. Most have less than 12 years of formal schooling, and many have serious health problems or have recently experienced domestic violence. In addition, many employers are reluctant to engage people with disabilities, mature age workers or Indigenous people regardless of their actual level of productivity.

Over the 1990s, growth in full time employment was biased against low skilled workers, but this was offset by growth in low skilled part time jobs. Among the OECD countries, Australia is second only to the Netherlands in its high level of part time employment (29% of all jobs). However, over the last five years growth in low skilled fulltime jobs has exceeded that in low skilled part time jobs.²⁶

In the US, which has much lower minimum wages (in 2005, US minimum wages were worth \$A278 per week in 'purchasing parity terms' compared with \$A467 here) there has been stronger long-term growth in low skilled full time jobs. However, the gap between hourly minimum wages in Australia and the US is so great that an Australian employee working three days a week on the minimum wage has a similar living standard to a full time minimum wage earner in the US.²⁷

Conditions in the labour market remain favourable though there is a build up of inflationary pressures in the economy:

²⁴ Dawkins (2000) *The labour market*, in Reserve Bank, *The Australian economy in the 1990s*; Australian Industrial Relations Commission website and Australian Fair Pay Commission 2006 and 2007, *Wage setting decisions*; ABS, *Consumer Price Index and Labour Force data*.

²⁵ Frijters & Gregory 2005, *From golden age to golden age – Australia's great leap forward?* Conference Paper, ANU Centre for Economic Policy Research; OECD 2007, *Employment Outlook*; Kennedy 2007, *Full employment in Australia and the implications for policy*, Department of the Treasury.

²⁶ Borland & Gregory 2001, *Work Rich, Work Poor*, Victoria University; Song & Webster 2003, *How segmented are skilled and unskilled labour markets?* Australian Economic Papers 42:3.

²⁷ ACOSS calculations for 2005, using Purchasing Power Parities from OECD (2005) *Principal economic indicators*.

- Employment growth of 2.25% in 2007-08 was forecast in the Government's Mid Year Economic and Fiscal Outlook. Unemployment was forecast to continue to fall over the year to historically low levels, and stood at 4% in February 2008.²⁸
- The labour market remains broadly favourable for low skilled workers. Although growth in the overall number of low skilled jobs appears to have plateaued over the last four years, there has been an increase in their average hours worked as jobs growth for the low skilled has shifted from part time to full time positions. Over the last five years, the number of fulltime elementary clerical sales and service employees rose by 7% and the number of fulltime labourers rose by 3%, while the numbers of part time elementary clerical sales and service employees remained constant and the number of part time labourers fell by 8%.²⁹
- Overall wage increases as measured by movements in the Wage Price Index remain moderate for this stage in the business cycle though they are trending slightly upwards. The MYEFO forecasts a 4.25% increase in the Wage Price Index over 2007-08, which is slightly above the 4% increase over 2006-07.
- The Reserve Bank forecasts that the underlying inflation rate will remain above its target zone of 2-3% for the next two years, having reached 3.6% over the year to December 2007.

However, as noted above the impact of the Commission's decisions on inflation are likely to be small given that only 20% of all employees are directly affected.³⁰

Minimum wages, income support and work incentives

The living standards of low income households rest on three foundations: jobs, minimum wage levels, and income support payments. All three play a vital role in preventing poverty. Policies that rely too heavily on one to the exclusion of the others pose risks for people on low incomes.

Policies that rely too heavily on the income support system to prevent poverty in working households impose fiscal costs that future Governments and taxpayers may be reluctant to bear. For example, a modest earned income tax credit for low income working families of \$47 per week was recently modelled by the Melbourne Institute as costing \$5 billion per year. Even if such a payment was introduced, if minimum wages are too low most of the benefits could be 'captured' by employers.³¹ The cost of Family Tax Benefits, which provide substantial, welcome income support for low paid working families, doubled from \$6.6 billion to \$13 billion per year between 1997 and 2004.

Adequate hourly minimum wages are important to maintain work incentives, especially for jobless people and 'second earners' in low and middle income families. Analysis by the Commission accompanying its 2007 decision indicates that the disposable incomes for jobless income support recipients are typically between 61% (for singles without children)

²⁸ Australian Bureau of Statistics 2008, *Labour Force, Australia* (January 2008).

²⁹ Australian Bureau of Statistics 2008, *Labour Force, Australia, detailed* (November 2007). Data are for the period from November 2002 to November 2007.

³⁰ Australian Bureau of Statistics 2007, *Employee earnings and hours*.

³¹ Buddelmeyer et al 2004, *Policy options to encourage welfare to work*, Melbourne Institute Working Paper 9/06; Kravitz T 2005, *Minimum wage, earned income tax credit, and inflation*, Urban Institute Brookings Institution Tax Policy Centre

and 77% (for couples with two children) of the incomes they would receive working fulltime on the Federal Minimum Wage. The 'gap' between people's incomes when jobless and what they receive on minimum wages is relatively large in Australia compared with other OECD countries. It is desirable to maintain a significant gap to encourage jobless people to join the labour force. However, since Newstart Allowance and other payments are indexed to at least the Consumer Price Index, the gap will close if minimum wages are not increased by at least this amount, unless income tests are eased or taxes are reduced for low paid employees. Since easing income tests and cutting taxes would be costly for governments to implement on a regular basis, there is a strong risk that payments for jobless people would be cut to preserve work incentives if minimum wages fell substantially. This is the main reason that countries with low minimum wages also have low income support payments for jobless people, and one of the reasons that poverty is higher in countries with low minimum wages.

Concerns have been raised that a significant proportion of any increase in the minimum wage will be absorbed by social security income tests and income tax, thus eroding the financial benefits and 'incentive effects' from the wage rise. To assess the extent of this problem, the Commission asked NATSEM to model the 'effective tax rates' imposed on a 39 cents per hour increase in the earnings of low paid employees. This study found that the effective tax rates for a majority (52%) of low paid employees were 30% or less and that only 10% attracted effective tax rates of more than 50%. That is, in the vast majority of cases the wage earner retained more than half of the pay increase.³² Increases in minimum wages are therefore an effective way to improve work incentives for jobless people.

Entry level and 'regional' wages, and the Supported Wage System

Australia has a separate set of lower minimum wages for young people, apprentices and trainees, and some people with disabilities (under the Supported Wage Scheme). The rationale for lower minimum wages for these groups is twofold:

- to recognise working time spent in training towards a widely recognised qualification,
- to improve the employment prospects of people who may otherwise struggle to find employment due to inexperience or low productivity.

As a general principle, apart from 'training wages', lower minimum wages for specific groups in the workforce are discriminatory and should only apply in exceptional circumstances. If 'sub-minimum' wages become too widespread, there is also a risk that the minimum wage itself will be undermined.

Young people are generally paid less than adult minimum wages. Although unemployment among young people has declined over the past two decades, many still struggle to progress from school to secure employment. However, this is due mainly to such factors as poor educational outcomes and social disadvantage rather than the level of minimum wages for young people.

Apprenticeships have historically provided a reliable point of entry into the workforce for young people in blue collar occupations, and increasingly do so for people in other age groups and in service sector jobs. However, 'traditional' apprenticeships have declined over

³² NATSEM 2006, *Interactions between wages and the tax-transfer system*, Report for the Fair Pay Commission.

the long term, and almost half of those who commence these apprenticeships do not complete them. The reasons include low levels of pay for extensive periods of time.³³

Regional labour market inequalities, including differences in unemployment rates, are less pronounced in Australia than in other wealthy countries. This problem is best addressed by structural adjustment policies (such as retraining of displaced workers in regions where major industries decline) rather than by allowing employers in high-unemployment regions to pay wages below the national minimum. Wages are already generally lower in rural and regional areas than in capital cities.³⁴

Only 43% of people with disabilities are employed compared with 72% of the population of workforce age. A major barrier to employment for many people with disabilities is employer perceptions of a high 'risk' associated with employing people with disabilities, for example that they are more likely to make Workers Compensation claims. These perceptions are often inaccurate, and many jobless people with disabilities would be highly productive if the workplace were organised to facilitate this.³⁵

The keys to a fair and effective system of sub-minimum wages for workers with disabilities are a transparent and consistent system of productivity assessment that incorporates a requirement to change the workplace and work practices to improve productivity as far as possible prior to the assessment of individual worker productivity. This was part of the Commission's decision when it extended the Supported Wage System to more employees with disabilities in different industries. The extension of the Supported Wage System makes careful monitoring of the reliability and equity of the various instruments used to assess productivity essential. On equity grounds, it would be desirable to standardise the instruments as far as possible.

³³ NCVET 1999, *Apprentices and trainees in Australia 1985 to 1999*; NCVET 2005, *Apprenticeships and traineeships*. Ball 2004, *Factors influencing completion of apprenticeships and traineeships*, NCVET.

³⁴ OECD 2006, 2003 and 1998, *Employment Outlook*; Kennedy & Borland 1997, *A wage curve for Australia?* ANU CEPR Discussion Paper No 372. Leigh 2005, *op cit*.

³⁵ ABS 2003, *Disability, carers and ageing survey*; Human Rights and Equal Opportunities Commission 2005, *People with disability in the open workplace*.

1. The Fair Pay Commission's remit

Section 23 of the Workplace Relations Act gives the Fair Pay Commission authority to set a standard federal minimum wage for adults and to determine relativities in the award structure between this and rates of pay for higher classifications. In doing so, it must take account of:

- the economic prosperity of the people of Australia
- the capacity of the low paid to obtain and remain in employment
- employment and competitiveness across the economy
- providing a safety net for the low paid.

This list of objectives is very broad.

The '*economic prosperity of the people of Australia*' has a much wider meaning than growth in Gross Domestic Product. For example, it is acknowledged in the Australian Treasury's 'Well being framework' and in international economic literature that the extent to which national income is widely or narrowly distributed is an important factor in community well being. The fundamental reason for this is that, in assessing their satisfaction with life, people usually compare their circumstances with others. The distribution of living standards also has a major influence on other, more tangible aspects of community well being - for example, countries with high levels of social inequality are more likely to have higher infant mortality rates.³⁶

The European Union has developed a set of key structural indicators to measure community well being more broadly than growth in the economy (see box below). Also, the Australian Bureau of Statistics regularly updates its Measuring Australia's Progress publication, which also contains a range of indicators of community and environmental well being.

This objective includes any effect of minimum wages on individual and household incomes and on workforce participation (for example, work incentives among mothers) and unemployment.

The '*capacity of the low paid to obtain and remain in employment*' includes any effect of minimum wages on the overall level of employment (especially low skilled jobs) and any effect on 'churning' in the labour market between low skilled jobs and joblessness.

'*Employment and competitiveness across the economy*' includes any effect on employment (as above) and any effect on national productivity.

'*Providing a safety net for the low paid*' includes the benchmarking of minimum wages to indicators of individual and household living standards, including any effect on income poverty and on the ability of people to afford the essentials that comprise a 'decent basic living standard' in Australia today. This benchmarking of living standards should arguably take account of the Australian ethos that wages should be enough for people to live and work with dignity, and that large inequalities of income are unacceptable.

³⁶ Treasury 2004, *Policy advice and Treasury's well being framework*. Paper delivered at ACAS meeting.

The European Union's key structural indicators

At the 'Stockholm Summit' in March 2001, the European Commission endorsed seven key social indicators, for adoption across Europe:

1. Distribution of income (ratio of share of top 20% to share of bottom 20%)
2. Share of population below poverty line before and after social transfers (defined as 60% of national median equivalised income)
3. Persistence of poverty (share of population below poverty line for three consecutive years)
4. Proportion of jobless households
5. Regional disparities (coefficient of variation of regional unemployment rates)
6. Low education (proportion 18-24 not in education or training and have only lower secondary education)
7. Long term unemployment rate.³⁷

2. The federal minimum wage and low paid employees in Australia and overseas

Current level of the minimum wage

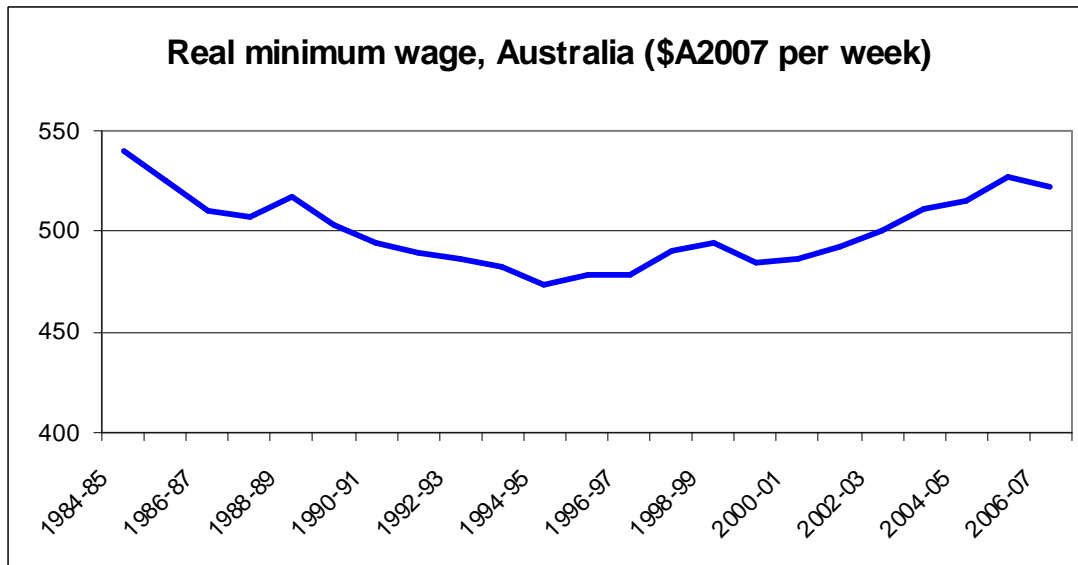
The Federal Minimum Wage (FMW) is currently \$13.74 per hour, \$522.12 per week, or approximately \$27,150 per year.

Growth in real minimum wages over time

The minimum wage has fallen in 'real terms' over the 1980s, but risen moderately since the mid 1990s. As a result, its real value is approximately the same now as it was 20 years ago (see graph below). Last year, its real value fell by about 1% (from December 2006 to December 2007) after rising for a number of years.³⁸

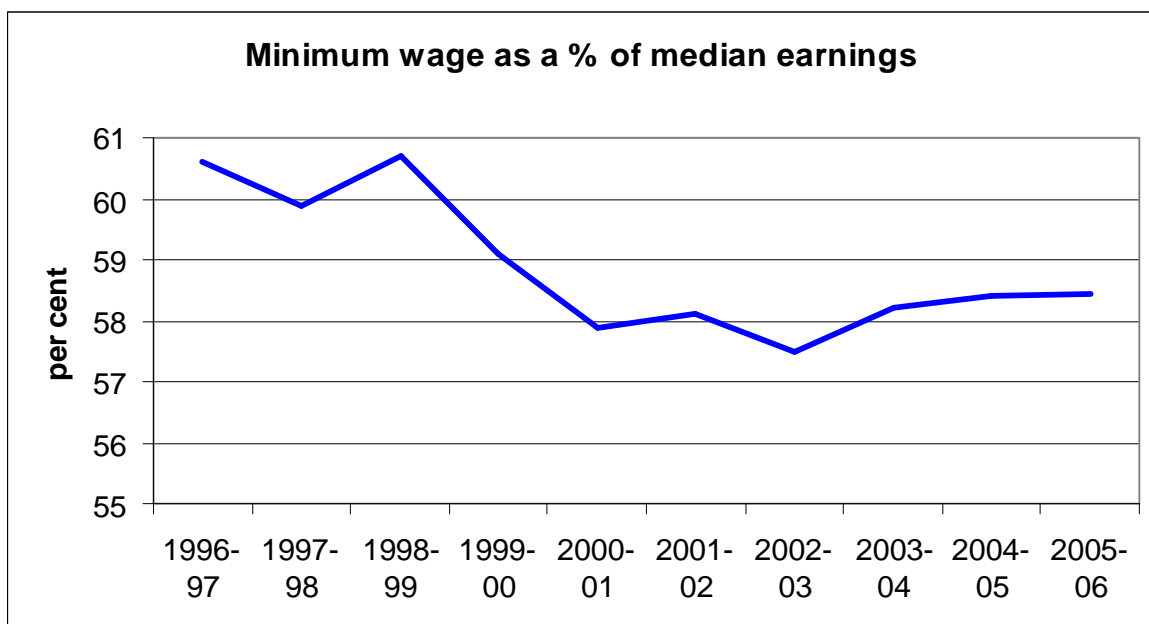
³⁷ European Commission (2000b) *Structural Indicators*, Annex 2 to the Stockholm Report, Communication from the Commission, COM (2000) 79 final/2. Atkinson et al (2002) *Social Indicators – the EU and Social Inclusion*, Oxford University Press, Oxford.

³⁸ Based on an increase in the CPI of 3% over this 12 month period. See ABS 2008, *Consumer Price Index*.



Sources: Dawkins (2000) *The labour market*, in Reserve Bank, *The Australian economy in the 1990s*; ABS, *Consumer Price Index*; Australian Fair Pay Commission 2006, *Wage setting decision*.

Although real minimum wages have grown modestly over the last decade, they have fallen substantially when compared with median (middle) wages (see graph below). This is consistent with a rise in earnings inequality over this period (see section on 'inequality' below).



Sources: Australian Industrial Relations Commission 2005, *Safety net adjustment decision*, ABS 6302, *Employee earnings & hours*.

Who relies on minimum wages?

Estimates of the number of low paid workers and their profile vary according to how 'low pay' is defined, the data source used, and whether part time employees are included.

(1) The incidence of low pay

Leigh (2005) used a benchmark of up to an hourly wage of the Federal Minimum Wage plus \$2, and data from the ABS Income Distribution Survey to conclude that 23% of *all* employees were low paid in 2004, comprising:

- 10% of wage earners earned just over the minimum wage (he found that the size of this group is diminishing over time).
- Up to another 13% earned *below* adult minimum wages. Possible reasons for this include lower 'youth rates', occupations and industries outside the award system, underpayment of employees, and under-estimation of incomes in the ABS data.³⁹

A more recent study by the National Institute of Labour Studies yielded similar results:

- 9% of fulltime adult employees (701,000 employees) earned between the FMW and \$2.20 per hour above it.
- 10% (725,000 employees) earned *less than or equal to* adult minimum wages.⁴⁰

(2) The demographic profile of low paid employees

According to Leigh, the basic profile of low paid employees is as follows:

- The incidence of low pay is much greater for young people, and about 40% to 50% of the low paid are under 25 years
- It is also much greater among those with low educational qualifications
- A majority were women, who are overrepresented among low paid employees.⁴¹
- About one third of minimum wage earners are the sole breadwinners in their household.
- About two fifths are the highest earner in their household.
- The rest are mainly 'second earners' in married couple households or young people living with their parents.

These findings regarding the higher incidence of low pay among young people, women and people with low qualifications are similar to those in other research, including that commissioned by the Fair Pay Commission.⁴²

Other studies have also found that:

- there is a higher incidence of low pay among employees living outside major cities,

³⁹ Leigh A 2005, *Does the minimum wage help the poor?* ANU Centre for Economic Policy Research Discussion Paper 501.

⁴⁰ See also Healy & Richardson 2006, *Updated profile of the minimum wage workforce in Australia*, Report for Fair Pay Commission, National Institute of Labour Studies, which found that 52% of low paid employees were women compared with 45% of the overall workforce.

⁴¹ Healy & Richardson 2006, *op cit*. The authors note that 45% of the overall workforce are women.

⁴² McGuinness et al 2006, *Characteristics of minimum wage employees*. Melbourne Institute.

- low paid employees come mainly from the retail, hospitality, and community services industries, and
- they come mainly from low skilled occupations such as elementary or intermediate service workers, labourers, and production workers.⁴³

Leigh found that most low paid employees are engaged part time, and about half are casuals (most of whom would also be employed part time).

(3) Low pay in the community services sector

As the peak organisation in the non government community services sector, ACOSS has a special interest in employment issues in community services. The community sector's capacity to provide quality services depends on the availability of suitably skilled employees, many of whom rely on the Pay Scales for their wages. With approximately 12% of Pay Scale reliant employees working in health and community services, the industry ranks as the fourth largest employer of these workers.⁴⁴ A major reason for this is that Government funding contracts often provide no scope for employers to offer above-award rates of pay notwithstanding the qualifications and skills required of their employees and labour shortages in the sector.

The vast majority of employees in the community services sector (88%) are women. A high proportion of employees in community services work part time, often due to restrictions in funding rather than personal preference. In health and community services overall, 45% of employees were part time in 2004, compared with a national average of 29%. Limitations on paid working hours exacerbate the low hourly rates of pay across the sector.⁴⁵

ACOSS conducts a regular survey of the state of non government community services, the 'community sector survey'. In last year's survey, 58% of service provider respondents reported difficulty in recruiting qualified staff.⁴⁶ This problem is likely to worsen if the Pay Scales continue to be adjusted in flat dollar amounts, reducing rewards for skill in the sector.

Labour shortages in community services are likely to worsen over the next decade, given the age profile of the sector. In 2001, over 40% of the community sector's workforce was over 44 years of age.⁴⁷

(4) The household incomes of minimum wage earners

Leigh's research found that:

- Minimum wage earners come mainly from the middle of the income distribution when retired households are included (see table below). The reason for this is that around three quarters of retired people are age pensioners on very low incomes.

⁴³ Leigh op cit; State of Working Victoria project 2003, *The low paid in Victoria*; Richardson & Harding op cit.

⁴⁴ AFPC 2007, *Wage setting decisions and reasons for decisions*. Note that the community services sector described here is a subset of health and community services, excluding core health services.

⁴⁵ Australian Services Union 2007, *Building social inclusion in Australia: priorities for the social and community services sector workforce*.

⁴⁶ ACOSS 2007, *Australian Community sector survey*.

⁴⁷ Australian Services Union 2007, *ibid*.

- However, since minimum wages only directly affect people of workforce age (whether in jobs or unemployed) it is appropriate to exclude retired people when examining the effect of minimum wages on income inequality. When this is done, half of all minimum wage earners come from households in the bottom 40% of the distribution.

This is consistent with the findings of research commissioned by the Commission last year, and with Richardson & Harding’s findings for 1995.⁴⁸

Where minimum wage earners fit in the household income distribution (2002)

	Bottom 20%	2nd 20%	3rd 20%	4th 20%	Top 20%
<i>All households</i>					
Location of bottom 20% of hourly wage earners	19%	20%	26%	20%	14%
<i>Working age households (15-55 years)</i>					
Location of bottom 20% of hourly wage earners	23%	28%	22%	16%	11%

Source: Leigh, 2005, *Does raising the minimum wage help the poor?*

International comparisons

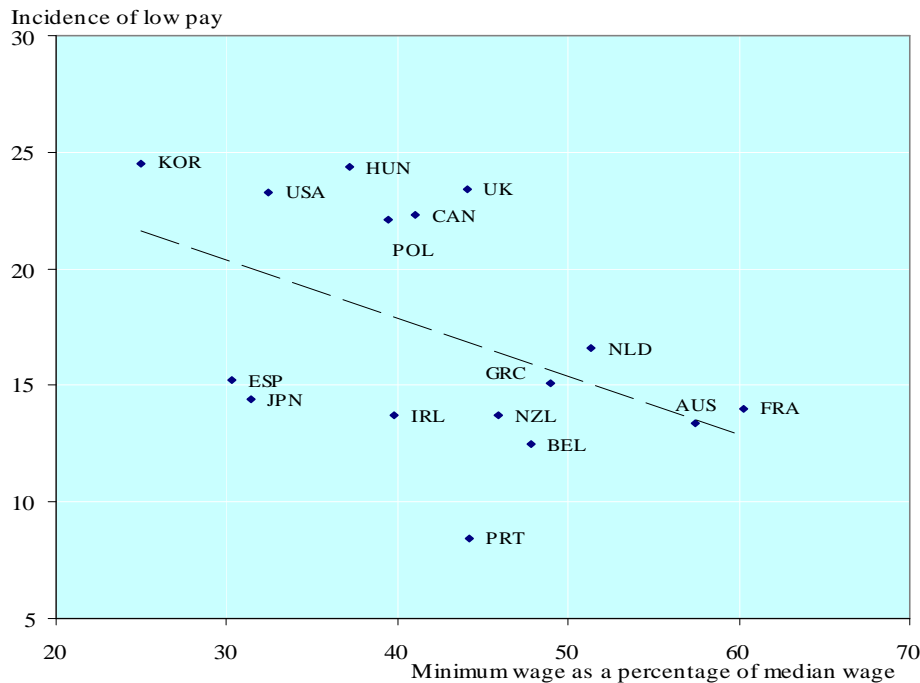
Australian weekly minimum wages are around 58% of the median weekly wage. This is higher than most OECD countries, and has been so for many years.

Despite our relatively high minimum wages, the proportion of Australian employees who are *low paid* (defined in this case as earning less than two thirds of median full time wages) is close to the median of 15 countries recently surveyed by the OECD (for Australia, the estimate is 13-14%, compared with a median level of around 15% - see graph below). One possible explanation for the difference between these two indicators of low pay is that, compared with other wealthy countries, a high proportion of Australian employees earn wages that are *below or just above* the minimum. The former interpretation appears to be borne out by research commissioned by the Fair Pay Commission last year, which found a substantial number of employees on below minimum rates of pay across Australia.⁴⁹

⁴⁸ Healy & Richardson 2006, *An updated profile of the minimum wage workforce in Australia*. National Institute of Labour Studies; Richardson & Harding 1999, op cit.

⁴⁹ McGuinness et al 2006, *Characteristics of minimum wage employees*, Melbourne Institute.

Minimum wages and low pay in the OECD (2000-03)



Source: OECD 2005, Employment Outlook, supplementary data.

Note: Incidence of low pay (% of full time employees on less than 2/3 of median wages) is on the vertical axis; Minimum wage as a % of median wage is on the horizontal axis.

3. Trends in income inequality in Australia and overseas

Trends in earnings inequality

Earnings have become less equal in Australia since the mid 1970s. The graph below shows the disparate growth in real earnings of full time employees among low, middle and high income earners over that period.

From 1986 to 2001, full time non-managerial earnings increased by:

- 5% for tenth percentile (top of the bottom 10%) of full-time wage earners;
- 9.9% for the 50th percentile (median) full-time wage earner;
- 18.3% for the 90th percentile (bottom of the top 10%).

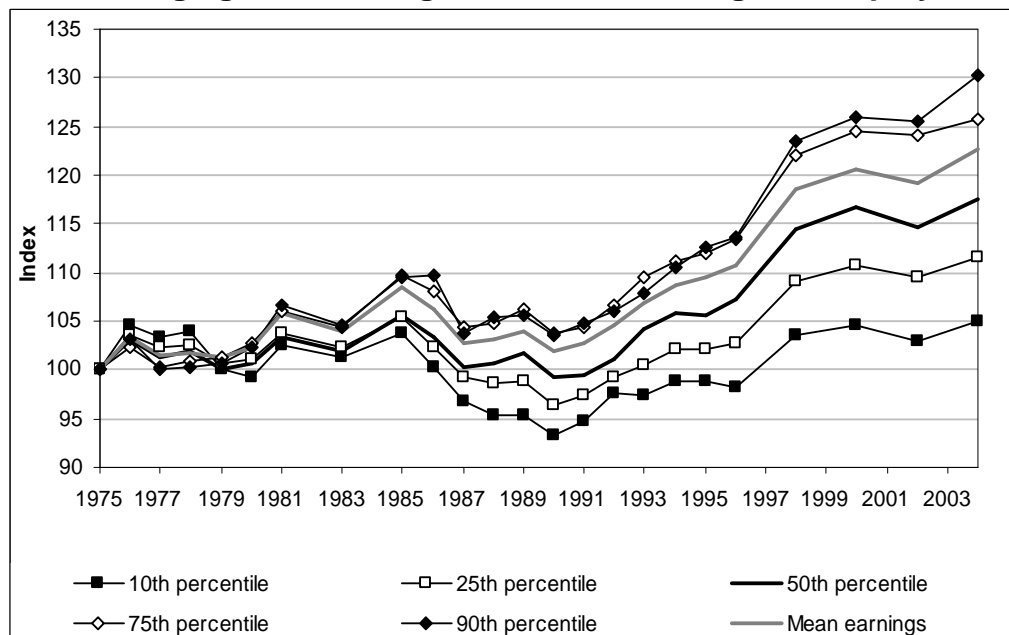
Male full time wages have become relatively more unequal over this period compared to female full time wages.⁵⁰

This trend towards wider dispersion of earnings continued between 2001 and 2006.⁵¹

⁵⁰ Saunders 2005, *Reviewing recent trends in wage income inequality*. Social Policy Research Centre, University of NSW.

⁵¹ Over that period, the increases at each of the three points in the earnings distribution cited above were zero, 4% and 9% respectively. Source: ABS (6306.0) *Employee Earnings and Hours*, Australia.

Real earnings growth among full time non managerial employees



Source: FACS 2003, *Submission to Senate Inquiry into Poverty*, updated using ABS (6306.0) *Employee Earnings and Hours, Australia*.

Wage inequality has a major impact on the overall inequality of income among households. The way in which jobs are distributed across the population (the level of unemployment and joblessness) has a bigger impact than the distribution of wages (wage inequality) on the *current* overall level of household income inequality in Australia. However, when we examine changes in the level of inequality over time, the *increase* in earnings inequality over the past 20 years explains much of the overall *rise* in household inequality over that period.

Earnings inequality between men and women, as measured by gender pay equity ratios, dramatically declined in the 1970s and continued to decline more slowly between 1981 and 2002, but has increased since 2004.⁵² In 2006, women earned 84% of the average weekly earnings of male employees, compared with 87% in 2004. International research suggests that adequate minimum wages are a key factor in reducing the gender pay gap, since most women are usually located near the bottom of the wage distribution.⁵³

Causes of greater earnings inequality

There are a number of different theories to explain the rise in earnings inequality in Australia and many other OECD countries:

- Some argue that technological change has biased job creation towards high skilled jobs to the disadvantage of the low skilled.
- Others argue that jobs growth has been stronger both at the bottom and the top of the earnings structure (the 'disappearing middle' theory), reflecting changes in industry structure and the deregulation of wage fixing.

⁵² URCOT 2005, *Pay equity – how to address the gender pay gap*, Industrial Relations Victoria; ABS, *Employee earnings and hours survey*.

⁵³ Blau 2003, *Understanding international differences in the gender wage gap*, *Journal of Labor Economics* 21:1.

- Others argue that the distribution of hourly wage rates according to different levels of skill has not changed much, but that full time jobs growth has occurred mainly at the high skilled end while most of the extra jobs at the bottom end have been part time.⁵⁴

Household income inequality

Since the mid 1980s, income inequality among households has increased in Australia, though the rate of increase may have slowed in recent years. This rise in inequality is the result of two forces pushing in opposite directions – substantially greater inequality in market incomes (jobs and wages) and greater effort by Governments to reduce it.

According to the ABS income distribution surveys, between 1994 and 2006, average household disposable incomes have increased in real terms by:

- 31% for low income households in the second two deciles (from the 10th percentile to the 30th)
- 32% for middle income households in the fifth and sixth deciles (from the 40th percentile to the 60th)
- 36% for high income households in the top two deciles (from the 80th percentile to the 100th).⁵⁵

According to analysis by NATSEM of ABS Household Expenditure Surveys, income inequality had already increased between the mid 1980s and mid 1990s.⁵⁶

International comparisons

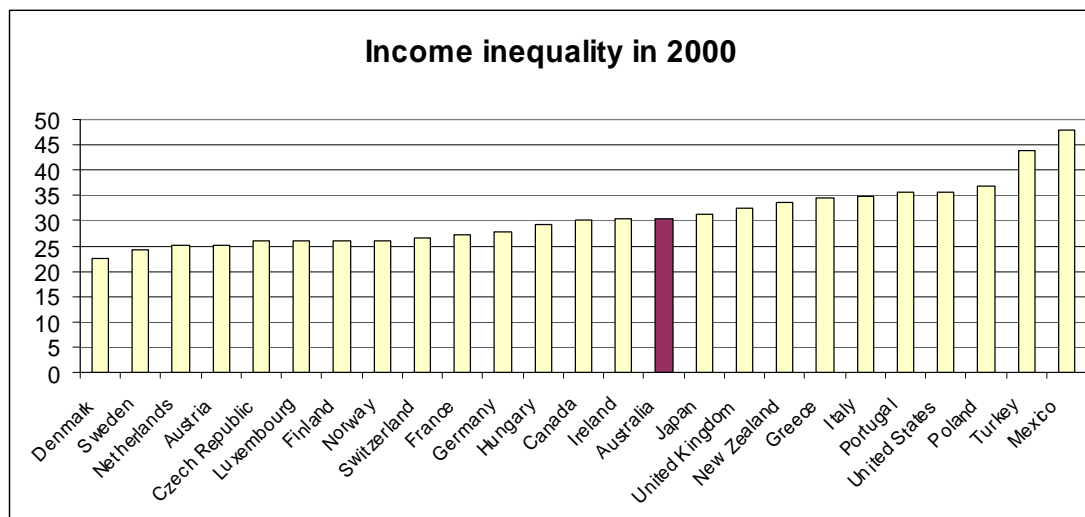
A trend towards higher income inequality is not the inevitable consequence of ‘globalisation’ or national economic ‘reform’ in response to it. Over each of the past two decades, household income inequality has fallen in almost as many OECD countries as it has risen.⁵⁷ There is also considerable diversity in the level of household income inequality among OECD countries. Generally speaking, the ‘Anglophone’ countries (including Australia), along with the poorer OECD nations (such as Mexico) have relatively high levels of income inequality. The graph below shows that Australia has an overall level of household income inequality slightly above the median (middle) level among OECD countries.

⁵⁴ Borland & Gregory 2001, *Work Rich, Work Poor*, Victoria University; Gregory 1993, *Aspects of Australian and US living standards*, Economic Record Vol 69; Watson et al 2003, *Fragmented futures*, Federation Press; Keating 2003, *Earnings and inequality*, ANU Centre for Economic Policy Research Discussion paper 460; Frijters & Gregory 2005, *From golden age to golden age – Australia’s great leap forward?*; Saunders 2005, *Reviewing recent trends in wage income inequality*; Richardson 2004, *Low wage jobs and pathways to better outcomes*. NILS.

⁵⁵ ABS *Household income and income distribution survey 2005-06*. See also Saunders 2003, *Examining recent changes in income distribution in Australia*, Social Policy Research Centre. It is not possible to compare incomes directly from these surveys with previous ABS income surveys due to a break in the series in the mid 1990s. Further, changes in the ABS methodology from 2003-04 raised the estimated incomes of many low income households, so that the above estimate of a 31% increase in their incomes from 1994 to 2006 probably overstates the increase in their incomes.

⁵⁶ Harding & Greenwell 2001, *Trends in income and expenditure inequality in the 1980s and 90s*.

⁵⁷ OECD 2006, *Employment Outlook*.



Source: Forster & dErcole, *Income distribution and poverty in OECD countries*, OECD Working Paper. Inequality measure used was gini coefficient. A gini coefficient of 1.0 means that one individual has all the nation's household income, a value of 0 means complete equality of income.

When we examine specifically how household income is shared among high, middle and low income households, we also find a good deal of diversity among wealthy countries.

For example, in the late 1990s, the share of all household income going to the *bottom* 20% of households was:

- Relatively low in Australia, the US and UK at 7.6%, 6.2% and 7.7% respectively, compared with an OECD average of 8.2%.
- Relatively high in Denmark, France and the Netherlands, at 10.2%, 9.1% and 9.2% respectively.

The share of all income going to the *top* 20% of households was:

- Around the middle in Australia, and France, at 36.8%, and 36.7% respectively, compared with an OECD average of 37.2%;
- Relatively high in the US and UK, at 40.8% and 39.4% respectively;
- Relatively low in Denmark and the Netherlands, at 32.7% and 34.2% respectively.⁵⁸

This evidence suggests that national policies and institutions matter in determining the level of income inequality in each country.

⁵⁸ Forster & dErcole 2005, *Income distribution and poverty in OECD countries*, OECD.

4. Minimum wages and living standards

Possible minimum wage benchmarks

An adequate 'safety net' for low paid employees and their families requires an objective assessment of their basic income needs. Ideally, this assessment should be informed by a set of 'basic income' benchmarks. This does not mean that minimum wages should be targeted towards a single benchmark, since other factors (including employment impacts) must be considered. It is also unlikely that a consensus will be forged over a single benchmark. Instead, a set of basic income benchmarks should be used as a guide in assessing the adequacy of minimum wages.

There are three issues to resolve in setting benchmarks for the adequacy of incomes.

The first issue is the *type of family to be used as the 'benchmark' family*. ACOSS considers that for the purpose of fixing minimum wages, the basic income needs of a single adult living alone is the appropriate reference point since:

- it is not feasible for wages to take account of the size of an employee's family,
- for this and other reasons, Australia developed a national system of child endowment (now called Family Tax Benefit) to meet the minimum costs of raising children in low income families,
- also, it is generally accepted today that women are income earners in their own right rather than 'dependents' of their partners. This is reflected in the 'equal pay' decision of the AIRC in the early 1970s, and in the payment of income support separately to men and women in married couples (though the income of the partner is taken into account).

The second issue is the *level of living standard* that a person should be able to attain on a full time minimum wage. For many years, Australia has set minimum wages well above poverty levels. This reflects:

- a strong consensus in the community that minimum wages should be sufficient for people to live in dignity, not well below the living standards of the rest of the community,
- a pragmatic judgement that, if wages were set around poverty levels, work incentives for jobless social security recipients would be eroded.⁵⁹

ACOSS believes that minimum wages should be sufficient for a single adult to achieve a 'decent' basic living standard, well clear of poverty levels, in accordance with community expectations. This living standard is likely to lie somewhere between a 'poverty' standard of living and the living standard of the median (middle income) earner. It is likely to rise over time, along with standards in the community generally.

⁵⁹ This assumes that these payments should be sufficient to keep their recipients out of poverty.

The third issue is *how to measure this living standard*. There are three main approaches to setting 'basic income' benchmarks:

- The 'budget standards' approach in which experts draft 'basic budgets' encompassing the minimum expenditure requirements for different types of families⁶⁰
- Direct measurement of the living standards of low income households, on the basis of access to a set of 'essential' goods and services. This requires a degree of consensus over what comprises essential goods and services in Australia today.
- Poverty lines - income levels below which it is considered that households face a high risk of failing to achieve a 'basic' minimum living standard. These may be expressed as a proportion of overall average or median household income, or they may be set with reference to the other two methods above.⁶¹

At this stage, the most robust and credible of these benchmarks for wage fixation purposes appears to be the Budget Standards developed by the Social Policy Research Centre. The main advantages of this approach are its transparency (the budgets and the items comprising them, are readily understood) and its adaptability (the budgets can easily be changed in the event of disagreement over any item included). The main problems include reliance on the judgement of 'experts' as to which items should be included, and the need to update them from time to time to reflect changes in what constitutes a 'basic' living standard. As this has not been done since these Budget Standards were developed in 1996, they are probably somewhat out of date with current community expectations of a decent living standard.⁶²

The Budget Standards, and two poverty lines for single adults and a family of four are detailed in the table below. There are two sets of Budget Standards – a 'low cost' standard which is equivalent to 'poverty', and a 'modest but adequate' standard which is a basic standard of living set above poverty levels. When indexed to December 2006 using the CPI, the 'Modest but Adequate' Budget Standard for a single adult was \$512 per week. By comparison, the federal minimum wage is approximately \$475 per week after tax for a single adult without children in 2006.⁶³

⁶⁰ This was the approach adopted by the Industrial Commission in developing the 'Harvester standard' or 'basic wage' early last century. It was also adopted in a 1996 study by the Social Policy Research Centre, commissioned by the former Department of Social Security, to assist in the assessment of the adequacy of social security payments. See SPRC 1997, *Indicative budget standards for Australia*. Dept of Social Security.

⁶¹ The 'Henderson Poverty Lines' were developed for a National Inquiry into Poverty commissioned by the Australian Government in 1970. Their development was informed by a survey of the living standards of Melbourne residents. However, the benchmark used for a family of four was the then 'basic wage' together with child endowment. Other poverty lines used here and overseas are based on 50 or 60% of median family incomes, or 50% of average family incomes.

⁶² Updating is a problem with all three methods described above. A further technical problem with the SPRC Budget Standards is that they do not take account of wide variations in housing costs across Australia. This could be addressed fairly easily by using a median national estimate for rents, or by developing different budget standards for different housing markets.

⁶³ Saunders 2003, *Updated budget standards estimates*. Social Policy Research Centre. The Budget Standards are a measure of expenditure, so they are equivalent to disposable (after tax) income rather than the gross wage. It might be argued that these Budget Standards are inflated by the use of Sydney rents as the benchmark for housing costs. On the other hand, since they are a decade old, the Budget Standards need updating to take account of changes in living standards since 1996 when they were set.

Living standard benchmarks (2003)

	Single adult	Couple, 2 children (5-12)
‘Modest but adequate’ income thresholds (\$ per week, after tax)		
Budget Standards: ‘Modest but adequate’ (2003)	\$452	\$868
Poverty thresholds (\$ per week, after tax)		
Budget Standards: ‘Low cost’ (2003)	\$354	\$709
Poverty line (50% of average income)	\$244	\$452
Poverty line (Henderson)	\$294	\$551

Source: Saunders 2003, *Updated budget standards estimates*. Social Policy Research Centre.

Note: The equivalent wage levels for single adults will usually be higher than these figures (due to income tax) while those for families will usually be lower (due to Family Tax Benefits and other payments).

Minimum wages and poverty

Although poverty lines do not tell the ‘whole story’ of deprivation, they are a widely accepted benchmark for measuring disadvantage. The available evidence suggests that although the risk of income poverty (living below a poverty line) is low for full time minimum wage earners in Australia today, a much higher proportion of income-poor families includes at least one wage earner.

Caution should be exercised in interpreting estimates of poverty based on ‘poverty lines’ since the results are sensitive to:

- the level of the poverty line chosen and how the poverty line itself is affected by changes in low pay, especially if the poverty line is based on a percentage of median household income (see discussion below);
- the definition of ‘low pay’ or ‘minimum wage earner’ that is used;
- the reliability of the incomes data used.

For these reasons, it is desirable to apply ‘sensitivity tests’ by using a range of poverty lines and measures of low pay, instead of relying on a single set of results. Unfortunately, there are few recent studies of the extent of poverty in Australia on which we can rely.

We examine below research conducted by the Social Policy Research Centre (SPRC) for Australia Fair on the incidence of income poverty in Australia in 2005-06, using ABS incomes data. We then examine international poverty research conducted for the OECD and UNICEF.

(1) Recent research on income poverty in Australia

Research conducted by the SPRC for Australia Fair used the ABS Household Expenditure Survey for 2005-06 to estimate the numbers of people living below poverty lines set at 50%

and 60% of equivalent household disposable income. These are the standard poverty lines used by the OECD and the European Union countries respectively.

In 2006, the 'risk' of income poverty was between 6-15% for individuals in households with one wage earner and between 1-4% for those with two or more wage earners, depending on the poverty line used.⁶⁴ However, between 17% and 22% of individuals in households living below these poverty lines had one wage earner and between 8-10% had two or more wage earners. The reason that a higher proportion of people below the poverty line are in wage earning households is that there are many more wage earning households overall than jobless households. Based on these estimates, between 396,000 and 829,000 people in wage earning households lived below the poverty line. These are likely to mainly comprise families with children.⁶⁵

Individuals over 15 years in income poverty in 2005-06

	Risk of poverty (%)		Profile of poverty (%)	
	50% of median poverty line	60% of median poverty line	50% of median poverty line	60% of median poverty line
One wage earner in household	6.9	14.5	17.9	21.5
Two or more wage earners in household	1.9	3.6	8.7	9.5
Jobless household	39.9	65.5	73.4	69.0
All	11.1	19.4	100	100

Source: Social Policy Research Centre 2007, *Poverty in Australia*, report for *Australia Fair*.

The findings are broadly consistent with earlier studies. For example, NATSEM found that in 2001, 4% of people in families with at least one fulltime wage earner and 8% of those in families with at least one part time wage earner were poor, based on the '50% of median income' poverty line. Overall, individuals from wage earning households comprised 27% of all people living below that poverty line.⁶⁶

(2) International comparisons

International evidence suggests that there is a link between levels of low pay and income poverty across nations. Broadly speaking, the greater the incidence of low pay (typically defined as employees earning less than two thirds of the median wage) the greater the

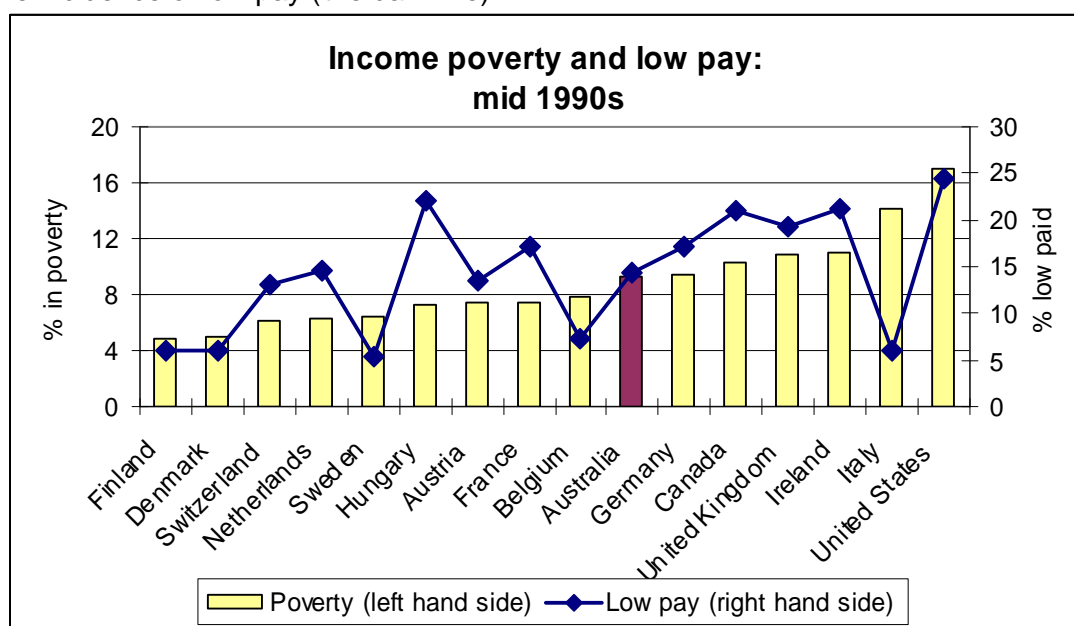
⁶⁴ The lower estimates are based on a poverty line set at 50% of equivalent household disposable income and the higher estimates are for a poverty line set at 60%. The 'Henderson Poverty Lines' lay in between these two poverty lines.

⁶⁵ Social Policy Research Centre 2007, *Poverty in Australia*, report for *Australia Fair*.

⁶⁶ Source: Lloyd, et al 2004, *Australians in poverty in the 21st century*, NATSEM.

incidence of income poverty (typically defined as income below a fixed percentage of median disposable household income).

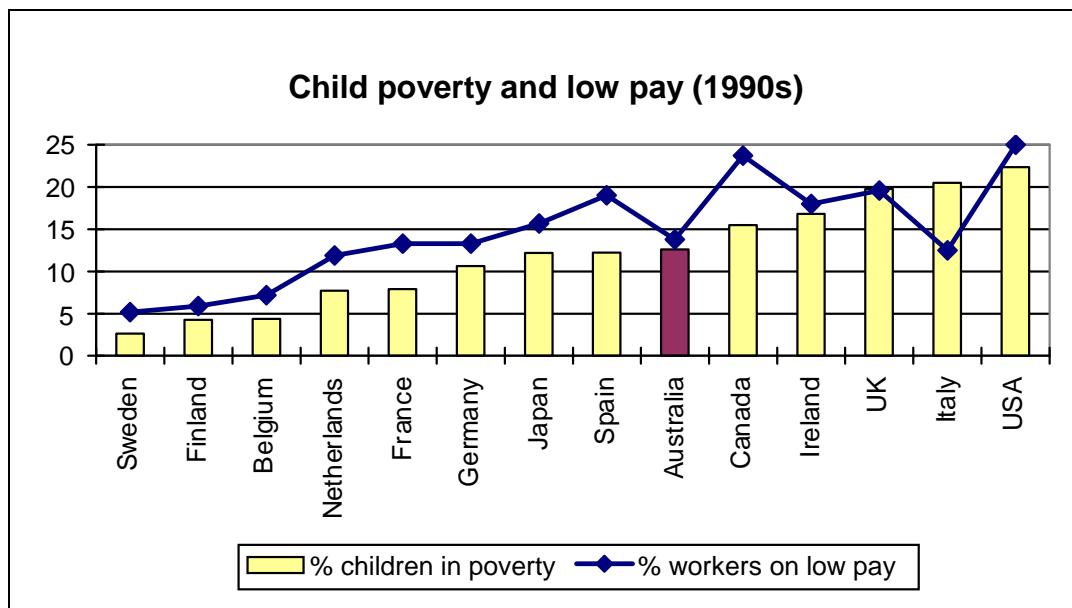
As discussed above, it is not inevitable that the two indicators will be linked in this way, since low pay is a measure of individual income and income poverty is a measure of household income. The graph below is derived from an OECD study of income poverty. It charts the relationship between income poverty across the whole population (see bars in the graph) and the incidence of low pay (the dark line).



Source: Förster, M. (2000), *Trends and driving factors in income distribution and poverty in the OECD area*, Labour Market and Social Policy Occasional Paper, No. 42, OECD, Paris.

Note: "Low pay" refers to the % of full-time workers on wages less than 2/3 of the median wage. "Poverty" refers to the % of all people living in poor households, with the poverty line based on half median equivalent household disposable income.

The graph below is derived from a separate international study of *child poverty* conducted on behalf of UNICEF. It charts the relationship between income poverty among children and the incidence of low pay. The link between minimum wages and child poverty is stronger, because in this analysis retired households are not included in the estimation of poverty.



Source: UNICEF (2000), *Child poverty in rich countries*. Florence.

Note: "Workers on low pay" refers to the % of full-time workers on wages less than 2/3 of the median. "Children in poverty" refers to the % of all children living in poor households, with the poverty line based on half median equivalent household disposable income.

This study found that that 14% of Australian workers were low paid (earning less than two thirds of median wages). The proportion of Australian children living below a low poverty line (half median household income) was 13%, around the middle of the OECD countries surveyed. The US had a higher proportion of low paid workers (25%) and a much higher child poverty level (22%). By contrast, just 5% of Swedish employees were low paid and 3% of children in that country lived below the poverty line. The authors of the UNICEF study suggest that minimum wages may have an internationally consistent indirect effect on child poverty in jobless families because:

- social security payments are often linked to minimum wage levels (to maintain work incentives), so countries with low minimum wages have lower social security payments.
- in countries with high minimum wages there is a stronger policy consensus in favour of reducing inequality generally.⁶⁷

(4) The living standards of low paid families

Income poverty is only an indicative measure of family living standards, since families may have different expenditure needs (for example, for health care) and different assets at their disposal (for example, savings). Nevertheless, with some exceptions, income poverty data provides a reasonable indicator of the risk of poverty.⁶⁸

⁶⁷ UNICEF (2000), *Child poverty in rich countries*. Florence

⁶⁸ ACOSS 2003, *The bare necessities*. The main exceptions are low income self employed people and low income retirees with substantial assets.

A major study has just been completed that seeks to measure Australian living standards directly. This was conducted by the Social Policy Research Centre in collaboration with ACOSS, Mission Australia, the Brotherhood of St Laurence, Anglicare NSW and Baptist Community Services NSW. A national survey was conducted to ask respondents what they consider to be 'essentials', whether or not they have them, and whether or not they lack them due to lack of resources. This study was not specifically designed to assess the levels of deprivation among low paid working households, though the data could be adapted to that purpose.⁶⁹

Another recent study by Masterman-Smith et al using focus groups of low wage earners sheds more light on the lived experience of low paid workers. This study indicates that families reliant on low pay must budget very carefully to avoid financial hardship, foregoing things most Australians take for granted such as dental care, annual holidays, a car, eating out with friends, and buying a home.⁷⁰

(5) ABS data on financial hardship

Another useful source of data on the living standards of Australian households is derived from the Australian Bureau of Statistics' 'financial stress' indicators. These are used by the ABS in its income and expenditure surveys, and are also included in the Melbourne Institute's HILDA longitudinal survey.

These data have rarely been used for the purpose of assessing the living standards of low paid households. As might be expected, they indicate that lower incomes generally, and low pay specifically, are associated with higher levels of financial stress: for example not being able to raise \$2,000 in an emergency, not being able to heat ones' home, and not being able to pay bills on time.⁷¹

(6) Housing costs

Another potentially useful source of data on the living standards of low paid households is housing costs, since housing is the largest 'fixed' component of most family budgets.

Estimates of the affordability of housing have been prepared using 'housing stress' indicators. These are the proportions of different kinds of households in the bottom 40% of the household income distribution who spend more than 30% of their disposable income on housing (rents or mortgages).

Recent research on housing stress found that 407,000 working households, or 10% of all working households, experienced housing stress in 2001. Over one quarter of these households included employees in the low paid occupations of sales assistants, drivers,

⁶⁹ Social Policy Research Centre 2007, *Towards new indicators of disadvantage*.

⁷⁰ Masterman-Smith, May, & Pocock 2006, *Living Low Paid:*

Some Experiences of Australian Childcare Workers and Cleaners.

⁷¹ See Bray, *Hardship in Australia*, FACS Occasional Paper No4; ACTU 2002, *Living wage case submission*, composite exhibit contains results of an analysis of financial stress data by the ABS, commissioned by the ACTU.

carers, cleaners, administrative workers, or hospitality workers. A clear majority of these employees who were in housing stress had incomes below \$600 per week.⁷²

Housing costs have a big impact on the budgets of low income households in our major capital cities. For example:

- median rents for a recently-let single or three bedroom flat in Sydney in December 2006 were \$300 per week and \$310 respectively,
- median rents for a recently let single bedroom or three bedroom flat in Melbourne in September 2006 were \$200 and \$265 per week respectively.⁷³

When these rents are compared with the Federal Minimum Wage (after tax), it is clear that a single adult minimum wage earner living alone would have great difficulty renting in Sydney or Melbourne. Commonwealth Rent Assistance is generally not available to low wage earning households without children.

(7) Recent trends in incomes and costs

The Commission's latest minimum wage decision maintained the real value of the Federal Minimum Wage (FMW) between the previous decision in December 2006 and the latest one in October 2007, but it has fallen by about 1% on a year-on-year basis (from December 2006 to December 2007).⁷⁴ Moreover the real value of most Pay Scales above the FMW (which provide minimum rates of pay for most low paid employees) declined since they were increased by the same flat dollar amount as the FMW. Further, the FMW declined relative to movements in median and average weekly earnings, which indicates that minimum wage earners continued to fall behind wage movements across the community generally.⁷⁵

Reductions in income tax that took effect from July 2007, especially the increase in the Low Income Tax Offset (LITO) from \$600 to \$750 per year, together with the latest increase in minimum wages, led to modest improvements in the disposable incomes of many low paid employees, when adjusted in accordance with the CPI.⁷⁶ The effect on their actual living standards is more difficult to assess since the CPI is an average measure of inflation, and the expenditure patterns of low paid employee households are likely to vary in consistent ways from those of other households. For example, low paid employees and their families have been disproportionately affected by sharp increase in rents over the past year (since they are more likely to rent) and higher fuel prices (since they are more likely to live in outer urban and rural areas). The average increase in rents across capital cities from December 2006 to December 2007 was 6.4% and the corresponding increase in petrol costs was 14.3%.⁷⁷

⁷² Yates et al 2006, *Housing affordability, occupation and location*. Australian Housing and Urban Research Institute.

⁷³ NSW Dept of Housing and Victorian Office of Housing 2006, *Rental Reports*.

⁷⁴ Based on an increase in the CPI of 3% over this 12 month period. See ABS 2008, *Consumer Price Index*.

⁷⁵ Australian Fair Pay Commission 2008, *Economic and social indicators monitoring report*.

⁷⁶ Australian Fair Pay Commission 2008, op cit.

⁷⁷ Australian Bureau of Statistics 2007, *Consumer Price Index* (December 2007).

Over the year to December 2008, the Reserve Bank forecasts that the CPI will increase by 3.5%. Expressed as a proportion of the FMW, this is an increase of \$18 per week.⁷⁸

The Government has signalled its intention to further reduce personal income tax from July 2008, in accordance with the following tax rate schedule.

Proposed income tax cuts

Current	Tax rates	2008-09	Tax rates
0-6000	0	0-6000	0
6001-30000	15	6001-34000	15
30001-75000	30	34001-80000	30
75001-150000	40	80001-180000	40
150000+	45	180000+	45
Low Income Tax Offset ⁷⁹	\$750	Low Income Tax Offset	\$1200

The change affecting employees on or close to the FMW is the \$450 increase in the Low Income Tax Offset, which is equivalent to a \$9 per week increase in disposable income for those low paid employees with enough income to pay tax.

It is not known at this stage whether the tax cuts will be legislated, and whether other measures announced in the Federal Budget will add to or detract from the disposable incomes of low paid employees.

⁷⁸ Reserve Bank of Australia 2008, *Statement on monetary policy*, February 2008.

⁷⁹ This is income tested above individual income of \$30,000, with additional income reducing the amount by 4 cents in the dollar.

5. Minimum wages and employment

Modest real increases in minimum wages are unlikely to reduce employment growth in the present labour market conditions. Further, any effect of modest increases in minimum wages on structural unemployment in Australia is likely to be small.

Economic research into the effects of minimum wages on employment yields diverse and often conflicting results. The OECD concludes from a thorough evaluation of the international evidence that the effect of lower minimum wages on employment is ambiguous. Modest reductions in minimum wages may have no effect at all.⁸⁰

In theory, there are two main ways in which higher minimum wages could affect employment and unemployment rates:

- by increasing or slowing the rate of job growth across the economy. For example, a rise in minimum wages could lower employment because interest rates are increased to curb inflation,
- by reducing the number of jobs available to low skilled employees specifically, because employers consider their productivity too low to justify employing them at the higher wage. This could increase unemployment (especially long term unemployment) because unemployed people are disproportionately low skilled.

To simplify, we refer below to these two effects as the effect of minimum wages on the 'macro-economy' and on 'structural unemployment'.

Adverse effects of higher minimum wages on employment may be offset by three factors:

- wage assimilation – where employers offset the cost of minimum wage rises by reducing other work benefits,
- turnover costs – where employers prefer to pay a higher wage to reduce the costs of the higher turnover induced by low pay,
- monopsony – where the labour market so strongly favours employers that wages are too low to encourage workers to seek employment.⁸¹

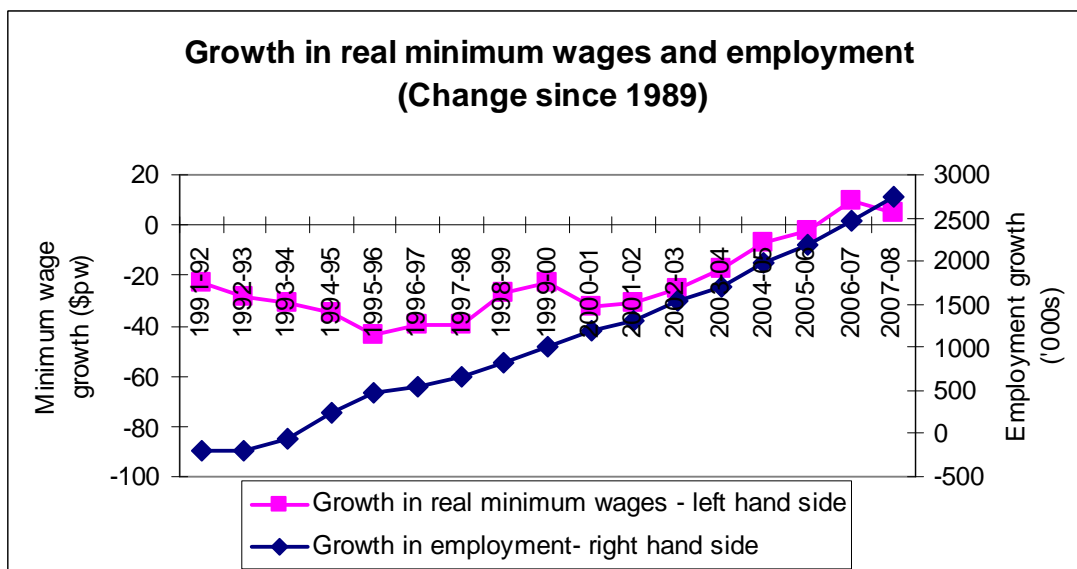
The effect of higher minimum wages on the macro-economy

There is no evidence to suggest that the real increases in minimum wages awarded in recent years have had an adverse effect on the macro-economy, or on employment growth generally.

Following a sluggish recovery from the recession of the early 1990s, employment has grown strongly since the AIRC began to increase minimum wages in real terms (from about 1998, see graph below). From 1997 to 2007, real minimum wages rose by 9% (including the latest rise) and employment rose by 24%.

⁸⁰ See, for example, the discussion on minimum wages in OECD 2006 *Employment Outlook*, and the more substantial study in its 1998 *Employment Outlook*.

⁸¹ Gregg P 2000, *The use of wage floors as policy tools*. OECD Economic Studies No 31.



Sources: Dawkins (2000) *The labour market*, in Reserve Bank, *The Australian economy in the 1990s*; Australian Fair Pay Commission 2006 & 2007, *Wage setting decision*; ABS, *Consumer price Index* and *Labour Force*. Note: Employment and inflation data for 2007-08 are for December 2007.

Since the mid 1990s, there has been more ‘room’ for the economy to grow *and* to deliver higher wages. The reasons for this include:

- lower inflation,
- higher productivity growth,
- decentralised wage bargaining – for example, minimum wages already ‘flow through’ to a declining proportion of the workforce.

Conditions in the labour market remain favourable though there is a build up of inflationary pressures in the economy:

- Employment growth of 2.25% in 2007-08 was forecast in the Government’s Mid Year Economic and Fiscal Outlook. Unemployment was forecast to continue to fall over the year to historically low levels, and stood at 4% in February 2008.⁸²
- The Reserve Bank forecasts that the underlying inflation rate will remain above its target zone of 2-3% for the next two years, having reached 3.6% over the year to December 2007.
- Overall wage increases as measured by movements in the Wage Price Index, remain moderate for this stage in the business cycle though they have been trending upwards since the close of the 1990s. The MYEFO forecasts a 4.25% increase in the Wage Price Index over 2007-08, which is slightly above the 4% increase over 2006-07.

In its Statement on Monetary Policy in February 2008, the Reserve Bank concluded that: *The inflation outlook is affected by opposing forces. The strong growth in demand, output and employment in recent years has resulted in a reduction in spare capacity in the business sector and the labour market. This has contributed to a pick up in cost pressures and pricing power, with a rise in underlying inflation to around 3.5% over the*

⁸² Australian Bureau of Statistics 2008, *Labour Force, Australia* (January 2008).

*past year. However the worsening global outlook and the turmoil in financial markets are expected to result in some moderation of domestic growth.*⁸³

The increase in the underlying rate of inflation over the past year is of concern. This raises the risks of higher interest rates and unemployment in the near future. It is possible that inflation can be controlled at the present level of unemployment, but to sustain further reductions in unemployment, Governments and business will need to take concerted action to raise workforce participation and skills. This includes more investment by Government to improve the capacity of jobless income support recipients to participate effectively in the labour market, for example by raising their skill levels and addressing other barriers to work such as disabilities and chronic illness. These 'capacity building' measures will take some time to improve the level and quality of labour supply.

Therefore, it is important at the present time to ensure that the overall level of real growth in wages does not increase further. However, this will not be achieved by restraining growth in minimum wages, since the Pay Scales directly affect approximately one in five employees only. It would be unfair for low paid employees to bear the burden of restraint in wages. They have less capacity to absorb any decline in their real incomes without cutting expenditure on essentials. They are also disproportionately affected by recent increases in the cost of essentials such as rents and fuel.

Effect of minimum wages on structural unemployment

At just over 4%, the official unemployment rate is relatively low in Australia, and below that of the US which has much lower minimum wages. Many more jobless people of working age are not captured in the unemployment figures. Around 30% of Australians of working age are not employed (though not all are seeking work) and around 18% rely on income support. Nevertheless, the level of reliance on income support in Australia lies just below the OECD average.⁸⁴

At a time when conditions of 'full employment' have been achieved in some parts of Australia – especially in the wealthier suburbs of capital cities and in regions dominated by the mining industry - it is likely that a large proportion of Australian unemployment is 'structural'. That is, it will not be reduced much further simply by growing the economy. Major changes to policies and institutions are needed to reduce it further.

One theory that is advanced to explain structural unemployment is that most jobless people are not as productive (or not perceived to be by employers) as those who have jobs. For example, they may have low skills and education levels. According to this theory, to assist them to get jobs, either their (perceived) productivity must be improved, or minimum wages must be reduced to a level at which employers will be prepared to take them on.⁸⁵

This view is consistent with one explanation of growth in earnings inequality: that in wealthy countries demand for low skilled employees has declined relative to the higher skilled, due to technological change.⁸⁶

⁸³ Reserve Bank 2008, *Statement on Monetary Policy*, February 2008.

⁸⁴ Whiteford & Adema 2007, *What works best in reducing child poverty?* OECD.

⁸⁵ Frijters & Gregory 2005, *From golden age to golden age - Australia's great leap forward?*

⁸⁶ See section dealing with earnings inequality, above.

1. Changes in the structure of employment

However, as discussed above, the reality of labour market restructuring over the longer term in Australia is more complex. Employment growth has not been 'biased' exclusively to high skilled jobs. Instead, it appears that the workforce has 'hollowed out', with employment growth concentrated on low and high skilled positions rather than middle level jobs. For example, over the 1990s *full time* jobs growth was biased towards the high skilled, but *part time* jobs growth was concentrated in low skilled occupations especially in service industries (see table below).

Change in employment by skill level and job status (1990-2000)

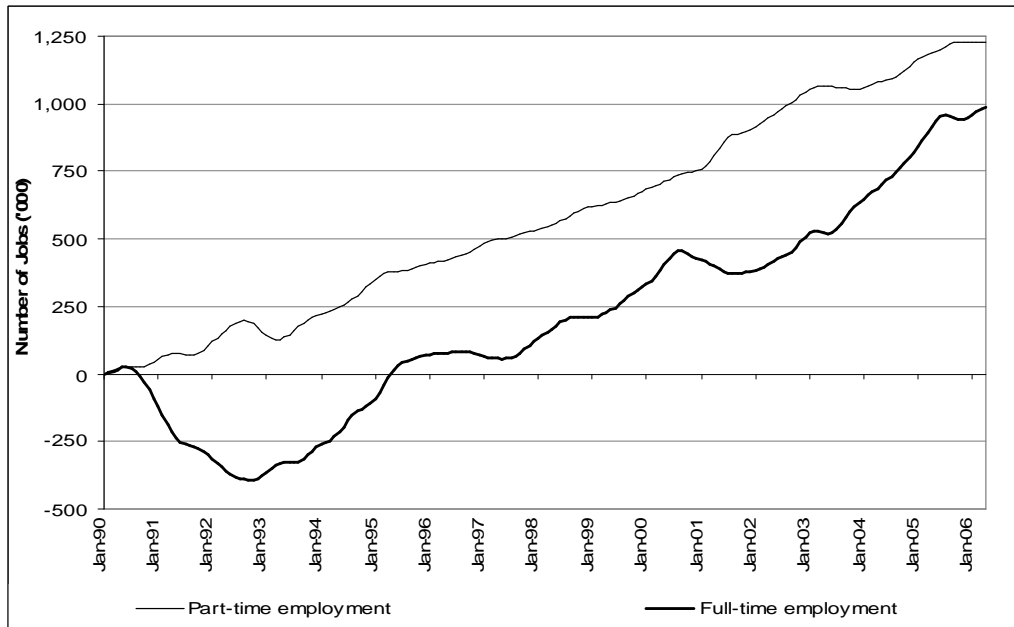
Skill level	Full time permanent	Full-time casual	Part-time permanent	Part-time casual	Total
Managers and professionals	387,000	135,000	115,000	20,000	657,000
Trades, advanced sales and service	-238,000	59,000	25,000	27,000	-127,000
Lower-skilled workers	-200,000	138,000	215,000	446,000	600,000
Total	-51,000	333,000	356,000	493,000	1,130,000

Source: Borland, Gregory & Sheehan, 2001, *Inequality and economic change*, in Borland et al, *Work rich, work poor*, Victoria University. Shaded areas represent net reductions in jobs.

In this regard, the Australia labour market has the characteristics of a 'dual labour market' in which higher skilled employees have access to full time jobs, while lower skilled employees are 'quarantined' in lower paid part time jobs. As the graph below shows, these two forms of employment have grown at markedly different rates over the long term. In contrast to full time jobs, part time jobs continued to grow when the economy slowed in the early 1990s.⁸⁷

⁸⁷ Since about 2001, growth in full time employment has exceeded that in part time jobs. This appears to include strong growth in full time low skilled jobs, especially in construction. However, this pattern is likely to reflect the 'peak' of economic boom conditions, and may not be sustained over the medium term.

Full and Part-time Employment growth, 1990-2006



Source: FaCS 2002, *Submission to Senate inquiry into poverty and financial hardship*, updated to 2006 using ABS Labour Force data.

Australia is exceptional in its incidence of part time and casual employment: 29% of employees are employed part time and a similar proportion are casuals. Compared with other OECD countries, Australia's incidence of part time employment is second only to the Netherlands and its incidence of casual work is second only to Spain. There is a high incidence of low pay in both part time and casual employment.

Aside from differences in the supply of part time and full time workers (the greater reliance of mothers and students on part time jobs), one possible explanation for this 'two track' labour market is that employers have been prepared to engage lower skilled workers on a part time or casual basis because these jobs are perceived to be more 'productive'. For example, many part time and casual employees (such as shop assistants and bank tellers) are brought in to work only during times of peak activity.⁸⁸

If there has been a long term bias in favour of skilled employment in Australia, this has been tempered by strong growth in low skilled part time employment. That is, the bias lies in the distribution of *working hours* rather than the distribution of jobs.⁸⁹

⁸⁸ Most part time jobs are casual, and vice versa, so that employers have the flexibility of 'daily hire' in addition to the flexibility of working people for only part of the week. On the other hand, many casual jobs are actually long term jobs, albeit without job security. See Watson et al 2003, *Fragmented Futures*, Federation Press; Wooden & Warren 2005, *The characteristics of casual and fixed term employment*, Melbourne Institute Working Paper 15/03. For an empirical analysis of labour market segmentation in Australia, see Song & Webster 2003, *How segmented are skilled and unskilled labour markets?* Australian Economic Papers 42:3.

⁸⁹ Keating 2002, Watson et al 2005.

Since the close of the 1990s, the pattern of jobs growth has changed. Higher skilled jobs have grown at a faster rate than lower skilled jobs overall. However, among low skilled jobs, most of the growth has been in fulltime positions. For example, over the last five years, the number of fulltime elementary clerical sales and service employees rose by 7% and the number of fulltime labourers rose by 3%, while the numbers of part time elementary clerical sales and service employees remained constant and the number of part time labourers fell by 8%.⁹⁰ Thus, while overall growth in low skilled jobs has been flat in recent years, there has been a shift towards low skilled full time jobs.

Low skilled jobs are relatively easy to obtain in Australia. In 2005, the average unemployment rate among people with less than full secondary education qualifications (12 years of schooling) in Australia was 6.3% compared with 9% in the US and 11% across the OECD as a whole.⁹¹ Given the above trends, one problem for low skilled Australian employees is that it is more difficult to secure fulltime jobs than part time jobs. Further, as outlined below, a substantial minority appear to be 'stuck' in low skilled, low paid jobs.

2. Estimates of the effect of minimum wages

Given the ambiguous outcomes of economic research in this area, and the segmentation of the labour market described above, ACOSS is sceptical of estimates of the effect of minimum wages on employment that rely on a single figure – such as the overall elasticity of demand for labour to aggregate wages.

In any event, the research suggests that modest changes in minimum wages generally have little or no impact on unemployment.⁹²

It is possible that the very large increase in wages for low skilled jobs (accompanied by a large rise in wages across the board) in Australia in the mid 1970s and early 1980s contributed to the high level of structural unemployment in those two decades. However, as indicated in this submission, real minimum wages have not increased above the levels attained in the early 1980s, and they have fallen substantially relative to median wage levels.

Even large variations in minimum wages among nations are not consistently related to the employment prospects of low skilled workers. For example, despite the much lower minimum wages paid in the United States, their unemployment rate for low skilled labour is consistently higher there than in Australia (9% of the low skilled labour force in the US compared with 6.3% in Australia in 2005).⁹³

Although the effect of minimum wages on employment is ambiguous, the effect on the incomes of minimum wage earners is immediate and finite. In our view, it would not be worth putting the living standards of low paid households at risk – by cutting real minimum wages – in return for uncertain gains in employment.

⁹⁰ Australian Bureau of Statistics 2008, *Labour Force, Australia, detailed* (November 2007). Data are for the period from November 2002 to November 2007.

⁹¹ OECD 2007, *Employment Outlook*.

⁹² Gregg 2000, *op cit*.

⁹³ OECD 2007, *Employment Outlook*; see also Kennedy 2007, *Full employment in Australia and the implications for policy*. Department of the Treasury.

If minimum wages were reduced substantially – for example, to US levels - it is conceivable that over the long term, the composition of growth in low skilled employment in Australia would shift from part time to full time jobs. The reasons for this are that employers could ‘afford’ to engage low skilled workers on a full time basis, whereas employees could no longer afford to work part time only.⁹⁴ However, it is doubtful that low skilled workers would be better off. For example, at US minimum wage rates, they would have to work full time to attain the same living standard they now achieve working three days a week.⁹⁵

3. Barriers to employment for jobless people

Regardless of how responsive the demand for labour is to minimum wages, real reductions in minimum wages are unlikely to lead to a substantial reduction in unemployment and reliance on income support. The main reason for this is that a substantial proportion of income support recipients of workforce age are some distance away from being ready to take on employment at the levels of productivity now expected by employers. So lowering the ‘productivity bar’ a little will not help them to jump from joblessness into employment.

Income support recipients of workforce age generally receive one of three payments. In 2007, there were approximately 500,000 Newstart and Youth Allowance recipients (other than full time students), 600,000 Parenting Payment recipients (mostly single parents), and 700,000 Disability Support Pension recipients, most of whom were jobless.⁹⁶

The main factors preventing most from securing employment are very low skill levels and personal and social barriers to employment. Those who remain unemployed after many years of strong growth in the economy are generally drawn from the most disadvantaged sectors of the community.

For example:

- Around 60% of jobless Parenting Payment recipients and people with disabilities have a year 10 education or less.
- About half of jobless Parenting Payment recipients suffer from anxiety or depression and around 20% were recent victims of violence.
- Many income support recipients cannot afford to rent in ‘jobs-rich’ cities. For example, during 2000, around 18% of Parenting Payment recipients and 10% of DSP recipients moved out of Brisbane, mainly to surrounding regional areas.⁹⁷
- Many income support recipients are not proficient in English, and this adversely affects their job prospects.
- In 2006, 59% of Newstart Allowance and Youth Allowance recipients received these payments continuously for over 1 year and 22% did so for over 5 years. The average

⁹⁴ These may be the main reasons that the level of part time employment is much lower in the US than in Australia.

⁹⁵ ACOSS calculations based on OECD purchasing parities for 2005.

⁹⁶ Administrative data. Around 40% of Parenting Payment recipients, 20% of NSA/YA recipients, and 10% of DSP recipients had jobs, mainly part time.

⁹⁷ See ACOSS 2005, *Welfare reform, participation or punishment?* and Marshall et al 2003, *Welfare outcomes of migration of low income earners from metropolitan to non metropolitan Australia*, AHURI, February 2003

duration of receipt of Parenting Payments and Disability Support Pensions is much longer.⁹⁸

A major barrier to employment for most people with disabilities is not their actual productivity, but employer perceptions of a high ‘risk’ associated with employing people with disabilities, especially those with mental health problems. For example, many employers associate employment of people with disabilities with a higher risk of compensation claims, although the evidence suggests otherwise.⁹⁹

The Government’s *Welfare to Work* policy, which commenced in July 2006, requires two major groups of income support recipients – parents whose youngest child is 6 years or over and people with disabilities able to work part time - to seek at least part time employment. The number of people potentially subject to these requirements is as follows:

- around 20,000 additional parents per year on Newstart Allowance, plus from July 2007 approximately 200,000 parents who continue to receive Parenting Payment,
- around 20,000 additional people with disabilities per year on Newstart Allowance, plus an additional 20,000 who are transferred from DSP to Newstart Allowance.

Data on employment outcomes from the highest level of assistance available to job seekers in the Job Network (‘Customised Assistance’) suggest that they will find it difficult to obtain full time employment (see table below). These figures greatly overstate the likely employment impacts of the *Welfare to Work* changes, since most of the single parents and people with disabilities in the Job Network at the time the data were collected were voluntary participants. It should also be noted that these employment outcomes include short term casual jobs that may not be sustained over time.

Employment outcomes from Job Network Customised Assistance (March 2007)

Job outcomes 3 months after assistance	People with disability on Newstart Allowance	Single parents	Very long term unemployed (24-36 months)	Mature age (50 or more)
Full time job	12%	17%	15%	11%
Part time job	26%	33%	28%	29%

Source: DEWR 2007, *Labour market assistance outcomes for year ending March 2007*.

The evidence of entrenched labour market disadvantage among income support recipients suggests that lowering real minimum wages is unlikely to greatly improve their job prospects. More investment in programs that improve their skills, work capacity, health and personal circumstances is likely to produce better outcomes. Better education of employers about the actual capabilities of groups they are currently reluctant to employ - especially people with disabilities, mature age workers and indigenous people - could also make a difference, especially as growth in the supply of labour falls in the coming years due to population ageing. Attempts to reduce minimum wages specifically for those groups experiencing

⁹⁸ Response from DEWR to Senate Estimates questions, November 2005.

⁹⁹ HREOC 2005, *People with disability in the open workplace*.

discrimination could backfire, by reinforcing employers' impressions that their work capacity and productivity are low.

Low paid jobs as stepping stones to better paid jobs

Employees and unemployed people have been characterised as the 'insiders' and 'outsiders' of the labour market, respectively. According to this view, increases in wages may benefit those with jobs (the 'insiders') but disadvantage those out of work (the 'outsiders').

This view of the labour market is too simplistic. In reality, many people cycle between joblessness and employment – especially low paid employment - within a given year. People also move from low paid employment to higher paid jobs, and vice versa.

Therefore, when considering the well being and living standards of low paid employees, their *job mobility* should be taken into account. If employees are 'stuck' in low paid jobs for many years, this will have a greater adverse effect on their well being than one short bout of low paid employment. Evidence as to whether low paid jobs are 'stepping stones' from unemployment to higher paid or more secure employment should also be considered.

The evidence on the job mobility of low paid employees is mixed. Jobless people are more likely to be able to secure low paid jobs – especially casual jobs – than they are to move straight into higher paid, more secure jobs. There is also some evidence to suggest that these low paid or casual jobs can lead to better paid, or more secure employment, including for people who were previously jobless. But many return to joblessness, and many others remain in low paid work over the long term - especially if they were previously unemployed or have major work barriers such as a disability.¹⁰⁰

The tables below are from research examining transitions over a number of years from low paid employment (first table) and transitions from casual employment (second table). Most casual jobs are also low paid.

They indicate that people who were formerly jobless who obtain a low paid or casual job have about an equal chance of moving up in the next year to a higher paying or permanent job, or falling back into joblessness. Their chances of moving up are much lower than those of low paid or casual employees who were not recently unemployed, suggesting that unemployment has a 'scarring effect' that endures for at least a few years after they get a job. A substantial minority remain in low paid or casual employment from year to year.

¹⁰⁰ Productivity Commission 2006, *The role of non traditional work in the Australian labour market*; Dunlop 2001, *Low paid employment in the Australia labour market* in Borland et al, *Work Rich Work Poor*, Victoria University; Kalb 2000, *Are part time jobs a stepping stone to full time employment?*

Changes in the labour market status of low-paid and formerly jobless workers (1995-1997)

Labour market status in 1995	Labour market status in 1997			
	Higher paid job	Low paid job	Jobless	All
Low paid workers	50%	33%	16%	100%
Low paid former job-seekers	36%	32%	32%	100%

Source, Dunlop Y, 2001, *Low paid employment in the Australian labour market*, in Borland et al, 2001, *Work rich, work poor*. Victoria University.

A study commissioned by the Fair Pay Commission last year produced broadly similar findings in regards to movements from low paid employment to higher paid jobs and joblessness. In this study, over a three year period from 2001, 58% of fulltime low paid employees progressed to higher paying jobs, 32% remained low paid, and 11% were no longer employed. The equivalent figures for part time low paid employees were 43%, 25% and 30% respectively. Taking these together, the results are similar to those obtained by Dunlop for a two year period in the mid 1990s. However, the study does not estimate wage mobility for low paid former jobseekers, the group of particular interest here.¹⁰¹

Changes in the labour market status of casual and formerly jobless workers (2001-2003)

Labour market status in 2001	Labour market status in 2003			
	Ongoing employees	Casual employees	Jobless	All
All casual employees ¹⁰²	38%	46%	12%	96%
Casual employees in 2002 who were unemployed in 2001 ¹⁰³	27%	47%	27%	100%

Source, Productivity Commission 2006, *The role of non traditional work in the Australian labour market*.

It is sometimes argued that in countries with low minimum wages such as the US, low skilled employees are partly compensated for their low pay by a relatively high level of upward mobility to higher paid employment. The evidence suggests otherwise.

For example, in the US and UK, which have a relatively high incidence of low paid jobs, fewer people progress from these jobs to higher paying jobs than in countries such as Australia, Denmark and the Netherlands, where low pay is less widespread (see table below). This suggests that, all things being equal, major reductions in minimum wages could *diminish* low skilled employees' prospects of moving up from low paid to higher paid jobs. For example, the evidence points to a *lowering* of upward mobility for low paid employees in the US and UK over the 1980s and 1990s, a period over which minimum wages fell in real terms.

¹⁰¹ McGuinness et al 2006, op cit.

¹⁰² Data in this row do not add up to 100% because 4% become self employed.

¹⁰³ Data in this row are one year transitions from casual employment between 2002 and 2003, following joblessness in 2001. Few or none become self employed.

This could be due to a ‘bottleneck effect’, where a larger proportion of low paid employees has to compete for a smaller proportion of middle level jobs.¹⁰⁴

Earnings mobility of employees over a five year period (1990s)

	Australia	Denmark	Netherlands	USA	UK
Movement from low paid to higher paid jobs after 5 years	41%*	54%	45%	38%	23%
Incidence of low paid jobs (% of fulltime jobs)	14%	6%	15%	25%	19%

Sources: OECD 2003 *Employment Outlook*, Carino-Abello 2001, *Dynamics of earned income in Australia*, ABS; Keese, M and A. Pumoyen (forthcoming), *Changes in earnings structure*, OECD Occasional Papers.

* Note that data for Australia are from a separate study conducted over a 3 year period from 1994 to 1997 rather than 5 years. Upward mobility could be higher for Australia over a 5 year period.

6. Minimum wages, income support and work incentives

The living standards of low income households rest on three pillars: jobs, minimum wage levels, and income support payments. All three play a vital role in preventing poverty, and it is counter-productive to focus on one to the exclusion of others.

In the absence of adequate minimum wages:

- Poverty would rise substantially unless government income support for working households was increased to ‘picked up the slack’. However, the US experience suggests that this would be expensive for Governments and ineffective in keeping poverty levels low.
- There would be pressure to reduce income support for jobless households to maintain work incentives.

Arguments that minimum wages are a ‘blunt instrument’ to reduce poverty ignore these dynamic relationships between jobs, minimum wages, and income support – which help explain why countries with very low minimum wages generally have higher overall income poverty levels.

The current income support system for low paid households

The Australian income support system has three main components:

¹⁰⁴ Richardson 2004, *Low wage jobs and pathways to better outcomes*, NILS. Stewart 2002, *The inter-related dynamics of unemployment and low pay*. EALE/SOLE World Congress, Milan; Buchinsky & Hunt 1999, *Wage mobility in the United States*. Review of Economics and Statistics, 81:3; Dickens 2000, *Wage mobility in Great Britain - 1975-1994*, *Economica* 67, 477-497.

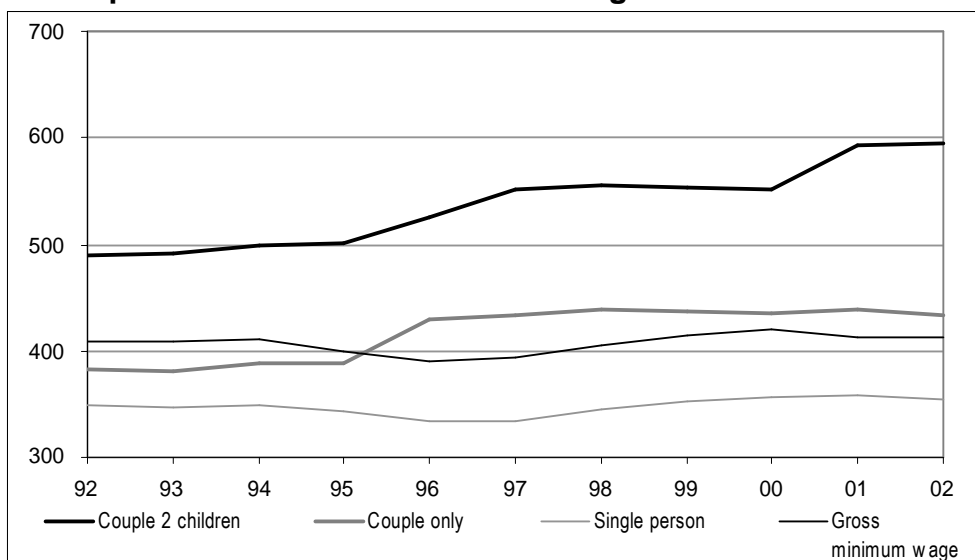
- income support payments for adults in low income households,
- Family Tax Benefits for children, targeted mainly towards low income families,
- supplementary benefits such as Rent Assistance payments and pensioner concession cards.

Of these, only *Family Tax Benefits* have traditionally been designed to supplement low full time wages. These payments were substantially increased in the mid 1990s, in the 2000 tax reform package, and in subsequent Federal Budgets. Although *income support payments* and supplements for adults do extend to low wage earning households under some circumstances (mainly part time employees), they were not designed with this aim in mind, and few full time employees receive them. However, Newstart Allowance and Parenting Payment have been paid to the unemployed partners of low paid full time employees since 1996.

The graph below illustrates the main ways in which the social security system supplements low pay. It shows that:

- Low paid full time single employees without children receive no assistance. Their disposable income is lower than their wage due to income tax.
- Couples without children on a low full time wage have received some support since 1996, due to the payment of income support to the partner of a low paid wage earner.
- Couples with children on a low full time wage receive this together with Family Tax Benefit, which has increased on a number of occasions since the mid 1990s.

Gross and disposable incomes of minimum wage earners



Source: FaCS 2002, *Submission to Senate inquiry into poverty and financial hardship*,

Note: The gross value of the minimum wage is compared with the disposable incomes of minimum wage earners from different family types.

(1) Single adults without children

In Australia, there is no income support payment to top up low wages generally, including for single adults without children.

The main unemployment benefit, Newstart Allowance (NSA), is income tested in a way that *deliberately* excludes minimum wage earners. This payment cuts out completely at earnings of about \$400 per week. Above that income level, there are no supplementary payments (e.g. Rent Assistance for low income private tenants) or fringe benefits (e.g. low income health care cards) available.

There are two circumstances in which a single adult without children can receive income support payments and supplementary benefits.

First, if they receive Pension payments, such as Parenting Payment Single and the Disability Support Pension, they may keep a part pension if they earn up to about \$750 because the income test is less stringent. The reason for this is that these recipients are generally only expected to work part time (if at all), so the income test is designed to encourage part time work, not to exclude full time workers. Few recipients of these payments are employed full time.

Second, many single income support recipients (including those on Newstart Allowance) work part time, and retain 'part-payments' under the income test. However, the income test for Newstart Allowance is severe (clawing back 60 cents per dollar earned over a wide range of part time earnings). This is consistent with its traditional objective – to encourage people to move to full time jobs and off income support rather than living on a combination of part time earnings and income support.

(2) Couples and Families

For low paid *couples and families*, the situation is different.

In the case of *couples without children*, Newstart and Parenting Allowances are paid to the *partners* of low paid full time employees. This is consistent with the view that married women should be supported to achieve a degree of financial independence. However, if the main wage earner in a couple earns significantly above minimum wages (above about \$30,000) then their partner is no longer entitled to these income support payments. Couples on pension payments can continue to receive a part-payment up to a combined income of about \$60,000, but it is rare for pensioner couples to earn this much.

In the case of low income *families with children*, family allowances (now called Family Tax Benefit) have for many years explicitly supplemented low pay. The objective was to reduce child poverty and maintain work incentives, since it is difficult for the wage system to take account of the size of each employee's family.

Almost all low income families with children with family incomes below \$40,000 receive a higher rate of Family Tax Benefit to assist them with the costs of their children.

Family Tax Benefits for low income families have substantially increased in recent years, and this has helped many low income families avoid poverty. A recent study by NATSEM of the bottom 20% of families with children, commissioned by ACOSS, Anglicare Australia,

Brotherhood of St Laurence, Family Services Australia, the Welfare Rights Centre, and Australian Education Union¹⁰⁵ found that:

- 28% of families in the bottom 20% earn a full or part time wage - for two thirds of these low paid families, wages are the main source of income
- From 1997 to 2004, real wages and family payments for low income families have both risen.
 - The average level of wages paid to the bottom 20% of families rose by about 8% in real terms.¹⁰⁶
 - The average level of income support (mainly Family Tax Benefits) paid to the bottom 20% of families rose by about 20%.¹⁰⁷
- As a result, the income of a married couple family with two school age children on the minimum wage rose by about 12% in real terms over the same period.¹⁰⁸

The limits of income support

Notwithstanding the recent income gains for low paid families described above, the role of the income support system in sustaining living standards is limited by its cost, and Government concerns about 'welfare dependency'.

For example, the increases in family payments noted above have come at considerable cost to the federal budget. From 1997 to 2004:

- Spending on family payments doubled, from \$6.6 billion to \$13 billion per year:
- As a percentage of Federal Government spending, it rose from 4.9% to 6.7%
- As a percentage of GDP, it rose from 1.3% to 1.5%.¹⁰⁹

Further, the cost of increasing Family Tax Benefits has risen in recent years, as the income test for this payment has been eased to encourage mothers to take up jobs. Around half of all families now receive the higher rate of FTB Part A that was previously reserved for low income families. As a result of the easing of this income test in 2005 and 2006, the cost of a \$1 per week rise in the maximum rate of payment has risen by 50%. For this reason, it is unlikely that Family Tax Benefits could be used to 'pick up the slack' for low paid families, in the event that minimum wages fall in real terms.

An earned income tax credit or some other form of 'in work payment' would also be costly option. For example, the tax credit proposed by some of the 'five economists' to preserve

¹⁰⁵ McNamara et al (2004), *How low income families have fared in the boom times*. NATSEM.

¹⁰⁶ This could be due to families in the bottom 20% working more hours, as well as minimum wage rises.

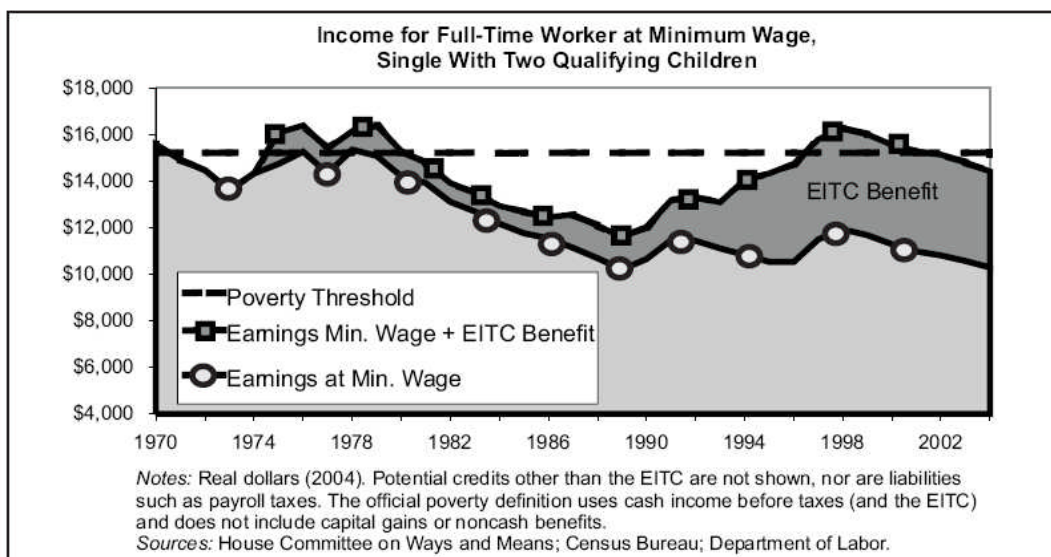
¹⁰⁷ Note that part of these family payment increases were to compensate for the GST, so they did not all translate into higher living standards.

¹⁰⁸ From \$641 to \$700.

¹⁰⁹ Budget Papers 2004-05; FACS 2001, *Income support statistics* 1989 to 1999.

family living standards in the event of a fall in minimum wages would cost well over \$5 billion per year if introduced today.¹¹⁰

Another problem with general public subsidies for low pay such as earned income tax credits is that much of the subsidy would be captured by employers, especially if minimum wages fall in real terms. This has been the outcome in recent years in the US. As real minimum wages have fallen through lack of indexation, the cost of the Earned Income Tax Credit has risen (see graph below). The US currently spends around \$40 billion per year on the Earned Income Tax Credit, which is more than it spends on traditional social assistance programs such as the Temporary Assistance for Needy Families program for jobless and low paid families. Despite this, minimum wages and the tax credit combined are now insufficient to protect a single parent family with two children from income poverty.



Source: Kravitz T 2005, *Minimum wage, earned income tax credit, and inflation*, Urban Institute Brookings Institution Tax Policy Centre.

A further concern about expanding income-tested payments such as these to support low paid households is that they reduce work incentives in the income ranges over which the payment is phased out (see section below on work incentives). These income tests usually have the greatest impact on incentives for ‘second earners’ within families, since they are based on family income rather than personal income. Depending on the design of the income test, another possible consequence is to discourage upward job mobility among low paid employees, effectively ‘trapping’ them in low paid jobs.¹¹¹

For these reasons, a robust minimum wage is needed in addition to adequate public income support, to protect families from poverty.

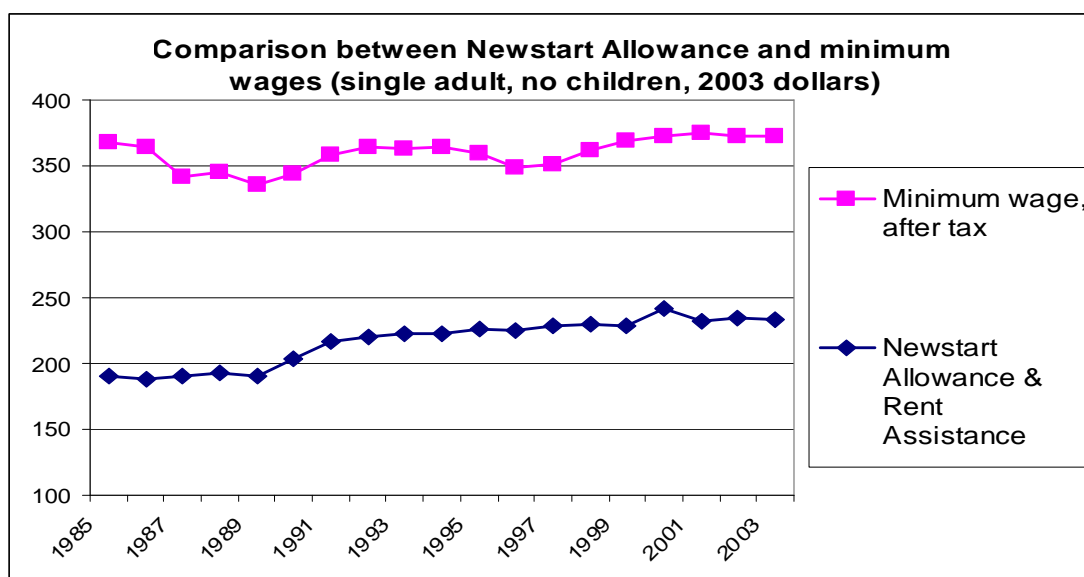
¹¹⁰ Buddelmeyer et al 2004, *Policy options to encourage welfare to work*, Melbourne Institute Working Paper 9/06. Note that the proposed EITC would cost much more than indicated in this paper, because its family income test is integrated with that for FTB, and that income test has since been substantially eased.

¹¹¹ Gregg 2000, op cit.

Effects of minimum wages on income support payments

In Australia, income support payments have traditionally been set at levels well below minimum full time wages in order to preserve work incentives.

For example, a single jobless adult who obtains a full time job at the minimum wage would almost double their disposable income. The relationship between minimum wages and unemployment benefits for single adults has been remarkably stable over the past 20 years. As the graph below indicates, disposable income from Newstart Allowance for jobless adults has increased slightly relative to minimum wages over this period. The main reasons for this were increases in Rent Assistance for social security recipients renting privately (which does not extend to low paid full time employees), and a lack of real growth in minimum wages over the longer term. Newstart Allowances were indexed to the Consumer Price Index throughout this period.



Source: Oliver 2003, *Taxes, benefits and families in Australia, an historic perspective*. Paper delivered at National Economists Conference.

Recent modelling by the Commission indicates that the benefit replacement rates (the ratio of disposable incomes on income support to those on the FMW) for selected families in 2007 were:

- Between 55% and 60% for single adults,
- Between 60% and 65% for sole parent with one preschool age child,
- 70% for a couple with no children,
- 75% to 80% for a couple with two school age children.

The gap between income support for jobless people and low pay could, therefore, narrow to some extent without a major adverse impact on work incentives.

However, if minimum wages fall consistently in real terms the gap will narrow over time because income support payments are indexed to at least the CPI.¹¹²

A point would be reached where Governments would adjust the income support system to preserve work incentives, by either:

- introducing or expanding 'in work payments', such as Family Tax Benefit or an Earned Income Tax Credit; and/or
- reducing income support payments for jobless people.

If Governments were under fiscal pressure at the time, the second option is more likely. This was pursued by the previous New Zealand Government during a recession in 1991. Wage fixation was deregulated with the introduction of the *Employment Contracts Act*. In the same session of Parliament, legislation was passed to substantially reduce social security payments for unemployed people. The link between lower minimum wages and lower social security payments was explicitly made by the Minister for Social Welfare at the time.¹¹³

It is likely that Governments would pre-empt any major reduction in work incentives, rather than wait until significant numbers of income support recipients are better off jobless than employed on the minimum wage.

A more direct link exists between wages and *pension* rates (including age pensions, disability support pensions, and parenting payment single). The single pension rate is benchmarked in the Social Security legislation to 25% of male total average weekly earnings.

Income tests and work incentives for low paid employees

The Australian social security system generally targets income support to families on low incomes, using income tests. One problem with these income tests is that they reduce work incentives.

This has two implications for minimum wages:

- If minimum wages are too low, the combined effect of low pay and income tests could discourage jobless people from working.
- If they are increased, part of the increase could be 'clawed back' by the income tests, reducing families' social security entitlements.

There are three types of social security income tests (see table below):

- those for Allowances such as Newstart Allowance (unemployment benefits):
 - these are designed to exclude low paid full time employees from payment so they are very stringent,
- those for Pensions such as Parenting Payment Single:
 - these are designed to encourage recipients to work part time, so they are less severe than the 'Allowance' income test,
- those for Family Tax Benefit
 - these are designed to support low paid families as well as jobless families, so they

¹¹² Pensions are indexed to movements in average earnings, but as indicated above a full time low paid employee may receive a part pension, so this blunts any adverse effects on work incentives.

¹¹³ Stephens R 1994, *Budgeting with the benefit cuts*, in Dalziel P: *The decent society* Wellington 1994.

generally don't take effect until a family earns well above a single minimum fulltime wage (but they do affect 'second earners' in low and middle income families).

Social security income tests, March 2008

	Newstart Allowance (single) (\$pw or %)	Pensions (single) (\$pw or %)	Family Tax Benefit (2 chn. under 13) (\$pw or %)
Free area	\$31	\$66	\$800
First taper rate	50%	40%	20%
2 nd threshold	\$125	n.a.	\$1,289*
Second taper rate	60%	n.a.	30%
Cut out point	\$405	\$746	\$2,073

Source: Centrelink, *Guide to Australian Government payments*

Note that FTB refers to FTB Part A only.

* beyond this level, only a small payment is available.

When the effect of these income tests is combined with income tax and other income tested programs (such as Child Care Benefit and public housing rental subsidies), they give rise to high 'effective marginal tax rates' (EMTRs) that may discourage employment at low hourly wages.

For example, in 2005, the effective marginal tax rates on the next dollar of earnings were:

- 73% for a single adult on Newstart Allowance earning \$200pw
- 57% for a single parent on Parenting Payment Single earning \$200pw
- 45% for a second earner in a low income family with two children in child care, earning \$800pw.¹¹⁴

When other costs are added in (such as transport to work, child care, and any reduction in subsidised public rents), these high effective marginal tax rates mean that some people have little financial incentive to take up employment.

As noted above, financial incentives for single adults to move into a full time job at the minimum wage are reasonably strong, though they are weaker for married jobless people.

The worst work disincentives in our social security system are those affecting:

- jobless people on Allowance payments working part time
- second earners (usually mothers) in low and middle income families working part time.

This is of concern, given that 28% of Australian jobs are part time.

Under these circumstances, adequate hourly minimum wages are likely to play an important role in strengthening incentives for these people to work part time. This will be crucial in the

¹¹⁴ NATSEM 2005, *Distributional impact of welfare to work reforms*, and ACOSS calculations.

coming years, as the supply of labour dwindles due to population ageing. Increasing the labour force participation of mothers and income support recipients generally will become a core objective of public policy. Adequate minimum wages make a significant contribution to economic growth and efficiency through the mobilisation of additional labour, for example from 'second earners' in middle income households.

On the other hand, high effective marginal tax rates can erode the value of increases in minimum wages. For example, as noted above, a single parent on Parenting Payment who earns \$200 per week faces the 'loss' of almost 60% of her next dollar of earnings due to taxes and social security income tests.

The effect of minimum wages and high effective marginal tax rates on work incentives is qualified by the following factors:

- The evidence suggests that these financial work disincentives are strongest at the point when a jobless person decides whether or not to take a job, but that they have much less impact on decisions to increase working hours.
- Other factors, such as a desire to start a career or the social benefits and status of paid employment, often override financial disincentives.

In addition, the effect of high effective marginal tax rates on work incentives is qualified by the fact that only a minority of employees face them.

The Commission recently asked NATSEM to estimate the incidence of high effective marginal tax rates among low paid employees whose hourly earnings increase by 39 cents. This study found that the effective tax rates for a majority (52%) of low paid employees were 30% or less and that only 10% faced effective tax rates of more than 50%. That is, in the vast majority of cases the wage earner retained more than half of the pay increase.¹¹⁵

On balance, increases in minimum wages are an effective way to improve work incentives for jobless people. Research conducted by the Commission indicates that work incentives have improved significantly for typical jobless households since 2005, due to increases in minimum wages and changes to taxes and transfers.¹¹⁶

7. Entry level and 'regional' wages

Australia has a separate set of lower minimum wages for young people, apprentices and trainees, and some people with disabilities (under the Supported Wage Scheme). Some have also called for special sub-minimum wages in regions with high unemployment. The rationale for lower minimum wages for certain groups varies, but generally twofold:

- to recognise working time spent in training towards a widely recognised qualification,
- to improve the employment prospects of people who may otherwise struggle to find employment due to inexperience or (perceived) low productivity.

¹¹⁵ NATSEM 2006, *Interactions between wages and the tax-transfer system*, Report for the Fair Pay Commission.

¹¹⁶ Australian Fair Pay Commission 2008, *Economic and Social Indicators*.

Apart from 'training wages', as a general principle lower minimum wages should only be paid to specific groups in the workforce in exceptional circumstances. If sub-minimum wages become too widespread, there is also a risk that the minimum wage itself will be undermined, or that the groups targeted for sub-minimum wages will displace other workers.

Young people

Young people are generally paid less than adult minimum wages. Although they fare relatively poorly in the recessions because employers often close their books to new hires, unemployment among young people has declined along with that among other age groups over the past two decades.

Nevertheless, many young people still have problems with the transition from school to work. Of all teenagers aged 15 to 19 years in May 2006, 14% were economically 'inactive' (neither working nor studying) along with 23% of young adults aged 20 to 24 years.¹¹⁷

The main structural barriers to employment for these young people appear to be:

- poor performance at school, often linked to social disadvantage;
- the lack of comprehensive school to work programs that link 'inactive' young people who fared poorly at school with mentoring, career planning, job search, and training assistance;
- the long term decline in traditional apprenticeships, which previously provided a pathway for many young men to secure employment;
- cultural norms and family responsibilities that delay the entry of many young women to further education or the workforce.

Although employment levels for young people are generally more sensitive to wage levels than for adults, there is no convincing evidence to indicate that the present minimum wage levels for young people have reduced their employment prospects relative to workers in other age groups.

Apprentices and trainees

Apprenticeships have historically provided a reliable point of entry into the workforce for young people in blue collar occupations, and increasingly do so for people in other age groups and in service sector jobs. Employers who train apprentices receive subsidies from Governments, and from their employees in the form of lower rates of pay. In return, they are expected to invest in the employee's training, release them from work for any off the job courses and guarantee them employment on completion of the apprenticeship. In principle, this is a fair 'bargain' that benefits all.

However, there are problems with the apprenticeship system. 'Traditional' apprenticeships have declined over the long term, at a greater rate than the decline in employment in the manual trades. Almost half of those who commence traditional apprenticeships do not complete them. The result is severe shortages of tradespeople, and the attendant risk of wage inflation in conditions of sustained economic growth such as the present time.¹¹⁸

¹¹⁷ Dusseldorp Skills Forum 2006, *How young people are faring*.

¹¹⁸ Ball 2004, *Factors influencing completion of apprenticeships and traineeships*, NCVET.

The reasons for this decline in traditional apprenticeships appear to include:

- a clash between the expectations of the present cohort of young people and the traditional 'master and apprentice' culture in many trades;
- low levels of pay that are not clearly linked to skills training;
- their unnecessarily long duration;
- a 'free rider' problem among many private sector employers, who 'poach' new tradespeople from other employers, and therefore fail to invest in training themselves. This is compounded by a decline in apprenticeships in the public sector.

Although in the past concerns were expressed that wages for apprentices were pricing many out of the labour market, in the present circumstances an increase in their wages may be part of the solution to these problems.

Compared to young people, adult apprentices are paid much closer to standard wage rates for their classification. There is no evidence to suggest that this has discouraged employers from taking them on. Of 400,000 apprentices and trainees in December 2005, 41% were 25 years or over. This proportion has risen dramatically from just 15% in 1997. This may be due in part to the expansion of apprenticeships into the service sector of the economy.¹¹⁹

This evidence does not suggest that pay levels for adult apprentices discourage employers from recruiting them. There is a case, however, to 'target' lower training wages to adults who are disadvantaged job seekers on income support, when they participate in structured training programs. In this way, sub-minimum wages for adults can be targeted towards those jobless people who are least likely to have the opportunity to participate in structured training if they were paid normal wages. Structured training can substantially improve the job prospects of people who have been unemployed long-term because it combines experience in employment with the upgrading of their skills. The former *Jobskills* program for long term unemployed people, for example, achieved good employment outcomes. Trainee wage rates for programs of this kind are set by the Commission.¹²⁰

There is no justification or need to extend sub-minimum wages to disadvantaged job seekers generally (that is, regardless of whether they are engaged in structured training). Given the substantial number of income support recipients, this could undermine the minimum wage system. A fairer way to encourage employers to engage income support recipients would be for the Government to temporarily subsidise the wages of disadvantaged jobseekers working in low skilled jobs at 'normal' wages. Australia has a long history of large scale wage subsidy schemes of this kind, for example the JOBSTART program in the 1990s. Their main purpose is to give disadvantaged jobseekers already capable of performing low skilled work a 'foot in the door' which would otherwise be denied them, for example due to the long duration of their unemployment. As part of its Welfare to Work package, the Government announced in the 2005 Federal Budget a new wage subsidy scheme for long term unemployed people

¹¹⁹ NCVER 2005, *Apprenticeships and traineeships*, NCVER 1999, *Apprentices and trainees in Australia 1985 to 1999*. See www.ncver.edu.au/statistics.

¹²⁰ See Stromback et al 1998, *Labour market programs and labour market outcomes*, Melbourne Institute Working Paper 14/98.

called *Wage Assist*. This program will operate on a very small scale (15,000 workers over three years) but it could be substantially expanded to good effect.¹²¹

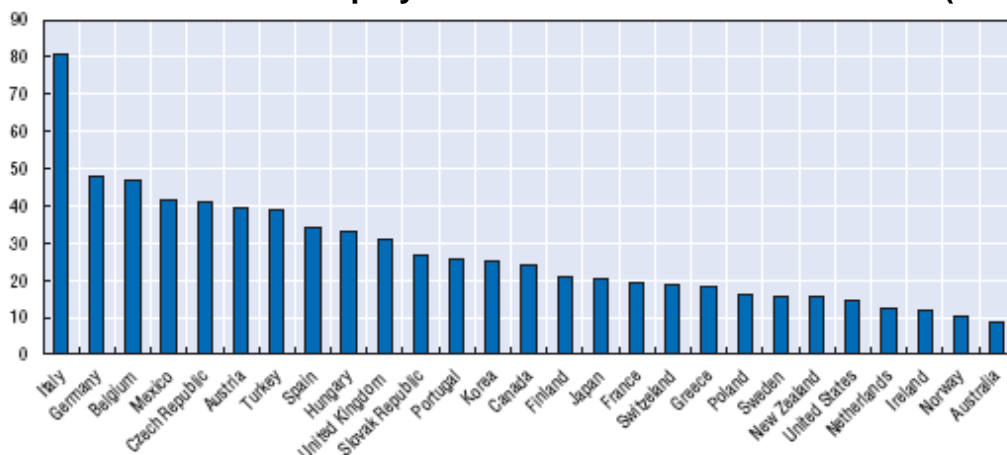
Unlike a general reduction in minimum wages for 'less productive' jobless workers, programs such as this enable the Government to target wage subsidies carefully to those who are most likely to benefit, to withdraw them when they are no longer needed, and to minimise the displacement and substitution of other employees.

Jobs-poor regions

Some countries with severe regional inequities in the labour market have attempted to reduce unemployment in their most disadvantaged regions by allowing minimum rates of pay to vary across the nation.¹²²

However, Australia does not have the severe regional labour market inequalities faced by countries such as Italy, Germany and Spain (see graph below).

Regional variation in unemployment rates within OECD countries (2003)



Source: OECD 2006, *Employment Outlook*. Note: The bars represent an 'index of variation'. The greater the index, the greater is the variation in unemployment rates across regions within a country.

In Australian regions where unemployment rates are much higher than the national average, the main reason is usually a factor other than location per se, such as the decline of employment in traditional large scale manufacturing industries (for example in the Hunter and Illawarra regions of NSW) or the disadvantaged economic and social position of indigenous Australians (for example in Central Australia and Cape York). Policies that directly address the main causes of high unemployment in these areas are likely to be fairer and more effective than lower minimum wages. Another alternative approach is to facilitate greater mobility from disadvantaged regions to those with better job opportunities.

¹²¹ Stromback et al 1998, *Labour market programs and labour market outcomes*, Melbourne Institute Working Paper 14/98; DEETYA 1997, *The net impact of labour market programs*.

¹²² De Koning et al 2004, *Report to the European Union on Policies for full employment*.

In any event, there is already a fair degree of regional 'flexibility' in wages across Australia, in response to the state of regional labour markets.¹²³ As noted previously, low paid workers are more likely to come from rural and regional areas.

People with disabilities

Only 43% of people with disabilities are employed compared with 72% of the workforce age population as a whole.¹²⁴ It would be misleading to suggest that this is due to 'lower productivity' among workers with disabilities. Many jobless people with disabilities would be highly productive in their occupation if the workplace were organised to facilitate this. For example, a person with tertiary qualification with paraplegia may be highly productive in a professional job, if the workplace is modified appropriately. If the person has a visual impairment, they may be highly productive with the assistance of information technology.

To address the barriers to employment of some people with disabilities who have much lower productivity levels than the general community (such as some people with developmental disabilities) Australia has a *Supported Wage Scheme*. Under this scheme, employees with severe disabilities who are assessed as having a much lower level of productivity than the general community may be paid at lower hourly rates. The scheme is currently small-scale.

To the extent that the productivity of people with disabilities is substantially lower than that of other employees, and this cannot be redressed by changes in the workplace, a system of sub-minimum wages can improve their employment prospects in mainstream jobs. The keys to a fair and effective system of sub-minimum wages for workers with disabilities are a transparent and consistent system of productivity assessment that incorporates a requirement to change the workplace and work practices to improve productivity as far as possible prior to the assessment of individual worker productivity. This was part of the Commission's decision last year when it extended the Supported Wage System to more employees with disabilities in different industries. The extension of the Supported Wage System makes careful monitoring of the reliability and equity of the various instruments used to assess productivity essential. On equity grounds, it would be desirable to standardise the instruments to a greater degree than at present.

Substantial improvements to the employment prospects of people with disabilities require a much broader strategy, including:

- an expansion of specialised employment services for people with disabilities such as the Disability Employment Network, which train, rehabilitate or mentor people with disabilities seeking jobs, work with employers to make adjustments to the workplace and work practices, and intervene when problems arise.
- a major national education campaign targeted to employers and the non-disabled workforce would also help overcome inaccurate negative perceptions about the employability of people with disabilities. Steps have been taken along these lines in the Welfare to Work package, but there is much more that could be done.

¹²³ Kennedy & Borland 1997, *A wage curve for Australia?* ANU CEPR Discussion Paper No 372.

¹²⁴ ABS 2003, *Disability ageing and carers*. Data cited are for people with specific activity restrictions.

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