

Submission to the Australian Industrial Relations Commission



**National Wage Case
March 2004**

**ACOSS INFO 355
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Overview

The Australian Council of Social Service (ACOSS) has sought and been granted leave to intervene in a number of National Wage Cases since 1996. While we do not claim any special expertise in the area of industrial relations or wage fixation, we have a deep interest in the adequacy of living standards and the quality of life of low-income Australians. Although wage fixation has traditionally been regarded as the province of employers, unions and the government rather than a social policy concern, there has always been a close relationship between wage fixation, poverty alleviation and the social security system in Australia.

In most industrialised countries, minimum wages are fixed with a view to providing a decent standard of living for low-paid workers. In Australia too, wage fixation has always been critical to the welfare of low-income Australians. The shift from centralised wage fixation through arbitrated across-the-board wage increases towards greater reliance on decentralised wage bargaining and individual contracts places much greater weight on the role of the award safety net.

The establishment and maintenance of a fair safety net of minimum wages and conditions of employment is critically important to prevent an increase in poverty and widening income inequalities, and to preserve work incentives for jobless people. A fair safety net is one which (subject to macroeconomic circumstances) does all it can to assist low-paid workers meet their needs in the context of generally prevailing living standards.

ACOSS submits that there is a need for substantial increases in minimum wages over time to stem growing wage inequality and to enable low-paid workers (with the support of the social security system where appropriate) to meet reasonable basic living costs. We respectfully submit that in the short-term, the Commission should increase minimum wages so as to ensure that they do not fall any further behind movements in average wage rates. Over the medium-term, we propose that the Commission undertake an inquiry to ascertain an appropriate benchmark for the adequacy of minimum wages.



Inequality

A high level of inequality in the distribution of income matters because it divides the community. Those with very low-incomes struggle to meet their basic needs and participate in society. On the other hand, those at the top are increasingly out of touch with the experience and world-view of the majority of households. Such divisions weaken a society, and ultimately undermine economic efficiency as well because social cohesion and community consensus play an important role in any nation's economic development.

The evidence of deep and growing economic divisions in the Australian community is overwhelming. Since the mid 1970s, the distribution of private income has become substantially more unequal and governments have attempted (without success over the medium to long term) to prevent the gap from growing¹.

Wage dispersion is a key part of the income inequality story, since:

- wages comprise the majority of household income;
- wage inequality has been at the heart of growth in household income inequality over the past 20 years.

Earnings inequality in Australia has grown over the last 25 years mainly due to the lowering of real wages at the bottom of the wage distribution scale, together with sharp increases at the top (see table below).

Earnings inequality among full-time employees

	Ratio of 10th percentile to median (bottom to middle)	Ratio of median to 90th percentile (top to middle)
Male full-time employees in 1975	68%	165%
Male full-time employees in 1999	59%	188%
Female full-time employees in 1975	63%	144%
Female full-time employees in 1999	62%	166%

Source: Borland Gregory & Sheehan, *Work rich, work poor*. Victoria University (2001).

¹ Saunders P (2001), *Household income and its distribution*. in Australian Bureau of Statistics, *Australian Economic Indicators*. June 2001. Harding & Greenwell (2001), *Trends in income and expenditure inequality in the 1980s and 1990s*. NATSEM Discussion paper No 56.



Since the 1980s, governments have attempted to cushion the impact of earnings inequality through improvements in social security payments, especially for families with children. These efforts have helped to stem growth in inequality in household disposable income. However, there are definite and legitimate limits to the extent to which governments can continue to play this role in the face of greater wage inequality:

- There is no mechanism (except part-unemployment benefits, to a very limited extent) in place to top up the wages of low-paid single workers without children, who comprise a growing proportion of the population and a large proportion of low-paid workers. If the government introduced a payment (or tax concession) for low-paid single workers, it would find itself in the position of directly subsidising employers of low-cost labour generally². This would fundamentally change the role of government and it has wide-ranging social and economic implications, many of them adverse. Such a step should not be taken lightly.
- Increases in government transfers come at a cost. ACOSS considers that this fiscal price is worth paying where it leads to a significant and sustained reduction in poverty. However, if government were to undertake *primary* responsibility for preventing poverty among low wage-earning households (for example, if minimum wages were sharply reduced and the difference was made up by public subsidies), the outcome would be an unsustainable increase in public outlays that would probably fail to significantly reduce poverty.
- No substantive action has been taken by Governments in recent years to reduce the impact of earnings inequality (or disposable income inequality) at the upper end of the distribution scale, or to support across-the-board wage restraint in order to boost employment.

Poverty

The Australian wage fixing system, together with our system of family payments, has been very effective in the past in insulating low-paid workers and their families from poverty. Although only a small proportion of wage-earning households³ live in poverty today, their number is steadily increasing, both in absolute terms and as a proportion to the population living in poverty.

The most recent data from the National Centre for Social and Economic Modelling, published by the Smith Family, indicates that in 2000, among households whose main source of income was wages, 365,000 people lived in poverty. Although this represented just 3.2% of people living in such wage-earning households, it represented 15% of all people living in poor households⁴.

² Governments do this indirectly through the Family Tax Benefit system for low-income families with children. However, a direct subsidy for low wages has different implications for the cost to Government and the responses of employers.

³ To simplify, we use the term "household" here to describe the statistician's concept of "income unit", although in reality there may be more than one income unit in a household.

⁴ Smith Family, *Financial disadvantage in Australia*. (2001).



Government social security policies have always played a crucial role in reducing poverty, including among wage earning households. However, as we argue with regard to income inequality above, there are limits to the extent to which we can rely on government action alone to address the problem.

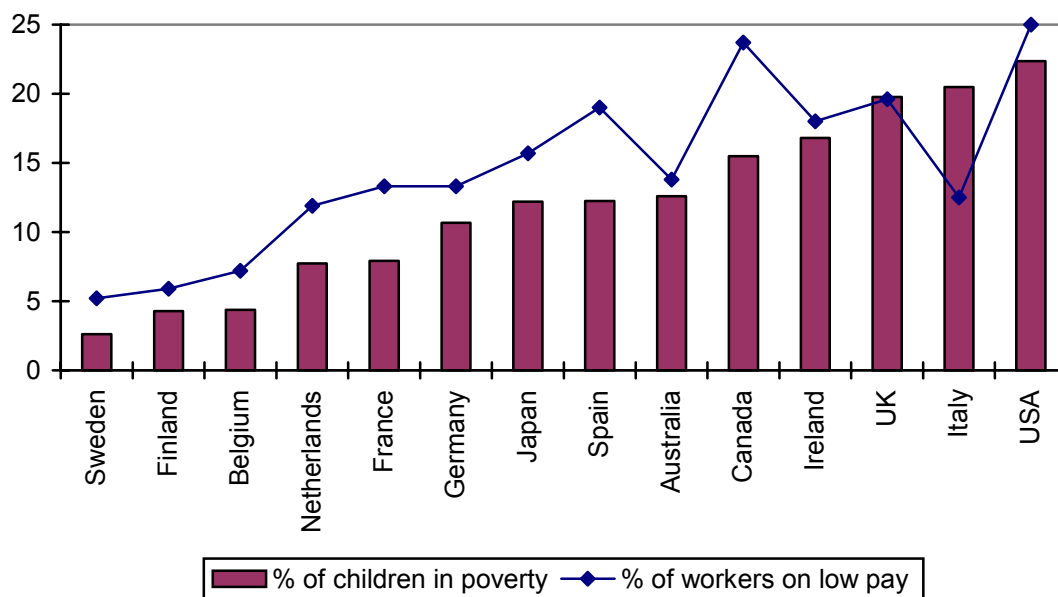
While it is true that government transfer payments can be more precisely targeted towards low-income households at risk of poverty, decent minimum wages provide a critical "floor" for the incomes of many low-income households. Without this floor, governments would struggle to prevent widespread poverty among wage-earning households.

Moreover, the argument that these households should rely more on transfers and less on minimum wages to stave off poverty ignores the strong dynamic relationship between minimum wages and social security payments for people of workforce age:

- In countries where minimum wages are relatively low, social security payments are generally also relatively low and poverty rates tend to be high.
- Countries with relatively high minimum wages also tend to have relatively high social security payments and relatively low poverty rates.

This is illustrated by data contained in an international comparative study of child poverty conducted recently for UNICEF. The graph below suggests a strong positive relationship between the incidence of low pay and child poverty rates.

Child poverty and low pay (1990s)



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 pattern is repeated in other international studies⁵.

One reason for this relationship is that governments preserve work incentives by not allowing benefit levels to come too close to minimum wages. Another way to resolve this work incentive problem in the context of low minimum wages is to extend "in work" benefits (such as our Family Tax Benefit) to low-paid working families. However, there are fiscal limits to the capacity of governments to raise these payments while still providing adequate social security benefits for those without jobs.

Part time, casual and under-employed workers

Adequate minimum wages are particularly important in sustaining a decent standard of living for the growing number of casual and part-time workers⁶. In addition, intermittent work has become a feature of life for many job-seekers, blurring the previous sharp distinction between employed and unemployed workers (the so-called "insiders and outsiders" of the labour market).

A recent study of low-paid workers using a longitudinal data set developed by the Australian Bureau of Statistics (ABS) concluded that there was significant movement between joblessness and low-paid employment:

- 13% of low-paid adult workers drawn from a representative sample of the whole population were out of work one year after the reference point for the study (namely, September 1995);
- 29% of low-paid adult workers drawn from a representative sample of people who were jobless four months prior to the reference point of this study (that is, in May 1995), were out of work again one year later (in September 1996)⁷.

Along with the social security system, minimum wages are a key foundation for the living standards of this growing body of people who move in and out of employment. Given the tenuous nature of their employment, they are less likely than the majority of workers to benefit from individual or collective bargaining arrangements.

⁵ See Smeeding Rainwater & Burtless, *United States poverty in cross-national context*. Maxwell School of citizenship and public affairs Syracuse University, New York Luxembourg Income study working paper No 244 (2000).

⁶ Australian Bureau of Statistics 1999(a) "Australian Social Trends." 1999.

⁷ Australian Bureau of Statistics (1999), "Labour market outcomes of low-paid adult workers" Catalogue No. 6293.0.00.005.



Employment impact of changes in minimum wages

Although there is a relationship between wage levels and employment growth, there is considerable debate over the likely magnitude of the employment response to any decline in low wages. It has been suggested that deregulating wage setting for low-paid workers would yield only a small increase in employment⁸. Others argue that employment growth in Australia has been much less responsive to real wage reductions than was the case in the United States⁹. This suggests that very large reductions in real minimum wages would be required in Australia to substantially reduce unemployment, a conclusion that is reinforced by our experience with wage subsidies for unemployed people. Employers have often been reluctant in the past to take on disadvantaged job-seekers even where half their wage is subsidised by the government¹⁰.

In our view, the Australian evidence suggests that *aggregate* wage restraint will be more effective than reductions in the *relative* wages of low-paid workers in reducing unemployment. Aggregate wage restraint imposed by the Accord in the 1980s contributed substantially to the strong employment growth enjoyed during that economic recovery¹¹.

On the other hand, there is little or no evidence to suggest that greater *wage dispersion* between different groups of workers has helped reduce unemployment in Australia. Youth wages have fallen over the past few decades while their employment opportunities have diminished. In contrast, women's wage rates have increased relative to those of men at the same time that their employment opportunities have improved. Unemployment has increased over the past 30 years across all skill levels. These *increases* in unemployment have not been skewed towards low-skilled workers¹², as we would expect to find if these workers had been priced out of the labour market by high minimum wages¹³.

While ACOSS believes that aggregate wage restraint is important to help reduce unemployment levels, we reject suggestions that low-paid workers should bear a disproportionate burden of wage restraint. They are the least able to cope with a decline in their living standards.

⁸ Borland J and Woodbridge G, "Wage Regulation, Low-wage Workers and Employment" in Richardson S (ed.) "Reshaping the Labour Market: Regulation, Efficiency and Equality in Australia." Cambridge University Press Melbourne 1999

⁹ Gregory, B, Klug, E, Martin YM, "Labour Market Deregulation, Relative Wages and the Social Security System" in Richardson S Ibid.

¹⁰ Department of Employment Education Training and Youth Affairs: "Working Nation - evaluation of the employment, education and training elements." Canberra, 1996

¹¹ Chapman & Gruen, *An analysis of the Australian consensual incomes policy*. Centre for Economic Policy Research Discussion Paper No 221 (1990).

¹² Although it is true that this group has *consistently* faced a higher risk of unemployment.

¹³ Vickery J (1999), *Unemployment and skills in Australia* Reserve Bank of Australia Research Discussion Paper 1999/12.



We therefore reiterate the view expressed in previous submissions that the burden of wage restraint should be fairly shared. This is especially important in current circumstances where those on higher market incomes have secured the lion's share of the benefits of the strong economic growth over the past eight years.

Distributional impact of changes in minimum wages

Some argue that increasing minimum wages is a costly and inefficient way to reduce poverty and income inequality at the level of the household. The basis for this argument is that there is a weak correlation between low wages at the individual level and low-incomes at the household level. For example, the majority of poor households are jobless. Some also argue that most low-paid workers are second earners (either married women or young people) drawn from the top 50% of households.

The latter argument is based on empirical work such as Richardson and Harding's study of the relationship between wages and household incomes¹⁴. However, it only holds (if it does at all) if retired households are included in the income distribution. This is misleading because household needs vary across the life cycle (and are much lower for most people after retirement), and there will always be a substantial gap between the average incomes of retirees and those of wage-earning households.

A more appropriate basis on which to locate low-paid workers within the household income distribution is to confine the analysis to households of workforce age. If this is done, the majority of low wage-earners clearly fall within the bottom half of the distribution¹⁵.

In any event, the argument that increasing transfer payments is a better way to prevent poverty among low-income working households than raising minimum wages incorrectly assumes that we face an "either/or" choice between these two strategies. As ACOSS has argued in previous submissions, this is a false dichotomy. A sustainable reduction in poverty and income inequality requires a balanced approach. Wages should be sufficient for a single person living alone to live decently, and they should be supplemented by social security payments where a wage-earner supports dependents.

Inadequate minimum wages also raise important gender equity issues. The majority of low-paid workers are women, many of whom rely totally on award wage increases. It will be very difficult to sustain significant progress in reducing the gap between male and female wages without increasing the relative level of minimum wages.

¹⁴ Richardson S "Who gets minimum wages?" ANU Centre for Economic Policy Research, Discussion Paper No 386(1998)

¹⁵ The difference between these two measures of household income distribution can clearly be seen in Figure 1 of Richardson's paper cited above.



Moreover, an increase in rates of pay for married women whose husbands are also employed would probably reduce, not increase, household income inequality. This is demonstrated by studies showing that the large increase in (mainly part-time) employment among married women over the 1980s actually *reduced* household income inequality, despite the fact that it was mainly concentrated within two-earner households¹⁶.

Impact of changes in minimum wages on work incentives

A major change in minimum wage levels will have a significant effect on work incentives, all other things being equal. We submit that this, along with the general relationship between the wages and social security systems, should be one of the factors that is taken into account in setting minimum wages. Otherwise, there is a danger that work incentives will be eroded, or that social security payments will be cut to prevent this outcome - leading to a sharp increase in poverty levels as was the case in New Zealand in the early 1990s¹⁷.

At present, *benefit rates* for people of workforce age in Australia are so low that they pose virtually no threat to work incentives. Benefit rates for single unemployed people are particularly low (\$239 per week as at March 2004, which includes the maximum rate of Rent Assistance). A single unemployed adult can expect to roughly double his or her disposable income if he or she secured a full-time job at the minimum wage¹⁸, and that is probably still the case. The gap between the maximum rate of unemployment benefits for a couple and their disposable income if one partner earns the minimum full-time wage is much smaller, but still significant.

On the other hand, *low wages* probably do act as a workforce disincentive for many married women with children whose partners are employed full-time. The main reasons for this are:

- Hourly wage rates for women employed part-time are low in both absolute and relative terms.
- Family Tax Benefit is clawed back as family income increases above a single low full-time wage level, leading to effective marginal tax rates for second earners of more than 50% when income tax is also taken into account.

¹⁶ Saunders P: "*Married women's earnings and family income inequality in the eighties.*" Australian Bulletin of Labour Vol 19 (199-217)

¹⁷ At the same time that legislation was presented to the New Zealand Parliament (in 1990) to deregulate the industrial relations system, another Bill was presented to substantially cut social security payments for people of workforce age. The connection between these two Bills was explicit: the Government was concerned that reductions in wage levels among low-paid workers would erode work incentives if benefits were not also cut. See Stephens R: "*Budgeting with the benefit cuts,*" in Dalziel P: "*The decent society,*" Wellington, 1994

¹⁸ Based on ACOSS calculations.



- Child care costs are often prohibitive. The Child Care Benefit leaves large "gap fees" for families to pay.

To some extent, these work disincentives can be alleviated by reforms to the income tests for family assistance, and improvements in Child Care Benefit. Improvements were made in these areas in 2000 and we advocate further change along these lines, especially to ease the harsh impact of the "stacking" of income tests for families in receipt of more than one child payment (for example, Family Tax Benefit and Youth Allowance). However, as argued above there are fiscal and political limits to the extent to which the social security system can be used to compensate for the inadequate incomes of low wage-earning households.

We submit that financial disincentives for married women to undertake part-time employment, as well as pay equity issues, should be taken into consideration in setting minimum wages. These factors both suggest that increases in minimum wages flowing to women in low paid jobs are desirable. If growth in female workforce participation falters in the coming years, then it will become more difficult to sustain economic growth in the face of the ageing of the population.

Benchmarks for adequate minimum wages

In its first "Living Wage" submission in 1997, ACOSS presented a detailed proposal for the establishment of a benchmark for the adequacy of minimum wages that is objectively grounded in research into the living standards and income needs of low-paid workers. We continue to argue that establishing such a benchmark is imperative.

In the absence of such a benchmark, we respectfully argue that it is difficult to envisage how the Commission can fulfil its responsibilities under section 88B(2) of the Workplace Relations Act (1996) to establish and maintain a safety net of fair minimum wages, having regard to:

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

Examples from countries such as Ireland, which have established official benchmarks and targets for the reduction of poverty, have highlighted both the social and economic advantages of this action¹⁹. The use of such benchmarks and targets is becoming more common in European countries as a result of their adoption by the European Commission²⁰.

We also reiterate our arguments that such a benchmark should:

- be objectively constructed using contemporary social research methods and tested against indicators of actual living standards;

¹⁹ Nolan B: "Targeting Poverty: The Irish Example." Paper for Social Policy Research Centre Conference University of New South Wales, July 1999

²⁰ European Commission (2000a) Structural Indicators, Communication from the Commission, COM (2000) 594.



- set at a level that enables a single adult living alone to live in "modest comfort" and participate fully in society in accordance with contemporary community standards (that is, a benchmark that is significantly above poverty levels).

The benchmark should be based on the needs of a single person rather than a family. Although the original Basic Wage introduced following the Harvester judgement was fixed at a level that was just sufficient to prevent a family of four or five from falling into hardship, minimum wages have not been set on this basis for many years. It is more appropriate in present-day conditions for the social security system to meet the additional costs of raising children in low-income families - *provided* family income is underpinned by a minimum wage that is adequate to support the wage-earner²¹.

In our view, minimum wages should be set significantly above the poverty level for a single person, to provide a decent standard of living and a fair reward for labour, and to preserve work incentives for unemployed people. Minimum wages have been set well above poverty levels for a single adult for many years now, but it is doubtful whether they enable a person to live in modest comfort in accordance with contemporary Australian living standards.

The *Budget Standards Project*, undertaken by the Social Policy Research Centre (SPRC) at the University of New South Wales and commissioned by the former Department of Social Security, (now the Department of Family and Community Services), provides valuable information which could inform the setting of an appropriate minimum wage benchmark. This comprehensive research developed detailed household budgets for a range of family types, sufficient for those households to attain a "Modest But Adequate" or "Low Cost" standard of living. While no single benchmark of living standards should be relied upon exclusively for this purpose, this work could inform the development of appropriate benchmarks for a minimum wage²².

We note that Professor Saunders from the SPRC, in a report on Budget Standards submitted to the Commission, suggests that a benchmark somewhere between the low cost and modest but adequate benchmarks would be appropriate for minimum wage fixation²³. The modest but adequate standard is defined by Saunders as one that '*affords full opportunity to participate in contemporary Australian society and the basic options it offers*', while the low cost standard represents a level of living which '*may require frugal and careful management but would still allow social and economic participation consistent with community standards*'²⁴.

²¹ This implies that the wages system and the social security system should together be responsible for ensuring that families with children do not fall into poverty.

²² See Depart of Social Security, *Development of indicative Budget standards for Australia*. Research Discussion Paper No 74 (1998).

²³ Saunders P (2004), *Updated Budget Standard estimates for working families in September 2003*. Report prepared for for the ACTU.

²⁴ Ibid, page 4.



We agree with Professor Saunders that the Low Cost standard is more appropriate for benchmarking social security payments or measuring poverty, than for wage fixation. However, it is difficult to conceive on what basis a third benchmark 'in between' these two levels would be cast. At the least, this would require very careful consideration of the *purpose* of the proposed standard, the *level of living* to which it corresponds, and how this level could be *clearly distinguished* from both a "Low Cost" and Modest But Adequate' standard.

Saunders indicates that the Modest But Adequate standard was designed as a 'middle income' standard. His comparisons of Budget Standards with the actual distribution of household expenditures suggest that the updated Modest But Adequate standard was roughly 20% higher than the overall median expenditure level for a lone person household in 2003. However, this includes households of workforce age, and retirees, who are reliant on social security payments. He argues, and we agree, that the more appropriate comparison for wage fixation purposes is with lone person households *in employment*. On this basis, the Modest But Adequate standard was around 80% of the median expenditure for a lone employed person in 2003. If we compare this standard with the median expenditure for lone *full time* workers, this falls to around 75%²⁵.

This may seem a far cry from the harvester standard established in 1907. It is based on a single adult rather than a family, and on a Modest But Adequate standard rather than the more frugal one (in effect, a poverty benchmark) set by Justice Higgins. On the other hand, the principle enunciated by Higgins J was that the basic wage should meet '*the normal needs of an average employee regarded as a human being living in a civilized community*'²⁶. It is open to conjecture that one of the reasons Higgins J set his benchmark at a 'poverty' standard was that the incomes of *average* production workers were not far removed from a poverty standard at that time (especially given the lack of family allowances). This is no longer the case. Given the much higher *relative* living standards of today's production workers, it is possible that the basic wage fixed by Higgins (or perhaps the one recommended by the subsequent, more thorough, Piddington Report) bore a relationship to median full time earnings that is not much different to the Modest But Adequate standard today ²⁷.

We conclude, as we have in previous submissions, that the most appropriate benchmark available *at the present time* for fixing minimum wages is the "*Modest But Adequate*" benchmark for a single person of workforce age living alone and renting privately. Its current value stands at approximately \$450 per week²⁸. This is a *consumption* benchmark, and as such it corresponds more closely to *disposable* income than gross income. The equivalent before-tax wage is approximately \$550 per week.

²⁵ Ibid, See Table 8 on page 34 (using the average of the third quintile as a rough approximation of the median) and Table 12 on page 40. Note that the equivalent proportion of *gross* median wages would be lower since median wages attract a higher tax rate than the gross equivalent of the Modest But Adequate standard.

²⁶ Johnson D (1987), *The calculation and use of poverty lines in Australia*. Australian Economic Review 4/1987.

²⁷ That is, around 75% of the median full time wage. See Piddington A (1920), *Royal Commission on the basic wage*. Justice Piddington found that the cost of living '*according to reasonable standards of comfort*' for a family of five was much higher than the then basic wage. With considerable foresight, he recommended that the basic wage be supplemented by a national system of child endowment to meet the minimum costs of raising children. This was established many years later.

²⁸ See Saunders, *op cit*. This Budget Standard is for a single adult renting privately. The equivalent Budget Standard for a home purchaser is significantly higher.



Accordingly, ACOSS recommends that the Commission undertake an inquiry into the living standards of low-paid workers with reference to those in the wider community, in order to arrive at an objective benchmark for a minimum wage appropriate for a single adult. We recommend that this inquiry be informed by the work undertaken by the Budget Standards Project and other relevant living standards research.

Conclusion

ACOSS believes it is essential that the award system continue to play a central role, along with the social security system, in protecting the living standards of low-paid workers and their families. A minimum wage benchmark that is not linked in some way with rates of pay for workers higher up the earnings distribution is vulnerable to erosion and political manipulation, as the experience of the United States and New Zealand demonstrates. The award system provides the necessary link in Australia. However, the award system itself is becoming less relevant to the growing numbers of workers engaged in enterprise bargaining, so this too is now vulnerable to erosion.

It is critical that the living standards of low-paid workers not be allowed to fall further below community standards. Since the early 1980s minimum award wages have fallen substantially relative to average weekly ordinary-time earnings.

An effective minimum wage "floor" is essential to improve the living standards of low-paid workers and their families and to ensure they do not fall further behind.

In summary, ACOSS respectfully submits that, in the short-term the Commission should increase minimum wages so as to ensure that they do not fall any further behind movements in average wage rates. Over the medium-term, we propose that the Commission undertake an inquiry to ascertain an appropriate benchmark for the adequacy of minimum wages.