

## **Chapter 2: Economic developments**

### **Introduction**

- 2.1 This chapter provides an overview of economic conditions in Australia. This is presented to assist the Commission in relation to its objective to promote the economic prosperity of the people of Australia and to have regard to employment and competitiveness across the economy.
- 2.2 The chapter begins with an economic overview and outlook. This material is provided by the Australian Government Treasury and is consistent with their analysis and forecasts contained within the 2006-07 Budget.
- 2.3 A more detailed examination of trends in the labour market and wages follows. The particular focus is on the recent labour market data relating to key groups within the labour market including the long-term unemployed, teenagers and lone parents.
- 2.4 The last section concludes with the Australian Government's view that there are strong grounds to justify the Commission awarding an appropriate level of increase in minimum wages for the low paid.

### **Economic outlook**

- 2.5 The Australian economy is expected to strengthen in 2006-07, with the world economy continuing to provide significant impetus to Australia's economic growth. Strong global demand for commodities is boosting business investment, supporting growth in corporate profits and household incomes, and establishing conditions favourable to increasing exports. Gross national expenditure growth is forecast to remain moderate, with growth in business investment offsetting slower growth in household consumption and a modest decline in dwelling investment. After a period of strength, employment growth is forecast to ease in 2006-07, and inflation is expected to remain moderate.

### **Domestic forecasts**

- 2.6 The Australian economy continued to record modest growth in the second half of 2005, with robust growth in business investment and moderate growth in household consumption offset by a fall in dwelling investment and sluggish

growth in exports. Partial indicators point to a strengthening in activity in early 2006. Real GDP is forecast to grow by 3¼ per cent in 2006-07, up from 2½ per cent in 2005-06. The sources of growth are expected to continue to shift from the domestic sector to the external sector, although at a slower pace than anticipated in the *Mid-Year Economic and Fiscal Outlook 2005-06*.

- 2.7 Gross national expenditure is forecast to grow by 3½ per cent in 2006-07. Household consumption growth is expected to remain moderate, as households continue to experience a period of weaker growth in dwelling wealth. Dwelling investment is forecast to subtract marginally from GDP growth, but growth in business investment should continue to support economic activity. The outlook for export growth is positive, underpinned by the significant investment undertaken to boost productive capacity, particularly in the mining sector. Import growth is forecast to moderate from the recent strong rates of growth.
- 2.8 The combination of sharp increases in the prices of mineral commodity exports and moderate growth in the prices of many imported consumption and capital goods has significantly increased the purchasing power of Australian households and businesses. However, Australia's terms of trade are expected to change little in 2006-07 as commodity price growth eases, leading to lower growth in domestic income from external sources.
- 2.9 The current account deficit is expected to widen to 6¼ per cent of GDP in 2006-07. While the trade deficit is expected to be broadly unchanged in 2006-07, the net income deficit is forecast to increase in line with growth in the stock of net foreign liabilities. Net income payments to the rest of the world are expected to rise as increased dividends and retained earnings accrue to foreign investors in Australia's mining sector, and interest payments are made on a growing stock of net foreign debt.
- 2.10 Employment is anticipated to grow a little below trend in 2006-07, as the labour market responds to the recent weakness in GDP growth. The unemployment rate is expected to be around 5¼ per cent in 2006-07. Wage growth should remain solid, given continuing strong demand for labour in some sectors of the economy.
- 2.11 Inflation is forecast to remain moderate in 2006-07. Expected moderate growth in import prices, together with below-trend growth in household consumption, should see inflation remain contained. High oil prices and relatively strong unit

labour costs are expected to partly offset these moderating influences on inflation.

## **Outlook for the world economy**

- 2.12 The world economy is expected to continue to expand at a strong rate, with world GDP forecast to increase by 5 per cent in 2006 and 4¾ per cent in 2007. The positive global outlook reflects expectations for continued trend growth in the United States, strong growth in China, increasingly solid growth in Japan and a continuation of the moderate recovery underway in Europe.

## **Outlook for the domestic economy**

- 2.13 On the domestic front, household consumption growth is forecast to strengthen slightly to 3 per cent in 2006-07. This is well below the growth rates recorded earlier this decade when households allowed consumption growth to run ahead of income growth, supported in part by the significant increase in dwelling wealth. With dwelling wealth having increased much more slowly over the past two years, debt servicing requirements increasing, and fuel prices remaining high, consumption growth is likely to remain moderate in the period ahead.
- 2.14 Dwelling investment is expected to fall by 1 per cent in 2006-07, following two years of small declines. The downturn in the current housing cycle is mild by historical standards, and the risk of a sharp fall in house prices appears to have largely abated. Underlying demand for new dwellings is expected to remain stable over the forecast period, with dwelling completions moving broadly in line with demand.
- 2.15 Business investment is expected to continue to be a major contributor to economic activity. After two years of exceptionally strong growth, business investment is forecast to grow by 8 per cent in 2006-07. The high level of activity in the mining sector and healthy corporate finances should see business investment remain at high levels.
- 2.16 Public final demand is forecast to grow by 3¼ per cent in 2006-07, reflecting strong growth in investment by all levels of government. Public consumption is expected to continue to grow at near trend rates.
- 2.17 Net exports are expected to subtract ½ of a percentage point from GDP growth in 2006-07, after subtracting 1 percentage point in 2005-06. Strong growth in non-rural commodity exports, coupled with improved conditions in the rural

sector, should see exports grow by 7 per cent in 2006-07. Imports are also forecast to grow by 7 per cent in 2006-07, reflecting the moderation in household consumption growth.

- 2.18 The terms of trade reached their highest level in three decades in 2005. Non-rural commodity export prices are expected to be flat in aggregate in 2006-07 after increasing by around 25 per cent per annum in 2004-05 and 2005-06. As a result, the terms of trade are forecast to settle near their current high level.
- 2.19 The current account deficit is expected to narrow marginally in 2005-06, to around 6 per cent of GDP, before widening to 6¼ per cent in 2006-07. The trade deficit is expected to be 1¾ per cent of GDP in both 2005-06 and 2006-07. However, the net income deficit is forecast to widen in 2006-07 as strong mining profits result in increased dividends and retained earnings accruing to the rest of the world. Increasing world interest rates and a higher stock of net foreign debt are also anticipated to contribute to the widening net income deficit.
- 2.20 Employment growth is expected to moderate to 1 per cent in 2006-07, in line with the lagged effects of slower GDP growth in 2004-05 and 2005-06. Following a record high in mid-2005, labour force participation is expected to decline gradually over the forecast horizon. The unemployment rate is forecast to be around 5¼ per cent in 2006-07. A more detailed outlook for the labour market is presented later in this chapter.
- 2.21 Wages are expected to continue to increase solidly, with the *Wage Price Index* forecast to grow by 4 per cent in 2006-07. The forecast easing in employment growth in 2006-07 should have a dampening effect on wage growth, although continuing tight conditions in parts of the labour market, particularly those most affected by the mining sector, will prevent wage growth from slowing significantly.
- 2.22 Inflation is expected to remain moderate at 2¾ per cent in 2006-07. In the near term, the direct effect of higher oil prices is expected to continue to contribute to inflation. However, the cyclical upswing in productivity and slow growth in import prices should have a moderating influence on inflation.

## Key risks to the economic outlook

- 2.23 In recent years, developments in the economy have been influenced by two very large price movements. The first was a prolonged boom in house prices until the end of 2003 and a subsequent period of little growth in prices. The second is a dramatic increase in the terms of trade stemming from very strong world demand for commodities that has not yet ended. Fortunately, the economy has adjusted remarkably well to these price changes, but some risks remain in the aftermath of these developments.
- 2.24 The boom in house prices prompted very strong consumption growth in 2003-04 and 2004-05. Since the end of 2003, house prices have shown only a small increase and consumption growth has moderated accordingly. The risk that house prices fall, at least in nominal terms, and trigger a significant weakening in consumer spending appears to have largely abated.
- 2.25 Nevertheless, household borrowings have increased significantly and, consequently, debt servicing requirements have also increased. This has left the household sector, and the path of consumption growth, more sensitive to changes in labour market conditions and interest rates. Consumption may also be more vulnerable to adverse movements in external factors such as a further increase in oil prices or even a shock that affects confidence, such as a health or security concern.
- 2.26 High commodity prices have generated a significant amount of additional export income for Australia, although the dampening impact on the economy of flat house prices has helped to weigh against this stimulus. Past terms of trade booms have been associated with very rapid increases in wages and inflation.
- 2.27 This scenario has not played out on this occasion, partly reflecting the benefits of a floating exchange rate, an independent monetary policy regime, and competitive labour and product markets. While the Australian economy has adjusted well to the dramatic increase in commodity prices, it may also need to adjust to a fall in prices at some stage. The timing and extent of any fall in commodity prices is uncertain and will depend, in part, upon the speed with which additional supply comes to market.
- 2.28 Wage rises associated with higher commodity prices have been confined to the geographical areas where mining operations are concentrated and in those industries most directly affected, such as in the mining and construction sectors.

There does remain some risk that the higher wages paid in these sectors will spill over into increased wage demands in other sectors. However, while there has been some broadening in wage pressures more recently, wages still appear well-contained.

- 2.29 Oil prices remain high and volatile. The main effect of higher oil prices to date has been higher automotive fuel prices, which have increased by 20 per cent over the past year. There remains a risk that higher fuel prices, combined with solid wage outcomes, will feed into higher prices for other goods and services.
- 2.30 The forecasts for the rural sector are predicated on an assumption of average seasonal conditions in 2006-07. However, as is always the case, the timing and distribution of rainfall will have an important impact on the prospects for rural production and exports.
- 2.31 In terms of the world economy, the outlook remains positive, though a number of potential risks remain. These risks include global imbalances, high oil prices, increased financial vulnerability and a possible influenza pandemic. Current account imbalances have continued to widen despite favourable conditions for policy makers to undertake reforms. While these imbalances may persist for some time without significant adverse consequences, they increase the vulnerability of the world economy to destabilising changes in financing flows.
- 2.32 More detailed information on the economic outlook can be found in the *2005-06 Budget, Paper No. 1 Statement No.3*.

## **Labour market overview<sup>1</sup>**

- 2.33 Australia has experienced an unprecedented period of economic prosperity since the end of the 1990s recession. Against the backdrop of strong and sustained growth, labour market conditions have been historically robust, with employment growth averaging 1.9 per cent per annum over the decade to May 2006. Over this period, employment has increased by 1,780,900 (or 21.3 per cent) to 10,142,200, its highest level on record. The recent strong employment growth, coupled with a significant reduction in unemployment, has resulted in the unemployment rate falling to 4.9 per cent, its lowest level in around 30 years.

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<sup>1</sup> The data in the 'Labour market overview' are in seasonally adjusted terms, except for the section on 'Jobless parents' which are in original terms.

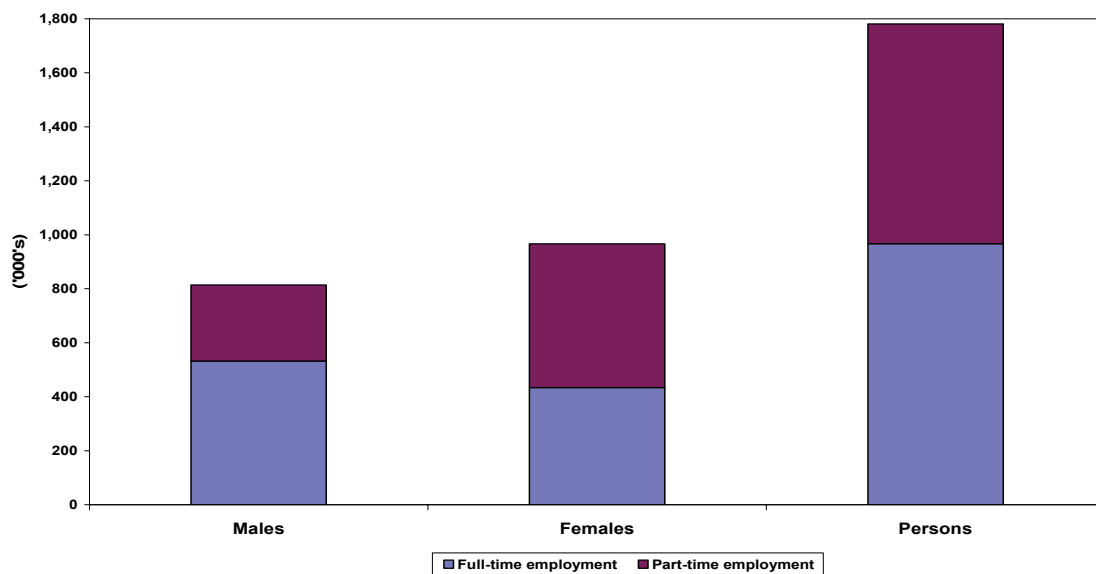
2.34 Despite these recent strong conditions, a number of forward indicators point to an easing in labour market activity in the coming year. Indeed, the pace of employment growth has already begun to slow, from a robust rate of 4.2 per cent in the year to August 2005 to 1.7 per cent over the year to May 2006. There are a number of specific groups, including teenagers, the long-term unemployed and lone parents, who continue to experience significant labour market disadvantage.

## Employment

2.35 Over the last 10 years, employment growth has been fairly evenly split between full-time employment (up by 966,800 or 15.4 per cent) and part-time employment (up by 814,100 or 39.3 per cent) (see Chart 2.1). While full-time employment has accounted for just over half (54.3 per cent) of total employment growth over the period, part-time employment has grown at a much faster pace (an annual average rate of 3.4 per cent) than full-time employment (up by 1.4 per cent).

2.36 As illustrated in Chart 2.1, women have gained an additional 532,300 part-time jobs and 434,300 full-time jobs over the past decade. While the majority of the growth in male employment over the period has been full-time, it should be noted that male part-time employment has increased by 281,900 (or 52.5 per cent) since May 1996.

**Chart 2.1: Change in full-time, part-time and total employment over the 10 years to May 2006**

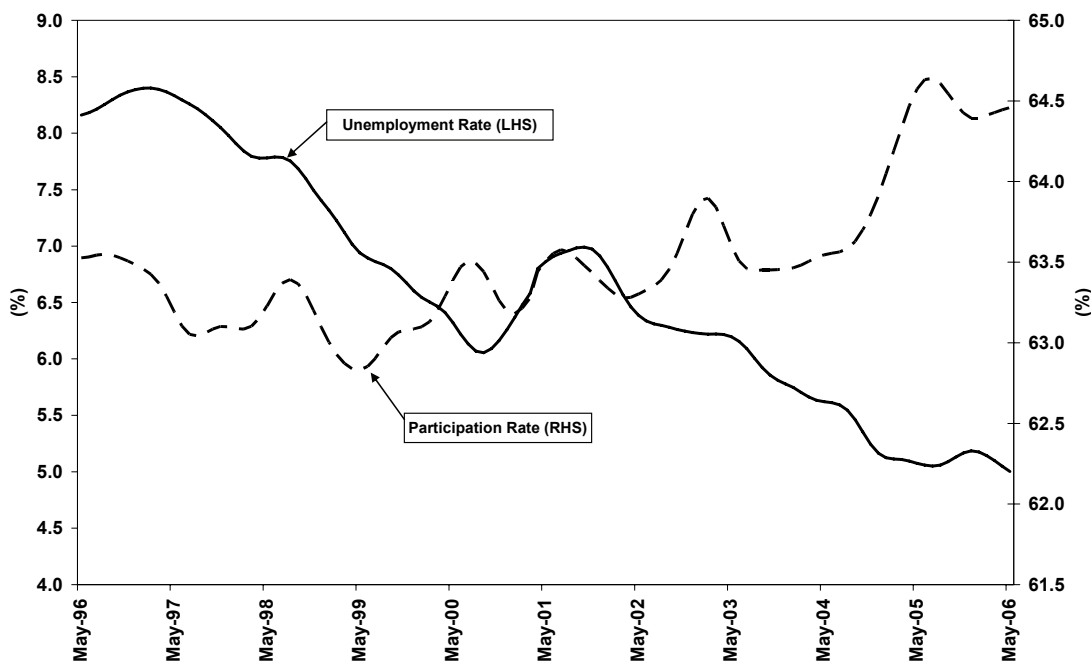


Source: ABS Labour Force, Australia, Spreadsheets (Cat No. 6202.0.55.001), Seasonally adjusted data.

## Unemployment

2.37 Reflecting a clear strengthening in labour market conditions in Australia over the last decade, the level of unemployment has fallen by 216,600 (or 29.4 per cent) to 521,300 in May 2006. The fall in unemployment has been due principally to a decrease in male unemployment, which has accounted for 70.2 per cent of the total decline in unemployment over the period. Not surprisingly, the unemployment rate has also fallen substantially to its current level of 4.9 per cent.

**Chart 2.2: Unemployment rate and participation rate, May 1996 to May 2006**



Source: ABS Labour Force, Australia, Spreadsheets (Cat No. 6202.0.55.001), Trend data.

## Participation rate

2.38 Consistent with the clear strengthening in labour market conditions, the participation rate has also risen over the decade, by 1.0 percentage point to 64.5 per cent in May 2006 (see Chart 2.2). Over this period, the female participation rate has risen by 3.7 percentage points to 57.4 per cent, while the male participation rate has fallen by 1.8 percentage points to 71.9 per cent.

2.39 It should be noted, however, that while the participation rate currently stands at close to record highs, the continuing ageing of the population will mean that in

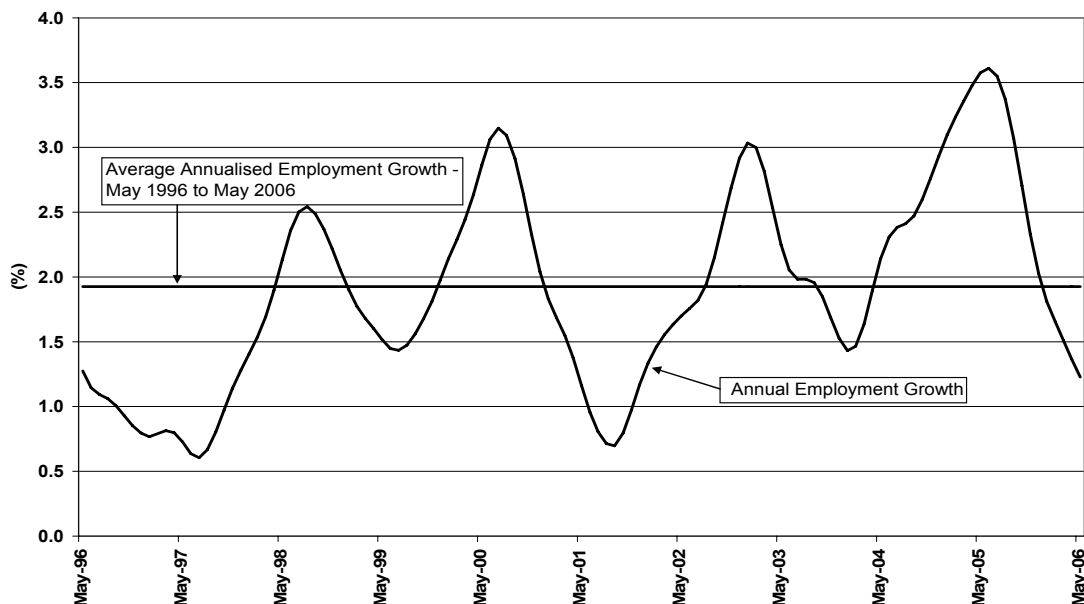
the coming years, it will be increasingly difficult to maintain the current levels of participation in the labour force. Indeed, the ABS projects that by the year 2016 the participation rate will fall to 60.6 per cent.

## Outlook

2.40 Aside from a temporary slowdown in the pace of employment growth in 1996-1997 and again in 2000-01 (see Chart 2.3 below), a widespread and sustained improvement in labour market conditions has occurred across Australia over the last 10 years, with a particularly strong performance being evident over the last two years. This has been due, in large part, to a once in a generation commodity price boom and strong associated business investment, underpinned by record mining company profits and Australia's highest terms of trade in over 30 years.

2.41 However, a number of downside risks to the economy and labour market are apparent. In particular, any sizeable fall in profits, resulting from a decline in commodity prices (as new supply starts to come on stream), would ultimately see companies scale back on investment which would put downward pressure on underlying demand for labour.

**Chart 2.3: Annual employment growth, May 1996 to May 2006**



Source: ABS Labour Force, Australia, Spreadsheets (Cat No. 6202.0.55.001), Trend data.

2.42 Irrespective of this point, however, while scope exists for further labour market improvements in the coming 12 months, forward indicators suggest the pace of

employment growth may ease over the course of the next financial year. Indeed, Treasury's latest Budget forecasts indicate that employment growth will slow to just 1.0 per cent in 2006-07, with the unemployment rate projected to rise to 5.25 per cent by June 2007.

- 2.43 In a climate where labour market conditions appear to be easing, increases in minimum wages that result in the minimum wage being set too high may have negative repercussions for certain cohorts in the Australian labour market and could potentially put further upward pressure on the unemployment rate.

## **Disadvantaged groups in the labour market**

- 2.44 While labour market conditions have strengthened over recent years, a number of groups, including teenagers, the long-term unemployed and lone parents, continue to face labour market disadvantage. As a result of the ageing population, and the labour supply challenges this is likely to pose now and into the future, it is important that these groups are given the assistance needed to participate in the labour market.
- 2.45 A critical aspect of this is ensuring that any increase in minimum wages does not price these vulnerable groups out of the labour market. In this context, the labour market performance of each of the disadvantaged groups outlined above is discussed in further detail below.

### **Teenagers**

- 2.46 Teenagers have benefited from strengthening labour market conditions over the past decade, with employment increasing by 96,200 (or 15.8 per cent). While the teenage full-time unemployment rate has declined, by 6.4 percentage points over the last decade, it remained at 21.1 per cent in May 2006, more than four times higher than the equivalent rate for the population as a whole.
- 2.47 For a more detailed examination of the teenage labour market and the disadvantages faced by this group, please refer to Chapter 9 and Appendix E9.

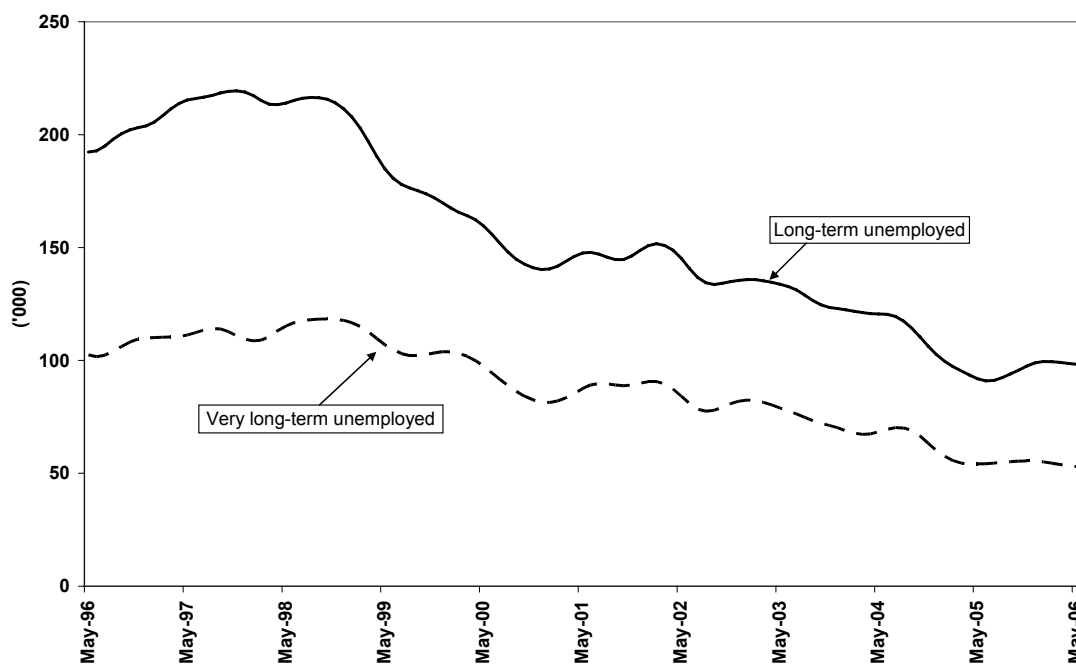
### **Long-term unemployed**

- 2.48 While the level of long-term unemployment has fallen substantially over the last decade, by 87,200 (or 47.9 per cent), it should be noted that as at May 2006, there were still 95,000 jobseekers (or almost 1 in 5 unemployed persons) who had been unemployed for 12 months or more.

2.49 Similarly, while there has also been a fall of 46,500 (or 47.0 per cent) in the number of persons who are very long-term unemployed (persons unemployed for two years or longer) over the last 10 years, there remain 52,500 unemployed persons (or over 50 per cent of long-term unemployed persons) who were very long-term unemployed in May 2006.

2.50 Once again, minimum wage increases that are too high may exacerbate the disadvantage faced by this cohort.

**Chart 2.4: Long-term unemployment and very long-term unemployment, May 1996 to May 2006**



Source: ABS Labour Force, Australia, Spreadsheets (Cat No. 6291.0.55.001), Trend data.

### Jobless parents

2.51 In June 2005 (latest available data), there were 2,228,900 families with dependent children in Australia, with 333,800 being families with children where no parent was employed. Significantly, lone parent families accounted for the vast majority (72.4 per cent) of these families.

2.52 While the number of dependent children in jobless families has fallen by 71,800 (or 10.7 per cent) over the last decade, there remain almost 600,000 children under the age of 15 who live in a family where no parent is employed.

- 2.53 Children who grow up in jobless families are at a significantly greater risk of being unemployed later in life and are more likely to experience poverty as a consequence. Accordingly, it is essential that parents in these families are given the opportunity and incentives to find employment, thereby reducing the risk of intergenerational unemployment.
- 2.54 While the unemployment rate of lone parents with dependent children under 15 years fell marginally over the decade, by 0.9 percentage points to 16.4 per cent in June 2005, it remains almost five times higher than the unemployment rate for parents in couple families with dependent children, which stood at 3.3 per cent in June 2005.
- 2.55 With greater numbers of lone parents set to enter the labour market in July 2006 as a result of the Australian Government's Welfare to Work reforms, it is crucial that any increase in the minimum wage is of a magnitude that does not price this cohort out of a job.

## **Wages developments**

- 2.56 As discussed previously in this submission, the WR Act empowers the Commission to adjust the FMW and APCSs having regard to 'the capacity of the unemployed and low paid to obtain and remain in employment' as well as to 'provide a safety net for the low paid'. There is no requirement in the principal object of the WR Act or the Commission's legislative parameters for the APCS wages or FMW to be linked with growth in average earnings or wages.
- 2.57 The establishment and maintenance of a safety net for the low paid needs to take account of a number of factors occurring in the labour market and social policy environment. To establish a safety net with regard to only broader movements in earnings would risk greater unemployment for low paid workers.
- 2.58 Nevertheless, it is inevitable that the Commission will be invited in some submissions to replicate aggregate wage trends in its wage adjustment.
- 2.59 Over the past decade the broad ABS measure of earnings – Average Weekly Ordinary Time Earnings (AWOTE) for full-time adults – has increased by 55.9 per cent reflecting the sustained improvements in the labour market.
- 2.60 Movements in earnings can be the result, however, of both changes in wage rates and changes in the composition of employment. That is, such movements

can be an indicator of strength of demand for workers in the labour market (or particular types of workers) taking into account both movements in the wage of the workers and the types of workers employed.

2.61 This is illustrated by looking at the changes in the occupational structure of the workforce over the recent past. The change in full-time employment between 1996 and 2006 indicates marked differences by occupation. The classification of the occupational groups has been developed by the ABS and generally reflect a skills hierarchy.<sup>2</sup> As Table 2.1 shows, the strong full-time jobs growth in the first three occupational categories has been in stark contrast to the relatively poor increase in the number of full-time jobs in the bottom three categories.

**Table 2.1: Change in full-time employment by occupation, August quarter 1996 to February quarter 2006**

|  | <b>Increase in full-time employment<br/>1996 – 2006<br/>(per cent)</b> |
|--|--|
| Managers and administrators                      | 68.3   |
| Professionals                                    | 38.8   |
| Associate professionals                          | 45.3   |
| Tradespersons and related workers                | 5.3  |
| Advanced clerical and service workers            | -10.3  |
| Intermediate clerical, sales and service workers | 8.7  |
| Intermediate production and transport workers    | 0.8  |
| Elementary clerical, sales and service workers   | 2.5  |
| Labourers and related workers                    | 3.9  |
| All occupations                                  | 19.6   |

Source: ABS Labour Force, Australia, Detailed, Quarterly (Cat No 6291.0.55.003).

2.62 In addition, variations in the distribution of employment between industries affect movements in earnings.

2.63 The ABS, through the development of the Wage Price Index (WPI), has addressed the confounding influences of workforce compositional change when estimating changes in average earnings levels. The ABS first devised a measure of changes in the pay rates of actual jobs when it established the WPI series in September 1997 (formerly the Wage Cost Index).

2.64 The WPI is the ABS's preferred measure of wage movements. The WPI measures wages growth for performing the same work at the same level, unlike

<sup>2</sup> ABS *Australian Standard Classification of Occupations*, Second Edition, 1997, (Cat. No. 1220.0), page 5.

earnings measures that are affected by compositional shifts in the workforce. In other words, relatively stronger growth in high skilled occupations compared with low paid and middle paid occupations, as have occurred recent times, could lead to a higher increase in other earnings measures than in the WPI even when all workers receive the same percentage increase in pay.

2.65 The ABS advises that:

*The Average Weekly Earnings series does not provide a reliable indicator of changes in wage rates, as it is significantly affected by compositional shifts in the workforce.*

*Users who require a reliable measure of change in wage and salary rates should refer to the quarterly Wage Cost index series (results published in Catalogue No. 6345.0), which directly measure changes in wage and salary rates each quarter.<sup>3</sup>*

2.66 Over the year to the March quarter 2006, the WPI rose by 4.0 per cent, down from the 4.2 per cent recorded over the year to the December quarter 2005, but slightly higher than the growth of 3.9 per cent recorded over the year to the March quarter 2005.

2.67 The annual increase in the WPI for the public sector over the year to the March quarter 2006 was 4.1 per cent, while for the private sector the annual WPI rose by 4.0 per cent.

### ***Wages growth and the composition of employment***

2.68 Table 2.2 below shows that the pay rates of higher skilled (and generally speaking, higher paid) occupations have not grown at a significantly higher rate than those of lower skilled occupations. Overall wages have grown by 33.7 per cent over the period. By comparison AWOTE have grown by 46.5 per cent over the same period. The difference is largely accounted for by a shift in the composition of the workforce from low paid to higher paid jobs, as noted in Table 2.1.

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<sup>3</sup> ABS, *Average Weekly Earnings* (preliminary), November 2000 (Cat. No.6301.0).

**Table 2.2: Increase in total hourly rates of pay (excluding bonuses), as measured by the ABS Wage Price Index, September quarter 1997 to March quarter 2006**

|  | <b>Increase in total hourly rates of pay (excluding bonuses) 1997 – 2006 (per cent)</b> |
|--|---|
| Managers and administrators                      | 34.3  |
| Professionals                                    | 37.2  |
| Associate professionals                          | 32.8  |
| Tradespersons and related workers                | 34.1  |
| Advanced clerical and service workers            | 31.2  |
| Intermediate clerical, sales and service workers | 31.5  |
| Intermediate production and transport workers    | 32.3  |
| Elementary clerical, sales and service workers   | 28.8  |
| Labourers and related workers                    | 31.3  |
| All occupations                                  | 33.7  |

Source: ABS Labour Price Index (Cat. No. 6345.0)

- 2.69 This shift in demand away from low skilled workers has major implications for decisions regarding the nature of the safety net. The employment of the low skilled is likely to be far more vulnerable when employment growth is not strong.
- 2.70 Moreover, this shift towards higher skilled jobs also has implications for the distribution of earnings in the labour force and the limited relevance of movements in average weekly earnings for informing the appropriate level or change in the safety net for the low paid.
- 2.71 Table 2.3 presents the change in real earnings across the workforce over the past two decades. While our main interest lay in recent changes over the last decade, we include an earlier period for historical perspective. Real earnings for the 10th percentile (the point on the earnings distribution at which 90 per cent of employees earn more) have experienced a real increase in their earnings of 7.0 per cent since 1996.
- 2.72 The higher paid, however, have experienced noticeably faster growth rates since 1996. Earnings for the 90th percentile have increased by 14.6 per cent over this period. This is also faster than the rate of growth in median earnings.

**Table 2.3: Growth in earnings across by selected percentiles, 1986 to 2004 (per cent)**

|                 | 1986 to 1995 | 1996 to 2004 |
|-----------------|--------------|--------------|
| 10th percentile | -1.5         | 7.0          |
| 25th percentile | -0.1         | 8.5          |
| 50th percentile | 2.2          | 9.7          |
| 75th percentile | 3.7          | 10.9         |
| 90th percentile | 2.7          | 14.6         |
| Mean earnings   | 3.1          | 10.9         |

Source: ABS Employee Earnings and Hours (Cat. No. 6306.0), unpublished data.

2.73 The widening of earnings dispersion in Australia is also evident when examining trends in the ratio of earnings of the high paid to median earnings, earnings of the high paid to that of the low paid and median earnings to that of the low paid.

2.74 Table 2.4 shows the following:

- The ratio of earnings of the high paid to median earnings has gradually increased over the past 20 years. Whereas those at P90 earned 1.54 times median earnings in 1985, in 2004 they earned 1.65 times median earnings.
- The ratio of earnings of P90 to P10 has increased at a faster rate, from 2.09 in 1985 to 2.45 in 2004.
- The ratio of median earnings to the earnings of the low paid has gradually increased from 1.36 in 1985 to 1.49 in 2004.

**Table 2.4: Change in the ratio of earnings of selected percentiles, 1985 to 2004<sup>4</sup>**

|         | 1985 | 1995 | 2004        |
|---------|------|------|-------------|
| P90/P50 | 1.54 | 1.58 | <b>1.65</b> |
| P90/P10 | 2.09 | 2.25 | <b>2.45</b> |
| P50/P10 | 1.36 | 1.42 | <b>1.49</b> |

Source: ABS Employee Earnings and Hours (Cat. No. 6306.0), unpublished data.

2.75 As explained above, however, movements in earnings can be affected by both changes in wages and compositional changes. The impact of compositional change on the growth of earnings is not a new phenomenon. Compositional change to the workforce also affects the distribution of earnings.

<sup>4</sup> When analysing these data, it is important to understand that groups across the earnings distribution are not constant. Many employees would have transited across the earnings distribution groupings.

- 2.76 A number of Australian academics find that compositional change is the main cause of increased earnings dispersion. For example, Norris and McLean observe that “between 1986 and 1995 very little change in wage relativities occurred but there were large differences in employment growth”.<sup>5</sup>
- 2.77 The authors point out that the information technology revolution in Australia has resulted in an increase in the demand for highly skilled labour relative to other types of labour. This trend in labour demand, when accompanied by stable wage relativities, has raised the number of persons in the high paid group and hence, the median wage.
- 2.78 Keating’s 2003 study<sup>6</sup> reaches a similar conclusion. He presents data which show that between 1976 and 1997, rates of pay for the higher paid (managers and administrators, professionals and associate professionals) actually increased at a slightly lower rate than that of all occupations. In fact, Keating finds that there was little difference in the rate of wage relativities across the range of occupational classifications.
- 2.79 By contrast, full-time employment growth was considerably stronger in the higher paid occupations compared with lower paid occupations. Keating concludes that the increase in employment “accounted for most of the increase in dispersion of male earnings and practically all of the increase in the dispersion of female earnings”.<sup>7</sup>
- 2.80 Shifts in employment towards more highly skilled occupations will tend to pull up the median wage in addition to that achieved through wage rises.
- 2.81 Moreover, the shift in demand for labour away from the low paid towards higher paid occupations reflects a more vulnerable environment for the continued employment of some of the low paid for any given increase in their minimum wage.

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<sup>5</sup> K Norris and B Mclean, ‘Changes in Earnings Inequality 1975-1998’, *Australian Bulletin of Labour*, Vol 25, No 1, pages 23-31.

<sup>6</sup> M Keating, ‘Earnings and Inequality’, Discussion Paper No 460, Centre for Economic Policy Research, Australian National University, January 2003.

<sup>7</sup> *Ibid*, page 3.

## **Do economic conditions support a case for a wage rise?**

- 2.82 Workplace relations reform has contributed to increased productivity and employment growth. The reforms also recognise that a proportion of workers remain on a safety net of minimum wages.
- 2.83 As explained in the previous chapter, the legislation does not narrowly define the factors that are encompassed within the term of a safety net for the low paid. Current and forecast economic conditions will appropriately be one of the factors considered by the Commission in coming to its decision.
- 2.84 This review takes place against a backdrop of continuing favourable economic conditions. Strong employment growth, low levels of inflation and strong business investment have contributed to a strong economic environment.
- 2.85 As well, the world economy continues to provide significant impetus to Australia's economic growth. The Australian economy is expected to strengthen in 2006-07.
- 2.86 As a consequence, employment growth is expected to remain sound with an unemployment rate around historically low levels. Wages growth is expected to remain steady and underpinned by productivity improvements.
- 2.87 In determining the appropriate increase in minimum wages the Commission will consider, among other things, the interests of two broad groups in the labour market – the unemployed and low paid workers.
- 2.88 The current economic conditions provide the Commission with the opportunity to balance the interests of both groups.
- 2.89 A strong economy means the unemployed benefit from increased opportunities to find the jobs that will provide them and their families with the financial independence to more fully participate in economic and social life.
- 2.90 Low paid workers who receive the safety net of minimum wages, and who may not have received a wage increase for twelve months or more, would benefit from some increase at a time when economic conditions minimise any detrimental effects on job creation.

- 2.91 Accordingly, the Australian Government believes that sound economic conditions and a strong labour market provide grounds for the Commission to determine an appropriate level of increase in minimum wages for the low paid.
- 2.92 In coming to its decision, the Commission should also take into account the period that has elapsed since low paid workers received the 2005 Safety Net Adjustment.
- 2.93 The Australian Government further believes that the precise quantum and application of any increase/s in minimum wages is a matter for the Commission to determine.

## **Conclusion**

- 2.94 The Australian economy and the labour market continue to perform strongly. Accordingly, the Australian Government believes that the Commission could provide some increase in minimum wages for the low paid at a time when the detrimental effects on job opportunities for the unemployed are minimised.

