

Chapter 7: Wage transitions and stepping stones

Introduction

- 7.1 The consideration of a safety net for the low paid should be informed by an appreciation of the dynamic nature of the labour market and the diversity of living arrangements of low paid employees. This chapter demonstrates that low paid jobs are important stepping stones to higher paid jobs – often within a short time-span of two to three years.
- 7.2 Low paid jobs serve as a useful starting or re-entry point in the workforce for many unemployed and unskilled persons. Decisions about the appropriate increases in minimum wages, therefore, need to take account of the dynamic nature of the labour market.
- 7.3 It is the Australian Government's view that minimum wages are set in a manner that has regard for the capacity of the unemployed and low paid to obtain and remain in employment as set out in the WR Act. It is important for the longer term improvements in the living standards of the low paid and the unemployed that they are not denied access to employment opportunities.

Wage transitions for low paid workers – do low paid jobs provide stepping stones to higher paid jobs?¹

- 7.4 As discussed in Chapter 6, low paid workers are defined for the purposes of this analysis as having received an hourly wage rate between the FMW and up to two-thirds of the median wage rate.² This broad definition is similar to that used by the OECD. This range covers approximately the lower one-third of APCS-reliant workers. Clearly, this is only one of many possible definitions of low paid workers.

¹ Unless otherwise stated the data presented in this section are from the Household Income and Labour Dynamics of Australia (HILDA) Survey, Release 4.0 (February 2006).

² An adjustment was made to the lower and upper bounds of the low paid to allow for the time taken for increases in Safety Net Reviews to flow through to various awards and the time taken for respondents to be interviewed in the HILDA survey (usually over an 8 month period in each year). Hence the range for low paid employees is somewhat wider and more generous than a stricter interpretation could have allowed at both the lower and upper bounds. See the methodology in Appendix A.7 for a full explanation of how bounds for the low paid were calculated.

- 7.5 Low paid jobs are transitional for many workers and can act as important stepping stones to higher paying jobs. In many cases, this transition may only take a year or two. Low paid jobs often act as an entry point to the workforce – particularly for school leavers, people returning to the labour market following child caring duties, and less skilled unemployed job seekers.
- 7.6 HILDA data indicate that around 16.6 per cent of employees aged 21 years and over were low paid in 2004 compared with 17.0 per cent in 2001.³ While this indicates that the incidence of low pay is relatively stable, the composition of low paid workers varies over time.
- 7.7 Firstly, a relatively high proportion of unemployed persons find a low paid job as their first job. Of all unemployed persons who found a job between 2002 and 2004, around 57.1 per cent found a low paid job.
- 7.8 Secondly, there is considerable upwards wage mobility for low-paid employees. Upwards wage mobility is defined as movement to a higher hourly wage rate (above the upper bound of the low paid) in the following year(s).⁴
- 7.9 Table 7.1 shows that of low paid employees aged 21 years and over in 2001, 37.1 per cent were in higher paying jobs in 2002, 42.9 per cent were in higher paying jobs in 2003, and 44.1 per cent were in higher paying jobs in 2004.
- 7.10 Just over half of those who were low paid in 2001 remained in low paying jobs in 2002. This proportion falls consistently over the subsequent two years to 38.1 per cent by 2004. Only a very small proportion became unemployed each year while an average of 11.2 per cent of low paid employees exited the labour force at some point over the three year period.

³ Only low-paid workers aged 21 years and above were included in this analysis as it was considered that a large majority of persons aged 15 to 20 years would be receiving junior rates or training rates which can be less than the FMW. They would also be more likely to be living with their parents as either dependents or non-dependents. Also a high proportion of them are likely to be students. Such low paid employment is clearly transitory and the inclusion of these groups would tend to increase the estimated transition rates.

⁴ For a full explanation of the methodology used to calculate wage transitions for the low paid see Appendix A.7.

Table 7.1: Wage and labour force transitions for those who were low paid in 2001

	Wage Rate and Labour Force Status		
	2002	2003	2004
Low Paid	50.9	41.9	38.1
Higher Paid (above LP range)	37.1	42.9	44.1
Employed but no wage rate⁵	2.7	4.1	5.6
Unemployed	2.6	1.7	1.6
Not in the Labour Force	12.1	9.6	11.9
	100.0	100.0	100.0

Source: *Household Income and Labour Dynamics Australia (HILDA) Survey Release 4.0 (February 2006)*.

- 7.11 Age, gender and household type can influence the likelihood of progressing to higher wages (see Table 7.2). For example younger people aged 21 to 25 years have a much higher likelihood of moving to a higher paying job than mature-aged persons (aged 45 years and above).
- 7.12 Around 52.6 per cent of people aged 21 to 24 years who were low paid in 2001 had progressed to a higher paying job in 2004. By comparison 39.5 per cent of mature-aged persons had progressed to a higher paying job. Persons that are in partnered relationships with dependants also had a greater likelihood of moving to a higher paid job than a person in a lone person household (46.8 per cent compared with 41.8 per cent).
- 7.13 Men have a greater likelihood of moving to a higher paid job than women (48.0 per cent compared with 40.2 per cent).
- 7.14 This section demonstrates the dynamic nature of the labour market. Low paid workers are not a static population all stuck in low paid jobs. Nonetheless, some low paid will not progress to higher paid employment, at least in the short term. The provision of a safety net is still important for such workers, bearing in mind their need to remain in employment.

⁵ These data refer to low paid employees in 2001 who responded to questions on their labour force status over the next 3 years. Note that in some cases it was evident that low paid employees were still employed in successive waves. However, it was not possible to determine wage rates from the information available. Hence, it was not possible to determine whether these respondents were low or higher paid.

Table 7.2: Wage transitions in 2004 for low paid employees in 2001 – by age, gender and household type

Demographic Characteristic	Wage rate in 2004 or Labour Force Status					
	Low Paid	Higher Paid	Emp in W4 but no Wage Rate Available	Unemployed	Not in the Labour Force	Total
Age						
21 to 24 years	38.1	52.6	2.0	1.0	6.2	100.0
25 to 44 years	38.0	45.0	7.9	0.8	9.5	100.0
45 years plus	37.9	39.5	1.6	2.8	18.5	100.0
Gender						
Men	34.1	48.0	7.4	1.8	8.8	100.0
Women	38.8	40.2	4.5	1.4	15.1	100.0
Household Type						
Partnered	35.3	43.5	6.2	1.5	13.5	100.0
Partnered with dependents	34.9	46.8	6.8	3.3	8.2	100.0
Lone Persons	41.8	41.8	4.1	2.0	10.2	100.0
Lone parents	40.6	43.8	3.2	3.1	9.4	100.0
Lone parents with dependents	41.7	43.8	2.1	2.1	10.4	100.0
All Employees	38.1	44.1	5.6	1.6	11.9	100.0

Source: Household Income and Labour Dynamics Australia (HILDA) Survey Release 4.0 (February 2006)

Wage transitions for the unemployed

- 7.15 Analysis of HILDA data helps to shed light on the importance of low paid jobs for the unemployed as they seek to find employment and gain financial independence. It is more likely that people who are unemployed will secure a low paid job rather than a higher paid job when they initially secure employment.
- 7.16 Between 2001 and 2003, around 57 per cent of unemployed persons aged 21 years and over who found a job in the following year were employed in a low paid job.
- 7.17 Low paid jobs also provide an opportunity for unemployed persons to find higher paying jobs in the future. HILDA data show that of those people who were unemployed in 2001 and found a low paid job in 2002 around 23 per cent were in a higher paying job in 2003 and 30 per cent were in a higher paying job in 2004 (see Table 7.3).

Table 7.3: Wage and labour force transitions for those who were unemployed in 2001 and low paid in 2002

	Wage Rate or Labour Force Status	
	2003	2004
Low Paid	53.1	42.2
Higher Paid (above LP range)	23.4	29.7
Employed but no wage rate ⁶	0.0	4.7
Unemployed	15.6	9.4
Not in the Labour Force	7.8	14.1
	100.0	100.0

Source: Household Income and Labour Dynamics Australia (HILDA) Survey Release 4.0 (February 2006)

- 7.18 Unemployed persons or those not in the labour force who subsequently found low paid employment account for a significant proportion of people in low paid jobs. According to HILDA data, around one-fifth of low paid workers were either unemployed or not in the labour force in the previous year.⁷ This is an indication of the dynamic nature of the labour market and an example of the way in which the composition of low paid workers can change rapidly.
- 7.19 If minimum wages are set too high this could reduce the participation of these groups in the workforce. Many of these people are relatively disadvantaged, are less skilled and have a less stable employment history. They are attempting to secure a foothold in the workforce.
- 7.20 The Australian Government considers that the best form of income comes from a job rather than welfare. As a consequence, the Government's Welfare to Work policies are designed to encourage more people on income support to look for work. The Government believes that more people who can work – even part-time – should seek work.
- 7.21 Of the 2.5 million Australians of workforce age (15-64 years) receiving income support as at March 2006, only about 15 per cent had a requirement to look for work. This has resulted in a high rate of welfare dependence and a reduction in the labour supply, despite a relatively low unemployment rate.

⁶ Note that in some cases it was evident that low paid employees were still employed in successive waves however it was not possible to determine wage rates from the information available hence it was not possible to determine whether they were subsequently employed in low or higher paid jobs.

⁷ HILDA data show that of low paid workers in 2002 around 19.2 per cent were either unemployed or not in the labour force in the previous year.

- 7.22 The Welfare to Work reforms seek to increase the workforce participation of income support recipients, such as people with disabilities (able to work more than 15 hours per week) and primary care parents (with a youngest child aged over six years), as well as the very long term unemployed and mature aged workers. These groups often possess lower skill levels and less recent work experience.
- 7.23 The Government is spending \$3.7 billion over four years to assist these people into the workforce, and it is important that employment opportunities be available for these job seekers and new entrants.

Evidence from DEWR Administrative Studies

- 7.24 There are a range of other studies which demonstrate both the dynamic nature of the labour force and the importance of low paid jobs as stepping stones. The DEWR report *The Sustainability of Outcomes* examined outcomes of participation by unemployed job seekers in a number of labour market programmes including Job Search Training, Intensive Assistance and Work for the Dole in the period between May 2001 and May 2002.⁸
- 7.25 Average hourly earnings for persons interviewed 12 months after their programme placement were higher than 3 months after placement for all of the programmes analysed (see Table 7.4). In the case of participants in Work for the Dole, their average hourly rate 12 months after placement was 15.4 per cent higher than the rate they were on 3 months after assistance.

⁸ DEWR *The Sustainability of Outcomes: Job Search Training, Intensive Assistance and Work for the Dole*, 2004. Available from <http://www.workplace.gov.au/NR/rdonlyres/7A616BB0-988E-499F-96D1-9529FF04B857/0/longJSTIAWFD.pdf> (accessed 19 July 2006).

Table 7.4: Average hourly pre-tax earnings of those employed post assistance (received in May 2001) by program or service

	Job Search Training	Intensive Assistance	Work for the Dole
3 months post assistance (Aug 01)	\$14.70	\$14.10	\$12.30
12 months post assistance (May 02)	\$16.20	\$14.40	\$14.20
Change	Up \$1.50 (or 10.2 per cent)	Up \$0.30 (or 2.1 per cent)	Up \$1.90 (or 15.4 per cent)

Source: DEWR Administrative Data

7.26 Involvement by job seekers in employment can also lead to higher earnings as a result of more hours of work as well as higher rates of pay. Employed persons that were participants in Work for the Dole were earning an average of \$50 per week more 12 months after assistance than they were 3 months after assistance. Participants in Job Search Training were earning an average of \$60 a week more (Table 7.5).

Table 7.5: Average weekly pre-tax earnings of those employed post assistance (received in May 2001) by program or service

	Job Search Training	Intensive Assistance	Work for the Dole
3 months post assistance (Aug 01)	\$415	\$360	\$350
12 months post assistance (May 02)	\$475	\$380	\$400
Change	Up \$60 (or 14.5 per cent)	Up \$20 (or 5.6 per cent)	Up \$50 (or 14.3 per cent)

Source: DEWR Administrative Data

7.27 The report concluded that there was a strong increase in earnings for participants over the period of employment resulting from both an increase in the amount of work performed as well as increases in rates of pay. A significant proportion of participants moved from part-time to full-time employment.

7.28 The results of this report confirmed findings from an earlier DEWR report titled *Job Matching: A Stepping Stone to a Better Future*. The report contained findings that a significant proportion of unemployed persons who had obtained low paid employment through participation on DEWR employment programmes

had moved to higher paying jobs over time.⁹ This movement in earnings was often associated with the transition from part-time to full-time work, and movement from less skilled to more highly skilled jobs. The report cites similar findings by Carion-Abello et al¹⁰, and Dunlop¹¹ who examined ABS *Survey of Employment and Unemployment Patterns* (SEUP) data.

- 7.29 Dunlop concluded that the amount of joblessness in a person's past was strongly related to the likelihood of low pay. Further, the potential to be low paid was significantly *less* for those who had improved their work skills through training during the past year, and as tenure in the current job increased. Remaining in employment and cultivating a solid employment history is one of the main ingredients in assisting low paid workers to move to higher paid jobs.
- 7.30 According to authors of the Melbourne Institute report *Families, Incomes and Jobs*, studies conducted into income mobility in the USA indicate that two major factors associated with upward household income mobility are finding a job and entering the labour market.¹² One of the major factors associated with downward mobility was unemployment or voluntarily leaving the labour force.

Household joblessness

- 7.31 As noted previously, household joblessness is a major contributor to persistent social disadvantage. Families with no parent employed can experience a combination of economic disadvantage and reduced social opportunities through the impact of exclusion and isolation associated with unemployment. The ABS *General Social Survey* concluded that jobless households were more likely to experience financial stress (such as the inability to raise at least \$2,000 in a week or pay their electricity, gas or telephone bills on time) compared with other family households in which at least one person was working.¹³

⁹ DEWR, *Job Matching: A Stepping Stone to a Better Future?*, 2001. Available from http://www.workplace.gov.au/NR/rdonlyres/C241252F-E213-4008-9522-CBCB71E72E64/0/JM_Report.pdf (accessed 19 July 2006).

¹⁰ A Carino-Abello, D Pederson and A King *Dynamics of Earned Income in Australia: An Application Using the 1994-1997 Survey of Employment and Unemployment Patterns*, ABS Occasional Paper, 17 March 2000, (Cat No. 6293.00.007), 22 February 2001.

¹¹ Y Dunlop, *Labour Market Outcomes of Low Paid Adult Workers: An Application Using the Survey of Employment and Unemployment Patterns*, ABS Occasional Paper, 17 March 2000, (Cat. No. 6293.0.00.005).

¹² G Duncan *Years of Poverty, Years of Plenty: The Changing Economic Fortunes of American Workers and Families*, 1984, University of Michigan; and M Bane and D Ellwood 'Slipping into and out of poverty: The dynamics of spells', *Journal of Human Resources*, 1986, Vol 21, No 1, pages 1-23.

¹³ Data from ABS *General Social Survey* (2002) cited in article 'Family Functioning: Families with No Employed Parent' in ABS *Australian Social Trends*, 15 June 2004, (Cat. No. 4102.0), pages 46-50.

- 7.32 Jobless households are also income poor when compared with households in which members are working. ABS Census data (2001) indicated that a large proportion (79 per cent) of couple families with no employed parent and one-parent families with the parent not employed (88 per cent) had equivalised gross household income of less than \$300 per week. Only 15 per cent of families with an employed parent earned less than \$300 per week.¹⁴
- 7.33 According to Scutella and Wooden¹⁵, household joblessness is a relatively persistent phenomenon unlike individual relative poverty. Of the 26 per cent of households found to be jobless in any of the three years between 2001 and 2003, 17.6 per cent were jobless for at least two of those years and 11.5 per cent were a jobless household for the whole three years.
- 7.34 The incidence of jobless households in Australia is one of the highest in the OECD. Many OECD countries, including Australia, have experienced rising shares of jobless households even though employment and participation rates have risen.
- 7.35 There are more than 333,800 Australian families with dependent children¹⁶ where no parent is employed, and more than 597,400 dependent children live in a jobless household.¹⁷ Over 72.4 per cent of these households are headed by single parents. Over 70 per cent of the children who lived in jobless households for 3 years running between 2001 and 2003 were in lone parent households.¹⁸
- 7.36 Unemployment can have a range of negative impacts on families. Young people living with parents on income support are much more likely than average to leave school early and become unemployed and reliant on income support. Young people whose parents work have the benefit of positive role models in their lives and fare much better.¹⁹
- 7.37 The maintenance of low paid job opportunities is an important and necessary condition to address the incidence of jobless households and provide a pathway

¹⁴ ABS, 'Family Functioning: Families with No Employed Parent' in ABS *Australian Social Trends*, 15 June 2004, (Cat. No. 4102.0), pages 46-50.

¹⁵ R Scutella and M Wooden, *Effects of Household Joblessness on Subjective Well Being* Melbourne Institute Working Paper No 10/06, May 2006.

¹⁶ Dependent children includes those aged 0 to 14 years and dependent students aged 15 to 24 years.

¹⁷ ABS, *Labour Force Survey*, Detailed Data Release (Cat. No. 6291.0.55.001) Families data cube.

¹⁸ B Headey, D Warren and G Harding *Families, Incomes and Jobs: A Statistical Report of the HILDA Survey* Melbourne Institute of Applied Economic and Social Research, 2006, page 80.

¹⁹ ABS, 'Family Functioning: Families with No Employed Parent' in ABS *Australian Social Trends*, 15 June 2004, (Cat. No. 4102.0), pages 46-50.

out of its attendant social disadvantage and intergenerational welfare dependence.

Transfer payments, earnings and incentives to work

- 7.38 In Chapter 6 it was demonstrated that the transfer system provided substantial assistance to low paid workers and low income households. This section will show that interaction of the tax-transfer and wages systems provides the unemployed with sufficient incentives to pursue employment opportunities.
- 7.39 DEWR modelled the interaction between the tax-transfer system and the wages system to establish the potential rewards to households from a member finding a low-paid job.
- 7.40 DEWR assessed a broad range of hypothetical households including lone persons, couples with no children, and lone parents and couples with dependent children (or students) of various ages.
- 7.41 This analysis considered the potential impact of earnings from a low paid job on combined household income from sources such as income support (Newstart Allowance or Youth Allowance), other transfer payments (such as Parenting Payment and Family Tax Benefits) and other earnings (if other members of the household were already receiving earned income from employment).
- 7.42 Of the household scenarios analysed, incentives to take on low paid work are highest for single adults and lone parents with one child (see Table 7.6). Single adults are 125 per cent (or \$257) per week better off financially in net terms by taking on a low paid job paying \$530 per week²⁰ while lone parents with one child are around 68 per cent better off per week.
- 7.43 Financial incentives to take on a low paid job are lower for couples and some lone parent households with dependents but are still substantial. The reasons the incentives are lower for this group is due to the part withdrawal of some transfer payments as earnings rise. Despite these reductions, these households are still much better off financially with one member working than their previous state of joblessness.

²⁰ A low wage job of \$530 per week was chosen for this analysis as this represents the average of low paid jobs between the FMW (\$484.40) and \$578.20 per week (the C10 rate in the Metal, Engineering and Associated Industries Award which is approximately 2/3 of median income). This acknowledges that most low wage workers will commence employment at wage rates above the FMW or will move above that level in a very short period of time.

7.44 For example, if we consider a couple household with two children in which neither parent is working - one parent is on Newstart and the other is on Parenting Payment. If the member formerly on Newstart secures a low paid job paying \$530 per week, the take home pay of the low paid worker increases household income by \$470. This is partially offset by the fall in transfer payments received of \$269. Overall, the household total disposable income increases from \$582 to \$783 - a rise of \$201 or 34 per cent.

Table 7.6: Single earner households – one member formerly unemployed accepts a low paid job paying \$530 per week

Household Type	Transfer payments before member finds low paid job (A)	Transfer payments after finding job (B)	Tax & Medicare (C)	Disposable income after finding job (D=\$530+B-C)	Improvement in relative financial position (%) E=((D-A)/A)
Single Adult (UE on NewStart)	205.30 (NSA)	0	67.96	462.04	125.1
Couple with no children – neither working – both on NewStart – one gets a low paid job	370.50 (NSA)	80.55 (NSA)	53.97	556.58	50.2
Couple with 1 child aged 7 – neither working – both on NewStart – one gets a low paid job	370.50 (NSA) <u>110.26 (FTB)</u> 480.76 (Total)	80.55 (NSA) <u>130.97 (FTB)</u> 211.52(Total)	62.16	679.36	41.3
Couple with 2 children, aged 4 and 7 years – neither working – one on NewStart, one on Parenting Payment – one gets a low paid job	185.25(NSA) 185.25 (PP) <u>211.41(FTB)</u> 581.91 (Total)	80.55 (PP) <u>232.12 (FTB)</u> 312.67(Total)	60.01	782.66	34.5
Couple with 2 children aged 9 and 11 – neither working – both on NewStart – one gets a low paid job	185.25 (NSA) 185.25 (NSA) <u>193.07 (FTB)</u> 563.57 (Total)	80.55 (NSA) <u>213.78 (FTB)</u> 294.33(Total)	60.01	764.32	35.6
Couple with one dependent student aged 16 years – both on Newstart Allowance - one gets a low paid job	185.25 (NSA) 185.25 (NSA) <u>91.60 (YA)</u> 462.10 (Total)	80.55 (NSA) <u>91.60 (YA)</u> 172.15(Total)	53.97	648.18	40.3

Household Type	Transfer payments before member finds low paid job (A)	Transfer payments after finding job (B)	Tax & Medicare (C)	Disposable income after finding job (D=\$530+B-C)	Improvement in relative financial position (%) E=((D-A)/A)
Couple, neither working, both on Newstart Allowance, with 2 dependent students aged 16 and 18. One member of the couple gets a low paid job	185.25 (NSA)	80.55 (NSA)	53.97	758.33	32.5
	185.25 (NSA)	<u>201.75 (YA)</u>			
	<u>201.75 (YA)</u>				
	572.25 (Total)	282.30(Total)			
Lone parent with 1 child aged 4 years, receiving PP – gets a low paid job	252.75 (PP)	71.27 (PP)	76.56	674.02	67.6
	<u>149.31 (FTB)</u>	<u>149.31 (FTB)</u>			
	402.06 (Total)	220.58(Total)			
Lone parent with 1 child aged 9 years, receiving NSA – gets a low paid job	225 (NSA)	130.97 (FTB)	60.01	600.96	68.8
	<u>130.97 (FTB)</u>				
	355.97 (Total)				
Lone Parent with 2 children aged 4 and 6 years, receiving PP – gets a low paid job	252.75 (PP)	76.19 (PP)	76.71	761.60	57.1
	<u>232.12 (FTB)</u>	<u>232.12 (FTB)</u>			
	484.87 (Total)	308.31(Total)			
Lone Parent with 2 children aged 9 and 11 years, receiving NSA –gets a low paid job	225.00 (NSA)	213.78 (FTB)	60.01	683.77	55.8
	<u>213.78 (FTB)</u>				
	438.78 (Total)				

Source: DEWR Modeling using various sources. See Appendix A6.

Note: NSA refers to NewStart Allowance, FTB is Family Tax Benefit, PP is Parenting Payment, and YA is Youth Allowance.

7.45 Households are also much better off financially when a second member of the household secures a low paid job (see Table 7.7). For example a household headed by a couple with one child is 41.2 per cent or \$280 better off with both partners working.

Table 7.7: Second earner in household – one partner is already working in low paid job (\$530 per week) while the other partner formerly unemployed finds a low paid job paying \$530 per week

Household Type	Disposable income - P1 working (see column D in Table 7.6) (A)	Transfer payments after finding job (B)	Tax and Medicare (C)	Disposable income with both in low paid jobs (D=\$1060+B-C)	Improvement in relative financial position (%) E=((D-A)/A)
Couple with no children – one person working other on NewStart (income below threshold) – unemployed person gets low paid job	556.58	0	67.96 (P1) <u>67.96 (P2)</u> 135.92(Total)	924.08	66.0
Couple with 1 child aged 7 – one person working other on NewStart (income below threshold) – unemployed person gets low paid job	679.36	35.07 (FTB)	67.96 (P1) <u>67.96 (P2)</u> 135.92(Total)	959.15	41.2

Source: DEWR Modeling using various sources. See Appendix A.6.

Note: P1 refers to person already in low paid job, P2 is second person finding low paid job and FTB is Family Tax Benefit .

Reservation wages

7.46 As noted throughout this submission, the WR Act directs the Commission to have regard to the capacity for the unemployed to obtain employment. The minimum wage is an important entry point for the unemployed to access job opportunities that can act as stepping stones to higher paid jobs. A high FMW can price some of the unemployed out of the workforce and deny them an opportunity to gain higher paid jobs.

7.47 An important issue for the unemployed in obtaining employment is their ‘reservation wage,’ or the lowest wage per hour (before tax) that they would be willing to work for, assuming work was available. Appendix B.7 contains a detailed analysis of HILDA data to investigate this issue further and test the extent to which those who are not working, are willing to enter the workforce at wages below the FMW.

- 7.48 Analysis of HILDA data shows that there was a sizable proportion of respondents with reservation wages below the FMW, ranging from between 30.5 per cent to 32.6 per cent across the four years of HILDA data. The majority of these individuals had low educational qualifications with between 71.1 per cent and 84.0 per cent completing Year 11 and below.
- 7.49 Further, more than three quarters of these respondents, across the four surveys (waves) were enthusiastic about working. Given their relatively low educational qualifications, most of these individuals are likely to seek lower skilled, lower paid jobs as an entry point into the workforce.
- 7.50 This analysis illustrates how a high FMW can lock some employees out of the workforce and subsequently hinder their progression to higher paying jobs. Importantly, a higher FMW is not required to encourage them to participate in the workforce.
- 7.51 The analysis also illustrates that respondents with reservation wages above the FMW had better educational qualifications. Therefore, their higher reservation wage was not unexpected. Most are likely be 'holding out' for jobs that closely matched their educational qualifications rather than simply seeking a lower skilled, lower paid job as an entry point into the workforce. In light of this, the FMW has little bearing on the employment opportunities of these individuals.

Conclusion

- 7.52 The labour market is a dynamic environment where low paid jobs serve an important function in providing stepping stones to higher paying employment. The composition of individuals in low paid jobs is constantly changing.
- 7.53 If the minimum wage is set too high, the safety net may act to close off low paid job opportunities for the unemployed and the potential for the low paid to improve their living standards by securing higher paying employment.
- 7.54 Nonetheless, some low paid will not progress to higher paid employment, at least in the short term. The provision of a safety net is still important for such workers balanced against having regard to their capacity to remain in employment.
- 7.55 The interaction of the tax-transfer system and the wages system appears to provide low paid workers with adequate incentives to accept higher paying

employment. Low paid jobs appear to provide sufficient incentive for individuals from low income households to participate in the workforce.

Appendix A.7: Low paid employees

Methodology

Calculation of wage rates for low paid employees

- A7.1 Wage rates were determined using current weekly gross wages and salary imputed in all jobs (i.e. the HILDA variable `_WSCEI`) and combined hours worked per week earned in all jobs (`_JBHRUC`). Analysis was restricted to employees (excluding self employed, own account workers and unpaid family workers).
- A7.2 A lower and upper bound for low paid employees was used ranging from FMW to two-thirds of median earnings. The lower bound for low paid employees that were employed on a permanent basis or on fixed-term contracts was adjusted downwards and the upper bound adjusted upwards to allow for the time taken for respondents to be interviewed in the HILDA survey (usually over an 8 month period). Hence the wage rate range for low paid employees is somewhat wider than a stricter point in time interpretation could have allowed.

Table A7.1: Calculation of low paid ranges for low paid employees

		Metal Industries Award Hourly Rates		Low paid Employees on fixed-term contract and permanent employees	
		FMW	2/3 median earnings	Lower Bound	Upper Bound
Wave 1	2001	\$10.90	\$13.30	\$10.50	\$13.50
Wave 2	2002	\$11.40	\$13.80	\$11.00	\$14.00
Wave 3	2003	\$11.80	\$14.30	\$11.50	\$14.50
Wave 4	2004	\$12.30	\$14.80	\$12.00	\$15.00

Source: *Metal, Engineering and Associated Industries Award and ABS Employee Earnings Benefits and Trade Union Membership (EEBTUM) Survey (Cat. No. 6310.0)*

- A7.3 Some employee responses to the survey contributed to wage rates being calculated that were well below the lower bound provided for low paid employees. While there may be a number of people being paid much less than the FMW they were regarded as being beyond the scope of this analysis and were excluded.

A7.4 The wage range for low paid employees was also adjusted to account for loadings paid to casual employees (see Table A7.2). A loading of 20 per cent was factored in for those casual employees receiving close to FMW while a loading of 25 per cent was factored on top of the wage rate for those receiving near two thirds of median earnings²¹.

A7.5 Table A7.2 provides hourly wage rate ranges for low paid employees used in this analysis by employment type.

Table A7.2: Wage range for low paid employees – 2001 to 2004

		Low paid employees on fixed-term contract and permanent employees		Low paid casual employees	
		Lower Bound	Upper Bound	Lower Bound	Upper Bound
Wave 1	2001	\$10.50	\$13.50	\$12.60	\$16.90
Wave 2	2002	\$11.00	\$14.00	\$13.20	\$17.50
Wave 3	2003	\$11.50	\$14.50	\$13.80	\$18.10
Wave 4	2004	\$12.00	\$15.00	\$14.40	\$18.80

Source: *Metal, Engineering and Associated Industries Award* and *ABS Employee Earnings Benefits and Trade Union Membership (EEBTUM) Survey (Cat. No. 6310.0)*

A7.6 The population of the low paid in Wave 4 is composed of permanent employees and employees on fixed-term contracts earning between \$12 and \$15 per hour as well as casual employees earning between \$14.40 and \$18.80 per hour (a loading of 20 per cent was added at the lower bound and 25 per cent at the upper bound). In other words, a casual employee earning \$18.80 per hour in Wave 4 was equivalent to a person on a fixed-term contract or permanent employee earning \$15 per hour as the loading was paid to compensate for the absence of leave entitlements.

Calculating wage transitions for low paid employees

A7.7 Analysis of low-paid employees was restricted to persons aged 21 years and above. It was considered that a large majority of persons aged 15 to 20 years would be living with their parents with a high proportion of them also likely to be students. Persons aged 15 to 20 years were also likely to be on junior wage rates and would not fit into bounds for low paid employees. Junior wage rates

²¹ As different awards can have different casual loadings (most commonly around 20 to 25 per cent) a higher loading was applied at the upper end of the definition of low paid casual employees. This raises the hourly rate needed by casual employees to be considered higher paid.

are much lower than the minimum wage particularly for those aged 15 to 18 years. For example, a person 18 years of age that worked in the Metals industry and was a casual employee would have earned \$10.40 per hour in 2004. The bounds for low paid adult casual employees in 2004 ranged from \$14.40 to \$18.80 per hour. See Table A7.3 for junior rates in the Metals industry in 2004.

Table A7.3: Junior rates in the Metals Industry - 2004

	June 2004		
Age	Percentage of C13 rate	Hourly Rate (\$)	Plus 25% casual loading
Under 16 yrs	36.8	4.7	5.9
16 Years	47.3	6.0	7.5
17 years	57.8	7.4	9.2
18 years	68.3	8.7	10.9
19 years	82.5	10.5	13.1
20 years	97.7	12.4	15.6

Source: *Metal, Engineering and Associated Industries Award*

- A7.8 A number of studies have concluded that upward wage mobility for younger workers is much stronger than for workers in other age groups.²²
- A7.9 When further adjusting for respondents who provided nil responses for individual gross yearly income and/or gross household income there were 1,018 low paid employees in 2004 aged 21 years or more. This population was used to calculate distribution of low paid employees among households by income discussed in Chapter 6.
- A7.10 Transition rates for low-paid employees were based upon wage and labour force transitions of employees that were low paid in 2001 and who responded to questions on labour force status, employment contract, and earnings received from all jobs and hours worked in 2002, 2003 and 2004.
- A7.11 Tracking movements of low paid employees was made possible by the use of a cross wave ID variable. If a casual employee moved to a permanent job they needed to be paid above the upper bound for a low paid permanent employee to be considered as having moved to a higher paying job. Similarly, if a low paid permanent employee moved to a casual job they need to be paid an hourly

²² Y Dunlop, *Labour Market Outcomes of Low Paid Adult Workers: An Application Using the Survey of Employment and Unemployment Patterns*, ABS Occasional Paper, 17 March 2000, (Cat No 6293.0.00.005) page 31 and M B Stewart and J K Swaffield, 'Low Pay Dynamics and Transition Probabilities' *Economica*, 66 (262) pages 23-42.

rate above the upper bound for casual employees to be considered as having moved to a higher paid job.

Appendix B.7: Reservation wages

Methodology

- B7.1 As noted throughout this submission, the Commission must have regard to the capacity for the unemployed to obtain employment. The minimum wage is an important entry point for the unemployed to access job opportunities that can act as stepping stones to higher paid jobs. A high and increasing FMW can price some of the unemployed out of the workforce and deny them an opportunity to gain higher paid jobs.
- B7.2 An important aspect for the unemployed in obtaining employment is their 'reservation wage' or the lowest wage per hour (before tax) that they would be willing to work for, assuming work was available. Previous Australian studies have found evidence of individuals willing to work for less than the minimum wage.²³
- B7.3 This section analyses HILDA data to investigate this issue further and test the extent to which those who are not working, are willing to enter the workforce at wages below the FMW. The HILDA survey collects the reservation wage of all respondents who were not working, and were looking for work or wanting to work.
- B7.4 We are not attempting to suggest in this section that every unemployed individual who has a reservation wage below the FMW would be employed if the FMW was lower. Many individuals might still face labour market disadvantage and not gain employment at their reservation wage. Nonetheless, a comparison of the reservation wage to the FMW is still an important indicator of how a relatively high and increasing FMW can price some workers out of the workforce.
- B7.5 HILDA collects the reservation wages of respondents in 'whole dollar' amounts. As shown in Table B7.1 below, the FMW has not been equal to a whole dollar amount at any time since the HILDA survey began. This makes a comparison of reservation wages with the FMW somewhat problematic at amounts close to the FMW. This is perhaps best illustrated by using 2001 as an example.

²³ P Miller and P Volker, 'The Youth Labour Market in Australia: A Survey of Issues and Evidence', Australian National University Centre for Economic Policy Research Discussion Paper, 1987, No. 171, page 78 and A Heath and T Swann, 'Reservation Wages and the Duration of Unemployment', Reserve Bank of Australia Research Discussion Paper, 1999-02, page 10.

- B7.6 In 2001, the FMW stood at \$10.90. It is open to conjecture whether reservation wages of \$10 reported by HILDA respondents in that year should be considered to be above or below the FMW.
- B7.7 To deal with this issue we have been deliberately conservative by rounding down the FMW in 2001 to \$10. We have made similar adjustments to the FMW for the other three waves. This rounded down FMW will be referred to as FMW*. Table B7.1 below displays the FMW and the corresponding FMW* for the four HILDA waves.
- B7.8 In a further step to clarify the issue of borderline responses, we grouped responses that equalled the FMW* with those that were above the FMW*. For example, in 2001 reservation wages that equalled \$10 were classified as being above the FMW.

Table B7.1 The FMW and the 'rounded down' FMW (FMW*)

	FMW	FMW per hour	FMW* per hour
Wave 1 - 2001	\$413.40	\$10.90	\$10
Wave 2 - 2002	\$431.40	\$11.40	\$11
Wave 3 - 2003	\$448.40	\$11.80	\$11
Wave 4 - 2004	\$467.40	\$12.30	\$12

Source: *Household Income and Labour Dynamics Australia (HILDA) Survey Release 4.0 (February 2006)*

- B7.9 As explained above the HILDA Survey asks respondents about their reservation wage if they are not employed, and are looking for work or wanting to work. The percentage of respondents who were unemployed or not in the labour force (NILF), and who provided a reservation wage ranged from 29.5 per cent to 33.0 per cent across the four waves. A very small proportion of the cohort, ranging from 2.1 per cent to 3.4 per cent, across the four waves, 'did not know' what reservation wage they would work for. On average about 65 per cent of each cohort, across the four waves, were not asked about their reservation wage because they were either not interested in looking for work or did not want to work.

Table B7.2 Reservation wages above and below the FMW*

	FMW*	No. of respondents who provided Reservation Wages	% of Reservation Wages above the FMW *	% of Reservation Wages below FMW*
Wave 1 - 2001	10	1 797	83.7	16.3
Wave 2 - 2002	11	1 603	67.4	32.6
Wave 3 - 2003	11	1 483	69.5	30.5
Wave 4 - 2004	12	1 352	68.3	31.7

Source: *Household Income and Labour Dynamics Australia (HILDA) Survey Release 4.0 (February 2006)*

B7.10 The last column of Table B7.2 shows that there was a sizable percentage of HILDA respondents willing to work for a wage below the FMW*, ranging from 30.5 per cent to 32.6 per cent across waves 2 to 4. This is a sizable minority. It is highly likely that a high and increasing FMW is denying these individuals access to employment. Interestingly, Wave 1 had a relatively lower percentage of individuals with reservation wages below the FMW* – only 16.3 per cent. This relatively low figure, however, is explained by the results in Table B7.3 which shows the percentage of reservation wages that equalled the FMW*.

Table B7.3 Reservation wages equal to the FMW*

	FMW*	% of Reservation Wages equal to FMW*
Wave 1 - 2001	10	20.4
Wave 2 - 2002	11	2.0
Wave 3 - 2003	11	1.6
Wave 4 - 2004	12	9.1

Source: *Household Income and Labour Dynamics Australia (HILDA) Survey Release 4.0 (February 2006)*

B7.11 Table B7.3 shows that about 20 per cent of respondents in 2001 had reservation wages that equalled the FMW* which explains why there was a relatively smaller percentage (16.3) of respondents with reservation wages less than the FMW*. Responses in 2002 and 2003 witnessed much smaller percentage of respondents with reservation wages equal to the FMW* (2.0 and 1.6 per cent) while in 2004, 9.1 per cent recorded a response equal to the FMW*. It is not entirely clear why the proportion of respondents who provided a reservation wage equal to the FMW* was higher in 2004. This could be due to the fact that this was the year in which the FMW first surpassed \$12.

Willingness to work

B7.12 Only those who were either unemployed or NILF were asked their reservation wage in the HILDA survey. In general about 70 per cent of the respondents who provided reservation wages were classified as being NILF across the four waves (with the remainder being unemployed). While only respondents who were looking for work or wanting to work were asked about a reservation wage, it is important to ascertain the willingness to work of those who were NILF and provided a reservation wage. This acts as an important cross check in examining the likelihood of these persons accepting a job at their reservation wage.

B7.13 The HILDA Survey asks participants who are not looking for work whether they: 'want to work'; 'maybe want to work'; or, 'don't want to work'. We only included respondents in this analysis with reservation wages less than the FMW* to gain an indication of whether they would work for their reservation wage.

Table B7.4 Willingness to work – reservation wages below the FMW*

	% Wants to Work	% Maybe wants to Work
Wave 1 - 2001	78.4	8.8
Wave 2 - 2002	78.4	11.1
Wave 3 - 2003	81.5	11.2
Wave 4 - 2004	79.0	7.9

Source: *Household Income and Labour Dynamics Australia (HILDA) Survey Release 4.0 (February 2006)*

B7.14 Table B7.4 shows that of those respondents who were NILF and had a reservation wage below the FMW*, between 78.4 and 81.5 per cent 'wanted to work,' while 8.8 to 11.2 per cent 'maybe wanted to work'. In general, more than three quarters of the respondents were enthusiastic about working. We would therefore expect that the overwhelming majority of respondents with reservation wages below the FMW* would be willing to work at their reservation wage.

Explanatory factors

B7.15 In our analysis so far we have concentrated on respondents with reservation wages below the FMW*. However, in seeking to explain why some individuals have relatively higher reservation wages it is necessary to examine their characteristics. An important consideration is the educational qualifications of the respondents. It is likely that respondents with higher educational

qualifications will have higher reservation wages because they would expect a return on their human capital investment (their education). For these individuals, the FMW plays little role in their employment decisions.

B7.16 Miller and Volker²⁴ found that reservation wages and education levels were positively correlated. That is, higher educational qualifications lead to higher wage demands. More specifically, they found that individuals with a degree had reservation wages around 50 per cent higher than early school leavers, while respondents who completed Year 12 had reservation wages that were 17 per cent higher than early school leavers.

B7.17 Heath and Swann²⁵ using the ABS *Survey of Employment and Unemployment Patterns* (SEUP) dataset found that work experience played a role in explaining reservation wages. They also found that respondents from high-skilled professions tended to have higher reservation wages than respondents from low-skilled professions.

B7.18 The results of these studies are consistent with our analysis conducted using HILDA. The results across the four waves are presented below.

Table B7.5 Highest educational qualifications – reservation wages below the FMW*

	% Year 11 and below	% Year 12	% Certificate 3 or 4	% Bachelor degree
Wave 1 - 2001	84.0	11.3	2.1	1.0
Wave 2 - 2002	71.1	12.8	8.4	2.5
Wave 3 - 2003	74.6	12.2	6.0	2.2
Wave 4 - 2004	75.0	11.7	7.5	1.4

Source: *Household Income and Labour Dynamics Australia (HILDA) Survey Release 4.0 (February 2006)*

B7.19 Table B7.5 shows that across the four waves, between 71.1 per cent and 84.0 per cent of respondents with a reservation wage below the FMW* completed Year 11 or less, while between 11.3 and 12.8 per cent of the cohort completed Year 12. A small percentage of the cohort (between 2.1 per cent and 8.4 per cent) completed a Level 3 or Level 4 Certificate while a very small proportion of respondents (between 1 to 2.5 per cent) completed a Bachelor degree.

²⁴ P Miller and P Volker, 'The Youth Labour Market in Australia: A Survey of Issues and Evidence,' Australian National University Centre for Economic Policy Research Discussion Paper, 1987, No. 171, page 73.

²⁵ A Heath and T Swann, 'Reservation Wages and the Duration of Unemployment,' The Reserve Bank of Australia Research Discussion Paper, 1999-02, page 28.

Table B7.6 Highest educational qualifications – reservation wages above the FMW*

	% Year 11 and below	% Year 12	% Certificate 3 or 4	% Bachelor degree
Wave 1 - 2001	47.1	17.0	14.8	8.2
Wave 2 - 2002	43.5	16.3	16.2	9.1
Wave 3 - 2003	42.3	14.7	18.8	9.2
Wave 4 - 2004	40.7	17.3	18.3	9.6

Source: *Household Income and Labour Dynamics Australia (HILDA) Survey Release 4.0 (February 2006)*

B7.20 Table B7.6 shows that across the four waves, between 40.7 per cent and 47.1 per cent of individuals with a reservation wage above the FMW* completed Year 11 or below, while 14.7 per cent to 17.3 per cent completed Year 12. Between 14.8 per cent and 18.8 per cent completed a Level 3 or Level 4 Certificate. In addition, between 8.2 and 9.6 per cent of the cohort completed a Bachelor degree.

B7.21 A comparison of Tables B7.5 and B7.6 illustrates how educational qualifications affected the reservation wages of respondents. For example, comparing the results of wave 4, 9.6 per cent of respondents with reservation wages above the FMW* completed a Bachelor degree, compared with just 1.4 per cent for individuals with reservation wages below the FMW*. Only 40.7 per cent of respondents with reservation wages above the FMW* completed Year 11 or below as their highest qualification, compared with 75.0 per cent for respondents with reservation wages below the FMW*.

B7.22 Clearly, respondents whose reservation wages were above the FMW* completed higher educational qualifications compared with those with reservation wages below the FMW*.

B7.23 Thus, individuals with higher educational qualifications were more likely to demand higher reservation wages.

Summary of the analysis of reservation wages

B7.24 Analysis of the HILDA data shows that there was a sizable proportion of respondents with reservation wages below the FMW* ranging from between 30.5 per cent to 32.6 per cent in waves 2 to 4. This was a sizable minority. The majority of these individuals had low educational qualifications with between 71.1 per cent and 84.0 per cent completing Year 11 or below. Moreover, more

than three quarters of these respondents, across the four waves, were enthusiastic about working. Given their relatively low educational qualifications, one might infer that most of these individuals would be simply seeking lower-skilled, lower paid jobs as an entry point into the workforce.

B7.25 This analysis illustrates how a high and increasing FMW can lock some employees out of the workforce and hinder their progression to higher and better paying jobs. While we acknowledge that some of these individuals might not be able to gain employment due to labour market disadvantage, it is essential that the Commission, in adjusting minimum wages, ensures that the unemployed and low skilled are not priced out of the workforce.

B7.26 The analysis, above also illustrates that respondents with reservation wages above the FMW* had better educational qualifications. Therefore their higher reservation wage was not unexpected. One might infer that they would most likely be 'holding out' for jobs that closely matched their educational qualifications rather than simply seeking a lower-skilled, lower paid job as an entry point into the workforce. In light of this, the FMW has little bearing on the employment opportunities of these individuals.

