



Australian Government

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**Submission**  
**to the**  
**Australian Fair Pay**  
**Commission**  
**Minimum Wage Review**  
**2008**

**14 March 2008**



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## Overview

- 1.1 The Australian Government's (the Government's) submission to the Australian Fair Pay Commission's (the Commission's) 2008 Minimum Wage Review occurs at a time of significant national and international economic challenges.
- 1.2 The most pressing of these economic challenges is the heightened inflationary environment.
- 1.3 This environment presents challenges for the Commission in its wage setting function of promoting the economic prosperity of the people of Australia.
- 1.4 The Commission must carefully consider the impact of an increase in minimum wages on inflation as well as on employment and competitiveness across the economy.
- 1.5 Headline inflation increased by 3.0 per cent over the year to the December quarter 2007. The Reserve Bank's preferred measures of underlying inflation – the weighted median and the trimmed mean – show underlying inflation outside the Reserve Bank's target band of 2-3 per cent for headline inflation.
- 1.6 Higher inflation not only represents the higher prices of goods and services paid by consumers, but also puts upward pressure on interest rates. Indeed, since the release of the CPI data, the Reserve Bank Board has increased interest rates by 50 basis points to 7.25 per cent.
- 1.7 The Reserve Bank has forecast that underlying inflation will be at around 3.5 per cent over the year to the December quarter 2008. While the Bank allows some short run variation in inflation over the business cycle, this forecast suggests there will be inflationary pressures in the economy for some time.
- 1.8 Higher inflation impacts on low paid workers, including those who are Pay Scale-reliant. It is clear that some low paid workers continue to experience financial stress. These workers are least able to maintain their standard of living in the face of higher prices and mortgage repayments or rents.

- 1.9 The impact of the Commission's minimum wage decision extends beyond those who automatically receive an increase in minimum wages. For example, it can also encourage higher wage claims in wage bargaining negotiations.
- 1.10 A number of important certified agreement negotiations are due to take place in 2008. If wage outcomes negotiated in these agreements are not underpinned by productivity improvements, they are likely to add to inflationary pressures.
- 1.11 In addition, the Commission is required to have regard to the need to provide a safety net for the low paid and the capacity for the low paid to obtain and remain in employment.
- 1.12 The Commission must therefore balance the needs of those low-income households whose minimum wage reliance is persistent, against the importance of not pricing some people out of the labour market.
- 1.13 While the majority of low paid workers make the transition to higher paid employment over time, there is a sizeable minority of workers who remain in low paid jobs over time, or churn between low paid jobs and joblessness. Many of these workers rely on minimum wage increases to maintain their standard of living.
- 1.14 While the overall unemployment rate is at a 33-year low, the unemployment rate for the unskilled and disadvantaged remains relatively high.

### **Post-budget submission**

- 1.15 There will be a number of releases of key economic data and information over the coming months, including the Australian Government's 2008-09 Budget in May 2008.
- 1.16 To ensure the Commission has the most up-to-date economic information, the Government asks the Commission to accept and consider post-Budget submissions prior to handing down its 2008 Minimum Wage Review Decision, as it did in its 2007 Minimum Wage Review.

## **Government position**

- 1.17 The Australian economy and labour market continue to perform well. Jobs growth is strong, the unemployment rate is low and participation rates for both men and women have risen in recent years. Nevertheless, increasing inflationary pressures in the economy are of concern. Inflation has the potential to inhibit Australia's economic prosperity unless a concerted effort is made to address it.
- 1.18 The Government's submission is that the Commission should grant an increase in minimum wages so that those who are reliant on minimum wages share in the strong growth in prosperity in Australia.
- 1.19 However, in arriving at its decision, the Commission should balance the potential impact of minimum wage increases on inflation, employment and the financial needs of low paid workers.
- 1.20 The Government's submission does not include a recommendation as to the quantum of any minimum wage increase.
- 1.21 Rather the Government's submission provides the Commission with recent economic data on wages growth, labour market, the economy, minimum wage-reliant workers and the inflation outlook to assist the Commission in its minimum wage setting functions.



## Chapter 2: Economic and labour market environment

### Introduction

- 2.1 Key considerations in the Commission's assessment of employment and competitiveness across the economy are the labour market, wages growth, inflation and the economic outlook. This chapter presents recent data and analysis relating to these key issues; updated information will subsequently be included in the Government's post-budget submission to the Commission. As noted already, inflation is the major challenge confronting the economy.
- 2.2 The two final sections of this chapter present the latest data on key groups in the labour market who are more likely to be impacted by the Commission's decision, and highlight the regional differences in labour market performance across the country.

### Economic environment

- 2.3 The Australian economy is forecast to continue to grow strongly, operating close to the limit of its capacity, although there are indications that this rate of growth will moderate in the future. Despite the growing risk of a downturn in the US economy, the overall outlook for the world economy remains favourable and should continue to support the domestic economy. Real GDP in Australia is forecast to grow by 4¼ per cent in 2007-08 and 3½ per cent in 2008-09,<sup>1</sup> underpinned by strong global demand for Australia's mineral and energy resources.
- 2.4 Large increases in commodity prices have boosted mining profits and investment, and mining production and export volumes are expected to accelerate from 2007-08 as projects come on line. Strong business investment is forecast over the next two years, particularly in the mining, manufacturing and property and business services sectors.
- 2.5 Household consumption is expected to grow solidly at 4¼ per cent in 2007-08, largely due to strong employment growth. Household income

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<sup>1</sup> 2007-08 Mid-Year Economic and Fiscal Outlook.

is expected to outpace consumption and as a result the household saving ratio is anticipated to rise. The interest rate rises in 2007-08 and the possible impact of increased credit market spreads on household borrowing costs are expected to have a moderating effect on household consumption.

- 2.6 Consistent with strong GDP growth, employment is expected to grow by 2¼ per cent in 2007-08. Strong employment growth since the Mid-Year Economic and Fiscal Outlook present some upside risks to this forecast. The participation rate is expected to rise to 65¼ per cent, while the unemployment rate is forecast to be around 4½ per cent, partly reflecting the new eligibility and participation requirements for Disability Support Pension and Parenting Payment recipients. Employment growth is expected to moderate in 2008-09 in line with an easing in economic growth and higher near term growth in labour costs.
- 2.7 Despite sustained tightness in the labour market, wages growth remains relatively contained. Wage growth appears to have gathered pace recently, however, with the ABS Wage Price Index increasing by 4.2 per cent and the national accounts measure of average earnings increasing by 4.6 per cent over the year to the December quarter 2007. The pressure on wages is expected to persist, with wages forecast to grow at 4¼ per cent in 2007-08<sup>2</sup> and 2008-09. Strong wage growth is expected to continue in those states and industries most affected by mining and construction activity, in which skills shortages are intense.
- 2.8 Inflationary pressures intensified over the past year, evidenced by headline inflation rising by 0.9 per cent in the December quarter 2007, to be 3.0 per cent higher in through the year terms. Measures of underlying inflation, which remove the influence of more volatile price movements, have also strengthened. The Reserve Bank's measures of underlying inflation, the trimmed mean and weighted median were 1.0 per cent and 1.1 per cent higher in the December quarter to be 3.4 per cent and 3.8 per cent higher through the year, respectively.
- 2.9 Australia has experienced historically strong labour market conditions and continued strength in the labour market, including skills shortages, is a key source of the upward pressure on prices. Adding to these labour

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<sup>2</sup> This is unchanged from the Budget forecast presented in the Commission's July 2007 Wage-Setting Decisions and Reasons for Decisions.

market factors are a range of specific price pressures. Low water storage levels in the Murray Darling Basin and adverse climatic conditions are contributing to higher food prices. Housing costs are also rising, with record low vacancy rates adding pressure to rental costs and rising prices for materials and labour used in house building contributing to growth in house purchase prices. In addition, oil prices remain at a high level and there is a risk that this may flow through to higher prices generally.

- 2.10 These economic forecasts have been framed against a backdrop of significant turbulence in global financial markets. The ongoing implications arising from the events in the US sub-prime market for the Australian and world economies are uncertain, and introduce greater downside risks to the outlook. Further volatility in financial markets has the potential for a more protracted slowdown in growth in the United States and would consequently dampen world growth more broadly beyond simple trade linkages. A significant slowdown in world growth would also slow the demand for Australia's exports and could result in falls in some commodity prices, national income and activity over the medium term.

## **Inflation**

- 2.11 As noted above, underlying inflation is now outside the Reserve Bank's target band of 2-3 per cent for headline inflation.
- 2.12 In its latest quarterly Statement of Monetary Policy, released 11 February 2008, the Reserve Bank forecast that underlying inflation is expected to be around 3.5 per cent over the year to the December quarter 2008, and will remain around 3 per cent through to mid 2010.<sup>3</sup>
- 2.13 The Government considers inflation to be its most important economic challenge and has developed a five point plan to address inflationary pressures in the Australian economy. The plan, as outlined by the Prime Minister in January, contains the following points:<sup>4</sup>

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<sup>3</sup> Reserve Bank, Statement of Monetary Policy, 11 February 2008, page 55.

<sup>4</sup> K Rudd, Building Australia's Economic Future, Address to Lord Mayor's Business Breakfast, 21 January 2008, Perth.

- a. First, the Government will ensure that it takes the pressure off demand by running a strong budget surplus.
  - b. Second, in the period ahead the Government will examine all options to provide real incentive to encourage private savings.
  - c. Third, the Government will unfold its plan for tackling chronic skills shortages in the economy. This will assist to alleviate the wages pressure in industries experiencing higher labour demand.
  - d. Fourth, the Government will provide national leadership to tackle infrastructure bottlenecks.
  - e. Fifth, the Government will provide practical ways of helping people re-enter the workforce and remove disincentives to work to lift workforce participation.
- 2.14 The Commission's decision can impact on inflation in two obvious ways: through an automatic flow-on to those receiving the minimum wage increase, or by setting expectations for other wage negotiations.
- 2.15 In relation to the automatic flow of minimum wage increases, as noted in the Commission's last decision, the latest ABS data from May 2006 show that 12.5 per cent of Australian employees were Pay Scale-reliant and 6.5 per cent were covered by a state workplace relations system or working in a non-constitutional corporation in the federal system covered by a transitional award.<sup>5</sup>
- 2.16 Many workers receive a flow-on of the Commission's decision through workplace bargaining with their employer, whether through a formal or informal agreement. According to the Department of Education, Employment and Workplace Relations' Workplace Agreements Database, 11 per cent of collective agreements, covering less than 4 per cent of employees in the federal workplace relations system, automatically flow on the Commission's decision. An additional 22 per cent of current collective agreements, covering a further 11 per cent of federal system employees are linked in some form to the Commission's minimum wage outcomes, however, conditions and/or qualifications of some type apply.

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<sup>5</sup> Australian Fair Pay Commission, Wage-setting Decisions and Reasons for Decisions, 2007, page 62.

- 2.17 In the current tight labour market, employers are more likely to agree to wage rises in excess of the relative increase in minimum wages in order to attract labour. In other words, a higher minimum wage increase is likely to encourage higher wage outcomes in workplace bargaining negotiations.
- 2.18 Almost half (48 per cent) of all federally registered collective agreements expire in 2008. These agreements account for 44 per cent of employees who are currently covered by federally registered collective agreements. Of these agreements, 186 cover 500 or more employees.
- 2.19 Those sectors with registered collective agreements which will expire in 2008 include the building and construction industry (particularly in Victoria), vehicle manufacturing (Toyota, with the Holden agreement having already expired) and retail (Target, David Jones and KFC).
- 2.20 The extent to which the outcomes of collective agreement negotiations in 2008 will add to inflationary pressures depends on the extent to which negotiated wage increases are underpinned by productivity improvements. While productivity data are volatile, it is important to note that the most recent ABS figures<sup>6</sup> show that trend productivity in the market sector increased by only 0.7 per cent over the year to the December quarter 2007.

## **Labour market overview**

- 2.21 Australia has experienced historically strong employment growth over recent years, resulting in the unemployment rate falling to 4.0 per cent in February 2008 - its lowest level in over 33 years - and the participation rate rising to 65.2 per cent.
- 2.22 Recent strong economic growth, together with a number of other forward indicators of labour market activity, suggests that employment should continue to expand in the near future.

## **Employment**

- 2.23 Over the five years to February 2008, full-time employment rose by 12.8 per cent to 7,633,500 and part-time employment increased by 11.8

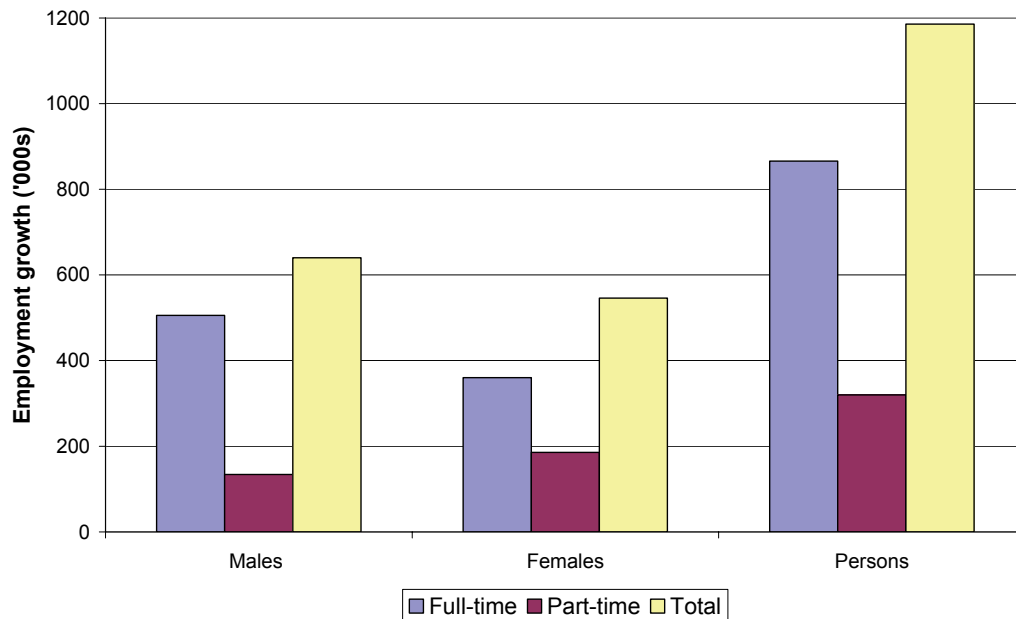
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<sup>6</sup> ABS *National Accounts*, Cat. No. 5206.0, December quarter 2007.

per cent to 3,032,100. Full-time employment accounted for 73.0 per cent of the total employment growth over this period, compared with 49.5 per cent of the jobs created over the previous 10 years.

- 2.24 This strong increase in employment growth is largely attributable to the mining sector and its substantial flow-on effects in construction and property and business services, which largely employ full-time workers.
- 2.25 Over the five years to February 2008, employment growth has been evenly split between male employment (up by 639,700 or 12.2 per cent) and female employment (up by 546,000 or 12.8 per cent).

**Chart 2.1: Change in full-time, part-time and total employment ('000s), January 2003 to February 2008**



Source: ABS Labour Force, Australia, January 2008 (Cat No: 6291.0.55.001), seasonally adjusted data.

- 2.26 Over the five years to November 2007 (latest available data), all of the 17 main industry groups except agriculture, forestry and fishing and manufacturing experienced an increase in employment. Employment growth (in percentage terms) was particularly strong in mining (up by 54.4 per cent), construction (up by 35.0 per cent) and transport and storage (up by 25.7 per cent).
- 2.27 The large percentage increase in employment in mining has been the result of the commodities boom as well as the fact growth has been from

a very small base. Indeed, the industry only accounted for 1.3 per cent of total employment in the November quarter 2007. The resources boom has also generated strong employment growth in other industries.

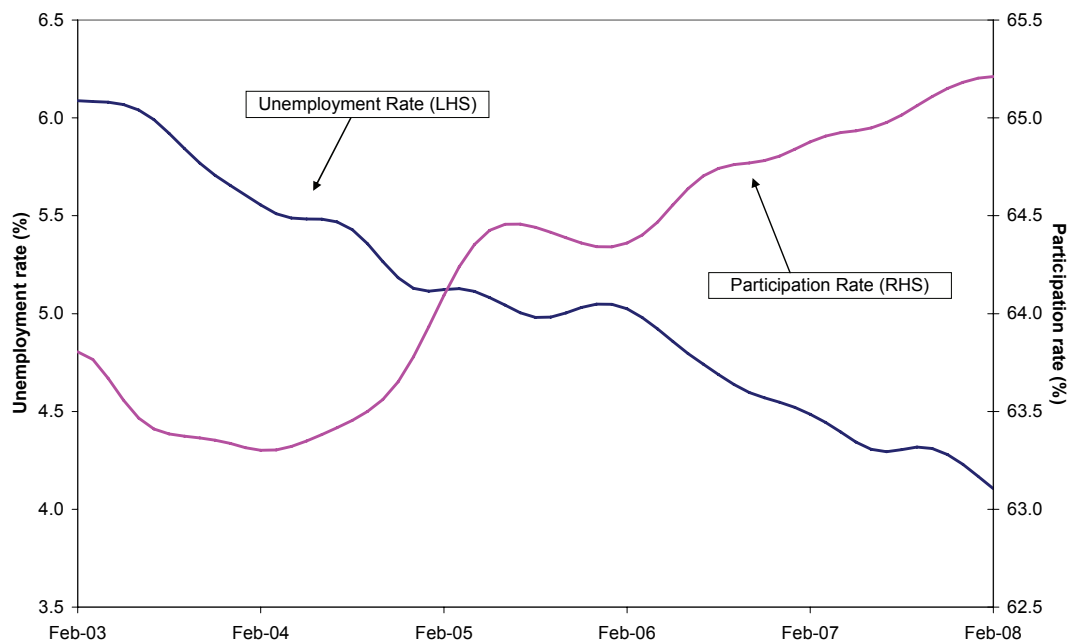
## **Unemployment**

- 2.28 In line with the strong increase in total employment over the last five years, the level of unemployment has also fallen, by 164,300 (27.1 per cent) to stand at 440,900 in February 2008. The decline in male unemployment accounted for almost three-quarters (73.8 per cent) of the total fall in unemployment. Extra jobs were also taken up by people who were previously not in the labour force, such as women with child caring responsibilities, migrants, students and people who have come out of retirement.
- 2.29 Against this backdrop the unemployment rate has also declined, from 6.0 per cent in February 2003 to 4.0 per cent in February 2008 (see Chart 2.2), its lowest level since November 1974.

## **Participation rate**

- 2.30 Over the past five years, the participation rate has increased significantly from 63.9 per cent in February 2003 to 65.2 per cent in February 2008. The female participation rate has increased by 1.9 percentage points to 58.2 per cent while the male participation rate has risen by 0.5 percentage points to 72.4 per cent.

**Chart 2.2: Unemployment rate and participation rate, January 2003 to February 2008**



Source: ABS Labour Force, Australia, Spreadsheets, January 2008 (Cat No: 6202.0.55.001), trend data.

- 2.31 Based on 2006 OECD data Australia ranks 10<sup>th</sup> in the OECD (out of 30 countries) for its participation rate for the population aged 15 and over.
- 2.32 However, after adjusting for statistical differences across countries, based on 2005 data, Australia has a relatively low ranking in relation to participation for a number of key cohorts:
- a. prime aged males (25 to 54 years) where Australia was ranked 23<sup>rd</sup>;
  - b. child bearing aged females (25 to 44 years) where Australia was ranked 20<sup>th</sup>; and
  - c. people nearing retirement (55 to 64 years) where Australia was ranked 13<sup>th</sup> for both men and women.
- 2.33 Male participation rates are of particular concern. Our ranking for males aged 15 and over has fallen from 10<sup>th</sup> place in 1995 to 12<sup>th</sup> place in 2006.

- 2.34 The decline in the participation rates of males with no post school qualifications has been particularly dramatic, falling by around 14 percentage points in recent decades.
- 2.35 There is further evidence that participation rates for males have been falling behind. In recent decades, the decline in the participation rate for males with no post-school qualifications has been particularly dramatic, with participation rates for this group falling by around 14 percentage points.

## **Key groups in the labour market**

- 2.36 While labour market conditions have strengthened for most cohorts over recent years, a number of groups, including teenagers, the long-term unemployed, lone parents and lower skilled workers continue to face significant labour market disadvantage. Members of these groups are more likely to be employed, or to seek employment in low skilled, low paid jobs and therefore be most affected by the Commission's decisions. Any adverse labour market effects of the Commission's decisions could therefore be expected to be more noticeable amongst these groups. However there is no indication that this has so far been the case.

### **Teenagers**

- 2.37 Teenagers have benefited from the strengthening labour market conditions over the past five years with their employment increasing by 10.4 per cent to 754,500 in February 2008. This has not been at the expense of participation in full-time education, which has also increased, by 0.5 percentage points to 68.8 per cent.
- 2.38 The teenage full-time unemployment to population ratio was 3.5 per cent in February 2008, down from the 4.7 per cent recorded in February 2003. Significantly, the teenage full-time unemployment to population ratio is now at its lowest level since the inception of the monthly series in February 1978.
- 2.39 However, according to the ABS, the teenage unemployment rate as at February 2008 was 12.4 per cent – compared with an overall unemployment rate of 4.0 per cent. While there are a number of ways of

interpreting teenage unemployment data, teenage unemployment is still high compared with other groups.

### **Discouraged jobseekers and long-term unemployed**

- 2.40 The strength of the economy and the labour market has also contributed to a reduction in the number of discouraged jobseekers (people with marginal attachment to the labour force who wanted and were available to work but did not think they would find a job), down from 106,500 in September 2000 to 52,900 in September 2006.<sup>7</sup>
- 2.41 The level of long-term unemployment fell considerably by 61,900 (48.1 per cent) over the last five years. As at January 2008, however, there were still 66,800 jobseekers, or around one in seven unemployed persons, who had been unemployed for 12 months or more.
- 2.42 However, while very long-term unemployment (persons unemployed for two years or longer) declined by 44,200 (55.5 per cent) over the last five years, over half of all long-term unemployed persons (35,400) remained very long-term unemployed in January 2008.

### **Lone parents**

- 2.43 In June 2007 (latest available data), there were 2,240,400 families with dependent children aged under 15 in Australia. Of these families, 13.5 per cent had no employed parent, of which lone parent families accounted for 70.2 per cent.
- 2.44 The vast majority of jobless families are headed by a lone parent. Over the five years to June 2007, the number of employed lone parents with dependent children rose by 14.0 per cent (32,800) to 267,800. In comparison, employment for parents in a couple family with dependent children increased by only 6.7 per cent (170 200) to 2,720,900.
- 2.45 While the unemployment rate of lone parents with dependent children fell significantly over the five years to June 2007 (by 3.6 percentage points to 12.5 per cent), it remains over four times higher than the 3.0 per cent unemployment rate for parents in a couple family with dependent children.

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<sup>7</sup> ABS *Persons Not in the Labour Force* (Cat. No. 6220.0) September 2006, Table 1 page 7,.

- 2.46 While the number of dependent children in jobless families has fallen by 179,900 (24.6 per cent) over the past five years, there remain 551,200 children who live in a family where no parent is employed.

### **Less skilled group**

- 2.47 The strength of the economy has benefited both those with post-school qualifications and those without post-school qualifications. The unemployment rate for people aged 15 to 64 years without a post-school qualification has fallen from 8.6 per cent in May 2003 to 6.5 per cent in May 2007. In comparison, the unemployment rate for people with post-school qualifications fell from 4.3 per cent to 2.8 per cent.
- 2.48 Notwithstanding the fall in unemployment and increase in participation rate for the low skilled, it remains the case that those groups most likely to be reliant on minimum wages have considerably higher unemployment rates than the rest of the labour force.

### **Regional disparities**

- 2.49 While labour market conditions have strengthened significantly throughout Australia, some disparity in labour market performance continues to exist between specific regions. The Commission should therefore be aware that its decision could have differing impacts in different parts of the country.

### **States**

- 2.50 Labour market conditions have improved in all states and territories, consistent with the strengthening in conditions at the national level. States with above average employment growth (in percentage terms) were Queensland (up by 20.6 per cent), Western Australia (up by 17.7 per cent) and Tasmania (up by 13.8 per cent).
- 2.51 The unemployment rate has decreased in all states and territories over the five years to February 2008. The largest falls were in Tasmania (down by 4.1 percentage points to 5.1 per cent), followed by Queensland (down by 3.5 percentage points to 3.6 per cent) and Western Australia (down by 2.9 percentage points to 2.8 per cent). Queensland and

Western Australia continue to experience strong labour demand and skill shortages, due to the resources boom.

### **Regional disadvantage**

- 2.52 The strong labour market conditions prevailing at the national level are mirrored in most regional labour markets across Australia. Not one region recorded a double-digit unemployment rate in January 2008.
- Pockets of disadvantage remain evident in some parts of Australia, however. For instance, the unemployment rate stood at 7.3 per cent in Wollongong and 6.6 per cent in Tasmania's Mersey-Lyell region in January 2008, while their participation rates (59.7 per cent and 59.2 per cent respectively) remain well below the national average of 64.9 per cent.

### **Wage developments**

- 2.53 The Wage Price Index (WPI) has been trending up over the past year and is forecast to grow at 4¼ per cent in 2007-08 and 2008-09. The WPI increased by 1.1 per cent in the December quarter 2007 to be 4.2 per cent higher through the year.<sup>8</sup>
- 2.54 The ABS notes that the Commission's July 2007 decision, which took effect from 1 October 2007, mostly impacted on the WPI figures in the December 2007 quarter.
- 2.55 Strong wage growth has been recorded in those industries most affected by the high levels of mining and construction activity.<sup>9</sup> Through the year to the December quarter 2007, the mining industry recorded the strongest wage growth of any industry of 5.1 per cent and the construction industry recorded the third highest wage growth with 4.6 per cent wage growth. The second highest rate of growth (5.0 per cent) occurred in retail trade.
- 2.56 Retail trade had the highest wage growth of all industries in the December quarter 2007 (2.1 per cent). The most recent ABS data from

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<sup>8</sup> These data are seasonally adjusted.

<sup>9</sup> All industry and state/territory WPI data are original.

May 2006 show that 28.7 per cent of employees in the retail trade industry were award or Pay Scale-reliant.

- 2.57 However, the industry with the highest incidence of Pay Scale-reliance (accommodation, cafes and restaurants) had wages growth of 1.0 per cent,<sup>10</sup> equivalent to the aggregate increase for the quarter. It is, therefore, possible that other factors in addition to the Commission's decision contributed to the increase in retail wages in the December quarter 2007.
- 2.58 Wage outcomes differ considerably across the states.<sup>6</sup> Western Australia recorded strong wage growth through the year to the December quarter 2007 of 5.9 per cent. In contrast, wage outcomes in Victoria and New South Wales remain subdued, with both states recording growth of 3.9 per cent over the year to the December quarter 2007.
- 2.59 The results in Western Australia reflect the strong labour market conditions due to the demand for resources, including the difficulty in attracting suitable labour.

## Conclusion

- 2.60 The economy continues to grow strongly, fuelled by the resources boom, leading to continuing strong jobs growth in most regions and for most Australians. However there are still some poorer performing regions and large differences in labour market outcomes persist between demographic groups. Wage pressures, while generally restricted to industries and occupations subject to skill shortages, including mining and construction, are significant.
- 2.61 The Commission's decision should maximise the economic prosperity of all Australians, particularly those most dependent on the Commission's deliberations. The Government recognises that many workers and working families, particularly those relying on lower paid employment, are facing cost pressures.
- 2.62 The Government also submits that the Commission should carefully consider the impact of minimum wage increases on inflation. Adding to

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<sup>10</sup> In original terms, the aggregate WPI also increased by 1.0 per cent over the December quarter 2007.

inflationary pressures could perversely erode real disposal incomes and limit economic growth.

## Chapter 3: Who are Australia's low paid?

### Introduction

- 3.1 The Commission's wage setting parameters require it to have regard to both the capacity for the low paid to obtain and remain in employment, as well as providing a safety net for the low paid. In this chapter, the Government provides some additional analysis of the incidence of low pay and the characteristics of low paid employees<sup>11</sup> based on the first five waves of the Household, Income and Labour Dynamics in Australia (HILDA) survey, covering the years 2001 to 2005.
- 3.2 The chapter then focuses on the dynamics of low pay, including wage and labour market transitions, using the same data. The Government supplements this dynamic analysis with a short overview of related research. A particular focus of the analysis is the pattern and persistence of low paid employment.
- 3.3 While a sizeable proportion of low paid workers progress quickly to higher pay, others remain in low pay, or churn between low pay and joblessness. These latter groups are likely to be more dependent on the Commission's decision for increases in their pay.
- 3.4 However these workers are also at risk that any increase in the minimum wage which is too large will be counterproductive if it leads to a reduction in hours of work (including the loss of jobs) for these workers or contributes to inflationary pressures.

### Incidence of low paid employment

- 3.5 The analysis presented in this chapter is from the HILDA survey. The analysis is based on all respondents who were in each of the first five waves and were an employee in at least one wave.<sup>12</sup>

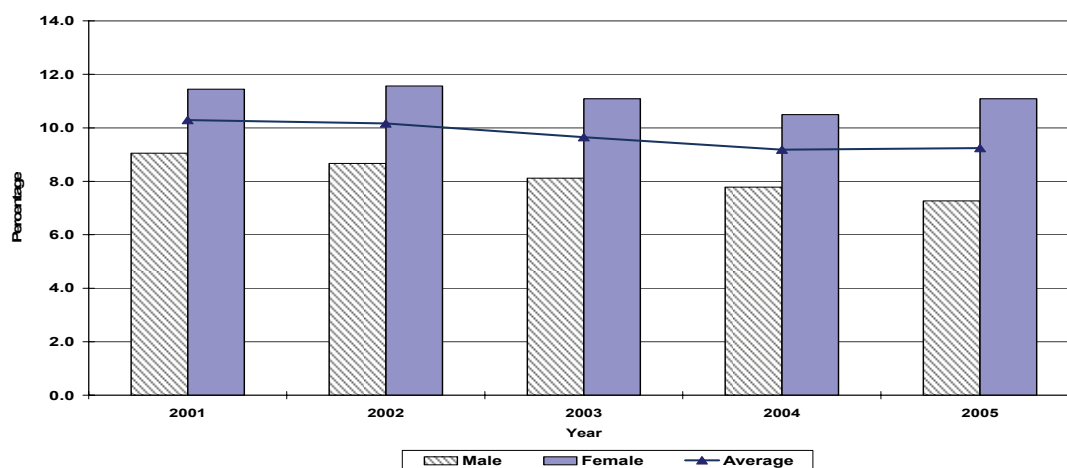
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<sup>11</sup> All references to low pay concern low paid employees only, not employers or the self-employed.

<sup>12</sup> In this analysis, the labour market status assigned to respondents in waves or years was their status during the survey week. Some respondents may have had variable labour market status throughout each year. People aged under 21 years and full-time students were excluded. The sample size was 4 879. Females are over-represented, which may skew the results for other variables.

- 3.6 Low paid employees are defined as those employees earning up to two-thirds of median hourly earnings. This threshold is one of the most commonly used definitions in Australian and international studies of the earnings mobility of low paid workers. More details about the sample selection criteria are displayed in Appendix A.3.
- 3.7 The proportions of workers receiving low pay each year in the sample are summarised in Chart 3.1.
- 3.8 Overall, the incidence of low paid employment declined slightly from 10.3 per cent in 2001 to 9.2 per cent in 2005. The incidence of women in low paid employment remained constant at 11 per cent over the period, while the incidence of men in low paid employment declined from 9 per cent to 7 per cent.

**Chart 3.1: Incidence of low paid employment by gender**



*Household Income and Labour Dynamics in Australia (HILDA) Survey, Release 5.1, 2007.*

## Patterns of low paid employment between 2001 and 2005

**Table 3.1: Number of years being low paid**

Number of times being low paid	All respondents		At least low paid once	
	N	%	N	%
0	3 466	71.0	-	-
1	829	17.0	829	58.7
2	340	7.0	340	24.1
3	150	3.1	150	10.6
4	61	1.3	61	4.3
5	33	0.7	33	2.3
<b>Total</b>	4 879	100	1 413	100

Source: *Household Income and Labour Dynamics in Australia (HILDA) Survey, Release 5.1, 2007.*

- 3.9 Table 3.1 shows that 58.7 per cent of those persons who were low paid at least once over the five waves were only low paid in one wave. A further 24.1 per cent were low paid in two waves while 17.2 per cent were low paid in three or more waves. However, of all those who were in every wave of the first five waves of the HILDA data set and were an employee in at least one wave, only 2.3 per cent were low paid in every wave and a further 4.3 per cent were low paid in four waves.
- 3.10 Table 3.1 summarises the number of years in which individuals in the sample received low pay over the period of 2001 to 2005. A total of 71.0 per cent of respondents were never low paid, 17.0 per cent received low pay in one out of the five waves, 7.0 per cent were low paid in two waves, and only 0.7 per cent were low paid in each of the five waves.
- 3.11 In order to analyse movements in and out of labour market states, respondents are grouped into one of five categories based on their labour market status (see Table 3.2). Following the Commission's focus on low paid and vulnerable employees, the groups of interest in this analysis are those who were 'occasionally low paid, not always in work'<sup>13</sup> and those who were 'persistently low paid'. Those who were 'occasionally low paid, always in work' are excluded because they were in a higher paid job in three or four of the five waves.

<sup>13</sup> Information about the reason as to why people in this cohort were not always in work is not available.

**Table 3.2: Definition of different labour market states**

	<i>Definition</i>
<b>1</b>	<b>Not low paid, always in work (<i>Not LP, always in work</i>)</b> Respondents who were never low paid and were in work in each wave.
<b>2</b>	<b>Not low paid, not always in work (<i>Not LP, not always in work</i>)</b> Respondents who were never low paid, but were not employed in every wave.
<b>3</b>	<b>Occasionally low paid, always in work (<i>Occ LP, always in work</i>)</b> Respondents who were low paid once or twice over the five waves and employed in every wave.
<b>4</b>	<b>Occasionally low paid, not always in work (<i>Occ LP, not always in work</i>)</b> Respondents who were low paid once or twice over the five years period, but were not employed in every wave.
<b>5</b>	<b>Persistently low paid (<i>Persistent LP</i>)</b> Respondent who were low paid in at least three years out of the five waves.

3.12 Table 3.3 shows the patterns of employment based on the definition outlined in Table 3.2. Of the groups of interest, a total of 5.0 per cent of all individuals were persistently low paid, and 13.5 per cent were occasionally low paid and not employed in every wave.

**Table 3.3: Patterns of employment**

	All respondents		At least low paid once	
	N	%	N	%
<b>Not LP, always in work</b>	2 315	47.4	-	-
<b>Not LP, not always in work</b>	1151	23.6	-	-
<b>Occ LP, always in work</b>	512	10.5	512	36.2
<b>Occ LP, not always in work</b>	657	13.5	657	46.5
<b>Persistent LP</b>	244	5.0	244	17.3
<b>Total</b>	<b>4 879</b>	<b>100</b>	<b>1 413</b>	<b>100.0</b>

Source: Household Income and Labour Dynamics in Australia (HILDA) Survey, Release 5.1, 2007.

## Characteristics of low paid employees

3.13 This section examines the characteristics of the ‘occasionally low paid, not always in work’ and the ‘persistently low paid’ to see if they differ in any systematic way from other employees and also from each other.

### *Demographic characteristics*

3.14 Table 3.4 displays the key demographic characteristics by patterns of employment. The table demonstrates that those employees more likely to be associated with ‘occasionally low paid and not always in work’ in the HILDA survey were females (63.8 per cent compared with their

average of 55.7 per cent),<sup>14</sup> those born in other countries (23.0 per cent, average 20.3 per cent), lone parents (9.9 per cent, average 7.7 per cent) and those with children aged 0-4 years (24.2 per cent, average 19.5 per cent).

3.15 Those employees more likely to be ‘persistently low paid’ were people aged 21-30 or aged 45 and over, females and lone parents. They were considerably less likely to be aged 31-44, born in other countries, married or have children aged 0-4.

**Table 3.4: Demographic characteristics by pattern of employment**

Pay patterns	Not LP, always in work	Not LP, not always in work	Occ LP, always in work	Occ LP, not always in work	Persistent LP	Total
	<i>percentages</i>					
<b>Female</b>	45.1	54.7	57.2	63.8	57.8	55.7
<b>Born other countries</b>	22.1	22.1	18.4	23.0	16.0	20.3
<b>Married</b>	65.9	67.2	54.3	61.2	51.2	60.0
<b>Lone parent</b>	6.3	5.5	6.8	9.9	9.8	7.7
<b>Children aged 0-4</b>	17.3	34.4	14.6	24.2	7.0	19.5
<b>Aged 21-30</b>	8.5	9.1	14.6	10.5	15.6	11.7
<b>Aged 31-44</b>	42.9	42.4	39.8	41.4	30.3	39.4
<b>Aged 45 and over</b>	48.6	48.5	45.5	48.1	54.1	49.0
<b>Average Age (years)</b>	44.2	46.0	43.2	45.0	45.3	44.7

Source: Household Income and Labour Dynamics in Australia (HILDA) Survey, Release 5.1, 2007.

*Income and educational qualifications*

3.16 Table 3.5 shows that employees who were ‘occasionally low paid, not always in work’ also worked the lowest average weekly hours. In relation to their level of education, these employees were less likely to have a degree and were more likely to have a certificate or ‘below year 12’ education. ‘Persistently low paid’ employees had the lowest average ‘other household income’ and were less likely to have a degree or certificate and were more likely to have year 12 or ‘below year 12’ educational qualification.

<sup>14</sup> The average percentage for each characteristic is in the ‘Total’ column.

**Table 3.5: Income and educational qualifications by pay patterns**

Pay pattern	Not LP, Always in work	Not LP, not always in work	Occ LP, always in work	Occ LP, not always in work	Persistent LP	Total
<b>Income and Hours</b>						
Hours per week	40.6	31.9	36.6	30.5	34.5	34.8
Other household income per year	\$48,550	\$54,015	\$51,310	\$51,143	\$46,328	\$50,269
<b>Education</b>	<i>Percentages</i>					
Degree	36.0	29.3	14.3	13.7	8.6	20.4
Certificate	34.4	32.8	38.9	37.7	29.1	34.6
Year 12	11.0	11.4	15.6	12.2	17.2	13.5
Below year 12	18.6	26.6	31.3	36.4	45.1	31.6

Source: Household Income and Labour Dynamics in Australia (HILDA) Survey, Release 5.1, 2007.

### *Type of employment*

3.17 Table 3.6 displays the employment status of each group of employees. Those ‘occasionally low paid, not always in work’ were the most likely of all groups to be employed on a part-time and/or casual basis. The ‘persistently low paid’ were also more likely to be employed on a part-time and casual basis, but not to the same extent.

**Table 3.6: Type of employment (percentages)**

Employment Contract	Not LP, always in work	Not LP, not always in work	Occ LP, always in work	Occ LP, not always in work	Persistent LP	Total
Full-time	82.1	46.9	65.2	43.0	53.1	58.1
Part-time	17.9	53.1	34.8	57.0	46.9	41.9
Permanent	85.9	60.3	70.5	39.9	52.0	61.7
Casual	5.8	26.0	22.1	50.3	43.9	29.6
Contract	8.1	13.2	7.2	9.5	4.1	8.4

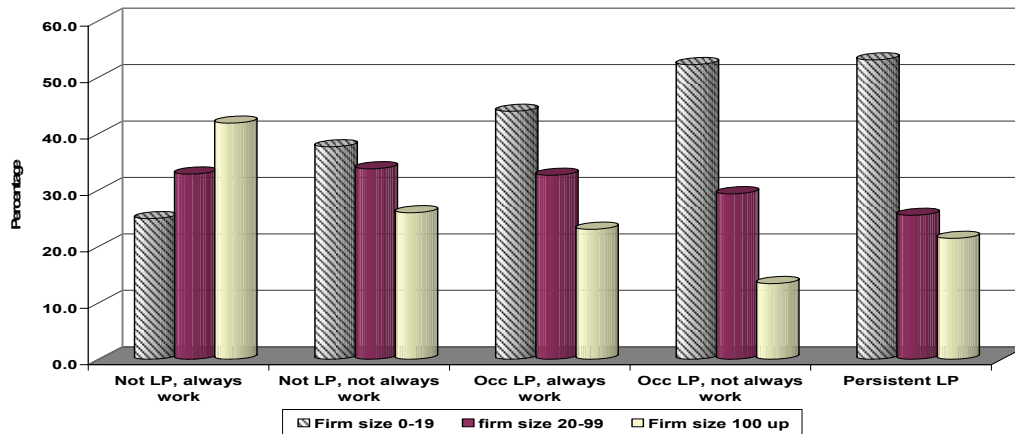
Source: Household Income and Labour Dynamics in Australia (HILDA) Survey, Release 5.1, 2007.

(Percentages might not sum to 100 due to rounding.)

### *Firm size*

3.18 Chart 3.2 summarises patterns of low paid employment in 2005 by firm size. The chart shows that both employees who were ‘occasionally low paid, not always in work’ and ‘persistently low paid’ were far more likely to work in firms with less than 20 employees. Those employees who were ‘occasionally low paid, not always in work’ were less likely than the other cohorts to be employed by large businesses (firms with 100 or more employees).

**Chart 3.2: Pay and employment stability by firm size**



Source: Household Income and Labour Dynamics in Australia (HILDA) Survey, Release 5.1, 2007.

*Summary characteristics*

- 3.19 Overall, the above analysis shows that compared with other groups, ‘persistently low paid’ employees are more likely be aged under 30 or over 45, female, lone parents and have lower educational qualifications. They are concentrated in smaller firms in the private sector and are more likely to be employed on a casual basis.
- 3.20 The ‘occasionally low paid, not always in work’ group were more likely to be female, born in other countries, lone parents and have children aged 0-4 years. They had relatively low hours of work, lower educational qualifications and were more likely to work on a part-time and/or casual basis and be employed by firms with fewer than 20 employees.
- 3.21 The Commission may be interested to note that, while the characteristics of the ‘occasionally low paid, not always in work’ and the ‘persistently low paid’ differed from groups of higher paid employees, there were also significant differences between these two groups. The profile of the ‘occasionally low paid, not always in work’ group was much closer to that of the population at large, with the notable exceptions that they were more likely to be female, work part-time, be employed on a casual basis, and be employed in firms with fewer than 20 employees.

## Previous research on low pay dynamics

- 3.22 A common finding of international studies conducted on the topic of earnings mobility and low paid dynamics is that a significant proportion of minimum wage workers make the transition to higher paid work in the short term. However, there is a sizeable minority of employees who do not make this transition and stay in low paid jobs or cycle between low pay and unemployment.
- 3.23 For example, a United Kingdom study by Jones et al<sup>15</sup> found that while the majority of workers found minimum wage employment to be a temporary phenomenon, some workers remained employed at or below the UK National Minimum Wage for longer periods.
- 3.24 Research on the dynamics of minimum wage workers in Australia has reached similar conclusions. For instance, Dunlop<sup>16</sup> found that low paid employment was a temporary state for about half of low paid employees. For the remaining half, however, low paid employment was relatively persistent, or involved churning in and out of joblessness.
- 3.25 Buddelmeyer et al<sup>17</sup> found that low paid jobs could be a bridge to higher paid jobs for most respondents. More than half of low paid employees in 2001 managed to progress to a higher pay job by 2002. However, while two thirds of those on higher pay in 2002 were still in higher paid jobs in 2004, almost a fifth had moved back to low pay employment.
- 3.26 Various papers by Masterman-Smith et al<sup>18</sup> emphasised that research focussing only on upward wage mobility tended to ignore the full range of labour force transitions, notably downward wage mobility and churning. They found that the stepping stone hypothesis may be true for some workers, but it is not applicable in certain low paid sectors such as cleaning and childcare.

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<sup>15</sup> M K Jones, RJ Jones, PD Murphy and P J Sloane, 'The Dynamics of the National Minimum Wage: Transitions Between Labour Market States', Institute for the Study of Labor (IZA), Discussion Paper No. 1690 (July), 2005.

<sup>16</sup> Y Dunlop, 'Low-paid Employment in the Australian Labour Market, 1995-97', in J. Borland, B. Gregory and P. Sheehan (eds), *Work Rich, Work Poor: Inequality and Economic Change in Australia*, Centre for Strategic Economic Studies, Victoria University, Melbourne, 2001.

<sup>17</sup> H Buddelmeyer, W Lee, M Wooden and H Vu, "Low Pay Dynamics: Do Low Paid Jobs Lead to Increased Earnings and Lower Welfare Dependency Over Time", report prepared under the Social Policy Research Services (SPRC) Agreement between DEWR and the Melbourne Institute, 2007.

<sup>18</sup> H Masterman-Smith, B Pocock and R May, "Low Paid Services Employment in Australia: Causes, Dimensions, Effects and Responses", Centre for Work + Life Discussion Paper 1/06, University of South Australia, 2006.

H Masterman-Smith, B Pocock and R May, "Living Low Paid: Some Experiences of Australian Childcare Workers and Cleaners", AIRAANZ conference paper, February 1-3, Glenelg South Australia, 2006.

## Dynamics of low pay employment in the short run

- 3.27 In interpreting the data in the following analysis, it should be remembered that the transition probabilities reflect only adults who were employees at some point in time, not the whole adult population. Transition probabilities from Not-In-Labour-Force (NILF) and unemployment to employment will therefore be higher than those for the population.
- 3.28 Table 3.7 summarises movements between various labour market states in consecutive waves of the HILDA survey. The table shows the proportions of individuals employed in low paid jobs in the initial year ( $t$ ) by their labour force and earnings status in the following year ( $t+1$ ).<sup>19</sup>

**Table 3.7: Labour market dynamics, 2001-2005 (Percentages)**

<i>Initial year (t)</i>	<i>Following year (t+1)</i>					
	<b>Low Pay</b>	<b>Medium Pay</b>	<b>High Pay</b>	<b>Unemployed</b>	<b>NILF</b>	<b>Total (%)</b>
<b>Low Pay</b>	35.8	27.1	20.3	2.6	14.3	100
<b>Medium Pay</b>	14.7	46.0	29.3	1.5	8.5	100
<b>High Pay</b>	6.3	12.1	74.8	0.9	5.9	100
<b>Unemployed</b>	26.1	25.2	19.0	15.8	13.9	100
<b>NILF</b>	21.1	21.0	17.7	5.5	34.8	100

Source: Household Income and Labour Dynamics in Australia (HILDA) Survey, Release 5.1, 2007.

- 3.29 The highest degree of state persistence was for the high pay cohort, with 74.8 per cent continuing to receive high pay in the following wave. The next highest was 46.0 per cent for the medium pay cohort. In total, 35.8 per cent of low paid employees remained low paid.

### *Entry into low pay employment*

- 3.30 The unemployed were the most likely to transition to low paid jobs (26.1 per cent), followed by the NILF (21.1 per cent). While the majority of employees stay in the same cohort or move to a higher paying one from one wave to the next, there is considerable downward mobility. The probability of moving to unemployment or NILF decreases as earnings rise. All earnings cohorts were more than five times more likely to move to NILF than to unemployment.

<sup>19</sup> Medium pay means an hourly rate greater than two-thirds median and less than or equal to two-thirds of median plus 40 per cent, and high pay is more than this amount.

*Exit from low pay employment*

- 3.31 On average, 83.2 per cent of those employees who were low paid in one wave of the HILDA survey were still in employment in the following wave. Only 2.6 per cent became unemployed while 14.3 per cent became NILF. In total, 47.4 per cent of the low paid moved into medium or high paid jobs, indicating a high degree of mobility from low paid to higher paying jobs. However, as noted above, 35.8 per cent of low paid employees remained low paid.
- 3.32 In summary, although a considerable proportion of low paid employees were able to progress into a higher paying job, 16.9 per cent either became unemployed or NILF and are vulnerable to remaining in low paid employment or churning between low pay and joblessness. It is, therefore, clear that around 50 per cent of low paid employees remained low paid or moved from low paid jobs to NILF or unemployment in the short term. The following section examines transitions over the longer term.

**Wage transitions from 2001 to 2005**

- 3.33 The following analysis compares the labour market status of the sample in the 2005 HILDA wave with their status in the 2001 wave, with a particular focus on those who were low paid in 2001.

**Table 3.8: Wage outcomes in 2005 by labour force status in 2001**

2001		2005					
		Low Pay	Medium Pay	High Pay	Unemployed	NILF	Total
Low Pay	N	143	150	108	15	86	502
	%	28.5	29.9	21.5	3.0	17.1	100
Medium Pay	N	168	467	342	17	128	1122
	%	15.0	41.6	30.5	1.5	11.4	100
High Pay	N	175	321	1,803	23	183	2505
	%	7.0	12.8	72.0	0.9	7.3	100

Source: *Household Income and Labour Dynamics in Australia (HILDA) Survey, Release 5.1, 2007.*

- 3.34 Table 3.8 shows that, of employees who were low paid in 2001, 28.5 per cent remained low paid in 2005, 51.4 per cent had moved to a job with higher pay and 20.1 per cent were unemployed or NILF. As pay in 2001 increased, the probability of being unemployed or NILF decreased.

## Conclusion

- 3.35 The characteristics of low paid workers differ significantly from those of higher paid workers. There are also significant differences in the characteristics of ‘persistently low paid’ and ‘occasional low paid, not always working’ employees in the HILDA survey.
- 3.36 In terms of transition of low paid workers to higher paid jobs, our analysis confirms that around half of the low paid end up in higher paid job in both the short and long term. However, the remaining low paid employees do not make that transition.
- 3.37 Low paid employees have a much higher likelihood of exiting the labour force or becoming unemployed compared with medium and higher paid employees. However, those people who ‘churn’ between low paid jobs and unemployment or remain persistently low paid are considerably better off financially than they would be without a job at all. A consideration for the Commission should be the capacity of these workers to obtain and remain in employment.

## Appendix A.3

### Identifying low pay workers - Methodology

- A3.1 The analysis conducted in this chapter is based on data drawn from the HILDA survey between waves 1 and 5.
- A3.2 Analyses in this chapter only includes persons who were aged above 21 years old, not studying on a full-time basis, were in each wave over the period of 2001 to 2005 and were an employee in at least one wave, and for whom all the required information was available on the key variables used in the analysis.
- A3.3 In addition, respondents' employment status was based on their survey week, not the whole 12 months. Thus, participants may have experienced labour market states within the years alternative to those recorded.
- A3.4 Weekly earnings in all jobs were used to calculate hourly wage rates rather than earnings in main job. The Government considered that low paid workers were more likely to need to pool the earnings from a number of part-time jobs to earn sufficient income than more highly paid workers, who were more likely to be satisfied with the income generated by their main job.
- A3.5 Low paid workers are defined as those workers earning up to two-thirds of median hourly earnings. This threshold is one of the most commonly used definitions in the Australian and international studies of earnings mobility of low paid workers.
- A3.6 Casual employees' earnings are discounted by 20 per cent to allow for loadings paid in lieu of other benefits.<sup>20,21</sup>
- A3.7 Table A3.1 shows the hourly rates used in this chapter to define the pay groups over the sample period at the 2005 price level. The low pay

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<sup>20</sup> The pay of casual employees is typically higher than permanent employees as it includes the pay loadings to compensate for their ineligibility for work entitlements such as annual leave, paid sick leave and irregularity in availability of work.

<sup>21</sup> Y Dunlop, 'Labour Market Outcomes for Low Paid Adult Workers: An Application Using the Survey of Employment and Unemployment Patterns', ABS Occasional Paper 6293.0.00.005, Australian Bureau of Statistics, Canberra, 2000.

threshold based on two-thirds of median hourly earnings is only just above the Federal Minimum Wage (FMW).

**Table A3.1: Low pay thresholds estimates**

	<b>Federal Minimum Wages</b>	<b>2/3 median</b>	<b>Medium wages</b>
<b>2001</b>	\$10.90	\$11.21	\$15.69
<b>2002</b>	\$11.40	\$11.75	\$16.45
<b>2003</b>	\$11.80	\$12.15	\$17.01
<b>2004</b>	\$12.30	\$12.59	\$17.63
<b>2005</b>	\$12.75	\$13.33	\$18.66

Source: *Source: Household Income and Labour Dynamics Australia (HILDA) Survey, Release 5.1, 2007.*

A3.8 Medium wages are defined as wages between the two-thirds of the median and the two-thirds of the median wage plus 40 per cent. High wages are defined as wages greater than two-thirds of the median wage plus 40 per cent.



## Chapter 4: The Safety Net

### Introduction

- 4.1 The Commission's wage setting parameters require it to have regard to providing a safety net for the low paid.
- 4.2 This chapter illustrates the degree of financial stress experienced by some low paid households.
- 4.3 The Government agrees with the Commission's view that "... statutory minimum wages, along with the tax/transfer system, have a significant role to play in providing a safety net for the low paid".<sup>22</sup> This chapter examines the interaction of minimum wages and the tax system, including upcoming changes to taxation arrangements that will benefit low paid workers.

### Financial stress and the low paid

- 4.4 In determining the level of minimum wages, the Government submits that the Commission should take into consideration the degree of financial stress reported by the low paid. At a time of rising prices and with recent increases in interest rates, it is important to consider the number of low paid households experiencing financial stress.
- 4.5 The Government's policy is to introduce a strong and simple safety net of minimum terms and conditions of employment for the low paid through 10 legislated National Employment Standards and new modern awards. This safety net will protect minimum conditions for low paid employees. The Government's new safety net, which will be operational from 1 January 2010, will not be able to be undermined by workplace agreements like Australian Workplace Agreements, as was allowed by the previous Government's Work Choices laws.
- 4.6 In a report to Industrial Relations Victoria, Dr Ian Watson analysed household expenditure using the HILDA dataset. Watson's research

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<sup>22</sup> Australian Fair Pay Commission, Wage-setting Decisions and Reasons for Decisions, 2007, page 68.

into the incidence of financial stress found that a significant proportion of low paid households perceived themselves as struggling financially.<sup>23</sup>

- 4.7 Importantly, Watson found that financial stress among low paid households was also caused by an inability to meet day to day expenses. Low paid households were more likely to go without meals, not heat their homes, or seek financial assistance.
- 4.8 Table 4.1 presents a selection of Watson's results which show that 37.6 per cent of low paid households described themselves as poor or very poor, or just getting along, compared with 31.6 per cent of 'other' households.<sup>24</sup>
- 4.9 Table 4.1 also shows that 21.8 per cent of low paid households experienced two or more episodes of financial hardship. This compares with 16.1 per cent of 'other' households.
- 4.10 Access to credit was also limited for low paid households with about 36.9 per cent not owning a credit card compared with 25.1 per cent of 'other' households.

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<sup>23</sup> I Watson, 'Low paid workers in Australia: insights from HILDA,' March 2007, A report for IR Victoria.

<sup>24</sup> Ibid, page73.

**Table 4.1: Household Financial Stress**

	Households comparisons					
	Adult low paid		Other		All households	
	'000s	%	'000s	%	'000s	%
<b>Family finances: pessimists</b>						
Poor or very poor	27	5.9	123	2.7	150	3.0
Just getting along	145	31.7	1,309	28.9	1,454	29.1
Reasonably comfortable	239	52.4	2,504	55.2	2,742	55.0
Prosperous or very comfortable	46	10.0	598	13.2	644	12.9
<b>Total</b>	<b>456</b>	<b>100.0</b>	<b>4,534</b>	<b>100.0</b>	<b>4,990</b>	<b>100.0</b>
<b>Episodes of financial hardship</b>						
Three or more	60	13.2	370	8.2	430	8.7
Two	39	8.6	358	7.9	397	8.0
One	60	13.1	609	13.5	668	13.5
None	297	65.2	3,176	70.4	3,472	69.9
<b>Total</b>	<b>455</b>	<b>100.0</b>	<b>4,512</b>	<b>100.0</b>	<b>4,967</b>	<b>100.0</b>
<b>How easily raise \$2000 in one week</b>						
Could not raise it	105	23.1	620	13.7	725	14.6
Have to do something drastic	75	16.4	518	11.5	593	11.9
Raise it, but some sacrifices	117	25.8	1,153	25.5	1,270	25.5
Easily raise it	158	34.7	2,234	49.4	2,393	48.0
<b>Total</b>	<b>456</b>	<b>100.0</b>	<b>4,526</b>	<b>100.0</b>	<b>4,981</b>	<b>100.0</b>
<b>Ownership of credit card</b>						
No Credit card	189	36.9	1,263	25.1	1,452	26.2
Owns credit card	324	63.1	3,762	74.9	4,086	73.8
<b>Total</b>	<b>514</b>	<b>100.0</b>	<b>5,025</b>	<b>100.0</b>	<b>5,538</b>	<b>100.0</b>
<b>Sample size</b>	<b>455</b>		<b>4,594</b>		<b>5,049</b>	

Source: I Watson, *Low paid workers in Australia: insights from HILDA, A report for IR Victoria, March 2007* page 73.

## Housing affordability and the low paid

4.11 In December 2007, the Australian Housing and Urban Research Institute prepared a paper based on a comprehensive assessment of housing affordability.<sup>25</sup> The paper focused, in particular, on lower income Australians.<sup>26</sup>

<sup>25</sup> T Burke, S Pinnegar, P Phibbs, C Neske, M Gabriel, L Ralston and K Ruming, *Experiencing the housing affordability problem: blocked aspirations, trade-offs and financial hardships*, The Australian Housing and Urban Research Institute Research Paper No.9, December 2007.

<sup>26</sup> Respondents were grouped into the lower income cohort if their income falls into the two lowest-income quintiles and their housing cost exceeds 30 per cent of their income. The researchers interviewed 1,381 renters and 399 recent home purchasers across New South Wales, Queensland and Victoria.

4.12 The Institute found that levels of financial stress were notably higher for renters in the lowest income quintiles, and a significant number of renters were unlikely to ever achieve home ownership.

**Table 4.2: Measures of financial difficulty for renters by income cohort**

		Lower Income		Higher Income		Total	
		No	%	No	%	No	%
<b>I worry constantly about my financial situation</b>	Agree	461	86	362	58	938	72
	Neither	47	9	115	18	185	14
	Disagree	27	5	148	24	187	14
<b>It is a constant struggle to pay regular bills</b>	Agree	390	75	223	37	702	55
	Neither	73	14	130	21	231	18
	Disagree	60	11	254	42	337	27
<b>My family has sometimes gone without meals</b>	Agree	88	26	41	9	143	16
	Neither	38	11	21	5	70	8
	Disagree	207	62	386	86	682	76
<b>I don't have enough money set aside to meet unexpected expenses</b>	Agree	443	84	335	55	889	70
	Neither	41	8	79	13	134	11
	Disagree	41	8	192	32	252	20
<b>My children have missed out on school activities such as excursions</b>	Agree	94	42	30	17	142	29
	Neither	27	12	16	9	54	11
	Disagree	105	46	128	74	288	60
<b>Costs put stress on household relationships</b>	Agree	201	61	130	34	393	47
	Neither	61	18	85	22	170	20
	Disagree	68	21	169	44	274	33

Source: T Burke, S Pinnegar, P Phibbs, C Neske, M Gabriel, L Ralston and K Ruming, Experiencing the housing affordability problem: blocked aspirations, trade-offs and financial hardships, *The Australian Housing and Urban Research Institute Research Paper No.9, December 2007*.

4.13 Table 4.2, taken from the study, shows that 86 per cent of all low income renters constantly worried about their financial situation, 75 per cent struggled to pay regular bills, 26 per cent sometimes went without meals and 42 per cent could not pay for school excursions. In comparison, as one would expect, levels of financial stress among higher income renters were much less intense.

4.14 The paper illustrated that a substantial proportion of renters in the lowest income quintiles were assigning a significant proportion of their income to housing costs.

## Trade-off between efficiency and equity

- 4.15 The *Workplace Relations Act 1996* assigns the Commission an over-arching objective of promoting the economic prosperity of the people of Australia.
- 4.16 The Government notes that the Commission interprets ‘economic prosperity’ broadly rather than narrowly and that the Commission considers an economically prosperous Australia to be one where those seeking work have ample opportunity to participate in employment and where a safety net mitigates against hardship.<sup>27</sup>
- 4.17 These statements point to the tension between the maximising employment prospects for job seekers on the one hand (efficiency) and provision of a safety net on the other (equity).
- 4.18 Stilwell and Jordan argue that the evidence of any such trade-off between efficiency and equity is inconclusive.<sup>28</sup> They argue that people’s willingness to participate cooperatively in the creation of social wealth depends on their expectation that the benefits of cooperation will be fairly shared.
- 4.19 They add that entrenched inequalities can undermine the necessary conditions for efficiency, productivity and growth within the economy. So in an efficiency-equity trade-off, inequity may endanger efficiency.<sup>29</sup> Stilwell and Jordan also cite research on cross-country comparisons by Kuttner<sup>30</sup> and Boreham, Dow and Leet<sup>31</sup> in support of the view that there is no trade-off between efficiency and equity. These studies found that some countries with relatively egalitarian income distributions perform better in terms of economic growth rates than do less egalitarian nations.<sup>32</sup>

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<sup>27</sup> Australian Fair Pay Commission, *Wage Setting Decision and Reasons for Decision*, 2007, page 10.

<sup>28</sup> F Stilwell and K Jordan, ‘Who Gets What? Analysing Economic Inequality in Australia’, 2007, Cambridge University Press, page 7.

<sup>29</sup> Ibid, page 187.

<sup>30</sup> R Kuttner, ‘The Economic Illusion: False choices between prosperity and social justice’, 1984, Houghton Mifflin, Boston.

<sup>31</sup> P Boreham, G Dow and M Leet, ‘Room to Manoeuvre: Political aspects of full employment’, 1999, Melbourne University Press, Melbourne.

<sup>32</sup> F Stilwell and K Jordan, ‘Who Gets What? Analysing Economic Inequality in Australia’, 2007, Cambridge University Press, page 187.

- 4.20 In the following section we examine how upcoming changes to the tax/transfer system will assist low income earners which is important in supporting the living standards of the low paid.

### **Recent taxation initiatives in the 2007-08 Budget**

- 4.21 This section examines how upcoming changes to the tax/transfer system will assist low income earners and are important in supporting the living standards of the low paid.
- 4.22 The Government recognises that the tax/transfer system has a significant role to play in alleviating income inequality and supporting the living standards of low paid workers.
- 4.23 From 1 July 2008, the Government will increase the 30 per cent income tax threshold from \$30,001 to \$34,001 and up to a level of \$37,001 for 2010-11.
- 4.24 The low income tax offset (LITO) will increase from \$750 to \$1,200. The LITO will continue to be withdrawn from the income level of \$30,000. Those eligible for the full LITO will not pay tax until their annual income exceeds \$14,000, an increase from the current level of \$11,000.
- 4.25 In 2007-08 the LITO is only available when a person lodges their tax return, which means that it cannot reduce the amount of tax withheld on their wages or salary through the year. From 1 July 2008, half of the LITO (up to \$600 in 2008-09 for those eligible for the full LITO) will be available through the year as reduced income tax withholding. This will mean that low-paid workers will receive around \$11.50 per week in additional after-tax income, although it would also result in a smaller refund (or a larger debt) when they lodge their 2008-09 tax return.
- 4.26 The LITO will increase from \$750 in 2007-08 to \$1,500 in 2010-11. As a result of these changes taxpayers eligible for the full LITO, that is taxpayers with an income up to \$30,000, will not pay income tax until their annual income exceeds \$14,000 for 2008-09, \$15,000 for 2009-10 and \$16,000 for 2010-11.

- 4.27 These measures will allow low income earners, including part-time workers, to keep more of their earnings and maintain their disposable incomes, provide further incentives for people to enter the workforce or work more hours and mitigate income inequality.
- 4.28 Compared with their income tax liability for 2007-08 and excluding the Medicare levy, a person on \$20,000 will have an income tax reduction of around 56 per cent and a person on \$50,000 will have an income tax reduction of around 18 per cent by 2010-11.
- 4.29 The personal income tax reforms will lift aggregate labour supply by around 65,000 persons in the medium term. The increase in the number of workers, together with the increase in the effort of existing workers, will make available around 2.5 million additional hours of work to the economy each week.
- 4.30 The Government will raise the level of assistance to families with child care costs by increasing the Child Care Tax Rebate from 30 per cent to 50 per cent and increasing the threshold from \$4,354 to \$7,500 per child per year. It will further assist recipients by paying the rebate quarterly rather than annually, providing more timely assistance. The first payments are due after the 1st quarter in 2008-09.

## **Conclusion**

- 4.31 At a time of economic prosperity, high employment and high workforce participation low paid households in Australia are experiencing significant financial stress.
- 4.32 The tax/transfer system has an important role in mitigating against income inequality. Changes to the tax/transfer system, due in July 2008, will have a positive impact on the incomes of low paid Australians.



# **Chapter 5: Effect of minimum wage increases on low skilled employment**

## **Introduction**

- 5.1 In determining the quantum of an increase in minimum wages, the Commission must have regard to the capacity for the low paid to obtain and remain in employment.
- 5.2 Chapter 2 provided evidence of strong employment growth for key groups in the labour market facing significant labour market disadvantage, which indicates that in the context of recent Commission decisions, the relationship between increases in minimum wages and reductions in employment outcomes has not been very evident.
- 5.3 This chapter provides a brief review of the economic literature regarding minimum wage increases and employment. The chapter also considers the need for the Commission to consider its decision in relation to both the demand for and supply of labour.

## **Minimum wages and employment**

- 5.4 Conventional labour market theory indicates that when the price of labour increases (due, for example, to an increase in minimum wages), there will be a decline in the demand for the labour of those employees affected and a substitution of other labour and/or capital.
- 5.5 There is a large body of research which suggests that a minimum wage which is set too high will constrain the employment prospects of low skilled workers and others who are most vulnerable in the labour market. On the other hand, other research has found that minimum wage rises have a negligible affect on employment.
- 5.6 In 2006, Neumark and Wascher published a comprehensive review of international literature on the effects of minimum wages on employment. The authors found that of the 86 international studies

surveyed, the vast majority indicated that minimum wage increases had a negative effect on employment.<sup>33</sup>

- 5.7 More importantly, Neumark and Wascher highlighted the sensitivity of the employment of low skilled groups to minimum wage increases. Studies which focused on low skilled groups found that their employment outcomes were adversely affected by minimum wage increases. However, Neumark and Wascher found differing estimates of the magnitude of this negative effect.
- 5.8 This is consistent with the findings of the Commission in its 2006 Minimum Wage Review decision. The Commission found that a number of studies indicate that a negative relationship exists between the level of minimum wages and employment in Australia. Further, the main conjecture rests not with whether or not a relationship exists, but the size of the negative relationship.<sup>34</sup>
- 5.9 Table 5.1 shows the increases in minimum wages determined by the AIRC and the Commission between 2002 and 2007, with a particular focus on the FMW. The FMW increased in real terms in all decisions except for 2007, when it maintained its real value for employees on the FMW, but not for all award or Pay Scale-reliant employees.

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<sup>33</sup> D Neumark and W Wascher, 'Minimum Wages and Employment: A Review of Evidence from the New Minimum Wage Research,' National Bureau of Economic Research, Working Paper 12663, November 2006.

<sup>34</sup> Australian Fair Pay Commission, *Wage-Setting Decision and Reasons for Decision*, 2006, page 8.

**Table 5.1: Increases in the FMW under the AIRC and the Commission over the past 6 years**

	<b>Australian Industrial Relations Commission</b>	Nominal increases in the FMW (%)	Real increase in the FMW (%)
2002	\$18 increase per week to all awards	4.4	1.5
2003	\$17 increase per week to all awards	3.9	1.2
2004	\$19 increase per week to all awards	4.2	1.7
2005	\$17 increase per week to all awards	3.6	1.1
	<b>Australian Fair Pay Commission</b>		
2006	\$27.36 increase per week in the FMW and all Pay Scales up to and including \$700 per week	5.6	0.8
2007	\$10.26 increase per week increase in the FMW and \$10.25 increase per week in all Pay Scales up to and including \$700 per week	2.0	0.0

Notes:

(a) Prior to the establishment of the Commission, increases in the FMW generally occurred on an annual basis. With the Commission's first two decisions, the periods between increases were 18 months and 10 months respectively.

(b) Real increases between 1997 and 2006 are calculated by deflating the increases in the FMW by the ABS All Groups – Consumer Price Index (CPI).

5.10 A significant proportion of low paid workers are employed by firms with fewer than 20 employees. According to HILDA data, 56 per cent of low paid employees were employed by firms with fewer than 20 employees in 2005 compared with 35 per cent of all employees.

5.11 Firms with fewer than 20 employees may find it harder to absorb increased labour costs associated with increases in minimum wages compared with medium and large businesses. In response to increased labour costs, businesses can react in a number of ways. They may seek to pass these increased costs onto consumers through higher prices for goods and services or limit the cost increase by reducing labour through a combination of shedding staff, reducing hours, and reducing hiring intentions. All of these actions would have negative impacts on the economy in aggregate terms.

5.12 The OECD noted in its 2007 Employment Outlook:

*While there is no clear-cut evidence that minimum wages affect aggregate unemployment (see OECD, 2006a for a survey of recent literature), available evidence suggests that high minimum wages can reduce demand for unskilled labour, relative to skilled labour,*

*thereby leading to substitution of skilled for unskilled workers, without any overall change in the employment level (Neumark and Wascher, 2006; Aaronson and French, 2007).<sup>35</sup>*

- 5.13 In line with existing strong labour market conditions, the pool of unemployed persons has increasingly lower skill levels. There have been significant increases in the numbers of unemployed who were recent immigrants, attending full-time education, or looking for their first job.<sup>36</sup> The percentage of unemployed who had never worked before increased from 17.1 per cent in November 2002 to 20.4 per cent in November 2006 and 24.8 per cent in November 2007.<sup>37</sup>
- 5.14 Given the widespread skill shortages, this could be more to do with an encouraged worker effect. The recent strength of the labour may have encouraged many people to start looking for work, including those with lower skills. The current unemployment situation may reflect an increasing supply of, rather than a decrease in the demand for, unskilled workers. The Government has substantial plans in place to address skill shortages as part of, and in addition to, its five point plan to tackle inflation.
- 5.15 It is important that the Commission carefully balances the need to promote the economic prosperity of the people of Australia, including providing a safety net for the low paid, with employment and competitiveness across the economy, including the requirements to avoid dampening the demand for labour or fuelling inflation.

## **Conclusion**

- 5.16 The majority of empirical research indicates that there is a negative relationship between minimum wage increases and employment. There is, however, disagreement over the magnitude of this relationship.
- 5.17 The Commission's decision must balance the need to encourage employers to hire low skilled employees with the need to offer minimum wages that encourage those not in employment to engage in paid employment.

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<sup>35</sup> OECD Employment Outlook 2007, page 72.

<sup>36</sup> There could be significant overlaps between these groups.

<sup>37</sup> ABS *Labour Force, Australia, Detailed, Quarterly, November 2007* (Cat. No. 6291.0.55.003).