

5. Economic Effects

5.1 Awarding the ACTU claim will have a negligible impact on inflation and employment. In chapter 3 we dealt extensively with the costing of the ACTU claim. In this chapter we deal with the likely economic effects of awarding the claim.

Aggregate Wages

5.2 The net addition to economy wide earnings as a result of the ACTU claim is of the order of 0.5% (the actual range is 0.45 – 0.56%). At this level the net impact on economy wide earnings is 0.2%.

5.3 The net impact of 0.2% on aggregate wages growth is properly described as “very limited”, that is as the Bench described its safety net adjustment last year; see *Safety Net Review Wages May 2001* PR002001 at 30, paragraph 86.

Inflation

5.4 We calculate the impact on inflation by reference to the wage cost share of total factor income from the most recent national accounts data (54.7% see ABS Cat. 5206.0). This gives a net impact on inflation of less than 0.1%. It is to be noted that any measures taken to offset the impact of the increase through productivity improvements would reduce this inflationary impact. In other words, on any view the impact of the ACTU claim on inflation is genuinely described as negligible.

Employment

5.5 In its past decisions the Commission has dealt with two main aspects in relation to the impact of any safety net increase on employment. These are:

- The macroeconomic effects, including the effect of a higher general level of real wages on economic activity and employment; and
- The microeconomic effects, including the extent to which wage increases which impose or accentuate a pattern of wage relativities different from that which would emerge from the market will cause structural unemployment.

See *Safety Net Review Wages – May 2001* PR002001 at 30, paragraph 89.

5.6 For the reasons already set out in chapter 3 the impact of the ACTU claim on aggregate real wages growth is limited. In this regard it is noteworthy that the relative standard error on the level of AWOTE is 0.7% and the relative standard error on the level of all employees AWE is 0.9%. The relative standard error on growth figures for each series is higher than the relative standard error on the level estimate. Seen in this context the 0.2% addition to net earnings calculated to arise from the ACTU claim falls within the range of measured error of AWOTE and AWE.

5.7 In terms of the microeconomic impact we note;

- The Commission's conclusion in previous cases that "moderate wage increases in the wages of the low paid, of themselves, do little or nothing to diminish job prospects";

- The wage increase proposed by the ACTU is moderate in the context of other community wage movements and in light of the recent history of safety net increases;
- There is simply no evidence that recent safety net increases have had any adverse impact on employment;
- There is good evidence of improvement in labour market performance after approximately 12 months of a weaker environment.

5.8 In previous cases the Commission has been taken to a significant body of academic work and empirical research regarding the impact of minimum wages on employment.

5.9 That extensive body of research points to a firming international consensus that moderate rises in minimum wages do not cause unemployment, or harm the job prospects of the unemployed. Further, the firming consensus is that effective minimum wage regulation assists low paid workers better meet their needs and, importantly, complements and underpins the effectiveness of the tax transfer system in targeting assistance to needy families.

5.10 Since the last Living Wage case, the Third Report (Volume 2) of the UK Low Pay Commission [LPC] has been released [*The National Minimum Wage, Making a Difference: The Next Steps* June 2001]. Earlier volumes of the LPC Reports have been tendered to this Commission in previous Living Wage cases.

5.11 In our submission, the work of the UK Low Pay Commission on minimum wages and employment is important in several respects:

- First, the LPC is broadly constituted with academic experts in the

field, employer and union representatives, with secretariat support.

- Second, the LPC has a substantial research budget and has commissioned a wide-ranging series of applied studies into the impact of the introduction of a Minimum Wage in the UK.
- Third, the LPC was established prior to the introduction of the UK Minimum Wage, and accordingly instigated research projects to measure the effects of the introduction of the UK Minimum Wage, having regard to the international literature and state of the art statistical techniques.
- Fourth, the evidence assembled to date by the LPC research shows that the introduction of the Minimum Wage in the UK (i) did not cost jobs; and (ii) did assist low paid workers.

5.12 Selected extracts from the latest LPC Report are included at Tag 8 of the Composite Exhibit.

5.13 In his Foreword to the Report, the LPC Chairman notes his Commission's conclusion that 'the National Minimum Wage has been a success', having 'benefited many workers without any discernible adverse impact on employment', with women accounting for some 70% of beneficiaries. [p vi, para 1]

5.14 Other notable findings include:

- *"While the minimum wage affects households across the income distribution, it has had most of its impact on the poorest working households"* [p x, para 4. See also Ch 3, tables 3.1 and 3.2]
- *"Young people have benefited from the National Minimum Wage*

without any discernible negative impact on their employment” [p ix, para 2. See also Ch 2] The LPC recommends extending the Minimum Wage to young adults at age 21 (a reduction from age 22), with further changes to be phased incrementally.

- *“A process for reviewing the National Minimum Wage at regular intervals will ensure that it continues to provide effective protection for low-paid workers and predictability for businesses.”* The LPC recommends biennial reviews; it should be noted that the LPC practice to date has been to report in February and recommend annual adjustment of the National Minimum Wage [see eg para 1.2 of the Report].
- There is clear evidence of the impact of the introduction of the National Minimum Wage, on the earnings of low paid workers [Appendix 2, figures A2.1 – A 2.4]
- An overview of LPC research projects is set out at Appendix 4.
- Appendix 6 provides an international comparison of minimum wage regulation, both as to regulatory mechanisms and levels of minimum wages.

5.15 Also included, at Tag 9 of the Composite Exhibit, is a paper commissioned by the LPC from Professor Mark Stewart, entitled “The Impact of the Introduction of the UK Minimum Wage on the Employment Probabilities of Low Wage Workers”. Professor Stewart lists his research interests as ‘Econometrics, Labour Economics’, and teaches at the University of Warwick. He has articles published in leading Journals, including the *Economic Journal* and *Economica* and official UK Treasury Occasional Papers, along with contributions in several books.

- 5.16 Professor Stewart uses three contrasting official data sources to *'estimate the impact of the introduction of the UK minimum wage in April 1999 on the probability of subsequent employment among those whose wages would have had to be raised to comply with the new minimum'*. He reports that *'the evidence suggests zero, or if anything small positive employment effects for adult men, young men and young women'*. Stewart reports the results for adult women are *'slightly less clear cut'* – one of the three datasets generates a (statistically insignificant) positive result; a second produces a (statistically insignificant, not robust) negative result; the third data set yields a negative result approaching significance, however *'the t-ratio is weak for a sample size approaching 300,000 and the case for a negative effect even for this group is not convincing.'* [extract from the Abstract]
- 5.17 Professor Stewart's paper is necessarily technical in several of its sections. He describes the three datasets in forensic detail, and carefully sets out his analytical approach including basic model construction and modifications to it designed to test for robustness in his results. However his findings are clear and concise: there is no hard evidence that the introduction of the National Minimum Wage in the UK costs low paid workers their jobs.
- 5.18 In our submission, Professor Stewart's findings for the UK are further evidence in support of the firming international consensus the fair minimum wages do not cost low-paid jobs.
- 5.19 The third and final paper at Tag 10 is entitled "Is the Minimum Wage an Effective Tool to Promote Decent Work and Reduce Poverty? The Experience of Selected Developing Countries", by Catherine Saget of the Employment Strategy Department of the ILO.

- 5.20 We accept that Saget’s focus on developing countries limits the particular relevance of her findings for developed nations.
- 5.21 Nonetheless, the generic issue of interest is the impact of minimum wages on employment (and on poverty alleviation). The difficulty of finding a statistically significant negative relationship between minimum wages and employment for adults has seen much of the research effort in developed country contexts directed to the impact of minimum wages on the employment of juniors. This reflects a view that the impact of minimum wages on the employment of juniors would be more significant, because juniors are less skilled and their employment more vulnerable to minimum wages set at too high a level. [The evidence is, nevertheless, ambiguous at best for advocates of the view that minimum wages cost young people’s jobs.] By similar argument, evidence from developing countries – where skill levels are lower and employment more precarious than in developed countries – is germane to the generic issue.
- 5.22 Saget provides a detailed overview of the literature on minimum wages and employment (and minimum wages and poverty), summarises a number of earlier empirical studies, and provides original empirical estimates of the relationships between minimum wages and employment from econometric analysis. Her findings are clearly stated:
- *“In all cases, we are unable to identify a significant effect of changes in the ratio of minimum wage to average wage that would explain variations in employment. Restricting the analysis to manufacturing employment or excluding specific geographic areas like Africa leads to the same conclusion.”* [page 16]

- “ ... we can say that there are indications that a higher minimum wage is associated with a lower level of poverty.” This assessment is qualified on two counts, however; first that countries with a higher minimum wage may also have higher commitment to the reduction of poverty and hence also have more developed social policies; and second, that the incidence of extreme poverty in developing countries is not negatively correlated with the level of the minimum wage (this perhaps having to do with non-compliance).

5.23 In summary, the Saget analysis provides no support for the view that minimum wages cost low-paid jobs.

5.24 In our submission, the growing body of literature on the effects of minimum wages on employment provides no support for any departure by this Full Bench from this Commission’s previously expressed conclusion that ‘moderate wage increases in the wages of the low paid, of themselves, do little or nothing to diminish job prospects’ [PR002001, p 32, para 98]

5.25 Finally, as we noted in our submissions last year, there is no evidence that safety net adjustments have impacted adversely on those industries which have the greatest proportion of award dependents. In the three industry sectors with the highest proportion of award dependents (Accommodation, Cafes and Restaurants – 65.2%, Health and Community Services – 37.1% and Retail Trade – 35.0%) employment growth has exceeded the All Industries average for the period August 1996 to November 2001. If minimum wage increases had had a significant employment effect we would expect to observe it in those industries with high concentrations of award only employees – we simply do not.

Conclusion

5.26 Consistent with the findings of the Commission in last year's decision, the economic outlook as a whole suggests that the economy can accommodate further reasonable improvements in the safety net of minimum wages. The contribution to aggregate wages growth from the ACTU's claim will have a limited effect on economic activity, inflation, employment levels and productivity. In the circumstances, the negligible economic effects of the increase sought allow the Commission to proceed with caution and confidence to award a substantive increase to the low paid, one which does something significant to ameliorate the harshness and hardship of the circumstances.

