

## **Overview**

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

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

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

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

## Inequality

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

The evidence of deep and growing economic divisions in the Australian community is overwhelming. Since the mid 1970s, the distribution of private income has become substantially more unequal and Governments have attempted (without success over the medium to long term) to prevent the gap from growing.<sup>1</sup>

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

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

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

### Earnings inequality among full-time employees

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

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

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

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

- There is no mechanism (except part-unemployment benefits, to a very limited extent) in place to top up the wages of low-paid single workers without children, who comprise a growing proportion of the population and a large proportion of low-paid workers. If the Government introduced a payment (or tax concession) for low-paid single workers, it would find itself in the position of directly subsidising employers of low-cost labour generally.<sup>2</sup> This would fundamentally change the role of Government and it has wide-ranging social and economic implications, many of them adverse. Such a step should not be taken lightly.
- Increases in Government transfers come at a cost. ACOSS considers that this fiscal price is worth paying where it leads to a significant and sustained reduction in poverty. However, if Government were to undertake *primary* responsibility for preventing poverty among low wage-earning households (for example, if minimum wages were sharply reduced and the difference was made up by public subsidies), the outcome would be an unsustainable increase in public outlays that would probably fail to significantly reduce poverty.
- No substantive action has been taken by Governments in recent years to reduce the impact of earnings inequality (or disposable income inequality) at the upper end of the distribution scale, or to support across-the-board wage restraint in order to boost employment.

## Poverty

The Australian wage fixing system, together with our system of family payments, has been very effective in the past in insulating low-paid workers and their families from poverty. Although only a small proportion of wage-earning households<sup>3</sup> live in poverty today, their number is steadily increasing, both in absolute terms and as a proportion to the population living in poverty.

The most recent data from the National Centre for Social and Economic Modelling, published by the Smith Family, indicates that in 2000, among households whose main source of income was wages, 365,000 people lived in poverty. Although this represented just 3.2% of people living in such wage-earning households, it represented 15% of all people living in poor households.<sup>4</sup>

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

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

<sup>4</sup> Smith Family, *Financial disadvantage in Australia*. (2001).

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

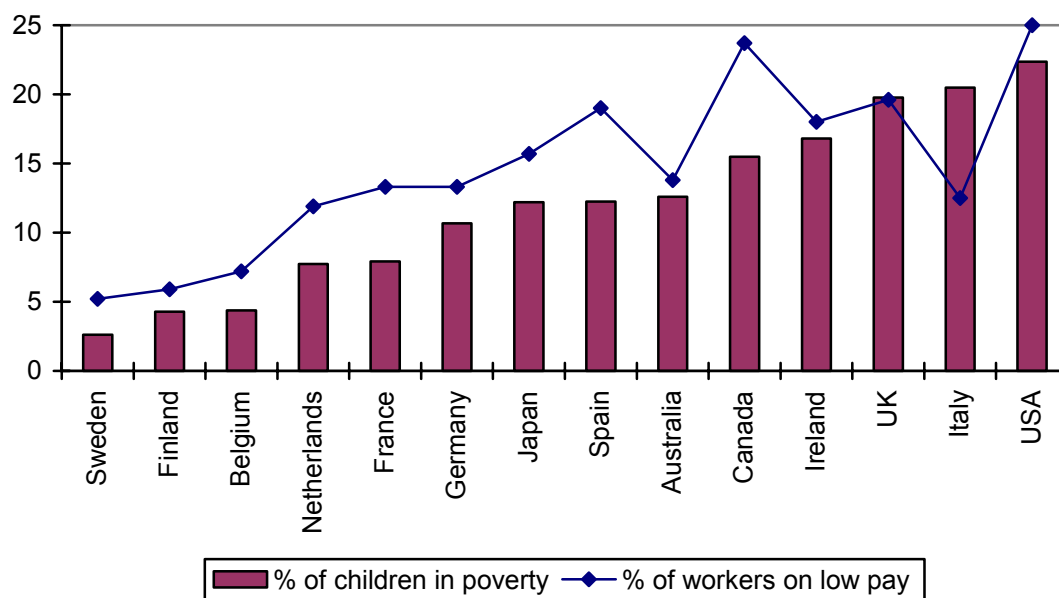
While it is true that Government transfer payments can be more precisely targeted towards low-income households at risk of poverty, decent minimum wages provide a critical "floor" for the incomes of many low-income households. Without this floor, Governments would struggle to prevent widespread poverty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

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

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

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

**Child poverty and low pay (1990s)**



Source: UNICEF (2000), *Child poverty in rich countries*. Florence.

Note: "Workers on low pay" refers to the % of full-time workers on wages less than 2/3 of the median. "Children in poverty" refers to the % of all children living in poor households, with the poverty line based on half median equivalent household disposable income.

This pattern is repeated in other international studies.<sup>5</sup>

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

## **Part time, casual and under-employed workers**

Adequate minimum wages are particularly important in sustaining a decent standard of living for the growing number of casual and part-time workers.<sup>6</sup> In addition, intermittent work has become a feature of life for many job-seekers, blurring the previous sharp distinction between employed and unemployed workers (the so-called "insiders and outsiders" of the labour market).

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

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

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

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

<sup>6</sup> Australian Bureau of Statistics 1999(a) "Australian Social Trends." 1999.

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

## Employment impact of changes in minimum wages

Although there is a relationship between wage levels and employment growth, there is considerable debate over the likely magnitude of the employment response to any decline in low wages. It has been suggested that deregulating wage setting for low-paid workers would yield only a small increase in employment<sup>8</sup>. Others argue that employment growth in Australia has been much less responsive to real wage reductions than was the case in the United States<sup>9</sup>. This suggests that very large reductions in real minimum wages would be required in Australia to substantially reduce unemployment, a conclusion that is reinforced by our experience with wage subsidies for unemployed people. Employers have often been reluctant in the past to take on disadvantaged job-seekers even where half their wage is subsidised by the Government.<sup>10</sup>

In our view, the Australian evidence suggests that *aggregate* wage restraint will be more effective than reductions in the *relative* wages of low-paid workers in reducing unemployment. Aggregate wage restraint imposed by the Accord in the 1980s contributed substantially to the strong employment growth enjoyed during that economic recovery.<sup>11</sup>

On the other hand, there is little or no evidence to suggest that greater *wage dispersion* between different groups of workers has helped reduce unemployment in Australia. Youth wages have fallen over the past few decades while their employment opportunities have diminished. In contrast, women's wage rates have increased relative to those of men at the same time that their employment opportunities have improved. Unemployment has increased over the past 30 years across all skill levels. These *increases* in unemployment have not been skewed towards low-skilled workers<sup>12</sup>, as we would expect to find if these workers had been priced out of the labour market by high minimum wages.<sup>13</sup>

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

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

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

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

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

<sup>12</sup> Although it is true that this group has consistently faced a higher risk of unemployment.

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

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

## **Distributional impact of changes in minimum wages**

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

The latter argument is based on Richardson and Harding's empirical work on the relationship between wages and household incomes.<sup>14</sup> However, it only holds (if it does at all) if retired households are included in the income distribution. This is misleading because household needs vary across the life cycle (and are much lower for most people after retirement), and there will always be a substantial gap between the average incomes of retirees and those of wage-earning households.

A more appropriate basis on which to locate low-paid workers within the household income distribution is to confine the analysis to households of workforce age. If this is done, the majority of low wage-earners clearly fall within the bottom half of the distribution<sup>15</sup>.

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

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

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

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

Moreover, an increase in rates of pay for married women whose husbands are also employed would probably reduce, not increase, household income inequality. This is demonstrated by studies showing that the large increase in (mainly part-time) employment among married women over the 1980s actually *reduced* household income inequality, despite the fact that it was mainly concentrated within two-earner households<sup>16</sup>.

## **Impact of changes in minimum wages on work incentives**

A major change in minimum wage levels will have a significant effect on work incentives, all other things being equal. We submit that this, along with the general relationship between the wages and social security systems, should be one of the factors that is taken into account in setting minimum wages. Otherwise, there is a danger that work incentives will be eroded, or that social security payments will be cut to prevent this outcome - leading to a sharp increase in poverty levels as was the case in New Zealand in the early 1990s.<sup>17</sup>

At present, *benefit rates* for people of workforce age in Australia are so low that they pose virtually no threat to work incentives. Benefit rates for single unemployed people are particularly low (\$233 per week as at February 2003, which includes the maximum rate of Rent Assistance). In July 2000, a single unemployed adult could expect to double his or her disposable income if he or she secured a full-time job at the minimum wage<sup>18</sup>, and that is probably still the case. The gap between the maximum rate of unemployment benefits for a couple and their disposable income if one partner earns the minimum full-time wage is much smaller, but still significant.

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

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

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

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

<sup>18</sup> Based on ACOSS calculations.

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

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

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

## **Benchmarks for adequate minimum wages**

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

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

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

Examples from countries such as Ireland, which have established official benchmarks and targets for the reduction of poverty, have highlighted both the social and economic advantages of this action<sup>19</sup>. The use of such benchmarks and targets is becoming more common in European countries as a result of their adoption by the European Commission.<sup>20</sup>

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

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

We also reiterate our arguments that such a benchmark should:

- be objectively constructed using contemporary social research methods and tested against indicators of actual living standards;
- set at a level that enables a single adult living alone to live in "modest comfort" and participate fully in society in accordance with contemporary community standards (that is, a benchmark that is significantly above poverty levels).

The benchmark should be based on the needs of a single person rather than a family. Although the original Basic Wage introduced following the Harvester judgement was fixed at a level that was just sufficient to prevent a family of four from falling into hardship, minimum wages have not been set on this basis for many years. It is more appropriate in present-day conditions for the social security system to meet the additional costs of raising children in low-income families - *provided* family income is underpinned by a minimum wage that is adequate to support the wage-earner<sup>21</sup>.

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

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

The "low-income" budget standards are arguably more appropriate for social security purposes than for wage fixing purposes, as they are set at a levels just sufficient to avoid poverty.

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

A more appropriate benchmark for wage fixing purposes is the "*modest but adequate*" benchmark for a single person of workforce age living alone and renting privately. The benchmark determined for this by the researchers stands at \$445 per week, after indexation for inflation<sup>22</sup>. This is a *consumption* benchmark, and as such it corresponds more closely to *disposable* income than gross income. The equivalent before-tax wage is approximately \$550 per week.

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

## Conclusion

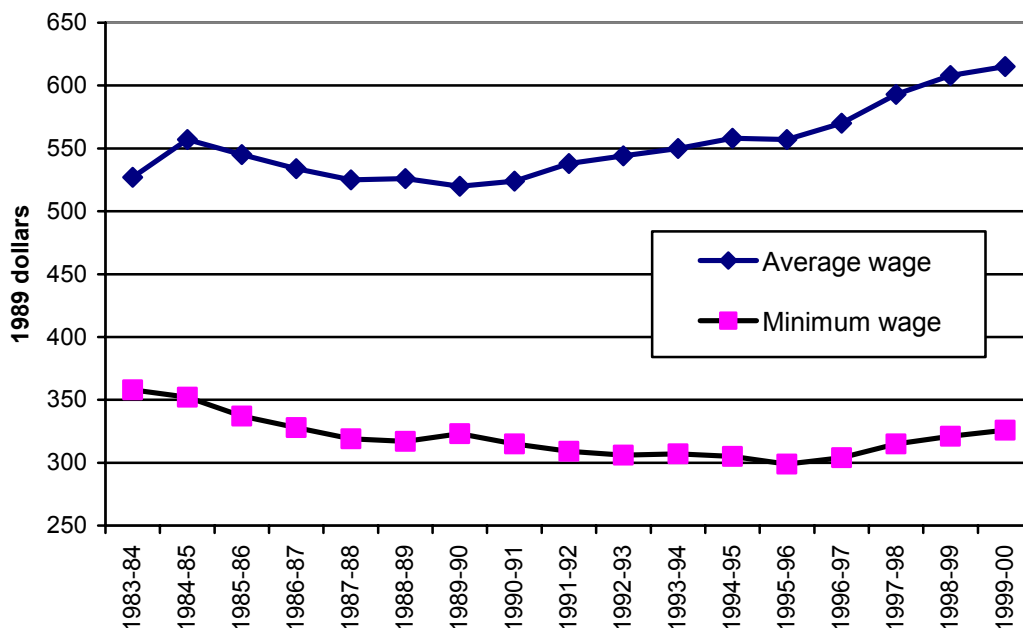
ACOSS believes it is essential that the award system continue to play a central role, along with the social security system, in protecting the living standards of low-paid workers and their families. A minimum wage benchmark that is not linked in some way with rates of pay for workers higher up the earnings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

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

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<sup>22</sup> Since 1998 when the study was published. See Department of Social Security, *Development of indicative Budget standards for Australia*. Research Discussion Paper No 74 (1998). This Budget Standard is for a single adult renting privately. The equivalent Budget Standard for a home purchaser is \$547 per week

### Real average and minimum wages (1983-1999)



Source: Dawkins P (2000), *The Australian labour market in the 1990s*. in Reserve Bank of Australia, *The Australian economy in the 1990s*.<sup>23</sup>

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

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

<sup>23</sup> Average wage refers to average weekly ordinary time earnings for full-time adults. Minimum wage refers to the base grade award rate in the Metal Industry Award up to 1997, and the federal minimum wage thereafter. These wages are indexed for inflation using the CPI and expressed in 1989 dollars. They should be increased by about 25% to bring them up to year 2000 values.