

2005 SAFETY NET REVIEW CASE



**Submission to the
Australian Industrial Relations Commission
by
The Australian Industry Group
and
Engineering Employers' Association, South Australia**

March 2005

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2005 SAFETY NET REVIEW CASE

Submission

1. Introduction

1. The ACTU begins its submission by expressing the view that the Commission's role in Safety Net Review Cases will change in the near future and that the Commission should take the opportunity to award a very large safety net adjustment of \$26.60 to create what it says would be a lasting difference to the lives of low paid workers.
2. Whether or not the current system of Safety Net Review Cases continues and, if not, what system replaces it remains to be seen. The Commission and all of the industrial parties obviously need to operate within the framework of the legislation that is in place at the present time rather than speculating about what may occur in the future.
3. At the present time, the *Workplace Relations Act* is in place and the Act sets out some clear objects to guide the Commission in carrying out its functions.
4. Such objects include the promotion of economic prosperity by encouraging the pursuit of high employment, improved living standards, low inflation and international competitiveness.
5. The Act's objects also emphasise the importance and primacy of agreement-making between employers and employees with regard to the determination of wages and working conditions.

6. The ACTU's claim is not consistent with the objects of the Act and therefore should be rejected by the Commission.
7. A safety net adjustment of \$26.60 would be unfair on employers struggling to compete in intensely competitive global markets, and cope with recent substantial increases in input prices.
8. Small businesses, in particular, would be amongst the worst affected because the statistics show that a high proportion of award-dependent workers are engaged by small businesses and that over-award payments are generally lower in such businesses.
9. In addition to the negative impacts on employers, a safety net adjustment of \$26.60 would be very unfair on low paid workers because it would:
 - Reduce their employment security; and
 - Increase the risk of further rises in interest rates for mortgages, credit cards and other loans, which would have a particularly harsh impact upon low paid workers.
10. The Commission needs to be very cautious this year. The economy is slowing and interest rates have recently risen. If the adjustment awarded is too high it will harm the very people that the safety net review process is intended to benefit – that is, the low paid.
11. Over the past year, the low paid – particularly those with children – have received massive increases in income support payments. The result is that a high proportion of low paid workers on award wages are better able to meet their needs today than they were a year ago.
12. The Commission needs to recognise that sweeping changes have occurred in society over the past 20 years concerning the interaction

between the wages, tax and tax transfer systems. The level of income support provided by Governments to workers has increased more than tenfold over the period and it is essential that the Commission adjust its wage setting approaches to take account of this.

13. Minimum wages are part of the broader social safety net. Whether minimum wages should be adjusted and by what amount needs to be considered in conjunction with other adjustments to the social safety net.
14. Given that income support payments have been increased so substantially in the past year, if the Commission is not prepared to take these adjustments to the social safety net into account in these proceedings, the question arises of when would the Commission ever regard changes to non-wage elements of the social safety net as being worthy of taking into account?
15. We submit that now is the logical and essential time for the Commission to give effect to its recognition in the past few Safety Net Review Decisions that minimum wage rates are part of the broader social safety net. The safety net adjustment that the Commission would otherwise have awarded in these proceedings should be substantially discounted to take account of the recent increases to income support payments.
16. Safety net adjustments provide a disproportionately small benefit to low paid workers whilst having a disproportionately harsh impact upon employers. On average, employers face costs of around double the amount received by low-paid workers from a safety net adjustment. In this context, given all of the risks, the Commission should adopt a cautious approach to increasing minimum wages and adjust minimum wages by the amount proposed by Ai Group rather than that claimed by the ACTU.

17. In determining the level of a fair and reasonable safety net increase, Ai Group submits that an \$11.00 per week increase would assist the low paid whilst not damaging the Australian economy.

2. Ai Group's Position

18. Ai Group's understanding of the ACTU's claim is as follows:

- An increase of \$26.60 per week in all award rates of pay;
- A commensurate adjustment of allowances which relate to work or conditions of employment which have not changed; and
- Absorption of safety net adjustments into existing above award payments.

19. Ai Group strongly opposes the ACTU's claim on the basis that:

- The claim is excessive and unsustainable;
- It ignores the fact that the economy is slowing, productivity performance is weaker and capacity constraints are emerging;
- If the claim was granted the consequent inflationary pressures would increase the risk of further interest rate rises, which low paid workers with mortgages, personal loans and credit card debts can ill-afford;
- The claim fails to take account of the fact that low income families have received massive increases in income support payments over the past year;
- Many people who are seeking work would be deprived of a job if the claim was granted and many existing employees would suffer decreased job security;
- The claim would damage the international competitiveness of Australian companies and it fails to take account of the fact that Australian workers in industries exposed to international competition (eg. the manufacturing sector) are amongst the highest paid in the world;
- It would have a disproportionately negative impact on small businesses;

- The claim comes at a time when many companies are endeavouring to cope with huge increases in input prices (eg. steel, fuel) and other cost pressures;
- The claim, if granted, would significantly out-strip current enterprise bargaining wage outcomes and diminish the primacy given to workplace bargaining under the *Workplace Relations Act*.

20. Accordingly, Ai Group proposes the following:

- A flat adjustment of \$11.00 per week;
- The adjustment to be applied to adult award rates with proportionate increases for juniors, trainees and apprentices;
- The adjustment to be payable from a date not earlier than 12 months after the operative date of the safety net adjustment in the relevant award flowing from the *May 2004 Safety Net Review Decision*, with no retrospectivity;
- The adjustment to be subject to full absorption into over-award payments.

3. Economic Conditions and Outlook

21. On 18 February 2005, the Governor of the Reserve Bank of Australia made the following statement in giving evidence to the House of Representatives Standing Committee on Economics, Finance and Public Administration¹:

“At some point in this phase where we believe inflation is heading up and where we think there are wage pressures and capacity constraints and demand is still running quickly further, interest rate increases will be needed”.

22. The ACTU in its assessment of economic conditions has argued that the AIRC should grant a minimum wage increase of \$26.60 based on the supposition, among others, that there is no evidence of inflationary or wage pressure in the Australian economy.²
23. While Ai Group does not seek to review the ACTU's reporting of current economic data on the Australian economy, it is what lies ahead that matters most. This point was strongly emphasised in the ACTU submission last year,³ but seems to have received less prominence in this year's submission.
24. Strong growth, rising employment, and low inflation have been achieved in recent years through solid domestic demand, productivity growing strongly, falling import prices and supply bottlenecks in the economy being largely avoided. In such an environment, wage adjustments have been able to be absorbed without excessive disruption to the economy.

¹ Testimony by Ian Macfarlane, Governor, RBA to the House of Representatives Standing Committee on Economics, Finance and Public Administration, 18 Feb 2005 – **Annexure 1**.

² ACTU submission, p.21.

³ ACTU's submission in the 2004 Safety Net Review, p.71.

25. However, as the RBA Governor, Ian Macfarlane has highlighted this scenario no longer holds true. After 13 years of uninterrupted growth, emerging supply and capacity constraints in the economy mean the risk of wages and inflationary pressures are greater, leading to the RBA recently deciding to increase official interest rates by 25 basis points to 5.5 per cent. In making the decision the Board concluded *“that an increase in the cash rate was warranted in order to reduce the risk of an unacceptable rise in inflation in the medium term”*.⁴ The Board expressed concerns about capacity constraints, inflationary pressures, and the strength of domestic demand, the implications of which are largely ignored in the ACTU's submission.
26. In such an environment, the granting of a \$26.60 minimum wage increase, equivalent to a 5.7% rise in the Minimum Wage, will add fuel to the fire regarding the argument for further interest rate rises.
27. The increase sought by the ACTU comes on top of a 4.2% increase in the Minimum Wage granted last year, well in excess of private sector enterprise agreements (3.7%) and overall movements in labour prices (3.6%) as measured by the Labour Price Index.⁵
28. The ACTU's proposed increase will not be backed by productivity improvements, which will add to the employers' bottom line wage bill at a time when skill shortages are putting added pressure on wages and costs. As the Federal Treasurer recently stated:
- “If we have wage increases that are not based on productivity improvements then we run the risk that inflation will increase. And having contained inflation to the 2 to 3 per cent band it is important that we keep it there”*.⁶

⁴ Statement by the Governor, Ian Macfarlane, Monetary Policy, 2 March 2005.

⁵ Department of Employment and Workplace Relations, *Trends in Federal Enterprise Bargaining*, December Quarter 2004 and Labour Price Index, December Quarter 2004, Cat No.6345.0.

⁶ Treasurer, Doorstop Interview, Parliament House, Canberra, Monday 7 February 2005, p.1.

29. As well, any gain a worker may obtain from a wage adjustment, could be more than offset by increases in interest rates. The 25 basis point lift in interest rates on 2 March resulted in a \$32 dollar a month increase in workers' mortgage repayments (based on an average mortgage of \$200,000).
30. The AIRC needs to be very careful in this year's case that its determination does not add pressure to concerns about wages and prices inflation, which would contribute to the case for further interest rate rises.

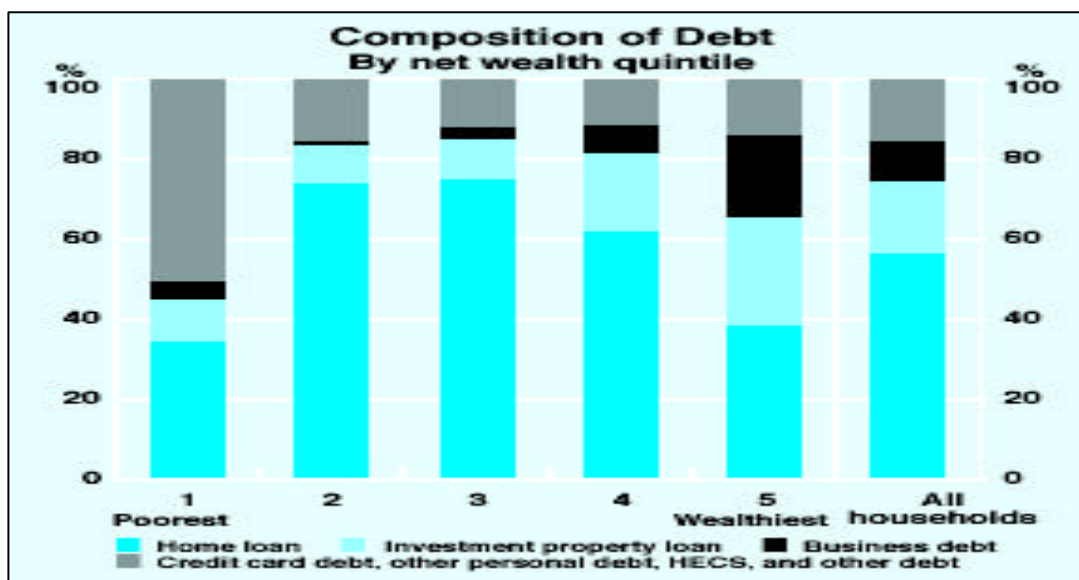


Chart 1 – Composition of Debt

Source: RBA

31. The low paid in particular are vulnerable to the adverse effects of further interest rate increases. About one third of households have no mortgage, based on RBA analysis of the ABS Housing Income and Labour Dynamics Survey. The debt-servicing ratio (interest payment as a proportion of household incomes) is at a historical high of 9.3% and set to rise further⁷. This ratio is calculated on all household income, but if account is taken of the proportion of household with no

⁷ Statement on Monetary Policy, February 2005, p.28 – Annexure 2.

debt, then the real debt-servicing ratio is likely to be substantially higher, particularly among the low paid. Further, as **Chart 1** above compiled by the RBA,⁸ highlights, mortgage debt tends to be inversely rated to household income, with house mortgages making up about 80% of debt for households in the second income quintile, compared to over 60% for households in the fifth income quintile.

32. Higher interest rates, of course, do not simply impact upon mortgages, they flow through to credit card debts, car loans, personal loans and so on. The vulnerability of the poorest households to increases in interest rates on credit cards and personal loans is starkly illustrated by **Chart 1**.
33. Of course, not only would low paid workers be affected by higher interest rates, many households and businesses would be affected, as higher interest rates flow across all sectors of the economy.
34. More than any other year, the Commission needs to be mindful of the RBA Governor's view of the need to try to "anticipate what is happening" rather than simply rely on what the official data says has happened.⁹
35. Why does Ai Group believe that granting a \$26.60 minimum wage increase is a major risk in this year's wage case? The reasons are set out below.

The economy is slowing

36. Most economic forecasts have the economy slowing throughout 2005. Indeed, the latest December quarter 2004 National Accounts suggest that Australia's economy grew by 0.1% in the December quarter 2004

⁸ The Composition and Distribution of Household Assets and Liabilities: Evidence from the 2002 HILDA Survey, RBA Bulletin, April 2004.

⁹ Testimony by Ian Macfarlane, Governor, RBA to the House of Representatives Standing Committee on Economics, Finance and Public Administration, 18 February 2005.

and by 1.5% over 2004, the lowest annual outcome since June 2001. In the most recent assessment of the Australian economy by the RBA Governor, he stated:

*“Despite its growth probably being understated, GDP is also starting to slow under the constraints imposed by capacity limitations. I think we have to get used to seeing GDP growth rates starting with the numbers 2 or 3 rather than 3 or 4 for a time”.*¹⁰

37. While (as the quote highlights) there is mixed economic data on the Australian economy and some doubts about the extent of its recent weaknesses as measured by the National Accounts, there is wide acceptance that the economy has slowed into 2005. Weaker growth will imply a greater constraint on employers’ capacity to cover wage adjustment than has been experienced in previous years.

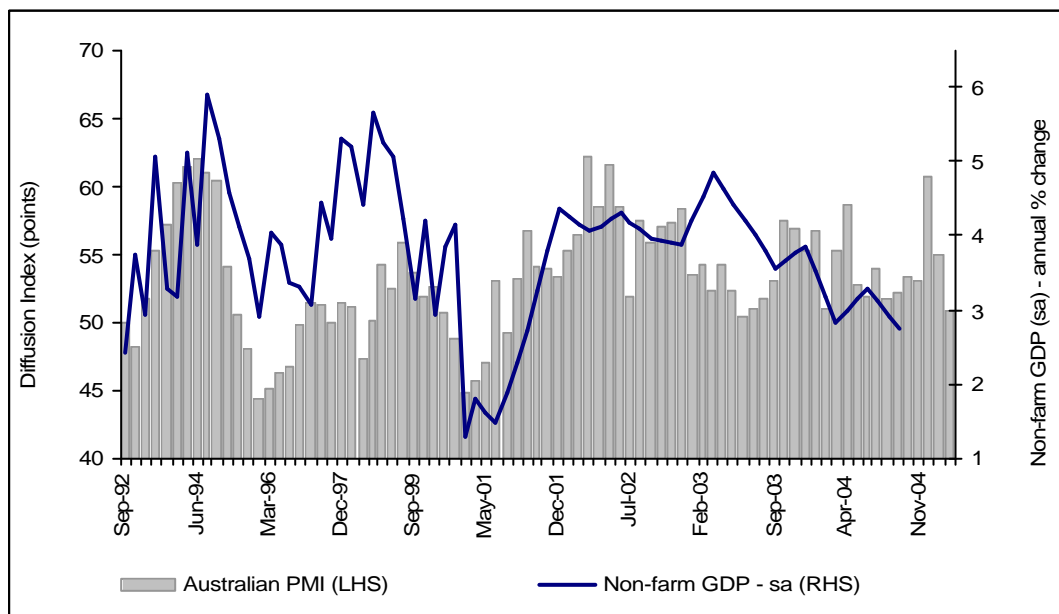


Chart 2 - Australian Performance of Manufacturing Index (PMI™), Australian Industry Group and PricewaterhouseCoopers.

¹⁰ Opening statement, Testimony by Ian Macfarlane, Governor, RBA to the House of Representatives Standing Committee on Economics, Finance and Public Administration, 18 February 2005.

38. Indeed, the Australian Industry Group's most recent readings of activity in the manufacturing and service sectors points to the economy slowing sharply in recent months. As set out in **Chart 2**, the Australian PMI™, measuring manufacturing conditions, has fallen by 10 points since the start of 2005, to a seasonally adjusted 50.8 in February 2005, only slightly above the critical 50-point mark. While a reading above 50 points indicate that activity is expanding; it is only barely growing. The slowing in activity has been affected by weaker domestic demand and declines in export earnings.
39. In the service sector, after strengthening steadily over the final quarter of 2004, services sector growth appears to have stalled in early 2005. The seasonally adjusted Australian PSI™ fell 4.8 points in February to 48.7 - the lowest level yet recorded - and following a 6.6 point decline in January (see **Chart 3**). The deterioration in activity in February was largely due to sharp contractions in both supplier deliveries and inventories, centred in the retail and wholesale trade sectors. Sales also contracted slightly - the first such occurrence recorded.

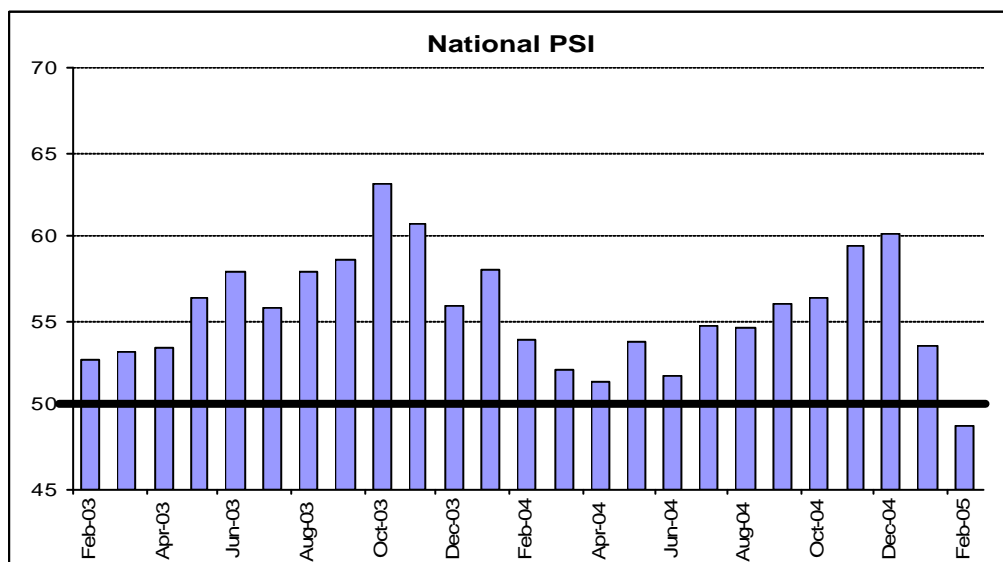


Chart 3 - Australian Performance of Services Index (PSI™), Australian Industry Group and Commonwealth Bank of Australia.

Productivity has slowed

40. The ACTU submission is misleading to imply that “average labour productivity growth since 1995 [has been] at a record high of 2.4 per cent per year”.¹¹
41. The Australian Bureau of Statistics and most economists examine productivity through comparing growth cycles. This is important in order to avoid the risk of comparing productivity in the early phase of the cycle (when it should be high) with productivity towards the top of the cycle (when it should be lower).
42. Indeed, the ABS in its annual National Accounts publishes such a table of comparison (**Annexure 3**). It shows that in the current growth cycle (from June 1999) labour productivity (on an hours worked basis) grew by 2.3 per annum compared to 3.2 per cent in the previous cycle period (1993/4 to 1998/9).¹² Most importantly, multifactor productivity (which measures the impact of technology change) has declined from 2.0 to 1.0 per cent per annum.
43. As well, rather than 2.4 per cent reported by the ACTU as being a record, the ABS table in **Annexure 3** shows that higher annual growth rates were achieved between 1964/5 and 1968/9 at 2.5 per cent, between 1968/9 and 1973/4 at 2.9 per cent, and as mentioned above, between 1993/4 and 1998/9 at 3.2 per cent.
44. The significance of our weaker productivity performance yet again highlights the increased difficulty for employers in absorbing wage adjustments without it adding to inflationary pressures. This is particularly so when the economy faces capacity constraints.

¹¹ ACTU submission, p.6.

¹² Australian Bureau of Statistics, Australian System of National Accounts, 2003-04, Cat No. 5204.0, Table 23, p.48 – **Annexure 3**.

Capacity constraints are emerging

45. The RBA, private business surveys and a range of economic commentators have highlighted the emerging signs of capacity constraint and its implications for wages and inflationary pressures.

46. As the RBA Governor highlighted,

*“[Capacity constraints] is something that is happening now, although it is a piecemeal process....For example, there has clearly been pressure on capacity in the building industry for some years ... Over the past year, many parts of the resources and heavy engineering sectors have also been at virtually full capacity ... Some parts of the service sector, such as accountancy and other professional services, are also fully stretched.... But overall we are hearing more reports of businesses finding difficulty in hiring suitable labour and having to pay more for material costs”.*¹³

47. In the manufacturing sector, Ai Group has highlighted that there are between 18,000 and 21,000 positions for skilled tradespersons in manufacturing that currently remain unfilled.¹⁴ The Housing Industry Association has recently called for additional skilled immigrants to overcome skills shortages in the construction sector, particularly in regional areas.¹⁵

48. As well, manufacturers over the last twelve months have experienced significant jumps in the cost of fuel and metal inputs. Indeed, flat steel prices, for example, have risen by over 30 per cent in the last twelve

¹³ Opening statement, Testimony by Ian Macfarlane, Governor, RBA to the House of Representatives Standing Committee on Economics, Finance and Public Administration, 18 February 2005.

¹⁴ Australian Industry Group, *Australia's Skill Gap, Costly, Wasteful and Widespread*, September 2004, p.5 – **Annexure 4**.

¹⁵ *HIA Seeks Skilled Migration Boost*, Housing Industry Association, 11 February 2005.

months¹⁶. Recent reports point to significant further rise in steel prices in 2005, with, for example, Japanese steel producers agreeing to a 71.5 per cent price increase for iron ore from Brazil, the world biggest producer¹⁷. As well, prices for light sweet crude have recently climbed passed \$US50 a barrel¹⁸.

49. Higher input costs are now starting to be reflected in producer prices, with immediate goods prices (that feed as inputs into production) having lifted from an annual increase of 1.6 per cent in the first half of 2004 to 5.1 per cent in the second half of the year.¹⁹
50. What is the relevance of skills shortages and cost pressures for minimum wage setting? In an environment where companies face these pressures, in a way not seen for many years, higher minimum wages without offsetting productivity gains can only end up feeding into higher prices and inflation. This adds to the weight of argument for the RBA to further lift interest rates, the worst possible outcome for the low paid.

Wage pressures have a long pipeline

51. The ACTU has argued that “*wages growth is moderate and there is no evidence of systematic wages pressures*”²⁰ as part of its justification for granting a wage adjustment for \$26.60.
52. However, the reason for the lack of wages pressure to date is because of the long lag time for it to show up under current wage setting. Greater market flexibility and setting of wage agreements for up to three years in length means that wage adjustment take longer to flow

¹⁶ CRU Steel Price Index.

¹⁷ *The Age*, Business Section, 23 February 2005, p.1.

¹⁸ The price hit \$US51.15 a barrel on 22 February 2005.

¹⁹ Opening statement, Testimony by Ian Macfarlane, Governor, RBA to the House of Reps Standing Committee on Economics, Finance and Public Administration, 18 February 2005.

²⁰ ACTU submission, page 61, and also pages 6 and 21.

through into inflation. This was acknowledged by the RBA Governor when he stated:

*“there have been important changes in wage setting arrangements that have meant that pressure in labour markets does not feed as quickly as previously into wage inflation”.*²¹

53. With unemployment down to its lowest level since late 1976 at 5.1 per cent, it is not unexpected that it should be asked whether the economy is operating close to full capacity, raising concerns that further reductions in unemployment may be at the expense of higher wages and prices inflation.
54. Consequently, the ACTU claim for a \$26.60 adjustment to minimum wages must be seen in a climate, as the RBA has identified, where wages pressures are mounting. Granting such a wage claim would add to these wages pressures.
55. In summary, the economic data and forecasts for 2005 suggest that wage adjustment unaccompanied by productivity increases are likely to add to wages and inflation pressures, particularly in an economy that is moving towards slower growth, weaker productivity and capacity constraints. The AIRC needs to recognise this reality in adjusting award wage rates.
56. Ai Group agrees with the ACTU in its previously held proposition that wage adjustments should be seen in terms of the economic conditions in which they will apply, namely the third quarter of 2005 and beyond.
57. With the RBA concerned about capacity constraints and signalling its intention to lift the cash rate further, granting a \$26.60 wage increase would only add to the case for a further interest rate rise. And under

²¹ Opening statement, Testimony by Ian Macfarlane, Governor, RBA to the House of Reps Standing Committee on Economics, Finance and Public Administration, 18 February 2005.

this scenario, all workers and businesses would carry the costs as interest rates are adjusted for home loans, credit card rates and business borrowings.

4. The Needs of the Low Paid and Changes in the Social Safety Net in the Past Year

58. In its *2004 Safety Net Review Decision*, the Commission agreed with Ai Group's argument that:

“Changes in income tax and income support arrangements that improve disposable incomes of the low paid are clearly relevant to the questions of whether, and by how much, minimum wages should be increased to address the needs of the low paid.”²²

59. In the *2002 and 2003 Safety Net Review Decisions*, the Full Bench stated that, in future decisions, it may be prepared to adjust the amount that it would otherwise award if significant adjustments were made in the social safety net. The following extract from the 2003 decision is relevant:

“[228] We also note AiG's submission that the Commission should accord greater recognition of the interrelationships between wages and the broader social safety net. We reiterate what we said in the May 2002 decision about this issue:

‘[153] For our part, we accept that significant adjustments in the social safety net may be relevant to the determination of the level of the award safety net. We note that there is no proposal on this occasion that we should adjust the amount that we would otherwise award because of a particular change in the social safety net.’

[229] We note that on this occasion there are again no specific proposals to make significant adjustments to the social safety net”.

²² *2004 Safety Net Review Decision*, Para 301.

60. Unlike in the few years leading up to last year's *Safety Net Review Decision*, in the past year there have been massive increases in income support payments. Accordingly, it is essential that the Commission reduce the safety net adjustment that it would otherwise have awarded in these proceedings to take account of such developments. If it is not prepared to do so:

- The statements made by the Commission in its 2002, 2003 and 2004 *Safety Net Decisions* expressing its preparedness to take changes in the social safety net into account, will not have amounted to anything of substance;
- There will be little incentive for Governments to search for more socially and economically superior ways of addressing the needs of low paid - while the existing system of regular *Safety Net Review Cases* remains in place;
- Weight will be added to the arguments of those who assert that the existing *Safety Net Review Cases* are incapable of adequately dealing with the interactions between the wages, taxation and tax transfer systems, and consequently that an alternative system should be created through legislative change.

61. The relevance of the social safety net to the needs of the low paid is fully borne out by the study by Michael Keating²³ that Ai Group brought to the attention of the Commission in 2004. The study shows that there have been dramatic changes over time in the level of Government income support. As Keating pointed out:

²³ Michael Keating (2004), "The Case for Increased Taxation", *Academy of Social Sciences*, 2004, pp.1-28.

*“[G]overnments have dramatically increased their income and other support to low income families. For example, in January 2003 a single income family with a dependent spouse and two children under five, earning two thirds of average male earnings and renting privately, received 46 percent of their net disposable income from government transfers. By comparison these transfers accounted for 41 per cent of that family’s income in January 1996, but only 4 per cent of their income in January 1983”.*²⁴

62. It can be seen that over the 20 year period leading up to January 2003, government transfer payments as a proportion of net disposable income of the above low income family unit increased from four percent to 46 per cent – a more than tenfold increase. It is essential that the Commission recognise these enormous societal shifts and adjust its wage fixing approaches to suit.
63. Significant changes to income support arrangements for families over the past year have further boosted the proportion of government transfers in household disposable incomes for low and middle income households with dependent children.

Major changes to the broader social safety net in the past year

64. Over the past year major changes have been made to income support arrangements in Australia. **Table 1** sets out some of the more important changes to income support arrangements over the past year.

²⁴ Keating 2004, p. 9.

Table 1 - Major Income Support Changes between 1 March 2004 and 28 February 2005²⁵

Measure	Nature of the Change
Family Tax Benefit A (FTBA)	
One-off supplementary FTBA payment	Every family eligible for FTBA received an additional \$600 per child in the middle of 2004.
Permanent (i.e. ongoing) supplementary FTBA payment	Both the maximum and the basic rates of FTBA were raised by \$600 per child payable at the time of the reconciliation of the 2003-04 tax assessment (i.e. generally in the second half of 2004).
Reduction in the income test applying to FTBA	The taper between the maximum and the basic rates of FTBA was reduced from 30 cents in the dollar to 20 cents in the dollar from 1 July 2004.
Family Tax Benefit B (FTBB)	
Relaxation of the threshold in the FTBB income test	From 1 July 2004 the threshold at which the income test begins to apply to the secondary earner in a family was increased from \$1,825 to \$4,000.
Reduction in the income test applying to FTBA	The taper applying to the second earner's income in the FTBB income test was reduced from 30 cents in the dollar to 20 cents in the dollar from 1 July 2004.

²⁵ All measures other than the additional increase in FTBB and the Child Care Rebate were announced in the 2004-05 Budget. These two non-Budget measures were foreshadowed in the *Better Assistance for Families* announcement by the Liberal/National Party Coalition on 26 September 2004. Following the election, announcements confirming and bringing forward these two measures were made by the Treasurer, on 22 December 2004, and by the Minister for Family and Community Services, on 9 February 2005.

Additional increase in FTBB	The amount of FTBB was increased by \$150 per year from 1 January 2005.
Maternity Payment	
A new maternity payment payable from 1 July 2004	This payment of \$3,000 per child born after 1 July 2004 replaced the former Maternity Allowance of \$833.52.
Child Care Tax Rebate	
Introduction of a rebate for child care expenses	The rebate covers 30 per cent of out-of-pocket child care expenses. The new scheme applies to expenses incurred after 1 July 2004. The Child Care Rebate is payable up to a maximum of \$4,000 per child per year.
Superannuation Co-Contribution Scheme	
Increase in maximum co-contribution amount	From 1 July 2004 the maximum amount of co-contribution paid by the Government was increased to \$1,500 pa when individuals make personal contributions to superannuation accounts of \$1,000 (an increase of \$500 pa).

65. The above changes to the social safety net have had a very large impact on the disposable incomes of a wide-cross section of the community and particularly for families with children.

66. Even the income tax changes made in 2004-05 budget, which were targeted towards reducing the impact of the high marginal tax rates applying to people with incomes above \$52,000 will favourably impact upon many award workers - either directly or because they are members of households which have received a direct benefit from these income tax changes.

Regular changes to income support arrangements in the past year

67. In addition to the major changes set out above, during the past year regular adjustments were made to basic rates of income support payments and thresholds. This second group of changes in combination raises the nominal incomes of income support recipients and should be included in any comprehensive assessment of the financial circumstances of the low paid.
68. In its *2004 Safety Net Review Decision*, the Commission appeared to adopt the view that the regular adjustments to income support payments and the thresholds in income tests are merely indexation adjustments and should not be taken into account when looking at the needs of the low paid.²⁶ This view, which is also repeated by the ACTU in its submission,²⁷ overlooks two important facts.
- These regular adjustments are highly relevant to assessing whether families are better off in real terms as a result of the total set of changes to their financial situations over the previous year. Changes in one component of incomes should not be excluded simply because of a belief that these changes simply preserve the real value of income support payments. Even if this belief was warranted, this exclusion would be equivalent, in a methodological sense, to excluding an indexation-based increase in wages from analysis of changes in a family's financial situation.
 - The second fact is that, in reality, for all families with incomes in bands over which income tests apply, the combination of regular changes in the amount of payment and the regular changes in

²⁶ 2004 Safety Net Review Decision, Para 303.

²⁷ ACTU submission, Para 7.53

income test thresholds delivers an increase in income support that is greater than the change required to maintain the real value of the benefit received. This is illustrated in greater detail in **Annexure 5**.

Impacts of changes in the social safety net

69. Ai Group has calculated the impact of some of the changes made to the social safety net between 1 March 2004 and 28 February 2005 on the disposable incomes of households of different types and at different levels of private income. The analysis of the impacts of these changes reveals a very different situation for households with and without children. This is a consequence of the explicit emphasis the Commonwealth Government placed on improving living standards for families with children through the significant changes in income support that took effect over the past year.

Families with children

The following examples of the changes experienced by families with children are drawn for the detailed tables presented at **Annexure 6**.

- These data **do not include** the impacts of the *one-off* change in FTBA; the much more generous Maternity Payment or the change in the Superannuation Co-contribution Scheme. They also do not include the benefits currently accruing to families with children from the new Child Care Rebate.²⁸
- **They do include** the substantial *permanent* changes to FTBA and FTBB payments, thresholds and income tests and the regular, inflation-related changes to FTBA and FTBB made over the past year.

²⁸ While these four measures are clearly relevant to the well-being of families with children, they are either not permanent; do not impact on current year disposable income or are not available to all families with children. Leaving them out of the calculations isolates the impacts of the permanent increases in disposable income.

Two-Parent Families with Two Children (see Tables 1 to 3 in Annexure 6)

For low-income, two-parent households with two children renting privately where total earned income is \$450.00 per week:

- A single income family with these characteristics has enjoyed a *permanent* increase in disposable income of **\$35.09** per week.

This is equivalent to an increase in pre-tax wages of **\$53.16** per week.

The household's disposable income increased by **5.5%** over the past year as a result of these permanent changes to income support arrangements.

- A dual-income family with both adults earning the same amount (\$225.00 per week) has enjoyed a *permanent* increase in disposable income of **\$46.60** per week.

This is equivalent to a combined wage increase of **\$68.53** per week.

The household's disposable income increased by **7.7%** over the past year as a result of these permanent changes to income support arrangements.

- A dual-income family in which one adult earns twice as much as the other adult has enjoyed a *permanent* increase in disposable income of **\$47.60** per week.

This is equivalent to a pre tax increase of **\$65.12** per week.

The household's disposable income increased by **7.6%** over the past year as a result of these permanent changes to income support arrangements.

Further, each of these families has received an additional \$1,200 (approximately **\$23** per week) in disposable income as a result of the one-off, additional Family Tax Benefit A payment of \$600 per child.

Two-Parent Families with One Child (see Tables 4 to 6 in Annexure 6)

For low-income, two-parent households with one child renting privately where total earned income is \$450.00 per week:

- A single income family with these characteristics has enjoyed a *permanent* increase in disposable income of **\$21.78** per week.

This is equivalent to an increase in pre-tax wages of **\$33.01** per week.

The household's disposable income has increased by **3.8%** as a result of the permanent changes to the social safety net.

- A dual income family with both adults earning the same amount (\$225.00 per week) has enjoyed a *permanent* increase in disposable income of **\$33.30** per week.

This is equivalent to a combined wage increase of **\$48.97** per week.

The household's disposable income has increased by **6.1%** as a result of the permanent changes to the social safety net.

- A dual-income family in which one adult earns twice as much as the other adult has enjoyed a *permanent* increase in disposable income of **\$34.30** per week.

This is equivalent to a pre tax increase of **\$46.92** per week.

The household's disposable income has increased by **6.1%** as a result of the permanent changes to the social safety net.

Further, each of these families has received an additional \$600 (approximately **\$11.50** per week) in disposable income as a result of the one-off, additional Family Tax Benefit A payment of \$600 per child.

Sole Parent Households (see Table 7 in Annexure 6)

For a sole parent households with one child and with wage income in the range between \$300 per week and \$450 per week:

- *Permanent* disposable income has increased by **\$37.78** per week due to changes in family income support arrangements.
- Because of the very high effective marginal tax rates faced by these households, this is equivalent to a pre-tax wage increase of **\$109.52** per week.
- These households' disposable income increased between **6.1%** and **6.6%** over the past year as a result of these permanent changes to income support arrangements.

Further, these families have received an additional \$600 (approximately **\$11.50** per week) in disposable income as a result of the one-off, additional Family Tax Benefit A payment of \$600 per child.

70. These examples and the more detailed data presented in **Annexure 6** illustrate that, for families with children, the changes to income support arrangements between 1 March 2004 and 28 February 2005 have clearly increased their capacity to meet their needs. Further, as the examples given above and the tables in **Annexure 6** suggest, households with dependent children are overwhelmingly better off in real terms as a result of changes in the social safety net that have occurred over the past year.

71. It should be recalled that the data on which this conclusion is based exclude:

- The one off additional FTBA payment made in mid 2004;
- The substantial increase in Maternity Payments;
- The increase in the superannuation co-contribution payment; and
- The currently accruing entitlements for families under the new child care tax rebate.

72. As a consequence, the data presented understates by a considerable margin the extent to which households with dependent children are better off than a year ago.
73. If the *2005 Safety Net Review Decision* applied only to income earners who were members of families with children, Ai Group could see no reason to grant an increase in safety net wage rates at all this year. The changes in family income support over the past year have significantly increased the real disposable income of families with children and have clearly improved the ability of low-paid members of families with children to meet household material needs.

Households without children

74. Most of the changes to the social safety net in the past year have targeted income support increases towards families with children. Family income support changes based on payments related to the households' responsibilities for dependent children provide no direct benefit for households without children. These include single person households; households in which adult partners do not have dependent children and share households of various kinds.
75. An important change made to the social safety net over the past year that has impacted on households without dependent children is the \$500 increase in the maximum payment made under the Superannuation Co-contribution Scheme. All lower-income Australians are eligible for this scheme in which a co-contribution of \$1.50 is made in support of each \$1 of personal contributions to superannuation accounts. The new level of maximum co-contribution is \$1,500 for lower-income people.
76. As it is part of the broader social safety net, the superannuation co-contribution payment available under this scheme should be taken into consideration in the evaluation of changes to the social safety net. This

is particularly the case for low-paid workers without responsibilities for, and the expenses associated with, dependent children. These workers have greater discretion over their income and are generally in a better position to save than low-paid people with children.

77. The following examples of the changes experienced by single people are drawn from the detailed tables presented at **Annexure 7**. The situation faced by single person households can serve as an indicator of general income changes faced by the broader range of wage earning households without dependent children.

Single Person Households

Low paid single people have not experienced increases in *disposable income* due to changes to tax and income support payments over the past year. However, single people are able to take advantage of the increased level of co-contribution under the Superannuation Co-contribution Scheme.

- A single person with earned income between \$425 and \$525 per week and making an unchanged level of personal superannuation contributions of \$19.20 per week has enjoyed an increase in total saving of **\$9.59** per week as a result of the higher co-contribution payment.
- In the absence of the increased level of co-contribution, to make extra saving of this amount from after-tax income would require an increase in pre-tax income of **\$14.87** per week.
- The increased superannuation co-contribution payment is equivalent to a rise in the combination of disposable income and the superannuation co-contribution of **between 2% and 3%** for the bulk of low-paid single income households without children.

Conclusion

78. The Commission accepts that changes to the social safety net are relevant to the questions of whether and by how much minimum wages should be increased to address the needs of the low paid.
79. Over the past year, changes to the social safety net have permanently boosted the real disposable income of households with dependent children. Even on the very conservative basis of assessment used in the preceding analysis, households with dependent children are, therefore, better able to meet their material needs than was the case a year ago.
80. As far as the needs of low paid people in households with dependent children are concerned there is no case for an increase in minimum award wages.
81. In households without children there has been no change in *disposable income* due to changes in the social safety net. However, a significant boost to the broader social safety net has occurred in the form of the 50% increase in the superannuation co-contribution payment.
82. The overall inter-temporal financial position of low-wage households without dependent children (including in relation to their capacity to meet future needs), has been roughly preserved in real terms by the increase in the superannuation co-contribution payment. Nevertheless, the capacity of families without children to take advantage of the superannuation contribution scheme has decreased due to the impacts of inflation.
83. While, in the absence of the substantial changes to the social safety net, there would have been a case for a larger rise in safety net changes, Ai Group submits that the Commission should discount the amount it would otherwise have granted to take into account these

social safety net changes.

84. Ai Group proposes a safety net adjustment of \$11 per week.

5. The Impacts of Increases in Minimum Award Wages on Low-skilled Employment Opportunities

85. Ai Group welcomes the apparent increased focus of the Commission on the impact of increases in minimum award wages on employment among low skilled workers. Ai Group also backs the Commission's support for more detailed analytical work to assist in illuminating the association between the level of minimum wages and the quantity of employment offered to minimum wage employees.
86. The Commission has noted the increased level of commentary about the employment impacts of Australia's system of highly structured minimum award wages by respected international agencies such as the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD).
87. In this Chapter of our submission we firstly bring a new study of joblessness to the attention of the Commission. This study, while not specifically directed at the impacts of adjustments to minimum wages on employment, is nevertheless highly relevant to the Commission's considerations on this important issue.
88. We also examine the comments made by the IMF and the OECD and the ACTU's criticisms of those comments. Notwithstanding the ACTU's criticisms, Ai Group submits that the Commission should take into account the important observations by the IMF and the OECD of the impacts of Australia's high minimum wages on the employment opportunities of the low skilled.
89. Finally, we note the important place that casual and part-time workers who would like to work more hours, play in the overall pattern of labour

underutilisation in Australia. We note the emphasis the ACTU places on this argument in other forums and seek to have the Commission extend its consideration of the employment impacts of minimum wage rises to embrace the underutilisation of casual and part-time workers.

90. In drawing attention to the nexus between minimum wage levels and job opportunities for the lesser skilled, Ai Group is not advocating a reduction in minimum wages.

Fred Argy's analysis of joblessness in Australia²⁹

91. In a very recent paper (see **Annexure 8**) the respected economist and policy commentator Fred Argy examined the dimensions and the nature of joblessness in Australia. His paper contains some welcome insights into the nature of the association between minimum wage levels and unemployment – particularly among the low skilled.

92. One of the more fundamental observations made by Mr Argy is that the official unemployment (and employment) data provide only a partial, and misleading picture of the extent of underutilisation of labour in Australia. Mr Argy points out that definitions of unemployment omit both under-employment and discouraged workers. The total of 800,000 “hidden unemployed” compares with, and is in addition to a “headline” level of unemployment of 600,000.³⁰

93. In total, about 1.4 million working age people are “underutilised” in the sense that they do not find sufficient opportunities to match their workforce expectations. Mr Argy argues that the relative significance of the hidden unemployed has risen over the past twenty years.³¹

²⁹ Fred Argy, 2005, “An Analysis of Joblessness in Australia”, *Economic Papers*, Vol.24, No.1, pp. 75-96.

³⁰ Argy, 2005, pp. 76-77.

³¹ Argy, 2005, pp. 78.

94. According to Mr Argy, the significance of the large and growing group of hidden unemployed is that impressions of declining unemployment over recent years:

“overstate the trend improvement in the labour market and understate the present level of labour underutilisation in Australia.”³²

95. Mr Argy classifies labour underutilisation into several categories. The two largest categories are “classical” and “structural”. The classical category describes underutilisation that arises because wages are too high relative to the rate at which employers can profitably engage workers. The structural category describes underutilisation arising from mismatches between the skill levels and location of potential employees and the requirements of employers.³³

96. In practice Mr Argy maintains that because labour market mismatches are “aggravated by rigidities in wage relativities” these two categories are best viewed in conjunction. Combined, according to Mr Argy, they account for over half (55%) of total labour underutilisation.³⁴

97. In line with the dominant role attributed to classical and structural labour underutilisation, Mr Argy also finds it concentrated among those with lower levels of workforce skills. Mr Argy finds:³⁵

“The people most vulnerable to long term joblessness or under-employment are the over 50 year olds, sole parents, indigenous Australians, people with disabilities and migrants with English as a second language.”

³² Argy, 2005, pp. 76.

³³ Argy, 2005, pp. 80-83.

³⁴ Argy, 2005, p. 84 and p. 80.

³⁵ Argy, 2005, p. 79.

98. Further, in the light of the dominance of the classical and structural categories of unemployment and in light of estimates of employment elasticities ranging between -0.15 and -1.0 , Mr Argy identifies Australia's high level of minimum wages as a causal factor in the persistently high level of underutilisation. He concludes that:³⁶

"Few economists believe that there will be no employment gain from appreciable real wage cuts, especially as Australia's minimum wage is high relative to median earnings by OECD standards."

99. While Ai Group does not advocate a reduction in the level of the minimum wage, we submit that two particular elements of Fred Argy's contribution to the analysis of joblessness should be taken into account by the Commission:

- The emphasis on a wider consideration of the employment impacts of minimum wages than merely the level of employment or unemployment should be adopted. In addition to the officially unemployed, discouraged workers and casual and part-time workers who would like to work more hours should be taken into consideration when assessing the full impact of minimum award wages on employment opportunities for lesser-skilled workers.
- The association between Australia's high level of minimum wage level and the underutilisation of unskilled labour is clearly relevant to the considerations of the Commission – and particularly to its considerations of the needs of the low paid.

100. On a number of occasions (for example in the *2004 Safety Net Adjustment Decision* at Paragraph 259) the Commission has made it very clear that, in considering the needs of the low paid, its attention is confined to low paid people in employment. The underutilisation of

³⁶ Argy, 2005, p. 83.

casual and part-time workers is clearly relevant to the consideration of the needs of the low paid. Of particular relevance is the potential impact of increases in minimum award wage rates on restraining the availability of additional hours of work for these low paid people in employment.

Recent IMF and OECD commentary on the employment impacts of Australian minimum wages

101. According to the IMF³⁷ Australia's minimum wage:

“has contributed to a relatively high unemployment rate for low-skilled workers.”

102. In the OECD's *Economic Survey of Australia*, 2004, the OECD implicitly accepted the same argument with the following recommendation.³⁸

“To further encourage participation and favour employment, the industrial relations system ... needs to be reformed so as to increase the flexibility of the labour market, reduce employment transaction costs and achieve a closer link between wages and productivity.... ‘Safety Net’ award wage increases should be guided by the productivity and thus employability of low-skilled workers.”

103. The OECD also observes that minimum wages in Australia, at around 58 per cent of median earnings for full time adult employees, are the second highest in the OECD and that they may, therefore:

³⁷ International Monetary Fund, Country Report No. 04/353, Australia: 2004 Article IV Consultation – Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, November 2004.

³⁸ OECD, *Economic Survey of Australia*, 2004, Policy Brief, p.7.

“constrain employment prospects for the low-skilled.”³⁹

104. It is critical to note that these statements are observations about a structural feature of segments of Australian labour markets (i.e. the lesser-skilled). The IMF’s statement, for instance, is not one that that could be challenged by evidence about the aggregate labour market performance in general or, more particularly, by observations of aggregate labour market performance over a limited period of the economic cycle.

The ACTU’s criticisms of recent commentary by the IMF and the OECD

105. In discussion of the IMF report the ACTU makes the following observations:⁴⁰

“It is extraordinary that there is no attempt by the IMF to provide empirical or other evidence to support the assertion that the establishment and maintenance of minimum wages ‘have contributed to a relatively high unemployment rate for unskilled workers.’ Nor is there any evidence that there is a high unemployment rate for low skilled workers relative to other workers. The Treasurer appears to be of the view that there are shortages of low-skilled workers.

Unemployment has continued to drop in Australia whilst participation levels have risen. The Treasurer and Prime Minister describe unemployment at close to its natural level. There is no evidence to support the claims made by the IMF. To the contrary the evidence is that the current system is working...[the ACTU Submission] correctly portray[s] the economy as vibrant with a positive outlook for continued growth and prosperity. The RBA’s more recent and informed view ... is

³⁹ OECD, Economic Surveys, Country Review, Australia, December 2004, p.157.

⁴⁰ ACTU Submission, Paras 8.18 and 8.19.

that employment and participation rates will continue to grow and measures of unemployment will decrease.”

106. In these comments the ACTU uses arguments about aggregate labour market performance in a period of cyclical buoyancy of the economy to challenge the IMF's statements about a structural feature of particular segments of the labour market. Inferences based on such evidence are inappropriate in this context. Observations about the aggregate performance of the labour market during a cyclical peak in performance are not relevant to assessing a claim about structural characteristics of particular labour market segments.
107. The ACTU arguments in relation to the IMF statement of the association between minimum wages and low-skilled unemployment are therefore misdirected and provide no reason to reject the IMF's statement.
108. The ACTU,⁴¹ in its submission, discusses in detail some of the issues raised in the OECD's *2004 Employment Outlook*.⁴² The ACTU's attention is devoted entirely to the chapter "Wage-setting Institutions and Outcomes" in which countries with widely varying wage setting arrangements are compared. The OECD report is very tentative about the support of the empirical evidence for a range of hypotheses regarding the link between different institutional arrangements and employment outcomes.
109. Ai Group submits that this tentativeness is not surprising given the nature of the study and because of the difficulties of controlling for the vast number of variables apart from institutional factors that influence employment outcomes in different countries at different times.

⁴¹ ACTU Submission, Paras 8.21 to 8.41.

⁴² OECD, 2004, *OECD Employment Outlook*.

110. One important difficulty with this study is that the measures of employment outcomes used are the rate of unemployment and the employment-population ratio.⁴³ Neither of these measures is entirely satisfactory because their measurement is not consistent across countries or even within countries over time. Some differences that are not captured in these measures include the proportions of casual, part-time and full-time employment; the measurement of “unemployment” and the availability of income support payments without work tests (which can influence the degree of hidden unemployment).
111. In view of the shortcomings of the study Ai Group agrees with the ACTU’s conclusion that the study is of very limited use in the context of the Commission’s interest in the employment impact for low-skilled workers of Australia’s high level of minimum wages.
112. In its comments on the latest OECD *Country Review of Australia*,⁴⁴ the ACTU points out that the AIRC has previously decided not to rely on evidence cited by the OECD in support of its claims. The ACTU expresses disappointment that:
- “The OECD has chosen to deal with the serious criticism of these works only within the endnotes of the report. We also note that there is no reference to the Commission’s independent finding that the reports were flawed.”*
113. While Ai Group appreciates that the Commission has a right to accept and reject academic studies as it sees fit, we can see no reason to accept the ACTU’s criticism of the OECD for not following the Commission’s lead and instead giving some weight to academic studies not accepted by the Commission.

⁴³ OECD, 2004, *Employment Outlook*, pp. 137-138.

⁴⁴ ACTU Submission, Paras 8.42 to 8.50.

114. This is particularly the case because the context of the Commission's deliberations implies that factors other than the usual criteria of intellectual rigour and standards of evidence may properly weigh on decisions to accept or reject particular arguments and evidence. These factors need not inhibit the OECD's consideration of the same evidence and argument because such consideration is completely independent from the unique context of the Commission's deliberations.
115. Further, even though the Commission has previously decided not to rely on some of the empirical material cited by the OECD study, Ai Group maintains that the study itself, and certainly the main lines of its arguments in relation to the association between high minimum wage levels and low skilled employment opportunities, should be taken into account by the Commission.

Further consideration of the IMF and OECD commentary

116. Unlike the ACTU, Ai Group does not take exception to the broad thrust of the statements by the OECD and the IMF in relation to the impacts of Australia's high level of minimum wages on employment opportunities for the low skilled.
117. Ai Group accepts the ACTU's arguments that the available empirical evidence does not provide incontrovertible proof of the association between Australia's high minimum wages and the employment opportunities faced by low skilled Australians. We do not find this surprising for the following reasons:
- It is always difficult, if not impossible, to "prove" with empirical measures the associations between economic variables - such as wages and employment levels – particularly when these variables are subject to influence from a variety of factors.

- The particular association under consideration can manifest itself in a variety of ways. The impacts of high minimum wages on the employment opportunities for low-skilled people may manifest themselves in high concentrations of unskilled people among the unemployed; in greater casualisation of the lower-skilled workforce and/or in the slower growth in low-skilled employment opportunities relative to employment opportunities in higher skilled occupations. Further, the relative importance of these different outcomes may change over time.

118. These considerations create considerable challenges when incontrovertible “proof” of association is required.

119. Even though the empirical evidence falls short of “proof” it is clear that both the IMF and the OECD accept the underlying logic of the association between high minimum wages and poorer employment opportunities for the low skilled than would otherwise apply.

120. In simple terms that economic logic can be summarised as follows:

- To the extent that Australia’s minimum wages are effective in propping up wages that would otherwise settle below the minimum, they will reduce the quantity of labour cleared in the market at the supported price.
- The impacts on employment opportunities are likely to fall heavily on less skilled workers who are likely to be over-represented in the population of people whose wages would have settled below the minimum.

121. Ai Group acknowledges the difficulties in obtaining incontrovertible verification of this logic. We submit, however, that these difficulties

provide no reason to reject the logic itself and that the Commission should give weight to the widely accepted nexus between minimum wage levels and employment opportunities for low skilled people.

122. Given the appeal of the logic of the association between high minimum wages and less favourable employment outcomes for the low skilled, Ai Group further submits that the Commission should consider insisting that the onus of proof be placed on those who would argue against the association between poor employment outcomes for low skilled people and high minimum wages.

Casualisation of the workforce and minimum wages

123. In its commentary on the IMF study cited above the ACTU makes the statement that, in relation to employment opportunities for low skilled workers, “the current system is working.”

124. In contrast to this assertion, the ACTU’s position in other places is that the current system is not working for large numbers of generally lesser skilled workers. The following statements are extracts from a speech delivered on 3 August 2004 by the ACTU Secretary Mr Greg Combet.⁴⁵

“One in three of all the net jobs created in the period of the Howard government have been casual with more than 40 per cent of all full time jobs in that period casual.

The explosion of casual employment is then simply the wholesale conversion of jobs which are regular and ongoing from permanent status to casual status.

The recent Job Futures Survey tells us that a majority of casuals would prefer permanent full-time or part-time work.

⁴⁵ ACTU Secretary Greg Combet’s Address to ACTU Casuals Conference, 3 August 2004.

ABS data tells us that whilst 28 per cent of employees are casual only 7.1 per cent indicate that their preferred working hours arrangements is casual or relief work.”

125. Further ACTU commentary on casualisation is set out in the ACTU’s *Fact Sheet on Casual Employment*.⁴⁶ According to the ACTU:

“37% of all casual workers want more hours of work because they need the income.”

Casualisation rates are highest in lowpaying industries and jobs:

- *59% of workers in accommodation, cafes and restaurants are casual;*
- *44% of workers in retail are casual workers;*
- *Only 14% of managers and administrators are casual - compared to casual rates of 60% for elementary clerical, sales and service jobs and 47% for labouring jobs.*

The most recent JOB Futures/Saulwick Employee Sentiment Survey found that 54% of casual workers would prefer permanent full time or part time jobs.”

126. As Mr Argy has made clear, a full picture of underutilisation of labour in Australia must take into account the extent to which part-time and casual workers are unable to find the number of hours of work they would like to undertake.

127. A clear candidate for at least a partial explanation of the extent to which part-time and casual workers are unable to find sufficient work is the high level of Australia’s minimum wages. In this connection it is

⁴⁶ ACTU, Fact Sheet, *Casual & Insecure Employment in Australia*, 2 August 2004.

instructive to note the ACTU's observations about the movements in minimum award wages over approximately the same time period as covered by the ACTU's data concerning increased casualisation. According to the ACTU website:⁴⁷

“Since that time [1997] the ACTU has won a \$100 increase in the minimum wage – a 10 per cent increase in real terms.”

128. The acceleration of the use of casual labour and the high underutilisation of the labour of casual and part-time workers that features so prominently in the ACTU's views outside the consideration of minimum wage rates is conspicuously absent from its arguments in these cases.
129. While the ACTU may be reluctant to bring its concerns with the underutilisation of casual and part-time labour to the present case, Ai Group submits that the picture those concerns paint of a significant underutilisation of unskilled segments of the labour markets remains highly relevant to the Commission's assessment of the employment opportunities of lesser-skilled workers. It certainly provides reason to suggest that, particularly in relation to the lesser-skilled, the current system may not be working all that well.
130. The association may not be countenanced by the ACTU and incontrovertible proof may not be at hand. Nevertheless, Ai Group submits that the Commission should consider the views of the IMF, the OECD and Mr Argy among many others about the likely impact of increases in minimum award wages on the level of employment opportunities for the low skilled.

⁴⁷ Downloaded on 8 March 2005 from
http://www.actu.asn.au/public/about/union_achievements.html

6. Interactions Between Wages, Taxation and Income Support

131. Ai Group has been a leading contributor in several recent Safety Net Review Cases regarding the interactions between the wages, income support and taxation systems. In this Chapter of our submission, we address the following issues relating to such interactions:

- The question raised by the Commission concerning an OECD mention of a possible impact of a fall in wage levels in the context of high effective marginal tax rates;
- A correction to the one-sided nature of the ACTU's treatment of effective marginal tax rates in its submission to the Commission;
- A comment on the "Harvester legacy" in the context of a suggested approach to the interactions between the wages system and the tax and social welfare system.

Downward wage flexibility and high effective marginal tax rates

132. The Commission has invited comment on an observation made by the OECD about the possible employment effects of downward wage flexibility in the context of interactions between the tax and income support systems.

133. In the OECD's *2004 Employment Outlook*⁴⁸ the following statement is made:

"Allowing downward flexibility for the wages of low skilled workers could do very little to increase employment should labour supply elasticity be high for this workforce segment. In many OECD countries,

⁴⁸ Organisation for Economic Cooperation and Development, 2004, *OECD Employment Outlook*, p.142.

the interaction of the tax system and income-tested benefits is such that the net income returns to working become very low (or even vanish) once wages fall below a certain level (Carone et al., 2004). In such a context, the main impact of downward wage flexibility may be to worsen inactivity, unemployment and low-pay traps, and the most effective way to bring more low skill workers into employment might be targeted subsidies or tax exonerations for employers of these workers.

134. This statement is a highly conditional hypothesis about a possible reaction in a possible circumstance. If wages fall and workers move into an income range over which they become insulated against significant loss of disposable income through tax and income support arrangements, some workers may react by withdrawing – either partially or fully - from the workforce. If this is a leading reaction (ie. if there is a high labour supply elasticity among low-skilled workers in general), the net impact of the wage reduction on employment levels *may* be small.
135. The statement contains a number of assumptions that may or may not be satisfied. For instance, there is an assumption that entitlement to income support remains unchanged when people voluntarily withdraw from the workforce. This may occur when income support payments are not conditional on recipients actively seeking employment.
136. There are also key assumptions made about the proximity of the previous wage level and key thresholds in the income tests for income support payments.
137. If, for instance, the income support threshold was at a higher level than the one assumed, the phenomenon of withdrawal from the labour force may also have been evident at the higher wage level and the reduction in wage rates may have little additional impact.

138. Conversely, if the income test threshold remained below the level of wages once they have fallen, the reaction posited above may not occur at all.
139. Further, as may happen in the case of Australia's family income payments, a reduction in wage rates could result in family income falling below the income test threshold. A reduction in wages in this circumstance would be associated in a reduction in effective marginal tax rates and may induce a very different response from the one posited above.
140. Even given the assumption of a high elasticity of labour supply (i.e. workers readily change the quantity of work sought when wage rates change), the overall impact on employment depends also on the elasticity of demand (i.e. how readily employers change the level of employment on offer when wages change). The possible net impact hypothesised above is one of several possible outcomes even if the elasticity of labour supply is high.
141. The statement in the OECD's *2004 Employment Outlook* certainly cannot be taken to be descriptive of a general result. It is one of many possible outcomes that may hold true under highly stylised circumstances. Ai Group submits that the Commission should not give this particular possible outcome weight unless it also considers the full range of other possible outcomes of variations in wages.

Effective marginal tax rates and the benefit to cost ratio of increases in minimum wages

142. Ai Group notes that the ACTU submission presents material⁴⁹ that it claims supports the conclusion that "the Commission can have confidence that safety net adjustments are not substantially eroded by

⁴⁹ ACTU Submission, Paras 7.15 to 7.41.

the effects of the tax and transfer systems.”

143. With regard to the material presented by the ACTU, Ai Group notes:

- The ACTU case is essentially a semantic one and that its conclusions depend on an arbitrary definition of what “substantial” means;
- More importantly, the ACTU argument overlooks a complete set of interactions between the tax, income support and wages systems – namely the additional non-wage costs face by employers;
- Ai Group does not seek to contradict the modelling work prepared by NATSEM. It does, however, reject the narrow interpretation of NATSEM’s work by the ACTU.

144. There is a substantial wedge between costs borne by employers and benefits received by employees in the form of increases in disposable incomes.

145. In **Annexure 9**, Ai Group presents a number of tables that indicate the range of benefit to cost ratios that arise due to the interaction of the effective marginal tax rates faced by low-income people and additional non-wage costs borne by employers.

Benefit to Cost Ratios arising from the Interactions between Wage and Non-Wage Costs and Effective Marginal Tax Rates

The following examples are drawn from the tables in **Annexure 9**.

For a single income, two-parent family with two children earning between \$425 and \$575 per week, the benefit to cost ratio of a rise in minimum award wages ranges between 40% and 60%. This means that for these households, safety net wage increases raise disposable incomes by between 40% and 60% of the additional costs borne by employers.

For sole parent households earning between \$300 and \$650 per week, safety net wage increases raise disposable incomes by between 17% and 30% of the additional costs borne by employers.

For single person households earning between \$425 and \$700 per week, safety net wage increases raise disposable incomes by between 51% and 56% of the additional costs borne by employers.

146. The benefit to cost ratios of increases in minimum award wages vary in a range centred around 50%. In other words, the costs to employers of increases in safety net wage rises for low paid people are, on average, about twice as great as the level of benefits received by low paid households.
147. Ai Group submits that this represents a substantial wedge between the extra costs of employment and the extra benefits received by employees and that the Commission should take these low benefit to cost ratios into account when assessing the overall cost and benefits of its decisions. This is particularly the case when assessing the responsiveness of employers to award wage increases. Employers respond to the total cost increase implied by decisions to raise minimum award wages.
148. Contrary to the argument presented by the ACTU, that there is not a substantial erosion of resources involved as a result of interactions between the wages, tax and transfer systems, the tables in **Annexure**

9 show that the benefit to cost ratio of increases in minimum award wages is small and that only about half the extra costs borne by employers are received in the form of higher disposable income by low income people.

149. Few would attempt to argue that this is not a substantial erosion of resources expended in order to address the needs of the low paid. The low benefit to cost ratios come on top of the widely appreciated dispersal of wage increases directed to meeting the needs of the low paid towards middle and higher income households as a result of the workforce participation of second income earners.

150. The AIRC has acknowledged the existence of the wedge described above. In its *2004 Safety Net Review Decision*, the Commission said:

“[308] As noted in the May 2003 decision, the Commission acknowledges that increases in award wages are a blunt instrument in addressing the needs of the low paid in employment. We accept that a significant number of households with minimum wage earners lie in the middle or high income bands. Moreover, we recognise that adjustments to award wages are a relatively inefficient means of increasing the disposable income of the low paid. On-costs mean that for every dollar awarded by the Commission, employers must spend more than \$1, whereas the impact of tax and tax transfer arrangements means that, in many cases, the employee receives substantially less than \$1 as additional disposable income...”

Minimum wage increases, the social safety net and the Harvester legacy

151. In its submission,⁵⁰ the ACTU describes the AIRC's Safety Net Review Cases as being part of what it terms the "Harvester legacy". At the centre of this legacy is the Harvester standard based on the wage required for a sole bread winner with a dependent spouse and three children to maintain the reasonable standard of living.

152. Since the *1997 Safety Net Review Case*, where the issue was canvassed in depth, the Commission has consistently rejected the notion of a "living wage" as a basis for reviewing minimum rates of pay. Rather, the Commission has recognised that a broad range of factors bear upon the assessment of an appropriate safety net increase, including:

- The capacity of firms to pay;
- The impact of international competitiveness upon Australian industry;
- Community living standards;
- The objective of encouraging the making of enterprise agreements; and
- The needs of the low paid.

153. Notwithstanding the Commission's sensible approach of not endeavouring to determine a "living wage" - as set out in Chapter 4 of this submission, the Commission over recent years has recognised the importance of the interrelationships between wages and the broader social safety net.

⁵⁰ ACTU Submission, Paras 1.2 and 1.13.

154. Over the past twenty years in particular the income support component of the social safety net has become a much more significant contributor to family well-being.⁵¹
155. These societal changes raise significant questions for the Commission in its consideration of the role of minimum wage increases in addressing the needs of the low paid. It is fair to say that, to date, these questions have not yet been resolved by the Commission. Ai Group therefore welcomes the ACTU's interest in this area as a contribution towards the development of a more coherent and rigorous approach to the interactions between the wages system and the social safety net.
156. In its discussion of the nature of safety net adjustments and the income support system,⁵² the ACTU puts forward the proposition that minimum wage adjustments and the broader social safety net should be considered as complements rather than substitutes. Ai Group supports this proposition. It is one that has been reflected in Ai Group's submissions to Safety Net Review Cases over several years.
157. Ai Group has encouraged the Commission to take into account the interactions between the social safety net and minimum wage adjustments in its decisions about minimum wage increases. We welcome the recognition of the Commission and the ACTU that the two systems need to be considered jointly.

⁵¹ As set out in Chapter 4, over the past 20 years, government transfer payments as a proportion of net disposable income have increased more than tenfold.

⁵² ACTU Submission, Paras 7.55 to 7.61.

Relative effectiveness of minimum wage increases and adjustments to the social safety net in addressing the needs of low income Australians

158. The ACTU refers to a point raised by Ai Group on a number of occasions that the needs of the low paid are better addressed through the broader social safety net rather than through adjustments in minimum wages.⁵³ The ACTU addresses this point by arguing that safety net adjustments are not substantially eroded by effective marginal tax rates.

159. In light of the ACTU's characterisation of Ai Group's position, there is a need to re-state some of the main grounds on which Ai Group bases its argument about the relative ineffectiveness of minimum wage adjustments, compared to other changes to the social safety net:

- As shown in the previous section, the combination of effective marginal tax rates and non-wage costs faced by employers implies that only about half of the cost of minimum award wage increases is received in the form of higher disposable incomes by wage earners. Changes to the social safety net, however, particularly when they are in the form of non-taxed benefits such as Family Tax Benefits A and B, are not subject to the same erosive forces as wage rises.
- As has been observed many times, a substantial proportion of low paid wage earners are members of middle or higher-income households. Higher wages paid to all low paid workers are a less effective way of directing resources to low income households than changes to the social safety net. The latter are targeted using a family income test that is not available under the wages system.

⁵³ ACTU Submission, Para 7.60.

- As discussed in Chapter 5, there is a strong argument to suggest that Australia's high minimum wages are associated with less employment opportunities for the low paid than would otherwise be the case. To the extent that annual adjustments to the safety net maintain and raise minimum wages, they impose costs on sections of the community that would not arise if the needs of the low paid had been addressed through the tax and transfer system.

160. Ai Group appreciates the importance of resolving the nature of the relationships between the social safety net and minimum wages. However the ACTU's characterisation of the argument about the relative effectiveness of wage adjustments and changes to the tax and transfer system is clearly inadequate. This issue calls for a much more open and balanced treatment than that provided by the ACTU in its submission in these proceedings.

7. International Competitiveness and Labour Costs

161. Australian industry is now, more than ever before, competing in a globally connected world economy characterised by high levels of competition and intense pressures on prices.
162. The industrialisation of China, in particular, is presenting a major challenge to Australia's manufacturers in both the domestic and export markets. The emerging challenges posed by the rapid economic development of India are being felt by Australia's information and communication technology (ICT) companies. Over the next 10 years, these two countries, each over sixty times our size are set to rapidly grow and massively expand their export activities.
163. The pace of growth and the extent of the challenges that lie ahead are indicated in the following statistics:
- China currently has 15,000 highway projects underway covering 162,000 kilometres of road – enough to circle the equator four times;
 - China will produce 325,000 engineers this year. This is five times as many at the US;
 - In 2003 China accounted for 40% of global cement consumption; it accounted for 30% of the growth in oil demand; 90% of the growth in steel demand and 99% of the growth in demand for copper.
164. The competitive pressures facing Australian businesses extend well beyond those emanating from the emerging giants of China and India. Australian competitiveness is being called into question even when assessed against that of other developed countries.

165. The challenges to Australia's competitiveness among other developed countries are borne out by data in the latest edition of the OECD's *Taxing Wages* publication.⁵⁴ According to the OECD's measures of the wages of average production workers, on a purchasing price parity basis, Australia's wage levels in the manufacturing sector are the highest of the 30 OECD countries. This is evident from the OECD Table reproduced below.⁵⁵

Table 2 – Wage Levels of Production Workers in Various Countries

Table I.2. **Income tax plus employee social security contributions¹**
(as % of gross wage), 2004

Country ²	Income tax (1)	Social security contributions (2)	Total payment ³ (3)	Gross wage earnings ⁴ (4)
Australia	24.3	0.0	24.3	38 330
Denmark	30.6	10.6	41.2	37 582
Belgium	26.6	14.0	40.5	35 622
Germany	19.6	20.9	40.5	35 203
United States	16.5	7.7	24.2	34 934
Switzerland	9.8	11.1	20.9	34 411
Netherlands	8.5	25.8	34.4	34 062
Canada	17.8	6.9	24.7	34 038
Norway	20.9	7.8	28.7	33 221
Korea	2.2	7.1	9.3	33 207
United Kingdom	15.9	8.5	24.4	32 896
Luxembourg	8.9	13.8	22.7	31 525
Japan	5.9	11.6	17.4	31 194
Iceland	25.5	0.2	25.7	30 449
Finland	24.2	6.1	30.3	29 979
New Zealand	20.7	0.0	20.7	28 228
Ireland	10.6	5.0	15.7	27 301
Austria	10.8	18.0	28.8	26 617
Italy	18.6	9.2	27.8	26 303
Sweden	24.0	7.0	31.0	26 078
France	13.1	13.6	26.7	25 459
Spain	12.7	6.4	19.0	22 497
Greece	0.6	16.0	16.6	17 287
Turkey	15.4	15.0	30.4	16 463
Poland ⁵	6.1	25.4	31.5	14 381
Czech Republic	11.4	12.5	23.9	14 366
Portugal	5.6	11.0	16.6	13 033
Slovak Republic	7.9	13.4	21.3	10 322
Hungary	12.4	13.5	25.9	9 671
Mexico	3.0	1.5	4.5	9 104

1. Single individual without children at the income of the average production worker.

2. Countries ranked by decreasing gross wage earnings.

3. Due to rounding total may differ from aggregate of columns for income tax and social security contributions.

4. Dollars with equal purchasing power.

5. A submission was not received from this country and consequently the tax/benefit structure for this country has been updated using external data sources. Given the potential for error, the reader should use caution in interpreting the results.

Source: OECD calculations based on country submissions.

⁵⁴ OECD, 2005, *Taxing Wages 2003-2004*.

⁵⁵ OECD, 2005, *Taxing Wages 2003-2004*, p.14.

166. The OECD data show that gross wages paid to average production workers are higher in Australia by a considerable margin even relative to other OECD countries. This is borne out starkly in **Table 3** below in which the gross wages received by an average production worker in a number of other OECD countries are compared with the Australian wage level. On a purchasing power parity basis, Australian wages are nearly 10% higher than in the United States; more than 15% higher than in the United Kingdom and over 35% higher than in New Zealand.

Table 3 - Comparison of Gross Wages Paid to Average Production Workers

	Gross wage of an average production worker, \$US (adjusted for purchasing price parity)	Margin by which the gross wage paid to an average production work in Australia (\$38,330) exceeds this
US	34,934	9.7%
Korea	33,207	15.4%
UK	32,896	16.5%
Japan	31,194	22.9%
NZ	28,228	35.8%

167. These comparative wage data point to the importance of elevating competitiveness and productivity to the forefront of considerations about Australia's existing labour market arrangements and, in particular, about the potentially severe implications of adjustments to minimum wages of the order of magnitude advocated by the ACTU.

8. Disproportionate Negative Impacts of Safety Net Adjustments on Small Businesses

168. In its *2004 Safety Net Review Decision*, the Commission identified that award-reliant employees are:⁵⁶

- Generally paid less than the rest of the working community;
- More likely to be women;
- Concentrated in three industry sectors: accommodation, cafes and restaurants; retail trade; and health and community services;
- Overwhelmingly employed in the private sector; and
- Overwhelmingly employed in non-managerial occupations and concentrated in lower-skilled occupations.

169. The above characteristics of award-reliant employees were drawn from ABS Cat. No. 6306.0. However, this statistical catalogue shows that there are two other important characteristics of award-reliant employees that were not mentioned by the ACTU in its submission, nor by the AIRC in its *2004 Safety Net Review Decision*. That is:

- A much higher proportion of award reliant employees are engaged in small businesses; and
- The award-reliant employees engaged by small businesses are paid substantially less than the award-reliant employees engaged by larger businesses.

170. ABS Cat. No. 6306 will shortly be re-released to set out the results of the May 2004 *ABS Employee Earnings and Hours Survey*. As correctly pointed out by the ACTU in its submission⁵⁷, only preliminary data is

⁵⁶ *2004 Safety Net Review Decision*, Para 135

⁵⁷ ACTU Submission, Para 3.3.

available at this stage and this preliminary data is set out in ABS Cat. No. 6305.

171. The preliminary data is not segmented to the same degree as the final data and a breakdown by employer size is not displayed in ABS Cat. No. 6305. Therefore, for the time being, the latest published ABS statistics relating to the award-reliance of employees engaged by employers of different sizes is ABS Cat. No. 6306 released on 26 March 2003.
172. **Table 4** below is drawn from ABS Cat. No. 6306. It shows that a high proportion of award-reliant employees are engaged by companies with up to 99 employees, whereas only a very small proportion of award-reliant employees work for companies with 1000 or more employees.

Table 4 – Proportions of Award-reliant Employees by Employer Size

Size of Employer	Proportion of Award-only Employees (%)
Under 20 employees	26.1
20 to 49 employees	32.4
50 to 99 employees	27.2
100 to 499 employees	22.2
500 to 999 employees	19.8
1000 and over employees	5.2
Total	20.5

Source: ABS Cat. No. 6306.0

173. **Table 5** below, which is also drawn from ABS Cat. No. 6306, highlights that award reliant employees engaged by small businesses receive much lower average weekly total earnings than those employed by larger businesses.

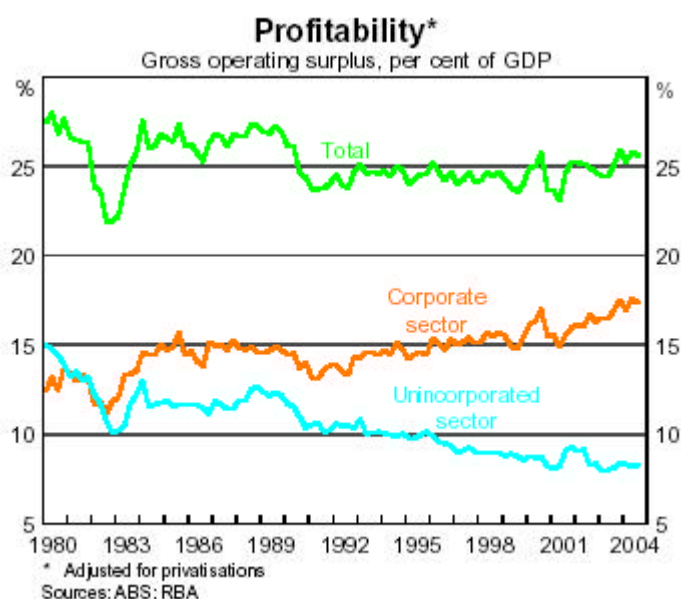
Table 5 – Average Weekly Total Earnings of Award-reliant Employees by Employer Size

Size of Employer	Average Weekly Total Earnings (\$)
Under 20 employees	387.00
20 to 49 employees	401.70
50 to 99 employees	421.50
100 to 499 employees	466.10
500 to 999 employees	460.50
1000 and over employees	480.80
Total	419.90

Source: ABS Cat. No. 6306.0

174. The above statistics clearly show that, on average, small businesses are much more likely to be impacted by safety net adjustments than larger businesses.
175. Small businesses also have less capacity to pay wage increases than larger businesses.
176. In its submission, the ACTU places great weight on business profitability statistics to argue that its claim is affordable. The macro statistics presented by the unions, however, do not shed any light on the profitability levels of companies of different sizes.
177. **Chart 5** shows the relative decline in the profit share of the unincorporated sector. The corporate sector includes both public and private companies. The unincorporated sector includes sole traders, trusts and regular partnerships. These are the typical structures used by small businesses.

Chart 5 – Profitability of Employers – Corporate and Unincorporated Sectors



Source: Reserve Bank of Australia

178. At the present time, small businesses are experiencing significant cost pressures. For example, the massive recent rises in input prices (eg. steel and fuel) impact more severely on smaller businesses because they have less ability to lock-in prices for periods of time in contracts with suppliers.
179. Further, as a result of the *AIRC's Redundancy Case Decisions*, from 8 June 2005⁵⁸ severance pay obligations will be imposed upon small businesses covered by Federal awards, increasing cost pressures for them.

⁵⁸ In the *Supplementary Redundancy Case Decision*, the AIRC decided that, in calculating service, small businesses would not be required to take into account service rendered prior to the date of the award variation. The awards which were used as vehicles for the *Redundancy Case* were the first to be varied, with such variations becoming operative from 8 June 2004. Under the standard award clause, redundancy pay obligations arise after 12 months of service.

The importance of small businesses and their characteristics

180. Small businesses are vital to the Australian economy. Such businesses:

- Employ well over three million people and are the largest employer in Australia;⁵⁹
- Account for 47% of all private sector non-agricultural employment;⁶⁰
- Account for 96% of all business in the private sector (excluding agriculture);⁶¹
- Make a major contribution to employment growth in Australia and are an important source of new jobs in the economy.⁶²

181. A Senate Committee recently conducted a comprehensive inquiry into small business employment. The findings set out in the report which arose from the inquiry include the following:

- The cost of employing staff remains a significant deterrent to employment growth in the small business sector;⁶³
- Employment levels in small businesses can be highly volatile;⁶⁴
- Small businesses face difficulties and disadvantages in obtaining the key inputs of capital and skilled labour, and are treated less favourably by banks, insurance companies and other big businesses in many areas including settling of

⁵⁹ *Small Business Employment: Research Note*, Department of Parliamentary Library, September 2002

⁶⁰ *Ibid*

⁶¹ Australian Bureau of Statistics (ABS) *Small Business in Australia 2001*, Cat No 1321.0

⁶² Report on Small Business Employment, Senate Employment, Workplace Relations and Education References Committee at p.27

⁶³ *Report on Small Business Employment, Senate Committee on Employment, Workplace Relations and Education References*, February 2003, pp.6, 49

⁶⁴ *Ibid*, p.32

accounts, terms of trade, interest rates and bank fees and charges;⁶⁵

- Most small businesses rely on their own equity or borrowings and frequently use the family home as security;⁶⁶
- They are more susceptible to being given risk finance and require a strong cash flow and ability to repay debts. Most small businesses typically face uncertain cash flow streams;⁶⁷
- Many small businesses operate on an overdraft and have a high level of debt. The limited financial resources of small businesses is a constraint on their capacity to weather downturns and grow and compete with larger businesses;⁶⁸
- Many small businesses operate on small margins, with highly variable cash flow, particularly in their early years;⁶⁹
- Late payments are a constant problem;⁷⁰
- The fundamental characteristic that distinguishes small businesses from large businesses is their higher probability of ceasing to trade. Almost half of the small businesses in operation have been in business for less than five years. Larger small businesses (for example those approaching the *Corporations Act* definition of 50 employees) are more likely to have been in business for longer periods.⁷¹

182. The Senate Committee report reproduces the following extract from a recent OECD publication which highlights the importance of small businesses to modern economies:⁷²

“SMEs [Small and Medium Enterprises] are at the core of future economic growth in OECD countries. Productivity growth is fuelled by

⁶⁵ Ibid, pp.6, 13

⁶⁶ Ibid, p.12

⁶⁷ Ibid, pp.13, 44

⁶⁸ Ibid, p.12

⁶⁹ Ibid, p.12

⁷⁰ Ibid, p.12

⁷¹ Ibid, p.22

⁷² Ibid, p.51

competitive processes in industry, which, to a large extent, build on the birth and death, entry and exit, of smaller firms. Over 95 per cent of enterprises in the OECD are SMEs, which account for 60-70 per cent of jobs in most countries. They are the source of most new jobs and make significant contributions to innovation and high-technology employment. In addition, they are of considerable importance for regional developments and social cohesion. However, less than one-half of small business start-ups survive for more than five years and only a fraction develop into high-performance firms...”.

183. When making its decision in these proceedings it is vital that the Commission not lose sight of the particular negative impacts that a large safety net adjustment will have on small businesses.

9. The ACTU's Claim is Inconsistent with the Objects of the Act

184. An important consideration for the Commission in these proceedings is whether or not the unions' claim is consistent with the objects of the *Workplace Relations Act 1996*.
185. Such objects include the promotion of economic prosperity by encouraging the pursuit of high employment, improved living standards, low inflation and international competitiveness (s.3(a) of the Act).
186. The Act's objects also emphasise the importance and primacy of agreement-making between employers and employees with regard to the determination of wages and working conditions (s.3(b) and (d)(i)).
187. Section 90(1) requires that the Commission perform its functions, having regard to the state of the national economy and the likely effects on the economy of any award that it proposes to make or vary.
188. Section 88A(d) of the Act provides that with respect to the making, or varying of awards, the Commission must exercise its powers in a way which encourages agreement-making at the enterprise level and which promotes youth employment.
189. The ACTU's claim for a \$26.60 safety net adjustment is inconsistent with the objects of the Act. If granted, the claim would lead to:
- Reduced employment for both youths and other workers;
 - Higher inflation;
 - Higher interest rates; and
 - Reduced international competitiveness.

190. The ACTU's claim would also reduce the scope for bargaining over wages at the enterprise level. This directly conflicts with the objects of the Act.
191. The ACTU claim of \$26.60 per week represents an increase of six per cent on the Federal Minimum Wage. The safety net adjustment proposed by the ACTU far exceeds current enterprise agreement wage outcomes.
192. According to the Department of Employment and Workplace Relations' *Trends in Federal Enterprise Bargaining* report, average annualised wage increases for agreements certified or approved in the December 2004 Quarter were:
- All Industries 4%
 - Private Sector 3.7%
193. Safety net adjustments need to be pitched at a level below average enterprise agreement wage outcomes to avoid diminishing the primacy which is given to enterprise agreement-making under the Act.

10. Impact of Safety Net Adjustments on Wage Relativities

194. Both Ai Group and the ACTU propose a flat rate adjustment to all award wages, with the ACTU proposing \$26.60 and Ai Group proposing \$11.00.
195. The Commission has not awarded a percentage adjustment to award rates since the *April 1991 National Wage Case*. The flat rate adjustments which have been awarded over the past 13 years have resulted in relativities being compressed. The effect of this can be seen from **Table 6** below which relates to the classification structure in the *Metal, Engineering and Associated Industries Award 1998*.
196. Even though a flat increase will further compress the relativities within skills-based classification structures, it is submitted that a flat dollar increase of \$11.00 per week, as proposed by Ai Group, represents an appropriate balance given the fundamental tension between the goals of:
- Assisting the low paid, taking into account the economic considerations; and
 - Protecting the integrity of award classification structures.
197. Ai Group maintains that relativities between award rates have not eroded to such an extent as to be ineffective or unworkable.
198. Market factors and the incidence of over award payments reduces the detrimental impact arising from compressed relativities between award rates.

199. In addition, Ai Group’s proposal for a flat \$11.00 per week adjustment would produce significantly less distortion than the ACTU’s approach. As **Table 6** demonstrates, the ACTU’s proposal to apply a flat \$26.60 per week increase to all classifications would exacerbate the compression of relativities between award rates relative to Ai Group’s proposal.

Table 6 - Relativities in the *Metal, Engineering and Associated Industries Award*

Wage Group	1991 Relativities %	Current Weekly Award Rate \$	Current Relativities %	Effect on Relativities – Ai Group Proposal %	Effect on Relativities – ACTU Claim %
C14	78	467.40	83.3	83.6	84
C13	82	484.10	86.3	86.5	86.9
C12	87.4	506.60	90.3	90.4	90.7
C11	92.4	527.50	94.0	94.1	94.3
C10	100	561.20	100	100	100
C9	105	582.10	103.7	103.7	103.6
C8	110	602.90	107.4	107.3	107.1
C7	115	621.80	110.8	110.6	110.3
C6	125	663.50	118.2	117.9	117.4
C5	130	684.40	122.0	121.5	121
C4	135	705.20	125.7	125.2	124.5
C3	145	746.90	133.1	132.5	131.6
C2(a)	150	767.80	136.8	136.2	135.1
C2(b)	160	805.50	143.5	142.8	141.6
C1(a)	180	889.00	158.4	157.4	155.8
C1(b)	210	1014.10	180.7	179.3	177.1

11. Conclusion

200. Ai Group urges the Commission to reject the ACTU's claim for another large safety net adjustment.
201. The level of increase proposed by the ACTU is unaffordable and would have damaging effects on the Australian economy.
202. The economy is slowing and interest rates have recently risen. The Commission needs to be very cautious this year in determining the level of the safety net adjustment. If the adjustment awarded is too high it will harm the very people that the safety net review process is intended to benefit – that is, the low paid. An excessive safety net adjustment would:
- Reduce the employment security of low paid workers;
 - Reduce the international competitiveness of Australian companies;
 - Increase inflationary pressures; and
 - Increase the risk of further rises in interest rates for mortgages, credit cards and other loans, which would have a particularly harsh impact upon the low paid.
203. Over the past year, the low paid – particularly those with children – have received massive increases in income support payments. This should be taken into account by the AIRC and the amount that the Commission would otherwise have awarded should be substantially discounted.
204. In determining the level of a fair and reasonable safety net increase, Ai Group submits that an \$11.00 per week increase would assist the low paid whilst not damaging the Australian economy.

Annexure 5

Regular Adjustments to Income Support Payments and Income Tests

This Annexure is aimed at dispelling the belief that the combination of inflation-related regular adjustments to income support payment and income test thresholds merely preserve the real value of those payments. In its *2004 Safety Net Review Decision* (at paragraph 303), the Commission appeared to adopt this belief. This argument was also repeated by the ACTU in its submission in the current safety net review case (at paragraph 7.53).

Income support payments are generally adjusted periodically to reflect changes in general price levels and/or changes in a measure of average wages. In addition, for many categories of income support, the thresholds in income tests are similarly adjusted.

For example, between 1 March 2004 and 28 February 2005, the maximum Family Tax Benefit A (FTBA) payment for a child aged between 13 and 15 years old increased from \$165.48 per fortnight to \$169.40 per fortnight.⁷³ This regular, inflation-related adjustment amounted to an increase of 2.4%. In addition, in the same year, the threshold at which the maximum amount of FTBA became subject to the income test was increased from \$31,755 to \$32,485 per year. This regular, inflation-adjusted adjustment amounted to an increase of 2.3%.

⁷³ This change does not include the additional, permanent, \$600 per year per child announced in the 2005-06 Budget. This payment has subsequently been raised to \$613.20 per year per child.

The combined impact of these two changes on levels of income support payment received over an illustrative range of incomes is set out in the following table.⁷⁴

Table - Illustration of Combined Impact of Inflation-Related Changes in Income Support Payment levels and Thresholds

Household private income (\$ pa)	Previous level of income support (\$ per fortnight)	New level of income support (\$ per fortnight)	Change in income support payment (%)
29,721	165.48	169.40	2.4%
30,973	165.48	169.40	2.4%
32,224	160.08	169.40	5.8%
33,476	145.68	158.00	8.5%
34,727	131.28	143.60	9.4%
35,979	116.88	129.20	10.5%
37,230	102.48	114.80	12.0%
38,481	88.08	100.40	14.0%
39,733	73.68	86.00	16.7%
40,984	59.28	71.60	20.8%
42,236	44.88	57.20	27.5%

As illustrated, regular inflation-related changes in the amount of payment and the level of the threshold often deliver increases in payments considerably greater than that required to maintain their real values. This occurs for all households with incomes above the threshold in the original income test.

Inflation-related adjustments in income support payments and thresholds are clearly relevant to assessing the needs of the low-paid and should not be overlooked in the belief that these adjustments merely preserve the real value of payments. This belief is, in any case, erroneous.

⁷⁴ For the purposes of the illustration and to isolate the impacts of purely inflation-related changes, the change in the taper in the income test announced in the 2004-05 Budget is ignored and is assumed to have remained unchanged at 30 cents in the dollar.

Annexure 6

Changes in the Social Safety Net for Households with Children

This Annexure illustrates the impacts of changes in the social safety net between 1 March 2004 and 28 February 2005 for families with children.

Not all changes in the social safety net are included in the illustrations below.

Changes **not taken into account** include:

- The one-off payment of \$600 per year per child made in the middle of 2004;
- The new Maternity Payment payable to families with a new child;
- The advantage that households with children can take of the increased superannuation co-contribution payment; and
- The currently accruing entitlements for the new Child Care Rebate.

These exclusions imply that the illustrations considerably understate the degree to which families with children are better off as a result of changes in the social safety net over the past year.

The changes that **are included** in the illustrations below are:

- The permanent increase in the maximum and basic rate of Family Tax Benefit A (FTBA);
- The permanent increase in the maximum payment of Family Tax Benefit B (FTBB);
- The large discretionary increase in the threshold at which the income test for FTBB begins to apply;
- The reduction in the income test taper rate for both FTBA and FTBB;

- The regular adjustments to the level and income test thresholds of payments under FTBA, FTBB and Rent Assistance;
- Changes in the Medicare Levy thresholds;
- The changes to the income tax rate scales (which, however, are not applicable to the range of incomes illustrated).

The tables set out below show that families with dependent children have experienced significant increases in real disposable income as a result of changes to the social safety net over the past year.

**Table 1 - Two-Parent Household, 2 Children, Eligible for Rent Assistance
(Single income earner)**

Household Wage Income	Increase in Disposable Income	Equivalent to an Increase in Wage Income of	Percentage Increase in Household Disposable Income
\$ per week			
250	35.09	42.27	7.4%
275	35.09	42.27	7.1%
300	35.09	42.27	6.8%
325	35.09	42.27	6.5%
350	35.09	42.27	6.3%
375	35.09	42.27	6.1%
400	35.09	42.27	5.9%
425	35.09	53.16	5.7%
450	35.09	53.16	5.5%
475	35.09	53.16	5.4%
500	35.09	53.16	5.3%
525	35.09	53.16	5.1%
550	38.38	76.77	5.5%
575	38.38	76.77	5.4%
600	35.09	51.22	4.8%
625	39.48	81.41	5.3%
650	41.98	86.56	5.6%
675	44.48	91.72	5.9%
700	46.98	96.87	6.1%

**Table 2 - Two-Parent Household, 2 Children, Eligible for Rent Assistance
(Two income earners with one earning twice as much as the other)**

Household Wage Income	Increase in Disposable Income	Equivalent to an Increase in Wage Income of	Percentage Increase in Household Disposable Income
\$ per week			
250	47.60	60.47	10.1%
275	47.60	60.47	9.7%
300	47.60	60.47	9.3%
325	47.60	60.47	8.9%
350	47.60	65.12	8.6%
375	47.60	65.12	8.3%
400	47.60	65.12	8.0%
425	47.60	65.12	7.8%
450	47.60	65.12	7.6%
475	47.60	65.12	7.3%
500	47.60	65.12	7.1%
525	47.60	65.12	7.0%
550	50.90	95.85	7.3%
575	48.13	90.63	6.7%
600	47.60	66.48	6.5%
625	52.00	129.31	7.0%
650	54.50	135.53	7.2%
675	56.68	140.95	7.4%
700	56.70	141.01	7.3%

**Table 3 - Two Parent Household, 2 Children, Eligible for Rent Assistance
(Two income earners each with the same level of wage income)**

Household Wage Income	Increase in Disposable Income	Equivalent to an Increase in Wage Income of	Percentage Increase in Household Disposable Income
\$ per week			
250	47.60	70.00	10.2%
275	47.60	70.00	9.8%
300	47.60	70.00	9.4%
325	47.60	70.00	9.1%
350	47.60	70.00	8.8%
375	47.60	70.00	8.6%
400	47.60	70.00	8.3%
425	47.60	70.00	8.1%
450	46.60	68.53	7.7%
475	42.85	63.02	6.8%
500	39.10	57.50	6.0%
525	35.35	51.99	5.3%
550	31.60	65.84	4.6%
575	28.00	44.45	3.9%
600	31.58	38.75	4.3%
625	35.91	58.38	4.9%
650	34.90	56.75	4.6%
675	37.40	60.81	4.9%
700	39.90	64.88	5.1%

**Table 4 - Two-Parent Household, 1 Child, Eligible for Rent Assistance
(Single income earner)**

Household Wage Income	Increase in Disposable Income	Equivalent to an Increase in Wage Income of	Percentage Increase in Household Disposable Income
\$ per week			
250	21.78	26.25	5.3%
275	21.78	26.25	5.1%
300	21.78	26.25	4.8%
325	21.78	26.25	4.6%
350	21.78	26.25	4.4%
375	21.78	26.25	4.3%
400	21.78	26.25	4.1%
425	21.78	33.01	3.9%
450	21.78	33.01	3.8%
475	21.78	33.01	3.7%
500	21.78	33.01	3.6%
525	21.78	33.01	3.5%
550	25.08	50.17	4.0%
575	25.08	50.17	3.9%
600	21.78	31.80	3.3%
625	26.18	53.98	3.9%
650	28.68	59.14	4.2%
675	31.18	64.29	4.5%
700	33.68	69.45	4.8%

**Table 5 - Two-Parent Household, 1 Child, Eligible for Rent Assistance
(Two income earners one earning twice as much as the other)**

Household Wage Income	Increase in Disposable Income	Equivalent to an Increase in Wage Income of	Percentage Increase in Household Disposable Income
\$ per week			
250	34.30	43.58	8.4%
275	34.30	43.58	8.0%
300	34.30	43.58	7.7%
325	34.30	43.58	7.3%
350	34.30	46.92	7.0%
375	34.30	46.92	6.8%
400	34.30	46.92	6.5%
425	34.30	46.92	6.3%
450	34.30	46.92	6.1%
475	34.30	46.92	5.9%
500	34.30	46.92	5.7%
525	34.30	46.92	5.5%
550	37.60	70.81	5.9%
575	34.82	65.58	5.4%
600	34.30	47.90	5.1%
625	38.70	96.23	5.7%
650	41.20	102.45	6.0%
675	43.37	107.87	6.2%
700	43.40	107.93	6.1%

**Table 6 - Two-Parent Household, 1 Child, Eligible for Rent Assistance
(Two income earners each with the same level of wage income)**

Household Wage Income	Increase in Disposable Income	Equivalent to an Increase in Wage Income of	Percentage Increase in Household Disposable Income
\$ per week			
250	34.30	50.44	8.6%
275	34.30	50.44	8.1%
300	34.30	50.44	7.8%
325	34.30	50.44	7.5%
350	34.30	50.44	7.2%
375	34.30	50.44	7.0%
400	34.30	50.44	6.8%
425	34.30	50.44	6.5%
450	33.30	48.97	6.1%
475	29.55	43.46	5.2%
500	25.80	37.95	4.4%
525	22.05	32.43	3.6%
550	18.30	38.13	2.9%
575	14.70	23.33	2.3%
600	18.28	22.43	2.8%
625	22.61	36.76	3.4%
650	21.60	35.12	3.1%
675	24.10	39.18	3.4%
700	26.60	43.25	3.7%

Table 7 - Single Parent Household, 1 Child, Eligible for Rent Assistance

Household Wage Income	Increase in Disposable Income	Equivalent to an Increase in Wage Income of	Percentage Increase in Household Disposable Income
\$ per week			
250	40.47	117.30	7.3%
275	38.52	111.64	6.9%
300	37.78	109.52	6.6%
325	37.78	109.52	6.5%
350	37.78	109.52	6.4%
375	37.78	109.52	6.3%
400	37.78	109.52	6.2%
425	37.78	109.52	6.2%
450	37.78	109.52	6.1%
475	37.59	167.09	6.0%
500	36.87	163.88	5.8%
525	36.87	163.88	5.7%
550	37.14	110.55	5.7%
575	37.47	111.51	5.7%
600	36.34	108.16	5.5%
625	36.20	171.58	5.4%
650	33.85	160.44	5.0%
675	31.18	64.29	4.5%
700	33.68	69.45	4.8%

Annexure 7

Social Safety Net Changes for Households without Children

The significant changes in the social safety net over between 1 March 2004 and 28 February 2005 have concentrated benefits towards families with dependent children.

This Annexure shows the impacts of the extension of the social safety net of the increase in the superannuation co-contribution payment announced in the 2004-05 Commonwealth Budget. This change to the social safety net has not increased disposable income but has increased the capacity of low-income households to meet their needs (including their future needs).

The impacts of the change to the superannuation co-contribution payment on low-income households without dependent children is illustrated by the presentation below of the impacts of this change on the financial position of single person households at different levels of income. The table also includes the impacts of the change to the thresholds applying to the Medicare Levy.

Table - Change in Financial Position of a Single Person Household

Wage Income	Increase in Disposable Income and Superannuation Co-contribution	Equivalent to an Increase in Wage Income of	Percentage increase in Disposable Income and Superannuation Co-contribution
\$ per week			
250	9.59	11.55	3.8%
275	9.59	11.55	3.5%
300	11.38	18.06	3.9%
325	9.59	11.77	3.1%
350	9.59	11.77	2.9%
375	9.59	11.77	2.7%
400	9.59	11.77	2.6%
425	9.59	14.87	2.5%
450	9.59	14.87	2.4%
475	9.59	14.87	2.3%
500	9.59	14.87	2.2%
525	9.59	14.87	2.1%
550	10.75	16.92	2.3%
575	11.50	18.10	2.4%
600	12.25	19.29	2.5%
625	13.00	20.47	2.5%
650	13.75	21.65	2.6%
675	14.50	22.83	2.7%
700	15.25	24.01	2.7%

Annexure 9

Effective Marginal Tax Rates and Benefit to Cost Ratios of Increases in Minimum Award Wages

This Annexure illustrates how the interactions between the tax, income support and wages systems results in low benefit to cost ratios from increases in minimum award wages.

The low benefit to cost ratios arise from the interaction between the effective marginal tax rates faced by employees **and** the proportional non-wage costs that flow from increases in minimum award wages:

- Effective marginal tax rates arise from the combination of income tax and income support means tests. Effective marginal tax rates imply that disposable income of wage earners is significantly below the level of pre-tax wages paid.
- The proportional non-wage costs faced by employers when minimum award wages rise include payroll tax; the superannuation surcharge; workers compensation premiums and proportional allowances. These costs vary from industry to industry and from State to State. In the data presented in this Annexure extra non-wage cost calculations included cover a range of non-wage costs between 15% and 25% of extra wage costs. As the tables show, the benefit to cost ratios are not highly sensitive to variations in non-wage costs within this range.

The benefit to cost ratios in the tables below are calculated using the formula:

$$\text{Benefit to Cost Ratio} = (1 - \text{emtr}) / (1 + \text{nwcp})$$

Where:

- “emtr” is the effective marginal tax rate; and
- “nwcp” is the proportion of non-wage costs to wage costs.

The tables show that the benefit to cost ratios vary considerably between the three household types presented but, as a rule of thumb vary along a range centred around 50%. In other words, on average, employers face costs of around double the amount received by low-income families.

Table 1 - Effective Marginal Tax Rates and Benefit to Cost Ratios (Two-parent, single income family with two children and renting privately)

		Benefit to Cost Ratios (Proportion of additional costs borne by employers received as disposable income by households)		
Household Wage Income (\$ per week)	Effective Marginal Tax Rate	Range of extra non-wage costs as a proportion of extra wage cost		
		15.0%	20.0%	25.0%
250	17.0%	0.72	0.69	0.66
275	17.0%	0.72	0.69	0.66
300	17.0%	0.72	0.69	0.66
325	17.0%	0.72	0.69	0.66
350	17.0%	0.72	0.69	0.66
375	17.0%	0.72	0.69	0.66
400	17.0%	0.72	0.69	0.66
425	34.0%	0.57	0.55	0.53
450	34.0%	0.57	0.55	0.53
475	34.0%	0.57	0.55	0.53
500	34.0%	0.57	0.55	0.53
525	34.0%	0.57	0.55	0.53
550	50.0%	0.43	0.42	0.40
575	50.0%	0.43	0.42	0.40
600	31.5%	0.60	0.57	0.55
625	51.5%	0.42	0.40	0.39
650	51.5%	0.42	0.40	0.39
675	51.5%	0.42	0.40	0.39
700	51.5%	0.42	0.40	0.39

Table 2 - Effective Marginal Tax Rates and Benefit to Cost Ratios (Sole parent family with one child and renting privately)

		Benefit to Cost Ratios (proportion of additional costs borne by employers received as disposable income by households)		
Household Wage Income (\$ per week)	Effective Marginal Tax Rate	Range of extra non-wage costs as a proportion of extra wage cost		
		15.0%	20.0%	25.0%
250	65.5%	0.30	0.29	0.28
275	65.5%	0.30	0.29	0.28
300	65.5%	0.30	0.29	0.28
325	65.5%	0.30	0.29	0.28
350	65.5%	0.30	0.29	0.28
375	65.5%	0.30	0.29	0.28
400	65.5%	0.30	0.29	0.28
425	65.5%	0.30	0.29	0.28
450	65.5%	0.30	0.29	0.28
475	77.5%	0.20	0.19	0.18
500	77.5%	0.20	0.19	0.18
525	77.5%	0.20	0.19	0.18
550	66.4%	0.29	0.28	0.27
575	66.4%	0.29	0.28	0.27
600	66.4%	0.29	0.28	0.27
625	78.9%	0.18	0.18	0.17
650	78.9%	0.18	0.18	0.17
675	51.5%	0.42	0.40	0.39
700	51.5%	0.42	0.40	0.39

Table 3 - Effective Marginal Tax Rates and Benefit to Cost Ratios (Sole parent family with one child and renting privately)

		Benefit to Cost Ratios (proportion of additional costs borne by employers received as disposable income by households)		
Wage Income (\$ per week)	Effective Marginal Tax Rate	Range of extra non-wage costs as a proportion of extra wage cost		
		15.0%	20.0%	25.0%
250	17.0%	0.72	0.69	0.66
275	17.0%	0.72	0.69	0.66
300	37.0%	0.55	0.53	0.50
325	18.5%	0.71	0.68	0.65
350	18.5%	0.71	0.68	0.65
375	18.5%	0.71	0.68	0.65
400	18.5%	0.71	0.68	0.65
425	35.5%	0.56	0.54	0.52
450	35.5%	0.56	0.54	0.52
475	35.5%	0.56	0.54	0.52
500	35.5%	0.56	0.54	0.52
525	35.5%	0.56	0.54	0.52
550	36.5%	0.55	0.53	0.51
575	36.5%	0.55	0.53	0.51
600	36.5%	0.55	0.53	0.51
625	36.5%	0.55	0.53	0.51
650	36.5%	0.55	0.53	0.51
675	36.5%	0.55	0.53	0.51
700	36.5%	0.55	0.53	0.51