

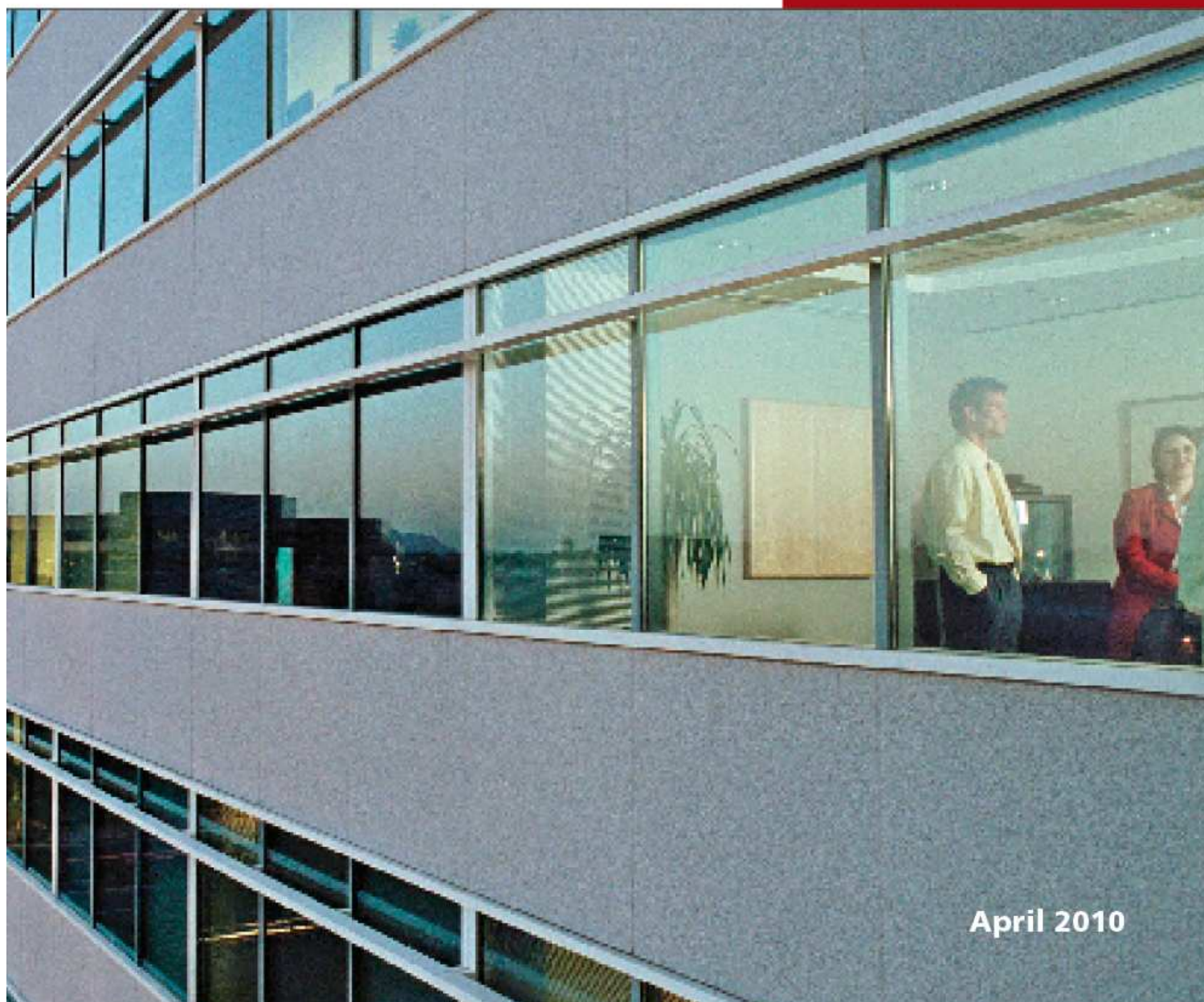


# Reply Submission in 2010 Annual Wage Review



AUSTRALIAN INDUSTRY GROUP

**Ai GROUP SUBMISSION**



April 2010

# **REPLY SUBMISSION**

## **2010 ANNUAL WAGE REVIEW**

### **Introduction**

1. This submission in reply deals with a limited number of issues, particularly some issues raised by the ACTU.
2. The submissions of other parties have not changed Ai Group's view on the matters covered in our March 2010 submission, including the quantum of the minimum wage increase which should be awarded.
3. The ACTU's proposed increase of \$27.00 is overly ambitious and economically unsustainable. The idea of a minimum wage "catch up" increase is fanciful given the economic experience of the past 12 months, and the need to be cautious over the next 12 months to avoid hampering the economic recovery.

### **Relative Living Standards and the Needs of the Low Paid**

4. In Ai Group's March 2010 submission (Chapter 4) we pointed to Australia's well-developed and highly-progressive income tax and transfer systems and suggested they have a decisive impact on relative living standards and the needs of the low paid.
5. We argued that as a general principle, changes to the social safety net and in particular the income tax and transfer systems should be taken into account in considering the role of minimum wage adjustments in addressing relative living standards and the needs of the low paid.
6. We also argued that minimum wage adjustments were a very blunt and poorly targeted instrument for addressing relative living standards.

## ***Relative Wages and Relative Living Standards***

7. Although Ai Group's submission did not directly address measures of relative living standards, it did emphasise the importance of the broader social safety net and particularly Australia's highly progressive income support and taxation systems in the consideration of relative living standards and the needs of the low paid.
  
8. In contrast, in some submissions to the current case, there appears to be an implication that relative living standards can be assessed by looking at measures of relative pre-tax wages. For example, in Chapter 10 of its submission, the ACTU's summarises its argument that relative living standards have deteriorated in Australia (page 135) in the following terms:  
  

*"The relative pay of minimum wages workers has declined in comparison to average weekly earnings, generally, and the mean and median earnings of full time employees."*
  
9. Wages are clearly an important element in living standards. However, relative pre-tax wages of individuals cannot by themselves provide meaningful insights into the much broader issue of relative living standards of people in households.
  
10. Rather, as argued in Ai Group's March 2010 submission (pp. 30-31), a very wide variety of factors other than wages impact on relative living standards. In support of taking a more holistic approach to relative living standards, we point to the range of issues covered by the Australian Bureau of Statistics (ABS) when it seeks to provide insights into relative living standards.
  
11. The following extract is from the most recent (August 2009) publication of the Bureau's *Household Income and Income Distribution* (ABS 6523.0).

*“The economic wellbeing of individuals is largely determined by their command over economic resources. People’s income and reserves of wealth provide access to many of the goods and services consumed in daily life. This publication provides indicators of the level and distribution of after tax (disposable) household income, after adjusting for household size and composition.*

*“The estimates of disposable income in this publication are derived by deducting estimates of income tax liability, the Medicare levy and Medicare levy surcharge from the gross income data collected in the Survey of Income and Housing (SIH). Gross income is defined as receipts available for, or intended to support, current consumption, and are collected in respect to income from employment income (including non-cash benefits, bonuses, termination payments and irregular overtime), profit/loss from own unincorporated business, investment income (including interest, rent and dividends), lump sum workers’ compensation receipts, private transfers (including superannuation, child support), other transfers from other households and cash transfers from government pensions and allowances. Some limits have been placed on items included as income, where the magnitude of the individual amounts received exceed that likely to be used to support current consumption e.g. termination payments, workers compensation payments.*

*“While income is usually received by individuals, it is normally shared between partners in a couple relationship and with dependent children. To a lesser degree, there may be sharing with other members of the household. Even when there is no transfer of income between members of a household, nor provision of free or cheap accommodation, members are still likely to benefit from the economies of scale that arise from the sharing of dwellings. The income measures shown in this publication therefore relate to household income.*

*“Larger households normally require a greater level of income to maintain the same material standard of living as smaller households, and the needs of adults are normally greater than the needs of children. The income estimates are therefore adjusted by equivalence factors to standardise the income estimates with respect to household size and composition, while taking into account the economies of scale that arise from the sharing of dwellings. The equivalised disposable income estimate for any household in this publication is expressed as the amount of disposable cash income that a single person household would require to maintain the same standard of living as the household in question, regardless of the size or composition of the latter.”*

12. The ABS analysis of household income distribution provides the most comprehensive analysis of changes in relative living standards for Australia. **Table 1** below sets out summary data comparing income distribution in 1994-94 and 2007-08.
  
13. The summary data presents a mixed picture of changes in income distribution. Some measures, for example the measures of income shares enjoyed by lower income quintiles fell slightly over this period. In contrast, key measures of relative standards of living such as the ratio of the income of the first 80% and the first half of the income distribution (P80/P50) and the ratio of the income of the first 80% to the first 20% (P80/P20) of the income distribution fell suggesting improved relative living standards of lower income households.

**Table 1: Summary Measures of Income Inequality**

	<b>1994-5</b>	<b>2007-08</b> <i>(excluding impacts of new data changes)</i>
<b>Income share</b>		
Lowest quintile	7.9%	7.6%
Second quintile	12.8%	12.7%
Third quintile	17.7%	17.4%
Fourth quintile	23.7%	22.9%
Highest quintile	37.8%	39.4%
Second and third deciles	10.8%	10.4%
<b>Precentile ratios</b>		
P90/P10	3.78	4.11
P80/P20	2.56	2.54
P80/P50	1.55	1.53
P20/P50	0.61	0.60

Source: ABS, August 2009, *Household Income and Income Distribution 2007–08*, (ABS 6523.0), Table S1, p.6.

14. In all cases the changes were small. Complicating the analysis is that changes in measures were also affected by methodological refinements over time. As the ABS suggested in the previous release of *Household Income and Income Distribution 2003-04* (ABS 6523.0, August 2007) when comparing income distribution over the period 1994-95 to 2005-06:

*“While it is difficult to assess changes in income distribution over longer time periods due to the methodological improvements introduced with the 2003–04 survey, it appears that there has been no significant change in income inequality from the mid 1990s to 2005–06.”*

15. With the benefits of the ABS's broader assessment of relative living standards, Ai Group challenges the suggestion that the relative living standards of lower income Australians has worsened over the past couple of decades. The most comprehensive assessment of relative living standards available in Australia is that of the ABS and its data do not support the suggestion that there has been a distinct erosion of the relative living standards of lower income Australians over this period.

### ***Minimum Wages, Household Income and Relative Living Standards***

16. In Ai Group's March 2010 submission (page 38) we suggested, as part of an argument that minimum wage adjustments are a very blunt and poorly-targeted instrument for addressing relative living standards, that:

*"Many low-paid people are members of households where total disposable income is not low."*

17. The ACTU submission provides strong reinforcement for this suggestion when they conclude (at page 135) that:

*"When compared against all adult employee households two thirds of low paid employee households are found in the bottom half of the distribution of household income."*

18. Although the population of "adult employee households" is a selected group that leaves out a large proportion of lower quintile households, the corollary of the ACTU's data is that a full one-third of low paid employee households are found in the top half of the income distribution (of adult employee households).

19. A logical conclusion of this is that a large share of increases in wage rates for low paid employees raises incomes for middle and higher income households. This reinforces Ai Group's view that adjustments to the minimum wage are a very poorly targeted way to address society-wide relative living standards.

## **Promoting Social Inclusion through Increased Workforce Participation**

20. In our March 2010 submission (Chapter 5) Ai Group argued that in considering the promotion of social inclusion through increased workforce participation, FWA should give greater weight to the possible impacts of its decisions on the demand for labour ahead of possible impacts on the supply of labour.
21. We pointed out that the Australian labour market is characterised by high rates of labour underutilisation. This illustrates an excess of supply of labour relative to demand.
22. We argued that, in these circumstances, an additional supply of labour stimulated by higher minimum wages is unlikely to give rise to additional participation in paid work ("workforce participation") but, rather, to a higher incidence of unemployment and underemployment. Such an outcome would not promote social inclusion through increased workforce participation.
23. We would like to restate this argument in view of the emphasis in other submissions on the role increases in minimum wages can play in stimulating additional labour supply.

### ***Misplaced emphasis on the supply of labour***

24. A number of submissions appear to base their arguments in relation to the promotion of social inclusion through increased workforce participation, on the suggestion that an increase in wage rates will induce a greater supply of labour.

25. The ACTU, for instance, argues (page 115) that raising minimum wages can promote social inclusion by “increasing labour supply”.
26. Ai Group does not dispute the logic of the proposition that an increase in wage rates is likely to induce an increase in the supply of labour. Although the strength of the supply response needs to be tested, the proposition itself is simply a standard application of neo-classical economics which, of itself, we have no reason to call into question.
27. Ai Group’s view is that the claim that social inclusion or workforce participation would be promoted by increasing labour supply leaves out two important factors.
- Firstly it does not recognise that the labour market in Australia has for many years been characterised by over-supply as evidenced by persistently high rates of labour underutilisation.
  - Secondly, it omits to take into account even the possibility of an adverse employer response to higher wage rates in the form of a reduction in the demand for labour. (Even though such a response flows from the same neo-classical reasoning on which the labour supply argument is based.)
28. When these factors are included in the analysis, the links between increased labour supply and the promotion of social inclusion are not apparent.
29. High rates of labour underutilisation point firmly to an excess of supply relative to demand for labour in Australia (notwithstanding some areas of skill shortages). Simply adding to supply is not likely to improve either active participation in the workforce or social inclusion.

30. When the risk that increases in minimum wage rates would reduce the demand for labour (relative to what it would otherwise be) is taken into account, the conclusion that raising minimum wages will promote social inclusion by increasing the supply of labour looks extremely tenuous.
  
31. Ai Group maintains its view that the promotion of social inclusion through increased workforce participation calls for the recognition of the existing over-supply of the labour market. In this context, emphasis should be placed on the risks of an adverse demand response by employers. Such a response would result in lower levels of active participation in employment to the detriment of social inclusion.