

Australia's Minimum Wage

Submission Paper to the Workplace Relations Framework Public Inquiry

March 2015



The UNSW Policy Society is a student run society whose objective is to develop its members abilities in engaging with, analysing and developing sound public policy. The society prioritises the public good and aims to produce policy analysis that adheres to the principles of analytically sound research, that is evidence-based, thoughtful and traceable.

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Executive Summary

This submission seeks to clarify and determine the extent of the impact of Australia's minimum wage regime on key economic and social outcomes. The outcomes discussed in this submission include living expenses for minimum wage worker, employment, small businesses, inequality, productivity and competitiveness.

Overall, our analysis finds that the Australian minimum wage has continued to serve its purpose of setting an income that satisfies a basic standard of living. The current rate of \$16.87, when earned by a full-time worker, should allow them to cover their living expenses. The historical growth of the minimum wage has also reacted appropriately against changing inflationary and cost of living pressures. This has not come at a large cost to other outcomes, such as unemployment and small businesses. Our research also suggests that the minimum wage has a negligible, or ambiguous, impact on inequality and Australia's global competitiveness. In light of this, it could be appropriate to place more emphasis on ensuring the wage can meet the changing living expenses for a worker, the unemployment rate and its impact on small businesses in determining the future policy direction for the minimum wage.

Following our research undertaking, UNSW Policy Society recommends the following in relation to the minimum wage:

- The continuation of the current regime of the Fair Work Commission (FWC) based on annual reviews and incremental increases.
- There is also scope for lower increases in the minimum wage below the increase in living costs to reduce the real value of the minimum wage.
- Consideration should be put into other policy instruments to complement the minimum wage in targeting low income earners.
- Policy instruments that can be considered include training and education programs, welfare, and targeted taxation.
- The commissioning of more extensive and frequently updated data specific to the minimum wage its outcome. This will promote transparency and foster better policy direction.
- Similar to New Zealand's MBIE, the FWC should produce an annual report on the minimum wage and its specific effects on the Australian economy.
- Promoting and maintaining certainty for business owners in relation to the minimum wage by becoming more transparent in decision making and ensuring any policy shift be implemented gradually over time.

Introduction

This paper responds to the call for submissions relating to the Productivity Commission inquiry into the Workplace Relations Framework in Australia. This submission specifically addresses the minimum wage, in particular the impact that changes to the minimum wage will have on the Australian economic and social environment.

The underlying rationale for minimum wage policy development into the future should be to ensure that the minimum wage continues to act as a safety net for low-income earners. The minimum wage should be capable of sustaining an individual's basic needs. A priority such as this protects vulnerable members of the community from exploitation, whilst ensuring that the value of work is not demeaned. Without such a safety net, unemployment risks becoming a palatable alternative to employment, leading to a decline in participation and in the social benefits that follow. A minimum wage that satisfies basic needs ensures that a dignified life is made possible for low-income earners.

The development of minimum wage policy into the future should be guided by clear objectives that support this 'safety net' rationale. It should also be sensitive to and informed by the effect of a changing minimum wage on unemployment, small businesses and competitiveness.

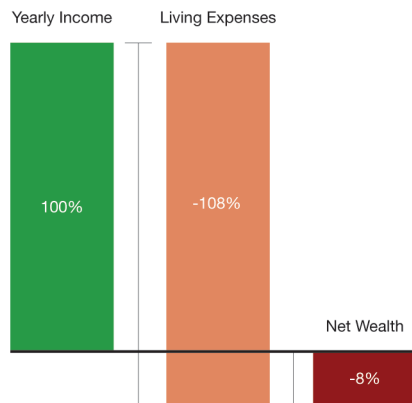
Living Expenses

Over the past 18 years the yearly income on the minimum wage has grown, on average, faster than living expenses. As a result, the negative gap between living expenses and the full-time minimum wage salary that existed in the mid-1990's has mostly been closed. See Exhibit A. Our modelling shows that today an individual on the federal minimum wage, working full time and earning \$16.87 an hour should be able to sustain themselves with the basic accommodation, food and other essentials. Even in major cities, such as Sydney, where the cost of living is higher than other regions, full-time minimum wage earners should be able to sustain themselves. With the support of the Parenting Payment provided by Centrelink, this should also be sufficient for low-income single-parent families to provide for themselves with basic necessities.

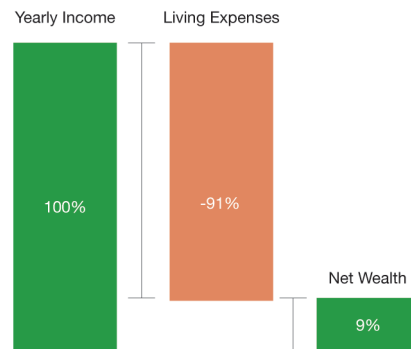
Exhibit A

Income on the Minimum Wage vs Living Expenses - 1997 & 2014

Income & Net Wealth (1997) In Real Terms



Income & Net Wealth (2014) In Real Terms



Sources: AMP Cost of Living for Australia Report (2012), UNSW Policy Society Modelling (2015)

Our modelling shows that if current trends were to continue, people who work full time jobs on the minimum wage will slowly earn an increasing amount of disposable income year on year in real terms.

This analysis suggests that the current method of setting the minimum wage has (in the long run) reacted appropriately to the gap between living expenses and income earned, as well as to the changing year on year living expenses caused by inflation and an evolving consumer basket. In light of this, there would appear to be some scope for decreasing the rate by which the minimum wage grows year on year. However, in order that the expense of living does not become too onerous, this decrease should only go so far as to be in line with the rate of inflation (plus a tax effect)..

Unemployment

The potential unemployment effects of a change in the minimum wage have been flagged as a concern in the workplace relations' issues paper. After surveying the academic literature on the minimum wage, we find that the effect of changing the minimum wage on unemployment is disputed when looked at in generality across the world. To overcome this, research on Australia and other countries with similar circumstances to Australia have been prioritised. With this methodology, the evidence indicates that changing the minimum wage has a negligible impact on overall unemployment. However, some research has indicated that an increase in the minimum wage could negatively affect vulnerable groups such as the non-skilled and youth.

Australian research on the minimum wage demonstrates an ambiguous link between employment and the minimum wage. Leigh (2003) finds that the minimum wage is associated with a negative effect on the employment to population ratio in Western Australia. Research also suggests that an employment opportunity cost is incurred by increases in the real value of the minimum wage. Lewis (2006) argues that between 1994-2004 around 290,000 extra jobs would've been created if the minimum wage stayed constant in real terms. However, Australian evidence has also pointed to negligible minimum wage effects on employment (Plowman 2007; Lee and Suardi 2010).

Countries such as the United Kingdom and New Zealand can be seen to be comparable to Australia in regards to the effect a change in the minimum wage could have on its unemployment rate. Both countries have similar minimum wage frameworks and a high minimum wage relative to median incomes in the country (47 per cent and 60 per cent, respectively). This mirrors Australia's minimum wage to median income percentage of 54 per cent (OECD, 2014).

Research completed on these two countries finds that there is a negligible impact on unemployment when the minimum wage is raised. Metcalf (2007) considers the overall impact of the minimum wage since its introduction in the the UK in 1999, finding that there was "little or no evidence of any employment effects" when the minimum wage had changed. In the first 7 years of having a minimum wage in the U.K. (1999-2006), employment in eight low paying sectors rose from 6.3million to 6.7million. This increase

was enough to maintain the relative size of these sectors in employment at around 26 per cent (Metcalf 2007). The U.K experience strongly suggests a limited impact of the minimum wage on employment.

Similarly, modelling done in New Zealand by the Ministry of Business, Innovation and Employment (MBIE, 2014) suggests that there is negligible impact of the minimum wage on employment. They conclude that only a significant change (greater than 3.5 per cent) will stunt employment growth. This emphasises the importance of consistent and incremental changes to the minimum wage to avoid any negative employment effect

Other international evidence has pointed to a negative employment effect of increasing the minimum wage, especially on youth. Neumark (2014) suggests that an increase in the minimum wage would destroy jobs for young people with the elasticity ranging between -0.1 and -0.3. Further, higher minimum wages often lead to the substitution of labour from non-skilled workers to low or semi-skilled employees (MBIE, 2014).

The overall evidence from Australia is relatively thin and inconclusive, and more research should be undertaken for a definitive conclusion to be reached. On balance, international research suggests that the impact of the minimum wage on unemployment is negligible, although vulnerable groups such as youth are more likely susceptible to changes in the minimum wage.

Small Business

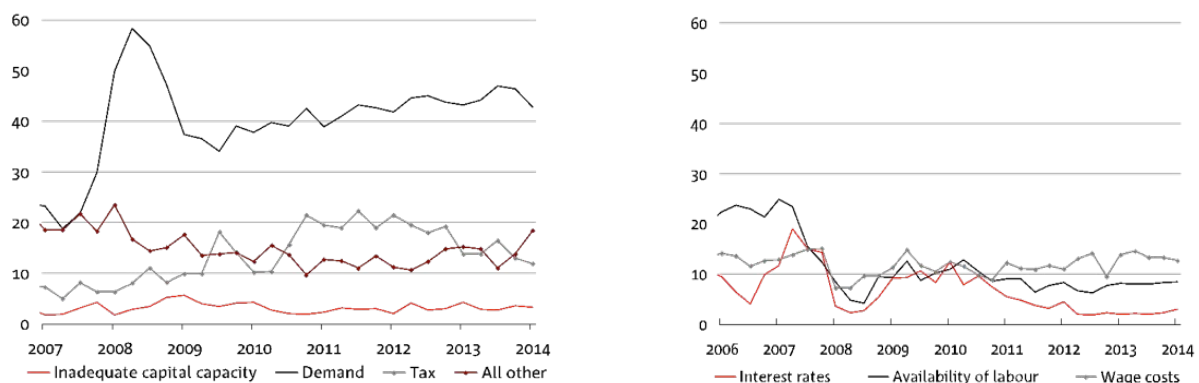
The effect of changing the minimum wage for small businesses is also placed as an issue for the Productivity Commission inquiry. Within small businesses there are over 350,000 individuals on the minimum wage, making up around 7 per cent of all the people employed by small businesses (Bray 2013). To evaluate the impact of the minimum wage on small businesses, surveys which highlight the challenges that small businesses face when dealing with wage costs, as well as research on the actions small businesses can take in reaction to a change in minimum wage, have been used. These sources demonstrate that there is an overall negligible impact on the small business sector when the minimum wage changes, even though there is a suggested small decline in profitability.

Small businesses will face increased costs as a result of minimum wage increases. In 2011, an ACCI survey, which comprised of predominately small businesses found that 65.9 per cent of respondents experienced a decline in profitability as a result of the 2010 increase in the minimum wage.

Despite decreases in profitability, it is unlikely that the incremental changes to the minimum wage in the Australia have represented a material shock to small businesses. This is evidenced by the quarterly NAB Small to Medium Enterprise (SME) survey (National Group Economics, 2015), wherein SMEs have, over time, labelled demand as the greatest constraint on profitability. In the same survey wage costs were listed as a constraint on profitability by less than 20 per cent of SMEs surveyed.

Exhibit B

Significant constraints on Profitability (% of firms)



Source: NAB, 2014

The minimal effect of the minimum wage on small businesses reflects the properties of small businesses. Small businesses must continually offset other costs, and any changes to the minimum wage are small relative to these other costs (Hirsch et al. 2011). Further, channels of adjustment such as increasing prices, reduced turnover, or wage compression mean that small businesses are unlikely to be shocked out of customary practices and habits by changes to the minimum wage (Arrowsmith et al. 2003).

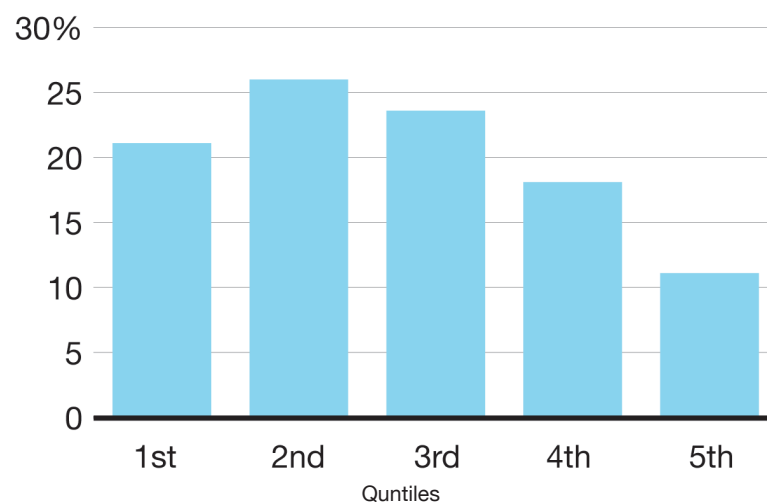
This evidence shows that despite a negative profitability effect on small businesses of a higher minimum wage, on the whole it is unlikely that this impact is material to the longevity of a small business. Furthermore, a consistent and incremental approach to adjusting the minimum wage enables firms to transition smoothly with any changes to the minimum wage.

Inequality

The impact of an increase or decrease in the minimum wage will likely have a negligible impact on income inequality in Australia. While it is often assumed that minimum wage earners gather around the lowest quintiles, the majority of minimum wage earners are instead located in the middle three quintiles. This is seen in Exhibit C. Bray (2013) finds that only 21.1% of minimum wage earners are in the first income quintile. This distribution across quintiles seen in Exhibit B indicates that the effect of increasing or decreasing the minimum wage will not flow disproportionately to low income earners. This aligns with studies in OECD countries, which conclude that changes in

Exhibit C

Percentage of minimum wage earners by income quintile



Source: Bray, 2013

the minimum wage have ambiguous effects on income inequality (Koske et al. 2012; Hoeller et al. 2014). Together, this suggests that any increase in the minimum will not significantly affect the income discrepancy between those households with the lowest and highest incomes. Minimum wage policy should therefore not be seen as the appropriate tool by which to decrease income inequality in Australia.

Other policy tools are more likely to have an impact on income inequality. For example, OECD research has found the use of training and education helps decrease income inequality more effectively than raising the minimum wage (Hoeller et al. 2014). Training minimum wage employees during the course of their employment can also operate as a means of reducing inequality because training would provide the means for minimum wage employees to increase their skills and move on to employment with higher levels of pay (Lixin Cai 2013).

The demographics of those in the lowest household income bracket also casts light on the appropriate means of addressing income inequality. The majority of households in the first quintile are either lone or single parents, and about half of those households have an average adult age over 65 (Greenville et al. 2013). By contrast, eighty percent of working age adults in the fifth quintile are in the labour force (Greenville et al. 2013). This breakdown highlights the demographic and social differences underlying significant discrepancies in income. More effective outcomes can be sought with policies focusing on education, training and transfers that acknowledge these demographic and social discrepancies between those households with the highest incomes and those with the lowest

Productivity

Research suggests that an increase in the minimum wage will likely have positive, though largely insignificant impact on the productivity of low-income employees. Metcalf (2007) finds evidence that in the U.K the introduction of the National Minimum Wage resulted in more workers obtaining training and for longer periods than before. However, industry and business-level evidence points to a positive (though often insignificant) association between the U.K minimum wage and productivity (Metcalf 2007).

The capacity for higher wages to spur increased productivity through training is exhibited in the case of Denmark. Denmark pursues a high wage-high productivity industrial model. This is achieved through a coordinated social effort for training between government, employers and industrial bodies (McLaughlin 2009). As evidence suggests that a minimal effect on productivity will follow from an increase in the minimum wage, the policy measures pursued by Denmark can be viewed as an alternative approach to maximising the productivity of low-income employees

Competitiveness

The impact of the minimum wage on Australia's international competitiveness is likely to be small as Australia's internationally competitive sectors do not rely largely on minimum wage workers

Bray (2013) highlights which industries will be most impacted by changes to the minimum wage by detailing the portion of each industry's workforce earning minimum wage. The results are detailed in the table below:

Exhibit D

Percentage of workers in Industry on Minimum Wage vs if Industry is greater than 5% of Australia's export value

Industry	Workers on the Minimum Wage (%)	Greater than 5% of export value
Accommodation and Food Services Sector	11.8	No
Admin and Support services	8.2	No
Other Services	7.6	No
Construction	7.2	No
Retail Trade	5.9	No
Rental Hiring and Real Estate	5.3	No
Manufacturing	5.1	Yes

Source: Bray, 2013

Of the above industries, manufacturing is the only industry that contributes to over 5 per cent of Australia's annual exports, accounting for 14.82 per cent of Australia's exports in 2012 - 2013 (Australian Bureau of Statistics 2014). This analysis suggests that changes in the minimum wage could potentially impact the competitiveness of the manufacturing sector. However, with only 5.1 per cent of the workers on the minimum wage in manufacturing, the negative impact on competitiveness of changing the minimum wage will likely be of a limited nature.

Furthermore, manufacturing has declined from 29.42 per cent to 14.82 per cent of Australia's export mix from 2006-2007 to 2012-2013 (Australian Bureau of Statistics 2014). A similar trend is evident in retail trade exports. These outcomes can be attributed to various other factors outside of the minimum wage, including the growth of production capacity in a number of low-cost countries, a high Australian dollar, and low economies of scale in Australia.

Conclusion

UNSW Policy Society finds that over the past decade the minimum wage regime has largely achieved its mandate by ensuring the basic needs for a dignified life are met. This has been achieved without any clear negative externalities. Despite this the impacts of the minimum wage are limited, highlighting that the minimum wage is only one tool in targeting low-income earners. The minimum wage should be used in conjunction with other complementary policy measures to fully achieve its goals. Our research has also led us to conclude that inequality, competitiveness, and productivity should not be high priority outcomes from the minimum wage.

UNSW Policy Society recommends the following actions in relation to the minimum wage:

- Continuation of the current regime of the Fair Work Commission (FWC) based on annual incremental increases.
- There also remains policy scope for lower increases in the minimum wage below the increase in living costs to reduce the real value of the minimum wage.
- Consideration should be put into other policy instruments to complement the minimum wage in targeting low income earners. Policy instruments that can be considered include training and education programs, welfare, and targeted taxation.
- The commissioning of more extensive and frequently updated data collection specific to the minimum wage and its outcome will promote transparency and foster better policy direction.
- Similar to New Zealand's MBIE, the FWC should produce an annual report on the minimum wage and its specific effects on the Australian economy.
- Promoting and maintaining certainty for business owners in relation to the minimum wage by becoming more transparent in decision making and ensuring any policy shift be implemented gradually over time.

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