

**Productivity Commission Inquiry into the Workplace Relations
Framework**

Submission concerning the Minimum Wage

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Section 1: Introduction

This paper responds to the call for submissions relating to the PC Inquiry into the Workplace Relations Framework.

This submission is restricted to the specific issues relating to the minimum wage as identified in Issues Paper 2. This limitation reflects the relatively limited time available for comment on an extremely wide range of matters, and my particular area of expertise.

Structure of submission

In addition to this introductory section this submission contains a further 3 sections:

- Section 2 provides a commentary on some aspects of the Productivity Commission Issues Paper. I have provided some reasonably extensive comment on some of the matters presented in the Issues Paper as I have strong concerns about the extent to which it actually provides a good background to a consideration of the issues before the Inquiry. These concerns include the extent to which the content that is provided in the paper tends to slant the consideration in a particular direction (including in terms of motivating responses to the questions) and leaves some very important issues off the table. It is important that the work undertaken by the PC on the question of the minimum wage is done so in an unbiased and transparent manner.
- Section 3 contains responses to the 17 specific questions the Productivity Commission raises within its Issues Paper.
- Section 4 details an approach which I believe the Productivity Commission should propose to achieve a more considered and balanced approach to the development of policy in this area over time.

I provide as an attachment a copy of the paper “Reflections on the evolution of the minimum wage in Australia: Options for the future” (Bray 2013) which I prepared in 2013. I am aware that the PC has utilised some of this material in the issues paper.

Background to approach

Central to the approach underlying this submission is the finding of my analysis in the attached paper which is that while there is no immediate crisis which needs to be addressed with respect to the minimum wage in Australia, there is a need for serious policy considerations for future approaches.

This position reflects the way in which the minimum wage has evolved over recent decades. Essentially it has transitioned from being a ‘family wage’ to that of a single person, with the state taking over the primary function of supporting dependent children and in some cases a dependent partner.¹

¹ As documented in Bray (2013) and in some of the additional data provided in this submission, while this ‘transition’ is very clear in the data when the sources of household income are analysed, and has been

This in turn has been reflected in a long term trend where the minimum wage has essentially been held flat in real terms, while falling markedly relative to other earnings in the community. My analysis suggests that this has largely occurred without any significant major adverse social consequences. Families with children reliant upon the minimum wage as a source of income have seen their living standards very substantially boosted through the transfer system, as well as, for some, through increased workforce participation by partners. The gains for single people on the minimum wage over this period have been lower. However this needs to be weighed against the fact that the relative outcomes for this group were, at the time of the commencement of this process, relatively high because the minimum wage had been set, to some degree, in terms of the needs of a family rather than just for a single person. While this group has as a result faced a relative decline in their position, this was from a much higher starting point, and their real standard of living has not suffered.

This process, as noted, has occurred through a major increase in the level of government financial support to families including working families, and some reduction in the level of income tax paid. While given the difficulty in ascertaining the effective minimum wage between 1978 and 1997², estimates are necessarily tentative, I estimate that, over the 25 year period to 1 January 2015, while the real value of the minimum wage has increased by some 12.2 per cent:

- for a single person in receipt of the minimum wage and working full, they have had a fall in their income tax payable by 29.3 per cent and as a result their real disposable income has increased by 19.3 per cent;
- for a single breadwinner, again working full-time, with a dependent partner and two young children, disposable incomes have increased by 49.9 per cent, primarily as a result of increases in family assistance.

Looking over a slightly longer time period, and back to a period when the rate of the minimum wage was clearer, the real value of the minimum wage has increased from \$563.65 in June 1978 to \$640.90 in July 2014. This is a 13.7 per cent increase over 36 years, and equates to an annualised rate of just 0.36 per cent. If however the comparison is limited to those who worked in the major industry sectors which were subject to the metal industry award, or where this award had been picked up as the community standard, over the 32 years from its peak in July 1982, the real value of the minimum wage has declined by 6.5 per cent.³

effectively acknowledged in the decisions of the wage setting bodies, it is somewhat less clear whether it can be seen as representing a specific and defined 'policy' but rather has occurred as the consequence of a range of decisions taken without a clear and consistent policy framework.

² As discussed in Bray (2013) this period spans the time from the granting of the first supplementary payment to metal workers under the Metal Industries Award in September 1978, and the 1979 work value case under the same award, through to the adoption of the C14 rate in this award as the basis of the new Federal Minimum Wage in April 1997 as this was "*the minimum classification rate in most federal awards*" (AIRC 1997).

³ These historical trends are particularly prone to cherry picking, as the real value of the wage has fluctuated over time and it is possible to tell a variety of stories depending upon the actual starting point chosen. This reinforces a need for analysis to be explicit in explaining the circumstances of the comparison being made, and a preference for multiple comparisons over different time periods.

A consequence of this process has been a very long period of over a quarter of a century in which there has been little or no wages pressure from the minimum wage. This can be interpreted as providing as a consequence potential benefits for industry and for job seekers. This period is now coming towards an end, as continuing to hold real increases in the minimum wage at very low levels is likely to see adverse relative living standards outcomes emerging for single people reliant upon this as their source of income. The actual timing of when this will become a significant problem is however unclear, depending upon many factors including patterns of productivity and earnings growth and the impact of the tax and the transfer system.

I would however argue that there is however no immediate crisis or need for any urgent action, rather, in the short term, “steady as she goes” policies in the setting of the minimum wage directed at maintaining its real value will continue to deliver relatively adequate outcomes for all parties. This though is not a call for inaction, because, as I indicated in Bray (2013), the long-term adjustment phase is coming to an end. Rather it is a call for a considered review including processes which are directed at obtaining a broad consensus of the future direction of the minimum wage and its interaction with the tax and transfer system, and in designing the mechanisms to enable the implementation of this. As such a clear commitment to ‘steady as she goes’ policies in this period provides certainty to all parties, even if it does necessarily reflect their preferred outcome⁴, but the stability and reassurance of this approach will maximise the opportunity for genuine cooperation and exploration of the issues.

In the context of this review I am of the view, given the time frame of the current Inquiry, the clearly weak evidence base, and the nature of the PC process, that this review is not the mechanism to achieve this. As such I would suggest that the PC not attempt to make any specific recommendations regarding changes to the long-term framework for the minimum wage but rather I suggest that the PC recommends that:

1. A process be established which will enable these matters to be considered in detail over a number of years, drawing upon experts and with the participation of all parties including employers and their representatives, employees and their representatives, governments and community and other organisations with an interest in both the minimum wage and the social welfare outcomes from it; and
2. In the interim the minimum wage be maintained in real terms at its current value, with this also being applied to supporting payments including family support, although noting that there may be grounds for increasing these latter initiatives in line with any overall real gains in community living standards, if these occur.

⁴ In making this assessment I would also note that, to the extent wages decisions which effectively (as most do) only deliver a real change in income of a few percentage points at most, the outcomes sought by the parties do not just reflect short term objectives, but also long term trajectories, and potentially the risks of being unable to catch up at a future point if immediate opportunities for even quite small gains are neglected. This in part can be seen as a consequence of these decisions being made on a short-term basis, taking account of ‘current’ circumstance.

Section 2: Comments on particular aspects of Productivity Commission Issues Paper 2 as it relates to the minimum wage

As a background paper for consultation I consider that the current paper has a number of marked gaps and the selection of the information in the paper, and the way in which issues are raised, does not provide good grounds for consideration of the issues. This is concerning as it is important that the PC address this question in an independent and balanced way and that appropriate weight is given to all dimensions of the minimum wage and its impact.

Within a relatively brief submission it is not possible to address all of these matters but I highlight below some of the more contentious statements in the existing text and the way in which some of the material appears to orient debate onto a relatively narrow set of issues, while ignoring others.

"Minimum wages have been part of the workplace relations system for more than a century, but remain a persistently controversial issue."(p 1)

This statement is made with no justification for the claim that minimum wages *"remain a persistently controversial issue"*. While clearly the rate at which the minimum wage is to be set is of course a matter which is subject to debate, more generally there is little evidence for a broader claim that the existence of the minimum wage is a persistently controversial issue. It would appear in fact that only some fringe organisations such as the Institute of Public Affairs (Novak 2014) have called for the abolition of the minimum wage, with not even other libertarian/conservative think tanks such as the CIS taking such a stance. (This organisation has in the past argued for the maintenance of a minimum wage as part of their wider preference to effectively abolish other statutory rates (CIS 2013).) While there was an employer bid in the 1978 National Wage Case to abolish the concept of the minimum wage *"because it had no basis or concept behind it"* (Plowman 1995 p 280), this was not so much an issue to do with the question of providing a floor to wages, but rather the complexity of the conceptual and practical interactions between rates within awards, which act as a minimum wage, as these tend to be inclusive of all job classifications within the industry, and a further concept of a minimum wage. Plowman reports that *"They conceded that the Minimum Wage could continue 'provided it was adjusted only at the same rate as award rates generally and that this adjustment took place as a consequence of national wage decisions'"* (Plowman 1995 p 280)

At the time of the introduction of the Federal Minimum Wage the major employer groups provided support for the concept. In the Decision (AIRC 1997) the Australian Chamber of Commerce and Industry (ACCI) is cited as proposing that *"The Commission should consider reviving the minimum wage, granting a modest increase to it, stating that award parties should in future include the minimum wage in the award at the updated level and stating that the Commission will review the minimum wage in the next review of principles."* (AIRC 1997 4.2.1) Similarly the Business Council of Australia (BCA) was reported as proposing *"The Commission should establish a safety net wage; that is, a level of wage rate below which no employee may be paid"* (AIRC 1997 4.2.1) and the AIRC noted in their decision to set it at the C14 rate that this was *"consistent with the proposal of the BCA"* (AIRC 1997 8.2.4)

This is scarcely evidence of persistent controversy. Furthermore, without undertaking an exhaustive study my understanding is that at most employers have in general have only called for no, or low, increases in the minimum wage at subsequent hearings, with no sustained proposals for the rate to be cut.

At the political level the concept of a minimum wage has been a feature of industrial relations policies of both sides of politics. This can be seen in the more recent period where, even if there was little agreement on the institutional framework for the minimum wage, it remained central to wage setting:

- The AIRC which introduced the ‘Federal Minimum Wage’ in 1997 was operating under the provisions of the Workplace Relations Act 1996 introduced by the Coalition Government with provisions for: *“the maintenance of an effective award safety net of fair and enforceable minimum wages and conditions”* (s.3 (d)(ii)).
- The 2005 Work Choices legislation established the Australian Fair Pay Commission which was specifically charged with *“adjusting the standard FMW (short for Federal Minimum Wage)”* Division 2 71(1)(b)(a) was established under a Coalition government. Indeed, as indicated by the then Prime Minister John Howard: *“The government remains committed to protecting workers with a fair and sustainable safety net of wages and conditions. A new body—the Australian Fair Pay Commission—will set a single adult minimum wage on a periodic basis. This will be guided by parameters to be set out in the legislation.”* (Hansard 26 May 2005)⁵
- The 2009 Fair Work Act introduced by a Labor Government gave responsibility to the Fair Work Commission (constituted by an Expert Panel) to conduct annual reviews of the *“National minimum wage”*.

Attitudes to arbitration and the then Basic Wage over the first 50 years can be considered to be summarised by Menzies in 1953 *“nobody since then has ever dreamed of putting a hand on it and saying that this system has to be abolished. On both sides of the house in Canberra we all say this is a great system. Each side of the house has had its shot at improving the working of it by shortening time, by making procedure more simple, but there is no basic argument in Canberra as to whether there ought to be this system because everybody knows that as a result of this system the employee in Australia has things he never dreamed, or his father or grandfather ever dreamed of having when this system began. ... Let us remember that nobody in the wide world had ever heard of such a thing as a basic wage until the Commonwealth Arbitration Court created it. We take so many of these things for granted, just as we take, in some sense, arbitration for granted. ... These things have all*

⁵ In a slightly earlier speech Howard expanded on this *“I have to say to you that I think it would be out of step with the Australian ethos to not have a minimum wage. People will argue in pure economic theory that you shouldn't have a minimum wage, and you can mount a very good intellectual case for that to which a lot of people might say yes, but there is such a thing as the Australian ethos, and there is such a thing as the perception in the Australian community of what is regarded as a fair go. And I think the perception of there being the idea that there is no minimum wage at all would in the eyes of a majority of Australians challenge part of the Australian ethos.”* (Howard 2005)

This speech also clearly identified the difference between this strong support for the minimum wage per se and the question of the mechanism through which it was set.

been done for the great mass of employed people in Australia as a result of a system with all its faults has been, I believe of inestimable benefit to employees” (Menzies 1953)⁶

This persistent level of consensus is also reflected in a recent reflection by Malcolm Fraser: *“To me, the federation, and Deakin’s liberalism, was really trying to define a new kind of society ...They didn’t want the class consciousness of the United Kingdom. And in the earliest days of federation, whether it was old-age pensions, rights of women, (Henry Bournes Higgins’s) Harvester judgment (that established the minimum wage), we were light years ahead of the British and light years ahead of the Americans.”* (The Australian 2014) and more recently *“There’s nothing as Australian as the minimum wage”*. (Fraser 2015)

In ascribing a sense of particular controversy to the subject the PC in the discussion document seems to be echoing the views of one particular fringe organisation, rather than a wider consensus on the need for a minimum wage, although there is some disagreement on its actual level, and a range of different mechanisms have been adopted, especially over more recent times, for setting the rate. This is unfortunate and tends to add a degree of conflict to the issues paper which is neither appropriate nor warranted, as well as misrepresenting the balance of views.

Nature of the minimum wage in Germany, Finland, Denmark and Norway

The PC paper states *“Statutory minimum wages are common among developed economies (with 26 of 34 OECD countries having minimum wages). Some OECD countries that do not have a universal minimum rate, including Germany (currently), Finland, Denmark and Norway, still have disparate minimum rates covering many workers, with the rates determined on an industry basis.”* (p 2)

The throwaway reference to a lack of a universal minimum rate and disparate rates, which actually refers to the absence of a statutory rate, however misses a more fundamental issue. This is that most of these countries have very high minimum wages covering a vast swathe of the workforce, underpinned by very robust collective bargaining arrangements, including the support for strong unions as a party. In the case of Denmark this is explained as: *“In Denmark, pay and working conditions are typically laid down by collective agreements concluded between trade unions and employers’ organisations. This system of labour market regulation is referred to as the Danish Model. ... Strong labour market organisations with a high membership rate is a precondition for a system based on the social partners’ self-regulation and this is also the case in Denmark.”* (Ministry of Employment 2015)

These collective agreements are typically sectoral and in a number of these countries apply to all firms within the sector – whether they are actually parties to the agreement or not.

The rationale for the minimum wage

While the PC tracks the history of the minimum wage in Australia back to the Harvester decision it is quite misleading to treat this as the *“the original rationale for the Australian federal minimum wage”* (p 2). While it can be seen as providing the rationale for the level at which the rate was set, the Harvester decision cannot be seen as providing the rationale for a universal minimum – and much

⁶ It is noted that at this time Menzies was also talking in terms of a centralised wage fixation system as opposed to decentralised collective bargaining which he saw as *“good old jungle warfare”* (Menzies 1953)

more importantly from a policy perspective – as providing the rationale for intervention in the labour market to establish minimum rates, and indeed a much wider range of minimum standards. The rationale for such an intervention was established much earlier in Australia including in the role of wages boards as part of the “anti-sweating movement”⁷.

This point is not just a matter of obscure historical detail but rather an acknowledgment of two points which are glossed over in the PC presentation, the first is that the minimum wage was not just the invention of a particular form of industrial arbitration, but rather the outcome of a very long process of economic, social and political development^{8,9} and secondly that unconstrained market mechanisms can, and indeed did and do still today, produce some extremely poor outcomes

Turning to this second, it would be appropriate, and to my mind very important, for the PC to acknowledge this and to recognise that much of the industrial relations system has developed in response to the negative outcomes of unconstrained markets. In particular the PC must recognise that the counter-factual to the a regulated workplace relations framework is not some idealistic concept of a perfect market, but rather a labour market that can and will produce adverse outcomes

⁷ The anti-sweating movement sought an elimination of what they saw (and indeed the evidence would suggest the community more broadly viewed) as being inappropriate and exploitative employment conditions. While some of the focus of this movement was on out-work it more broadly ranged across a much wider set of employment arrangements.

⁸ Indeed it can be suggested more specifically with respect to the Harvester decision that the rationale for the wage was in the political decisions behind the Excise Tariff 1906 Act which specified that the Act would not apply to goods manufactured under conditions of remuneration which were “fair and reasonable” (Commonwealth of Australia 1906), with Higgins’ decision simply quantifying this.

⁹ This includes industry specific legislation such as the 1873 Factories Act in Victoria, the development of conciliation and arbitration including the 1894 South Australian Conciliation Act and the 1902 Industrial Conciliation Act in Western Australia and similar legislation in NSW as well as the role of wages boards, with initial boards being established in Victoria in 1896 under the Factory and Shops Act. In addition there was the rapid growth of trade unionism – with membership increasing from some 34,000 in 1896 to 172,000 in 1907 (Knibbs 1913 p13) and the political developments such as the growing role of the Labor Party including the Watson Labor government in 1904.

The magnitude of the extent of low pay and exploitation in the absence of some form of intervention was severe. With regard to working conditions the 1883 Victorian Royal Commission on Employés in Shops, noted in their progress report: *“The evidence adduced clearly proved that a large number of persons in Melbourne and the suburbs, numbering over 20,000, were subjected to grievous and unnecessary hardships; also, that in connexion with various trades, beyond the scope of your Commissioners’ authority, there existed a system of forced labour, repugnant to every sense of justice and humanity. In shops, hotels, restaurants, refreshment saloons, and similar establishments, the employés were obliged to work, or at least to remain in attendance, for periods beyond the limits of physical endurance.”* (Royal Commission on Employés in Shops 1883 p iii)

The impact of these measures, again all prior to the Harvester decision, was strong. The report of the Royal Commission Appointed to Investigate and Report on the Operation of the Factories and Shops Law of Victoria (1903) noted, for example, with respect to shirt-making: *“To sum up the evidence in this trade, sweating in its worst form, which brought misery into so many homes, has almost disappeared”* (p xli). The impact on pay levels and conditions underlying this statement were frequently large and the report cites as an example: *“One worker said that the Act had been distinctly beneficial to her. Before the rates were fixed, she used to work twelve to sixteen hours a day, and the weekly average of her earnings was 12s. 6d. while the minimum rate was now 20s.”* (ibid p xl) A similar impact was identified, around the same time, by the Victorian Government Statist (1904) who reported: *“For instance, the average weekly wages of all employés (including boys) in the bread-making trade was £1 12s. 6d. in 1896, prior to the Wages Board being in operation, and £2 2s. 10d. in 1902 when its determination was in full force”*. (p 91)

for significant groups¹⁰. Even today, with the set of existing protections, it is very clear that the tendency to “sweating” and exploitation remains strong amongst some employers and industries. This can for example be seen in the reports of some of the cases identified by the Fair Work Ombudsman, such as the payment of rates of \$8-10 an hour to international students at a Gloria Jeans Franchise (Fair Work Ombudsman 2015b), the payment of backpackers in Tasmania as low as \$1.35 per hour (Fair Work Ombudsman 2015a) and the prosecution of a service station for paying two adult console operators rates as low as \$10 per hour (Fair Work Ombudsman 2014).

Again I would emphasise that the issue of poor labour market outcomes without strong regulation are not just historical anecdotes, nor can they simply be portrayed as the consequence of the behaviour of one or two ‘rogue’ employers – who eventually get found out, but rather it is the type of outcome which can be expected to occur in a labour market where not every one of the assumptions of a perfect labour market – including perfect information, mobility, absence of transaction costs and where employers are price takers with no market power – applies, and even more so where the market operates in a state of macro disequilibrium.¹¹

Turning back to the specific PC claim on the ‘rationale’ for the minimum wage there is almost more sense in seeing the Harvester decision as being the final step in the creation of the minimum wage and not the source. Failure to pay regard to this, as well as a failure to recognise the range of economic processes at play in the labour market, will lead to simplistic and misleading analysis and obscure many important issues. It is important for the PC to spell out these issues and pay due regard to them.

Minimum wage as stepping stone

The PC notes (page 3) *“Moreover, the degree to which people remain at low pay levels is important in considering the long-run impacts of the minimum wage on individuals”*. It then goes on to provide a single example to illustrate the subject – that of a young person starting on the minimum wage before progressing to a higher wage and considers that in this case the income effects are temporary and this should be taken into account in setting the rate.

This is a very asymmetrical way of framing the issues which the PC is to consider. Why is this *“progress to a higher wage”* the only case cited? What about the person who remains in unskilled low pay jobs over an extended period and has to live on the minimum wage – or at rates close to it for an extended period? It can well be argued that this latter case has perhaps a stronger weight in terms of minimum wage setting (as the person has no other options) than the case cited. This again gives an impression that the issues paper seems to reflecting just what might be considered to be

¹⁰, I would emphasise here that various forms of ‘exploitation’ a term used in both its common meaning of taken advantage of, and in the terms proposed by Robinson and others, is neither an unexpected or avoidable market outcome. The dynamic monopsony model of labour markets, for example, clearly demonstrates the sort of mechanism which can lead to this type of outcome. More specifically the model highlights that in the absence of all of the assumed perfect market prerequisites, a strong rationale to expect that wages below the “perfect market clearing wage” can, and indeed will, persist in the labour market.

¹¹ For example Booth and Katic (2009 p13) conclude from an empirical analysis of labour supply that *“it would be difficult to make a case that labour markets are perfectly competitive”*.

the arguments in favour of a low minimum wage rather than being balanced. The PC needs to be very cautious in ensuring that it does not slant the consideration of these issues in just one direction.

Ratio of minimum wage to average wage

The chart, Figure 2.2 “Minimum wages to average weekly wages” is relatively uninformative – and at least needs to be very heavily qualified and the substantive reasons for its inadequacy discussed. There is also a curious reference in the header to a plurality of “Minimum wages”- whereas there is only one Federal Minimum Wage in Australia (and, for example, the only state minimum wage is not reported on).

The lack of information value in the chart arises from the comparison of the minimum wage with average earnings rather than the more usual comparison with median earnings. As average earnings can be heavily distorted by wages in the upper tail of the wage distribution, this type of comparison has only limited value in informing people of the relativity of the minimum wage and the wage earned by the ‘typical’ person in the community.

The more substantive issue is the fact that I presume the PC has adopted this approach because of the lack of “current” information on median earnings at the state level (and indeed the difficulty in obtaining this for the Territories). This is one of the multiple points in the paper where it would be appropriate for the PC to note the inadequacy of data on wages and the wages distribution and the massive underinvestment in this data by the ABS, in large part due to the impact of funding constraints. As I discuss later, this is a serious problem which needs to be addressed to avoid policy making on the basis of half-baked data such as that in the chart.

The Minimum Wage and tax and transfer system

This part of the discussion, commencing on page 6, reflects again a very narrow approach to the issues and one which is likely to result in an unbalanced consideration of the role of the minimum wage and the operation of labour markets. This is illustrated below.

The PC commences this discussion with the statement *“People’s decisions about whether to take a job ... depend partly on the relative attractiveness of their net wages, the income they would otherwise receive through social security benefits and other considerations such as their prospects for promotion.”* (p 6)

While it might be considered that the PC has qualified this statement by the inclusion of the word “partly”, there appears to be no discussion of the range of these other factors in the Issues Paper (including the role of obligations and sanctions for a not meeting these with regard to the receipt of transfers, preferences of individuals for employment relative to non-employment, the limitations of the role of incentives where labour supply is inelastic and the capacity of individuals to find jobs). Rather the paper chooses to focus most of the further discussion on incentives¹².

¹² The need for caution in trying to focus on a single issue such as incentives is given particular weight by the wide variation in the elasticity of labour supply. For some groups, including married and single men, and to a lesser degree, single women, labour supply is relatively inelastic and hence this type of effect has little impact.

This highly restricted approach is also the case with the statement at the bottom of page 6: *“Below this point, the binding constraint on employment is not the level of demand by employers, but the degree to which households are willing to supply labour at a given net wage.”* While this theoretical statement is correct and is highlighted in elementary economics text books, the essential question is whether the PC considers that the current level of unemployment – and indeed the rate of unemployment Australia has experienced over a considerable period has been simply as a result of households being unwilling to supply labour at current wage rates, and not an inadequacy of demand? If this is the PC interpretation then it really is incumbent on the PC to release their analysis, including as it relates to recent increases in unemployment, for public scrutiny and debate. Alternatively, and more probably, it would appear that this is yet another case where the Issues Paper appears to have got itself caught up in one narrow theoretical position, underpinned by assumptions about a perfect labour market, and then moved down this one path. It is critical, if the PC is to provide analysis that takes the debate forward, that it avoids this type of approach but rather provides a balanced and more comprehensive approach.

For example, if the PC is to focus on the question of the mismatch of labour supply and demand and the willingness of people to accept employment they should at least identify the range of key factors which might impact and the relative importance of these. It can be suggested that a decision to take a job is primarily affected by:

- a) The ability of the person to find a job. This is critical during a period of elevated unemployment caused by a lack of aggregate demand, or where unemployment is being maintained at a ‘natural rate’ to limit the risk of inflationary pressure. Are the PC seriously arguing that the current level of unemployment is primarily a result of people not accepting jobs because of the relative level of Newstart Allowance (and indeed that recent increases in the unemployment rate are a consequence of a change in these incentives)? If this is the understanding of the PC then this needs to be clearly spelled out – along with the underlying analysis. If it is not the fundamental argument of the PC then there is a need for a much more balanced approach which considers the main reasons first.
- b) This statement also totally ignores the fact that a significant proportion of the population in receipt of income support who are able to take up employment are subject to strict work testing – where refusal to take up employment results in the termination of the receipt of income support. In these cases the hypothetical financial incentives simply do not come into play. Rather people in this situation face the option of accepting the job or having no income due to suspension/cancellation of benefits.
- c) The cost of work, this can be particularly important in the case of people with family responsibilities, as well as those located in areas of lower cost housing who may face very large costs in getting to work, especially where there is limited public transport (including a lack of public hours if the job is at non-standard hours, or where people have to combine the journey to or from work with picking up or dropping off children.

See for example Dandie and Mercante (2007) for discussion on empirical estimates of labour supply elasticities in Australia.

- d) It also ignores the extent to which many people seeking employment, including in low skilled and low paid occupations may neither be eligible for, or in receipt, of income support and hence these particular issues do not apply. This group includes for example some partners and others within households, as well as overseas students and visitors¹³.

As has been noted earlier the empirical evidence suggests that there are very large variations in the elasticity of labour supply across population subgroups in Australia. There is a clear need for the implications of this to be taken into account in providing a balanced perspective in the analysis.

Role of an EITC

An extension of this discussion on the interaction between the minimum wage and the tax and transfer systems in the Issues Paper relates to the role of an Earned Income Tax Credit (EITC). Again, to my mind, the discussion of this by the PC seems to focus on some secondary issues rather than the primary purpose. This can be seen in the statement in the paper *"It follows that government-funded in-work benefits, which increases net wages, may encourage people to work if the minimum wage is relatively low"* (p 7).

The primary purpose of an EITC is usually to increase the level of disposable income of households to achieve societally acceptable standards of living in cases where wages are inadequate to do so. In some cases an EITC can be used to correct for poor design of interactions between taxes, transfers and earnings, but in the context of the setting of the minimum wage it is an additional, supplementary, means of ensuring that households which are engaged in the workforce have adequate incomes to achieve a suitable standard of living.

While this is at times cast politically as 'improving the reward for work' it is far less clear as to the extent this is either the motivation or the effect, and even to the extent it is a motivation the context is usually one in which the welfare or the tax system impose high Effective Marginal Tax Rates which may create a disincentive (to the extent, as noted above, this alone actually is a disincentive).^{14,15}

¹³ The issue of payment for these groups is important not just intrinsically but also in terms of the extent to which this group can undercut the wages of other employees. The impact of this group can be seen, for example in three consecutive media releases recently posted by the Fair Work Ombudsman "Sushi bar reimburses Korean backpacker, revamps workplace practices after \$5000 underpayment", 11 February 2015; "Darwin café to face court for allegedly underpaying overseas workers", 10 February 2015, and "Court action after alleged underpayment of overseas worker at 7-Eleven in Brisbane", 9 February 2015. (Fair Work Ombudsman 2015c).

¹⁴ In Australia the payment of Child Endowment and family assistance, while not employment contingent, can be considered as a form of in work benefit. The political expressed motivation for these has varied over time. In 1941 Holt (1941 p 337) expressed the rationale in terms of restraint of wages and consumption; Hawke (1987) expressed it in terms of an anti-poverty measure; Keating (1994 p145) as *'essential for improving the incentive for one member of a couple to accept a low paid job'* and to *'give these families greater choice as to whether one of them stays at home to care for their children while the other works'* (Keating 1994 p151); and Howard (2004) as providing *'Greater choice for families to choose how they will balance their work and their family responsibilities.'*

¹⁵ The impact of EITCs has been studied in a wide range of research especially in the US and the UK, but also in New Zealand. In general they have been found to have a positive impact on the extensive margin (workforce participation) for single parents, in couples with children a positive impact for men but negative for women, and relatively limited impact for singles. Findings on the intensive margin are more mixed. The research has

As such I find the presentation of this matter in the issues paper as being quite strange. The framing of the role of the EITC in terms that it “*may encourage people to work*” is incredibly narrow, and ignores the much wider range of issues, in particular well-being, which should sit at the heart of any discussion around the minimum wage and indeed the welfare system.

As a consequence I find that the PC Issues Paper on this item again tends to direct the discussion of the minimum wage and the options around it, including the role of an EITC, in a way which will not provide for a balanced consideration.

Finally the statement that an EITC increases ‘net wages’ requires some scrutiny. While it increases household net income the extent to which it is delivered as part of wider transfers means the link with wages is somewhat remote, especially in a system such as Australia where these transfers cross over both earned and unearned income and provide a continuity of support across varying degrees of participation. Also it should be noted that without strong wage regulation and depending on the nature of their design, they can decrease gross wages and result in substitution with limited net income gains.

also found differential effects on fertility and partnering and on children and some studies have found negative impact on wage rates.

Section3: Response to specific questions raised in the PC discussion document

This section of this submission considers the 17 specific questions raised by the PC in the discussion paper, although in some cases full responses to the questions will be in section 4.

1. The Commission seeks feedback on the advantages and disadvantages of different approaches for comparing minimum wages across countries, and how such results should be interpreted.

To my mind this is a very curious question to ask and the ordering of issues within the question seems to be inverted.

The first question should be how much value is there in making comparisons of the minimum wage in different countries and what would be the role of these in this type of inquiry?

My answer to this is there is quite limited value in these comparisons.¹⁶ There are a number of reasons for this:

1. Comparisons of the actual value of minimum wages detached from any consideration of the interaction of these with the tax and transfer system, let alone with the wider range of social wage benefits (including, for example, the costs of education, health care, etc), as well as the extent to which there are payroll taxes and other levies imposed on these wages, are largely meaningless, or even worse, can be very misleading. That is, a simple comparison of minimum wage rates neither informs on the welfare of people in receipt of the wage nor the labour cost of employing them. Trying to draw all of these elements into a comparison is however a major exercise, which usually cannot be justified.
2. Even if all the steps of 1. are undertaken, the comparisons are largely of limited value unless the comparison is being made for countries with broadly similar industry structures and aspirations. A country which aspires to promote a low waged manufacturing sector may strike quite a different minimum wage to one which seeks a focus on other activities.

The second question relates to some of the more technical aspects of such comparisons. In the first instance I would take issue with the statement by the PC that *"It is common to examine international differences in the exchange-rate corrected values"* (p5). I would consider that almost all credible comparisons do so on the basis of Purchasing Power Parity (PPP) values¹⁷. This is the appropriate

¹⁶ While as I indicate there is limited substantive value in making these comparisons, they do remain a common feature of most 'studies' of the minimum wage. What is important is that any interpretations of these comparisons are undertaken with appropriate attention to the limitations – and are not just used spuriously.

¹⁷ The reasons for this are quite neatly summarised in Webb (2011) *"Measures of income levels and living standards based on exchange rates can be very misleading. While the measurement of PPPs has its own set of problems, PPPs avoid the obviously wrong assumptions that price levels are the same across all countries by using actual prices, and that exchange rates reflect only or primarily the relative purchasing powers of currencies in their national markets. PPPs are therefore to be preferred to exchange rates measures."*

basis for such an approach. If the PC considers that this is not the case and that exchange rate based approaches are more common, then the evidence for this should be provided. However, even if PPP comparisons are made there are limitations:

1. As noted above, the first of these limitations is that of making comparisons of minimum wages in isolation from interactions with tax and transfer systems, and the wider set of national institutions.
2. The second is that PPPs are designed as tools to enable point in time comparisons. They have a much more limited value in making comparisons of trends over time. This introduces some large constraints on the amount of useful analysis which can be undertaken.

There are many other comparisons that can be made. These include: the ratio of the minimum wage to earnings at other points in the earnings distribution – say relative to low income earners using the 10th and 25th percentiles of earnings, with the ‘average’ employee, using median earnings, and with upper income earners using the 75th and 90th percentile. These comparisons can be undertaken on the basis of gross wages, or, for example, on the basis of household disposable income using different hypothetical household cameos. Similarly the level of minimum wages can be compared relative to various forms of unemployment insurance/benefit payments.

A further dimension of comparisons are around the minimum wage bite – the proportion of the workforce that is on the minimum wage; and with regard to the occupational and industrial structure of the minimum wage workforce, and consider questions such as the extent of dependence on the minimum wage in different industries and occupations. In addition there are questions such as the age, gender, educational attainment, minority status, etc, characteristics of the minimum wage workforce, and the extent to which minimum wage employment is concentrated amongst groups defined by these characteristics.

There is value in doing all of these, however while they are all informative it is difficult to see just how much value they have in the current considerations of the PC.

2. What is the rationale for the minimum wage in contemporary Australia? How effective is the minimum wage in meeting that rationale? To what degree will the role and effects of the minimum wage change with likely future economic and demographic developments?

I would argue that the essential role of the minimum wage (in association with the tax and transfer system) is to ensure that people who undertake low paid jobs within our community have the capacity to achieve an adequate standard of living to be able to live, with dignity as full members of our society, and participate in all aspects of community life¹⁸.

¹⁸ I would note that while my view is that this outcome is one which should be achieved by the combination of the minimum wage and transfers, there are other perspectives on question. One approach is that this should be achieved by the wages system alone – that is it is an obligation on an employer to pay a living wage. Alternatively there is a view that there should be a guaranteed minimum income as a right of citizenship, with this being delivered in the first instance through the transfer system, or as a negative income tax. The combination approach also features in the Universal Declaration of Human Rights: “Everyone who works has

A minimum wage can also be seen as being important for a range of other reasons, with each of these providing an additional rationale:

- Because of labour market imperfections, including as discussed previously the case of dynamic monopsony – which is likely to be a reasonable approximation of some sections of the labour market – there is a risk of wages being set well below what may be considered as being the market clearing wage in a perfect market. The minimum wage helps to reduce this sub-optimal outcome. This is also the case where the market is seen from a bargaining perspective and there is asymmetric bargaining power.
- In the case of periods of an insufficiency of labour demand the minimum wage can act to limit the extent of a possible downwards wages spiral. While this may result in some unemployment this is a trade-off which a society may consider to be appropriate and less destabilising, and under which it is willing to provide appropriate support/compensation to those excluded from the labour market.
- The minimum wage can act as a floor to the lower end of the earnings distribution and hence address inappropriate wages dispersion and income inequality.
- A minimum wage may be important from the perspective of ensuring a high level of productivity. It has long been recognised that individuals can vary their productive capacity and will respond to incentives in this regard. While it may be considered that the payment of efficiency wages is primarily a matter for a firm, a case can be made that this is important more generally. Issues here concern the extent to which employment behaviours may become embedded in the workforce and also the extent to which firms are not necessarily efficient in their operations, but frequently seek to reflect common practice.
- There is a strong moral tradition about the value of labour – which is seen by many as being embedded in the wages system¹⁹.

the right to just and favourable remuneration ensuring for himself and his family an existence worthy of human dignity, and supplemented, if necessary, by other means of social protection". (UN 1948 Article 23(3)). Finally it can also be argued that this outcome should be achieved through the transfer system alone – that is all people should have this capacity to fully live and participate in society – and that employment should offer additional rewards above this.

¹⁹ One example of this type of proposition is: *"Let the working man and the employer make free agreements, and in particular let them agree freely as to the wages; nevertheless, there underlies a dictate of natural justice more imperious and ancient than any bargain between man and man, namely, that wages ought not to be insufficient to support a frugal and well-behaved wage-earner. If through necessity or fear of a worse evil the workman accept harder conditions because an employer or contractor will afford him no better, he is made the victim of force and injustice". (Pope Leo XIII para 45)*

In 1996 the then US Secretary of Labor put the case that: *"an implicit moral code operates just under the surface of our otherwise impersonal economy ... there are times and there are conditions when we insist on a minimum standard of fairness. This implicit moral code also requires that people work for a living. We are unwilling to permanently support those who are able to work but choose not to. But society has a reciprocal responsibility to ensure that there is enough work for these people to do.*

Finally, this implicit moral code stands for the simple proposition that anyone who works hard should earn at least enough to keep themselves and their immediate families clothed, fed, and sheltered. Hence, we now have

- There are also normative approaches to the industrial structure, some of which reflect these moral traditions. This is seen in proclamations such as that of Higgins *"If a man cannot maintain his enterprise without cutting down the wages which are proper to be paid to his employees - at all events, the wages which are essential for their living - it would be better that he should abandon the enterprise"* (Cited in Hammond 1913 p282) and *"It seems to me to be equally plain that no business which depends for existence on paying less than living wages to its workers has any right to continue in this country"* (Roosevelt 1933).
- Finally it can be argued that the minimum wage needs to be paid at a rate somewhat above rates of income support – a position which can be argued on a) incentive grounds; b) costs of work grounds; or c) on the basis of valuing employment over non-employment. This type of argument however needs to be well grounded in essential questions of living standards rather than just comparative rates. That is what is the standard of living the community is appropriate for a person on income support and what is the standard appropriate for a person in employment, not simply whether one rate is higher than the other.

I have detailed the extent to which the minimum wage is currently achieving a number of well-being outcomes in Bray (2013). As described in section 3.3.6 of the analysis while there are some indicators that suggest some weakness in this capacity, on balance my view is that, in association with the tax and transfer system the current level of the minimum wage is just achieving this in terms of measures of financial stress and material well-being, where people are able to obtain full-time employment.

Here I would note that in considering these issues, the question of the role and objective of the minimum wage become important. In particular when approached from a social policy perspective this question of well-being and outcomes is most frequently done in terms of household outcomes. This is the case in both the PC perspective in their discussion of "income distribution in working households" and "the minimum wage and the tax and transfer system", and indeed much of the analysis in my paper. An alternative perspective is that these questions should be looked at at the individual level as well. Or to put it another way, if a minimum wage worker cannot achieve appropriate well-being outcomes for themselves, but rather has to rely upon the assistance/charity of others in their household to achieve this, is this a satisfactory outcome? While to my mind while this is not the primary focus, neither is it one which should be ignored.

The Bray (2013) paper also contains (Chapter 6) a discussion around future options. As indicated I consider there is a need for some significant attention to this in the future. However at this point I would note, as I detail later in this submission:

1. I do not consider that the issues require immediate attention, rather I think we have something like a 5 year timeframe to work through the questions and adopt appropriate measures;
2. The questions which need to be considered require considerable levels of data and analysis which are not currently available and are unlikely to become available within the time frame for this inquiry. In addition, to the extent possible, they are questions upon which there is a need

a minimum wage which, when coupled with a refundable earned-income tax credit, will accomplish this bare requisite of decency." (Reich 1996)

for a degree of political and broader consensus. While this consensus is not required on all of the detail, such as the criteria to be used in taking some decisions, which can be subject to the priorities of governments over time, there is a need for a level of consensus on the nature of the institutional framework.

Given this I do not think that this current inquiry should attempt to make significant pronouncements on this subject and come up with knee-jerk and short-term 'solutions' which will of necessity be based on incomplete knowledge and little consultation, and will be rushed where no need for urgency has been made. Rather I consider that the focus should be on some short term measures which essentially stop any major new issues arising and which establish an environment which will be conducive to good faith discussions between all parties.

3. How many people receive the minimum wage (and for how long)? What is the best measure of this share and why?

I can only assume that the PC is asking this question in the discussion paper as a rhetorical question. Given the references cited by the PC in their discussion paper it is very clear that the PC is aware of the range of estimates in the literature on this and of the extensive discussions in the literature on the difficulties in making these estimates.

Perhaps a more useful question for the PC to ask is what needs to be done to enable better estimates of the minimum wage workforce to be obtained, and to provide some recommendations on this in its report. Implicit in identifying this is also, as I have emphasised in this submission, the need for caution in trying to propose any changes to existing arrangements where even this type of most basic information is not available.

I consider that there is a strong case for additional funds to be provided to the ABS to enhance their survey program including the EEH and various household surveys, including additional validation checking within the data collection phase. For example, in the EEH additional data verification could be used to test the effective hourly wage rate (at least for adult employees) at the time of initial data collection and use this as a trigger for additional questions in the case of people who appear to be paid at or below the minimum wage. A similar approach is needed in a number of the household surveys with the identification of cases where additional follow up questions are needed being relatively easy with computer based data collection. Some of the household surveys also need some additional questions to allow for better identification of casual rates of pay.

While this sort of data verification is not the usual approach in household surveys where responses are in general taken at face value, the extent to which the current data appears to suggest some improbable results, the case for moving in this direction is strong.

In the case of HILDA while these matters also need to be considered, the primary focus, as this survey is the only source of information on the longitudinal pattern of receipt of earnings, should be on the quality of information on the persistence of low income over time. The issue here is building a better understanding of the extent to which apparent income mobility in HILDA reflects 'noisy' data, and the extent to which it reflects real change. While there are various options in this regard, some being research projects conducted on the HILDA data alone, one promising option is the use of

longitudinal income tax data held by the ATO which would allow for the comparison of the extent of volatility over time in administrative and survey data on earnings.

I again stress that these are areas which require additional investment by the federal government.

4. What are the effects of minimum wages on different households, taking account of direct and indirect wage and price effects, and the tax and social transfer system?

Extensive analysis of these issues is provided in Bray (2013).

5. Are there any issues associated with the special minimum wage rate arrangements that apply to juniors, trainees and apprentices?

There are many issues, however my view is that none of these require immediate attention to alter current arrangements. Rather they should form part of a much more in depth and longer term review with this also being able to draw upon improved data and analysis.

6. What are the impacts of minimum wages on employment as a whole, and on particular groups of people (by age, skill, education, gender, and location, among other things)? How robust is the evidence? Are zero or positive employment effects from minimum wages for low-skill workers plausible for the industries in which minimum wages predominate, and if so why?

While this is a subject of considerable research both in Australia and overseas, the evidence on the impact of minimum wages on employment is contested and inconsistent.

It is also an issue I address in Bray (2013) and where I argue that trying to find simple answers is misplaced. The labour market is very complex and great caution needs to be exercised in seeking to apply any one single theoretical model to their operation. As I indicate in my paper: *"Given the array of potential theoretical approaches to wage setting and the minimum wage, it is easy to dismiss these theories as being conflicting, or to cherry pick particular theories which tend to reinforce pre-conceptions or aspirations."*

An alternative approach, as intimated in the introduction to the section, is to recognise that each of the theories is seeking to simplify one dimension of a very complex relationship where at any one time several forces will be at play. More so, different circumstances may result in quite different weights to each of these." (Bray 2013 p 73)

Very clearly initial questions which need to be considered include: whether or not the minimum wage is below the 'perfect market' clearing wage as, if it is below, then it is possible it has positive effects on employment, while if it is above it may have negative effects; it depends upon the elasticity of demand for those products where it plays an important role in the final cost; and the extent to which domestic production can be substituted by imports; it depends on the cross price

elasticity of demand for different forms of labour; and that of labour and capital; it also depends on factors such as the extent to which it generates an efficiency wage effect; its impact on training and education (see 8. below); the extent to which other workers may accept some wages compression; and more generally, the extent to which there is bargaining re the profits share.

To the extent empirical analysis is considered, in addition to the likelihood that a series of the above mechanisms will be in play, attention needs to be given to:

1. Recognition of the fact that most changes in the minimum wage in Australia and indeed overseas have been relatively small in real terms²⁰, and as such they are likely to have small effects which are difficult to identify; and
2. There is a body of research which suggests that the timing of impact is far from instantaneous, but rather some responses may be anticipated or lagged, with this latter potentially involving long term investment decisions including at the plant level. (See discussion on adjustment effects in sections 5.2.3 and 5.2.4, as well as the cited work of Pinoli (2010) on timing in the attached paper. A more formalised 'putty clay' model is proposed by Aaronson, French and Sorkin 2013). Again this has potentially significant implications for empirical research which seems to establish cause and effect based on the timing of changes in the minimum wage and relatively short term outcomes.

7. What would be the best process for setting the minimum wage, and how (and why) does this vary from the decision-making processes used by the minimum wage Expert Panel of the Fair Work Commission? Are there grounds to vary the criteria used by the Panel? Should the ratio of the minimum wage to median wages change and, if so, in which direction?

As I indicated in the introduction to this submission I consider that these issues do require attention, but the time scale and mechanism for this are beyond this current inquiry. As noted, and developed more fully in the next section I propose:

1. A process be established which will enable these matters to be considered in detail over a number of years, drawing upon experts and with the participation of all parties including employers and their representatives, employees and their representatives, governments and community and other organisations with an interest in both the minimum wage and the social welfare outcomes from it; and
2. In the interim the minimum wage be maintained in real terms at its current value, with this also being applied to supporting payments including family support, although noting that there may

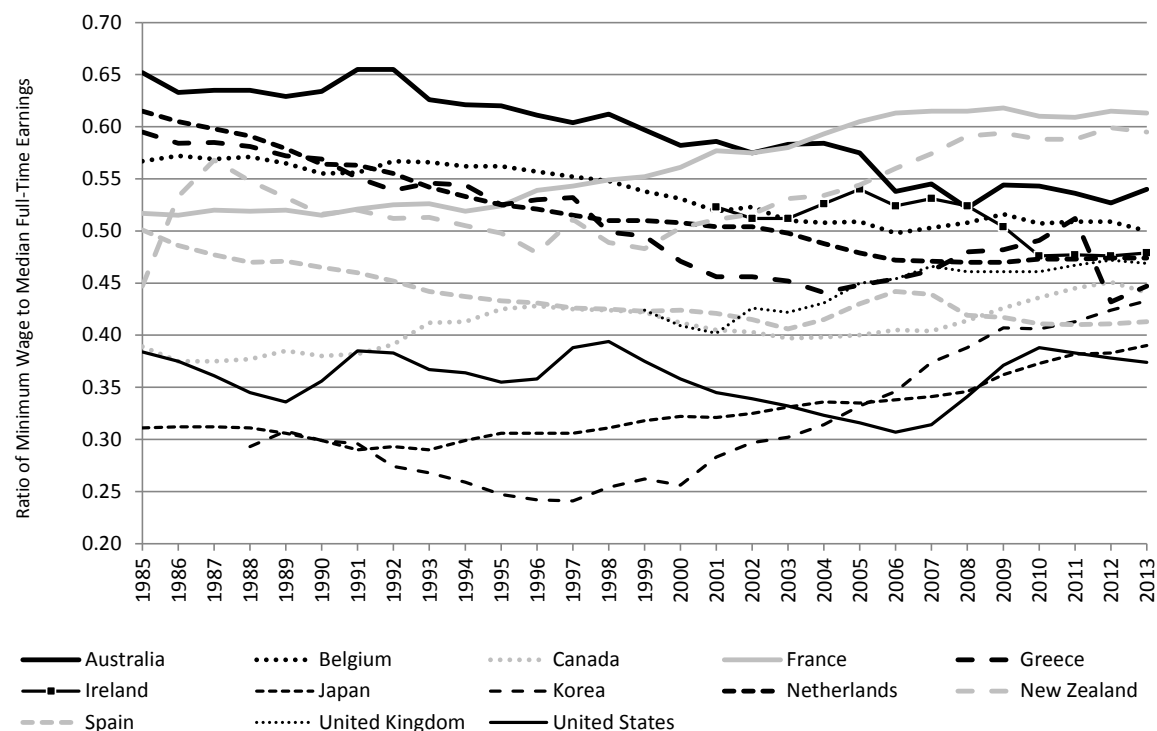
²⁰ In this submission my primary focus is on the real value of the minimum wage. I think it is important that this is the approach used, rather than falling for the money illusion and focusing on the nominal wage level. Effectively the minimum wage needs to be considered in terms of consumption capability – which is a real and not nominal concept; in terms of the costs of production – with product price, other than in the very short term, being relative to the price of other goods and productivity – which is measured in real terms. Under these circumstances there appears little value in considering nominal values.

be grounds for increasing these latter initiatives in line with any overall real gains in community living standards if these occur.

With regard to the question of the relationship between the minimum wage and the median wage, in addition to finding this an odd juxtaposition to the more conceptual question about processes. I consider the question needs to be linked with question 2 on the purpose of the minimum wage. To simply ask whether the minimum wage should increase or decrease as a proportion of median earnings appears to totally ignore the questions of the rationale of the wage, and appears to invite ill-informed responses – without any underlying explanation as to why any change should occur and how this relates to the purpose of the wage.

While some information is provided in Figure 2.1 of the Issues Paper on the ratio of the minimum wage to median earnings (as identified in the ABS Employee Earnings, Benefits and Trade Union Membership Survey) this has been truncated from the full range of information provided by the OECD. A fuller version of the chart is shown below in Figure 1.

Figure 1: Federal Minimum Wage as a proportion of earnings of Full-Time Adult Employees (EEBTUM), 1985-2012



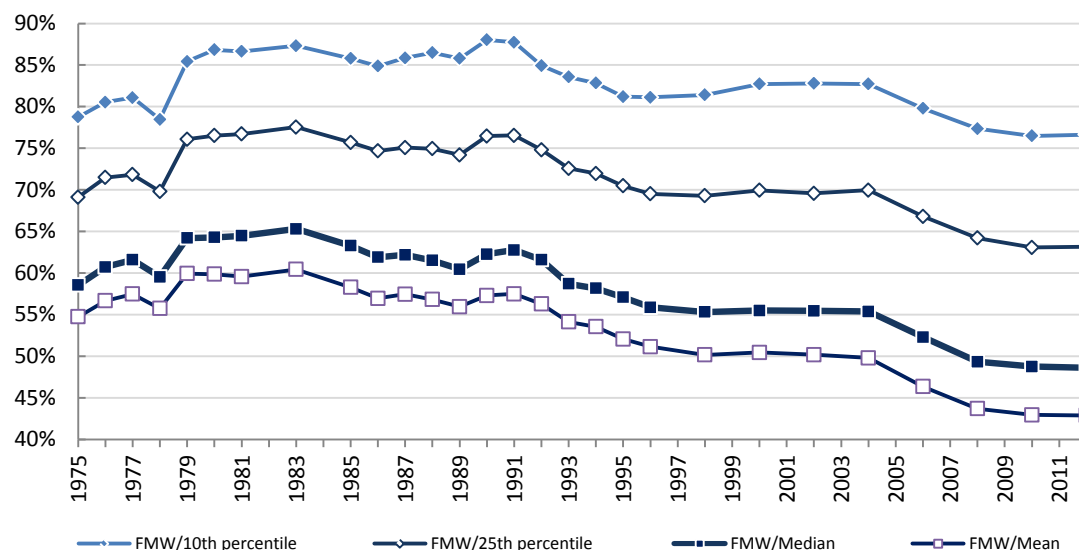
Source: OECD.Stat Dataset: LFS - Minimum relative to median wages of full-time workers

Figure 2 below, which extends the data provided in Bray (2013), provides an even longer perspective for Australia. It shows that the relative value of the minimum wage has declined when measured against most points of the earnings distribution. While initially rising in the late 1970s from being 58.6 per cent of the median earnings of a Full-Time Adult non-Managerial Employee in 1975, to around 65 per cent in the early 1980s the rate has declined to being just 48.6 per cent in 2012.

While I would argue that this type of comparison is important to build an understanding of trends in the minimum wage, and I would note that some would consider the relationship with median

earnings to be a valuable indicator of whether or not the earnings of minimum wage workers are 'keeping in touch' with the 'average worker', as discussed here and in Bray (2013), I do not consider that the trend to date is of too great a concern given the increased support for families through the transfer system and the extent to which the minimum wage for a single person historically contained, to some degree, some provision for a family.

Figure 2: Federal Minimum Wage as a proportion of earnings of Full-Time Adult non-Managerial Employees (EEH), 1975-2012



Source: Bray 2013, updated

8. What evidence is there about the effects of minimum wages on the incentives for employees and employers to increase employees' skills?

There are published studies such as Booth and Bryan (2006) and Acemoglu and Piskchke (2001). I would emphasise that seeking to find a generalised answer to this question, as discussed elsewhere in this submission with respect to other questions about the minimum wage, may be misplaced. Rather it needs to be recognised that different outcomes may occur due to the specific characteristics of the labour market and at a specific time.

This can be seen in the extent to which the theory suggests potentially diverse outcomes. From the employee perspective a higher minimum wage might a) lead to people reducing their investment in education and training as they can obtain this higher income without additional skills; b) result in them undertaking additional education and training in order to compete more effectively with others who may be drawn into the labour market, including to retain an existing job which is now paid more highly. From an employer perspective they may a) reduce training given that they should have a larger and more skilled workforce to draw on; or b) increase the training provided to existing employees to raise their productivity to match the new wage, given the high transaction costs of replacing them with a more skilled set of workers.

Each of these then is dependent upon factors such as the labour supply elasticity and skill set of the workforce, the actual and perceived long and short term returns to education and training, the

actual impact of training on productive capacity; and the search and transaction costs of hiring and firing.

Further, as noted previously, given a real increase in the value of the minimum wage of less than 14 per cent over a 36 year period it is probable that the magnitude of any change is likely to be small.

9. How do minimum wages ripple throughout the wage system and over what time frame? Are any ripple effects desirable or undesirable and, if the latter, how would they be mitigated?

To the extent there has been so little change in the real level of the minimum wage in Australia over recent decades, and a substantial proportion of these other wages tend to have been codetermined with the minimum wage, identifying the historical impact and linkages is difficult, and or, relatively meaningless.

In terms of future changes it is largely dependent upon the mechanisms adopted.

10. Should there be a process to allow the minimum wage to vary by state and territory or region? If so, on what basis? What would be the effects of such variations at the borders between states or regions? What would be the overall impacts?

While there are some possible arguments for this approach – in particular where the cost of living varies by location – ultimately my simple answer to this is no.²¹

If such a regionalised minimum wage approach were to be adopted the initial operational question would be about the geographies upon which the differentiation should occur. In this regard the idea of using states seems to be rather strange – on what rational basis would a state justify a basis for such a differentiation? It is unlikely that this would be the cost of living, as these vary significantly across locations within states, and there seem to be no grounds to be concerned about variations between states but not within. In particular I think there are very few state specific variations in cost (such as the impact of state regulation on some prices such as utilities, or charges such as motor vehicle registration) which would impact on costs to an extent to justify such a policy. The only grounds for using the political division of states as a rationale would appear to be political grounds²². Rather any approach would need to be based upon geographically defined labour market regions.

²¹ The essential question is that of the rationale for such a policy – something which is not asked by the PC. It is also a question which is intimately bound up with the purpose of the minimum wage. The second question is whether if there might be merit whether the operational costs (including potentially adverse outcomes) are worth the gains. Since the latter are high I have mainly focused on the operational aspects.

²² It also raises the spectre of a competitive race to the bottom between states – something which is not unknown in Australian history, especially where states can effectively transfer some of the costs onto the Commonwealth which already provides significant levels of in work financial assistance to families with children, and may in the future provide more through an EITC.

Further to the extent it might be considered that a spatial approach is valued in that it reduces the rough justice of a single national rate, it simply imposes another form of rough justice within states.

A major issue then arises around the cost of obtaining information to enable this type of approach to be adopted. Specifically if one is to go for such a differentiated approach, given the primary purpose of the minimum wage to enable a person working for this wage to be able to achieve an acceptable standard of living in our society, such a minimum wage needs to be based on some measure of adequacy – either of inputs or outcomes. Each of these is exceptionally difficult to achieve. The first requires the derivation of a cost of living (including the cost of working) for each labour market in Australia. Essentially this would involve the derivation of a basket of consumption for the target type of household in each of the locations (using a survey such as HES) and then the regular adjustment of the prices of this specific basket in this location, and regular updating of the basket. The ratio of the value of these baskets would then provide an adjustment mechanism for a minimum wage established for some reference location. (The need for separate baskets, not just prices, in locations reflects the fact that people in different locations make quite different trade-offs depending upon their location. While housing may be cheap in some locations this may be because the cost of transport to get anywhere is high and hence the consumption basket for this location would have a much lower weighting for housing and much higher weight for fuel and private motor vehicles.) The cost of doing this would be very high.

An alternative would be using some form of outcome measurement such as well-being to measure the relative self assessed well-being of people on the minimum wage in different locations and seeking adjust the minimum wage on this basis. This again requires the collection of extensive data at a highly geographically disaggregated level and, as in the above case, the cost of doing this would be exceptionally high.

A further question is what the objective of this type of tailoring would be. While a case may be able to be made in a social welfare context (a perspective which up to now the PC has totally eliminated from discussion), the arguments for doing so on labour market grounds are much more complex. One issue is whether a uniform minimum wage helps industry locate to areas where they can obtain the ‘best’ workforce for this price. That is, an industry which essentially only requires relatively unskilled labour may find it best to locate in an area with low living costs and pay the minimum wage and obtain a higher quality workforce, than they could in alternative locations. This approach has some merit for depressed regions.

Another issue which comes into consideration if location differentiated rates of the minimum wage are to be considered, are the complex set of interactions this would have with a uniform national income support system. While the PC seems to be inordinately concerned with the incentives which arise from this, it is not mentioned in this discussion.

In even raising this issue the PC should also reflect upon the fact that they could not even produce a comparison chart of the minimum wage and median earnings at a state level for inclusion in their discussion document. With not even this one relatively simple indicator, let alone the much wider array of information upon which any decision would need to be made, being available, it is rather hard to see how any evidence based policy can be made and the reasons why the PC is seeking opinions as a ground for their discussion.

It would also be useful for the PC to consider the extent to which this sort of differentiation has been attempted in the past and has been eliminated. For an extended period of its history Australia has

had state and, indeed on some occasions, location-specific minimum wages. This, for example, saw the ABS produce in the 1920s price indices for some 200 towns (CBCS 1929 Chapter 1²³).

11. Are there grounds for an in-work benefit, taking into account their social and distributional impacts, effects on employment and economic efficiency, risks, administrative requirements, and compliance costs?

We already effectively have such a system for families with dependent children. The question hence needs to be asked in terms of whether changes, including better linkages between the wages system, the tax and the transfer system are required to this system, and whether or not it needs to be extended to people without children.

Options are discussed in the next section.

12. How would any in-work benefit be designed and implemented? How would it be targeted to minimise deadweight costs?

See discussion in next section.

13. To what extent should an EITC or some other in-work payment serve as a complement or substitute for minimum wages?

I would argue strongly that any such EITC has to operate as a complement to a minimum wage and not as a substitute, and I believe that the overwhelming balance of analysis supports this contention.

The complementary role of these two mechanisms was emphasised in the 1998 OECD Employment Outlook which called for countries to consider integrated approaches which combined both minimum wages and in work benefits. They argue that: *“a well-designed policy package of economic measures, with an appropriately set minimum wage in tandem with in-work benefits, is likely, on balance, to be beneficial in moving towards an employment-centered social policy”* (OECD 1998 p. x).

This is echoed in the literature including Immervoll and Pearson (2009) who focus on how the two policies, and potentially wage subsidies directed at employers, can effectively be combined with the goal of obtaining *“additional policy leverage to tackle the dual challenge of high rates of non-employment and in-work poverty.”* They specifically argue *“the case for a minimum wage becomes stronger when IWBs [In Work Benefits] are in place ... a minimum wage improves the targeting of IWBs. By preventing wage levels at the bottom from falling, they prevent employers from ‘pocketing’ the value of IWBs by lowering wages”* (p 39).

²³ This chapter provides a summary history to the production of these statistics including the role of the role of the Royal Commission on the Basic Wage and its recommendations. The same publication describes in Chapter 2 how the Harvester rate *“has been varied from time to time in accordance with the Retail Price Index Numbers (Food, Groceries and Rent (All Houses)) computed by the Commonwealth Bureau of Census and Statistics for the city or town in which the persons affected are employed”*. (CBCS 1929 p85).

This and related issues is discussed in Section 5.2.9 of my attached paper.

A more recent report indicates *“Combining the EITC with a higher minimum wage can lead to better distributional effects than the minimum wage alone, although it increases the adverse effects of the minimum wage on other groups”* (Neumark 2014 p 8) In assessing this claim it needs to be noted that the adverse effects referred to in the quote arises for *“specific groups—like teenagers and less-skilled minority men—that are not eligible for the EITC (or are eligible for a trivial credit)”* (Neumark 2014 p 8) This additional clarifying statement indicates that the adverse outcomes identified in the study are not a result of an EITC per se, but rather the specific design of the specific US EITC and its eligibility criteria. That is the issue is one of the design, not a fundamental flaw in the use, of an EITC as a mechanism for achieving appropriate welfare outcomes.²⁴

14. How should any such payments be funded, and what would be the economic and distributional outcomes of alternative funding mechanisms?

This question, in the abstract, is much the same as any question of the determination of how government policies are funded, whether these are issues around how tax cuts are to be funded, or how income support, including family assistance which already acts as an EITC for some minimum wage workers, is funded. At a conceptual level the answer is through an efficient taxation system. This would suggest that an EITC be funded through a range of corporate and personal income and expenditure taxes, rather than any specific additional funding mechanism which is likely to add complexity and inefficiency to the tax system.

Furthermore the impact of these measures are very complex and depend on the design, and the net cost of the measure need to be weighed against alternative strategies, or the cost of inaction. This sort of detailed work is something that would be explored under the strategy I propose in the following section.

15. What would be the budgetary implications of any in-work benefit, and how would this affect its desirability and possible timing?

As per previous response.

²⁴ It is of interest that this study is cited in the PC issues paper – as a footnote on page 7. The footnote reads *“However, others question whether the hybrid approach helps the most disadvantaged (Neumark 2014, p. 8)”*. This reference by the PC – which ignores the fact that the problem that was identified by Neumark was a consequence of this EITC either excluding this group, or only making them “eligible for a trivial credit”, but rather portraying the finding as applying to the “hybrid approach” – again raises some concerns about the balance which is being brought to bear by the PC in this area of inquiry.

16. What reforms, if any, should be made to the processes used to determine the current minimum wage?

In large part, the substance of the next section is a discussion of the processes which might be put in place to develop such reforms. In the short term, I would propose a policy which seeks to maintain the value of the minimum wage in real terms for the next five years.

17. Should the desired processes be more prescribed in regulation or law; or are guidelines preferable?

In the short term, there is a case for a more prescriptive approach to guarantee the maintenance of the minimum wage in real terms, while the process of longer term consideration takes place. As I note in the next section I do not think that this will either cause significant disadvantage to either employers or employees and will provide a calm and less politicised environment in which options can be considered.

Section 4: A possible approach

As indicated throughout this submission I consider that there is a need for a thorough consideration of the long term future of the minimum wage in Australia. Essentially this seeks to identify an approach which:

- Ensures appropriate living standard outcomes for minimum wage employees and their families relative to living standards across the Australian community as a whole;
- Does so in a manner which does not inappropriately restrict the long term employment opportunities of people, in particular those with limited skills and capacity, or puts in place other appropriate mechanisms to assist this group.

Central to this are questions about the extent to which the minimum wage workforce can achieve productivity improvements in line with the balance of the workforce, and the consequences for those who cannot.

I do not consider that the current PC inquiry is appropriate to this. For future policy to be sustainable it needs to be based on a consensus of views and direct participation of key players including employers, employees and the community, as well as seeking to build a degree of bi-partisan support. It also requires a much more developed evidence base than currently exists. Doing this will require a time-scale beyond that of the inquiry as well as quite different mechanisms.

I am also concerned that, on the evidence provided in the issues paper, the PC appears to have approached the questions which need to be considered in a highly selective manner which has been unduly influenced by the perspective of some fringe organisations.

Rationale for the approach

Underlying my approach is analysis which indicates that the minimum wage in Australia has essentially remained flat in real terms over the past 20-30 years. This has occurred as the wage has transitioned from being a wage set to meet the needs of a family to being one for a single person without dependents.

For families reliant upon the minimum wage the provision for family support has moved from the wages system to the transfer system primarily through the family payments system. This has led this group to achieve levels of welfare growth at least consistent with the community as a whole. A contribution has also been made through changing patterns of family workforce participation. The relative living standard of single people in receipt of the minimum wage has declined. It has however declined from a relatively high level to one which is now commensurate with that of the family with dependent children in receipt of the minimum wage.²⁵

²⁵ As at 1 January 2015 a single person in receipt of the minimum wage of \$640.90 would have a disposable weekly income of \$581.37. A couple with a single breadwinner on this wage with a dependent partner and children aged 2 and 7 years and renting privately would have an income of \$1094.49. Using the modified

If this policy remains in place then it is likely that the living standards of a single person in receipt of the minimum wage will continue to decline relative to the community as a whole and as a consequence adverse outcomes will become more prevalent in this group. As I note above the current situation has been one which is as a result of a long-term trend, and my analysis of current outcomes suggests that, while there are some possible negative indicators, there is no immediate crisis – either in terms of the impact of the minimum wage on the labour market or on well-being outcomes for people working on this wage on a full-time basis.

As I explore in Bray (2013) a number of approaches can be taken in response to this. However each of these approaches has a need for a range of other policies. Essentially a coordinated strategy and an appropriate institutional framework for this is required.

Proposal

Given this I would propose that a process be established which will enable these matters to be considered in detail over a number of years. This process would involve the participation of all parties including employers and their representatives, employees and their representatives, governments and community and other organisations with an interest in both the minimum wage and the social welfare outcomes from it. It would also seek to build a much stronger evidence base upon which policies can be formulated, with this also requiring a significant boost in the activities of the ABS and other data gathering and analysis organisations.

Timing

As indicated above, I do not believe there is a strong case for any immediate change. From an employment perspective the minimum wage has been falling in relative terms and broadly stable in real terms, while from a well-being perspective outcomes, for both single and other, full-time minimum wage earners do not give immediate cause for concern. Indeed there is little scope for the introduction of an EITC for full-time single minimum wage earners under current rates of the minimum wage and tax settings, while couples with dependent children reliant upon the minimum wage receive support through family payments and related transfer payments. This gives scope for policy considerations to occur in a measured manner and to be underpinned by necessary research and fully discussed with key groups.

I would, without being prescriptive, consider that a minimum of 3 years be spent on the initial development phase including the development of improved data upon which policy can be more appropriately built.

This could be followed by a period of a further year or so for more detailed consultation and refinement and another year for the development of appropriate administrative/delivery mechanisms should these be required.

OECD equivalence scale this is equal to a disposable \$521.18 for a single person. This suggests an equivalised disposable income ratio for the single person relative to the couple of 1.12:1. This ratio is estimated to have fallen from 1.86:1 in 1975, to 1.65:1 in 1985, 1.32:1 in 1995 and 1.13:1 in 2005. (It needs to be stressed that while the OECD equivalence scale is used widely as with all such scales it is a crude tool. The use of alternative equivalence scales will generate different point at time ratios, but show similar trends over time.)

Interim arrangements

Over this period I would propose that policies be directed at ensuring a stable and reassuring environment for the development of future options.

- With regard to the minimum wage I would suggest annual indexation to reflect changes in consumer prices to maintain its real value. This I consider is unlikely to produce significant disadvantage to any parties. Given that historic real increases in the minimum wage have been relatively small, even a five year period of maintenance is not likely to have a major impact on the actual disposable incomes of low paid employees, and in the interim there will be a firm guarantee that their living standard will be maintained in real terms. Similarly the maintenance of the minimum wage in real terms should have little impact on employers.
- Similarly it would be appropriate for government to ensure that the tax and transfer system allows this stability to be reflected in disposable income over the period, at least for major groups of recipients.

To the extent this effective moratorium on real changes may not permit some underlying trends to flow through, this can be corrected at the end of the period through both any mechanisms such as EITC and through a wage round which takes account of this new mechanism.

In the event of a significant shift in living standards across the community as a whole (something which may be considered, at this stage, as being relatively problematic given current economic weaknesses), the policy of a real freeze can be reconsidered.

Role of PC inquiry

Adoption of this strategy would effectively involve the PC inquiry not seeking to delve significantly into the issues associated with the minimum wage, other than to make a recommendation in favour of a longer term review process. Of course, from its work the PC may well wish to make observations which may be useful to the process.

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