Australian Government
Productivity Commission

Workplace Relations Framework

Productivity Commission Draft Report

August 2015

This is a draft report prepared for further public consultation and input. The Commission will finalise its report after these processes have taken place.

An appropriate reference for this publication is:

Productivity Commission 2015, *Workplace Relations Framework*, Draft Report, Canberra

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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au).

Opportunity for further comment

You are invited to examine this draft and comment on it by written submission to the Productivity Commission, preferably in electronic format, by **18 September 2015**. Further information on how to provide a submission is included on the inquiry website http://www.pc.gov.au/inquiries/current/workplace-relations.

The final report will be prepared after further submissions have been received and public hearings have been held, and will be forwarded to the Australian Government by the end of November 2015.

Public hearing dates and venues

Location	Date	Venue
Bendigo, VIC	Friday 4 September 2015	TBC
Hobart, TAS	Monday 7 September 2015	The Old Woolstore 1 Macquarie Street
Melbourne, VIC	Tuesday 8 September 2015	Rattigan Room Productivity Commission Level 12, 530 Collins Street
Canberra, ACT	Friday 11 September 2015	Hearing Room Productivity Commission Level 2, 15 Moore Street
Perth, WA	Monday 14 September 2015	Hotel Mercure Perth 10 Irwin Street
Adelaide, SA	Tuesday 15 September 2015	Stamford Plaza Adelaide 150 North Terrace
Sydney, NSW	Thursday 17 September 2015	The Grace Hotel 77 York Street
Ipswich, QLD	Monday 21 September 2015	TBC

Commissioners

For the purposes of this inquiry and draft report, in accordance with section 40 of the *Productivity Commission Act 1998* the powers of the Productivity Commission have been exercised by:

Peter Harris Presiding Commissioner

Patricia Scott Commissioner

Terms of reference

WORKPLACE RELATIONS FRAMEWORK

Productivity Commission Act 1998

I, Joseph Benedict Hockey, Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby request that the Productivity Commission undertake an inquiry into the workplace relations framework.

Background

The Australian Government believes that it is fundamentally important to make sure that the Fair Work laws work for everyone.

Workplaces are important to our economy and society. Higher living standards, better pay and more jobs all depend on having fair, productive, and effective workplaces. The prosperity of tomorrow is driven by what happens in our workplaces today and this is why it is in our national interest to make sure that the Fair Work laws are balanced and effective.

The Australian Government's objectives in commissioning this Inquiry are to examine the current operation of the Fair Work Laws and identify future options to improve the laws bearing in mind the need to ensure workers are protected and the need for business to be able to grow, prosper and employ.

Scope of the Inquiry

The Productivity Commission will assess the performance of the workplace relations framework, including the *Fair Work Act 2009*, focussing on key social and economic indicators important to the wellbeing, productivity and competitiveness of Australia and its people. A key consideration will be the capacity for the workplace relations framework to adapt over the longer term to issues arising due to structural adjustments and changes in the global economy.

In particular, the review will assess the impact of the workplace relations framework on matters including:

- unemployment, underemployment and job creation
- fair and equitable pay and conditions for employees, including the maintenance of a relevant safety net

- small businesses
- productivity, competitiveness and business investment
- the ability of business and the labour market to respond appropriately to changing economic conditions
- patterns of engagement in the labour market
- the ability for employers to flexibly manage and engage with their employees
- barriers to bargaining
- red tape and the compliance burden for employers
- industrial conflict and days lost due to industrial action
- appropriate scope for independent contracting.

In addition to assessing the overall impact of the workplace relations framework on these matters, the review should consider the Act's performance against its stated aims and objects, and the impact on jobs, incomes and the economy. The review should examine the impact of the framework according to business size, region, and industry sector. It should also examine the experience of countries in the Organisation for Economic Co-operation and Development.

The workplace relations framework encompasses the *Fair Work Act 2009*, including the institutions and instruments that operate under the Act; and the *Independent Contractors Act 2006*.

The review will make recommendations about how the laws can be improved to maximise outcomes for Australian employers, employees and the economy, bearing in mind the need to ensure workers are protected, the need for business to be able to grow, prosper and employ, and the need to reduce unnecessary and excessive regulation.

The Productivity Commission will identify and quantify, as far as possible, the full costs and benefits of its recommendations.

An overarching principle for any recommendations should be the need to ensure a framework to serve the country in the long term, given the level of legislative change in this area in recent years.

In conducting the review, the Productivity Commission will draw on the full spectrum of evidence sources including, but not limited to:

- Australian Bureau of Statistics data and publications
- data sources maintained by other relevant Government bodies, including but not limited to the Department of Employment, Fair Work Commission and Fair Work Ombudsman
- employers or their representatives
- employees or their representatives

- academia
- special interest groups.

The review should also identify gaps in the evidence base where further collection may assist in the analysis of the overall performance and impact of the system.

Process

The Commission is to undertake an appropriate public consultation process including holding hearings, inviting public submissions and releasing a draft report to the public.

The final report should be provided to the Government in November 2015.

J. B. HOCKEY

Treasurer

[Received 19 December 2014]

Contents

Abbreviations and explanations

Abbreviations

ABCC	Australian Building and Construction Commission
ABS	Australian Bureau of Statistics
ACAS	Advisory, Conciliation and Arbitration Service
ACCC	Australian Competition and Consumer Commission
ACCI	Australian Chamber of Commerce and Industry
ACOSS	Australian Council of Social Service
ACREW	Australian Centre for Research in Employment and Work
ACTU	Australian Council of Trade Unions
AHA	Australian Hotels Association
AHRI	Australian Human Resources Institute
AIRC	Australian Industrial Relations Commission
ALAEA	Australian Licenced Aircraft Engineers Association
AMMA	Australian Metal and Mines Association
AMWU	Australian Manufacturing Workers' Union
ANAO	Australian National Audit Office
ANZSIC	Australian and New Zealand Standard Industrial Classification
APPEA	Australian Petroleum Production & Exploration Association
APS	Australian Public Service
APSC	Australian Public Service Commission
AWA	Australian Workplace Agreement

AWALI	Australian Work and Life Index
AWRS	Australian Workplace Relations Study
AWU	Australian Workers Union
BCA	Business Council of Australia
BOOT	Better Off Overall Test
BRICS	Brazil, Russia, India, China and South Africa
BRIT	Bendigo Regional Institute of Technical and Further Education
CEPU	Communications, Electrical, Electric ,Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia
CFMEU	Construction, Forestry, Mining and Energy Union
CGE	Computable General Equilibrium
CMS	Case Management System
COAG	Council of Australian Governments
COAT	Council of Australasian Tribunals
COSBOA	Council of Small Business Australia
CPI	Consumer Price Index
CPSU	Community and Public Sector Union
CURF	Confidentialised Unit Record File
DEEWR	Department of Education, Employment and Workplace Relations
DET	Department of Education and Training
DFAT	Department of Foreign Affairs and Trade
DIBP	Department of Immigration and Border Protection
EA	Enterprise Agreement
EBA	Enterprise Bargaining Agreement
EITC	Earned Income Tax Credit
EPL	Employment Protection Legislation

FWA	Fair Work Australia
FWAFB	Fair Work Australia Full Bench
FWBC	Fair Work Building and Construction
FWC	Fair Work Commission
FWCFB	Fair Work Commission Full Bench
FWO	Fair Work Ombudsman
GDP	Gross Domestic Product
HILDA	Household, Income and Labour Dynamics in Australia
HR	Human Resources
HSU	Health Services Union
IFA	Individual Flexibility Arrangement
ILO	International Labour Organization
IR	Industrial Relations
IRC	Industrial Relations Commission
LITO	Low Income Tax Offset
MBA	Master Builders Australia
MUA	Maritime Union of Australia
NAIRU	Non-Accelerating Inflation Rate of Unemployment
NATSEM	National Centre for Social and Economic Modelling
NBER	National Bureau of Economic Research
NCC	National Competition Council
NCOSS	Council of Social Service of New South Wales
NES	National Employment Standards
NTEU	National Tertiary Education Union
OECD	Organisation for Economic Cooperation and Development

OLS	Ordinary Least Squares
PAYG	Pay As You Go
PC	Productivity Commission
PIR	Post-Implementation Review
PISA	Programme for International Student Assessment
PPP	Purchasing Power Parity
QUT	Queensland University of Technology
RBA	Reserve Bank of Australia
SACES	South Australian Centre for Economic Studies
TCF	Textile, Clothing and Footwear
TCFUA	Textile, Clothing and Footwear Union of Australia
TRYM	Treasury Macroeconomic
TWU	Transport Workers Union
UNSW	University of New South Wales
VECCI	Victorian Employers' Chamber of Commerce and Industry
WAIRC	Western Australian Industrial Relations Commission
WHS	Workplace Health and Safety
WR	Workplace Relations
WTO	World Trade Organization

Explanations

Billion	The convention used for a billion is a thousand million (10^9).

OVERVIEW

Key points

- A workplace relations (WR) framework must recognise two features of labour markets.
  - Labour is not just an ordinary input. There are ethical and community norms about the way in which a country treats its employees.
  - Without regulation, employees are likely to have much less bargaining power than employers, with adverse outcomes for their wages and conditions.
- The challenge for a WR framework is to develop a system that provides balanced bargaining power between the parties, that encourages employment, and that enhances economic efficiency. It is easy to over or under regulate.
- Set against that framework, Australia's WR system is not dysfunctional — it needs repair not replacement.
- Toxic relationships between employers and employees can sometimes surface due to poor relationship management rather than flaws in the WR framework.
- Contrary to perceptions, Australia's labour market performance and flexibility is relatively good by global standards, and many of the concerns that pervaded historical arrangements have now abated. Strike activity is low, wages are responsive to economic downturns and there are multiple forms of employment arrangements that offer employees and employers flexible options for working.
- Nevertheless, several major deficiencies need addressing.
- While the Fair Work Commission (FWC) undertakes many of its functions well, the legalistic approach it adopts for award determination gives too much weight to history, precedent and judgments on the merits of cases put to it by partisan lobbyists. A preferred approach to award determination would give greatest weight to a clear analytical framework supported by evidence collected by the FWC itself.
- There is also concern that the appointment process for FWC members can lead to inconsistencies in some of its decisions, a problem that a new 'fit for purpose' governance model involving all Australian jurisdictions could resolve.
- The *Fair Work Act 2009* (Cth) and sometimes the FWC can give too much weight to procedure and too little to substance, leading to compliance costs and, in some cases, poor outcomes
  - some minor procedural defects in enterprise bargaining can require an employer to recommence bargaining
  - an employee may engage in serious misconduct but may receive considerable compensation under unfair dismissal provisions due to procedural lapses by an employer.
- These problems could be easily remedied without removing employee protections.
- Minimum wages are justified, and the view that existing levels are highly prejudicial to employment is not well founded. However, significant minimum wage increases pose a risk for employment, especially when set against a weakening labour market. Minimum wages are also often paid to higher-income households.
- Complementary policies that provide in-work benefits — such as wage subsidies or an earned income tax credit — might support higher incomes for lower paid employees, while not damaging employment. However, there are challenges in developing effective policies of this kind.

(continued next page)

Key points (continued)

- Awards are an Australian idiosyncrasy with some undesirable inconsistencies and rigidities, but they are an important safety net and a useful benchmark for many employers. The FWC should address specified troublesome hotspots on a thematic basis, rather than completely replace them.
- Penalty rates have a legitimate role in compensating employees for working long hours or at unsociable times. They should be maintained. However, Sunday penalty rates for cafes, hospitality, entertainment, restaurants and retailing should be aligned with Saturday rates.
- Enterprise bargaining generally works well, although it is often ill-suited to smaller enterprises. However,
  - the 'better off overall test' used to assess whether an agreement leaves employees better off compared with the award can sometimes be applied mechanically, losing some benefits of flexibility for employees and employers. Switching to a no-disadvantage test with guidelines about the use of the test would encourage win-win options. The same test should be used for individual arrangements
  - bargaining arrangements for greenfields agreements pose risks for large capital-intensive projects with urgent timelines. A limited menu of bargaining options would address the worst deficiencies, while taking account of the different nature of greenfields projects.
- Individual flexibility arrangements have many possible advantages, but their take up is relatively low. In part, this reflects ignorance of their existence. But there are perceptions (sometimes not well based) of defects that also constrain their use. These could be resolved, including by providing information on their use, extending the termination period of the arrangements and by moving to the no-disadvantage test.
- There is scope for a new form of agreement — the 'enterprise contract' — to fill the gap between enterprise agreements and individual arrangements. This would offer many of the advantages of enterprise agreements, without the complexities, making them particularly suitable for smaller businesses. Any risks to employees would be assuaged through a comprehensive set of protections, including the right to revert to the award.
- Industrial action in Australia is at low levels. Only some minor tweaks are required:
  - processes for secret ballots can be overly complex
  - aborted strikes and brief stoppages are sometimes ingeniously used as bargaining leverage by unions, but a few simple remedies can address this without affecting the legitimate use of industrial action
  - there may be grounds to give employers more graduated options for retaliatory industrial action other than locking out its workforce.
- It seems to be too easy under the current test for an employer to escape prosecution for sham contracting. Recalibrating the test may be justified.
- Migrant workers are more vulnerable to exploitation than are other employees, and this is especially true for illegally working migrants. This may require more proportional penalties to deter exploitation and further resourcing of the Fair Work Ombudsman to detect it.

Overview

Despite sometimes significant problems and an assortment of peculiarities, Australia's workplace relations system is not systemically dysfunctional. Many features work well — or at least well enough — given the requirement in any system for compromises between the sometimes conflicting goals of the parties involved.

The system reflects that labour differs from other inputs, and that a sound workplace relations system must give primacy to the wellbeing of employees (and would-be employees), and take account of community norms about the fair treatment of people. While there are hot spots that justifiably attract major concerns, the day-to-day life of most employees and employers is harmonious and productive, with a reasonable balance between the relative powers of the parties.

The key message of this inquiry is that repair, not replacement, should be the policy imperative. The adapted system needs to give primacy to substance over procedure, rebalance some aspects of the system that have favoured some parties over others, and revitalise its principal regulator. An improved workplace framework must involve decision making that is not unnecessarily beholden to precedent or to dated labour market structures. It must rely much more on evidence as a basis for its future direction, including information on the relevance of new developments in labour relations. The framework's broader menu of bargaining arrangements and the more coherent wage setting capacity of its key institution will underpin greater responsiveness to emerging social and economic developments (for example greater demand for flexible work arrangements with shared child care, an even greater shift to the 24/7 economy, and further automation of services).

This broad strategy will improve productivity, increase employment, and aid flexibility for employees and employers, without destabilising the system.

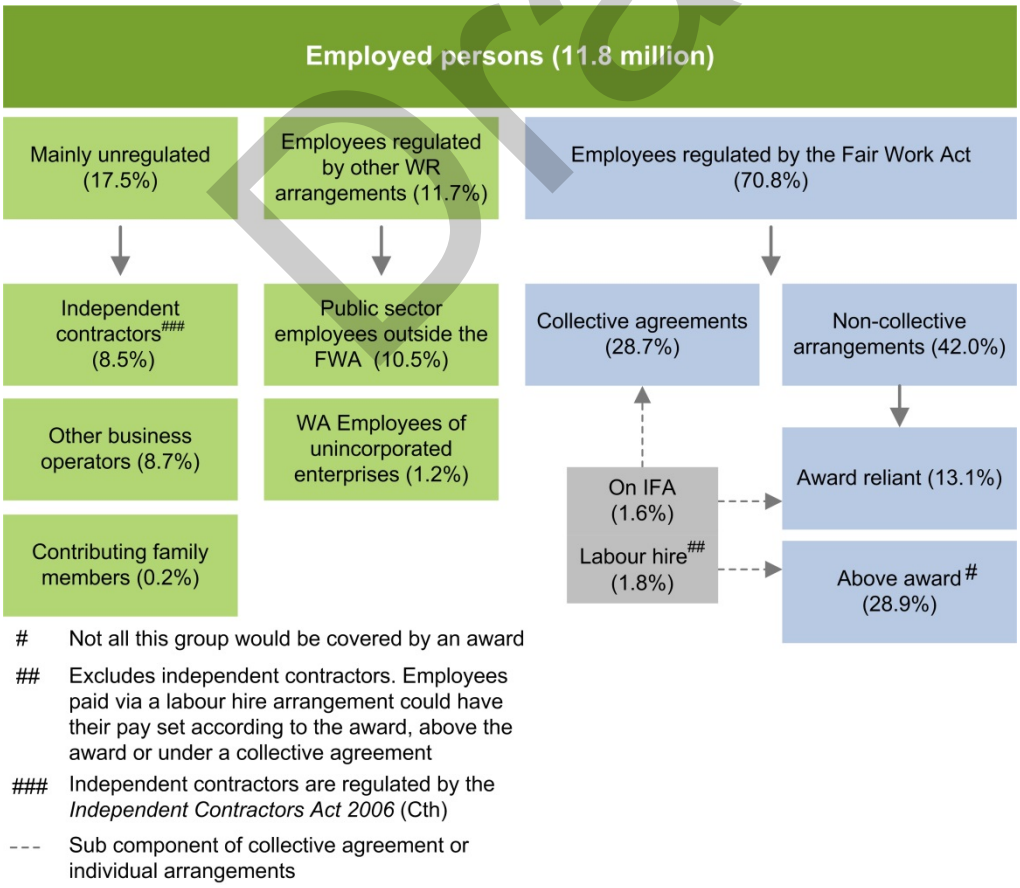
The workplace relations (WR) framework comprises a complex array of labour laws, regulations and institutions. Along with market forces, accepted practices, cultural norms and the common law, these shape people's behaviour, the nature of their workplaces and their working lives.

The national system directly affects millions of Australian workers. In mid-2015, around 11.8 million people worked in more than 2 million workplaces around Australia. Of these people, around 70 per cent were covered directly by federal workplace laws (figure 1), and others are indirectly affected. For instance, an owner-manager of a small firm must comply

with WR laws, while the choices of people to become self-employed are strongly influenced by the alternative wages and conditions that they could receive by being an employee. There are also more than 700 000 unemployed whose job prospects are affected by the system. Even employees outside the national system (some state public servants and some employees captured by the separate Western Australian system) find that their arrangements are shaped by the national arrangements. Further, to the extent that the WR system embodies community expectations about fairness or influences national prosperity and productivity, all Australians have a stake in its effectiveness.

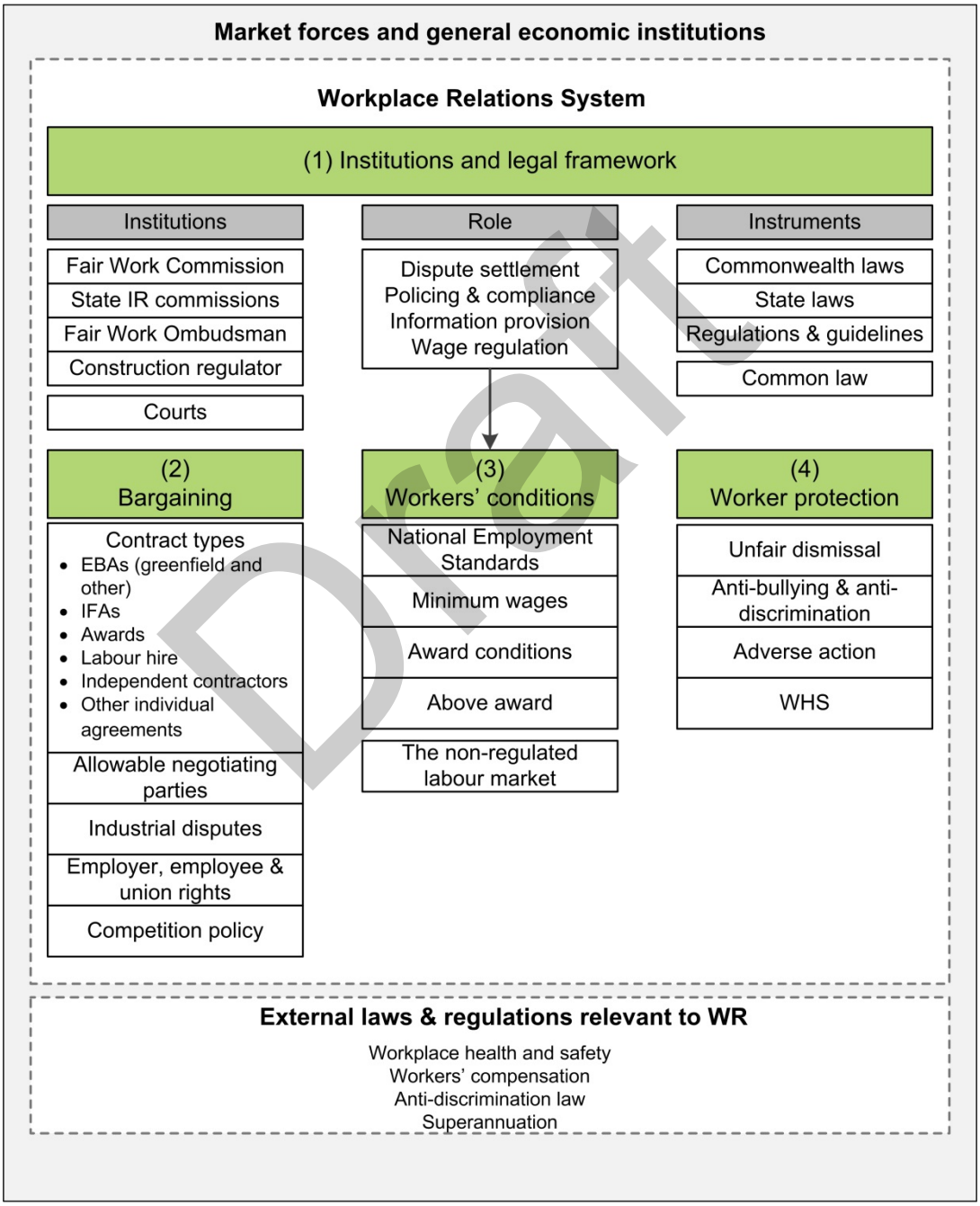
The premise of any WR system is that, absent specific workplace legislation and oversight, employees would particularly suffer from unequal bargaining power. Most stakeholders recognised this. Of course, bargaining power is not always in the hands of employers. Aspects of the *Fair Work Act 2009* (Cth) ('the Fair Work Act') and the *Competition and Consumer Act 2010* (Cth) seek to address excessive use of bargaining power by unions. *Once a system is in place to regulate bargaining power*, there will always be questions about the efficiency and effectiveness of the system, and whether the system has over or under shot in remedying any prior imbalances.

Figure 1 **Employment arrangements, 2015**



In trying to produce a balanced system, WR legislation, institutions and regulation are now highly elaborate and broad ranging (figure 2). However, market forces play a larger role in most wage outcomes and, in the longer term, have a strong impact on conditions.

Figure 2 **The main elements of the current workplace relations arrangements**



For example, wage growth is strongly influenced by the business cycle, long-run productivity and sectoral changes.

The regulatory arrangements have grown from a limited Commonwealth role in dispute settlement one hundred years ago to a position today where the Commonwealth through its statutory bodies regulates the bulk of industrial awards, resets minimum wages, mediates disputes, provides information, registers agreements, checks compliance with the law and adjudicates on key matters of WR law.

It is a busy institutional space. Three bodies, the FWC, the Fair Work Ombudsman and Fair Work Building and Construction, are the key national regulators, while the Federal Court is the principal judicial body. Various other institutions — state and territory work safety regulators, anti-discrimination bodies and the Australian Competition and Consumer Commission — also have specialist roles in parts of the WR system, for example in relation to regulation of secondary boycotts.

In its roughly 900 pages, the Fair Work Act covers most aspects of the way in which parties should deal with each other in their employment relations, and in setting a variety of minimum standards. An extensive body of common law sits beside the statutory framework. Reflecting the regulatory underpinning of the system, wages and conditions for most national employees must be at, or above, the safety net of those set in 122 awards.

Notwithstanding complaints from some employers, there is considerable scope for flexibility through independent contracting and employers' capacity to negotiate individual and firm-specific outcomes. In fact, award wages are less important now than at any other time in the last 100 years. Nevertheless, the 'clunkiness' of the system, concerns about the complexity of forming enterprise agreements, inconsistencies and lack of clarity in awards, barriers to forming individual flexibility arrangements, and the unpredictability of FWC decisions on a range of matters deters firms from using some of the available avenues.

The Fair Work Act cites objectives that are diverse and — as is often the case with such diversity — inevitably sometimes in conflict. The Fair Work Act is intended to deliver outcomes that are fair, flexible, co-operative, productive, relevant, enforceable, non-discriminatory, accessible, simple and clear. The legislation is complex and there are meaty pickings for lawyers and workplace practitioners on all sides.

People are confused by the system, and some parties that should have a bigger voice in it — consumers, the unemployed and underemployed — have marginal influence. There are unquestionable inefficiencies, remnant unfairness, some mischief and absurd anachronisms.

In this messy context, there is an understandable tendency to imagine that there must be a much neater and coherent system, and that it would be desirable to start with a clean slate. The view from the bulk of stakeholders and from this inquiry's analysis is that such a view would be misplaced. The system needs renovation, not a 'knockdown and rebuild'.

Moreover, some of the Productivity Commission's recommendations in this draft report are not new. The 2012 review of the Fair Work Act identified a range of worthwhile reforms, some of which were not acted on at the time. But this inquiry does not simply

traverse the territory of the previous review. The terms of reference require the Productivity Commission to cover all those aspects of workplace relations that impinge upon the ability of the system as a whole to adapt to longer-term structural shifts and changes in the global economy.

1 Australia's recent labour market performance does not suggest a dysfunctional system

There are several myths about Australian labour markets that suggest that some of the key concerns voiced by stakeholders on all sides are of dubious validity.

The prevalence of independent contracting has remained an important source of labour and has been stable over the last decade.

Security of work appears to have changed relatively little in recent years. While the proportion of casual jobs increased throughout the 1990s, this trend tapered off during the 2000s, particularly for women. Most people working in casual jobs move into permanent jobs in later stages of their lives.

The labour market has accommodated well to large shifts in labour supply. Many more women, more mature age workers and large numbers of skilled migrants have entered the labour market. For example, the current level of skilled migrant intake is almost three times higher than levels of the late 1990s. Most people who experience unemployment do not do so for long. The shift away from making solid things to services has largely been achieved without growing unemployment.

Weekend work is now common. The traditional Monday to Friday week is not dead, but nor is it as predominant as in the past. Some 4 million employed people — more than one in three in the workforce — work at least a Saturday or Sunday each week.

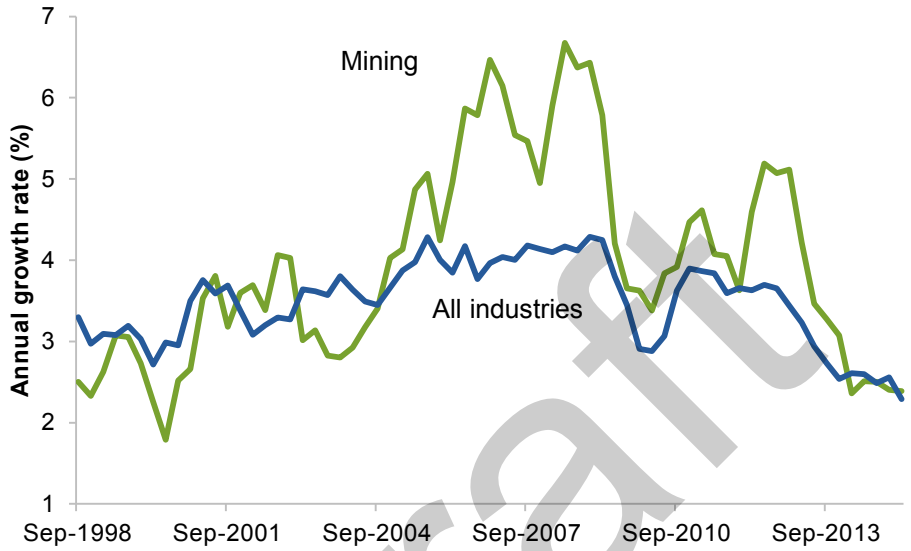
There are several indicators that the labour market has become more flexible, most notably through a greater tendency to adjust hours rather than employment during demand downturns, and the unresponsiveness of inflation to strong labour demand in leading sectors. Economywide wage breakouts and associated stagnation — the horror of the 1970s — seem as dated as floppy disks. The resources boom led to strong growth in mining wages, but not wages in general (figure 3). There is little evidence that labour market mismatch has changed.

Surmise aside, there is little robust evidence that the different variants of WR systems over the last 20 years have had detectable effects on measured economywide productivity. This does not mean there are no effects, but simply that they apply at the enterprise and industry level and are hard to identify in the aggregate economy given the myriad of other factors shaping productivity.

However, there are some potentially concerning trends. In particular, youth unemployment is rising, and by more than the growth in the unemployment rates of prime-aged people in the labour market. Underemployment and long-term unemployment has also risen in recent years.

Figure 3 **The end of wage contagion**

Growth in the mining wage index compared with all industries



2 Institutional reform

The performance of Australia's workplace relations system relies strongly on the capabilities and functioning of its main institutions. Discretion and judgment exercised by competent and independent bodies are as critical as statute in an efficient and fair system.

The Fair Work Ombudsman is performing well, adopting targeted and innovative approaches to compliance and information provision. It is highly regarded by many stakeholders. It is essential to the credibility of any future systemic reforms that it receive sufficient resourcing as new hot spots emerge (such as for emerging problems for 417 visa holders).

Likewise, the FWC has adopted efficient conciliation processes in unfair dismissal cases, and has introduced a variety of innovations more generally. Its approach to the current Modern Award Review acknowledges some of the glaring problems that still beset awards (but do not go far enough). While there are concerns about the FWC's use of evidence (see below), its expert panel on annual wage reviews does consider some empirical evidence in its annual wage case determinations, particularly information on current labour market and macroeconomic conditions.

That said, some perceive the FWC in less positive terms, although in part this is the inevitable accompaniment to the diverse, complex, and controversial nature of its functions. However, there are three flaws in the structure and operation of the FWC.

The heavy weight of history

History and precedent play too big a role in some of the FWC's key economic and social functions, particularly award determinations. In effect, the past is assumed innocent unless found guilty, embedding old, but outdated, features of the WR system. One award still provides employees with the option of an X-ray every six months if they work in a tuberculosis home or hospital (the last of which closed in 1981). The survival of this provision is benign, but is nevertheless telling about the weight of history.

A distinguished former high court judge has noted the power of the past in industrial relations:

> The past is another country. It is a place safer for people like me to dwell than in the industrial present or the future. Judges live with the past, surrounded by its stories in their books, from which they seek to derive logical analogies and the great streams of principle that will promote consistency and predictability in decision-making. (Justice Kirby 2004)

This backwards−looking perspective is a necessary feature of the legal judgments of the FWC as a tribunal. Past decisions assist in interpreting the law. Although not formally bound by the rules of evidence used in courts, the FWC's practices also tend to give greatest weight to the evidence put by the contesting parties, rather than on better evidence that it has actively sought. These approaches have carried over to the FWC's wage determination functions, which require a different mindset. Wage determination is inherently an economic, statistical and social matter that needs to give most weight to new evidence on the consequences of regulatory choices in contemporary society. As new evidence or analytical approaches emerge, its economic decisions should be re-framed.

The implication is that the FWC should develop clearer analytical frameworks and proactively undertake its own data collection and systematic high-quality empirical research as the key basis for its award decisions and wage adjustments. (While the FWC does initiate some research, much of it is of limited specific relevance to its actual decisions.) The FWC should not just impartially hear evidence from parties, but also engage with parties that do not usually make submissions, such as those representing consumers and the jobless.

The virtue of consistency

While the Fair Work Act sometimes compels members of the FWC to give too much weight to procedure over substance (as discussed later), the attitudes of individual members also play a role. Guidelines issued by the FWC about statutory interpretation and performance assessment of members should curtail this.

Governance

The governance of the FWC needs reform. Some of the primary causes of inconsistencies in its determinations reflect the choices made by successive governments, particularly the emphasis on appointing persons with perspectives oriented more to one side or the other of industrial relations debates. FWC members will accordingly reach different judgments even in instances where the circumstances are similar. This is not so much the result of bias, but rather a reflection of the fact that they come with different mindsets, are obliged to weigh up the often competing objectives laid down by the Fair Work Act, and must deliberate on matters that are inherently subjective. As an illustration, there is good statistical evidence that the findings in unfair dismissal cases have allowed some inconsistencies to creep into judgments. Given their different perspectives, it is not surprising that members with an employer association background are more likely to find in favour of an employer compared with other members, while on average those with a union background produce outcomes in the opposite direction.

Better governance practices are essential for a body with determinative powers on economically important matters operating in a politically sensitive and highly technical area. Two main reforms are required.

First, the FWC should have two distinct divisions. A *Minimum Standards Division* would have responsibility for wage determination, and would undertake the annual wage review and make award determinations. Its members should primarily have expertise in economics, social science and commerce, not the law. A *Tribunal Division* would be responsible for the quasi-judicial functions of the FWC, such as decisions relating to unfair dismissals, adverse actions, approval of agreements, rights of entry and industrial disputes. Its members should have broad experience and be drawn from a range of professions, including the law, commercial dispute resolution, ombudsman's offices and economics.

Second, the processes for appointing members of the FWC also require reform. The Australian, state and territory governments should create an expert appointments panel, which would provide a merit-based shortlist of candidates for the two divisions. The relevant Australian Government minister would then choose members from the shortlist for a fixed tenure (with the potential for renewal). Both the panel and the relevant minister would need to be satisfied that the person would be widely seen as having an unbiased and credible framework for reaching conclusions and determinations.

These changes would align governance within the FWC more closely with that observed in many other contemporary decision-making bodies.

Structural changes of this nature will take some time, but action on some fronts is needed, and can be taken, now. The FWC already has the capacity to appoint more experts as advisors to its members and to take an activist and evidence-based approach to an assessment of awards. A change in mindset requires no legislation, and a move in this direction under the strategic guidance of the President would be a major step.

3 The safety net

The safety net comprises three main instruments that set floors to wages and conditions for employees: the national minimum wage, the National Employment Standards and awards (including penalty rates).

Minimum wages

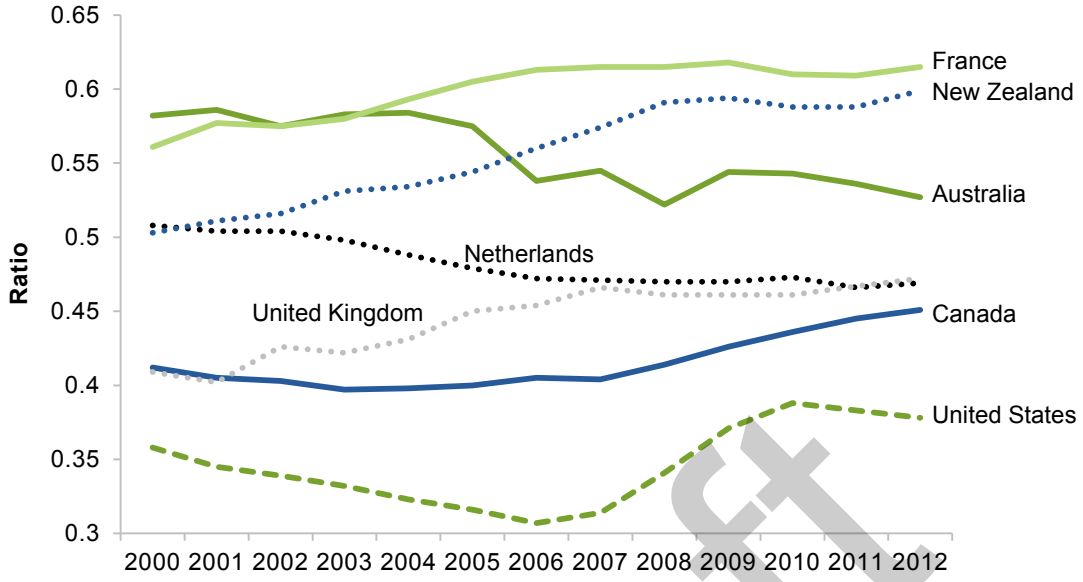
Minimum wages in Australia are set by an FWC Expert Panel, taking into account changes in economic conditions and representations, especially from the government, business and union stakeholders. It generally awards modest rises in minimum wages, and its predecessors have occasionally suspended increases during downturns. A commonly used measure of the comparative level of the minimum wage is its ratio to the median wage rate, which also enables meaningful comparisons with other countries. While the minimum-to-median wage ratio remains high in Australia compared with most other countries (France and New Zealand being the notable exceptions), it has declined over the past decade. Indeed, no other OECD country has shown such a strong trend decline (figure 4).

There are several rationales for minimum wages:

- Minimum wages (if not set too high) may address the stronger bargaining power of employers. There is reasonable empirical evidence that many individual firms have some market power in hiring employees. This reflects the various frictions associated with job search and matching. As well as having distributional effects, this means that unregulated labour markets can suppress wages below their efficient level and, in some cases, may actually reduce employment.
- Minimum wages increase the pay levels of the lowly paid so long as they retain their jobs and can work the desired hours.

However, even accepting such rationales, the question of the impacts on (and the risks they pose for) employment and earnings is an empirical matter. Unfortunately, while some confidently assert the matter is decided on one side of the debate or the other, the vast international evidence and the (more limited) Australian evidence is not so definitive. Much of it is beset by data and methodological limitations, or misinterpreted. That said, the evidence suggests some patterns. If set below a modest level, the employment effects of minimum wages would be likely to be negligible or even positive. Small increases in the minimum wage are unlikely to have readily measurable effects on employment, but the larger they become, the more likely that the hours available to existing workers will fall and job opportunities for new workers (and sometimes for existing workers) will be lost. The effects also depend on the characteristics of the labour force. Particularly low-skilled or disadvantaged people have poorer prospects of employment at any feasible minimum wage.

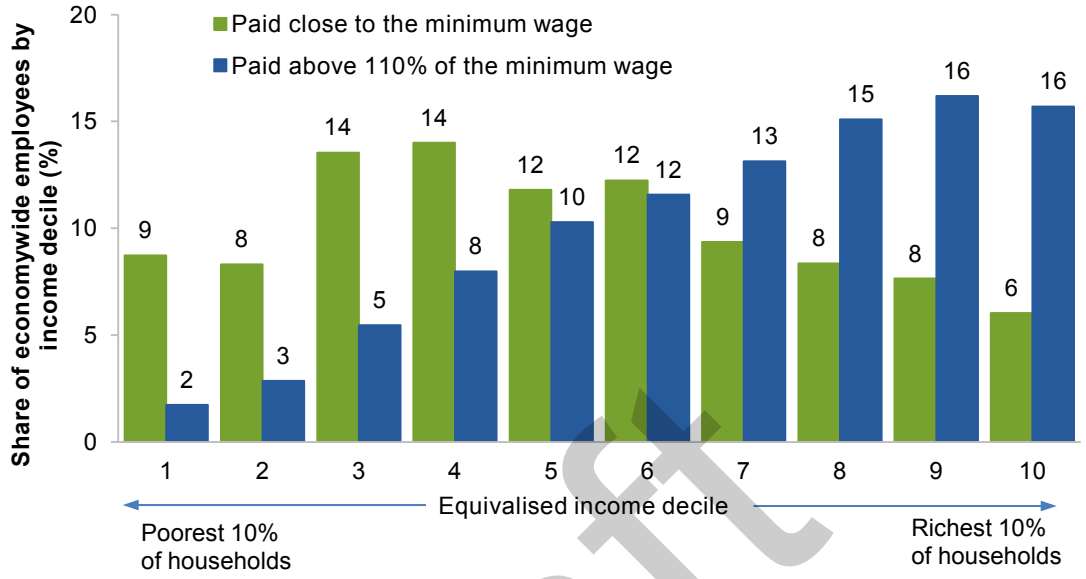
Figure 4 **Minimum to median wages for several OECD countries**



The risk of jeopardising employment is just one consideration. The effects on household income of annual wage reviews depend on:

- how those pay increases affect all other wages in the economy. Australia's unique system of awards creates hundreds of wage floors for different jobs whose annual growth rates are linked to changes in the adult minimum wage
- the overall income of households where some people are paid at the minimum wage or whose wage level is strongly related to it. Many employees with wages linked to the minimum wage are not in low-income households. In 2013-14, around 30 per cent of such wage earners were in the richest 40 per cent of working households (figure 5). This reflects that many higher-income households have some family members in low paid jobs.
- the degree to which it reduces employment and hours worked. Unemployment is not only strongly associated with lower income levels, but has highly adverse effects on people's wellbeing. As emphasised throughout this report, labour market outsiders tend to have little voice in the current WR system, a defect that requires correction
- possible dynamic effects. On the one hand, people facing the risks of unemployment at high minimum wages may acquire skills to avoid this. On the other hand, for many people, minimum wage jobs are a temporary part of their working lives, and indeed such jobs can be a 'stepping stone' into the world of work and higher paid jobs later.

Figure 5 **Many people receiving wages around the minimum wage are from middle income households**



Nevertheless, there is strong evidence that the minimum wage (and awards) tend to assist those lower paid households that retain jobs, with a high share of low-income working households on the minimum wage. In 2013-14, the likelihood that an adult employee in the lowest decile of working households was at or close to the minimum wage was around seven times higher than that for the top decile of households (figure 6).

Policy implications

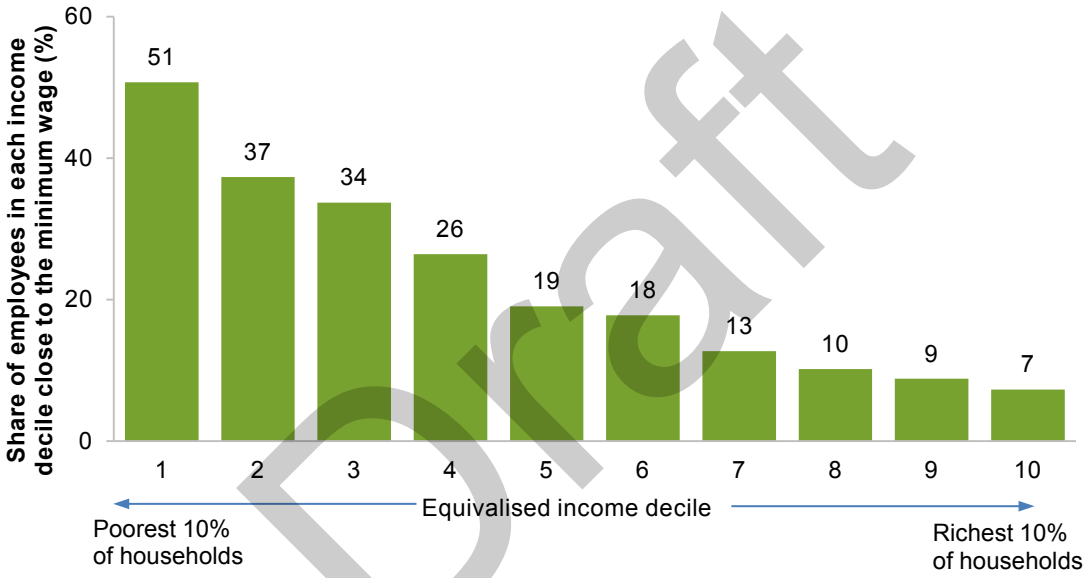
Against that background, while some minimum wage is justified, the FWC faces Goldilocks's dilemma of determining the level that is 'just right'.

That level has a long-run and short-run dimension. On the former score, it could be expected that long-run minimum wages would grow approximately in line with economywide productivity levels and maintain a roughly fixed ratio to median wages. That long-run ratio might sometimes shift with the skills and capabilities of the jobless and those employees paid close to the minimum wage. For example, if the average skills of existing jobless people improved over a sustained period, there would be more scope to increase minimum wages without significant adverse effects on their employment prospects.

Over the shorter run, another set of considerations comes into play. Given the highly adverse outcomes of unemployment for people's wellbeing, whenever the economy is weakening (as appears to be the case now), there are grounds for the FWC to temporarily adopt a conservative approach to minimum wage setting. This does not require that

minimum wages fall, but rather that they grow at less fast a pace than during normal economic times. Notably, real labour productivity in the market sector increased by 13 per cent over the five years from 2008-09 to 2013-14. Were this trend to continue, it would be possible to increase the real incomes of the low paid, but set real minimum wage increases just below the productivity growth rate, thereby simultaneously encouraging employment of people currently priced out of the labour market (and assuaging underemployment). In improved economic circumstances, minimum wages would catch up to restore their long-run ratio to median wages.

Figure 6 **But an employee in a low income group is much more likely to be paid around the minimum wage rate**



Some have suggested that Australia should follow the example of some other countries that have geographical variations in minimum wages. Currently, Australia has two minimum wages — a national minimum wage applying to most employees, and a Western Australian minimum wage applying only to the employees of unincorporated enterprises in that state. The difference in wage rates is very modest.

In contrast, some countries have multiple geographically varying rates with large disparities between rates across regions. For example, Canada, Japan and the United States have different minimum wages by state (and indeed, in some US states, even variations between cities, Los Angeles being an example). In principle, such minimum wage variations look attractive as they could be set at levels that took account of local labour market conditions, thus reducing unemployment risks. However, there are many practical difficulties in an Australian context, including doubtful constitutionality, interactions with modern awards and the tax and transfer system, and complexity for national employers. (Notably, few employers have called for geographically varying rates, even in regions

where the labour markets are relatively weak.) The Productivity Commission does not propose their introduction.

Complementary measures

A critical question is the degree to which the regulated wages system can effectively achieve its re-distributional and social equity goals. Minimum wages were developed at a time when it was typically only a man who worked in a household and when the social welfare system was weakly developed — both of which have now changed. However, the welfare system itself has a limited capacity to alleviate income inequality because it can stigmatise people, also discourage employment and embed social disadvantage.

That invites the question of new ways of providing income supplementation to the low paid, while maintaining employment incentives. One approach is an 'earned income tax credit' (EITC), which many countries use to top-up the incomes of the low paid, typically as a complement to minimum wages. For example, in its country report for the United States, the OECD has recommended that as the Great Recession recedes, it should expand its EITC *and* raise its minimum wage, indicating that hybrid policies are seen as appropriate.

By design, EITCs encourage labour force participation, and the evidence usually suggests that they do this, especially for single parents, though their effectiveness depends on their exact design. However, they do have several drawbacks, including high levels of overpayments (around one quarter of the funds in the United States), reduced incentives to work for second earners in some households, and barriers to working above a certain level of hours as household income rises. They must also be financed through taxes, which have their own adverse economic effects. In an Australian context, any EITC would also interact with a well-developed tax-transfer system, which is also intended to improve the incomes of the low paid. The interactions between that system and an EITC would need to be carefully assessed.

Reducing these incidental impacts is one reason why significant attention must be given to the design of any instrument and the economic context in which it sits. The OECD has highlighted that the impacts of in-work benefits depend on their design and the institutional settings of each country. In its study of 15 European countries, it found that the efficiency costs from in-work benefits were highly variable. The results were highly positive in some, but questionable in others.

Some have claimed that there *may* be constitutional constraints for an EITC that extended to single people as well as families, but this a complex area of law and is untested in this context. (If this was an obstacle, the EITC might have to be narrower in its application or state cooperation would be required.)

The Productivity Commission is seeking views on whether there are grounds for giving further consideration to an EITC as a complement to minimum wages.

Governments should not neglect other policies that are complementary to minimum wages. These could include measures that improve the employability of less skilled people and wage subsidies, but only where these are designed carefully and properly targeted. Inevitably, improved social and economic inclusion requires more than a single policy, which is why governments should seek to use minimum wages as part of a policy suite.

Wages for juniors, apprentices and trainees

The FWC sets out minimum pay rates for younger workers, apprentices and trainees. Wage rates for juniors are a share of the adult minimum wage and increase with age until the person reaches 21 years old (although some awards vary this). Similarly, trainee wage rates also have an age-based structure, with rates depending on the time elapsed since leaving school. Apprentice wages vary across awards and are set as a proportion of a qualified tradesperson's wage and increase the closer the apprentice is to completion.

Australia is one of around the fifty per cent of OECD countries that set youth wages as a share of the adult rate. Indeed, notwithstanding the high ratio of the adult minimum wage to median wages, Australian youth wages start at comparatively low levels relative to those in many other countries. For example, a fast food level 1 employee aged under 16 years could have more than a year of experience, but would get $7.59 an hour (44 per cent of the adult minimum wage). In many states in the United States, many such employees would receive at least US $8. The decisive test in some countries is not age per se, but also experience, with substantially lower wages for someone with short experience in a job. In the United States, the federal minimum wage is around 60 per cent of the adult minimum for a person aged under 20 who has worked with their employer for less than 90 days. New Zealand has a similar system, with no minimum wage for people aged less than 16 years, and a discounted wage for 16- and 17-year olds with less than six months job experience with their employer.

The Productivity Commission is wary about making any precipitate changes to the current system of youth wages if that was to put at risk the employment of more vulnerable people with lower skills. The transition from education to work is one of the critical pathways, and changes that affected employment of the less academically able could have adverse generational impacts. That said, the Productivity Commission is exploring a hybrid option that recognises that experience or competency might sometimes justify a higher minimum wage.

The training system, of which apprenticeships and traineeships are a component, involves a complex set of interlocking issues. The FWC has increased award wages for apprentices, while the Australian Government also provides incentive payments to employers and wage top-ups. These affect the relative attractiveness of apprenticeships to employers and would-be apprentices, with unknown impacts.

These complex issues go beyond the scope of this inquiry as they also involve concerns about the adequacy of skill formation and competency-based training and pay arrangements. The Australian Government should undertake a comprehensive review of

Australia's apprenticeship and traineeship arrangements. This review should provide an assessment of the appropriate structure of junior and adult training wages, as well as government incentives.

National Employment Standards

The National Employment Standards (NES) specify minimum requirements for 10 conditions of employment — including hours of work, various forms of leave and redundancy pay. Awards, enterprise agreements and employment contracts cannot exclude any elements of the NES, or provide ongoing employees with less favourable employment conditions. The NES have attracted little controversy — mainly because their prime aspects (like annual leave) have a long and accepted role by all stakeholders and accord with community norms. There is also considerable scope for flexibility. For example, an employee can be required to work more than the standard hours if reasonable.

Nonetheless, there are concerns about several aspects of the National Employment Standards.

The Standards specify eight national public holidays on which people are entitled to a paid day of leave (and penalty rates of typically 250 per cent if they work). Public holidays can yield community benefits by enabling coordinated social activities, particularly on days of major cultural or spiritual significance. However, many people treat *some* national public holidays as just normal days off, which throws doubt on their community function. The FW Act allows awards and enterprise agreements to include terms that allow an employer and their employees to observe a public holiday gazetted by government on a date other than the one prescribed, but not all awards contain such provisions. All awards should include the provisions so that the option of swapping holidays is available to all workplaces.

Moreover, the Standards also recognise any public holiday declared by a state or territory government. (In a bizarre twist, every Sunday is a public holiday in South Australia — though there is a tacit agreement to ignore this by most employers and employees.) So, by declaring new holidays (say *Grand Final Eve* holiday), state and territory governments can unilaterally create obligations under the National Employment Standards for any national employer in their jurisdiction to provide further leave days with pay. The 2012 review of the Fair Work Act recommended limiting the total days that would attract penalty rates to just 11. However, employers would still have to pay employees absent on additional state public holidays. Should they want an employee to work on a public holiday, they would, for commercial reasons, have to pay them significantly more than 100 per cent of their base pay (since 100 per cent is what the employee would get if they did not go to work at all).

State and territory public holidays represent a policy conundrum in a national WR system, given that a substantial goal of the new system was to avoid interstate variations. The Australian Government should amend the National Employment Standards so that employers are not required to pay for leave or any additional penalty rates for any *newly*

designated state and territory public holidays. (Existing state holidays should be grandfathered.) Of course, employers and employees could still negotiate pay for any new state-declared public holiday, but that would be at their discretion, not state governments.

Long service leave (LSL) is an Antipodean idiosyncrasy. It was invented in the mid-19th century to allow citizens to sail to and back from England every decade. Despite its peculiar origins, it now has strong community support. However, the National Employment Standards do not prescribe any consistent national LSL arrangements, so that there are relatively complex interstate variations. This means that national employers must deal with a diversity of qualifying periods and entitlements for LSL across the different arms of their national operations. This has been a longstanding complaint, and the last review of the Fair Work Act recommended a uniform national approach. Any change would produce winners and losers, and this may explain why there has been little appetite by states to change the status quo. Overall, there remains some uncertainty about the net benefits of moving to a uniform system, the appropriate transition to any such standard, and the scope for some more minor simplification of the current system.

Awards

Awards are the regulations that describe various floors on wages and conditions for a wide variety of skill levels across multiple industries. Relatively few people on individual contracts are *exactly* on an award payment. Awards still influence other employment contracts because some conditions (such as the span of hours or penalty rates) are derived from them, the wages and conditions of some employees who are part of an enterprise agreement largely reflect those in the relevant award, and because they form the regulatory benchmark against which to test whether other employment contracts genuinely make people better off.

Awards are a longstanding part of Australia's workplace relations framework, with the FWC and its various quasi-judicial predecessors determining awards for more than 100 years. They are unique to Australia (and New Zealand until 1991), and sometimes this is seen as an indication that they are unnecessary. However, other countries have devised alternative wage determination systems that often also embody rigid rules to protect the low paid. And, while they are rigid and history bound, awards and the processes for determining them have adapted over time (though not by enough):

- For many years, awards were determined in response to industrial disputes, while now reviews are scheduled as a stipulation of the Fair Work Act and are primarily used to reassess their relevance, iron out anomalies, and ensure that the Modern Awards Objective of the Fair Work Act is met. The Modern Awards Objective comprises various unobjectionable, but often competing, goals. Awards must take into account the living standards of the low paid, the need to promote social inclusion through increased workforce participation, the need to provide additional remuneration for working during unsociable hours, on shifts, or on public holidays, and the likely impact of

awards on business, productivity, regulatory burden, employment growth, inflation and the performance of the economy.

- With the advent of enterprise bargaining in 1993, the primary role for awards shifted from being an instrument for setting actual wages and conditions to contributing to a broader safety net containing various floors for wages and conditions (that is, from a key driver of the system to a safety net). As part of this safety net, awards help to balance the unequal bargaining power of employees and employers and increase the wages and conditions for some employees above those that they would be able to negotiate on their own. Awards have been effective in this role by reducing the dispersion of pre-tax employment income (especially in the lower half of the household wage distribution) and increasing the wages of low-wage workers.
- Through the award modernisation process, thousands of awards were collapsed to just 122, so the system is simpler than earlier.

It is therefore likely that modern awards are less rigid and costly than their historical predecessors. Nevertheless, they remain relatively inflexible and are often ambiguous, imposing costs for employers and employees. (Even the Fair Work Ombudsman is sometimes unclear about the interpretation of clauses.) In some instances, they are more historical relics of the relative bargaining strength of past protagonists than a carefully thought out way of remunerating employees.

However, few stakeholders recommended their elimination, but rather suggested reform and the easier availability of alternative options for employment contracts. Most consider that the (uncertain) benefits of eliminating awards might be outweighed by the cost of any transition.

- All parties suggested that the costs of transitioning to the modern awards between 2009 and 2014 were considerable ('nightmarish' according to some stakeholders). Any major shift away from awards altogether would trigger costs of a higher magnitude again. Removing awards would also require re-assessment of many other features of the WR system. For example, what benchmark, if any, would be used for testing whether an enterprise agreement really met some 'reasonable' wage standards? A no-disadvantage test is meaningless without a benchmark.
- The current system does not appear to be producing highly adverse outcomes.
- The tax-transfer system, while already highly developed, would need to further extend its reach to emulate the re-distributive effects of awards.
- Some of the 'distortions' created in labour markets are beneficial since they address unequal bargaining power and reduce the transaction costs of forming employment contracts for small business.

Nevertheless, there are strong grounds for improving the award system.

One relatively straightforward step — already partly underway — relates to the form of awards, rather than their content. Awards should be easier to understand and no more

complex than they need to be. As the Business Council of Australia notes, many awards are unclear on penalty rates and overtime requirements. Awards should be in plain English and be written to avoid the mistakes and misunderstandings that arise from the present ambiguities of awards.

A more fundamental challenge is how to address the more systemic flaws in awards, without repeating the transitional costs of award modernisation. After the completion of the current four yearly award review (whose scope is considerably constrained), the FWC should adopt a different approach to its amendments to awards. It should undertake careful empirical analysis into the aspects of awards that are the source of the greatest problems — 'hotspots'. It should then consider how it might vary awards to address these on a thematic basis. Those hotspots cannot be determined ahead of analysis, but any analytical framework would attempt to identify the award variations (such as in allowances, wage rates, penalty rates, and spans of hours) that were genuinely problematic, rather than merely untidy.

The FWC should also make changes to awards where there are easy gains from adding consistency or where anomalies become apparent.

However, there is no need for the FWC to review all aspects of awards, term by term. That would be an ambitious task, with diminishing returns and high costs for stakeholders. Once the current four yearly review has been completed, these periodic reviews should cease. Future assessments should be undertaken on a needs basis.

Regulated penalty rates for shift, overtime and weekend work should stay

Many Australians work non-standard hours either by working longer than the 38 hour norm under the National Employment Standards or by working at non-standard times, such as at night or on weekends. They are compensated by regulated premiums on normal wage rates (sometimes generically categorised as 'penalty' rates).

Penalty rates are strongly dependent on when work is undertaken and the total time spent working. The three principal time-related wage rates are:

- shift loadings, and weekend and evening pay premiums. These are requirements placed on employers to pay additional wages at certain times of the day or on certain days of the week, and are not dependent on how many hours in total a person has worked during the week
- overtime rates, which represent higher wage rates for hours worked greater than the usual ordinary hours listed under an award or an agreement
- payments for working on public holidays.

There are compelling grounds for premium rates of pay for overtime, night and shift work:

- Long hours of work involve risks not only to an employee's health and safety but also for the community. (Long working hours are not rare. In mid 2015, around 2.8 million Australian employees reported working more than 40 hours per week and over 1.5 million reported working 50 hours or more per week. In 2012, around one third of employees worked overtime.)
- There are proven adverse health effects from night shift and rotating shift work.
- By definition, public holidays are intended to encourage shared community activities. As such, there are strong grounds for deterrence against their use for working, but with some flexibility to provide some services on these days. The appropriate rate for public holidays would need to account for (a) the fact that as is normal for other leave, public holidays are generally paid at ordinary wage rates despite the fact that people are not working, and (b) the additional requirement to deter activities that undermine the intended goal of such holidays.

Regulated minimum penalty rates recognise the impacts of such work and that absent regulation, the weaker bargaining power of employees may not lead to adequate compensation. The Productivity Commission has not recommended any changes in these rates. This is also in line with the views of participants in this inquiry, who did not raise any significant concerns about penalty rates for overtime, night or shift work.

Sunday penalty rates in the cafes, hospitality, entertainment, restaurants and retailing industries

In recent years, there has been intense debate about penalty rates for just one type of work — weekend work in the hospitality, entertainment, retailing, restaurants and cafes industries.

The same controversies have not occurred for other industries. The community, employers and customers have long accepted weekend work and associated high penalty rates in other parts of the economy (agriculture, transport, utilities, those parts of manufacturing requiring continuous production, health and emergency services). Notably, in New Zealand, where regulated penalty rates no longer apply, employers still pay penalty rates commensurate with Australian rates for many of these industries.

However, for many years, the community did not accept weekend work where seven-day operations were not essential for the community or for the efficient operation of the economy. The crucial development in the past few decades has been the growing demand for the weekend supply of certain services, precisely in the industries where penalty rates have become a controversial issue. Increased female workforce participation rates, the reduction in religious observance, changing social norms about shopping times, the softening of trading hour restrictions, and the emergence of international online commerce will have contributed to this.

However, the quid pro quo to growing consumer demand on weekends is the requirement that *someone* must supply the labour to provide these services at these times. Australian surveys show that most employees value weekends more highly than weekdays. In an unregulated well-operating market, it could be expected that penalty rates would be needed to elicit sufficient labour supply on weekends. But labour markets are not perfect (which is why workplace relations systems exist in the first place). Individual businesses possess some bargaining power in respect of the labour they hire, with the risk that market-set penalty rates would be lower than they should be. Community standards about the reasonable rates for working on weekends in such industries are also relevant.

The question is then whether regulated weekend penalty rates are set at the 'right' level. In the controversial industries, the average skill levels are low, job tenure short, much of the work is part-time and casual, the average age of employees is low and award dependence is relatively high. The frictions from moving from job to job do not appear to be high. The overall evidence suggests that the employers in such industries are not likely to have the same level of bargaining power over their employees as in many other industries, and accordingly, that the businesses are likely to have a weaker capacity to depress wages on weekends.

Large premiums in wage rates for such employees are more likely to elicit reductions in the demand for hours and employment than in many other industries. While the FWC and its predecessors have always (legitimately) argued that the social costs from working asocial hours warrant some penalty rate, they have generally not considered the relevance of the strength of bargaining imbalances and the type of employee in determining penalty rates.

Moreover, on average, award modernisation raised average penalty rates in the relevant industries. This is notwithstanding that one plank underpinning regulated weekend penalty rates — the notion of deterring weekend work — is now acknowledged by the FWC, unions and businesses as irrelevant.

The result is some surprising anomalies, particularly in relation to Sunday penalty rates. Under the present award, an inexperienced level 1 pharmacy assistant with limited qualifications who worked ordinary hours on a Sunday is paid around 40 per cent more than the usual weekly rate for an experienced pharmacist (who requires four years of undergraduate training, a one-year internship and ongoing professional development). In effect, the return to skills are much lower than the returns from working at a different time of the week — and by a large margin.

Moreover, rates for Sundays (usually around 200 per cent of base pay) appear particularly at odds with rates for times that are also important for social activities (evenings), and to an even greater degree for times that pose clearly demonstrated health risks (night shifts and rotating shifts). Evening/afternoon shift penalty rates can be as low as 10 per cent and night shift loadings as low as 15 per cent (figure 7). Survey evidence shows that the overall social costs of daytime work on Sundays are similar to Saturdays, and consistently lower than evening work (figure 8).

The Productivity Commission recommends that Sunday rates in the hospitality, entertainment, retailing, restaurants and cafes industries should be brought into line with Saturday rates.

Employment and hours worked on Sundays would rise after the change. Lower regulated penalty rates are likely to increase the opening hours of businesses and encourage higher staffing ratios, with the job opportunities that this presents for people. It would also provide a greater capacity to employ more experienced, often permanent, employees (whose hourly labour costs are particularly high under current penalty rates). Lower penalty rates would also be likely to reduce the incidence of weekend work by small business owner-managers, who often work long hours to avoid high labour costs.

Reductions to Sunday penalty rates will particularly affect the incomes of people who work Sundays only. While there are relatively few such workers in the hospitality, entertainment, retailing, restaurants and cafes industries, the Productivity Commission proposes a lag before any change occurs, allowing people to adjust their lives and working patterns. Moreover, there will be positive outcomes for people who cannot currently obtain jobs in the relevant industries.

In the longer run, businesses would not be the beneficiaries of deregulated penalty rates given the high levels of competition in the relevant industries. Instead, consumers would benefit from more convenient access to services they value highly and, in some cases, lower prices (for example, through the ending of Sunday surcharges in restaurants and cafes). Failure to recognise the current impacts of high Sunday rates in the relevant industries will also have longer-run effects by frustrating new business models (and the employment they can bring). For example, there are complementarities between online supply and opening hours of some bricks and mortar stores, as in ‘click and collect’ services.

Changes to Sunday penalty rates would desirably occur as part of the current four yearly review.

Figure 7 **Effective penalty rates by day and time of the week**

Permanent and casual employees in the hospitality industry

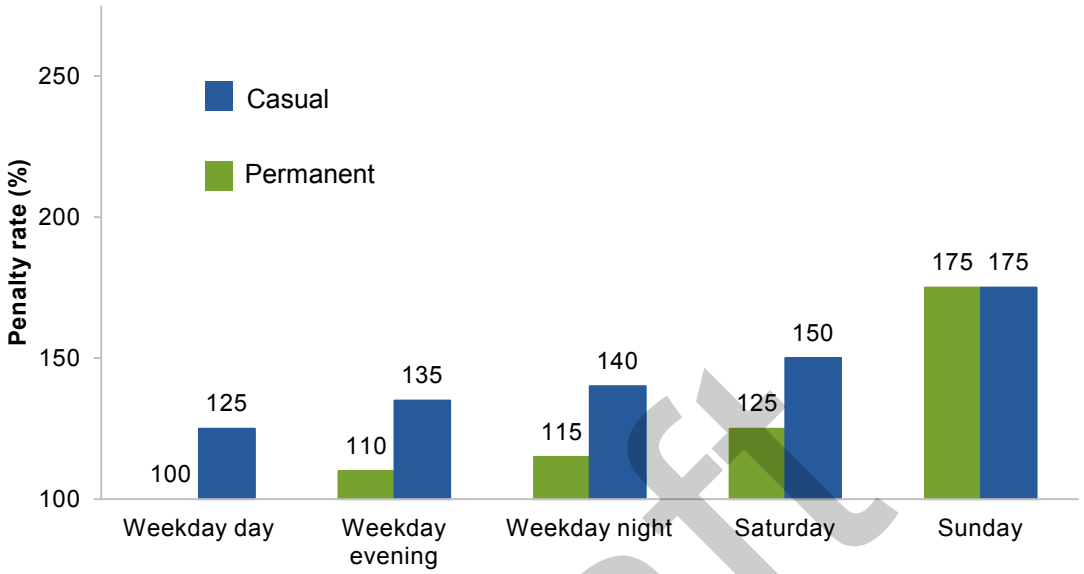
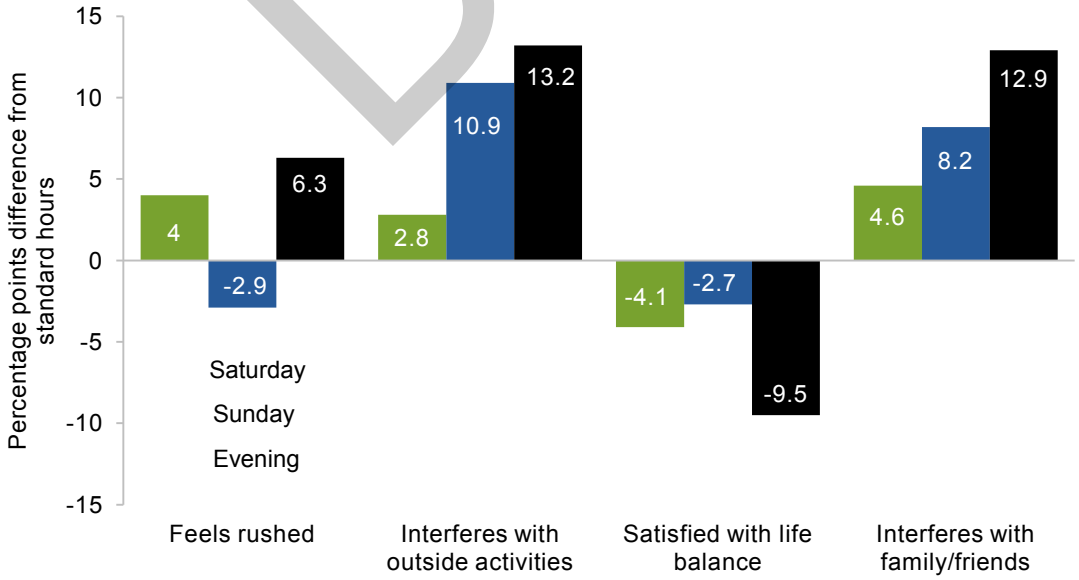


Figure 8 **The social 'disabilities' of working on Sundays are always less than evening work and sometimes less than Saturdays**[a]



[a] The results control for other factors that affect social disabilities, such as having young children.

4 Protecting employees

Australia has a range of laws that protect employees from discrimination, bullying, unfair treatment and dismissal. While sometimes depicted as onerous, complex and overprotective, objective measures of such employee protection arrangements around the world suggest that Australia has one of the more light-handed suites of arrangements.

Unfair dismissal

Australia's WR system provides remedies for workers who are dismissed in a 'harsh, unjust or unreasonable' manner. The FWC may order the unfairly dismissed employee to be reinstated, or paid compensation where reinstatement is not feasible.

Unfair dismissal arrangements reflect that employees and employers are not always angels. Employees may underperform, be disruptive or behave badly. Firms and labour markets can only function efficiently if managers have the power to demand behavioural change by poorly performing employees and, absent that, to dismiss or otherwise penalise them. On the other hand, employers may bully workers, make unreasonable demands (such as working longer without pay or overlooking safety issues) or may dismiss people based on prejudice, whimsy or without due process. Accordingly, there is a need for some balance between the prerogative of businesses to manage and the rights of employees to fair treatment.

The prevalence statistics show that unfair dismissal claims remain relatively small in proportional terms across the Australian labour force and that employers only infrequently encounter unfair dismissal cases. It appears that even where employees are dismissed with cause, around 90 per cent make no claims, and of those that do, around half receive compensation.

Perceptions aside, there is little evidence that unfair dismissal laws are a major obstacle to hiring, especially given the relatively long probationary periods that exempt an employer from any claims (six months for an employer with 15 or more employees and one year for smaller businesses). Conciliation processes may sometimes be 'rough justice' in that the full circumstances of a case are not tested meticulously. However, once unfair dismissal claims go to arbitration, the outcomes can be very uncertain (and far more costly than conciliation) and, as observed earlier, some inconsistency is evident.

The costs of progressing cases through conciliation and arbitration provide incentives for businesses to pay 'go away' money to employees who claim employers have unfairly dismissed them. While it no doubt occurs, there is insufficient data about the extent of go away money, and how it can be distinguished from cases where the employer and the employee agree that the justification for dismissal is not clear cut.

The most problematic aspect of the current legislation is that an employee who has clearly breached the normal expectations of appropriate work behaviour may nevertheless be

deemed to have been unfairly dismissed because of procedural lapses by the employer. For example, in one case a business dismissed two employees after they assaulted their supervisor.[1] The FWC concluded that their physical assault was a valid reason for dismissal, but that the employer's failure to follow certain procedures meant that the dismissals were unjust, unreasonable and therefore unfair.

Moderate and incremental reforms can address the current flaws, while leaving much of the existing legislation and its legitimate protections intact:

- The Fair Work Act should be amended so that procedural errors alone are not sufficient to award compensation or restore employment in what would otherwise be regarded as a valid dismissal. Nevertheless, procedural errors by an employer should, at the discretion of the FWC, lead to either advice to the employer, or where serious or repeated, financial penalties.
- There should be more upfront filters that focus on the merits of claims.
- Somewhat higher lodgment fees may also assist in limiting the automatic recourse to the FWC, but these would likely have to be tailored to an employee's income, and vary depending on whether conciliation or arbitration was being sought. The Productivity Commission is seeking more views on this.
- To reduce some of the present inconsistencies, the governance of the FWC should be reformed along the lines discussed earlier.
- The emphasis on reinstatement as the *primary* goal of the unfair dismissal provisions should be removed. Good legislation should not give primacy to a goal that is rarely achieved and not necessarily even in the interests of the parties involved.
- The above reforms, complemented by further targeted provision of information and regulator engagement with small business, will deal with many of the current issues experienced by small businesses. Subject to implementation of these reforms, the Small Business Fair Dismissal Code should be removed. The basic premise of assisting small business to navigate the complexities of unfair dismissal legislation is reasonable, but the Code does not achieve that outcome and provides a false sense of security.

The general protections

The general protections provisions of the Fair Work Act comprise a lengthy (sometimes relatively technical) set of prohibitions against conduct by employers and industrial associations that breaches an employee's workplace rights — 'adverse action'. For example, adverse action might comprise discrimination against employees because of their union membership (or in some cases because they are not union members). There are very strong grounds for such protections, as employees should not be subject to disadvantage for reasons unrelated to their actual work performance.

1 *Sheng He v Peacock Brothers & Wilson Lac v Peacock Brothers* (2013) FWC 7541.

However, there are some deficiencies in the current arrangements.

The General Protections are broad and sometimes ambiguous. Unlike the specific unfair dismissal provisions, they provide uncapped compensation, which provides incentives to use them as a more lucrative avenue for compensation for dismissals. Moreover, an employee dismissed for underperformance or breaching workplace codes of conduct has strong incentives to claim that some other non-permitted reason was the true basis for the dismissal (for example, because they had complained about some aspect of management), even if this claim was confected. These factors may have been one of the accelerants for the rapid growth of dismissal cases under the General Protections. (Dismissal cases account for nearly 80 per cent of total General Protection cases).

This is not to say that many cases are not genuine. However, a well-functioning system should be designed to limit perverse outcomes, not just because this avoids inefficient and unfair outcomes, but to shore up its integrity. Regulations that lack credibility do not serve the interests of employees with a strong basis for their claims.

A further issue is that business restructuring (for example, moving to labour hire arrangements or adopting labour-displacing technology) sometimes has adverse consequences for existing unionised employees. Some employers claim that such consequences may be depicted as adverse action, which could stymie efficient transformation of businesses. However, while there are some instances where the adverse action provisions may have hampered an employers' legitimate prerogative to manage their businesses to maximise productivity and minimise costs, there is little evidence that unions have systematically frustrated structural change. Accordingly, any response to this apparent problem has to be circumspect.

One notable feature of the General Protections is that the onus is on the employer to prove that adverse action has not occurred. Since employees cannot be in a position to acquire the information to prove intent, there is reasonable justification for such a reverse onus. However, some stakeholders claimed that the reverse onus of proof, while of itself unproblematic, can nevertheless trigger a discovery process that allows a union or court to sift through potentially hundreds of thousands of documents in search of intent (and this has occurred). Doing so may not only be costly in its own right, but may disclose many aspects of a business that would be unreasonable to expose to third parties. Moreover, the court processes that accompany adverse action cases are slow (years can pass), creating large administrative and legal costs and frustrating business plans. However, in its Access to Justice inquiry report, the Productivity Commission found that many superior courts, particularly the Federal Court, have taken significant steps to curtail discovery. This has generally reduced costs and timelines.

Courts are now also successfully addressing a previously identified prime problem. Some key High Court cases have established legal precedents that an adverse action case will not succeed because of some coincident possible breach of a workplace right (such as dismissal of a union official who has performed poorly). To the extent that the precedent is observed in

other cases, adverse action would require that such a breach was, on examination of the subjective intentions of the decision maker, the main reason for the dismissal.

Other modest reforms can address the other limitations:

- The currently quite uncertain 'complaint' trigger for protection of a workplace right needs to be better defined.
- Consistent with reform in judicial processes in several jurisdictions, the Fair Work Act should be amended to make the discovery process used in adverse action cases proportional to the issue at hand.

These measures would not throw the baby out with the bathwater. Strong protections should remain in force.

Anti-bullying

Bullying can have devastating consequences for people, which is why various laws have attempted to discourage it by penalising those who engage in it or who permit it to happen, and by providing compensation to victims. There are multiple avenues for addressing bullying — such as through various anti-discrimination and workforce health and safety laws, and since January 2014, as an addition to the Fair Work Act.

The Fair Work Act accords a key role to the FWC in overseeing this new jurisdiction. As is the case for unfair dismissal, the FWC is the mediator, conciliator and, as a last resort, adjudicator. The FWC can make any order it considers appropriate to stop the bullying. However, it cannot make orders requiring payment. Workers may be able to seek compensation through other means, including workers' compensation, workplace health and safety, and common law claims. A failure to comply with FWC orders would expose the employer and/or the relevant bullying party to civil penalties.

While some have questioned whether anti-bullying provisions needed to be incorporated into the Fair Work Act given the other avenues for addressing the issue, the expected barrage of claims has not materialised. In fact, over 2013-14, the FWC received only 197 applications for an order to stop bullying (FWC 2014), with 21 finalised by a decision. Of these, only one application resulted in an order to stop bullying. However, the provision is resource intensive for the FWC as evidence provided by applicants can be extensive, if not always substantive.

Overall, while the FWC's current approach appears to be considered and effective, sufficient time has not elapsed to reach a final judgment on the effectiveness of the provision. A post-implementation review is already scheduled, and this would provide a timely opportunity to assess the operation of the jurisdiction.

5 Enterprise bargaining

Following almost one century of centralised conciliation and arbitration, Australia introduced enterprise-level bargaining in 1993. Enterprise bargaining involves employees working together to reach an agreement with their employer over the terms and conditions of their employment. Enterprise bargaining can potentially yield efficiencies through negotiating and using one, rather than many, individual arrangements. It is also a vehicle for a delicate balance between the parties' interests. On the one hand, it provides a counterweight to the bargaining power of the employer (the adversarial aspect to bargaining), and, on the other hand, the scope for cementing cooperation between parties that have a mutual stake in the efficiency and performance of the individual enterprise. Enterprise bargaining provides some flexibility to take into account the special circumstances of any one firm. This contrasts with collective bargaining across multiple enterprises and industries (the arrangements preceding 1993), which did not have a focus on the individual enterprise.

The Fair Work Act has detailed rules around enterprise bargaining. While the bulk of agreements appear to be formed with no difficulty and with benefits for all parties, there are several flaws in the current arrangements.

Where a staple can undo an agreement

Peabody Moorvale Pty Ltd[2] provided three pages — stapled together — to all of the employees to be covered by a proposed enterprise agreement. Some bargaining ensued, an agreement was struck and the agreement was lodged with the FWC. However, by attaching the three documents together, the employer contravened requirements about the form of notice to be given to employees. The FWC had no real discretion in the matter, and was obliged by the Fair Work Act to reject the agreement. So, absurdly, the employer had to recommence the agreement process. There is a convincing variety of similar examples.

While there are often good reasons for imposing procedural requirements (for example, to prevent employers including extraneous and potentially misleading information in a notice to employees), substance rather than form should prevail, which is a recurring theme in this inquiry. In this type of instance, the solution is that the FWC should have the discretion to overlook a procedural defect (that poses no risks to employees) without requiring an undertaking by the employer.

Good faith bargaining

The good faith bargaining requirements appear to be working relatively well. While some have advocated for time limits on bargaining, this would reduce the incentives for parties

2 *Peabody Moorvale Pty Ltd v Construction, Forestry, Mining and Energy Union* [2014] FWCFB 2042 (2 April 2014).

to agree among themselves. A central tenet of the shift to enterprise bargaining was to step away from third party arbitration. The FWC already has sufficient powers to step in, as a matter of last resort, when there are repeated breaches of the requirements. The good faith bargaining requirements should also be applied to greenfields negotiations, as recommended by the 2012 review of the Fair Work Act.

The better off overall test (BOOT)

The application of the BOOT is creating uncertainty during the bargaining process and at the agreement approval stage. The main source of confusion lies with how to assess whether the relevant groups of employees (or prospective employees in the case of a greenfields agreement) are better off overall compared with the relevant award. A particularly vexing issue — for both enterprise agreements and individual flexibility arrangements — is how to trade off non-monetary benefits against other benefits of an award.

While the BOOT is not in principle defective, in practice it has sometimes lent itself to a 'line by line' approach, which involves assessing whether the relevant class of employees are made better or worse off by each individual term in the agreement when compared with the relevant term in the award. The intention of the BOOT was that it should be a global test, which takes into account the sum of all the benefits of an agreement and tests those against the overall benefits of the award. Shifting to a new 'no-disadvantage' test is likely to assist in supporting that intention. It would still ensure that employees were not disadvantaged compared with the award — an essential requirement — while allowing employees and employers to develop agreements that represent wins for both parties. Changing to this test should be complemented by more detailed, practical guidance on the new no-disadvantage test from the FWC (in concert with similar advice given by the Fair Work Ombudsman to employers and employees developing individual arrangements or enterprise contracts — see later).

Greenfields agreements pose major dilemmas in regulatory design

The unique circumstances of bargaining for a greenfields agreement warrant a different regulatory approach. Such agreements are struck between a union and a new enterprise that has not yet hired any employees. Since 2011, the use of greenfields agreements has expanded. Greenfields agreements now make up 10 per cent of all enterprise agreements, up from 6.4 per cent in September 2011. Greenfields agreements are most prevalent in construction projects, which make up roughly two-thirds of greenfields agreements. However, they are also currently used in many other contexts, including healthcare and manufacturing, so they do not always relate to large capital-intensive projects with a given life. However, the problems of the agreement-making processes strike most hard for such projects.

The main concerns are that large capital-intensive projects require some certainty about the start date of the project to secure finance, to plan the project, and to more generally manage risk. Unions' capacity to hold out in their negotiations provides them with unique and excessive bargaining power, and risks stripping some of the needed returns from inherently risky projects. Unlike other enterprise bargaining processes, the usual disciplines for speedy bargaining — the absence of pay increases for an existing workforce — are not present.

There are no easy solutions. Avoiding all uncertainty for employers would shift the balance of power too far in their direction. Allowing the FWC to determine the 'best' outcome would be at odds with the desirability of leaving essentially commercial decisions in the hands of those parties with the greatest information. The Productivity Commission has devised a menu approach, which would allow parties to choose between three options. If an employer and union have not reached a negotiated outcome for a greenfields agreement after three months, the employer would be able to:

- continue negotiating with the union. This would only occur if the employer was confident that a reasonable agreement could be reached, and that the cost of waiting was not prohibitive. It is nevertheless likely that constructive dialogue between the parties — not always guaranteed by the instinctive culture of the two parties — may go a long way
- request that the FWC undertake 'last offer' arbitration of an outcome by choosing between the last offers made by the employer and the union. The FWC would not re-open the matter to make its own judgment, but would merely act as an umpire for the two choices put to it. Knowing this, the parties to the agreement would have strong incentives to make reasonable claims. It would, however, still require that the FWC consider the proposals with a high degree of expected impartiality. The 2012 review of the Fair Work Act also recommended that 'last offer' arbitration be used to resolve stalemates in greenfields negotiations
- submit the employer's proposed greenfields arrangement for approval by the FWC without any need for union agreement, with a 12-month nominal expiry date. At that point, the business would have hired employees, and a normal enterprise bargaining round could occur. The advantage of this menu option is that the employer would have the capacity to negotiate tradeoffs with employees that unions might be unwilling to accept. On the other hand, such bargaining could also lawfully trigger industrial action, with the potential to delay a large already committed project. This would give employees and their representatives a potentially high degree of leverage. An employer facing those risks would be unlikely to select this menu option. It would, however, be much more likely to be attractive to non-capital-intensive greenfields arrangements in which an employer wanted to engage positively with its employees.

Regardless of the agreement making process chosen by the employer, the ensuing greenfields arrangement would have to pass the proposed no-disadvantage test.

Another complementary mechanism that would also reduce the hold-up problem and uncertainty for construction greenfields projects would be the capacity for an employer to form an agreement whose duration matched the life of the construction project (with approval from the FWC if that duration exceeded five years).

The content of enterprise agreements

While all enterprise agreements must include a flexibility term that allows parties to make an individual flexibility arrangement (see later) to vary the conditions of an enterprise agreement, the range of matters over which such individual arrangements may be made can be whittled down during the bargaining process. Such a narrowing of options should not be permitted.

The range of matters that should be permitted in an enterprise agreement is an area of fierce contention. Employers generally wish to reduce the range of matters over which bargaining can occur, based on the primacy they give to managerial prerogative, while employees seek a more expansive range of matters (for example, in relation to the use of labour hire or subcontractors):

- There are grounds for changes to the Fair Work Act to limit the capacity of agreements to regulate the use of contractors and labour hire (which are in any case, in spirit, contrary to the *Competition and Consumer Act 2010* (Cth)).
- In terms of permitted matters more broadly, the Fair Work Act deliberately moved away from the legislative prescription in previous regimes to a reliance on jurisprudence about 'matters pertaining'. This concedes that it is hard (and perhaps undesirable) to set out a white or black list of *all* permitted matters without reference to context. Apart from the employment of labour hire employees and contractors, further evidence is required to assess whether particular sorts of terms should or should not be permitted.

Despite calls for the introduction of productivity clauses within all enterprise agreements, this might perversely generate outcomes inimical to productivity and be counter to managerial prerogative. Most employers constantly look for ways to improve productivity in ways that do not require any quid pro quo in terms of increased wages and conditions (for example, if the business invests in more productive equipment or innovates). Where there are gains from cooperation, employers, employees and their representatives already have strong incentives to commit to productivity improvements and, where possible, to specify ways in which this might be achieved through enterprise agreements without resorting to new regulation.

Bargaining representatives must represent more than a trivial share of the workforce

Multiple non-union bargaining representatives who represent small groups of employees can add considerably to the cost and smooth progression of bargaining. There should be a requirement that a non-union party can only act as a bargaining representative if they have secured the support of a reasonable share of the workforce. (The Productivity Commission has proposed 5 per cent, but a different value may readily achieve the same objective.)

6 Individual arrangements

Even when part of an enterprise agreement, all employment contracts are, in law, individual arrangements. A WR system merely provides different ways in which such contracts can be packaged, weighing up the advantages and disadvantages of individual flexibility, the costs of contract variations across workers in the same enterprise, and the risks of power imbalances that arise from different contractual arrangements.

While most employees are paid at rates determined by an enterprise agreement or stipulated in an award (figure 1), a sizeable minority are paid on an individual basis at above-award rates. A relatively few — around 2 per cent of all employees covered by the Fair Work Act — have formed so-called 'individual flexibility arrangements' under the Act.

In principle, individual flexibility arrangements allow an employee and employer to negotiate terms and conditions that suit their personal circumstances. For example, an individual flexibility arrangement may change rostering arrangements to suit an employee and an employer. An individual flexibility arrangement may allow, but does not require, an employee to forgo some award or enterprise agreement conditions so long as they pass a 'better off overall test' as described above. (The BOOT is against the enterprise agreement if an employee is opting out of the agreement, but otherwise against the pre-existing award or award-based arrangement.) No agreement can trade off conditions specified under the National Employment Standards.

Individual flexibility arrangements represent a new marque of statutory individual arrangements, and supersede several variants of Australian Workplace Agreements (AWAs). Under WorkChoices, AWAs were not subject to a no-disadvantage test, and were contentious because some employees who lacked bargaining power had their entitlements reduced. Such AWAs were offered as a condition of employment ('take it or leave it') and had a low safety net threshold. Available data suggest the take up of AWAs was around 3 per cent of employees. Prior to WorkChoices, AWAs had stronger protections and were less controversial.

It is surprising that employees and employers have not used individual flexibility arrangements more frequently, as they offer considerable flexibility, provide protections for employees, and are not hard to make. One immediate and easily implemented reform

would be simply to better advertise the option of an individual flexibility arrangement to employees and employers. Many have not even heard of them.

Some of the other obstacles to their use are more perceived than substantive, but are still worth remedying.

For example, employer groups argue that the ambiguity about the BOOT makes them reluctant to form an agreement lest subsequently the Fair Work Ombudsman finds that they breached the test. This concern arises because individual flexibility arrangements are not vetted against the BOOT by the Fair Work Ombudsman when they are made (to avoid the large transactions costs of doing so). However, unless there has been egregious conduct (such as coercion to make an agreement), the most likely outcome of a breach of the BOOT would be immediate termination of the agreement and reversion to the award, enterprise agreement or other pre-existing arrangement. There have been very few instances where the Fair Work Ombudsman has acted against an employer in respect of an individual flexibility arrangement. And surveys of employers (as opposed to the views of employer groups) suggest that fear of failing the BOOT at some future date is not a major obstacle. Nevertheless, there appears to be no harm in eliminating any perceived risks where they do not undermine the protection of employees. The switch to a no-disadvantage test as discussed above would represent a straightforward remedy, as would guidance to businesses and the development of example agreements that would be compliant.

Another potential deficiency is that employers can be reluctant to invest in flexible arrangements because an employee on an enterprise agreement can terminate an individual flexibility arrangement with 28 days' notice and individual flexibility arrangements can only be offered to existing employees, rather than as a condition of employment. Short notice can expose businesses to financial and operational risks. As a concrete illustration, a business might set up rostering arrangements underpinned by commitments by employees set down in individual flexibility arrangements, only to find that the termination of several of these made the arrangements untenable. By reducing their expected return, the risk that individual flexibility arrangements may be terminated soon after their formation may undermine the incentives for managerial innovations. Likewise, rapid termination by an employer can adversely affect employees who may have made flexible home arrangements (for instance, to coordinate childcare with working times) only to find them vanish.

The evidence about the severity of these problems is weak but, as in the previous case, there is a remedy that has few downsides. The Australian Government should amend the Fair Work Act so that the minimum termination period should be 13 weeks (as proposed in the 2012 review of the Act), but with the capacity of employers and employees to agree at the formation of the agreement to a one year minimum period.

A possible new type of agreement that spans individual and enterprise agreements — the enterprise contract

However, even with these changes, it is unlikely that the prevalence of truly bespoke individual arrangements would ever be high, simply because of the high transaction costs of their negotiation. This is especially so for businesses with high staff turnover or that are rapidly expanding. The scope of individual flexibility arrangements is determined by particular clauses (the flexibility term) in the overarching award or enterprise agreement, which can be quite restrictive.

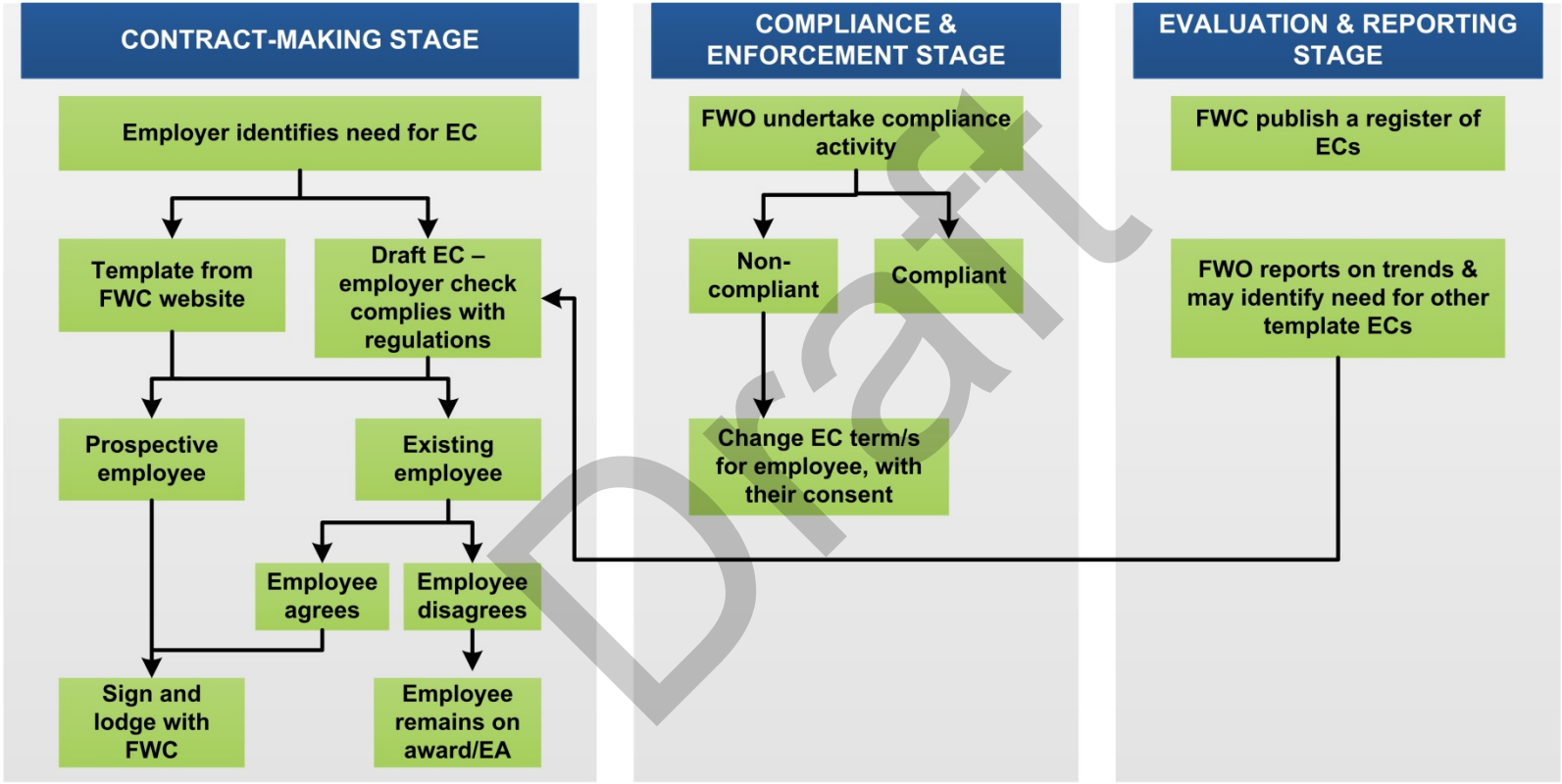
In principle, businesses could still achieve flexible arrangements across their operations by negotiating enterprise agreements but, as discussed later, such agreement making is still rare amongst small and medium-sized businesses. This is because the procedural aspects of such bargaining can be daunting (though the perceptions are probably worse than the reality).

To meet the needs of such businesses, the Productivity Commission is floating the option of a new type of statutory arrangement — the enterprise contract (figure 9).

This would permit employers to vary an award for entire classes of employees (level 1 retail employees, for example), or for a group of particular employees, without having to negotiate with each party individually or to form an enterprise agreement.

It would effectively amount to a collective individual flexibility arrangement, but with some further flexibility. Employers could offer it to all prospective employees as a condition of employment (resembling enterprise agreements, where new employees are covered by an existing agreement when they are hired). No employee ballot would be required for the adoption of an enterprise contract, nor would any employee group be involved in its preparation and agreement unless the employer wished this to be the case. As in enterprise agreements, employers and individual employees could still negotiate individual flexibility arrangements as carve outs from the enterprise contract if they mutually agreed.

Figure 9 **Making an enterprise contract**



The enterprise contract would be accompanied by a comprehensive suite of safeguards and measures to reduce the transaction costs of its adoption:

- Existing employees would be able to choose whether to sign on or stay with their existing employment contract.
- The enterprise contract would be lodged with the FWC, but unlike enterprise agreements would not require ex ante approval. Ex post, lodgment would enable the FWC, after a complaint by a covered employee, to test compliance using the (holistic) no-disadvantage test, as for individual flexibility arrangements. Where a complaint was upheld, the Fair Work Ombudsman would be empowered to vary the contracts of all other relevant employees.
- Lodgement would also allow the FWC or the Fair Work Ombudsman to analyse the nature and trends in such agreements, and to provide a basis for industry templates that would enable any business to adopt an agreement with the surety that it would pass a no-disadvantage test (with equal certainty for an employee). Transparency would also allow employees to assess where any particular 'take it or leave it' contract fitted among the spectrum of offerings provided by various competing businesses, giving them information that could influence their choice of employer.
- The employer would be required to provide employees with a written form of the contract, so they were aware of its entitlements and obligations. The incremental costs of doing this would be negligible, as the business would have to lodge the agreement with the FWC. This would be particularly easy where the employer adopted a template. The Fair Work Ombudsman would provide an easy guide for employers and employees about enterprise contracts.
- Employees could exit the enterprise contract after one year and return to the award (or any other agreed contract).

The enterprise contract would also have an expiry date, at which time parties would have to select among various contract options, including continuation of the current contract, an adapted version, separate individual arrangements or an enterprise agreement. In the latter respect, enterprise contracts might provide a natural vehicle for progression to standard enterprise agreements as employees could, after one year, elect through a majority vote to commence enterprise bargaining.

However, the desirability, practicalities and detailed design of an enterprise contract needs to be tested further.

7 Industrial disputes and right of entry

The credible threat of industrial action by both employees and employers is an important negotiating tool for parties engaging in enterprise bargaining, helping to reduce asymmetries in information and bargaining power. Nevertheless, there need to be rules that

ensure that neither employers nor employees hold too much power and that take account of the economywide effects of major disputes.

The existing provisions outlined in the Fair Work Act governing industrial action are extensive and complex. Numerous conditions and procedural steps must be satisfied by employees to obtain authorisation to undertake lawful ('protected') industrial action during enterprise bargaining. (Industrial action is unlawful outside the bargaining period.) Employers are provided notice in advance of protected industrial action and have the ability to respond with contingency plans or by lockout. Employees are not paid while engaging in any action (and indeed it is unlawful for an employer to do so). There are also multiple avenues through which protected industrial action can be challenged by employers, or suspended or terminated by the FWC or the Employment Minister (with the latter only possible in special 'public interest' circumstances). Penalties are in place for parties that engage in unprotected industrial action.

Industrial disputes do not appear to be a major problem in Australia's WR framework. The measured prevalence of industrial action has declined substantially over the past three decades, and has remained relatively low in recent years. The average number of days lost over the past five years was less than one tenth of the days lost on average from 1985 to 1990. Moreover, despite the views of some employer groups, the level of disputation does not appear to have meaningfully increased following recent changes to the WR framework. Indeed the biggest contributor to some recent spikes have related to public sector disputes that are outside the scope of the Fair Work Act. Nevertheless, some forms of industrial action — for example, work bans — creep below the statistical radar.

Regardless, there are several shortcomings in current arrangements that allow the excessive strategic use of industrial action.

- The Fair Work Act permits industrial action after the expiry of an enterprise agreement, but before bargaining has commenced. Since employees can always compel an employer to commence negotiations through a majority vote, there is no rationale or community interest in permitting industrial action prior to bargaining. This was also recommended by the 2012 review of the Fair Work Act.
- Secret ballots are an essential part of industrial disputes regulations since they reduce risks of coercion by employers or employee representatives, prevent hollow threats of disputes that do not actually have employee consent, and provide a clear point at which the FWC can intervene in circumstances where the parties have not genuinely been trying to reach an agreements. Nevertheless, they can be overly burdensome, with two leading legal academics noting that the existing provisions have 'proved to be a fruitful source of revenue for the legal profession'. Unions have said much the same, and the Productivity Commission agrees that there might be some scope for simpler and lower cost arrangements, and is accordingly seeking further feedback on this issue.
- Aborted strikes and brief stoppages can involve low costs for employees, but impose disproportionate transaction costs on employers (and customers). For example, a one-minute stoppage would legally obligate the employer to suspend pay to employees

for that duration, despite there being considerable administrative costs in doing so. It is ironic that the 'no strike pay' measure, which was intended to reduce coercion, can be used to strengthen the bargaining power of the striking party. Similarly, a business may be advised of a strike and implement costly measures to address the disruption that it expects to ensue (for example, rescheduling deliveries or carriage of passengers), and yet the strike may then be called off. To reduce the use of this strategic ploy, employers that have engaged in a reasonable contingency response to what ultimately was an aborted industrial action should be given the capacity to stand down the relevant employees for the duration of that response. Employers should also be able to pay employees for short duration strikes or to deduct pay for periods that are more administratively feasible.

- There may be grounds to grant employers more graduated options for retaliatory industrial action than the 'nuclear' lock-out option. The Productivity Commission is seeking views on what would be practical and proportional.
- The penalties for unlawful industrial action (by any party) should be increased, as this would allow the FWC and the Federal Court more scope to apply penalties commensurate with the harm associated with such action.

There are also areas where employers have called for changes to industrial dispute regulations, but that are not warranted by the evidence.

- There should not be any legislative requirement that protected industrial action can only proceed after a FWC assessment confirms that employee's claims are not 'excessive', or will not have an adverse impact on the enterprise's productivity. A test of this kind is both asymmetric (favouring employers over employees), but could run into a definitional quagmire about what was 'excessive' in the context of a particular enterprise's commercial environment. It is inherently undesirable to have an industrial regulator effectively act as a commercial arbiter between two parties. The circumstances in which it exercises any such role should be minimised. *This is a broad principle that should inform any future development of the Fair Work Act.*
- There should be no restriction on industrial action by high-income employees. Incidentally, were it introduced, it would place Australia in an unusual position among most other countries, where no such restrictions apply
- There is not a strong case for adding further criteria to the test for whether employees are 'genuinely trying to reach agreement'.

In the debates about regulation of industrial disputes, there is often a mantra that disputes are harmful to productivity and efficiency, and that there should therefore be more binding constraints on their use. Disputes may have such effects, although in aggregate there is little evidence that the effects are material. Many disputes are about who gets what portion of a cake, not the quantum of the cake. In fact, a missing story is that the toxic relationships that can surface between employers and employees are sometimes the result of poor relationship management — a key skill for both employers and employee representatives — not a fault of the WR system.

The provisions providing rights of entry by union officials to worksites are broadly sound, though at times both sides play games with each other. That said, there are grounds for the FWC to consider more closely the impacts on employers and employees before making any orders concerning disputes about the frequency of right of entry requests.

8 Sham contracting

Independent contractors comprise an important share of the workforce (figure 1). This employment form provides workers with much more autonomy in their working arrangements, and enables them to change their wage rates to maximise their returns (including by decreasing the likelihood of unemployment in weaker labour markets). Employers often choose to use these employment forms because, in some circumstances, they can improve productivity or lower costs. They can also provide intermittently required skills and can act as more flexible sources of labour than ongoing employees.

Contractors generally receive different pay and entitlements to ongoing workers. This generally reflects the degree to which each employment form is regulated by the Fair Work Act. There is some concern that the differential application of the Fair Work Act creates incentives to misclassify employees as independent contractors (sham contracting). This can occur with a worker's consent, or through misrepresentation or coercion. It is most prevalent in the construction, cleaning services, hair and beauty and call centre industries.

Some have argued that the current common law approach to determining whether a worker is an employee or an independent contractor lacks clarity. The lack of clarity associated with this approach — which balances multiple factors including the length of employment as well as the choice of work, manner of work, hours of work and payment for work rather than relying on a single indicator — makes it hard to identify the genuine status of employment arrangements, makes enforcement difficult and leads to inadvertent errors. While the existing common law definition of a subcontractor may not always be easy to apply, it is hard to develop a better legislative definition or test.

The requirement that an employer must have been 'reckless' for them to be prosecuted for misrepresenting the nature of an employment contract appears to be a high hurdle for legal action. Changing from a test of 'recklessness' to a test or 'reasonableness' would help discourage sham contracting, including through the regulators' out-of-court actions, though such a change needs to be tested further.

9 Public sector bargaining

Public sector bargaining differs from bargaining in the private sector in several ways. The most obvious of these is that there are relatively few employers, but public sector employees account for a substantial amount — around 16 per cent — of the total

workforce. Moreover, in some cases, government is also a legislator and a regulator — effectively making and enforcing the laws it uses to hire workers.

Governments have *potential* market power because while individual agencies may negotiate with their employees, the government can set rules for such agreement making, and close off certain bargaining options by simply tightening the purse strings. In some instances, governments are also the dominant hirer or funder of people performing certain jobs (teaching, nursing, emergency services, disability and aged care).

It is hard to test the degree to which governments exercise any such power, or when they might do so. There is some evidence that pay rises are lower during periods of fiscal stringency but, on the whole, pay rates catch up during upturns in the business cycle. There is also evidence that, after having accounted for differences in skills and experience, wage levels for female employees in the public sector are higher than those of their counterparts in the private sector. There is scant evidence of a premium or a discount for males. Taken in concert, this evidence suggests that the wages of public sector employees have not been systematically depressed. This may be due to several factors, including the high unionisation rates in parts of the public sector, a desire to attract and retain high quality employees and cyclical budget pressures. However, what is true for the whole may not be true for all occupations.

There are also many challenges in bargaining in the public sector that are less evident for private employers. In most cases, there are no paying customers in the normal sense. Productivity is not easily measured, though linkages between pay rises and productivity in enterprise agreements are far more common in public sector than private sector agreements. The agreements set by agencies often involve what one public service commissioner referred to as the 'adoption of interminable or excessively bureaucratic processes' for managing underperformance. There are no easy fixes for these challenges — and probably the best solutions need to be developed at the agency level.

10 Migrant workers in Australia

Although covered under the Fair Work Act, permanent and temporary migrant workers face higher risks of exploitation. These can be for several reasons, such as limited English language skills or lack of awareness of their rights in the workplace. A remedy is to provide additional resources to the Fair Work Ombudsman to strengthen its existing risk-based approach to monitoring employers. This would allow the Ombudsman to enhance information sharing with other departments and conduct more investigations and audits. Recommendations from the Independent Review into the 457 visa program in 2014 — such as increasing deterrents for employers — could also be expanded to cover all employment-related visa classes.

In addition to permanent and temporary migrant workers, it is estimated that at least 50 000 migrants are working in breach of the *Migration Act 1958* (Cth). As a result, they are not

covered under the Fair Work Act. These migrants either do not hold a valid visa to be in Australia, have overstayed the term of their visa, or are breaching a visa condition by working. Unlike many other employees, an unlawfully working migrant worker is unlikely to complain, reducing the most common avenue for discovering exploitation.

As a deterrent, employers can face fines or imprisonment under the Migration Act for employing these migrants, but depending on how these penalties are applied, an employer may still benefit from hiring and exploiting a migrant working in breach of their visa conditions. This is largely due to the fact that an employer currently does not have to pay the difference between what the worker was actually paid and their minimum entitlements under the Fair Work Act.

A solution to eliminate an employer's benefit from hiring such migrants would be to impose a two-part penalty on employers: a punishment for breaching the Migration Act and a fine equal to at least whatever the worker was underpaid over the duration of their employment.

Draft recommendations, findings and information requests

OVERALL DRAFT REPORT FINDING

Despite sometimes significant problems and an assortment of peculiarities, Australia's workplace relations system is not systemically dysfunctional. It needs repair not replacement.

Chapter 3 Institutions

DRAFT RECOMMENDATION 3.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) to establish a Minimum Standards Division as part of the Fair Work Commission. This Division would have responsibility for minimum wages and modern awards. All other functions of the Fair Work Commission should remain in a Tribunal Division.

DRAFT RECOMMENDATION 3.2

The Australian Government should amend s. 629 of the *Fair Work Act 2009* (Cth) to stipulate that new appointments of the President, Vice Presidents, Deputy Presidents and Commissioners of the Fair Work Commission be for periods of five years, with the possibility of reappointment at the end of this period, subject to a merit-based performance review undertaken jointly by an independent expert appointment panel and (excepting with regard to their own appointment) the President.

Current non-judicial Members should also be subject to a performance review based on the duration of their current appointment. Existing Members with five or more years of service would be subject to review within three years from the commencement of these appointment processes with reviews to be staggered to reduce disruption. Non-judicial Members with fewer than five years of service would be reviewed at between three to five years, depending on the date of their appointment.

DRAFT RECOMMENDATION 3.3

The Australian Government should amend the *Fair Work Act 2009* (Cth) to change the appointment processes for Members of the Fair Work Commission. The amendments would stipulate that:

- an independent expert appointment panel should be established by the Australian Government and state and territory governments
- members of the appointment panel should not have had previous direct roles in industrial representation or advocacy
- the panel should make a shortlist of suitable candidates for Members of the Fair Work Commission against the criteria in draft recommendation 3.4
- the Commonwealth Minister for Employment should select Members of the Fair Work Commission from the panel's shortlist, with appointments then made by the Governor General.

DRAFT RECOMMENDATION 3.4

The Australian Government should amend the *Fair Work Act 2009* (Cth) to establish separate eligibility criteria for members of the two Divisions of the Fair Work Commission outlined in draft recommendation 3.1.

Members of the Minimum Standards Division should have well-developed analytical capabilities and experience in economics, social science, commerce or equivalent disciplines.

Members of the Tribunal Division Membership should have a broad experience, and be drawn from a range of professions, including (for example) from ombudsman's offices, commercial dispute resolution, law, economics and other relevant professions.

A requirement for the Panel and the Minister for Employment respectively is that they be satisfied that a person recommended for appointment would be widely seen as having an unbiased and credible framework for reaching conclusions and determinations in relation to workplace relation matters or other relevant areas.

DRAFT RECOMMENDATION 3.5

The Australian Government should require that the Fair Work Commission publish more detailed information about conciliation outcomes and processes. In the medium term, it should also commission an independent performance review of the Fair Work Commission's conciliation processes, and the outcomes that result from these processes.

Chapter 4 National Employment Standards

DRAFT RECOMMENDATION 4.1

The Fair Work Commission should, as a part of the current four yearly review of modern awards, give effect to s. 115(3) of the *Fair Work Act 2009* (Cth) by incorporating terms that permit an employer and an employee to agree to substitute a public holiday for an alternative day into all modern awards.

DRAFT RECOMMENDATION 4.2

The Australian Government should amend the National Employment Standards so that employers are not required to pay for leave or any additional penalty rates for any newly designated state and territory public holidays.

DRAFT RECOMMENDATION 4.3

Periodically, the Australian, state and territory governments should jointly examine whether there are any grounds for extending the existing 20 days of paid annual leave in the National Employment Standards, with a cash out option for any additional leave where that suits the employer and employee. Such an extension should not be implemented in the near future, and if ultimately implemented, should be achieved through a negotiated tradeoff between wage increases and extra paid leave.

INFORMATION REQUEST

The Productivity Commission seeks information on whether it would be practical for casual workers to be able to exchange part of their loading for additional entitlements (for example personal or carer's leave) if they so wish, and whether such a mechanism would be worthwhile.

Chapter 5 Unfair dismissal

INFORMATION REQUEST

The Productivity Commission seeks further views on possible changes to lodgment fees for unfair dismissal claims.

DRAFT RECOMMENDATION 5.1

The Australian Government should either provide the Fair Work Commission with greater discretion to consider unfair dismissal applications 'on the papers', prior to commencement of conciliation; or alternatively, introduce more merit focused conciliation processes.

DRAFT RECOMMENDATION 5.2

The Australian Government should change the penalty regime for unfair dismissal cases so that:

- an employee can only receive compensation when they have been dismissed without reasonable evidence of persistent underperformance or serious misconduct
- procedural errors by an employer should not result in reinstatement or compensation for a former employee, but can, at the discretion of the Fair Work Commission, lead to either counselling and education of the employer, or financial penalties.

DRAFT RECOMMENDATION 5.3

The Australian Government should remove the emphasis on reinstatement as the *primary* goal of the unfair dismissal provisions in the *Fair Work Act 2009* (Cth).

DRAFT RECOMMENDATION 5.4

Conditional on implementation of the other recommended changes to the unfair dismissal system within this report, the Australian Government should remove the (partial) reliance on the Small Business Fair Dismissal Code within the *Fair Work Act 2009* (Cth).

Chapter 6 The General Protections

DRAFT RECOMMENDATION 6.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) to formally align the discovery processes used in general protection cases with those provided in the Federal Court's Rules and Practice Note 5 CM5.

DRAFT RECOMMENDATION 6.2

The Australian Government should modify s. 341 of the *Fair Work Act 2009* (Cth), which deals with the meaning and application of a workplace right.

- Modified provisions should more clearly define how the exercise of a workplace right applies in instances where the complaint or inquiry is indirectly related to the person's employment.
- The FW Act should also require that complaints are made in good faith; and that the Fair Work Commission must decide this via a preliminary interview with the complainant before the action can proceed and prior to the convening of any conference involving both parties.

DRAFT RECOMMENDATION 6.3

The Australian Government should amend Part 3-1 of the *Fair Work Act 2009* (Cth) to introduce exclusions for complaints that are frivolous and vexatious.

DRAFT RECOMMENDATION 6.4

The Australian Government should introduce a cap on compensation for claims lodged under Part 3-1 of the *Fair Work Act 2009* (Cth).

DRAFT RECOMMENDATION 6.5

The Australian Government should amend Schedule 5.2 of the *Fair Work Regulations 2009* (Cth) to require the Fair Work Commission to report more information about general protections matters. Adequate resourcing should be provided to the Fair Work Commission to improve its data collection and reporting processes in this area.

Chapter 8 Minimum wages

DRAFT RECOMMENDATION 8.1

In making its annual national wage decision, the Fair Work Commission should broaden its analytical framework to systematically consider the risks of unexpected variations in economic circumstances on employment and the living standards of the low paid.

Chapter 9 Variations in uniform minimum wages

DRAFT RECOMMENDATION 9.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that the Fair Work Commission is empowered to make temporary variations in awards in exceptional circumstances after an annual wage review has been completed.

INFORMATION REQUEST

The Productivity Commission seeks information on whether the structure of junior pay rates should be based on a model other than age, such as experience or competency, or some combination of these criteria.

DRAFT RECOMMENDATION 9.2

The Australian Government should commission a comprehensive review into Australia's apprenticeship and traineeship arrangements. The review should include, but not be limited to, an assessment of:

- the role of the current system within the broader set of arrangements for skill formation
- the structure of awards for apprentices and trainees, including junior and adult training wages and the adoption of competency-based pay progression
- the factors that affect the supply and demand for apprenticeships and traineeships, including the appropriate design and level of government, employer and employee incentives.

Chapter 10 Measures to complement minimum wages

INFORMATION REQUEST

The Productivity Commission invites participants' further input on the feasibility, merits and optimum design on an earned income tax credit in Australia, what its introduction might mean for future minimum wage determinations and employment outcomes, and in what conditions it would be appropriate to implement such a scheme.

Chapter 12 Repairing awards

DRAFT RECOMMENDATION 12.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) to:

- remove the requirement for the Fair Work Commission to conduct four yearly reviews of modern awards
- add the requirement that the Minimum Standards Division of the Fair Work Commission review and vary awards as necessary to meet the Modern Awards Objective.

To achieve the goal of continuously improving awards' capability to meet the Modern Awards Objective, the legislation should require that the Minimum Standards Division:

- use robust analysis to set issues for assessment, prioritised on the basis of likely high yielding gains
- obtain public guidance on reform options.

DRAFT RECOMMENDATION 12.2

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that the Minimum Standards Division of the Fair Work Commission has the same power to adjust minimum wages in an assessment of modern awards as the minimum wage panel currently has in annual wage reviews.

Chapter 14 Regulated weekend penalty rates for the hospitality, entertainment, retail, restaurants and cafe industries

DRAFT RECOMMENDATION 14.1

Sunday penalty rates that are not part of overtime or shift work should be set at Saturday rates for the hospitality, entertainment, retail, restaurants and cafe industries.

Weekend penalty rates should be set to achieve greater consistency between the hospitality, entertainment, retail, restaurants and cafe industries, but without the expectation of a single rate across all of them.

Unless there is a clear rationale for departing from this principle, weekend penalty rates for casuals in these industries should be set so that they provide neutral incentives to employ casuals over permanent employees.

DRAFT RECOMMENDATION 14.2

The Fair Work Commission should, as part of its current award review process, introduce new regulated penalty rates as set out in draft recommendation 14.1 in one step, but with one year's advance notice.

INFORMATION REQUEST

The Productivity Commission seeks views on whether there is scope to include preferred hours clauses in awards beyond the current narrow arrangements, including the scope for an arrangement where an employer would be obliged to pay penalty rates when it requested an employee to work at an employee's non-preferred time in the employment contract.

What would the risks of any such 'penalty rate' agreements be and how could these be mitigated?

Chapter 15 Enterprise bargaining

DRAFT RECOMMENDATION 15.1

The Australian Government should amend Division 4 of Part 2-4 of the *Fair Work Act 2009* (Cth) to:

- allow the Fair Work Commission wider discretion to approve an agreement without amendment or undertakings as long as it is satisfied that the employees were not likely to have been placed at a disadvantage because of the unmet requirement.
- extend the scope of this discretion to include any unmet requirements or defects relating to the issuing or content of a notice of employee representational rights.

INFORMATION REQUEST

The Productivity Commission seeks feedback on whether there is a mechanism that would only restrain pattern bargaining:

- *where it is imposed through excessive leverage or is likely to be anticompetitive*
- *while allowing it in circumstances where it is conducive to low transaction cost agreements that parties genuinely consent to.*

DRAFT RECOMMENDATION 15.2

The Australian Government should amend s. 203 of the *Fair Work Act 2009* (Cth) to require enterprise flexibility terms to permit individual flexibility arrangements to deal with all the matters listed in the model flexibility term, along with any additional matters agreed by the parties. Enterprise agreements should not be able to restrict the terms of individual flexibility arrangements.

DRAFT RECOMMENDATION 15.3

The Australian Government should amend s. 186(5) of the *Fair Work Act 2009* (Cth) to allow an enterprise agreement to specify a nominal expiry date that:

- can be up to five years after the day on which the Fair Work Commission approves the agreement, or
- matches the life of a greenfields project. The resulting enterprise agreement could exceed five years, but where so, the business would have to satisfy the Fair Work Commission that the longer period was justified.

DRAFT FINDING 15.1

The case for imposing statutory requirements for employers and employees to discuss productivity improvements as part of the bargaining process, or for the mandatory inclusion of productivity clauses in agreements, is not strong. Voluntary agreements that promote productivity are highly desirable, but such agreements, and the gains they deliver, should arise from better management, not from a regulated requirement, which is likely to have perverse effects.

DRAFT RECOMMENDATION 15.4

The Australian Government should amend the *Fair Work Act 2009* (Cth) to replace the better off overall test for approval of enterprise agreements with a new no-disadvantage test. The test against which a new agreement is judged should be applied across a like class (or series of classes) of employees for an enterprise agreement. The Fair Work Commission should provide its members with guidelines on how the new test should be applied.

INFORMATION REQUEST

What should be the basis for the revised form of the no-disadvantage test, including whether, and to what extent past forms of the no-disadvantage test provide a suitable model and would be workable within the current legislative framework?

DRAFT RECOMMENDATION 15.5

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that:

- a bargaining notice specifies a reasonable period in which nominations to be a bargaining representative must be submitted
- a person could only be a bargaining representative if they represent a registered trade union with at least one member covered by the proposed agreement, or if they were able to indicate that at least 5 per cent of the employees to be covered by the agreement nominated them as a representative.

DRAFT RECOMMENDATION 15.6

The Australian Government should amend the rules around greenfields agreements in the *Fair Work Act 2009* (Cth) so that bargaining representatives for greenfields agreements are subject to the good faith bargaining requirements.

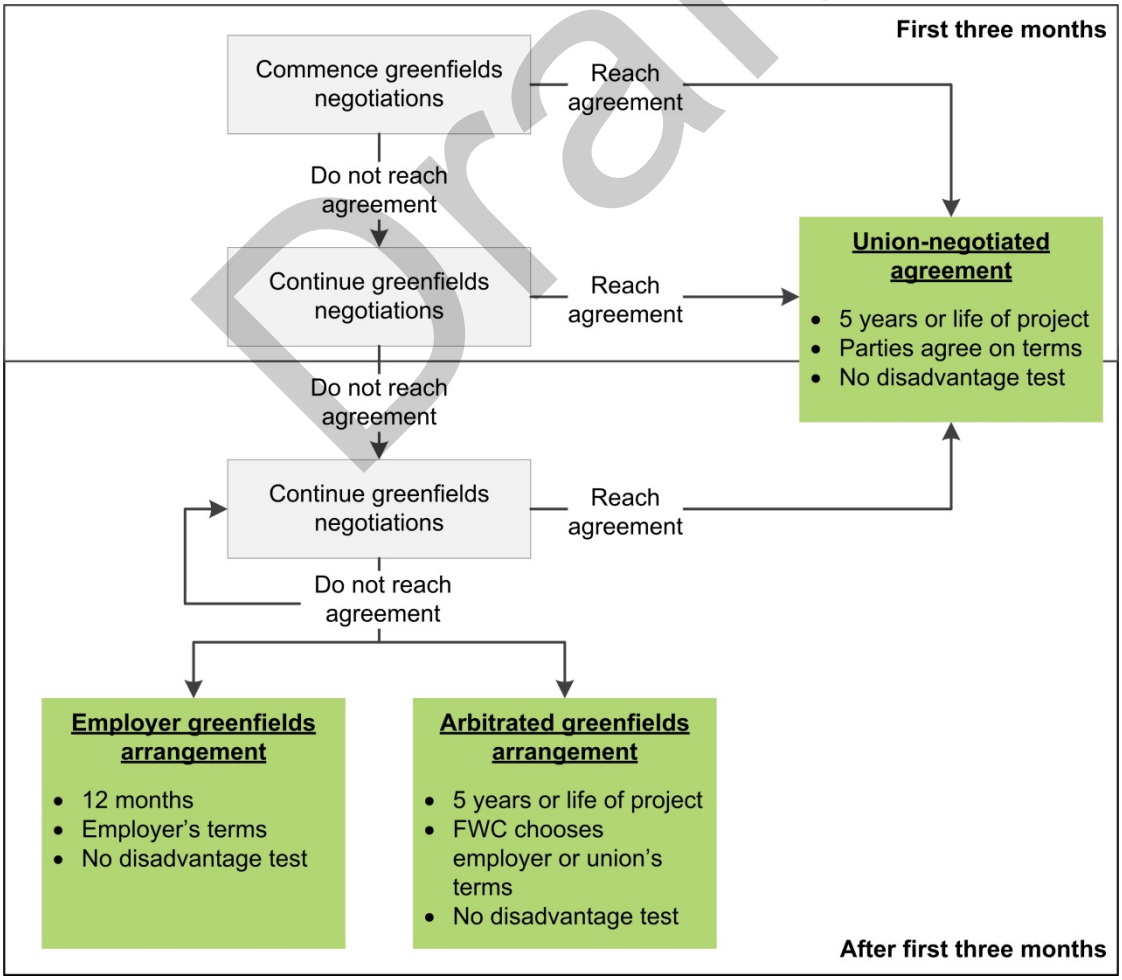
DRAFT RECOMMENDATION 15.7

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that if an employer and union have not reached a negotiated outcome for a greenfields agreement after three months, the employer may (as illustrated in figure 15.5):

- continue negotiating with the union
- request that the Fair Work Commission undertake 'last offer' arbitration of an outcome by choosing between the last offers made by the employer and the union
- submit the employer's proposed greenfields arrangement for approval with a 12 month nominal expiry date.

Regardless of the agreement-making process chosen by the employer, the ensuing greenfields arrangement must pass the proposed no-disadvantage test.

Figure 15.5 **Greenfields agreement-making process**



Chapter 16 Individual arrangements

DRAFT RECOMMENDATION 16.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that the flexibility term in a modern award or enterprise agreement can permit written notice of termination of an individual flexibility arrangement by either party to be a maximum of 1 year. The Act should specify that the default termination notice period should be 13 weeks, but in the negotiation of an agreement, employers and employees could agree to extend this up to the new maximum.

DRAFT RECOMMENDATION 16.2

The Australian Government should amend the *Fair Work Act 2009* (Cth) to introduce a new 'no-disadvantage test' (NDT) to replace the better off overall test for assessment of individual flexibility arrangements. The guidance in implementing the new NDT should also extend to collective agreements (as recommended in draft recommendation 15.4).

To encourage compliance the Fair Work Ombudsman should:

- provide more detailed guidance for employees and employers on the characteristics of an individual flexibility arrangement that satisfies the new NDT, including template arrangements
- examine the feasibility, benefits and costs of upgrading its website to provide a platform to assist employers and employees to assess whether the terms proposed in an individual flexibility arrangement satisfy a NDT.

DRAFT RECOMMENDATION 16.3

The Fair Work Ombudsman should develop an information package on individual flexibility arrangements and distribute it to employers, particularly small businesses, with the objective of increasing employer and employee awareness of individual flexibility arrangements. It should also distribute the package to the proposed Australian Small Business and Family Enterprise Ombudsman, the various state government offices of small business, major industry associations and employee representatives.

Chapter 17 The enterprise contract

INFORMATION REQUEST

The Productivity Commission seeks information on the costs (including compliance costs) and benefits of an enterprise contract to employers, employees and to regulatory agencies. Particular areas that the Commission seeks information on are:

- *additional evidence on the potential gap in contract arrangements between individual arrangements (broadly defined) and enterprise agreements*
- *the extent to which the enterprise contract would be a suitable addition to the current suite of employment arrangements, how it could fill the gap identified, and specific examples of where and how it could be utilised*
- *clauses that could be included in the template arrangement*
- *possible periods of operation and termination*
- *the advantages and disadvantages of the proposed opt in and opt out arrangements.*

In addition, the Productivity Commission invites participants' views on the possible compliance and implementation arrangements suggested in this chapter, such as their impact on employers, employees and regulatory agencies.

Chapter 19 Industrial disputes and right of entry

DRAFT RECOMMENDATION 19.1

The Australian Government should amend s. 443 of the *Fair Work Act 2009* (Cth), clarifying that the Fair Work Commission should only grant a protected action ballot order to employees once it is satisfied that enterprise bargaining has commenced, either by mutual consent or by a Majority Support Determination.

INFORMATION REQUEST

The Productivity Commission seeks further input from stakeholders on how protected action ballot procedures may be simplified to reduce compliance costs, while retaining the benefits of secret ballots. Potential simplifications include:

- *removing the requirement that a protected action ballot specify the types of actions to be voted on by employees, and instead simply requiring a vote in favour of any forms of protected industrial action*
- *amending or removing the requirement that industrial action be taken within 30 days of ballot results being declared*
- *granting the Fair Work Commission the discretion to overlook minor procedural defects when determining if protected industrial action is authorised by a ballot.*

INFORMATION REQUEST

The Productivity Commission seeks further input from stakeholders on how 'significant harm' should be defined when the Fair Work Commission is deciding whether to exercise its powers under s. 423 and s. 426 of the Fair Work Act 2009 (Cth).

DRAFT RECOMMENDATION 19.2

The Australian Government should amend s. 423(2) of the *Fair Work Act 2009* (Cth) such that the Fair Work Commission may suspend or terminate industrial action where it is causing, or threatening to cause, significant economic harm to the employer ***or*** the employees who will be covered by the agreement, rather than both parties (as is currently the case).

INFORMATION REQUEST

The Productivity Commission seeks further input from inquiry participants on whether s. 424 of the Fair Work Act 2009 (Cth) should be amended to allow industrial action to proceed where the Fair Work Commission is satisfied that the risk of a threat to life, personal safety, health or welfare is acceptably low.

DRAFT RECOMMENDATION 19.3

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that where a group of employees have withdrawn notice of industrial action, employers that have implemented a reasonable contingency plan in response to the notice of industrial action may stand down the relevant employees, without pay, for the duration of the employer's contingency response.

DRAFT RECOMMENDATION 19.4

The Australian Government should amend the *Fair Work Act 2009* (Cth) to grant the Fair Work Commission the discretion to withhold a protected action ballot order for up to 90 days, where it is satisfied that the group of employees has previously used repeated withdrawals of protected action, without the agreement of the employer, as an industrial tactic.

DRAFT RECOMMENDATION 19.5

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that where employees engage in brief work stoppages that last less than the shortest time increment used by their employer for payroll purposes, the employer should be permitted to choose to either:

- deduct the full duration of the increment from employee wages. The maximum permissible deduction under this provision would be 15 minutes per person, or
- pay employees for the brief period of industrial action, if the employer is willingly doing so to avoid the administrative costs of complying with prohibitions on strike pay.

INFORMATION REQUEST

While the Productivity Commission sees a prima facie case for allowing employers to deduct a minimum of 25 per cent of normal wages for the duration of any partial work ban that impacts on the performance of normal duties, the Commission requests feedback from stakeholders about the risks that such a change may entail.

INFORMATION REQUEST

The Productivity Commission seeks further feedback from inquiry participants on what forms of more graduated employer industrial action should be permitted, and how these should be defined in statute.

DRAFT RECOMMENDATION 19.6

The Australian Government should increase the maximum ceiling of penalties for unlawful industrial action to a level that allows federal law courts the discretion to impose penalties that can better reflect the high costs that such actions can inflict on employers and the community.

DRAFT RECOMMENDATION 19.7

The Australian Government should amend s. 505A of the *Fair Work Act 2009* (Cth) for determining when the Fair Work Commission may make an order to deal with a dispute about frequency of entry by an employee representative to:

- repeal the requirement under s. 505A(4) that the frequency of entry would require an unreasonable diversion of the occupier's critical resources
- require the Fair Work Commission to take into account:
  - the combined impact on an employer's operations of entries onto the premises
  - the likely benefit to employees of further entries onto the premises
  - the employee representative's reason(s) for the frequency of entries.

DRAFT RECOMMENDATION 19.8

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that unions that do not have members employed at the workplace and are not covered by (or are not currently negotiating) an agreement at the workplace, would only have a right of entry for discussion purposes on up to two occasions every 90 days.

Chapter 20 Alternative forms of employment

DRAFT RECOMMENDATION 20.1

Terms that restrict the engagement of independent contractors, labour hire and casual workers, or regulate the terms of their engagement, should constitute unlawful terms under the *Fair Work Act 2009* (Cth).

INFORMATION REQUEST

The Productivity Commission seeks feedback on the extent to which unpaid internships have become more commonplace across the economy, whether any growth in such arrangements has led to problems rather than opportunities, as well as the potential remedies to any specific issues.

Chapter 21 Migrant workers

DRAFT RECOMMENDATION 21.1

The Fair Work Ombudsman should be given additional resources for investigation and audits of employers suspected of underpaying migrant workers (including those in breach of the *Migration Act 1958* (Cth)).

The Migration Act should be amended so that employers can be fined by at least the value of any unpaid wages and conditions to migrants working in breach of the Migration Act, in addition to the existing penalties under the Act.

Chapter 22 Transfer of business

DRAFT RECOMMENDATION 22.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that an employee's terms and conditions of employment would not transfer to their new employment when the change was at his or her own instigation.

Chapter 24 Competition policy

INFORMATION REQUEST

The Productivity Commission seeks further input from inquiry participants on whether the secondary boycott prohibitions in the Competition and Consumer Act 2010 (Cth) should be amended to:

- *amend or remove s. 45DD(1) and s. 45DD(2)*
- *grant Fair Work Building and Construction a shared jurisdiction to investigate and enforce the secondary boycott prohibitions in the building and construction industry.*

Chapter 25 Compliance costs

INFORMATION REQUEST

The Productivity Commission seeks data or other information on the extent to which the workplace relations system imposes unnecessary ongoing costs on unions, and how these costs are likely to be affected by draft recommendations proposed in this inquiry.

1 Introduction

Key points

- This inquiry is a broad-ranging assessment of Australia's workplace relations (WR) framework, considering current laws, institutions and practices. It uses an economywide approach, looking at possible reforms that, where merited, are likely to enhance the welfare of Australians as a whole.
  - In analysing the workings of the current system, the inquiry draws on the disparate views of the many participants who have provided information. However, a premium has been placed on considering topics that are often disputed, and on providing an evidence-based viewpoint. In many cases this is based on the Productivity Commission's own research.
  - The inquiry takes into account that many features of the legal and institutional framework have developed over a long period, but asks whether these features are likely to serve Australia's future interest well, while taking into account the costs of change.
  - The inquiry recognises that a well-performing WR framework must balance the needs of businesses within the economy with the requirement to adequately compensate, protect and develop the Australian workforce.
- The inquiry has not set out to cover a number of issues that intersect with the WR system, such as the separate arrangements for workplace health and safety, nor matters being considered by the Royal Commission into trade union governance.
  - There has been a deliberate attempt to focus the analysis on matters that most directly impact on the operation of the WR system and that drive the most significant economic and social outcomes that it produces.
- An important purpose of this draft report is to elicit further feedback from interested parties. In particular, the Productivity Commission welcomes:
  - further empirical and other evidence
  - views on where the proposed reforms could be further improved, or where other reforms should be considered
  - observations on the practicality, implementation and impacts of the draft recommendations
  - feedback on errors of fact, omission or analysis.

The WR system has multiple influences on a very wide range of economic and social outcomes within the Australian economy. Along with market forces, accepted practices, cultural norms and the common law, the complex array of labour laws, regulations and institutions that make up the WR framework shape people's behaviour, the nature of their workplaces and their working lives.

At an enterprise level, the framework can influence innovation, profitability, the internal culture of the workplace, its hiring and dismissal arrangements and, more broadly its business strategies (such as business expansion or new investment). It can provoke or mitigate industrial conflicts. Since many of these factors are drivers of productivity, there is a link between the design of a system and its promotion or otherwise of growth and efficiency.[3] And of course, productivity has ripple effects on prices and thereby consumers.

For employees, the system affects wages, their hours of work, the conditions of the workplace (for instance, working time arrangements, working conditions and safety) and can stimulate or frustrate skill formation. It thereby has impacts on personal and household income distribution, as well as longer-term life prospects. It can empower (or not) employees and their representatives in workplaces. It shapes the distribution of returns to and powers of the various parties in the system.

WR is not just about existing workplaces and employees. It can create barriers to employment of people without jobs, and create barriers to entry for new businesses and competition in the labour market from the self-employed.

Its effects can vary across regions, by the size and industry of firms, and by the age, skills and preferences of people. It can affect the way in which wages and prices move in an economy, and thereby influence overall macroeconomic performance and policy.

More broadly, a WR system has social effects beyond income distribution. In part, the origins of the system reflect social and community norms, such as the desirability of fairness. But the causal link can also go the other way. A system can also reinforce and sustain social norms because it provides legislative support for them. Changes to it can further support or undermine trust and cooperation between people, and the degree to which they regard a society as fair.

The Productivity Commission's analysis has aimed to reflect the diversity of the impacts of the WR system, and to understand how different configurations have varying impacts. The draft recommendations also reflect this approach, and consider the potential impacts — positive and negative — on a range of labour force participants and across a range of workplace types and locations.

1.1 The inquiry terms of reference

The issues associated with assessing Australia's WR arrangements are deep and wide. Successive Australian governments have recognised that choices about the design of a WR

[3] As noted later, assessing the impact of WR changes on aggregate productivity (and a host of other economic performance measures) is difficult when there are a myriad of other forces also at work (such as demand shocks, technological change, management practices, skill changes and competition). This does not mean these effects are absent.

system reflect not just its pre-eminence in economic policy, but also its equity and ethical objectives.

The Australian Government requested that the Productivity Commission undertake a wide-ranging inquiry into Australia's WR framework, focussing on key social and economic indicators that are important to wellbeing, productivity and competitiveness. This draft report represents the Productivity Commission's interim assessments within the tight timetable for the inquiry. The Productivity Commission will undertake further analysis post-draft in a range of empirical areas.

The terms of reference ask the Productivity Commission to consider the impact of the WR framework on a range of matters including:

- unemployment, underemployment and job creation
- fair and equitable pay and conditions for employees, including the maintenance of a relevant safety net
- small businesses
- productivity, competitiveness and business investment
- the ability of business and the labour market to respond appropriately to changing economic conditions
- patterns of engagement in the labour market
- the ability for employers to flexibly manage and engage with their employees
- barriers to bargaining
- red tape and the compliance burden for employers
- industrial conflict and days lost due to industrial action
- the scope for independent contracting.

While the terms of reference cover an assessment of the performance of the framework's main regulatory instrument, the *Fair Work Act 2009* (Cth) (FW Act), the Government has requested that the Productivity Commission go beyond evaluating the current system to consider the type of system that might best suit the Australian community over the longer term.

The Productivity Commission has also been asked to recommend improvements to maximise outcomes for employers, employees and the economy and to identify and quantify the costs and benefits of its recommendations.

Past reviews

This inquiry takes place against a background of previous reviews into WR. The most recent holistic review was that of the Hancock Committee (1985), although other reviews

have periodically considered the legislation in place, such as in the most recent review of the FW Act (McCallum, Moore and Edwards 2012) (box 1.1) Senate Committees have examined particular parts of the system in response to proposed amendments to the principal legislation (such as the report into exemptions for small business from penalty rates).

Box 1.1 The 2012 post-implementation review of the Fair Work legislation

The review assessed the operation of the FW Act and the extent to which it was consistent with the legislation's objectives, as well as its efficacy compared with the legislation it replaced. The panel concluded that outcomes under the Act were favourable to continuing prosperity (with the exception of productivity growth, where it did not accept that Australia's poor productivity performance had resulted from the legislative framework). The Panel made 53 recommendations aimed at improving the operation of the legislation to:

- encourage flexibility and productivity by extending the role of institutions to encourage productive workplaces, providing new powers for conciliation, supporting good faith bargaining and making individual flexibility arrangements easier to access
- increase workplace equity through changes such as removing the ability for employees to opt out of enterprise agreements, and extending the right to request flexible working arrangements.

Several important recommendations of that review were not adopted by the government of the time, but on further examination by the Productivity Commission in this inquiry, some should be implemented.

Source: McCallum, Moore and Edwards (2012).

Some issues are largely outside this inquiry

The Productivity Commission has not examined in any detail a number of issues that intersect with or are part of the WR framework, including:

- governance arrangements of individual unions and concerns about specific instances of corruption and other criminally unlawful conduct by employers, employees and unions. Notably, criminal conduct is covered by the criminal law, not the FW Act
- institutional arrangements in the construction industry, which were addressed in the Productivity Commission's inquiry into Public Infrastructure (PC 2014b)
- financial assistance for legal representation for WR matters, a matter covered in the Productivity Commission's inquiry into Access to Justice (PC 2014a)
- separate Workplace Health and Safety (WHS) institutions and laws, including workers' compensation schemes. However, the more general impact of the WR system on WHS is relevant to this inquiry — and there are complementarities in issues like right of entry provisions and the new anti-bullying legislation in the FW Act

- the Superannuation Guarantee. While it may have arisen as an industrial relations tradeoff, the Guarantee is now recognised as one of a set of interlocking retirement income policy measures, and consideration of it in any detail would therefore cover many issues not central to this inquiry
- Australia's vocational training system, with the important exception of agreements that may specify training requirements in a way likely to be inefficient or inconsistent with wider economic and social needs
- the Fair Entitlements Guarantee, a statutory scheme that provides assistance to employees for unpaid entitlements following the insolvency of their employer. The Productivity Commission has examined this scheme in its inquiry into Business Set-up, Transfer and Closure (PC 2015).

The Productivity Commission notes that the Australian Government has proposed several changes to the FW Act via a number of Parliamentary Bills.[4] The inquiry's primary focus will be on the preferred structure for WR in Australia and only directly assesses proposed amendments to relevant legislation, where that is necessary to conform to its proposed policy framework.

1.2 Australia's workplace relation system

The stated objectives of Australia's workplace relations system

The FW Act is the primary legislative device governing the WR system in Australia, although the pre-eminence of a Commonwealth statute is relatively recent. Historically and constitutionally, the Commonwealth and the states have shared responsibility for WR. The FW Act cites objectives that are diverse and — as is often the case with such diversity — potentially in conflict. The FW Act is intended to deliver outcomes that are **fair, flexible, co-operative, productive, relevant, enforceable, non-discriminatory, accessible, simple and clear** (s. 3). It also provides for special arrangements for small businesses; preference for collective bargaining; balance between family and workplace responsibilities; minimum wage and employment standards; and the right of freedom of association.

State-based laws still survive, albeit with reduced reach, and their objectives largely mirror those of the FW Act, though sometimes with greater elaboration. For example, the Queensland *Industrial Relations Act 1999* specifies 14 separate objectives, such as 'meeting the needs of emerging labour markets and work patterns', and 'promoting and

[4] *Fair Work Amendment Bill 2014*; *Fair Work Amendment (Bargaining Processes) Bill 2014*; *Fair Work (Registered Organisations) Amendment Bill 2014*; *Building and Construction Industry (Improving Productivity) Bill 2013*; *Building and Construction Industry (Consequential and Transitional Provisions) Bill 2013*.

facilitating jobs growth, skills acquisition and vocational training through apprenticeships, traineeships and labour market programs' (s. 3).

One issue for this inquiry is whether any system can hope to achieve coherence across this diversity of objectives. By its nature, legislation often claims multiple objectives. But establishing what a system is meant to achieve is important for this inquiry, and the relevant legislation is an obvious starting point.

The architecture of the current system

WR policy, institutions and regulation are now highly elaborate and broad ranging (figure 1.1). They have grown from a limited Commonwealth role in dispute settlement one hundred years ago to a position today where the Commonwealth regulates the bulk of industrial awards, sets minimum wages, and has created three specialist bodies that collectively mediate disputes, provide information, register agreements, check compliance with the law and adjudicate on some key matters of WR law.

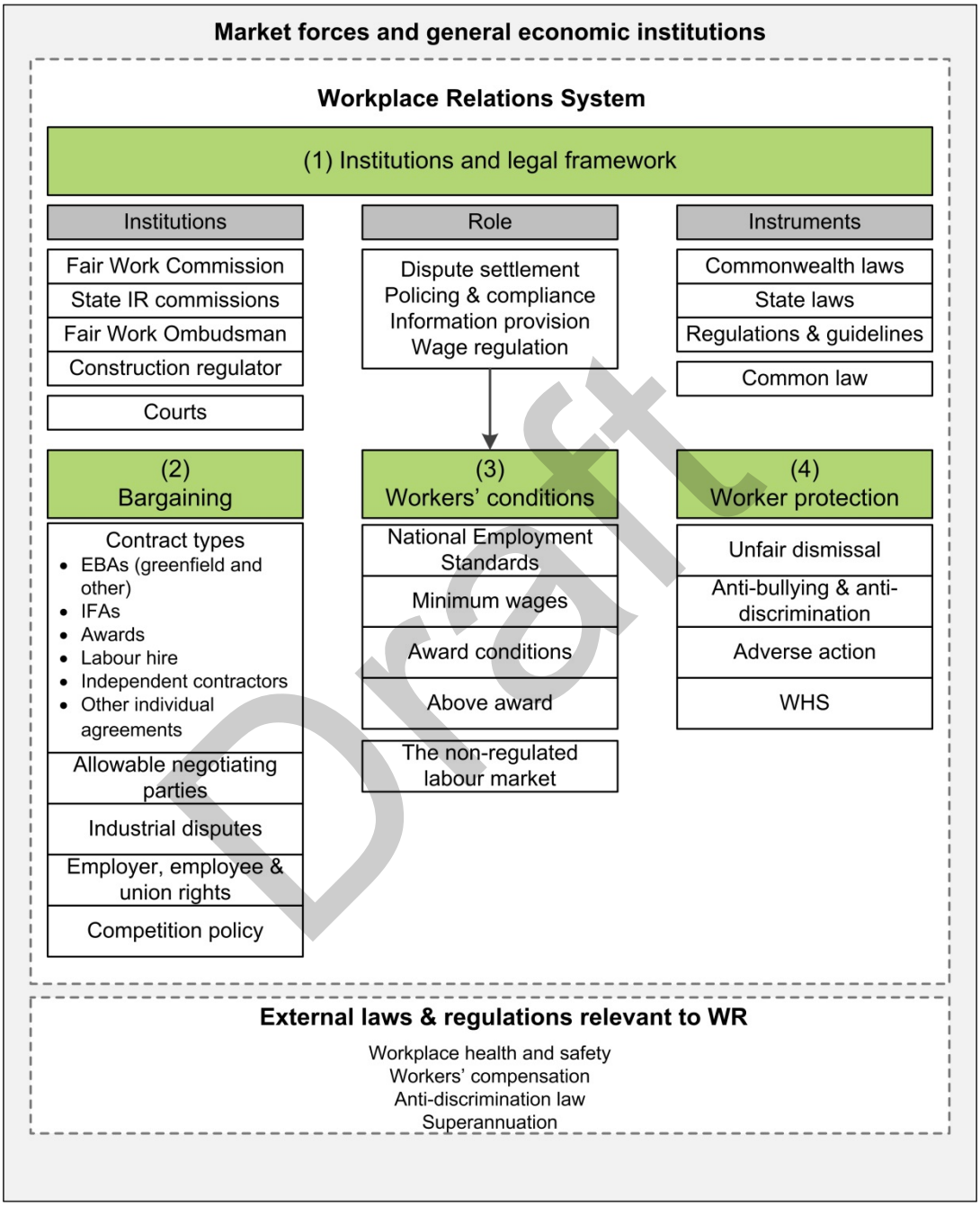
The Fair Work Commission (FWC), the Fair Work Ombudsman (FWO) and Fair Work Building and Construction are the key national regulators. The Fair Work Federal Division of the Federal Court and the Federal Circuit Court are the principal parts of the judicial system that deal with WR matters, though some cases have, on appeal, progressed to the High Court of Australia (in some instances, with wide ramifications for the system).

In this inquiry, the primary interest in institutional arrangements centres on the FWC and the FWO (chapter 3).

Various other institutions — state and territory work safety regulators, anti-discrimination bodies and the Australian Competition and Consumer Commission — also have specialist roles in parts of the WR system, for example in relation to regulation of secondary boycotts.

It is easy to overlook that this architecture does not dominate the economic landscape, but forms one component of it. The WR system sets floors not ceilings. Many aspects of the economy that are the target of WR policy are predominantly shaped by market forces. In buoyant economic times, wage dispersion increases across industries (which is not an adverse outcome). Increased over award wages and conditions are important signals for employees to move to areas of high demand. Similarly, when demand eases, there will be downward pressure over time on over award payments.

Figure 1.1 **The main elements of the current workplace relations arrangements**



Which employers and employees are covered by the national system?

Under the current system, coverage is provided by the various protections and processes of the FW Act to a range of employers and their employees (box 1.2, figure 1.2 and appendix D). The Productivity Commission estimates that just over 70 per cent of

employed Australians are covered by the FW Act, and around 85 per cent of all employees. Even people outside the system — such as independent contractors — may be directly influenced by the system because enterprise agreements sometimes have attempted to control their role (chapter 20).[5]

Box 1.2 Coverage of the Fair Work Act 2009 (Cth)

The overwhelming majority of private sector employees are covered by the FW Act.

- The bulk of such employees work for so-called 'constitutional' corporations (incorporated entities). This wide coverage reflects the change in the basis for the Commonwealth's powers to regulate industrial relations from its industrial relations powers under s. 51 of the Constitution to its corporations power.
- Most private employees of non-constitutional enterprises are also covered by the FW Act because all states, bar Western Australia, referred their powers to regulate these employees.

The 2012 review of the WR system undertaken for the Australian Government estimated that the FW Act extends to approximately 96 per cent of private sector employees (McCallum, Moore and Edwards 2012), which is close to the Productivity Commission's current estimates.

Coverage of public sector employees is less wide. Public sector employees are covered by the FW Act if they work in:

- the Commonwealth Government
- the local government sector in Tasmania
- the public sector in Victoria, the Australian Capital Territory or the Northern Territory (except a law enforcement officer or an executive in the public sector in Victoria, or a member of the Police Force in the Northern Territory)
- public sector trading corporations (which are classified as constitutional corporations).

Employees of not-for-profit financial or trading corporations (which are also classified as constitutional corporations) are also covered by the FW Act.

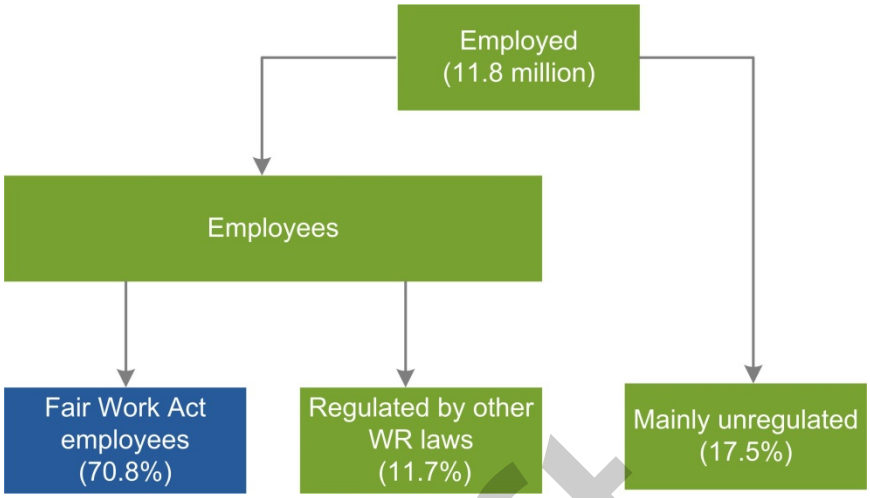
All other employees, primarily state public sector employees in New South Wales, Queensland, South Australia, and Western Australia are regulated by state-specific legislation.

Some aspects of the FW Act also refer to matters specified in state legislation, such as state public holidays and long service leave (an area of some complexity — chapter 4).

Sources: Adapted from Forsyth et al. (2010, pp. 15–16), Department of Commerce (WA) (2015), and information from the Fair Work Ombudsman.

[5] It is hard to provide exact estimates because different survey datasets use different definitions of employment, some data are dated and counts of employees of unincorporated enterprises in Western Australia are imprecise.

Figure 1.2 **Principal coverage in this inquiry, 2015**



Source: Appendix D.

All employees are covered by the common law

Every employee in Australia has a common law employment contract, whether formal, informal, written or oral. For 40 per cent of employees (most of whom appear to be higher-earning professionals in a select number of industries) it is this arrangement, rather than an award or collective agreement, that sets their pay. The reach of a common law employment contract depends on the nature and coverage of the relevant statute (in this case the FW Act). Statutory law has precedence over the common law when they conflict. An implication of the common law's residual role is that if statutory employment law widens or narrows its reach, the common law either retreats or advances in significance (Stewart and Riley 2007). In turn, this means that in examining changes to the FW Act, the counterfactual is implicit regulation through the common law (which can involve quite distinct costs and risks for all parties).

1.3 The past and the future cannot be ignored

The circumstances under which Australia's WR laws and practices developed are unique to this country, but have adapted considerably over time. As this inquiry has discovered, the past has left indelible impressions on the current system that influences how it operates today. These need to be understood before policy changes are advocated.

Two significant events shaped the early development of the system in Australia:

- the debilitating strikes of the 1890s, which resulted in the creation of industrial arbitration tribunals at the state and Commonwealth levels and the introduction of a limited dispute settlement power into the Constitution at federation

- the Harvester Judgment of 1907 in the Commonwealth Conciliation and Arbitration Court, which defined the minimum conditions under which a man would be able to support his family in 'reasonable and frugal comfort'. The criteria for determining the minimum wage and its scope have since changed considerably. This was exemplified by the Commonwealth Conciliation and Arbitration Commission's 'equal pay for work of equal value' decision in 1972, which among other things, removed the separate minimum wage for women. The decision was the first of many to come that set base-level standards for the wages and conditions.

Gradually, the system of federal awards grew, mostly due to efforts by some unions to broaden their national application through the active use of the Commonwealth's dispute settlement powers. These awards and the processes that determined them distinguish Australia from most other developed countries.

While their names and roles have changed, various specialist Commonwealth agencies have played an increasing role in regulating WR across all jurisdictions relative to their state organisational counterparts, in part due to the growing use by the Commonwealth of its constitutional powers and state governments' willingness to refer their powers (Lucev 2008; McCallum 2005). The pessimism expressed by the Constitution Commission in 1988 about the capacity of the Australian Constitution to provide for a more national system was largely misplaced. As noted above, the main remaining exceptions to a national system are employees of unincorporated enterprises in Western Australia and many employees paid by state governments — which provide an example of the lingering presence of past arrangements in the current system.

Although changes in the system have mostly been gradual over the past few decades, these have cumulatively changed the system in quite fundamental ways.

- The shift from centrally determined wages and conditions to enterprise-level bargaining has been the biggest break from the past. After almost one hundred years of centralised conciliation and arbitration, enterprise-level bargaining was introduced as the centrepiece of the *Industrial Relations Reform Act 1993* (Cth). While awards still provide a floor for employment conditions, there is no longer a third party industrial tribunal that settles industrial disputes by making awards (Hamilton 2012, p. 2).
- Legislated minimum standards have taken greater precedence over arbitrated outcomes.
- There has been greater emphasis on productivity and flexibility at the enterprise level as *goals* of the WR system. (An aspect of this inquiry will be to assess whether these goals have been achieved and whether regulatory requirements for enterprise bargaining to extract commitments to these would be sensible.)
- Awards have been simplified — from many thousands of state and federal awards to 122 'modern' awards in 2010 (McCallum, Moore and Edwards 2012). Greater flexibility has been introduced into such awards.
- The scope of the federal minimum wage has widened to encompass employees of all businesses except those employed by unincorporated enterprises in Western Australia.

The FW Act specifies legislative criteria for setting the minimum through the 'minimum wage objective' (s. 284).

- Governments have introduced protections for individual workers (rather than collectives of workers) that exceeded the protections in particular awards, specific state and territory laws, and remedies at common law. The most important development was the inclusion of unfair dismissal arrangements into the federal WR system (Figgis 1998, pp. 1–2; Forsyth 2008, p. 509; Wheelwright 2001, pp. 173–176). In 2014, federal employment protection was extended so that workers subjected to alleged workplace bullying in constitutionally-covered businesses could take the matter to the FWC, which could make an order to stop any proven bullying.
- Some key matters relating to working conditions (such as workforce health and safety) have been shifted to dedicated laws and institutions outside the WR system (although, in the case of anti-bullying, the shift has sometimes also been the other way).
- The system has accorded less weight generally to the powers of unions as negotiating parties for wages and conditions, and as monitors of workforce health and safety. This has been accompanied by a general decline in union membership (chapter 2).
- The creation of the Australian Building and Construction Commission (and its successor, Fair Work Building and Construction) — the first industry-specific WR agency — has also reflected a major departure from historical practices.

At the end of this period of considerable change, there nevertheless remains some continuity. Safety net arrangements remain a fundamental part of the system (through awards covering a wide range of industries; National Employment Standards that must be reflected in all agreements; and a regularly re-set minimum wage). There are still elaborate laws and administrative processes governing employment relations in all but a few pockets of the economy, and multiple specialist agencies still oversee the system. Even as the system has moved towards much greater use of enterprise bargaining, the requirements for review and registration of each agreement and the circumstances under which negotiations may proceed have remained within the (adapted) legal structure.

In some important respects, Australia's WR system is not internationally unique. Most countries have safety nets of some form, use multiple specialist agencies for (quasi and actual) judicial and mediation purposes, and prescribe laws about the processes for negotiation between parties. No system is simple. Arguably, many other federations have more fragmented WR systems. However, notwithstanding a shift towards enterprise bargaining (and, to a lesser extent, individual arrangements), Australia appears to give more weight than other Anglo-Saxon countries to elaborate rules about WR processes and, most particularly, to the centralised determination of minimum wages and conditions for many employees. This then requires a complex legal and institutional architecture that is distinctive to Australia.

The future

While there is an impression amongst some that labour markets have experienced major changes in the past few decades, that perception is largely misplaced. Indeed, in that period, labour markets have changed little. Labour mobility and tenure, casualisation, underemployment and unemployment have fluctuated slightly, but not by much (though there appears to be gathering risks in respect of the latter). There has been an expansion in the service sector and a temporary resources boom, but without significant labour market disruption.

However, recent experience may be a poor guide to future labour market developments — such as automation, further changes in social expectations of flexible working arrangements for people, greater online competition in services, the further reduction in union representation, and changes to the tax and transfer system (the latter of importance to the role of the safety net role of the regulated wage system). The impacts of such changes are unknown and there are risks in trying to anticipate future possible outcomes by changing legislation now.

The swinging pendulum

Views about the need for major reform against an uncertain future and perceptions of current problems vary. Some advocate significant shifts in the WR landscape. Other key commentators have been sceptical about the need for further major changes, placing an emphasis on the value of stability (Borland 2012; Giudice 2014).

The current WR system reflected the rebalancing of the interests of employers and employees brought about with the implementation of the FW Act, and following the concerns with the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth). There was bipartisan support for some re-balancing.

The re-adjustment following the enactment of the FW Act does not necessarily mean there is no scope to improve outcomes from the WR system. But there is some sense in caution. Change is not costless, and drastic shifts would need to be warranted.

At the same time, a WR system should not *frustrate* desirable shifts in the economy and society, though inevitably legislation will have to adapt as new unforseen problems emerge (as in 'zero- hours' contracts in the United Kingdom — chapter 16). Legislation and decision-making should avoid a circumstance where the past acts as a prison for new ideas. The Productivity Commission has given these concerns some weight, particularly in its draft recommendations for institutional reforms and a new type of employment contracts.

1.4 The Productivity Commission's conceptual framework

Policy choices about the design of a WR system can affect economic performance and equity outcomes.

The stated objectives of the WR system are largely reasonable (if broad), and these operate through a variety of policy levers (figure 1.3). The key goal of the Productivity Commission is to ensure that those levers, and the drivers of outcomes are designed to achieve the best outcomes. Doing this requires a conceptual framework for understanding the WR system.

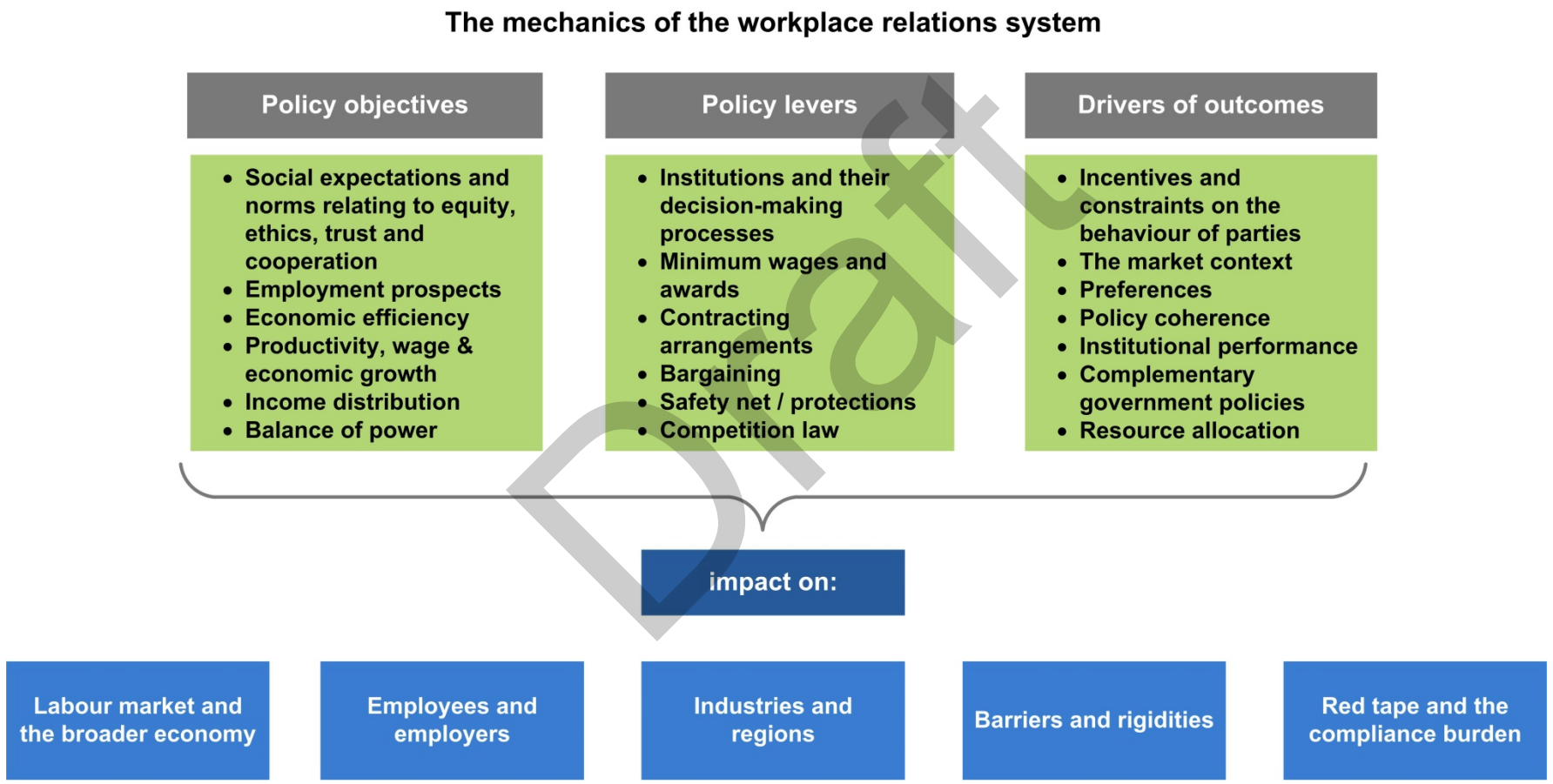
An immediate observation about policy in WR is that, unlike fiscal policy, government does not control the most responsive levers directly, and by their nature, legislative changes are often slow to make. Above all, the key decision-makers are the institutions created by the Australian Government, particularly the FWC. It interprets statute in its tribunal function, but above all is given broad discretion in wage determination. The performance and governance of institutions is therefore a critical design aspect of the system (chapter 3).

Ethical and social dimensions

As the Productivity Commission has previously noted, labour is a distinctive 'input' to production (PC 2005b). Labour market outcomes do not just affect economic performance — they also have a substantial impact on equality of opportunity, the stability of family relationships and social cohesion more generally. The ethical and social dimensions of the labour market form the basis for many aspects of the WR system that differentiate it from the regulation of other markets.

For example, the 'price' of labour differs from the price of most other inputs in an economy. A broad principle underpinning Australia's competition policy framework is that lower prices from competition are almost always desirable. In labour markets it is less clear that a lower price is necessarily desirable, given that many people's incomes and wellbeing depend to a considerable extent on the price of labour and it can be costly to use alternative mechanisms to redistribute income. Indeed, the existence of a minimum wage — a 'floor price' set by regulation, which would usually be seen as contrary to the public interest for other goods and services — illustrates this distinction.

Figure 1.3 **Objectives, policy levers and drivers of outcomes in the workplace relations system**



Economic considerations

As discussed above, any framework for analysing Australia's WR system is underpinned by views about how labour markets operate, and the consequences these have for people's wellbeing and in understanding the outcomes of different policies.

How do labour markets work?

Labour economists generally recognise that labour markets work somewhat differently from the pure competition model. Of course, no market aligns completely with the basic and tractable model described in introductory economic textbooks, and some of the common divergences from the competitive model arise in labour markets too. However, labour markets additionally have some particularly distinctive features.

These features provide a potential economic rationale for different aspects of labour market regulation (although, as is always the case for regulation to be warranted, it must still be 'fit for purpose', minimise adverse side-effects and be able to pass a broad benefit-cost test.)

Anti-competitive structures and behaviour

Labour markets are sometimes distorted in 'orthodox' ways, through particular market and/or regulatory structures or anticompetitive business behaviour.

In standard models of labour market monopsony, for example, businesses that are the sole employer of a certain type of labour, or labour in a particular area, are able to use their sole demander status to supress wages (by restricting employment). Monopsonies are generally associated with 'one company towns' where employees have little recourse to seek jobs nearby — a coal mine in 19th century Wales is a well-known example. (However, with improvements in transport and communications, such traditional monopsonies are hard to identify in developed economies in the 21st century.)

Behaviour to similar effect can still occur, however, where employers in certain specialised industries may 'cooperate' to prevent wage bidding wars for talented employees. For example, there was agreement by major Silicon Valley firms not to solicit employees from competitors, and bilateral agreements between competitors to prevent wage bidding. This resulted in substantial damages (that appear likely to rise above the initial US $325 million settlement value) (Caves 2014, 2015). However, as in traditional monopsony, such cases are rare.

Another established deviation from the competitive model occurs when professions, typically abetted by government regulations, increase barriers to entry to increase their returns. The Harper review identified concerns about various parts of the medical and legal professions and the building trades in these respects (Harper et al. 2015, p. 140).

Some of the above examples (wage bidding agreements and professional 'cartels') are the focus of orthodox competition policy rather than industrial relations regulation, although they can still be relevant to understanding how some labour markets can operate.

Bargaining imbalances in workplaces

There is a distinctive range of real world factors that can provide greater bargaining power to employers relative to employees.

First, there can be large costs and risks associated with attaining or switching jobs, strengthening the bargaining position of employers. Job searching is costly, as are recruitment processes. If an individual is unable or unwilling to endure extended periods of unemployment, then they may accept work conditions they nonetheless perceive to be unfair or less than they might otherwise be able to obtain. For workers whose skills or knowledge are not easily transferable between jobs, the financial costs and time taken to switch between employers or job sectors may be particularly high.

Second, information asymmetries can limit an employee's ability to bargain effectively. For example, it may be difficult for a jobseeker to know the extent of competition for a job or the standard levels of remuneration and conditions for a comparable employment opportunity. Employees do not have complete information about the non-wage conditions of a new employer — such as the nature of the other staff, the atmosphere and flexibility of the workplace, and whether public transport to the new location is reliable. These gaps in information increase the uncertainty of rejecting an offer during negotiations. This is starkly different in goods markets, where online searches and exact pricing comparisons are available. Even if employees can overcome these information asymmetries (for example, by acquiring professional representation), this is likely to come at a significant cost.

Third, employers can strongly influence the job prospects of a person who leaves their employment (because they hold power over references).

Typically, the greater the size of the employer and its resources, the more these inequalities in bargaining power are exacerbated. This can partly be explained by differences in the relative risks faced by the parties. For example, if a large firm makes an employee an offer on a 'take-it-or-leave-it' basis, the firm faces the risk of a relatively small temporary reduction in its labour output, while the employee faces a potentially extended period of unemployment. Further, larger firms are more likely to be 'repeat players' in labour markets, with greater negotiating experience and access to relevant information than workers.

In order to overcome these inequalities in bargaining power, the WR system sets regulatory floors to certain conditions — as in minimum wages and annual leave (in the same way that the workforce health and safety system sets workplace safety standards).

The WR system also allows employees to organise and act collectively through enterprise bargaining (chapter 15) and industrial action (chapter 19). The endorsement of collective

action is in stark contrast to competition policy (chapter 24), which generally regards collective behaviour as anticompetitive, and requires parties to act independently of their competitors when making decisions about the terms and conditions of doing business.

Nevertheless, up to some point, collective action can act as an efficient countervailing power to the bargaining power of employers. Accordingly, unions and employees acting collectively can mitigate wage suppression, improve other protections for employees (such as safety), enhance the efficiency of bargaining, and provide a channel through which employees and employers can agree cooperatively on technological change (the latter a more European approach).

A well-functioning WR framework places limits on the countervailing power of employees. It also recognises that unions predominantly represent their members, not necessarily all employees or other potential employees and so, if possessing greater power than employers, may achieve conditions that lock out alternative (including non-union) labour, with the adverse equity and efficiency effects that this may entail.

Achieving the balance in bargaining power between employees and employers is one of the most critical objectives of a WR system — and a key area of examination by the Productivity Commission throughout this inquiry.

Human complexities

In the real world, employers and employees are people with all their various flaws and virtues, and these can collide in workplaces in ways that have ramifications for how labour markets function:

- People make mistakes (for example, employers and employees may form an employment contract without any real due diligence).
- Employers and employees have values that are important to the way they do their work. An employee may want to work many additional hours at no cost because of professional pride. Employers may want to pay bonuses, provide better staff facilities or assist an employee facing family problems (say domestic abuse) because they are dealing with human beings who they wish to help and please. Employers and employees dealing with each other are not merely doing so as part of a calculated business strategy, and in some cases this opens the door for one party to exploit the other's goodwill and non-monetary motivations. (One less altruistic formulation of this is that employers may sometimes set higher prices for labour to motivate trust and to increase the cost of shirking — one example of so-called 'efficiency wages'.)
- There are few 'representative' employers and employees. People have heterogeneous tastes for workplace conditions and heterogeneous abilities, even when paid the same wage rate.
- Some businesses are poorly managed, and most are not at the technological and managerial frontier. An inadequately managed firm may provide poor training, treat

people poorly, leave them bored or over-busy with poor task scheduling, pay them too little for what they do, or provide no praise for good work — and yet people do not leave the first time they are ill-treated. On the other hand, there are model employers, with a spectrum of employers between the two extremes. The poorest performing employers may fail ultimately, but failure usually takes time, and damage in the interim may not be limited to just the employer. There is a persistent poorly performing tail in the distribution of firm performance in all countries and all industries (Bloom and Van Reenen 2010; Bloom, Sadun and Van Reenen 2012).

Some of the above complexities suggest a need for regulation, others not. For example, regulation of blatantly unfair dismissal is justified, not only because the act itself is problematic but also because the potential to do it allows leverage by an employer to exploit vulnerable employees. Bullying would fall under the same category (whether by an employee or employer). Voluntary consent to work longer hours than the average is not an obvious problem, unless it is actually not 'voluntary', but obtained through coercion.

Some labour economists see labour markets as 'workably' competitive. This view implies that the competitive model can generate reasonable predictions of outcomes from various policy and other shocks over the medium term. While the Productivity Commission agrees that workable competition may well apply in some labour markets, it also considers that, on average, employers have stronger bargaining power than employees, with consequences for wages and conditions, unless countered by regulations or (constrained) employee collective bargaining. There is reasonable empirical evidence of such employer bargaining power across different industries and countries, though comparatively little research in Australia (Ashenfelter, Farber and Ransom 2010; Booth and Katic 2011).

Any regulation based on this evidence has to recognise that the degree of such power is hard to establish, and that, unlike the past, minimum wages and awards are intended primarily to serve as a safety net, not to regulate wages and conditions for the majority of employees.

1.5 Considerations for assessing policy proposals

The Productivity Commission's approach to this inquiry has been to recommend policies that maximise the wellbeing of the community as a whole, as it is required to do under its Act. The draft recommendations of this inquiry are not intended to maximise the benefits to any particular groups, whether they be businesses, unions, employees, consumers or other stakeholders, as their individual interests may not coincide with those of Australians as a whole. Of course, the interests of these different parties have formed part of a broader assessment.

This inquiry's approach has recognised the social as well as the economic aspects of wellbeing; and in the case of an inquiry into WR, the concepts of fairness and equitable treatment, the balance of negotiating strength and the ability of parties to remain

well-informed and able to manage their own interests effectively have clearly been relevant, albeit sometimes difficult to balance.

In examining submissions and other material, a key consideration in the inquiry has been how any proposed changes:

- improve the overall use and allocation of resources in workplaces and around the economy (encompassing managerial as well as employee efficiency)
- enhance employment opportunities, matching of people to jobs and informed employment choices
- accommodate differences in the needs and circumstances and of different types of businesses and different regions
- promote efficient pricing and efficient investment in innovation, skill and capital
- promote institutions that are efficient and effective and avoid undue administrative or compliance costs
- ensure that any regulatory requirements are necessary and simple to understand and use
- curtail the abuse of power that could add significantly to social and economic costs
- achieve outcomes that are consistent with community norms, for example in relation to equitable outcomes and ethical behaviour
- are consistent with complementary regulations and policies
- are adaptable, particularly, but not solely, in the light of future demographic and global economic trends.

Issues in assessing the economic impacts

In undertaking the assessment of impacts, the Productivity Commission has been mindful of the complexity of the linkages between WR and the economy as a whole, and the difficulties in isolating its effects from other factors driving economic performance:

- the impacts may be indirect, such as through training, innovation, the adoption of new information technologies and investment, and thereby hard to separate from them
- the desired impacts may require other complementary organisational changes or policy shifts
- even if gains from any change 'only' show up as a modest one-off permanent upward shift in incomes, a possibility raised by Peetz (2012), these can be important to people's lifetime incomes, but hard to discern empirically amongst the noise in the economy
- there may be opposing benefits and costs from reform, which make it hard to identify the effects separately. Related to this, there is no single measure by which to gauge whether a WR system has been successful (is it lower unemployment, anchoring low inflationary expectations, higher real net national disposable income, productivity,

greater job security, job satisfaction, lower dispute rates, higher wages, more equitable outcomes, among many other possible measures?)

- there are limited observations in macroeconomic data, which may not be ideally suited to isolating the effects of reform, and this appears to be reflected in the lack of consensus in this area (Borland 2012; Deakin, Malmberg and Sarkar 2014). Contrary to this more aggregate analysis, more disaggregated studies based on firm-level data appear to be more promising in discovering effects that may still have aggregate impacts (Farmakis-Gamboni and Prentice 2011; Loundes, Tseng and Wooden 2003; Tseng and Wooden 2001). Many macroeconomists cite past labour relations reforms as a contributor to Australia's improved macroeconomic performance since the mid-1990s (chapter 2)
- some WR policy reforms may impose short-run costs on some groups (which may be immediately measurable), but lead to longer-run gains (which are not). For example, some enterprises make above usual profits if they are innovative, efficient, take risks and adopt astute business strategies. It may seem in the interests of employees to extract some of these above average profits, but if in fact these are the carrots for entrepreneurial endeavour, facilitating their extraction through regulation may reduce productivity and future wage growth. This is another reason for examining how a system balances the powers of competing parties, and the extent to which any given design crowds out cooperative arrangements between employees and employers.

While there are measurement challenges in discerning aggregate impacts, the Productivity Commission has, as far as possible, attempted to assess the materiality of the impacts of its draft recommendations.

Data and analytical methods

As specified in the terms of reference, this inquiry has drawn on a wide spectrum of evidence, including, amongst others:

- past overarching reviews of the system (most recently, the 2012 post–implementation review of the FW Act (McCallum, Moore and Edwards 2012)), analysis undertaken or commissioned by the FWC (including as part of its minimum wage and award reviews), and submissions to various recent Senate inquiries into changes to the WR system
- extensive ABS data,[6] including confidentialised unit record data from the Survey of Employer Earnings and Hours (2014) and the Survey of Income and Housing (2011-12)

[6] For example, surveys such as the Population Census, Australian Industry, Forms of Employment, Working Time Arrangements, the Time Use Survey, the Survey of Employee Earnings and Hours, and various data from the Labour Force Survey.

- other non-ABS confidentialised unit record survey data, including the Survey of Household, Income and Labour Dynamics in Australia (HILDA), the Australian Workplace Relations Study (AWRS) and the Australian Work and Life Index (AWALI)
- information provided by certain businesses, such as the Shopping Centre Council of Australia and a major credit card provider
- data from the Chamber of Commerce and Industry Queensland
- data from the Department of Immigration and Border Protection on migrant workers
- data from NCVER on apprentices and trainees
- data held by the Australian Department of Employment, such as its Workplace Agreements Database
- data from the FWO and the FWC that shed light on specific aspects of the WR system (such as trends in unfair dismissal cases and their outcomes)
- key legal cases
- submissions to this inquiry. The Productivity Commission also provided scope for stakeholders to make brief comments about WR matters on its website.
- data on opening hours of restaurants and cafes in major cities in Australia and New Zealand
- data on the contents of enterprise agreements in New Zealand
- various international sources of evidence about WR systems, such as the United Kingdom Workplace Employment Relations Study (Van Wanrooy et al. 2013); the ILO NATLEX database, and data from the OECD (2014c), the World Bank (2013a) and the World Economic Forum (2014). These have several inconsistencies and other limitations (Aleksynska and Cazes 2014; Hall and Casey 2006), but have still been useful in this inquiry.

Various modelling and analytical methods have supported the findings of the inquiry, including econometric and micro-simulation analysis. Further work in these areas is proposed. The Productivity Commission may also assess the scope for general equilibrium modelling of some policy changes, since such modelling can show how reforms percolate throughout industries and regions.

1.6 Conduct of the inquiry

The terms of reference for this inquiry were received from the Treasurer on 19 December 2014.

To assist interested parties to prepare submissions to the inquiry, the Productivity Commission released five extensive issues papers to reflect its initial view about the

priority questions in the inquiry, informed by initial consultations. The Productivity Commission met with a wide range of inquiry participants and held roundtables with employer and employee representatives.

The Productivity Commission received 255 submissions from diverse groups involved in the WR system (employee, employer and industry groups, WR practitioners and advisers, WR academics, large and small businesses, community sector representatives and many individuals). Governments and the key institutions (the FWC and the FWO) also contributed.

Many hundreds of personal views were provided through an online survey undertaken by the ACTU. The Productivity Commission also sought comments from Australians generally — and received useful feedback from predominantly small businesses, employees, union representatives and community organisations. These added depth and personal insights to the inquiry.

Appendix A provides details of the individuals and organisations that formally participated in the inquiry.

The Productivity Commission thanks all inquiry participants for meeting with Commissioners and staff, participating in the roundtables, and making submissions to the inquiry.

1.7 Guide to the draft report

The current chapter presents relevant background information and definitions, the broad framework applied in this inquiry, and the basis for government involvement in WR. The major aspects of the Australian labour market are then outlined in chapter 2.

The remaining chapters are organised principally around several central policy themes:

The performance and structure of the two key institutions of the WR system (the FWC and the FWO) are integral to its effective functioning (chapter 3).

A central component of any WR system is the basic levels of protection it provides for employees, such as its fundamental standards (the National Employment Standards — chapter 4), the avoidance of unfair dismissals of employees (chapter 5), a set of wider protections against adverse action by employers, for example, because of being or not being a union official (chapter 6) and measures that aim to discourage and remedy workplace bullying (chapter 7).

As in many other counties, Australia places regulated floors on the wages and conditions of employees. The adult minimum wage is the pre-eminent policy tool (chapter 8), but wage floors are also set for younger people, and some have suggested variants on the minimum wage, such as by region or state (chapter 9). There are potential

complementarities between the minimum wage and other tax/transfer policies, such as earned income tax credits (chapter 10).

A (nearly) unique feature of Australia's WR framework is that there are also hundreds of additional minimum wages for people with given sets of skills or in particular industries — 'awards' (chapter 11), which pose some significant policy challenges (chapter 12). Two particular features of awards are sometimes highlighted — penalty rates and loadings for different working time arrangements. Penalty rates for long hours, night and evening work involve health and welfare issues (chapter 13). These issues are quite distinct from the more controversial issues surrounding weekend penalty rates for the hospitality, entertainment, retail, restaurants and cafes industries (chapter 14).

While a significant part of Australia's WR system involves regulated protections and minimum standards, another critical part concerns the rules about how parties can arrange employment contracts on their own terms. There are diverse ways in which these contracts may be formed. Some are at the enterprise level, usually involving bargaining between an employer and employee representatives (chapter 15). Particularly among smaller businesses, employment contracts often involve an individual reaching an arrangement with an employer (chapter 16). The Productivity Commission has floated the idea of a new type of arrangement — the enterprise contract — which lies between these two arrangements (chapter 17). Bargaining in the public sector involves some special issues (chapter 18). Industrial disputes are a feature of the bargaining process. The Australian system provides a window between the expiry of an old enterprise agreement and the formation of a new one. In this period, employers and employees (collectively) can lawfully engage in industrial disputes to encourage settlement and to gain leverage. This is not a free-for-all contest between parties — there are strict rules about the nature and form of engagement (chapter 19).

Discussions about the WR system often tend to ignore particular subgroups of the employed. For example, contractors — who are not employees — play an important role as a source of labour, but there can be complex interactions between them and the WR system (chapter 20). Similarly, certain kinds of migrant workers are subject to the risk of exploitation (chapter 21).

Labour markets are always in motion, and inevitably (and mostly desirably), people have to sometimes move between jobs. One aspect of that dynamic process, largely confined to large businesses, is the arrangements that come into play when a business changes hands ('transfer of business' — chapter 22).

Australia is a signatory to various international conventions, the implications of which are addressed in chapter 23.

Much of a WR system concerns the desirability of ensuring that there is some balance of power between the contracting parties. In some cases, the arrangements that deal with the potential for excessive market power in labour relations is not part of the FW Act, but rather embedded in competition policy more generally (chapter 24).

The FW Act is an understandably complex piece of legislation (around 900 pages in length) and is accompanied by other important regulations (most particularly the stipulations in the 122 Awards). Inevitably, this complexity is accompanied by some compliance costs — and these do not only relate to employers (chapter 25).

This inquiry has canvassed many possible policy options, which will have a variety of impacts (chapter 26).

There are also six appendixes of supporting material — mainly of a statistical nature.

2 Developments in Australia's labour market

Key points

- Australia's modern labour market has been shaped by fundamental changes to the structure of the Australian economy, the workplace relations framework, and social norms.
- The distribution of jobs across industries has changed dramatically. While the manufacturing industry has experienced a decline in employment, many service-intensive industries have seen significant growth.
- Australians are also working in different occupations, with more jobs requiring high skill levels.
- Security of work appears to have changed relatively little in recent years.
  - Increases in rates of casual employment have tapered off during the 2000s, the prevalence of independent contracting has been stable and average job tenures have not declined.
- Union membership has continued to decline over time.
- There have been big changes in who works.
  - More women are in the workforce, more mature age people are participating and skilled migration has increased strongly in the past 15 years.
- While unemployment in Australia has generally fallen over the last two decades, there has been an upturn in recent years, with rising youth and long–term unemployment a particular concern.
- There are several indicators that the labour market has become more flexible, most notably through a greater tendency to adjust hours rather than employment during downturns in business demand, and the unresponsiveness of prices to strong labour demand. There is little evidence change in the matching efficiency of labour markets, though this may deteriorate if long-term unemployment rises.
- Labour productivity growth has outstripped wages growth in recent years.
- Income inequality has risen in recent years, with wage dispersion an important contributor.
- Anticipating future labour market trends is fraught with difficulty. However, it is possible to create workplace relations structures that respond to new economic developments and new social norms as they arise.

Australia has undergone substantial economic and social change over the last 40 years, with significant implications for debates about the role and form of the best workplace relations system. At the institutional and regulatory level, the Australian economy has progressively opened to the global economy, with the reduction and removal of tariffs,

along with the introduction of a floating exchange rate. Over the same period, the locus of wage-setting has moved between extremes, from the centralised Prices and Incomes Accord to bargaining at the enterprise level. While some of these trends have now abated, others will continue for some time yet, and entirely new ones will emerge.

Markets forces have been a major driver of change in the Australian labour market, however, regulatory developments have also had a substantial impact. Notwithstanding the different criticisms of the various industrial relations regimes in place over the last two decades, these regimes have coincided with positive developments in labour markets and economic performance:

> Over … two decades, the pertinent economic outcomes have been congenial. … industrial disputes are uncommon, overall wages growth has been consistent with low consumer price inflation … unemployment has steadily declined while participation in the workforce has increased … and at the same time the profit share of incomes has increased. These are considerable achievements, not to be put at risk lightly. (McCallum, Moore and Edwards 2012, p. 21)

Several commentators have identified past changes in labour relations as supporting improvements in Australia's macroeconomic environment, although they are cautious about precisely quantifying their relative importance (Ballantyne, De Voss and Jacobs 2014; Battellino 2010; Borland 2012; Lowe 2012; Mallick 2014; PC 2013b).

The focus of much of this report will be on how to improve the system further. The Productivity Commission recognises the effectiveness of workplace relations reform over the last two decades, but will examine whether Australia can do better without sacrificing essential elements of what has been achieved to date.

This chapter outlines major features of the Australian labour market, including:

- a brief snapshot of work in Australia (section 2.1)
- trends in the gender, age, industrial and occupational/skill composition of the Australian labour market, as well as the role of unions (section 2.2)
- the increasing importance of non-traditional work and changing job tenure patterns (section 2.3)
- job stability and labour market transitions (section 2.4)
- labour utilisation — one of the main goals of governments is to ensure that policy settings do not frustrate people's access to jobs and to their desired hours of work (section 2.5)
- flexibility in adjusting to shocks. It may be that much of the stability apparent in recent years reflects better macro and microeconomic policy settings, including those relating to the workplace relations (WR) system. Or it may be that, in part, Australia has been lucky, and that the capacity of Australia's current settings to adapt to shocks has not been yet tested (section 2.6)

- the degree to which wage pressures have changed, and associated with that, the degree of earnings dispersion (section 2.7)
- the future of work and its implications for workplace relations policy (section 2.8)
- a summary of the key labour market trends discussed throughout this chapter (section 2.9).

2.1 A snapshot of the Australian labour market

Effective labour market regulations must take account of the large degree of variation in the working patterns of Australians (table 2.1). It is not possible to characterise a 'normal' pattern of work. Many people do not work in regular full-time long–tenure jobs in daylight hours on weekdays. Indeed, there are many part-timers, shift and overtime workers, people in non-traditional forms of employment, and people with short–term tenure in their jobs. More than one in twenty people are multiple jobholders and close to one in three secondary students work.

There is also a tendency by some to see the labour market in static terms. Yet, there is a large amount of dynamism in Australian labour markets. Even over the very short term, many people change their labour force status. For instance, nearly one in five people who were unemployed in January 2015 were employed one month later. And, as shown in many of the sections below, there have been major long–run shifts in working patterns.

Table 2.1 **Patterns of working — a snapshot**

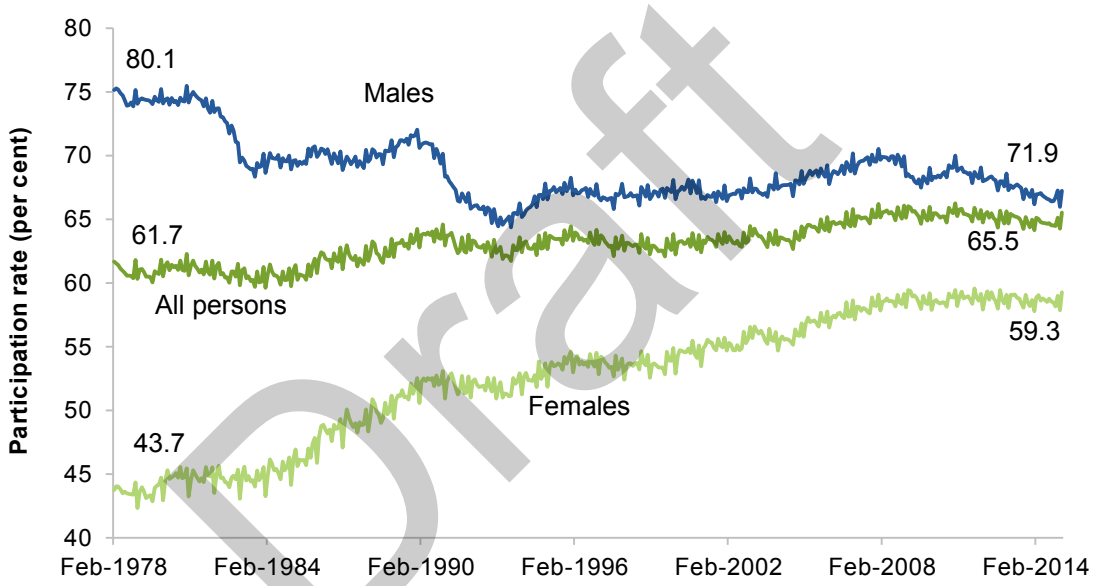
Measure	
Employed persons 2014 ('000)[a]	11 563
Unemployed persons 2015 ('000)[a]	747
Unemployment rate 2014 (%)[a]	6.1
Vacancy rate — vacancy to labour force ratio, November 2014 (%)	1.2
Share of unemployed in January 2015 who were employed in February 2015 (%)[e]	22.8
Participation rate 2014 (%)[a]	64.7
Female (share of employed %)[a]	45.9
Employees (share of employed %)[b]	82.7
Independent contractors (share of employed %)[b]	8.5
Other business operators (share of employed %)[b]	8.8
Average hours per week worked by employees, 2014[a]	32.7
Working part-time 2014 (share of employees %)[a]	29.7
With paid leave entitlements (share of employees %)[b]	76.5
Required to be on call (share of employees %)[b]	22.3
Did not have any say in starting/finishing time (share of employees %)[b]	58.7
Working shift time (share of employees %)[c]	16.1
Usually worked on weekends (share of employees %)[b]	31.8
Work overtime (share of employees who %)[c]	34.3
On a fixed term contract (share of employees %)[b]	3.8
Are multiple job holders (share of employees %)[c]	5.6
In the private sector (share of employees %)[d]	83.2
In large businesses (>200 employed) (share of employed %)[f]	31.7
Less than 1 year job tenure (share of employed %)[g]	18.2
1 to less than 5 years of job tenure (share of employed %)[g]	37.4
5 or more years of job tenure (Share of employed %)[g]	44.4
Share of school students aged 15-19 years who are employed (%)[a]	32.1
Experienced a change in work over past year (share of employees that %)[g,h]	22.0

[a] For January 2014 to December 2014 from ABS 2015, *Labour Force, Australia*, Cat. no. 6202.0. [b] All employed people with data from ABS 2013, *Forms of Employment, Australia,* Cat. no. 6359.0. [c] ABS 2012, *Working Time Arrangements, Australia,* Cat. no. 6342.0. [d] ABS 2013, *Employee Earnings, Benefits and Trade Union Membership,* Cat. no. 6310.0. [e] ABS 2015, *Labour Force, Australia*, Cat. no. 6202.0. [f] ABS 2012–2013, *Australian Industry,* Cat. No. 8155.0. [g] ABS 2013, *Labour Mobility, Australia,* Cat. no. 6209.0. [h] Where change in work may refers to occupations changes, change in usual hours worked, or a promotion/transfer.

2.2 Who works? Participation and the composition of the labour force

The composition of Australia's labour force has changed substantially over the past 40 years. Women who work are now the norm, rather than the exception (figure 2.1), more mature age Australians are participating in the labour force, and skilled migrants are forming an increasing share of Australia's migrant intake. These shifts have all contributed to an increased participation rate over time.

Figure 2.1 **Female participation rates up, male rates down**
February 1978 to February 2015



Source: ABS 2015, *Labour Force, Australia*, Cat. No. 6202.0.

More women are in the workforce

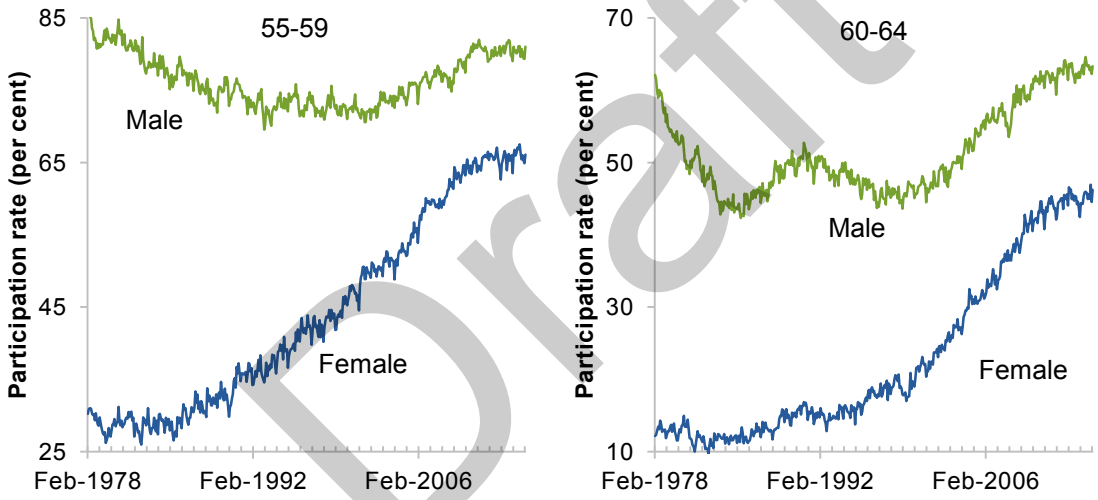
Female participation rates have steadily increased over the last 40 years, both in Australia and other advanced economies. In Australia, they have risen from just under 45 per cent to almost 60 per cent. A number of factors have contributed to this increase, including several social and economic developments. Educational attainment has increased substantially among females since 1960, while fertility rates have declined over the same period. Moreover, increasing access to childcare has facilitated entry into the workforce. Such changes have been partly reflected in regulatory developments. For example, the equal pay

cases in the late 1960s and 1970s established the principle of equal pay for work of equal value, overturning the 'Harvester Man' view of the minimum wage.[7]

More mature age people are working

Mature age workers (those aged 55–64 years) have been growing as a share of both the population and labour force. While female mature age workers have traditionally had lower rates of workforce participation, this has increased markedly over the last three decades. Moreover, the decline in male participation rates among mature age workers has reversed in the last 15 years (figure 2.2).

Figure 2.2 **Mature age workforce participation has been increasing**
February 1978 to February 2015 , 55-64 year olds



Source: ABS 2015, *Labour Force, Australia, Detailed,* Cat. No. 6291.0.55.001.

The trend of rising participation rates of older workers is likely to continue for some time — partly offsetting the decline participation rates resulting from the shift in the age structure of the labour force (PC 2013a).

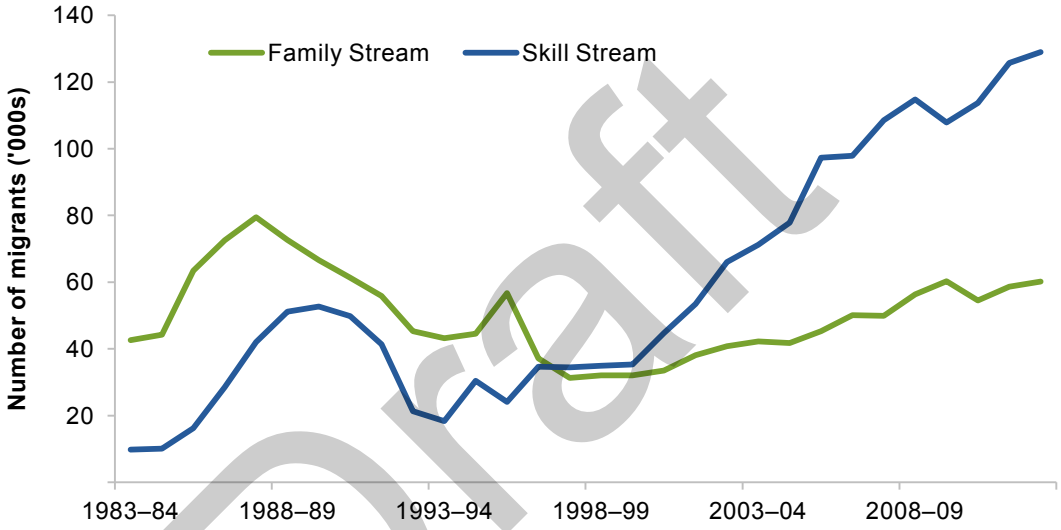
The increase in mature age workforce participation is attributable to a range of factors, such as increased life expectancy and improved health in the years before retirement. Additionally, mature age workers have had increasing access to flexible work practices, such as part–time and causal work, while the growth of employment in the services industries has allowed for work in less physically strenuous roles.

7 The Harvester decision in 1907 determined that the federal minimum wage should reflect an income level sufficient for a male breadwinner to meet the reasonable needs of his wife and three children; suggesting that a women could only ever be paid a portion of a man's wage.

Skilled immigration has increased

Immigration is an important contributor to Australia's labour force. In the year to June 2014, Australia accepted around 190 000 permanent migrants through its Migration Programme and around 650 000 temporary migrant visas with some working rights (DIBP 2015a). Skilled migrants have become the largest proportion of Australia's Migration Program in the last 15 years (figure 2.3). Since 1996, migrants have increasingly entered through the skilled stream rather than the family stream.

Figure 2.3 **Skilled migration has been increasing**



Source: Department of Immigration and Border Protection (2014).

Growing employment in service industries

The composition of the Australian economy has changed markedly over the past half century. Like many other Western, developed nations, employment has shifted away from manufacturing and towards services (figure 2.4).

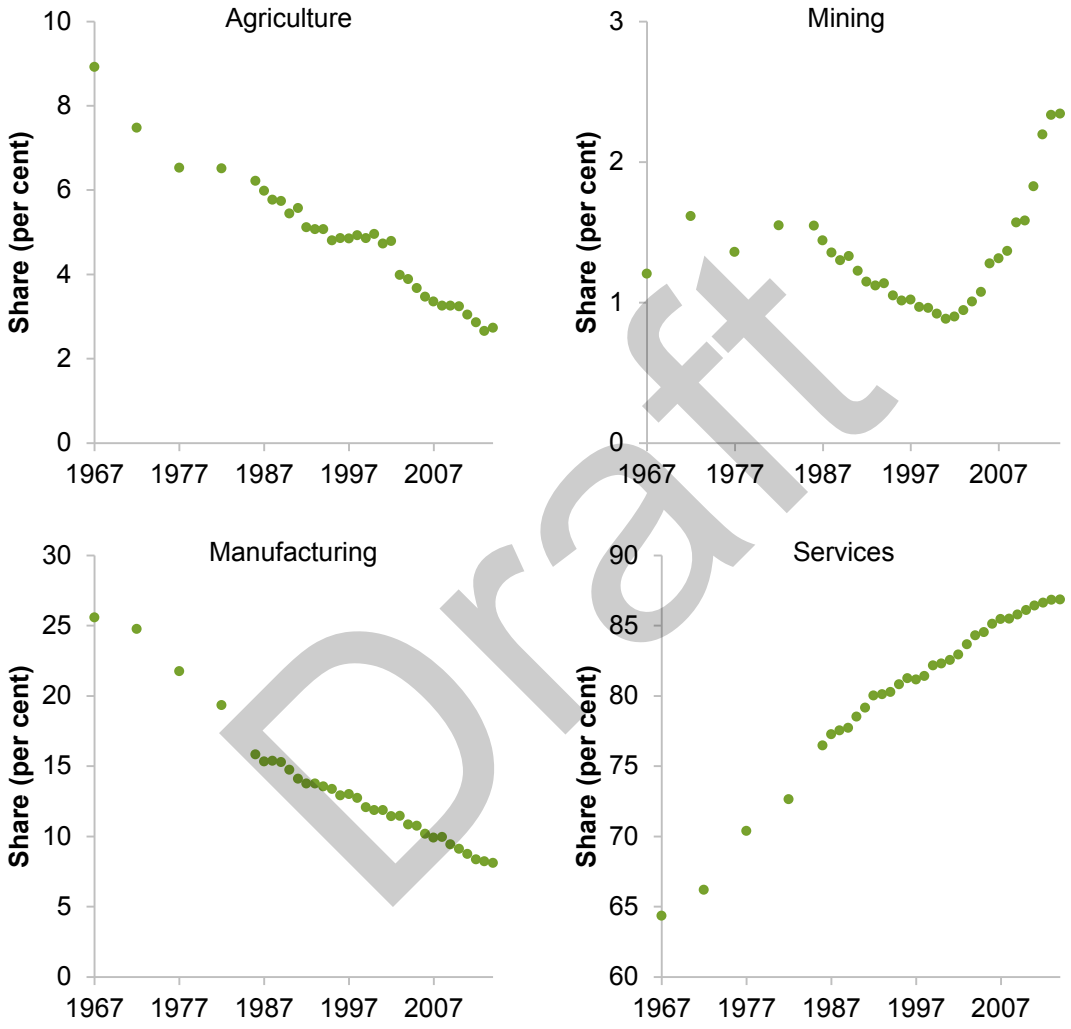
Employment in manufacturing has progressively declined (figure 2.5). In 1985-86, manufacturing employed around 16 per cent of Australian workers. This share fell to less than 8 per cent by 2013-14. In absolute terms, the industry lost 150 000 workers. The agriculture, forestry and fishing industry also experienced a decline in employment over the same period. Its share has fallen from just over 6 per cent to under 3 per cent, while absolute employment numbers have fallen by around 115 000 workers.

On the other hand, service industries have experienced robust employment growth over the past 30 years, growing by more than 4.6 million from 1985-86 to 2013-14. In terms of overall employment, the fastest growing *share* of total employment was in the

professional, scientific and technical services industry, followed by the health care and social assistance industry.

Figure 2.4 **Services have increased markedly**

Share of total employment by sector, 1966-67 to 2013-14[a]



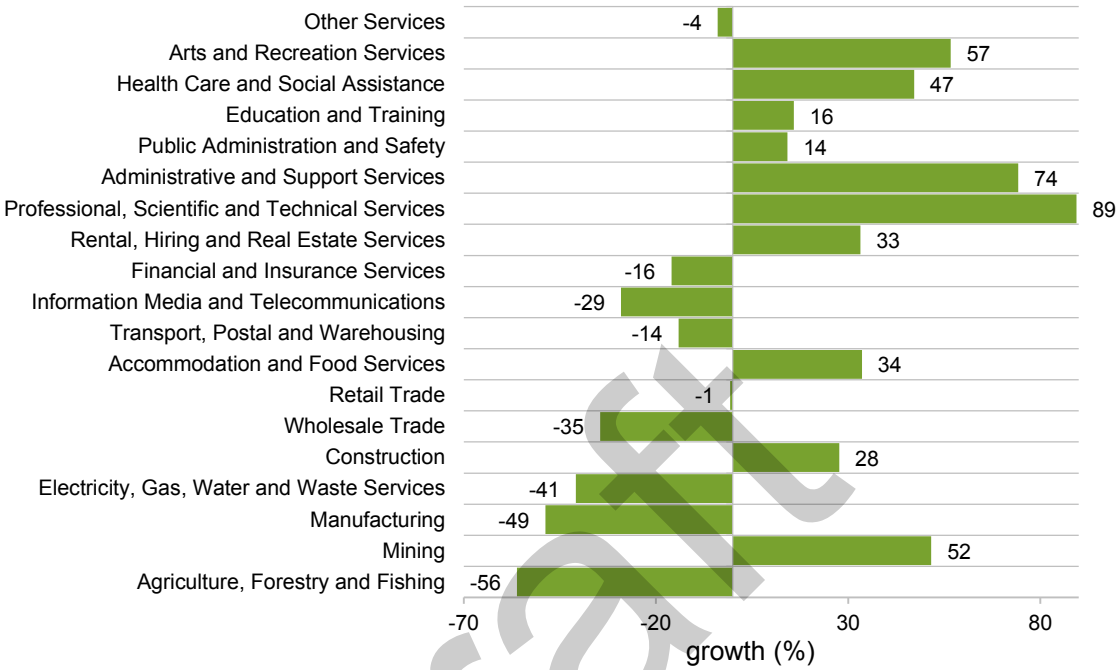
[a] From 1986-87, annual employment was calculated as the average of quarterly data.

Sources: Productivity estimates based on ABS 2014, *Labour Force, Australia, Detailed*, *Quarterly*, Cat. No. 6291.0.55.003.; Productivity Commission (2003b, p. 27).

Demographic trends are likely to contribute to a continuation of these shifts. For example, those over the age of 65 consume services at a rate almost 10 percentage points above those aged 15-64. Given Australia's ageing population, these age-specific patterns of consumption suggest an increasing shift toward services (Kent 2014a).

Figure 2.5 **The distribution of employed persons across industries has been changing**

Percentage change in employment shares, 1985-86 to 2013-14[a]



[a] Employment levels were calculated as averages of quarterly data ending May. The percentage changes are calculated as $(S_t/S_{t-1}-1)*x\ 100$ where S is the employment share in any given year.

Source: ABS 2014, *Labour Force, Australia, Detailed, Quarterly*, Cat. No. 6291.0.55.003.

More jobs require higher skills

Australians are not only working in different industries, they are also working at different skill levels. Highly skilled occupations are playing a more important role in economic activity, and there is broad consensus that this trend is likely to continue.

Since the early 1990s, the largest increase in share of jobs has been among professionals (figure 2.6). At the other end of the spectrum, the largest decline in job share has occurred for machinery operators and drivers, clerical and administrative workers and labourers. The Department of Employment (2014a) has forecast that these trends will continue.

Other research has proxied skill levels using hourly wage rates or ABS–defined skill levels. Such studies have consistently found higher rates of growth among high–skill occupations. On the other hand, trends in growth among low–skill occupations have been contested.

Figure 2.6 **Share of employment by occupation (per cent)[a]**

[a] Data are average of quarterly data in the year ending May (and the three quarter average for 2013–2014).

Source: ABS 2014, *Labour Force, Australia, Detailed*, Cat. No. 6291.0.55.003.

While many agree that technological development is the main driver of this shift in occupational composition, the resulting pattern of change has been disputed. Some argue that developments in technology is favouring skilled workers over the unskilled. This phenomena has been coined 'skill–biased technical change'. Others argue that technology is, more specifically, replacing easily routinised work, which is concentrated in the middle of the skill distribution. The corresponding growth in high and low skill occupations has been coined 'job polarisation'.

International evidence has generally supported job polarisation, however evidence in Australia has been mixed. Wilkins and Wooden (2014) notes that job growth from 1993 to 2013 has favoured highly skilled occupations, and suggests that a relatively high minimum wage may be inhibiting job growth for low–skill occupations. More recently, Coelli and Borland (forthcoming) have found that patterns of employment growth for high- and low-skill occupations have varied over time, with job polarisation occurring in the 1980s and 1990s, and job growth limited to high–skill occupations in the 1970s and 2000s.

The decline of union membership

Unions have lost their pre-eminent role as employees' representatives, especially in key parts of the private sector.[8] This raises questions about the best ways to represent employee interests, especially where a power imbalance is present. At its height — from the 1940s to late 1970s — union membership covered roughly half of employees. However, from the 1980s onwards, union membership steeply declined, dropping from 41 per cent in 1990 to 19 per cent by 2007. Since then, membership has remained under 20 per cent (figure 2.7), and has been particularly low for younger people (table 2.2).

There are a number of explanations for Australia's decline in union membership.

Regulatory developments — prompted by change in social attitudes — have been a primary driver. Compulsory union membership was banned by five out of six state governments between 1990 and 1995. Additionally, governments have increasingly legislated employee rights and protections. The historical tendency to shift employee protections and benefits from negotiated arrangements to statute has seen the creation of the National Employment Standards, and stronger regulation of workforce health and safety. Awards are no longer formed as the arbitration outcome of industrial disputes. Government institutions, such as the Fair Work Commission and the Fair Work Ombudsman, provide a wider range of assistance to employees in seeking redress.

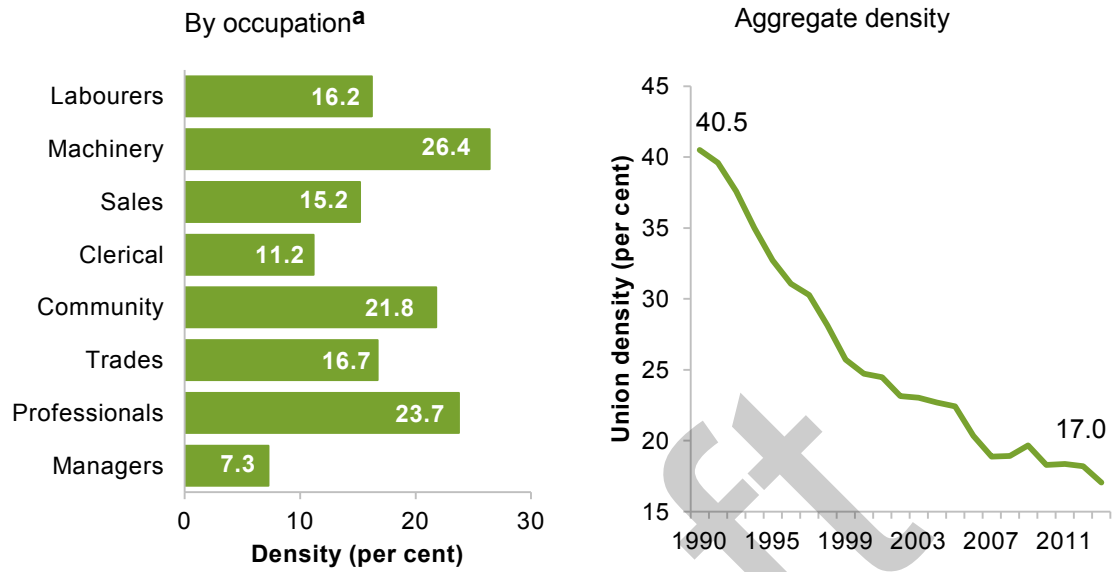
Moreover, potential benefits from union membership have dissipated. The progressive opening up of the Australian economy has increased the competition faced by Australian firms. As a result, a substantial portion of economic rents resulting from monopoly and oligopoly has been competed away. In the past, these rents were partially allocated to employees due to union pressure. Once these rents declined with the opening up of the Australian economy, so too did incentives for union membership. Moreover, employees who enjoy the benefits of a union-negotiated enterprise agreement are not required to pay for union membership, resulting in a 'free rider' effect.

Finally, structural changes have reduced the relative importance of industries with higher rates of union membership, such as manufacturing and the public sector.

[8] Such as manufacturing, heavy and civil engineering construction, air transport, telecommunications and finance (based on data from 2006 to 2013 from ABS 2014, *Employee Earnings, Benefits and Trade Union Membership, Australia - Trade Union Membership*, Cat. No. 6310.0).

Figure 2.7 **Union density has declined sharply**

Union members as a proportion of employees, 1990 to 2013



[a] The occupational groups are abbreviated. The groups are (from bottom to top): Managers, Professionals, Technicians and trades workers, Community and services workers, Clerical and administrative workers; Sales workers; Machinery operators and drivers and Labourers. This graph uses data from 2013.

Source: Productivity Commission estimates based on ABS 2014, *Employee Earnings, Benefits and Trade Union Membership, Australia - Trade Union Membership*, Cat. No. 63100TS0001.

Table 2.2 **Trade union membership rates by age group**

Age group	*2013*	*Trend 1990 to 2013*
	(per cent)	growth rate (per cent)
15–19	7.2	-6.0
20–24	9.0	-5.9
25–29	11.1	-5.6
30–34	14.2	-5.3
35–39	16.2	-4.7
40–44	18.3	-3.9
45–49	20.8	-3.3
50–54	24.9	-2.7
55–59	27.6	-2.5
60–64	24.2	-3.0
65 and over	17.9	0.1
Total	17.0	-3.9

Source: ABS 2014, *Employee Earnings, Benefits and Trade Union Membership, Australia - Trade Union Membership*, Cat. No. 63100TS0001.

2.3 Not just full-time employees — more variety in forms of work

There are many employment arrangements and associated differences in coverage of the WR system (table 2.3, table 2.4 and chapter 20).

Around 17 per cent of those employed are not covered by the protections of the *Fair Work Act 2009* (Cth), simply because they are either independent contractors or business owners. A further 20 per cent are casual employees, who have weaker rights (but receive pay loadings to reflect this).

There are differing views about the desirability of these forms of employment. By their nature, some have a greater likelihood of uncertain hours and tenure. These forms of work are sometimes described negatively as insecure or precarious. The Australian Council of Trade Unions (ACTU 2012b, p. 14) has defined insecure work as 'poor quality work that provides workers with little economic security and little control over their working lives'. The strongest concerns relate to casual, fixed term and some independent contracting jobs (where these are 'sham' in character — chapter 20). The concerns sometimes widen to include fluctuating pay and working time insecurity, which takes into account irregular, too few, and too many hours of work.

Table 2.3 **Forms of employment**
2013

Employment category	*Number*	*Share of employed*
	('000)	(per cent)
Employed[a]	11 573.8	100.0
Owner managers	1 938.8	16.8
Of incorporated enterprises	782.6	6.8
Of unincorporated enterprises	1 156.2	10.0
Employees	9 635.0	83.2
Permanent	7 332.7	63.4
Casual	2 302.3	19.9
Alternative classification of employees[b]		
Employed	11 573.8	100.0
Owner managers	1 999.9	17.3
Independent contractors	986.4	8.5
Other business operators	1 013.5	8.8
Alternative estimate of employees	9 573.9	82.7

[a] From ABS 2014, *Australian Labour Market Statistics*, Cat. no. 6105.0. [b] The source is as in note a, but takes account of the underestimation of self-nominated independent contracting status. The result of the ABS's re-classifications is that there are fewer employees and more owner managers.

Source: See above.

The ACTU and others claim that insecure work is increasing over time and reflects a range of technological, regulatory and global trends (for example, Wilson 2013). Were there to be a sustained increase in work with inadequate protections under a workplace relations regime, this would be of policy concern (an issue examined more closely in chapter 20).

There is little question that some members of the workforce see work that is not performed within a permanent employment relationship as a one–sided bargain, with job insecurity affecting their own schedules, the capacity to bargain with employers and the ability to borrow and make plans for the future.

Table 2.4 **Fixed term contracts and labour hire**
2013

Employment category	*Number*	*Share of employed*
Fixed term contract prevalence[a]	('000s)	(per cent)
Employees on fixed term contracts	367.2	3.2
Employees not on fixed term contractors	9 267.8	80.1
Non-employees	1 931.6	16.7
Labour hire prevalence[b]		
Employed people who are in labour hire	144.4	1.2
Employed people who are not in labour hire	11 429.3	98.8

[a] From ABS 2013, *Forms of Employment, Australia,* Cat. No. 6359.0. [b] The share of total employment was obtained from ABS 2011, *Forms of Employment,* Cat. No. 6359.0 and applied to total employment for November 2013.

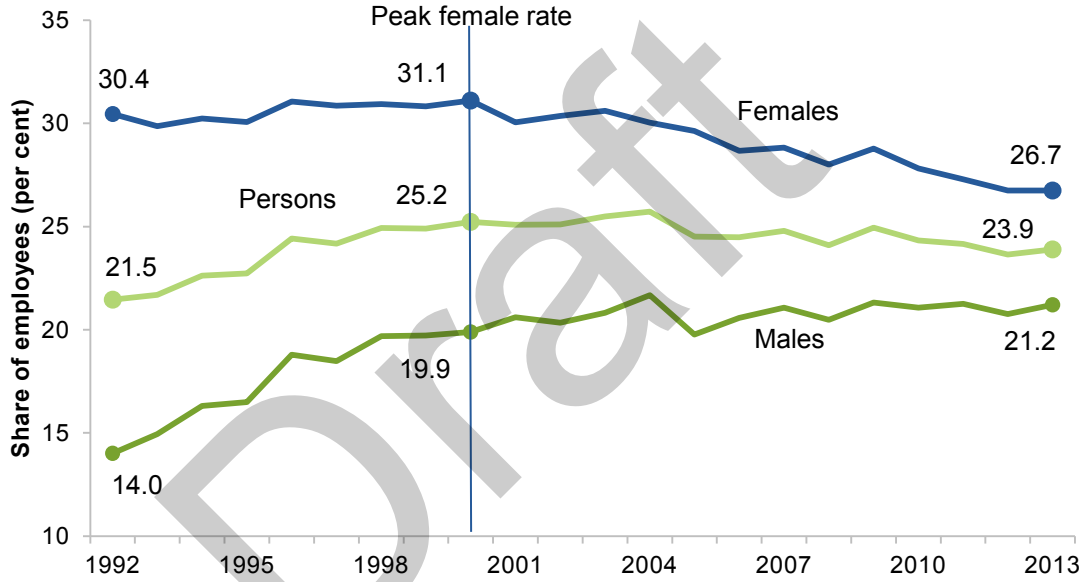
However, this perspective on non–standard work is an overly negative one. What holds for some does not hold for all. There is little evidence that the prevalence of non–traditional forms of labour is an adequate predictor of low quality jobs (PC 2006; Wooden and Warren 2004). People in non-standard jobs are highly heterogeneous. Such jobs can suit people's circumstances well and can act as stepping stones for more secure employment. Moreover, many people in non–standard forms of work have positive views about their jobs, although prime working age male casual workers with dependents appear to be an exception. As the Productivity Commission has previously observed:

> Whether non-traditional work is satisfactory or unsatisfactory, from a worker's point of view, can only be assessed in relation to individual forms of employment and to particular socio-demographic groups within them. (PC 2006, p. xxv)

Casual work — a now critical part of the labour market

The increase in employment share of non–standard forms of employment has abated, and to some extent even reversed. For example, the share of female employees without leave entitlements — the most commonly used description of a casual worker — scarcely grew between 1992 and 2000, and has since dropped significantly (figure 2.8). While male casual rates grew strongly from 1992 to 2000, they have since stabilised. The share of casuals working part-time has also stabilised (figure 2.9).[9]

Figure 2.8 **The casual job share has been falling in recent years**
Share of employees, 1992–2013[a]

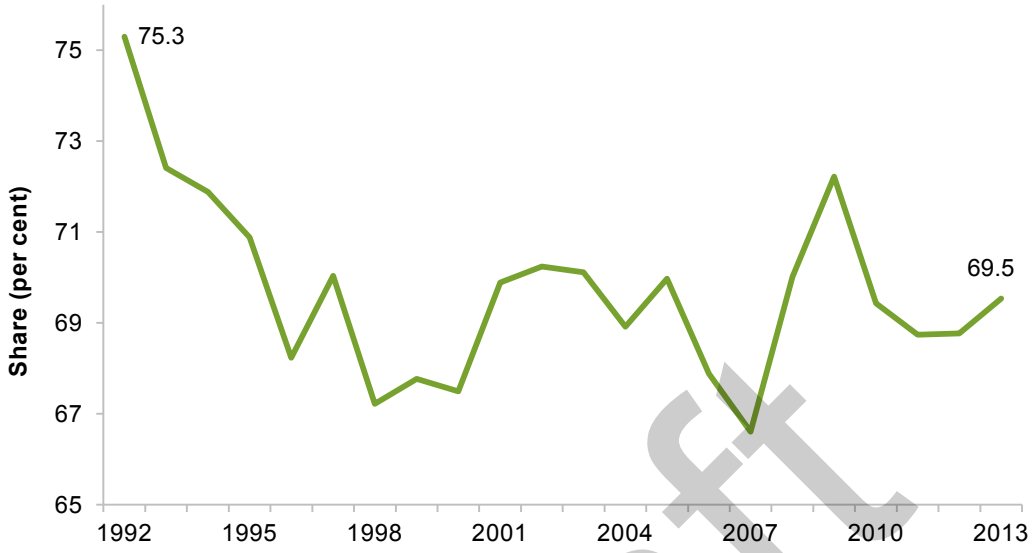


[a] Casual job status is identified as a person without paid leave entitlements. This is a commonly accepted definition, but there are others, including the existence of a leave loading or self-perceptions (Shomos, Turner and Will 2013). The shares are based on August data from 1992 to 2007, and on November data from 2008 to 2013. Note that the difference between the casual share in this chart and in table 2.3 reflect that the former relates to the share of all employees and the former to the share of all employed.

Source: ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0.

9 There is little evidence that the proportion of workers operating as independent contractors — a form of work also often, but dubiously, cited as insecure — has increased in recent years (chapter 20).

Figure 2.9 **Share of casuals working part-time**
1992 to 2013

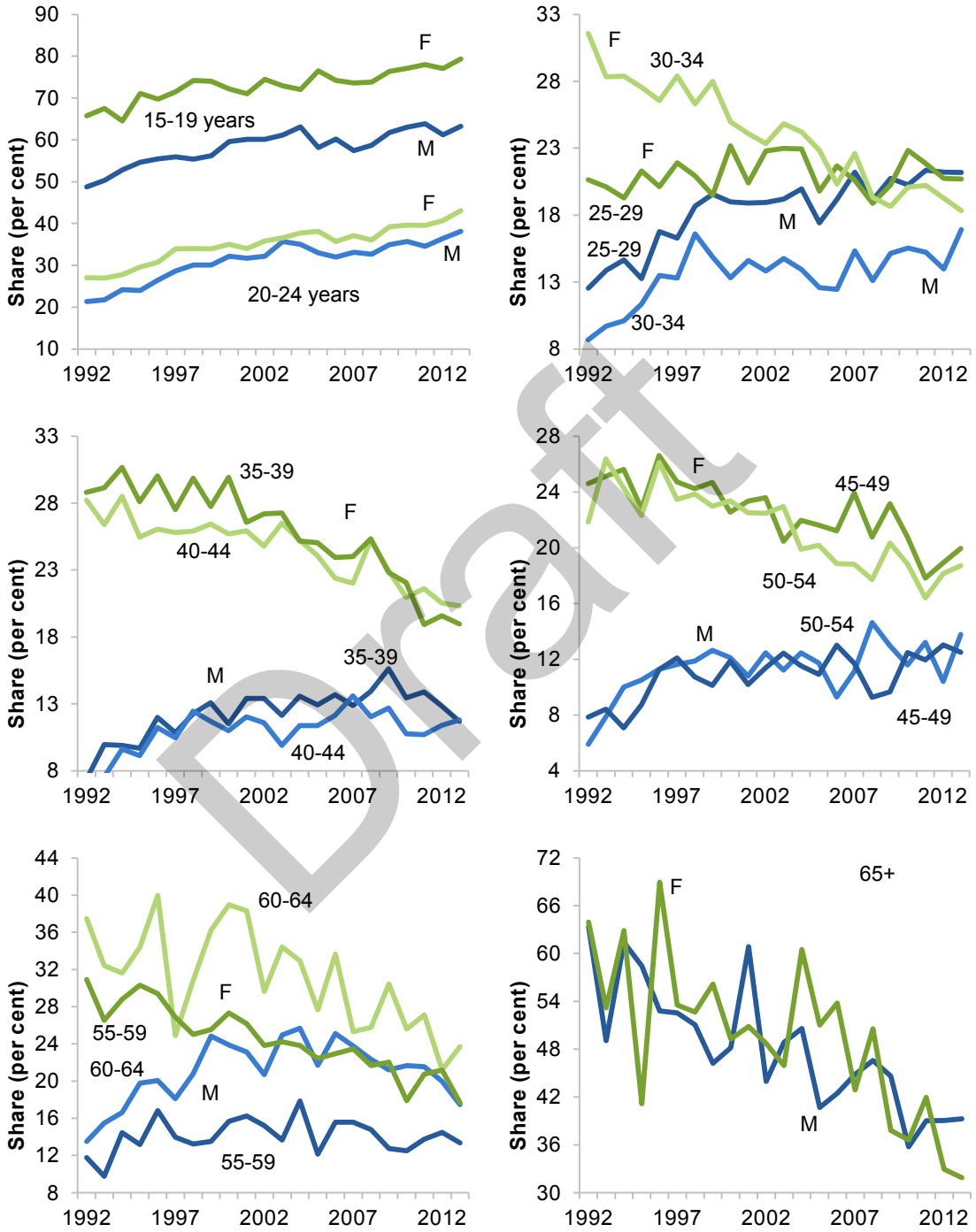


Source: ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0.

More generally, understanding contemporary trends in casual work should not only take account of gender, but also age and cohort effects (figures 2.10 and 2.11):

- Casual work rates are highest among the very young — people aged 15-19 years — and become progressively lower (for a given gender) until age 60-64 years. Since school retention rates have risen (figure 2.12), the rising casual rates among young people suggests that more are combining employment with education. Employment rates for 15-19 year olds who are in full-time education have increased markedly since the mid-1980s, though after the global financial crisis, they have fallen back to the levels apparent in the late 1990s (figure 2.12). In contrast, employment rates for young people who are not in full-time education have not changed appreciably since the mid-1980s (though this outcome is strongly influenced by economic cycles).
- Were the youngest females to be excluded from the analysis, female employee casual rates would have fallen precipitously. As for many other labour market indicators, female casual rates are converging to male rates for many age groups.
- The implication of lower casual rates for older employees is that casual employment is often temporary, as shown in the cohort analysis (figure 2.11).

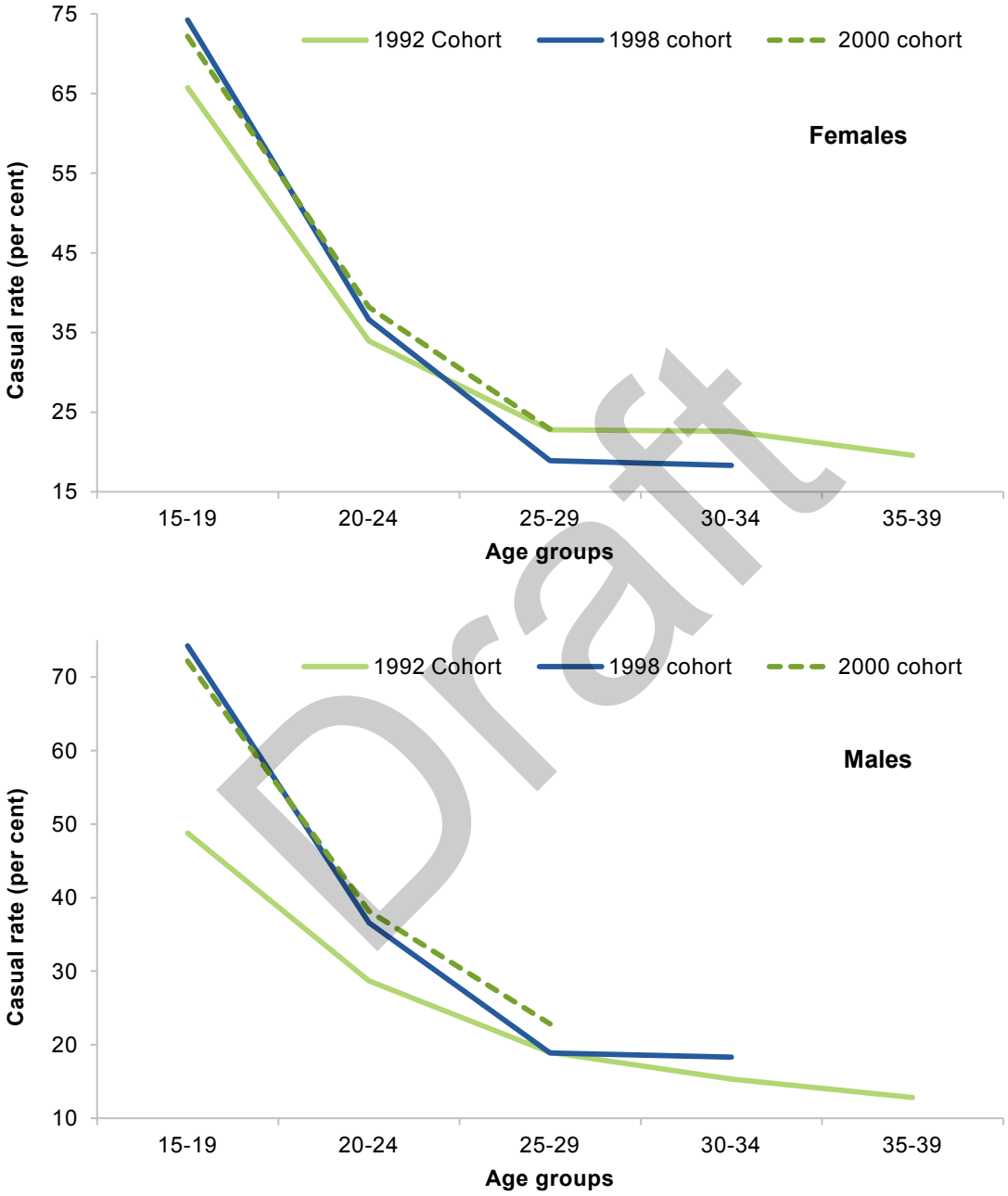
Figure 2.10 **Casual rates for employees**
By gender, 1992 to 2013[a]



[a] See note of figure 2.8. F= female, M= male.

Source: ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0.

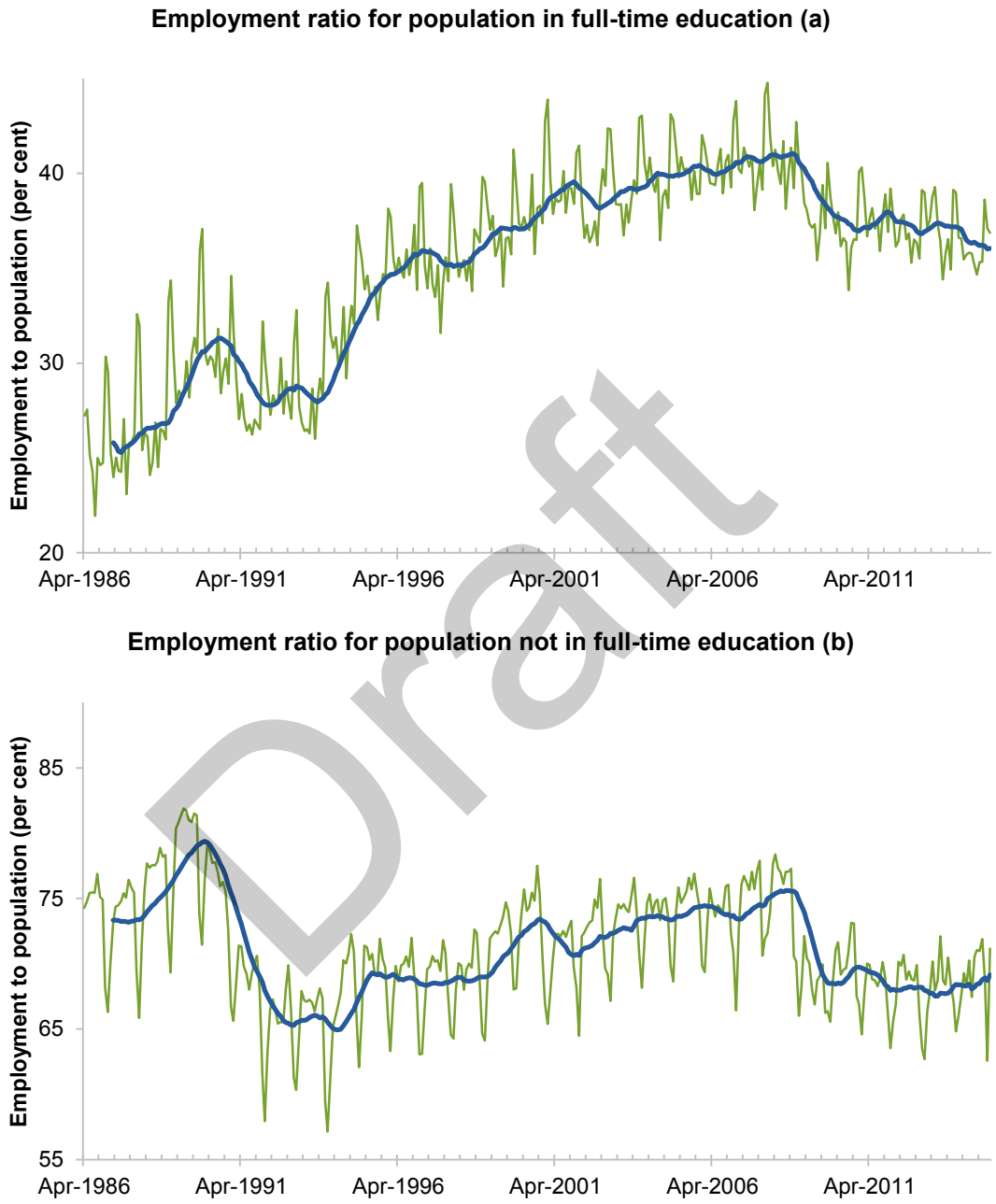
Figure 2.11 **Cohort casual rates for employees**
1992, 1998 and 2000 cohorts[a]



[a] Cohort rates are the casual rates for a cohort aged 15-19 at a given time, as they age over successive years. For example, the group of females aged 15-19 in 1992 are aged 20-24 five years later, and the casual rates for these two ages shows the extent to which their average casual rates shift as they age in the labour force. It is not possible to take account of exits to and entries from outside employment using this method, but it still provides an indication of likely cohort rates of casual employment.

Source: ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0.

Figure 2.12 **Education and employment among the young[a]**
April 1986 to February 2015



[a] Chart (a) presents the share of full-time students that are in employment. Chart (b) presents share of persons in employment among those not in full-time education. All populations relate to people aged 15-19 years old only.

Source: ABS 2015*, Labour Force, Australia, Detailed*, Cat. No. 6291.0.55.001.

As the ABS has noted:

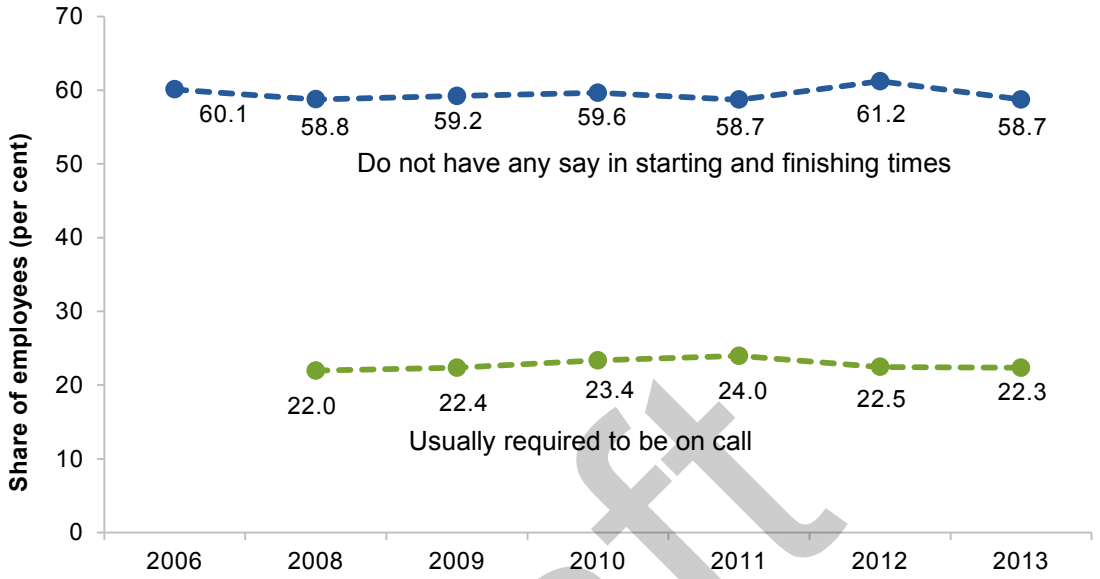
> The labour market in 2011 was much more flexible than in 1976. In 2011, a third (34%) of young adults who were employed, worked part-time hours (less than 35 hours per week), compared with 11% in 1976. … Many students may need to work part-time in order to support themselves while studying, and the increased flexibility in the workplace has made it easier for them to do so. In 2011, over a third (38%) of young adults attending an educational institution also worked part-time hours, while only one in ten (10%) did so in 1976. The option to work part-time hours has also allowed young adults more flexibility when managing their work hours based on their study needs, or vice versa. These differences may be a reflection of the changes in the labour market. For example, since the 1970s, there has been a general fall in full-time job opportunities for young people. In addition, there has been substantial growth in industries that offer part-time employment such as retail and hospitality services, while there has been a decline in industries that offer traditional full-time employment such as manufacturing. (2013c)

Are employers providing more flexible workplaces *for employees*?

One of the goals of workplace flexibility is to fashion arrangements that suit both parties to an employment contract. Various workplace arrangements — statutory agreements, such as Australian Workplace Agreements (pre–WorkChoices and during WorkChoices), individual flexibility arrangements and various other forms of common law contracts[10] — offer the scope for some flexibility (chapter 14), as do many informal arrangements between employees and employers that are invisible to regulators. However, data on an (albeit limited) range of workplace flexibilities suggests little change for employees over the last decade (figure 2.13).

[10] While the *Fair Work Act 2009* (Cth) and/or specific statutory arrangements may shape employment contracts, the common law fills any gaps left by Acts. In that sense, all employment contracts could loosely be referred to as common law contracts. The usage above covers contracts that are bespoke, but not AWAs or IFAs.

Figure 2.13 **Flexibility for employees**
2006–2013[a]



[a] The figure for the share of people required to be on call in 2006 was not available from the Forms of Employment publication for that year.

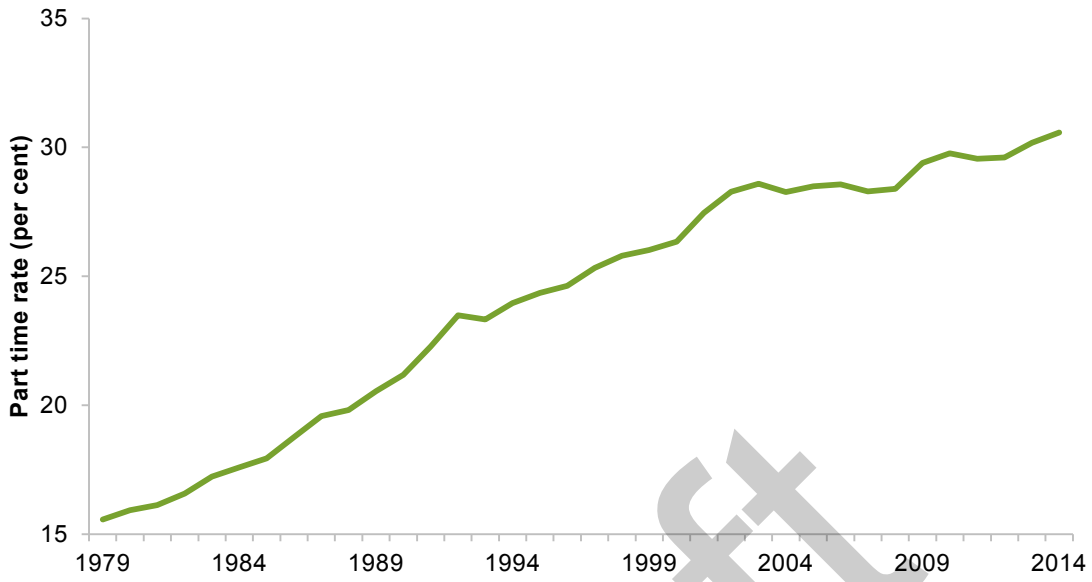
Sources: ABS (various issues), *Forms of employment*, Cat. No. 6359.0; and ABS (various issues), *Working Time Arrangements*. Cat. No. 6342.0.

Part time work generally has increased

While casual part-time rates have been relatively static in the last 20 years, the proportion of all employed persons working part–time (less than 35 hours) grew quickly from 1970 to 2002, but only at a moderate pace thereafter (figure 2.14). From 2002 to 2014, the share of part–time workers rose from 28.3 per cent to 30.6 per cent (or just 2.3 percentage points), whereas over the previous 12 year period, it grew by more than 7 percentage points.

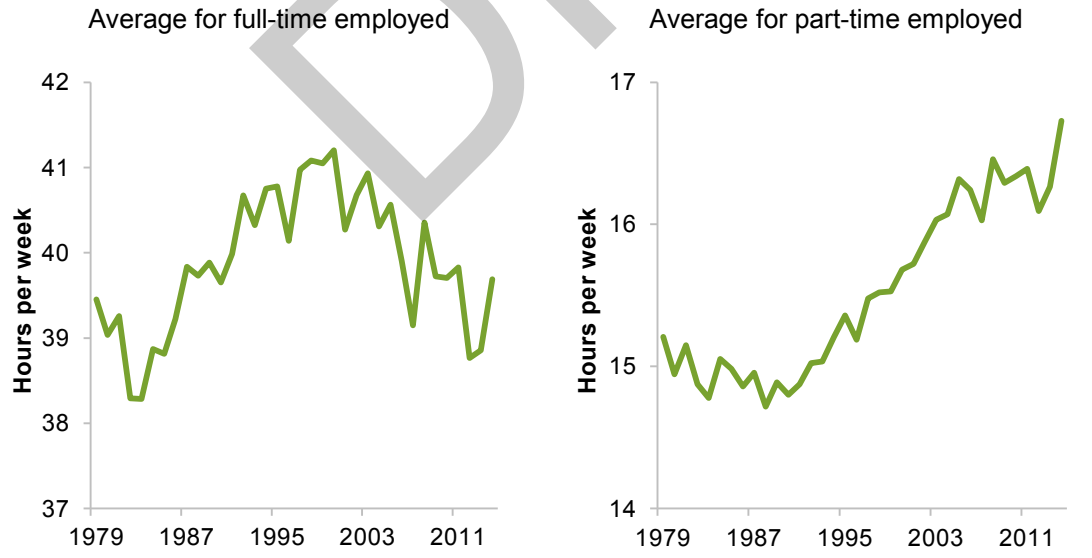
Average working hours among those employed part-time has also progressively increased (figure 2.15). In contrast, the steady lengthening of average hours worked by full-time workers apparent in the two decades from 1980 has since reversed. It is possible, that there has been some substitution between these forms of labour.

Figure 2.14 **Part-time work, 1979–2014**



Source: Productivity Commission estimates based on ABS 2015, *Labour Force, Australia, Detailed,* Cat. No. 6291.0.55.001 (derived calendar year data).

Figure 2.15 **Average hours worked per week, 1979–2014**



Source: Productivity Commission estimated based on ABS 2015, *Labour Force, Australia, Detailed,* Cat. No. 6291.0.55.001 (calendar year data).

2.4 Job tenure and turnover

The notion that people are increasingly switching employers and jobs is not borne out by trends over the past two decades (table 2.5). More than 40 per cent of employed people have tenure of five or more years — and this figure has scarcely changed over two decades. Short tenures (of under three months) have almost halved over this period.

Table 2.5 **Job security has been rising**
Length of tenure for employed people, 1994 to 2013

Tenure	*1994*	*1996*	*1998*	*2000*	*2002*	*2004*	*2006*	*2008*	*2010*	*2012*	*2013*
	%	%	%	%	%	%	%	%	%	%	%
Under 12 months	22.4	23.5	21.8	23.6	22.9	22.8	21.3	22.1	18.0	19.9	18.2
Under 3 months	8.9	8.9	8.4	9.4	7.6	7.5	6.5	6.6	5.5	5.7	5.0
3 and under 6 months	5.3	5.6	5.5	5.8	6.1	6.3	6.0	6.4	5.2	5.4	5.2
6 and under 12 months	8.2	8.9	7.9	8.5	9.2	9.1	8.8	9.0	7.3	8.8	8.1
One year or more	77.7	76.6	78.3	76.3	77.2	77.2	78.7	77.9	82.0	80.1	81.8
1 and under 2 years	10.5	12.2	12.3	12.7	11.9	11.7	11.8	12.1	11.9	11.4	11.7
2 and under 3 years	8.4	9.3	10.5	9.7	10.6	10.0	10.4	10.8	12.0	10.1	11.2
3 and under 5 years	15.0	12.3	14.0	13.1	13.7	15.0	13.9	13.7	15.6	14.6	14.5
5 and under 10 years	20.2	19.5	17.0	16.4	17.0	16.9	17.6	17.1	17.9	18.6	19.0
10 and under 20 years	15.1	15.1	15.9	16.1	15.3	15	15.7	14.8	14.6	15.3	15.2
20 years and over	8.5	8.2	8.6	8.3	8.7	8.0.6	9.3	9.4	9.9	10.1	10.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

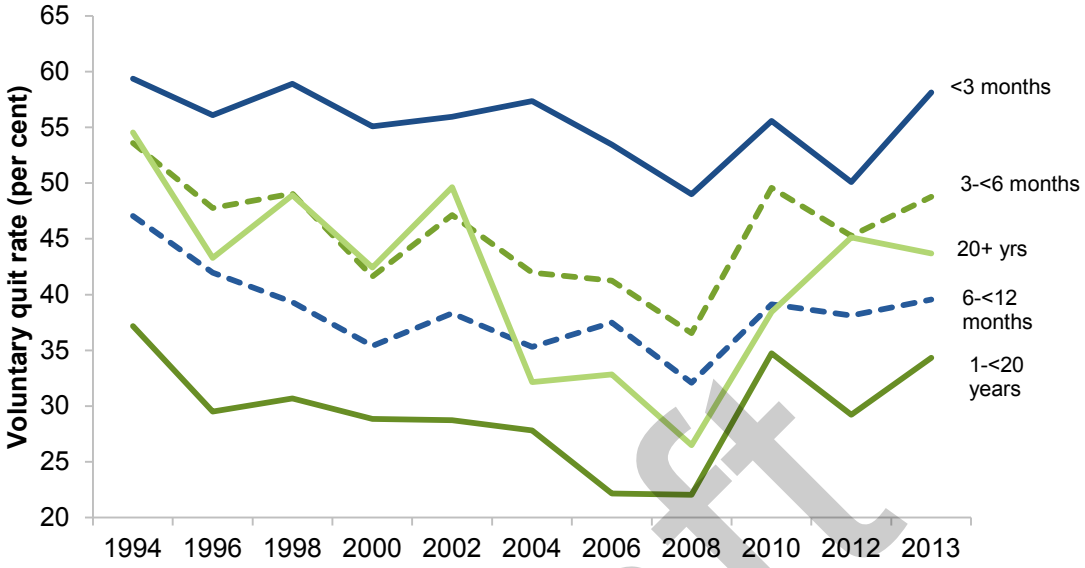
Source: Productivity Commission estimates based on ABS (various issues), *Labour Mobility, Australia*, Cat. No. 6209.0.

Similarly, involuntary exit rates do not appear to have change structurally over the past two decades. While an increase in involuntary quit rates was observed following the Global Financial Crisis, over the longer-term these rates do not exhibit a clear trend — again suggesting that jobs are not becoming more insecure.

Nevertheless, the likelihood that an exit is involuntary is much higher for people with short employment tenures (figure 2.16), primarily reflecting that:

- short tenure jobs are often seasonal or temporary
- the main reason for quits among long tenure jobs is voluntary retirement, necessarily reducing the relative prevalence of involuntary quits in comparison with short tenure jobs.

Figure 2.16 **Share of exits that are involuntary by tenure with the firm**
1994 to 2013

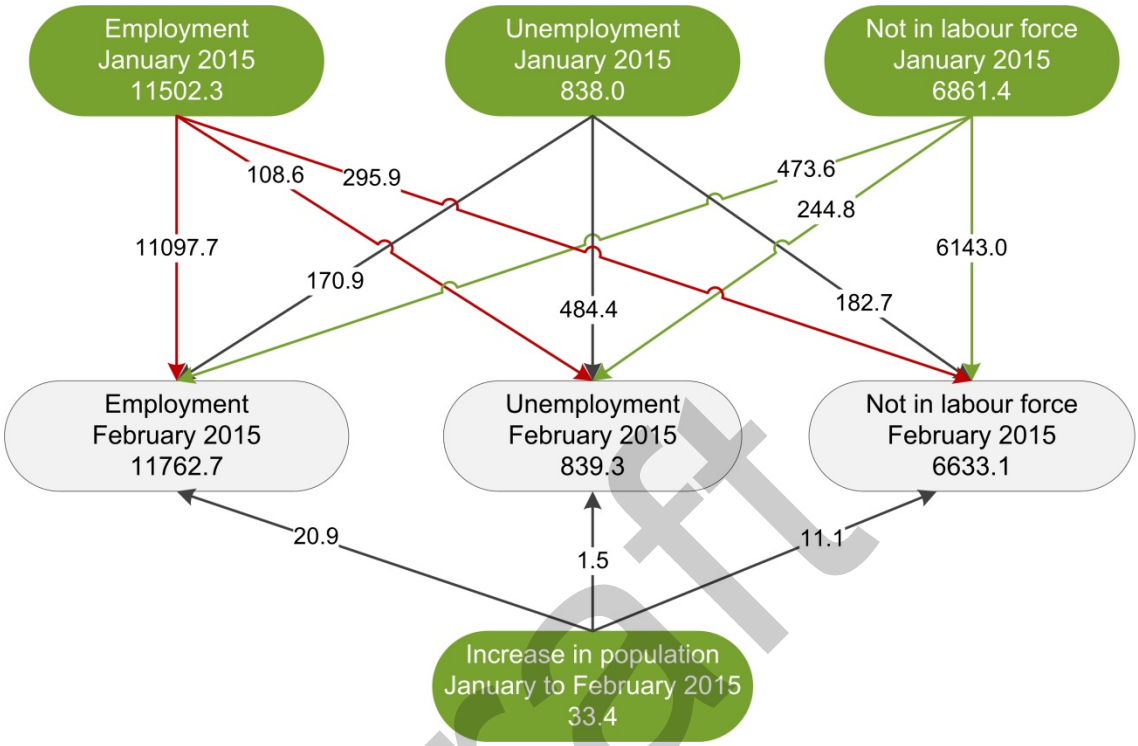


Source: Productivity Commission estimated based on ABS (various issues), *Labour Mobility, Australia*, Cat. No. 6209.0.

This stability in tenure and involuntary quits does not necessarily imply that Australia's labour market is static. Notwithstanding that many people stay in jobs for long periods, labour market transitions are high as a share of total employment. In 2013, more than two million employed people left their jobs . (The two phenomena can be partly reconciled because some groups are constantly mobile.) There is also significant flow of people into work, even from month to month (figures 2.17 and 2.18). For example, of the 838 000 people unemployed in January 2015, around 171 000 were employed one month later. Indeed, more than 40 per cent of people unemployed in January had changed their labour force status over just this one month period.

Figure 2.17 **Flows between labour force states in just one month**

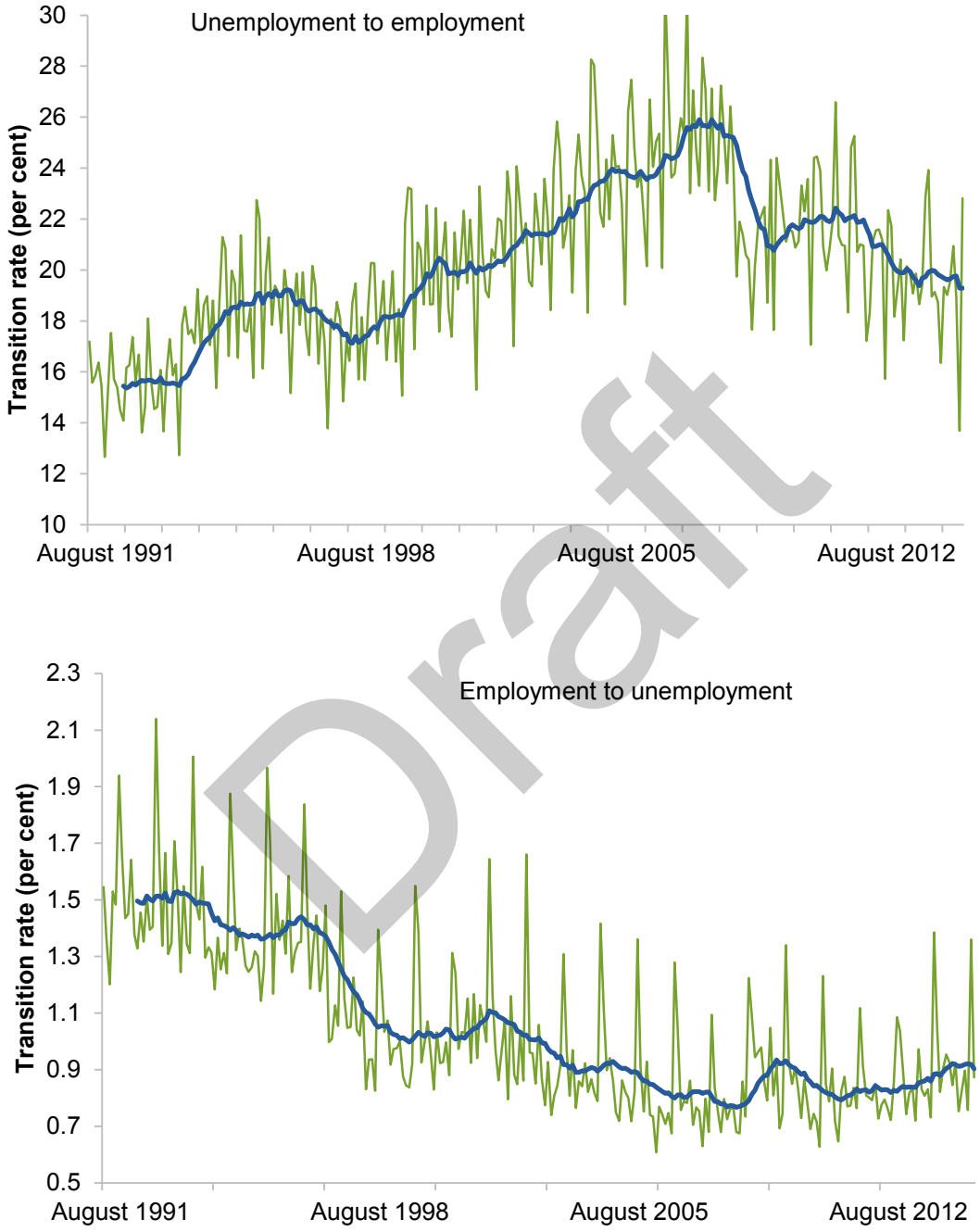
Population aged 15 years or over ('000s), January 2015 to February 2015[a]



[a] The ABS gross flows data relate to a matched sample of people who change status from one month to the next. The start and end values of the various labour market states from the flow data do not match the stock data from the full labour force survey, reflecting different samples. Nevertheless, it is possible to estimate the flows that are consistent with the labour force stock data, by solving a set of equations (in a manner similar to that used by Dixon et al. (2014) — and these estimates are the basis for the numbers shown above. Difference between the stock levels presented and those implied by flows are due to population growth between periods.

Sources: Productivity Commission estimates based on Gross flows (ST GM1) from ABS 2015, *Labour Force, Australia*, Cat. No. 6202.0; and ABS 2015, L*abour Force, Australia, Detailed*, Cat. No. 6291.0.55.001.

Figure 2.18 **Inflows and outflows in the labour market**
August 1991 to February 2015



a The transition rate from one labour market state to another is the share of people in an initial state who change to another state. For example, a transition rate from employment to unemployment at a particular point in time is measured as the share of people who were employed in the previous period who become unemployed in the current period.

Source: Productivity Commission estimates based on GM1 database from ABS 2015, *Labour Force, Australia,* Cat. No. 6202.0.

Employment flows can offer valuable insights into labour market dynamics. Indeed, without a broad consideration of flows — not only between employment and unemployment, but also into and out of the labour market — the true effectiveness of workplace policies can be obscured. For example, increased labour force participation can result in higher rates of unemployment, despite increasing absolute levels of employment.

The best labour market and workplace policies allow for a greater flow from unemployment to employment'.[11] A workplace relation system that allows free flows in both directions between employment and unemployment can achieve lower average unemployment rates, lower duration of unemployment spells and better skill matching. Countries — like Australia — with higher average inflows from unemployment to employment and higher average quit rates tend to have less enduring unemployment. In that context, the future evolution of Australia's WR system should avoid creating excessive frictions that frustrate hires (and quits).

Regulation can create barriers to businesses hiring employees

The stringency of employment protection measures (including unfair dismissal laws) must balance the benefits of greater protection for existing employees against the barriers created for hires (Blanchard, Jaumotte and Loungani 2013). On the one hand, protecting jobs creates greater certainty for employed people (important for financial security), strengthens the incentives for training, and reduces the risks of unfair dismissals. On the other hand, excessive barriers to firing and hiring employees frustrate efficient matching of people to jobs that suit their skills. It also poses barriers to the employment of people with less certain productivity — such as unskilled workers or those with long periods without employment.

Many European countries impose significant levels of employment protection compared with Australia. High levels of employment protection are associated with substantially longer durations of unemployment for those who do lose their jobs, or, for some younger people in search of a foothold in the labour market (Bassanini, Nunziata and Venn 2008).

[11] This notion is consistent with statistical simulation of labour market flows. Long run numbers of people in different labour states can be estimated by multiplying the original populations in these states by M^T where M is the transition matrix and T the number of periods ahead such that the new population is stable. This is an experiment only and provides a guide to the long–run effects. It would tend to exaggerate the actual labour market benefits because it is likely that as the relative numbers in future labour market states change, so do future transitions rates. This endogeneity reflects that shifts of people from one labour force category to another also change the average abilities of the people in the respective groups. For example, a shift from unemployment to full-time work is likely to leave less employable people among the remaining unemployed, and so the transition rate into future full-time work will not be as great. Nevertheless, the results provide a qualitative indicator of the directions in gross transition rates that reduce unemployment rates.

Regulation can create a disincentive for employees to quit

The existence of restrictions on hires also creates barriers to quits for people who have not already secured another job. Similarly, any regulatory measures or conventional practices (sometimes bargained by unions) that favour existing employees of a firm or those with longer job tenures, discourage people from quitting because of the forgone benefits of tenure when they move to another employer. Any changes in workplace regulations that preserved legacy arrangements for existing employees, while diluting the bargaining power or working conditions of aspiring employees to a business would tend to discourage quits.

2.5 Can people who want to work get a job? Labour utilisation

Measuring labour force utilisation

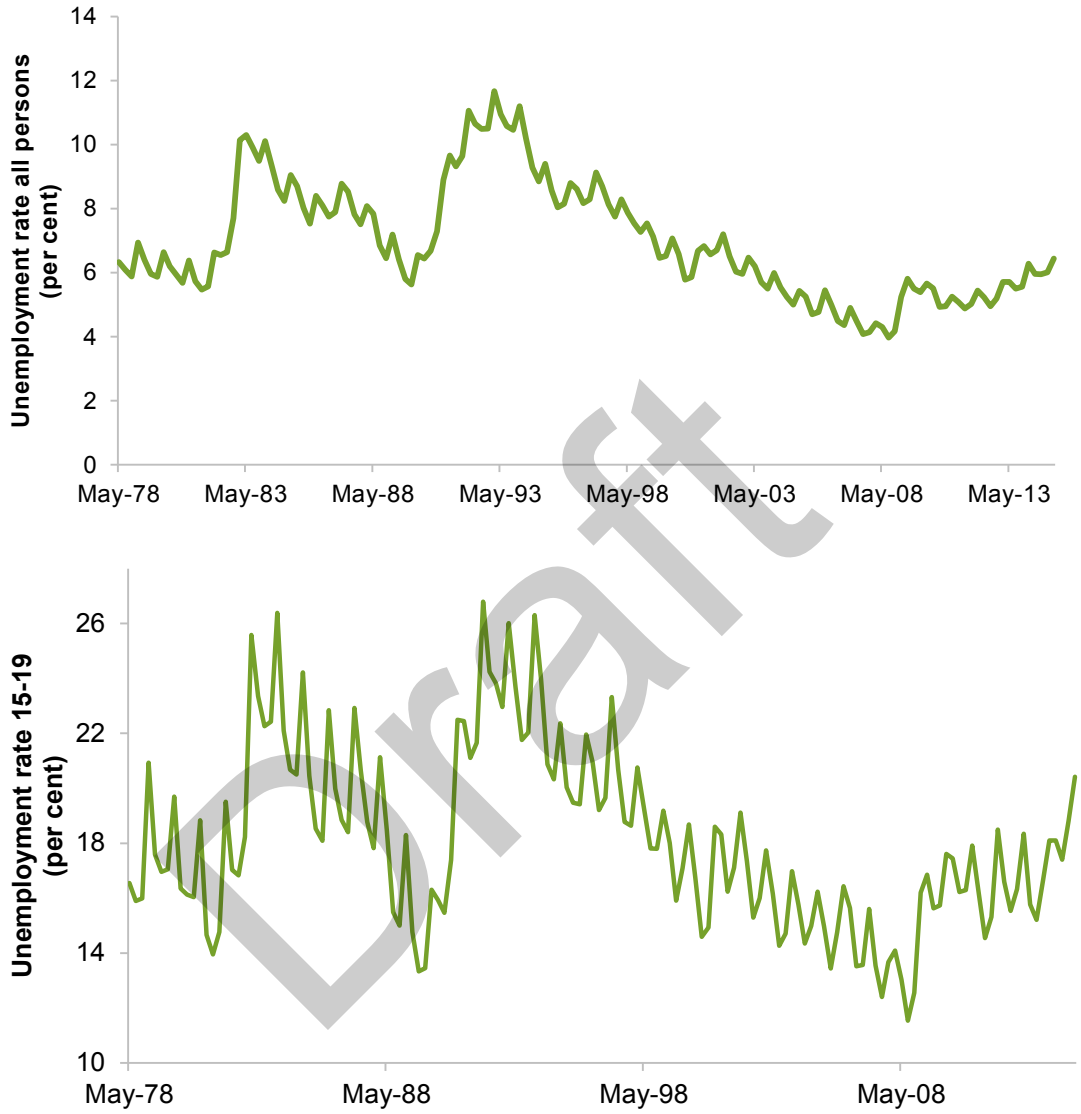
The most common measure of labour utilisation is the unemployment rate — the share of people in the labour force who are currently without a job, but actively searching for one.

In the early 1970s, unemployment fluctuated at around 2 per cent, before increasing significantly (as it did for many other countries). Following the 1970s peak in the unemployment rate, Australia has experienced four further spikes (figure 2.19).

- In 1981, unemployment increased from 5.8 per cent to 10 per cent. Over time, the unemployment rate recovered to just over 6 per cent.
- The early 1990s displayed a similar pattern, with an increase in the unemployment rate from 6 per cent to just below 11 per cent by 1992, followed by a recovery to around 6.2 per cent by 2000.
- The upturns in unemployment since the early 1990s have been relatively mild. In 2001, unemployment increased only half a percentage point over the year.
- More recently, Australia experienced a downturn during the Global Financial Crisis in 2008. Unemployment increased from 4.3 per cent to 5.5 per cent.

Since then, the unemployment rate has been gradually increasing (figure 2.19). This gradual increase has coincided with a declining terms of trade, reduced capital expenditure in the mining sector, and subdued investment in the non-mining sector.

Figure 2.19 **Unemployment in Australia**
All persons and 15-19 year olds, 1978 to 2015



Source: ABS 2015, *Labour Force, Australia, Detailed,* Cat. No. 6291.0.55.001 (Data converted to quarterly values).

Current youth unemployment rates are the highest since 1998 (based on calendar year data). Youth unemployment rates are significantly above the average unemployment rate (figure 2.19) and there is a particularly large gap between these rates and that applying to workers aged between 35 and 44 years old (who tend to have the lowest unemployment rates).

The gap between youth and prime aged unemployment rates primarily reflects the time taken to match entirely new and often inexperienced workers to businesses. Some period searching for a job is efficient because poor job matching fails to take account of the

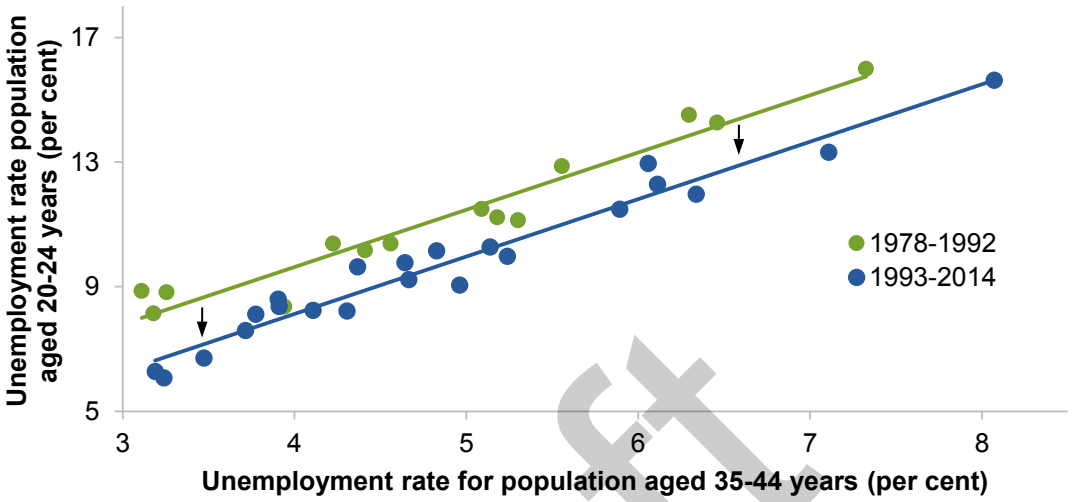
particular aptitudes and skills of new workers. On the other hand, those experiencing excessive search durations have a progressively lower likelihood of finding a job as they age. As noted earlier, this highlights the importance of limiting barriers to new hires — and has implications for the design of any WR system. There also appears to be a shift in the relationship between youth and prime aged unemployment rates (figure 2.20). Since 1993, since 1993, the rate of youth unemployment has fallen by around 1.5 percentage points relative to the level of the prime aged unemployment rate. The source of this is unclear, but *may* reflect:

- greater labour market efficiencies following the 1993 industrial relations reforms and the change in the behaviour of bargaining parties following the scarring effects of the deep recession in the early 1990s
- the greater encouragement of continued education for young people, which means that they are more likely to exit the labour force when there is a demand shock than to continue to search for jobs
- the greater availability of casual work for young people, which is another reason for being cautious about characterising such jobs as 'bad'.

As unemployment increases and the labour market tightens, as may be expected, the gap between youth and prime age unemployment widens.

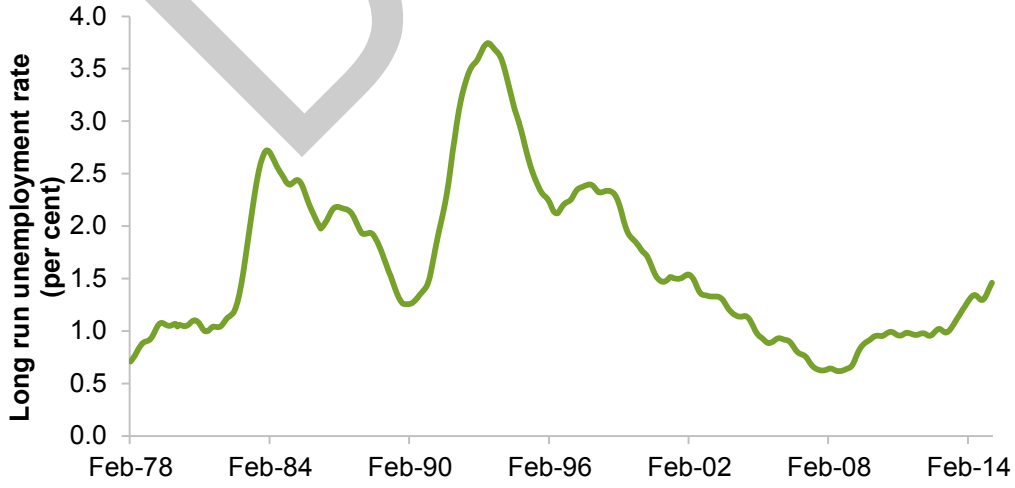
Long term unemployment rates have also generally be rising since the Global Financial Crisis — another indicator of growing labour market vulnerability (figure 2.21). Not only is long run unemployment problematic for the wellbeing of the people experiencing it, but it also tends to reduce search efficiency, as people in long run unemployment find it increasingly difficult to secure employment. The predominant view is that the non-cyclical component of unemployment (sometimes referred to as the non-accelerating inflation rate of unemployment — NAIRU) is currently between 5 and 6 per cent (Ballantyne, De Voss and Jacobs 2014).

Figure 2.20 **A positive relationship between youth and prime age unemployment rates**
1979–2014



Source: Productivity Commission estimates based on ABS 2015, *Labour Force, Australia, Detailed,* Cat. No. 6291.0.55.001 (Data converted to quarterly values).

Figure 2.21 **Long-term unemployment rates**
February 1978 to February 2015, trend adjusted[a]



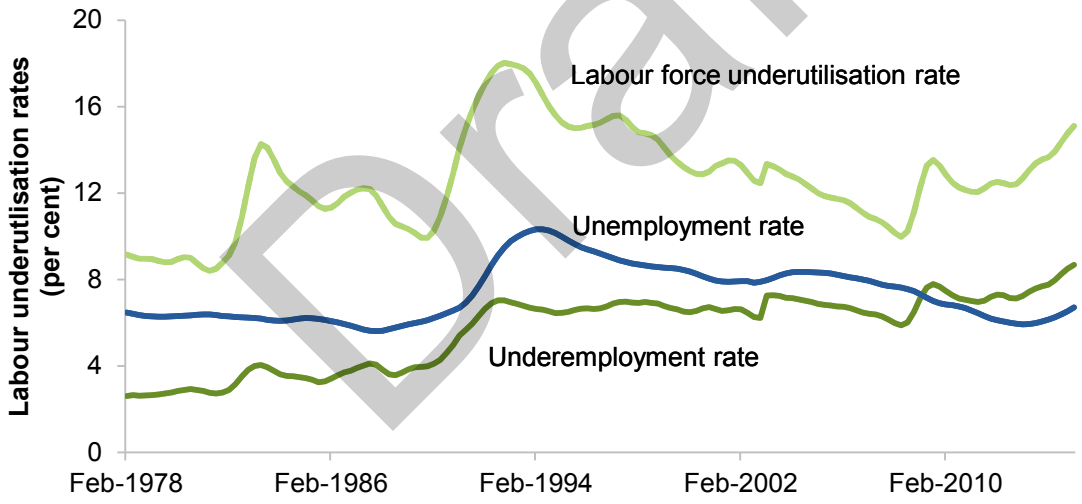
[a] The data from 1978 to 1986 from ABS Cat. No. 6204.0 was spliced onto the subsequent ABS data.

Sources: ABS 2015, *Labour force*, Cat. No. 6204.0 and *Labour Force, Australia*, Detailed, Cat. No. 6291.0.55.001.

Less tangible labour underutilisation

While the unemployment rate is the predominant measure of labour underutilisation, it has several limitations. Foremost, it does not capture hidden unemployment. The ABS defines an unemployed person — consistent with international standards — as an individual without work, actively seeking work and currently available for work. As such, those who would like to work but have given up searching (discouraged workers) are not counted in such measures. Moreover, the unemployment rate does not capture 'underemployment', or people who work less than 35 hours per week, but want to work more hours. As a result, the traditional head count measures of unemployment do not fully reflect the true degree of labour market 'slackness'. The underemployment rate is a measure of the number of people underemployed persons as a proportion of the labour force. Additionally the labour force underutilisation rate expresses the unemployed, plus the underemployed, as a proportion of the labour force (figure 2.22).[12]

Figure 2.22 **Various measures of labour underutilisation**
February 1978 to February 2015, trend estimates



Source: ABS 2015, *Labour Force, Australia,* Cat. No. 6202.0.

All measures of labour utilisation suggest that the Australian labour market is weakening, and the level of youth unemployment is high. Any workplace changes in the next few years will be taking place in the context of increasing vulnerability to unemployment. The labour

[12] The ABS also estimates the extended labour force underutilisation rate. This comprises the unemployed, plus the underemployed, plus two groups of marginally attached to the labour force: (i) persons actively looking for work, not available to start work in the reference week, but available to start work within four weeks (ii) discouraged jobseekers. This rate is around 1.4 per cent higher than the labour underutilisation rate from 1994 to 2013 (ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0), but is not shown in figure 2.22 due to the limited estimation period for this measure. The volume based measures of labour utilisation are significantly lower than headcount based measures.

market vulnerability of young people who are not in full–time education is becoming particularly apparent.

2.6 Some measures of flexibility in labour markets

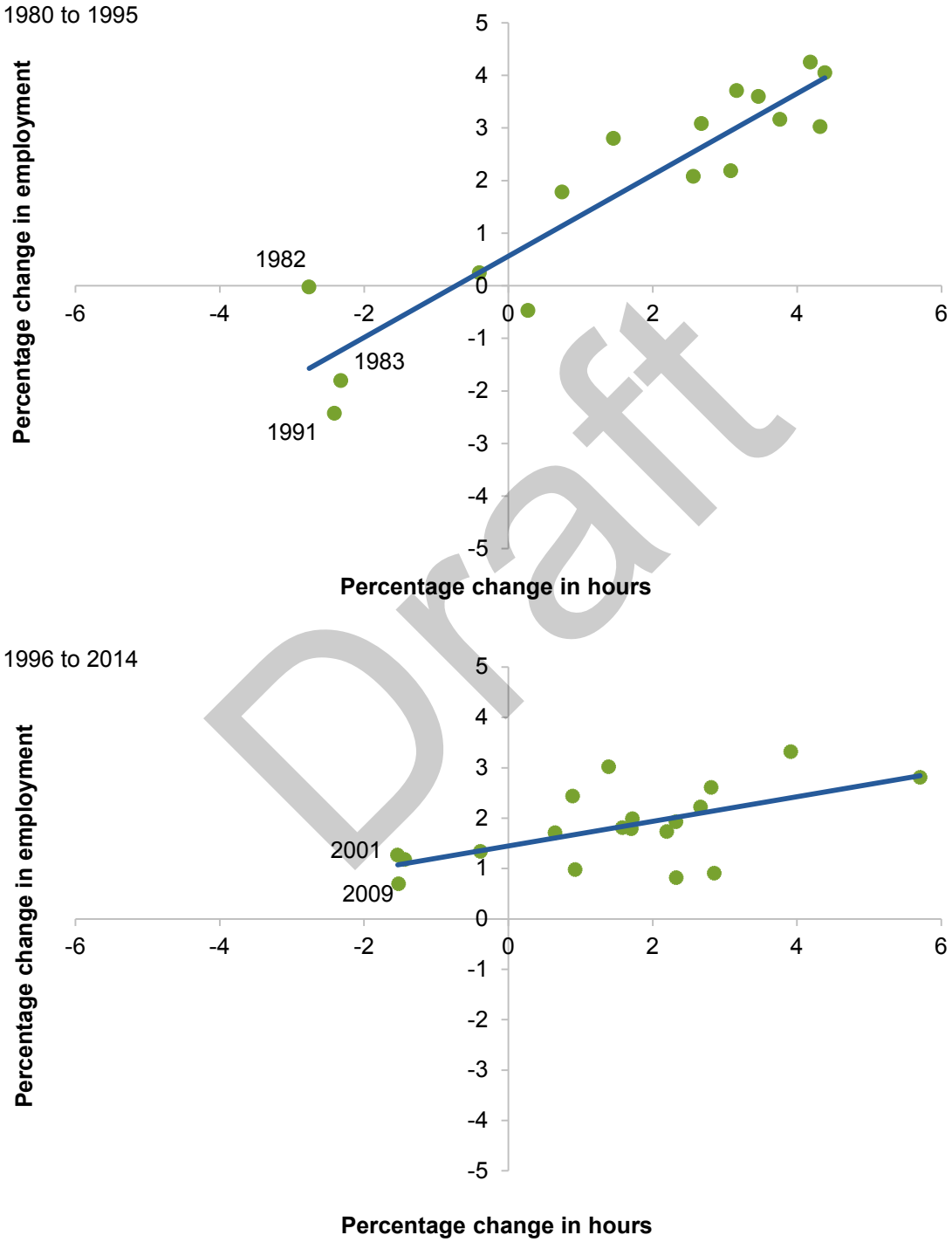
Mismatch

Mismatch is the degree to which the skills and aptitudes of job searchers matches the types of jobs available. Poor mismatch tends to be associated with high unemployment and vacancy rates. Typically, vacancy rates are negatively related to unemployment rates. However, there have been some periods, when much the same vacancy rate has been associated with very different unemployment rates. For example, from August 1981 to May 1983 (and again from November 1990 to February 1993), unemployment rates rose significantly, but vacancy rates were much the same. People searching for jobs during these periods were not being matched into the available jobs (or the vacancy rate would have fallen). It appears that most of the shifts in relationship between the unemployment and job vacancy rate (a relationship referred to as the 'Beveridge curve') do not reflect enduring mismatches (which might reflect policy settings, including the workplace industrial relations system). Rather, shifts in the relationship may be explained by changes in long term unemployment rates (as noted above and in Borland (2011, p. 203)). It is hard to discern any impacts of various industrial relations regimes on matching efficiency.

Has the Australian labour market's response to shocks changed?

Australia has experienced several major economic downturns in the last 30 years, which have always been accompanied by some increase in unemployment. Any demand shock reduces the need for labour input (measured in hours worked). The effect on employment depends on whether firms shed labour or reduce hours (figure 2.23). Over the past two decades, a given reduction in hours has been associated with a weaker reduction in employment than occurred in the previous 15 years (also a finding of Borland (2012, pp. 275–276)). It is possible that this reflected the post-1993 changes to workplace relations.

Figure 2.23 **A change in the relationships between hours and employment**
1980 to 2014



Source: Productivity Commission's estimates based on ABS 2015, *Labour Force, Australia*, Detailed, Cat. No. 6291.0.55.001.

In this respect, the ACTU noted:

> In terms of the industrial relations system, flexibility around hours appears to have played an important role in avoiding large employment losses. Faced with massive uncertainty in the wake of the collapse of Lehman Brothers, and a tottering banking system, employers faced a dilemma. They had just weathered several years of a tight labour market, with high vacancy rates and sectoral skills shortages, and many were loathe to begin large-scale retrenchments. Instead, many opted for shortening the working hours of their existing employees or engaging new workers on a part-time basis. This strategy is evident in both the employment and hours [data]. It was a strategy facilitated by the industrial relations system, with both enterprise agreements and the award system sufficiently flexible to accommodate this situation. (sub. 167, p. 33)

The capacity to vary hours of work may also reflect the greater willingness of employees to retain a job (and for employee representatives to support this), even at the loss of some wage income.

It may also be the case that demand shocks from the mid-1990s have been shorter and shallower than those in the 1980s and early 1990s, so that a future larger and more protracted demand shock might elicit similarly large employment losses as in the earlier periods. The resilience of the contemporary labour market has yet to be tested for big shocks.

Moreover, as pointed out by the ACTU, underemployment does not seem to very responsive to positive demand shocks, with weaker reductions compared with unemployment after the recovery from the recession in the 1990s. This is puzzling, as wage pressures have been relatively low in recent years (suggesting people are not being priced out of extra work). The factors behind the relative unresponsiveness of underemployment to the business cycle are unclear.

2.7 Wages

Wages are a central determinant of both the competitiveness of the Australian economy, and the standard of living and wellbeing of Australian workers. Wage levels, and their impact on price inflation, have been a key concern for policy makers over last half century.

Wages and levels of inflation

The wage setting process has strong implications for the level of inflation. Across the business cycle, workers have varying degrees of bargaining power. The extent to which industry-specific booms lead to wage growth in other industries driven partly by the locus of bargaining. Throughout the 1970s and early 1980s, Australia's centralised wage setting processes allowed little flexibility to adjust relative wages across industries. With centralised wage setting, secular booms prompted widespread wage growth, leading to high levels of inflation.

The Prices and Incomes Accord[13] was implemented in 1983 in response to the problem of stagflation (high inflation and high unemployment) in the 1970s. There is evidence that the Accord delivered improved macroeconomic outcomes (for example, Chapman and Gruen 1990).

However, the Accord was a policy response to a crisis, and there was tension between the Accord and the longer run direction of Australia's economic reforms in product markets, which intensified competition and opened up the Australian economy to global markets. Centralised wage–setting inhibited the efficient allocation of labour among industries and firms facing differing commercial environments. Enterprise bargaining was introduced in 1993, allowing the negotiation of wages and conditions at the enterprise level. Since the introduction of enterprise bargaining in 1993 and inflation targeting the following year, inflation has been less volatile and has not been a central issue for policymakers.

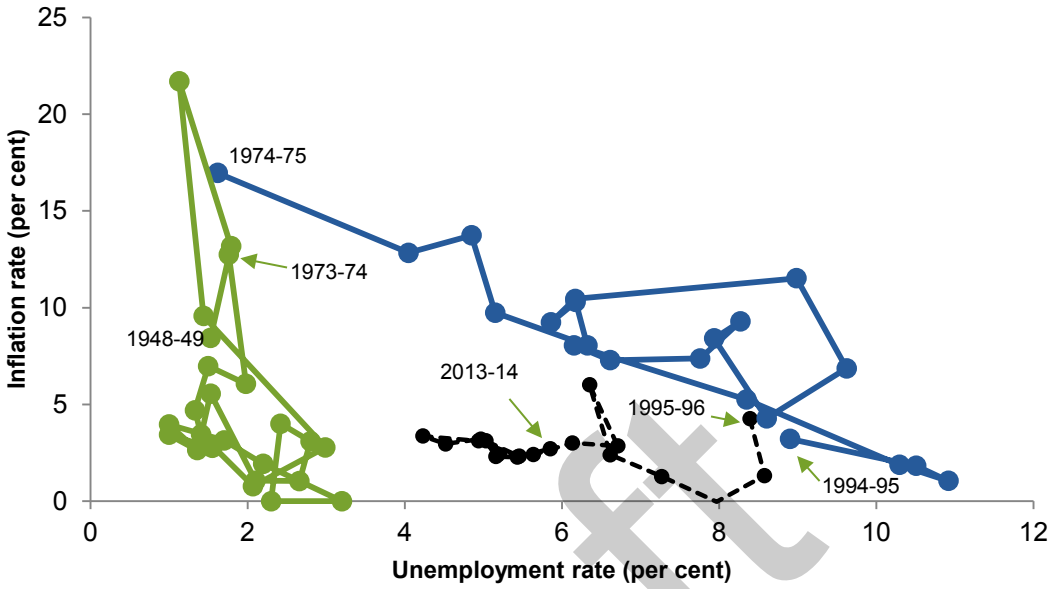
Wage shocks that affect one part of the economy (as in the resources boom) do not appear to now reverberate so greatly throughout the rest of the wage system (Borland 2012). An Assistant Governor of the Reserve Bank of Australia has noted:

> During these earlier booms, inflation had been more variable and Australia's centralised wage-setting system had the effect of spreading wage increases across the economy, to occupational categories for which the value of marginal product had not increased. Not surprisingly then, the result was a rise in inflation and unemployment. (Kent 2012, p. 26)

As the mining boom has abated, so have wages in the mining and construction industries. Indeed, in the latter case, a key union in Western Australia has suggested that it may accept a new enterprise agreement that reduces some wages by around 20 per cent (Barrett 2014). More broadly, the distribution of wage growth has recently shifted toward lower increases, compared with the decade average (Kent 2014b).

[13] The Prices and Incomes Accord involved an agreement between the Australian government and the ACTU to moderate wage demands.

Figure 2.24 **Prices are now less responsive to strong labour demand**
1949-50 to 2013-14[a]



[a]The relationship is typically referred to as the 'Phillip's curve' and is based on the premise that at some point lower unemployment creates inflationary pressures. Borland (2012) investigated the relationship between unemployment and wage pressures, finding a similarly flatter Phillips curve after the introduction of enterprise bargaining.

Sources: ABS 2014 *Labour Force Australia, Detailed*, Cat. No. 6291.0.55.001; ABS 2015, *Consumer Price Index, Australia*, Cat. No. 6401.0; Wither, Endres and Perry (1985).

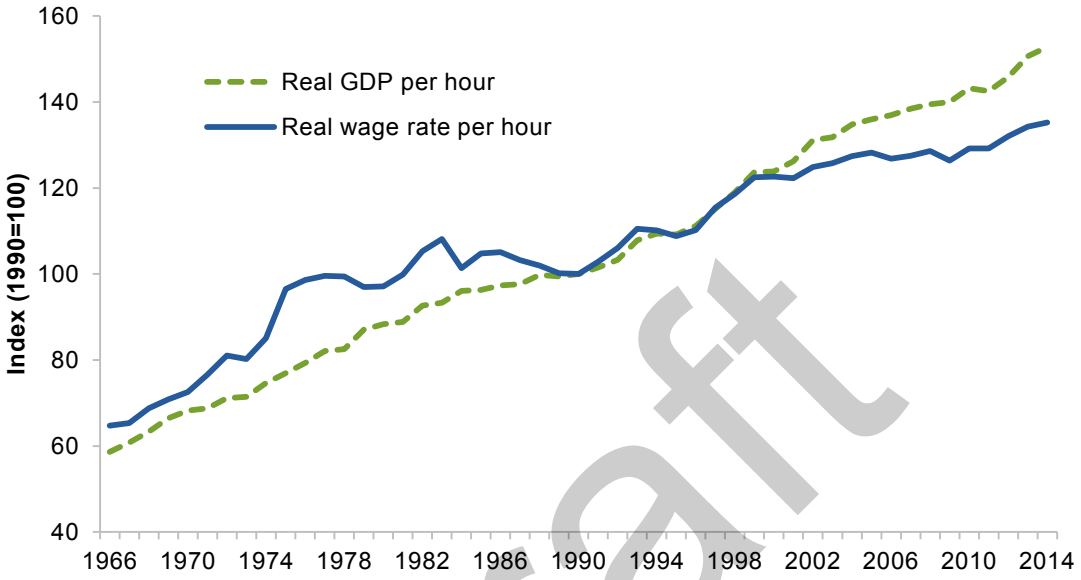
Real wages and labour's share of income

A high–wage economy is a natural aspiration of any country. However, real wages divorced from growth in productivity cannot be sustained in the long run. Excessive wages that exceed productivity growth can lead to higher levels of unemployment or substitution of capital for labour at rates that would not otherwise have been experienced. Consequently, growth in labour market opportunities may be inefficiently restricted. Many have credited Australia's relatively high levels of employment growth throughout the 1980s to the wage restraint associated with the Accord.

Claims of economywide wage breakouts (in excess of labour productivity) appear unfounded. Where wages growth exceeds labour productivity growth, the labour share of income increases. Over the last 50 years, Australia has seen periods where wage growth has outpaced, tracked and fallen behind labour productivity growth. Strong wage growth from the early 1970s outpaced labour productivity growth, increasing labour share of national income from below 70 per cent to over 75 per cent in 1983. From the early 1980s, the introduction of the Accord mitigated wage growth, returning labour share of income to previous levels of around 70 per cent. Wages growth tracked productivity growth over the

1990s, before the two series departed from 2000 onwards, with increases in labour productivity outpacing wage growth (figure 2.25).

Figure 2.25 **Trends in real wages and labour productivity growth**[a]
1966 to 2014



[a] Both series are deflated by the GDP implicit price deflator.

Sources: Productivity Commission estimates based on ABS *Australian System of National Accounts, 2013-14*, Cat. No. 5204.0; ABS *Labour Force, Australia, Detailed, Quarterly, Feb 2015*, Cat. No. 6291.0.55.003; RBA (1997) table 4.7 and 4.12.

Rising income inequality

In Australia, inequality of income has been rising in recent years. In its report on trends in income distribution, the Productivity Commission found an increase in the Gini coefficient for both individual and equivalised household income from 1988-89 to 2009-10 (Greenville, Pobke and Rogers 2013). [14]

Several factors have contributed to this trend. A key determinant of increased inequality has been a widening dispersion of hourly wages for full–time employees and growth in part–time work. Higher growth in capital income among high–income households has further contributed to increasing household inequality.

[14] The Gini coefficient is a measure of income inequality, taking a value between zero and one, where zero implies complete equality (all individuals receive the same level of income) and one implies complete inequality (all income goes to one individual). Equivalised household income controls for household size by dividing total household income by a weighted sum of persons in the household. The first adult is allocated a weight of 1, while addition adults are weighted at 0.5 and children weighted at 0.3.

On the other hand, the effect of wage dispersion and growth in capital income has been somewhat offset by a decrease in the share of jobless households. Moreover, growth in the value of government benefits have further mitigated the effects of increasing wage dispersion on income inequality.

This reflects the notion that the tax and social welfare systems are important means to address inequality of incomes. While aspects of the workplace relations system contribute to this — for example, the Federal Minimum Wage — they may not always be the most effective instrument. As noted above, the long-term relationship that matters is the linkage between labour costs and productivity. Inequality may be most observable in the labour market, but that does not indicate that it best managed by that market alone.

2.8 Workplace relations and the future of work

A former high court judge has noted the power of the past in industrial relations:

> The past is another country. It is a place safer for people like me to dwell than in the industrial present or the future. Judges live with the past, surrounded by its stories in their books, from which they seek to derive logical analogies and the great streams of principle that will promote consistency and predictability in decision-making. (Justice Kirby 2004)

This backwards-looking perspective is a necessary feature of legal judgments, though not for wage determination, nor for policy development.

The question then is how a good workplace relations system can take account of current and impending labour market developments in a nuanced way. This involves several broad considerations, which are set out in greater detail below. But the essential narrative involves two themes:

- the institutions must function well and have sufficient discretion and powers to be responsive to changing circumstances, and the law should permit employers and employees to engage with each other in ways that cater for inevitable changes in business models and preferences of employees
- while useful, forecasts of what may actually happen over the *longer run* can distract policymakers from the more important task of creating a WR framework that:
  - provides a safety net and above that options for employees and employers to tailor outcome to their changing circumstances
  - continually gathers intelligence about developments in workplaces and is then amenable to efficient change when that is needed.

The time horizon and the nature of changes

The time horizon for any appraisal of the future, and the nature of the change being examined, influence the reliability of any views about future labour market developments.

Other than when there are abrupt shifts in the business cycle, short run forecasts of labour market trends are likely to be reliably inferred from recent trends. The technologies and new business models that can transform labour markets do not happen overnight (see below). As shown in this chapter, many aspects of the Australian labour have been relatively stable (such as tenure and casualisation), and for the next few years, it is unlikely that this will change dramatically. However, emerging developments in labour markets can still have an important bearing on workplace relations policies. For example, the ongoing trend to a '24/7' economy, and growing preferences by consumers for services on weekends is likely to continue unabated.

For some aspects of the labour market, it is also possible to forecast over long horizons with reasonable certainty. The average age of the working population will increase with demographic change, therefore raising the share of people who are mature aged. The latter will be reinforced by the long running trend towards higher participation rates by older Australians. The ageing workforce is clearly closely connected to policies in the retirement income system, but less so to workplace relations, especially as one of the potentially significant issues — discrimination — is already covered by a variety of workplace laws. A concomitant aspect of an ageing population is that industrial structure will tend to shift to consumption patterns that reflect the needs of that population — such as in health and aged care services.

The trend towards greater female participation in the workforce is likely to also continue (albeit at a slower rate than previously) as it has been such a longstanding feature of the labour market, and that involvement is now strongly supported by other policies. The educational qualifications of the working age population are also likely to rise as the cohort of younger well-educated people ages.

Social changes that involve a greater role by men in caring for children also seem highly probable given that this growing role has been apparent for some time. The relevance of that change to the WR framework is less clear. The National Employment Standards are gender-neutral and so are already well geared to any such social trends.

Guessing future social trends is not always clearcut. For example, historically, discrimination against women (by statute and attitude) created barriers to employment and lower pay. In the 1950s, the basic wage for women was still set at 75 per cent of the male basic wage (Sheridan and Stretton 2004). Until the 1960s, married women in the Commonwealth public service could not occupy permanent positions. A survey of public attitudes of Woman's Day readers in the mid-1950s found them six to one against married women working in the paid workforce. But then attitudes and finally legislation changed, changing the face of Australia's labour market, and in turn, creating imperatives for future WR changes (such as rights for parental leave). The WR system had to respond to such attitudinal changes as they emerged.

Equally, it is difficult to anticipate the timing, character and impacts of long-run *disruptive* changes to labour markets and previous attempts at doing so have often been wrong. Prognostication often misses the big things, and anticipates radical changes that do not

eventuate. For example, in 1985, one leading scholar said that the 30 hour week may be the norm in the next few decades. There were views that people would change job types and careers frequently. Neither has eventuated, despite their appeal at the time. More recently, the Economist noted:

> The predictions sounded like promises: in the future, working hours would be short and vacations long. "Our grandchildren", reckoned John Maynard Keynes in 1930, would work around "three hours a day" — and probably only by choice. Economic progress and technological advances had already shrunk working hours considerably by his day, and there was no reason to believe this trend would not continue. Whizzy cars and ever more time-saving tools and appliances guaranteed more speed and less drudgery in all parts of life. Social psychologists began to fret: whatever would people do with all their free time? This has not turned out to be one of the world's more pressing problems. (*The Economist* 2014)

It does seem highly likely that the trend towards automation — by no means a new phenomenon — will continue, but it is not clear in which industries and skills this will be most prominent. Notably, unemployment rates are not correlated with measures of multifactor productivity (an indicator of technological change). The implication is that while old jobs disappear, typically new ones emerge. That pattern might change, but it is hard to know with enough certainty that it could be used for policy purposes. By its nature, disruption surprises us. Serendipity is its usual hidden self.

There are likely to be many other conjectures about future changes in labour markets — some well based, and others less so. However, the key design challenge is to develop a system that is responsive, rather than one that embeds (often mistaken) long-run foresights into its structures.

Relevance of future labour market changes to the workplace relations system

There are two general strategies for addressing the future. First, some labour market and economywide developments have been established for some time and are likely to continue, but the WR system does not always adequately catch up with these quickly enough. The risk is that excessive inertia might then forgo future economic opportunities. An example is the continued trend towards a 24/7 and online economy, and the constraints represented by high weekend penalty rates in certain consumer-oriented industries (chapter 14).

Second, a critical source of flexibility in any WR system is the capacity of its key institutions to make decisions that reflect contemporary circumstances, rather than to be overly beholden to history and precedent. The Productivity Commission has recommended major reforms to the Fair Work Commission that would broaden its intelligence gathering capacity and expertise, and that would facilitate a more systematic and principles-based approach to the issues it confronts. These reforms, coupled with strong organisational

capabilities and nimbleness, are one of the best ways of ensuring a WR system that can adapt to uncertain futures.

Ultimately, it is not possible or desirable to entirely future-proof Australia's WR system. The most appropriate policy responses are:

- to ensure that the system is not so elaborate and cumbersome that it cannot readily change to suit new circumstances. The Productivity Commission has proposed a raft of changes that should make the system simpler and more flexible
- at least encourage debate on, and sometimes to set in train, changes that will take some time to implement. For example, the issue of people's preferences for leisure and the existing rigidities that form barriers to that (such as designated public holidays) may require orderly but slow reform. Further, while the notion of an earned income tax credit for Australia has been mooted in the past (Dawkins 2002; Potter 2014), re-visiting a debate where interest has waned can sometimes be useful
- to have a range of work arrangements available to employers and employees that allows them to develop arrangements that suit their circumstances. The Productivity Commission has floated a new type of agreement — 'enterprise contracts' — that would expand the menu of contracting options, and allow more flexibility into the system
- to investigate areas where there appears to be problems across complex interlocking systems (VET and apprenticeship arrangements, training wages and changing industry demands). Apprenticeship wages have been increased for older apprentices, while the Australian Government also provided incentive payments to employers and wage top ups. These affect the relative attractiveness of apprentices, and would be apprentices, with unknown impacts
- to adapt the system as new developments in technology, employment arrangements or social norms occur.

2.9 The bottom line

The workplace relations system is one of many factors that affect labour market performance. Profound changes in Australia's labour market have seen shifts participation and industry structures. There is evidence that contemporary labour markets are more flexible than in the 1980s, which may partly reflect a shift towards enterprise bargaining (though other factors may also have contributed). There is little evidence that casualisation or other non-traditional forms of employment have been increasing in importance over the last decade, except among the young. On average, job security has been increasing. The biggest immediate risk is that all measures of unemployment are now rising, particularly long term and youth unemployment.

3 Institutions

Key points

- While the institutional architecture of Australia's workplace relations system has been the subject of very significant recent changes, some further change is required to deliver better outcomes.
- The Fair Work Ombudsman (FWO) is generally well regarded. Elements of the Fair Work Commission's (FWC's) conciliation activity are also often well regarded. However, the FWC's emphasis on legal precedent rather than analysed impact, and a continued attachment to historically anomalous decisions is restricting its development as an effective institution. Inconsistencies in cases of individual disputes have also been identified.
- Given the volume of tribunal and other matters dealt with, and the contentious and subjective nature of many of these matters, some negative appraisal of the FWC was to be expected and the Productivity Commission's overall judgment is that the FWC is taking a professional approach to internal improvement (although consistency remains an issue).
- Some of the inconsistency arises from choices made by governments, particularly the emphasis on appointing persons with strong commitment to one side or the other of industrial relations debates. Better governance practices are essential for a body with determinative powers on economically important matters operating in a politically sensitive and highly technical space.
  - The processes for appointing Commissioners to the FWC should involve all Australian jurisdictions, be transparent, and ensure that appointments are based on merit.
  - Appointments should be determined by an appointments panel and be made on a fixed term basis (with the potential for renewal), as occurs in many specialist bodies.
- The Australian Government should change the structure of the FWC, and the FWC itself should significantly update its processes for determining the national minimum wage and, most particularly, awards.
  - A Minimum Standards Division should be established within the FWC to undertake the FWC's minimum wage and award functions. Given this Division would hear matters that have economy- and society-wide impacts, Members should have wider expertise than workplace relations.
  - The FWC should not just impartially hear evidence from parties, but also seek out and engage with parties that do not typically make submissions, and proactively undertake data collection and systematic high-quality empirical research as a key basis for its decisions.
  - The FWC should move to give pre-eminence in its decisions to substance over form.
- The FWO is undertaking its education, compliance and enforcement activities in an effective and innovative manner. It is essential to the credibility of any future systemic reforms that sufficient resourcing is provided for the FWO.

The operation of Australia's workplace relations (WR) system is overseen by two key institutions, the Fair Work Commission (FWC) and the Fair Work Ombudsman (FWO). These are the main Australian Government workplace regulators and dispute resolution bodies and, given their importance in the current system, they form the focus of the present chapter. [15]

There are a range of other institutions in the current system which, while important, are not the main focus of the chapter. At the Australian Government level, these include the Fair Work Divisions of the Federal Court and the Federal Circuit Court; and the specialist construction-specific regulator (Fair Work Building and Construction) which has wider powers than the FWC (box 3.1). State and territory industrial relations commissions, which are present in all jurisdictions except Victoria (and of which the Western Australian Industrial Relations Commission has the broadest functions) also play an important, albeit diminishing, role. Considered more broadly, unions and employer associations are also important institutions in the current system.

Box 3.1 The roles of the various other Australian Government WR agencies

Other than the FWC and FWO, institutions with specific workplace relations (WR) functions include:

- the Fair Work Division of the Federal Court of Australia, which has jurisdiction over all civil and criminal matters under the *Fair Work Act 2009* (Cth)
- the Fair Work Division of the Federal Circuit Court of Australia, which provides a simpler, less formal alternative to employment litigation than the Federal Court of Australia, including a small claims proceedings option
- the Australian Competition and Consumer Commission, which is responsible for ensuring compliance with the secondary boycott provisions of the *Competition and Consumer Act 2010* (Cth)
- Fair Work Building and Construction (FWBC), which is responsible for workplace relations in the building and construction industry. While the FWO and the FWC remain relevant, FWBC assumes most of the functions of the FWO for the construction industry, and has special investigatory powers.
- the Road Safety Remuneration Tribunal, which, among other functions, approves road transport collective agreements, conducts research into pay and conditions, and deals with certain disputes between the parties in the industry. The Tribunal was evaluated in 2014, but the Australian Government has not announced its response to the review (with one central issue being the continued existence of the Tribunal).

Sources: Information from the websites www.fairwork.gov.au; www.fwc.gov.au; http://www.rsrt.gov.au; http://www.fwbc.gov.au; and PC (2014b).

[15] As discussed in detail below, while the FWC is often described as 'the tribunal', and the FWO 'the inspectorate', in reality their role and functions are much more varied and diverse than these simple descriptors would suggest.

The chapter is organised as follows.

- Section 3.1 discusses the current institutional setting and, in particular, the roles and functions of the FWC and the FWO as per Parts 5-1 and 5-2 of the *Fair Work Act 2009* (Cth) (FW Act).[16]
- Evidence on the performance of the FWC and the FWO is presented in section 3.2. This includes evidence and argument provided by participants to the present inquiry, as well as past analysis and reviews of performance.
- Reform options, including proposed changes to the structure of the FWC, the appointment process, and operating practices at the FWC, are assessed in section 3.3.

3.1 The current system

The current system of WR institutions in Australia is the result of significant recent change, although, at its core, there is also a high degree of continuity with the past. The FWC, known as Fair Work Australia from 1 July 2009 to 1 January 2013, took over the functions of several predecessor bodies, including the Australian Industrial Relations Commission (AIRC), the Australian Industrial Registry and the Australian Fair Pay Commission (Justice Iain Ross, sub. 171, p. 7). The FWO also has several predecessors, including the Office of Workplace Services and the Office of the Workplace Ombudsman.

In establishing the FWC and FWO, the government of the day placed a recurring emphasis in its public statements on proportionality, flexibility and greater smoothness of process. For example, it proposed that Fair Work Australia (and, by implication, the FWC):

> … will be a modern institution with a user-friendly culture. It is not intended that it will adopt processes that are overly formal, legalistic or unnecessarily adversarial. (Australian Government 2008, p. 340)

In regard to the FWO, the then Government foresaw a graduated approach to its enforcement activities:

> The functions of the FWO emphasise preventative compliance (e.g., through education and advice) and co-operative and voluntary compliance (e.g., through enforceable undertakings). However, in some circumstances it will be necessary for the FWO to enforce compliance more formally, through compliance notices or court proceedings. (Australian Government 2008, p. 386)

While these objectives provide one useful broad metric with which to assess the performance of both institutions some six years on, the most important tests are whether the institutions are efficient and impartial, produce consistent and evidence-based decisions, have the confidence of stakeholders, and have governance and processes that support these outcomes.

[16] In the case of the FWC, it also administers provisions of the *Fair Work (Registered Organisations) Act 2009* (Cth).

The Fair Work Commission's role and functions

Main functions

The FWC's functions are many and varied, mixing what can be called individual, rights-based matters (such as dealing with unfair dismissal, general protections and bullying claims) with more collective matters (box 3.2).

Box 3.2 The broad mandate of the FWC

The FW Act accords an extensive group of functions to the FWC, including to:

- resolve unfair dismissal claims
- deal with applications for orders to prevent bullying at work
- deal with general protections and unlawful termination disputes
- annually review and determine national minimum wages and minimum wage rates in modern awards
- make and regularly review and vary modern awards
- make orders to ensure equal remuneration for work of equal or comparable value
- make orders in relation to the transfer of business
- make orders to facilitate enterprise bargaining (including orders for ballots on protected industrial action and good faith bargaining) and deal with bargaining disputes
- make workplace determinations in certain circumstances in which enterprise bargaining parties have been unable to reach agreement
- approve, vary and terminate enterprise agreements
- make orders to stop or suspend industrial action
- deal with disputes brought to the Commission under the dispute resolution procedures of modern awards and enterprise agreements
- issue, suspend and revoke entry permits and deal with disputes concerning rights of entry
- deal with disputes about stand downs
- promote cooperative and productive workplace relations and prevent disputes
- provide assistance and advice about its functions and activities.

Source: Justice Iain Ross, sub. 171, p. 7.

Structure

The structure of the FWC reflects, in part, its quasi-judicial nature. The Commission comprises a group of 'primary members' that includes the President, two Vice Presidents, and 42 Deputy Presidents and Commissioners. Additionally, there are presently six members of state industrial relations tribunals who hold a dual appointment to the FWC and five Expert Panel members, appointed on a part-time basis, who sit on annual wage

reviews and default superannuation fund assessments. The President has the same status as a Judge of the Federal Court of Australia. FWC Members, in performing their functions, have the same protection and immunity as a Justice of the High Court (s. 580).

Appointment terms for Members vary. The appointment of the President, Vice Presidents, Deputy Presidents and Commissioners are until the age of 65, excepting resignation or termination. Expert Panel members can be appointed for a maximum five years.

Members are supported in their work by administrative staff employed under the *Public Service Act 1999* (Cth). At the end of 2014 there were 299 staff organised into four branches: Client Services, Corporate Services, Regulatory Compliance and Tribunal Services (Justice Iain Ross, sub. 171, p. 9).

Approach

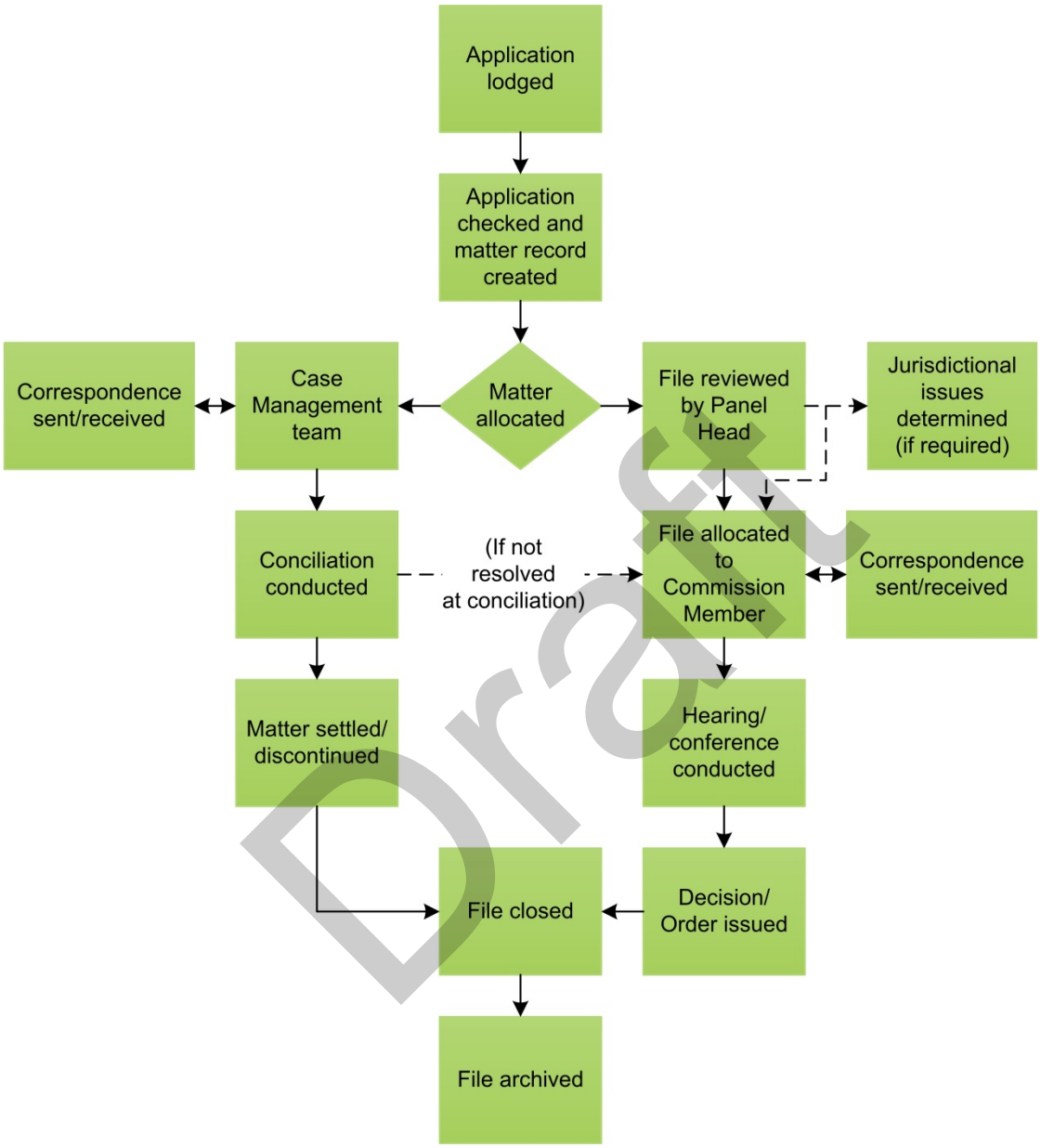
In keeping with the breadth of matters it deals with, the FWC's approach mixes tribunal work with larger deliberations on issues such as awards and the minimum wage.

Much of the work of the FWC is administered through its panel system. There are five industry panels (government services; media, ports, oil and gas; manufacturing and building; mining, agriculture and electric power; and transport, logistics and services) and several specialist panels (dealing with various matters, including anti-bullying, termination of employment, organisations and major resources/infrastructure projects). Two Expert Panels are constituted for annual wage reviews and assessment of default superannuation funds in modern awards. (Justice Iain Ross, sub. 171, pp. 8–9) The President of the FWC has stated that he allocates Members into panels based on experience and expertise.

The FWC uses a triage system in considering most matters, with an emphasis in many areas on the use of conciliation as an alternative to the more costly and time consuming alternative of arbitration (figure 3.1).

The FWC uses full benches in a number of contexts, including appeals on individual matters such as arbitrated unfair dismissal cases; and on award determinations.

Figure 3.1 **FWC tribunal workflow**



Source: FWC, pers. comm, 24 March 2015.

Recent changes in workload

As noted elsewhere, there has been a substantial change in the balance of matters dealt with by the FWC. There is now a far greater focus on individual, rights-based matters, such as unfair dismissal and general protections cases. A much smaller relative share of work is now accounted for by collective matters, such as bargaining, disputes, awards and minimum wage determinations (figure 3.2). As the Law Institute Victoria put it:

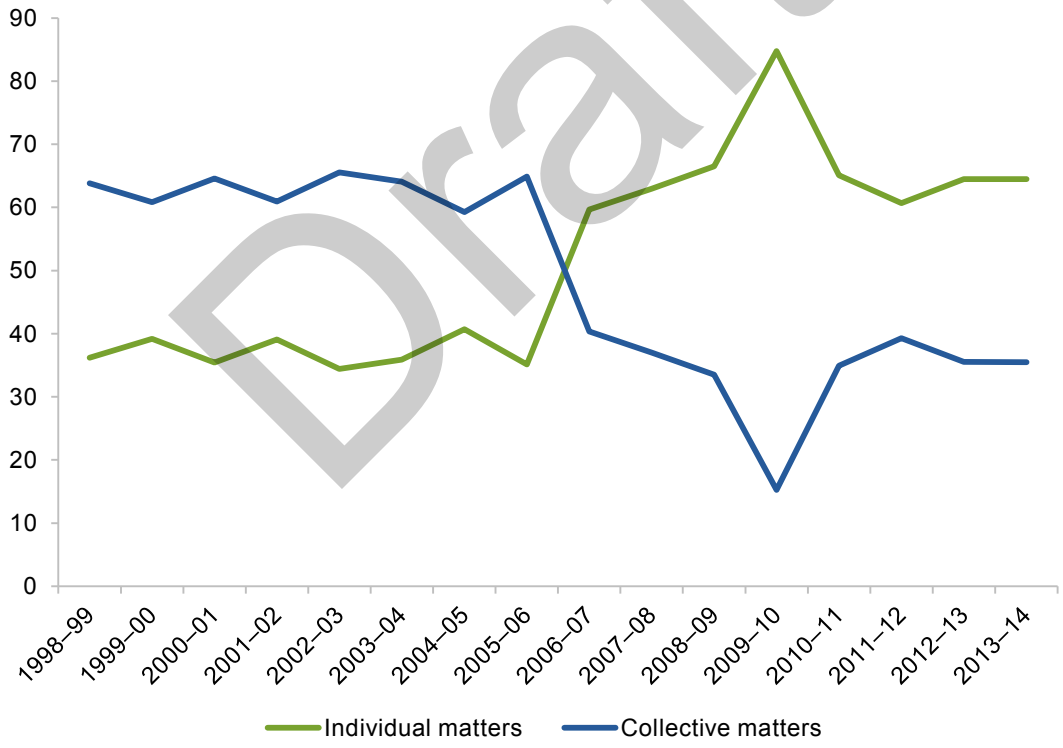
> Fourteen years ago, 65% of the Commission's workload was collective disputes; now, 65% of its workload are individual disputes. The Commission is now, in effect, operating like a court for individuals. The old system of employer and employee associations appearing by right based on full or high membership is no longer valid. (sub 195, pp. 2–3)

This change has been driven, at least in part, by broader changes in the workplace and in workplace law (as discussed in chapter 1). In turn, such changes have also meant that a far greater proportion of FWC matters involve individual disputes considered by individual Members.

Partly in response to such changes the FWC has, since mid-2012, been implementing a program of organisational change under the banner of 'Future Directions' (box 3.3).

Figure 3.2 **The changing nature of the Fair Work Commission's activities**

Share of applications (per cent)



Source: Justice Iain Ross (sub. 171, p. 12).

Box 3.3 Future Directions

In October 2012, Fair Work Australia's President, Iain Ross AO, launched the Future Directions policy (Fair Work Australia 2012b). Based on a process of internal and external consultation, this was intended to provide a multi-staged program of organisational change stretching over several years, grouped under four key themes:

- Promoting Fairness and Improving Access
- Efficiency and Innovation
- Increasing Accountability
- Productivity and Engaging with Industry.

The second stage of this program commenced in May 2014 and involves 30 initiatives to be implemented across 2014-15. These include: an enterprise agreements pilot involving the direct allocation of agreement applications to FWC staff for initial analysis and reporting; a general protections pilot whereby staff conciliators conduct conferences under delegation of the President of some general protections (s. 365) matters; and a pilot program for dealing with certain applications for permission to appeal. A further notable initiative in the context of the current chapter involves proposed assessment of the FWC's performance against the Council of Australasian Tribunal's (COAT) International Framework for Tribunal Excellence. The FWC is proposing to complete this work in 2015-16.

Source: FWC (2015), Justice Iain Ross (sub. 171, pp. 18–27).

The Fair Work Ombudsman

Main functions

The FWO provides information about the roles, rights and responsibilities of actors in the system, monitors compliance with suspected breaches of workplace laws and regulations (for example, under-award payments), and can seek penalties for breaches (through the Federal Circuit Court and the Federal Court of Australia).

In performing its work, the FWO is guided by Part 5-2 of the FW Act (box 3.4).

Box 3.4 The FWO's main statutory functions

The FW Act sets out the main strands of the FWO's role within the workplace relations framework, including:

- promoting harmonious, productive and cooperative workplace relations and compliance with the Act and fair work instruments
- providing education, assistance and advice to employees, employers, outworkers, outworker entities and organisations and producing best practice guides to workplace relations or practices
- monitoring compliance with the Act and associated instruments
- inquiring into, and investigating, any act or practice that may be contrary to the Act, instruments (including modern awards, enterprise agreements, workplace determinations or an FWC order) or safety net entitlements
- where necessary, commencing proceedings in a court, or making applications to the FWC, to enforce the Act, instruments or safety net entitlements
- representing employees or outworkers who are, or may become, a party to proceedings in a court or before FWC, if the FWO considers that representing the employees or outworkers will promote compliance with the Act or fair work instrument.

The Act also requires that the FWO consults with the FWC in producing guidance material that may relate to its functions.

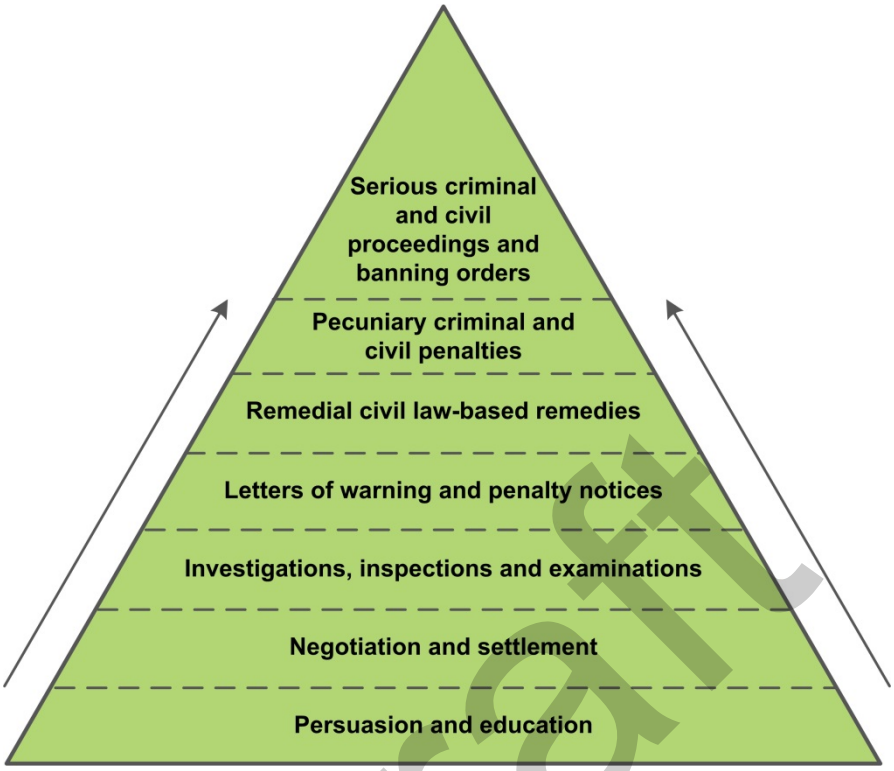
Approach

The FWO's approaches to its functions are set out in its latest Compliance and Enforcement Policy, and include:

- 'softer' measures, such as advice, support and assistant services, campaigns, compliance partnerships and pre-complaint intervention
- 'harder' measures, such as inquiries, investigations, notices, enforceable undertakings and litigation. (FWO 2015c).

This varied approach is broadly consistent with good regulatory practice (figure 3.3), and represents a significant departure from the practices of its predecessor agencies. FWO has undertaken major changes in its delivery model for several reasons, including significant reductions in the agency budget, but also a recognition that the FWO could undertake its activities in a more effective and proportionate way (box 3.5). An important feature of FWO's revised approach is an emphasis on voluntary compliance (Hardy, Howe and Cooney 2013).

Figure 3.3 **Example of an enforcement pyramid**



Source: PC (2010b).

While an emphasis on voluntary compliance is apparent, the FWO has continued to use litigation as part of its approach where warranted:

> Litigation is an essential action for three reasons:
>
> 1. enforcing the law and obtaining court orders sends a powerful public message to others not to engage in similar conduct (general deterrence)
> 2. stopping people from engaging in unlawful behaviour now and in the future makes the need to comply real for individuals (specific deterrence)
> 3. clarifying the law helps the community understand what are the various obligations and rights from Commonwealth workplace laws. (FWO 2015c, p. 26)

However, what differs greatly in regard to the FWO's more recent approach to litigation, is that it is used in a more targeted and strategic fashion, in conjunction with the suite of 'softer' approaches, such as dispute resolution:

> As one [FWO] manager put it, a judgment was made internally 'that running a hundred litigations wouldn't necessarily get you twice the deterrence that running 50 would.' (Hardy, Howe and Cooney 2013, p. 165)

The use of test cases by the FWO is a good example of this more targeted approach.

Box 3.5 The evolution of the FWO's approach

The FWO discussed recent changes in the way it conducts its regulatory activities:

> As a newly formed independent regulator in 2007 (as the Workplace Ombudsman) our focus was on responding to workplace complaints from workplace participants (mostly employees). Our primary response to such complaints was to commence an investigation, often at a point where the workplace relationship had already broken down.
>
> This was a formal and detailed process that proved to be inefficient and very time consuming for all parties involved. Where the employee who had asked for our assistance was still employed, on many occasions, our investigation process also contributed to the deterioration of the employment relationship.
>
> In our experience, the vast majority of employers want to comply with the law. Often, workplace issues arise from employers not understanding their obligations or being confused by the complexity of the workplace relations system. In the past 18 months, the FWO has focused on delivering practical workplace relations advice and on resolving disputes earlier and more efficiently.
>
> We encourage self−resolution by intervening early in workplace disputes, particularly in situations involving employees who are still employed. Our focus is on resolving the dispute as quickly as possible and maintaining the employment relationship. Often, this will involve the FWO directly assisting both the employee and the employer and/or offering a mediation service.
>
> The FWO is also focused on being proportionate and risk-based in our approach to compliance and enforcement. While the vast majority of requests for assistance are resolved through effective and efficient dispute resolution techniques, we continue to conduct investigations and use compliance notices, enforceable undertakings and litigations in cases of serious non−compliance. Specifically, the FWO directs these efforts where we can deliver the greatest impact and benefit, including situations where there is the exploitation of vulnerable employees, significant public interest concerns, blatant disregard for the law, the deliberate distortion of a level playing field to gain a commercial advantage or an opportunity to provide an educative or deterrent effect.

Source: Fair Work Ombudsman (sub. 228, pp. 2–3).

Structure and governance of the FWO

Unlike numerous past Australian inspectorates, the FWO has a considerable degree of independence from government in regard to its location and day to day operations (table 3.1).

The FWO's structure aligns with its functions and also with its revised regulatory approach. As pointed out by Hardy, Howe and Cooney (2013, p. 12):

> The FWO's emphasis on continual change, combined with the resourcing reductions, led to the development of a new organisational structure which appears to place a heavier emphasis on dispute resolution and compliance rather than investigation and enforcement.

Key sections of the organisation, as currently configured, deal with dispute resolution and compliance; advice, support and assistance; proactive compliance and education; and legal and business improvement.

Table 3.1 **Institutional location of the enforcement inspectorate**

Period	*Institutional Location – title of agency*	*Government(s)*
1954–1977	Attached to department	Menzies Coalition; Whitlam Labor
1 March 1978–1983	Statutory authority – Industrial Relations Bureau	Fraser Coalition
1983–1985/86	Attached to department – Arbitration Inspectorate	Hawke Labor
1985-86 – 2006	Within department – Arbitration Inspectorate, Award Management Branch, Office of Workplace Services	Hawke & Keating Labor; Howard Coailtion
March 2006 – June 2007	Executive agency – Office of Workplace Services	Howard Coalition
1 July 2007– current	Statutory authority – Workplace Ombudsman	Howard Coalition; Rudd and Gillard Labor; Abbott Coalition

Source: Adapted from Maconachie and Goodwin (2009).

By the end of 2014 the FWO had 794 employees, with a full-time equivalent staffing of 744. This included 253 Fair Work Inspectors and 106 Fair Work Infoline Advisors (FWO, sub. 228, p. 2).

3.2 How are the institutions performing?

This section examines the effectiveness of the FWC and the FWO in performing the various roles discussed above, drawing on participant views and other evidence.

The Fair Work Commission: participant views

Participant views on the work of the FWC were mixed, ranging from strongly supportive to critical. These views touched on various matters, but can be broadly grouped into three areas:

- the FWC's roles and the structure and governance of the organisation
- its conciliation and arbitration processes and the resulting outcomes
- minimum wage and award processes.

Given the overlap of these areas with other chapters, in particular chapters 5, 6, 7, 8, 11, 12 and 15, the following section should be read in conjunction with those later discussions.

Roles, structure and governance

The role of the FWC was discussed in many submissions. Some stakeholders, including some employers, unions and academics, argued that, while they sometimes disagreed with certain outcomes or approaches, they were nevertheless supportive of its role. For example, Clubs Australia Industrial (CAI) stated:

> Generally, CAI is of the view that the bodies that administer and enforce the various workplace relations laws are performing their functions in a manner which is both efficient and effective, particularly the FWC in its handling of unfair dismissal matters. (sub. 60, p. 45)

Stewart, Gahan, McCrystal and Chapman stated:

> … FWC has earned the right to continue to play a central role in the regulation of employment and workplace relations. (sub. 118, p. 13)

The Australian Council of Trade Unions (ACTU) was also broadly supportive of the FWC and its work, stating:

> Within the footprint of its present functions, the FW Commission is in our experience functioning highly effectively … Unions report the FW Commission processes as generally user friendly, especially compared to other institutions. (sub. 167, p. 350)

This is despite several areas where, in the ACTU's view, improvements were required, including the award review process, the processing of Right of Entry matters, and the inflexibility and delay in the processing of unfair dismissal matters.

Other stakeholders were far less positive. For example, the Australian Federation of Employers and Industries argued that the provisions of the FW Act:

> … were deliberately drafted to enable the FWC to embed itself further into the day to day running of businesses thus preventing business from making the thousands of decisions big and small which are an inherent part of trying to be productive, competitive and profitable. (sub. 219, p. 6)

Of course, to the extent it holds, this is more a criticism of the FW Act than the FWC, which is obliged to follow its enabling legislation.

The Australian Mines and Metals Association (AMMA) called for a complete overhaul of the system, using the model of the Advisory, Conciliation and Arbitration Service (ACAS) in the UK as a starting point, and dismantling the FWC in its current form. It stated:

> Fair Work is a failed organising concept for Australia's employment institutions and legislation … Australia needs a new, properly organised system of tribunals, more specialised and targeted than the existing generalist FWC. (sub. 96, p. 358)

The Victorian Employers' Chamber of Commerce and Industry (sub. 79) also made calls for a radical overhaul along similar lines.

Appointment processes and duration of appointments were a particular source of further adverse comment. One view in this regard was that, in line with the changing nature of its work, the appointment process for FWC members should accommodate appointees with a broader skill set than has previously been the case (see for example: AMMA, sub. 96, p. 362). A more general view was that the lengthy appointment tenure for Commissioners impinged upon accountability. For example, Brendan McCarthy, until recently a Commissioner, stated that:

> Another aspect of the absence of normal types of accountabilities for those that establish standards is the tenure of Members of the FWC. There are other bodies with a legislative or regulatory type role that have been given an independent role by parliament. Those bodies usually have persons appointed to them for a limited term. (sub. 43, p. 7)

The Council of Small Business Australia (COSBOA) said:

> The selection process for commissioners to the FWC needs to become much more transparent and much more competitive. (sub. 115, p. 4)

The Business Council of Australia also stated:

> The appointment process should be subject to public accountability, with roles advertised and information on the interview process and appointment made publicly available at the time of the appointment.
>
> Consistent with other independent offices and good corporate governance, the appointment term for a Commissioner should be time-limited. Commissioners should resign at the end of the term with the option of nominating for another term. (sub. 173, p. 72)

As will be discussed further below, criticisms of appointments to the workplace tribunal have a long history. What is of interest is whether:

- evidence exists of a demonstrable link between appointment processes and prior systematic bias in outcomes that could be avoided
- regardless of whether that is the case, governance changes might be justified on the grounds that a body must not only *be* impartial, but be *perceived* to be so
- whether a clear case can be made on other grounds that reform of such processes will deliver net improvements in outcomes.

Conciliation and arbitration processes and outcomes

The rebalancing of the FWC's workload towards dealing with far more individual matters has meant that conciliation processes are now a critical part of its work.

Several stakeholders were very positive about these processes, arguing that they saved time, reduced travel and other costs, and resulted in outcomes that were generally acceptable to all parties. Conciliation allows disputing parties to recognise that there are often two sides to any story. An early emphasis on conciliation is also in accord with the basic principles of alternative dispute resolution arrangements (Forsyth 2012), since it

avoids an overly adversarial approach and allows parties to be heard, even if they do not get the outcome they like. For example, CAI stated:

> … CAI is of the view that as a whole, the telephone conciliations work very efficiently in these matters. (sub. 60, p. 29)

Others were critical of the conciliation process, arguing that it forced parties to an outcome that was not always fair, and that the FWC's focus on time limits during the process meant that it was a willing driver of this approach. For example, the Catholic Commission for Employment Relations said:

> Based only on real-life experience and anecdotal accounts (as we understand data on merits are not kept for settled cases), it is reasonable to conclude that of the 79% of total cases settled at conciliation last financial year, a not insignificant portion were meritless, without reasonable prospects of success, or vexatious. This presents a public policy problem. (sub. 99, p. 34)

The virtues of conciliation — speed, low costs and compromise — may also sometimes be flaws if the compromises that are accepted undermine public acceptance of the unfair dismissal arrangements or create incentives for employees to seek redress when none should be given. For example, if an employee's expectation is that disputing a dismissal is unlikely to go to arbitration, and that there is a reasonable prospect of at least some compensation through the conciliation process, then this may encourage higher (and unwarranted) disputation rates. Testing the extent to which this holds is very difficult, and views about it often reflect anecdote.[17]

That said, it is doubtful that recourse to costly arbitration should be an easier avenue. The avoided costs of the current model are likely to outweigh the costs of the 'rough justice' that sometimes arises. However, some changes may be warranted. An important focus in this area needs to be on the processes used by the FWC, and on the public transparency of outcomes from these processes. As Southey (2012, p. 9) states:

> A further point worth investigation is the impact of the language used by the conciliator to bring about a settlement and what specific words and phrases trigger an association, in a participant's mind …

While the FWC has commissioned past research that suggests broad satisfaction with the outcomes of conciliated matters (TNSSR Consultants 2010), there are further reforms that would improve conciliated outcomes and the transparency around such outcomes. These are discussed further in section 3.3.

[17] Nevertheless, there is some evidence on this issue, as discussed in chapter 5 and in TNSSR Consultants (2010). For example, the latter found that one of the grounds for settling a dispute was that the settlement was 'reasonable'. Some 55 per cent of applicants and 53 percent of respondents agreed that this was one driver for not taking the matter forward to arbitration (p. 51). On the other hand, 42 per cent of applicants (employees), but only 14 per cent of respondents (employers), reported that 'a feeling that their case would not stand up if it went any further had a medium or high influence on the decision to settle' (p. 53).

Arbitration processes and outcomes were also discussed at length in several submissions (see, for example, Paws a While Boarding Kennels, sub. 71, pp. 8–9; ACCI, sub. 161, pp. 108–127; Major Events Consulting Australia Pty Ltd, sub. 38, pp. 1–2). A recurring theme was the tendency in many FWC decisions to place excessive weight on procedure over substance. [18]

For those stakeholders critical of the outcomes resulting from FWC arbitration, a frequent suggestion was that a dedicated appeals jurisdiction be established, either within the FWC or external to it. This reform is also evaluated in the following section.

The minimum wage and award processes

The processes the FWC uses in undertaking its review of awards and minimum wage cases are discussed in chapters 6, 7 and 11. These discussions find that, while the FWC conducts its award reviews in a competent way, improvements are justified in several areas, including in the diversity of backgrounds of panel members, and regarding the conceptual frameworks and empirical evidence underlying decisions.

In contrast, the Expert Panel in annual wage reviews has a broader set of skills than the award panels, and gives significant weight to economic issues. It also undertakes some research and prepares a detailed statistical summary of the performance of the Australian economy as part of the wage review, to which it gives considerable weight when making its decision. It also sometimes examines empirical issues, where these arise from a requirement to consider a matter specified in the Modern Award Objective of the FW Act (s. 134). For example, in its Annual Wage Review of 2012-13, the FWC discussed the links between minimum wages and productivity (as required under s. 134(1)(f)). In doing so, it considered two pieces of (overseas) empirical analysis.[19] It may be that the FWC could have undertaken more in-depth analysis of what is a complicated issue, but clearly the panel was investigating the issue in a scientific way.

However, while less so than the award panels, it is still evident that the conceptual approach of the FWC's Expert Panel is to have a prior view (often established from past reviews) that must be dislodged by a fresh and compelling piece of evidence, and that absent that, the prior holds. Accordingly, in many cases, the FWC indicates that it is 'not persuaded' (or some similar kind of words) that some past proposition is untrue — effectively putting the onus of proof on a dissenting party. The requirement for new evidence to overturn a prior is reasonable if the prior has strong empirical and theoretical foundations but, in industrial relations as practiced for decades, this is not likely to be the case. It would often be better if the FWC Expert Panel itself re-investigated its priors, and did so, regardless of whether any party had adduced evidence on the matter. Nevertheless,

[18] Similar claims were also made about the emphasis on procedural detail, in the context of FWC's consideration of disputes, in the submission by Teys Australia Pty Ltd and NPH Foods Pty Ltd (sub. 179).

[19] Annual Wage Review 2012-13 [2013] FWCFB 4000 at 175.

the conduct and approach of the Expert Panel on the minimum wage review provides a useful starting approach for reforming award panels.

The Fair Work Ombudsman: participants' views

The views of participants on the FWO's overall performance were, in general, positive. A view expressed by several was that, given recent changes in roles and requirements with regard to such things as enforcement, the FWO had proved to be a nimble and innovative institution that had adapted well to the different demands placed on it across time by government and by the broader community.

Unions also highlighted the effectiveness of the FWO's approach. The ACTU stated in this context:

> The FWO is a regulatory agency of substantial value in the industrial relations system. Its core functions are essentially education and enforcement, both of which it executes well in an objective sense, notwithstanding that we and our affiliates could point to examples of where we consider the advice given by the FWO is not correct. Even in those outlying cases, the FWO have engaged with us to discuss the areas of disagreement or how standard advice might be revised. (sub. 167, p. 347)

The Shop, Distributive and Allied Employees' Association (SDA) was also strongly supportive of the FWO, and stated:

> The SDA expresses its support for the Fair Work Ombudsman particularly for the transparency of its decisions and advice, its increased consultation with employee and employer representatives, its educative role and its prosecutorial function when flagrant infringements of workers' rights have occurred. (sub. 175, p. 72)

The SDA argued strongly that the transparency of FWO's processes stands in stark contrast with that of its predecessor, the Office of the Employment Advocate.

Criticism of advisory and regulatory roles

One notable criticism from some stakeholders concerned the FWO's decision to step out of its normal advisory and regulatory role to participate in the current 4 yearly review of modern awards. For example, Business SA stated:

> Business SA supports their [the FWO's] role as educator and compliance monitor, but has concerns regarding the increasing initiatives by the FWO to provide interpretation on industrial relations matters. Blurring the lines of the educator and interpreter can lead to confusion for employers and employees alike. (sub. 174, p. 18)

Given the important role of the FWO in advising individuals regarding their award entitlements, this was seen by some as a case where the FWO should more appropriately have not been involved in providing such input to FWC.

This criticism ignores clear benefits from the FWO's involvement. To the extent that the FWO has expertise with regard to the operation of awards 'on the ground', it has valuable information and experiences of use in such processes. In its submission to the inquiry, the FWO discussed this involvement as follows:

> As a regulator who has extensive contact with millions of employers and employees each year, the FWO is uniquely placed to assist the FWC to simplify and clarify how awards operate. Our involvement is focussed on providing the FWC with information to clarify aspects of awards that, in our experience, cause complexity and ambiguity for business. (FWO, sub. 228, pp. 4–5)

The FWO also stated that FWC appreciated its involvement in this space, and it is clear that there is a good working relationship between the two agencies.

Some broader criticisms were also made of the FWO's recent approach to enforcement. For instance, Legal Aid NSW stated:

> The FWO seems to have retreated from using its investigative powers and making findings and determinations. Unscrupulous employers we encounter seem undeterred by the possibility the FWO could take enforcement action against them. Bodies such as WorkCover NSW seem much more adept at instilling and enforcing a culture of compliance. (sub. 197, p. 18)

Overall, though, such criticisms were not widespread across the broad swathe of commentary in submissions on the FWO's approach and performance.

Enforceable undertakings: the FWO's approach

A further minor criticism of the FWO concerned its use of enforceable undertakings (EUs) (Ai Group, sub. 172, p. 95). The concern was that the FWO's approach was less flexible and imputed an actual, as opposed to potential, breach, in contrast to the use of EUs by other regulators, such as the Australian Competition and Consumer Commission (ACCC). However, the contexts are different, in particular given that FWO matters will more often involve an individual or individuals that are the aggrieved party. Overall, it appears that the FWO's recent increased use of EUs is measured and effective, although, as has been previously observed by Goodwin and Maconachie (2012), it may be too early to make a final call on the effectiveness of the FWO's approach in this area.

Past evaluations

The performance of the FWO and, to a lesser extent, the FWC, has been the subject of several external reviews since 2009.

A comprehensive performance audit of the FWO was undertaken by the Australian National Audit Office of its workplace services in 2012 (ANAO 2012). The report was generally positive regarding this aspect of the FWO's operations, but recommended greater use of risk management in prioritising service delivery offerings, and a more comprehensive reporting of the outcomes for users of the FWO's services. A broadly

positive review was also undertaken of the FWO's approach to compliance and enforcement by the Centre for Employment and Labour Relations Law (O'Neill 2012a).

The activities of both the FWC and the FWO were also considered as part of the 2012 review of the FW Act (McCallum, Moore and Edwards 2012).

Technology and information management

This inquiry has not examined the information systems and supporting technology of the FWC or the FWO in any detail. However, it is apparent that there is scope for increased sophistication in this area (for example in recording conciliation outcomes at the FWC and the underlying factors that might inform those outcomes and the linking of data from calls to the FWO and its compliance functions).

Recent improvements, such as those made by the FWC to its CMS+ data system and discussed in (O'Neill 2012a), are indicative of some much needed progress in this area. The relative sophistication of the FWC's systems when compared with many of the other courts and tribunals examined in the Productivity Commission's Access to Justice inquiry (PC 2014a), should also be noted.

Summing up

There are a wide range of views about the performance of the two key institutions, and some external reviews. While both institutions are generally regarded with respect, the FWO received much more uniformly positive appraisals. There is no evident need for changes to the FWO, except in relation to an expanded role for the FWO on unions' right of entry to enterprises — as discussed below.

Given the volume of tribunal, inspectorate and other matters dealt with by the FWC, and the contentious and subjective nature of many of these matters, some level of negative appraisals would be expected for this body. Losing inevitably begets dissatisfaction. It is also the case that some of the complaints about the FWC reflect flaws in the FW Act, not the FWC itself. For example, as formulated, the 'better off overall test' (BOOT) is an inherently hard test to apply.

Nevertheless, there are sufficient concerns raised by participants and arising from the empirical and qualitative analysis in other chapters in this report, to investigate possible institutional reforms.

3.3 Reform options

This section considers a number of reforms, mostly applying to the FWC. These are supplementary to reforms proposed elsewhere in the report, including in regard to the

FWC's frameworks and practices in decisions on agreements. These are discussed in chapter 15.

Changing the structure of the FWC

The institutional structure for dealing with workplace matters in Australia is the result of considerable historical change. While much continuity with past approaches and functions can be observed in the current working of the FWC and FWO, there has also been a significant amount of innovation in the workings of both organisations that has ensured that they are very different bodies to their predecessors.

Participants in the present inquiry had at times diametrically different views on what further, if anything, needs to change regarding the main institutions. For example, Andrew Stewart and others (sub. 118) and John Buchanan (sub. 131) argued that present arrangements were working well, with both institutions garnering widespread support for their work, netting out the occasional difference on specific decisions. In this view, more major changes would not be justified given the performance of the WR system since 2009.

Other participants, including the Business Council of Australia, AMMA and VECCI, called for more radical reforms. In the case of AMMA, their proposal would require the abolition of the FWO and the FWC in their present forms, with reconstitution of the system into a series of specialised institutions, including an Employment Conciliation and Arbitration Service, Employment Tribunal, Employment Appeals Tribunal, Employment Safety Net Commission and Employment Ombudsman (sub. 96, p. 360).

Much of the analysis in this report touches on three main institutional functions within the workplace relations system:

- ombudsman functions (broadly defined, as is the case in the current FW Act)
- tribunal functions, as currently performed by FWC in regard, for example, to unfair dismissal cases
- broader determinations on matters with economy wide impacts, such as awards decisions and minimum wage setting.

While the Australian system, as currently configured, has two key institutions sharing these roles, other countries, such as the United Kingdom, have chosen a more separated structure, of the type outlined in AMMA's submission.

Establishment of a Minimum Standards Division

The Productivity Commission is not currently of the view in this Draft Report that radical change in the architecture of Australia's WR system is required.

Nevertheless, an improved institutional approach, particularly around the functions fitting under the third category above, is attainable, and would deliver considerable benefits within the FWC and more broadly. Better governance practices are essential for a body with determinative powers on economically important matters operating in a politically sensitive and highly technical area. In the Productivity Commission's view, therefore, separating the FWC into two distinct divisions, with different senior personnel, is required.

For annual minimum wage reviews currently, the full bench includes expert members with a range of different experiences — there are no expert members presiding over the award reviews. For award reviews, the members of the full bench usually have either a legal or industrial relations background. According to Brendan McCarthy (sub. 43, p. 8), '[t]he members of the FWC seem to have more expertise in dispute resolution and determination but that expertise does no[t] generally include expertise in examining and determining minimum employment standards'.

Having award reviews carried out by Commissioners of a quasi-judicial body is likely to influence its outcomes. The legal and industrial relations disciplines are clearly very important for many of the quasi-judicial decisions of the FWC, such as in matters like adverse action and unfair dismissal. In contrast, the determination of minimum wages and conditions involves balancing social and economic objectives and the process should be informed by a detailed assessment of empirical evidence. There should be a greater reliance on the use of the social science disciplines (such as economics, social science, commerce or equivalent disciplines) in reaching conclusions about wages and conditions (in awards and the minimum wage).

While much of this type of work can already be commissioned by the FWC as part of the review process, there is a difference between information from an expert, and decisions by one. The FWC therefore needs not only the internal expertise to undertake and interrogate research, but Commissioners with the expertise to use that evidence to make considered determinations.

Under a reconfigured FWC, a Minimum Standards Division would have responsibility for wage determination, and would undertake the annual wage review and make award determinations. Its members should primarily have expertise in economics, social science and commerce, not the law.

A Tribunal Division would continue to be responsible for the quasi-judicial functions of the FWC, such as decisions relating to unfair dismissals, adverse actions, anti-bullying, approval of agreements, rights of entry and industrial disputes. Its members should have broad experience and be drawn from a range of professions, including the law, commercial dispute resolution, ombudsman's offices and economics.

Structural changes of this nature will take some time, but action on some fronts is needed, and can be taken now. The FWC already has the capacity to appoint more experts as advisors to its members and to take an activist and evidence-based approach to an

assessment of awards. A change in mindset requires no legislation, and a move in this direction under the strategic guidance of the President will be a major step.

The processes for appointing members of the FWC also require reform, and these are discussed further below.

DRAFT RECOMMENDATION 3.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) to establish a Minimum Standards Division as part of the Fair Work Commission. This Division would have responsibility for minimum wages and modern awards. All other functions of the Fair Work Commission should remain in a Tribunal Division.

Changing appointment processes at FWC

Claims of 'stacked' appointments in the workplace tribunal have a long history in Australia, essentially dating back to inception (box 3.6).

Box 3.6 Allegations of tribunal stacking – a brief history

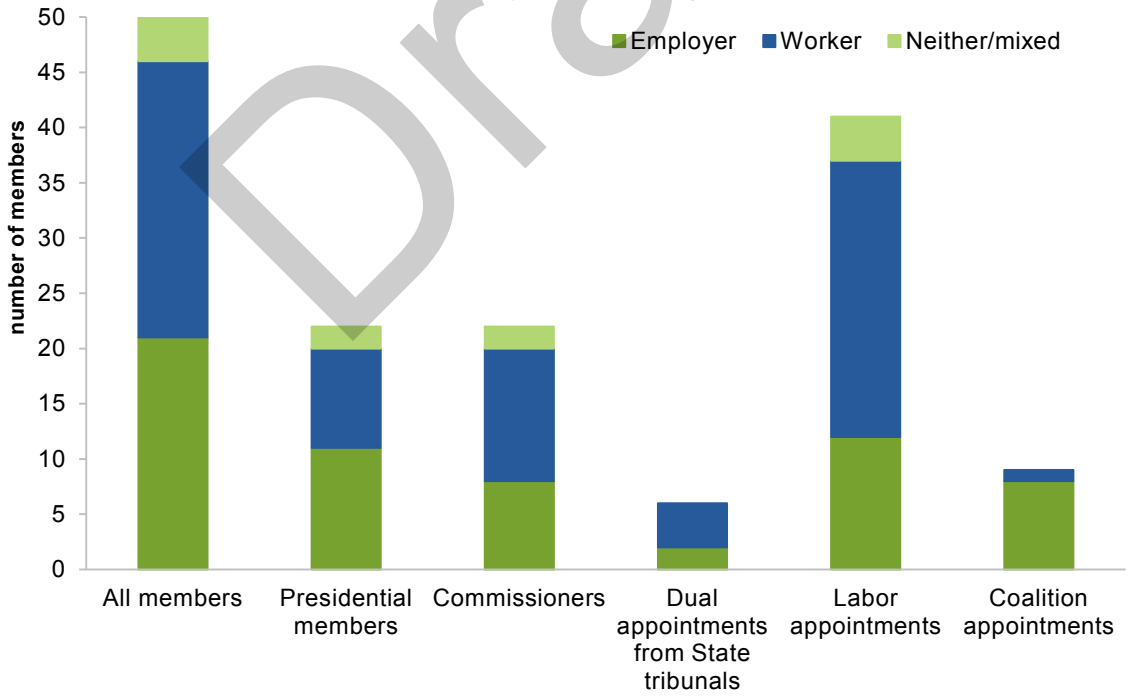
Allegations of stacking regarding the selection of tribunal members date back to the appointment of Justice Higgins in 1907 (Southey and Fry 2012). The following is a selection of past quotes on this topic.

> The federal government must take much of the blame for the Commission's current problems. For some years now its appointments to the Commission have been biased in favour of the trade union movement, thus destroying the balance which had previously been so important in maintaining the Commission's credibility. (The Sydney Morning Herald 1994)
>
> The unions claimed Mr Reith had breached a longstanding political tradition of making balanced appointments to the Commission. They also claim he broke convention by failing to discuss the appointments with the trade union movement. (Shaw 2001)
>
> The Government had stacked the AIRC to shore up its conservative workplace agendas and to suit its political purposes. They are trying to destroy the independent umpire and undermine bipartisanship and political neutrality in industrial relations. (Sharon Burrow, reported in Robinson (2001))
>
> Kelty claimed that the National Wage cases were 'rigged' to favour employers. Kelty referred here to the role of the President in composing the bench for such cases. By his reckoning, there were fifteen members with employer backgrounds, seventeen with union backgrounds and thirteen 'independents', yet he found that those with employer backgrounds made up a majority of the bench in nearly half of the National Wage Cases. (Macintyre 2004)
>
> When Howard was in power, the ACTU strongly criticised the Coalition Government of political and employer bias in appointments to the Australian Industrial Relations Commission. It would seem the lessons of the past have not been learnt by this Labor government … Let's hope that the future IR policy is not based on the whim of self-interest and a truly stable, independent and transparent FWA becomes the norm for Australia's interests. (Gollan 2013)

The possibility of inconsistencies in unfair dismissal decisions is discussed in chapter 5. The research found evidence of outcomes at the margin, which depended on the workplace background of commissioners involved (Booth and Freyens 2014). This is supported by earlier research finding that at 'pinch points' in decision making, the past professional history of decision makers can be a significant predictor of outcomes (Southey and Fry 2012).

Several submissions discussed this issue at some length. Stewart and others (sub. 118) stated that the present composition of Commission members is not unbalanced and, in support of their view, presented a breakdown of current appointees by background (figure 3.4). The figure nevertheless shows that successive governments favour certain backgrounds over others, and that there are very few members who are not drawn from employer or employee groups. Moreover, even if the average direction of inconsistencies was zero, many decisions are made by a single member, which means that there will be inconsistencies in decisions across members. The ideal would be that parties coming to the FWC would be indifferent to who was assigned their case.

Figure 3.4 **Pre-appointment background of FWC members as at March 2015**[a]



[a] All figures exclude part-time appointments to Expert Panel only.

Source: Andrew Stewart and others, sub. 118, p. 14.

Appointment durations

As discussed earlier, several participants argued that the very long possible appointment periods for commissioners (until the age of 65 years) entrenched problems, and were not consistent with current practice in other key public institutions.

A number of current commissioners have had long running appointments. Data on existing members suggests that the average duration of current appointments is around 6 years, with some members having served for close to 15 years[20]. Given that most existing members can be expected to continue to serve for some time, it suggests that the average duration of tenures at the FWC will be considerably longer.

There are several tradeoffs in determining appropriate appointment lengths. Longer appointments allow the development of expertise and knowledge across the broad swathe of matters considered by the FWC. Tenure for judicial appointments is also intended to remove the risk of influence regarding reappointments. On the other hand, excessively long tenures must, by definition, limit the inflow of members with different perspectives and expertise. In addition, in practice, it is hard to dismiss an underperforming member (and there is no organisation that is free of the risk of some underperformance). Limited tenures provide at least a vehicle for addressing this (albeit rather slowly).

Long tenures may reduce the momentum for moving away from an overly legalistic approach.

A balanced solution would be the introduction of a system of five year appointments for new Members, with reappointment for a further five years subject to a merit-based review of commissioner performance by an external party. This proposed approach would provide for terms of long enough duration for the development of skills and knowledge, while also providing limits to ensure greater accountability and to provide options for other talented people to become commissioners.

Appointment processes

At present, appointments of Members of the FWC are made by the Governor General in Council on the recommendation of the Australian Government of the day (Justice Iain Ross, sub. 171, p. 8). Opening up this process to provide for a far broader range of skills, greater input from state and territory jurisdictions and a more balanced, less partisan representation seems highly desirable in the light of:

- the very significant shift of activity from collective to individual dispute resolution in recent years
- some apparent bias issues connected to appointment processes by Governments

[20] This includes appointment within predecessors of FWC.

- the existence of a wide range of skills that are not represented on the Commission (for example, professional dispute resolution practitioners)
- the likely future development of the FWC under the recommendations of this inquiry, in particular the establishment of a Minimum Standards Division and the greater use of research and analysis to arrive at decisions rather than persisting with an historical reliance on form and on precedent.

Drawing on features from appointment models such as those currently in use to determine membership of the ACCC would be one way to achieve such improvements (box 3.7). This model has, over time, proven to be a successful way to obtain input from across the jurisdictions in regard to appointments.

Box 3.7 Appointments to the ACCC

The 1995 Conduct Code Agreement sets out the following process for the Australian Competition and Consumer Commission (ACCC) appointments:

> 4 (1) When the Commonwealth proposes that a vacancy in the office of Chairperson, Deputy Chairperson, member or associate member of the Commission be filled, it will send written notice to the Parties that are fully-participating jurisdictions inviting suggestions as to suitable persons to fill the vacancy. The Commonwealth will allow those Parties a period of thirty five days from the date on which the notice was sent to make suggestions before sending a notice of the type referred to in subclause (2) or (3).
>
> (2) The Commonwealth will send to the Parties that are fully-participating jurisdictions written notice of persons whom it desires to put forward to the Governor-General for appointment as Chairperson, Deputy Chairperson or member of the Commission.
>
> (3) The Commonwealth will send to the Parties that are fully-participating jurisdictions written notice of persons whom it desires to put forward to the Commonwealth Minister for appointment as associate members of the Commission.
>
> (4) Within thirty five days from the date on which the Commonwealth sends a notice of the type referred to in subclause (2) or (3), the Party to whom the Commonwealth sends a notice will notify the Commonwealth Minister in writing as to whether the Party supports the proposed appointment. If the Party does not notify the Commonwealth Minister in writing within that period, the Party will be taken to support the proposed appointment.
>
> (5) The Commonwealth will not put forward to the Governor-General a person for appointment as a Chairperson, Deputy Chairperson or member of the Commission unless a majority of the fully-participating jurisdictions support, or pursuant to this clause are taken to support, the appointment.
>
> (6) The Commonwealth will not put forward to the Commonwealth Minister a person for appointment as an associate member of the Commission unless a majority of the fully-participating jurisdictions support, or pursuant to this clause are taken to support, the appointment.

Source: National Competition Council (1995).

This would involve the following main features:

- All Australian governments would be consulted in jointly determining the members of an expert appointment panel, which would advertise FWC positions, independently assess candidates on their merit and make recommendations on the appointments of FWC Members.

- The relevant Australian Government Minister would then choose members from the shortlist for a fixed tenure (with the potential for renewal). Both the panel and the relevant minister would need to be satisfied that the person would be widely seen as having an unbiased and credible framework for reaching conclusions and determinations.
- It should be a requirement that panel members should have experience in board or senior executive selection rather than previous direct roles in industrial representation or advocacy.
- The selection processes for membership of the FWC would stipulate that prospective applicants may include those with a broad experience, and be drawn from a range of professions. Given the different work conducted by the two proposed Divisions within a reformed FWC, separate eligibility criteria would assist.
- Written guidelines on conflicts of interest specific to the task are also highly desirable.
- Structural changes of this nature will take some time, but action on some fronts is needed, and can be taken, now. The FWC already has the capacity to appoint more experts as advisors to its members and to take an activist and evidence-based approach to an assessment of awards. A change in mindset requires no legislation, and a move in this direction under the strategic guidance of the President would be a major step.

This proposed appointment process is shown in figure 3.5.

The above model would reduce the risks of partisan appointments, while giving state and territory governments a bigger say in a system that regulates most of the employees in their jurisdictions. In retrospect, it is surprising that in referring their IR powers, the states and territories sought no role in the governance arrangements.

It would over time lead to greater transparency and the capacity to use an expert panel to make appointments without fear or favour. The fact that a considerable number of current FWC members are reaching the end of their terms will also provide a window for appointing a number of members.

While the above measures should reduce the risk of partisan decisions, the Productivity Commission is aware that no appointment process will be perfect. The goal is the more realistic one of reducing imperfection, rather than achieving perfection.

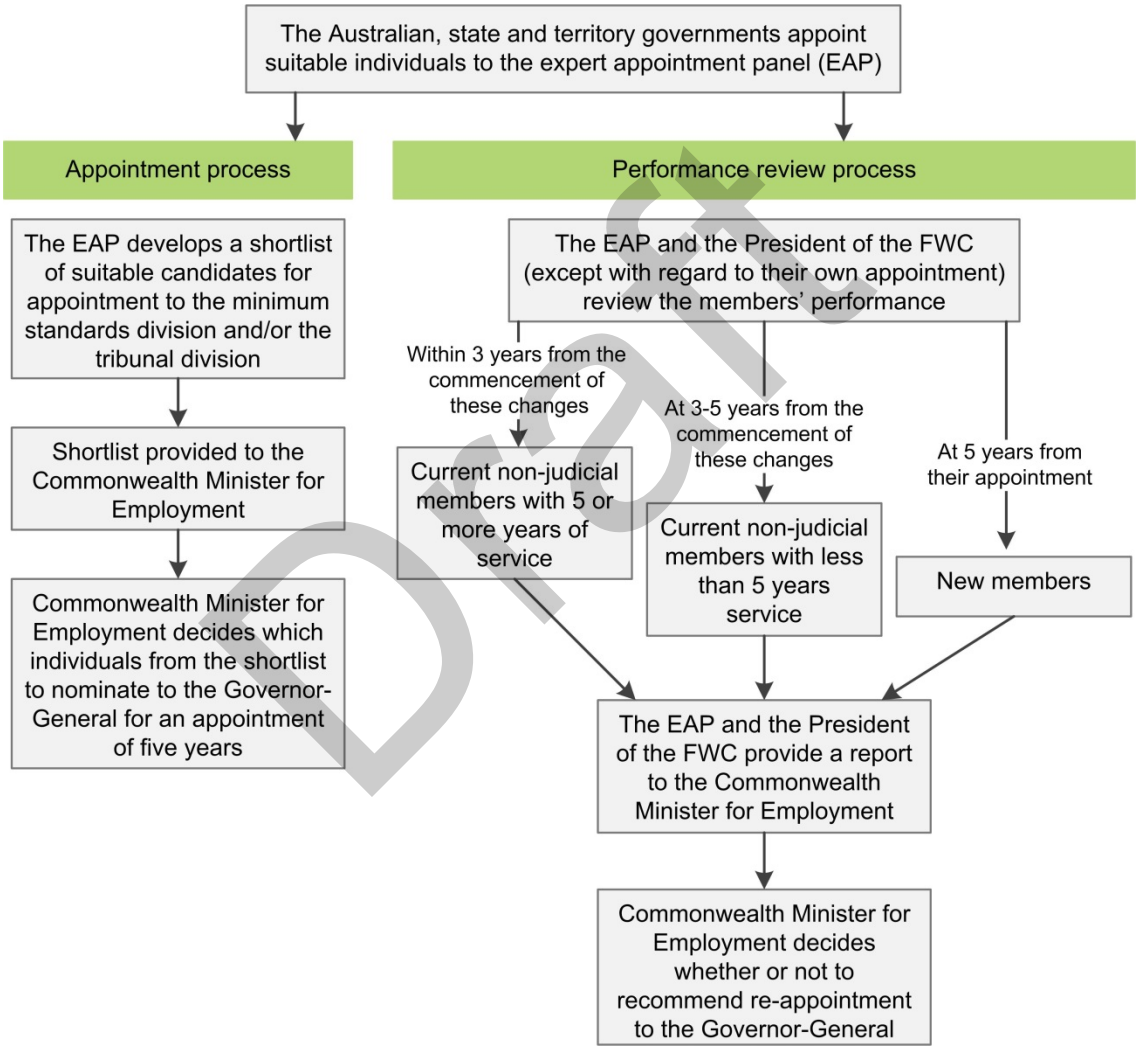
Different processes for new and existing Members?

Over the medium term, the Productivity Commission's suggested reforms will result in some different outcomes for new and existing Members.

Four current Members, including the President, are judicial officers, and as such are constitutionally immune from the termination of their appointments except in extraordinary circumstances (s. 72 of the Australian Constitution). The protection of judicial officers

from dismissal arises from the pre-eminence given to judicial independence as a separate arm of government, distinct from the legislature and executive, such that this outweighs any concerns that might arise about their performance and efficiency (Evans and Williams 2008). This recognises that judicial officers are far from being ordinary employees, and that making them so would make them vulnerable to political pressures that few would regard as acceptable.

Figure 3.5 **A reformed appointment process for the FWC**



However, the bulk of Members of the FWC are non-judicial appointees (just over 92 per cent), who are not afforded the same constitutional immunity. This status would seem more appropriate to the modern day roles and functions of the FWC and consistent with many other tribunals and determinative bodies. The FW Act itself gives them a high degree of immunity. Under s. 580 of the FW Act, an FWC Member has, in performing his or her functions or exercising his or her powers as an FWC Member, the same protections as many other statutory office holders. At the individual Member level, it is important that

government or the President should not be able to arbitrarily remove a Member. Accordingly, the Australian Government does not have the power to remove a Member on its own account. Nevertheless, the *Parliament* can legislate to change employment arrangements for existing as well as new appointees.

For such Members, a requirement for review of performance at a period of between three to five years, with exact review timing determined by the date at which they were appointed, would be feasible. This would align the review requirements faced by new members more closely with the vast bulk of existing appointees. It would also have the benefit, in the medium term, of providing greater certainty to existing non-judicial appointees regarding the timing of review and possible reappointment.

The Productivity Commission's institutional reform is not aimed at any given member, and does not repudiate the notion that the executive should have limited capacity to dismiss a member except under the circumstances typically applicable to tribunals (O'Connor 2013). Equally, the usual underpinning requirements for independence — security of remuneration, security of tenure for the designated legislated period, and control over the arrangements of the listing and case allocation — should all be preserved (O'Connor 2013).

Instead, the goal of the proposed changes is to align the treatment of existing members to those of new appointees. The goal of those new arrangements is actually to shore up the independence from government of the FWC, not to undermine it. Further, this would also be more consistent with the requirements governing many other appointees to other tribunals. Existing non-judicial officers would still serve a period of time with the FWC, consistent with new appointees.

In many instances, the customary reticence by government to legislate changes that affect existing quasi-judicial officers is caused by reliance on expectations, past practice and concerns about the expense of any such changes. However, when changes are made in other policy areas, such concerns are just one part of the assessment of the relative costs and benefits of change.

Failure to place existing non-judicial officers on a more equal basis with new appointees would slow progress in establishing a body that needs a more diverse membership and one that has greater public confidence. But at least eventually, the FWC would obtain a stature even greater than it currently has, buttressed by the usual protections afforded bodies employing non-judicial officers. On the latter score, it would be desirable that all appointments to the FWC would be of a quasi-judicial nature and time-limited.

DRAFT RECOMMENDATION 3.2

The Australian Government should amend s. 629 of the *Fair Work Act 2009* (Cth) to stipulate that new appointments of the President, Vice Presidents, Deputy Presidents and Commissioners of the Fair Work Commission be for periods of five years, with the possibility of reappointment at the end of this period, subject to a merit-based performance review undertaken jointly by an independent expert appointment panel and (excepting with regard to their own appointment) the President.

Current non-judicial Members should also be subject to a performance review based on the duration of their current appointment. Existing Members with five or more years of service would be subject to review within three years from the commencement of these appointment processes with reviews to be staggered to reduce disruption. Non-judicial Members with fewer than five years of service would be reviewed at between three to five years, depending on the date of their appointment.

DRAFT RECOMMENDATION 3.3

The Australian Government should amend the *Fair Work Act 2009* (Cth) to change the appointment processes for Members of the Fair Work Commission. The amendments would stipulate that:

- an independent expert appointment panel should be established by the Australian Government and state and territory governments
- members of the appointment panel should not have had previous direct roles in industrial representation or advocacy
- the panel should make a shortlist of suitable candidates for Members of the Fair Work Commission against the criteria in draft recommendation 3.4
- the Commonwealth Minister for Employment should select Members of the Fair Work Commission from the panel's shortlist, with appointments then made by the Governor General.

DRAFT RECOMMENDATION 3.4

The Australian Government should amend the *Fair Work Act 2009* (Cth) to establish separate eligibility criteria for members of the two Divisions of the Fair Work Commission outlined in draft recommendation 3.1.

Members of the Minimum Standards Division should have well-developed analytical capabilities and experience in economics, social science, commerce or equivalent disciplines.

Members of the Tribunal Division Membership should have a broad experience, and be drawn from a range of professions, including (for example) from ombudsman's offices, commercial dispute resolution, law, economics and other relevant professions.

A requirement for the Panel and the Minister for Employment respectively is that they be satisfied that a person recommended for appointment would be widely seen as having an unbiased and credible framework for reaching conclusions and determinations in relation to workplace relation matters or other relevant areas.

A need for an enhanced appeals mechanism?

A related issue raised by several stakeholders regarding FWC decision making is the extent to which review and appeal of decisions is effective under current arrangements.

While appeals are presently dealt with by the FWC through the appeals full bench system, and the Federal Court, there have been some calls for the introduction of a dedicated appeals section, either as a separate area or entity within the FWC, or as a body independent from the FWC. For example, ACCI argued that such a mechanism would:

> … increase the capacity for parties and practitioners to anticipate likely decisions, which in turns helps inform management and litigation strategies. Certainty also serves to reduce the amount of litigation. (sub. 161, p. 148)

Subject to the implementation of the other proposed reforms in this chapter and other chapters, such a reform may not be merited. There is a balance to be struck in this area between adequate oversight of, and transparency in, decision making, and the need to guarantee the independence of the FWC and the efficiency of its processes. The proposed merit based review of Commissioner performance mentioned previously, together with greater transparency regarding conciliation and arbitration processes and outcomes, may go a large way towards solving the problems that those proposing a separate appeals mechanism are aiming to address.

Improving conciliation processes and transparency

There is a need for greater transparency in, and internal and external analysis of, the FWC's conciliation processes.[21] This is particularly the case given that conciliation is becoming a more frequently used method for solving matters at the FWC. An imbalance currently exists between what occurs in conciliations and what is reported. The FWC should be more active in providing information both about the processes it uses for conciliation in various contexts, and on the aggregate outcomes of such conciliations.

The current information published by the FWC regarding unfair dismissal conciliation clearances, settlement amounts, and views on outcomes is useful. But there are good grounds for implementing further reporting of the conciliation process and of outcomes (whilst also acknowledging some limits on this possibility given the more private nature of conciliation processes). The commissioning of an independent performance review of this part of the FWC's operation may also be valuable, along the lines of the recent review of the FWO's performance completed by the Centre for Employment and Labour Relations Law (O'Neill 2012a). This would provide more information about the use of conciliation at the FWC, provide an evidence base for further refinement in this area, and, potentially, allay some concerns about the ways in which conciliation is used at present. Consideration of the possible use of pre-claim conciliation as an additional approach could also be a point of focus for such a review.

The FWC should also publish more detailed information regarding conciliation outcomes and settlements. This should include information to a level of detail that is equivalent to that currently published in regard to unfair dismissal conciliations.

DRAFT RECOMMENDATION 3.5

The Australian Government should require that the Fair Work Commission publish more detailed information about conciliation outcomes and processes. In the medium term, it should also commission an independent performance review of the Fair Work Commission's conciliation processes, and the outcomes that result from these processes.

Right of entry and the investigation role of unions

Employee representatives (such as union officials) granted an entry permit by the FWC have the right to enter workplaces to investigate suspected contraventions of the FW Act, where these relate to a member of their organisation. Entry permit holders are also empowered to inspect workplaces for compliance with state and territory work health and safety (WHS) laws.

[21] Recent publications, such as Fair Work Commission (2015), provide some much needed further detail.

These rights of entry for investigative purposes mean that union officials occupy dual roles within the WR framework, both representing employees, as well as ensuring compliance with relevant employment and WHS laws. This latter role is also performed by government agencies, such as the FWO and state and territory WHS regulators.

Historically, unions have played an important role in the compliance and enforcement of labour and safety standards (Maconachie and Goodwin 2009). However, as the WR system has matured and the resourcing of workplace safety and standards has increased (over historical norms) it is reasonable to ask whether it is appropriate for private parties to be exercising the role of a public interest investigator, normally the responsibility of a government agency. There are arguments both for and against having employee representatives contribute to a compliance role already being undertaken by a government agency:

- On the one hand, by investigating workplaces where their members are employed, union officials are acting in the interests of their members to ensure that they are receiving the working conditions and safety standards they are entitled to. By having an ongoing relationship with members within a workplace, union officials may also be better placed than a government inspector to be informed of any potential breaches of workplace laws. If unions are willing to bear these investigation costs (for example, the salaries of union officials) instead of a government agency, to some extent they are subsidising the enforcement of laws and standards to the benefit of the wider community, as well as their members. Further, consigning enforcement duties entirely to government agencies runs the risk that governments, for example for fiscal reasons, may not be inclined to provide these agencies with the resourcing and powers required to adequately enforce workplace laws in the absence of union enforcement.
- On the other hand, it is unrealistic to expect a union representative, who has the primary duty of representing members' interests, to always act in the public interest. Entry to investigate a workplace can impose costs on the employer through disruptions and administrative costs, and thus may be used strategically as leverage in an industrial dispute (chapter 19). Even where entry rights are exercised with restraint, the enforcement role of unions may be a source of resentment in their relationships with employers. To the extent that the outcomes lead to excessive bargaining power, this is not only inimical to the interests of employers, but also the community as a whole.

The WR framework attempts to reconcile the conflict of interest between unions' industrial objectives and their investigative role by placing some conditions on rights of entry. For example, unions are currently required to provide employers with 24 hours' notice before entering a workplace to investigate a suspected breach. This notice requirement is aimed at minimising the disruption to employers, in effect reducing the ability to use inspections as a tool for leverage. However, the ACTU has argued that this can also alert an offending employer in advance, giving them the opportunity to alter, destroy or conceal evidence of breaches, effectively defeating the very purpose of the entry and investigation power (sub. 167, p. 338).

Such conflicting arrangements will be inevitable in a WR system that affords 'quasi-regulatory' powers to parties that the system also recognises as having other objectives to pursue. By contrast, government agents, such as Fair Work inspectors or state workplace safety officers, do not have a bargaining agenda within a workplace. As such, they are not bound by the same restrictions and notice requirements as employee representatives.

The Productivity Commission has recommended some limitations on the frequency of union entry for discussion purposes, to reduce the use of entries for strategic purposes in industrial or demarcation disputes (see chapter 19). This may require the FWO to expand its enforcement role — and would require commensurate funding commitments by the Australian Government — to adequately counteract any resulting loss of union contributions to enforcement.

However, these changes would not affect the powers of unions to conduct bona fide investigations of workplaces, nor preclude a union from lodging complaints or from taking other steps consistent with their charter to support workers placed in unsafe circumstances. If an employee representative suspects that an employer is breaching the FW Act or relevant WHS regulations following a discussion with their members, they should (and already do) refer the grounds for their suspicion to the FWO or the relevant work safety authority.

4 National Employment Standards

Key points

- The National Employment Standards (NES) specify minimum requirements for 10 conditions of employment — including hours of work, various forms of leave and redundancy pay. Awards, enterprise agreements and employment contracts cannot exclude any elements of the NES, or provide less favourable employment conditions.
- Enhancing or constraining employment entitlements can have much more varied effects than simply redistributing benefits from employers to workers or vice versa. It can also affect employment levels, consumer prices and the ability of firms to sustain or increase workers' wages over time. Increases in workers' entitlements do not come for free.
- The NES as a whole have attracted little controversy, although there are concerns about the details of some elements.
- In the absence of a national standard for long service leave (LSL), national employers must deal with a diversity of qualifying periods and entitlements for LSL across the different arms of their national operations. This creates complexity for business and variations in leave entitlements among Australian workers.
- This has been a longstanding complaint, and the last review of the *Fair Work Act 2009* (Cth) (FW Act) recommended a uniform national approach. However, there remains some uncertainty about the net benefits of moving to a uniform system, the appropriate transition to any such standard, and the scope for some minor simplification of the current system.
- Some stakeholders to this inquiry have raised the proposal for the introduction of a national scheme to provide portability of LSL entitlements. A compelling case has yet to be made that the benefits of such a scheme, at a national level (and in addition to those currently in place), would be sufficient to offset the costs.
- Public holidays can yield community benefits by enabling coordinated social activities, particularly on days of genuine cultural or spiritual significance.
- However, many people treat *some* national public holidays as just normal days off, which throws doubt on their community function. There are arrangements in many awards for employees to choose another paid holiday as a substitute for a public holiday designated by the National Employment Standards. These give employees the freedom to choose alternative days off that better suit their circumstances. The Fair Work Commission should include these arrangements to all awards.
- These changes would not affect the penalty rates for permanent or casual employees.
- The NES should also be amended so that employers are not required to pay for leave or any additional penalty rates on any newly designated state and territory public holidays.
- There is not a strong case for extending the NES paid annual and sick leave entitlements to casual workers so long as casual loadings adequately reflect these forgone benefits. However, there may be scope to offer casual employees an expanded set of employment options in exchange for some part of the casual loading.

Introduced in 2009 as part of the *Fair Work Act 2009* (Cth) (FW Act), the 'National Employment Standards' (NES) are work-related entitlements that employers covered by the national system must provide for their employees.[22] They cover 10 matters including hours of work; flexible work arrangements; public holidays; sick, annual, parental and other forms of leave; and redundancy pay and procedures (box 4.1).

Box 4.1 What are the National Employment Standards?

The National Employment Standards (NES) currently comprise 10 minimum standards, specifying entitlements to:

- maximum working hours — a maximum of 38 hours work per week, plus reasonable additional hours
- request flexible working arrangements — where the circumstances meet the criteria set out in the FW Act
- parental leave and associated entitlements — up to 12 months unpaid leave per employee, plus a right to request an additional 12 months unpaid leave, plus other forms of maternity, paternity and adoption related leave
- annual leave — four weeks paid annual leave per year (plus an additional amount for certain shift-workers)
- personal, carer's and compassionate leave — 10 days paid personal or carer's leave, two days unpaid carer's leave and two days compassionate leave (unpaid for casuals)
- community and jury service leave — unpaid leave for voluntary community and jury service, with an entitlement of up to 10 days paid jury service
- long service leave — a transitional entitlement derived from pre-reform awards and enterprise agreements. (For most other employees access to state and territory statutory long service leave entitlements is guaranteed elsewhere in the FW Act.)
- public holidays — a day off with pay on a public holiday, except when reasonably requested to work
- notice of termination and redundancy pay — up to five weeks' notice of termination and 16 weeks redundancy pay depending on the length of service
- the provision of a Fair Work Statement — which contains information on the NES, modern awards, agreement making, individual flexible agreements, the right to freedom of association, termination of employment, union rights of entry, transfer of business and the roles of the Fair Work Commission (FWC) and the Fair Work Ombudsman (FWO).

The FWO has a role in ensuring adherence to the NES. Where the FWO determines that an award, agreement or contract offers entitlements less favourable than the NES, it can issue a non-compliance notice to the employer. Ongoing non-compliance can result in the pursuit of penalties through the Court system.

Source: Fair Work Ombudsman (2015e).

[22] While full-time employees must be provided with conditions that meet all 10 standards, casual workers are paid a loading in lieu of some of the entitlements. Concerns related to their access to the NES are covered in section 4.4.

The NES operate as a 'safety net': Federal awards, agreements and employment contracts can offer conditions that improve on the NES, but they cannot exclude any element of the NES or offer a less favourable condition.

The concept of a set of minimum national employment standards, and the particulars of several of the current standards, attract little controversy (box 4.2). This is partly because a number of the NES entitlements, such as 4 weeks annual leave and 10 days paid personal leave, were aspects of the preceding 'Australian Fair Pay and Conditions Standards' and were already common to many employment contracts.

Box 4.2 Participants' views on the National Employment Standards

A number of submissions to this inquiry were broadly supportive of the National Employment Standards (NES). Participants such as the Employment Law Centre of WA (sub. 89), Qantas (sub. 116), the Sydney Symphony Orchestra (sub. 100) and the Catholic Commission for Employment Relations (sub. 99) suggested that the NES, as currently stipulated, was either appropriate or effective. For example, the Employment Law Centre of WA commented that 'the NES as a whole strike a balance between the needs of both employers and employees, and generally operate effectively, in accordance with the legislative intent.' (sub. 89, p. 11)

The Australian Mines and Metals Association went further. It suggested there may be scope to expand the NES. By moving some content that is consistent across modern awards to the NES, it may be possible to simplify awards and improve the clarity around a range of matters (sub. 96).

Other submissions reaffirmed the value in legislating minimum standards, rather than leaving them in awards or enterprise agreements. Because they are consistent across workplaces and not subject to periodic revision, having the NES incorporated into legislation creates a measure of certainty and transparency for both employers and employees. Bluescope Steel noted that:

> … [t]he introduction of the NES harmonised these minimum standards in a way that could be more readily understood by the people they were designed for — the Australian employee and employer (sub. 58, p. 3).

Rather than object to the rationale or content, submissions critical of the NES tended to focus on aspects which, in their view, required attention. In this spirit, the Australian Council of Trade Unions noted that:

> … [t]he content of the National Employment Standards is largely based on safety net standards developed by the [Australian Industrial Relations Commission] through the Award system. In broad terms that content is uncontroversial and unobjectionable, however there are some particular features of the National Employment Standards that warrant further development (sub. 167, p. 168).

The most commonly cited problem areas include long service leave and public holidays. Concerns about these are developed in more detail in the chapter.

Further, the NES or elements of them have been examined in two recent reviews. These were the 2012 post-implementation review of the FW Act (box 4.3), and a Fair Work Australia review of the provisions relating to requests for flexible working arrangements and extensions to unpaid parental leave (FWA 2012).

Box 4.3 The 2012 FW Act Review's recommendations on the National Employment Standards

The 2012 post-implementation review of the FW Act made a number of recommendations, of which seven pertained directly to the National Employment Standards (NES). They were that:

- employees do not accrue annual leave while absent from work and in receipt of workers' compensation payments
- the employer and the employee meet to discuss a request for extended unpaid parental leave, unless the employer has agreed to the request
- taking unpaid special maternity leave should not reduce an employee's entitlement to unpaid parental leave
- the right to request flexible working arrangements be extended to a wider range of circumstances and, unless the employer has agreed to the request, a meeting be held to discuss the request
- annual leave loadings not be payable on the termination of employment, unless a modern award or enterprise agreement expressly specifies otherwise
- the development of a national long service leave standard be expedited
- the number of public holidays under the NES on which penalty rates are payable be limited to a nationally consistent number of 11.

Of these, only the recommendation that unpaid special maternity leave not affect an employee's entitlement to unpaid parental leave was implemented in full, although the Australian Government did widen the range of circumstances under which flexible working arrangements can be requested.

Source: McCallum, Moore and Edwards (2012).

Accordingly, this chapter does not critique the existence of the NES or most of the current elements. Nor does it revisit issues related to the NES explored in previous Productivity Commission inquiries (such as how it relates to adoptive parents and to parents who have children with disabilities).[23] Another issue not covered here is whether there is scope to reduce duplication and complexity by transferring some entitlements from awards to the NES or vice versa. That matter is discussed in chapter 11.

[23] The Productivity Commission explored these matters in its inquiries into *Paid Parental Leave: Support for Parents with Newborn Children* and *Disability Support and Care* (PC 2009, 2011a) and recommended that the unpaid leave entitlements be extended to all parents adopting children aged under 16 and that parents with a disabled child over 18 years of age, but requiring a substantial amount of care, have the right to request flexible working arrangements. To date, only the first of these has been incorporated into the NES.

This chapter instead assesses elements of the NES around which there is more contention and/or where prima facie there appears scope for material improvement. To aid that assessment, section 4.1 outlines some characteristics and effects of employment standards. Subsequent sections then look at the following NES elements:

- long service leave (LSL) provisions (section 4.2)
- public holidays and annual leave entitlements (section 4.3)
- leave entitlements for casual workers (section 4.4).

4.1 Some economic aspects of job conditions and entitlements

Types of benefits and costs

Workplace entitlements provide benefits for workers, typically at some cost to employers.

The benefits of more generous conditions to employees can take many forms. For example, they may include better health and work/life balance (in the case of working hours and flexibility provisions); more personal, family or community time (in the case of leave and public holidays); or greater peace of mind (in the case of minimum termination notice periods and redundancy pay provisions).

While such employee benefits are not financial, in principle, the worth of most entitlements can also be expressed as a wage or salary equivalent. This notion is most obvious for entitlements that can be 'cashed out' — that is, where workers can elect to transform certain entitlements, such as annual leave, into extra pay.[24] Yet there is still some implicit monetary value for entitlements that cannot be cashed out, such as long service leave, minimum termination notice periods and redundancy pay. This is because, in the absence of such entitlements, employees would require additional wages to make them no worse off.

When employers provide more generous conditions for their workers, the cost entailed is broadly equivalent, from their perspective, to a wage or salary increase. The cost of providing some entitlements will be minimal (for example, providing staff with a Fair Work Statement), while others (such as providing annual and long service leave) impose a more substantial cost. Productivity Commission estimates suggest that, on average, the cost of a worker taking an extra day away from work as a part of an increased annual or sick

[24] Where a worker elects to cash out an entitlement, the implication is that the worker values the entitlement at no more than the money received. However, for other workers who do not elect to cash out their entitlements, the implication is that they value the entitlement more highly than the money they could have received.

leave entitlement is around 0.5 per cent of that worker's annual output. For shift workers with increased annual leave entitlements, the cost is slightly higher.

Of course, some employers may voluntarily offer generous conditions as a means of attracting, retaining and motivating employees, which provides benefits to the employer.

Simple models of labour markets can hide important features

In a simple model of labour market behaviour, employees and employers would prefer to have purely cash-based employment contracts rather than ones involving a mix of entitlements and cash. The underlying assumption is that employees have different preferences (for example for leave) and that employers could construct contracts that minimised the costs of attracting employees to the business. This model, taken in isolation, would imply that the conditions set down by the NES are inefficient because employees would choose (and the employers agree) to a mix of conditions and wages that best suited them as individuals. This is analogous to arguments about consumer choice, where it is often thought better to give people cash than to hypothecate particular expenditures. Were such a model to apply, employees would 'purchase' the amount of leave that suited their needs. This would sometimes be in excess of the standard and, on other occasions, less, in the same way that people's preferences for many other 'services' also vary.

However, much observed employer or employee behaviour does not accord with this simple model. For example, in the United States, where there is no statutory minimum leave, firms usually voluntarily provide the same leave entitlements to all employees, despite the fact that worker preferences for such leave varies (Altonji and Oldham 2003). In Europe, where relatively long leave entitlements are mandated, the hours of work given up during holidays are not made up through multiple job holding or other ways of increasing hours (which would be the strategy used by employees who did not value extended leave as much as others).

In Australia, under law, cashing out leave is only permitted when an award, enterprise agreement or any other agreement allows it (FWO 2015a). While around a third of enterprise agreements approved between 1 March 2011 and 31 March 2014 contained provisions dealing with the cashing out of annual leave (with some additional safeguards), prior to the 2014 review, only one modern award — the Seafood Processing Award 2010 — offered something similar. However, on 11 July 2015, the Full Bench of the Fair Work Commission (FWC) decided to incorporate a model clause permitting the cashing out of annual leave into *all* awards (FWC 2015j).[25] This decision may still be contested as a part of the review process.

People can also purchase leave in excess of the usual NES, but where data are available for given industries, this practice is very rare. For example, in the Queensland Public Service, only 5.6 per cent of employees purchase additional leave (Queensland Government 2010,

[25] Under the model clause, cashing out of two weeks within a 12 month period is permitted

p. 79). Moreover, there is evidence that many Australians would prefer more leave than a pay rise (Denniss 2003), and as discussed in section 4.3, some do not ask employers for such arrangements in anticipation of employers' responses.

The simple model of leave entitlements does not capture some important features of real world labour markets. These features are important in understanding the NES.

- Mandatory long-service leave may be important in maintaining employees' productivity by reducing the risk of 'burnout', especially where it is hard to observe where particular employees might be at risk. Were these leave entitlements customarily cashed out, employees might not take the time off that is important to their long run productivity.
- Employees may be reluctant to request carers' and personal leave or seek flexibility in their working arrangements if it is seen as signalling a lack of commitment to the business, or if it is seen by colleagues as counter to the workplace culture. This would result in generally excessive hours and insufficient flexibility for employees. A recent study conducted at a consulting firm where its employees routinely logged 80-90 hours per week found that 31 per cent of men and 11 per cent of women did not wish to formally request flexible working arrangements, but instead found other ways to achieve flexibility that were not visible to management (Reid 2015).[26] As a result, statutory entitlements can make it easier for workers to access leave and flexible work arrangements.
- Some of the entitlements of the NES address real imbalances in the bargaining power of employees compared with employers.
- Given their simplicity, it is easier for employees to verify whether they have received a well-known non-pecuniary benefit under the NES — such as annual leave — compared with their wage entitlements in what are a complex set of pay rates in a regulated workplace relations (WR) system. The NES may therefore improve employer compliance
- It may be less costly, given contracting costs, for there to be a simple set of uniform standards for employment that are implicit in all employment contracts.
- The NES may provide efficient risk pooling, where cash in lieu would not.[27]
- The NES is not just an economic instrument, but one that also seeks to establish or shape social norms (for example, that working and caring for children are compatible). There may be some costs associated with realising those norms, but it is common for a government to use laws to achieve social goals.

[26] This phenomenon was corroborated by the Work and Family Policy Roundtable and the Women + Work Research Group which noted that '[r]ecent research shows that most workers (and their managers) do not know about the right to request. It also shows that men are less likely than women to make a request, and men are more likely to be refused' (sub. 130, p. 10).

[27] For example, it is costly for individual employees to purchase income protection in the event of enduring illness, but less costly for businesses to do so.

Some broad effects of changing entitlements

It follows that while changes in worker entitlements have effects similar to an increase or decrease in workers' wages (chapter 8), the overall effects will be more complex. Nevertheless, to the extent that there are tradeoffs between entitlements and wages, the effects of changing entitlements principally occur through re-distribution from one party to another, effects on employment, and wage and price effects.

The extent to which these effects (either alone or in combination) occur depend largely on whether a change to entitlements affects the total cost of employing a worker and the capacity of the employer to absorb the additional cost. In some markets (technically, those yielding economic 'rents'), increases in entitlements are likely to have largely redistributive effects rather than impacts on the prices of goods and services (although businesses may change their capital intensity in response to an increase in the relative cost of labour). In more competitive goods markets (as is the case with a substantial proportion of Australian markets), increases in entitlements are likely to reduce labour inputs, reduce future wage growth (to the extent that the WR system permits this) and raise consumer prices. Given that *some* NES requirements act more like fixed costs than ones related to the hours of work, increases in entitlements may also affect employment numbers by more than they do hours of work (unlike minimum wage requirements, which tend to have the opposite effect — chapter 8).

Assessments of increasing entitlements need to take account also of the more subtle social and economic roles of the NES — as outlined above.

The upshot is that enhancing or constraining workers' conditions or entitlements (whether through the NES or other means) can have more varied effects than redistributing benefits between employers and employees. A key challenge in appraising proposals to improve the NES is to recognise these potential effects and, accordingly determine whether a potential change likely delivers a benefit to employers, workers *and/or* other members of the community that exceeds its cost.

The future role of the NES

One of the reasons the NES has been largely uncontroversial is that its content is either consistent with strongly affirmed social norms about workplace entitlements or reflects much of what was already consistent across awards, enterprise agreements and employment contracts. The scope for further additions to the NES will depend in part on the degree to which further inconsistencies in awards can be eliminated. The more systematic analysis by the FWC of common issues in awards, such as weekend penalty rates and leave loadings, may pave the way for further consolidation of entitlements in the NES.

Moreover, the NES can be expected to adapt as social norms evolve. As noted earlier, in past inquiries, the Productivity Commission itself has recommended changes to the NES that reflected clearly apparent community norms.

Several participants in this inquiry recommended adaptations to the NES to achieve further social goals — particularly in relation to the need for further flexibility for employees with family responsibilities (box 4.4). It is clear that the community has increasingly favoured a workplace framework that gives employees more scope for work-life balance (INSEAD, Universum and HEAD Foundation 2014).

Box 4.4 The right to request a change in work arrangements and the extension of parental leave

Some participants have claimed that there are flaws in the *Fair Work Act 2009* (Cth)'s (FW Act) provisions relating to the right to request a change in work arrangements (s. 65) or to obtain an extension of parental leave (s. 76).

The Australian Council of Trade Unions (ACTU) argued that the current provisions make it far too easy for employers to deny these requests. The ACTU submitted that:

> … [t]he provisions are drafted so that:
>
> - No obligation is placed on employers to reasonably accommodate a request;
> - Employers are only required to give an employee (in writing) the reasons for the refusal which can be on a very wide range of 'reasonable business grounds'; and
> - Under s. 739 of the [Fair Work Act] employees are specifically denied a right to appeal an employer's unreasonable refusal of a request for both sections 65(5) and 76(4), unless they have the bargaining strength to reach agreement with their employer to do so in a workplace agreement (sub. 167, p. 169).

The ACTU suggested that the FW Act require employers to reasonably accommodate employees' requests for flexible work arrangements or to extend a period of parental leave. It proposed that the FW Act provide guidance about how an employer should appraise any request and that there should be an appeals mechanism where an employer refused (sub. 167, pp. 173–174). The Work and Family Policy Roundtable and the Women + Work Research Group proposed a similar arrangement (sub. 130, p. 10).

In 2003, United Kingdom lawmakers made it a statutory duty for employers to follow certain procedures in considering similar requests. In addition, they established a right of appeal, which appears to have increased the likelihood that employers approved requests (ACTU sub. 167, p. 171).

However, in making judgments about the desirability or best timing of any such changes to the NES, several (sometimes overlooked) considerations are relevant.

The likely behavioural responses by people to any such measures needs be assessed, since these responses can sometimes undermine their prime objectives. A particular concern is that any obligations perceived to be costly by employers and that predominantly affect only one group of employees, may unwittingly lead to employment discrimination. In the particular proposals for improved leave access discussed in box 4.4, the Australian Council

of Trade Unions (ACTU) noted that ' … [d]espite the issue being significant to all working parents, it is mostly women who are affected by the need to balance work and family' (sub. 167, p. 170). There is therefore a risk that women may find their career and hiring prospects reduced by some employers without any real capacity to detect this. Moreover, to the extent that the provisions are seen as largely oriented to women, men may be reticent about even requesting to use such provisions.

Solving this dilemma requires a number of changes. These include addressing any misperceptions about the actual costs of such flexibility measures, increased public awareness of employers that use flexibility as a strategy to attract talented people, the diffusion of such flexibility arrangements in enterprise agreements, advocacy more generally, and changing social mores that make it acceptable for men also to request such leave. Regulatory measures that provide avenues for complaints or appeals by people denied reasonable flexibility (as described in box 4.4) may have some benefits, but this may primarily arise from the fact that such regulations signal the unacceptability of certain conduct by employers. The regulations themselves may be only weakly enforceable given the difficulty of establishing what is reasonable.

Accordingly, the degree of public acceptability of additional workplace entitlements, as well as their more tangible costs and benefits, should factor prominently in any decision to amend the NES.

A further factor that affects the evolution of the NES is that it creates a set of obligations that, by design, are not intended to be negotiated away through individual agreements or enterprise agreements. As argued earlier, the incapacity to relinquish entitlements for other benefits can sometimes be warranted because of a commonly agreed social goal or where for various reasons, people do not take advantage of entitlements due to their signalling effects, even if they would prefer to do so. However, in other cases, employees negotiating enterprise agreements may wish to determine the repertoire of entitlements that suits them, trading off one against another. This would be precluded if such entitlements are incorporated into the NES.

Moreover, the further the NES departs from social norms, the greater the risk of it becoming widely controversial or objectionable. This can bolster the argument for legislative amendments and put a number of the entitlements contained in the NES at risk.

4.2 Long service leave

Paid LSL is a leave type unique to Australia and New Zealand (although Finland has a lowly paid sabbatical option for employees). LSL provides a paid break of up to three months to workers who have spent a lengthy period (usually 10 or 15 years) with the same employer. It was conceived in Victoria in the 1860s to allow a predominately immigrant workforce ample time to make the lengthy voyages necessary to visit their home countries, without jeopardising their employment (Thornthwaite and Markey 2014).

Whereas the NES provisions on other leave entitlements are quite specific and self-contained — for instance stipulating that all full-time national system workers are entitled to four weeks paid annual leave per year or up to 12 months unpaid parental leave — the NES provisions on LSL are neither. They provide only for a 'transitional' entitlement to LSL for the workers who would have otherwise been covered by a pre-reform award or enterprise agreement. Most employees in the national system derive their LSL entitlement from state and territory legislation (preserved by section 27(2)(g) of the FW Act) (Stewart 2015, p. 252).[28]

This complicates the task of determining the specifics of a worker's entitlement. The employer must first check whether the worker is covered by either an agreement made prior to January 2010 that remains in effect, or by an 'award-based transitional instrument'.[29] Where an agreement has lapsed, and so does not cover the worker, and/or where the relevant instrument does not specify the worker's LSL entitlement, as is commonly the case, the employer must abide by the relevant state or territory's legislation instead.

The reliance on state and territory legislation has resulted in considerable variation in LSL arrangements and entitlements across Australia. For example, whereas workers in Victoria receive 13 weeks leave after 15 years continuous service, their neighbours in South Australia accrue the same amount of leave after just 10 years, while Australian Capital Territory workers qualify for 6 weeks leave after giving 7 years' service (table 4.1).

Several submissions to this inquiry (box 4.5) have expressed concern about LSL entitlements. The concerns centre around the lack of portability of LSL entitlements (a concern of employee representatives) and the compliance and other costs for business of the divergent arrangements between jurisdictions. These concerns, and potential solutions to them, are considered in turn below.

[28] The exception to this is employee of the Commonwealth public service who derive their entitlement from the *Public Service Act 1999* (Cth)

[29] These instruments were formerly 'pre-modernised awards' or 'notional agreement preserving state awards'. Modern awards cannot include terms that deal with LSL. Enterprise agreements can, but the terms of these agreements for any single worker must not be inferior to the terms in either the transitional instrument or the state or territory legislation. A worker is covered by an award-derived transitional instrument if, before the award modernisation process, their entitlements were specified by the award.

Table 4.1 **Long service entitlements**[a]

State	*Legislation*	*Qualifying Period*	*Entitlement*
New South Wales	Long Service Leave Act 1955	10 years	2 months
Victoria	Long Service Leave Act 1992	15 years	13 weeks
Queensland	Industrial Relations Act 1999	10 years	8.667 weeks
Western Australia	Long Service Leave Act 1958	10 years	8.667 weeks
South Australia	Long Service Leave Act 1987	10 years	13 weeks
Tasmania	Long Service Leave Act 1976	10 weeks	8.667 weeks
Australian Capital Territory	Long Service Leave Act 1976	7 years	6.06 weeks
Northern Territory	Long Service Leave Act 1981	10 years	13 weeks

[a] This table does not show the rate at which additional entitlements accrue for service in excess of the qualifying period. There are also some exceptions. For instance, in most states, there is separate legislation for the construction industry, while Commonwealth public servants are covered by the *Long Service Leave (Commonwealth Employees) Act 1976* (Cwth) rather than LSL legislation in the ACT.

Sources: Casey, McLaren and Passant (2012); Workplaceinfo (2015).

Portability of long service leave entitlements

Many worker entitlements accrue in line with the worker's length of service. For instance, full-time ongoing workers who do not use their annual leave will accrue four weeks leave at the end of one year, eight weeks leave at the end of two years and so on.

If a worker leaves one employer to take up a job elsewhere, this process is reset. On termination of the worker's current contract of employment, some of their entitlements are cashed out, while others are forfeited. When a worker commences employment with their new employer, the accrual process begins afresh. This means that workers may lose some accrued benefits if they transfer jobs. This is usually the case with long service, sick and carer's leave.

Portability schemes, particularly for LSL, enable workers to maintain their entitlements when they change employer. Proponents have raised several concerns about the current LSL arrangements, which they believe portability would mitigate:

Box 4.5 Participants' views on long service leave

Submissions to this inquiry were highly critical of the current long service leave (LSL) arrangements. These criticisms centred on the farrago of transitional entitlements that have prevailed in place of an explicit standard. The Australian Industry Group noted:

> … Australia's long service leave laws are a mess. The interaction between the long service leave provisions in the NES [National Employment Standards], State and Territory laws and enterprise agreements is so complex that employers and employees find it difficult to navigate and determine entitlements' (sub. 172, p. 76).

The Victorian Government elaborated on the breadth of the concerns. It submitted:

> … [t]he interim LSL NES can be very complex for employers and employees to apply because it may require them to look at the interaction between the Fair Work Act, old award entitlements and State or Territory LSL laws. Secondly, the interim LSL NES appears to lock in any award-derived entitlements, without any mechanism for these eventually to be phased-out or overridden through enterprise bargaining. Thirdly, the rules largely lock in the differences in LSL entitlements under State and Territory LSL laws, without any mechanism for State and Territory laws to be overridden through enterprise bargaining. In addition, the LSL NES provides only very limited means for employers operating businesses across jurisdictions to introduce uniform LSL arrangements for their employees. (sub. 176, p. 68)

No submissions spoke in favour of the current arrangements, although the Queensland Government did commend them for 'ensuring the maintenance of LSL entitlements' (sub. 120, p. 8) or effectively acting as a placeholder.

Many submitters agreed on the benefits of moving to a uniform national standard. The Australian Council of Trade Unions (ACTU) argued that 'the missing element in the comprehensive suite of minimum standards set out in the [National Employment Standards] is long service leave' (sub. 167, p. 174). Without agreeing on the specifics of any entitlement, the Australian Workers' Union, the Australian Industry Group, the Australian Mines and Metals Association and the Victorian Government joined the ACTU in endorsing, in principle, a national approach.

There were, however, some concerns about the challenges associated with establishing a national standard. The South Australian Government argued that the development of a national uniform standard is unlikely, and that the simplifying the current arrangements to reference state and territory legislation only would be a more practical alternative (sub. 114, p. 7).

Other submitters warned of the impact on employers. BusinessSA argued that 'a national approach to LSL will be ineffective, particularly as the establishment of a national standard could lead to increased costs for employers' (sub. 174, p. 18). The Australian Chamber of Commerce and Industry noted that it 'would not be able to support the establishment of a national long service leave standard that would impose additional costs on businesses which would be in no better as a result' (sub. 161, p. 166), a sentiment echoed by the Australian Hotels Association and the Accommodation Association of Australia (sub. 164, p. 25).

The Housing Industry Association went further. It submitted that 'a broader approach needs to be taken by considering the merits and ongoing utility of long service leave in its entirety' (sub. 169, p. 63).

- Whether employees receive benefits is dependent on the survival of the business and on whether it is practically feasible for an employee to stay with a given employer for the qualifying period. This has become increasingly problematic over time. For example, in

contemporary Australia, many more households contain multiple job holders, but if one jobholder finds a job that requires relocation, other jobholders in the household may also have to shift employers. And, while women's workforce participation has increased, women often have fractured employment histories associated with having and caring for children and thus will often leave their employment before they become eligible for long service leave. These equity concerns reflect the relatively long period of service (10 to 15 years) required for qualification.

- Where LSL acts as an incentive for loyalty, in principle it must also discourage labour mobility. Labour mobility and efficient matching of the skills and attributes of individual employees to businesses may contribute to dynamic efficiency in an economy.[30]
- LSL provides people with the scope to have a protracted break from work to rejuvenate (with potentially long-term productivity gains) as well as aiding work-life balance.[31] It can also provide workers with the opportunity to transition to an alternative career path by acquiring skills through study or training and undertaking extended job searches. These benefits may apply as much to a person who is engaged in continuous work with multiple employers as one who is engaged with a single employer, but under current arrangements they miss out.

However, there are doubts about the magnitudes of some of these benefits. There are several natural experiments on the impacts of LSL portability provided by various existing state-based industry arrangements (table 4.2). It appears that, notwithstanding the goal of providing a time for recuperation, employees under portable schemes do not necessarily take the leave. For example, in a submission to a review of a New South Wales scheme for contract cleaners, for instance, the Australian Industry Group argued that:

> … the experience in other States shows that it is rare for employees to actually take leave under these schemes; rather the emphasis has been on the employees accumulating money. … [The schemes] do not, in practice, have the effect of giving workers a period of rest and recuperation. (Ai Group 2013)

Similarly, according to the NSW Industrial Relations Advisory Council, 'in many cases, LSL is not regarded as an opportunity for career renewal, but rather as an economic asset' (2013).

[30] There are circumstances where it may be advantageous for a businesses to engender longer term relationships with parts of their workforce, particularly where the workers have essential skills that are costly or difficult to acquire. However, there is little to suggest that businesses could not tailor a contract with a more targeted incentive structure than a blunt statutory instrument.

[31] For workers the opportunity to take LSL has been ascribed a range of benefits, including enabling rest and recuperation, providing a consolidated block of time in which to undertake other (personally or socially valuable) activities, such as working in the home, acting as a carer, volunteering or engaging in study; and potentially increasing the workers' productivity on return to the workplace (Thornthwaite and Markey 2014). Many of these benefits can also be captured through other forms of leave and/or outside working hours during normal day-to-day life.

Table 4.2 **Portable long service leave (LSL) legislation**
By jurisdiction

Jurisdiction	*Industry*	*Start*	*Legislation*
Cwth	Coal mining	1949	*Coal Mining Industry (LSL) Administration Act 1991*
NSW	Building & Construction	1986	*Building and Construction Industry Long Service Payments Act 1986*
			Building and Construction Industry Long Service Payments Regulation 2011
	Contract cleaning	2011	*Contract Cleaning Industry (PLSL Scheme) Act 2010*
Vic	Building & Construction	1976	*Construction Industry Long Service Leave Act 1997*
			Rules of the Construction Industry LSL Fund as at 7 April 2009
Qld	Building & Construction	1992	*Construction Industry Long Service Leave Act 1987*
			Building and Construction Industry (PLSL) Act 1991
			Building and Construction Industry (PLSL) Regulation 2002
	Contract cleaning	2005	*Contract Cleaning Industry (PSLS Scheme) Act 2005*
WA	Building & Construction	1986	*Construction Industry Paid Portable Long Service Leave Act 1985*
			Construction Industry Paid Portable LSL Regulations 1986
SA	Building & Construction	1987	*Construction Industry Long Service Leave Regulations 2003*
Tas	Building & Construction	1971	*Construction Industry (Long Service Leave) Act 1997*
ACT	Building & Construction	1981	*Long Service Leave (Portable Schemes) Act 2009*
	Contract cleaning	1999	*Long Service Leave (Portable Schemes) Act 2009*
	Community Service	2010	*Long Service Leave (Portable Schemes) Act 2009*
	Security	2012	*Long Service Leave (Portable Schemes) Act 2009*
NT	Building & Construction	2005	*Construction Industry Long Service Leave and Benefits Act 2005*
			Construction Industry LSL and Benefits Regulations as in force at 3 August 2012

a Under these models, the employer makes payments to cover an employee's leave entitlements into an administered account or fund, either as they accrue or in the form of a lump sum when the worker changes employment. In most circumstances, the entitlement is funded by the employer via a levy proportional to the worker's wage. The entitlement can be paid out once the worker reaches a defined period of service within the industry. Arrangements which permit the portability across well-defined employers through awards and agreements are not included in the table.

Source: McKell Institute (2012).

Further, while the argument that LSL portability may improve dynamic efficiency is sound in principle, it is not clear that the effects are significant.

In many cases, it would appear that portability schemes are more a direct result of bargaining power by parties in select industries, than of significant evidence of the benefits of such schemes for productivity.

There are still likely to be some benefits from making LSL portable, although in considering the merits of introducing a portable scheme, those benefits must be compared with the costs entailed:

(i) While LSL may not be an efficient measure for creating employer loyalty, it must have some effect, which would be diluted with full portability.

(ii) Some employers may be reluctant to hire workers with accumulated entitlements as these would be more likely to request protracted leave close to their commencement date.

(iii) A move to mandate portability *at the current level of LSL entitlements* would entail a significant increase in LSL costs to business. Under current arrangements, the total costs of LSL for an employer depend on the tenure distribution of its workforce. As many employees leave before the qualifying period, the total claims under the current arrangements are much smaller than would apply under a portable scheme (where employees' tenure would be based on their working lives, not their specific tenure with an employer).[32] The greater coverage of employees would be reflected in the levy imposed on employers, with one estimate suggesting that portable LSL costs could be up to 2.5 per cent of wage costs (McKell Institute 2012).[33] In the absence of any counteracting wage reductions, this would have some dampening effect on employment and encourage businesses to use more capital instead of labour.

An alternative design

An alternative design could address concerns about the excessive cost to business of portable LSL in (iii) by scaling back the average portable entitlement such that the overall costs to business were similar as under the current system. For example, if the average employee received the equivalent of 2 days per year from current arrangements, then a portable scheme could simply add two days to the current NES provision for four weeks of annual leave.

There would be a number of benefits to this approach. Under this alternative proposal, a benefit would be extended to employees who fail to reach the eligibility trigger of 10 or 15

[32] The Australian Workplace Relations Study found that, of a sample of over 5000 people, just over 40 per cent had been with their employer for over 5 years. Depending on the instrument which governs their entitlement, a large proportion of these employees would be eligible for the full entitlement, or a pro-rata entitlement.

[33] Depending on the qualifying period and the duration of the entitlement, and making some other assumptions, the McKell Institute (2012) estimates the levy to be of the magnitude of between 1.67 and 2.5 per cent of remuneration. This is broadly in line with state and territory industry-based schemes.

years in the workforce *in total* — including those who spend extended periods overseas or out of the workforce for purposes like raising children — as well as those who change employer or industry or who take brief breaks from the workforce and who are captured by standard portability schemes. This would better address the equity concerns associated with LSL. It would also provide LSL portability without a levy or an interposed third party — a key departure from the schemes described in table 4.2. This would make it more simple than a full portability option (although costs for a number of firms would increase).

However, any such approach would still have the deficiencies outlined in (i) and (ii) above. In particular, by removing LSL, businesses who value longer duration working relationships would have to find and fund other ways to promote tenure, while *also* providing improved annual leave entitlements (although it is likely that many such firms would have other mechanisms anyway). To maintain cost neutrality, this would need to be factored in to any decision to replace LSL with more days of annual leave. Moreover, shifting some LSL benefits to those previously unable to access them would remove benefits from employees who would have qualified for full LSL benefits under the current arrangements.

Overall, it is not clear that the benefits of either the typical model of portable LSL or the alternative proposed above, would be sufficient to justify the costs and complications entailed. Submissions to this inquiry are yet to provide compelling evidence of major and widespread concern about the present non-portability of most LSL arrangements.

The Productivity Commission would welcome comment on, not only portability of LSL, but the costs, benefits and practicality of providing all national system employees with additional days of annual leave in exchange for their long service leave entitlements. In particular, how such a scheme could be designed to extend the entitlement to employees who would not otherwise receive LSL while reducing complexity and limiting any additional cost to business.

Towards a nationally uniform standard?

The combination of multiple LSL instruments and legislation clearly creates complexity and costs, particularly for businesses operating across state borders. Several participants highlighted such costs in submissions to this inquiry (see box 4.5).

National employers may need to comply with not only the arrangements in several states, but also the entitlements specified in multiple award-based transitional instruments. Indeed, a business that operated nationally would have to comply with at least eight different types of LSL arrangements — and potentially more if any of its workers could have been covered by pre-reform state or federal awards which featured LSL entitlements. Employers, in these instances, face costs both in determining who is covered by which instrument, and in complying with a number of entitlements.

Compliance costs aside, nationally operating businesses can, depending on where their operations are located, face higher labour costs than their competitors from meeting LSL entitlements (all other things being equal) in several jurisdictions (table 4.3).

Multi-state or national employers have only limited scope to mitigate these costs. Since new enterprise agreements *cannot* supersede state or territory laws, these employers' only option to realise consistency across their workforce is to offer all workers the entitlements that prevail in the most generous award or jurisdiction. The alternative is to provide otherwise equivalent employees in their business with different entitlements depending on where they work.

Table 4.3 **Significance of long service leave labour costs**

State	Ratio of weeks of leave per week of work	State share of total Australia-wide labour costs
	%	%
New South Wales	1.54	33.1
Victoria	1.67	23.9
Queensland	1.67	18.5
Western Australia	1.67	12.6
South Australia	2.50	6.3
Tasmania	1.67	1.8
Australian Capital Territory	1.66	2.6
Northern Territory	2.50	1.1

Sources: Table 4.1 and ABS 2012, *Labour Costs, Australia, 2010-11*, Cat. No. 6348, released 7 May 2012.

The 2012 post-implementation review of the FW Act recommended that 'Commonwealth, state and territory governments should expedite the development of a national long service leave standard with a view to introducing it by 1 January 2015'(McCallum, Moore and Edwards 2012, p. 104).

However, there has not been significant progress towards a national standard since the review, largely because the adoption of a standard will entail losers as well as winners. Businesses operating mainly in one state would not want to emulate higher-cost arrangements in another, while employees (and their representatives) in a state with more generous entitlements would not want to relinquish these to achieve uniformity.

While there would no doubt be some benefits from achieving a uniform standard, their scale is less clear. Gauging the costs that divergent LSL arrangements pose for businesses is difficult, but several factors are likely to mitigate their size:

- Most enterprises operating across a number of states typically have sophisticated management of payroll and entitlement obligations. Since LSL arrangements do not change frequently over time, it is likely that the compliance costs associated with meeting LSL requirements across different states are relatively modest.

- Most businesses do not operate across state borders.
- The differences in the implicit wage premium associated with LSL are not substantial. Only the Northern Territory and South Australia have LSL provisions that provide many more benefits than other jurisdictions. All other things being equal, the additional generosity of their LSL arrangements adds less than 1 percentage point to those states' labour costs than other states. Moreover, this estimate assumes that all employees ultimately receive long-service entitlements, when in fact, many people leave their workplaces before they are eligible for their entitlements.
- Most Australian labour markets are unaffected by interstate differentials in LSL. The share of Australia-wide total labour costs provides a rough indication of the size of different labour markets in Australia. The results suggest that there are negligible differences in implicit premiums for over 90 per cent of Australia's labour market. Accordingly, even if there were some incentives to shift resources due to implicit wage differentials, this would relate to only a small share of the labour market.
- Nationally operating businesses tend to pay above award wages or use enterprise bargaining. They therefore have greater scope to adjust wages if they wished to reduce the implicit wage differential between states with different LSL arrangements.
- The costs of higher entitlements in various states may be costs to businesses, but some of these are transfers to employees. From an economic perspective, the relevant cost is the net cost.

A further complicating factor is that changes in regulatory arrangements between states require considerable political commitment, and bureaucratic, business and union resources. To justify the use of these resources, the case for a uniform standard has to be compelling. The Productivity Commission would welcome further evidence on the magnitude of the costs and benefits of adopting a national standard.

There may nevertheless be merit in pursuing more modest changes in the short term simply to alleviate some of the complexity, without taking the possibility of a national standard off the table.

The Productivity Commission sees a case for ensuring all employees (except Commonwealth public sector employees) derive their LSL entitlements from state and territory based legislation only.[34] This would strip away a layer of complexity for business. In calculating a worker's entitlement, a business would not have to consider award-based transitional instruments. The workers that are covered by these instruments would find their LSL entitlements reverting to the level enjoyed by most other workers in their state or territory. However, since LSL entitlements appear in only some of these instruments[35], a

[34] This would require removing the transitional entitlement in the NES and replacing it with a reference to section 27(2) of the Fair Work Act which preserves an entitlement to state and territory statutory LSL schemes.

[35] FWC estimates suggest that 21 of the 1560 instruments considered as part of the award modernisation process (and leaving aside the 1625 instruments that covered a single enterprise) provided for LSL only

limited number of workers would be affected (who in principle could bargain over compensating wage adjustments), while the benefit of reduced complexity would span all employers.

One option, which may bring any proposal for a nationally uniform LSL entitlement closer to consensus, would be to agree to 'grandfather' existing entitlements. Grandfathering would mean that the new national standard, once agreed, would apply only to new hires, *not* to existing jobs. This would remove the prospect of current workers losing their present entitlements, and of employers having to countenance sudden increases in what they might owe to their workforce. The proportion of workers initially covered by the new national standard would be low. However, it would expand over time, as some workers move to new jobs and as new workers enter the labour force and others retire.

While in theory, employees might decide to stay with an existing employer rather than move to a new one where lower statutory entitlements might apply, as noted previously, there is little discernible effect of LSL on labour mobility. Any effect would be further reduced by the fact that the worker would only gain the incremental benefit of their current leave entitlements compared with the new standard — a benefit that in any case may not be realised for several years.

The main concern with this approach is that it would trade one source of complexity for another, with associated compliance burdens for businesses. However, if implemented in concert with simplification of the transitional entitlements, a business would only need to know when a worker commenced their employment, and which state they work in, to determine their LSL entitlements.

Overall, there remains some uncertainty about the net benefits of moving to a uniform system, the appropriate transition to any such standard, and the scope for some minor simplification of the current system. In that light, the Productivity Commission is hesitant about proposing changes in this area, and seeks information on its benefits, costs and practicality.

4.3 Public holidays

Public holidays are an additional leave entitlement established by Commonwealth or state law. On these days, all permanent employees can take a day off with pay. If they are reasonably required to work, they are compensated with a higher wage, or a penalty rate[36] depending on their award or enterprise agreement (for a discussion of penalty rates, see chapters 13 and 14). Several submissions claimed that statutory provisions for public holidays were flawed (see box 4.6).

while 239 instruments contained a specific LSL entitlement while a further 563 referred to the relevant state or territory legislation.

36 Casual workers are entitled to a day off on a public holiday, but without pay. If they are called in to work, they may receive penalty rates depending on the terms and conditions of their employment.

Box 4.6 Participants' views on public holidays

Employers and their representatives were the predominant source of concerns about public holidays. While no submitter argued for the abolition of public holidays, several commented on the need for consistency across jurisdictions and consideration of the business costs of new public holidays. The Australian Hotels Association and the Accommodation Association of Australia stated:

> … [t]he concept that a reasonable amount of public holidays is a valid reward for employees is supported. It is also agreed that rates of pay are warranted for those working public holidays. However:
>
> - there is no consistency regarding the number of public holidays
> - business bears the cost when excessive numbers of dates are sanctioned. (sub. 164, p. 11)

The majority of the concerns about public holidays centred on the role of the states and territories in creating additional public holidays, and, as a result, additional obligations for businesses that operate under the national workplace relations system. In outlining the two main ways in which this occurs, Clubs Australia Industrial argued:

> … [o]ne area identified as having a deleterious effect on employers are the public holiday provisions under the National Employment Standards (NES). The difficulty appears to arise as a result of the duplicity of State and Federal laws in this area. In particular, the individual States gazetting 'additional' public holidays, with the effect on employers effectively paying two separate days of public holiday rates arising out of the same public holiday, or simply gazetting a number of public holidays that are in excess of those defined within the meaning of section 115(1)(a) of the Act. (sub. 60, p. 4)

New public holidays are costly. In their analysis of the effects of a new public holiday across Victoria on the eve of the AFL Grand Final, the Victorian Employers' Chamber of Commerce and Industry estimated that 'the cost to pay many of Victoria's almost 2 million full-time employees not to come to work could reach $543 million for the day' (sub. 79, p. 34).

The balance between public holidays and leave

The NES currently discriminates between leave entitlements taken as public holidays and as normal leave. There are grounds for shifting the balance between the two in the NES.

The main rationale for paid leave on specially designated days is that there is some genuine social benefit associated with widespread community engagement in events, especially on days of cultural or spiritual significance. This rationale generally holds for some days such as gatherings of the extended family at Christmas, and for days where people often engage with the wider community (good examples are Anzac and New Year's day, but there are others too). Public holidays that affirm important cultural beliefs may help bind communities together.

In many cases, a public holiday is not necessary to achieve considerable community coordination. Increasingly Australia's communities have found ways to recognise and celebrate their contributions to society. Special days like Chinese New Year, the Sydney Gay and Lesbian Mardi Gras and National Tree Day (among others) thrive without being

officially designated a public holiday. On another level, there are also a substantial number of festivals and awareness events in which the actions of certain parts of the community are synchronised. The success of these events suggests that, while coordinating community interactions is one rationale for stipulating shared holidays, it is not the only one.

There are several other important considerations.

- For some people, the common timing of public holidays provides people with a greater opportunity to share their time off with their partners and children. Normal leave arrangements may not always provide that opportunity because children may be at school and both partners may not be able to obtain consent from their employer for time off on the same day. On public holidays, employees are entitled to a day off, except where reasonably requested to work. (That said, many people are still able to coordinate their leave to suit their families, and in many cases people already are able to share time with their families on weekends.[37])
- There is also empirical evidence that more shared days of leisure enrich the relationships of people with their friends and acquaintances, which then improves the quality of leisure on other days, such as weekends (Merz and Osberg 2006).

While there is a strong case for public holidays, it is also clear that for any total leave entitlements (the sum of public holidays and annual leave entitlements) there is a tradeoff between leave days that are legislatively prescribed for given days (public holidays), and those leave days where employees have a significant degree of choice about the timing of days off (annual leave). Few Australians would prefer a system in which all of their annual leave entitlements were fixed dates, as is the case with public holidays. This would prevent people from having leave in a continuous form, placing constraints on family holidays away from home and many types of recreational activities (for instance, overseas holidays).

There has been no public debate about the tradeoff, because the underlying framework for thinking about public holidays neglects the possibility that a society could choose more annual leave and fewer public holidays, without reducing the overall amount of days off. That debate should commence. An important starting point in that debate is to note that only some public holidays have a common cultural significance, and that other public holidays are decided on much less compelling rationales. In the latter case, such holidays are treated by many people as just another day off.

What about the 'swap option'?

One option that provides employees with greater flexibility would be to replace the current rights to paid leave on (certain) public holidays with an equivalent extension in rights to

[37] In August 2013, 73 per cent of employees could choose when to take holidays, and a further 16 per cent said that they could sometimes choose (ABS 2014, *Employee Earnings, Benefits and Trade Union Membership, August 2013*, Cat. No. 6310.0, released 4 June).

annual leave, which employees could take when it most suited their particular plans (subject to normal work requirements[38]) or 'cash out' if they preferred. This would also have the benefits of reducing congestion on the relevant public holidays and, given the impacts of penalty rates, may increase consumer access to services at lower prices. It could enable parents to better juggle the care of children during school holidays. For firms working to tight delivery schedules, it might eliminate a delay factor.

However, such a proposal would not benefit everyone and the Productivity Commission is not advocating this. In particular, simply rolling some public holidays into extra annual leave would result in fewer days on which penalty rates would be paid. While less of a concern for salaried employees, the loss of multiple public holidays could significantly affect the annual income of casual and ongoing workers who are paid by the hour and who would ordinarily work on the affected public holidays.

Moreover, a few employees may have a preference for the government to specify the days on which they can take leave. This could be the case for workers who struggle to get leave from their employer or whose annual leave entitlement is partly exhausted by a shut-down by the business. For example, childcare sector workers are often forced to take a large amount of their leave over Christmas when the centre is closed.

Furthermore, deciding (and agreeing on) which days are genuine public holidays is not a trivial exercise, particularly when the sovereignty of the states is involved (discussed in more detail subsequently). It may be the case that some regions or states place a high value on a special day, and would recoil from it losing its status as a public holiday under the FW Act, particularly if there were some doubt about whether they could access their annual leave to celebrate it. For example, Melbourne Cup Day is highly valued by a large number of Victorians (particularly those who choose to attend the festivities in person) while some businesses (for example the racing industry) may be disadvantaged if it is changed to 'normal leave' and subject to the employee's discretion.

There is some flexibility for employees and employers to vary public holiday arrangements. The FW Act (at s. 115(3)) permits a modern award or enterprise agreement to include terms providing for an employer and employee to agree to substitute public holidays for the purposes of the FW Act. The substitution may be of a day or part-day that would otherwise be a public holiday under the NES.

Notwithstanding that the drafting implies the swap term only permits swaps on an individual basis — an employer and 'an employee' — some awards and agreements permit the swap on a collective basis. For example:

- General Retail Industry Award 2010: An employer and a majority of employees may agree to substitute another day for a public holiday. If either the public holiday or the substitute day is worked, public holiday penalties must be paid. If both days

[38] People would still have to request consent for leave from their employers.

are worked, one day at the election of the employee must be paid at public holiday rates.

- Manufacturing and Associated Industries and Occupations Award 2010: By agreement between the employer and the majority of employees in the enterprise or part of the enterprise concerned, an alternative day may be taken as the public holiday instead of any of the prescribed days.[39]

- Australian National University Enterprise Agreement 2013–2016: In order to minimise disruption to teaching and other University business, the University may substitute for Family and Community Day public holiday a day off in lieu for specified teaching and teaching/student support areas, where such a holiday falls in a teaching period. Such substituted say would be taken in conjunction with the Christmas closure. Reasonable notice of the substitution will be provided to students and staff.

- David Jones Enterprise Agreement 2012: At the store level, by agreement between David Jones and a majority of employees, another day may be substituted for the actual days listed.

Swap arrangements are essentially available to any workplace that selects to negotiate an enterprise agreement (and includes such a term in the enterprise agreement). The same is not true for award-reliant businesses. These businesses will only have access to a swap arrangement if the FWC includes a term permitting a swap in the relevant modern award.

Analysis by the FWC suggests 87 of the 122 modern awards have a provision for the substitution of public holidays. While data are not available on the prevalence of such terms in current enterprise agreements, the Department of Employment's Workplace Agreements Database indicates around 23 per cent of enterprise agreements current up until 2009 contained clauses allowing for the variation of public holidays by mutual agreement.[40] These terms were more prevalent in agreements involving larger businesses.

Given the swap option provides employees and employers with flexibility, and may encourage some businesses to open on days that may otherwise have not, the Productivity Commission considers that all businesses should have access to swap arrangements. Therefore, the FWC should include a term permitting swap arrangements in all modern awards.

Providing access to swap arrangements in all modern awards would be beneficial for both employers and employees.

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[39] Following an enterprise-level swap, this award permits 'an employer and an individual employee' to agree to an individual swap, whereby the employee would take another day as the public holiday instead of the day which the enterprise has agreed be observed as the public holiday.

[40] Unilateral swaps, either on the part of the employer or the employee, is not permitted.

Overall, employees would not be financially worse off because of a swap. If a swap occurs, all affected employees would receive a day's leave on the day that they or their workplace has agreed to observe as the public holiday. Like on any other public holiday, permanent employees would be paid for this day and casuals would not. Permanent and casual employees who are required to work on the new public holiday, rather than have a day's leave, would receive public holiday penalty rates.

The main benefit of a swap for most employees though, is not financial. The swap option allows employees to observe the public holiday entitlement conferred by the NES on a date that suits their needs. For example, employees may favour an additional public holiday around Christmas over a day off in June for the Queen's Birthday.

The effect on businesses of such swaps is more complex, but ultimately positive. To the extent that greater numbers of employees are willing to work on a public holiday (and take a paid day off or earn the penalty rate on another occasion), businesses may see increased trading gains on public holidays. There is some evidence that such days are magnets for consumer spending (for example Boxing Day sales and Black Friday sales in the US). The net effects on overall trade for an entire year may or may not change, as they depend on a wide range of factors. But some retailers maintain that the overall special high profile of trading days are of net benefit.

For those that generally operate on public holidays (such as in the hospitality and retail sectors), this could be welcome. It may allow more businesses for which trading on certain public holidays is attractive to open, leading to mild employment effects. But for others that generally find it unprofitable to operate on public holidays (in sectors, such as banking and finance, whose goods and services hold little appeal for those on a day off), the new flexibility may not be enough to induce them to open and there will be no change to the current status of either employee or employer.

Since there is no obligation to open when it is unprofitable to do so, business retains a 'check' on an employee's wish to work on a public holiday. In a similar vein, because it would require their consent, employers could not be compelled to agree to a substituted public holiday that greatly inconveniences them. By this logic, businesses can only benefit from this proposal.

DRAFT RECOMMENDATION 4.1

The Fair Work Commission should, as a part of the current four yearly review of modern awards, give effect to s. 115(3) of the *Fair Work Act 2009* (Cth) by incorporating terms that permit an employer and an employee to agree to substitute a public holiday for an alternative day into all modern awards.

State and territory public holidays

State and territory public holidays represent a particular policy conundrum in a national WR system, given that a substantial goal of the national system was to avoid interstate variations. While the NES specifies eight national public holidays, by automatically recognising public holidays declared by a state or territory government (s. 115(1)(b)), it also imports state and territory public holidays into the national system (table 4.4). So, by declaring new holidays (say Grand Final Eve in Victoria), state and territory governments can unilaterally create obligations under the NES for any employer in their state or territory to provide further leave days with pay.

Table 4.4 **State and territory public holidays over and above the NES**
2016 (green = public holiday)

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Regatta / Recreation Day						✓[a]		
Canberra Day								✓
March Public Holiday					✓			
8 hours Day						✓		
Easter Saturday	✓	✓	✓		✓		✓	✓
Easter Sunday	✓							
Easter Tuesday						✓		
May Day							✓	
WA Day				✓				
Bank Holiday	✓							
Picnic Day							✓	
Family and Community Day								✓
AFL Grand Final Eve		✓						
Labour Day	✓	✓	✓	✓	✓			✓
Melbourne Cup Day		✓						
Christmas Eve					✓[b]			
Christmas Day	✓[c]	✓[c]	✓[c]	✓[c]		✓[c]	✓[c]	✓[c]
Proclamation Day / Boxing Day					✓[d]			
New Year's Eve					✓[b]			
Cup Days	✓[e]							
Show Day			✓[f]			✓	✓[a]	
Total	6	5	4	3	6	5	5	5

[a] Different days, depending on the region. [b] Part-day holiday. [c] Substitute for a public holiday which falls on a weekend. [d] Christmas Day moved to Boxing Day, and an additional day taken for Boxing Day. [e] Cup Days in NSW are generally part day holidays that fall on different days, depending on the region. [f] Brisbane area only.

Sources: Australian Hotels Association (2015); Fair Work Ombudsman (2015f).

There is considerable variation across jurisdictions

The National Retailers Association has questioned the role of state and territory governments (most particularly, the South Australian Government in relation to two part-day public holidays that it declared in 2012) in creating holidays, with pay consequences that would otherwise be determined by the FWC in awards or by businesses in enterprise agreements:

> … NRA submits that the SA Government should not countenance a practice of declaring public holidays purely for the purpose of increasing the remuneration of employees. The level of remuneration paid to employees is a matter either for Fair Work Australia in terms of private sector employers or is a matter for enterprise bargaining (National Retailers Association 2011).

There are many holiday variations across jurisdictions (table 4.5), including some interesting peculiarities. For example, while most states celebrate the Queen's birthday on 8 June, Western Australia celebrates it on 28 September. The birthday was first celebrated in Australia in 1788 in honour of the birth of King George III, although in fact his birthday was 3 June. So, Australia's Queen's birthday celebrates the birthday of a long dead king, and on different days in different states and in no instance actually aligns with a monarch's birthday.[41] So long as people value a given public holiday as serving a valuable community role, the fact that its origin and name might have limited historical validity is largely immaterial. However, once the date is arbitrary, it is unclear why the dates should not be the same across jurisdictions, particularly when it creates costs (typically by making it more difficult to conduct business across state lines).

The lack of uniformity around public holidays and the dates on which they are celebrated was recognised as an issue by the Council of Australian Governments as far back as 1993. Despite the Council agreeing to establish a working group (COAG 1993), there is little evidence to suggest that it was ever set up, and nor was any progress report made. The Council has not considered the issue since.

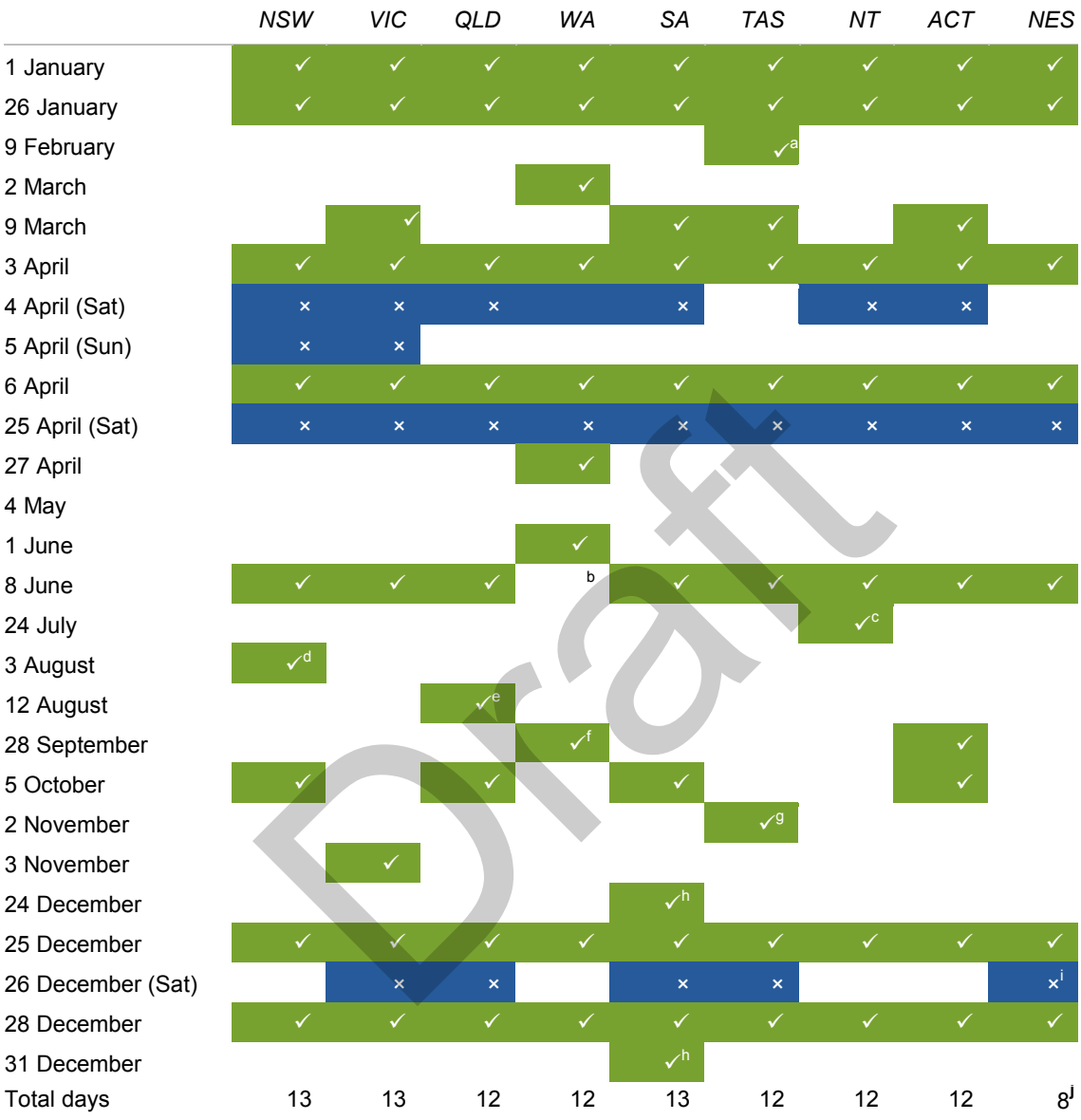
Though not shown in table 4.5, there are several other oddities in state and territory holidays:

- Some public holidays are only paid when they fall on a weekday, though in others, the paid day off switches to the closest weekday. This means that the number of paid public holidays varies by the year.
- There are variations in public holidays within states (for example, various show days in different towns and regions) and variations in days depending on the industry ('bank' holidays).
- Some states have declared Easter Saturday and Sunday as public holidays, which means that penalty rates on those days are higher than they would otherwise be.

[41] The Queen's birthday is recognised in the NES as a public holiday (without any reference to an actual date because the dates vary by jurisdiction).

Table 4.5 **Public holidays in Australia**

2015 (green = weekdays, blue = weekends)



a Only some regions. **b** Western Australia does celebrate the Queen's birthday (consistent with the NES requirement), but does so on 28 September. **c** Show day Darwin. Other areas in the NT have other days for their show day. **d** Financial institutions only. **e** Brisbane only. **f** Western Australia's Queen's Birthday holiday. **g** Only some awards/enterprise agreements. **h** Part-public holiday for Christmas and New Year's Eves. **i** Under the FW Act, a state or territory can elect a substitute day for an NES-specified day, which is why for some states, the 26th is not designated as a public holiday. Some states have chosen to designate the 28th December as a public holiday, as well as retaining 26 December as a holiday. **j** There are only eight holidays named in the NES, but it does recognise additional public holidays established by state and territory governments.

Sources: *Fair Work Act 2009* (Cth); Fair Work Ombudsman (2015f).

- South Australia's March holiday was in May prior to 2006, and there have been pressures by some groups to move it back to May (Rau 2013), suggesting that the day does not have a distinctive community value.
- South Australia is also unique in that under the *Holidays Act 1910* (SA), *all* Sundays are designated as public holidays (box 4.7).
- For the overwhelming majority of employees in the Australian Capital Territory, Anzac Day is only a paid day off when it falls on a weekday. However, for ACT public servants, Monday 27 April 2015 was declared a public holiday (in lieu of the previous Saturday), meaning that schools closed and public transport ran on a weekend schedule, with disruptions for the bulk of the workforce and workplaces.

Declaring a new public holiday has consequences

State and territory governments can choose to designate public holidays that have some particular cultural significance for their jurisdictions. However, in doing so, they should take into account the total number of public holidays in the jurisdiction relative to the national benchmark of eight national public holidays, and the impacts, which vary depending on whether the public holiday is on a weekend or weekday. Declaring additional days as public holidays may be electorally popular, but the costs are not insignificant.

A public holiday declared on a weekday will often lead to closure of an enterprise on that day, with losses in output, reduced convenience for customers, and reduced capital utilisation.[42] As noted previously, each new weekday public holiday increases annual labour costs by around 0.5 per cent — not a trivial amount. (In contrast, employers and employees can time normal annual leave without any significant impacts on output or capital utilisation.)

If the enterprise still opens on a weekday, its labour costs rise by even more (for example by 2.5 times for some employees where the public holiday is on a weekend). That in turn, encourages employees to choose labour saving technologies, to only open a part of a business, use skeleton staffing, or to deploy lower cost labour, with potentially adverse unintended effects on some types of labour and the quality of service offered to consumers.

For days declared on weekends, the cost implications are reduced because many employers do not open on weekends anyway. Nevertheless, for those that do typically open — such as hotels and retail outlets — the penalty rates increase substantially as a result, especially for Saturdays. For example, in many cases this would increase the penalty rate for a Saturday.

[42] There is some scope in some awards for employees to consent to take off another day as a public holiday to assist in the day-to-day operations of the business, for example, the Mining Industry Award 2010. Some awards allow substitution, but in the more limited sense that it requires agreement by the majority of employees in an enterprise and does not cater for agreements between an employer and an individual employee (for example, as in the Restaurant Industry Award 2010 and the Registered and Licensed Clubs Award 2010).

Box 4.7 Sunday public holidays in South Australia

One of the more unique, and enduring, characteristics of the South Australian workplace relations landscape is that every Sunday is a public holiday. A remnant of an earlier time — Sunday public holidays were originally written into the *Holidays Act 1910* (SA) to ensure that institutions such as banks and state government departments would not open on what was regarded as a day of rest.

Since the referral of industrial relations powers to the Commonwealth in 2009, most employers in South Australia have been moved into the national workplace relations system, meaning that they are subject to regulation under the *Fair Work Act 2009* (Cth) (FW Act), rather than under state industrial laws. However, since the FW Act recognises any other day or part-day declared under state or territory legislation as a public holiday (s. 115(1)(b)), all employers across the state — whether they are in the state or national systems — are affected.

In principle, the implication is that workers should receive public holiday penalty rates rather than Sunday penalty rates. Given the former is generally higher than the latter, this would mean a greater impost on employers. Moreover, it could mean that, in accordance with the National Employment Standards, employees have the right to a paid day off on Sundays.

In practice (and with the exception of the restriction on authorised deposit taking institutions and state government departments), there appears to be an informal détente, where neither employers nor employees regard Sundays as public holidays (SACES 2013, p. 8). This is reinforced by the notion that, at the state level, awards and enterprise agreements specifying Sunday rates of pay supersede public holiday penalty rates.

At the national level, the situation is even more perplexing. There is little evidence on the degree to which national system employers operating in South Australia treat Sundays as public holidays and pay their workers accordingly. A number of Commonwealth agencies operating in South Australia have been caught by the century old Act, with some, but not all, back-paying public holiday penalty rates (Robertson 2012). Some advice has suggested that this problem may diminish over time as new enterprise agreements nullify the problem by expressly specifying that employees earn Sunday rates, rather than public holiday rates (Australian Government Solicitor 2012).

The position of the Fair Work Ombudsman (FWO) is that state and national system employers should face similar obligations. In this sense, the national system regulator takes its lead from established practice in South Australia. The FWO does note, however, the absence of test cases establishing case law precedent in this regard. Moreover, while it will not seek rectification or bring a claim against employers for paying Sunday, rather than public holiday, rates, there is nothing to stop another party from doing so.

While it is not clear to what extent workers in South Australia are able to pursue claims for unpaid penalty rates on a Sunday, at the very least, without a decision by the South Australian Industrial Relations Tribunal in the state system, or by the Federal Court in the national system, the *prospect* of retrospective claims cannot be entirely disregarded. That is, businesses found to have paid Sunday, rather than public holiday penalty, rates over a long period of time may face a substantial liability for backpay.

While the *Holidays Act 1910* (SA) has been reviewed since — a recent example being its amendment in 2012 to provide for two part day holidays on Christmas Eve and New Year's Eve — the designation of every Sunday as a public holiday remains unaltered.

Source: Safework SA (2011).

from 125 per cent to 250 per cent. As is the case for weekday holidays, this can affect the behaviour of such enterprises (such as opening hours, staffing and so on).

Changes to public holiday arrangements can also involve tricky compliance issues for businesses, such as managing state variations for national businesses, and in the case of part day holidays, a variety of complexities about appropriate payments under the FW Act (WorkplaceInfo 2015a). The declaration of the two half-day holidays in South Australia in 2012, led to an exhaustive examination of part day payments by the Full Bench of the Fair Work Commission,[43] which in turn required changes to most awards, with the compliance costs and misunderstandings for businesses and employees that such amendments entail.

Finally, casuals only benefit partially from the declaration of new public holidays. They are entitled to a day off from work, unless reasonably requested to work on the public holiday. Regardless, if they take the day off, they will typically not be paid given the day-to-day character of employment arrangements for casuals. Such employees would still benefit from the higher penalty rates imposed on such days, but only to the extent that businesses continued to employ them on those days.

The implication is that newly designated public holidays will often involve no effective pay increases for the most low-paid employees.

Notwithstanding all of these problems and costs, sometimes the benefits of coordinated leisure may outweigh the overall costs of newly designated public holidays (some of which are transfers between parties anyway). As with any new regulation entailing large burdens on business (and consequences for others), state and territory governments should analyse these costs and benefits before any declaration.

Can we do better?

The 2012 review of the FW Act recommended limiting the total days that would attract penalty rates to just 11. However, much depends on which are the 11 days, and where they fall. This is because in a number of cases the market rate on a public holiday would approach the penalty rate anyway. Where a new public holiday fell on a weekend, this would have the effect of removing the cost impacts of the unilateral declaration by states and territories of new holidays. However, for new designated *weekday* holidays, it would not obviate the fact that employers would still be required to pay an employee absent on a state public holiday. Employers wanting an employee to work on a public holiday would, for commercial reasons, have to pay them at least what they would get on a normal working day (so the effective penalty rate for a person at work on a weekday public holiday would already be at least 200 per cent, even if there was no regulated penalty rate). To the extent that people would like to enjoy whatever community activities occurred on any designated holiday, then an employer might need to pay an additional amount to attract them to work. Accordingly, in practice, the wage rates negotiated between employees and

[43] Modern Awards Review 2012 — Part-day public holidays [2012] FWAFB 10738.

employers might be similar to those that would have been required under regulation.[44] In that case, the 2012 Review's penalty rates recommendation might have little effect on business costs on weekday holidays.

An alternative might be that the s. 115(1)(b) of the FW Act could be amended to remove any obligation for an enterprise to pay for an employee's absence on newly designated state and territory public holidays (unless for sick, annual or other forms of existing leave). In this case, employees would have to negotiate with their employers — either individually or through enterprise agreements — to be paid for absence on these days.

To avoid reductions in the current level of employees entitlements, were this proposal to be adopted, it would need to still permit jurisdictions (if they so wish) to declare substitute days when an existing public holiday falls on a weekend. This is currently allowed under the FW Act, although not all state and territories choose to exercise this ability.

DRAFT RECOMMENDATION 4.2

The Australian Government should amend the National Employment Standards so that employers are not required to pay for leave or any additional penalty rates for any newly designated state and territory public holidays.

This recommendation would not stop a state or territory government exercising their sovereignty to declare a public holiday. Doing so would still result in higher payments to any public sector employers that are not covered by the national system, but at least some additional accountability might be encouraged.

Do workers get enough leave?

A broader issue is a public debate about the desirable number of days available as holidays (regardless of their form) to Australian employees. Some countries have more legislated annual leave entitlements than Australia (such as Sweden and Austria with 25), while others like Canada (10 days) and the United States (zero) have less. Given that the demand for leisure generally rises with income, it could be expected that over the *longer term*, the preferences of people would be for implicit pay rises to take the form of more annual leave rather than just more dollars.

In theory, the same objective for more time off work could be achieved by allowing people to take unpaid annual leave funded by accumulated savings from a higher average hourly wage rate, leaving existing leave entitlements alone. However, while it is acceptable (and even expected) that people request standard annual leave, this is not true for unpaid leave.

[44] The exception to this is salaried workers who are generally expected to work reasonable extra hours in order to execute the tasks outlined in their contract of employment. Employers would not have to pay these workers extra should they require them on a public holiday.

Around 25 per cent of employees requesting changed employment arrangements have these refused by their employers, and a substantial number of employees wanting arrangements that are more flexible did not request them because of concerns about the responses from their employers.[45] In that instance, longer paid annual leave times, with a cash-out option, would establish an expectation that the leave would be provided, but still leaving some flexibility. As is the case for all annual leave, the exact time chosen for leave would be determined consensually between the employer and employee.

Changing the NES paid annual leave entitlements is not warranted at this stage (beyond those that would arise from transferring some public holidays to annual leave). Nevertheless, Australian governments should periodically assess whether there are grounds for increasing current annual leave entitlements in the NES. It would be preferable for a coherent discussion of that issue, rather than the creation, willy-nilly, of public holidays by state and territory governments that result in the same total leave amounts, but in a form that is less valuable to employees and more costly to employers. Any future policy initiative to raise the NES annual leave entitlements should not come at a higher total cost of labour, with an explicit tradeoff between the wage rate growth and any additional leave entitlements.

DRAFT RECOMMENDATION 4.3

Periodically, the Australian, state and territory governments should jointly examine whether there are any grounds for extending the existing 20 days of paid annual leave in the National Employment Standards, with a cash out option for any additional leave where that suits the employer and employee. Such an extension should not be implemented in the near future, and if ultimately implemented, should be achieved through a negotiated tradeoff between wage increases and extra paid leave.

4.4 Sick and annual leave for casual workers

There have also been calls recently to extend sick leave and annual leave to casuals and, when doing so, to make it portable.

Proponents of such changes note that it is increasingly common for workers to be asked (and/or to choose) to work in ways that differ from the standard ongoing full-time employment arrangement; a development which has not been complemented by progress in the way leave entitlements are earned. In this regard, the Secretary of the ACTU, Dave Oliver, has argued:

[45] For example, in Victoria for every 100 people requesting a change in work arrangements, around 20 people did not request changes because they thought their employer would not allow it, they were worried about job security or thought their workplace was not flexible (ABS 2011, *Workforce Participation and Workplace Flexibility, Victoria, December 2010*, Cat. No. 6210.0, released 11 August 2011.

> … [w]e live in a world where many people have two or three employers one week, and the next week just one. In this world, entitlements that we all agree should be the right of everyone with an Australian job – things like annual leave and sick leave – don't translate very well (Oliver 2013).

Casual workers are not entitled to annual or sick leave under the NES, but are generally paid a 'casual loading' instead (box 4.8). Any extension of the NES annual and sick leave provisions to casual workers would likely be at the expense of some or all of this premium.

Box 4.8 Casual workers and the National Employment Standards

Casual workers do not enjoy the same entitlements under the National Employment Standards (NES) as permanent, ongoing employees. Instead, they are entitled to:

- request flexible working arrangements after being employed for 12 months on a regular basis
- parental leave and related entitlements after being employed for 12 months on a regular basis
- 2 days unpaid carer's leave and 2 days unpaid compassionate leave per occasion
- unpaid community and jury service leave
- public holidays - a day off on a public holiday, except when reasonably requested to work
- long service leave where they can demonstrate continuous service (and depending on the relevant jurisdiction).

Casual workers may also have the right to use the unfair dismissal protections of the *Fair Work Act 2009* (Cth) where they have been employed for a minimum period and can prove they have an ongoing employment contract with their employer.

These entitlements differ from those available to permanent, ongoing employees. They do not include notice of termination, redundancy pay, paid annual leave, leave loadings and personal/carer's leave.

In lieu of these entitlements, casual workers are paid a 'loading'. This loading is specified in awards, agreements and minimum wage orders. Some awards, like the Seagoing Industry Award 2010 or the Fire Fighting Industry Award 2010, do not explicitly specify casual loadings, however this is generally attributable to a lack of casual workers in the particular industry, rather than any unwillingness to compensate the casual worker for their reduced entitlements.

The casual loading associated with the minimum wage is currently set at a minimum of 25 per cent. While most other instruments use this as a benchmark, there are some awards which prescribe different casual rates. For example, the Vehicle Manufacturing, Repair, Services and Retail Award 2010 specifies a casual loading of only 17.5 per cent.

Sources: Fair Word Ombudsman (2015b) and (2015g) .

Casual workers already possess a right (after a specified period of time with the employer) to ask for their casual position to be converted to a permanent one, but in practice there are few examples of this occurring (Stewart 2013). It may be that this reflects the preferences of some employees for casual employment arrangements and/or that the casual loading is sufficient to outweigh the forgone benefits of permanent employment. Alternatively, it may be that people do not make such requests because they expect them to be refused. However, there is compelling evidence that female casual employees derive as much job

satisfaction as female permanent employees, though this is not true for males (Buddelmeyer 2014).

Accordingly, there is not a strong case for extending the NES paid annual and sick leave entitlements to casual workers so long as casual loadings adequately reflect these forgone benefits. Imposing any significant additional regulations may reduce employers' willingness to provide such jobs.

However there may be merit in offering each casual worker an expanded set of choices. Since workers value some entitlements and not others, allowing casual workers to exchange a portion of their loading for additional entitlements may offer improved outcomes to both workers and employers. These exchanges could be at rates specified in the relevant award, enterprise agreement or minimum wage orders or set by in negotiations between employers and their workers (and guided by the FWC).

The merits of such an approach depend in large measure on its administrative workability and the costs entailed.

INFORMATION REQUEST

The Productivity Commission seeks information on whether it would be practical for casual workers to be able to exchange part of their loading for additional entitlements (for example personal or carer's leave) if they so wish, and whether such a mechanism would be worthwhile.

5 Unfair dismissal

Key points

- Unfair dismissal laws provide important and needed protections for employees, but are capable of misuse. They should strike a balance between creating incentives for treating people fairly at a time of significant shock; and potentially imposing costs on good employers that bear the risks of vexatious claims and compliance burdens.
- While the reported incidence of unfair dismissal is low in Australia as a proportion of all work separations, unions, advocacy groups, businesses and business representative bodies can all demonstrate fault with individual process and outcome matters. For this inquiry, the crucial question is whether that translates to a need for fundamental change.
  - The answer is that it appears not to do so.
- Moreover, the inquiry assesses that unfair dismissal laws are not playing a major role in hiring and firing decisions, a further crucial test.
- The current unfair dismissal regime reflects twenty years of intense debate. While recent legislative amendments to strengthen the Fair Work Commission's (FWC's) hand in regard to costs and the dismissal of unmeritorious cases are steps in the right direction, some further incremental reform is needed to:
  - prevent spurious cases from resulting in financial settlement, by introducing more effective upfront filters that focus on the merits of claims
  - not favour form over substance, by changing the penalty regime to ensure that procedural errors alone are not sufficient to award compensation or restore employment in what would otherwise be regarded as a fair dismissal
  - reform the governance of the FWC and some aspects of its conciliation and arbitration processes (see Ch 3)
- If these changes are all made, the Small Business Fair Dismissal Code should be removed, with a reliance instead on improvements in education and related generic arrangements through procedural and governance reforms.
- Removing statutory unfair dismissal laws is not justified on the evidence presented to date. Moreover, it could see an increase in cases pursued via alternative, costlier avenues (such as common law remedies through the courts), and a renewed direct involvement by self-interested third parties.

Australia's workplace relations (WR) system provides remedies for workers who are dismissed in a 'harsh, unjust or unreasonable' manner. The Fair Work Commission (FWC) may order the unfairly dismissed employee be reinstated, or paid compensation where reinstatement is inappropriate.

Unfair dismissal arrangements reflect that employees and employers do not always act appropriately. Firms and managers may act harshly or without sufficient cause. They may

dismiss employees based on whimsy or without due process. Dismissal is typically a shattering experience for employees, and can have long-term effects on their employment prospects and their lives.[46] On the other hand, sometimes employees may underperform, be disruptive or behave inappropriately, with adverse consequences for a business and its managers. Labour markets can only function efficiently if employers are able to require improvement from poorly performing employees and, absent of that, are able to dismiss or otherwise penalise them. Accordingly, there is a need for balance between the prerogative of businesses to manage and the rights of employees to fair treatment.

The system for unfair dismissal protections and remedies in Australia has as its centrepiece the unfair dismissal provisions in the *Fair Work Act 2009* (Cth) (FW Act), and the related role of the FWC in overseeing conciliation and arbitration processes. This chapter looks in detail at the operation of this framework and evaluates the case for further reform.

The chapter is organised as follows:

- section 5.1 discusses the current institutional setting, providing an overview of the main avenues by which employees can lodge unfair dismissal claims and the key institutions considering such claims
- evidence on the prevalence of unfair dismissal cases and how well the current unfair dismissal system is working is presented in sections 5.2 to 5.5
- reform options are assessed in section 5.6.

5.1 The institutional setting

In the current workplace relations framework employees have several avenues of remedy if they think their employment has been terminated unfairly or unlawfully. The lion's share of applications (roughly around 85 per cent at present) are made under s. 394 of the FW Act (application for unfair dismissal remedy). This avenue is available to all national system employees, subject to minimum employment periods. Award and agreement free national system employees earning more than the high income threshold are not protected from unfair dismissal.[47]

The other avenues for remedy are s.365 (application for the FWC to deal with a contravention of the general protections involving dismissal) and s.773 (application for the FWC to deal with other terminations of employment). Finally, in certain circumstances, an employee can seek damages from unfair dismissal through the common law.

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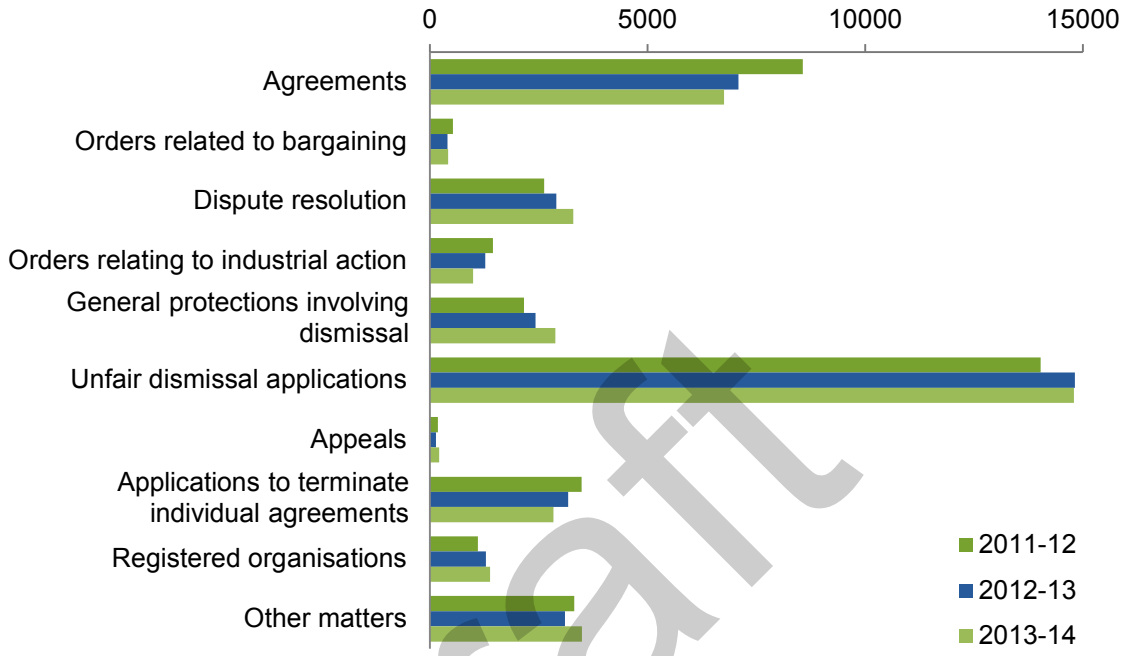
46 For a discussion of the mental health aspects of job insecurity and dismissal see, for example, D'Souza et al. (2003), Domenighetti, D'Avanzo and Bisig (2000), Freyens (sub. 149, p. 4), Employment Law Centre of WA (sub. 89, pp. 28-30).

47 Further detail on the definition and scope of the national employment system is provided in Chapters 1 and 2.

Since the commencement of the FW Act in 2009, unfair dismissal applications have been the biggest source of work for the FWC (figure 5.1).

Figure 5.1 **Case load by matter type: Fair Work Commission**



Source: FWC (2014b).

Protection from unfair dismissal under the *Fair Work Act 2009*

Unfair dismissal is covered in Part 3-2 of the FW Act. The stated object of this part of the Act is to establish a framework for dealing with dismissal that:

- balances the needs of business (including small business) and employees
- establishes procedures that are quick, flexible and informal; and that address the needs of employers and employees
- provides remedies if a dismissal is found to be unfair, with an emphasis on reinstatement rather than financial compensation
- in regard to procedures and remedies, ensures that a 'fair go all round' [48] is accorded to both the employer and employee concerned. (FW Act, s. 381)

[48] An expression used by Sheldon J in *Re Loty and Holloway v Australian Workers' Union* [1971] AR (NSW) 95.

Protection from unfair dismissal in Australia has a relatively long history, and the current formulation of protections in the FW Act is the result of modifications and refinements over several decades (figure 5.2).

What constitutes an unfair dismissal?

In the FW Act (s. 385), a person has been unfairly dismissed if the FWC is satisfied that:

- the person has been dismissed; and
- the dismissal was harsh, unjust or unreasonable; and
- the dismissal was not consistent with the Small Business Fair Dismissal Code; and
- the dismissal was not a case of genuine redundancy.

The Act contains detailed criteria on the identification of harsh, unjust or unreasonable dismissals. These include criteria relating to the person's capacity or conduct at the time of dismissal, notification and enterprise size.

A person is not unfairly dismissed where he or she has been genuinely made redundant (FW Act, s. 389). A genuine redundancy is said to have occurred if the employer no longer required the person's job to be performed by anyone because of changes in the operational requirements of the employer's enterprise; and the employer has complied with any obligation in a modern award or enterprise agreement to consult about the redundancy.

There are minimum employment or probation periods set down in the FW Act that must elapse before employees can access the Act's main unfair dismissal protections. Specifically, under the FW Act (s. 382), employees are protected from unfair dismissal only if they have served a minimum employment period (six months, or one year for those employed by small businesses (defined as businesses having fewer than 15 employees)). Service as a casual employee does not count towards the period of employment unless it was on a regular and systematic basis and the employee had a reasonable expectation of continuing engagement on a regular and systematic basis.

Finally, to be eligible for protection, the employee must be covered by a modern award or enterprise agreement (which together covers most employees), or earn less than the high income threshold (set at $136 700 on 1 July 2015, but adjusted annually).

An employee has 21 days from the date on which they were dismissed to make an unfair dismissal application.

Figure 5.2 **Comparison of unfair dismissal protections in the FW Act and previous frameworks**

	Workplace Relations Act 1996	*WR Amendment Act 2005*	*Fair Work Act 2009*
Commencement date	November 1996	March 2006	July 2009
Coverage of workforce	About 50%	About 50%, taking in account exemptions	About 90%
Test for unfair dismissal	'harsh, unjust or unreasonable'. Some dismissals also unlawful.	Same as WR 1996	Same as WR 1996
Employer size threshold for claims	No threshold	>100 employees	No threshold
Qualifying period of service for Employment Claims	3 months	6 months	6 months (but 12 months for small businesses)
Time limit to lodge claims	21 days for the date that the dismissal takes effect	21 days from the date that the dismissal takes effect	At commencement of Act was 14 days. Increased in late 2012 to 21 days from the date that the dismissal takes effect
Exclusions	Casuals with <12 months' service	Casuals	Casuals who are not employed on a regular/ systematic basis (s. 384(2))
	Contractors	Contractors	Contractors
	Trainees	Trainees	Trainees
	Fixed term employees	Fixed term employees	Fixed term employees at end of term
	High wage employees	High wage employees	Employees earning <$136k indexed[a], if not covered by award or agreement
Redundancy definition	'Job performed by no one" There was a reluctance of courts to intervene in employer judgments about economic reasons.	'Genuine operational reasons' There is no need for employer to show that this was the only reason, or that the operational reasons made the dismissal necessary.	'Genuine redundancy'
Remedies	Reinstatement, compensation, capped at 6 months	Reinstatement, compensation, capped at 6 months	Reinstatement, compensation, capped at 6 months
Other dismissal remedies	Unlawful termination	Unlawful termination	Dismissal claims possible under adverse action provisions s. 365

a As of 1 July 2015. Adjusted annually. **b** Discussed in greater detail in chapter 11.

Source: Adapted from Freyens and Oslington (2013, p. 304).

Separate arrangements apply to small businesses

For small businesses, a dismissal will be deemed fair if the FWC is satisfied the employer followed the Small Business Fair Dismissal Code (box 5.1).

Box 5.1 The Small Business Fair Dismissal Code

Summary (or immediate) Dismissal

It is fair for an employer to dismiss an employee without notice or warning when the employer believes on reasonable grounds that the employee's conduct is sufficiently serious to justify immediate dismissal. Serious misconduct includes theft, fraud, violence and serious breaches of occupational health and safety procedures. For a dismissal to be deemed fair, it is sufficient, though not essential, that an allegation of theft, fraud or violence be reported to the police. The employer must have reasonable grounds for making the report.

Other Dismissal

In other cases, the small business employer must give the employee a reason why he or she is at risk of being dismissed. The reason must be a valid reason based on the employee's conduct or capacity to do the job.

The employee must be warned verbally or preferably in writing, that he or she risks being dismissed if there is no improvement.

The small business employer must provide the employee with an opportunity to respond to the warning and give the employee a reasonable chance to rectify the problem, having regard to the employee's response. Rectifying the problem might involve the employer providing additional training and ensuring the employee knows the employer's job expectations.

Procedural Matters

In discussions with an employee in circumstances where dismissal is possible, the employee can have another person present to assist. However, the other person cannot be a lawyer acting in a professional capacity.

A small business employer will be required to provide evidence of compliance with the code if the employee makes a claim for unfair dismissal to the Fair Work Commission, including evidence that a warning has been given (except in cases of summary dismissal). Evidence may include a completed checklist, copies of written warning(s), a statement of termination or signed witness statements.

Source: Australian Government (2011).

In the FW Act (s. 23), a small business is defined as employing fewer than fifteen workers on a head count basis (not full-time equivalents). Casual workers employed on a regular and systematic basis are counted as employees (Australian Government 2011).

This count includes the employee claiming unfair dismissal, any other employees dismissed at the same time, as well as any employees working for an 'associated entity' of the employer as defined by the Act (Stewart 2013, p. 346). Given this head count definition, two businesses with identical labour inputs in terms of hours worked may be

classified into different employment size categories, and subject to different statutory requirements (an issue that is examined further below).

Remedies and procedures

Reinstatement is a primary object of the unfair dismissal framework in the FW Act (s. 390). The *reinstatement* provisions require that, where an order for reinstatement is made, the person either be reappointed to the same position as they occupied immediately prior to the dismissal, or to another position on terms or conditions that are no less favourable than those on which the person was employed immediately prior to dismissal. These provisions apply to employers and their associated entities. The FWC can only award compensation where it is satisfied that reinstatement is inappropriate.

Compensation for unfairly dismissed employees is capped at the lesser of either half the high income threshold (which would currently be equal to $68 350), or 26 week's remuneration, with determination of the amount paid up to that cap based on likely future income of the employee, deductions of any money earned since termination and several other factors. While the FWC may reduce compensation if the employee's misconduct contributed to the employer's decision to dismiss, the compensation amount is in many cases essentially formulistic (box 5.2).

Box 5.2 The 'Sprigg Test'

In awarding compensation for unfair dismissal, the Fair Work Commission tends to rely in many cases on the so-called Sprigg Test. The recent case of *Haigh v Bradken Resources Pty Ltd* [2014] FWCFB 236 discusses the structure and application of the test:

> The frequently quoted case on compensation calculations is *Sprigg v Paul's Licensed Festival Supermarket* (1998) 88 IR 21 in which a Full Bench of the Australian Industrial Relations Commission (AIRC) confirmed the following steps in determining compensation under the unfair dismissal provisions of the Workplace Relations Act:
>
> 1. Estimate the amount the employee would have received or would have been likely to receive if the employment had not been terminated.
> 2. Deduct monies earned since termination.
> 3. Deductions for contingencies.
> 4. Calculate any impact of taxation.
> 5. Apply the legislative cap.
>
> The legislation has been amended since that time by permitting a reduction in an amount otherwise payable if an employee's misconduct contributed to the employers decision to dismiss.

Source: Watson, Sams and Riordan (2014).

Compensation amounts are not related to the seriousness of any unfair action by the employer or the emotional effects of the dismissal. Indeed, the FW Act specifically excludes consideration of 'shock, distress or humiliation' as relevant for compensation. High compensation amounts are more likely if the employee would have been expected to

otherwise have stayed in their job for an appreciable period, and if they did not receive significant wages after termination. There is, in effect, an incentive not to get a job for some dismissed workers, though the importance of that incentive is not clear.

In practice, the average compensation paid is relatively low. For example, in 2013-14, of the 150 arbitrated cases where compensation was granted, around 55 per cent involved payment of less than $10 000, while 36 per cent of cases involved payment of less than $6000 (FWC 2014b). These totals include wages owed to employees.

Other FW Act avenues for remedy

As discussed previously, an application for a remedy for unfair dismissal is not the only avenue available to an employee whose employment has been terminated.

First, it is possible to make an application for the FWC to deal with a breach of the *general protections* involving dismissal (s. 365). This avenue differs from the unfair dismissal provisions in Part 3-2 in several respects. For example, compensation is uncapped; there is no high-income threshold; relief is available to certain employees outside the national WR system; and, rather than using the 'harsh, just or unreasonable' formulation, the dismissal must constitute 'adverse action' or otherwise contravene Part 3-1 of the Act. As will be discussed further below, and in chapter 6, this alternative avenue for relief has seen a significant growth in cases in recent years (table 5.1).

Table 5.1 **Dismissal lodgments by type**

	FW Act, s.394: Application for an unfair dismissal remedy	*FW Act, s.365: Application to deal with contraventions involving dismissal (General protections)*	*FW Act, s.773: Application to deal with an unlawful termination dispute*	*WR Act, s.643: Application for relief re termination of employment*	*Total*
2009-10	11 116	1188	262	488	13 054
2010-11	12 840	1871	174	12	14 897
2011-12	14 027	2162	141	3	16 338[a]
2012-13	14 818	2429	128	2	17 377
2013-14	14 796	2879	130	2	17 807

[a] The total for 2011-12 is stated to be 16 338 in the relevant annual report, yet the sum of all lodgments only equals 16 333.

Sources: Fair Work Australia (2012a), FWC (2013a), FWC (2014b).

Second, a claim of *unlawful termination* is possible under Part 6-4, Div 2 of the Act (s.773).

It is not possible to pursue both a s. 394 application for unfair dismissal *and* an application via either s. 773 or a general protections application, as this is ruled out by sections 725-733 of the FW Act. Further, dismissed employees cannot pursue an unlawful termination claim if they are able to make a general protections complaint (s. 723).

State unfair dismissal laws

With the exception of Victoria, each state also has laws on unfair dismissal:

- the *Industrial Relations Act 1996* of New South Wales
- the *Industrial Relations Act 1999* of Queensland
- the *Industrial Relations Act 1979* of Western Australia
- the *Fair Work Act 1994* of South Australia
- the *Industrial Relations Act 1984* of Tasmania.

Claims brought under these laws are heard in the relevant state-based commissions.

The coverage provided by the state laws is quite limited and, given the national coverage of the FW Act, confined to non-national system employees, such as state government employees and in Western Australia employees of unincorporated enterprises. This limited coverage is reflected in the increasingly low prevalence of claims lodged under these provisions (as noted below).

Common law remedies

A final avenue of recourse for employees is to pursue a claim of *wrongful dismissal* at common law. Wrongful dismissal generally requires dismissal to be in breach of the employment contract, which is a much higher bar than the unfair dismissal protections under the FW Act.

While wrongful dismissal can be more difficult to establish, expensive to pursue, and contain greater risks of having to pay a defendant's costs if unsuccessful, it can nevertheless suit some individual's circumstances. For example, higher paid workers whose salary exceeds the high income exclusion threshold ($136 700 as at 1 July 2015), and workers on longer fixed-term contracts, may find it necessary to pursue claims via the common law (Stewart 2013).

Compensation rather than reinstatement is the primary remedy available to employees for wrongful dismissal (in contrast to the pre-eminence given to reinstatement under the FW Act). Further, there is no cap on the quantum and nature of compensation that can be sought at common law.

The number of common law claims is currently small relative to those undertaken via the FW Act. To the extent that they establish significant precedent, recent cases (most notably *Commonwealth Bank of Australia v Barker*[49]) have ruled out certain avenues for undertaking common law actions, and clarified the circumstances under which an action may proceed successfully. In particular, after the Barker case, it appears that it is more difficult to successfully pursue cases alleging breach of an implied duty of mutual trust and confidence than may have been supposed previously. This is expected to reduce the number of claims being pursued in the future via this route.

Compensated no fault dismissal — the 'nuclear option'

Some have argued for the complete dismantling of unfair dismissal protections, while still providing some compensation (see, for example, Johns (2011), Collier (2011) and box 5.3). This would involve the introduction of a novel 'no fault' arrangement where, on dismissal, employees would receive some settlement from employers, but there would no further avenue of appeal. There would be some advantages from this approach, including the reduction in the current $80 million budget of the FWC (where individual matters constitute a large share of the total business), and significant savings in the private costs of parties to disputes. It would displace the current compensation payments required by the FWC. And, depending on the level of the payment, it would still provide some broad incentives for businesses not to unscrupulously dismiss workers.

Box 5.3 Divorce and unfair dismissal: a comparison

Grace Collier outlines the basic features of a no-fault dismissal system as follows:

> Employment is a relationship, a very important one; but like all relationships the only guarantee it contains is that one day it will end. Dismissal, resignation, redundancy or business closure will see all Australians one day put out of their jobs. So it is with marriage too, but when the relationship of marriage ends, people don't insist that the government steps in to make a judgment on whether the separation was 'fair' or not.

A no fault dismissal system with a reasonable paid notice period, including an assistance package and supportive job transition service, may be a better way. It would certainly be cheaper. It would remove the legal argument over whether it is 'fair', 'unfair', a 'redundancy', 'dismissal' or 'constructive dismissal' and the costs of mounting those arguments. It would put a lot of Fair Work Australia commissioners and lawyers out of work and that would not be a bad thing.

Source: Collier (2011).

On the other hand, moving to a no-fault arrangement (compensated or not) raises several major issues:

[49] [2014] HCA 32. The High Court of Australia held that under the common law of Australia, employment contracts do not contain an implied term of mutual trust and confidence. See also *State of New South Wales v Shaw* [2015] NSWCA 97 (17 April 2015).

- if compensation was included, it would provide some restitution in minor cases, but inadequate payments for genuinely egregious dismissals
- it would also leave open the possibility that all employees subject to dismissal with cause (a substantially larger group than those currently lodging claims) could seek and obtain compensation
- it might create perverse incentives for some employees to engage in misconduct to receive the no-fault payout, since the employee knows that the employer has no recourse to have a vexatious claim dismissed
- no fault arrangements do not create effective incentives for employers because the costs of an unfair dismissal would not be proportionate to the lost employment opportunities of any given dismissed employee. The failure to do this adversely affects employees, but also means that the imbalance of power between employers and employees shifts
- regardless of whether compensation was permitted or not, such a measure would leave parties to seek remedies through the common law. In theory, such common law rights could be removed through statute, but the grounds for doing so would be weak. Accordingly, no fault dismissal might simply open a less efficient door for uncapped restitution.

Notwithstanding its ingenuity, the Productivity Commission considers that such a major reform of dismissal protections is not warranted. The current arrangements provide significant exemptions and probation periods for businesses of all sizes. On balance, while these arrangements do require improvements, their wholesale dismantling is not justified by the weight of evidence presented to the inquiry thus far.

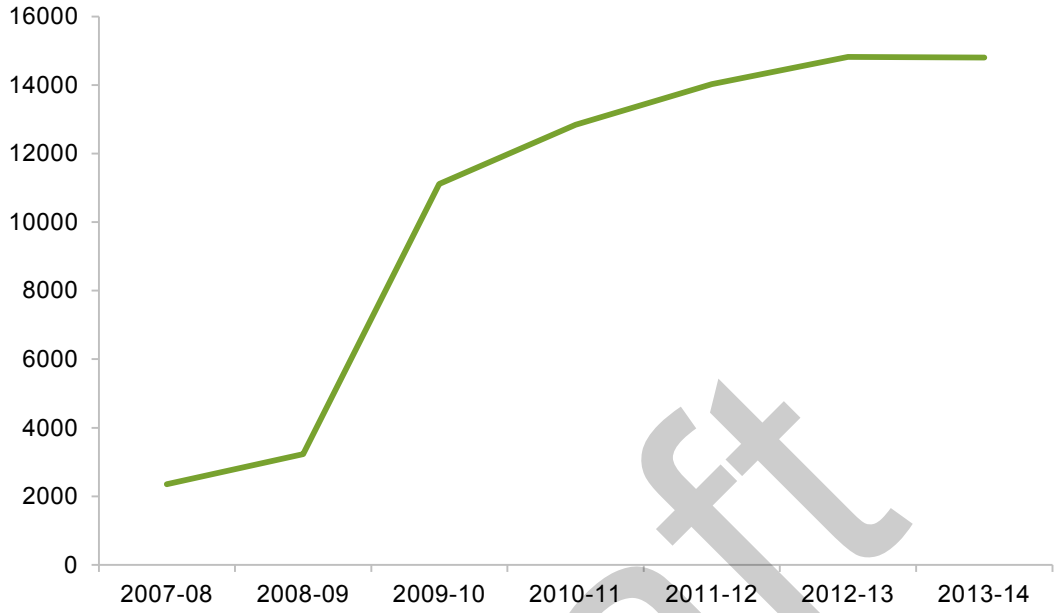
5.2 The incidence and costs of unfair dismissal cases in Australia

As a first step in evaluating current arrangements, it is important to consider evidence on the frequency of unfair dismissal claims and their impacts on employers and employees. This is discussed in this section and more detailed accompanying data are available in appendix B.

The incidence of claims

There has been a significant increase in the number of unfair dismissal lodgments since the introduction of the FW Act in 2009 (figure 5.3). This is to be somewhat expected give removal of the 100 employee exemption, expansion of the national WR system and growth in the labour force.

Figure 5.3 **Unfair dismissal applications lodged**
s. 394 lodgments



Sources: Australian Industrial Relations Commission (2008), Australian Industrial Relations Commission (2009), FWC (2014b).

Following lodgment with the FWC, if claims are not dismissed for jurisdictional or procedural reasons[50], they proceed to conciliation and, where necessary, arbitration. *Conciliation* of unfair dismissal applications is a voluntary, informal process in which participants 'identify the issues in dispute and endeavour to reach an in-principle agreement to resolve the dispute in a way that meets the needs of the parties' (O'Neill 2012b). Most conciliations are conducted by telephone conference organised by the FWC. In 2013-14, the proportion of conciliated cases was large, at around 80 per cent of the 14 900 total applications made in that year, and this continues a trend that has been apparent since the introduction of the FW Act.

If an application is not dismissed or settled through conciliation, it proceeds to substantive *arbitration* (O'Neill 2012b). Following a long decline, the rate of substantive arbitration has risen since 2009-10. Around 800 unfair dismissal cases proceeded to substantive arbitration at FW Act in 2013-14. The rise in claims that proceed all the way to arbitration has been accompanied by a noticeable fall in the success rate for claimants (appendix B, table B.2).

[50] Cases can be dismissed on procedural or jurisdictional grounds. Examples include cases where the claimant is an irregular or casual employee, where the minimum employment period has not been served, where there was no award, agreement, or the claimant was a high-income employee, as well as late claims, cases of genuine redundancy, frivolous or vexatious claims, and claims where the applicant has not actually been dismissed.

One significant limitation of the available data is that it fails to capture any unfair dismissal disputes that do not make it to the lodgment stage. Some employees with valid unfair dismissal claims may not lodge a claim for a number of reasons, including lack of knowledge about their rights. Further, as discussed below, some employers may pay employees to leave the business (sometimes referred to as 'go away money') to avoid a dispute making its way to the FWC, even though the employers believe the dismissal was for a valid reason (Hannan 2012). Past commentary in Australia has called for greater scrutiny of the pre-claim stage, and some commentators have called for the introduction of pre-claim conciliation as a way to resolve many disputes while the employment relationship is still extant (for example (Howe 2012)).

Monetary settlements

In the current system, a considerable number of conciliated cases result in some form of monetary settlement. Using FWC data, for example, across 2010–14, around 60 per cent of total successful conciliations initiated resulted in monetary settlement. On average, the settlement amounts are relatively modest, with over 50 per cent being set at $4000 or less (figure 5.4). Nevertheless, some businesses may not have the liquidity or access to borrowing to easily meet such payments.

Figure 5.4 **Conciliation settlements involving money**
Distribution of payment totals, 2013-14

Sources: O'Neill (2012b), Fair Work Australia (2012a) FWC (2013a), FWC (2014b).

Around 20 to 30 per cent of total cases that proceed to substantive arbitration also result in payment (appendix B, table B.4). In general, compensation awarded under arbitration exceeds that awarded under conciliation, although the $2000–$3999 band is still the most common under both methods of finalisation.

Cost perspectives

Putting perceptions aside, the available data provide some evidence about the degree to which unfair dismissals are likely to have significant adverse economic effects via their cost impacts. The statistics show that unfair dismissal claims remain relatively small in proportional terms across the Australian labour force. For example, in 2012-13, there was a total of around 17 000 unfair dismissal and other dismissal related lodgments made via the various available avenues available. This equates to roughly 0.18 per cent of employed persons, and 4.5 per cent of cases where an employee involuntarily lost their job due to retrenchment, redundancy, their employer going out of business, no work being available or for dismissal with cause.[51]

Unfortunately, there are few estimates of the number of dismissals with cause. Very dated information for the 1990s suggested that between 2.1 and 4.4 per cent of employees were dismissed for cause (Harding 2002). Were such a figure still to apply, it suggests that there would have been between 200 000 and 420 000 dismissals with cause in 2012-13. The latter is implausible because it is higher than separations associated with a far broader range of reasons, but if the 200 000 estimate is taken as a more reasonable estimate, it suggests that unfair dismissal lodgments (many of which are unsuccessful) comprise around 10 per cent of total dismissals with cause. Unfair dismissal lodgments resulting in compensation payments from the employer would comprise around 5 per cent of dismissals with cause.

Ben Freyens (sub. 149, p. 5) also discussed dismissals for cause, stating:

> … we have no information at all about the number and characteristics of individuals dismissed for cause in any given year … McCallum, Moore and Edwards (2012) suggests an annual claim rate of about 1.5%, but that is worked out against all separations, not just dismissals for cause, which should be our reference group. Buechtemann (1993) provides a 10% rate for the UK, which suggests 9 out of 10 workers dismissed for cause do not contest the dismissal.

These data are clearly highly uncertain, and accordingly the Commission seeks further information on dismissals. Nevertheless, they suggest that employers will infrequently encounter unfair dismissal cases taken to the FWC, with around only half of these occasioning compensation (though the business still bears administrative and other non-pecuniary costs with the remaining cases).

[51] Based on ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0 for November 2013 and ABS, 2014, *Labour Mobility, Australia, February 2013*, Cat. No. 6209.0, table 11. It should be noted that the ABS labour mobility data will underestimate total separations over a year because it records multiple instances of separations for a given person as a single separation.

The cost data provided by the FWC regarding conciliated settlements and arbitrated outcomes does not incorporate indirect costs to employers or employees (box 5.4). Including the time cost to employers for the conciliation or arbitration process, the cost of obtaining legal advice, and any settlement payment to the dismissed employee suggests that average total costs of an unfair dismissal case going to the FWC are currently around $13 500. Even so, this is likely to underestimate the true costs of an unfair dismissal system because it fails to take into account the costs to the business of employees who are not dismissed despite poor performance and of processes used by the business to attempt to avoid unfair dismissal cases arising in the first place (Harding 2005).[52] It also does not assess costs to employees who are unfairly dismissed, but do not take action. Nor does it include other costs borne by dismissed employees from unfair dismissal processes, such as travel costs and costs associated with disruption to job search activities. There are no reliable estimates of such costs.

The potential longer term costs for employees

For *employees*, the longer-term effects of involvement in unfair dismissal (through lodgment, settlement, conciliation and/or arbitration) can be significant. These effects are also germane in any consideration of the costs of unfair dismissal arrangements, and should be of particular importance in deciding if a cap on compensation is appropriate, and what the level of the cap might be.

5.3 Impacts on employment and productivity

Existing theoretical and empirical work, from Australia and internationally, shows varying economic effects of unfair dismissal regulations on employment, productivity and labour market transitions. This section considers some potential costs and benefits of unfair dismissal regulation, and explores the available evidence on employment and productivity effects.

[52] However, it should also be noted that the compensation amounts shown in the tables above include payments for entitlements that the employee would have received anyway (including unpaid wages), and so should not properly be characterised as compensation associated with unfair dismissal. This has been ignored in the estimates.

Box 5.4 What about administrative and time costs?

In considering cost estimates regarding unfair dismissal, data provided by the FWC, while useful, does not provide detail on some important elements of cost. For employers in particular, involvement in unfair dismissal cases is likely to incur time and administrative costs that are additional to more direct costs associated with compensation. Employees also incur time, emotional disturbance and administrative costs in bringing their claim, in addition to the FWC's lodgment fee.

It is possible to make high-level comparisons between the FWC data on unfair dismissal costs and the findings of earlier research by Freyens and Oslington (2007)(F&O), which incorporate a broader set of costs. (This research was conducted when the 100 employee exemption applied.) They estimate costs of dismissal using a large-scale survey of small and medium-sized Australian enterprises and present figures displaying the distributions of firing costs for uncontested dismissal, conciliation costs, arbitration costs and redundancy costs.

The data available from F&O and the FWC differ in their source and level of detail. The costs F&O report for conciliated and settled dismissals include the time cost of the conciliation process, the cost of obtaining legal advice, and any settlement payment to the dismissed employee. On the other hand, the FWC data employed to represent conciliation costs include only compensation payments, so that the values are lower on average.

	Conciliation: Average compensation (2012 dollars)
F&O (2007)	12 240
FWC, 2010-11	5560
FWC, 2011-12	5670
FWC, 1 July 2012 – 31 January 2013	5830
	Arbitration: Average compensation (2012 dollars)
F&O (2007)	14 594
FWC, 2010–11	11 642
FWC, 2011–12	11 200
FWC, 1 July 2012 – 31 January 2013	11 440

Sources: F&O (2007); FWC (2013); O'Neill (2012).

For arbitration costs, F&O report the total costs associated with a dismissal challenged by an employee and arbitrated. These costs incorporate all possible outcomes of arbitration, including cases where no remedy is attained. However, time and administrative costs are not included. The FWC reports only compensation payments awarded for granted applications under arbitration. Therefore, the FWC average arbitration costs are less complete than F&O's costs, and lower on average since additional costs to the employer of the arbitration process are not considered.

Sources: Freyens and Oslington (2007) and Fair Work Commission (2013a).

Potential benefits and costs

Unfair dismissal legislation is a feature of many countries' WR systems (section 5.4). There are several motivations for such provisions:

- The most obvious of these is the protection of vulnerable workers from the vicissitudes of unfair practices on the part of negligent or malicious employers. Unfair dismissal can result in large adverse impacts on an employee, including loss of income, stress, reduced social status, lower future employment prospects and the loss of social networks in their workplaces. It can also adversely affect other employees who are not dismissed, but nevertheless fear that his or her employer may do so.
- If unfettered, the capacity to dismiss an employee without any safeguards changes the relative bargaining power of the parties and also leaves open the potential for abuse of power in other ways. For example, an employer may request that an employee work longer hours without payment, or that he or she acquiesce to inappropriate employer conduct. If such conduct is hard to objectively monitor (and this may be the case), even the *threat* of dismissal can reduce the capacity of an employee to resist any such behaviour. So employees can bear significant costs, even if no dismissal actually occurs.
- In the absence of well-defined legislative and institutional approaches to apparently unfair dismissals, other less efficient processes may predominate. For instance, an unfair dismissal may prompt industrial strife (although this is more likely to directly affect medium to large employers). The outcome may subsequently reflect the industrial muscle of the competing parties, rather than the merits of the case. In the meantime, the industrial action itself can have significant immediate costs on employees and employers, as well as undermining future trust. Similarly, common law claims involve uncapped compensation amounts and have high transactions costs (and, accordingly, for many are an inaccessible) remedy. As Freyens and Oslington (2013) point out:

  > We must remember that … (unfair dismissal) costs include payouts of statutory entitlements which would be recoverable in the absence of an unfair dismissal claims system, and that the counterfactual is not the absence of an unfair dismissal claims system (Collier 2011) but common law claims for breach of contract, damages etc (as emphasised by (Howe 2012)).

- Statutory protections mean that an employee's capacity to contest arbitrary dismissal does not depend on the capacity to enlist union support (Howe 2013, p. 1; Peters et al. 2010, p. 6).

While not a motivation, unfair dismissal legislation can also improve aggregate productivity performance by penalising poorly managed businesses (Ji and Wei 2013).

Although unfair dismissal regulations are an important part of an employment protection framework, they are also not socially costless. As Oslington (2012) states:

> Both the effect of the regulations on incumbent wages and the subtle discrimination against risky workers induced by dismissal regulation mean that the 'social justice' arguments are not all on the side of those advocating stronger employment protection. Regulation can hurt some of the most vulnerable in the Australian labour market.

Where regulation is poorly designed or implemented, it can have several adverse effects:

- If employers feel restricted in exercising the prerogative to dismiss underperforming employees, it undermines the efficiency, flexibility, profitability and even the viability of some enterprises. Recent literature on firm performance associates positively the capacity of an organisation to reward high performers and to re-train or remove underperformers with productivity and return on capital (Bloom, Sadun and Van Reenen 2012). There is international evidence that some forms of employment protection increase absenteeism, lower productivity and discourage investment.[53] However, the extent to which these findings are relevant to Australia is not clear.
- Moreover, other employees may be adversely affected if managers face obstacles in dismissing underperforming colleagues. Workloads may be unreasonably distributed, the workplace may be less pleasant, and the time costs of addressing underperformance diverts talented people away from essential tasks.
- Managers and owners of businesses also face emotional costs from vexatious claims, and the stress of managing these. Several participants discussed this point in detail (see, for example, Remy Favre (sub. 20, p. 2); Major Events Consulting Australia Pty Ltd (sub. 38, pp. 1–2); Western Australian Government (sub. 229, p. 33)).
- Such regulations can also act as a disincentive to hire workers who are perceived to be higher risk, such as the long term unemployed and those with lower levels of educational attainment.[54]
- Dismissal regulations can also facilitate the earning of unjustified wage premiums for incumbent workers, and may also act as a blocker to firm-level innovations.

Empirical evidence on employment and productivity effects

The *employment effects* of workforce protection laws (of which unfair dismissal laws form an important part) have been extensively studied internationally. As a whole, these empirical studies present a mixed picture.

In this context (Autor, D., Kerr, W. and Kugler, A. 2007) explain that the impact of unfair dismissal costs on employment is theoretically ambiguous. This is because dismissal costs are akin to a tax on firing, which reduces dismissals, but also decreases the chance of new workers being hired. However, if expected unfair dismissal costs are small, then unfair dismissal laws are unlikely to play a major role in the hiring and firing decisions of firms (which is the interim finding of the Productivity Commission in relation to Australia).

Research from Australia has shown mixed results.

[53] There is an extensive literature on effects, such as on absenteeism (Ichino and Riphahn 2005); productivity (Autor, Kerr and Kugler 2007; Bassanini, Nunziata and Venn 2008; Bjuggren 2014; Cingano et al. 2014; Gianfreda and Vallanti 2013; Laporsek and Stubelj 2012; Trentinaglia De Daverio 2014); employment (Micco and Pages 2006); and investment (Calcagnini, Ferrando and Giombini 2014).

[54] For further discussion on this point see Oslington (2012).

- Harding (2002) used the results of a survey undertaken of 1802 businesses with fewer than 200 employees, and estimated that unfair dismissal laws reduced employment of workers on the average wage by about 0.46 per cent, corresponding to approximately 41 400 jobs Australia-wide at that time.
- Freyens and Oslington (2007) used quantitative survey results and other publicly available information to calibrate a labour demand model, and found much lower impacts, estimating that repealing all Australian unfair dismissal laws would create approximately 12 000 jobs (an upper bound for the direct employment impact).
- In a more recent study of the impact of the WorkChoices legislation, Venn (2011) found no significant employment effect associated with the 100-employee exemption. The study found that the reform had no discernible impact on hiring, firing or working hours in the treatment group, compared with larger firms.
- A later paper by Freyens and Oslington (2013), using more recent data on unfair dismissal claims under the FW Act, confirmed the conclusion of their earlier paper that unfair dismissal regulations impose small actual costs on business and have minimal impacts on aggregate employment.

Some of the international empirical evidence has identified small but significant negative employment effects of more stringent regulations (OECD 2013a).

Research on *productivity effects* has, if anything, less clear results. As stated by the OECD and ILO in 2011:

> Theoretically the effects of employment [protection] regulations on productivity are uncertain. Overall there is evidence that overly strict employment protection regulations have a negative effect on labour turnover and … on productivity growth. (cited in Freyens 2014, p. 19)

In theory, limitations on dismissal *may* affect productivity through a number of channels. At the firm level, it may have some positive effects on firm-level productivity because it provides an incentive to screen potential worker productivity more thoroughly, and to substitute from labour to capital. On the negative side, such regulations could be productivity-reducing if they require employers to follow costly processes to dismiss a less productive employee and thereby retain less productive workers for longer periods than would otherwise be the case.

Disentangling the productivity effects of such regulation at the *aggregate* level is very difficult. Even were unfair dismissal regulations to increase labour productivity of employees by excluding less productive people, it could reduce aggregate output per capita.

5.4 How does Australia compare internationally?

International comparisons of dismissal arrangements tend to place Australia towards the less interventionist end of the spectrum:

> Australia has an intermediary level of unfair dismissal protection, stricter than the complex but highly decentralised and unpredictable system in place in the United States, but far less constraining than the unfair dismissal provisions that operate in Continental Europe, and the even more constraining systems in place in BRICS [Brazil, Russia, India, China and South Africa] countries. (Freyens, sub. 149, p. 8)

However, the exact results of such comparisons depend on the methodology and indicators of stringency used.

Since 1985, the OECD has published annually a series of indicators capturing various facets of the protection of permanent workers against individual dismissal (OECD 2013a). Australia currently has a relatively low rank regarding the level of procedural inconvenience attached to its dismissal laws. This includes such things as notification procedures and delays before notice can effectively start. A low rank is also shown on the overall difficulty of dismissal, which includes indicators of the definition of unfair dismissal, compensation requirements, maximum times for claims, length of employee trial periods and the possibility of reinstatement (figure 5.5).

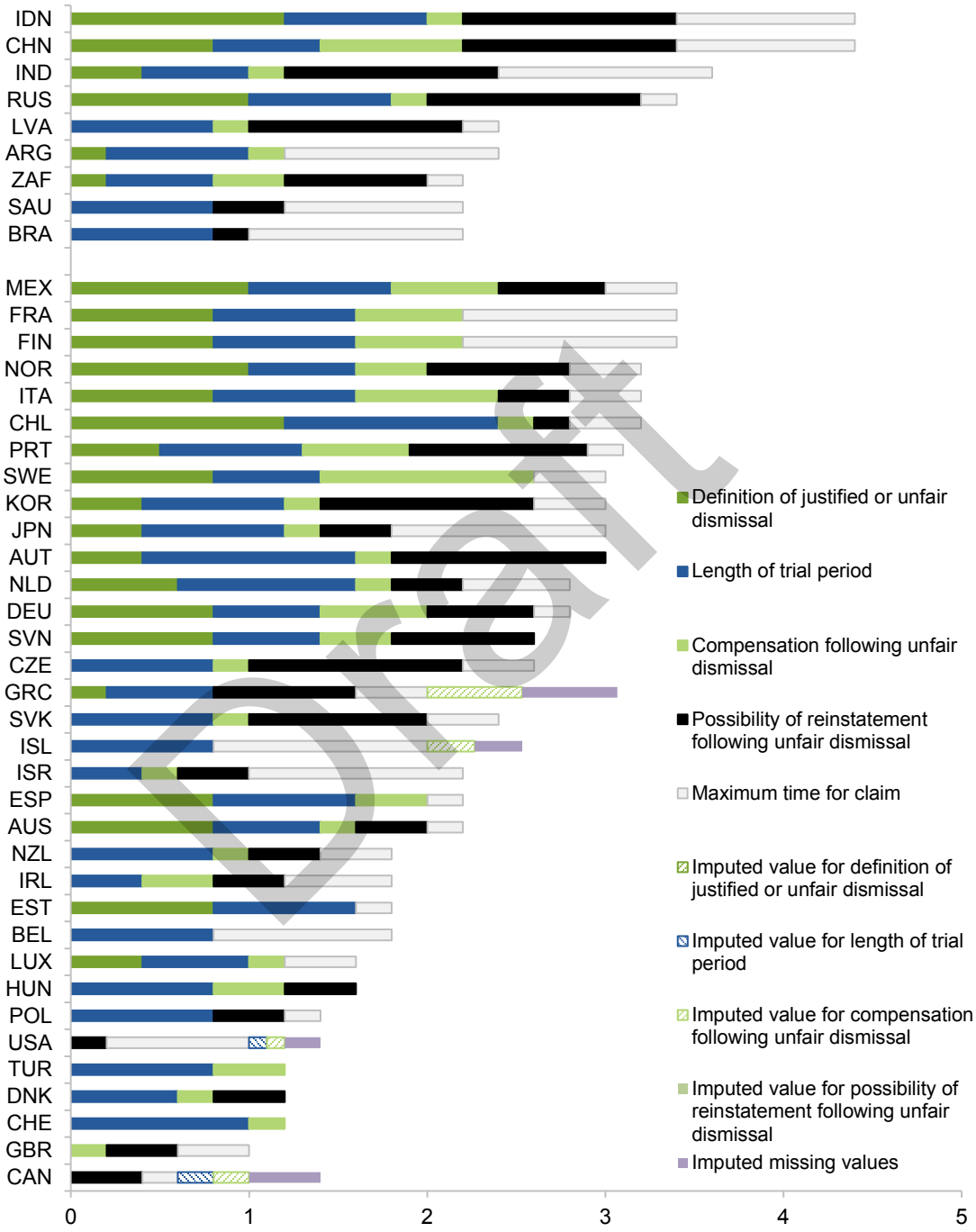
The OECD's results align closely with those of the International Labour Organization (2015).

Drawing on the perceptions of business leaders, international comparisons of the relative restrictiveness of Australia's dismissal arrangements are also published as part of the Global Competitiveness Report (World Economic Forum 2014). The surveyed businesses ranked Australia relatively poorly in the capacity of employers to hire and fire employees compared with other developed economies. However, the OECD measure and business perceptions do not coincide for Australia. Countries rated by the OECD as having highly restrictive systems compared with Australia — Mexico, Sweden and Norway — were rated by business leaders as having much easier arrangements (figure 5.6). Similarly, while the OECD categorises the New Zealand and Australian systems as similarly unrestrictive, business leaders perceive them to be very different.

There is some research into the unreliability of business surveys in this area.[55] That said, such material may indicate the level of business disquiet about a system, but not a measure of its cost nor its effectiveness. Of course, if those perceptions are firmly held they will impact on hiring behaviour.

[55] The unreliable nature of business surveys regarding unfair dismissal laws is discussed in some detail in Oslington (2005) and Freyens and Oslington (2007).

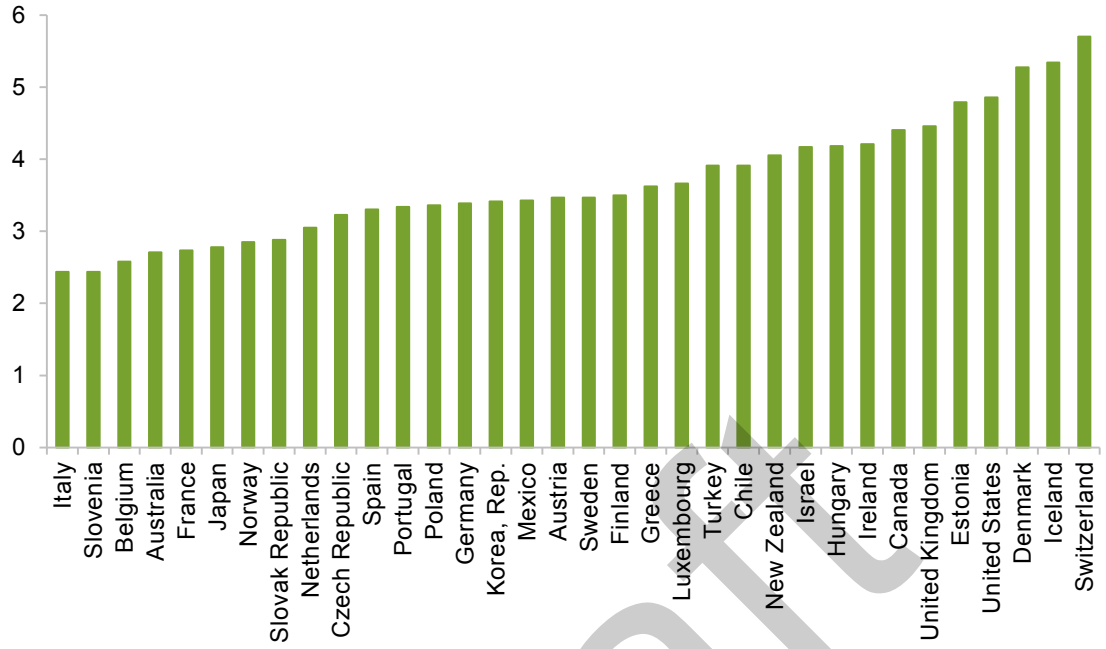
Figure 5.5 **International comparison of the difficulty of individual dismissal (OECD)**



[a] Data refer to 2013 for OECD countries and Latvia, 2012 for other countries. The figure presents the contribution of different subcomponents to the indicator for difficulty of dismissal. The length of the bar represents the value of the indicator for difficulty of dismissal. For the sole purpose of calculating the indicator of difficulty of dismissal, missing values of specific subcomponents are set equal to the average of other non-missing subcomponents (excluding the maximum time for claim) for the same country.

Source: OECD (2013).

Figure 5.6 **World Economic Forum rankings on ease of hiring and firing**



Note: Higher bars indicate greater ease of dismissal.

Source: World Economic Forum (2014).

5.5 The performance of the current system

Stakeholder views were very divided on the operation of the unfair dismissal system as currently configured (box 5.5). For those stakeholders who did have concerns about the system, these tended to focus on three main areas:

- the continued presence of 'go away' money
- the current arrangements as they apply to small businesses
- the role and performance of the FWC.

The extent to which employers pay employees to leave their business

Employers sometimes say that they provide money to dismissed employees to avert an unfair dismissal claim ('go away' money), even though the employer believes dismissal was appropriate. This is because the time and administrative costs associated with defending a case and the uncertain outcome of the processes may make this a cost effective option. 'Go away' money is an easily misunderstood term, and any measure of its frequency should not include cases where an employer may pay an employee some amount in addition to redundancy and unpaid entitlements to encourage an easier separation of the

parties. There may also be cases where both parties are partially at fault, the employment relationship must end, and money is the lubricant for that outcome.

Box 5.5 Some participant's views

Employment Law Centre of WA (inc):

> The current unfair dismissal framework has too great a focus on protecting businesses from unfair dismissal claims, at the expense of employees. The current framework protects too narrow a range of employees from unfair dismissal. (sub. 89, p. 17)

Kingsford Legal Centre:

> Many of our clients who have been unfairly dismissed suffer financial, psychological and family stress as a result of losing their job. Often the remedies available through unfair dismissal do not adequately reflect the effect of unfair dismissal on employees. (sub. 87, p. 7)

Queensland Industry:

> Unfair dismissal is the number one workplace relations issue for Queensland businesses … Even among those businesses that have not had any claims, 47 per cent indicated major to critical concern with the current legislation. (sub. 150, p. 29)

Ethnic Communities' Council of Victoria:

> … more recognition is needed that investing in workplace protections, including unfair dismissal and discrimination, is a necessary and strategic cost – and not just a 'burden' on business. (sub. 75, p. 5)

Australian Hotels Association and Accommodation Association of Australia:

> Becoming more prevalent are lawyers and IR consultants who work on a 'no win - no fee' basis, and they are the only real winners (Commercial decisions are made more often than not to pay the 'go away money' because the cost of defending the matter is usually higher, regardless of the facts of the matter). (sub. 164, p. 18)

Sydney Symphony Orchestra:

> The current unfair dismissal provisions provide a clear and equitable process for parties to address a dispute as a consequence of the termination or possible termination of an employee's employment. It is our experience that the compulsory conciliation requirement is essential to the timely resolution of many disputes of this nature. (sub. 100, p. 9)

Ben Freyens:

> … achieving a perfect balance in the strictness of the legal provisions is nearly impossible. All we can do is amend the laws incrementally and regularly, and try to observe as best we can whether these changes engender net positive flow-on outcomes. (sub. 149, p. 7)

The practice of paying 'go away' money to settle unfair dismissal claims was raised extensively in submissions to the current inquiry, and has been a source of contention in past reviews and commentary (for example, McCallum, Moore and Edwards 2012, p. 218; Sloan 2012; Collier 2012). It has been reported in the past that the average amount paid was $5000 to $6000 (Hannan 2012), though it is hard to gauge the accuracy of data of this kind unless the circumstances of the cases are clear.

A considerable number of participants, mostly employers or their representative bodies, claim that paying 'go away' money is still a widespread occurrence, that current arrangements under the FW Act contain an in-built bias towards such payments, and that,

in many cases, this results in unfair outcomes for employers. It may also be unfair for employees if a legitimate case is not pursued because of a quick settlement. While anecdotal evidence suggests that 'go away' money is still paid, the exact share of settled cases falling into this category is not clear.

Cases where unfairly dismissed employees leave without any compensation

The problems of 'go away' money should also be set against instances where an employee is unfairly dismissed, but does not take the matter up with the FWC (what could be termed 'go away quietly' cases). There are many reasons why employees may not act. The costs of embarrassment, concern about references, and the emotional and time costs of pursuing a case may exceed the uncertain value of any outcome with the FWC. Such instances may or may not involve a pecuniary cost, but they do represent a cost, as does taking a new job at a lower wage, or being unemployed while looking for a new job. As with 'go away' money being paid, the evidence for the prevalence of these outcomes is not readily available.

It is inevitable that any system for regulating dismissal arrangements will elicit, on the one hand, undetected instances where an employee is appropriately sacked, but given money to leave, and on the other, cases where the employee is inappropriately sacked but no claim is made (despite being unfairly dismissed). The objectives should be to make the system sufficiently simple and relatively inexpensive to use and with reasonable prospects of a timely result that these instances are few. Were arrangements to lower any compensation from unfair dismissal then it might address the first problem, but exacerbate the second. A good system must try to balance these two unintended incentives (and minimise the overall costs).

Regardless, a major problem in assessing the number of instances of 'go away' money or 'go away quietly' cases is that there is no independent party to assess whether either has occurred. An employer may strongly believe a dismissal to be just, and this can mean that, in such cases arbitrated by the FWC, employers will remain of this view regardless of a contrary finding. Similarly, many employees believe that their dismissals are unfair, but when assessed, this has been found to be incorrect. Self-assessed cases of what constitutes fair or unfair dismissal are always going to be tainted by bias.

Particular concerns around arrangements for small business

Some participants were also concerned about the impacts of unfair dismissal arrangements on small business[56]. The OECD, reflecting on the recent introduction of new unfair dismissal arrangements in Australia as part of the FW Act, stated:

> Care needs to be taken that the restoration of unfair dismissal protection at small and medium-size enterprises does not impair labour market flexibility … . The new system of

[56] The impacts of unfair dismissal laws on small business are also discussed in detail in chapter 26.

> dealing with unfair dismissal claims should … be closely monitored to make sure that the administrative costs faced by the firms, especially smaller ones, are not so high as to jeopardize productivity growth and redeployment of labour … (OECD 2010, p. 135)

Arguments in support of a tiered regulation for small business that point to an absence of HR expertise in small business — connected in part to resourcing — have also been prominent. This point was also made by several participants to the inquiry (for example, VECCI, sub. 79, p. 78; Clubs Australia Industrial, sub. 60, p. 41), who used it to argue either for the maintenance of existing arrangements for small business or, indeed, for a lifting of the employee threshold.

Box 5.6 Employment status of small businesses in Australia

The Australian Bureau of Statistics (ABS) catalogue *Counts of Australian Businesses, Including Entries and Exits* (2013) provides information about the number of Australian businesses by size category. This provides an overview of changes in business size across the period June 2008 to June 2012.

Businesses operating in June 2012

	Number of businesses	*Share of total*	*Share of employing*
	No.	%	%
Non-employing	**1 306 093**	**61**	
1 to 4	514 859	24	62
5 to 19	231 591	11	28
20 to 199	82 326	4	10
200+	6411	~0	1
Total employing	**835 187**	**39**	**100**
Total	**2 141 280**	**100**	

Source: ABS (*Counts of Australian Businesses, Including Entries and Exits*, Cat. no. 8165.0).

The ABS data above shows that, as at June 2012, businesses employing fewer than 20 employees made up approximately 90 per cent of all employing businesses.

In this release, the ABS also reports firm survival rates, which is the proportion of firms operating in June 2008 that were still operating in June 2012. Aside from non-employing businesses, businesses employing 1 to 4 employees had the lowest survival rate across the period (68.1 per cent), and businesses employing 15 to 19 employees had the second lowest (75.1 per cent).

Businesses employing less than 20 employees account for less than 25 per cent of the total number of employees.[57] (This figure excludes owner-managers of incorporated enterprises — who are in some ABS series also referred to as employees.)

Mixed views were evident, in particular, about the effectiveness of the small business fair dismissal code. Some have positive views about the code. For example, the Council of

[57] ABS 2015, *Employee Earnings and Hours, Australia, May 2014*, CN 6306.0, released 22 January.

Small Business of Australia (COSBOA) said that small businesses appreciated the guidance provided by the Code and the certainty and simplicity of its checklist approach (pers. comm., 15 January 2015). The Office of the Small Business Commissioner also stated:

> The information in the Code is easy to understand and the checklist provides practical steps to follow. In our opinion, the Code is a valuable resource which assists small business employers and should remain part of the workplace relationship system. (sub. 119, pp. 8–9)

On the other hand, there have been concerns about its impacts and effectiveness from many other quarters.

Possible reforms to arrangements for small business, and in regard to the utilisation of a Code, are discussed further in section 5.6.

The role and performance of the FWC

A further major concern of numerous stakeholders in regard to unfair dismissal was the apparent randomness of FWC decisions. Several participants argued that the outcomes of cases heard by the FWC are unpredictable, and that some decisions turn more on finer points of interpretation about select provisions of the FW Act than on judgments about reasonable outcomes in the context of a place of employment (see, for example, Remy Favre (sub. 20, p. 2); Major Events Consulting Australia Pty Ltd (sub. 38, pp. 1–2) (box 5.7)).

In regard to *arbitration* at the FWC, the Productivity Commission was also made aware of some research pointing to outcomes partly reflecting the background of the Fair Work commissioners hearing the case. As discussed in Booth and Freyens (2014), and in earlier research by Southey and Fry (2010), whether an appointee to the FWC and its predecessors has a business background appears to be a significant predictor of case outcomes (table 5.2).

The exhibition of preferences in table 5.2 is concerning, although indicative of a more general phenomena regarding 'political activism' that is present in many other legal fora. While not necessarily incontrovertible evidence of inconsistencies, this perception has developed and the data appears to support it. There is also a broader concern that in arbitrated cases matters are determined using an overly legalistic approach, with little apparent focus on the economic costs of such cases or on the quality of outcomes for all parties (see, for example, Air Conditioning and Mechanical Contractor' Association, sub. 85, p. 1; AMMA, sub. 96, p. 298; Western Australian Government, sub. 229, p. 33).

Box 5.7 Some notable recent dismissal cases

The following selection of recent cases demonstrates some of the complexities in the FW Act, and the tension between fair process and the substantive case for dismissal that can exist.

Sheng He v Peacock Brothers & Wilson Lac v Peacock Brothers (2013) FWC 7541.

This case involved dismissals after two employees punched one another in the head in an argument. The two employees were dismissed after a brief investigation by management. The FWC accepted that the employees' conduct was a valid reason for dismissal, but that management's failure to follow procedural fairness (such as seeking corroboration from witnesses and offering translation services) was sufficient to deem their dismissal 'unjust, unreasonable and therefore unfair'. The employer was required to provide compensation to the dismissed workers.

Mr David Taleski v Virgin Australia International Airlines Pty Ltd T/A Virgin Australia (U2011/12885) [2013] FWC 93 (11 January 2013)

Mr Taleski was employed as a flight attendant with the airline. Mr Taleski wished to maintain a hairstyle past collar length, and claimed he suffered from a body image disorder that prevented him from cutting his hair. This style contravened Virgin Australia's 'Look Book', a company policy prescribing acceptable dress and presentation standards for male and female flight crew. On 24 October 2011, Mr Taleski's employment was terminated.

At arbitration, the FWC Commissioner found that five of the eight medical certificates provided by Mr Taleski to support his claims prior to dismissal did contain the information Virgin Australia sought. The Commissioner also found that Mr Taleski was, to the best of his ability and within the constraints of a medical condition linked to the length of his hair, intending to comply with the 'Look Book'. Taken together, the Commissioner was satisfied that Mr Taleski's dismissal was harsh, unjust or unreasonable, and the Commissioner ordered that Mr Taleski be reinstated to his former duties as a flight attendant. No orders were made as to how Mr Taleski's appearance was to be handled in the future. Virgin Airlines lost a subsequent appeal in mid 2014.

Gary Homes v Coles Group Limited T/A Coles Warehouse Edinburgh Parks [2014]

A Coles warehouse employee Gary Homes won his job back after the FWC found that taking company-supplied Milo home was not a valid reason for dismissal. During the time of his dismissal, Homes was notified that he had removed Coles' property without consent, preparing his own mix of Milo. This was seen as serious misconduct, which led to the termination of his employment.

Homes claimed that Coles could have stopped him taking Milo home for his special mix, as he had not made this a secret. He said that if he had been told to stop, he would have complied. Moreover, the company had provided the Milo for employee use, with no restrictions on how it could be used or consumed. On the other hand, Coles asserted that Homes had inappropriately used its resources, said it was his Milo at first and then subsequently altered his story. This action breached the employee Code of Conduct and he was dismissed due to theft and employee compliance attached to the Code.

(Continued next page)

Box 5.7 (continued)

Ultimately, the FWC found that there was no valid reason for dismissal, as Homes only drank his Milo mix at work, bringing the Milo home only to prepare the mix. Evidence had also shown that the Milo he drank at work was not provided by Coles, and it could not be constituted as theft. The Commission also noted that the matter could have easily been avoided with clear instructions.

Sources: Norton Rose Fullbright (2013), Employment Law Matters Australia (2014).

Further evidence on the performance of the FWC was presented in chapter 3. Possible reforms affecting conciliation and arbitration are also discussed in section 5.6 below.

A further concern by some employees and employers is the complexity of the unfair dismissal system. In discussing the complexity of processes around dismissal, several participants cited the example of serious misconduct. In their view, the current process for summarily dismissing employees is overly complex and time consuming.

But a range of other participants argued that such complexity is an inevitable feature of a jurisdiction that deals with often contentious claims and counterclaims on a matter — employment termination — that has large impacts on all parties involved. These participants argued that present arrangements were generally working well, and were the result of gradual refinement over several decades (Freyens, sub. 149, pp. 7–8).

Table 5.2 **Case determinations and tribunal judges' work backgrounds**
Author's calculations from courts transcripts, 2001-2010

	Employer association background		*No employer association background*	
Award employee	123	(29%)	306	(43%)
Award employer	297	(71%)	409	(57%)
Total	420	(100%)	715	(100%)
	Union background		No union background	
Award employee	189	(46%)	240	(33%)
Award employer	222	(54%)	484	(67%)
Total	411	(100%)	724	(100%)
	Labor appointee		Conservative appointee	
Award employee	303	(42%)	126	(31%)
Award employer	420	(58%)	286	(69%)
Total	723	(100%)	412	(100%)

Source: Booth and Freyens (2014).

Stakeholder views that were strongly supportive of current arrangements

Many participants to the current inquiry were also strongly supportive both of unfair dismissal protections generally, and more particularly, of the current arrangements set out in the FW Act.

A consistent theme was that an appropriate balance had been achieved between the needs of employers and employees. For example:

> Legal Aid NSW believes that the current Unfair Dismissal processes meet the purpose of providing remedies to workers where they are unfairly dismissed, while balancing the rights of employers and business realities. (sub. 197, p. 10)

In a similar fashion, Professionals Australia argued that the current tests to establish unfair dismissal:

> … are appropriate for the purposes of determining whether conduct is unfair on the basis that they strike a balance between the interests of businesses and the rights employees have to fair treatment. (sub. 212, p. 36)

The important role of unfair dismissal protection in situations of power imbalance between employees and employers was also discussed in several submissions (see, for example, Footscray Legal Centre, sub. 143, p. 11).

The role of perceptions

Perceptions have tended to play a major role in people's views about the working of the current system. Individual cases where, as reported, an employee should have been fairly dismissed, but has instead received compensation, may create an impression of a system in crisis. Equally, some reports claim instances where employers have behaved egregiously — underpinning support of the status quo or even the strengthening of the arrangements. In both cases, the evidence appears insufficient to assert either crisis or a need for strengthening.

Perceptions can still influence people's behaviour. Business perceptions about the prevalence of unfair dismissals and 'go away' money, and reported instances of the apparent misuse or unexpected outcomes of the provisions, may affect their hiring practices, even if the reality does not match the perceptions. Similarly, employees' perceptions about their workplaces and relationships with their employers may be conditioned by particular instances of unfair dismissal highlighted in the media (box 5.7).

Despite the relatively small number of total unfair dismissal applications lodged each year, and evidence that direct settlement payments are, on average, quite low, there remains some level of disquiet amongst employers and employer groups regarding the dismissal jurisdiction. One reason for this continuing concern could be that the *potential* quantum of

an unfair dismissal payout (up to six months wages) weighs more heavily on employers' minds than the low actual likelihood of a payout.

Large enterprises with hundreds of employees and specialised human resources personnel will probably have a relatively accurate impression of the true probabilities of unfair dismissals and their likely costs.

However, small businesses have neither the specialised resources, nor do they have the employee numbers needed to accurately estimate the true probabilities. They may also be more liquidity constrained, so that an unexpected financial cost has greater impacts on their viability. In these instances, there is a potential for bias. People tend to overestimate the probabilities of emotionally salient events outside their control (shark attacks and plane crashes for example), so any bias is more likely to inflate perceived probabilities — especially for small businesses.

In addition, people tend to often overreact to high cost, but low probability events:

> Behavioural economics (e.g. Kahneman, 2003) suggests an alternative explanation of their concern about dismissal regulation. A consistent experimental finding is that agents heavily weight large low probability losses when making decisions. To the extent that payouts capped at six months wages can be regarded as large losses then we would expect these to weigh more heavily on employers minds when making employment decisions than the expected cost calculations might suggest. Another explanation might be concerns about fairness (Fehr, Goette and Zehnder, 2009) of compensation payouts weighing heavily on the participants – employers don't like paying out when they are in the right. (Freyens and Oslington 2013)

So actual responses to unfair dismissal arrangements may be much more significant than may be warranted by the actual impact of these arrangements.

The impacts of unfair dismissal — a summing up

Australia's policy debate about unfair dismissal regulation appears to be beset by mythologies about the prevalence and economic impacts of cases (as observed previously, for example, by Oslington (2005)). Nevertheless, the Productivity Commission's own analysis, and other sources of reliable international and Australian evidence, suggests that Australia's unfair dismissal arrangements are unlikely to have significant negative impacts on medium to large businesses, especially considering that their purpose is not to minimise costs to employers, but to balance the interests of both employees and employers.

More contemporary data on the incidence of dismissals for cause and the indirect costs of unfair dismissal legislation would help narrow the estimates of the effects of unfair dismissal legislation. The Productivity Commission will seek to refine its analysis in this area for the final report, but over the longer term, additional data from the FWC and the

ABS would also assist greatly in improving the accuracy of estimates. The ABS is introducing a more comprehensive and frequent measure of retrenchments.[58]

Given the twenty year history of unfair dismissal regulation in Australia at the Commonwealth level, there appears to be widespread general awareness of these laws. There is also a greater degree of stability in current arrangements following the more dramatic pendulum swings that characterised the WorkChoices period.

Notwithstanding some uncertainty about the effects of unfair dismissal regulations, however, there is reasonable evidence of some remaining flaws in the system. Arguably, parts of the process are overly legalistic, there may be too much of an emphasis on procedural fairness in instances where the conduct of the employee would normally warrant dismissal, and there are concerns about the consistency of arbitrated decisions. There remains scope for some limited, careful adjustment of the current arrangements.

5.6 Reform options

Several proposals for change from stakeholders, and other possibilities suggested by the literature and overseas experience, warrant further consideration. These include possible reforms in the following main areas:

- some further measures to better identify cases without genuine merit (thereby reducing the practice of 'go away' money) and to reduce the average value of such settlements including where feasible, separating arrangements to penalise 'poor' process from compensation of employees
- revisiting the need for the tiered regulatory arrangements for small business described in section 5.1.

In each of these areas, the Commission has considered the case for reform with an emphasis on delivering better employment outcomes for both employees and employers, while retaining reasonable opportunity for redress for all parties. Consideration of a move to compensated no fault dismissal arrangements was also raised by some parties, but, as discussed above, the case for such a major reform is weak.

Possible reforms to the governance structure and conciliation and arbitration processes of the FWC, which are also fundamental to improving outcomes in the unfair dismissal jurisdiction, but will have broader effects, were discussed in chapter 3.

[58] If nothing else, the new data may allow the cyclical component of retrenchments to be isolated, giving a better estimate of the residual, which includes dismissals for cause.

Measures to better identify dubious cases and limit amounts of 'go away' money

The continued problem of 'go away' money was acknowledged by the 2012 review of the FW Act, which suggested that the current system may contain incentives towards such settlements, with adverse consequences for the overall fairness of the system:

> It is not surprising that this might become a feature (though to what extent is another question) of a legal process in which one party can seek a remedy against another party using processes that are comparatively informal, inexpensive and where the grant of the remedy is likely to depend upon a subjective evaluation of criteria which are fairly broadly expressed. We accept that it is undesirable that payments of this character are made. (McCallum, Moore and Edwards 2012)

The issue continues to be prominent, and, as discussed above, was raised repeatedly in submissions and discussions for the inquiry.

As has been identified elsewhere, there are several key design elements of the present system that create incentives for such settlements. One important contributing factor is the general absence of a requirement that losers in arbitrated cases pay the winner's costs (other than for vexatious/groundless claims). Another key factor is the capping arrangements.

Recent changes following the 2012 review of the FW Act were intended to reduce this practice further by addressing several of the main incentives. These included increased powers for the FWC to:

- dismiss applications where it was satisfied that the applicant had behaved unreasonably (FW Act, s. 399A)
- make an order for costs against a party if their unreasonable act or omission caused the other party in the matter to incur costs (FW Act, s. 400A)
- impose cost orders on lawyers and paid agents where the tribunal is satisfied that they encouraged speculative claims (FW Act, s401(1A)).

The Productivity Commission considers that these changes were a step in the right direction, however some further reforms may assist in reducing this practice to a greater degree.

Changes to lodgment fees?

While the recent further measures outlined previously appear to have improved outcomes, several further changes were suggested by participants to reduce gaming within the settlement process, or to reduce the overall magnitude of settlement payments when they do occur.

One option suggested by several parties was to raise the application fee for lodging a dismissal claim from its current level of around $70 to a larger amount (see, for example, Australian Meat Industry Council, sub 236, p. 23; Australian Higher Education Industrial Association, sub 102, p. 9; Chamber of Commerce and Industry of Western Australia, sub 134, p. 55; Australian Sugar Milling Council, sub 226, p. 6). In this context, the South Australian Wine Industry Association and the Winemakers' Federation of Australia (sub 215, p. 50) pointed to application fees in the United Kingdom equivalent to $480 per unfair dismissal application and a further $1800 for cases going to arbitration.

As part of its recent inquiry into access to justice (PC 2014a), the Productivity Commission discussed at length the use of court and tribunal fees. A consistent theme in that discussion was that the targeted and consistent use of fees, *where appropriate*, could improve the efficiency of dealing with cases and provide adequate cost recovery for courts and tribunals.

The cost and time disadvantages of arbitration (as opposed to conciliation or pre-claim conciliation) are well-documented in many judicial contexts, and apply equally to unfair dismissal cases. For example, a rough estimate of the direct costs of conducting conciliation was provided by the FWC as follows:

> In regards to unfair dismissals - in 2013-14, *10, 972* unfair dismissal conferences were conducted by staff conciliators. Taking conciliator wages only into account (including salary super, leave etc.) the cost per conference was $356.20. (pers. comm., 1 May 2015)

The costs of arbitration are not known, but the salaries of members are much greater than those of conciliators, and the processes and documentation more elaborate and time consuming. It can be safely assumed that the costs are many multiples of $350 per conciliation case. Moreover, arbitration also involves costs for the respondent, and given that costs are not awarded to respondents when an unfair dismissal case is rejected, some account might reasonably be taken of the average level of those costs too. Full cost recovery is not appropriate for the reasons given in the Productivity Commission's inquiry into access to justice (PC 2014a), but recovery should be sufficient to reduce claims that have little intrinsic merit.

There may be merit in considering a revised, two-tier approach to lodgment fees by:

- increasing by a *modest* amount the fees for application lodgment, and tying the fee to income levels at the time of dismissal, such that higher income earners pay more to lodge applications; and/or
- introducing an additional fee for cases proceeding to arbitration to partly recover the substantial costs involved with conducting proceedings in the FWC.

Further views are sought on the effectiveness of this approach, and its possible consequences for all parties.

INFORMATION REQUEST

The Productivity Commission seeks further views on possible changes to lodgment fees for unfair dismissal claims.

Consideration by the FWC of applications 'on the papers' or via more merit focused conciliation processes?

The absence of an effective filter at the front end of the unfair dismissal claims process and, at conciliation, a tendency to steer parties towards financial settlement, were issues raised in a number of submissions (see, for example, Qube Ports and Bulk, sub. 123, p. 12; Catholic Commission for Employment Relations, sub. 99, p. 33).

In regard to an upfront filter, one suggested reform (a variant of which is currently being considered) is to accord the FWC with greater discretion to consider the merits of an application 'on the papers', following lodgment by an employee (Form F2) and receipt of an employer response (Form F3) and prior to commencement of the conciliation process. The clear risk of such an approach would be to weight outcomes against applicants who (in applying via a Form F2 application), present an incomplete or illegible application. This may be more likely in cases with applicants who have poor literacy or are from a non-English speaking background. It has also been suggested in a previous review that such a reform, where it had been tried in the past, had not proved to be effective. (McCallum, Moore and Edwards 2012)

Another possibility would be to conduct a more detailed, merit focused conciliation process, post the F2 and F3 lodgment, as suggested by Catholic Commission for Employment Relations:

> … this concept incorporates the conciliation into the initial assessment, rather than allowing applications to be struck out on the papers … This will enable the parties to still turn their mind to settlement, however this will be done in the context of a more robust discussion of merits and in the knowledge that the parties will receive the conciliator's opinion on merits soon after the conciliation. (sub. 99, pp. 35–36)

Further detail on this proposed process is shown in figure 5.7.

Some of the inherent risks in such proposals could be managed via a process of assistance for applicants. Subject to this occurring, procedural changes of this type, married with changes to conciliation discussed in chapter 3, may serve to reduce the number of unmeritorious unfair dismissal cases considered by the FWC, and to reduce claims of 'rough justice' resulting from conciliation processes.

DRAFT RECOMMENDATION 5.1

The Australian Government should either provide the Fair Work Commission with greater discretion to consider unfair dismissal applications 'on the papers', prior to commencement of conciliation; or alternatively, introduce more merit focused conciliation processes.

The balance between procedural and substantive matters

A further complementary reform is to separate the approach taken by the FWC in relation to procedural matters followed by the employer and those pertaining to the appropriate conduct of the employee. In its submission to the 2012 Review of the Fair Work Act, ACCI (2012, p. 142ff) identified a set of cases where the employee appears to have clearly underperformed or behaved inappropriately, however the dismissed employees were awarded compensation (the case of Mr N. above fits into this group, as does *Sheng He v Peacock Brothers & Wilson Lac v Peacock Brothers* (2013) FWC 7541 in box 10.7).

The existing arrangement means that an employee who, on prima facie grounds, should have been dismissed, still receives compensation because of faults in the termination processes. This opens the door to possible hunting by dismissed employees (or their agents) for technical reasons for compensation, and may provide leverage for 'go away' money. An alternative is that where the FWC is satisfied that:

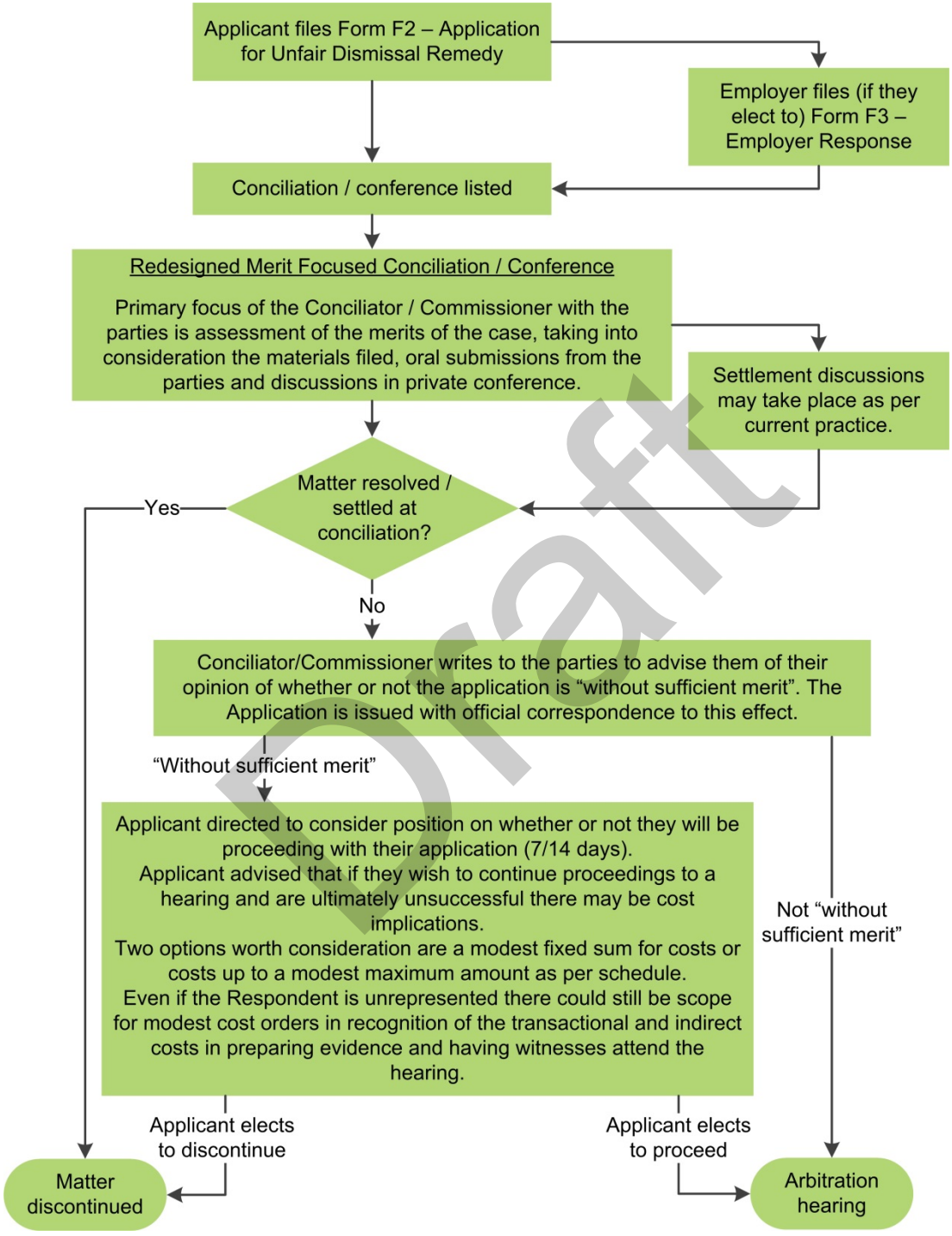
- the employee has either committed serious misconduct or genuinely underperformed, their dismissal is upheld without any compensation
- the employer has failed to follow due process, the FWC has the discretion to choose between advice to the employer to educate them, and where the employer is a recidivist or the procedural lapse a serious one, the capacity to levy a penalty within the present cap.

DRAFT RECOMMENDATION 5.2

The Australian Government should change the penalty regime for unfair dismissal cases so that:

- an employee can only receive compensation when they have been dismissed without reasonable evidence of persistent underperformance or serious misconduct
- procedural errors by an employer should not result in reinstatement or compensation for a former employee, but can, at the discretion of the Fair Work Commission, lead to either counselling and education of the employer, or financial penalties.

Figure 5.7 **A redesigned merit focused conciliation process**



Source: Adapted from Catholic Commission for Employment Relations (sub. 99, p. 38).

Should reinstatement be the favoured remedy?

While reinstatement is a core objective of the FW Act's unfair dismissal provisions, it occurs rarely in practice. For example, of the 826 unfair dismissal matters reported as going to arbitration at the FWC in 2013-14, only 9 resulted in reinstatement, while a further 25 resulted in a combination of reinstatement and lost remuneration. This contrasts with 150 matters resulting in compensation only, and a further 175 applications that were dismissed (FWC 2014b).

The low level of reinstatement is hardly surprising given that the trust that is central to a harmonious and productive employment relationship is irremediably destroyed at the end of most unfair dismissal cases. It may also be more difficult in practice to reinstate an employee into a small business than a larger firm.

While Part 3-2 of the FW Act places an emphasis on reinstatement as a remedy for unfair dismissal, the Commission understands that, at the FWC arbitrations, consideration of the reinstatement objective is, in a very large proportion of cases, a mere formality, and is honoured more in the breach than the observance.

Several inquiry participants raised the issue of the reinstatement objective, and called for greater emphasis on compensation as the primary remedy in the FW Act. Compensation is also the favoured remedy under the common law.

There are good grounds for revising the current formulation. It is apparent that employers and employees are consulted about reinstatement during conciliation or arbitration processes but that, in a very large number of cases, alternatives such as compensation are chosen. Retaining reinstatement as an objective (but not the primary objective) would be consistent with established legislative practice in some comparable countries, and the product of refinements in legislative formulation in this area that have taken place over a considerable period of time. However, as it now stands there is little concordance between the objective and practice on the ground.

DRAFT RECOMMENDATION 5.3

The Australian Government should remove the emphasis on reinstatement as the *primary* goal of the unfair dismissal provisions in the *Fair Work Act 2009* (Cth).

Changing arrangements for small business?

The case for regulatory tiering

As discussed in section 5.1, the current framework has special rules for businesses with fewer than 15 employees. Special unfair dismissal arrangements for small business are

often premised on the likely higher compliance costs of such arrangements for these businesses, their reduced access to human resource (HR) expertise and arguments about employment creation by such businesses.

The employment-creating potential of small business has been researched in Australia and overseas in the past, with varying results (see, for example Barrett (2003) and Bauernschuster (2013)). There has also been a lengthy past debate in Australia about the effects of unfair dismissal exemptions specifically on job quality in small business and on employment practices in such businesses.

While this is very much contested ground, the weight of reliable analysis shows that:

- small business is a significant employer numerically in the economy overall
- a large share of small business hiring activity is related to new businesses, and a relatively smaller share is accounted for by new hires by existing small firms
- employment protection laws, such as unfair dismissal laws, are often nominated in opinion surveys of small business as an important factor in hiring decisions, although the reliability of such surveys has been questioned (see, for example Oslington (2005)).

Exemptions and lighter regulation for small business can be problematic for several reasons.

In principle, it is desirable wherever possible not to have special arrangements for some businesses, if the need (for recognition of their limited resources) can be achieved without altering the broad approach of the law. This helps both employees — creating fewer exceptions to the rules — and lowers complexity costs for business.

Further, exemptions can distort the efficient size distribution of businesses, create growth traps for firms approaching the threshold defining a small firm and change the mix of full time and part-time workers to be under the threshold. In effect, tiering ignores the fact that if a larger business can more efficiently meet certain regulatory requirements, this is similar to other aspects of the business environment that confer advantages on firms based on their size. In many other areas of regulatory compliance, such as tax or pollution standards, small firms do not receive exemptions or face reduced regulatory requirements.

On the other hand, in some cases, regulatory tiering can be efficient (Central Bank of Ireland 2013; Bickerdyke and Lattimore 1997; Nijsen et al. 2008), especially in circumstances where the effect of the tiering is to reduce compliance burdens without substantively reducing compliance. In effect, the marginal benefits of more elaborate compliance arrangements fall with firm size. The fact that small enterprises are more intensive employers of employees at the margins of the labour market — who may be particularly vulnerable to stricter employment protection — may reinforce this argument.

Accordingly, there are grounds for retaining some special unfair dismissal arrangements for small business. An important point is that the existing framework involves a more delayed exposure of small businesses to unfair dismissal laws (for example, the minimum

employment period is 12 months rather than six months), as opposed to a blanket exemption (as was proposed by some stakeholders). This provides employees of small businesses with access to unfair dismissal protections, whilst balancing this with the resourcing difficulties faced by small business and their need to screen and verify the performance of new employees across time.

The definition of small business, and coverage implications

As has been observed in several previous Productivity Commission inquiries, there is a large degree of arbitrariness in defining small business, including through the use of definitions based on sales turnover or the number of employees. The Reserve Bank of Australia has also identified the very different revenue and employment thresholds for describing small businesses (Connolly, Norman and West 2012). In this context, several participants pointed to a discrepancy between the definition used for the purposes of unfair dismissal, and the '20 employees' definition used by the ABS to define small businesses within its reporting activities.

Largely, the choice of cut off comes down to broader objectives about how much, or how little, coverage is required. Certainly, current arrangements mean that all businesses still face unfair dismissal regulation in some form.

The average firm with around 15 employees has annual revenue close to $3 million,[59] and will have a range of regulatory requirements involving tax, accounting standards, WH&S and payroll. Such firms are also likely to have some access to HR knowledge, even if not of a specialist nature. In combination with the guides available from the FWC, it is reasonable that businesses of such size would be able to meet relevant employment standards. This would suggest that, for the purposes of applying unfair dismissal regulations, shifting from the existing definition of small business to one involving a larger number of employees would probably not be warranted.

Use of the fair dismissal code

The Small Business Fair Dismissal Code (box 5.1) is an important component of the current special arrangements applying to small businesses. The Code is accompanied by a checklist which was intended to simplify its application. Any assessment of the success or otherwise of the Small Business Fair Dismissal Code and its checklist hinges on a judgment about the extent to which it provides adequate protections to employers and employees alike. On this, much rests on how it has been used, for good or ill, in practice.

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[59] The average sales and service income per employee in small businesses (those employing less than 20 employees) was around $190 000 in 2012-13. This suggests that average sales and service income per employee of a business employing 15 people would be around $2.9 million annually (ABS 2014, *Australian Industry 2012-13*, Cat. No. 8155.0, released 28 May).

Early in its operation there were doubts raised about the code as an approach. For example, Chapman (2009, p. 763) stated that it:

> … may represent a significant lessening of the standard that has been required of employers in the past. Whether it does will depend on how the concept of 'reasonable grounds' is interpreted. For an employer to believe 'on reasonable grounds' that a summary dismissal is justified may require that a level of procedural fairness be accorded to an employee, such as being provided with an opportunity to respond to allegations of misconduct or lack of performance.

The concerns persist, albeit reflecting sometimes quite different perspectives about what constitutes failure (box 5.8).

The checklist has also had a chequered history. In its original form the list did not alert employers to some of the important matters they had to consider. For example, in *Mr. N v The Bakery* [2010] 3096, an employee was dismissed for submitting false time sheets. The employer filled in the checklist (on the advice of Fair Work Australia), but failed to ensure that the employee had the right to a support person during the investigative stage. Fair Work Australia's judgment in the case was that the termination of Mr N. was neither unjust nor unreasonable, but that it was 'harsh' because it occurred without notice or access to a support person. The Bakery was ordered to pay a small compensation to Mr. N. The Commissioner on the matter concluded that:

> There is nothing in the Checklist itself that would have alerted Ms O to the requirement in the Code for an employee to have another person present to assist in circumstances where dismissal is possible. This deficiency, together with the extent to which the Checklist does not assist where there are disputed facts or an element of doubt about the reasonableness of the employer position means that I consider the checklist to be of dubious value as a determinant of whether the Code has been complied with.

The current checklist preamble includes advice that an employee 'can have another person present to assist', and has tick boxes relating to whether an employee has sought support and whether they have been permitted to receive it. However, filling in the relevant tick boxes is not required if an employee has been terminated on the basis of what the employer perceives as serious misconduct. Yet if, on assessment by the FWC in any unfair dismissal case, it is determined that the alleged serious misconduct is not genuinely serious, the failure to offer support may be decisive in the outcome of the case. More generally, the checklist does not indicate whether a yes or no to *any* given question is likely to protect the employer from an unfair dismissal action. It may be that greater guidance in filling in the checklist may be helpful, but many of the critics saw more fundamental problems, such as that guidelines and codes cannot be comprehensive enough to substitute for better education and widespread understanding of the law.

Box 5.8 Is the Code working? Some criticisms from participants

Participants had a variety of sometimes contradictory views about the code. Some saw it as removing effective worker protections; others considered that it gave the appearance of providing a simpler avenue for fair dismissals, but that in reality, the simplicity was illusory:

> … unfortunately the Code does not provide businesses with the certainty they need and does not prevent the bringing of unfair dismissal claims. The matters subject of the Code are still subjective and capable of challenge. (Housing Industry Association sub. 169, p. 48)
>
> The Small Business Fair Dismissal Code (SB Code) is of limited value to small business because reliance upon it is open to challenge, with a small business employer required to provide evidence of compliance with the … code if the employee makes a claim for unfair dismissal to the FWC. (Australian Chamber of Commerce and Industry sub. 161, p. 109)
>
> … the small business fair dismissal code offers a broad exemption for small businesses from unfair dismissal laws, often to the detriment of employees who would otherwise be successful in an unfair dismissal action. (Kingsford Legal Centre sub. 87, p. 7)
>
> Having examined unfair dismissal cases since 2001 I am not convinced that the Code makes any real difference for small business compared to the procedural requirements in place prior to the Code. If small businesses are to be provided any substantial relief from the costs of unfair dismissal other policies should be formulated. … The Code is no panacea. It reflects the substantive and procedural questions that an arbitrator would investigate through arbitration. It is difficult to see how ticking the boxes of the Code actually change much to the workings of unfair dismissal laws. (Ben Freyens sub. 149, p. 11)

On balance, it appears that the Small Business Fair Dismissal Code is neither fish nor fowl. Appearances aside, it poses considerable risks to small businesses if a decision is contested, undermining its original goal. In a separate review, the Code was characterised in a similar fashion by the Reviewer as follows:

> I do not favour the Small Business Fair Dismissal Code … It seems a poor document to me. On the one hand it encourages employers to escalate certain types of misconduct into police matters as a matter of course. And on the other hand, it completely fails to deal with misconduct falling short of serious misconduct which might nevertheless justify termination on notice (as opposed to summary dismissal). The Small Business Fair Dismissal Code seems to suggest that such misconduct needs to be the subject of performance management as a matter of course, which is odd, to say the least, and bordering on the bizarre. (Amendola 2009)

Problems with the Code in relation to its effect on unfair dismissal protections for the employees of small businesses have also been raised previously (Howe 2012).

Following the Code does not appear to be a sufficient safeguard for small businesses against a claim of unfair dismissal, nor is the advice provided by the Code clear and concise. It is not easy to see how amendments to the guidelines could remedy this, especially given the difficulties in precisely delineating 'serious misconduct'. A business's *perception* of serious misconduct is neither here nor there. If an employee contests a decision by an employer, the conduct still has to meet the legal tests set by the Fair Work Act and the precedents of past cases determined by the FWC. The common advice appears to be for small businesses to obtain legal advice if terminating someone's employment. If that is seen as the sensible course of action, then the Code is failing its purpose. The more

general reforms proposed below regarding the FWC's treatment of procedural matters in unfair dismissal cases, together with ongoing guidance material provided by the FWC on such matters and on unfair dismissal processes more generally, are likely to be sufficient in meeting small business needs in this area.

DRAFT RECOMMENDATION 5.4

Conditional on implementation of the other recommended changes to the unfair dismissal system within this report, the Australian Government should remove the (partial) reliance on the Small Business Fair Dismissal Code within the *Fair Work Act 2009* (Cth).

6 The general protections

Key points

- The general protections under Part 3-1 of the *Fair Work Act 2009* (Cth) (FW Act) bring together a range of previously dispersed protections. While many of these protections were part of past legislative frameworks, the current framework differs in the breadth of many of these protections and there are uncertainties about their interpretation and implementation.
- Stakeholders have very different views about the effectiveness of the protections as a group and on the design of individual protections.
  - Many employers argued that the adverse action provisions are flawed, particularly regarding the allowance of multiple reasons and the unclear definition of what constitutes a workplace right.
  - Claims of jurisdiction shopping and speculative cases were also common.
  - The reverse onus of proof, which requires those alleged to have taken adverse action for a proscribed reason to prove they did not, was seen by some participants as problematic.
  - Some employers and employer groups argued that the general protections are misused to obstruct legitimate business restructuring and to drive excessive discovery processes.
  - Unions, legal and employee groups were more positive about the general protections and, in some instances, called for their expansion.
- The Commission recognises that many of the general protections have strong prima facie justification. However, the practical effect of the complicated structure and absence of active guidance on defences and coverage is causing unnecessary contention. Improvements are required:
  - The ambiguous right to make a 'complaint or inquiry' needs to be better defined.
  - Active management by the Fair Work Commission (FWC) and the Courts on discovery processes, consistent with similar limits to sweeping discovery action in the Federal Court, is essential when a reverse onus of proof is in operation.
  - A cap on compensation for claims lodged under the general protections is needed.
- The FWC should be required to report more details about general protections claims and the outcomes of such cases, and be adequately resourced to do so.

The industrial relations framework in Australia provides a broad range of protections to employees, employers and industrial associations. The general protections provisions of the FW Act prohibit a wide range of conduct defined as 'adverse action'. Adverse action includes doing, threatening, or organising an action *because of* a particular proscribed reason. For example, it is unlawful for employers to discriminate against workers or to dismiss them because of temporary absence due to illness or injury.

Australia is not unique in providing an array of employment-based protections. What *is* unique to the Australian protections is the combined effects of: their breadth; their operation under the rubric of 'adverse action'; and some ambiguities in their coverage. These ambiguities were a particular focus in submissions for a large number of employer groups, who expressed concerns about the general protections framework.

The chapter describes the current array of protections (section 6.1), looks at evidence on their impacts (section 6.2), which is a much neglected area in the consideration of these arrangements, and assesses possible areas for further reform (section 6.3).

The focus of the chapter is on the general protections part of the FW Act (Part 3-1). Other protections such as unfair dismissal (Part 3-2) and anti-bullying (Part 6-4B) are considered elsewhere in the report (in chapters 5 and 7 respectively).

6.1 Key features of the general protections

The individual elements that make up the general protections have a long history in Australia, with some dating back to the early 1900s (box 6.1). As stated by Burnett (2014):

> Section 340 and s. 346 represent almost one hundred years of statutory evolution concerning the taking of prejudicial action against employees because of union membership or associated activities.

While originally intended to safeguard unions and their members, the protections have gradually broadened to cover a range of behaviours adversely affecting individuals in the workplace (Winckworth 2011). In addition to protecting freedom of association, the stated objects of the general protections include protecting workplace rights, providing protection from workplace discrimination, and providing effective relief for persons who have been discriminated against, victimised or otherwise adversely affected by contraventions of the protections (s. 336).

Interestingly, given the historic objective of the protections, they have also been used for some time to guarantee the right *not* to join a union (Stewart 2013), and have been used in cases to allege adverse action by union officials.

Content of the main protections

The principal protections in Part 3-1 are divided into protections relating to workplace rights and engaging in industrial activities.

A person has a *workplace right* if he or she:

- is entitled to the benefit of a workplace law, workplace instrument or order made by an industrial body
- has a role or responsibility under such a law, instrument or order

- is able to initiate or participate in a process or proceedings under a workplace law or instrument
- is able to make a complaint or inquiry to a person or body with the capacity to seek compliance with that law or workplace instrument
- is able to make a complaint or inquiry in relation to their employment. (section 341(1) FW Act)

Box 6.1 The development of the protections over time

Chapman, Love and Gaze discuss the (cumulative) history of prohibited conduct and prescribed grounds in Australia:

> In 1904, the prohibition covered only one prohibited action (dismissal), and two prescribed grounds: being an officer or member of an organisation, or being entitled to the benefit of an agreement or award.
>
> Five years later, amendments added a new prohibited action (injuring an employee in their employment), and expanded the prescribed grounds to include being an officer or member of an association that has applied to be registered as an organisation.
>
> In 1911, altering an employee's position to his or her prejudice was prohibited, and in 1914 a new prescribed ground was added: where the employee has appeared as a witness, or given evidence, in a proceeding under the Act.
>
> The trend of introducing new prohibited actions and prescribed grounds continued throughout the 20th century. The enactment in 1996 of the *Workplace Relations and Other Legislation Amendment Act 1996* (Cth) heralded significant expansion to the federal victimisation scheme. With this Act, the prohibitions on victimisation were expanded beyond the traditional realm of the federal system, to encompass, for example, conduct by an incorporated employer regulated through a state system, or conduct by a union that was not registered in the federal system. Principals and independent contractors were brought within the scheme. These expansions relied on a broader constitutional base for the federal statute than its predecessors and in 2000, Creighton and Stewart expressed the view that as a consequence the framework of the *Workplace Relations Act 1996* (Cth) 'is far more complex than its predecessors', and that the provisions 'have become ridiculously convoluted.'
>
> Immediately before the FW Act came into effect, the legislation defined five prohibited actions taken by an employer against an employee or prospective employee, and specified 16 prescribed grounds. The prescribed grounds included:
>
> - being, or not being, a union officer, delegate or member;
> - making an application for a secret ballot;
> - making an inquiry or complaint to certain persons or bodies; and
> - being absent from work without leave for the purpose of carrying out duties or exercising rights as a union officer, if an application for leave had been unreasonably refused.
>
> Throughout the 20th century, there was considerable litigation regarding both the scope of prohibited conduct and the breadth of prescribed grounds, reflecting uncertainty in these aspects of the jurisdiction.

Source: Chapman, Love and Gaze (2014).

The *industrial activity* provisions protect:

- being or not being a member or officer of an industrial association
- participation or non-participation in other lawful industrial activity

- non-participation in unlawful industrial activity.

Legislation and case law provide detailed definitions of the various terms above. For example, an industrial body encompasses a wide range of bodies including the FWC, the Federal Court, the Federal Circuit Court, and eligible state and territory courts and commissions (FWC 2014e).

Certain persons, including employers, employees and industrial associations, are prohibited from taking adverse action against certain other persons because the other person has, or exercises a workplace right, or engages in industrial activity.

The type of conduct that constitutes adverse action will depend on the relationship between the parties, covering conduct by employers and employees (including prospective employers and employees), people (principals) who engage independent contractors, the contractors themselves and industrial associations.

The wide scope of protections provided by Part 3-1 of the FW Act is indicated by the array of actions that are defined as 'adverse':

- an employer dismissing an employee, injuring them in their employment, altering their position to their detriment; or discriminating between them and other employees
- an employer refusing to employ a prospective employee or discriminating against them in the terms and conditions the employer offers
- a principal terminating a contract with an independent contractor, injuring them or altering their position to their detriment, refusing to use their services or to supply goods and services to them, or discriminating against them in the terms and conditions the principal offers to engage them on
- the actions of an employee or independent contractor taking (or not taking) industrial action against their employer or principal
- an industrial association, or an officer or member of an industrial association, organising or taking industrial action against a person, or taking action that is detrimental to an employee or independent contractor
- an industrial association imposing a penalty of any kind on a member. (s. 342 FW Act)

As well as adverse action, this Part also prohibits a person from:

- coercing another person to engage in industrial activity
- knowingly or recklessly making a false or misleading representation about another person's obligation to:
  - become or not become, or remain or cease to be, an officer or member of an industrial association; or
  - disclose whether she or he, or a third person, is or is not, an officer or member of an industrial association; or

  - disclose whether she or he, or a third person, is or is not, an officer or member of an industrial association, or is becoming, or not becoming, or remaining or ceasing to be, an officer or member of an industrial association.
- taking adverse action against another person on discriminatory grounds.

Some illustrative examples of what constitutes a workplace right, 'adverse action' and other contravening behaviours are provided in box 6.2.

Protections related to *industrial activities* form a second main tranche (Part 3-1, Division 4). Under these protections, a person must not take adverse action against another person for membership (or not) of an industrial association, or for engaging (or not), or proposing to engage in, industrial activity.

A third area within Part 3-1 (Division 5) provides for an array of *other protections*, including those covering discrimination, temporary absence due to illness or injury, bargaining services, fees and types of coercion. The discrimination provisions have been, and are likely to remain, an important area of debate. While employers must not take adverse action against employees or prospective employees due to race, colour, sex, sexual preference, age, physical or mental disability, marital status, family or carer's responsibilities, pregnancy, religion, political opinion, national extraction or social origin, employers will not contravene this protection where their action is lawful under discrimination laws (figure 6.1), or it was taken because of the inherent requirements of the particular job, or was in accordance with certain religious beliefs (s. 351).

Finally, a fourth area of the general protections deals with *sham contracting* (Part 3-1, Division 6). An employer must not misrepresent to employees (actual or prospective) that the contract of employment is a contract for services for work performed by an independent contractor. It also proscribes dismissing an employee in order to engage them as an independent contractor to perform the same, or substantially the same, work under a contract for services. False statements by employers to employees aimed at persuading or influencing the employee to enter into a contract for like work are also prohibited. (Sham contracting is discussed further in chapter 20).

Coverage and lack of a cap

Not only do the general protections cover many different types of conduct, they also apply to a much wider group of people than most other parts of the FW Act (such as the unfair dismissal provisions).

Box 6.2 Illustrative examples of key concepts

What is a workplace right?

Freddy works part-time at a petrol station. He believes he is not being paid the correct award rate for a console operator. He writes a letter of complaint to the Australian Competition and Consumer Commission (ACCC) as he mistakenly believes that it is able to investigate wage underpayments. Freddy tells his manager about the letter. Following this, his hours for the next fortnight are halved. While the complaint would not be covered by paragraph 341(1)(c)(i) of the FW Act, as the ACCC does not have capacity under a workplace law to seek compliance with the applicable award, Freddy would still have exercised a workplace right because he has made a complaint regarding his employment (subparagraph 341(1)(c)(ii)).

Adverse action

Kylie is employed by Daffy Duke Pty Ltd. Daffy Duke proposes, during negotiations for an enterprise agreement, to make a number of rostering changes at the workplace. A number of staff are unhappy about the proposal and the relevant union organises protected industrial action that includes a strike against Daffy Duke. Kylie is happy with the proposed rostering changes and declines to participate in the protected action ballot or participate in a strike. The union would be prohibited from taking adverse action against Kylie (for example, refusing to provide her with union services) because she refused to participate in the protected action ballot and any subsequently approved strike.

Coercion

John was told by his employer, Big Bird Constructions Pty Ltd, that if he did not sign an individual flexibility arrangement he would become a casual employee, would not receive standard hours each week, could not continue working the hours he was currently working and could not be employed by the company. Under the FW Act, this would amount to threatening to take action with intent to coerce John to exercise or not to exercise his workplace right and/or exercise his workplace right in a particular way.

Undue influence

Sam is employed by Happy Café Pty Ltd (Happy Café) as a casual waiter. The manager of Happy Café would like Sam to work from 5am – 1pm each day so that the restaurant can open for the lunch and breakfast trade. The manager would like Sam to work these hours at his regular hourly rate of pay (that is, no penalty rates) under an individual flexibility arrangement. The manager tells Sam that if he doesn‘t agree to the arrangement, he cannot guarantee Sam a minimum number of hours of work each week. The manager‘s threat of reduced hours convinces Sam that he should agree to the proposed arrangement. This would amount to undue influence or pressure and would be prohibited by subclause 344(a).

False or misleading representation

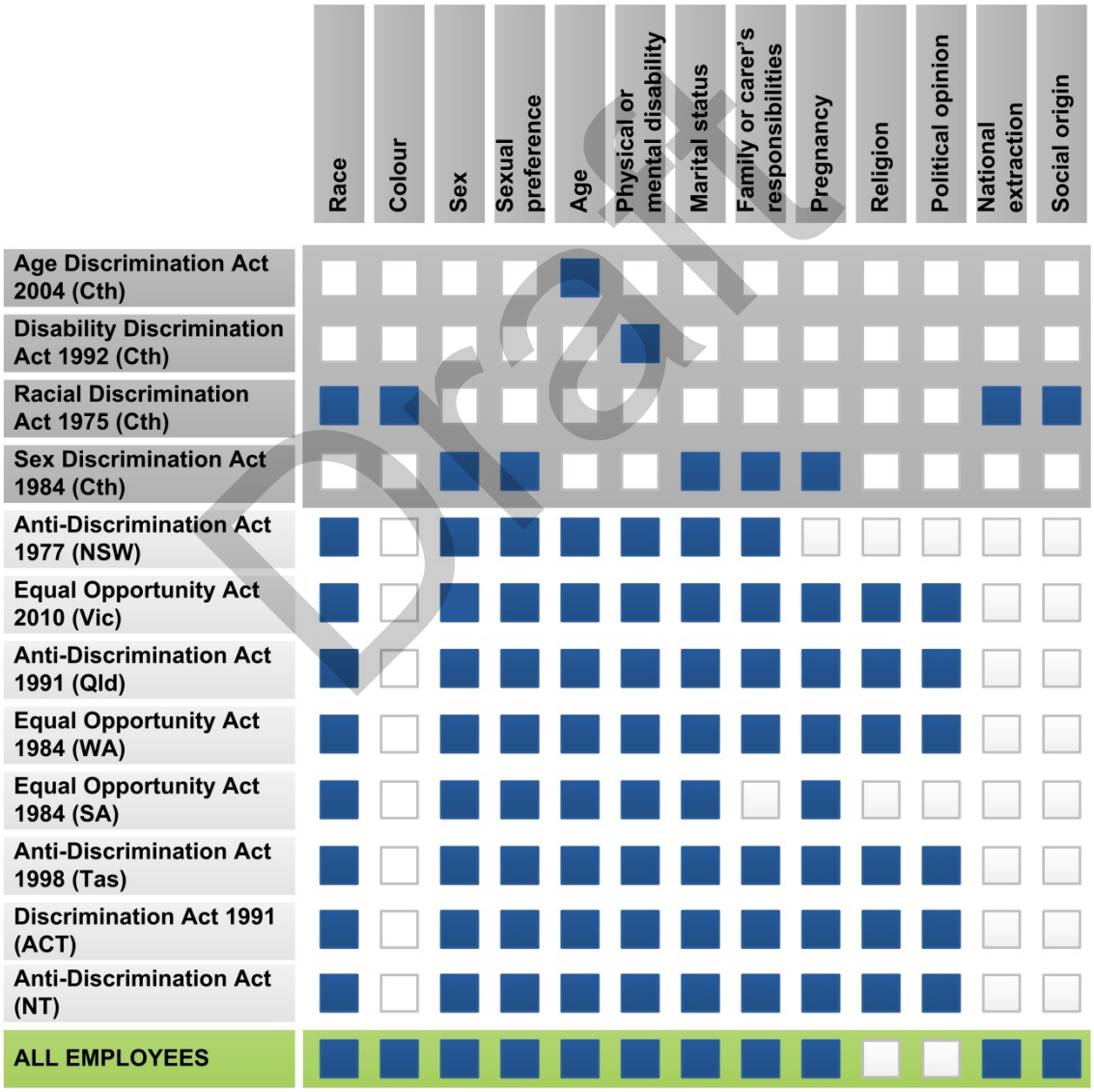
Madison is a long-term casual employee of Benny J Enterprises Pty Ltd. Madison is pregnant with her first child and asks her manager about her parental leave entitlements. Madison‘s manager tells her that only full-time employees are entitled to parental leave, knowing that this is not true. In doing so, the manager will contravene the prohibition in paragraph 345(1)(a) regarding false or misleading representations about a person’s workplace rights.

Source: Australian Government (2008).

The protections apply to certain types of 'action' — action taken by particular persons, action that has a particular effect, or action taken in a territory or Commonwealth place. Hence the protections are not limited to national system employees and employers, but also extend to principal contractors, industrial associations and, in some circumstances, non-national system employers and employees (Forsyth et al. 2010, p. 168). They also extend to potential employees. Further, there is no high-income threshold.

Figure 6.1 **Coverage of anti-discrimination protections at the Commonwealth and state and territory levels**

Blue squares denote attributes covered by the relevant legislation



Source: FWC (2014e).

Payouts arising from successful claims under Part 3-1 can be potentially much larger than via other parts of the FW Act, as the compensation provisions in Part 3-1 do not include a

cap. Further, unlike the unfair dismissal sections of the FW Act, compensation for pain and suffering is not precluded. There may also be a tendency towards higher average payments under this part of the Act, as high-income earners who are effectively 'capped out' from pursuing cases via other routes may choose the general protections where they are eligible to pursue cases. (Evidence on the magnitude of actual payouts is assessed in section 6.2).

Who does what? The role of the Fair Work Commission and the courts

General protections disputes can involve both the FWC and/or the courts. The nature and extent of involvement of each institution depends partly on whether the dispute is dismissal-related or not, and these roles have developed over time (box 6.3).

Box 6.3 The Fair Work Commission and general protections claims

The FW Act requires the FWC to handle s.365 applications differently to s.372 applications.

- Where a matter does not relate to a dismissal (s.372), the FWC can only hold a conference to deal with the dispute if both parties agree to attend. If one of the parties to a non-dismissal dispute does not agree to participate in a conference, or if the dispute remains unresolved after the conference, the employee can choose to make an application to the Federal Court or the Federal Circuit Court to deal with the matter. During a conference, a Commission Member will work with those involved to reach an agreed resolution to the dispute. The Commission Member may make a recommendation or express an opinion during the conference, but cannot make a binding final decision or an order.
- If a dispute involves a dismissal (s.365) the FWC must convene a conference. Both parties must attend the conference. If the dispute is not resolved during the conference, and the Commission is satisfied that all reasonable attempts to resolve the dispute (other than by arbitration) have been, or are likely to be, unsuccessful, then the Commission will issue the parties a certificate stating these facts. It must also advise the parties if it considers that a consent arbitration or an application to a court would not have a reasonable prospect of success. If there is some prospect of successful arbitration and parties agree within 14 days of the issuance of the certificate, then at the first instance, the Commission can arbitrate their dispute. If one or both of the parties do not consent to arbitration by the Commission, the dismissed employee can choose to take the matter to a court.

Source: FWC (2015f).

Most recently, the FWC's role has expanded to allow arbitration, with the parties' consent, of general protections claims involving dismissals. Prior to 1 January 2014, the FWC could only conciliate regarding such disputes, but did not have arbitration powers (FWC 2014b). This change in responsibility, together with the growth over time in the number of general protections claims (discussed below), has resulted in a significant increase in workload for the FWC (see figure 3.1):

> Individual matters continue to make up a significant proportion of the Commission's workload. Consistent with previous years the greatest numbers of applications are for unfair dismissal. Whilst this year there was a slight decline in the number of unfair dismissal applications

received there was also an increase of 18.5 per cent in the number of applications for general protections involving dismissal. (FWC 2014b)

The implications of this expanded role for the resourcing of the FWC and the quality of outcomes form part of the discussion in the next section.

Multiple reasons and a reverse onus of proof

The general protections have several design elements that, at first glance, appear unusual. These are covered in Part 3-1, Division 7 within a section entitled Ancillary Rules.

First, *multiple reasons* for action are considered to be material. That is, 'a person takes action for a particular reason if the reasons for the action include that reason'. This means that, in proving that an employer took adverse action, for example, an employee needs to demonstrate that, amongst the reasons which the employer had for taking such action (and they can be numerous), only one was a proscribed reason.

Second, there is a *reverse onus of proof*, such that reasons for action will be presumed unless proved otherwise. That is, the person who took the action will be presumed to have taken that action for contravening reasons unless they can prove otherwise.

As will be discussed below, these design elements have been the subject of considerable commentary and debate during this inquiry.

6.2 Adequacy of current arrangements

In assessing the performance of the general protections, the Productivity Commission has considered:

- (limited) available data on the nature, incidence and cost of claims since the introduction of the general protections in their current form in 2009
- the views of participants regarding scope and process problems in general protections cases
- analysis of the potential economic impacts of the dismissal and non-dismissal segments of the protections.

The recent large growth in applications

The number of general protections claims has been growing strongly (table 6.1). By far, the largest number of lodgments under Part 3-1 relate to disputes about dismissals. There is very little information available about the balance of matters that comprise non-dismissal disputes. What is clear is that non-dismissal disputes under the general protections provisions have also increased significantly in recent years.

Table 6.1 **General protections lodgments across time**
Number of applications lodged

Matter type	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*2013-14*
Dismissal disputes *(s.365)*	1 188	1 871	2 162	2 429	2 879
Non-dismissal disputes *(s.372)*	254	504	598	555	779

Sources: Fair Work Australia (2010), Fair Work Australia (2011) and FWC (2014b).

A significant proportion of dismissal-related matters do not proceed to arbitration (table 6.2). Around 65 per cent of matters lodged in 2013-14 were finalised without certificate, indicating that settlement is likely to be a common occurrence.

Table 6.2 **General protections matters involving dismissal (s. 365); manner of finalisation**

	2011-12	*2012-13*	*2013-14*
Certificate issued	931	832	967
Finalised without certificate issued [a]	1 393	1 517	1 811
Total finalised	2 268 [b]	2 349	2 778

[a] Finalising without issuing a certificate includes disputes that are settled, applications that were withdrawn, invalid or late, and matters that are adjourned indefinitely. [b] Total reported also includes s. 773 matters relating to the unlawful termination of employment. These totalled 141 matters in 2011-12.

Sources: FWC (2013a), FWC (2014b).

The size and growth of compensation payments can also affect the behaviour of parties. To the extent that general protections claims result in very large payments, and expose senior management to liability, it is more likely that they will play an influential role in determining workplace decisions and processes. These payments can occur informally, through settlement at early stages, or formally, as a result of arbitration.

The value of compensation settlements is unknown. Aggregate information on payments of compensation arising out of arbitrated Part 3-1 cases is not readily available.

Problem areas identified by participants

Despite recent reforms (see below), stakeholders (mainly employers and employer groups) continued to express concern about how Part 3-1 operates in practice. Such concerns are not new, and significant problems have (according to a wide variety of commentators) beset the general protections jurisdiction for some time.

One focus of past concerns was on the (previously) different time limits for lodgments of dismissal claims that existed between Parts 3-1 and 3-2 of the FW Act. For example, in their submission to the 2012 review of the FW Act, Forsyth and Stewart stated:

> The larger problem for us, is the veritable flood of dismissal-related claims now being lodged with FWA under s 365 … It is widely believed or acknowledged amongst practitioners that a significant proportion of these claims involve speculative or tenuous allegations. (Forsyth and Stewart 2012)

They went on to recommend harmonisation of lodgment timeframes across these parts of the FW Act, and this occurred in 2013.

But concerns of a more general, systemic nature have also been raised about the general protections. For example, in its submission to the 2012 review, the Victorian Employers' Chamber of Commerce and Industry (VECCI) stated:

> … general protections claims threaten to be the nadir of the Fair Work reforms – without much in the way of jurisdictional hurdles, mandating the operation of a reverse onus of proof, requiring only 'one reason' being proscribed (not being the sole or even dominant reason) as the basis for the adverse action taken by an employer, and uncapped compensatory possibilities in addition to pecuniary penalties that may be imposed. (Victorian Employers' Chamber of Commerce and Industry 2012)

This more generalised view of problems was a theme also running through VECCI's submission to the present inquiry (sub. 79, p. 90).

The Australian Human Resources Institute (AHRI) presented the results of a survey of its members in its submission to this inquiry. The results showed particular concern regarding the adverse action provisions of the general protections (figure 6.2). Interestingly, there was far greater concern evident amongst surveyed members about general protections than other specific areas of employment protections, such as anti-bullying and unfair dismissal. Of course, such surveys may not be representative of all businesses.

Claims of excessive breadth

One major area of concern raised by a considerable number of inquiry participants was that the general protections are bedevilled by their excessive breadth. The broad scope of the protections was intended. The Australian Government acknowledged, even prior to the introduction of the provisions, that generalising the protections could also expand their scope.

> … fairness and representation at the workplace by recognising the right to freedom of association and preventing discrimination and other unfair treatment … The consolidated protections in Part 3-1 are intended to rationalise, but not diminish, existing protections. (Australian Government 2008)

Figure 6.2 **AHRI's member survey on the impact of adverse action provisions in the workplace**[a]

799 respondents

[a] It is important to treat surveys of this kind with caution, as they are not undertaken by an impartial body, may not be representative, and answers may be conditioned by the context of the questions. Some other surveys examined by the Productivity Commission have also been subject to these concerns. They provide some information, but are not definitive.

Source: AHRI, sub. 46, p. 12.

Many participants argued that the expansion in scope has turned out to be excessive, and that the current formulation provides a much too broad set of avenues for appeal. For example, VACC, MTA NSW and MTA SA stated:

> Our members are very concerned about the general protections provisions. We are seeing more claims in this area as awareness is raised. These provisions are so broad and subjective they create great uncertainty for employers. These provisions encourage vague, vexatious and ill-advised claims. (sub. 201, p. 9)

In a similar vein, the Australian Federation of Employers and Industries stated:

> The breadth of employer actions identified under s. 342 (1) as adverse or prejudicial to an employee's actual or future employment is excessive, the nature of a 'workplace complaint' is all-encompassing. (sub. 219, p. 53)

Concerns about the definition of a workplace right

A particular concern of several stakeholders (including the Catholic Commission for Employment Relations as described in box 6.4) was that the definition of what constitutes a 'workplace right' was overly vague. Many employers argued that the current definition of a workplace right could be used to prevent them from undertaking legitimate performance management or restructuring activities for fear of facing an adverse action claim[60]. For example, the Minerals Council of Australia stated:

> Such claims are being used to interfere unreasonably with ordinary management decision making and performance management processes. (sub. 129, p. 33)

Box 6.4 Specific areas of ambiguity and uncertainty: one participant's view

The Catholic Commission for Employment Relations (sub. 99, pp. 40–41) provided the following list of features that, in its view, lead to ambiguity and uncertainty around the complaint or inquiry right in the FW Act:

1. Whether an employee making a complaint needs to hold a genuine belief in its merits in order for the complaint or inquiry to fall within the definition in s 341(1)(c)(ii) of the FW Act.
2. 'Complaint or inquiry' is not defined in the FW Act or in the Fair Work Regulations 2009, nor is it comprehensively analysed in the Explanatory Memorandum to the Fair Work Bill 2008. As a consequence:

(a) There is no test or qualification regarding the substance or content of a complaint for it to constitute a 'complaint' within the meaning of the FW Act … ;

(b) The FW Act does not define how the complaint or inquiry right must be exercised. Consequently, there is a lack of clarity as to whether the complaint needs to be properly communicated to the employer, or for the employee to demonstrate that they reasonably intended for the employer to take significant steps in response to it. In other words, there is uncertainty as to whether a complainant needs to reasonably put the employer on notice that they have actually exercised the right to make a complaint …

3. There is uncertainty as to the meaning of a complaint or inquiry that is 'in relation to his or her employment'. There is a divergence in the case law on this point, and consequently it is unclear whether the protection is limited to complaints directly related to the complainant's own employment, and if not, the extent to which a complaint may be indirectly 'in relation to' the complainant's employment.
4. Whether the meaning of the words 'is able to' in s 341(1) of the FW Act, means there are certain circumstances in which an employee is not able to make a complaint or inquiry that attracts the protection.
5. Whether 'complaint or inquiry' is one cumulative workplace right with a single meaning, or whether they constitute two distinct workplace rights with their own scope and meaning.

60 The 2012 FW Act Review did not see problems in this regards, and stated: "The Panel has not seen any evidence of a judicial interpretation of the general protections which infringes unjustly on an employer's right to initiate performance management processes against an underperforming employee. With time, the Panel believes a body of jurisprudence regarding the general protections will develop, which should provide employers and employees with greater certainty about the range of behaviour prohibited by the general protections". (McCallum, Moore and Edwards 2012)

Overlapping legislation an issue for some

The overlap with other laws, particularly in the area of anti-discrimination (figure 6.1), was also discussed by several participants. To the extent that this overlap ensures protection in otherwise exposed areas of human interaction, there can be potential grounds for initially accepting such duplication. However, this duplication can also encourage jurisdiction shopping and gaming. Ultimately, a simplifying exercise would require formal conferencing of the Commonwealth, states and territories and numerous independent regulators. The gain may not be worth the pain, desirable as such simplification might be.

Concerns about the onus of proof

The reverse onus of proof was also seen as problematic, but by a far more limited number of participants. For example, Minter Ellison said:

> In our experience, the reverse onus is being misused. The fact that there is a reverse onus is being used to make assertions of contravention where there is no logical (or actual) connection between alleged adverse action and alleged motivation. While … these allegations will ultimately fail, they can significantly add to the costs of defending a claim. (sub. 94, p. 3)

Several submissions (such as Qantas, sub. 116, p. 16) argued that a reverse onus is not observed in other parts of the FW Act or in many other legal contexts.

Benefits

The general protections are aimed at protecting workplace rights, freedom of association and non-discrimination in the workplace. Intrinsically, such protections have a valid role as:

- discrimination against any party based on factors unrelated to their work performance is both inefficient and contrary to well established social norms
- the realistic capacity for collective action by employees must address any attempts by employers or other parties to subvert this through covert measures (such as disadvantaging union members or employee representatives).

In that light, unions, legal and employee groups were generally positive about the general protections, arguing that, despite some faults, they nevertheless provided critical coverage to employees against a range of adverse behaviours. For example, the Employment Law Centre of WA stated:

> The general protections in the FW Act do provide necessary protections to employees, and provide a large degree of certainty to all parties. (sub. 89, p. 42)

The Queensland Council of Unions stated:

> The introduction of the general protections into the Fair Work Act 2009 was a positive step in providing decent workplace rights for Australian employees. These provisions are not onerous

> and would only penalise employers engaging in vindictive conduct towards their workforce. (sub. 73, p. 38)

Several parties described the protections as the result of an evolutionary process, and of gradual refinement over time.[61] The consolidation of the protections within a single part of the FW Act was also seen by some as a positive step, resulting in clarification of coverage and scope.

The effects of the *BRIT v Barclay* and *CFMEU v BHP Coal* decisions

Several recent decisions have improved and clarified some important aspects of the general protections.

Foremost amongst these has been the High Court judgment in September 2012 of the appeal regarding *Board of Bendigo Regional Institute of Technical and Further Education (BRIT) v Barclay* [2012] HCA 32 (box 6.5). Prior to the High Court judgment in this case, employers were concerned that disciplinary actions taken against an employee who was underperforming, but also happened to be a union official or had some other attribute that was irrelevant to an assessment of their underperformance could be caught up under the general protections. This would have had the effect of legitimising unacceptable conduct by some employees, or in some cases, providing unwarranted industrial leverage to those few union officials willing to push the legislation to its limits. The High Court judgment is generally seen to have clarified that the central consideration about the reason for adverse action is the subjective intention of the person taking the alleged adverse action and that in this regard a decision maker's evidence of the reason for their decision is enough, provided that there is no contradictory evidence.

The decision of the High Court in *Construction, Forestry, Mining and Energy Union v BHP Coal Pty Ltd [2014] HCA 41A* is also seen as a second significant case that has further clarified aspects of the general protections. This case involved a BHP employee, who was also an official of the union, who was involved in a protest on his day off and was dismissed by the company for waving a placard that it deemed was offensive to other employees. The majority decision in this case has generally been seen as reiterating the logic applied earlier in the Court's judgment in the Barclay case.

The dismissal segment is critical in assessing impacts

In considering the economic impact of the general protections (box 6.6), the prevalence of dismissal-related claims is likely to be a key driver of costs and benefits.

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61 For discussion of the historical development of the general protections, see (Love 2014) and (Chapman, Love and Gaze 2014).

Box 6.5 The BRIT v Barclay case

Mr Barclay was a senior teacher employed by the Bendigo Regional Institute of Technical and Further Education (BRIT). He was also the Sub-Branch President at BRIT of the Australian Education Union (AEU).

Mr Barclay forwarded an email to AEU members employed at BRIT, regarding an upcoming re-accreditation audit, in which he said he was aware of reports of serious misconduct by unnamed persons in BRIT. Before sending the email he did not advise any of his line managers of the details of the alleged misconduct. The email was passed on to senior managers and subsequently, the Chief Executive Officer (CEO) of BRIT. She wrote to Barclay requiring him to show cause, why he should not be disciplined for failing to report the misconduct alleged in his email to senior managers. Barclay was suspended on full pay, had his internet access suspended and was not required to attend BRIT during the suspension period.

The respondents (Mr Barclay and the AEU) commenced proceedings, contending that BRIT had contravened provisions of the Fair Work Act 2009 (Cth) (the Act), designed to protect the right of union officials and members, so that the action taken by the CEO constituted adverse action within the meaning of s 342 of the Act. BRIT conceded that Barclay's suspensions and preclusion from BRIT did constitute adverse action. However BRIT submitted that the decision to require Barclay to show cause was not adverse action within the meaning of the Act. The respondents submitted that the test of the reason why the relevant action was taken was objective and not subjective.

In February 2011, the Full Court of the Federal Court held that sending of email was part of Barclay's functions as AEU officer and therefore adverse action had been taken within the meaning of the Act.

On appeal, the then Minister for Tertiary Education, Skills, Jobs and Workplace Relations, the Hon. Bill Shorten MP, intervened in support of the appellant, as allowed under s. 569 of the FW Act.

In September 2012, the High Court decided that BRIT had not breached the adverse action provisions by suspending and issuing a show cause letter to a union delegate over an inflammatory email — reversing the decision of the Full Court of the Federal Court.

The High Court's decision included the following points.

- There will be no legitimacy in the search for an 'unconscious' reason, which the Federal Court had undertaken in the appeal decision.
- Direct evidence of the decision-maker's state of mind, intent or purpose will be crucial to establishing the employer's reasons for imposing adverse action on an employee, and evidence comparing what the decision maker would have done if an employee who was not a union official had engaged in the misconduct will be relevant.
- An employee's union position and activity will not in and of itself be a factor which must have something to do with adverse action, or which can never be dissociated from adverse action.
- An employer's reasons that will be relevant are only those that are 'operative and immediate' so that, for example, the mere fact that a decision maker is aware of past industrial activity by an individual will not make that activity a substantial and operative reason.

Sources: Minter Ellison (2012), High Court of Australia (2011), Hunt and Hunt Lawyers (2012).

Box 6.6 The economic impact of the general protections

The key empirical goal is to assess the impacts of the various protections currently afforded under Part 3-1 on hiring behaviour, workplace organisation change and other aspects of performance against a counterfactual in which such protections were absent. In considering this goal, an overarching problem is how to adequately address the overlap between protections afforded elsewhere in the FW Act or in other legislative frameworks (such as those that apply for unfair dismissal or anti-discrimination), which would nullify or dampen the effect of the modification or removal of Part 3-1. In this context, determining the aggregate economic impacts of the general protections with any precision is likely to be difficult. There are several possible methodologies.

Surveys of businesses

Surveys of firms or employer groups may provide some evidence on the effects of the general protections on workplace practices and hiring decisions. While such results can indicate perceptions of businesses and usefully uncover the ways in which the protections might affect business efficiency and conduct, they are also inherently subjective and open to bias as they reflect the views of parties that will more often be losers than winners from the arrangements.

Firm-level statistical analysis

Any such statistical analysis would have to carefully control for the fact that the causal impacts may flow in the opposite direction or reflect missing covariates. For instance, firms with poor management may experience both declining employment and higher claims under the general protections. Poor management is often difficult to observe. It is possible that some more reliable results might include in regression both the total number of claims, and the claims that are successfully defended by employers, but it would be hard to characterise settlements, which may not be related to the fault of the business. The data at the firm level would, in practice, be difficult to collect.

Cross-country regression analysis

Another statistical approach might be to score the regulatory restrictiveness of any general protections across comparable countries (which has been undertaken for unfair dismissal provisions), and then examine the effect of such scores on unemployment or some other measure of flexibility in economies. However, international comparisons are fraught in many cases, and too often result in 'apples with oranges' problems if very detailed accompanying analysis is lacking. Even across roughly similar economies, it would be difficult to characterise the multiple dimensions of the general protections. That said, some empirical strategies — which are beyond the scope of this report — might attempt to more rigorously characterise the various aspects of the various protections by using a set of ordinal, dichotomous and continuous variables.

For example, it might be possible to measure countries' relative compensation rates, whether these were capped or not, their use or otherwise of conciliation or arbitration, the capacity of an employer to seek an adverse action and not just an employee, the coverage of employed people, and so on — creating a series of variables that reflect the nature of the protections. Panel data analysis, controlling for other variables, might then be used to assess any employment, investment or productivity effects. While there has been no such analysis based on variations in cross-country general protections (or their equivalents), this type of regression approach has been used in various other analyses of the impacts of regulatory regimes (for example, Boeri and Jimeno 2005; Cahuc and Postel-Vinay 2002; Freeman 2005; Nicoletti and Scarpetta 2003; Pierre and Scarpetta 2004).

As shown above, data provided to the inquiry by the FWC show that by far the largest share of general protections applications (around 80 per cent) involve a dismissal (s. 365). Many of these applications are similar disputes to those covered by s. 394 but are made via the general protections route because applicants are capped out or excluded for other reasons:

> Compared to an unfair dismissal claim there are fewer exclusions, there is often no cap on the compensation that may be awarded, and in some instances the legislation puts the burden of proof on the employer to show the true reason for dismissal. As against those advantages, such proceedings can sometimes take a long time to be resolved. (Stewart 2013)

Historically, a further reason for many dismissal applications under s. 365 reflected the capacity to lodge claims well after the time limit had elapsed under the specialised unfair dismissal provisions of the FW Act. A significant change in this context concerns the recent harmonisation of timeframes for lodging a dismissal dispute under s. 365 and s. 394 as mentioned above. The results of this change were discussed in detail in the previous chapter, and, following alignment of the time limits, this driver has disappeared.

Any impacts from the dismissal segment of the general protections on hiring behaviour and employment will be similar in form to those made under the s. 394 unfair dismissal protections, though they are likely to be of a lower magnitude given the smaller number of claims. Nevertheless, there is some evidence from participants that the cost per case under the general protections exceeds that of the specialist regime.

There were 779 applications in 2013-14 for breaches of the general protections not involving a dismissal. Unfortunately, as mentioned above, the FWC is not required to record more detailed data on which protections these applications relate. They use a binary classification, splitting claims into dismissal and non-dismissal.

The potentially beneficial impacts of the protections (as discussed above) also need to be weighed against any of their adverse effects.

Interim assessment

There is a reasonable presumption that many of the protections have positive impacts. For example, it would be hard to justify adverse action against an employee because they were or were not a union member. Removing any such protection would widen the scope for employers or unions to abuse any power they might have, with damaging consequences for the efficiency of labour markets. The main issue for these kinds of protections, then, is not their inherent validity, but whether there are problems associated with uncertainty about their application, the compliance costs they might entail, any unintended behavioural responses by employers and employees, and the processes by which disputes are resolved.

On the other hand, many stakeholders pointed to problems associated with the combination of broad protections, multiple reasons and the reverse onus of proof, and overlap with other parts of the FW Act or other laws. These go to matters largely of design, rather than the

existence of the protections per se. The way that the protections are implemented in practice is an important further consideration. A particular issue in this regard concerns the potential misuse of the adverse action provisions to frustrate commercial restructures, with both direct effects (such as delay) and indirect, 'chilling' effects on future restructure plans.

The rise in lodgments in recent years, both for dismissal and non-dismissal matters, could be evidence simply of a jurisdiction that is finding its feet. But a considerable number of stakeholders to the present inquiry disagreed with this, and pointed to many cases where the general protections were being used as a 'stalking horse' to launch dubious, but costly and time-consuming cases.

Some limited further reform of the general protections is needed to restore greater balance between the needs of employers and employees and to strengthen the ex-ante filters around such cases. Reforms are needed both to the architecture of protections, as well as to arrangements concerning their practical implementation. These are discussed in the next section.

6.3 Further reforms to the general protections

Reinstating the sole or dominant reason test?

As discussed, the current general protections allow for multiple reasons for taking action to be considered as material, with contravention if one or more of the reasons are proscribed. This test applies generally, as set out in the Ancillary rules of Part 3-1 (Division 7). Many participants argued that a return to a sole or dominant reason test, as applied in a previous formulation, is more appropriate. Several submissions focused on the operation of the current test in practice, and argued that it inevitably places employers at a disadvantage in disproving allegations of proscribed conduct.

A common argument was that the general protections have provided a very extensive list of grounds for contravention, and this, in combination with the current test, amounts to a 'one strike and you're out' approach to cases. While allowance for multiple reasons is important in complex cases, a sole or dominant reason test would, in this view, remove unnecessary ambiguity, reduce the scope for primarily vexatious claims and refocus consideration of genuinely adverse actions.

There are several counterarguments regarding the reintroduction of the sole or dominant test. First, the High Court's decision in the Barclay case has clarified to a considerable degree the operation of the test within the general protections. As is now clear, a prohibited reason must still be a 'substantial or operative' factor influencing an employer's decision to dismiss an employee, or an 'operative or immediate' reason for acting. If there were other strong grounds for dismissal — such as poor performance — the dismissal would

unlikely be adverse action. This judgment has provided guidance, particularly for employers, on the operation of the test. Second, when it was in operation, the 'sole or dominant reason' test was widely seen as providing too high a hurdle in proving claims of contravention, so reverting to it may shift the balance too much in favour of employers.

On balance, and given recent case law, the grounds for significant change do not seem persuasive. Recent decisions have clarified substantially that the test to employ is whether a person took adverse action against another person, with a focus on 'substantial or operative' factors influencing the decision, or an 'operative or immediate' reason for acting, as the primary consideration. Given this, the evidence presented thus far to the inquiry does not suggest that a return to a test based on a sole or dominant reason is required.

Reforms to the onus of proof

As discussed, unlike many of the other major provisions in the FW Act, and other legislation (such as anti-discrimination law), Part 3-1 of the FW Act requires that, in cases where adverse action is alleged for proscribed reasons, employers or other respondents must disprove that action was taken for those reasons (s. 361), reversing the usual onus of proof.

The inclusion of this reverse onus has its historical foundation in the desire to make it easier for applicants to prove that an action was carried out for a proscribed reason (Chapman, Love and Gaze 2014). The decision maker, rather than the claimant, is in the best position to provide evidence about the reasons for his or her action. In essence, it is a tool used to tease out causal reasons for an action or actions, and to therefore consider a range of possible motives underlying such action.

Some participants claimed that the reverse onus had significant negative consequences. A particular concern was that adverse action cases may be taken where a business undertakes structural reforms that have adverse impacts on the job security or wages and conditions of its employees (for example, moving to labour hire arrangements or adopting labour-displacing technology). The general protections do not outlaw adverse action per se, but do constrain structural adjustment where the *purpose* is to undermine the employment conditions of employees.

Since employees cannot be in a position to discover intent, there is some justification for such an onus. However, the reverse onus of proof can, several participants claimed, also trigger a discovery process that allows a union or court to sift through potentially hundreds of thousands of documents in search of intent. Doing so may not only be costly in its own right, but may disclose many aspects of a business that it would be unreasonable to expose to third parties. Moreover, the court processes that accompany adverse action cases are slow (years can pass), creating large administrative and legal costs and frustrating business plans.

Recent significant improvements to limit discovery processes in the Federal Court are noteworthy here, as are that Court's pre-existing practices in this area. These reforms and practices were noted in the Productivity Commission's 2014 report on Access to Justice Arrangements (PC 2014a), and include:

- presumptions against standard discovery
- the development and maintenance of judicial education and training programs specifically dealing with judicial management of the discovery process in Federal Court proceedings
- requirements to seek the leave of the Court to obtain discovery.

Many of the Federal Court's practices in this area are detailed in its Rules and in Practice Note CM5 from August 2011 (box 6.7). Introducing limits on discovery processes for general protections cases that align with such practices is recommended, and would provide safeguards against overly onerous or excessive discovery.

Box 6.7 Case management of discovery in the Federal Court

Federal Court rules require all applications for discovery orders to specifically address the need for the orders sought and require the Court in all cases to make a determination as to whether discovery is necessary. In this way, discovery obligations in Federal Court proceedings are the result of conscious judicial decision making.

In determining whether to make any order for discovery, the Court will have regard to the issues in the case and the order in which they are likely to be resolved, the resources and circumstances of the parties, the likely benefit of discovery and the likely cost of discovery and whether that cost is proportionate to the nature and complexity of the proceeding.

In making orders for discovery the Court must actively fashion any order to suit the issues in a particular case and consider the following:

- Is discovery necessary to facilitate the just resolution of the proceeding as quickly, inexpensively and efficiently as possible?
- If discovery is necessary, for what purpose?
- Can those purposes be achieved by a means less expensive than discovery or by discovery only in relation to particular issues?
- Where there are many documents, should discovery be given in a non standard form, e.g. initially on a limited basis, with liberty to apply later for particular discovery or discovery on a broader basis?
- Whether discovery should be given by the use of categories or by electronic format or in accordance with a discovery plan?
- Should discovery be given in the list of documents by categories and by a general description rather than by identification of individual documents?

Sources: Federal Court Rules 2011 (Cth), r. 20.11. Federal Court of Australia (2011), PC (2014a).

More broadly, subject to the other reforms proposed in this chapter being introduced, and accompanying changes with regard to the interpretation of the test for establishing the reasons for action, retention of the reverse onus provisions is justified. They remain an important feature in instances of evidentiary imbalance between parties.

DRAFT RECOMMENDATION 6.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) to formally align the discovery processes used in general protection cases with those provided in the Federal Court's Rules and Practice Note 5 CM5.

Tightening up arrangements regarding a 'workplace right'

As it currently stands, both the definition of a workplace right and aspects of the associated provisions result in a very broad range of potential applications. Problems with the drafting and definitions in this section of the general protections have been apparent for some time. For example, in 2010 Creighton and Stewart stated that this part of the FW Act:

> … opens up the possibility that an employee who makes any complaint or inquiry to *any* body or person about any matter relating to their employment, even if the 'matter' does not pertain to a workplace law or workplace instrument, would still be entitled to the protection of Division 3 … If that were indeed found to be the case, it would give employees and their industrial representatives a new basis for challenging the actions of employers in the workplace – an option that is made all the more potent by the reverse onus provisions in s 361. (Creighton and Stewart 2010)

Several stakeholders argued that the generality of these provisions present problems. For example, Master Builders Australia stated:

> The protection of 'workplace rights' should be limited to protecting employees from adverse action for filing a formal inquiry or complaint with a competent administrative authority that is directly in relation to his or her employment. Further, it should go without saying that in order for such inquiry or complaint to be protected, it must be one that has been made in good faith and not for an ulterior purpose. (sub. 157, p. 52)

The Australian Chamber of Commerce and Industry raised similar concerns in its submission (sub. 161, pp. 143–144), arguing that the implementation of such broad provisions inevitably created difficulties for employers and afforded a very wide range of grounds for dispute to employees.

Varying views on the breadth or narrowness of this section of the FW Act have been evident in recent judgements (see, for example (Young 2014). There is a need to more precisely define the meaning of a workplace right. Modification in particular of s 341 (1)(c) and related explanatory material is needed to ensure greater clarity around the nature of a complaint or inquiry that is indirectly related to a person's employment.

Given the significant increase in general protection claims, clarity about grounds for exclusions are required. This may ensure that those claims that are lodged have a genuine basis and are being pursued in good faith by the claimants involved.

DRAFT RECOMMENDATION 6.2

The Australian Government should modify s. 341 of the *Fair Work Act 2009* (Cth), which deals with the meaning and application of a workplace right.

- Modified provisions should more clearly define how the exercise of a workplace right applies in instances where the complaint or inquiry is indirectly related to the person's employment.
- The FW Act should also require that complaints are made in good faith; and that the Fair Work Commission must decide this via a preliminary interview with the complainant before the action can proceed and prior to the convening of any conference involving both parties.

DRAFT RECOMMENDATION 6.3

The Australian Government should amend Part 3-1 of the *Fair Work Act 2009* (Cth) to introduce exclusions for complaints that are frivolous and vexatious.

Compensation caps

The absence of compensation caps for matters covered by Part 3-1 of the FW Act creates incentives for some parties to choose this avenue for action, rather than the standard unfair dismissal provisions of the Act. For example, the Australian Retailers Association said:

> … it has been the experience of ARA members that these types of claims are being made by terminated employees where they cannot access unfair dismissal protection, or because the absence of a compensation cap and the risk of civil penalties is a bigger stick that the employee and their representative can use against the employer. (sub. 217, p. 18)

The lack of a cap may encourage some employees to press claims with little or no basis for essentially speculative reasons.

The absence of a cap is, in part, due to the protections covering matters that are diverse, can have very adverse impacts on claimants, and which include dismissal, but are far broader in scope.

Nevertheless, the case for maintaining uncapped provisions is not compelling. As the general protections offer an appeals avenue for applicants above the high-income threshold, and have been harmonised recently with Part 3-2 regarding lodgment timeframes, inclusion of similar capping arrangements for claims pursued under Part 3-1 is justified.

Dismissed employees seeking levels of compensation higher than the cap should still be able to access the courts directly. The Commission is interested in any impediments that may arise by taking the FWC out of any role in assessing such claims, and may address this further in the final inquiry report.

DRAFT RECOMMENDATION 6..4

The Australian Government should introduce a cap on compensation for claims lodged under Part 3-1 of the *Fair Work Act 2009* (Cth).

Improvements to reporting arrangements

Notwithstanding their rising prevalence, there is surprisingly little information about the main drivers of lodgment of claims under the general protections section of the FW Act, the aggregate outcomes of such cases, and the implications for resourcing and priorities of the FWC. This dearth of information is in contrast to the relative abundance of information concerning unfair dismissal claims made under Part 3-2 of the FW Act. There is therefore a strong case for the Australian Government to require the FWC to provide more information about Part 3-2 claims.

DRAFT RECOMMENDATION 6.5

The Australian Government should amend Schedule 5.2 of the *Fair Work Regulations 2009* (Cth) to require the Fair Work Commission to report more information about general protections matters. Adequate resourcing should be provided to the Fair Work Commission to improve its data collection and reporting processes in this area.

The end goal in reforming the general protections

Given the complexities around this set of protections, and the diversity of views about the many and varied legal aspects that underpin them, it is useful to return to first principles and consider what the general protections are trying to achieve.

The historical foundations of the protections lie in a legitimate desire to provide safeguards of freedom of association, in all its various guises. Across time, the gradual addition of protected matters, together with the introduction of concepts such as workplace rights and adverse action, have broadened the scope of the protections considerably.

The importance of balance and a common sense approach should be emphasised, as should the economic impacts of such protections in addition to their legal interpretations. In this regard, the High Court judgment in the Barclay case and, in particular, its emphasis on subjective intentions is, across time, likely to provide much needed clarity about Part 3-1 cases.

As emphasised above, the general protections provide valid safeguards against adverse actions, and their long historical lineage underscores their necessity. But this is certainly a case where the 'devil is in the detail' and, where some further improvement is possible to what is in principle a desirable set of protections.

The reforms outlined above are likely to rebalance this part of the FW Act. A watching brief will need to also be kept by government.

7 Anti-bullying

Key points

- Surveys of employees suggest that bullying behaviour in its various forms is relatively common in workplaces in Australia and many other countries.
  - Very serious cases in Australia have received considerable publicity, prompting further recent action by the Commonwealth and state governments.
  - Given the considerable differences in methodologies and survey sizes, comparisons of prevalence across countries and even across jurisdictions can be extremely difficult.
  - Estimates of the costs of workplace bullying also vary widely. Commonly quoted cost estimates remain somewhat experimental.
- Anti-bullying provisions are a very recent addition to the *Fair Work Act 2009* (Cth) (FW Act). It is too early to conclude on the effectiveness of – or indeed the need for – national laws and their impact on businesses and the economy.
  - Situating such protections within the FW Act was questioned by a number of participants.
  - There is overlap between the anti-bullying jurisdiction in the FW Act and a number of other avenues for recourse at both the Commonwealth and state levels, particularly workplace safety regulation.
  - Others have argued that these protections are a necessary safeguard in modern workplaces that are increasingly based on the rights of individual employees, and where there is a growing diversity of views, cultures and ways of working.
- Evidence on the operation of the jurisdiction thus far by the Fair Work Commission (FWC) shows a gradual development in approach.
  - While the caseload has been small to date, the jurisdiction is resource intensive for the FWC as evidence provided by applicants can be extensive if not always substantive.
  - Overall, the FWC's approach appears to be considered and effective.
- A further independent review of performance of this jurisdiction in the medium term is scheduled, and will be useful in monitoring its effectiveness.

Anti-bullying provisions are a new feature of the workplace relations system, being introduced into the *Fair Work Act 2009* (Cth) (FW Act) in January 2014. This chapter examines the operation of the anti-bullying jurisdiction within the FW Act.

- Section 7.1 discusses the current institutional setting, looks at the anti-bullying provisions, considers the role of the Fair Work Commission (FWC), and analyses alternative avenues by which individuals can pursue bullying claims.
- Evidence on the current prevalence and costs of bullying are discussed in section 7.2.

- Section 7.3 considers evidence and arguments on how well the anti-bullying jurisdiction is performing.
- Options for further review are assessed in section 7.4.

7.1 Anti-bullying protections

The main provisions

Part 6-4B of the FW Act concerns workers bullied at work. Bullying is defined as behaviour towards another person that is unreasonable, repeated, and creates a risk to health and safety (s. 789FD). Reasonable management action, carried out in a reasonable manner, is not classified as bullying behaviour.

The Act accords a key role to the FWC in overseeing the jurisdiction. As is the case for unfair dismissal (chapter 5), the FWC is the mediator, conciliator and, as a last resort, adjudicator.

The FWC can make any order it considers appropriate to stop the bullying. However, it cannot make orders requiring payment to workers. Workers may be able to seek compensation through other means, for example, through workers' compensation, workplace health and safety and common law claims. A failure to comply with FWC orders exposes the employer and/or the relevant bullying party to civil penalties.

Coverage

The anti-bullying provisions in the FW Act provide coverage for persons conducting a business or undertaking (using the same meaning of a worker as in the *Work Health and Safety Act 2011* (Cth)), where that person is either a constitutional corporation, Commonwealth authority, incorporated in a Territory, or operating in a Territory or a Commonwealth place (Stewart 2015).

The provisions in the FW Act do not relate to employees of unincorporated enterprises or to state government agencies (though such parties could use one of various avenues outside the FW Act for redress). Nor do they relate to people who have been bullied in the past, but have since left the employer. They may apply to bullying occurring at times prior to the commencement of the new regime, so long as the person is still employed by the same employer, and where there is a concern that, absent action, bullying might re-occur (Murphy 2014).[62]

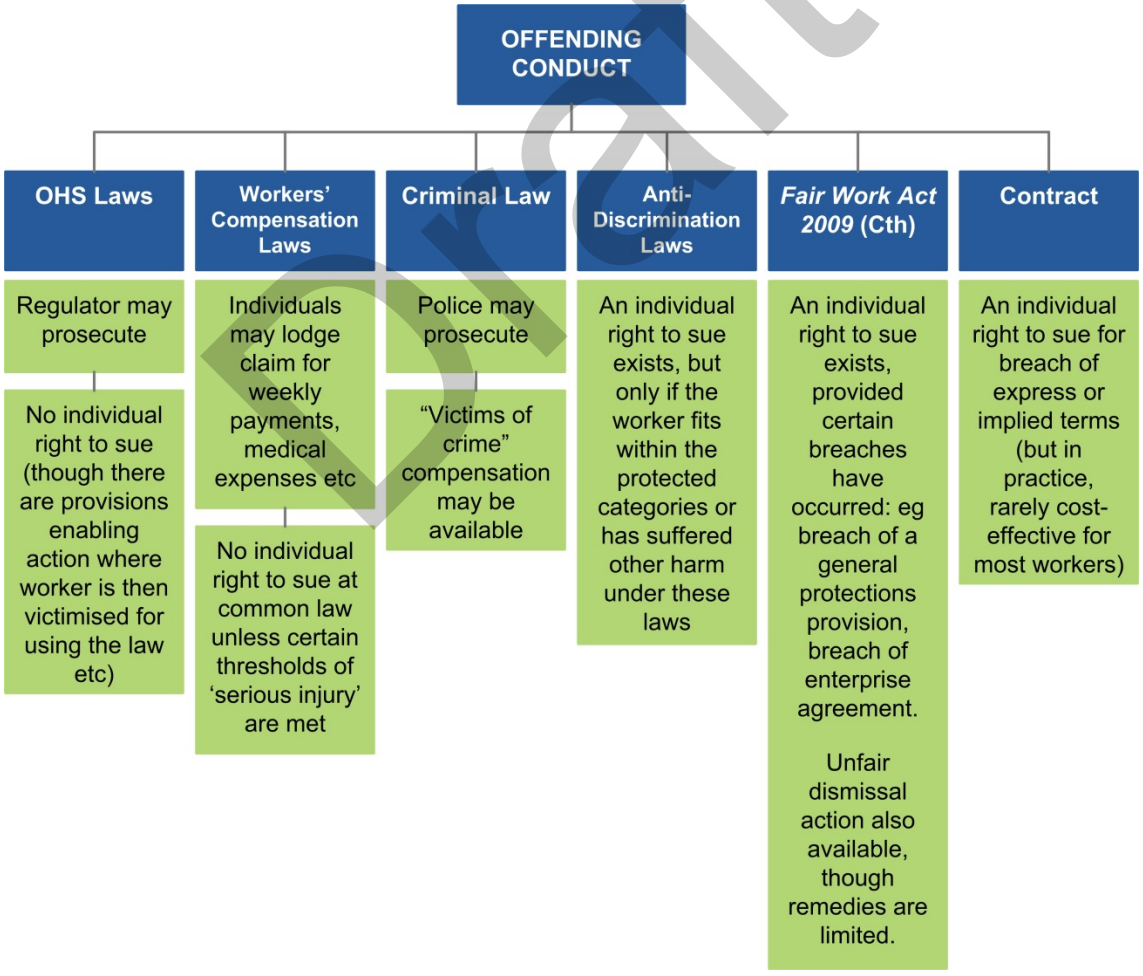
[62] An important recent decision on this is *Ms K McInnes* [2014] FWCFB 1440 (unreported, Ross J, Hatcher VP, Hampton C, 6 March 2014).

There are no differences in the applicability of the measures by the size of the business, or the salary or tenure of the worker (unlike unfair dismissal). The bullying party may be a supervisor, subordinate or colleague. Anti-bullying laws could apply to intimidation by, or of, union officials employed in a business.

Alternative avenues available

Prior to the introduction of specific provisions on anti-bullying in the FW Act, there were other provisions within the same Act, as well as a range of other alternative avenues, that were (and remain) available to pursue a claim. Figure 7.1 provides an example in relation to Victoria.

Figure 7.1 **Triaging a typical bullying claim in Victoria prior to FWA's anti-bulling jurisdiction**



Source: Ryan Carlisle Thomas Solicitors, Submission 106, p. 8, as quoted in House of Representatives Standing Committee on Education and Employment (2012).

Victoria is also unique in that particular protections are available following amendments by the Victorian Government to the *Crimes Act 1958* (Vic) (box 7.1). These were made to clarify that serious instances of bullying are a criminal offence (House of Representatives Standing Committee on Education and Employment 2012). Few have challenged this law.

Box 7.1 The introduction of 'Brodie's Law' in Victoria

In 2006, Brodie Panlock, a 19 year old waitress, committed suicide after enduring persistent and vicious bullying at work. Her case gained public attention when, in 2011, the Victorian Government amended the *Crimes Act 1958* (Vic) to remove doubt that serious instances of bullying, such as that experienced by Brodie, are criminal offences. The amendments, colloquially known as Brodie's Law, were introduced in response to community outrage at the apparent inadequacy of sanctions against the parties who bullied Brodie. Although the men who bullied Brodie were fined for breaching their health and safety duties, they were not charged with serious criminal offences under criminal legislation.

Source: House of Representatives Standing Committee on Education and Employment (2012).

Across all jurisdictions, there is a wide range of other remedies:

> At common law, the occurrence of workplace bullying may give rise to a variety of actions in tort and contract, often concurrently. A number of statutory avenues may also be available under occupational health and safety legislation, anti-discrimination legislation, workers' compensation and the *Fair Work Act*. (Kelly 2011)

The effectiveness of the latter suite of remedies has been questioned in the past by numerous parties (as discussed in (House of Representatives Standing Committee on Education and Employment 2012)). Indeed, an important motivating factor for introducing a separate jurisdiction was the desire to provide an alternative appeal mechanism that was more easily navigated and provided more extensive coverage. In particular, differing burdens of proof under the different legal avenues, and uncertainties regarding remedies, were seen as problems. As noted by the House of Representatives Standing Committee on Education and Employment (2012), while there are a variety of frameworks to protect against workplace bullying:

> … none of these frameworks provide an 'all in one' response to workplace bullying; that is, none provide both universal protection and recourse. Thus, workers are left to navigate the overlapping frameworks, which can be frustrating and confusing for targets of workplace bullying. The variation across jurisdictions in each of these areas creates more confusion and frustration.

The question of whether a separate jurisdiction within the FW Act was required for anti-bullying was the subject of considerable debate in 2012 and 2013 prior to its introduction.

Numerous parties argued for the development of a dedicated anti-bullying jurisdiction. For example, the Australian Council of Trade Unions (ACTU) submitted in 2012 that:

> … existing health and safety regulatory frameworks are an ineffective deterrent against workplace bullying… To redress this imbalance the ACTU calls for a national regulation and national supporting codes of practice to address psychosocial hazards including bullying. (Australian Council of Trade Unions 2012)

However, industry representatives typically argued against the new provision:

> Additional legislation we feel is unlikely to aid in changing workplace behaviours and will simply result in increased complexity and confusion. Given that workplace safety and health provisions have been the primary means of dealing with bullying to date, and the connection is fairly well understood, our viewpoint is that that should continue, that there is no need for a separate arm of legislation dealing with the same issue. (Moss 2012)

> … confusion would arise particularly from adding a specific federal jurisdiction to receive complaints as this step potentially allows forum shopping and adds another layer of complexity for business and enforcement agencies. (Calver 2013)

They, and other participants, also noted the absence of a dedicated bullying jurisdiction in comparable countries, such as the United Kingdom (box 7.2).

As discussed further below, debate regarding the need for a separate jurisdiction in the FW Act continues to be evident in submissions to the current inquiry.

Box 7.2 The United Kingdom approach

There is no specific legal provision protecting employees from bullying in the UK. Instead, a range of statutes are relied upon to deal with bullying. The *Employment Rights Act 1996* enables an employee to claim unfair constructive dismissal if the employer has failed to maintain trust and confidence and has breached their employment contract. Bullying may be a feature of claims brought under constructive dismissal and other jurisdictions.

The employer's duty of care under the *Health and Safety at Work Act 1974* may also apply to cases of alleged bullying. If the employer has breached the duty to protect the employee's health and safety work (for example by failing to protect against bullying), the employee could be in a position to bring a civil action for damages against the employer … In addition, employers are subject to vicarious liability in the case of employees who commit bullying and harassment and can be pursued for failing to cease or protect against bullying and harassment, unless reasonable steps have been taken to prevent it (Acas 2006).

Acas advisers stated that in their (considerable) experience, they had not heard or known of anyone that had taken a bullying and harassment case using health and safety legislation as a lever. Bullying and harassment cases were almost entirely taken through the Employment Tribunal (under the *Employment Rights Act or Equality Act 2010*).

Source: Oxenbridge and Evesson (2013).

7.2 Evidence on prevalence and cost

This section considers the available evidence from Australia and overseas regarding the prevalence of bullying in the workplace and estimates of related costs.

Prevalence

An important precursor to assessment of anti-bullying regulations is the *prevalence* of bullying among workplaces and employees (McLinton et al. 2014)

A very wide range of estimates are apparent internationally regarding the prevalence of bullying at work (table 7.1). These are generally derived using similar survey methodologies and show prevalence rates among surveyed employees varying from lows of around 5 per cent to highs of 1520 per cent over a given period (usually six months).

There have also been some attempts at cross-country meta-analysis. For example Nielsen, Matthiesen and Einarsen (2010) combined 86 studies across 130 000 individuals to obtain a prevalence estimate that 14.6 per cent of workers had been bullied in the workplace. However, this result is open to question given many of the relevant studies covered industries generally considered to be higher risk, such as health and education (Safe Work Australia 2012b, p. 5).

In Australia, the most prominent recent estimates of prevalence include the:

- Australian Workplace Barometer (AWB) study, which estimated in 2012 that 6.8 per cent of the adult employed workers surveyed (N=5743) experienced bullying in the previous six months (Safe Work Australia 2012b, p. 60)
- Personality and Total Health (PATH) Through Life Project, which in 2011-12, collected data from 1286 workers aged 3236 years via an online survey, together with follow up face-to-face interviews with 546 respondents (Butterworth, Leach and Kiely 2013). Over 5 per cent of respondents reported currently experiencing bullying in their workplace; a further 16 per cent reported previously being bullied in their current workplace; and 24 per cent of respondents reported being bullied in a previous workplace (p. v).

In its 2010 report on occupational health and safety regulation (PC 2010b), the Productivity Commission also considered prevalence estimates from Australia and other countries. This work did not produce new estimates of prevalence, but drew largely on previous work, in particular, estimates in (Sheehan et al. 2001) (discussed below). The Productivity Commission's report noted that, while prevalence estimates varied, the levels of accepted claims for workplace bullying or harassment were relatively low (equal to 14.7 claims per 100 000 employees in 2007-08 or 0.014 per cent of employees) (PC 2010b).

Table 7.1 Comparable estimates of the prevalence of workplace bullying of employees

Country	*Prevalence estimate by methodology (share of employees affected)*[c]			*Period*	*Year*	*Source*
	Self-labelling	Bullying behaviours	Overall			
Australia	6.8%	Some data collected on harassment behaviours	-	6 months	2009-11	Australian Workplace Barometer (AWB) study
	6.8%	Data collected	Research ongoing	6 months	2011	PATH through life study
Belgium	-	NAQ severe bullying: 3.6% [a]	-	Probably 6 months	Not reported	Notelaers et. al. (2011)
Denmark	8.3%	-	-	12 months	2004/05	Ortega et al. (2009)
France	Male: 22% Female: 27%	LIPT M: 11% F: 13% [b]	Male: 9% Female: 11% Overall: 10%	12 months	2004	Neidhammer et al. (2007)
Great Britain	10.6 %	NAQ severe bullying: 5%	-	6 months	Not reported	Hoel et al. (2001) Einarsen et al. (2009)
Ireland	7%	-	-	6 months	2000/01	O'Connell and Williams (2002)
	7.9%	-	-	6 months	2006/07	O'Connell et al. (2007)
Norway	4.6%	NAQ 6.2%-14.3%	6.8%	6 months	2005	Neilsen et al. (2009)
Spain	unclear	NAQ severe bullying: 5.8%	-	6 months	2006/07	Gonzalez Triueque and Grana Gomez (2010)
USA	9.4%	NAQ 28%	-	6 months	Not reported	Lutgen-Sandvik et al. (2007)

[a] NAQ: Negative Acts Questionnaire. [b] LIPT: Leymann Inventory of Psychological Terror. [c] Measurement methods: Studies usually survey exposure to workplace bullying by one of two methods: either by assessing perceived victimisation/self-labelling of bullying or by assessing perceived exposure to specific bullying behaviours. It has been noted that these methodologies generate different estimates of bullying, with some groups of workers being less likely to self-identify as having been bullied despite reporting exposure to specific bullying behaviours. The reverse is also true, where some groups self-label/identify as being bullied but do not report exposure to bullying behaviours. Ideally, studies would use both measurement approaches.

Source: Safe Work Australia (2012a).

The Australian Public Service Commission (APSC) also reports annually on survey responses by Commonwealth public servants on a range of issues, including perceived bullying and harassment over the past year (box 7.3). These surveys have shown significant levels of bullying. However, as noted by the APSC in an earlier report, such results should be treated with some caution, given that only a very small number of actual cases proceed to formal claim and investigation (with claims by 0.13 per cent of all APS employees formally investigated in 2010-11) (APSC 2012).

Box 7.3 Bullying behaviour reported in the 2013-14 *State of the Service* report

Seventeen per cent of employees responding indicated they had been subjected to harassment or bullying in their workplace in the 12 months before the survey. Twenty-one per cent reported they witnessed another employee being subjected to what they perceived as bullying or harassment in the same period. These results are similar to 2012-13 (16 per cent and 21 per cent, respectively).

When asked to report on the most serious type of behaviour that the bullying or harassment involved, just over one-quarter of respondents selected verbal abuse. The other main categories of unacceptable behaviour related to inappropriate and unfair performance management practices (15 per cent), inappropriate and unfair application of other work policies or rules (14 per cent) and harassment based on a personal characteristic (12 per cent).

Of employees who considered they had been harassed or bullied, 37 per cent reported it, down from 43 per cent in 2012-13. The reporting rate was higher for employees who reported witnessing what they perceived as the harassment or bullying of others (40 per cent, up from 35 per cent in 2012-13).

Type of harassment or bullying employees felt they had been subjected to, 2014

Type of behaviour	*Share of those that reported harassment or bullying*
	%
Verbal abuse	26
Inappropriate and unfair application of performance management practices	15
Inappropriate and unfair application of other work policies or rules	14
Harassment based on a personal characteristic (e.g. gender, disability, ethnicity, age, religion, political opinion, sex)	12
Inappropriate and unfair application of fitness for duty assessments	2
Physical behaviour	1
'Initiations' or pranks	1
Other	29

Source: Australian Public Service Commission (2014).

The difference between the prevalence and investigation rates are likely to reflect the reluctance of parties to make official complaints, an awareness that bullying may be hard to substantiate, the quiet resolution of matters without any formal investigation, and that

there is a spectrum of bullying severity, with people more likely to take action when the bullying has particularly severe outcomes.

Cost

In Australia, the most frequently quoted estimates of the cost of bullying are those produced in (Sheehan et al. 2001). Over time, these estimates, have also been attributed (incorrectly) to the Productivity Commission.

This analysis estimated low and high cost ranges using the following methodology:

- Two prevalence rates were used. The 'more conservative' prevalence rate was 3.5 per cent over 12 months, drawing on a Swedish workplace survey that measured the exposure rate of the Swedish working population to one or more 'unethical or hostile actions' at least once a week for six months or longer (Leymann 1996). It was assumed that this is a reasonable indicator of the annual rate. The higher prevalence rate was 15 per cent over 12 months, based on the midpoint of (Hoel, Cooper and Faragher 2001) 10.5 per cent rate from 5300 UK employees and (Keashley and Jagtic 2000) survey rate of 21.5 per cent for the Minneapolis population (Sheehan et al. 2001)
- These prevalence rates were applied to the then working population in Australia of 10 million people, to obtain a low cost range of between $6 billion and $13 billion per year, and a high cost range of between $17 billion and $36 billion per year (table 7.2).

Interim assessment

While all Australian estimates of the prevalence and cost of workplace bullying point to a considerable problem, such estimates are somewhat experimental and so rather imprecise. Clearly, much depends on estimated prevalence, and there are quite divergent rates obtained in the research, both in Australia and overseas. While the much-quoted work of Sheehan et al. (2001) characterised an annual prevalence rate of 3.5 per cent as 'conservative', other authors (for example, Hoel (2003) and Beswick, Gore and Palferman (2006)) consider rates of 1-4 per cent more likely in the European context. In Australia, more recent estimates have ranged from 520 per cent, but the upper bound figure for Australia may, in part, reflect methodological differences.

Table 7.2 **Estimated annual cost per costed impact**

	With a 3.5 per cent prevalence rate	*With a 15 per cent prevalence rate*
	$ million	$ million
Absenteeism among victims	235.7	1010.1
Staff turnover among victims	169.0	724.1
Absenteeism and staff turnover among co-workers	20.2-80.9	86.7-346.9
Legal costs for court and tribunal matters	44.9	192.4
Compensation costs for courts and tribunals	11.8	50.6
Compensation costs – conciliated/mediated	24.5-61.3	52.5-131.3
Redundancy and early retirement payouts	420.0	1800.0
Total overt direct costs	**926-1024**	**3916-4255**
Formal grievance procedures	350.0	1500.0
Management/supervisor time addressing impacts	336.0-672.0	1440.0-2880.0
Workplace-based support services (eg. EAP, HR)	29.40-73.5	29.40-73.5
Workers Compensation costs	680.0	680.0
Total hidden direct costs	**1395-1776**	**3649-5134**
Productivity loss - reduced performance by victims	390.4-1561.4	1673.0-6691.8
Productivity loss - replacement employees	175.0-525.0	750.0-2250.0
Productivity loss - internal transfer	17.5-43.8	75.0-187.5
Productivity loss - co-worker	29.14-116.6	124.9-499.6
Productivity loss - absenteeism	364.4	1561.6
Total lost productivity costs	**976-2611**	**4184-11190**
Intra-sector lost opportunity costs[a]	**2609-7828**	**5219-15656**
Out of sector flow-on costs	**min. 35**	**min.150**
Overall costs per annum	**5942-13273**	**17118-36384**

[a] Increased to 1 to 3 per cent for 15 per cent prevalence rate estimate.

Source: Sheehan et al. (2001).

Estimates of prevalence rates depend on the definition of bullying, the breadth of industry coverage, the date and methodology of the survey, and the measure of prevalence. For example:

- All of the prevalence rates in the literature are 'period' prevalence rates that measure the presence or not of bullying over a given period (usually six months or one year). Clearly, the longer the period, the higher the prevalence rate.
- As discussed by Safe Work Australia (2012a, p. 5), studies tend to use differing definitions of bullying, which can affect the comparability of results:

  …the Australian AWB study and the Norwegian study used the same definition of bullying. This was the most narrow definition of bullying, explicitly excluding bullying that may occur

between opponents of equal 'strength'. The remaining studies (except PATH) defined bullying in a similar way to the AWB and Norwegian study, with the exception that they did not exclude bullying that may occur between opponents of equal 'strength'. If the remaining studies had used the same definition as the AWB, this may have resulted in lower prevalence estimates for workplace bullying in these studies. The PATH through life study had the broadest definition of workplace bullying, with no mention of repetitive behaviours.

There is also a wide variation in estimates of the cost of bullying. Again, much depends on the chosen methodology. The very large cost estimates produced by (Sheehan et al. 2001) in the Australian case, for example, are only the estimated costs to employers, but the results are still nonetheless large.

There are considerable difficulties in estimating costs, so much so that one recent review of the literature noted:

> … in monetary terms, the calculations and assessments of costs involved with bullying can only be as good as the research on which they are based, and the many uncertainties exposed in previous studies means that such cost estimations at best represent what has been referred to as well-informed guesses. (Hoel et al. 2010, p. 142)

Nevertheless, this study still strongly argued that it made 'good business sense for organisations to prevent and stop workplace bullying'.

A recent Australian assessment also acknowledged the wide dispersion of prevalence and cost estimates in Australia and overseas (House of Representatives Standing Committee on Education and Employment 2012):

> The discrepancy of estimates indicates an urgent need to improve Australia's evidence base. Yet, collating solid evidence faces many statistical challenges, including:
>
> - lack of common definition;
> - self-reporting – may affect both under reporting and over reporting as workers and employer's struggle with defining behaviour as bullying;
> - lack of consistency in the research or data across Australian jurisdictions; or
> - duplication – reports to state-based regulators may relate to the same instance as reported to federally-based industrial relations regulator or anti-discrimination commissions.

If there are problems with measuring prevalence estimates at particular times, the challenges are even greater for the assessment of any trends. Currently, there is no adequate indicator of trends. More reliable and valid measures of cross-sectional prevalence measures will be required before any meaningful attempt to gauge trends can occur.

7.3 How well is the current jurisdiction performing?

The anti-bullying jurisdiction in the FW Act is relatively new, having been in operation for little more than a year. Further, the very small number of claims makes a definitive assessment of the performance of the jurisdiction unrealistic at this early stage.

Initially, it was anticipated by the FWC, the Law Council of Australia and others that many thousands of claims would be lodged annually (Lucas 2013a). However, over 2013-14 the FWC received 197 applications for an order to stop bullying (FWC 2014c), with 21 finalised by a decision. Of these, only one application resulted in an order to stop bullying (tables 7.3 and 7.4).

Table 7.3 **Anti-bullying claim applications to the Fair Work Commission**
2013-14

Application withdrawn early in case management process[a]	59
Application withdrawn prior to proceedings[b]	34
Application resolved during the course of proceedings[c]	63
Applications withdrawn after a conference or hearing and before decision	20
Application finalised by decision	21
Total	**197**

[a] Applications withdrawn with case management team or with Panel Head prior to substantive proceedings. [b] Includes matters that are withdrawn prior to a proceeding being listed; before a listed conference, hearing, mention or mediation before a Commission Member is conducted; before a listed mediation by a staff member is conducted. This also includes matters where an applicant considers the response provided by the other parties to satisfactorily deal with the application. [c] Includes matters that are resolved as a result of a listed conference, hearing, mention or mediation before a Commission Member or listed mediation by a staff member..

Source: FWC (2014b).

Table 7.4 **Anti-bullying finalisations by nature of decision**
2013-14

Applications dismissed	Number
Jurisdictional objection upheld	3
Bullying not found or no risk of bullying continuing	4
s.587 – includes matters not pursued by applicant or not made in accordance with the Act	13
Total applications dismissed	**20**
Applications granted	
Worker at risk of continued bullying – order issued	1
Worker at risk of continued bullying – order yet to be issued	0
Worker at risk of continued bullying – further decision and order issued	0
Total applications granted	**1**
Total decisions	**21**

Source: FWC (2014b).

There is some evidence of broader interest in the jurisdiction. For example, the Victorian Government cited FWC figures for 2014 involving over 185 000 unique website hits about bullying and around 7000 telephone inquiries (sub. 176, p. 64).

Claims may increase as people become aware of the legislation. On the other hand, the absence of compensation and the fact that any redress only applies to people who have continued their employment in the relevant business may limit the use of the provisions (Caponecchia 2014).

Participant's views on the role of the FWC

Support for the central role of the FWC was expressed in several submissions. For example, the Shop, Distributive and Allied Employees' Association stated:

> Personal rights must be afforded to individuals along with appropriate and effective dispute resolution processes via the resources and expertise available in the Fair Work Commission. This jurisdiction operates in the domain of the workplace and is therefore cognizant of the machinations which exist in workplaces. FWC also provide fast and effective dispute resolution. (sub. 175, pp. 67–68)

Clubs Australia Industrial also supported the role of the FWC, stating:

> From the perspective of an employee who genuinely is seeking that the bullying stop rather than compensation, the FWC is a low cost and user friendly tribunal to appear in. For employers, the same benefits apply, and it provides an alternative option for employees who would otherwise go to the more costly, adversarial jurisdictions to seek a remedy. (sub. 60, p. 36)

However, some concerns were raised in submissions by other parties about the effectiveness of the process. For example, the Australian Federation of Employers and Industries stated:

> The FWC case management processes afford applicants every opportunity to pursue their allegations…This can tie employers up for months, including where it appears the applicant cannot be contacted, until the FWC finally dismisses the matter. (sub. 219, p. 71)

In a similar fashion, the Catholic Commission for Employment Relations said its experience was that the bullying jurisdiction involved processes that were 'lengthy, resource intensive, and adversarial' (sub. 99, p. 26). The Employment Law Centre of WA (Inc) (sub. 89, p. 38) argued that its clients generally found the FWC process to bring actions was overly complex and difficult to access.

Several participants argued that, if anything, the introduction of a new jurisdiction has added to the uncertainties, and made the system less navigable for individual claimants and more onerous for employers. For example, the Chamber of Commerce and Industry of Western Australia said:

> The punitive action which can arise from a bullying incident conflicts with the well understood common law concept of double jeopardy. It also results in two regulators (namely, the Fair Work Ombudsman and the WHS inspectors) and is an example of unnecessary duplication and red tape. (sub. 134, pp. 57–58)

Another view was that these provisions are not well placed within the FW Act. In this regard, a number of stakeholders argued that bullying is better dealt with in occupational health and safety frameworks, and that additional protections within the FW Act simply add another layer of regulation to an already crowded space. For example, ACCI stated:

> The change ACCI proposes is the repeal of the anti-bullying provisions. Workplace bullying must instead continue to be addressed as a work health and safety (WHS) issue and not through the national WR Framework. (sub. 161, p. 128)

Several submissions that were critical of the provisions argued that they overextended the work of the FWC, and were a time-consuming distraction to its 'core business' (for example, Business SA, sub. 174, p. 17).

Several participants pointed to the very low number of applications granted, and the high relative number of applications either withdrawn or dismissed, as proof of problems with the jurisdiction (for example, ACCI, sub. 161, p. 131; Chamber of Commerce and Industry of Western Australia, sub. 134, p. 57). However, the evidence that many claims are withdrawn was seen as desirable and an indicator of the efficacy of FWC processes by others (see, for example, Dr Carlo Caponecchia, sub. 72, p. 2).

Despite such adverse commentary, it appears that the FWC has made considerable efforts to implement effective and evidence-based systems and processes for dealing with cases. There is a staged process for dealing with claims, and related triage. FWC's processes also draw on international practices that are considered effective, such as those used by the

Advisory Conciliation and Arbitration Service (ACAS) in the UK (Oxenbridge and Evesson 2013).

Commentary about several of the formal decisions made since commencement in early 2014 also suggests that they have gone some way towards clarifying the operation of the new provisions (box 7.4).[63]

Box 7.4 The recent DP World case

The case of *Bowker, Coombe and Zwarts v DP World, MUA and Others, [2014] FWCFB 9227* is an example where an arbitrated anti-bullying decision has significantly clarified aspects of the provisions. It involved alleged bullying behaviour, including via social media, by members of the Maritime Union of Australia who were also employees of DP World:

> In a ruling on the reach of the anti-bullying regime, a five-member FWC bench has held that "at work" means performing work or engaging in employer-authorised activities, rejecting a much broader definition sought by a group of DP World employees.
>
> President Iain Ross, Vice President Adam Hatcher, Deputy President Val Gostencnik and Commissioners Peter Hampton and Leigh Johns, in a decision on the meaning of "at work" in s789FD of the Fair Work Act, said the words encompassed "both the performance of work (at any time or location) and when the worker is engaged in some other activity which is authorised or permitted by their employer, or in the case of a contractor their principal (such as being on a meal break or accessing social media while performing work)."
>
> The bench said alleged bullies need not be "at work" at the time of their conduct.
>
> … In hearings in November — during which the ACCI and AiG also made submissions — the workers argued that conduct occurred on the job if it had a "substantial connection to work", but the full bench said there was "no persuasive argument linking the definition proffered with the actual language of s.789FD(1)(a))".
>
> The tribunal said the words should be "construed conformably with the evident policy or purpose of the substantive enactment and the mischief that it was designed to overcome".
>
> "As we have seen the mischief to which Part 6-4B is directed is workplace bullying.
>
> "Seen in that context the words 'at work' in the expression 'while the worker is at work' (in s.789FD(1)(a)) are words of limitation which are intended to confine the operation of the substantive provisions."

Source: Workplace Express (2015).

63 Also see, for example, *Mac v Bank of Queensland Limited*; *Locke; Thompson; Hester; Van Den Heuvel; Newman* [2015] FWC 774 (13 February 2015); *James Willis v Marie Gibson; Capital Radiology Pty Ltd T/A Capital Radiology; Peita Carroll* [2015] FWC 1131 (17 February 2015); and *Application for an order to stop bullying* [2015] FWC 562 (11 February 2015) (Barringtons 2015).

Impacts on businesses and employees

The particular impacts of anti-bullying laws on business were discussed in some submissions.

Given the evidence presented in table 7.2, such laws would be likely to have positive economic effects on the operation of businesses if they were effective at reducing workplace bullying or encouraging better management of it when it occurred. Moreover, the provisions might be expected to prompt better policies and practices regarding workplace interaction and behaviour and, more generally, encourage more sophisticated human resources management. Positive productivity benefits may also result through improvements in staff morale and reductions in labour turnover.

Conversely, several submissions focused on costs for firms, both in terms of compliance costs and costs caused by employees using the anti-bullying laws to frustrate genuine attempts at performance management. For example, the Catholic Commission for Employment Relations stated:

> … we note concerns expressed by some employers that bullying claims remain 'a strategic lever' for employees to pursue various agendas including workplace change of to extract 'advantageous exit packages'. Alternatively, claims may be made to frustrate performance arrangement or to support claims for workers compensation. (sub. 99, p. 23)

Immediately prior to the introduction of the new jurisdiction in early 2014, there was a palpable sense of uncertainty regarding its operation and the obligations it would exert on employers. There is some evidence that the ongoing operation of the laws has largely allayed such concerns.

Impacts on employees were also discussed in some submissions. Many participants drew on personal experience to argue that the new laws are necessary and effective. The positive benefits of such laws on mental health outcomes for workers were discussed in several submissions (see, for example, Clubs Australia Industrial sub. 60, p. 35). These participants argued that while many workers may not use the laws in any formal sense, they still view them as providing legitimate protections against bullying from employers or co-workers, and derive a considerable degree of reassurance through their existence.

On balance, while there is clear scope for net benefit from improved management of workplace bullying, the realisation of this through regulation will depend on the FWC's skill in implementation; and the willingness of firms to adopt better internal processes. Yet the incentives may not be aligned. As an example, currently laws do not require that internal review processes within firms should be the first means of response by employees experiencing bullying. The FWC could encourage this, while not denying applicants their right under the law. If it does not, a powerful incentive for better management could be lost.

7.4 A further review?

Bullying behaviours are a serious and possibly growing problem in Australian workplaces. Such behaviours can have profound and prolonged adverse impacts on individuals, their co-workers and families and friends. In addition to their obligations to make places of work safe and to cultivate a workplace culture of respect, most employers also have an interest in developing innovative and productive workplaces. Bullying is anathema to such goals.

In the course of its inquiry, the Productivity Commission was presented (as were previous inquiries on this topic) with compelling evidence about the adverse impact of such behaviours on workers, workplaces and society in general. This evidence points to the need for an effective and broad-based mechanism for prevention, detection, cessation and redress. The recent introduction of a separate jurisdiction under the FW Act was intended to provide such a mechanism.

A post-implementation review of the law was due to commence within 1 to 2 years of its introduction (Australian Government 2013). While the results of this review are yet to be made public, the Productivity Commission understands that this will occur in the near term. The results of the review will form an important input into any further consideration, if required, of broader matters regarding the inclusion of a dedicated anti-bullying avenue within the workplace relations framework.

8 Minimum wages

Key Points

- Australia's national minimum wage is high by international standards. It has risen in real terms over the last decade, although its growth rate has been constrained to reduce its 'bite' (the minimum wage as a share of median wages).
- There is an economic rationale for a regulated minimum wage that lifts the incomes of low paid workers above the levels they would otherwise receive, to counter the effects of imbalances in bargaining power and other market distortions.
- There are also equity arguments, although some have raised concerns that minimum wages are not targeted towards low income groups and can adversely affect employment. A threshold question is the degree to which the wages system should be used for handling equity issues.
- At present, it is not possible to pinpoint the impacts of minimum wages on employment. Economic theory and some international empirical studies suggest that increases in minimum wages can reduce jobs and/or hours worked, but they also indicate that employment gains are possible in some circumstances. There have been few clear cut wage 'experiments' in Australia and many studies are dated and/or have data and methodological limitations. The indirect evidence is also not clear cut.
- While not definitive, the Productivity Commission's draft assessment is that modest increases in Australia's minimum wage are unlikely to measurably affect employment, but that marked increases in the minimum wage bite would reduce employment. How, and at what rate, such effects manifest will vary depending on economic conditions and other policy settings.
- The benefits of minimum wage adjustments are spread throughout the income distribution, but favour middle income households. People in lower income households benefit less, although for some people on lower incomes, the minimum wage is an important component of their total income.
- There are complementary measures that could supplement the pay of low-wage workers without putting pressure on employment, although these have their own costs and limitations.
- The Fair Work Commission should broaden its analytical framework to systematically consider the risks of unexpected variations in economic circumstances on employment and the living standards of the low paid.

Minimum wages are a persistent source of controversy. While the need for a national minimum wage is widely accepted in Australia, employer groups, unions and governments regularly disagree about its appropriate level. There are also ongoing disputes among economists about how minimum wages affect employment and poverty, and there has been debate about proposals (such as the '5 economists plan' in Australia — chapter 10) that would rely less on the minimum wage to achieve society's equity objectives.

These debates have many angles and nuances.

- Some see a strong minimum wage as a key means of making society fairer and more equitable, by helping to prevent worker exploitation, placing a floor under the incomes of the low paid and thereby safeguarding or lifting their living standards. Proponents of higher minimum wages contend that they enhance the wellbeing of the low-paid without having any significant impact on employment or economic activity. Indeed, some researchers claim a strong minimum wage, by counteracting the effects of employers' stronger bargaining power and other 'market failures', can make the labour market more efficient, with benefits for the economy more broadly.
- Others consider that a strong minimum wage does in fact price some people (including some of the more disadvantaged) out of jobs, actually worsens equity, disadvantages labour-intensive industries with a high share of lower paid employees, and reduces overall economic activity. Some proponents of lower minimum wages point to complementary policies, such as wage subsidies, measures to raise skills or tax credits for low paid workers, that they believe could more effectively meet society's equity goals while avoiding adverse effects on employment, business and economic activity.

Which viewpoints are most valid turns on several empirical matters, as well as value judgments about what weight should be given to the welfare of those who benefit from the minimum wage as compared with those who lose, including any people excluded from employment by it. They also invoke a larger question: to what extent are concerns about equity best addressed through the wage-setting system, which assists only people in jobs while placing a direct cost on employment, rather than through more dedicated and generally applicable mechanisms such as the taxation and social security systems?

This is a complex area, and the empirical issues as well as the value judgments are often contested. Public debate about the minimum wage sometimes can also be clouded by claims that appear to be based more on conviction than on careful consideration of evidence, argument and current and evolving circumstances.

The Productivity Commission's task through this inquiry is to sort through these matters transparently and objectively, and to determine their implications for the minimum wage in Australia and how it should be set in future. To provide background for the analysis, this chapter starts by outlining the origins of Australia's minimum wage, the institutional arrangements that govern it today, trends in its level over recent years and how it compares internationally (section 8.1). Subsequent sections then examine: how minimum wages affect employment (section 8.2); their impact on workers' incomes and living standards, and the distribution of household income (section 8.3); and future directions for minimum

wages policy (section 8.4). Chapter 9 examines some related matters, including youth and training wages and whether minimum wages should vary geographically, while chapter 10 looks at measures that could complement the minimum wage, such as earned income tax credits and wage subsidies.

8.1 Australia's minimum wages

Minimum wages have been part of Australia's workplace relations (WR) system for more than a century, although the institutional arrangements for setting them, the rationale for their level, and the coverage of the national minimum wage have varied and evolved during this period (box 8.1).

Box 8.1 Evolution of the national minimum wage

Colonial Australia alongside New Zealand was the birthplace of minimum wage regulation. Following a campaign by the Victorian Anti-Sweating League to eliminate harsh and exploitative employment conditions, from 1896 the Victorian government established several Wage Boards, comprising employers and workers, to determine minimum wages and piece rates for selected industries. Minimum wage regulation soon followed in other colonies/states of Australia.

A national minimum wage was effectively introduced with the Harvester 'basic wage' judgment of 1907, and was set at a level deemed sufficient to ensure that a male breadwinner's income could meet the reasonable needs of a family household (a man, his wife and their three children). Since then, women's social and economic roles have changed dramatically, family structures have evolved and the social welfare safety net has widened. Minimum wage provisions have partly adapted to these changes, most notably with the decision in the mid-1970s to require a common rate for males and females. At this time the Commonwealth Conciliation and Arbitration Commission declared that it was not a social welfare agency and that 'the care of family needs is principally a task for governments' (Bray 2013, p. 16).

The national minimum wage has not always been the (near) universal minimum it is today. For much of the 20th century, most workers' pay was governed by state systems. With an increasingly centralised WR system, Western Australia is now the only state that has an independently-determined minimum wage, which applies to relevant employees of unincorporated enterprises (WAIRC 2014). In addition, whereas aboriginal stockmen were initially excluded from coverage, and women were paid only a share of the rate, these groups have been entitled to the full minimum wage, since 1966 and 1975 respectively.

The real weekly value of the national minimum wage has increased substantially over the last century. For some of this period the value was indexed to inflation. At other times, it has been adjusted following ad hoc or annual 'living wage' or 'safety net' reviews by the Commonwealth Conciliation and Arbitration Commission and its successor bodies. In 2006 the Australian Fair Pay Commission was created as a specialist body to consider minimum wage adjustments. Since 2009-10, that role has been reintegrated into the main industrial tribunal — now, the Fair Work Commission (FWC) (box 8.2).

Source: Bray (2013.

Today, the national minimum wage is set by an Expert Panel of the Fair Work Commission (FWC) and is usually adjusted each year following an annual review (box 8.2). The current national minimum wage rate is $17.29 per hour for adults (or $656.90 per week for a full-time employee). This sets a floor on the wage rates of most Australian workers, although there are lower rates for younger workers, apprentices and trainees, and some people with disabilities. The FWC also makes annual adjustments to the rates of pay specified in modern awards, which mostly start at equal to or just above the national minimum. (However, the returns to labour of some important employment categories — independent contractors, working business operators and unpaid family members — are not influenced by the minimum wage and are entirely market-determined.)

Box 8.2 Annual wage reviews

Under the *Fair Work Act 2009 (Cth)*, minimum wages for employees in the national employment system are adjusted each year following an annual wage review. The review is conducted by an Expert Panel that comprises four full-time FWC members and three part-time members, who must have expertise in workplace relations, economics, social policy and/or 'business, industry or commerce. During a review, the Panel draws on consultations and submissions from experts and interested parties, as well as commissioned research. It typically receives submissions from business groups, unions, community groups and the government of the day.

Based on the review, the Panel makes a 'national minimum wage order' which sets the base minimum wage applicable for all national system employees. It also makes determinations for the rates of pay specified in modern awards. It normally lifts award minimums, as well as other (higher level) award pay rates, in unison with the national minimum wage.

In deliberating on minimum wage levels, the panel is required (under s. 284 of the FW Act) to 'establish and maintain a safety net of fair minimum wages', taking into account:

- the performance and competitiveness of the national economy, including productivity, business competitiveness and viability, inflation and employment growth
- promoting social inclusion through increased workforce participation
- relative living standards and the needs of the low paid
- the principle of equal remuneration for work of equal or comparable value
- providing a comprehensive range of fair minimum wages to junior employees, employees to whom training arrangements apply and employees with a disability.

In determining rates of pay to apply in awards, it must also consider the 'modern awards objective' (s. 134), which refers to a broader range of matters, although many are similar to those above. Some other matters include 'the need for bargaining', 'the need to provide additional remuneration for employees working overtime or unsocial, irregular or unpredictable hours', and 'the need to promote flexible modern work practices'. (The full modern awards objective is set out in chapter 11.)

There is no agreed estimate of the number of adult Australians paid at the hourly minimum wage rate. Using a variety of surveys, one study reported that in 2010 and 2011 between 4.1 and 9.1 per cent of employees were paid below, at or close to the national minimum wage rate (Bray 2013, p. 22).[64] More recent estimates based on the ABS Employee Earning and Hours survey put the figure at around 7.2 per cent (see section 8.3).

While originating in Australasia, statutory minimum wages are now common among developed economies (with 27 of 34 OECD countries having minimum wages (OECD 2015a)). Some OECD countries that do not have a *universal* minimum rate, including Finland, Denmark and Norway, still have disparate minimum rates covering many workers, with the rates determined on an industry or sectoral basis. Overall, the trajectory of international policy has been to establish universal minimum wages. For example, the German Government introduced a near-universal minimum wage in January 2015.

Australia's (adult) minimum wage is high by international standards. In 2013 Australia had the third highest minimum wage rate among OECD countries (when measured on an hourly 'purchasing power parity' basis) (figure 8.1 and box 8.3). It also has a greater 'bite' — which in this report is measured as the minimum wage as a proportion of median wages or earnings — than in several other countries, and notably the United States (figure 8.2).

Box 8.3 Comparing wages in different countries

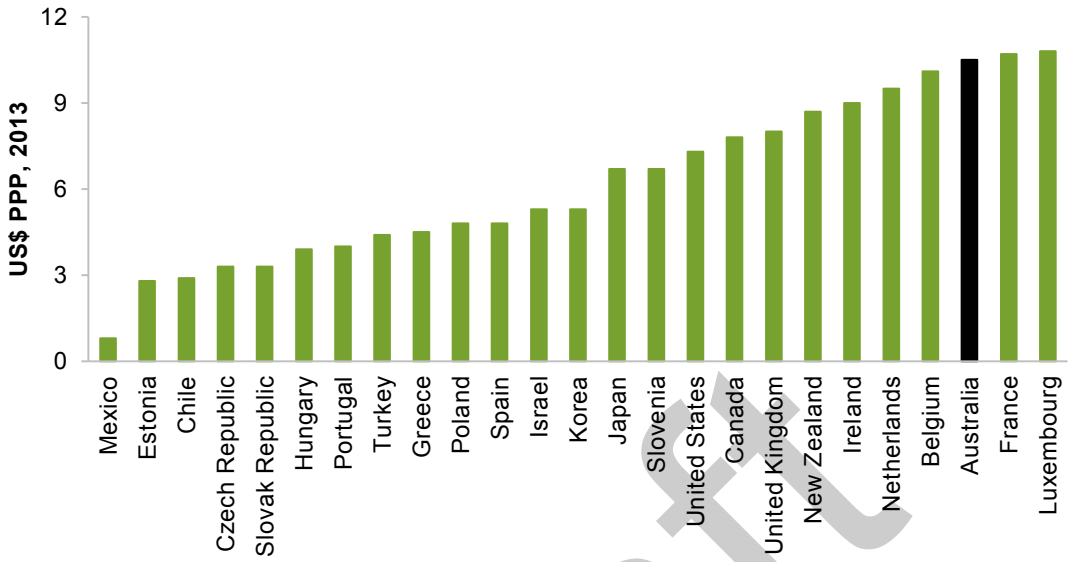
It is common to use the exchange-rate corrected values of adult minimum wages to measure the differences between minimum wages in different countries. Such comparisons may be misleading if exchange rates are volatile, but more problematically they do not take account of differences in labour productivity levels between countries.

Expressing minimum wages relative to median wages (as in figure 8.2) is one way to address this. Changes in the ratio of minimum to median wages can act as a proxy for the extent to which the minimum wage will bite with respect to business employment decisions (since median wage growth will be strongly influenced by productivity growth. As an alternative, for some minimum wage jobs, it may be possible to estimate unit labour costs (PC 2014).

Exchange-rate adjusted wages also do not take into account differences between countries in the prices of consumer goods and services and so can exaggerate differences in the living standards in different countries. Adjusting wages or incomes on a 'purchasing power parity' basis (as in figure 8.1) addresses this problem. Measured on a PPP basis, in 2013 Australia's minimum wage was US$10.50 per hour (rather than US$15.61 per hour as measured on an exchange rate adjusted basis). By comparison, the US minimum wage was US$7.25 per hour. PPP-adjusted wages are relevant to international comparisons of wage earners' buying power, but do not necessarily have much relevance to the decision by businesses to employ people.

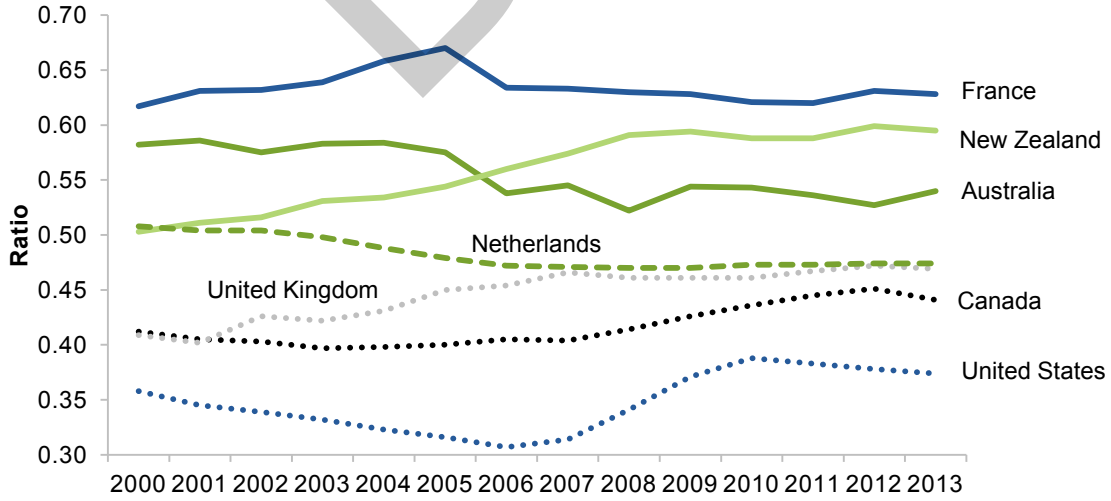
64 Some workers may be reported as receiving wages lower than the minimum wage because, for example, their reported hourly wages did not take account of salary sacrificing or because employers have not complied with the minimum wage obligations. The variations across surveys reflect sampling, measurement error and other methodological issues.

Figure 8.1 **Minimum wage rates in OECD countries**
$US/hour PPP, 2013



Data source: OECD Stat database.

Figure 8.2 **Changes in adult minimum to median wages** [a] **for several OECD countries**
2000–2013



[a] Based on adult National Minimum Wage to the median of full time adult ordinary weekly cash earnings.

Data source: OECD Stat database.

However, the bite of the minimum wage in Australia has declined significantly over time. Between 2004 and 2013, the bite fell from almost 60 per cent to less than 55 per cent (figure 8.2). This followed an earlier, more gradual, decline: Australia's minimum wage bite exceeded 65 per cent during the recession of the early 1990s. Data provided by Bray (sub. 32) show that the relative decline in the value of the minimum wage, evident in comparisons against median wages, has also occurred in comparison to other points in the wage range.

The decline of the ratio of the minimum wage to median earnings in Australia mainly reflects strong growth in the latter. Median earnings increased by 12 per cent in real terms over the period 2004–2013. The minimum wage was also increased throughout this period (except in 2009), with its real value having grown 4 per cent by 2013.

8.2 What effect does the minimum wage have on employment?

A key issue in debates about minimum wages is whether they have any effect on levels of employment and unemployment and, if so, in what direction. As Neumark (2014) has pointed out, were it found that the minimum wage had either no effect or a positive effect on employment, there would be a strong case for increasing it. If the minimum wage adversely affects employment, on the other hand, this would be a consideration in favour of constraining its growth or reducing it (albeit potentially in conjunction with the introduction of other measures for promoting equity).

The minimum wage is just one of many economic variables that can affect employment levels, and it should be recognised that some of the others are likely to have more significant impacts. The level of aggregate demand and macroeconomic stability, and the workforce's levels of education, skills and experience, are likely to be particularly important. However, history suggests that there is no simple solution for achieving a low unemployment rate using these other levers. Any effects that changes in minimum wages have on employment thus remain particularly important in assessing appropriate minimum wage settings.

In assessing the effects, the Productivity Commission has drawn on a range of material, including economic theory, empirical studies from Australia and overseas, and other evidence and arguments provided in submissions.

Economic theory paints a complex picture

The economic literature on the employment effects of minimum wages does not provide a simple and universal answer. Some strands of theory suggest that imposing (or lifting) minimum wages could adversely affect employment levels, while others point in the opposite direction. The theory also covers a range of conditions in which these different

outcomes might be more likely. Together with the varied results of empirical studies (discussed later), this suggests that effects of changes in minimum wages can be contingent on circumstances specific to them.

The literature is complex and covers many detailed matters, side-issues and possible exceptions to broader propositions. Rather than a comprehensive review, this section provides a general guide to matters of most relevance for the Productivity Commission's assessment.

Characterising the role of wages in employment decisions[65]

The demand for labour depends largely on demand for business' output. To maximise profits, businesses would use more labour only if the extra expected revenue were to exceed the additional costs entailed. Businesses also need to determine the mix of factor inputs (different labour types, capital inputs, energy and intermediate inputs), given their relative costs.

From a business's perspective, wages paid are typically the key cost of employing labour (as well as a means of attracting and motivating people of different skill levels to work in the business). Businesses incur other employment costs, such as workers compensation premiums, provision for leave, superannuation and payroll taxes (many of which relate to the wage rate). There are also additional costs in hiring new staff, including the costs of recruitment and any initial training. Given these fixed hiring costs, employers requiring additional labour often increase the hours of work of existing staff (and vice versa). However, when existing staff are fully utilised, firms must engage new employees to increase output. In that instance, the costs of hiring, wage rates and on-costs are decisive factors in deciding how much (or whether) a business expands its workforce.

For employees, wages are often the main 'return' from working, such that an increase in wages induces more people to enter the labour force to seek work (and vice versa). People's decisions about whether to take a job, which job to take, and how many hours to work depend partly on the relative attractiveness of their net (post-tax) wages and the income they would otherwise receive through social security benefits (as well as on other matters such as their prospects to gain promotion and/or acquire workplace skills and experience, and the non-monetary aspects of working).

Volunteering aside, below some wage level a person will not be willing to do a particular job. That wage level (the 'reservation wage') varies across individuals, depending on their

[65] This is a simplified characterisation of real world behaviour. For example, businesses have imperfect information about the performance of new employees, the nature of product demand, future technologies and prices. Employers may accordingly use heuristics and judgment when making employment decisions. That, and the fact that increasing output may require sudden discrete changes in inputs (buying half a milling machine is not feasible), means that for any *given* business, changes in labour demand associated with wage variations may not be smooth or instantaneous. However, when aggregated across many firms, this heterogeneity will typically not be relevant to analysis.

preferences for work and leisure, their long-term job prospects, their eligibility for social security benefits (and any associated requirements for job searching). At certain wage levels, the binding constraint on employment will not be the level of demand for labour by employers, but the degree to which households are willing to supply labour.

Potential for disemployment effects

'Disemployment' covers situations in which existing workers face reduced hours or unemployment, and/or fewer jobs or jobs of shorter duration are created as the economy grows over time.

There are several mechanisms by which binding minimum wages may cause disemployment. Faced with higher wages for lower-skilled workers, businesses have an incentive to reduce employment of such workers, and/or to invest in labour displacing capital, hire (or make more intensive use of existing) higher skilled workers, and/or seek to pass on costs. Minimum wage increases can therefore also have second-round 'general equilibrium' effects as, for example, price rises prompt a shift in demand away from domestically produced labour-intensive goods and services.

The magnitude of such disemployment will vary between firms and industries, being most acute where:

- the share of production costs accounted for by low skilled labour is higher
- the less difficult or costly it is to use other inputs (such as high skilled labour or machinery) as a substitute for low skilled labour
- the more price responsive is demand for the product, and the greater the level of competition, as this limits the scope for firms to pass on higher costs to consumers.

Changes in employment from an increase in the minimum wage would be expected to vary over time. Some changes in employment decisions could occur in advance of a change in minimum wages, if that change was anticipated. Others may not occur for some months or years afterwards, as businesses reconfigure their production models by, for example, investing in more capital equipment to enable them to make do with fewer low skilled workers, and as firms enter or exit the market.

The way in which employment or disemployment effects will manifest may also vary depending on macroeconomic conditions and expectations. For example, due to hiring and firing costs, in downturns employers may tend to 'hoard' workers and meet reduced demand by reducing employees' hours, whereas disemployment during prolonged expansions may manifest more through the reduced uptake of extra staff. However, even just reduced inflows into employment can lead to permanent unemployment effects if some people exit the labour force ('discouraged workers') or if longer periods without employment erodes skills, reduces job search effectiveness and demotivates people.

It should be noted that there may be circumstances when people priced out of 'employee' labour markets due to minimum wage laws are not priced out of labour markets more generally. Such people may take up self-employed or contractor roles, or informal jobs where workers are paid 'cash-in-hand' or 'in-kind' (as in the case of a live-in housekeeper or nanny), which avoid the need to be paid at the rate of the minimum wage. Jobs such as housekeeping, household maintenance and care work appear particularly amenable to these arrangements. Activities within the illicit economy also provide alternatives some people may take where they are priced out of the formal labour market.

Employment effects under imperfect competition and efficiency wages

Higher minimum wages (up to some level) could in theory increase employment in markets where individual businesses are able to exert control over the level of wages they pay rather than needing to pay a competitive market rate. In such markets, employers have an incentive to restrict employment and suppress wages. This would be expected to occur in standard 'monopsony' labour markets[66], which today are most likely to exist mainly in relation to government-provided services such as health, education, policing and defence. However, as discussed in chapter 1, the economic literature suggests that individual firms more generally may have a degree of market power in labour markets, which can enable them to hold wages below the level that would arise in a fully competitive market.

In this context, the literature suggests that wage suppression and sometimes inefficient levels of staff turnover can arise due to relatively weak worker bargaining power, the costs of searching for or transferring to a new or better paying job that can inhibit employee mobility, and the costs of matching worker skills with business needs, and workers' (non-wage) preferences over where they work (Bhaskar, Manning and To 2002). There is some empirical evidence that even sectors with many small employers may exhibit the characteristics of what is loosely termed 'monopsonistic competition', meaning that a binding minimum wage, up to the level equivalent to the competitive market clearing rate, could increase employment in those sectors (Ashenfelter, Farber and Ransom 2010). However, there remains some uncertainty about the extent to which monopsonistic competition exists in practice.

66 In standard models of labour market monopsony, businesses enjoy monopsony power over labour if they are the sole employer of a certain type of labour, or where the employees are in an isolated area and only have the choice to work for a single employer. An example (prior to the advent of fly-in fly-out operations) would be a workforce located near a major mine or dam project. In these circumstances, the businesses would have an incentive (and ability) to restrict employment so as to hold wages below the 'marginal revenue product', or the level that might occur were there several employers who needed to compete to attract workers. If the monopsony employer were required to pay a minimum wage, however, not only would all workers receive this higher wage but the incentives for the monopsonist to restrict employment would be nullified.

Another strand of economic theory suggests that some firms might voluntarily pay higher wages to encourage greater motivation and effort from their staff (Yellen 1984).[67] If successful in lifting worker productivity, this strategy would not necessarily increase unit labour costs and may even reduce them. To the extent that imposing (or lifting) a minimum wage were similarly to increase low skilled workers' productivity, this could counter any disemployment effects that might otherwise arise from the initial increase in unit labour costs[68] (although enhanced worker productivity could, in theory, either increase or decrease employment in particular industries).

Importantly, neither monopsonistic competition nor efficiency wage theories suggest that (higher) minimum wages must necessarily increase employment or hours worked. Under either theory, minimum wages that are too high will always harm employment. And even where the minimum wage is *below* the competitive market clearing level, increases in it can also potentially have *net* negative (rather than positive) employment effects, if it causes sufficient firms to become unprofitable and exit the market (Bhaskar, Manning and To 2002, p. 169).

What can international empirical studies tell us?

On top of these theoretical complexities, there are several empirical obstacles that together can bedevil attempts to gauge the effects of minimum wages on employment:

- individual changes in minimum wages are often small and incremental, albeit with the potential to have more significant cumulative effects
- there is often incomplete or 'noisy' data on the incidence of minimum wages and on job loss, takeup and changes in hours worked
- the timing of business responses to a change in minimum wages can vary considerably, but some responses can potentially be quite lagged while others could even occur in advance of a foreshadowed increase
- it is not straight-forward to disentangle the effects of changes in minimum wages from other factors, both in the labour market and the economy that may affect employment
- aggregate findings and trends may conceal offsetting effects, given that theory suggests that minimum wages can have positive or negative employment effects, depending in part on the market(s) to which they apply.

[67] It is similarly argued that individual businesses might voluntarily pay higher wages to increase staff satisfaction and loyalty to the firm (Akerlof 1982), and/or to reduce staff turnover and thus rehiring and retaining costs. This seems less likely to be a significant consideration in relation to an increase in minimum wages that requires that all firms in an industry pay the higher rate.

[68] A related argument is that employers, facing a higher wage for their low skilled employees, might invest in more training to lift their skill levels and productivity, so as to help offset the higher costs of employing them. Another way higher minimum wages may lead to off-setting skill increases is if they entice already skilled workers who have left the labour force to re-enter it.

Economists have devoted significant effort to overcome such difficulties in order to assess the effects of minimum wages on employment. A variety of data and methodologies have been used, and the literature is vast. Some have involved economic modelling; others have involved regression analysis using cross-sectional and time series data or both (panel data), and using different granularities of data (unit record information on individuals and enterprises; industry by industry data or economywide information). Some draw on standard statistical sources; others have utilised surveys or datasets developed specifically for the studies. Much of the most sophisticated research has been conducted in the United States, where geographical variations in minimum wages can enable more telling studies to be conducted, but there have also been studies in many other countries, including in recent times several studies commissioned in the United Kingdom on the (limited) employment effects of the introduction and increase in its minimum wage.

Divergent results

Estimates of the impact of minimum wages on employment and hours worked vary in direction as well as in size and the conclusions drawn from this body of research can appear contradictory and are often the subject of dispute (Doucouliagos and Stanley 2009; Dube, Lester and Reich 2010; Sawhill and Karpilow 2014). The uncertainties about the importance of any employment effects are reflected in economists' opinions, most notably by the divergence of views by a sample of eminent US economists (IGM Economic Experts Panel 2013). Asked whether raising the US federal minimum wage to US$9 per hour would make it noticeably harder for low-skilled workers to find employment, around one third of the economists surveyed agreed, one third disagreed, and the remainder indicated that they were uncertain or offered no opinion.

Nevertheless, there appears to have been some convergence in views over time on the size of the effects. Whereas many scholars used to posit that minimum wages had significant negative effects on employment, the more recent wave of research suggests that the effects in the United States, even if negative, are smaller than earlier thought (with the US Congressional Budget Office (2014) settling on a 'central estimate' that a 10 per cent increase in minimum wages reduces employment among affected workers by up to 1 per cent in the United States (an 'elasticity' of -0.1 (box 8.4)). Similarly, according to the World Bank:

> New data and more rigorous methodologies have spurred a wave of empirical studies over the past two decades on the effects of labor regulation. … Based on this wave of new research, the overall impact of [employment protection laws] and minimum wages is smaller than the intensity of the debate would suggest … The majority of minimum wage studies do find negative employment effects, especially on young workers. But magnitudes tend to be small and a number of studies report no effect, or in some cases, even positive effects. (2013b, pp. 261–262)

On the other hand, some prominent academics in this field (Neumark 2014) maintain that the most credible studies still suggest that minimum wages generally have significant disemployment effects on groups most affected by minimum wages (cf Kuehn, D. 2014).

Box 8.4 Understanding what employment elasticities relate to

The empirical studies often report their results as 'employment elasticities', which measure the responsiveness of the level of employment to changes in another economic variable. For example, an employment elasticity with respect to the minimum wage of -0.5 would mean that a 1 per cent increase in the minimum wage would cause employment to fall by half a per cent.

Elasticities can relate to a variety of aspects of both wages and employment. Rigorous discussions need to compare like-with-like. Some important nuances to be aware of are:

- what is the numerator of the elasticity? For example, does the study estimate the change in *total* employment, or just the change in the employment of a subgroup (such as 15-20 year olds, or those on, or close to, the minimum wage, or those in particular industries)? Does it look at chances in employment in terms of hours, job gain, job loss or some aggregate of these? And does it look at employment per se, or at labour demand or labour supply?
- what is the elasticity's denominator? For example, does the study examine the effects of changes in the minimum wage, or in minimum award rates, or in all wages? And is it a measure of the nominal wage rate, or for example a measure of the bite (the minimum wage relative to the median wage)?
- over what period is the elasticity calculated? Many studies report elasticities that capture short-run responses in employment (say, the change after a few months). However, some report long-run estimates, which show the change after there is enough time for capital to adjust to the change in wages.

Typically, the responsiveness of employment to wage changes is higher in the long-run than in the short run, as is the responsiveness of people with lower skills (compared with employees in aggregate).

It should also be noted that employment elasticities can vary as minimum wages change. So if the elasticity at the current level of the minimum wage is -0.4, it might be greater (say -0.7) were the minimum wage at a higher level (and vice versa).

Some implications for assessing the employment effects of minimum wages

The remaining differences in the estimates and conclusions noted above partly reflect disagreements about how best to analyse employment effects of minimum wages and what weight to give to the results of different kinds of studies. They also reflect the inherent difficulties and complexities of empirical work in this area.

Beyond that, Bray (2013, p. 93) points out that the breadth of the theory and evidence on the minimum wage can be better conceived as 'being complex and necessary components of an explanation of the complex set of interrelationships which exist in labour markets'. He argues that because the force of particular theories will depend very much on specific circumstances and institutions:

> … it is not surprising that there is diversity of findings in empirical analysis. That is, rather than identifying conflicting processes, the diversity of findings is better seen as illustrating the ways in which these different mechanisms are operating in different contexts. The contradictions arise when it is assumed that a single one of the theories wholly explains all labour markets under all circumstances and without bounds.

This in turn suggests that one should not expect to find a simple and universal answer to the employment effects of minimum wages, and that significant care is required in translating the findings of studies undertaken in one context to other contexts.

Most obviously, there are likely to be differences in the effects of changes in minimum wages from country to country, reflecting differences particularly in:

- the starting level and coverage of the minimum wages
- whether one or more minimum wage applies. (In some countries there are regional variations in minimum wages, differences in wage rates by age and training status and, as in Australia, hundreds of industry and occupational minimum wages in awards whose annual growth rates depend on the annual national wage case)
- the tax/transfer system and job search requirements for the unemployed, which will affect people's reservation wages and motivations to get a job
- other institutional arrangements, such as levels of unionisation and laws governing bargaining or wage setting, which may affect the extent to which there is a pass-on of minimum wages to other wages.

For Australia, this implies some caution in drawing lessons from studies in countries with significantly different institutional wage setting arrangements and lower minimum wages (such as the United Kingdom and especially the United States) or different social security systems (as many countries have, given Australia's highly targeted transfer payments system and the high effective marginal tax rates it creates).[69] As the ACTU observed:

> Much of this international debate in the English-speaking countries has focused on either the US labour market or the situation in the UK. In both cases, their historical, geographical and institutional arrangements differ markedly from that which prevails in Australia. (sub. 167, p. 115)

[69] This does not mean that international labour market studies cannot provide useful insights. Some models can correct for institutional factors, and institutional and cultural variations can shed light on how such variations can affect employment elasticities. For example, if various international studies found that employment supports, and/or changing job search requirements, and/or social transfers altered the responsiveness of employment to the minimum wage, this could provide useful policy information in the Australian context. However, Australia's different conditions do mean that conclusions from international studies cannot automatically be transplanted here.

What do the Australian empirical studies reveal?

That context matters so much provides grounds to place most emphasis on Australian studies when assessing the employment effects of changes in Australia's minimum wage. The foregoing discussion also highlights the need to carefully investigate the robustness of different studies, and to recognise the potential limits of empirical analyses in this area to deliver definitive results.

Previous studies

In contrast to the prolific research abroad, there have been relatively few Australian studies of minimum wages.

This may partly be because the broad coverage of Australia's national minimum wage and the generally modest and incremental changes have not provided rich 'natural experiments' for study. This contrasts with the United States in particular, where there have been significant changes in the minimum wage in some states and even cities, with no change in neighbouring areas.

The main exception to this has been changes in the Western Australian statutory minimum wage where they have occurred out-of-step with the changes in the federal system. Between 1994 and 2001, for instance, there were six such increases in the Western Australian minimum wage, of between 3.5 and 9.3 per cent.

Leigh (2003, 2004a, 2004b) studied the effects by comparing subsequent changes in the ratio of aggregate employment to population in Western Australia to the changes in the ratio for the rest of the country. Leigh found that this measure of employment in Western Australia fell after all but one increase, with the greatest effects on younger workers. Most annual effects were negative and statistically significant. Across the workforce as a whole, Leigh calculated an employment elasticity with respect to the minimum wage of -0.29 (which implies that a 10 per cent increase in the minimum wage would reduce employment by 3 per cent, other things equal). Leigh also considered how employment effects varied for different age cohorts and found that the effect was greatest for workers aged 15-24 (an elasticity of -1).

Leigh's study is widely cited but is now more than a decade old and was conducted when the minimum wage's bite was higher than today, which may reduce its relevance for current levels of the minimum wage. There has also been debate about the methodology employed and the resultant size of the estimates (appendix C; sub. 167).

There have been several other Australian minimum wage studies, using different methodologies, some of which have also found significant disemployment effects, some which have found little or no evidence of an effect, and one that suggested a small positive effect. Again, the studies are often dated and/or have data or methodological limitations that lessen the weight their findings warrant. The studies, and aspects of their approach and relevance, are listed in table 8.1 and examined in more detail in appendix C.

Table 8.1 Australian empirical studies of the employment effects of minimum wages

Authors	*Minimum wage event*	*Method of analysis*	*Description of data*	*Estimate of elasticity for all workers with respect to the minimum wage*
Mangan and Johnston (1999)	1: Variation in Queensland youth award wage relative to adult average weekly earnings for non-managerial occupations from 1980 to 1994 2: Minimum wage change in 1996	1: Generalised least squares regression of ratios of full time and part time employment to population of youth on the ratio of the youth award wage relative to the adult average weekly earnings, gross state product and a time trend 2: Multinominal logit model of a young person's labour market status (full time, part time, unemployed or not in the labour force)	1: ABS annual Queensland employment data 2: unit record census data for Queensland and Australia. Census year not stated, but personal communication with author indicates it was 1996	1: -0.08 (full time, real, 1 year) and -0.19 (part time, real, 1 year) 2: -0.07 to -0.28 (Queensland, real, 1 year) and -0.05 to -0.31 (Australia, real, 1 year)
Junankar, Waite and Belchamber (2000)	Variation over time in youth minimum wage relative to adult average weekly earnings from 1987 to 1997	Error correction model in which youth hours of employment depends on the youth minimum wage relative to the adult average weekly earnings and output. Estimated for retail trade and manufacturing; full time and part time; male and female and ages 16, 17, 18, 19 and 20 year olds.	ABS quarterly data of industry output, youth wages and adult average weekly earnings	Reported little to no effect
Leigh (2003, 2004a, 2004b)	Six increases in the Western Australian minimum wage from 1994 to 2001	Difference-in-differences analysis of the employment to population ratio in Western Australia relative to the rest of Australia	ABS monthly employment and population data for Western Australia and the rest of Australia	-0.29 (nominal, 3 month)
Harding and Harding (2004)	1. The 2003 national safety net adjustment; 2. hypothetical freeze in national safety net for five years	Respondents stratified so estimates would be representative of the Australian small and medium sized business sector	Survey of 1800 small and medium–sized businesses in October/November 2003[a]	1. -0.05 (nominal, 1 year) 2. -0.25 (real, 5 year)

(Continued next page)

Table 8.1 (continued)

Authors	*Minimum wage event*	*Method of analysis*	*Description of data*	*Estimate of elasticity for all workers with respect to the minimum wage*
Lewis (2005, 2006)	Changes in wages in two industries (Accom., cafes and restaurants, and Health and community services) compared with the whole economy between 1994 and 2004	Compared wage and employment growth in the two industries (the 'minimum wage sector') with that of the total economy	Source not stated	-0.55 (nominal, 10 year) -0.72 (real, 10 year)
Plowman (2007)	Minimum wage changes affecting Western Australia between 1990 and 2006	OLS regression of employment on the minimum wage and state final demand. Analysis for: total WA labour force; two age groups (15–19 and 20–24); and three sub sectors (Retail trade; Accom., cafes & restaurants; and Personal & other services)	ABS data for employment in Western Australia. Source of minimum wage data not stated.	Reported that the effect on employment is 'small'. The sign of the test statistic implies the direction of change is positive.
Wheatley (2009)	Changes in the Federal minimum wage relative to average wages between 2001 and 2008	Error correction model in which changes in the ratio of national employment of high–skilled to low–skilled occupations depends on the Federal minimum wage, GDP and a time trend.	ABS data for national employment by occupation, GDP, and wages	n/a (Estimate a 1.4-1.6 per cent substitution away from low skilled labour and towards high skilled labour from a 1 per cent rise in the minimum wage relative to the average wage.)
Lee and Suardi (2011)	1. Introduction of the Federal minimum wage in April, 1997 2. changes in Federal minimum wage between 1997 and 2007	Statistical test for a structural break in the youth employment to population time series for Victoria, Northern Territory and ACT.	ABS Labour Force Survey time series data from 1992 Q1 to 2008 Q1	No evidence of an effect on employment
Olssen (2011)	Effect of award minimum wage increases at each birthday for youths between 2001 and 2008	Regression discontinuity approach to measure the change in hours and wages that occurs upon the birthdays of young people	HILDA, wave 8	No evidence of an effect on hours worked

a Small–sized businesses are defined as those with between one and twenty full time employees. Medium–sized businesses are defined as those with between 20 and 200 full time employees. **b** Based on Healy and Richardson (2006).

Appendix C also surveys several Australian studies that have looked at the employment effects of wages generally (rather than of minimum wages). These studies confirm that the level of real output is the main driver of employment over time. However, the studies also typically find that higher average wages are associated with reduced employment or higher unemployment, with an overall elasticity of employment with respect to average wages ranging from -0.2 to -0.9. In the Productivity Commission's view, this provides some guidance as to the more likely effects on the employment of minimum wage workers of changes in minimum wages also, although there will of course be differences. For example, changes in wages at the higher end of the wage distribution are unlikely to prompt unemployment, but rather shifts to different employment forms that pay less wages.

Taken together, the Productivity Commission's reading of the Australian empirical studies is that increases in Australia's minimum wages are likely to have caused some disemployment, but that the effects have not been major relative to other influences. Further, while the studies provide an indication of the likely direction of change, they provide neither definitive evidence nor clear guidance on the magnitude of any employment effects that would result from future changes in Australia's minimum wages.

The Productivity Commission's preliminary analysis of RED data

For this inquiry, the Productivity Commission has explored whether it is possible to gain additional, and more up-to-date, evidence on the employment effects of minimum wages in Australia by exploiting a newly-available administrative dataset: the Research and Evaluation Database (RED).[70] It was used to assess the impact of annual minimum wage increases between 2008 and 2013. The exercise applies a difference-in-differences approach to individual employment transitions, and uses a range of techniques to ascertain the robustness of the results obtained. The data, methodology and results are described in detail in a separate supplement to this draft report (to be published shortly).

Notwithstanding its strengths, RED has proven to have some important limitations for this exercise and the preliminary results were inconclusive in parts, reflecting both positive and negative associations between employment and the minimum wage (box 8.5). Overall, the results suggest that adverse employment effects from minimum wage increases were felt more by 'would-be employees' (that is, the unemployed and those outside the labour force). For those already in jobs, the main consequence appears to have been a reduction in hours worked rather than job loss. However, concerns about the robustness of the preliminary results mean that, at this stage, the Productivity Commission analysis cannot draw firm conclusions about the employment effects of minimum wages from the study.

[70] The RED data-set is constructed by the Department of Employment. It covers all recipients of federal income support payments (including, Newstart Allowance and Parenting Payments but not Family Tax Benefits or childcare subsidies) and their parents and children. The data-set contains longitudinal data on individuals' income, hours worked and labour earnings, together with some demographic details. RED has millions of observations on employment status over time, and therefore has the potential to provide rich insights into the effects of changes in wages on employment of low-paid workers.

Box 8.5 The RED analysis: preliminary results and caveats

The RED data-set was used to assess the impact of annual minimum wage increases between 2008 and 2013, but it has proven to have some important limitations for this exercise. In particular, the absence of information on whether pro-rated 'junior' rates apply meant that younger people (aged from 15 to 20 years) have had to be omitted from the sample, even though many studies suggest that minimum wages can have greater effects on this group. Moreover, in capturing those adult minimum wage workers who are part of households that receive income support payments, the data do not include the larger number of adult minimum wage earners who are not, and who may have different work preferences and incentives.

The study used the most recent data available in RED, which include periods of both significant wage rises and significant labour market uncertainty. There is a limit to what can be achieved quantitatively to control for shifts as dramatic as a record terms of trade rise, a world economic downturn or a major government financial stimulus package. Moreover, as in all minimum wage studies of this type, a major difficulty is ensuring that the control group is fit for purpose.

Perhaps unsurprisingly given the data issues, changing economic environment and technical complexities, the analytical results were inconclusive in parts, suggesting both positive and negative associations between employment and the minimum wage.

Job loss was the main area of ambiguity, with the relationship between the minimum wage increase and the probability of exit ranging from positive to negative, depending on the year and model variant considered. For 2010 and 2011, minimum wage increases were mostly associated with a heightened risk of job loss, whereas the association was invariably positive for 2008 and 2013. Paradoxically, a lower risk of job loss was also evident for 2009, when no minimum wage increase took place. Finally, the results for 2012 were evenly divided between positives and negatives. Across all years, the size of significant adverse effects ranged from 1 to 2 percentage points, while the size of favourable effects ranged from 1 to 3 percentage points. The analysis focusing solely on the non-payment partners of income support recipients displayed far less variation, with all but one significant results reflecting adverse employment responses.

These differing annual results for job loss may reflect several factors. Reasons why some minimum wage increases may increase employment are canvassed earlier in this section. Even when the minimum wage increases beyond the point where larger increases could start to cost jobs, it is possible that employers do not always (or in the main) respond via lay-offs, opting instead for alternative cost-lowering strategies. The reduced risk of job loss estimated for 2009 may, on the other hand, owe more to the special economic circumstances created at the time by the global economic downturn and the government fiscal stimulus package.

The analysis' results were far more consistent with regard to hours worked and entry into employment. Throughout the period considered, minimum wage increases were associated with adverse employment effects in these two dimensions: six-monthly changes in hours worked by minimum wage workers were significantly more likely to be negative after minimum wages went up; and the prevalence of minimum wage workers among new hires invariably fell when the minimum wage was raised.

Overall, the results suggest that adverse job effects from minimum wage increases were felt more by the unemployed and those outside the labour force, with the main consequence for those already in jobs appearing to have been a reduction in hours worked.

However, the fact that several results for 2009 were significant throughout the analysis appears counter-intuitive, since a minimum wage freeze applied then. This raises concerns about the robustness of the results obtained for other years.

Other arguments and indicators

In view of the limitations of empirical studies that seek to measure the employment effects of minimum wages changes directly, researchers have sometimes relied on other, less direct evidence and argument. Below the Productivity Commission has examined a range of possible indicators to see what it might reveal. The matters examined include:

- qualitative studies of employer responses to minimum wage changes
- the effects of penalty rates
- the effects of youth wages
- effects of changes in gender wage relativities
- changes in the skill profile of Australian jobs
- the level and nature of unemployment and underemployment.

Qualitative studies of employer responses to minimum wage changes

The FWC and the earlier Australian Fair Pay Commission commissioned two studies that have sought to examine the responses of firms to wage adjustments.

The first study, Wearne, Southwell and Selwyn (2008), used online discussion boards to explore the impacts of changes in the national minimum wage and related pay scales on small and medium businesses within the retail, hospitality, and health and community services sectors. A majority of the 92 businesses that responded indicated that labour costs and pay rates were 'very important', tending to 'critical' in cases where labour costs represented a comparatively larger proportion of total costs. The study found that employers responded to wage increases in a variety of ways, some proactively but most reactively. The most common responses included:

- raising prices
- reducing staffing hours (or hours of overtime)
- seeking improvements in productivity and staff efficiency.

In some cases, business owners or managers worked additional hours themselves. Other, less common, responses included changes in opening hours, investing in capital to reduce labour needs, replacing experienced staff with staff at lower pay rates (such as juniors), and hiring freezes.

The second study, Evesson et al. (2011), drew on interviews with 20 minimum wage-reliant enterprises in different sectors, before and after the July 2010 minimum wage adjustment. The firms used a number of the strategies for dealing with wage pressures evident in the first study. However, the second study's authors found that, while there were large variations in the pressures confronting the firms and their employees, the increase in minimum wages had limited impact on enterprises and their business performance. Further:

> While there were differences in the type and extent of adjustments evident over the course of the study, they were rarely regarded by employers as exclusively and specifically driven by the minimum wages increase. In cases where adjustments were linked to the minimum wages increase, those adjustments were slight and tended to be continuations of pre-existing labour management, pricing and cost control strategies. (Evesson et al. 2011, p. 151)

The studies' findings suggest that although wage pressures are often important in business decisions, some minimum wage adjustments will have little immediate impact on the decisions of many existing businesses as to how many staff to employ. This is consistent with the FWC's view that modest minimum wage adjustments will have little or no effect on employment.

However, the studies were not well equipped to examine the cumulative effects of multiple minimum wage adjustments, or to identify disemployment through slower uptake of new staff or expansion of hours, or reduced entry of new firms or new jobs into minimum wage intensive sectors. Nor do they reveal what the level of employment might be were the minimum wage to be substantially higher or substantially lower than its current level. Nor were they sufficiently robust to provide reliable evidence.

Impacts of weekend penalty rates

Arguments about the employment effects of penalty rates in Australia, particularly in sectors with high levels of low-wage employment, may provide some indirect evidence of the effects of changes in minimum wages.

The Productivity Commission's assessment in chapter 14 is that, given their very high level, weekends penalty rates have caused disemployment in some industries, including in restaurants, accommodation and retail industries. Of course, lower weekend employment may have been offset to some extent by greater employment through the week, although as discussed in chapter 14 a net reduction in employment can be expected.

This suggests that substantial increases in the minimum wage above its current level would cause disemployment, although it does not provide evidence of the effects of more modest increases to minimum wages or the likely effect of reductions in minimum wages from their current level.

In addition, given that weekend penalty rates often apply to industries with many low paid workers, increases in minimum wages could themselves translate into increases in weekend rates and, through that channel, may contribute to further disemployment.

Impacts of youth wages

Arguments around youth wages may provide some indirect evidence of the effects of changes in minimum wages more generally. (Youth wages are examined in chapter 9.)

It is notable in the Australian context that few claim that the wide disparity between junior minimum pay rates (currently starting at around $6.20 an hour for a person aged below 16 years — or about 40 per cent of the adult rate) should be entirely eliminated. The size of the wage discount has long been justified on the grounds that younger workers have typically lower productivity and would be disadvantaged in labour markets were they paid at the adult rate — a point of consensus among many unions, employers and wage regulators.

This suggests an acceptance that minimum wages can affect employment, but that views about the effects depend on the nature of the employee and the current level of the wage.

Earlier changes in gender wage relativities

Keith Hancock (sub. 233) — who chaired the Committee of Review of Industrial Relations Law and Systems, which reported in April 1985 — drew attention to that committee's examination of whether more 'flexible' wages than the award system provided were necessary for the efficient operation of the labour market. Hancock pointed to the committee's discussion of the introduction of equal pay for women in the early 1970s. The committee observed that, so far as could be told from the employment statistics, there had been no adverse effect on the relative employment prospects of women.

These changes were also investigated by Gregory and Duncan (1981) who found:

> The relationship between the change in wage relativities between the groups and the performance of employment is very confused. Institutionally determined wage changes alone cannot explain the changing employment patterns. Adult male employment, which should have been favoured by the changes in relativities, has grown least and adult female employment, which has been subject to the largest increase in wage relativities, has grown most. Junior male employment has done considerably better than junior female employment and this is consistent with the fact that junior females have increased their wages relative to junior males. This evidence does not disprove that the relative wage changes have affected the demand for labour in the expected way, but, if they have, it has to be conceded that other influences in the opposite direction — particularly in respect of adult males — have been more important. (pp. 307–308)

This evidence is of course dated and the subsequent and continuing declines in male employment relative to female employment, after implementation of the equal pay decision in the 1970s, is consistent with broader economic and societal shifts being at work. It nevertheless adds weight to the view that changes in relative wages levels will not necessarily have major and/or readily observed impacts on employment levels.

Changes in the skill profile of employment

If Australia's (relatively high) minimum wage bite has adversely affected employment of low skilled workers, another indicator might be in the skills structure of Australia's jobs.

In this regard, Wilkins and Wooden (2014, p. 424) argue that job growth from 1993 to 2013 has favoured highly skilled occupations more so here than in Europe and the United States, and suggest that our relatively high minimum wage may be inhibiting low–skill job growth:

> Our only explanation lies in differences in the regulation of wages of low-paid workers. Minimum wage regulation applies to many more workers in Australia than is typical in other countries, with around 16 per cent of Australian employees dependent solely on award regulation. That, combined with relatively high wage minima, may mean that employment growth within relatively low-paid occupations has been less than it would have been under different institutional settings, such as those that prevail in the United States or most Western European countries.

Borland and Coelli (2015), however, have found that, when defining skill in the same way as some key studies of the United States and Europe, the changes in the skill mix of work in Australia appear very similar to those in those countries. This raises doubt about the skills mix changes that Wilkins and Wooden have suggested might be attributable to Australia's high minimum wage.

The availability and skills of people not at work

A precondition for any policy change to increase employment is that there must be a group of people willing and able to take on additional jobs or hours of work.

The most obvious group available is the unemployed. There are more than 750 000 Australians who are classified as unemployed, around 180 000 of whom have been unemployed for more than 12 months.[71] Additionally, there are also many 'discouraged' workers — almost 120 000 as at September 2013 (people who are available and willing to work, but have given up looking because they believe they cannot find a job).[72]

The capacity of this seemingly large pool of people to seize employment opportunities will be limited to some extent by structural mismatches and barriers that may impede their ability to take on available jobs. Structural unemployment can arise where potential workers live in the wrong area, are unable to work the requisite hours, or do not have the skills or qualities required for available jobs. There are also other barriers to obtaining employment that may not be overcome simply by increasing the number of available jobs, such as health problems or disabilities, family responsibilities, or age discrimination by employers. These structural mismatches and other barriers to employment appear to be the main difficulty in finding work for over half of all unemployed people (based on self-reported data).[73] Without other forms of assistance to overcome these barriers, many

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71 ABS, *Labour Force, Australia, June 2015*, Cat. No. 6291.0.55.001.

72 ABS, *Persons Not in the Labour Force, September 2013*, Cat. No. 6220.0, table 7.

73 51.6 per cent of unemployed people reported their main difficulty in finding work as 'lacked necessary skills or education', 'insufficient work experience', 'no vacancies in line of work', 'too far to travel/transport problems', 'own ill health or disability', 'unsuitable hours', 'other family responsibilities'

of these individuals may not be able to take advantage of any additional jobs that might be made available by changes to the minimum wage. The social security system may also act as something of a floor on feasible wages that employers could offer to attract workers.

There nonetheless remains a large pool of unemployed Australians (at least 225 000 at July 2013), who claim to face either no barriers to employment, or who consider that the primary difficulty in gaining employment is that there are insufficient jobs available.[74] Of these, some 35 000 were classed as long-term unemployed, with 190 000 having been out of work for less than 12 months. Of course, some of these people might still have had inadequate skills or qualities for particular minimum wage jobs. And this group of unemployed will also have contained many people in the process of searching for the 'right' job further up the income scale, rather than seeking an 'entry level job' on the minimum wage. There is also some evidence that employers can sometimes find it difficult to attract suitable workers to their businesses.[75] Even so, with the unemployment rate currently around 6 per cent and youth unemployment well above historical averages (chapter 3), there would appear prima facie to be a sizable number of workers in this group able to take up employment without significant additional training were there an increase in jobs on offer.

Moreover, as shown in chapter 3, the pool of unemployed is turbulent. Accordingly, it is important to consider the impacts of the minimum wage and other policies on transition rates between different labour market states (unemployment, a job, being outside the labour force). Shifts in those transition rates can affect the duration of people in the various states and the long-run share of the working age population in any given labour market state (Lattimore 2007).

Minimum wage changes can have several, complex impacts on such transition rates. For example, were the minimum wage to grow at a reduced rate, then to the extent that this reduced job exit rates and raised job entry rates, it would decrease the unemployment rate and increase the employment-to-working age population rate. However, higher employment likelihoods may encourage some people outside the labour force to commence job searching and, other things equal, this will tend to increase the

or 'considered too old by employers' (ABS 6222.0 - Job Search Experience, Australia, July 2013). These data are 'self-reported' which may make them more open to subjective biases.

74 This estimate of 225 000 people includes those who reported their main difficulty finding work as 'too many applicants for available jobs', 'no vacancies at all' or 'no difficulties at all' (ABS 6222.0 - Job Search Experience, Australia, July 2013).

75 There is varying evidence on this matter. For example, an employment search firm found over half of the 500 Australian small businesses it surveyed indicated that they struggle to find the right people for open roles, with the main challenges including to find workers who fit the company culture, and attracting candidates with the best skills. (PCWire 2015). And the Department of Employment (2014c) found that only 16 per cent of applications for jobs covered by its 'Survey of Employers who have Recently Advertised', were deemed 'suitable' by the employers. However, the same report shows that that there are very few pressure points in terms of employers' ability to recruit skilled workers, with most having the choice of multiple suitable applicants, and that skill shortages have lessened over the last year. These reports do not necessarily address issues of whether unskilled workers are readily available.

unemployment rate, because this group has inherently lower probabilities of job entry than other unemployed people. Nevertheless, some of these people will acquire jobs, increasing the ratio of employment to the working age population. There are several insights from understanding the importance of transitions in the labour market:

- in empirical analysis it may be better to examine the effects of labour market policies, such as the minimum wage, on the ratio of employment to the working age population, and not the ratio of employment to the labour force
- changes to minimum wages might have some of their biggest effects by reducing the number and duration of spells of unemployment
- as shown by multiple, but sporadic, episodes of lifetime employment, many people who are unemployed are employable.

Further, there are more than 1 million 'underemployed' Australians who would be willing to take on additional work if more hours were available to them. Among this group, those who work in jobs that are paid at, or close to, the minimum wage may be able to capture some of the benefits of any possible expansion in available working hours arising from a change to the minimum wage.

Overall, the Productivity Commission does not see a lack of willing and able workers as being a major impediment to at least some expansion in employment in lower skilled jobs in Australia. The Reserve Bank has also noted recently that there appears to be spare capacity in the labour market (Ballantyne, De Voss and Jacobs 2014; Reserve Bank of Australia 2015). Equally, beyond some point, expansions in employment may require extra effort to ensure that prospective workers have the skills and aptitude for viable employment.

The Commissions' conclusions on the employment impacts of Australia's minimum wages

The Productivity Commission's preliminary examination suggests that it is not currently possible to arrive at a straight-forward and definitive conclusion about the effects of changes in Australia's minimum wages on employment levels or hours worked. Economic theory points to a range of possible effects in different markets. Empirically, while Australia's adult minimum wage is high by world standards, and the Australian econometric studies taken together suggest that minimum wages adversely affect employment, the number of studies is small, they are often dated and their findings are subject to methodological and other caveats. Internationally, the results of empirical studies are mixed and contested, and economists' views remain split on this matter. Some other Australian evidence examined (for example, in relation to weekend penalty rates) supports a finding that higher minimum wages can cause disemployment, although that evidence is indirect and some of it mixed.

This highlights the need for better Australian data and more thorough research, an issue taken up in chapter 26. In the meantime, careful judgments about the effects (and the

probabilities associated with different effects occurring) are still required to help determine appropriate policies in relation to minimum wages.

For its part, the Expert Panel of the FWC, which determines the national minimum wage in Australia, has argued that 'modest and regular increases in minimum wages have a small or even zero impact on employment' (Annual Wage Review 2014-15 at 435). This is an unsurprising conclusion, particularly for times of economic stability, although it would be unsafe to draw inferences from this about large increases or decreases in the minimum wage (say of 10 or 20 per cent in real terms).

Based on its examination of the available evidence together with its understanding of the Australian economy, the Productivity Commission is in little doubt that large increases in the minimum wage bite would make lower-skilled, less experienced employees less attractive to employers and, beyond some point, higher minimum wages would reduce employment (on both a headcount and hours basis).

The impacts of reductions in the minimum wage bite are less clear. They may increase employment but there are more caveats and uncertainty about this. That is because, below some level, reductions in the minimum wage would have little effect on unemployment, due to skills mismatch issues for example, or could even see employment decline in some markets characterised by monopsonistic competition, or due to the withdrawal of labour were, for example, some parents to remain at home and reduce child-care costs. The government might also seek to use the tax/transfer system to offset any adverse income effects for households were wages growth to decline. However, this would increase marginal effective tax rates on wages and would require additional tax revenue, both of which can adversely affect employment (chapter 10).

The employment impacts of any changes in minimum wage growth would vary at different times, depending on other policy settings and broader economic conditions.

8.3 What effect do minimum wage requirements have on workers' incomes and living standards?

A key objective of the minimum wage is to promote equity by placing a floor under the incomes of low paid workers and thereby safeguard or lift their living standards. This section examines how many people are on the minimum wage, some characteristics of their employment, and the impact of minimum wages on their material living standards and the distribution of household incomes.

How many people earn the minimum wage?

There is no agreed estimate of the number of adult Australians paid at the hourly minimum wage rate. Previous estimates have ranged between 4 and 11 per cent of employees are

paid up to or close to the national minimum rate (table 8.2). The differences in the estimates result from differences in the data and methodologies used to estimate minimum wage employment.

Table 8.2 **Surveys including wage information**

Survey	*Sample size*	*Survey population*	*Estimated share of workers on minimum wages (per cent)*
Survey of Income and Housing (SIH)	18 298 households	Australian population	10.3[c]
			7.4[e]
The Household, Income and Labour Dynamics in Australia Survey (HILDA)	13 609 individuals	Australian population	7.2[b]
			9.5[c]
			11.2[d]
			6.8[e]
Employee Earnings and Hours (EEH)	Approx. 50 000 employees	Australian employees (excluding those employed in agriculture, forestry and fishing)	4.1[a]
			4.1–4.9[b]
Survey of Employment Arrangements, Retirement and Superannuation (SEARS)	26 972 individuals	Australian population (aged 15 years and over)	9.2[e]

[a] Bray (2013). [b] McGuinness, Freebairn and Mavromaras (2007): adult employees. [c] Healy and Richardson (2006). [d] Dockery, Seymour and Ong (2010). [e] Nelms, Nicholson and Wheatley (2011).

Each of the data sources listed in table 8.2 has its own strengths and limitations for gauging minimum wage reliance. Crucially, surveys differ according to who reports income, with all but the Survey of Employee Earnings and Hours (EEH) relying on employee-reported income and hours, which can be vulnerable to recall and rounding error. On the other hand, these surveys contain rich information on respondents' characteristics and attributes, such as demographics and household income, and are an important source of policy–relevant information. The EEH lacks this detail and omits agricultural workers, a sector with high rates of minimum wage reliance, as measured by other surveys.

While there are different definitions of minimum wage workers (box 8.6), applying the Productivity Commission's approach (as set out in that box) to the EEH data results in an estimate of around 7.2 per cent of employees paid at up to the hourly minimum wage rate (or very close to it). Using a similar estimation procedure with data from the Household Income and Labour Dynamics in Australia (HILDA) Survey produces an estimate of 17.8 per cent. This is likely an overestimate and less reliable than the EEH.

Box 8.6 Definitions and measures of minimum wage workers

Estimates of the number of minimum wage workers can vary markedly depending on the definition and methodology used. The Department of Employment (sub. 158, pp. 8–9) observed:

> Some commentators say that there are around 1.5 million employees who rely on the minimum wage. This is inaccurate. … When some commentators give a figure for the number of employees receiving the 'minimum wage', they really mean to say the number of people receiving the award classification wage for their relevant classification. Some award classification wages can be as high as $150,000 (for example, in the Air Pilots Award 2010). Accordingly, on some definitions and approaches, this amount is a 'minimum wage'. It is therefore important that the concept of 'minimum wage' that is used is clearly defined to avoid confusion.

A distinction can also be made between 'minimum wage workers' and 'the low paid'. The Department of Employment (sub. 158, p. 8) defined low paid employees as employees earning less than two-thirds of the median hourly wage (or $18.67 per hour in May 2014). On this basis, the Department estimated that 13.3 per cent of all employees were low paid in 2014.

By contrast, a very strict interpretation of minimum wage workers would be those who receive the national minimum rate. Using this benchmark, the Department (sub. 158, p. 8) estimated that in May 2014 around 1.6 per cent of all employees (or 157 100 employees) were paid the minimum wage rate. This figure included 62 800 award-reliant workers; 20 700 workers covered by a collective agreement, and 73 600 award and agreement free workers.

(For comparison, the Australian Workplace Relations Study (FWC 2015d, p. 39) estimated that 0.2 per cent of employees are paid at the National Minimum Wage. This figure excludes workers who are award-reliant or covered by a collective agreement).

Some workers who are on slightly more than the national minimum wage may still be considered to be 'minimum wage workers'. This is because the base or entry level wage in many modern awards is slightly higher than the National Minimum Wage. Moreover, even where the minimum wage in a modern award is set exactly equal to the national minimum, this is often only a temporary wage, as the Department of Employment (sub. 158, p. 8) explained:

> The national minimum wage rate of $16.87 [in 2014-15] is contained in 45 of the 122 modern awards. In a number of these awards, the national minimum wage rate is paid as an introductory rate or a trainee rate. Under awards such as the Hospitality Industry (General) Award 2010 and the Restaurant Industry Award 2010, employees with little or no experience generally receive the introductory rate for up to three months while training to become a level 1 employee.

In the Productivity Commission's view, workers on entry level or similar levels of award wages, even if slightly above the national minimum wage, can reasonably be considered to be minimum wage workers. Data are not available to precisely identify the number of workers that fits these criteria. Researchers often include workers earning up to, say, 5 or 10 per cent above the national minimum wage in their measures of minimum wage workers.

The Productivity Commission has used the EEH and HILDA surveys to examine the characteristics of minimum wage workers. For both surveys, a threshold of 10 per cent above the national minimum wage rate has been used, in part because this captures the base level minimum rates of a large share (more than 80 per cent) of modern awards. Junior rates are accounted for using those listed in the Miscellaneous Award 2010 — consistent with recent national minimum wage orders. For casual employees, a loading of 25 per cent has been applied. The Productivity Commission's EEH estimates use the standard hours and income to calculate an employee hourly wage, while the HILDA estimates have used income and hours across all jobs, top-coding hours at 60 for each job. The EEH-based estimates include only federal system workers. Neither dataset enables adjustments to account for penalty rate payments, such as shift and weekend loadings.

Some characteristics on minimum wage workers

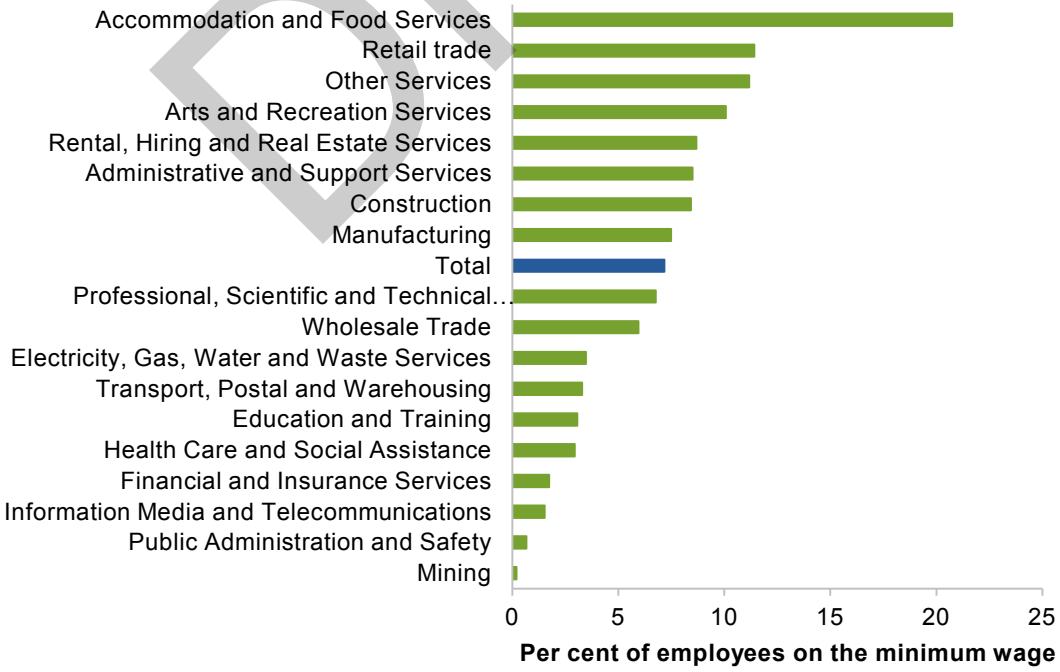
In view of its likely greater accuracy, the Productivity Commission has used the latest EEH Survey wherever possible. As well as providing an estimate of the total number of minimum wage workers (above), EEH is used to estimate the industry in which they work and their occupation, their gender, whether they are permanent or casual, and whether they work full- or part-time. The Commission has augmented this information with data from HILDA wave 13, to examine patterns in the household characteristics of minimum wage workers. While HILDA may overestimate the number of workers on the minimum wage, it is less likely that the patterns it reveals would differ significantly with a 'tighter' sample of minimum wage workers. In all cases, the surveys relate to the lowly paid.

The Productivity Commission's analysis of the EEH Survey reveals several characteristics of minimum wage earners:

- *Industry*: Higher rates of minimum wage reliance are found in accommodation and food services; retail trade and other services (figure 8.3).
- *Occupation*: Labourers and sales workers are the occupations with the largest shares of workers on minimum wages (figure 8.4).

Figure 8.3 **Minimum wage reliance varies across industries**

Proportion of employees earning the minimum wage, 2014



Source: Commission estimates based on ABS 2014 *Employee, Earnings, and Hours* CURF, Cat. No. 6306.0.55.001.

Figure. 8.4 **Minimum wage reliance varies across occupations**[a]

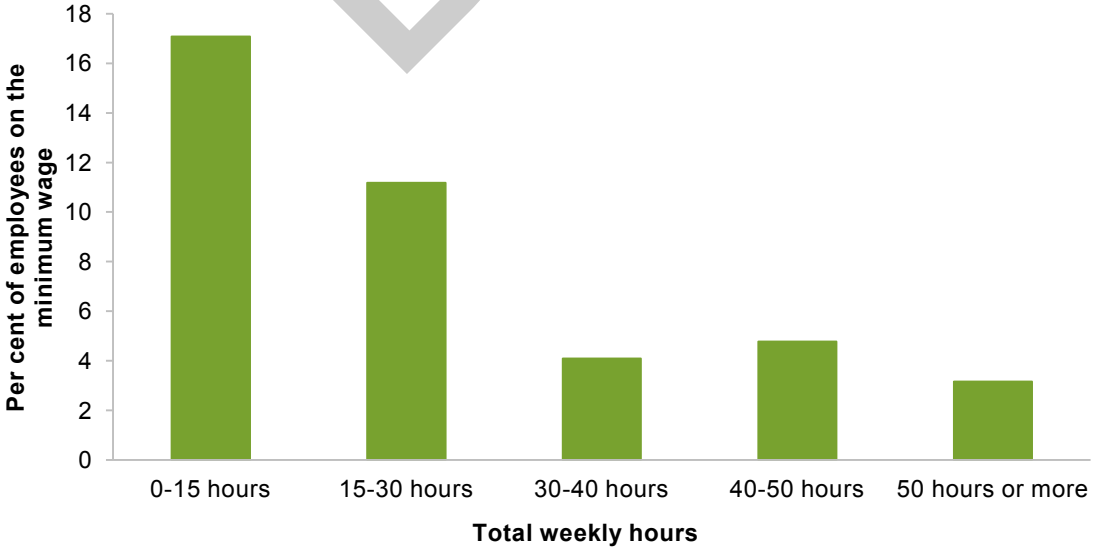
Proportion of working earning the minimum wage, 2014

[a] The Commission's estimates do not exclude professionals and managers from being classified as minimum wage reliant. While it may be unlikely that these employees earn the minimum wage, their reported working hours and income imply an hourly wage within 10 per cent of the national minimum.

Data source: Commission estimates based on ABS 2014 EEH CURF, Cat. No. 6306.0.55.001.

Figure 8.5 **Many minimum wage workers work short hours**

Hours worked per week by people earning the minimum wage, 2014



Sources: Commission estimates based on ABS 2014 EEH CURF, Cat. No. 6306.0.55.001.

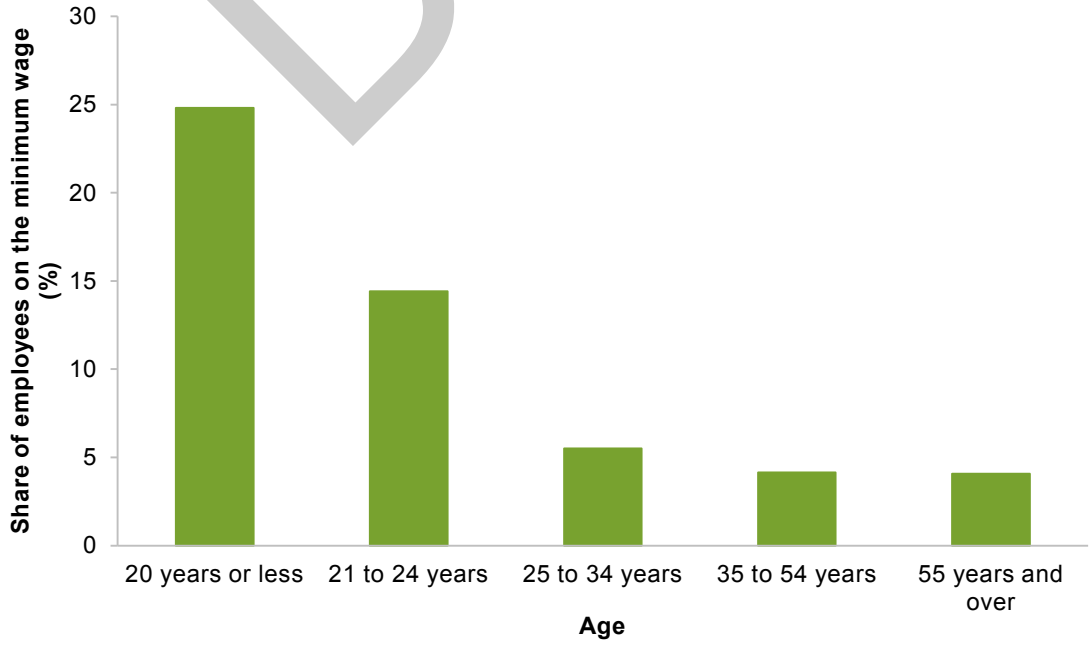
- *Gender*: Female employees (8 per cent) are slightly more minimum wage reliant than males (7 per cent).
- *Full-time vs part-time:* Lower weekly hours correspond with higher rates of minimum wage reliance (figure 8.5, previous page). For example, employees working less than 15 hours per week are much more likely to be on the minimum wage, compared with employees working 30 to 40 hours per week.

How does the importance of the minimum wage vary?

Temporary or more permanent employment at the minimum wage?

In many cases, minimum wage jobs are entry level, providing (often young) employees with valuable experience. This work is often temporary and part-time, providing employees with supplementary income while they are studying and/or representing a stepping stone to higher–skilled and better compensated work. This is revealed by the much higher rates of minimum wage reliance observed among employees aged less than 20 years (25 per cent) and between 21 to 24 years (14 per cent), compared with those aged 25 to 54 (roughly 5 per cent). Casual employees (20 per cent) are also more likely to be minimum wage reliant, compared with all other employees (4 per cent).

Figure 8.6 **Reliance on the minimum wage is often temporary**
Proportion of workers reliant on minimum wage by age, 2013-14



Data source: Commission estimates based on ABS 2014 EEH CURF, Cat. No. 6306.0.55.001.

The minimum wage and personal and household income

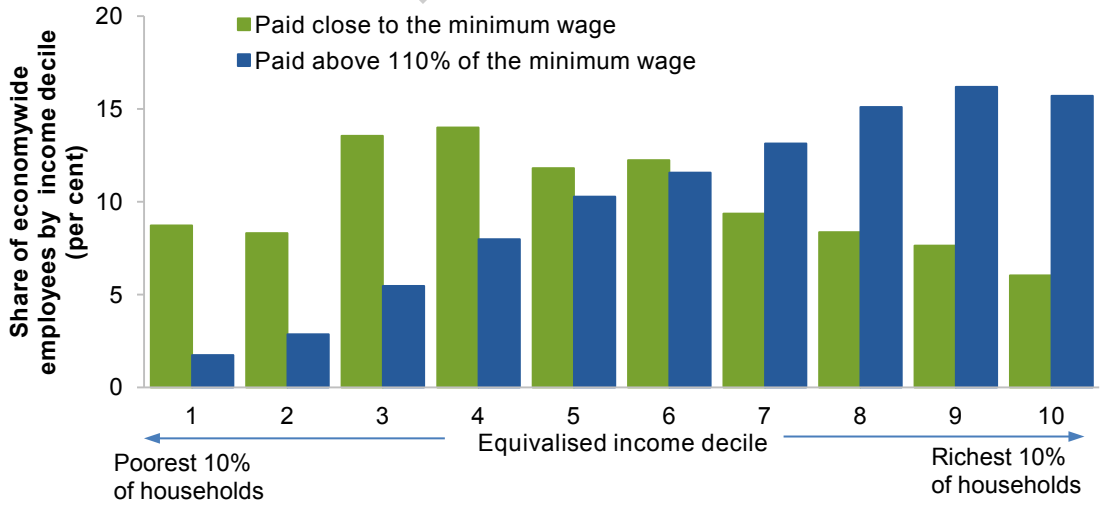
For a given individual, material living standards typically depend more on household income than individual income. For instance, the living standards of a dependent student on the minimum wage may be largely unaffected by a change in the minimum wage. At the other end of the spectrum, the living standards of households whose primary income is from minimum wages, and whose income is not significantly supplemented by social security payments, are obviously much more reliant on minimum wages.

The evidence on the distribution of minimum wage earners according to household equivalised income reveals two distinctive patterns:

- *Minimum wage earners* reside most frequently in middle income groups (Bray 2013; Leigh 2007 and figure 8.7). This reflects several factors, including that minimum wage earners sometimes live with other, better-renumerated household members and that two minimum wage earners with full time jobs and no children earn close to the median equivalised household income. Notably, minimum wage earners in higher income households tend to work longer hours than those in low income households, who often face high effective marginal tax rates (figure 8.9). It also reflects that many people in the lowest income quintile are welfare dependent and not in work.
- *Employees* in the lowest income groups are more likely to be on the minimum wage than those in higher income groups (and by more than a fivefold factor) (figure 8.8). So, while most people in the lowest quintile are not in work (and therefore do not receive any wages), almost half of those who are in work are paid at a minimum rate.

Figure 8.7 **Many minimum wage workers live in middle income households**

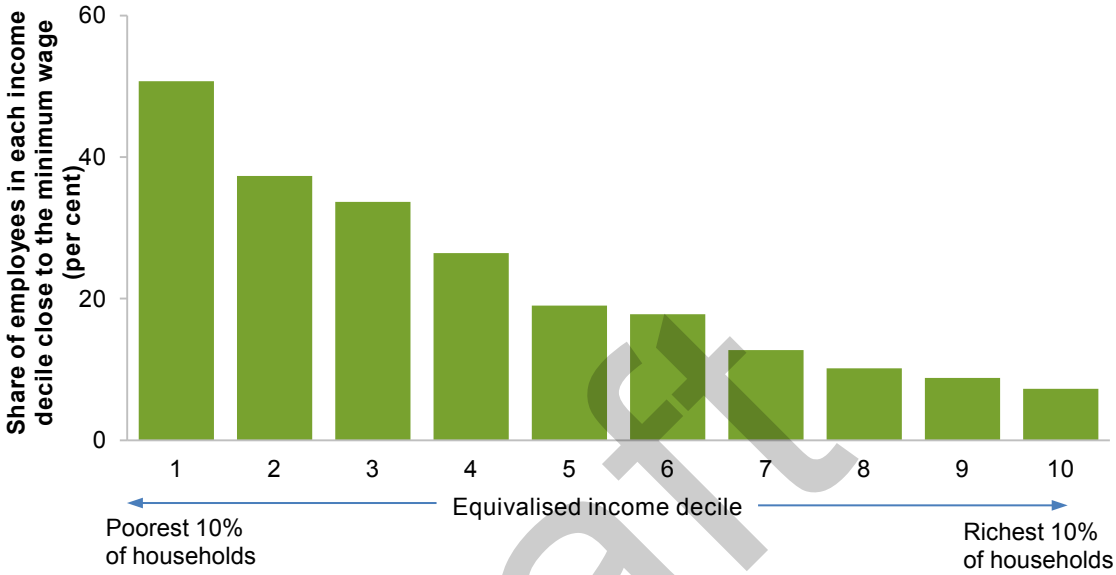
Distribution of minimum wage earners according to household equivalised income deciles, 2013-14



Data source: Productivity Commission estimates based on HILDA Release 13.

Figure 8.8 **An employee in a low income group is much more likely to be paid around the minimum wage rate**

Minimum wage reliance among employees according to household equivalised[a] income deciles, 2013-14



[a] Equivalised household income controls for household size by dividing total household income by a weighted sum of persons in the household. The first adult is allocated a weight of 1, while addition adults are weighted at 0.5 and children weighted at 0.3.

Source: Productivity Commission estimates based on HILDA release 13.

Table 8.3 **Share of population according to equivalised household income, minimum wage reliance and employment status**

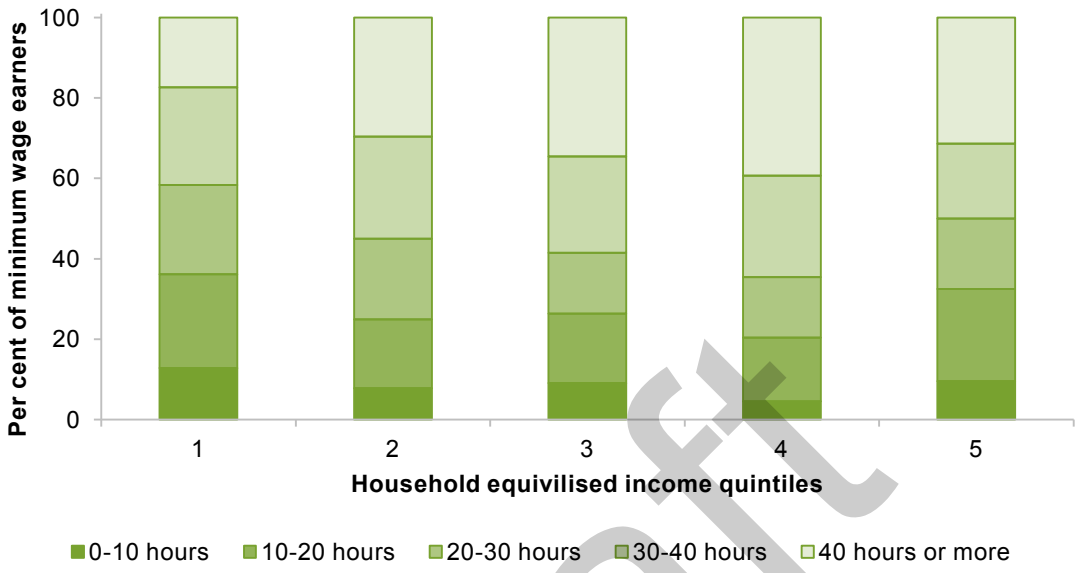
All persons aged 15 years or more, 2013-14

Category	*1st quintile*	*2nd quintile*	*3rd quintile*	*4th quintile*	*5th quintile*
	(%)	(%)	(%)	(%)	(%)
0 to 110 per cent of the minimum wage	1.5	2.5	2.2	1.6	1.3
Above 110 per cent of the minimum wage	2.0	5.9	9.6	12.4	14.0
Other employed persons	1.3	1.9	1.8	1.9	2.8
Unemployed	1.1	1.1	0.6	0.5	0.3
Not in the labour force	14.8	7.1	5.0	3.8	3.1

Source: Productivity Commission estimates based on HILDA release 13.

Figure 8.9 **Minimum wage earners in low income households work fewer hours than those in higher income households**

Hours worked by minimum wage earners, by equivalised household income



Source: Productivity Commission estimates based on HILDA Release 13.

Impacts on material living standards

Although many minimum wage workers do not reside in low-income households or work on the minimum wage for long, it is important to recognise the financial constraints and difficulties that arise for a proportion of people in minimum wage employment. Numerous participants on, or close to, the minimum wage commented on the difficulties they face in making ends meet, particularly where they have taken on mortgages, have dependents to support, incur difficult-to-predict costs, such as bills for health care, or are able to gain work on only an occasional or part-time basis (box 8.7). Many said that the minimum wage should be increased and/or at least keep pace with individual or family living costs.

One issue these comments raise is the relevant living standards benchmark for assessing the adequacy of minimum wages. For example, should they address family or just individual needs? And should they provide a complete social safety net on their own, or is the contribution of other government support payments also relevant? Participants' views on these matters varied (box 8.8). For its part, the FWC has stated:

> We affirm our use of the single-person household as the principal, but not the sole, reference point. We consider the position of many family types and take into account the interaction between wages and the tax-transfer system to produce equivalent household disposable income. (Annual Wage Review 2014-15 at 38)

Box 8.7 Some low paid workers' experiences

Numerous participants on or close to the national minimum wage commented on the difficulties they face in making ends meet and/or voiced their views on the need for an increase in the minimum wage. Below is a selection of the comments, made through the ACTU comments facility (sub. 188) and the United Voice submission (sub. 224).

> The lives of people on a low/minimum wage are so different from those on high wages. There is great mental and emotional stress placed on people and their families when they are struggling to pay the rent and food. Many people can no longer afford their own house — by paying rent they will never have an end to it, and will need more when they retire. I know many young families struggling to raise children, with the father working full-time, the mother part-time, and young children in day care when they can be. They still struggle to pay for essentials, as they are on minimum wages. It should not be like that. (Coburg, Vic, sub 188, line 327)
>
> I could not live on the minimum wage for a disability worker. My mortgage payment takes a good piece of my salary. Then I still have to pay bills and live. Some savings would be a dream come true. (St Clair NSW, sub. 188, line 408)
>
> My household finances have gotten much more difficult in the last few years. … [T]here have been very few positions available over the last year and although I am registered with most employment agencies and go through every single job advertised on SEEK, I have only had 8 days' work in the past 3 months. At this stage, if I didn't get a Centrelink top-up, we would not survive. Imposing a pay cut or pay freeze on the minimum wage would be counterproductive because Centrelink would just need to top-up more. (Springwood Qld, sub. 188, line 103)
>
> Power and utilities make it such a struggle. I can only put the heater on when it's really necessary. The last increase took our electricity bill from $250 to $400 and it seems to just keep rising … In 2008, I had a car accident so not only am I a low income earner, but I have medical expenses for chronic pain. (School Cleaning, WA, sub. 224, p. 5)
>
> The cost of living is increasing and wages just aren't keeping up. To keep up, we need to raise the minimum wage as a start. I mean, look at the price of electricity! I don't think anyone should earn less than $30 an hour no matter what job they're doing. (Catering, Vic, sub. 244, p. 13)

The Productivity Commission notes the degree to which changes in minimum wages affect the lowest income households depends largely on household structures. Single person working households with a part-time employee on the minimum wage will be significantly affected, while working families in the lowest income groups receive considerable family benefits and other social security transfers, which partly shields them from the income effects of minimum wage movements.

In light of changing family structures and the availability of family assistance and other government support measures to address the needs of dependents and people in need, the Productivity Commission agrees with the focus adopted by the FWC for the purposes of assessing the effects of the minimum wage on the living standards of the low paid.

Box 8.8 Participants' views on the role of minimum wages in safeguarding people's living standards

Several participants argued that the objective of the minimum wage is, or should be, to meet at least basic family needs. Tom McDonald (Former National Secretary, Building Workers Industrial Union) (sub. 33) harked back to the principles underpinning the Harvester judgment and argued that 'protecting the family unit was the Arbitration Commission's principle consideration rather than economic and equity considerations' and that these principles remain relevant today. Similarly, the Catholic Commission for Employment Relations (sub. 99, p. 2):

> … supports the payment of minimum wages — what may be termed a 'living wage' — that enable a worker and their family to achieve a decent standard of living, not wages merely sufficient to avoid poverty. … minimum wages should be fixed by reference to community living standards to meet the needs of a family (couple or sole parent with two children) not a single person.

It went on to criticise the FWC's adoption of a single person household as the appropriate reference household for benchmarking minimum wages, commenting that existing safety net wages are inadequate for families. Likewise, the Employment Law Centre of WA (sub. 89) observed that the minimum wage was around two-thirds of the amount that a single-income couple with two dependent children would need to avoid poverty.

While also focusing on equity issues in relation to low paid workers, ACOSS (sub. 165) argued that the minimum wage should be set at a level sufficient to enable a single individual to attain a decent 'basic' living standard. It considered that this should be well above poverty levels and developed in accordance with community expectations.

Other participants argued that poverty and equity as well as family needs are best tackled with instruments such as taxation measures, social security and other family assistance, and that the minimum wage should be focused on modern labour market conditions. Jobs Australia (sub. 221), which represents nonprofit organisations that assist unemployed people, argued:

> [Jobs Australia] assumes that the purpose of the minimum wage is: *to ensure that workers with little bargaining power are guaranteed a fair minimum rate of pay, with that rate set on the basis of an appropriate, basic standard of living for a hypothetical worker who earns the minimum hourly rate through a standard working week.*
>
> … Note that we do not assume that the rationale for the minimum wage is to reduce poverty, for instance, or to ensure a family with one 'breadwinner' can get by. The minimum wage would not meet such a rationale, because … the poorest households in Australia have no breadwinners at all, while the one breadwinner family is becoming a rarity. (p. 6)

The Australian Federation of Employers and Industries (sub. 219, p. 20) submitted:

> The distribution of disposable household income is determined by employment levels, income from assets, taxes, social welfare payments, household composition and so on.
>
> Minimum wage increases which cannot be sustained by business output and revenue are unlikely to improve the situation of those on lower pay, especially for those at the bottom of income distribution. An increase in the minimum wage is only effective in improving their living standard if these lower paid workers receive them by having sustainable jobs.
>
> The minimum wage should be sufficiently low to encourage employers to recruit employees of low educational attainment, low skill levels and low employability but high enough to encourage participation in the labour market and out of the welfare system, even if only partially.

And the Australian National Retailers Association (sub. 216, p. 11) said:

> ANRA has supported the use of minimum wage settings as one of several policy tools that can be used for maintaining the living standards of award dependent workers and their families. … However, ANRA believes the tax and transfer system (tax system) is better suited to acting as a safeguard for household – which might include both workers and non-workers – living standards.

A further question is to what extent the regulated minimum wage is higher than the wage affected workers would otherwise have received for their work. The extent of such a gap is dependent on the characteristics of the individual (for example, their skill, occupation, experience, and location). The smaller the gap, the less important is the minimum wage in raising living standards.

Identifying the magnitude of the gap is empirically challenging. Overseas data on relative wages between occupations in markets where minimum wages are lower and less binding might provide a rough basis for identifying those gaps, but no research of this kind has been undertaken.

The analysis in chapter 11 suggests that the operation of awards (including award minimum wages) over the last century has generally worked to compress wages and lift the relative employment-based incomes of low paid workers, which accords with the Productivity Commission's judgment that Australia's minimum wages generally 'bind'. This suggests that regulated minimum wages are indeed likely to have directly increased the incomes of low paid workers. In this respect, regulated minimum wages are similar to supplementary financial assistance for low paid workers, except that the cost is borne in the first instance by employers rather than taxpayers.

That said, the interactions between minimum wages, the tax and transfer system, and the labour market mean that that there is not a one-to-one relationship between changes in the minimum wage and the material living standards of workers on the minimum wage.

Modelling the distribution of the benefits of a minimum wage increase

To further explore the impacts of statutory minimum wages on people's living standards and the distribution of income, the Productivity Commission has modelled the direct effects on household finances flowing from a recent (2012) adjustment to the national minimum wage.

The model is based on 2012 HILDA survey data on personal and household incomes and characteristics, and is calibrated to take into account the effects of income taxes and transfer payments as they were in 2012-13. The modelling considers only the direct 'morning after' effects of a wage change; it does not consider broader or longer-terms effects, such as changes in employment, product prices or the composition of the economy, that may flow from an increase in wage costs, and how these would affect real incomes. The modelling is described in box 8.9.

In the scenario modelled, minimum wage workers are granted an increase in wages of 2.9 per cent — the nominal minimum wage increase awarded in 2012 — while the wages of all other workers are unaffected. In practice, under current institutional settings, it would be expected that an increase in the minimum wage would also raise the wages of people on higher starting wage levels too, as the FWC increased award rates in line with the change in the national minimum wage. This in turn would increase the wages of employees paid

under enterprise agreements or other mechanisms that are directly linked or indirectly influenced by award rates. Higher flow-on wages further up the scale would benefit those higher-income workers. For this analysis, the Productivity Commission has not sought to model these impacts but, rather, has focused on the group earning minimum wages. (That said, as the exercise is based on HILDA data, it captures a larger number of 'minimum wage workers' than would be captured using the EEH survey, so the exercise can be seen as equivalent to modelling a significant degree of wage pass-on to workers earning above the national minimum wage.)

Box 8.9 The Productivity Commission's minimum wage modelling

The Productivity Commission has developed a micro simulation model to help assess the effects of changes in minimum wages rates on people's gross and net incomes and their distribution across households. Aspects of the modelling are outlined in this box; further details will be provided in a technical supplement to be published shortly.

The model database is based on the HILDA survey in 2012. As such, each of the 13 600 individuals whose income level and employment status are modelled represents a real person who was surveyed in 2012. The gross income of individuals in the HILDA database is calculated by summing income from all sources, including labour earnings and income support payments. This provides a baseline for evaluating the effects of an increase in the minimum wage on gross income.

The Productivity Commission has simulated the effects of an increase in the minimum wage to just 'minimum wage workers'. These workers are identified in the dataset based on the procedure outlined in box 8.6. As the microsimulations are based on the HILDA survey dataset, they capture more workers as 'minimum wage workers' than would be captured applying equivalent procedures to the EEH dataset.

The Productivity Commission Tax and Transfer model (PCTT) is then used to calculate the effects on net income. PCTT contains information on tax rates, offsets and rebates, and various allowances, pensions and other welfare provisions. The PCTT model was calibrated based on policy settings in 2012-13, and benchmarked against 2012 HILDA data (collected mainly during September and October of that year). It is used to calculate taxes and transfers for each individual based on their gross taxable income and personal and family circumstances (drawn from the HILDA survey).

Direct impacts on gross incomes

The 2012 increase in the minimum wage of 2.9 per cent is estimated to increase the *gross* income of households with at least one minimum wage worker by around $767 per year on average. Most households (around 85 per cent) do not contain minimum wage workers and in the scenario are unaffected (table 8.4).

The estimated impacts differ substantially across high and low income households. The average gains of $43 per year to households in the lowest equivalised income quintile are the smallest in absolute terms, with this quintile receiving around 7 per cent of the total

increase in gross income (table 8.5). The largest average gains are for households in the middle quintile, with an increase of around $174 per year (table 8.4).

The relatively small benefits accruing to households in the lowest quintile are primarily because they are less likely to contain minimum wage workers — around 8 per cent for the lowest quintile in 2012 compared with 20 per cent for the middle quintile.

Table 8.4 **Change in household gross income by equivalised household income quintile**

Average gain, 2.9 per cent increase in the minimum wage

	Beneficiaries		*Unaffected*		*All households*	
Quintile	*$/yr*	*%*	*$/yr*	*%*	*$/yr*	*%*
1	509	8.39	0	91.61	43	100
2	735	17.87	0	82.13	131	100
3	847	20.49	0	79.51	174	100
4	846	18.05	0	81.95	153	100
5	805	9.68	0	90.32	78	100
Total	767	14.65	0	85.35	112	100

Source: Productivity Commission estimates based on HILDA wave 12.

Table 8.5 **Share of increase in total gross and net income by equivalised household income quintile**

2.9 per cent increase in the minimum wage

Quintile	*Gross income*		*Net income*	
	$m	%	$m	%
1	71	7.4	64	9.1
2	219	22.7	151	21.4
3	289	30.0	204	28.9
4	254	26.4	190	26.9
5	130	13.5	97	13.7
Total	963	100.0	705	100.0

Source: Productivity Commission estimates based on HILDA wave 12.

Effects on net incomes

Household *net* incomes change in the same direction as household gross incomes, although the magnitudes of these changes are moderated.

The estimated increase in average household net income (that is, across all households, with and without minimum wage workers) was around $82 per year (table 8.6), compared with $112 per year in gross income (table 8.4). This is because higher wages trigger lower income support payments and higher taxes. There is a very small proportion of instances where the increase in net taxes outweighs the increase in wage income, and net income falls for households with minimum wage workers (this accounts for the losers in table 8.6).

The estimated gains are again smallest for households in the lowest quintile ($39 per year) and largest for households in the middle quintile ($122 per year). Overall, the tax and transfer system has little effect on the pattern of gains across and within quintiles, with the third quintile again emerging as the main recipient.

For context, average annual net household income varies from around $20 000 for the lowest quintile to $140 000 for the highest quintile. So although households in the lowest quintile receive the least benefit from the minimum wage change in absolute terms, this translates into a larger percentage increase in their gross incomes, although the modelled increase in their *net* incomes still does not exceed the increase enjoyed by households in the two quintiles immediately above them ('All households' columns, table 8.7).

Table 8.6 **Change in household net income by equivalised household income quintile**

Average gain, 2.9 per cent increase in the minimum wage

	Beneficiaries		*Losers*		*Unaffected*		*All households*	
Quintile	*$/yr*	*%*	*$/yr*	*%*	*$/yr*	*%*	*$/yr*	*%*
1	459	8.39	NA	0.00	0	91.61	39	100
2	511	17.77	-61	0.11	0	82.13	91	100
3	596	20.49	NA	0.00	0	79.51	122	100
4	630	18.05	NA	0.00	0	81.95	114	100
5	597	9.68	NA	0.00	0	90.32	58	100
Total	563	14.63	-61	0.02	0	85.35	82	100

Source: Productivity Commission estimates based on HILDA wave 12.

Table 8.7 **Percentage change in household gross and net income by equivalised household income quintile**

2.9 per cent increase in the minimum wage

Quintile [a]	*Gross income (%)*		*Net income (%)*	
	All households	*Working households*	*All households*	*Working households*
1	0.78	0.79	0.18	0.45
2	0.47	0.31	0.21	0.22
3	0.24	0.19	0.18	0.16
4	0.14	0.11	0.13	0.10
5	0.04	0.04	0.04	0.04
Total	0.15	0.22	0.12	0.18

[a] The quintiles for 'Working households' are recalculated, for a different (narrower) group of households, compared with the quintiles for 'All households'.

Source: Productivity Commission estimates based on HILDA wave 12.

The distribution of benefits among working households

The above results pertain to all households and not just households with workers. If non-working households are excluded, the distribution of the gains from the minimum wage favour households in the lowest quintile of working households, both in gross and net terms (tables 8.8 and 8.9). Although workers in such households work fewer hours on average than those further up the income scale, a larger share of workers in this quintile are on minimum rates. These households also enjoy a lesser reduction in other transfers as their wage income increases. Overall, the minimum wage increase leads to a higher percentage increase in both the gross and net incomes of households in the lower quintiles of working households, with progressively smaller percentage gains for households in higher quintiles (as shown in the 'Working households' columns of table 8.7).

Table 8.8 **Change in household gross income by working household equivalised income quintile**

Average gain, 2.9 per cent increase in the minimum wage

	Beneficiaries		*Unaffected*		*All households*	
Quintile	*$/yr*	*%*	*$/yr*	*%*	*$/yr*	*%*
1	648	37.52	0	62.48	243	100
2	841	24.79	0	75.21	208	100
3	841	21.67	0	78.33	182	100
4	816	16.84	0	83.16	138	100
5	808	9.22	0	90.78	75	100
Total	767	22.15	0	77.85	170	100

Source: Productivity Commission estimates based on HILDA data.

Table 8.9 **Change in household net income by working household equivalised income quintile**

Average gain, 2.9 per cent increase in the minimum wage

	Winners		*Losers*		*Unaffected*		*All households*	
Quintile	*$/yr*	*%*	*$/yr*	*%*	*$/yr*	*%*	*$/yr*	*%*
1	492	37.36	-61	0.17	0	62.48	184	100
2	585	24.79	NA	0.00	0	75.21	145	100
3	616	21.67	NA	0.00	0	78.33	133	100
4	614	16.84	NA	0.00	0	83.16	103	100
5	591	9.22	NA	0.00	0	90.78	55	100
Total	563	22.12	-61	0.03	0	77.85	125	100

Source: Productivity Commission estimates based on HILDA data.

Some implications

The modelling confirms that, unsurprisingly, minimum wage increases lift the gross and net incomes of minimum wage households, and lead to some compression in incomes across working households.

However, it also illustrates that the impact on the living standards of people at the lower end of the household income distribution is likely to be relatively limited. There are three reasons for this:

- the direct benefits of a minimum wage change increase will be spread throughout the income distribution because many minimum wage workers reside in higher income households
- for many lower income households, transfer payments represent a more significant share of net household income than do wages
- those minimum wage earners located in the bottom quintile tend to work relatively fewer hours on average.

It should be emphasised that minimum wage regulation can also have broader and indirect effects on the living standards of people on low incomes (and, indeed, on the broader community) than the 'morning after' effects modelled here. These can arise through changes to employment, output and input prices, the incentives for workers to undertake education and acquire skills, and the composition of the economy. These induced effects give rise to wider resource allocation effects that may vary geographically and by industry. For the final report the Productivity Commission is exploring the scope for modelling some of these effects.

8.4 The future of the minimum wage

Drawing on the earlier analysis, this section considers the continuing relevance of, and future directions for, Australia's minimum wages.

Is there a case for deregulating minimum wages?

A threshold question is whether regulated minimum wages should be maintained. The Institute of Public Affairs (sub. 64), for instance, called for their abolition while the Commission of Audit (2014), although not going that far, advocated some changes that would significantly reduce the level of the minimum wage bite in some states (chapter 9). These calls raise the question of whether there is a valid rationale for regulated, binding minimum wages.

In the more-than-a-century since minimum wages were introduced, there have been marked shifts in family structures and women's social and economic roles, a social welfare safety net has been introduced and progressively widened, and Australians' living standards have increased dramatically. These changes have largely rendered redundant the original rationales for Australia's minimum wages, to deal with 'sweated labour' and to ensure that the reasonable needs of a family with a single male breadwinner are met. In turn, there have been changes to the objectives ascribed to the minimum wage during this period, although concerns about employee exploitation and notions of 'a fair day's work for fair day's pay' and social equity considerations have remained central.

In the Productivity Commission's view, it remains the case that a 'free market' for low skill labour would not be economically justified. As noted earlier, the labour market, particularly for low wage jobs, is characterised by significant imbalances in the bargaining power of employers and employees. These imbalances along with other market distortions mean that there remains an economic rationale for a minimum wage that lifts the incomes of low paid workers above the levels they would otherwise receive. Accordingly, the Productivity Commission does not support abolishing or neutering the minimum wage.

Whether there is also a social equity justification to (further) lift the minimum wage — that is, to levels higher than the level necessary to respond to bargaining power imbalances and other labour market distortions — is less clear. Governments already have in place various dedicated mechanisms, most notably the progressive taxation and social security system, that are intended to directly address social equity issues. Higher regulated minimum wages could be separately justified on these grounds only if they are more 'cost-effective' for addressing genuine social equity objectives than alternative policies.

Of course, while Australia's general taxation and social security system is highly targeted, it is not without its own limitations. The withdrawal of benefits often involves steep tapers, which create high effective marginal tax rates which in turn can discourage employment. There is also some evidence that recipients of some forms of welfare can feel stigmatised by them, and welfare provisions are amenable to significant change.

Australia's regulated minimum wages do not have these latter features, and the earlier analysis shows that minimum wage adjustments provide some improvement to the living standards of low-income working households. Some key union and welfare groups (ACTU sub. 167, ACOSS sub. 165) have argued that regulated minimum wages are an important tool for addressing social equity. The latter stated:

> There is a dynamic relationships between jobs, minimum wages, and income support, within which minimum wages both reduce poverty and provide an incentive for workforce participation. … The minimum wage reduces poverty, both directly by improving wages for people in low paid work, and indirectly by enabling an incentive-gap between the minimum wage and adequate social security payments for people who are unemployed. (p. 1)

While (higher) minimum wages can indeed increase incentives for people to seek work, the earlier analysis shows that regulated minimum wages also have important limitations as a tool for promoting equity: minimum wages lift the incomes only of those in jobs, do not target poverty or equity directly, and have the potential to cause unemployment and underemployment. This suggests that, above some point, attempts to improve the outcomes for those households with the lowest incomes through minimum wages may not be particularly efficient or effective. Some economists have further suggested that, contrary to popular perceptions, increases in the minimum wage in fact have the potential to detract from equity. Leigh (2007) has shown that minimum wages have the potential to widen earnings and income inequality, depending on the nature and extent of the disemployment effects, and Wooden (2010) has stated:

> Minimum wage rises benefit low-paid workers at the expense of the unemployed. Any action that increases the cost of hiring low-wage labour reduces the likelihood of those without jobs finding one in the future. Moreover, it is the long-term unemployed whose employment chances are most damaged. This seems very unfair. And it certainly does not promote social inclusion through greater workforce participation, as is required under the Act. The decision [by FWA to increase minimum wages in 2010] looks even more unfair once you realise that many low paid workers do not live in poor households, and that a low-paid worker has a much better chance of getting a better paid job than someone who doesn't have a job at all.

Should the minimum wage be complemented by other policies?

The above discussion suggests that while there is a plausible rationale to retain minimum wages, there may also be a role for complementary measures that lift the incomes of people in low income households, potentially in a more targeted way, while avoiding the risks to employment associated with higher minimum wages.

The FWC is already strongly cognisant of the joint role of the tax-transfer system and minimum wages on low paid households with dependent children, and takes this into account when considering whether its decision meets the minimum wage objective of the FW Act. For example, in the 2014-15 decision it noted:

> Evidence that the net effect of the various factors acting upon the ability of an employed family to meet their material needs has the consequence of increasing or reducing levels of unmet need

among low-paid and award reliant families would be one factor that we would take into account in our decision. (Annual Wage Review 2014-15 at 338)

Chapter 10 examines a range of measures that could complement minimum wages. Many countries use 'earned income tax credits' (EITCs) for this purpose. Some Australian economists have suggested that an EITC be introduced here as part of a wage-tax tradeoff (see chapter 10). By design, EITCs encourage labour force participation, and the evidence usually suggests that they do this, especially for single parents, though their effectiveness depends on their exact design. However, they do have several drawbacks (some of which are shared with minimum wages), including the potential for high levels of overpayments, reduced incentives to work for second earners in some households, and barriers to working above certain levels of hours as household income rises. They must also be financed through taxes, which have their own adverse economic effects. In an Australian context, any EITC would also interact with a well-developed tax-transfer system, which is also intended to improve the incomes of the low paid. The interactions between that system and an EITC would need to be carefully assessed.

Other policies examined in chapter 10 that can be used to support the incomes of the low paid while taking the pressure off minimum wages include wage subsidies and work-related social security payments and in-work benefits. Measures that improve the employability of less skilled people should also be part of the policy mix.

There is a range of uncertainties about the feasibility, benefits and costs of some of these options, particularly an EITC. These matters are discussed further in chapter 10.

The level of the minimum wage?

As described earlier, the minimum wage is adjusted each year following an annual wage review conducted by the FWC Expert Panel. In doing so, it draws on research as well as submissions from interested parties, and considers various objectives as set out in the FW Act (box 8.2). Much of the most useful and detailed research is provided by the Australian Government in its submission, rather than undertaken by the FWC itself.

Australia's minimum wage is high by world standards although its bite is lower than in the 2000s. The minimum wage was frozen in 2009 (by the former Australian Fair Pay Commission) during the Gobal Financial Crisis but has since been increased each year. Over the last five years, the FWC Expert Panel has awarded annual increases of between 2.5 and 3.4 per cent.[76] Business groups appearing before the FWC have typically called for smaller increases than have been awarded, while unions have typically supported larger increases. No groups appear before the FWC that specifically represent unemployed

[76] In its last five annual reviews, the panel awarded the same percentage increase in award rates, thereby maintaining relativities between these rates. In 2009-10, the panel announced a flat dollar increase (of $26 per 38 hour week) for all wage rates, contributing to some compression in percentage terms between higher and lower rates.

people, although bodies such as ACOSS and Jobs Australia have a particular concern for the unemployed as well as low paid workers.

Key considerations

While the FW Act sets out an array of objectives the Expert Panel must consider in adjusting minimum wages, the Productivity Commission considers that employment impacts should be a key focus. As noted earlier, without adverse employment effects, there would be little reason not to increase the minimum wage and its bite. This would lift the incomes of the low paid and could improve equity (albeit imperfectly) at little or no loss of economic efficiency. But the likelihood that minimum wages cause some disemployment means that, in considering adjustments to minimum wages, there is a need to weigh up the potential benefits to low paid workers who retain their jobs (and/or hours) against the potential losses to those 'would be' employees who fail to gain employment, or experience greater underemployment or job loss, as a result. The greater the assessed risk and extent of such disemployment effects, the greater would be the case for constraining the growth of minimum wages (so as to reduce the minimum wage bite) or even reducing them.

Determining 'optimum' minimum wage adjustments depends largely on how these gains and losses are balanced. This involves judgements about both the employment response to changes in the minimum wage and the relative size of the groups affected, and value judgements about whose welfare warrants the most weight. Several considerations are relevant.

As discussed earlier, although many people on the minimum wage live in higher income households and minimum wage employment is often a temporary state, there remain many people on the minimum wage without these same supports and opportunities. Many of these people are clearly in tight financial circumstances and face personal stresses and hardships (section 8.3). While reducing the minimum wage bite could be achieved through a more modest *growth* in the minimum wage (rather than a reduction in it), the recipients would see their earnings would grow less quickly than other employed Australians. Moreover, the number of people currently on the minimum wage is much larger that the number of people who would stand to gain or retain employment from a reduction in the minimum wage bite.

However, the adverse effects of unemployment on the individuals experiencing it, as well as on society more broadly, can be considerable. The Department of Employment has drawn attention to the much greater 'financial stress' experienced by the unemployed relative to the low paid:

> Government analysis shows that in general, while low paid employees have a higher incidence of financial stress than higher paid employees, both groups of workers have a considerably lower level of financial stress than the unemployed. This suggests that employment, even if low paid, is a far better aid to meeting financial needs and avoiding financial hardships than the alternative. (Australian Government 2014b, p. 53)

Moreover, joblessness can severely harm other aspects of people's wellbeing (Lattimore 2007; McLachlan, Gilfillan and Gordon 2013). Employment is not only a source of income but also, often, provides an enhanced sense of purpose, self-worth and self-efficacy. Work is also a place where friends can be made and social capital developed. An early entry into the jobs market can also be an important stepping stone into the world of work and potentially more rewarding careers. While work for the majority of people is not an end in itself, within the current structure of society it is a key pathway for many people to a more complete and happy life. Beyond these important individual benefits, there are broader reasons for concern about unemployment: it can represent a waste of productive resources and can cause a drain on the public purse. As the McClure Review (Commonwealth of Australia 2015a, p. 7) stated:

> There are many benefits of work. Most people gain health benefits associated with employment, both physical and mental. Work can be a vital part of recovery for people with mental health conditions. Intergenerational benefits of work accrue as children who grow up in employed households have better social, emotional, physical development and learning outcomes. The community also benefits. Increased employment supports economic growth, minimises the cost of income support payments and increases the amount of tax paid.

Prudent policy when disemployment impacts are uncertain

These considerations suggest that the FWC should give significant weight to employment impacts of when determining the level of the minimum wage.

The conundrum is that there is considerable uncertainty about the responsiveness of employment and hours worked to changes in the current minimum wage. That fact, combined with the transitional costs that would be imposed on currently-low paid employees from any immediate nominal reduction in the minimum wage, and the implementation difficulties in developing soundly-based alternative income replacement approaches (chapter 10), suggests that a reduction in the current levels is not warranted.

In considering these issues, Jobs Australia (sub. 221, p. 9) took a similar view and indeed supported (upwards) wage adjustments, albeit with the important proviso that other policies to support employment be adequate:

> The question, really, is whether a potential (and contestable) small negative impact on employment is an acceptable trade-off for equity and other gains accruing to low paid workers. In our view, it is – provided that other policies, such as concessional wages (youth wages, training wages), active labour market programs (such as Work for the Dole, relevant training) and wage subsidies (such as those available for the long-term unemployed) make up the difference for those who are disadvantaged by the minimum wage.

However, during periods of heightened unemployment and underemployment, there is less doubt that restraining minimum wage growth would yield material benefits through promoting employment. At present the unemployment rate is around 6 per cent and many Australians (including many minimum wage workers in the lowest quintile of equivalised household income) are underemployed. Heightened unemployment and underemployment

rates provide stronger grounds to moderate the growth rate of the minimum wage to below the growth in median wages (which ultimately themselves reflect rising trend labour productivity growth in the economy).

This approach should still allow for nominal increases in the hourly incomes of low paid workers and would avoid the transition costs of any precipitous cut in minimum wages. Notably, real labour productivity in the market sector increased by 13 per cent over the five years from 2008-09 to 2013-14, so, were this trend to continue, there may be ample headroom for paying modest minimum wage increases.

Where greater employment ensued, it would be expected that most of the people to take up new work (and/or retain existing work) would come from the ranks of the underemployed and the short-term unemployed (section 8.2), whose wellbeing may be less at risk than the long-term unemployed. However, a reduction in short-term unemployment would also reduce the flow into long-term unemployment, and some existing long-term unemployed people could in any case be expected to find work directly because of a falling minimum wage bite.[77] As noted earlier, higher employment probabilities would be likely to encourage the re-engagement of people who have left the labour force.

There is also evidence that, where it is binding, the minimum wage tends to reduce hours worked by more than employment. As discussed in chapter 3, there is significant underemployment in Australia, with many people wanting to work more hours but unable to do so. Limiting growth in minimum wages would be more likely to better accommodate such employees' preferences.[78]

Enhancing the FWC's approach

In assessing the range of matters in the FW Act related to the minimum wage objective (and, for floor wages in awards, the modern awards objective), the FWC Expert Panel considers information, indicators and forecasts on a range of relevant matters under the headings 'economic', 'social' and 'collective bargaining'. Among the matters examined are economic conditions, the outlook for employment growth and the needs and living standards of the low paid. The annual wage reviews provide a degree of transparency around the judgments underlying the FWC's decisions.

The Expert Panel also makes qualitative assessments of the cumulative effect of increases in the minimum wage, and seeks to avoid the materialisation of significant, adverse

[77] A sustained reduction in short-term unemployment and underemployment would be expected to lead to fewer people transitioning to long-term unemployment, and provide greater opportunities for those in long-term unemployment to find work. However, skills mismatch issues and other impediments to employment may also need to be addressed effectively if this group were to make the most of the increased employment opportunities.

[78] The impacts on the underemployed are in fact mixed. As a group they might gain more hours of work, but would also suffer reduced growth of their hourly income, including on the hours they originally worked.

employment outcomes in its considerations. It has indicated that it is 'mindful of the possibility that higher rates of growth of minimum wages could diminish the number of entry level and low-skill jobs over the longer term', and sets the minimum wage at a lower level as a result of that consideration (Annual Wage Review 2014-15 at 433)

The Productivity Commission sees scope for the FWC to enhance its approach to annual wage reviews. A more targeted approach to assessing and determining award wages and conditions is recommended in chapter 12. This includes more extensive use of and reliance on evidence and research, more explicit recognition and measurement of the tradeoffs between the different elements of the minimum wage and modern awards objectives, and better account taken of the effects of determinations on all affected parties. While the Productivity Commission considers that the Expert Panel takes a more rigorous approach to minimum wage setting than is adopted currently in modern award reviews, many of the points made in chapter 12 would also be relevant to some extent for annual wage reviews.

The Productivity Commission recognises that determining the level of the minimum wage that is 'just right' on a consistent basis is neither easy nor reducible to a simple formulaic approach. The OECD (2009, p. 199) has described that challenge as being to set the minimum wage at a level that minimises the potential employment losses relative to the income gains of lower paid workers.

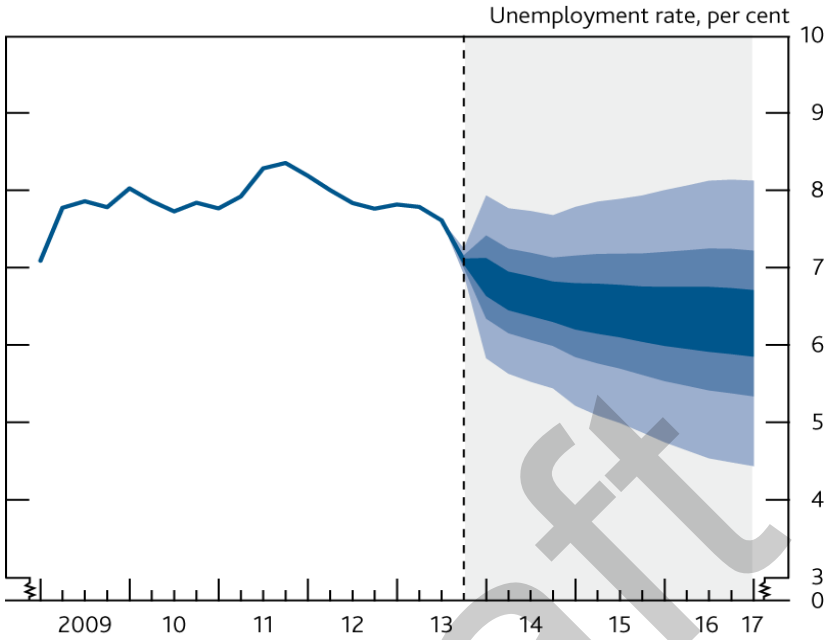
This would entail consideration of short-term exigencies as well as longer-term trends. Over the long-run, it could be expected that minimum wages would grow approximately in line with economywide productivity levels and maintain a roughly fixed ratio to median wages. That long-run ratio might sometimes shift with the skills and capabilities of the jobless and those employees paid close to the minimum wage. For example, if the average skills of that group improved, there would be more scope to increase minimum wages without significant adverse effects on their employment prospects. Over the shorter run, another set of considerations come into play. Given the highly adverse outcomes of unemployment for people's wellbeing, there are, as noted earlier, grounds for the FWC to temporarily adopt a conservative approach to minimum wage setting whenever the economy is weakening. In improved economic circumstances, minimum wages would catch up to restore their long-run ratio to median wages.

A particular issue in the context of annual wage reviews is how the FWC considers the issue of forecasting risks pertaining to unemployment. There is greater uncertainty surrounding the employment outcomes of any minimum wage increases when confidence about forecasts of output, productivity and wage is particularly low.

Internationally, central banks and treasuries routinely consider the uncertainty in their forecasts of inflation, unemployment, GDP and other key macroeconomic indicators (see, for instance, Alessi et al. (2014), Bank of Governors of the Federal Reserve System (2015) The Treasury (2015), and Tulip and Wallace (2012)). The Bank of England has developed a graphical way of presenting such uncertainty through the use of fan charts, which provide both a technically useful and intuitively appealing presentation of such uncertainty. Figure 8.10 provides an example.

Figure 8.10 **The depiction of uncertainty**

Unemployment forecasts in the United Kingdom



[a] The different shades depict the different confidence intervals around the mean forecast.

Source: Bank of England (2014).

The advantage of more formally assessing uncertainty in minimum wage decisions is that it allows the explicit consideration of the consequences for employment and household income of forecasting errors. Arguably, the FWC should care somewhat more about the risks of overshooting in its minimum wage increases (with the consequences this has for unemployment) and change its decisions to reflect this. (An analogy is that, when catching a train, it is best to arrive earlier than the expected departure time since the cost of a little waiting is much less than the cost of missing the train.)

Consideration of unemployment risks in minimum wage decision-making does not purely have to rely on technical forecasts, but can take into account expert opinion (Osterholm 2006). Currently, the FWC's analysis of risk appears relatively simple. This suggests that there is scope for both more formal consideration of risk, and changes in its decision-making to reflect those risks.

DRAFT RECOMMENDATION 8.1

In making its annual national wage decision, the Fair Work Commission should broaden its analytical framework to systematically consider the risks of unexpected variations in economic circumstances on employment and the living standards of the low paid.

9 Variations from uniform minimum wages

Key points

Geographical variations in minimum wages

- Nationally uninform minimum wages do not account for differences in living costs and labour market conditions in different places.
- Moving to state-based minimum wages would do little to overcome this problem. Commonly-cited measures of differences in states' minimum wage 'bites' overstate the issue, and a state-based minimum wage would be a blunt instrument for targeting disadvantage.
- A regionally-based model would provide greater scope for tailoring minimum wages to areas of relative prosperity and disadvantage, although there are other, more targeted instruments available that potentially could better address pockets of labour market disadvantage.
- Both state and regionally based models could have several drawbacks, associated with their interactions with the national tax-transfer system and with national awards, compliance costs and questionable constitutionality. The Productivity Commission does not recommend them.
- The Fair Work Act provides for temporary relief from minimum wage adjustments for businesses in exceptional circumstances. There are tight requirements to ensure this is not misused to permanently shield industries from structural change. Sectors temporarily affected by natural disasters can also find the requirements difficult to meet.

Junior pay rates

- Juniors generally are less productive and have different material needs than adults. They also face important choices around work and education. Lower minimum pay rates for juniors should be retained.
- There could be merit in restructuring junior pay rates to take into account experience and/or competency and not just age.

Arrangements for apprentices and trainees

- Apprenticeships and traineeships provide an important pathway into work for many young people as well as a retraining option for older workers.
- A recent FWC decision to increase award wages and conditions for apprentices may affect participation rates, although it is difficult to disentangle this from the many other influences, including changes in government–provided financial incentives.
- In light of the importance of coordinating policies to promote training and skills acquisition, and uncertainty about the impact of recent changes, there should be a comprehensive review of apprenticeship and traineeship arrangements.

Under the current workplace relations (WR) system, the Fair Work Commission (FWC) sets a National Minimum Wage for national system employees throughout Australia as well as floor wages for all classifications in awards. Following decisions in 2009 by all states, except Western Australia, to refer their WR powers for private sector employees to the Commonwealth, the FWC sets minimum wages for about 70 per cent of employed people in Australia.

The first issue examined in this chapter is whether there is a case for geographically-based variations from these national minimums. Section 9.1 addresses this firstly at the state level and then at the regional level.

As well as the standard adult rates, the system of national minimums administered by the FWC includes special rates for younger workers, apprentices and trainees, and some people with disabilities. Section 9.2 examines aspects of youth wages. Arrangements for apprentices and trainees are canvassed in section 9.3.

9.1 Geographical variations in minimum wages

Is there a case for state-based variations?

The idea that *uniform* minimum wages may not be appropriate arises because labour markets are geographically diverse. A particular concern is that minimum wages that are 'optimised' for some labour markets may be too high in others, effectively pricing some would-be employees in those markets out of jobs. A related consideration is that the cost of living can vary significantly from area to area. Thus, for example, a person living on the national minimum wage in a smaller state capital or in many country towns may enjoy a higher material standard of living than a minimum wage worker in, say, Sydney or Melbourne, due to differences in housing and transport expenses. A uniform national minimum wage means that economically depressed or declining areas that have low living costs cannot entice businesses to establish or remain in the area to provide employment by allowing them to offer relatively lower wages as a quid pro quo for lower living costs.

There have been a few calls to re-introduce variations in minimum wages for Australian states and territories. Notably, the National Commission of Audit (2014) recommended that minimum wages vary across the states and territories, over time being set at a fixed proportion (44 per cent) of each jurisdiction's average weekly earnings. In doing so, it stated:

> Having a single national minimum wage disadvantages workers attempting to gain a job in states like Tasmania and South Australia where wages and the costs of living are generally lower than in other States. (p. 322)

The Tasmanian Hospitality Association has also reportedly argued that there is a case for Tasmanian state award rates and allowances to be set below modern award rates, to reflect the relative strength of the state's economy (Clark 2015).

A small minority of participants in this inquiry, notably from Western Australia, supported the concept of there being some variation in state minimum rates, although UnionsWA added a critical caveat about how state-based minimum wages should be set (box 9.1). Its support for Western Australia's separate minimum wage largely reflected the benefits to low wage workers from higher minimum wages in a booming state. However, notwithstanding sometimes significant variations over recent years between the labour markets of Western Australia and Australia as a whole, the rates have varied little from each other (with a maximum difference of around 65 cents per hour) (figure 9.1).

Box 9.1 Views from Western Australia

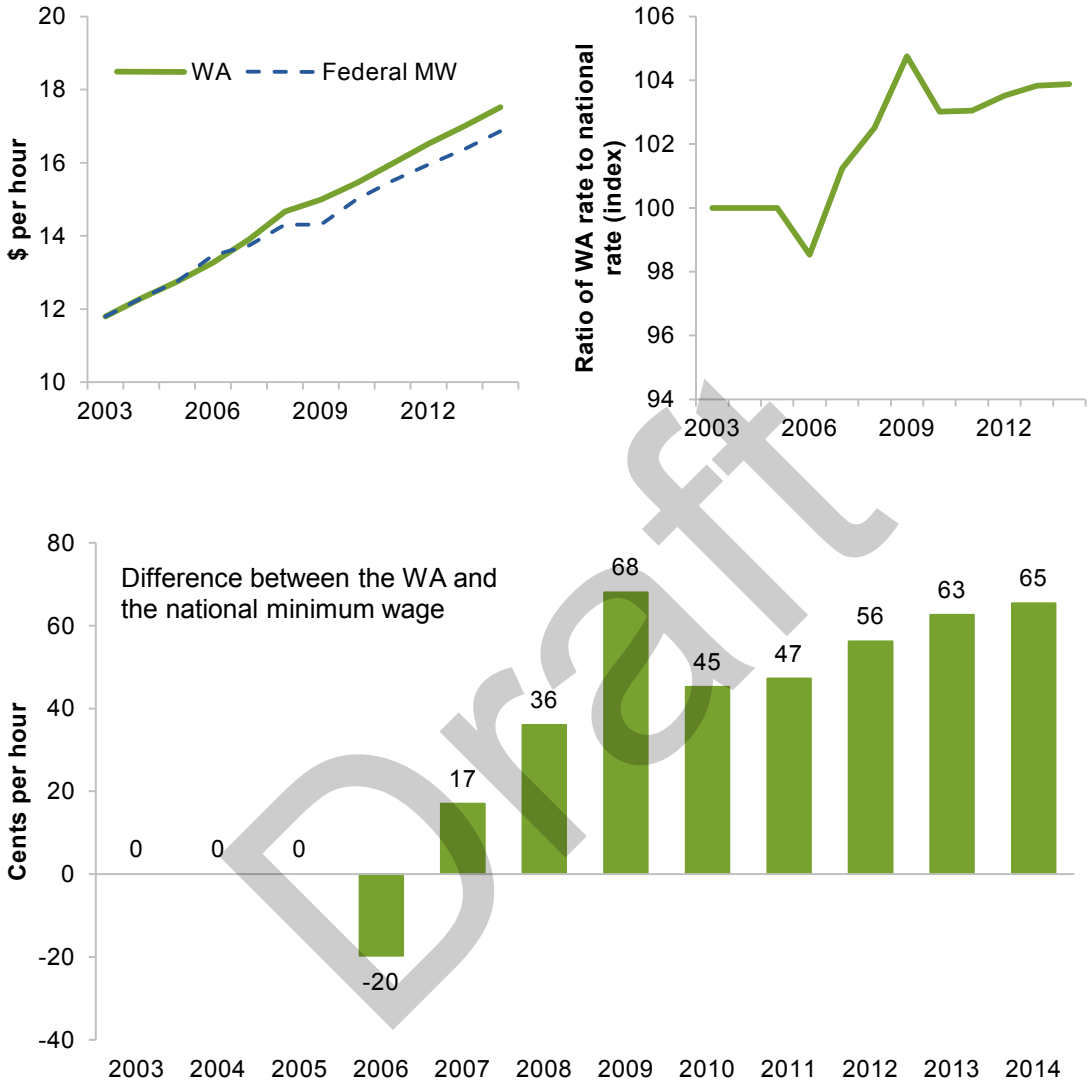
Some Western Australian participants commented favourably on that states' retention of powers to set its own minimum wages (which apply for employees of unincorporated for non-national system employees). Jonathan Lukman (sub. 76, p. 3) said that the current split system should be retained or that the power to set minimum wages should be fully returned to the states. He saw several advantages of a system of state-based minimum wages:

> Having such a system gives the states control to be more competitive where required; to lower or increase the minimum wage taking into account their state's economic health. Australia's states do not have equal division of resources, manufacturing capabilities, or people. As such, more often than not, one state may be economically suffering a mining bust while another state may be seeing a recovery in their manufacturing sector. States which retain their right to set their own wage rates allows such states to respond more quickly during economic crises and allows the benefits of economic booms to be also enjoyed by those on minimum wage.

UnionsWA (sub. 112, pp. 1–2) also saw benefits from having a separately determined state minimum wage, although it emphasised that this does not imply support for a formulaic approach that would see state minimum wages adjusted to equate to a specific proportion of average weekly earnings in the state:

> The Western Australian minimum wage began to diverge from the national minimum wage after 2005. UnionsWA argues that the WA state Industrial Relations Commission has correctly decided that a minimum wage set specifically for Western Australia should reflect the stronger economic conditions prevailing in WA, and provide for real wage increases to the low paid.
>
> However, UnionsWA warns against using the existence of a WA state minimum wage as evidence that varying the minimum wage across Australia, such as proposed by the Audit Commission, should be considered a just or viable proposition for either Australian or WA workers.
>
> In particular, what WA retains is not just a state minimum wage, but a state minimum wage case … This process is in stark contrast to the Audit Commission's proposal for a 44 per cent 'benchmark', which would essentially do away with an evidence based hearing.

Figure 9.1 **Variations between the Western Australian and National minimum wage, 2003–2014**



Sources: WA Department of Commerce, FWC and Bray (2013).

Magnitude of the potential benefits from state variations?

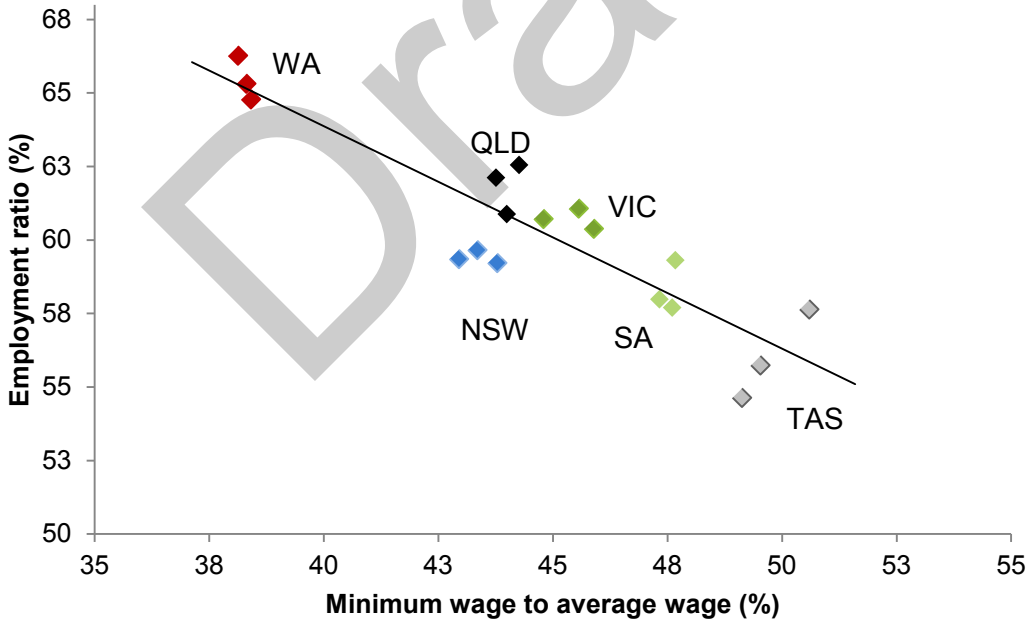
As in much of the empirical literature on minimum wages (chapter 8), it is difficult to draw definitive conclusions on the employment effects of geographical variations in minimum wages within countries. Many international studies find no robust employment effects from geographical variations in minimum wages, even for states that are contiguous and with quite different rates (Dube, Lester and Reich 2010). Australia has a uniform minimum wage (aside from the slightly higher rate in Western Australia), so there is limited evidence on the effects of different minimum wage rates within Australia.

An alternative approach is to examine the effects of variations in the level of the minimum wage 'bite' in different areas. One possible measure of the bite is the ratio of the minimum wage to the average wage. This measure was reported by the National Commission of Audit (2014) and in the Productivity Commission's Issues Paper, and is readily constructed from published ABS data.

Figure 9.2 shows the relationships between the minimum-to-average wage ratio and the level of employment in the different Australian states using data for the years 2012–2014. It shows that higher state minimum-to-average wage ratios are associated with lower rates of employment (relative to population). Over recent years, unemployment rates in Tasmania, and to a much lesser extent South Australia, have deviated from average Australia-wide unemployment rates (Tasmania by around 2 percentage points from the average). These are the states where the ratios of the minimum wage to average adult weekly ordinary-time earnings are highest. The opposite is the case for Western Australia.

Figure 9.2 **Bigger bite, fewer jobs?**

National minimum wage to average state wage, and employment to population, by state, 2012–2014 [a] [b]



[a] Wage, employment and population data are for November each year. Minimum wage refers to that in force in July of each year. [b] Straight line depicts the linear relationship between the ratio of the minimum wage to average earnings and the ratio of employment to population.

Source: Productivity Commission estimates based on ABS, cat. no. 6302.0 and cat. no. 6202.0.

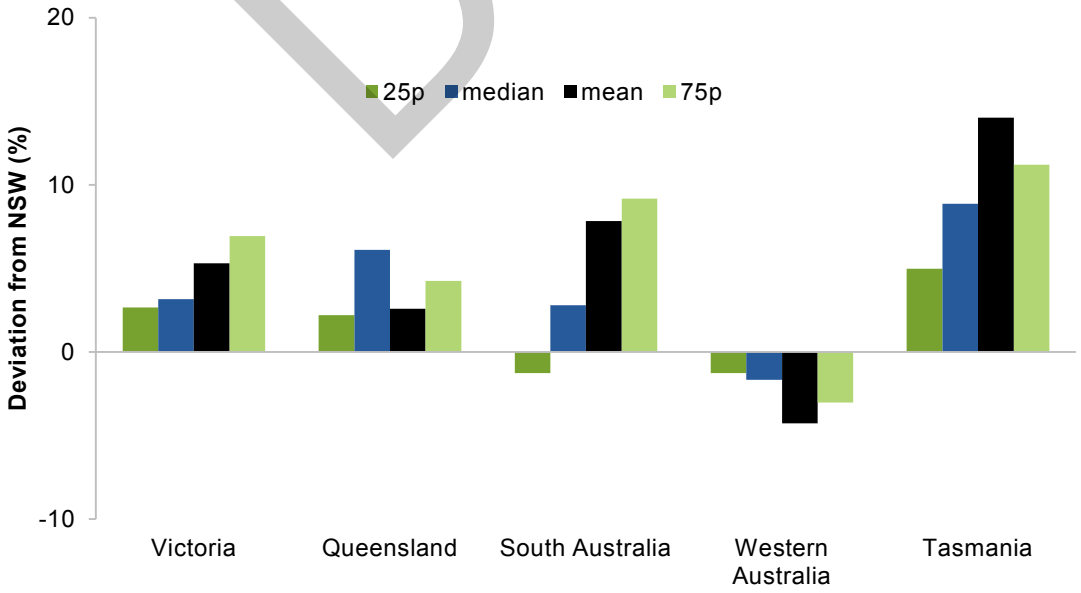
While prima facie this might suggest that measures to change the minimum wage could be effective in increasing employment in disadvantaged states, it is easy to draw too much from such analyses. There are three key complications or counterpoints.

First, different employment and unemployment rates in themselves provide only a limited guide to the potential effects of changing the minimum wage bite, because differences in unemployment rates reflect not only minimum wages but also differences in skill levels, skills mismatch, structural change and the other characteristics of labour markets. To the extent that geographical variations in employment and unemployment are explained by the traits of the unemployed, this is likely to reduce the benefits of corresponding variations in the minimum wage. Measures that directly address the employability of the unemployed, such as support for training and skills development (chapter 10), would be more appropriate to deal with these problems.

Second, the ratio of the minimum wage to the *average* wage is potentially problematic because the average can be disproportionately affected by very high wage earners. If the wage distribution in one area has a longer tail of high wage earners, that pushes up the average, but says nothing about the left hand tail of the wages distribution, which is where minimum wages bite.

Consequently, the Productivity Commission has used data from the ABS survey of Employee Earnings and Hours to derive estimates of the distributions of wages within States, including estimates of State median wages (figure 9.3). Using the more orthodox measure of the bite — the ratio of the minimum wage to the median — the divergence of Tasmania's bite falls.

Figure 9.3 **The Tasmanian results are affected by low mean wage rates**
Deviation in quartile measures of the bite from NSW, May 2014



Source: Productivity Commission estimates based on unpublished data from the ABS EEH survey.

The ratio of the minimum wage to the 25th percentile is likely to be an even better measure of the bite because it concentrates on the relevant part of the wage distribution. Using this measure, the deviation of Tasmania's bite from other states is even lower. Moreover, the deviations in the bite using the 25th percentile as the benchmark hardly varies between NSW, Victoria, Queensland and South Australia. This implies that differential minimum wages at a state level would seem likely to have relatively small impacts on unemployment rates for most of Australia's population.

The third issue is that, even if minimum wage bites (appropriately measured) were to vary significantly across states and employment in depressed areas was sufficiently responsive to the bite, varying the minimum wage by state would still be a relatively blunt instrument for tackling disadvantage. This is because all states contain many prosperous areas and many depressed areas, so a state-based minimum wage would still involve 'averaging' across quite disparate areas. Moreover, the variation in the level of prosperity *within* states is far larger than the variation in prosperity *between* states. A state-based minimum wage is therefore likely to be little better than a nationally-based minimum wage for 'targeting' prosperous or depressed areas.

Other policy options (for example, targeted wage subsidies or support for educational attainment (chapter 10)) would likely have greater net benefits in such areas. For example, compared with other jurisdictions, a much larger share of the Tasmanian workforce (around 30 per cent in 2013) has not gone past year 10 at school (PC 2014e), with students performing significantly below the OECD average for reading and mathematical literacy (Thomson, DeBortoli and Bucklye 2013). This suggests that measures to improve educational attainment in Tasmania may be warranted.

While a differential minimum wage rate might be still expected to promote greater employment (and, to a greater extent, hours of work) in Tasmania, the national benefits would be modest and would have to be set against the compliance and transitional costs of any shift in policy.

Other implications of differential state minimum wages

Were there to be state variations in minimum wages, the determination of national awards may also have to change. Under the current system, the FWC's annual wage review relates to both minimum wages and awards. Where the FWC grants an increase in the national minimum wage, this is usually translated to all award wages through either an equal percentage increase, or through the addition of a fixed dollar amount to award wages. If the percentage changes in state minimum wages are not equivalent, there is no longer a single rate that can be applied to awards. If the FWC continued its current arrangement, then wage relativities between the state minimum wage and uniform national award rates would vary considerably, with complex and uncertain impacts on labour markets (and additional compliance costs for multi-state employers).

Minimum wages and the tax/transfer system also interact. Working involves various benefits to households (which can include not just wage income but also a sense of self-worth, opportunities for social engagement and the avoidance of any costs of complying with social security requirements, such as meeting job diary obligations) and costs (commuting costs, loss of leisure and untaxed home production, and lower social security entitlements). The combination of a geographically varying minimum wage and a uniform national tax/transfer system may discourage labour supply for some people in areas where the minimum wage is lower. (The case of Japan (box 9.2) is an extreme example.)

Box 9.2 Geographic variations in regulated minimum wages in other countries

Geographical variations in the minimum wage apply in several, principally lower-income, countries (such as Mexico, Brazil, China, India Mexico, Indonesia, Kenya, Malaysia, South Africa, and Vietnam).

Among developed economies, the United States, Canada and Japan have adopted geographically-varying rates. Minimum rates within Canada do not vary significantly, and so its experience provides little guidance for a system where bigger variations in minimum wages might be contemplated. In contrast, large deviations can occur between regional rates in the US and Japan. For example, the highest prefecture rate in Japan is 30 per cent higher than the lowest rate.

Japan's regional minimum wage setting arrangements are complicated (Nakakubo 2009), and involve some perverse features because, in a significant number of prefectures, welfare recipients earn more income than minimum wage employees (Kyodo 2013). The Japanese system is also overlaid by an elaborate system of industrial wages akin to Australia's award wage system, albeit with even more categories.

In the United States, the US Federal Government sets the floor wage for most employees. State governments can set higher minimum wages for employees covered by the Federal minimum wage, and vary the minimum wage in any direction for non-covered employees. While many states have adopted the Federal minimum wage for all employees, very few have set lower rates, a few have no state laws, and a significant number have set higher rates (Bradley 2014). For example, California will set a minimum wage of US $10 per hour on 1 January 2016, which is nearly 40 per cent higher than the Federal minimum.

Some states set different rates for different industries and many vary the rate based on business employment size. They also use many different approaches for re-calibrating their minimum wages, from irregular legislated changes, regular indexation to various cost of living indexes, and formulas that regularly reference the federal rate. In other words, there is little coherence in setting minimum wages for a large share of US employees, and a diverse set of motivations are at work in determining rates. For example, for an employer, the cost of living for employees is not a relevant consideration for employing a person, while a large enterprise with low-skill, low paid workers may have no greater capacity to pay a higher minimum wage than a small enterprise.

If the US experience provides any lessons, it is perhaps that state government control over minimum wages does not necessarily respond much to local labour market conditions. This is all the more so since, within states, such as California (a state with a population roughly equivalent to Australia), there are many diverse labour markets (although there are also some city-based variations in minimum wages).

To reduce any such effects would require the adoption of a geographically distinct tax/transfer system. State and territory governments already have some capacity to vary social security entitlements in their jurisdictions, for example though criteria for access to public housing, and various transport and other government concessions. However, there is currently no mechanism for fine tuning cash transfers. In theory, States have the constitutional power to do so, but this would involve a bold step for state and territory governments, and would further complicate Australia's tax/transfer system.

The compliance costs associated with geographically varying rates may also be a consideration. One of the motivators for referral of powers by most Australian states was to make Australia's WR system simpler. Common minimum wages and awards were one feature of this. In this context, the South Australian Government noted:

> … the Government of South Australia also rejects the concept of different wage outcomes based upon particular circumstances in each industry or region. A core objective in establishing a national workplace relations system was to remove complexity and duplication and to ensure that Australian workers and employers were subject to consistent workplace laws irrespective of geographic location or size of business. (sub. 114. p. 9)

The legal issues surrounding a move to state or regionally-based minimum wages are relatively complex and, in some instances, not yet clear:

- There is no doubt that were State Governments to withdraw their referral of industrial relations powers to the Commonwealth, they could set different minimum wages for non-national employees. This is already the case in Western Australia, but notably, few employees are non-national employees (appendix B) and so any effects on employment would probably be modest.
- An alternative might be that the Australian Government attempt to use its current powers to set state (or/and regional-based) minimum wages for all employees currently covered by the FW Act. Whether it would have the constitutional power to do so is a vexed issue (box 9.3), but any intention to introduce such a major change would need to examine the legal issues closely. And of course, as noted above, were State governments to reject such a unilateral move, they could cease referral of their powers, and set their own, potentially different minimum wages for non-national employees. That itself would probably not matter a great deal, but it would also mean that non-national employees were not covered by any of the other aspects of the FW Act.

Other than the few exceptions described earlier, there has been no call by business groups, individual employees or unions (including those in Tasmania) for different minimum wage rates for different states. This reflects the view that the minimum wage is now a safety net, and that many workers receive more than this. Some key Tasmanian employers consulted by the Productivity Commission acknowledged that they paid above award wages for employees in Melbourne, but that they saw the national minimum wage as right for their Tasmanian employees.

The Productivity Commission has concluded that there is not good reason to recommend that minimum or award wages be varied on a state and territory basis.

Box 9.3 Some legal issues

Constitutionality and governance

All states except Western Australia referred their WR powers for private sector employees to the Commonwealth in 2009. While this enables the FWC to set a uniform national minimum wage for all such employees in the relevant states, it is less clear that the Commonwealth has the constitutional capacity to vary minimum wages by state.

Section 99 of the Australian Constitution represents one possible obstacle. The section states:

> The Commonwealth shall not, by any law or regulation of trade, commerce, or revenue, give preference to one State or any part thereof over another State or any part thereof

An initial question is whether s. 99 could extend to employment arrangements. If it did not, then that section would not seem to rule out state-varying rates. This is not a decided matter. On the one hand, the jurisprudence on the terms 'trade and commerce' in the Australian Constitution has come to be broadly interpreted (Gray 2008), including employment conditions of employees engaged in commercial activity (*R v Foster; Ex parte Eastern & Australian Steamship Co Ltd* (1959) 103 CLR 256). On the other hand, this interpretation has arisen for s. 51, but not expressly s. 99. A difficulty in drawing conclusions on this issue is that all recent cases involving s. 99 have been tax cases.

The meaning of 'preference' in s. 99 also has considerable importance, since if variations in regulated wages do not amount to a preference, then s. 99 would not have any application. This has only been partially clarified. The majority of the High Court accepted that in *Permanent Trustee* (2004) (220 CLR 388), differential taxes could be imposed and yet still meet the s. 99 test. In that case, the Commonwealth was setting tax rates that were indeed different in different states, but that were equal to the tax treatment by each state for comparable assets. The dissenting judges in *Permanent Trustee* took a more literal interpretation of s. 99 and considered the conduct was preferential, and therefore in breach. Dissenting judgments can ultimately overwhelm precedent and have frequently done so in Australia (Lynch 2007). The Australian Government Solicitor has also indicated that the High Court did not elaborate on some key concepts underpinning its determination, raising the question of how a judgment might proceed in a different context.

A separate constitutional issue may arise from section 92, which relates to free trade between the states. Setting different regulated wages for enterprises engaged in interstate trade may represent a barrier to such trade. The bottom line is that careful analysis of the constitutional issues would be an important precursor to any serious intention to introduce regional or state varying regulated wages.

Equal pay for equal work

Another legal consideration is that the Australian national WR system has a long established principle of 'equal remuneration for work of equal or comparable value' for regulated wages. On face value, setting different minimum wages across borders for the same job would not align with this principle.

However, as discussed in chapters 11 and 12, there are profound difficulties in determining what is work 'of equal value'. Further issues are that jobs yielding the same monetary benefits may provide quite different non-monetary benefits for workers, and the value (in terms of the wellbeing gained) of a particular quantum of money is likely to vary from one person to the next, and from one place to the next, given differences in preferences and living costs. Equalising monetary remuneration will thus not equalise the benefits people gain from work 'of equal value', and in some cases may inhibit efficient matching of workers with jobs.

Are more granular variations in minimum wage rates warranted?

Aside from calls for variations in minimum wages between states and territories, some other arguments have been made that might support more granular variations in minimum wages:

- The Chamber of Commerce and Industry Queensland (CCIQ, sub. 150) urged the Productivity Commission to consider relief from minimum wage increases for regional businesses affected by natural disasters, such as droughts and cyclones.
- Some also argue that rural businesses' employment decisions are more sensitive to minimum wages (Lewis 2004).
- One participant argued for higher minimum wages in places like Sydney with high living costs (sub. 188, line 275), which in effect is equivalent to arguing for relatively lower minimum wages outside such places.

General regional variations?

Compared with minimum wage variations based around state borders, there would be greater advantages in a model that allowed for regional variations:

- While the minimum wage bite (when measured appropriately) at the State level does not vary significantly, it could be expected to vary more between regions and between different cities and towns.
- While all states contain both relatively prosperous and relative depressed areas making targeting problematic, variations by region or location could in principle be tailored much more closely to areas of relative prosperity and disadvantage.

As in the case of state-base variations in minimum wage, there are other instruments available for addressing pockets of labour market disadvantage. These including support for training and skills development and transport and wage subsidies (chapter 10). Although not without their own costs and limitations, these could potentially target disadvantaged people more readily than a system of regional variations in minimum wages.

Nevertheless, for this inquiry, the Productivity Commission explored whether it is possible to use data on regional wages and employment to shed light both on the employment effects of the minimum wage and on the desirability of varying the minimum wage by geographic area (box 9.4). The analysis confirms that the wage bite (at least when measured using the minimum wage to average wage ratio) does vary more significantly between regions than between states. However, various data and technical issues rendered deeper analysis inconclusive.

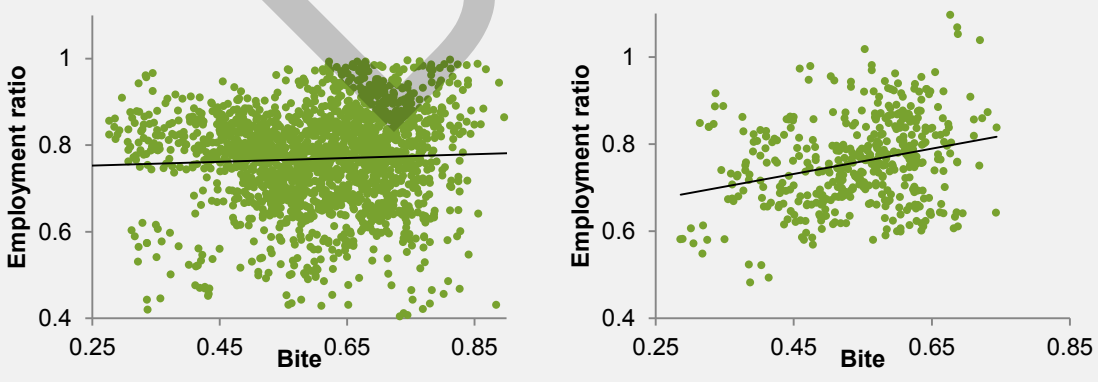
Box 9.4 Analysing the employment effects of regional differences in the minimum wage bite

Several international studies have implemented a geographic 'bite' approach to the identification of employment effects from the minimum wage (Bryan, Salvatori and Taylor 2013; Dickens, Riley and Wilkinson 2009, 2012; Dolton, Bondibene and Stops 2012; Neumark and Wascher 1992). This approach exploits regional variations in the ratio of the minimum wage to the average or median wage, or in its coverage of the workforce. Even in countries with a uniform minimum wage, such as the United Kingdom and Australia, geographic differences in average or median wages or workforce composition can result in different bites across locations. This allows the association between the bite and a given employment outcome to be explored, potentially shedding light on the employment effects of the minimum wage and the desirability of varying the minimum wage by geographic area.

The most common form of geographic bite analysis seeks to detect a link between a Kaitz Index (the ratio of the minimum wage to the average wage or median wage) and the employment-to-population ratio. Evidence on the existence of this link is mixed (Neumark and Wascher 2006). This uncertainty is frequently attributed to the vast range of influences that can impact on a state's or region's labour market over time and, hence, its employment ratio and its Kaitz Index.

The Productivity Commission has explored the value of replicating the approach of some overseas studies of the minimum wage that used geographic bite analysis. A useful starting point is a visual examination of the Kaitz Index–employment ratios relationship at various levels of regional aggregation. As the two panels in figure 9.4 illustrate, that relationship appears to be slightly positive at the two levels of regional aggregation shown, constructed using data available for the period 2008–2011. Regional data on median wages were available for only one of the years covered, so the analysis used average wage data for its Kaitz index measure.

Figure 9.4 **Kaitz Index and employment ratio, by region, 2008–2011**[a]



505 Local Government Areas **111 Functional Economic Regions**[b]

[a] In both the graphs above, the Kaitz Index is measured on the horizontal axis, and the employment ratio on the vertical axis. Some employment ratios are greater than 1, due to data inconsistencies. [b] Functional Economic Regions are an amalgamation of contiguous Local Government Areas, based on a taxonomy devised by the Centre of Full Employment and Equity (http://e1.newcastle.edu.au/coffee/).

Sources: Productivity Commission estimates based on data from ABS cat. no. 6524.0.55.002 and Cat. No 3235.0, Department of Employment small area labour market publications and CofFEE.

(Continued next page)

Box 9.4 (continued)

However, this graphical approach is potentially misleading, as it does not account for the range of influences — some state- or region-specific, others time-related — that impact on the two variables of interest. For example, the natural resources boom of the 2000s would have caused the bite of the minimum wage to fall and the employment ratio to rise in parts of Western Australia for reasons unrelated to the minimum wage.

The influence of local economic conditions is apparent when both the Kaitz Index and the employment ratio are summarised at the state level (figure 9.2). At that level of geographic aggregation, the relationship of interest appears negative. That result is strongly influenced by Western Australia on the one hand, and Tasmania on the other. In the former state, a low index and high ratio coexisted during the 2012–14 period. The opposite was true of Tasmania. This illustrates the potential for misinterpretation from ignoring state-level influences in figure A. When the relationship between the Kaitz index and the employment ratio by region is estimated econometrically while controlling for time-invariant state and regional characteristics, the regional relationship is negative and significant.

However, when time-varying influences arising from events such as the Global Financial Crisis are accounted for, this estimated econometric relationship breaks down. The sensitivity of the model to changes in control variables and functional forms reflects the technical challenges posed by geographic bite analysis. One challenge — spatial correlation between contiguous regions — is addressed by choosing Functional Economic Regions as the geographic unit of analysis. A more fundamental issue, not able to be accounted for here, is the simultaneous determination of the Kaitz Index and the employment ratio, resulting in possible endogeneity bias.

Due to the difficulty of addressing this form of bias, the existence, let alone direction, of the relationship of interest remain uncertain. The issues around the use of average rather than median wage data for bite analysis (see text) and the quality of regional data concordances used are also potentially relevant. As a result, the Productivity Commission has not relied on results from its exploratory geographic bite analyses to inform its thinking.

While the Productivity Commission would still expect that varying minimum wages at the regional level could have some employment benefits, many of the same difficulties that apply at the State level also apply at the regional level. These include issues around interactions with the national tax/transfer, difficulties in determining award rates (were they also to vary in line with minimum wages in different regions), and the need for state governments to acquiesce to such an approach. Moreover, there would be greater complexities in adjusting regional minimum wages each year, given that: movements in the bite in local areas could vary significantly from year-to-year because of greater volatility in the wage distribution; and reliable data collection for such areas is intermittent. An alternative to attempting to set regional wages according to year-to-year changes in the minimum wage bite would simply be to set district allowances (as contained in some awards) and/or district discounts that could be varied from time to time by the FWC. This process would have its own challenges.

Few participants advocated regional variations in the national minimum wage of this type, and the Productivity Commission does not see sufficient grounds to recommend them as a general approach.

Temporary relief for struggling areas?

The question of deferrals or temporary exemptions for natural disasters, raised by the CCIQ, raises a slightly different set of issues. It argued:

> Key impacts of natural disasters such as drought include a significant reduction in or no capital expenditure, loss of skilled staff and loss of crops and livestock. As the agricultural industry is a key economic driver in many rural communities, the impact of drought on the industry has significant ripple effects that can result in higher unemployment rates, reduced rural populations, and reduced economic activity. …
>
> At present, there is no capacity for the Fair Work Commission to take into consideration factors such as natural disasters, and our Organisations strongly argue that extenuating circumstances such as ongoing drought and exposure to the destructive effects of cyclones warrant exemption from the minimum wage adjustment for a given period. (sub. 150, p. 21)

While delaying a minimum wage adjustment for workers in affected industries would undoubtedly provide some immediate financial relief for the employers, it would also deny already lowly paid workers funds at a time when, in some cases, they may also face unusual financial demands, and it could lessen the funds available for expenditure in the local community. Of course, where affected businesses scale back employment, this will reduce the workers' income and wellbeing, and local consumption, much more. However, governments already have an array of mechanisms they can and do use to assist affected businesses and communities subject to such disasters. It could be argued that, provided the minimum wage is playing a legitimate safety net function, these other mechanisms should be the first port of call for assisting affected business where appropriate.

Nevertheless, s. 286 and 287 of the FW Act provide some scope for the FWC to take into account 'exceptional circumstances' when adjusting minimum wages. In 2007 its predecessor, the Australian Fair Pay Commission, decided to defer the annual increase in minimum wages (for classifications above the basic National Minimum Wage) for all farmers in receipt of the exceptional circumstance interest rate subsidy payment for 12 months, following a request from the National Farmers Federation. In more recent years, the FWC has considered submissions from several industry groups seeking exceptional circumstances deferrals or exemptions in relation to a range of natural disasters, including droughts, floods and cyclones. Industry groups have also applied for deferrals or exemptions on a variety of other grounds, including poor trading conditions, the effects of a high Australian dollar and reduced tourism, high business failure rates in particular sectors, the effects of the former carbon tax, the effects of increases in minimum wages for apprentices, and the costs of the award modernisation process.[79]

[79] See, for example, Annual Wage Review 2011-12 [2012] FWAFB 5000 [1 June 2012] at 270-272, and Annual Wage Review 2013-14 [2014] FWCFB 3500 [4 June 2014] at 539-540.

In articulating its approach to the exceptional circumstances provisions, the FWC has said:

> Consideration of differential increases or timing of minimum wage increases in relation to individual employers or specific industry sectors in exceptional circumstances should be primarily directed to addressing temporary issues and temporary relief from minimum wage increases, rather than to seek to hold back the ongoing process of structural change in the economy. (Annual Wage Review 2014-15 at 510)

It has further stated that the scheme of the FW Act is 'more consistent with establishing adjustments across the range of modern awards and, in the absence of exceptional circumstances, taking the sectoral variations into account when determining the level and nature of adjustments that will apply to the modern awards generally'. It also notes that basing different wage outcomes on the particular circumstances in each industry, as they might vary from time to time, would lead to the loss of any relativity between the wages specified in modern awards, which could run afoul of the 'equal remuneration for work of equal or comparable value' principle (Annual Wage Review 2014-15 at 109).

The Productivity Commission agrees that annual wage reviews are not well suited to adjusting minimum wages (whether the national minimum wage or the floor wage rates set in awards) to deal with long run changes in the viability and competitiveness of different industries. Moreover, if the national minimum wage is set correctly to play its legitimate safety net role, it would not be appropriate to provide ongoing 'discounts' from it to businesses that would otherwise not be viable. Put simply, businesses that could remain viable only by paying wages well below the relevant community standards reflected in the national minimum wage are probably not ones Australians would want to encourage.

However, as reflected by the existence of the exceptional circumstance provisions in the FW Act, there can be grounds for temporary exemptions or deferrals of adjustments to the national minimum wage (and/or the relevant award floor wages) for industries that are struggling temporarily.

To date, the FWC has not found cause to provide such an exemption or deferral. In rejecting the CCIQ's recent request that such relief be provided in relation to drought and cyclones in Queensland, the FWC stated:

> We readily accept that natural disasters have an adverse impact on business. Similarly, they are likely to have an adverse impact on employees engaged within the relevant affected areas. In many cases these employees may be among the lowest paid in the community and facing financial stresses because of the effects of those natural disasters on them and their families.
>
> We also accept that a deferral of any rise in minimum wages would make some contribution towards easing the burden on businesses. However, the difficulties observed by the Panel in the 2011-12 [regarding an exception circumstances request in relation to flooding] … again face us in this Review.
>
> The fact that an area is "drought declared" of itself will not constitute exceptional circumstances for the purposes of ss. 286 or 287 of the Act. Similarly, a submission that cyclones have impacted some regions of Queensland will not of itself establish exceptional circumstances.

> … The submission provides little material upon which we could make a finding that exceptional circumstances exist and that they are such as to warrant a deferral of any increases to minimum wages. (Annual Wage Review 2014-15 at 513-518)

The FWC went on to point out that while the CCIQ had said that there should be a deferral of any wage increase for farmers and agribusinesses in the regions which have been affected by drought, it had not proposed any mechanism to properly identify the employers or employees affected. Identifying such groups in a way that meets the requirements of the FW Act as interpreted by the FWC has been an obstacle in several exception circumstances decisions relating to natural disasters. The FWC also identified several other requirements that would be needed to make the case for a deferral that it considered had not been made by the CCIQ.

The question that arises is whether the approach to exceptional circumstances claims taken by the FWC under the FW Act is sufficiently tractable and allows a proper weighing of all relevant benefits, costs and risks to affected workers, employers and communities of allowing temporary relief. The Productivity Commission has no firm view on these matters and would welcome further input, including any options for practical reform if they are warranted.

The FWC has also identified a difficulty with the FW Act, which prevents it responding to requests for temporary variations in award wages on exceptional circumstances grounds *after* an annual wage review has been completed (Annual Wage Review 2014-15 at 78-79). The FWC has drawn attention to this problem each year since 2011-12, but no legislative amendments have been forthcoming. The Productivity Commission supports action to address this anomaly.

DRAFT RECOMMENDATION 9.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that the Fair Work Commission is empowered to make temporary variations in awards in exceptional circumstances after an annual wage review has been completed.

9.2 Junior pay rates

Federal Junior Pay Rates (as they will be labelled here) specify minimum wages for people aged under 21, as a proportion of the adult National Minimum Wage. Although the adult rate is high by world standards, the junior rates start at just 36.8 per cent of it (for workers aged under 16). They then increase incrementally, with 20 year olds entitled to close to the full adult rate (table 9.1). Around 50 per cent of OECD countries that set youth wages as a share of the adult rate (OECD 2015a).

Table 9.1 **Federal Junior Pay Rates**[a]

Age	*Junior pay rate*	
	Share of the Adult National Minimum Wage	*Value*
	%	$
Under 16	36.8	6.36
16	47.3	8.18
17	57.8	9.99
18	68.3	11.81
19	82.5	14.26
20	97.7	16.89

[a] As at July 2015.

Source: Annual Wage Review 2014-15 – National Minimum Wage Order 2015 FWC [29 June 2015].

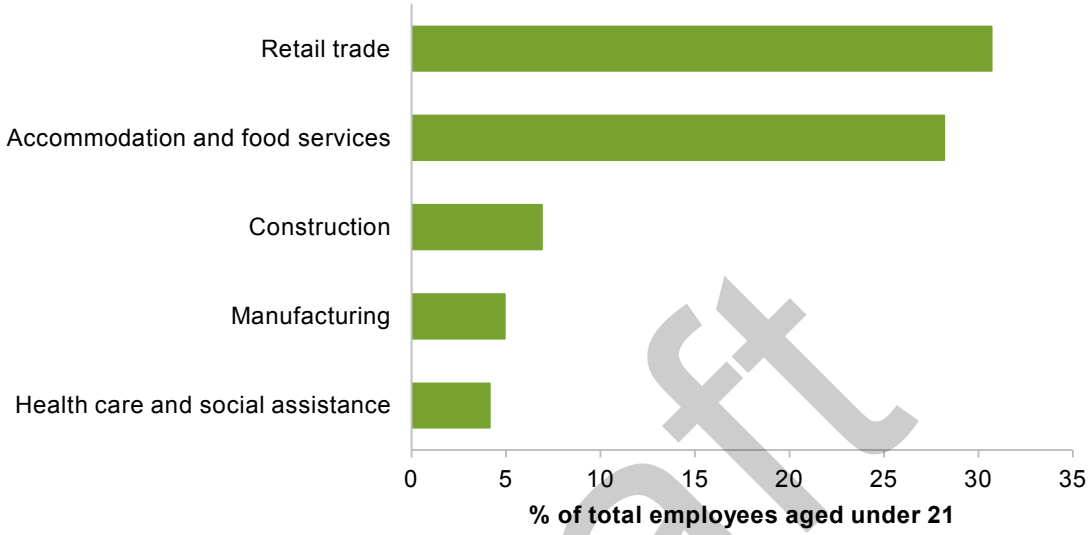
As with the adult National Minimum Wage, the Federal Junior Pay Rates serve as a true minimum wage, with juniors' actual pay more likely to be specified in awards or enterprise agreements and to vary from the federal junior rates. For instance, the minimum rate of pay for workers aged under 16 and covered by the *General Retail Industry Award 2010* is $8.54 per hour. More generally, it is common in awards for 16 years olds to get 50 per cent of the relevant adult wage, 17 year olds to get 60 per cent and so on (Stewart 2015, p. 211) However, not all 122 awards specify junior wages, with the 47 that do not usually covering more skilled qualifications that require more experience.

The structure of junior wages can vary with each award. For example, junior wages in the *Wine Industry Award* apply only to people younger than 18. People aged under 17 years old are paid 80 per cent of the adult wage, and 17 year olds are paid 90 per cent. In the *General Retail Industry Award*, 20 year olds who have worked for more than six months are paid at the adult wage. However, most junior wages in awards adjust with changes to adult award wages, which are generally linked to adult National Minimum Wage.

The Department of Employment estimates that 217 300 15 to 20 year olds in 2012 were paid a junior wage specified in an award (sub. 158, p. 11). Around 60 per cent of all junior employees work in the retail trade and the accommodation and food services industries

(figure 9.5). Depending on age, the junior wages in some of the main awards that cover these industries are up to 36 per cent higher than the Federal Junior Pay Rate (figure 9.6).

Figure 9.5 **In which industries do juniors work?** [a,b,c]



[a] As at May 2014 [b] Standard errors of shares for construction, manufacturing, and health care and social assistance are around 25% [c] Excludes the Agriculture, Forestry and Fishing industry; analysis of ABS *Labour Force, Detailed Quarterly, February 2015* Cat. 6291 suggests that the proportion of juniors working in this industry is below 3.5 per cent.

Source: ABS, *Employee Earnings and Hours, Australia, May 2014*, Cat. 6306.

Junior pay rates in enterprise agreements are determined through bargaining although, in many cases, they resemble the structure of the Federal Junior Pay Rates. For example, both McDonald's and Woolworths specify junior pay rates as a proportion of the adult wage rates set out in their agreements. Like Federal Junior Pay Rates, the proportion of the adult rates that juniors earn increase with the workers' ages. McDonald's and Woolworths' junior pay rates exceed the federal junior rates and the junior rates in relevant awards.

Impacts on employment and education

Juniors' involvement with the labour market differs in some ways from that of adult workers. Many (though not all) juniors, particularly teens, live at home, are supported by their parents, and typically do not have dependents of their own. Many juniors (although again not all) have the discretion not to earn an income or may only work as a (part-time) adjunct to other activities such as school or further education. Of course, all juniors at some point face a critical life decision between continuing with study or other non-work activities and seeking to enter the labour force full-time. Another consideration is that juniors, at least when they first start work, can be expected to be less skilled, qualified and

competent than adult workers (although this is not always the case as some young people such as university students can start with considerable work-relevant capabilities).

Figure 9.6 **Junior wages in selected awards and enterprise agreements[a,b]**

Percentage of Federal Junior Pay Rates

[a] As at July 2015. [b] When applicable, rates are based on introductory positions in NSW.

Sources: General Retail Industry Award 2010; Fast Food Industry Award 2010; Restaurant Industry Award 2010; Hospitality Industry (General) Award 2010; McDonald's Australia Enterprise Agreement 2013; Woolworths National Supermarket Agreement 2012.

These differences have some ramifications for the employment effects of junior wages, although the impact of junior pay rates will in many respects mirror the (complex) effects of the adult minimum wage (section 8.2). To the extent that juniors are less productive than adults, commensurately low pay would be necessary to make them an attractive proposition for employers. Regulated minimum pay rates for juniors that are higher than this level would adversely affect junior employment (although they may promote greater adult employment).

Junior pay rates can also indirectly affect some people's long term job prospects. This is because holding down a job early can be a 'stepping stone' to employment in adulthood. Working can develop people's work-related knowledge, skills and habits, as well as signalling general work aptitude to prospective employers. There is evidence that young people who have been unemployed find it harder to find steady work compared to those who have been working (Richardson 2002). Young people with insufficient work experience (or good educational qualifications) may face barriers to the job market when

they reach adulthood and need to compete with more experienced workers. To the extent that junior pay rates increase the number of juniors who are able to secure employment, they may serve to increase those people's employment prospects in later years.

Education is most juniors' main alternative to employment, and the level of junior pay rates can influence their decision to remain in or leave education. A high enough junior pay rate may encourage some juniors to leave education and venture into the job market. But a junior's decision is also affected by the availability of work, with a junior more likely to stay in education if few jobs are available — dampening (but clearly not eliminating) any rises in the youth unemployment rate during periods of weak labour market conditions.

Importantly, even though most juniors that remain in education appear better off[80], some juniors are likely to benefit from leaving school and entering the workforce early. For example, young people who underperform academically but continue through to year 12 may struggle to find a job upon graduation as they must compete at a higher pay scale with candidates with stronger academic credentials or work experience. Were such young people to leave school and seek work at an earlier age (and thus at a lower rate of pay), they are more likely to initially find a job, gain experience and may eventually fair better against year 12 graduates, particularly in jobs where employers value practical work experience above education.

Empirically, a number of the Australian studies surveyed in appendix C that assess the employment effects of changes in minimum wages are concerned with youth employment effects. Leigh (2003), for example, considered how employment effects of changes in the minimum wage in Western Australia varied for different age cohorts, finding that the effect was greatest for workers aged 15-24. Only three of the studies specifically considered the effect of changes to junior rates (Mangan and Johnston (1999), Junankar, Waite and Belchamber (2000) and Olssen (2011)), but with the methodologies and results varying.

Across the Tasman, a series of significant changes to New Zealand's junior pay scales during the 2000s have provided useful experiments that have been studied by economists (box 9.5). While the picture is somewhat complicated, it appears that increasing the rates payable to juniors had some disemployment effects. The New Zealand evidence also suggests that increases in youth wages may also have enticed some juniors away from schooling.

80 There is much evidence that education is generally beneficial for a junior's immediate and future employment. For example, Quintini et al. (2007) found that, in most OECD countries, young people with higher education qualifications were less likely to be unemployed one year after leaving education. ABS (2014a) data shows that, at May 2014, 9.6 per cent of adults who had not finished year 12 were unemployed, compared with 6.7 per cent of those whose highest level of education was year 12. More broadly, education affect juniors' future earnings, with more qualified workers typically earning more. For example, Cassells et al. (2012) estimated expected lifetime earnings for a 25 year old Australian with postgraduate qualifications to be 1.8 times those of a person whose highest level of education was year 11 or below.

Box 9.5 Youth wages in New Zealand

New Zealand made a series of changes to its minimum wages for 16-19 year olds in the 2000s:

- In 2001, the minimum wage for 18-19 years olds was increased from 60 per cent to 100 per cent of the adult minimum
- From 2001 to 2002, the wage for 16-17 years olds was progressively increased from 60 per cent to 80 per cent of the adult minimum.
- In 2008, the wage for 16-17 years olds was increased to the adult minimum, and a *new entrants* rate at 80 per cent of the adult rate applied for 16-17 year olds' first three months or 200 hours of work (which was replaced by the *starting-out wage* in 2013 and applied for a 16-17 year old's first six months of work).

In an analysis of the 2001 changes, Hyslop and Stillman (2004) concluded that they had no adverse effect on employment of teenagers, but induced 16-17 years olds to work more hours. The authors found some evidence suggesting that 16-17 year olds had reduced educational enrolments, and there was also an increase in unemployment amongst teenagers.

In a subsequent review of the 2004 study, Neumark and Wascher (2006) concluded that there were in fact some net disemployment effects. The review authors noted that the changes to junior pay rates were announced in the base period of Hyslop and Stillman's analysis, and that their assessment of employment effects relative to this base may not have captured some adjustments by employers. The review authors also observed that the employment of 16-17 and 18-19 year olds fell immediately after the minimum wage changes. Moreover, the share of 20-21 year olds employed in successive years increased by more than the share of either 16-17 or 18-19 year olds (although their employment shares still increased), which might suggest a substitution towards the slightly older workers — with the adverse effects on teenage employment being nullified by broader economic factors boosting employment across all age groups.

In examining the 2008 minimum wage changes, Hyslop and Stillman (2011) concluded that they caused some disemployment effects which were compounded by the late 2000s financial crisis. The wage increases caused a fall in the share of 16-17 year olds employed of 3-6 percentage points in the subsequent two years, and a fall in the average number of hours worked by them … The authors found that the fall in the employment share was attributable to fewer students working and some evidence of employers substituting them for 18-19 year old students.

The different effects of the two sets of wage changes may partly reflect changes in the share of teenagers employed at the minimum wage. In 2000, only 3 per cent of 16-17 year olds were employed at the minimum wage or less, but this share had increased to 30 per cent by 2007 (Maloney and Pacheco 2010). As a result, the 2008 minimum wage change was probably more likely to affect the employment of 16-17 year old workers.

Policy issues

The Productivity Commission sees good reasons for retaining some form of discounted wages for young workers. While there will be exceptions, young workers are likely to be less productive than adults. Without wage differences, in most cases employers would be likely to employ adults rather than young workers. In effect, without discounted rates, many young workers would be priced out of the labour market, foregoing the benefits that

some early employment, even if on a part-time basis, can bring. The net impact on overall employment is hard to foretell, but it is possible that discounted junior rates make viable some economic activities that could not proceed at adult rates. Paying higher or adult rates to young workers would also provide a greater incentive for some to cease education early, potentially hampering their future employment prospects (although, as noted, for some young people, an earlier move into the workforce may be beneficial). Finally, many young workers, particularly teens, are not as reliant on wages as are adult workers.

While no inquiry participant argued for the elimination of some form of discounted pay for young people, several were critical of the level and structure of junior pay in Australia. For example, against the backdrop of youth unemployment reaching its highest level since 1998 (see chapter 2), the CCIQ suggested that ongoing increases in junior rates of pay are contributing to rising youth unemployment (sub. 150, p. 5). The Australian Council of Trade Unions (ACTU), on the other hand, considered that some junior discounts should be removed (at least for older 'juniors') and/or that rates should be restructured to shift the emphasis from age to skills, ability and work value (sub 167, p. 138).

Level of junior pay rates

Given the current age-based structure of Federal Junior Pay Rates, one question is whether the current levels of the rates, and the rate at which they increase with age, is appropriate. Similar issues arise in relation to junior rates in awards.

As with the task of setting the level of the National Minimum Wage (chapter 8), it is something of a Goldilocks' dilemma to determine the levels of junior minimum rates that are 'just right'. In theory, optimal rates would need to balance young people's productiveness and employment prospects at particular ages against incentives for them to remain in education where appropriate, while also accounting for their material needs. Given the significant heterogeneity among young people, even of the same age, any one rate will necessarily involve some kind of rough 'average'. Moreover, information on the youth labour market, and particularly the share of young people paid near the junior pay rate, can be difficult to ascertain. Analysis of junior pay rates is also complicated by the many minimum rates prescribed in the awards for different industries and occupations.

While the Productivity Commission has not sought to form a view on the appropriateness of specific junior pay rates, it would advise caution about any changes to the current rates that might put at risk the early employment of more vulnerable people with lower skills. The transition from education to work is one of the critical pathways, and changes that affected employment of the less academically-able could have adverse generational impacts.

The appropriate age cut-off for 'junior' wages?

Against this background, the Productivity Commission does not concur with an argument, put by the ACTU, that because the community treats people as adults when they turn 18 they should be paid 'adult' rates from that time. The ACTU (sub. 167, p. 138) stated:

> Adult should be paid as adults, meaning that workers aged 18 and over should be entitled to the relevant adult rate for work they are performing, unless they are in a formal and genuine apprenticeship or traineeship arrangement that combines work with on-the-job and off-the-job accredited training.
>
> … The ACTU and affiliated unions have long held the view that the provision of junior rates for workers over the age of 18 years is unjustifiable and discriminatory, and fundamentally inconsistent with the principle of equal remuneration for work of equal or comparable value.

Although 18 year olds are considered adults at law and for many policy purposes, governments do use different age cut-offs for labour market policies: for example, the Youth Allowance provides financial support for young people looking for work up age 21 (or studying up to age 24). Moreover, given that individuals' maturation from youth into adulthood does not occur 'overnight' or at the same ages for all people, any specific age chosen to mark the start of adulthood for legal purposes will necessarily be arbitrary. In the Productivity Commission's view, it is more important to examine the practical effects of a policy on the opportunities and wellbeing of the people affected than to ensure that it aligns with an arbitrary legal benchmark.

In this respect, the key questions are whether raising the regulated minimum pay rate for 18 to 20 year olds to the full adult rate would inappropriately price some people out of jobs and into unemployment, and/or encourage some people to leave education and look for work at an unduly early age.

While not addressing the issues of incentives with respect to education, the ACTU pointed to the 2015 decision of the FWC to vary the *General Retail Industry Award 2010* to ensure that 20 year old retail employees receive the full adult rate of pay (provided that they have worked for the employer for more than six months).[81] The FWC found that there is little difference in the duties, responsibilities and required supervision for 20 or 21 year old retail employees.

What is not clear from the FWC decision is whether its findings for 20 year olds in the retail industry would apply more generally across industries; and the extent to which those findings would also apply to 18 year olds and 19 year olds. These matters are relevant to the question of whether the current structure of junior minimum pay rates based only on age is to change to take into account experience and/or competency (see below).

[81] Modern Award Review 2012 – General Retail Industry Award 2010 – Junior Rates [2014] FWCFB 1846 [21 March 2014]

Age, experience or competency?

The broader issue raised by the ACTU is on what basis discounted wages for younger workers should be offered. Its view is that 'wages should be based on skills, abilities and work value and not on the age of the worker' (sub. 167, p. 138).

The model adopted for the Retail Award combines an age and experience requirement, at least for 20 year olds. This structure has similarities to the New Zealand approach to junior wages, wherein 16-17 year olds start on 80 per cent of the adult minimum and transition to the full rate after working with an employer for six months (MBIE 2015). The United States has a similar system with a minimum wage of US$4.25 (59 per cent of the federal adult minimum) for a person aged under 20, which applies for the 90 days from when they begin working for an employer (US Department of Labor 2008). While the federal wages form the minimum conditions, individual states may choose to specify higher minimum wages, or not provide discounted wages, for young people (US Department of Labor 2015).

The current age-based model is premised primarily on the view that worker productivity generally increases with age during the years which junior rates cover, whereas the experience model is premised on the view that experience is a key determinant of worker productivity, even for the young. In the Retail Award case noted above, the FWC heard that most junior retail employees achieve a satisfactory level of proficiency after 6 months.

It is of course possible to envision a range of hybrid models that would entail elements of both age and experience criteria. For illustration, one possible model (shown in table 9.2) might start with the current structure of junior minimum rates, but add a wage premium (of, say, 20 percentage points of the adult minimum wage, with the total capped at 100 per cent of that wage) for junior workers who had accrued 6 months experience with an employer. Alternatives could entail different lengths of experience necessary before qualification for the premium, or different base rates and experience premiums, or only introducing a premium from a particular age (say, from age 18).

Table 9.2 **Hypothetical hybrid junior minimum pay scale[a]**
Percentage of Adult National Minimum Wage

Age	*No experience [a]*	*6 months or more experience [b]*
	(%)	(%)
Under 16	36.8	56.8
16	47.3	67.3
17	57.8	77.8
18	68.3	88.3
19	82.5	100
20	97.7	100

a Based on Federal Junior Pay Rates as at June 2015, set as a proportion of the Federal Adult Minimum Wage. **b**Calculated as the current ('No experience') rate plus 20 percentage points, capped at 100 per cent of the Federal Adult Minimum Wage.

It might also be possible to include education attainment or other indicators of competency in a model. For instance, awards specify higher wages for apprentices who have completed year 12 compared with those who have not (section 9.3). However, the complexity of any model should also be considered.

The Productivity Commission sees potential merit in hybrid model, and invites further views and evidence that could inform an assessment of the merits and design of different models.

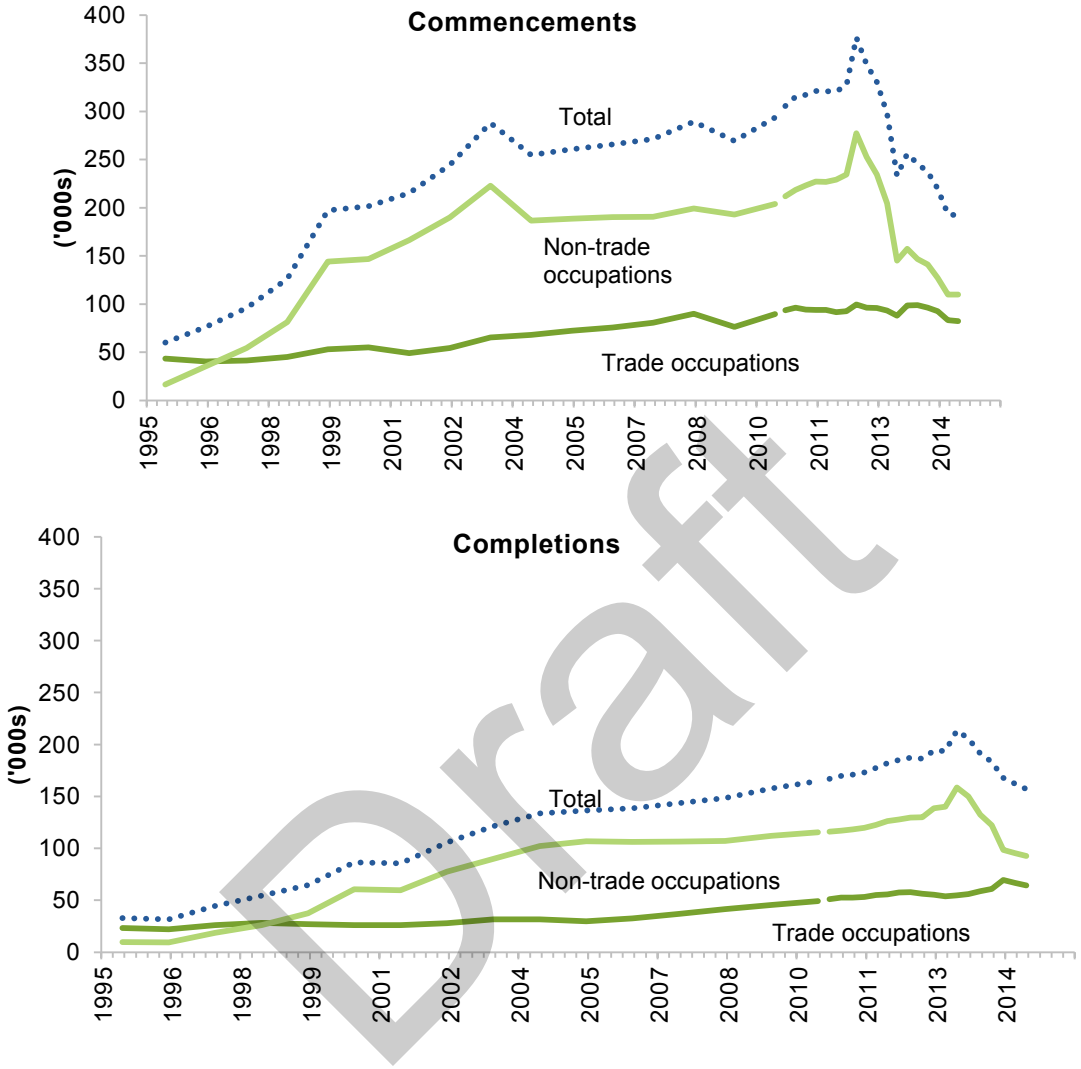
INFORMATION REQUEST

The Productivity Commission seeks information on whether the structure of junior pay rates should be based on a model other than age, such as experience or competency, or some combination of these criteria.

9.3 Arrangements for apprentices and trainees

Apprenticeships and traineeships combine on-the-job training with formal study and provide a pathway into work for many young people as well as a retraining option for older people looking to change careers. There were 316 400 apprentices and trainees in-training at the end of 2014. The numbers increased following a push commencing in the 1990s that saw many new traineeships introduced across industries and occupations as well as a large scale increase in government-provided financial incentives (Knight 2012). A 2011 *Apprenticeship for the 21st century* report said that 'effective skill formation through apprenticeships and traineeships is vital for addressing the skill needs of the economy' (McDowell et al. 2011, p. 17). However, in recent years, there have been large fluctuations in takeup, particularly for traineeships (figure 9.7).

Figure 9.7 **Apprentices and trainees since 1995**[a,b]



a Based on annual data to June from 1995, and rolling annual data from the September 2010 quarter onwards. **b** The trade series counts the number of person undertaking an apprenticeship or traineeship in a *technicians and trade* occupation, including for example, metal and vehicle, electrical, building, painting, and food occupations. 'Non-trade' covers all other occupation groups.

Sources: NCVER (2014, 2015b).

The training system, of which apprenticeships and traineeships are a component, involves a complex set of interlocking issues. The FWC recently increased apprenticeship wages and conditions, and there have been changes to the level of government support available, which will have affected the relative attractiveness of training to employers and would-be trainees and apprentices.

This section outlines these arrangements and explores some possible ramifications of some of the recent changes. In view of the complexities and uncertainties entailed, and the

importance of effective skills formation, it recommends a comprehensive review of Australia's apprenticeship and traineeship arrangements.

Apprentice and trainee wages

Apprentice and trainee wages are clearly a determinant of the number of commencements and completions. Other things equal, higher in-training wages will make starting (and continuing) training relatively more attractive than alternative options that prospective and current apprentices and trainees may face. Equally, higher wages will increase costs to employers and, subject to broader economic conditions and business confidence, may deter employers from taking on apprentices and trainees.

As detailed in box 9.6, minimum trainee wages are specified in the National Training Wage Schedule (which is attached to nearly all 102 awards that explicitly refer to traineeships (Department of Employment, sub. 158, p. 11) and increase with the number of years that a trainee is out of school. These rates are adjusted each year, in line with the National Minimum Wage.

Minimum apprentice pay rates are included in the 49 awards that refer to apprenticeships, and vary according to age and level of schooling, and increase the closer the apprentice is to completion. Award rates for apprentices increase with changes to the relevant qualified tradesperson's award rate.[82]

Apprentices and trainees may be able to negotiate higher wages with their employers or be paid higher wages if provided for in their enterprise agreement. Indeed, Oliver (2012) estimated that, in 2009, only around 20 per cent of trainees were paid award wages and around 36 per cent of apprentices were paid the award wage or close to it (up to 10 per cent more). Oliver concluded that over-award payments were common place for both trainees and apprentices.

[82] The FWC does not separately set minimum wages for award free apprentices, however it is likely that the vast majority of apprentices are covered under an award or enterprise agreement.

Box 9.6 Apprenticeships and traineeships

An apprenticeship is required for most trade occupations (for example, to become a qualified electrician) and can take 3-4 years to complete. Traineeships are more common for non-trade professions — such as sales, clerical and administrative roles — and generally take less time to complete (typically 1-2 years).

Apprentices and trainees must enter a training contract with their employer that covers matters including the study component for their qualification. This must be undertaken at a registered training organisation, such as a TAFE. The employer normally pays for this study component, which, although variable, generally takes up around 20 per cent of apprentices' and trainees' time. (School-based apprentices spend part of their time in the workplace or training centre and the remainder completing school work). For the training and qualification to be recognised, the training contract must be registered with an appropriate state or territory training authority.

Trainee wages

Minimum rates for trainees are set out in the National Training Wage Schedule, which categorises occupations into three broad groupings and specifies wages within the groups based on the highest level of schooling the trainee has attained and number of years since they left school. Despite the Schedule containing no explicit age-related criteria, the structure of trainee wages mimics the age-based structure of Federal Junior Pay Rates. Training wages are, however, higher than the equivalent junior pay rates for individuals aged under 17 years and some 17 and 18 year olds, yet lower than the equivalent pay rates for individuals over 18 (figure 9.8).

Apprentice wages

No universal wage schedule applies to apprentices as their wages are a proportion of the qualified tradesperson's wage in the relevant award, which varies between occupations. A recent FWC decision introduced changes (phased in between 2014 and 2015 specifying that for apprentices commencing on or after 1 January 2014:

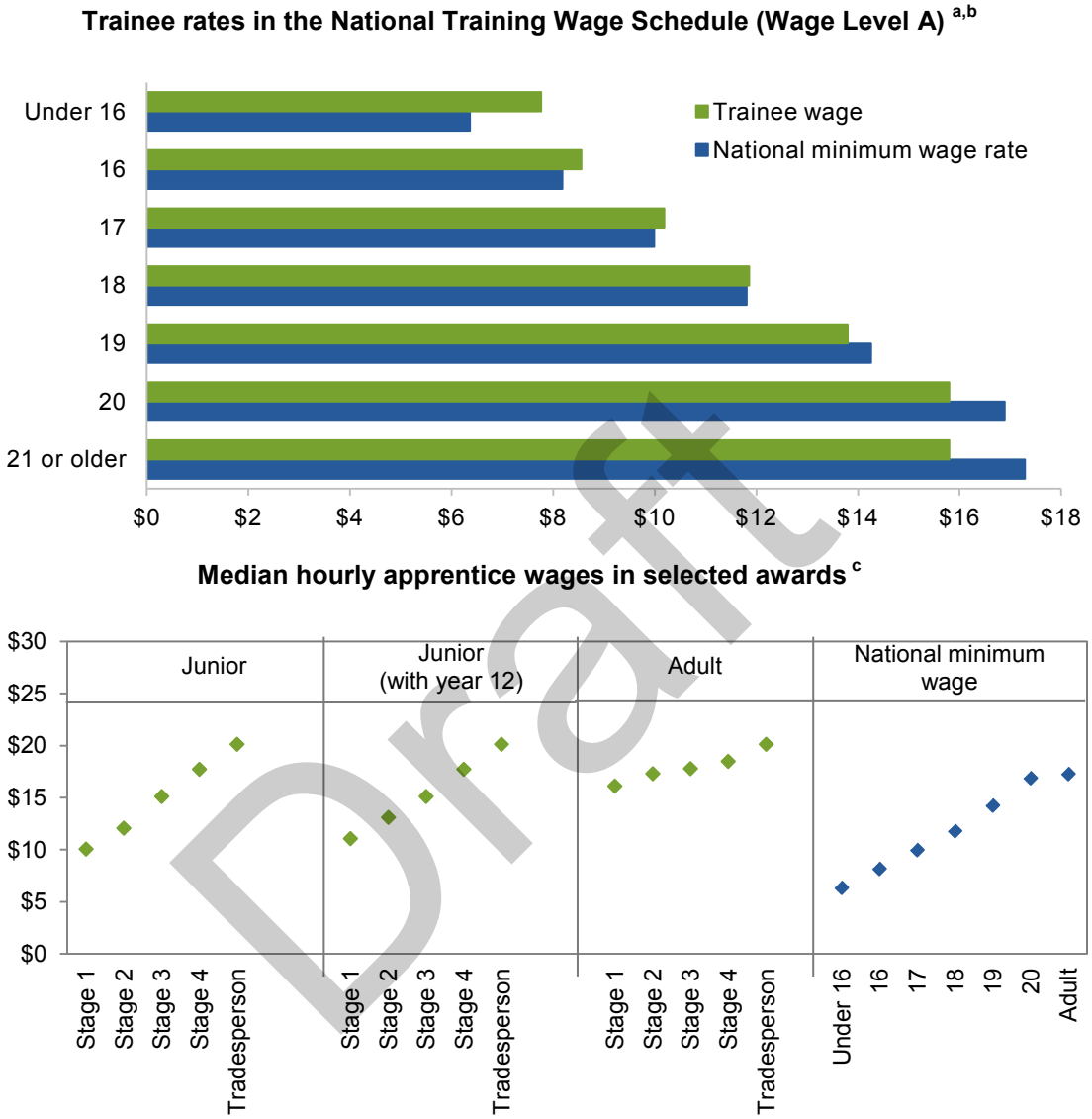
- junior apprentices (aged under 21) should be paid no less than: 50 per cent of the C10 qualified tradesperson's award rate (rising to 55 per cent for those who had completed year 12) in their first year; and 60 per cent in the second year (65 per cent for those with year 12 qualification) (see section 11.3 for a discussion of the C10 rate)
- adult apprentices should be paid no less than 80 per cent of the C10 qualified tradesperson's award wage in their first year; rising to be the higher of the national adult minimum wage or the lowest adult classification rate in the award in their second year
- adult employees commencing an apprenticeship who have worked full-time for an employer for at least six months, or for 12 months on a part-time or casual basis, will not suffer a reduction in their minimum rate of pay.

Apprentice wages increase the closer the apprentice is to completion, assessable on either a time basis (that is, after working for a defined time period) or a competency basis (that is, the apprentice achieving a defined skill level or completing a training requirement).

The bulk (68 per cent) of apprentices work under awards covering occupations in automotive and engineering, construction, and electrotechnology and telecommunication (NCVER 2015). Starting apprentice wages in these awards are slightly above the national junior pay rate for 17 year olds (figure 9.8).

Source: Modern Awards Review 2012 – Apprentices, Trainees, and Juniors [2013] FWCFB 5411 [22 August 2013].

Figure 9.8 **An illustrative comparison of hourly trainee and apprentice rates to the national minimum wage, July 2015**



a Training hourly wages account for time spent in training, approximated to be 20 per cent of total weekly working hours in the National Training Wage Schedule. **b** Hourly trainee wages are based on minimum wages in the National Training Wage Schedule for full-time AQF Certificate Level I-III traineeships categorised under Wage Level A. Wages under Wage Levels B and C are slightly lower. **c** Apprentice wages in selected awards (*Vehicle Manufacturing, Repair, Services and Retail Award, Building and Construction General On-site Award, Manufacturing and Associated Industry and Occupations, Joinery and Building Trades Award, Electrical Power Industry Award,* and *Electrical, Electronic and Communications Contracting Award*) increase by stages which depend on an apprentice's time in training and qualifications attained or competency level achieved.

Sources: Annual Wage Review 2014-15 [2015] FWC FB 3500 [2 June 2015]; Building and Construction General On-site Award 2010; Electrical, Electronic and Communications Contracting Award 2010; Electrical Power Industry Award 2010; Joinery and Building Trades Award 2010; Manufacturing and Associated Industry and Occupations 2010; Vehicle Manufacturing, Repair, Services and Retail Award 2010.

Other factors affecting commencements and completions

While apprentices and trainees wages are important, many other factors will influence the number of commencements and completions in particular periods. A range of such factors, which complicate attempts to pin-point the effects of changes in minimum training rates, is outlined below.

Relative wages and employment opportunities

As with other education and training decisions, individuals considering whether to undertake or continue with an apprenticeship or traineeship will also be influenced by their potential income in alternative employment. This will depend, in part, on prevailing economic conditions.[83] Other things equal, the lower are training wages relative to the wages in alternative employment, the less attractive undertaking and remaining in training will be. (As noted earlier, trainee wages are set lower than the equivalent minimum pay rates for individuals over 18 (figure 9.8)).

Even if training wages are relatively low, however, individuals may still undertake an apprenticeship or traineeship if the investment in their skills is likely to deliver a payoff in terms of higher future earnings. Wage premiums provide a signal to individuals about the type of skills valued in the labour market. Karmel and Mlotkowski (2011) found that the wage premium earned when finishing training in trade-related occupations is a significant factor in whether a person completes their training. However, wages in alternative employment was found to matter more than the wage premium on completion to trainees' decisions to withdraw or complete their training.[84]

On the other hand, the level and structure of training wages (as well as any offsetting government incentives) will arguably bear much more weight in employers' decisions about whether to take on an apprentice or trainee than the future benefits to the employer.

[83] Apprenticeship and traineeship commencements may decline during a downturn as employers may be unable to afford taking on as many apprentices or trainees. At the same time, completions may rise as more apprentices and trainees continue their training due to fewer alternative job prospects. During the 2009 Global Financial Crisis total apprentice and trainee commencements for the year to June 2009 fell by 7 per cent compared with the previous year, while completions rose by 6 per cent.

[84] Comparing the wages of apprentices and trainees nine months after completing their training to the wages of those that had dropped out and found 'alternative employment', Karmel and Rice (2011) found that 90 per cent of apprentices and trainees in trade occupations had a wage benefit from undertaking their training while only around half of males and two-thirds of females in non-trade occupations had an expected wage benefit. These results should be interpreted with some caution as they do not take into account the cumulative difference in wages over an individual's lifetime or the differences in employment rates between the two groups.

Government incentives

Governments provide an array of financial incentives for apprenticeships or traineeships, both to employers and individuals. There are various state and territory government subsidies and a myriad of Australian Government financial incentives and income support payments (table 9.3). For some individuals, such support supplements their wages, making undertaking apprenticeships or traineeships more attractive. Financial incentives paid directly to employers, by offsetting some of the cost of taking on an apprentice or trainee, are also intended to help prevent skill shortages by increasing the number of employers offering training positions.

There have been some major changes in Australian Government incentive payments over time, with evidence suggesting mixed impacts depending on the specifics of the incentive. For instance, the 2012 expert panel on *Apprenticeship for the 21st century* concluded that payments to employers have only a marginal effect on hiring decisions (McDowell et al. 2011). Deloitte Access Economics (2012), however, found that government employer incentives of greater than $1000 in the first year of an apprenticeship or traineeship had a significant positive impact on commencements. For apprentices and trainees, Deloitte Access Economics also found that the Living Away From Home Allowance and the Commonwealth Trade Scholarships lifted completion rates for apprentices and trainees.

At the aggregate level, past changes in government incentive payments do seem to have played out in apprentice and trainee commencements and completions:

- Participation in apprenticeships and traineeships increased substantially in the 1990s coinciding with the large scale increase in government employer incentive payments in the mid-1990s. Knight (2012, p. 5) notes that this had ' … a spectacular impact on traineeship numbers but much less effect on trades apprenticeships'
- Changes to a number of government financial incentives in 2012 and 2013 — including the removal of employer standard commencement, recommencement and completion incentive payments for existing workers in training not on the Department of Education's National Skills Needs List (NSNL) — appear to have contributed to a marked decline in the number of commencements in non-trade occupations from mid-2012 (figure 9.6).[85]

The past year (from July 2014 to July 2015) has seen further significant changes to the *Australian Apprenticeship Incentives Programme* — including the removal of Tools For Your Trade payments, the apprentice component of Support for Adult Australian Apprentices, and the introduction of Trade Support Loans. However, any impact these changes may have on the aggregate level of participation in apprentices and traineeships is not yet evident.

[85] The removal of some government commencement incentives as part of the 2012-13 Budget was announced in May 2012. The earlier announcement seems likely to have contributed to the sharp increase in non-trade commencements in the June 2012 quarter.

Table 9.3 **Selected Australian Apprenticeship Incentives, 1 July 2015** [a]

	Certificate II	*Certificate III or IV*	*Diploma or Advance Diploma*
Commencement incentive, specified apprentices [b]	$1250 (only 'new workers' in *Nominated Equity Groups*)	$1500	$1500 (only 'new workers' in priority occupations)
Recommencement incentive, specified apprentices [b]	na	$750	$750 (only 'new workers' in priority occupations)
Completion incentive, specified apprentices [b]	$1000 (only Group Training Organisations that support *Nominated Equity Groups*)	$1500 to $3000	$2500 to $3000 (only priority occupations)
Australian School-based Apprenticeships Incentives (Cert II and above)	$750 on commencement & $750 on retention (at least 12 weeks after the student completes school)		
Support for Adult Australian Apprentices (aged 25 years or older) for National Skills Needs List (NSNL) apprentices, where the actual wage paid is equal to or greater than the National Minimum Wage. Paid to employer.	na	$4000 (once 1 year of training completed)	na
Mature Aged Workers incentives for employers that support a disadvantaged person 45 years or older (Cert II and above)	$750 on commencement & $750 on completion		
Disabled Australian Apprentice Wage Support,	$104.30/week (full-time)		
Living Away From Home Allowance (Cert II and above)	First year — $77.17/week; Second year — $38.59/week; Third year — $25.00/week		
Trade Support Loans for NSNL & Agriculture and Horticulture occupations (Cert II to Cert IV). Loans are reduced by 20% for successful completion of the apprenticeship; and are repayable through the tax system once minimum income threshold reached ($53 345 in 2014-15).	First year — $666.67/month (up to $8000) Second year — $500.00/month (up to $6000) Third year — $333.34/month (up to $4000) Fourth year — $166.67/month (up to $2000)		na

a Apprentices and trainees may also be eligible to access fortnightly government income support payments including Youth Allowance, Austudy, and ABSTUDY. **b** Incentives are available to: full-time and school-based apprentices, and in some cases part-time apprentices; *new and existing workers* in National Skills Needs List (NSNL) apprenticeships, and *new workers* in non-NSNL priority occupations (aged care, childcare, disability care worker and enrolled nursing) and non-NSNL non-priority occupations. An *existing worker* is one that has worked for the employer for at least 3 months on a full-time basis, or for 12 months as a part time or casual basis (including seasonal and contract work).

Sources: Australian Apprenticeships (2015a, 2015b, 2015c).

Impacts of recent changes to apprentice wages?

To attract more people into apprenticeships, halt falling completion rates and better support older apprentices' living costs, from January 2014 the FWC increased minimum (or base) apprentice pay rates for juniors, in their first two years of an apprenticeship, and for adults (box 9.6). However, several industry bodies have argued that these changes have reduced the willingness of employers to take on apprentices which, if correct, could reduce opportunities for some prospective apprentices and undermine government policy objectives in the skills formation area.

Higher minimum training rates for first and second year apprentices

Citing the decline in commencements of apprentices and trainees since September 2013, the Australian Chamber of Commerce and Industry (sub. 161) contended that the increases to wages for first and second year apprentices from 2014 onwards contributed to a decline in employers' willingness to hire apprentices. The Chamber of Commerce and Industry Queensland (sub. 150) pointed to the results of the survey in which 38 per cent of Queensland small business respondents indicated that they had hired fewer apprentices/trainees as a result of the Fair Work Act and modern awards. While the relevant survey question did not refer specifically to the change in apprenticeship wages, the CCIQ argued that:

> … the Fair Work laws are also affecting business hiring intentions, particularly with respect to the loading up of 1st and 2nd year apprentice rates. (sub. 150, p. 11)

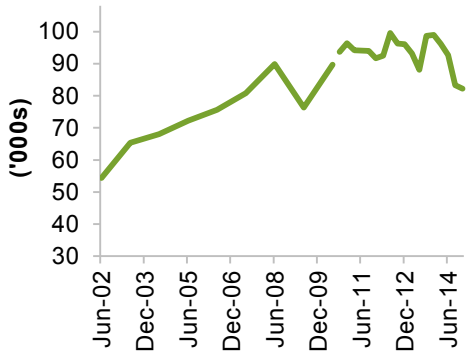
As alluded to above, assessing how the FWC changes to minimum wage settings has affected the number of apprentices is complicated. Higher minimum training wages, *to the extent that they are binding*, will generally encourage more people to undertake apprenticeships, but wages that are too high will deter employers from hiring new apprentices. Meanwhile, many other factors can influence apprenticeship decisions. Further, the FWC's changes to apprentice wages were phased in over two years, with the most recent increase only taking play in January 2015, and there may be anticipatory or lagged effects to account for.

Somewhat dated evidence suggests that around one third of apprentices (and two fifths of junior apprentices) are paid the award rate or close to it (up to 10 per cent more) (Oliver 2012). To the extent that a large minority of apprentices were still paid at or close to award rates just prior to the increase in award wages, it would be expected that some employers would have been less willing to hire apprentices due to the award wage increase. However, without more contemporary evidence, the extent to which the minimum apprentice rates bind is not clear.

The data on commencements after the first stage of the increase to apprentice wages — when youth first and second year apprentice wages were increased by at most 5 per cent

and adult apprentice wages were introduced into a number of awards — shows a decline in the number of people in trade-related training (mostly apprenticeships) of nearly 17 per cent (or around 16 000 individuals) between the years to December 2013 and December 2014 (figure 9.9). This decline appears consistent with the increase in apprentice wages having reduced employer demand for apprentices.

Figure 9.9 **Commencements in trade occupations**[a]



[a] Based on figure 9.7

Source: NCVER (2014, 2015b).

However, commencements in training in non-trade occupations also declined markedly over the same period (falling by around 25 per cent), implying that other factors were contributing to the fall in the number of apprentices and trainees during 2014. For instance, recent changes to financial incentives, such as the removal of completion payments in August 2013 for employers of apprentices and trainees in a number of occupations, may also explain some of the recent fall in apprentice and trainee commencements. The CCIQ acknowledged that other factors, including the removal of employer incentives, would have impacted on decisions to employ apprentices.[86]

Higher training wages and 'no loss of pay' for adult apprentices

In 2013, the FWC decided to introduce higher minimum pay rates for adult apprentices (21 years and over) in all awards that include apprentice rates of pay (box 9.6). It also introduced a 'no loss of pay' requirement for existing adult employees commencing an apprenticeship.[87] Unlike hiring a new apprentice, the requirement limits employers' ability to adjust wages for the additional cost of on-the-job training particularly in the first two years of the apprenticeship, and time spent in off-the-job training.[88] These changes were made largely in response to a substantial increase in the number and share of mature aged

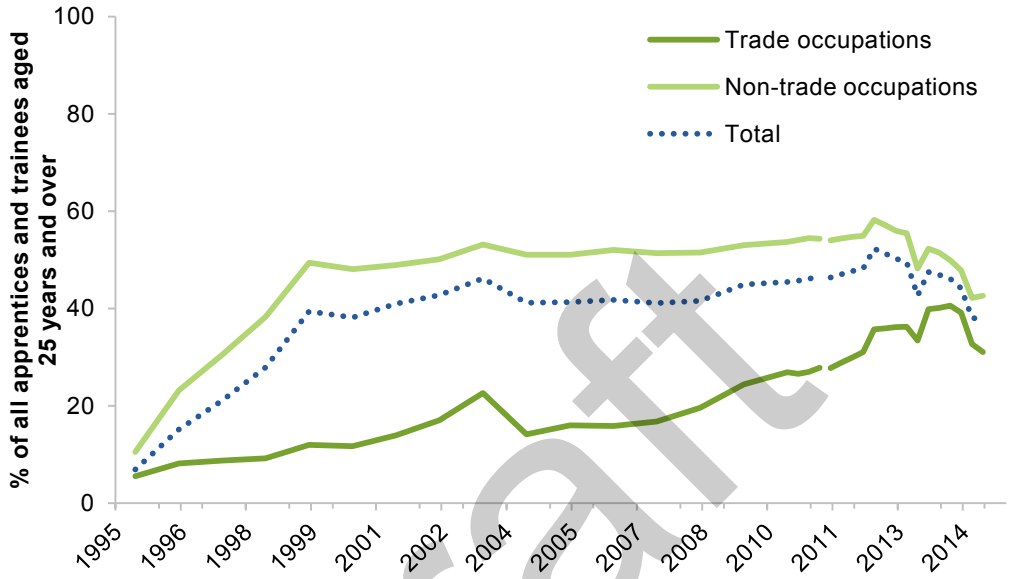
[86] The February 2015 Workplace Relations Survey discussed by the CCIQ also showed that apprentice and trainee wages were the item least mentioned as being of moderate, major or critical concern by the surveyed businesses, although the survey's broader focus meant that it did not also ask about changes to financial incentives for apprenticeships, which would have enabled comparison of these two potential sources of concern (sub 150, p. 7).

[87] Prior to the 2013 FWC decision, the *no loss of pay* condition for existing employees was already included in a number of relevant awards. For example, the condition has been in the Manufacturing and Vehicle Award for over 20 years (FWC 2013b).

[88] The difference in the 'minimum' wage between new and existing workers is compounded by government employer incentive payments, which for some occupation only apply to new workers. This is because employers are not eligible to receive government commencement and recommencement and completion payments when taking on existing workers as apprentices, for those apprenticeships not included on the National Skills Needs List (NSNL) or in a specified priority occupation (table 9.3).

individuals undertaking apprenticeships and traineeships (figure 9.10) and concerns over the higher living costs of adult apprentices.

Figure 9.10 **Changing shares of mature aged apprentices and trainees[a b]**
Commencements



[a] Based on annual data to June from 1995, and rolling annual data from the September 2010 quarter onwards. [b] The 'trade' series counts the number of person undertaking an apprenticeship or traineeship in a *technicians and trade* occupation, including for example, metal and vehicle, electrical, building, painting, and food occupations. 'Non-trade' covers all other occupation groups.

Sources: NCVER (2014, 2015a, 2015b).

By increasing the (minimum) cost of taking on adults and existing workers, the changes could discourage employers from offering these workers apprenticeships. Figure 9.7 shows that there is now a sizable wedge between the minimum wage for employing and training an adult compared to a junior apprentice in the early stages of an apprenticeship. At the time of the FWC decision, employer organisations submitted to the FWC that apprentice wages are training wages and that both junior and adult apprentices spend a considerable amount of time off-the-job and not in productive work (FWC 2013b).

However, the FWC anticipated that the introduction of adult apprentice rates 'is not likely have a significant negative effect on business costs having regard to the incidence of over-award payments, the likelihood that adult apprentices will be more productive, and the relative proportion of the workforce constituted by such employees' (FWC 2013b, p. 59).

At an aggregate level, in the year from December 2013, the number of adults (20 years and over) commencing training in trade occupations declined by 25 per cent (roughly 14 000 individuals). This was primarily due to a decline in matured aged commencements (aged

25 years or older). This is notwithstanding the possibility that a relatively high proportion of adult apprentices were being paid above award rates prior to the 2014, and that there was simultaneously an increase in award pay rates for junior apprentices.[89] Without more complete information on apprentice wages and commencements and deeper analysis that controls for changes in other relevant factors, it is not possible to determine the actual impact of the changes to adult apprentice wages.

Policy complementarity

Whatever the actual outcomes of the recent changes, both to minimum apprentice wages and to government incentives, the foregoing discussion points to the desirability of coordinating wages policy and the other arms of government policy that bear on the apprenticeships and traineeships. Ensuring that apprentices have access to an adequate or 'living' income, particularly in the early stages of the apprenticeship and for those financially supporting a household, is a concern to apprentices, employers and policymakers alike. So is the need for employers to be able to afford to provide apprenticeship and training opportunities.

In Australia, minimum training wage settings as well as targeted government income support and apprenticeship incentive payments together determine the income level of apprentices and trainees. Eligible apprentices and trainees can access a number of support payments, such as Youth Allowance, Austudy and the Living Away From Home Allowance. Several government wage top-up payments have also targeted participation of older individuals in apprenticeships. Until July 2015, full time apprentices aged 25 years and over undertaking an apprenticeship on the National Skills Needs List were able to access the Support for Adult Australian Apprentices of $150 per week in the first year of their apprenticeship and $100 per week in their second year. More recently income-contingent Trade Support Loans have been introduced to support individuals training in a number of occupations (table 9.3).

In view of these support payments, the case for using minimum training pay rates to provide a higher 'living' wage for adult (over junior) apprentices is not clear. A counterview is that that training wages should reflect the investment in on-the-job and off-the-job training provided and/or paid for by employers. Also relevant is the evidence that:

- for trade occupations, it is the higher future earning (or the premium) attached to becoming a qualified tradesperson rather than the training wage that is a significant factor to completion (Karmel and Mlotkowski 2011)

[89] Oliver (2012) estimated that 81 per cent of adult apprentices in 2009 were paid greater than 110 per cent of the relevant award wage; and around 42 per cent were paid greater than 150 per cent. In comparison, 58 per cent of junior apprentices were paid greater than 110 per cent of the relevant award wage; and around 30 per cent were paid greater than 150 per cent.

- adult and existing workers are likely to have relevant skills, knowledge and experience that may improve their productivity relative to other apprentices (FWC 2013b).[90] An effective system of competency-based pay progression can facilitate the recognition of relevant skills and experience on an individual basis.[91]

This raises the question as to whether targeted wage top-ups — including the newly introduced income-contingent Trade Support Loans — may be a fairer and more effective mechanism for delivering a living income to eligible apprentices.

The need for a review

The traineeship and apprenticeship system has been affected by a number of recent reforms, to the level and structure of training wage rates and to government incentive payments. These changes have occurred in a somewhat piecemeal fashion. Elements in play include the introduction of adult apprentice award rates, competency-based pay progression, as well as a move away from wage top-ups for apprentices aged 25 years and over towards a system of income contingent government loans. These changes will have as yet unknown net impacts on the attractiveness of apprenticeships to would-be apprentices and employers.

There are other concerns about the training system that intersect with apprenticeships and traineeships. For example, a recent review of school-based Trade Training Centres highlighted concerns of some employer and industry groups that existing competency-based pay arrangements, by requiring school-based VET students holding a Certificate II to be paid as a second year apprentice on commencement, present a barrier to such students gaining employment as an apprentice after graduating (Scott 2014). This suggests that an effective competency-based pay system that supports school-based pathways must strike a balance between recognising the qualification and level of workplace experience that students gain while at school with the perceived value of these skills to employers.[92]

Given the multiple, interlocking factors affecting the supply and demand of apprentices and trainees, the Productivity Commission (2014b) recommended in its inquiry into Public

[90] Indeed, a 2011 survey of Employers of Apprentices undertaken by the Department of Employment found that employers held a more positive view — in terms of apprentices' attitude to work, consistency and reliability, and maturity — of adult compared to teenage apprentices (DoE 2013, p. 126).

[91] The FWC (2013b), in its decision to introduce competency-based wage progression into several modern awards, acknowledged that one of the benefits of competency-based pay progression was reduced completion times for mature individuals already working in the industry.

[92] In September 2014 Skills Tasmania and the Tasmanian Training Agreements Committee introduced a credit system for new apprentices in the building industry in Tasmania (Housing Industry Association sub. 169). Under this system, those entering an apprenticeship with a Certificate II are given six months credit towards their Certificate III qualification. Therefore, school graduates with a building-related Certificate II are now required to complete six months on the job work experience before progressing to a second year apprentice wages level in Tasmania.

Infrastructure that there be a comprehensive review of Australia's apprenticeship and traineeship arrangements. The need for a review remains. The review should assess the appropriate structure of junior and adult training wages, the interaction with the tax and transfer system, and the appropriate design and level of government incentives. It should also consider the ability of competency-based pay progression arrangements to take account the value of the skills of existing workers and school-based VET students. The review may benefit from using longitudinal administrative data on Australian apprentices and trainees, among other analytical and research options.

DRAFT RECOMMENDATION 9.2

The Australian Government should commission a comprehensive review into Australia's apprenticeship and traineeship arrangements. The review should include, but not be limited to, an assessment of:

- the role of the current system within the broader set of arrangements for skill formation
- the structure of awards for apprentices and trainees, including junior and adult training wages and the adoption of competency-based pay progression
- the factors that affect the supply and demand for apprenticeships and traineeships, including the appropriate design and level of government, employer and employee incentives.

10 Measures to complement minimum wages

Key points

- Given the risks to employment and limited 'targeting' of minimum wages, several economists have pointed to complementary measures that could mitigate the risks while improving living standards for those on low incomes.
- Earned Income Tax Credits supplement the incomes people obtain for work and could be introduced as part of a wage-tax tradeoff.
  - EITCs are widely used overseas. They have the potential to improve work incentives and/or to be targeted to low income working households or individuals. However, they may adversely affect the labour supply of certain types of employees, sometimes come at a high fiscal cost, and can involve other limitations.
  - The effects of an EITC scheme depend greatly on its design, implementation and interface with the tax and transfer system more generally. Design differences can materially alter the impacts on equity, work incentives and the budget. Those design issues (and the constitutional standing of the measure) would need investigation before any trial of an EITC in Australia.
  - The Productivity Commission is modelling some EITC designs to help inform longer-term consideration of the benefits and costs.
- Wage subsidies, social security payments and other measures could also be used to relieve pressures on minimum wages while safeguarding the living standards of the low paid. These options have their own advantages and disadvantages. The Productivity Commission has not recommended their (further) adoption, but governments could reassess their relative net benefits as needs be in the future (including if unemployment should worsen significantly).

Regulated minimum wages have long been seen as a means of promoting a more equitable distribution of income, helping to limit the gap between the high income earners and those Australians in low-paid employment. The Productivity Commission's modelling in chapter 8 shows that, among working households, minimum wage increases benefit those in lower quintiles the most. Similarly, chapter 11 concludes that the awards system has helped to compress wage dispersion in Australia.

However, the analysis in chapter 8 also shows that minimum wages do not target poverty or equity directly and, moreover, have the potential to cause unemployment and underemployment. Chapter 8 reveals that many people in the lowest quintiles do not have jobs or work for relatively few hours, while many people on the minimum wage in fact live

in higher quintile households. This suggests that attempts to improve the outcomes for those households with the lowest incomes through minimum wages may not be particularly efficient or effective. The OECD (2009, p. 168), in a review of measures to lift the living standards of the working poor in advanced countries, has argued that the minimum wage by itself:

> … has a limited effectiveness in fighting in-work poverty as it is not well targeted. In particular, it does not offer much support to the large majority of the working poor who cannot find a full-time job, and is not well suited to address other important factors underlying poverty risk, such as specific family situations. (p. 168)

And Leigh (2007) has shown that minimum wage increases may even widen earnings and income inequality, depending on the nature and extent of the disemployment effects.

This raises the question of whether there are other measures that could address relevant equity issues more effectively and/or without the same risks to employment as increases in the minimum wage. Governments already have in place various dedicated mechanisms, most notably the progressive taxation and social security system, which are intended to directly address equity issues. In principle, adjustments to tax rates and thresholds or existing rates of social security payment could help redistribute incomes further towards the low paid, albeit potentially at some fiscal cost. Australia's income taxation and social security system has the advantage of being highly targeted, but this is not without its own limitations. The withdrawal of benefits often involves steep tapers, which create high effective marginal tax rates which in turn can discourage employment. There is also some evidence that recipients of some forms of welfare can feel stigmatised by them, and welfare provisions are amenable to significant change. These observations raise the question of whether there might be other, more innovative measures that could better achieve relevant redistributive goals.

Additionally, it is important that policy makers in considering any future increases in the minimum wage, and the associated risks of disemployment, have an understanding of the effectiveness of policy measures governments can use to address employment issues.

This chapter therefore examines the merits a range of policies that can either augment the minimum wage to enhance the living standards of people on low incomes and/or address employment and employability issues. They include the use of earned income tax credits (EITCs), as recently canvassed by some Australian economists (section 10.1), and wage subsidies, in-work social security benefits and other welfare measures (section 10.2).

10.1 Earned income tax credits

The debate in Australia

An EITC offers a credit for people who pay no tax on their labour income so their after-tax income exceeds their wage level. As such, it supplements the incomes people obtain for work, and in practice is often used help working families, in particular, on low incomes.

The case for EITCs in the Australian context often starts with the limitations of minimum wage regulation as a means of delivering equitable outcomes, mentioned above.

Concerns that minimum wages do not directly target poverty and equity and may cause disemployment have led several economists to advocate EITCs or other policies that could, as Bray (2013, p. 88) puts it, 'relieve the burden on the minimum wage as an instrument to achieve improved living standards for those on low incomes'. In theory, an EITC could be used either in place of the minimum wage or as a complement to a lower minimum wage, although most debate has been about the latter approach (box 10.1). For example, the original 'five economists' plan for greater employment (Dawkins 2002) included a 'wage-tax tradeoff' proposal in which the nominal value of the minimum wage would be frozen for four years, thereby allowing its real value to fall, with workers in low income households being compensated by means of an EITC. The issue of an EITC was canvased by the original McClure Review[93] and also some submissions to the Henry Tax Review (Henry et al. 2008, p. 101). The Henry Review itself suggested that it could be used in certain circumstances, although it did not recommend its adoption (Henry et al. 2009, p. 527). Four of the five original proponents for its adoption in Australia have called again for its consideration (Potter 2014).

The Productivity Commission therefore canvassed EITCs in its Issues Papers and sought input. Notably, both the ACTU and Jobs Australia recognised that in principle an EITC could be useful to enhance the living standards of the low paid in Australia (although both raised notes of caution, particularly about the likely cost of EITCs). Other participants also pointed to the fiscal costs, along with other aspects that led them to oppose the idea of an EITC (box 10.2). It is not clear, however, that these same concerns would apply for all possible designs an EITC could take (see below).

It should be noted that it would of course be open to governments in Australia to use an EITC as a tool to do more than just compensate low income earners as part of a minimum wage-tax credit tradeoff. Depending on the weight society gives to income equality and the relative wellbeing of the low paid, the EITC could be made more generous. Indeed, there

[93] Although the most recent McClure report (Commonwealth of Australia 2015a) emphasised the importance of employment for people currently on benefits, its scope did not expand to consideration of an EITC.

Box 10.1 EITCs and the minimum wage: complements or substitutes?

While in theory it would be feasible to use an EITC (appropriately designed) in place of minimum wage regulation, the economic literature does not recommend this path. Rather, as Bray (2013, p. 91) states:

> [T]his literature suggests that there is a strong case for using both in work benefits such as an earned income tax credit in association with a binding minimum wage. Such a combination of instruments can allow increases in disposable income to be achieved by low earning households without putting pressure on labour demand, and permits a degree of targeting of these gains to low income households, rather than to all low earning rate individuals.

Similarly, the has OECD (2009, p. 165) found that:

> Fighting in-work poverty requires implementing targeted policy responses. In this respect, social transfers play a key role, precisely because they can be targeted towards the most vulnerable households … Among these transfers, in-work benefit schemes can be particularly effective, if they are well conceived and combined with a binding minimum wage set — by law or collective agreements — to a moderate level.

No advanced country has sought to replace its minimum wages with an EITC; rather the measures are seen as complementary. Notably, the OECD has recommended that as the Great Recession recedes, the United States should expand its EITC *and* raise its minimum wage, indicating that hybrid policies are seen as appropriate (OECD 2014b, p. 29). In Australia, the 'five economists' plan also involves retaining the minimum wage but topping it up with an EITC.

For these reasons, and because the Productivity Commission considers that there are valid economic grounds to justify retention of minimum wages to address bargaining power imbalances and other market distortions (chapter 8), it has also considered the case for EITCs only as a complement to the minimum wage.

may be a case for an EITC (or a more generous EITC) independent of any changes to the minimum wage. Depending on its design, an EITC might alternatively be used to complement (or to some extent take the place of) existing family assistance measures. It has also been suggested that an EITC could be used to provide compensation for an increase in the GST, were one to be implemented (although by itself it does not seem especially suited to that role).

For this draft report, the Productivity Commission has not attempted to specify the 'optimum' design of an EITC for Australia, although in the first instance it has explored whether an EITC might be warranted essentially as a means of maintaining the real net incomes of low paid workers while encouraging greater employment though slower growth in the minimum wage.

The following discussion canvasses some of the in-principle strengths and weaknesses of EITCs for supplementing minimum wages. The Productivity Commission is also undertaking analysis of some different types of EITCs, using the microsimulation model with which it examined the effects of a change in minimum wages in chapter 8. That analysis will examine the five economists plan, albeit modified to reflect changes in tax and welfare arrangements since then, but also some alternative designs including some based on individual incomes, to illuminate some of the costs, benefits and design issues

entailed. A technical supplement with this modelling will be released in September, and further feedback invited.

Box 10.2 Participants' views on an EITC

A small number of participants commented on the merits of an earned income tax credit, with a common thread being concern about the fiscal costs of such a scheme.

The ACTU said that such policies can help to boost living standards, but that they should be seen as complements to minimum wages, rather than substitutes (sub. 167, p. 129). It said that the first priority should be to ensure that the minimum wage setting framework gives better effect to the distributional purposes of the industrial relations system, and that:

> … It is only once that objective has been fulfilled that one can have some confidence that intended beneficiaries of the in work benefit will experience a net gain in their living standards. Furthermore, and at a more practical level, even without doing the sums it is readily apparent that the costs of implementing an EITC or other in work benefit would be substantial. This factor alone is sufficient to make it unappealing to government based on its present policy positions concerning the budget.

Jobs Australia (sub. 221) said that it also supports investigating how an in-work benefit might work in the Australian context, but that it could be expected to be a very large expense to the Federal Budget and many other policy settings in the tax and transfers system would need to be adjusted to accommodate it.

In opposing an EITC, the Queensland Council of Unions (sub. 73, p. 21) said that 'employers do and should have an obligation to pay a fair wage; this responsibility should not be handed to taxpayers.' Similarly, NSW Young Lawyers (sub. 198) commented:

> It should not be the role of the tax payer to support people who already have a fulltime job or have a part-time job but simply choose not to work as many hours as they could. Both the employer, through paying adequate wages to meet the costs of the worker living in a civilised society while allowing frugal comfort, and the worker, through bringing a committed attitude to the quality of their work including the improvement of skills, should come together on this point to alleviate the welfare system.

The National Federation of Australian Women (sub. 154, p. 9) also opposed introduction of an EITC, contending that:

- It is a costly option. If the minimum wage falls in real terms, it amounts to a wage subsidy for employers and draws a larger percentage of the population into the welfare system.
- EITCs could reduce work incentives in income ranges where the payment is phased out.
- EITCs don't address negative impacts on secondary earners because they are based on family income rather than personal income.
- EITCs can discourage upward mobility.

ACOSS (sub. 165, p. 4) raised questions about how an EITC in the Australian context would work with other elements of Australia's social security system:

> An earned income tax credit or some other form of 'in work payment' that extends to all minimum wage earners would be a costly option, especially if minimum wages fall in real terms and much of this low-wage subsidy is captured by employers. This has been the outcome over many years in the US …
>
> In countries like Australia and Britain which – unlike the United States – have comprehensive social security systems, it is inefficient and complex to add tax credits for low paid workers to the existing social security and family payment systems. Indeed, due to these inefficiencies, and to strengthen work incentives for unemployed people entering part time jobs, the British Government is replacing its existing Working Credit with a 'Universal Credit' which is a broadly based income support payment paid through the social security system.

The prospective benefits of a minimum wage-tax credit tradeoff

The promise of wage-tax tradeoffs involving freezing, or reducing the rate of growth of, the minimum wage coupled with a top-up from an EITC is fourfold.

- Reducing the growth of the minimum wage would reduce the cost of employing labour and could lead to greater employment. This could benefit people who would otherwise remain unemployed or underemployed, as well as overall economic activity.
- The EITC would compensate people in work who would otherwise receive lower wages due to there being a lower growth in the minimum wage. In principle, these workers could be left in the same (or better) financial position as before the reduction in the growth of the minimum wage. Alternatively, the benefits provided through the EITC could be targeted to those in low income households only, or to other subsets of the low paid, thereby reducing the upfront fiscal costs entailed and/or potentially better targeting the moneys to the most needy).
- The risk that lower growth in the minimum wage would cause some people to leave the labour force (because the minimum wage would be less than their reservation wage) could also be nullified by a tax credit tied to working that returned them to the equivalent financial position.
- While the EITC would have fiscal costs, the expansion in employment and economic activity brought about by the slower growth in the minimum wage could mitigate those costs. This would reflect reductions in the total quantum of unemployment benefits and related welfare expenditures, and increases in the broader tax collections associated with economic expansion.

Importantly, some of these benefits depend on the assumption that higher minimum wages do cause disemployment. As discussed in chapter 8, there is some uncertainty on this matter although the Productivity Commission's preliminary assessment is that significant increases in minimum wages in Australia will tend to come at some cost to employment.

Many countries have found an EITC scheme to be an effective instrument to achieve some social welfare objectives which in Australia appear to be left to the wage-setting system. EITCs were used in 17 OECD countries in 2010, including the United States, United Kingdom (now as part of Universal Credit), Ireland, France, Denmark, and the Netherlands (OECD 2011, p. 68). Australia has its own (modest) Low Income Tax Offset (box 10.3) but the assistance it provides is not work-contingent and thus it does not qualify as an EITC.

Box 10.3 Australia's low income tax offset

The LITO was introduced in 1993 and initially offered a maximum non-refundable tax offset of $150. It was increased several times in the 2000s and, by 2010, provided a benefit of up to $1500 for people earning less than $30 000 per year.

Following recent changes, the maximum value of the LITO is currently $445 per annum, which is available for incomes up to $37 000. The value declines at a rate of 1.5 cents for every additional dollar earned, cutting out completely for incomes above $66 667.The Tax Office automatically calculates the entitlement when processing tax assessments. There are some exceptions, including where taxpayers want upfront deductions from their PAYG instalments.

Qualification for LITO depends purely on individual income however it is earned: there is no work test. Nor does LITO affect eligibility for other government payments or offsets.

Some design issues

The incentives and equity effects created by any particular EITC will depend on its configuration and the circumstances of the nation in which it is applied. EITCs can vary in terms of the generosity of credits, income cut-offs and taper rates, eligibility criteria, methods for payment, and how they interface with other parts of the tax-transfer system (OECD 2011, pp. 67–90).

A detailed EITC proposal was developed in conjunction with the 'five economists plan'. There have been significant changes to Australia's tax and welfare system since then, with the tax system now much more targeted towards social policy objectives through changes to Family Tax Benefits and the provision of paid parental leave and other modifications (including a substantial lift in the tax-free threshold). More changes have been mooted following the McClure Committee's report (Commonwealth of Australia 2015a). Accordingly, the five economists plan would require modification to suit Australia today.

Another possible model would be similar in some respects to the original LITO (box 10.3), but augmented inter alia by some form of work test. A key difference between LITO and the EITC recommended by the five economists is that the LITO is based on individual income; not on household income. (As discussed in box 10.4, there is some debate over which basis is the more equitable.)

Were the government to decide to implement a new EITC in conjunction with changes to the minimum wage, it would need to decide on an appropriate model, including whether it would be based on individual or household income, and then fine tune the details. The design would need to take into account not just other aspects of the current tax and welfare system, but also proposals emanating from other reviews, including the recently completed McClure review and the current taxation review.

Box 10.4 The basis for EITC payments: individual or household income?

In designing EITCs to supplement the incomes of low paid workers, a threshold issue is whether they should be based on individual or household incomes.

Basing EITCs on household income is often seen as advantageous because many low income earners in fact live in higher income households (chapter 8). Excluding those workers from EITC reduces the fiscal costs of a scheme and/or allows higher EITC payments for low income workers who live in low income households. Some also see it as more equitable than providing benefits on the basis of individual incomes, partly because it is sometimes assumed that a household with two low income earners would enjoy the same standard of living as a single income household on the same total income, yet that single (high) income earner would not receive a tax credit (and, indeed, would pay more income tax as they would be in a higher personal tax bracket).

However, Apps (2002) strongly challenges the basis for this view. She contends that it is well established that the assumption that living standards comparisons can be made on the basis of household income is a fallacy, stating:

> Family living standards and household income (with or without an equivalence scale of adjustment) are poorly correlated, particularly in the case of two-parent families.
>
> One of the most important reasons for this is that parents with the same number of children, in the same phase of the life cycle and with the same wage rates and non-labour incomes, make very different choices regarding the way in which they provide for their children. In some families one parent works in the market place while the other specialises in providing child care and domestics services at home. In other families, both parents work in the market place and buy-in child care and related services. In these circumstances, studies which use household income to make living standard comparisons confuse low-wage dual income families working long hours with higher wage single income families enjoying a much higher standard of living. Many of the dual income families spread across the middle deciles of household income are found in the bottom deciles of a ranking defined on a more accurate measure of living standards.

Apps also points out that EITCs based on household incomes can result in larger work disincentives through their effects on 'effective marginal tax rates' compared with those based on individual incomes (see further below).

From an economic viewpoint, non-monetary elements of living standards are indeed important. Whether dual-income families purchase domestic help or supply these services themselves (before and after their paid jobs), they will have either less disposable income or less leisure time, than otherwise equivalent single-income families, and thus will enjoy a lower standard of living.

There are other complexities to this debate however. For example, dual-income families will often benefit from government subsidies for child-care whereas otherwise single income families may not. Sorting through these issues and determining the optimal apportionment of taxes and subsidies between dual and single income families is beyond the scope of this inquiry.

There is also a threshold issue with ramifications for possible EITC designs. Some have claimed that there may be constitutional constraints for an EITC that extended to single people as well as to families. This a complex area of law and is untested in this context (box 10.5). If this was an obstacle, the EITC might have to be narrower in its application or State cooperation would be required.

Box 10.5 Constitutional matters

Since several recent pivotal High Court judgments (*Pape v Federal Commission of Taxation* and *Williams v Commonwealth*[94]), it has been made clear that the Commonwealth Government does not have the unfettered capacity to spend and make contracts (Leong, McDermott and Volling 2014; SDober 2012). The implication is that the Commonwealth Government would need to find a constitutional head of power in order to introduce an EITC unilaterally.

The social services power — s. 51 xxiiiA of the *Commonwealth of Australia Constitution Act 1900* (Imp) — includes the capacity for the Government to make laws with respect to 'family allowances' among other transfers, but this section does not cover payments made to single persons. Although this has not been tested, some legal scholars argue that a guaranteed minimum income scheme might still be covered by this section if a broad definition of 'family' were adopted (Arup 1980). Even if not, some consider that the social services power might still provide the required head of power for an EITC oriented at families (the predominant focus of the United States variant of the EITC).

The Commonwealth's taxation powers under s. 51(ii) may also provide a more general basis for an EITC — though this would require a certain interpretation of that power, given that EITCs do not amount to levying taxes.

While the Productivity Commission has been alerted to some of the possible constitutional issues raised by an EITC, the matters are complex and the degree to which they would provide a genuine obstacle to the introduction of different forms of EITCs by the Commonwealth has not been clarified. If necessary, however, state governments could refer any relevant powers to the Australian Government for an EITC.

Fiscal matters

In assisting the low paid through the tax system, an inherent feature of a wage-tax tradeoff proposal involving an EITC is that governments will become responsible for delivering some income to the low paid that would otherwise come from employers in the form of higher wages. As such, EITCs can be expected to entail fiscal costs (although these will be offset to the extent that lower wages lead to greater employment and, with it, reduced social transfers and higher income taxes). Several participants raised concerns about the fiscal aspects of EITCs, particularly in a tight economic environment.

Direct fiscal costs

Although EITCs can be expensive for governments, the cost of different designs can vary significantly. Most countries with EITCs included in the OECD's 2011 report spent less than 0.5 per cent of GDP on working credits, but Sweden spent more than 2 per cent in 2009(OECD 2011, p. 80), with its much broader coverage and generous rates.

94 *Pape v Federal Commissioner of Taxation* [2009] 238 CLR 1, *Williams v Commonwealth* [2012] HCA 23 (20 June 2012) (Williams (No 1)), *Williams v Commonwealth of Australia* [2014] HCA 23 (Williams (No 2)).

There can likewise be variations in the efficiency costs of different schemes. In its study of 15 European countries, the OECD found that introduction of a simple in work benefit scheme would be highly positive in some countries, but questionable in others (Immervoll and Pearson 2009).

The direct fiscal cost of an EITC scheme depends on how many workers it covers, the size of the benefits it provides, and also the administrative and compliance costs entailed in its operation. The factors that would determine the cost of an EITC in Australia are:

- the extent of the reduction in minimum wages accompanying the EITC as part of a wage-tax tradeoff
- the coverage of the scheme. In particular, an EITC designed to fully compensate all minimum wage earners for a reduction in the minimum wage would be more expensive than one targeted on minimum wage earners in low income households (or other subsets of low-income workers)
- other design aspects that would affect the size of credits paid, such as its eligibility requirements (for example, in relation to hours worked) and taper rates
- scheme 'integrity' costs — an issue would be the extent to which people are able to manipulate in-work tax credits or make mistakes in their reporting (Slemrod 2010, p. 264). Overcompensation has been cited as an issue, and different countries adopt different approaches to minimise it (OECD 2011, p. 85)
- claims processing costs.

As noted, the net fiscal cost of a policy to introduce an EITC as part of a wage-tax tradeoff would also depend on any reductions in income tax that resulted from the lower wages and what employment response would flow from slower growth in the minimum wage, and how that extension in labour demand was met. Both the extent and the source of employment response are areas of some uncertainty that have ramifications for assessments of the fiscal effects of a scheme.[95] Another consideration is that an expansion in employment may also necessitate increased government spending on child-care support and any other in-work benefits.

The Productivity Commission intends to explore the main direct fiscal costs of different EITCs in its forthcoming modelling.

[95] For instance, if all expanded employment came from the ranks of the unemployed, there could be fiscal savings as their unemployment and other payments were ceased or wound back, and as they generated income tax. At the other extreme, if the expansion in employment were fully met by previously 'discouraged workers' who were not in receipt of social security payments, or by underemployed people already not on welfare who simply increased their hours of work, there would be no direct fiscal savings in the form of reduced welfare payments to offset the costs of the EITC payment (although there would still be higher income taxes associated with the expansion in employment).

Deadweight financing costs

A further issue relevant when assessing the merits of an EITC is how this net fiscal cost would be funded and what efficiency (or 'deadweight') costs would arise from the need to fund it?

Any in-work government payment (or, indeed, any government expenditure that does not generate compensating revenue) must ultimately be funded through higher taxes or forgone government services and transfers. Some tax measures, such as Australian corporate and income taxes, can significantly distort labour and investment choices (KPMG Econtech 2010). Accordingly, if distributional objectives in relation to the low paid are partly met through an EITC, this might eliminate some of the inefficiencies of wage regulations but, unless well-targeted, might raise (potentially greater) inefficiencies associated with taxes (OECD 2011, p. 11).

Unless tax reform occurs, it appears that the marginal source of additional tax revenue for Australian governments is now income tax, which is a highly distorting tax source. It should be noted that raising effective income taxes through fiscal drag would then require a further adjustment to EITC payments to return low-income workers to their initial (pre-reform) level of net income.

Stability of an EITC

Another consideration is that, because of its high up-front fiscal costs, an EITC introduced to provide compensation for a lower minimum wage might be exposed to changes by future governments. The risk of future change of course applies to any taxation or savings measure, and indeed to minimum wages too. However, it appears that social security payments can be particularly susceptible to change. That said, the EITC in the United States has come to garner significant public support and has been extended over time (Maag 2015). Even so, the current institutional arrangements for setting minimum wages in Australia, through the FWC, make them much less open to any significant real reduction.

Were people to perceive significant risks that the government might rescind or weaken an EITC, that perception would itself have efficiency implications, by reducing the confidence and predictability recipients would have about their future net income levels.

Overall, the independent setting of the minimum wage creates a relatively certain environment for employees, unions and employers. In theory, the government could also authorise the FWC to set an EITC or equivalent in-work benefit in the same framework. Alternatively, were an EITC mainly a vehicle to supplement a minimum wage that grew more slowly than otherwise, concerns about its stability would be less well founded.

Work incentives?

A key aim of a hybrid minimum wage/EITC would be to sustain or lift the living standards of people on low incomes while encouraging employment. In explaining some of the thinking that led to original five economists proposal, Keating and Lambert (1998, p. 14) pointed to the value of an EITC as a means of encouraging people to move from welfare to work without the downsides of other strategies:

> Another key aim in any reform package to improve incentives for low income people to pursue work rather than welfare is to ensure an adequate gap between their income from work and the Social Security safety net. This gap can be achieve by raising wages, particularly at the low end, by lowering the Social Safety net or by introducing an earnings credit. Higher wages will, however, not increase the gap by much as long as effective marginal tax rates remain high, and they risk creating higher unemployment (Richardson and Harding 1998). Equally, if the safety net is to do its job, any expansion of this gap should not be achieved by lowering the safety net. Instead pensions should remain at 25 per cent of male average weekly earnings. Thus the best option is to provide low income earners with an earning credit.

The evidence suggest that EITCs usually encourage labour force participation, especially for single parents, although again their effectiveness depends on their exact design (Brewer, Duncan and Shephard 2005; Hotz and Scholz 2006; Hoynes and Patel 2015; De Luca, Rossetti and Vuri 2012; Meyer 2010; OECD 2011).

At the same time, introducing an EITC could also create *some* offsetting work disincentives, due to its effects on the effective marginal tax rates facing workers (OECD 2011, pp. 69–70). In this respect, an EITC carries similar risks to many other measures aimed at benefitting the low paid (including, to some extent, regulated minimum wages themselves). For example, were an EITC based on household incomes there could be potentially substantial disincentives for second income earners. As Apps (2002, p. 2) pointed out in her critique of the five economists proposal:

> The withdrawal of the credit on the basis of household income usually means that a low wage married mother who goes out to work does not receive the credit and she repays the primary earner's credit. And so both low-wage parents in a dual income family are uncompensated for pay cuts, as is the single low-wage individual.

This is an inherent trait of certain EITCs based on household income alone, and would need to be given weight when considering the overall merits and detailed design of such a scheme. More generally, while supportive overall of the EITCs, the OECD (2011, p. 60) has noted:

> In-work tax credits are a commonly used measure to address concerns regarding unemployment and inactivity traps. While they can be successful in reducing disincentives to enter the workforce (and in alleviating poverty), they have the potential to exacerbate poverty traps as targeting generally requires the tax credits to be withdrawn at higher income levels. They can also reduce second-earner work incentives where they are withdrawn on the basis of family income rather than individual income. Design is therefore a delicate balance.

A future EITC?

In principle, an EITC coupled with restraint in the growth of the minimum wage is attractive, having the potential to reduce disemployment while addressing concerns about the living standards of the low paid. EITCs should also able to better target the 'assistance' provided to people on low incomes than an equivalent increase in minimum wages.

However, several issues would need to be favourably resolved before it would be possible to recommend a move towards an EITC as part of a wage-tax tradeoff. These include its constitutional standing and various design issues, which would have implications for its costs, incentives and equity effects. The design would also need to be coordinated with other changes to the tax and welfare systems.

A key determinant of both the fiscal cost of the scheme and the benefits would be the employment response to the accompanying reduction in the growth of the minimum wage. This is an area of some uncertainty.

Even if there were not scope to introduce an EITC in the near term, it may be an option governments could revisit in the future if, for example, labour market conditions were to deteriorate and involuntary unemployment increased markedly. In those circumstances, the uncertainties around the likely employment response to lower minimum wages would reduce and the balance of benefits and risks of an EITC would shift. EITCs might also have a future role on equity grounds as a response to further polarisation in the labour market, should it occur, as it would help compress net in-work earnings. As noted earlier, an EITC might also introduced for other purposes.

It is difficult at this stage to reach a firm view on whether an EITC in Australia could be feasible or justified. The forthcoming modelling will provide a tool to help further assessments of the merits and design of EITCs in the Australian context. The Productivity Commission invites further input on these matters, including following release of the modelling paper scheduled for September.

INFORMATION REQUEST

The Productivity Commission invites participants' further input on the feasibility, merits and optimum design on an earned income tax credit in Australia, what its introduction might mean for future minimum wage determinations and employment outcomes, and in what conditions it would be appropriate to implement such a scheme.

10.2 Other policies to enhance the wellbeing of low paid workers and jobseekers

There are several other options that could take the pressure off minimum wages on businesses' decisions about employment and hours of work, while achieving similar distributional goals of the minimum wage.

One option would be a low-income employment-conditional social security payment. This would be similar to an EITC, except with the wage top-up delivered through the social security system rather than through the tax system. It would be possible to design a social security payment that had broadly the same impacts on the effective marginal tax rates of employees and with the same fiscal costs as an EITC. Many of the administrative arrangements would also be similar, as it is hard to see how either an EITC or a social security payment could be implemented other than jointly through the ATO and the Department of Human Services. Hence, such a payment has many of the same merits, flaws and complexities as an EITC as discussed in the previous section. One difference is that social welfare payments may be more likely to social stigmatise recipients (Sykes et al. 2015).

Another approach would be some benefit-in-kind that relates to employment. Of such benefits, the most important current one is child care subsidies provided by the Australian Government. However, these subsidies only target families with young children, currently provide significant benefits up to relatively high incomes, are tested against household income (not the personal income of an employee), and are also available to some non-working parents. There are grounds for childcare assistance, but they are not well targeted at individuals with low hourly wage rates.

The only other obvious non-cash payment that could supplement the effective income of low paid employees would be transport subsidies. Existing public transport is highly subsidised in all jurisdictions for all users, and there are supplementary concessions for particular disadvantaged groups, but not generally for low-paid working households (as noted by NCOSS (2013) in its 2013 scrutiny of NSW fare concessions). Some countries do provide transport subsidies as work incentives (for example, the Work Incentive Transport Subsidy Scheme in Hong Kong). However, there are particular problems in implementing an Australia-wide arrangement for such subsidies, given that concessions are matters for state and territory governments. The transaction costs of ensuring that recipients were indeed low-paid would not be trivial. Unlike measures such as an EITC, any practical subsidy would probably have to be either 'on' or 'off' (as with most other concessions), which means that they could create very high effective marginal tax rates around a given income threshold. Moreover, the implicit value of any such subsidy would depend on the proximity of workplaces to people, and so would provide little help to people who worked in jobs close to their homes or where public transport services are lacking.

Putting aside these options, there remain several other mechanisms for achieving the objectives of the minimum wage while limiting its impacts on the decisions of employers

about people's hours worked and employment, as well as for addressing employment and employability issues more generally.

Wage subsidies

A wage subsidy allows the minimum wage to serve its distributional goals, albeit with its lack of targeting, while reducing its impact on business employment decisions. Wage subsidies have been shown to be reasonably effective in increasing employment outcomes for disadvantaged workers (for example, Card et al (2010); Jaenichen and Stephan (2007); Heyer et al.(2011); Sjogren and Vikstrom (2015)).

The Australian Government has several wage subsides in place, including:

- the Employment Pathway Fund (EPF), which includes provision for wage subsidies for job seekers registered with Job Services Australia (JSA). Around $160 million in wage subsidies were paid to around 50 000 job seekers in the two years between October 2009 and October 2011, or around $3100 per recipient (DEEWR 2012a, p. 5).[96]
- various wage subsidy arrangements for specific groups. Indigenous job seekers can qualify for the Indigenous Wage Subsidy, with special arrangements for young people that increase the likelihood of uptake for that group. The Restart Wage Subsidy, provides wage subsidies to employers that employ and retain job seekers aged 50 years or older who were formerly unemployed and on income support for six months or more. People registered with a Disability Employment Services provider are also eligible for a tailor made Australian Government wage subsidy.

The most recent evaluation of the Australian EPF suggests that it had relatively positive outcomes for qualifying job seekers (DEEWR 2012a). For example, employers reported that around one quarter of JSA wage subsidy job seekers obtained a job they would not have if not for the wage subsidy. Analysis of administrative data that controlled for the differing characteristics of recipients and non-recipients, found that the odds of being off income support in 12 months were around 14 per cent higher for job seekers who received a wage subsidy compared with job seekers who received only a job placement in the same time period.

Nevertheless, as with any subsidy, wage subsidies involve several inefficiencies:

- employers obtain subsidies for people they were going to employ anyway or receive subsidies that were above the amount needed to encourage employment (low 'additionality')
- employers choose people qualifying for wage subsidies over other non-qualifying job seekers (displacement)

96 Another Australian Government wage subsidy program, *Wage Connect*, has been paused since December 2013.

- they can create churn if people are only employed for periods commensurate with the wage subsidy. The goal of wage subsidies is to achieve sustained employment. Yet in the survey used to evaluate the EPF, about 45 per cent of employers did not intend to retain the subsidised employees
- unless designed expressly to do so, they make no difference to the incentives for employers to increase the hours of work for existing employees.

Labour market intervention programs — including EITCs — share some of these problems. For example, an EITC may also involve problems with additionality. An EITC enables the government to set a minimum wage at a level lower than that required to achieve some income target for the individual. If a person would still have been employed at the latter wage, then the EITC is in this respect redundant for that person.

A wage subsidy could act as a partial alternative to an EITC for improving the attractiveness of 'outsiders' to employers. It may be particularly suited to temporary measures to reduce the cost to employers of hiring unskilled job seekers during economic downturns as it is relatively easy to ramp up existing programs.

However, unlike an EITC, wage subsidies are not usually intended to be permanent for any given individual, but rather to overcome the reluctance of employers to hire people with prior unemployment spells and to let people gain experience, such that they can then sustain employment at an unsubsidised rate. In contrast, the combination of a lower minimum wage and a compensating EITC is intended to *permanently* reduce the cost of labour.

As there is a wage subsidy equivalent to an EITC, it is conceivable that a permanent wage subsidy could be instituted instead. It would have some inherently different characteristics, because its level would (desirably) vary with the employability of the recipient, and would act on the incentives of an employer to take a worker, rather than the incentives of an employee to work. Under an EITC, there is still a minimum wage, but it bites less, and so locks out only some from the labour market. In contrast, a wage subsidy calibrated to the labour market disadvantage of the employee amounts to setting multiple effective minimum wage rates for employers, with the lowest for the least employable. In theory, it could be designed to lock out few workers. However, it is not straightforward to design a wage subsidy of this kind (though attempts to do so have been made).

While permanent wage subsidies may motivate businesses to employ people with enduring labour market disadvantage who are priced out of the labour market by minimum wages, there are risks with their adoption. There are few international schemes of this kind to test designs, and it would be premature to roll out any such scheme without thorough pilots, and without further information on how to better target even the existing wage subsidies used in Australia. Any permanent subsidy would involve high risks of low additionality and would be costly. A subsidy of this kind may, however, be no better or worse than an EITC, and any initiative to introduce the former should consider the latter as an alternative option.

Payroll tax reductions

All Australian states and territories levy payroll taxes on wages in enterprises with payrolls exceeding certain thresholds. (These thresholds and the applicable tax rate vary by jurisdiction.) A common feature of these taxes is that once the payroll threshold is exceeded, all of the payroll is taxed at the tax rate — thus creating an incentive for smaller employers to curb wages and/or employment growth.

As noted in the recent Tax Discussion Paper , businesses will respond differently over time to changes in payroll taxes. In the short run, business are unlikely to be able to change existing wages and prices and so bear any costs associated with increased payroll taxes (Commonwealth of Australia 2015b). However, in the long run, the cost of the tax is likely to be passed onto employees (through lower wages) and consumers (through higher prices).

Cutting payroll tax is seen by some as a way of reducing wage costs and achieving stronger employment outcomes and has been raised as an alternative to an EITC. However, the employment effects of a reduction in payroll tax has been the subject of debate among economists for some time. An analysis of the original five economists plan suggests that the employment effects an EITC were larger than those associated with a cut in payroll tax (Dixon and Rimmer 2000). Moreover, current exemptions and thresholds mean that a significant proportion of the payroll base is not subject to tax. The Business Council of Australia has estimated that close to half of the potential payroll tax is exempt.

Other mechanisms to encourage employment and employability

There are a host of other approaches that attempt to increase the employability of marginal job seekers, and to thereby raise the likelihood that an employer will hire them at, or above, the minimum wage. Such mechanisms include training subsidies (either at training institutions or on the job) and targeted school programs for non-academically able children. The outcomes of such programs depend strongly on their design, the quality of the staff who manage them, and the duration of the interventions. In their meta-analysis of active labour market policies, Card et al. (2010) found that training interventions had relatively poor short-term benefits, but more favourable medium term impacts.

However, Australia already expends a large amount of public resources on training and education. Many see this system as deficient. The immediate reform task is not to expand that system to improve the employability of marginal job seekers, but to improve the efficiency and design of the system itself. That task — well beyond the scope of this inquiry — may well have a high benefit-cost ratio, and might be preferred to any direct measures to lower the costs to employers of marginal labour. tradeoff

11 Role of awards

Key points

- Awards are the regulations that describe the minimum wages and conditions of employment for the majority of employees in Australia. There are 122 modern awards including 107 awards that correspond to a broad industry classification, and 15 awards that correspond to occupational groups.
- Around 19 per cent of all employees have their wages and conditions set at exactly those contained in the relevant award. In addition, the wages and conditions of some employees who are part of an enterprise agreement, or are on individual arrangements will nevertheless also largely reflect those in the relevant award.
- Awards have been part of the workplace relations framework in Australia for more than 100 years. They are unique to Australia. Their role and the process by which they are determined and reviewed have changed in the past two decades, but there are many distinctive features of awards that have remained the same.
- Awards are part of the safety net in Australia's workplace relations framework. Specifically, awards help to balance unequal bargaining power between employees and employers.
- As a part of the safety net, awards have reduced the dispersion of pre-tax employment income (especially in the lower half of household wage distribution) and increased the wages of low wage workers.
- Other countries use different mixes of employee protections and wage determination systems. While awards are distinctly Australian, some other countries have similarly rigid systems of wage determination coupled with employee protections.
- There are two broad policy options for awards — replace them or repair them. Replacement is probably not currently a practical option because:
  - the costs of transition would be significant
  - the current system of awards in general does not appear to be producing highly adverse outcomes, although there are well known exceptions
  - some of the distortions that awards create are positive while the costs of others could be reduced
  - few participants have suggested a complete shift away from awards. For example, the Business Council of Australia suggests a partial departure, but still recommends repairing rather than replacing awards.

11.1 Introduction to modern awards

Awards are regulations that describe the minimum wages and conditions of employment for the majority of employees in Australia. There are 122 awards at present — known as modern awards — which mostly correspond to broad industry classifications. The Manufacturing and Associated Industries Award 2010 and the General Retail Industry Award 2010 are two examples. Award wages and conditions are the benchmark against which an enterprise agreement must leave employees better off overall (chapter 15).

The wages and conditions contained in the current set of awards were determined by the Fair Work Commission (FWC) between 2008 and 2010 with input from interested parties, including employer organisations, unions, and Australian and state and territory governments, among others. The FWC is required to undertake a systematic review of all awards every four years (the current review commenced in 2014) and to conduct annual reviews of the minimum wage rates contained in awards as part of the annual minimum wage reviews (Stewart 2013).

The rest of this chapter seeks to answer several broad questions.

- Whom do awards cover, where are they currently applied and how do award wages compare to average wages?
- Where have awards come from and to what extent does the long history of awards in Australia continue to influence the role and content of modern awards?
- What is the role of modern awards as part of a safety net and is there evidence that awards carry out this role successfully?
- Could an alternative to awards fulfil this role with lower costs or is the choice to repair awards a more sensible option?

The following chapter (chapter 12) starts with the premise — established in this chapter — that repairing awards is the more sensible option and discusses how awards, and the processes associated with the annual wage review and four yearly award review, could be improved to allow awards to more effectively fulfil their role.

Awards under the Fair Work Legislation

The *Fair Work Act 2009* (Cth) (FW Act) provides the basis for the FWC to make, vary and revoke modern awards, and also include requirements for the content of awards and how that content should be interpreted.

Modern awards objective

Awards are based on the modern awards objective in the FW Act, which states that:

The FWC must ensure that the modern awards, together with the National Employment Standards, provide a fair and relevant minimum safety net of terms and conditions, taking into account:

(a) relative living standards and the needs of the low paid; and

(b) the need to encourage collective bargaining; and

(c) the need to promote social inclusion through increased workforce participation; and

(d) the need to promote flexible modern work practices and the efficient and productive performance of work; and

(da) the need to provide additional remuneration for:

i. employees working overtime; or

ii. employees working unsocial, irregular or unpredictable hours; or

iii. employees working on weekends or public holidays; or

iv. employees working shifts; and

(e) the principle of equal remuneration for work of equal or comparable value; and

(f) the likely impact of any exercise of modern award powers on business, including on productivity, employment costs and the regulatory burden; and

(g) the need to ensure a simple, easy to understand, stable and sustainable modern award system for Australia that avoids unnecessary overlap of modern awards; and

(h) the likely impact of any exercise of modern award powers on employment growth, inflation and the sustainability, performance and competitiveness of the national economy. (FW Act s. 134)

This objective — possibly a misnomer, as it encompasses several potentially conflicting objectives — also applies to the FWC's decisions about any variation to awards.

Permitted and mandatory terms in awards

The FW Act specifies what awards *must* contain and gives examples of what awards *may* contain. Awards are allowed to include terms that are ancillary or supplementary to the National Employment Standards (NES), but cannot include terms that would reduce those standards.

Modern awards must contain:

- coverage terms that explain which employers, employees, organisations and outworker entities are covered by that award. Enterprise awards and public sector awards must also include coverage terms
- flexibility terms that allow employers and employees to vary the effect of some parts of the award. Most awards contain a flexibility term that closely resembles the model flexibility term that was developed as part of the award modernisation process. These terms specify which parts of awards can be varied, and how to ensure that the

variations make the employee better off overall, which is a requirement of the FW Act. Flexibility terms allow an employee and their employer to make an individual flexibility arrangement (IFAs) — these are discussed in detail in chapter 16.

- terms requiring employers to consult employees about changes to rosters or hours of work
- terms about settling disputes
- terms to define ordinary hours of work
- terms specifying base and full rates of pay for pieceworkers
- terms about automatic variation of allowances, superannuation, and superannuation default funds.

The FW Act also prohibits modern awards from containing specified terms, including terms that are objectionable, deal with right of entry, are discriminatory, contain state-based differences, or deal with long service leave.

Outside of these terms, awards can contain other terms that might provide more detail about the wages and conditions of the covered employees as long as they do not reduce the conditions contained in the NES.

As part of the current four yearly review (see below), the FWC has developed an exemplar version of the Security Services Industry Award 2010 to show how the content in awards might be arranged and presented in a manner that is easy to understand. While this exemplar award does not represent the content that is contained in all the different awards, it does give a flavour of the types of issue that awards deal with. The table of contents from the exemplar award is reproduced in box 11.1 below.

However, within these types of content, there remain large variations between awards, which reflect the characteristics and requirements of the different industries or occupations to which they pertain.

Four yearly reviews of modern awards

The FW Act requires the FWC to undertake a review of all awards every four years, during which time it can make changes to awards where warranted to meet the modern awards objective. The FWC is in the process of undertaking the first of these reviews. As part of these reviews, the FWC can vary wage rates in awards, but only when changes can be justified by work value reasons.

Outside these reviews, the FWC can vary an award of its own initiative, or vary on application, but only where there is need to clarify an ambiguity or uncertainty, or to correct an error. Prior to the first four yearly review, there were few successful applications for variations, with the FWC requiring that the requested change be necessary to achieve the objective and not ‘merely desirable’ (Stewart 2013).

Box 11.1 **Table of contents from a draft exemplar award**

Security Services Industry Award 2014
Part 1 — Application and Operation of Award
1. Title and Commencement
2. The National Employment Standards and this award
3. Coverage
4. Award flexibility
Part 2 — Types of Employment and Classifications
5. Types of employment
6. Classifications
Part 3 — Ordinary Hours of Work, Minimum Wages and Allowances
7. Ordinary hours of work and rostering
8. Breaks
9. Minimum wages
10. Allowances
Part 4 — Penalties and Overtime and Allowances
11. Penalty rates
12. Overtime
Part 5 — Other award entitlements
13. Superannuation
Part 6 — Leave, Public Holidays and other entitlements under National Employment Standards
14. Annual leave
15. Personal/carer's leave and compassionate leave
16. Parental leave and related entitlements
17. Public holidays
18. Community Service Leave
19. Termination of employment
20. Redundancy
Part 7 — Consultation and Dispute Resolution
21. Consultation regarding major workplace change
22. Dispute resolution
Schedule A — Definitions and interpretation
Schedule B — Summary of hourly award rates of pay
Schedule C — National Training Wage
Appendix C1: Allocation of Traineeships to Wage Levels
Schedule D — 2013 Part-day public holidays

Source: FWC (2014f).

11.2 Coverage and application of awards

Most employees in Australia have their minimum wages and conditions set by awards. However, for many employees, these minimums sit below the actual wages, and to a lesser extent, the conditions, that they receive. This is the difference between the *coverage* of award wages, and their *application*.

Employees (and employers) are *covered* by an award if they fit into one or more of the categories of employees or workplaces included in the coverage terms for that award. These terms usually include or refer to lists of occupations or types of employee (such as resort worker, cleaning services employee, market research interviewer, or retail employee) or types of activities (such as coating, painting, colouring, or varnishing). Sometimes the terms include coverage for all employers in a defined sub-industry. Put together, the coverage terms in all the 122 modern awards include the majority of employees in Australia.

Employees remain covered by awards even if another instrument applies to their employment (such as an individual contract or enterprise agreement). The only employees not covered by awards are those who:

> … because of the nature or seniority of their role, have traditionally not been covered by awards (whether made under laws of the Commonwealth or the States)
>
> … perform work that is not of a similar nature to work that has traditionally been regulated by such awards. (FW Act s. 143A(8))

Employees who fall into these non-covered categories often include managerial staff and employees in occupations that have not been covered by an award in the past, such as lawyers, financial advisors, accountants, public relations managers, human resources managers, or information technology specialists.[97] For these employees, their minimum wages and employment conditions are the NES, but many are remunerated at levels well in excess of those.

While awards *cover* the majority of employees in Australia, the application of awards is less far-reaching. An award *applies* to an employee if they are covered by the award and their wages and conditions of employment are exactly those set out in the award. A looser definition of award application (also referred to as award-reliance) includes employees not covered by an enterprise agreement, whose wages and conditions are slightly superior to those set out in the award, but are mostly the same. For example, an employee's contract might specify that they receive the award wage rate plus 5 per cent. Awards cover, but do not apply to employees who are covered by enterprise agreements, or who earn above the high-income earners threshold. The threshold until July 2016 is $136 700 per year.

The application of awards has fallen since its peak in the middle of the 20th century, when more than 90 per cent of employees in Australia had their pay and conditions set by an award (Mitchell 1998). In 1963, Commonwealth and state awards applied to 86.7 per cent of males and 90.7 per cent of females (Vernon 1965). However, by 1990, around 67 per cent of employees were paid at exactly the award rate, and by 2000 this had fallen to 23 per cent (Department of Employment sub. 158). In 2014, the Australian Bureau of Statistics (ABS) Employee Earnings and Hours (EEH) survey found that almost 19 per cent of employees have their wages and conditions set at exactly the award rates (ABS 2015c). The most recent Australian Workplace Relations Study (AWRS) and the

97 Miscellaneous Award 2010.

Household, Income and Labour Dynamics in Australia (HILDA) survey also report similar levels of award-reliance.

This fall in the application of awards is partly due to an increase in the use of enterprise agreements (especially in the last two decades). It also reflects a conscious effort by consecutive Commonwealth governments in the 1990s and 2000s to shift the role awards play away from setting wages and conditions (that is, when awards are applied to employees) towards setting a safety net to stop wages and conditions from falling below a regulated floor (that is, when employees are covered by an award, but their employment wages and conditions are set using another method, such as an enterprise agreement).

However, as described in appendix D, a strict interpretation of the application of awards might understate their influence on wages and conditions more broadly. Awards also influence the wages and conditions of employees who are covered by both enterprise agreements, and over-award individual arrangements, although it is difficult to know how far this influence stretches. This is partly by design, since awards provide the benchmark for the better off overall test for enterprise agreements, and it is partly a reflection of a reluctance of some employers, especially in particular industries, to negotiate higher wages and conditions because they consider that awards are fair and provide appropriate remuneration (Wright 2013).

Who are award-reliant employees and where do they work?

Award-reliant employees are more likely to work in the accommodation and food services; administrative and support services; retail trade; other services; and health care and social assistance industries. They make up a larger proportion of total employees in small and medium enterprises than in micro and large enterprises. Award-reliant employees are more likely to be female, and are younger and less skilled on average than other groups – see appendix F for a more detailed discussion.

How do award wages compare to the average?

Awards influence the relative pay rates of employees in three ways. They:

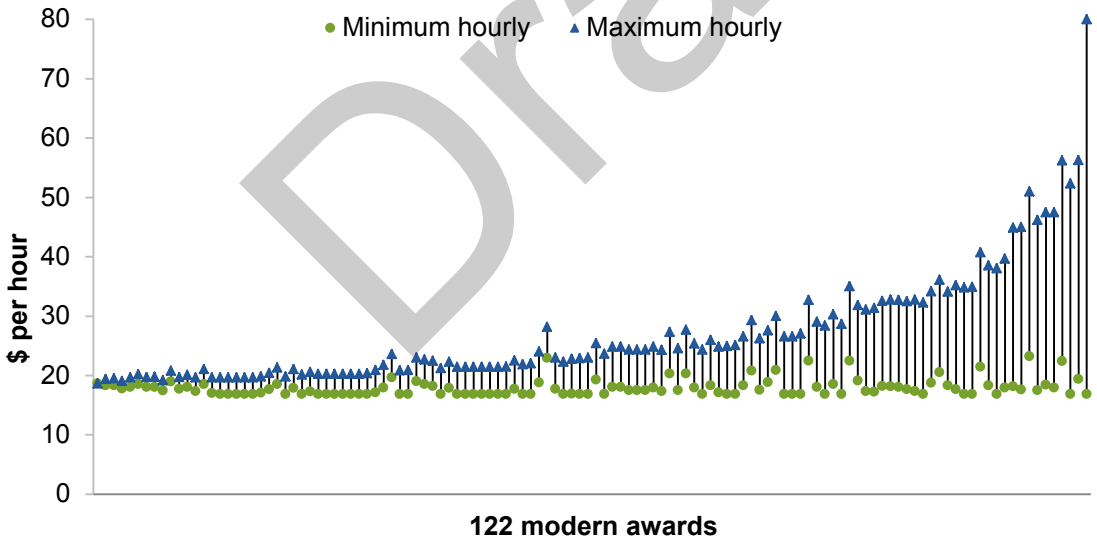
1. set the relative rates of pay between the classifications within an industry or occupation covered by a single award. For example, decisions to increase award wages by dollar increments have the effect of condensing the distribution of wages within an award
2. set the relative rates of pay between occupations in industries covered by different awards
3. influence the relative rates of pay between employees who are award-reliant and those who are not. For example, where award-reliant employees sit on an overall earnings distribution relative to employees on collective or individual arrangements will

determine whether an increase in award wages shifts the aggregate earnings distribution up or down, or causes it to condense or expand.

There is little variation between the minimum wage rates in awards (which correspond to the base wage rate for the lowest classification in each award) (figure 11.1). Forty five of the 122 awards have a minimum wage rate equal to the national minimum wage (Department of Employment sub. 158), and the variation between the remainder is minimal (with a coefficient of variation of around 7.7 per cent).[98] The variation in the maximum rates is higher (the coefficient of variation is around 19 per cent).

Figure 11.1 shows that for the majority of awards, the base rates of pay for different classifications sit within a reasonably narrow band. Similarly, figure 11.2 below shows the number of base rates of pay in 82 awards spread across different hourly rate brackets. More than 50 per cent of all classifications in these awards receive base hourly rates of between $17 and $23 per hour and the median rate of pay is $21.78. These data suggest that wage rates in most modern awards display quite limited variation.

Figure 11.1 **Minimum and maximum base wage rates in modern awards**
Dollars per hour, 2014

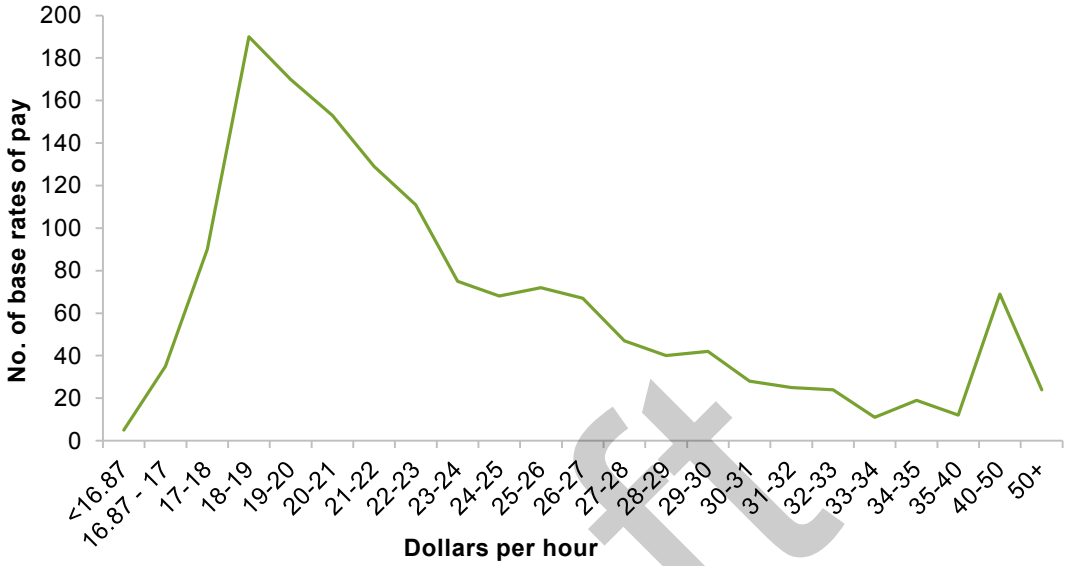


Source: Information from the Australian Government Department of Employment (December 2014).

98 The coefficient of variation is calculated as the standard deviation divided by the mean. It shows the extent of variation of observations in comparison to the mean of the population.

Figure 11.2 **Incidence of base rates of pay across modern awards** [a]

Dollars per hour



[a] Forty awards (those contained in group four of the current four yearly review of modern awards) are excluded from this figure.

Source: Data provided by Fair Work Ombudsman, pers. comm., 13 April 2015.

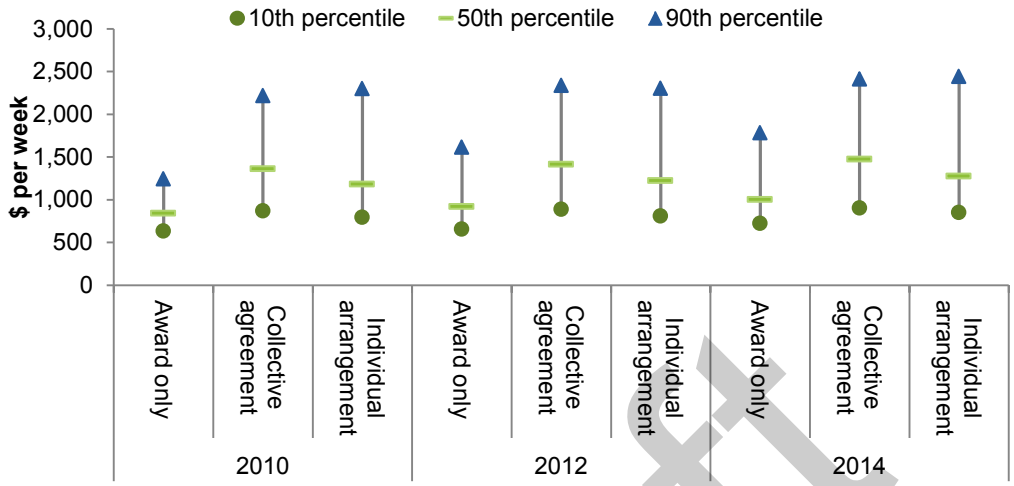
However, the base rates of pay in awards are only one driver of the dispersion in the earnings of award-reliant employees. Other factors include:

- the number of hours worked and when in the week those hours fall. For example, working on weekends, at night, or outside of agreed regular hours can attract penalty rates and overtime rates of pay
- the type of employee (for example casual employees receive casual loadings)
- various allowances. These fall into two broad groups — those that reimburse actual expenses incurred (for instance, tools, travelling, and meals) and those that relate to the nature or location of the work itself. For example, the latter includes payments for the special skills of an employee (such as first aid allowances); the remoteness of the work location; and for various undesirable tasks, such as cold work disability allowances, hot work allowances, wet work allowances, and confined spaces allowances. Payments of allowances often vary from individual to individual because the daily tasks of people on the same basic wage may still vary.

Nevertheless, the dispersion of earnings for award-reliant employees is narrower and sits below that for employees whose pay is set by another method (figure 11.3). Between 2010 and 2014, earnings for award-reliant employees at all points on the earnings distribution increased, but in each of those three years the distribution remained below those for the other methods of setting pay.

Figure 11.3 **Weekly earnings distributions by method of setting pay, 2010, 2012 and 2014[a]**

2014 dollars per week



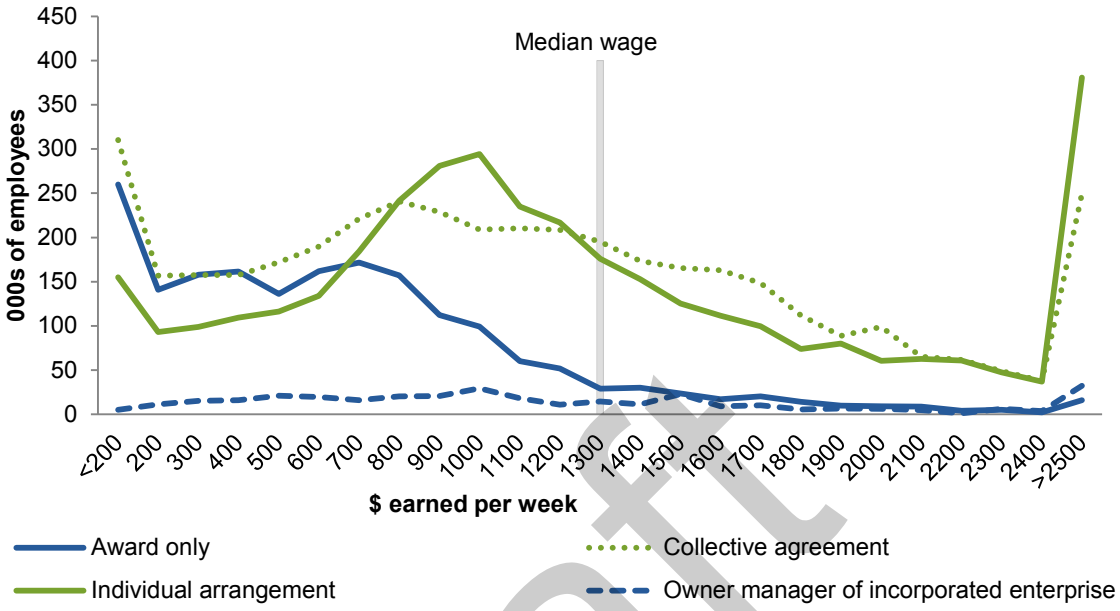
[a] Dollar values deflated using average annual rate of inflation of 2.5 per cent.

Source: ABS (*Employee Earnings and Hours, Australia, May 2014*, Cat. No. 6306.0).

The median wages of award-reliant employees (represented by the lines for the 50th percentile in the figure above) sit below those for all the other methods of setting pay, so that the earnings of the majority of award-reliant employees are below the median for all employees captured in the ABS data.

The aggregate median wage and the income distribution of employees on different types of pay setting arrangements are depicted in figure 11.4 below. Most award-reliant employees earn less in a week than the median weekly wage.

Figure 11.4 **Weekly earnings by method of setting pay**
Weekly earnings in dollars, and 000s of employees, 2014



Source: ABS (*Employee Earnings and Hours, Australia, May 2014*, Cat. No. 6306.0).

11.3 History of awards

For most of their history, awards have been detailed and complex documents that contained the explicit details of how employers and workers were to relate to each other: how much employees would be paid, exactly what functions different workers were to perform, when they were to perform them, what responsibilities employers had to their employees and so on.

Understanding the history of awards and the successive responses to past decisions by the various bodies determining awards brings into relief two main features of Australia's regulated wage determination system.

On the one hand, history matters. Modern awards still carry with them features inherited from the old award system.

On the other hand, while awards have been a building block in all the legislative variations of Australia's workplace relations (WR) system over time, their prominence and use has changed. For instance, over time and often simultaneously, awards have been used as wage setting instruments, vehicles for dispute resolution, and benchmarks for enterprise level and individual bargaining. Similarly, the bodies determining awards have intermittently taken into account economic, political and social trends, depending on the consequences of not doing so at the time.

Unlike for the majority of the century of awards, the last three decades have seen the awards system begin to catch up to the flexibility required by the Australian economy. This is perhaps one reason why only a few stakeholders in this inquiry have suggested something approaching radical change to awards (the notable exceptions being the Business Council of Australia (BCA), the Australian Chamber of Commerce and Industry (ACCI) and Master Builders Australia).

The current collection and structure of awards in Australia are the result of a century of evolution, which began with the establishment of legally constituted bodies with the responsibility to settle industrial disputes over wages and conditions through compulsory arbitration (Chapman, Isaac and Niland 1984). In reviewing the scope of change that has occurred since that time, it is important to note that the system was born in dispute. Without a dispute there could be no award.

The Commonwealth Court of Conciliation and Arbitration (CCCA) was established through the *Conciliation and Arbitration Act 1904*. This first court was established so that an authority would exist that could settle the kinds of industrial disputes that resulted in the great strikes of the 1890s, which were considered to be the great social problem of the age (Hamilton 2012, footnote 22). Parliaments in Australia decided that a means of preventing and resolving conflict was needed. The CCCA was designed to have the power to not only conciliate disputes, but also eventually to arbitrate. Once the CCCA made a ruling, through either conciliation or arbitration, this ruling became law and was known as an award.

In the early twentieth century when the original awards were developed, it was not unusual for judicial bodies (like the CCCA) to perform administrative functions. In doing so, the CCCA was required to act according to equity, good conscience and the substantial merits of the case (Hamilton 2012, footnote 25).

The bodies responsible for the creation, termination and variation of federal awards have changed over the last century. The CCCA operated from 1904 to 1956, after which it was replaced by the Conciliation and Arbitration Commission from 1956 to 1973. The Australian Conciliation and Arbitration Commission then operated from 1973 to 1988, after which it became the Australian Industrial Relations Commission (AIRC) from 1988 to 2009. In July 2009, Fair Work Australia commenced as the new national WR tribunal and the AIRC finished operating in December 2009. In 2012, Fair Work Australia was renamed as the FWC.

State-level courts were also created at around the same time as the federal court, but the CCCA emerged as the most influential of these authorities. This was partly as a result of a deliberate strategy by some trade unions to extend disputes across state borders, so that an award could be created under the federal court's jurisdiction (Stewart 2015). However, it also reflected the extensive coverage of the wages under its mandate. By the 1920s, more than half of all wage changes were affected by changes to its awards (Hancock 1984).

For most of the 20th century, awards were documents that contained the detailed resolution of a dispute over employment wages and conditions. One or more parties to the dispute

would bring these disputes before the court. In some cases, the disputes were resolved through consensus, and the court's role was limited to approving the content of an award. These awards looked more like the enterprise agreements of today. In other cases, the disputes were heavily contested, and the court was required to arbitrate by balancing the differing views of the parties, and weighing the evidence provided.

Representatives for employees, most often unions, or representatives for employers typically brought disputes. From this process, awards were developed at the industry level, occupational level and often at the single or multi enterprise level. Organisations often responded to more than one award, since different classifications of employee could be covered by different awards. This was exacerbated by many small unions claiming rights to represent different groups of employees doing different tasks within an organisation — which also often led to demarcation disputes between unions. At their peak, more than 5000 awards operated in Australia at the one time.

Influences on award determinations over time

Perceptions of what is fair have always been important

From early on, the CCCA demonstrated that its objective was not only to mediate between parties to a dispute (and to arbitrate when an agreement could not be reached) to reduce their political, social and economic costs. Rather, the court also sought to ensure that outcomes were fair, especially when there was a significant difference in bargaining power between the parties to a dispute.

The first major manifestation of this occurred in 1907 in the case of Ex parte H.V. McKay (Harvester Case)[99] when Justice Higgins first described a fair and reasonable wage for workers in the Sunshine Harvester Works. This became the Harvester standard of a basic wage, and was subsequently applied in the Marine Cooks, Bakers and Butcher' Association of Australia v The Commonwealth Steam-Ship Owners' Association case in 1908, and later extended to all awards. Justice Higgins noted that 'one cannot conceive of industrial peace unless the employee has secured to him wages sufficient for the essentials of human existence'(Chapman, Isaac and Niland 1984, p. 5). In this way, the basic wage came to be regarded as the applicable wage for unskilled work.

The concept of comparative wage justice

Until 1966, award wages contained the basic wage, plus a margin that was determined by the comparative skills, responsibilities and experience required to carry out each particular occupation. The relativities between the original set of margins for different occupations were set using a mixture of intuition, logic and, to some extent, the market-determined

[99] Ex Parte H. V. McKay [1907] 2 CAR 1.

relative wages of different occupations. Skills and expertise from professional or trade training, experience, and occupations that involved responsibility, physical strain, the exercise of authority, unavoidable danger or discomfort, and the need for care, alertness or intelligence were all considered to deserve higher margins (Hancock 1984). Skills, qualifications and experience continue to influence the differences in modern award classifications across occupations, and tasks that cause employees to experience discomfort, danger or physical strain are often still compensated through modern award allowances.

The margins above the basic wage were originally determined on an occupation-by-occupation basis, but as time went on, the relative wage rates between occupations became stable and were set and altered in reference to a fitter in the metal industry. By the end of World War II, it was generally accepted that a change in the margin of a fitter in the metal industry would signal a change for margins more broadly (Hancock 1984). In 1952, Justice Galvin remarked explicitly that:

> … first the members of the Court and later Conciliation Commissioners have adopted the practice of treating the rate of pay prescribed for the general engineering fitter as the focal point or yardstick upon which to measure the rates of other skilled tradesmen, and to relate thereto the services of the semiskilled and unskilled class of workers… That has been proved time and time again, and there is no more recent exemplification of it than what happened subsequent to the Full Court's 1947 Metal Trades decision, where notwithstanding the clear pronouncement that is was designed to cover the special circumstances of the Metal Trades industry, it was quickly imported into the awards of most other industries. (Hancock 1984, p. 87)

Due to this flow-on between awards, there was little room for wage changes to vary between industries, either to reflect productivity improvements in one industry or to relieve cost pressures that had reduced capacity to pay higher wages in another industry (Mitchell 1998). Similarly, wage relativities neither responded to the increasing demand for service skills (which were different from the skills required in manufacturing or construction), nor shifted to prompt workers to move away from industries experiencing slowing growth to those that were growing quickly. Once having established a set of wage relativities, the focus shifted to the overall wage increase that would flow through the system.

> The most notable feature of this system, at least where the public was concerned, was the practice that grew up of having 'national wage cases'. These involved an application by one or more unions to seek a generalised increase in the wage rates set by a number of specified awards. These would be used as a test case for all other federal awards. The increase sought might be to compensate workers for the effect of price inflation over the period since the last wage case, and/or to ensure that workers shared in the benefits of any increases in national productivity. (Stewart 2013, p. 22)

By the 1980s, the AIRC was reluctant to allow award wages to depart significantly from the established relativities.

> We have seen that there is a tendency for changes in industrial pay relativities over time to be fairly small, and not obviously related to economic variables. At least the former fact is

> probably due to the widespread use of comparability in negotiations over wages, whether these are played out in front of a body like the Arbitration Commission, or bargained between unions and employers. It is seen as fair by both sides if workers maintain their proportionate wage relativity with some perceived reference group, or in a more general sense their place in the pay ranking. (Norris 1983, p. 158)

This sentiment, coupled with an understanding that those doing work of comparable value and difficulty should be paid the same wage, is known as comparative wage justice.

How comparative wage justice has been applied

Studies of award wage rates between 1965 and 1975 show that dispersion between award wages seemed to remain reasonably stable over time (table 11.1). The data suggest that while the relativities between awards did change from one year to the next, the system adjusted back to keep overall relativities largely unchanged over the decade.

Table 11.1 Dispersion of award wages, 1965 to 1975
Coefficient of variation [a]

Year	*Per cent*
1965	16.7
1971	19.5
1974	17.6
1975	15.6

[a] The coefficient of variation is calculated as the standard deviation divided by the mean. It shows the extent of variation of observations in comparison to the mean of the population.

Source: Norris (1977).

On rare occasions, wage relativities have been reappraised. The current relativities within and between awards were largely determined during an extensive review of award wages in 1989 at a time when the AIRC moved to consolidate and standardise the minimum rates of pay across awards.

Referred to as the Minimum Rates Adjustment, the objectives included:

- establishing skill-related career paths to provide an incentive for workers to continue to participate in skill formation
- eliminating impediments to multiskilling and broadening the range of tasks which a worker may be required to perform
- creating appropriate relativities between different categories of workers within the award and at enterprise level
- ensuring that working patterns and arrangements enhance flexibility and the efficiency of the industry

- including properly fixed minimum rates for classifications in awards related appropriately to one another, with any amounts in excess of these properly fixed minimum rates being expressed as supplementary payments
- updating and/or rationalising the list of respondents to awards
- addressing any cases where award provisions discriminate against sections of the workforce.[100]

The AIRC intended the adjustments to rectify irregularities that had developed through time, as changes to awards were determined without explicit consideration to changes in other awards. According to the AIRC:

> [f]or too long there have existed inequitable relationships among various classifications of employees. That this situation exists can be traced to features of the industrial relations system such as different attitudes adopted in relation to the adjustment of minimum rates and paid rates awards; different attitudes taken to the inclusion of overaward (sic) elements in awards, be they minimum rates or paid rates awards; the inclusion of supplementary payments in some awards and not others; and the different attitudes taken to consent arrangements and arbitrated awards.[101]

Through this adjustment process and subsequent simplification processes (including that in the late 1990s), a set of relativities was established that used the structure of classifications in the Metal Industry Award (as is traditional) as the benchmark against which occupations in different awards were compared.

The Metal Industry Award included classifications ranging from C14 which was the lowest, to C1(b) at the top. Classifications between C14 and C11 were for low or semiskilled occupations. The C10 rate represented the minimum wage for a qualified tradesperson and classifications above C10 were for occupations requiring more advanced skills and qualifications, up to C1(b) for professional engineers. When the Federal Minimum Wage (FMW) was introduced in 1997, it was set at the C14 rate. In 2005, Justice Guidice (2005) remarked that most awards had a 'classification structure consistent with the 14 levels operating in the metal industries award although very few awards have all 14 levels and most have fewer than 10 levels'.

The process the AIRC used during this review included as a first step, identifying the classification in each award that best corresponded to the C10 rate. They did this by comparing the tasks and responsibilities that corresponded most closely to those in the C10 description in the Metal Industry Award. This classification then became the benchmark for the other classifications within the award. From there the existing relativities within the award were considered, although it was not necessarily the case that these were changed. Qualifications frameworks were also used to compare skills between different types of occupation.

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100 Review of the Structural Efficiency Principle [1989] AIRC February [Dec 340/89 M Print H8200].

101 Review of the Structural Efficiency Principle [1989] AIRC February [Dec 340/89 M Print H8200].

Under the FW Act, the FWC is now restricted in its ability to make changes to minimum wage rates in modern awards (apart from flow through adjustments made during annual wage reviews), unless those changes can be justified by 'work value' reasons. Work value reasons, according to the FW Act include:

- the nature of the work
- the level of skill or responsibility involved in doing the work
- the conditions under which the work is done.

These requirements make it more difficult for the relativities in award wages to shift, without good reason being presented, and therefore effectively lock in the relativities that exist.

The need to consider the economic capacity to pay

From as early as the 1920s, the wage determining bodies have considered the balance between setting a fair and reasonable wage and the capacity of businesses to pay. In 1931, the prevailing economic conditions of the Great Depression led to a real wage cut of 10 per cent. In the Court's decision, it was noted that '[a]lways it has been necessary and always it will be necessary to entertain applications to vary awards on the ground of substantial change in economic conditions' (Chapman, Isaac and Niland 1984, p. 6). Similarly, in 1952, Justice Galvin did not grant an increase to wages in the metal trades awards, due mostly to the assumption that any increase would flow onto other awards, and that, at that point in time, wide-spread increases in wages were likely to have adverse effects on the state of the national economy more broadly (Hancock 1984).

A more recent example includes the FWC's consideration of an exemption of the minimum wage increase for employers under the Pastoral Award 2010 due to the effects of drought in 2013-14. In this case, the exemption was not granted, but it still underlines that the FWC considered the impacts of its decisions on businesses (and therefore on employment).[102]

A similar circumstance arose in the Australian Fair Pay Commission 2006 Wage-Setting Review and the AIRC Wages and Allowances Review 2006 when the National Farmers Federation (NFF) proposed an increase of no more than the CPI due to the difficulties faced by farmers experiencing drought (NFF 2006). The following year, the NFF requested that wage increases should be set according to one of two methods. The first was the capacity to pay wages at the lowest common denominator, having regard to the industries facing difficult economic conditions. The alternative was to allow any wage increases to be deferred for employers in the agriculture industry, especially those in areas declared as under exceptional circumstances (NFF 2007a). After two farm visits for three of the commissioners, the (then) Australian Fair Pay Commission, decided to defer the annual

[102] Annual Wage Review 2013-14 [2014] FWCFB 3500 [4 June 2014].

wage increase to all farmers in receipt of the exceptional circumstance interest rate subsidy payment for 12 months. Subsequently, the NFF described the decision as 'balanced, appropriate and consistent with current conditions across the economy as a whole' (NFF 2007b).

Consideration for the needs of the low paid

Consideration for the needs of the low paid has consistently been reflected in award decisions through a greater willingness to adjust the rates of low-paid workers more often and by larger amounts (especially in proportional terms) than the wages of higher paid workers. Until 1966, this primarily occurred because changes to the basic wage were considered annually, whereas changes to the margins for different occupations in different industries occurred in a more piecemeal and less consistent fashion. As a result, the wage differentials between low skilled workers for whom the basic wage constituted a relatively large share of their total wage, and the regulated wage floor for high skilled (and higher paid) workers were reduced over time by successive increases in the basic wage and less consistent increases in margins.

This erosion of differentials between low and high skilled workers persisted until the decision was made in 1966 to determine wage changes based on the 'total wage' of each award, that is, the sum of the basic wage and the relevant margin.

Between the early 1990s and 2005, the AIRC mostly awarded dollar amount increases to award wages during the annual safety net wage adjustments. These dollar amounts were often uniform across wage classifications[103], which compressed the relativities between award minimum rates. In 1994, the AIRC noted that:

> … there is clearly a practical limit to the utility of using flat dollar increases to adjust the safety net as, over time, such increases will create unsustainable pressures to restore pre-existing relativities. However, we are not satisfied that we have yet reached that point.[104]

[103] There was an exception in 2001, when the AIRC granted a three-tier adjustment of $13 per week for those earning up to $490 per week, $15 per week for those earning between $490 and $590 per week, and $17 per week for those earning more than $590 per week (Healy 2009).

[104] Second Safety Net Adjustment and Review [1994] AIRC September [Dec 1634/94 M Print L5300].

The change in the differences between the 14 classifications in the Metal, Engineering and Associated Industries Award 1998 (subsequently the Manufacturing and Associated Industries and Occupations Award 2010) exemplifies the compression of wage rates in awards. Over the period from 1993 to 2014, the wage rates at the lowest classifications have increased, while the highest rates have decreased in real terms (table 11.2 and figure 11.5). The C10 rate for a qualified tradesperson is often used as a marker between the low skill classifications below and the high skill classifications above. The wage rates for the lower classifications have increased as a proportion of the C10 rate, while the higher classifications have decreased.

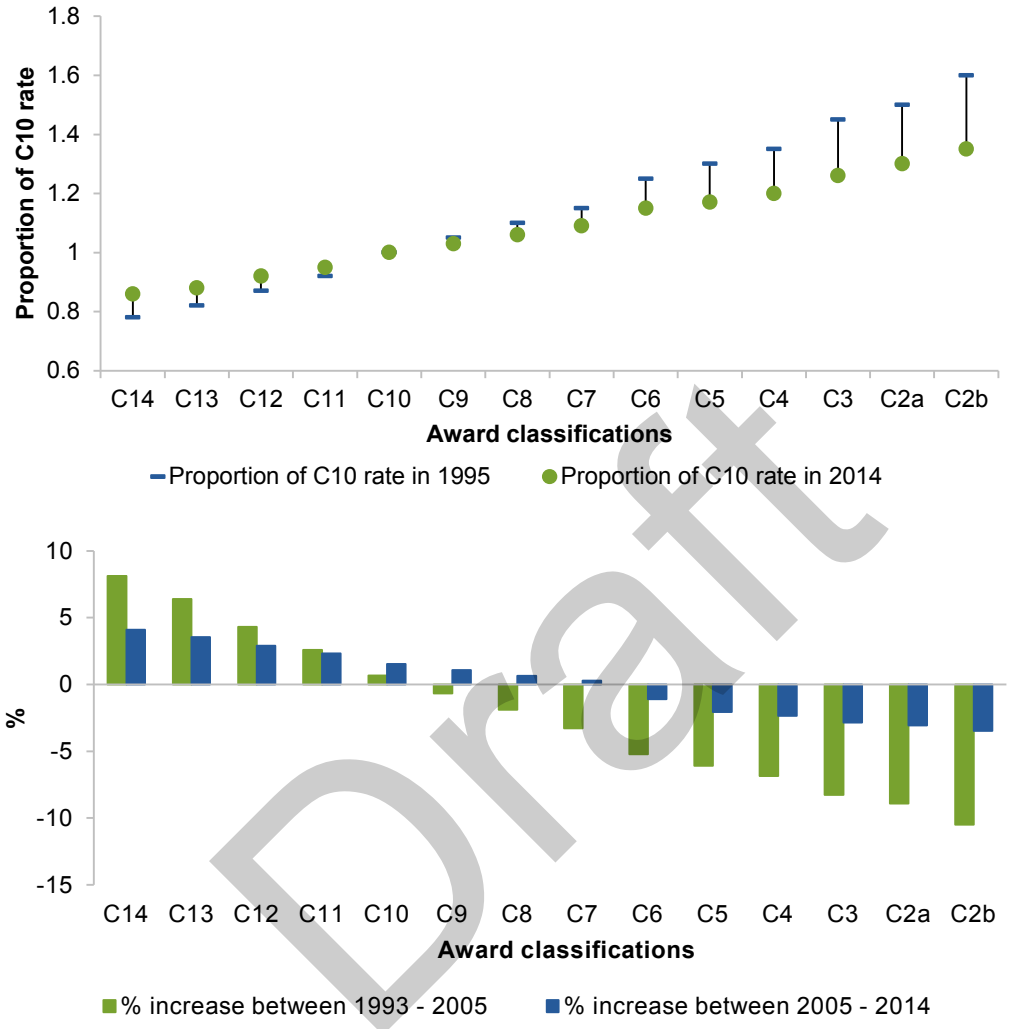
Table 11.2 **Changes in award classification minimum weekly wage rates in the Metal, Engineering and Associated Industry Award[a]**
1993, 2005 and 2014

Level	*1993*[b]	*2005*	*2014*	*% increase between 1993 - 2005*	*% increase between 2005 - 2014*	*Proportion of C10 rate in 1993*	*Proportion of C10 rate in 2014*
	$2014	$2014	$2014	%	%		
C14	569.37	615.66	640.90	8.13	4.10	0.78	0.86
C13	598.59	636.88	659.40	6.40	3.54	0.82	0.88
C12	637.96	665.48	684.70	4.31	2.89	0.87	0.92
C11	674.53	692.04	708.20	2.60	2.34	0.92	0.95
C10	730.00	734.87	746.20	0.67	1.54	1.00	1.00
C9	766.57	761.44	769.60	-0.67	1.07	1.05	1.03
C8	802.97	787.87	793.00	-1.88	0.65	1.10	1.06
C7	839.54	811.89	814.20	-3.29	0.28	1.15	1.09
C6	912.50	864.89	855.50	-5.22	-1.09	1.25	1.15
C5	949.25	891.46	873.00	-6.09	-2.07	1.30	1.17
C4	985.47	917.89	896.40	-6.86	-2.34	1.35	1.20
C3	1058.43	970.89	943.30	-8.27	-2.84	1.45	1.26
C2a	1095.00	997.45	966.80	-8.91	-3.07	1.50	1.30
C2b	1167.97	1045.37	1009.10	-10.50	-3.47	1.60	1.35

[a] The Metal, Engineering and Associated Industries Award 1998 preceded the Manufacturing and Associated Industries and Occupations Award 2010. [b] All values are in 2014 dollars.

Sources: Healy (2009, p. 94) and Manufacturing and Associated Industries Award 2010.

Figure 11.5 **Changes in award classification minimum weekly wage rates in the Metal, Engineering and Associated Industry Award [a]**



[a] The Metal, Engineering and Associated Industries Award 1998 preceded the Manufacturing and Associated Industries and Occupations Award 2010. All values are in 2014 dollars.

Sources: Healy (2009, p. 94) and Manufacturing and Associated Industries Award 2010.

Linking wage increases to productivity and efficiency

By the late 1980s, there was a growing consensus that the centralised wage determination system was not resulting in efficient wage outcomes. There was an increasing push towards allowing wages and conditions to be at least partly determined at the enterprise level.

In 1987, the AIRC briefly ventured into enterprise-level wage determinations, in which a wage increase of up to four per cent could be directly negotiated between unions and employers at the enterprise level. However, it backed away from this in 1988. Nevertheless, the intent to tie wage increases to increases in productivity remained and led to the introduction of the Structural Efficiency Principle. Under this principle, wage increases needed to be negotiated to reflect improvements in the competitiveness and efficiency of the industry (Wooden and Sloan 1998). This was the start of the principle that wage increases under awards should be tied to improvements in industry performance.

Awards contain more than rates of pay

The detail and complexity of awards is also partly a product of history. For example, in the 1980s, the Metal Trades Award contained more than 350 classifications of employee.

> By the mid-1980s, awards had grown from relatively short instruments covering some basic terms and conditions of employment, into much longer documents often running into hundreds of clauses and sub-clauses, finely detailing almost every aspect of employment. This process was assisted by decisions of the High Court in the 1970s and 1980s which helped to restrict the concept of managerial reserved rights and thus allowed the expansion of matters which might be covered by awards. (Mitchell 1998, p. 118)

Modern awards continue to reflect this history. They can include descriptions of occupations and duties, ordinary hours of work, breaks, allowances, superannuation, leave and other entitlements, and procedures for termination, consultation and dispute resolution. There are separate pay and conditions for trainees, apprentices, young employees and employees with disabilities.

These terms and conditions of employment are the result of more than 100 years of arbitration between employer and employee representatives. They have been built up as issues have arisen, and contested and refined over many years of review. They continue to be debated, including by participants in this inquiry.

However, despite their detail, modern awards are much simpler, and provide more room for enterprise level flexibility than their earlier incarnations. Moreover, their adjustment need no longer be born in dispute. The modernisation and subsequent review process allows for change without first creating conflict. This may be a deeply underestimated benefit of changes in the last two decades.

Multiple review processes and changes to legislation have limited the content that is currently found in awards. Most businesses (76 per cent) now only respond to one award, and very few have to respond to more than three (3 per cent). However, a disproportionate number of large organisations respond to more than three awards (17 per cent of

organisations) compared with only 2 per cent of medium organisations and less than 1 per cent of small and micro businesses (Wright 2013).[105]

The number of allowances is a good example of the role that history plays in current awards, but also demonstrates how much change has occurred (box 11.2). In recent reviews, the FWC has committed to monitor allowances to make sure that awards only contain those that continue to be relevant.

Box 11.2 The role of allowances in awards

Allowances in awards are payments that are made to employees when they undertake specific tasks or incur specific costs. Allowances have a long history, and until recently many allowances remained in awards despite being redundant. For example, during an examination of allowances in 2006 several redundant allowances were identified including an allowance for retail employees who rode a bicycle (to carry out their duties), and for employees who undertook specific tasks when a vessel was wrecked or stranded in the course of a voyage (Award Review Taskforce 2006). The Building and Construction General On-site Award 2010 also provides an example of an outdated provision in the form of an allowance for employees to have an x-ray every six months at their employer's expense if they have been working in a tuberculosis home or hospital; the last of which was closed in 1981 (Master Builders Australia sub. 157, p. 23).

Allowances are used for several reasons:

to compensate employees for costs they incur. For example, a meal or a meal allowance is provided to some employees who have to work overtime without sufficient notice.

to compensate employees for undertaking difficult or unpleasant tasks. For example, a hot work allowance is paid to some employees when they work for more than one hour in the shade when the temperature is raised artificially to between 46 and 54 degrees.

to compensate employees for taking on extra responsibility or supervisory roles. For example, a leading hand allowance is paid to some employees who supervise two to five other employees.

Allowances introduce flexibility into awards by allowing targeted payments to certain groups of employees. However, they can also impose costs if they are numerous and complicated to apply, or if they are negotiated as a quasi-wage increase and could be easily rolled into award wage rates. Allowances in modern awards are also often changed during negotiations for enterprise agreements. The Department of Employment found that in more than half of the agreements examined, allowances were increased above the award, and in 18.5 per cent they were decreased. No other type of clause was decreased as often as allowances (Department of Employment sub. 158, p. 14).

Allowances and penalty rates provide some wage flexibility to the extent that they take into account the variations in working patterns of employees at the same classification.

On the other hand, it can sometimes be in the interest of employers and employees to roll allowances into wages (for example, as in annualisation of penalty rates) or to allow people

105 The survey covered non-public sector organisations in Australia.

to trade off particular allowances against other benefits (for example, time off at a certain time in exchange for a reduced overtime rate at another time). Under the FW Act, trade-offs under enterprise agreements and IFAs must meet the better off overall test, which implicitly requires some notion of the wage equivalent of any given allowance at the employee level. The extent to which this can be practically achieved affects the capacity of IFAs to introduce meaningful flexibility into awards and their application (chapter 16).

11.4 Awards in the modern era — the shift to a safety net

The current set of modern awards is the culmination of a number of processes to review, simplify, modernise and consolidate awards. It also reflects a shift in the role that awards play more broadly in the WR framework.

The Keating Government's *Industrial Relations Reform Act 1993* (Cth) stipulated that awards should 'act as a safety net of minimum wages and conditions of employment underpinning direct bargaining' (s. 88A(b)) (Healy 2009). By the 1990s, the award system was viewed as providing a 'floor of minimum labour standards' (Campbell and Brosnan 1999, p. 355) and as a safety net above which employees would receive wage increases through enterprise level bargaining (Stewart 2013).

However, as a safety net in the 1990s, coverage of the award system excluded:

- around 15 per cent of the employed labour force who were not considered to be 'employees', including for example those who were self employed
- around 20 per cent of employees, including workers in small, private sector workplaces who were often located 'at the bottom of the income and occupational hierarchy' (Campbell and Brosnan 1999, p. 356) and of course managerial and executive level staff (although in some cases, lower level supervisors were also excluded from awards).

The protections offered by the awards were also directed largely towards permanent, full-time, waged employment. Those clauses directed towards casual employees, fixed-term employees, part-time permanent employees, apprentices and trainees were primarily designed to limit the numbers of people employed under these types of arrangements (Campbell and Brosnan 1999). This was because unions often saw these types of employment as undermining the primacy of full-time waged employment (Campbell 1996), especially where there was a significant degree of substitutability between workers under different types of arrangements and potentially a wide variation in relative costs.

Clauses limiting the employment of certain types of employees, however, were classified as a 'not allowable award matter' and were removed under the *Workplace Relations Act 1996* (Cth) (s. 515). Coverage was also generalised (and expanded) in subsequent reforms as coverage terms were changed from being respondent-based (including lists of unions,

employers and employer organisations) to being industry-based, with lists of occupations or tasks.

Nevertheless, while the role of awards as a safety net has been retained in legislative changes since the early 1990s, including most recently in 2009, the coverage of awards continues to exclude a significant minority of the employed workforce including those not considered to be employees and those who have not traditionally been covered by awards.[106]

Furthermore, while Prime Minister Keating in 1993 described awards as a safety net that was not 'intended to prescribe the actual conditions of work of most employees, but only to catch those unable to make workplace agreements with employers'(O'Neill 2005), awards continue to directly set the wages and conditions of employment for almost one in five employees. Consequently, while the shift to a safety net signifies an important change in emphasis for awards, and for the WR system in Australia more generally, the efforts to decentralise the system have not eliminated the role awards have always played as wage setting instruments and as a floor for negotiating above award wages and conditions.

Award modernisation

The most ambitious modernisation of awards commenced in 2008 with a request from the then Minister for Employment and Workplace Relations to the AIRC (box 11.3). However, several other reviews and simplification processes preceded it. These included: the Section 150A Review Process (1994 – 1997); the Section 151 Review of operation of awards (1994 – 2005); and Award Simplification (1997 – 2005) (FWC 2014a).

Work had also already been done by the Award Review Taskforce in 2006 as part of the intention to rationalise and simplify awards under Work Choices (Minister for Employment and Workplace Relations 2005). However, one of the key recommendations from that review — to rationalise awards according to Australian and New Zealand Standard Industrial Classification codes — was not developed under the award modernisation process.

The request from the Minister placed several restrictions on how the AIRC was to modernise awards, including that, 'as far as possible, the modernisation process should not either disadvantage employees or increase costs for employers' (Stewart 2015, p. 120).

106 Fair Work Act 2009, s. 143(7).

Box 11.3 Terms of reference for the AIRC to carry out award modernisation

The request specified that the Commission was to have regard to the following factors:

(a) promoting the creation of jobs, high levels of productivity, low inflation, high levels of employment and labour force participation, national and international competitiveness, the development of skills and a fair labour market;

(b) protecting the position in the labour market of young people, employees with a disability and employees to whom training arrangements apply;

(c) the needs of the low-paid;

(d) the desirability of reducing the number of awards operating in the WR system;

(e) the need to help prevent and eliminate discrimination on the grounds of race, colour, sex, sexual preference, age, physical or mental disability, marital status, family responsibilities, pregnancy, religion, political opinion, national extraction or social origin, and to promote the principle of equal remuneration for work of equal value;

(f) the need to assist employees to balance their work and family responsibilities effectively, and to improve retention and participation of employees in the workforce;

(g) the safety, health and welfare of employees;

(h) relevant rates of pay in Australian Pay and Classification Scales and transitional awards;

(i) minimum wage decisions of the Australian Fair Pay Commission;

(j) the representation rights, under this Act or the Registration and Accountability of Organisations Schedule, of organisations and transitionally registered associations.

Source: Award Modernisation - Request from the Minister for Employment and Workplace Relations [2008] AIRC 387 [29 April 2008].

The process of award modernisation was complex and detailed, and involved extensive consultation with stakeholders and interested parties. It was also done remarkably quickly. During the process, both employer groups and unions expressed concerns about the timeframe for the modernisation process and the difficulty of providing input into the process within the tight deadlines[107]. Despite this, '[t]o the surprise of many, the massive and complex Part 10A award modernisation process was completed on schedule' (Stewart 2015, p. 120).

The initial planning process that set out the process of review and key dates was discussed with ACCI, the Australian Council of Trade Unions and the Australian Industry Group before it was recommended by the AIRC.[108]

The process started with around 100 broad industry groups that were defined by the existing industry panel system in the AIRC. Within each of these industry (and, in some

107 Award Modernisation – Request from the Minister for Employment and Workplace Relations [2008] AIRCFB 618 [22 July 2008].

108 Award Modernisation - Request from the Minister for Employment and Workplace Relations [2008] AIRC 387 [29 April 2008].

cases, occupational) groups, the existing federal award was used as the starting point for the drafting of a modern award. Similar state awards, and other federal awards were then allocated to one of the broad groups.[109]

Extensive consultation was carried out with interested parties and the review was conducted by a full bench of the AIRC. At the end of the process, the AIRC had drafted and agreed to a set of 122 modern awards — a considerable achievement given that there were around 4000 awards in 2008 when the process began (Stewart and others sub. 118, p. 24). The 122 modern awards were then reviewed in 2012 (as per the requirement of the original request from the government) ahead of the first four yearly review to ensure they were operating as expected and without any technical problems.

Some participants in this inquiry have expressed satisfaction in the modernisation process and suggest that it is now 'far easier than it has ever been for a worker or small business to determine which award applies to them and what rates must be paid' (Stewart and others sub. 118, p. 24). Others submit that award modernisation failed (Housing Industry Association sub. 169 and HopgoodGanim sub. 225), and that due to the tight timeframe, the process consolidated and rationalised awards rather than modernised and adapted awards to contemporary settings (ACCI sub. 161, Chamber of Commerce and Industry of Western Australia sub. 134, and VECCI sub. 79).

The award modernisation process continues to influence the ongoing process for award reviews including the continuing separation of the consideration of the wage rates in awards (considered as part of the annual wage review) and the consideration of everything else (as part of the four yearly reviews of awards).

The FWC has also expressed reluctance to revisit issues during the current four yearly review that were decided upon during the modernisation process and the interim two year review. Anyone seeking to vary an award as part of the four yearly review will be required to provide evidence that such a change is necessary to achieve the modern awards objective, while keeping in mind that all modern awards created during the award modernisation process have already been determined to meet the objective. Some have nevertheless expressed regret that the exercise did not live up to their expectations and that there is still a need for urgent and real reform (ACCI sub. 161, VECCI sub. 79 and Housing Industry Association sub. 169). Others have expressed a feeling more akin to exhaustion.

11.5 What role do awards play?

The intent of the changes introduced under the FW Act was for awards to be 'an important safety net and an effective floor for collective bargaining'(Rudd and Gillard 2007, p. 10).

109 A list of all the previous awards that fed into the first round of the award modernisation process can be found on the AIRC's website.

By design, awards provide a floor for collective bargaining since they provide the benchmark for enterprise agreements, which must make employees 'genuinely better off overall'(Rudd and Gillard 2007, p. 10). As a safety net, awards also increase the wages and conditions for some employees above what they would otherwise be able to negotiate for themselves. This is evidenced by the almost one in five employees whose wages and conditions are set at exactly the award rate (and who are not under an enterprise agreement) — in this way the safety net can be said to 'bind'. Awards therefore rectify some of the imbalance of bargaining power that can exist in employee-employer relationships. One effect of this is for income to be redistributed from employers to employees. Awards can also affect employers' decisions about factors and technology used in production, and employees' decisions about education and training (chapter 12).

The relative bargaining strength of parties to employment contracts has always been a defining aspect of industrial relations laws and regulations around the world. The view put by Otto Kahn-Freund that the 'main object of labour law [is] to be a countervailing force to counteract the inequality of bargaining power which is inherent and must be inherent in the employment relationship' remains the dominant perspective (Creighton and Stewart 2010, p. 5). In support of this notion, a burgeoning economic literature has developed to demonstrate that even 'vanilla' firms have some capacity to set wages (chapter 1).

This view has long been influential among Australian commentators:

> It is unrealistic to postulate a world devoid of market power – of a multitude of separate employers and separate workers freely contracting with each other, each too insignificant to influence overall market outcomes. That kind of world affords no place for the large employer, nor does it encompass trade unions which seek to counter the employers' market power and to establish power of their own. (Hancock 1982, p. 43)
>
> In most situations which require negotiation over wages or other conditions of employment, employers enjoy a marked advantage both in terms of resources and bargaining skills. (Creighton and Stewart 2000, p. 4)

Two economists in the field, Borland and Woodbridge (1999, p. 91), argue that, at least where high costs of mobility for workers who exit from an employment relation exist, the bargaining power of those employees is expected to be lower. They also suggest that deregulating wage setting in Australia (at least to the extent necessary to see an increase in employment) would result in a substantial shift in bargaining power towards employers and away from employees.

The AIRC has also explicitly recognised that awards play a role when there is unequal bargaining power, and that the maintenance of a safety net is important for those for whom awards set their take home rates of pay (Healy 2009).

> … [N]o one would suggest that all employees are capable of bargaining. Bargaining is not a practical possibility for employees who have no bargaining power. It is to be inferred from the

statutory scheme that the award safety net should be adjusted with the interests of these employees in mind.[110]

Is there evidence that awards have increased the wages received by workers?

Research suggests that, at least until the 1990s, Australia had a relatively low dispersion of pre-tax employment income and that this was likely to be partly due to awards (since awards tended to raise wages in the bottom half of the household wage distribution).

- Among 25 countries in the 1960s, Australia and New Zealand (which still had awards at the time), and Czechoslovakia and Hungary (both communist at the time) had the lowest degree of dispersion of income (Lydall (1968), as cited in Whiteford 2013).
- Whiteford (2013) considered that the most likely reason that Australia continued to have a less unequal distribution of earnings than the majority of OECD countries, even into the late 1990s, was the legacy of Australia's wage fixing institutions (awards), which compressed wage differentials.
- According to Borland and Woodbridge (1999, p. 97), 'earnings dispersion and the structure of earnings between skill and demographic groups in Australia are consistent with the hypothesis that the wage regulation system in Australia has acted to narrow earnings relativities, in particular for low-wage workers'. Borland and Woodbridge (1999) estimated that, relative to the United States, the effect of wage regulation in Australia may be to increase earnings of low-wage workers by around 15 per cent.

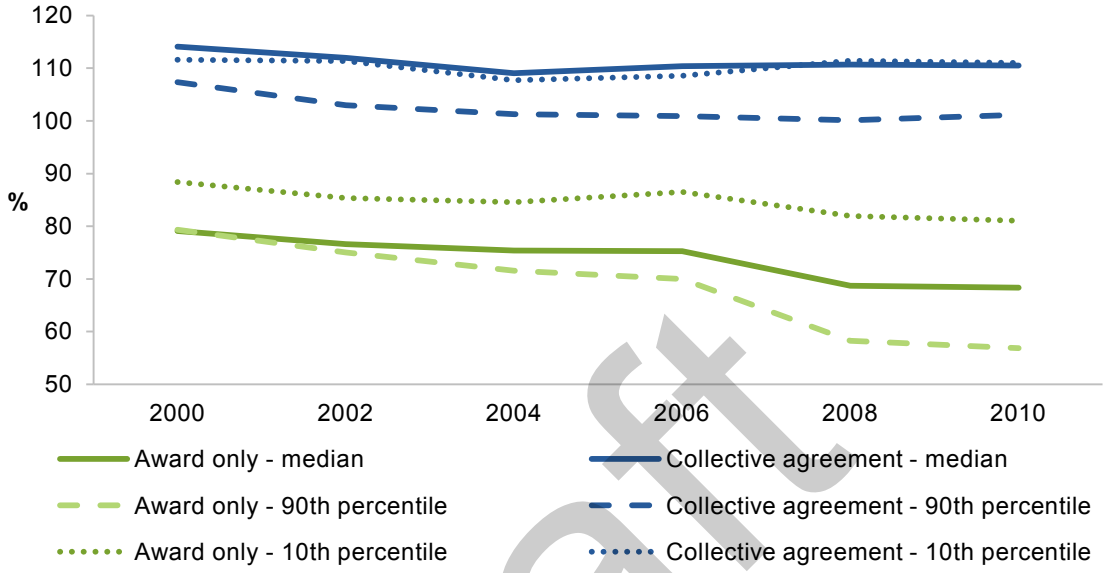
However, the ability of the FWC (and its predecessors) to influence earnings has declined over time (Healy 2009). As awards shifted from setting wages to setting a safety net, and as fewer employees have their earnings explicitly determined by the rates set in awards, the link between awards and earnings has become weaker. Earnings for all employees and for award-reliant employees have diverged over time (figure 11.6), although most of the divergence has occurred at higher income levels. The Australian Catholic Council for Employment Relations (sub. 99, p. 6) suggest that families of four dependent on one adult earning an award wage at or below the C10 wage rate would be living in poverty (as defined as earning below 60 per cent of the median) in 2015 compared with 2004 when wages at or above the C12 rate would support a family of four above the poverty line. Nevertheless, awards remain relevant to the pay distribution given the persistence of a significant linkage of many employees' wages to awards and that the majority of these earn less than the median wage.

On the other hand, to the extent that award wages are excessive, they may create unemployment, and for some groups, exacerbate economic disadvantage, a problem they share with minimum wages more generally (chapter 8).

110 Safety Net Review – Wages [2004] AIRC [Print PR002004].

Figure 11.6 **Relative weekly earnings for full-time adult non-managerial employees**

Wage relative to average of all wages, 2000 to 2010, median, 10th and 90th percentiles[a,b]



[a] The data for 2014 (not shown) are anomalous. The 2014 data show a reversion to 2000–2002 levels, but the reason for this is unclear.

[b] For example, the award- and collective agreement-median earnings are calculated as a percentage of the median earnings of all full-time non-managerial employees (for all methods of setting pay). For these data, employees on a collective agreement receive more than the average median earnings, and employees on award wages receive less. The same pattern holds for earnings at the 10th and 90th percentiles.

Source: ABS, *Employee Earnings and Hours, Australia*, Cat. No. 6306, table 5 (various issues).

Is this role for awards as a binding safety net justified?

As part of the safety net in Australia's WR framework (along with the national minimum wage and the NES), the role of awards is to ensure that all employees in Australia receive reasonable wages and conditions for their work, and to counter the poor bargaining power of vulnerable employees. Four conditions under which regulated award wages and conditions *may* be justified include:[111]

- when employers hold significant bargaining power, which can result in inefficient wages (or allow employers to capture any rents, rather than employees).

111 These justifications, and evidence for them in Australia, are discussed in more detail in chapter 8 and chapter 1.

- when increasing the wages of the low paid through minimum wages and conditions is a better method of income redistribution than the tax-transfer system[112] — due to relatively higher costs and distortions in markets created by the tax-transfer system, both in terms of economic efficiency and administration (as discussed in chapter 8). This justification, while also resulting in redistribution in income to low paid employees, is quite separate to the redistribution required to rectify any bargaining power imbalance discussed above, and is just as likely to exist in a perfectly competitive labour market environment.
- where awards overcome some of the biases against the acquisition of general skills. Business incentives to provide training are blunted for on-the-job training for skills that are readily transferable to other businesses (Brunello and De Paola 2004). While state-subsidised education may substantially alleviate this, awards provide very strong and predictable signals to employees about the returns from training.
- where awards address social biases against particular groups — most notably women. In a meticulous analysis of gender wage differentials (controlling for the observable characteristics of people, such as education), Wilkins and Wooden (2011, p. 20) found evidence that awards have an equalising effect on the pay of men and women.

Awards also provide a useful template for setting wages and conditions especially for smaller businesses.

Under these conditions, regulated award wages and conditions as part of a safety net help to create a better functioning labour market than would exist in their absence.

11.6 Is there another way?

Alternative systems

Australia is the only country in the world that has supplemented a basic minimum wage, some standard employment conditions and employee protections by an additional layer of detailed minimum wages and conditions across multiple job classifications throughout the economy.[113] Since many other countries appear to have reasonable, if not better, basic working conditions and earnings than Australia, this might suggest that awards are no longer relevant.

However, this neglects some other aspects of WR systems. Other countries use a different mix of regulations to tilt the balance of power in employment relationships to ensure that

[112] In saying this, it should be noted that no system of re-distribution is perfectly targeted, and that many households that receive award wages are not in the lowest-income households (Wilkins and Wooden 2011).

[113] There are a few countries that have some skill-based wage tiers. However, these are simple in character. For example, Hungary has a skilled as well as unskilled minimum wage.

workers receive reasonable wages and conditions of employment. Indeed, in some WR dimensions, most notably employment protection, many countries have far more stringent regimes than Australia. The Organisation for Economic Co-operation and Development (OECD), European Commission, and World Bank undertake cross-country comparisons by collecting data on comparable types of employment protection around the world. Similarly, Anderson et al. (2011) compared the protection provided in Australia to that provided in New Zealand, Germany, the United Kingdom, France, India and the United States between 1970 and 2010. They found that in almost all years, the systems in France and Germany provided the highest protection, whereas the lowest protection was provided in the United States followed by the United Kingdom. The systems in India, Australia and New Zealand sat between these.[114]

While these employment protections do not *necessarily* lead to different wage determination outcomes,[115] they can still embed what are, de facto, quite rigid wages and conditions when combined with other regulatory aspects of a system. For example, collective bargaining between a major union (or unions) across an entire industry (as in Germany), when combined with strong employee protections, can lead to relatively regimented wages. In some sectors — most notably health services — multi-enterprise collective agreements (effectively pattern bargaining) have achieved much the same in New Zealand, even though that system is often seen as lightly regulated.[116] In other words, the processes for determining wages in many countries are different from those in Australia, but the outcomes may be less so.

For example, an analysis by the European Central Bank commented that:

> Although it has been declining over the past decade in Europe, a large proportion of workers are still covered by some kind of collective wage agreement and collective bargaining coverage is still generally high. Coverage generally increases with firm size and is more common for high-skilled employees, full-time employees and in the case of industry, also manual workers. Furthermore, extension procedures (which make a collective bargaining agreement binding for all employees and employers within its usual field of application) are widespread in Europe. (Du Caju et al. 2008)

Deregulated negotiations in Europe are the exception, not the norm (Du Caju 2010). In many European countries, a large share of firms has union agreements, and bargaining arrangements cover a large share of employees.[117] This is true for Austria, Belgium, France, Hungary, Poland and Spain, among others. In the Euro area, the second most important reason for downward rigidity in wages is labour regulation (Du Caju 2010).

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114 Cross-country analyses of this type do, however, have some drawbacks. These are discussed in chapter 5.

115 For example, someone might be on a low wage, but be nearly impossible to dismiss.

116 Based on evidence from Multi Employer Collective Agreements (*DHB Shared Services* nd).

117 Union membership densities are different from the penetration of union agreements. Higher union densities have independent effects on wage determination, and are much higher than Australia in many European countries (Du Caju et al. 2008, p. 11).

Portugal provides a revealing example of how the interaction of labour law and institutions can lead to rigidities that, though less visible, are almost certainly higher than Australia:

> According to the Portuguese law, a firm cannot reduce contracted wages, including other regular and periodic monetary or non-monetary pay components, unless this is permitted by collective agreements. Also, collective negotiations are usually conducted at the industry or occupation level, and collective agreements stipulate minimum working conditions, like the monthly minimum wage for each category of workers, overtime pay and the normal duration of work. Such collective bargaining covers a large part of the workforce resulting both from the presence of labour unions and the existence of mechanisms of contract extension, i.e., the Government normally uses extension mechanisms to broaden the coverage of the collective bargaining agreement to workers not covered by unions. This largely regulated institutional framework, as well as the existence of a compulsory minimum wage, which establishes a wage floor for many workers, introduces strong additional rigidity in the wage-setting process. (Martins 2013, p. 3)

Ideally, comparisons between different international systems for wage determination would consider how they affected the wage distribution, employment, skill formation, inter-firm and inter-industry labour mobility, labour mismatch, productivity and other features of the labour market. Little systematic research has been undertaken in this arena, but the Productivity Commission's analysis of Australian labour market performance (chapter 2) suggests that it is more flexible and better functioning than might have been suggested by its regulatory underpinnings.

New Zealand provides a potentially insightful experiment in deregulation, as awards (similar in nature to Australia's) were abandoned in 1991 (chapter 14, chapter 16 and box 11.4). This decision appears to have increased wage disparities (as might be expected), but whether it improved overall economic and labour market performance is contested, partly because of other policy changes that accompanied workplace law changes.

Box 11.4 Regulation in New Zealand

The WR framework in New Zealand shared many common features with the framework in Australia until around 1970, when commentators suggest the two systems began to diverge. The major break however, occurred in 1991 with the introduction in New Zealand of the *Employment Contracts Act* (the Act). The Act was introduced as part of a wide range of economic reforms that targeted financial and product market deregulation and reduced the protection from international competition that had been afforded to some industries. The Act:

- abolished the industrial conciliation and arbitration system, and removed all awards
- made industrial action taken during the term of a contract illegal
- removed the primary role of the unions as bargaining representatives for workers by forcing them to compete with other 'bargaining agents' for the right to represent the interest of workers in contract negotiations
- maintained, and in some cases improved, the minimum statutory entitlements that had previously existed, which covered conditions such as holidays, sick leave and minimum wages
- established an Employment Tribunal to provide mediation and arbitration in the case of employment disputes
- established an Employment Court to hear appeals from the tribunal and adjudicate on breaches of the Act (Brosnan, Burgess and Rea 1992).

The Act reduced the protective strength of the WR framework in New Zealand. Anderson et al. (2011, p. 161) describe '[t]he precipitous decline in labor law protection in New Zealand following the enactment of the Employment Contracts Act in 1991' and state that the Act took labor protection in New Zealand below that of Australia for the first time.

There is a lack of consensus around the economic effects of the Act due to it being difficult to isolate the effects of the Act from the other reforms and the improving global economic conditions more broadly. In general terms, in the years following the Act, there was a marked decline in union membership, an increase in the use of individual employment contracts, a downward trend in wages, an increase in employment, and an increase in wage dispersion (especially for those with low incomes due to less favourable conditions for some vulnerable groups). Labour productivity (which was low in New Zealand compared with other OECD countries at the time) had been increasing up to 1990 and continued to increase at a slightly slower rate from 1990 to 2000 (Conway and Meehan 2013).

In 2000, the Employment Relations Act was introduced. Anderson et al. (2011) describe the levels of protection under the Act and then under the Employment Relations Act after 2000. The Employment Relations Act strengthened the protection for workers through restrictions on employers using alternatives to the standard employment contract, and increased workers' rights to representation through recognition of unions and bargaining rights. The result was that the overall level of employee protection in New Zealand increased, although not to the level it was at in 1990. This suggests that there might be different combinations of instruments that provide similar levels of protection, but at different levels of cost.

Sources: Anderson et al. (2011); Brosnan, Burgess and Rea (1992); Conway (1999); Dixon (1996); Easton (1997); Evans et al. (1996); Hector and Hobby (1998); Kelsey (1995); Rasmussen and Deeks (1997).

Replace or repair?

Any examination of alternative systems of regulation implicitly questions whether the current system of awards in Australia is superior, at least in the unique circumstances of the Australian economy, to any other system that exists or could be designed. In all likelihood the answer is no. The current system of awards in Australia is the culmination of a century of disputes and negotiations within a set of institutions that were initially designed more than 100 years ago. While the system has adapted, the lingering presence of that history makes it unlikely that awards closely reflect the type of regulatory settings that could be designed for today's economic environment.

However, the adaptations that have occurred — particularly the weight given to greater simplicity and the role of awards as a safety net — appear likely to have reduced the costs of the system. Moreover, some see awards as meeting some community expectations, though it seems possible that these might be achieved in other ways:

> … it is important to appreciate that awards still play a crucial role in the federal industrial relations system, and in the broader society. This can be attributed to the interplay of a range of factors. These include a deep (and perhaps unconscious) community attachment to the award system, and its perceived benefits in terms of maintaining an equitable balance between the interests of employers and workers, and acting as a social safety net (Creighton and Stewart 2000, p. 122).

There are two broad policy options for awards — replace or repair. The deciding factor is whether the net benefits of replacement are likely to outweigh the benefits of repair.

Replacement would be costly

Transitioning to a new framework would involve significant costs. Reports from business groups, the Fair Work Ombudsman and the FWC suggest that the costs of transitioning to the modern awards between 2009 and 2014 were considerable ('nightmarish' according to some stakeholders). Any major shift away from awards altogether would trigger costs of a higher magnitude again. In saying this, it is important to note that removing awards would require re-assessment of many other features of the WR system. For example, what benchmark, if any would be used for testing whether an enterprise agreement really met some 'reasonable' standards? A no-disadvantage test or a better off overall test are meaningless without a benchmark.

The likelihood is that a more detailed version of the NES (or similar model) would be needed if the awards system were replaced. In practice, this would effect a move away from negotiation for that (larger) part of the economy that presently takes advantage of either individual arrangements or enterprise agreements. The increase in Parliamentary standard setting would need careful consideration, which the Productivity Commission has yet to see in submissions advocating radical change.

Whether such a shift would improve or reduce flexibility and certainty (mutually inconsistent concepts to a degree), is impossible to know for sure. However, given the partisan nature of WR, it is likely there would be an increase in policy instability in this area.

The current system works

The current system does not, despite its potential to do so, appear to be producing highly adverse outcomes. Indeed, the large majority of proposals for change were for changes inside the system, and can be loosely summarised as either outmoded limits on management ability to respond to market pressure or consumer need, or system deficiencies amounting to a triumph of form over substance.

The outcomes of any entirely new system are, by comparison, uncertain and would inevitably involve significant dissent plus implementation problems on a national scale. Moreover, the parties to employment contracts are not passive, but can be expected to respond (or attempt to respond) to circumstances that are not favourable to them. Further, if the re-distributive effect of awards were to be reduced, the tax-transfer system would almost certainly have to markedly extend its reach.

Efficiency effects

Awards create distortions in both product and labour markets. Some of these are positive distortions since they address undoubted social ills (unequal pay between the sexes as an example), unequal bargaining power, and the high costs of contracting employees for small business (chapter 12, chapter 17). Others create significant costs, but at least some of these could be remedied within the existing system, and are not reasons in and of themselves to abandon awards altogether.

No identified need?

Several participants in this inquiry including the BCA, ACCI and Master Builders Australia (box 11.5), have suggested a significant shift away from the current award system, but the majority have not.

Master Builders Australia recommended replacing awards with one junior and one adult minimum wage (sub. 157) by sunsetting awards over five years.

ACCI presented a spectrum of options for how to move to a more decentralised and deregulated system, and suggested that the Productivity Commission recommend a set of legislated minimum standards (against which a full suite of agreement making options would be assessed), a national minimum wage and industry rates of pay, and any award conditions that are agreed upon by parties to an agreement.

The BCA recommended the continuation of awards, but in a significantly more streamlined form that accentuates their role as a safety net. All of these employer groups detail examples of costs and inefficiencies that awards create (and these are referenced in more detail in the relevant chapters).

However, none questions the need for a safety net of some form, and in the case of the BCA and ACCI, while the degree of overhaul of the awards system is considerably greater than entertained by most stakeholders, the recommendations are still to repair, not replace the current system.

Box 11.5 The BCA's proposal for a new award system

The BCA supported the role that awards 'play in contributing to a safety net for workers' (p. 26). However, it argued that current awards lacked coherence and clarity, and that their legitimate role as a safety net was not always consistent with the contents of awards (which often have clauses that provide benefits above the minimum). It proposed a more streamlined set of awards from the current 122 to one per industry, and the shift of common economywide entitlements into the NES.

The BCA argued that there should still be industry awards because some matters are specific to certain industries, such as the normal hours worked. It also argued that industry awards would be useful as templates for employment arrangements for small enterprises that did not want to negotiate an enterprise agreement.

Each industry award under the BCA proposal would be limited to specification of:

1. accident pay
2. agreement in writing to pattern of hours of work (part-time workers)
3. allowances for travel costs/times and transport
4. apprenticeship requirements
5. employment categories, including definition of a shift worker
6. industry specific redundancy schemes
7. national training wage, and allocation of traineeships to wage levels
8. ordinary hours of work
9. rostering issues, limited to maximum days of work, maximum hours per day,

meal breaks, minimum break between times worked and minimum engagement

10. wage classifications (up to a maximum of five categories per award).

The BCA floated the idea that at some time in the longer run, there might only be a need for a single 'universal award', though it did not suggest a timetable for this more radical shift.

Source: BCA (sub. 173, p. 55).

In order, therefore, to repair awards rather than replace them, the next chapter (chapter 12) discusses some of the effects of awards and explores what might need to change to reduce the costs that awards impose.

12 Repairing awards

Key points

- A new Minimum Standards Division (MSD) within the Fair Work Commission would offer an opportunity to move to a more targeted, evidence-based approach to award reform. This would be a critical first step to ensure that award reform gradually and systematically addresses the priorities necessary for a modern Australian labour market.
- The MSD would use a process that includes:
- decisions based on a transparent framework of objectives and methodologies that draw primarily from economics, social science, commerce and equivalent disciplines
- primary reliance on independent and expert research and analysis in its decision-making
- ensuring the impact of changes on all affected parties are articulated in award and minimum wage determinations.
- The current four yearly review of awards is extensive and resource-intensive. It should cease after this round, to be replaced by a more evidence-based and targeted approach to award reform. After robust analysis of awards and their impact, the MSD would prioritise reform areas based on their likely net gains and seek public guidance on reform options.
- As a first priority, issues that make awards complex and expensive to use should be addressed as part of a targeted award reform process.
- Awards set hundreds of minimum wage rates. Some of these wages do not bind because employers willingly pay their employees more. Others do bind and address unequal bargaining power between employers and employees, but might also have negative employment effects in some cases.
- Award wages can also affect:
- decisions about the mix of factors used in production
- the rate of inflation in some circumstances.
- Award entitlements and conditions have different purposes and different effects. While awards tend to contain the same types of entitlements and conditions, there is significant variation in how they are applied between awards.
- Some entitlements and conditions appear to have become divorced from their original purpose. Others impose constraints upon the way managers choose to operate their businesses. However, entitlements and conditions also play a protective role for employees.
- Given the expertise of Members in the MSD, award reviews should also consider how changes in minimum wage rates might allow awards to better meet the modern awards objective. No reference to work value reasons would be required.

The Productivity Commission has concluded awards should be retained to provide a safety net to address the imbalance of market power. However, the process for determining

awards should be reformed (chapter 11). The retention of awards does not mean there will be no change in the future to either the content or number of awards. Rather, *the process by which actions are taken* should be upgraded to adopt an analytical approach given the impact of awards on individuals, businesses, and opportunities in the Australian economy.

The Productivity Commission has examined the history of awards and the process of review. It has not considered the 122 awards from the perspective of assessing the correctness of every wage rate, condition, and entitlement, but rather, to identify substantive issues about the process for determining awards. In doing so, the Productivity Commission has found scope for improvements in the framework and processes used by the Fair Work Commission (FWC) to assess wages, conditions, and entitlements. Three conclusions have been reached and will be expanded upon in the remainder of the chapter:

1. The current institutional framework in which awards and their minimum wages are determined uses decision-making frameworks and relies upon expertise that are ill-suited for assessing what are predominantly economic issues (chapter 3). The new Minimum Standards Division (MSD) within the FWC will be better suited to carrying out award assessments.
2. The current four yearly review of modern awards should, as much as its scope allows, use the analytical and conceptual framework that the Productivity Commission proposes for future assessments. After completion of that review, a more focused, less resource-intensive model of assessing awards is required.
3. As a first priority within a new model of award assessments, issues that make awards complex and expensive to use should be addressed. A complementary stream of work would assess more complicated and critical issues that require more extensive empirical analysis.

12.1 Award assessments within the Minimum Standards Division

The FWC and its predecessors have had significant responsibility for wage determination for a large (though diminishing) share of employees for over a century. These institutions have brought a particular mindset to deliberations — of which a legalistic framework, an emphasis on fairness, and an arbitral function, appear to have been enduring features. The history of awards generally, and of past determinations specifically, often appear to remain a persistent influence.

Both the analysis in this inquiry and submissions from participants suggest that awards include undesirable features. Such features are not a requirement by law, but rather an outcome of precedent and decision-making by the FWC (and its predecessors). The FWC, through the new MSD, should adopt a more systematic and evidence-based approach to address the deficiencies in awards (see chapter 3). This new approach should have its foundations in the frameworks and methodologies applied in the social sciences (most

importantly, economics), and rely upon robust quantitative and qualitative research for decision making.

Evidence and research

The use of evidence is referenced throughout the history of award reviews, and decisions frequently mention the need for parties to present evidence to support their claims. For example, the processes of the Australian Industrial Relations Commission (AIRC) prior to 2005 have been described as follows:

> Justice Guidice … explained that the AIRC was a quasi-judicial body and, as such, could not inform itself independently of formal hearings for fear of undermining the Commission's impartiality. The only research the AIRC ever saw was submitted to the Commission as evidence and then subjected to cross-examination in open court (Harper 2009, p. 4).

This is no longer the case. The FWC can commission research to inform both award reviews and annual wage reviews, and undertake internal research where it sees fit. The current review process reflects a shift away from a largely adversarial system to one better described as inquisitorial. This could be partly a reflection of the processes adopted under the Australian Fair Pay Commission (AFPC), which relied more heavily on independent research, wide-reaching consultation and 'accountability to evidence' (Harper 2009, p. 7). The FWC's expert panel on the minimum wage has inherited at least some of the AFPC's approaches.

However, the FWC does not appear to rely heavily on objective, robust research when making award review and annual wage review decisions, although the use of evidence is more apparent in the latter. The FWC does emphasise that parties participating in a review must provide evidence to support their claims. But this raises several concerns.

First, parties participating in both award and annual wage reviews are rarely objective, and usually represent either employer, employee or government interests. As a result, these parties have an incentive to provide selective evidence that supports their position.

Second, the fact that a party does not present detailed, robust evidence does not mean a problem does not exist, or is not worth examining. Several opportunities to carry out rigorous research on the impacts of changes to award conditions following award modernisation slipped by because the AIRC did not take the initiative to undertake or commission research at the time.

Third, parties are required to provide evidence in order for the FWC to consider the merits of a proposition to change an award. As a result, a lack of evidence can become the reason not to do something. A scientific methodology would instead rely on the opposite approach, which is that having identified likely problems, the FWC would proactively collect the evidence about the effects of alternative decisions. The failure of advocates to provide evidence of their own would not be relevant. The difference is subtle, but points to a different decision-making process.

The establishment of the MSD therefore provides the FWC with an opportunity to revitalise its approach to the use of research and evidence in decision making. Impartial, self-initiated research undertaken (or commissioned) by the MSD would shed better light on many award determination and minimum wage matters that are the perpetual source of contention by partisan stakeholders. For example, there is ample room to carry out more extensive analysis of the effects of award variations (such as in penalty rates, spans of hours, allowances, and other entitlements and conditions), wage relativities, wage levels and the clarity and structure of awards. A new approach should therefore consist of:

- the deliberative collection and analysis of evidence *relevant* to the specific award matters under consideration ('pointed' rather than general research). Evidence presented by parties would of course still be considered, but that would be only a partial basis for decision-making
- exploiting modern analytical techniques
- inviting public scrutiny
- constantly seeking to improve and refine the research and analytical process.

Tradeoffs between elements of the modern awards and minimum wage objectives should be clearly articulated

Both the modern awards objective and the minimum wage objective contain different elements that the FWC is required to take into account. Sometimes it is clear within the decision statements released by the FWC which of these elements weighed most heavily on a decision. For example, while discussing requests from several industries for the FWC to make industry-specific minimum wage adjustments during the 2013-14 Annual Wage Review, the FWC cited previous reviews, which had articulated that:

> … the onus is on the party seeking to rely on economic incapacity and a strong case must be made out in order to warrant relief … [and] any decision to provide different wage outcomes based upon the particular circumstances in each industry, as they might vary from time to time, would inevitably lead to the loss of any relativity between the wages specified in modern awards. This would not sit comfortably with the principle of equal remuneration for work of equal or comparable value.[118]

At other times, the FWC has simply acknowledged that it can be difficult to weigh the different parts of the minimum wage objective. In a hearing as part of the 2014-15 Annual Wage Review, Justice Ross remarked that:

> Beyond saying that we've taken them into account … you can't reduce the set of statutory criteria into an algorithm … [t]hat says we've given [0].2 to this and [0].3 to that. … We can certainly perhaps indicate from year to year what factors have borne more heavily on the

118 Annual Wage Review 2013-14 [2014] FWCFB V3500 [4 June 2014].

> decision making in that particular context but a number of submissions seem to suggest almost a mathematical waiting (sic) exercise. For myself, I just don't see how that could be done.[119]

The different elements of the minimum wage objective and the modern awards objective might, by their nature, conflict. Therefore, weighing the benefits of increased earnings for the low paid, against the potentially slower employment growth from more generous increases in minimum wages for example, might be as much a matter of judgment as rigorous analysis.

However, scientific methodologies can provide the metrics and processes for assessing the consequences of different minimum wage and award review decisions, and can ensure that decisions are, as much as possible, informed, transparent, logical, substantiated and consistent.

The new MSD, having undertaken rigorous research to identify the tradeoffs it is seeking to weigh, should therefore be required to articulate exactly how its decisions are reached as well as the consequences of its decisions for all those affected, both positively and negatively.

Participation in modern award and annual wage reviews

Participation from interested parties through submissions and appearances at hearings plays a prominent role in modern award and annual wage reviews. For example, as part of the penalty rates case in the current four yearly review of modern awards, more than 25 organisations have actively participated in the submission and hearing process so far, with most contributing more than once throughout the process (FWC 2015b).

Open, transparent and participatory processes should remain as an important element of any MSD review process since the MSD would be making decisions affecting broad groups within the community. The MSD will most likely be able to rely on the ongoing participation of the parties that commonly appear as part of award reviews including employer representatives (prominently the Australian Chamber of Commerce and Industry and the Australian Industry Group), employee representatives (who are usually unions) and government. However, the MSD will also need to consider how to ensure the needs of all those affected by its decisions are presented and taken into account. While other parties, including non-governmental organisations, also produce submissions and appear at hearings, they do so against the backdrop of the deep entrenchment of traditional interests. In recent determinations these interests have been difficult to ignore.

Some commentators suggest that this is slowly changing and that a wider range of parties are making submissions to recent FWC review processes (Bray 2011). Further, the FWC has commissioned research that seeks the views of small businesses on their use of awards

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119 Transcript of Proceedings, Fair Work Commission's Annual Wage Review 2014-15 Final Consultations, C2015/1 [20 May 2015].

to inform its work to simplify and clarify award content (Hodges and Bond 2014). However, the annual wage review decision statements from the FWC still largely reflect the input of the three traditional groups of participants.

As a consequence, the needs of the unemployed and of consumers seem to be underrepresented in current reviews. In particular, there is no group that expressly reflects the concerns of the unemployed as social advocacy groups usually span those with low paid jobs as well as the jobless.

The MSD should encourage the participation and representation of all those affected by its decisions, and ensure that its decisions transparently and logically follow from an objective assessment of the evidence, including that gathered or solicited by the MSD for any of its judgments.

Focusing the award review process

Currently, modern awards are reviewed every four years as a requirement of the *Fair Work Act 2009* (Cth) (FW Act), as well as upon application from parties or at the initiative of the FWC. The Productivity Commission has received mixed views about the current four yearly review, some of which are contained in box 12.1 below.

Given that the four yearly reviews of modern awards, in which every award must be reviewed, are a requirement under the FW Act, the FWC has taken the initiative to restrict and streamline the process where possible. To limit the issues brought before the FWC as part of the review, President Ross instructed parties that they provide 'probative evidence' to demonstrate the facts supporting a proposed variation, and to show that the variation is necessary to achieve the modern awards objective.[120] The FWC has also identified common issues that arise in numerous awards that it is exploring one by one in order to avoid dealing with the same matters repeatedly in different awards, and to introduce more consistency into how these matters are dealt with across awards.

120 4 Yearly Review of Modern Awards — Preliminary Jurisdictional Issues [2014] FWCFB 1788 [17 March 2014].

Box 12.1 Most participants do not like the four yearly award reviews – but their reasons vary

The four yearly award reviews were the subject of criticism from several participants in this inquiry. The FWC detailed the breadth of the task:

> The conduct of the 4 yearly review is a very large body of work, both for external stakeholders as well as requiring extensive internal resources to support it. For example, more than 2 500 documents have been posted to the Commission's website, six decisions and 27 statements have been issued to date, and the process is expected to be completed in 2016. (FWC sub. 171, p. 47)

The National Farmers' Federation submits that the requirement to review all 122 awards every four years is excessive (National Farmers' Federation sub. 223, p. 15) and Master Builders Australia expressed pessimism about the outcomes of the reviews:

> … the extent of the litigation generated by the review, the intensity of resource allocation and the polarisation of stances between unions and employer groups where all matters seem destined for adversarial outcomes, detracts from optimism that the outcome will bring any radical changes to the matters only touched on in this submission. (Master Builders Association sub. 157, p. 32)

The Australian Council of Trade Unions suggested that the periodic reviews prompted unions and employer groups to contest award matters:

> … simply because the review process provides a trigger for doing so. Employer organisations and unions are effectively bound by their charters to use the review mechanism as an opportunity to improve their position. As a result, elements of the safety net that were well-entrenched and relatively uncontroversial prior to the creation of modern awards (such as penalty rates) have become a battleground for industrial parties. (Australian Council of Trade Unions sub. 167, p. 147)

The Australian Federation of Employers and Industries similarly assert that the four yearly reviews give unions the opportunity to pursue improved employment conditions as award test cases to be applied as minimum safety net entitlements (Australian Federation of Employers and Industries sub. 219, p. 36).

Other participants, however, have expressed support for the reviews, such as the Catholic Commission for Employment Relations (sub. 99) and the Australian Services Union who submits that the reviews ensure that as industries evolve, the conditions for award reliant workers are maintained (sub. 128).

Nevertheless, the current four yearly review appears to be an expensive exercise requiring extensive investment from interested parties. Further, due to the breadth of the issues before the FWC as part of the review, the current review is likely to take at least two years to be completed. After this, the system should remain relatively 'stable' for two more years before the next review is due to commence. A more targeted approach is required.

As part of such an approach, the MSD of the FWC would:

- continue its ongoing approach of dealing with small issues that intermittently arise and that need fixing (without much elaborate analysis or input from stakeholders). It would identify and address any remaining or emerging anomalies, technical problems and typographical errors in particular awards (such as those addressed in the Fast Food

Industry Award 2010 as part of the Modern Awards Review 2012)[121] that frustrate the use of awards and that can be easily fixed (stream 1 in figure 12.1 below)

- identify and address issues that are relatively straightforward and uncontroversial (but important) and that once addressed, would make awards easier to use. Addressing these issues has the potential to significantly improve how easy awards are to understand and to reduce the costs of using and complying with awards. For example, there are problematic issues in awards that are well known and recognised by both employer and employee representatives. Ambiguous language and a lack of pay tables are examples of issues that could be quickly and easily addressed. The FWC has recognised this as part of the current four yearly review and has agreed that some proposed changes may be self-evident and can be determined with little formality.[122] These are discussed in section 12.2 and depicted in stream 2 of figure 12.1 below)
- initiate a research agenda to identify more complex but critical issues. These issues include those that might improve awards so that they more effectively meet the modern awards objective and improve the wellbeing of those affected by awards. Some of the commentary around the modern awards objective suggests that in any given award, the decisive test of its adequacy is whether collectively the set of minimum wages and conditions meets the objective or does not. The FWC has stated that at the end of the award modernisation process, all 122 modern awards were considered to meet the objective. However, this is not to say that an alternative set of wages and conditions might not improve some of the outcomes within the objective without significantly reducing outcomes under others. Where there is scope, these kinds of improvements should be the focus of a targeted, thematic approach to award modernisation. This process is discussed further in sections 12.3, 12.4 and 12.5 and depicted in stream 3 of figure 12.1 below.

Once these complex and critical issues have been identified, the MSD would:

- develop policy options for addressing these issues, and articulate how these options would impact on all affected parties
- consult with interested parties on the merits of the preferred options
- incorporate the improvements into all applicable awards and evaluate the effects of the changes.

Award assessments following the completion of the current four yearly review should adopt this new targeted approach by dividing the issues identified in awards into three work streams (figure 12.1 below). However, to the extent possible, the FWC should also adopt the principles of a targeted and evidence-based approach for the remainder of the current four yearly review of awards.

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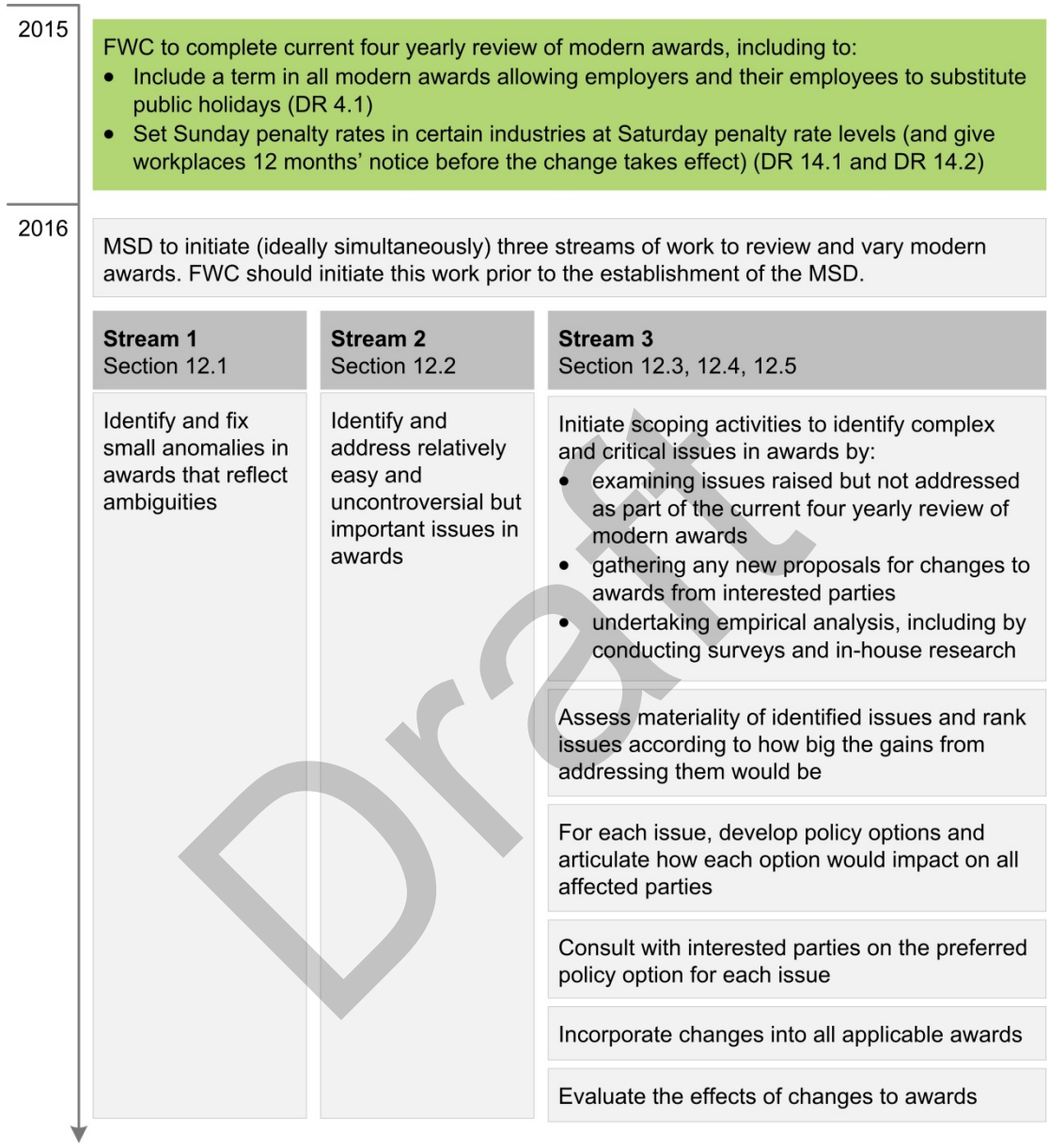
121 Fast Food Industry Award 2010, [2014] FWC 1592, [17 March 2014].

122 4 Yearly Review of Modern Awards — PreliminVary Jurisdictional Issues [2014] FWCFB 1788 [17 March 2014].

Figure 12.1 **A targeted approach to future award assessments**



The benefits of this type of evidence-based prioritisation of issues in awards would include focussing the resources of both the MSD and participating parties on issues that have the potential to make the greatest improvements to outcomes under awards, and avoiding over-reliance on participating parties to raise issues as part of award assessments.

DRAFT RECOMMENDATION 12.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) to:

- remove the requirement for the Fair Work Commission to conduct four yearly reviews of modern awards
- add the requirement that the Minimum Standards Division of the Fair Work Commission review and vary awards as necessary to meet the Modern Awards Objective.

To achieve the goal of continuously improving awards' capability to meet the Modern Awards Objective, the legislation should require that the Minimum Standards Division:

- use robust analysis to set issues for assessment, prioritised on the basis of likely high yielding gains
- obtain public guidance on reform options.

12.2 Making awards easier to use

In labour markets that face a myriad of information gaps and transaction costs, awards reduce the cost of negotiating employment contracts by setting a reference point for workers and employers to begin negotiating — both for those employees who are award reliant as well as many of those who are employed under another method of setting pay.

For award-reliant employees, awards provide the information that they need to ensure that their pay and conditions are comparable to those received by other employees who do the same job. Where an employee considers that they have skills or experience that warrant higher pay than that set out in the award, they may seek to have this recognised in an individual arrangement (chapter 16).

Employers use awards to inform the terms and conditions that they offer their employees. Small business owners, in particular, have stated that they value having a reference point for the contracts they offer their employees. Participants in this inquiry have provided examples of reasons why businesses like to use awards.

> As well as protecting the rights of employees, awards provide certainty for employers in determining what conditions to apply as well as a '*level playing field*' for organisations competing in the same industries. (Catholic Commission for Employment Relations sub. 99, p. 12)

The most recent Australian Workplace Relations Study research commissioned by the FWC also found that 46 per cent of businesses using awards did not have an enterprise agreement because the award rates and conditions are adequate (FWC 2015d).

For those businesses with enterprise agreements, awards provide the benchmark above which agreements can incorporate terms that are more flexible and higher rates of pay.

Awards therefore provide a starting point for negotiations, especially when an enterprise agreement has not previously been in place. Agreements also often reflect the relativities between rates of pay found in awards.[123]

Awards can therefore lower the transaction costs of forming employment contracts. While there are other sources of information that employers and employees could use to identify the 'going pay rates' in an industry (such as pay guide websites, or job vacancy search engines), awards provide economies of scale and scope that reduce the costs employers face when developing award-based employment contracts.

The Fair Work Ombudsman plays a role in helping employers and employees understand the terms and conditions contained in awards by providing advice through its information line, as well as by posting resources on its website. Further improvement in the useability of awards could provide additional benefits.

Reviewing award structure, language and presentation

The modern awards are friendlier documents than were their predecessors. Some participants in this inquiry have remarked that, in some cases, the improvement has been considerable, and that the onus is now on employers to ensure they are complying.

> Award modernisation was a major step forward for many small businesses because with it came the simplification of many outdated and complicated clauses that had developed over years of amendments and additional clauses. (Master Grocers Australia and Liquor Retailers Australia sub. 246, p. 10)
>
> The consolidation of awards and transitional instruments and replacement with fewer modern awards is a significant improvement. The modern awards are generally well-drafted and the consistency of provisions across modern awards makes them much easier to interpret. (Employment Law Centre of Western Australia sub. 89, p. 15)
>
> Professionals Australia considers that employers need to educate themselves to ensure that they are award compliant and rejects arguments that suggest that the modern award system provides unnecessary regulation and is burdensome on employers. (Professionals Australia sub. 212, p. 17)

However, references to the complexity of awards in submissions to this inquiry have been more common (box 12.2). To the extent that the structure, language, order, and overlap of provisions contribute to this complexity, awards can be improved further.

The FWC is continuing to improve the usability of awards as part of the current four yearly review — for example, its exemplar award with consistent presentation and use of plain English suggests improvements that could be applied to all modern awards. The FWC also sought feedback from small businesses about how awards could be improved to make them easier to use (Hodges and Bond 2014).

123 Safety Net Review – Wages, AIRC, [1997] [Dec 335V/97 S Print P1997].

Box 12.2 Participants' concerns about the complexity of awards

Several participants referred to the complexity of awards in their submissions to this inquiry. Examples include:

> Many small business operators find the system to be complex and a major impediment to employing more staff or transitioning from being a sole trader to an employer. … This is further compounded as employees in small businesses often wear many hats, and have a range of positions with varying levels of responsibility. In this situation it can be confusing to work out which modern award, position and classification an employee should be paid at. (Australian Small Business Commissioner sub. 119, p. 7)

> Questions regarding award matters not only represent the biggest issue for our members, but are also the most complex to address, representing 45 per cent of the total time spent by this team in providing advice to members. Employers frequently contact the Employee Relations Advice Centre to seek assistance in interpreting the relevant award and applying it against the pattern of work performed by their employees. The most complex queries in this regard are in respect to determining an employee's entitlement to wages where they are required to work overtime or perform shift work. These issues frequently require employers to consider the application of multiple clauses which are not only difficult for small business to interpret but also frequently baffle experienced [industrial relations] and [human resources] practitioners. (Chamber of Commerce and Industry of Western Australia sub. 134, p. 31)

> Small business find the complexity of awards overbearing and may try to find 'work-arounds' that risk compliance breaches when considered against the technical prescription of award provisions. (Australian Chamber of Commerce and Industry sub. 161, p. 33)

> Many modern awards present a set of complicated and complex provisions that are not reflective of flexible and modern work practices. (Housing Industry Association sub. 169, p. 20)

> The system is legalistic, complex and rapidly changing. Therefore it requires a considerable investment in time and resources for an employer to be able to understand and comply with the system. This is particularly problematic for smaller businesses. (HopgoodGanim sub. 225, p. 3)

The Fair Work Ombudsman is similarly working to improve how easy awards are to use by providing pay tables to be included in awards — their inclusion is being considered as part of the current four yearly review — which would reduce the need for employers to make multiple calculations to determine how much to pay their employees. The Fair Work Ombudsman has also identified other areas where awards could be improved, including by stating:

- when overtime and penalty rates apply
- whether overtime is calculated on a daily or weekly basis
- how the casual loading interacts with overtime and/or penalty rates
- the location/labelling of particular entitlements within modern awards
- whether annual leave loading or the applicable penalty rate should apply (FWO 2014d, p. 3).

As awards change and adapt over time, and as users of awards increasingly seek online platforms for accessing awards, this work will need to continue. In future assessments of awards, the MSD should aim to:

- improve the accessibility and ease of use of all awards

- promote interactive platforms to guide award users through award content
- consider other methods of providing support to users of awards, such as online chat functions, or award- and classification-specific pay calculators that calculate pay based on entered hours worked.

12.3 Assessing the complex and critical issues

The FWC is examining a number of issues that have long been part of awards, such as terms around penalty rates, part-time work, casual work, and award flexibility, as part of the current four yearly review of modern awards. These types of issue that consider the core conditions and entitlements contained in awards are often contentious and difficult to resolve through consensus between different parties.

The issues being addressed as part of the current four yearly review have been identified either at the discretion of the FWC, or by parties participating in the review. An alternative approach would use empirical analysis to identify the issues that are problematic first, and then consult on them once they have been prioritised.

There is a variety of methods that could be used to identify issues in awards. One method might include carrying out a detailed, independently-undertaken survey of employers to identify which aspects of each award affect their operations most, and garner suggestions for change. Another complementary method might involve mapping how conditions and entitlements vary between awards, and undertaking empirical research to assess what effects the variations have. A third method might involve a systematic collection of data following any significant adjustments to awards (such as those that occurred as part of the award modernisation process) so that their effects can be measured and changes can be reassessed where problems have subsequently emerged. A fourth approach might also systematically gather information from employees about the effects of the work practices and complexities that can emerge from awards (for example, where rostering arrangements lead to tensions between employees). It should not be assumed that employer and employee interests are always at odds. Employees may also identify faults in awards that affect productivity and flexibility in workplaces. (The survey conducted by the FWC in relation to individual flexibility arrangements is one area where the FWC has proactively produced useful information from both employer and employee perspectives (chapter 16).)

A variety of research techniques would be needed to identify what aspects of which awards are either imposing unnecessarily high costs to employers (and potentially restricting employment) or are failing to provide adequate entitlements to employees. Once identified, these ‘hotspots’ could then be assessed in detail using a scientific methodology to assess the merit of the case for change. The assessments would examine issues across the awards in which they emerge (this would be more of a ‘thematic’ approach) or on an award-by-award basis when an issue is award-specific.

The objective of these assessments would be to ensure that awards provide an adequate safety net for employees at least-cost to employers. This process is described in sections 12.4 and 12.5 below.

Currently, the FWC is constrained in its ability to carry out some of the reforms that might emerge from a research-driven award reform process. The FW Act prevents the FWC from varying minimum wages in awards without those changes being justified by work value reasons. For example, the FWC would be unable to recommend rolling one or more rarely-used allowances into base wage rates in an award to simplify the payroll for small businesses under the award. Similarly, the FWC is unable to vary minimum wages in response to obvious and dramatic shifts in demand within a particular industry as part of the four yearly reviews.

The FWC can vary minimum wage rates in awards as part of the annual wage review but, to date, the minimum wage panel has been reluctant to introduce changes that would have the effect of changing the current set of award relativities.

This should change. The MSD should consider amendment of wage relativities where that is consistent with the modern awards objective and where empirical evidence suggests that change is warranted. Allowing this additional avenue for considering changes to minimum wages in awards would require a change in the FW Act to remove the requirement that award reviews only vary minimum wages in awards when justified by work value reasons.

DRAFT RECOMMENDATION 12.2

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that the Minimum Standards Division of the Fair Work Commission has the same power to adjust minimum wages in an assessment of modern awards as the minimum wage panel currently has in annual wage reviews.

While the discussion below separates wages and classifications from other conditions in awards, any assessment of awards should not consider changes to one of these without reference to the other. Awards provide a set of wages and conditions that determine the terms of employment relationships. Sometimes new terms are added to awards to reflect changing societal expectations about what employment relationships should look like. The addition of parental leave might serve as an example.

The combination of wages and conditions received also define the 'experience' of employment, which is to say that while wages are important, moderate wage increases are unlikely to ever be able to compensate fully for the loss of some conditions. Therefore, while research might identify 'hotspots' that warrant further attention, and a detailed, systematic assessment might conclude that some change is warranted, a third equally important step would be to consider all proposed changes to an award to assess whether costs to employers, and remuneration and protection to employees would shift

considerably in aggregate in one way or the other and to make sure this is justified if it is to occur.

12.4 Assessments of minimum wage rates and classifications in awards

The FWC alters the award wage rates annually as part of the annual minimum wage review, usually by either one (or several) broadly applied percentage increase(s) or by several dollar amounts applied to brackets of award wage rates. Despite some applications to delay or reduce any annual increases in award wage rates for certain industries, award wage increases are generally applied consistently across awards. Consequently, the relativities between wages in different classifications within awards and between awards have not been explicitly assessed since 1989.

The assessment in 1989 was based on the premise of comparative wage justice (chapter 11). Box 12.3 below discusses why this might no longer be a helpful concept to apply in an award wage assessment today. Any assessment undertaken by the MSD of award wage rates should instead seek to answer three broad questions:

- Given that awards make up part of the safety net in Australia's workplace relations framework, what role should award wage rates play and to whom should they apply?
- What other effects do award wage rates have?
- Can award wage rates be improved?

What role should award wage rates play and to whom should they apply?

Awards set hundreds of wage rates that cover a substantial share of the labour market and hundreds of thousands of employers (chapter 11 and appendix E). Some of these wage rates will not bind — that is, act as a determination of price — (or not by much) because employers can pay above the award wage if they choose to. However, other award wages will bind and potentially limit resource reallocation. Whether this is desirable depends on the intended consequences. For example, a binding award wage that addresses unequal bargaining power or that redistributes income to lower paid workers without negative employment effects is likely to be a good outcome if this is the objective. Alternatively, a binding award wage rate that is divorced from the market realities of an industry may reduce growth, employment and productivity or force the use of substitute resources such as technology at a higher than efficient (competitive) cost. Some award wage rates most likely fall into the former category and some into the latter.

Box 12.3 Equal pay for equal work – is it a workable concept?

The concept of equal pay for equal work has had uneven application over time, and has been premised on the desirability of wage equalisation on fairness grounds:

- between men and women (currently applied and which may be both fair and efficient)
- between the same occupations in different awards (not currently applied)
- between occupations in different industries with similar levels of difficulty/required training (currently applied).

The concept is reasonable in some contexts. For example, it is widely regarded as unfair (and is now unlawful) to discriminate between people on the basis of their race or gender. It is almost certainly also inefficient to do so as prejudiced discrimination wastes talent. As noted in chapter 11, and supported by Household, Income and Labour Dynamics in Australia Survey analysis, awards appear to have reduced gender wage inequality.

However, in other contexts, the issue of fairness is far more vexed, and other considerations, such as efficiency, also play a role.

It is probably not possible to determine meaningfully that different occupations deserve equal pay because they share some common features, such as years to qualify or a requirement to supervise people. Common durations of training periods or the same basic level of qualification (a degree, for example) do not necessarily equate to any similarity in the complexity of a task, the level of responsibility and accountability attached to a position, the intensity and stress of a job, the non-pecuniary benefits, the costs of errors in making decisions, the degree to which a job might be subject to shirking and principal-agent risks (as in efficiency wages), and innumerable other dimensions of jobs. It might be possible to use some qualitative judgments about what might be anomalous wage differences (such as that a plumber should not receive wages ten times higher than a carpenter), but making judgments that identify 'equal work' in a way that could genuinely inform precise wage differentials looks to be profoundly difficult.

Moreover, jobs and their requirements change. Wage relativities determined 25 years ago could still apply, but since technologies and knowledge required for different occupations have changed markedly in the intervening period, this may be an area for targeted review.

Furthermore, market driven wage relativities serve many useful functions that help an economy grow. Economic growth has benefits for all people and provides the scope for re-distribution — an important aspect of fairness. Markets have the advantage that wage relativities can change to reflect: occupational demand, the encouragement for people to train (or to move), and the broad set of difficulties and complexities of a job — a point developed further in the main text.

The role for award wage rates

As detailed in chapter 11, under certain circumstances, awards that raise wage rates above what they would otherwise be create more efficient (and more equitable) outcomes. This role for awards should remain. Awards should not, however, raise wage rates so high as to create significant negative employment effects. Determining how high is too high is discussed further below.

Consideration should be given to whether award wage rates are likely to act as a starting point for bargaining (either at an enterprise or individual level) or are likely to be applied with minimal adjustment to the majority of a class of employee. In the latter case, it is more important to ensure that, where justified, award wage rates provide wages that look reasonably similar to those that would emerge if bargaining power between employers and employees were equal.

Detailed empirical analysis is therefore required to assess which employees, in which businesses, and in which locations, are paid award wage rates (or very close to them). Whether these employees are covered by an award-dependent individual arrangement, enterprise agreement or a slightly above award individual arrangement is also important. Some of this analysis is presented in appendix E but more detailed analysis will be required if the MSD is to adequately identify who is paid what and where.

There are, however, circumstances where awards cannot rectify situations of unequal bargaining power. Two are discussed below.

When an employer is a single purchaser

In Australia, there are industries and occupations in which government is the primary employer (or purchaser), such as in education and health services, policing and defence. These are examples of monopsony markets in the conventional sense, in that one employer (or funder) is dominant.

As is the case for other industries, awards in these industries are likely to improve on the *base* wages and conditions that employees would otherwise receive, but the distribution of earnings may be compressed because there are limited options for employees to move to seek out better wages and conditions in the same job. This is an empirical issue (for the public sector, it is addressed in chapter 18) and whether it holds or not at any given time will depend in part on any government budget settings and the countervailing power exerted by employee representatives and public sympathies. Participants in this inquiry (including the Queensland Nurses Union, Australian Services Union and the Australian Nursing and Midwifery Federation) have suggested that this issue arises in the aged care, nursing and social and community services sectors, where employers rely on government funding — a selection of views is in box 12.4 below.

Box 12.4 Examples of participants' views on purchasing power in selected sectors

Below are three examples of purchasing power in employment as provided by participants to this inquiry.

From the Queensland Nurses Union (sub. 86, p. 10):

> As aged care is also largely dependent on the Commonwealth for funding it has been in the interests of successive governments to restrain wages in this sector, particularly in the context of the ageing demographic. Previous Labor government initiatives in this area such as the aged care supplement made only minimal difference in adjusting wages growth. The aged care wages gap relates not only to the nature of work performed in the sector (caring work where it is difficult to take industrial action to advance claims and therefore there is an inherent bargaining imbalance) but also the funding source.

From the Australian Services Union (sub. 128, p. 5):

> When bargaining occurs in the social and community service sector it almost never deals with wages or wage related matters such as allowances, overtime and penalty rates. It is not possible to seriously bargain around these matters as employers are only funded to pay Award wages and conditions and no more. They do not "control the purse strings", the funding bodies do and the funding bodies are never at the bargaining table as they are not the employer. This vicious circle has made enterprise bargaining a difficult exercise for most of the industry. This issue was the subject of extensive evidence and submissions in the *Equal Remuneration Case* 2012.

From the Australian Nursing and Midwifery Federation (sub. 132, p. 10):

> It is estimated 70% to 80% of nurses and midwives are employed in workplaces that receive public monies to meet labour costs and, in sectors such as aged care and public hospitals, employers receive the bulk of their funding from government.
>
> It has been broadly recognised the failure to appropriately fund services, coupled with an inability to generate revenue, has resulted in employers of nurses and midwives being slow to embrace enterprise specific bargaining and has also generally put downward pressure on wages and employment conditions, leading to recruitment and retention problems and declining health care standards.

While the FWC could, in principle, act to offset this monopsony power (although not for state government employees as they are generally outside the FW Act), government policy and budget settings would then have effects on employment and service provision. Altering budget policy to address market power is as much a political choice as a policy choice. Not addressing the regulated wage outcomes of the FWC would seem a peculiar choice.

When imbalances in bargaining power favour employees

Awards also have no ability to affect imbalances in bargaining power that favour employees. In some circumstances where there is excess demand for workers, especially when workers cannot be easily substituted (for example, in highly specialised professions), employees can hold more bargaining power than employers, and can demand higher wages than those that would result under equal bargaining power. Often such power will be transitory, and will be eroded by cycles in the demand for the specific form of labour (such as geologists in the mining industry) or when higher wages encourage new entrants into the labour market.

Where such power is prolonged, it will often reflect either statutory or other barriers to entry. In the latter case, the *Competition and Consumer Act* provides one remedy (an area of industrial relations that is addressed under generic competition law — chapter 24). If statutory, there are grounds for competition reforms of the professions of the kind recommended by the Productivity Commission in past reviews (Harris 2014; PC 2005a, 2005c, 2014d) and most recently by the Harper Review (Harper et al. 2015).

What other effects do award wage rates have?

Award wage rates and conditions affect decisions about the mix of factors used in production

Awards change the cost of employing more workers by raising the minimum wages and conditions of employees, which might affect input decisions such as:

- capital versus labour (including decisions about automation)
- skilled versus unskilled labour
- the degree to which capital is utilised (for example, high regulated wage rates at certain times may make it optimal for a business to cease or reduce operations at these times)
- attempts to intensify work
- training of workers to raise their productivity
- substitution between juniors and adults
- the extent of outsourcing. On the labour side, this might include the greater use of contractors, labour hire, and work by an owner-manager (or his or her family). On the goods side, it might mean that a business purchases a good that it would otherwise have produced itself (for example, pre-fabrication is increasingly important in construction).

Changes to award wage rates and conditions might also affect employees' productivity, which may in turn increase the productive use of capital. For example, if employees have greater incentives to work harder because of a higher minimum wage or better working conditions, then capital will be used more intensively than otherwise.

The connection between awards and inflation rates

There have sometimes been concerns about the flow-on effects from minimum wage and award wage adjustments to inflation, interest rates, and aggregate employment. The concerns were legitimate in the 1970s and 1980s, when large scale strikes organised by unions led to wage increases as part of traditional award disputes (especially during periods of high inflation).

However, following the Prices and Income Accord (1983), changes to macroeconomic management, the advent of enterprise bargaining and a new framework for award determination, few now consider that award outcomes are likely to have any significant inflationary effects (although the flow-on effects are routinely assessed by the Reserve Bank of Australia and the Australian Government Treasury as part of their inflation forecasting procedures).

Can award wage rates be improved?

While there are justifications for awards at an aggregate level, these are not uniform or universal. For example, bargaining power is likely to be more or less unequal at different skill levels, in different industries (including those expanding or contracting), in different size businesses and in different locations. The imbalances are also likely to change over time.

Identifying where unequal bargaining power would otherwise have particularly adverse consequences for employees would be a useful first step. This is not straight forward, but it is important: where evidence suggests employees would be likely to receive less than an efficient wage without regulation, there is a strong rationale for setting award wage rates that have the effect of redistributing income to these employees. Otherwise, award wages should provide a floor above which employees and employers collectively negotiate.

Since the data used for this sort of exercise will reflect the effects of the current set of award wages, an assessment of wage rates and classifications should start with the current set of wages and then ask whether and in which awards the evidence supports larger, smaller or zero increases in wage rates.

What happens if award wage rates are set too low?

If bargaining power is unequal, the primary effect of setting award wage rates too low (or close to those that would exist in an unregulated labour market) would be that employees are paid a smaller share of any rents. In circumstances where even small firms hold some market power, there might also be the potential for forgone employment.

While highly skilled and well trained employees might be considered to be more able to negotiate better wages and conditions than the low skilled, as long as there are significant costs to changing jobs, market power can still exist for occupations with wage rates above the minimum wage (as the empirical evidence suggests). This is recognised by the tiered classifications within awards that set higher wages for jobs that require employees to be trained, qualified or highly skilled, or manage or take responsibility for other staff.

Without these multi-layered minimum wages, or with sets of wages that differ little from what they would be in the absence of awards, market power would have the effect of pushing wages down.

Award wages that are too low can also reduce investment in education and training. For the national minimum wage (and award wages that are close to it), the literature discusses two possible effects of increases in the minimum wage on the demand for further education and skills.

- One effect is to increase the demand for education and skills, especially by employees on the minimum wage who need to increase their productivity to match the increased wages. Similarly, those outside the labour market have more of an incentive to seek work at the higher wage, and to the extent that education or skills are required for minimum wage jobs, undertake the necessary training first.
- The second (and converse) possible effect is that increases in the minimum wage reduce the incentive for job seekers to undertake further education and training because the minimum wage provides a reasonable income and there is consequently less need to up-skill to obtain jobs above the minimum wage.

In Australia, award wages are most likely to elicit the first of these effects since they include a progression of wages that extend well above the national minimum wage and there is evidence that more skilled employees use minimum wage jobs as stepping stones into higher paid employment (often because the lowest classifications in awards are training wages that employees move off quickly) (chapter 8).

Award wages that are set too low for higher skilled occupations reduce the returns to more specialised training and skills since there is no certainty for prospective employees that their investment in education will be reasonably remunerated once they are employed.[124] The effect, therefore, of setting award wages too low and reducing the incentive for potential and incumbent employees at all levels of award classifications to undertake further education or training is to slow the growth in the stock of human capital making the economy less productive in the long run.

What happens if award wage rates are set too high?

As discussed in the Productivity Commission's analysis of minimum wages, at some point high regulated wages must reduce the employment of labour (on a headcount and hours basis). Where there are multiple regulated wages and many different types of labour (by skill, experience, age, location, occupation and industry), these effects will vary by the type of employee (Healy et al. 2011).

The incidence of any adverse employment effects will depend on the relative wages of different employees. For instance, employers might increase their demand for younger or less skilled workers, depending on the substitutability of such employees with more experienced, skilled workers. Alternatively, employers might respond by reducing training,

[124] This applies only to the extent that employers do not set above-award wages to attract such workers. This may occur if the employer has greater bargaining power and obtains greater benefits from lower wages than lost workforce skills.

hours, and overtime, and changing the way work is organised (Healy et al. 2011). Similarly, employers might choose to substitute labour for increased use of capital such as increasing mechanisation in place of employing labour (depending on how substitutable capital is for labour and the relative costs of each).

The rigidity of award wage rates makes this problem worse

Award wage rates are rarely changed (except for yearly adjustments as part of the annual wage review). The rigidity in award wage rates partly reflects a conscious decision by the FWC to keep relativities between awards largely consistent. For example, in the Annual Wage Review 2013-14 decision,[125] the Full Bench discussed the proposals put forward by a number of parties to justify different increases to wages in different awards. These proposals were rejected for two main reasons:

- there was insufficient evidence of an incapacity to pay
- any differential changes would alter the existing relativities, which would undermine the concept of 'equal pay for work of equal value' (a concept with many flaws — box 12.3).

Rigidities also exist because minimum wages are generally difficult to adjust down (chapter 8). If there is a strong case for downward adjustment of award wages, the FWC is effectively constrained to real wage decreases by approving increases that are smaller than inflation.

These rigidities stop award wage rates from efficiently responding to changing economic circumstances in cases where market forces would otherwise push relative wages down. (There are few evident problems where there are upward wage pressures as awards create floors, not ceilings.) In industries facing reduced demand and/or increased competition, rigid award wages do not allow businesses to ease the adjustment by lowering wages or altering the mix of skills and occupations by varying relative wages. In these circumstances, lower employment (or reduced hours) is likely to take a disproportionate part of the adjustment burden. Rigid wages also mute the signals to would-be employees of the likelihood of vacancies and future unemployment in contracting industries and occupations. This could increase skill mismatches and frictional unemployment.

In contrast, enterprise bargaining facilitates downward flexibility in wages and conditions, as apparent in the negotiation of much lower wages in some Western Australian agreements following the collapse of the mining boom. This recognised the unemployment effects of wages that could not be supported by the prevailing economic circumstances in that state. Even in other states, some new enterprise agreements have significantly cut wages and conditions (for example for Coca Cola Amatil and Woolworths). These cuts have sometimes applied just to new hires, which overcomes some of the incentives for businesses under stress to curtail recruitment (Salmon 2014). In addition, following

125 Annual Wage Review 2013-14 [2014] FWCFB 3500 [4 June 2014].

clarification by the Full Federal Court that 'no claims' clauses in enterprise agreements have no effective legal force, it is possible for employers to vary enterprise agreements (with the consent of employees), if the commercial environment deteriorates.[126]

Of course, this flexibility is underpinned by the fact that many agreements provide above award wages, so that there is room for downward movements after the expiry of an agreement (or indeed, in exceptional circumstances, even during the life of an agreement). However, the very willingness of employees to accept any reduced wages suggests that downwards flexibility can sometimes meet their preferences for job security. In theory, this preference could be partly and slowly realised through smaller increase to award minimum wages. In practice, this is unlikely because of the reluctance to use industry specific conditions to inform different award wage increases.

How to tell if award wage rates are too high

The FWC considers the capacity of industries to pay when deciding how much to increase the wage rates in awards. When doing this, the FWC examines wage costs, levels of employment, award reliance, gross value added, gross operating profits and hours worked. Data on these indicators help the FWC to decide whether all industries, but especially those with high levels of award reliance, will be able to sustain the wage increase that year without risking business viability and unemployment.

The FWC also considers applications to postpone award wage increases determined as part of an annual wage review when particular industries are experiencing exceptional circumstances. This is discussed in more detail in chapter 8 and the Productivity Commission recommends that the FWC should also be able to make temporary variations in exceptional circumstances after a review has been completed (Draft Recommendation 8.2).

There are, however, many other types of information that the FWC could take into account when considering the employment and business consequences of its decisions, such as:

- aggregate data on transition times into and out of employment
- evidence on unemployment at the granular level (for example, by occupation, skill level, location, and duration)
- flow rates out of the labour force by people at the lower end of the wage continuum in awards ('discouraged' workers)
- econometric evidence on the probabilities of job loss or gain associated with the characteristics of employees typical of the lowest skill levels in awards, for example, of the kind undertaken by Borland (2002)

126 *Toyota Motor Corporation Australia Limited v Marmara* [2014] FCAFC 84 (18 July 2014).

- surveys of perceptions by employees of job security in different awards (as collected in the Household, Income and Labour Dynamics Australia survey)
- the characteristics of the relevant firms. Awards are more likely to bind in businesses that are part of a highly competitive industry, have a high elasticity of demand for their products, employ mostly low-skilled labour, have a high wage share, have easily scalable processes of production and are subject to significant risks of labour displacing technological change (so that capital can more easily replace unskilled labour). Award increases in such businesses risk higher unemployment and reduced hours of work
- skill mismatches — for instance, skill shortages in some industries or occupations might signal that there is greater room for increased award wages. Conversely, surpluses of particular skills or movements of people from one skilled occupation to another may reveal where awards are binding.

The nature of the wage distribution may also provide some insights. Where observed wages are well above the award rate, it can be assumed that small increases in the award rates are unlikely to result in employment effects, simply because the award is not a binding constraint. Awards are more likely to create negative employment effects in industries and occupations where awards set wages higher than would occur in a market with equal bargaining power between parties. Where that occurred, the *distribution* of observed wages would tend to bunch around the award rate, and a significant share of the workers in the relevant industry or occupation would be award reliant. (The relevant industries are described in appendix F, and typically involve lower-skill jobs.) Of course, for any given business, the fact that employees may be paid at the award rate does not necessarily imply that regulated wages are too high. That the award wage rates 'apply' to employees is a prerequisite for assessing whether they bite, but it is not sufficient. For example, where a business has some market power in its local labour market, it could choose to pay the award rate even if the efficient wage were higher.

There are also grounds for exploring differences in wage outcomes for those covered by awards and those who are not. For example, qualified tradespeople often choose to work as contractors or subcontractors. While these workers demand higher wages to compensate them for the uncertain nature of their employment and for the cost of paying for their own insurance and tools, substantial increases in the gap between the returns to contractors and the award wage for a similar occupation might reveal that employers have a greater capacity to pay. Similarly, a small or decreasing gap might signal that the award wage rate for that industry or occupation is getting too high.

Enterprise agreements (and possibly the proposed enterprise contract – chapter 17) could also provide information on award wages. Where enterprise agreements consistently offer higher wages (even after changes in conditions and entitlements have been compensated for), it is possible that there is room for increases in award wage rates.

Similar comparisons can also be made with 'like' groups overseas where it can be shown that those groups and the industries in which they work are broadly comparable to Australia. These types of comparisons might be particularly useful for assessing whether

wages in a given industry should be compressed or allowed to expand. For example, if the percentage wage difference between those in the last year of their apprenticeship and those with their trade qualification is significantly smaller in New Zealand than in Australia, especially in one industry but not the others, this might (depending on other performance data) support a smaller dollar value increase to the wages in that particular award rather than a percentage change.

The implications of the above points are that the FWC should take a forensic approach to unemployment and business risks for different groups of awards, and be open to decreases (or slower increases) in wage rates if this is likely to preserve jobs. Such an approach could possibly be coordinated with government training initiatives and adaptations to the tax-transfer system (for example through an earned income tax credit — chapter 10). A more flexible approach to minimum wage and award decisions by the FWC could be one plank of a new Australian labour regulation framework, but would require changes to the decision-making norms of the FWC (as recommended through the establishment of the MSD) and potentially to the modern awards objective.

12.5 Assessments of conditions and entitlements in awards

Awards contain different types of entitlements and conditions of employment aside from minimum wage rates, including conditions that repeat or supplement terms in the National Employment Standards. Most awards, however, have the same type of conditions or entitlements, including specifying types of employment, allowances, hours of work, and leave entitlements.

That awards contain similar material is a function of a number of factors. First, the parties that raise issues for review in awards often represent employers or employees covered by more than one award. Second, the conditions of employment negotiated in one award are picked up and applied during subsequent reviews of other awards. Third, the amalgamation of awards through successive processes (listed in chapter 11) is likely to have led to a consolidation of common content. Last, awards broadly and over-time reflect community consensus on what constitutes fair and reasonable conditions of employment, and consensus on broad issues of workplace relations tends not to be demarcated by industry or occupational classifications.

The conditions and entitlements in awards have different effects and are included for different purposes. For example, allowances compensate employees for undertaking undesirable or more difficult tasks or for incurring costs while working (chapter 11). Where the frequency of undertaking unpleasant tasks is spread non-uniformly through a group of otherwise similarly paid employees, it may be reasonable to have allowances for such tasks. Moreover, by raising the cost of particularly unpleasant tasks, allowances encourage employers to find substitute ways of working that avoid such tasks.

On the other hand, if unpleasant tasks are more generally spread across a class of employees, it may be more efficient to raise the wage rate for that class. This would recognise that allowances also impose costs on employers due to added payroll complexity, especially where the application of allowances changes between employees and from one shift to the next.

To some extent, this complexity was reduced during the award modernisation process as some defunct allowances were eliminated from modern awards. However, in other cases, the 'amalgamation' process in award modernisation simply created lists of allowances that only applied to distinct groups of classifications within a single award. This made it more difficult to identify which allowances should be paid to whom and when. Inconsistencies in allowances also continue to persist between awards.

The complex and inconsistent treatment of allowances is not an anomalous feature of awards. Other chapters provide more detailed examples of variation between awards such as variation in penalty rates (chapter 14), overtime rates (chapter 13) and annual leave loadings (appendix F). There is not always an obvious rationale for the persistence of these variations.

Participants in this inquiry have raised concerns about conditions and entitlements in awards. For example, the Business Council of Australia (BCA) (sub. 173) and others have expressed their concern about conditions and entitlements that constrain the ability of organisations to manage their operations efficiently. Some examples provided in submissions to this inquiry are included in box 12.5 below.

Restrictions on management prerogative can reduce business efficiency and innovation. On the other hand, they may be necessary to ensure safe working conditions. Furthermore, for many employers multiple avenues exist (or might in future exist) to negotiate away particularly restrictive conditions (while safeguarding the National Employment Standards), including through enterprise agreements or individual flexibility arrangements, or by using a proposed enterprise contract (chapter 17).

Box 12.5 Some clauses in awards affect management prerogative more than others

The BCA (sub. 173, p. 28) pointed to conditions in some awards that created 'rigidities in the employment relationship that undermine the capacity of an enterprise and its workers to negotiate a balance that meets each of their needs'. The BCA includes several examples, including detailed prescription:

- of how a roster should be constructed (that goes beyond maximum hours to be worked in a day, or minimum break time between shifts)
- about when and how meal breaks should be taken.

Other participants also listed examples of what they perceive to be particularly restrictive conditions in awards, such as:

- restrictions on the flexibility of rosters for part time workers who have converted from casual employment in the Hospitality Industry (General) Award 2010 (Australian Hotels and Accommodation Associations of Australia sub. 164, p. 15)
- the requirement to pay employees covered by the Hospitality Industry (General) Award 2010 an extra 50 per cent of their usual hourly rate if they have not been given a break after six hours of work until a break is taken (VECCI sub. 79)
- casual conversion clauses, including in the Manufacturing and Associated Industries and Occupations Award (2010) which according to the Australian Mines and Metals Association (sub. 96, p. 415):

  > … are misguided, and fundamentally misunderstand the nature of employment through offer and mutual acceptance of terms. It should remain a matter for employers whether to offer jobs on a full-time, part-time or casual basis based on their assessment of their commercial and operational requirements and their chosen commercial, operational and employment strategies.

- the requirement in the Building and Construction General On-site Award 2010 that wages be paid not later than the end of ordinary hours of work on Thursday of each working week (Civil Contractors Federation sub. 62, p. 2)
- the restriction in the General Retail Industry Award 2010 that an employee cannot work ordinary hours or any reasonable additional hours over more than six days in a row (Norris Park IGA sub. 23).

Nevertheless, to the extent that wages and different employment conditions can be substituted to provide protection for workers, there seems to be little justification for providing protections through conditions in awards that unnecessarily restrict operations and the ability of management to manage effectively.

Similarly, participants in this inquiry raised several award specific complaints that appear to have been resolved, at least to some extent, in other awards. Minimum shift clauses are discussed as an example in box 12.6 below.

Box 12.6 An example of award specific issues

Several participants in this inquiry have raised award specific issues that they believe are creating costly constraints in their industries. For example, participants have raised concerns about minimum shift length restrictions that exist in several awards, including the General Retail Industry Award (2010), the Fast Food Industry Award (2010) and the Pastoral Award (2010). Selected comments include:

- One member respondent to the 2015 Member Survey in the fast food industry:

  "The Award is unable to provide flexibility for junior team member hours. We have had to let go of many of our junior staff as they could not work a 3 hour shift after school as the shopping centre closed. They could only work a 2 hour shift due to school commitments, which then requires me to find older (and more costly) staff to work these longer hours." (VECCI sub. 79, p. 30)
- The three hour minimum engagement has had a number of negative ramifications on farm business operations. For instance, the clause removes any incentive for staff to milk in a time-efficient manner, thus lowering productivity. Many dairy farm businesses choose to allow milkers to go home as soon as they have finished milking in order to motivate staff to work efficiently. However, this means that farmers often pay for time in which no actual work is performed, and these payments are higher on public holidays. (Australian Dairy Farmers sub. 56, p. 1)

In contrast, the underlying purpose of minimum shifts was reiterated by the National Working Women's Centre (sub. 242), who claimed that regular hours and minimum shifts are important for casual employees.

The General Retail Industry Award (2010) includes an extra clause that allows school students to work shifts as short as 1.5 hours with parental/guardian permission. However, Council of Small Business Australia (sub. 115, p. 4) consider this to also be too restrictive:

> The current situation where an employee has a minimum time of 3 hours or where the employer has to seek approval to employ a school student for less than three hours is not reflective of the real world. By all means if an employer is obviously abusing employees (sic) time by demanding long travel times for short periods of work where the cost of getting to work makes the time spent at work not rewarding then fix that problem. Let the employee contact the regulator and have them sort that out.
>
> But if a small business employs a school student after school for a short time than (sic) it is obvious this is acceptable and there should be no need to seek approval.
>
> A minimum of one hour for people under 20 years of age who are in full time education should be a simple enough rule for employers.

It would seem though that this type of clause might alleviate some of the concerns in the fast food industry as raised by the Victorian Employers' Chamber of Commerce and Industry (sub. 79). So too might the introduction of the shorter minimum shift time of two hours that is contained in the Hospitality Industry (General) Award (2010) for casual employees.

This chapter does not seek to make an assessment of the merit or costs of various conditions and entitlements in awards. Rather, this chapter suggests an approach that would have the MSD examine conditions and entitlements across awards using detailed, empirical research to identify problematic conditions or entitlements in awards ('hotspots'), and then make a determination that relies on a considered and detailed assessment of the evidence of the effects of these provisions in different industries and types of businesses, and on their employees.

An assessment of this type would therefore undertake to answer the following questions with respect to conditions and entitlements in awards:

- What is the purpose of the type of condition or entitlement? Is this purpose still relevant? Does the effectiveness of the condition or entitlement to meet this purpose depend on how the condition or entitlement is applied?
- Is there evidence that those conditions or entitlements of each type in awards are effectively meeting their purpose?
- What alternatives exist, and can they be provided at lower cost?
- How would these alternatives alter both the overall income and protection provided to employees under the award, and the costs to their employers?

The FWC has already started to assess conditions and entitlements in awards thematically through its consideration of nine common issues as part of the current four yearly award review. The list of common issues includes:

- annual leave
- apprentice conditions
- award flexibility
- casual employment
- family and domestic violence clause
- family friendly work arrangements
- part-time employment
- public holidays
- transitional provisions (FWC 2015a).

Since the first four yearly review of awards is currently underway, it is not clear what the FWC will decide or whether its decisions will be applied consistently across awards. Justice Ross has signalled, however, that a consistent approach has merit:

> … if the bench were minded to grant the claims in whole or a variant of them, in relation to cashing out and excessive leave, it raises a question, why shouldn't that be a standard modern award provision? … There is something to be said for the proposition that, if you can standardise core provisions like annual leave, then that would make the modern award system simpler and easier to understand.[127]

After that review, the Productivity Commission proposes that the newly-created MSD would use an evidence-based approach to assess conditions and entitlements in awards consistently — since a problem identified in one award may well exist elsewhere. The Productivity Commission also recommends that the MSD promotes consistency in how

[127] Transcript of Proceedings, Fair Work Commission's 4 Yearly Review of Modern Awards – Annual Leave, AM2014/47 [16 October 2014].

conditions and entitlements are *applied* in awards, but only to the extent that any streamlining would not ignore industry or occupation-specific requirements or unique situations that warrant (as verified through the assessment process) different entitlements or conditions (as raised by Hair and Beauty Australia sub. 47). Simplicity for simplicity's sake is not a good enough reason to streamline conditions and entitlements in awards. Nor is differentiation for the sake of precedent and tradition a good enough reason not to.

An assessment of problematic award conditions and entitlements should also be coupled with an overall assessment of each award to measure whether, in aggregate, the income and entitlements for employees contained in the award have significantly changed. As part of this assessment, the MSD should articulate to what extent conditions and entitlements are substitutes both for increases in wages and for each other. In recommending this type of assessment process, the Productivity Commission does not envision that the aggregate monetary equivalent of wages and conditions of employees covered by each award would significantly change, but neither should the MSD be constrained by having to ensure that no one (neither employers nor employees) is worse off. Rather, the MSD should identify the rationale for each element of awards assessed and then verify whether there is a good reason to change it.

13 Penalty rates for long hours and night work

Key Points

- Many Australians work long hours and during nights.
- The working time regulations discussed in this chapter exist to protect employees. They do not apply to the self-employed or contractors.
  - Around 2.8 million Australian employees report working more than 40 hours per week and over 1.5 million reported working 50 hours or more per week.
  - Almost 1.2 million Australian employees report working schedules likely to involve night work.
- Current regulations of long working hours and night work for employees are contained within both the National Employment Standards (NES) and modern awards.
  - The NES specify a maximum weekly limit of 38 hours, giving employees the right to refuse unreasonable additional hours.
  - Most awards specify wage premiums for both long hours and night work.
- The case for working time regulation is strong where overtime is imposed on employees and they lack the bargaining power to negotiate wage premiums that reflect additional personal costs.
- There is strong evidence that sustained long hours and night work impose substantial costs on the health of employees.
- Given this, the current restrictions on hours worked (with a capacity to vary these when reasonable) and premium rates of pay for long hours or work at night are justified. Few participants contested this.

Many employees work non-standard hours — either more than the NES maximum — or at non-standard times, such as at night or on weekends. A substantial number of these employees are rewarded by regulated premiums on normal wage rates (sometimes generically categorised as 'penalty' rates).

Indeed, under the modern awards objective, the *Fair Work Act 2009* (Cth) requires that modern awards take into account the need to provide additional remuneration for overtime, weekends, public holidays, shift work and, more generally, 'unsocial, irregular or

unpredictable hours' (s. 134 (1)(da)).[128] Various awards specify premium rates for such work, with the premium rates depending on the industry and/or occupation.

Premium rates of pay are strongly dependent on when work is undertaken and the total time spent working. The three principal time-related wage rates are:[129]

- shift loadings, and weekend and evening pay premiums. These are requirements placed on employers to pay additional wages at certain times of the day or on certain days of the week, and are not dependent on how many hours in total a person has worked during the week
- overtime rates, which represent higher wage rates for hours worked greater than the usual ordinary hours listed under an award or an agreement
- holiday pay. Public holidays are a form of paid leave, with the exception that, unlike personal leave, they are prescribed for days with a cultural or religious significance that society has deemed should involve widespread community participation (with its implications for cultural identity). If people work on such days, they typically receive additional pay.

The Fair Work Ombudsman categorises all the above premium rates as 'penalty' rates, while the Fair Work Commission (and awards) distinguish between penalty rates and overtime rates.

The different types of work mean that there can be a complex set of overlapping time-related payments (table 13.1). Unfortunately, the various debates about the determination of such rates, or their 'right' level, have sometimes intermingled the quite separate issues that relate to the different forms of non-standard hours. This chapter focuses on penalty rates for long hours and night (and associated shift) work, and explains why the Productivity Commission concludes that the preserving the status quo is largely justified and, if anything, the community should be more aware of the risks entailed by such work patterns.

The next chapter has a quite distinct orientation. It concentrates on daytime penalty rates on weekends for consumer-focused industries (such as retailing and restaurants) where social changes and consumer preferences have increasingly prompted weekend trading. The application of penalty rates for weekend work requires the assessment of quite separate empirical, analytical and policy issues. In this more narrow area, the Productivity Commission still recommends regulated penalty rates, but not the status quo for the relevant industries.

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128 While the concept of compensation for asocial hours has a long legacy in WR legislation, s. 134(da) is a recent insertion (following the passage through Parliament of the *Fair Work Amendment Act 2013*, No. 73, 2013).

129 The words used to describe time-based rates sometimes vary. For example, the Fair Work Ombudsman describes penalty rates as any pay rate higher than ordinary time — which therefore includes weekend work, public holidays, overtime, and late and early morning shifts

Table 13.1 **The types of work covered by this and the next chapter**[a]

	Weekend			Weekday		
	Ordinary daytime	Evening	Night and rotating shifts	Ordinary daytime	Evening	Night and rotating shifts
Not public holiday or overtime	B	C	A	N	D	A
Public holiday	C	C	A	C	C	A
Overtime	A	A	A	A	A	A

a 'A' describes the focus of this chapter — premium rates that relate to overtime at any time of the week and to night and rotating shifts. 'B' describes the focus of chapter 14 — penalty rates that relate to normal daytime hours worked on a weekend. 'C' and 'D' relate to the other areas of interest of chapter 14. 'C' relates to public holiday pay arrangements on any day, except where there are night, long hour or rotating shifts in place. 'D' relates to evening work on any day of the week (excepting public holidays). Ordinary daytime work (N), a reducing norm, is not considered in either chapter.

Working time regulations affect a wide range of employers and employees

Many Australians work long hours and during nights. In early 2015, 2.8 million Australian employees reported working more than 40 hours per week, while over 1.5 million employees reported working 50 hours or more per week (ABS 2015b). Although there are no current statistics that record the prevalence of night work *per se*, work schedules typically associated with night work are common. In 2014, almost 1.2 million Australian employees reported working schedules likely to involve night work (including night and rotating shifts, as well as irregular working patterns).[130]

Regulations[131] of long hours and night work have multiple and sometimes conflicting objectives. They aim to balance the needs the needs of business with those of employees. On the one hand, extending the hours of existing employees avoids the fixed costs of hiring. Moreover, in some roles, employees may be more effective working long hours. On the other hand, employees can bear significant additional personal costs from working long hours. There is strong evidence that persistently working long hours increases the risk of a range of illnesses.

Working time regulations apply to a heterogeneous body of employees and workplaces. Regulations aimed at employees most burdened by overtime and night will invariably

130 Calculated from the HILDA Survey, Release 13.0.

131 References to 'regulation' in this chapter only relate to the NES and to award provisions, and not any other forms of regulation.

affect some who prefer such arrangements. As such, these regulations must balance the potential benefits of reducing the personal costs of long hours and night work against the inefficiencies from intervening in otherwise mutually beneficial arrangements.

In Australia, long working hours and night work are regulated by both statute and modern awards. Under the FW Act, the National Employment Standards (NES) provide for maximum weekly hours, while modern awards define ordinary hours, along with overtime and shift loading rates.

The case for regulation rests on the existence and extent of detrimental effects to employees, and the degree to which market mechanisms minimise these costs and/or compensate those who bear them. Where the market fails to provide adequate compensation to affected workers, the effectiveness of regulations and their potential introduce burden in correcting this failure is a key consideration.

This chapter is structured as follows. It outlines past and present working time regulation in Australia to provide context and lessons for any future policy developments (section 13.1). The chapter then examines the prevalence of long working hours and night work, along with the characteristics of those who work these schedules (section 13.2). Finally, the chapter assesses the impact of long hours and night work regulation (section 13.3), and provides options for reform (section 13.4).

13.1 Current regulation of long hours and night work

Regulations targeting working hours use varied terminology. While the chief concerns in this chapter are long working hours and working at night, provisions that regulate 'overtime' or 'shift work' may or may not deal with these concerns (box 13.1).

For the purposes of this chapter, 'overtime' refers to hours worked *in excess* (rather than *outside*) of 'ordinary hours'. This may refer to excess hours worked within a day, week, or number of weeks. Night work refers to work undertaken between roughly 7 pm to 7 am. While shift work provisions within modern awards generally apply to these hours, 'overtime' provisions may also apply where they refer to the *span* of hours.

Box 13.1 Some terminology for this chapter

Working time regulation is generally concerned with **how many hours** an employee works, and **when** he or she works those hours. This chapter focuses on people who work very long hours, and people who work at night.

Overtime means working in excess of ordinary hours

The terminology of working time regulation can be confusing. For example, the term 'overtime' has two distinct meanings. It refers to both the number of hours worked *in excess* of aggregates of 'ordinary hours' (specified within awards), as well as work *outside* the daily or weekly span of 'ordinary hours' (also specified within awards), which generally includes evening, night and weekend work. For part–time employees, the number 'ordinary hours' corresponds to an employee's typical weekly hours. In this chapter, the term 'overtime' will be used to refer to work *in excess* of ordinary hours. Weekend and afternoon/evening work are discussed in chapter 14.

Night work is work during nights, whether 'shift' or 'overtime'

Many awards contain specific provisions for night shift work. However, in industries where shift work is uncommon, 'overtime' provisions may contain wage premiums for night work. This chapter will consider all of the above as regulations pertaining to night work.

A brief history of working time regulations in Australia

Working hour regulations have long been a central component of Australia's Workplace Relations (WR) law. Awards have historically regulated this area, though more recently, statutory provisions have arisen to provide an upper limit to working hours.

In the mid–19th century, Australia led the world in reducing the length of the standard working week. Following the 48–hour week negotiated by Victorian building unions in the 1850s, award conditions progressively reduced weekly hours. In 1947, the standard week was reduced to 40 hours.

By the turn of the 21st century, the majority of awards stipulated a 38–hour week. Following the Working Hours Case 2002, in which the Full Bench of the Australian Industrial Relations Commission mandated a maximum working week of 38 hours with reasonable additional hours, the 38-hour week became the national standard (box 13.2). These conditions, however, remained limited to employees covered by awards.

The conditions borne of the Working Hours Case were extended to all employees following the introduction of the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth), which contained the Australian Fair Pay and Conditions Standard (AFPCS). The AFPCS largely inherited its 'ordinary hours' conditions from the Working Hours Case, with its key provision that employers could not request or require employees to work unreasonable additional hours.

Box 13.2 The Working Hours Case (2002)

The Working Hours Case 2002 114 IR 390 was brought by the Australian Council of Trade Unions (ACTU) to incorporate various working time related provisions within all awards. Specifically, the ACTU proposed that awards contain restrictions on the number of additional hours employees that may be asked to work, along with provisions for additional paid leave following periods of extreme working hours. The ACTU was successful with the former, but not the latter. The Australian Industrial Relations Commission Full Bench determined that the following be inserted into awards:

> 1.1 Subject to clause 1.2 an employer may require an employee to work reasonable overtime at overtime rates.
>
> 1.2 An employee may refuse to work overtime in circumstances where the working of such overtime would result in the employee working hours which are unreasonable having regard to:
>
> 1. any risk to employee health and safety;
> 2. the employee's personal circumstances including any family responsibilities;
> 3. the needs of the workplace or enterprise;
> 4. the notice (if any) given by the employer of the overtime and by the employee of his or her intention to refuse it; and
> 5. any other relevant matter.

Source: Working Hours Test Case [2002] PR072202 [23 July 2002].

Current arrangements

Current working time arrangements are a product of their history. Though statutory maximum hours provisions are now located within the NES under the FW Act, they closely resemble those of the AFPCS. Similarly, although awards have undergone substantial rationalisation and simplification, they remain the main vehicle for regulating long hours and night work by specifying ordinary hours, overtime and night shift loading.

For full–time employees, the NES specify that an employer must not request or require an employee to work more than 38 hours per week, unless the additional hours are reasonable. Similarly, part–time employees must not be asked to work more than their 'ordinary hours — where the term 'ordinary hours' refers to the number of hours typically worked — unless the additional hours are reasonable. The NES specify various criteria for assessing whether additional hours are reasonable (box 13.3). These include factors such as the risk to employee health and safety, as well as the needs of employees and employers. Although the relevant provisions of the NES have rarely been invoked, the limited numbers of cases highlight the importance of context in the interpretation of the legislation.

Box 13.3 What are 'reasonable' additional hours?

Two notable cases provide some insight into the application of working time provisions in the National Employment Standards. The outcomes of each case reveal the importance of context in the determination of whether additional hours are 'reasonable'.

MacPherson v Coal & Allied Mining Services involved a judgment on the increase of an employee's weekly hours from 40 to 44 per week. The Federal Magistrates Court found that the additional hours associated with the new rostering were reasonable given a number of compensating factors, such as an associated pay increase, the increase in day work, prior notice from the employer, industry norms around working hours and the potential for the mitigation of safety risks.

Brown v Premier Pet involved the dismissal of an employee following refusal to work additional hours. Mr Brown refused to work three additional hours on non–trading days to complete maintenance work. The court found that Mr Brown had the right to refuse additional working hours, and that his dismissal constituted adverse action. Relevant factors in this decision included Mr Brown's circumstances, the needs of the workplace, lack of attempts to negotiate rostering arrangements and the fact that the additional work fell on weekends.

Source: Stewart (2013, p. 224); *Brown v Premier Pet Pty Ltd (2012) FMCA 1089 [6 November 2012]*; *MacPherson v Coal & Allied Mining Services Pty Ltd (No.2) (2009) FMCA 881 [9 September 2009].*

Long working hours are also regulated by modern awards. Awards typically define 'ordinary hours' of work (which are separate and sometimes different from the 38 hours notional maximum contained within the NES) and provide some compensation for working in excess of these hours (table 13.1). As compensation for work beyond ordinary hours, awards generally offer either overtime premiums or time off in lieu. For example, the *Nurses Award 2010* defines 'ordinary hours' to be 10 hours per day (exclusive of meal breaks) and 38 hours per week. Work in excess of 10 hours in a day accrues double time pay (a premium of 100 per cent). However, working hours can be averaged over four weeks such that hours worked in excess of 'ordinary hours' for a given week may not accrue overtime. The award also defines the span of ordinary hours, which allows for overtime due to work *outside* ordinary hours.

Modern awards also regulate night work. For industries and occupations in which shift work is common (that is, work that that regularly takes place outside 'ordinary hours'), modern awards generally define shift times (including night shifts) and their corresponding loadings (table 13.2). For example, the *Nurses Award 2010* defines a night shift as beginning after 6.00 pm and finishing before 7.30 am the following day. A loading of 15 per cent is associated with night shift.

Table 13.2 Long hours regulations are fairly consistent across awards

Working time regulations in various awards

Award	*Span*	*Hours per day*	*Hours per week*	*Averaging*	*Premiums (per cent)*
Aged Care Award 2010	6am – 6pm, Mon-Fri[a]	8 (day) 10 (night)	38	4 weeks	50 100[c]
Social, Community, Home Care and Disability Services Industry Award 2010	6am – 8pm, Mon-Sun[a]	10	38	4 weeks	50 100[c]
Building and Construction General On-site Award 2010	7am - 6pm, Mon-Fri[a]	8	38	4 weeks	100
Nurses Award 2010	6am – 6pm, Mon-Fri[a]	10	38	4 weeks	50 100[c]
General Retail Industry Award 2010	7am – 9pm, Mon-Fri, 7am – 6pm, Sat 9am – 6pm, Sun	9[b]	38	4 weeks	50 100[d]
Hospitality Industry (General) Award 2010	—	11.5	38	4 weeks	50 100[c]
Mining Industry Award 2010	6am – 6pm, Mon- Sun[a]	10	38	26 weeks (for NES purposes)	50 100[d]

[a] Separate conditions apply for shift workers. [b] One 11-hour day per week is permitted. [c] After two hours of overtime. [d] After three hours of overtime.

Table 13.3 Night work regulations vary substantially across awards

Night shift regulations in various awards

Award	*Commences*	*Finishes*	*Premiums (per cent)*
Aged Care Award 2010	4pm – 4am 4am – 6am	—	15 12.5
Social, Community, Home Care and Disability Services Industry Award 2010	before 6am	after 12am	15
Building and Construction General On-site Award 2010	3pm-11pm	—	15
Nurses Award 2010	after 6pm	before 7.30am	15
General Retail Industry Award 2010	after 6 pm	before 5am	30 [a]
Hospitality Industry (General) Award 2010	7 pm	12am	10
Mining Industry Award 2010	—	12am – 8am	15

[a] For a permanent employee on a weeknight.

Not all workers are covered

Although the AFPCS (and later the NES) vastly broadened the coverage of weekly hour limits, this did not extend to all Australian workers. The WR system does not stipulate any minimum conditions associated with hours of work or pay rates for genuine contractors. A contractor might include overtime or penalty rates in a service contract, but that would be a matter for the two contracting parties.[132] For obvious reasons, working business owners do not face any regulatory constraints on their hours of work or the compensation they receive for them.

Arrangement overseas

Internationally, limits on weekly work hours and overtime pay are the most common forms of working time regulation. Over the last century, working hour limits across countries have broadly converged to a 40-hour working week. However, the application of limits varies across countries (table 13.4). Some jurisdictions (for example, Canada) stipulate a maximum number of hours above which wage premiums apply, while others (for example, New Zealand) specify a maximum which employers require written agreement to exceed.

Table 13.4 **Overseas long hours regulation**

Country	*Long working hours regulations*
New Zealand	Employers and employees are not restricted in the hours of work to which they may agree, provided that these hours are reasonable and that they do not endanger the health of employees. In instances where an employment agreement does not specify weekly hours, the Minimum Wage Act applies, specifying 40 hours as a maximum working week. Compensation for work in excess of agreed weekly hours is also subject to the employment contract.
Canada	The Canada Labour Code outlines overtime provisions for industries over which the federal government has jurisdiction. In these industries, employees are entitled to overtime if their hours on average exceed 40 hours per week. Over the period of averaging, however, an employee may not work in excess of 48 hours in any week. Managers, superintendents, and employees who carry out management functions are exempted. Architects, dentists, engineers, lawyers, and medical doctors are also excluded.
United Kingdom	The United Kingdom's Working Time Regulations specify a maximum weekly limit of 48 hours, though employees may opt out of this through written agreement. A reference period of 17 weeks applies over which weekly hours may be averaged. No overtime premium is provided within the Working Time Regulations.

Sources: GOV.UK (2014); Immigration New Zealand (2013); Government of Canada (Government of Canada 2010).

[132] It is conceivable that a contract that required very long hours of work for little additional remuneration might be deemed as being harsh or unfair under the *Independent Contractors Act 2006* (Cth), but the case law is too limited to reach a firm conclusion about the interpretation of the Act.

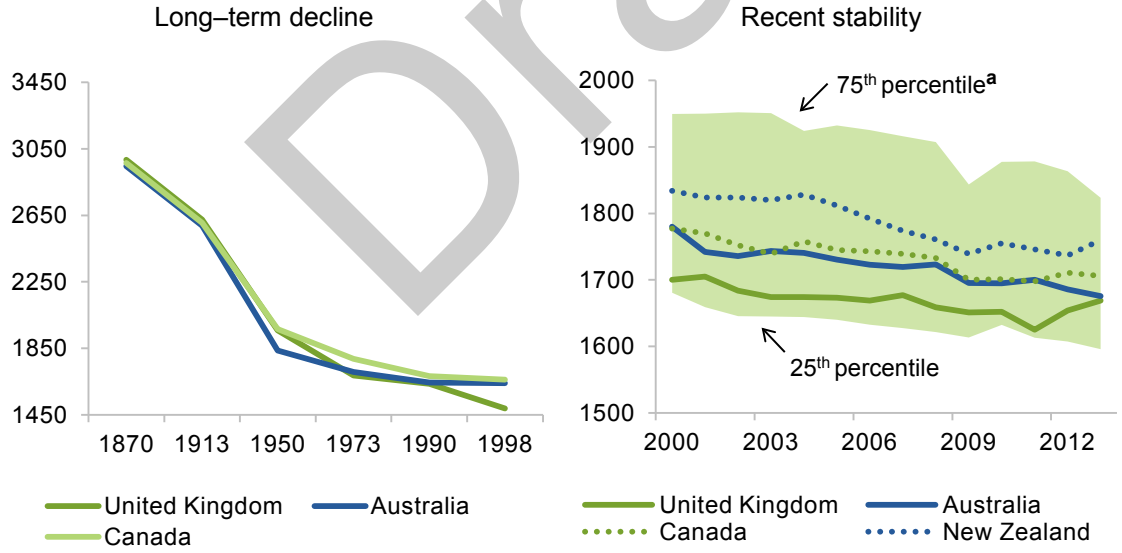
13.2 The prevalence of long hours and night work

Working hours have been falling on average

Over the last century, average annual working hours have declined in Australia and internationally (figure 13.1). In 1918, the average Australian employed person[133] worked just under 2600 hours per year. This figure had dropped to just over 1600 hours by 1998. Similar patterns are evident in comparable economies, such Canada, New Zealand and the United Kingdom. The decline in average working hours was most pronounced in the first half of the 20th century, with a less marked decline observed more recently.

Several factors explain this fall in average working hours. These include norms about the appropriate balance of work and other activities, workplace health and safety issues, and union and employee pressures. Indeed, unions had a central role in the gradual reduction of 'ordinary hours' in Australia. This followed similar movements in other countries, particularly the United Kingdom (Cahill 2007).

Figure 13.1 **Average annual working hours have declined over time**
Average annual working hours of employed persons[a]



[a] Among 34 OECD countries.

Sources: OECD (2001); OECD (2015b).

133 These averages include the working hours of not only employees, but all employed persons. As non-employees, such as business owners, generally work longer hours, the average annual hours reported above are likely higher than those of the employee population.

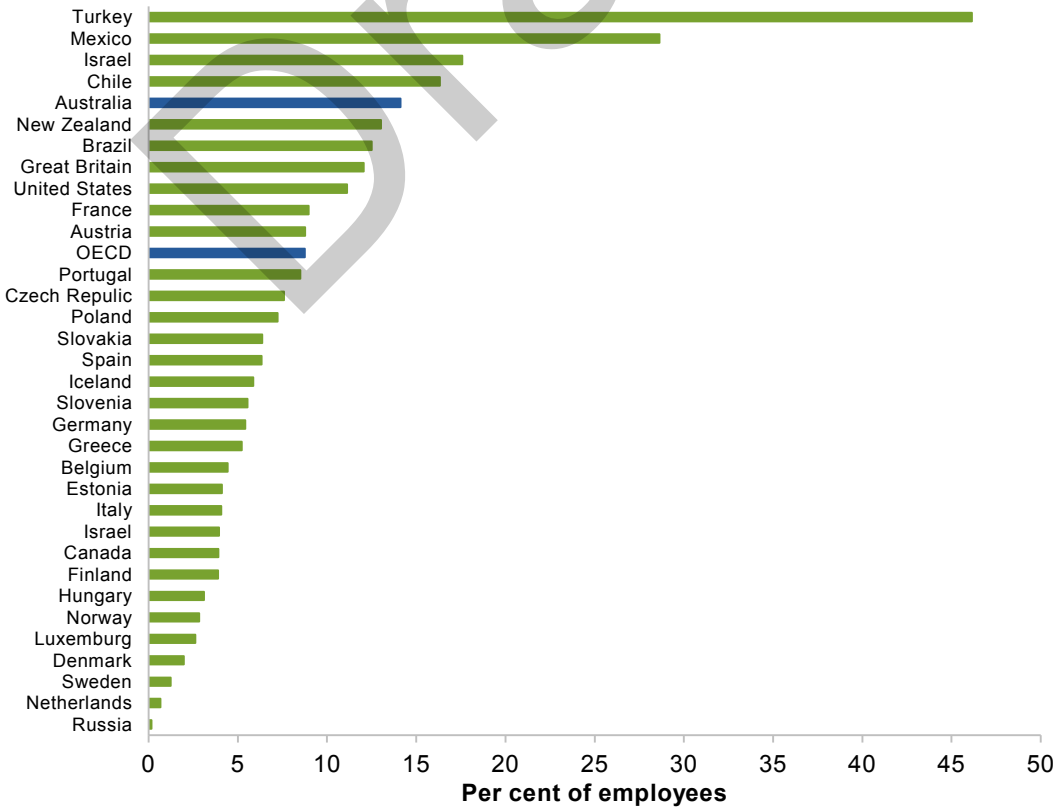
But some still work very long hours

Australia's *average* annual hours of work are not high by international standards. In 2011, it ranked only 19th highest among 34 OECD countries (OECD 2015b). However, aggregate annual working hours provide an incomplete story because they mask compositional changes in the ways that Australians are working. For example, part–time work as a proportion of employment has increased from around 16 per cent in 1980 to just over 30 per cent in 2014.

Supporting this notion, Australia has a particularly high proportion of employees working very long hours, as compared with other OECD countries (figure 13.2). According to OECD data, just over 14 per cent of Australian employees work 50 hours or more per week. This is much higher than the OECD average of just under 9 per cent, and exceeds many comparable economies such as the United Kingdom and the United States. That said, variations in reported long hours may reflect not only differences in actual hours worked, but also the data collection techniques of the various national statistical agencies.

Figure 13.2 **Australia has a high proportion of employees working very long hours**

Per cent of employees working more than 50 hours, 2011



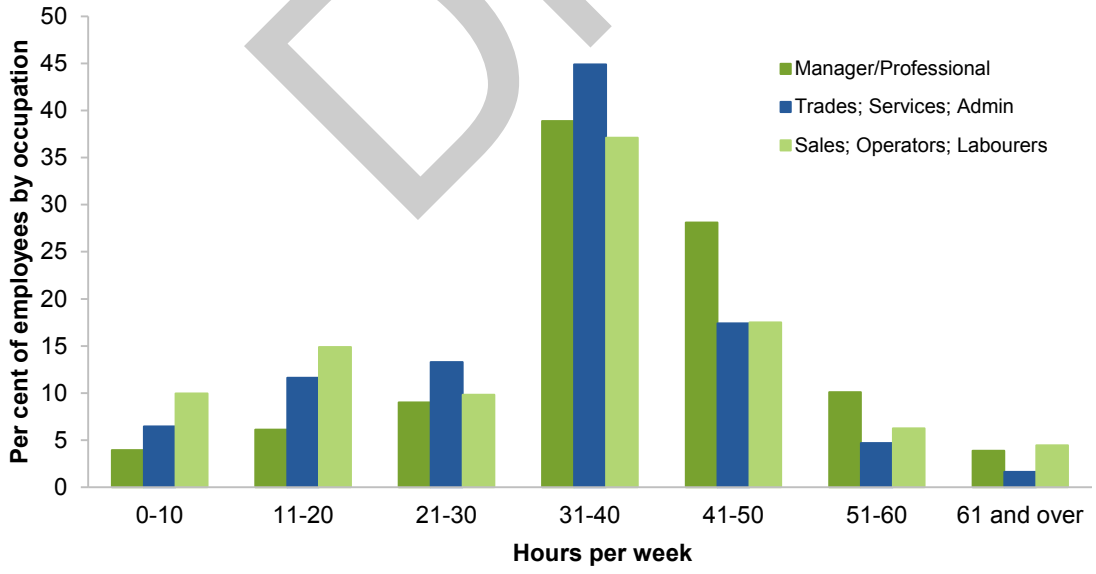
Source: OECD (2013c).

Who works long hours?

Long working hours are particularly common in high-skill occupations. People who work more than 40 hours per week are much more likely to be a manager or professional (figure 13.3). Several factors explain the prevalence of long hours by occupation:

- award-based overtime premiums create incentives for employers to avoid employing staff for hours in excess of their 'ordinary hours'. For salaried employees that are not award-based, no such premiums apply
- norms about working longer hours vary by occupation and workplace. In part, this may reflect employees' perceptions that long working hours signal commitment to the enterprise (affecting job security and promotion). The non-pecuniary benefits of some types of work — its learning opportunities and job stimulation — may also lead to long hours
- the nature of work in some industries/enterprises is more conducive to employing many employees on short shifts than others. For example, it is relatively easy to coordinate the activities of many retail assistants working short hours in a retail outlet. This is not true for many professions where it is difficult to transfer knowledge that is important to the efficient functioning of the business between different employees.

Figure 13.3 **Managers and professionals are more likely to work long hours**
Weekly hours worked, by occupation



Source: Productivity Commission estimates based on HILDA Release 13.0.

Overtime

As discussed above (box 13.1), 'overtime' is an ambiguous concept, and although the data on overtime may capture more than long working hours, which are the focus of this chapter, they can provide some general insights for policy consideration.

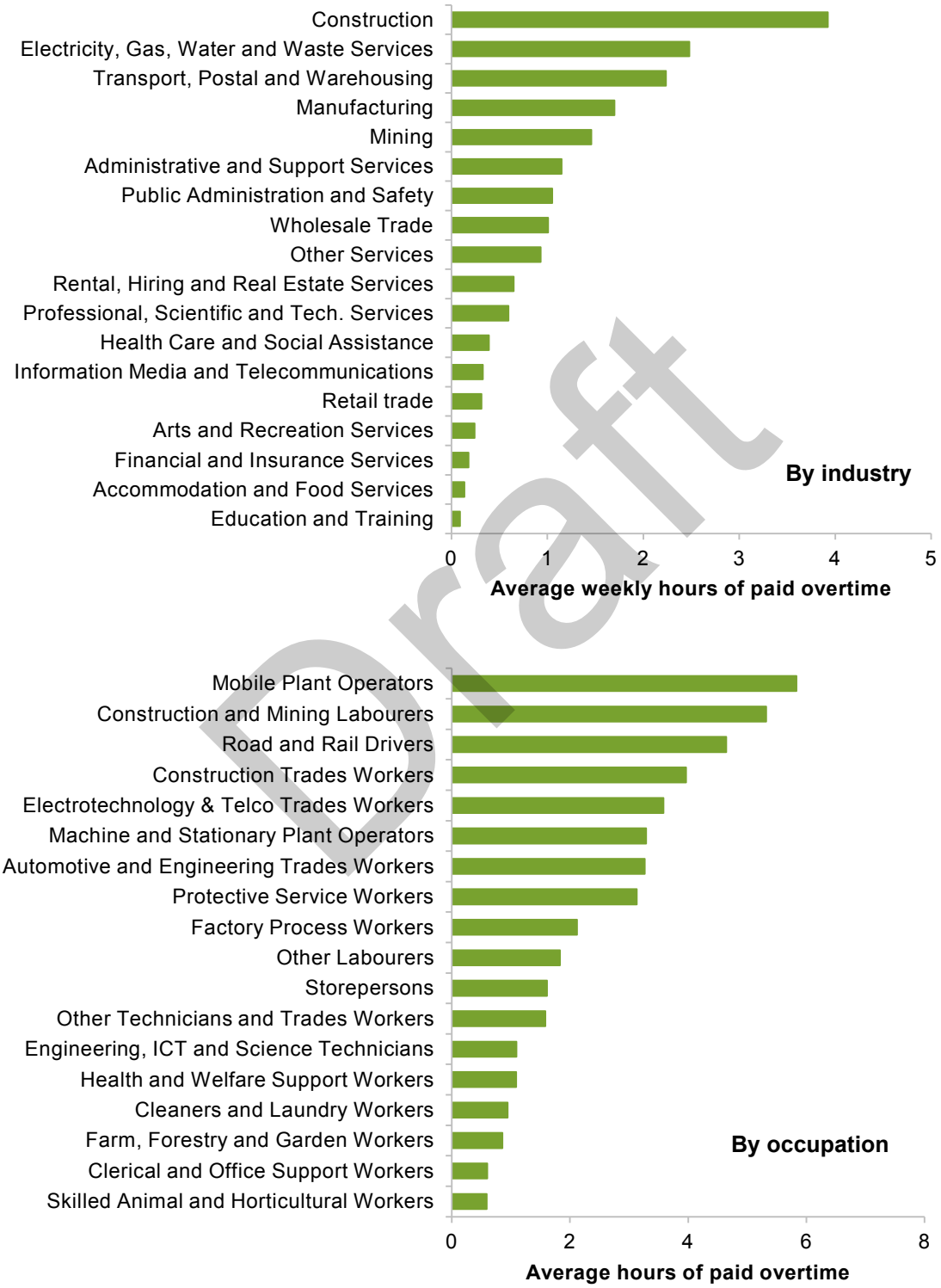
The available data suggest overtime is common for many employees. In 2012, roughly a third of employees reported usually working overtime (both paid and unpaid) (figure 13.4), although this was substantially lower than the recent peak of just under one half of all employees in 2003.

Figure 13.4 **Proportion of employees working overtime**
1993–2012

Source: ABS (various years), *Working Time Arrangements*, Cat. No. 6342.0, table 1.

Overtime rates vary considerably by industry and occupation (figure 13.5). In terms of industry, the highest rates of paid overtime are seen in construction, followed by electricity, gas, water and waste services. In terms of occupation, mobile plant operators work the highest number pad overtime hours, followed construction and mining labourers. The lack of overtime recorded among occupations traditionally associated with long hours — such as health workers and various types of managers — reflects that these employees are typically in salaried work, without defined ordinary hours.

Figure 13.5 **Overtime by industry and selected occupations**
Weekly hours of overtime

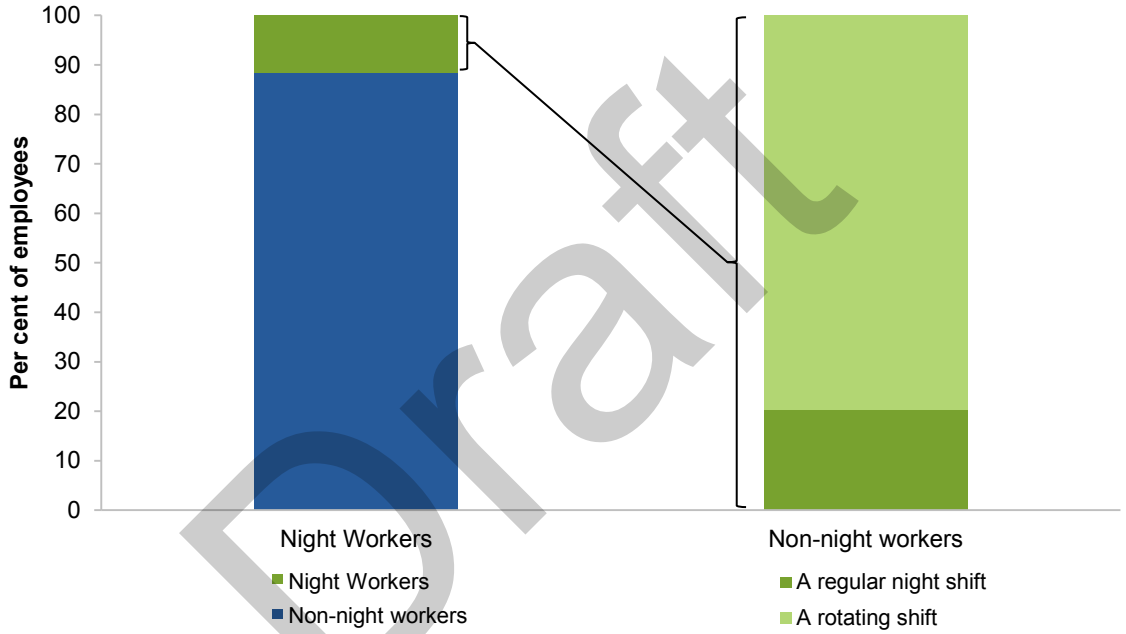


Source: Productivity Commission estimates based on ABS (2014) *Employee Earning and Hours, Expanded CURF*, Cat No. 6306.0.55.001.

Night work

In 2013-14, almost 1.2 million Australian employees (around 11 per cent) reported working schedules likely to involve night work (including regular night shifts and rotating shifts) (figure 13.6). Among these workers, rotating shifts were most common. Only around 2.5 per cent of employees were involved in regular night shift work. This distribution of working schedules has remained fairly stable since 2001.[134]

Figure 13.6 **Night–working employees in Australia[a]**
Proportion of workers, 2013-14



[a] Night workers includes those who work a regular night shift and a rotating shift. The figures do not count people who work irregular hours and split shifts or who are on call. Some work undertaken as part of these working patterns will involve working at night, and so the figures in the main test and the chart are likely to underestimate the actual prevalence of night work. If the former categories of work were included in the estimates then up to 2 million Australian employees (almost 20 per cent) could be involved in night work. The underestimate due to the omissions will be partly mitigated by the fact that rotating shifts may not always involve night work.

Source: Productivity Commission estimates based on HILDA Release 13.

134 There is considerable uncertainty over these estimates because night shift work is not separately identified in any of the relevant surveys. The ABS recorded 1.5 million employees who worked on shift work in November 2012 (or 16.1 per cent of all employees), which included rotating shifts, regular shifts (covering any of regular evening or graveyard shifts, regular morning shifts and regular afternoon shifts), and irregular shift, split shift, on call arrangements (ABS 2013, *Working Time Arrangements, Australia, November 2012*, Cat. No. 6342, table 7, released 3 May). Many of these arrangements will not involve night shift at all. The 2014 Australian Work and Life Index (AWALI) survey undertaken by the University of South Australia found that 19.1 per cent of employees 'often or always' worked evenings or nights past 9 pm (based on Productivity Commission analysis of the survey).

Who works nights?

The incidence of schedules likely to involve night work (regular night shift and rotating shifts) varies substantially across industries, ranging from just under 40 per cent of employees in accommodation and food services to around 5 per cent in financial and insurance services (table 13.5). Other industries with high proportions of night workers include agriculture, arts and recreation services, mining, transport and warehousing, and health and social assistance — all with over 25 per cent of employees regularly working nights.

In absolute terms, the health care and social assistance industry contains the largest number of night working employees, followed by accommodation and food services and retail trade — each with over 200 000 of these night workers.

Table 13.5 **Work schedule varies substantially by industry**

Per cent of employees by work schedule, average from 2009-10 to 2013-14[a]

Industry	*A regular night shift*	*A rotating shift*	*Irregular schedule*	*Other*
Accommodation and Food Services	7.6	17.6	13.6	61.2
Arts and Recreation Services	1.8	15.2	19.6	63.4
Mining	1.5	28.7	2.8	67.0
Transport, Postal and Warehousing	5.5	13.7	11.9	68.9
Health Care and Social Assistance	4.0	16.7	7.6	71.8
Agriculture, Forestry and Fishing	0.7	1.7	25.3	72.4
Retail Trade	2.8	8.9	9.4	78.9
Public Administration and Safety	1.8	11.4	4.8	82.0
Rental, Hiring and Real Estate Services	0.9	2.7	14.0	82.4
Information Media and Telecommunications	1.3	5.8	9.5	83.4
Administrative and Support Service	1.7	4.9	9.1	84.4
Manufacturing	3.3	6.4	4.7	85.7
Other Services	0.2	2.7	10.5	86.7
Professional, Scientific and Technician	0.0	1.3	10.9	87.8
Wholesale Trade	0.9	1.3	7.1	90.8
Electricity, Gas, Water and Waste Services	0.1	5.8	2.7	91.3
Construction	0.6	1.5	6.6	91.4
Education and Training	0.3	1.1	5.0	93.7
Financial and Insurance Services	0.4	1.4	3.5	94.7
All Industries	2.3	7.9	8.5	81.4

[a] Estimates are averages from the last 5 waves of the HILDA Survey.

Source: Productivity Commission estimates based on HILDA Release 13.0.

13.3 Assessing long hours and night work regulation

Long hours and night work can be detrimental to employees, however regulatory responses that restrict work schedules must balance the potential gains from regulation against the impacts on individuals who genuinely benefit from long working hours and night work.

The personal costs of working overtime and night shifts

There is a wide body of evidence suggesting that long hours and night work impose health costs on employees. The existence of such personal costs may justify regulatory intervention, such as working hour limits and wage premiums, to compensate employees.

The health effects of working long hours

Studies of health effects for long hours primarily relate to coronary, sleep and psychological health conditions.

Both heart disease and its precursors have been linked to working long hours. Raised blood pressure has been attributed to both daily and weekly long hours, with work beyond 40 hours per week found to be detrimental (Nakamura et al. 2012; Nakanishi et al. 2001). Moreover, working 11–12 hours per day has been estimated to cause a 1.56 fold increase in incidence of coronary heart disease, and a 1.67 fold increase in incidence of coronary death or non-fatal myocardial infarction (Virtanen et al. 2010).

Disrupted sleep behaviours are also linked to long working hours. Both low duration of sleep and difficulty falling asleep appear to result from long hours (Virtanen et al. 2009). Moreover, long hours of work have been linked to lower sleep quality and reduced daytime function (Nakashima et al. 2011; Sekine et al. 2006).

Psychological impacts of long working hours have been found for various measures of mental health. For example, Nash et al. (2010) found higher rates of psychiatric morbidity among Australian doctors working long hours. Other studies have linked long working hours to poor performance in cognitive measures, such as reasoning and vocabulary tests. A number of studies have found working long hours to be associated with increased likelihood of anxiety, depressive symptoms, and major depressive episodes (Virtanen et al. 2012).

The health effects of working nights

The most obvious effects of night work are those relating to sleep. Night work can disrupt circadian rhythm and result in long–term sleep deprivation. Across a number of studies, night shift workers have been found to sleep less and have lower quality of sleep (de Cordova et al. 2012). Indeed, the International Classification of Sleep Disorders recognises

Shift Work Disorder (SWD) as a condition characterised by excessive sleepiness and insomnia due to non–standard work hours.

However, the effects of night shift are not limited to sleep. Shift work has been linked to higher rates of smoking, increased stress, higher body mass index, and metabolic syndrome — a cluster of risk factors including elevated blood pressure, obesity, and problems with cholesterol (Bannai and Tamakoshi 2014). Furthermore, some research suggests a direct link between night work and cancer, supporting the notion that high exposure to light during the night supresses secretion of melatonin, which in turn distorts the levels of other hormones and increases risk of cancer (International Agency for Research on Cancer 2007; Stevens 1987).

Impacts of regulation on employment, working hours and wages

The primary rationale for working time regulations examined in this chapter is to mitigate the detrimental effects of long hours and night work on employees. However, in addition, some argue that regulations have broader impacts, particularly on equilibrium levels of employment. These potential effects and their supporting evidence are discussed below.

Overtime regulations and working hours

There is strong evidence that long working hours decrease following regulation. For example, Hamermesh and Trejo (2000) compare rates of overtime work for males and females in California before and after the introduction of laws that increase overtime rates for men only. Their estimates of the relationship between overtime rates and overtime work suggest that 1 per cent increase in overtime premiums corresponds to a 0.5 per cent reduction in overtime hours, a hardly surprising outcome given that the demand for the total hours of work are inversely related to its price.

Overtime regulations and equilibrium levels of employment

Some consider that working hour restrictions and wage premiums increase overall levels of employment, even though they reduce the average hours of work for any given employee. However, the net employment impacts are uncertain.

- Some employers may hire new employees because of limits on overtime hours per employee or higher overtime rates. However, employers face fixed costs hiring additional employees, especially for higher-skill employees. Moreover, labour is not a homogeneous input, and additional employees may not be as effective as existing employees.
- Businesses may substitute away from employment to production equipment and technology, decreasing overall employment.

- As business costs rise, some firms may restrict their operating hours, which could also reduce employment.

Accordingly, regulations limiting hours or adding a premium to shift work may reduce overall labour demand (measured in hours) without increasing the number of jobs. Overall, there is little empirical evidence that levels of employment increase as a result of increased (or newly introduced) overtime premiums (Oaxaca 2014).

Further regulatory considerations

Working time regulations appear effective in reducing the incidence of overtime. Both economic theory and empirical evidence suggest that overtime rates reduce the prevalence of long working hours. To the extent that they are complied with, by definition, working time limits reduce the prevalence of long working hours.

Given the health costs associated with longs hours and night work, and the lack of bargaining power of many employees, there is a strong case for retaining a policy response. Current arrangements implement a mix of working time limits imposed by the NES, along with wage premiums contained within awards. The appropriateness of current regulations rests on answers to a number of questions:

- To what extent do long hours of work reflect the preferences of employees?
- Are long hours of work only a temporary issue for most employees?
- To what extent do employers (and employees) comply with current overtime regulations?

Volunteers or conscripts?

While the NES stipulate a maximum 38-hour week for full-time employees, employers may request 'reasonable' additional hours of work. The subjective concept of 'reasonable' hours means that there is no specific cap on weekly hours, not only because reasonable additional hours may vary by circumstance, but also because employees may volunteer to work additional hours.

Multiple sources of evidence reveal a mixture of voluntary and involuntary overtime. Some inquiry participants have reported dissatisfaction with requests to work overtime, while others appreciate the opportunity to earn additional income (box 13.4). Figure 13.7 illustrates the variation in working preferences according to length of working week reported in HILDA (see appendix B for a summary of the HILDA survey). Employees are much more likely to prefer fewer hours when working in excess of 50 hours per week,

while a minimal number of employees prefer additional hours from around 40 hours onwards.[135]

Box 13.4 Participant attitudes towards overtime varies

A number of participants have expressed dissatisfaction with the hours that they work, and many indicate little control over these arrangements:

> We are called in to work extra hours sometimes not given the right amount of notice and only paid at part time rates, we could turn it down but have to find someone else to take our place which makes you feel like you are a bad employee. (Group of individuals, sub. 188, p. 268)
>
> 76 hours per week. No say in the shift I get managers do rosters and You have to swap with co-workers or have sickies to juggle personal life with work hours. (Group of individuals, sub. 188, p. 270)

On the other hand, some employees see welcome overtime work, and see it as opportunity to earn additional income .

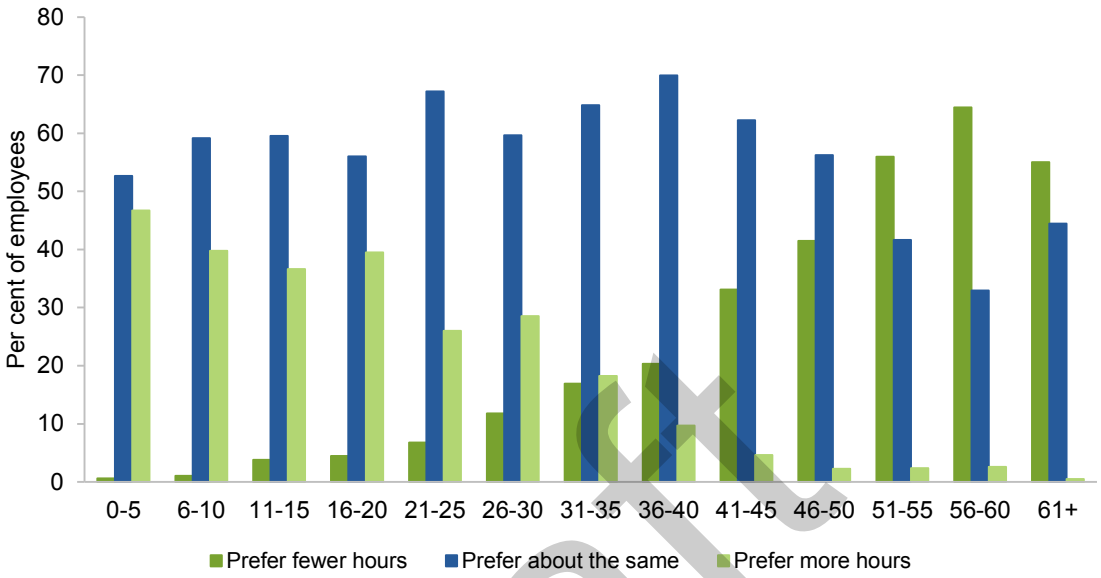
> I try to do as much OT as I can. I also try to work the Sunday shift they offer once a month to help with paying my bills. (Group of individuals, sub. 188, p. 264)
>
> I work overtime every week at the moment, which is excellent as the penalty rates help with the cost of living. I am able to strike a fair balance currently between work and life, however I am concerned that this will soon change. (Group of individuals, sub. 188, p. 270)
>
> I have contract hours which I'm obliged to complete and am often offered work beyond those hours, which I don't have to accept. Work can be offered literally hours before it's due to be done due to staff illness etc. If I'm available I'm happy to accept extra work. It supports clients and creates goodwill with the supervisors and colleagues. (Group of individuals, sub. 188, p. 271)

Drago, Wooden and Black (2006) differentiate long-hours employees as either 'volunteers' or 'conscripts' using data from HILDA. Those who work long hours (more than 50 hours per week) and prefer to work less are termed 'conscripts', while the remaining long-hours employees are labelled 'volunteers'. Importantly, HILDA respondents were asked to take into account the impact of their preferred hours on income. In 2013-14, around 10.4 per cent of employees met the criteria of 'conscripts'.

135 This was supported by other analysis. Ordinal logit analysis of the unit record file from AWALI (provided by the University of South Australia) suggested that the likelihood that the average employee wanted to work more hours than the current level was around 36 per cent when he or she worked 20 hours, 9 per cent for a working time of 38 hours and 2.9 per cent for a working time of 50 hours a week. The left hand side variable was based on three outcomes (more hours wanted, the same or less), and the explanatory variables (all statistically and economically significant) were gender, hours actually worked, blue collar status, whether the employee had young children, and whether they were aged between 20 and 24 years.

Figure 13.7 **Working hours preferences**

Per cent of respondents working a given amount of hours indicating preference for fewer, the same or more hours, 2013-14



Source: HILDA Release 13.0.

How long do conscripts persist?

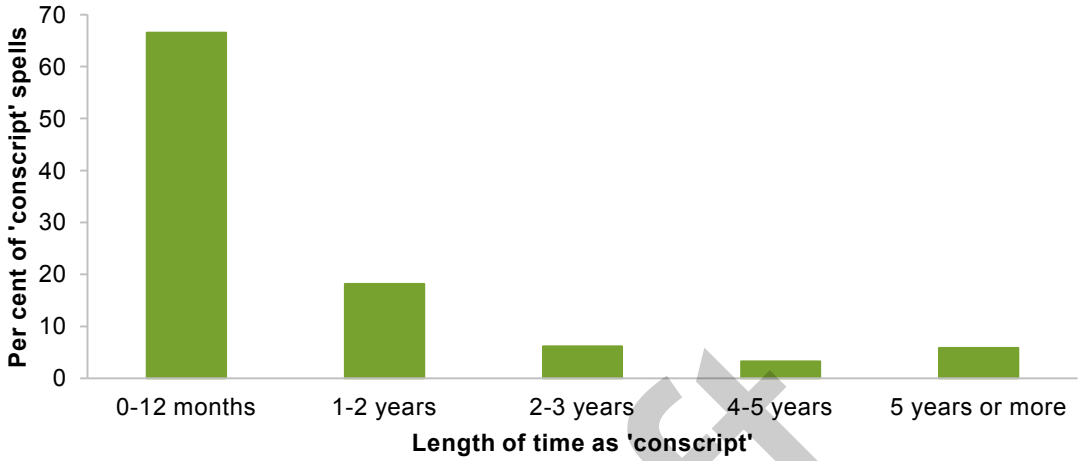
Mismatch between working hours and the preferences of employees is inevitable. However, a WR system should help to prevent extended periods of long hours in order to limit personal costs. That said, these costs must be balanced against the benefit of permitting long working hour arrangements where these are unavoidable and/or mutually preferred by employers and employees.

Moreover, there are common-sense limits to what can be achieved by regulatory intervention. Some individuals' preferences will incline them towards taking risks even where this may involve actions that medical advice indicates are against their longer term interests.

Evidence from HILDA suggests that employees tend to spend a short amount of time working more than 50 hours while preferring to work less. Among all conscript spells[136] recorded in HILDA from 2001 to 2014, over 65 per cent lasted 12 months or less. Just over 90 per cent of spells lasted three years or less (figure 13.8). Around 50 per cent 'conscript' spells were followed by reduced hours in the same job, while around 30 per cent of 'conscripts' became long hours 'volunteers' (figure 13.9).

136 In this case, a 'conscript spell' refers to an uninterrupted period of working more than 50 hours while preferring to work less.

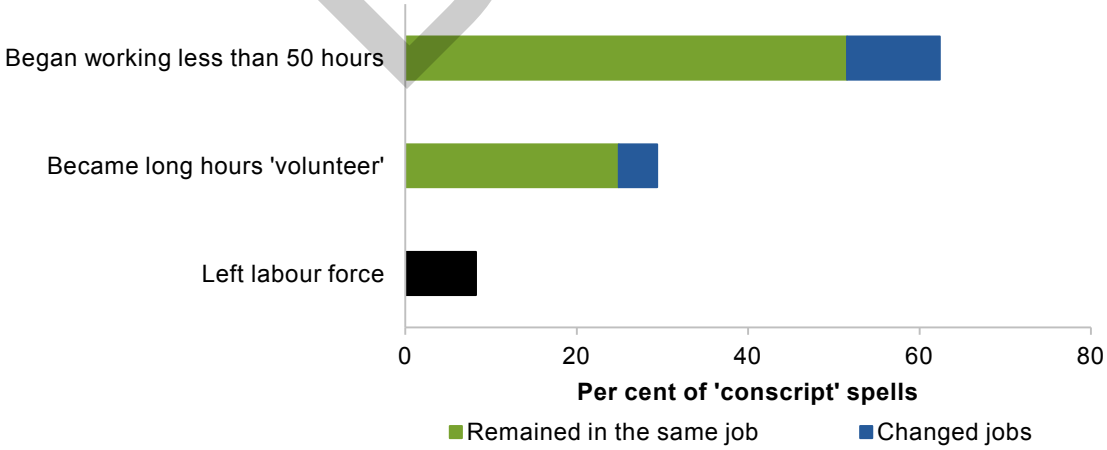
Figure 13.8 **How long do employees remain 'conscripts'?**
Distribution of conscript spells according to length[a, b]



[a] Conscript spell refers to a period in which an employee works 50 hours or more while preferring to work less. [b] This figure refers to the distribution of all conscript *spells* recorded across the first 13 waves of HILDA. Employees can register multiple spells. For example, if an employee is a conscript in waves 2 and 3, and again in waves 7 and 8, both these spells will be counted in the figure above.

Source: Productivity Commission estimates based on HILDA Release 13.0.

Figure 13.9 **How do employees leave 'conscript' work schedules?**
Type of working schedule following spell as 'conscript'[a]



[a] See note for figure 13.8.

Source: Productivity Commission estimates based on HILDA Release 13.0.

Unpaid overtime

A number of participants report working unpaid overtime (box 13.5). Indeed, nationally, just over a quarter of employees report working overtime with no additional explicit compensation (figure 13.10). However, this overtime work is not necessarily exploitative. For example, some employees may work long hours in exchange for implicit compensation in the form of better prospects of promotion. Several studies have found higher rates of pay to be associated with working long hours in earlier years, all other things equal (Anger 2005). Moreover, employees may be implicitly compensated in other ways, and content to occasionally work unpaid overtime given the nature of their work and overall conditions. However, in other instances, employees are required to work long hours against their preference with no additional explicit or implicit compensation. The views of inquiry participants reflect the varied nature of unpaid overtime (box 13.5).

Box 13.5 **Participant views on unpaid overtime**

A number of participants report working unpaid overtime. Many have expressed dissatisfaction with these arrangements:

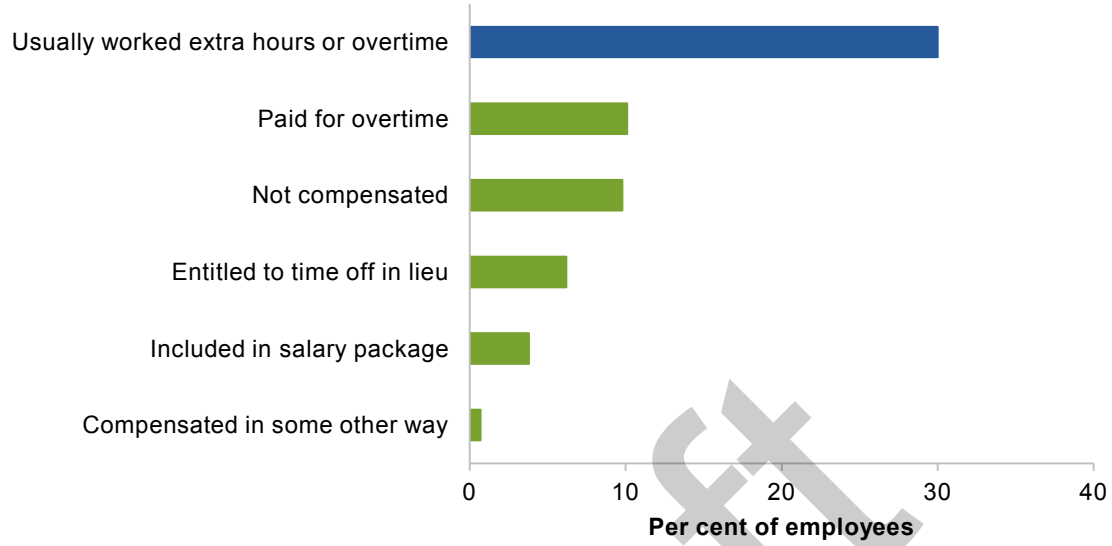
> I stay at work until my notes are written and I have safely handed over the care of my patients to the next nurse/midwife. Paid overtime is like hens teeth. (Group of individuals, sub. 188, p. 266)
>
> I am contracted for 40 hours per week, although I often work 6-12 hours overtime each Fortnight- which is unpaid and I don't recoup 'time in lei'. (Group of individuals, sub. 188, p. 271)
>
> My particular job is one which demands much of my time - I am paid for 35 hpw, but often work 50 hpw. I am only paid overtime for a small percentage of that - maybe one or two hours out of 15. This is typical of teachers (school and TAFE). (Group of individuals, sub. 188, p. 263)

However, some participants consider work beyond 'ordinary hours' an implicit part of their remuneration:

> As a former teacher I spent many nights and week-ends working - checking student reports/papers - preparing lessons etc. I saw that as part of my salary - and professional responsibility. But there were many over-and-aboves which I and my teaching colleagues performed which might properly have in other professional contexts attracted bonuses/extra considerations! (Group of individuals, sub. 188, p. 264)

The often subtle nature of compensation for overtime precludes quantification of what is exploitative unpaid overtime and what is not. Some unpaid overtime is undoubtedly exploitative, but some is the product of longer term career investment or a reflection of strong personal commitment beyond the expectation of the employer. Where regulation will struggle to identify let alone solve a problem, it may be preferable to rely on individuals applying personal judgment.

Figure 13.10 **The prevalence of overtime and its compensation**
Share of respondents that report usually working overtime, 2012



Source: ABS 2013, *Working Time Arrangements, Australia, November 2012*, Cat. No. 6342.0 (table 1).

Overtime — but not working long hours

Like full–time employees, part–time employees can be asked to work 'reasonable' additional hours, with their maximum weekly hours defined as their typical hours of work. As noted earlier (box 13.1), overtime rates can sometimes apply to these additional hours.

While some of the concerns outlined in this chapter relating to the effects of working long hours may not apply to such overtime, there are other implications to consider.

- Working in excess of ordinary hours can impose personal costs through the effects on caring arrangements or other responsibilities outside of work.
- Such employees may not have sufficient bargaining power to negotiate wage premiums that reflect these additional costs.

Unfortunately, the full extent of these sorts of overtime arrangements are unknown, and there is limited discussion in the literature around this issue.

13.4 A case for reform?

Maximum weekly hours of work?

The 'maximum weekly hours' provisions of the NES stipulate a 38-hour working week, and provide that employers may not request 'unreasonable' additional hours of work. This does not preclude outcomes where both the individual employee and employer agree to working greater than 38 hours, since this would typically pass a 'reasonableness' test. The allowance for 'reasonable additional hours' highlights a trade off between the ability of working time regulations to consider unique employee circumstances and the prevention of exploitative working arrangements.

A dilemma in this area is that the definition of 'reasonable' is subject to interpretations of the courts, and can be unclear. The inherent ambiguity of a reasonableness test means that some employers will avoid requesting additional hours of work if employees object, even if those requests were in fact reasonable.

In enterprise agreements, the issue becomes more complex as the working time arrangements apply to whole groups of employees, and the business's operations may be planned around the expectation that employees are all able to work the designated hours. *MacPherson v Coal & Allied Mining Services Pty Ltd* has established that rosters affecting multiple employees can exceed the maximum weekly hours. However, how far such arrangements can go depends on context and therefore can be uncertain. Some employers and employer groups suggest that the 'maximum weekly hours' provisions are not flexible enough. In its submission, ALDI states:

> ALDI recommends that the National Employment Standards (NES) be amended to enable employers and employees greater flexibility to determine reasonable additional working hours above the standard 38 hour week. This would allow employees to work the hours they wish and enhance the ability of employers to utilise labour more productively. If an employee seeks additional hours — as occurs regularly at ALDI — it is not clear why they should be denied the opportunity to boost their income. (ALDI, sub. 146, p. 2)

Some employee representatives conceived the problem in the opposite way, with the view that the flexible application of the 'maximum weekly hours' provisions undermine their enforceability. For example, the Australian Services Union states that:

> … the 'entitlement' to a maximum working week of 38 hours per week is immediately qualified by the rider 'unless the additional hours are reasonable' which largely renders the entitlement unenforceable. (Australian Services Union, sub. 128, p. 7)

Similarly, Professionals Australia state:

> Professionals Australia considers that some employers are taking advantage of the fact that there is no legislative definition of what constitutes 'reasonable' additional hours. Instead section 62(3) of the Fair Work Act 2009 (Cth) lists a number of factors which must be taken into consideration when determining whether additional hours are reasonable. Whilst this is a

> practical approach to what can be a complicated issue and the outcome of a test case which was subsequently reflected in legislation, Professionals Australia submits that the concept of 'ordinary hours' needs to be clarified. (Professionals Australia, sub. 212, p. 12)

The relatively few disputes relating to the reasonableness test suggests that its subjective nature has created little uncertainty in practice. Courts use this test in many contexts, and a more definitive test might fail to take account of the varying contexts of workplaces and individuals.

Along with the evidence of additional personal costs associated with working long hours, the above suggests that current restrictions on hours worked (with a capacity to vary these when reasonable) and premium rates of pay for long hours are justified. However, it is possible that the FWC could provide guidelines with simple examples. The existing case law (box 13.3) already provides some guidance, which could be converted into plain English explanations.

Changing regulation of night shift work?

There is strong evidence that night work has adverse health costs. Moreover, these costs are unlikely to be factored into freely negotiated wages given the imbalance of market power between many employers and employees. Given that night shift loadings likely reduce the incidence of night work, and compensates employees for the additional costs associated with working these hours, there is a case for a regulated wage premium associated with night work.

As discussed in the next chapter, the established premiums for night shift work are relatively low compared with penalty rates for weekend work, which appears to involve far fewer risks.

14 Regulated weekend penalty rates for selected consumer services

Key points

- Regulated weekend penalty rates are a common feature of the Australian workplace relations system.
- It is reasonable that employees are rewarded more for weekends, as there is strong evidence that it involves a greater loss of amenity. There are also economic reasons why some unregulated markets might not efficiently remunerate weekend work.
- Penalty rates as currently constructed for essential services and many other industries are justifiable. They align with long-held community expectations, the typical working arrangements and the job skills required in these industries.
- At the same time, social trends and community norms have shifted so that in particular segments of the services sector — cafes, hospitality, entertainment, restaurant and retail industries — Sunday working is now inherent in the job. Australian society expects to be able to shop, go to a pharmacy, and eat at cafes and restaurants on weekends. The value of supermarket shopping on Sundays now exceeds some weekdays.
- This trend will not diminish. Consequently, the workplace relations system should embrace the concept of 7-day weeks in the relevant services industries. It should provide penalty rates that take account of the types of jobs and skills needed in these industries, and that are proportionate to the impacts on their employees.
- Given the nature of these industries, the regulated rates for Sundays are significantly out of step with Saturday rates and with other times that involve demonstrably greater adverse social and health impacts.
  - In the hospitality industry, the night shift penalty rate is 15 per cent, whereas the wage premium for a permanent employee working during the day on a Sunday is 75 per cent.
  - A pharmacy assistant with limited qualifications working on a Sunday can be paid 50 per cent more than a pharmacist working on weekdays, though the latter must have completed a four year degree and a one year internship to practice.
  - Survey evidence shows that people's perceptions of their life balance are much the same for those working on Sundays as those doing so on Saturdays.
- Excessive penalty rates for Sundays reduce hours worked, mean unemployment is higher than it needs to be, and reduce options for businesses and consumers. Trading hours are likely to be lower, and capital underutilised.
- Accordingly, Sunday penalty rates in the relevant consumer oriented industries should be set at the Saturday rate.
- Lower rates would affect the incomes of employees currently working on Sundays in the relevant industries. However, this would be partly offset by higher demand for labour. Moreover, many only work in these industries early in their careers, and many households where people work on Sundays have above median household earnings.
- Nevertheless, given the social impacts of precipitate change, new regulated penalty rates should be introduced with one year's advance notice, and simultaneously across affected industries. Employees and employers would thus have time to make adjustments.
- Penalty rates for public holidays should remain at current levels.

There is very little contention about the existence or level of penalty rates for overtime or shift work in any industry (chapter 13). Nor is there much controversy about the desirability of some premium rates for weekend work, even where that does not involve shift or overtime work. The Fair Work Commission and its predecessors has justifiably accepted penalty rates as a legitimate and continuing feature of the safety net for all non-standard hours across all industries. Many,[137] but not all, stakeholders argued for the retention of regulated penalty rates.

However, the appropriate *level* for regulated penalty rates for weekend work in a number of consumer service industries, specifically the hospitality, entertainment, retailing, restaurants and cafes industries (the HERRC industries for brevity), has become a highly contested and controversial issue. These are industries where society-wide expectations for access to services has expanded over time, and that are important sources of entry-level jobs for relatively unskilled casual employees and young people needing flexible working arrangements.

Accordingly, this chapter concentrates on daytime penalty rates on weekends in these industries, but also explains why what holds for these industries less clearly holds for others (such as essential services). It is important not simply to acquiesce to the advocacy of those that most complain about penalty rates, but to have a reasonable rationale for the selective treatment of some industries.

The chapter also briefly considers penalty rates for public holidays, which involve some distinctive issues (some of which are also addressed in chapter 4).

For ease of exposition, unless otherwise specified, this chapter refers to 'penalty' rates as the premiums for pay associated with weekend work that is neither overtime nor part of ongoing shift work.

The structure and fundamental arguments of the chapter

Since it is not possible to explore any problems with weekend penalty rate regulations without understanding their current form, this chapter first examines these arrangements and recent developments (section 14.1).

[137] For example, the Government of South Australia (sub. 114, p. 10); the Queensland Government (sub. 120, p. 2, 6); Australian National Retailers Association (sub. 216, p. 18); and NSW Young Lawyers (sub. 198, p. 5).

Sections 14.2 to 14.7 set out the principal arguments for preserving, but amending, existing penalty rates in the consumer services industry, but not in other industries. This represents the skeleton of the argument:

- The widespread provision of (discretionary) consumer services on weekends — such as retailing and restaurants — is a more recent feature of Australia's economy (section 14.2). Today, people commonly expect to being able to shop, eat at cafes and purchase other consumer services on a seven day basis — and these are seen as vital to lively cities and regional communities. The HERRC industries often inherited penalty rates from a different economic environment involving very different consumer expectations, but with little consideration of whether such penalty rates were justified in this new economic context.
- Many people prefer weekends than weekdays for time off, reflecting the family and other adverse impacts of working on weekends (section 14.3).
- Policy should enable wages that attract people to work on weekends, but are not so high that there is underprovision of services and clearly adverse effects on hiring. While in the absence of any regulation, some premiums might be paid, there is nevertheless a risk that markets might deliver lower than optimal weekend penalty rates (section 14.4). Accordingly, there are arguments for some regulated penalty rates for weekend work. Some suggest that there are supplementary arguments for penalty rates, which, if true, would justify increments to penalty rates beyond those supported by the direct costs of weekend work to employees and their immediate families. These arguments are less compelling (and are covered in appendix F).
- Quite separate from the fact that the widespread expectations of the availability of HERRC services on weekends is a strengthening trend, these services have several traits that suggest that regulated penalty rates should not be as high as in many other industries (section 14.5). Such weekend rates are also often higher than rates for other times of working where the basis for compensation is stronger.
- A lower rate of penalty rates for consumer industries has (sometimes surprising) implications for businesses, consumers, and employees, including those not working currently on weekends (section 14.6). While some parties lose, the overall community-wide gains from reforms are positive.
- Section 14.7 synthesises the analysis and discusses the policy options for penalty rates for the relevant industries.

There are also other policy issues concerning payment for work outside standard hours, and these are addressed in section 14.8.

Arrangements for public holidays involve some distinctive issues. There are few grounds for reducing penalty rates for public holidays for any industry, with section 14.9 explaining why this is the case.

14.1 Weekend penalty rate arrangements

The origin of, and legislative basis for, weekend penalty rates

Regulated penalty rates for weekend work have been a longstanding feature of Australian industrial relations regulations. They arose as part of a broader objective to increase the scope for working people to engage in life beyond work and physical recuperation (Chapman 2010). Accordingly, weekend penalty rates, shorter standard working hours and overtime rates all originated from a similar social goal (though their incorporation in regulations occurred at different times and with varying scope). In this regard, the Australian Council of Trade Unions (ACTU, sub. 167, p. 150) and the Australian Nursing and Midwifery Federation (sub. 132 p. 23) identified as pivotal, Justice Higgins' decision in 1909 that penalty payments should be made at time and a half of ordinary hourly wages on Sundays, public holidays and for overtime.[138]

The resulting premium was intended to act as a deterrent against 'long or abnormal hours being used by employers' (the deterrence argument), and to compensate employees for working at inconvenient times where they were required to work (the compensation argument). Subsequently, other decisions by various industrial tribunals extended penalty rates to Saturdays, increased Sunday rates and gave increasing emphasis to the compensation argument (box 14.1 and DEEWR 2012b, pp. 4–5).

In 2013, a provision was added to the modern award objective of the *Fair Work Act 2009* (Cth) (FW Act) that specified the need for compensation for working at asocial hours (s. 134 (1)(da)). Section 134 of the FW Act states that:

> (1) The Fair Work Commission must ensure that modern awards, together with the National Employment Standards, provide a fair and relevant minimum safety net of terms and conditions, taking into account: …
>
> (da) the need to provide additional remuneration for:
>
> (i) employees working overtime; or
>
> (ii) employees working unsocial, irregular or unpredictable hours; or
>
> (iii) employees working on weekends or public holidays; or
>
> (iv) employees working shifts …

While the provision makes the role of penalty rates in awards clear, previous legislation and practice by industrial relations tribunals had already cemented the concept as an important part of wage determination.

138 *Barrier Branch of Amalgamated Miners Association v Broken Hill Pty Company Ltd* (1909), (3 CAR).

Box 14.1 Penalty rates as compensation for lost social amenity

The modern awards objective of the *Fair Work Act 2009* (Cth) places some emphasis on the premise that weekend work is socially detrimental, as do various conventions of the International Labour Organization (ILO). The notion of Sunday as a desirable day of rest has also been commonly perceived as a labour relations matter in case law in Canada, the United Kingdom and the United States, as well as Australia (Law Reform Committee of South Australia 1987). In the pivotal Australian case, delivered in 1919, Justice Higgins of the Commonwealth Conciliation and Arbitration Commission (CCAC) observed the special status of Sundays:

> The true position seems to be that extra rate for all Sunday work is given … because of the grievance of losing Sunday itself – the day for family and social and religious reunions, the day on which one's friends are free, the day that is most valuable for rest and amenity under our social habits … *Gas Employees Case* (1919) 13 CAR 437 at 469 cited in Phillips (2012)

In 1947, the CCAC determined that Saturdays should be paid at 1.25 times the ordinary rate (United Voice 2012b, p. 9) and in 1950 the Industrial Commission of New South Wales enunciated its principle that:

> In our opinion, additional rates for weekend work are given to compensate the employee having to work on days which are not regularly working days for all employees in the industry. The aim is to compensate for disturbance of social and family life and the full opportunity of religious observance, and in some cases to discourage employers working employees on non-regular working days. Re Engine Drivers General (State) Interim Award [1950] AR (NSW) 260 at 267 cited in Phillips (2012)

Awards only sometimes specify weekend penalty rates

While awards typically involve some penalty for working on weekends, this is often part of overtime or shift arrangements, or incorporated into the average shift wage rate (as in the Maritime Offshore Oil and Gas Award 2010). Only around half of awards specify penalty rates for Saturday or Sunday work that are not part of overtime or shift work (appendix F). Accordingly, the principles that underpinned various decisions by workplace relations (WR) regulators have taken account of the usual working patterns of the various industries and occupations covered by various awards. This recognises that in some industries, shift or overtime arrangements are the typical pattern of working on weekends (with the special issues that these working arrangements pose — chapter 13).

Where penalty rates apply, the most common rates are between 125 per cent and 150 per cent on Saturdays and between 150 per cent and 200 per cent on Sundays (appendix F). In the HERRC industries, the rates are often at 125 per cent on Saturdays (table 14.1).

Recent changes to weekend penalty rates are revealing

The shift to modern awards in 2010 harmonised several state–based awards (excluding those in Western Australia) and collapsed many specific awards into ones with wider

industry coverage. In turn, this led to significant changes in some penalty rates, although transitional arrangements meant that these changes were made over several years. The net impact on labour costs is not easily established because modern awards not only changed penalty rates, but also other costs (PC 2011b, pp. 334–336).

Table 14.1 **Penalty rate arrangements for selected modern awards[a]**

	Permanent			Casual				
	Percentage of permanent base rate			Percentage of permanent base rate			Relative business cost of casual to permanent employee[b]	
	Base rate	Sat.	Sun.	Base rate	Saturday	Sunday	Saturday	Sunday
	%	%	%	%	%	%	%	%
Restaurant Industry Award 2010	100	125	150	125	150	150 (175)[c]	0	-14.3
General Retail Industry Award 2010	100	125	200	125	135	200	-10	-11.1
Hospitality Industry (General) Award 2010	100	125	175	125	150	175	0	-12.5
Amusement Events and Recreation Award 2010	100	100	150	125	125	175	0	0
Fast Food Industry Award 2010	100	125	150	125	150	175	0	0
Pharmacy Award 2010[d]	100	125-150	200	125	150-175	225	0	0
Hair and Beauty Industry Award 2010	100	133	200	125	133	200	-15.8	-11.1

[a] With the exception of the last two columns, the values shown are the percentage of the base rate for a permanent employee. Accordingly, the casual base rate is 1.25 times the permanent base rate. [b] The relative business costs of a casual is based on comparing the total labour costs for a business employing a casual worker for a given number of hours compared with a permanent employee (taking into account the extra costs of permanent employees and the casual leave loading). Wherever a weekend penalty rate for a casual is not equal to the sum of the casual loading and the permanent employee's weekend penalty rate, there is a bias in favour of one form of labour. In three of the awards, there is no bias, but in four, casuals do not receive the casual allowance on weekends and therefore there is a bias in favour of the employment of casuals. For example, in July 2015, the casual loading is $4.75 per hour during weekdays so that the weekday rate is $23.47 for casuals and $18.99 for permanents. However, on a Saturday, the pay rate is $25.26 for both types of labour (or a penalty rate of 133 per cent relative to the permanent rate). However, for neutrality of costs, the casual rate would instead be $30.01 for a Saturday, so the effective casual employee cost is 15.8 per cent lower on a Saturday than permanent employees.[c] Level 1–2 employees receive a penalty rate of 150 per cent on Sundays, while Level 3–6 casual employees receive 175 per cent. [d] There are two penalty rates for Saturday, based on the time of working.

Source: Relevant awards and Fair Work Ombudsman pay guides.

The variations in penalty rates between and within industry and state awards prior to award modernisation illustrates that a significant degree of subjectivity underpinned the earlier determination of penalty rates by state and industry.[139] This is exemplified by some striking differences over time and between the jurisdictions in various fast food industry awards (table 14.2):

- Prior to the modern award, for example, there was no difference in the penalty rates for permanent employees on Saturdays and Sundays in South-east Queensland (for employees covered by the *Fast Food Industry Award - South Eastern Division 2003*) and, indeed, no difference in casual rates regardless of the day of the week worked. Yet the same award as applied to the rest of Queensland involved higher penalty rates for all employees, and provided casual workers with weekend rates higher than usual hours of working on Mondays to Fridays. Unfortunately, there was no analysis of the impacts of these variations on employment or business outcomes.
- Causal workers can be quite differently treated in different jurisdictions. In the 2003 South East Queensland award, the pay rate for casuals did not vary by the day of the week — so that the premium wage on Sundays was zero (or an *effective* penalty rate of 100 per cent)[140]. In South Australia, the casual wage rate for working on a Sunday was twice that of a weekday (an effective penalty rate of 200 per cent)
- Rates could vary by whether work was undertaken before or after noon.
- Award modernisation sometimes led to decreased penalty rates (as in South Australia and the Northern Territory). If nothing else, this suggests that regulatory changes do not necessarily have to embed the highest conditions prevailing at the time of the reforms.

The existing differences between awards covering similar employees (as in table 14.1), and the historical differences in awards covering identical employees (table 14.2), shows that the various industrial regulators have not given meticulous consideration of the social and economic impacts of the selected rates. Penalty rate determination by the Fair Work Commission (FWC) and its predecessors is an art borne of history, precedent, compromise and the lack of a coherent overarching set of principles. This is no different from many other features of awards, and reflects their origin in industrial disputes. The FWC has already advocated a more coherent framework for considering some of the major features of awards (chapter 12).

139 While penalty rates are described in different ways (appendix F), this report uses the most common nomenclature, which is 100 times the pay rate on a weekend relative to the pay rate on a weekday. That is, the penalty wage rate is calculated as the percentage of the base wage rate for a permanent employee.

140 The *effective* penalty rate for a casual is the ratio of the relevant casual weekend wage rate to the *casual* weekday rate (times 100). Standard penalty rates are typically expressed as the ratio of the casual wage rate on a weekend compared with the weekday wage rate of a *permanent* employee (AHA 2015). There is nothing wrong per se with such a definition so long as it is understood that the casual penalty rate is inclusive of the casual loading.

Table 14.2 **Fast food awards over the years**

	Casual loading	*Saturday penalty – FT & PT*	*Saturday penalty casual*	*Sunday penalty FT & PT*	*Sunday penalty casual*
	%	%	%	%	%
Fast Food Industry Award 2010 (The current award)	25	125	150	150	175
Modern Award Shop Employees (State) Award NSW	15	125	115% plus a fixed $ loading	150	150
National Fast Food Retail Award 2000 VIC	25	125	150	175	175
Fast Food Industry Award - State (Excluding South-East Queensland) 2003[a]	25	150	175	150	175
Fast Food Industry Award - South Eastern Division 2003 (QLD)	23	125	123	125	123
QLD Retail Take-Away Food Award - South-Eastern Division 2003	23	150	173	150	173
Delicatessens, Canteens, Unlicensed Cafes and Restaurants Etc. Award SA	20	125% up to 12:00 midday; 150% after 12:00 midday	145% up to 12:00 midday; 170% after 12:00 midday	200	220
Fast Food Outlets Award 1990 WA[b]	25	..	..	..	..
Restaurant Keepers Award TAS	25	125	150	175	175
Liquor and Allied Industries Catering, Cafe, Restaurant, Etc. (Australian Capital Territory) Award 1998	25	125	150	175	175
Hotels Motels Wine Saloons Catering Accommodation Clubs and Casino Employees (Northern Territory) Award 2002	25	150	175	175% - 200% subject to duties	200

[a] For full time workers. No explicit specification for part-time workers. [b] There is no specification of standard penalty rates. Overtime rates may apply. These are 150% for FT/PT employees on Saturdays until 12 noon, and 200% for FT/PT employees after 12 noon on Saturdays and any time Sunday. Casual employees receive an additional 25 percentage points on these loadings.

Source: Various awards obtained from the Fair Work Ombudsman (http://awardfinder.fwo.gov.au), specific awards and DEEWR (2012b, pp. 17–19).

There has been recent downward pressure on penalty rates

As part of the transitional two-year review of modern awards, the FWC recently examined the issue of penalty rates (amongst other conditions) for restaurant workers following an application for a variation to the Restaurant Industry Award 2010 from the Restaurant and Caterers Association (RCA) and other business interests.

Business groups proposed that penalty rates should only apply for the sixth and seventh consecutive day of work — similar to systems in place in some OECD countries. The

implication would be that any person working five days or less per week, regardless of when those days fell, would receive ordinary time pay rates. As an alternative, the proponents also advocated equalisation of Saturday and Sunday penalty rates of 125 per cent for non-casuals and 150 per cent for casuals ([2013] FWC 7840).

The FWC initially dismissed both proposals. It noted that the 'disabilities' associated with working weekends and evenings remained, and that this had not changed since the making of the award. The FWC also noted that such a change would have a significant negative effect on the relative living standards of those affected.

However, on appeal, the majority of the Fair Work Commission full bench reduced penalty rates for the least skilled workers — level 1 and level 2 casual workers.[141] It held that the combination of the casual loading and weekend penalty rates overcompensated inexperienced and transient employees, and that the high rate at the time was 'more than is required to attract them to work on that day' (para 138 of the judgment). The FWC changed the award so that Sunday penalty rates for level 1 and level 2 casual workers were reduced from 175 per cent to 150 per cent of the ordinary rate, effectively eliminating the casual loading for Sunday work. The FWC stated that this reduction in penalty rates would be less likely to affect long-term career restaurant workers, who are generally not employed at lower levels. In reaching its judgment, the FWC still maintained that there was a special disability associated with working on Sundays, and that reducing penalty rates for all classifications would not have significant positive employment effects. In that respect, the decision was not a qualitative departure from previous award decisions or their inherent logic — which embody some fundamental contradictions.

There are already flexibilities in paying penalty rates

While many characterise the treatment of penalty rates in awards as rigid, awards and enterprise agreements already have some flexible features that mitigate this.

Annualisation

One of the prime mechanisms for flexibility is that awards allow an employee to agree to be paid an annual salary instead of a weekly or hourly award pay rate, forgoing penalty and overtime rates (referred to as 'annualised salary arrangements').[142] The implicit hourly rate of the salary must be such that the salary paid over a year would be sufficient to cover what the employee would have been entitled to if all their usual award overtime and

141 See [2014] FWCFB 1996. The minority judgment considered Sunday penalty rates was too high for *any* employees in the industry.

142 Annualisation must pass the BOOT. Arrangements that involve pay increases for workers in exchange for reduced penalty rates must not prejudice other classes of employees (most particularly casuals whose work is more likely to involve weekend work). This issue has arisen for an enterprise agreement formed between the Shop Distributive and Allied Employees' Association (SDA) and Coles supermarkets.

penalty rates had been paid. For example, in the Restaurant Industry Award, salaried employees must be paid at least 25 per cent above the minimum wage as compensation.

Annualised salary arrangements provide some flexibility and certainty for employees and businesses. Employers currently often design work schedules to avoid weekend penalty rates. A business using an annualised salary can ensure that it can more flexibly allocate employees to weekend work depending on projected demand. Annualisation also reduces any incentives for an employee to reduce productivity during mainstream hours to obtain higher payments through weekend work or overtime (though the prevalence of such conduct is unknown). It is not clear how often these arrangements are used or if there are any obstacles to their takeup. The FWC does not have data indicating how often these arrangements are used; nor has the Productivity Commission been advised of any obstacles to their takeup.

Using labour that does not require penalty rates

Businesses also can use the labour of the owner-manager, unpaid family members or employ subcontractors without any requirement for penalty rates.

The use of subcontractors in the key industries affected by penalty rates is limited because the terms of engagement will usually resemble that of an employee. Businesses in the relevant industries would typically set the hours of work, the manner in which it is undertaken, and provide any equipment, which collectively would be likely to fail the subcontractor test. So, while subcontracting arrangements may remove the need for paying penalty rates to an IT consultant providing services to a major retailer on a Sunday, the scope to use them for routine tasks that involve a high degree of employer control (such as checkout services) is unlikely. Indeed, it is notable that subcontracting arrangements are rare in the retail, and accommodation and food services industries (comprising 2 and 1.1 per cent of employed persons respectively in these industries).[143]

Contributing family members (who are not paid) also play a small role in providing labour services (accounting for around 2 per cent of employment in the relevant industries).[144]

The owners of businesses are a more important source of labour, accounting for 8.6 per cent of labour in the retail industry and 9.6 per cent in accommodation and food services. However, there is a limit to the role they can play.

[143] This ranks as 17th and 19th among the 19 ANZSIC industries (ABS 2014, *Forms of Employment, Australia, November 2013*, Cat. No. 6359, released 7 May.

[144] ABS, *2011 Census of Population and Housing*.

14.2 The shift to a seven-day consumer economy

The community has long accepted weekend work in some parts of the economy (agriculture, transport, utilities, those parts of manufacturing requiring continuous production, and health and emergency services). Penalty rates represented an additional payment for work that was routinely provided on weekends, with expectations by businesses and customers that the relevant goods and services should be provided over a seven-day period. Penalty rates were simply part of the overall wages package in such industries, and had penalty rates been lower or zero, average wage rates would have to have been higher. Indeed, as shown above, in many industries, there are no weekend penalty rates, but weekend work is compensated through higher average pay rates, as well as shift and overtime payments.

However, for many years, the community did not accept weekend work where seven-day operations were neither essential for the community nor required to avoid large costs. Several developments over the past 30 years have changed this historical pattern.

More demand on weekends

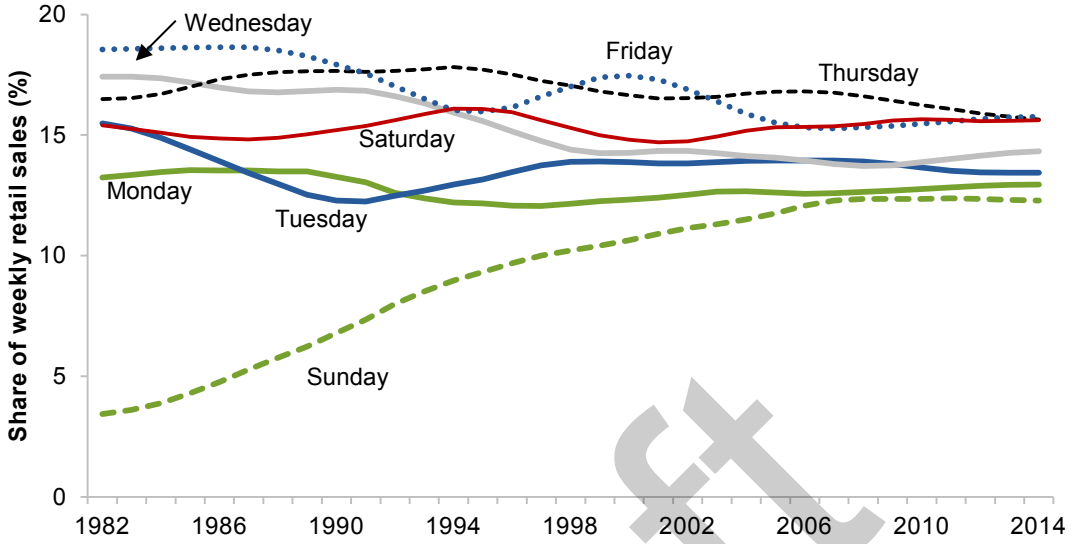
There has been a growing demand for the supply of HERCC services over the weekend, and it is precisely in these industries where penalty rates are a controversial issue. In such industries, the customer is buying convenience and variety as much as the good itself. The industrial relations system has not caught up with this shift in consumer expectations and social norms, a point made by a variety of participants in this inquiry.[145] Indeed, even as far back as 1980, the Confederation of Australian Industry argued that there were 'discernible social trends towards greater flexibility in life patterns generally, and working patterns in particular' (CAI 1980, p. 13).

In 1992, women used to spend 50 per cent more time buying goods and services on each weekday than each weekend day. The latest data (for 2006) suggest that gap has vanished, and in the case of men, weekend days are more important for this activity than in the past (appendix F).

In retail generally, Sundays have gone from a relatively small share of weekly sales to a share close to other days (figure 14.1). Sunday trading for some retail outlets accounts for up to 25 per cent of revenue (ACRS 2012). Moreover, there is some evidence that people are making more frequent trips to supermarkets, taking advantage of their longer trading hours.

[145] For example, the Busselton Chamber of Commerce and Industry (sub. 65, p. 2) and VECCI (sub. 79, p. 19).

Figure 14.1 **Retailing trends by the weekday**
Share of weekly retail sales, 1982 to 2014[a]



[a] Based on estimating trading days effects on ABS monthly retail data.

Source: Unpublished data provided by the ABS and based on a research paper: Campbell, J. and Chen, L. 2015, *Improved Time-varying Day Adjustment in SEASABS*, Canberra.

Information from a major credit card provider indicated that in 2014, the average daily transaction rate is now largely the same for weekdays and weekends. The share was very similar to that applying in 2012, consistent with the last few years of data in the ABS retail trends data above. Longer term transaction data were not available.

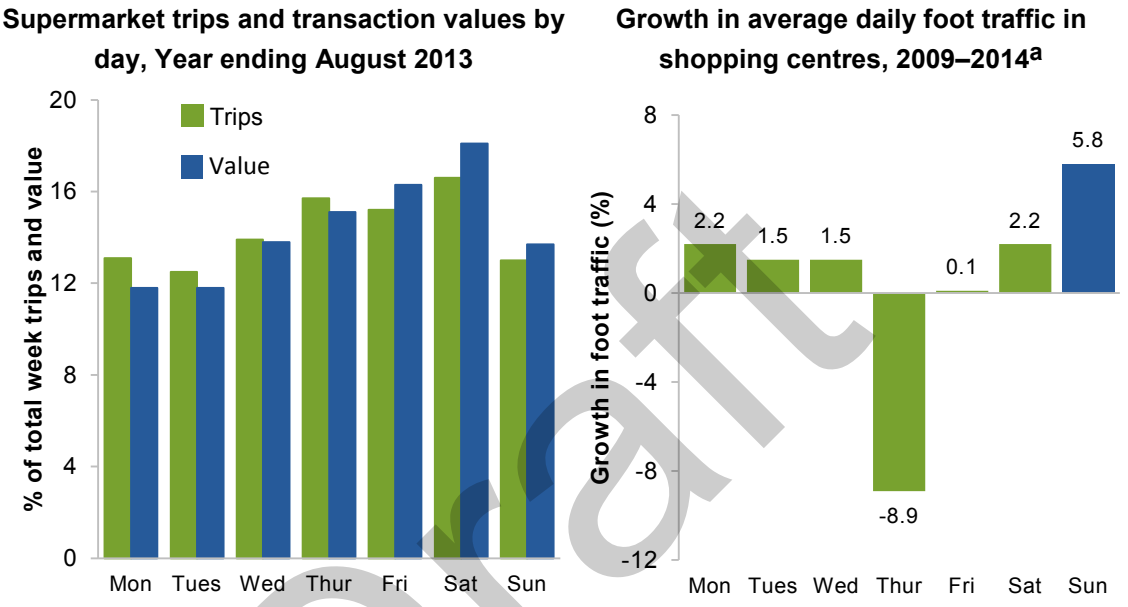
In major shopping centres, foot traffic growth for Sundays has been far stronger than any other day (figure 14.2). Other evidence also suggests that where trading hour restrictions do not apply, the number and value of supermarket shopping trips on Saturdays is more important the any other day.

Data from Coles supermarkets in Victoria also suggests trading is highest on Saturdays, but show Sunday trading exceeds some weekdays (ERA 2014). Survey data for 2013 suggest that Sunday was increasingly becoming the 'new Saturday' for trips to the supermarket, with 18 per cent of Australians making Sundays their primary shopping day (KPMG, Quantium and Woolworths 2013).

The above data relate to the time taken for transactions, but ignores browsing for goods and services, and the time taken to consume some services (for instance, in eating lunch or going to a gym compared with the time taken in paying for such services). While there is no information about such demand patterns over time, there is official data for one year (2006) by the day of the week. This shows that the time spent by the average consumer in commercial enterprises is around one hour a day during weekdays, nearly two hours on

Saturdays and 1.25 hours on Sundays.[146] Unfortunately, there is no contemporary matching data, but the data on sales and foot traffic shown above strongly suggest that time spent in commercial enterprises on weekends will have increased further in the subsequent nine years.

Figure 14.2 **Growth and significance of shopping by weekdays**



a The Shopping Centre Council of Australia obtained six years of data (between 2009 and 2014) pertaining to centre foot traffic for 'stabilised' centres, that is those that are unaffected by development from the beginning to the end of the analysis period, across most states. Further, data were used from centres that were already subject to seven day trade and therefore could be considered 'super stable' centres. Using 2009 as the 'baseline' for the analysis, the change in foot traffic was then calculated over the following five years. The data relate to shopping centres owned by one major shopping centre provider. The results exclude Western Australia, where Sunday trading has only been permitted since 2012, and also exclude the ACT, Tasmania and the Northern Territory either because they did not have stabilised centres, or the dataset was not sufficiently reliable.

Source: Data from Aztec (2014) and the Shopping Centre Council of Australia for supermarkets and shopping centres respectively.

More workers on weekends

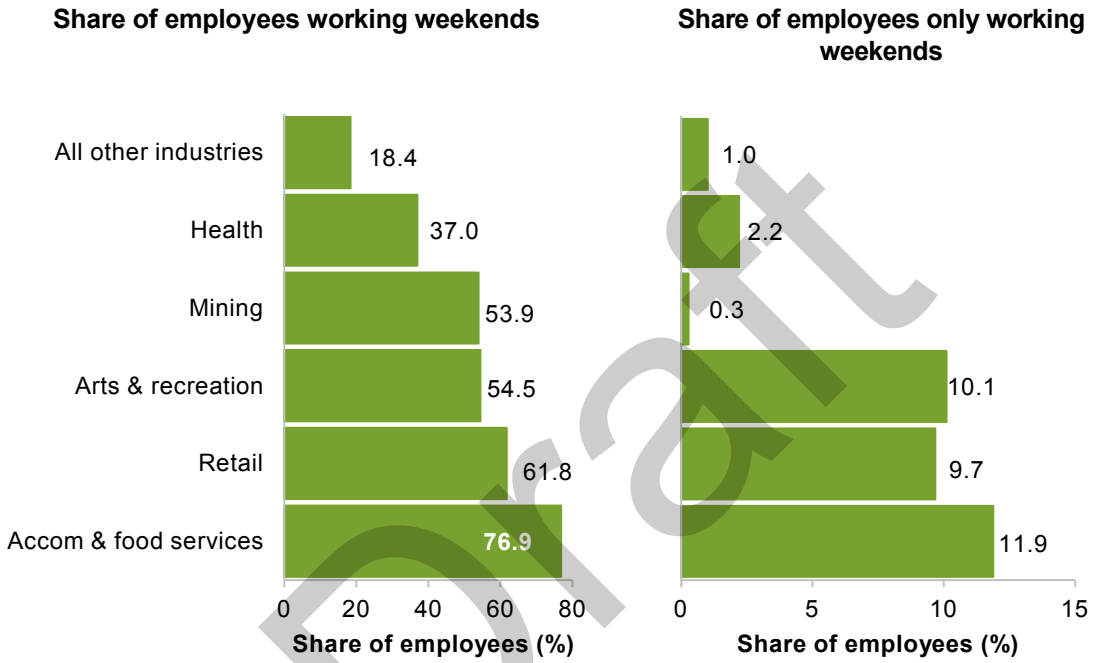
Weekends have also grown in prominence as a time for working (appendix F). The HERRC industries that are the focus of this chapter have developed different employment patterns because of these shifting patterns of consumer demand. They have patterns of

146 This is based on the 2006 ABS *Time Use Survey* and covers the total time spent by people in 'commercial or service areas', establishments for 'leisure, culture or sport' and 'eating and drinking locales'.

employment that are much more strongly focused on weekends than most other industries (figure 14.3). Not only does a greater share of their workforces work on weekends, but a non-trivial share of the workforce *only* works on weekends. The latter distinguishes them from industries — like health and mining — where weekend work is common, but is usually allied to working at routine times on weekdays too.

Figure 14.3 **The importance of weekend work by industry**

Ratio of workers employed on weekends compared with weekdays. 2012[a]



[a] The data relate to one month of an employee's working time arrangements.

Source: Analysis of wave 12 of HILDA.

The nature of HERRC industries is unlike many industries where customer demand often peaks during weekdays (as in most financial and administrative services) or where demand and supply do not have to be aligned on a day-by-day basis because of inventory management. Some other industries can use technology to meet weekend peak demands without much additional labour (for example, the services provided by utilities, and automated services, such as ATMs and online account management). However, many HERRC services must be delivered at the time of consumption and in person, such a eating a meal or going to a live musical performance. And convenience services are defined as ones that must be available at a time that suits the particular circumstances of a consumer, which applies to some (but by no means all) retail services.

Many interrelated factors lie behind these changing patterns

Female workforce participation rates have increased dramatically over the past decades (chapter 2). Women have long been the dominant purchasers of food and other weekly necessities, and their growing participation in the workforce has meant that families have needed other times to perform these domestic tasks. Men have increased their time engaged in household errands (of which a prime component is shopping), which may have been partly caused by changing gender roles, but also by the capacity for them to also shop at times that do not clash with typical work times (Wilkins 2014, p. 99ff). Moreover, as norms about female workforce participation have changed, it has made it easier for businesses to find labour for weekend work.

More generally, *social norms* about shopping times have shifted. Shopping has become a recreational pursuit in its own right for families and friends, while shopping centres are places for social interaction more generally. In one survey, 39 per cent of people nominated the local shopping centre as the most important gathering place in their community, compared with 11 per cent for the local community centre, 16 per cent for a community park or sports ground and 19 per cent for a local club or hotel (mccrindle et al. 2014). Many commercial services are inherently social in character — such as having a meal or a drink with others. Consequently, the increase in the number of businesses open on weekends has its own social spillovers. The availability of entertainment and restaurant/cafe services on weekends and evenings produces lively social places and liveable cities (ACRS 2012).

In addition to the changing role of women and work, a likely contributor to these changing social mores has been a steady *reduction in religious observance*. The number of people reporting no religion in Australia has markedly increased over the past hundred years. In 1911, only 0.4 per cent of the Australian population chose the option 'no religion' on their Census form. This rose to 7 per cent in 1971, 15 per cent in 2001 and 22 per cent by 2011, or just under 4.8 million Australians (ABS 2013b). The trend was particularly strong for younger people, who contribute disproportionately to labour supply on weekends. Moreover, other religions for which Sunday is not a day of worship are becoming increasingly prevalent in Australia. Of those people who profess Christian belief, only one in seven actually attended church regularly in 2013, so religious belief and particular observance of it at a given time and place are different things. The average time spent by people on religious activities on weekends — whether communally or otherwise — fell by more than 25 per cent from 1992 to 2006 (ABS 2008a).

The changing prevalence of religious beliefs and the times when people seek to express their convictions communally is not just important because it has affected what people want to do on weekends. It is also relevant because industrial relations tribunals have given this issue considerable weight in their decisions to limit business activity on days of religious importance (particularly Sundays), or to require higher levels of wages as compensation for forgone religious observance (see below).

Changing norms about the acceptability of buying goods and services on weekends have both led to, and been further encouraged by, the softening of *trading hour restrictions*. Currently, all states but Western Australia, South Australia and Queensland have deregulated weekend trading hours. Trading hour restrictions have been progressively relaxed in states that still limit weekend trading (Harper et al. 2015, p. 156ff; PC 2014c). There is a continued impetus for further deregulation, which will further encourage the supply of HERRC services on weekends.

Online provision also has several implications for service provision, which is one reason why a WR framework must take into account emerging trends, and not overemphasise the past:

- Even if the service is provided virtually, the growth of online provision of consumer goods and services — which are available 24/7 from throughout Australia and globally — will reinforce weekend consumer activity.
- Online provision creates further competitive pressures on bricks and mortar stores. Those that cannot open on weekends due to costs or trading hour restrictions will increasingly lose demand to virtual shops that are open all the time. Accordingly, failures to address regulatory impediments may shift demand from a physical shop to a warehouse (Busselton Chamber of Commerce and Industry sub. 65, p. 2). Already, the online provision of music, books and video has strongly challenged old models of providing content to people.
- Successful operation of online stores in Australia providing global services requires a 24/7 workforce as the purchasers may be in quite different time zones to Australia.
- There are also complementarities between online supply and opening hours of some bricks and mortar stores. Department stores and supermarkets are offering 'click and collect' for their own products. There have also been other innovative collaborations between the online and bricks and mortar worlds, as in the partnership between Woolworths/BigW and eBay, which involves the former offering a parcel pickup service for the latter (Sadauskas 2015). An effective service requires staff and attractive opening hours for consumers, and this may be particularly true for smaller retailers wanting to offer similar innovative services.

Growing incomes have also spurred the demand for discretionary services that complement people's leisure — particularly accommodation, recreational and cultural services.[147] Research from the HILDA survey shows that:

> … time spent on household errands has increased over the period, rising by an average of 0.8 of an hour per week for both males and females. This increase primarily occurred between 2002 and 2006, with little change between 2006 and 2011. The increase may reflect an increase in the time spent on (discretionary) shopping, in turn deriving from the growth in household incomes over the period … (Wilkins 2014, p. 100)

These various social and economic trends have also influenced, to some degree, the decision making of industrial relations regulators. While the early industrial cases emphasised the goal of penalty rates as a deterrent against employers opening at asocial times (ACTU 2012a, p. 32ff; Dawkins, Rungie and Sloan 1986, p. 565), this view is now largely seen as dated. Australian governments and the FWC have instead recognised the legitimacy of businesses opening on weekends. For example, in its recent assessment of penalty rates in the restaurant industry ([2013] FWC 7840), the FWC drew on a 2003 decision of the full bench of the Australian Industrial Relations Commission that repudiated the goal of deterrence.[148] The modern awards objective (s 134) only refers to a need for remuneration for asocial hours. The Productivity Commission is not aware of any major stakeholder that regards weekend trading as inherently undesirable. Indeed, by having penalty rates, the current Australian industrial relations system creates incentives *to* work at asocial times.

14.3 The effects of working on weekends for employees and their families

The quid pro quo to growing consumer demand on weekends is the requirement that someone must supply the labour to provide these services at these times. The debate concerns the appropriate price for those services.

The Fair Work Commission and its predecessors have argued that weekends represent asocial times for working and that this justifies penalty rates (section 14.1). Notwithstanding the shifts in consumption preferences described above, it remains the case that people often see weekends as a key period for the social interaction within families and with the wider community. Many continue to emphasise this view. For instance:

> Arguments put by employers to abolish penalty rates are based on spurious economic claims; accepting these claims would undermine established and cherished societal norms about the importance of compensation for time missed with family and friends. In this sense penalty rates

147 The trend in current price value of accommodation services has exceeded the trend in total household consumption by around 0.5 per cent per annum. The comparable figure for recreational and cultural services is 1.6 per cent per year (ABS 2014, *Australian System of National Accounts, 2013-14*, Cat. No. 5204, table 42, released 31 October).

148 AIRC PR941526 re *Shop Distributive and Allied Employees Association v $2 and Under*.

are more than an economic tool, they are a reflection of the values of the Australian community. (United Voice 2012b, p. 30)

The very fabric of our society is held together by engaging with friends, family and the wider community and these times frequently occur in the evenings, on weekends and on public holidays. For those who work during these times, regardless of whether or not they have elected or been required to, they are deserving of recompense for missing out on valued and valuable social times, especially when they are amongst the lowest-paid workers in the country. (Shop Distributive & Allied Employees Association 2012, p. 3)

It is fair and reasonable that Additional Payments are mandatory to compensate workers for the inherent anti-social, family 'unfriendly' and sometimes exhausting and unhealthy nature of these arrangements. (Legal Aid NSW sub. 197, p. 9)

Recent evidence on the effects on employees and families

The most prominent Australian evidence on the impact of weekend work is from the Australian Work and Life index (AWALI), a survey-based instrument developed by the University of South Australia with funding from Safework SA and the Australian Research Council (Skinner and Pocock 2014). The index is based on responses to five (overlapping) areas where work may affect social life:

- the frequency that work interferes with responsibilities or activities outside work
- the frequency that work restricts time with family or friends
- the frequency that work affects workers' ability to develop or maintain connections and friendships in their local community
- satisfaction with overall work-life 'balance'
- the frequency of feeling rushed or pressed for time.

These five items are summed to arrive at an overall work-life index scaled from 0 (lowest work-life interference) to 100 (highest work-life interference). The high scores found for people working weekends suggest poorer work-life outcomes (*ibid*, p. 10, 28). The AWALI scores were: 52.5 for people working regularly on Saturdays and Sundays; 51.4 for regular Sundays (but not Saturdays); 43.8 for regular Saturdays (but not Sundays) and 38.9 for work on weekdays only.[149] However, it is important not to see all weekend work as adverse to people, since these results are averages (box 14.2). As discussed later, a more

[149] Differences in ordinal scores, like those produced by the AWALI survey, can be difficult to interpret. For example, is a difference of 5 points small or large in terms of its effects on wellbeing? One way of assessing this is to consider the difference between two working situations that, prima facie, are likely to involve a material change in people's work-life balance, and then to use this as a benchmark when interpreting other working conditions. One such benchmark is the difference between part-time work (low expected interference with home life) and very long hours of work (high expected impacts on work-life balance). The AWALI score between working part-time (<34 hours a week) and long full time hours (48+ hours a week) is 18 percentage points. In comparison, the difference in AWALI scores between working on Saturdays and Sundays during normal hours and working weekdays at normal hours is nearly 14 percentage points, suggesting that the effects of weekends on work-life balance are significant.

detailed assessment of the work-life measures suggests a more complex story (section 14.5).

Box 14.2 What holds for many does not hold for all

While the overall evidence suggests that people prefer weekends for leisure not work, it is important to recognise that individual preferences vary, and that some people do not find weekend work as problematic as others.

Indeed, some may prefer weekend work because of other responsibilities, such as attending an educational institution, with weekends the preferred time of work.

People also have different preferences about the degree, form and timing of social engagement. For instance, for some people, evenings may be more important for socialising than during the daytime on weekends. It is notable that young people (aged 18-24 years) and singles with no children are disproportionately represented in weekend work (Daly 2014, p. 9). This is consistent with the greater likelihood that they are students, and do not have family responsibilities on weekends. These groups tend to be less responsive to wages, so that changes in penalty rates are less likely to affect their willingness to supply labour on weekends (*ibid* pp. 14–15). The fact that most people take account of their own personal circumstances when choosing a job should reduce the social impacts of asocial working hours, in that those who find it most problematic would be less likely to seek weekend jobs.

Furthermore, social engagement with colleagues and customers is often a positive aspect of working, and may partly substitute for other types of social engagement. This appears to hold for even lower-paid and relatively unskilled jobs (Watson 2011, p. 34).

The income from jobs may also increase the quality of out of work social interactions (for example, by allowing people to own and run a car or to go on holidays).

A further indicator of the special value of weekends is that people say that they would be less willing to work on weekends without some premium on standard weekly wage rates. Most unions, employers and employees agree that high wage rates attract workers to weekend and evening work. For example, United Voice noted that there were already shortages in the hospitality and restaurant industry, and that:

> If this compensation [penalty rates] were to be removed, and these jobs were devalued as a result, employers would find their labour shortage problems would only increase. (United Voice 2012b, p. 18).[150]

150 United Voice then argued that were such shortages to occur, it would prompt businesses to push government to allow more overseas workers. Regardless of whether businesses would do that or not, government could more directly address such an issue through the terms of its visa requirements rather than through the design of its penalty rate regime.

United Voice cited employees' perspectives that exemplified this concern:

> It would make me rethink working in hospitality. The reason why I get those penalty rates is because I'm missing out on time with my family and friends and I would question why I would bother (United Voice 2012b, p. 14)
>
> Without penalty rates, I would have to change career completely, get out of the industry. I couldn't make ends meet without penalty rates (United Voice 2012b, p. 18)

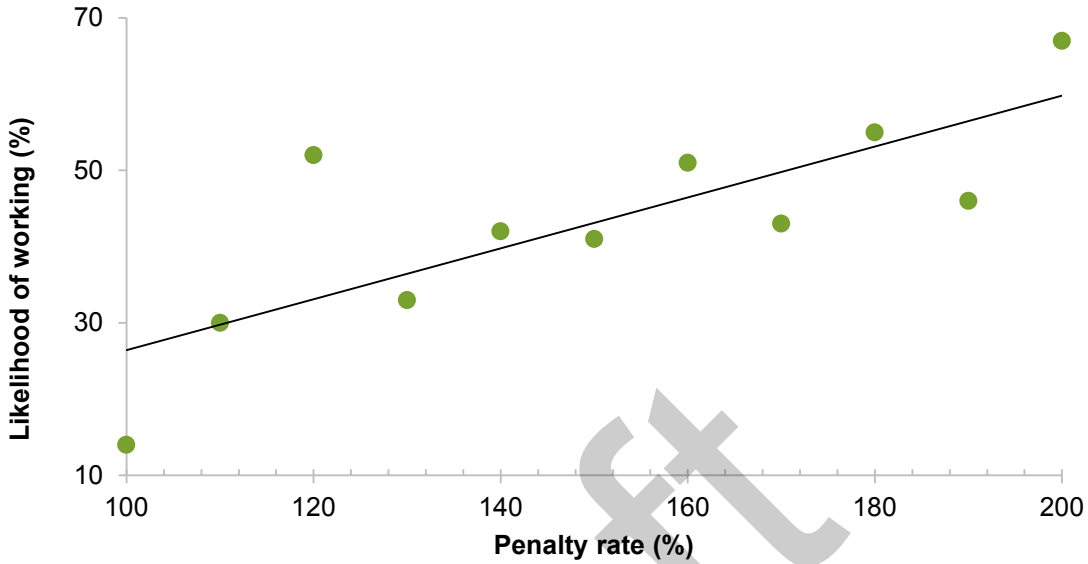
The evidence from the AWALI survey suggests that many people would not work on weekends if there were no premium rate for doing so. About 37 per cent of people who often or always worked Saturdays (but not Sundays) said that they would work on a Saturday without penalty rates (Daly 2014, pp. 14–17). A slightly higher share of people (37.5 per cent) who often or always worked Sundays (but not Saturdays) said they would continue to work on that day in the absence of penalty rates.[151] If these claims are correct, this suggests that for every 10 per cent increase in wage rates, there is a 14.2 per cent increase in people working on a Sunday. Another more elaborate survey, which invited retail floor employees to assess whether they would work at different penalty rates, found a nearly identical degree of responsiveness to penalty rates (figure 14.4).

These elasticities are headcount, rather than hours-based. In addition, these estimates are indicative only since they are perception-based. Nevertheless, these results suggest that people's choice of working on weekends responds to changes in wage rates, which reinforces the view that they do strongly value their time at home during the weekends compared with time at work.

In part, this responsiveness will reflect the positive value people place on social interactions outside work, but it is also may partly reflect the influence of the characteristics of the jobs to which penalty rates apply. There is Australian evidence that labour supply elasticities are higher for jobs with less desirable characteristics, such as those with lower levels of autonomy and less security (Kunze and Suppa 2013).

151 This means that, under double time rates, labour supply (in employment terms) would be 2.67 times the level that would apply if Sunday wages were paid at ordinary time rates. Assuming a constant elasticity labour supply function (the usual assumption), this implies that the estimated uncompensated wage elasticity is 1.4. Since it could also be expected that higher wage rates would elicit more hours for those who are already working, the implied own wage hour elasticity must be higher than 1.4. This is a very high labour supply elasticity compared with the usual results (Bargain, Orsini and Peichl 2012), but may reflect the fact that if people do not get high wages on weekends, they prefer to work weekdays. In that case, it is possible to reconcile a small labour supply elasticity for yearly labour supply with high elasticities for supply on Sundays.

Figure 14.4 **The willingness to work on Sundays depends on penalty rates[a]**



[a] The data are based on a survey of retail shop floor staff, regardless of the days they work during the week. They were asked whether they would be highly willing to work at penalty rates between 100 (no penalty rates) and 200 (double time), in ten percentage point increments. When the relationship between the likelihood of working is estimated in log form, the implied elasticity is 1.43. This means that a 10 per cent increase in the penalty rate increases the likelihood of someone working on a Sunday by around 14.3 per cent. The elasticity does not count the labour supply responsiveness of people outside the retail sector (probably upwardly biasing the estimate), but also does not account for the likelihood that hours as well as employment responds to wages (which counteracts the preceding bias).

Source: ACRS (2012, p. 48).

14.4 The implications of the higher value people place on weekends

Overall, the evidence that many people generally prefer not to work on weekends is uncontroversial. The question is then how labour markets could be expected to respond to this, and the appropriate role of regulation.

People often talk about preferring 'this over that'. This is one of the central questions to which mainstream economics is directed. How do we organise an economy in which people's preferences for different goods and services, leisure versus working hours and different job types are best achieved?

The economics of labour markets provides some (much under-utilised) insights into the debate about the private and family impacts of working on weekends. Unregulated markets may partially compensate employees for the private social impacts of weekend working

because many people have choices about the nature and timing of their employment and employers need people to supply their labour at such times.[152] This would be most likely for higher-skilled employees (and the New Zealand evidence, where there are no regulated rates, appears to substantiate this — see later).

Accordingly, people weigh up their decisions about the nature of jobs — their wages and conditions, the occupation, the hours worked, career prospects, the timing and location of work and the employer — against the impacts on their private social lives. As it is clear that many people dislike working on weekends at the weekday rate, employers might have to pay some kind of premium to attract employees, but would only do so to the extent that the profits of weekend trading justified these higher costs. The labour supply curve shown in figure 14.4 and the views of people about the advantages and disadvantages of working on weekends (figure 14.5) demonstrate that people weigh up the returns from working against the costs of doing so.

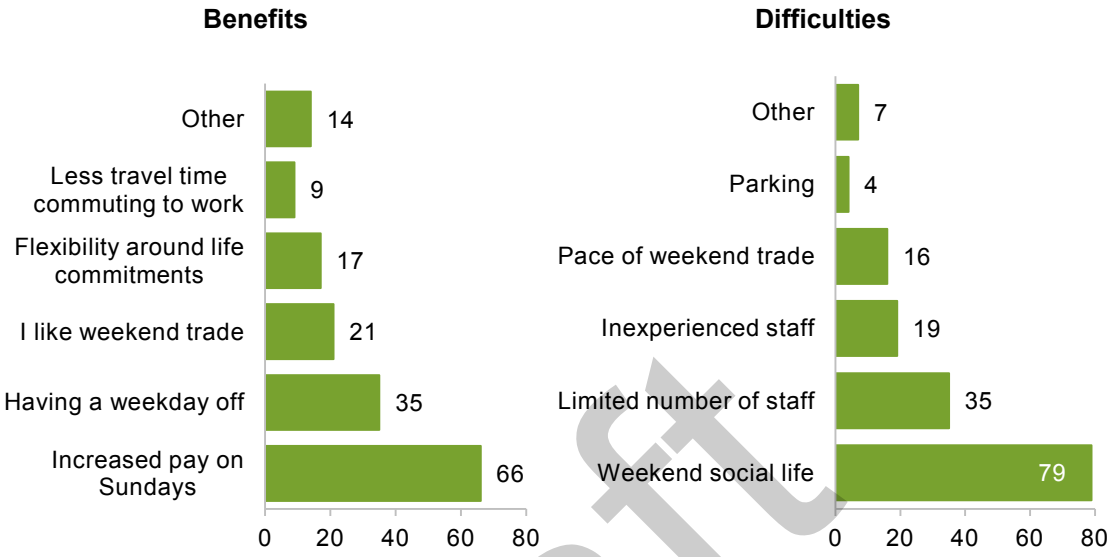
In summary, the private social costs from working on weekends inform the extent to which people are willing to work at a given wage (or 'compensation' rate). A well-operating labour market would not need a regulator to set penalty rates to address the social disabilities associated with work — wages would adjust to achieve that outcome. But labour markets do not always operate well or deliver what the community more broadly expects. It is primarily this fact, not the social disability associated with weekend work per se, that needs emphasis in understanding how penalty rates might be set.

There are several reasons why unregulated labour markets might incompletely compensate people for the loss of social amenity on weekends.

152 Some argued that a reason for regulated penalty rate was that reductions would lead to undersupply of labour (for example, United Voice sub. 224, p. 10, Vintage Reds ACT sub. 163, p. 8; Health Services Union sub. 203, p. 5; Queensland Government sub. 120, p. 7). However, regulated penalty rates represent a *floor* on wages, not a *ceiling*. Bargaining imbalances aside — an important issue addressed later — it is not clear why an employer would not respond to any enduring labour shortages by increasing weekend rates if the regulated penalty rate was not sufficient to attract adequate labour supply, a point made by several employers (for example, the Australian Retailers Association sub. 217, p. 9). More generally, empirical evidence suggests that persistent skill shortages do trigger wage rises (for example, (Mavromaras, Oguzoglu and Webster 2007). Some businesses report that wages that are too high cause skill shortages, but by this they mean that the business cannot afford to employ the skilled worker (a demand effect), not that the labour supply itself is inherently insufficient (Healy, Mavromaras and Sloane 2012).

Figure 14.5 **Employees understand many of the tradeoffs of working on Sundays**

National survey of the retail industry, 2012



Source: ACRS (2012).

For some, weekend work is a lifeline

For some employees in adverse circumstances, working on weekends at even weekday wages avoids some extreme consequences (say foreclosure on the family home or the loss of custody of a child). Yet they still experience the losses in social interactions that usually accompany such work. The Productivity Commission has taken a close interest in submissions from people facing problems like these. High penalty rates appear to be a solution, and the apparent alternative of finding a different job is very hard to find and a daunting prospect even in positive economic times.

But in considering policy solutions, it is nevertheless apparent that the employment system is not necessarily the best mechanism for addressing truly adverse personal circumstances. The social security system has expanded significantly since penalty rates were introduced and additional social support choices are now available (such as increased family payments and income-tested concessions for some public services). Tailored solutions can be more readily designed (or are already available) via Commonwealth and State programs. And from a national public policy perspective, the regulation of wage rates should take into account the net benefit for those seeking work as well as those in work, and the ability to meet consumer needs. (While only a part of this issue, the income effects of changes to penalty rates are discussed in section 14.6.)

Unequal bargaining power

The existence of some bargaining imbalances between individual employees and employers is a defining premise of any workplace relations system. Absent a countervailing force exerted by regulations or (proportionate) collective bargaining by employees, many accept that wages and conditions would be inefficiently and inequitably low (chapter 1).

While these bargaining imbalances may be explained in several ways, in modern labour economics, the theory of 'dynamic monopsony' has increasingly been seen as a useful construct for understanding that wage suppression may still occur in businesses facing strong competition. (This model is not the simple 'company town' model of labour markets, whose unrealism and rarity is sometimes used as a straw man to dismiss out of hand more sophisticated versions of firm behaviour.) While dynamic monopsony is far from undisputed, and is unlikely to be an adequate model in all circumstances, real world labour markets with frictions can generate a sufficient degree of employer market power to warrant some regulatory action to avoid such wage suppression. Were the FWC to address any such market power for weekday jobs by setting a wage closer to the notionally efficient one, but did not set a minimum penalty rate for weekends, then businesses would still be free to set wage rates for weekends at too low a level. Labour supply functions are different on weekends than weekdays given the preferences of people to not work on weekends. In that case, it would be legitimate for the FWC to attempt to replicate the outcome that would occur in a better operating labour market by setting minimum penalty rates for weekend working hours.

An important caveat here is that if the award wages for *weekdays* are too high,[153] then the efficient penalty rate for weekends should be lower than would be the case had the FWC set the efficient weekday award wage. If this is true, the remedy is for the FWC to set sensible award and minimum wage rates using the analytical methods outlined in chapter 12.

There may also be non-economic considerations

Many awards recognise that some tasks in jobs have unpleasant physical impacts, and hence there are special task-specific allowances for working in extreme temperatures, confined or wet spaces, exhuming bodies and working in slaughtering rooms — to name a few. As specified in the modern award objective (section 14.1), penalty rates are compensation for another unpleasant job attribute — the unsociable hours of weekend work.

Unpleasant facets of work represent an effective reduction in the rewards from working. For a given wage, most people would prefer a job that does not entail unappealing tasks.

[153] As shown later, award reliance is comparatively high for the relevant industries.

Accordingly, if the community regards a given minimum award wage as the *acceptable* floor for an ordinary job without such tasks, then consistency would suggest a higher rate would be required for one that did involve them.

This is not a standard economic rationale in that even were a labour market perfectly efficient, it might not meet community standards. To be justified on the grounds of community norms, penalty rates in the relevant industries would have to be proportionate to the unpleasantness of working on weekends compared with the unpleasantness of other job tasks (an issue examined below).

14.5 What does the evidence suggest about the level of penalty rates?

The strongest economic argument for regulating penalty rates on weekends, rather than letting markets determine the rate, is that employers would tend to use their greater bargaining strength to set weekend pay rates that were lower than the efficient level. The extent to which businesses in the HERRC industries possess significant enduring bargaining power in respect of their employees is hard to discern empirically. In particular, the degree of bargaining imbalance is not readily tested in a market where wage regulations are already ubiquitous.

That said, variations in minimum wages in the United States have enabled some testing of the degree of bargaining power and wage suppression for fast food outlets and restaurants (Addison, Blackburn and Cotti 2012; Card and Krueger 1994; Dube, Lester and Reich 2010; Ropponen 2011; Schmitt 2013). The results, although contested strongly by some, provide some support for the notion that even businesses operating in such highly competitive industries may still have enough bargaining power to suppress wages.[154]

An additional factor is that the countervailing bargaining power of unions is relatively low in the relevant industries, particularly for accommodation and food services (table 14.3). Associated with this, collective agreements are less frequent, and the share of people receiving wages set exactly by the award more so. For instance, in 2012, collective agreements covered 18.8 per cent of employees working weekends in accommodation and food services, compared with 31.2 per cent for non-consumer industries (figure 14.6).[155] The comparable figures for people paid exactly at the award were 41 and 17 per cent.

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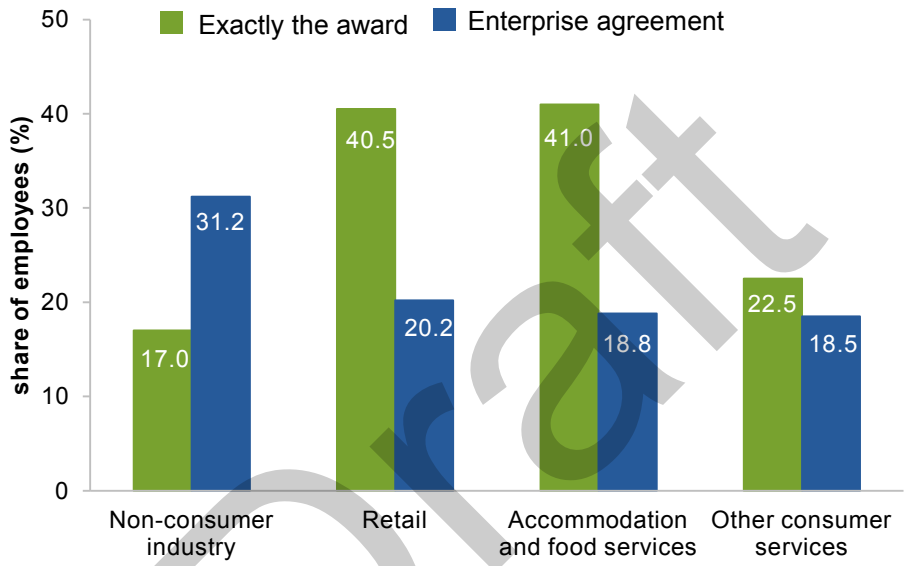
154 The United States evidence that even fast food outlets might have material bargaining power does not necessarily imply that raising (lowering) existing *Australian* regulated penalty rates would stimulate (lower) employment. To the extent that regulated minimum penalty rates have overshot the level required to compensate for unequal bargaining power, lowering regulated penalty rates would initially increase employment.

155 Based on HILDA wave 12 data.

It is notable that in New Zealand, where there are no statutory requirements for weekend penalty rates, premiums are rarely included in collective enterprise agreements in the HERRC industries, whereas penalty rates are often negotiated between parties in many other collective enterprise agreements (table 14.4). The former tend to have low union membership rates at the enterprise level and the countervailing bargaining power exercised in crafting agreements is correspondingly low.

Figure 14.6 **Award and enterprise agreements**
HERRC and other industries, 2012



Source: HILDA wave 12, 2012.

Table 14.3 Characteristics of the industries where concerns are greatest

	Retail	*Accommodation and food services*	*Arts and recreation services*	*All other industries*
Number of non-managerial employees, 2014 ('000) (and share of total employment %)[a]	1081.6 (15.2)	697.3 (9.8)	158.2 (2.2)	7122.8
Share of non-managerial employees on award, 2014 (%) (and rank)[a]	29.6 (3rd)	45.4 (1st)	23.2 (6th)	16.5
Share of employees not on adult rate, 2014 (%) (and rank)[a]	17.6 (2nd)	25.1 (1st)	7.2 (5th)	3.5
Share of employees aged under 25 years, 2014 (%) (and rank)[a]	36.4 (2nd)	45.1 (1st)	26.2 (3rd)	10.4
Average weekly hours paid for award non-managerial employees, 2014 value (and rank)[a]	24.5 (14th)	22.7 (16th)	18.2 (18th)	32.4
Average weekly non-managerial cash earnings, 2014 ($) (and rank)[a]	$554 (15th)	$518 (17th)	$427 (18th)	$1149
Average hourly cash earnings, 2014 ($) (and rank)[a]	$24.90 (17th)	$23.10 (18th)	$31.20 (15th)	$35.50
Small business share of employment (%) (and rank) in 2012-13[b]	36.1 (9th)	45.5 (6th)	38.2 (8th)	43.7
Union membership rate 2013 (%)[c]	13.9 (9th)	4.6 (15th)	10.4 (11th)	18.5
Responsiveness of operating profit to 10% wage increase, 2012-13 (% change) (and rank)[d]	-20.6 (11th)	-26.8 (5th)	-15.7 (15th)	-8.0
Share of income from the general public directly (%) (and rank), 2012-13[e]	78.2 (2nd)	86.6 (1st)	74.0 (5th)	<45
Part time share of employees 2013 (%) (and rank)[f]	53.2 (2nd)	63.3 (1st)	46.5 (4th)	24.7
Casual share of employees 2013 (%) (and rank)[f]	40.2 (4th)	64.6 (1st)	41.6 (3rd)	17.0
Share of employed with business for less than 12 months (%) (and rank), 2013[g]	21.7 (3rd)	31.6 (1st)	19.8 (7th)	16.6

[a] Based on EEH, May 2014. The rank is from high to low out of 19 industries. [b] Based on AI, 2012-13 Small business are businesses employing less than 20 employees. The rank is from high to low out of 18 selected industries. [c] EEBTUM August 2013. The rank is from high to low out of 19 industries. [d] Based on AI and calculated as the percentage change in the operating profit before tax of a 5 per cent increase in the costs to businesses of wages, salaries and superannuation contributions. A higher rank means a larger degree of sensitivity of profits to wage increases. The rank is out of 18 selected (private sector) industries. [e] Based on SCAB for 2012-13 for 17 industries. [f] Based on FE November 2013. The rank is out of 19 industries. [g] Based on LM for all employed (including managers and self-employed) working in February 2013. The rank is out of 19 industries.

Sources: AI= ABS 2014, *Australian Industry 2012-13*, Cat. No. 8155.0, released 28 May 2014; EEBTUM = ABS 2014, *Employee Earnings, Benefits and Trade Union Membership, Australia - Trade Union Membership*, Cat. No. 6310.0, released 4 June 2014; EEH = ABS 2015, *Employee Earnings and Hours, Australia, May 2014*, Cat. No. 6306.0; SCAB = ABS 2014, *Selected Characteristics of Australian Business, 2012-13*, Cat. No. 8167.0 released 18 September 2014; FE = ABS 2014, *Forms of Employment, Australia, November 2013*, Cat. No. 6359.0, released 7 May 2014; LM = ABS 2013, *Labour Mobility, Australia, February 2013*, Cat. No. 6209.0, released 21 August 2013.

Table 14.4 **A natural experiment in New Zealand**

Penalty rates in New Zealand Collective Enterprise Agreements, 2014

						Share of agreements
Day of weekend	*No penalty rate*	*Penalty rate below 150%*	*Penalty rate 150%*	*Penalty rate above 150%*	*Other*[a]	*2nd period rate*[b]
	%	%	%	%	%	%
Saturdays						
All private sector	60	3	30	5	2	15
Food retailing	95	0	5	0	0	1
Other retailing & wholesale trade	97	0	2	0	0	1
Accommodation & food services	99	0	0	0	1	0
Sundays						
All private sector	58	3	17	20	2	3
Food retailing	95	0	2.5	1	0	1
Other retailing & wholesale trade	97	0	0	2	1	1
Accommodation & food services	99	0	0	0	1	0

[a] This includes arrangements where premiums are paid in dollars rather than as percentage increases in ordinary rates, or where only certain levels of employees obtain premiums.[b] In some cases, a higher premium rate is paid after a certain number of hours in an earlier period. Penalty rates above 150 per cent are usually at 200 per cent.

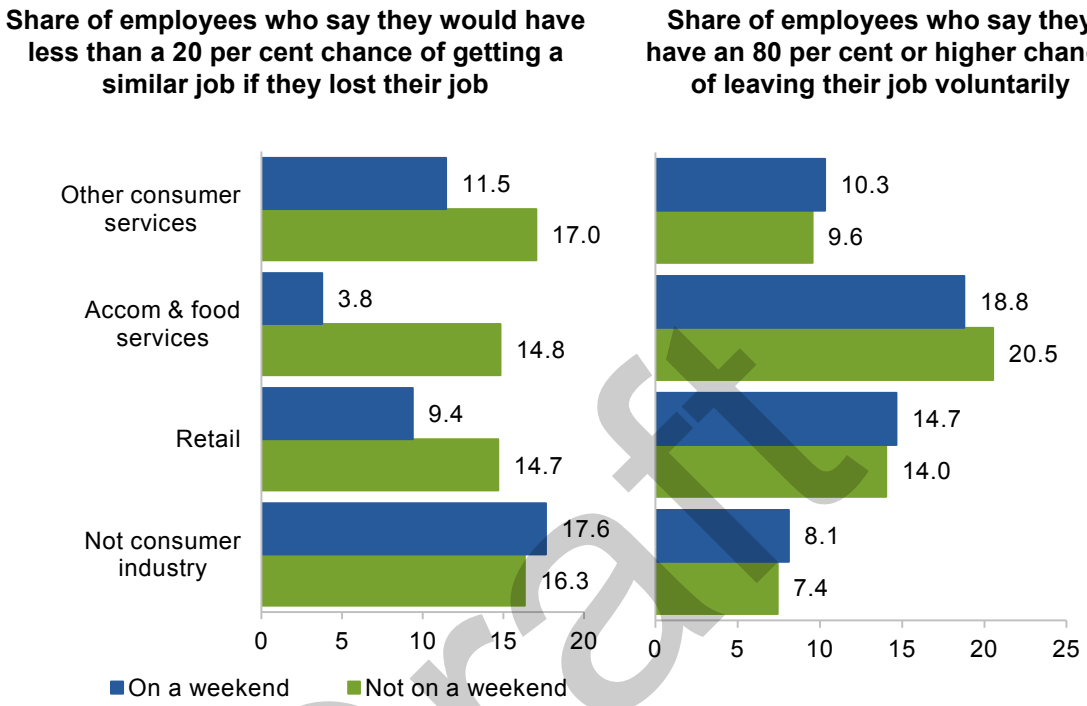
Source: Centre for Labour, Employment and Work, Victoria Business School, University of Wellington.

Nevertheless, even if employers in the HERRC industries could exercise some bargaining power in the absence of regulated rates, other evidence suggests that the extent of this power is likely to be modest. This is because the long-run search costs and other frictions appear to be lower for these industries.[156] The empirical evidence shows that, compared with other industries, employees have much less difficulty finding an equivalent job if they lose their current one (figure 14.7). Likewise, they are also much more willing to leave their job voluntarily. Job optimism and mobility are reasonable direct tests of the severity of bargaining imbalances.

[156] However, even in these industries, wage offers by competing providers are often not posted (raising search costs), and many aspects of a job that are important to a prospective employee remain unknown (for example, the nature of the workplace environment), which favours inertia.

Figure14.7 **Weekend employees in the HERRC industries face fewer difficulties getting another job and are more willing to leave their jobs[a]**

subtitle



[a] The HILDA survey asked for the likely probability of getting another, equally well-paid, job in the next 12 months if they lost their current one. It also asked people for the probability that they would voluntarily leave their jobs over the next 12 months. The data relate to people who work on weekdays but not weekends and those who work on weekends (and who may also work on weekdays).

Source: HILDA (wave 12).

Several features of the jobs and the relevant workforce explain the likely lower level of frictions. The jobs often involve relatively low skills with well-defined tasks (as shown by low average wages, the greater share of inexperienced workers and the higher prevalence of casual jobs). This suggests that skills are more readily portable across firms (table 14.3). The workforce is younger and has low average tenures, so that mobility is higher. This market is often densely populated with many prospective employers.

While the empirical evidence is incomplete, a regulated penalty rate commensurate with the commonly applied Saturday 125 per cent rate for permanent employees of HERRC services is reasonably plausible (box 14.3).

However, the Sunday rates for these industries seem to be much less clearly justified either on economic grounds or according to community norms compared with other working times (figure 14.8 for the hospitality industry). Rates for Sundays (usually around 175-200 per cent of base pay) appear at odds with rates for times that are also important for

social activities (evenings), and to an even greater degree for times that pose clearly demonstrated health risks (night shifts and rotating shifts). Evening/afternoon shift penalty rates can be as low as 10 per cent and night shift loadings as low as 15 per cent. While public holidays are often paid at 250 per cent — seemingly much higher than Sunday penalty rates — permanent employees are paid their full wage if they do not work on a public holiday (100 per cent in effect). Paying 250 per cent amounts to an effective penalty rate of 150 per cent (that is 250 less 100 per cent) — actually lower than the typical Sunday rate.

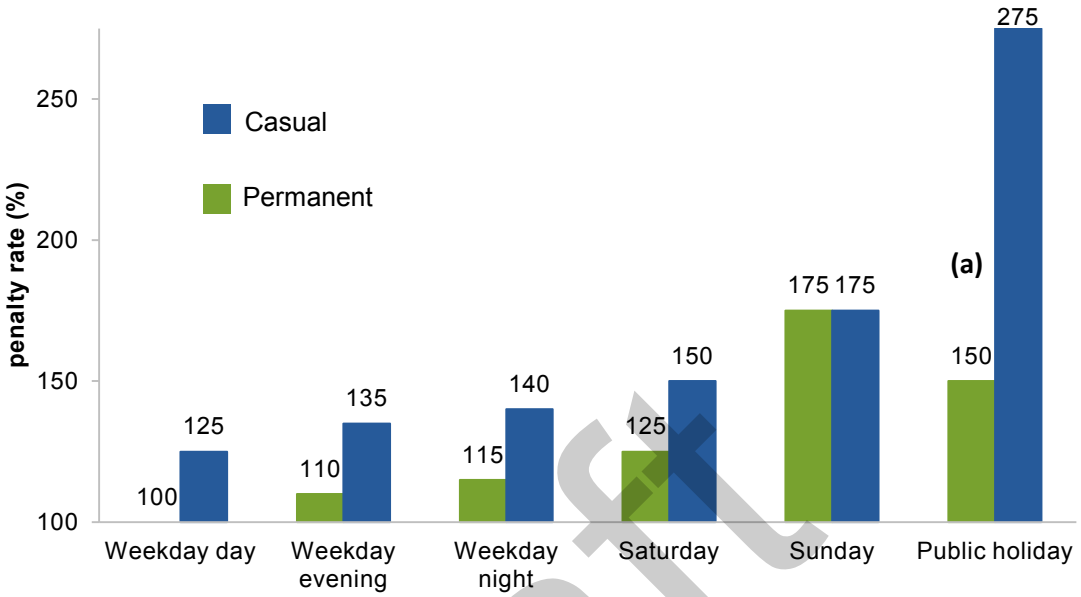
Box 14.3 Putting a value on bargaining power

The wage elasticity of labour supply is the degree to which people are willing to provide their labour to a given business at different wages. The lower the elasticity, the more bargaining power the business has. The features of the HERRC services described in the main text, suggest that the long-run estimates of the wage elasticity of labour supply for the average firm in these industries would tend to be towards the higher end of those found in the international empirical research. This would imply values of 5 to 10 (for example, Ashenfelter, Farber and Ransom 2010; Depew and Sørensen 2013). A supply elasticity of 5 to 10 implies that that an efficient wage rate would be 20 to 10 per cent higher than the monopsony outcome respectively. (The higher the elasticity, the closer the market is to one that is workably competitive.)

This does not mean penalty rates should be between 110 and 120 per cent. This is because penalty rates relate to the regulated *weekday* rate, not to an unobserved *weekend* rate without any wage regulations. If the latter rate was more than the regulated weekday rate, it is readily possible that an elasticity of 5 to 10 would be consistent with penalty rates of 125 to 130 per cent.

Figure 14.8 **Penalty rates by day and time of the week**

Permanent and casual employees in the hospitality industry



[a] The effective penalty rate for public holidays is the amount extra that a business would have to pay for someone who works on a public holiday. Permanent full-time employees are entitled to a day's pay even if they do not work on a public holiday. Accordingly, a notional 'penalty' rate of 250 per cent (the award rate for permanent full time employees on public holidays) actually provides an effective rate of pay for working of 1.5 times the ordinary salary (150 per cent), since the employee would have been paid their full daily wage even had they not worked on the given day. Casual employees do not typically receive public holiday pay when absent from work. In that case, their effective penalty rate is 250 per cent plus a 25 per cent casual loading (or 275 per cent). Part-time employees (not shown in the chart) who do not work routinely on a public holiday also do not receive a day's pay if they do not work on the public holiday, and so their penalty rate is 250 per cent (as they do not receive a casual loading).

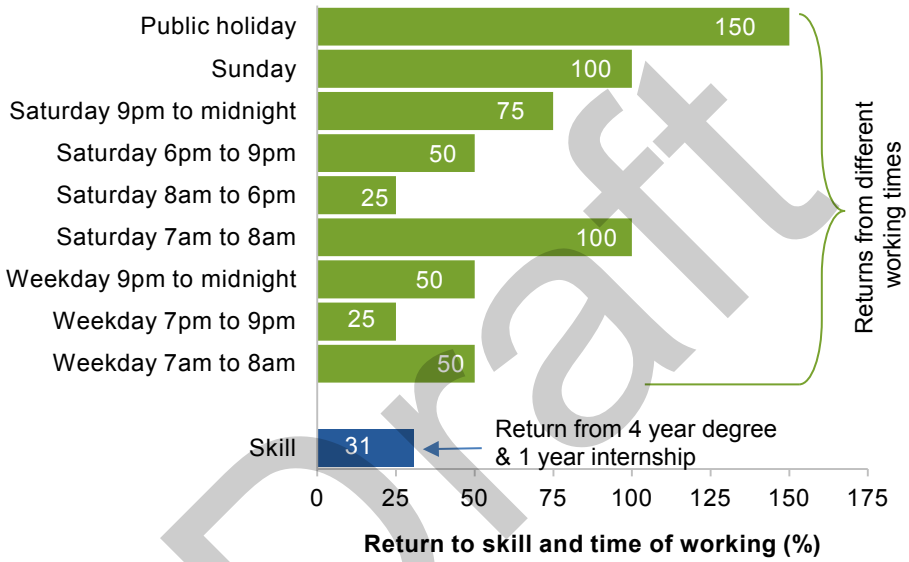
Source: Hospitality Industry (General) Award 2010.

There are other surprising anomalies, particularly in relation to Sunday penalty rates. Under the present award, an inexperienced level 1 pharmacy assistant with no or few qualifications will often receive higher wage rates than a pharmacist. For example, an assistant who worked ordinary hours on a Sunday is paid more than 50 per cent higher than the usual weekly rate for a pharmacist. It implies that the rate of return in wages from working outside normal hours is often far greater than the return to skill (figure 14.9). Pharmacists must complete four years of a university degree course, serve a one year internship and pass registration tests to qualify to serve the public unsupervised. They must also undertake ongoing professional development. A pharmacy assistant has no equivalent training. The return to a pharmacist from such educational qualifications is 31 per cent. In contrast, the return from working on a Sunday is 100 per cent compared with a standard working time.

The evidence about the social disabilities of working on weekends also suggests that, once other personal traits have been accounted for, employees working on Sundays have no worse a life balance or feel any more rushed than those who work on Saturdays

(figure 14.10). Other measures of social activities displaced by weekend work suggest that for many households, Saturdays and Sundays have similar impacts, and where that is not the case, the differences are modest (appendix F). Sunday employment *does* more adversely affect outside activities and relationships compared with Saturday work. However, in all instances the worst social disabilities arise from evening work, which, as noted above, involves significantly lower penalty rates than either Saturdays or Sundays.[157]

Figure 14.9 **The returns from skill and different working times**
Pharmacy industry[a]



[a] A pharmacist must complete 4 years in a university degree course, serve a one year internship to qualify to serve the public unsupervised, pass registration tests and undertake ongoing training. A pharmacy assistant is not statutorily obliged to have any training. The additional standard wage rate for a pharmacist is 31 per cent higher than an untrained assistant. In contrast, the return from working a Sunday over a normal day is 100 per cent.

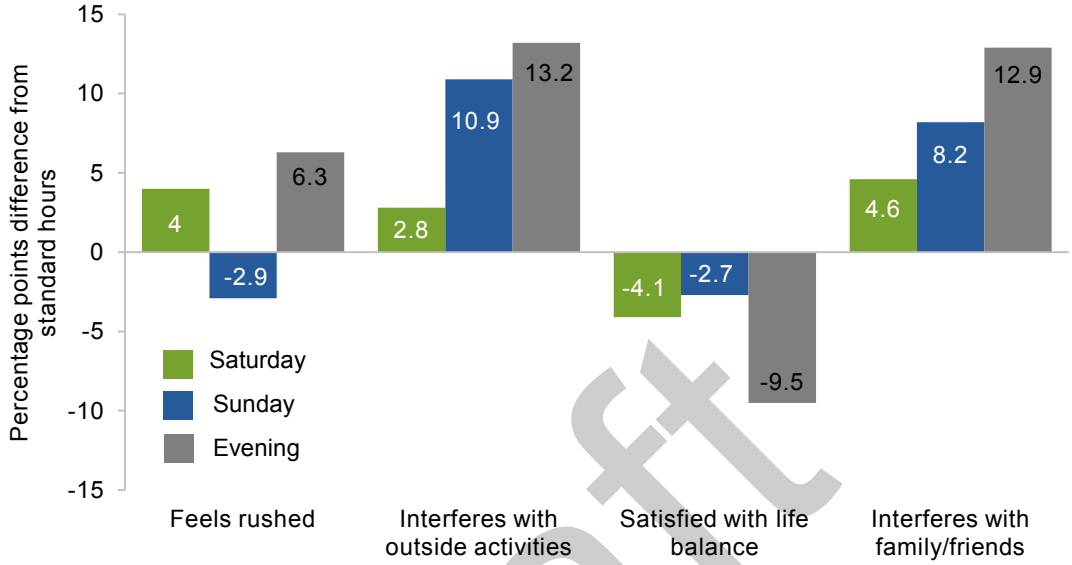
Source: Pharmacy Industry Award (2010).

The above considerations suggest that regulated minimum Sunday rates should be equal (or very close) to Saturday rates. While this represents a shift from the current award settings for the relevant industries, there have been occasions when the regulated Saturday and Sunday rates have been aligned, as in some previous Queensland and Western Australian Awards (FWC 2014d, p. 102). Parity of regulated rates is a simple and easily followed rule. In a fanciful world of perfect regulators, penalty rates would change as skill shortages and demand shocks occurred. However, regulators must choose something reasonable and practical, and though guaranteed to be wrong, this is likely to be better than no regulation.

157 Analysis of various indicators of life satisfaction measures in the HILDA database (such as life satisfaction generally, free time available, and community linkages) are qualitatively similar for people who work on Saturdays and Sundays.

Figure 14.10 **Degree to which employees 'often or almost always' experience work impacts**

Outcomes relative to standard hours[a]



[a] The results are estimates from an ordered logit of the various measures of work impacts against a series of independent variables, including whether a person works mostly (often or almost always) on Saturdays, on Sundays or on evenings. Other regressors included gender, age and whether an employee had young children. Each of the dependent variables were based on a Likert scale of never, rarely, sometimes, often or almost always. The logit regression was used to estimate the likelihood that an employee was often or almost always experiencing some impact if they worked at a non-standard time compared with a standard time (Mondays to Fridays). For example, there was around a 4 percentage point difference between the share of people feeling often or almost always rushed for time if they worked on a Saturday (but not a Sunday or evening) compared with those working at standard times.

Source: AWALI database.

There are also grounds for more consistency in rates between the HERRC industries

Notwithstanding award modernisation, there appear to be many inconsistencies in penalty rate settings. Wide disparities in rates persist in industries with similar structural characteristics and employee skill levels (table 14.3). For example, casual penalty rates are 150, 175, 200 and 225 per cent for Sunday work in the restaurant, hospitality, retail and pharmacy industries respectively. Various participants noted these inconsistencies across the HERRC industries, and more generally (for example, BCA sub. 173, p. 48; COSBOA sub. 115, p. 5).

Differences in rates create compliance costs and uncertainty for employers and employees. Even though the transitional arrangements associated with award modernisation are now complete, the compliance costs associated with penalty rates appear to be significant. The Fair Work Ombudsman (2014a, p. 23) noted that:

> In our experience, there are three main areas where employees and employers often encounter difficulty in applying awards, these are: interpreting coverage provisions, especially where more than one award may apply; calculating rates of pay, especially overtime and penalty rates; understanding the interaction with the National Employment Standards.

It was evident in the Commission's consultations that even the most sophisticated stakeholders did not know how to calculate the penalty rates that should apply in certain circumstances. In this context, there should be some bias towards simplicity.

Some key awards also create incentives to employ casuals over permanent employees on weekends, because of the varying methods for applying casual loadings. Only one of the three different methods for calculating penalty rates provides neutral incentives for employing casuals (appendix F). The lack of neutrality predominantly occurs for Sundays rather than Saturdays (table 14.1), so setting Sunday rates at Saturday rates would more often create neutral incentives for choosing between permanent and casuals employees. Permanent employees in retailing, hospitality and hairdressing could be expected to obtain more work on Sundays.

14.6 The impacts of change

Effects on employment

As noted in a recent landmark decision by the FWC on penalty rates (FWC 2014d), the responsiveness of labour demand to changes in rates is a decisive issue. The degree to which there is an employment response depends on the:

- change in the wage rate. The analysis in this chapter suggests that existing levels of penalty rates for Sundays are excessive, sometimes to a marked degree. Accordingly, lowering rates to close to, or at, Saturday rates would represent a significant reduction in wage costs. For example, a reduction in the Sunday penalty rate of 150 per cent to the Saturday rate of 125 per cent in the restaurant industry would imply a reduction in wage rates of around 17 per cent. In the case of the retail industry, parity of the Sunday rate with the Saturday rate would imply a wage rate reduction of 37.5 per cent were the new regulated penalty rate to bind
- responsiveness of labour demand to any given wage change. The broad empirical evidence suggests that, with the exception of youth wages, a 10 per cent decrease in wage rates increases the demand for labour (on both a headcount and hours basis) by around 5 per cent (appendix C).[158] While much of the demand response would represent an increase in employment for a given amount of capital, there would also

[158] This does not contradict the existing evidence that small changes to the minimum wage around their current levels have modest employment effects. That is to be expected given that the changes are small and one of the prime goals of the expert group setting the minimum wage is to avoid any significant adverse employment effects.

likely be some substitution between employment and labour-displacing capital (or at least a reduction in the trend towards capital substitution)

- degree to which business operators and working family members in family businesses work less and use employees as an alternative source of labour. Several stakeholders noted that working proprietors and family members were often the only resort for weekend work (for example, Andrew Steers sub. 5, p. 1). Such people currently work much longer hours than other employees and more commonly on weekends (appendix F).

Were the elasticity of -0.5 to apply, the anticipated increase in hours from a 37.5 per cent reduction in wage rates would be around 26 per cent.[159] Even low-end estimates (of around -0.3) lead to employment effects of 15 per cent. However, unfortunately, there does not appear to be any empirical estimates of the degree to which wage relativities between Sunday, Saturday and weekday work affect labour demand in the HERRC industries at those times, and the total labour demand over the week.

A complicating factor in estimating the employment outcomes is that only some goods and services change their prices by the day of the week. Cafes and restaurants sometimes vary prices by imposing weekend surcharges, although the degree to which they do so is unknown and may not be transparent.[160] But in most instances, the prices of goods and services do not typically vary by the day of the week or time of the day. A shirt in a department store costs the same on Mondays and Sundays, as does a burger, a prescription from a pharmacy, or a pack of cereal. While competition between the various HERRC service providers can sometimes be expected to lead to lower consumer prices, even this would predominantly be spread over the full week. This consumer demand effect would stimulate labour demand for all days of the week by a small amount. The Commission's assessment excludes any account of a *price-based* consumer demand effect, though some is likely to occur.

Nevertheless, consumers value greater convenience (which represents a decrease in the quality-adjusted price of services), and so businesses that opened on Sundays or extended their trading hours could expect increased custom. The value of consumer convenience is apparent by comparing transaction numbers and timing in jurisdictions with and without trading hour restrictions. It is notable that weekend trading hour restrictions in

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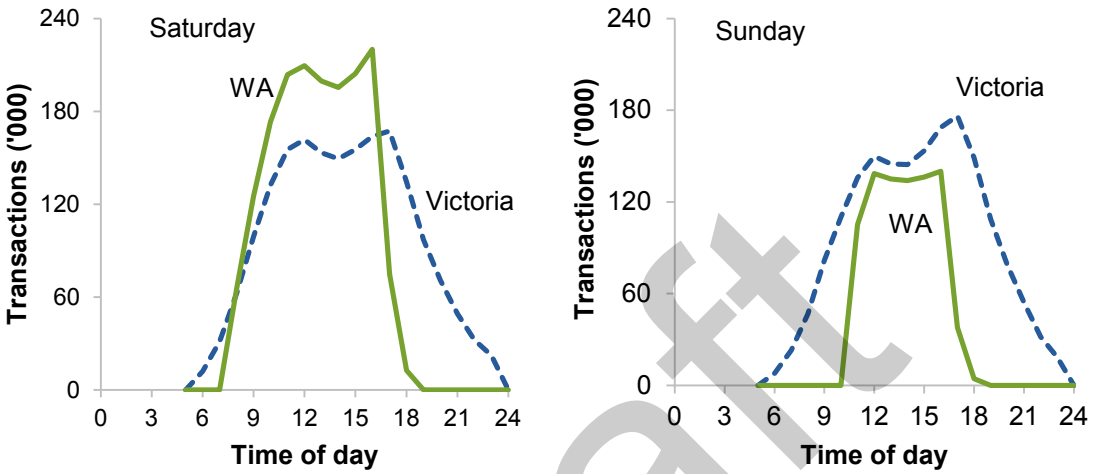
159 Based on a constant elasticity model of demand, with the proportional change in demand for labour being equal to $\varepsilon \cdot \Delta \ln(125/200)$ where ε is the demand elasticity (of -0.5 in this case). In his analysis of the impacts of changes to penalty rates, Lewis (2014) *assumes* a much higher degree of responsiveness, even to the degree that he regards it as possible that a 1 per cent increase in wage rates would reduce hours worked by 3 per cent (a labour demand elasticity of -3). This is well outside most estimated labour demand elasticities. It implies a very substantial (and unrealistic) increase in weekend employment.

160 This was more difficult for such businesses prior to legislation in mid-2013 that exempted restaurants and cafés from the single pricing requirement in Australian Consumer Law. A business was previously obliged to provide separate menus when a weekend surcharge was applied. While accommodation providers also often charge more for weekends, this is usually a form of peak pricing to reflect that demand would otherwise exceeds capacity.

supermarkets not only confine transactions to a shorter period, but also reduce the aggregate number of weekend transactions (figure 14.11). Lowering penalty rates would have effects that partly mimic the relaxation of such restrictions.

Figure 14.11 **Longer weekend opening hours boost total transactions**
Victoria and Western Australia, 2012–2013[a]



[a]. Average daily Coles' supermarket transactions. A transaction represents the purchase of any basket of goods that generates a receipt.

Source: Economic Regulation Authority (WA), 2014, *Inquiry into Microeconomic Reform in Western Australia*, 30 June (pp. 285–286).

An indicative comparison of opening times of restaurants in New Zealand (where penalty rates are not regulated) and Australia (where penalty rates are regulated) shows that Sunday trading is more frequent in New Zealand, and that the average available hours of restaurant services are higher, in some cases by a substantial degree (table 14.5).

This provides one indicative strand of evidence, and to the extent that the differences reflect penalty rates, implies significant employment effects for some cities. The comparison does not take account of any changes in staffing ratios, which may magnify the effect. The FWC could examine this issue further by undertaking analysis using larger samples, across more geographical locations and encompassing a wider range of HERRC services to better assess overall effects (though this will still not capture any staffing ratio impacts).

Table 14.5 **Opening hours of restaurants in New Zealand and Australia**
July 2015[a]

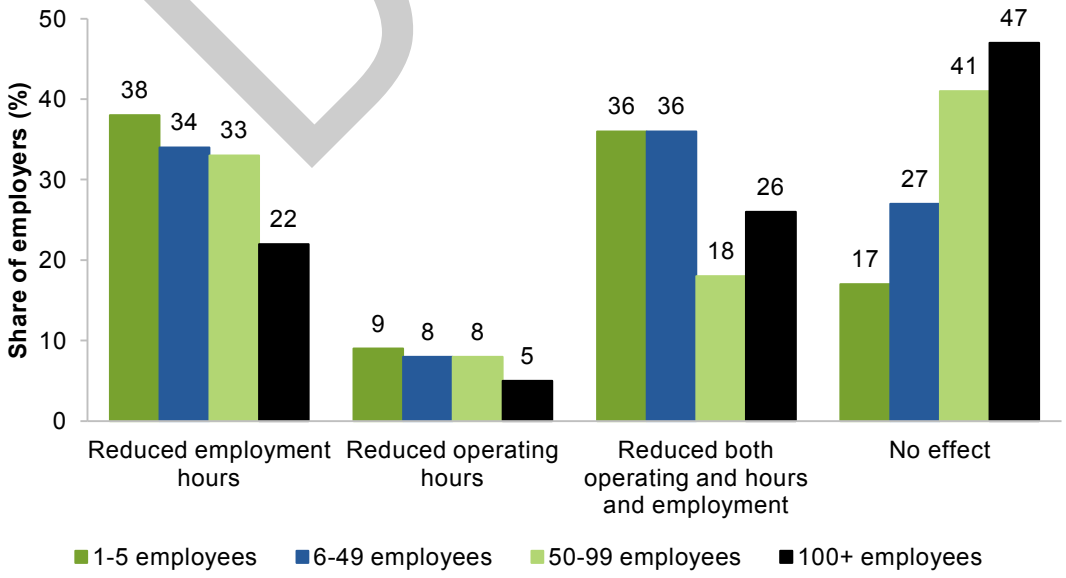
	Sydney	*Melbourne*	*Brisbane*	*Canberra*	*Auckland*	*Wellington*
Open all week (%)	49.2	63.8	51.3	48.0	70.4	65.3
Open on Sunday (%)	68.8	69.3	77.2	67.6	77.2	73.5
Open on Monday (%)	71.4	89.9	68.3	71.6	87.3	84.2
Average hours open per Sunday (hours)[b]	5.8	6.7	6.9	5.5	7.2	7.1

[a] Based on a sample of outlets first listed in the tripadvisor listings of restaurants in the respective cities (undertaken in mid July 2015). Where opening hours were not disclosed, a web search was undertaken to find the opening hours. The sample size was 192 outlets for all cities bar Canberra and Wellington, which had sample sizes of 102 each. [b] Average hours open is an overall measure of hours of services available, including outlets that do not open. It is the single best measure of the availability of cafes and restaurant services on Sundays.

Source: PC data collection.

There is also some indicative survey evidence of the impacts of penalty rates on employment in the HERRC industries. Some survey results suggest that penalty rates appear to affect employment and opening hours more among smaller enterprises than larger ones (figure 14.12).

Figure 14.12 **Employment effects of penalty rates**
Sample of Queensland businesses[a]



[a] The survey asked employers to rate the importance of penalty rates on employment and operating hours. Few other business stakeholders quantified the employment impacts of penalty rates, but instead provided subjective measures of concern about them.

Source: Queensland Business sub. 150, p. 27.

Drawing on the results of a survey of local businesses, the Launceston Chamber of Commerce (sub. 124) estimated that employment in the retail and accommodation/hospitality sectors in their region would increase by 943 full time equivalents (or a 9 per cent increase) if penalty rates were 'either significantly reduced or abolished'.

An Australia-wide survey of 1000 restaurant and café services claimed significant increases in employment and hours worked from reduced weekend penalty rates (Jetty Research 2015). For example, around half of the surveyed businesses said that they would increase employment on Sundays/public holidays (by an average of about three employees) and around 40 per cent indicated that they would open for longer. The study projected increases in employment of nearly 40 000 employees. However, a major deficiency in the study is that it asked for employers' views about the impacts of a reduction in penalty rates, but did not specify the actual magnitude of that reduction. Accordingly, the answers given would reflect different judgments by respondents on the magnitude of the hypothetical change. It may be that some would have considered that the reduction was from 150 to 125 per cent (the Sunday and Saturday penalty rates respectively for the relevant industries), but others may have made different surmises, such as from 150 to 100 per cent. It is therefore unclear whether the results are meaningful.

Given the limitations in surveys of this kind, the numbers should be treated as indicative.[161]

Industry submissions to this inquiry (and to the FWC and other inquiries)[162] have generally claimed significant employment effects, while employees and unions have questioned this (box 14.4). Indicative of the same tensions, the full bench of the FWC was equally divided in its view. The majority of the full bench concluded that penalty rates 'have some effect, but not a significant effect, on employment on Sundays' ([2014] FWCFB 1996, para 139).[163] The relevant members cited uncertainty over labour demand elasticities and a view that minimum wage decisions had not had obvious employment effects.

161 As an indication of the subjective nature of the answers, in contrast to the relatively high frequency of businesses identifying no effect from penalty rates shown in figure 14.12, an ACCI survey (2013, p. 9) indicated that only 10.1 per cent of businesses had no concern with penalty rates (and 50 per cent said that it was a major concern). A survey by the Australian Human Resources Institute (sub. 46, p. 17) indicated that 50 per cent of respondents considered that rates 'required less regulation and realignment to today's economy' (a potentially leading question).

162 For example, a Senate inquiry into a penalty rate exemption for small businesses (EEWRLC 2013).

163 If this were true, it would raise the question about why the FWC had not proposed *increases* in penalty rates. Were there only small employment consequences, then higher penalty rates would ostensibly increase the earnings of the low paid.

Box 14.4 Participants' views on employment effects

Big effects:

Although operating days and hours is a decision to be made by the business owner and is based on a range of factors, it is disappointing to think that Australia is in a situation where business turnover and employment opportunities are reduced due to penalty rates. This is not advantageous for employment levels, productivity or the economy. (Office of the Australian Small Business Commissioner sub. 119, p. 7)

Penalty rates can be a deterrent to employment, particularly when combined with rules around minimum engagement of employees. In the pig breeding and raising industry … on a Sunday, the combined effect of these provisions for one hour's work is equivalent to $100 per hour. This is disproportionate to the inconvenience to the employee and a significant disincentive to employment. As the dairy example provided earlier shows, many farmers choose to undertake this work themselves because they cannot justify the cost. Ultimately, this dampens productivity by causing fatigue among farm owners and stifling job creation. (National Farmers' Federation sub. 223, p. 16)

… employers have legitimate concerns that some aspects of the current system, for example penalty rates, excessively inflate labour costs and discourage job creation. In the present economic climate, it is particularly important that minimum and award rates of pay do not unduly constrain the ability of employers to retain staff or hire new employees. (Western Australian Government sub. 229, p. 1)

44 per cent of (surveyed Queensland) businesses noted that they have decreased or substantially decreased the number of full time staff. Taken together, the results suggest that rising labour cost loadings are affecting business decisions about staffing hours and negatively impacting employment. (Chamber of Commerce and Industry Queensland sub. 150, p. 25)

There is a concern that in a climate where many small to medium Clubs are struggling financially, that unsustainable penalty rates will have the effect of these employees suffering a reduction in hours or no employment all together. (Clubs Australia Industrial sub 60, p. 12)

On many occasions, we would have liked to give staff members the weekend work that they desire, but are instead unable to offer them ANY work on these days because we can't afford the over-time pay rate. This is a lose-lose for both the business and the employee. (Steven and Michelle Finger sub 142, p. 2)

Limited or no effects:

I'd like to see evidence presented (of which a great deal exists) that finally puts an end to the furphy that reducing minimum wages or cutting penalty rates will solve business' 'problems'. Better management will solve business' problems. I'd also like to see an end to lazy blaming of the legislation for poor workplace relations - workplace relations don't rely on law, they rely on people knowing their jobs, working together, and behaving respectfully. (Respondent to survey of 813 members by Australian Human Resources Institute sub. 46, p. 26)

… employers have provided limited evidence that penalty rates have had the negative effects claimed, such as causing them to employ fewer workers on a Sunday. In FWC's 2013 penalty rates decision, the Commission noted the 'significant evidentiary gap in the cases put [by employers]". (Employment Law Centre of WA sub 89, p. 15)

There is no reliable evidence or economic analysis that removing penalty rates will boost employment and job creation in cases put before the FWC to date. Further, minimum wage earners and their families who rely on penalty rates to make ends meet would be disproportionately affected by reductions. (Catholic Commission for Employment Relations sub. 99, p. 2)

As with the minimum wage, the argument for the abolition of penalty rates assumes that allowing lower rates of pay would mean that employers could employ more people to work more hours – thus resulting in a win for everyone. However, the Society disagrees with this argument for a number of reasons. Firstly, it places value on employment at the cost of all else, including an adequate standard of living. … Secondly, the argument that deregulation of incomes will lead to better outcomes assumes that dissatisfied employees will be able to get more hours, or move on to better-paid work elsewhere. However, in the current employment market, with rising unemployment and one job for every thirteen jobseekers, this seems highly unlikely. … Thirdly, the argument assumes that lowering pay will increase employment. As the Issues Paper points out, the reality is far more complicated, and in fact the reverse relationship might hold. In any case, the cost to individuals who are already struggling must be weighed, as well as the risk that increased business income would not be used to employ more staff but for other purposes. (St Vincent de Paul Society sub. 78, p. 3)

Both of the latter contentions are correct, but neither have much implication for the labour demand changes that could be expected when wage changes are large. The difficulty of identifying employment effects associated with the small real wage changes in annual wage reviews does not have much relevance to real wage shocks of a completely different order of magnitude. The minority view of the full bench considered the effects were significant, reflecting the greater weight they gave to employers' evidence.

The Productivity Commission's overall view — informed largely by the reality that labour demand responds to wage rates — is that as there is a significant differential between Saturday and Sunday penalty rates, their greater alignment is highly likely to have sizable employment effects.

This conclusion is not underpinned by the simple adoption of any assumption that employment is highly responsive to wage rates, as in Lewis (2014), nor by uncritical acceptance of anecdote or surveys of businesses, though the latter has some value because businesses are the parties that make the decisions about whether to open or employ people. It rests primarily on the significant size of the wage differential between Saturday and Sunday.

Beneficiaries

The prime beneficiaries of optimal reductions in regulated Sunday penalty rates would be:

- consumers. They would have access to labour-intensive services for periods when these were previously unavailable. They may get better service if employers choose to use more experienced staff and less juniors on Sundays, and face fewer queues due to potentially higher staffing ratios. In some cases, they may face lower prices. The magnitude of these effects is hard to assess given inadequacies in the data
- people outside the workforce, who would obtain jobs (as suggested by the findings above). Since joblessness is particularly adverse for people's wellbeing, such gains are particularly important
- working proprietors, who may have a better work-life balance
- permanent employees in some industries because casuals would largely not be cheaper to employ (as noted in section 14.5).

There would be potential productivity improvements as the fixed costs of running a business were spread over greater opening times and demand.[164] In 2006-07, such costs were around 16 per cent of total expenses for the cafes and restaurant industry (the most recent data).

Better capital utilisation would also put downward pressure on average unit costs and prices. Moreover, the lower labour costs associated with reduced penalty rates may permit

[164] For example, leasing, rental costs, franchising fees, repairs, insurance premiums, software, and depreciation.

the payment of targeted incentive-based payments that motivate staff and enhance productivity (Contact Centres Australia Pty Ltd sub. 240, p. 2).

Impacts on the earnings of existing employees

The degree to which the labour earnings change for people currently employed on Sundays depends on the:

- new regulated Sunday penalty rate for each relevant award
- extent to which some negotiated weekend wages might lie above a new lower penalty rate for Sundays. Even in New Zealand and the United States, where there are no legislated penalty rates for weekend work at all, they are still prevalent in some enterprise agreements
- timing of new enterprise agreements, as any penalty rates in existing agreements would continue to apply
- relative proportion of an employee's time spent working on Sundays
- extent to which lower wage rates induced greater demand for labour on Sundays. One labour economist has suggested that some existing employees might actually earn greater incomes on Sundays (Lewis 2014, p. 22), although that requires that the proportional increase in the hours of work they obtain would be sufficient to offset the proportional decline in wage rates, which seems improbable.

In general, it seems likely that most *existing* employees would face reduced earnings. Even if the responsiveness of labour demand (measured in hours) was relatively responsive to wage changes compared with most empirical estimates, then at least some of those additional hours from lower penalty rates would be likely to come from new employees.[165] Once that is the case, existing employees are not likely to obtain enough additional hours of work to offset the earnings effects of lower wage rates.

Nevertheless, the adverse effects on existing employees would still be moderated to some extent by the availability of more hours of work, and potentially ones that suit their circumstances better. While employees as a group want more often to work fewer hours, data from the AWALI survey showed that the share of employees preferring to work longer was significantly higher for people working on weekends than on regular days.[166]

165 The models of the kind used by Lewis and others to assess the labour demand effects of wage changes do not distinguish between hours worked by current employees, hours worked by new employees, and headcount employment (and could not do so unless disaggregated data were available).

166 The effect was most pronounced for Saturdays, but also applied to Sunday employees.

The distributional effects of lower Sunday penalty rates

Given the above results, the FWC, many employees and unions rightly identified the adverse effects of reductions in penalty rates on the earnings of low paid employees, whose welfare is a prominent goal of the Modern Award objective (box 14.5).

The prominence of this concern was a key motivation for the FWC's decision to preserve Sunday penalty rates for most employees in the restaurant industry. The FWC observed that:

> The operating premise must be, therefore, that the full grant of the alternative application would reduce the take-home pay of a large proportion of those employees covered by the Restaurant Award who already work on Sundays, and the extent of the reduction may be as high as approximately 17% for weekly employees and 14% for casual employees. Given that the modern awards objective requires the establishment of "a fair and relevant safety net", taking into account among other things "relative living standards and the needs of the low paid", any countervailing considerations concerning increased employment opportunities or productivity or other benefits to business would have to be clearly identified and demonstrated in order for the alternative application to be seriously entertained. ([2014] FWCFB 1996, para 295)

For some other HERRC industries where Sunday penalty rates are higher — most notably, retailing — the income effects would likely to be larger for employees working predominantly on weekends. Even so, it is the minority of employees that work only on weekends — figure 14.3.

There are further considerations in making assessments of the ultimate income distributional effects of weekend penalty rates:

- incomes would increase for those who do not currently have a job or for those whose preferred hours of weekend work are significantly below their current hours. This group may also benefit from improved lifetime participation in the labour market
- the adverse income effects may be partially offset by automatically increased transfers through the tax and transfer system for some households
- households, not individuals, are the usual target for distributional policies. People earning penalty rates are spread across the household income distribution range. For example, 47 per cent of people working often or nearly always on Sundays in the accommodation, food services and retailing industries are in households earning more than $90 000 a year, very close to the share applying to people in these industry groups who do not work on weekends. Results for people working often or nearly always on Sundays are less reliable because of lower survey samples, but show qualitatively similar results (figure 14.13)
- some employees receiving penalty rates only engage in the relevant consumer services industry in the earlier years of their working lives and may have high lifetime expected incomes. For example, this would often be true for people undertaking tertiary studies.

Box 14.5 Concerns about the income effects of lower penalty rates

The QCU is also concerned with the plight of those workers for whom penalty rates are not a luxury, but rather allow them to make ends meet (rent, bills, food, etc.). An estimated 34.6% of employees in receipt of penalty rates rely upon them to meet their household expenses (Daly 2014–13). (Queensland Council of Unions sub 73, p. 3)

Many United Voice members are in insecure work arrangements and a large proportion rely on penalty rates to make ends meet and to compensate them for missing time off with family and friends on weekends, evenings and holidays. (United Voice, sub 224, p. 2)

… a reduction in penalty rates would have detrimental and disproportionate impacts on female workers in these industries. (Textile Clothing and Footwear Union of Australia (TCFUA) sub. 214, p. 44)

… any suggestion of the removal of penalty rates for casuals and award-based employees … would have a significant impact on employees in retail, hospitality and nursing, which tend to be industries in which a large number of women work. (Women's Legal Services NSW sub. 234, p. 1)

A reduction in penalty rates may disproportionately affect women who are award reliant, who are often employed in the hospitality, retail and community and disability care industries and who juggle their hours around family responsibilities and work hours where childcare is available via their partners or family. Quality affordable childcare is difficult to access on weekends so many women rely on family. (Working Women's Centres sub. 242, p 13)

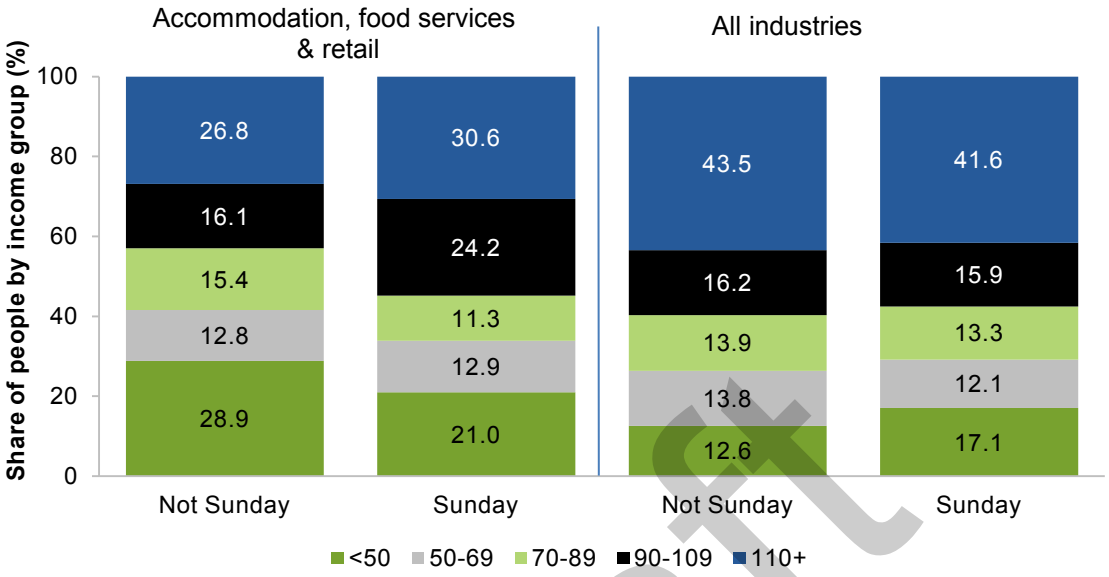
… those who rely on penalty rates to meet their household expenditure are far more likely to have any of the following characteristics: be single parents; women; in receipt of a household income less than $30 000; not living in cities; be labourers; and be on contracts … What this makes clear is that it is those Australians already doing it toughest who are relying on penalty rates to get by. Single parents, families living on less than the minimum wage, rural and regional Australians, and people in lower-paid professions are the most financially vulnerable to the removal of penalty rates. This creates a very strong presumption that penalty rates should remain untouched. (St Vincent de Paul sub 78, pp. 3–4)

Penalty rates supplement base wage rates and they are an important component of the income of award-reliant workers. Many of these workers are the lower paid and use the opportunity to work for penalty rates to top up their wages to a reasonable level. (SA Government sub. 114, p. 10)

Effects on business profitability

While it is sometimes claimed that employers would obtain longer-term higher profits from deregulated or reduced penalty rates, this seems highly unlikely in industries where competition is generally high (for example, as noted in [2014] FWCFB 1996, para. 27). Either prices would fall or new entry would occur, which would erode any temporary profits.

Figure 14.13 **Household earnings of Sunday employees**
2014[a]



[a] A Sunday worker is someone who often or almost always on Sundays. Sample sizes are small for Sunday workers, so the results are less reliable than those who work on other days.

Source: Derived from AWALI survey.

Accordingly, the argument that business profitability is affected by *current* penalty rates is not relevant to this assessment. Long-run profitability of an industry is determined by the interaction of market competition, innovation and risk, and not by wage rates.

Moreover, arguments that the FWC should lower regulated penalty rates because some businesses are unviable at those rates is not a compelling basis for such a change. In any industry, there is a share of businesses that are making losses or are close to doing so. Lowering wages may provide temporary respite, but competition will always lead to a tail of underperforming businesses (as ABS data on profitability across a multitude of industries attests).[167]

14.7 Change is warranted

Based on the comparison with Saturday and evening work rates, the evidence above suggests that the penalty rates for a Sunday are out of step with the social costs borne by people working on that day.

167 ABS (various issues), *Australian Industry*, Cat. No. 8155.

The costs of reform fall more on some groups than others, although that has not prevented the FWC or its predecessor from sometimes reducing penalty rates for some employees (for example, for lower-skill level 1 and 2 employees in the restaurant industry).

Moreover, it is easy to overlook the widely dispersed small gains to consumers and those seeking employment from reform in this area (as in incremental technological changes) and concentrate on the smaller group bearing the adjustment costs. Governments should not stand in the way of technological change to maintain outdated jobs (telephonists) or have terms and conditions that are out of step with the times. Whole sectors have, and are, adjusting with massive technological change (for example, media). Social change can be just as transformational. Finally, the intent of the modern award system is to provide a *safety net*. The rates for Sundays appear to extend beyond that 'safety net' role.

A particular concern in making any changes to penalty rates is that there will be significant income effects for some people. That suggests an adjustment process so that people can seek other jobs, increase their training and make other labour market choices. An extended transition that involves staggered small changes to Sunday rates would replicate some of the uncertainties and compliance costs associated with award modernisation. Moreover, it might reduce the scope for new employment, increased hours of work for existing employees, workload relief for owners, and the benefits from permanent/casual substitution. A better approach would be to give advance notice of a change so that employers and employees can review their circumstances, and then introduce the change in a single step.

Part of this notice period will arise naturally from the workload associated with the FWC's broader suite of award assessment (chapter 12). It appears unlikely that any decision could be practically implemented before early 2017. If an adjustment period of a year was added, this would provide more than two years before changes were made.

DRAFT RECOMMENDATION 14.1

Sunday penalty rates that are not part of overtime or shift work should be set at Saturday rates for the hospitality, entertainment, retail, restaurants and cafe industries.

Weekend penalty rates should be set to achieve greater consistency between the hospitality, entertainment, retail, restaurants and cafe industries, but without the expectation of a single rate across all of them.

Unless there is a clear rationale for departing from this principle, weekend penalty rates for casuals in these industries should be set so that they provide neutral incentives to employ casuals over permanent employees.

DRAFT RECOMMENDATION 14.2

The Fair Work Commission should, as part of its current award review process, introduce new regulated penalty rates as set out in draft recommendation 14.1 in one step, but with one year's advance notice.

14.8 Other industries

As noted at the outset, the focus of this chapter has been on penalty rates where they are not just deeply inconsistent with the costs being compensated, but substantially out of touch with community expectations and social trends. Essential services, by comparison, are subject to payment of penalties arrangements that have remained in lock-step with community expectations. There is no comparable case to alter them.

Between these two poles lie a range of industries where the case may, or may not, be equivalent to that in the HERRC industries. Based on the improved practices and experience with conducting the award assessments recommended in chapter 12, the FWC should undertake research and seek proposals from other industries in the medium term, and assess whether a similar case can be made for equalisation between Saturday and Sunday penalty rates.

However, the capacity to make change may also be achieved through enterprise bargaining. There is, as noted earlier, no economic case for common penalty rates across the country.

Changing the modern awards objective

The FW Act's modern awards objective has an extensive list of considerations that the FWC must weigh up when making its decisions. Somewhat surprisingly, there is no overarching requirement that awards increase the overall wellbeing of the Australian community. This was apparent in a FWC decision on restaurant penalty rates ([2014] FWCFB 1996). The majority members of the Full Bench gave most weight to the distributional benefits to *existing* employees, and considered that there were no significant employment benefits or broader economic benefits. The two dissenting members had a quite divergent reading of the evidence, and gave more weight to the unemployed and economywide impacts of the current weekend penalty rates in the award. The main implication of the disagreement is that while there are grounds to revisit the modern awards objective, in this instance, the FWC's decision was not strongly constrained by the FW Act.

Rather, the pertinent issue in this instance is the interpretation of the provision introduced in 2013 in the Modern Awards Objective that relates to additional remuneration for

weekend work (section 14.1 above). Whether the amendment makes any difference is a moot question. In its submission to the four-yearly award process, the Australian Government interpreted the section in relatively broad terms, with the implication that the FWC would not be obliged to include penalty rates in any award that did not already have them, and that the FWC would have the latitude to determine:

> … whether the additional remuneration and the hours and/or days in which it is provided in modern awards are appropriate in a particular industry. (Australian Government 2014a para 3.6)

However, the FWC interprets its freedom as partial, noting that the modern award objective '*requires* additional remuneration for working on weekends' ([2014] FWCFB 1996, para 295). The wording of the FW Act may contribute to the ambiguity by stipulating the '*need* to provide additional remuneration'. It would be unfortunate if this required the wider adoption of weekend penalty rates even in circumstances where the context of other industries did not require that. Legislative amendment appears necessary to achieve this.

It would be unfortunate if the existing framework for determining penalty rates were to spread throughout awards that currently do not have any, recognising that awards can provide compensation through average wage rates, rather than through special time-dependent wage rates.

If the Modern Awards Objective is not simplified more broadly (chapter 12), then there are grounds to amend the FW Act so that it is clear that the FWC would not be obliged to incorporate weekend penalty rates into all awards, taking account of the fact that awards should be seen as a package of benefits.

Individual flexibility arrangements

All modern awards include (or are deemed to include) a flexibility clause that allows employees to make agreements with employers that vary the conditions of the award (or enterprise agreement).

In principle, individual flexibility arrangements (IFAs) could allow an employee to relinquish penalty rates in exchange for other benefits so long as the exchange would meet the 'better off overall test' (the BOOT). Flexible working hours and penalty rate changes figure prominently in the relatively few IFAs that have been formed. For example, employees reported that nearly 60 per cent of IFAs related to arrangements for when work was performed (especially important for females) and around one in five to penalty rates (O'Neill 2012a, p. 69). Employers had similar views (*ibid* pp. 61–62 and p. 66).

There are several obstacles to the wider use of IFAs, including the manner of their negotiation, the BOOT, the duration of agreements, the degree to which they are genuinely flexible, and lack of awareness (chapter 16). In the latter case, it is notable that awareness is particularly low for younger employees, who are overrepresented in the HERRC

industries (O'Neill 2012a, pp. 31–32). The reforms recommended in chapter 16 to IFAs and the potential creation of enterprise contracts (chapter 17) will remedy many of these deficiencies, and should address, on the one hand, some employees' preferences for working times suited to them and, on the other, some employers' frustrations with rigid arrangements for penalty rates. A win-win option may be available to some.

Enterprise agreements also currently permit variations to award conditions so long as the majority of employees support the agreements and that the variations meet the BOOT. Shifting to a no-disadvantage test would further promote the creation of agreements allowing tradeoffs between penalty rates and other employee benefits.

Time off in lieu

Time off in lieu (TOIL) provisions in awards are common but are not universal (and their use requires consent by the employer and employee). TOIL arrangements depend on the nature and timing of work. For example, it is common to allow time off paid at ordinary rates instead of payment for overtime, with the time allowed typically equal to the time worked overtime multiplied by the overtime penalty rate,[168] though some awards only allow hour for hour substitution.[169] However, in the key awards that are the focus of this chapter, there are no provisions for time off in lieu instead of penalty rates for weekend work. However, some awards allow for TOIL for public holidays. Overall, this highlights inconsistencies of awards and the desirability of the assessment process set out in chapter 12. The Fair Work Commission is also considering this issue.

Preferred hours clauses

Outside IFAs, enterprise agreements may include clauses that enable an employee to nominate (with consent) preferred hours of work because they suit the employee's circumstances. Where these hours fall on a Saturday or Sunday, the employee would not be paid penalty rates. These are referred to as 'preferred hours' clauses, though some characterise this as any arrangement in which an employee can decide to work different or additional hours without attracting penalty or overtime rates (which would therefore include some IFA and TOIL arrangements). This chapter uses the more narrow description of such clauses in enterprise agreements.

While some agreements have included such clauses,[170] the current practice of the FWC is to reject agreements that incorporate them (Cameron 2012). The concern is that such

168 This applies in the Restaurant Industry Award 2010, the General Retail Industry Award 2010 and the Pharmacy Award 2010. There are no provisions for time off in lieu for overtime in the Hospitality Industry (General) Award 2010.

169 An hour for hour time in lieu arrangement holds for the Funeral Industry Award 2010.

170 The *Milbag Pty Ltd T/A Eagle Boys Pizza Adamstown & Eagle Boys Pizza Belmont* enterprise agreement (AG2009/23877) was seen as a landmark agreement that included a preferred hours clause.

clauses may erode employee benefits and thus fail the BOOT. Preferred hours clauses may still be permitted in exceptional circumstances (requiring that a public interest test be passed). However, under current arrangements, preferred hours clauses provide negligible scope for employers and employees to trade off higher wage rates at some times for a preferred roster.

Nor do they generally provide the scope for employees to obtain additional hours of work during particular seasonal peaks, while giving up penalty rates or other premium rates of pay for these transitory periods. There has been one notable exception — a potato farm with a peak picking period (the Black Crow agreement).[171] However, the approval by the FWC was based on a rarely applied 'public interest' test, and dismissed the principle that obtaining additional hours of work in exchange for less benefits could pass the BOOT (Cameron 2012, pp. 50–51). Fonterra Australia (a dairy producer) has called for more general flexibility in being able to match working hours with seasonal supply cycles without the need for penalty rates — a capacity that already applies in New Zealand (Lynch 2014).

One lateral approach to a preferred hour clause would be for a permanent employee to forgo any penalty rates for their preferred hours even if these fell on a weekend, but to receive penalty rate payments where an employer requested them to work at a time not preferred by the employee. This would amount to choosing their own 'unsociable hours'. This could provide employers with some flexibility, but also create a strong incentive for them not to deviate from an employee's preferred hours. Unlike present arrangements, this would recognise that times deemed asocial by some, are quite social for some. This arrangement could mean that a penalty rate might apply to any day of the week, depending on the preferences of employees.

However, as for 'preferred hours' clauses generally, employees may lack the bargaining power to nominate their truly preferred hours. The employees at greatest risk in this situation would be the most disadvantaged, with less experience, skill and bargaining power. Similar issues arise wherever more flexibility is introduced to work place relations.

One response to this is to give employees the flexibility to unilaterally opt out of contracts. This approach has been used in the United Kingdom for penalty rate arrangements on Sunday in betting shops, and also in Australia for IFAs. While it would be difficult to ensure employees are nominating their true preferences for penalty rate days, allowing for unilateral termination of a penalty agreement would prevent employees being 'trapped' in a non-preferred arrangement.

171 *Black Crow Organics Enterprise Agreement 2009* [2010] FWAA 5060.

INFORMATION REQUEST

The Productivity Commission seeks views on whether there is scope to include preferred hours clauses in awards beyond the current narrow arrangements, including the scope for an arrangement where an employer would be obliged to pay penalty rates when it requested an employee to work at an employee's non-preferred time in the employment contract.

What would the risks of any such 'penalty rate' agreements be and how could these be mitigated?

14.9 Holiday pay

By definition, genuine public holidays are intended to serve a special community role and, as such, there are strong grounds to limit the expectation that they are for working.

Current penalty rates for public holidays are typically 250 per cent, although a very few offer more.[172] To put holiday pay rates in perspective, a penalty rate for a permanent employee who would normally work on a public holiday would have to be at least 200 per cent to ensure that the employee was not working at a discount over a typical working day. Adding a further charge to provide deterrence would lead to penalty rates commensurate with the rates that are typical in awards.

Australia is not exceptional in relation to holiday pay. In New Zealand, where the workplace relations system is much less regulated than Australia, holiday penalty rates have been maintained. The typical arrangement is a penalty rate of 1.5 times ordinary pay, plus a later day off in lieu at ordinary pay (or equivalent to a penalty rate of 250 per cent in Australian terms). Some enterprise agreements offer more.

Current penalty rate arrangements for public holidays do not need to change, except where they relate to the additional days of leave that State and Territory Governments may announce in the future (draft recommendation 4.2).

[172] For example, the rate is 300 per cent in the Black Coal Mining Industry Award and the Oil Refining and Manufacturing Award. In some instances the 300 per cent rate only applies to specific holidays (Christmas day and Good Friday), as in the Waste Management Award and the Road Transport and Distribution Award. In one award, the Stevedoring Industry Award, the rate is 350 per cent (or an effective rate of 250 per cent). The latter is not for ordinary daytime hours, but for the night shift component of a double header, and therefore constitutes a special case.

15 Enterprise bargaining

Key points

- Bargaining at the enterprise level over the terms and conditions of employment has been a mainstay of Australia's workplace relations (WR) system for over two decades. Since 2000, coverage has been generally stable at around 40 per cent of employees working under some form of enterprise arrangement, generally in larger businesses, with coverage often varying markedly by occupation and industry.
- The *Fair Work Act 2009* (Cth) (FW Act) has detailed rules around enterprise bargaining, including how bargaining begins, carries on and ends, and the approval process. Some of these are working better than others.
- The good faith bargaining requirements appear to be working relatively well. The Fair Work Commission (FWC) has the power to step in as a last resort when there are repeated breaches of bargaining orders.
- The application of the better off overall test (BOOT) is creating uncertainty during the bargaining process and at the agreement approval stage. The BOOT should be replaced by a no-disadvantage test, and the FWC should issue guidelines to its members on how to apply the test in order to reduce the gap between legislative intent and practice.
- Allowing parties to negotiate agreements with longer durations, up to five years, would reduce the costs associated with bargaining. Greenfields agreements should be allowed to match the period for the construction phase of the project, to avoid undue bargaining power by unions when a project is not completed at the expiry of a greenfields agreement.
- The rules around negotiation of greenfields agreements require modification to reduce inefficiencies and end stalemates in negotiations.
  - Bargaining representatives for greenfields agreements should be subject to the good faith bargaining requirements.
  - Where parties do not successfully negotiate a greenfields agreement after three months, an employer should have the option to request that the FWC approve their proposed offer for a 12 month lifespan, or request that the FWC carry out 'last offer' arbitration.
- Despite calls for the introduction of productivity clauses within all enterprise bargains, this might generate outcomes inimical to productivity. Employers, employees and their representatives already have strong incentives to commit to productivity improvements and, where possible, to specify ways in which this might be achieved through enterprise agreements without resorting to new regulation.
- Individual flexibility arrangements (IFAs) within enterprise agreements are underutilised. To create more opportunities for using IFAs that meet the genuine needs of employees and employers, the matters covered by the model flexibility term should be included in all enterprise agreements as the minimum matters over which flexibility is permitted.

The WR framework provides a safety net of employment conditions through the National Employment Standards (NES) (chapter 4), minimum wages (chapter 8) and awards (chapters 11 and 12).

However, employees and employers can bargain together to improve the terms and conditions provided by the safety net. They can do this through individual arrangements (chapter 16), or by bargaining collectively for an enterprise agreement (EA).

The focus in this chapter is on the latter area: enterprise bargaining. This lies at the heart of the FW Act, which sets out detailed rules and requirements for the conduct of such bargaining processes. The chapter first covers the history of collective bargaining in Australia, and how we arrived at the current system of enterprise bargaining (section 15.1). It then outlines the current rules around making an EA (section 15.2). Section 15.3 briefly describes who is using EAs and why. Finally, section 15.4 covers the adequacy of the current arrangements and suggested improvements.

Industrial action associated with enterprise bargaining is discussed in chapter 19. Issues specific to enterprise bargaining in the public sector are discussed in chapter 18.

15.1 Collective bargaining in Australia

While collective action is generally frowned on in competition policy (chapter 24), collectively determined wages and conditions have been a mainstay of WR policy since Federation (and is an ubiquitous feature of WR systems in most countries). The current system of enterprise bargaining is the result of a prolonged process of innovation and modification of this collective approach.

For almost a century, Australia's bargaining and agreement making was characterised by centralised conciliation and arbitration. However, collective bargaining still occurred informally under the auspices of the centralised system — typically, an industrial tribunal stepped in between employers and employees to arbitrate matters on which the parties could not agree (Creighton and Stewart 2010). As noted in chapter 11, in the early 20th century, dispute settlements often resulted in multi-and single enterprise awards. These resembled current EAs in some respects, often with employers and unions negotiating terms, except that the content of the award was ultimately determined by a tribunal. However, as the Commonwealth Court of Conciliation and Arbitration grew in significance, awards shifted more to an industry and occupational basis.

The move to enterprise-level collective bargaining

Gradual moves away from the centralised system began in the late 1980s. 'Consent awards' and 'certified agreements' under the *Industrial Relations Act 1988* (Cth) recognised agreements hammered out at the enterprise-level. However, enterprise-level

bargaining came into its own in 1993, when it was introduced as the centrepiece of the *Industrial Relations Reform Act 1993* (Cth) (table 15.1).

Table 15.1 **How collective bargaining has evolved in Australia**

Pre 1993	***Centralised wage fixing and arbitration***
	Enterprise-level variations negotiated between unions and employers, and ratified by the Australian Industrial Relations Tribunal (AIRC) through firm-specific clauses or standalone enterprise awards.
	Informal bargaining also occurred. If agreement reached on a 'matter pertaining', AIRC could make a consent award; if no agreement reached, AIRC could arbitrate.
1993	***Enterprise bargaining introduced***
	Underpinned by a safety net of awards, introduction of good faith bargaining rules and a no-disadvantage test**.**
	Union (Certified Agreements) and non-union (Enterprise Flexibility Agreements) agreements could be made. Parties could bargain about 'matters pertaining'. If agreement reached, collective agreement was made; if no agreement, AIRC could arbitrate.
1996	***Enterprise bargaining continues, individual statutory agreements introduced***
	Australian Workplace Agreements (AWAs) prevailed over awards and any collective agreement, and could be offered as a condition of employment, subject to a no-disadvantage test.
	Union and non-union certified agreements could be made, subject to a no-disadvantage test in comparison to the award. Parties could bargain about 'matters pertaining'; AIRC had conciliation powers, but no power to arbitrate. Good faith bargaining requirements were removed.
2006	***Further changes to individual statutory agreements***
	AWAs could undercut awards, until a no-disadvantage test was restored in May 2007.
	'Enterprise flexibility' terms in collective agreements were prohibited; no new enterprise awards to be created. Employers could put collective agreements directly to an employee vote. Parties could bargain about 'matters pertaining' but not 'prohibited content' or 'pattern' claims. AIRC had voluntary conciliation powers, but could not arbitrate.
Since 2009	***Enterprise bargaining given primacy again***
	Ability to make AWAs removed, collective bargaining given precedence.
	Parties can bargain about lawful terms, but term unenforceable if not a 'matter pertaining'. Good faith bargaining reintroduced. FWC cannot arbitrate.
	Enterprise agreements can be modified through individual flexibility arrangements (IFAs), subject to a 'better off overall' test in comparison to the agreement. IFAs cannot be made a condition of employment, and can be unilaterally withdrawn by an employee.

Sources: Adapted from ACTU (2012c, p. 8) and McCallum et al. (2012).

The introduction of enterprise bargaining in the early 1990s was an historic break from the past. Enterprise bargaining carried the expectation that employees and employers should work together at the enterprise-level to agree on conditions of employment, subject to a safety net of awards. The more decentralised system heralded by enterprise bargaining created greater potential for wages and conditions to match the individual circumstances of employers and employees, while still giving employees the benefits of collective action.

Despite the promises offered by a decentralised system, a centralised system had its own benefits during one of Australia's important historical moments. The Prices and Incomes

Accord of the 1980s capitalised on Australia's then centralised WR system, working to break the inflation-wage growth nexus and help with structural change of the economy.[173]

Both businesses and unions supported the move towards enterprise bargaining. Frustrations associated with the Accord process eroded union solidarity behind centralised wage fixing, with some unions judging that they could deliver better outcomes for their members if they were free to bargain outside the strictures of the Accord (Briggs 2001).

Further changes — shifting to individual bargaining, then back to enterprise bargaining

Under the *Workplace Relations Act 1996* (Cth), individual bargaining through Australian Workplace Agreements (AWAs) was given priority over collective bargaining. While union and non-union collective agreements were provided for, there were no legislative mechanisms to compel employers to engage in collective bargaining (Forsyth et al. 2010, p. 116). Further changes made through the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) reinforced the central place of individual agreements.

The FW Act has returned to an emphasis on enterprise-level collective bargaining as the basis for determining wages and conditions and, more broadly, for shaping the relationship between business owners and their employees. While individual registered agreements were a feature of previous regimes, EAs are the only form of registered agreements under the FW Act. The object of the FW Act is to provide a balanced framework for cooperative and productive workplace relations that promotes national economic prosperity and social inclusion for all Australians, including by:

> … achieving productivity and fairness through an emphasis on enterprise-level collective bargaining underpinned by simple good faith bargaining obligations and clear rules governing industrial action. (s. 3(f))

Part 2-4 of the Act, which regulates the making of EAs, includes as an object to:

> … provide a simple, flexible and fair framework that enables collective bargaining in good faith, particularly at the enterprise level, for enterprise agreements that deliver productivity benefits … (s. 171(a)).

The administrative discretion exercised by the predecessor bodies to today's FWC through compulsory conciliation and arbitration of bargaining disputes has disappeared. In its place are legislated minimum standards and tests that aim to ensure a net benefit for employees involved in enterprise bargaining.

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173 As noted in Chapman (1990, p. 57): 'In macroeconomic terms, it is hard to believe that the Accord has not delivered what its proponents apparently hoped for: wage restraint and job growth, leading to a substantial – and, because of measurement problems, an understated – decrease in the unemployment rate. This has been associated with increases in labour supply and a reduction in long term unemployment.'

The FW Act's rules around enterprise bargaining are discussed in greater detail in the following section.

15.2 Current rules around enterprise bargaining

Negotiations between employers and employees on conditions of employment are subject to a detailed system of rules and requirements. The content or terms that can be agreed, and the negotiation process itself, is regulated, mainly by the FW Act.

Types of enterprise agreements

Three types of EAs can be made under the FW Act (s. 172). There are:

- single-enterprise agreements, which employers can makes with some or all of their employees. Two or more employers can be treated as 'single interest employers' (for example, employers engaged in a joint venture or common enterprise, or related bodies corporate) for the purposes of enterprise bargaining
- multi-enterprise agreements, which can be made between two or more employers (not single-interest employers), and some or all of their employees
- greenfields agreements, which can only be made where there is a 'genuine new enterprise'. Employers cannot unilaterally determine the conditions for future employees in new work sites. They must be negotiated with one or more relevant employee organisations (usually, unions).

The overwhelming majority of EAs are single-enterprise agreements (appendix E). For example, in 2013-14, of the 6754 total agreements lodged for approval, 88 per cent were single-enterprise agreements, 11 per cent were greenfields agreements, and less than 1 per cent were for multi-enterprise agreements.

Standard and non-standard processes

When an employer initiates bargaining, or agrees to bargain when initiated by their employees, the standard bargaining process involves:

- an agreement making process (where parties can appoint bargaining representatives)
- bargaining (parties and/or their representatives need to bargain in good faith)
- an approval process (employees and the FWC need to approve the agreement) (figure 15.1).

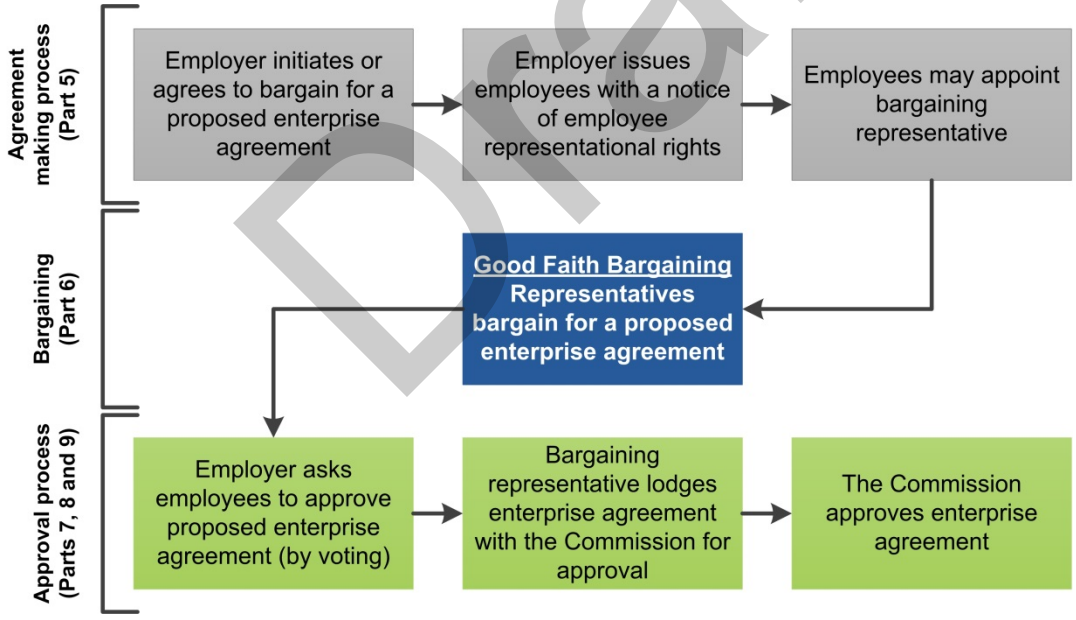
Additional bargaining processes can include:

- majority support determinations (if a majority of employees want to bargain and their employer refuses, an employee bargaining representative may apply to the FWC for a

majority support determination to require that the employer bargains. If the employer continues to refuse to bargain, the employee bargaining representative may seek a bargaining order to require the employer to meet the good faith bargaining requirements)

- an application for a single interest employer authorisation, to allow employers who are bodies corporate or joint venture partners to bargain as one employer (for example, franchisees, schools in a common education system, and public entities providing health services)
- Low-paid authorisations (which allow low paid employees to collectively bargain with their employers)
- scope orders (where there is a dispute about which employees are to be covered by the proposed agreement)
- bargaining orders to uphold the good faith bargaining requirements
- bargaining disputes.

Figure 15.1 **Standard bargaining process under the Fair Work Act[a]**



[a] This diagram sets out the bargaining process as it applies in general terms. It does not relate to the process for making a greenfields agreement.

Source: Fair Work Commission (2015c, p. 12).

How does bargaining commence?

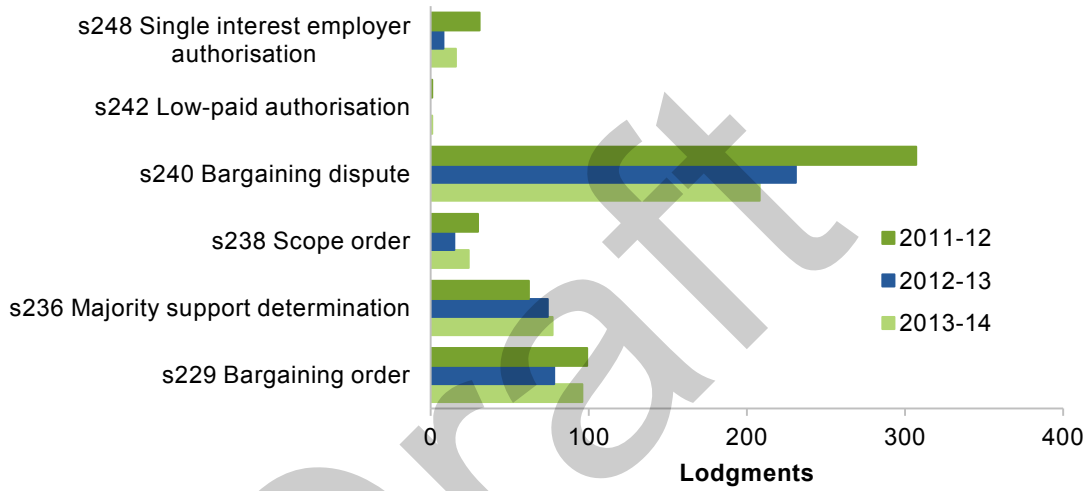
Bargaining for an EA begins when:

- the employer agrees to bargain or initiates bargaining (which happens in most cases); or

- the employer is compelled to bargain because the FWC makes a majority support determination (s. 236), a scope order (s. 238) or a low-paid authorisation (s. 242).

Around 70 applications for a majority support determination were lodged with the FWC each year, for the past three years (figure 15.2). Majority support determinations are proving to be a highly effective mechanism for unions to overcome employer resistance to collective bargaining (Forsyth et al. 2010, p. 133).

Figure 15.2 **Bargaining applications with the FWC**



Source: Fair Work Commission (2014b, p. 59).

Scope orders allow the FWC to arbitrate the scope of a proposed agreement, and are only available in relation to single-enterprise agreements. Twenty-four scope order applications were made in 2013-14, up from 15 in the previous year (figure 15.2). An employee or employer bargaining representative may apply for a scope order if he or she is concerned that bargaining is not proceeding efficiently or fairly because the agreement will not cover appropriate employees, or that it will cover inappropriate employees.

A bargaining representative or relevant union can also apply to the FWC for a low paid authorisation. Low-paid authorisations provide entry into a special multi-employer bargaining stream for low-paid employees and their employer. These rules recognise that certain types of employees (for example, those employed in community services, cleaning, child care, security and aged care) have, for various reasons, not been able to participate in enterprise bargaining, and are therefore 'stuck' on minimum safety net wages (Forsyth et al. 2010, p. 137). These provisions have been widely identified as one of the most novel features of Australia's bargaining framework from an international perspective (Forsyth et al. 2012, p. viii).

Since the provisions commenced on 1 July 2009, there have been five applications for a low-paid authorisation. An authorisation was made in response to two of the applications, two were dismissed, and one was withdrawn:

- The first applications were made by United Voice and the Australian Workers Union and covered employers and employees in the aged care industry. An authorization was granted by a Full Bench of the then Fair Work Australia in 2011.[174]
- In 2013, the Australian Nursing Federation's bid for an authorisation for nurses employed in private sector medical practices was refused. The authorisation was refused on a number of grounds, including: that most practice nurses do not fall within the definition of 'low-paid' employees; that the union had not sought to advance the interests of its members through other avenues available under the FW Act such as enterprise-based negotiations; and that multi-employer bargaining was likely to be cumbersome and less appropriate than enterprise bargaining.[175]
- In September 2014, the FWC refused United Voice's application for an authorisation to cover five private sector security companies in the ACT. This application was rejected on the grounds that efforts had not been made to bargain with the relevant employers, and it had not been demonstrated by the union that the employees did not have access to collective bargaining or faced substantial difficulty bargaining at an enterprise level.[176]

Employees must be informed of their right to appoint a representative

Once an employer initiates bargaining or agrees to bargain (or a scope order, majority support determination or low paid authorisation comes into operation), they must notify each employee of his or her bargaining rights via a notice of employee representational rights (NERR) as soon as practicable, and no later than 14 days (s. 173). The content of the NERR is prescribed by regulation (s. 174), and includes information on the employee's right to appoint a bargaining representative. The FWC's website includes a step-by-step guide for employers on how when and how to complete the notice (FWC 2015g).

Employees can represent themselves, or appoint a representative. Union members are represented by their union by default, but may choose to appoint another person (s. 176). A union needs only one employee to be a member to become a bargaining representative. Unions are among several potential bargaining representatives; from 1993 onwards, collective bargaining without union representation has been recognised.

Employers can also appoint another person to bargain for them, such as an employer association. However, the employer always remains a bargaining representative (s. 176).

174 *United Voice v The Australian Workers' Union of Employees, Queensland* [2011] FWAFB 2633.

175 *Australian Nursing Federation v IPN Medical Centres Pty Limited and Others* [2013] FWC 511.

176 *United Voice* [2014] FWC 6441 [29 September 2014].

An employee bargaining representative can request a copy of the instrument of appointment (s. 178).

Parties must bargain in good faith

Under the FW Act, employers, employees and their representatives are required to bargain in 'good faith'. If negotiations break down or become deadlocked, the FWC has only limited powers to assist parties through the bargaining process. It can issue bargaining orders (s. 229) and, when requested by the parties, mediate, conciliate or arbitrate disputes about the making of the agreement (s. 240).

The FW Act prescribes six good faith bargaining requirements, including attending and participating in meetings, disclosing relevant information and giving genuine consideration to proposals made by other bargaining representatives (box 15.1). The requirements do not apply to bargaining representatives for greenfields agreements, or multi-enterprise agreements (unless there is a low-paid authorisation in place) (s. 229(2)). Further, they only apply during the process of bargaining for a new EA, not the process of varying or terminating an EA.

Box 15.1 The good faith bargaining requirements

A bargaining representative must meet the following good faith bargaining requirements:

- attending, and participating in meetings at reasonable times
- disclosing relevant information (other than confidential or commercially sensitive information) in a timely manner
- responding to proposals made by other bargaining representatives for the agreement in a timely manner
- giving genuine consideration to the proposals of other bargaining representatives for the agreement, and giving reasons for the bargaining representative's responses to proposals
- refraining from capricious or unfair conduct that undermines freedom of association or collective bargaining
- recognising and bargaining with the other bargaining representatives for the agreement.

The good faith bargaining requirements do not require a bargaining representative to make concessions during bargaining for the agreement, or to reach agreement on the terms that are to be included in the agreement.

Source: Section 228 of the *Fair Work Act 2009* (Cth).

The requirements are *procedural only*. Parties are not required to make concessions or forcibly sign up to an agreement.

The good faith requirements begin to apply when employers and employees mutually agree to bargain for a new agreement, or where the FWC makes an order requiring parties to bargain, via a majority support determination, scope order or low paid authorisation.

Majority support determinations are the most widely used of the three gateways to bring reluctant parties to the bargaining table. They allow a majority of employees to compel an employer to commence bargaining, and have demonstrably encouraged collective bargaining (McCallum, Moore and Edwards 2012). The FWC may determine whether a majority of employees want to bargain using any method it considers appropriate. Where an employer continues to refuse to collectively bargain following a majority support determination, the employee bargaining representatives would need to apply for a bargaining order based on breaches of the good faith bargaining requirements (Forsyth et al. 2010).

A breach of the requirements is not a contravention of the FW Act. A representative can seek a 'bargaining order' (s. 229) from the FWC if they have concerns that good faith bargaining requirements are not being met. The FWC made around 100 bargaining orders in 2013-14 (figure 15.2). Such orders commonly involve some form of direction as to the conduct of the negotiating process, usually designed to facilitate the parties' resumption of bargaining activities such as attending meetings, setting a timetable for negotiations, or disclosing specific information (Rinaldi, Lambropoulos and Millar 2014). The FWC is not empowered to make an order that has the effect of requiring particular content to be included or not included in a proposed EA (s. 255(1)(a)). In a number of decisions, the FWC has established that 'hard bargaining', or holding resolutely to a position in negotiations, is permissible; a natural consequence of s. 228(2) (Forsyth et al. 2010).

Examples of the kinds of bargaining orders that the FWC may make include (s. 231(2)):

- an order requiring the bargaining representatives to attend meetings on specified dates to discuss the proposed EA
- an order excluding a bargaining representative from bargaining, or requiring some or all representatives to meet and appoint one representative
- an order than an employer not terminate the employment of an employee or, if already terminated, an order reinstating the employee
- an order delaying the conduct of a ballot on a proposed agreement (Forsyth et al. 2010, pp. 127–8).

Failure to comply with orders can lead to penalties[177] and, potentially (as a last resort), FWC arbitration where repeated breaches occur.

[177] Failure to comply with a bargaining order is a breach of a civil penalty provision (s. 233 FW Act). An individual bargaining rep who fails to comply with a bargaining order may be ordered to pay a penalty of up to $6,000 following civil remedy proceedings in the Federal Court or the Federal Circuit Court (s. 539). A body corporate that fails to comply may be ordered to pay a penalty of up to $33,000 (s. 546). Injunctions may also be obtained to enforce bargaining orders (Forsyth et al. 2010, p. 128).

There are limits on when an application for a bargaining order can be made. If parties are already covered by an existing agreement, an application for a bargaining order may not be made until 90 days or fewer before the existing agreement reaches the nominal expiry date, or the employer requests employees to approve a proposed agreement (whichever comes first): s. 229(3)(a). If parties are not covered by an existing agreement, an application can be made at any time (s. 229(3)(b)).

The FWC may deal with bargaining disputes, on request

Section 240 of the FW Act allows a bargaining representative to seek assistance from the FWC in relation to a dispute about the making of an EA. For single-enterprise agreements or multi-enterprise agreements in the low-paid authorisation stream, a bargaining representative can apply to the FWC, independently of the other representatives. For other multi-enterprise agreements, the application must be made jointly by all bargaining representatives.

Regardless of whether the application is made jointly or by a single bargaining representative, the FWC may only arbitrate (i.e. determine) the dispute if all bargaining representatives agree. For example, the bargaining representatives may agree to empower the FWC to arbitrate a particular term of a proposed EA that has been an insurmountable obstacle to resolving the process where all other matters have been agreed. But absent such agreement, the FWC may only deal with the dispute via mediation or conciliation, and may issue a recommendation or express an opinion as to the appropriate resolution of the matter, but not resolve it (Rinaldi, Lambropoulos and Millar 2014).

Employees approve an agreement by voting for it

An EA cannot be approved by the FWC unless employees have approved the agreement. An employer may request employees to be covered by an agreement approve the agreement by voting for it. The request to vote must be made at least 21 days after the NERR was given (s. 181). During the seven days prior to the start of the voting process, employees must be given a copy of the proposed agreement, and the employer must take reasonable steps to notify employees of how and when voting will occur, and explain the agreement (s. 180).

Final step — obtaining FWC approval

Once an EA has been made, a bargaining representative must apply to the FWC for approval of the agreement (s. 185). Before approving, the FWC must be satisfied of various things for different agreements (figure 15.3), including that the agreement has been made with the genuine agreement of those involved, passes the BOOT, and meets various requirements regarding content and procedure.

Figure 15.3 **Requirements for FWC approval**

Requirement for approval	*FW Act section*
For ALL enterprise agreements, the FWC must be satisfied that:	
The agreement has been genuinely agreed to by the employees covered by the agreement (this does not apply to a greenfields agreement)	186(2)(a)
The group of employees covered by the agreement was fairly chosen	186(3)
The agreement passes the 'better off overall test'	186(2)(d)
The agreement specifies a nominal expiry date	186(5)
The agreement includes a dispute settlement term	186(6)
The agreement does not include any unlawful terms	186(4)
The agreement does not include any designated outworker terms	186(4A)
The enterprise agreement meets the requirements with respect to particular kinds of employees (shiftworkers, pieceworkers, school-based apprentices and school-based trainees and outworkers)	187(4)
Where a scope order is in operation, that approval of the agreement is not inconsistent with good faith bargaining	187(2)
Additional requirements for multi-enterprise agreements:	
The agreement has been genuinely agreed to by each employer covered by the agreement, and that no person coerced, or threatened to coerce, any of the employers to make the agreement	186(2)(b)
If the agreement was *not* approved by the employees of *all* of the employers proposed to be covered — then the agreement has been varied so that it only covers those employers whose employees approved the agreement	187(3)
Additional requirements for greenfields agreements:	
The relevant unions that will be covered by the agreement are (taken as a group) entitled to represent the industrial interests of a majority of the employees who will be covered by the agreement, in relation to work to be performed under the agreement	187(5)(a)
It is in the public interest to approve the agreement	187(5)(b)

Source: Fair Work Commission (2015c, pp. 112–3).

Rules around the content of agreements

The FW Act requires that EAs only contain 'permitted matters' that relate to the employee-employer relationship or the union-employer relationship (s. 172(1)). While the FW Act is specific on some permitted matters, such as terms that deal with the way in which an agreement will operate, and employee-authorised deductions from wages, it is largely silent on the large set of matters that might be considered as part of the employee-employer or union-employer relationship, leaving the detail to case law.

While the FWC scrutinises EAs for unlawful terms, it does not check whether agreements only contain permitted matters. This is not a problem because an approved agreement is still valid even if it includes terms that are not permitted matters. The offending terms though will have no effect (s. 253).

The following terms *cannot* be included in EAs:

- unlawful terms (s. 194), which relate to issues such as discrimination, the ability to 'opt out' of an agreement, requirements to pay bargaining service fees, terms that breach the FW Act's general protections provisions, attempts to modify rights to unfair dismissal protection or protected industrial action, and terms that provide an entitlement to right of entry that are inconsistent with the FW Act's right of entry provisions.
- designated outworker terms (that is, terms that relate to outworkers in the textile, clothing or footwear industries), as the relevant terms in a modern award continue to apply.

A consultation term and a flexibility term *must* be included in EAs. If no such term is included, the model consultation term and model flexibility term are taken to be terms of the agreement (s. 201).

- A consultation term requires the employer to consult with their employees about major workplace change that is likely to have a significant effect on employees, and allows for representation of employees for consultation purposes.
- A flexibility term must enable an employer and employee to make an IFA that varies the effect of the EA, in order to meet the genuine needs of the employee. While such a term must be included, parties are able to bargain over the content of the term and, thereby, the scope to vary the EA via use of an IFA.

Enterprise agreements need to make employees 'better off overall'

An EA needs to make employees 'better off overall' than if the relevant modern award applied to the employee. The better off overall test or BOOT (s. 193) is the mechanism for assessing this (box 15.2). It replaces various formulations of the no-disadvantage test that applied under previous federal enterprise bargaining laws.

For approval of an EA, the BOOT only requires comparison against the modern award, not any previous or existing agreement, meaning that employees might conceivably receive lower rates of pay than under a previous agreement (although in normal circumstances this is unlikely). In principle, it is a global test; not every provision needs to be an improvement, provided that the advantages outweigh the disadvantages. It is not a collective test, as each employee (or prospective employee[178]) under the agreement must be better off — though the FWC can assume (in the absence of contrary evidence) that an employee is better off if the class of employees they belong to is better off. So while there is scope in an EA to trade off particular benefits of a modern award against other benefits that are valued more highly by employees, this requires that all classes of employees covered by the agreement are better off overall.

[178] For greenfields agreements, the BOOT applies to prospective award covered employees.

The FWC makes the final determination and must be satisfied that the agreement meets the BOOT before it will approve an agreement. There are exceptional circumstances when, on public interest grounds, the FWC may approve an agreement that does not pass the test; for example, for a business experiencing a short term crisis (s. 189).

Box 15.2 The better off overall test

An enterprise agreement passes the BOOT if the FWC is satisfied that each employee (and prospective employee) for the agreement would be better off overall under the agreement than the relevant modern award that would apply to the employee. The comparison is made between the agreement and the award at the time of the application for approval.

Flexibility terms in modern awards and EAs must contain a requirement that the employer ensure that an IFA must result in the relevant employee being better off overall than if no IFA were agreed to.

Overall, the relevant benchmarks for the BOOT can be summarised as follows:

- an EA must make the employees better off than if the relevant award applied (s. 193)
- an IFA made under an EA must make the employee better off than the EA (s. 203(4))
- an IFA varying an award must make the employee better off than if no IFA were agreed to (s. 144(4)(c)).

Source: *Fair Work Act 2009* (Cth).

Unions may choose to be covered

A union can apply to be covered by a proposed EA, provided it was a bargaining representative and it applies before the FWC approves the agreement (s. 183). The legal consequences of a union being covered are limited to ensuring that agreement content under s. 172(1)(b) is permitted; providing rights to terminate the agreement; and prohibiting organising and engaging in industrial action until 30 days before the nominal expiry date of the agreement (McCallum, Moore and Edwards 2012, p. 154).

Between 70 and 80 per cent of all EAs lodged with the FWC each quarter for approval, cover a union (DoE 2015, p. 32).

Moreover, unions can (and do) intervene, to be added as a party to an agreement, even if they have not participated in the negotiation process. This may have a benefit for the employer (limitation on future industrial action); but can also have costs (it may encourage demarcation disputes with an incumbent union; it may even see the agreement re-opened).

Once an enterprise agreement is in place

Individual flexibility arrangements (IFAs) can be made

IFAs are the vehicle through which individual employees and employers can vary an EA to suit their circumstances. For example, IFAs can be made in relation to working hours and family-friendly work practices (Australian Government 2008, para. 860). As discussed above, all EAs must contain a flexibility term that gives employees and employers the capacity to make IFAs that vary the effect of the EA. However, the content of the term is a matter for negotiation between parties.

An IFA has effect in the same way as if it were a term of an agreement (and is therefore enforceable in the same way), and the agreement operates as if it were varied by the IFA, but only in relation to the employee and employer that have made the IFA (s. 202) (Creighton and Stewart 2010, p. 313).

IFAs need to make employees better off overall than if there was no IFA. That is, the EA provides the relevant benchmark for assessing whether the employee is better off overall. IFAs must satisfy a number of other requirements (s. 203), including that it is genuinely agree, and that either the employer or employer can terminate the IFA with 28 days' notice. IFAs can only be formed after the relevant employee has commenced employment; they cannot be formed as a condition of employment. Further, existing employees cannot be required to sign an IFA to continue employment.

The use of IFAs is further examined in chapter 16, which focuses on individual arrangements.

How to enforce the agreement and resolve disputes over terms and conditions

The various WR institutions (chapter 3) have different roles to play in enforcing EAs and resolving disputes over terms and conditions in EAs.

The first place to look is the dispute resolution procedure in the applicable EA. The FWC can deal with disputes about EAs where the EA's dispute resolution clause allows. EAs must include a procedure allowing an independent person to settle the dispute, which may or may not be the FWC. The FWC can only deal with disputes if an application has been made by the parties to the dispute. Where a provision in an EA refers a dispute to the FWC:

- depending on the terms of the clause, the FWC may settle a dispute via mediation, conciliation, or by making a recommendation or expressing an opinion, except in the circumstances where the parties have agreed to limit the powers of the FWC
- the FWC may, where agreed by the parties, deal with the matter by arbitration and make a binding decision about the dispute (FWO 2010). While an order made by the FWC is legally binding, only courts have powers to enforce FWC orders.

Parties can, with permission, appeal a FWC decision to the Full Bench of the FWC.

The Fair Work Ombudsman can assist parties by providing advice, offering dispute resolution processes, and sometimes litigating on a person's behalf in the courts.[179] The Fair Work Ombudsman's functions include promoting and monitoring compliance with the FW Act (s. 682). It can investigate disputes related to breaches of a Fair Work instrument, such as an EA. Fair Work inspector have compliance powers, including the power to enter premises and require a person to produce documents. The Fair Work Ombudsman can accept enforceable undertakings and can issue compliance notices.

Ability to vary or terminate an enterprise agreement

EAs can be varied through a similar process to that involved in making agreements (Division 7 of Part 2-4 FW Act). A variation is made if it is approved by a majority of affected employees who have cast a valid vote. While many agreements include a 'no extra claims' provision that attempts to constrain changes to the EA during its life, the recent *Toyota* decision (see box 15.3) has confirmed that such provisions cannot prevent proposed variations to EAs that would otherwise be allowed by the FW Act (Ellery, Creighton and Levy 2014).

[179] The overwhelming bulk of the Fair Work Ombudsman's litigation relates to underpayment (around 80 per cent of litigation cases in 2013-14). Most are in relation to awards, not enterprise agreements. Other litigation matters have included adverse action, sham contracting, failure to comply, and discrimination, and unlawful conduct in relation to individual agreement making. In other words, the Fair Work Ombudsman's litigation is entirely aimed at remedies for (and deterrence of) clear breaches of the FW Act and primarily does not relate to enterprise agreements.

Box 15.3 The *Toyota* decision

In late 2013, in the context of uncertainty about the car industry's future, Toyota contacted its employees requesting a number of variations to its existing enterprise agreement, which was due to expire in 2015. The company argued that to deliver scheduled pay increases, some 'outdated and uncompetitive terms and conditions' would have to be removed from the enterprise agreement. The 29 proposed changes included:

- removal of a 4-hour paid leave allowance for blood donations
- a requirement that employees be available to work at least of 20 hours overtime each month
- removal of shift premiums for employees taking long service leave
- reductions in Sunday penalty rates from double and a half to double.

The proposed variations were challenged in the Federal Court by a number of employees, who argued that the requested changes were in breach of the enterprise agreement's 'no extra claims' clause, which stipulated that the parties:

> 'will not prior to the end of this agreement: make any further claims in relation to wages or any other terms and conditions of employment; and take any steps to terminate or replace this agreement without the consent of the other parties'.

In response, Toyota put forth a number of arguments in defense of the variations, including that the employees' interpretation of the clause was inconsistent with part 2-4, division 7 of the Fair Work Act, which expressly allows employers to request their employees to approve a proposed variation to an enterprise agreement.

Justice Bromberg found that the proposed changes contravened Clause 4 of the agreement, and ordered that Toyota refrain from organising or facilitating a vote to approve the proposed variations to the enterprise agreement. Justice Bromberg concluded that because the 'no extra claims' clause itself could first be removed from the agreement, it was not inconsistent with part 2-4, division 7 of the Act.

This decision was overturned on appeal by Toyota to the Full Court of the Federal Court. The Full Court concluded that the proposed changes to the agreement were 'extra claims', and that the 'no extra claims' clause was inconsistent with the Fair Work Act regardless of whether it could be removed or varied itself. However, the Full Court also agreed with Justice Bromberg that the 'no extra claims' clause pertained to the relationship between employer and employees, thus making it a permitted matter. However, it has no material effect.

Sources: Ellery, Creighton and Levy (2014); Johnston and Wellington (2014); Wood, Mason and Eglezos (2014); *Toyota Motor Corporation Australia Ltd v Marmara* [2014] FCAFC 84.

15.3 Patterns in the use of enterprise agreements

Evidence on the prevalence of EAs and their effects varies because of different survey respondents (employers versus employees), different sampling frames, diverging definitions, missing data (for example, coverage of national system employees rather than all employees) and sampling errors. The results are covered in detail in appendix E. Nevertheless, some clear patterns are apparent:

- Around 40 per cent of employees are on an EA

- Few enterprises use EAs, reflecting the large number of very small employing businesses,[180] which do not tend to form EAs. The share of employees on EAs is around 80 per cent for the largest enterprises (employing 1000 or more people) and under 5 per cent for enterprises employing less than 20 employees
- EAs are least common for technicians and trade workers and managers, but otherwise fairly similar for other occupational groups
- EAs are highly prevalent for employees of public sector service agencies providing education, health and administrative services, and for utilities (with roughly 60 per cent or more of employees on EAs in these industries). EAs have low prevalence for employees (below 15 per cent) in professional services, real estate, administrative and support services and wholesale trade.
- Around 70 per cent of national system EAs cover unions, but this does not necessarily mean the union is prominent as the negotiating party
- The number of EAs has generally increased over time and at a faster rate than numbers of employing businesses, suggesting that the prevalence of EA has risen.
- Wage increases in EAs have considerably outpaced awards (but so too have individual arrangements), suggesting the role of awards as a safety net. Areas where unions have higher bargaining power — such as greenfields agreements (a form of EA) — tend to have produced higher wage outcomes.
- The content of EAs demonstrates significant flexibility in wages and other conditions, with above and below award arrangements relatively frequent. The latter is feasible because of flexibility arrangements that allow tradeoffs between different aspects of an agreement (or award), if the new outcome passes the BOOT.

Why do parties use (or not use) enterprise agreements?

Businesses indicate that they use EAs:

- to respond to demands from employees or employee representative bodies (22 per cent)
- reward employees with higher wages than the applicable award rate (21 per cent)
- to address the fact that award terms and conditions were not suitable or flexible enough for the enterprise (20 per cent)

[180] Of the roughly 825 000 employing businesses in June 2014, there were around 570 000 businesses employing 1-4 businesses, and a further 200 000 businesses employing 5-19 employees. Accordingly, those remaining businesses most likely to have EAs represent a small share of employing businesses, with businesses employing 20-199 employees representing 6.3 per cent and those employing 200+ representing only 0.4 per cent (ABS 2015, *Counts of Australian Businesses, Including Entries and Exits, Australia*, Cat. No. 8165, released 2 March 2015).

- to reduce complexity from otherwise having to use multiple awards (17 per cent) (FWC 2015d, pp. 23–24).[181]

Businesses without agreements identified several reasons for not using them, but mainly because they saw advantages in other employment arrangements, not because of negative features of EAs. For example, of those enterprises that only used awards to set pay for their employees, almost half indicated that they did not have an EA because award rates and conditions were adequate. Similarly, many of those enterprises only using individual arrangements (not at the award rate) did not use EAs because of a preference to negotiate with employees individually rather than collectively.

15.4 Adequacy of current arrangements and possible reforms

While enterprise bargaining successfully allows some employers and employees to craft flexible arrangements that suit the circumstances of the particular enterprises, several features have made the arrangements more rigid and costly than necessary.

Make procedure a servant, not the king

The commencement of bargaining occurs when the employer issues the NERR, which, ultimately leads to lodgment of an EA with the FWC, and assuming that it passes the various legal requirements, its approval.

The FWC is meeting its own performance benchmarks for processing times. Its benchmark is that, from the date of lodgment: 50 per cent of all s. 185 applications are to be finalised within three weeks; 90 per cent within eight weeks; and 100 per cent within 12 weeks. In 2013-14, the FWC met its benchmark: 59 per cent of agreements were finalised within three weeks; 93 per cent within eight weeks, and 98 per cent within 12 weeks (FWC 2014b, p. 32).

While the FWC approves agreements relatively efficiently, the whole bargaining process from start to finish can be protracted. Data from the Department of Employment provided to the Productivity Commission suggest that, where the old agreement has a direct relationship with the new one, it takes an average of 151 days (including approval processing time) to replace the EA under the FW Act.

As noted by various participants, sometimes undue emphasis is placed on procedural requirements when agreements are submitted for approval (VECCI, sub. 79; Catholic

[181] Totals do not add to 100 per cent as multiple responses were permitted. Base = 774 enterprises. Enterprises that did not know whether there was an enterprise agreement in place are excluded from the analysis.

Commission for Employment Relations, sub. 99; Minerals Council of Australia, sub. 129; Peabody Energy, sub. 241; Ports Australia, sub. 249).

The infamous 'staple case'[182] illustrates the rule of form over substance, where a bargaining representative nomination form that was stapled to the NERR tainted the entire bargaining process, requiring the employer to begin the agreement-making process again (Caspersz 2014).

While there are often good reasons for imposing procedural requirements (for example, to prevent employers including extraneous and potentially misleading information in a NERR), substance rather than form should prevail, which is a recurring theme in this report. Where the FWC rejects an EA on procedural grounds, it can trigger a fresh round of complex negotiations — a costly process. As noted by the Minerals Council of Australia:

> Procedural 'trip wires' can add considerable costs and delays to the enterprise bargaining process. Employers can successfully negotiate an enterprise agreement directly with employees (with majority or even unanimous support) only to have a third party stymie the approval process by alleging procedural non-compliance on a technicality. (sub. 129, p. 30)

There are other strong grounds for avoiding standards that place technical purity above fundamental soundness in EAs:

- Once expired, EAs do not provide for further wage increases, with possible adverse financial consequences for employees if delays continue. They would also delay any new benefits for employees that might have been a feature of the EA.
- Procedural issues when negotiating a greenfields agreement can delay the commencement of new projects.
- Even where an agreement is not a greenfields agreement, businesses want some certainty when making large investments, innovating and introducing efficiency-improving measures. Delays in EAs leave them susceptible to several risks. Decisions about capital, in part, depend on the cost of competing inputs, of which labour is one. Equally, uncertainty about future labour costs, and therefore overall costs, can affect a business's capacity to self-finance investments or may raise the cost of capital when seeking external finance.
- Moreover, to the extent that any business strategy (investment, entry into new markets, new product lines or restructuring) is contingent on striking an agreement, the consumer benefits of that strategy are also delayed, costing not just the participants in the negotiation but also third parties.
- If a pattern of delay emerges, then over time businesses will have incentives to keep these separate from EA negotiations. This in turn limits scope for a harmonious workplace and delays the economic benefits of the new business strategy.

182 *Peabody Moorvale Pty Ltd v Construction, Forestry, Mining and Energy Union* [2014] FWCFB 2042 [2 April 2014].

There is no acceptable rationale for delays that are the result of inefficient extraneous technicalities in the law.

The FWC can approve agreements with defects under s. 190

Under s. 190 of the FW Act, the FWC has the power to approve an agreement that it is concerned does not meet the requirements set out in s. 186 and s. 187 (such as being genuinely agreed to by employees, passing the BOOT, no unlawful terms etc.) if the employer agrees to undertakings that will meet the FWC's concerns. Any such undertakings must not be likely to cause financial detriment to any employee or result in substantial changes to the agreement.

Stakeholder views on the current efficacy of s. 190 are mixed. Some employer groups expressed concern about how undertakings during the approval process are applied by the FWC. For example, the Australian Mines and Metals Association (AMMA) argued that the use of undertakings under s. 190:

> … often involves FWC members making subjective assessments about what can and cannot be included, requiring employers to enter into undertakings that may not necessarily be required under the FW Act in order to get an agreement approved and that may not be required by other FWC members. (sub. 96, p. 143)

Similarly, in its submission the Victorian Employers' Chamber of Commerce and Industry (VECCI) argued:

> This step essentially requires the employer to commit to additional benefits/practices it will provide employees (in addition to the benefits/practices already agreed to throughout the negotiation) so as to satisfy the FWC Member concerned. (sub. 79, pp. 51–52)

By contrast, the Australian Council of Trade Unions (ACTU) argued that undertakings under s. 190 usually resolve issues with the BOOT efficiently (sub. 167).

The concerns expressed by some employers about the way the FWC exercises its discretion with respect to undertakings may be assuaged to some extent by improvements to the FWC's governance arrangements, as recommended in chapter 3. The existing limitation that undertakings must not result in substantial changes to the agreement should also continue to limit any potential misuse of undertakings by FWC members. Further, some degree of uncertainty with respect to how the FWC exercises its discretion may also be beneficial, by helping to discourage employers from deliberately shirking procedural requirements. If an employer is concerned about potential undertakings imposed by the FWC, they will have an incentive to ensure that they have met all the necessary requirements for approval of their agreement.

The Productivity Commission thinks the agreement approval rules in Division 4 of Part 2-4 of the FW Act should be improved, so that unmet procedural requirements do not require undertakings or prevent the FWC from approving the EA.

Allowing an agreement to be approved without undertakings

In its current form, Division 4 of Part 2-4 only allows the FWC to approve an EA if it meets all the requirements in ss. 186 and 187, and in other limited circumstances (where approval of the EA would not be contrary to the public interest and where the employer agrees to undertakings). Undertakings are used when the FWC member is concern the proposed agreement doesn't meet the requirements in ss. 186 and 187. In some instances though, the member's concern cannot be addressed by an undertaking and the member is left with no choice but to reject the application for approval. This is so even in circumstances where the unmet requirement has not materially affected bargaining or the proposed EA.

In cases where an undertaking is not feasible or would cause undue inconvenience, the FWC should have the discretion to determine that the procedural defect is not material and does not require an undertaking to remedy it. The key test for exercising discretion should be that the FWC is satisfied that employees were not likely to have been placed at a disadvantage during bargaining or the pre-approval process because of the unmet requirement. The FWC should also have regard to the likely costs to the parties — including the employees — associated with further delaying approval of the agreement. To help maintain transparency for all parties, the FWC could develop and publish guidelines about how members should exercise their discretion. The goal of this proposed change is to resolve procedural inflexibilities and prevent minor errors or defects in the bargaining process derailing an otherwise fundamentally sound agreement at the approval stage.

For example, s. 181(2) requires that an employer not request its employees approve an EA until at least 21 days after the last NERR is issued. Satisfying s. 181(2) is a precondition for establishing that an EA was genuinely agreed to by employees, which is a requirement for an agreement to be approved. The FWC has previously rejected applications for agreement approval on the grounds that the agreement was voted on by employees before this 21 day period was reached.[183] While s. 190 would notionally permit an undertaking to address this concern, it seems unlikely (in the absence of time travel) that an undertaking to meet this requirement would be feasible.

Allowing the FWC the discretion to overlook a procedural defect without an undertaking should not be seen as an avenue to allow some employers to skirt procedural requirements in order to gain an edge during bargaining. Employers generally do not have an incentive to expose themselves to the FWC over procedural issues. It is also unlikely that a deliberate procedural error by an employer would both lead to a meaningful advantage in bargaining and yet also escape the scrutiny of the FWC.

183 Eg. *Lincoln Sentry Group Pty Ltd Prestons Warehouse Enterprise Agreement 2010* [2010] FWA 6765.

Deficiencies in notices of employee representational rights

Some participants have raised concerns specifically with the overly prescriptive treatment of deficiencies in a NERR (Catholic Commission for Employment Relations, sub. 99). This is not isolated to the 'staple case' — in another, a NERR was deemed invalid because it contained an omission reading '[Name of employer]', notwithstanding that the letterhead on the notice contained the employer's name.[184] A FWC decision invalidating a NERR can particularly delay an agreement because the parties must wait at least 21 days after issuing a new NERR before the agreement can be approved.

One option (suggested by the Catholic Commission for Employment Relations, sub. 99, pp. 19–20 and Qantas, sub. 116, pp. 5–6) is that the FWC should have the legal discretion to decide whether deficiencies in the notice should prevent the agreement from being approved, rather than simply invalidating the notice and forcing bargaining to start over. Indeed, in the case outlined above, the FWC member noted:

> If it seemed the Act allowed discretion in relation to the matter, I would exercise it; that is, the departure in the content of the notices of representational rights from the prescribed form might be considered to be something akin to a misnomer of no real consequence, rather than anything that, in a practical sense, alters the advice to employees of their rights in such respects.

In assessing whether the departure was 'something akin to a misnomer of no real consequence' the FWC should take into account the views of the employer, bargaining representatives, the employees to be covered by the agreement, and any evidence on whether the deficiency in the NERR had disadvantaged an employee who would be covered by the agreement (for example, by being confusing, misleading or intimidatory to the extent that it affected an employee's nomination of a representative).

Some unions suggested that the policy intention of the NERR is not being met because some members fail to inform their union that bargaining is about to commence. The 2012 review of the FW Act (McCallum, Moore and Edwards 2012, p. 145) recommended that a NERR be lodged with the FWC and made available on its website. While it would be consistent with attempting to maintain a less adversarial workplace, such behaviour is best sought cooperatively rather than via legal obligation. Moreover, a union with active representation at a workplace is sure to be informed by its members, if not by the employer. Employers also have little incentive not to inform an active union, as the addition of a union representative at a later stage in negotiations, participants in this inquiry have noted, can be problematic.

184 *Catholic Commission for Employment Relations through Executive Director Anthony Farley* [2013] FWC 8686.

DRAFT RECOMMENDATION 15.1

The Australian Government should amend Division 4 of Part 2-4 of the *Fair Work Act 2009* (Cth) to:

- allow the Fair Work Commission wider discretion to approve an agreement without amendment or undertakings as long as it is satisfied that the employees were not likely to have been placed at a disadvantage because of the unmet requirement.
- extend the scope of this discretion to include any unmet requirements or defects relating to the issuing or content of a notice of employee representational rights.

Majority support determinations

Currently, the FWC has the discretion to decide the method for determining whether a majority of employees want to bargain (s. 237). This can include a range of methods, such as a secret ballot, a survey of employees, written statements or a petition. A number of participants have expressed dissatisfaction with this approach, arguing that a secret ballot be specified as the sole basis for establishing majority support for bargaining to commence.[185]

It may be that this would be a reasonable approach in some cases, but it is not likely to be required in all. As noted previously, rigidly prescribed approaches have the potential to lead to unnecessary disputes over process. Indeed, in its submission the Australian Institute of Employment Rights argued:

> … the flexibility given to [FWA] under the legislation to determine the question of majority support where this [is] in dispute is … an appropriate way of avoiding the potential for complex litigation in this area. (sub. 140, p. 31)

The Productivity Commission is unconvinced that tying the hands of the FWC would necessarily achieve many gains, unless there was evidence that it was applying its current discretion capriciously in this area. While one employer provided anecdotal evidence of a secret ballot showing a different result to a union petition (Glencore, sub. 185), no such systematic evidence is apparent at this stage of the inquiry. In any case, the Productivity Commission's recommendations about the FWC's governance arrangements should ease concerns about how the FWC exercises its discretion (chapter 3).

[185] This approach was recommended by the Business Council of Australia (sub. 173), Bluescope Steel (sub. 58), VACC, MTA-NSW and MTA-SA (sub. 201), AMMA (sub. 96), Linney Strategies (sub. 113), Glencore (sub. 185) and Rio Tinto (sub. 122).

Does good faith bargaining work?

The intention of enterprise bargaining was for parties to negotiate in good faith, avoiding the requirement for arbitration (which is, in effect, a regulatory incursion) by a third party umpire — currently the FWC. The FW Act lists the types of behaviour that are 'good faith' for the purposes of bargaining, but by its nature, good faith in this context can be hard to codify. Bargaining is a game in which parties do not have entirely coincidental interests. Each wants a bigger slice of the cake. This can be achieved not only by making the whole cake bigger, but also by changing how it is cut. Consequently, tactical behaviour is to be expected. The key problem is to establish a set of rules that provide some bounds on strategic behaviour, while not overly encumbering the bargaining process.

> The 2012 review of the FW Act recommended relatively few changes, arguing that the measures were largely effective (McCallum, Moore and Edwards 2012), drawing on the evidence in submissions. In prescribing the bargaining model and the good faith bargaining obligations, the legislation avoids many of the pitfalls of similar legislation in international jurisdictions. One such pitfall is to be over-prescriptive, making it even more technically complex and thereby deterring employees from undertaking their own negotiations. For this reason the BCA does not support further prescription, but rather, clarification and streamlining. (BCA 2012, p. 35)

> The reach of the new good faith bargaining provisions are still being worked out through FWA and court decisions. The legitimacy of a range or practices — such as 'surface bargaining', using replacement labour during strikes, unilateral employer offers, and employer direct-dealing with staff (without the knowledge of their bargaining representatives) — are yet to be decided conclusively. (ACTU 2012c, p. 40)

Several peak union and employer groups continue to echo the view that not much is wrong. For example:

> … the good faith bargaining provisions in the Fair Work Act do not need to be supplemented by further prescriptive rules. The Group has some experience with bargaining in overseas jurisdictions. In particular, our experience of the more prescriptive good faith bargaining provisions under the otherwise simple and flexible New Zealand legislation has been that these provisions tend to lead to a focus on process at the expense of expedition and outcomes. The good faith bargaining obligations also, prior to the recent amendments to the New Zealand legislation, seriously inhibited an employer's ability to communicate directly with its employees. (Qantas, sub. 116, p. 5)

Others participants in this inquiry had a more jaundiced perspective. Some unions said that the FWC's narrow construction of good faith bargaining meant they were of limited effect, while some employers claimed that the FWC adopted an overly bureaucratic approach. Some argued that the notion of 'good faith bargaining' was difficult to define, a general proposition that is hard to disagree with, but does not lead to a solution. For example, while parties cannot 'surface bargain' (going through the motions and pretending to bargain in good faith by superficially meeting the requirements), they can 'hard bargain' by maintaining a certain position without ceding ground (box 15.4). But, as Smith (2009)

remarked 'enterprise bargaining was not meant to be easy'. The case law does seem to have successfully distinguished between hard and surface bargaining.

Some inquiry participants called for a greater role for the FWC to intervene in protracted bargaining stalemates. For example, the ACTU has suggested that the FWC should be empowered to take a more active role to facilitate agreement making in intractable disputes, by initiating a form of supervised negotiation process (sub. 167). Similarly, Bluescope Steel advocated that compulsory arbitration should be triggered where negotiations have been exhausted and the future commercial viability of the employer is threatened by an intractable dispute (sub. 58).

Box 15.4 'Surface bargaining', or just 'hard bargaining'?

In *Endeavour Coal Pty Ltd v Association of Professional Engineers, Scientists and Managers Australia* (2012) 217 IR 131, a Full Bench found that the employer had breached the obligations in s. 228 in significant ways. Even though the company had superficially complied with the formal requirements by participating in meetings and responding to proposals put by the union, it did not show a genuine effort to bargain, feeling no obligation to present proposals of its own. This conduct spanned a period of 12 months. The company said that it had never had a collective agreement in the workplace and it needed to be convinced otherwise. Significantly, the union had to apply for a majority support determination under s. 237 to enable bargaining to commence as the employer had no intention to start a collective bargaining process.

Whilst there is no requirement to make substantive concessions during negotiations, there still must be evidence of an attempt to reach agreement by giving genuine consideration to the proposals and giving genuine reasons for rejecting a proposal. The FWC found that the employer did not make these efforts.

This decision can be contrasted with *Construction, Forestry, Mining and Energy Union v Tahmoor Coal Pty Ltd* [2010] 195 IR 58, where the FWC found that the employer had not breached s. 228 as it was simply engaged in 'hard bargaining'.

Source: Rinaldi, Lambropoulos and Millar (2014, p. 311).

It might be tempting to institute legislated thresholds that would trigger arbitration (for example, a time limit on the bargaining period). Compulsory arbitration may indeed bring some protracted disputes to an end. However, in other cases, this can create an incentive for parties to hold out until a third party will intervene and arbitrate, instead of genuinely bargaining and trying to reach agreement. Policymakers should thus be wary when considering the introduction of legislated triggers for arbitration.

It is also hard to see how further codification would address the fundamental issue that an industrial umpire does not have access to the day-to-day information that would allow it to discern whether bargaining was in good faith or not. Purpose cannot reliably be inferred from effect. In any case, all parties recognise that some strategic game playing is legitimate, and that no code could realistically eliminate it.

There are also some natural breaks on such strategic game playing, primarily that both sides generally have incentives to agree, in order to lock in gains, and to avoid triggering disruptions. Employees want pay rises and employers want to lock in certainty, avoid the threat of industrial action, and achieve enterprise change. For most businesses, the relationship between employees and employers are long term ones, so bargaining is a repeated game. This also naturally limits strategies that overly disadvantage one side or the other in any single bargaining round. Most employment contracts are negotiated without fuss or bile — on average, agreements are approved less than 6 months after expiry (Department of Employment, sub. 158) — and it is good management practice to develop non-adversarial relationships within an enterprise. Finally, as noted above, the FWC already has powers to step in as a last resort when there are repeated breaches of bargaining orders.

Overall, at this stage the Productivity Commission does not accept that greater access to arbitration will lead to improved behaviour across the bargaining landscape. Occasional problems, while painful, do not necessarily require legislative solutions. For the moment, the case for returning to greater FWC control of the process seems weak.

Some participants have also called for the FWC to have greater powers to terminate bargaining and impose an arbitrated outcome where an intractable dispute has led to industrial action. This issue is addressed more specifically in chapter 19, which deals with industrial disputes.

There is one remaining potential peculiarity in the current bargaining process that does not involve the issue of forced arbitration as the remedy for delay. While failure to comply with orders can lead to penalties and potentially, as a last resort, FWC arbitration, negotiations in some relatively rare cases have extended for considerable periods. For example, bargaining (ultimately unsuccessful) for a new agreement has extended for more than five years in the case of Cochlear Limited (a manufacturer of an implantable hearing device) and its workforce (McCallum, Moore and Edwards 2012, p. 137). The delay was not a problem to the extent that it represented hard bargaining between the parties, and employees do not appear to have been disadvantaged, based on their decisions during the process (box 15.5).

Box 15.5 A long, long time

The circumstances of the protracted Cochlear bargaining process were that the employees of the business had made a majority support determination to commence bargaining for an EA. In addition to Cochlear and the union concerned (the AMWU), there were several other enterprise bargaining representatives. Once the majority support determination has been made, several processes are triggered under the Fair Work Act, and bargaining commences. It does not need to be fast, and the parties can bargain strenuously and are not obliged to reach agreement. In principle, Cochlear's employees could have taken industrial action to accelerate the proceedings, but there was little appetite by employees to do this. Cochlear provided pay increases during the bargaining process, so there were few incentives to take such action.

The FWC found that the difficult relationship between the negotiating parties and their respective stances on bargaining contributed to the 'extraordinary length and complications of the bargaining'. In general, the FWC considered that the fact that Cochlear had 'fought hard' and had taken advantage of 'every procedural point' in bargaining was a reflection of the adversarial nature of the relationship, and not itself a breach of good faith bargaining. There was only one substantive matter that led the FWC to conclude that Cochlear had breached the good faith bargaining requirements of the Fair Work Act, and that related to a tardy response to a proposal for an agreement put by the union.

Notwithstanding the single instance of a failure to meet good faith bargaining requirements, the main lesson from the Cochlear case is that, as in commercial bargaining, the parties are not obliged to reach agreement. An EA achieved via bargaining is not the sole solution to the employer-employee relationship, and alternative employment agreements were ultimately used.

Source: *AMWU v Cochlear Limited* [2012] FWA 5374.

However, the case raises the question of whether it should be possible for employees to retract a majority support determination if the majority of them wish to do so. This would allow parties to consider other bargaining options without the risks to the enterprise of industrial action and the costly theatre of a bargaining process that is going nowhere, and where neither an EA nor arbitration is the desired end.

Instances of such protracted delays are not common, and intervention by the FWC to force a vote to assess whether employees stand by their majority support determination could be open to strategic game playing by an employer that would undermine enterprise bargaining. Nor would industrial action really be a genuine concern if the majority of employees (by now) were uninterested in bargaining. That leaves the costly theatre, again a regrettable but relatively rare event. Given the relative rarity, at this stage, the Productivity Commission is sceptical about the case for more FWC control. Bargaining should be about the two parties. Other options for agreement making are available to the parties (as indeed occurred recently with Cochlear) if bargaining proves to be ineffective.

Is pattern bargaining a problem?

Pattern bargaining is the practice of a bargaining representative seeking common terms in agreements across two or more different enterprises. The FW Act does not contain a

blanket prohibition on pattern bargaining. However, a party that is engaged in pattern bargaining is generally not permitted to undertake protected industrial action, unless the party can establish they are 'genuinely trying to reach agreement'.

During its Public Infrastructure inquiry (PC 2014b), the Productivity Commission found pattern bargaining to be rife in Australia's construction industry, as did the Australian Chamber of Commerce and Industry (ACCI) in its submission to this inquiry:

> The Construction Forestry Energy and Mining Union (CFMEU) has promoted common terms that exist within the agreements it negotiates, stating that for the period 2009–2011 over 90% of its enterprise agreements are identical, with a small number containing either higher or lower benefits, depending on the sector/trade. This is not only indicative of strong evidence of a pattern bargaining approach in the construction industry but also demonstrates the bargaining strength of the union in negotiations relative to the employers with whom it is bargaining. (sub. 161, p. 95)

Pattern bargaining is problematic where it is imposed by a party with excessive leverage. If pursued on a mutually convenient basis by employer and union, it can also be seen as a form of anti-competitive conduct. Moreover, as also noted by some participants, pattern bargaining can conflict with the WR system's goal to develop agreements that reflect the circumstances of the enterprise and its employees (Housing Industry Association, sub. 169).

However, in some circumstances pattern agreements may not be disadvantageous or coercive, and perhaps even desirable for both parties:

- Pattern bargaining may reduce the costs of negotiating EAs and may, as some employer groups have argued, reduce project risk if they take the form of identical agreements forged by a head contractor and subcontractors on a major project (Ai Group 2014a, p. 15). It is notable that in New Zealand, a country that has generally embraced a relatively light-handed industrial relations regime, multi-enterprise collective agreements are relatively commonplace.
- Template agreements may also provide guidance and lower the costs of developing EAs for smaller enterprises, and may sometimes be preferred over awards or individual arrangements, as noted by both the Shop, Distributive and Allied Employees' Association (sub. 175) and the Australian National Retailers Association (sub. 216). Indeed, the Productivity Commission has explored the adoption of enterprise contracts as a new form of employment contract, especially for smaller enterprises that find EAs too costly to negotiate (chapter 17). Enterprises could unilaterally form their own bespoke enterprise contracts, but the Fair Work Ombudsman would also provide templates that might make enterprise contracts easier to develop. Use of these templates would likely lead to some common features across agreements.
- For practical purposes, something like a template of success is likely to emerge from multiple EA rounds across similar firms, over time.

Thus, it is not, per se, the presence of common features across bargaining agreements that is problematic, but the extent to which those common outcomes reflect the excessive power of one party over another, and an unwillingness to allow negotiation of some different set of conditions. Ideally, the current prohibition on protected industrial action where a party is engaged in pattern bargaining should address concerns about the use of excessive leverage to impose pattern agreements on employers.

However, in practice it appears that the current restriction on industrial action is of limited effect due to the narrowness of the definition of pattern bargaining. Under the FW Act, a course of conduct does not amount to pattern bargaining so long as the bargaining representative is 'genuinely trying to reach an agreement' by, for example, demonstrating a preparedness to bargain by taking into account the individual circumstances of that employer. Indeed, Forsyth et al. (2010, p. 146) have noted that negotiating parties would need to be seeking identical (rather than merely similar) terms across two or more employers to fall foul of the existing prohibition. In the case law, 'even if the cumulative arithmetic of the increases ended up the same', the preparedness by a union to negotiate different wage outcomes for different employers is sufficient to protect the union from a claim of pattern bargaining.[186] As a result, some have argued that unions can still advance pattern agreements with the threat of industrial action by carefully constructing their claims to eschew the allegation of pattern bargaining.

One inquiry participant called for a complete prohibition on pattern bargaining (National Farmers Federation, sub. 223). However, a blanket ban would not be a sustainable solution, as it would risk throwing the baby out with the bath water. Regulations should be slow to disturb agreements where common terms across enterprises have arisen from genuine consent between the parties. As noted by Teys Australia and NH Foods:

> If employers want to agree to pattern bargaining they should be permitted to do so, but no coercion should be permitted if they do not so choose. (sub. 179, p. 21)

Others have argued that the 'genuinely trying to reach agreement' exemption against pattern bargaining should be removed (Master Builders Australia, sub. 157; Housing Industry Association, sub. 169). Such a change would further restrict the ability of parties to use protected industrial action to pursue identical terms in agreements across multiple employers. This would not pose a barrier to the mutually agreed use of a pattern agreement as a template, as parties can still reach agreement in the absence of industrial action.

However, without an exemption for those who are 'genuinely trying to reach agreement', the existing definition of pattern bargaining under the FW Act would be too broad. This may unduly restrict the use of protected industrial action in sectors where agreements are very similar or identical across employers — even where employee representatives are not deliberately pursuing pattern agreements, but rather bargaining at an established market rate. As noted by Creighton and Stewart:

186 *Farstad Shipping (Indian Pacific) Pty Ltd v Maritime Union of Australia* [2014] FWC 8130.

> It is simply not plausible to suggest that unions will not, or should not, seek common terms and conditions in particular industries or parts of industries, or that they will not do so by reference to some notion of the 'going rate' for the industry or its part. (2010, p. 777)

This highlights the difficulty of discriminating between pattern agreements where the negotiations are genuine and those that are imposed through excessive leverage.

Ideally, the key test for pattern bargaining would be one that includes an examination of the competitive circumstances of the industry and the relative leverage of each bargaining party. If an industry exhibits evidence of low barriers to entry, and perhaps other features of a competitive market, the existence *in negotiations* of very similar proposals *from either side* is unlikely to represent the adverse aspect of pattern bargaining that should concern public policy. The Australian Shipowners Association's (sub. 206) suggestion that the FWC be empowered and required to look to the character of a union's conduct and look beyond the claims advanced on paper has merit in principle, but in practice may not be widely enforceable. The Productivity Commission is interested in further exploring whether a similarly nuanced approach to pattern bargaining is possible.

Ultimately, concerns about the adverse use of pattern bargaining in some sectors may be largely addressed by other recommendations in this report. These include changes to greenfields agreement negotiations, which are discussed later in this chapter, and recommendations relating to the industrial action provisions in the FW Act (chapter 19). These recommendations are likely to reduce the excessive leverage that can be used by parties to press claims for pattern agreements during bargaining.

INFORMATION REQUEST

The Productivity Commission seeks feedback on whether there is a mechanism that would only restrain pattern bargaining:

- *where it is imposed through excessive leverage or is likely to be anticompetitive*
- *while allowing it in circumstances where it is conducive to low transaction cost agreements that parties genuinely consent to.*

Are the rules on agreement content justified?

Permitted matters

The range of matters that should be permitted in an EA is an area of fierce contention. Consistent with a relatively lengthy history of disagreement, employer participants generally sought to reduce the range of matters upon which bargaining can occur, while employee groups argued for a more expansive range of matters.

For example, ACCI (sub. 161, pp. 102–3) argued that the following list of matters should *not* be seen to pertain to the employment relationship: independent contractors; WHS; right of entry; industrial action and extra claims; and dispute resolution clauses beyond those in a model clause. As discussed above, terms that attempt to modify the FW Act's provisions around right of entry and rights to take protected industrial action are already unlawful terms.

Other matters that employers argued should *not* be permitted include:

- training requirements, such as an obligation to engage a certain number of apprentices
- clauses that limit the capacity of employers to use foreign workers, contractors or non-union workers (Australian Petroleum and Exploration Association Limited [APPEA], sub. 209)
- clauses that automatically force casual to permanent conversion, irrespective of individual or business desires (BCA 2012, p. 47)
- trade union training leave, time off and pay for attendance at union meetings (AMMA, sub. 96; Qube Ports, sub. 123; South Australian Wine Industry Association and the Winemakers' Federation of Australia [SAWIA and the WFA], sub. 215)
- 'no extra claims' clauses (Qantas, sub. 116).

A number of employers (AMMA, sub. 96; Asciano, sub. 138; Bluescope Steel, sub. 58; Manufacturing Australia, sub. 126; Teys Australia and NH Foods, sub. 179) called for a return to a formula consistent with the High Court's *Electrolux* decision,[187] which ruled that EAs under the then *Workplace Relations Act 1996* (Cth) could not include matters pertaining to the employer/union relationship.

On the other hand, the ACTU (2012c, p. 57) argued that the FW Act should allow EAs to be made on all matters affecting employees' working lives, as permitted by the International Labour Organization (ILO), including job security, and social and economic matters that have a direct impact on workers in general.

Some employers called for a prescriptive list of prohibited content that could not be included in an EA (AMMA, sub. 96; SAWIA and the WFA, sub. 215). The FW Act deliberately moved away from the legislative prescription in previous regimes to reliance on jurisprudence about 'matters pertaining'. This concedes that it is hard (and perhaps undesirable) to set out a list of all permitted or prohibited matters without reference to context. For example, a term that imposes a training requirement might represent a two-way commitment intended to achieve productivity improvements. Alternatively, it might be an intrusive arrangement that limits an employer's ability to manage. There is a tradeoff between the certainty of legislative prescription, and the flexibility of allowing precedent to build and develop via the common law.

187 *Electrolux Home Products Pty Ltd v Australian Workers Union* (2004) 133 IR 49; [2004] HCA 40.

Inclusion of terms that relate to non-permitted matters

A related issue raised by some participants was that, regardless of the permitted matters formula chosen, the FWC can still approve an EA that contains non-permitted matters. While the FWC scrutinises proposed agreements for unlawful terms, it does not assess whether it only contains permitted matters. Some stakeholders called for matters that are not permitted matters to be classified as unlawful terms and excluded from an agreement before it can be approved (ACCI, sub. 161).

If a term that relates to a non-permitted (but lawful) matter makes it through the approval stage, it has no legal effect (s. 253). This is similar to the legitimacy of 'no extra claims' clauses — the Full Bench of the Federal Court clarified in the *Toyota* decision that such clauses in an EA are inconsistent with Division 7 of Part 2-4 of the FW Act, which permits parties to vary a current agreement (see box 15.3). Thus while 'no extra claims' clauses remain permitted matters, they have no binding effect in a legal sense.

The merits of allowing terms with no legal enforceability to be present in an agreement are debatable:

- On the one hand, it may be argued that it is immaterial whether such clauses are permitted or not, as they are 'dead' words in a legal sense. Thus, the lack of legal enforceability may provide adequate protection for parties, without creating undue hold ups with the agreement approval process.
- On the other hand, a term which is legally unenforceable can still be applied until such time as one or other party challenges it or refuses to abide by it. Indeed, the fact that parties still bother to bargain over the inclusion of such terms in an agreement indicates that non-permitted terms can still hold value to a party. The legal inefficacy of a term is only exposed if the parties become aware of a query over the provision; and then if they choose to challenge it in court. Further, a legally void term may still be enforced in practice by a party through industrial leverage, either unlawfully or covertly during the life of the agreement, or at the negotiating phase of the next agreement. Thus a non-permitted term in an agreement can still hold sway and increase the potential for disputes — industrial or legal — to arise between the parties.

While, in principle, it is undesirable that non-permitted matters be able to linger on in agreements, the removal of them by legislation or FWC scrutiny may have undesirable consequences. Attempting to restrict agreement content to only those matters that are expressly permitted under the FW Act is likely to impose a substantial burden on the agreement approval process. Such a restriction would require the FWC to carefully scrutinize each term of an agreement, accounting for the context of the agreement and the existing jurisprudence about 'matters pertaining', to determine whether each term was permitted under the FW Act. This may lead to considerable uncertainty and litigation during approvals — indeed, those disputes that can currently arise during an agreement's operation over the validity of a non-permitted term may simply be shifted to legal disputes at the approval stage.

Terms that regulate labour hire and contractors

Terms that purport to regulate the engagement of labour hire and contractors are an especially contentious matter.

Most employer groups viewed such terms as unduly restricting their ability to manage and allocate resources, and argued that such terms should not be permitted (ACCI, sub. 161; APPEA, sub. 209; Manufacturing Australia, sub. 126, p. 5; Qantas, sub. 116; VECCI, sub. 79; SAWIA and the WFA, sub. 215). The BCA (2012, p. 47) has said that such terms inevitably limit the capacity of employers to respond to changing market conditions or to make best use of the skills of their employees. Qantas (sub. 116) suggested that unions were using such terms to fetter business strategy and to obstruct change, negatively affecting productivity.

Some employee groups argued that employee's bargaining power and the integrity of collective agreements can be undermined by an employer's ability to undercut the conditions by using labour hire or contractors (ACTU 2005; Unions NSW 2005). These concerns are valid to the extent that the work performed by employees and contractors is substitutable.

Labour hire and subcontracting is rare in most industries. Moreover, restrictions on labour hire and subcontractors can be likened to restrictions on the choices of suppliers to a business more generally. For example, few would accept that it would be reasonable for an EA to include provisions that prohibit the use of imported inputs produced in another state or territory, despite this weakening the capacity of employees to bargain. There are grounds for changes to the FW Act to limit the capacity of agreements to regulate the use of contractors and labour hire (which are in any case, in spirit, contrary to the *Competition and Consumer Act 2010* (Cth)). This is discussed further in chapter 20 on alternative forms of employment.

Apart from the employment of labour hire and contractors, further evidence is required to assess whether particular sorts of terms should or should not be permitted.

Mandatory terms

Some employer groups argued that mandatory consultation clauses in EAs interfere with managerial prerogative and flexibility. One criticism of mandatory consultation terms was that they can be used as a starting point for further demands for consultation. As noted by the Australasian Railway Association:

> … the requirement to include a term about consultation on roster changes provides leverage for employee bargaining representatives to negotiate terms that further entrench the right of employees and unions to agree on any changes to rosters before they are implemented. (sub. 155, p. 28)

To address this, AMMA (sub. 96) suggested that if mandatory terms are to be included in agreements, then the use of the model term should be required, with no scope to depart from it — noting that model clauses should be crafted to be fair to all parties.

Some studies suggest that workplaces that include employees in change processes perform better (Farmakis-Gamboni et al. 2014, p. 20). In many European countries, there are statutory provisions for consultation and it is common for board-level employee representation on company boards (though their determinative power varies). There are doubts about its value in some countries, but it appears more favourably regarded in Germany, though even here the empirical evidence is mixed.[188] However, Germany has a distinctive industrial relations system, and it is doubtful that the model adopted in that country would translate well to Australia (any more than those from the United States would so so).

Arguably, if there were clear benefits from cooperation, good business managers would have incentives to promote it. Equally, poor managers may not. Mandatory requirements may also reduce the goodwill from voluntary arrangements. As with a number of other regulated aspects of the Fair Work arrangements, what is in principle desirable is at risk due to process and an emphasis of form over substance — for example, where the apparent threat of a 'failure to consult' becomes an industrial lever rather than a desirable part of a non-adversarial environment:

> The requirement for consultation also provides an opportunity for any proposed changes to agreements to be stalled by the invoking of dispute resolution procedures if employees or their representatives take the view that consultation processes have not been strictly followed. (Australasian Railway Association, sub. 155, p. 28)

Consultation does not require acquiescence, and if managed well, may well address the risks posed by its mandatory nature. It is premature to remove the requirement for consultation, but the Productivity Commission will revisit that view if more widespread evidence of negative effects is obtained during the latter part of this inquiry.

A flexibility term authorising the use of IFAs must also be included in all EAs. IFAs vary the effect of the EA, in a manner that suits the needs of the employee and their employer and leaves the employee better off overall compared to the terms of the EA (chapter 16). However, there is evidence that the range of matters over which an IFA can be made sometimes gets whittled down during the bargaining process, with many flexibility terms in EAs allowing less flexibility that the model flexibility term set out in the *Fair Work Regulations 2009*. The Post Implementation Review Panel (McCallum, Moore and Edwards 2012) recommended that EAs only be allowed to supplement, rather than erode, the level of flexibility provided by the model flexibility term, , to encourage greater use of IFAs.

[188] For example, Fitzroy and Kraft (2005), Addison et al. (2013), Kriechel et al. (2014) and Feils et al (2014).

If the opportunity for workplace flexibility is of genuine interest to individuals and firms, as it appears to be on occasion, it seems perverse to create the opportunity but then allow a collective negotiation process to prevent its use.

Adopting the reform proposed by the 2012 Review panel would reduce the extent to which the bargaining process can restrict the scope for IFAs.

DRAFT RECOMMENDATION 15.2

The Australian Government should amend s. 203 of the *Fair Work Act 2009* (Cth) to require enterprise flexibility terms to permit individual flexibility arrangements to deal with all the matters listed in the model flexibility term, along with any additional matters agreed by the parties. Enterprise agreements should not be able to restrict the terms of individual flexibility arrangements.

More flexibility around duration of enterprise agreements

Currently, EAs must include a nominal expiry date that is not more than four years after the day on which the FWC approves the agreement. In the absence of a limit on agreement life, parties may be able to exploit short term disparities in bargaining power to lock in favourable terms for a very long period (perhaps decades). Excessive agreement durations could particularly undermine the bargaining power of employees since industrial action is not permitted during the life of an agreement. For some EAs that have conditions close to the award level, there is a risk that longer agreement lives could lead to a gulf between award and EA conditions, as the BOOT is only applied at the time the agreement is approved, even if the conditions in the award were subsequently improved to be better than those in the agreement.

However, there are several rationales for extending this maximum period to five years:

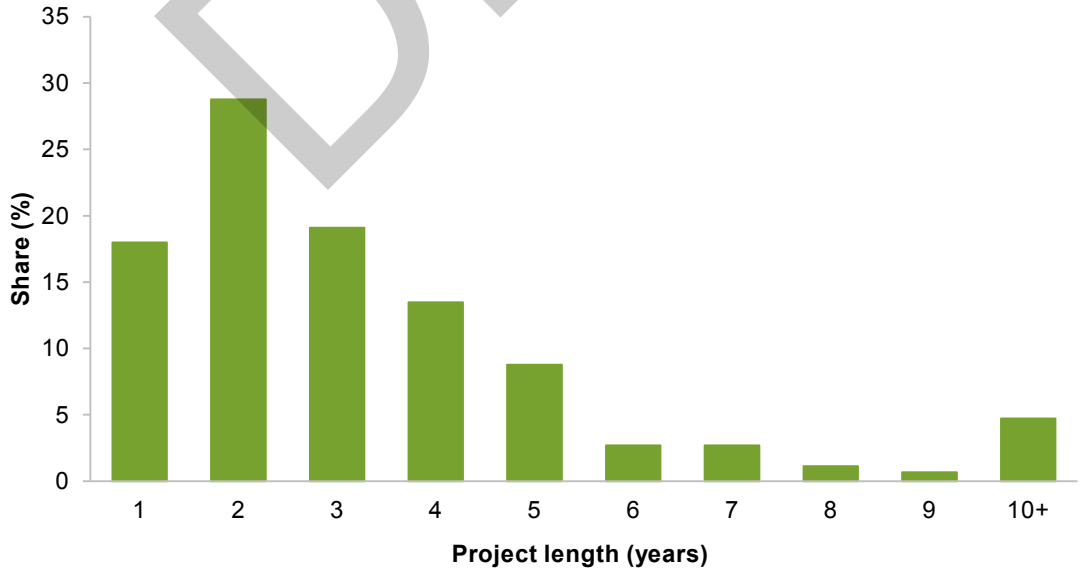
- As bargaining for an EA can be prolonged, the investment in achieving a bargain may currently be spread over too few years. Moreover, as noted earlier, the bargaining process can defer the implementation of business strategies — such as innovation — prior to a new agreement for fear that the returns will be partly bid away during bargaining. (How much this is so is an empirical issue that has not yet been investigated — and it should be.) Longer EAs increase the returns both of the time and effort in negotiating an agreement (for both parties to the agreement), and provide more certainty for employers about measures that enhance productivity and performance.
- Greenfields agreements are not intended to be enduring, but logically should survive for the duration of construction of a particular project. Any agreement with a life less than the expected duration of the project exposes the business to substantial risks. Delays in negotiating a greenfields agreement can lead to underutilised capital and may cause the contractor to incur a penalty for delay in the delivery of the project. This

creates an imbalance in bargaining power. Even if employees do not actually use this leverage, the ex-ante risk of it raises investor risk and may add to project cost. Empirical evidence suggests that there is a preference for longer lifespans for greenfields agreements — roughly two thirds of current greenfields agreements are for a period greater than 3 years (appendix E). Productivity Commission analysis of construction project lengths also suggests that extending the maximum nominal expiry date for all EAs to five years would capture the full length of an additional 9 per cent of construction projects (figure 15.4). Further, where an employer can demonstrate that a project will take longer than five years to construct, there are clear and irreducible grounds for the FWC to approve greenfields agreements with an expiry date that matches the construction project phase. This proposal was supported by some participants (APPEA, sub. 209; Origin Energy, sub. 141).

- The *Toyota* decision removing the legal force of 'no extra claims' clauses (see box 15.3) has addressed the risk that extended EA lives might reduce the capacity of a business to adapt to adverse economic shocks (noting that the employees are protected by opportunistic exploitation of this capacity because they must approve any variations)
- Parties might *both* accede to longer EAs because they wish to lock in provisions that they believe advantage them. Qantas (sub. 116) argued that an employer and its employees should be able to agree to a longer nominal EA length of up to five years.

Figure 15.4 **Distribution of construction project lives**[a]

Share of projects in sample



[a] Based on start and projected end dates from a sample of 445 publicly and privately owned construction projects.

Source: Deloitte Access Economics Investment Monitor database, September 2013.

Were the maximum agreement period to be extended, it is likely that agreements of less than five years duration would still remain common — almost 60 per cent of current agreements are less than three years duration despite being able to last up to four years (appendix E). Similarly, the data suggests that many greenfields agreements would continue to be less than five years duration. Even if not commonly used, there are grounds for permitting longer EAs where they are desired.

DRAFT RECOMMENDATION 15.3

The Australian Government should amend s. 186(5) of the *Fair Work Act 2009* (Cth) to allow an enterprise agreement to specify a nominal expiry date that:

- can be up to five years after the day on which the Fair Work Commission approves the agreement, or
- matches the life of a greenfields project. The resulting enterprise agreement could exceed five years, but where so, the business would have to satisfy the Fair Work Commission that the longer period was justified.

Does enterprise bargaining promote productivity?

Some employer participants expressed concern that agreements do not give enough emphasis to productivity. While EAs can contain clauses that specify commitments to improve productivity in exchange for improvements in wages and conditions, these are not mandatory.

Data provided to the Productivity Commission suggest around one third of agreements include some specific productivity measures, while around half make general commitments (these are not mutually exclusive; a given agreement may include both). It is more common for agreements negotiated with unions to contain 'commitment to productivity' clauses (McCallum, Moore and Edwards 2012, p. 143). Case studies of particular EAs suggest that the parties sometimes agree to quite concrete arrangements (Farmakis-Gamboni et al. 2014).

A study by Farmakis-Gamboni et al. (2014, p. 43) found that, by industry, EAs in the construction (64 per cent of agreements) and manufacturing (57 per cent) industries are most likely to contain a 'commitment to improve productivity' clause. Rental, hiring and real estate services (49 per cent) and construction (46 per cent) agreements are most likely to contain 'specific productivity measures' clauses.

The same study also found that there does not appear to be a directly observable association between ABS measures of productivity growth and productivity clauses in EAs among industries that have a high proportion of collective agreements (Farmakis-Gamboni et al. 2014, p. 43). This is consistent with the Productivity Commission's findings in its inquiry into Public Infrastructure (PC 2014b).

Some participants suggested that the FWC should be required to consider the parties' ability to achieve productivity benefits when approving any EA. The Australian Government is proposing to introduce rules that require discussion of productivity improvements as part of the bargaining process. The Fair Work Amendment (Bargaining Processes) Bill 2014 requires the FWC to be satisfied, in order to approve the agreement, that the parties to a proposed EA discussed productivity improvements at the workplace during negotiations.

Prima facie, a commitment to bargaining processes and/or agreements that promote productivity may appear sensible. The goal is that employees wishing to bargain for increases should show why they should get them, and that some sort of commitment to productivity improvement would be one basis for improved wage rises.

However, any *regulated* requirement suffers from several limitations.

- Its underlying premise is wrong. There may be a misapprehension that real wage increases are *only* justified if there are real productivity improvements at the firm level. There are many sectors where productivity growth is low — such as aged care — and yet any employer would have to provide wage increases at least commensurate with those in the other industries that might otherwise employ such workers. To do otherwise, would mean an industry could neither retain nor attract workers.
- Any 'requirement to discuss' during bargaining is easily met, even if not genuine, and so lacks enforceability. In general, governments should not include in legislation any unenforceable entreaties. The objectives of legislation are a more traditional place to locate such a sentiment.
- It may also inadvertently create perverse incentives that work against productivity improvement. Where clauses are required, employees may have incentives to obstruct (or at least not actively facilitate) any new management-initiated productivity improvements during the (later) life of an EA, so that they can then agree to relax any obstructions as part of a productivity clause in the next agreement. Qantas claimed that productivity bargaining might in fact reward the least efficient work groups because they have the most to trade away (sub. 116) — of course, that would not in itself be a reason not to trade, but it does exemplify an incentive for a work group to remain inefficient until the next agreement.
- There are several practical obstacles to leaving judgments about productivity improvements to the FWC. This might involve significant subjective judgment by a party that is not aware of the commercial circumstances of the firm[189], potentially delaying approval of the EA and potentially forcing the parties to return to the bargaining table.

[189] One participant also questioned whether the FWC currently has the expertise required to make such commercial judgments (McCarthy, sub. 43).

In saying this, it is important to be clear that arguing against *regulated* requirements does not repudiate the potential for parties to *voluntarily* negotiate mutually-beneficial changes in work practices.

But negotiating for productivity gains is inherently a responsibility for employers — if they are not motivated by market forces to seek productivity gains, it is unlikely that regulation will alter their stance. Instead, the use of competition policy reforms or other removal of other impediments to effective management (for example, in the public sector) would seem far more effective.

The debate about mandated productivity discussions or clauses in EAs also misses productivity-improving options that lie outside legislated enterprise bargaining processes. A complementary model for achieving long-run productivity improvements is to encourage greater employee engagement and higher levels of trust between employers and employees.

There is a large literature suggesting that employee engagement is associated with higher firm performance (Rayton, Dodge and D'Analeze 2012), although the research is not of great quality (Briner 2014). Engagement cannot be legislated, and indeed regulatory requirements that attempt to do so within an adversarial bargaining framework undermine the voluntary nature of trust.

There is also a body of research that has highlighted the role of better management in enhancing labour productivity. Some studies have shown that while Australia's WR system placed relatively few constraints on the ability of managers to hire, fire, pay, and promote employees, the performance of Australian firms at managing employee incentives was comparatively poor (Bloom and Van Reenen 2010; Bloom et al. 2012). This suggests improved management practices may be a more fruitful source of productivity gains than legislative changes.

The 2012 review of the FW Act recommended that the FWC play a more active role in promoting productive workplaces (McCallum, Moore and Edwards 2012). Consequently, the FWC will conduct and publish qualitative research to identify clauses in EAs that enhance productivity or innovation (FWC 2014b, p. 58). Further, the Fair Work Ombudsman has a best practice guide on improving workplace productivity in bargaining, which explains how best to negotiate when making EAs to take advantage of productivity benefits (FWO 2013). Whether promotion, pilots and research in this area produces results will need to be determined after evaluation. Yet these approaches have the advantage that they do not limit the capacity of employers and employees to have discussions about productivity as they see fit, without the leverage, process and appeal burdens implied by the presence of an umpire.

DRAFT FINDING 15.1

The case for imposing statutory requirements for employers and employees to discuss productivity improvements as part of the bargaining process, or for the mandatory inclusion of productivity clauses in agreements, is not strong. Voluntary agreements that promote productivity are highly desirable, but such agreements, and the gains they deliver, should arise from better management, not from a regulated requirement, which is likely to have perverse effects.

Concerns with the BOOT

To approve an EA, the FWC must be satisfied it passes the BOOT. A number of participants in this inquiry expressed concern with the test and way it is applied by the FWC.

Some participants questioned whether awards should continue to serve as the benchmark against which proposed EAs are assessed (ACCI, sub. 161; BCA, sub. 173; Master Builders Australia, sub. 157). For example, ACCI suggested that clear and simple minimum statutory standards should form the benchmark for bargaining. The Productivity Commission's view is that, while the award system is in need of repair, there is no case for replacing awards as the safety net (chapters 11 and 12) and therefore, awards remain the appropriate benchmark for EA approval purposes.

Replacing the BOOT with a no-disadvantage test

The Productivity Commission recommends that the BOOT be replaced by a no-disadvantage test for the purposes of approving EAs (as well as IFAs — this is discussed further in chapter 16). As mentioned above, the relevant award should remain the benchmark against which proposed EAs are assessed.

Box 15.6 The various forms of the no-disadvantage test

The no-disadvantage test was first introduced in the early 1990s to prevent the certification of enterprise agreements that disadvantaged any employee compared to the award or any other relevant law, or were contrary to the public interest. In practice, this involved a line-by-line consideration of the agreement against the award. The no-disadvantage test was modified over subsequent years and ultimately abandoned in 2006. In 2007 another test — the Fairness Test — was introduced built around the concept of 'fair compensation' for any loss of protected award conditions.

The no-disadvantage test was reinstated by the *Workplace Relations Amendment (Transition to Forward with Fairness) Act 2008* (Cth). Collective agreements and individual transitional employment agreements (in effect, Australian Workplace Agreements) were required to pass this no-disadvantage test before being approved by the Workplace Authority. An agreement passed the test if the agreement "does not result, or would not result, on balance, in a reduction in the overall terms and conditions of employment of the employees whose employment is subject to the agreement under any reference instrument [e.g. any designated award] relating to one or more of the employees".

The no-disadvantage test that applied between 1996 and 2006 was similar to the version above, in that it facilitated a global assessment rather than line-by-line consideration and was conducted for a class of employees rather than each employee. Furthermore, agreements made between 1996 and 2006 were tested against a narrower class of instruments — either the relevant or designated award.

A no-disadvantage test is also used in assessing Employer Employee Agreements in Western Australia. The Registrar of the Western Australian Industrial Relations Commission determines the relevant award (or other instrument as prescribed in the regulations) that would apply to the employee and is required to be satisfied that the agreement is no less favourable than the applicable award or order 'when considered as a whole'.

Under a no-disadvantage test, parties would need to have sufficient practical information to be able to apply the test and be confident that an agreement would pass. Although the 'transitional' no-disadvantage test under the Fair Work transitional arrangements was virtually identical to that in place prior to Work Choices, it had few procedural safeguards and the vagueness of the criteria created uncertainty for employers as to whether an agreement would pass the test.

Sources: Pittard and Naughton (2010), Sutherland (2009), WAIRC (2002).

While the difference between these two tests should be marginal in theory, a no-disadvantage test is likely to be much more workable in practice. This is because in order to approve an agreement, the BOOT requires the FWC to be positively satisfied that an agreement will make all employees better off than the relevant award. This provides a wider scope for agreements to be rejected at the approval stage when compared with a no-disadvantage test, which would require the FWC to identify how an agreement makes a class of employees worse off overall in order to reject an agreement.

A no-disadvantage test is also a well-established concept which has been extensively used under federal and state jurisdictions, albeit in different forms (box 15.6). However, the Productivity Commission seeks further information from inquiry participants on how a new no-disadvantage test should be formulated.

Issues with how the test is applied

Regardless of whether a BOOT or no-disadvantage test is used, a primary concern is the manner in which the test is applied by the FWC at the agreement approval stage. A number of participants were critical of how the FWC apples the BOOT. Concerns related to the limited consideration of non-monetary benefits to employees, the need to ensure that every employee under an agreement was better off, and claimed inconsistencies in the application of the BOOT by the FWC. Similar concerns were raised during the 2012 FW Act review (McCallum, Moore and Edwards 2012).

The BOOT already contains mechanisms for workplaces to achieve flexibility. For example, it allows for increases in base rates of pay as compensation for the removal of penalty rates. However, there seems to be a gap between the law and practice.

First, there is a concern that members of the FWC tend to adopt an excessively legalistic approach to applying the test, and that there are significant differences of approach between members. According to submissions (ALDI, sub. 146; Teys Australia and NH Foods, sub. 179; Qantas, sub. 116), there is a tendency for a pedantic 'line by line'[190] reading of the BOOT to arise, and uncertainty persists around trading off monetary for non-monetary terms and conditions. For example, Qantas said that:

> There also needs to be greater consistency in application of the BOOT. We have had experience of some FWC members applying a line-by-line test and others applying a global test. (sub. 116, p. 5)

ALDI also argued that the global nature of the test should be clarified through legislation:

> ALDI recommends that the legislation be amended to clarify/reinforce FWC's role in applying the 'better off overall' test to one of ensuring that employees will be advantaged in a total or global sense by the enterprise agreement, rather than a line-by-line comparison with the terms and structures of the relevant award. (sub. 146, p. 3)

The FWC itself has noted in its benchbook that a line-by-line approach to the test is not appropriate (FWC 2015c). This was reinforced by a recent decision of a Full Bench of the FWC in which the Full Bench quashed a first instance decision to reject an EA, on the grounds that the single member had taken 'a line by line rather than a global approach to the application of the better off overall test'.[191] To minimise inconsistency, the FWC should also have the power and obligation to issue guidelines to its members to clarify the global nature of the test, reduce a dominance of form over substance and reduce the gap between legislative intent and practice.

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190 A 'line by line' approach involves assessing whether employees are made better or worse off by each individual term in the agreement when compared with the relevant term in the award . This contrasts with the (correct) global approach, where the beneficial terms of the agreement (when compared with the award) are collectively compared against the less beneficial terms of the agreement to make an overall assessment as to whether an employee would be made better off by the agreement (FWC 2015c).

191 *AKN Pty Ltd t/a Aitkin Crane Services* [2015] FWCFB 1833.

Another level of debate arises over the application of the BOOT for any given individual and the BOOT as it applies for a *class* of employees (s. 193(7)). In IFAs, the BOOT is unequivocally an individual test. However, the guidance in the Explanatory Memorandum to the Fair Work Bill 2008 (Australian Government 2008, p. 128) states that, while the BOOT requires each award-covered employee to be better off overall, it is intended that the FWC would generally apply the BOOT to classes of employees, and the FWC is not required to enquire into each employee's individual circumstances.

The BCA (2012, p. 53) has suggested that some members of FWC have been applying the BOOT by reference to the circumstances of individual employees rather than classes of employees, contrary to the guidance above. In applying the new no-disadvantage test for EAs, the reference group should be the relevant class of employees, and not the individual. Internal guidance within the FWC should clarify this.

ACCI (sub. 161, p. 103) also suggested that the FWC should give greater weight to the views of employee representatives prior to deciding not to approve an agreement (even if it does not pass the BOOT or offends on technical/procedural grounds), and that a failure to pass the BOOT should not override the view of the majority of employees. Where employers have significant bargaining leverage, there would be risks to this approach. For EAs that do not involve a 'to and fro' bargaining process, but rather feature management making a proposal, and the employees voting without prior negotiation (and possibly understanding) a majority vote might not be an adequate protection.

DRAFT RECOMMENDATION 15.4

The Australian Government should amend the *Fair Work Act 2009* (Cth) to replace the better off overall test for approval of enterprise agreements with a new no-disadvantage test. The test against which a new agreement is judged should be applied across a like class (or series of classes) of employees for an enterprise agreement. The Fair Work Commission should provide its members with guidelines on how the new test should be applied.

INFORMATION REQUEST

What should be the basis for the revised form of the no-disadvantage, test, including whether, and to what extent past forms of the no-disadvantage test provide a suitable model and would be workable within the current legislative framework?

Who can bargain?

No single party may be able to represent all employees adequately, especially in large workplaces with heterogeneous types of labour. Such employees may work in quite different working environments or have different goals from each other. Accordingly, a statutory provision for multiple bargaining representatives is reasonable. However, there can be too many, which raises the costs of bargaining (and can be a nuisance to the main parties).

There are already some constraints on multiple bargaining representatives. The FWC has powers to make a bargaining order if bargaining is not proceeding efficiently or fairly because there are multiple bargaining representatives for the agreement (s. 230). The bargaining order may involve excluding a bargaining representative, or ordering some or all of the bargaining representatives to meet and appoint one of them to represent the others (s. 231(2)).

However, this power has not been commonly invoked, and business groups continue to see the existing provisions as inefficient. Some of the problems they have identified are:

- individual bargaining representatives make claims that are often particular to the circumstances and experiences of an individual employee, or a very small number of employees. Their interests may not reflect the views of the broader workforce and they may raise only a subset of the issues upon which bargaining is required (BCA 2012, p. 44; Australasian Railway Association, sub. 155; Qantas, sub. 116)
- the appointment of multiple bargaining representatives increases the time and cost associated with bargaining, especially for employers with employees that are geographically dispersed or work within 24/7 operations (Australasian Railway Association, sub. 155; Qantas, sub. 116)
- there is currently no time limit on when a new bargaining representative can be appointed (even if the negotiations have been progressing for some time) which has the potential to significantly slow or frustrate the bargaining process.

Quite apart from the concerns about the *number* of representative parties, there is some concern about who such parties are and the degree to which they can assume pre-eminence in negotiations without necessarily having wide endorsement from employees. A particular concern of some employer groups is that unions have disproportionate power. For example, ACCI (sub. 161) said that:

> Collective bargaining under the current system has the potential to erode collaborative approaches by encouraging the involvement of a third party in the negotiations pursuing a largely pre-determined industrial agenda that does not appropriately consider the needs of the particular business or the individuals working within that business. (sub. 161, p. 94)

Some have suggested that unions should not be the default bargaining representative of union members (Manufacturing Australia, sub. 126, p. 4). For example, Qube Ports

(sub. 123, p. 6) said that an opt-in system would reduce the prevalence of unions acting in their own self-interest about issues that members may be apathetic about.

However, while self-interested action by unions will inevitably occur, this is not problematic if this largely aligns with the interest of its members. People join unions voluntarily, and pay their dues presumably with some expectation that the union has their broad interests at heart. If unions do not do this, they may be in breach of the law (raising union governance matters outside the remit of this inquiry) or risk losing members.

Further, although union membership in an enterprise may be low, unions may still play an important role in bargaining to the benefit of all employees.[192] Unions tend to be better-resourced than other bargaining representatives, and often take a lead role in bargaining, with employees (through choice or apathy) often yielding to this arrangement. The Business Council of Australia (BCA) observed that:

> Few employees have nominated themselves as their own bargaining representatives. Nor are there many instances of employees (or other non-union parties) being nominated as bargaining representatives for work-groups. Instead, employees appear to prefer to leave the process to better-resourced unions. (2012, p. 44)

While some union representatives may be obstructive, many are experienced and pragmatic negotiators who are familiar with the FW Act, and can therefore act as competent and predictable representatives, to the benefit of both principal negotiating parties.

Moreover, the capacity for competition from other representatives provides one discipline on unions (and is an important motivation for some allowance for multiple representation). Finally, no EA is lodged until the majority of employees agree — which acts as another brake on bargaining that is not broadly consistent with employees' preferences.

The Productivity Commission's proposal for Enterprise Contracts, amended IFAs and less constrained flexibility terms in EAs should go a long way in allowing enterprises to negotiate with individuals without union representation if that is their wish.

Nevertheless, a small number of practical reforms could improve the process of appointing bargaining representatives:

- A bargaining notice could fix a reasonable period in which nominations to be a bargaining representative must be submitted (a suggestion made by a number of participants, including Qantas, sub. 116, p. 6).

[192] The right to, or not to, join a union (freedom of association) is an important protection of employees who wish not to be represented by unions. However, as some unions have pointed out, low union representation in a workforce may reflect 'free riding' because non-members may benefit from a union's superior bargaining capacity without paying for it. Accordingly, low union representation in a workforce may not equate with any illegitimacy of that representation.

- A person could only be a bargaining representative if some reasonable proportion of the employees to be covered by the agreement (say 5 per cent) nominated them as a representative, or if they represent a registered trade union with members covered by the proposed agreement. A representative's level of support could be demonstrated through the written appointments currently provided by employees after they receive a NERR. For a relevant union, membership records would be a sufficient indication of support unless the relevant employee/s have stated otherwise.

DRAFT RECOMMENDATION 15.5

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that:

- a bargaining notice specifies a reasonable period in which nominations to be a bargaining representative must be submitted
- a person could only be a bargaining representative if they represent a registered trade union with at least one member covered by the proposed agreement, or if they were able to indicate that at least 5 per cent of the employees to be covered by the agreement nominated them as a representative.

Specific concerns with greenfields agreements

Unions wield excessive bargaining power under the current arrangements

The notion of enterprise bargaining sits somewhat ill at ease with a situation where there is no workforce yet to bargain with. Employers setting up new enterprises do not have to use a collective agreement to set the terms and conditions of employment on the project — they can rely instead on the relevant award or an individual arrangement. However, if they wish to have a long-term statutory agreement in place prior to the project commencing, the only means of doing so is to negotiate a greenfields agreement with the relevant union/s.

Many employers have argued that there are limited ways to resolve bargaining stalemates for greenfields agreements, giving unions the ability to use delay as a negotiating tool (VECCI, sub. 79; Rio Tinto, sub. 122; Minerals Council of Australia, sub. 129; Business SA, sub. 174; APPEA, sub. 209; National Electrical and Communications [NECA], sub. 159). Because agreement delays can potentially jeopardise the starting date and viability of projects, employee representatives hold a unique position of bargaining power in such situations — the imperative to settle an agreement just to get a project underway means employers may accede to various demands. It has been described by some as 'gun to head' bargaining (BCA 2012, p. 58).

Many employers have also alleged that unions use the excessive bargaining power afforded to them by the existing greenfields arrangements to impose standard terms and conditions on an industrywide basis. For example, Qube Ports said:

> … QUBE embarked on a new project and sought to negotiate with a union for a greenfields agreement for employees with a union. In the early part of the discussions, the union provided QUBE with a copy of an agreement which was in place for a competitor at a nearby site. The union informed QUBE that it would only agree to terms that were the same or better than those of the competitor. (sub. 123, p. 4)

Indeed, in its submission, the Australian Workers' Union acknowledged that unions can use their bargaining power in greenfields negotiations to impose industry-wide terms and conditions on employers, with the union arguing:

> By having to negotiate Greenfield agreements with relevant employee representatives, certain checks and balances ensure that no employer can 'out-compete' other local employers through slashing workers' terms and conditions. Instead the new employer must apply and respect not just the rules of the game, but also the incremental and mutually agreed conditions that have been formalised in the industry locally.
>
> The AWU sees the certainty of new employers having to follow these rules as not just fair for the local communities the employer is setting up in or just for the existing local employers that the new employer may tender against, but also as helpful fixed costs that any investor into the project can expect. (AWU, sub. 74, p. 23)

Greenfields agreements are especially important in project-specific employment arrangements in the construction and resources industries. Data from the Department of Employment shows that over two-thirds of greenfields agreements are in the construction industry. Greenfields agreements can be important for negotiating finance, as project risk is influenced by labour costs and any barriers to the efficient and speedy completion of projects. Accordingly, any weaknesses in the arrangements have potentially large impacts on major project investment in Australia. The 2012 review of the FW Act shared these concerns (McCallum, Moore and Edwards 2012, recommendations 27-30).

That being said, greenfields agreements now have slightly more flexibility. Data on agreements approved between 1 October 2009 and 30 June 2014 reveal that the newer greenfields agreements are more likely to contain flexibilities, though this observation is based on a relatively small data set. The increased flexibilities were primarily in the area of working hours and, specifically, increased requirements for employers to negotiate the setting of those hours with employees.

Given the existing imbalances in bargaining power and incentives for delay that exist under the current framework, a number of improvements can be made to the greenfields agreement-making process.

Greenfields agreements should be bargained in good faith

It is likely that the current absence of any good faith bargaining requirements during greenfields negotiations may partly exacerbate bargaining stalemates. This is an anomaly, given that it is required for other types of enterprise bargaining, and should be corrected. Numerous inquiry participants supported such a change, including the ACTU (sub. 167),

AMMA (sub. 96), Civil Contractors Federation (sub. 62), VECCI (sub. 79), Qube Ports (sub. 123), Rio Tinto (sub. 122) and Business SA (sub. 174). It was also recommended by the 2012 review of the FW Act (McCallum, Moore and Edwards 2012), and was included in the Fair Work Amendment Bill 2014.

DRAFT RECOMMENDATION 15.6

The Australian Government should amend the rules around greenfields agreements in the *Fair Work Act 2009* (Cth) so that bargaining representatives for greenfields agreements are subject to the good faith bargaining requirements.

Unions should continue to play a role in negotiating greenfields agreements

Numerous employer groups called for changes to allow the use of employer greenfields agreements that employers could put in place without any negotiations with a union (ACCI, sub. 161; AMMA, sub. 96; Business SA, sub. 174; National Retail Association, sub. 144; NECA, sub. 159).

Whether this would lead to excessive bargaining power is likely to depend on a number of factors. On the one hand, bargaining power may not be as imbalanced for greenfields projects, meaning that an employer would still have to offer a reasonable suite of wages and conditions, as:

- The main priority for many greenfields employers is to commence a project as soon as possible. This means they must place greater emphasis on offering sufficiently high wages to attract new workers to their project.
- An employer must also offer wages that are high enough to encourage their employees to remain on the project, given that the costs of losing workers to other employers and delaying the project may be high. Indeed, one greenfields employer noted that they must pay market rates to attract and retain experienced and competent employees (VECCI, sub. 79, p. 56). The incentive for employers to offer competitive wages, at least in the long run, also appears to have been accepted by the Australian Workers Union in its own arguments against employer greenfields agreements, saying:

  > … to enable a new employer to unilaterally determine conditions at Greenfield sites would only mean that employment costs down the line become hard to forecast if the employees' conditions are out of kilter with those of their peers — workers will rightly expect and ask for the same as their peers and their conditions will have to increase. (sub. 74, p. 23)

- Where a greenfields project takes place as part of a major project or during a substantial expansion in investment, there may be a substantial increase in economic activity and employment in the region or industry where the project is occurring. This may lead to a skills shortage that increases the bargaining power of employees.

- It can be easier for some greenfields employers to offer temporarily higher wages and conditions to employees during 'boom' periods, as these terms are only preserved for the life of the project, and employees are then discharged. Employers with a standing workforce may find it harder to bargain for lower wages and conditions on the expiry of an agreement as this may affect employee morale and create a combative environment. Such an employer would have to convince employees that wage reductions were necessary due to changes in the economic environment.
- Because potential employees for a greenfields project are not yet engaged by the employer, they are likely to face comparatively lower 'switching' costs from seeking an alternative employer if faced with a poor pay and conditions offer.

On the other hand, employees may not have greater bargaining power if:

- there were relatively few alternative projects available to potential employees. This may not necessarily be undesirable where the lack of projects arises from a slowdown in the relevant region or sector: wages and conditions should generally reflect the economic circumstances of a sector (subject to the safety net). However, concerns would arise if a small number of employers with substantial market power were able to use employer greenfields agreements to drive down industry-wide wages and conditions below the competitive market level
- policy changes led to the greater use of greenfields agreements in non-project settings where timing is not as critical, or where employees may be less mobile or skilled, meaning that imbalances in bargaining power may persist. This is a conceivable outcome. While greenfields agreements are currently predominantly used in project based sectors, such as construction, they can be used anywhere there is a genuinely new enterprise that has not yet employed any persons for its normal operations. The introduction of employer greenfields agreements under Work Choices led to a significant expansion in their use in sectors such as accommodation and food services, retail trade and health care and social assistance, and changes to greenfields arrangements under the FW Act led to a corresponding decline in these sectors (McCallum, Moore and Edwards 2012).

There is some empirical evidence that employer greenfields agreements under Work Choices led to overall reductions in wages and conditions. In a study of employer greenfields agreements in the first year following the introduction of Work Choices, Gahan (2007) revealed a significant reduction in entitlements for employees, particularly through the removal of protected award conditions, with employees generally not receiving equivalent compensation for the loss of these conditions. However, these agreements were made in the absence of a no-disadvantage test and, as noted by Gahan, it is likely that most of them would not have been approved were such a test in place.

On balance, the Productivity Commission does not recommend a return to wholly unilateral employer greenfields agreements. There is a role for unions in the greenfields process to act as representatives for prospective employees. However, as discussed further

below, short term employer greenfields arrangements should be available where greenfields negotiations reach a stalemate.

But more options are needed to break stalemates in greenfields negotiations

Given that the threat of 'hold-out' by a union can lead to excessive bargaining power, there is a need for a mechanism to break stalemates in greenfields negotiations where they arise. This could be achieved by placing a time limit on the negotiating period for greenfields agreements — three months is proposed in the Fair Work Amendment Bill 2014 and is supported by several stakeholders in this inquiry.

After this period, alternative agreement-making options could be available to the employer, in addition to continuing negotiations with the union. These could take several forms, including that the FWC conduct some form of arbitration, or approve the employer's proposal (subject to the no-disadvantage test). These options are discussed further below.

Arbitration by the Fair Work Commission

A number of inquiry participants expressed support for some form of FWC arbitration of stalled greenfields negotiations (ACTU, sub. 167; APPEA, sub. 209; Rio Tinto, sub. 122), while others were strongly opposed to it (AMMA, sub. 96).

A broad arbitration function would be undesirable and runs counter to the goal of privately undertaken negotiations. Arbitrated outcomes are also more likely to be exposed to variations in decision-making between FWC members, and can be costly and time consuming. However, an arbitrated outcome is also less likely to lead to exploitation of bargaining power by a particular party (whether that is an employer or union).

The various shortcomings of arbitration could be reduced by using a form of 'last offer' arbitration (also called 'pendulum' arbitration), where the FWC would be limited to choosing between the employer and union's last proposals as the final agreement outcome. This approach to greenfields agreement stalemates was also recommended by the 2012 review of the FW Act (McCallum, Moore and Edwards 2012). A primary advantage of this form of arbitration is that it would encourage parties to moderate their offers throughout negotiations for fear the other party's offer appears more reasonable and is accepted during last-offer arbitration. Thus the parties' bargaining behaviour in anticipation of a possible arbitrated outcome may in fact lead to a negotiated outcome.

However, such an approach is still vulnerable to institutional fallibilities. As discussed previously, arbitration can create undesirable incentives to hold out if a party anticipates that the FWC's arbitrated outcome would be preferred to one it might negotiate privately. The use of 'last offer' arbitration is dependent on the FWC being perceived as a neutral body. The willingness of some employers to propose that the FWC have the role of impasse-breaker, as expressed in submissions, suggests it has that status. Adopting the

Productivity Commission's recommendations regarding institutional arrangements should also strengthen this status (chapter 3).

The employer's proposed EA (subject to a no-disadvantage test)

Some participants suggested that where an employer had negotiated with a union for at least three months, the employer should be able to have their proposed terms and conditions approved, subject to a no-disadvantage test (Business SA, sub. 174; Civil Contractors Federation, sub. 62; Minerals Council of Australia, sub. 129). A similar proposal is included in the Fair Work Amendment Bill 2014.

Such a proposal would provide a strong incentive for unions to reach agreement with employers within three months. However, employers may have an incentive to take a 'hard bargaining' approach (passing the good faith bargaining requirement), holding out until the three month period had elapsed and having its proposed terms approved (Maritime Union of Australia, sub. 121). Approving the employer's terms for a long term period — thus precluding any further bargaining or industrial action — would likely shift the bargaining pendulum too far in favour of employers.

The Fair Work Amendment Bill 2014 requires that the proposed agreement pass the BOOT *and*, when considered on an overall basis provides for pay and conditions that are consistent with the prevailing pay and conditions within the relevant industry for equivalent work.

However, using an industry-based benchmark would undermine the decentralised and enterprise-oriented focus that underpins the bargaining framework. Some inquiry participants were critical of this benchmark (AMMA, sub. 96; Master Builders Australia, sub. 157). If greater FWC intervention is to be introduced, 'last offer' arbitration would better facilitate bargaining, and provide a more balanced means of weighing the parties' offers against each other.

Rather than approving employer proposals for five years or the life of the project, a shorter duration — such as 12 months — would help safeguard employees' terms and conditions. These 12 month arrangements could effectively act as a stopgap until a longer term agreement can be reached with employees once the project is in operation. This would be similar to the previous role of 12 month employer greenfields agreements, but with greater employee safeguards (such as union involvement during the three month negotiating period, as well as the no-disadvantage test). Under this approach, employers would still have an incentive to reach agreement with the union during the three month negotiating period in order to secure a long term deal.

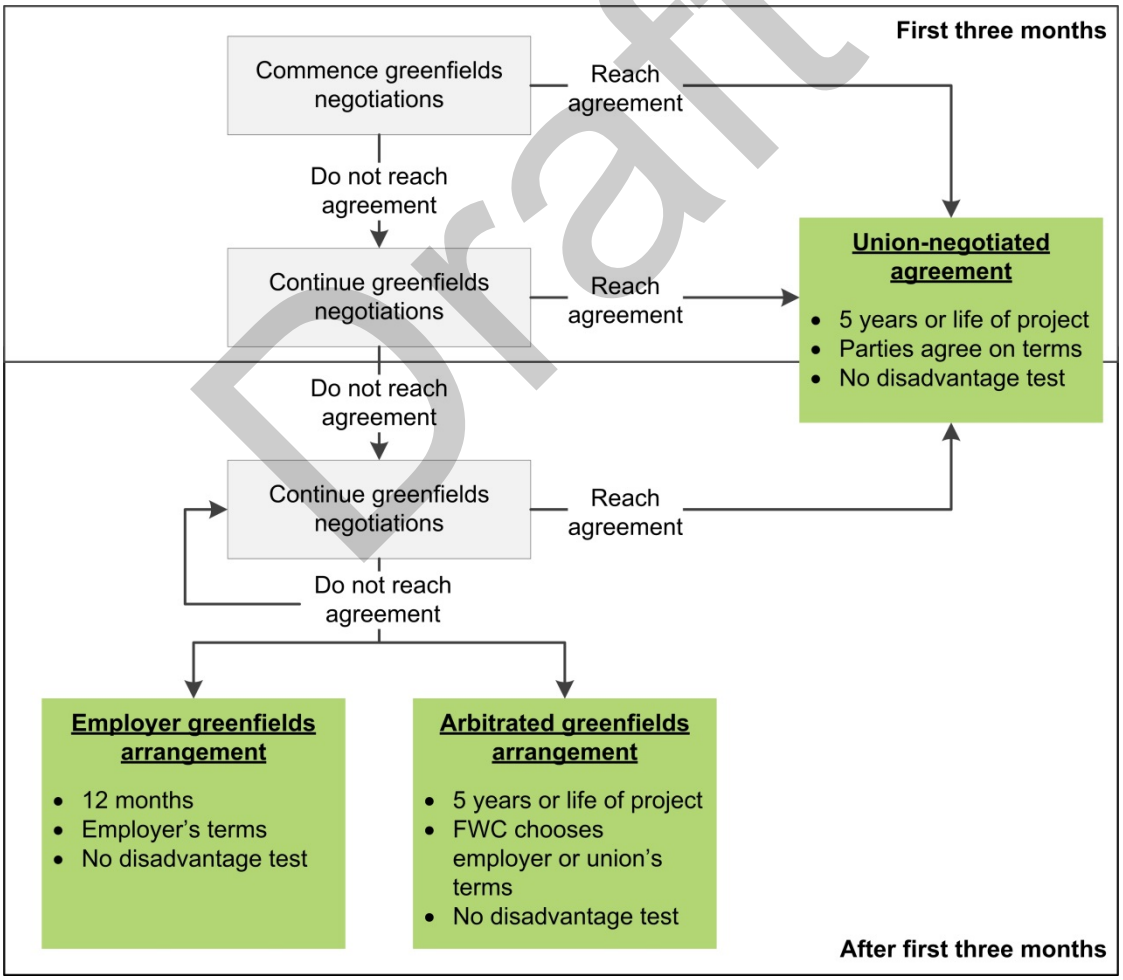
Parties should choose the option that fits the circumstances

The above options are not mutually exclusive, and need not be used in all circumstances. Rather, they could feature as part of a menu of options (figure 15.5). If an agreement were not reached between the parties after three months, the employer could choose to:

- continue to negotiate with the relevant unions to reach an agreement
- apply for 'last offer' arbitration by the FWC
- put forth their own proposal for FWC approval with a 12 month expiry date.

Regardless of the option chosen, the resulting employment arrangements would need to pass the no-disadvantage test.

Figure 15.5 **Greenfields agreement-making process**



This approach should help encourage privately negotiated settlements within the three month negotiating period. Employers would have an incentive to reach a long-term agreement that matches the lifetime of the project, without being exposed to arbitration by

the FWC. Unions would also have an incentive to reach an agreement, lest the employer choose to put forward its own agreement for approval and thus bypass the union's involvement in the agreement's content. If the parties do not reach agreement, this proposal allows employers to choose the most appropriate option for the circumstances of their firm, while providing safeguards for employees' wages and conditions.

Were an employer to choose the option of FWC arbitration, they would have greater stability over the life of the project, but would be exposed to the initial uncertainty of an arbitrated outcome. The possibility that an employer may choose this option would help moderate both parties' claims during the initial three month bargaining period, while the FWC's arbitration role would help ensure that employees would not be disadvantaged.

Employers that choose the final option — a 12 month greenfields agreement — would be exposed to potential delays and industrial action following the 12 month expiry date. The size of this risk is likely to vary between employers. For some employers, the risk of industrial action may be minimal — as noted previously, greenfields agreements are not exclusive to the construction and mining sectors — and therefore this option may be preferable to an arbitrated outcome. The shorter lifespan may also provide an important check (in addition to the no disadvantage test) on employers offering insufficient wages and conditions, as doing so may lead to employees demanding competitive wages once bargaining for a longer term agreement has commenced. For many employers, the costs or risks of renegotiating mid project would be too great — an advantage of a menu approach is that these employers can avoid these risks by choosing the other available options, such as arbitration or a union negotiated agreement.

These proposed greenfields arrangements strike the right balance between creating incentives for agreements between employers and unions, preventing the inefficient delay of projects where stalemates occur, and safeguarding employees' terms and conditions.

DRAFT RECOMMENDATION 15.7

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that if an employer and union have not reached a negotiated outcome for a greenfields agreement after three months, the employer may (as illustrated in figure 15.5):

- continue negotiating with the union
- request that the Fair Work Commission undertake 'last offer' arbitration of an outcome by choosing between the last offers made by the employer and the union
- submit the employer's proposed greenfields arrangement for approval with a 12 month nominal expiry date.

Regardless of the agreement-making process chosen by the employer, the ensuing greenfields arrangement must pass the proposed no-disadvantage test.

Once an agreement is in place, is it easy to enforce and resolve disputes?

The capacity to vary an EA is most important when business viability is reduced and employees face likely retrenchments. However, it would be undesirable for agreements to be constantly subject to re-negotiation. This would be costly and would undermine other reforms, such as matching the duration of EAs to infrastructure construction periods. The Productivity Commission's view is that the prohibition of protected industrial action during the life of an EA and the requirement for mutual consent to a variation satisfactorily constrains the capacity to change an agreement before it expires. (As noted earlier, the Toyota case seems to have clarified matters regarding attempts to fetter the ability to vary an EA under the FW Act.) Participants did not otherwise raise any concerns about the operation of this provision in the FW Act.

Some suggested that the FWC and Fair Work Ombudsman need greater powers to interpret and enforce entitlements under EAs. The ACTU (pers. comm., 15 January 2015) said that there is a need for greater access to quick dispute resolution regarding interpretation of entitlements under agreements. The FWC is unable to make orders regarding the interpretation of EAs, unless there is a term in the agreement allowing it to arbitrate. The Fair Work Ombudsman focuses on underpayment, not other terms and conditions. The Federal Court and Federal Circuit Court can grant injunctions for breach of an EA.

The Fair Work Ombudsman can issue infringement notices (fines), issue compliance notices (not taken lightly), accept enforceable undertakings (for serious breaches, where undertakings are publicly available and legally binding) and pursue litigation (for the most serious cases).

Given the range of remedies and assistance available, the Productivity Commission does not propose any additional protections.

15.5 Is enterprise bargaining suited to changing ways of working?

Several participants questioned the role of enterprise bargaining in the face of modern business practices, such as labour hire and independent contracting, and employees moving between jobs. The ACTU has said that:

> The system is designed around, and arguably works best for, a very particular model of the workplace that is far from the norm. We have created a bargaining system that is predicated on the existence of employers who enjoy at least a measure of economic autonomy, and who engage a relatively stable and secure workforce. (ACTU 2012c, p. 41)

Labour hire arrangements (chapter 20) make enterprise bargaining challenging. Labour hire involves a three-way relationship between the host employer, the labour hire agency and the worker, where agencies may have limited control over the work environment.

Given these limitations of an enterprise-based approach, some participants argued for the ability to bargain across enterprises. The ILO considers that parties should be free to choose the level at which collective bargaining occurs, rather than be restricted to bargaining at the enterprise level. The ACTU has argued that the FW Act should allow access to multi-employer bargaining (beyond access to the low-paid bargaining stream) based on a simple 'public interest' test (ACTU 2012c, p. 57). The NUW said that:

> The Act's collective bargaining provisions need to be expanded to better facilitate multi-business, industry and sector-level bargaining. A strict focus on enterprise level bargaining permits irresponsible economic behavior in which the legal identity of the employer is separated from the real source of economic power and control. (sub. 125, p. 6)

The public interest test could limit the potential for such a system to revert to pre-1993 collective bargaining arrangements, but there is insufficient evidence that the challenges and risks posed by new employment arrangements are sufficient to require a new bargaining framework.

Others questioned the suitability of collective bargaining for many businesses. In particular, several participants pointed out that enterprise bargaining is not very suited to small businesses (ACCI, COSBOA). Sectors in greater need of flexibility such as retail trade and accommodation/food services have a greater concentration of small business employers (ACCI, sub. 161, p. 99). ACCI said that:

> The small business proprietor is not contemplated in commentary concerning the evolution of collective bargaining because collective bargaining did not arise in this context. Bargaining concerned the ability of large groups of workers to take coordinated industrial action.
>
> In the modern era, while larger business may have a dedicated team of human resources and industrial relations specialists representing the business during discussions, small businesses will not typically have access to such resources, nor do they have the time or expertise to dedicate to the complex processes themselves. Equally, they may not be able to fund the engagement of external consultants to represent them during negotiations. The cost of bargaining can take its toll on the profitability of small businesses and they are much more limited in the concessions they can viably make during bargaining. (sub. 161, pp. 96–7)

The data certainly support the notion that enterprise bargaining is mainly the province of larger businesses rather than small businesses. However, this plain fact need not suggest that there is a problem. Enterprise bargaining comes with certain 'economies of scale'. The time and costs associated with striking a bargain and complying with certain unavoidable procedural requirements may outweigh any efficiency gains from negotiating and using one EA rather than many individual agreements for businesses with a smaller number of employees. This is why any WR framework must provide employees and employers with multiple mutually-beneficial contracting possibilities. The Productivity Commission considers that enterprise bargaining is one of these, but has explored changes to the FW Act — such as the creation of enterprise contracts (chapter 17) — that would widen the available options to parties.

Like so many other features of Australia's WR system, there are grounds for some important reforms of enterprise bargaining, but not for radical change. The system will never be perfect because it is too costly (or impossible) to constantly fine-tune laws to deal with any the defects that arise for some parties. If the system responds to every flaw, it either becomes too complex (raising compliance costs), or it shifts the bargaining pendulum in the wrong direction.

16 Individual arrangements

Key points

- Individual arrangements let employees and employers negotiate variations to pay and conditions based on personal circumstances and business needs to benefit both parties. Individually-tailored arrangements based on genuine negotiation are intended to provide mutual gains, but uneven bargaining power can undermine this outcome — consequently, regulation is needed.
- The main questions that arise in assessing the effectiveness of statutory individual arrangements relate to their scope and whether they are fit for purpose. The use of the current form of individual statutory arrangement (individual flexibility arrangements (IFAs)) has been quite limited (at around 2 per cent of employees).
- Some employees (such as working mothers) and employers have made IFAs to vary full time hours, and increase hourly pay rates, leave or flexible hours. But other employers are uncertain whether an IFA would be compliant with the *Fair Work Act 2009* (Cth) (FW Act) were it to be subsequently tested. Furthermore, awareness of IFAs is generally low, especially among employees and small businesses.
- Nonetheless, IFAs provide flexibility and could be more widely adopted if awareness was higher and risk lower. The main regulatory impediments to parties using IFAs are:
  - the notice period for either party to terminate an IFA is exceptionally short, which increases the risks — particularly but not exclusively — to employers
  - IFAs are not exposed to independent scrutiny which may make employees doubtful
  - the 'better off overall test' (BOOT) is not simple to apply and consequently reduces the possibility of effective beneficial tradeoffs; in turn this may expose employers to compliance risks.
- These disincentives could be addressed by:
  - amending the FW Act to allow employers and employees to agree a unilateral termination period of up to one year, with 13 weeks the default if no termination period is specified
  - the Fair Work Ombudsman (FWO) providing better targeted information
  - the adoption of a 'holistic' no-disadvantage test rather than the BOOT to determine if an IFA makes an employee worse off overall.
- Many past (and therefore possibly present) IFAs breach the FW Act. Better education, stronger compliance and better-resourced monitoring by the FWO will be essential to the effective introduction of any improvements to individual arrangements.

With boundaries between work and life increasingly porous, individually-tailored arrangements are a way for employees to manage their work and family or other personal commitments, or to negotiate a salary that is more directly related to their skills and experience than a standard, such as an award.

For employers, the desire for individual arrangements can arise from an intent to:

- enhance a cooperative and accommodating workplace
- improve alignment with the characteristics of the individual business or industry, such as size, capital intensity and competitive pressure,
- offer greater incentives linked to performance.

It falls to individual arrangements to meet this need.

The main questions that arise in assessing the effectiveness of statutory individual arrangements relate to the degree to which they may authorise movement away from an award or enterprise agreement via an arrangement (an individual flexibility arrangement (IFA)); and whether they are fit for purpose. This chapter examines the role of individual arrangements and statutory arrangements in the workplace relations (WR) system, and their effectiveness.

Section 16.1 examines why individual arrangements are used and section 16.2 sets out types of statutory individual arrangements, including those observed within the existing framework. Section 16.3 investigates the merits and shortcomings of the current arrangements and advances possible proposals to address the specific concerns identified, and section 16.4 explores the potential impacts.

16.1 Why employers and employees use individual arrangements

Potential benefits

An individual arrangement puts the employer's relationship with an individual employee at the heart of the employment arrangement. This has benefits for the employer and employee as it:

- provides greater scope for taking account of individual circumstances
- is a more practical way to achieve these outcomes than trying to negotiate all these individual concerns into a collective agreement
- enables employers to offer above-award rates to attract and retain staff, and provide different pay outcomes for staff, taking into account their skills and experience

- provides flexibility in terms of rostering or other operational matters to suit the needs of the business.

A frequently stated rationale for individual arrangements is that they develop productive and competitive employment systems based on trust, performance and employee empowerment (Gollan 2004; Mitchell and Fetter 2003). The trust relationship was also apparently central to the introduction of individual employment contracts in New Zealand (as discussed further below), where the *Employment Contracts Act 1991* (EC Act) made a fundamental break from the previous regime of collective agreements, to one based on individual contracts that was intended to provide mutual benefits to employers and workers (Brook 1991).

At the firm level, individual arrangements may be driven by both market conditions or business structure. In capital-intensive industries (such as mining), arrangements that determine the utilisation of labour can have a crucial influence on capacity utilisation (Topp et al. 2008). Heiler and Pickersgill (2001) reported that thinner profit margins in the coal sector from lower commodity prices led employers to extract optimum flexibility, including through the use of individual arrangements. In a survey of employers in Australia and New Zealand, Gilson and Wagar (1996) found that organisations in the service sector were more likely to pursue individual employment contracts. Other evidence on individual arrangements suggested that in Australia they were more commonly associated with workplaces where communication structures were well developed — such as quality circles and semi-autonomous work groups (Wooden 2000). However, the relevant arrangements mainly related to well-paid managerial and professional employees — a circumstance that does not hold for all subsequent variants of individual arrangements.

Improving productivity has often been advanced as a benefit of individual arrangements. However, there are differing views on whether, by promoting greater flexibility and efficiency in the labour market, individual arrangements improve aggregate productivity. Contributing to these differences is the difficulty in drawing definitive conclusions given the need to isolate the benefits of reform from other drivers of productivity improvements (Evans et al. 1996) (also discussed in chapter 26).

In Australia, the regulation impact statement for the 2005 WorkChoices legislation stated that individual bargaining would lead to agreements that accommodated productivity offsets, which the award system did not do (Minister for Employment and Workplace Relations 2005). However, Peetz (2012) cites studies that show little relationship between individual contracting and productivity outcomes.

There may be several reasons for this finding. It is possible that the particular form of individual arrangement did not increase productivity because it eroded some employee benefits, with the demotivating effects this can entail. Alternatively, the type of changes sought were only indirectly related to productivity, and more directed towards responding to external factors such as changes in market preferences. Moreover, while Peetz cites

several studies, the empirical work at the enterprise level in this area is relatively thin, and it difficult to control for possible selection bias effects.[193]

The evidence also does not convincingly demonstrate any robust link to the new contracting arrangements (or other aspects of the WR system) that were introduced at that time. That may be because there were no or few effects, or simply that amongst all of the other factors determining productivity, it would be highly unlikely to find an effect, even if there was one.[194] The inability to verify or reject any productivity effects would be further reinforced by the relatively small uptake of individual arrangements in that period.

The main reason for preferring a statutory individual arrangement is that it can provide a 'safe harbour' for arrangements that deviate from awards, particularly if there is some trading off of wages and conditions.

Possible drawbacks

Individual arrangements are not a panacea for all ills of the WR system, for either employers or employees.

For employers, having all or most employees on genuinely individual arrangements will, for an employer with more than a handful of employees, be complex and add to management costs. Gains need to be significant to offset this. Moreover, such an approach may require more constant attention to renegotiation than a three year enterprise agreement or simply sticking to the award.

For employees, individual arrangements can require negotiating skills and knowledge that relatively few possess and potentially invites exposure to criticism in the workplace if it appears special deals have been done.

In the absence of sufficient safeguards, employers' uneven bargaining power could lead employees to accept lower wages and conditions than under collective arrangements, because the employee is forced to 'take it or leave it'. The risk would be greatest where employees could trade off the minimum conditions provided by awards against other asserted (but actually illusory) benefits for them, since this could take them effectively below the award safety net. The outcomes could not only involve redistribution between the parties, but also to the inefficient wage suppression that can occur under dynamic monopsony (chapter 14). Moreover, short-sighted decisions by some businesses to form employment arrangements that overly disadvantage employees can undermine trust,

193 These would occur where businesses pursuing individual arrangements have different traits to those that do not, and where those traits are themselves correlated with productivity.

194 In its analysis of the construction sector, the Productivity Commission faced a similar empirical issue. The asserted substantial gains to aggregate productivity from particular institutional changes in that industry did not withstand critical scrutiny (PC 2014b). But that finding did not rule out the possibility of smaller benefits that could not be excepted to show up in aggregate data.

discourage efficient practices and adversely affect workplace harmony. Such businesses may ultimately lose their employees or fail, but the transition can be costly for people and the economy.

The net benefit calculation for the two parties may differ, too, explaining at least in part why *statutory* individual arrangements were not at any time in the last twenty years as widespread as lore suggested (see data later in this chapter).

Individual arrangements in New Zealand and other countries

Individual arrangements (either statutory or using the common law[195]) are used widely in some jurisdictions, but do not feature prominently in the WR systems of many other countries (table 16.2). New Zealand is particularly interesting from an Australian perspective because it had a very similar system to Australia prior to the 1990s, and has made large changes since, commencing with the EC Act (Rasmussen 2010). For example, awards were abolished and the system of collective bargaining shifted to the enterprise level. The EC Act was replaced by the *Employment Relations Act 2000*, but many of the fundamental changes to the system created by the EC Act were preserved.

In New Zealand, individual employment agreements (IEAs) are now an established feature of the employment relationship. Employees can choose either to negotiate an individual arrangement (which must be in writing) or be covered by an enterprise-based collective agreement. An employee joining a business that has a collective agreement must be offered the conditions of that agreement, but must join the union that negotiated that agreement within 30 days if they wish to maintain those conditions. If they choose not to, or the enterprise does not have a collective agreement, then the employee negotiates an IEA.

IEAs have a mandatory set of clauses and must not offer conditions that are worse than a statutory set of benefits. The latter are similar to the National Employment Standards (NES) — covering matters such as recreational, parental and personal leave, break entitlements, statutory rights to vary hours of work (which employers can only refuse on certain grounds) and a requirement to at least pay the minimum wage. There is no requirement for premium wage rates for weekend work, overtime or shift work, nor any mandatory allowances. Any of these may be negotiated between employers and employees. Agreements vary, with different premiums for overtime across different agreements (Rudman 2013). The *Minimum Wage Act 1983* specifies the maximum hours of work to be 40 hours per week, exclusive of overtime. As for the NES, this can be exceeded if deemed reasonable. As in Australia, there are protections for unfair dismissal (and to a lesser extent, elements of Australia's General Protections).

Collective bargaining density (and union density) collapsed after the EC Act. In 2011, collective agreements (now at the enterprise level) covered less than one in ten New

195 Chapter 1 outlines the common law as it applies to individual arrangements in Australia.

Zealand private sector employees (New Zealand Treasury 2012). Most employees covered by private sector enterprise agreements are in larger firms (Blumenfeld 2010). Individual arrangements are therefore the dominant employment type in New Zealand. (In that respect, while Australia also moved away from bargaining at the industrywide collective level, enterprise bargaining in Australia has gained much greater traction than New Zealand, and correspondingly, individual arrangements, less so.)

Non-guaranteed hours contracts, often called 'zero-hours contracts' are an emerging and controversial individual contract type in the New Zealand system, and a more established one in the United Kingdom following the global financial crisis (table 16.1 and (Acas 2014). Such contracts offer no guarantee of hours of work, but require the employee to be available to work. They are also legal in Australia, though their penetration into the labour market is unknown. There is a concern in New Zealand that such contract types — appealing as they may be to employers wishing high levels of flexibility in labour contracting — may fall foul of the requirement under employment contracts for mutuality of obligations (dundas street employment lawyers 2014).

Zero-hours contracts (as compared to standard casual employment contracts) present two major problems. The employee is still tied to an employer and cannot readily engage in multiple job holding even if no hours are offered (the 'exclusivity' problem) and the lack of a clear definition of a zero-hours contract, which makes it hard for employees to know about the consequences of signing such an agreement (the 'transparency' problem) (Acas 2014). It is too early to say whether zero-hours contracts will gain much of a foothold in Australia, or if they do, whether some of the problems identified by Acas (the UK Advisory, Conciliation and Arbitration Service) for the UK will also emerge here. Either way, zero-hours contracts provide a case study of the potential new developments in employment relations.

16.2 Forms of statutory individual arrangements

Australian Workplace Agreements

There have been three forms of statutory individual arrangements in Australia — Australian workplace agreements (AWAs) pre- and post-WorkChoices; and IFAs.

AWAs were first introduced at the federal level as part of the *Workplace Relations Act 1996* (Cth) as an alternative to collective negotiation (state-based arrangements had been in place prior to 1996). The objective of the arrangements was to place primary responsibility for industrial relations on employers and employees, thereby removing third party involvement (including removal of the right to protected action for employees with an AWA) (Minister for Industrial Relations 1996). Parties to the agreement were able to register the AWA so long as it complied with the requirements set out in legislation (Minister for Industrial Relations 1996).

Box 16.1 Zero-hours contracts

Zero-hours contracts do not guarantee a minimum number of hours, but employees agree to be available for work when required by the employer. They appear to be a post-global financial crisis phenomenon in the UK, where it has been estimated by the Office of National Statistics that there were around 1.8 million zero-hours contracts providing work in August 2014 based on a survey of businesses. The labour force survey of employees (which counts the number of people with contracts) suggests around 2.3 per cent people in work in the UK were employed under a zero-hours contract.

In the UK, employees on zero-hours contracts work on average two-thirds the hours than workers on other contracts and they apply to skilled and unskilled employees. According to one estimate, they are concentrated in accommodation and food services, education and health care.

There is no one definition of a zero-hours contracts, although a defining feature in the UK has been the use of 'exclusivity clauses', which means the employee must work exclusively for one employer, regardless of the hours offered, because the intention of the contract is that the employee must be available when the employer chooses. As these clauses restrict multiple job holding, or limit the capacity of a person to engage in other activities that have routine scheduled hours, such as education, they can lead to underutilisation or reduced acquisition of skills. The UK Government has legislated to make exclusivity clauses unenforceable.

Those against zero-hours contracts (employees) say it is just a way of avoiding them receiving the benefits of permanent employment (for example, leave entitlements). Employer organisations in the UK have argued that they are crucial for keeping people in employment. While employees are not obliged to accept work, they are concerned that not accepting work will lead to work no longer being offered.

In New Zealand, the Opposition Labour Party has proposed a Bill to require that specified hours of work be included in individual and collective arrangements, in response to concerns about the use of zero-hours contracts, for example, in the fast food industry.

Zero-hours contracts can be drafted for use in Australia. Net Lawman, a UK company which operates in a number of countries, including Australia and New Zealand, can draft a zero-hours contract for use in all Australian states and territories for a $59 fee. The website states that the contract has the following features:

> Sometimes known as a casual work contract or a zero hours contract, it places no obligation on the employer to provide work, and pay and benefits are pro rated in line with hours worked. This casual employment contract covers all legal requirements for information to be given to an employee and provides strong protection for the employer organisation.

Sources: Lees-Galloway (2015), Net Lawman (nd), Pyper and Dar (2015).

The increased flexibility and self-regulation available under AWAs was accompanied by safeguards that aimed to guarantee that employees received the statutory minimums on pay rates, leave entitlements, equal pay for work of equal value and jury service, as well as dispute resolution procedures. For example, the statutory minimums were deemed to be included in AWAs that did not meet those minimum requirements. The minimum conditions were also enforceable by a court (following conciliation by the complaints body, the Employment Advocate) with employers able to be fined $10 000 plus recovery of entitlements for breach of agreement (Minister for Industrial Relations 1996).

AWAs could be made before or after an employee commenced employment, so terms and conditions of employment could be set as a condition of employment. AWAs made under duress could be invalidated (Minister for Industrial Relations 1996).

AWAs were concentrated in communication services, government, mining, cultural and recreational services and the electricity, gas and water industries. Most AWA employers were small and medium-sized businesses (Mitchell and Fetter 2003).

In 2005, under the WorkChoices legislation, AWAs were altered so that the statutory minimums were reduced to five minimum standards covering minimum rates of pay, leave entitlements and maximum hours of work (which could be averaged over 12 months) (Minister for Employment and Workplace Relations 2005). These AWAs were contentious and widely criticised by employee organisations as undercutting worker entitlements. Most research tends to find that wages and conditions were lower under AWAs than collective agreements (van Barneveld 2006), and that AWAs under WorkChoices were approved even though they reduced pay rates below the applicable minimum (Sutherland 2009).

Statutory individual arrangements have also been used to reduce union influence over the setting of employment terms and conditions, or to de-unionise the workforce (Peetz 2002; Roan, Bramble and Lafferty 2003). An early survey of organisations in Australia and New Zealand found that some employers saw individual contracts as an important device for reducing union influence (Gilson and Wagar 1996).

Estimates of the take up rate for AWAs vary between 1.9 per cent and 7 per cent (ABS 2008b; McCallum, Moore and Edwards 2012; Mitchell and Fetter 2003). ABS data suggest that, at their peak, registered individual agreements covered 3.1 per cent of employees and in 2008 (prior to their abolition), they covered 2.2 per cent of employees and were the second least common method of setting pay. However (the then) Department of Education, Employment and Workplace Relations estimates suggest that between 5 to 7 per cent of Australian employees had an AWA by February 2008 before their abolition under the *Fair Work Act 2009* (Cth) (FW Act).

Those agreements lodged before 31 December 2009 could continue to operate. Given AWAs had a nominal expiry date of up to five years, the last AWAs will have expired on 31 December 2014. As with enterprise agreements, an expired agreement still has force unless terminated by either the employee or the employer, so that a very small number of AWAs may still be in operation. The conditions set down by modern awards and the NES override any lesser conditions embedded in AWAs.

Individual flexibility arrangements

IFAs were introduced in the FW Act as part of a broader shift away from AWAs which is reflected in the object of the Act:

> The object of this Act is … ensuring that the guaranteed safety net of fair, relevant and enforceable minimum wages and conditions can no longer be undermined by the making of

> statutory individual employment agreements of any kind given that such agreements can never be part of a fair workplace relations system … (Division 2 – Object of this Act)

Accordingly, unlike AWAs, which could be offered as an alternative to a collective agreement, an IFA stems from, and remains rooted in, the terms and conditions of the relevant award or enterprise agreement. This is because the IFA is made under an overarching 'flexibility term' that must be included in all awards or enterprise agreements. The IFA is taken to be a term of the enterprise agreement or award and takes effect as though it varies the award or enterprise agreement. The IFA does not change the effect of the award or enterprise agreement and is not a contract in its own right.

Several boundaries are placed around the making of an IFA, which restrict its scope and effect.

First, the IFA must have the purpose of meeting the 'genuine' needs of the employee and employer. 'Genuine' is not defined in the FW Act for the purposes of making an IFA.

Second, the terms and conditions varied by the IFA must fall within those specified in the flexibility term. A model flexibility clause, developed during the award modernisation process, and included in all modern awards, permits flexibility around when work is performed, overtime rates, penalty rates, allowances and leave loadings (McCallum, Moore and Edwards 2012).

The flexibility term must specify how an IFA can be terminated. IFAs under enterprise agreements have a notice period of 28 days for either party to terminate the arrangement. IFAs under modern awards or enterprise agreements can be terminated by mutual agreement in writing at any time. The IFA could specify a maximum period, or, in the absence of a prescribed maximum, it would align with the term of the overarching enterprise agreement or award.

Where arrangements do not meet the requirements of the flexibility term, they still continue to operate, but may contravene the general protections under the FW Act, for which sanctions may apply.

In addition, IFAs:

- must identify the terms being varied
- be genuinely agreed between the employee and employer
- are in writing, signed by both parties with a copy given to the employee
- do not need third party approval or consent.

Whereas AWAs provided a safety net of minimum pay and conditions employers must ensure that an IFA makes the employee better off overall than if there were no IFA (the 'better off overall test', or BOOT). Employers must satisfy the BOOT twice in relation to IFAs made under an enterprise agreement — first when the enterprise agreement itself is made, and then again with respect to the IFA. However, the BOOT for IFAs, unlike the

BOOT applied to enterprise agreements, is not specifically compared to the relevant award and can (in theory) take into account intangible, non-monetary benefits.

Take up of IFAs

In 2012, the Fair Work Commission (FWC) published its first assessment of IFAs, based on survey data which found that IFAs are most often used to vary awards rather than enterprise agreements (O'Neill 2012b).

Productivity Commission estimates based on subsequent Australian Workplace Relations Survey data indicate that around 2 per cent of employees had an IFA in effect between February and July 2014. Overall the take up has been low, and broadly in line with that of AWAs.

The likelihood of making an IFA increases with employer size (O'Neill 2012b) which suggests that the design of IFAs is best suited to larger enterprises with more sophisticated human resources processes (or with greater awareness of their existence).

Overall, employees reported that they were more likely to initiate an IFA (56 per cent compared to 44 per cent that were employer initiated) (O'Neill 2012b).

16.3 Issues with individual flexibility arrangements

Survey data suggest that IFAs have some benefits for employers and employees but are not widely used. Participants in this inquiry suggest a number of shortcomings that appear to be inhibiting their wider use, which restricts the potential value of individual flexibility in the workplace.

Instances of beneficial use

The main benefits of IFAs to employees are more flexible working hours and increased take home pay (O'Neill 2012b). Employers with one employee on an IFA indicate that IFAs have created incentives to attract or retain staff and clarified employment conditions (O'Neill 2012b). Employers with multiple IFAs identify the main benefits as clarity about conditions, the capacity for staff to work hours as needed by the employer, and increased rostering flexibility (O'Neill 2012b). Employers with multiple IFAs also nominated formalisation of an existing arrangement as a benefit.

The majority of employees consider that they are net beneficiaries of the arrangement (O'Neill 2012b).

IFAs have also benefited at least one major group for whom flexible working arrangements are paramount — working mothers. Productivity Commission estimates based on

Australian Workplace Relations Survey employee data suggest that whereas 9 per cent of all employees are female part-time employees aged between 25-44, 15 per cent of IFAs are made by this group. The conditions most likely to be varied in an IFA are arrangements about when work is performed, increases in penalty rates and overtime rates (O'Neill 2012b). Such variations can produce tailored arrangements that provide significant flexibility benefits to this group.

A broad look at the shortcomings of IFAs

Several deficiencies limit the benefits of IFAs, and consequently they were widely criticised by participants — what the Victorian Employers' Chamber of Commerce and Industry (VECCI) termed a 'consensus of disenchantment' (sub. 79, p. 40).

The Australian Mines and Metals Association (AMMA) (sub. 96, p. 80) summed up the position of employers as:

> … [facing] considerable legislative and other impediments to achieving genuine flexibility under IFAs. Any resulting flexibilities are generally hard-won and in many cases illusory.

Employee groups (the Australian Workers Union (sub. 74), the Shop, Distributive and Allied Employees' Association (SDA) (sub. 175), the Australian Council of Trade Unions (ACTU) (sub. 167) and the Textile, Clothing and Footwear Union of Australia (TCFUA) (sub. 214)) also criticised aspects of IFAs, and that they were another form of individual arrangement that would disadvantage workers. The SDA considered IFAs to be inconsistent with the object of the FW Act to ensure that the safety net cannot be undermined by individual statutory arrangements. The ACTU saw multiple disadvantages, stemming from its view that the unsupervised character of the arrangements meant that the safeguards were not effective or observed.

> IFAs are being used by employers in a similar fashion to AWAs — that is, to drive down wages and conditions and exploit vulnerable employees. (ACTU, sub. 167, p. 284)

In effect, while all parties were disenchanted, their perspectives emanated from opposite concerns. Employee groups identified all the deficiencies of AWAs in IFAs, while employer groups saw too little of AWAs in IFAs.

Employers' primary concerns about IFAs related to the business risks they posed, including the financial risk of the arrangements arising because an employee can unilaterally terminate the arrangements with 28 days' notice. Several participants including Clubs Australia Industrial (sub. 60) and Manufacturing Australia (sub. 126) said that employers need greater certainty that they can rely on flexible arrangements. In contrast, the ACTU saw unilateral termination as an important safeguard for an agreement that does not genuinely meet the employees' needs (sub. 167).

Some participants (Brickworks Limited sub. 207 and Clubs Australia Industrial sub. 60) considered the scope of IFAs, which are restricted to matters laid out in the flexibility

terms in enterprise agreements or awards, too narrow to be effective as a means to achieve flexibility. Enterprise agreement negotiations often can and do act to reduce the scope for IFAs, such that future employees and the employer are constrained in using this approach to improve the workplace arrangement outside collective bargaining. The scope of flexibility terms is discussed further in chapter 11 (on awards) and in chapter 15 (on enterprise bargaining).

Many participants maintained that there was an ongoing need for individual statutory arrangements, which IFAs failed to meet, and some called for a return to pre-WorkChoices-style AWAs.

Employer organisations have also called for the capacity to negotiate IFAs as a condition of employment (which is currently prohibited under the FW Act), to provide certainty about flexibility in a workplace. Notwithstanding this prohibition, FWC data show that 35 per cent of employers with one IFA and 55 per cent of employers with multiple IFAs required that employees sign an IFA to commence or continue employment (O'Neill 2012b). The 2012 post-implementation review recommended an additional statutory prohibition against making IFAs as a condition of employment (McCallum, Moore and Edwards 2012).

Employers and employees are not realising the potential value of individual flexibility in the workplace because of the various shortcomings of IFAs. The question is how to address these shortcomings. The solutions need to be multi-tiered and respond to their specific deficiencies. They also need to recognise that there are good practical reasons why individual arrangements are not a panacea, as noted earlier in this chapter.

The specific deficiencies

The notice period for termination is too short

One of employers' main concerns about IFAs was that the capacity for an employee to unilaterally terminate the arrangements with 28 days' notice exposed businesses to financial and operational risks. For example:

> … IFAs can be unilaterally cancelled by either party on the giving of notice. This kills certainty. (Ports Australia, sub. 249, p. 7)

> While IFA's are free from many of the procedural complexities associated with enterprise bargaining, they do not offer the same level of certainty and stability as they may be terminated unilaterally. (Housing Industry Association, sub. 169, p. 45)

As a concrete illustration, a business might set up rostering arrangements underpinned by commitments by employees set down in IFAs, only to find that the termination of several IFAs made the arrangements untenable. By reducing their expected return, the risk that

IFAs may be terminated soon after their formation may undermine the incentives for managerial innovations.

There were divided views as to whether this inflexibility harmed or helped employees. Employee representatives were generally hostile to IFAs. The ACTU saw unilateral termination as an important safeguard for an agreement that does not genuinely meet the employees' needs (sub. 167). Professionals Australia (sub. 212) submitted that extending the notice period would unfairly impact on employees.

However, employers can also terminate IFAs — and that capacity might sometimes disadvantage employees. Clubs Australia Industrial provided an example where reform aimed at 'locking in' an arrangement could benefit employees:

> The continuing challenge that these unilateral termination provisions presents for both parties to an IFA is the lack of certainty. For example, an employee may be relying on a higher rate of pay only available under an IFA in order to meet mortgage repayments. An employer who is looking at ways to reduce a wages bill may decide, without any obligation of consultation with the employee, revert to the base Award or Enterprise Agreement conditions and the employee is placed in a situation where they can no longer meet their mortgage repayments. (sub. 54, p. 28)

How often IFAs are terminated to the disadvantage of either party to an arrangement is unclear, and claims about either instances rely substantially on anecdote and assertion. However, there is some information on the incidence of termination generally of IFAs following their commencement (O'Neill 2012b):

- The bulk of employers with one IFA (71 per cent) reported that IFAs had not been reviewed, modified or terminated since their commencement.
- A relatively small share of employers with one IFA indicated that IFAs had been modified (1 per cent) or terminated (15 per cent). In more than two-thirds of cases where IFAs had been modified or terminated, the employer was the instigator of change. In very few cases (1.4 per cent), was an agreement to terminate or modify an arrangement a mutual decision of the employer and employee.
- Not surprisingly, the share of employers with multiple IFAs indicating *any* modification or termination of an IFA in their enterprise was higher (at 7.2 and 13.1 per cent respectively), simply because there were more IFAs subject to that likelihood. As with employers with one IFA, the majority of modifications/terminations (70 per cent) were initiated by the employer and in 8 per cent of cases by both the employer and the relevant employee.
- A somewhat different story emerges when information is collected at the employee level. As for employers, the bulk of employees (again more than two-thirds) reported that IFAs had not been reviewed, modified or terminated since their commencement. However, unlike the employer-based data, employees claimed that they initiated three quarters of modifications and 40 per cent of terminations, with around 40 per cent terminated by the employer, and 8 per cent by mutual consent. 15 per cent of

employees could not recall the initiator of termination for the remainder of terminated agreements.

Of course, these figures relate to IFAs with varying durations, and so do not provide an accurate measure of the probability of termination or modification. It would be desirable to have data on the probability of termination and modification of agreements for different periods after their commencement (the 'hazard' function).

Overall, the picture provided by the survey evidence is inconsistent, but it indicates that employees are not the primary instigators of termination. This does not mean that employer concerns about termination risks are unwarranted because the data do not reveal whether the outcomes of any terminations were adverse for employers and employees. The available evidence does not *confirm* employer concerns, but nor does it necessarily mean their concerns are unfounded.

Without solid evidence, only judgment can be used to set a termination period. The 2012 post-implementation review noted that a short termination period was inconsistent with an IFA that was the product of genuine agreement and recommended a 90-day period for unilateral termination of an IFA (McCallum, Moore and Edwards 2012).

Amendments to the FW Act propose a minimum 13-week notice period for unilateral termination of an IFA. While 13 weeks reduces the financial risk to businesses, it appears arbitrary given the lack of consensus from businesses on a termination period. An alternative is for the 13 weeks to be used as a default period for awards and enterprise agreements, with parties to an IFA able to specify a longer termination period where that suits their individual circumstances. However, there would be risks to employees, particularly if apparently mutually-agreed termination periods were completely open-ended. This suggests that employees and employees should be able to unilaterally terminate arrangements at any time after a certain period has elapsed. One year appears reasonable.

DRAFT RECOMMENDATION 16.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that the flexibility term in a modern award or enterprise agreement can permit written notice of termination of an individual flexibility arrangement by either party to be a maximum of 1 year. The Act should specify that the default termination notice period should be 13 weeks, but in the negotiation of an agreement, employers and employees could agree to extend this up to the new maximum.

The ambiguities and challenges of the 'better off overall' test

The purpose of the BOOT is to ensure that IFAs do not undermine minimum employee entitlements. The BOOT under IFAs differs from that for enterprise agreements. The latter

is assessed against the award and has raised concerns at the 'line by line' approach rather than a holistic assessment of whether, overall, employees are better off overall than the relevant award (see discussion in chapter 15).

For IFAs, the Productivity Commission understands that the BOOT could be assessed against the award, enterprise agreement or other above-award arrangement under s. 144(4)(c) of the FW Act.

Many participants criticised the BOOT for IFAs as impractical, complex and inflexible because the extent to which non-financial benefits should be taken into account is unclear and quantifying these is difficult. VECCI said that:

> Members report an overwhelming lack of familiarity and/or hesitance in implementing IFA's due to systemic issues including the … inconsistency and uncertainty over the operation of the 'better off overall test' ("BOOT"). (sub. 79, p. 8)

Sources, including participants, suggested that the example in the explanatory memorandum to the FW Act, which purports to illustrate how to pass the BOOT, may, in practice, fail the test.

> In this example the Explanatory Memorandum states, quite tellingly, that "it is intended that, in appropriate circumstances, such an arrangement would pass the better off overall test". It is not apparent to me why that would be so. (Amendola 2009, p. 157)

The practical effect of this ambiguity would be that businesses have poor incentives to seek tradeoffs of any substantive kind.

An associated concern was the compliance risks of agreeing to an IFA that, if subsequently tested, was found to fail the BOOT. The Fair Work Ombudsman (FWO) website highlights the employer responsibility to ensure that an IFA is properly made:

> If an employer fails to ensure that an IFA is properly made in accordance with the FW Act, they may be liable to a penalty of up to $10,200 for an individual or $51,000 if the employer is a body corporate. (FWO, nd)

The Australian Chamber of Commerce and Industry (ACCI) illustrated the potential compliance risk:

> Employers are discouraged from using IFAs to confer a non-monetary benefit on an employee in exchange for a monetary benefit in the manner contemplated by the FW Act's Explanatory Memorandum as there is an element of risk that they may be breaching the award terms should a court conclude that the IFA does not meet the BOOT as against all award conditions. A FWC Full Bench decision … has doubt that they can be used in this way … (sub. 161, pp. 101–102)

In an attempt to fix some of the problems identified with the BOOT in the 2012 post-implementation review, the Australian Government proposed amendments in the Fair Work Amendment Bill 2014. However, these are likely to be limited in their effect. The Bill proposed a legislative note to confirm that an IFA can confer a non-monetary benefit in exchange for a monetary benefit. It is unclear what further guidance this provides that

would reduce the uncertainty for employers, as the FW Act already permits non-monetary benefits to be taken into account when determining whether an IFA passes the BOOT and this has not provided certainty to employers.

While the peak bodies and some lawyers consulted by the Productivity Commission considered that the ambiguities of the BOOT raised significant compliance risks, a large-scale survey of firms did not support those views. The 2012 FWC survey suggested that fewer than 1 per cent of employers were averse to IFAs because of the risk of penalties (O'Neill 2012b). Another large, more recent, workplace survey commissioned by the FWC found that of those that did not use IFAs, only 0.5 per cent were concerned about future penalties if they used IFAs incorrectly. Preference for alternatives, including continuing existing informal undocumented arrangements instead were overwhelmingly more important (FWC 2015d).

There have also been very few instances where the FWO has acted against an employer in respect of an IFA (even though many IFAs appear to be formed as a condition of employment, in breach of the FW Act). The notable exception was Fair Work Ombudsman v Australian Shooting Academy Pty Ltd[196] in which the Academy attempted to coerce two employees to agree to an IFA as a condition of employment (in one case by threatening to dismiss an employee if he did not sign the IFA and, in the other, providing no work to an employee because he refused to sign). The conduct was unambiguously in breach of the FW Act and the business recognised it was at fault (and apologised). In reality, the compliance risks would appear to be relatively small for employers that set out to reach flexible arrangements in good faith with their employees.

Moreover, the most likely remedy for an employee who, after initially consenting to an IFA, decided ex post it had failed the BOOT would be to terminate the arrangement (and thereby automatically revert to the pre-existing arrangement). It is unlikely that, without evidence of coercion preceding the arrangement, the FWO would intervene any further (and this appears to be its practice).

Accordingly, on the issue of compliance risk, there is a gap between the perceptions of employer representatives, the views of individual businesses, and the compliance measures adopted by the FWO. Nevertheless, there appears to be no harm in eliminating those risks where they do not undermine the protection of employees.

Employee representatives were also concerned about the BOOT

The fundamental concern of employee representatives[197] was that the BOOT was not applied with rigour by employers and that the ambiguity of the BOOT might allow an unfair tradeoff between monetary (or other important) entitlements and intangible benefits:

196 *Fair Work Ombudsman v Australian Shooting Academy Pty Ltd* [2011] FCA 1064, 6 September 2011.

197 Such as the TCFUA (sub. 214) and the National Foundation for Australian Women (sub. 154).

> … it is difficult to quantify a non-monetary benefit and … if this amendment to the Fair Work Act 2009 (Cth) was to pass and become law … employees may be significantly disadvantaged, to the extent that employers will try to trade off entitlements for non-monetary benefits that employees already receive. (Professionals Australia, sub. 212, p. 34)

> … employer organisations frequently assert that non-monetary entitlements such as arrangements that provide 'the opportunity to earn extra income' or that otherwise 'meet employee needs' can be used to offset the loss of financial entitlements such as penalties and loadings. (ACTU, sub. 167, p. 288)

In fact, in many cases, the BOOT appears not to have been applied at all. 18 per cent of employers with one employee on an IFA, and 27 per cent of employers with multiple IFAs, did not assess whether an employee was better off overall (O'Neill 2012b).

Views on proposed new provisions to address compliance risks

A new provision in the FW Act proposed in the Fair Work Amendment Bill 2014 sought to address compliance risk by providing a defence to an alleged contravention of a flexibility term where the employer reasonably believes that the term was complied with at the time an IFA was made. Supporting evidence is to be provided via a 'genuine needs' statement from the employee setting out why they believe that the IFA meets their genuine needs and satisfies the BOOT.

However, this would require the employee to identify how the IFA meets the BOOT. As 42 per cent of employees reported that they made IFAs without knowing whether they are altering an enterprise agreement or award (O'Neill 2012b), the reliability of a genuine needs statement could be questionable in a number of cases.

Further, the ACTU expected that a lack of guidance would adversely affect employees:

> There is no protection offered to an employee through the genuine needs statement, rather the genuine needs statement has the opposite effect, denying an employee the ability to assert that they were not fully informed of what they were agreeing to. (sub. 167, p. 291)

AMMA was concerned that the requirement would have the unintended consequence of reducing the incentive to use IFAs:

> … AMMA members are extremely concerned about how this requirement will operate in practice. This threatens to create such a level of complexity and administrative burden on businesses that it will dissuade them from using IFAs. (sub. 96, p. 84)

In light of the foregoing, a key consideration is whether there are other changes that could be made to the BOOT that could make it work, or whether an alternative approach is needed to make IFAs more attractive.

Increasing transparency (see below) by exposing IFAs to independent scrutiny is suggested by participants as essential to ensuring the BOOT does not undermine wages and conditions. However, while this would provide some measure of comfort to employers and

employees after the arrangement is made, getting to that point still requires the sifting and weighing of monetary and non-monetary benefits.

AMMA considered that while the Fair Work Amendment Bill 2014 contained some provisions relating to flexibility clauses and IFAs that were positive, this was:

> … within an IFA architecture that is flawed and in need of more fundamental re-examination rather than piecemeal amendment … (sub. 96, p. 84)

Changing the BOOT to a no-disadvantage test

While there are questions about the extent to which the BOOT really acts as an impediment to the formation of IFAs, the BOOT has some intrinsic difficulties, not just in its application to IFAs, but more generally to collective agreements (chapter 15). Further guidance from the FWO on meeting the BOOT and the circumstances in which it would take compliance action against an employer where it subsequently led an IFA to breach to the FW Act could allay the concerns of some employers. That said, it is only realistic to recognise that the FWO is in an invidious position with a test as opaque as the BOOT (see chapter 15). As noted in chapter 5 (unfair dismissal), no code can substitute for clear and consistent legislation.

A no-disadvantage test (NDT) is likely to be a more workable protection for employees, while being less ambiguous. A NDT assesses whether the terms and conditions of employment disadvantage an employee relative to a stated benchmark.

On face value, the BOOT is similar to the NDT that preceded it. In theory the difference should be marginal with an arrangement passing the latter if the employee is at least as well off, and passing the former if it improves the employee's overall position (if only by a dollar). However, one concern is that a BOOT may be interpreted in practice as making an employee *materially* better off — a much harder test to satisfy. A NDT appears to be more straightforward to apply. It also has the great advantage over the BOOT of being clearly an aggregated test, that is, one that balances potential advantage and disadvantage, rather than being capable of interpretation as requiring all elements of an arrangement to be unambiguously favourable to an employee.

The NDT is also a well-established concept which has been extensively used under federal and state jurisdictions, albeit in different forms (chapter 15).

A new form of the NDT should compare the terms and conditions as a whole for employees relative to a benchmark but be able to operate in the context of the FW Act. The Productivity Commission is seeking information on the formulation of a revised NDT.

The proposal for a NDT, effectively implemented, appears on its face not to be inconsistent with section 3(c) of the FW Act as it would prevent the undermining of 'fair, relevant and enforceable minimum wages and conditions'.

To reduce uncertainty for employers and employees the NDT should be accompanied by practical guidance from the FWO to employers and employees. At present, the FWO best practice guide to making IFAs is the main source of information on its website. It contains one case study, and very basic examples, which provides minimal guidance on monetary and non-monetary benefits.

The Productivity Commission heard from one employer organisation that the FWO had provided oversight of a process to make IFAs, which provided confidence that it had satisfied the BOOT. While using this approach for a NDT would provide a high degree of certainty to employers, it is resource intensive and would displace other compliance activities.

Instead, and accompanied by legislative reform as recommended, the FWO should provide more detailed, practical guidance on the NDT, including a template arrangement and a step-by-step guide to compliance or checklist. Existing technology (for example, PayCheck Plus) enables specific guidance on penalty rates. Subject to examining feasibility and the costs and benefits, this type of platform could be adapted to enable employers and employees to assess the overall effect of IFAs.

DRAFT RECOMMENDATION 16.2

The Australian Government should amend the *Fair Work Act 2009* (Cth) to introduce a new 'no-disadvantage test' (NDT) to replace the better off overall test for assessment of individual flexibility arrangements. The guidance in implementing the new NDT should also extend to collective agreements (as recommended in draft recommendation 15.4).

To encourage compliance the Fair Work Ombudsman should:

- provide more detailed guidance for employees and employers on the characteristics of an individual flexibility arrangement that satisfies the new NDT, including template arrangements
- examine the feasibility, benefits and costs of upgrading its website to provide a platform to assist employers and employees to assess whether the terms proposed in an individual flexibility arrangement satisfy a NDT.

Lack of awareness

A lack of awareness may also contribute to the low take up of IFAs. A significant number of employers and employees are not aware of their existence. Around 65 per cent of employees, and around 45 per cent of employers were not aware that those who had their employment conditions set by an award or enterprise agreement could agree to an IFA (O'Neill 2012b). Small businesses and younger employees were more likely not to be aware of IFAs. Most employees who were aware of IFAs had received this information from their employer or manager.

The FWO has invested in its online resources and these are heavily accessed. However, the FWO website provides only limited information on IFAs. In any case, the online information is only useful for those employers and employees who already know about the existence of IFAs. It does not solve the problem that many parties are not even aware they exist ('You don't know what you don't know'). Targeted promotion of IFAs would be one way to increase employer and employee awareness. As most employees receive information on workplace relations from their employer, efforts should be directed at employers, particularly small businesses, and the effectiveness of the communication strategies assessed periodically by the FWO.

Businesses that are aware of IFAs are more likely to use them. But whether they would actually do so depends on the potential administrative burden of making individual arrangements (this is further discussed in chapter 17, on the enterprise contract).

DRAFT RECOMMENDATION 16.3

The Fair Work Ombudsman should develop an information package on individual flexibility arrangements and distribute it to employers, particularly small businesses, with the objective of increasing employer and employee awareness of individual flexibility arrangements. It should also distribute the package to the proposed Australian Small Business and Family Enterprise Ombudsman, the various state government offices of small business, major industry associations and employee representatives.

Individual flexibility arrangements need independent scrutiny

The recommendations in this chapter are primarily aimed at reducing the disincentives to the use of IFAs. Participants (from both employer and employee groups) have called for IFAs to be exposed to independent scrutiny to provide greater protection to both parties to the agreement and address one disincentive to their use.

Participants identified a lack of transparency as a weakness of current IFAs and sought independent scrutiny of the arrangements to strengthen compliance. The Printing Industry Association of Australia said that independent scrutiny of IFAs would:

> … provide certainty and thereby assurance to both employers and employees. (sub. 139, p. 6).

The ACTU cited widespread non-compliance with the prohibition of IFAs as a condition of employment (amongst other concerns) as highlighting:

> … that existing safeguards on the use of IFAs are relatively ineffectual as a means of protecting employees. The absence of external scrutiny in relation to the content of IFAs and the process of making them enables employers to pressure employees to accept substandard IFAs that reduce wages and conditions. (sub. 167, p. 287)

David Peetz noted that the absence of scrutiny cloaked non-compliance:

> IFAs are not routinely scrutinised by anybody … If the FWO comes to a workplace to inspect the wage records, and an IFA is below standard, then the employer is in breach of the award. But this only happens if they are found out. (sub. 133, p. 22)

Andrew Stewart and others (sub. 118) also raised that notification to the FWO when an IFA is made would enable the FWO to audit agreements and take action.

The 2012 post-implementation review recommended that employers notify the FWO of IFAs to enable it to investigate at its discretion whether IFAs were being abused, and to provide data about the incidence of IFAs (McCallum, Moore and Edwards 2012).

AMMA did not support the requirement for notification, as it would raise concerns that employees would be pressured by unions that did not want employees to enter into individual arrangements at the expense of enterprise agreements (AMMA, sub. 96).

Lodgment should not imply — nor require — clearance by the FWO. It is simply designed for confidence-building. Nevertheless, lodgment of itself (as proposed by the 2012 post-implementation review) may not be sufficient. The FWO can and should conduct random audits.

It is possible that lodgment would stretch existing FWO resources (unless technology provided a solution), and with a proportion of these agreements potentially minor in nature, the costs of lodgment across all parties (particularly small businesses) could outweigh the benefits.

Compliance and enforcement should be proportionate to their costs and benefits. Compliance (including education and enforcement) is already a significant budgeted expense for the FWO, representing around 61 per cent of its total resourcing in 2013-14 (Department of Employment 2014b). It may be that over time, the rate at which IFAs are registered could be expected to stabilise or even decline, depending on the duration of the arrangements made, which could then reduce administrative costs imposed on the FWO.

Modern technology solutions involving electronic lodgment of IFAs could provide a solution. This could be supplemented by software-automated extraction of the key elements of the agreements, and provision of this to employers and employees, so that they are aware of the kinds of agreements that have been agreed. The FWO could use ‘big data’ analysis for monitoring and enforcement purposes. Human hands and paper could be minimised.

16.4 Retained safeguards

The proposals in this chapter retain the following safeguards in the current legislation that IFAs:

- must be genuinely agreed to by the employee and employer

- are only made after the employee has commenced employment
- are in writing and signed by the employer and employee (or their parent or guardian if under 18)
- still involve a termination option of no longer than one year.

Table 16.1 sets out how the safeguards proposed by the draft recommendations in this chapter respond to some concerns raised in submissions, particularly in relation to an imbalance of bargaining power between employees and employers.

Despite greater information and modifications, IFAs may not suit some businesses (particularly small and medium-sized businesses). Use of the enterprise contract model discussed in chapter 17 could provide a mechanism to allow such businesses and their employees access to revised arrangements.

Table 16.1 **Safeguards to making individual flexibility arrangements**

Concern	*Possible impact without safeguard*	*Safeguard*
Mutually agreed unilateral termination period up to one year. Default unilateral termination period of 13 weeks	Employee is locked into an arrangement that does not benefit them for up to one year	The no disadvantage test and guidelines as to its operation
Increased scope of flexibility term (chapter 15)	A greater range of matters could be covered in IFAs than in some existing enterprise agreements	The no disadvantage test and guidelines as to its operation
IFAs made as a condition of employment	Employees have been offered 'take it or leave it' IFAs that undermine wages and conditions	FWO information campaign

Table 16.2 **Individual arrangements: international comparison**

Jurisdiction	*Arrangement*
Australia	All employees have a written or implied common law contract, with the scope determined by the boundaries of statute and relevant awards and enterprise agreements. Individual flexibility arrangements on a limited basis are permitted under *the Fair Work Act 2009* (Cth).
Canada	Wages and conditions are set through collective bargaining, which does not make provisions for individual arrangement to override or exclude collective arrangements.
European Union	Employers must advise employees of the terms and conditions of employment in writing within two months of employment commencing, unless they are provided with a document referring to a collective agreement or a written contract.
Germany	Terms and conditions are mainly regulated by statute, collective agreements or works agreements. As employment contracts must comply with these arrangements, there is little scope for individual arrangement, except for senior managers.
Japan	Individual employment contracts must not contravene collective agreements.
New Zealand	Where there is no collective agreement, an employer and employee negotiate an individual employment agreement. Individual arrangements must be offered in writing and include a number of mandatory clauses detailing, for example, duties, working hours, salary and how to resolve employment relationship problems. Employers must provide the minimum employment entitlements for workers as set out in the employment legislation, including payment of at least the minimum wage, four weeks' annual holidays and receiving wages without deductions. Where there is a collective agreement and the employee is not a member of the union that negotiated the agreement, the employer and employee can have an individual arrangement based on the collective agreement.
Sweden	Individual contracts and collective agreements are mutually exclusive. Individual protections are provided under law and apply to all employees, except those in managerial positions. If the employer is a member of an employers' association or has signed a collective agreement for a particular sector, individual contracts are prohibited. Employers are obliged to provide employees with information about salary, working hours and other terms and conditions within one month of the starting date of employment.
United Kingdom	Around a third of employees are not covered by collective agreements and may have individual arrangements with their employer. Certain 'particulars of employment' (terms and conditions) must be provided to the employee in writing under the *Employment Rights Act 1996*. Employees can apply for flexible working arrangements if they have worked continuously for the same employer for 26 weeks. They can make one application a year. The application must be in writing, to the employer, with a decision to be made within three months, although this can be lengthened if the employee agrees. If the employer agrees to the request, it must be reflected in the employee's contract. Where an employer refuses the request, they have to provide business reasons for the refusal in writing.
United States of America	Most employees do not have a written employment contract. Individual arrangements are common among professionals and executives, as well as sports people, entertainers and scientists.

Source: Blanpain (ed) (2010).

17 The enterprise contract

Key points

- Some employers, particularly small and medium-sized businesses seeking to modify award wages and conditions, appear to lack options for making agreements that suit their businesses, while adhering to protections for employees.
- Such employers may find it too daunting to make an enterprise agreement, and data show that small businesses overwhelmingly do not take up this form of arrangement.
- Consequently, these employers use individual arrangements — either individual flexibility arrangements (IFAs) or common law contracts — to modify award terms and conditions. But IFAs are not helpful for some types of employers and common law contracts do not offer the certainty to employees and employers of a statutory arrangement. The scope of IFAs is also limited to matters in the flexibility term of the overarching award or enterprise agreement.
- A possible new approach would be to introduce a new statutory arrangement that would provide a 'safe harbour' agreement to vary awards. Such an arrangement could have features of enterprise and individual agreements but avoid the elements that are a disincentive to their use. The new hybrid — an 'enterprise contract' — could vary the award for a class, or a particular group of employees.
- Such an arrangement could be made easily accessible and simple to use by providing sample templates on the Fair Work Commission (FWC) website that already have been structured to satisfy a no-disadvantage test.
- Transparency would be aided where businesses lodged the contracts with the FWC. The FWC's approval would not be required, but it could publish and report on the content of enterprise contracts. This would provide examples to employers, but also allow employees to assess where any particular contract they were offered fitted on the spectrum of offerings by competing businesses.
- The Fair Work Ombudsman could also play a support and education role, in addition to undertaking compliance activity.
- As a safeguard, employees could choose to opt out and return to a pre-existing arrangement (for example, the award) after a specified period (for example, 12 months) or choose to stay with the enterprise contract. This would provide an incentive for employers to ensure that the enterprise contract does not undercut wages and conditions.

The workplace relations (WR) system should offer employers enough choice to enable them to structure their employment arrangements consistent with their business operations, while preserving the necessary employee protections. Under the current system, employers seeking to modify awards have two options — an arrangement negotiated collectively under an enterprise agreement, or an arrangement negotiated individually using an individual flexibility arrangement (IFA) (as part of an award or enterprise agreement) or common law contract. There may be a gap in contracting options, since, depending on the scope of any variations in employment arrangements, both of these options may impose excessive administrative costs on smaller businesses. One possible approach that could fill this gap could be to introduce a new statutory arrangement for businesses that could be used to vary awards for a given class of employees, but in a way that would maintain the safety net for employees. Such an arrangement would then occupy the ground between enterprise agreements and awards. This hybrid arrangement — an 'enterprise contract' — could vary the award for a class, or a particular group of employees using a template contract. It could adopt aspects of the current system that would be useful to businesses, but place them in a form that is simple and less costly to use.

Consistent with its inception as a new instrument to fill an identified need not met by the existing system, the new arrangement would intend to add utility to the existing system, not to disrupt existing arrangements. It would be best suited to small and medium-sized businesses with limited human resources capacity and workforces structured around awards. It would be unlikely to be of significant benefit to employers that already provide above-award wages and conditions (using common law arrangements), although they may prefer to use a statutory, rather than common law, agreement.

Section 17.1 discusses the factors that identify the need for a new type of employment instrument. Sections 17.2 and 17.3 set out the options and outline the key elements of the new instrument's scope and operation and section 17.4 sets out the possible impacts.

17.1 The gap in employment arrangements

Businesses seeking to modify the default entitlements of awards can either:

- use options specified in some awards (such as annualisation and time-off-in lieu) for varying the default
- undertake a collective negotiation with staff through an enterprise agreement
- reach an agreement using a common law contract, or
- negotiate an IFA.

The first option is at best incomplete because the scope for variations in arrangements is not uniform across awards.

Participants state that small businesses are reluctant to use enterprise agreements and data show that collective arrangements are generally rejected by small businesses as a means to

set wages and conditions. In 2014, only around 6 per cent of non-managerial employees in small enterprises (employing less than 20 employees) were covered by enterprise agreements compared with around 80 per cent for the largest enterprises (table 17.1). Data based on a different survey finds qualitatively similar results, with enterprise agreements covering only 7 per cent of employees in businesses employing 5-19 employees (figure 17.1). These data show that contracts exactly set at the award account for around half of the agreements set by businesses with fewer than 200 employees.

Table 17.1 **Methods of setting pay**

Share of employees by employment size of businesses, 2014

Employee size (non-managerial)	*Award only*	*Collective agreement*[a]	*Individual arrangement*	*All methods of setting pay*
	%	%	%	%
Under 20 employees	33.4	5.9	60.7	100.0
20 - 49 employees	32.3	17.5	50.2	100.0
50 - 99 employees	24.7	28.2	47.1	100.0
100 - 999 employees	14.7	52.2	33.2	100.0
1 000 and over employees	9.5	79.7	10.8	100.0
Total	20.4	43.5	36.1	100.0

[a] The ABS refers to enterprise agreements as collective agreements.

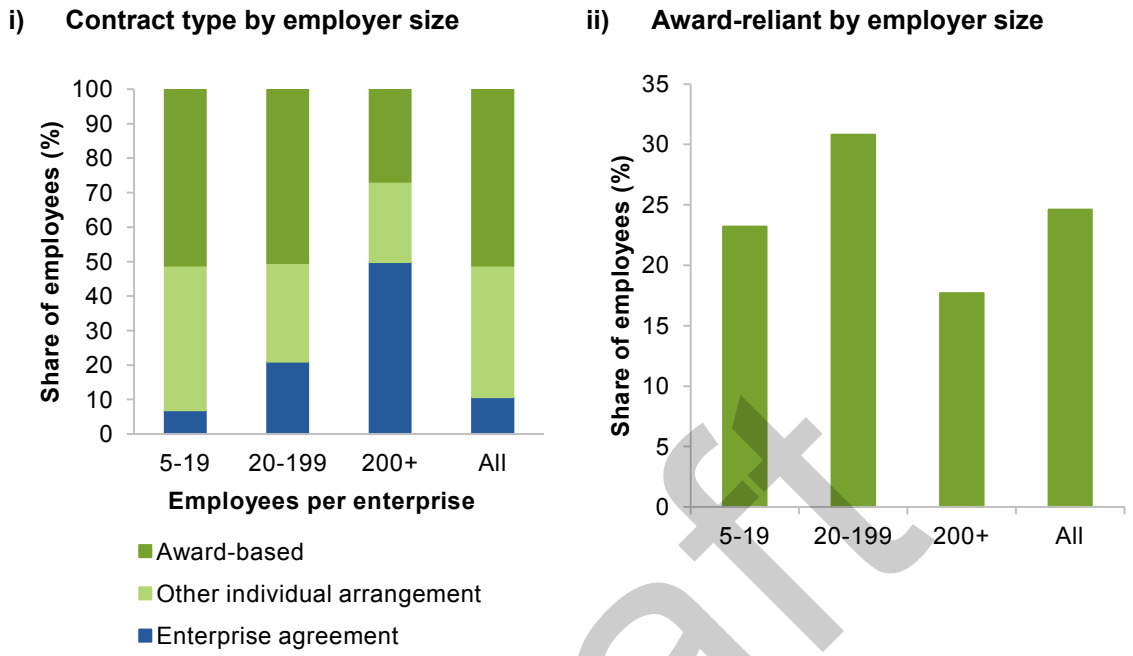
Source: ABS, 2015, *Employee Earnings and Hours, Australia, May 2014*, Cat. No. 6306, table 5, released 22 January.

Enterprise agreements are least likely to be made in the rental, hiring and real estate services and professional, scientific and technical services industries. Small businesses (20 employees or less) are highly concentrated in these industries — they comprise 16.7 per cent of all small businesses in Australia and generate 9.4 per cent of value-added production (ABS 2015a, 2015d).

Hourly wage rates for small businesses that did use enterprise agreements were the highest for all methods of setting pay for that group of businesses (table 17.2). This suggests that the segment of small employers using such agreements is quite distinctive.

Smaller employers tend not to have the backroom resources, such as sophisticated human resources systems or in-house legal or financial advice, that help to smooth the enterprise bargaining path for larger entities. Smaller enterprises cannot spread such fixed costs of negotiating arrangements across many employees. Nor do smaller enterprises necessarily have an established relationship with experienced employee representatives (often unions), which may often underpin efficient bargaining at the enterprise level. Over 60 per cent of enterprises employing 200 or more workers communicated to their employees through employee representatives or union delegates. The comparable figure for a business employing 20-199 employees was around 27 per cent (employee representation was not considered applicable in businesses with a relatively small workforce) (FWC 2015d, p. 29).

Figure 17.1 **Contract type by employer size**
Share of employees by employer size, 2014[a]



[a] Unlike the ABS data, the AWRS has data on the nature of the award. Award-based agreements cover both award-reliant agreements (where the employee entitlements are exactly equal to the award) and above-award agreements (in which the award is the benchmark agreement, but with additional wages). AWRS excludes micro employing businesses.

Source: AWRS 2014 from the Fair Work Commission.

Employer representatives suggested that Australia's WR system tended to give undue emphasis to enterprise agreements as the preferred vehicle for establishing flexibility — despite such agreements being ill-suited for smaller employers.

> The system must offer viable alternative mechanisms for setting wages and conditions for small business … enterprise agreements are not the dominant mode of engagement for small business employers and their employees. (ACCI, sub. 161, pp. 98–99)

> … whilst enterprise bargaining has a role to play for some businesses and employees … it is not an appropriate, necessary or accessible option for the majority in Australia, being the small to medium enterprise. (Clubs Australia, sub. 60, p. 13)

Enterprise agreements also were identified as costly and less suited to the cultural values of small businesses:

> The use of external bargaining agents often goes against the culture of a small business, where employer and employee relations are established and maintained on personal interaction. Further to this, collective bargaining is cost-inhibitive to small businesses, and our members tell us that they see entering into a collective agreement as unnecessary and more geared towards larger organisations that can find efficiencies in agreement making on a larger scale. (Business SA, sub. no. 174, p. 11)

Table 17.2 **Relative hourly rate of pay by method of setting pay**

Relative rates of pay by employment size of businesses, 2014

Employer size (non-managerial)	*Award only*	*Collective agreement*[a]	*Individual arrangement*	*All methods of setting pay*
	%	%	%	%
Under 20 employees	63.2	95.5	87.8	81.0
20 - 49 employees	67.7	93.5	93.5	86.1
50 - 99 employees	69.7	97.2	106.5	96.6
100 - 999 employees	73.7	105.4	118.4	106.2
1 000 and over employees	105.4	111.3	139.9	114.4
Total	73.4	107.1	104.0	100.0

[a] The ABS refers to enterprise agreements as collective agreements. b The table measures the rate of pay by method of setting pay by employer size relative to the rate applying to all enterprises for all methods of setting pay. For example, award only non-managerial employees in small businesses have an hourly pay rate that is 63.2 per cent of the average rate for all enterprises.

Source: ABS, 2015, *Employee Earnings and Hours, Australia, May 2014*, Cat. No. 6306, table 5, released 22 January.

The complexity of enterprising bargaining also made it a daunting prospect (sometimes even for larger enterprises). Several participants shared their experiences including:

> … due to the prescriptive nature of the good faith bargaining requirements in s 228 of the *Fair Work Act 2009* (Cth), employers who genuinely have no desire to enter into an enterprise agreement nevertheless have no real option but to engage in the bargaining process initiated by the relevant union. (Printing Industry Association of Australia, sub. 139, p. 7)

> … one aggressive bargaining representative (which may represent only a minority of the workforce) dominating the process, particularly against inexperienced or poorly resourced employers. (Peabody Energy, sub. 241, p. 2)

These examples illustrate the capacity and experience (not available to smaller firms) needed to manage such processes. As a consequence, smaller businesses tend to have a greater reliance on individual arrangements. But these are not helpful for some types of employers, particularly those with high staff turnover, as their costs rise with the frequency with which they need to make separate arrangements with new staff. Relying on individual arrangements could place a higher administrative burden on businesses in industries such as retail and hospitality.

17.2 Could common law contracts fill the gap?

One option already available to employers is to vary the award in a similar manner for a number of employees using a common law contract. However, they may be reluctant to do so unless the wages and conditions specified in the contract are unambiguously above the award and therefore unlikely to be subject to a dispute as to whether they meet the minimum award wages and conditions. A common law contract is not a stand-alone

document, as its overall effect relies not only on the terms included in the contract, but the effect (express or implied) of the relevant statute or award, including the safety net.

In this circumstance the outcome under a common law contract, where it diverges from a statute or award, depends on the effect of the statute and this is not always straightforward to determine:

> What is the legal status of a contractual term that differs in content from a provision of a statute or award dealing with the same subject matter? Loose language is rife: for example, the authorities speak of awards rendering "inoperative" or "unlawful", "displacing", "modifying" or "suppressing" contractual provisions dealing with the same subject matter … The correct position is that there is no universally necessary or true answer to the question with which this paragraph began: the answer, in every case, depends on the express or imputed effect of the relevant statute. (Neil and Chin 2012 pp. 96–97)

As such, a common law contract is, in theory, always subject to an ex ante test at law (although, in practice, the cost of pursuing this course in the event of a dispute may be prohibitively high).

While some employers by necessity already rely on common law arrangements to vary awards, they do not offer the certainty to employees and employers of a statutory agreement. One employer highlighted an undesirable consequence of the interaction of the common law and complex regulatory requirements:

> The Australian workplace relations framework is complex because of the interaction of the common law, the Fair Work Act, state/territory legislation, enterprise agreements, awards, and in many cases, a signed 'Contract of Employment' document each employee has executed with his/her employer. This layered set of rules is a recipe for error. A major problem arises because too many parties to employment contracts operate under the misapprehension that such a document displaces regulatory oversight and all the layers of red tape. (Ports Australia, sub. 249, p. 8)

Therefore, one attraction of a 'safe harbour' statutory template over a common law arrangement is that the former provides certainty for employers and employees that it meets the statutory obligations and provides the requisite protections, particularly in circumstances where the net effect of the contract differs marginally from the award.

17.3 A better option to bridge the gap – the enterprise contract

Scope of an 'enterprise contract'

The enterprise contract could be a *statutory* agreement that follows a template, and that would apply to a class of employees (for example, level 1 retail employees), or a group of employees. Templates are a common means of making individual agreements under past

and current workplace laws. For example, most IFAs vary the same condition across multiple employees (O'Neill 2012b).

The contract would be required to be in a standard form that would need to be specified in regulations. This would include that the contract be in writing. The incremental costs to businesses of doing this would be negligible, as the business would also have to lodge the agreement with the Fair Work Commission (FWC) (see below) and this would be particularly easy where the employer made use of a template.

Sample templates (for example, for each award), that would conform to the regulations, could be made available on the FWC website. The New Zealand contract builder (box 17.1) provides one example of how this could be done (though unlike New Zealand, the agreements would apply to a class of employees, not just an individual). The FWO already provides a standard letter of engagement for casual, full-time and part-time employees on its website.

Employers would not be required to use the templates provided by the FWC, but any alternative form that they formulated would still need to meet the safety net and other terms specified in the regulations. Employers would deal directly with employees rather than be required to adopt the more elaborate processes of enterprise agreements.

As employers could use a template that already complied with specified requirements in the regulations, the enterprise contract would avoid the costs of enterprise or individual bargaining to smaller employers by not requiring negotiation with each party to the contract, either individually or as a group. In a similar vein, it would not require the approval or consent of any other party (for example a trade union or employer association).

The employer should provide the enterprise contract to the employee in writing and the employee should have sufficient time to assess and understand the enterprise contract before agreeing to it.

Box 17.1 A sample template agreement

All employees in New Zealand must have an employment agreement in writing. The New Zealand Department of Labour has created an employment agreement builder, which uses templates and drop-down menus. Employers can draft their preferred employment agreement choosing the relevant options (figure 17.2). The agreement builder includes mandatory clauses, such as the name of the employee and employer, working hours and salary, as well as how to resolve employment relationship problems. Standard clauses on other matters such as employee benefits and entitlements are also provided for use by the employer.

Figure 17.2 Online template

Section 3: Nature of Agreement

An agreement's nature may be defined as:

- **permanent**, where an employee is employed for an indefinite duration;
- **fixed term**, where an employee is employed for a specific time period; or
- **casual**, where the employee is only expected to work from time to time.

Before a fixed term agreement can be agreed on there must be a genuine business reason for the fixed term, such as the temporary absence of an existing employee or a specified project to be undertaken.

Please read the following options carefully, as the choice made here may affect the options available to you later in the agreement. If you're not sure, you can always come back by clicking on the **Progress Bar.**

○ **Individual Agreement of Ongoing and Indefinite Duration**

This Employment Agreement is an individual employment agreement entered into under the Employment Relations Act 2000. The employment shall commence on
insert date and shall continue until either party terminates the agreement in accordance with the terms of this agreement. The clauses in this agreement may be varied or updated by agreement between the parties at any time.

Source: NZ Department of Labour (nd).

For transparency, the documents would be lodged with the FWC (including electronically), to operate from the time of lodgment, and these would be compiled and published periodically (figure 17.3). This would provide examples for employers, but would also allow employees to assess where any particular 'take it or leave it' contract fitted among the spectrum of offerings provided by various competing businesses to give them information that could influence their choice of employer.

The FWO could play a support and education role and would be able to scrutinise contracts and conduct compliance and enforcement (figure 17.3).

Lodgment would also allow the FWC or the FWO to analyse the nature of and trends in such agreements, which would also provide a basis for new industry templates so that any business could adopt a template agreement with the surety that it would pass a no-disadvantage test (with equal certainty for an employee).

Compliance and enforcement and evaluation and reporting would be ongoing processes and conducted simultaneously.

An enterprise contract could maintain and add to employee (and employer) protections

Although a standalone statutory instrument, the enterprise contract would not be carved out from the protections applying to other agreements under the *Fair Work Act 2009* (Cth) (FW Act). That is, it would be subject to the national employment standards (NES) and the new no-disadvantage test proposed in chapter 15 (enterprise bargaining) and chapter 16 (individual arrangements).

With a no-disadvantage test, the statutory contract operates alongside the safety net (awards and the NES) and does not undercut it. Without a no-disadvantage test, a statutory contract may override the safety net and standards in enterprise agreements and IFAs (although in theory should not be able to undermine the NES).

To avoid any ambiguity, the base rate of pay in an enterprise contract must never fall below the national minimum wage rate or that in the relevant award, consistent with the principles already established in the FW Act (for example, as in s. 206 for enterprise agreements).

Enterprise contracts that do not meet a no-disadvantage test may, upon complaint by the employee, be varied to achieve that outcome and ensure that the employee is no worse off under the enterprise contract. One option to assist compliance would be for the FWO to be able to order that the contracts of other employees that contain similar clauses could be varied, with those employees' consent.

The enterprise contract would meet the award wages and conditions (albeit in a different form) and employees should not be worse off under an enterprise contract compared to the award. However, in the event the employee believed they were disadvantaged relative to the award, an employee could have the option to return to an existing arrangement (for example, the relevant award) after the minimum period of an enterprise contract as stated in the regulations (for example, 12 months) or at the expiry of the agreement, whichever is the shorter.

Allowing such an 'opt out' after a period would provide an added incentive for employers to offer wages and conditions that do not disadvantage the employee and therefore risk disruption to the operation of the enterprise contract.

Existing employees could not be forced to enter into an enterprise contract, and the employer could not 'cherry pick' parts of the contract, consistent with the treatment of awards, enterprise agreements and IFAs. As the design of this approach is focused on a set of employees rather than an individual, the scope for coercion is reduced as the number of employees subject to an enterprise contract increases.

By increasing transparency, the enterprise contract may well increase employee and employer protections where it replaces informal or unwritten arrangements, which are common in a number of service industries in particular. It would also enable employers to avoid the cost and administrative burden of drawing up formal common law agreements. Written agreements protect employers as much as employees in the event of a dispute about pay and conditions, particularly where these deviate from an award.

It could replace other agreements and allow employees to 'opt in'

The new contract would be available to all the employees specified in the contract, providing horizontal equity. This means it would be offered to prospective employees as a condition of employment.

The enterprise contract could replace the award or an employer's enterprise agreement and instead be the primary instrument to regulate the employment relationship for those employees of those businesses that choose to use it. In these circumstances, it should not be limited just to addressing the terms of any award or agreement that it replaces.

An 'opt in' mechanism could permit an existing employee to choose to have their employment relationship determined by the enterprise contract provided they were in the class of employees referred to in the contract. Such a right should not be able to be bargained away, for example, through an IFA.

However, an employer and employee could still choose to make an IFA if it offered flexibilities that suited the circumstances of the employer and employee. The model flexibility term, which applies to IFAs, could be a standard inclusion in an enterprise contract.

It would operate for a specified period

The contract would be for a specified term and operate for a minimum period (for example, 12 months) to provide stability to a business's operations and a maximum period (for example, three years) to suit the needs of the employer and employee, and these periods could be specified in the regulations. Upon expiry of the contract, the employer and

employee could choose to continue the contract until terminated by either party, or move to a separate arrangement.

It could also be possible for employees (with majority consent) to initiate an enterprise bargaining process after the enterprise contract has expired. In these circumstances, the enterprise contract could for some businesses become a transitional contract type, and could facilitate a higher penetration of enterprise agreements.

17.4 Possible implementation impacts

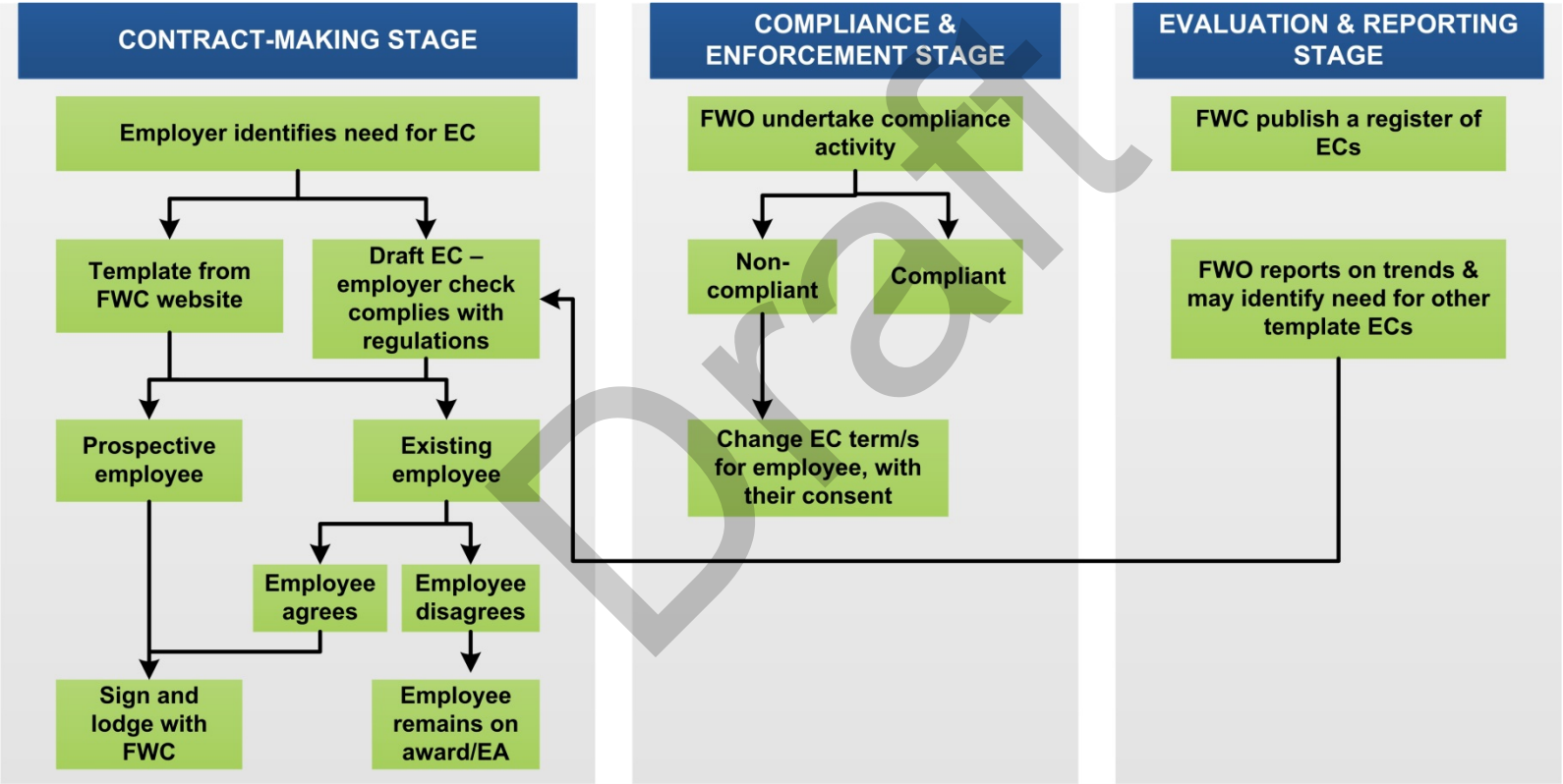
The proposal for an enterprise contract is aimed to increase the options for small and medium-sized businesses to vary awards and increase the transparency of employment relationships by making available an easily accessible, written contract suited to the needs of the business and employee.

Large enterprises would not be prevented from adopting enterprise contracts, that is there would be no restriction on the size of a firm able to use them. However, the policy gap that has been identified in the Productivity Commission's analysis is at the small-to-medium firm end of the business spectrum.

There are three safeguards in place to reduce the potential for enterprise contracts to be used to exploit vulnerable workers.

- the operation of the safety net and the no-disadvantage test will be critical to achieving net benefits from the arrangement, as it will provide confidence that the enterprise contract does not disadvantage the employee relative to the award or enterprise agreement
- businesses must notify the FWC of the arrangement. While there will be some additional compliance costs for businesses, these are not expected to be large since lodgment relates to a whole class of employees, not each individual employee, and would be further facilitated by electronic lodgment options
- the employee may 'opt out' after a specified period.

Figure 17.3 **Making an enterprise contract**



The arrangements suggested in this chapter are likely to impose additional compliance costs on regulators as they propose lodgment, reporting, compliance, and education/support. The first two of these functions could be undertaken by the FWC, and the second two by the FWO. This would be expected to create additional resourcing needs for both agencies and that there would be transitional, as well as ongoing costs.

INFORMATION REQUEST

The Productivity Commission seeks information on the costs (including compliance costs) and benefits of an enterprise contract to employers, employees and to regulatory agencies. Particular areas that the Commission seeks information on are:

- *additional evidence on the potential gap in contract arrangements between individual arrangements (broadly defined) and enterprise agreements*
- *the extent to which the enterprise contract would be a suitable addition to the current suite of employment arrangements, how it could fill the gap identified, and specific examples of where and how it could be utilised*
- *clauses that could be included in the template arrangement*
- *possible periods of operation and termination*
- *the advantages and disadvantages of the proposed opt in and opt out arrangements.*

In addition, the Productivity Commission invites participants' views on the possible compliance and implementation arrangements suggested in this chapter, such as their impact on employers, employees and regulatory agencies.

18 Public sector bargaining

Key points

- Commonwealth, state and local government workers comprise 16 per cent of the total workforce.
  - At least 37 per cent of these are covered by the national workplace relations system.
- As centralised budget holders, governments have an inherently greater capacity to shape wage bargains with their employees, even though bargaining takes place at the agency level. However, while there are exceptions, wage growth has largely exceeded that in the private sector since 1998. There is also evidence suggesting that, as a group, public sector employees receive higher wages.
- Delegation of the authority to bargain involves a tradeoff between the cost of reaching an outcome and the degree of control over the process. Governments need to make this tradeoff with regard to the costs of the bargaining process to all parties.
- There is little scope in the public sector for either the good faith bargaining requirements to be tightened to force parties to make concessions, or for the Fair Work Commission to intervene at an earlier stage to force an outcome.
- A number of issues complicate the measurement of productivity in the public sector. These can be attributed to the nature of the work, where outcomes are often longer term and multifaceted, and the absence of markets. As a result, there are likely to be circumstances in which strongly linking pay and productivity may not be practical.
- There is some evidence that the management of underperformance is a concern across the Commonwealth public service. The removal of terms that specify unnecessarily lengthy, costly and inflexible performance management and termination processes from agency enterprise agreements may go some way towards rectifying this. However, this is likely to come at some cost.

Public sector bargaining is the process by which an agreement is reached between the management and employees of government departments, statutory authorities and public financial or non-financial corporations over the terms and conditions of employment.

In Australia, public sector bargaining shares many characteristics with bargaining in the private sector. In the national workplace relations (WR) system, it involves the striking of an enterprise agreement in which the minimum standards stipulated in the National Employment Standards (NES) must be met, while any trading off of terms and conditions must satisfy a better off overall test (BOOT) with reference to the Public Sector Award.

The most notable difference[198] is that, in the public sector, a few key players have substantial influence over the terms and conditions of a large number of workers.[199] While in some regions, Commonwealth, state and local governments vie for quality public servants, in many there may only be one level of government. Since they face limited competition for public sector workers, governments are, if they wield it, likely to have stronger bargaining power than the majority of employers in the private sector.

Beyond their role as the only employer of public sector workers, governments also fulfils other tasks. Not only do governments hire workers, but in many cases they make employment laws, set policies and enforce compliance. As the Australian Education Union put it:

> … the State – whether Commonwealth or state – is in a unique and unbridled position of power. It is legislator, executive, employer, policy controller or formulator and funder/purchaser. (sub. 63, p. 7)

The operation of labour markets may partly mitigate such power. Many employees can move between different government workforces, as well as into the private sector, while others try to balance current and predicted wages and conditions with perceptions of job security and career progression. Moreover, there is a difference between having power, and exercising it.

This chapter does not canvas issues unique to the current Australian Commonwealth public service bargaining round, but instead seeks to identify a preferred approach to future public service workplace arrangements, accepting that governments, as employers, have different obligations and responsibilities than other employers. It focuses on longer-term questions about governments' roles as dominant employers in their sectors, and how this may sometimes conflict with their other roles. To facilitate this, the chapter outlines some characteristics of the public sector in Australia, including an examination of the market structure and outcomes (section 18.1). It then examines bargaining processes (section 18.2), the capacity of the Fair Work Commission (FWC) to intervene in public sector bargaining (section 18.3), productivity (section 18.4) and performance management (section 18.5) as well as some other issues particular to the public sector (section 18.6).

198 This is not the only distinguishing feature of public sector employment arrangements. There are also a number of employment statutes at the State and Federal level that cover public sector employers. In this sense, the public sector has some regulations that the private sector does not (Australian Council of Trade Unions sub. 167, p 247).

199 The strong position of the Australian Government when it comes to public sector employment is made clear by the Public Service Act 1999 (Cth) which emphasises that Agency Heads have all the rights, duties and powers of an employer (s 20), yet while they may engage employees for the purposes of their Agency, they do it on behalf of the Commonwealth (s 20). Most state public service acts are similar in effect.

18.1 Some features of public sector bargaining

The public sector is large

In 2013-14, there were just under 2 million Commonwealth, state and local government public sector workers, accounting for just under 16 per cent of Australia's total workforce (ABS 2014b) — a figure in line with the average 15 per cent share apparent in other developed economies (Gregory and Borland 1999). Since, WR systems relate to employees, not all workers, the importance of government employers is even higher at 18.8 per cent in May 2014.[200]

Of the people employed in the public sector, just under 250 000 were employed on behalf of the Australian Government and almost 1.5 million on behalf of state governments (table 18.1). To put this in context, the five largest states (New South Wales, Victoria, Queensland, South Australia and Western Australia) and the Commonwealth were responsible for the employment of over 1.6 million workers or just over 14 per cent of the total workforce (or around 17 per cent of employees).

Table 18.1 **Public sector employees by jurisdiction**[a]
June 2014

Jurisdiction	*Commonwealth public sector*	*State public sector*	*Local Government*
New South Wales	56 500	469 700	56 100
Victoria	47 200	333 200	51 300
Queensland	28 200	298 100	41 700
South Australia	16 000	114 100	10 600
Western Australia	13 400	167 300	22 000
Tasmania	5 100	39 200	4 000
Australian Capital Territory	75 700	24 400	..
Northern Territory	4 300	26 900	3 200
Total	246 400	1 472 900	188 900

[a] These figures exclude permanent defence force personnel (whose pay is set by the Defence Force Remuneration Tribunal), employees of overseas embassies, employees based overseas, workers on workers compensation and unpaid directors of public sector organisations.

Source: ABS, *Employment and Earnings, Public Sector, Australia, 2013-14*, Cat. No. 6248.0, released 13 November 2014.

200 This is based on a different ABS survey (ABS, *Employee Earnings and Hours, Australia, May 2014*, Cat. No. 6306.0, released 22 January 2015) from that used in table 18.1. The EEH survey separates total employee numbers into the public versus the private sector and records 1.864 million public sector employees at May 2014, whereas the total number of public sector employees (including local government) was 1.908 million in June 2014.

The sheer size of the sector means that public sector bargaining processes have the capacity to affect a large number of workers and may even have broader macroeconomic consequences.

Not all public sector employees are covered by the *Fair Work Act 2009* (Cth) (FW Act), reflecting the 'patchwork' of referrals over the last 20 years (see table 18.2). In addition to those of the Commonwealth, public sector employees in Victoria, the Australian Capital Territory and the Northern Territory are also covered by the national WR system. 'Constitutional corporations', which includes some state-owned trading entities, are also captured by the national system, as are local government employees in Tasmania. All other state and local government workers in the other states remain covered by State laws.

While it is possible that other states will ultimately refer the industrial powers that cover their public services to the Commonwealth, the lack of public discourse about this makes the prospect of this occurring in the near future unlikely.

Table 18.2 **The patchwork of referrals between the state and Federal systems**

Jurisdiction	*Who is covered by the Fair Work Act?*	*Who is covered by state laws?*
NSW	Private sector employees and employees of constitutional corporations	State public sector workers and local government employees
Qld	Private sector employees and employees of constitutional corporations	State public sector workers and local government employees
SA	Private sector employees and employees of constitutional corporations	State public sector workers and local government employees
Vic	All employees	
WA	Employees of constitutional corporations with some additional areas where employers and employees have other connections with the federal system	All other employers
Tas	Private sector employees, local government employees and employees of constitutional corporations	State public sector workers
ACT	All employees	
NT	All employees	

Source: CPSU SPSF Group, sub. 90, p. 12.

Since the national workplace relations system captures the 246 600 Commonwealth public sector employees, 384 500 state public sector employees[201] and 80 500 local government employees (using the figures from table 18.1 and the coverage detailed in table 18.2), a conservative estimate suggests it covers at least 37 per cent of all public sector employees[202], equivalent to over 6 per cent of the total number of employees.

201 The Northern Territory police operate under a discrete Tribunal directly provided for in the Police Administration Act (Police Federation of Australia, sub. 106, p. 2).

202 This estimate may exclude employees of some state-owned 'constitutional corporations' which fall into the national WR system.

While the assessment in this section is restricted to the public sector agreements struck under the FW Act, the defining feature of public sector bargaining — a single employer with considerable bargaining power — is consistent across all jurisdictions.

In theory, the Government has purchasing power

The strength of a government's bargaining position largely derives from the fact that it is the most substantial employer of public servants in a particular region.[203] While there can be some competition for these workers from private companies or from other governments, it may be dulled by a reluctance on the part of the worker to move to the private sector or interstate.[204].

In some situations, an employee's choice of occupation constrains their ability to find employment outside the public sector. This is largely because governments are the major providers of health, education, emergency and corrective services. So, for example, if a police officer wishes to remain a police officer, they have no choice but to do so as a public sector employee, strengthening the Government's bargaining power.

In other circumstances, public sector workers are restricted in their ability to take industrial action. The FW Act stipulates that the FWC may make an order to suspend proposed industrial action where it is likely to endanger life or cause significant harm to a third party or to the economy.[205] Because of this, the parts of the public sector that are focused on service delivery to the vulnerable or in maintaining public safety (such as police officers, firefighters, prison officers and child protection workers) may find it difficult to take industrial action and, as a result, cannot so easily countervail the Government's bargaining power.

Several inquiry participants cited examples illustrating these points. For instance, in their submission to this inquiry, the Australian Education Union gave the example of teachers in the Northern Territory, who proposed industrial action in pursuit of an enterprise agreement. Rather than take the attendance roll electronically, they proposed to take it manually, and not provide it to school administrators. The proposal was found to threaten endangerment to personal health and safety or welfare, and the action was suspended by the FWC under s. 424 of the FW Act (sub. 63, p. 9). Similarly, the Police Federation of Australia observed that:

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203 The exception is when Commonwealth and state governments both have a significant presence in the same region and can effectively compete against each other for workers.

204 Features of the Australian labour market such as safety nets, organised labour and enterprise bargaining have evolved over time to offset market power on the part of the employer. This has advanced the simplistic model that any wage offer has to be enough to stop a worker from decamping. Even so, ensuring the employee is not driven away is one of the major considerations of employers in any enterprise agreement or individual contract negotiation.

205 It can also suspend industrial action where it considers that the bargaining process may benefit from the suspension – or a 'cooling off' period.

> Police officers, due to our Oath of Office, can be prejudiced in their capacity to fully participate in enterprise bargaining, particularly as they are an essential emergency service. To achieve a desired outcome, enterprise bargaining clearly envisages that negotiations may develop into more than a discussion around claims or a debate on wages policy, but may eventually test the resolve of parties around the principles of supply and demand. To not have the legal ability to fully extract the potential of a bargaining position is to enter into the exercise without the necessary tools to effectively participate. Whilst there is a perception that police unions possess significant industrial strength, they are unable to engage in industrial action in the same way as other members of the workforce. (sub. 106, p. 4)

Public servants are not entirely bereft of options. They can take industrial action, or threaten to take industrial action that causes irritation and increased costs, so long as it does not endanger life or the economy. For example, anecdotal evidence suggests increased numbers of passengers, mail and cargo were selected for screening as a part of industrial action taken by quarantine officers at the Department of Agriculture. Where industrial action typically leads to a strike or a cessation of work, in this instance it resulted in them *working harder*. While this led to delays, it did not weaken Australia's quarantine controls.

Notwithstanding such creative solutions, these restrictions must have some effect on public sector workers' ability to wield power in enterprise agreement negotiations.

To the extent that it enjoys a degree of purchasing power, the Government could, in theory, drive the terms and conditions of employment in enterprise agreements closer to the safety net wages and conditions specified in the Public Service Award.

In practice, wage outcomes have not generally been poor

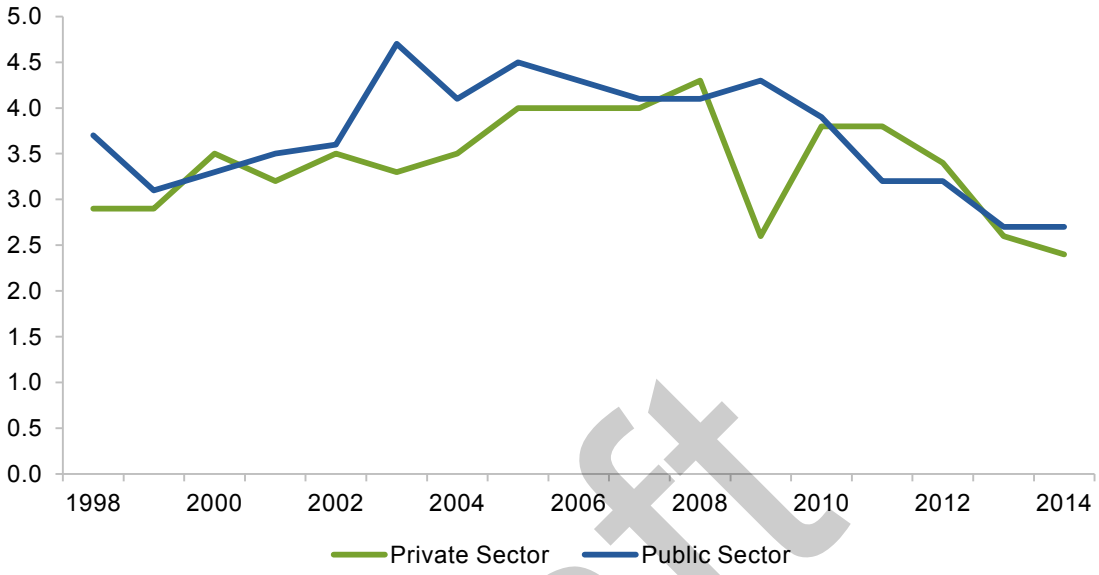
Notwithstanding the strong market position of Commonwealth and state governments, evidence suggests that public sector workers have enjoyed higher wage growth than the private sector.

Since 2001, aggregate annual wage growth in the public sector has been lower than that of the private sector on only four occasions (figure 18.1). Over this period, average annual wage growth has been 3.7 per cent in the public sector, compared to 3.4 per cent in the private sector. To put this in perspective, if two workers – one in the public sector and one in the private sector – commenced work in 1998 on the same wage, the differential in wage growth would lead to the public sector worker's wage being 63 per cent higher by 2014, compared to 58 per cent higher for the private sector worker.

This data (and the ratio data examined below) suggest that governments have not, in any systematic sense, been either excessively growing or shrinking public sector wage levels at the aggregate level.

Figure 18.1 **Public vs private sector wage growth**[a]

Wage price index, 1998-2014



[a] Annual wage growth is determined from the percentage change from the corresponding quarter of the previous year, commencing with December 1998. It excludes bonuses.

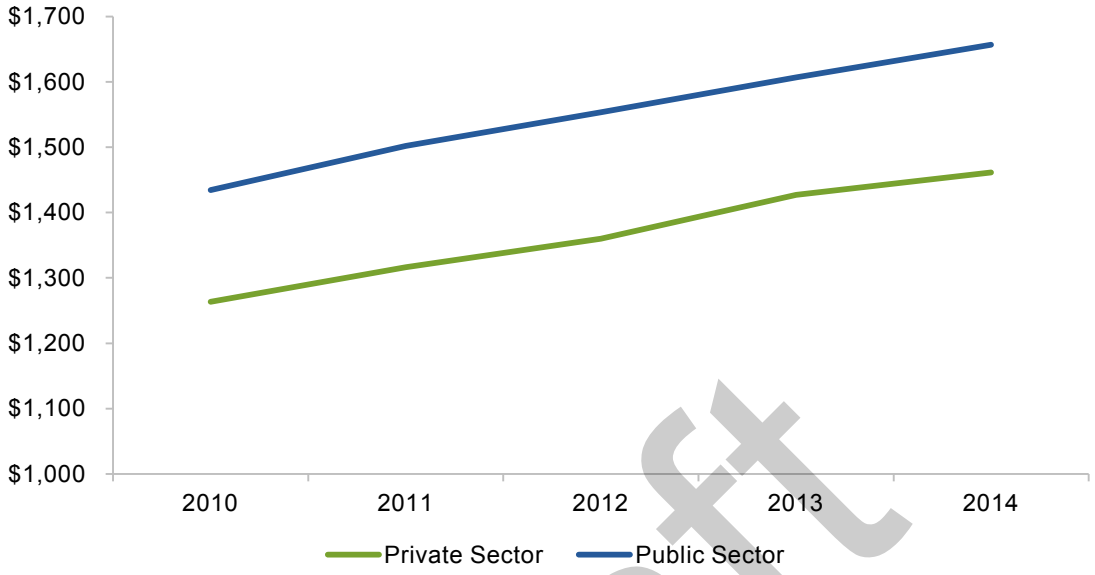
Source: ABS, *Wage Price Index, Australia, Dec 2014*, Cat. No. 6345.0, released 24 February 2015.

However, trends alone cannot indicate whether Australian governments have used their market power to lower average wage levels at any point in time. To assess this requires a comparison between employees in the private and public sector who otherwise share common skills and aptitudes. The most recent assessment of this issue suggests that female government public sector workers receive wage premiums over their private sector counterparts, not discounted wages. There is little evidence of a statistically significant premium for males (Siminski 2011).

Aggregate wage levels, while offering less of a like-with-like comparison, also show that workers in the public sector in Australia are typically more highly remunerated than those in the private sector. From 2010 to 2014, public sector workers received wages almost 14 per cent higher on average than their private sector counterparts (figure 18.2). This result was broadly consistent across the states, with the average public sector premium being just under 16 per cent in 2014 (figure 18.3), and with no state offering a premium of less than 12.5 per cent.[206]

206 There are likely to be some parts of the public sector that get higher premiums than others, reflecting the potential for productivity enhancements or a measure of market power. Ascertaining exactly where in the public sector these premiums occur is difficult, as there are little data. Suffice to note, there are likely pay differentials across the public sector.

Figure 18.2 **Private vs Public Average Weekly Earnings**[a]
May, 2010 to 2014

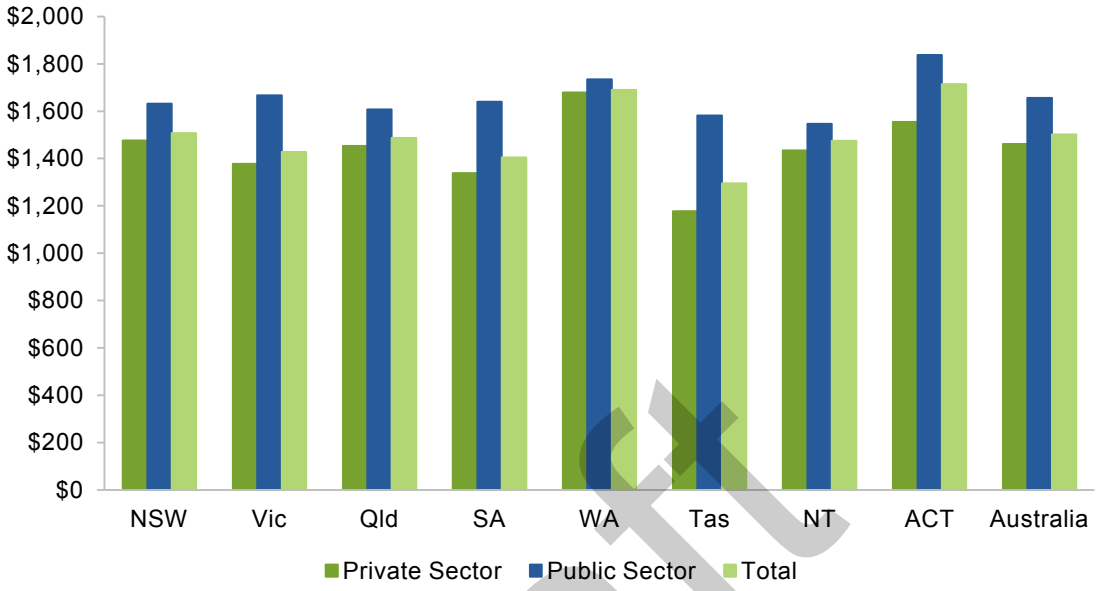


[a] Figures are full time, adult, ordinary time cash earnings.

Source: ABS, *Average Weekly Earnings, Australia, Nov 2014*, Cat. No. 6302.0, released 25 February 2015.

So, despite having a stronger position than most private sector businesses when it comes to influencing the wages and conditions of the workers they hire, there is little evidence to suggest that governments systematically use their power to restrict wage growth. There are a number of factors that may contribute to this. The public sector is more highly unionised than the private sector. While private sector unionisation rates fell to around 13 per cent in 2011, the rate in the public sector rates was still over 43 per cent (figure 18.4). This suggests that public sector workers have buttressed their own bargaining position, countering the market power of the government with some of their own.

Figure 18.3 **Private, Public and Total Average Weekly Earnings**[a]
May 2014



[a] Figures are full time, adult, ordinary time cash earnings.

Source: ABS, *Average Weekly Earnings, Australia, Nov 2014*, Cat. No. 6302.0, released 25 February 2015.

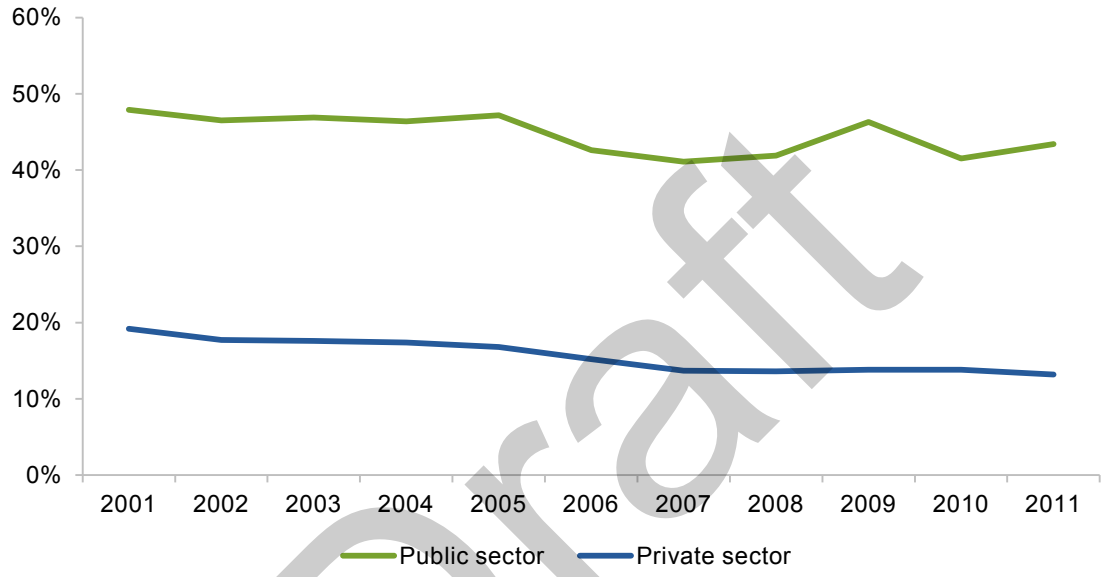
One of the core functions of government is the provision of public goods and services. Given many public sector workers are intrinsic to this, the Government has an incentive to not restrict wage growth for fear that it may affect, or may be perceived to affect, either the number or the quality of goods and services provided to the wider community. In this sense, it is in the Government's interests to attract and retain high calibre workers, with wages being a key mechanism for doing so.

Moreover, the incentives to use their market power are weaker for governments because of the way they fund their expenditures. While both private and public sectors face financial constraints on the wages they can offer, the nature of those constraints varies. Private enterprise bargaining is influenced by the profitability of the business — which reflects business costs and customer revenues. If there are downturns in sales (say due to increased competition, macroeconomic shocks or management errors) or cost pressures (say from higher rents or energy prices), then it is apparent to managers and employee representatives that any deal struck cannot involve high wage rate increases without risks to employment or enterprise viability. Australia has seen considerable reductions in wage pressures in recent years as economic growth has faltered.

However, there are many parts of the public sector where there is no, or only partial, pricing for services. Since they cannot recover the cost of producing these services through markets, governments cover the shortfall with tax revenues. This has the effect of linking

government wage bargains to tax revenues, rather than the price returned in the market (which is what private businesses operating in functioning markets would do). In a high growth period, there may be greater scope for governments to accede to public sector pay rises. In other words, there are times in the business cycle where it may be expedient for governments to relinquish their greater bargaining power and to agree to wage demands.

Figure 18.4 **Public vs private sector unionisation rates**
Employees in main job, by sector, 2001-2011



Source: ABS, *Employee Earnings, Benefits and Trade Union Membership, Australia, Aug 2011*, Cat. No. 6310.0, released 24 February 2015.

On the other hand, where there are significant deficits or increases in net lending that cannot be readily met through higher tax rates, the dynamic is the opposite, and governments may put downward pressure on public sector wages and employment. In other words, as there is stickiness in adjusting tax rates upwards, taxation revenue is strongly dependent on the performance of the economy. When the economy slows down, budget pressures begin to bite, and wage and employment restraint may occur.

In the wake of the Global Financial Crisis in Europe and the United States, there have been examples of public sector wage freezes and even nominal wage cuts (Lamo et al. (2014); Hall (2010)). No such outcomes have yet occurred in Australia. Nevertheless, the *ratio* of public sector to private sector wages has fallen at times of severe budget pressure, as in 2008 (figure 18.5), and with low growth in recent years. In the case of the Australian Government, there have been policy initiatives to reduce public sector employment and to reach enterprise bargains that permit only slow wage growth over the life of new agreements. This is consistent with responses to cyclical budget pressures, not the continuous use of market power.

That said, this is an 'average' result. In some public services, governments keen to contain budget costs may set portfolio budgets (or special purpose payments in the case of the Australian Government) that restrict feasible pay rises. This may not only have immediate effects on motivation and productivity, but also reduce the inflow of quality employees. This issue is considered further in the inquiry's discussion of awards (chapter 12).

Figure 18.5 **Ratio of public sector to private sector wage indices**
September 1997 to December 2014, Trend adjusted[a]

[a]The graph is based on trend-adjusted data from the ABS Wage Price Index. The index takes account of compositional shifts in labour, and so is a better measure of relative wages than standard wage measures.

Source: ABS, *Wage Price Index, Australia, Dec 2014*, Cat. No. 6345.0, released 24 February 2015.

18.2 Bargaining with the decision maker

One concern about public sector bargaining has been that, while negotiations for enterprise agreements occur at the agency level, decisions affecting bargaining are largely driven by governments, which adopt an 'across the board' approach.

In the case of the Australian Government, it generally provides guidance to its bargaining representatives in individual agencies through documents such as the Australian Government Public Sector Workplace Bargaining Policy (Bargaining Policy) and its precursors. In the notes to one of these precursors, the Australian Public Service Commission (APSC) noted that the document:

> … provides a framework for the management of workplace relations in Australian Government employment consistent with both the broader principles of Australian Government workplace relations policy, and legislative requirements. (APSC 2009)

The Bargaining Policy sets out the guidelines for all enterprise agreements or common-law contracts in the Commonwealth public sector. It provides guidance on employment arrangements; affordability and funding; remuneration and productivity; employment conditions and arrangements; performance management; enterprise agreement content and the approval requirements for enterprise agreements.

This places some restrictions on the Australian Government's bargaining representatives. When bargaining, they are able to neither offer nor reach agreement on any term that is not consistent with the Bargaining Policy without special dispensation from the agency's Minister and the Public Services Minister (APSC 2015).

The practice of providing guidance to agencies is neither new nor controversial. The Australian Public Service Commissioner noted that delegated bargaining, albeit with some guidance, is common in the private sector. He noted that:

> … [s]uccessive governments have determined a workplace bargaining policy that establishes the parameters in which bargaining in the APS is to occur. In this respect, the APS is like large and multi-faceted private sector employers that devolve responsibility for bargaining to individual business unit managers within a head office approved framework (sub. 170, p. 3).

While the necessity of delegation is not contentious, the degree of control governments sometimes choose to exercise through the Bargaining Policy has raised concerns (CPSU PSU Group, sub. 160, p. 6). This is particularly the case at the Commonwealth level, given there are no businesses that have so many 'subsidiaries' and employees as the Australian Government.

Where governments exercise a high level of control, negotiations may be prolonged, initially because the agency's bargaining representatives have reduced scope to negotiate, and then subsequently by the time taken to receive the Government's imprimatur for counter-offers, concessions and approvals. Unlike private sector enterprise agreements, Australian Government agreements must be approved by the Department of Finance, the Public Service Commissioner and the Fair Work Commission. (The scope for streamlined approval processes are more generally mooted in chapter 15).

Ultimately, the best balance between the freedom of delegates undertaking negotiations at the agency level and the reasonable need for the ultimate employer to control costs is a judgment issue that should take account of:

- the costs of negotiations
- the fact that delegates at the agency level have better information about, and control of, the operations of their agency than government as a whole. Reducing delegates' negotiating freedom limits the scope for negotiating parties at the agency level to make

productivity improvements whose dividends may be shared between government and employees.

18.3 Good faith bargaining in the public sector

A further concern raised by a number of submitters to the inquiry has been the current requirements for, and effectiveness of, good faith bargaining across enterprises generally (chapter 15), and for the purposes of this chapter, in the public sector.

Currently, the requirements for good faith bargaining are largely procedural. Section 228 of the FW Act specifies that bargaining representatives can meet the requirement to bargain in good faith by participating in meetings, disclosing relevant information, considering and responding to claims made by other bargaining representatives, giving genuine consideration to the proposals of other bargaining representatives, refraining from conduct that undermines freedom of association or collective bargaining and recognising other bargaining representatives.

Good faith bargaining does not require a bargaining representative to either make concessions or reach agreement on the terms that are to be included in the agreement.

In this vein, the CPSU PSU Group noted that:

> … [t]his underlines a significant weakness in the Act. The situation in Commonwealth bargaining is not directly addressed by the good faith bargaining provisions. Instead, the good faith bargaining provisions provide a procedural check list that an employer can meet without ever having any intention of genuinely negotiating and reaching agreement with employees. The system needs to be significantly re-worked so that it is geared towards genuine bargaining rather than mere compliance with procedure (sub. 160, p. 4).

The concern is that without forcing representatives to make progress towards an outcome, negotiations may be drawn out. Protracted negotiations are not a problem *per se* (particularly where longer negotiations are part and parcel of obtaining an efficient result or where the stakes dwarf the cost of a longer process). However, there may be instances where 'holding out' or refusing to make concessions may be a viable negotiating tactic, particularly where one side has a significant amount of market power. In the public sector, this may enable a government in pursuit of its preferred fiscal outcome[207] to apply pressure on employees by drawing out the bargaining process, rather than finding agreement through genuine back and forth negotiating.

[207] Drawing out negotiations can save governments money in two ways. It can lead to lower wage increases, and, because they are typically not backdated, it can take longer before the pay increase comes into effect.

Should the FWC have a role in bringing public sector negotiations to a conclusion?

The FWC has various powers to step in and resolve protracted negotiations (chapter 14 and Stewart 2013). Some participants have argued that the capacity of the FWC to intervene in the public sector is too limited and that 'the suite of powers of the Fair Work Commission to deal with bargaining disputes is not sufficient to deal with the range of issues that come before it' (CPSU SPSF Group, sub. 90, p. 7).

The CPSU SPSF Group go on to suggest that, as a consequence, poor outcomes have resulted. It argued:

> … [t]he operation of the bargaining system in the [Fair Work Act] has entrenched a war of attrition. In order to progress bargaining claims, bargaining representatives are forced to escalate to more disruptive industrial action in order to either force concessions or to move towards a workplace determination. (sub. 90, p. 7)

However, as noted earlier, there is little evidence that, over the span of a year, the average outcomes of enterprise bargains result in pay rates that are excessively low by private sector standards. The concerns appear to mainly reflect the current round of enterprise bargaining in the Australian Government public service. The grounds for changes to the FW Act for only the public sector to deal with a perceived set of problems for one losing party in one round of bargaining are not compelling, unless this pattern were to persist or were to be replicated in all Australian jurisdictions. As shown in figure 18.5, periods where public sector wage growth has not kept up with the private sector are typically followed by subsequent periods of more rapid growth. Were this historical pattern not to hold in the future, then the grounds for change should be assessed at that time, and careful consideration given to whether a mechanism for bringing negotiations to a head is warranted. This issue is also considered in chapter 15 (in the context of enterprise bargaining more generally).

18.4 Productivity in the Public Sector

Enterprise agreements can be used as a tool by employers to obtain productivity improvements from their workforce. They do this by including terms and conditions (such as changed work practices or patterns) which lead to higher output per worker, in exchange for wage increases. In this way, employers and workers share the benefits that result from the increased productivity.

Measurement challenges

Typically, this approach makes more sense in the private sector than it does in the public sector. This is largely because the measurement of productivity is much more difficult for the provision of public goods and services. Both the former Department of Finance and

Deregulation in Australia, and the Office of National Statistics in the United Kingdom, have argued that there is currently no agreed way of measuring productivity in the public sector (ACTU sub. 167, p. 260).

The measurement of productivity requires relating quantities of inputs to outputs. But, in a number of instances, the *nature* of some public sector work — where it involves longer term, multifaceted outcomes which may be shared across agencies — does not easily lend itself to a neat definition of outputs.

Even if this could be overcome, since most services produced by the government are not traded in markets[208], the absence of a market price complicates aggregation across the sector into a single, relatable output measure (Simpson 2006). Faced with this, some organisations use partial measures, such as the number of visits to the doctor, as proxies for output volume when attempting to measure productivity. However, this neglects the other services they may offer, any differences in the quality of the service as well as any deficiencies associated with the chosen measure. In this particular illustration, more visits to the doctor could equally be argued as a measure of a *failure* to prevent illness, and thus, could be considered a conflicting measure. Statistical organisations like the Australian Bureau of Statistics often assume that, in the public sector, inputs equals outputs (ABS 2000, p. 363). Both approaches reveal the extent of the challenge.

Current approaches in bargaining frameworks

Despite this, in what has been a feature of successive governments, the Bargaining Framework for the Commonwealth public service has routinely linked *all* pay increases to productivity enhancements. This has also been the practice of several states not covered by the FW Act. While it is common for enterprise agreements negotiated in the private sector to include either general or specific productivity measures (see chapter 15), the practice is nowhere near as extensive as in the public sector. Nor is the stated link between productivity and pay as strong.

There are several general concerns associated with directly linking pay increases to productivity (including flaws in its underlying premise, questions about what actually remains the prerogative of management and therefore are not able to be exchanged for a pay increase, the incentives it may create, as well as practical concerns about the ability of the FWC to evaluate productivity related clauses in enterprise agreements, and enforcement), but many of these apply to both the public and private sectors and, as such, are discussed in more detail in chapter 15.

The concern most specific to the public sector is the interpretation of what constitutes a productivity improvement. Some interpretations suggest that a reduction in entitlements (such as a reduction in sick days), or agreements to work longer hours (for example, by

[208] There are a number of exceptions to this. For example, Australia Post has paying customers and is subject to government wage policy.

reducing Christmas shutdowns) are productivity enhancements. But, as discussed in chapter 4, exchanging entitlements for cash simply trades one form of compensation for another with little gain to either party (assuming the worker is compensated exactly for the loss of the entitlement) or to productivity. Moreover, paying an employee to work more could harm productivity, if the worker's effectiveness falls in those additional hours.

A genuine productivity increase requires a change in the *way* a public sector organisation uses its resources to better perform its core activities, including improved quality of its outputs. This relates more to the adoption of new processes and technologies, rather than simply working harder or changing the mix of entitlements in a worker's overall compensation. A well-publicised example is scope for the reduction in travel expenditures resulting from more widespread use of video and teleconferencing (fuelled by technological improvements) and the complete demise of the large typing pools that existed in the 1980s.

However, even with an appropriate interpretation of productivity, the difficulty in measuring outputs mean that the overall effect is largely speculative. This, along with the concerns outlined in chapter 15, mean that there are fundamental impracticalities in strongly linking pay and productivity in the public sector.

Productivity enhancements are important, and, where they offer gains, they should be negotiated in enterprise agreements. But where direct links with pay are infeasible, an alternative way of enabling productivity enhancements is to align the incentives of the employer and the employee. While the absence of shareable profits and the lack of bargaining authority for the agency representatives makes this approach less effective than in the private sector, building trust and fostering engagement between employers and employees, with the understanding that all parties will benefit over the longer-term, generally does enhance productivity. Where this becomes a part of the culture of the agency, both employers and employees have an incentive to find ways to improve productivity.

18.5 Performance management in the public sector

Anecdotal evidence, presented throughout the course of the inquiry, suggested that it is more difficult to terminate the employment of underperforming Commonwealth public servants than their counterparts in the private sector. Similarly, management of underperformance and sick leave (and thereby its incidence) seems to be source of concern, especially in some large agencies.

Responsibility for these difficulties is often directed at the culture of the public service. In particular, participants have cited the need for the government to be a 'model employer', high unionisation rates, risk aversion on the part of management and human resources staff as well as the attitude of the regulator to the public service as contributing factors. However, there is little documented evidence to substantiate any of these.

Few dispute, however, that the requirement to provide procedural fairness to the employee in instances where they are facing possible termination is at least as relevant in the public sector as in the private sector. However, overextending this requirement may have resulted in unnecessarily lengthy, costly and inflexible performance management and termination procedures.

Results from the Australian Public Service Commission's *State of the Service* survey point to ongoing problems with performance management in the Commonwealth public service. For example, the 2013-14 survey indicated that only 37 per cent of employees surveyed agreed that their supervisor managed underperformance well (APSC 2014a). Prior to the leaving office, the former Australian Public Service Commissioner, Steven Sedgwick, , noted:

> … [t]he need to afford an employee procedural fairness is deeply enshrined in administrative law and APS practice. Similarly the need to provide an individual with reasonable opportunity and support to lift their contribution is deeply entrenched in APS culture. Neither of these requires, however, the adoption of interminable or excessively bureaucratic processes. (Sedgwick 2014)

The grounds for the termination of an ongoing public service employee are outlined in the *Public Service Act 1999* (Cth) (PS Act). These include being excess to requirements, loss of an essential skill or qualification, non- or unsatisfactory performance, failure to meet a condition of engagement or breaches of the APS Code of Conduct. Further guidance about the legal framework governing the termination of employment is published by the Australian Public Service Commission (APSC) (APSC 2014b), in addition to policies covering issues such as the redeployment of staff and the handling of code of conduct violations.

In accordance with the PS Act and the guidance provided by the APSC, Commonwealth agencies have agency-specific policies for the management of underperformance and code of conduct violations. In some cases, these policies are shaped by the agency's enterprise agreement. For example, the enterprise agreement of the Department of Human Services specifies a performance process, a 'back on track' process and formal performance counselling for the management of underperformance.

To the extent that these terms shape agency policy, they can make it difficult to get better performance outcomes out of the public sector workforce over time, impinge on managerial prerogative and create a barrier to the termination of employment (even where it is warranted). In this sense, Sedgwick noted that:

> … [i]f an employee is not sufficiently responsive and performance expectations remain unfulfilled, then the Public Service Act is clear that an "agency head may at any time, by notice in writing, terminate the employment of an [ongoing] employee … [for] non-performance or unsatisfactory performance, of duties". However an examination of agency enterprise agreements has highlighted that many agencies have, over time, surrounded the performance management process with excessive procedural and other encumbrances (Sedgwick 2014).

Removing these terms from enterprise agreements would restore managerial prerogative over performance management and termination processes.

One complication is that it is difficult to ascertain the impacts of excising such terms from enterprise agreements. Given many people have strong preferences for job security (and therefore resist easy dismissal), excision might require higher levels of compensation. Otherwise it would risk detrimental changes to productivity or morale. Moreover, if the notion of procedural fairness is sufficiently ingrained in the public sector (and more broadly than specified in some enterprise agreements), then while agencies would be able to develop less onerous processes, the ultimate effects on performance management or termination processes may be minimal.

Consequently, the decision to remove or not such provisions should involve a hard-headed practical assessment of the tradeoffs, a task best undertaken at the agency level.

18.6 Other public sector concerns

Several other public sector issues have emerged in this inquiry, including:

- the effects on public sector employees of state law changes
- the degree to which 'corporatisation' moves employers from the state to the national system.

The first of these centres on the effects of law changes in the state systems, and the potential for these changes to adversely affect public sector workers. The Australian Education Union noted that:

> … [s]hould a state operate to unfairly constrain the powers and functions of its industrial tribunal or to remove the capacity for industrial awards or enterprise agreements to contain certain subject matter, state based employees are left no capacity to resolve issues associated with significant terms and conditions of their employment. (sub. 63, p. 7)

In support of this argument, the Australian Education Union cited the passage of legislation in both NSW and Queensland that affected industrial relations processes and, as a result, outcomes in those states. (sub. 63, p. 8)

With regard to the second of these concerns, in its submission to the inquiry, the Australian Council of Trade Unions (ACTU) expressed concern about the extent of the national system. It noted that:

> … [t]here are many State owned corporations that have been sucked into the Federal system even though they have more in common with the Aboriginal Legal Service than with Rio Tinto. Many of these corporations are formed for the purposes of implementing State Government policy rather than trading or making a profit. (sub. 167, p. 256)

In a number of instances, it is not a trivial matter to determine what constitutes a 'trading or financial' corporation, and, as a result, whether the corporation in question is covered by

the national system or remains in the state system. While the ACTU concedes that, to some degree, this issue will be resolved by common law precedent, it argued that 'it is not good policy to wait for developments in the common law of Australia to give more clarity around the meaning of 'trading or financial corporation' for the purposes of s 51 (20) [of the Constitution]' (sub. 167, p. 256).

However, there may be circumstances in which states can prevent employers from automatically being shifted into the national system. The Australian Education Union noted that:

> … [e]ven when corporatisation does occur, this does not necessarily mean the 'transfer' of employees and the new 'corporate' employer into the federal jurisdiction. Section 14 of the Fair Work Act 2009 [Cth] contains a mechanism enabling a state or territory to declare, and for the Commonwealth Minister to endorse, that a particular employer is NOT an employer for the purposes of the federal Act. This occurred in 2014 with respect to TAFE employees in Queensland who were transferred from employment by the relevant state department to that of a new corporate entity, TAFE Queensland. (sub. 63, p. 7)

While not unimportant, these examples are not sufficient to bring into question the extension of the national system, particularly where states retain the power, through s 14(2)(b) of the FW Act, to keep employers in their own industrial system should they see fit.

Moreover, throughout this inquiry, the Productivity Commission has decided to only consider state WR issues where they provide some lessons for the Commonwealth system, where coverage issues arise (as above), or where there are troublesome interactions. A comprehensive analysis of all features of state systems — which would have to not only consider public sector employees, but also employees in unincorporated enterprises in Western Australia — is beyond the scope of this inquiry.

That said, in principle the FW Act should provide a guiding framework for all industrial relations law throughout Australia, even where the states have not ceded their powers in respect of the employees of non-constitutional corporations, public sector employees or employees of unincorporated corporations. Therefore, the Productivity Commission's view is that, experimentation aside, the FW Act should serve as the fundamental template for any residual roles of the states in industrial relations matters.

19 Industrial disputes and right of entry

Key points

- The credible threat of industrial action is an important negotiating tool for parties engaging in enterprise bargaining, helping to reduce asymmetries in information and bargaining power.
- Because industrial action comes at a cost to employees, employers and consumers, and may involve socially unacceptable misuse of market power, it is appropriate that government at times plays a role.
- The workplace relations (WR) framework distinguishes between the use of protected industrial action for legitimate bargaining purposes, and unlawful industrial action.
  - There are numerous conditions and procedural steps that must be satisfied by employees to obtain authorisation to engage in protected industrial action.
  - There are currently penalties and remedies when parties undertake unlawful industrial action, but these should be strengthened in a selected fashion.
- The measured prevalence of industrial action has declined substantially over the past three decades and has remained relatively low in recent years. The available evidence does not suggest that the level of industrial action has meaningfully increased following recent changes to the WR framework.
  - However, some types of industrial action are not captured by official statistics, and therefore the true level of disputation may be somewhat higher than the data suggest.
  - Nonetheless, there is insufficient evidence for sweeping changes.
- Improvements recommended include:
  - prohibiting the use of protected industrial action until bargaining has commenced
  - potentially reducing the complexity of the protected action ballot process
  - deterring the use of aborted strikes and brief stoppages that impose disproportionate transaction costs on employers
  - allowing more graduated options for employers to respond to employee industrial action
- The provisions providing union officials with rights of entry to worksites are broadly sound, but at times these provisions can be used for strategic reasons by both sides. To limit such conduct, there is a case for:
  - modifying the threshold for the Fair Work Commission (FWC) to deal with disputes about the frequency of entry by employee representatives
  - limiting union entry for discussion purposes where a union is not covered by an enterprise agreement or does not have members at the workplace.

This chapter begins by providing background on industrial action — how it arises, what forms it can take, and how it is regulated under the *Fair Work Act 2009* (Cth) (FW Act). Section 19.2 outlines the prevalence of industrial disputes in Australia based on the available data, literature and stakeholder inputs, and queries whether this requires further policy intervention. A discussion of proposed policy changes to improve the WR framework's approach to industrial action is provided in section 19.3 and 19.4. Finally, section 19.5 includes an analysis of right of entry under the FW Act, which like industrial action can be used to disrupt normal work practices but which has wider use and implications.

19.1 Bargaining disputes can lead to industrial action

Industrial action by employees is commonly characterised as a refusal by employees to attend or perform work, more commonly known as a 'strike' — though as discussed later, industrial action can take other forms. The only industrial action available to employers is to lock out its workforce for some period.

Disputes involving industrial action come at a short-term cost to all parties. Employers lose profits from the output normally produced by their employees, who in turn must forego the wages that they would otherwise have earned from their labour. However, strike action is not simply a case of employees 'cutting off their noses to spite their faces' — they choose to bear the short term costs of a strike if they perceive holding out to be in their longer term interests. Similarly, unless they provide some longer-run return, lockouts would be irrational because they would leave capital idle and would relinquish revenue that is not offset by unpaid wages. There are a number of reasons why bargaining participants may find it in their long-run interests to undertake industrial action.

First, parties that engage in bargaining may be in possession of private information about their willingness to pay, or to work for, a given wage offer. By imposing costs on the other side for not reaching agreement, a party can use industrial action to gain information about the other's willingness to accept a given bargaining claim. A more detailed explanation of the use of industrial disputes as an information gathering exercise is given in box 19.1.

Second, where there are considerable economic rents being accrued by a firm, an industrial dispute may arise during bargaining over how those rents should be divided between employees and the firm's owners or shareholders. In these circumstances, parties may engage in industrial action to inflict losses on the other party in an attempt to force a favourable settlement. Where the rents are substantial, this may be rational behaviour — albeit perhaps only temporarily. For example, a resource company that is earning substantial profits from a temporarily high resource price may be willing to direct a share of these resource rents towards wages to avoid or bring an end to strike action, in order to maximise production while prices are high. In other cases, both parties may be willing to endure a protracted dispute, and find themselves in a situation where both would be better off reaching agreement, but it is in neither party's immediate interest to concede — such a standoff may necessitate outside intervention by an institution such as the FWC.

Box 19.1 Industrial disputes as an information gathering exercise

While there is no single, widely accepted theory that can fully explain why industrial disputes arise in the labour market, a common and intuitive explanation is that disputes arise from the incomplete information available to employers and employees when they bargain over wages and conditions.

Generally speaking, there is a maximum value of wages and employment conditions that an employer would be willing to give its employees, while employees will have a minimum level of wages and conditions that they are willing to work for. In theory, were the labour market perfectly competitive, these two amounts would be the same, and thus wages would equal the value of the output that is produced by an employee's labour.

In reality, because labour markets are not perfectly competitive (see chapter 1), the value of the output from an employee's labour (and thus the maximum wage an employer is willing to pay) will usually exceed the lowest wage the employee would be willing to accept for their labour. It is the 'wedge' between these two amounts that gives rise to the bargaining process — employees and employers must negotiate to determine where exactly between these two amounts the final wage outcome will be (and thus the relative share of this wedge that is captured by either side).

If both employees and employers knew the other's willingness to pay and work for a given wage level respectively, then they would easily be able to reach a negotiated outcome and avoid the costs to both parties arising from an industrial dispute. This theoretical outcome — clearly at odds with the observed occurrence of industrial disputes — was first described by Hicks (1932), and is sometimes referred to as the 'Hicks paradox'.

However, employees and employers do not have complete information about each other's bargaining positions. Indeed, both possess private knowledge of — and have strong incentives to misrepresent — the wage level that would be acceptable to them. Thus, industrial action (or the threat of it) can be used by parties as an 'information gathering' exercise — albeit an imperfect one — to better ascertain each other's bargaining positions. The loss of income and profit associated with the industrial action is the price of obtaining information.

For example, imagine an employer makes a wage offer that is less than the amount their employees' suspect they would be willing to pay. The employees cannot know for certain whether this is a 'low-ball' offer or genuinely reflects the most that the employer would be willing to pay them. Coupling a threat of industrial action with a demand for a higher wage can help the employees assess the employer's offer, as an employer that is 'low-balling' them is more likely to concede a higher wage offer to avoid the loss of profits from industrial action. However, such a course of action is not without risks and costs. In some cases employees may undertake strike action against an employer that cannot afford a higher wage offer, ultimately leaving both parties worse off. In other cases, employees may extract a slightly higher wage offer, but the earnings foregone from going on strike may make it a hollow victory.

Source: Kennan (2008).

It should be emphasised that the credible threat of industrial action by bargaining parties is an important way of addressing negotiating impasses and imbalances during bargaining. Enterprise agreements continue to apply after their nominal expiry date, but employees do not receive any wage increases (unless agreed separately by the employer) until a new agreement is approved by the FWC. Consequently, unless countered by some other threat,

there is a risk that a hard bargaining employer can use the expiry provisions to force negotiations that excessively favour itself. The capacity to withdraw labour or engage in other forms of industrial action provides employees with countervailing bargaining power. However, in some other instances, the risk of prolonged industrial action by employees can put employers at a bargaining disadvantage, which warrants some capacity for lawful industrial action by employers.

In some sectors, such as construction, industrial action may also be used for non-bargaining related reasons, such as disputes over workplace health and safety. In these disputes, industrial action may be used to draw attention to alleged breaches of workplace health and safety laws, and signal to employers that unacceptable safety conditions will incur industrial retribution. In some instances, unprotected industrial action over safety issues may be a Trojan horse for other industrial objectives (Cole 2003; PC 2014b).

Where it is used rationally and sensibly, industrial action can be an important bargaining tool to reduce asymmetries in information and bargaining power between parties. However, because industrial action can come at a cost to workers, employers and consumers, and involves the exercising of at least some market power, there is a compelling basis for government to play some role in regulating it as part of the WR framework. Consequently, part 3-3 of the FW Act contains more than 70 sections that regulate industrial action.

Protected industrial action

Under the FW Act, industrial action can be 'protected' if certain conditions are met. 'Protected' means employees, unions and employers are immune from civil liability in respect of the action — unless the action involves personal injury or the damage, destruction or taking of property. Employers cannot threaten to dismiss or discriminate against an employee who chooses to take part in protected industrial action (chapter 6). Similarly, employees that do not want to take part in industrial action are under no obligation to do so, and there are laws that aim to protect these individuals from adverse action by other employees or representatives.

Protected industrial action is a modern concept

Legal protection for industrial action is a relatively modern concept in Australia. The distinction between protected and unprotected industrial action was first made in 1993. Prior to this, virtually all industrial action was unlawful in Australia (Briggs 2006). However, despite this illegality, strikes were common and employers rarely sought remedies or attempted to take employees or unions to court (Philipatos 2012). In fact, as discussed further below, Australia's strike rate was one of the highest in the world prior to the introduction of protected industrial action, and has substantially fallen since that time.

Protected industrial action can take many forms

Industrial action is a negotiating tool that can be used by either employees or employers to advance a claim in the workplace. For employees, it is usually the performance of work in a manner that is different from how it is customarily performed.

Under the FW Act, industrial action by employees is defined to include:

- performing work in a manner different from how it is normally performed
- adopting a practice that restricts, limits or delays the performance of work
- a ban, limitation or restriction by employees on performing or accepting work
- a failure or refusal by employees to attend for work or perform any work.

While strikes are perhaps the most commonly understood form of industrial action, there are also more graduated lawful options for bringing pressure on employers, including:

- partial work bans, where employees refuse to undertake certain types of work; to work with certain managers, employees and third parties; or to work overtime
- working at a slower pace than usual ('go slows')
- employees refusing to perform work tasks that are not strictly required by their employment conditions ('work to rule')
- picketing (provided it does not involve trespassing, obstruction, coercion, harassment, violence or damage to property)
- other less conventional forms of action (see box 19.2).

Some parties may also use other tactics to gain leverage in industrial disputes, including improperly exercising rights of entry or engaging in unlawful or criminal behaviour — these other tactics are discussed in more detail later in this chapter.

As noted above, for employers, protected industrial action is limited to 'lockouts', where they do not allow employees to work. Industrial action by an employer can only be initiated in response to employee industrial action. The response action does not need to be proportionate to the employees' action.[209]

209 *Australian and International Pilots Association v Fair Work Australia* [2012] FCAFC 65.

Box 19.2 Unconventional forms of protected industrial action

In addition to more traditional forms of industrial action, which generally involve reducing the amount of work performed, some employees may engage in action that less directly inconveniences their employer or simply conveys their displeasure with a bargaining process.

More creative industrial actions that have been proposed or staged during industrial disputes in recent years have included:

- performing computer work with the 'caps lock' key engaged
- eating meals and drinks during rest breaks in unoccupied management offices
- taking coordinated lunch breaks at particular times of the day
- setting up automated responses to internal emails that include a message relating to the union's industrial action campaign.

Sources: Lucas (2013b); Towell (2015).

Requirements for protected industrial action

Industrial action is only protected under certain circumstances, and where particular conditions and procedures are fulfilled. Employees can initiate protected action to support their claims when negotiating an enterprise agreement, while employers can only undertake action (through a lockout) in response to action by employees.

Action will only be protected when taken during negotiations for an enterprise agreement, and the agreement is not a greenfields agreement or a multi-enterprise agreement (chapter 15). Action taken before the expiry of an enterprise agreement will be unprotected.

Further, there are other conditions that must be met for action to be protected, including:

- the parties must be 'genuinely trying to reach agreement'
- the party taking action must provide notice of the action to the other party[210]
- the action must be in support of claims regarding 'permitted matters' (chapter 15)
- the action must not be in relation to unlawful terms or pattern bargaining (chapter 15)
- the action must comply with any relevant orders or declarations
- action taken by employees must be authorised by secret ballot (box 19.3).

[210] Before taking industrial action, parties must provide written notice specifying the nature of the industrial action and the date it will commence. Employees taking industrial action must provide three days' notice to their employer, unless the action is in response to action by their employer or if the ballot order from the FWC specifies a longer period. Employers taking action must provide written notice to the bargaining representatives of employees covered by the agreement, as well as taking reasonable steps to notify the employees themselves.

Box 19.3 The protected action ballot process

A protected action ballot to authorise industrial action must be undertaken before industrial action can be lawfully taken, except where the action is in response to industrial action by the other party. The requirement to put proposed industrial action to a secret ballot was first introduced by the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth), and was retained in the FW Act.

A ballot can only be conducted if the FWC makes a protected action ballot order as a result of a protected action ballot application being made. The application must outline the types of actions that members will be asked to endorse and the group of employees to be balloted.

If the FWC makes the order, and before the ballot takes place, the ballot agent (usually the Australian Electoral Commission) will prepare a roll of eligible voters comprising employees who would be covered by the proposed agreement and who are represented by the bargaining representative. Following this, the ballot can take place.

For a protected action ballot to authorise industrial action:

- the industrial action must relate to the questions approved in the ballot order
- at least 50 per cent of employees on the roll of voters in the ballot voted
- more than 50 per cent of those valid votes approve the industrial action
- the industrial action must start within 30 days of the ballot result being declared.

Payment during industrial action is prohibited

It is unlawful for employers to pay employees during a period of industrial action or for employees (or unions) to request or accept 'strike pay' while taking action. For example, an employer must withhold two hours' pay if their employees strike for two hours.

Where employees engage in a protected partial work ban, the employer has two options:

- they can give notice to the employees that no payment will be made during the partial work ban period, provided that the employer will not accept any work from the employees until they return to normal work duties
- they can issue the employees with a notice outlining the proportion of their pay that will be withheld in proportion with the partial work ban, and pay employees accordingly.

The provisions against strike pay are more punitive for unprotected industrial action. If employees engage in unprotected industrial action lasting less than four hours, their employer must withhold a minimum of four hours payment. When action lasts more than four hours, the employer must withhold payment for the full duration of the action.

There is no prohibition on an employer choosing to pay workers that have been locked out. However, as noted by Wheelwright (2013), it is difficult to imagine a circumstance where an employer's bargaining position would be advanced by paying locked out employees.

While it may be obvious why employers should not be required to pay their employees for engaging in industrial action, there are also various reasons for having provisions that expressly prohibit strike pay. Some judges have interpreted the purpose of these provisions as preventing employees from taking further strike action to coerce employers to pay them for an earlier strike (Wheelwright 2013). Others have discerned a more general purpose of discouraging industrial action and encouraging negotiated resolution, by requiring parties to bear the costs of their own actions. But the wider principle is the most logical — payment is made in return for work that is performed. Where work is consciously not performed, and yet payment is made, the basis of the employment relationship is corroded.

Suspension or termination of industrial action

The FWC has the power to make orders suspending or terminating protected industrial action (Part 3-3, Division 6), either on its own initiation or on application by a bargaining participant or the Minister for Employment. Such an order to suspend or terminate industrial action can be made on grounds that:

- the action is protracted and is causing (or is going to cause) significant economic harm to a bargaining participant (s. 423) — for example, *Schweppes Australia v United Voice* (see box 19.4)
- the industrial action threatens to endanger a person's life, personal safety, health or welfare, or cause significant damage to the Australian economy (s. 424) — for example, in the case of the 2011 Qantas dispute (see box 19.5)

In other circumstances, the FWC's only option is to suspend action. This occurs where:

- the bargaining participants would benefit from a cooling-off period (s. 425)
- the action is adversely affecting the employer or employees and is threatening to cause significant harm to a third party (s. 426).

The Minister for Employment can also make a declaration to terminate protected industrial action if satisfied that the action threatens to endanger people or the economy (s. 431). Following a declaration, the Minister can also direct bargaining participants to take (or not take) specified actions.

If protected industrial action is terminated by the FWC, a post-industrial action negotiating period commences. Generally this period lasts 21 days, but can be extended to 42 days if the parties jointly apply to the FWC for an extension. If at the end of that negotiating period the parties have not settled all of the matters that were at issue during bargaining, a Full Bench of the FWC must make an industrial action related workplace determination. This amounts to compulsory arbitration.

Box 19.4 *Schweppes Australia v United Voice*

To date, the only successful application to terminate industrial action on grounds of significant economic harm to a bargaining participant (under s. 423) occurred in a bargaining dispute in 2011 between Schweppes Australia and its employees at a Melbourne factory, who were represented by United Voice. Interestingly, in this case the employer attempted to have their own lockout terminated in order to force a workplace determination by the FWC.

Schweppes applied to the FWC to have its own lockout terminated on the basis that the lockout was causing significant economic harm to Schweppes' employees. The company's application largely relied upon academic evidence estimating the effect of the lockout on the income, spending and savings of its employees. The FWC rejected this application, largely on the grounds that the union, and a large majority of the employees, opposed termination and argued they were not at risk of significant economic harm.

Six weeks later, after 155 employees had sustained 58 days of lost wages, the FWC terminated the industrial action after both Schweppes and United Voice jointly argued for termination. A number of the locked out employees wrote anonymously to the FWC requesting that the protected action be terminated.

Sources: ACTU (sub. 167); *Schweppes Australia Pty Ltd* v *United Voice - Victorian Branch (No.1)* [2011] FWA 9329; Smith and Howard (2012a); FCB Group (2012).

Box 19.5 **The 2011 Qantas dispute**

On 29 October 2011, Qantas announced that it would be locking out all of its engineers, ramp staff, baggage handlers and pilots, effective from 31 October. Qantas aircraft currently in the air would complete their sectors but no further Qantas flights would depart anywhere in the world — grounding the entire Qantas fleet and stranding passengers across the globe.

The lockout was initiated in response to ongoing campaigns of protected industrial action by the Transport Workers Union (TWU), the Australian Licensed Aircraft Engineers Association (ALAEA), and the Australian and International Pilots Union (AIPA). Members of the unions were variously authorised to take:

- one hour work stoppages (ALAEA)
- various work bans and stoppages (TWU)
- wearing red ties and making particular in-flight announcements (AIPA).

Qantas (sub. 116) has described the employee industrial action as a deliberate campaign of aborted stoppages, with unions announcing a stoppage, leading to Qantas cancelling or rescheduling flights as required, only to cancel the action at the last minute. According to Qantas, the employee industrial action leading up to the lockout affected 70 000 passengers, led to the cancellation of 600 flights, the grounding of 7 aircraft, and cost the airline $70 million.

Within hours of Qantas' announcement to lock-out its employees, the Federal Minister for Employment made an application to terminate the industrial action on the grounds it was threatening to cause significant damage to the economy. After a two day hearing, a Full Bench of the then Fair Work Australia delivered its decision on 31 October, terminating all industrial action at Qantas (including the lockout) and triggering arbitration of the dispute.

Sources: Qantas Group (sub. 116); Smith and Howard (2012b); Friedman (2012); *Minister For Tertiary Education, Skills, Jobs And Workplace Relations* [2011] FWAFB 7444.

Unprotected industrial action

Any industrial action that is not protected (i.e. unprotected) is unlawful. The FWC can, by itself or through an application, make an order to stop or prevent unprotected industrial action. Where the FWC has issued an order to stop or prevent unprotected industrial action, it is unlawful for that industrial action to occur or continue in contravention of the order. Contravening an order made by the FWC can result in penalties of up to $10 200 for an individual and $51 000 for a corporation. The Fair Work Ombudsman can investigate allegations of unprotected action and where there is sufficient evidence of unlawful behaviour and it is in the public interest to do so, it may commence litigation.

Employers, employees and bargaining representatives who take unprotected industrial action can face other consequences too — for example, being sued for damages for losses suffered as a result of the action, by anyone affected by the action, such as a business that lost money.

Other actions and tactics used in industrial disputes

Aborted strikes

Employees may cancel a proposed period of industrial action, even if they have obtained authorisation for protected action and notified their employer. In some instances, the withdrawal of strike action can be beneficial to the employer, or at least benign. For example, impending industrial action may be called off by employees as a sign of good faith in pursuit of further discussions (Asciano, sub. 138), or where the parties reach agreement on the disputed matter that gave rise to the industrial action. There has been at least one case where a strike was aborted because the organisers had accidentally scheduled it for a time that would have been outside a protected action period (MacDonald 2014).

However, numerous employers have also highlighted the deliberate use of 'aborted' strikes as a tactic in industrial disputes (Qantas Group, sub 116; Asciano, sub. 138; Qube Ports, sub. 123; BHP Billiton, sub. 168). Often, in these cases employees obtain authorisation for protected industrial action and notify their employer of pending action, with no intention of carrying out the strike. After the employer has borne the costs of preparing for the expected disruption, the employees call off the action at the last moment — at little or no cost to themselves.

Aborted strikes can be an effective weapon when the costs to the employer of preparing for the loss of services or output anticipated to arise from the strike are substantial. This will particularly be the case for employers in sectors where the timing or consistency of its services or output is critical — for example, an airline or an electricity generator.

Unlawful conduct

Some types of unlawful activities can give parties leverage in an industrial dispute by inflicting (or threatening to inflict) substantial harm (which may be economic or personal) on the other party, unless the offending party's demands are met. While unlawful conduct is relatively rare in the WR system, it remains a significant problem in some sectors, such as the construction industry (PC 2014b).

Aside from unprotected industrial action, other examples of unlawful conduct include:

- delaying or blockading of workplaces and sites (see box 19.6)
- bullying, verbal abuse and other coercive conduct
- unlawful entry to sites.

Box 19.6 **Delaying tactics**

Disruption of construction sites can take many forms, with formal stoppages and strike actions being only the most visible examples. During its previous inquiry into public infrastructure, the Productivity Commission found various cases of less visible, but still highly costly, delays. These included:

- blocking access to work sites through a range of means, including the dumping of debris or materials at work gates, or parking of machinery or trucks for the same purpose
- delaying the delivery or use of materials (including concrete pours), by either preventing access to sites or preventing the further handling of materials once on site
- stopping the removal of waste from sites
- placing 'bans' on the use of critical equipment, such as cranes.

While some instances involved relatively short disruption, others were lengthy, involving multiple days or even weeks.

Source: Productivity Commission (2014b).

While there is a risk that parties may use criminal behaviour as a weapon in some industrial disputes, the FW Act, as a civil legal structure, is not appropriate for dealing with such matters. The Royal Commission into Trade Union Governance and Corruption is currently examining claims of criminal conduct by some parties. Fair Work Building and Construction — the construction industry equivalent to the FWC — may refer concerns about possible criminal conduct to the police (though such referrals amounted to less than one half of one per cent of its total referrals in 2013-14).

Secondary boycotts

In the WR context, a secondary boycott involves a group of people (such as union officials and/or employees) hindering a third party from either supplying or purchasing goods or services to or from a business, where the targeted third party is not the employer of the people imposing the boycott. For example, if employees use a picket (or other means) to block a supplier from delivering materials to their employer, those employees may be enacting a secondary boycott of the supplier.

While secondary boycotts are generally unlawful, the ability to use them to pressure an employer during an industrial dispute still occurs from time to time and works by jeopardising the employer's interactions with other firms or customers. A more detailed discussion of the secondary boycott provisions, and possible reforms to improve them, is provided in chapter 24.

19.2 How well are the current arrangements performing?

Because industrial action comes at a cost to employees, employers and consumers, high levels of industrial disputation are generally not in the best interests of the wider community. That does not imply that no or few disputes is necessarily an efficient outcome either. Were one party or the other to wield overwhelming bargaining power, then this could result in no disputes, simply because the threat of them would be enough to secure concessions. Therefore it is important to assess the extent to which the WR system helps parties avoid industrial disputes, while preserving equitable bargaining outcomes that satisfy both employees and employers.

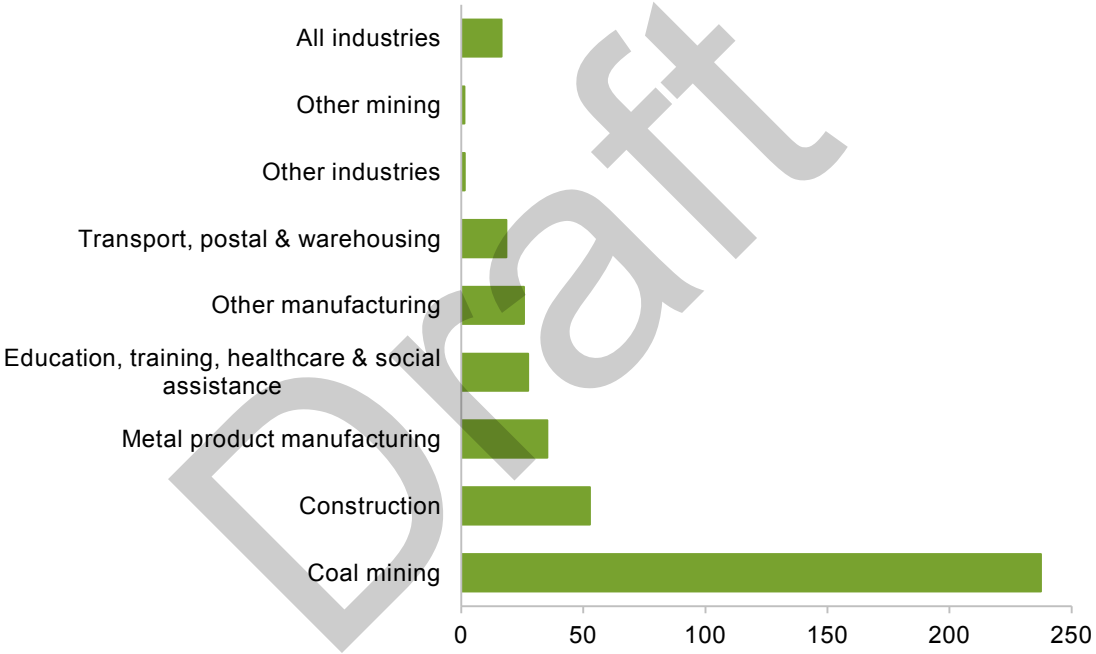
In considering how current arrangements are performing, and assessing the need for further possible reforms, the Productivity Commission has considered the available quantitative evidence on the prevalence and costs of industrial disputes, and evidence put to the inquiry by employers and employees involved in bargaining and industrial action. This evidence is outlined in the following section.

Data suggest that industrial action is uncommon in Australia

One approach to evaluating the effectiveness of a WR system in addressing industrial disputes is to measure the prevalence of disputes within the economy. While quantitative measures of prevalence do not necessarily capture the full impacts of industrial action (discussed further below), they nonetheless allow for some empirical comparisons — for example, comparisons over time or between countries.

The prevalence of industrial disputation in an economy is often measured by the number of working days lost to industrial action per 1000 employees. The economywide rate has not exceeded 30 days per 1000 employees since 2004, and was around 7 days per 1000 employees in 2014. Rates can vary widely between different industries (figure 19.1) and from year to year (figure 19.2). In recent years, working days lost to industrial action per 1000 employees has been highest in the coal mining industry, followed by the construction and metal product manufacturing industries.

Figure 19.1 **Average number of working days lost annually to industrial disputes per 1000 employees, 2010 to 2014**
By industry

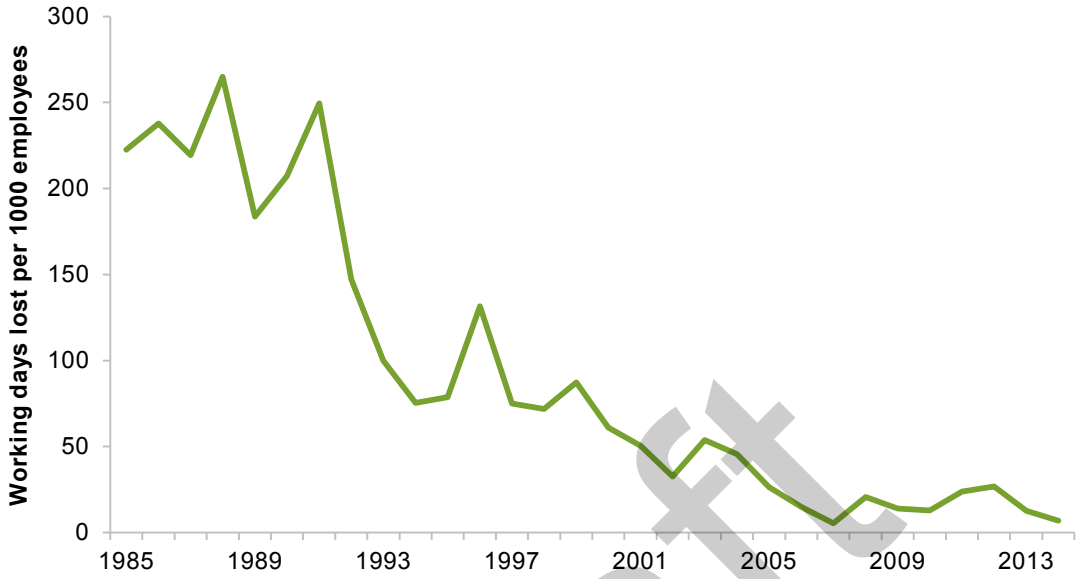


Source: ABS (2015e) *Industrial Disputes, Australia, December 2014*, Cat. no. 6321.0.55.001.

The prevalence of industrial disputes has substantially declined in recent decades

Industrial disputation, as measured by working days lost per 1000 employees, has declined markedly over the past three decades, as shown in figure 19.2. The average number of days lost over the past five years was less than one tenth of the days lost on average from 1985 to 1990. Similarly, the total number of industrial disputes, the number of employees involved in industrial disputes, and the total number of working days lost to industrial action, have all declined substantially over this period, notwithstanding the substantial increase in employment over the ensuing decades (ABS 2015e).

Figure 19.2 **Working days lost to industrial disputes per 1000 employees**
All sectors, annually, 1985 to 2014



Source: ABS (2015e) *Industrial Disputes, Australia, December 2014*, Cat. no. 6321.0.55.001.

Some employer groups have expressed concern that the rate of industrial disputation has increased following the introduction of the FW Act. For example, the Chamber of Minerals and Energy of Western Australia has argued:

> Since the implementation of the FWA in 2009, the scope for protected industrial action has grown. This 'Fair Work Act' period has shown an increase in the overall working days lost from the previous period 2006–08 on average of 60 per cent … (sub. 199, p. 8)

However, these concerns may be based on quite selective comparisons drawn over a short timeframe, by comparing more recent 'spikes' in the rate of disputation around 2011 and 2012, with low levels observed in 2006 to 2008. In doing so, they overlook the similarly low rates of disputation that were subsequently observed in 2013 and 2014, and fail to acknowledge that the apparently high levels of disputation in 2011 and 2012 were roughly the same as the level in 2005, just one year prior to the chosen reference period. As the OECD (2007, p. 110) has noted, because levels of industrial disputation can vary substantially from year to year, the most reliable way to monitor trends in disputation is through averages taken over consecutive years. Indeed, the OECD has previously used five year averages of strike rates to make comparisons.

It is also worth noting that a substantial share of the higher rates of disputation measured in 2011 and 2012 can be attributed to a small number of particularly large state and territory public sector disputes — which largely occur outside the operation of the FW Act. Therefore higher rates of disputation in these particular years cannot reliably be attributed to alleged underlying problems with the FW Act.

Moreover, at a conceptual level, an increase or decrease in industrial disputes associated with a change in WR laws does not, by itself, say anything about the desirability of the change. Low dispute rates might occur in quite different regimes (on the one hand, near prohibitions of industrial action, or on the other hand, systems that give such unchecked protection to strike, that the threat never needs to be exercised). Accordingly, the efficacy of the current arrangements should not be evaluated purely by measures of the prevalence of industrial action. This is discussed further later in this chapter.

Australia's level of industrial disputation is not atypical compared with overseas

The decline in disputes over the last few decades has not been unique to Australia. Similar decreases have been observed across the developed world — though Australia is amongst a few countries that have experienced particularly strong declines (OECD 2007). The available evidence suggests that Australia's level of industrial disputation is fairly typical when compared with other developed countries.[211]

According to estimates from the OECD (2007), Australia's average level of disputation over the years 2000 to 2004 (in terms of days lost per 1000 workers) was the 11th highest out of 25 member states — with a lower level of disputation than a number of comparable countries, including Canada, Norway, South Korea and France, but a higher level than others such as New Zealand, the United Kingdom and the United States. Using figures provided by Hale (2008), the Productivity Commission has estimated a similar ranking — 11th highest out of 26 OECD members — for the period of 2002 to 2006.

Why has the rate of industrial action declined?

The decline in strike activity in recent decades is likely to have reflected changes to the WR framework and its institutions, shifts in the structure of industry and employment, and broader macroeconomic developments. Many of these factors are not unique to Australia, and have been observed in other developed countries where industrial action has declined.

Reforms to the WR framework during the 1990s, such as the introduction of enterprise bargaining and protected industrial action, have been identified by some as the most important factors in the decline in industrial disputes (Hodgkinson and Perera 2004; Philipatos 2012). Prior to this period, unlawful strike activity was widespread, but largely

211 Noting that the exact approaches taken by countries to collect data on industrial action vary somewhat, meaning that comparing rates of disputation can be an imperfect exercise.

went unpunished. The introduction of protected industrial action brought not only a set of conditions to be met for protection, but also introduced more effective and accessible penalties and pathways to legal action against unprotected action (Briggs 2006; Philipatos 2012). Thus, perhaps counterintuitively, the legalisation of industrial action in some circumstances has led to an overall reduction in its use.

The level of disputation has also been influenced by changes to the role and power of institutions in the WR framework over the past few decades. This includes declines in trade union membership, which has been falling consistently since the early 1970s (Healy 2002; Perry 2013; Philipatos 2012). The move away from conciliation and arbitration by industrial tribunals has also played a role, as previously employees often had an incentive to undertake industrial action to instigate tribunal proceedings (Briggs 2006). Improvements in workplace health and safety standards, and increased enforcement by independent government agencies rather than by unions themselves, are also likely to have contributed to reductions in industrial disputation in some sectors (discussed below).

Industrial disputation is also shaped by structural changes in the economy. The OECD (2007) has noted that shifts in employment from industrial sectors (such as manufacturing and construction) towards service sectors, which generally have lower rates of industrial action, can partly explain recent declines in disputation. Changes in the structure of employment towards casual and part-time work may also be a factor, as these workers have less job security and may not be able to sustain a loss of income from industrial action as easily as those in full-time employment (Philipatos 2012).

Macroeconomic conditions also have influenced the declining prevalence of industrial disputes. Perry (2013) has pointed to numerous studies that have found a link between inflation and industrial disputes, with employees engaging in strikes to maintain real wage levels. Low levels of inflation in recent decades have therefore been a likely contributor to the lower incidence of industrial action. A number of studies have found that the Prices and Incomes Accord (chapter 2) also played an important role in reducing industrial disputation (Chapman 1998; Morris and Wilson 1999; Perry 2013).

While the literature has generally found that the incidence of strikes increases with stronger economic conditions (Kennan 2008), Hodgkinson and Perera (2004) have also noted that the restriction of industrial action to periods after the expiry of an agreement has limited the ability of employees to time their wage claims and strike activity to take advantage of favourable economic conditions. The increased exposure of the Australian economy to trade and competition with firms overseas has eroded the economic rents previously captured by some firms, reducing the ability for employees to demand higher wages and their incentive to attempt to extract these demands using industrial action.

Improvements in workplace health and safety may have reduced disputation

Workplace health and safety issues can be a flashpoint for industrial disputes. In some cases these disputes reflect genuine concerns for the wellbeing of employees, while in others safety issues can be used as an tool for industrial leverage — similar observations have previously been made by the Productivity Commission (2014b) and the Royal Commission into the Building and Construction Industry (Cole 2003).

Some have speculated that safety issues, workplace injuries and fatalities can contribute to the rates of industrial disputation in particular sectors, such as construction (Perry 2006). Indeed, safety has been a prevalent issue in a recent dispute in the construction sector in Victoria, with one union singling out safety concerns, specifically a dispute over the appointment of safety officials, as the motivation for its strike actions (Setka 2014).

Figure 19.3 **Comparison of safety incidents with industrial action**
Averaged from 2001 to 2013, by industry

Sources: Safe Work Australia (2014a); Safe Work Australia (2014b); ABS (2015e) *Industrial Disputes, Australia, December 2014*, Cat. no. 6321.0.55.001.

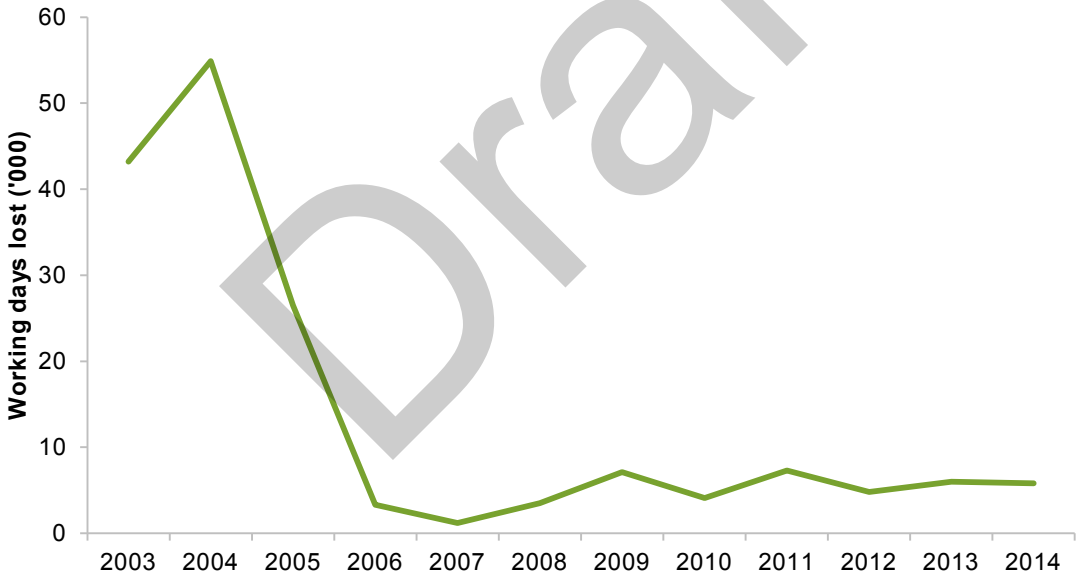
The available evidence suggests there may be a link between safety issues and industrial disputation, but is not sufficient to establish a clear causative relationship. Industries with relatively high rates of industrial activity over the past decade or so have generally had higher rates of safety incidents (figure 19.3). However, these levels are not proportional when compared across industries — for example, the transport, postal and warehousing industry has a higher rate of safety incidents and fatalities than the mining, manufacturing and construction industries, but a much lower rate of industrial disputation. This reflects the numerous factors that can contribute to industrial disputation.

Given this relationship between safety and disputation, employers may be able to reduce their exposure to safety-related disputes (and other industrial action taken under the guise of safety concerns) by consciously improving workplace safety. Similar observations were made by some commentators following the Cole Royal Commission:

> … if you could reduce occupational health and safety problems — in particular, if you could reduce deaths — then you would be able to reduce the strike figures. (Dabscheck 2004, p. 41)

Indeed, there appear to have been substantial improvements in reducing the prevalence of safety incidents over the past decade, especially in high disputation sectors. From 2000-01 to 2012-13 the prevalence of safety incidents declined by 55 per cent in mining, 38 per cent in construction, 34 per cent in manufacturing and 35 per cent in the transport, postal and warehousing industries. These improvements were reflected in a decrease in the number of working days lost to disputes over health and safety issues (figure 19.4).

Figure 19.4 **Working days lost (000s) to disputes over health and safety**
Annually, all sectors



Source: ABS (2015e) *Industrial Disputes, Australia, December 2014*, Cat. no. 6321.0.55.001.

Traditional measures of industrial action do not capture the full extent of industrial disputes

The estimates presented above suggest that the prevalence of industrial action in Australia is relatively low. Nonetheless, it is important to note that these estimates will underestimate the level of industrial disputation, as:

- some types of industrial action are either not included in current estimates, or do not translate into a measurable loss of hours worked
- in some cases, industrial action can impose costs on employers other than a loss of hours worked by employees
- the occurrence of a strike or lockouts is not a direct indicator of industrial disputation, but rather occurs when one party fails to have their demands met in a dispute.

Some types of protected industrial action have not been included in measures

Some forms of industrial action that are permitted under the FW Act are not currently included in the ABS estimates of industrial disputes. While the Australian Worker's Union (AWU) (sub. 74, p. 36) argued that this was a 'wildly speculative' assertion, the ABS explicitly notes that its current estimates do not include industrial actions such as work-to-rule, go-slows and partial work bans (ABS 2015e). As discussed later in this chapter, the Productivity Commission has estimated that partial work bans are approved by employees in three quarters of protected action ballots, suggesting that they may form a substantial share of the industrial action that is undertaken by employees.

Further, the ABS data only includes a dispute if it amounts to an equivalent of 10 or more working days lost. This means that some brief work stoppages among large workforces, or longer stoppages among a small number of employees, might not be counted. For example, if 150 employees engaged in a 30 minute strike, or 25 employees engaged in a three hour strike, both would amount to less than 10 working days and not be counted (assuming a 38 hour work week).

The ABS has noted the above shortcomings with the existing measures of industrial disputation, and has signalled its intention to extend these measures in the future to include work bans and all stoppages (regardless of the number of working days lost) (ABS 2015f). While this should improve the accuracy of these measures in the future, at this stage the existing data still paints only a limited picture of this part of the industrial landscape.

The costs of industrial action are not necessarily proportionate to working days lost

There are some types of industrial action that impose costs on employers that are not directly proportional to the amount of working time that is lost. As such, measures of prevalence based on working days lost will not account for the practical impacts of these incidents of industrial action.

In many workplaces, an employee may perform a multitude of tasks that are not all equally critical to the operation of the business. The importance of any given task may also not be proportional to the amount of time required to carry out the task. This means that the full cost and impact of the industrial action on the parties will not be captured by a measure of

time lost. Some employers have provided examples of situations where relatively minor work bans can have large impacts on output:

> This allows unions to place bans on work that takes little time to perform but has a very high effect on operational efficiency and customer needs. Bans such as a limitation on processing student assessment results, which may take a mere matter of minutes to apply, can have a major effect on an educational institution (Australian Higher Education Industrial Association, sub. 102, p. 6)

> Protected industrial action may currently take the form of a strike or a selective work ban. The situation loses balance, however, if the industrial action is a selective work ban. It enables considerable damage to the employer's operation (for example, shutting down a critical production process only) but does not result in any significant economic impact on employees imposing the ban. (BHP Billiton, sub. 168, p. 11)

In other workplaces — such as a major construction project — a project may run on a tight schedule, and the costs associated with late completion may be substantial. Thus, for these types of projects, a lost working day may be more costly when compared to other circumstances. If the greenfields agreement negotiated at the commencement of a project expires prior to completion, industrial action may arise while a new agreement is negotiated. Some employers have argued that in these circumstances, even relatively short stoppages may lead to substantial costs (Australian Petroleum Production and Exploration Association [APPEA], sub. 209).

Brief work stoppages and minor work bans can also impose administrative costs on the employer that are relatively fixed, and not proportional to the time lost to industrial action. The Qantas Group has provided an example of the cost of making pay adjustments to comply with strike pay provisions:

> In service based industries, bans that do not involve stoppages can also be very damaging to the business without any real countervailing consequence for employees. … the 2011 dispute in Qantas provided an extreme example of how the current rules can be exploited. In this dispute, the union notified a one-minute stoppage, knowing that the complexity and administrative cost of making the required one-minute deduction from pay would exceed the actual amount of the deduction, while also exposing the employer to the risk of prosecution for any error in calculating the numerous deductions involved. (Qantas Group, sub 116, p. 11)

Aborted strikes

As mentioned previously, some employees can use aborted strikes as an industrial tactic, by withdrawing notice for an impending industrial action after their employer has already borne the costs of preparing for the strike. This tactic was illustrated in examples provided by BHP Billiton during the BHP Billiton Mitsubishi Alliance dispute:

> … the economic impact of industrial action was enhanced by threatening action with the prescribed three days' notice, but withdrawing the notice at the last minute.
>
> The statutory purpose of the notice of intention to take industrial action is to enable employers to minimise economic damage – BMA ceased plant and equipment, supplier deliveries and service providers in line with these notices. The late withdrawal of notices or failure to carry through became a weapon in itself, and created significant loss and damage for BMA with no direct impact on employee earnings. (sub. 168, p. 14)

The Qantas Group has also reported similar experiences of withdrawn strike actions:

> Another tactic used by both the ALAEA and the TWU in Qantas in 2011, was to repeatedly notify a stoppage and then cancel the action at the last minute, after schedules had been recut, passengers advised and other staff disrupted from their normal rosters. Such behaviour caused significant loss of revenue and cost to Qantas, inconvenienced customers and other staff and came at no cost to the union or its members directly involved in the 'action'. As one example of this tactic, the TWU notified a two-hour stoppage for all airports to take place between 16:00 to 17:59 on 7 October 2011. The notice was subsequently withdrawn, but the timing of the notification and withdrawal still meant that this 'action' by the TWU affected 4343 passengers and resulted in the cancellation of 17 flights and the rescheduling of 19 other flights. As a second example, the ALAEA provided separate notices of four-hour stoppages at different times of the day in Brisbane, Sydney and Melbourne. Each of these notices was subsequently withdrawn but this 'action' by the ALAEA affected 8318 passengers and resulted in the cancellation of 38 flights and the re-scheduling of 27 flights. The average delay for re-scheduled passengers was 95 minutes. (Qantas Group, sub 116, p. 12)

Although aborted strikes impose costs on an employer, these costs do not translate into working days lost. As such, they will not show up in measures of disputation — by definition, no industrial action has occurred.

Industrial muscle can be flexed without taking action

One participant also argued in submissions that the existing measures cannot account for threats of industrial action, which arguably can be a sufficient means to gain leverage in a dispute:

> The aforementioned statistics on lost time do not cover the threat of industrial action, which has been used by unions to win concessions from employers whilst also causing reputational damage and causing uncertainty. (Chamber of Minerals and Energy of Western Australia, sub. 199, p. 8)

Indeed, the occurrence of a strike indicates the failure of a union to have its demands met. As noted by Norris:

> Although strike activity is an intuitively appealing guide to militancy, it is not ideal, as a strike is in a sense the outcome of the failure of militancy to achieve its aims. Thus, a powerful militant union may win wage increases simply through the threat of a strike. (1996, pp. 264–265)

Does the evidence indicate that reform is needed?

Some employee groups have pointed to low measured rates of disputation as an indicator that the existing arrangements governing industrial disputes are adequate:

> The QCU [Queensland Council of Unions] would rely upon the current, historically low level of disputation to suggest existing dispute resolution is working effectively. (sub. 73, p. 32)

Indeed, while numerous inquiry participants[212] have suggested that the WR framework currently encourages an adversarial approach to bargaining, the low rate of disputation suggests that reforms over the past two decades have improved its performance with respect to industrial disputes. However, this begs an important question — what level of industrial disputation should be considered desirable from a policy perspective?

While it is preferable for parties to bargain and reach agreement without the need for welfare-destroying industrial action, industrial action can be an important mechanism for employees to exercise a degree of bargaining power. Therefore the sole policy objective of the industrial action provisions should not be to minimise the rate of industrial disputation — the logical conclusion from such an objective would be to place as many restrictions on industrial action as possible. While this could possibly reduce the rate of disputation to almost zero (though the high levels of disputation prior to 1993 when all industrial action was unlawful may suggest otherwise), it would likely lead to inequitable bargaining outcomes for employees.

Rather than focusing on increasing restrictions on industrial action, the WR framework should seek to ensure that parties' incentives to engage in action are appropriately aligned. An observed low rate of disputation is desirable where industrial action can be credibly used, but without giving either party too much bargaining leverage. Low rates would then indicate that parties were able to reach mutually satisfactory bargains, rather than being pressed into an agreement through lack of power.

212 For example, Klaas Woldring (sub. 2), NECA (sub. 159), Busselton Chamber of Commerce and Industry (sub. 65), BCA (sub. 173), CCIWA (sub. 134), AIER (sub. 140) and HopgoodGanim Lawyers (sub. 225).

A particular concern arises where one party or another is lawfully permitted to undertake industrial action that involves few penalties for themselves, while imposing high costs on the other. As noted above, to the extent that they occur, aborted strikes would be an example. In section 19.3, a number of reforms are proposed to reduce these avenues for strategic behaviour.

19.3 Reform possibilities to improve the framework

There is scope to improve the industrial action provisions in the FW Act, particularly to weaken some of the avenues that allow for the excessive strategic use of industrial action. The prime areas for possible reform were identified through analysis of evidence in the literature and from various stakeholders. They include:

- changes to the conditions and processes for authorisation of protected industrial action
- lowering the threshold for termination of protected industrial action
- reforms to reduce the impact of aborted strike actions on employers
- changes to strike pay arrangements to reduce the impact of brief stoppages
- increasing penalties for unlawful industrial action

Conditions for authorising protected industrial action

Stakeholder views on the appropriate conditions to be met for the FWC to authorise protected industrial action are generally divided along employer and employee lines. Many employer groups have sought to further restrict employee access to protected industrial action — either by adding more conditions for authorisation, or raising the burden that must be satisfied to meet existing conditions. On the other hand, employee groups have generally submitted to this inquiry that the existing provisions are already quite onerous, and should be wound back, or at least not added to further.

A number of changes to the conditions for authorising protected industrial action have been raised by various stakeholders. These include:

- requiring bargaining to commence before protected industrial action can be authorised
- simplifying the processes involved in applying for a protected action ballot
- raising the bar to deem that a party is 'genuinely trying to reach agreement'
- introducing requirements for employees' bargaining claims to be 'reasonable' or 'not excessive' for protected action ballot orders to be granted
- introducing an income threshold to limit high wage earners' access to protected industrial action.

These suggestions are addressed, in turn, below.

Requiring bargaining to commence before authorising protected industrial action

At present, the FW Act allows employees to seek authorisation for protected industrial action where bargaining has not yet formally commenced due to a refusal by their employer to bargain. This was clarified in the *JJ Richards* case in the Federal Court in 2012, in which the employer challenged the granting of a protected action ballot to its employees, on the grounds that an order could not be granted under s. 443 of the FW Act unless bargaining had commenced, or the employees had exhausted all available avenues to compel the employer to bargain (such as through a majority support determination).[213] The Full Court of the Federal Court rejected the employer's arguments, finding that the operation of s. 443 was not conditional upon bargaining having commenced (Catanzariti 2012; Ralph and Crocker 2012).

While the Court's rejection of the employer's arguments in the *JJ Richards* case has clarified the operation of s. 443 in its current form, there remains a strong case for amending the section to reflect the employer's interpretation.

Through majority support determinations, the FW Act currently provides employees with an accessible avenue to compel employers to bargain. Thus it is unclear why it would be in the community's interests to continue to allow employees to choose the more damaging avenue of industrial action, which can impose costs on employees, employers and consumers. Indeed, as noted by Jessup J in his decision in *JJ Richards*, the availability of majority support determinations and scope orders would seem to indicate that the government had envisioned other avenues be utilised to commence the bargaining process in the event of an employer's refusal to bargain.

A similar conclusion was reached by the post implementation review of the FW Act. The review panel concluded that while the *JJ Richards* settled the law, it was not an appropriate outcome from a policy perspective, and that the capacity for industrial action to be taken to compel employers to bargain would undermine the use of majority support determinations. As such, the panel recommended:

> … that Division 8 of Part 3-3 be amended to provide that an application for a protected action ballot order may only be made when bargaining for a proposed agreement has commenced, either voluntarily or because a majority support determination has been obtained. The Panel further recommends that the FW Act expressly provide that bargaining has commenced for this purpose despite any disagreement over the scope of the agreement. (McCallum, Moore and Edwards 2012, p. 177)

[213] J.J. Richards & Sons Pty Ltd and Australian Mines and Metals Association Inc. v Fair Work Australian and Transport Workers' Union of Australia[2012] FCAFC 53.

Numerous employer groups have supported limiting industrial action to the period once bargaining has been commenced, either by mutual consent or through a majority support determination (Manufacturing Australia, sub. 126; BHP Billiton, sub. 168; Australian Higher Education Industrial Association, sub. 102; SAWIA and WFA, sub. 215; Australian Federation of Employers and Industries, sub. 219; VECCI, sub. 79; Chamber of Minerals and Energy of Western Australia, sub. 199).

The ACTU has opposed introducing a requirement for bargaining to have commenced to take protected industrial action, arguing:

> The ability to take strike action to compel an employer to bargain has been a feature of the industrial relations system for as long as protected industrial action itself has been such a feature. It is part and parcel of requiring that the party that is seeking to take protected action is 'genuinely trying to reach agreement'. To reward employers with immunity from industrial action where they are deliberately non-responsive to bargaining claims runs directly counter to the purposes and objectives of industrial relations system … (sub. 167, p. 233)

However, these arguments do not demonstrate that the other available avenues to compel an employer to bargain, such as obtaining a majority support determination, are not sufficient to achieve these objectives.

Given the costs to the community associated with industrial action, the WR framework should not encourage employees to use industrial action if the employees can obtain the outcome they seek through an available alternative — in this case a majority support determination. If inquiry participants have specific concerns with the utilisation of majority support determination by employees, the Productivity Commission would be interested in analysing these concerns.

DRAFT RECOMMENDATION 19.1

The Australian Government should amend s. 443 of the *Fair Work Act 2009* (Cth), clarifying that the Fair Work Commission should only grant a protected action ballot order to employees once it is satisfied that enterprise bargaining has commenced, either by mutual consent or by a Majority Support Determination.

Simplifying protected action ballot order procedures

At present, employees are required to vote in favour of industrial action in a secret ballot in order to gain FWC approval for protected industrial action (box 19.3). There are a number of benefits that can arise from such a requirement:

- Secret ballots give employees democratic input into the decision to take industrial action, while providing anonymity to reduce potential pressure from representatives or peers to support the proposed action. This can ensure that the decisions of employee representatives more closely align with the wishes of the employees themselves.

- Ballots make threats of strike action more credible, as a positive ballot result provides confirmation that employees are in favour of industrial action (or at least, having the option to undertake it). Thus ballots decrease the possibility of 'hollow' strike threats — this can benefit both employees and employers.
- Requiring parties to apply for a ballot order provides a stage at which the FWC can apply criteria for action, such as the 'generally trying to reach agreement' test.

However, there are also compliance costs associated with the existing ballot requirements. These costs are borne not only by government — the estimated cost of conducting protected action ballots in 2013-14 was $863 000, at an average cost of roughly $1500 per ballot — but also by the parties themselves.

For example, the ACTU has argued that the complexity of the existing laws governing protected industrial action creates numerous opportunities for employers to challenge ostensibly legitimate industrial action on procedural grounds. In particular, the ACTU has identified the seeking of approval for a ballot of union members and the issuing of a notice of intention to take industrial action as the main points where employers exploit the rules to mount legal challenges against employee actions (sub. 167). Some academics have remarked that the existing ballot provisions have 'proved to be a fruitful source of revenue for the legal profession' (Creighton and Stewart 2010, p. 822).

Given these procedural difficulties and costs, the AWU argued that the existing protected action ballot arrangements could be simplified:

> The AWU would like to see more streamlined bureaucratic processes in relation to secret ballots for protected industrial action.
>
> This would not lead to an increase in industrial action but rather make the bargaining process more efficient, which is beneficial for both employers and employees. (sub. 74, p. 36)

The Productivity Commission agrees in principle with this suggestion, and is interested in further exploring potential changes to simplify the existing arrangements.

Empirical evidence suggests that most protected action ballots are 'landslides'

While protected action ballots notionally exist to prevent employee representatives from declaring industrial action without the support of employees, some commentators have argued such behaviour is rarely observed. As noted by Stewart and Creighton:

> … there is a singular absence of credible evidence of workers being led into taking industrial action against their will. This seems to be borne out by the fact that protected action ballots very rarely lead to the rejection of proposed industrial action. On the contrary, the proposed action is almost invariably overwhelmingly supported … (2010, p. 822)

To empirically test this, the Productivity Commission analysed the results of a random sample of 133 protected action ballots that were held between January 2013 and May 2015. The results of this analysis confirm that most ballots approve industrial action in 'landslide' majorities. Among the 82 per cent of ballots that met the quorum requirement[214], more than 98 per cent of ballot questions were approved by employees. The majorities of votes approving ballot questions were also decisive — the average share of 'yes' votes for each ballot question was around 90 per cent of voting employees. Where protected action ballots were not successful, a failure to meet the quorum requirement was the reason in almost all cases.

These findings are supported by similar results from the 2012 review of the FW Act, which examined a sample of 50 ballot result declarations. The panel found that 90 per cent of the ballots in the sample authorised protected industrial action, while in the remaining ballots, industrial action was not authorised because of a failure to meet the quorum requirements (McCallum, Moore and Edwards 2012).

From the Productivity Commission's analysis, it is also worth noting the frequency with which different types of industrial action were put to voters as options in protected action ballots. Almost 95 per cent of ballots contained at least one question proposing some form of work stoppages, while questions on overtime bans and partial work bans were each in roughly three quarters of ballots (figure 19.5). Roughly 90 per cent of ballots included at least two of these three main types of industrial action, and 56 per cent of ballots contained all three types. In many ballots, the range of questions was very comprehensive, and asked employees to vote on almost every conceivable type and duration of action available.[215]

214 Requiring at least 50 per cent of eligible voters to participate in the ballot for the action to be approved.

215 Ballots also differed in the level of specificity contained within questions — for example, some gave employees the option to vote yes or no on work stoppages of different lengths (for example, two hours, four hours and six hours) individually, while others contained a single question asking employees to vote yes or no on stoppages of an unspecified, variable length.

Figure 19.5 **Proportion of ballots asking and approving various actions**

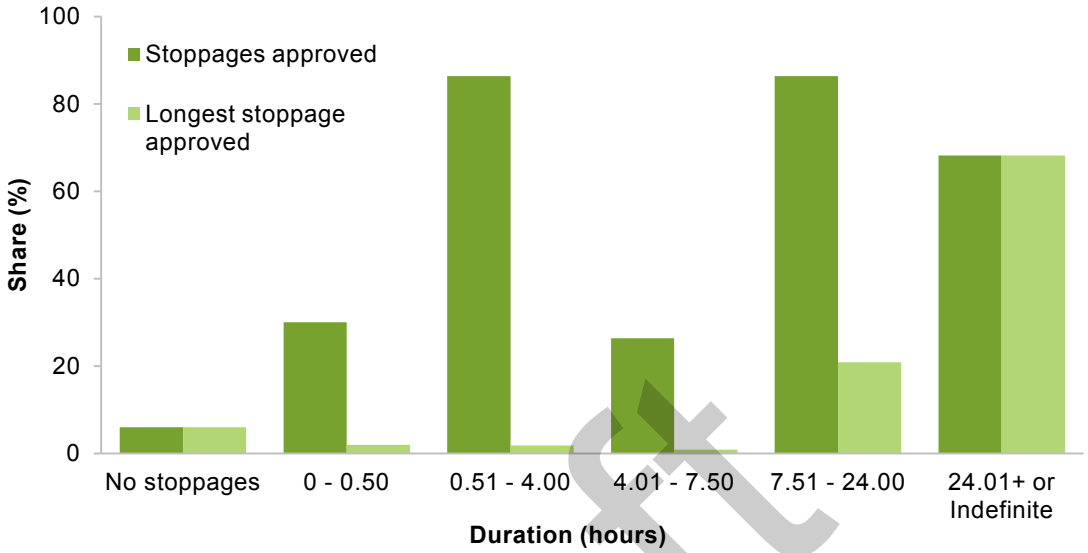
Proportion of all valid ballots in sample[a], by type of industrial action

[a] Ballots that met the quorum requirement of 50 per cent of eligible voters voting in the ballot (n=109). 'Other' includes ballot questions that proposed types of industrial action that did not constitute a stoppage or ban. Most commonly, these involved employees making some form of public statement, announcement or recorded message in support of industrial action. Percentages add up to more than 100 per cent because ballots can contain more than one question.

Source: Productivity Commission analysis of a random sample of 133 ballot results published by the Fair Work Commission.

Ballots also do not appear to have any moderating or filtering impact on the actions approved by employees. More militant strike actions, such as lengthy or indefinite work stoppages, were approved by employees equally as frequently as less drastic actions. Among ballots that contained at least one question regarding work stoppages, 95 per cent approved stoppages of more than 7.5 hours duration (figure 19.6). Employees also do not appear to discriminate between different proposed actions when voting. Out of a sample of 109 valid ballots, in only one instance did employees vote to approve and reject different actions on the same ballot.

Figure 19.6 **Durations of work stoppages approved by ballots**
Proportion of all valid ballots in sample [a]



[a] Ballots that met the quorum requirement of 50 per cent of eligible voters voting in the ballot (n=109).

Source: Productivity Commission analysis of a random sample of 133 ballot results published by the Fair Work Commission.

These findings are unsurprising given the current arrangements. First, given the costs and effort associated with holding a ballot, employee representatives have little incentive to put action to a vote unless they think it is likely to lead to approval. Second, it costs nothing extra for representatives to propose any given action in a ballot, and employees have little to lose by giving themselves the option of potentially exercising each type of action in the future. The critical decision about whether an approved action is actually carried out is then deferred to when employees decide whether to give notice of industrial action to their employer.

Secret ballots should be maintained

Secret ballots have a strong foundation. They reduce the risks that employers can pressure employees not to engage in action or unions to pressure them to do so against their consent. They also preclude circumstances where an employee representative could notify an employer of future industrial action without adequately consulting with the employees themselves. This could lead to adverse outcomes — for example, employees being locked out by an employer in response to notified industrial action that a majority of them did not support. Further, some representatives may be willing to misrepresent the level of employee support and use unsubstantiated threats of industrial action in order to gain leverage during negotiations — as mentioned previously in this chapter, a threat of industrial action does not necessarily need to be carried out in order to press bargaining claims. In these cases, employees may be pressured into supporting action once a threat has already been made without their consent.

As such, secret ballots should be maintained as a prerequisite for approval of protected industrial action. However, there nonetheless remains a case for simplifying the rules that govern the ballot process.

But could be simplified

Currently, for industrial action to be protected, the action taken by employees must reflect the questions that were asked and approved in the ballot. This may help prevent disputes from escalating beyond the level of industrial action that employees are willing to undertake. However, this can also lead to employers disputing the validity of employee actions on the grounds that the proposed action does not match the content of a ballot. In its submission, the ACTU (sub. 167) raised the example of a dispute at the Yallourn Power Station, where the employees were dragged into a long-running legal dispute due to a semantic challenge by an employer as to whether notified industrial action by the employees met the definition of a work ban as proposed in the protected action ballot. The employees eventually carried out a second ballot which contained questions that satisfied the more precise definition of a ban, and industrial action recommenced.

There is merit in considering whether proposed actions should be required to be specified in ballots. The empirical evidence outlined above suggests that most ballots canvass a wide range of actions that are generally approved by employees on a rather indiscriminate basis. As such, simply requiring ballots to approve the taking of unspecified protected industrial action may achieve the same outcome as the existing arrangements, without the potential for semantic legal disputes. Of course, employee representatives would still have to informally consult with the employees on what types of action to take (ultimately it is the employees themselves who choose whether to carry out the industrial action), and comply with requirements to specify the action to be taken when providing employers with notice.

Removing or extending the 30 day 'use it or lose it' rule

Some inquiry participants were also critical of the current provision that stipulates industrial action is only protected if it commences within 30 days of the ballot result (with a possible extension of up to 60 days). This provision is intended to prevent employees from holding the threat of industrial action over an employer indefinitely once approval is obtained. Stakeholders argued that this rule can either encourage unions to 'rush' to take protected industrial action within the 30 day period in order to maintain the ability to take protected action subsequently, or lead to greater compliance costs in applying for an extension or a new protected action ballot order (Qube Ports, sub. 123, Australian Education Union, sub. 63). The Productivity Commission considers either removal or extension of this 30 day period to be a potential avenue for simplification.

Quorum requirements

The Australian Education Union argued in its submission that the quorum requirement for protected action ballots are anomalous and confusing, given that no such requirement applies for employees to vote to approve an enterprise agreement (sub. 63). The union suggested that this requirement should be removed so that only a majority of votes cast would be required to approve protected industrial action.

However, quorum requirements can be an important check to ensure that ballot results are at least somewhat representative of employee views. Productivity Commission analysis shows that voter turnout was generally quite low — on average, around just one third of eligible voters — in ballots that were invalid because of a failure to meet the quorum requirement. Whether a similar quorum requirement should also be required to approve an enterprise agreement is a separate issue, and may be worth considering if there is evidence that similarly low turnout has occurred in votes to approve enterprise agreements.

Greater discretion for the FWC when dealing with disputes over ballots

In addition to simplifying the rules governing ballots, procedural disputes could be reduced by granting the FWC the discretion to overlook minor defects or unmet requirements in the ballot process and approve protected industrial action if the FWC is satisfied that a procedural defect was not likely to have substantively affected the outcome of the ballot. This would be in line with similar recommendations in chapter 15 to increase the FWC's discretion to focus on substance over form.

Concerns about procedural challenges to protected action ballots may also be addressed partly by avoiding the complexities that may arise from proposals to change requirements for a party to be 'genuinely trying to reach agreement', which are discussed further in the following section.

INFORMATION REQUEST

The Productivity Commission seeks further input from stakeholders on how protected action ballot procedures may be simplified to reduce compliance costs, while retaining the benefits of secret ballots. Potential simplifications include:

- *removing the requirement that a protected action ballot specify the types of actions to be voted on by employees, and instead simply requiring a vote in favour of any forms of protected industrial action*
- *amending or removing the requirement that industrial action be taken within 30 days of ballot results being declared*
- *granting the Fair Work Commission the discretion to overlook minor procedural defects when determining if protected industrial action is authorised by a ballot.*

Determining whether a party is 'genuinely trying to reach agreement'

To issue a protected action ballot order, the FWC currently must be satisfied that the party applying for the ballot order is 'genuinely trying to reach agreement' with the employer in question.

Numerous employers have submitted that the current requirement is inadequate, making protected industrial action too accessible at the early stages of bargaining (APPEA, sub. 209; Australian Shipowners Association, sub. 206; BHP Billiton, sub. 168; Australian Federation of Employers and Industries, sub. 219). For example, the Australian Shipowners Association has argued:

> It is exceedingly easy for a bargaining representative (usually a union) to obtain a secret ballot order from FWC. It has become largely a form filling exercise. The 'genuinely trying to reach agreement' test in section 443(b) of the Act is satisfied by showing that claims have been made and pressed, and to some extent explained, and assertion that the applicant bargaining representative really wants what is claimed. (sub. 206, p. 9)

It has been argued by employers that industrial action should only be available as a 'last resort', where negotiations have stalled or reached an impasse (Chamber of Minerals and Energy of Western Australia, sub. 199; SAWIA and WFA, sub. 215). One employer group suggested that protected industrial action should not be possible unless there has been a period of six months of negotiation (APPEA, sub. 209), while others suggested that the FWC should be satisfied that negotiations have reached an impasse before authorising protected action (AHEIA, sub. 102; BHP Billiton, sub. 168).

It is not clear that these suggested changes would lead to desirable bargaining outcomes. In certain cases, a six month moratorium would place employees at a significant bargaining disadvantage given that no pay rises can occur after the nominal expiry date of an enterprise agreement. Moreover, a union wanting to retain its bargaining power under such a rule would have to credibly commit to a high cost strike at the end of the six months in the event that no satisfactory bargaining occurred in the interim. Credibility can often only be achieved by sometimes acting on the threat. A six month rule might therefore either undermine reasonable bargaining power or inadvertently prompt high-cost, infrequent strikes, neither of which would be desirable.

Only allowing industrial action after negotiations have stalled may encourage a party to refuse to compromise on ambit claims in order to stall negotiations and trigger access to industrial action. Further, this proposed solution ignores the role that industrial action (or the threat of it) can play in preventing negotiations from stalling in the first place, by compelling parties to reach agreement in order to avoid or bring an end to industrial action.

The Australian Parliament is currently considering the Fair Work Amendment (Bargaining Processes) Bill 2014, which would add a new subsection 443(1A) to the FW Act, setting out what the FWC must have regard to when considering whether a party applying for a protected action ballot order is 'genuinely trying to reach agreement' as follows:

> For the purposes of paragraph (1)(b), the FWC must have regard to all relevant circumstances, including the following matters:
>
> (a) the steps taken by each applicant to try to reach an agreement;
>
> (b) the extent to which each applicant has communicated its claims in relation to the agreement;
>
> (c) whether each applicant has provided a considered response to proposals made by the employer;
>
> (d) the extent to which bargaining for the agreement has progressed.

While the amendments in the Bargaining Processes Bill have been supported by some employers (SAWIA and WFA, sub. 215), employee groups have expressed opposition to the proposed changes. In its submission, the ACTU has argued:

> The practical effect of the proposed new subsection (1A) is not to be understated. For unions, it creates a sizeable burden to document every single interaction that occurs in bargaining so as to be in a position to leave open the option to pursue a protected action ballot at some future point in time. … These burdens arise because section 443 is concerned not only with whether a union is genuinely trying to reach agreement, but whether it *has* been. … unions will *always* face this

> burden, should they wish to leave the option of a protected action ballot open, even where they are confident or assured that an employer will not oppose such an application. This is because section 443 requires the FW Commission to reach a *positive state of satisfaction* as to whether the union 'has been, and is, genuinely trying to reach agreement'. (sub. 167, p. 232)

These concerns appear to be warranted. The amendment is likely to substantially increase compliance burdens, and provide a number of new avenues through which industrial action is likely to be challenged on procedural grounds. An increased focus on process is unlikely to improve the efficiency of the WR framework.

The Explanatory Memorandum to the Bargaining Processes Bill notes that the list of matters to be considered by the FWC are drawn from the principles used by the Full Bench of the then Fair Work Australia in *Total Marine Services Pty Ltd v Maritime Union of Australia*. However, as referenced by the ACTU (sub. 167) in its submission, this overlooks the broader views expressed by the Full Bench in its decision on the case in question:

> In our view the concept of genuinely trying to reach an agreement involves a finding of fact applied by reference to the circumstances of the particular negotiations. … it is not appropriate or possible to establish rigid rules for the required point of negotiations that must be reached. All the relevant circumstances must be assessed to establish whether the applicant has met the test or not. (*Total Marine Services Pty Ltd v Maritime Union of Australia* [2009] FWAFB 368)

While there are anecdotes, there is no evidence to suggest that there is any widespread industrial action undertaken by employees who are not trying to reach agreement. The evidence does not justify the regulatory burden, and potential restrictions on industrial action that the proposed new test is likely to impose on all employees engaged in enterprise bargaining.

Requiring employees' claims to not be 'excessive'

Numerous employer groups have argued that prior to the FWC authorising protected industrial action, it should determine whether the bargaining claims of employees are 'reasonable', 'genuine' or are not 'excessive' (APPEA, sub. 209; Australian Shipowners Association, sub. 206; CCIWA, sub. 134; Manufacturing Australia, sub. 126; Chamber of Minerals and Energy of Western Australia, sub. 199). These participants also supported a proposed amendment to the FW Act that would require the FWC to reject an industrial action that had a significant adverse impact on workplace productivity.[216] On face value, such requirements may seem reasonable in principle. However, in practice they involve considerable practical difficulties and have implications for the role of the FWC.

216 Fair Work Amendment (Bargaining Processes) Bill 2014.

Given that enterprise bargaining is predicated on the notion that wages and conditions should be tailored to suit enterprises individually, defining what would constitute an 'excessive' claim is difficult, and endeavours to confine its possible scope may risk some unintended consequences. The Bargaining Processes Bill proposed a benchmark based on conditions at the workplace and the industry in which the employer operated. However, such a benchmark would risk undermining the decentralised and enterprise-oriented focus underpinning the WR framework. While employers and employees may currently choose to look to comparable enterprises to inform their bargaining claims, there is no mandatory requirement to do so.

An associated point is that any requirement for the FWC to indicate what is excessive implies that the industrial umpire would assume a quasi-arbitral role in disputes, though it may be poorly equipped to make those judgments without a thorough (and resource-intensive) examination of the circumstances of the business. Consistent with the Productivity Commission's approach throughout this report, such an arbitral role should be avoided if possible. Moreover, even were the FWC to attempt to make such judgments, a subjective term like 'excessive' means that different members of the FWC would reach quite different conclusions in different applications for protected action. In some cases, a member might set the bar quite high (as is the case in other areas of the FW Act, such as the termination of industrial action) and thus the amendments would have little effect on bargaining (except to raise complexity and uncertainty), or a FWC member might set the bar low, and thus effectively place an industry-based ceiling on the bargaining claims of employees and restrict their access to industrial action. This would increase uncertainty for all parties.

This is not to suggest that the WR system can never require the FWC to make potentially subjective judgments such as what is 'reasonable'. Indeed, there are other sections of the FW Act that require parties to conduct themselves in a reasonable manner. However, evaluating the reasonableness of bargaining claim requires presupposing some level of acceptable wages and conditions before the negotiations are concluded. Such presupposed outcomes risk becoming self-fulfilling prophecies — by placing an ex ante constraint on industrial action if employees' bargaining claims are deemed to exceed a particular level, a lack of access to industrial action to press for a higher wage claim may mean that the final negotiated outcome will resemble the level chosen by the FWC.

Assessments of productivity involve some similar dilemmas, especially as claims for high wages would not generally decrease productivity. Indeed, to the extent that they prompted capital-labour substitution or greater incentives for innovation in labour saving measures, both labour and multi-factor productivity might rise. Costs and productivity are quite different things. Employees and employers also have some aligned interests in encouraging firm-level productivity to secure job security and higher wages.

Moreover, while most people can adduce examples of what they might see as excessive claims, the evidence on wage increases in recent enterprise agreements (chapter 15), does not suggest that this is widespread. And, where they occur, 'excessive' claims sometimes may be an attempt by employees to secure a bigger slice of the rents that occur in booming times in an industry (as occurred in the resources boom). That may be galling to employers, but it need not always be inefficient. Both sides want a better deal, but so long as investment is not curtailed, the exact bargaining outcome need not have adverse efficiency impacts. Indeed, where employees do push for seemingly 'excessive' claims during a boom period, employers should also recognize the temporary nature of any such pay rises, and equally push back and emphasise that corresponding reductions in wages must occur when economic conditions are less favourable.

That said, this does not mean that there should never be any concern about industrial action in support of excessive claims. Indeed, the ability to take different approaches to such claims, depending on the circumstances of the firm, is what public policy should be aiming to support. For example, the provisions to terminate disputes under Part 3-3, Division 6 of the FW Act reveal a desire to constrain unreasonable actions where they lead to damaging and intractable disputes that harm the bargaining parties or the public interest.

In considering the question of whether there should be ex ante constraints, it is best to assess the fundamental reasons why employees would strike in support of what might seem to be unreasonable claims. The answer is that employers sometimes do not have the capacity to exert countervailing power to lower the payoffs to employees of using industrial action to press such claims. This chapter recommends several changes that would provide greater countervailing powers to employers, without moving the power pendulum too much their favour. An effective bargaining arrangement must attempt always to strike some balance between the bargaining parties, while allowing hard bargaining by *either* party (an observation made in chapter 15).

Accordingly, the solution to any manifestly excessive claims that are underpinned by industrial action is best achieved by lowering the incentives for such behaviour, not outlawing it through the intervention of an arbitrating regulator.

High income threshold for industrial action

Several employer groups, particularly in the resources sector, suggested that there should be a restriction on industrial action by employees earning above a certain income. Some have proposed the unfair dismissal high income threshold of $133 000 (AMMA, sub. 96;

Chamber of Minerals and Energy of Western Australia, sub. 199; BHP Billiton, sub. 168). This would likely preclude many employees from any industrial action (or at least during some parts of the business cycle), including many remote workers in the mining industry, engineers on offshore gas platforms, and tug boat operators.

There are arguments both for and against this proposal. On the one hand, AMMA claimed that such a threshold is justified by the greater bargaining power held by high-income employees. It may also be argued that when they do engage in industrial action, they have greater capacity to endure prolonged strike action, as they would be less financially vulnerable than other employees, thus providing them with more leverage.

On the other hand, there are numerous arguments against any such restrictions:

- In the absence of industrial action, it is unclear what alternative mechanism would be available to these employees to press their claims when bargaining. Having a high income does not necessarily equate with high bargaining power, especially where the skill is highly job-specific or highly cyclical (for example, a coal miner).
- High wages can reflect the risks and nature of a job (for example, long hours, isolation, danger, extreme discomfort). Placing a restriction on industrial action would risk providing inadequate compensation for such risks.
- It is unclear that, as a group, high-income employees generally have any stronger incentives to undertake unreasonable industrial action than others (except in circumstances in which their scarcity enables them to garner a greater share of any rents obtained by their employer). Higher income employees also face a greater opportunity cost from the income foregone by undertaking strike action (and may well have commitments tied to their income such that their deep pockets are illusory).
- The arguments that lead (reasonably) to a threshold on unfair dismissals involves quite different considerations to those applying to industrial action (chapter 5).

Overall, there are not sufficiently compelling grounds for a restriction on industrial action by high-income employees. Incidentally, were it introduced, it would place Australia in an unusual position among most other countries, where no such restrictions apply.

Grounds for termination and arbitration of industrial disputes

Numerous employers have called for changes to the FWC's powers to suspend or terminate industrial action (Manufacturing Australia, sub 126; APPEA, sub. 209; AMMA, sub. 96; CCIWA, sub. 134; BHP Billiton, sub. 168; Minter Ellison, sub. 239). Broadly, most have called for lower thresholds for economic harm or broader circumstances in which the FWC can terminate industrial action.

The bar for 'significant harm' currently appears to be too high

At present, industrial action can be suspended or terminated on the grounds that it is causing significant harm to bargaining participants (s. 423) or a third party (s. 426). While the FW Act does not provide an explicit definition of significant harm, the Explanatory Memorandum to the Fair Work Bill 2008 notes that significant would mean 'more serious nature than merely suffering of a loss, inconvenience or delay'. The FW Act also provides a list of factors to be considered when deciding whether harm is significant, including the source, nature and degree of the harm suffered or likely to be suffered; the likelihood that the harm will continue to be caused; and the capacity of the parties to bear the harm.

Through its interpretations of the meaning of significant harm, the FWC has set a high bar for intervention. The *Woodside* decision in 2010 by the Full Bench of the FWC interpreted the meaning of 'significant' under s. 426 as being 'exceptional in its character or magnitude when viewed against the sort of harm that might ordinarily be expected to flow from industrial action in a similar context.'[217] On this basis, the Fair Work Commission rejected an application by Woodside This interpretation has also been subsequently adopted in other decisions relating to applications under s. 423.[218]

A variety of stakeholders have argued this threshold for significant harm under s. 423 and s. 426 is too high, and suggested that it be lowered or modified (see box 19.7).

On the one hand, the current definition of 'significant' appears to be unworkable in all but the most egregious of circumstances. Indeed, this is illustrated by the lack of successful applications under s. 423 and s. 426. Other than the Schweppes case (where both employees and employers jointly applied for termination — see box 19.4), the FWC has not made any orders under s. 423 in the 30 applications that have been made since the FW Act was introduced. Similarly, not one of the 11 applications under s. 426 have been successful. This contrasts with applications to suspend or terminate under s. 424 (where an action threatens to endanger a person's life, personal safety, health or welfare) which are much more commonly approved (as discussed further below).

217 *CFMEU v Woodside Burrup Pty Ltd and Kentz E & C Pty Ltd* [2010] FWAFB 6021.

218 *Prysmian Power Cables and Systems Australia Pty Ltd v NUW, CEPU, AMWU* [2010] FWA 9402.

Box 19.7 Participants' views on the definition of 'significant harm'

Australian Council of Trade Unions (ACTU):

> … the practical reality is that the capacity to obtain access to interest arbitration of industrial disputes (in all bar the most exceptional cases) is largely unattainable for employees due to the very high threshold established under ss. 423 and 424 of the FW Act – unless of course, the employees concerned are health workers engaged in effective protected industrial action. The current provisions relating to access to arbitration do not contain the right balance and are complex and unwieldy. (sub. 167, p. 239)

Australian Mines and Metals Association (AMMA):

> AMMA recommends that the current thresholds be modified so that the currently ridiculously high bar is set at a level that would meet community expectations for 'significant harm' rather than the subjective notions applied by the FWC. (sub. 96, p. 188)

Australian Petroleum Production & Exploration Association (APPEA) recommends:

> The option for the employer to have the bargaining terminated in the event of threatened or actual industrial action which causes damage to the business (something more than 'inconvenience' but short of 'significant'). (sub. 209, p. 39)

Australian Shipowners Association:

> … the test of 'significant harm' in sections 423 and 426 has been interpreted and applied very restrictively as illustrated in the Woodside case. The significant harm test, as it has been applied by the FWC (and its predecessor Fair Work Australia), legitimises the use of disproportionate power to force concession of excessive remuneration and conditions in the maritime industry. It is not operating in a way that is fair or reasonably balanced. (sub. 206, p. 10)

Brendan McCarthy:

> In respect of significant harm Orders the FWC has interpreted the meaning of 'significant' in such a way that the hurdle to achieve relief is extraordinarily high. It would appear that the only way an employer can obtain relief is to create a crisis. … for significant harm Orders (s.423 and s.426) a clearer legislative direction to the FWC should be established. It should be directed at ensuring that the primary, if not the only considerations, should be the public interest and not the rights and interests of those involved in the action. (sub. 43, p. 18)

Chamber of Commerce and Industry of Western Australia (CCIWA):

> … the definition of *'significant economic harm'* under s. 423 of the FW Act should be replaced with a new test to assess whether industrial action is causing unreasonable economic harm or has a serious adverse impact on the employer or other affected party (e.g. another business, person or sector of the community). (sub. 134, pp. 51–52)

Minter Ellison:

> … 'significant economic harm' does not mean harm different from the sort of harm which might ordinarily be expected to flow from industrial action in a similar context. Instead, 'significant' should be given its ordinary meaning. (sub. 239, p. 13)

Defining significant as being exceptional when compared to industrial action in a similar context also ignores the important role that context can play in causing or magnifying the economic harms of industrial action (for example, if an enterprise operates in an industry where disruption is particularly costly). As noted by Minter Ellison:

> … in some industries an employer can lose tens of millions of dollars through industrial action. The mere fact that this would be an 'expected' consequence of industrial action in that industry does not mean that it is not significant. (sub. 239, p. 7)

Indeed, this was relevant in the *Woodside* case, where the FWC concluded that the potential losses from industrial action identified by Woodside (approximately $3.5 million a day) were a function of the large size of the project, and thus were not significant when considered in the context of the project as a whole.

On the other hand, there can be good reasons for setting a relatively high threshold for significant economic harm to suspend or terminate industrial action.

- If industrial action could only be used where it would cause little harm to a bargaining participant, it would have little effect on negotiations, and employees would have little incentive to undertake it. Doing so would lead to a loss of wages without corresponding pressure on employers to meet demands for wage increases. As noted by the Australian Education Union in its submission:

  > Industrial action always adversely affects the employer/s and employees involved and it always adversely affects in significant ways a host of 'third parties'. This is its purpose: to create pressure to influence one side in a bargaining situation to make decisions they otherwise would not. (sub. 63, pp. 15)

- Lowering the threshold for termination of disputes may also have the unintended effect of increasing the prevalence of industrial action. Termination triggers a determination by the FWC if agreement is not reached following a 21 day negotiating period. Accordingly, if a party believes that they would get a more favourable outcome from a determination by the FWC, they may undertake industrial action in the hope that it will be terminated. Indeed, under the former conciliation and arbitration system, 'stoppages were often used to instigate proceedings in the conciliation and arbitration tribunals' (Briggs 2006, p. 347). Thus lowering the threshold for termination carries the risk of returning the incentives for industrial action that existed under the previous system. It may offer some comfort to those employers who already experience industrial action under the current system, but in doing so cause harm to a whole new group of employers.

On balance, at this stage the Productivity Commission agrees with inquiry participants that the prevailing definition of significant harm sets the bar for FWC intervention too high. While the powers under ss. 423 and 426 should be used sparingly, this should not extend so far as to consign these powers to irrelevance.

However, this begs the question as to how the definition of 'significant' should be legislatively clarified. Indeed, defining apparently nebulous words such as 'significant' can be a vexing issue in public policy, and the FWC is placed in the unenviable position of having to interpret and apply such definitions. Bearing in mind the tradeoffs discussed above, the Productivity Commission seeks further input from inquiry participants on how 'significant harm' should be defined to give the FWC greater scope to intervene in some intractable and damaging disputes, while avoiding unintended consequences and preserving the ability to use industrial action as a legitimate bargaining tool.

Regardless of the definition or threshold of significance chosen, there will inevitably be some exceptional cases that creep between any legislative distinctions of whether harms are significant or not. However, there are major dilemmas in attempting to tailor legislation to cater for all exceptions. The FWC applying its judgment is still, on balance, the right answer. This will be particularly so with improvements to FWC appointment qualifications and selection processes (chapter 3).

INFORMATION REQUEST

The Productivity Commission seeks further input from stakeholders on how 'significant harm' should be defined when the Fair Work Commission is deciding whether to exercise its powers under s. 423 and s. 426 of the Fair Work Act 2009 (Cth).

Should actions be halted before they commence?

Some inquiry participants have also criticised the requirement that industrial action must be engaged in before it can be suspended or terminated under ss. 423 and 426. This means that a party cannot seek intervention from the FWC until they have already endured significant harm for a protracted period of time. Minter Ellison (sub. 239) argued that this means employers have a strong incentive to concede to employee demands when faced with threats of seriously damaging industrial action. They further suggested that the FWC should be empowered under s. 423 to suspend or terminate industrial action that is threatened, impending or probable (as is the currently the case for s. 424).

It may seem appealing to attempt to pre-emptively shield parties from harms where they are likely to be significant. However, this misconstrues the purpose of the powers under ss. 423 and 426, which do not exist to pre-emptively protect or balance the bargaining power of parties. Rather, their purpose is to bring an end to disputes that are significantly damaging but are unlikely to reach a negotiated outcome. Arguably, this can only be clearly established once the parties have demonstrated a continued failure to agree even when the harms of industrial action are felt.

Indeed, the threat of significant harm from industrial action (whether it be a strike or a lockout) may be the decisive factor that breaks an impasse in bargaining, if the costs of industrial action exceed the costs of making a concession in bargaining. While some parties may resent bowing to such pressures, these outcomes are not necessarily inefficient, particularly where one party is simply capturing a greater share of surplus from the employment relationship. Where excessive bargaining power is a concern, the more direct policy response would be to address the sources of any imbalances in industrial muscle, which other recommendations in this chapter aim to address.

Further, allowing termination of industrial action and access to arbitration before action is actually carried out may also lead to an increase in threats of industrial action that is significantly damaging (to either a bargaining participant or a third party) in pursuit of

favourable outcomes at arbitration (similar to the effect outlined above for lowering the threshold for 'significant harm'). The current arrangements require parties to 'put their money where their mouths are' before a dispute is terminated. Under the suggested change, parties could merely make threats of drastic industrial action to access termination and arbitration, without bearing the costs associated with taking industrial action (such as foregone wages).

For the above reasons, the Productivity Commission does not recommend that ss. 423 or 426 be amended to allow the suspension or termination of industrial action that is threatened, impending or probable.

Suspension or termination should not require both parties to be harmed

A peculiarity with s. 423 in its current form is that in order to suspend or terminate industrial action initiated by employees, the action must cause significant economic harm to *both* the employees and the employer. By contrast, to suspend or terminate a lockout by an employer requires that only the employees are being significantly harmed.

The apparent effect of the current wording is that s. 423 is ineffective for dealing with employee industrial action that is causing significant harm to an employer. It would seem to be rare and counterintuitive for employees to choose to engage in industrial action that inflicts significant harm on themselves. Some stakeholders have also noted that some forms of industrial action, such as work bans, can inflict substantial damage on an employer without employees suffering a substantial loss of wages. While this is not necessarily a reason for FWC intervention, it does mean that significant harms to both parties will rarely coincide (Minter Ellison, sub. 239).

In its current form, s. 423 may also encourage more drastic response actions by employers, such as a lockout, in order to cause sufficient harms to employees to justify termination. This was illustrated in the *Schweppes* case, where the employer locked its employees out, then applied for termination under s. 423 on the basis that its own lockout was harming the employees (box 19.4).

Given these shortcomings, s. 423(2) of the FW Act should be amended to require that *either* the employer *or* employees must be suffering significant economic harm in order for the FWC to suspend or terminate employee industrial action, similar to the current arrangements for employer response actions under s. 423(3).

DRAFT RECOMMENDATION 19.2

The Australian Government should amend s. 423(2) of the *Fair Work Act 2009* (Cth) such that the Fair Work Commission may suspend or terminate industrial action where it is causing, or threatening to cause, significant economic harm to the employer ***or*** the employees who will be covered by the agreement, rather than both parties (as is currently the case).

Intervention is more common in disputes that threaten health or safety

The FWC must suspend or terminate proposed industrial action where it threatens to endanger a person's life, personal safety, health or welfare, or cause significant harm to the Australian economy (s. 424). In contrast to ss. 423 and 426, the FWC appears to intervene more frequently in these cases, having made orders to suspend or terminate industrial action in more than half of applications brought under s. 424 since 2009.

One consequence of this relatively low bar is that employees in some sectors, particularly parts of the public sector, that are focused on delivering health services or in maintaining public safety (such as nurses, paramedics, police officers, firefighters, prison officers and child protection workers) can find it difficult to take industrial action, as:

> … there is a strong prospect that practically any effective (as opposed to merely symbolic) industrial action taken by employees in the public health sector will be exposed to ready termination under s424(1)(c) of the FW Act. (ACTU, sub. 167, p. 237)

For public sector employees in particular, it means they cannot so easily countervail the Government's bargaining power (as discussed in chapter 18).

One of the reasons for the low bar under s. 424 is that the section requires that the FWC *must* act if it is satisfied that the industrial action would threaten to endanger the personal safety, health, welfare or life of a person, with no regard to the magnitude of the threat or risk. This contrasts with ss. 423 and 426, which require the FWC to be satisfied not only that harm is occurring, but also that it is 'significant'. This means that industrial action that may seem relatively benign may still face FWC intervention — the Australian Education Union (sub. 63) gave the example of teachers in the Northern Territory, who proposed to take industrial action by taking attendance rolls manually, rather than electronically, and not provide it to school administrators. The proposed action was found to threaten endangerment to personal health and safety or welfare, and was suspended by the FWC.

There may be justifications for some form of precautionary principle — arguably personal safety should have primacy over the economic and bargaining interests of the parties. However, sound public policy also generally emphasises that risks (even those to personal safety or human life) should be appropriately balanced against any associated benefits, rather than purely minimised. This means not only assessing the magnitude of potentially harmful outcomes that could arise from industrial action being taken, but also accounting for the likelihood that such outcomes would actually occur.

There may be merit in giving the FWC greater discretion to allow industrial action to continue if the FWC is satisfied that the risks to health or safety from the action are acceptably low. On the one hand, this may reduce the number of cases where relatively harmless industrial action is terminated. On the other hand, this discretion may lead to highly variable and subjective decisions — some FWC members may be reluctant to be responsible for allowing an ex post harmful action to have proceeded, leading to overly cautious decisions, while others may set a very high bar for intervention, as is the case with

ss. 423 and 426. The Productivity Commission seeks further input on this issue from inquiry participants, particularly in those sectors where s. 424 is more frequently used.

INFORMATION REQUEST

The Productivity Commission seeks further input from inquiry participants on whether s. 424 of the Fair Work Act 2009 (Cth) should be amended to allow industrial action to proceed where the Fair Work Commission is satisfied that the risk of a threat to life, personal safety, health or welfare is acceptably low.

Aborted strikes

Aborted strikes allow employees to impose costs on their employers while bearing little or no costs to themselves. This poses a problem for public policy. Industrial action should be supported by law where it is a necessary (if undesirable) step to settling a dispute — the incentive for both parties to seek to move closer should arise as a consequence. But where industrial action imposes no cost on one of the parties, it will not have this desirable effect.

It may be argued that unions do not have an incentive to repeatedly undertake aborted strikes, as they would undermine the credibility of future threats of strike action — perhaps invoking the story of the 'boy who cried wolf'. However, unlike Aesop's fable, it is the employer who bears the greatest risk if they ignore a notice of strike action under the assumption it will be aborted. Further, if employees are able to identify whether their employer has put in place a contingency plan, they can choose whether to proceed with strike action or not based on what will maximise damage to their employer. This asymmetry of information and risk can make aborted strikes an effective industrial tactic.

Given that strikes may be withdrawn for legitimate reasons, such as a sign of good faith or if a negotiated outcome is reached, it would be inadvisable to attempt a blanket prohibition on aborted strikes. Such a prohibition would eliminate any incentive for employers and employees to attempt to negotiate once a union has 'crossed the Rubicon' by providing notice of a strike. Indeed, as noted by the Queensland Council of Unions:

> On the topic of aborted strikes, the QCU would be unsure of the remedy. It would be absurd to suggest that a tribunal order union members to undertake industrial action that had been threatened as part of a campaign. (QCU, sub. 73, p. 33)

The post implementation review of the FW Act recognised the use of aborted strike actions as an industrial tactic, but ultimately concluded that sufficient remedies were available under good faith bargaining obligations:

> … the FW Act already contains a mechanism for addressing this conduct under its good faith bargaining provisions. It is almost certainly open to an employer who is subjected to 'aborted strikes' to apply to the tribunal for an order under s. 230 restraining conduct involving the giving of notice by a bargaining party who does not pursue the industrial action that has been

> notified. Whether an order should be made will obviously depend on the facts and the reason why the industrial action wasn't taken. We acknowledge that to date no bargaining order has been issued to stop or limit the taking of industrial action. However, the Full Bench in Boral has provided a clear indication that this remedy is available. (p. 184)

However, it is not clear that this avenue adequately addresses the problem. First, whether the good faith bargaining requirements would prohibit such conduct remains untested. Indeed, as the Panel has acknowledged, there are no examples of the requirements being used in this fashion. Second, such a response would require the employer to demonstrate that the union had already been repeatedly engaging in aborted strikes — thus it would provide little deterrence of such behaviour or remedy for the employer until significant one-sided damage may have occurred.

There are two policy options suggested by stakeholders that appear to be appropriate for addressing the use of aborted strikes.

First, the Qantas Group (sub. 116) suggested that where employees unilaterally withdraw notice of an industrial action, and where the employer has already commenced a reasonable contingency plan in response (such as rescheduling services), the employer should be entitled to:

- deduct from the wages of employees covered by the relevant protected action ballot order, an amount equal to the duration of the contingency response enacted (which may be longer than the notified action where it has ramifications beyond the notified period) and that this will not expose the employer to employee response action; and
- stand down the employees covered by the relevant protected action ballot order because they cannot usefully be employed as a consequence of the contingency plan.

To illustrate how such a policy might operate, take the 7 October 2011 example provided by the Qantas Group (sub. 116). The TWU provided notice of a two-hour strike for all airports, which was subsequently withdrawn following the cancellation of 17 flights and the rescheduling of 19 other flights. In this case, because the strike was withdrawn following the contingency plan (the cancellation and rescheduling of flights) being enacted, under the proposed policy the airline would be able to stand down the relevant employees without pay for the periods when they otherwise would have been providing services to the cancelled or rescheduled flights.

This would reduce the impact of aborted strikes on employers, while maintaining the incentive for parties to continue negotiating and cancel impending strike actions where it is in the interests of both employees and employers to do so.

Second, both BHP Billiton (sub. 168) and the Business Council of Australia (sub. 173) suggested that where the FWC is satisfied that a union has repeatedly and unreasonably notified and withdrawn strike action, the FWC should have the power to withhold protected action ballot orders for a specified period, for example 90 days. This would provide a deterrent to parties carrying out aborted strikes in a strategic fashion, while still

allowing employees to withdraw strike action in good faith or upon reaching agreement with the employer.

DRAFT RECOMMENDATION 19.3

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that where a group of employees have withdrawn notice of industrial action, employers that have implemented a reasonable contingency plan in response to the notice of industrial action may stand down the relevant employees, without pay, for the duration of the employer's contingency response.

DRAFT RECOMMENDATION 19.4

The Australian Government should amend the *Fair Work Act 2009* (Cth) to grant the Fair Work Commission the discretion to withhold a protected action ballot order for up to 90 days, where it is satisfied that the group of employees has previously used repeated withdrawals of protected action, without the agreement of the employer, as an industrial tactic.

Strike pay arrangements

As mentioned in section 19.2, the existing strike pay arrangements mean that employees can use brief work stoppages or partial work bans to impose substantial administrative costs on their employer, at a very small cost to themselves. Roughly one third of protected action ballots analysed by the Productivity Commission gave approval to strike actions lasting between zero and 30 minutes (figure 19.6), though the share of disputes in which these brief stoppages were actually undertaken may be much lower.

To address this issue, some employers recommended reintroducing a minimum four hour pay deduction for any protected industrial action taken by employees (Qube Ports; Australian Higher Education Industrial Association). This was previously the case under the WR framework from 2006 to 2008. However, this would be likely to discourage graduated, less disruptive forms of industrial action, as employees would have no incentive to undertake industrial action lasting less than four hours. Accordingly, this report does not recommend the re-instatement of such a provision.

However, a more tenable option without these drawbacks would be to permit an employer to withhold strike pay for either the period of a short-duration strike or the standard period of time over which payrolls are calculated. For example, were an employer to record work time in 6 minute increments and employees were to strike for 4 minutes, the employer would be permitted to deduct 6 minutes of pay. This may help reduce the administrative costs of addressing strike pay, though it would not eliminate the costs of identifying the

relevant employees and making adjustments. This model would also require employers to inform employee representatives of the increments used for payroll purposes upon request.

A complementary approach would be to make it lawful for employers to choose to pay employees for industrial action if it only lasts a short-duration, if the employer believes that the administrative costs of making a deduction would be prohibitive. However, such a change would require the FWC to be satisfied that employers were doing so willingly, and may carry the risk of employees coercing their employer to pay for a short duration strike with threats of further strike action.

The Qantas Group has also argued for changes to the pay arrangements for partial work bans, arguing that the current requirements are:

> … particularly onerous for employers where employees engage in a work ban that does not prevent the employees from performing their normal duties (or, if so, only to a limited extent) but where it is extremely difficult (or cost prohibitive) to calculate and administer the deduction. (sub. 116, p. 11)

As a solution, the Qantas Group suggested that employers should have the discretion to deduct a minimum of 25 per cent of normal wages for any partial work ban that impacts on the performance of normal duties, but that any deduction above 25 per cent must be proportionate to the impact of the partial work ban, assessed on an objective basis (sub. 116). While this approach may help an employer avoid the administrative difficulties from calculating pay deductions, it may lead to similar (albeit smaller) undesirable effects as the minimum four hour pay deduction that existed previously in the WR framework. The Productivity Commission sees the desirability of this proposal as a 'razor's edge' judgment, and seeks views from stakeholders about the risks of such a formulistic model.

DRAFT RECOMMENDATION 19.5

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that where employees engage in brief work stoppages that last less than the shortest time increment used by their employer for payroll purposes, the employer should be permitted to choose to either:

- deduct the full duration of the increment from employee wages. The maximum permissible deduction under this provision would be 15 minutes per person, or
- pay employees for the brief period of industrial action, if the employer is willingly doing so to avoid the administrative costs of complying with prohibitions on strike pay.

INFORMATION REQUEST

While the Productivity Commission sees a prima facie case for allowing employers to deduct a minimum of 25 per cent of normal wages for the duration of any partial work ban that impacts on the performance of normal duties, the Commission requests feedback from stakeholders about the risks that such a change may entail.

Employer responses

Allowing more graduated employer response actions

At present, protected industrial action by employers is limited to a lockout in response to protected industrial action by employees. This means employers must take an 'all or nothing' approach if they want to use countervailing pressure to reach a negotiated agreement. In some cases, employers may be forced to choose a dramatic and disproportionate response, even where the industrial action being undertaken by employees may appear to be relatively minor (Qube Ports, sub. 123).

One recent example in the manufacturing sector involved an employer locking out its employees in response to a ban on paperwork. The employer stated that the paperwork ban would have affected quality control processes, leaving it with no choice but to institute the lockout (ABC 2015). This led to the employees staging a 'sit-in' in the factory's lunchroom for more than four days, until the parties agreed to return to the negotiating table (Toscano 2015).

In addition, the loss of profit and possible reputational damage associated with a lockout may make it a prohibitively expensive action for some employers to take. This means that some employers may be forced to bear the cost of ongoing industrial action by employees with no viable avenue to end the dispute, other than conceding to their employees bargaining claims.

One option to address these drawbacks would be to allow employers more graduated options in response to employee industrial action. Some employers would be likely to increase their use of response actions if more graduated, lower cost forms of action were available. This may be beneficial in some circumstances — for example, where such actions displace an otherwise more disproportional lockout, or bring an otherwise intractable bargaining dispute to a close. However, it may also lead to escalation of some disputes, not only from an increase in employer response actions, but also from employees undertaking further industrial action to counter their employer's response.

This proposal, in isolation, would increase the bargaining power of employers (though this increase, and the relative balance of power between employer and employees, will vary between workplaces). It may reduce the willingness of employees to take industrial action,

knowing that the employer will be more likely to respond with action of their own. In its submission, the AWU has expressed opposition to expanding the responses available to employers, arguing that it would increase existing imbalances in bargaining power:

> Employers by their very nature have all the cards stacked in their favour. It is for this very reason that unions came to be and legislation was put into place to protect workers from employers, who too often put profit-making before the wellbeing and safety of their workers. … The AWU does not therefore believe that employers need 'a wider set of options in bargaining that mirror those available to employees' … (AWU, sub. 74, pp. 35–36)

Further, it is also worth noting that there is arguably less of a need for employers to have a mechanism for compelling employees to reach a negotiated settlement, as the expiry of an enterprise agreement means that in most circumstances employees are foregoing wage increases as bargaining drags on. Because employers are less likely to be disadvantaged by stalled negotiations than their employees — indeed this is one of the rationales for allowing employees to undertake industrial action — a wider set of graduated response actions is more likely to be used by employers with the primary goal of pressuring employees to end industrial action, rather than necessarily reach a negotiated outcome.

However, it is not clear that employers always possess a strong advantage over employees with respect to industrial action. Some employers have argued in submissions that the existing industrial action provisions place employers at a disadvantage:

> Presently employers are only able to react (by imposing a lockout) after a union commences protected industrial action while employees have the ability to engage in covert industrial action in the form of 'go slows' and the employer is usually powerless to respond (Manufacturing Australia, sub. 126, p. 6).

The AWU's concerns may also be ameliorated by maintaining the current restriction that limits employer industrial action to responses to employee industrial action. This would prevent employers using industrial action pre-emptively to exert pressure on employees early in the dispute. Further, because an employer's response action would open the door for further employee action (for example, complete work stoppages) without notice, many employers may still be hesitant to undertake partial response action lightly.

While the Productivity Commission supports allowing the use of graduated employer response actions in principle, it is yet to conclude how exactly such actions should be defined in practice. Possible options could include allowing employers to:

- institute their own equivalents of partial work bans — for example, directing employees to only perform a particular subset of their normal work functions and adjusting their wages accordingly
- impose a form of 'partial lockout' by reducing the working hours of employees.

It is possible that these options, particularly the latter, are already permitted in theory under the FW Act. At present, a lockout is defined under s. 19(3) as when an employer 'prevents the employees from performing work under their contracts of employment without

terminating those contracts.' However, the exact boundary of this definition is yet to be clarified. As noted by Creighton and Stewart, the current definition of a lockout:

> … would clearly cover the 'classic' situation of an employer locking its gates or doors and refusing to allow some or all of its employees to attend for work. But it is unclear whether it would extend to a situation where, for example, an employer reduces the working hours (and hence the pay) of a particular group. (2010, p. 773)

That this is yet to be clarified may indicate that employers have not attempted to pursue more graduated alternatives to lockouts under the existing laws. This raises the question as to whether more graduated responses would be used if they were made explicitly available under statute. The Productivity Commission seeks further feedback from participants on whether more graduated employer response actions should be explicitly defined as lawful in the FW Act, and if so how such response actions could be defined.

INFORMATION REQUEST

The Productivity Commission seeks further feedback from inquiry participants on what forms of more graduated employer industrial action should be permitted, and how these should be defined in statute.

Extending notice requirements for employer response actions

Some employee groups have suggested that the three day notice requirement that currently applies to employee-initiated industrial action be extended to industrial actions by employers. Employers are currently required to notify employees and their representatives of a response action, but there is no requirement for them to do so three days in advance. However, to some extent employees are already aware that should they provide notice of impending industrial action, there may be an employer action in response.

In its submission, the Australian Services Union argued that just as employers are given time to prepare in advance for the effects of industrial action on their business, employees whose economic interests are affected by an employer response should also be given time to prepare for it (ASU, sub. 128). Providing notice in advance of an employer response action may encourage employees to withdraw industrial action and pursue a more peaceful resolution of their disputes.

On the other hand, requiring employers to comply with a notice period in advance of a response action would undermine their capacity to use these responses in a defensive manner. For example, a notice period could force an employer to allow workers to undertake stoppages for several days (even if these had an extensive impact on operations) before finally locking them out. This could potentially be overcome by giving employers a shorter notice period than employees (for example, a period of two days, giving the employer an extra day to consider a response action). However, this raises the question of

whether a notice period of two days would provide much benefit to employees in preparing for a lockout. Employers may also not have the ability to properly assess the effect of employee industrial action on their operations until the action has already commenced — a notice period would require them to then tolerate these operational impacts for several more days before responding.

Advance notice of an employer response may also allow employees to undertake further actions against their employer once notice is given. For example, employees could engage in escalated industrial action (either lawful or otherwise), or would be more readily able to stage a sit-in. Employees could also repeatedly cease industrial action once their employer has given notice of a future response action, thus preventing employers from using a response action (such as a lockout) as a decisive mechanism to put an end to 'slow-bake' industrial action (though recommendations 19.3 and 19.4 already provide employers with some protection from these forms of industrial action).

Given these drawbacks, and the ongoing restriction that employers may only take industrial action in response to employee industrial action, at this stage the Productivity Commission is sceptical that a 3 day (or similar) notice period for employer industrial action should be introduced. Nonetheless, if inquiry participants can put forward a stronger rationale for such an approach, the Productivity Commission would be interested in analysing these arguments.

Remedies for unlawful industrial action

At present, the maximum monetary penalties for unlawful conduct relating to industrial action are $10 200 (60 penalty units[219]) for an individual, and $51 000 (300 penalty units) for a corporation. These penalties pale in comparison to both the financial benefits that can be potentially gained by some parties from using (or threatening) unlawful industrial action, and the damages that may be suffered by parties that are the victims of industrial action. This imbalance between the potential gains from unlawful conduct and the existing penalties means that they are currently unlikely to provide effective deterrence.

Further, while parties harmed by unlawful industrial action can seek compensation through the courts, some employers have argued that this avenue is impractical:

> Unlawful industrial action is capable of remedy only in common law courts where a tort has to be proved in order to secure damages. In practice, a damages claim is expensive and slow to mount and is invariably 'traded away' as part of a compromise to a deal. (APPEA, sub 209, p. 41)

Similar observations were made by the Productivity Commission during its previous inquiry into public infrastructure:

[219] The monetary value of a penalty unit (currently $170) is set out in s. 4AA of the *Crimes Act* 1914 (Cth).

> While affected parties can seek common law damages against a union (or other party), that process is slow, and fraught when there is a risk of industrial reprisal. (PC 2014b, p. 547)

This means that while civil litigation under common law may help some parties recover the costs of unlawful industrial action if they are willing to spend the time, money and effort to do so, it is unlikely to serve as a strong deterrent across the broader WR landscape.

There is a case for increasing the maximum penalties available under the FW Act for unlawful industrial action. This would allow the FWC and (on appeals) the Federal Court the discretion to charge penalties for contraventions of the FW Act that are more commensurate with the losses resulting from unlawful behaviour. The appropriate penalty in any individual case would be determined by the presiding judicial officer in accordance with the severity of the unlawful behaviour. A similar recommendation was made by the Productivity Commission with respect to penalties for unlawful industrial activity in the construction sector during the Productivity Commission's inquiry into public infrastructure (PC 2014b).

DRAFT RECOMMENDATION 19.6

The Australian Government should increase the maximum ceiling of penalties for unlawful industrial action to a level that allows federal law courts the discretion to impose penalties that can better reflect the high costs that such actions can inflict on employers and the community.

19.4 What are the likely impacts of these reforms?

As noted earlier in this chapter, the primary goal of the recommendations in this chapter is to provide parties with appropriately aligned incentives when undertaking industrial action. Ideally, this will lead to fewer industrial disputes because parties will reach mutually satisfactory agreements in the knowledge that industrial action can be taken. More specific likely impacts include:

- reducing the time and money spent on compliance issues (such as protected action ballots and strike pay) and legal disputes
- reducing the use of some disruptive industrial tactics, such as aborted strikes, which can come at a disproportionate cost to consumers and firms
- increasing the capacity for employers to use graduated response actions to encourage striking employees to return to negotiations
- the FWC being better empowered to enforce compliance with the industrial action provisions.

It is unlikely that these impacts would have a large effect at the macro level, or substantially decrease the *measured* rate of aggregate industrial disputation in Australia. First, because the current measures suggest that on the whole in most sectors there is very little industrial disputation to be reduced. Second, because several of the recommendations in this chapter are targeted at types of industrial action that are not captured by current measures, such as partial work bans and very brief or aborted stoppages. Nevertheless, at the micro level, these recommendations (if adopted) would be likely to produce benefits to those employers and employees that find themselves in bargaining situations where industrial action is considered as an option by one or more parties.

The aggregate impacts on productivity are likely to be relatively small

Several of the recommendations in this chapter may lead to some decreases in the number of days lost to industrial action. In theory, a reduction in days lost to industrial action would generally improve productivity to some extent, by reducing the amount of idle capital and time spent engaged in unproductive strike activity.

However, in practice these reductions in days lost (and any associated productivity increases) are likely to be relatively small — the currently low rate of disputation in most sectors leaves little room for improvement. Even in sectors where industrial disputation is most prevalent, such as construction and coal mining, the economic implications of time lost to industrial action are relatively insignificant. This was previously noted by the Productivity Commission in relation to the construction industry during its inquiry into Public Infrastructure:

> To place some perspective on the apparent economic implications of industrial disputes, in 2012-13, they reduced time worked by employees in the construction industry by around 0.032 per cent or about 40 minutes per employee per year. This is a fraction of unscheduled absenteeism due to sickness each year. Taking account of idle capital on affected building sites, the estimated effect on economic output is around $30 million in value-added terms in 2012-13 in current prices, or around 0.025 per cent of gross value added in the construction industry. As the effects extend throughout the economy, the economywide GDP loss would be somewhat larger, and is estimated to be around $40 million in that year … Many of the apparent losses are internalised by the workers themselves, as workers are not paid wages during industrial disputes … (PC 2014b, pp. 535–536)

Some participants have attempted to quantify the productivity benefits of reforms to the industrial action provisions. For example, AMMA argued that reductions in the ability to take industrial action would contribute to a 2-5 per cent increase in labour productivity in the resources sector. This was attributed to both a reduction in days lost to industrial action, and a 'reduction in the ability of industrial action to contribute to excessive wages and conditions' (AMMA, sub. 96 attach., p. 13). However, the Productivity Commission has reservations about these estimates. As with other sectors, the direct measured value of days lost to industrial action in the resources sector is likely to be small. Even in the coal mining industry, which has had the highest measured rate of disputation over the past five

years, industrial disputes only reduced time worked by roughly one quarter of one working day per employee per year (figure 19.1).

Further, the notion that avoiding 'excessive wages and conditions' (by restricting employee industrial action) would lead to labour productivity gains is deeply flawed. While lower wages can reduce labour costs (and thus increase profits and investment), as noted earlier in this chapter, costs and productivity are quite different things. Indeed, high wages can actually lift both labour and multi-factor productivity, by encouraging capital-labour substitution or innovation in labour saving measures.

Industrial disputes may potentially harm productivity where employees view their relationship with management as adversarial, and thus have little reason to identify ways to improve their work or avoid shirking. However, cooperative workplace environments are unlikely to be manufactured by a legislative band-aid on the taking of protected industrial action. If the underlying causes of a dispute remain, restrictions on protected industrial action are likely to merely encourage more covert forms of action, such as shirking, which may have a more enduring adverse impact on productivity than temporary stoppages or work bans. This highlights a recurring theme in this report — that positive WR outcomes are ultimately the responsibility of firms and their employees, and cannot be obtained merely through attempts to regulate behaviour via legislation.

19.5 Right of entry

Part 3-4 of the FW Act gives union officials conditional rights to enter workplaces during working hours. On occasion, right of entry, like industrial action, can be used by unions to disrupt the efficient operation of a workplaces, thereby harming productivity. However, unlike industrial action, union entry to a workplace is not restricted to periods of enterprise bargaining. Right of entry can be exercised by an authorised union official at any point in the bargaining cycle, subject to many conditions.

Right of entry is generally not exercised for disruptive purposes. Indeed often it is exercised in good faith where union officials want to investigate a genuine suspected breach of workplace laws or to speak with members or potential members at the workplace. The rules around right of entry aim to balance the rights of employees to meet with representatives and the rights of employers to conduct their business operations without disruption.

Current arrangements

Union officials can enter a workplace (even if the employer does not want them to) if they have a valid right of entry permit issued by the FWC and they are entitled to represent workers at the workplace. Permits, valid for three years, can only be issued to an official

who the FWC is satisfied is a 'fit and proper person'. The FWC can revoke or suspend a permit on a range of grounds.

Permit holders can exercise their entry rights to:

- investigate alleged contraventions of the FW Act or a fair work instrument (for example, a modern award or enterprise agreement) (s. 481)
- hold discussions with employees (s. 484)
- perform inspections under state and territory workplace health and safety laws (s. 494).

When entering a workplace, a permit holder must give written notice of at least 24 hours but no more than 14 days before the intended visit, unless the FWC agree otherwise. Where there is a suspected breach of the FW Act or a fair work instrument, a permit holder can:

- inspect any work, process or object that relates to the breach
- interview any person related to the suspected breach, if the person is
  - entitled to be represented by the union and
  - willing to be interviewed
- meet with employees if the employees are
  - entitled to be represented by the union and
  - willing to meet the union
- access records relating to the breach.

Problem areas

On occasion, rights of entry are abused. Both employee representatives and employers have submitted during this inquiry that the arrangements are sometimes abused by the other party.

By exercising the right too frequently, unions can impose significant burdens and costs on employers due to:

- the need to prepare and document the visit
- the need to escort the permit holder around the worksite
- disruptions to the normal performance of work.

The Minerals Council of Australia provided the following example of, in its view, "the skewed nature of the current regime":

> Between 2011 and 2013, union representatives made more than 550 'right of entry' visits to BHP Billiton's Worsley Alumina refinery work site to hold discussions with employees, resulting in work stopping and seriously reduced productivity. (sub. 129, p. 34)

Another employer group has estimated that the direct administrative costs of a right of entry visit — taking on average two hours to process and oversee — are $86.45 an hour for tasks performed by the HR manager (AMMA, sub. 96). They further estimated that the total costs of a union entry visit are $200 an hour, with an average duration of four hours per visit. The employer has had 49 entries in the first two months of the year, costing an estimated $39 200.

The ACTU submits that excessive visits are sometimes the result of restrictive entry policies by the employer, rather than a union tactic to maximise disruption. According to the ACTU (sub. 167), this was the case in the Foster Wheeler Worley Parsons (Pluto) Joint Venture[220] — which some employer groups (AMMA, sub. 96; Business SA, sub. 174) put forward as an example of excessive union entries:

> In *Pluto* FWA dealt with an entry dispute on a major construction site in a remote site in the North Western region of Western Australia. The site, valued at $11b, consisted of over 3300 workers, an engineering, procurement and construction management contractor (FWW), twelve to fourteen major contractors and from 50 to 70 lower tier subcontractors.
>
> Amongst other things the head contractor, FWW, insisted in its 'entry protocol' that unions meet only with the employees of one contractor at a time. In practice, this meant that even where the official visited this remote site every day of the week, the union could meet only 10 contractors' employees in that week. (ACTU, sub. 167, p. 343)

Employers and employer representatives participating in this inquiry have also submitted that the rules around the location of discussions are problematic. The Minerals Council of Australia provided the example of a request from the CFMEU to hold discussions in the cabin of a dragline excavator, "notwithstanding the threat such a request would pose to safe operations" (Minerals Council of Australia, sub. 129, p. 34).

Right of entry may also be abused by either side during a bargaining dispute to gain leverage (PC 2014b, p. 516).

Reform options

Frequency of entry

The FW Act already contains provisions aimed at preventing excessive entry by employee representatives. Section 505A empowers the FWC to deal with disputes about the frequency of entry to hold discussions. The FWC can deal with the dispute by any order it considers appropriate, including by suspending, revoking or imposing conditions on an officials entry permit.

220 *CFMEU v. Foster Wheeler Worley Parsons (Pluto) Joint Venture* [2010] FWA 2341.

However, the FW Act limits the circumstances in which the FWC can make orders. It can only make orders where it is satisfied that the frequency of entry by a permit holder requires an unreasonable diversion of the employer's[221] 'critical resources' (s. 505A(4)).

In practice, this has proved a high bar. Employers are required to demonstrate that each visit is a *critical* issue requiring an unreasonable diversion of their resources. This test overlooks the possibility that excessive entries may impose large, unwarranted costs on an employer without necessarily diverting 'critical resources'. Indeed, when considering excessive *frequency* of entries, it would seem more likely that it is the ongoing accrual of the incremental costs of each entry that would be most damaging to employers.

A more fundamental concern, from a policy perspective, is that s. 505A currently places a burden on the employer to prove that the costs of entry would be unreasonable and critical, with no consideration of the relative size of the benefits of entry to employees. Ideally, the entry provisions should seek to balance these costs and benefits. At present, s. 505A effectively assumes that the value of the benefits to employees of entries by representatives is equal to just less than the cost of an 'unreasonable diversion of the employer's critical resources'. Where being used for tactical purposes, this is unlikely to be the case. In these circumstances, the costs of entry to a workplace should not have to be critical, before the merits of additional entry should be questioned.

In its submission, Linfox has recommended changes to s. 505A:

> [Section 505A] is an unrealistic and irrelevant test. It ought not be about the application of the employer's resources, but the effect of the excessive entry that is the relevant consideration and there ought be some onus on the permit holder to justify why excessive entry is warranted. …
>
> Section 505A should be amended so that the level of disruption required to be established by an occupier before the FWC makes orders regarding the frequency of entry to hold discussion is significantly lowered. The current requirement that the occupier must be subjected to an 'unreasonable diversion of its critical resources' before the FWC can intervene imposes an excessive imposition on an occupier's productivity. (sub. 137, pp. 4–5)

The Fair Work Amendment Bill 2014, if passed, would repeal s. 505A(4), removing the requirement of an unnecessary diversion of critical resources. The Bill also includes amendments s. 505A(6) — which requires the FWC to take into account fairness between the parties concerned — to include consideration of the combined impact on the employer's operations of entries onto the premises by permit holders of organisations.

In the Productivity Commission's view, these proposed amendments are broadly sound. An even-handed threshold of what constitutes excessive use of entry rights should take into account the benefits of entry rights for employees and the cumulative costs imposed by strategic use of entry rights by employee representatives. However, any change to s. 505A

[221] For clarity, the Productivity Commission has decided to use 'employer's' in this context, though we note and support the use instead of 'occupiers's' in 505A(4) to cover a wider range of businesses who may be negatively impacted by frequent visits (for example, a lead contractor who is not technically the relevant employer).

should also take into account the reasons why repeated or costly entries are being made — for example, whether the employer is deliberately inflating the costs or frequency of entries by employee representatives (as claimed for the Pluto project discussed earlier).

DRAFT RECOMMENDATION 19.7

The Australian Government should amend s. 505A of the *Fair Work Act 2009* (Cth) for determining when the Fair Work Commission may make an order to deal with a dispute about frequency of entry by an employee representative to:

- repeal the requirement under s. 505A(4) that the frequency of entry would require an unreasonable diversion of the occupier's critical resources
- require the Fair Work Commission to take into account:
  - the combined impact on an employer's operations of entries onto the premises
  - the likely benefit to employees of further entries onto the premises
  - the employee representative's reason(s) for the frequency of entries.

Recruitment of members

Union officials are currently able to exercise their right of entry for holding discussions at any workplace where employees are eligible to be members of the union in question. This criteria for entry was established in 2009 with the introduction of the FW Act. Previously, under the WR framework from 1996 to 2008, union officials could only seek entry for discussions in workplaces where the union was bound by an award or enterprise agreement. Some have argued that the existing provisions have allowed unions to use vastly expanded entry rights primarily to undertake recruitment drives in workplaces where they currently have no members (Housing Industry Association, sub. 169; AMMA, sub. 96; Minerals Council of Australia, sub. 129; BHP Billiton, sub. 168; CCIWA, sub. 134).

The primary benefit from allowing entry by unions that do not have any members on site and are not party to an agreement in a workplace is that it may facilitate greater choice by employees about the party they wish to represent them. Of course, site entry is not the only way that a union could potentially gain access to potential members. For example, other methods could include by:

- telephone or email contact
- mail to employees' homes
- meetings at locations outside the firm.

However, unless potential members choose to proactively approach the union themselves, initial communication with these individuals could be difficult. The workplace provides a captive audience of potential members. Moreover, the first two of these alternative

recruitment avenues do not allow for the 'to and fro' discussion that is usually required for people to be properly informed. The third avenue is feasible, but forcing unions to operate outside the premises appears unreasonable if there is scope for non-disruptive meetings in the workplace.

The issue then is whether the conduct of employee representatives in the workplace is proportionate to their legitimate purpose and non-disruptive. Frequent visits might start to resemble spam mail. Equally, visits that are intended mainly to make employees aware of a union's attractiveness to them can be abused if they become the vehicle for disruptive turf battles by competing unions — referred to as demarcation disputes. These disputes have the potential to damage workplace harmony, especially where their effects spill over to employees who may feel uncomfortable or intimidated by the presence of union officials, and employers, who are required to facilitate and accommodate the union's visits. In its submission, Linfox has described a period where the National Union of Workers (NUW) made numerous entries to Linfox's Truganina site in an attempt to recruit members:

> In the period from August 2013 to October 2013, Linfox was provided with multiple entry notices under the FW Act from officials of the National Union of Workers (NUW) to enter the Truganina site under s.484 of the FW Act. … While the stated purpose for effecting entry was to hold discussions with employees eligible to join the NUW who wished to participate in those discussions, the real purpose of the officials was to recruit employees to join the NUW and to agitate for a separate enterprise agreement to cover just the Truganina site separate to the national agreement between Linfox and the TWU.
>
> NUW permit holders exercised rights under s.484 on an excessive number of occasions. They consistently insisted on entry to the lunchroom at the site, relying on the 'default arrangements' sanctioned by s.492 of the FW Act. Having gained access to the lunch room the NUW officials engaged in insistent and unwanted approaches to employees to try to get them to join the NUW (in preference to the TWU which had traditionally represented them at the site). They also approached employees in the car park at night as they left the site at the end of their shift. Many employees felt intimidated and harassed by this conduct and Linfox management received numerous complaints – both written and verbal - directly from employees and through the TWU. (sub. 137, pp. 2–3)

Finally, some employer groups have expressed concern that the current entry rules determine the rights of an official to enter a worksite based on the eligibility rules of the union itself. They have argued it can be difficult for employers to determine whether a union is entitled to enter a workplace, arguing that union eligibility rules can be complex and arcane (AMMA, sub. 96).

The complexities and potential for abuse of the current entry provisions can be addressed without entirely relinquishing the entry rights of unions that do not have members onsite and are not bound by an agreement at the workplace. A proportionate approach would be to allow entry by such unions on an infrequent basis (say no more than twice every 90 days). That would provide the relevant unions with scope to communicate what they can offer to employees and to leave contact details and promotional material with them, while avoiding the game playing and confrontations that appear at times to result from the

current arrangements. Having made initial contact, the unions concerned could use all the other available mediums to communicate with those employees who were interested in further contact (mail, telephone, email and so on).

If any of these employees join the union, permit holders would then be entitled to the normal entry arrangements for discussions with members, subject to the limitations on excessively frequent entries discussed above in recommendation 19.7.

DRAFT RECOMMENDATION 19.8

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that unions that do not have members employed at the workplace and are not covered by (or are not currently negotiating) an agreement at the workplace, would only have a right of entry for discussion purposes on up to two occasions every 90 days.

Location of discussions with employees

Employers are required to provide an onsite venue for union representatives to meet with employees. Since amendments to s. 492 of the FW Act in 2013, discussions are now required to be held in meal break rooms if the employer and employee representatives cannot reach agreement on a different location.

Prior to these amendments, employee representatives were required to conduct discussions in a specified room or area of the premises in accordance with a 'reasonable' request by the employer. Such a request would be considered unreasonable, among other things, if the location was not fit for the purpose of holding discussions, or if the request was made with the intention of intimidating, discouraging or otherwise making it difficult for a person to attend a discussion (for example by requesting a location that is not easily accessible during mealtimes or other breaks).

Some employers have argued that the recent changes have led to disagreements with unions as to what constitutes a meal break room. AMMA argued that 'a substantial amount of case law has been devoted to interpreting the meaning of the lunch rooms access provisions since they were introduced' (sub. 96, p. 223). In some cases, this has allegedly led to union officials insisting on holding discussions in disruptive and costly locations — for example, inside the cabin of a dragline excavator (BHP Billiton, sub. 168; Minerals Council of Australia, sub. 129).

At this stage, the Productivity Commission is not yet convinced that the current rules are more ambiguous or open to disputation than the previous rules. The previous rules allowed for disputes over whether a requested location was unreasonable, not fit for purpose or intended to intimidate. As the ACTU noted in its submission, establishing whether it was the *intention* of an employer to discourage or intimidate employees from attending is almost an impossible task (sub. 167). By contrast, judging whether or not a location

constitutes a meal or break room would seem to be a straightforward proposition — though parties may still attempt to push the boundaries, as in the dragline example above.

The primary drawback of enshrining a default location (that is, meal break rooms) in statute, as the current arrangements do, is that it will usually require sacrificing some degree of flexibility should a dispute about location arise. Indeed, a recurring theme in this report has been that the FW Act should focus on the substance of a matter, rather than adherence to prescriptive requirements. Given that the FW Act stipulates that discussions may only be held during employee breaks, a meal or break room would seem to be the logical location in most conceivable circumstances. If employers can put forth tangible evidence of the use of break rooms leading to operational difficulties, the Productivity Commission would be interested in examining this evidence.

Aside from operational concerns, the effect of these provisions on the employees themselves should be considered. On the one hand, it has been suggested by some inquiry participants that making meal break rooms the default location has led to some workers feeling inconvenienced or intimidated by the presence of union officials in meal rooms during their breaks (Mitolo Group, sub. 213; BHP, sub. 122; Rio Tinto, sub. 122; AMMA, sub. 96). On the other hand, some unions have suggested that the discretion offered to employers under the previous arrangements led to designated meeting locations that were inconvenient, uncomfortable or intimidating (SDA, sub. 175; TCFUA, sub. 214).

At this stage, the evidence from both sides on this issue appears to be largely anecdotal, and the examples put forward in submissions suggest that there can be inappropriate conduct by employers and employee representatives alike. The current arrangements appear to minimise the scope for strategic or disruptive conduct by either side, by providing a default, non-operational location in the event that parties cannot agree. Further, if there is substantial evidence that union officials are intimidating or harassing employees in lunchrooms, this issue may be more appropriately addressed through enforcing better standards on the conduct of union officials whilst on site. The Productivity Commission is not yet convinced that there is a need for change in this area, but is willing to analyse any further evidence or concerns raised by participants following the draft report.

20 Alternative forms of employment

Key points

- Independent contracting, labour hire and casual workers comprise just under 40 per cent of the workforce. This figure has decreased slightly over the last five years.
- The prevalence of these alternative forms of employment can be attributed in part to ways in which they differ from standard, ongoing employment. It is these differences that make them attractive to some workers and employers.
- Workers who are employed under these alternative employment forms generally receive different pay and entitlements to ongoing workers. This generally reflects the degree to which each employment form is regulated by the *Fair Work Act 2009* (Cth) (FW Act).
- Sham contracting is the practice of misclassifying employees as independent contractors. It can occur with the workers consent, or through misrepresentation or coercion.
  - Sham contracting is most prevalent in the construction, cleaning services, hair and beauty and call centre industries.
- The existing common law definition of a subcontractor may not always be easy to apply, but alternatives such as a legislative definition or test have their own problems.
- The requirement that an employer must have been 'reckless' for them to be prosecuted for misrepresenting the nature of an employment contract appears to be a high hurdle for legal action. Changing from a test of 'recklessness' to a test of 'reasonableness' would help discourage sham contracting, including through the regulators' out-of-court actions.
- Under the FW Act, terms in an enterprise agreement that prohibit an employer from engaging with independent contractors, labour hire and casual workers have no legal authority. However, it is lawful to include provisions that permit unions to influence the terms of any engagement.
  - These terms can take the form of jump up clauses — which ensure that all workers receive the same terms and conditions — and requirements to interact with the union ahead of any potential engagement.
  - These terms are not purely redistributive, but can also have adverse effects on productivity by restricting flexible work practices.
  - Terms that either restrict the engagement of independent contractors, labour hire and casual workers or regulate the terms of their engagement should constitute unlawful terms under the FW Act.
- There are currently few grounds for changing the way in which unpaid internships and work experience arrangements are regulated.

While the majority of workers are engaged on an ongoing basis, there are some common alternatives. These alternatives have characteristics that appeal to some workers and/or employers, offering them an improvement over the standard employment relationship.

The more substantial of these employment forms include:

- independent contractors, who supply their services on a job-by-job basis
- workers contracted to labour hire firms, who are then hired out to a 'host'
- casual workers
- owner-managers of incorporated and unincorporated businesses, who are not independent contractors.

There are a number of other forms of work that comprise small but significant proportions of the workforce. These include fixed term employees, piece or outworkers, interns, apprentices and trainees.

Each of these employment forms have become established aspects of the Australian workplace relations (WR) landscape and, collectively, have grown as a share of the workforce over the last few decades (Louie et al. 2006). But the move away from more traditional employment relationships has led to concerns about their regulation (box 16.1).

Some of these concerns have been explored in recent reviews and inquiries. The nature of independent contracting and labour hire was examined ahead of the introduction of the *Independent Contractors Act 2006* (Cth) (IC Act) (Australian Government 2005). The prevalence and implications of sham contracting in several industries was examined by the Fair Work Ombudsman (FWO) (FWO 2011), the Australian Building and Construction Commission (ABCC 2011) and the Productivity Commission (PC 2014b), while a broader review of the overarching framework was undertaken by the post implementation review of the *Fair Work Act 2009* (Cth) (FW Act) (McCallum, Moore and Edwards 2012). The Victorian and South Australian Governments have also recently announced inquiries into labour hire. Outside government, the Australian Council of Trade Unions (ACTU) conducted an inquiry into 'insecure work'[222] – a term that largely captures independent contractors, labour hire and casual workers (ACTU 2012b).

This chapter details some characteristics of these alternative forms of employment (section 20.1), before examining concerns about the definition of an employee (section 20.2) and whether clauses that affect a business' use of independent contractors or labour hire should be permitted in the FW Act (section 20.3). Issues associated with other forms of work are discussed in section 20.4.

This chapter does not discuss owner-managers in any detail. By definition, their employment conditions are outside the WR system. It also does not examine issues concerning the expansion of entitlements to casual workers (chapter 4) or whether or not labour hire workers should be able to negotiate a joint enterprise agreement (EA) with a

222 It is questionable whether the term 'insecure' aptly applies to contractors, since by the nature of their chosen employment form, they shift from job to job. Security would then depend on any unwanted waiting period between jobs, not attachment to an employer.

labour hire agency and their host employer (chapter 15). The issues associated with migrant workers are discussed in chapter 21.

Box 20.1 Comments on the regulation of alternative forms of employment

Submitters to this inquiry have expressed a wide-variety of concerns about the regulation of alternative forms of employment in the FW Act.

Submitters such as the Australian Chamber of Commerce and Industry, the Australian Industry Group and the Housing Industry Association among others stated their unease with the regulation of alternative forms of employment via enterprise agreement. They argued that 'in the interests of a competitive environment, businesses should generally be free to supply goods and services, including contract labour, if they choose' (Australian Chamber of Commerce and Industry sub. 161, p. 160).

A number of employee groups such as the Queensland Council of Unions, National Union of Workers and the Australian Council of Trade Unions (ACTU) argued that there is a lack of protection for non-permanent workers that results from the inadequate regulation of labour hire workers. To this end, the Australian Council of Trade Unions argued that:

> … [l]abour hire exists purely as an avoidance strategy and its continued operation in the present regulatory settings is untenable unless one accepts that the workers who are engaged by the labour hire agencies are second class citizens. A first order issue is ensuring that labour hire workers engaged in a workplace — however temporarily — have the same level of industrial citizenship as the employees they work with. (sub. 167, p. 3)

The National Union of Workers suggested that the FW Act could better protect these workers by offering them the same wages and conditions as the employees of the host organisation through a joint agreement or a dual employment guarantee (sub. 125, p. 6). Joint agreements are discussed in more depth in chapter 15.

Others suggested that there are issues with the way in which the FW Act regulates the employment of casual workers. In particular, they suggested casual workers should have greater access to the National Employment Standards and stronger rights to convert from casual to permanent positions (the Work and Family Policy Roundtable and the Women + Work Research Group sub. 130, pp. 10–11; ACTU sub. 167, p. 102). Casual workers are discussed in more detail in chapter 4.

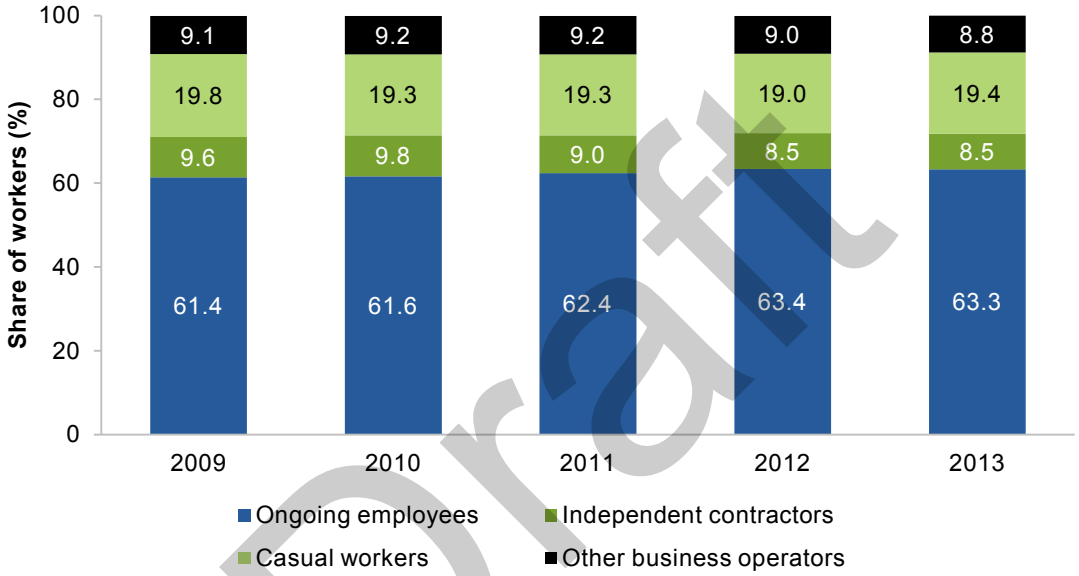
20.1 Some characteristics of alternative forms of employment

Prevalence of alternative employment forms

While the use of alternative forms of employment in Australia increased significantly in the two decades prior to 2000, it has been relatively stable since (figure 20.1) (Shomos, Turner and Will 2013). According to Burgess and de Ruyter (2000), the amount of casual or non-employee workers increased from 28 per cent of the workforce in 1982 to 40 per

cent in 1999. Between 2009 and 2013, however, the proportion of the workforce engaged under alternative employment forms fell marginally from 38.4 to 37.7 per cent (ABS 2014c). Since this covers the period immediately before and after the introduction of the FW Act it suggests that the current WR settings may not have had a dramatic effect on the way in which workers are engaged. If anything there has been a slight movement back towards ongoing employment.[223]

Figure 20.1 **Stability in the forms of employment**
2009–2013, per cent of total workers



Source: ABS 2014, *Forms of Employment, Australia, November 2013*, Cat. No. 6359, released 7 May 2014.

Over this period, ongoing employees accounted for over 60 per cent of the workforce while casual employees comprised around 20 per cent and independent contractors and business operators each accounted for around 10 per cent. A recent estimate suggests that labour hire employees make up around 1 per cent of the workforce (Shomos, Turner and Will 2013). However, this category of worker is not uniquely identified by Australian Bureau of Statistics (ABS) survey methods. Depending on the nature of their relationship with their labour hire agency, they may be classified as ongoing employees, independent contractors or casual workers.

223 It should be noted that these estimates are for national and state system employees combined.

The benefits of alternative employment forms

The prevalence of alternative forms of employment depends on the degree to which they meet the needs of employers, match the preferences and circumstances of workers and are affected by institutional factors. Whether or not an employer seeks to use a certain form of work depends on their assessment of how productive *and* how costly the workers might be. For workers, the attractiveness of various forms of work depends largely on the associated financial and non-pecuniary benefits. While there are also a number of institutional factors such as the tax and transfer system and organisation-specific factors which affect the prevalence of each form of work (Shomos, Turner and Will 2013), the major focus of this chapter is labour market regulation and the national WR system.

Workers value different employment forms

Independent contracting differs from ongoing work in that it offers greater autonomy. Because they contract out their services on a job-by-job basis (most are single person owner-operated businesses), independent contractors can usually choose what jobs to take, the hours they work, and the way in which they complete the job. They can also work for a number of clients simultaneously. Independent contracting arrangements developed unaided as an alternative to the standard employment form and, by 2006, they had become such an intrinsic aspect of the WR system that the *Independent Contractors Act 2006* (Cth) was introduced. The purpose of this act was to:

> … recognise and protect the unique position of independent contractors in the Australian workplace. This Bill will enshrine the freedom of independent contractors to enter into arrangements that are primarily commercial relationships, free from prescriptive workplace relations regulation (Australian Government 2006).

In contrast to the standard form of employment which is generally described as being ongoing, casual work is generally characterised as being informal, uncertain and irregular (Stewart 2013). Rather than work a regular schedule, casual workers can be rostered on or off at the discretion of the employer. Typically, casual work appeals to workers who value flexible hours, with the option of declining work (Shomos, Turner and Will 2013) as well as workers who are either just entering or close to leaving the workforce. Adding to this appeal is the higher hourly rate, or casual loading (discussed subsequently).

While some casual work is genuinely uncertain — such as bar staff or shop assistants who are called in whenever needed, or students who work at special events – there are many examples of regular casual work. Indeed, nearly 59 per cent of casuals work the same hours every week, while 40 per cent of casual workers had been with the same employer for more than two years, indicating that there are a large number of casual workers who have the benefit of regular work *as well as* the higher wage rates associated with the loading. Moreover, casuals also have legal conversion rights that allow them to request a

move from casual to ongoing work after a certain period of employment.[224] However, few such requests are made (Stewart 2013).

Labour hire requires a three-way arrangement between the worker, their employer — the labour hire agency — and the business that ultimately uses their services (the host). The worker, capitalising on the agency's ability to procure work, is supplied by an agency to the host. They then work at the direction of the host for an agreed period. Instead of paying the worker directly, the host pays the agency the costs of the worker's services, plus a profit margin. The agency then pays the worker. As a result, labour hire workers are generally either ongoing or casual employees of the agency, although in some instances they have been engaged as independent contractors.

Fixed term work features an agreement by the employer and employee about when the work relationship will end. It is generally preferred by employees who enjoy changing jobs periodically, enjoy having a finite horizon for their work relationship, but do not want to be self-employed.

Given that not everybody wants to work under the same conditions, these alternative employment forms partly satisfy the wide variety of preferences across the workforce. Whether it be the autonomy of independent contracting, the flexibility and the higher wage rate of the casual worker or the reduction in job search costs for the labour hire worker, each of these employment forms has some appeal to a large number of workers.

Employers benefit too, with implications for the wider community

Employers value these alternative forms of employment because they can improve productivity or lower costs in some circumstances. They can provide intermittently required skills and can act as more flexible sources of labour than ongoing employees:

- For a task that requires substantial training or experience (and is not expected to occur frequently or on a continuous basis), it will often be less costly for an employer to engage an independent contractor or labour hire worker with specialist skills on a short term agreement.
- Where the employer's need for labour is sporadic, short term or uncertain in the future and the skill and training requirements are low, they will often prefer casual workers (Shomos, Turner and Will 2013).
- For project-specific work or work with a definable end date — where a particular task assembles a group of workers for a particular project — employers may prefer to use contractors, labour hire and fixed-term employees. This partly explains the relatively high prevalence of subcontractors in the construction industry.

[224] Some stakeholders suggested that the capacity to change from casual to permanent status was problematic because it constrained the ability of the employer to manage flexible resourcing. Moreover, the casual loading meant some casuals were not interested in moving to permanent employment.

- Such workers provide a more flexible source of labour where work has a cyclical or seasonal element (such as in fruit picking, a peak tourist season, or for infrequently scheduled maintenance of equipment) or where a firm's internal labour market is inefficient due to work practices outside the control of management.
- Labour hire and subcontractors have low 'firing' costs, as they are only temporary workers.
- Where union bargaining power is high, subcontractors may provide a lower cost form of labour. However, in cases where this applies, unions will sometimes attempt to maintain their bargaining strength through restrictive terms in enterprise agreements (EA) (section 20.3)

Labour hire and subcontracting are less well suited to activities where there is a need for complex coordination of employees, there are difficulties in monitoring the performance of people acting independently, firm-specific training is required, working in teams accentuates learning and skill diffusion, or where a constantly available workforce is required.

Where using alternative labour forms does lower costs then, in any workably competitive market, the wider community will typically capture most of the benefits through lower prices.

Different forms of employment have different protections

The FW Act only regulates the terms and conditions of 'employees' in the national WR system. It sets out different entitlements and protections for ongoing employees and casual employees. Independent contractors are outside the scope of the FW Act (table 20.1).

As employees, all ongoing and casual workers in the national system are covered by the Fair Work legislation. Nonetheless, there are key differences in the *way* they are covered. Minimum wage orders and awards generally specify loadings for casual workers, taking their hourly wage rate above that of ongoing employees (box 20.2). This compensates casual workers for not only the uncertainty of their work, but also for the fact that they cannot access as many of the entitlements in the National Employment Standards (NES) as ongoing employees, such as paid leave (chapter 4).

As they are not employees, the pay and conditions of independent contractors are determined outside the FW Act. Rather than have their wage rates specified by an industrial instrument, they negotiate a payment for their services on a job-by-job basis. Because of this, as well as their inability to access any of the minimum entitlements set out in the NES, there is only a limited safety net for independent contractors. However, the FW Act does protect independent contractors from adverse action, coercion and abuses of freedom of association. Furthermore, under the national unfair contracts scheme in the *Independent Contractors Act 2006* (Cth), independent contractors can request a court to set aside a contract if it is harsh or unfair.

The regulation of a labour hire worker's conditions depends largely on whether they are employees (with full rights under the FW Act) or independent contractors (with the limited rights outlined above). While, strictly speaking, the contract is between the worker and the labour hire agency, there have been instances of host organisations being held accountable for the wages and conditions of workers[225].

Table 20.1 **Entitlements by form of employment**

Protections	*High Earners*[a]	*Ongoing employees*	*Independent Contractors*	*Casual Workers*	*Self employed / owner – managers*
38 hour week max	✓	✓	×	✓	×
Flexible work arrangements	✓	✓	×	✓ [b]	×
Unpaid parental leave	✓	✓	×	✓ [b]	×
Annual leave	✓	✓	×	×	×
Personal /carers leave	✓	✓	×	✓ [c]	×
Community service leave	✓	✓	×	✓ [c]	×
Long service leave	✓	✓	×	✓ [d]	×
Paid public holidays	✓	✓	×	✓ [c]	×
Termination notice / redundancy pay	✓	✓	×	×	×
Fair Work Information Statement	✓	✓	×	✓	×
Fair dismissal	✓	✓	×	✓ [e]	×
Subject to minimum wage	×	✓	×	✓	×
Subject to Award conditions	×	✓	×	✓	×

[a] High earners are defined by the FW Act as those whose annual earnings exceed the high income threshold. From the 1st of August 2014, this threshold was set by the Fair Work Commission at $133,000 per year. [b] Casual workers have a right to request flexible work arrangements and unpaid parental leave after being employed for 12 months on a regular and systematic basis. [c] Casual workers are able to access unpaid personal / carers and community service leave, and an unpaid day off on a public holiday. [d] Casual workers may be able to access long service leave, if their jurisdiction defines continuous service in a way that includes a regular series of casual engagements. [e] Casual workers are also protected from unfair dismissal provided they can demonstrate they have an ongoing employment contract that their employer has terminated.

Sources: Fair Work Ombudsman (2015b) and (2015d); Stewart (2015).

225 As part of an Enforceable Undertaking entered into in October 2014, Coles acknowledged that it 'is responsible with compliance across all aspects of the law across its business operations and welcomes the opportunity to work closely with the FWO to ensure ongoing compliance with Commonwealth workplace laws in respect of contractors of trolley collection services and their employees who conduct such services for and on behalf of Coles' (FWO 2014b).

Box 20.2 The Casual Loading

The *FW Act 2009* (Cth) allows each award to specify its own casual loading. Most use 25 per cent. A few, like the Seagoing Industry Award 2010 or the Fire Fighting Industry Award 2010, which cover occupations that are incompatible with casual work, do not specify a loading at all. In addition, as a part of its annual wage review, the Fair Work Commission determines a loading for all casual workers not covered by an award. This is typically 25 per cent.

The magnitude of the loading is not arbitrary. Rather it is calculated to compensate casual workers operating under each award for the entitlements they do not receive as a result of their lack of coverage by the National Employment Standards. It pays them a higher wage rate in lieu of entitlements like personal, annual and long service leave, as well as termination and redundancy provisions (Shomos, Turner and Will 2013, p. 13).

As noted by submitters, a number of decisions by various tribunals over a long period of time have established precedents for determining the components of the loading. Graham (sub. 117, p. 5) suggested that, if these precedents were adhered to, foregone annual and personal leave would add 15-20 per cent to a base pay rate, while foregone redundancy payments and termination notice together would add 4 per cent. The rest of the loading is attributable to the loss of promotion and training opportunities, the lack of rostering certainty as well the likelihood of termination. Each of these are far more difficult to quantify.

The calculation of the old pastoral industry award undertaken by the Australian Industrial Relations Commission (2003a) illustrates the composition of the casual loading.

Comparison of permanent versus casual employment by entitlement to payment, in days (Pastoral Industry Award)[a,b,c]

Permanent Employee	**Days**
Total Days (5 days * 52 weeks)	260
Plus accrued entitlements	
Annual leave	20
Leave loading (17.5 per cent of annual leave)	3.5
Long service leave	4.3
Equivalent in days for which an entitlement accrues after one year	*287.8*
Casual Employee	
Total Days (5 days * 52 weeks)	260
Less days allowed for benefits not received	
Payment for public holidays	10
Allowance for short time (time lost due to travel between engagements)	10
Allowance for sick/personal leave	5
Allowance re notice of termination / redundancy	5
Equivalent in days for which an entitlement accrues after one year	*230*
Ratio of equivalent in days for which an entitlement accrues after one year	*1.25*

[a] Figures presented for station hands. [b] Assuming 1 year of work with 5 day weeks but with no work on public holidays. [c] This is indicative. The composition of the loading may change over time (for example, to reflect that there are typically more than 10 public holidays in a year).

Source: Australian Industrial Relations Commission (2003a).

Improving productivity and strengthening worker's rights can conflict

While some protections or enhancements to workers' rights can improve productivity, in other circumstances the two goals may conflict.

Where the strengthening of a certain regulation or entitlement *increases* the unit cost of production, it is imperative to balance the financial and non-pecuniary interests of employers, workers, consumers and tax payers to deliver the greatest benefit to the community as a whole. This task is complicated by effects over and above the transfers between employers and workers that can arise from such changes. Properly evaluating them requires careful judgment and consideration.

In the simplest sense, restrictive workplace regulations can constrain employers' ability to get the most out of their workforces, leading to higher costs. On the other hand, weakening workers' rights and entitlements can undermine their willingness (and ability) to work productively. Since both employers and workers (via greater job opportunities and future wage increases) share the profits, compromising businesses' productive capacity is of little benefit to either party.

There can also be significant effects on 'outsiders', or those who would like a job, but who are currently not employed by the business. For example, substantially increasing the benefits of work can lead to employers hiring less (assuming it increases the cost of labour) while simultaneously inducing more workers to enter the workforce. Where this occurs, increased unemployment can result (discussed in chapter 8).

Moreover, enhancing the conditions of certain forms of work (relative to others) may lead employers to choose to use one form over another, with consequences for certain types of workers. For example, moving to give casual workers a legal right to become permanent employees may be attractive to casuals looking for permanency and prepared to give up the loading, but where it dampens the employers' motivation to hiring casuals and instead leads to an increased use of labour hire staff, it will likely disadvantage the workers with few skills and experience that welcome casual work and the associated loading (particularly when the alternative is unemployment).

It is reasonable and entirely rational for employers to work to reduce costs and lift productivity, even if this does involve moving to the use of alternative forms of employment like casual workers, labour hire or genuine independent contractors. It becomes problematic when businesses sham contract or do not take reasonable steps to ensure that labour hire workers receive the appropriate pay and conditions. Arrangements like these are unlawful, and have a number of adverse effects. Not only do they hurt the workers that are directly involved, but they place pressure on the pay and conditions of other lawfully engaged employees by weakening their capacity to bargain. Moreover, because it lowers their labour costs, businesses may obtain an unlawful competitive advantage over other firms in their market. Finally, these arrangements can also adversely affect the broader population where they lead to tax avoidance by either employers and employees.

20.2 Sham contracting

Since employees have many aspects of their pay and conditions determined by the FW Act, while those of independent contractors are substantially less regulated, one concern is that some employees are misclassified as independent contractors. This practice is called *sham contracting*.

An employee who is classified as a contractor would not receive the entitlements and protections of the FW Act, or the relevant award or enterprise agreement. Such employees would also miss out on superannuation and worker's compensation.

Sham contracting disproportionately affects vulnerable workers who are at risk of exploitation or who have little bargaining power. It may sometimes involve coercion and deception by the employer. Nevertheless, in some cases it may involve consensual arrangements between the parties. For example, there is compelling evidence that sham contractors avoid taxes (ACTU 2011), which means that it is possible for a genuine employee and a sham contractor to earn the same *after-tax* incomes, although the costs to the employer are lower in the latter case.[226]

The practice of misclassifying employees as independent contractors appears to be common in some industries. For example, up to 13 per cent of self-defined contractors in the building and construction industries may be misclassified (FWBC 2012).

A targeted audit[227] of 102 employers in 2011 in the cleaning services, hair and beauty and call centre industries found that:

> … 11 had employee-only workforces or did not engage contractors. Of the remaining 91 enterprises that were trading and did engage contractors, 21 (23%) were assessed as having misclassified employees as independent contractors and one third of those were assessed as either knowingly or recklessly having done so and are therefore suspected of having contravened the sham arrangement provisions of the FW Act (FWO 2011).

Suspected sham arrangements are investigated by the FWO and, in the construction industry, the Fair Work Building and Construction (FWBC). Where they are confident that a contract for services is actually of employment, or a worker effectively operates as an employee despite having a contract for services, the regulators can advise the employer that they are non-compliant and work with them to fix the arrangements. Where the employer refuses to address the situation, they can also choose to take action through the courts to restore the contract of employment. In instances where they consider the employer to have acted inappropriately, as opposed to having made a simple mistake, they may also take actions against the employer for civil remedies (discussed later).

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226 In most states, business payments to contractors are liable for payroll tax (Payroll Tax Australia 2015).

227 The FWO emphasised that the sample for the audit was not representative of the broader industry. Instead, it was targeted at employers who had either been referred to the FWO for potential sham contracting or recently advertised for workers with an ABN.

Where the regulator does investigate potential sham arrangements, the majority of cases do not result in court action. For example, in 2013-14, the FWO dealt with 471 complaints about sham contracting. Of the 114 that proceeded to investigation, six resulted in litigation (FWO 2014a).

Several submissions to both the post-implementation review of the FW Act (the Fair Work Review) in 2012 (box 20.3) and to this inquiry (box 20.4) have expressed a variety of concerns about sham arrangements. These concerns centre on the practical difficulties in differentiating between employment and contracting arrangements, and the extent to which employers can escape sanctions when found to be at fault. These concerns, and potential solutions to them, are considered in turn below.

Box 20.3 The Fair Work Review and sham contracting

Several submissions to the post-implementation review of the *FW Act 2009* (Cth) (FW Act) argued that the current legislation was ineffective at curtailing sham contracting.

In particular, the Australian Council of Trade Unions asserted that sham contracting is a growing problem and the current provisions are failing to deal with it (ACTU 2012d), while the Construction, Forestry, Mining and Energy Union complained that there is nothing in the FW Act that explicitly prohibits sham arrangements (CFMEU 2012).

Some submissions claimed that the existing common law test of independent contracting is ambiguous. In particular the Australian Services Union and United Voice argued that a definition of a genuine independent contracting arrangement might help to restrict sham contracting practices (ASU 2012;United Voice 2012a). Others articulated a need to tighten the wording of the current provisions. For instance, the Textile Clothing and Footwear Union of Australia argued that currently the evidentiary burden is too high for the prosecution of suspected sham arrangements (TCFUA 2012).

There were mixed reactions from submitters representing the views of employers. Despite the major employer associations arguing that the current provisions were sufficient (ACCI 2012; Ai Group 2012), Spotless Group Ltd (2012) noted that, to the extent that it helped an employer to reduce their labour costs, sham contracting represented a unfair advantage to employers acting unlawfully, with harmful implications for the ongoing viability of lawful employers and, in this sense, changes may be warranted. This notion was supported by the ACT Government (2012).

Box 20.4 Selected comments on sham contracting

Several submitters to this inquiry expressed concerns about the prevalence of sham contracting. They contended that it was common in several industries and allowed employers to routinely avoid paying statutory entitlements.

Submitters pointed to two enablers of the practice — the lack of clarity associated with the common law interpretation of what actually constitutes an independent contractor and the relative ease for an employer to escape sanction for sham contracting.

With regard to the first of these, a number of submitters (including Job Watch Inc (sub. 84, p. 18), Footscray Community Legal Centre (sub. 143, p. 23) and the Australian Services Union (sub. 128, p. 18)) proposed the incorporation of an unambiguous statutory definition. For instance, the Housing Industry Association suggested that the 'Independent Contractors Act 2006 could be amended to provide a statutory definition of a contractor based on the current APSI (Australian Personal Services Income) criteria. This is a proven, workable definition that reflects and codifies the common law' (sub. 169, p. 63).

While this approach has strengths, there are also weaknesses. While acknowledging that it would reduce ambiguity, Norton Rose Fulbright cautioned that:

> First, were a statutory definition to be created, it would likely amount to a series of factors — some mandatory and some optional, with weightings applied. In doing so, this approach would have circled back to the common law test.
>
> Second, this approach would likely re-create a new basis for subjective interpretation, in this case, of the statutory definition by regulatory bodies and their staff, and would suffer from the same problems as the interpretation of the common law.
>
> Third, the legislative process may not be able to keep pace with workplace developments (for example, if amendments to the definition cannot be passed through the Parliament. A statutory approach may therefore result in the codification of old factors, frozen in time (sub. 61, p. 2).

They ultimately recommended against a definition, and their position was echoed by a number of other participants (such as Professionals Australia (sub. 212, p. 43) the Australian Mines and Metals Association (sub. 96, p. 480) and the Australian Industry Group (sub. 172, p. 88)).

Moreover, Stewart, Gahan, McCrystal and Chapman noted that even though there are difficulties with the common law approach, it is necessary for an independent body (in the form of a court or a tribunal) to adjudicate on the issue (sub. 118, p. 18).

A number of submitters also argued that it was relatively easy for employers found to have misrepresented a contract for employment as a contract for services under section 357 of the FW Act to escape penalty by demonstrating that they did not act recklessly. The Australian Workers Union (AWU) argued that:

> … [t]here are three distinct problems we have identified with the defence in s. 357(2) of the Act, that invariably provide employers a valid legislative defence in all but the most blatant and egregious of breaches:
>
> - There is no clear definition of the term 'reckless';
> - Once the employer relies on the subjective defence, the onus of proving the employer knew or was reckless, rests with the person alleging the breach; and
> - The defences are made out on purely subjective grounds (sub. 74, p. 39).

The AWU suggested that a test of reasonableness, rather than recklessness, would not suffer the same problems. While the Australian Council of Trade Unions agreed with the nature of the problem, it offered broader policy prescriptions (sub. 167, p. 96).

Could a definition or a test provide clarity?

One of the challenges in enforcing sham contracting arrangements is ascertaining whether a worker, having agreed to a contract for services, is actually working as an employee. The existing test is based on the common law rather than statute, with courts using a multi-factor test, rather than making a ruling based on any single feature of the work relationship. The tests include:

- length of employment — ongoing employees are appointed on a permanent part-time or full-time basis, while the employment of an independent contractor generally lasts as long as the job they are contracted for
- choice of work — ongoing employees are allocated to jobs by their employer, while independent contractors choose what jobs they will accept
- manner of work — ongoing employees may be directed by their employer how to perform a job, while independent contractors are generally able to undertake their work in any way that they see fit (a test that is given considerable weight in the holistic assessment of the courts)[228]
- payment for work — ongoing employees draw a regular wage, while independent contractors negotiate a fee for the services they provide on a per job basis
- hours of work — ongoing employees work standard hours, while independent contractors can choose their own hours of work
- employment entitlements — whereas employees are currently able to access a number of workplace entitlements (such as minimum wages, minimum work requirements, penalty rates, leave loading and unfair dismissal protections), independent contractors are not.

Several submitters to this inquiry have argued that the current reliance on the common law has proved problematic. In particular, in their submissions, the ACTU noted the complicated nature of the current common law multi-factor test and queried 'whether there might be a more certain or reliable mechanism for the law to give effect to what is, essentially, an effort by the courts to give primacy to substance over form' (sub. 167, p. 93), while Legal Aid NSW argued that a definition could:

> … more simply articulate the difference between an independent contractor and an employee than existing common law definitions. This would allow both workers and employers to better understand the legal meaning of an independent contractor, and therefore more easily assess the true nature of work arrangements (sub. 197, p. 21)

To the extent that these definitional problems have any substantive effects, there are several alternatives. A strict definition similar to that used in the *Income Tax Assessment*

[228] Based on information from http://www.fwbc.gov.au/employee-or-contractor (accessed 9 March 2015).

Act 1997 could be incorporated into the FW Act or other legislation.[229] An alternative might be a hybrid model, in which the common law approach was guided by a number of essential criteria in legislation.

This is not the first examination of these options. In 2005, the House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation, looked at the issues surrounding the definition of an independent contractor as part of a broader inquiry prior to the introduction of the IC Act. It recommended that the common law approach be adopted, with aspects of the personal service income tests of the *Income Tax Assessment Act 1997* (Cth) written into the legislation (Australian Government 2005). More recently, while the Fair Work Review (McCallum, Moore and Edwards 2012) noted that some stakeholders were concerned about the difficulty in distinguishing between employees and independent contractors, ultimately they made no recommendation on the matter.

The benefits (and costs) of being more specific

By more clearly demarcating between genuine and sham arrangements, a stricter statutory test has some appeal. It might make it easier for parties to identify the genuine status of employment arrangements, provide a better basis for efficient enforcement (thereby creating stronger incentives to avoid sham arrangements) and reduce the risks of inadvertent errors.

Nevertheless, there are several concerns about moving away from the current arrangements.

First, it is not clear the extent to which the prevalence of sham contracting reflects uncertainty in the definition, compared with the desire for the parties to conceal a relationship (however defined) that confers advantages to one or both of them. The critical question is whether a statutory provision would make much difference to the prevalence of some agreed definition of sham contracting. This is unknown.

Second, there remains a quandary about how any alternative definition would be tested for its validity. The common law definition has evolved to capture a subtle set of factors shaping different employment relationships. No single element of the multi-factor test is decisive. Subtlety is closely related to ambiguity, and getting rid of the latter may also eliminate the former. So, for example, while many independent contractors have the ability to choose their own hours, not all do. Similarly, not providing their own tools is not a plausible indication of sham contracting in clerical services where the contractor often

[229] The personal services income provisions of the *Income Tax Assessment Act 1997* (Cth) imposes a series of tests on contractors who are performing work, to establish they are genuinely running a 'personal services business'. These tests include obtaining less than 80 per cent of their income from a single source. Given these tests vary from the holistic approach of the common law, it is possible that workers who are determined to be independent contractors by the common law may be taxed as employees or vice versa.

works in the office of the client and, as a result, is not required to bring their own computer to work. However, it may be a much stronger sign of sham contracting if the worker is a carpenter.

Without a set of characteristics common to all independent contractors, the development of a definition to accurately categorise workers becomes less feasible. Were one implemented, it could lead to classification errors. Too narrow a definition of an 'independent contractor' would exclude genuine arrangements, while too broad a definition would encompass arrangements that are actually 'sham'.

Such classification errors could have perverse efficiency effects. For example, it might have the effect of dissuading employers and genuine contractors from including certain mutually beneficial terms in the contract in order to better comply with what is set out in the legislation. For example, if a definition specified that a worker was an independent contractor only if they had a reasonably diversified list of clients (reflecting one part of the personal services income test in the *Income Tax Assessment Act 1997*), it might discourage relationships that otherwise might be efficient[230]. Alternatively, independent contractors might turn down work that they could reasonably undertake at the lowest cost to avoid breaching a threshold in the legislation.

There is also a presumption in shifting away from the common law approach that either:

(a) the outcomes of a carefully drafted statute would reach the same conclusion as that found through a court's subtle judgments based on the common law, but at a lower cost

(b) the common law definition somehow deviates from a 'true' definition of independent contracting.

Testing (a) would require judges to confirm that for a wide spectrum of cases, the outcome of the common law and some ideal statute gave the same result. It would be useful to apply that test were any change to be envisaged.

The Commission has not seen any evidence of (b), and an inherent problem would be that different interest parties would pressure Government for a version of truth that suited their interests.

Finally, a further potential drawback of a statutory approach to the regulation of what are inherently ambiguous employment relationships is that once they are formally elaborated in legislation, loopholes invariably are found and exploited. This issue is common to many rule or law based regulatory approaches and reflects the difficulty of drafting legislation that addresses all the features of the employment relationship (Hulett 2005). Workers and

[230] If all independent contractors place high value on their tax status, then it may be the case that eliminating the disparity between tax and WR laws would have no effect, as most would already be meeting the requirements of *Income Tax Assessment Act 1997* (Cth). However, anecdotal evidence suggests that a number of independent contractors value other aspects of the contracting relationship and, as such, are content to work one way and be taxed another.

employers who are intent on disguising an employment relationship as independent contracting may shape their arrangements to meet the criteria in the legislation. As long as their arrangements met those conditions, they could be a sham in other ways.

The current common law approach avoids the above pitfalls. Since they can examine the entirety of the relationship, judges are in a position to assess the aspects of an arrangement that are most indicative of its true nature. And since this may vary from contracting relationship to contracting relationship, they have the flexibility to change the importance they place on these aspects on a case-by-case basis.

In conclusion, while a statutory definition is superficially attractive, there would be considerable difficulties and risks associated with a policy shift involving the rigid adherence to such a definition, and all to solve a problem of unknown dimensions.

Is it enough not to be reckless?

While the FW Act does not define sham contracting, it does incorporate sections that outlaw it. Currently, there are three sections in the FW Act that are aimed at curbing the incentives for employers to instigate sham arrangements. These provisions prohibit an employer from:

- misrepresenting an employment relationship or a proposed employment arrangement as an independent contracting arrangement (s. 357)
- dismissing or threatening to dismiss an employee for the purpose of engaging them as an independent contractor (s. 358)
- making a knowingly false statement in order to persuade or influence an employee to become an independent contractor (s. 359).

Where an employer has been found to have violated any of these, then they may be pursued for civil remedies in the Federal Court system under actions brought by the worker, their representative or an enforcement agency (FWO 2015d).

However, while s. 358 and s. 359 are strict liability offences, an employer is able to avoid penalties under s. 357 if they can demonstrate that they did not know that the contract was for employment rather than for service and that they were not acting recklessly. For example, this might mean that an employer who had sought and acted on incorrect advice and had, as a result, misrepresented a contract for employment as a contract for service could not be pursued for sham contracting.

Some submitters to this inquiry, and to previous inquiries, have argued that this provision needs to be narrowed. With reference to the highest profile instance of the 'reckless defence' being used successfully[231] — *CFMEU v Nubrick (2009)* — both the Sham

[231] This case was not under the Fair Work Act, but under the preceding Workplace Relations Act in which the relevant provision was similarly worded.

Contracting inquiry report (ABCC 2011) and the Fair Work Review (McCallum, Moore and Edwards 2012) recommended that a test of 'recklessness' be replaced with 'reasonableness'. Or, specifically, that the provision:

> … be amended to provide a defence to the prohibition on misrepresenting a contract of employment as a contract for services only when the employer proves that at the time the representation was made, the employer believed that the contract was a contract for services rather than a contract of employment, and could not reasonably have been expected to know otherwise (McCallum, Moore and Edwards 2012).

The Fair Work Review suggested that this might have two effects. First, it would remove some ambiguity resulting from the absence of a universal common law definition of 'recklessness' in relation to civil matters[232] and, second, make it harder for an employer to defend sham contracting allegations. Ultimately, the provision has not been strengthened by the current or former Government.

On face value, a conservative stance seems appropriate given the small number of cases mounted under s. 357 and the even smaller significance given to the issue of 'recklessness'. Since the inception of the FW Act, 35 cases involving potential contraventions of s. 357 of the FW Act have been decided[233] (LawCite 2015). In very few of these cases did the defendant rely on what is termed the 'reckless defence'. On fewer occasions still has it been integral to judgements in the employer's favour.

On the other hand, the high burden of proof required to establish 'recklessness', combined with the significant resources required to take any action, may discourage the FWO/FWBC or any aggrieved party from taking court action. By definition, cases that do not proceed are not observed. The main recourse left to regulators is to cooperatively work with the business to set aside the contract for services (which would entail no penalties). They could also issue a non-compliance notice, but this is only enforceable by a court (raising again the problem posed by the high burden of proof). Consequently, the status quo weakens incentives of businesses to avoid sham contracting, or for regulators to issue notices when infringements occur.

There do not appear to be any obvious disadvantages from switching to a 'reasonableness' test given that such tests are frequently applied in many other civil contexts without much concern. Such a shift would address the weaker incentives under the current regime. It may also help regulators to rectify sham arrangements out of court because any infringing business would be aware that it would have a lower probability of winning the matter in court. As noted earlier, litigation forms only a small part of the work of the FWO in relation to sham contracting. Moving to a 'reasonableness' test would not undermine this.

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232 In the case of *CFMEU v Nubrick Pty Ltd [2009] FMCA 981* the judge contrasted the respondent's actions with two separate legal definitions of 'recklessness'.

233 By way of contrast, four cases featuring section 358 and two cases featuring section 359 had been decided.

Unless presented with contrary evidence, the Commission sees merit in replacing the 'recklessness' test with a 'reasonableness' test.

20.3 Limitations on the use of subcontractors and labour hire employees

The capacity of an employer to contract with lower cost or more flexible forms of labour may undermine employees' collective bargaining power in reaching EAs. It is therefore understandable that employee representatives sometimes seek to discourage such contracting by seeking terms in agreements that effectively raise the costs of employing alternative forms of labour.

As it is currently written, the only restrictions on terms that apply to alternative forms of employment is the list of permitted matters in section 172 of the FW Act (for a detailed discussion of 'permitted matters', see chapter 15). This section specifies that EAs can only include:

- matters pertaining to the relations between each employer that will be covered by the agreement and its employees
- matters pertaining to the relations between each employer and any unions that are covered by the agreement
- deductions from wages for any purpose authorised by an employee covered by the agreement; and
- matters relating to how the agreement will operate.

The extent of these 'permitted matters has been tested on numerous occasions by cases before the Federal Court and Fair Work Commission (FWC). Among other things, these tests have determined that agreements cannot include an outright prohibition or prevention on the engagement of alternative forms of labour.[234] Nor can they include terms that restrict an employer's engagement of contractors to those who have union agreements.[235]

However, the full bench of the FWC found that EAs are able to regulate the terms under which independent contractors and labour hire workers are engaged.[236]

So while a union cannot directly bar an employer from engaging an independent contractor or a labour hire worker, it may be able to subtly exert pressure and affect the terms under which those workers are engaged.

234 Australian Postal Corporation v CEPU [2009] FWAFB 599.

235 Airport Fuel Services Pty Ltd v Transport Workers' Union of Australia [2010] FWAFB 4457.

236 Asurco Contracting v CFMEU [2010] FWAFB 6180; and Australian Industry Group v ADJ Contracting Pty Ltd [2011] FWAFB 6684.

One way of achieving this is to ensure that the employer's EA contains terms that give the union more control over the employer's engagement with independent contractors and labour hire agencies. This is typically done by requiring an employer to disclose to employees and their representatives:

- the name of any independent contractor or labour hire agency proposed for work
- the type of work
- the duration of work; and
- the qualifications of the independent contractor or labour hire workers.

Furthermore, while independent contractors or labour hire workers remain on the payroll the employer may not be permitted to make ongoing employees redundant.

Another way of achieving this is to ensure that the terms of engagement of these alternatives are roughly the same as those of ongoing employees. This is generally done through the insertion of 'jump up' clauses, which ensure that the terms and conditions of an independent contractor or labour hire worker's engagement are no less favourable than those of ongoing workers.

The circumstances under which these conditions find their way into enterprise agreements varies. Where they do not make regular use of independent contractors, labour hire or casual hire, businesses may willingly agree to such arrangements (particularly if they obtain changes in work practices that offer productivity improvements or wage restraint in exchange). In other instances, where there is an imbalance of bargaining power, businesses may have little alternative but to cede some authority over the use of alternative forms of employment to the unions.

Some submitters the Fair Work Review (box 20.5) and to this inquiry (box 20.6) have contended that terms that discourage the use of alternative employment forms should not be included in an EA. The principal argument is that the employer should have the prerogative to determine the mix of employment forms that minimise costs or maximise productivity. While it could be countered that the complete freedom to contract could shift the balance of bargaining power too much in favour of the employer (and, in the process, undermine one of the fundamental tenets of a WR framework — a reasonable share of income for labour), independent contracting (and even more so, labour hire) is far from a perfect substitute for ongoing labour. As a result, the freedom to contract is unlikely to undermine employee bargaining power to any great extent.

Box 20.5 The Fair Work Review and constraints on alternative employment forms

Submissions to the recent Fair Work Review – largely by employer groups – argued that terms which were making it more difficult to engage with independent contractors and labour hire agencies had begun to creep into enterprise agreements. Of these, the Business Council of Australia observed:

> … that some unions have been seeking the inclusion of terms in enterprise agreements that purport to regulate the terms and conditions to be observed by contractors and labour hire agencies in such a way as, in effect, to control the engagement of contract and agency staff (BCA 2012).

Furthermore, these submissions suggested that, from the unions' perspective, these terms were having the desired effect. In particular, Australia Mines and Metals Association argued that 'Fair Work Australia's approval in industrial agreements of clauses restricting the use of contractors is a huge issue for resource and construction industry employers' (AMMA 2012). The Institute of Public Affairs concurred. They noted that the 'fair work system enables unions to demand enterprise agreements that severely limit the use of independent contracting' (IPA 2012).

Ultimately, the Fair Work Review did not make a recommendation in relation to these concerns.

Should terms that affect the use of alternative employment forms be 'non-permitted'?

Given the above observations, there is a prima facie case to eliminate terms in enterprise agreements that act to restrict an employer's prerogative to choose the employment mix suited to their business.

Curiously, the evidence presented in the Fair Work Review indicated that the number of EAs that featured terms restricting the use of independent contractors and labour hire workers was considerably lower under the FW Act than in the period before amendments to the *Workplace Relations Act 1996* (Cth) (WR Act) in 2006 (McCallum, Moore and Edwards 2012). This raises the question of whether much is actually at stake in making a change. However, it is not clear that a lower incidence under one WR regime provides much of a basis for allowing the persistence of an inherently problematic term. Moreover, while 'jump up' clauses are not a strict impediment to hiring contractors, they do act to regulate the price of contract labour, and presumably when such clauses bind, must indirectly discourage the employment of contract labour. In some industries, this can be important. Around 70 per cent of a random sample of construction sector EAs contained jump up clauses. Moreover around 29 per cent of workers in the sector were classified as independent contractors (PC 2014b).

To the extent that any change would have a widespread effect, one option for restricting the inclusion of these terms is to have them written into the legislation as unlawful terms. As discussed in chapter 15, the FWC cannot approve EAs that contain unlawful terms.

Box 20.6 Selected comments on the constraints on alternative employment forms

A number of submissions to this inquiry noted that it was common for unions to try to regulate the use of alternative employment forms. They achieve this through the insertion of terms in enterprise agreements that give the union some say over a business' use of independent contractors, labour hire and casual workers. For example, the Australian Mines and Metals Association stated that 'in most states, particularly in Victoria, unions will insist on a contractor's clause in every agreement to which they are a party'. (sub. 96, p. 153)

While these clauses can have positive effects for ongoing workers, they come with broader costs. For example, Qantas argued that:

> … [e]mployee associations in EA bargaining routinely seek restrictions that if agreed would fetter business strategy, and obstruct change — and thus negatively impact productivity. A clear example of this is claims on the use of contractors or labour hire (the total prohibition of which is not a permitted matter) under the guise of 'job security' clauses (which may be found to be permitted matters) (sub. 116, p. 9).

The Australian Mines and Metals Association concurred. It submitted that:

> ' … [i]n AMMA's experience, a union's stated justification for contractor restrictions in bargaining will primarily be 'job security' but this ignores the reality of a contractor losing a contract over an uncompetitive deal and the job losses and other employment benefits that invariably go with it' (sub. 96, p. 153).

To the extent it is a substantial issue, there are a range of policy options that may work to prohibit enterprise agreements from restricting the engagement of alternative forms of employment. Of these, the Australian Chamber of Commerce and Industry argued for:

- Amending the definition of 'permitted matters' under section 172 of the [Fair Work] Act so that the terms of enterprise agreements are strictly limited to matters pertaining to the employment relationship; and
- Tightening the list of 'unlawful terms' contained in section 194 of the FW Act to make it clear that unlawful matters include matters which are not 'permitted matters' and in particular terms which seek to restrict the engagement of contractors or imposing conditions upon their engagement.
- Requiring that non-permitted, unlawful or designated outworker terms are excised from agreements before or when they are approved (sub. 161, p. 160).

The Australian Industry Group (Ai Group) and Manufacturing Australia each supported aspects of this position. Ai Group argued that terms in enterprise agreements that restrict the engagement of independent contractors, establish requirements relating to the conditions of their engagement or require the provision of information to unions about the use of independent contractors, labour hire and casual workers should be made 'unlawful' (sub. 172, p. 46) while, with regard to labour hire, Manufacturing Australia submitted:

> … [l]imiting the matters that can be included in enterprise agreements to 'matters pertaining to the employment relationship' and making terms about labour hire unlawful would ensure enterprise agreements' terms are about employment matters of direct relevance to the parties to the agreement (the employer and employees) (sub. 126, p. 5).

The Housing Industry Association proposed that independent contractors be regulated by commercial law, rather than workplace law. (sub. 169, p. 58)

This was the approach in amendments to the WR Act, which specified that a term of a workplace agreement is prohibited content to the extent that it deals with:

- restrictions on the engagement of independent contractors and requirements relating to the conditions of their engagement
- restrictions on the engagement of labour hire workers, and requirements relating to the conditions of their engagement, imposed on an entity or person for whom the labour hire worker performs work under a contract with a labour hire agency.

Unlike many other aspects of that legislation, these were not carried over into the FW Act.

The effects of these terms, and conversely of prohibiting them, can in part be characterised as redistributive. Where they are included and exercised, the benefits accrue to current employees (who might get extra hours) or potential employees (if more workers are needed). This comes at a cost to independent contractors, labour hire and casual workers, who may miss out on jobs. Alternatively, were these terms to be excluded, workers under alternative employment forms would enjoy increased employment, but possibly to the detriment of current and potential ongoing employees.

But, as noted earlier in this chapter, alternative employment arrangements can increase productivity and lower costs, with benefits that ultimately flow to the community as a whole through lower prices. Once these effects are considered, and given the fact that alternative employment arrangements are unlikely to significantly reduce collective bargaining power, there is a sound basis for excluding terms in enterprise bargains that have the effect of limiting the hiring of subcontractors, labour hire workers or casuals.

DRAFT RECOMMENDATION 20.1

Terms that restrict the engagement of independent contractors, labour hire and casual workers, or regulate the terms of their engagement, should constitute unlawful terms under the *Fair Work Act 2009* (Cth).

20.4 Other forms of work

There are a number of other forms of work. These include outworkers, apprentices or trainees and interns. Since they have characteristics that distinguish them from permanent ongoing, casual and contract work, they each have slightly different regulatory arrangements within the national WR system.

Most of the issues raised by submitters to this inquiry in relation to apprentices and trainees concerned the determination, level and effects of trainee and apprentice wages. As a result, they are discussed alongside other wage issues in chapter 9.

Outworkers

Outworkers are employees or contractors who perform their work at home, or somewhere other than standard business premises. They are most common in the textile clothing and footwear (TCF) industry.

A key characteristic of contract outworkers in the TCF industry (compared to independent contractors in other industries) is that the FW Act treats them as employees in most regards. This means that they can have their terms and conditions of employment outlined by an industrial instrument and are able to access the NES.

The major reasons for giving TCF contract outworkers the same entitlements as employees were, according to the ACTU, their 'position of vulnerability, proven exploitation and the thorough and effective advocacy of their union on their behalf' (sub. 167, p. 90). The change was formalised by the *Fair Work Amendment (Textile, Clothing and Footwear Industry) Act 2012* (Cth) (the TCF Amendment). The TCF Amendment:

- extended most provisions of the FW Act to contract outworkers
- enabled outworkers to recover unpaid amounts up the supply chain
- extended right of entry rules that apply to suspected breaches affecting outworkers
- allowed for a textile clothing and footwear code to be issued (Australian Government 2012).

Since a regulatory impact statement was not done at the time, a post-implementation review of the amendment was undertaken in 2014. The Productivity Commission understands that although it has been completed, it is yet to be made publicly available by the Australian Government.

Outworkers have not featured prominently in submissions to this inquiry. However, the main concerns articulated in submissions to the post-implementation review of the TCF Amendment were that there was limited evidence to support the changes and that they had had adverse effects on businesses and a number of genuine contractors (box 20.7). This section will examine this contention in some detail.

In theory, there is little to suggest that the FWO could not target and rectify sham contracting and exploitative behaviour in the TCF industry much in the same way it does in other industries. To the extent that exploitation is pervasive in the industry, it would attract more of the regulator's resources, particularly given its risk-based approach to enforcement.

Box 20.7 Selected comments about outworkers from the post-implementation review of the Fair Work Amendment

Submissions to the post-implementation review of the Fair Work Amendment (Textile, Clothing and Footwear Industry) Act 2012 (Cth) offered a range of views.

Several submitters endorsed the legislative changes. Fair Wear Inc submitted that:

> … the regulation is performing as intended, is still relevant and needed and strongly recommends retaining the FW Act rights and protections for outworkers in the Textile, Clothing, Footwear and Associated Industries. (FairWear Inc 2014, p. 13)

In a similar vein, the Law Committee of the Law Society of NSW submitted that:

> … [t]he TCF Act plays an important regulatory role in extending the rights and protections of TCF outworkers. In light of the vulnerable nature of TCF outworkers, the Committee supports the continuation of the TCF Act in its current terms. (Law Society of NSW 2014, p. 3)

The Textile, Clothing and Footwear Union of Australia (TCFUA) cautioned against repealing the amendment. It argued that:

> … [i]t would be a highly deleterious outcome if, via the process of the [Post-Implementation] Review, provisions of the TCF Act were removed at the very time the TCFUA is beginning to see positive changes in the working lives of TCF outworkers. (TCFUA 2014, p. 6)

Some questioned the need for the amendments. The Australian Industry Group (Ai Group) submitted:

> Whilst no one doubts the importance of having adequate protections within Australia's workplace relations laws to prevent the exploitation of individuals, the FW Act 2009 (FW Act) already contained very substantial protections for outworkers prior to the TCF Act being implemented. (Ai Group 2014c, p. 3)

The Australian Chamber of Commerce and Industry noted:

> … [m]any parties, including ACCI, were of the view that there was no evidentiary basis for the FW (TCF) Bill. In the absence of such evidence, it is ACCI's view that the FW (TCF) Bill was not relevant and in-turn the FW (TCF) Act is similarly not relevant. (ACCI 2014, p. 5)

Others argued that the amendments had gone too far. Textile, Fashion Industries of Australia (TFIA) argued:

> This is an unprecedented development in Australian Industrial history. No other industry has, with the stroke of a pen, seen such a substantial shift in regulation of the way, and by whom, work is carried out. No other industry has seen, overnight, such a substantial proportion of its workforce become subject to common rule industrial instrument regulation. (TFIA 2014, p. 6)

Critics also submitted that the changes caused problems. The TFIA also argued that 'the legislative solution is disproportionate, as it has substantial impacts on all TCF [textile, clothing and footwear] industry outworker contractors' (TFIA 2014, p. 7), and effectively barred some workers from engaging in their preferred work relationship. Ai Group concurred. It argued that 'the TCF Act is operating against the interests of TCF businesses, TCF workers and the broader community'. (Ai Group 2014c, p. 3)

In practice, however, there may be some characteristics that prevent the industry or outwork more generally from being effectively monitored and regulated. One explanation may be that some aspects of the work (such as working from home or workers providing their own equipment) challenge the common law distinction between contract and employee outworkers. This inquiry is yet to receive evidence of this, nor are the

submissions to the post-implementation review of the TCF Amendment persuasive in this regard. Without evidence, there is little justification for the changes.

Even if there are compelling arguments for alternative regulatory arrangements, their benefits need to be contrasted with the costs associated with bringing genuine contractors under the umbrella of the FW Act. As discussed previously, some employers and workers prefer and benefit from genuine contracting relationships. Preventing these could adversely affect productivity, production costs and, by extension, the viability of the business. Effectively barring workers from contracting in the TCF could affect their livelihoods as well as level of comfort with their work relationship. However, as is the case with evidence supporting the changes, the Productivity Commission is yet to receive evidence on the magnitude of these costs.

Moreover, it should be emphasised that even if their benefits exceed the costs, the existence of alternative arrangements for TCF contractors should not be treated as a pilot scheme for bringing independent contractors into the national workplace system more generally. This would have serious consequences, including substantial adverse effects on productivity.

At this stage, the Productivity Commission can see merit in arguments against the changes in the TCF Amendment, but cannot discount the possibility that there are compelling arguments in their favour. As a result, the Productivity Commission seeks more information from all parties on this issue.

Internships and work experience

An internship or a work experience placement is an arrangement where a person gains experience at performing a particular job or working in a particular industry. While they are often unpaid (Stewart 2015), they can represent an important first step for a worker — particularly young workers, or those contemplating a career change — into a new business, profession or industry. It can be a source of valuable experience, and can bolster a resume or form the basis of a positive reference — both of which can also benefit the worker in obtaining employment in the future. From the perspective of the business, hosting an intern or a work placement student can be an important way of getting more information about prospective hires, supporting students and providing a service to the community.

Unpaid work experience has become increasingly integrated into programs of study, and has become a formal part of many state school systems and vocational educational and training courses (Qld DET 2015; Vic DET 2015; TAFE NSW 2012). This reflects a broad acceptance that work experience, in combination with course work, can improve a student's transition from school or vocational and educational training to the workforce. To this effect, a United Kingdom study found that young people taking part in a Government-backed work experience were 16 per cent more likely to be off benefits 21 weeks after starting than their peers who did not take part (UK DWP 2012). Other industry

level studies have also suggested there are numerous benefits to work placements (Paisey and Paisey 2010; Wilton 2012).

These arrangements are not employment relationships, and as such, are not captured by the national WR system.[237] Specifically, several sections of the FW Act provide that a person is not to be considered an employee if they are on a 'vocational placement'. Simply put, workers undertaking a requirement of an education or training course (which is authorised under a federal, state or territory law or administrative arrangement) are not eligible for the minimum wage, the NES or the terms of any award or any enterprise agreement they might otherwise be covered by.

The Productivity Commission is not aware of any problems with unpaid work placements in the context of a curriculum (where WR are concerned).

There are concerns, however, about unpaid internships *outside* the requirements of a training course. Internship arrangements can vary quite markedly depending on the individual, the business and the industry. Interns Australia noted that:

> … [s]urveys conducted by Interns Australia have reflected a diverse range of internship practices, with significant variance in: hours of work performed; length of the internship; supervision of work; whether remuneration is provided; whether the internships is part of a formal education course (sub. 66, pp. 3–4).

The basis for this concern is the perceived lack of clarity about when a worker should be compensated (and regulated by the FW Act) for their efforts. In the absence of a definition or test for ascertaining this, a body of case law has determined that unpaid work arrangements constitute employment (and should be recognised as such) where the 'objective reality' of the arrangement is one of employment (Stewart 2015). Typically, a number of indicators guide the courts (and the FWO) in this assessment, including the reason for the arrangement, its length of time, its significance to the business, the tasks involved and who benefits from the arrangement (FWO 2015k). The fear is that some employers may exploit this opacity to use unpaid interns to do the work of a paid employee.

Participants' comments provide some support for this concern. In an informal comment to this inquiry, an employee from NSW echoed the concern that interns were occasionally used as a substitute for employees. They wrote:

> … I have undertaken internships where the tasks I was carrying out could have very easily been done by a paid employee. I was not gathering any new experiences or skills through being at the workplace, and was treated like free labour. There was one in which I was filling shoe orders and packing boxes all day, and others in which I have known I was hired as an intern after someone had been made redundant. There are many workplaces who use interns instead of

[237] Other state laws dealing with education and training, child employment, workers compensation, anti-discrimination and superannuation may also apply to unpaid work arrangements (Stewart and Owens 2013).

> paid employees under the guise that the interns are being paid in 'experience'. (comment no. 90, employee)

Over the last five years, the FWO has taken a number of steps to clarify the regulatory framework for these arrangements. As well as developing an educational program, in 2011 the FWO commissioned a report into what it considered to be an emerging concern[238]. The report found that:

> … [t]here is reason to suspect that a growing number of businesses are choosing to engage unpaid interns to perform work that might otherwise (and perhaps in other businesses is otherwise) be done by paid employees, especially in occupations that are considered particularly attractive or for which there is an oversupply of qualified graduates. (Stewart and Owens 2013)

In response to the report, the FWO has implemented a number of measures designed to foster a broader understanding of unpaid work arrangements, and the obligations employers may have to interns and work experience workers. These include an expansion of their web-based resources on unpaid work, a consultative process with stakeholders through the Young Workers' Team and the development and implementation of the Unpaid Work Education Program (delivered through universities and training organisations).

In addition, the FWO has tightened its compliance and enforcement processes by using a risk based monitoring framework (which works with job-finding websites to better direct resources towards employers who advertise unpaid positions). This includes undertaking investigations, seeking rectification from employers, initiating legal proceedings and appearing as a 'friend of the court' on some occasions where an unpaid worker have made a claim against an employer (FWO 2014c).

Since pursuing these measures, there has been a substantial increase in the number of inquiries relating to internships and unpaid work. The FWO recorded 126 requests for assistance in 2013-14 and 127 in 2012-13. This more than doubled the 53 reported in 2011-12 (FWO 2014c).

These figures are difficult to interpret. They may reflect greater community awareness of the issues involved and the role of the FWO, but they give little indication of the scale of the problem. They could represent a significant step towards resolving the issue. Or just a part of a larger problem, and that a substantial number of employers are still either unaware of their obligations or that they are not dissuaded from acting unlawfully.

There are also factors other than the activity of the regulator that may limit the extent of any problem. Once the promises that are used to procure the efforts of unpaid workers lose their currency, there is little to keep them at a company. Without a wage to bind them, there is little cost to leaving. Moreover, advancements in information and communication

238 The report itself noted that the FWO was prompted by a newspaper article advocating the 'free labour' offered by interns.

technologies (such as the internet and social media) have meant that business reputations, while hard won, are easily lost. Those contemplating an unpaid arrangement are more forewarned than at any time in the past. Plus the potential damage associated with an investigation by the FWO or an adverse finding in a court case is far greater than just a payout to the affected worker, with potential impacts on a business' workforce and customer base.

Accordingly, the Productivity Commission is reluctant to make any recommendations on the regulation of unpaid work arrangements at this juncture. This largely reflects a lack of information, a lack of engagement by submitters on this issue as well as recognition of the activity of the FWO, which generally undertakes its education, compliance and enforcement activities in an effective and innovative manner (chapter 3). Were submissions and stakeholder consultations post-draft to further elucidate this issue, the Productivity Commission may revisit this assessment.

INFORMATION REQUEST

The Productivity Commission seeks feedback on the extent to which unpaid internships have become more commonplace across the economy, whether any growth in such arrangements has led to problems rather than opportunities, as well as the potential remedies to any specific issues.

21 Migrant workers

Key points

- Migrants are more vulnerable to underpayment and other breaches of the *Fair Work Act 2009* (Cth) (FW Act) because they are more likely to be unaware of their workplace rights, have limited English language skills, and lack support networks.
- The Fair Work Ombudsman should be given additional resources to improve its enforcement of migrants' working conditions.
- Migrants working in breach of the *Migration Act 1958* (Cth) are particularly vulnerable, as they receive no protections under the FW Act. To reduce employers' incentive to take advantage of these migrants, employers should be fined by at least the value of unpaid wages and conditions, in addition to any penalties under the Migration Act.

Migrant workers have long been an important part of Australia's economy. However, evidence shows that some employers provide them with lower wages, reduced entitlements and fewer protections than stipulated in the *Fair Work Act 2009* (Cth) (FW Act). This chapter examines the ways in which migrant workers interact with the national workplace relations (WR) system.

Number of migrant workers in Australia

Migrants — either permanently or temporarily living in Australia — account for a significant share of Australia's workforce. In the year to June 2014, Australia accepted around 190 000 permanent migrants through its Migration Programme, which comprises skilled workers and people reuniting with families, and around 11 000 refugees and migrants for other humanitarian reasons (DIBP 2014b, 2015a).

Over the same period, Australia issued 650 000 temporary migrant visas with some working rights (DIBP 2014a).[239] The majority of these visas were issued to working holidaymakers and students. There were 710 000 temporary migrants in Australia at June 2014 (table 21.1). Overseas students made up 48 per cent of temporary migrants, a quarter were temporary skilled workers on 457 visas, and about a fifth were people on working holidays. A further small proportion were overseas graduates remaining in Australia after completing their studies.

[239] This figure includes working holiday visa holders, students, temporary skilled visa holders (457s) and temporary graduates. This excludes New Zealand citizens.

Migrants on 457 visas are used by employers to fill positions that require a certain amount of skill, and that cannot be filled by the local population (DIBP 2015c).[240] Of the 195 000 workers on 457 visas in Australia at June 2014 around 56 per cent were the primary visa applicants, while the remainder were applicants' family members (DIBP 2014c). The annual intake of workers on 457 visas has almost doubled over the past decade (figure 21.1).

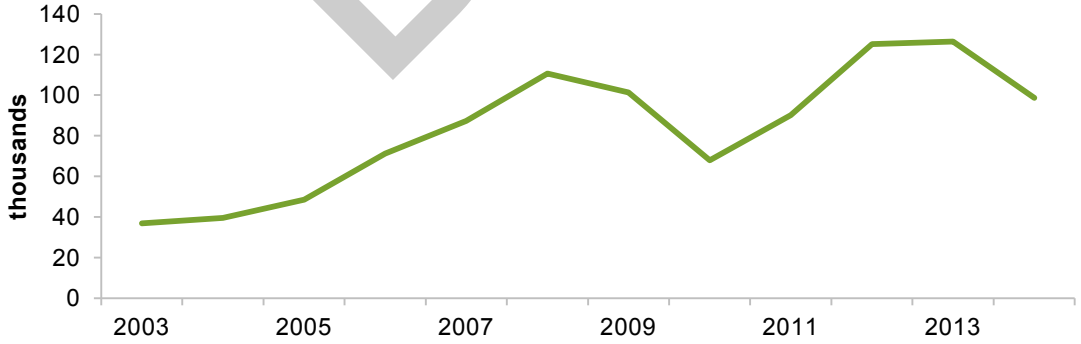
Table 21.1 **Temporary migrants able to work in Australia[a]**
As at 30 June 2014

Visa holder type	*No.*	*Per cent of total*
Student visa	339 760	47.8
Temporary skilled (subclass 457) visa	195 080	27.4
Working holiday maker visa (subclass 417)	151 200	21.3
Temporary graduate (subclass 485) visa	25 200	3.5
Total	**711 240**	**100.0**

[a] Data differ from ABS data (2014, *Characteristics of Recent Migrants, Australia, Nov 2013*, Cat. no. 6250, Canberra) which only include migrants living, or intending to live, in Australia for 12 months or more.

Source: Department of Immigration and Border Protection (2014d).

Figure 21.1 **Annual intake of temporary skilled workers (on 457 visas)**
Year to June



Sources: Department of Immigration and Border Protection (2014a), Department of Immigration and Citizenship (2013).

240 To issue a 457 visa, employers need to sponsor an overseas worker. Employers must gain approval from the Department of Immigration and Border Protection to become a sponsor. Workers on 457 visas can only work for their sponsor.

The vulnerabilities of migrant workers

Migrant workers' rights are covered by the *Migration Act 1958* (Cth) (Migration Act) and the FW Act. The Migration Act regulates migration into Australia and details the different working visa types and their conditions. The Migration Act also requires employers to meet specific obligations, which include ensuring sponsored migrant workers are appropriately paid and perform duties relating to their approved occupation. The FW Act covers the rights and protections of *all* employees in Australia's national WR system including lawful migrant workers. Moreover, the Fair Work Ombudsman's (FWO's) Fair Work Inspectors are also appointed as Migration Inspectors under the Migration Act, which allows them to ensure that 457 visa holders' nominated salaries are being paid and these visa holders are performing the jobs approved in their visas.[241]

The information available, although limited, suggests that migrant workers face higher risks of substandard working conditions. Complaints from visa holders comprised more than 10 per cent of the 25 650 finalised complaints made to the FWO in 2013-14 (FWO 2014a, pp. 26–30). In November 2013, the ABS (2014) estimated there to be around 340 000 employed temporary residents and around 11 million other employed people in Australia. This suggests that the complaint rate for employed temporary migrants was around 0.7 per cent, which while small, was more than three times the rate for other employees.[242] The FWO observed that working holiday visa holders (subclass 417) were particularly at risk:

> Our experience shows overseas workers, particularly those on working holiday visas, are more vulnerable to exploitation. These workers typically find understanding and exercising their entitlements difficult because of age and language barriers; the remoteness of their working location; and their dependence on employers to obtain eligibility for a visa. (FWO 2014a, p. 30)

In August 2014, the FWO announced an inquiry in this area, which looks at the wages and conditions of working holiday visa holders and whether they are being exploited by employers (James 2014). The Senate Education and Employment References Committee is also addressing this issue in its inquiry into the Australia's temporary work visa program (which is due to report in August 2015 following publication of this draft report) (Parliament of Australia 2015c).

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241 Apart from 457 visa holders, Fair Work Inspectors do not routinely monitor for other migrant workers' compliance with the Migration Act. However, the FWO does pass on information to the Department of Immigration and Border Protection if it finds any breaches of the Migration Act through its usual monitoring processes.

242 A breakdown of complaints data were provided by the FWO. The specific visa category was unknown for 30 per cent of visa holders making complaints in 2013-14. The complaints rate estimate assumes that the share of temporary visa holders where the visa type is unknown is the same as the share where visa categories are known. The complaint rate is 0.5 per cent when complaints from visa holders with unknown categories are excluded. The employment data are based on ABS, 2014, Characteristics of Recent Migrants, Australia, Nov 2013, 2014, Cat. no. 6250, Canberra. This is the best available estimate of temporary migrant workers. However, these data exclude migrants that are not living, or intending to live, in Australia for 12 months or more.

Audits provide another indicator of migrant workers' vulnerability. For example, in its monitoring of 457 visas, the FWO assessed more than 1000 employers, which employed around 1900 visa holders.[243] The FWO referred nearly one quarter of the audited employers (relating to 18 per cent of the relevant visa holders) to the Department of Immigration and Border Protection (FWO 2014a, p. 30). *Prima facie*, the problems appear to be greater than suggested by complaint rates, but because of the FWO's targeted monitoring process, audited employers are more likely to not meet their obligations. The complaints arising from audits mainly related to underpayment of wages, and breaches of the requirement to assign the employee to the position specified in the visa (which are breaches of the Migration Act, but not necessarily the FW Act).

In addition, in 2013, the Department of Immigration and Border Protection and the FWO sanctioned employers or cancelled employers' ability to sponsor in more than 250 monitored cases concerning 457 visa holders (Azarias et al. 2014, p. 85).

The greater vulnerability of migrant employees reflects several factors — such as limited English language skills, weak support networks, lack of awareness of their rights in the workplace and a reluctance to challenge their employers for fear of losing their sponsorship (box 21.1).

Protecting migrant workers' workplace rights and conditions

There are several possible remedies for the higher prevalence of employer non-compliance with the FW Act for migrant employees.

The Independent Review into the 457 visa program (Azarias et al. 2014) recommended several changes, which the Australian Government has mostly supported and the Department of Immigration and Border Protection is working to implement (DIBP 2015d).[244] These include:

- the mandatory provision of a summary of the visa holder rights and the FWO Fair Work Information Statement as part of the signed employment contract
- better online information about visa holders' rights
- greater monitoring
- mandatory provision to the ATO of the visa holder's Australian tax file number
- naming and shaming of employers that are sanctioned
- increasing the deterrence created by civil penalties by dedicating resources for litigation

[243] To provide context to these numbers, there are more than 2 million workplaces in Australia, and within that around 35,000 that sponsor 457 visa holders (ABS 2015b; Azarias et al. 2014).

[244] The Australian Government did not support two of the Review's recommendations which were to expand the list of nationalities not required to meet the English language requirement; and abolish labour market testing (DIBP 2015d).

Box 21.1 Factors contributing to migrant workers' vulnerability to exploitation

Several submitters to the inquiry outlined factors that make migrant employees particularly vulnerable to exploitation by employers. In particular, submitters mentioned migrants' limited English language skills and lack of support were key factors. The Salvation Army wrote:

> Many clients were tempted to and sometimes accepted [substandard conditions] due to barriers they faced in obtaining legitimate work and affordable housing. These barriers include limited English, lack of transferrable skills, and social isolation. (sub. 190, p. 7)

The Federation of Ethnic Communities' Councils of Australia also commented:

> Factors which contribute to [migrants'] vulnerability and lack of bargaining power include lack of familiarity with a new culture and customs and lack of English language proficiency. (sub. 69, p. 1)

Employers may take advantage of some migrant workers' poor understanding of their workplace entitlements, which can be compounded if entitlements and systems are different from those in workers' countries of origin. On this matter, the Federation of Ethnic Communities' Councils of Australia said:

> Newly arrived workers often do not have an understanding of their entitlements under the Australian workplace relations scheme including the National Minimum Wage or National Employment Standards. These workers are also not aware of enforcement mechanisms that exist including the services provided by the Fair Work Ombudsman. (sub. 69, pp. 2–3)

Australian Council of Trade Unions mentioned:

> [U]nscrupulous employers know that these workers' knowledge of their workplace rights is often limited and their bargaining position is weakened by their visa status. (sub 167, p. 58)

Footscray Community Legal Centre also commented:

> People of refugee background may have past experiences and cultural understandings of legal systems and authority figures, which deter them from seeking advice or enforcing their rights. (sub 143, p. 7)

Some submitters also suggested that migrant workers may be reluctant to challenge their employer for fear of losing their sponsorship, or losing their income as they may be in debt or financially supporting their family in their country or origin. Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church in Australia said that:

> Migrants may go into significant debt to pay these fees, which renders them more willing to accept substandard conditions in order to earn money … Employers can hold the offer, genuine or not, of eventual sponsorship for [permanent] residency in return for migrants' compliance with substandard or exploitative working conditions. (sub. 227, p. 4)

The Federation of Ethnic Communities' Councils of Australia also noted:

> Migrant and refugee workers often bear the heavy responsibility of providing financial support for family in their country of origin. (sub. 69, p. 1)

- providing streamlined processing for low risk employers, taking account of past sponsor behaviour, among other factors. The reduced compliance burden from streamlining creates incentives for employers to behave scrupulously.

Any such initiatives should cover all employment-related visa classes and may substantially address the employment problems affecting current visa holders.

In addition, more should be done to ensure new migrant workers are aware of their workplace rights and entitlements upon arrival to Australia or approval of their visa, as this reduces the likelihood of them accepting substandard working conditions. Currently, all migrants workers are provided with information when they begin work, but this does little to prevent a migrant worker from accepting substandard working conditions, particularly as unscrupulous employers are unlikely to provide employees with information on their workplace rights. Some migrant workers, upon visa approval, are also directed to websites which contain information about their workplace rights along with other information about their visa and about living in Australia, more broadly. Ideally, all migrant workers should be given information about their workplace rights upon receiving their approved visa. This could be, for example, in the form of a leaflet if a visa is approved in person or by mail, or through online correspondence if a visa is approved online. At a minimum, details of migrant workers' rights and conditions should be provided with any other information normally given to a migrant worker on visa approval or when they enter Australia.

Further, the FWO should explore ways to improve enforcement, with better resourcing. Currently, the FWO has a risk-based approach to monitoring which identifies employers more likely to offend, such as those with a history of unlawful behaviour or that operate in industries where such behaviour has been common over time. They also share some information with other Departments including the Department of Immigration and Border Protection and the Australia Taxation Office. Despite this, the exploitation of migrant workers continues to occur. Providing additional resources to the FWO would improve monitoring by, for example, allowing it to hire more workplace inspectors or enhancing information sharing with other Departments. This would improve the likelihood of discovering instances of exploitation.

Migrants working in breach of the Migration Act

In addition to permanent and temporary migrant workers, it is estimated that at least 50 000, and possibly in excess of 100 000, migrants are working in Australia in breach of the Migration Act (Howells 2011). These migrants either do not hold a valid visa to be in Australia, have overstayed the term of their visa, or are breaching a visa condition by working. Examples include people working on a visitor visa, or overseas students who work more than 40 hours in a fortnight.

Migrants who work in breach of the Migration Act have limited access to workplace rights and entitlements, because under current case law, they are not covered under the FW Act and are therefore ineligible for the minimum wage and the provisions of the National Employment Standards. The FWC decided in Smallwood v Ergo Asia Pty Ltd[245] that an employment contract entered contrary to the Migration Act is 'invalid and unenforceable', implying the FW Act cannot cover migrants breaching the Migration Act. They also face significant penalties, such as deportation, for breaching the Migration Act.

245 *Smallwood v Ergo Asia Pty Ltd* [2014] FWC 964 [14 February 2014].

Formally bringing these migrants into the national WR system could lead to legal and economic complications. Since the FW Act only covers workers in valid employment contracts and the Migration Act does not recognise the validity of agreements made by those in breach of their visa conditions, broader legislative changes would be required to reconcile the two Acts. Moreover, the guarantee of appropriate pay and conditions associated with enhanced workplace rights may cause more migrants to seek work in breach of their visa conditions. There may be benefit, however, in clarifying within the FW Act that it does not cover migrants who work in breach of the Migration Act. Clarification will allow the FWO and Department of Immigration and Border Protection to provide clearer information to all visa holders' about the workplace rights of those that breach the Migration Act, hopefully reducing their incentive to work in breach of their visa conditions.

Despite the formal absence of workplace rights and entitlements under the FW Act, there are penalties under the Migration Act intended to dissuade employers from employing workers without the correct visa. Individual employers can face fines of up to $51 000, and corporations can face fines of up to $255 000, for each of these migrants that they employ (DIBP 2015b). Employers can also be imprisoned for up to five years. Directors can face penalties if a company commits the offence.

Since workers in breach of their visa have limited access to workplace rights, and face penalties under the Migration Act, they have less incentive to self-report or complain about their situations than other workers. This deprives enforcement agencies of a major tool for identifying breaches[246] and, as it reduces the likelihood of finding exploitative employers, makes penalties under the Migration Act less of a deterrent for employers.

Some submitters to this inquiry have argued that the penalty regime currently in place does not effectively deter employers from taking advantage of migrants working in breach of the Migration Act (see, for example, Clibborn sub 26 pp 2-3), particularly where the benefit from exploitation is large or the chance of getting caught is low.

Once the exploitation is identified, under the current regime, the employer only pays the penalty under the Migration Act. They do not have to pay the difference between what the worker was actually paid and their minimum entitlements under the FW Act (as is the case when an employer has been found to have underpaid a worker with the right to work in Australia). This peculiarity of the regime means that, for an employer not meeting their minimum obligations, it may actually be *cheaper* to target workers who do not have an appropriate visa.

A solution for eliminating this incentive would be to close the gap between any benefit from underpaying migrant workers in breach of their visa conditions and the cost imposed by a penalty under the Migration Act.

246 The FWO does not have a separate approach for identifying workers who may be in breach of their visa conditions. Rather, and as noted earlier, it targets workers who are at risk of underpayment irrespective of their visa status. To this end, it incorporates a risk-based approach and targets problem industries and repeat offenders.

In practice, this would require that any penalty have two components. It would need to incorporate both:

(a) a fine or a punishment for breaching the Migration Act; and

(b) a fine equal to at least whatever the worker was underpaid over the duration of their employment.

While (a) is current practice, the introduction of (b) would reduce the circumstances under which it may be beneficial to exploit migrant workers. It should comprise both unpaid wages and the value of any entitlements they were eligible for, but not permitted to access. Upon recovery from the employer, (b) could not, however, be given to the worker as compensation, as this would only strengthen any incentives for the worker to work in breach of their visa conditions.

The two-part penalty should be high enough to deter employers from engaging in unlawful behaviour. This may require a higher maximum penalty under the Migration Act, and that employers are fined a multiple of the amount that the worker is underpaid. The implication of this proposal is that an employer may face higher penalties from underpaying a worker in breach of their visa than under the FW Act more generally. However, this difference is warranted because, as noted previously, the diminished threat of finding exploitative employers from the complaints of affected workers means there is an added incentive for employers to take exploitative actions.

In the event that an employer is found to have breached the Migration Act, the FWO should provide advice on the appropriate size of the penalty as a part of the standard applications process. Since the FWO generally conducts these assessments for cases brought to the FWC, not only would they bring considerable expertise, but it would make the fines consistent across all workplaces. If a two-part penalty is not specifically included in the Migration Act, the presiding judge in a court case should include consideration of any underpayment in a penalty they impose.

Since any penalty is likely to be included in the Migration Act, and its magnitude determined by the FWO, this would necessitate closer co-operation between the Department of Immigration and Border Protection and the FWO. There are likely to be benefits from further co-ordination, particularly where there is currently duplication of efforts or where one organisation can undertake some of the investigative duties of the other at reasonably low cost. For example, it may be efficient for the FWO to ask about workers' visa statuses in the course of their investigations into the payment of wages and the provision of conditions.

DRAFT RECOMMENDATION 21.1

The Fair Work Ombudsman should be given additional resources for investigation and audits of employers suspected of underpaying migrant workers (including those in breach of the *Migration Act 1958* (Cth)).

The Migration Act should be amended so that employers can be fined by at least the value of any unpaid wages and conditions to migrants working in breach of the Migration Act, in addition to the existing penalties under the Act.

22 Transfer of business

Key points

- The transfer of business provisions in the *Fair Work Act 2009* (Cth) protect the terms and conditions of employees when a business (or asset) changes hands, or when an in- or outsourcing arrangement occurs.
- Unless an order for an exemption or a variation is obtained from the Fair Work Commission, employees transferring to a national system employer retain the terms and conditions of their previous employment.
- There is some concern that these orders may be difficult to obtain without the approval of, or without disadvantaging, the affected employees.
  - To the extent this is the case, it may prevent some benefits accruing to the broader community or, in some instances, lead to a disinclination on the part of the new employer to take on either the business / asset or the transferring workers
- The provisions also make it difficult for employees to transfer voluntarily between associated businesses.
  - This should be rectified by statutorily exempting voluntary transfers from the transfer of business provisions.

The transfer of business provisions in the *Fair Work Act 2009* (Cth) (FW Act) protect the terms and conditions of employees when a business changes hands. For the purposes of the FW Act, a transfer occurs when:

- an employee's employment has terminated
- within three months, the employee has become employed by a new employer
- the employee's work is substantially the same as the work they performed for their previous employer; and
- there is a connection between the two employers resulting from the new employer using some or all of the old employer's assets, the work from the old employer being outsourced to the new one, work previously outsourced to the old employer being insourced to the new one or the two employers being associated entities under the *Corporations Act 2001* (Cth) (FWO 2015j).

Under these circumstances, the terms and conditions that covered the employee at their previous employment continue to cover the employee at their new employment, provided they are detailed in an instrument that can be transferred along with the business. 'Transferrable instruments' include awards, enterprise agreements, individual flexibility arrangements, and workplace determinations among others (WorkplaceInfo 2015b).

The transfer of business provisions in the FW Act were examined as a part of the post-implementation review of the FW Act (the Fair Work Review) in 2012. The Fair Work Review ultimately recommended:

> … [t]hat s. 311 be amended to make it clear that when employees, on their own initiative, seek to transfer to a related entity of their current employer they will be subject to the terms and conditions of employment provided by the new employer (McCallum, Moore and Edwards 2012, p. 25).

This recommendation was not picked up by the government at the time. Instead it made other amendments to the provisions in the FW Act.

The *Fair Work Amendment (Transfer of Business) Act 2012* (Cth) (Fair Work Amendment) expanded these provisions by ensuring that when there was a transfer of business from a state system employer to a national system employer,[247] transferring employees would retain their existing terms and conditions of employment. The amendment achieved this by creating a new federal instrument that would copy the employee's terms and conditions of employment from the relevant State award or agreement, ensuring that these new instruments interacted with the other aspects of the FW Act (including the National Employment Standards) and enabling the Fair Work Commission (FWC) to make orders over transfers of business in these circumstances.

At the time the amendment was legislated, no regulatory impact assessment was undertaken. As a result, a post-implementation review of the amendment was undertaken by the Department of Employment (Department of Employment 2015). The Productivity Commission understands that although the review is complete, it is yet to be released publicly by the Government.

There appears to be a vein of discontent with how the FW Act treats transfers of business. A number of submissions to this inquiry painted these provisions in a unfavourable light (box 22.1). Moreover, just under a third of the 254 businesses surveyed by the Australian Human Resources Institute responded that the impact of these provisions was either negative or strongly negative. This was around three times higher than the proportion who considered the impact positive or strongly positive.

This chapter explores some of the concerns with the transfer of business provisions. It examines whether they disincline an employer to take over a company or an asset, or take on the previous employer's employees (section 22.1), the effect of the Fair Work Amendment (section 22.2) as well as how the provisions apply to employees who change jobs voluntarily (section 22.3).

[247] Prior to 2012, the provisions in part 2-8 of the FW Act applied only to transfers of business between national system employers.

Box 22.1 Selected comments on transmission of business provisions

A number of inquiry participants argued that the transfer of business provisions in the FW Act make it harder for investors to turn around struggling businesses. As a result, in some cases, they can act as a deterrent to much needed investment. The Australian Mines and Metals Association argued:

> … [t]he current transfer of business rules are acting as a disincentive to employment by imposing foreign and inflexible [workplace relations] arrangements from previous businesses, including bureaucratic public sector entities, onto new businesses, preventing them from being more efficient than the old (sub. 96, p. 341).

Bluescope Steel concurred. It submitted:

> … [t]here are circumstances where provisions in an enterprise agreement have contributed to poor business performance, and the present provisions of the Act that preserve the agreement, combined with the fact that it would remain in force after its nominal term (if not replaced by agreement) are a major disincentive to a prospective buyer. The outcome can be business failure and the loss of jobs, instead of the possibility of an acquisition and turnaround and maintenance of jobs (sub. 58, pp. 8–9).

Several participants noted that the transfer of business provisions, as they are currently written, 'do not necessarily serve to secure employment of transferring employees or safeguard better terms and conditions because they may act as a disincentive to take on existing workforces' (Australasian Railway Association, sub. 155, p. 9). Given public sector awards and agreements have traditionally been more favourable than those in the private sector, this often occurs when public sector entities are privatised, or their functions outsourced to the private sector. The Chamber of Commerce and Industry of Western Australia submitted that:

> … [a]s part of the amendments to the [Fair Work] Act in 2013, the transmission of business provisions were extended to provide that state instruments transfer where government services are outsourced. Our discussion with employers affected by these provisions has revealed that they have a very clear policy of not engaging any existing employees. This is due to the incompatibility between public sector agreements and the operation of private sector organisations. This inevitably means loss of employment for these workers (sub. 134, p. 69).

Other participants noted the inefficiency of having to make an application for the Fair Work Commission to prevent the transfer of instruments where the employee has moved between associated entities voluntarily. Qantas submitted that:

> … [u]nder the FW Act, Qantas has been required to make numerous costly and resource intensive applications to the FWC for orders to prevent the transfer of instruments in these circumstances. In some cases, staff have lost opportunities as a direct result of these provisions because of the time periods involved in seeking union cooperation in any approach to the FWC. No Qantas application has been rejected; equally each application takes considerable resources to process for what, in all cases, are voluntary moves. It is a clear example of the FW Act working to restrict flexibility (sub. 116, p. 14).

Asciano agreed. It noted that these provisions 'cause considerable complexity when our employees seek to access opportunities within other employer members of the Asciano group, and therefore have the potential to restrict career progression and redeployment opportunities within the group' (sub. 138, p. 13).

A number of participants advocated large scale changes, such as the reinstatement of the provisions that were in place prior to the FW Act, including the Australian Chamber of Commerce and Industry (sub. 161, p. 166) and the Master Builders Association (sub. 157, p. 69), or greater protections for employees, such as the Australian Council of Trade Unions (sub. 167, p. 110) and the Australian Services Union (sub. 128, p. 18).

22.1 The effects on employment

Transfer of business provisions offer protection to transferring employees, but where the terms and conditions of work with the previous employer exceed those offered by the new employer, they may provoke some issues.

Submitters to this inquiry have argued that the cost of taking on employees *and* their previous terms and conditions may disincline a new employer from taking on these workers, or even dissuade them from acquiring the asset altogether. In these extreme cases, the provisions may cost some employees their jobs (box 22.1).

Even where they decide to take on some transferring employees, there are costs for business. In addition to higher unit labour costs, there may be issues with productivity and morale associated with having multiple instruments covering the same workforce. Differences in the nominal expiry date of the agreements can also lead to multiple, costly agreement negotiations.

However, the FW Act makes provisions for these issues. Both employers and employees can apply directly to the Fair Work Commission (FWC) for an order to exempt an employee (or a group of employees) from a transferable instrument (s. 318), or to vary a transferrable instrument (s. 320).[248] This contrasts with proposed variations to enterprise agreements which require the approval of the affected workforce via a vote prior to approval by the FWC (chapter 15).

The decision of the FWC whether or not to approve an application for exemption or variation is guided by a number of criteria. These include several that explicitly reference the productivity and economic circumstances of the new employer, as well as the degree to which the transferrable instrument works alongside the other instruments in operation at the new workplace (box 22.2).

Applications can be made in advance of likely transfers, or at some point after the transferrable instrument has come into effect (FW Act and Australian Council of Trade Unions sub. 167, p. 3), providing a measure of certainty for a business looking to effect a transfer of business and employees.

These provisions are not infrequently used. Since 2009, 366 applications have been brought under s. 318 in addition to 36 under s. 320, indicating a broad awareness of their usefulness. In most instances, they seem to be used in conjunction with the transfers of small numbers of employees.

248 The language of the FW Act in regard to s. 320 actually provides for a 'person' to make an application, while s. 318 explicitly references employers and employees. However, it appears s. 320 does not preclude employers from making an application as in at least one instance 'person' has been taken to include a corporation (*B C Meale Pty Ltd* [2010] FWA 7964).

Box 22.2 Criteria guiding decisions on transferrable instruments

When deciding on the merits of an application for an exemption (under s. 318) or an application for the variation of a transferable instrument (under s. 320), the *FW Act 2009* (Cth) directs the Fair Work Commission to take into account:

- the views of the employer (or likely employer) and the affected employees
- whether any employees would be disadvantaged by the order or the variation to their transferrable instrument
- the nominal expiry date of any agreement (if the order or the transferable instrument relates to an enterprise agreement)
- whether the order or transferrable instrument would have an adverse effect on the productivity of the new employer
- whether the new employer would incur significant economic disadvantage
- the degree of synergy between the transferable instrument and any workplace instrument that already covers the new employer
- the public interest.

Source: *FW Act 2009 (Cth)*.

However, while, in principle, sections 318 and 320 provide a way for employers to address issues arising from transferrable instruments, there are some questions about the effectiveness of these provisions.

In particular, it appears that few applications have been approved without the support of the affected employees, or at least without some indication that it would not disadvantage them. At least one decision[249] suggested that:

> … [i]f no employee were to be disadvantaged as a result of a s. 318 order, then more weight could be given to factors such as the views of the employer and matters of productivity, cost and business synergy (Catanzariti et al. 2014, p. 386)

This test may represent a threshold for approving an application. However, while it may be useful as a rule-of-thumb, there are risks associated with regarding this approach as an unwritten yet rigid rule.

While protecting transferring employees is the primary focus of the transfer of business provisions, it should not occur at all costs. As discussed in detail in chapter 4, excessively generous entitlements do not come for free. They can adversely affect employment, consumer prices and future wage increases. As a result, there may be some instances where the cost to the employee of exempting them or varying a transferrable instrument yields greater (yet possibly more diffuse) benefits to the broader community.

249 *Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia* [2010] FWA 1171.

There can also be impacts on behaviour. If this threshold is recognised by new employers, not only might they be dissuaded from making applications (even where they offer net benefits), but, more importantly, they might also baulk at taking on transferring employees with cumbrous terms and conditions of employment in the first place.

It may force employers to procure consent in other ways. On at least one occasion, an employer procured the consent of the employees and their union by making the offer of employment conditional on the approval of an exemption. The application was approved by the FWC, but other influential factors contributed to the decision (including the benefits to the employees from shifting from labour hire work to permanent employment) (Catanzariti et al 2014 and *Whitehaven Coal Mining Ltd* [2010] FWA 1142).

In light of these concerns, the Productivity Commission would welcome more information on the ease (or otherwise) of obtaining exemptions from the transfer of business provisions and variations to transferrable instruments, including how the criteria for approval are weighted by the FWC.

22.2 Transfers of business between state and national system employers

While transfers of business between national system employers are more common, transfers of business can also occur between state and national system employers. This occurs when businesses or assets are sold, or when outsourcing arrangements occur, between state governments (with the exception of Victoria) or 'non-constitutional corporations' in Western Australia and businesses who operate in the national workplace relations system.

The most commonly cited application of this is the privatisation of a state-owned asset or corporation (however a significant proportion of these undertake trading or financial activities and, as a result, fall into the national system anyway).

In these instances, the Fair Work Amendment augments the transfer of business provisions in the FW Act by protecting the workplace terms and conditions of state system employees who, by virtue of a transfer of business, are forced into the national system. Where these employees join the new employer in a role that is largely a continuation of their previous work, they are entitled to keep the terms and conditions from their state system employer.

Since the provisions work in a similar way for all transfers of business (irrespective of whether the old employer was in the state or national system), the major distinction between concerns about the Fair Work Amendment and those about the provisions contained in the FW Act more broadly appears to be the scale of any problem.

In particular, adverse effects may be more pronounced in transfers from the state system because state public service awards and agreements are typically more generous than those

covering private sector businesses in the national system.[250] Moreover, the work practices contained in these instruments may be incompatible with work in the private sector. As a result, the prospect of employees transferring with their pay and conditions in tow may reduce a new employer's willingness to offer positions to the old employer's workforce. To this effect, the Australian Chamber of Commerce and Industry noted that:

> … [t]hese transfer of business provisions materially impact the potential for efficiency gains, and the state public sector employers' decisions about whether to retain, transfer, re-size or redirect of close. A clear impact of the amendments is to reduce the likelihood that the new business service provider will engage former state public sector employees. This particularly affects the least specialist of displaced public sector employees (sub. 161, p. 154).

The Australia Services Union noted that if no employee transfers with the business, the previous state system instrument no longer applies. Where a state-owned enterprise is partly privatised, this could lead to two workforces working side-by-side on wildly differing terms and conditions (sub. 128, p. 18).

In this sense, it is difficult to obtain the full benefits of privatisation and outsourcing — the reduced cost of providing goods and services to the community — without jeopardising either the jobs or the terms and conditions of those formerly employed by the state-owned enterprise. Assuming the state-based instrument is particularly generous, the less flexible the provisions, the greater the threat of job losses.

To the extent that this is a widespread issue, there is a spectrum of potential policy solutions.

- One extreme is to leave the provisions as they are, and rely on the mechanisms discussed in the preceding section (applications for variations or exemptions) to resolve any egregious disparities.[251] This would continue to protect wages and entitlements, but at the cost of some jobs.
- At the other extreme is removing the part of the FW Act that relates to the transfer of entities from the state system to the national system. This would limit the adverse impact on jobs, but the employee would then be incorporated into the national system award or agreement that covers the new employer.
- Alternatively, there may also be scope to offer the employee the chance to opt out of their previous instrument in order to secure employment with the new employer (without having to apply for an exemption). But this option may allow an employer to obtain the consent of the workforce to reduced pay and conditions by threatening not to take them on.

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250 This issue is most keenly felt when the potential gains from restructuring are the greatest, or when formerly state-owned enterprises with generous industrial instruments move into the national system. It is less of an issue for two national system employers whose industrial instruments reference similar awards and who likely share similar work practices, wages and entitlements.

251 These include applications to either vary a transferrable instrument or to exempt employees from a transferable instrument.

Clearly, each of these options has drawbacks. The choice of policy option depends largely on the scale of the problem. However, the Productivity Commission is not aware of any data that may substantiate or refute the claim of widespread job losses attributable to the Fair Work Amendment, and would welcome more information in the regard.

22.3 The 'nuisance' cost when workers change work voluntarily

When an employee transfers between two associated employers, the transfer of business provisions in the FW Act mean that the employee will keep the terms and conditions from their previous employment *unless* the new employer makes an application to the FWC for an exemption or a variation. This is the case even if the employee makes the decision to switch jobs voluntarily.

Applying transfer of business provisions to voluntary switches ignores three considerations. These are that voluntary employee movements between associated employers are not uncommon, applications for exemptions involve costs to all parties and that barriers may make it less likely for employers to consent to any switch.

Employees change jobs for several reasons. In situations where the employee wants to make a change for reasons other than dissatisfaction with their employer (locational preferences, for example), one of the easiest ways of achieving a change is via a transfer between associated employers.

Moreover, some industries have only a few key players, each with a number of associated entities. This means that, for some employees, it can be difficult to find work in their chosen profession outside the umbrella of their current employer. For example, Qantas has several subsidiaries (including Jetstar, Eastern Australia Airlines and Sunstate Airlines) with their own industrial instruments, so, for pilots and flight crew, finding work with a company not associated with Qantas can be challenging.

While there is little empirical data on employee movements between associated entities, qualitative arguments such as these suggest that they are not uncommon. As a result, the provisions, as they are currently written, have the potential to effect a large number of employers and employees.

As noted previously, there are also unavoidable costs associated with obtaining an exemption for a voluntarily transferring employee. This is because it requires the preparation of documentation, coordination with the employee, the consultation with the relevant unions and attendance at a hearing before the FWC, meaning that employers need to commit resources to what is generally described as a fairly automatic process.

Despite the apparent ease of obtaining an exemption for a voluntary transfer, in some situations the employer may try to avoid the cost by refusing to facilitate such moves.

Where this occurs, employees are prevented from switching jobs even when they consider it to be in their best interests.

While there are benefits from exempting voluntary transfers between associated entities from the transfer of business provisions, these need to be set against any disadvantages of legislative changes.

The concern is that a change may weaken protections for other workers because some employers may respond by transferring employees, denying them their previous terms and conditions of employment and claiming the change of jobs was at the employee's instigation. Upon investigation, however, it appears the incentives of employers would remain unchanged were the provision to be amended. They would gain a defence — that the transfer was voluntary — in the face of claims that they had provided the incorrect entitlement, but this could be limited in statute to employees who initiated the switch. This removes the process of applying to the FWC. But, employees' rights of recourse remain. Transferring employees that know that they are to keep the entitlements from their previous employment could prompt swift investigation and enforcement by the Fair Work Ombudsman, while employees who are not aware of their rights rely on the employer to deliver them the correct terms and conditions — the same as is implied by the current provision.

Given that there is likely to be benefits to businesses and transferring employees, but little effect on involuntarily transferring employees, the Productivity Commission supports the recommendation of the Fair Work Review (McCallum, Moore and Edwards 2012) that an employee's terms and conditions of work not be transferred to their new employment when the change is at their own instigation.

RECOMMENDATION 22.1

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that an employee's terms and conditions of employment would not transfer to their new employment when the change was at his or her own instigation.

23 International obligations

Key points

- The International Labour Organization's International Labour Standards are intended to be a benchmark for countries' labour laws, and mainly consist of international conventions.
  - Australia is not obliged to ratify a convention and usually only does so when it aligns with existing domestic laws.
  - Australia's current approach is reasonable as it assesses the national interest of ratification, taking into account the costs of adjusting domestic laws and any benefits to Australia from raising standards in other countries.
- Some of Australia's preferential trade agreements contain labour provisions requiring Australia to uphold core labour standards, such as eliminating forced and child labour.
  - Australia's domestic laws are in line with these labour standards, and the legal system effectively enforces them.
  - When deciding whether to include labour provisions in a preferential trade agreement, the Government should carefully assess whether they are net beneficial.

Australia's commitment to international standards can influence the national workplace relations (WR) system. In particular, some argue that Australia should align labour laws with the International Labour Organization's (ILO's) International Labour Standards, and adjust labour laws following trade negotiations. Both are discussed below.

23.1 International Labour Standards

While labour laws generally vary from country to country, the ILO[252] provides a common reference point through its International Labour Standards. Several participants considered these standards as a benchmark for labour laws, with the Australian Council of Trade Unions noting:

> International Labour Standards can, if properly enforced be a useful method of lifting the minimum standards of employment for workers both domestically and abroad. (sub. 167, p. 22)

252 The International Labour Organization (ILO) is a specialised United Nations agency that focuses on labour issues, aiming to improve employment opportunities, outcomes and conditions (ILO 2015a). The ILO operates a 'tripartite' system, which consults with governments, workers and employers as a part of its work.

The Australian Institute of Employment Rights also said:

> It is from within the tradition of seeking social justice, and by that avoiding the devastation that injustice wreaks, that the AIER submits the ILO [standards] remain important benchmarks for assessing the workplace relations system. (sub. 140, p. 8)

The standards consist of international treaties (conventions) and recommendations that are non-binding guidelines. The standards assist countries when drafting their labour laws. As at July 2015, the Australian Government had ratified 58 of the 189 conventions, roughly in line with Australia's peers (figure 23.1) (DFAT 2014; ILO 2015).

Australia is not obliged to ratify a convention and may choose to only ratify a part of a convention.[253] Nor is the Australian Government required to align its domestic laws with ratified conventions or other recommendations (DFAT 2014).[254] This differs from other countries, such as the United States, which are more legally bound by conventions (and which partly explains the United States' low level of ratification).[255]

While the standards are, in many cases, useful points of comparison for domestic WR laws, the development of a convention or a recommendation by the ILO does not necessarily mean that it is in Australia's best interests to automatically comply. Australia has a framework for ratifying international treaties which allows it to make an informed decision on whether to ratify a convention (see box 23.1) Ultimately, this rests on whether the benefits of any change exceed the costs.

In most cases, Australia ratifies conventions when they are consistent with existing domestic laws (DFAT 2014).[256] Because laws do not need to change, the costs of ratifying these conventions are low and ratification itself could be described as largely symbolic, reinforcing a commitment to certain labour standards.

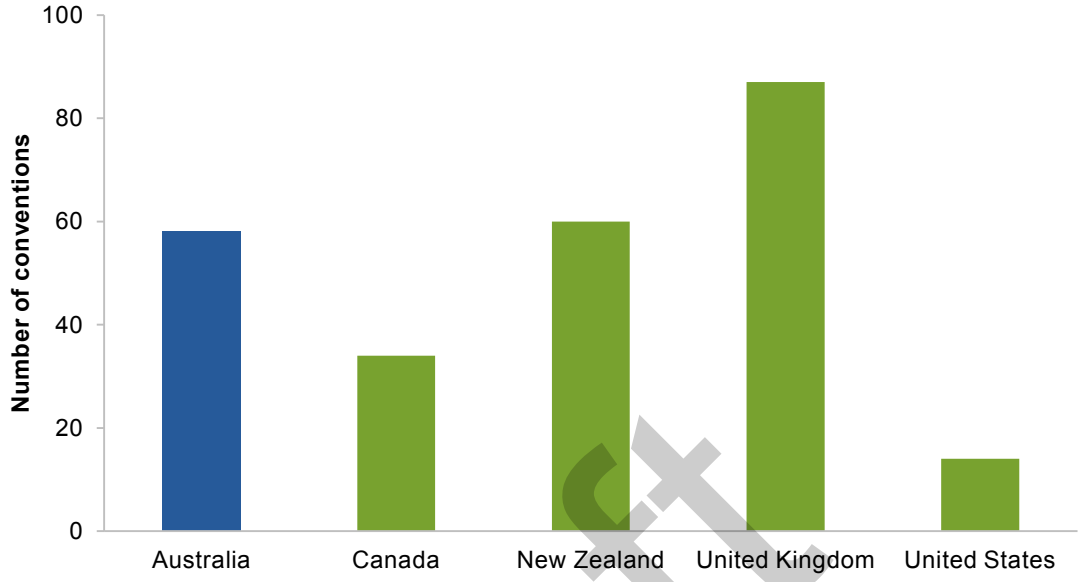
253 Australia, like all other members countries of the ILO, are effectively signatories to all ILO conventions. As a signatory, the Australian Government expresses its willingness to examine the treaty. Ratification is a commitment to implement the convention domestically, such as by incorporating it into laws or court decisions. Formally, it occurs when a Australia communicates its commitment to the ILO Director-General.

254 The ILO can request Australia to amend its laws if they breach a ratified convention, but it has limited power to implement more punitive measures. The ILO does not make any requests about unratified conventions or recommendations.

255 Unlike in Australia where a ratified convention needs to be implemented into domestic legislation for it to bind, ratified conventions in the United States are binding in their own right.

256 The Commonwealth may also ratify a convention in order to override states' and territories WR laws, which it can do under the external affairs power in the Constitution (Stewart 2013). For example, the Commonwealth ratified the *Termination of Employment Convention* in 1993 without formal agreement from the states and territories. Once ratified, the Convention applied to *all* Australian employers irrespective of whether they were previously a national system employer or not. The Commonwealth has other means of overriding states' and territories' laws apart from the external affairs power, such as through the corporations power in the Constitution.

Figure 23.1 **Number of ILO conventions ratified by country** [a,b]



[a] Includes all conventions that have been ratified including denounced conventions and those currently not in force.

Source: International Labour Organization (2015).

There may be benefits from symbolic ratifications. For instance, the Walk Free Foundation and the Salvation Army commented:

> … ratification of [the *Domestic Workers Convention, 189*] would have important symbolism in the Asia Pacific region, home to some 21.5 million domestic workers. Ratification would allow Australia to step forward as a regional leader within South East Asia, and serve as an example of best practice as efforts are made to strengthen national responses to abuse of domestic workers within the ASEAN region (sub. 156, p. 2).

More generally, there is a broad body of research that considers when it may or may not be in a nation's interests to export its own labour standards (Nankivell 2002).

Domestic laws are often *not* aligned with international conventions. This is because either the convention targets a concern yet to be fully addressed by lawmakers, or it prescribes standards at odds with community norms. In either event, the Government faces a choice between meeting the proposed international standard or maintaining the status quo.

While the merits of some standards are clear (such as eliminating child prostitution), for others the difference between the benefits and costs of any change is not so obvious. Assessments of the relative merits of a standard can vary from nation to nation, depending on what each nation considers appropriate. This means that a global consensus may be unachievable for some standards, with standards adopted by some countries, but not others. A good example of the dilemmas is the longstanding question of whether Australia should ratify the ILO's *Minimum Age Convention, 1973* (see box 23.2).

Box 23.1 Australia's Framework for Ratifying International Treaties

The Australian Government decides whether to ratify an international treaty (including a convention). In theory it can do so without consulting Parliament. For some urgent issues, this can substantially accelerate the process of ratification, but, more generally, doing so reduces public scrutiny of a treaty and the decision to ratify it.

In practice, however, the Government rarely ratifies a treaty without Parliamentary consideration. There are several processes that allow this:

- Treaties proposed for ratification are tabled for review in both Houses of Parliament and are accompanied with a National Interest Assessment produced by the relevant Department. The Assessment outlines the treaty's benefits and costs, the obligations arising from it, and the implementation process. When a treaty is tabled, Senators and Members of Parliament can raise and discuss their concerns.
- The Joint Standing Committee on Treaties (JSCOT) also reviews each tabled treaty. The JSCOT includes Members of Parliament and Senators from the Government, Opposition, and minor parties, and operates for the term of the Government. It invites submissions and conducts public hearings to inform their decision and usually reports within 15-20 sitting days of the treaty being tabled. The JSCOT presents their assessment of the proposed treaty in a report to the Parliament, including a recommendation on whether the Government should ratify it. The Government usually responds to the Committee's recommendations.

In addition to these processes, ratified international treaties are only binding if domestic laws and practices reflect the treaty conditions. In most cases, legislation needs to be passed for this to occur. This allows for Parliament to further scrutinise the domestic effects of an international treaty. More generally, Australia's practice is to ratify a treaty only once domestic laws are aligned with it.

Australia's processes are similar to some other countries. The Governments of New Zealand and Canada can also ratify treaties without consulting Parliament, but common practice in both countries is to table them in Parliament before ratification. The United Kingdom had a similar procedure until 2010 when it passed legislation requiring treaties to be tabled, and specifying that a treaty could not be ratified if either House resolved that it should not be. In the United States, international treaties need to be passed through the Senate with a two-thirds majority.

In 2015, the Senate Standing Committee on Foreign Affairs, Defence and Trade examined Australia's treaty-making process. One of its recommendations was that Parliamentarians and the JSCOT be granted access to draft treaty text during negotiations. At the time of publication of this draft report, the Government had not responded to the Committee's recommendations.

Sources: Department of Foreign Affairs and Trade (2014), Parliament of Australia (2015a).

Box 23.2 Minimum Age Convention

The Australian Government has not ratified the *Minimum Age Convention, 1973*, which prescribes a minimum working age of 15 and permits light work for children aged at least 13 (with some exceptions for developing countries). The Convention is one of the ILO's eight 'fundamental' conventions that focus on workers' rights and conditions. 167 of the ILO's member countries have ratified the Convention, and countries that have not include the United States, New Zealand and Canada.

There is no universal minimum working age in Australia. For example, New South Wales does not have a set minimum employment age, while Queensland's minimum working age is 15 with some exceptions (FWO 2015i). However, current labour laws generally adhere to the Convention's principles by ensuring children do not forego school for work and are not forced to work in inappropriate workplaces (Creighton 1996). There are now national consistent laws on the minimum school age and leaving age, and policies in all jurisdictions to retain students at school until year 12. Safe work practices are principally covered by OH&S laws.

Advocates suggest that ratifying this convention will better protect children against unsafe work practices, as well as improve Australia's international credibility on labour issues, particularly when addressing labour rights issues in the Asia Pacific region (ACTU 2013; DEEWR 2013; The University of Adelaide 2013). To ensure Australia's laws meet the principles of the convention, advocates propose listing exemptions upon ratification with the ILO to cover all situations where children are legally allowed to work in Australia but do so in breach of the convention. By listing exemptions, advocates suggest that Australia's domestic laws would not need to change in order for the convention to be ratified.

Critics argue that the exemptions are unlikely to cover all situations where children work, and Australia may breach the convention leading to compliance costs (ACCI 2013). Compliance costs could arise from adjusting different states' laws to be more in line with the convention, and preventing some families and children from earning, despite it being of apparent benefit (such as paper runs for pocket money, and working on the family farm and in family businesses). The Australian Bureau of Statistics found 175 100 children aged under 15 worked in 2005-06 (ABS 2006).

In 2013, the Australian Government proposed ratifying the convention, tabling it in Parliament which initiated a Joint Standing Committee on Treaties (JSCOT) inquiry examining the convention (Parliament of Australia 2015b). However, with the change in Government, the inquiry lapsed before the JSCOT could report and the Government could make a final decision on ratification.

23.2 Preferential trade agreements

Of Australia's nine active trade agreements (commonly referred to as free trade agreements or FTAs), those with the USA, Chile and Korea specify labour provisions (table 23.1).[257] Each of these require both countries to uphold the *ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up (1998)* which, among other things, stipulates the elimination of forced and child labour. The US and Korean agreements also require that each country ensures any repeated labour law breaches do not affect bilateral trade.

Table 23.1 **Australia's trade agreements**[a]

Active	*Signed* [b]	*Under negotiation*
ASEAN-Australia-New Zealand FTA	China-Australia FTA	Australia-Gulf Cooperation Council FTA
Australia-Chile FTA		Australia-India Comprehensive Agreement
Australia-New Zealand Closer Economic Relations		Environmental Goods Negotiations
Australia-United States FTA		Indonesia-Australia Comprehensive Economic Partnership Agreement
Japan-Australia Economic Partnership Agreement		Pacific Agreement on Closer Economic Relations (PACER) Plus
Korea-Australia FTA		Regional Comprehensive Economic Partnership
Malaysia-Australia FTA		Trade in Services Agreement
Singapore-Australia FTA		Trans-Pacific Partnership Agreement
Thailand-Australia FTA		

a Information is as at July 2015. **b** Signature means both Australia and China have agreed to begin domestic processes to make the agreement active (see box 23.1 for details of Australia's process).

Source: Department of Foreign Affairs and Trade (2015).

These provisions have little impact on Australia's WR Framework. Australia's domestic laws are in line with the principles of the ILO Declaration, with Australia ratifying seven of the eight conventions that underpin it, while Australia's laws uphold the principles of the eighth (see box 23.2 on the Minimum Age Convention). In addition, Australia's legal system effectively handles and resolves labour law breaches, which means that other countries are unlikely to be concerned with Australia's enforcement of laws.

257 The Korean and China-Australia agreements also include some concessions on visa requirements for migrants from these countries to Australia, such as the removal of labour market testing for some visa applicants. However, while these concessions may affect the labour market, they do not affect the functioning of the WR system, with all migrant workers being entitled to the same rights as Australian citizens under the Fair Work Act.

In the rare case that Australia does breach a labour provision, only the agreement with the United States allows for dispute settlement measures. These include the establishment of a panel to resolve the issue when informal discussions fail. In cases when a breach cannot be rectified, Australia can be asked to pay a fine; and although Australia's domestic laws do not enforce payment of the fine, non-payment can have adverse implications for trade and other aspects of Australia's relationship with the United States.

Should Australia include labour provisions in its bilateral and regional trade agreements?

Some participants in the inquiry are concerned that the absence of labour provisions in Australia's agreements do little to reduce poverty and may weaken workplace conditions (Maritime Union of Australia, sub. 121, p. 15).

Deciding whether to include labour provisions requires considering their impact on counterparty countries and Australia, which may be at odds with each other. Adherence to core labour standards can lead to economic and social benefits, but the net effects may not always be positive (PC 2010a). Some may be benign, but of little effect:

- As its domestic laws uphold the core labour standards and will be in line with the proposed provision (as is the case with the provisions included in its some of its recent agreements), most proposed labour provisions will not impose any costs on Australia, but will equivalently not produce any obvious domestic benefits
- Countries' compliance with labour standards through trade agreements may sometimes have little prospect of affecting the wellbeing of the other countries' workforce, particularly in developing countries where a large share of workers are in the informal or domestic sectors. Moreover, measures, such as technical or financial assistance, are more likely to be effective in enhancing living standards with fewer adverse effects.

However, some proposed provisions may require Australia to adjust its WR laws. The Government should examine these provisions on a case-by-case basis, assessing a provision's impact against the broader benefits from the trade agreement and the views of the Australian community. In some cases, the adjustments may be in line with the community's view and may not be costly, but in others, the community may oppose the provision, which could be burdensome or weaken Australia's workplace laws. In these latter cases, Australia and its counterparties need to carefully assess whether the inclusion of such provisions provide net benefit.

24 Interactions between competition policy and the workplace relations framework

Key points

- The workplace relations system is largely exempted from Australian competition law.
  - But some provisions still apply, including in relation to secondary boycotts, anticompetitive contracts or understandings in the supply or purchase of goods and services, and resale price maintenance.
- There is a strong policy rationale that the regulation of labour markets should continue to be separated from the regulation of other markets for goods and services.
  - Competition policy and the workplace relations system have both complementary and competing objectives that must be balanced.
  - There are ethical and social factors that separate the labour market from more conventional markets.
  - Collective action, which is generally limited by competition policy, is a core principle of the workplace relations system.
- Concerns about anticompetitive behaviour in employment matters appear to be mostly capable of being addressed through the workplace relations system itself, rather than through an expansion of competition policy.
  - While using competition law to regulate the workplace relations system would create more regulatory consistency between labour and goods markets, such consistency would not justify the associated transactions costs, uncertainty and complexity.
  - However, there is a case for incorporating principles of competition and efficiency into aspects of the workplace relations system.
- Secondary boycotts are a problematic area at the interface of the two legal systems.
  - Concerns about misuse of secondary boycotts appear to lie primarily in the construction industry. A solution may be to allow Fair Work Building and Construction, as the industry regulator, to obtain evidence, while leaving the Australian Competition and Consumer Commission to determine if action is then warranted. More information is sought on what may be a complex proposal.

While the *Fair Work Act 2009* (Cth) (FW Act) and its two main institutions are the centrepiece of Australia's workplace relations (WR) system, Australian competition policy — enshrined in the *Competition and Consumer Act 2010* (Cth) (CCA) and administered by the Australian Competition and Consumer Commission (ACCC) — represents a

complementary (and potentially competing) limb of that system. Various commentators have described WR policy and competition policy as 'neither married nor divorced' (Anderson 2003, p. 2) or as 'Siamese twins, unhappily separated at birth' (Litwinski 2001, p. 50).

This chapter is about the regulatory interactions between competition policy and the WR system in Australia — it does not directly address any alleged or proven illegal anticompetitive outcomes. The chapter first describes the nature and extent of the current interactions between the WR system and competition policy. Second, it discusses the similarities and differences between these laws, and whether there are any grounds for widening the capacity of competition policy to address anticompetitive behaviour in the labour market. Finally, it explores possible improvements to existing competition policy settings that currently influence the WR system.

24.1 How does competition policy currently interact with the WR system?

The WR system is largely exempted from competition law

The role of competition policy in Australia's WR system is limited. Section 51(2)(a) of the CCA generally excludes matters relating to the negotiation and determination of terms and conditions of employment from the restrictive trade practices provisions of the Act. This means that the ACCC cannot take action against anticompetitive conduct by employees and their representatives (or by industry associations) relating to wage claims or other employee benefits. The practical outcome is that WR is largely excised from competition law.

WR law permits some degree of anticompetitive conduct by unions and employer associations, and offsets it by constraining the exploitation of market power (for example, employers must still comply with the National Employment Standards, and only some forms of industrial action are lawful).

But competition law still applies to some employment-related activities

While s. 51(2)(a) broadly exempts WR matters from prohibitions on anticompetitive practices, some sections of the CCA — namely 45D, 45DA, 45DB, 45E, 45EA and 48 — apply. These sections relate to prohibitions on secondary boycotts; anticompetitive contracts, arrangements or understandings in the supply or purchase of goods and services; and resale price maintenance. Of these prohibitions, the two that interact most with the WR system — and attract some debate — are the provisions relating to secondary boycotts and anticompetitive arrangements.

Secondary boycotts

Section 45D of the CCA contains provisions prohibiting secondary boycotts. In the WR context, secondary boycotts occur when two or more people (such as union officials and/or employees) hinder or prevent a third party from: supplying goods or services to a business; acquiring goods or services from a business; or engaging in interstate or overseas trade or commerce; where the target business is not the employer of those people imposing the boycott (NCC 1999). This can be contrasted with primary boycotts (commonly known as strikes), which are a refusal by a group of employees to perform work for the employer that they are in a dispute with. Strikes are not prohibited by the CCA and they are expressly authorised in some circumstances, under the FW Act (chapter 19).

Secondary boycotts target third parties that are not directly involved in the dispute. By involving third parties, the harmful effects of a dispute are magnified across the community, to serve the interests of a single party. They also have the capacity to entrench the market power of larger players, as larger firms or unions will generally have greater capacity to exert pressure on third parties. As noted recently by the Competition Policy Review, 'secondary boycotts are harmful to trading freedom and therefore harmful to competition' (Harper et al. 2015, p. 387).

The provisions in the CCA prohibiting secondary boycotts are complex, involving many tests. Among other factors, the prohibition only applies where the main purpose of the action is not related to remuneration or the working conditions of the employees (s. 45DD). Thus a secondary boycott would be permissible under the CCA if its purpose was to increase wages of employees working for the employer (even if the action led to major costs for suppliers and customers). However, such actions might remain subject to penalties under the FW Act and the common law — for example, depending on whether protected industrial action has been authorised — so s. 45DD may only cut off one option for legal action against secondary boycotts.

Anticompetitive contracts in the supply or purchase of goods and services

Sections 45E and 45EA of the CCA prohibit a person from making, or giving effect to, a contract, arrangement or understanding with a group of employees that contains a provision that has the purpose of preventing or hindering the person from supplying (or acquiring) or continuing to supply (or acquire) goods or services to (or from) a second person that the first person has been accustomed, or is under an obligation, to supply (or acquire), or doing so subject to conditions. Some employer groups have expressed concern about recent court decisions[258] that have determined that enterprise agreements fall outside the scope of these provisions, allowing terms restricting the hiring of services such as independent contractors to be included in enterprise agreements. This is primarily addressed in chapter 20.

[258] For example, *Australian Industry Group v Fair Work Australia* [2012] FCAFC 108 (the ADJ Contracting case).

24.2 Competition policy and the WR system have commonalities and divergences

Market power is a major concern of both systems

Competition policy and the WR system have some features in common and others that are quite divergent. Both give an emphasis to the power of parties to influence the terms of any contracts they form with each other. However, the expression of these concerns sometimes differs.

Competition policy is primarily aimed at protecting and promoting effective competition between participants within markets. The CCA's stated objective is 'to enhance the welfare of Australians through the promotion of competition and fair trading and provisions for consumer protection'. This involves prohibiting anticompetitive conduct, such as price-fixing between market players or the abuse of market power by a dominant player, while at the same time permitting conduct that is pro-competitive (or more efficient) even at the cost of market disruption; and providing firms and consumers with clear, simple and predictable regulations (Harper et al. 2015; World Bank and OECD 1999).

An important feature of competition policy, and more specifically the CCA, is that it is not intended or designed to protect individual competitors. In fact, the rigorous competitive processes supported by Part IV of the CCA may well result in businesses downsizing or leaving a market. As the ACCC states:

> Competition law must strike a balance between, on the one hand, preventing business activities that undermine the competitive process, and on the other not inhibiting healthy rivalrous behaviour that is part of the ordinary cut and thrust of robust competition. (ACCC 2014c, p. 8)

The WR system is also concerned with market power, but the predominant goal is to address the unequal bargaining power between an employee and their employer, rather than between two businesses, or a business and consumers. The concern is that unequal labour market bargaining power can lead to the undesirable suppression of wages and conditions, a tolerance of poor workplace health and safety arrangements, and contract insecurity. Many facets of the WR system are intended to address the various dimensions of this bargaining imbalance — such as safety net provisions, employee protections, and arrangements that provide countervailing power, such as collective bargaining and the scope for lawful industrial disputes.

In principle, it might be possible to conceive of a competition policy approach to workplace relations, based on authorisation of collective bargaining and regulated price-setting. This is examined below. The degree to which this is overwhelmed by the practical regulatory structures and social objectives of the WR system is an important consideration.

The thresholds for action to address market power vary

Competition policy tolerates some market power provided it is not entrenched, high or based on the creation of cartels. Indeed, the merciless goal of an enterprise to gain market share at the expense of its competitors through better business strategies, higher product quality and innovation are regarded as positive features of competition. Regulations do not discourage high prices for new goods, and indeed in some cases are facilitated by patents and other intellectual property protections. The CCA generally does not use regulatory means to facilitate countervailing power to offset the efforts of one business to gain an advantage over a rival (as the WR system does).[259] In this context, the bar for regulatory action against the exertion of market power in goods markets is high in competition (and complementary) policies. Notably, there is a requirement under s. 46 of the CCA that regulatory action should only be taken if the firm has a 'substantial degree of power'.

Unlike competition policy, in labour markets there is a lower level of tolerance by the community of moderate and perhaps less enduring market power by businesses, and the overarching competitive drive by a business to lower its total wages bill is not a consideration. Associated with this is a different judgment about the likelihood of unequal bargaining power. The presumption of the CCA is that it is rare (or rare enough in any material sense), whereas the presumption in the FW Act is that, if unregulated, it would be common. Understandably, the two sets of laws adopt different processes depending on the risks of some outcomes, both of which may not otherwise serve the public interest well.

The mechanisms to address market power are different

In the WR system, the main strategies for achieving more balanced bargaining power are:

- regulated minimum conditions
- empowering employees, through their representatives (primarily unions), to exercise countervailing power against an employer that holds bargaining power (with a set of rules about how such negotiations must proceed and with limits on what can be negotiated away). The regulator itself does not largely (now) act as the mediating party or determine the outcome of the negotiations.

The CCA principally leaves businesses to make their decisions as they feel fit, with the regulator acting on an 'exceptions' basis. In limited areas only, there are prescriptive rules about the day to day interactions of businesses with other businesses or consumers, or the prices they may charge (telecommunications being an example). The bulk of monitoring

[259] There is one notable exception, in that the CCA permits small businesses to collectively bargain with a supplier or customer. The ACCC has permitted small business group bargaining in areas as diverse as dairy farming, vegetable growing, hotels and concrete carting (ACCC 2012, p. 16). However, permission must occur through the authorisation or notification process, and is therefore not automatic. In addition, an important test is that collective bargaining must result in a public benefit (for example, through more efficient bargaining) or otherwise lead to lower prices or greater variety.

and enforcement is undertaken by the ACCC which steps in to address situations where a party has misused their power or otherwise engaged in actions that breach the CCA.

As noted above, there is one limited area where competition law permits businesses to act collectively in their dealings with other businesses, but this is highly restricted. The CCA allows micro-businesses and professions a circumscribed right to collectively bargain with a supplier or customer. For example, this allowed general practitioners to engage in intra-practice price setting and collective bargaining with state and territory governments in relation to the provision of certain services. However, the capacity for collective action is not a blanket provision that permits such conduct generally. As an illustration, the ACCC sought undertakings that a group of doctors negotiating with a regional hospital not seek common prices where this was accompanied by the threat of collectively withdrawing services if that price was rejected (ACCC 2011b, p. 24). In this instance, collective action was seen as anticompetitive.

Moreover, authorisation of collective bargaining under competition law in the limited circumstances it occurs is quite different from that in the FW Act.

- Parties that collectively bargain under the CCA have to *prove* that such bargaining is in the public interest. The CCA only allows collective bargaining where the parties are authorised or notified by the ACCC. The decisive test is that the collective arrangements must result in a public benefit (for example, through more efficient bargaining) or otherwise lead to lower prices or greater variety (ACCC 2011a, 2011b; King 2013). It is therefore still subject to a fundamentally economic test. The presumption therefore in the CCA is that collective action between parties ('cartels') should generally be prohibited, even if that means overlooking the inequalities in bargaining power that can often arise between firms.
- In the FW Act, the onus of proof is reversed. Enterprise bargaining is an objective of the Act and the Fair Work Commission is expected to allow bargaining to proceed unless certain circumstances prevail (chapter 15). The FW Act recognises that *unfettered* collective bargaining could be anticompetitive, but the way in which this is addressed is through proactive regulatory measures that attempt to preclude it, rather than through ex post penalties if it occurs as under the CCA. For example, there are legal remedies against parties that try to coerce people to join unions ('adverse action'); union membership is voluntary and there can be multiple employee bargaining representatives; industrial disputes must follow certain rules; and there is competition from other non-regulated sources of labour (such as contractors, though, as discussed further below, this is an area where the Productivity Commission recommends pro-competitive strengthening to reduce constraints in the competitive forces posed).

The labour market exemption in the CCA seeks to reconcile the conflict between the use of collective action to address the likelihood of unequal bargaining power between an employer and employee, and competition policy, where the presumption is that collective action is more likely to be anticompetitive.

The concerns of the WR system go beyond efficiency

Competition law, as noted earlier, is not for the most part interested in individual competitors, their welfare or the minimum standard of their reward. It is acceptable to society that they may go broke. The same is not true of labour. The FW Act has a wide set of objectives — some of them non-economic, and, depending on the circumstances, parts of the objective can take precedent over other parts (chapter 1).

As discussed in chapter 1 (and above), there is a human dimension to labour that means that the market for labour does not always operate in the same way as markets for goods and services. The outcomes of labour markets (unlike those of most goods and service markets) are not just about economic performance; they also involve ethical and social considerations. For example, while competition policy generally emphasises the importance of firms entering and exiting markets, there can be significant personal and social costs associated with workers losing their jobs. Competition policy is mostly unconcerned about distributional issues.

Similar observations were also made by numerous inquiry participants (Australian Council of Trade Unions [ACTU], sub. 167; Australian Institute of Employment Rights, sub. 140; Andrew Stewart and others, sub. 118; Shop, Distributive and Allied Employees' Association [SDA], sub. 175). As noted in the Productivity Commission's Review of National Competition Policy Reforms, labour market outcomes also have 'a significant impact on equality of opportunity, the stability of family relationships and social cohesion more generally' (PC 2005c, p. 354).

Some inquiry participants also suggested that the exemption from competition policy is not unique to employees, arguing that while employer firms themselves comprise a collective of capital in the form of shareholders, such collective behaviour is also overlooked by competition policy (ACTU, sub. 167; David Peetz, sub. 133; SDA, sub. 175).

Treating labour differently is not unique to Australia

The separation of WR matters from competition law is not unique to Australia. Similar exemptions are in place in the United States, the United Kingdom, Canada and New Zealand.

In the United States the *Sherman Antitrust Act 1890* regulates concerted employer activity in the labour market only where the activity restrains the product market. While the Sherman Act was 'intended to promote only product market competition … the courts had permitted the Act be used as a weapon against unions and it was this perversion of congressional intent that required legislative correction' (Jerry and Knebel 2014, p. 194).

The *Clayton Act 1914*, was designed to withdraw the power of the United States Federal Courts to regulate labour through antitrust laws. Section 6 of the Clayton Act states that:

> … the labour of a human being is not a commodity or article of commerce … nothing contained in the antitrust laws should be construed to forbid the existence and operation of labour … organizations, instituted for the purposes of mutual help … or to forbid or restrain individual members of such organizations from lawfully carryout the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws.

Section 20 prohibits federal courts from enjoining certain specified acts 'involving or growing out of a dispute concerning terms and conditions of employment' and contains a clause making such acts lawful, notwithstanding any other legislation (Altman 1982).

Canada's *Competition Act 1985* also exempts labour union activities. Section 4(1) of the Act states that 'Nothing in this Act applies in respect of (a) combinations or activities of workmen or employees for their own reasonable protection as such workmen or employees'. It also exempts employer associations for collective bargaining purposes (s. 4(1)(c)).

Likewise, New Zealand's *Commerce Act 1986* exempts employment contracts: agreements relating to employees' wages, salaries or working conditions (s. 44(1)(f)).

A number of reviews into Australian competition policy have concluded that the existing exemption is warranted because labour markets are only partly comparable with other markets (Harper et al. 2015; Hilmer, Rayner and Taperell 1993; NCC 1999). For example, when the National Competition Council (NCC) reviewed the exemption for labour arrangements under s. 51(2), it concluded that the benefits (to the community as a whole) of the restriction on competition outweighed the costs, including that:

> Section 51(2)(a) … allows practices to occur which are permitted under labour laws but in breach of Part IV of the TPA. This supports a public policy, observed both nationally and internationally, that labour markets are generally treated differently to markets for goods and services. This policy is reflected in the mechanisms and institutions in place … international agreements relating to labour that recognise collective bargaining and the exemption of employment matters from competition laws in comparable countries. (NCC 1999, p. 41)

This inquiry has found no strong argument against the general exemption in submissions or in other sources. Specific exemptions are, however, another matter.

24.3 Competition policy cannot subsume the WR system

In summary, notwithstanding some of their congruent goals, there are strong reasons for separating (many aspects of) the WR system and competition policy. Repealing s. 51(2) of the CCA would represent a dramatic shift in Australia's WR system and would underplay some of the important differences between the systems. This inquiry finds, as the NCC did in 1999, that the social policy grounds for retaining a separate WR regime are clear.

In practical terms, the sheer volume of employment agreements and arrangements that would otherwise need to be authorised or notified if s. 51(2) of the CCA was repealed would suggest significant transaction and compliance costs (Andrew Stewart and others, sub. 118).[260] Removing the exemption would also create some uncertainty around the application of Part IV to employment arrangements. Authorisation from the ACCC would only be obtained if the agreement or arrangement could be shown to be in the public interest — some inquiry participants have argued that this public interest test is 'ill-suited to a labour relations framework in which collusive conduct plays a central role' (Andrew Stewart and others, sub. 118, p. 21).

As noted by Anderson, the repeal of s. 51(2) would affect employer organisations as much as unions (both would be subjected to the general prohibitions on collective organisation).

> The complete removal of the exclusion in 51(2)(a) may prevent what is wholly justified and indeed necessary — the capacity of employers to meet together and determine policy, strategy and representation over employment matters that have impacts across industry and across employers or that are imposed by governments, parliaments, unions or industrial tribunals across industry or across employers. And the same applies to unions. (Anderson 2003)

Both employee and employer organisations, expressed opposition to such a repeal on various grounds (Australian Mines and Metals Association [AMMA], sub. 96; Australian Education Union [AEU], sub. 63; SDA, sub. 175). While removing the exemption would mean regulatory consistency across product and labour markets, using the CCA would appear to be a 'blunt' instrument for addressing concerns about anticompetitive behaviour given the distinctive features of the labour market (as discussed above).

Further, while the authorisation and notification processes in the CCA allow for the determination of whether a group should be *allowed to* bargain collectively, it provides little insight into *how* the parties should bargain. Thus (again on practical grounds) using the CCA to regulate WR would either lead to a loss of these procedural rules, or require such rules to be enshrined within the CCA, leading to greater complexity. It would also lose some of the on-the-ground information that informs negotiations under the FW Act. In essence, the FW Act empowers another agent (typically a union) to address bargaining imbalances and that is also close to the specific employer and worker. This can produce efficient outcomes at lower costs, and can take account of the specific context of the business and its employees. The risks of overreach by this agent are then controlled through a host of regulations.

260 Currently the CCA does not empower the ACCC to grant block exemptions. The Competition Policy Review (Harper et al. 2015) recommended that exemption powers based on the block exemption framework in the United Kingdom and European Union should be introduced to the CCA to supplement the authorisation and notification frameworks (largely in respect of non-employment matters). In principle, a block exemption process might reduce the transaction costs of dealing with large numbers of employees, but this would not overcome the need to have a thorough public benefit test, nor address some of the other deficits of the CCA in dealing with employment matters.

While the Productivity Commission considers that the reach of competition laws should not be further expanded into the employment space, there is a case for increasing the prominence of competition policy *principles* in the framework of the WR system itself. Exclusion from competition laws should not preclude WR regulation being informed by principles of competition and efficiency — especially as this would also improve the consistency of regulations across labour and product markets, while still remaining separate. This notion was also supported by a number of inquiry participants (Australian Petroleum Production and Exploration Association, sub. 209; Minerals Council of Australia, sub. 129).

Indeed, as outlined in chapter 1, one of the focuses of this inquiry is to identify reforms to the WR system that appropriately balance principles such as competition and efficiency with the other goals of the WR system. A standalone WR framework that holistically accommodates these competing goals is preferable to a chimeric approach that attempts to shoehorn provisions from the CCA into WR issues.

24.4 Are there gaps in the WR system that allow anti-competitive conduct

While there is a strong case for regulating labour markets differently to other markets for goods and services, what continues to be questioned is the appropriate balance between the two broad regulatory systems. In particular, some claim that the anticompetitive detriment of particular arrangements may sometimes outweigh the labour law policy objectives. For example, while noting the differences between product markets and labour markets, a former Chair of the Productivity Commission questioned whether the lack of scrutiny around particular restrictions on competition in the labour market was justified:

> Industrial relations regulation has generally been regarded as falling outside the purview of competition policy altogether and, secondary boycotts aside, union activities are largely exempt from the anticompetitive conduct provisions of the Competition and Consumer Act. The basis for this has been that labour markets are more complex than product markets and involve a significant human dimension. And these points are correct. But are they good reasons for foregoing scrutiny of whether the benefits of particular restrictions on competition and other regulatory measures in the labour market exceed the costs and, where they do, whether they are the best way of achieving those benefits? (Banks 2012, p. 8)

Anderson also argues that the industrial relations exclusion should not be misused by allowing anticompetitive provisions in agreements:

> It should not be the case that an industrial exclusion for the legitimate policy purpose of allowing for an orderly system of minimum standards and collective bargaining to exist, should be misused by allowing the inclusion in agreements (particularly unregistered agreements) anticompetitive provision that undermine the public interest, or economic efficiency or even the interests of parties affected by the agreement. (Anderson 2003).

In cases where one party is able to exert substantial market power, the use of an employment arrangement could raise concerns about unreasonable constraints on competition and costs to the community. Some of the costs to the community of such behaviour could include: higher prices for consumers in the short term caused by the higher labour costs of a non-competitive labour market; fewer people employed because of higher labour costs; and lower economic growth (NCC 1999, p. 61).

The ACCC reported to the Harper Competition Policy Review that on certain occasions it investigates allegations of anticompetitive conduct involving employee organisations, usually relating to interactions between such organisations and other businesses. For example, the ACCC recently investigated allegations of anticompetitive conduct involving Toll and the Transport Workers Union. However, the ACCC noted that in many cases 'a threshold consideration is whether or not the conduct at issue falls within the 'employment exemption' of Part IV' (ACCC 2014a, p. 5).

The specific concerns and which Act should address them

Numerous stakeholders expressed concern to the Harper Competition Policy Review about the use of terms in enterprise agreements to limit the capacity of employers to hire independent contractors (Ai Group 2014b; AMMA 2014; MBA 2014). They argue that such terms conflict with the intended purpose of ss. 45E and 45EA, and constitute an anticompetitive restriction on business-to-business activity. Similarly, Ai Group (2014b) previously advocated that industrywide pattern agreements should be outlawed by modifying s. 51(2)(a) to exclude industrywide pattern agreements from the exemption.

The Competition Policy Review (Harper et al. 2015) noted these concerns and agreed that the conflict between the CCA and the WR system should be resolved. The Review recommended that ss. 45E and 45EA be amended so that they expressly include awards and enterprise agreements (except to the extent they deal with the remuneration, conditions of employment, hours of work or working conditions of employees). This would extend the reach of competition policy into the WR system, and would prohibit restrictive terms on contractors in enterprise agreements by subjecting them to the CCA.

As outlined in chapter 20, this inquiry prefers to resolve concerns related to independent contractors directly via s. 194 of the FW Act, which sets out unlawful terms that cannot be included in an enterprise agreement. Broader alterations, such as those proposed via amendment to the CCA, would raise the prospect of unintended consequences.

Similarly, pattern bargaining would be best dealt with directly in the WR context where it arises. In chapter 15, the Productivity Commission has sought further input from inquiry participants on how the FW Act can constrain coercive pattern bargaining (for example, in the construction industry), while still allowing the voluntary use of template agreements to lower bargaining costs.

The difficulties in finding the right legislative framework for alleviating anticompetitive conduct in WR are further illustrated by the swinging statutory pendulum for consideration of secondary boycotts. Secondary boycotts first found a home in the *Trade Practices Act 1974* (Cth) in 1977, only to be evicted into WR legislation in 1993, and then re-housed in competition law in 1996, where it has stayed ever since.

The presumption in favour of adapting the FW Act rather than resorting to a broader role for generic competition law is that any change is likely to involve substantial compliance problems, legislative complexity and uncertainty, and regulatory challenges. A broad exemption for employment matters from competition policy provides clarity for parties about the legal framework that applies to them. Selectively reinserting competition policy into employment matters through specific exclusions from the exemption could reduce clarity and undermine the abilities of these separate policy frameworks to achieve their own objectives. Further, such a shift would require the ACCC to actively involve itself in regulating the WR system — this is likely to create a confusing and duplicative regulatory environment. Some inquiry participants also questioned whether the ACCC possesses the expertise or capacity to fulfil a role in regulating labour markets (Andrew Stewart and others, sub. 118; SDA, sub. 175).

Secondary boycotts

Secondary boycotts are an apparent exception to the general rule of locating core employment issues in the WR Act. The provisions dealing with these matters are at least conceptually well placed in the CCA, given that they involve third parties external to the employee-employer relationship. Secondary boycotts can involve non-WR matters, such as interactions between multiple firms, or between firms and consumers.

Some stakeholders criticised the existing secondary boycott provisions as they apply to WR matters, on the grounds that they do not currently provide adequate exemptions for secondary boycotts and sympathy strikes by unions (ACTU, sub. 167; AEU, sub. 63). These stakeholders argue that Australia, as a signatory to International Labour Organization (ILO) conventions, should feel obliged to observe existing conventions recognising the rights of trade unions to be able to engage in secondary and sympathetic industrial activity.

Being a signatory to ILO conventions is not, on its own, a sufficient justification for changes to laws prohibiting secondary boycotts. Such conventions are not legally binding unless Parliament chooses to enact domestic laws to bring them into effect (chapter 23), thus any inconsistencies do not present problems from a legal perspective, and there is little evidence that organised labour is unable to find alternative ways to express its support for causes wider than the workplace relationship.

In contrast, there are strong perceptions in sections of the business community, particularly in the construction sector, that there is inadequate enforcement of secondary boycott provisions. Recent high-profile cases have further shaped these perceptions (see box 24.1).

Various submissions to the Competition Policy Review have raised questions about the appropriate reach and enforcement of the secondary boycott provisions of the CCA and the degree to which even applicants and respondents understand their application (ACTU 2014; AMMA 2014; Lloyd 2014; MBA 2014). For example, Lloyd (2014) claims that the secondary boycott provisions are 'essentially ineffectual' due to inadequate enforcement.

The ACCC has commented that while there was a view in the business community that there were a large number of complaints regarding secondary boycotts, in reality the ACCC received very few complaints in this area. While some have alleged that the ACCC does not take enforcement action in response to the complaints they receive, the ACCC responded that they will enforce such complaints where there is sufficient evidence. The Chair of the ACCC, has stated 'when we go and talk to people and they do not want to provide us with that evidence, there is very little we can do' (Sims 2014, p. 24).

Box 24.1 Disputes between the CFMEU, Grocon and Boral

Business' perceptions of the secondary boycott provisions of the CCA have been formed against the background of the widely reported dispute between the Construction, Forestry, Mining and Energy Union (CFMEU) and Grocon, which resulted in the CFMEU preventing Boral Concrete from entering construction sites in the Melbourne CBD.

In response, Boral sought legal action against the union and injunctions were issued by the court to halt the secondary boycott. However, Boral has also told the Royal Commission into Trade Union Governance and Corruption that the injunction has had no effect and the company is unable to secure work in the Melbourne CBD.

The ACCC has commenced proceedings in the Federal Court against the CFMEU, alleging that the union has engaged in secondary boycott conduct against Boral.

Sources: Kane (2014); ACCC (2014b).

It appears that there are barriers to the enforcement of the current law in some cases, but its location in the CCA seems to be the lesser of these. The status quo may be problematic in several respects. For example:

- the imputation is that there may be cases of genuine secondary boycotts that are not disclosed because people fear the consequences for their businesses.
- the FW Act specifies matters that are unlawful in enterprise agreements. A union would not be able to take protected action in respect of unlawful terms, nor could an agreement with such terms be registered by the Fair Work Commission. Yet secondary boycotts might be able to circumvent this restriction in some circumstances.
- action under the secondary boycott provisions is seen as cumbersome and difficult to carry through successfully.

As McClelland has observed:

> Section 45D of the CCA is a significant coercive weapon in the area of industrial disputation. However, it would be overly simplistic for those who would seek to rely on s 45D to assume that it will achieve a direct hit in all cases. While s 45D will inevitably receive attention during intense industrial campaigns, the reality is that the proceedings are extremely complex and require careful preparation. (2014, p. 51)

The exemptions that currently exist under s. 45DD(1) and s. 45DD(2), which make a secondary boycott permissible under the CCA if its purpose is to increase wages of employees, may be worth querying. As noted previously, penalties can still exist for such actions under the common law and the FW Act, but this does not necessarily justify an exemption under the CCA — indeed, a desire for regulatory consistency might suggest that such actions should also be prohibited by the CCA. However, it is possible that incidental secondary boycotts may also occur in the course of otherwise conventional protected industrial action. It would be inconsistent with the purpose of allowing access to protected industrial action — a core purpose of the FW Act — to remove a part of the careful balance between the parties to most negotiations simply because of misuse in a few cases. Given these concerns, the Productivity Commission seeks further input from inquiry participants on the merits and risks of any possible changes to s. 45DD(1) and s. 45DD(2).

There may be more practical remedies to any concerns about secondary boycotts. The recent Competition Policy Review found that there was no sufficient case to change the relevant provisions, but recommended more vigorous enforcement (Harper et al. 2015).

The issue for the ACCC appears to be obtaining sufficient evidence to effectively prosecute secondary boycotts. The complaints received about secondary boycotts appear to centre largely on the construction industry. If this is indicative of a localised (even if serious) problem, the solution may not lie in a change across the full gamut of WR. It is possible that the powers of Fair Work Building and Construction to compel witnesses to provide evidence could be applied, by giving Fair Work Building and Construction shared jurisdiction with the ACCC to investigate secondary boycotts within the construction industry. Having obtained evidence, the ACCC would then be able to take action. A similar approach was also recommended in submissions to the Royal Commission into Trade Union Governance and Corruption (Boral 2014).

An advantage of this approach is that parties or activities that are potentially in breach of the secondary boycott prohibitions can also be the subject of other concurrent investigations by Fair Work Building and Construction into potential breaches of WR laws (ACCC 2014a). It would leave intact the general responsibility of dealing with all forms of secondary boycott via the appropriate mechanism, but address the core issue — obtaining evidence — via another mechanism. That said, given that such a change may add to complexity, the Productivity Commission would prefer to gather further comment and evidence before taking a final position.

INFORMATION REQUEST

The Productivity Commission seeks further input from inquiry participants on whether the secondary boycott prohibitions in the Competition and Consumer Act 2010 (Cth) should be amended to:

- *amend or remove s. 45DD(1) and s. 45DD(2)*
- *grant Fair Work Building and Construction a shared jurisdiction to investigate and enforce the secondary boycott prohibitions in the building and construction industry.*

25 Compliance costs

Key points

- Compliance costs of interest to this inquiry go beyond those costs that might reasonably be required to meet the objectives of the workplace relations system — that is, the focus is on the wasteful incremental costs rather than total compliance costs.
- Complexity is a major source of compliance costs in the regulatory framework. Most parties find the system complex.
- Unnecessary compliance costs tend to manifest as increased leadership and management time to comply with obligations or the added expense of seeking external advice. As a result, compliance costs can displace more productive activities.
- Small businesses and unions are less able to bear this compliance burden and in exceptional cases it can reduce resources that may be used to assist union members or improve businesses.
- Two previous regulatory analyses suggested that regulatory costs under the *Fair Work Act 2009* (Cth) were expected to be transitional in nature, but concerns persist. Businesses have provided data and anecdotes to this effect but data also suggest that the compliance burden is decreasing. Despite this overall perception, the available data are not informative of the incremental costs to businesses.
- The compliance burden on unions appears mainly to have been transitional in nature, but some ongoing concerns remain. Further data are sought from unions.
- The effectiveness of regulators (the Fair Work Ombudsman and the Fair Work Commission) in overseeing how the workplace relations system is implemented is critical to minimise compliance costs. Both regulators are proactive and strategic in seeking to manage their caseload.
- The Australian Government has introduced the Regulator Performance Framework from 1 July 2015 as part of its commitment to reduce the cost of unnecessary or inefficient regulation imposed on individuals, businesses and community organisations. Subject to further evidence, the Productivity Commission considers that the new Framework and recommendations proposed in this inquiry, effectively implemented, are likely to meet the specific concerns raised.

For most businesses employment costs are their largest expense. As well as the direct costs of employing staff (such as wages and on-costs), the costs to comply with employment laws and other parts of the workplace relations (WR) system are necessarily a part of doing business and to provide adequate protections for employees. However, where workplace regulations are poorly designed or implemented, these compliance costs can outweigh the benefits to compliance (such as reducing adverse outcomes for employees or the risk of penalties to employers). In such cases, this leads to the needless imposition of a compliance burden beyond that required to meet a policy objective.

Unions too can be victims of compliance burdens. Membership dues may be a declining revenue source in some cases, with falling membership overall, and the diversion of staff to handle compliance burdens will reduce a union's ability to service its members. Moreover, as more active users of parts of the regulatory apparatus, they have a familiarity with the system's strengths and weaknesses.

This chapter surveys the evidence on the compliance impact of the current system. The compliance impact of draft recommendations on specific areas of the WR system and the costs of regulatory distortions are considered in other parts of the report. Data used in this chapter include 2015 survey data provided by the Chamber of Commerce and Industry Queensland (CCIQ).[261]. The chapter also draws on the published results of past surveys by the CCIQ, the Australian Chamber of Commerce and Industry (ACCI) and the Australian Human Resources Institute (AHRI).

Section 25.1 provides a brief overview of regulatory compliance costs. Sections 25.2 and 25.3 examine whether and to what extent there are ongoing, unnecessary compliance costs for businesses and unions, and section 25.4 suggests how ongoing compliance burdens may be managed.

25.1 Sources of compliance costs

Compliance costs are incurred by businesses or other parties to undertake actions that are necessary to comply with their regulatory requirements (OECD 2014a).

Compliance costs of interest to this inquiry go *beyond* those costs that might reasonably be required to meet a particular objective of the *Fair Work Act 2009* (Cth) (FW Act) — that is, the wasteful *incremental* costs rather than total compliance costs. For example, a regulatory process may involve unnecessary steps for a business that tie up staff and other resources without any offsetting benefit to the business or its employees. For a union, this might be the time spent by union officials dealing with procedural requirements to fill out applications or other paperwork, or appear before the Fair Work Commission (FWC) when

[261] The CCIQ surveyed around 1000 small, medium and large businesses in February and March 2015 on a range of workplace relations issues, including indicators of the compliance burden on businesses. Findings from the survey data are also presented in its submission to the inquiry (sub. 150).

they could be undertaking other tasks for their members (such as consultations or inspections).

The following, which draws on the OECD's guide to assessing regulatory costs, indicates where compliance costs can arise.

Administrative burdens

These are the costs of complying with information obligations set out in government regulations, such as obligations to provide information and data to the public sector or third parties. The information does not actually have to be provided to incur a cost — administrative burdens include the costs involved in having information available for inspection or supply on request.

For businesses unnecessary costs can arise from redundant regulations, variations between regulations in definitions and reporting requirements and overlapping regulatory requirements (Regulation Taskforce 2006). For unions, these costs could include the time taken to record or document employer-union interactions during bargaining in order to demonstrate compliance with the good faith bargaining requirements.

Transitional costs

These are the costs from learning to operate under a new regulatory regime such as developing compliance strategies and allocating responsibilities for compliance-related tasks. These were examined in two regulatory analyses of the FW Act (discussed below).

Substantive compliance costs

These are the costs of generally dealing with regulation and affect both businesses and unions. They include:

- direct labour costs — the cost of wages paid and non-wage labour costs
- overhead costs — rent, office equipment, utilities and other inputs
- equipment costs — where purchased to comply with regulation (for example software)
- external services costs — where specific technical expertise is required.

To the extent that compliance activity is unnecessary, these costs will be higher than they need to be.

Assessing compliance costs

Generally, a full assessment of compliance costs would involve collecting relevant data, developing a base case for comparison (without the unnecessary compliance costs), and estimating the incremental compliance costs. However, the available data are limited and tend to relate to the costs of compliance without taking into account the offsetting benefits.

The CCIQ data used below to assess the impact of compliance on businesses assess the performance of the regulators — the Fair Work Ombudsman (FWO) and FWC. These bodies play a critical role in minimising compliance costs, particularly for small businesses. Regulators can add to compliance costs through ineffective communication, unnecessarily extensive reporting requirements, excessive numbers of inspections or audits (relative to compliance risk) and excessive prescriptiveness and rigidity in enforcement (PC 2013c).

25.2 Compliance costs were expected to be transitional in nature

Two previous analyses have considered the compliance costs imposed by the FW Act on businesses and trade unions compared to the system it replaced (WorkChoices). These reviews found that there were transitional costs of compliance for businesses and unions under the FW Act, but also that compliance costs should not raise any ongoing concerns.

A regulatory analysis was included in the explanatory memorandum to the Fair Work Bill 2008. The findings on compliance costs included that:

- while there would be a moderate increase in compliance costs associated with the national employment standards (NES), these would not impede the competitiveness and viability of businesses
- the new bargaining system was expected to generate some transitional costs but would ultimately provide net benefits
- removing the 100-employee exemption for unfair dismissal laws would significantly impact businesses under this threshold, but the Fair Dismissal Code was expected to minimise the burden for genuinely small businesses
- changes to the industrial action provisions were clear and improved the regulatory impact
- any regulatory burden placed on employers and employees by the creation of the new FWC should be minimal.

As the FW Act was exempted from regulatory review at the decision-making stage on the grounds of exceptional circumstances, the then Department of Education, Employment and

Workplace Relations conducted a post-implementation review in 2012 to meet best practice regulation requirements.

The post-implementation review examined compliance costs in the context of transitioning to the new WR system. The review found there were compliance costs associated with transitioning to the new system but that the costs would reduce over time and they were justifiable, bearing in mind the objects of the FW Act and the longer-term benefits.

25.3 Are compliance costs an ongoing concern?

The compliance burden on business

Data from the CCIQ 2015 survey of Queensland businesses suggest that the compliance costs associated with the FW Act are not as 'transitional' as the earlier analyses suggested would be the case. In contrast with the earlier analyses, the 2015 CCIQ survey results show compliance costs remain a significant concern for businesses (table 25.1). However, there is conflicting evidence about the compliance burden over time (see discussion on complexity below) and relative to other issues. While businesses perceive that the red tape and compliance cost burden has increased under the FW Act and modern awards (table 25.1), some survey data suggest that concerns about these costs are marginal compared to concerns about other costs of employment — particularly wage and penalty rates and the burden imposed by unfair dismissals (table 25.2).

Table 25.1 **Key indicators of the compliance burden on Queensland businesses[a]**

Indicator	*Business view*
Impact of the FW Act and modern awards on red tape	Increased
Impact of the FW Act and modern awards on the overall cost of compliance with the Fair Work Act	Increased
The extent to which complexity of the WR system is a cause for concern	Moderate concern

[a] Mean response to the survey questions. Responses have not been weighted by industry or business size.

Source: Productivity Commission estimates based on CCIQ data from its 2015 survey of Queensland businesses.

Table 25.2 **The top workplace relations issues nominated by Queensland businesses**[a]

Issue	*Responses (per cent)*
Wages	17
Penalty rates/overtime	15
Unfair dismissals/dismissals	15
Leave	5
Awards	4
Complexity and compliance	3
Red tape	1

[a] Percentage of all survey respondents who nominated a top workplace relations issue for their business (approximately 57 per cent of all respondents answered this question). The table does not include all responses below 4 per cent.

Source: Productivity Commission estimates based on CCIQ data from its 2015 survey of Queensland businesses.

Complexity

Complexity is a significant contributor to the compliance burden on businesses and arises from:

- technicality (the need for specialist knowledge)
- density (the number of rules)
- differentiation (the different instruments or decision-making systems)
- uncertainty. (Andrew Stewart and others, sub. 118)

It also arises from inconsistency between parts of the WR system. For example, the FWO has pointed to inconsistencies between awards and other mandated conditions (Dunckley 2014). This increases the opacity of employment standards for small businesses in particular — and means that in complying with the award, employers could find themselves in breach of the FW Act.

Participants in this inquiry have also identified inconsistencies in the FWC's appeals process:

> When matters do go to the FWC, there should be consistent decision making and interpretation. Unfortunately, this is currently lacking at both an individual commissioner and Full Bench level in some cases. (Australian Mines and Metals Association, sub. 96, p. 375)

The sheer number of decision-making rules or instruments in the WR system increases the time businesses need to take from their day-to-day business operations to meet their compliance obligations (particularly where these rules are not easily navigable) and can manifest as an increase in management time:

- to interpret and determine the meaning and requirements of the statutory framework (South Australian Wine Industry Association and the Winemakers' Federation of Australia, sub. 215)
- to keep records and manage employment contracts. An AHRI survey in 2011 found that to comply with the FW Act, 63 per cent of respondents reported an increase in record keeping while 65 per cent reported it took more time to formulate employment contracts (AHRI 2012).

On the other hand, HR Business Direction (sub. 91) did not consider that the legislation was of itself necessarily difficult to comply with, but knowing what to comply with, and how, were issues. For example, businesses may not be aware of the coverage of awards, but once they are aware, compliance is relatively easy.

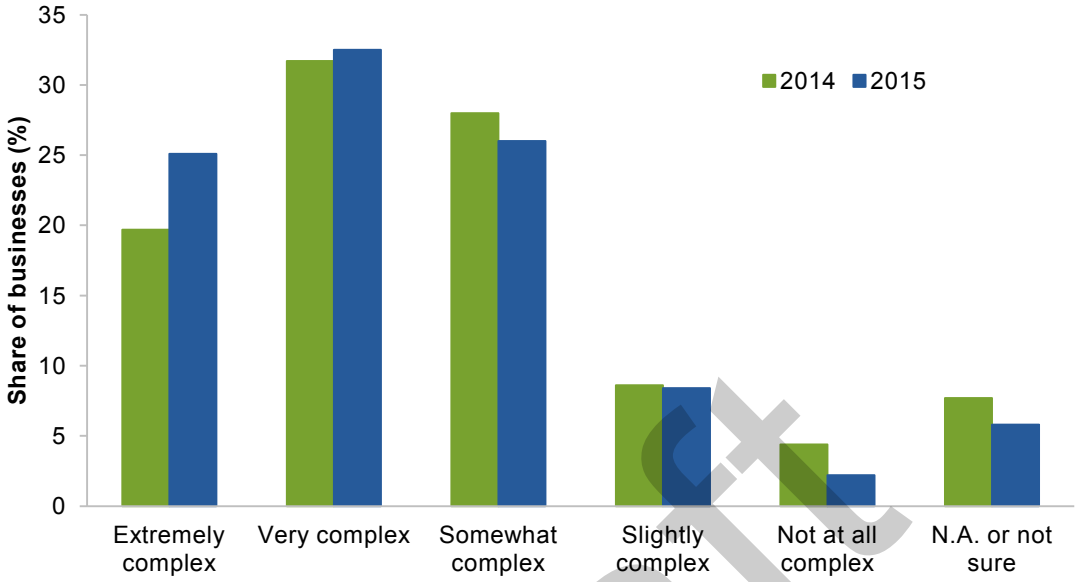
Complexity also increases the need for businesses to seek specialist advice, which can be costly and time consuming. According to AHRI, 77 per cent of human resources professionals surveyed perceived an increase in the need to seek legal advice in order to comply with the FW Act (AHRI 2012).

In addition to seeking advice from the FWO and FWC, employers seek assistance from employer groups and specialists (such as employment lawyers) to manage compliance obligations. However, seeking advice from multiple sources can have unintended consequences, as one small business in the services industry found when it received three different and conflicting answers from the FWO small business helpline, a private lawyer and an industry association (Geelong Chamber of Commerce, sub. 177).

Survey data provide conflicting evidence on whether complexity is perceived as decreasing over time (which would be expected as businesses become more familiar with their regulatory obligations and/or introduce systems to manage these), or increasing.

ACCI's national red tape survey found that the proportion of businesses responding to the survey who reported that the WR regulations were extremely complex or very complex had increased between 2014 and 2015, and that complexity centred around employing workers, wages and conditions of employment and unfair dismissal (figure 25.1).

Figure 25.1 **Complexity in workplace relations regulations**
Percentage of businesses responding to ACCI red tape surveys



Sources: ACCI (2014, 2015).

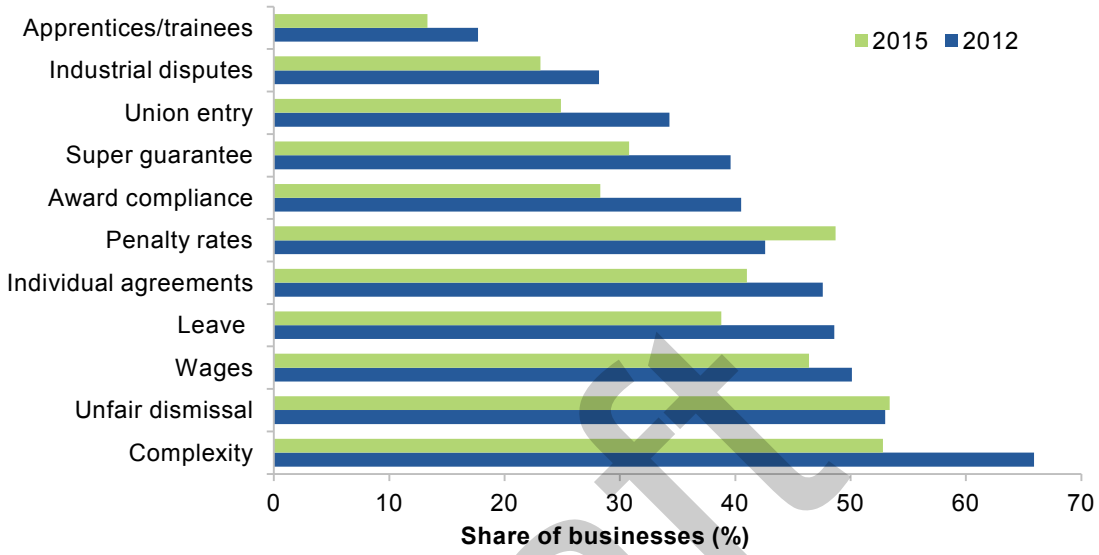
By contrast, the findings from CCIQ surveys are consistent with the expectation that perceptions of complexity would decrease over time. The percentage of surveyed Queensland businesses who reported that the complexity of WR matters was a major or critical concern fell by 13 percentage points between the 2012 and 2015 CCIQ surveys (from 66 per cent to 53 per cent of businesses) (figure 25.2). This was part of a broader decline evident in the degree of concern about a range of WR issues (which would be expected as businesses familiarised themselves with the new system).

Awards

Awards specifically were raised by participants as imposing compliance burdens (see also the discussion in chapter 12 on award reform). The FWO has provided considerable assistance to businesses through its education activities and its information line to manage the transition to modern awards (of which a prominent feature has been the shift in penalty rates to a new award) by employers who previously understood the specifics in their smaller, more targeted award. CCIQ survey data show that the degree of concern among Queensland businesses about award compliance has fallen since 2012 (figure 25.2).

Nonetheless, participants reported that award compliance continues to frustrate employer groups and businesses.

Figure 25.2 **Proportion of Queensland businesses reporting major or critical concerns with different aspects of the workplace relations system in 2012 and 2015**



Sources: CCIQ (2012), Productivity Commission estimates based on CCIQ 2015 survey data.

The Chamber of Commerce and Industry of Western Australia reported that 29 per cent of calls to its Employee Relations Advice Centre were queries about award provisions (sub. 134). Callers sought assistance to interpret the award, in particular an employee's entitlement to wages when they are required to work overtime or perform shift work.

> These issues frequently require employers to consider the application of multiple clauses which are not only difficult for small business to interpret but also frequently baffle experienced IR and HR practitioners. (Chamber of Commerce and Industry of Western Australia, sub. 134, p. 31)

Small differences between award provisions and changes to those provisions were also a source of annoyance:

> The descriptions on award rates are not specific enough between the levels and the hourly rates do not vary very much … The descriptions for the levels change by stealth, you think you were paying someone at the correct level for their duties, then check 18 months later and find it is not enough. (Launceston Chamber of Commerce, sub. 124, p. 9)

This has adverse effects for employees where they do not receive the correct entitlements.

Unfair dismissals

A number of participants (the Office of the Australian Small Business Commissioner, CCIQ, South Australian Wine Industry Association and Winemakers' Federation of Australia, Sydney Symphony Orchestra and the Australian Hotels Association and

Accommodation Association of Australia) criticised the cost of complying with unfair dismissal laws. The Sydney Symphony Orchestra said that:

> Each and every claim of this type [unfair dismissal cases and severance packages] means at least 2 of our Senior Executive Team are required to redirect their time and energies away from their necessary work to spend significant work time in dealing with a dispute or a claim and this does come at the detriment of their other work. This is an enormous cost to a medium size business such as ours. (sub. 100, p. 10)

A Gold Coast business operator in the hospitality sector also commented that:

> As a small business owner, I have been reluctant to take on new employees for fear of unfair dismissals. In the past, employees have sought settlement money as a first resort to discourage the matter going to the Fair Work Commission. Even in instances where the employee was on the facts, objectively in the wrong, I have paid over $12,000 just to be able to get on with running my business. (CCIQ, sub. 150, p. 8)

The CCIQ surveys suggest that the degree of concern with unfair dismissals has not diminished since 2012 (figure 25.2), and remains one of the top concerns for Queensland businesses (table 25.2).

Unfair dismissals is discussed further in chapter 5.

Small and medium-sized businesses

Small and medium-sized businesses are more likely to feel the compliance burden of complexity — as they have fewer resources to manage their regulatory obligations.

> … [T]he vast majority of small business operators are not lawyers or industrial experts and so the complexity of the system magnifies the potential for error and misinterpretation. (ACCI, sub. 161, p. 44)

> For a large employer with a sophisticated payroll system and dedicated payroll expertise the effort involved in interpreting awards or agreements to determine the applicable rates of pay, including penalties, loadings, overtime and allowances may be relatively small. However, for a family-operated small winery business carrying out the relevant wages calculations may involve considerable effort, time and resources. (South Australian Wine Industry Association and the Winemakers' Federation of Australia, sub. 215, p. 15)

> Most small business owners do not have the resources to fully understand their compliance obligations nor do they fully understand how to interpret issues relating to workplace relations. (Geelong Chamber of Commerce, sub. 177, p. 3)

The special needs of small and medium-sized businesses are acknowledged in the objects of the FW Act (s. 3). Despite this, a number of participants raised concerns about the impact of the FW Act on small businesses, suggesting a need for increased support to ensure they could understand and comply with the laws.

Compliance costs also not only affect a small business's bottom line:

> … the costs to small businesses are often non-financial in that it can cause stress and related ill-health, and also affect the personal life of the small business people, which can have just as much of an impact on their ability to carry on business. (National Tourism Alliance, sub. 39, p. 2)

The Australian Road Transport Industrial Organisation (sub. 103) suggested structuring compliance obligations to reduce the burden on small organisations, similar to the Australian Charities and Not-for-Profits Commission which has a sliding scale of accounting and auditing standards based on turnover.

Around 80 per cent of respondents to the 2015 CCIQ survey perceived that the FW Act, despite its intentions, is unfriendly to small and medium-sized businesses.

The compliance burden on unions

In its submission, the Australian Council of Trade Unions (ACTU) reported that drivers of compliance costs have been mainly transitional in nature (sub. 167), which is consistent with the findings of previous analyses of the FW Act (discussed above).

Award modernisation and the subsequent award reviews imposed a substantial cost on unions (as well as employers). The ACTU stated that peak bodies bore the weight of these proceedings, in part due to the increase in 'test cases' while the new system beds-down (sub. 167). Moreover the stakes of each 'test case' were higher under the current system than under previous systems given each award covers a larger proportion of the workforce (ACTU, sub. 167). Costs to unions, including staff time, administration and professional services (legal representation and research) and the cost for individual unions to participate in the modern award review process ranged from $22 000 to almost $900 000 (ACTU, pers. comm. 18 June 2015). The 2013-14 federal budget provided $4 million over two years to employee and employer groups to assist them to participate in the award modernisation process. These grants were terminated after one year.

Ongoing costs to unions arise from prescriptive requirements for protected action ballots (see chapter 19), right of entry permit renewal and reporting requirements under the *Fair Work (Registered Organisations) Act 2009* (Cth) (RO Act) (ACTU, sub. 167).

The ACTU says that unions are prepared to bear the compliance burdens under the RO Act given 'the clear and balanced objectives of transparency and democracy' (sub. 167, p. 2).

Administering and applying for right of entry permits has increased union compliance costs, including the need to provide education and testing facilities to enable officials to satisfy requirements of the FW Act (ACTU, sub. 167).

Duplication of process under enterprise bargaining also imposes costs on unions and the Queensland Council of Unions suggested industry level bargaining and site level agreements to reduce duplication (Queensland Council of Unions, sub. 73).

The Productivity Commission is interested in the quantification of ongoing costs to unions in relation to compliance with the FW Act, and the extent to which these are necessary to achieve the objectives of the WR system.

INFORMATION REQUEST

The Productivity Commission seeks data or other information on the extent to which the workplace relations system imposes unnecessary ongoing costs on unions, and how these costs are likely to be affected by draft recommendations proposed in this inquiry.

The role of regulators in addressing compliance costs

Regulators have a significant impact on the compliance costs of businesses, unions and individuals through education, compliance and adjudication activities.

Employees need transparent and easy accessible information to understand their rights and responsibilities. Poorly-designed websites or congestion can increase the cost of seeking advice and diminish the benefits of accessing information. (The benefits of transparency to employers as well as employees are discussed in chapter 17 in relation to the proposed enterprise contract.)

The CCIQ survey indicates that on average around 42 per cent of surveyed businesses had engaged with the FWC on various issues and around 40 per cent of surveyed businesses had engaged with the FWO. Businesses appeared to be satisfied overall with the FWC and FWO (table 25.3) as the ratio of businesses who were satisfied was greater than one (that is, more businesses were satisfied than dissatisfied) (except for the FWC's handling of unfair dismissal claims).

Table 25.3 **Satisfaction with regulators**

Issue	*Satisfaction ratio*[a]
Satisfaction with the Fair Work Commission	
Approving agreements and facilitating collective bargaining	2.1
Dealing with industrial action	1.4
Dealing with workplace disputes	1.2
Dealing with unfair dismissal claims	0.9
Satisfaction with the Fair Work Ombudsman — Advice received	1.4

[a] The ratio of businesses responding that they were either 'satisfied' or 'very satisfied' to those businesses responding that they were 'dissatisfied' or 'very dissatisfied'.

Source: Productivity Commission estimates based on CCIQ data from its 2015 survey of Queensland businesses.

Notwithstanding these findings, participants consider that there is an ongoing need to ensure regulators are sensitive to the particular needs of small businesses. Monash Business School considered clear communication and a user friendly WR framework can lower transactions costs for small businesses (Australian Consortium for Research on Work and Employment, Monash Business School, sub. 181).

The Office of the Australian Small Business Commissioner (sub. 119) commended the efforts of the FWO and FWC, but was also one of the participants who identified ongoing concerns about the compliance burden for small businesses.

Both the FWO and FWC already carry a large caseload.

In 2013-14, the FWO responded to more than 595 000 enquiries (resolving 99 per cent at first contact), received more than 11 million visits to its website with more than 2 million downloads. It also finalised 25 650 complaints and 4567 targeted campaign audits. It issued 116 infringement notices to employers who breached record keeping or payslip obligations and 65 compliance notices to recover unpaid wages. The FWO also entered into 15 enforceable undertakings and initiated 37 civil penalty litigations (for serious contraventions) (FWO 2014a).

In 2013-14, the FWC's website was around visited 3.3 million times and the FWC received 208 102 phone queries. The FWC also received 37 066 applications. This led to 19 620 hearings and conferences resulting in 13 302 decisions, orders and determinations. 97 per cent of applications were processed in two business days (FWC 2014b).

Both regulators are proactive and strategic in seeking to reduce the burden of compliance with the FW Act through education and attempting to resolve queries and disputes in a timely fashion. For example:

- the FWO is seeking to reduce the complexity associated with the implementation of modern awards through a range of measures such as incorporating feedback from businesses and workers in reviews and publishing guidance on awards and pay tables
- in April 2015, the FWO issued its Compliance and Enforcement Policy to provide practical advice and assistance to businesses so that that they find it easy to access, understand and apply (FWO 2015c). The policy focuses on promoting a culture of compliance and early intervention to resolve issues at the workplace level
- in 2012, the FWC commenced its Future Directions initiative which sets out a range of activities to improve its performance and quality of service. These include increasing resources available online (such as benchbooks and practice notes), introducing timeliness benchmarks for decisions, increasing accountability by establishing user groups, and developing an engagement strategy with industry. The Law Council of Australia (sub. 247) noted that benchbooks, which offer clear, plain language guidance on issues including unfair dismissal, have been widely praised as providing detailed practical assistance to unrepresented parties and practitioners.

25.4 Addressing unnecessary compliance costs

Submissions to this inquiry indicate that parts of the WR system continue to frustrate and impose compliance burdens, although the data are not as informative as to the extent to which these burdens are not necessary to achieve the objectives of the WR system. However, what is clear is that businesses (particularly small businesses) continue to regard effective engagement with the FWO and FWC as crucial to managing compliance costs.

To address concerns about the WR system, draft reforms proposed in this inquiry are expected to reduce unnecessary compliance impacts, including in those areas identified as being of specific concern in this chapter.

In relation to awards (chapter 12), the proposed new approach to award assessments would:

- improve the accessibility and ease of use of awards
- improve the transparency around the effects of changes to award wages and conditions
- reduce the resources required by interested parties to participate in award assessments.

Other proposals would:

- change unfair dismissal arrangements (chapter 5)
- change enterprise bargaining arrangements to reduce costs and rigidities (chapter 15)
- lower the costs of industrial disputes by reducing scope for gaming the system (chapter 19)
- address FWC governance issues to improve quality of decision-making (chapter 3).

In relation to the performance of the FWO and FWC, the Australian Government introduced the Regulator Performance Framework in 2014, as part of its commitment to reduce the cost of unnecessary or inefficient regulation imposed on individuals, businesses and community organisations by regulators.

The Framework, which commenced on 1 July 2015, requires regulators to examine their operations and the effect of administering regulation. Regulators will self-assess annually and receive performance reviews from an external body. The Ministerial Advisory Council in the employment portfolio is the default body for external validation of reviews of regulators in the WR system.

The framework will assess regulators against the following outcome-based key performance indicators:

- regulators do not unnecessarily impede the efficient operation of regulated entities
- communication with regulated entities is clear, targeted and effective
- actions undertaken by regulators are proportionate to the regulatory risk being managed

- compliance and monitoring approaches are streamlined and co-ordinated
- regulators are open and transparent in their dealings with regulated entities
- regulators actively contribute to the continuous improvement of regulatory frameworks. (Department of the Prime Minister and Cabinet 2015, p. 1)

The Regulator Performance Framework does not apply to the FWC's tribunal function as courts or administrative tribunals are not subject to the Framework.

The FWO and FWC have published these key performance indicators on their respective websites and the performance metrics (such as data, summaries of processes or case studies) that will be used to assess their performance.

The Productivity Commission understands that the FWO's assessment will be published as part of its annual report, with the first report a benchmark for future assessments against the key indicators. The FWC will provide a report against its measures on its website at the end of the first reporting period (30 June 2016).

The Productivity Commission considers that the Framework, which will provide ongoing assessment of the effectiveness of regulators against key performance indicators, provides a holistic and measurable way of reducing the compliance burden in the WR system.

To the extent that the issues raised in the inquiry are not already being examined as part of this process, the Framework provides an opportunity to better address the compliance burdens on business, particularly small businesses.

In the absence of further evidence of a net cost of complying with the WR system, the Productivity Commission considers that the recommendations proposed in this inquiry are likely to meet the specific concerns raised. Subject to further evidence about specific measures needed to address regulatory burdens, the Productivity Commission considers that the new processes in place from 1 July 2015 under the Regulator Performance Framework are likely to be sufficient to manage ongoing regulatory burdens in the WR system if implemented effectively.

26 Impacts

Key points

- The Productivity Commission does not recommend a substantial shift in any of the major strands of the current Workplace Relations (WR) framework, but previous chapters in this report identify aspects of the system that are in need of change.
- The impacts of recommendations in previous chapters can be assessed according to changes in:
  - employment protection
  - minimum wages and conditions
  - bargaining regimes
  - ease of making agreements.
- Theoretical and empirical literature details how changes to these elements of the framework can affect unemployment, productivity and wages.
- Theoretical literature examining impacts of changes to WR systems reveals that:
  - elements in WR frameworks affect unemployment and productivity through a variety of channels
  - some channels predict positive effects, while others predict negative effects.
- Empirical literature examining impacts of changes to WR systems contains mixed results and often lacks consensus.
- The recommendations in this report are expected to have positive effects on employment and productivity, and to reduce compliance costs. These would be expected to be observable at the enterprise and sometimes industry level but, by their nature, would be hard to detect at the economywide level because so many other factors determine aggregate outcomes.
  - This outcome is characteristic of many other policy reforms outside WR. Reforms in WR resemble incremental innovations at the firm level in that they form a component of a portfolio of microeconomic policies across many other areas, and it is this portfolio that has the wider economic impacts.
  - The notion that WR reform alone will transform productivity is misplaced.
- The recommendations will increase the functions of both the Fair Work Commission and Fair Work Ombudsman and will consequently have a small immediate fiscal cost to government, though these are a worthwhile investment in the fiscal benefits of greater employment and productivity.
- There is a paucity of both data and related research on the labour market and impacts of changes to the WR framework over time in Australia. Future analysis of Australia's WR framework would benefit from better data sets and a deeper Australian economic literature examining the effects of different elements of the WR system.

Earlier chapters in this report contain recommendations to improve aspects of Australia's Workplace Relations (WR) framework, and have considered some of the impacts of implementing these. The goal of this chapter is to synthesise and, in some cases extend, this analysis, set against the broad international and Australian empirical evidence on the impacts of workplace reform.

The emphasis is necessarily on economic consequences — unemployment, productivity, growth, wage dispersion and inequality. It should be emphasised that WR frameworks have other social and ethical dimensions that, though less easily scrutinised and measured, are also important (unfair dismissal being an example). These have been acknowledged in the relevant chapters, and the Productivity Commission's policy changes have generally attempted to preserve the social and normative purposes of workplace regulations (such as avoiding unfair treatment of employees), while producing better employment and efficiency outcomes.

A framework for analysis

This inquiry has scrutinised Australia's WR framework by examining its key parts, and the different emphases of the report reflect to a large extent the areas where the Productivity Commission has identified need for change. The structure of the report, however, does not necessarily reflect the breakdown of a WR system into parts most commonly assessed in economic and industrial relations literature. This chapter therefore departs from the structure of the rest of the report and instead examines the impacts of the report's recommendations on:

- employment protection
- minimum wages and conditions
- bargaining regimes
- ease of making agreements.

26.1 Impacts of changes to employment protection

Employment protection (EP) includes measures such as dismissal protection, limitations on the use of fixed term or temporary work contracts, regulation of working hours, minimum wages, mandatory leave entitlements, and rights to representation. Researchers use differences that exist in one or more of these elements, either between countries, within countries across time, or when regulation differentiates between types of firms, to assess the effects of employment protection on unemployment, productivity and economic growth. The results of the research are mixed.

Effects of employment protection on unemployment

Employment protections have a sound basis in preventing unfair treatment of employees. They can also affect employment. While the overall impacts on employment are an empirical matter, the avenues through which employment effects may arise are:

- to the extent that employment protection raises labour costs (for example, through more costly hiring practices or greater costs associated with layoffs and dismissals), and there is no scope to reduce wages, output will fall. This would then be accompanied by reductions in employment of both labour and capital. As is normally the case when labour costs rise relative to capital, there is also likely to be substitution away from labour towards capital, and possibly substitution between types of labour (for example by increasing the number of casual employees and decreasing the number of full time, ongoing employees). Unemployment would be expected to increase
- high costs of dismissal may prompt firms to choose their employees more carefully, and make them reluctant to employ workers that present dismissal risks for the employer, especially where there are strict wage floors in place. These workers tend to be more vulnerable, such as people with a sporadic history of work and those with lower skills
- if the costs of dismissals increase, firms will choose to lay off fewer employees than they would when demand for their product falls. Similarly, when demand increases, firms will take into account the likelihood of having to pay redundancy pay when making hiring decisions and might choose to hire fewer workers due to the risk of future costs (Skedinger 2010). This results in smaller employment fluctuations within a business cycle
- less turnover of employees increases unemployment duration (as there are fewer vacancies over time), which can result in greater income loss to those who spend time unemployed and possibly greater stigmatization of, and skill atrophy for, the unemployed. The resulting reduced job search effectiveness and greater unemployment duration also tend to reduce the extent to which any given unemployment rate moderates wage pressures (Gregg, Machin and Fernandez-Salgado 2014; Layard, Nickell and Jackman 2005)
- less turnover also constrains the efficient reallocation of labour from declining sectors to expanding sectors, and restricts the ability of emerging industries to dynamically adjust their workforce in response to shifts in more volatile demand
- Where temporary employees (primarily contractors) do not receive similar protections, the provision of strict employee protections for employees may distort the mix of labour market arrangements towards contractors (Scarpetta 2014)

Researchers have used empirical analyses to try to untangle and measure the importance of these various avenues for employment effects.

An additional challenge is that there are several measures of employment protection and the particular choice can make a large difference to empirical results (box 26.1). For

instance, the literature generally shows that strict employment protection can adversely affect employment. World Economic Forum data (which draw heavily on perceptions of Chief Executive Officers) places Australia at the high level of restrictiveness. It might therefore be inferred that Australia's regulatory regime has adverse effects on employment. However, this would only be true if the World Economic Forum data are reliable. Every indication is that they are not. The Organisation for Economic Co-operation and Development (OECD) data that are the primary basis for the findings of the literature place Australia at the lower, not higher, end of restrictiveness, and this corresponds well with Australia's relatively lower unemployment rate.

Box 26.1 Comparative measures of employment protection in Australia

There are a number of organisations that publish international cross-country comparisons of the relative level of employment protections. These include the OECD, the World Bank, the International Organisation of Employers and the World Economic Forum. Reports of this kind tend to rely on composite indexes, which assign scales to the various elements within a country's employment laws, and then compare the aggregated totals that result.

The OECD's indicators on the strictness of Employment Protection Legislation are the most commonly used of such measures. These are made up of four sub-indicators on, respectively: regulation of individual dismissal of workers with regular contracts; additional restrictions for collective dismissal; regulation of standard fixed-term contracts; and regulation of temporary work agency employment. In 2013, the OECD updated its collection methodology, which had previously relied heavily on questionnaire responses from member governments, to also include a detailed analysis by the OECD itself of legislation, collective bargaining agreements and case law.

Other measures, such as those used by the World Economic Forum in its annual World Competitiveness Report, tend to rely more heavily on surveys of businesses within the various countries reported on.

As discussed in chapter 5, different index constructions and, most importantly, different methodologies, can affect the reliability and comparability of such measures. In regard to unfair dismissal laws, for example, the OECD measure ranks Australia at the relatively less restrictive end of the scale, while results from the World Competitiveness Report suggest Australia is more restrictive in relative terms. Given its methodology, the latter is likely to be unreliable, with compelling evidence of its flaws (Aleksynska and Cazes 2014).

Sources: OECD (2013b) and World Economic Forum (2014).

Cross country studies give mixed results (Scarpetta 2014; Skedinger 2010). Lazear's (1990) early multivariate cross country analysis – which concluded that while the evidence is mixed, generous severance pay did help explain higher rates of unemployment in France and Portugal – prompted further cross country assessments. Of 15 cross country studies examined by Addison and Teixeira (2001), none report a positive correlation between employment protection and employment, however they also find very little evidence of a negative effect on the employment of prime age males. There is also evidence of a positive relationship between employment protection and self employment. Other studies find no

negative effects of employment protection on employment (Addison and Grosso 1996; Pissarides 2001).

and some find a positive relationship between employment protection and employment (Cazes, Khatiwada and Malo 2012). Modelling from the ILO suggests that the relationship is hump shaped – that is, very low levels of employment protection are associated with higher levels of unemployment that decrease with increased employment protection up to a tipping point of 2.6 of the OECD's employment protection legislation index (which ranges from 0 to 6). Two thirds of OECD countries have an employment protection legislation index of less than 2.6, including Australia (Cazes, Khatiwada and Malo 2012).

The mixed results of the cross country studies are perhaps not surprising since they rely on indexes of employment protection, which might hide some of the more subtle differences between different protections in different countries. Further, as theory highlights, the effects that the studies are seeking to measure in each country are possibly the net effects of different types of employment protection; some of which increase employment, while others decrease it.

Country level studies do not suffer from comparability issues and can benefit from using more disaggregated data. For example, studies that examine the effects of different employment protection treatment for firms of different sizes have found that stricter employment protection reduces the flow of workers into and out of employment, but the overall impact on employment is mixed (Cazes, Khatiwada and Malo 2012; Kugler and Pica 2005).

Effects of employment protection legislation on productivity

Theory and empirical analysis of the relationship between employment protection and labour productivity also produce mixed results. Research highlights several channels through which employment protection can affect productivity:

- OECD research concludes that stringent employment protection for regular contracts is estimated to have large, negative and statistically significant effects on worker reallocation (OECD 2010), and that 'there is quite a lot of evidence that gross job reallocation and productivity growth are positively correlated'(OECD 2010, p. 173):
  - several single country studies show jobs tend to be reallocated from firms with lower labour productivity to those with higher labour productivity. Multi-country studies have confirmed this result, and find the result is stronger for effects on multi-factor productivity
  - productivity-enhancing labour reallocation can be improved by reducing barriers to product market competition and encouraging entrepreneurship, as around one third of job creation and destruction are the result of firms entering and exiting markets (OECD 2010)

  - international empirical analysis using micro data supports the finding that higher dismissal costs and shorter trial periods reduce hiring, dismissal and total worker flows. However, some studies find no effect, including one that examined the effects of the change in unfair dismissal laws in Australia in 2009 (chapter 5). The author suggests the lack of any significant effects could be due to the levels of employment protection in Australia which are some of the lowest in the OECD even after the reform (Venn 2010).

- Greater labour reallocation is not, in and of itself, conducive to greater productivity if it is the result of an overreliance on temporary contracts — which become relatively more attractive when dismissal costs for ongoing contracts are high (Scarpetta 2014):
  - Temporary workers are less likely to participate in job-related training, more likely to have a work related accident, and provide less effort when the likelihood of their contract being converted into an ongoing position is low (OECD 2010).
- Workers are encouraged to cooperate with management to incorporate new innovations into the production process if they are more certain of their ongoing employment.
- Employment protection increases the cost of turnover, prompting employers to provide further education and training to their existing employees rather than use turnovers to adjust the mix of skills they use in production (Addison and Teixeira 2001).
- A unique quasi-experiment in Portugal suggested that employees who are not safeguarded by unfair dismissal laws tend to work harder (Martins 2009).

The OECD (2010, p. 187) cautiously concludes that 'for countries close to the OECD average, reforms relaxing provisions for individual and collective dismissals would increase productivity growth', and that lighter restrictions on dismissals is the main channel through which employment protection affects productivity. Given that employment protection in Australia is, however, comparatively low, it is not necessarily the case that reducing it further would have any positive effect.

Impacts of Productivity Commission recommendations on employment protection

In this inquiry, the Productivity Commission has examined aspects of employment protection in detail, including unfair dismissal laws, general protections, anti-bullying laws, employee rights to representation, restrictions on alternative forms of employment (such as labour hire and contracting) and mandatory leave provisions (such as public holidays and long service leave). Minimum wages and conditions are considered separately below. The Productivity Commission recommends several changes to these elements of the framework and these would have varying impacts:

- Ensuring that unfair dismissal cases focus on the substance of the reason for dismissal rather than on whether procedure was followed (chapter 5) would have the effect of reducing the number of dismissal cases before the Fair Work Commission (FWC) that

are deemed to be 'unfair' as a result of employers failing to precisely follow dismissal procedures in cases where there is otherwise good reason for dismissal.

  – This would most likely reduce the number of unfair dismissal cases that come before the FWC, but would not reduce the protection to employees, except for those who should otherwise have been dismissed with cause.

- Tightening the terms on which a spurious general protections claim can be made, and clarifying the intent and interpretation of aspects of the protections in this area (chapter 6), would have the effect of removing ambiguities for employers and employees about the scope of the protections, and the likely interpretation of important elements such as workplace rights.

  – This would reduce confusion about the types of conduct that are likely to constitute adverse action and remove the possibility of long running discovery processes in cases. These changes would refocus the protections and remove a greater number of cases launched with trivial and vexatious intent.

- Improving the ability of the FWC to deal with abuse of right of entry, and to limit right of entry to unions with no members in an organisation (chapter 19) would have the effect of reducing the costs imposed on some businesses by unions that make excessive entries into a workplace.

- Changing the way the *Fair Work Act 2009* (Cth) (FW Act) treats public holidays and leave entitlements in the National Employment Standards (chapter 4) would offer flexibility in the workplace and constrain the ability of the States and Territories to declare new public holidays without consideration of their impacts on prices, output and employment.

  - This would allow employees to take leave at times that more closely match their preferences. The change could also provide some relief for employers from the increased costs associated with the expansion of public holidays.

- Making terms that restrict the use of alternative forms of employment unlawful (chapter 20) — such as independent contracting, casual work and labour hire — would prohibit employee organisations from exercising control over the hiring decisions of a business.

  - There would be productivity gains from this change, as businesses would be able to use the mix of employment types that best suits their business. Workers who prefer these forms of employment would benefit, as there would be fewer barriers to their employment. This would come at a potential cost to permanent employees, as their security of employment would be slightly diminished.

- Increasing the ability of the Fair Work Ombudsman to undertake additional audits and investigations to identify employers who underpay migrant workers (chapter 21) would have the effect of deterring unscrupulous employers from exploiting migrant workers.

These recommended changes do not significantly shift employment protection in Australia and effectively make no change to the level of protection in the FW Act. However, they do seek to improve how well the provisions in the FW Act are applied, adhered to and, where necessary, enforced.

For some parties, these changes could have a big effect.

- the changes to unfair dismissal, general protections and rights of entry would affect the case load of the FWC
- some unions may need to change the way they engage with their members and recruit new members in the workplace
- some workplaces that have incurred costs from unions that have abused their right of entry would be protected from similar costs in the future
- some permanent employees might experience reduced job security if contractors or labour hire could do the same job for less.

In aggregate, these changes would not move Australia further up or down in the OECD's employment protection legislation index because they do not significantly change the protections currently enjoyed by employees. Nor would these changes be likely to prompt firms to re-think their production processes, factor and skills mixes, or future recruitment decisions, because the employment protection-related costs incurred by the majority of firms would not be considerably affected.

Consequently, the impacts of the recommendations in this inquiry that affect employment protection in Australia's WR framework, though important, would be unlikely to show up in measures of unemployment and productivity at the national, sectoral or regional levels.

26.2 Impacts of changes to minimum wages and conditions

Australia has a complex set of minimum wages and conditions contained in the National Employment Standards and the awards. Several chapters in this inquiry examine these minimum conditions and include detailed assessments of the likely effects of them on unemployment and productivity.

Effects of minimum wages and conditions on unemployment

The theoretical and empirical literature that examines the effects of minimum wages and conditions on employment is extensive and is described in detail in chapters 8, 9, 10, 13, and 14 and appendix C. In general, the literature suggests that small increases in labour costs do not have marked employment effects (in part, because regulators attempt to calibrate the regulations to avoid such effects). Indeed, in some instances, small wage

increases may even increase employment. However, increases above some threshold have disemployment effects (either through headcounts of employees or hours worked). This can prolong unemployment spells (with the effects this has on the wellbeing of the person and their dignity), particularly for more vulnerable people.

Effects of minimum wages and conditions on productivity

The main channel through which minimum wages and conditions affect productivity is through incentives for employees to undertake further education and training. However, as summarised in chapter 8, contradictory effects are discussed in the literature:

- increases in minimum wages and conditions can increase employees' demand for education and skills if they recognise that they need to increase their productivity to match the increased wages. Similarly, those outside the labour market have a greater incentive to seek work at the higher wage, and to the extent that education or skills are required for minimum wage jobs, undertake the necessary training first.
- increases in the minimum wage can reduce the incentive for job seekers to undertake further education and training because the minimum wage provides a reasonable income and there is consequently less need to up-skill to obtain jobs above the minimum wage.

Minimum wages and conditions can also affect productivity if they influence how much effort employees put in while at work. If employees feel they are being paid a fair wage, it is less likely that they will shirk on the job.

Effects of minimum wages and conditions on consumers

Minimum wages and conditions can redistribute income from employers to employees. The relevant chapters in this report have discussed these effects in detail. Employees (who are also consumers) use this income in different ways to employers (or producers). As a result, a change in minimum wages and conditions can also affect consumption patterns and demand for consumption goods and services for minimum wage workers. The way that these changes flow through the economy can be captured in a computable general equilibrium (CGE) model (see box 26.2).

Historically, increases in award wages also affected inflation and so have had an effect on consumption patterns more broadly. Today, increases in award wages are less likely to be a key driver of changes to inflation due to low levels of award reliance.

Impact of Productivity Commission recommendations on minimum wages and conditions

Most of the proposed changes in this inquiry do not have marked effects on wages, and therefore their employment impacts are likely to be modest. However, changes to Sunday penalty rates for a variety of consumer-focused service industries will have significant effects on labour costs and are likely to have significant positive employment effects on Sundays (as well as increasing hours of work for existing employees and improving customer convenience).

As part of this inquiry, the Productivity Commission has made several recommendations to change the levels of minimum wages and conditions in the WR framework, or to re-formulate how they are set, including to:

- use a more formal risk-based approach when seeking to meet the employment goals of the minimum wage objective in the FW Act
- use a targeted and evidence-based approach to assess award wages and conditions to:
  - identify those award wages and conditions that could be having a negative impact on employment, and consider adjustments to them over time
  - identify those award wages and conditions that have the effect of redistributing income from employers to employees without causing a reduction in employment, and consider whether there is room to increase them
- reduce Sunday penalty rates in several consumer-oriented services industries (such as hospitality and retailing) with the effect of:
  - increasing employment on Sundays (as well as increasing the hours of work for existing employees and improving customer convenience). This effect may be significant because the wage change would be considerable for some awards
  - decreasing the income of those employees who consistently work on Sundays.

Many of these changes are underpinned by significant institutional change, and in particular a change to the expertise, evidence and methodologies used to set awards, and wage setting more generally.

In aggregate, the impact of these recommendations on unemployment is likely to be positive, but again small in a national analysis. The Productivity Commission is investigating the feasibility of quantitative analysis to understand how responsive employment might be to changes in minimum wages and to understand the potential economywide implications (box 26.2), but will release any results after the draft report. The same quantitative techniques can also be used to assess other aspects of the WR framework.

Recommendations that affect minimum wages and conditions, including penalty rates, would have impacts that differ between industries. The changes would depend on factors

such as the magnitude of the changes imposed, the levels of award reliance, the labour intensity of the industry and any effects of growing demand on the size of the industry.

Box 26.2 How can modelling help to unravel the impacts of changes to minimum wages and conditions?

A key task in this inquiry is that of determining the economic impacts of changes to minimum wages and conditions. This involves:

- assessing the initial impacts of changes to minimum wages and conditions on measures such as productivity, business and government costs, prices, workforce participation and income distribution
- assessing the ensuing economywide impacts on measures such as jobs, incomes and the industry and regional distribution of economic activity that flow from the initial impacts.

Quantitative analysis can play an important role in establishing and understanding the direct impacts, if any, of changes to the WR framework. It does this by using any in-sample variation in the data to estimate the nature and strength, if any, of the relationship between economic measures such as the level of employment or unemployment and particular aspects of the WR framework, such as minimum or award wages. Econometric analysis can isolate the influence of WR framework changes from the impact of other factors that affect the measure of interest. The strength of econometric analysis therefore depends on having suitable datasets that are capable of allowing these relationships to be explored in a statistically rigorous and meaningful way. The findings of overseas econometric studies may not translate to Australia given the unique characteristics of the Australian labour market.

Techniques such as micro simulation modelling can help in understanding the initial behavioural responses and impacts of individuals and families of changes to the WR framework and the interactions between the tax-transfer system and the labour market. Such techniques may assist in understanding how the labour supply responses of individuals, and collectively, may respond to changes in the WR framework.

General equilibrium modelling can assist in understanding and assessing the economywide impacts that might be expected to flow from the initial impacts of changes to the WR framework. Computable general equilibrium models are suited to tracing the initial impacts of actual or potential policy changes through the wider economy as it incorporates many of the key economic interlinkages between industries, households and government. As such, it is capable of showing the wider impacts on employment and industry output nationally and, sometimes, by region as well as implications for national, state and household incomes and expenditures, and for trade and investment. Unlike most other quantitative techniques, such modelling takes into consideration the associated economywide resource constraints.

26.3 Impacts of changes to bargaining regimes

Bargaining over employment conditions is a central tenet of most WR systems. In some countries, bargaining occurs at the national or industry level, while in others, it occurs within enterprises and at the individual level. In Australia, bargaining occurs at the enterprise and individual levels, and for those who are award-reliant, wages and conditions

are set nationally. The extent to which bargaining is centralised and coordinated, and the matters subject to bargaining, can affect the outcomes employees receive and the labour costs that firms face. Consequently, the economic and industrial relations literature examines the impacts of bargaining regimes on wage outcomes, unemployment and productivity. Bargaining regimes can also have significant costs to firms (and their representatives) and to unions – these impacts are discussed further in section 26.4 below.

Effects of bargaining regimes on unemployment

Theoretical literature that examines the effects of bargaining regimes on employment suggests that, in systems with highly decentralised bargaining, employers will have relatively greater bargaining power than employees and will make employment and wage decisions in accordance with their profit-maximising objective.

Conversely, in highly centralised bargaining systems, coordinated union action will ensure that employees receive better wages and conditions (as a result of the increased bargaining power that results from union-led collective negotiations), but coordinated action will ensure that wages are not so high as to threaten the viability of businesses and the jobs of union members (Arpaia and Mourre 2012).

Calmfors and Driffill ignited debate about the shape of the relationship between the centralisation of bargaining and macroeconomic outcomes, suggesting that systems of bargaining in the middle of these two extremes are likely to have the worst outcomes (Calmfors 1993) — for example, each union might have enough bargaining power to push the wages for their members higher, but not enough members to need to worry about the economic consequences of raising wages more broadly. More recently, the debate has focused on the degree of coordination rather than the level of bargaining (Cazes, Khatiwada and Malo 2012).

> … [T]he evidence suggests that if bargaining is highly co-ordinated, this will completely offset the adverse effects of unionism on employment. Co-ordination refers to mechanisms whereby the aggregate employment implications of wage determination are taken into account when wage bargains are struck. This may be achieved if wage bargaining is highly centralised, as in Austria, or if there are institutions, such as employers' federations, which can assist bargainers to act in concert even when bargaining itself ostensibly occurs at the level of the firm or industry. (Nickell et al. 2001, p. 8)

Addison and Teixeira (2001), among others, find evidence that coordinated collective bargaining can have positive results on employment that offset the negative impacts of employment protection. Other studies have found that collective bargaining has no impact on employment in OECD countries (Cazes, Khatiwada and Malo 2012).

Effects of bargaining regimes on productivity

There are several channels through which bargaining regimes can affect productivity. When bargaining occurs at a decentralised level (such as the individual or firm levels), firms adapt to new technologies by changing the composition of their workforce to bring in people with the required training and skills.

When bargaining occurs at a centralised level (such as the industry or national level) and where wages are consequently compressed, firms cannot attract the skills they require by offering higher wages, so they train their own workers (Scarpetta and Tressel 2004). When the costs of hiring and firing are high, there is an added incentive to adopt a 'competence accumulation' strategy based on firm-sponsored training (Scarpetta and Tressel 2004).

The characteristics of production also affect how bargaining and employment protection affect the adoption of new technology. In those industries that rely more on cumulative technological progress, it is more likely that up-skilling existing staff is an efficient way to incorporate new technologies (Scarpetta and Tressel 2004). Conversely, industries that rely on frequently changing the types of physical and human capital used to respond to technological progress would be hindered by rigid, compressed wages and high hiring and firing costs.

International empirical evidence finds that countries with centralised bargaining regimes and stringent employment protection (such as Germany and Austria) have a comparative advantage in industries characterised by cumulative technological progress (which is more easily absorbed through training of existing staff) than countries with decentralised bargaining systems and low employment protection (such as the United States, United Kingdom and New Zealand) (Scarpetta and Tressel 2004).

In the Australian context, bargaining is decentralised. Awards provide a floor for wages and do not stop firms from offering above award wages and conditions to attract highly skilled workers, and the WR framework does not impose high costs of hiring and firing by international standards (box 26.1). As such, Australian firms looking to innovate and respond to changing market demands are not hindered from offering higher wages to attract workers with the right skills when they need them most, or from downsizing when demand for their products shrinks. Undoubtedly, however, this relies on there being Australian workers with the skills and training required to ensure firms can adapt. Consequently education and skill development is a crucial part of any strategy to promote improvements in productivity.

Has shifting to enterprise bargaining in Australia improved productivity?

Borland's (2012) view is that the shift to enterprise bargaining in the 1990s was the reform that has had the most consequences for Australia's macroeconomic performance. However, attempting to isolate the effects of enterprise bargaining on productivity is a difficult task. A macro data analysis (looking at economywide productivity trends), or a micro data

analysis, can be adopted. Loundes, Tseng and Wooden (2003) provide a good overview of the different ways to do this, and the studies that have attempted it. Their main conclusion is not the absence of a clear-cut finding, but how poorly developed the literature is in Australia.[262]

Much of what is written is highly derivative and lacking in serious analytical content. For example, there have been very few studies that have attempted to quantify linkages between objective measures of business performance and measures of changes in bargaining structure. Further, those that have attempted this exercise have invariably found that their data are not well suited to the task (Loundes, Tseng and Wooden 2003).

Regarding micro data analyses, Loundes, Tseng and Wooden (2003) suggest that enterprise- and workplace-level research generally falls into one of four main categories:

- case studies that document the experience with enterprise bargaining at specific workplaces and/or firms
- attempts to draw inferences about the implications for workplace productivity from analyses of the content of agreements
- surveys to collect data from managers about their perceptions of the effectiveness of agreements
- analyses of workplace- or enterprise-level data to identify any independent associations between the presence of enterprise agreements and various productivity-related measures.

While there is a political consensus that enterprise bargaining has improved productivity, many academics claim that research has been unable to establish a clear causal relationship. Loundes, Tseng and Wooden (2003, p. 257) recommended that:

- the preoccupation with what is written in formal agreements needs to be abandoned. It is not obvious that this has any direct relationship with productivity outcomes
- case study research should move away from single-firm studies and look for clusters of firms that are similar, but nevertheless structure their arrangements with employees differently
- new data sets are needed that link records-based data on output to tailored surveys designed to provide measures of the various elements that define bargaining structure
- wherever possible, case-study methods and quantitative methods should be used in tandem as complements to each other.

Farmakis-Gamboni et al.'s (2014) review of the literature on enterprise bargaining and enterprise agreements (rather than on particular clauses within enterprise agreements)

262 Quiggin (2001) describes some of the difficulties of accurately measuring productivity improvements, including attributing increases in output to productivity improvement rather than to unmeasured increases in inputs (such as from increased intensity of worker effort, or increased (but unmeasured) hours from workers skipping breaks, or by replacing continuous shifts with split shifts).

found ambiguous results on the relationship between bargaining and productivity. The literature also highlighted the difficulty in finding a causal relationship in this area (Hancock et al. 2007).

A wide range of workplace level drivers of productivity are identified in the literature, including increasing employee skill levels, introducing new machinery or making changes to firm level organisation, management practices and work arrangements. Regarding enterprise bargaining and productivity in particular, the literature and analysis of Australian data in this area do not provide a clear conclusion, suggesting workplace level case studies may provide further insights.

The Productivity Commission's inquiry into public infrastructure included a detailed review of studies and empirical evidence on aggregate productivity and stated that:

> … it is hard to isolate numerically the effects of workplace arrangements, including industrial relations, from all the other factors shaping workplace productivity, especially given small and inadequate datasets and statistical noise. (PC 2014b, p. 543)

Similarly, Peetz and Preston found that:

> British evidence … suggested little difference in most performance indicators between workplaces that maintained and those that abandoned collective bargaining in favour of individualised approaches. Where there were differences, workplaces that had abandoned collective bargaining had weaker improvements in productivity. Does individual contracting offer an assumed 'efficiency wage' benefit, in that employers pay a premium in the belief that they will reap benefits from having a non-unionised workforce? Or does individualisation increase dispersion because workers with less skill and bargaining power lose out because of widening power gaps under individualisation? (Peetz and Preston 2009, p. 446)

Enterprise bargaining, income inequality and low paid workers

Peetz and Preston (2009) point to various studies that show that centralised wage systems, unions and collective bargaining are generally associated with more compressed wage structures. There is broad consensus in the international literature to support this conjecture (Cazes, Khatiwada and Malo 2012). Peetz and Preston (2009) also point to OECD evidence showing increased wages dispersion in recent years and, consistent with theory, it is particularly present in countries pursuing more flexible wage-setting arrangements such as Australia. Other aspects of the Australian wage structure show related trends including a widening gender pay gap, particularly among part-time employees.

The FW Act's low paid bargaining stream is, from an international perspective, a novel aspect of Australia's WR framework. It is one of the few instances in which multi-employer agreement making is allowed under the FW Act.

> Will the Fair Work Act help bargain away low pay? Potentially employees, particularly low paid women, have a new avenue to use to access increases in their terms of employment via a unique form of collective bargaining. But this case has certainly not paved the way for the

industry-based grand bargain envisaged by some observers and feared by many employers. The current evidence seems to suggest that the low paid stream will not be a mechanism that, on its own and in its current form, will erase low pay sector. It will just mean a bit more enterprise-based bargaining. But I think that is what it was meant to do. (Cooper 2011)

Effects of individual-level bargaining

There is little evidence to shed light on the employment impacts of individual arrangements. If individual arrangements reduce labour costs, then there might be employment effects from an increase in their use. This effect, however, would be limited to common law agreements in Australia given that individual flexibility arrangements (IFAs) need to pass a better of overall test (BOOT). Any overall reduction in labour costs would therefore be quite small, unless their take up increased dramatically.

Peetz (2005) examines whether there is evidence of productivity gains from the introduction of Australian Workplace Agreements (AWAs) as part of Work Choices and concludes that there is no evidence that they increased productivity. Hancock et al. (2007) explain that is might be partly due to the fact that few AWAs included provisions for training and development.

Impacts of Productivity Commission recommendations on bargaining regimes

The Productivity Commission has recommended several changes to the way that enterprises and employees bargain in Australia. Most of these, however, seek to improve the agreement-making process, rather than to shift the level at which bargaining occurs (these are discussed in the next section). Several recommendations could, however, prompt the movement of a larger share of previously award-reliant workers (for whom wages and conditions are set centrally) to enterprise-based arrangements, or individual arrangements.

The proposal for an enterprise contract (chapter 17) is intended to:

- increase the options for small and medium sized businesses to set the terms and conditions of employment
- increase the transparency of employment relationships by making available an easily accessible written contract suited to the needs of the business and employees
- set out in easily understood language the terms and conditions of employment for the benefit of employees.

There are three safeguards in place to reduce the potential for pre-employment contracts to be used to exploit vulnerable workers.

- The operation of the no disadvantage test (NDT) will be critical to achieving net benefits from the arrangement, as it will provide confidence that the enterprise contract does not disadvantage the employee relative to the award or enterprise agreement.
- Businesses must notify the Fair Work Ombudsman of the arrangement. While there will be some additional compliance costs for businesses, these are not expected to be large as there are options to minimise costs to businesses, such as limiting the information required and providing options to communicate the information (including by electronic means) to suit the employer.
- There is the option for an employee's terms and conditions to be set by the award after the contract has operated for 12 months.

Introducing an enterprise contract is intended to reduce the costs that small and medium businesses face when making agreements with their staff. It is not intended to replace enterprise agreements, and as such has not been designed to significantly shift either the centrality or coordination of bargaining in Australia.

The impacts of the enterprise contract on employment costs would depend on the exact design of the instrument and the consequential uptake.

At the firm level, if an enterprise contract provided opportunities for employers to create incentives for their staff to work more efficiently and to look for new, innovative ways to work as a business unit, there might be positive productivity gains for the business.

If, however, employers use these contracts to introduce working conditions that, while not making employees materially worse off, would not be agreed to if employees (or their representatives) were at the negotiating table, productivity in the business might be reduced through increased staff turnover and lower effort. In aggregate, these impacts are likely to be small.

The suggested changes to IFAs in chapter 16 are proposed to make them more attractive to employers and employees, and as such, would be expected to increase their uptake and provide net benefits by encouraging flexibility in the making of workplace arrangements for employers and employees. This recommendation is supported by proposed changes that would:

- increase the access of employers and employees to information about how to use IFAs
- improve termination procedures for IFAs
- reduce the barrier to implementing IFAs through the implementation of a no disadvantage test to replace the BOOT (see the next section).

These changes are not expected to materially increase the uptake of IFAs, which are used by only a small proportion of employees, but for those who would benefit from added flexibility in their working conditions, the recommendations would have a positive effect. However, aggregate impacts from these changes would be very small.

26.4 Impacts of making it easier to form agreements

Recommendations intended to reduce procedural complexity, compliance costs and regulatory burden associated with WR in Australia relate to employment protections, minimum wages and conditions, bargaining regimes (all discussed above), and the ease with which enterprise agreements and IFAs can be made.

There is an extensive literature that deals with the aggregate impacts of compliance costs generally, but much less that examines the impacts of compliance costs of WR systems. Chapter 25 discusses compliance costs of the current framework generally and the impacts that they might have.

As part of this inquiry, the Productivity Commission recommends several changes to procedure and regulations, with the primary objectives of making it easier to form enterprise agreements and to lower the costs imposed on all parties during the agreement-making process. These include to:

- reduce the ability and incentive of unions to organise and threaten strike action that is either pre-emptive (that is, before negotiations have begun), unlawful, likely to cause significant harm, or likely to impose high costs on an employer but immaterial costs on employees (chapter 19)
- increase the ability of employers to impose a graduated response to strike activity, and reduce the costs that employers face when dealing with strike activity (chapter 19).

These recommendations are not intended to broadly reduce the bargaining power that strike activity gives to unions and their members, but rather to ensure that strikes are not imposing unnecessarily high costs on business. This may somewhat reduce the potency of industrial action for some unions, but only those unions for whom industrial action currently confers disproportionate power.

Other recommendations to change procedures and regulations of enterprise agreement-making include extending the life of greenfields agreements to reduce the uncertainties and costs that businesses otherwise face if they are forced to renegotiate partway through a project. The Productivity Commission has also recommended a menu of arrangements to make it easier to make greenfields agreements including last offer arbitration by the FWC, and a 12 month employer greenfields arrangement. These changes are likely to produce small efficiency gains in getting projects started faster and at lower cost.

The Productivity Commission also recommends replacing the BOOT with an NDT. The intention of this change is to reduce the barriers that an agreement and an IFA must overcome before they can be approved and to allow win-win arrangements that provide flexibility or other benefits to both parties to the agreement. The change is not intended to make employees worse off. Indeed, reducing delays in agreement approvals can lead to employees gaining faster access to the benefits of a new agreement, such as pay rises.

Awards also attract criticism, especially from small business, for being overly complex (chapter 12). The Productivity Commission recommends that, where specific sources of poor practice have been identified, awards be revised to be shorter, less complex, and in plain English.

These recommendations are intended to reduce compliance costs to businesses, and make it quicker and easier to make agreements generally.

26.5 Fiscal impacts

As part of this inquiry, the Productivity Commission makes several recommendations to change the roles and the functioning of the principal WR institutions. This would require additional resources, and therefore greater funding. These recommendations include:

- to increase the functions and funding of the Fair Work Ombudsman to:
  - record and monitor notifications of IFAs and enterprise contracts (chapter 16)
  - provide information and resources on how the NDT is applied (chapters 15 and 16)
  - produce an information package on IFAs (chapter 16)
  - support the FWC to undertake evidence-based assessments of awards (chapter 12)
  - undertake additional audits and investigations to identify and penalise employers who deliberately underpay migrant workers (chapter 21)
- to increase the functions of the FWC to:
  - improve reporting about general protections matters (chapter 6)
  - determine and communicate how the NDT is applied (chapters 15 and 16)
  - revise the methodologies applied during award assessments (chapter 12)
  - produce and publish template enterprise contracts (chapter 17)
  - undertake last offer arbitration of greenfields agreements (chapter 15)
  - publish more detailed information about conciliation outcomes and processes and about general protections claims (chapters 3 and 6)
  - respond to additional applications for intervention on right of entry (chapter 19).

Some recommendations, however, would have the effect of reducing the burden on these organisations, such as recommended changes to unfair dismissal, general protections, and the move to an NDT, to the extent that the NDT is a less onerous test to apply than the BOOT.

The recommended review into apprentice wages would require additional resources from government for the organisation undertaking the review. The Productivity Commission also seeks feedback on the merits of an EITC and other alternatives (chapter 10). The introduction of an EITC would have direct costs to government.

The Productivity Commission has not completed its deliberations but it would be reasonable to argue that the measures set out in the draft recommendations would, over time, improve employment outcomes and have a beneficial impact on productivity and compliance costs. These changes would increase growth and incomes generally. This will reduce the size of transfer payments, and would be likely to increase tax revenue. The net fiscal impacts of WR reform are therefore hard to determine, and concentrating on the costs that are easy to enumerate (such as funding for the FWC and Fair Work Ombudsman) provides too pessimistic a perspective.

26.6 Summary

As the preceding discussion highlights, the Productivity Commission does not recommend fundamental reform of the central tenets of Australia's WR framework. Rather, it has identified aspects of process in most parts of the framework that could be improved, and the discussion in this chapter has identified the likely impacts of the recommendations contained in earlier chapters in this report. The discussion has also included reference to theoretical and empirical literature that examines the impacts of different aspects of WR systems on unemployment, productivity, and wages, to provide context for the possible effects of recommended changes. In most cases though, the anticipated impacts at the aggregate level are likely to be small or of indeterminate size and direction.

That the draft recommendations are likely to have small aggregate impacts does not mean these changes are not meaningful. In some sectors and for some participants in the system they will be notable. There will also be 'soft' policy outcomes, in the sense that incentives to game the system by both employers and employees are discouraged when regular review of a policy structure is undertaken. The gains from regulatory gaming should desirably, always prove fleeting.

Further, the flexibility of the Australian economy to deal with shocks will be improved. Studies have identified the employment impacts of different WR studies by assessing how well countries have responded to shocks.

- Bertola, Blau and Kahn (2001) found mixed evidence of the direct effects on employment of the rigid wage setting institutions and interventionist benefit systems that typically occur in Europe. However, the laissez-faire approach in the United States contributed to reducing the impact on employment of macroeconomic shocks due to flexibility in real wages and relative wages.
- Nickell et al. (2001) suggest that 55 per cent of the change in unemployment in Europe between the 1960s and 1990s is explained by changes to institutions (of which 39 per cent can be attributed to changes in welfare benefits, 26 per cent to increases in labour taxes, 19 per cent to changes to union variables and 16 per cent to changes to employment protection laws). They attribute much of the rest of the increase in unemployment to the deep recession that Europe experienced in the latter part of the period studied (Nickell et al. 2001, p. 18).

Accepted and evolving societal norms about how people should interact with each other in the workplace can also affect productivity. These norms can have a sizeable effect and can work as a conduit, or in opposition to, the regulations in the framework.

- Some literature suggests that wage rigidities are not only the result of rules in a WR framework, but also a result of 'deeply rooted social customs' (Agell 1999, p. F143). Several studies find that employers are unwilling to cut wages because they fear that the cuts will affect morale and effort negatively. Akerlof's (1982) model of gift exchange suggests employers will be willing to pay more to encourage greater effort. Other studies find that fairness and reciprocal kindness have a strong effect on the actions of both employers and employees, and that this effect can be strong enough to prevent the labour market from clearing even in the absence of legal constraints on wages (Agell 1999).
- Research from the United Kingdom concludes that,

> … businesses which reported good employment relations and high trust relationships in 2004 were less likely in 2011 to report themselves weakened by economic downturns … [and that] … around a quarter of the UK's productivity gap with the US is down to poor workplace management … which covers everything from job design to communication channels and management skills. (Acas 2015, p. 5)

To a large extent, the impact of recommendations contained in this report will be best measured retrospectively. However, unless both the available data and the appetite for enhanced empirical analysis in this area improve, that retrospective analysis would be hard to undertake. More importantly, the capacity for using evidence to further refine policies would be considerably lower than is desirable. In part, this deficiency should be overcome by putting more weight on evidence-based decision making by WR regulators.

The Productivity Commission therefore recommends an ongoing research agenda to ensure that future policy changes that affect the Australian labour market will be well supported. This requires asking clear questions that are directed at policy-relevant problems, and supported by empirical evidence that provides directions for policy. Table 26.1 sets out some of the policy research areas and the corresponding data that could assist policy formulation.

Table 26.1 **A future research agenda**

Policy Issue	*Examples of research and/or data gap*	*Additional data collection requirements*
Safety net adjustments directly affect some employees and can indirectly affect others (such as those on enterprise agreements). The proportions of people affected and the extent to which their wages and conditions change are not currently known	• Longitudinal data on the proportion of employees on enterprise agreements who receive award wages and conditions – disaggregated by industry, occupation, region, sex, age, earnings • Longitudinal data on how many employees are on each award – disaggregated by industry, occupation, region, sex, age, earnings	• A recurring and expanded AWRS • An additional question in EEH about the awards that employees are employed on
The empirical research in Australia on the effects of changes to minimum wages on employment is not conclusive. More could be learned from exploring the differences in: • WR regulation between Australia and New Zealand and their effects outcomes in Australia such as between industries under different awards or between days of the week that attract variations in penalty rates.	• Longitudinal data on the days that people work – disaggregated by earnings, employment type (full time, part time, casual), occupation, level of education • Research on the factors that affect a person's capacity to get a job both in terms of job to job movements, and unemployment to job movements – disaggregated by age, sex, region, industry, occupation • Research comparing the earnings of employees under 16 in New Zealand and Australia • Research identifying the main drivers of unemployment in Australia and New Zealand • Comparative analysis of the incidence of penalty rates in New Zealand (where they are not regulated) to Australia (where they are).	• Collection of working schedule information within HILDA and/or AWRS, including which days of the week are worked regularly, often or rarely.
• Despite anecdotal evidence and some survey data that the WR framework in Australia imposes high compliance costs on business, there is little available data that assess unnecessary compliance costs and their scale	• Comparative assessment of compliance costs imposed on business by WR regulations before and after any legislative change • Comparative assessment of the contribution that WR related compliance costs make to the total regulatory burden on business	• New survey evidence required • Further disaggregation of survey data (perhaps by adding new questions) to establish the incremental nature of compliance costs

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Table 26.1 (continued)

Policy Issue	*Examples of research and/or data gap*	*Additional data collection requirements*
Little is known about how often casual workers seek to exercise their right to convert to permanent employment and the degree to which these requests succeed.	• Longitudinal data on the proportion of casual workers who have requested conversion to permanent employment after fulfilling their qualifying period and the success rate of these requests (including whether the disposition of the employer has affected the worker's decision to exercise their right).	• New survey evidence required • An expansion of HILDA might also be possible
Many of the policy options pertaining to long service leave depend on accurate data about the eligibility of employees for long service leave and their preferences about the drawing down of the entitlement. Currently, there is little data available indicating this.	• Longitudinal data on the proportion of workers who have become eligible for, take and/or cash out long service leave (including whether they take it in large chunks or in smaller portions).	• New survey evidence required • An expansion of HILDA might also be possible
There have been concerns around the potential for an increasing use of labour hire arrangements to displace ongoing employees.	• Survey data on workers who identify as labour hire employees and whether they are permanent, casual or independent contractors.	• Expansion of ABS surveys to take this into account.

These recommendations reflect some of the gaps in data and rigorous research that the Productivity Commission has encountered during this inquiry. For some, data might already exist — in these cases, the Productivity Commission requests that those data be made available. For others, new or extended data collections and new research would need to be commissioned. These activities imply that data collection and research agencies will incur additional costs. As a result, each of these should only be undertaken once it has been established that the additional data and research will provide net benefits by allowing better-informed policy recommendations and FWC decisions in the future.

A Conduct of the inquiry

This appendix lists parties the Productivity Commission consulted with through:

- submissions received (table A.1)
- visits (table A.2)
- roundtables (table A.3)
- workshops (table A.4).

The Productivity Commission received the terms of reference for this inquiry on 19 December 2014. Following receipt of the terms of reference, the Productivity Commission placed notices in the press and on its website inviting public participation in the inquiry. Information about the inquiry was also circulated to people and organisations likely to have an interest in it. The Productivity Commission released an issues paper in January 2015 to assist inquiry participants with preparing their submissions. Prior to the publication of this draft report, the Productivity Commission accepted a total of 255 submissions (table A.1).

The Productivity Commission consulted with a range of organisations, individuals, industry bodies and government departments and agencies via visits and roundtables.

Table A.1 **Submissions received prior to publication of draft report**

Submitter	*Submission number*
Academics, University of Western Australia	189
Ai Group	172
Air Conditioning and Mechanical Contractors' Association of Australia	85
ALDI Stores	146
Alugia, J	55
Anglicare Australia	108
Asciano	138
Association of Mining and Exploration Companies	182
Australasian Railway Association	155
Australian Licenced Aircraft Engineers Association	183
Australian Association of Progressive Repairers	77
Australian Bureau of Statistics	166
Australian Catholic Council for Employment Relations	232, 254
Australian Chamber of Commerce and Industry	161
Australian Consortium for Research on Work and Employment (ACREW), Monash Business School	181
Australian Council of Social Service	165
Australian Council of Trade Unions	167
Australian Dairy Farmers	56
Australian Dismissal Services	44
Australian Education Union	63
Australian Federation of Employers and Industries	219
Australian Higher Education Industrial Association	102
Australian Hotels Association and Accommodation Association of Australia	164
Australian Human Resources Institute	46
Australian Human Rights Commission	110
Australian Institute of Employment Rights	140
Australian Institute of Marine and Power Engineers	68
Australian Logistics Council	52
Australian Meat Industry Council, The	236
Australian Mines and Metals Association	96
Australian National Retailers Association	216
Australian Newsagents Federation	218
Australian Nursing and Midwifery Federation	132
Australian Petroleum Production and Exploration Association	209
Australian Psychological Society	205
Australian Public Service Commissioner	170
Australian Public Transport Industrial Association	210
Australian Retailers Association	217
Australian Road Transport Industrial Organisation	103
Australian Services Union	128

(Continued next page)

Table A.1 (continued)

Submitter	*Submission number*
Australian Shipowners Association	206
Australian Sugar Milling Council	226
Australian Workers' Union, The	74
Balranald Pty Ltd (trading as Norris Park IGA)	23
Bergwald, A	1
BHP Billiton	168
Bluescope Steel	58
Bowley, TJ	148
Bray, JR	32
Brickworks	207
Buchanan, J	131
Building Service Contractors Association of Australia	220
Bushell, J	12
Business Council of Australia	173
Business SA	174
Busselton Chamber of Commerce and Industry	65
Byford, M	59
Caponecchia, C	72
Carers Australia	82
Catholic Commission for Employment Relations	99
CB&I Constructors Pty Ltd	238
Cement Industry Federation	204
Chamber of Commerce and Industry of Western Australia	134
Chamber of Commerce and Industry Queensland	150
Chamber of Minerals and Energy of Western Australia	199
Choong, K	11, 36
Civil Contractors Federation	62
Clare Dewan and Associates	42
Clubs Australia Industrial	60
Clubs Queensland	88
Co Invest Limited as Trustee for the Victorian Construction Industry Long Service Leave Fund	202
Communist Party of Australia	105
Community and Public Sector Union	160
Community and Public Sector Union, SPSF Group	90
Council of Small Business Australia	115
Craig Joy Consulting	49
Creighton, B, McCrystal, S and Johnstone, R	48
Cully, M	237

(Continued next page)

Table A.1 (continued)

Submitter	*Submission number*
Australian Government Department of Employment	158
East Coast Apprenticeships	27
eChenn	208
economic Security4Women	250
Ellem, B	45
Employment Law Centre of Western Australia	89
Ethnic Communities' Council of Victoria	75
Everson's Food Processors	54
Extron Design Services Pty Ltd	18
Fair Work Ombudsman	228
Fairweather, R	24
Family Business Australia	10
Favre, R	20
Federation of Ethnic Communities' Councils of Australia	69
Finance Sector Union	243
Finger, S and M	142
Footscray Community Legal Centre	143
Forsyth, A	251
Frappell, G	15
Freebairn, J	13
Freyens, B	149
G&T Security	50
Geelong Chamber of Commerce	177
Glencore	185
Government of South Australia	114
Graham, D	117
Griffiths, D	35
Group of individuals	188
Hair and Beauty Australia	47
Hancock, K	233
Health Employment Relations Medical Imaging eRelations Group	81
Health Services Union	203
Hemlof, L	3
Hicks, D	17
Hicks, R	40
Holland, S	25
HopgoodGanim Lawyers	225
Housing Industry Association	169
HR Business Direction	91
Information Technology Contract and Recruitment Association	193

(Continued next page)

Table A.1 (continued)

Submitter	*Submission number*
Innovative Research Universities	196
Institute of Public Accountants	180
Institute of Public Affairs	64
Interns Australia	66
Job Watch Inc	84
Jobs Australia	221
Jones, R	4
Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church in Australia	227
Justice Connect	127
Justice Iain Ross	171
JW Shannon Engineers	37, 67
K&L Gates	151
Kelly, S	83
King, A	152
Kingsford Legal Centre	87
Koci, S	34
Laan, R	107
Launceston Chamber of Commerce	124
Law Council of Australia	247
Law Institute of Victoria	195
Law Society of New South Wales	184
Law Society of South Australia	211
Legal Aid NSW	197
Linfox Australia Pty Ltd	137
Linney Strategies	113
Local Government NSW	222
Lukman, J	76
MacIver, L	111
Major Events Consulting Australia Pty Ltd	38
Mannkal Economic Education Foundation	92
Manufacturing Australia	126
Manufacturing Industries Group Apprenticeship Scheme	30
Mapleson, J	21
Maritime Union of Australia	121
Master Builders Australia	157
Master Electricians Australia	245
Master Grocers Australia and Liquor Retailers Australia	246
McCarthy, B	43
McDonald Murholme	194
McDonald, T	33

(Continued next page)

Table A.1 (continued)

Submitter	*Submission number*
McGrath-Champ, S	22
McPherson, G	101
Minerals Council of Australia	129
Minter Ellison (Melbourne)	239, 252
Minter Ellison (Sydney)	94
Mitolo Group, The	213
Mount Gambier Chamber of Commerce	147
National Centre for Epidemiology and Population Health, Australian National University	57
National Disability Services	136
National Electrical and Communications Association	159
National Farmers' Federation	223
National Foundation for Australian Women	154
National Retail Association	144
National Road Transport Association	186
National Tourism Alliance	39
National Union of Workers	125
National Working Women's Centres	242
Networks NSW (Ausgrid, Endeavour Energy, Essential Energy)	98
Northern Rivers Community Legal Centre	191
Norton Rose Fulbright	61
NSW Young Lawyers	198
O'Brien, F	6
Office of the Australian Small Business Commissioner	119
Office of the Commissioner for Public Employment	178
Office of the Merit Protection Commissioner	109
Origin Energy	141
Patmore, G	192
Paul Murphy and Associates Lawyers	14
Paws a While Boarding Kennels	71
Peabody Energy	241
Peetz, D	133
Per Capita	235
Philanthropy Australia	80
Police Federation of Australia	106
Ports Australia	249
Price, S	93
Printing Industry Association of Australia	139
Professionals Australia	212
Qantas Group	116

(Continued next page)

Table A.1 (continued)

Submitter	*Submission number*
Qube Ports Pty Ltd	123
Queensland Association of Independent Legal Services Inc	7
Queensland Council of Unions	73
Queensland Government	120
Queensland Nurses' Union	86
Rail, Tram and Bus Union	231
Recruitment and Consulting Services Association	248
Restaurant and Catering Australia	97
Rio Tinto	122
Rogers, N	9
Salvation Army, The	190
Seymour Timber and Hardware	53
Shockwaves Hair Design	41
Shop, Distributive and Allied Employees' Association	175
Shopping Centre Council of Australia	153, 255
South Australian Wine Industry Association and the Winemakers' Federation of Australia	215
St Vincent de Paul Society National Council	78
Steers, A	5
Stewart, A and others	118
Strategic Human Resources	104
Sydney Symphony Orchestra	100
TAB Agents Association (SA Branch) Inc	230
Textile Clothing and Footwear Union of Australia	214
Teys Australia and NPH Foods	179
Teys Australia	95
Toga Group	19
Transport Workers' Union	145
Ultimacy	16
Unions Tasmania	244
Unions WA	112
United Voice	224
University of New South Wales Policy Society	135
University of Sydney Business School Discipline of Work and Organisational Studies	26
Victorian Automobile Chamber of Commerce, Tasmanian Automobile Chambe of Commerce, Motor Trader's Association of New South Wales and Motor Trade Association of South Australia	201
Versatile Group	31
Victoria Legal Aid	200
Victorian Employers' Chamber of Commerce and Industry	79

(Continued next page)

Table A.1 (continued)

Submitter	*Submission number*
Victorian Government	176
Vintage Reds of the Canberra Region	163
Walk Free Foundation, and the Salvation Army-Freedom Partnership	156
Walk Industrial Services Pty Ltd	51
Watkins, S	8
Watts, S	162
Western Australian Government	229
Wilson, P AM	70
Woldring, K	2
Women's Legal Services NSW	234
Work and Family Policy Roundtable and the Women + Work Research Group, The	130
Worksite Resolutions	28
Young, S	29
In confidence	187, 240, 253

Table A.2 **Stakeholder consultations**

Organisation
Amendola, Steven
Acas (Advisory, Conciliation and Arbitration Service)
Australian Chamber of Commerce and Industry
Australian Council of Social Service
Australian Council of Trade Unions
Ai Group
Australian Mines and Metals Association
Ashurst
Australian Hotels Association
Australian Human Resources Institute
Australian Retailers Association
Australian Small Business Commissioner
Belchamber, Grant
Boral
Buchanan, John
Business Council of Australia
Catholic Commission for Employment Relations
Centre for Employment and Labour Relations Law
Cochlear
Council of Small Business Australia
Australian Government Department of Employment
Employment Research Australia
Fair Work Commission
Fair Work Ombudsman
Freyens, Benoit
Giudice, Geoffrey
Independent Contractors Australia
Isaac, Joe
Joint Commonwealth Tasmanian Economic Council
Melbourne University
Minerals Council of Australia
Ministry for Business, Innovation and Employment (NZ)
Power, Charles
Qantas
Reserve Bank of Australia
Richardson, Sue
Shell
Stewart, Andrew
Treasury
Teys Australia

Table A.3 **Roundtables**

Organisation	*Attendee/s*
Unions Roundtable	
Monday 23 March 2015	
530 Collins Street, Melbourne	
Australian Council of Trade Unions	Belinda Tkalcevic
	Gabrielle Starr
	Jessica Dolan
	Matt Cowgill
	Trevor Clarke
Australian Education Union	David Colley
Australian Manufacturing Workers' Union	Sally Taylor
	Sonja Terpstra
Australian Nursing and Midwifery Federation	Nick Blake
Australian Services Union	Linda White
Australian Workers Union, The	Jamila Gherjestani
Community and Public Sector Union	Karen Batt
	Mark Perica
	Rebecca Fawcett
Construction, Forestry, Mining and Energy Union	Tom Roberts
Health Services Union	Leigh Svendsen
Maritime Union of Australia	Aaron Neale
National Tertiary Education Union	Susan Kenna
Professionals Australia	Michael Butler
Shop, Distributive and Allied Employees' Association	Julia Fox
	Katie Biddlestone
Minerals Council of Australia Roundtable	
Tuesday 24 March 2015	
10-16 Queen Street, Melbourne	
BHP Billiton	Matthew Brady
Downer EDI Mining	Hilton Hurst
Glencore	Dave Paterson
Minerals Council of Australia	Brendan Pearson
	John Kunkel
MMG	Leanne O'Brien
Newcrest Mining	Simon Beach
Peabody Energy	Geoff Woodcroft
Rio Tinto	Paul Davies
Wesfarmers Resources	Grant Harrison

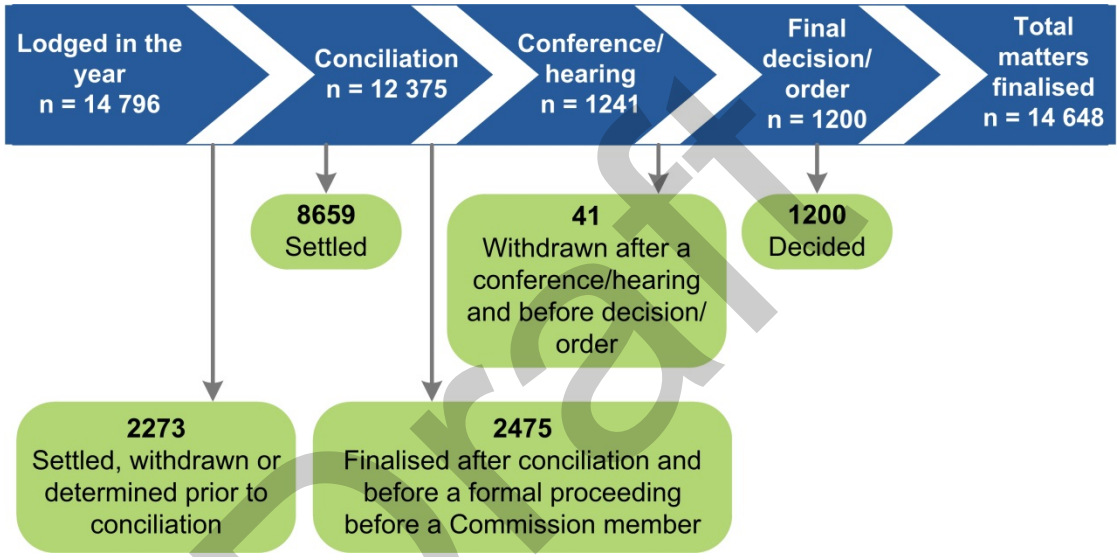
Table A.4 **Workshops**

Organisation	*Attendee/s*
Preliminary Workplace Relations CGE Modelling Workshop	
Wednesday 24 June 2015	
15 Moore Street, Canberra	
Australian Bureau of Statistics	Joe Whelan
	Rajni Madan
Australian Government Department of Employment	Victoria Gilmore
	Leo Vance
	Lace Wang
Australian Government Department of the Prime Minister and Cabinet	Oliver Richards
Reserve Bank of Australia	Martin McCarthy
The Treasury	Mike Kouparitsas
	Damian Mullaly
University of Melbourne	Jeff Borland
Victoria University Centre of Policy Studies	Philip Adams

B Unfair dismissal data

Figure B.1 **Flow chart of unfair dismissal cases by manner of finalisation**

Cases finalised in 2013-14[a]



[a] Totals do not match due to some matters not being finalised in the year.

Sources: FWC (2014b), Appendix K, table K.9.

Table B.1 Incidence of recent dismissal claims (from AIRC/FWC annual reports)

Cases	*Lodged (total)*	*Lodged under general protection provisions (s.365)*	*Dismissed (procedure or jurisdiction)*	*(WCh)*	*(FW)*	*Finalised*	*(WCh)*	*(FW)*	*Conciliated (finalised at or prior to conciliation)*	*%*	*Finalised pre-arbitration (without requiring tribunal/ decision)*	*Substa-ntively arbitrated*	*(WCh)*	*(FW)*	*% of lodg-ments*
2000-01	8109					7809			6096	78	1422	291			3.7
2001-02	8658					8658			6719	78	1648	291			3.4
2002-03	7121		223 ave. for period 1997–2006			7326			5876	80	1209	241			3.3
2003-04	7044					7125			5763	81	1139	223			3.1
2004-05	6707					6841			5654	83	985	202			3.0
2005-06	5758					6006			4739	79	1143	124			2.1
2006-07	5173		357			5531			4508	82	922	101			1.8
2007-08	6067		531			6281			5282	84	930	69			1.1
2008-09	7994		598			6980			5972	86	913	95			1.4
2009-10	11 116[a]	1188	350	241	109	11 569	2200	10 545	8897	77	780	142	55	87	1.2
2010-11	12 840[a]	1871	201	5	186	12 398	97	12 301	9948	80	1922	316			2.5
2011-12	14 027	2162	226			14 063			11 410	81	2059	325			2.3
2012-13	14 818	2429	258			13 945			11 143	80	2093	402			2.7
2013-14	14 796	2879	374			14 648			10 932	75	2475	826			5.6

a Values reported for lodgments from 2009-10 to 2010-11 in this table include unfair dismissal applications lodged under s.394 of the FW Act (FW), and s.643 of the Workplace Relations Act (WCh). This differs from F&O (2013a) but is consistent with the FWC's reporting requirements (see O'Neill (2012)). Because of the addition of lodgements from several avenues, totals may differ from those shown in subsequent tables.

Sources: Updated from Freyens and Oslington (2013) using data from the FWC Annual Reports, 2009-10 to 2013-14, (2012b).

Table B.2 Number and outcomes of arbitrated cases (from AIRC/FWA annual reports)

Arbitrated Cases	*Substantive Arbitration: Total*[a]		*FWA Compensation: Total*		*FWA Reinstatement: Total*		*FWA Dismissed on merit: Total*		*Plaintiff success rate in cases substantively arbitrated: Total*[b]	*FWA*
2000-01	291		96		42		142		47	
2001-02	291		96		47		148		49	
2002-03	241		81		24		136		44	
2003-04	223		84		22		117		48	
2004-05	202		69		18		115		43	
2005-06	124		52		17		55		56	
2006-07	101		35		8		58		43	
2007-08	69		17		18		34		51	
2008-09	95		22		14		59		38	
2009-10	142	87	51	35	22	15	67	35	51	57
2010-11	316	316	122	122	25	25	165	216	47	40
2011-12	325	325	85	85	17	17	215	215	31	31
2012-13	402	402	112	112	20	20	256	256	33	33
2013-14	826	826	150	150	34	34	175	175	22	22

[a] Totals refer to claims under all workplace relations systems. The FWA column includes only claims made under the FWA. The number of FWA cases is not explicitly stated for 2012-13. However, in 2011-12, all substantively arbitrated cases related to s. 394 of the FWA. Therefore the assumption is made that this is also the case in 2012-13. [b] The plaintiff success rate is the sum of compensation and reinstatement outcomes divided by the total number of cases arbitrated.

Sources: Updated from Freyens and Oslington (2013) using data from the FWC Annual Reports, 2009-10 to 2013-14; O'Neill (2012b).

Table B.3 **Average timeframes of Fair Work Australia to process s.394 applications**

	1 July 2010-30 June 2011	*1 July 2011-30 June 2012*
Average number of days taken from lodgement to initial allocation	1	1
Average number of days taken from lodgements to dispatch of notice of listing	9	9
Average days taken from lodgement to finalised conciliation[a]	29	29
Average days taken from lodgement to arbitration listing (conference or hearing)	140	152
Average days taken from lodgement to judgment [b] by Fair Work Australia member	175	171
Average days [c] taken from lodgements to finalisation	49	49

[a] Includes any subsequent conciliation listings (e.g. where matter is adjourned). [b] Judgement relates to a final decision or order (ie. 'jurisdictional objection upheld', application dismissed or application granted). [c] Finalisation relates to a matter that has had a final result recorded and includes conciliations, arbitrations and matters withdrawn and is based on all matters finalised.

Source: O'Neill (2012b).

Table B.4 **Conciliation settlements**

	2010-11			*2011-12*			*2013-14*		
	Number	% of monetary settlements		Number	% of monetary settlements		Number	% of monetary settlements	
Settlements involving money	**5641**	**100**	**100**	**6629**	**100**	**100**	**6607**	**100**	**100**
$0–$999	587	10		630	10		460	7	
$1000–$1999	970	17	55	1120	17	53	1010	15	49
$2000–$3999	1559	28		1784	27		1786	27	
$4000–$5999	993	18	27	1167	18	28	1275	19	30
$6000–$7999	542	10		661	10		741	11	
$8000–$9999	285	5	13	376	6	13	406	6	14
$10000–$14999	426	8		503	8		556	8	
$15000–$19999	138	2		184	3		172	3	
$20000–$29999	95	2		142	2		141	2	
$30000–$39999	24	0	5	43	1	6	43	1	6
$40000–max	16	0		12	0		14	0	
>maximum	6	0		7	0		3	0	
Non-monetary	**2097**			**2435**			**2313**		
Total	**7712**			**9039**			**8920**		

Source:O'Neill (2012b), Fair Work Australia (2012a), FWC (2013a), FWC (2014b).

Table B.5 **Arbitration payments**

	2010-11			*2011-12*			*2012-13*			*2013-14*		
	Total	Share of total		Total	Share of total		Total	Share of total		Total	Share of total	
Application granted: compensation	**118**			**81**			**104**			**140**		
$0–$999	1	1%		4	5%		8	7%		7	5%	
$1000–$1999	2	2%	31%	11	14%	36%	12	11%	34%	9	6.4%	26%
$2000–$3999	33	28%		14	17%		15	13%		20	14.3%	
$4000–$5999	17	14%	25%	12	15%	26%	13	12%	20%	18	13%	21%
$6000–$7999	12	10%		9	11%		8	7%		12	8.6%	
$8000–$9999	6	5%		5	6%		8	7%		17	12.1%	25%
$10000–-$14999	13	11%	16%	6	7%	14%	14	13%	21%	18	12.8%	
$15000–$19999	16	14%		7	9%		7	6%		8	5.7%	
$20000–$29999	12	10%		5	6%		8	7%		13	9.3%	
$30000–$39999	4	3%	29%	4	5%	25%	8	7%	25%	8	5.7%	28%
$40000–maximum	2	2%		4	5%		3	3%		10	7.2%	

Sources: O'Neill (2012b), Fair Work Australia (2012a), FWC (2013a), FWC (2014b).

C Australian empirical studies of wage employment effects

This appendix reviews the Australian empirical literature on the effects of wages on aggregate employment to gauge the possible overall employment responses of changes in wages (whether they be changes to minimum wages, award wages or general wages). The aggregate responses assessed subsume a vast array of responses by individual firms, their employees and potential employees. These responses are conditioned by many firm-specific and local characteristics that make it difficult to ascertain the extent to which the findings of these studies apply to labour markets in aggregate, and are the subject of an extensive literature which is not the focus of this appendix.

The appendix has the following structure:

- section C.1 outlines some of the theoretical, data and technical issues that need to be confronted to help assess the relationship between wages and employment
- section C.2 summarises the key findings of the Australian empirical studies
- section C.3 discusses the studies' methodologies and findings in more detail
- section C.4 reviews how the empirical findings have been interpreted in general equilibrium modelling.

C.1 Issues in assessing the employment effects of wage changes

Theoretical considerations

Wages can have a variety of effects. Wage rates, and the associated additional costs incurred in employing labour, affect the *relative* cost of labour compared to the cost of other inputs such as capital, while variations in *relative* wage rates influence the demand for different types of workers (such as the combinations of skills, experience and other characteristics that different types of workers possess), by affecting the cost of one group of workers relative to another. These impacts may affect the number of people employed, the nature or type of their employment (such as full-time vs part-time or ongoing vs contract) and the hours that they work.

By affecting the cost of employing workers on the minimum wage *relative* to those that are not and relative to the cost of capital, changes in the minimum wage may have wider employment and income impacts than just those directly resulting from minimum-wage changes (box C.1).

These impacts may take time to occur and any measured impact may be influenced by both labour market effects and broader responses, such as changes in investment behaviour of firms, the relative competitiveness of those firms and consumer behaviour that occurs in response to changes in their disposable income. Because the nature and scale of adjustment takes time, identification of the time-period over which empirical estimates of the responsiveness of employment to changes in wages rates is critical to the interpretation of estimates of change.

To aid comparability across studies, the empirical literature usually presents the employment effects of wage changes in terms of 'employment elasticities'. *Minimum-wage elasticities* denote the percentage change in employment implied by a one per cent change in the *minimum* wage, while *average-wage elasticities* indicate the employment effects of a one per cent change in the *average* wage, that is, the broad level of wages that applies across the economy. The sign of the elasticity indicates whether employment is positively or negatively related to the wage change being examined (either the nominal or real wage depending on the study). Thus, for example, a minimum-wage elasticity of -1 would indicate that employment of minimum-wage workers *decreases* by one per cent in response to a one per cent *increase* in the minimum wage, while an elasticity of +1 indicates that employment of minimum-wage workers *increases* by one per cent.

In turn, minimum wage elasticities fall into three broad groups:

- the impact of minimum-wage changes on the employment of *minimum-wage* workers (termed the 'own-price elasticity of employment');
- the impact of minimum-wage changes on the employment of *above minimum-wage* workers (termed the 'cross-price elasticity of employment'); and
- the impact of minimum-wage changes on *total* employment (covering both minimum-wage and above minimum-wage workers) (termed the 'total elasticity of employment').

Data issues

There is no one measure of 'minimum-wage' employment in Australia, in large part due to the interaction between the national minimum wage, the entry-level minimum wage that applies in each award and the interlinkage with award rates of pay more generally. Moreover, there is no comprehensive statistical data on the way employee remuneration is determined in Australia (chapter 2). As a result, the studies reviewed adopt different measures of 'minimum wage' employment or instead use proxies that they consider to be appropriate.

Box C.1 Stylised economywide employment effects arising from changes in the wages of certain groups of workers in the labour market

Estimating the responsiveness of employment to wage changes is complicated by numerous complexities in that way labour markets operate in the real world (such as the presence of search and transaction costs, information asymmetries, firm-specific characteristics and lagged responses) that affect the nature and timing of responses of employees (which affects the supply of labour) and employers (which affects the demand for labour). While relevant to all assessments, these complexities are more of an issue for firm-level studies than for those of the aggregate or economywide labour markets.

This box presents a stylised partial-equilibrium framework for conceptualising how specified changes in the wages of one group of workers (in this case, those on minimum wages) may impact on *aggregate* employment (as opposed to firm-level employment). The nature of these impacts is important in understanding what each of the studies reviewed in this appendix seeks to do and to better understand the nature and relevance of their findings.

The framework adopts the simplifying assumptions that the minimum wage is paid to a proportion of workers and is binding (that is, it is set above the wage that would otherwise prevail), that there is a pool of ('involuntarily') unemployed workers, and that labour markets are free to adjust to changes in relative wage rates. In this partial framework, a rise in the minimum wage, from W_0 to W_1, would be expected to lead to a fall in the employment of those workers (the treatment group for this example) and increase unemployment from U_0 to U_1 (figure C.1, left panel), all other things remaining equal. This corresponds to a negative 'own–price elasticity' of employment for the minimum-wage workers in aggregate.

Firms, in aggregate, may respond to the rise in the minimum wage relative to other wages by substituting towards workers who are not on the specified wage (figure C.1, middle panel). This substitution effect, in aggregate, gives rise to a positive 'cross-price elasticity' of above minimum-wage workers with respect to the minimum-wage wage rise.

Figure C.1 Stylised representation of the employment effects of a hypothetical rise in the minimum wage

(Continued next page)

Box C.1 (continued)

The net effect on *total* employed persons depends on two potentially opposing effects (figure C.1, right panel). The net effect of an increase in the minimum-wage rate on workers subject to the minimum wage relative to the wage rate of other workers would be negative if the decrease in minimum-wage employment in persons is not offset by an increase in employment in persons of workers that are not on the minimum wage. The magnitude of any net effect on total employment may be negligible if the change in minimum wages is small or if those workers affected by the specified change constitute a small share of the overall labour market.

In this stylised representation, if the prevailing wage is below the market clearing wage, employment of minimum wage workers would rise with an increase in the wage rate. The impact of a wage change on overall employment of the treatment group would then depend on the relationship between the prevailing wage and the 'equilibrium' or competitive market-clearing wage.

In practice, estimating the responsiveness of employment to wage changes is not straightforward, as employees and employers move along their labour supply and labour demand curves, and both the demand and supply curves for labour shift over time (both of which affect observed employment outcomes). Estimating the responsiveness of employment to wage changes also involves an assessment of the relationship between the designated wage rate (the minimum wage in this case), the wage rate actually paid to workers and the wage rate that would apply in the absence of the specified wage. The effects of other non-wage factors on the observed employment outcomes also need to be taken into account where relevant (such as the effect of changes in output, profitability, productivity and the regulatory environment).

It is also important to understand the level of analysis used in each study. The employment impacts may be on the economy as a whole, on a particular industry or sector, or on groups or individuals. Surveys and analysis of unit-record datasets — datasets containing records on the labour-market responses of individuals — often use sample weights to draw inferences on the implications for the wider population after controlling for environmental factors that may influence decision making.

The higher the level of analysis undertaken, the more likely it is that factors other than minimum wages, which should be controlled for in the analysis, determine the observed employment outcomes. Thus, minimum-wage employment elasticities would be expected to be lower for *total* employment than for employment of minimum-wage workers.

Technical issues

The empirical literature uses quantitative techniques, usually econometric, to seek to ascertain whether changes in wage rates are statistically related to changes in employment (typically expressed in terms of persons employed or total hours worked) (box C.2).

Given the generally small changes in minimum wages in Australia (chapter 8), estimating the overall response of employment is not straightforward. The studies typically use data on observed employment outcomes, which are a consequence of the demand for labour by employers and the supply of labour by workers as well as a range of other factors such as

changes in output, the general business environment, firm-level profitability, productivity and the regulatory environment. In addition, the impact of any wage change on an individual firm or group of firms need not be the same as the impact on the overall labour market, which takes into account the responses of all firms and all people looking for work (the supply of labour).

The studies reviewed seek to establish the *aggregate* effect of wage changes on employment in one of two ways:

- by comparing the impact on affected workers (termed the treatment group) relative to non-affected workers (termed the control group) using cross-sectional or panel data techniques; or
- by ascertaining the effect on total employment, or that of the subgroup being examined for minimum-wage studies, over time (often termed time-series analysis).

Box C.2 Techniques used in the Australian empirical literature to assess the effects of wage changes on the aggregate employment

The Australian empirical literature uses a range of methodologies to assess the effects of minimum-wage changes on employment, while average wage studies typically use a single technique (error correction models).

Ordinary least squares regressions (OLS) use regression analysis to ascertain if employment growth is statistically related to the growth in wages and aggregate demand (usually expressed in terms of real GDP) over time. Aggregate demand is included to account for the effect of changes in the level of output on employment. Some studies also include a time trend to pick up the effects of technological change. There are many weaknesses with the use of OLS regressions in this context, including the need to control for other factors affecting employment growth and the potential for spurious results if there are underlying trends in the wages and employment time series being used.

Generalised least squares regressions (GLS) correct for the presence of correlation over time in employment and wages. This approach is suited to large sample sizes, but can be less reliable than OLS for small samples.

Error correction models are an extension of OLS regressions that ascertain the impact of changes in wages (usually general wage changes) on aggregate employment over time. A strength of this approach is that it enables the speed at which employment (the dependent variable) returns to equilibrium after a change in wages (one of the independent or explanatory variables) to be assessed. Error correction models can be used to estimate both short-term and long-term effects of one time series on another and can overcome the spurious results that may arise from the use of OLS where trends exist in the wages and employment data being used. A potential weakness with error correction models is that they generally do not control for the influence of other factors that may affect the dependent variable, such as changes in the institutional arrangements that govern the operation of the labour market.

(Continued next page)

Box C.2 (continued)

Difference–in–differences regression analysis estimates the effect of minimum-wage changes on one group affected by that policy (termed the treatment group) compared with the measured effect on another otherwise 'identical' group (termed the 'control' group). Instead of controlling for the various factors that influence employment, as would normally be done in regression analysis, it is assumed that the employment growth in the treatment group would have been the same as in the control group, but for the difference in the policy being examined. A challenge for difference–in–differences analysis is to find a control group that is sufficiently comparable to the treatment group so that any differences reflect the effect of the minimum-wage changes on the treatment group.

Regression discontinuity analysis is a related technique that measures the change in employment immediately before and after a change in the minimum wage. The situation before is used as the 'control' and the situation immediately after is considered to be affected by the change. Any difference is regarded as the effect of the change. It assumes that the change in wage is not anticipated and factored into employment decisions before it occurs and that any change in employment only reflects the effects of the minimum wage.

Structural break analysis involves a statistical test to see if there is a change in the characteristics of the employment data when the minimum wage is adjusted. If such a change does occur, this may suggest that the minimum wage has affected employment.

A *multinominal logit model* uses regression techniques to estimate the probability of alternative labour market outcomes (such as staying in employment, gaining employment, becoming unemployed or exiting the labour market) based on the characteristics of individuals in cross-sectional unit or panel data (a time series of cross-sectional data over time).

Surveys have also been used to estimate the effect of wage changes on employment by asking employers to indicate how their employment decisions were affected by an actual wage change or how their employment decisions might be affected by a hypothetical policy change. The usefulness of this technique depends on, among other things: the size of the sample used; how well the sample represents the underlying population of interest, and whether there are biases present in the questions and/or responses.

Some studies, such as those using difference-in-differences techniques, may seek to combine aspects of both approaches. The minimum-wage studies reviewed in this appendix use both approaches — cross-sectional and time-series — whereas the studies into the employment effects of average wages typically use time-series analysis.

The choice of benchmark used in measuring the effect of any wage change (termed the 'counterfactual') is an important aspect of empirical studies and affects how the results should be interpreted and what other factors should be controlled for. Some studies use estimates of what would have happened in the absence of the wage change being examined as their counterfactual. This becomes the basis for estimating the effect of the wage change. Other studies use the state of the world *before* the wage change being examined as their counterfactual. Yet other studies use a control group as a counterfactual on the basis that they are deemed to have the same (or sufficiently similar) characteristics as the treatment group (and, hence, that the key difference between the two groups should arise from the change in wages affecting the treatment group).

Whichever approach is used, it is important that the studies control for the impact of other factors that may affect the measure of employment being used in order to avoid spurious conclusions being drawn about the impacts of wage changes. The choice of other factors can be controlled for directly in some techniques by including other variables in the relationships being estimated or indirectly through statistical techniques such as 'fixed' or 'random' effects models, or by differencing. This is particularly important in time-series studies, as changes in the level and composition of employment are also driven by a myriad of factors over time, including:

- employer and employee characteristics that are persistent during the sample and which influence behaviour in a manner material to the study of the responsiveness of employment to wage changes (often referred to as fixed effects);
- changes in market conditions, skill levels, technology and organisational change that affect the demand for labour;
- demographic and other factors that affect the supply of labour; and
- the broader institutional and economic environment that govern the operation of labour markets (such as employment standards).

Most empirical studies assess the 'initial' impacts of minimum-wage changes (typically those occurring within less than one year), as they do not control for longer-term factors that may affect the level of employment (such as changes in the use of capital and profitability of firms' employment). Some studies attempt to ascertain impacts beyond one year by controlling for some of these longer-term factors influencing employment, such as ongoing economic growth or changes in relative competitiveness arising from non-labour market factors (for example, terms of trade effects). This is usually achieved in Australian studies through the use of error correction models (box C.2).

C.2 Summary of the Australian effects of wage changes

Overview of the studies reviewed

The Commission has identified eight Australian empirical studies that, since 1999, assess the effect of changes in the *minimum wage* on employment, and a further eight that look at the broader impact of changes in *average wages*. Each of these studies is reviewed in section C.3.

The minimum wage studies identified comprise a mix of:

- published articles in refereed academic journals (Junankar, Waite and Belchamber 2000; Lee and Suardi 2011; Leigh 2003, 2004a, 2004b; Mangan and Johnston 1999);
- published articles in a journal that have not been refereed (Lewis 2005);

- research papers submitted to, or published by, government agencies, such as the Fair Work Commission (and its predecessor organisations) or the Department of Employment and Workplace Relations, that do not appear to have been externally refereed (Harding and Harding 2004; Lewis 2006); and
- conference papers that do not appear to have been externally refereed (Olssen 2011; Plowman 2007).

Reflecting in part the different publication and refereeing requirements, the quality and thoroughness of the studies reviewed here may vary.

This appendix also includes studies that look more broadly at the impact of general wage changes on total employment (covering wage changes applying to both minimum-wage and above minimum-wage workers). These have all been peer reviewed.

The average wage studies identified comprise a mix of:

- published articles in a journal that have been refereed (Dixon, Freebairn and Lim 2005; Lewis and MacDonald 2002);
- research papers published by government agencies that have been peer refereed — the Fair Work Commission (Yuen and Mowbray 2009), Productivity Commission (Daly et al. 1998), the Reserve Bank of Australia (Debelle and Vickery 1998; Dungey and Pitchford 1998) or the Australian Treasury (Downes and Bernie 2009; Hutchings and Kouparitsas 2012).

A lack of suitable Australian data restricts the analysis that can occur

One conclusion that emerges from the studies reviewed is that there is a dearth of Australian data for identifying and assessing the impact of minimum wages on *minimum-wage* workers. Plowman (2007) notes that:

> … the capacity to undertake statistical analysis in Australia [on the effect of minimum-wage adjustments] is more limited as there is not the same richness of data. In the USA, it is possible to obtain a range of data on those who are employed at hourly rates at, or below, the federal minimum. These include such matters as industry of employment, marital status, age, gender, educational attainment, usual hours worked per week, region/state, ethnicity, major occupation, and full-time or part-time status. (p. 12)

In an attempt to overcome this, some Australian studies seek to draw inferences from:

- industries considered to be more likely to be affected by minimum-wage adjustments (Junankar, Waite and Belchamber 2000; Plowman 2007); or
- in one case, a group of two industries relative to the rest of the economy (Lewis 2005).

Even where data are available, there are apparent inconsistencies across studies in how they use what appears to be otherwise comparable data items (table C.1).

Table C.1 **Minimum wage reported for Western Australia**

$ per week

Wage applying at:	*Plowman (2007)*	*National wage case (excluding metal workers)*[b]	*National wage case (including metal workers)*[b]	*Federal minimum wage*	*Western Australia's statutory minimum wage (Leigh 2003)*
June 1996	270[a]	260.30	349.4	n/a	317.1
June 1997	370[a]	n/a	n/a	359.40	332.0
…	…			…	
June 2006	484.40			484.40	

[a] Estimate based on Plowman (2007, fig. 3). [b] Prior to the introduction of the Federal Minimum Wage in April 1997, the national minimum wage for metal workers differed from that of other workers.

Sources: Bray (2013); Leigh (2003); Plowman (2007).

The employment effects of changes in minimum wages

Drawing firm conclusions about the wider impacts of minimum-wage changes in Australia is not straightforward, given the limited number of studies undertaken, coupled with differences in the techniques and counterfactuals used as well as the time-periods analysed.

While the quality of the Australian empirical studies on the employment effects of changes in minimum wages vary, they are generally less robust and rigorous than the average wage studies. Of the minimum wage studies, Leigh undertakes far more rigorous testing than most, reflecting in part his response to various criticisms. Further, there is also relatively less consensus across the minimum-wage studies in terms of their findings than for the average wage studies. This is understandable given the relatively small number of Australian workers on minimum wages, the relatively modest changes in minimum wages relative to average wages and the limited number of natural wage experiments that can be analysed.

Of the eight minimum-wage studies reviewed, the five earliest studies found employment to be negatively related to changes in the minimum wage (table C.2)[263], Of these, three reported a statistically significantly relationship (Junankar, Waite and Belchamber 2000; Leigh 2003, 2004a; Mangan and Johnston 1999).[264] While not calculating the standard

[263] A negative effect indicates that a rise/fall in the minimum wage leads to a fall/rise in employment.

[264] Statistical significance is generally used in the literature as one indicator of how robust a finding may be, The statistical significance of results is the statistical probability of incorrectly concluding that there is an impact when in fact there is no impact. A one per cent level indicates this probability is only one per cent, and is the converse of saying there is a 99 per cent probability that there is an impact. This is the highest level of statistical significance usually reported. A five per cent level is less statistically

errors needed to test for statistical significance, two additional studies also found a negative relationship between minimum-wage changes employment (Harding and Harding (2004) and Lewis (2006)). In contrast, Plowman (2007) found a statistically significant positive relationship between the minimum wage and youth employment.[265] The two most recent studies — Lee and Suardi (2011) and Olssen (2011) — did not find a statistically significantly relationship. The different findings on statistical significance may reflect changes to the workplace relations framework that has occurred since 1999.

With respect to the *minimum* wage, the Australian studies find elasticities of:

- *total* employment range from -0.05 to -0.29 for up to one year (based on two studies) and -0.25 after five years (based on one study).
- *award-wage* employment of -0.55 for nominal wages and -0.72 for real wages after 10 years (based on one study); and
- *youth-wage* employment range from -0.05 to -3.1 for up to one year (based on two studies) and -2.6 after more than one year (based on one study) (table C.2).

Some of these elasticities appear implausibly high. For example, one study (Junankar, Waite and Belchamber 2000) found that a one per cent reduction in the ratio of the minimum-wage to adult wage may increase youth employment by between 2 and 3 per cent. In part, this may reflect the small sample size used which gives rise to high standard errors in the study.

Even without this study, the remaining elasticities generally suggest that, given the small number of minimum-wage workers in Australia, there is a degree of pass through of minimum-wage changes to the elements of the broader workforce or that the substitution possibilities between minimum-wage workers and other workers are limited, so that changes in minimum-wage employment flows directly to aggregate employment.

significant than the one per cent level. A ten per cent level is usually the lowest level that is reported in the literature.

265 While Plowman did not report the magnitude of the employment effect, the sign of the effect can be inferred from the test statistic which he did report Plowman (2007, p. 18).

Table C.2 **Australian estimates of the elasticity of employment with respect to minimum-wage changes**

Study	*Broad type of technique used*	*Elasticity measure*	*One-year or less*	*More than one-year*
Employment specified in terms of persons				
Mangan and Johnston (1999)	Econometric	Youth employment wrt the ratio of the youth award wage to adult average weekly earnings	-0.05** to -0.31 (1 year)	
Junankar, Waite and Belchamber (2000)	Econometric	Youth employment wrt the ratio of the youth minimum wage to adult average weekly earnings	-3.1** (1 quarter, manufacturing)	-2.6** (time scale n/a, retail)
Leigh (2003, 2004a)	Econometric	Total employment wrt the nominal minimum wage	-0.29*** (3 months)	
Harding and Harding (2004)	Sample based	Total employment wrt the nominal minimum wage	-0.05 (1 year)	
		Total employment wrt the real minimum wage		-0.25 (5 years)
Lewis (2005, 2006)	Statistical	Minimum-wage employment wrt the nominal minimum wage		-0.55 (10 years)
		Minimum-wage employment wrt the real minimum wage		-0.72 (10 years)
Plowman (2007)	Econometric	Total employment wrt the nominal minimum wage	No estimate provided, but reports 'little effect'	
Lee and Suardi (2011)	Econometric	Youth employment wrt the nominal minimum wage	No evidence of any effect	
Employment specified in terms of hours worked				
Olssen (2011)	Econometric	Youth employment wrt the nominal minimum wage	No evidence of any effect	

wrt: with respect to. Statistical significance: ★★★: one per cent; ★★: five per cent; and ★: ten per cent.

Notwithstanding possible concerns with individual studies, when viewed collectively these employment elasticities suggest that:

- minimum-wage changes in Australia, if anything, tend to have a small and negative effect on the total employment (that is, taking into account the impact on both minimum-wage and above minimum-wage workers);
- the impacts may be stronger for certain subsections of the labour market, particularly younger workers (Leigh found statistically significant effects for females aged 15 to 24 and males aged 15 to 34. Mangan and Johnston found statistically significant effects for young people in Queensland and in Australia, but of a smaller magnitude than those reported by Leigh).
  - In contrast, Junankar, Waite and Belchamber (2000) reported little evidence of a statistically significant employment effect on youth employment. However, they did report that their sample size was small (Junankar, Waite and Belchamber 2000, p. 180) which would make it more difficult to discern a statistically significant effect;
- there is some evidence to suggest that minimum-wage changes may indirectly impact on other subsections of the labour market — the statistical significance of Leigh's finding that minimum-wage changes have a positive impact on female workers aged 45 to 54 suggests that they may be substitutes for minimum-wage workers; and
- the impact tends to increase (to be higher in an absolute sense) over longer time periods, which is consistent with employers having greater scope and ability to expand or contract operations over time and for employees to move between employment opportunities and in and out of employment.

The employment effects of changes in average wages

The findings of Australian empirical studies on the employment effects of changes in *average wages* are generally more robust than the minimum wage studies. Access to better data and wage changes that affect the broader workforce enable the average wage studies to employ more uniform methodologies, control for additional variables and undertake more rigorous statistical testing.

A key finding that emerges from these studies is that the level of real output is the main driver of employment over time, rather than wages *per se*. Estimates of the elasticity of employment in Australia with respect to real output lie in the range of +1.0 to +1.3. That is, a one per cent *rise* in real output is found to lead to between a 1 to 1.3 per cent *increase* in aggregate employment.

Another key finding is that that average wage changes have a negative and statistically significant effect on employment, which rises as more time passes after a change in wage. Estimates of the total elasticity of employment with respect to the average wage range from:

- -0.2 to -0.5 after one quarter, and
- -0.3 to -0.8 after one year (or -0.4 to -0.9 if employment is measured in hours worked).

Furthermore, these elasticity estimates are based on the assumption that output is unaffected by the change in wage. As output adjusts, the employment effects are likely to increase further.

The *average-wage* studies raise three additional issues that may assist in understanding the *minimum-wage* effects on employment, but, because of data limitations, are not generally explored in the Australian minimum-wage literature.

First, the literature indicates that the employment impact of a change in wages is greater on employment specified in terms of hours worked than in terms of persons employed. Two studies considered the employment effect in terms of both hours worked and the number of employees (Downes and Bernie 2009; Lewis and MacDonald 2002). Both found the real, long–run wage elasticity to be larger when employment is defined in terms of hours worked than when it is defined in terms of the number of employees.

Second, most of the studies indicate that employment adjusts to its long–run equilibrium in response to, for example, a change in the average wage, within one to three years (table C.3). Dixon, Freebairn and Lim (2005) found that the speed of adjustment varies over the business cycle, with the speed of adjustment being higher during a recession than during the rest of the business cycle. They estimate that employment adjusts within one year during a recession, but employment would otherwise take three years to adjust. They contend that there is greater adjustment pressure from employers during a recession and more willingness on the part of workers to accept the adjustment.

Third, the employment response to wages is concentrated in the private sector. Downes and Bernie (2009) analyse the employment response of the Australian labour market both including and excluding Government employment. They find the elasticity of private employment to be around -0.8, compared with -0.6 for total employment.

Table C.3 Australian estimates of the elasticity of employment with respect to average-wage changes

Study	*Broad type of technique used*	*Elasticity measure*	*One-year or less*	*More than one-year*
Employment specified in terms of persons employed				
Daly et al. (1998)	Econometric	Youth employment wrt average youth wage	-2 to -5 [a] (1 year)	
Dungey and Pitchford (1998)	Econometric	Total employment wrt the real average wage		-0.4*** (time scale n/a)
Downes and Bernie (2009)	Econometric	Total employment wrt the real average wage	-0.3 to -0.4 (1 year)	-0.6 (2 to 3 years)
Lewis and MacDonald (2002)	Econometric	Total employment wrt the real average wage		-0.8*** (1 to 1.5 years)
Dixon, Freebairn and Lim (2005)	Econometric	Total employment wrt the real average wage	-0.11*** (1 quarter)	-0.32*** (3 to 4 years)
Yuen and Mowbray (2009)	Econometric	Total employment wrt the real average wage	-0.2 (1 quarter)	-0.5*** (1.5 to 2 years)
Hutchings and Kouparitsas (2012)	Econometric	Total employment wrt the real average wage	-0.14 (1 quarter)	-0.4*** (7 to 8 years)
Employment specified in terms of hours worked				
Debelle and Vickery (1998)	Econometric	Total hours worked wrt the real average wage	-0.21*** (1 quarter)	-0.4*** (1.5 to 2 years)
		Total hours worked wrt the real average wage	-0.51*** (1 quarter)	-0.7*** (1.5 to 2 years)
Lewis and MacDonald (2002)	Econometric	Total hours worked wrt the real average wage		-0.9*** (time scale n/a)

wrt: with respect to. Statistical significance: ★★★: one per cent; ★★: five per cent; and ★: ten per cent. [a] Range of elasticity estimates reported by authors for industries that employ a high proportion of youth. Statistical significance varied from not statistically significant at the 10 per cent level in some industries, to statistical significant at the one per cent level in other industries.

C.3 Empirical studies of the impact of wage changes

This section reviews each of the sixteen Australian empirical studies identified that estimate the effects of wage changes on employment.

For each study, the review focuses on:

- how the study was undertaken;
- the techniques and data sources used;
- what other factors, if any, were controlled for;
- whether the findings are robust, including whether results were statistically significant at either the one, five or ten per cent level;
- the sign of the effect found on employment to indicate the estimated direction of the relationship (positive or negative);
- the employment elasticity if it is reported, or the elasticity implied if not, to indicate the magnitude of the effect; and
- the type of publication and the extent of any external refereeing or peer review.

Where relevant, the review also includes assessments of the studies in the literature.

Studies of the employment effects of changes in minimum wages

The Commission has found eight empirical studies of the employment impacts of minimum wages in Australian since 1999. These studies are summarised in table C.4.

Table C.4 **Australian empirical studies of the employment effects of minimum-wage changes**

Study [Coverage]	*Minimum wage event and time period of analysis*	*Method of analysis*	*Description of data*	*Estimate of elasticity with respect to the minimum wage*	*Statistical significance of results*
Mangan and Johnston (1999) [Australia and Queensland]	Method 1: Variation over time in Queensland youth award wage relative to adult average weekly earnings for non–managerial occupations from 1980 to 1994 Method 2: Minimum wage change in 1996 **a**	Method 1: Generalised least squares regression of both full time and part time employment to population ratio of youth on the ratio of the youth award wage relative to the adult average weekly earnings, gross state product and a time trend Method 2: Multinominal logit model of probability of a young person's labour market status (full time, part time, unemployed or not in the labour force)	Method 1: ABS annual Queensland data Method 2: unit record census data for Queensland and Australia **a**	Method 1: -0.08 (full time, real, 1 year) and -0.19 (part time, real, 1 year) Method 2: -0.07 to -0.28 (Queensland, real, 1 year) and -0.05 to -0.31 (Australia, real, 1 year)	Method 1: no results were significant at the 5 per cent level Method 2: Four out of six elasticity estimates were statistically significant at the 5 per cent level
Junankar, Waite and Belchamber (2000) [Australia]	Variation over time in youth minimum wage relative to adult average weekly earnings from 1987 to 1997	Error correction model in which youth hours of employment depends on the youth minimum wage relative to the adult average weekly earnings and output. Estimated for retail trade and manufacturing; full time and part time; male and female and ages 16, 17, 18, 19 and 20.	Seasonally unadjusted quarterly data: output by industry from ABS, youth wages and adult average weekly earnings from unspecified source **b**	-3.1 (real, 1 quarter, manufacturing) -2.05 (real, over 1 year, retail) **c**	Reported impacts were significant at five per cent level. The other elasticity estimates were not statistically significant and were not reported.
Leigh (2003, 2004a) [Western Australia]	Six increases in the Western Australian minimum wage from 1994 to 2001	Difference-in-differences analysis of the employment to population ratio in Western Australia relative to the rest of Australia. Estimates employment elasticities for Western Australia	ABS employment and population data for Western Australian and the rest of Australia	-0.29 (nominal, 3 month)	Impacts significant at one per cent level for youth and for males aged 25-34. Impacts for other age-gender cohorts generally not significant at the 10 per cent level.
Harding and Harding (2004) [Australia]	1. The 2003 national safety net adjustment; 2. hypothetical freeze in national safety net for five years.	Survey of 1 800 small and medium–sized businesses in October/November 2003. Estimates employment elasticities for the Australian small and medium–sized business sector **d**	Businesses surveyed stratified to be representative of the Australian small and medium-sized business sector	-0.05 (nominal, 1 year) -0.25 (real, 5 year)	Sampling errors not provided **e**

(Continued next page)

Table C.4 (continued)

Study [Coverage]	*Minimum wage event and time period of analysis*	*Method of analysis*	*Description of data*	*Estimate of elasticity with respect to the minimum wage*	*Statistical significance of results*
Lewis (2005, 2006) [Australia]	Changes in wages in two national industries compared with the whole economy between 1994 and 2004	Comparison of wage and employment growth in two industries — Accommodation, cafes and restaurants; and Health and community services (collectively denoted as the 'minimum wage sector') — with that of the total economy	Wage and employment growth for these two industries and for the total economy. Source not stated	-0.55 (nominal, 10 year) -0.72 (real, 10 year)	Standard error not provided
Plowman (2007) [Western Australia]	Minimum wage changes affecting Western Australia between 1990 and 2006	OLS regression of employment on the minimum wage and state final demand. Analysis for: total WA labour force; two age groups (15–19 and 20–24 year olds); and three sub-sectors (Retail trade; Accommodation, cafes and restaurants; and Personal and other services)	ABS data for Western Australia	Reported that the effect on employment is 'small'	Impact significant at one per cent level for total employment. (The sign of the test statistic implies the direction of change is positive.)
(Wheatley 2009) [Australia]	Changes in the Federal minimum wage relative to average wages between 2001 and 2008	Error correction model in which the ratio of national employment of high-skilled occupations to low-skilled occupations depends on the Federal minimum wage, GDP and a trend term	ABS national employment by occupation, GDP, and wages	n/a[f]	Impact on employment relativities significant at the one per cent level
Lee and Suardi (2011) [Victoria, Northern Territory, and the ACT]	1. Introduction of the Federal minimum wage in April 1997; 2. changes in Federal minimum wage from 1997 to 2007	Statistical test for structural breaks in the youth employment to population ratio for each state over time	ABS Labour Force Survey time series data from 1992:Q1 to 2008:Q1	No evidence of any effect on employment	Impacts not significant at the ten per cent level
Olssen (2011) [Australia]	Effect of award minimum wage increases for youths at each birthday	Regression discontinuity approach to measure the change in hours and wages that occurs upon the birthdays of young people	HILDA, wave 8	No evidence of any effect on hours worked	Impacts on employment not significant at the ten per cent

[a] Year of census data was not reported but personal communications with the principal author indicates it was 1996. [b] Source of wage data was not reported and the data appendix could not be obtained from the authors. [c] No other results were reported for this regression. [d] Small-sized businesses are defined as those with between one and twenty full time employees. Medium-sized businesses are defined as those with between 20 and 200 full time employees. [e] Low reported response rate, but its stated that the estimates are unbiased because the low response rate was not related to the inclusion in the survey of the questions related to the safety net. [f] Estimated substitution between low and high-skilled labour in response to the minimum wage instead of employment elasticity with respect to the minimum wage.

Mangan and Johnston

In a refereed journal article, Mangan and Johnston (1999) considered the sensitivity of youth employment to changes in youth award minimum wages in Queensland and in Australia. They used two approaches — a generalised least squares regression on Queensland data; and a multinominal logit model on unit record census data for both Queensland and Australia.

The results generally show a small negative relationship between the youth wage and employment (both part time and full time). The results for Queensland from the GLS estimation were not statistically different from zero (table C.5). Nine out of the twelve elasticity estimates from the logit model for Queensland and Australia were statistically significant, at least at the five per cent level.

The results indicate that full-time employment of youth in Australia is less responsive to changes in the minimum youth wage than part-time employment, at least for youth aged 15 to 17 years. In contrast, the results indicate that full-time employment of youth in Queensland is more responsive than part-time employment. The authors attribute this difference to the different industrial structure in Queensland and to the greater importance of part time and other forms of non–standard employment in Queensland relative to Australia.

The logit modelling for Queensland otherwise indicates that full-time male employment is more responsive to youth award wages than full–time female employment. However, for part-time employment, the female employment elasticity is not statistically different from zero.

Table C.5 **Estimates of youth employment elasticities with respect to the youth award wage in Mangan and Johnston (1999)**
1980–1994

	Full–time	*Part–time*
Queensland		
GLS (ages 15-19)	-0.08	-0.19
Logit (ages 15-19)	-0.27★★	-0.12
Female	-0.15★★	-1.76
Male	-0.55★★	-0.22★★
Logit (ages 15-17)	-0.28★★	-0.07★★
Australia		
Logit (ages 15-19)	-0.17★★	-0.31
Logit (ages 15-17)	-0.05★★	-0.21★★

Statistical significance: ★★★: one per cent; ★★: five per cent; and ★: ten per cent.

Source: Mangan and Johnston (1999, pp. 423, 426).

The authors identify limitations in their work. In particular, there is the risk of self–reporting error in census data which could lead to misclassifying the labour market status of young people. The authors found evidence that around 30 per cent of labour market states were misclassified by their logit model.

Junankar, Waite and Belchamber

In a published book, Junankar, Waite and Belchamber (2000) assessed the effects of minimum wages on youth employment using an error correction model. Their aim was to identify a statistically significant relationship in two of the industries that account for a high proportion of minimum wage employment — Manufacturing and Retail trade. They report finding little to no effect of minimum wages on youth employment.

The authors estimate the employment–wage relationship for 38 different categories of employment, disaggregated by industry, gender, age (16, 17, 18, 19 and 20 year olds) and the basis of employment (full-time and part-time).

In their preferred error correction model, youth employment in hours was regressed on the ratio of the youth minimum wage to adult average weekly earnings and on output. Youth employment is expressed in terms of total youth employment rather than just those employed on the minimum wage. The authors only report results for this model if they are statistically significant and results are only statistically significant for two categories of employment. The results that they reported are presented in table C.6. It is relevant in this context that the authors indicate that their sample size is small (Junankar, Waite and Belchamber 2000, p. 180) which would make it difficult to discern a statistically significant effect.

Table C.6 **Estimates of youth employment elasticities with respect to the youth minimum wage in Junankar, Waite and Belchamber (1999)**
1987 to 1997

Industry	*Aggregation*	*Elasticity*	*t–value*
Manufacturing	Full time, male, 18 year olds	-3.1 (real, 1 quarter) ★★	-2.17
Retail trade	Full time, female, 19 year old	-2.05 (real, longer–run but exact time scale not reported) ★★	-2.58

Statistical significance: ★★★: one per cent; ★★: five per cent; and ★: ten per cent.

Source: Junankar, Waite and Belchamber (2000, p. 184).

Junankar, Waite and Belchamber (2000) also estimated an alternative equation in which the youth minimum wage was expressed as a ratio of the adult minimum wage. However, as the authors point out, there is a close relationship between youth and adult minimum

wages. Youth award minimum wages typically begin at 50 per cent of the adult minimum wage for people aged younger than 15, and increase by about 10 per cent each year until the age of 21 (Olssen 2011, p. 2). It may be then that any variation in the ratio of the youth minimum wage to the adult minimum wage reflects changes in the pattern of occupations within the relevant industries. Only one elasticity estimate was found to be statistically significant in this alternative equation, that of part-time males aged 18 who were employed in the manufacturing industry.

Leigh

In a published journal article, Leigh (2003) used a difference-in-differences approach to examine the effects of a series of six minimum wage changes in Western Australia from August 1994 to March 2001, one of the few natural minimum-wage experiments in Australia.

The analysis was updated to address errors in the original paper (Leigh 2004a). A subsequent paper (Leigh 2004b) responded to methodological concerns raised by Watson (2004) about the earlier papers and to test the sensitivity and robustness of the updated results to alternative assumptions.

The six changes in the Western Australian statutory minimum wages examined occurred out of step with changes to the Federal minimum wage and Western Australian payroll taxes, and before other states introduced a statutory minimum wage (table C.7). Leigh excluded the 1997 change in the Western Australian minimum wage from his analysis, as the wage increased by a trivial amount (less than one per cent). There was no increase in the Western Australian statutory minimum wage in 1999.

Leigh (2004a) examined the impact of the minimum-wage rises in Western Australia by comparing the employment impacts in Western Australia (the treatment group) before and after each rise with the changes in employment in the rest of Australia (the control group), on the basis that the principal source of employment differences between the two groups arose from the changes in Western Australian minimum wages.

For the treatment and control groups, these changes were specified in terms of the three month period before and after each minimum-wage change. This resulted in 247 difference-in-differences estimates spanning seven month periods between 1981 and 2002.

Each model estimated expressed the difference in the change in the seasonally-adjusted, full-time equivalent, employment-to-population ratio in Western Australia compared to the rest of Australia as a function of the percentage change in the nominal Western Australian

minimum wage, which was zero in each month other than the months in which the six wage changes being examined occurred (table C.7).[266]

Table C.7 **Western Australian and Federal adult minimum wage changes examined by Leigh, 1994 to 2002**[a]

	Federal minimum wage set by AIRC	*Federal minimum wage incorporated into state awards by WAIRC*	*Western Australian statutory minimum wage*	*Included in analysis?*
1994	**b**	**b**	29/8/94	Yes
1995	**b**	**b**	29/9/95	Yes
1996	**b**	**b**	29/10/96	Yes
1997	22/4/97	14/11/97	10/11/97	No
1998	29/4/98	12/6/98	7/12/98	Yes
1999	29/4/99	1/8/99	No change	No
2000	1/5/00	1/8/00	1/3/00	Yes
2001	2/5/01	1/8/01	22/3/01	Yes
2002	9/5/02	1/8/02	8/4/02	No
			1/8/02	No

AIRC: Australian Industrial Relations Commission. WAIRC: Western Australian Industrial Relations Commission. [a] Persons aged over 21. [b] No single minimum wage applied across all low-wage industries.

Source: Based on Leigh (2003, p. 364).

The elasticities of *total* employment with respect to the change in Western Australia's *minimum wage* were derived from the coefficient estimated on the minimum-wage term by dividing by the average of Western Australian employment-to-population ratio over the period 1994 to 2001. The resulting employment elasticity from the pooled sample of -0.29 is statistically significant at the one per cent significance level (Leigh 2004a, p. 104).

As well as undertaking an aggregate analysis, employment elasticities were also estimated for various age and gender cohorts (table C.8). The reported elasticities were only statistically significant for:

- males and females aged 15 to 24 (at the one per cent significance level for males and at the five per cent significance level for females);
- males aged 25 to 34 (at the one per cent significance level); and
- females aged 45 to 54 (at the ten per cent significance level).

266 The original Leigh (2003) paper inadvertently used employment to labour force ratios rather than the stated, and more theoretically appropriate, employment to population ratios. This was pointed out by Junankar (2004, p. 66) and rectified in Leigh (2004a).

The minimum-wage elasticity of -1.0 for young people aged 15 to 24 is more than three times larger than that for the overall labour market. To some degree, this reflects the higher minimum-wage reliance of youth. In contrast, the elasticity for males aged 25 to 34 was estimated to be -0.24, just below the estimate for the overall labour market. In contrast, the elasticity for females aged 45 to 54 was +0.22.[267]

Table C.8 **Employment elasticities by age-sex sub-groups in Leigh (2004a)**[a]

Age group	*15 to 24*	*25 to 34*	*35 to 44*	*45 to 54*
Persons				
Elasticity	-1.009★★★	-0.141	-0.032	-0.069
Standard error	(0.344)	(0.087)	(0.108)	(0.150)
Females				
Elasticity	-1.426★★	0.033	-0.253	+0.217★
Standard error	(0.708)	(0.298)	(0.318)	(0.131)
Males				
Elasticity	-0.681★★★	-0.238★★★	+0.079	-0.236
Standard error	(0.232)	(0.083)	(0.0119)	(0.198)

Statistical significance: ★★★: one per cent; ★★: five per cent; and ★: ten per cent. **a** Dependent variable is all seven-month difference-in-differences estimates between Western Australia and the rest of Australia between February 1981 and February 2002.

Source: Leigh (2004a, p. 105).

While it is arguably the most rigorous and comprehensive of the Australian minimum-wage studies, the Leigh studies have proven to be contentious.

Watson (2004) and Junankar (2004) raised a number of methodological concerns about the Leigh study (2003, 2004a) that may affect the validity and robustness of the results presented. A key concern was whether the rest of Australia's labour market was a suitable control group for minimum-wage changes in Western Australia (including whether the employment trends were similar in the treatment and control groups). Other concerns raised covered:

- whether it was meaningful to use data on aggregate employment ('macrodata') rather than data on the employment of individuals ('microdata');
- whether the three month period before and after the minimum wage examined over which the employment effects were assessed was appropriate;
- whether the potential for employment effects may have influenced the magnitude of changes in the minimum wages that occurred (giving rise to potential endogeneity); and

267 This positive result may indicate that females aged 45 to 54 substitute for minimum-wage workers (and, hence, would be expected to have a positive cross-price elasticity).

- whether changes in the Western Australian minimum wage can be distinguished from the 'noise' of month to month changes in ABS employment data.

Watson (2004, p. 166) concluded that:

> … close scrutiny of Leigh's article shows that it is fundamentally flawed. Despite Leigh's efforts, it remains the case that we simply do not know a great deal about the employment impact of Australia's system of minimum wages.

Leigh responded specifically to all of these concerns in a further paper (Leigh 2004b), where he also undertook additional testing of the robustness and sensitivity of his estimates. Leigh concluded that:

> Careful reanalysis of the Western Australian minimum wage experiment demonstrates that this critique [that of Watson] is not well founded. Further checks show that the results are robust to a number of alternative specifications, in addition to those presented in the original article. (p. 173)

Leigh stood by his original findings and dismissed these potential concerns. Furthermore, Leigh went on to indicate that:

> Since Watson never provides evidence that the estimated elasticity of labour demand in my study is biased towards the finding that raising the minimum wage costs jobs, one could accept his critique in its entirety, and still be left unable to explain why my estimate of the elasticity of labour demand is negative and statistically different from zero at the 1 per cent level. (p. 173)

In his response, Leigh did not publish the results of his parallel paths assumption testing which would provide the evidence required to ascertain whether the rest of Australia was a suitable control group for Western Australia. Without recourse to the original data and without further analysis, and in the absence of evidence to the contrary, it is difficult to assess the validity of these competing claims and counterclaims and their implication, if any, for Leigh's findings.

In a review of the international literature on minimum-wage studies, Neumark and Wascher (2006) found that:

> The elasticities that Leigh reports for aggregate employment of young individuals are quite large relative to those found for other industrialized countries, especially given his estimate that only about 4 percent of workers were affected by these changes in the minimum wage. Unfortunately, he does not offer a potential explanation for the size of his estimates, and in the absence of such an explanation, the magnitudes of these estimates, at least, might be regarded skeptically. (Neumark and Wascher 2006, p. 90)

Given the analysis undertaken by Leigh was at a time when the minimum wage coverage was higher than it is today, and given that there are significant differences in labour markets and institutional arrangements across economies, it is not possible to resolve the issue about whether the implied employment elasticity in Leigh of -0.29 is excessive or not.

Harding and Harding

In a report to the Department of Employment, Harding and Harding (2004) used a survey of 1800 small and medium-sized businesses to estimate the employment elasticities with respect to changes in Federal minimum award wages.

The businesses surveyed were drawn from the *Australian Bureau of Statistics Business Register*. The survey sample was stratified to take into account known characteristics of the population of small and medium-sized businesses in Australia. To maintain an accurate representation of the population based on industry, region and business size, any non-respondent business was replaced by another with the same characteristics.

Businesses were asked:

4. how their employment decisions were affected by the 2003 national safety net adjustment; and
5. how their employment decisions would be affected if there were a hypothetical freeze in the nominal safety net over a future period of five years.[268]

The businesses surveyed were asked to report on the total change in employment. As a result, the employment elasticities reported include workers who earn above the minimum wage.

Answers to question one were used to estimate 'short-run' elasticities of employment with respect to minimum award-wages (proxied by the safety net adjustment). The key 'short-run' elasticities derived were:

- -0.2 for minimum award-wage workers; and
- -0.05 for all workers in the survey (table C.9).

The positive employment responses to the hypothetical freeze in the nominal safety net derived from the answers to question two were converted to 'medium to long-run' employment elasticities (over five years) of:

- -0.9 for *minimum award-wage* workers; and
- -0.25 for *all* workers (table C.9).

Both 'medium to long-run' elasticities are over four times larger than the implied short-run elasticities. However, these are real wage elasticities, which will be higher than nominal wage elasticities to the extent of inflation.

[268] Businesses were also asked to indicate the importance of selected factors for wage setting. Answers were used to assess the empirical evidence in support of alternative theories of labour markets, a topic not covered in this appendix.

Table C.9 **Implied employment elasticities with respect to the real minimum award wage rate in Harding and Harding[a]**

	Minimum-award wage workers		*All workers*	
	Short run[b,c]	*Medium to longer–run*[d]	*Short* run[b,c]	*Medium to longer–run*[d]
Full-time employees	-0.24	-1.14	-0.04	-0.20
Part-time employees	-0.33	-0.89	-0.16	-0.41
Casual employees	-0.08	-0.67	-0.03	-0.27
Total employees	-0.19	-0.90	-0.05	-0.25

[a] Based on a survey of 1800 small and medium-sized businesses. [b] Taken by the authors to be a period of three months. [c] Derived by dividing the reported percentage changes in employment in the short run by the percentage change in award wages. [d] Taken by the authors to be a period of five years.

Source: Harding and Harding (2004, pp. 49, 60).

These long-run elasticities are based on the assumption in the study that the inflation rate of 2.5 per cent over the twelve months that preceded the survey would apply over the five year period, such that the hypothetical change in the nominal safety net over five years is equivalent to a 13 per cent decline in the real value of the minimum-award wage rates.

The study does not provide standard errors or confidence intervals, as 'until … further work is undertaken the calculation of standard errors could be interpreted as misleading readers regarding the precision of the estimates presented in this report' (Harding and Harding 2004, p. 116).

While considering the response rate to the survey of between 20 and 22 per cent as low, the authors emphasised that:

- non-response was independent of the inclusion of the questions regarding the safety net and would not have biased the survey responses; and
- the use of design-based estimation methodology ensured that non-responses did not bias the survey (Harding and Harding 2004, pp. 109–110).

Lee and Suardi (2011) questioned the validity of the short-run elasticities given that only 37 businesses reported an adverse effect in response to the 2003 safety net adjustment, and that such a small number may not be a sufficient basis for economywide estimates.

It is unclear to what extent other factors other than the safety net changes affect the employment responses stated and how the stated survey responses to the hypothetical wage freeze would have translated into actual employments outcomes for the firms concerned if the wage freeze had eventuated. Moreover, Harding and Harding is a firm-level survey and, notwithstanding the use of sample weights to aggregate the results, it is unclear as to how applicable their findings are to the economy as a whole.

Lewis

In a published journal article that has not been refereed, Lewis (2005) compared the employment and wage growth in the Accommodation, café and restaurants and Health and community services industries (referred to collectively as the 'minimum-wage sector') — two of three industries characterised by the ACTU as 'award-wage reliant industries' in a submission to the Australian Fair Pay Commission — with that of the rest of the economy over the period 1994 to 2004.

The employment elasticities reported were derived by dividing the percentage point difference in the employment growth rates for the two minimum-wage sectors and the rest of the economy by the corresponding percentage point difference in wages growth.

The study found a *minimum-wage* elasticity of employment with respect to:

- the *real* minimum wage of -0.72; and
- the *nominal* minimum wage of -0.55 (table C.10).

Table C.10 **Implied elasticity of minimum-wage employment with respect to the minimum wage in Lewis**
1994–2004

	Units	*Nominal wages*	*Real wages*	*Employment*
Minimum wage sector[a]	Per cent	40.2	7.7	29.9
Total all sectors	Per cent	53.9	18.2	22.4
Difference	Percentage points	-13.7	-10.5	7.5
Implied elasticity[b]		-0.55	-0.72	

[a] Accommodation, café and restaurants and Health and community services. [b] Implied elasticity of minimum-wage employment with respect to the minimum wage.

Source: Lewis (2005, p. 19).

Lewis (2006) reported the results of the 2005 study in an Australian Fair Pay Commission research paper.

The study did not undertake any rigorous statistical analysis of the significance of the results, did not control for the influence of other factors that may have affected these two 'minimum-wage' sectors and did not detail the data sources used.

Plowman

In a conference paper that has not been refereed, Plowman (2007) undertook a series of OLS regressions to examine the impact of the minimum wage on young workers (those aged 15 to 19 years and 20 to 24 years). The study considered youth employment because

it was considered that young, unskilled workers were the most adversely affected by minimum-wage changes. The objective was to assess the effect of changes in the minimum wage applying in Western Australia between 1990 and 2006 on full-time employment, part-time employment, total employment and on the share of part-time employment for:

- the Western Australian workforce; and
- three industries considered to be most affected by minimum wage adjustments (where 'award only' employees predominate) — Personnel and other services, Retail trade, and Accommodation, cafes and restaurants.

Plowman regressed the growth in employment and participation rates for the two age groups (the dependent variables) on an estimate of the prevailing minimum wage and State Final Demand (the independent variables).

Despite not reporting the actual employment effects, the paper reported that the minimum wage had:

- 'little effect' on overall employment;[269] and
- no statistically significant effect on youth employment.

At the industry level, the paper found that the impact of minimum-wage changes on employment was sometimes statistically significant, with a mix of positive and negative relationships (table C.11).

- The relationship between employment and the minimum wage was statistically significant for part-time employment, total employment and the proportion of employees working part time, but not for full time employment, and suggested to the author that, 'if there are employment effects arising from minimum-wage increase, those effects relate to part-time employment' (p. 18).
- Minimum-wage changes had statistically significant impacts on part-time employment in the Personnel and other services (negative impact) and in Retail trade (positive impact), but not in Accommodation, cafes and restaurants.
- The only statistically significant impact on full-time employment at the industry level was for Retail trade (positive impact at a five per cent).

The results indicate that state final demand is the primary determinant of all types of employment in Western Australia (full time, part time and total), both in aggregate and for each of the industries examined.

[269] The sign of the test statistic reported indicates the employment elasticity with respect to the minimum wage was positive.

Table C.11 **Effect of minimum wage on employment in the Western Australian labour market in Plowman**

	Employment effect
Aged 15–19	nss
Aged 20–24	nss
Personnel and other services	
Full time	nss
Part time	-ve[a]★★
Total	nss
Retail trade	
Full time	nss
Part time	+0.21★★★
Total	+0.26★★
Accommodation, cafes and restaurants	
Full time	+0.01★★★
Part time	nss[b]
Total	0.0★★
Western Australian labour force	+ve[a]★★★
Full time	nss
Part time	+ve[a]★★★
Total	+ve[a]★★★

nss: not statistically significant. Statistical significance: ★★★: one per cent; ★★: five per cent; and ★: ten per cent. [a] The sign is indicated by the test statistic, but the employment effect was not reported. [b] The impact on the proportion of part-time employees in this sector's employment found to be statistically significant and negative at the one per cent level.

Source: Plowman (2007, pp. 17–18).

Wheatley

In a report commissioned by the Australian Fair Pay Commission, Wheatley (2009) considered the impact of minimum-wage changes on the substitution between low-skilled workers (representing minimum-wage workers) and high-skilled workers. While not estimating an employment elasticity, the analysis is useful for understanding the strength of substitution by employers away from minimum wage workers in response to changes in the minimum wage.

Wheatley observed that, in a growing economy, there had been a shift towards high-skilled employment and away from low-skilled employment. Two main theoretical explanations for this shift were postulated:

- that international trade had reduced the demand for low-skilled workers in developed countries because of the competition from imports from developing countries; or
- that there had been skill-biased technological change favouring high-skilled workers over low-skilled workers.

Given that the shift towards high-skilled workers was across a range of industries in Australia, both traded and non-traded, the study concluded that it was more probable that technological change was the most important factor driving the change in relative employment of high-skilled labour.

The study went on to estimate an error correction model in which changes in the ratio of employment of high-skilled occupations and employment of low-skilled occupations depended on the Federal minimum wage, the level of economic activity (as indicated by GDP) and a trend decline to represent technological change favouring skilled employment.

The trend term was found to be statistically significant at the one per cent level and was attributed to skill-biased technological change. Changes in minimum wages were also found to have a statistically significant effect (at one or ten per cent significance levels depending on the choice of skill level) on employment, with a one per cent increase in the minimum wage relative to average ordinary-time earnings reducing low-skilled employment relative to high-skilled employment by 1.4 to 1.6 per cent (table C.12).

Table C.12 **Effect of minimum wage 'bite' on the change in the gap between low-skilled employment and high-skilled employment in Wheatley** [a]

	Impact on low–skilled employment relative to high–skilled employment	*Standard error*
Low-skilled occupations represented by skill levels 4 and 5	–1.411★	0.514
Low-skilled occupations represented by skill level 5	–1.681★★★	0.913

Statistical significance: ★★★: one per cent; ★★: five per cent; and ★: ten per cent. [a] Average ratio of minimum wage to full-time adult average weekly ordinary-time earnings over past four quarters.

Source: (Wheatley 2009, p. 57).

Wheatley pointed out that the study does not indicate the effect of minimum wages on the total employment of unskilled workers, noting that employment grew for all skill levels over the period analysed.

Lee and Suardi

In a published journal article, Lee and Suardi (2011) used time-series data to test for the presence of (unknown) structural breaks in the employment-to-population ratio following the introduction of the Federal minimum wage in 1997, and subsequent changes (covering 11 federal minimum wage changes in total).

The analysis focused on the impact on full-time equivalent and part-time employment for teenagers aged 15 to 19 in Victoria, Northern Territory and the Australian Capital Territory between 1997 and 2007. The study focused on teenage outcomes because this sub-group of the population was considered to be that most likely to be affected by minimum wage changes. The three states were chosen as they were the 'only … states that had all employees under federal industrial jurisdiction and subject to a binding federal minimum wage' (p. S378).

The model used for each state expressed the aggregate employment-to-population ratio for each age group (the dependent variable) as a function of the following independent variables:

- the real minimum wage;
- the real adult wage;
- the unemployment rate for males aged 25 to 54 (as a proxy for overall labour demand and business cycle effects);
- the population of teenagers aged 15 to 19 as a proportion of the total work force (as a proxy for labour supply).

All of the variables were expressed as natural logarithms with quarterly data used from 1992:Q1 to 2008:Q1 and sourced from the ABS *Labour Force Survey*.

The approach used statistical tests to determine if the timing of changes in minimum wages coincided with any statistically significant discontinuities in the data series of the dependent variable (to test for structural breaks).

The study did not find any evidence of statistically significant structural breaks. Further, the coefficient on the minimum wage variable was not significant in any of the models estimated (table C.13). The authors concluded that this implied 'that changes in minimum wages appear to have had no negative employment effects' (p. S397). The authors offer the explanation that minimum wage increases over the period of analysis had been moderate and predictable.

Table C.13 **Structural break test statistics following the introduction of the Federal minimum wage in 1997**

Chow test statistic

	Victoria	*Northern Territory*	*Australian Capital Territory*
Full time	7.9 (nss)	7.6 (nss)	6.2 (nss)
Part time	11.9 (nss)	3.3 (nss)	9.4 (nss)

nss: not statistically significant.

Source: Lee and Suardi (2011, pp. 24–26).

Olssen

In a conference paper that has not been refereed, Olssen (2011) used youth award rates (minimum wages) in Australia to investigate the effect of minimum wages on actual wages and youth employment over the period 2001 to 2008.

The study used regression discontinuity analysis to assess the short–term impact of age-based wage increases of young people on their hours of employment around their birthday. Under the awards, youth minimum wages were typically discounted in proportion to adult minimum wages based on the age of the youth. The discount started at 50 per cent for 16 year olds and went up by ten percentage points each birthday until the full adult rate was reached at 21 years of age.

The study used data sourced from wave 8 of the *Household, Income and Labour Dynamics in Australia* (HILDA) survey. Youth in the data are divided into similar sized treatment groups and control groups.

This stratification is predicated on the basis that the measure being examined only affects the treatment group (Olssen 2011, p. 14), including that employers do not factor in the change in entitlement in advance of the birthdays of their employees (Olssen 2011, pp. 9–10).

However, the study noted that employers tended to increase the wages of their 19 and 20 year old employees in advance of their birthdays (Olssen 2011, pp. 22, 30), which may indicate that this assumption did not hold. If the assumption did not hold, the approach used may not pick up such effects, thereby biasing the results downwards or rendering the approach inappropriate (Olssen 2011, pp. 10, 22).

Notwithstanding this, the study found that the ten per cent wage rise that occurred on a young person's birthday led to an increase in actual wages of about six per cent. The study found no statistically significant impact of the wage increase on the hours of employment (table C.14).

Table C.14 **Estimates of the impact of award minimum wage increases on employment hours in Olssen**
Discontinuity

	Model 1	*Model 2*	*Model 3*	*Model 4*
19 year olds				
Employment impact	0.6517	1.8218	0.5960	1.5773
Standard error	0.8421	1.6855	1.1385	1.9790
20 year olds				
Employment impact	0.2612	-1.3040	0.0752	-2.0963
Standard error	0.8786	1.7833	1.1801	1.9717
21 year olds				
Employment impact	-0.6105	-1.4288	0.6868	-0.6156
Standard error	0.8870	1.8289	1.2800	2.0316

Statistically significance: ★★★: one per cent; ★★: five per cent; and ★: ten per cent.
Source: (Olssen 2011, p. 33).

Studies of the employment effects of changes in average wages

The Commission has found eight empirical studies of the employment impacts of average wages in Australian since 1999. These studies are summarised in table C.3.

Error Correction Model approach

Seven Australian studies have estimated the relationship between average wages and employment by using a single equation error correction model (table C.15). In all of these studies, employment is expressed as dependent on real wages, output and a time trend representing labour–augmenting technical change.

Dixon, Freebairn and Lim (2005) include standard hours as an additional independent variable, in order to control for the change in standard hours of work.

These studies use national macroeconomic quarterly data. All but one consider the civilian labour market. The exception is that of Downes and Bernie (2009) who consider private sector employment.

While most studies measure employment in terms of persons employed, Debelle and Vickery (1998) measure employment in terms of hours worked. Lewis and MacDonald (2002) estimate the same equation for both employment measured in persons and employment measured in hours worked.

Table C.15 Australian empirical studies of the effects on employment and output of average wage changes

Study [Coverage]	*Time period of analysis*	*Employment measure used*	*Method of analysis*	*Short-run wage elasticity*	*Longer–run wage elasticity*	*Longer–run output elasticity*	*Speed of adjustment*[a]
Daly et al. (1998)	1990 to 1995	Persons employed	Labour share equations (youth as share of total labour) (independent variables: relative wages, total hours worked and educational attainment)	-2 to -5[b] 1 year)			
Debelle and Vickery (1998)	1978:Q1 to 1997:Q4	Hours worked in non–farm sector	Error correction model (independent variables: real hourly labour costs, non–farm GDP, time trend)	-0.21★★★	-0.40★★★	1.09★★★	-0.54 (to 2 years)
	1969:Q1 to 1997:Q4	Hours worked in non-farm sector	As above	-0.51★★★	-0.68★★★	1.19★★★	-0.41 (to 2 years)
Dungey and Pitchford (1998)	1984:Q4 to 1997:Q1	Persons employed	Error correction model (independent variables: real earnings, GDP, average weekly hours, time trend)	n/a	-0.40★★★	1.30★★★	n/a
Downes and Bernie (2009)	1971:Q1 to 1998:Q3	Persons employed and unfilled vacancies in private sector	Error correction model (independent variables: real wages, hours worked, output and a time trend)		-0.82	n/a	(2 to 3 years)[c]
Lewis and MacDonald (2002)	1959:Q3 to 1998:Q3	Persons employed (non–farm wage and salary earners)	Error correction model (independent variables: real weekly wages, GDP, time trend)	n/a	-0.8★★★	1.06★★★	(1 to 1.5 years)[c]
	1966:Q4 to 1998:Q3	Hours worked	As above	n/a	-0.9★★★	1.29★★★	n/a
Dixon, Freebairn and Lim (2005)	1969:Q1 to 2004:Q1	Persons employed (non–farm wage and salary earners)	Error correction model (independent variables: real average earnings plus payroll tax, real non–farm GDP, standard hours, time trend)	-0.11★★★ (one quarter)	-0.32★★★	1.1★★★	-0.26★★★ (3 to 4 years)
Yuen and Mowbray (2009)	1985:Q1 to 2008:Q4	Persons employed	Error correction model (independent variables: real wage, GDP, time trend)	-0.2 (one quarter)	-0.49★★★	1.11★★★	-0.43★★★ (to 2 years)
Hutchings and Kouparitsas (2012)	1972:Q4 to 2011:Q4	Persons employed	Error correction model (independent variables: real average earnings plus payroll tax, GDP, time trend)	-0.14★★★ (one quarter)	-0.40★★★		-0.15★★★ (7 to 8 years)

Statistical significance: ★★★: one per cent; ★★: five per cent; and ★ ten per cent. n/a: not applicable. [a] Speed of adjustment back to longer–run trend. [b] Reported range of elasticity estimates for industries employing a high proportion of youth. Statistical significance varied from not significant at the 10 per cent level to one per cent. [c] The study reports the time that employment takes to adjust to its longer–run trend, but does not report the value of the speed of adjustment parameter.

Most studies estimate real wage effects after one quarter and after employment has adjusted back to a longer–run equilibrium. The speed of adjustment back to a longer–run equilibrium is reported in the last column of table C.15 and represents the rate of adjustment in each quarter. The rate reported in the studies varies from 15 per cent in the most recent study, Hutchings and Kouparitsas (2012) to 54 per cent in Debelle and Vickery (1998).

The relationship between wages and employment estimated in these studies is technically the substitution elasticity between labour and capital (Downes and Bernie 2009; Lewis and MacDonald 2002). This is because the regression equation in these models is not a general labour demand curve, but the derived cost minimising employment hire decision rule. (Lewis and MacDonald 2002), therefore, take further steps to derive a general employment elasticity, including by allowing for the second round employment effects of output increasing in response to the wage change.

Nonetheless, the substitution elasticity between labour and capital estimated in these studies can be interpreted as an output constant employment elasticity, albeit not in general terms, and two of the three most recent studies have taken that interpretation (Dixon, Freebairn and Lim 2005; Yuen and Mowbray 2009). In practice, the generalised estimate of Lewis and MacDonald lies marginally above that of the literature more broadly.

The key point is that, apart from that of Lewis and MacDonald (2002), the employment elasticities reported in table C.15 are partial elasticities based on the assumption that there is no change in output as a result of the wage change being examined. If output were allowed to change, the employment effect may be expected to be larger.

Labour share equations approach

In a published research paper, Daly et al. (1998) estimated the impact on youth employment of a change in average earning of youth relative to adults (table C.15). They used cross-sectional data from the *Australian Workplace Industrial Relations Survey* for the year 1995 (AWIRS95). The AWIRS95 data did not include any data on capital, and the authors therefore assumed weak separability in the cost function. Given this, they estimated the share of youth hours of employment in total hours of employment as a function of youth average weekly earnings relative to adult average weekly earnings and output (proxied by total hours worked in the workplace) and an education index.

The paper generally found a statistically significant negative relationship between youth employment and youth wages (table C.16). The paper also reported evidence that adult employment was negatively affected by youth wages, suggesting complementarity between youth and adult employment.

The paper reported youth employment elasticity estimates for:

- the full data sample;

- a group of industries that are large employers of youth (Retail trade, Accommodation, Construction and Manufacturing);
- a group of industries that employ youth more intensively (Retail trade, Accommodation, Cultural and recreation services and Personal services); and
- a selection of individual industries, specifically Retail trade, Accommodation, Manufacturing, Construction, Cultural and recreation services and Personal services.

Table C.16 **Youth own wage elasticity estimates in Daly et al**
1995

	Youth–adult female	*Youth–adult male*
Full sample	-15.50***	-16.88***
Large employers of youth	-10.91***	-11.06**
Intensive employers of youth	-6.65***	-6.92***
Retail trade	-2.08***	-2.14***
Accommodation	-5.06***	-4.97***
Manufacturing	-20.03***	-20.32***
Construction	0.22	-0.11
Cultural and recreation services	-2.47	-2.59
Personal services	n/a	-18.19***

Statistical significance: ★★★: one per cent; ★★: five per cent; and ★: ten per cent.

Source: Daly et al. (1998, pp. 57, 62).

The authors identified a number of possible shortcomings in their methodology. They reported evidence that the weak separability assumption may not hold and, as a result, the omission of capital from the equations may have biased the own-wage and cross-wage elasticity estimates.

The authors also reported that the magnitude of the elasticity estimates for some equations was unreliable because of the small share of youth in the relevant data sample. They indicated this to be the case at least for the full sample and for Manufacturing, Construction and Personal services.

They also reported that there may be aggregation bias in the full sample and group estimates because the production structure may vary between industries.

A number of additional issues have been raised concerning the results of Daly et al. by Junankar, Waite and Belchamber (2000). In particular:

1. the use of average weekly earnings may have introduced spurious correlation because average weekly earnings (on the right hand side of equation) are determined by using hours of employment (on the left hand side of equation);

2. the use of a virtual wage to proxy for youth wages in those workplaces that did not employ youth may have introduced bias into the estimates to the extent that the virtual wage is determined by those factors that also determine hours of employment; and

3. the use of total hours of employment as a proxy for output may have contributed to bias in the results.

Junankar, Waite and Belchamber (2000) indicated that these problems may have given rise to unreliable results, including the result not otherwise found in the literature that adult labour was complementary to youth labour rather than being a substitute for youth labour.

C.4 General equilibrium modelling of the impact of wage changes

In addition to the econometric and partial-equilibrium estimates of the impact of wage changes on employment, 'general equilibrium models' have also been used to analyse the nature and dynamics of responses in the aggregate demand for labour to changes in wages.

The employment responses in such models depend on various factors, including the 'elasticity of substitution' between labour and capital and the capital (or labour) intensity of industries. When a wage change occurs in just one segment of the labour market, the employment response also depends on the capacity to substitute between different types of labour and on the responsiveness of labour supply to relative wage changes (leading to inter-regional migration and movement between industries and/or occupations).

General equilibrium models typically assume that producers seek to maximise profits subject to technological, resource and other market constraints. The 'short-run' partial employment elasticity with respect to a uniform economy–wide wage change implied by these assumptions (ε) can be derived from the labour–capital substitution elasticity (σ) and the share of capital in primary factor payments (S_K) (Dixon, Madden and Rimmer 2010):

$$\varepsilon = -\sigma / S_K.$$

Based on a review of the econometric evidence by Debelle and Vickery (1998), a 'short-run' national employment elasticity of -0.5 was targeted in the MONASH computable general equilibrium model of the Australian economy. This estimate is also consistent with a more recent review of the literature undertaken by Yuen and Mowbray (2009), who estimated an average real-wage elasticity of -0.5. Given that the share of capital (S_K) in the MONASH model is about 0.3, the elasticity of labour–capital substitution (σ) in MONASH is set at 0.15 in each industry (Dixon, Madden and Rimmer 2010).

A recent application of the MONASH model extended this to address the question of award-wage changes (Dixon, Madden and Rimmer 2010). The study considered the impact

of a one-off permanent increase in real award wages in 2005 using a version of the MONASH model that distinguished between award and non-award workers, and which allowed for an unemployment–vacancy mismatch combined with atrophying of the skills of unemployed people over time. The model allowed after-tax (non-award) wage rates to adjust in the short to medium-run in response to a change in employment conditions.

As the study involved dynamic simulations, implied average and award-wage elasticities can be derived for each year's results. The average-wage elasticity was -0.47 after one year and the corresponding award-wage elasticity was -0.13 (table C.17). These one-year elasticities are broadly similar to those derived from the partial-equilibrium studies reviewed in sections C.2 and C.3. Reflecting a gradual increase in opportunity for capital — labour substitution, the value of both elasticities increased with time. For example, after 11 years, the implied average-wage elasticity was -1.28 and the award-wage elasticity was -0.35.

Table C.17 **Implied general equilibrium employment elasticities in Dixon, Madden and Rimmer**
MONASH model

Wage elasticity	*Year 1*	*Year 11*
Average-wage elasticity	-0.47	-1.28
Award-wage elasticity	-0.13	-0.35

Source: Dixon, Madden and Rimmer (2010).

In an earlier paper, Dixon and Rimmer (2000) analysed the macroeconomic effects of combining a freeze on award wage rates in Australia with the provision of earned tax credits to low wage workers. They assumed that the reduction in award wages was fully accommodated by an expansion in the supply of labour, reflecting the assumed introduction of an earned income tax credit.

While using a different model database, the implied employment elasticities are generally similar to the 2010 study, albeit with a slightly lower average-wage elasticity after a decade (-0.9 compared with -1.28) (table C.18).

Table C.18 **Implied general equilibrium employment elasticities in Dixon and Rimmer**
MONASH model

Wage elasticity	*Year 1*	*Year 10*
Average wage elasticity	-0.4	-0.9
Award wage elasticity	-0.2	-0.4

Source: Dixon and Rimmer (2000).

D Employment arrangements

Appendix D draws together data on various aspects of the workplace relations system to present an overall picture of Australia's employment arrangements. As different data sources characterise employment arrangements in several different ways and vary in their populations and methods, the appendix attempts to confront and reconcile their findings, while applying a framework consistent with this report.

Section D.1 outlines the framework and data sources used to quantify employment arrangements. Section D.2 discusses the concepts used to define employment arrangements in more detail, how these are used to measure employment arrangements and the results. Section D.3 presents the overall findings.

D.1 Framework and data sources

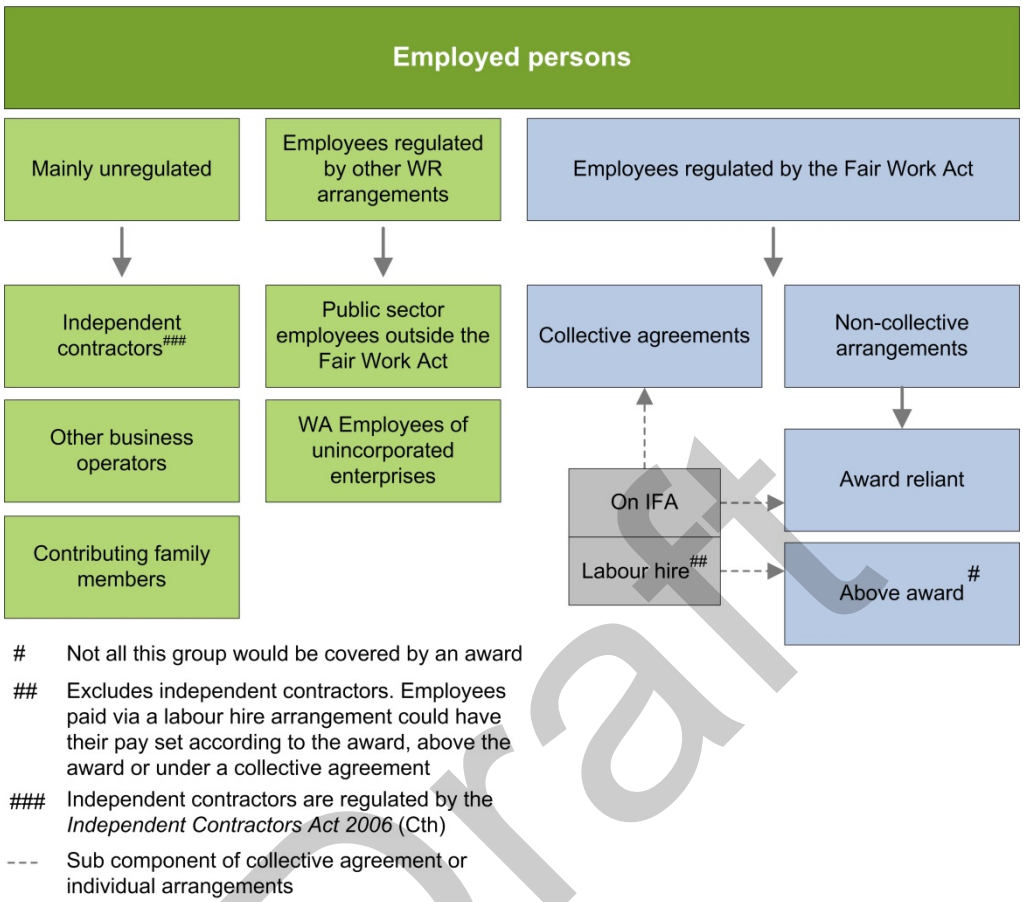
Persons in work may be classified according to various aspects of their employment or business operation. This appendix classifies workers in a manner consistent with the issues examined within this report.

The classification of 'employed persons' (the term used by the ABS and adopted for the purposes of this appendix) , which includes employees and other workers, presented below is broad in scope (figure D.1). It includes all workers, and requires a combination of data sources. Moreover, the classification of workers differs from some existing approaches. For example, the Department of Employment (sub. 158) has classified employees according to the method of setting pay and whether they are low paid, but has not classified non employees. On the other hand, the Productivity Commission (2013) has previously classified employees according to forms of work, but not according to pay setting arrangements. The Productivity Commission's approach for the purposes of this report includes all employed persons, differentiating according to the regulations that apply and the method by which their pay is set. These aspects are most relevant to this inquiry.

In the first instance, employed persons may be classified as either:

- employees regulated by the *Fair Work Act 2009* (Cth) (FW Act)
- employees regulated by other workplace relations arrangements, or
- mainly unregulated persons.

Figure D.1 **Employment arrangements framework**



Mainly unregulated persons include the self-employed and contributing family members. Employees regulated by other workplace relations arrangements include those working in the public sector within states that have not referred their workplace relations (WR) powers (see chapter 18), as well as employees of Western Australian unincorporated enterprises. These workers are not regulated by the FW Act.

Employees covered by the FW Act are the primary concern of this report. Quantifying the number of these employees reveals the reach of the national workplace relations system.

Among employees covered by the FW Act, pay may be set in a number of ways. Pay setting can be undertaken collectively — through enterprise bargaining (chapter 15) — or non collectively. Employees that set their pay non-collectively may be paid payed at the award rate or above.

In addition to pay setting, employees can be differentiated according to their use of individual flexibility arrangements (IFAs) (chapter 16) or employment through labour hire (chapter 20) — both of which are aspects of employment examined within this report.

As IFAs are made as part of a collective agreement or award (that is, the employee is covered by both the collective agreement or award and the IFA), the use of IFAs is incremental to other pay-setting methods.

The Productivity Commission's estimates of labour hire prevalence include only employees.

Data sources

This broad classification of employed persons requires several data sets to estimate the prevalence of each group of workers. Several Australian surveys report on employment arrangements, including:

- The Australian Bureau of Statistics (ABS) Survey of Employee Earnings and Hours (EEH)
- The ABS Forms of Employment (FOE) Survey
- The Fair Work Commission (FWC) Australian Workplace Relations Study (AWRS)
- The FWC Award Reliance Survey (ARS)
- The Melbourne Institute Household, Income and Labour Dynamics in Australia (HILDA) survey
- The FWC General Manager's (FWCGM) report into the extent to which individual flexibility arrangements are agreed to and the content of those arrangements.

The ABS EEH survey provides statistics on the composition and distribution of employee earnings, along with job characteristics such as paid hours of work and the method of setting pay. The survey was conducted yearly between 1993 and 1995 and then every two years from 1996 onwards. The survey methodology of the EEH involves sampling employers, rather than households. As such, it is a linked employer-employee data set. Importantly, EEH estimates reflect information about jobs, rather than employed persons.[270]

The annual ABS FOE survey is a supplement to the ABS Labour Force Survey, and collects information on the nature of employment arrangements in Australia, such as status as an employee, independent contractor, or other business operator. Additionally, information on employment characteristics such as hours worked, industry and occupation are also available. In its most recent release, the survey included 26 321 respondents. The FOE survey has recently been replaced by a new publication, *Characteristics of Employment, Australia*, with the first release due towards the end of 2015.

[270] In this appendix, EEH estimates have been used to calculate the *proportion of jobs* that have pay set either collectively, at the award rate or above the award rate. These proportions have then been combined with FOE figures to estimate the *absolute number of employed persons* in various pay setting arrangements in their main job. This assumes that pay setting proportions across all jobs are equal to pay setting proportions for employees in their main job.

The AWRS was conducted in 2014 and includes linked data on employers and employees. All together, the study included 3057 enterprises and 7883 employees. The survey collects information on employment arrangements from both employers and employees.

The ARS was commissioned by the FWC to examine the composition of the award-reliant workforce. The survey was undertaken in 2013 and includes 11 569 employers from the private sector, of which 2781 completed the survey's supplementary detailed questionnaire.

The HILDA survey collects information from Australian households covering a wide range of topics, including family relationships, education, income, health and employment. The first year of the survey covers 2001-02 with survey waves released annually thereafter. This first wave included 13 969 individual respondents and 6872 household respondents.

Finally, the FWCGM report examined the use of IFAs. It surveyed 2650 employers and 4500 employees, and was undertaken during March and June in 2012 to cover the period from January 2010 to July 2012. The data collected related to employer and employee awareness of IFAs, the prevalence and nature of existing IFAs, as well as the characteristics of employers and employees that implement IFAs.

Survey design and scope

Inconsistencies in design can drive different results across surveys. For example, surveys that exclude the public service are likely to underreport the prevalence of employees on enterprise agreements, since this method of setting pay is more prevalent in the public sector. While such omissions are not easily corrected statistically, they can inform the likely direction of bias for an estimate.

The sampled population is a major inconsistency across the surveys listed above. HILDA, AWRS, AWS and the EEH have all excluded separate groups from their sampling (table D.1). The HILDA sample includes the broadest range of employees, with its major omissions limited to those who live remotely. AWRS, AWS and EEH all exclude workers in agriculture, forestry and fishing, in addition to other, less significant omissions.

While employees governed by the federal workplace relations system are the main concern of this inquiry, a number of surveys collect information from both state and federal system workers. As chapter 18 outlines, state public sector workers and local government employees in New South Wales, Queensland, South Australia, Western Australia and Tasmania are covered by state-based systems, along with employees working in Western Australian unincorporated enterprises (see chapter 18). Some surveys examine only federal system workers, others differentiate state and federal workers, while others contain both but do not allow for differentiation. The potential for these differences to influence results have been factored in to the Productivity Commission's final estimates.

Table D.1 **Population of surveys used in this appendix**

Survey	*Scope*	*Definition of an employee*
EEH	All employing organisations in Australia except: • enterprises primarily engaged in agriculture, forestry and fishing • private households employing staff • foreign embassies, consulates, etc.	A person who works for a public or private employer and receives remuneration in wages, salary, or a retainer fee from their employer while working on a commission basis, or for tips, piece-rates, or payment in kind; or a person who operates his or her own incorporated enterprise with or without hiring employees
FOE	As for the ABS Labour Force Survey — occupants of private and non-private dwellings covering approximately 0.32 per cent of the civilian population of Australia aged 15 years and over.	People who work for a public or private employer and receive remuneration as wages or salary. They are engaged under a contract of service (an employment contract) and take directions from their employer/supervisor/manager/foreman on how the work is performed. The definition differed from that in the Labour Force survey from November 2008.
AWRS	National system employers and employees, except: • enterprises with fewer than 5 employees • enterprises classified into the Agriculture, Fishing and Forestry ANZSIC 2006 industry division • Enterprises in the Defence industry (ANZSIC sub-division 76: Defence)	Workers employed directly by an enterprise on a permanent, casual or fixed term contract basis who are paid a wage/salary. This definition excludes workers who are paid a fee for service on a consultancy or individual contractor basis, unpaid workers who are not paid for the services they provide and business partners/working proprietors.
AWS	Non-public sector organisations operating within the national workplace relations system (national system), except: • businesses in the Agricultural, forestry and fishing industry division which were excluded (pursuant to the approach in the Australian Bureau of Statistics (ABS) Employee Earnings and Hours (EEH) 2012 Survey	Not provided.
HILDA	Household members of private dwellings in Australia, with the following (relevant) exceptions: • certain diplomatic personnel of overseas governments, customarily excluded from censuses and surveys; • members of non-Australian defence forces (and their dependents) stationed in Australia; • residents of institutions (such as hospitals and other health care institutions, military and police installations, correctional and penal institutions, convents and monasteries) and other non-private dwellings (such as hotels and motels); and • people living in remote and sparsely populated areas.	No definition of an employee is provided. However, the HILDA survey includes data that classifies respondents according to the ABS definition of employment status, in addition to its own, which differentiates employees of own business. These two data items include: Current employment status • Employee • Employee of own business • Employer/Self-employed • Unpaid family worker Current employment status (ABS defined) • Employee • Employer • Own account worker • Contributing family member

Sources: ABS (Cat. no. 6202.0, April 2015), ABS (Cat. no. 6306.0, May 2014), ABS (Cat. no. 6359.0, November 2013), Summerfield et al. (2015). FWC (2015i).

Inconsistency also stems from whether information was collected from employers or employees. For employer surveys, responses are assisted by employment records, whereas employee surveys tend to reflect that a proportion of employees are uncertain as to the nature of their employment arrangement. Wilkins and Wooden (2011) noted the significant problem of measurement error in pay setting data derived from employee reports, and that comparisons with employer sourced data showed a tendency to overstate award reliance. However, in all surveys 'don't know' and/or 'other' responses comprise a small proportion of the sample and do not preclude the use of these surveys as means of measuring the prevalence of the various employment arrangements.

The surveys used had varied response rates. In instances where non–respondents differ systematically from respondents, there is the potential for bias. ABS surveys have high response rates, compared with HILDA, AWRS and AWS. Indeed the FWC notes:

> It is important to note that AWRS data should not be a substitute for ABS catalogues that provide more robust estimates of the characteristics of the employee populations in Australia. This is primarily due to the significantly larger sample sizes and higher response rates that ABS estimates are based on. (FWC 2015i)

D.2 Measuring employment arrangements

Aspects of the employment relationship are measured in different ways across surveys and this can introduce additional inconsistencies. Measures for the various aspects of the employment relationship covered in this appendix are discussed below.

Mainly unregulated employment arrangements

Independent contractors and employers

The ABS Labour Force survey, FOE survey (a supplement to the Labour Force survey) and the HILDA survey provide data on contracting arrangements and business ownership.

The ABS FOE survey publication presents information about the nature of different types of employment arrangements and the conceptual framework classifies employed persons as either employees (table D.1), independent contractors or other other business operators (table D.2).

Independent contractors are employed under a commercial contract, which distinguishes them from employees, who are employed under an employment contract. Shomos, Turner and Will (2013) noted the difficulties in estimating the prevalence of independent contractors and the extent to which some independent contractors should be classified as employees. According to the ABS FOE survey, an independent contractor can include

employees who are able to draw funds from the business for their personal use and invoice clients (ABS 2013a). This is broadly aligned with the definition in the HILDA survey.

Other business operators have their own business, with or without employees, and differ from independent contractors in that they generate their income from managing staff or providing goods and services to the market rather than providing their services to a client (ABS 2013a). Other business operators include owner managers of incorporated businesses (OMIEs) (the owner is separable from the business entity) and owner managers of unincorporated enterprises (OMUIEs))(the owner is inseparable from the business entity) (ABS 2013a). The HILDA survey includes similar labels (table D.2). Some surveys allow owner-managers to be classified as employees. The term 'employee' in this appendix will not include such workers. Table D.2 outlines the classification of forms of employment for a number of labour force surveys.

The FOE and HILDA surveys suggest that independent contractors and business owners can be engaged through labour hire arrangements. Productivity Commission estimates based on HILDA survey data suggest that around 10 per cent of independent contractors and 7 per cent of business owners are engaged using labour hire arrangements. Labour hire arrangements are not excluded from the estimates of independent contractors and business operators. (This category is discussed separately below with respect to employees.)

Whereas the proportion of employed persons who are independent contractors is similar between the FOE and HILDA surveys, it differs for other business operators.

The FOE survey indicates that 8.5 per cent of employed persons (excluding employees) are independent contractors, which is slightly lower than the comparable measure in the HILDA survey of 9.1 per cent (figure D.2). The FOE estimate of business operators of 8.7 per cent is higher than the HILDA survey estimate of 5 per cent (figure D.2). However, combined, as a proportion of employed persons, the two classifications are broadly similar (16 per cent for the FOE survey and 14 per cent for the HILDA survey).

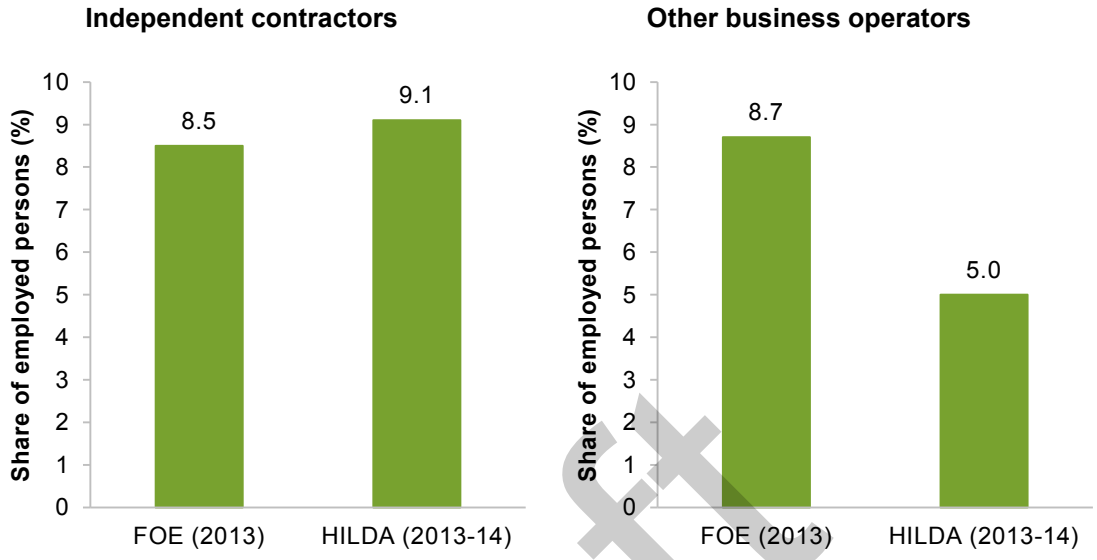
The discrepancy between the ABS and HILDA surveys could be due to either differences in definitions between the surveys, or classification differences and this is leading either to the ABS over-estimating, or the HILDA survey under-estimating, the proportion of employed persons who are other business operators. Having regard to the larger ABS sample size, the ABS FOE survey estimates will be used for the purposes of the appendix.

Table D.2 **Employment arrangement classifications: Independent contractors, business operators and contributing family members**

Survey	*Classification label*	*Definition*
FOE	Independent contractor	Independent contractors operate their own business and contract to perform services but do not have the legal status of an employee (that is they are engaged under a commercial contract not an employment contract). They can be an incorporated or an unincorporated business. The Commission has included employees who are able to make drawings from a business and invoice clients.
FOE	Other business operator	Other business operators operate their own business, with or without employees, but are not independent contractors. Unlike independent contractors, they generate income from managing staff or selling goods or services to the public, rather than providing labour services to a client directly. Other business operators can be either an incorporated or unincorporated business.
EEH	Owner manager of incorporated enterprise	Working proprietors of incorporated businesses with an individual arrangement which sets the main part of their pay.
HILDA	Independent contractor	• usually issue invoices (including tax invoices) to bill clients for the work that they do for them • usually earn income from using their skills and effort, not just from owning their business • do not spend most of their work time dealing with administrative tasks and paperwork for their business • may be able to negotiate the terms of their work contract • may perform work for more than one client • may subcontract work to another person or business
HILDA	Employment status – employee of own business or employer/self-employed	Works in own business (incorporated or unincorporated) with or without employees.
Labour Force	Contributing family worker	Works without pay in an economic enterprise operated by a relative.
Labour Force	Own account worker	Operates their own unincorporated economic enterprise or engages independently in a profession or trade and hires no employees.
Labour Force	Employer	Operates their own unincorporated economic enterprise or engages independently in a profession or trade, and hires one or more employees.

Sources: ABS (Cat. no. 6359.0, November 2013), ABS (Cat. no. 6306.0, May 2014), Roy Morgan (nd) ABS (Cat. no. 2901.0, November 2006).

Figure D.2 **Independent contractors and other business operators by survey**



Sources: Productivity Commission estimates based on ABS (Cat. no. 6359.0, November 2013).

Contributing family members

A contributing family member works without pay in a family business or on a farm. The ABS detailed quarterly Labour Force survey indicates that 26 400 persons were contributing family members in May 2014 (ABS 2015b).

Contributing family members are not included in the number of employed persons in the FOE survey, and are therefore added to employed persons to estimate the numerator for the purposes of estimating the proportion of those in less regulated employment arrangements. Contributing family members comprise 0.2 per cent of employed persons.

Employees regulated by other WR arrangements

State public sector employees

States have referred their industrial relations powers federally to differing degrees. For example, while all employees in the Northern Territory are covered by the federal industrial relations system, in New South Wales state and local government employees are covered by the New South Wales industrial relations system. In total, around 1.2 million employees are covered by a state industrial relations system, and therefore not covered by the FW Act. This group comprises approximately 10.5 per cent of all employed persons.

Western Australian employees

Western Australia's industrial relations system applies to unincorporated businesses and the state public sector. While the number of state public sector workers is directly measured by ABS Employment and Earnings (Public Sector) there is no current survey that directly measures prevalence of employees within Western Australian unincorporated enterprises. The Western Australian Department of Commerce (2014) used the 2010 issue of EEH to estimate the number of these employees, producing an estimate of 23.8 per cent of Western Australian employees. Assuming that the share of employees in Western Australian unincorporated enterprises has remained constant since 2010 would imply that these workers account for around 1 per cent of employed persons in Australia.

Employees regulated by the FW Act

Employees in collective agreements

Broadly, employees can be classified as setting their pay collectively or non-collectively (which can be subsequently classified as award reliant and above award). Within the federal system, pay is set collectively through enterprise bargaining.

The definition of collective pay setting is fairly consistent across surveys (table D.3). Since AWRS and ARS sample only federal system employees, their definitions refer to enterprise agreements, which is consistent with the purposes of this appendix. While these surveys include unregistered enterprise agreements, the number of employees reporting their use is small. EEH surveys both federal and state system workers, and thus includes a range of collective industrial instruments in its definition. However, state and federal system workers are distinguished within the survey, though for around 12 per cent of respondents jurisdiction is 'not determined'. While HILDA references enterprise agreements in its definition, its inclusion of state system workers suggests that respondents covered by collective agreements within the state systems have also been allocated to this classification. In addition, HILDA measures the prevalence of pay set by a combination of individual and collective arrangements. For the purposes of this appendix, these employees are classified as in collective arrangements.

Collective pay setting is not necessarily mutually exclusive to pay set according to the award (a category below). Indeed, some employees on an enterprise agreement may be paid at award rates. The ARS and AWRS classify these employees as on collective agreements.

Table D.3 **Employment arrangement classifications: Collective agreement**

Survey	*Classification label*	*Definition*
EEH	Collective agreement	Collective agreements set pay and conditions for a group of employees through a negotiation process. Including • Enterprise agreements • Workplace, industry, site or project collective agreements • Preserved Collective State Agreements • Enterprise Bargaining Agreements (EBA) or Certified Agreements (CA) • Enterprise awards and consent awards • Unregistered or verbal collective agreements Excluding • Notional Agreements Preserving State Awards (NAPSAs) (include in Question 22) • Awards and individual agreements or individual contracts
AWRS	An enterprise agreement (EBA, collective agreement)	A registered enterprise agreement is lodged with the Fair Work Commission (formerly Fair Work Australia) and approved. An unregistered enterprise agreement would not have been lodged and approved (e.g. an informal pay-setting arrangement that applies to a group of employees at a workplace).
ARS	An enterprise agreement (EBA, collective agreement)	A registered enterprise agreement is lodged with Fair Work Commission (formerly Fair Work Australia) and approved. An unregistered enterprise agreement would not have been lodged and approved (e.g. an informal pay-setting arrangement that applies to a group of employees at a workplace).
HILDA	Collective (enterprise agreement)	An agreement made at the workplace or firm between the employer and either a union or a group of employees. *It may sometimes be known as an Enterprise Agreement*.
HILDA	Combination of collective/enterprise agreement and individual agreement	This will apply in those cases where an employee is covered by a collective (i.e. enterprise) agreement, but is paid above the rate specified in that agreement.

Sources: ABS (Cat. no. 6306.0, May 2014), FWC (2015h), Roy Morgan Research (nd), Wright and Buchanan (2013).

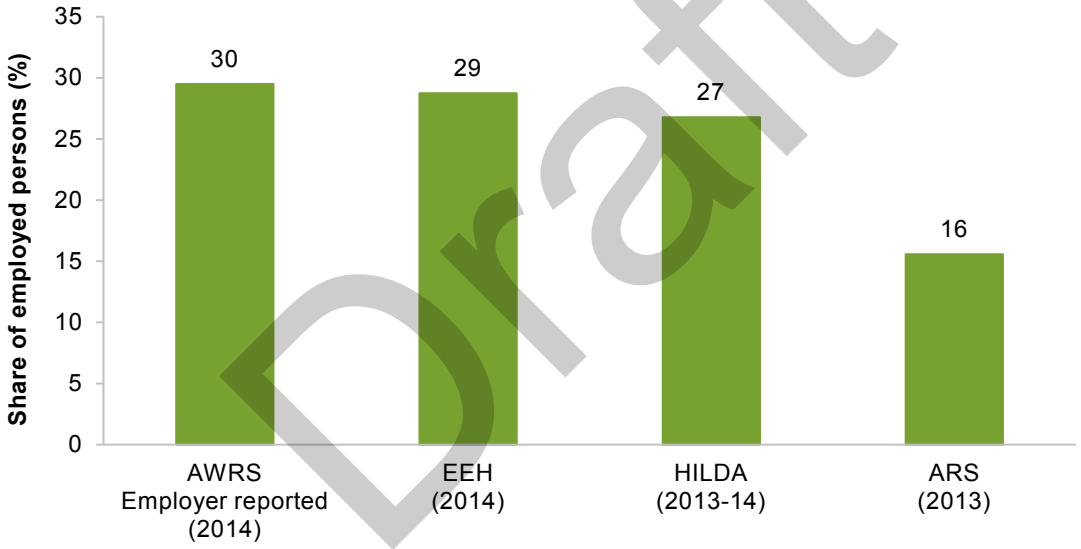
Estimates of collective agreement prevalence are fairly consistent with the exception of ARS (figure D.3). This may partly result from ARS excluding public sector workers, who are more likely have their pay set collectively. The HILDA estimate is also relatively low. This is consistent with employee-based surveys under-reporting the use of collective agreements and over-reporting award reliance. On the other hand, HILDA includes state system workers, who are more likely to use collective agreements. AWRS produces the highest estimate. This may be expected, given its exclusion of employees that work in business with less than 5 employees, which have lower rates of collective agreement use.

The estimates of EEH are most likely to accurately reflect the use of collective agreements, given its use of employer-reported data and high response rate. EEH differentiates federal and state systems employees, though for around 12 per cent of these employees jurisdiction

is listed as not determined. This incomplete classification is unlikely to substantially affect results. Excluding employees with undetermined jurisdiction produces an estimate of 29.1 per cent of employed persons. Conversely, including these employees results in an estimate of 28.9 per cent.

Additionally, the EEH excludes employees in agriculture, forestry and fishing. However, this is also unlikely to affect its estimate substantially. The labour force survey estimates that the agriculture, forestry and fishing industry includes around 183 100 employees. At most, including the employees could reduce the estimate to 28.1 per cent of employed persons, and increase the estimate to 29.7 per cent[271]. Together, this suggests that around 28.7 per cent of employed persons are on collective agreements under the FW Act.

Figure D.3 **Prevalence of FW Act employees in collective arrangements among all employed persons [a,b]**



[a] Respondents reporting 'don't know' or 'other' have been excluded from this analysis and estimates have been adjusted accordingly. [b] Initial estimates have been calculated as a share of employees, and then multiplied by 70.8% (the estimated share of employees covered by the FW Act) to approximate the share of total employed persons.

Sources: Productivity Commission estimates based on ABS (Cat. no. 6306.0, May 2014), AWRS (2014), HILDA Release 13, ARS (2013).

Employees in non-collective arrangements

For the purposes of this appendix, employees who have not had their pay set collectively are classified as in non-collective arrangements. Pay set by these arrangements may be

271 Assuming that all agriculture, forestry and fishing employees were not on collective agreements, or that all employees were on collective agreements, respectively.

equal to the award or higher, and measures of pay setting typically classify non-collective arrangements according to this distinction. Those with pay set exactly equal to the award are classified as award reliant, while those with pay above the award are classified as on an above-award individual agreement.

Award reliance

The measurement of award reliance is fairly consistent across surveys. Although the information provided to respondents regarding the definition of an award varies (table D.4), all surveys classify award reliant employees as those who have their pay set at the exact award rate. In the case of AWS and AWRS, this measure explicitly excludes those paid at the award rate on an enterprise agreement.

Table D.4 **Employment arrangement classifications: Award reliant**

Survey	*Classification label*	*Definition*
EEH	Award only	Awards are legally enforceable determinations of Federal and State industrial tribunals or authorities that set pay and conditions. Including • Modern awards • Australian Pay and Classification Scales (Pay Scales) • Notional Agreements Preserving State Awards (NAPSAs) • Transitional awards • Pre-reform awards Excluding • Enterprise awards and consent awards (included as collective agreements) • Collective agreements and individual agreements or individual contracts
AWRS	An award	An award contains the minimum conditions of employment – including pay rates – that apply to employees in particular industries or occupational groups. The award can be used to set wages a exactly the applicable rate specified in the award, or at an amount above the award rate.
AWS	An Award	An award contains the minimum conditions of employment – including pay rates – that apply to employees in particular industries or occupation groups.
HILDA	Paid exactly the Award (or APCS)	No description provided.

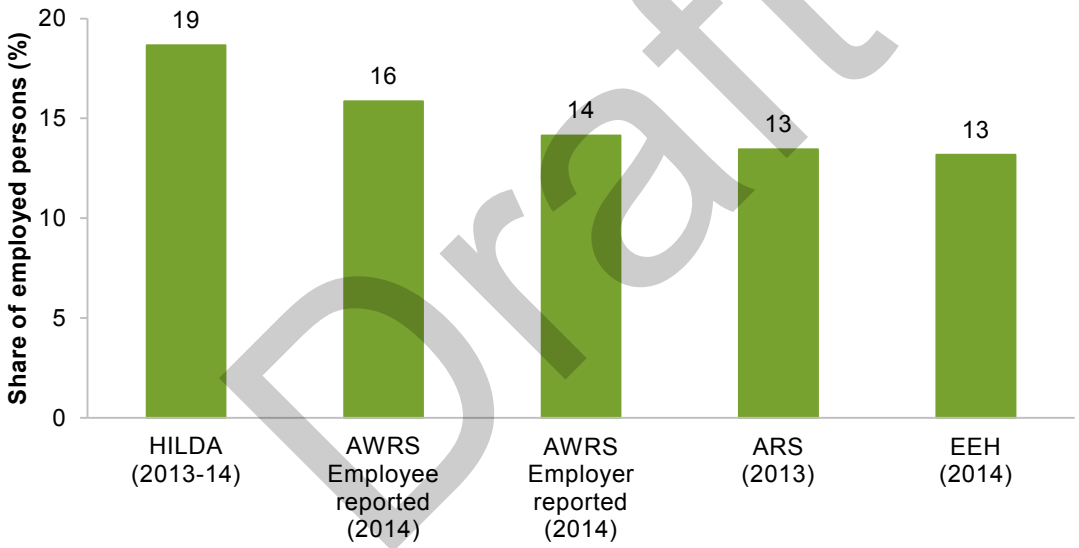
Sources: ABS (Cat. no. 6306.0, May 2014), FWC (2015h), Roy Morgan Research (nd), Wright and Buchanan (2013).

Award reliance estimates are broadly consistent (figure D.4). That said, there is some variation attributable to survey design. Both employee-reported measures show a higher prevalence for award reliance, which likely reflects a lesser awareness of pay setting arrangements among employees and a bias towards assuming award pay rates.

Among the employer-reported surveys, population estimates of award reliance are consistent. This is despite differing sample designs that are likely to introduce bias in differing directions. For example, the exclusion of small business in AWRS is likely to result in underestimation of award reliance.

Again, EEH estimates are most likely to accurately reflect award reliance. It produces a population estimate of 12.9 per cent or 13.6 per cent, dependent on the inclusion of those with undetermined jurisdiction. Accounting for the potential impact of excluding employees in the agricultural, forestry and fishing sector produces a maximum point estimate of just over 14.5 per cent and a minimum of 12.9 per cent. Around 13.1 per cent of employed persons appear to be paid at the relevant federal award rate.

Figure D.4 **Prevalence of award reliant FW Act employees among all employed persons [a,b]**



[a] Respondents reporting 'don't know' or 'other' have been excluded from this analysis and estimates have been adjusted accordingly. Further adjustments were made to provide an estimate as a proportion of employed persons. [b] Initial estimates have been calculated as a share of employees, and then multiplied by 70.8% (the estimated share of employees covered by the FW Act) to approximate the share of total employed persons.

Sources: Productivity Commission estimates based on ABS (Cat. no. 6306.0, May 2014), AWRS (2014), HILDA Release 13, ARS (2013).

Above-award arrangements

This classification covers all employees who are not paid according to a collective agreement and are not paid the exact award rate. This is a residual group that could be sub-classified a number of ways — for example, some will have award-based pay[272], some will be above the FW Act high income threshold or in an occupation not traditionally covered by awards. As a residual category, this group likely includes a heterogeneous body of employees (although likely to comprise highly paid professionals in certain industries (appendix E)). The classifications used in surveys are listed in table D.5.

Table D.5 **Employment arrangement classifications: above award arrangements**

Survey	*Classification label*	*Definition*
EEH	Individual arrangement	Individual agreements or contracts set the pay and conditions for an individual employee. They may be verbal or written and signed by the employee. Including • Individual Transitional Employment Agreements (ITEA) • Australian Workplace Agreements (AWA) • Preserved employment contracts • Informal individual arrangements Excluding • Collective agreements and awards
AWRS	An individual arrangement	An individual arrangement is a wage-setting practice where an award or enterprise agreement does not play a role in determining the amount an employee is paid.
AWRS	Over award	Over-award is a method where pay is set with reference to an award rate (i.e. as the base) but not at exactly the applicable award rate
AWS	Other pay-setting arrangements	Individual arrangements may include both 'above award' and 'award' rates of pay. An individual agreement is an agreement between a business/organisation and a single employee . It may also be called a common law contract.
HILDA	Individual agreement (or contract)	An agreement (formal or informal) between the employee and employer. It may be verbal or written. It could simply be a letter of appointment.

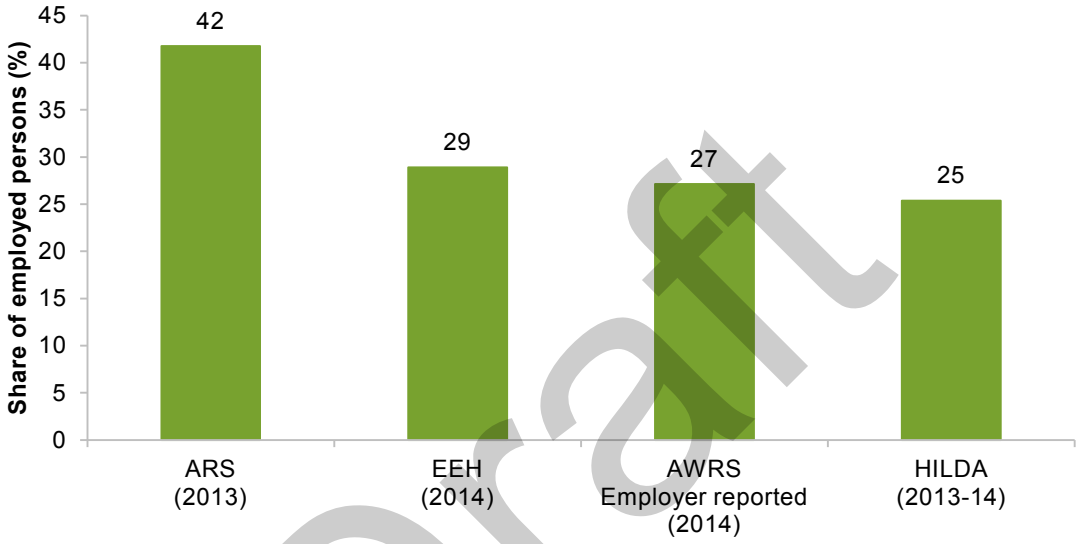
Sources: ABS (Cat. no. 6306.0, May 2014), FWC (2015h), Roy Morgan Research (nd), Wright and Buchanan (2013).

While the ARS provides a relatively high estimate of employees on above-award arrangements, the remaining surveys are fairly consistent (figure D.5). The higher estimate from the ARS is likely driven by its focus on private sector employers. The same rationale suggests that the inclusion of state workplace relations system employees within the HILDA results in downward bias.

[272] Where 'award-based pay' refers to pay setting influenced by, but not set at, the award rate.

EEH produces an estimate of between 28.9 per cent and 29.5 per cent, depending on whether employees with 'not determined' jurisdiction status. At most, the inclusion of agricultural employees may decrease the point to 28.2 per cent and increase the point estimate to around 29.8 per cent. Around 28.9 per cent of employed persons appear to be on above-award individual arrangements.

Figure D.5 **Prevalence of FW Act employees in above award individual arrangements among all employed persons [a,b]**



[a] Respondents reporting 'don't know' or 'other' have been excluded from this analysis and estimates have been adjusted accordingly. Further adjustments were made to provide an estimate as a proportion of employed persons. [b] Initial estimates have been calculated as a share of employees, and then multiplied by 70.8% (the estimated share of employees covered by the FW Act) to approximate the share of total employed persons.

Sources: Productivity Commission estimates based on ABS (Cat. no. 6306.0, May 2014), ABS (Cat. no. 6306.0, May 2014), AWRS (2014), HILDA Release 13, ARS (2013).

Individual flexibility arrangements

IFAs are a separate individual arrangement negotiated directly between an employer and an employee under an award or enterprise agreement. IFAs modify some aspects of the employee's pay and conditions, with the remainder determined by the relevant award or enterprise agreement. This means the employee is on both an award or an enterprise agreement and has a separate individual arrangement (the IFA).

IFA data are collected in the FWCGM and AWRS employer and employee surveys (table D.6).

The FWCGM in 2012 estimated that around 3 per cent of employees had an IFA. The AWRS 2014 employer and employee surveys provide the most recent data on IFAs, but

the employer survey does not provide disaggregated data on the incidence of IFAs amongst employees; only whether the employer has created an IFA over the period being surveyed.

Table D.6 **Survey methodology — individual flexibility arrangements**

Survey	*When survey conducted*	*Survey question*
FWCGM employer	March to June 2012	Asks the employer about written arrangements with an employee made since 1 January 2010 that modified a condition of employment contained in a modern award or enterprise agreement, and whether this was an IFA.
FWCGM employee	March to June 2012	Asks the employee whether they had made a written arrangement with an employer since 1 January 2010 that changed or modified one or more employment conditions and follow questions to determine if this was an IFA.
AWRS employer	February to July 2014	Asks if the employer made an IFA with any employees since 1 July 2012, and how many employees the employer has agreed to an IFA with since that time.
AWRS employee	February to July 2014	Asks the employee if they had made an IFA since 1 July 2012 which modified one or more of their employment conditions contained in a modern award or enterprise agreement. If yes, employees were asked if the IFA was still in effect.

Sources: FWC (nd), O'Neill (2012b).

The AWRS employee survey does provide data on the number of IFAs in effect during the survey period (February to July 2014) which could proxy for a 'point in time' estimate. However, the estimate of the number of IFAs reported by employees does not necessarily match the estimates from the employer survey. Therefore, to obtain a point in time estimate it includes employees who had created an IFA since July 2012 which was still in effect at the time of the survey, and whose employer had created at least one IFA in the same period.

Productivity Commission estimates of the percentage of employees with an IFA suggests that 2.3 per cent of employees, or 1.6 per cent of employed persons, had an IFA.

IFAs are discussed further in chapter 16 (on individual arrangements).

Labour hire

Labour hire data are sourced from the ABS (FOE) and HILDA surveys (table D.7). ABS data on labour hire arrangements were last published in 2012 (in respect of November 2011).

Table D.7 **Employment arrangement classifications: Labour hire**

Survey	*Classification label*	*Definition*
FOE	Found job through a labour hire firm/employment agency • Paid by a labour hire firm/employment agency • Not paid by a labour hire firm/employment agency	People who found their current job through a labour hire firm/employment agency, and were either paid or not paid by the firm or agency.
HILDA	Employed through a labour hire firm	Employed through a labour-hire firm or temporary employment agency, that is, the agency pays the wage.

Sources: ABS (Cat. no. 6359.0, April 2012), Melbourne Institute (nd).

For the purposes of determining employment arrangements, this appendix classifies an employment arrangement as a labour hire arrangement where the labour hire firm or agency (rather than the employer at whose workplace the employee is engaged) pays the employee's wage.

The estimates of the proportion of employed persons paid through labour hire arrangements are of a similar (small) magnitude, but vary slightly between the ABS FOE and HILDA surveys. The ABS reports that in 2011, 1.3 per cent of employed persons were paid through a labour hire arrangement and the estimate from HILDA for 2013-14 is 2.4 per cent. The latter is broadly in line with a 2002 HILDA estimate of 2.9 per cent presented in a Productivity Commission staff working paper (Laplagne, Glover and Fry 2005).

The labour hire category in both the FOE and HILDA surveys appears to include employees, independent contractors and business operators who are hired by labour hire firms. However, it is only employees who are engaged through a labour hire arrangement who are of interest. Restricting the HILDA estimates to this group (and to avoid double counting), it is estimated that around 1.8 per cent of employed persons are employees on labour hire arrangements (HILDA adjusted, figure D.6).

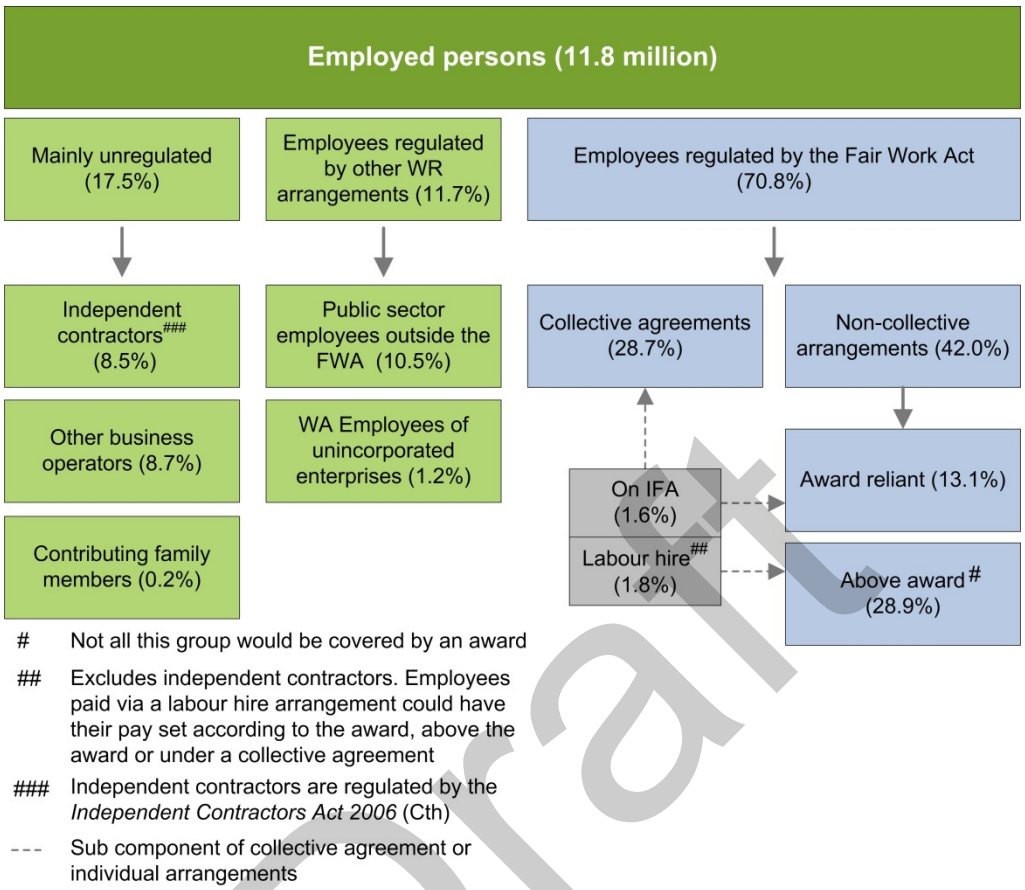
D.3 Conclusion

Applying the analysis in the appendix, figure D.8 provides an overview of the distribution of employed persons as determined by the framework discussed in section D.1 and the analysis in section D.2.

Figure D.6 **Prevalence of FW Act employees in labour hire**

Source: Productivity Commission estimates based on ABS (Cat. no. 6359.0).

Figure D.7 **Distribution of employment arrangements**



E Statistical overview of employment arrangements

While chapters 11, 15 and 16 in this report discuss the evidence on the nature, uptake and trends in various types of agreements and awards, they generally do not provide the data on these matters. This appendix fills that gap by setting out a statistical overview of the various employment arrangements and the characteristics of individuals that use them. Such evidence is important in understanding the economic significance of some of the issues raised in the chapters on awards and agreements.

While a variety of surveys collect statistical information on employment arrangements (as noted in appendix D), this appendix primarily draws on the Australian Bureau of Statistics (ABS) Survey of Employee Earnings and Hours.

Trends in the use of different employment arrangements

Across the Australian labour market, enterprise agreements (EA) and above-award individual arrangements are the most commonly used employment arrangements[273] (in terms of the proportion of employees using them) with each of these arrangements used by around 40 per cent of employees (figure E.1). However, these patterns of use are not consistent throughout the economy — they vary widely across a number of factors, including the size of the employer, industry, occupation, wages and other characteristics.

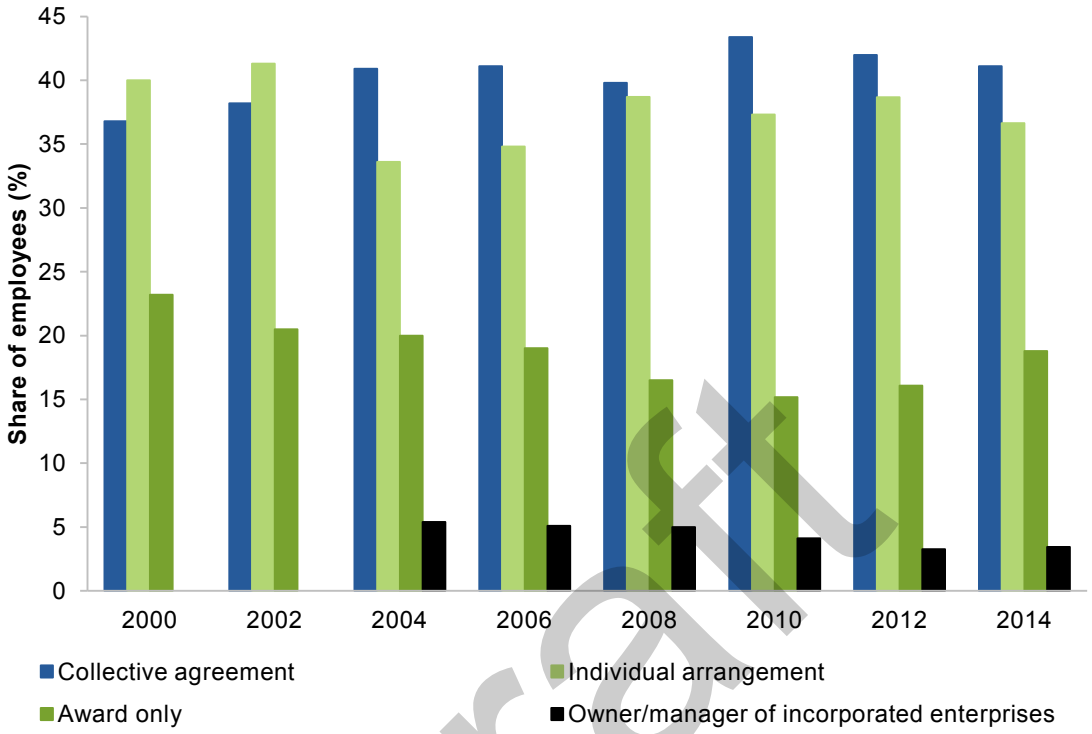
Employer size

The prevalence of each employment arrangement varies markedly with firm size. The share of employees on EAs is significantly higher in larger enterprises, while individual arrangements are dominant in smaller firms (figure E.2). Award usage also decreases with firm size. This suggests that transaction and compliance costs may play an important role in determining the type of wage setting arrangement used.

[273] The ABS Survey of Employee Earnings and Hours classifies employees in the 'collective agreement' category if they had the main part of their pay set by a collective agreement (registered or unregistered) or enterprise award. Employees are classified to the 'individual arrangement' category if they have their pay set by an individual contract, individual agreement registered with a Federal or State industrial tribunal or authority, common law contract (including for award or agreement free employees), or if they receive over-award payments by individual agreement. Employees are classified as 'award only' if they are paid at the rate of pay specified in the award, and are not paid more than that rate of pay.

Figure E.1 **Use of different employment arrangements**

Proportion of employees (per cent), 2000 - 2014

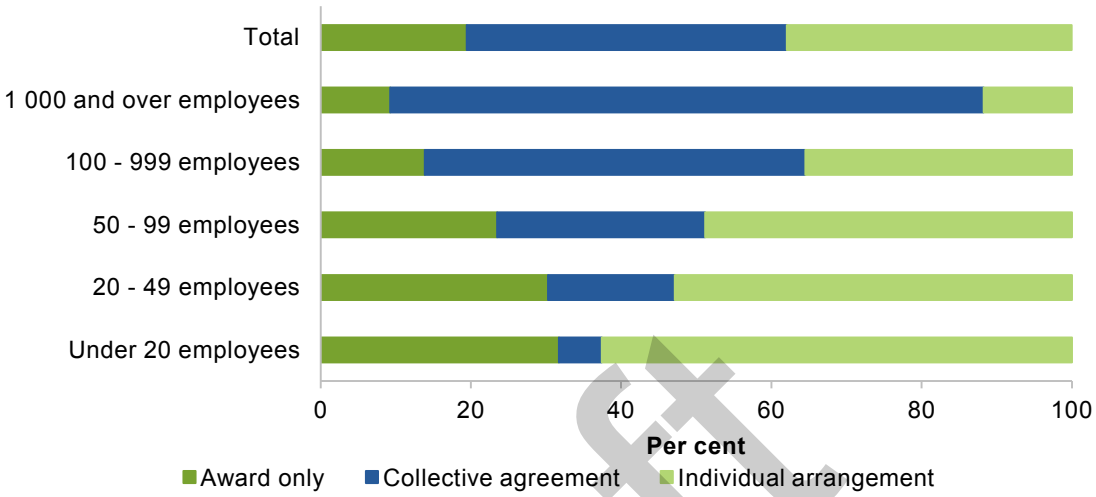


This survey was not designed as a time series, so caution should be exercised when comparing data between different years. Working proprietors of incorporated enterprises are counted as employees on an individual arrangement. Includes all collective arrangements, not only federal enterprise agreements.

Source: ABS *Employee Earnings and Hours*, Australia, May 2014, Cat no. 6306.0.

Figure E.2 **Share of employees using employment arrangements — by employer size**

Share of employees in each enterprise size group, 2012

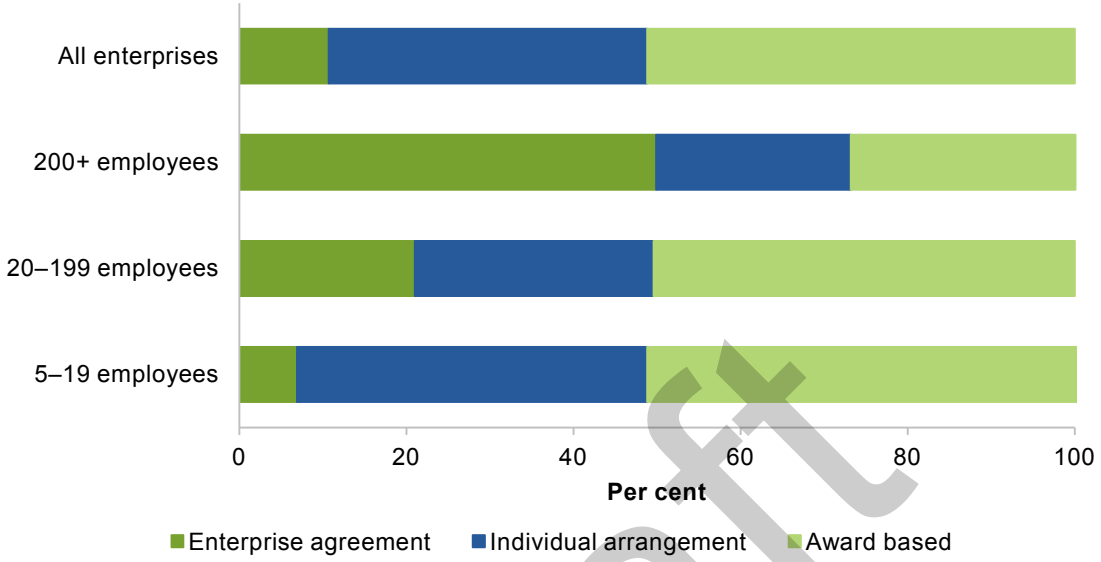


Source: ABS *Employee Earnings and Hours*, Australia, May 2014, Cat no. 6306.0.

The measured frequency of each arrangement changes somewhat when measured by the number of *employers* using them (figure E.3 and table E.1). EAs are much less frequent under this measure — this reflects that EAs used by a small number of large firms can each cover many employees. While EAs are the arrangement most commonly used by firms with 200 or more employees, individual and award-based arrangements are still used to set the pay of a majority of employees in roughly half of these large firms. Individual and award-based arrangements are the primary arrangement used by the largest proportions of firms, particularly those with less than 200 employees.

Figure E.3 **Share of employers using employment arrangements for the largest proportion of employees**

Share of employers (per cent), by employer size



[a] Base = 2971 for enterprise agreement, individual arrangement and award-based analysis. Includes enterprises that had a main employment arrangement calculated as the method that was used to set pay for the largest proportion of employees. Excludes 86 enterprises where two methods of setting pay were used in equal proportion.

Base = 2922 for Award reliant and Over-award analysis. Records where missing and unknown wage-setting arrangements have also been excluded (45 enterprises).

Award-based t is setting a pay rate at exactly the applicable award rate. Over-award is a method where pay is set with reference to an award rate (i.e. as the base) but not at exactly the applicable award rate

Data source: Fair Work Commission (2015d).

Table E.1 **Employment arrangements used for at least one employee**
Share of employers (per cent)

Pay setting method	*Per cent*[a]
Enterprise agreement – registered agreement	11.5
Enterprise agreement – unregistered agreement	2.5
Individual arrangement	63.5
Award-reliant	31.3
Over award	30.9

[a] Note: Does not add up to 100 per cent as employers may use multiple methods of setting pay.

Base = 3043 for enterprise agreement, Individual arrangement and Award-based analysis. Records where don't know, missing and unknown pay-setting arrangements have been excluded (14 enterprises).

Base = 2869 for Award reliant and Over-award analysis. Records where don't know, missing and unknown wage-setting arrangements have been excluded (89 enterprises).

Award-reliant is setting a pay rate at exactly the applicable award rate. Over-award is a method where pay is set with reference to an award rate (i.e. as the base) but not at exactly the applicable award rate.

Source: Fair Work Commission (2015d, p. 35), AWRS 2014 Employee Relations Survey.

The results reflect that there are a very large number of employing businesses, many of whom would find standard enterprise bargains unwieldy when they already have recourse to award-based and individual arrangements as their standard employment template. However, the data suggest a possible gap in contract types where a business wishes to craft an agreement that varies the award, but finds the enterprise bargaining arrangements too costly a route to achieve this. A new potential type of statutory arrangement, the 'Enterprise Contract', as elaborated in chapter 17 may fill this gap.

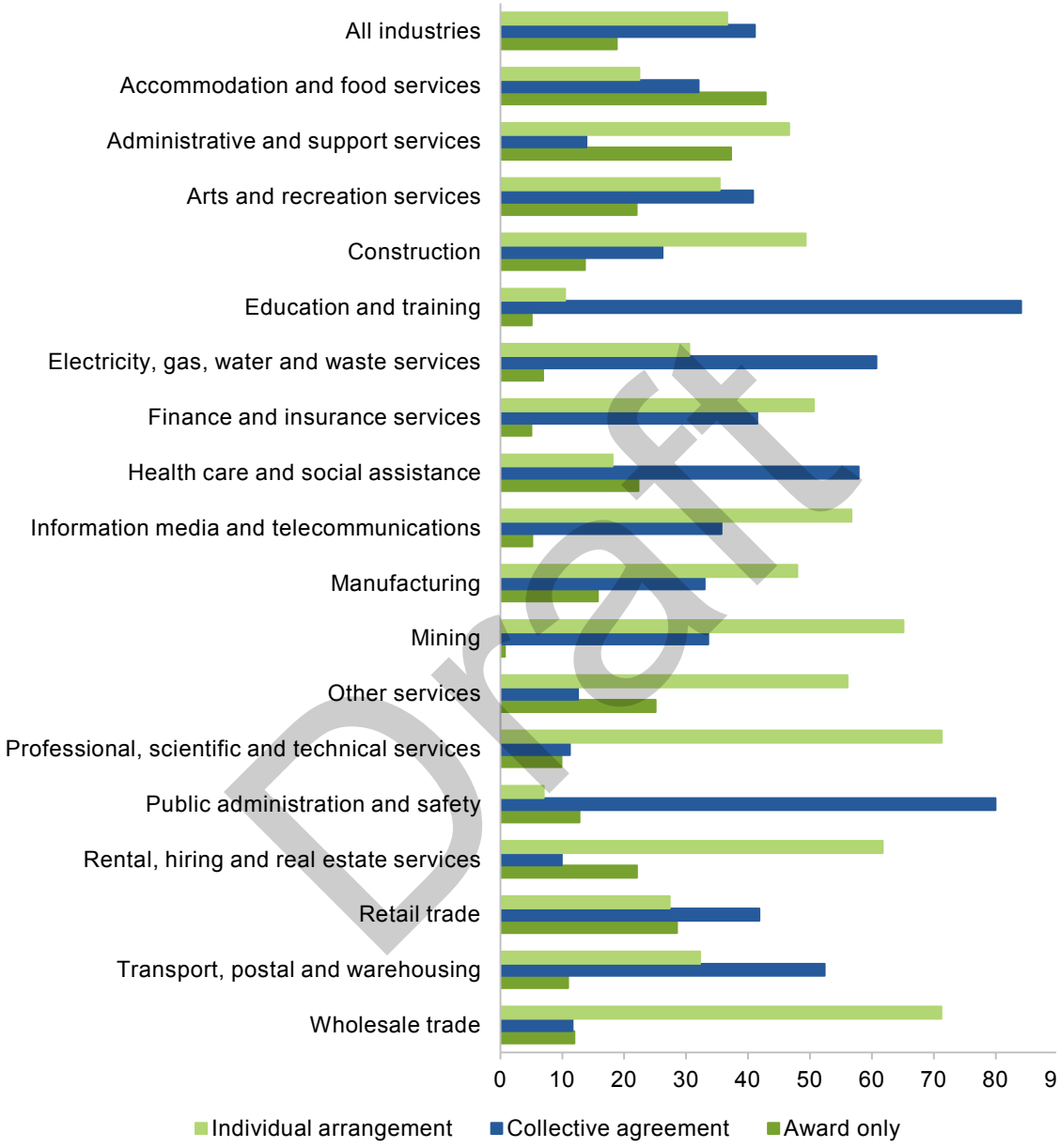
Industry

As figure E.4 shows, industry sectors vary widely in their use of different employment arrangements. Employees who work in education and training, public administration and safety and electricity, gas, water and waste services industries are most likely to have their pay set by a collective agreement.

By contrast, individual arrangements are the primary means of setting pay in the professional, scientific and technical services, wholesale trade, mining, rental hiring and real estate services, and information, media and telecommunications service sectors. More than 98 per cent of employees using individual arrangements are in the private sector.

Award-reliant employees are more likely to work in the accommodation and food services; administrative and support services; retail trade; other services; and health care and social assistance industries. These industries have been consistently award-reliant over the last six years, and, in several other industries, award reliance has been increasing.

Figure E.4 **Employment arrangements by industry**
Proportion of employees (per cent)

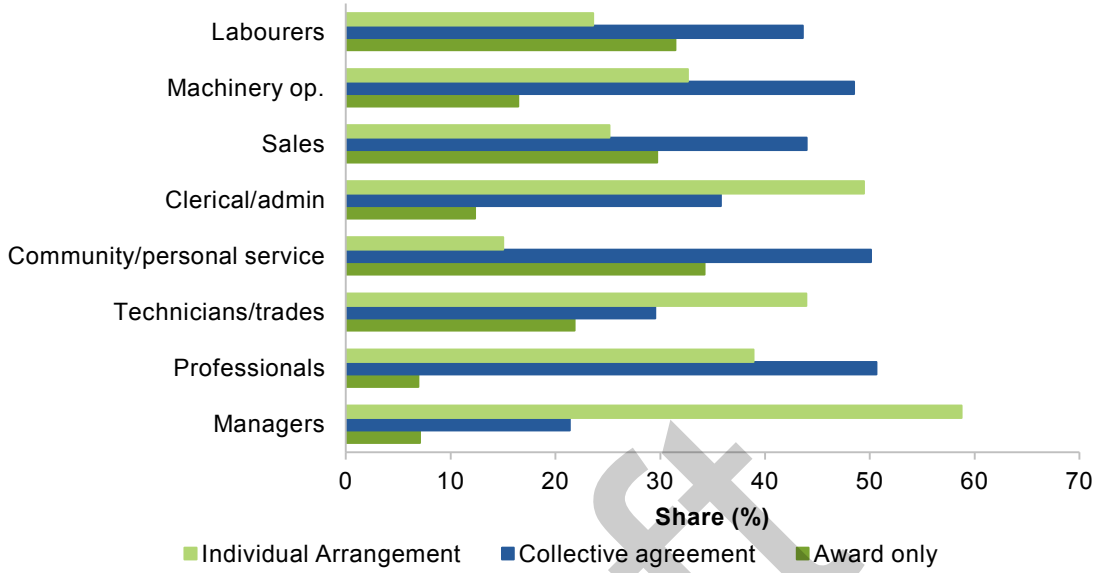


Source: ABS *Employee Earnings and Hours*, Australia, May 2014, Cat no. 6306.0.

Occupation and job characteristics

The relative frequency with which the various employment arrangements are used varies widely between occupational groups (figure E.5).

Figure E.5 **Employment arrangements by occupation**



Source: ABS *Employee Earnings and Hours*, Australia, May 2014, Cat no. 6306.0.

The occupations with the highest use of EAs are community service workers and professionals, followed by machinery operators and drivers, sales workers and labourers. Most workers on EAs are employed on a permanent or fixed term (rather than casual) basis (figure E.6).

Employees on individual arrangements more commonly work as managers, clerical or administration workers, technicians and trades workers or professionals (figure E.5). The overall picture that emerges is that individual arrangements are more likely to be made by higher paid professionals in a subset of industries.

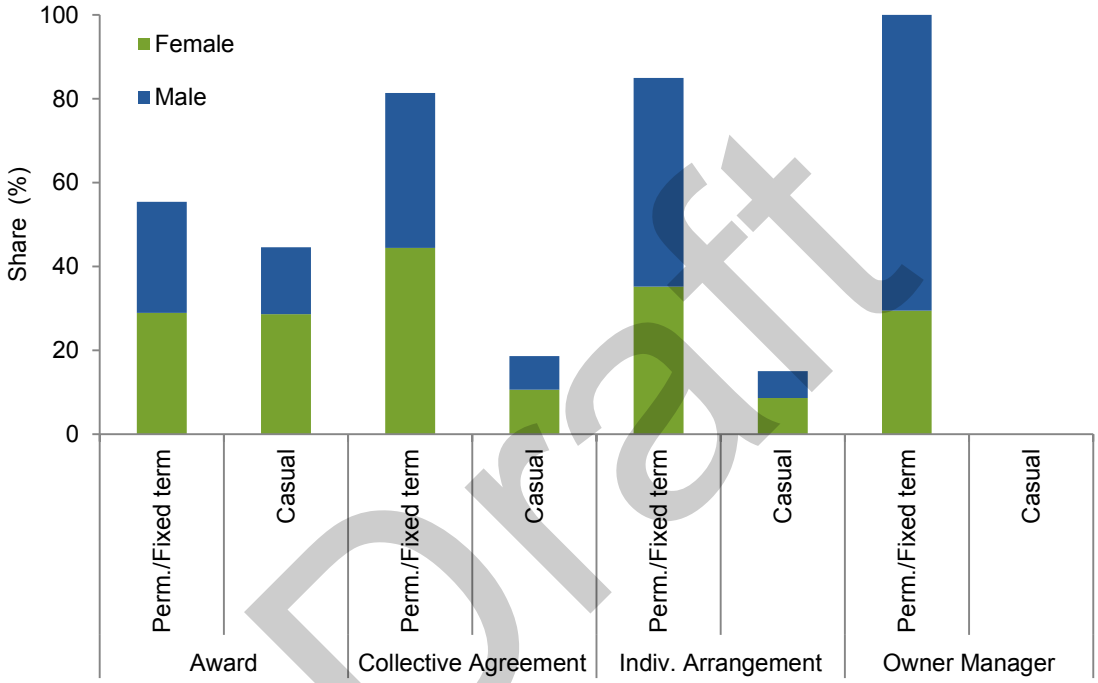
Award-reliant employees are most likely to work as community and personal service workers, sales workers, labourers, and technicians and trades workers (figure E.5). Bolton and Wheatley (2010) used the unit record file from the 2006 Employee Earnings and Hours survey to disaggregate the occupation groups of award-reliant employees further. They reported that:

- the majority of award-reliant community and personal services workers were either carers and aides (and of these, most were personal carers and assistants or child carers) or hospitality workers. Of all hospitality workers, 60.7 per cent were found to be award-reliant. Of all child carers, 69.4 per cent were award-reliant
- among award-reliant sales workers, the majority were sales assistants and sales persons
- within the group of award-reliant labourers, cleaners and laundry workers and food preparation assistants made up the majority. Fifty six per cent of cleaners and laundry workers and 46.2 per cent of food preparation assistants were award-reliant.

Award-reliant employees are also much more likely to work casually when compared with other employment arrangements (figure E.6). Employees in rural and regional areas are more likely to be award-reliant (almost one in four) compared to employees in metropolitan areas (around one in six) (Wright 2013).

Figure E.6 **Permanent and casual employment by employment arrangement and gender, 2014**[a]

Per cent



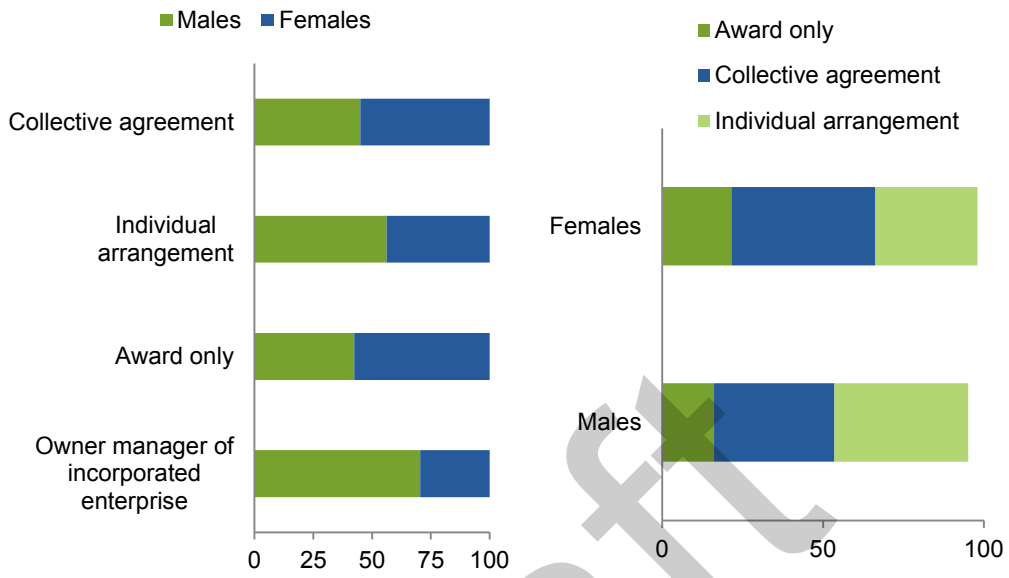
[a] The permanent and casual bars add to 100 per cent for each employment arrangement.

Source: ABS *Employee Earnings and Hours*, Australia, May 2014, Cat no. 6306.0.

Gender and age

The prevalence of different employment arrangements also appears to vary with gender. Employees on awards and collective agreements are more likely to be female, and of all female employees, a higher proportion is award-reliant or on a collective agreement compared with males (figures E.7). By contrast, individual arrangements are more commonly used by male employees. Rozenbes (2010) suggests that this is largely due to the different industrial composition of employment for males and females, with females more likely to work in industries with higher award reliance.

Figure E.7 **Gender differences in methods of setting pay**
Share of total (%), 2014



Source: ABS *Employee Earnings and Hours*, Australia, May 2014, Cat no. 6306.0.

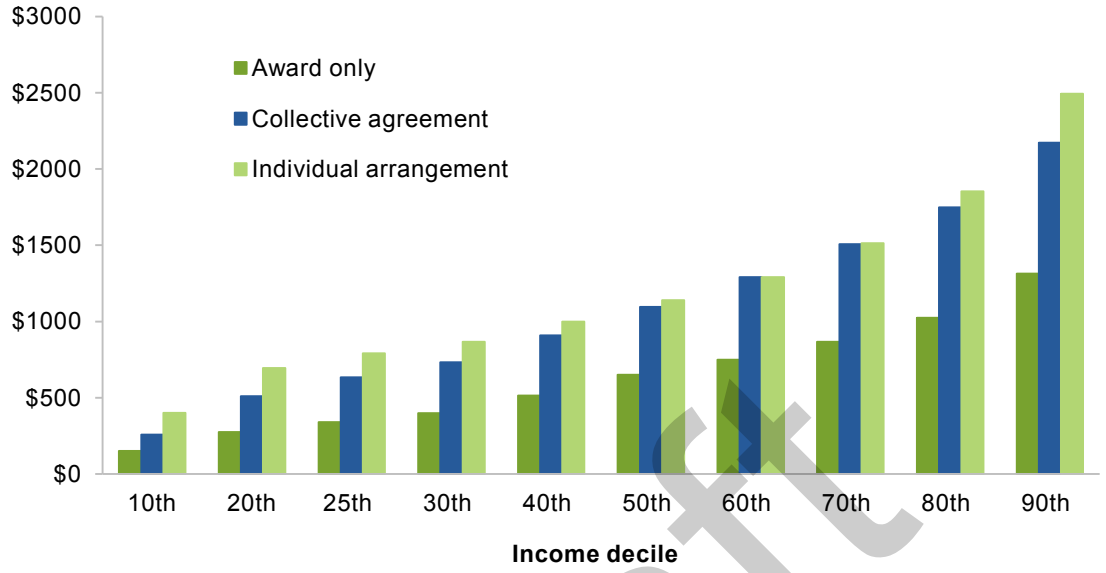
Employment arrangements also vary with age. Award-reliant employees are younger on average (35.7 years) than employees who have their pay and conditions set by another method (40.6 years for collective agreements, 39.4 years for individual arrangements and 48.3 years for owner managers of incorporated enterprises) (ABS 2015c). Data from the Australian Workplace Relations Study also suggest that job tenure affects the likelihood that an employee's pay is set by an individual arrangement — 81 per cent of those who had been with their employer for ten or more years had their pay set using an individual arrangement, compared with 23 per cent of those who were with their employer for less than a year.

Wage differences between employment arrangements

While the apparent difference in average weekly earnings between employees on collective agreements and individual arrangements is rather small, the earnings of employees on award-reliant arrangements are both lower and more evenly distributed across earning deciles (figure E.8). The gap between award earnings and those for other employment arrangements also increases in higher income deciles for each arrangement. This is rather unsurprising, given the use of awards as a safety net below which wages and conditions cannot be reduced.

Figure E.8 **Average weekly earnings by employment arrangement**

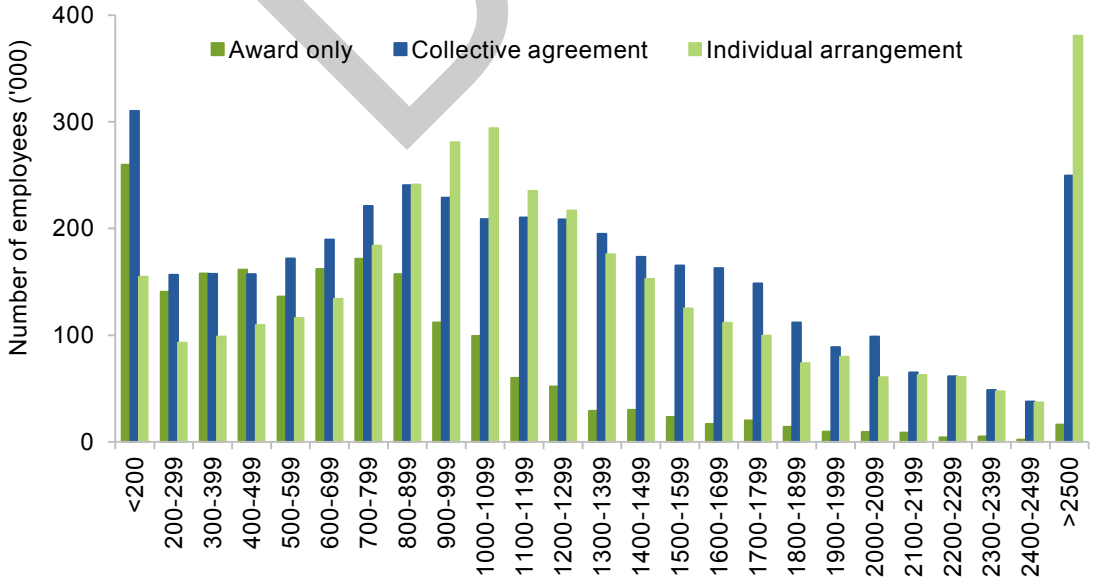
By income decile for each employment arrangement, 2014



Source: ABS *Employee Earnings and Hours*, Australia, May 2014, Cat no. 6306.0.

Figure E.9 **Employment arrangements by weekly cash earnings**

Number and proportion of employees in earnings bracket, 2014

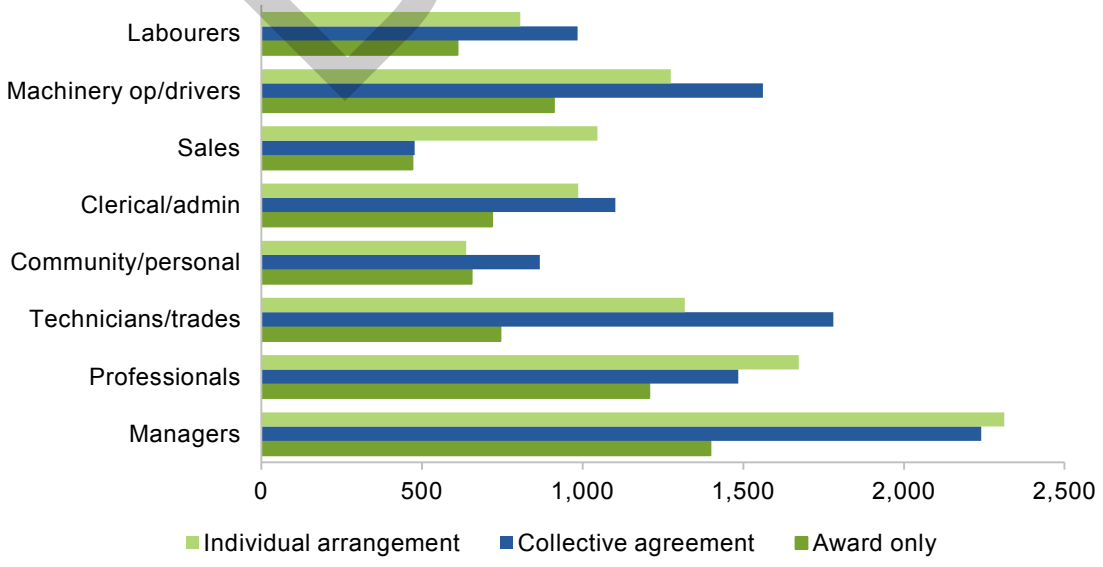


Source: ABS *Employee Earnings and Hours*, Australia, May 2014, Cat no. 6306.0.

The relative frequency of each employment arrangement can also be arranged by weekly cash earnings (figure E.9). This reveals similar results to those above — among award employees, most (roughly four fifths) are on below average incomes, while roughly half of employees on collective agreements and individual arrangements earned below average incomes. Of all employees earning above the Australian average weekly earnings of $1128.90 in 2014, roughly 7 per cent were on awards. Individual arrangements and collective agreements made up the remaining share of above average earning employees in roughly equal measure — though collective agreements were more common in 'upper middle' weekly earnings brackets while individual arrangements were particularly dominant in the top weekly earnings bracket.

While employees on individual arrangements on average earn more than those on other arrangements, this general trend does not hold for all occupations. In particular, technicians and trades workers, community and personal service workers and machinery operators and drivers on collective agreements have higher average earnings than their counterparts do on individual arrangements (figure E.10). By contrast, average earnings are substantially higher for sales workers and slightly higher for managers and professionals, on individual arrangements when compared to those under collective agreements. And, despite being in the minority, employees on individual arrangements in the public sector earn around 60 per cent more than those in the private sector (a difference that is more than that for collective agreements, but less than that for awards).

Figure E.10 **Average weekly earnings by employment arrangement and occupation**
2014



Source: ABS *Employee Earnings and Hours*, Australia, May 2014, Cat no. 6306.0.

It is important not to causally attribute all of the differing distributions of income to the type of employment arrangement because of the likely effects of selection biases. People with less-skilled jobs are generally paid less and more likely to be on an award, while those with higher-skill jobs are more likely to be on individual arrangements or EAs. For example, remuneration is higher for occupations such as professionals and managers and this group tends to have pay set using individual arrangements rather than awards or EAs (figure E.5). This does not mean that bargaining (on a collective or individual level) produces no premiums for employees, but that such premiums cannot be simply inferred by a face value comparison of the figures.

Differences between types of enterprise agreements

Not all EAs are the same. They can cover a single existing enterprise, a new enterprise that has yet to commence operations (a greenfields agreement) or, in relatively rare instances, multiple enterprises (table E.2).

The use of greenfields agreements has grown. Greenfields agreements make up 10 per cent of all EAs, up from 6.4 per cent in September 2011. Greenfields agreements are most prevalent in the construction industry, where over two-thirds of agreements are greenfields agreements. Other high users by industry are: administrative and support services (6.4 per cent); manufacturing (5.3 per cent); mining (5.2 per cent); transport, postal and warehousing (3.6 per cent); and professional, scientific and technical services (3.1 per cent) (McCallum, Moore and Edwards 2012, p. 169). These six industries have accounted for around 91 per cent of all greenfields agreements approved under the *Fair Work Act 2009* (Cth) (FW Act).

Table E.2 **Single enterprise agreements are most common**
Enterprise agreement approval applications lodged with the awr, by year

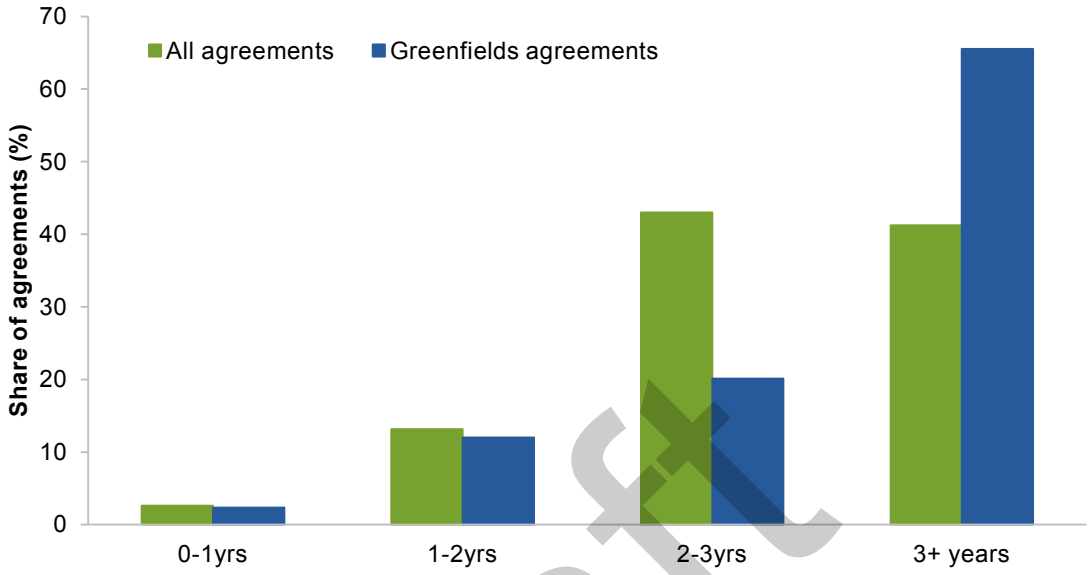
Type of application	*2011-12*	*2012-13*	*2013-14*
Single enterprise	7 812	6 333	5 945
Greenfields	705	712	749
Multi-enterprise	48	42	60
Total	8 565	7 087	6 754

Source: Fair Work Commission (2014b, p. 58).

Enterprise agreement durations

While enterprise agreements have a maximum duration of four years, roughly 60 per cent of current agreements have durations of three years or less (figure E.11). Greenfields agreements tend to have longer durations — two-thirds of current greenfields agreements have durations of more than three years.

Figure E.11 **Durations of current (not yet expired) enterprise agreements**
Proportion of agreements (per cent)

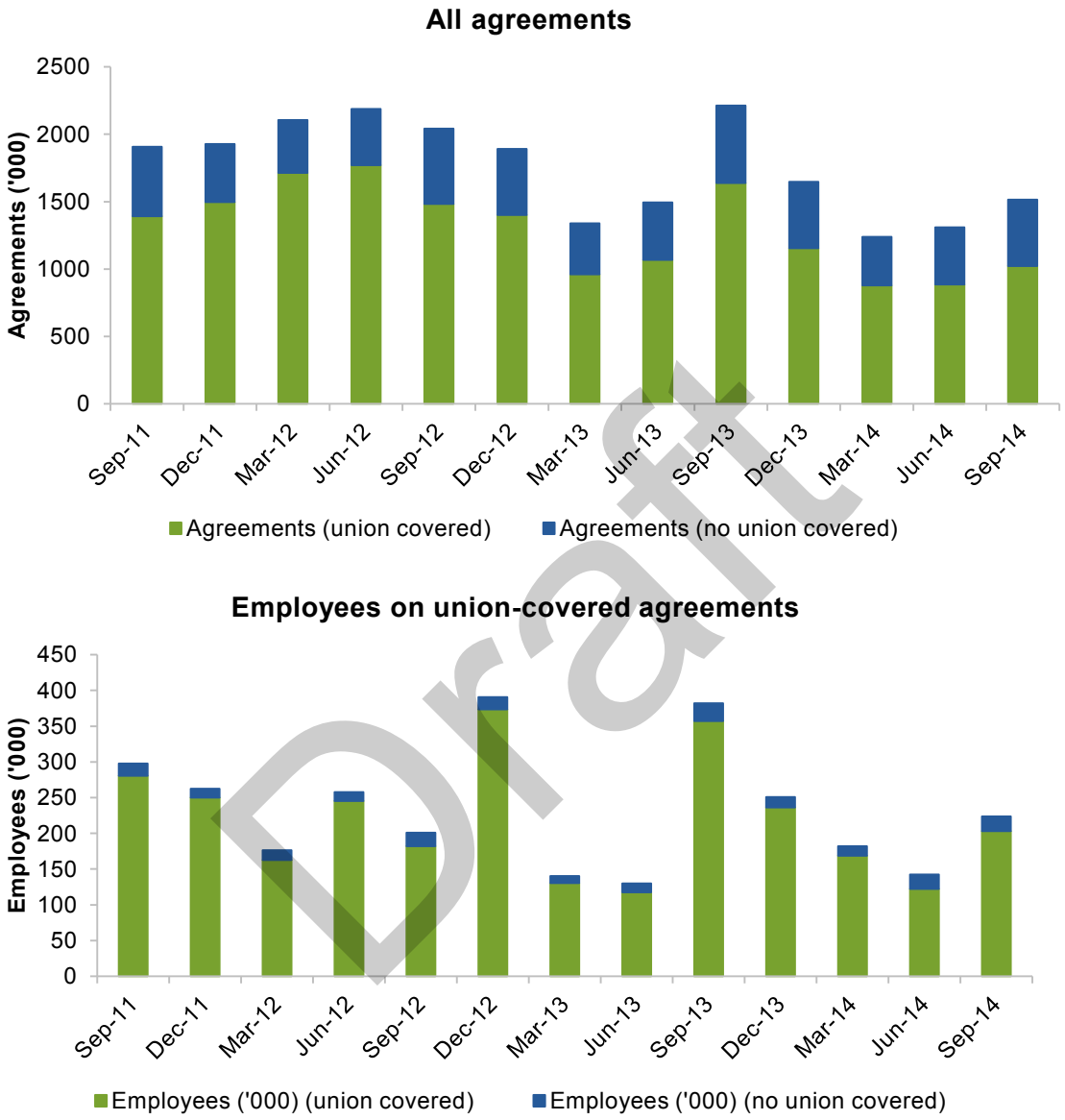


Source: Data provided to Productivity Commission by the Department of Employment.

Union coverage

While most EAs cover a union, around 30 per cent do not (figure E.12). However, it appears that non-union agreements are more common among smaller enterprises because over 90 per cent of employees whose pay is set by an EA are on union-covered agreements. Around two-fifths of employees covered by union agreements do not belong to a union, a rate which is apparently higher than many other countries (Peetz and Preston 2009, p. 448).

Figure E.12 **Unions and enterprise agreements[a]**
For agreements lodged in the nominated quarter



[a] An agreement is identified as being 'union' where the decision approving the agreement notes in accordance with s201(2) of the FW Act that the agreement covers the union(s) which has/have given notice under s183(1) that it/they want the agreement to cover them. It is recognised that this is a proxy measure as the data measures coverage rather than bargaining presence.

Source: Department of Employment (2015, p. 32).

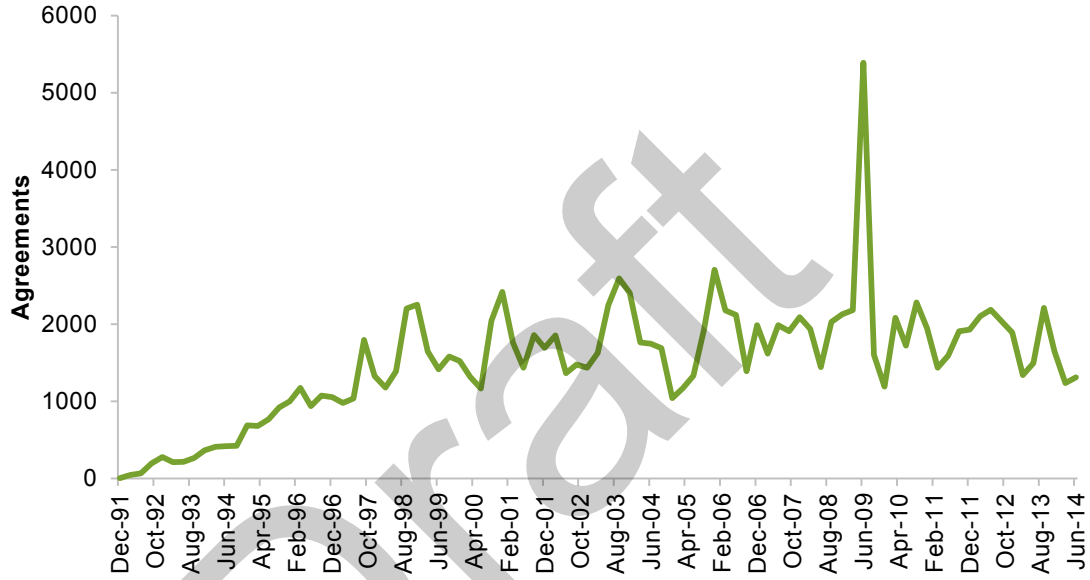
Long-term trends in agreement lodgements

The number of EAs lodged has stayed roughly constant in the past decade, although there were very substantial changes from quarter to quarter (figure E.13). (The spike in 2009

immediately preceded commencement of the FW Act.) Lodgments are the flow of new EAs, and are added to the existing stock of EAs. The stock has risen over time, though it has fallen most recently (figure E.14). The number of employees covered by lodged EAs has also been relatively stable, which suggests no substantial change in the distribution of firm sizes that make new agreements (figure E.15).

Figure E.13 **Trends in lodgments of enterprise agreements**

National system agreements, Dec quarter 1991 to June quarter 2014[a]

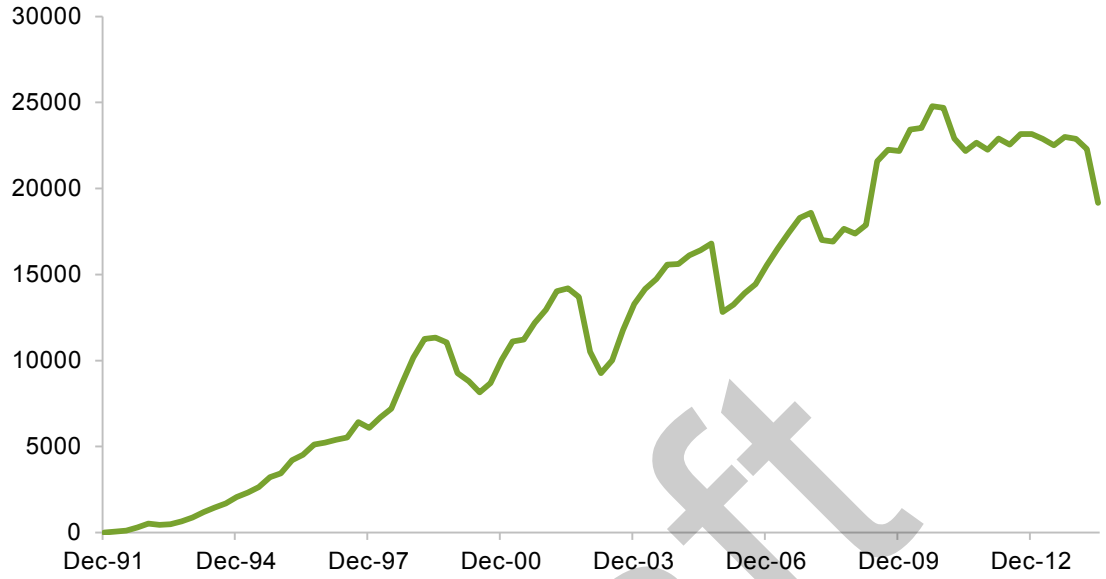


[a] The jump in agreements in mid-2009 coincides with the last days to lodge an agreement under the *Workplace Relations Act 1996* (Cth).

Source: Department of Employment Trends in Enterprise bargaining data.

Figure E.14 **The number of agreements**

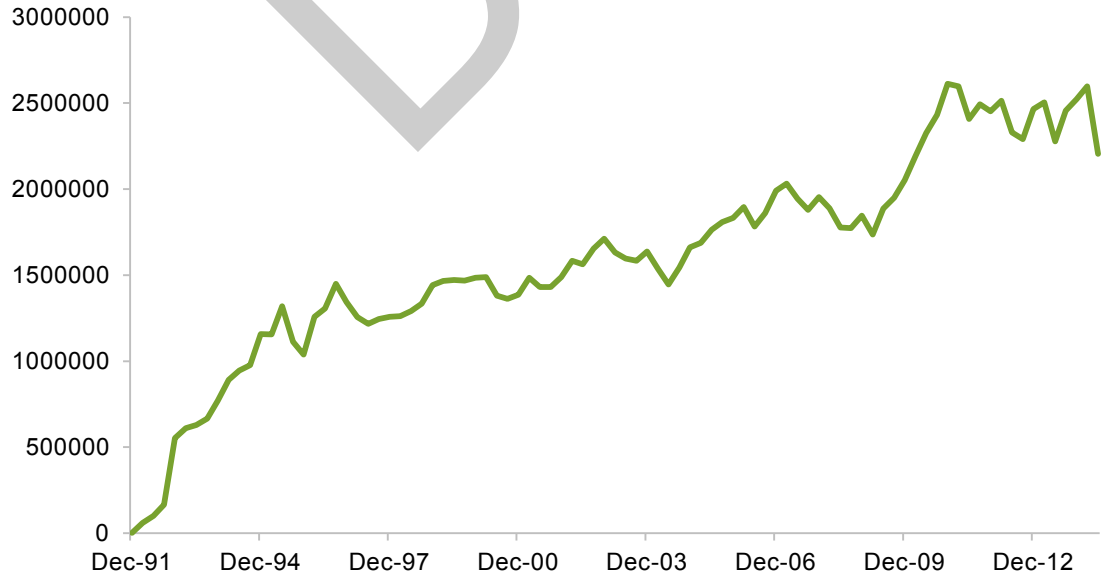
National system agreements, Dec quarter 1991 to June quarter 2014



Source: Department of Employment Trends in Enterprise bargaining data.

Figure E.15 **The number of employees covered by agreements**

National system agreements, Dec quarter 1991 to June quarter 2014



Source: Department of Employment Trends in Enterprise bargaining data.

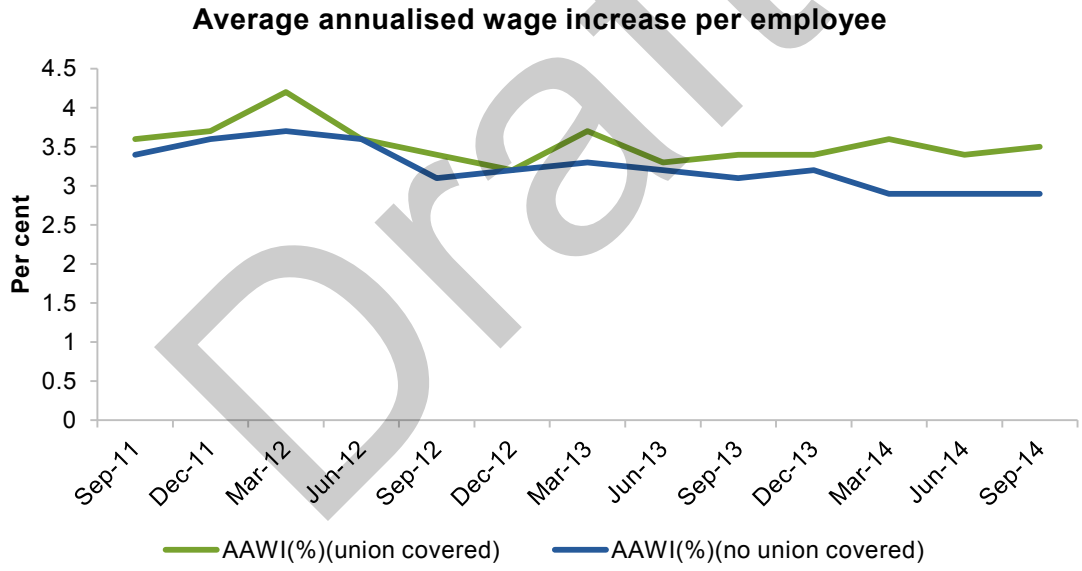
When compared to the number of enterprises, the data also suggests that the propensity for enterprises to form agreements has risen. For example, the number of enterprises employing 200 or more people (the enterprises most likely to have agreements) increased by 20 per cent from June 2003 to June 2014, but agreements increased by 125 per cent over this period.[274]

Wages and conditions under enterprise agreements

Wage growth rates also vary by EA type over the last few years. They appear to be slightly higher in union-covered agreements compared to other EAs (figure E.16).

Figure E.16 **Union-covered enterprise agreements have slightly higher wage outcomes**

AAWI per employee, for agreements lodged in the nominated quarter



[a] AAWI = Average Annualised Wage Increase per employee. [b] Agreement and employee estimates are for all federal wage agreements in the period, while estimates of AAWI per employee are based on quantifiable wage agreements.

An agreement is identified as being 'union' where the decision approving the agreement notes in accordance with s201(2) of the FW Act that the agreement covers the union(s) which has/have given notice under s183(1) that it/they want the agreement to cover them. It is recognised that this is a proxy measure as the data measures coverage rather than bargaining presence.

Source: Department of Employment (2015, p. 32).

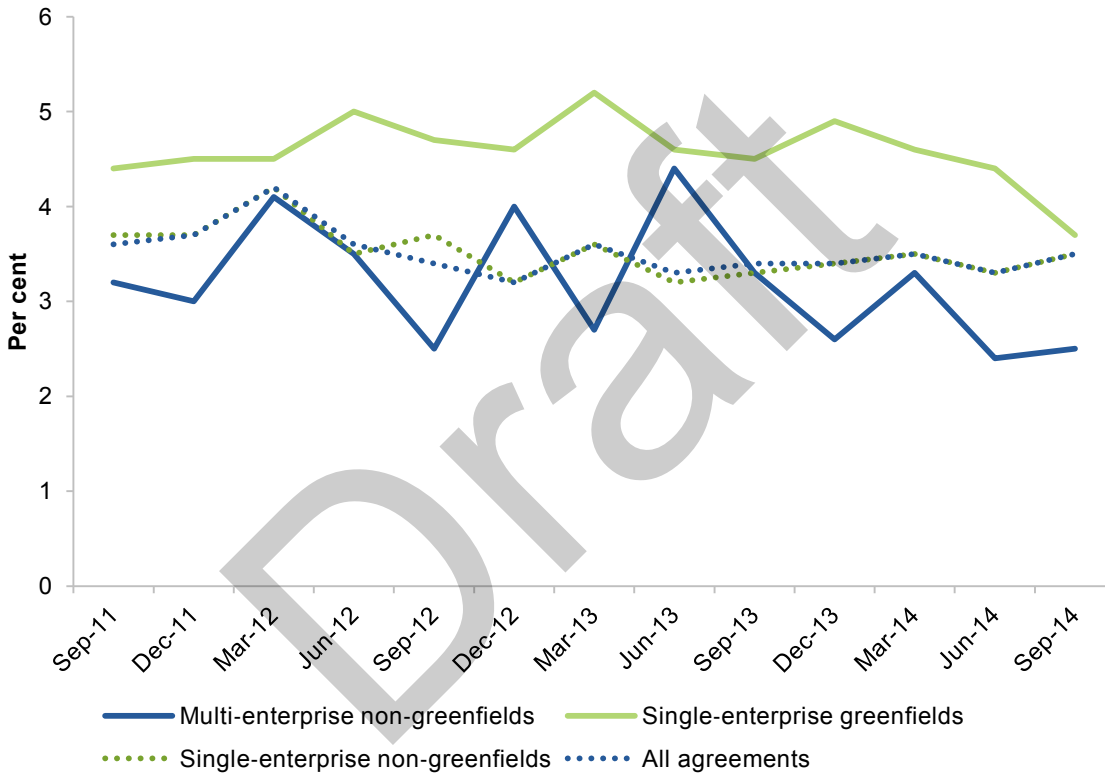
Greenfield agreements also appear to have higher wage growth rates than other EAs (figure E.17). The gap between average annualised wage increases for greenfields

274 Based on ABS 2015, *Counts of Australian Businesses, Including Entries and Exits, Australia*, Cat. No. 8165, released 2 March 2015.

agreements and non-greenfields agreements under the FW Act has expanded. The gap was 1.4 per cent for the period October 2011 to June 2014, up from 0.7 per cent (from the period October 2009 to September 2011). Industry-level data reveal that this widening gap is primarily due to a growth in the wages growth gap for manufacturing and mining industries in particular, but also for construction and transport.

Figure E.17 **Wage increases are slightly higher for greenfields agreements**

Average annualised wage increase, per employee



Source: Department of Employment (2015).

EAs allow parties to vary the terms of awards, subject to a better off overall test. There appears substantial scope to go below the award from some aspects of working arrangements, such as penalty or overtime rates (based on data provided by the Department of Employment from a sample of 216 agreements that broadly represent different industries). For example, of the people who are paid a Sunday penalty rate (and where it was possible to determine whether the provision is below, equal to or above the award), around one quarter are on less than the award, one quarter are above the award, and fifty per cent are exactly at the award (tables E.3 and E.4).

Table E.3 Day worker provisions in enterprise agreements

Overtime and weekend penalty rates

	Below award	*Equal to award*	*Above award*	*Other/unclear*[a]	*No relevant provision*
Weekday overtime for full time	12.5%	55.1%	19.9%	6.9%	5.6%
Weekday overtime for part time	24.5%	38.9%	11.6%	6.9%	18.1%
Saturday overtime	16.2%	40.7%	30.6%	7.4%	5.6%
Sunday overtime	7.9%	75.5%	3.7%	7.4%	5.6%
Weekend penalty rates - Saturday	6.0%	13.9%	7.4%	7.4%	65.3%[b]
Weekend penalty rates - Sunday	5.6%	13.9%	6.0%	6.5%	68.1%[b]

[a] Those agreements which have information on the relevant provision but for which it is not possible to decide that the provision is below/equal to/above the award, for example, the overtime rates have been absorbed into the agreement's wage rates.. [b] This percentage is high mostly because the day work in enterprise agreements is undertaken on a Monday to Friday basis.

Source: Department of Employment data, unpublished.

Table E.4 Shift worker provisions in enterprise agreements

Overtime, weekend penalty rates and shift loadings

	Below award	*Equal to award*	*Above award*	*Other/unclear*[a]	*No relevant provision*[b]
Weekday overtime	11.6%	44.9%	7.9%	6.5%	29.2%
Saturday overtime	18.1%	35.6%	12.5%	4.6%	29.2%
Sunday overtime	6.0%	58.3%	2.3%	4.2%	29.2%
Weekend penalty rates - Saturday	3.7%	23.6%	15.3%	6.0%	51.4%
Weekend penalty rates - Sunday	3.2%	25.0%	13.0%	6.0%	52.8%
Shift loadings - overall	9.7%	21.8%	26.4%	13.0%	29.2%
Day Shift Loading	4.6%	6.9%	18.5%	40.7%	29.2%
Afternoon Shift Loading	14.8%	27.3%	20.8%	7.9%	29.2%
Night Shift Loading	8.3%	30.6%	27.3%	4.6%	29.2%
Continuous Night Shift Loading	9.7%	15.3%	16.7%	29.2%	29.2%

[a] Those agreements which have information on the relevant provision but for which it is not possible to decide that the provision is below/equal to/above the award, for example, the overtime rates have been absorbed into the agreement's wage rates. [b] Depends on the provision. For shift work it is mostly because the agreement does not cover shift workers. For weekend penalty rates it is mostly because the day work is undertaken on a Monday to Friday basis.

Source: Department of Employment data, unpublished.

F Penalty rates

This appendix provides supporting material on penalty rates — mainly of a statistical nature — for chapter 14.

It is structured as follows:

- Section F1 explains some terminology that is used for describing weekend penalty rates and examines the prevalence of different levels of such penalty rates for permanent employees across Australia's 122 modern awards. It also examines the prevalence of weekend working (including differences in the importance of Saturday versus Sunday employment).
- The extent of adverse social effects (or social disabilities) is an important issue for regulatory decisions about penalty rates on Sundays compared with Saturdays. Chapter 14 uses qualitative evidence from survey analysis to examine this issue. Section F.2 examines other quantitative data that reveals people's preferences and that, while establishing that weekends have adverse social impacts, finds that these impacts do not appear to differ greatly between Saturdays and Sundays.
- During standard non-weekend hours, casual employees are typically given a loading (typically 25 per cent) on the wage rates applying to permanent employees. However, depending on the award, there is considerable variability in the treatment of loadings for casual workers for weekend work. Section F.3 examines this issue, and mathematically derives an approach that provides neutral incentives for employing casuals over permanent employees on weekends (as discussed in chapter 14).

F.1 The prevalence of weekend penalty rates

Some terminology

While notionally simple to understand, the terminology describing weekend penalty rates is sometimes confusing. Different parties express penalty rates in different ways. Penalty rates are referred to variously as:

(a) a multiple of hours worked. So 'time and a half' means that an employee working one hour on a weekend would be paid as if they had worked 1.5 hours at the base wage rate (for example, as in the Storage Services and Wholesale Award 2010, p. 25)

(b) a percentage loading on the base wage. For example, time and a half would mean a loading of 50 per cent (as in the Fast Food Industry Award 2010, p. 23). The Fair Work Ombudsman as referred to penalty loadings as penalty rates (FWO 2015h)

(c) the percentage of the base hourly rate (or an index relative to the normal rate times 100). So time and a half would be referred to as a penalty rate of 150 per cent (as in the Funerals Award 2010, p. 25).

Since (b) and (c) can both be referred to as penalty rates, it is important in any analysis to use the same nomenclature. Because of its more common usage, the Productivity Commission uses (c). In this case, with a base wage of $20 per hour and a penalty rate of 150 per cent, the base wage would be $30 per hour.

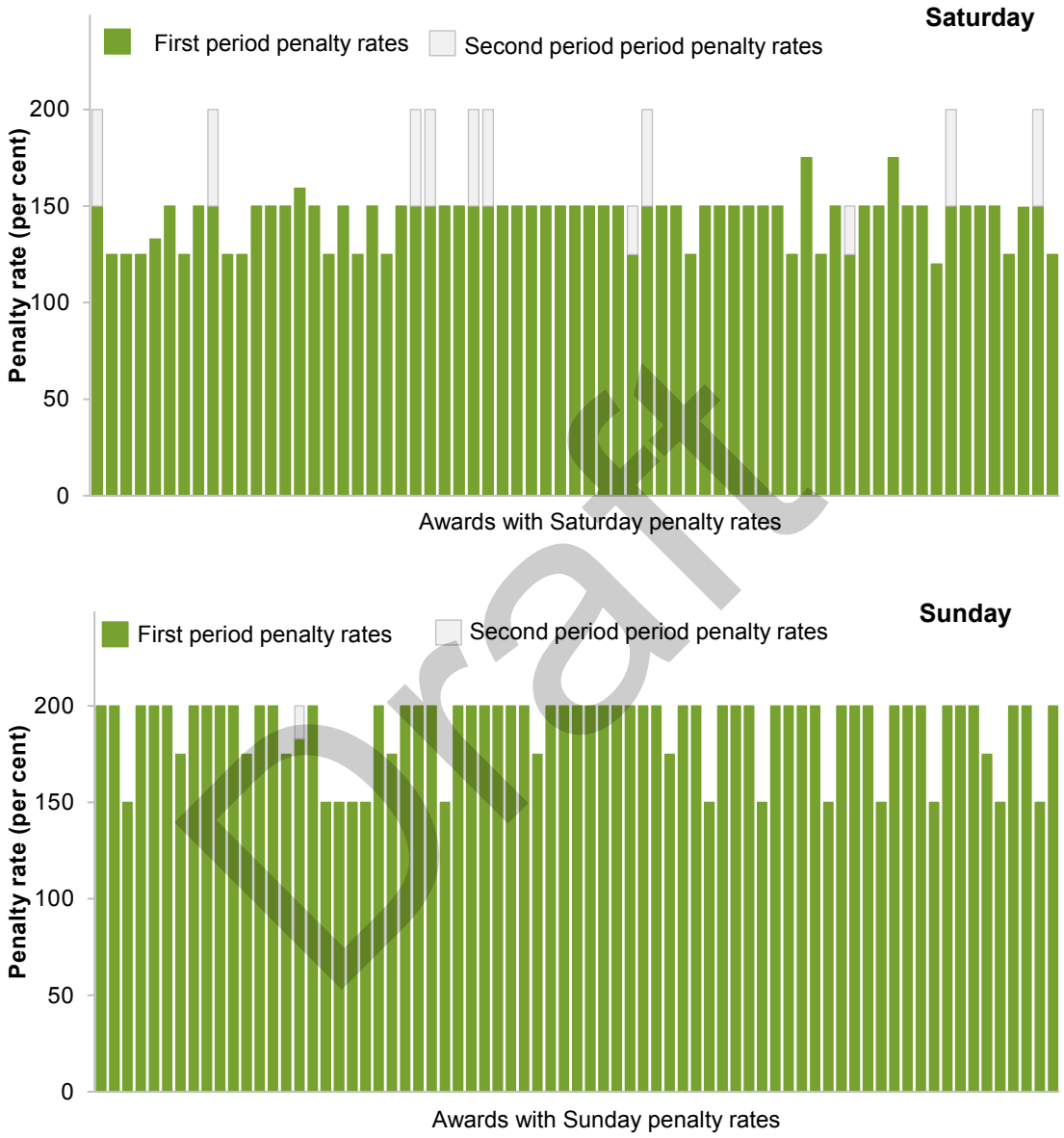
Prevalence of penalty rates by award

Notwithstanding popular impressions that regulated penalty rates are ubiquitous, many industry awards do not specify weekend penalty rates. The Commission's analysis of awards and the Fair Work Ombudsman's pay guides, supported by comprehensive data supplied by the Department of Employment, shows that more than 60 awards include some provision for non-overtime or shift penalty rates on Saturdays and more than 70 awards provide some (more than trivial) provision for such penalty rates on Sundays. In some awards, these rates only apply to some occupational categories, reflecting the broad coverage of some modern awards. Accordingly, around half of Australia's 122 modern awards have provisions for weekend penalty rates. However, the Department of Employment database shows that only around one quarter of awards provide *universal* eligibility to their covered employees for work on Saturdays or Sundays.[275]

The level of penalty rates varies considerably by award, particularly on Saturdays. Some awards also have tiered penalty rates in which there is an initial penalty rate for the first few hours, and a higher one for later hours.

[275] The 25 per cent estimate is based on analysis from the Department of Employment (DoE), where the total count of awards with penalty rates is 31 for Saturdays and 30 for Sundays. The algorithm used by DoE excludes some awards that do provide penalty rates, but not to all employees on an equivalent basis. Its count excludes an award from its count under three circumstances: (a) if any category of an award-covered employee is not eligible for a penalty rate even if many employees would be eligible; (b) where the penalty rates vary by the time of the day on a weekend day. So, in pharmacy, there are four penalty rates for Saturdays depending on the time they apply, and so the DoE database does not code Saturday as having a penalty rate; (c) ordinary hours vary by the class of worker (or must require agreement by the employer and employee). For example, in some awards, ordinary hours are Monday to Friday for some employee categories, which means that there is no ordinary hour rate for weekend work, and therefore no penalty rates for such employees (though there is scope for overtime). For other categories of employees in the same award, ordinary hours are from Monday to Sunday, with a penalty rate applying for weekends. Where these two types of ordinary hour definitions coexist in an award, the DoE approach records that there are no weekend penalty rates.

Figure F.1 **Penalty rates for weekends (permanent employees)**
Rates for 67 awards (Saturday) and 73 awards (Sunday)[a]



[a] Penalty rates relate to additional payments during ordinary hours worked, when those ordinary hours fall on a Saturday or Sunday (and are shown using the third method described earlier). These rates do not include higher rates for overtime (hours in excess of ordinary hours) or shift work, which also attract premium rates of pay. In most awards, the penalty rate is the same regardless of the hours worked on weekends. However, some awards specify stepped rates, where the initial hours on a penalty rate day are paid at a lower rate, with payment rates rising if hours exceed the initial threshold. Where only a very small share of employees covered by an award would qualify for daytime weekend penalty rates, the award is not included above. For example, in the Live Performance Award, only striptease artists qualify for a Saturday penalty rate, and so this award is not recorded as having a Saturday penalty rate.

Source: Information by provided by the Department of Employment, PC assessment of modern awards and the Fair Work Ombudsman pay guides.

For example, work undertaken in the funeral industry on a Saturday is paid at 150 per cent penalty rates for the first three hours worked, and at 200 per cent for subsequent hours.

While the data shown in figure F.1 represents the typical rates by awards, in some awards there are many different penalty rates depending on the occupation and the tasks of the employee. These complexities can be a significant source of confusion for employees and employers (chapter 14).

Prevalence of employment on weekends: the current facts

While Monday to Friday still remain the predominant working days for Australian employees (figure F.2),[276] around three million, or one third of, employees work on the weekend, mostly on just one of these days, in a given week. A negligible share of employees worked only on weekends (table F.1). Of employees who work outside the conventional Monday to Friday routine, Saturday is the most prevalent working day. Only around one in ten people worked on a Sunday, mostly in combination with some weekdays. These estimates relate to a given week, but over longer periods of time, a much greater share of people work on weekends (box F.1).

The share of total hours worked outside standard times is also much lower than the share of people working outside non-standard times (Venn 2003). This indicates that average hours of weekend employees are less than the average for employees generally. Given that many employees working on weekends rely on income from work on weekdays, any percentage change in penalty rates does not have an equivalent proportional effect on people's incomes.

276 While not as rigorous as the ABS Time Use survey, other more recent survey data suggest similar prevalence rates of weekend work (Skinner and Pocock 2014, p. 28).

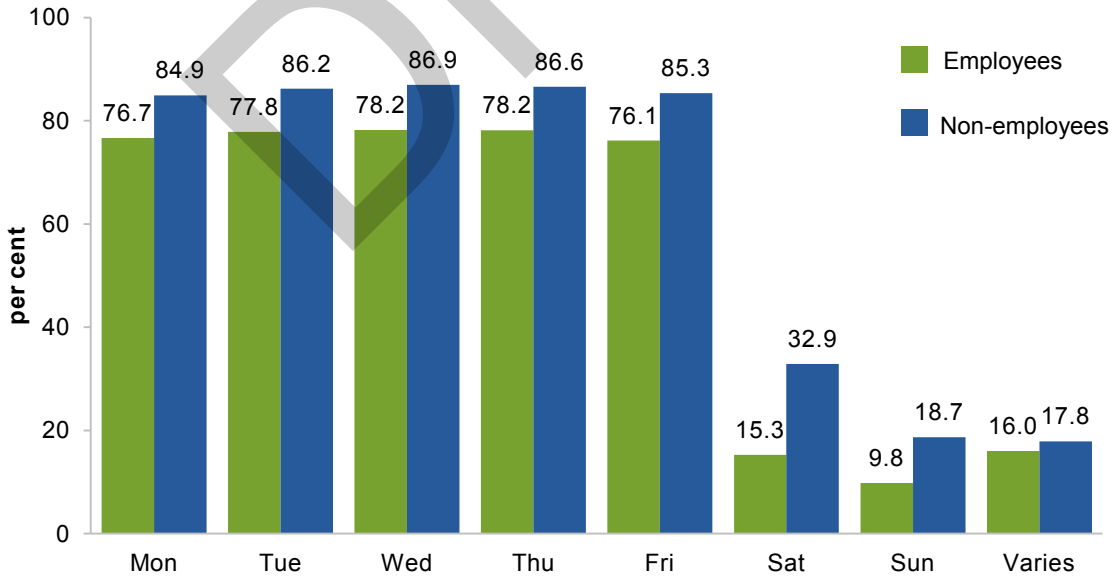
Box F.1 How many people *really* work on weekends?

The ABS data about people's weekend working arrangements are based on their working patterns during a particular reference week. A person answering that they worked on a weekend may have only done so for that week, and for no other times of the year, while someone who usually works on a weekend may not have done so in the reference week. Accordingly, the ABS estimates of working arrangements provide a point prevalence estimate. This is likely to significantly understate the prevalence of weekend working over a longer period, such as over the last few months or year.

Some surveys do not use the ABS 'reference week' approach, and will accordingly provide a different perspective on the prevalence of weekend work. For example, the Longitudinal Study of Australian Children asks employed parents of young children about their *usual* working patterns. Based on the 2004 wave of LSAC, around 24 per cent of fathers of children aged 4-5 years worked every week on weekends (20 per cent of mothers), but many worked on weekends more irregularly. Only 28 per cent of fathers and 46 per cent of mothers never worked on weekends (Baxter 2009b, p. 16). This is a special group of employees, but if anything, it would be expected that they would tend to have a lower inherent likelihood of working on weekends. In that case, weekend working prevalence rates may be higher for the average employee.

Figure F.2 Patterns of work by the day

Share of the employed working on given days (%)



Source: ABS 2014, *Forms of Employment, Australia, November 201*3, Cat. No. 6359.0, released 7 May.

Table F.1 **Who works on weekends?**
November 2013[a]

Period working	*Employees*	*Independent contractors*	*Other business operators*
		Share of group in each working time arrangement	
	%	%	%
Worked Monday to Friday only	54.8	44.5	35.3
Worked between 1 and 4 days weekdays only	13.4	11.6	9.4
People who only worked weekends	1.6	0.4	0.7
People who worked 5 weekdays and 1-2 weekend days	8.3	22.6	35.2
People who worked 4 or less weekdays and 1-2 weekend days	21.9	20.9	19.4
Total	**100.0**	**100.0**	**100.0**
Worked Saturday	15.3	25.3	40.3
Worked Sundays	9.8	12.7	24.4

[a] The data relate to the nature of working in a reference week.

Source: Unpublished data provided by the ABS 2014, *Forms of Employment, Australia, November 2013*, Cat. No. 6359.0, released 7 May 2014.

A significant number of people who work on weekends are not relevant to a discussion of penalty rates for weekend day work (chapter 14) because they are salaried, work on weekends as part of rotating or other shift arrangements, are independent contractors or business operators. These individuals are not eligible for penalty rates.

- In 2013, around one million business operators[277] and independent contractors worked on weekends (and like employees, typically on other days of the week too). These do not receive penalty rates for weekend work.
- In 2012, around 16 per cent of all employees worked on rotating, regular or irregular shifts.[278] While dated, other information suggests that around 70 per cent of people on such shifts worked them partly on weekends.[279] Accordingly, the relevant share of employees covered by weekend day penalty rates is even lower than suggested by table F.1 (and subject to statistical uncertainties suggests that the share of employees who are eligible to weekend penalty rates covered by chapter 14 might be around 20 per cent).[280]

277 These are owner-managers of incorporated and unincorporated enterprises.

278 ABS 2013, *Working Time Arrangements, Australia, November 2012*, CN6342, released 3 May.

279 ABS 2010, *Shift Workers, Australian Labour Market Statistics*, October 2010, Cat. No. 6105.0.

280 31.8 per cent of employees worked at least partly on a weekend, which would include shift workers who were employed on weekends. The share of employees who are shift workers employed on weekends is around 0.7 x 16 per cent, which is 11.2 per cent. Accordingly, a rough estimate of the number of employees working weekends excluding shift workers is around 20 per cent of employees.

New Zealand as a comparison

New Zealand industrial laws no longer prescribe penalty rates for weekend work, although collective enterprise agreements and some individual contracts include them. These are not very common however (chapter 14 and McLaughlin and Rasmussen 1998). The Productivity Commission has not recommended emulation of the New Zealand approach, but the differences between the countries' labour markets may provide some clues about the effects of different pay arrangements. Some data — presented in chapter 14 — suggest that Sunday restaurant opening is more frequent in New Zealand than Australia.

There is also some comparative evidence concerning weekend work by the employed. In New Zealand, 50.6 per cent of the workforce (including the self-employed and business owners) worked on weekends, while the comparative figure for Australia who 'usually' worked on weekends was 34.2 per cent. The two figures are affected by different survey methodologies, with the gap between them likely to be smaller if a 'like with like' comparison was possible.[281]

Trends

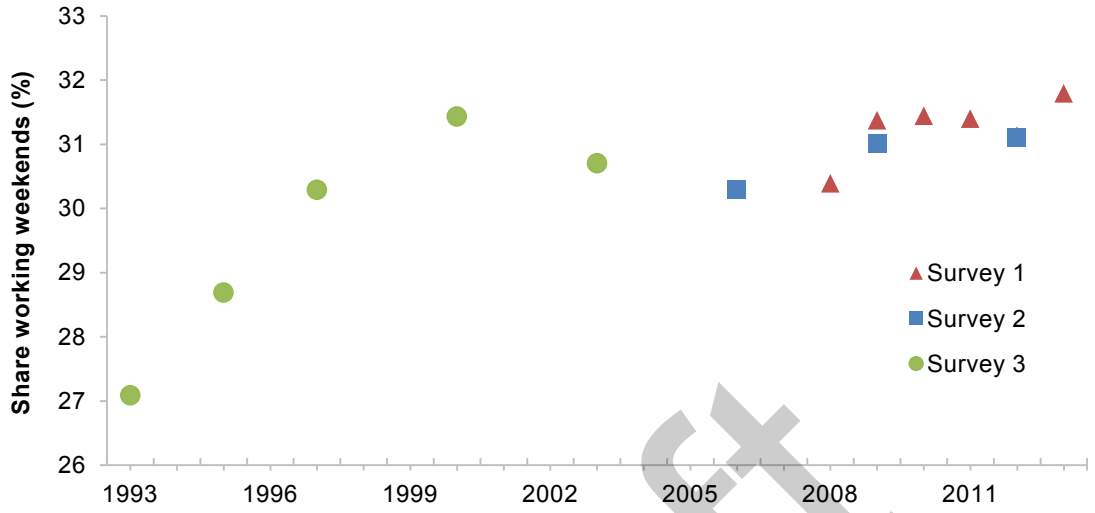
While variations in survey methodologies make it difficult to determine precise trends over long periods, there is good evidence that weekend work has become more important. Over the last two decades, the weekend employment share across the economy appears to have grown by around 5 percentage points — a significant shift in working patterns (figure F.3). It appears that part-time employment has been an important feature of this increase, since other information on how Australians spend their time shows no change in the relative significance of *working hours* supplied on weekends. Between 1992 and 2006, the share of total weekly hours worked on weekdays was respectively for females, 90.5 and 89.9 per cent, and for males 89.1 per cent and 88.7 per cent.[282]

These data tend to miss some important trends operating at the industry level. Although there are limited ABS data at the industry level on working time arrangements, chapter 14 indicates that real retail sales have increased substantially over the longer run. Other evidence also suggests that weekend trading in the retail sector has increased in importance (PC 2011c).

[281] Data are from the ABS 2014, *Forms of Employment, Australia,* November 2013, and Statistics New Zealand, 2013, *Survey of Working Life*: December 2012 quarter. The Australia survey is based on data collected during a reference week, but relates to usual working patterns, and so can relate to a longer period. The New Zealand data relates to a month's experience of working arrangements. Accordingly, a New Zealander who worked just once in a month on a weekend, but does not usually follow this working pattern will be recorded as a weekend worker, while an Australian would not be.

[282] Calculated from ABS 2008, *How Australians Use Their Time, 2006*, Cat. No. 4153, table 2.

Figure F.3 **Patterns of working weekends over time**
1993 to 2013, employees only[a]



[a] While substantially overlapping, the surveys employ different definitions for employees and jobs, which should be noted. Survey 1 is the ABS Forms of Employment survey and only covers people employed as wage and salary earners under a contract of service (an employment contract). The data relate to people categorised as such employees in their main job, but includes periods of work in all their jobs if they are multiple jobholders. Survey 2 is the Working Time Arrangements survey (WTA), and includes owner managers of incorporated enterprises as 'employees'. As for survey 1, the data cover people working in single and multiple jobs. Survey 3 is the Working Arrangements survey, the predecessor to the WTA, and uses the same definition of employees, but only relates to periods of work in the employee's main job.

Sources: ABS *Forms of Employment* (Cat. No. 6359) and *Working (Time) Arrangements*, Cat. No. 6342.

There has been progressive liberalisation of Sunday trading. Victoria completely deregulated in 1996, as did the Australian Capital Territory in 1997, but other jurisdictions have been slower to make changes. However, the (sometimes partial) deregulation that occurred in South Australia (2003), Queensland (2004), New South Wales (2008) and Western Australia (2012) must have increased the number of employees working in the Australian retail sector on Sundays. This observation is supported by the difference between spending patterns in jurisdictions with no trading restrictions and ones that had preserved such restrictions (chapter 14).

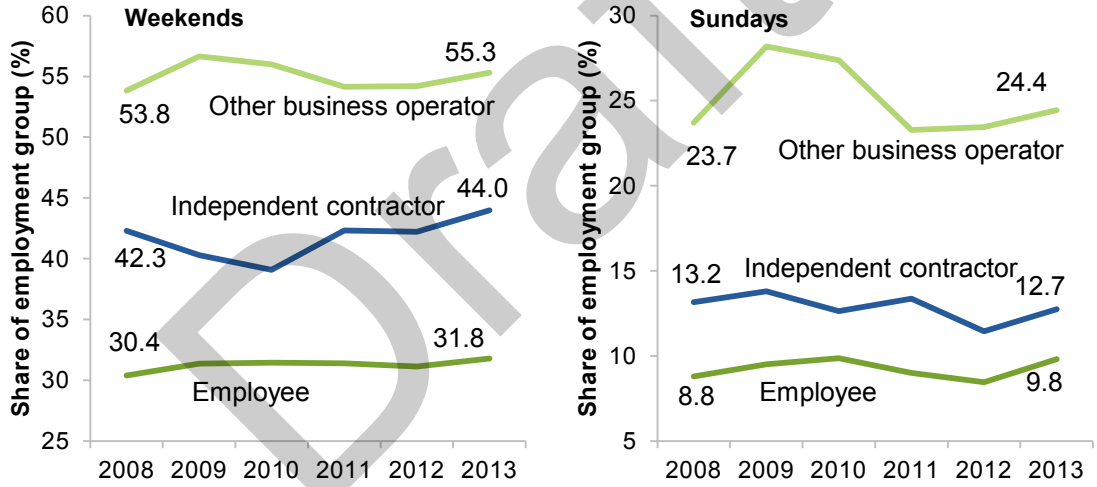
Trends of weekend work for different employment types

The working patterns of various employment types also provide a different perspective on the determinants of working on weekends. Contractors and business operators do not receive penalty rates and are free to supply their labour at any time, and so penalty rates cannot influence their pattern of working. The odds of working on weekends for other business operators is 2.7 times higher than employees, while the odds of weekend work for independent contractors are 1.7 times higher than employees (table F.1). In part, this will reflect the capacity for contractors and business operators to work flexibly and to increase

their income by working more hours, but it may also reflect that penalty rates discourage the engagement of employees on weekends. Several participants in this inquiry considered that business operators had poor life balance because they could not afford to employ other workers on weekends — chapter 14). Since 2008, the share of independent contractors and business operators working on weekends has generally increased slightly, although Sunday working actually fell for independent contractors (figure F.4).

Another, more stark trend is the relative growth rates in the numbers of people working on Saturdays versus Sundays (figure F.5). This reveals that there has been a strong growth in working on Sundays by employees in particular. Indeed, the growth in employees working on Sundays was around double that of employees working on Saturdays or more generally. As in the case of consumer demand, there has been a striking shift to Sunday work.

Figure F.4 **Contributions to weekend work by employment type**
Share of weekend work, 2008–2013



[a] In some cases, people said that their days of work varied, in which case they could not be identified as usually working on Sundays, and are therefore excluded from the calculations for Sundays.

Source: ABS, *Forms of Employment*, Cat. No. 6359.0.

Figure F.5 **Relative growth in Saturday and Sunday work**
Percentage change in numbers employed (2008 to 2013)

[a] In some cases, people said that their days of work varied, in which case they could not be identified as usually working on Sundays, and are therefore excluded from the calculations for Sundays.

Source: ABS, *Forms of Employment*, Cat. No. 6359.0.

F.2 Revealed preferences about the social costs of weekend work — is there a Saturday/Sunday divide?

The continued importance of Monday to Friday jobs is perhaps not surprising. Various institutional arrangements that support working are geared to a five-day working week, such as the availability of schooling and formal childcare services, and the regularity of public transport. Similarly, opportunities for certain leisure activities are oriented to weekends (and sometimes evenings), such as football games. As most partnered people enjoy each other's' company, they are likely to coordinate their choice of working days. In effect, the timing and extent of the leisure of one person in a family is a complement to other family member's leisure choices (Alesina, Glaeser and Sacerdote 2006, p. 47). Given that job opportunities are greatest on weekdays, this implies a greater preference for working on weekdays.

Accordingly, Saturdays and Sundays remain a focal point for community and family interactions (figure F.6 and F.7). Notably, there is relatively little difference in the degree to which people engage in social activities between Saturdays and Sundays (compared with weekdays). There is some difference in the types of engagements, but the largest deviation

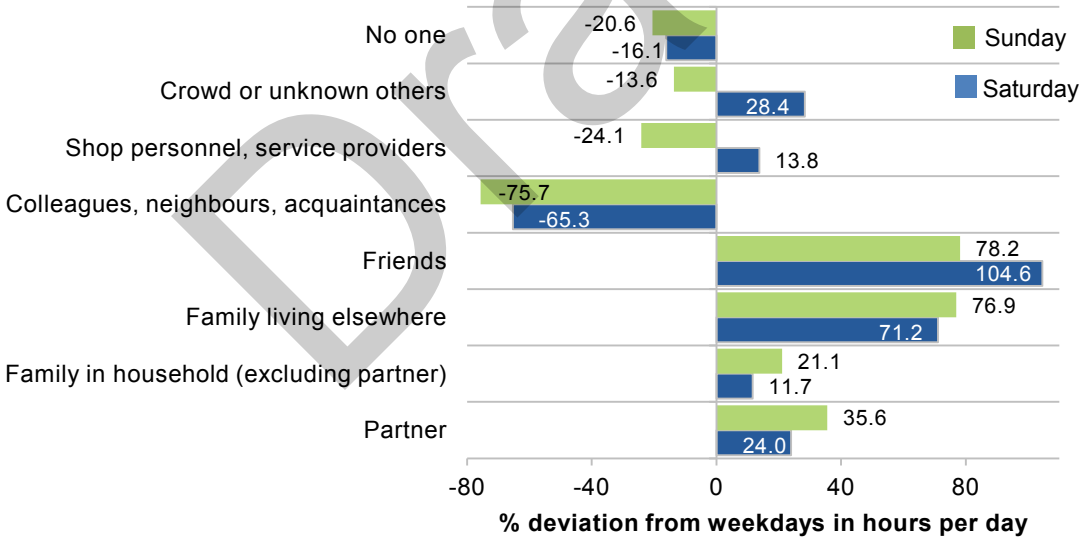
in social activities between weekends and weekdays — 'social and community interaction' — is actually higher on Saturdays.

These are aggregate data and mask differences in the activities of different household types (for example, singles compared with couples). Moreover, the data in figures F.6 and F.7 also relate to the time use of all people, not those who work on weekends.

In most cases, more disaggregated data show no differences in time forgone on social activities (with families or friends) on Saturdays and Sundays. For instance, a couple without children gives up around 4 minutes per hour with their family for every hour of weekend work regardless of the day of work. The comparable figure for a single is 7 minutes per hour of weekend work. Sundays involve bigger social costs for couples with children. They give up an additional 6 and 5 minutes on time per hour of work on Sundays with a spouse and children respectively — a relatively small difference between the two days (Craig and Brown 2014).

Figure F.6 **Who do people spend time with?**

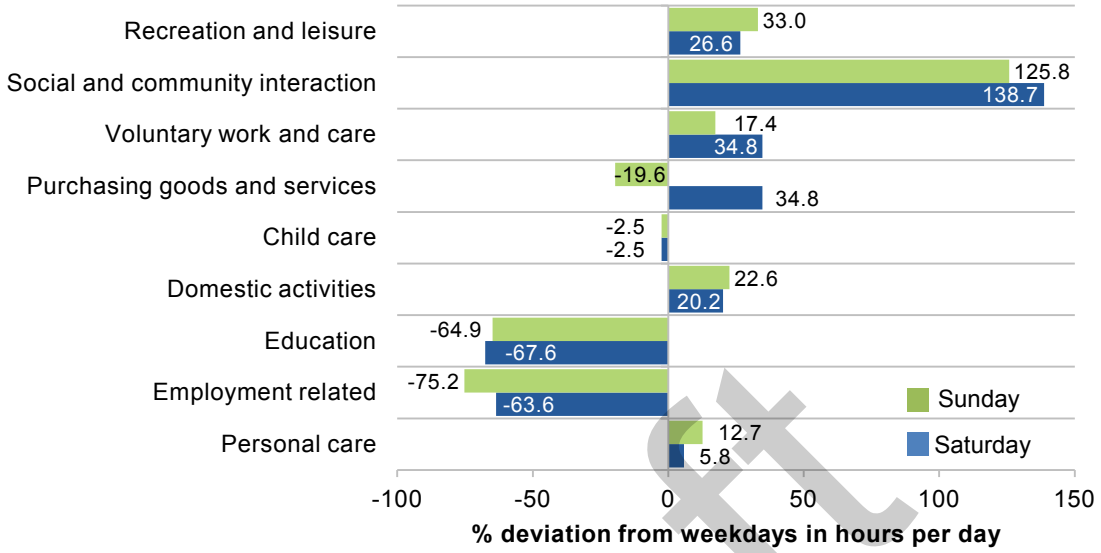
Deviation of hours per day on weekends from the average weekday (%)



Source: ABS 2008, *How Australians Use Their Time, 2006*, Cat. No. 4153.0, February.

Figure F.7 **What do people do with their time?**

Deviation of hours per day on weekends from the average weekday (%)



Source: ABS 2008, *How Australians Use Their Time, 2006*, Cat. No. 4153.0, February.

In many respects, it appears from the various data above that from an aggregate social perspective, Sundays do not occupy a distinctive social niche. Not only has a previously important aspect of Sundays — religious observance — declined significantly (chapter 14),[283] but in broader social terms, the days do not appear to be markedly different.

The above information corroborates the (more recent) qualitative evidence in chapter 14 that people rate the asocial aspects of working on Saturdays and Sundays as roughly equivalent. When scrutinised carefully, other arguments for higher Sunday penalty rates based on community and health grounds are not compelling (box F.2).

Moreover, while there is unquestionably a social disability associated with working on weekends, it is important to note that weekend workers sometimes adopt compensating strategies to reduce the asocial impacts of working (which would not be revealed in figures F.6 and F.7). For example, people working on a weekend may:

- increase some social activity during weekdays, which would weaken the asocial impacts of weekends. This is true for some types of activities for some types of households, but overall, most social interaction lost from working on a weekend is not recouped through weekday interactions. However, data from the Longitudinal Study of Australian Children on time spent with young children paint a complex story, with full

283 On the former score, only 4 per cent of people ruling out working on a Sunday said that religious observance was the cause (ACRS 2012, p. 43).

recoupment of time displaced by weekend work by mothers of young children, but no recoupment for older children or men generally (Baxter 2009a, 2009b)

- give up non-social activities (such as housework). There is reasonably good evidence of this (Bitman 2005; Craig and Brown 2014). As an illustration, for every hour of work, a couple without children gave up 18 minutes of leisure with their partner.

F.3 Penalty rates for casual employees

There are more complex (non-semantic) issues about the interaction of penalty rates and casual loadings, which can have significant effects on the earnings of casual workers on weekends and on the incentives of employers when making choices about who to roster at different times.

Casual loadings for standard hours of work vary between awards, and have also changed considerably over time. Historically, there has been no coherent framework for casual loadings. At times, they have simply been a benefit paid in some recognition of employment uncertainty (Graham sub. 117, p. 4; Campbell and Brosnan 2005). The factors that might reasonably be included in casual loadings have depended on the industrial tribunal considering the matter (including industrial relations tribunals). The most common casual loading is now 25 per cent.

Three methods for calculating penalty rates for casuals

There are three basic models for calculating penalty rates for casuals, and these involve the different treatment of the casual loading. The different methods can lead to substantial variations in the final weekend wage rate, and diverging relative employment costs for casuals compared with permanent employees.

The default approach in awards is to calculate the penalty wage rate as:

$$\textit{Penalty wage} = \textit{Base wage} \times (\textit{Casual loading} + \textit{Penalty rate})/100$$

where the penalty rate is based on the definition given in (c) in section F.1, while the casual loading is expressed as the percentage increase in the base wage. Accordingly, with a penalty rate of 150 per cent, a casual loading of 25 per cent and a base wage of $20 per hour, the penalty wage would be $35 per hour.

Box F.2 The effects of Sunday working on community and health

Community effects

Some are concerned that weekend working might have effects on the community's social fabric that are quite distinct from those applying to the families of employees. If material, any such effects could be particularly important because individual decisions by people to supply labour at market-determined wage rates may fail to take full account of the effects of those decisions on the community as a whole.

For instance, the effects of aggregate uncoordinated decisions by many individuals to work on weekends might mean that local community activities dependent on widespread involvement (for example, fetes, community celebrations, amateur games, and volunteering) would be less developed and sometimes not even viable. Such communal activities have broader benefits for trust and the development of local community networks — the social capital of the community. Social capital has many potential social and economic benefits (PC 2003a), yet no individual can sustain it by themselves. As Putnam has put it: 'In the absence of coordination and credible mutual commitment, however, everyone defects, ruefully but rationally, confirming one another's melancholy expectations'(Putnam 1993). The argument for penalty rates in this instance is that they act to 'tax' activities inimical to community activities. However, working on Sundays does not appear to displace such activities any more than Saturdays, and the concept of 'deterring' weekend work is no longer seen as a legitimate goal. Moreover, as the custom for a common set of rest days erodes, people are likely to find other ways in which they can share activities and create community networks. Such evolution has occurred in the past. In the mid-20th century, a common attitude was that female employment eroded the community, but this is not a contemporary social norm. For many Australians, it is hard to depict Sunday as having a *community* status different from Saturdays.

Health effects

While most commonly raised for shift, overtime and night work, some international researchers are also concerned that working non-standard hours in daytime hours on weekends (particularly Sundays) raises mental wellbeing and other health issues (Costa et al. 2004; Lee et al. 2014; Nachreiner et al. 2010; Wirtz, Nachreiner and Rolfes 2011; Wirtz et al. 2008). The European-centred research is considerably less compelling than research on shift and overtime work, and provides little information about the industries of primary interest in this inquiry. There are concerns about selection biases and confounding factors in this literature. As an illustration, there was no effect of working on Sundays in industries with generally high and medium risks of accidents, once confounding variables were taken into account (Wirtz, Nachreiner and Rolfes 2011, pp. 365–66). Also, the countries that are the focus of such research tend to have less normalised patterns of weekend working in consumer services than Australia (where it is a socially acceptable form of employment). Germany for example, has very strict rules about working on Sundays. Few employers, employees or consumers in Australia would advocate a return to Sundays as a highly restricted working day.

Australian evidence on the health effects of weekend work is practically nonexistent. Research on one aspect of positive mental health (the concept of 'flourishing') found that weekend work — especially on Sundays — had a negative effect on men, but no effect on women (Skinner and Pocock 2014, p. 48). The debate in Australia centres on the degree to which employees should be compensated for working on weekends, and on their capacity to opt out of weekend work where it is unreasonable.

Other awards specify their casual loading as 'all purpose', in which case the penalty rate applies to the casual rate, not to the base rate (for example, as for a casual mining industry services employee covered by the Mining Industry Award 2010). In this case, the penalty wage is:

$$\textit{Penalty wage} = \textit{Base wage} \times (1 + \textit{Casual loading}/100) \times \textit{Penalty rate}/100$$

Accordingly, with the same base and premium rates as in the previous example, the penalty wage would be $37.50 per hour, which reflects the compounding effects of the different rates. To obtain the same result as in method 1, the penalty rate would have to have been 162.5 per cent.

Finally, in some awards, the weekend penalty rate (on the base rate) is the same for casual and permanent workers. For example, in the Hair and Beauty Industry Award 2010, the penalty rate is 133 per cent of the basic non-casual wage for Saturdays regardless of whether the employee is a casual or not. A casual employee usually receiving a 25 per cent loading on weekdays would receive 33 per cent more than the non-casual basic rate. Were the default approach used, the implied penalty rate would be 8 per cent.

The three methods can have important impacts. For example, with a base wage of $20, a casual loading of 25 per cent and a Saturday penalty rate of 50 per cent, then depending on the method, the Saturday rate is one of $30, $35 or $37.50 per hour. Therefore, comparisons across awards that rely only on the various standalone rates can miss important differences in wage outcomes. These have potentially significant effects on the choices of employees and employers. For example, there are incentives in some industries — such as hairdressing — to employ casual employees on weekends to reduce wage costs.

This raises the question of whether one of the three methods is preferred to the others, a matter also posed by Graham (sub. 117). He suggests three possible objectives in determining the appropriate casual rate:

- equitable treatment with permanent employees
- discouragement of casualization (suggesting that the ultimate cost of employing a casual to an employer should be higher than that of a permanent employee)
- a method that is easily managed by employers.

The first could also be restated as the rate that makes an employer indifferent to hiring a casual compared to a permanent employee. In general, if an employer was only obliged to pay the same hourly rate for a casual employee with the same skill classification as a permanent employee, then their total labour costs would be lower because:

- they would not be obliged to pay wages for any recreational or personal leave (and nor would any leave loading be applied where an award included that as a provision for permanent employees)
- redundancy payments would not be paid if the employee was dismissed

- the costs associated with termination notice would be avoided
- there would be greater freedom to change rostering.
- it is easier to terminate their employment because more tests under the *Fair Work Act 2009* (Cth) must be met (for example, in relation to tenure and the regularity of employment).[284]

The main contributors to casual loadings are forgone recreational and personal leave entitlements.

What is the 'optimal' casual penalty rate?

If the underlying objective of regulated casual loadings and penalty rates is to avoid distortions in the market for casuals and permanent employees or (equivalently) to serve the 'equal pay for equal work' principle (the equity goal proposed by Graham in sub. 117), then casuals should receive the cash equivalent to benefits for permanent employees. *This is subject to the proviso that their patterns of work and skill levels are identical.*

To make the calculations easier, but still illustrating the essential points, suppose that the only penalty rate was for weekend work. The total cost of a permanent employee for a given number of weekend and weekday hours can be calculated as:

$$C_p = h_1\, w_1\, (1 + \phi/100 + \lambda/100) + h_2\, w_1\, (\beta + \phi + \lambda)/100$$

where:

- h_1 is hours worked during weekdays, while h_2 is hours during weekends
- w_1 is the standard hourly wage
- $\phi.w_1\ /100$ is the implicit value of the benefits earned by permanent employees and not paid to casuals (such as standard paid personal and recreational leave, but excluding the value of any leave loadings).
- $\lambda.w_1/100$ is the value of any leave loading for leave entitlements. The rationale for leave loadings is that were a person at work, for certain industries, they would have earned penalty rates on some of the days they worked. The (typical) 17.5 per cent loading added to the annual leave is intended to compensate for this. It spreads the value of penalty rates on weekends across all annual leave entitlements regardless of the times of the week that gave rise to those entitlements. A conceptually more sound model would apply a (higher) leave loading for hours on weekends, and no such loading for entitlements accruing on weekdays. However, the latter approach would be more complex, and so an averaging formula is used where weekend (or in other

[284] Graham notes that casuals forgo training and are less likely to be promoted. While casuals might prefer to have more training or better career prospects, employers are also aware that the rate of return on training for a person who has a higher likelihood of leaving is lower than for most permanent employees. Accordingly, the lower costs of training is less clearly characterised as saved expenditure.

circumstances, shift) work is a customary feature of permanent employees' working patterns. In any case, leave loadings are now often seen as simply another entitlement, regardless of the actual weekend/shift patterns of employees in an enterprise (Kelly, Plowman and Watson 2002).

- β is the percentage penalty rate (based on the definition given in (c) in section F.1). For example, double time would be defined as a penalty rate of 200 per cent.

For casuals, the wage cost is:

$$C_c = h_1 \, w_1 \, (1 + \eta/100) + h_2 \, w_1 \, \varepsilon/100$$

where ε is the percentage casual penalty rate and η is the percentage casual loading. Typically, η is set at 25 per cent, but it could be anything that the regulator settled on, and will depend on the basis on which it determines the loading. Historically, this was a matter of substantial contention (Queensland Industrial Relations Commission 2001).

If the efficient and equitable outcome is that $C_c=C_p$ then this implies that the penalty rate that achieves that is:

$$\varepsilon = h_1/h_2 \, (\lambda + \phi - \eta) \; + (\lambda + \phi + \beta)$$

If the casual loading is equivalent to $(\lambda + \phi)$, then the casual penalty rate is:

ε = (casual rating + penalty rate)

which gives a casual wage on a weekend as *Penalty wage=Base wage ×(Casual loading+Penalty rate)/100*, which is the default method described earlier. Neither of the other two methods would achieve parity of effective wages of casuals versus permanent employees.

This result depends on calculating the casual loading consistent with the forgone benefits of permanent work. This may not always occur (a point made by Graham sub. 117 and Shomos, Turner and Will 2013, p. 13). On the one hand, since many permanent employees do not use all of their personal leave entitlements (and these cannot be reimbursed on employment termination), the imputed value to casual employees of the permanent employees' entitlement to personal leave should use its actuarial value, not the maximum entitlement. On the other hand, the casual loading might not adequately reflect the leave loading available to permanent employees, thereby favouring the employment of casuals. However, in this respect, accounting for leave loadings is generally now recognised as an aspect in calculating casual loadings (AIRC 2003b).

The implication of this analysis is that unless there are flaws in the calculation of casual loadings, the default method for calculating casual penalty rates is the optimal approach.

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