



Australian Council of Social Service

25 March 2015

Workplace Relations Inquiry
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

Dear Commissioners,

Thank you for the opportunity to provide a submission to the Productivity Commission 'Inquiry into the Workplace Relations Framework'. ACOSS is a national voice for people affected by poverty, disadvantage and inequality. Our vision is for a fair, inclusive and sustainable Australia where all individuals and communities have the opportunities and resources they need to participate fully in social and economic life. Employment markets and their interactions with the tax and transfer system are central mechanisms by which participation is improved and poverty and inequality can be reduced.

Due to capacity constraints, our submission focuses on the question of the importance of retaining a system of national minimum wages in Australia.

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. With a focus on these interactions this submission argues:

- 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;
- The current minimum wage has declined as a proportion of median full time wages, reducing the living standards of those on the minimum wage relative to community living standards;
- The minimum wage should be retained and the Fair Work Commission guided to use a standard of living benchmark to determine the rate. This approach proposed would see an increase in the minimum wage;
- There is no evidence minimum wage increase have reduced employment growth in Australia. There is also no indication that a wage-price spiral will emerge as the economy adjusts to lower investment in mining construction, lower mineral prices and a weaker Australian dollar; and
- Increases in the minimum wage are an effective way to improve work incentives for people who are unemployed; while by contrast, across the board 'in-work payments' for low paid workers, or 'earned income tax credits' are a costly and ineffective substitute for an adequate minimum wage.
- Australia already has in-work payments in the OECD in the form of Family Tax Benefits, which are designed to assist low income families with children whether in paid work or not.



While employment is a central mechanism by which most people gain the resources they need to participate in social and economic life, employment does not guarantee that individuals will not be in poverty. The ACOSS report 'Poverty in Australia 2014' identified that in 2012, a third (33%) of people in households with incomes below the most austere poverty line used in international research (50% of median income) were in full time or part time employment, while close to a third (30%) of people living in poverty had wages and salaries as their main source of income.

Further, while the minimum wage is critical to reducing poverty for people in paid work, the level of the minimum relative to full time median wages has fallen significantly in the past two decades, from 61% of full time median wages in 1996 to 51% in 2012, increasing the risk of these households falling in to poverty.

In order to provide an adequate 'safety net' and minimise the risk of people who are in paid employment falling in to poverty, the minimum wage should be set at a level sufficient to enable a single individual to attain a decent 'basic' living standard, well above poverty levels, and developed in accordance with community expectations. ACOSS considers the minimum wage should be set based on an objective assessment of the income needed for an adequate standard of living, through use of a 'Budget Standards' approach. One model involves a panel of experts determining a 'budget standard' for different households.¹ The standards identify the goods and services expected to be consumed by each household type to enable a decent adequate living standard. Other options include setting the minimum wage with reference to deprivation studies (for example, the 2010 PEMA²) study.

Such an approach was used in 1996 by Department of Social Security to inform its assessment of the adequacy of social security payments. The Department at the time commissioned the Social Policy Research Centre (SPRC) at the University of NSW to develop two sets of budget standards: one low-cost 'poverty standard'; and the other a 'modest but adequate standard' set above poverty levels. ACOSS with United Voice and Catholic Social Services Australia has since commissioned the SPRC to update these standards to reflect what would constitute a 'basic' living standard today.

Modest real increases in minimum wages are unlikely to lead to significant reductions in employment growth or increases in unemployment. Economic research into the effects of minimum wages on employment yields diverse and often conflicting results, and the OECD concludes from a thorough evaluation of the international evidence that the effect of lower minimum wages on employment is ambiguous.

¹ This was the approach adopted by the first Australian industrial commission in developing the 'Harvester standard' or 'basic wage' early last century

² Poverty and Exclusion in Modern Australia; see Saunders and Wong ' Measurement and Change in Deprivation and Exclusion in Australia; A report on research in progress:
[http://www.poverty.ac.uk/sites/default/files/attachments/WP%20Methods%20No.11%20-%20Measurement%20and%20Change%20...in%20Australia%20\(Saunders%20%26%20Wong\).pdf](http://www.poverty.ac.uk/sites/default/files/attachments/WP%20Methods%20No.11%20-%20Measurement%20and%20Change%20...in%20Australia%20(Saunders%20%26%20Wong).pdf)



From 1997 to 2012, real minimum wages rose by 11% while employment rose by 36%³. Since the Global Financial Crisis in 2008, unemployment has increased largely as a result of external factors which reduced the pace of economic growth. It is difficult to suggest the minimum wage has had an impact on this outcome. There is also no indication to date that a wage-price spiral will emerge as the economy adjusts to lower investment in mining construction and mineral prices and the Australian dollar weakens. Indeed, wages growth has subsided in response to two years of weak employment growth, suggesting that wages have responded to market conditions.

The living standards of people on low incomes rest on three pillars: access to employment, minimum wage levels, and income support payments. All three play a vital role in preventing poverty, and the relationship of each to the other is critical to keeping people in paid employment out of poverty while retaining incentives.

In Australia, income support payments have traditionally been set at levels well below minimum full time wages in order to preserve work incentives. The relationship between minimum wages and unemployment benefits for single adults has been remarkably stable over the past 20 years, at between 40% and 43% before tax, and slightly higher after tax - in 2012, the ratio was 43% for a single adult (after tax).

The sizeable gap between Allowance payments and minimum wages creates room for Governments to improve the adequacy of Allowance payments without undermining paid work incentives for unemployed people. The rate of Allowances, both Youth Allowance and the Newstart Allowance have been indexed to the CPI only and have not increased in real terms since 1994 . As a result, the adequacy of Allowances has been severely eroded over the last two decades and the Newstart Allowance for a single adult is just \$36 a day. Consequently, over 50% of people on the Youth Allowance, and 55% of people on Newstart are already living below the poverty line.

The level of the minimum wage is also critical to the design of income tests for social security payments. Unless it is a goal for public policy to extend unemployment and other social security 'allowance' payments to fulltime minimum wage earners, the maximum rate and income test have to be designed so that these payments 'cut out' below the fulltime minimum wage. If the minimum wage was lower, this may require a tightening of the income test. However, income testing of these payments reduces work incentives, especially for the 30% of Australian jobs that are part time, a lower minimum wage because as the amount of income an individual earns from wages increases, the value of social security payments declines. Adequate hourly minimum wages therefore play an important role – both directly and indirectly - in strengthening incentives to participate in paid work, particularly for those seeking to work part time.

³ This may be due to changes in the operation of the Australian labour market between these two periods, including greater flexibility in the allocation of working hours and a declining role for regulated wages in wage fixation



On balance, increases in minimum wages are an effective way to improve work incentives for people who are unemployed. Research conducted by the former Australian Fair Pay Commission indicates that work incentives improved significantly for typical cohorts of people who were unemployed from 2005 to 2008, due to increases in minimum wages and changes to taxes and transfers.⁴

By contrast, if minimum wages fell consistently in real terms, the gap between wages and social security payments would narrow considerably over time and a point would then be reached where Governments would adjust the income support system to preserve work incentives, by either:

- introducing or expanding 'in work payments', such as Family Tax Benefit or an Earned Income Tax Credit; and/or
- reducing income support payments for people who are unemployed, and/or
- tightening income tests.

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. As real minimum wages have fallen through lack of indexation, the cost of the Earned Income Tax Credit has risen. In 2011 the US Government spent around \$60 billion per year on its Earned Income Tax Credit, more than it spent on traditional social assistance programs such as the Temporary Assistance for Needy Families program for families on low pay or without paid work. Despite this, minimum wages and the tax credit combined were still insufficient to protect a single parent family with two children from poverty. ACOSS has provided further commentary on the impacts of earned income tax credits in a 2003 paper 'Fairness and flexibility: reform of working age social security payments in Australia' which I attach for your consideration. Although the data are out of date, the basic principles involved are the same.

Australia already has a more narrowly applied system of in-work payments in the form of Family Tax Benefits, which are designed to assist low income families with children whether in paid work or not. Their main purpose is to prevent child poverty, but payment of the maximum rate to families on a fulltime minimum wage also improves work incentives, given that wages do not take account of the costs of children (or child care). 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 (see attachment). 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.

In conclusion, in the absence of adequate minimum wages:

⁴ Australian Fair Pay Commission 2008, *Economic and Social Indicators*.



- Poverty would rise substantially unless government income support for people in low paid work was increased to 'picked up the slack'. However, it would be expensive for Governments and ineffective in keeping poverty levels low; and
- There would be pressure to reduce income support for people who are unemployed in order to maintain work incentives.

Adequate minimum wages therefore are an important mechanism to reduce poverty and make a significant contribution to economic growth and efficiency through providing adequate financial gain for people to participate in paid employment, including from income support recipients, 'second earners' in middle income households, and mature age people seeking a part time job. The issues raised above are addressed in our submission to the Fair Work Commission Annual Wage Review 2014, attached for your consideration.

Yours sincerely,