



Australian Government  
Productivity Commission

# Workplace Relations Framework: Safety Nets

Productivity Commission  
Issues Paper 2

January 2015

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## **Issues Paper No. 2**

The Commission has released this issues paper to assist individuals and organisations to prepare submissions in relation to safety nets in the workplace relations system.

There are four other issues papers related to the inquiry that may also be of interest.

Information about the terms of reference, the key dates, how to make a submission, the processes used by the Commission and our contact details are in Issues Paper No. 1, and are also available on the Commission's website:

<http://www.pc.gov.au/inquiries/current/workplace-relations>

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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](http://www.pc.gov.au)).

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## 2.1 Providing safety nets

The workplace relations (WR) system provides employees with various guarantees about their wages and conditions, most notably through various minimum wages, a multitude of awards and obligatory employment standards (the National Employment Standards (NES)). Understanding the impacts of safety nets and their ripple effects throughout the wages system is important to their effective design.

These regulations principally relate to employees. Other people supplying labour — business managers, the self-employed and independent contractors — offer their services in a largely unregulated market, although the general protections of the *Fair Work Act 2009* (Cth) (FWA) still apply to independent contractors.

Minimum standards for wages and conditions depend on the circumstances.

- Where there is a ‘registered agreement’ in place (Issues Paper 3), the minimum pay and conditions in the agreement apply. To create a registered agreement, the parties must obtain the agreement of the Fair Work Commission (FWC), which decides if the employees are each better off overall under the agreement than the award — indicating that the award safety net directly affects the terms that can be negotiated under enterprise agreements.
- If there is no registered agreement, the minimum pay and conditions in the relevant award is likely to apply.
- Some high-income employees and managers are award free. Where no award or agreement applies, the NES and the federal minimum wage<sup>1</sup> sets the floor on pay and conditions.

## 2.2 The Federal minimum wage

Minimum wages have been part of the workplace relations system for more than a century, but remain a persistently controversial issue. The current federal minimum wage rate is \$16.87 per hour for adults (or around \$33 300 annually for a full-time employee) with various lower rates for younger workers, apprentices and trainees, some people with disabilities, and people whose capabilities are being assessed during a trial period (FWC 2014b).

For much of its history, the federal minimum wage was not a universal minimum wage. It formally applied only to federal awards and, until 1975, women were paid only a share of the rate (Bray 2013). With an increasingly centralised WR system, Western Australia is

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<sup>1</sup> Or the Western Australian minimum wage for employees of unincorporated enterprises in that state.

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now the only state that has an independently-determined minimum wage, which applies to relevant employees of unincorporated enterprises (WAIRC 2014).

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 estimated that in 2010 and 2011 between 4.1 and 9.1 per cent of employees were paid at or below<sup>2</sup> the minimum wage rate (Bray 2013, p. 22). Initial estimates by the Productivity Commission using the 2012 Household Income and Labour Dynamics of Australia (HILDA) survey suggests 7.1 per cent of adults were paid at or below the minimum wage.

Statutory minimum wages are common among developed economies (with 26 of 34 OECD countries having minimum wages). Some OECD countries that do not have a *universal* minimum rate, including Germany (currently), Finland, Denmark and Norway, still have disparate minimum rates covering many workers, with the rates determined on an industry basis. Overall, the trajectory of international policy has been to establish universal minimum wages, but to complement them with measures to stimulate employment. For example, the German Government is rolling out a universal minimum wage in 2015.

## **What is the appropriate role of minimum wages?**

The original rationale for the Australian federal minimum wage — rooted in the Harvester decision in 1907 — was to ensure that a male breadwinner's income was sufficient to meet the reasonable needs of a family household (a man, his wife and their three children). Since that decision, 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, which embedded the doctrine of 'equal pay for work of equal value' (Bray 2013, p. 16). Some see the economic and social developments over the last century as requiring a wider re-assessment of the role and design of the minimum wage in contemporary Australia.

Nevertheless, broader concerns about income distribution in working households remain an important consideration in the wage determinations by the minimum wage Expert Panel of the FWC (2014a). However, not all minimum wage earners are members of low-income households. In 2011, the likelihood that an adult employed person in the lowest quintile of working households was on the minimum wage (or lower) was nearly eight times higher than that for the top quintile of households (based on data from Bray 2013, p. 33). On the other hand, the same data showed that only around 30 per cent of all adult minimum wage earners were in the poorest 20 per cent of working households. Among other factors, the two results suggest the greater dependence of lower-income households on a single income earner (although the Commission will examine this issue further).

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<sup>2</sup> For example, because their reported hourly wages did not take account of salary sacrificing. The variations across surveys reflect sample and other methodological differences.

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Moreover, the degree to which people remain at low pay levels is important in considering the long-run impacts of minimum wages on individuals (Buddelmeyer, Lee and Wooden 2009; Cai 2013; McGuinness and Freebairn 2007). For example, a young person may start at the minimum wage, and then progress to higher wages. In that instance, any income effects of a minimum wage are temporary, which may affect the desirable level of the minimum wage.

The implication is that while minimum wages do assist some low-income households, they may not necessarily target poverty and inequality very well. Indeed, a higher minimum wage may actually increase inequality if it lowers employment in low income households (Leigh 2007). Findings on these issues depend on the degree to which non-market income (such as childcare at home) is included in household income (Apps 2001) and on evidence about the extent to which the labour market responds to minimum wages.

There is little consensus on the effects of modest changes in minimum wages on employment and equity. One of the Commission's challenges in this inquiry will be to unravel this contested area of labour economics, and to reach judgments about the size and nature of the effects of minimum wages.

In theory, for simple, highly competitive industries and labour markets, binding minimum wages should have unambiguous negative effects on employment. However, the effects are less clear-cut and may even operate in the other direction in more complicated labour market settings (Booth and Katic 2010).

On the empirical front, estimates of the impact of minimum wages on employment and hours worked vary substantially (Doucouliagos and Stanley 2009; Dube, Lester and Reich 2010; Neumark 2014; 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). For its part, the Expert Panel of the FWC, which determines the federal minimum wage in Australia, has argued that 'modest minimum wage adjustments lead to a small, or zero, effect on employment' (FWC 2014a, p. 10). However, the cumulative effect of successive increases in the wage may still have impacts on unemployment. There may be effects in only some regions and for some types of workers, and changing macroeconomic developments could increase (or decrease) the impacts of the regulated rate.

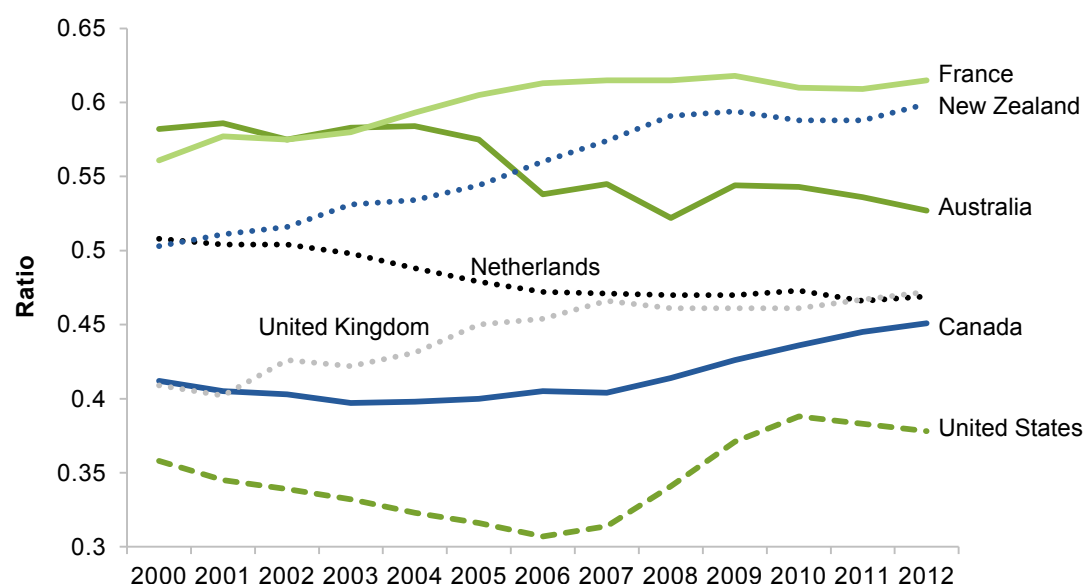
*Sufficiently* large increases in the minimum wage would make lower-skilled, less experienced employees less attractive to employers, and the FWC seeks to avoid the materialisation of this outcome in their consideration of any change to the minimum wage (FWC 2014a). Also, few claim that the wide disparity between junior minimum wages (currently 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 seems to suggest 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.

A further relevant factor may be that the ratio of the minimum wage to median full-time adult earnings has significantly fallen over the period from 2004 to 2012 (figure 2.1).<sup>3</sup> This may reduce the risks of increased unemployment.

The ultimate effects of minimum wage regulations are also influenced by the indirect impact of minimum wages on consumer prices, and the relative importance of the most affected consumer goods for households with different incomes.

**Figure 2.1 Minimum to median wages for several OECD countries 2000–2012<sup>a</sup>**



<sup>a</sup> Based on the ratio of the adult Federal Minimum Wage to the median of full time adult ordinary weekly cash earnings.

Data source: OECD.Stat database.

Minimum wages may also have other effects.

- Higher minimum wages may affect the returns to skill acquisition, with the direction and size of the effect dependent on the circumstances. A person who is either unemployed, or facing that risk, may acquire skills to be employable at the minimum wage. Moreover if the minimum wage rises, and in the presence of ‘firing costs’, it may pay for employers to raise the skills of any lower-skilled workers that are not

<sup>3</sup> While Australia has a relatively high ratio of minimum wage to median earnings by OECD standards, no other OECD country has experienced a decline in the ratio as steep as Australia (based on data from *OECD.stat*). The ACTU (2014b) has also undertaken extensive research in this area.



sufficiently productive at the higher minimum wage. There are also some arguments that minimum wages could lower training (Neumark and Wascher 2008, pp. 191–224)

- An increase in the minimum wage may also raise wages that are already above the minimum wage, so that the minimum wage affects many more workers than those on the minimum wage. Australia’s award setting processes build in a link between award wages and statutory minimum wages. Around one quarter of employees in non-public sector workplaces are award-reliant (Wright and Buchanan 2013).
- Minimum wages have varying impacts on different workers (by age, gender, skill, industry and location). Minimum wages are more likely to affect lower skilled workers’ employment prospects. Similarly, there may be varying state and regional impacts, with the ratio of minimum wages to average wages varying among these (figure 2.2). Some argue that rural businesses’ employment decisions are more sensitive to minimum wages (Lewis 2004).

**Figure 2.2 Minimum wages to average weekly wages**  
By state, May 2014<sup>a</sup>



<sup>a</sup> Based on the ratio of the adult Federal Minimum Wage to full time adult ordinary weekly cash earnings.  
Data source: ABS, *Average Weekly Earnings, Australia*, May 2014, Cat. No. 6302.0.

It is common to examine international differences in the exchange-rate corrected values of the adult minimum wage levels as a potential measure of whether any given country’s rate is excessive. Such comparisons may be misleading if exchange rates are volatile, but more problematically, do not take account of differences in labour productivity levels between countries. Expressing minimum wages relative to median wages (as in figure 2.1) is one way of addressing this. As an alternative, for some minimum wage jobs, it may be possible to estimate unit labour costs (PC 2014). *The Commission seeks feedback on the advantages*

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*and disadvantages of different approaches for comparing minimum wages across countries, and how such results should be interpreted.*

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

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

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

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

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

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

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

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

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

## **The minimum wage and the tax and transfer system**

The tax and transfer system interacts with the minimum wage. People's decisions about whether to take a job and how many hours to work depend partly on the relative attractiveness of their net wages, the income they would otherwise receive through social security benefits and other considerations such as their prospects for promotion. Accordingly, at some point, reductions in the minimum wages are unlikely to have much effect on hours worked and employment. That point will vary across individuals, depending on their long-term job prospects and on their characteristics (which determine their eligibility for social security and other benefits). Below this point, the binding constraint on employment is not the level of demand by employers, but the degree to which households are willing to supply labour at a given net wage.

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It follows that government-funded *in-work* benefits, which increases net wages, may encourage people to work if the minimum wage is relatively low. Some suggest that, in comparison with minimum wages, in-work social security payments can achieve better employment outcomes while delivering more targeted assistance for low-income households. The underlying question is where the balance should lie between wage regulation and the tax and transfer system in addressing concerns about income distribution. In-work benefits could take several forms:

- benefits in-kind that relate to employment, such as the child care subsidy provided by the Australian Government (which only targets families with young children)
- a minimum income paid to the employee comprising the employee's market wage plus a wage subsidy to the employer. An Australian Government program (*Wage Connect*) already provides such wage subsidies for the long-term unemployed to increase their likelihood of sustained employment. Similarly, state payroll tax exemptions for small businesses can be seen as a weakly targeted (and inefficient) subsidy for the size of firms most likely to employ minimum wage workers
- an earned income tax credit (EITC), which offers a credit for people who pay no tax on their labour income so their after-tax income exceeds their wage level. They 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).

A combined EITC and a minimum wage might have advantages over an EITC by itself (ACTU 2014a, pp. 18–19; Sawhill and Karpilow 2014).<sup>4</sup> Some Australian economists have suggested that the real minimum wage be lowered and accompanied by an EITC to cushion people against any distributional impacts (Dawkins 2002). The issue was canvassed by some submissions to the Henry Tax Review, and the Review itself suggested that it could be used in certain circumstances, but did not recommend its adoption (AFTSRP 2008, p. 101; 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 fifth economist has highlighted the poor skills sets of many unemployed as the critical issue that needs to be addressed.

Any in-work government payment 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 the distributional objectives of the FWA associated with the low paid (as specified in s. 284(c)) are partly resolved through in-work benefits, 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).

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<sup>4</sup> However, others question whether the hybrid approach helps the most disadvantaged (Neumark 2014, p. 8).

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In-work payments involve additional considerations specific to them, including:

- the deadweight losses associated with tax benefits for people who would have worked regardless of the credit. These costs need to be compared to the deadweight costs of the minimum wage (such as potentially forgone employment opportunities and reduced output for some enterprises)
- the design of income cut-offs, tapers and other features of any model (Leigh 2005). There is considerable diversity in the design of working credit schemes internationally, including their generosity, eligibility criteria, methods for payment, the withdrawal regime and fiscal costs (OECD 2011, pp. 67–90). Most countries spent less than 0.5 per cent of GDP on working credits, but Sweden spent more than 2 per cent in 2009 (ibid 2011, p. 80)
- the degree to which they differentiate between family types, and bias the choice of family type (Meyer 2010)
- 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)
- the complexity of any arrangements, including recipients' capacity to comprehend them and respond to the incentives they present, and interactions with the rest of the tax-transfer system
- the extent to which they might change community perceptions of recipients compared with traditional welfare measures (Sykes et al. 2013; cf Watson 1999)
- the degree of uncertainty about future net labour earnings. For instance, recent changes in the real minimum wage have tended to be relatively modest in Australia, so that uncertainty over future income is also low. Whether that would be true for budgetary measures (like the EITC) would depend on the institutional arrangements, the government's budget position and the state of the economy.

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

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

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

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

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

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## Practical aspects of the minimum wage and alternatives

Evaluation of the minimum wage or alternatives also needs to take account of the processes used to determine the level of payments. The existing process for minimum wage determination is a transparent process, but an elaborate one, involving many matters of judgment. For example, there was considerable debate between stakeholders and the FWC about the degree to which the phased increase in the superannuation guarantee levy from nine to 12 per cent from 2013 to 2019 — an implicit pay increase — should have been offset by reducing increases in the minimum wage. The FWC says its practice is to take the superannuation guarantee ‘into account’ when determining changes to the minimum wage, but not in any mechanistic way (FWC 2014a, p. 80). Other countries adopt different processes for formulating the minimum wage and in defining its components (Belser and Sobeck 2012).

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

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

## 2.3 National Employment Standards

If the first and primary safety net established in WR legislation is the minimum wage, the second safety net is the NES. Part 2-2 of the FWA specifies certain minimum standards for workers covered by the national WR system. Amongst other factors, the NES specifies minimum requirements for access to leave, hours of work, and termination and redundancy pay, though some provisions do not apply to casual employees. Terms in awards, agreements and employment contracts cannot exclude or provide a lower entitlement than the NES.

These standards have social and safety net goals similar to those that underpin the minimum wage, and in some cases there is an explicit acknowledgment that a condition has a wage equivalent (such as cashing out of paid annual leave in an award or enterprise agreement). Regardless, like minimum wages, there is a risk that they could impose a cost on employers that might exceed the marginal benefits of hiring some employees, with adverse implications for employment. Accordingly, some of the issues arising for minimum wages may also be relevant to the NES.

***Nevertheless, the Commission does not propose to undertake the same holistic analysis of the NES, unless submissions present solid grounds for review.*** Unlike the minimum wage, there appears to be little controversy over the NES as a whole. Although the value of the benefits rises with each increase in the wage level, the primary policy interest appears to lie with specific aspects of the NES. This then is where the Commission proposes to focus.

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Minimum standards may have impacts on workplace flexibility and compliance costs. The extent to which they do so will depend on the specific standard in the NES, the procedural obligations of employers, and the degree to which employers can use ‘reasonableness’ grounds to vary them (as in working on public holidays). As an illustration, the Australian Chamber of Commerce and Industry (ACCI) has claimed that some of the ‘family friendly’ provisions in the NES are problematic, and if nothing else, have uncertain impacts (Annexure 1, 2013). Similarly, the Australian Industry Group (2012, pp. 12–13) expressed concerns about the expansion of requests for flexibility of working arrangements beyond those associated with parental care. Of course, these might be balanced by the social benefits that such arrangements enable.

The Productivity Commission has previously recommended changes to specific aspects of the NES on social grounds, for example in relation to parents who have children with disabilities (PC 2011, p. 728) and to adoptive parents (PC 2009, p. XLIII). In some cases, it might be possible to preserve those social benefits and yet reduce compliance costs and uncertainty for employers.

In early consultations, participants also raised other concerns about the NES provisions:

- Although long service leave entitlements are included in the NES, the minimum entitlement is governed by different requirements in different states, rather than the one nationally-uniform set of provisions.
- In many industries, employees are unable to transfer some entitlements, such as qualification for parental leave and long service leave, when they move between jobs. Some claim that the capacity to transfer such entitlements may improve job matching and mobility, as well as being more equitable. Others suggest that the present contingency of these entitlements on tenure with the firm maintains loyalty to firms, and that changes would have cost implications for businesses. The issue of long service leave is raised further in Issues Paper 5.

*What, if any, particular features of the NES should be changed?*

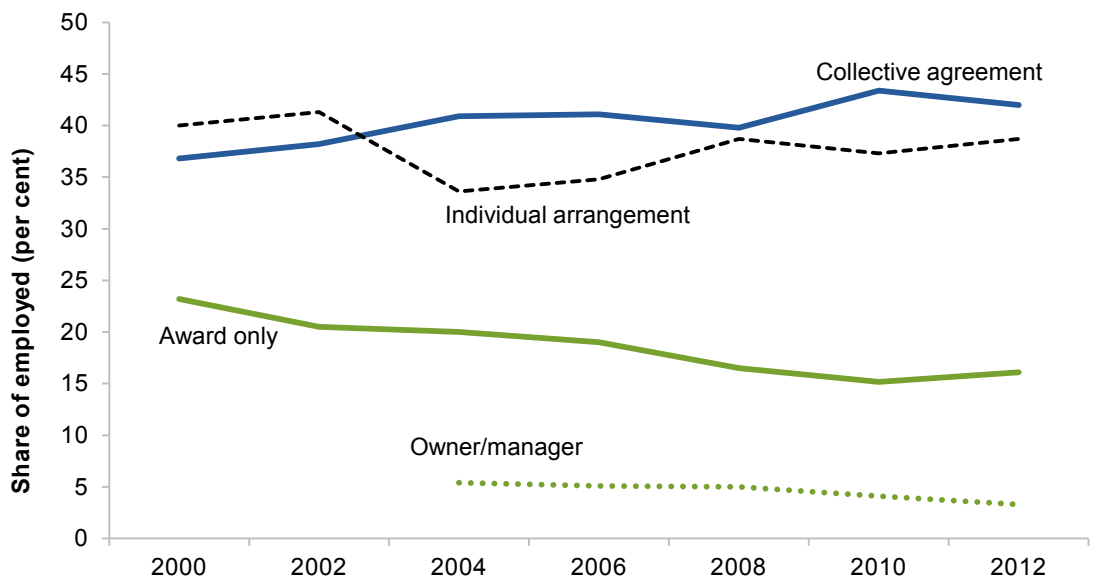
## **2.4 The award system and flexibility**

The modern award system is seen as another important safety net, and is specified as such in the Objects clause of the FWA (s. 3(b)). While there has been a large reduction in the number of awards and a dramatic decline in the number of wage classifications per award (Hamilton 2012, p. 10), modern awards still spell out minimum wages and conditions for a wide range of industries, occupations and skill levels (such as the wage rate for ‘Cemetery Employee Class 1’ or a ‘Car Parking Officer Level 1’).

The share of employees with wages and conditions set exactly at the award has been falling (figure 2.3). Nevertheless, awards retain importance in setting enterprise agreements (which often refer to them) and in individual agreements that seek to pay given percentage increases above the award payment.

The level of prescription in awards reflects the ‘modern awards objective’ (s. 134 FWA). This seeks to achieve certain distributional and equity goals (most notably, the ‘needs of the low paid’, ‘the principle of equal remuneration for work of equal or comparable value’ and additional remuneration for work outside ordinary working hours), while taking account of their economic effects and regulatory burdens.

**Figure 2.3 Award-only contracts are becoming less important**  
2000-2012<sup>a</sup>



<sup>a</sup> Individual agreements include a working proprietor of an incorporated enterprise (around 10 per cent of individual arrangements), an employee who has their pay set by an individual contract, registered individual agreement (for example, an AWA), common law contract or an individual agreement to receive over award payments. The survey was not designed as a time series, so caution should be exercised when comparing data between different years.

Data source: ABS, *Employee Earnings and Hours Australia*, Cat. No. 6306.0.

The FWC adjusts minimum wages in modern awards each year as part of the same process used to determine the federal minimum wage, typically copying the growth rate in minimum wages across to award rates. The FWC must also review all modern awards in a more holistic way every four years<sup>5</sup> based on legislated criteria set out under the ‘modern awards objective’ of the FWA (s. 134). The objective includes the goal of ‘a fair and relevant safety net’, consideration of the desirability of promoting social inclusion through increased workforce participation, the requirement to pay penalty and overtime rates, any impacts on business and the importance of simplicity. The FWC can also vary awards at other times if that is necessary to achieve the modern awards objective. However, the trigger for doing so must be an anomaly or a ‘significant’ change in circumstances ([2012] FWAFB 5600).

<sup>5</sup> And in the transitional phase associated with modern awards, review the awards on a more narrow basis.

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Many of the same considerations that influence the determination of the minimum wage are common to award decisions by the FWC, although the modern awards objective includes some further criteria (s. 284 versus s. 134 of the FWA).

Awards are more flexible than minimum wages. For example, at times, payments have gone down,<sup>6</sup> as illustrated by recent decisions by the FWC to change its initial versions of some modern awards. These decisions led to a *reduction* in the penalty rates for casual workers in the restaurant industry on Sundays ([2014] FWCFB 1996) and for allowances for pizza delivery drivers ([2014] FWC 1592). Modern awards must also include flexibility clauses, which allow an employer and an employee to create an individual flexibility arrangement (IFA) in which the parties agree to change (certain) award conditions if the employee is still better off (‘the ‘better off overall test’ or BOOT, discussed below). Enterprise agreements can also depart from award conditions. The degree to which such arrangements really confer flexibility is discussed in Issues Paper 3.

Awards may serve several positive functions. They may:

- provide a template set of conditions for small businesses and employees that do not want to craft their own enterprise agreements, use detailed individually-tailored contracts or hire subcontractors. There can be significant costs in negotiating terms under such arrangements that mean they are not necessarily suited to smaller businesses
- provide a starting point for negotiations of enterprise agreements (and above-award payments for individuals), reducing the scope of required negotiations
- address the power imbalance that may occur between employers and some employees when negotiating individual arrangements
- be seen as credibly ‘fair’ as they have longstanding historical legitimacy and are determined by an independent agency that balances their various impacts.

On the other hand, some argue that the tax and transfer system, the NES and minimum wages already serve as adequate safety nets, and that awards, in effect, set a multitude of further ‘minimum wage floors for jobs scattered across almost the entire wage distribution’ (Wooden 2010). This raises questions about the role of awards, including their efficiency and regulatory burden. The FWA gives primacy to wage determination through enterprise-level collective bargaining (s. 3(f)). Yet the backdrop for that bargaining has already locked in a set of minimum requirements based on the occupation and skills of the employee. Even though now much simpler than in the past, some claim that awards can complicate human resource management, may contribute to payment errors by employers, and reduce the capacity of businesses to adapt (especially for those enterprises covered by multiple awards).

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<sup>6</sup> In principle, they could do so for a minimum wage, though the Commission is not aware of any case where this has occurred.



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The FWC's award determination process is also sometimes seen as complex and lengthy, requiring fine judgments about appropriate entitlements, and involving challenges in identifying the appropriate coverage of jobs. These challenges permeated the process of award simplification. The issue persists, as illustrated by debates about the appropriate award for standalone catering businesses in the Restaurant Industry Award ([2013] FWC 7840). A question is whether there are arguments for further changes to awards, including:

- further consolidation and simplification
- reliance instead on the other safety nets in the WR system (potentially supplemented by the addition of some other basic provisions in the NES)
- changes to the processes for their determination by the FWC
- whether the four yearly review process is suitably nimble in addressing changing economic circumstances — an issue raised by some parties in early consultations.

The choice among these options depends on the:

- appropriate role of awards in a decentralised WR system that emphasises enterprise bargaining and allows for individual arrangements
- economic and social impacts of various type of award arrangements (including alternatives), taking account of the effects on different parties
- the scope for reducing the problems posed by awards through changes to the Modern Award Objective and the processes used by the FWC to periodically determine awards, including the timing of reviews.

*The Commission seeks feedback on these issues, and the implementation and transitional challenges of any significant changes.*

## **2.5 Penalty rates**

While penalty rates are an important feature of awards and are not separate from them, some types of penalty rates have aroused a special degree of controversy, and accordingly are worth considering alone. The FWA specifies that modern awards must take 'into account' the need for additional remuneration for people working on overtime, shift work, weekends, public holidays and at 'unsocial, irregular or unpredictable hours' (s. 134 (da)). 116 of the 122 modern awards specify penalty rates, albeit with different rates, depending on the industry, the day and time worked (DEEWR 2012, p. 12).

Overtime and penalty rates can be a particularly important element of overall remuneration for some workers, both by:

- industry, for example, in the retail and hospitality industries in the case of weekend and evening work, and health services in the case of shift allowances
- wage level. For instance, for a casual employee aged 20 years working in a restaurant for 6 hours at the minimum relevant award wage on a Sunday would earn \$172 of

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which around \$50 or just under 30 per cent would represent penalty rates (based on the tables reproduced in ACTU (2012b, p. 43). However, for most employees in such industries, income from penalty rates would comprise a much smaller share of total earnings.

While there are relatively few contentions about additional payments for overtime and shift work, there are polarised views about the appropriateness of weekend penalty rates in some sectors, which reprise aspects of the debate on the justification for, and effects of, minimum wages (Lewis and Mitchell 2014). The main concerns relate to arrangements in the hospitality and retail sectors.

Broadly, there are two alternative claims about penalty rates (summarised by the Senate Report into the matter, EEWRLC 2013).

Some argue that regulated penalty rates for working on weekends or evenings are justified because they compensate people for working at times that are asocial, and assist people who often have low incomes and poor bargaining power (ACTU 2012a, 2012b; SDAEA 2012; United Voice 2012). For instance, the Shop Distributive & Allied Employees Association has remarked that:

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. (2012, p. 3)

The FWC has typically accepted these arguments as valid when considering changes to awards although, at times, it has revised the rates.

In contrast, others claim that the social rationale for regulated penalty rates has declined as weekends have increasingly lost their historically special character as days of rest for some people, and as community and consumer expectations about buying goods and services have shifted in Australia towards a 24/7 economy (ACCI 2012; ARA 2013; Lewis 2014).

Changes in the regulatory environment may have also affected perceptions of normal working hours. A majority of states and territories in Australia have either completely deregulated trading hours or limited such restrictions to selected public holidays, with regulation of weekend trading hours remaining only in Queensland, South Australia and Western Australia.

It is sometimes further claimed that if penalty rates were de-regulated, profits, employment and hours worked would rise, and for some employees this might actually increase their earnings. Penalty rates might still be paid, but would be determined by the need to attract skilled and reliable workers, rather than because they were regulated. For example, the Council of Small Business of Australia has said:

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The nature of society has changed: trading hours of shops and restaurants have changed to 7 days a week; consumers expect service 7 days a week; rural areas rely upon tourist dollars to maintain jobs and their economic security; many people cannot work during the traditional Monday to Friday period and can only work on weekends or in the evening; as the population ages more and more people are seeking employment to supplement their income and also give them access to activity and interaction with people. (2012, p. 1)

A key question is therefore establishing a conceptually sound and consistent rationale for penalty rate regulations and, where testable, the empirical basis for any claims. An evidence-based understanding of the impacts of current and any amended penalty rate regulations on employees, businesses (by size and industry), the community and consumers will be an important issue for the Productivity Commission. The Commission will draw on survey research on ‘work and life’ (Skinner and Pocock 2014), a study of Sunday trading (ACRS 2012), various ABS datasets (including the Time Use Survey) and the Household, Income and Labour Dynamics in Australia (HILDA) Survey to further examine the issues. The FWC’s Australian Workplace Relations Study 2013–2014 may also assist. However, the Commission welcomes provision of other data and analysis that will contribute to a rigorous examination of the issues.

There are a several policy approaches to penalty rates that might result from such analysis. One would be to accept the principle that regulated penalty rates are an inherent element of any regulatory structure necessary to protect employee interests. In that case, the prime area of interest would be the methodologies and benchmarks for determining regulated rates. Another is that that setting of such rates is not part of an essential regulatory structure and should instead be a choice for individual enterprises and their employees, with less or no role by the regulator. Any premiums for weekend and evening work would then be market-determined, and might vary over time, place, occupations, industries and businesses.

*It would be helpful if submissions indicated whether one of these courses is the preferred model, why, and with what effects on society broadly, and on employees, consumers and businesses.*

It should also be recognised that there is already some in-principle flexibility under the modern awards system (and enterprise agreements) for employees and employers to negotiate individual agreements that alter penalty and overtime rates in exchange for other benefits (so long as the employee is better off overall). *The Commission is interested in participants’ views on the advantages and limitations of such (or other existing) approaches, and whether there could be alternative approaches that are superior. Actual and illustrative case studies involving time-based payments would be helpful.*

Other countries’ experiences may also be useful. Many do not have penalty rates for weekend trading, but instead have time-off-in-lieu arrangements. An interesting question is what happens to the prevalence of work on weekends in countries with different penalty rate arrangements, and the impacts on wages and profits. The experiences of New Zealand may be particularly instructive.

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*How should penalty rates be determined?*

*What changes, if any, should be made to the modern awards objective in relation to remuneration for non-standard hours of working?*

*What are the economic effects of current and alternative penalty rate arrangements on business profitability, prices, sales, opening hours, choice of employment type, rostering, hours worked, hiring, unemployment and incomes?*

*Were penalty rates deregulated, would wages fall to those applying at other times, or would employers still have to pay a premium to attract labour on weekends and holidays?*

*What are the long-run effects of penalty rates on consumers and on the prices of goods and services?*

*To what extent does working on weekends or holidays affect families, employees and the community? Are penalty rates effective at addressing any concerns in this area?*

*What do the experiences of countries like New Zealand, the United Kingdom and the United States — which generally do not require penalty rates for weekends — suggest about the impacts of penalty rates?*

*What are the variations in profit margins and sales over the week, and to what extent does this affect the appropriate design of penalty rate arrangements?*

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