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A Fork in the Road

Iain Ross
Australian Industrial Relations Commission

University of Wollongong

19th SIR RICHARD KIRBY LECTURE

Presented by

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DEPARTMENT OF
ECONOMICS

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'A FORK IN THE ROAD'

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Introduction

It is a great honour to be giving the 19th Sir Richard Kirby lecture and I thank the organisers for their kind invitation.

I want to use this opportunity to talk with you about the increasing divide between the rich and the poor in our country.

Such a topic seems particularly apt given Blanche d'Alpuget's description of Sir Richard as *'an underdog's man'*.

In recent years the notion of Australia as the *"lucky country"* with a reasonably fair distribution of income has been increasingly under challenge.[i]

There are two particular trends I want to examine:

- the earnings gap, i.e. the gap between income levels established as a result of enterprise bargaining and those determined by the award system; and
- income inequality in Australia.

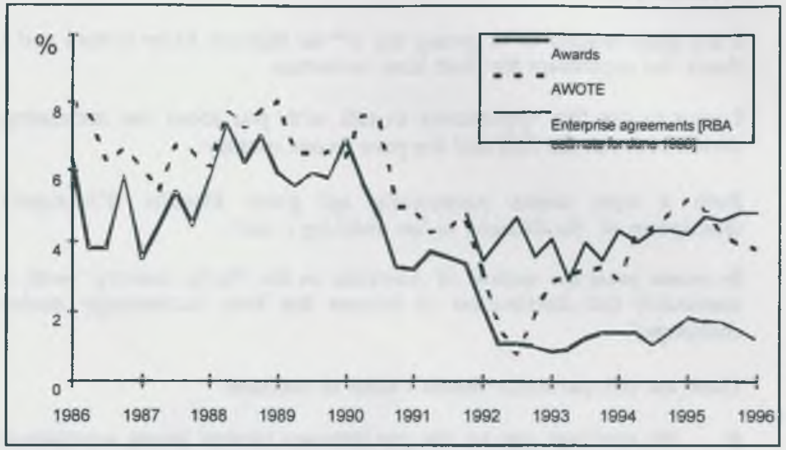
The Earnings Gap

In terms of the earnings gap it is clear that there has been a growing discrepancy between the level of growth in AWOTE and increases in award rates of pay in the 1990s. Between 1991-92 and 1995-96, AWOTE grew by 14.1 per cent, compared with growth in award rates of 5.4 per cent. Over the same period, the implicit price deflator for private consumption grew by 8.7 per cent.[ii] In real terms AWOTE rose by 5.4 per cent, whereas award rates fell by 3.3 per cent.

Chart 1 below shows how award rates of pay moved in comparison to AWOTE. The chart shows percentage increases on the previous year. The movements are similar throughout 1982-1989. However, from 1992 a gap forms between the rate of increase in AWOTE and the rate of increase in award rates. AWOTE reflects increases from enterprise bargaining and overaward payments, while award rates primarily reflect the three safety net adjustments by the Commission, provided for in October 1993, September 1994, and October 1995 and the remaining minimum rates adjustments that have occurred.

The chart clearly shows the beginning of a dispersion between minimum rates of pay and average earnings since the introduction of enterprise bargaining.

Chart 1: Wages - Annualised Growth



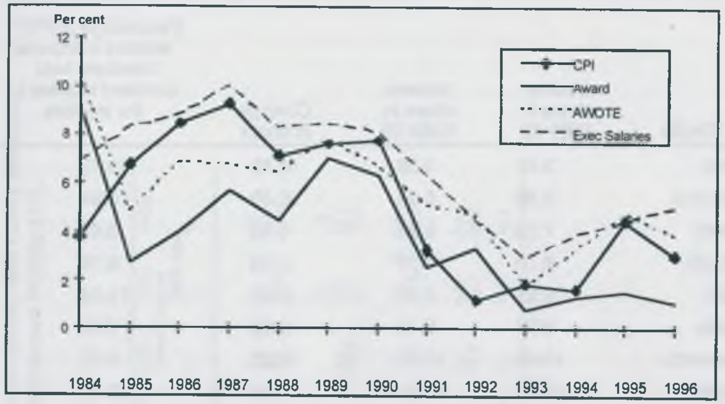
Source: Reserve Bank of Australia Bulletin December 1996

Table 1 and Chart 2 show movement in executive salaries compared with the CPI, award rates and AWOTE. *Executive salaries* in Table 1 represent the base salary paid to executives which excludes bonuses, commissions, loadings and benefits and therefore tends to **underestimate** the movement in executive salaries.

Table 1: Movement in Executive Salaries and Wages

	CPI	Award	AWOTE	Exec. Salaries
	%	%	%	%
1984	3.8	9.2	10.5	6.8
1985	6.7	2.7	4.8	8.3
1986	8.5	4.0	6.8	8.8
1987	9.3	5.7	6.7	10.0
1988	7.1	4.5	6.4	8.3
1989	7.6	7.0	7.8	8.5
1990	7.8	6.3	6.7	8.1
1991	3.3	2.6	5.1	6.3
1992	1.2	3.4	4.7	4.5
1993	1.9	0.8	1.8	3.0
1994	1.7	1.3	3.3	3.9
1995	4.5	1.6	4.8	4.5
1996	3.1	1.1	3.9	5.0

Chart 2: Movement in Executive Salaries and Wages



It is apparent from Chart 2 that movements in award rates of pay have been generally below CPI, AWOTE and executive salaries.

Income Inequality

Inequality in income distribution, in terms of wages dispersion, does not of itself necessarily mean that there has been a rise in poverty among those situated at the lower end of the dispersion scale. Increased wage dispersion can occur alongside rising wages for all workers, with those at the top simply rising faster than those at the bottom.

However, in the Australian context not only did the real earnings of those at the bottom decline but the real earnings of those at the top rose over the same period thereby contributing to greater wage dispersion.

A study based on most recent Household Expenditure Survey by the Social Policy Research Centre at the University of New South Wales found that low income working households have experienced the largest fall in relative income.[iii]

The results of a study by Saunders[iv] on the same issue shows that those in the second, third and fourth income deciles experienced the largest fall in income share between 1981-82 and 1989-90. By contrast the income share of the top two deciles increased over the same period. The results of the Saunders study are summarised in the table below:

Table 2: Changes in the Distribution of Wage Incomes Among Full-Year Full-Time (FYFT) Workers Between 1981-82 and 1989-90

Decile	Income share in 1981-82	Income share in 1989-90	Change in share	Percentage of FYFT workers in income brackets held constant relative to the median
First	3.81	3.66	-0.15	10.13
Second	6.28	5.95	-0.33	10.64
Third	7.35	6.93	-0.42	9.42
Fourth	8.10	7.77	-0.33	8.76
Fifth	8.91	8.61	-0.30	11.04
Sixth	9.74	9.48	-0.26	7.69
Seventh	10.80	10.58	-0.22	9.12
Eighth	12.02	11.87	-0.15	10.43
Ninth	13.84	13.85	+0.01	10.68
Tenth	19.16	21.29	+2.13	12.09

This trend has continued in the nineties.

The ABS has reported that between 1984 and 1994 the gap between high and low income households widened.

Household disposable (after tax) income increased by 52 per cent in the lowest income quintile compared to 71 per cent in the highest quintile.

In 1994 the top 20 per cent of households received 40 per cent of total household disposable income (an average of $1,205 per week). The bottom 20 per cent of households received a six per cent share or an average of $175 per week.[v]

The key benchmarks which have traditionally been used to assess income adequacy in Australia are the Henderson Poverty Lines (HPL).

Estimates can be made using the HPL to gauge the extent of wages poverty in Australia.

The Henderson Commission reached the conclusion that those below the poverty line were *"very poor"*, those less than 20 per cent above it were *"rather poor"* and that both groups together were *"poor"*.

In the April 1997 Safety Net wage case proceedings ACOSS described the circumstances of those at or below 110 per cent of the HPL as *"austere and disadvantageous"*.

Table 3 below shows that at 100 per cent of the poverty line, there are almost 200,000 workers living in poverty.

Table 3: Estimated Composition of the Population, by Economic Status, with Family Incomes Below Lines Set at 90, 100 and 110 Per Cent of the Henderson Poverty Line, November 1995

Henderson 'All-Costs' Poverty Line

	Number in poverty 90%	Number in poverty 100%	Number in poverty 110%	Proportion of all in poverty 90%	Proportion of all in poverty 100%	Proportion of all in poverty 110%	Poverty rate of family type 90%	Poverty rate of family type 100%	Poverty rate of family type 110%
	'000	'000	'000	%	%	%	%	%	%
Non-aged couple, No children									
Both employed	*	*	7.8	*	*	0.3	*	*	0.6
One employed	12.1	19.6	35.0	1.6	1.2	1.4	1.8	3.0	5.3
Neither employed	132.0	189.5	217.8	17.6	11.3	9.0	7.6	10.9	12.6
Couple, with children									
Both employed	*	11.6	64.8	*	0.7	2.7	*	0.3	1.8
One employed	27.2	109.1	302.7	3.6	6.5	12.5	1.1	4.4	12.1
Neither employed	204.6	381.8	488.8	27.2	22.8	20.1	32.2	60.1	76.9
Single person									
Employed	18.0	29.0	45.6	2.4	1.7	1.9	1.3	2.1	3.3
Not employed	247.5	654.1	828.7	32.9	39.1	34.2	17.3	45.8	58.1
Sole parent									
Employed	9.3	17.2	38.2	1.2	1.0	1.6	1.8	3.3	7.4
Not employed	97.6	257.1	397.1	13.0	15.4	16.4	16.8	44.4	68.5
All	751.7	1 671.9	2426.4	100.0	100.0	100.0	5.3	11.8	17.1

* Too few records on which to base reliable estimates.

Approximately 500,000 - or one in ten workers - are below 110 per cent of the HPL.

The HPL has been subjected to the criticism that it can obscure the depth of hardship experienced by particular low income families and individuals, because it masks variations in the actual costs faced by real households.[vi]

The poverty ines were designed to measure the levels of income below which people were, in effect, excluded from effective participation in society.

By comparison, minimum award rates were arguably designed to achieve a living standard that is somewhat higher than this.
As well as the statistical evidence the human face of increasing inequality is also readily apparent.

A recent study of poverty in Queensland found that over the last few years a much broader range of people have presented to welfare agencies needing financial assistance. The organisations interviewed for the project commented that the *"extent of the need"* seemed much higher than in the past, and expressed concern at the *"level of desperation"* of many of their clients.[vii]

The Smith Family reported that in 1990 it had 100,000 clients approaching their doors for help and 90 per cent were able to be assisted in some way. In 1995 the Smith Family had 400,000 contacting them and only 35 per cent could be helped.[viii]

In summary, there is a considerable body of evidence in support of the proposition that income inequality in Australia has increased over the past decade.[ix]

Three other issues related to the increase in income inequality are worth mentioning:

- ❖ wealth dispersion;
- ❖ urban ghettos;
- ❖ gender impact.

In terms of wealth dispersion there is little doubt that increased income inequality has had an impact on the distribution of wealth.

The wealth of Australian families is now heavily concentrated in the upper end of the distribution. About 95 per cent of total wealth is owned by the richest 50 per cent of families. The top ten per cent of families own about 43-44 per cent of total wealth, with the richest one per cent owning about 12 per cent alone.[x]

There has also been a marked change in the dispersion of household annual income across neighbourhoods. In this regard Gregory and Hunter[xi] have analysed Census data for different Collector Districts to determine the extent of the problem. A Collector District is the smallest geographical area for which Census data is available.

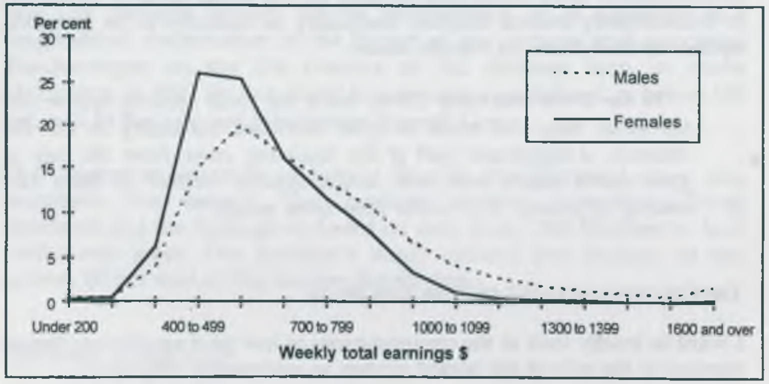
Gregory and Hunter found that in 1976 the ratio of the mean household income of Collector Districts from the lowest to the highest five per cent income areas was 60.4 per cent. This is a fairly equal geographical dispersion of household income.

Within the space of 15 years the ratio had fallen to 37.9 per cent. This change led the researchers to conclude that there had been a significant increase in the geographic polarisation of household income across Australia.

The poor are increasingly living together in one set of neighbourhoods and the rich in another set. The economic gap is widening.

The third point to note is that the majority of *low paid* employees are women. In May 1996, 33 per cent of all female full-time non-managerial employees earned less than $500 per week compared to only 19 per cent of male employees in the same category.[xii] The graph below illustrates the point that low paid employees are more likely to be female.

Chart 3: Distribution of Full-Time Adult Non-Managerial Employees by Levels of Weekly Total Earnings, Australia May 1996[xiii]



Source: ABS Catalogue No. 6305.0.

Australia is not alone in experiencing increased income inequality. In 1995 the OECD noted that the widening disparity in earnings has been accompanied by falling real wages at the bottom of the wage distribution in several OECD countries - including Australia - and that a new class of *"working poor"* has emerged:

> *"Widening earnings differentials can imply substantial hardship for a growing pool of workers with low wages. This would appear to be the case in the United States where real earnings for the lowest decile of earners fell by more than 10 per cent over the 1980s . . .*
>
> *A widening of earnings differentials also implied a fall over the decade in real wages for low-wage earners in Australia and Canada . . .*
>
> *The fall in real earnings at the lower end of the earnings distribution in the United States (with declines occurring even for men with median earnings) has prompted concern that its better performance than Europe in avoiding a sustained increase in unemployment has been at the expense of a growing number of 'working poor'."*[xiv]

The income support system in Australia has significantly moderated the trend towards inequality in market incomes over the past 20 years. However, the majority of major studies into changes in Australian income distribution over the 1980s suggest that neither the taxation, income support or *"social wage"* systems have managed to reverse the trend towards inequality in market incomes.[xv] Further a number of commentators have noted that reliance on the social security safety net to substantially reduce income inequality is unlikely to be a viable option in the future. As Nevile states:

> *"In the 1980s and early 1990s, when the social security system and the social wage did much to offset increased inequality in market incomes, a significant part of the financing came from the sale of government assets and from budget deficits. Neither of these two sources of finance is a viable long term option."*[xvi]

The Circumstances of Low Paid Employees

I want to briefly look at the circumstances of low paid employees before turning to the role of the award system in addressing inequality.

There is a clear relationship between wages and living standards. Studies of community living standards in Australia which have compared *"quality of life"* indicators with income levels have generally found a definite correlation between higher income levels and improved welfare according to such indicators as health, status, happiness and financial security. [xvii]

As Novak has said:

> *"If we are to arrive at a better conception of what constitutes and creates a minimum acceptable standard of living . . . we need to do so with reference to the way in which living standards are created and defined. In other words, we need to do so with reference to wages."* [xviii]

Saunders has also argued that:

> *". . . access to an adequate money income remains the most important single determinant of living standards for most Australians."* [xix]

Many low paid employees are in desperate circumstances.

A number of different approaches have been taken to provide an insight into the difficulties encountered by the low paid.

Two particular studies have examined aspects of the living standards of families with children and compared the circumstances of families on low incomes with other families.

The *Life Changes Study*[xx] by the Brotherhood of St Laurence is a longitudinal examination of the impact of low income and associated disadvantages on the life chances of 161 children born in inner Melbourne in 1990. In this study low income was defined as below 120 per cent of the relevant Henderson Poverty Line.

The Australian Institute of Family Studies (the Institute) have also examined this issue.[xxi] The Institute studied Australian living standards and the findings are based on data from 1768 families in four Melbourne areas. The Institute's study defined low income as the bottom 20 per cent of the income distribution.

The study found that:

- 18 per cent of the low income group had no car, compared with 1 per cent of the high income group;
- 20 per cent of the low income group had debts which they could not repay, compared with 4 per cent of the high income group;

- 22 per cent of the low income group had no money for school outings, compared with 3 per cent of the high income group;

- 38 per cent of the low income group spent more than 30 per cent of their income in housing costs, compared with 16 per cent of the high income group;

- 52 per cent of the mothers in the low income group had not visited the dentist in the last 12 months, compared with 31 per cent of those from the high income group;

- 16 per cent of the parents in the low income group reported *"poor"* or *"fair"* health, compared with 7 per cent of those in the high income group;

- 28 per cent of parents in the low income group believed that their secondary school age children were *"worse off"* than other Australian children because of the family's finances, compared with 1 per cent of those in the high income group.

In summarising the findings of both studies McClelland[xxii] argues that they demonstrate that in comparison with other families, families on low incomes were different in the following ways:

- They were considerably less likely to have been able to meet costs of children's education, clothing, the family health care costs (such as children's medicines) or leisure activities - a quote from a mother in the Life Chances Study provides an illustration:

  "We do not have money to buy toys, to let her take up piano lessons, to take her places. We have only enough money to pay for food. We will not have enough money to pay for her training and education."

  The Institute's study found that 56 per cent of low income families had difficulties in meeting secondary school costs in comparison with 17 per cent of high income families; 47 per cent of low income families had difficulty with health costs (19 per cent for high income); and 69 per cent of low income mothers could not afford leisure activities in contrast with 30 per cent of high-income mothers.

- Low income families were much more likely to have been in rental accommodation, to have little or no choice in selecting their housing, to have experienced housing problems and to be dissatisfied with their local area as a place to bring up children. One-third of the low income families in the Life Chances Study reported serious housing problems in the past year (compared with 10 per cent of other families). Housing problems included poor conditions and high cost of privately-rented housing, overcrowding and lack of safety in some public housing, and overcrowding and stress in shared housing.

- They were much less likely to be satisfied with their child's educational progress, but more likely to experience anxiety about the potential effect of family finances on the child's future.

- It was more common for the low income parents to feel worse-off in psychological terms and in terms of their personal well-being. Low income mothers in the Life Chances Study were much less likely to describe themselves as happy than mothers in higher income groups (40 per cent versus 84 per cent of other mothers).

- They were significantly more likely to report serious financial problems and serious disagreement with their partners. Some 45 per cent of low income mothers reported serious disagreements with their partners (compared with 20 per cent of mothers not on low incomes). Over half of these low income mothers linked the conflict with stress related to financial problems and/or unemployment.

A study by Saunders and Matheson examined the existence of situations in which respondents had, over the course of the year prior to the survey, difficulty *"making ends meet"* or had to go without basic goods and services. The results show that almost 40 per cent of the sample indicated that they had been unable to *"make ends meet"* at some time during the previous year. This compares with 23.9 per cent of respondents whose actual income was less than the *consensual poverty line* at the time of the survey.[xxiii] This suggests that even those respondents whose actual income was greater than the *consensual poverty line* had to go without basic consumer items. I will return to the notion of a *consensual poverty line* shortly.

The study also showed that, over the course of the previous year, around 10 per cent of the sample had experienced situations where they had not had enough money to buy food, 27 per cent could not pay for the clothing they needed and over 16 per cent could not pay for their medical bills or health care. Furthermore, 16 per cent of families with children had to deny their children basic items because of shortages of money at some time, while 7 per cent indicated that their children had to go without *"quite often"*.

Table 4 below summarises the survey results in this regard:

Table 4: Material Deprivation: The Incidence of Families Going Without Basic Consumer Items (all expressed in percentages)[xxiv]

Family type	Not enough money over the last year to:					
	Make ends meet	Buy food	Buy clothing	Pay for health care	Buy basic items for children	Children have had to go without at least quite often
Single adult						
Non-aged	39.7	14.3	30.2	17.5	na	na
Aged	22.9	2.9	17.1	5.7	na	na
Couple, no children						
Non-aged	31.2	5.3	17.5	12.7	na	na
Aged	17.6	4.4	11.0	3.3	na	na
Couple, 1 child	32.3	7.6	17.7	8.9	5.0	2.9
Couple, 2 children	47.9	14.3	33.6	20.4	14.3	5.4
Couple, 3 children	49.6	10.9	34.3	24.8	21.6	6.7
Couple, 4 children	47.5	20.0	47.5	27.5	28.2	17.9
Sole parent, 1 child	65.0	15.0	45.0	20.0	31.3	18.8
Sole parent, 2 children	60.0	33.3	53.3	40.0	33.3	20.0
Sole parent, 3 children	62.5	25.0	75.0	37.5	75.0	62.5
All families	**39.2**	**10.5**	**26.8**	**16.3**	**16.4**	**7.4**

These results led Saunders and Matheson to state:

> *"These figures are all alarmingly high. One in ten of our sample claimed that they could not always afford to buy the food their family needed, while the high figure for health care is also cause for concern, given that Medicare is intended to provide adequate basic health care irrespective of the financial circumstances of the sick."*[xxv]

Social Ramifications

Low incomes can also lead to a substantial reduction in equality of opportunity for large numbers of people. There is strong evidence that both health status and educational attainment is influenced by socio-economic status. Children in low income families more likely to have lower educational outcomes.[xxvi] People on lower incomes more likely to experience serious health problems.[xxvii] Given the importance of both health status and educational attainment in influencing a person's economic future, the impact of growing up in a low income family can be a substantial compounding of disadvantage in the longer term.

The emotional and psychological impact of low wages goes to the heart of social democracy. Without freedom of choice and without adequate resources to participate in social activities, low paid workers are denied the right to participate in society as active citizens. This was the point made by the Henderson Commission when formulating the poverty line based upon three key principles, of which the second principle was:

> *". . . every person should have equal opportunity for personal development and participation in the community. To achieve this, government intervention will be required not only to redistribute income but also to ensure a fair distribution of services and power to make decisions. Special consideration for disadvantaged groups, positive discrimination and devolution of power will be necessary."*

McClelland argues that the social costs of increased inequality can include a loss of social cohesion and an increased incidence of social problems.[xxviii] The available empirical evidence tends to support this proposition.

Growing inequality has also been found to contribute to an increased incidence of suicide[xxix] and crime.[xxx]

Freeman[xxxi] has argued that in the United States a rise in the economic rewards from crime relative to those from legal work helps explain the high and rising rate of criminal participation among American men.

Lee[xxxii] found a substantive positive correlation between levels of earnings inequality and crime rates. His estimates suggest that the increased inequality in the 1980s induced a 10 per cent increase in crime, as measured by the FBI's Uniform Crime Report Index.

A number of studies have shown a strong connection between inequality and poor health. The author of one international study concluded:

> *"National average death rates are so strongly influenced by the size of the gap between rich and poor in each society that differences in income distribution seem to be the most important explanation of why average life expectancy differs from one developed country to another."*[xxxiii]

It is apparent that increasing inequality has serious, adverse social ramifications.

The Award Safety Net and the Low Paid

What then is to be done about these issues?

As I have already noted the real value of award rates of pay have fallen over the last decade and movements in award rates have been consistently below increases in AWOTE and executive salaries. While the social security net in Australia has significantly moderated the trend towards inequality in market incomes, it has not managed to reverse the trend. As a consequence income inequality has increased over the past decade.

The gap between income levels established as a result of enterprise bargaining and those determined by the award system is widening.

Those who are dependent on an award for wage increases have had their living standards eroded relative to those who have received increases through bargaining.

Given the clear relationship between income and living standards the needs of the low paid can best be met by increasing their income.

In my view an adequate minimum wage should be sufficient to attain a level of material and social well-being considered minimally acceptable

by the community generally. In the *April 1997 April Safety Net Review decision* I concluded that the minimum safety net wage should, **over time and consistent with prevailing economic conditions,** be increased to the level of the *consensual poverty line* with consequent adjustments through the award structure to retain existing relativities.

Of course the outcome of any particular Safety Net Review is dependent on the circumstances existing at the particular point in time.

I should explain, briefly, what I mean by the *consensual poverty line.* In terms of an appropriate objective there is no absolute measure of income inadequacy which can be applied across all cultures and nations. Poverty is essentially a relative concept - what is regarded as poverty in Australia would not be so regarded in other countries.

Surveys of community attitudes regarding the adequacy of different income levels to establish a *consensual poverty line* are a useful data source for defining the *low paid.* Saunders and Matheson used such a survey to test the validity of the HPL in 1989. They asked the question: *"In your opinion, what would be the **very lowest** net weekly income (that is, income after tax but before payment of any bills) that your household would have to have to just make ends meet?"*[xxxiv]

The essence of the *consensual poverty line* approach involves deriving a poverty line from individual responses to questions concerning the minimum income levels that people in different circumstances say they require in order to *"make ends meet".* By seeking community views on this issue, the consensual approach has the advantage that it can produce a poverty standard based on the actual perceptions of minimum levels of adequacy in the community.

The results in the Saunders and Matheson study were based on a national random sample selected from the electoral rolls. The survey had an overall response of 62 per cent and the authors expressed satisfaction with the extent to which the survey respondents were representative of the community as a whole.[xxxv]

Saunders and Matheson constructed a set of alternative *consensual poverty lines* using the responses by people from different household types to this question, and compared these with the HPL. These *consensual poverty lines* were:

- 67 per cent higher than the HPL for a single person (equivalent to a disposable income of approximately $21,710 based on the present HPL); but
- about the same as the HPL for a couple with two children.

The results are comparable with earlier studies using similar methods[xxxvi] which led the authors to conclude:

> *"That our consensual poverty estimates are consistent with these aspects of previous research on poverty in Australia suggests that the evidence discussed in this section is robust, of interest and relevance and should not be dismissed lightly."*[xxxvii]

While the survey responses are subjective, the results nevertheless provide a useful indicator of the public acceptability of different income benchmarks. The fact that the *consensual poverty line* is based on community perceptions and that the survey specifically addressed the question of the income level required *"just to make ends meet"* supports the level as an appropriate benchmark for identifying the *low paid*.

The *consensual poverty line* is expressed in net terms. For a single adult with no dependants a *consensual poverty line* of $21,710 net is broadly equivalent to a gross income of $27,500 or $530 per week.
The *consensual poverty line* developed by Saunders and Matheson is consistent with the *decency threshold* established by the Council of Europe. Employees receiving less than the *decency threshold* are considered to be low paid and not in receipt of fair remuneration. The threshold is set at 68 per cent of average weekly full-time earnings. Applying this threshold to the latest ABS figures for full-time adult earnings suggests a decency threshold of $496 per week or $25,792 per annum.[xxxviii]

Any consideration of award wage rates needs to take place in the context of the relevant statutory framework, namely the *Workplace Relations Act 1996*.

Section 88B is central to the Commission's determination of the safety net wage claim. Section 88B(2) requires the Commission, in performing its functions under Part VI, to ensure that a safety net of fair minimum wages and conditions of employment is established and maintained having regard to the matters specified in paragraphs (a), (b) and (c).

Subsection 88B(2) provides:

"(2)In performing its functions under this Part, the Commission must ensure that a safety net of fair minimum wages and conditions of employment is established and maintained, having regard to the following:

(a) the need to provide fair minimum standards for employees in the context of living standards generally prevailing in the Australian community;

(b) economic factors, including levels of productivity and inflation, and the desirability of attaining a high level of employment;

(c) when adjusting the safety net, the needs of the low paid."

The factors relevant to the adjustment of the award safety net can be conveniently grouped into three categories:

- ❖ Economic - the likely effects of any adjustment on the state of the economy with particular reference to the impact on employment, productivity and inflation;
- ❖ Social - the need to provide fair minimum standards for employees in the context of living standards generally prevailing in the Australian community with particular reference to the needs of the low paid; and
- ❖ Bargaining - encouraging the making of agreements between employers and employees at the workplace or enterprise level by maintaining an incentive to bargain.

There is no particular priority to be assigned to these factors. The Commission is required to *have regard to* each of them. The most difficult issue is, of course, the balancing of each factor in circumstances where they conflict. This is a matter of judgment and outcomes will vary with the industrial, economic and social circumstances existing at a particular point of time.

Economic Effects

Care must be taken in determining the level of safety net adjustment in order to minimise any adverse employment effects. Unemployment is a significant cause of inequality.

Subjecting safety net increases to full absorption against all above award payments is one way of reducing the economic impact of a particular increase.

Since the late 1980s the Commission has relied upon absorption and commitments from union parties to awards to minimise the cost impact of award increases designed to assist the low paid, for example:

- supplementary payments in 1987;[xxxix]
- minimum rates adjustment in 1989[xl]; and
- safety net adjustments since 1993[xli].

The form of any adjustment granted may also have an impact. Flat dollar safety net increases generally provide greater assistance to employees on lower wage rates while not incurring the aggregate labour cost impact of a percentage increase for all employees equal to that provided to lower paid employees.

To the extent that a decision of the Commission may bring about an overall level of real wages higher than might otherwise have existed it may have a significant employment cost, although there is uncertainty about the size of such an effect. Further, there can be little doubt that a policy response by the Reserve Bank to counter the perceived inflationary potential of higher wages will adversely affect both employment and unemployment.

Some argue that there is also a *relative wage effect*. This requires careful examination. The claim that raising the wages of the low paid reduces their employment prospects. This is based on the neoclassical theory of the demand for labour. The basic proposition is that the labour market is like most other markets in that it has a downward sloping demand curve and hence if there is an excess supply of labour (or unemployment) the remedy is to reduce the price (or wage rate). The model underlying this proposition rests on a number of assumptions.

In a submission to the April 1997 Safety Net Review proceedings Emeritus Professor Nevile surveyed the theoretical issues associated with the presumption that raising wages will damage employment. He concluded that part of his submission in the following terms:

> *"To summarise, while neoclassical theory predicts raising minimum wage rates will reduce employment, this prediction rests on assumptions that have been widely challenged. Many observed aspects of the labour market are inconsistent with the assumption of perfect competition underlying neoclassical theory. Apparently identical workers are paid at markedly different wage rates. Implicit or explicit long term contracts are widespread. There are significant transaction costs in hiring and firing. Morale is important and workers may perform better just because wage rates are increased, and so on. In addition feedbacks from other markets are important and are not always easy to predict. The theory is such that it does not produce a convincing case for any stand on the issue except agnosticism. Hence empirical studies are all important."* [xlii]

The available empirical evidence casts doubt on the neoclassical prediction that raising wage rates will reduce employment. [xliii]

The 1990s saw an increase in the number of published studies, most of which suggested that earlier studies had overestimated the effects on employment of a rise in the minimum wage. A study of teenagers in the US by Wellington[xliv] found almost no effects at all. One by Bazen and Martin[xlv] for France found small effects for young people and virtually no effects for adults.

Despite the growing consensus in the empirical literature that increases in minimum wage rates have at most a very small effect in reducing employment, casual international comparisons have been used to support the argument that increasing minimum wage rates can result in massive unemployment.

In this regard contrasts are often made between the situation in continental Western Europe and the United States. In Europe there are high minimum wage levels and unemployment is over 10 per cent in many countries. In the United States both the minimum wage rate and the level of unemployment are much lower. Such a comparison invites the conclusion that low relative wages at the bottom end of the wage distribution in the United States caused more unskilled workers to be employed.

However a number of studies contradict this general proposition.[xlvi]

It would seem that the significant fall in wages of the low paid appeared to have no effect in increasing employment among the unskilled in the United States.

A similar result was found in an earlier US-Australian comparison by Gregory.[xlvii] In a later paper Gregory compared the labour market experiences of Australia and the United States over the period from the early 1970s to the mid-1990s.[xlviii] Gregory found that:

- between 1975 and 1995 the US produced 27.5 per cent more full-time jobs than Australia, after adjusting for population growth;
- US employment growth has not delivered income growth to most of the population. Over the 1979 to 1993 period adjusted real personal income of families from the bottom quintile fell 21 per cent, for the next quintile the fall was 7 per cent. Real family income only increased for the top 40 per cent of US families; and

- the US has created more jobs for less income per job. On average the US population has not become better off relative to Australians.

Gregory also observed that the relative rates of change in the numbers of high paid and low paid jobs have been much the same in the two countries:

> *"It is remarkable that the pattern of employment outcomes for each country are so similar, even though the aggregate employment growth has been so different. The regulated Australian labour market, with low wage flexibility and the loss of one quarter of male full-time jobs, seems to have produced the same relative employment outcomes as the more flexible US labour market where the loss of male full-time jobs has been confined to one in twelve. It appears as though the difference between the countries must originate in factors which affect employment growth across-the-board and not in factors unique to the United States, which have allowed rapid job growth in low paid jobs."*[xlix]

Gregory concluded as follows:

> *"Unemployment and the dispersion of relative wages has been increasing in Australia since 1975. These changes raise the question whether a larger fall in relative wages of the low paid would have led to a better employment record. In particular, the United States has had much stronger employment growth than Australia over the last decade and a half and is clearly a labour market with much greater wage flexibility.*
>
> *We have shown, however, that the pattern of job growth in the two countries is approximately the same. Both have experienced fastest job growth at the bottom of the earnings distribution. In this respect the United States has not been significantly different from Australia. The key difference is that the United States has generated more jobs at each point of the earnings distribution. As a result it seems unlikely that greater relative wage flexibility will significantly reduce Australia's unemployment problem. If the earnings distribution was to widen further, the major effect would be to create greater levels of inequality rather than sufficient jobs at low wages to deliver full employment."*[l]

In his survey of the empirical studies on the relationship between the minimum wage and employment Nevile concluded:

> *"Allowing the real value of minimum wage rates to fall will increase inequality in Australia. Modest rises are unlikely to have any significant effect on employment. The theoretical debate on this issue is inconclusive. There have been a large number of empirical studies carried out in other countries. The weight of evidence from these studies is that, at least within the range of differences studied, high minimum wage rates have little or no effect on the employment of unskilled workers."*[li]

It is, of course, not possible to draw a line under the relative wage debate. It is an issue which will need to be considered in the light of the available empirical evidence in future Safety Net Review proceedings.

Conclusion

Section 88B(2) of the new Act provides that the Commission must ensure that a safety net of *"fair minimum wages and conditions of employment is established and maintained"*, having regard to a number of factors including *"the needs of the low paid"*.

The establishment and maintenance of *fair minimum wages* involves a consideration of economic and social factors. The most appropriate balance between these factors is a matter of judgment based on the evidence in a particular case and opinions may differ.

In terms of the relevant social considerations an adequate minimum wage should be sufficient to attain a level of material and social well-being considered minimally acceptable by the community generally. The Saunders and Matheson *consensual poverty line* is the most useful current benchmark for income adequacy and a person earning below this level may be regarded as *low paid*.

A household of a single adult with no dependants is the most appropriate benchmark household type in the context of determining an adequate minimum wage. For a single adult with no dependants the current *consensual poverty line* of $21,700 net is roughly equivalent to a gross income of $27,500 or $530 per week.

Many employees earning less than the *consensual poverty line* are struggling to make ends meet and have to go without basic necessities such as food, clothing and health care.
While the social security safety net in Australia has significantly moderated the trend toward inequality in market incomes, it has not managed to reverse the trend. As a consequence income inequality has increased over the past decade.

The social cost of increased inequality includes a loss of social cohesion and an increased incidence of social problems.

Unless action is taken to substantially renew the system of minimum wage regulation there is a real risk that social divisions will become entrenched.

In the *April 1997 Safety Net Review decision* I expressed the view that the minimum safety net wage should, **over time and consistent with prevailing economic conditions**, be increased to the level of the *consensual poverty line* with consequent adjustments through the award structure to retain existing relativities.

The foreword to the submission by the Brotherhood of St Laurence in the April 1997 proceedings was in the following terms:

> *"With this case before the Industrial Relations Commission we have it within our power to choose to go down a route which promotes greater poverty and misery for low wage workers and their families. We also have it within our power to choose a different, more just, route which ensures that every Australian has a right to a decent standard of living.*
>
> *If we choose the first option we are in danger of creating a society which is deeply divided between the rich and the poor. If we choose the second, however, we can reaffirm the commitment of Australians to a just society. Given all the pressures which currently divide us, it is therefore important that the commitment be strongly stated."*

I agree with the proposition that wage fixation in Australia has reached a *"fork in the road"*. We can allow the living standards of low paid workers and their families to drift further below community standards, or we can set clear objectives for maintaining and improving them.

If we are to begin to address the problems confronting low paid employees and the widening gap between award and market wages, then subject to any economic constraints, we must do more than simply preserve the status quo. A status quo in which income inequality is increasing and many low paid workers and their families have to go without food or clothing, is neither fair nor equitable.

As Saunders and Matheson put it:

> *"To deny sections of the community a minimum standard of living is to condone 'poverty amongst affluence' a situation which is both personally humiliating and morally indefensible."* [liii]

[i] Borland J and Wilkins R, 'Earnings Inequality in Australia' (1995) 72:216 *Economic Record* 20-28; Harding A and Mitchell D, 'The Efficiency and Effectiveness of the Tax Transfer System in the 1980s' (1992) 9:3 *Australian Tax Forum* 277-303; Kakwani N, *Analysing Redistribution Policies A Study Using Australian Data* (Cambridge : Cambridge University Press, 1986); Saunders P, Stott H and Hobbes G, 'Income Inequality in Australia and New Zealand International Comparisons and Recent Trends' (1991) 37:1 *Review of Income and Wealth* 63-79.

[ii] Australian Bureau of Statistics, *Australian Economic Indicators*. Canberra: ABS, February 1997, Catalogue No. 1350.0. See Table 5.3 at 60; Table 7.3 at 89; Table 7.4 at 90.

[iii] Saunders P and Urquhart R, 'Australia Spending Patterns' (1996) 62 *SPRC Newsletter*.

[iv] Saunders P, *Unpacking Inequality - Wages Income, Disposable Incomes and Living Standards*. Discussion Paper No. 63, University of New South Wales, Social Policy Research Centre, December 1995 at 11.

[v] Australian Bureau of Statistics, *Australian Social Trends 1997*. Canberra, ABS, Catalogue No. 4102.0 at 117.

[vi] *Australia's Poverty Challenge*. Social Issues Paper No. 5, The Smith Family, October 1996 at 8.

[vii] Thornthwaite T, Kingston C and Walsh P, *Drawing the Line on Poverty : An Assessment of Poverty and Disadvantage in Queensland*. (Brisbane: QCOSS, June 1995).

[viii] Orr E, *The Working Poor Dilemma*. (The Smith Family, February 1996).

[ix] Raskal P and Urquhart R, *Inequality, Living Standards and the Social Wage During the 1980s*. SSEI Monograph No. 3, Centre for Applied Economic Research, Social Policy Research Centre, University of New South Wales, 1994.

[x] Backgaard H, 'The Changing Patterns of the Distribution of Household Wealth in Australia from 1986 to 1993', a paper presented to the *1997 Conference of Economists*, Hobart 1997.

[xi] Gregory RG and Hunter B, *The Macro Economy and the Growth of Ghettos and Urban Poverty in Australia*. Discussion Paper No. 325, Australian National University, Centre for Economic Policy Research, April 1995.

[xii] Australian Bureau of Statistics, *Employee Earnings and Hours Australia Preliminary*. Canberra: ABS Catalogue No. 6305.0, May 1996, Table 1 on 8.

[xiii] Note 12.

[xiv] OECD, *The OECD Jobs Study, Evidence and Explanations : Part 1 - Labour Market Trends and Underlying Forces of Change*. Paris: OCED, 1995 at 21-22.

[xv] Saunders P, *Welfare and Inequality*. (Cambridge University Press, 1994).

[xvi] Nevile JW, *Minimum Wages, Equity and Unemployment - A Submission in the 'Living Wage' Case* 1996 at 5.

[xvii] Brownlee H and McDonald P, *In Search of Poverty and Affluence*. Australian Institute of Family Studies, 1994.

[xviii] Novak T, *Poverty and the State* (Open University Press, 1988 at 21).

[xix] Saunders P, *A Challenge to Work and Welfare : Poverty in Australia in the 1990s*. Discussion Paper No. 64, University of New South Wales, Social Policy Research Centre, 1995 at 13.

[xx] Gilley T & Taylor J, *The Impact of Poverty on the Life Chances of Children by Three Years of Age*, (Melbourne: Brotherhood of St Laurence).

[xxi] McDonald P and Browlee H, 'Australian Living Standards: The Next Decade', in Disney J & Briggs L (eds), *Social Security Policy : Issues and Options* (Canberra: AGPS 1994) at 49-62.

[xxii] McClelland A, 'Growth and Inequality: A Welfare Perspective' (1995) 43 *Growth* 116-135 at 120-121.

[xxiii] Saunders P and Matheson G, *Perceptions of Poverty, Income Adequacy and Living Standards in Australia*. Reports and Proceedings No. 99, University of New South Wales, Social Policy Research Centre, April 1992, Table 4.10 at 77.

[xiv] Note 23 at Table 5.1 at 82.

[xxv] Note 23 at 83.

[xxvi] Williams T, *Participation in Education*. ACER Research Monograph No. 30, Melbourne, Australian Council for Education Research, 1987. Cited in McClelland, Note 22 at 123.

[xxvii] National Health Strategy, *Enough to Make You Sick. How Income and Environment Affect Health*. Research Paper No. 12, Melbourne, National Health Strategy, September 1992. Cited in McClelland, Note 22 at 123.

[xxviii] Note 22 at 118.

[xxix] Raskal P, 'The Influence of Economic Inequality and Unemployment on the Rate of Suicide and Homicide Over the 1980's', a paper to the *National Biennial Conference, Australian Crime Prevention Society*, Brisbane 1993.

[xxx] Wedderburn D, 'Economic Adversity and Crime' (August 1992) 40 *Trends and Issues in Crime and Criminal Justice* 1-8.

[xxxi] Freeman RB, 'Why Do So Many Young American Men Commit Crimes and What Might We Do About It?' (1996) 10(1) *Journal of Economic Perspectives* 24-42.

[xxxii] Note 31 at 33.

[xxxiii] *Inequalities in Health : Occasional Paper*. London: British Medical Association, 1995.

[xxxiv] Note 23.

[xxxv] Note 23 at 37 and 44-45.

[xxxvi] See Saunders P and Bradbury B, 'Some Australian Evidence on the Consensual Approach to Poverty Measurement', (1991) 21(1) *Economic Analysis and Policy* 47-48.

[xxxvii] Note 23 at 79.

[xxxviii] Australian Bureau of Statistics, *Average Weekly Earnings, Australia*. Canberra: ABS Catalogue No. 6301:0, November 1996. Based on the seasonally adjusted figure for full time adult total earnings.

[xxxix] *March 1987 National Wage Case*, Print G6800 at 17-19.

[xl] *August 1989 National Wage Case*, Print H9100 at 14.

[xli] *October 1993 Review of Wage Fixing Principles*, Print K9700 at 23-24; *September 1994 Safety Net Adjustments and Review*, Print L5300 at 25; *October 1995 Third Safety Net Adjustment & Section 150A Review*, Print M5600 at 71-76.

[xlii] Note 16 at 11-12.

[xliii] Brown C, Gilroy C and Kohen A, 'The Effect of the Minimum Wage on Employment and Unemployment' (1982) 20 *Journal of Economic Literature* 487-528. Cited in Nevile, Note 16 at 13. A survey covering the 30 years to 1980 reviewed a large number of studies on the effect of changes in minimum wage rates on the level of employment and concluded that:

> *"Time series studies typically find that a 10 per cent increase in the minimum wage reduces teenage employment by one to three per cent . . . We believe that the lower half of that range is to be preferred; to the extent that differences in results can be attributed to differences in the specifications chosen, the better choices seem to produce estimates at the lower end of the range . . . Cross-section studies of the effect on teenage employment produce a wider range of estimated impacts . . . but estimates of 0 to .76 percentage points are most plausible.*
>
> *The effect of the minimum wage on young adult (20-24 years) employment is negative and smaller than that for teenage employment. This conclusion rests on much less evidence than is available for those 16-19 years. The direction of the effect on adult employment is uncertain in the empirical work, as it is in the theory."*

See further: Card D and Krueger AB, *Myth and Measurement : The New Economics of the Minimum Wage*. (Princeton University Press, 1995 at 389-390). Cited in Nevile, Note 16 at 15-16.

[xliv] Wellington A, 'Effects of the Minimum Wage on the Employment Status of Youths : An Update' (1991) 26 *Journal of Human Resources* 27-46. Cited in Nevile, Note 16 at 14.

[xlv] Bazen S
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nd Martin J, 'The Impact of the Minimum Wage on Earnings and Employment in France. *OECD Economic Studies No. 16* Spring 1991 at 200-221.

[xlvi] Nickell S and Bell B, 'Changes in the Distribution of Wages and Unemployment in OECD Countries' (1996) May *American Economic Review* 302-308 at 303. Cited in Nevile, Note 16 at 18. See further: Card D, Kramuz F and Lemieux T, *Changes in the Relative Structure of Wages and Employment : A Comparison of the United States, Canada and France*. Working Paper No. 5487, National Bureau of Economic Research, 1996 at i. Cited in Nevile, Note 16 at 18-19.

[xlvii] Gregory RG, 'Aspects of Australian and U.S. Living Standards : The Disappointing Decades 1970-1990' (1993) 69(204) *Economic Record* 61-76.

[xlviii] Gregory RG, 'Wage Deregulation, Low Paid Workers and Full Employment'. *Dialogues on Australia's Future*, Victoria University of Technology, 1996.

[xlix] Note 48 at 92.

[l] Note 48 at 100.

[li] Note 16 at 20.

[lii] Note 23 at 1.

Department of Economics

University of Wollongong

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