THE MINIMUM WAGE AND THE AUSTRALIAN FAIR PAY COMMISSION

In dealing with its partly contradictory objectives, the Australian Fair Pay Commission must keep in mind the negative effects of minimum wages, argues **Joel Butler**

The Howard government's Work Choices legislation removed the power to set national minimum wages from the Australian Industrial Relations Commission and handed it to a new body—the Australian Fair Pay Commission (AFPC). The Commission is now collecting evidence and hearing submissions from parties around the country on an appropriate minimum wage, with a decision due in Spring 2006.

The union movement, social welfare groups and churches claim that the new procedures threaten the living standards of working Australians and will undermine the concept of a 'fair wage'. Some suggest that the Howard government has caved into business demands, and that a lower real minimum wage will increase business profits while forcing more working Australians into poverty. The evidence suggests, however, that the minimum wage is not, if it ever was, the best way to help low-income Australians.

History of the minimum wage

The first federal Act to regulate industrial relations in Australia was the Commonwealth Conciliation and Arbitration Act. Shortly after it was passed in 1904, the well known Harvester decision was handed down by Justice H B Higgins. It was the first 'living wage' case of its type in the world. Higgins was required to determine wages that were 'fair and reasonable' and until the recent changes it was this principle that was followed consistently by courts and tribunals in setting minimum wages.

The productivity or capacity of their employer or the economy to pay the wage was not a consideration until 1934. In that year, the Arbitration Court stated:

> If the general principle of a general basic wage be accepted, then arises the question whether its

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> amount is to be fixed according to the cost of living of a labourer's family or in accordance to national productivity.
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> In answering the question, they stated:
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> In as much as the source of all wages is the national productivity, and in as much as it is just that the share of the wage-earners as a whole should be proportionate to the national productivity for the time being, the latter proposition is theoretically the sounder.

The debate, and the centralised wage-fixing commission's response to the question of whether the main criterion informing the level of the minimum wage should be to provide a reasonable or fair standard of living, or alternatively should be related to the national economy, or even a firm's productivity, fluctuated in the decades to follow.

The Howard government has given power to set the minimum wage to a new commission that is more a panel of experts, including two professional economists, than a legal tribunal. In setting out what the AFPC must take into consideration, the Howard government emphasised productivity and the economic effects of the minimum wage on workers. The AFPC's objective in performing its wage-setting function is to 'promote the economic prosperity of the people of Australia', having regard to:

1. the capacity for the unemployed and low paid to obtain and remain in employment;
2. employment and competitiveness across the economy;
3. providing a safety net for the low paid; and
4. providing minimum wages for junior employees, employees to whom training arrangements apply and employees with disabilities that ensure those employees are competitive in the labour market.

The AFPC is therefore primarily focussed on economic prosperity, productivity, competitiveness and maintaining employment levels. The living standards of employees are but one of the four factors the Commission is to take into account.

The effects of a minimum wage

Clearly, minimum wages can 'artificially' raise the cost of labour. Where markets set wages, wage levels will be determined by employers' willingness to pay a wage for a particular job, and workers' willingness to work for the proposed wage. It may be that nobody will work for the wage available from a particular employer, or in a particular sector. In this case, employers will have to offer a higher wage, find other strategies to replace workers such as using machinery instead of labour, do without the additional help, or go out of business. This is not a case, as some commentators have suggested, where an increase in the minimum wage eliminates already 'unproductive' businesses, but a situation where the increase will make businesses unproductive.

The minimum wage also has 'economy-wide' effects. Empirical research into the actual effect of minimum wages across the world has repeatedly shown that a minimum wage reduces the number of people in work.[1] As noted by Australian economist Mark Wooden:

> Minimum wages need to balance the interests of workers against those of the unemployed, and ratios between minimum wage and median earnings of close to 60% [as we have in Australia] are indicative of a system that prices many of the unemployed out of the labour market.[2]

Crucially, as I have noted elsewhere,[3] the people most affected by minimum wage laws are those who are typically the most 'vulnerable' workers in a national economy: young people, women, the unskilled, and workers in regional areas. It is these groups of people whom the research overwhelmingly shows will be most likely to move out of the labour market as a result of imposing or increasing a minimum wage.

Employer responses to minimum wage increases have included strategies such as reducing the size of their workforce and improving training of retained workers. This increases the number of more highly trained workers remaining in jobs, widening the 'skills gap' between employed and unemployed workers. It becomes even harder for unemployed workers to gain or regain employment.

Tensions in AFPC tasks

To a significant degree, the Work Choices amendments seem to recognise the negative effects of a minimum wage as well as the former Australian Industrial Relations Commission's (AIRC) ongoing failure to take these effects into account. As Wooden points out:

> The actions of the AIRC … in persistently raising the federal minimum wage over time thus suggests that it does not care about the jobless or that it believes there is no relation between the price of labour and the volume of employment.[4]

The Work Choices amendments require the new Commission to take these effects into account.

The first and second objects of the AFPC in setting the minimum wage—'taking into account both the capacity for the unemployed and low paid to obtain and remain in employment' and 'employment and competitiveness across the economy'—seem to require the AFPC to recognise that there is a danger in setting a minimum wage that will cause unemployment, or entrench it among those already unemployed, thus damaging the capacity of the economy to 'provide' jobs for workers. By specifying that the AFPC must provide 'minimum wages for junior employees, employees to whom training arrangements apply and employees with disabilities that ensure those employees are competitive in the labour market', the amendments recognise that these groups are often disadvantaged when competing for jobs and generally, in order to compete, they need lower wages.

The AFPC, however, is also required to set the minimum wage as a 'safety net' for the low paid. There is clearly potential for tension among these competing requirements. If a 'safety net' results in the minimum wage being higher in some areas than the interaction of supply and demand would provide, this will possibly result in unemployment—which the other three objects directly or by implication require the AFPC to avoid.

What is (or should be) the 'safety net'?

Throughout the years the minimum wage has been described as delivering different but similar things to low paid Australian workers. In the 2004 'Safety Net Review' the AIRC noted that 'for certain household types the federal minimum wage is significantly below the amount which is necessary to provide a modest living standard for those households in the context of living standards generally prevailing in the Australian community.' This indicates that up to now there has still been some expectation that the minimum wage be set at a level that provides a 'decent living' or a 'living wage' or a wage that is 'fair and reasonable' for a worker with a family. At the least, in Higgins' terms, such a wage should put meat on the family's table every night, but in a contemporary context, what more should it provide?

This is a difficult but key decision for the AFPC. How much constitutes a 'safety net?' Is a safety net wage a wage that allows a worker to live in relative comfort or frugal comfort, or is it something else? Who is a 'benchmark worker' in this context? Is it, as it was for much of Higgins' day, a male breadwinner with a wife and three children? With a wife and one child and a mortgage and a credit card debt? The possible variations are, of course, endless.

> The consequence seems to be that the most appropriate benchmark is a younger, unskilled, single, female worker.

For most of Australia's wage-setting history, the minimum wage was linked to the needs of an 'average' working class male with a family. This is a less relevant benchmark in contemporary Australia. If the research shows that minimum wages negatively affect young, unmarried female workers without post-school qualifications who were born overseas[5] there can be no doubt that using the male, head-of-the-family wage earner as a minimum wage benchmark discriminates against females and young people, squeezing them out of jobs in favour of better off males.

The consequence seems to be that the most appropriate benchmark worker is a younger, unskilled, single, female worker. If the minimum wage is the tool that is most likely to affect her job prospects, she has the most interest in seeing the minimum wage set at a level which ensures she is in employment that will provide not only a 'safety net' income, but also opportunities for training, skilling and advancement.

The capacity of the AFPC to set differential minimum wages for different vulnerable classes of worker is also important. In May 2004 junior male average weekly earnings were $410 and the female average weekly earnings $395. At the same time the minimum (adult) average weekly wage was $484.40. Clearly the capacity for young people to be employed relies upon the existence of a competitive 'youth' minimum wage.

If businesses are to be welfare providers, it would seem fairer that this expense be spread equitably, rather than imposed on those that are probably most financially vulnerable.

Effects on living standards

There are other considerations that the AFPC will need to take into account in determining a safety net level of wages. The minimum wage is not the only policy tool at the government's disposal which affects workers' living standards. Social security payments, child assistance payments, medical benefits, transport concessions, variable tax rates, housing assistance and a wide variety of other government initiatives provide assistance in 'buffering' low income individuals and families from a 'pure' market system. Importantly, these other policies generally mean that non-workers are often not provided with any incentive to seek work. As Wooden points out, the combined effect of Commonwealth welfare tax and wage policies is that:

> Relatively few parents in single-earner couple households are on the minimum wage—if they cannot secure jobs paying much higher wages either the non-working partner moves into the workforce or they gravitate towards a life of welfare dependence.[6]

Economist Andrew Leigh also makes the important point that the effect of minimum wages on income distribution 'depends crucially on who earns minimum wages. If minimum wage earners are disproportionately teenagers from affluent families then a minimum wage rise will have less of an impact on poverty than if minimum wage earners are mostly sole parents.' His statistics indicate that individuals in poor families are disproportionately likely to be unemployed while only slightly more low-wage earners are found in the bottom 40% of households than in the top 40% of households.[7]

Business and welfare

A statutorily imposed increase for minimum wage workers forces business to incur a greater cost 'for the social good'. Is this fair? It is very clearly arguable that it is not.

Even if we accept that business should be part of the social welfare system, the minimum wage does not accord with the normal principles of financing income support. Most businesses already pay most workers more than the minimum wage.[8] They pay wages and salaries set by the markets in which they operate. This means that the effects of minimum wage decisions fall disproportionately on businesses employing low-paid workers.

Unlike progressive income tax financing welfare, a minimum wage takes no direct account of capacity to pay. Some businesses paying a minimum wage are doing so only because that is all they can afford to pay. Generally the businesses that pay more than the minimum wage can afford to do so. This would suggest that these businesses could in many instances more easily sustain an increase in minimum wages than those businesses actually paying the minimum wage. Minimum wage increases inflict most hardship on the businesses that can least afford them, while sparing businesses that can more easily pay for them any expense at all. So, for example, a small family-owned manufacturing company may be significantly affected by a minimum wage increase, while it would not affect an international merchant bank at all.

If businesses are to be welfare providers, it would seem fairer that this expense be spread equitably across all businesses, rather than imposed on those that are probably most financially vulnerable. Alternatively, this suggests that a minimum wage is not the public policy tool by which to provide 'social equity' outcomes at all: it not only negatively affects the businesses that can least afford it, but also penalises the most vulnerable workers.

Importantly, if low paying businesses are penalised by a minimum wage, and it is these businesses that provide low paid employees with jobs, again, the best, most equitable and most just principle seems to be that the minimum wage should be as low as possible—in order to maintain the profitability of those businesses and allow them to continue to provide jobs.

Conclusion

Unions, welfare groups, the Labor Party, church groups and others that portray themselves as promoters of social justice all support a 'generous' minimum wage. This, they claim, is one means of ensuring the living standards and dignity of the low paid and most vulnerable in society.

Calls for government measures to eliminate poverty and increase living standards can be justified, but it is important to understand the impact of the tools chosen to achieve these social justice outcomes. The use of a minimum wage to achieve these ends is counterproductive—it risks causing the opposite of what it sets out to do. The minimum wage only protects the low paid at the expense of the dignity of those who are unemployed. In addition, it imposes an inequitable tax on low-income businesses while those businesses that can more easily afford it are exempted from contributing this extra amount to 'the social good.'

Clearly the AFPC is at a disadvantage in alleviating poverty and assisting the unemployed into work and better living conditions. It is required to set a minimum wage, and that wage is, at least in part, aimed at providing employees with a 'safety net'. Other tools required to create a safety net—welfare policy, tax policy and so forth—remain in the hands of the federal government. Within these constraints, however, the AFPC needs to keep clearly in mind the negative effects of a statutorily imposed minimum wage. Set the wage too high, and the result will be to cause harm to those the wage is most intended to protect.

Endnotes

1. Philip Lewis, 'Low Pay or No Pay? Economics of the Minimum Wage', *Policy* 21:3 (Spring 2005), pp 14–20.
2. Mark Wooden, 'Minimum Wage Setting and the Australian Fair Pay Commission', *Journal of Australian Political Economy* No 56 (2006), p 82.
3. Joel Butler, 'Minimum Wage Laws and Wage Regulation: Do Changes to a Minimum Wage Affect Employment Levels?' *UNSW Law Journal* 29:1 (2006), p 181.
4. Wooden, 'Minimum Wage Setting', *Journal of Australian Political Economy*, p 82.
5. Andrew Leigh, *Does Raising the Minimum Wage Help the Poor? Discussion Paper No 51* (Canberra: ANU Centre for Economic Policy Research, November 2005), p 19.
6. Wooden, 'Minimum Wage Setting', *Journal of Australian Political Economy*, p 85.
7. Leigh, *Does Raising the Minimum Wage Help the Poor?*, p 1.
8. Statistics are difficult to find, but see my article above, Butler, 'Minimum Wage Laws and Wage Regulation', at pp 195–9.