AUSTRALIAN BUSINESS INDUSTRIAL

ANNUAL WAGE REVIEW 2018-19

SUBMISSIONS OF AUSTRALIAN BUSINESS INDUSTRIAL AND THE NSW BUSINESS CHAMBER Ltd

15 March 2019

About ABI and the NSW Business Chamber Ltd

Australian Business Industrial (ABI) is registered under the *Fair Work (Registered Organisations) Act 2009* and has some 4,200 members and the NSW Business Chamber Ltd (NSWBC) is registered under the (NSW) *Industrial Relations Act 1996* and is a State registered association recognised pursuant to Schedule 2 of the *Fair Work (Registered Organisations) Act 2009.* The NSWBC has some 20,000 members.

ABI comprises those NSWBC members who specifically seek membership of a federally registered organisation.

These submissions have been approved by the Council of ABI on behalf of its members and endorsed by the workplace policy committee of the NSWBC.

Contact:

Mark Frost
Chief Economist, NSW Business Chamber Limited
mark.frost@nswbc.com.au +612 9458 7259

Dean Tyler
Associate,
Australian Business Industrial
dean.tyler@ablawyers.com.au +612 9458 7583

Introduction

ABI and the NSWBC (collectively referred to as ABI) appreciate the opportunity to make a submission to the 2018-19 Annual Wage Review. Under the *Fair Work Act 2009* (Act) the Fair Work Commission (FWC), constituted by an expert panel (Panel), must undertake an annual wage review (AWR) each financial year.

The Panel has, as its statutory function, the review of modern award minimum wages, which may or may not lead to their variation, and the national minimum wage order (NMWO). The review must give rise to a new NMWO, and the Panel must take account of the rate of the national minimum wage (NMW) it proposes to set in the NMWO in any determination to vary (or set or revoke) modern award minimum wages.

The Act requires the Panel to weigh up the trade-offs presented by the inherent tensions in the statutory factors that it must take into account. ABI considers that recent increases, including those awarded as part of the in 2016-17 and 2017-18 AWRs of 3.3 per cent and 3.5 per cent respectively, were beyond the magnitude of what could be viewed as modest, and that they sub-optimally balanced the statutory considerations.

With this in mind, ABI recommends a more cautious approach than was taken in both the 2016-17 and 2017-18 AWR decisions and recommends an increase of not more than 2.3 per cent. ABI considers an increase within this range would limit detrimental impacts discussed in this submission while delivering improvements in the living standards of those on the minimum wage. The need for a cautious approach is heightened due to the cumulative impact of successive minimum wage increases which have been well in excess of broader wages growth. An increase of the magnitude recommended by ABI will maintain the relative impact of these recent increases and will not weaken the standing of award-reliant workers.

While the multitude of other influencing factors mean disemployment effects are difficult to observe, ABI contends that large increases in real minimum wages, particularly where they rise much faster than broader wages growth or improvements in productivity, will almost certainly contribute to reduced demand for the labour of impacted workers.

While the labour market has strengthened over the past year, this does not guarantee additional buffers to accommodate further large increases in minimum wages. Improvements in labour market conditions are not broad-based with many of the most award-reliant industries performing poorly. Employment growth among lower skilled occupations has not been strong while job vacancies for these occupations are lower than a year ago. In geographic terms, improvements in labour market conditions have been concentrated in New South Wales and Victoria as conditions in other jurisdictions have been much weaker. Large minimum wage increases concentrate pressures on the most vulnerable members of the workforce including those with few skills or experience, youth, the long term unemployed, and those located in disadvantaged regions.

Simultaneously productivity growth is low and cannot be relied on to underpin wages growth. A low productivity environment requires more moderate wage increases to help maintain competitiveness and employment growth.

ABI also encourages a cautious approach due to weaker economic conditions and a particularly uncertain economic outlook with the Australian economy facing significant downside risks.

Guide to this submission

This submission is divided into three parts. Part I examines the contemporary economic context of the 2018-19 AWR decision, Part II will examine the social costs of excessive minimum wage increases, and Part III will articulate the specific recommendations of this submission.

Note on terminology

As noted above, ABI recommends an increase to the NMW of not more than 2.3 per cent. ABI also proposes that the Panel apply the percentage of the proposed NMW increase to modern award minimum wages.

This submission refers to a change to the 'minimum wage', 'minimum wages' or the NMW in this context. That is, any reference should be viewed as referring to the totality of implications associated with changes to modern award minimum wages and other wages impacted by the AWR decision.

Relatedly, this submission often refers to the award-reliant workforce. This concept is applied broadly to refer to members of the labour force (both employed and unemployed) whose wages are affected, either directly or indirectly, or whose employment prospects are influenced by AWR decisions.

Part I — Economic context

Economic conditions are relevant to the AWR process due to the statutory considerations that must be taken into account by the Panel.

The economic context is relevant in a number of key ways. When considering whether to vary (set or revoke) minimum award wages the economic factors to be taken into account are those referenced under the minimum wages objective, the modern awards objective and the general matters prescribed under the object of the Act. To summarise, the Panel must take into account the performance and competitiveness of the national economy and the likely impact of any exercise of modern award powers on business, while the broader objects of the Act include the promotion of productivity and economic growth for Australia's future economic prosperity.

Similarly, social factors are also referenced under the minimum wages objective, the modern awards objective and the objects of the Act. This includes, but is not limited to, taking into account the relative living standards and the needs of the low paid. The need to encourage enterprise-level collective bargaining is also accommodated under the statutory framework provided for by the Act. Each of these considerations is affected by or underpinned by economic circumstances existing within the entire economy or those that impact on particular sub groups. The need to examine economic conditions is therefore both an explicit and implicit requirement borne out of the statutory framework.

Recent economic data reveals the economy has performed weaker than anticipated. At the same time there is significant uncertainty in the economic outlook. There are signs that weaker housing prices are impacting the real economy through weaker household demand and falling dwelling investment. At the same time the drought is having a significant impact in some parts of Australia while surveys reveal that businesses are less confident about their prospects.

On the other hand, there are some areas of strength. This includes strong employment growth and falling unemployment. While labour market indicators are favourable overall, it is not clear that they have generated improved employment outcomes for the award-reliant workforce. Indeed, by some measures labour demand is weaker in parts of the economy to which the award-reliant workforce is most exposed.

The macroeconomic environment and economic outlook

The performance of the Australian economy weakened in the second half of 2018 with economic growth performing well below official forecasts in both the September and December quarters. GDP grew by 2.3 per cent over the year to the December quarter, the slowest pace of growth since June 2017. GDP per capita fell in both the September and December quarters.

Table 1: Key macroeconomic indicators

Indicator	2017-18 AWR	Contemporary
GDP growth (tty) December quarter 2017 / December quarter 2018	2.4 per cent	2.3 per cent
GDP growth forecast (RBA) year ending June 2019 / year ending June 2020	3½ per cent	2¾ per cent
GDP growth forecast (Treasury) year ending June 2019 / year ending June 2020	3 per cent	3 per cent
GDP per hour worked (%chg, tty) December quarter 2017 / December quarter 2018	-1.0 per cent	0.8 per cent
GVA per hour worked – market sector (%chg, tty) December quarter 2017 / December quarter 2018	-0.9 per cent	0.7 per cent
real unit labour costs (%chg, tty) December quarter 2017 / December quarter 2018	0.9 per cent	-1.0 per cent
business-related bankruptcies year ending December 2017 / year ending December 2018	4,172	4,295
wages share of total factor income December quarter 2017 / December quarter 2018	52.8 per cent	52.2 per cent
profits share of total factor income December quarter 2017 / December quarter 2018	26.6 per cent	28.5 per cent
real net national disposable income (%chg, tty) December quarter 2017 / December quarter 2018	1.5 per cent	3.7 per cent
real net national disposable income per capita (%chg, tty) December quarter 2017 / December quarter 2018	0.0 per cent	2.1 per cent
headline CPI (%chg, tty) March quarter 2018 / December quarter 2018	1.9 per cent	1.8 per cent
headline CPI forecast (RBA) year ending June 2019 / year ending June 2020	2¼ per cent	2 per cent
underlying inflation March quarter 2018 / December quarter 2018	2 per cent	1.8 per cent
underlying inflation forecast (RBA) year ending June 2019 / year ending June 2020	2 per cent	2 per cent (Trimmed mean)

Source: ABS, ASFA, Treasury and RBA.
Notes: Data listed under the column "2017-18 AWR" references the latest data that was available at the time of the 2016-17 decision and does not include subsequent revisions. Seasonally adjusted used where available.

While the Australian economy continues to be supported by low interest rates and a low Australian dollar, several areas of weakness have emerged including falls in dwelling investment and slower growth in household demand.

Consumption growth has slowed with falls in household spending for electricity, gas and other fuel, purchases of vehicles, and furnishings and household equipment. Indeed, household demand has been weaker than first thought with downward revisions to most quarters over recent years. Weaker household demand may be linked to falling housing prices. Vehicle purchases are sensitive to changes in housing wealth, while demand for furnishings and household equipment are sensitive to housing market turnover.

Also weighing on growth has been the impact of the drought which has weakened rural activity and exports. Farm GDP fell by 5.8 per cent over the year to December 2018. A 2018 survey by NSWBC indicates that the impact of drought is being experienced beyond the primary industries, with 84 per cent of respondents across regional New South Wales indicating they were impacted (either directly or indirectly).[1]

On the other hand, the economy has been supported by strong public demand with government expenditure growing by 5.6 per cent and public investment growing by 9 per cent through the year (in part driven by high levels of infrastructure investment).

Economic outlook

Recent economic data suggests there is a degree of ambiguity as to the state of the Australian economy. While in some areas the economy is performing strong (such as the labour market), in others the economy has been much weaker (such as household demand).

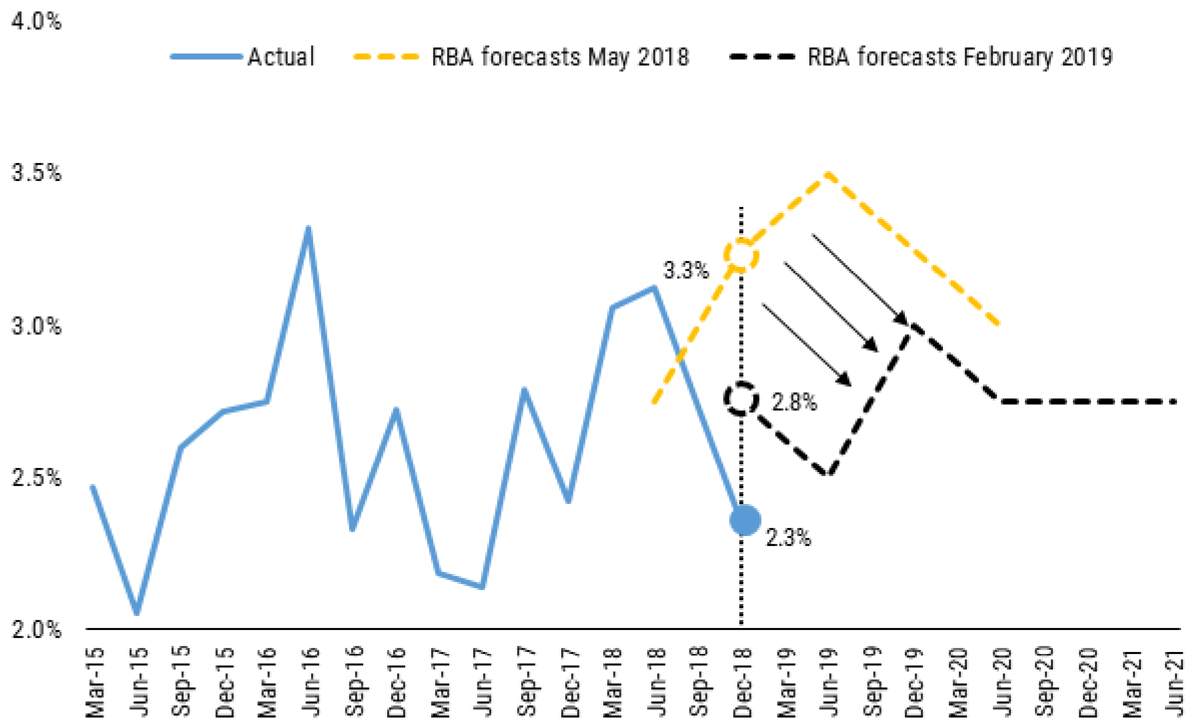
There are also significant downside risks to the economic outlook. This includes concerns relating to housing markets, slower economic growth in China, global trade tensions, uncertainty in the outlook for household demand, and signs of slowing construction. Overall there is significant uncertainty in the economic outlook with certain parts of the economy more vulnerable than in previous years. Dwelling investment may also represent a more considerable drag on the economy than had been expected.

ABI notes that there have been significant downward revisions to the economic outlook, including in the RBA's recent Statement on Monetary Policy in February (Chart 1 refers). The economy performed weaker in 2018 than had been expected at the time of the May Statement (which contained the RBA's most up to date forecasts at the time of the 2017-18 AWR decision). Meanwhile, the RBA has made significant downward revisions with growth forecasts falling from 3½ per cent for year-ended June 2019 (in the May statement) to 2½ per cent (in the February statement).

Even with these revisions, the December quarter GDP figures demonstrate that forecasts were too optimistic with the economy growing by 2.3 per cent compared to the 2.8 per cent forecast in the February statement. It remains to be seen whether contemporary data will precipitate further revisions to the RBA's outlook.

[1] The drought survey is accessible at: https://www.nswbusinesschamber.com.au/NSWBC/media/Policy/Drought-Survey-2018-Report-Final_1.pdf.

Chart 1: Revisions to the economic outlook (RBA)



Source: ABS, RBA Statement of Monetary Policy (May 2018 and February 2019)

Employment and the labour market

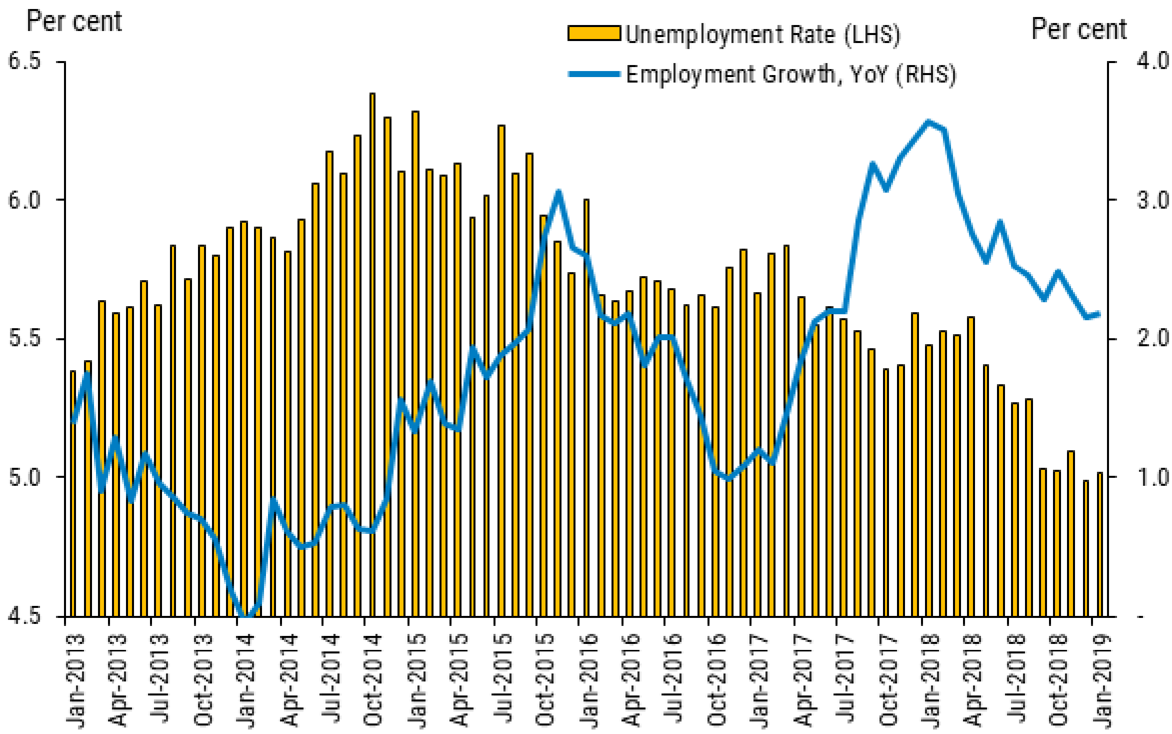
Strong employment growth has seen the unemployment rate fall to 5 per cent in seasonally adjusted terms, down from around 5.5 per cent a year earlier (Chart 2 refers). Employment growth has moderated to 2.2 per cent in the 12 months to January 2019, down from 3.5 per cent earlier in 2018. That said, job vacancies indicate employment growth is likely to remain strong. Official forecasts expect the unemployment rate to remain at around 5 per cent in the near term. Labour force participation is near record-highs.

Despite the improvement in labour market conditions, the gains have not been broad-based. New South Wales and Victoria account for a disproportionate share of new jobs generated over the past year. Indeed, the rest of Australia actually shed jobs over the past year with falling employment in Tasmania, Northern Territory, and the Australian Capital Territory; and very slow employment growth in Queensland, South Australia and Western Australia. Regional breakdowns reveal consistently high unemployment persists in many regions across Australia.

Youth unemployment remains a significant concern in many parts of Australia. In some regions one in four workers aged 15-24 are actively looking for work while the youth unemployment rate is 11.5 per cent Australia-wide. The youth unemployment rate is not alarmingly high relative to historical standards, however, it is influenced by relatively favourable conditions in New South Wales and Victoria. Youth unemployment is above 15 per cent in South Australia (15.4 per cent), Western Australia (17.2 per cent) and Tasmania (18.6 per cent).

While the unemployment rate has fallen, the long term unemployment ratio remains elevated (Chart 3 refers). Over 2018 around a quarter of those looking for work have been unemployed for a year or more. ABI further notes that, despite strong employment growth overall and falls to the unemployment rate, the underemployment rate has remained at elevated levels (Chart 4 refers). This suggests there remains spare capacity in the labour market that is yet to be absorbed.

Chart 2: Unemployment rate and employment growth



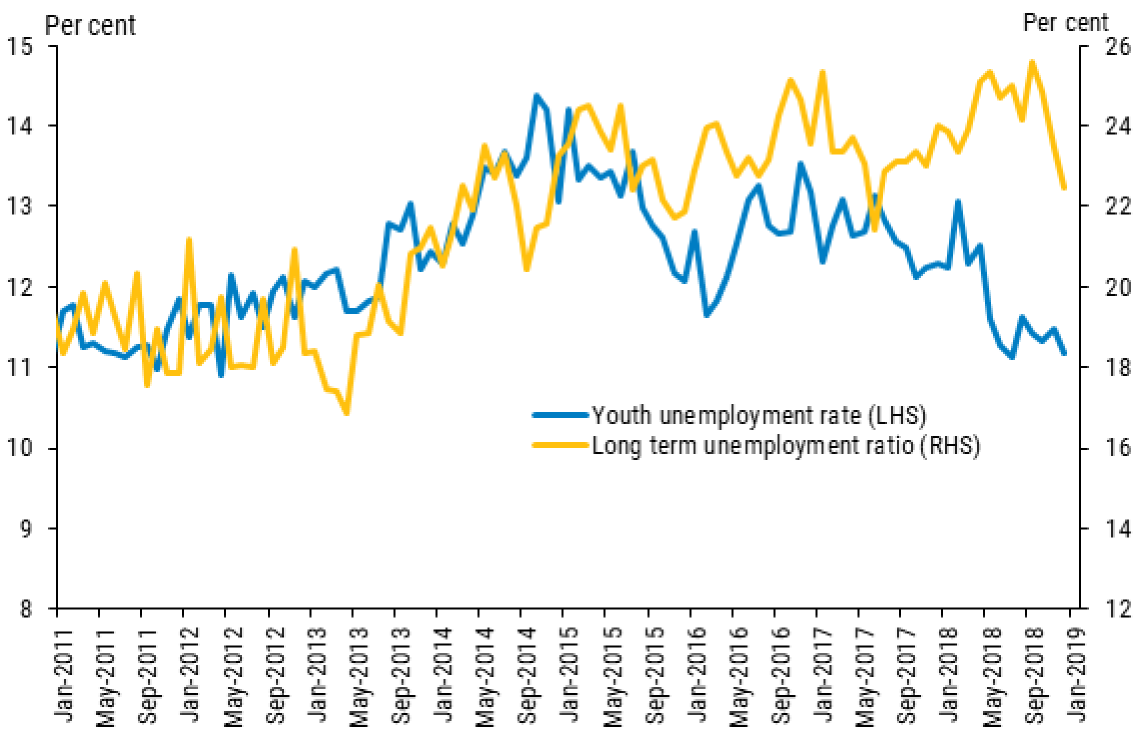
Source: ABS

Table 2: Labour market indicators

Indicator	2018 Decision	Contemporary
employment growth (%chg, tty) April 2018/January 2019	2.7 per cent	2.2 per cent
growth in hours worked (%chg, tty) April 2018/January 2019	5.4 per cent	3.2 per cent
Unemployment rate April 2018/January 2019	5.6 per cent	5.0 per cent
Participation rate April 2018/January 2019	65.6 per cent	65.7 per cent
Youth unemployment rate April 2018/January 2019	12.6 per cent	11.5 per cent
Long-term unemployment ratio April 2018/January 2019	25.0 per cent	24.1 per cent
Average weekly ordinary time earnings (full time) November 2017/ November 2018	2.4 per cent	2.3 per cent
Wage price index (private sector) (%chg, tty) March 2018/December 2018	1.9 per cent	2.3 per cent

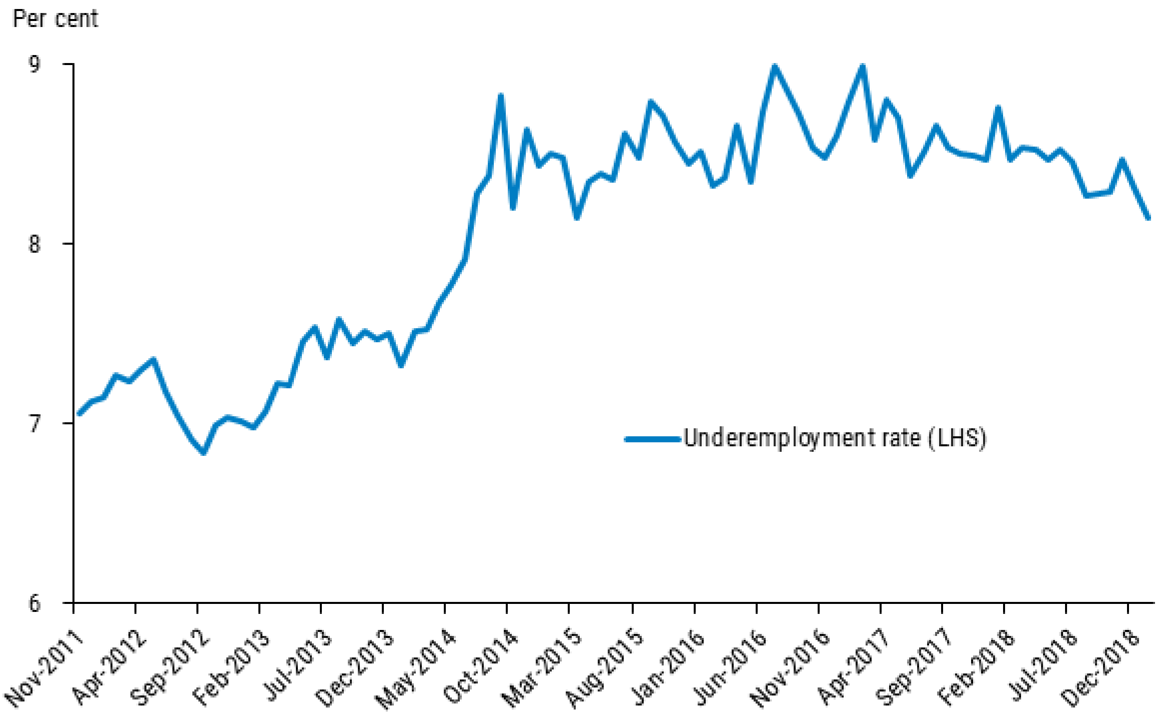
Source: ABS
Notes: Data listed under the column "2018 decision" references data that was available at the time of the 2017-18 decision and does not include any subsequent revisions. Seasonally adjusted figures used where available.

Chart 3: Long-term unemployment and youth unemployment



Source: ABS

Chart 4: Underemployment



Source: ABS

Inflation and wages growth

A range of measures indicates there is price stability in the Australian economy. What is particularly notable is that prices, including consumer prices and employee wages, have grown at a much slower pace than other periods.

In particular, it can be observed that over recent years the NMW has increased at a much faster pace than both the Consumer Price Index (CPI) and measures of wages growth (Chart 5 refers). The NMW is more than 18 per cent higher than in March 2013 whereas the CPI is only 11 per cent higher and the Wage Price Index (WPI) 13 per cent higher (Chart 6 refers). ABI notes the RBA has revised down its inflation outlook due to the impact of falling petrol prices. Inflation is expected to fall to 1¼ per cent with underlying inflation slightly higher at 1¾ per cent for year-ended June 2019. The RBA does not expect inflation to return to within the range of the RBA's inflation target until 2020.

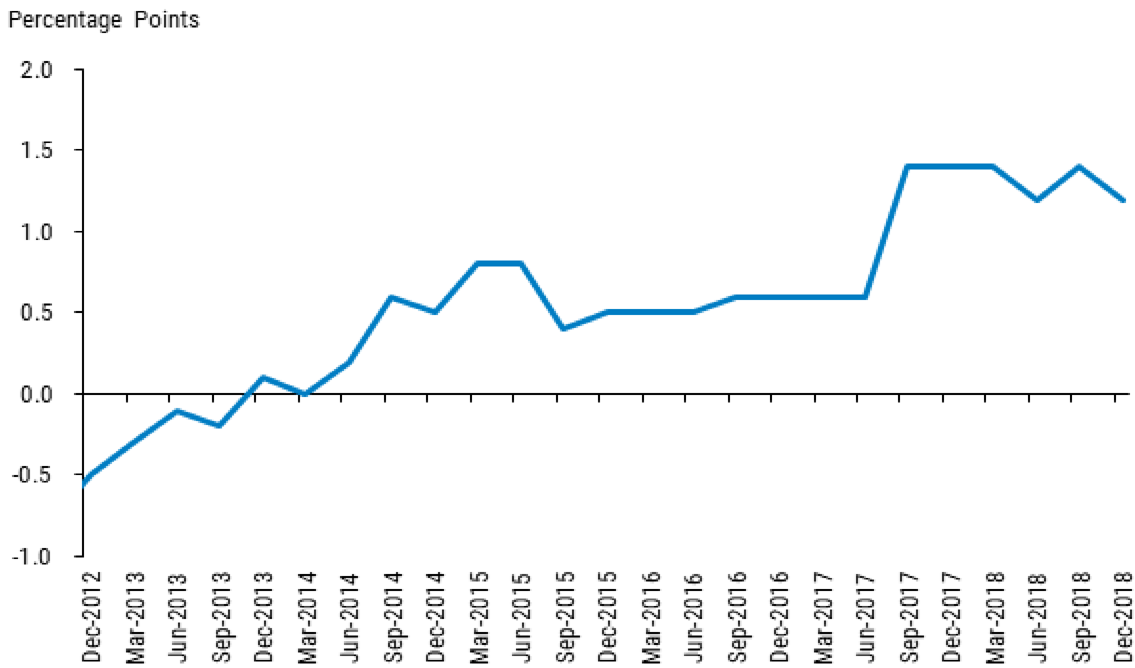
Low wages growth by historical standards is not confined to Australia. Indeed, Australian wages growth over the last decade has been at the high end among comparable countries internationally. This limits the persuasiveness of explanations for slower wages growth that relate to factors idiosyncratic to Australia, including the policy architecture relating to wage setting.

There are a number of implications of low inflation in the context of minimum wage setting. In a low inflationary environment there is less scope for firms to leverage price increases to fund wages growth. Instead, firms must absorb labour costs that increase at a faster pace than inflation leading to negative consequences for labour demand, business competitiveness/viability and employment growth. With inflation currently below the RBA's target of between 2-3 per cent, there is less scope for price adjustments to support firms' adjustment to a new cost structure.

A low inflationary environment also has implications for relative standards of living and the needs of the low paid. Where broader wages growth is relatively slow — as it has been when measured by the WPI — the minimum wage does not need to increase by the same extent to maintain (or improve) relative living standards. Stable prices helps to retain the purchasing power of wages with smaller increases capable of delivering improved living standards.

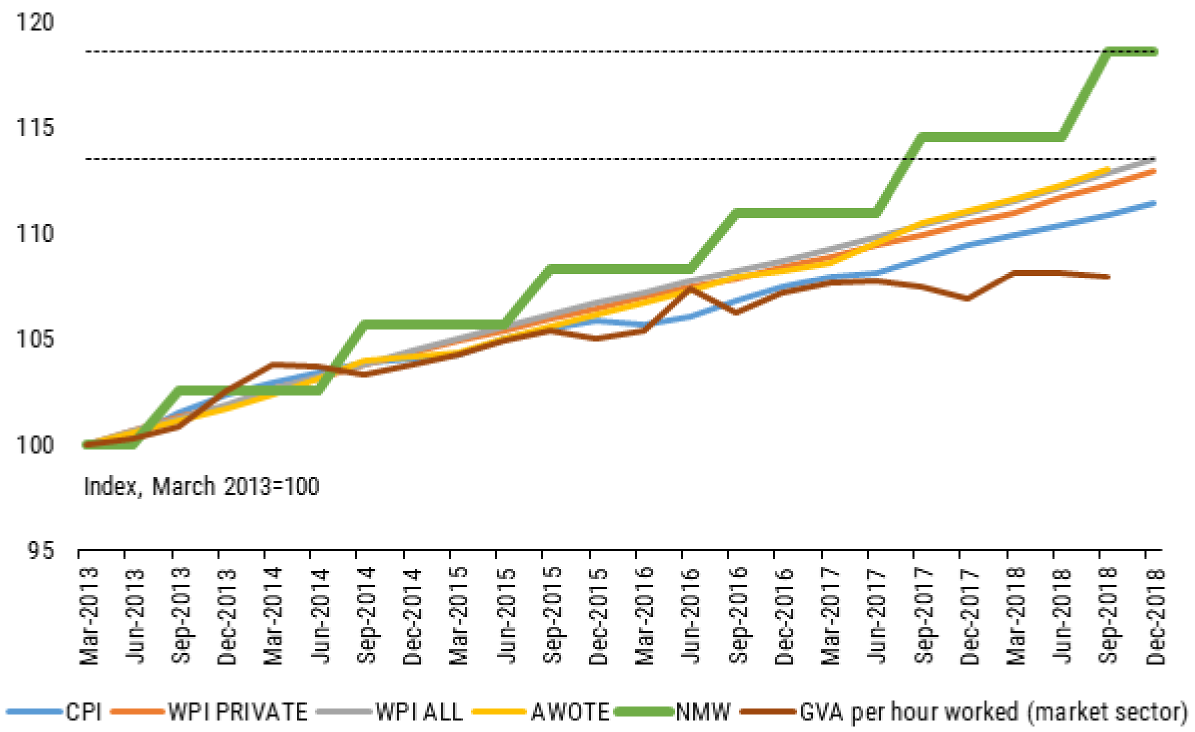
When considering changes to the minimum wage, it is essential to recognise that the quantum of a minimum wage increase in nominal terms offers little insight as to its impact. Increases awarded over the past two years (of 3.3 per cent and 3.5 per cent) were large by the standards of recent history. They also represented very large increases when observed in real terms. This is particularly striking with last year's increase the largest since the 2009-10 AWR when the minimum wage was increased by 4.8 per cent following a nil increase the year before. It was also higher than the 3.4 per cent increase awarded in 2011 at time when inflation was 3.3 per cent — far higher than today.

Chart 5: Difference between growth in the WPI and the NMW



Source: ABS, NSWBC calculations

Chart 6: Prices growth since March 2013



Source: ABS, NSWBC calculations

Productivity growth

Any minimum wage increase beyond productivity gains contributed by award-reliant employees will increase labour costs and have broader consequences for firms, labour demand and economic competitiveness.

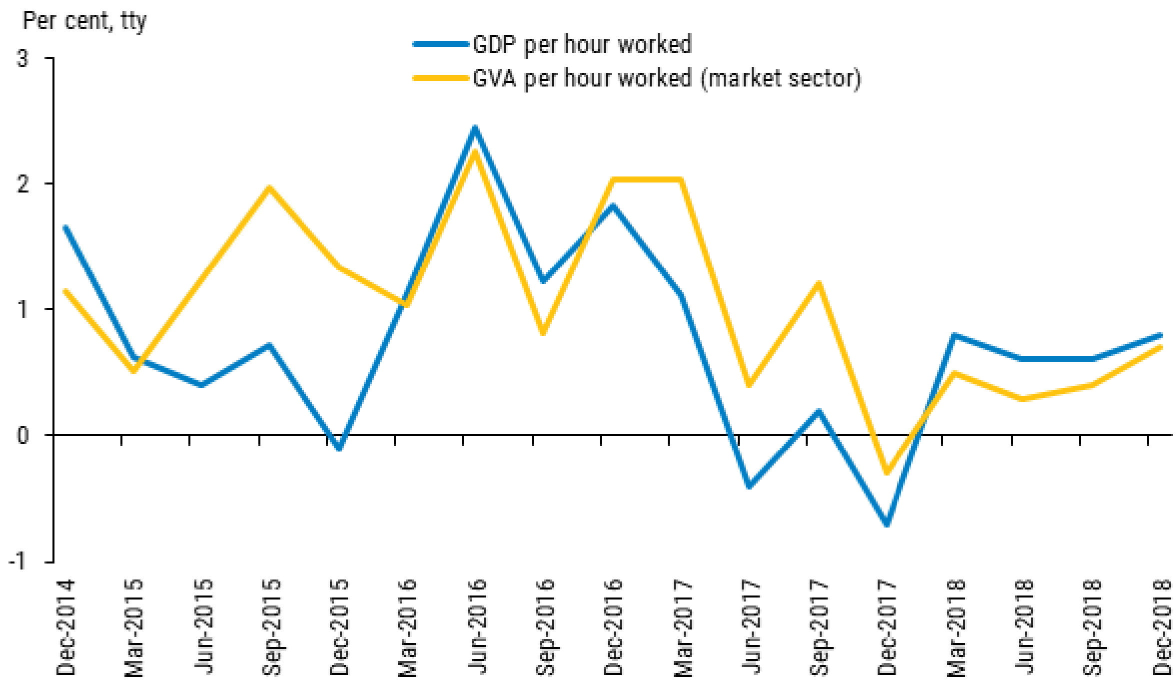
Real wage increases that are not backed by productivity growth are unsustainable and will harm Australia's international competitiveness. For this reason the Panel should consider the extent to which recent developments in wages growth and productivity are able to support an increase in the minimum wage.

Productivity growth — when measured by both GDP per hour worked or gross value-added per hour worked in the market sector — has been lower than wages growth over recent years (Chart 7 refers). Average productivity growth in the decade 2009-2018 has been lower than for the decade 1999-2008. Productivity growth has declined over the past decade with average productivity growth over the past two years lower than the two years prior. There is little basis to justify a minimum wage increase on the basis of improved productive capacity with year-ended productivity growth averaging around half a percent over the past four quarters (to December 2018).

Low productivity growth as it relates to minimum-wage setting may be further exacerbated by the uneven distribution of productivity gains throughout the workforce. Higher value-added labour possesses greater potential for productivity improvement given they are more likely to benefit from capital deepening, human capital gains and technological change.

As a result, aggregate productivity indicators may significantly overstate the direct productivity gains of the award-reliant workforce. With productivity growth already low at aggregate levels, there is cause to be concerned that productivity growth may be negligible or even negative for segments of the award-reliant workforce.

Chart 7: Productivity growth



Source: ABS

Business profits

A recent contention made by some parties and commentators has been that business profits have been soaring while wages have flat lined. Some go further to suggest that interventionist approaches are needed to achieve a rebalancing of wages and profits. At the outset, ABI states its rejection of both assertions.

To begin with, company profits have fallen from the relatively high levels recorded in 2017. While they remain above the decade average, improved profitability is not evenly distributed across the economy and business profits aggregated at the macro level cannot be relied on to infer the capacity of firms to deliver higher wages to award-reliant employees.

Company gross operating profits among the most award-reliant industries[2] have grown at around half the pace of all other industries. In addition, company gross operating profits have been heavily influenced by increased mining capacity together with a recovery in commodity prices. In the December quarter mining profits were equal to 85 per cent of total gross operating profits across all industries. So while company profits are up 10.5 per cent overall, company profits excluding mining grew by only 2.5 per cent.

Further, patterns of business profitability need to be seen within a longer run context. In the short-to-medium-term, profits' share of income tends to be highly affected by movements in Australia's terms of trade rather than any underlying structural factors related to Australia's workplace relations system.

ABI is also aware of recent commentary comparing growth in company profits compared to growth in wages. Even though non-mining company profits grew at around the same pace as broader wages growth (but much slower than last year's increase to the NMW), the comparison is a false equivalence. This is because growth in profits over the long term is driven by increases to the capital stock whereas measures of wages growth, such as the WPI, are a unit measure that is not influenced by changes in the size of the labour force.

Total compensation of employees has grown at a pace commensurate with growth in the labour force, which has been slower than the growth in the capital stock.[3] Any process of capital deepening, as occurred in Australia during the mining boom, will have an impact on capital and labour's share of total factor income but this is because income is boosted overall.[4] It is not because profits are displacing income that would have otherwise flowed to labour (in a zero sum sense).

Business conditions

Business surveys indicate deteriorating business confidence in the economy over recent quarters.[5] ABI notes that business surveys can be a useful indicator of current economic conditions (noting time lags in official data) and a leading indicator for future economic trends.

The Panel may be interested in the NSWBC Business Conditions Survey (the Survey). The Survey measures business perceptions of the New South Wales economy, and business performance across metrics such as profits, revenue, staffing and capital expenditure. The Survey is completed by around 1,000 businesses (though respondent numbers vary) and has accurately indicated broader economic trends in New South Wales. While the Survey does not report on business conditions across the rest of Australia, it provides useful insights into

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[2] Retail trade; Accommodation and food services; Rental hiring and real estate services; Administrative and support services; and Other services.

[3] The capital stock has grown at around twice the pace of the labour force over the past 15 years.

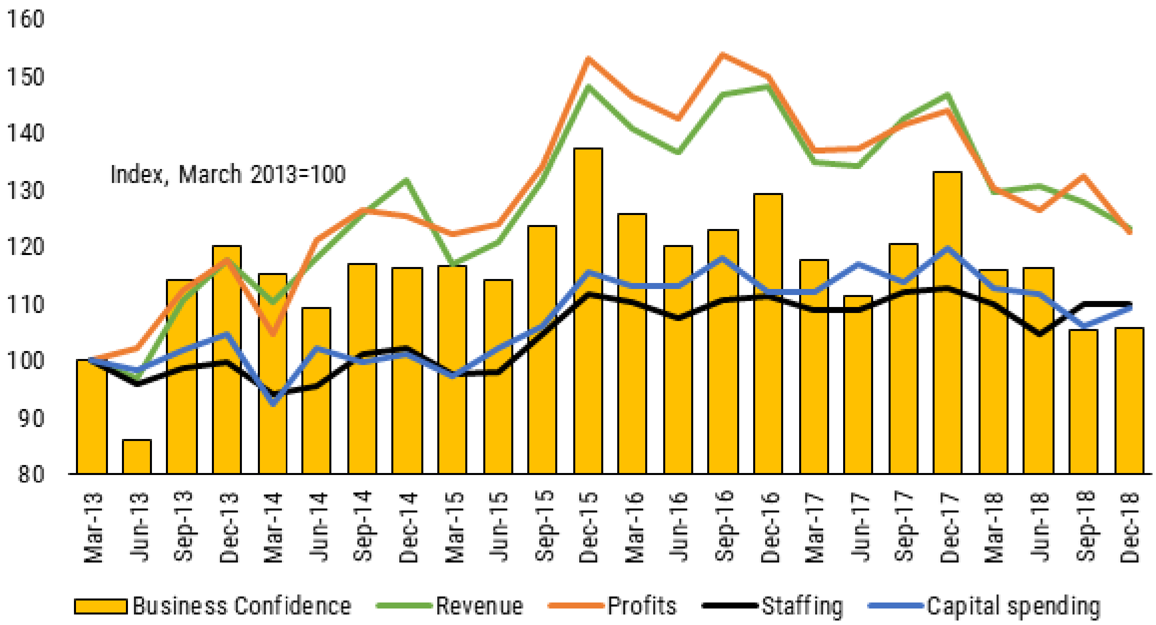
[4] Explored in Parnham (2013), *Labour's Share of Growth in Income and Prosperity, Productivity Commission Visiting Research Paper*, accessible at: https://www.pc.gov.au/research/supporting/income-prosperity/income-prosperity.pdf.

[5] Including the NAB Quarterly Business Survey and Sensis Business Index.

business conditions in New South Wales, a state that accounts for around a third of the national economy.

Reflecting the state's recent economic strength, the Survey has pointed to strong levels of business confidence and performance over the past several years. However, overall business confidence has recently fallen to levels not seen since June 2013 (Chart 8 refers). Business performance, including with respect to revenue and profits, is also falling according to the Survey. The December quarter survey results were particularly disappointing given business performance usually improves leading up to Christmas (the Survey is not seasonally adjusted). At this stage it would appear that businesses are continuing to hire staff and invest, albeit at a slightly slower pace than over recent years.

Chart 8: NSW Business Conditions



Source: NSWBC[6]

Note: Index calculated based on net scores (100 per cent plus the percentage of respondents reporting improved conditions minus the percentage reporting weaker conditions). 'Business Confidence' refers to respondents perceptions around the strength/weakness of the economy. See source link below for further survey details.

[6] For full results see https://www.nswbusinesschamber.com.au/Issues/Business-Surveys/Business-Conditions.

Part II – Social costs of excessive minimum wage increases

Both the minimum wages and modern awards objectives of the *Fair Work Act 2009* require the Panel to consider:[7]

- the relative living standards and needs of the low paid;
- social inclusion through increased workforce participation;
- the principle of equal remuneration for work of equal or comparable value; and
- economic considerations.

When taken together these considerations require an assessment of a broad range of factors. Among the most prominent is the relationship between changes to the minimum wages and labour demand. If on the one hand larger minimum wage increases benefit the low paid by boosting the living standards of affected employees; they may yet be detrimental overall if they reduce labour demand such that there are fewer employment opportunities for the unemployed. Even so a minimum wage increase resulting in higher salary and wages overall (when netting off the impact of reduced labour demand) may not be optimal with respect to the statutory framework given the need to consider social inclusion through workforce participation and other economic considerations.

ABI notes that disemployment effects associated with changes to the minimum wage has been actively considered by the Panel. As part of the 2016-17 decision, the Panel advised it considered it had been "overly cautious" in its regard for disemployment effects.[8] It would appear that this recalibration gave rise, at least in part, to decisions in the 2016-17 and 2017-18 AWRs which were significantly higher than in previous years.

It is essential to consider each decision on its own merits. The relationship between a change to the minimum wage and the impact that it will have on labour demand and the employment prospects of award-reliant workers is essentially unknowable. That said, previous AWR decisions have framed its thinking through the general observation that "…modest and regular minimum wage increases do not result in disemployment effects or inhibit workforce participation."[9] This framing invites the question as to what constitutes a 'modest' increase.

ABI contends that what constitutes a 'modest' increase is significantly lower than what was awarded in the 2016-17 and 2017-18 AWRs given:

- the impact of relatively large increases in recent AWR decisions;
- sustained low prices growth in the Australian economy (including wages and consumer prices);
- data suggesting award-reliant workers may not have benefit from strength in the labour market; and
- the need to create entry-level employment opportunities.

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[7] Para 9, [2018] FWCFB 3500.
[8] Para 523, [2017] FWCFB 3500.
[9] Para 80, [2018] FWCFB 3500.

Changes in labour demand do not occur instantly

An increase to the minimum wage that is significantly larger than broader wages growth will change the relative prices of high and low value-added labour. If low value-added labour becomes more expensive in relative terms, firms may alter its profile of labour demand.

While the labour force is not homogenous, there may nonetheless be substitution between different types of labour according to their cost-effectiveness in relative terms. A shift toward higher-value added labour unaffected by changes to the minimum wage can happen in a number of ways. For example, firms may decide to make greater use of higher value-added labour, to the extent substitution is possible, to perform business activities. Alternatively, firms may reallocate resources (through changes to investment and other business decisions) to activities that make greater use of higher value-added labour.

These processes may occur in response to the cumulative impact of successive changes in relative prices and do not necessarily occur instantly. There may be some capacity for firms to absorb higher wages for a period, however in the long-run they will generally seek to optimise their cost structure (including through changes in labour demand) and allocate resources to their most productive use. Even for the most responsive firms, practical barriers may delay action in response to changes to the minimum wage.

ABI has noted that the distribution of productivity gains might not be evenly distributed throughout the workforce and may be concentrated in cohorts which make greater use of human capital, technology and physical capital. This is likely to exacerbate processes relating to the substitution of labour in response to relative price changes.

Data constraints severely limit the ability to observe a relationship between minimum wage setting and the demand for labour. Empirical issues include a lack of control data to isolate the impact of minimum wages from other economic developments and an inability to isolate analysis to examine the impact on vulnerable workers (such as youth or the long-term unemployed).

Indeed, the Panel's view that "…modest and regular minimum wage increases do not result in disemployment effects…"[10] is in part justified by studies unable to find statistically significant evidence. For example, the Panel cited Bishop (2018)[11] as the "…strongest new evidence in support of this view…".[12] It is notable that Bishop (2018, p16) made clear that although no statistically significant evidence was found, "…this does not rule out an adverse effect on employment." Bishop (2018, p15) also stressed that the results may not generalise to larger increases.

A further observational issue relates to time lags between which minimum wages are adjusted and any subsequent response in labour demand. As discussed above, firms do not

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[10] Para 259, [2018] FWCFB 3500.

[11] Bishop J (2018), *The Effect of Minimum Wage Increases on Wages, Hours Worked and Job Loss*, RBA Research Discussion Paper RDP 2018-06, accessible at: https://www.rba.gov.au/publications/rdp/2018/pdf/rdp2018-06.pdf

[12] Para 259, [2018] FWCFB 3500.

necessarily react immediately[13] and for some firms may reflect the cumulative impact of successive minimum wage increases rather than a continuous response to wage changes. This exacerbates the challenge of attributing any change to labour demand with a change to the minimum wage within statistical models. With respect to his research, Bishop (2018, p15) notes:

> *"…my paper studies fairly tight windows around FWC decisions, and thus gives valid estimates of the effect of the minimum wage on hours worked and job loss only if employers take less than six months to adjust to changes in the award wage."*

ABI maintains that the impact of changes to the minimum wage on labour demand cannot be appropriately captured within a six-month window or other models which attribute a synchronised response.

ABI emphasises that 'absence of evidence' should not be interpreted as 'evidence of absence.' Difficulties in finding an observable empirical relationship between two factors does not mean it does not exist. Indeed, when economic theory is suggestive of a relationship between two factors, then it ought to be the default view if there is no strong empirical evidence to the contrary.

Overall the most prudent approach is to be cautious and to use broader wages growth as a guide as to the capacity of the economy to absorb higher wages without weakening labour demand. ABI contends that following successive increases of 3.3 per cent and 3.5 per cent, both well above inflation and broader wages growth, it would be appropriate for the Panel to allow these increases to be absorbed by awarding a more modest increase in the 2018-19 AWR.

This in part justifies ABI's recommendation of 2.3 per cent. An increase of this magnitude would maintain wage relativities without contributing further significant changes before the impact of earlier AWR decisions can be fully appreciated.

Award-reliant workers and the labour market

Any discussion around the potential for disemployment effects must occur within the context of developments in the labour market. Strong labour demand across the board — for example during times of strong employment growth, low unemployment and high levels of job vacancies — may reduce, to some extent, the Panel's concern about disemployment effects. One interpretation might be that there is sufficient pent up demand for labour such that minimum wage increases can be absorbed.

However, such a view cannot be formed based on aggregate labour market data with the impact of the minimum wage more profound for some workers than for others. Aggregate demand for labour can offer only limited insights for segments of the labour market that are highly award-reliant. This is because only a minority of Australia's labour force is impacted

[13] Such as because it may take time for businesses to fully appreciate the impact on their cost structures, or because practical considerations mean there is some inertia between an intended response and its implementation.

by AWR decisions and what may be true for the aggregate (for example, evidence of favourable labour market conditions overall), may not necessarily be replicated for award-reliant workers. Conditions in the labour market overall are therefore an insufficient proxy to inform an assessment of how changes to the minimum wage may affect award-reliant workers (most specifically their employment prospects).

ABI has earlier noted that while there is strength in the labour market, the gains have not been broad-based in geographic terms. Other labour market indicators suggest that strength in the labour market may not necessarily have translated into improved employment prospects for award-reliant workers.

One approach to observe employment trends in industries with a relatively high degree of award reliance. Overall, labour market conditions in the most award reliant industries have deteriorated over the past year. Employment growth (over the year to November 2018) in each of the six most award-reliant industries[14] was slower than for all industries combined. *Retail trade* and *Other services* recorded negative employment growth shedding 36,500 jobs combined. Employment in four out of the six most award-reliant industries grew at a slower pace than the same time last year. Those that grew faster than last year — *Rental hiring and real estate services* and *Administrative and support services* — account for a much smaller share of employment compared to those that grew at a slower pace or where employment fell.

Examining labour force data at the industry level does not provide a complete picture given the factors accounting for industry performance are unique and may not reflect the vulnerabilities that award-reliant workforce may face (for example if employment growth were in jobs inaccessible to award-reliant workers). ABI also notes that award-reliant workers account for a minority of employed persons in every industry.

As a result, there is merit in examining trends at the occupation level. Again, there are significant limitations with weaker visibility of levels of award-reliance for specific occupations.

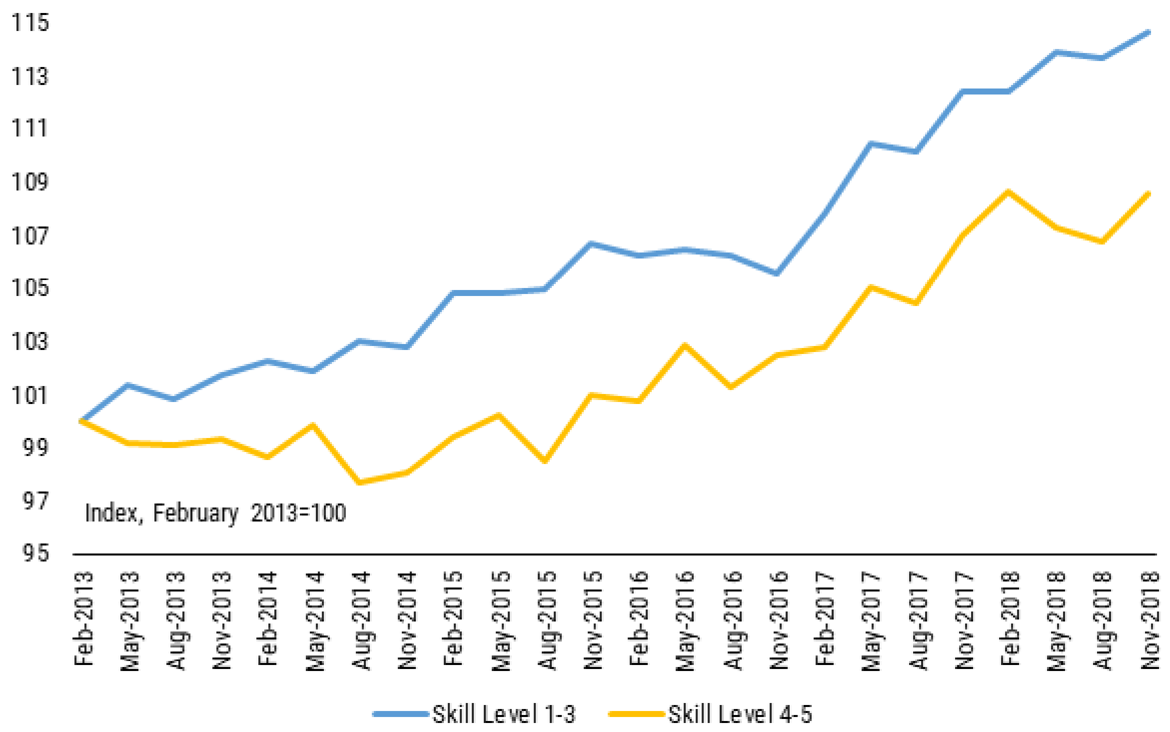
While it is not possible to gain a comprehensive view from occupation-level data, it is useful to examine employment trends based on skill-level classifications. While the skill-level classification of an occupation is not synonymous with its level of award reliance (indeed, awards cover employees working in higher skill-level classifications), employment trends among skill-level cohorts is relevant because they reflect on the employment prospects of workers with fewer skills or experience. These workers are among the most vulnerable members of the workforce.

When examining employment disaggregated by occupation and skill level groupings it is apparent that higher skilled occupations have accounted for a larger share of job gains over the last several years, in both absolute and relative terms (Chart 9 refers). Based on Australian and New Zealand Standard Classification of Occupations (ANZSCO) skill

[14] Retail trade; Accommodation and food services; Rental, hiring and real estate services; Administrative and support services; Healthcare and social assistance; and Other services.

classifications, occupations at skill levels 4-5 have grown at a much slower pace than occupations with higher training or experience requirements. Further, vacancies at skill levels 4-5 are actually lower than they were a year ago, while vacancies at skill levels 1-3 are 3 per cent higher.

Chart 9: Employment growth by skill level



Source: ABS, NSWBC calculations
Note: Skill level 1 requires the highest level of formal qualifications/experience

While aggregate labour market data has been a particular area of strength for the Australian economy over the past year, there is evidence that these gains have not improved employment conditions for the most vulnerable members of the labour force. Specifically:

- The geographic distribution of employment gains have not been broad-based with many parts of Australia experiencing weakness in their labour markets. This includes jurisdictions with persistently high unemployment and youth unemployment rates, and employment growth that is unable to support growth in the labour force.
- Employment gains have been more accelerated in industries with lower levels of award-reliance (such as *Mining; Financial and insurance services*; *Professional scientific and technical services*; and *Public administration and safety*) while weaker or negative in industries with higher-rates of award reliance. Over the past year, around 9,000 jobs were lost among the six most award-reliant industries combined. Overall, employment conditions in the most award-reliant industries are much weaker than last year.

- Employment growth in entry-level positions has been weak with fewer job vacancies (at skill levels 4-5) than a year ago.

For these reasons ABI recommends a cautious interpretation, for the purposes of the 2018-19 AWR decision, of recent labour force trends even though they have been broadly positive at the aggregate level.

Skills development and human capital formation

Divergence in the growth rate of high verses low skilled jobs is not a new phenomenon. It reflects broader structural changes in the economy and upskilling. While projecting future trends requires a high degree of speculation, the trajectory is very clear. Automation and technological innovations such as artificial intelligence and machine learning are likely to accelerate these trends. For the most vulnerable members of the labour force, including youth and the long-term unemployed, there is a risk that the availability of entry-level job opportunities will significantly diminish as a result of these trends.

If this eventuates, a broad suite of policy responses will be needed including greater flexibility to upskill workers through direct engagement within the labour market. Upskilling will be particularly vital to ensuring all Australians benefit from the dividends of technological innovation.

High entry-level wages, including due to the minimum wage, limits the ability for employers to nurture and develop the skills of staff. On-the-job training and the accumulation of experience, including through the apprenticeship and traineeship system, is a key source of human capital formation yet there are significant impediments for their potential to be fully realised. While formal education — including through the tertiary education system — is heavily subsidised, the potential to build human capital through work experience is not (apart from in some limited instances).

While the benefits of training and experience are large, they primarily accrue to the employee and so there is underinvestment in human capital accumulation via these channels. This underinvestment occurs in at least two ways. Firms are less likely to engage in activities dedicated to the upskilling of existing staff, but perhaps more perversely, employers are incentivised against taking on new inexperienced or untrained staff with a view to upskilling them for the purposes of filling higher value-added jobs. Large increases to the minimum wage discourage employers from taking on entry-level staff for the purposes of upskilling.

As noted above, entry level job opportunities at skill levels 4-5 have declined over the past year when measured by job vacancies. There is no shortage of unskilled and inexperienced workers seeking job opportunities given high rates of youth unemployment in some parts of Australia. Slower growth in the availability of lower skilled positions also has the effect of limiting the opportunities available to the long-term unemployed.

Part III – Specific recommendations

ABI's recommended increase

It difficult for parties to account for increases recommend to the Panel given the range of factors that must be considered and the complexity of trade-offs involved. Notwithstanding this challenge, ABI has given consideration as to the nature of any increase that would be broadly suitable to the conditions faced by employers and the needs of award-reliant employees. ABI submits that, within the contemporary context, broader price movements in the economy should anchor changes to the NMW. ABI is of the view this approach offers a useful foundation for determining a change to the NMW that optimises outcomes with respect to the statutory considerations.

Upon assessing a broad range of price measures in the economy, ABI has come to a view that an increase of not more than 2.3 per cent would be appropriate in the current economic environment.

To be clear, ABI does not argue that changes to the NMW should be mechanically linked to measures of prices growth such as CPI. That said, ABI notes that an increase of not more than 2.3 per cent is capable of delivering a significant real wage increase (with current and expected inflation well below this amount) and that it would see wage increase which are in line with the WPI.

ABI notes that this amount is higher than what ABI recommended in its submission to the 2017-18 AWR. ABI emphasises that these recommendations are not linked and that a higher recommended increase this year should not be inferred to imply that conditions are suited to a larger increase than what was awarded in previous years. Indeed, the opposite has been argued in the substantive arguments put forward in this submission.

The role of quantified recommendations

As noted in submissions to previous AWR decisions[15], ABI remains concerned about the lack of clarity for submitting parties about how the Panel comes to quantify the minimum wage increase that it considers provides the best-balanced outcome across the statutory considerations.

An area of concern previously raised is the lack of guidance as to how the Panel comes to translate the range of factors that it must consider into a quantified increase to the minimum wage. Specifically, what processes, heuristic or otherwise, does the Panel utilise to translate qualitative analysis into a quantifiable change to the NMW believed to be optimal with reference to the statutory considerations.

[15] For example, ABI's submission to the 2017-18 AWR.

Relatedly, ABI notes the Panel's practice of outlining submitting parties recommended changes to the minimum wage as part of its decision statement.[16] This in turn encourages recommendations which are nominated for their communication value and potentially reduces the decision's focus on parties' underlying arguments justifying their recommendations.

The Act requires the Panel to weigh up the trade-offs presented by the inherent tensions in the statutory factors that it must take into account. Viewed from this perspective quantified recommendations offered by parties would seem to offer very little value in terms of the Panel's actual task of taking into account the statutory considerations in the circumstances prevailing at the time of review.

Highlighting parties' proposals could be interpreted to imply that stakeholder recommendations (as opposed to broader aspects of their submissions) are a significant factor in the Panel's deliberations.

ABI encourages the Panel to consider how it can reduce or mitigate the potential for ambit informing parties' recommendations and to better explain what processes it undertakes to translate its assessment of the statutory considerations into a quantified increase.

Making the NMWO and determinations about modern award minimum wages

ABI has recommended any increase to the current NMW and any variation determination affecting modern awards is cautious having regard to the current low inflation, low wages growth environment and also having regard to the skew of positive economic variables away from where award-reliant employment is most concentrated.

An increase of the magnitude of last year's 3.3 per cent increase, or an increase approaching that quantum, would not represent an appropriate balance of the matters to be taken into consideration. Despite its misgivings about the practice of recommending identified increases, ABI has recommended that any increase to the current NMW be not more than 1.9 per cent.

Implementation

ABI also proposes that the Panel apply the percentage of the proposed NMW increase to modern award minimum wages. Varying modern award minimum wages by the percentage rate of increase to the NMW is consistent with the Panel's past practice[17], and it is consistent with the Panel's statutory obligations.

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[16] Paras 51-54, [2018] FWCFB 3500.

[17] Para 104, [2016] FWCFB 3500.

The National Minimum Wage Order

Following its review the Panel must make a new NMWO[18]. Assuming that the *National Minimum Wage Order 2018* follows the format of the *National Minimum Wage Order 2017* ABI proposes that the *National Minimum Wage Order 2018* reads as follows

- The NMW weekly and hourly rates (Clause 4.1) be set to reflect the Panel's decision;
- The casual loading (Clause 5.1) be set at 25 per cent;
- *Special National Minimum Wage* 1 (applying to employees with a disability whose productivity is not - affected Clause 6.2(a)) be set at the same rate as provided in clause 4.1;
- *Special National Minimum Wage 2* (applying to employees with a disability whose productivity is affected - Clause 7) be set in as in NMWO 2017. The rates prescribed in Appendix A, cll A.3.2 and A.8.3, be adjusted and set in the same way as the minimum amount payable under the Supported Wages System when that new rate becomes available to the Panel;
- *Special National Minimum Wage 3* (providing rates of pay for junior employees - Clause 8.2) be set as in NMWO 2017;
- *Special National Minimum Wage 4* (applying to apprentices - Clause 9) be set in as in NMWO 2017 with the rates prescribed in cl 9.3 set to reflect the determined increase to the proportionate classification rate;
- *Special National Minimum Wage 5* (applying to employees under a training arrangement which is not an apprenticeship - Clause 10) be set as in NMWO 2017.

Determinations about modern award minimum wages

For the purposes of modern awards ABI makes the following proposals:

- Modern award minimum rates be increased by the same percentage as the determined increase to the NMW for the NMWO 2018;
- Each cell of the National Training Wage schedules in the relevant awards (including clause E5 Schedule E in the *Miscellaneous Award 2010*) be increased by the same percentage rate as the determined increase to the NMWO 2018;
- The minimum amount payable under Supported Wages System schedules (at cll X.4.2 and X.10.3) be increased to the new amount set as the income test threshold for the Disability Support Pension becomes available to the Panel.

Casual loadings

The casual loading in the *Business Equipment Award 2010* be increased to 23 per cent, but the casual loading in all other modern awards not be increased and remain at 25 per cent.

The Equal Remuneration Order

In its 2017 decision the Panel said

[18] PR593544.

[698] We have decided that the increase we have awarded in modern award minimum wages should apply to those transitional instruments which remain in operation. That is the approach that has been taken in previous Reviews, and no interested party submitted that any different course should be taken.

[699] A different approach applies in relation to copied State awards currently in operation. Given the absence of any submissions on this matter, we have decided that increases to these instruments should be consistent with the approach set down in previous Review decisions, and the following increases will apply to copied State awards:

- *an increase of 3.3 per cent applies to wage rates in copied State awards that were not the subject of a state minimum wage decision that commenced after 1 July 2016 and before 1 July 2017;*
- *an increase of 1.65 per cent applies to wage rates in copied State awards that were the subject of a state minimum wage decision that commenced after 1 July 2016 and before 1 January 2017; and*
- *no increase applies to wage rates in copied State awards that were the subject of a state minimum wage decision that commenced on or after 1 January 2017 and before 1 July 2017.*[19]

ABI proposes that the rates in the relevant transitional instruments be increased consistently with any increase determined for modern award minimum wages [item 12A(5) Schedule 3; items 10(1) and 20(1) Schedule 9].

Paragraph [699] of the 2016-17 decision deals with copied state awards. This part of the Panel's decision was subject to further proceedings following which the Panel corrected an error and also advised a preliminary view about a different approach to copied state awards from the one determined in para 699 for parties to consider.[20]

ABI makes no submissions about the variation of copied state awards arising from this review.

Allowances in modern awards

As ABI has previously noted the Commission has adopted the practice of issuing drafts of the changes to allowances including reimbursement allowances and draft orders, and providing for comment. ABI remains a strong supporter of this practice and thanks the Commission for so doing.

[19] Paras 698 and 699, [2017] FWCFB 3500.
[20] Paras 41 and 43, [2018] FWCFB 2.