

3. ECONOMIC IMPACT & COSTS

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3.1 PROBLEMS WITH METHOD

Distributional effects

- [3.1] The ACTU repeats its flawed methodology of focussing on the micro for needs (see Chapter 7) and the macro for cost and effect (Chapters 5 and 6). This inflates needs and deflates costs. ACCI could on the same basis very well argue that an increase in the minimum wage will:
- a. Increase aggregate after-tax income to all households by an insignificant amount; and
 - b. Harm specific identified businesses greatly.
- [3.2] There would be no less validity to this approach than the ACTU's approach.
- [3.3] Given that the ACTU makes submissions at great length about the characteristics of award workers, it should at the very least look at the costs on similar terms. Not examining costs on a disaggregated basis is just as valid as lumping millionaires together with the low paid for an analysis of needs.
- [3.4] Mirroring the approach taken in analysing the characteristics of award workers (Chapter 3 of the ACTU submission), the ACTU should analyse the impact of its claim on:

- a. Award dependent industries.
- b. The private sector.
- c. The non-managerial wage bill.
- d. The casual wage bill.
- e. Obviously, employers who are low paid¹.

[3.5] It should be fairly obvious that the cost of the claim for the relevant groups above will be much higher.

[3.6] For example, the cost of the increase for minimum wage workers is \$26.60 per worker or 5.7 percent (not including other costs).

[3.7] The relevant legislation does not support the inconsistent ACTU approach. Section 88B(2) could easily apply to macro as well as micro analysis. For example, this section states the Commission should have regard to economic factors. This could mean a macro analysis of economic factors – such as productivity growth in the economy as a whole, or a micro analysis – such as productivity growth at a firm level. Similarly, 88B(2)(c) could mean the aggregated needs of the low paid, of the needs of individuals who are low paid.

Net Cost

[3.8] The ACTU continues to make debatable assumptions in determining the net cost of its claim. These assumptions are not made sufficiently clear in its submission.

[3.9] The ACTU calculates the net cost of the claim by subtracting a certain percent increase (which we will call the ‘base case’) from each of the gross cost numbers.

[3.10] It appears that the ACTU is assuming that the base case is growth in wages equal to the outcome of the 2004 case². An increase in awards above the amount of the 2004 case (the base case) adds to wages in net

¹ In the sense of struggling to make ends meet.

² This is not entirely clear. ACCI’s analysis is largely based on the ACTU correspondence to parties of

terms; an increase below the 2004 amount reduces wages in net terms.

[3.11] This assumption is highly questionable.

- a. Firstly, why is the base case the outcome of the 2004 case? This is not made clear. Is the ACTU assuming that wages will increase in 2005 by the same rate as in 2004? No evidence is presented to support this argument; and Section 2 of this ACCI submission makes it clear that such an assumption is very unrealistic.
- b. Secondly, the ACTU is implicitly assuming that award workers will get no pay increase if awards don't increase. No evidence to support this position is presented.
- c. Thirdly, it assumes that the calculation of the net cost of last year's increase is correct, when it clearly is not. The errors in last year's calculation compound the errors in this year's calculation. The (incorrectly) low level of the 2004 costing is used to reduce the cost of the 2005 claim.

[3.12] In essence, the ACTU is making very heroic assumptions about what the increase in wages will be in the absence of an award increase.

[3.13] As an example, if an employee was awarded a 4 percent increase last year, then the 'base case' is 4 percent. This means that the ACTU is arguing that the net cost to the economy of a 4 percent increase this year is zero. It is hard to see how this is possible.

[3.14] The ACTU ends up with the very unusual argument that a pay increase will reduce costs (see table 5.3).

[3.15] An extreme example will make this clear – a 100 percent increase in the wage bill last year will make the 'base case' an increase of 100 percent. This means that a 100 percent increase this year will cost nothing and a 50 percent increase this year will cut the total wage bill by 50 percent. This is absurd.

[3.16] Therefore, the Commission should place no weight on the ACTU's approach.

28 February 2005.

Over award payments

[3.17] The ACTU continues to ignore over-award payments (refer Tag 4). This is despite the substantial number of people who receive these payments.

Second round effects

[3.18] The ACTU also ignores second round effects, such as the effect of the CPI increase on wages.

Effect on business costs

[3.19] The ACTU appears to think that the only relevant figures to calculate are wages and CPI.

[3.20] The ACTU does not cost the impact on business of the wage claim. Businesses don't just pay wages. They must also pay a variety of on-costs, including payroll tax, superannuation and workers' compensation.

[3.21] As the ACTU argues, almost all the organisations that will pay the claim are businesses.

[3.22] Therefore, just calculating the effect on the wages bill is an interesting academic exercise but of limited relevance to the case before the Commission.

Unit Labour Costs

[3.23] A very important development in the Commission's consideration of this matter in the current circumstances is that labour productivity is falling – it fell by 0.4 percent in 2004 (or 0.6 in the market sector). This means that unit labour costs are increasing, even without *any* increase in wages.

[3.24] This emphasises the need to take account of ACCI's argument that wage increases should be linked to productivity. The table below examines various changes to C14. In all cases, increases are above productivity changes.

[3.25] This table calculates the real increase in wages by subtracting an assumed CPI increase of 2.3 percent for 2005 (as used in Table 5.5 of the ACTU submission). Note that CPI for 2005 could be significantly higher (see Chapter 2). From this is subtracted the labour productivity change for 2004. The fourth column of the table shows the excess of the claim above market sector labour productivity while the fifth column uses the whole of the economy measure of labour productivity.

Table 3.1:

Safety Net Adjustment and Increasing Unit Labour Costs

Safety Net Adjustment (\$)	Percentage Increase [^] (%)	Real SNA Increase [`] (%)	Excess Real SNA Over Market Productivity*	Excess Real SNA Over Productivity*
10.00	2.1	-0.2	0.4	0.2
11.00	2.4	0.1	0.7	0.5
12.00	2.6	0.3	0.9	0.7
13.00	2.8	0.5	1.1	0.9
14.00	3.0	0.7	1.3	1.1
15.00	3.2	0.9	1.5	1.3
16.00	3.4	1.1	1.7	1.5
17.00	3.6	1.3	1.9	1.7
18.00	3.9	1.6	2.2	2.0
19.00	4.1	1.8	2.4	2.2
20.00	4.3	2.0	2.6	2.4

[^] Wage Group - C14 at \$467.40 per week.

[`] CPI Increase 2005 assumed 2.3.

* GDP per Hour Annual Seasonally Adjusted Growth to December 2004 -0.4 (-0.6 Market Sector).

[3.26] For example, an increase of \$20 in the minimum wage will increase unit labour costs to the average employer by 2.6 percent, while a \$15 increase will increase unit labour costs by 1.5 (of course costs will be higher for some employers). It is hard to see in this context how a minimum wage increase will not have an effect on employment.

Lack of other costings

[3.27] In addition to not calculating labour costs, the ACTU fails to estimate the impact of the wage increase on growth, productivity and employment.

[3.28] Perhaps they think that their claim will have no impact on these variables at all. This is an entirely implausible outcome, and a position which would require substantial evidence to sustain.³

3.2 ACCI CALCULATION

[3.29] The simplistic macroeconomic costing the ACTU have put forward also fails to show the effects on just the private sector where the cost of their claim will fall in the macro-economy. Private sector earnings are affected to a much greater extent than the average for both private and public sector figures the ACTU present. When only the private sector is presented the costs of the claim are clearer, since the private sector will bear the cost of the increases. This is a central consideration that must be remembered in any assessment of costs.

**Table 3.2:
Weighted ACTU Proposed Increase for Private Sector
Award Only Employees**

	Adults				Juniors	Total
	Full-time		Part-time			
	Permanent	Non Permanent	Permanent	Non Permanent		
Proportion (%)	30.4	6.1	15.1	31.3	17.1	100.0
Weight	1.00	1.20	0.50	0.60	0.40	
Weighted Increase (\$)	26.60	31.92	13.30	15.96	10.64	
Proportional Increase (\$)	8.09	1.95	2.01	5.00	1.82	18.86

* Weighting the flat dollar increase of \$26.60 using ACTU data from the 2003 submission.

[3.30] The ACTU assumes a full-time adult works 38 hours a week, inappropriately ignoring overtime and any other award payment the employee may be in receipt of, and receives the full award increase granted by the commission. Every full-time award employee is given a weighting of one. This weighted increase is then factored into the wages of award workers to produce the percentage point addition to private sector total weekly wages in table 3.2, using the ACTU methodology for comparison.

³ It is certainly implied in Chapter 6.

- [3.31] While ignoring overtime in the numerator the ACTU includes overtime earnings in the denominator, causing their calculations to be understated. Additionally, no flow-on effects are counted so that some import implications of the safety net adjustment process are lost in the costing. But what is clear when using just the private sector is that the cost is much greater than what the ACTU present in averaging over all employees. Once an estimate of the effect of flow-ons is made in addition a more realistic estimate of the cost is produced.

- [3.32] The estimate for the flow-on was shown in last years ACCI submission at paragraph 10.17 through 10.23 and are unaltered this year.

- [3.33] The estimate derived on this basis of the addition to private sector earnings growth shows that the claim will add 0.78 percentage points to the rate of growth in private sector wages. This is a significant amount.

**Table 3.3:
Addition to Private Sector Total Earnings From a \$
26.60 Increase across the board**

	Proportion of Total Private Sector Employees	Proportion of Other Employees per Category Receiving Increases Directly Through Safety Net Decision	Proportion of Privates Sector Employees Receiving Increases Directly Through Safety Net	Weighted Increase Sought	Addition to Earning Growth	Private Sector Employees Total Earnings	Addition to Private Sector Earnings
	(%)	(%)	(%)	(\$)	(\$)	(\$)	(%)
Column	1	2	3	4	5	6	7
Data Source or Calculation	ABS	ACCI	1*2	ACTU Methodology	3*4	ABS	5\6
Private Sector Award Dependent Employees	24.6%	100.0%	24.6%	\$18.86	\$4.64	\$724.80	0.64%
Other employees	75.4%	7.0%	5.3%	\$18.86	\$1.00	\$724.80	0.14%
Total	100.0%						0.78%

[3.34] ACCI has indicated that it will not oppose a \$10.00 increase, given the state of the economy and the uncertain economic climate. ACCI has produced a costing using the ACTU methodology of a \$10.00 flat increase to all awards including an estimate of flow-ons to inform the Commission⁴.

**Table 3.4:
Addition to Private Sector Total Earnings From a
Flat \$10.00 Increase to all awards**

	Proportion of Total Private Sector Employees	Proportion of Other Employees per Category Receiving Increases Directly Through Safety Net Decision	Proportion of Privates Sector Employees Receiving Increases Directly Through Safety Net	Weighted Increase Sought	Addition to Earning Growth	Private Sector Employees Total Earnings	Addition to Private Sector Earnings
	(%)	(%)	(%)	(\$)	(\$)	(\$)	(%)
Column	1	2	3	4	5	6	7
Data Source or Calculation	ABS	ACCI	1*2	ACTU Methodology	3*4	ABS	5*6
Private Sector Award Dependent Employees	24.6%	100.0%	24.6%	\$7.09	\$1.74	\$724.80	0.24%
Other employees	75.4%	7.0%	5.3%	\$7.09	\$0.37	\$724.80	0.05%
Total	100.0%						0.29%

[3.35] The private sector costings shows the effect on wages over the entire private sector. A more detailed examination of the effect on award only wages is also warranted.

⁴ Note that ACCI does not support an across-the-board increase. However, this costing is for an across-the board increase for comparative purposes. It is also difficult to do a costing for an increase that is limited to the lowest paid, because there is very little useful data on the number of employees at these pay rates.

Table 3.5:
Percentage Increase in Private Sector Award
Only Average Weekly Total Earnings

	2000	2001	2002	2003	2004	2005
SNA Decision (\$)	15.00	13.00	18.00	17.00	19.00	26.60 [^]
Weighted SNA Increase (Private Sector Weights) (` (\$)	10.63	9.22	12.76	12.05	13.47	18.86
	May-00	May-01	May-02	May-03	May-04	May-05
Award Only Private Sector AWTE (\$)	391.20		412.80			
Estimated Award Only Private Sector AWTE* (\$)		401.80		425.60	437.70	451.20
Private Sector Award Only Increase (%)	2.7	2.3	3.1	2.8	3.1	4.2

* Estimated adding weighted increase derived using ACTU weighting methodology.

[`] Slightly understates impact due to overtime omission.

[^] ACTU proposed.

- [3.36] What the table demonstrates is the very large percentage increases that have taken place in award wages. The first row of the table shows the actual amount granted in Safety Net deliberations and the proposed increase from the ACTU in the latest case. The increases are then weighted using the ACTU methodology to produce an average increases for all private sector award employees and shown at row 2.
- [3.37] Based on the increases granted, we can estimate the average weekly total earnings series by adding the weighted increase to the average weekly total earnings for award only private sector employees. These estimates will be slightly lower than actuals since the effect of overtime is not included but this difference will only be slight in this context.
- [3.38] Row 3 shows the actual amounts as reported in the EEH survey for 2000 and 2002 and these figures are adjusted with the weighted increase to show the years for which no data is available. This estimated series is shown in row 4. Then we can calculate the addition

to private sector award only employees average weekly earnings. The present ACTU claim of 26.60 represents an estimated increase of 4.2 percent on top of the very large increases granted previously.

- [3.39] Given that 19.9 percent of all employees are award based employees (according to the ACTU composite exhibit tag 4), the total cost of the claim will be the average increase, weighted by the number of award employees to receive the increase.
- [3.40] The ACTU calculated an increase of \$18.73 for all award employees, including the public sector. Multiply this by the 19.9 percent of employed people who are on awards. In January 2005 the number of employed people stood at 9,851,600 in trend terms. Thus the total cost of the claim is 1,960,468 award wage workers each receiving an average increase of \$18.73. This represents an addition to the wages bill for award only employees of \$36,719,565.60 in 2005 assuming no employment growth and more than this if we account for new workers entering into award wage employment.

Including On-Costs

- [3.41] On-costs must be include in the calculations if any macroeconomic costing is to be achieved.
- [3.42] The on-costs associated with employment all rise in conjunction with wages. Taking the C14 level, the increase of \$26.60 per week for a full-time employee will cost an additional \$2.40 in superannuation, giving an increase of \$29.00 to the employer.
- [3.43] If payroll tax applies at an average rate of 5.5 percent then there would be an additional \$1.46 giving an increase of \$31.46. The table below shows a summary of payroll tax by jurisdiction.

**Table 3.6:
Payroll Tax Rates 2004-05**

State	Payroll Tax Rate (%)	Threshold \$,000
NSW	6.00	600.0
Vic	5.25	550.0
Qld	4.75	850.0
WA	6.00	750.0
SA	5.50	504.0
Tas	6.10	1010.0
NT	6.20	1000.0
ACT	6.85	1250.0
Australia*	5.50	662.0

Source: NSW Treasury, Interstate Comparison of Taxes, 2004-05.

*ACCI Calculation (weighted average)

- [3.44] Additionally, workers compensation insurance is levied at an average rate of 2.47 percent giving an extra \$0.66 cost at C14. Thus at the lowest level of the award rate spectrum the most basic on-costs attached to wage levels could likely be something of the order of \$4.50. Thus for many businesses the costs of the increase will be at least \$31.10 per week per C14 award employee.
- [3.45] The data on workers compensation is now outdated but is the latest available. More recent data by DEWR will be released imminently. The data does, however, indicate that rates do continue to grow and therefore the estimate may turn out to be understated. The latest data is below.

**Table 3.7:
Workers Compensation Rates November 2003**

Worker Compensation Jurisdiction	Standardised - excl. GST (%)	Change 2000/01 to 2001/02 (%)
NSW	3.06	6.03
Vic	2.43	-0.07
Qld	1.48	9.71
WA	2.42	-4.26
SA	2.21	-6.72
Tas	2.53	-3.21
NT	2.46	1.45
ACT	3.59	24.57
Australia	2.47	1.66

Source: DEWR, *Comparative Performance Monitoring*, November 2003.

- [3.46] The ACTU also does not consider the effect of the superannuation threshold level of \$450 per month. Award increases can push casual employees above this threshold, since the threshold is not adjusted annually to reflect changes in wages. Thus some employers will then also have to make superannuation payments for a greater proportion of their employees.
- [3.47] Nor does the ACTU claim take into account the introduction of superannuation choice of funds obligations on some 650,000 Australian employers from July 2005. This policy change will in and of itself impose additional regulatory costs on employers across all industry sectors.
- [3.48] Another major cost is the cost of overtime, which is relied on by some employees for increasing their earnings capacity.
- [3.49] In May 2002 award only employees relied on overtime payments for 4.9 percent of their weekly earnings and worked an average of 1.8 hours of overtime per week. This factor must be worked into the

weighted cost of the increase over the award sector since the impact will continuously be understated.

[3.50] It is incumbent on the ACTU to provide a revised / proper costing with overtime figures embodied into the weighted increase dollar amount produced in the two tables in Tag 4 - Costing the Claim.

3.3 EMPLOYMENT EFFECTS

Study by Andrew Leigh

[3.51] A paper by Andrew Leigh of ANU (formerly of Harvard University) was the subject of considerable debate in last year's case.

a. Leigh's study examined the difference in employment growth for Western Australia when it had different minimum wages to the rest of Australia. He concluded that increases in the WA minimum were associated with relative employment losses in that State.

[3.52] Since last year's decision, an erratum, comment and response on the paper have been published in the Australian Economic Review.

[3.53] The critique is by Ian Watson for the Australian Centre for Industrial Relations Research and Training at the University of Sydney. The rest of the papers are by Andrew Leigh.

[3.54] For clarity, attached to this submission are:

- a. The original Andrew Leigh Paper – Attachment 3-1
- b. The Andrew Leigh Erratum – Attachment 3-2
- c. The Ian Watson Critique – Attachment 3-3
- d. Andrew Leigh's response to Watson – Attachment 3-4

[3.55] Leigh's paper was the subject of some criticism in the 2004 decision. Some of the criticisms were raised in the Commission's decision of 2004 (at paragraph 214). The Commission in that decision argued that:

- [3.56] “In the circumstances we think that the appropriate course is not to place any weight on the study until it has been the subject of further debate.”⁵.
- [3.57] ACCI is mindful of the conclusions in paragraphs [229] to [231] of last years decision, and of the conclusions on Leigh’s research in particular.
- a. However, on consideration we maintain that these assessments are relevant to considerations in this matter.
 - b. A further assessment of the Leigh research should, we say lead the Commission to conclude it is not subject to mythological flaws.
 - c. We also seek to put further material before you on the relevance of single wage studies to the multiple minimum wage context in which these cases operate (noting that Leigh’s study was in fact undertaken in the context of a complex award wage system, not purely a US-style single minimum wage.
 - d. We also are aware that the Leigh/Watson discourse remains incomplete, and that this is one of the rare pieces of minimum wage research based on Australia, and therefore warrants a completion of discourse. This section provides the substance of debate on this research.
 - e. ACCI maintains that employment effects of minimum wages do remain a relevant consideration and in fact are very directly linked to the framework of considerations under the *Workplace Relations Act 1996*. It is on this basis that we seek to bring forward employment effects research on this occasion.
- [3.58] The criticisms and responses by Dr Leigh are outlined below. ACCI submits that Dr Leigh’s findings are robust to the critique – and that these considerations remain relevant to this case .

⁵ May 2004 Safety Net Decision, paragraph [215]

Control

- [3.59] It has been argued that Leigh does not control for important differences between WA and the rest of Australia, particularly that employment trends are going in different directions.
- [3.60] Leigh responds by stating that he has done significant work to show that he had taken account of any possible differences between WA and the rest of Australia:
- a. He determined that no single state or territory is a better control than the combination of all of them.
 - b. He showed that creating a ‘synthetic WA’ as a control (by weighting other states and territories) did not produce a better control.
 - c. He demonstrates that payroll tax changes were uncorrelated with changes in the WA minimum.
- [3.61] Leigh also points out that using the rest of Australia as control means that most shocks would not affect the results. To alter the results, a shock would have to impact on all states and territories except WA and be correlated with more than one of the minimum wage increases. It is difficult to see that this would be possible.
- [3.62] Leigh also tests for whether WA employment is trending away from employment in the rest of Australia, in particular by testing to see whether the employment gap (between WA and the rest of Australia) is expanding or contracting. He finds that there is no statistically significant change in the employment gap between WA and the rest of Australia. In any case, inclusion of this in the original model can *increase* the negative employment effect of minimum wages.

Calculation

- [3.63] It was argued that Leigh incorrectly calculated elasticities and employment to population ratios.
- [3.64] Leigh corrects these problems in an erratum (attached). Importantly, the correction makes the results more significant. The original paper

had two wage rises that had a significant and negative effect on employment; the revision means that four wage rises had a significant and negative effect on employment.

- [3.65] The employment effect of raising the minimum wage is increased as a result of this correction.

Aggregation

- [3.66] It is argued that there are problems with using ‘macrodata’ instead of microdata, because this assumes that all sectors of the labour market are roughly equivalent. Roughly, the criticism is that taking averages masks the performance of particular parts of the labour market (it should be noted that this criticism could be made of the ACTU’s costing methodology in this case).
- [3.67] Leigh responds by noting that the criticisms are actually of macroeconomic models, rather than macrodata. The main study cited in the critique actually uses macrodata to prove its point. Leigh’s study is a ‘natural experiment’ which is not a macroeconomic model. Leigh does acknowledge that it would be better to use micro data, but this is not available at this stage.

Choice of period

- [3.68] The critique argues Leigh investigates only the period three months before an increase and the period three months after an increase. Other periods could produce different results.
- [3.69] Leigh points out that this is the same period chosen as in Card and Krueger (1994), who are praised by Watson in his critique for having ‘methodological rigour’.
- [3.70] To check for the validity of the interval, Leigh recalculates the relationship for different before and after periods. The table below outlines the results:

	One month	Two months	Three months	Four months
Elasticity of labour demand	-0.17	-0.24	-0.29	-0.16

[3.71] The employment effect is negative for all periods; it is strongly statistically significant for one, two and three months. Leigh points out that it is not surprising that the estimate becomes less significant at four months, because other factors may be affecting employment in WA or the rest of Australia.

Endogeneity

[3.72] It is also alleged that Leigh has not controlled for endogeneity – the possibility that the policy is affected by labour market outcomes.

[3.73] Leigh responds by arguing that decisions in WA about minimum wage rises would be largely driven by political context rather than endogenous economic factors.

[3.74] In any case, Leigh argues that endogeneity would reduce the estimate of employment effect – so controlling for endogeneity would increase the measured effect of minimum wages on employment.

Standard errors

[3.75] The critique argues that the standard errors around the underlying data are too large for Leigh’s results to be accurate.

[3.76] Leigh responds by stating that all his statistical tests made use of the standard errors in the underlying data. Testing for significance using the ABS error data, Leigh showed in his original paper that his results are statistically significant.

Conclusion

- [3.77] Leigh makes the broader point that most of the critiques amount to stating that there are ‘errors-in-variables’. Leigh argues that if these errors would actually bias the result towards zero – so correcting for any remaining errors will *increase* the negative effect of minimum wages on employment!
- [3.78] In light of the robustness of Dr Leigh’s findings to these criticisms, ACCI believes that the Commission should re-examine Dr Leigh’s research and place significant weight on these findings.

Australian Award Structure

- [3.79] In previous years, the Commission has concluded that traditional studies of changes in a single minimum wage are of limited relevance to the case before it, because the ACTU’s proposal involves adjusting many award rates. There is some truth in this finding. Australia does have a relatively unique method of minimum wage setting.
- [3.80] With respect, ACCI does not agree with the understanding to date, for the following reasons:
- a. ACCI argues that the Commission should only adjust wage minimums at the bottom of the award structure. The traditional studies are clearly relevant to this proposal.
 - b. The relevance of these studies is also reinforced by the concentration of award only employees at the bottom of the income distribution (one of the key arguments of the ACTU, to the extent it is accurate).
 - c. It could be argued that employers have greater market power at higher salaries – so the theoretical argument for minimum wages⁶ disappears at higher salaries. Therefore, award increases at higher salaries clearly reduces employment.

⁶ The argument is that minimum wages can have a beneficial employment effect if employers have significant market power compared to employees. ACCI does not agree with this argument.

- d. Leigh's paper, referred to above, shows that an increase in the minimum wage has a negative employment effect. Given the previous point, this implies that the total employment effect of increases throughout the award structure is negative – and greater than the effect in Leigh's paper. This is evidenced in the following study.

Gindling & Tirrell paper

- [3.81] A study has recently been conducted of the effect of changes in multiple minimum wages in Costa Rica.⁷ ([Attachment 3-5](#)).
- [3.82] While there are differences between the Australian and Costa Rican system of regulating wages, there are also important similarities:
- a. At the start of the study period, there were over 500 minimum wages in Costa Rica; and
 - b. The Costa Rican minimum is around 70 percent of the average wage, which means it binds the wages of more employees and would be closer to the Australian minimum, which is the highest in the developed world.
- [3.83] Therefore the findings from the study should be informative to the Commission's deliberations in the case before it.
- [3.84] The paper finds that an increase in minimum wages does have a positive effect on wages, but cuts employment and hours worked by employees covered by the minimum wages⁸. In net terms, higher wages and shorter hours cancel each other out so that there is no effect on monthly earnings (so the on average the increases in minimum wages has no beneficial effect on incomes). The largest impact on wages and employment is in the lower half of the distribution.

⁷ Gindling & Terrell (2004) The effects of multiple minimum wages throughout the labor market IZA Discussion Paper No 1159, available from <http://ssrn.com/abstract=554044>

⁸ A 10 percent increase in the minimum increases real wages by 1.03%, cuts employment by 1.09% and hours worked fall by 0.6%.

[3.85] Some other relevant points from the study:

- a. Costa Rican minimum wages are typically adjusted twice a year and significant changes in the award structure occurred in the study timeframe. The study was able to use these frequent and substantial changes to ensure that the measured employment changes were solely due to minimum wages, and not due to external factors.
- b. Over the ten years from 1987 to 1997, the number of minimum wages was reduced from 500 (set by occupation, skill and industry) to 19 categories (set by skill only).

[3.86] This study should provide substantial assistance to the Commission in addressing its concern that existing studies only discuss adjusting a single minimum wage, when the current case is about adjusting many award wages.

3.4 MONTHLY UNEMPLOYMENT DATA

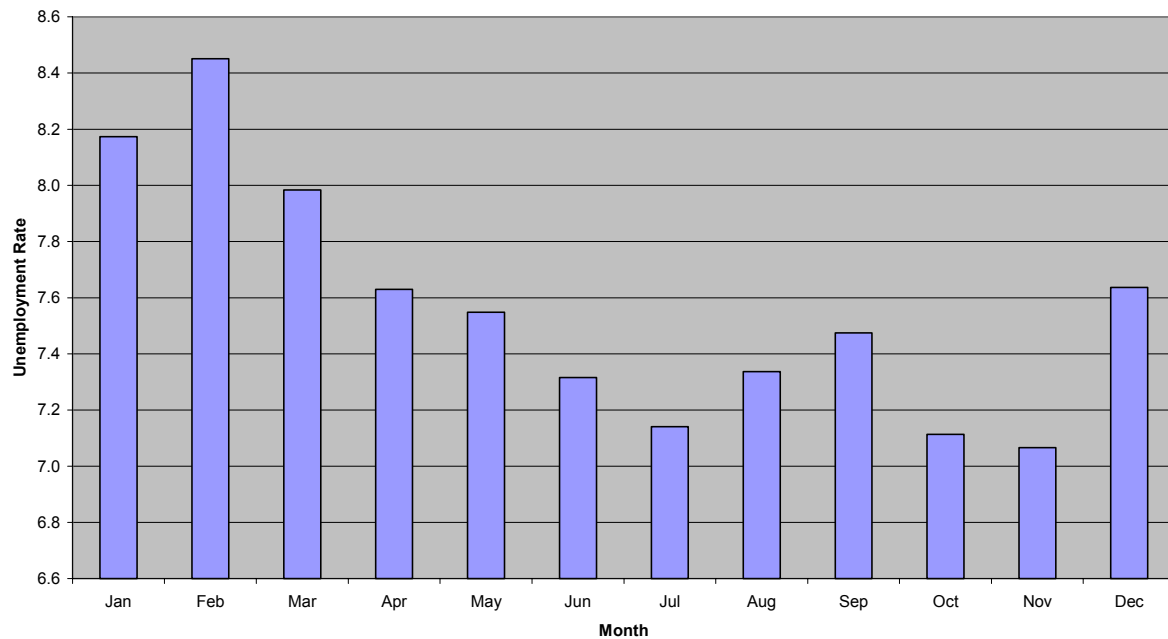
[3.87] As additional evidence for the Commission, ACCI has analysed the monthly unemployment data from the ABS, to see if there are any effects detectable when award wages are increased in July.

[3.88] There are significant caveats to the use of this data, which are addressed below.

[3.89] The first chart below shows average unemployment rates for each month since monthly data was first collected in February 1978. Note that there is a clear increase in unemployment in August and September, just after award increases generally take effect.

Table 3.8:

Australian unemployment - average for each month since 1978

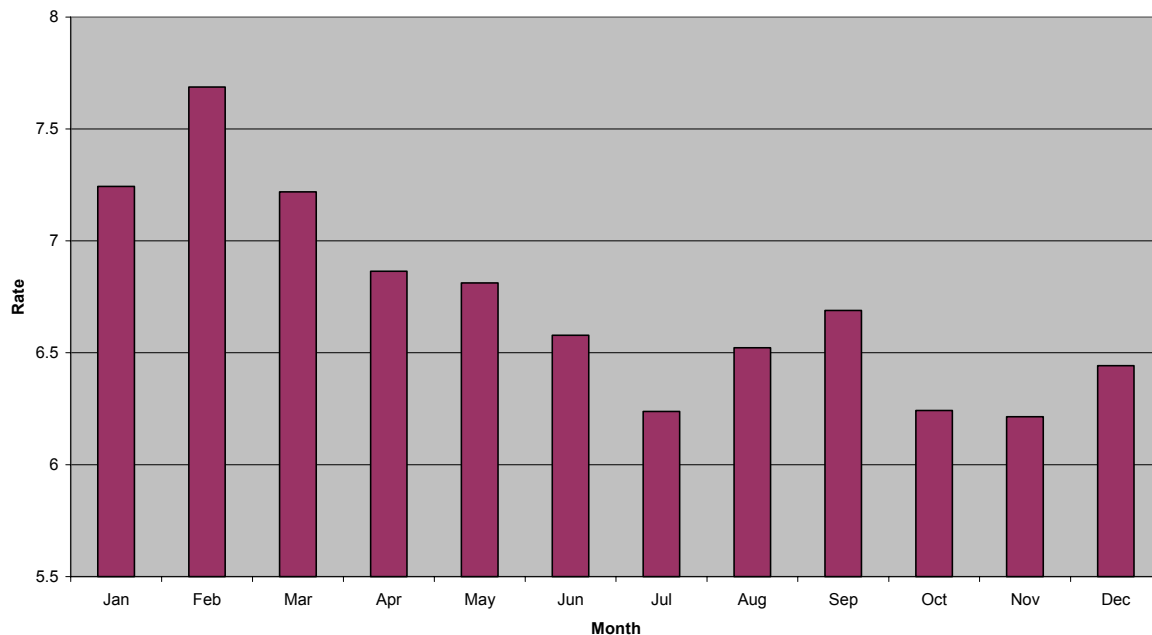


[3.90] Because the chart averages employment for every January, February etc in the sample, it generally removes extraneous changes and leaves only the fluctuations that are specifically related to the month in question.

[3.91] One possible problem with this analysis is that it includes data from 1978, when the wage determination process was quite different. The chart below shows the monthly average unemployment rates after 1996.

Table 3.9:

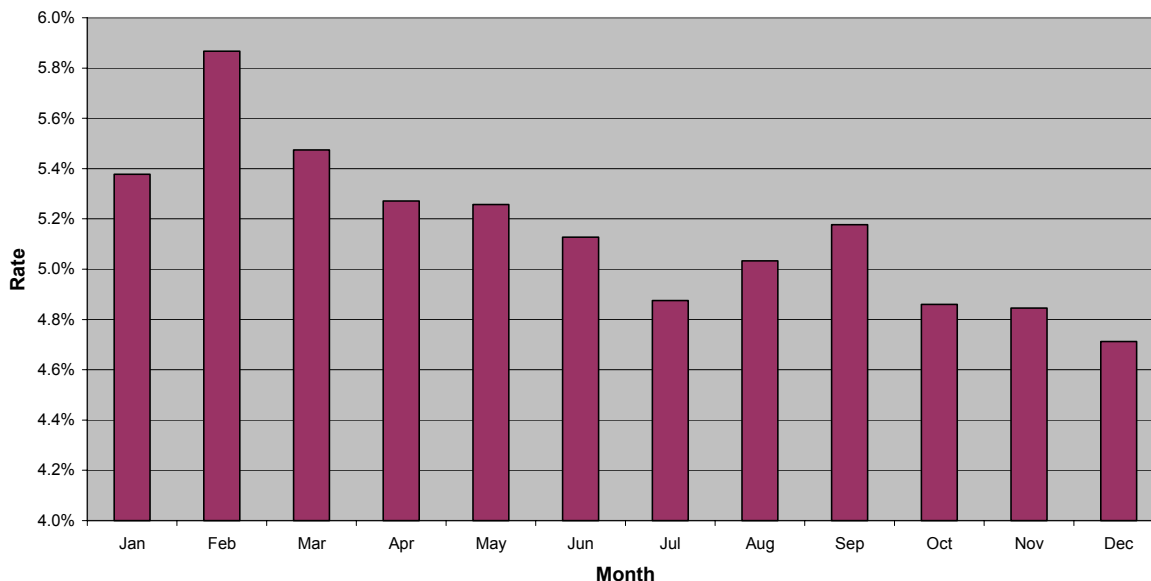
Australian unemployment - monthly average - post-1996



- [3.92] Note that the increase in unemployment in August and September has been retained.
- [3.93] The increase in unemployment in December, January and February would most likely be due to school and university leavers. It could be argued that this is the reason for the increase in August and September – for people finishing education part way through the year.
- [3.94] We therefore performed the same analysis for unemployment for those 25 and older. The results are below. The increase in unemployment in August and September remains.

Table 3.10:

Australian unemployment - monthly average for over 25s - post-1996



[3.95] It would be ideal to also analyse employment by industry by month. Unfortunately, this data is only available every quarter, which is not often enough to enable this type of analysis to be conducted.

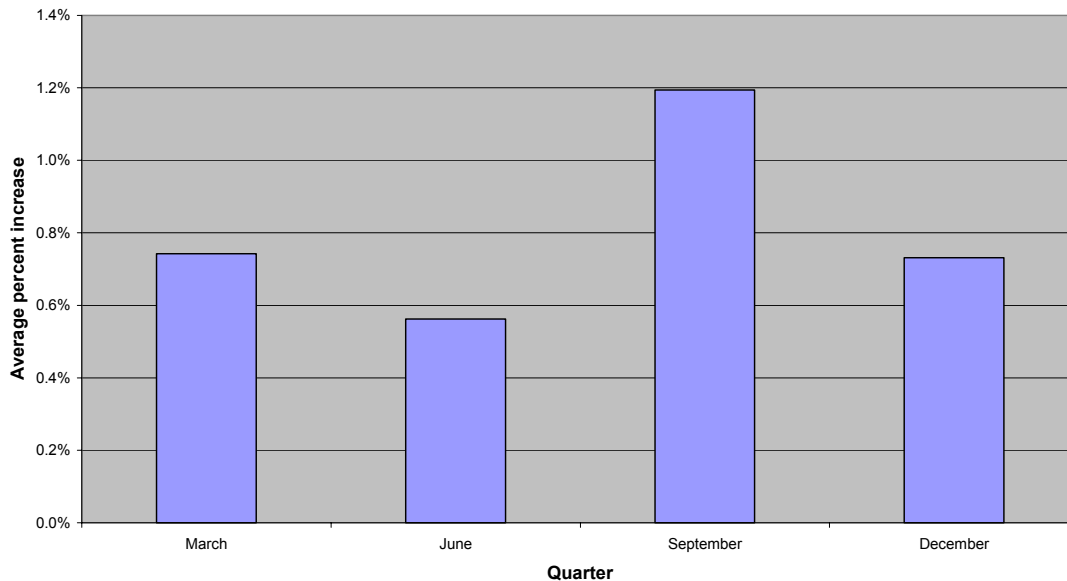
[3.96] However, this broad analysis supports ACCI’s argument that minimum wage increases have an adverse impact on employment.

[3.97] This evidence should be read in conjunction with the evidence presented last year by ACCI that wage costs increase more strongly in the September quarter. We noted that the ABS argued that the increase in award wages played a “prominent part” in the increase in the September wage measures (see ACCI’s submission for 2004 at 3.53).

[3.98] The following graph shows the average change in the wage price index since the data series started in 1997.

Table 3.11

Quarterly average increase in wage price index (original terms) for private sector



[3.99] Combined with the data on employment losses by month, this should be a useful indicator of the effect that award increases do have an effect on employment.

[3.100] It should also be noted that the increase in labour costs from an award increase will be made more severe by the decline in labour productivity over the 2004 year of 0.6 percent. This means that labour costs are increasing even if there is *no* increase in wages.

3.5 OTHER STUDIES

[3.101] Chapter 6 of this submission has an extensive list of studies showing that high levels of labour market regulation (including a high minimum wage) are associated with poor economic performance. These were the basis for the OECD and IMF observations that the award system has contributed to a relatively high unemployment rate for low-skilled workers, that 'muting market pressures' means weaker economic performance and that the minimum wage is too high.

- [3.102] Of particular note is the OECD Employment Outlook for 1998 Chapter 2 "Making the most of the minimum: statutory minimum wages, employment and poverty"⁹. (Attachment 3-6) The paper argues that "at high levels, there is general agreement that a statutory minimum wage will reduce employment." (p57) As argued elsewhere in this submission, Australia has the highest minimum wage in the developed world.
- [3.103] Also significant is Ramakrishnan & Cerisola (2004) "Regional Economic disparities in Australia" IMF Working Paper 144.¹⁰ (Attachment 3-7) This paper has results that: "suggest that the wage awards system may have impeded the adjustment of real wages to productivity differentials and contributed to higher unemployment rates in some states" (p13).
- [3.104] Fred Argy argues in a very recent publication (Argy (2005) "An Analysis of joblessness in Australia" *Economic Papers* Vol 24 No 1 at page 83)¹¹ that the estimates of the elasticity of employment in Australia vary from -0.15 to -1.0, which means that a 1% increase in wages cuts employment by between 0.15% and 1%. The papers backing this are substantial and varied.

3.6 EFFECT ON OTHER ECONOMIC VARIABLES

- [3.105] Chapter 6 highlights a significant number of studies showing that excessive labour market regulation (including from high minimum wages) makes economic performance weaker.
- [3.106] Even if the substantial evidence for employment effects is rejected, it has to be acknowledged that wage increases do not come out of thin air. They have to be paid for, by lower profits or higher prices. In the current economic context, either of these possibilities would be very dangerous.

⁹ http://www.oecd.org/document/21/0,2340,en_2649_34731_31685717_1_1_1_1,00.html

¹⁰ <http://www.imf.org/external/pubs/ft/wp/2004/wp04144.pdf>

¹¹ This paper has been released only during recent days. It will be forwarded to the Commission and parties shortly after the lodgment of this submission. We apologise for the non-availability of it at this time.

- [3.107] Lower profits would mean less for investment, which is essential to ensure that current capacity constraints are addressed. Without this investment, our net export performance will continue to be lacklustre and Australia could lose any benefit from the current strong terms of trade.
- [3.108] Higher prices mean higher inflation. This will cut real wages, cause interest rates to rise and harm Australia's international competitiveness.

3.7 CONCLUSION

- [3.109] The Leigh paper, the Gindling & Terrell paper and ACCI's research should together provide substantial guidance to the Commission when examining the employment effects of changes to Australian minimum wages. The Leigh paper and ACCI's research show that an increase in the Australian minimum wages has a negative impact on employment; the Gindling & Terrell paper shows that increases in multiple minimum wages have a negative impact.
- [3.110] This substantial evidence should mean that the Commission should be very wary of awarding the substantial and unaffordable increases in awards sought by the ACTU, and should reject the notion that awards can be increased without negative employment effects.