



**Australian Government**  
**Productivity Commission**

# Workplace Relations Framework

Productivity Commission  
Inquiry Report  
*Volume 1*

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## **The Productivity Commission**

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website ([www.pc.gov.au](http://www.pc.gov.au)).

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□ 30 November 2015

The Hon Scott Morrison MP  
Treasurer  
Parliament House  
CANBERRA ACT 2600

Dear Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, we have pleasure in submitting to you the Commission's final report into the *workplace relations framework*.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Peter Harris'.

Peter Harris AO  
Presiding Commissioner

A handwritten signature in black ink, appearing to read 'Patricia Scott'.

Patricia Scott  
Commissioner

---

# Terms of reference

## WORKPLACE RELATIONS FRAMEWORK

### *Productivity Commission Act 1998*

I, Joseph Benedict Hockey, Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby request that the Productivity Commission undertake an inquiry into the workplace relations framework.

#### **Background**

The Australian Government believes that it is fundamentally important to make sure that the Fair Work laws work for everyone.

Workplaces are important to our economy and society. Higher living standards, better pay and more jobs all depend on having fair, productive, and effective workplaces. The prosperity of tomorrow is driven by what happens in our workplaces today and this is why it is in our national interest to make sure that the Fair Work laws are balanced and effective.

The Australian Government's objectives in commissioning this Inquiry are to examine the current operation of the Fair Work Laws and identify future options to improve the laws bearing in mind the need to ensure workers are protected and the need for business to be able to grow, prosper and employ.

#### **Scope of the Inquiry**

The Productivity Commission will assess the performance of the workplace relations framework, including the *Fair Work Act 2009*, focussing on key social and economic indicators important to the wellbeing, productivity and competitiveness of Australia and its people. A key consideration will be the capacity for the workplace relations framework to adapt over the longer term to issues arising due to structural adjustments and changes in the global economy.

In particular, the review will assess the impact of the workplace relations framework on matters including:

- unemployment, underemployment and job creation
- fair and equitable pay and conditions for employees, including the maintenance of a relevant safety net

- 
- small businesses
  - productivity, competitiveness and business investment
  - the ability of business and the labour market to respond appropriately to changing economic conditions
  - patterns of engagement in the labour market
  - the ability for employers to flexibly manage and engage with their employees
  - barriers to bargaining
  - red tape and the compliance burden for employers
  - industrial conflict and days lost due to industrial action
  - appropriate scope for independent contracting.

In addition to assessing the overall impact of the workplace relations framework on these matters, the review should consider the Act's performance against its stated aims and objects, and the impact on jobs, incomes and the economy. The review should examine the impact of the framework according to business size, region, and industry sector. It should also examine the experience of countries in the Organisation for Economic Co-operation and Development.

The workplace relations framework encompasses the *Fair Work Act 2009*, including the institutions and instruments that operate under the Act; and the *Independent Contractors Act 2006*.

The review will make recommendations about how the laws can be improved to maximise outcomes for Australian employers, employees and the economy, bearing in mind the need to ensure workers are protected, the need for business to be able to grow, prosper and employ, and the need to reduce unnecessary and excessive regulation.

The Productivity Commission will identify and quantify, as far as possible, the full costs and benefits of its recommendations.

An overarching principle for any recommendations should be the need to ensure a framework to serve the country in the long term, given the level of legislative change in this area in recent years.

In conducting the review, the Productivity Commission will draw on the full spectrum of evidence sources including, but not limited to:

- Australian Bureau of Statistics data and publications
- data sources maintained by other relevant Government bodies, including but not limited to the Department of Employment, Fair Work Commission and Fair Work Ombudsman
- employers or their representatives
- employees or their representatives

- 
- academia
  - special interest groups.

The review should also identify gaps in the evidence base where further collection may assist in the analysis of the overall performance and impact of the system.

### **Process**

The Commission is to undertake an appropriate public consultation process including holding hearings, inviting public submissions and releasing a draft report to the public.

The final report should be provided to the Government in November 2015.

J. B. HOCKEY

Treasurer

[Received 19 December 2014]





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The Commission's report is in two volumes. **This volume 1 contains the overview, recommendations and findings and chapters 1 to 16.** Volume 2 contains chapters 17 to 34, appendixes A to J and references. Below is the table of contents for both volumes.

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# Abbreviations and explanations

## Abbreviations

ABCC	Australian Building and Construction Commission
ABS	Australian Bureau of Statistics
ACAS	Advisory, Conciliation and Arbitration Service
ACCC	Australian Competition and Consumer Commission
ACCI	Australian Chamber of Commerce and Industry
ACOSS	Australian Council of Social Service
ACREW	Australian Centre for Research in Employment and Work
ACTU	Australian Council of Trade Unions
AHA	Australian Hotels Association
AHRI	Australian Human Resources Institute
AIRC	Australian Industrial Relations Commission
ALAEA	Australian Licenced Aircraft Engineers Association
AMMA	Australian Metal and Mines Association
AMWU	Australian Manufacturing Workers' Union
ANAO	Australian National Audit Office
ANZSIC	Australian and New Zealand Standard Industrial Classification
APPEA	Australian Petroleum Production & Exploration Association
APS	Australian Public Service
APSC	Australian Public Service Commission
AWA	Australian Workplace Agreement

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AWALI	Australian Work and Life Index
AWRS	Australian Workplace Relations Study
AWU	Australian Workers Union
BCA	Business Council of Australia
BOOT	Better Off Overall Test
BRICS	Brazil, Russia, India, China and South Africa
BRIT	Bendigo Regional Institute of Technical and Further Education
CEPU	Communications, Electrical, Electric ,Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia
CFMEU	Construction, Forestry, Mining and Energy Union
CGE	Computable General Equilibrium
CMS	Case Management System
COAG	Council of Australian Governments
COAT	Council of Australasian Tribunals
COSBOA	Council of Small Business Australia
CPI	Consumer Price Index
CPSU	Community and Public Sector Union
CURF	Confidentialised Unit Record File
DEEWR	Department of Education, Employment and Workplace Relations
DET	Department of Education and Training
DFAT	Department of Foreign Affairs and Trade
DIBP	Department of Immigration and Border Protection
EA	Enterprise Agreement
EBA	Enterprise Bargaining Agreement
EITC	Earned Income Tax Credit
EPL	Employment Protection Legislation

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FWA	Fair Work Australia
FWAFB	Fair Work Australia Full Bench
FWBC	Fair Work Building and Construction
FWC	Fair Work Commission
FWCFB	Fair Work Commission Full Bench
FWO	Fair Work Ombudsman
GDP	Gross Domestic Product
HILDA	Household, Income and Labour Dynamics in Australia
HR	Human Resources
HSU	Health Services Union
IFA	Individual Flexibility Arrangement
ILO	International Labour Organization
IR	Industrial Relations
IRC	Industrial Relations Commission
LITO	Low Income Tax Offset
MBA	Master Builders Australia
MUA	Maritime Union of Australia
NAIRU	Non-Accelerating Inflation Rate of Unemployment
NATSEM	National Centre for Social and Economic Modelling
NBER	National Bureau of Economic Research
NCC	National Competition Council
NCOSS	Council of Social Service of New South Wales
NES	National Employment Standards
NTEU	National Tertiary Education Union
OECD	Organisation for Economic Cooperation and Development

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OLS	Ordinary Least Squares
PAYG	Pay As You Go
PC	Productivity Commission
PIR	Post-Implementation Review
PISA	Programme for International Student Assessment
PPP	Purchasing Power Parity
QUT	Queensland University of Technology
RBA	Reserve Bank of Australia
SACES	South Australian Centre for Economic Studies
TCF	Textile, Clothing and Footwear
TCFUA	Textile, Clothing and Footwear Union of Australia
TRYM	Treasury Macroeconomic
TWU	Transport Workers Union
UNSW	University of New South Wales
VECCI	Victorian Employers' Chamber of Commerce and Industry
WAIRC	Western Australian Industrial Relations Commission
WSC	Workplace Standards Commission
WHS	Workplace Health and Safety
WR	Workplace Relations
WTO	World Trade Organization

## **Explanations**

Billion                                      The convention used for a billion is a thousand million ( $10^9$ ).

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# OVERVIEW

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## Key points

- A workplace relations (WR) framework must recognise two enduring features of labour markets.
  - Labour is not just an ordinary input. There are ethical and community norms about the way in which a country treats its employees.
  - Without regulation and an ability to act collectively, many employees are likely to have much less bargaining power than employers, with adverse outcomes for their wages and conditions. Equally, poorly-designed regulation can risk bestowing too much power on organised labour in their dealings with individual employers.
- The challenge for a WR framework is to develop a coherent system that provides balanced bargaining power between the parties, that encourages employment, and that enhances economic efficiency. It is easy to both over and under regulate.
- The bulk of relationships between employees and employers are harmonious. The adversarial relationships between the parties that sometimes surface can often reflect poor relationship management, rather than flaws in the WR framework.
- Contrary to perceptions, Australia's labour market performance and flexibility is relatively good by global standards, and many of the concerns that pervaded historical arrangements have now abated. Strike activity is low, wages are responsive to the economic cycle and there are multiple forms of employment arrangements that offer employees and employers flexible options for working.
- Set against that background, Australia's WR system is not dysfunctional — it needs repair not replacement. Nevertheless, several major deficiencies need addressing.
- While the Fair Work Commission (FWC) undertakes many of its functions well, the legalistic approach it adopts for award determination gives too much weight to history, precedent and judgments on the merits of cases put to it by partisan interest groups. This calls for a change in institutions and in practices. The wage regulation function of the FWC should be separated from it. The existing FWC would concentrate on its tribunal and administrative functions. A new body, the Workplace Standards Commission (WSC), would be dedicated to determining minimum wages and award regulation.
  - The WSC would use different types of expertise, and apply a clear analytical framework supported by evidence it collected.
- The appointment process for FWC members can lead to inconsistencies in some of its decisions, a problem that a new 'fit for purpose' governance model involving all Australian jurisdictions could resolve. The same processes would apply to the WSC.
- The *Fair Work Act 2009* (Cth) and sometimes the FWC can give too much weight to procedure and too little to substance, leading to unnecessary compliance costs and poor outcomes. For example,
  - some minor procedural defects in enterprise bargaining can require an employer to begin the agreement-making process again
  - an employee may engage in serious misconduct but may receive considerable compensation under unfair dismissal provisions due to procedural lapses by an employer.
- These problems can be easily remedied without removing employee protections.
- Minimum wages are justified, and the view that existing levels are highly prejudicial to employment is not well founded. However, significant minimum wage increases pose a risk for employment, especially for more disadvantaged job seekers and in weakening labour markets.
- Complementary policies that provide in-work benefits — such as wage subsidies or an earned income tax credit — might support higher incomes for lower paid employees, while not damaging employment. However, there are challenges in developing effective policies of this kind.

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## Key points (continued)

- Awards are an Australian idiosyncrasy with some undesirable inconsistencies and rigidities, but they are an important safety net and a useful benchmark for many employers. The WSC should address specified troublesome hotspots on a thematic basis.
- Penalty rates have a legitimate role in compensating employees for working long hours or at asocial times. However, Sunday penalty rates for hospitality, entertainment, retailing, restaurants and cafes are inconsistent across similar work, anachronistic in the context of changing consumer preferences, and frustrate the job aspirations of the unemployed and those who are only available for work on Sunday. Rates should be aligned with those on Saturday, creating a weekend rate for each of the relevant industries.
- Enterprise bargaining generally works well, although it is often ill-suited to smaller enterprises. However,
  - while the better off overall test is cosmetically similar to a no-disadvantage test (NDT), in practice, the NDT makes agreement-making less costly and more efficient. A NDT with guidelines about the use of the test should be used for all enterprise agreements and individual arrangements
  - bargaining arrangements for greenfields agreements pose risks for large capital-intensive projects with urgent timelines. A limited menu of bargaining options would address the worst deficiencies, while taking account of the different nature of greenfields projects.
- Individual flexibility arrangements have many possible advantages, but their take-up is relatively low. In part, this reflects ignorance of their existence. But there are perceptions (sometimes not well based) of defects, which also constrain their use. These should be resolved by providing information on their use, extending the termination period of the arrangements, and by moving to the NDT.
- There is scope for a new form of employment arrangement, the ‘enterprise contract’, which would provide for variations to awards suited to the circumstances of individual enterprises. This would offer many of the advantages of enterprise agreements, without the complexities, making them particularly suited to smaller businesses. Any risks to employees would be assuaged through a comprehensive set of protections, including a clear written statement to employees of the implications of award variations, a no-disadvantage requirement, the right to revert to the award or to initiate enterprise bargaining, and continued coverage by the National Employment Standards and employee protections.
- Strike activity in Australia is at low levels, but debilitating processes and problematic new forms of action should be fixed:
  - overly complex processes for secret ballots should be simplified
  - aborted strikes and brief stoppages are sometimes ingeniously used as bargaining leverage by employees, but a few modest remedies can address this without affecting the legitimate use of industrial action
  - employers should be given more graduated options for retaliatory industrial action other than locking out its workforce.
- It is too easy under the current test for an employer to escape prosecution for sham contracting. Recalibrating the test from one of ‘recklessness’ to ‘reasonableness’ is justified.
- Migrant workers are more vulnerable to exploitation than are other employees, and this is especially true for illegally working migrants. This requires a package of measures that encourage migrants to report exploitation and support for the Fair Work Ombudsman to detect and pursue exploitative employers.

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# Overview

*Despite some significant problems and an assortment of peculiarities, Australia's workplace relations system is not systemically dysfunctional. Many features work well — or at least well enough — given the requirement in any system for compromises between the competing and sometimes conflicting goals the community implicitly has for the system.*

*The system acknowledges that labour differs from other inputs, and that a sound workplace relations system must give primacy to the wellbeing of employees (and would-be employees), and take account of community norms about the fair treatment of people. While there are hot spots that justifiably attract major concerns, the day-to-day life of most employees and employers is harmonious and productive, with a reasonable balance between the relative powers of the parties.*

*The key message of this inquiry is that repair, not replacement, should be the policy imperative. The adapted system needs to give primacy to substance over procedure, rebalance some aspects of the system that have favoured some parties over others, and reform its principal regulator. An improved workplace relations framework must involve decision-making that is not unnecessarily beholden to precedent, excessive process, or to dated labour market structures. It must rely much more on economic evidence as a basis for its future direction, including information on the relevance of new developments in labour relations. This is best achieved by removing award and minimum wage setting from the Fair Work Commission and placing it into a new statutory body with different expertise. The framework's broader menu of bargaining arrangements and institutional reform will underpin greater responsiveness to emerging social and economic developments (for example greater demand for flexible work arrangements with shared childcare, an even greater shift to the 24/7 economy, and further automation of services).*

*This broad strategy will improve productivity, increase employment, and aid flexibility for employees and employers, without destabilising the system.*

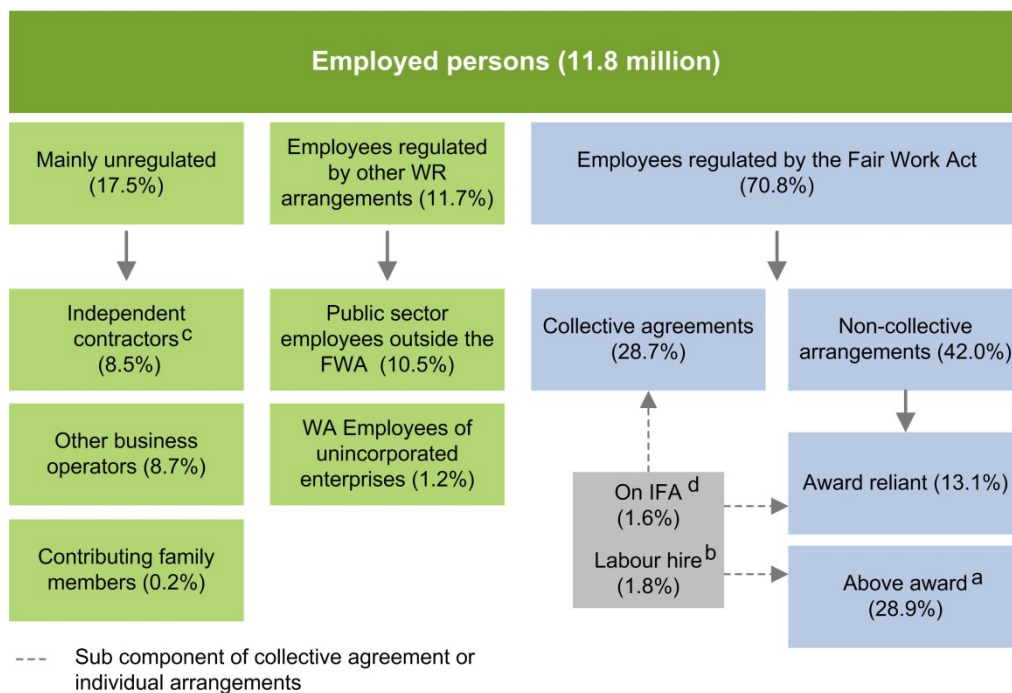
The workplace relations (WR) framework comprises a complex array of labour laws, regulations and institutions. Along with market forces, accepted practices, cultural norms and the common law, these shape people's behaviour, the nature of their workplaces and their working lives.

The national system directly affects millions of Australian workers. In mid-2015, around 11.8 million people worked in more than 2 million workplaces around Australia. Of these



people, around 70 per cent were covered directly by federal workplace laws (figure 1), and others were indirectly affected. For instance, the choices of people to become self-employed are strongly influenced by the alternative wages and conditions that they could receive by being an employee. There are also around 750 000 unemployed Australians whose job prospects are affected by the system, and an even greater number who are underemployed. Even employees outside the national system (some state public servants and some employees captured by the separate Western Australian system) find that their arrangements are shaped by the national arrangements. Further, to the extent that the WR system embodies community expectations about fairness or influences national prosperity and productivity, all Australians have a stake in its effectiveness.

Figure 1 **Employment arrangements, 2015**



<sup>a</sup> Not all this group would be covered by an award. <sup>b</sup> Excludes independent contractors. Employees paid via a labour hire arrangement could have their pay set according to the award, above the award or under a collective agreement. <sup>c</sup> Independent contractors are regulated by the *Independent Contractors Act 2006* (Cth). <sup>d</sup> Individual flexibility arrangement.

The premise of any WR system is that, absent specific workplace legislation and oversight, many employees would suffer from unequal bargaining power. Most stakeholders recognised this. Of course, bargaining power is not always in the hands of employers. Aspects of the *Fair Work Act 2009* (Cth) ('the Fair Work Act') and the *Competition and Consumer Act 2010* (Cth) seek to address excessive use of bargaining power by unions. *Once a system is in place to regulate bargaining power*, there will always be questions about the efficiency and effectiveness of the system, and whether the system has over or under shot in remedying any prior imbalances.

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In trying to produce a balanced system, WR legislation, institutions and regulation are now highly elaborate and broad ranging (figure 2). However, market forces play a larger role in most wage outcomes and, in the longer term, have a strong impact on conditions. For example, wage growth is strongly influenced by the business cycle, long-run productivity and sectoral changes. No WR system can guarantee job security.

The regulatory arrangements have grown from a limited Commonwealth role in dispute settlement one hundred years ago to a position today where the Commonwealth — through its statutory bodies — regulates the bulk of industrial awards, sets minimum wages, provides information, registers agreements, checks compliance with the law and adjudicates on key matters of WR law.

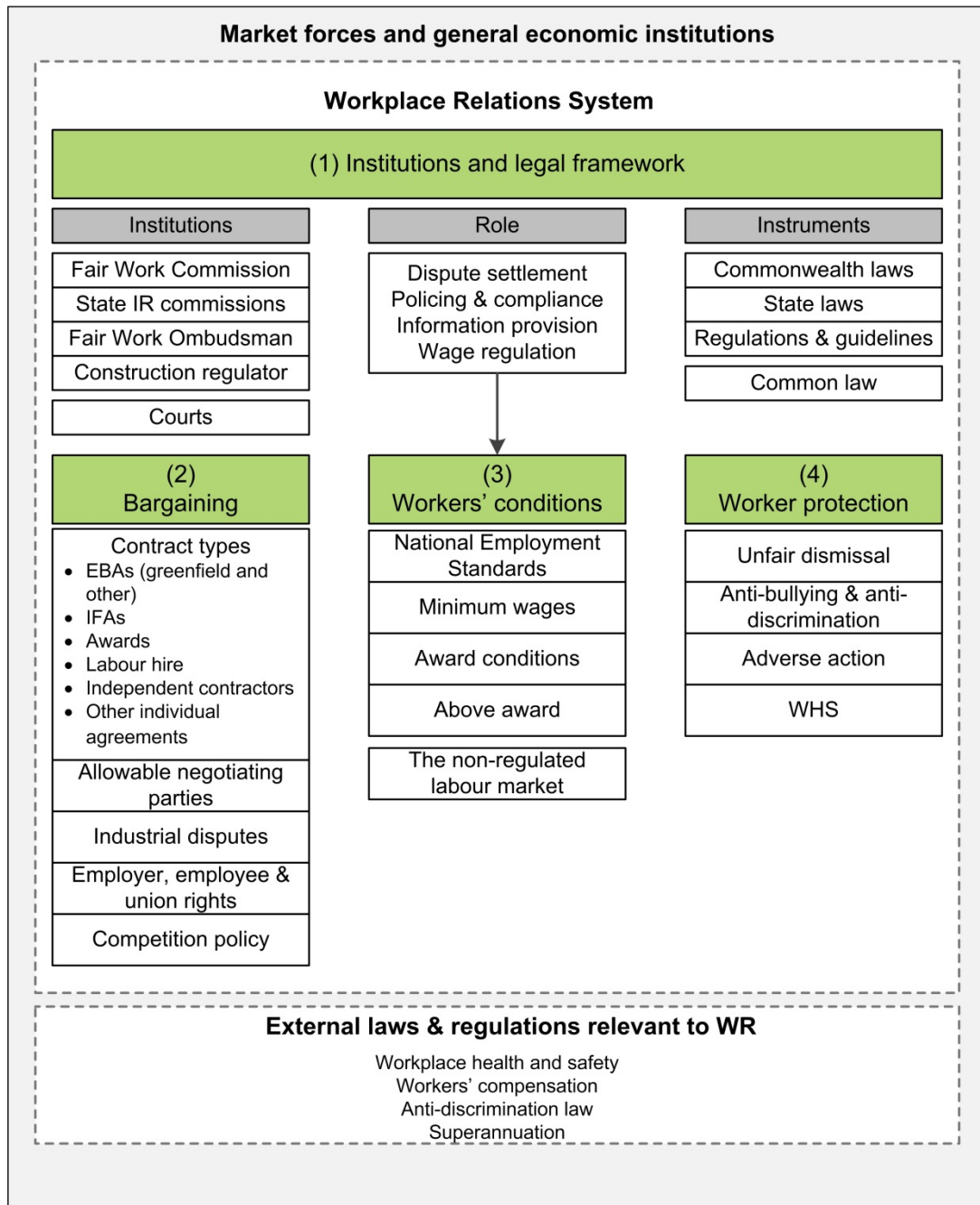
Three bodies, the FWC, the Fair Work Ombudsman and Fair Work Building and Construction, are the key national regulators, while the Federal Court is the principal judicial body. Various other institutions — state and territory work safety regulators, anti-discrimination bodies and the Australian Competition and Consumer Commission — also have specialist roles in parts of the WR system, for example in relation to regulation of secondary boycotts.

In its roughly 900 pages, the Fair Work Act covers most aspects of the way in which parties should deal with each other in their employment relations, and in setting a variety of minimum standards. An extensive body of common law sits beside the statutory framework. Reflecting the regulatory underpinning of the system, wages and conditions for most national employees must be at, or above, the safety net of those set in 122 awards.

Notwithstanding complaints from some employers, there is considerable scope for flexibility through independent contracting and employers' capacity to negotiate individual and firm-specific outcomes. In fact, award wages are less important now than at any other time in the last 100 years. Nevertheless, the 'clunkiness' of the system, concerns about the complexity of forming enterprise agreements, inconsistencies and lack of clarity in awards, barriers to forming individual flexibility arrangements, and the unpredictability of FWC decisions on a range of matters deters firms from using some of the available avenues.

The Fair Work Act cites objectives that are diverse and — as is often the case with such diversity — inevitably sometimes in conflict. The Fair Work Act is intended to deliver outcomes that are fair, flexible, co-operative, productive, relevant, enforceable, non-discriminatory, accessible, simple and clear. The legislation is complex and there are meaty pickings for lawyers and workplace practitioners on all sides.

**Figure 2 The main elements of the current workplace relations arrangements**



People are confused by the system, and some parties that should have a bigger voice in it — consumers, the unemployed and underemployed — have marginal influence. There are unquestionable inefficiencies, remnant unfairness, some mischief and absurd anachronisms.

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In this messy context, there is an understandable tendency to imagine that there must be a much neater and coherent system, and that it would be desirable to start with a clean slate. The bulk of stakeholders and this inquiry's analysis suggests that this view would be misplaced. The system needs renovation, not a 'knockdown and rebuild'.

Moreover, some of the Productivity Commission's recommendations are not new. The 2012 review of the Fair Work Act identified a range of worthwhile reforms, some of which were not acted on at the time. But this inquiry does not simply traverse the territory of the previous review. The terms of reference require the Productivity Commission to cover all those aspects of workplace relations that limit the ability of the system to adapt to longer-term structural shifts and changes in the global economy. An ageing workforce, and, as always, disruptive technologies, will figure prominently in that future.

This inquiry does not examine in any detail some dark aspects of the WR system — most particularly issues of union corruption, criminal conduct and intimidation, sometimes seemingly abetted by the tolerance, if not complicity, of some businesses. The current Royal Commission into Trade Union Governance and Corruption is examining these issues, as have previous inquiries such as those of Wilcox and Cole. In large part, the centre of the concerns is the commercial construction industry. The Productivity Commission has examined the construction industry as part of its previous inquiry into public infrastructure and proposed more severe penalties as part of the solution. This report has also recommended much higher penalties for unlawful industrial action regardless of the sector (see later). However, apart from recommending a stronger role for Fair Work Building and Construction in identifying secondary boycotts, this inquiry does not traverse territory covered by the Royal Commission or on measures aimed at criminal activities.

## **1 Australia's recent labour market performance does not suggest a dysfunctional system**

There are several myths about Australian labour markets that suggest that some of the key concerns voiced by stakeholders on all sides are of dubious validity.

The prevalence of independent contracting has remained an important source of labour and has been stable over the last decade.

Security of work appears to have changed relatively little in recent years. While the proportion of casual jobs increased throughout the 1990s, this trend tapered off during the 2000s, particularly for women. Most people working in casual jobs move into permanent jobs in later stages of their lives.

The labour market has accommodated well to large increases in the labour supply and to major compositional shifts. Many more women, students, more mature age workers and large numbers of skilled migrants have entered the labour market. For example, the current level of skilled migrant intake is almost three times higher than levels of the late 1990s.

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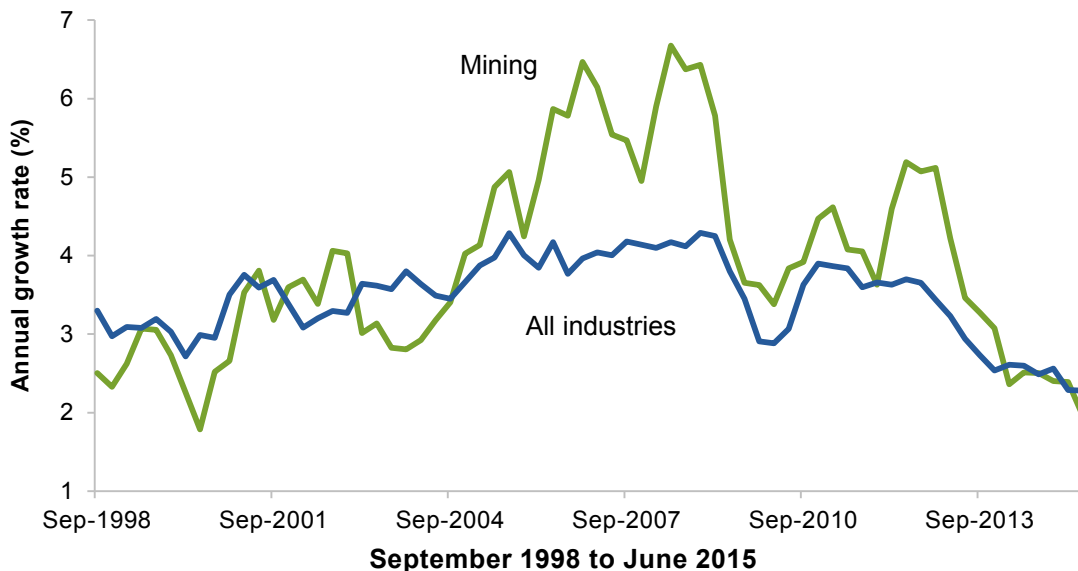
Most people who experience unemployment do not do so for long. The shift away from making solid things to services has largely been achieved without growing unemployment.

Weekend work is now common. The traditional Monday to Friday week is not dead, but nor is it as predominant as in the past. Some 4 million employed people — around one in three in the workforce — work at least a Saturday or Sunday each week.

There are several indicators that the labour market has become more flexible, most notably through a greater tendency to adjust hours rather than employment during demand downturns, and the unresponsiveness of inflation to strong labour demand in leading sectors. Economywide wage breakouts and associated stagnation — the horror of the 1970s — seem as dated as floppy disks. The resources boom led to strong growth in mining wages, but not wages in general (figure 3). There is little evidence that labour market mismatch has changed.

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**Figure 3 The end of wage contagion**  
Growth in the mining wage index compared with all industries



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Surmise aside, there is little robust evidence that the different variants of WR systems over the last 20 years have had detectable effects on *measured* economywide productivity. This does not mean there are no effects, but simply that they apply at the enterprise and industry level and are hard to identify in the aggregate economy given the myriad of other factors shaping productivity.

However, there are some concerning trends (figure 4). In particular, youth unemployment is rising, and by more than the growth in the unemployment rates of prime-aged people in

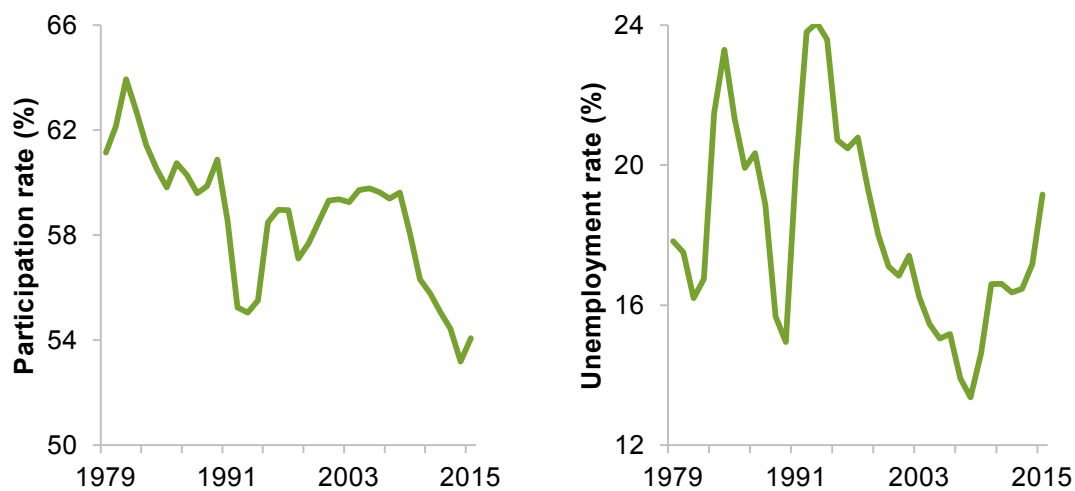
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the labour market. More generally, underemployment and long-term unemployment has also risen in recent years.

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**Figure 4 How are the young faring in labour markets?**  
Outcomes for 15-19 year olds, year ending June 1979 to 2015

**Participation rates have tended to fall since ... unemployment rates have tended to rise 2008, while ...**



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## 2 Institutional reform

The performance of Australia's WR system relies strongly on the capabilities and functioning of its main institutions. Discretion and judgment exercised by competent and independent bodies are as critical as statute in an efficient and fair system.

The Fair Work Ombudsman is performing well, adopting targeted and innovative approaches to compliance and information provision. It is highly regarded by many stakeholders. It is essential to the credibility of any future systemic reforms that it receive sufficient resourcing as new hot spots emerge (such as, for example, recently exposed problems for 417 visa holders).

Likewise, the FWC has adopted efficient conciliation processes in unfair dismissal cases, and has introduced a variety of innovations more generally. Its approach to the current four yearly review of modern awards acknowledges some of the glaring problems that still beset awards (but do not go far enough). While there are concerns about the FWC's use of evidence (see below), its expert panel on annual wage reviews does consider some empirical evidence in its annual wage case determinations, particularly information on current labour market and macroeconomic conditions.

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That said, some perceive the FWC in less positive terms, although in part this is the inevitable accompaniment to the diverse, complex, and controversial nature of its functions. However, there are three flaws in the structure and operation of the FWC.

### **The heavy weight of history**

History and precedent play too big a role in some of the FWC's key economic and social functions, particularly award determinations. In effect, the past is assumed innocent unless found guilty, embedding old, but outdated, features of the WR system. One award still provides employees with the option of an X-ray every six months if they work in a tuberculosis home or hospital (the last of which closed in 1981). The survival of this provision is benign, but is nevertheless telling about the weight of history.

A distinguished former high court judge has noted the power of the past in industrial relations:

The past is another country. It is a place safer for people like me to dwell than in the industrial present or the future. Judges live with the past, surrounded by its stories in their books, from which they seek to derive logical analogies and the great streams of principle that will promote consistency and predictability in decision-making. (Justice Kirby 2004)

This backwards-looking perspective is a necessary feature of the legal judgments of the FWC as a tribunal. Past decisions assist in interpreting the law. Although not formally bound by the rules of evidence used in courts, the FWC's practices also tend to give greatest weight to the evidence put by the contesting parties, rather than on better evidence that it has actively sought. These approaches have carried over to the FWC's wage determination functions, which require a different mindset. Wage determination is inherently an economic, statistical and social matter that needs to give most weight to new evidence on the consequences of regulatory choices in contemporary society. As new evidence or analytical approaches emerge, its economic decisions should be re-framed.

One option would be to create a specialist arm within the FWC, which, equipped with the right skills and experience would undertake the annual wage review and make award determinations. However, the legal and institutional culture of the FWC, which is suited to its tribunal and administrative functions, has such a powerful gravitational pull, that it could readily undermine the capacity of the new arm to apply fresh analytical frameworks to wage determination.

Accordingly, the Australian Government should create a separate institution — the Workplace Standards Commission (WSC) — to undertake wage determination. Most of its members would have professional capabilities in economics, the social sciences and commerce, with legal experts primarily used to ensure enforceable awards. Members would not have the status of judges, making both recruitment and culture change simpler. It should proactively undertake its own data collection and systematic high-quality empirical research as the key basis for its award decisions and wage adjustments. (While

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the FWC does initiate some research, much of it is of limited specific relevance to its actual decisions.) The WSC should impartially hear evidence from all parties. This should include the views of consumers and the jobless, who though substantially affected by the WR system, do not usually make submissions.

The FWC would then continue to be responsible for its current quasi-judicial functions, such as hearing matters relating to unfair dismissals and anti-bullying cases, and for various administrative functions, such approval of agreements, right of entry and authorisation of protected action ballots. Its members should have broad experience and be drawn from a range of professions, including the law, commercial dispute resolution and the ombudsman's offices. Given the shift of wage regulation to the WSC, fewer members would be required than today.

## **Governance**

The governance of the FWC needs reform. Some of the primary causes of inconsistencies in its determinations reflect the choices made by successive governments, particularly the emphasis on appointing persons with perspectives oriented more to one side or the other of industrial relations debates. FWC members will accordingly reach different judgments even in instances where the circumstances are similar. This is not so much the result of bias, but rather a reflection of the fact that they come with different priors, are obliged to weigh up the often competing objectives laid down by the Fair Work Act, and must deliberate on matters that are inherently subjective. As an illustration, there is good statistical evidence that the findings in unfair dismissal cases have allowed some inconsistencies to creep into judgments. Given their different perspectives, it is not surprising that members with an employer association background are more likely to find in favour of an employer compared with other members, while on average those with a union background produce outcomes in the opposite direction.

Better governance practices are essential for a body with determinative powers on economically important matters operating in a politically sensitive and highly technical area. Two main reforms are required.

First, the processes for appointing members of the FWC require reform (and these would also apply to the WSC). The Australian, state and territory governments should create an expert appointments panel, which would provide a merit-based shortlist of candidates for the two bodies.

The Australian Minister for Employment would then choose members from the shortlist for a fixed tenure. Both the panel and the relevant minister would need to be satisfied that a candidate for appointment had (and was seen to have) an unbiased and credible framework for reaching conclusions and determinations. Appointments would be made for a period of ten years, or to the age of 70, whichever comes first. There should be no reappointments beyond this term, to ensure a good stream of new talented people and to eliminate the risk



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(or perception of risk) that members might alter their decision-making to secure reappointments.

Second, the President should have greater scope to guide members. In cases where members have failed to perform, there should also be an external judicial review process (as already occurs for the judiciary in some states), which would encourage improvement, and in the worst of circumstances, provide an impartial basis for action by the Australian Parliament.

These changes would align governance within the FWC more closely with that observed in many other contemporary decision-making bodies.

### **Safe is not sound**

Some commentators have suggested that the politics of institutional change is too hard, and that the issues at the heart of WR are ones that distinguish the political identities of the two main parties. Each new government, faced with the appointment choices of former governments, attempts to restore ‘balance’ in the FWC by making safe appointments that more closely reflect its viewpoints. The argument is that if there is a reasonable mix of members with somewhat varying views, the FWC as a whole can reflect both sides of politics. This is exceptionally weak institutional design, and undermines the integrity of one of Australia’s foremost decision-making bodies.

The Productivity Commission is aware of the prevailing view that no Minister or government willingly gives up the power to determine appointments. Several decades ago, governments around the world struggled with the concept of independent central banks, but reforms occurred, and few would now contemplate reversing this policy. Genuine reform consists of breaking customary bad habits. The Productivity Commission strongly encourages a lateral shift in thinking about the governance and design of Australia’s workplace regulatory institutions. This reflects the primacy of these institutions in wage-setting and in interpreting, applying and enforcing the Fair Work Act — roles that are critical in an evolving economy. This shift would not remove the Australian Minister for Employment’s power, but is designed to lift skill levels and the standards of appointees, change the culture, and improve consistency in a system that has shifted away from arbitration cases heard by several Commissioners to a workload now more dependent on the determination of individual Commissioners. Outcomes in cases should not be a lottery draw depending on the background of a Commissioner. Institutional change would represent one of the bigger microeconomic reforms in the last 15 years.

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Structural changes of this nature will take some time, but action on some fronts is needed, and can be taken, now. The FWC already has the capacity to appoint more experts as advisors to its members and to take an activist and evidence-based approach to an assessment of awards. A change in mindset requires no legislation, and a move in this direction under the strategic guidance of the President would be a major step. The Australian Government can also be a catalyst for change. Its submissions to the periodic Annual Wage Review and award reviews are a vehicle to make clear the need for reforms in the FWC's *processes* for minimum wage and award determination along the lines recommended in this report.

### **3 The safety net**

The safety net comprises three main instruments that set floors to wages and conditions for employees: the national minimum wage, the National Employment Standards and awards (including penalty rates).

#### **Minimum wages**

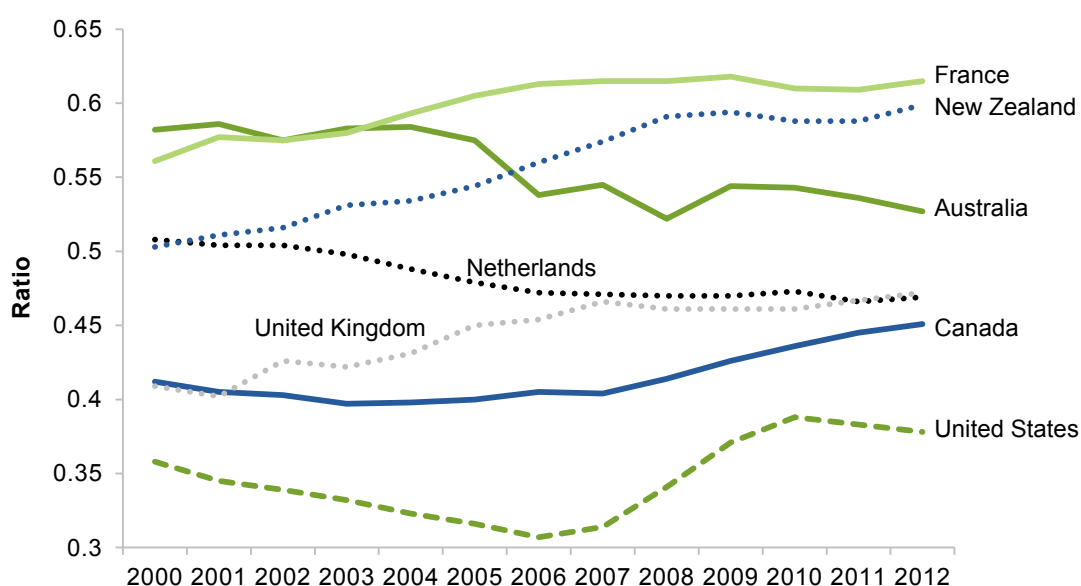
Minimum wages in Australia are set by the FWC Expert Panel, taking into account changes in economic conditions and representations, especially from the Australian Government, business and union stakeholders. It generally determines modest rises in minimum wages, and its predecessors have occasionally suspended increases during downturns. A commonly used measure of the comparative level of the minimum wage is its ratio to the median wage rate, which also enables meaningful comparisons with other countries. While the minimum-to-median wage ratio remains high in Australia compared with most other countries (France and New Zealand being the notable exceptions), it has declined over the past decade. Indeed, no other OECD country has shown such a strong trend decline (figure 5). Over the longer run, a smaller share of Australian employees has relied on the minimum wage as the safety net, and real growth in economywide productivity has substantially outpaced the real minimum wage (based on producer prices).

There are several rationales for minimum wages:

- Minimum wages (if not set too high) may address the stronger bargaining power of employers. There is reasonable empirical evidence that many individual firms have some market power in hiring employees. This reflects the various frictions associated with job search and matching. As well as having distributional effects, this means that unregulated labour markets can suppress wages below their efficient level and, in some cases, may actually reduce employment.
- Minimum wages increase the pay levels (and thereby the living standards) of the lowly paid so long as they retain their jobs and can work the desired hours.

However, even accepting such rationales, the question of the impacts on (and the risks they pose for) employment and earnings is an empirical matter. Unfortunately, while some confidently assert the matter is decided on one side of the debate or the other, the vast international (and more limited Australian) evidence is not so definitive. Much of it is beset by data and methodological limitations, or misinterpreted. That said, the evidence suggests some patterns. Small increases in the minimum wage are unlikely to have readily measurable effects on employment, but the larger they become, the more likely that the hours available to existing workers will fall and job opportunities for new workers (and sometimes for existing workers) will be lost. The effects also depend on the characteristics of the labour force. Low-skilled or disadvantaged people have poorer prospects of employment at any feasible minimum wage, and such prospects can be further reduced in weak regional labour markets.

**Figure 5 Minimum to median wages for several OECD countries**

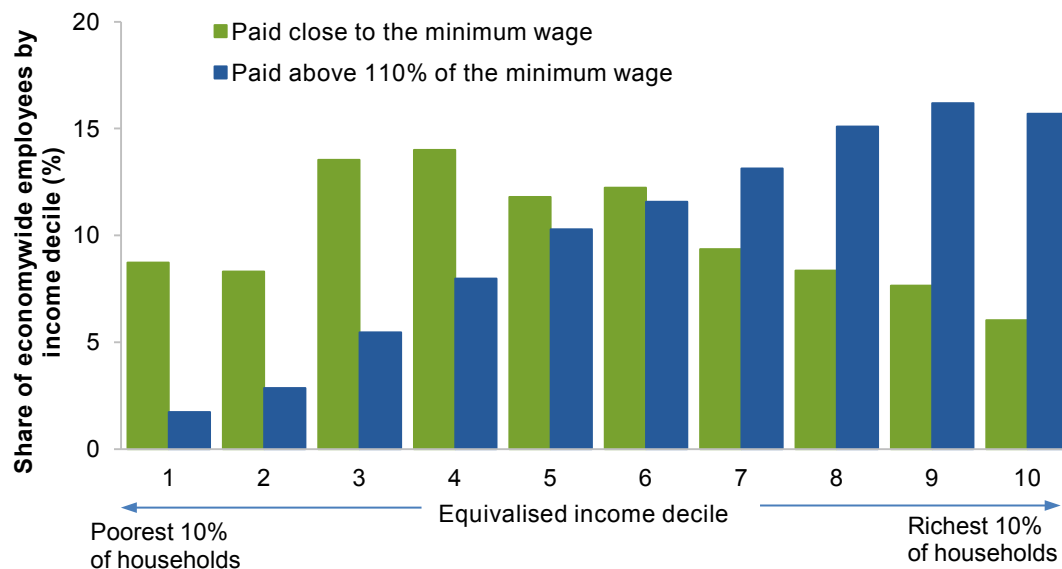


The risk of jeopardising employment is just one consideration. The effects on household income of annual wage reviews depend on:

- how those pay increases affect all other wages in the economy. Australia's unique system of awards creates hundreds of wage floors for different jobs whose annual growth rates are linked to changes in the adult minimum wage

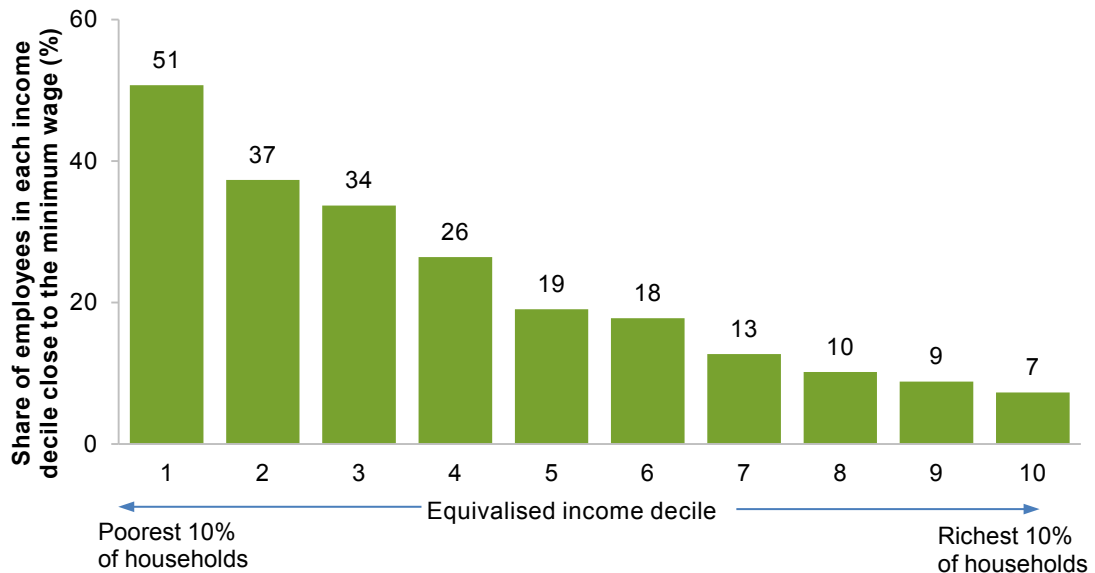
- the overall income of households where some people are paid at the minimum wage or whose wage level is strongly related to it. Many employees with wages linked to the minimum wage are not in low-income households. In 2013-14, around 30 per cent of such wage earners were in the richest 40 per cent of working households (figure 6). This reflects that many higher-income households have some family members in low paid jobs
- the degree to which it reduces employment and hours worked. Unemployment is not only strongly associated with lower income levels, but has highly adverse effects on people’s wellbeing. As emphasised throughout this report, people without jobs tend to have little voice in the current WR system, a defect that requires correction
- possible dynamic effects. On the one hand, people facing the risks of unemployment at high minimum wages may acquire skills to avoid this. On the other hand, for many people, minimum wage jobs are a temporary part of their working lives, and indeed such jobs can be a ‘stepping stone’ into the world of work and higher paid jobs later.

**Figure 6 Many people receiving wages around the minimum wage are from middle income households**



Nevertheless, there is strong evidence that the minimum wage (and awards) tend to assist people in lower paid households who retain their jobs, with a high share of low-income working households on the minimum wage. In 2013-14, the likelihood that an adult employee in the lowest decile of working households was at, or close to, the minimum wage was around seven times higher than that for the top decile of households (figure 7).

Figure 7 **An employee in a low income group is much more likely to be paid around the minimum wage rate**



### Policy implications

Against that background, while some minimum wage is justified, the FWC faces Goldilocks' dilemma of determining the level that is 'just right'.

That level has a long-run and short-run dimension. On the former score, the level of minimum wages that can sustain a particular level of employment depends on the skills and capabilities of the jobless and those employees paid close to the minimum wage, and on the relative demand for such people. For example, *if* the average skills of existing jobless people improved over a sustained period, or there was an increased demand for people in industries intensive in the use of minimum wage employees, such as retailing, aged care and hospitality, there would be greater scope to increase minimum wages without significant adverse effects on their employment prospects. (If that is *not* the case, it reinforces the case for complementary measures to supplement the incomes of the low-paid — as discussed further below.)

Over the shorter-run, another set of considerations comes into play. Given the highly adverse outcomes of unemployment for people's wellbeing, whenever the employment outlook is weakening, there are grounds for the FWC to temporarily adopt a conservative approach to minimum wage setting. This does not require that minimum wages fall, but rather that they grow at less fast a pace than during normal economic times. This would encourage employment of people currently priced out of the labour market (and assuage underemployment). In improved economic circumstances, minimum wages could rise at a faster pace.

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Some have suggested that Australia should follow the example of some other countries that have geographical variations in minimum wages. Currently, Australia has two adult minimum wages — a national minimum wage applying to most employees, and a Western Australian minimum wage applying only to the employees of unincorporated enterprises in that state. The difference in their minimum wage rates is very modest.

In contrast, some countries have multiple geographically-varying rates with large disparities between rates across regions. For example, Canada, Japan and the United States have different minimum wages by state (and indeed, in some US states, even variations between cities, Los Angeles being an example). In principle, such minimum wage variations look attractive as they could be set at levels that took account of local labour market conditions, thus reducing unemployment risks. However, there are many practical difficulties in an Australian context, including doubtful constitutionality, interactions with modern awards and the tax and transfer system, and complexity for national employers. (Notably, few employers have called for geographically varying rates, even in regions where the labour markets are relatively weak.) The Productivity Commission does not propose their introduction.

### Complementary measures

A critical question is the degree to which the regulated wages system can effectively achieve its redistributive goals. Minimum wages were developed at a time when it was typically only a man who worked in a household and when the social welfare system was weakly developed — both of which have now changed. However, while Australia's welfare system has been important in alleviating income inequality, it can also stigmatise people, discourage employment and embed social disadvantage.

That invites the question of new ways of providing income supplementation to the low paid, while maintaining employment incentives. One approach is an 'earned income tax credit' (EITC), which many countries use to top up the incomes of the low paid, typically as a complement to minimum wages. For example, in its country report for the United States, the OECD has recommended that as the Great Recession recedes, it should expand its EITC and raise its minimum wage, indicating that hybrid policies are seen as appropriate.

By design, EITCs encourage labour force participation, and the evidence usually suggests that they do this, especially for single parents, though their effectiveness depends on their exact design. However, they do have several drawbacks, including high levels of incorrect payments (around one quarter of the funds in the United States), reduced incentives to work for second earners in some households, and barriers to working above a certain level of hours as household income rises. They must also be financed through taxes, which have their own adverse economic effects. The Productivity Commission's own analysis shows that some types of EITCs still tend to provide transfers to more than low-income households.

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Reducing these incidental impacts is one reason why significant attention must be given to the design of any instrument and the economic context in which it sits, including any interactions with Australia's tax and transfer system. The OECD has highlighted that the impacts of in-work benefits depend on their design and the institutional settings of each country. In its study of 15 European countries, it found that the efficiency costs from in-work benefits were highly variable. The results were highly positive in some, but questionable in others.

At this stage, it is not clear that an EITC in Australia would be desirable. However, if there were systemic changes to the tax and transfer system — a matter beyond the scope of this inquiry — or if it was not possible over the long run to maintain a minimum wage that provided a balance between adequate income and unemployment risk, then it might reasonably be part of a repertoire of options that could be revisited.

Some have claimed that there may be constitutional constraints for an EITC that extended to single people as well as families, but this is a complex area of law and is untested in this context. (If this was an obstacle, the EITC might have to be narrower in its application or state cooperation would be required.)

Governments should not neglect other policies that are complementary to minimum wages. These could include skill development and wage subsidies, but only where these are designed carefully and properly targeted. Inevitably, improved social and economic inclusion requires more than a single policy, which is why governments should seek to use minimum wages as part of a policy suite.

## **Wages for juniors, apprentices and trainees**

The FWC sets out minimum pay rates for younger workers, apprentices and trainees. Wage rates for juniors are a share of the adult minimum wage and increase with age until the person reaches 21 years old (although some awards vary this). Similarly, trainee wage rates also have an age-based structure, with rates depending on the time elapsed since leaving school. Apprentice wages vary across awards and are set as a proportion of a qualified tradesperson's wage and increase the closer the apprentice is to completion. Australia is one of around the 50 per cent of OECD countries that set youth wages as a share of the adult rate.

Notwithstanding the high ratio of the adult minimum wage to median wages, Australian youth wages start at comparatively low levels relative to those in many other countries. For example, a fast food level 1 employee aged under 16 years could have more than a year of experience, but would get AUD \$7.59 an hour (44 per cent of the adult minimum wage). In many states in the United States, many such employees would receive at least US \$8 (100 per cent of the adult rate). The decisive test in some countries is not age per se, but also experience, with much lower wages for someone with short experience in a job. In the United States, the federal minimum wage is around 60 per cent of the adult minimum for a person aged under 20 years who has worked with their employer for less than 90 days.

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New Zealand has a similar system, with no minimum wage for people aged less than 16 years, and a discounted wage for 16- and 17-year olds with less than six months job experience with their employer.

The Productivity Commission is wary about making any precipitate changes to the current system of youth wages if that was to put at risk the employment of more vulnerable people with lower skills. The transition from education to work is one of the critical pathways, and changes that affected employment of the less academically able could have adverse generational impacts. That said, the WSC in its longer-run examination of systemic award issues could investigate the desirability of a hybrid system that recognises that experience or competency might sometimes justify a higher minimum wage. And of course, businesses may sometimes pay above-award wages to retain experienced young employees, and enterprise agreements can also vary award minima.

The training system, of which apprenticeships and traineeships are a component, involves a complex set of interlocking issues. The FWC has recently increased award wages for apprentices, while the Australian Government also provides incentive payments to employers and wage top-ups. These affect the relative attractiveness of apprenticeships to employers and would-be apprentices, with unknown impacts.

These complex issues go beyond the scope of this inquiry as they also involve concerns about the adequacy of skill formation and competency-based training and pay arrangements. The Australian Government should request the Productivity Commission to undertake a comprehensive review of Australia's apprenticeship and traineeship arrangements. This review should provide an assessment of the appropriate structure of junior and adult training wages, as well as government incentives.

## **National Employment Standards**

The National Employment Standards (NES) specify minimum requirements for 10 conditions of employment — including hours of work, various forms of leave and redundancy pay. Awards, enterprise agreements and employment contracts cannot exclude any elements of the NES, or provide ongoing employees with less favourable employment conditions. The NES have attracted little controversy — mainly because their prime aspects (like annual leave) have a long and accepted role by all stakeholders and accord with community norms. There is also considerable scope for flexibility. For example, an employee can be required to work more than the standard hours if reasonable.

Nonetheless, there are concerns about several aspects of the NES.

The Standards specify eight national public holidays on which people are entitled to a paid day of leave (and penalty rates of typically 250 per cent if they work). Public holidays can yield community benefits by enabling coordinated social activities, particularly on days of major cultural or spiritual significance. However, many people treat *some* national public holidays as just normal days off, which throws doubt on their community function. The



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Fair Work Act allows awards and enterprise agreements to include terms that allow an employer and their employees to observe a public holiday gazetted by government on a date other than the one prescribed, but not all awards contain such provisions. All awards should include the provision so that the option of swapping holidays is available in all workplaces.

Moreover, the Standards also recognise any public holiday declared by a state or territory government. (In a bizarre twist, every Sunday is a public holiday in South Australia — though there is a tacit agreement to ignore this by most employers and employees.) So, by declaring new holidays (such as the recently established *Grand Final Eve* holiday in Victoria), state and territory governments can unilaterally create obligations under the NES for any national employer in their jurisdiction to provide further leave days with pay. The 2012 post-implementation review of the Fair Work Act recommended limiting the total days that would attract penalty rates to just 11. However, employers would still have to pay employees absent on additional state public holidays. Should they want an employee to work on a public holiday, they would, for commercial reasons, have to pay them significantly more than 100 per cent of their base pay (since 100 per cent is what the employee would get if they did not go to work at all).

State and territory public holidays represent a policy conundrum in a national WR system, given that a substantial goal of the new system was to avoid interstate variations. The Australian Government should amend the NES so that employers are not required to pay for leave or any additional penalty rates for any *newly* designated state and territory public holidays. (Existing state holidays should be grandfathered.) Of course, employers and employees could still negotiate pay for any new state-declared public holiday, but that would be at their discretion, not state governments.

Long service leave (LSL) is an Antipodean idiosyncrasy. It was invented in the mid-19<sup>th</sup> century to allow citizens to sail to and back from England every decade. Despite its peculiar origins, it now has strong community support. However, the NES do not prescribe any consistent national LSL arrangements, so that there are relatively complex interstate variations. This means that national employers must deal with a diversity of qualifying periods and entitlements for LSL across the different arms of their national operations. This has been a longstanding complaint, and the last review of the Fair Work Act recommended a uniform national approach. Any change would produce winners and losers, and this may explain why there has been little appetite by states to change the status quo. Without a universal commitment by COAG to change, and an agreement about a workable transition, not much can happen in this area.

The NES adapt to community norms. Given the desirability that the NES continue to perform their role as a well-accepted baseline for workplace standards, changes to the NES should be preceded by high-quality analysis and public discussion.

Two significant social issues arose during this inquiry that could be considered as candidates for the NES. Equally, each could be considered for response via different mechanisms, such as a common clause in all modern awards or alternative avenues. Both

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affect employment and workplaces; yet both have implications beyond the workplace. They are leave arrangements for domestic violence and breast-feeding arrangements at work.

The FWC is paying significant attention to the first of these issues under the current four yearly award review and the Productivity Commission sees that as an appropriate method for assessment. There are alternatives, such as the NES and government assistance, and ideally, decisions on these should await the outcome of the award review process.

Support for breastfeeding arrangements at work has the potential to improve workforce retention and female workforce participation, both desirable outcomes. There may be other factors — for and against — that should also be taken into account. A more in-depth review of it should precede further consideration by government — in the context of the NES, via award modernisation or anti-discrimination law. Employers should take note of the relatively simple facilities required in most workplaces to make this option a reality, and the desirability from a staff attraction and retention perspective of doing so.

## Awards

Awards are the regulations that describe various floors on wages and conditions for a wide variety of skill levels across multiple industries. Relatively few people on individual contracts are *exactly* on an award payment. Awards still influence other employment contracts because some conditions (such as the span of hours or penalty rates) are derived from them, the wages and conditions of some employees who are part of an enterprise agreement largely reflect those in the relevant award, and because they form the regulatory benchmark against which to test whether other employment contracts disadvantage employees.

Awards are a longstanding part of Australia's workplace relations framework, with the FWC and its various quasi-judicial predecessors determining awards for more than 100 years. They are unique to Australia (and New Zealand until 1991), and sometimes this is seen as an indication that they are unnecessary. However, other countries have devised alternative wage determination systems that often also embody rigid rules to protect the low paid. And, while they are rigid and history bound, awards and the processes for determining them have adapted over time (though not by enough):

- For many years, awards were determined in response to industrial disputes, whereas today reviews are scheduled as a stipulation of the Fair Work Act and are primarily used to reassess their relevance, iron out anomalies, and ensure that the modern awards objective of the Fair Work Act is met.
- With the advent of enterprise bargaining in 1993, the primary role for awards shifted from being an instrument for setting actual wages and conditions to contributing to a broader safety net containing various floors for wages and conditions. As part of this safety net, awards help to balance the unequal bargaining power of employees and employers and increase the wages and conditions for some employees above those that

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they would be able to negotiate on their own. Awards have been effective in this role by reducing the dispersion of pre-tax employment income (especially in the lower half of the household wage distribution) and increasing the wages of low-wage workers.

- Through the award modernisation process, thousands of awards were collapsed to just 122, so the system is simpler than earlier.

It is often (but not always) the case that modern awards are less rigid and costly than their historical predecessors. Nevertheless, they remain relatively inflexible and are often ambiguous, imposing costs for employers and employees. (Even the Fair Work Ombudsman is sometimes unclear about the interpretation of clauses.) In some instances, they are more historical relics of the relative bargaining strength of past protagonists than a carefully thought out way of determining the minimum terms and conditions of employment.

However, few stakeholders recommended their elimination, but rather suggested reform and the easier availability of alternative options for employment contracts. Most consider that the (uncertain) benefits of eliminating awards might be outweighed by the cost of any transition.

- All parties suggested that the costs of transitioning to the modern awards between 2009 and 2014 were considerable (‘nightmarish’ according to some stakeholders). Any major shift away from awards altogether would trigger costs of a higher magnitude again. Removing awards would also require re-assessment of many other features of the WR system. For example, what benchmark, if any, would be used for testing whether an enterprise agreement (or the Productivity Commission’s new enterprise contract) really met some ‘reasonable’ wage standards? A no-disadvantage test is meaningless without a benchmark.
- The current system does not appear to be producing highly adverse outcomes.
- The tax-transfer system, while already highly developed, would need to further extend its reach to emulate the re-distributive effects of awards.
- Some of the ‘distortions’ created in labour markets are beneficial since they address unequal bargaining power and reduce the transaction costs of forming employment contracts for small business.

Nevertheless, there are strong grounds for improving the award system.

One relatively straightforward step — already partly underway — relates to the form of awards, rather than their content. Awards should be easier to understand and no more complex than they need to be. As the Business Council of Australia notes, many awards are unclear on penalty rates and overtime requirements. Awards should be in plain English and be written to avoid the mistakes and misunderstandings that arise from the present ambiguities of awards.

A more fundamental challenge is how to address the more systemic flaws in awards, without repeating the transitional costs of award modernisation. After the completion of

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the current four yearly award review (whose scope is considerably constrained), the new WSC should adopt a different approach to amendments to awards. It should undertake careful empirical analysis into the aspects of awards that are the source of the greatest problems — ‘hotspots’. It should then vary awards to address these on a thematic basis. Those hotspots cannot be determined ahead of analysis, but any analytical framework would attempt to identify the award variations (such as in allowances, wage rates, penalty rates, and spans of hours) that were genuinely problematic, rather than merely untidy.

An important complement to this change in approach is the development of a more coherent and streamlined set of goals in the ‘modern awards objective’. The current provision comprises various unobjectionable, but overly prescriptive, goals concerning, for example, the low paid, social inclusion, the desirability of collective bargaining, remuneration for unsociable hours, simplicity, and the impacts of award content on business, productivity, regulatory burden, employment growth, inflation and the performance of the economy. Different members of the FWC have given different weight to each element in making judgments on award issues. It is easy in moving from item to item to lose sight of the broader community interests, and especially of the specific impacts of awards on the jobless and consumers. A much-simplified Objective would give primacy to community wellbeing as a whole, and list only a few considerations in making an assessment.

The regulator should also make changes to awards where there are easy gains from adding consistency or where anomalies become apparent.

However, there is no need for the regulator to review all aspects of awards, term by term. That would be an ambitious task, with diminishing returns and high costs for stakeholders. Once the current four yearly review has been completed, these periodic reviews should cease. Future assessments should be undertaken on a needs basis. Over time, the adoption of the Productivity Commission’s evidence-based approach to awards will make them more adaptive to workplace realities, reduce unjustified differences in awards, and make them more flexible, but without undermining their intrinsic role as a safety net.

## **Regulated penalty rates for shift, overtime and weekend work should stay**

Many Australians work non-standard hours either by working longer than the 38-hour norm under the NES or by working at non-standard times, such as at night or on weekends. They are compensated by regulated premiums on normal wage rates (sometimes generically categorised as ‘penalty’ rates).

Penalty rates are strongly dependent on when work is undertaken and the total time spent working. The three principal time-related wage rates are:

- shift loadings, and weekend and evening pay premiums. These are requirements placed on employers to pay additional wages at certain times of the day or on certain days of

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the week, and are not dependent on how many hours in total a person has worked during the week

- overtime rates, which represent higher wage rates for hours worked greater than the usual ordinary hours listed under an award or an agreement
- payments for working on public holidays.

There are compelling grounds for premium rates of pay for overtime, night and shift work:

- Long hours of work involve risks not only to an employee's health and safety, but also for the community. (Long working hours are not rare. In mid-2015, around 2.8 million Australian employees reported working more than 40 hours per week and over 1.5 million reported working 50 hours or more per week. In 2012, around one third of employees worked overtime.)
- There are proven adverse health effects from night shift and rotating shift work.
- By definition, public holidays are intended to encourage shared community activities. As such, there are strong grounds for deterrence against their use for working, but with some flexibility to provide some services on these days. The appropriate rate for public holidays would need to account for (a) the fact that, as is normal for other leave, public holidays are generally paid at ordinary wage rates despite the fact that people are not working, and (b) the additional requirement to deter activities that undermine the intended goal of such holidays.

Regulated minimum penalty rates recognise the impacts of such work and that absent regulation, the generally weaker bargaining power of employees may not lead to adequate compensation. The Productivity Commission has not recommended any changes in these rates. This is also in line with the views of participants in this inquiry, who did not raise any significant concerns about penalty rates for overtime, night or shift work.

### **Towards weekend rates for the hospitality, entertainment, retail, restaurant and cafe industries**

Australia has multi-tiered arrangements for regulated penalty rates for weekend work. Only around half of the 122 awards specify such weekend rates, reflecting the different types of working arrangements of different industries and occupations. Of those that do have penalty rates, there is a wide variety of rates, eligibility criteria and triggers for when the arrangements apply. Factors such as the skill and occupation of the employee (even within a given award), whether they are a casual or permanent employee, and exact hours of working can be relevant to the rate. The variety exemplifies that penalty rates are an art borne of history, precedent, compromise and the lack of a coherent overarching set of principles.

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In an unregulated well-operating market, it could be expected that employers would have to pay premium rates if they were unable to elicit sufficient labour supply on weekends. This reflects that most employees value weekends more highly than weekdays. But labour markets are not perfect (which is why WR systems exist in the first place). Individual businesses possess some bargaining power in respect of the labour they hire, with the risk that market-set penalty rates would be lower than they should be. Community standards about the reasonable rates for working on weekends in such industries are also relevant. The question is then not whether there should be regulated weekend penalty rates (or some other method for remunerating people working at asocial times), but whether they are set at the ‘right’ level.

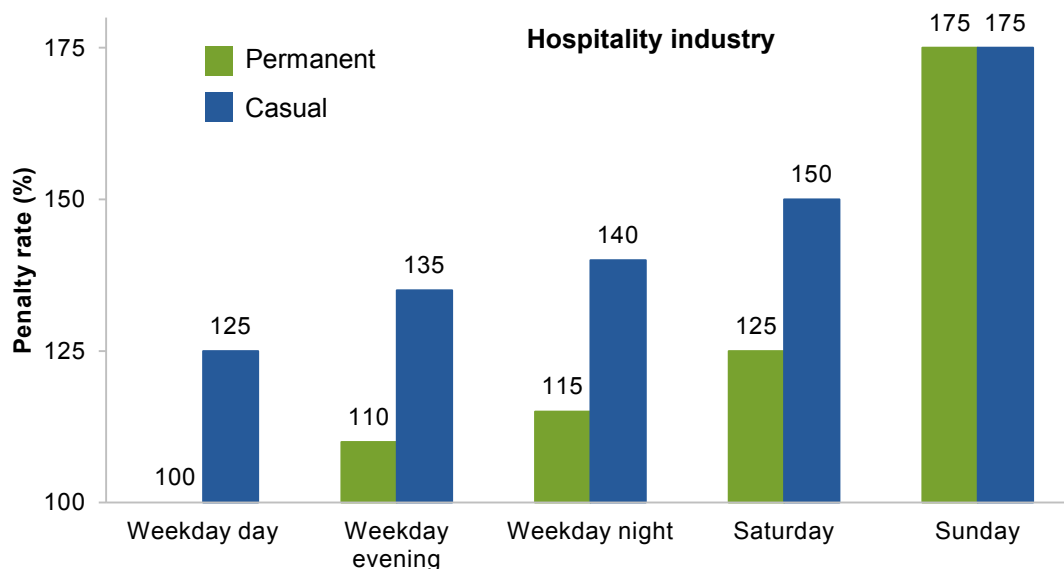
Regulated penalty rates are particularly high on Sundays — as illustrated by the various rates applying in the hospitality industry for different working-time arrangements (figure 8). The effects of Sunday penalty rates across different parts of the economy depend on the characteristics of the relevant goods and labour markets, including the:

- response of businesses to high wage rates
- degree to which customers want services on Sundays
- nature of the labour used in an industry
- typical working arrangements on weekends.

Given their characteristics, one group of industries — the hospitality, entertainment, retail, restaurant and cafe industries (HERRC) — are particularly affected by regulated penalty rates. For these industries, social trends and community norms have shifted so that the historically distinctive role of Sundays as a time when people did not shop or engage in other consumer-oriented activities has changed. Sunday trading is now normalised and highly valued by consumers. Increased female workforce participation rates, especially among married women, the steep reduction in religious observance on Sundays, changing social norms about shopping times, the softening of trading hour restrictions, and the emergence of international online commerce have contributed to this. In light of these changing preferences, existing penalty rates for Sundays now reduce consumer convenience and product diversity in a way that did not occur when the workplace regulator first introduced penalty rates.

Unlike most other industries, the HERRC industries are also an important source of jobs for young unskilled people, including those who are combining studying and work. Such jobs provide longer-term benefits for young people in integrating them into the labour market by building skills and experience. Barriers to youth employment in entry-level jobs can have adverse lifelong effects for engagement in work, especially for some groups.

Figure 8 **Penalty rates by day and time of the week**  
Rate relative to permanent employee on a weekday<sup>a</sup>



<sup>a</sup> Casual penalty rates are inclusive of any casual loading.

The overall evidence also suggests that employers in the HERRC industries are likely to have a weaker capacity to use bargaining power to depress wages on weekends, and regulated floors to wages should reflect this. For example, in the relevant industries, the frictions from moving from job to job — one indicator of the likely bargaining power of employers — do not appear to be high.

The industrial regulator, unions and businesses have acknowledged that the role of Sundays has changed and they, accordingly, have recognised that one of the original principal objectives of penalty rates — the deterrence of Sunday trading — is anachronistic. Yet that recognition has not been accompanied by sufficient reform of the rates. Indeed, paradoxically, award modernisation raised average penalty rates in some of the HERRC industries.

Some of the broader arguments that might conceivably have justified high regulated penalty rates for Sundays in the HERRC industries are also not compelling. There is little evidence that, in contemporary Australia, the social impacts of work on Sundays are disproportionately higher than Saturdays or other times deemed to be ‘unsociable’, despite this being the strongest rationale for a higher rate on that day:

- Most people working on weekends — Saturdays or Sundays — do not claim any major impacts on their lives. For example, 78, 75 and 70 per cent of people working on Saturdays, Sundays and evenings respectively said that their working patterns only infrequently affected the time they could have with family and friends.

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- Sometimes Sundays seem to pose fewer problems than Saturdays (such as feeling ‘rushed’ or having ‘work life balance’).
  - There is no difference in working on Saturdays or Sundays on subjective wellbeing.
  - People seem to engage in similar activities on Sundays and Saturdays.
  - For many people, weekend work suits their circumstances — which explains the predominance of students in some consumer industries — such as fast food.

Rates for Sundays appear particularly at odds with rates for times that are also important for social activities (evenings), and to an even greater degree for times that pose clearly demonstrated health risks (night shifts and rotating shifts). Evening/afternoon shift penalty rates can be as low as 10 per cent and night shift loadings as low as 15 per cent (figure 8).

Moreover, the returns from working at unsociable hours on Sundays is out of kilter for compensation for other aspects of a job — such as experience, responsibilities, or qualifications. For example, the wage premium from completion of tertiary compared with year 11 education is around 40 per cent, yet the premium for daytime Sunday work is often 100 per cent compared with daytime Monday to Friday work.

Given that the community norms that underpinned the original basis for high Sunday rates have now shifted, and the lack of compelling evidence that work on Sundays poses more social costs than Saturdays, there are few grounds for setting different penalty rates for these two days in the relevant industries. The FWC should change Sunday penalty rates to Saturday rates in the HERRC industries, preferably as part of the current four yearly review. Otherwise, the new WSC should prioritise reform as part of its attention to ‘hotspots of inefficiency’ in the award system.

In the longer run, businesses would not be the beneficiaries of deregulated penalty rates given the high levels of competition in the relevant industries. Survey and other evidence suggests that consumers (including tourists) would benefit from:

- more convenient access to services they value highly (due to longer opening hours and greater numbers of operating businesses)
- improved quality of services because of improved staffing ratios
- lower prices in some cases (for example, through the ending of Sunday surcharges in restaurants and cafes).

Those jobless (either unemployed or not in the labour force) suited to the Sunday labour market will be particularly responsive to the opportunities presented by greater demand for labour on that day. Since joblessness is particularly adverse for people’s wellbeing, any employment gains for this group would be particularly important. There is also likely to be a change in the mix of employment. Many business owners work long hours on weekends because of the costs of employment, and there will be substitution between their (sometimes excessive) workload and that of employees.



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Reductions to Sunday penalty rates will particularly reduce the incomes of people who work Sundays only. While there are relatively few such workers in the HERRC industries, the Productivity Commission proposes a lag before any change occurs, allowing people to adjust their lives and working patterns. Regardless, high Sunday penalty rates are not the best or fairest way of assisting households on low incomes (especially as a significant number come from higher-income households).

But what about other industries? Unless the WSC identifies compelling grounds for doing so, the Productivity Commission does not see grounds for extending penalty rates to the 50 per cent of awards that do not have them, nor for closing gaps in occupational coverage in awards that do. In many of the other awards that contain penalty rates — such as essential services — there are no strong grounds for change because the existing rates have few adverse effects and apply in labour markets that are quite different in character to the HERRC industries. Unlike the HERRC industries, penalty rates are not likely to materially reduce service availability (these are often not discretionary services), are unlikely to lead to job losses (the employees concerned are highly skilled), and align with working arrangements that often involve rotating shifts across the whole week, with the attendant risks this involves. Quite simply, unlike the HERRC industries, the basis for penalty rates in these industries has not changed.

Nevertheless, there may be other industries that are similar to the HERRC industries, and where the costs to the community exceed the benefits. There is no basis for immediate changes to their Sunday penalty rates, but based on the improved practices and experience with conducting award assessments, the wage regulator should undertake research and seek proposals from other industries in the medium term, and assess whether a similar case can be made for changes to penalty rates.

## **4 Protecting employees**

Australia has a range of laws that protect employees from discrimination, bullying, unfair treatment and dismissal. While sometimes depicted as onerous, complex and overprotective, objective measures of such employee protection arrangements around the world suggest that Australia has one of the more light-handed suites of arrangements.

### **Unfair dismissal**

Australia's WR system provides remedies for workers who are dismissed in a 'harsh, unjust or unreasonable' manner. The FWC may order the unfairly dismissed employee to be reinstated, or paid compensation where reinstatement is not feasible.

Unfair dismissal arrangements reflect that employees and employers can behave badly. Employees may underperform, be disruptive or act poorly. Firms and labour markets can only function efficiently if managers have the power to demand behavioural change by

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poorly performing employees and, absent that, to dismiss or otherwise penalise them. On the other hand, employers may make unreasonable demands (such as requiring employees to work longer without pay or overlooking safety issues) or may dismiss people based on prejudice, whimsy or without due process. Accordingly, there is a need for some balance between the prerogative of businesses to manage and the rights of employees to fair treatment.

The prevalence statistics show that unfair dismissal claims remain relatively small in proportional terms across the Australian labour force and that employers only infrequently encounter unfair dismissal cases (at around 0.2 per cent of employees in 2012-13). It appears that even where employees are dismissed with cause, around 90 per cent make no claims, and of those that do, 80 per cent enter a relatively low-cost conciliation process (with a 60 per cent chance of some compensation). The remaining claims go through a more intensive arbitration process (with about 30 to 40 per cent of total cases that proceed to substantive arbitration resulting in compensation). Compensation is usually modest, but the management and legal costs add to the overall costs associated with dismissals.

Perceptions aside, there is little evidence that unfair dismissal laws are a major obstacle to hiring, especially given the relatively long probationary periods that exempt an employer from any claims (six months for an employer with 15 or more employees and one year for smaller businesses). Conciliation processes may sometimes be ‘rough justice’ in that the full circumstances of a case are not tested meticulously. However, once unfair dismissal claims go to arbitration, the outcomes can be very uncertain (and far more costly than conciliation) and there is some troubling inconsistency in the decisions of different members of the FWC.

The costs of progressing cases through conciliation and arbitration provide incentives for businesses to pay ‘go away’ money to employees who claim employers have unfairly dismissed them. While it no doubt occurs, there is insufficient data about the extent of go away money, and how it can be distinguished from cases where the employer and the employee agree that the justification for dismissal is not clear cut.

The most problematic aspect of the current legislation is that an employee who has clearly breached the normal expectations of appropriate work behaviour may nevertheless be deemed to have been unfairly dismissed because of procedural lapses by the employer. For example, in one case a business dismissed two employees after they assaulted their supervisor.<sup>1</sup> The FWC concluded that their physical assault was a valid reason for dismissal, but that the employer’s failure to follow certain administrative procedures meant that the dismissals were unjust, unreasonable and therefore unfair.

Moderate and incremental reforms can address the current flaws, while leaving much of the existing legislation and its legitimate protections intact:

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<sup>1</sup> *Sheng He v Peacock Brothers & Wilson Lac v Peacock Brothers* [2013] FWC 7541 (27 September).

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- The Fair Work Act should be amended so that procedural errors alone are not sufficient to award compensation or restore employment in what would otherwise be regarded as a valid dismissal. Nevertheless, procedural errors by an employer should, at the discretion of the FWC, lead to either advice to the employer, or where serious or repeated, the potential for the FWC to seek financial penalties through an application to the Federal Circuit Court or Federal Court.
  - There should be an upfront assessment of whether there is a valid reason for dismissal.
  - Non-refundable lodgment fees may also assist at the margin in limiting the automatic recourse to the FWC, and reduce the considerable administrative load that the FWC faces in providing refunds.
  - There should be a two-part fee for applicants for unfair dismissal rulings, with an initial modest fee for accessing conciliation at the FWC, and a further fee for cases where a party takes the matter to arbitration. The FWC should also advise all parties that, based on recent decisions, 60-70 per cent of arbitrated cases do not lead to compensation. These measures should further encourage conciliation as the preferred vehicle for dispute resolution.
  - To reduce some of the present inconsistencies, the governance of the FWC should be reformed along the lines discussed earlier.
  - While reinstatement should not be relinquished as *a* goal of the unfair dismissal provisions, the emphasis on reinstatement as the *primary* goal should be removed. Its realistic attainability depends very much on the context of the employee, the circumstances of the dismissal, and the employer, which requires case-by-case assessment. Reinstatement is rarely achieved, and in many cases would not be desirable for any of the parties.
  - The above reforms, complemented by further targeted provision of information and regulator engagement with small business, will deal with many of the current issues experienced by small businesses. Subject to implementation of these reforms, the Small Business Fair Dismissal Code should be removed. The basic premise of assisting small business to navigate the complexities of unfair dismissal legislation is reasonable, but the Code does not achieve that outcome and provides a false sense of security.

## **The general protections**

The general protections provisions of the Fair Work Act comprise a lengthy (sometimes relatively technical) set of prohibitions, including against conduct by employers and industrial associations that breaches an employee's workplace rights — 'adverse action'. For example, adverse action might comprise discrimination against employees because of their union membership (or in some cases because they are not union members). There are very strong grounds for such protections, as employees should not be subject to disadvantage for reasons unrelated to their actual work performance.

However, there are some deficiencies in the current arrangements.

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The General Protections are broad and sometimes ambiguous. Unlike the specific unfair dismissal provisions, they provide uncapped compensation, which provides incentives to use them as a more lucrative avenue for compensation for dismissals. Moreover, an employee dismissed for underperformance or breaching workplace codes of conduct has strong incentives to claim that some other non-permitted reason was the true basis for the dismissal (for example, because they had complained about some aspect of management), even if this claim was confected. These factors may have been one of the accelerants for the very rapid growth of dismissal cases under the General Protections. (Dismissal cases account for nearly 80 per cent of total General Protection cases).

This is not to say that many cases are not genuine. However, a well-functioning system should be designed to limit perverse outcomes, not just because this avoids inefficient and unfair outcomes, but to shore up its integrity. Regulations that lack credibility do not serve the interests of employees with a strong basis for their claims.

In principle, placing a cap on compensation for breaches of the General Protections, or a part of them, would appear to provide a solution. However, this would have a range of unintended consequences, not least because the Protections are a catch-all for a wide range of discriminatory or adverse conduct by employers, unions and other parties, with difficulties in carving out any one element. In some instances, the adverse action is so severe that large compensation amounts should be payable, and failure to provide them would not adequately deter such conduct.

An alternative preferred remedy to vexatious claims is that the Fair Work Act be amended to allow the awarding of costs against an applicant who unsuccessfully pursues a claim in the face of an FWC recommendation that the claim not proceed. This measure is likely to put a break on opportunistic claims, while not throwing the baby out with the bathwater.

Some employers are concerned that unions sometimes use the General Protections to oppose business restructuring (for example, moving to labour hire arrangements or adopting labour-displacing technology) because it can have adverse consequences for existing unionised employees. In practice, this does not seem to have been a major problem, but should be reviewed by the Australian Government in 18 months. However, another issue also related to structural adjustment — the ‘transfer of business’ provisions of the Fair Work Act — are more problematic (see later).

One notable feature of the General Protections is that the onus is on the employer to prove that adverse action has not occurred. Since employees cannot be in a position to acquire the information to prove intent, there is reasonable justification for such a reverse onus. However, some stakeholders claimed that the reverse onus of proof, while of itself unproblematic, can nevertheless trigger a discovery process that allows a union or court to sift through potentially hundreds of thousands of documents in search of intent (and this has occurred). Doing so may not only be costly in its own right, but may disclose many aspects of a business that would be unreasonable to expose to third parties. Moreover, the court processes that accompany adverse action cases are slow (years can pass), creating large administrative and legal costs and frustrating business plans. However, in its Access

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to Justice inquiry report, the Productivity Commission found that many superior courts, particularly the Federal Court, have taken significant steps to curtail discovery. This has generally reduced costs and timelines.

Courts are now also successfully addressing a previously identified prime problem. Some key High Court cases have established legal precedents that an adverse action case will not succeed because of some coincident possible breach of a workplace right (such as dismissal of a union official who has performed poorly). To the extent that the precedent is observed in other cases, adverse action would require that such a breach was, on examination of the subjective intentions of the decision maker, the main reason for the dismissal.

Modest reforms can address the other limitations:

- The currently quite uncertain ‘complaint’ trigger for protection of a workplace right needs to be much better defined.
- Consistent with reform in judicial processes in several jurisdictions, the Fair Work Act should be amended to make the discovery process used in adverse action cases proportional to the issue at hand.

## **Anti-bullying**

Bullying can have devastating consequences for people, which is why various laws have attempted to discourage it by penalising those who engage in it or who permit it to happen, and by providing compensation to victims. There are multiple avenues for addressing bullying — such as through various anti-discrimination and workforce health and safety laws, and since January 2014, as an addition to the Fair Work Act.

The Fair Work Act accords a key role to the FWC in overseeing this new jurisdiction. As is the case for unfair dismissal, the FWC is the mediator, conciliator and, as a last resort, adjudicator. The FWC can make any order it considers appropriate to stop the bullying. However, it cannot make orders requiring payment. Workers may be able to seek compensation through other means, including workers’ compensation, workplace health and safety, and common law claims. A failure to comply with FWC orders would expose the employer and/or the relevant bullying party to civil penalties.

Some have questioned whether anti-bullying provisions needed to be incorporated into the Fair Work Act given the other avenues for addressing the issue, and were concerned that it might become the preferred avenue for complaint. The expected barrage of claims has not materialised, though they are increasing rapidly. In 2014-15, the FWC received just under 700 applications for an order to stop bullying (a more than doubling in the caseload over the previous year), with 60 finalised by a decision. Of these, only one application resulted in an order to stop bullying. However, the provision is resource-intensive for the FWC as evidence provided by applicants can be extensive, if not always substantive.

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Overall, while the FWC’s current approach appears to be considered and effective, sufficient time has not elapsed to reach a final judgment on the effectiveness of the provision or to assess whether the low probability of success may stem the flow of applications. A post-implementation review is already scheduled, and this would provide a timely opportunity to assess the operation of the jurisdiction.

## **5 Enterprise bargaining**

Following almost one century of centralised conciliation and arbitration, Australia introduced enterprise-level bargaining in 1993. Enterprise bargaining involves employees working together to reach an agreement with their employer over the terms and conditions of their employment. Enterprise bargaining can potentially yield efficiencies through negotiating and using one agreement, rather than many individual arrangements. It is also a vehicle for achieving a delicate balance between the parties’ interests. On the one hand, it provides a counterweight to the bargaining power of the employer (the adversarial aspect to bargaining), and, on the other hand, the scope for cementing cooperation between parties that have a mutual stake in the efficiency and performance of the individual enterprise. Enterprise bargaining provides some flexibility to take into account the special circumstances of any one firm. This contrasts with collective bargaining across multiple enterprises and industries (the arrangements preceding 1993), which did not have a focus on the individual enterprise.

The Fair Work Act has detailed rules around enterprise bargaining. While the bulk of agreements appear to be formed with no difficulty and with benefits for all parties, there are several flaws in the current arrangements.

### **Where a staple can undo an agreement**

Peabody Moorvale Pty Ltd<sup>2</sup> provided three pages — stapled together — to all of the employees to be covered by a proposed enterprise agreement. Some bargaining ensued, an agreement was struck and the agreement was lodged with the FWC. However, by attaching the three documents together, the employer contravened requirements about the form of notice to be given to employees. The FWC had no real discretion in the matter, and was obliged by the Fair Work Act to reject the agreement. So, absurdly, the employer had to recommence the agreement process. There is a convincing variety of similar examples.

While there are often good reasons for imposing procedural requirements (for example, to prevent employers including extraneous and potentially misleading information in a notice to employees), substance rather than form should prevail, which is a recurring theme in this

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<sup>2</sup> *Peabody Moorvale Pty Ltd v Construction, Forestry, Mining and Energy Union* [2014] FWCFB 2042 (2 April 2014).

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inquiry. In this type of instance, the solution is that the FWC should have the discretion to overlook a procedural defect (that poses no risks to employees) without requiring an undertaking by the employer.

## **Good faith bargaining**

The good faith bargaining requirements appear to be working relatively well. While some have advocated for time limits on bargaining and then recourse to a decision by the FWC as the workplace umpire, this would reduce the incentives for parties to agree among themselves. A central tenet of the shift to enterprise bargaining was to step away from third party arbitration. The FWC already has sufficient powers to step in, as a matter of last resort, when there are repeated breaches of the requirements.

## **The better off overall test (BOOT)**

The BOOT is intended to avoid circumstances where imbalances in workplaces stemming from employer power or the domination of certain employee bargaining representatives result in agreements where individual employees are not better off in comparison with the relevant award. However, a no-disadvantage test (NDT), which requires that people are not made worse off, can achieve the same outcomes more efficiently.

- The scope for tradeoffs that assure that the BOOT is passed is limited in enterprise agreements that involve employees who are predominantly on the award. This restricts the desirable uptake of enterprise agreements.
- The BOOT requires the FWC to be positively satisfied that an agreement will make all employees better off than the relevant award. This provides a wider scope for the FWC to reject agreements at the approval stage when compared with a NDT, because it changes the onus of proof. Under an NDT, the FWC would need to identify how an agreement makes employees worse off overall in order to reject an agreement.

Merely replacing the BOOT with an NDT does not resolve a further technical issue. There is ambiguity under the Fair Work Act about whether the test applies to every single individual in an agreement or to a class of similar individuals (such as weekend casual employees). Under an NDT, the former would have the unfortunate consequence that the FWC could not approve an agreement even if just one individual was made worse off, say because of idiosyncratic preferences about rostering. It would also make the NDT (or the present BOOT) administratively burdensome. In practice, the FWC has typically used the BOOT in relation to a given class of employees, but there remains a risk that a single employee's complaint might sink an agreement. Statutory change to ensure that the test be for a class of employees would address this problem.

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## **Greenfields agreements pose major dilemmas in regulatory design**

The unique circumstances of bargaining for a greenfields agreement warrant a different regulatory approach. Such agreements are struck between a union and a new enterprise that has not yet hired any employees. Since 2011, the use of greenfields agreements has expanded. Greenfields agreements now make up 10 per cent of all enterprise agreements, up from 6.4 per cent in September 2011. Greenfields agreements are most prevalent in construction projects, which make up roughly two-thirds of greenfields agreements. However, they are also currently used in many other contexts, including health and aged care and manufacturing, so they do not always relate to large capital-intensive projects with a given life. However, the problems of the agreement-making processes strike most hard for such projects.

The main concerns are that large capital-intensive projects require some certainty about the start date of the project to secure finance, to plan the project, and to more generally manage risk. Unions' capacity to hold out in their negotiations provides them with potentially excessive bargaining power, and risks stripping some of the needed returns from inherently risky projects. Unlike other enterprise bargaining processes, the usual disciplines for speedy bargaining — the absence of pay increases for an existing workforce — are not present.

There are no easy solutions. Avoiding all uncertainty for employers would shift the balance of power too far in their direction. Allowing the FWC to determine the 'best' outcome would be at odds with the desirability of leaving essentially commercial decisions in the hands of those parties with the greatest information. Given the varying nature of the industries, enterprises and unions that strike greenfields agreements, the Productivity Commission has devised a menu approach, which would allow employers to choose between three options that may suit their particular circumstances. The menu would only be available if an employer and union have not reached a negotiated outcome for a greenfields agreement after three months.

The first and most novel option is for the employer to request that the FWC undertake 'last offer' arbitration of an outcome by choosing between the last offers made by the employer and the union. The FWC would not reopen the matter to make its own judgment, but would merely act as an umpire for the two choices put to it. Knowing this, the parties to the agreement would have strong incentives to make reasonable claims. It would, however, still require that the FWC consider the proposals with a high degree of expected impartiality. The 2012 post-implementation review of the Fair Work Act also recommended that 'last offer' arbitration be used to resolve stalemates in greenfields negotiations.

Second, an employer could submit the proposed greenfields arrangement for approval by the FWC without any need for union agreement, with a 12-month nominal expiry date. At that point, the business would have hired employees, and a normal enterprise bargaining round could occur. The advantage of this option is that the employer would have the



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capacity to negotiate tradeoffs with employees that unions might be unwilling to accept. On the other hand, such bargaining could also lawfully trigger industrial action, with the potential to delay a large already committed project. This would give employees and their representatives a potentially high degree of leverage. An employer facing those risks would be unlikely to select this menu option. It would, however, be much more likely to be attractive to non-capital-intensive greenfields arrangements in which an employer wanted to engage positively with its employees (such as an aged care facility).

The third option would be continued negotiation with the union, recognising that sometimes parties may be close to an agreement anyway, or that after the three month limit had elapsed, unions have greater motivation to seek a mutually beneficial outcome. This would only occur if the employer was confident that a reasonable agreement could be reached, and that the cost of waiting was not prohibitive. It is nevertheless likely that constructive dialogue between the parties — not always guaranteed by the instinctive culture of the two parties — may go a long way.

Regardless of the agreement making process chosen by the employer, the ensuing greenfields arrangement would have to pass the proposed no-disadvantage test.

Another complementary mechanism that would also reduce the hold-up problem and uncertainty for construction greenfields projects would be the capacity for an employer to form an agreement whose duration matched the life of the construction project (with approval from the FWC if that duration exceeded five years).

## **The content of enterprise agreements**

While all enterprise agreements must include a flexibility term that allows parties to make an individual flexibility arrangement to vary the conditions of an enterprise agreement (see later), the range of matters over which such individual arrangements may be made can be whittled down during the bargaining process. Such a narrowing of options should not be permitted.

The range of matters that should be permitted in an enterprise agreement is an area of fierce contention. Employers generally wish to reduce the range of matters over which bargaining can occur, based on the primacy they give to managerial prerogative, while employees seek a more expansive range of matters. Sometimes it is not straightforward to determine the appropriate content of enterprise agreements. However, in one area, there is no basis for restrictive clauses. So-called ‘jump-up’ clauses that require businesses to engage subcontractors on the same terms as employees, or that limit the employment of casual and labour hire employees are, in spirit, contrary to the *Competition and Consumer Act 2010* (Cth). Employers should be able to use subcontractors and casual and labour hire employees, as suits their business operations and the workers themselves. The Fair Work Act should be amended to prohibit restrictions on such employment arrangements in enterprise agreements.

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In terms of permitted matters more broadly, the Fair Work Act deliberately moved away from the legislative prescription in previous regimes to a reliance on jurisprudence about ‘matters pertaining’. There are several disadvantages of the various statutory alternatives.

‘Black lists’ — as in many other prescriptive regulations — can include matters that might, on closer examination, legitimately be included in an agreement. One employer’s bad practice may be another’s effective reform. Barring ‘consultation’ is an example.

White lists that stipulate exhaustively the only matters that can go in agreements are equally, if not more, problematic because they fail to take into account future developments in labour relations that expand the matters that might reasonably be covered by the employer-employee relationship.

One of the benefits of collective agreement making is that it establishes conditions that are not frozen in time, and can take account of the different issues that could affect workplaces of the future. Context and detail matter a great deal. Moreover, a body of developing case law has clarified some key aspects of agreements that are not permitted matters, but in a more nuanced fashion than might occur through legislative dictate. That jurisprudence will evolve further over time.

That said, there is little basis for permitted matters in enterprise agreements to extend to matters pertaining to the relationship between an employer and employee organisations and that extension should be removed.

Despite calls for the introduction of mandatory productivity clauses within all enterprise agreements, this might perversely generate outcomes inimical to productivity and be counter to managerial prerogative. Most employers constantly look for ways to improve productivity in ways that do not require any quid pro quo in terms of increased wages and conditions (for example, if the business invests in more productive equipment or innovates). Where there are gains from cooperation, employers, employees and their representatives already have strong incentives to voluntarily commit to productivity improvements and, where possible, to specify ways in which this might be achieved through enterprise agreements without resorting to new regulation. Some employers noted the incentive this may create for employee representatives to frustrate productivity enhancements until the next bargaining round.

## **Bargaining representatives must represent more than a trivial share of the workforce**

Multiple non-union bargaining representatives who represent a very small number of employees may add considerably to the cost and smooth progression of bargaining. There should be a requirement that a non-union party can only act as a bargaining representative if they have secured sufficient support of the workforce. (The Productivity Commission has proposed 5 per cent or 20 employees, whichever is the smaller.)

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## Transfer of business

Business exits — whether arising from failure, restructuring or the sale of a going concern — result in movements of people, capabilities and capital around an economy. The potential for businesses to be purchased and/or to transfer work to new businesses, is important for productivity, innovation and structural change. Equally, however, employees of transferred businesses are concerned not to lose the conditions they had negotiated with the previous employer. The Fair Work Act requires that the conditions of the enterprise agreement in the business-of-origin transfer to the new enterprise (potentially in perpetuity). While this requirement prevents an employer from strategically restructuring their business to escape a previously negotiated agreement, it can also stymie genuine structural change and lead to significant job losses.

To reduce that risk, the Fair Work Act should be changed so that the Fair Work Commission must take into account the employment risks of any decision it makes about the arrangements for transfer of business. Moreover, the conditions inherited from the business-of-origin should lapse after 12 months, with the relevant employees then covered by whatever arrangement is in place in the new enterprise. There should also be no regulated limitations on the voluntary decision by an employee to move to the new enterprise and be immediately covered by its employment arrangements.

## 6 Individual arrangements

Even when part of an enterprise agreement, all employment contracts are, in law, individual arrangements. The WR system merely provides different ways in which such contracts can be packaged, weighing up the advantages and disadvantages of individual flexibility, the costs of contract variations across workers in the same enterprise, and the risks of power imbalances that arise from different contractual arrangements.

While most employees are paid at rates determined by an enterprise agreement or stipulated in an award (figure 1), a sizeable minority are paid on an individual basis at above-award rates. A relatively few — around 2 per cent of all employees covered by the Fair Work Act — have formed so-called ‘individual flexibility arrangements’ (IFAs) under the Act.

In principle, IFAs allow an employee and employer to negotiate terms and conditions that suit their personal and business circumstances. For example, an IFA may change rostering arrangements to suit an employee and an employer. An IFA may allow, but does not require, an employee to forgo some award or enterprise agreement conditions so long as they pass a better off overall test as described above. (The BOOT is benchmarked against the enterprise agreement if an employee is opting out of the agreement, but otherwise against the pre-existing award or award-based arrangement.) No agreement can trade off conditions specified under the NES.

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IFAs represent a new marque of statutory individual arrangements, and supersede several variants of Australian Workplace Agreements (AWAs). Under WorkChoices, AWAs were not subject to a no-disadvantage test, and were contentious because some employees who lacked bargaining power had their entitlements reduced. Such AWAs were offered as a condition of employment ('take it or leave it') and had a low safety net threshold. Available data suggest the take-up of AWAs was around 3 per cent of employees. Prior to WorkChoices, AWAs had stronger protections and were less controversial.

It is surprising that employees and employers have not used IFAs more frequently, as they offer considerable flexibility, provide protections for employees, and are not hard to make. One immediate and easily implemented reform would be for the Fair Work Ombudsman to better advertise the option of an individual flexibility arrangement to employees and employers. Many have not even heard of them.

Some of the other obstacles to their use are more perceived than substantive, but are still worth remedying.

For example, employer groups argue that the ambiguity about the BOOT makes employers reluctant to form an agreement lest subsequently the Fair Work Ombudsman finds that they breached the test. This concern arises because IFAs are not vetted against the BOOT by the Fair Work Ombudsman when they are made (to avoid the large transactions costs of doing so). However, unless there has been egregious conduct (such as coercion to make an agreement), the most likely outcome of a breach of the BOOT would be immediate termination of the agreement and reversion to the award, enterprise agreement or other pre-existing arrangement. There have been very few instances where the Fair Work Ombudsman has acted against an employer in respect of an IFA. And surveys of employers (as opposed to the views of employer groups) suggest that fear of failing the BOOT at some future date is not a major obstacle. Nevertheless, there appears to be no harm in eliminating any perceived risks where they do not undermine the protection of employees. The switch to a no-disadvantage test as discussed above would represent a straightforward remedy, as would guidance to businesses and the development of example agreements that would be compliant.

Another potential deficiency is that employers can be reluctant to invest in flexible arrangements because an employee on an enterprise agreement can terminate an individual flexibility arrangement with 28 days' notice and IFAs can only be offered to existing employees, rather than as a condition of employment. Short notice can expose businesses to financial and operational risks. As a concrete illustration, a business might set up rostering arrangements underpinned by commitments by employees set down in IFAs, only to find that the termination by several employees made the arrangements untenable. By reducing their expected return, the risk that IFAs may be terminated soon after their formation may undermine the incentives for managerial innovations. Likewise, rapid termination by an employer can adversely affect employees who may have made flexible home arrangements (for instance, to coordinate childcare with working times) only to find them vanish.

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The evidence about the severity of these problems is weak but, as in the previous case, there is a remedy that has few downsides. The Australian Government should amend the Fair Work Act so that the minimum termination period should be 13 weeks (as proposed in the 2012 post-implementation review of the Act), but with the capacity of employers and employees to agree at the formation of the agreement to a one year minimum period.

### **A possible new type of arrangement that spans individual and enterprise agreements — the enterprise contract**

However, even with these changes, it is unlikely that the prevalence of truly bespoke individual arrangements would ever be high, simply because of the high transaction costs of their negotiation. This is especially so for businesses with high staff turnover or that are rapidly expanding. The scope of IFAs is determined by particular clauses (the flexibility term) in the overarching award or enterprise agreement, which can be quite restrictive.

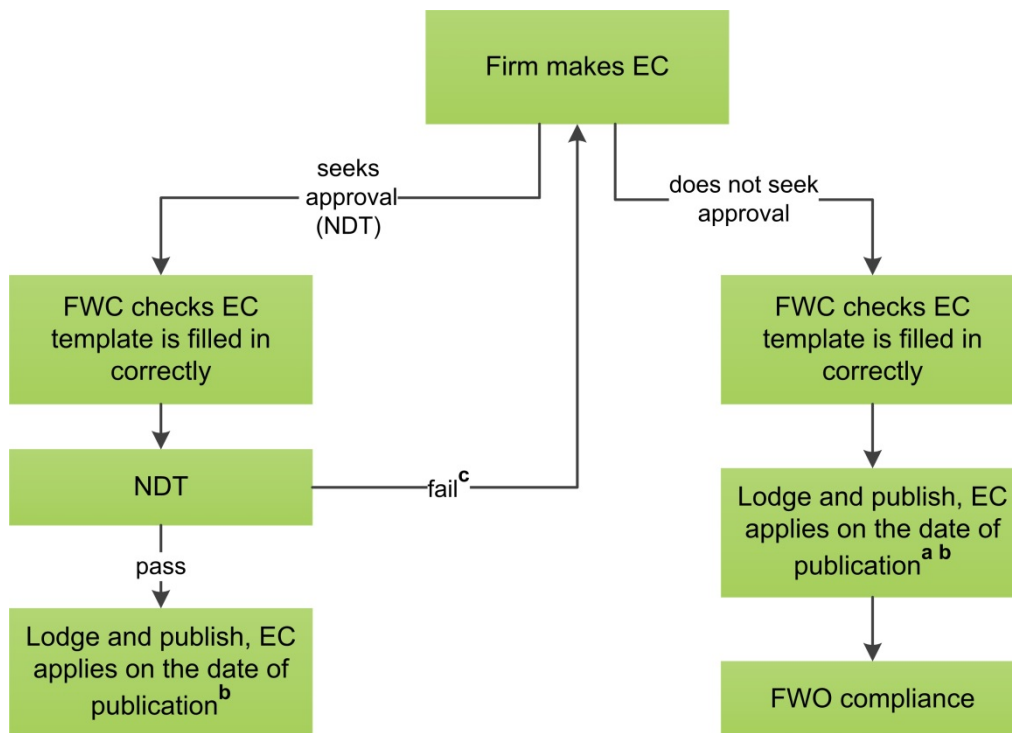
Businesses could still achieve flexible arrangements across their operations by negotiating enterprise agreements but, as discussed later, such agreement making is still rare amongst small and medium-sized businesses. This is because the procedural aspects of such bargaining can be daunting (though the perceptions are probably worse than the reality).

To meet the needs of such businesses, the Productivity Commission recommends the adoption of a new type of arrangement — the enterprise contract (EC) (figure 9). An EC would see employers vary awards for classes of employees (for example, casual employees or weekend employees), and this would allow employers to innovate at the firm-specific level in a way not otherwise available under awards. As with enterprise agreements, the EC could not include terms that disadvantaged employees relative to the award. Employees would be covered by the NES, and their rights to take actions under unfair dismissal and the General Protections of the Fair Work Act would not be diluted. An EC could not go below the minimum wage.

Employers could offer it to all prospective employees as a condition of employment (a process no different from that of engaging a new employee under the set terms of an award or an enterprise agreement). No negotiation or employee ballot would be required for the adoption of an EC, nor would any employee group be involved in its preparation and agreement unless the employer wished this to be the case. Employers and individual employees could still negotiate IFAs as carve outs from the EC if they mutually agreed.

Existing employees would be able to choose whether to sign on or stay with their existing employment contract, but it would be unlawful to coerce them to do so. Employers and employees would need to sign the EC, and would be informed about any tradeoffs against the award (for example, a \$1.50 increase in hourly wages in exchange for a new type of rostering arrangement). Tradeoffs that relate to the preferences of an individual employee should be addressed through an IFA.

Figure 9 The enterprise contract



- a Risk of compliance resides with the employer, penalties for non-compliance with the NDT will apply.
- b Unless otherwise specified
- c An EC that fails the NDT cannot be lodged and published in its current form (through the non-approval route), but the firm could seek subsequent approval for a modified EC.

Employers could select between two options for proceeding with an EC:

- they could request that the FWC undertake a no-disadvantage test prior to the adoption of the EC. This would provide certainty, but would not occur immediately
- they could merely lodge the EC without an ex ante no-disadvantage test, but would be liable to repay affected employees any deficit in effective wages if later it was discovered that the contract fails the test.

Employers could also use ECs to vary award wages and conditions by providing non-cash benefits. For example, an employer in tropical Queensland might want to shift its ordinary hours of work so that work commenced in the cooler hours — to the benefit of itself and its employees — without having to pay a loading for the earlier commencement. While on face value that seems reasonable, there would be a risk that some businesses might include questionable tradeoffs in an EC (such as relinquishing overtime or penalty rates in exchange for subsidised low quality accommodation). Accordingly, where an EC relies on

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non-cash benefits to meet the NDT, the business would need to go to the FWC for pre-approval.

For transparency, ECs should be open to third party scrutiny. All EC templates would have to be lodged with the FWC and published on its website, and the FWC would provide all ECs to the Fair Work Ombudsman for compliance and audit purposes. The publication of the template would have the advantage that other employers could use others' ECs as models for their own arrangements. The Fair Work Ombudsman and the FWC would highlight approved clauses that pass the NDT on its website. Employer associations may run test case ECs on behalf of a single firm, in order to establish a model capable of wider adoption by similar firms with the same employee classes.

The EC would operate for a nominal term of three years, but could not be rolled over automatically after that period. Employees should be able to opt out and fall back to the relevant modern award after 12 months on the EC as an additional protection. All employees would retain the right to commence bargaining (and after commencing bargaining, take protected industrial action in making an enterprise agreement). An employer could not unilaterally switch from an existing enterprise agreement to an EC unless that agreement had been lawfully terminated. The intention of the contract is not to undermine collective bargaining, but to act as a more flexible firm-specific arrangement.

There will be employers that attempt to engage in wilful misconduct in using non-approved ECs or that use coercion. Complaints by either the employee or any third party could be made to the Fair Work Ombudsman. In addition to penalties for coercion, the Act would specify penalties for firms for wilful misconduct in relation to the use of ECs. And businesses that misused ECs could be barred from their future usage for some period.

Since the EC is a new type of employment arrangement, the Fair Work Ombudsman should provide information about it and the compliance regime six months in advance of its commencement.

## **7 Industrial disputes and right of entry**

The credible threat of industrial action by both employees and employers is an important negotiating tool for parties engaging in enterprise bargaining, helping to reduce asymmetries in information and bargaining power. Nevertheless, there needs to be rules that ensure that neither employers nor employees hold too much power and that take account of the economywide effects of major disputes. This is an area of considerable contention and partisan representation by employers and unions as they jockey to seek rule changes that give them greater negotiating power.

The existing provisions outlined in the Fair Work Act governing industrial action are extensive and complex. Numerous conditions and procedural steps must be satisfied by

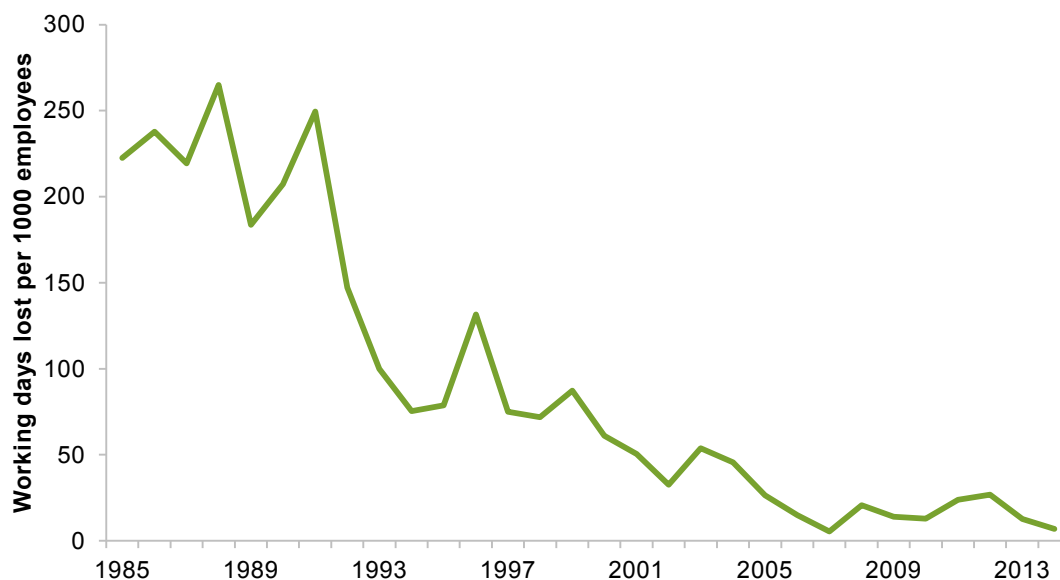
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employees to obtain authorisation to undertake lawful ('protected') industrial action during enterprise bargaining. (Industrial action is unlawful outside the bargaining period.) Employers are provided notice in advance of protected industrial action and have the ability to respond with contingency plans or by lockout. Employees are not paid while engaging in any action (and indeed, it is unlawful for an employer to do so). There are also multiple avenues through which protected industrial action can be challenged by employers, or suspended or terminated by the FWC or the Minister for Employment (with the latter only possible in special 'public interest' circumstances). Penalties are in place for parties that engage in unprotected industrial action.

Strike activity is currently not a major problem in Australia. The measured prevalence of industrial action has declined substantially over the past three decades, and has remained relatively low in recent years (figure 10). The average number of days lost over the past five years was less than one tenth of the days lost on average from 1985 to 1990. Moreover, despite the views of some employer groups, the level of disputation does not appear to have meaningfully increased following recent changes to the WR framework. Indeed the biggest contributor to some recent spikes have related to public sector disputes that are outside the scope of the Fair Work Act. Nevertheless, some forms of industrial action — for example, work bans — creep below the statistical radar.

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**Figure 10**     **Strike activity has fallen**  
1985 to 2014



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Regardless, there are several shortcomings in current arrangements that allow the excessive strategic use of industrial action.

- Aborted strikes and brief stoppages can involve low costs for employees, but impose disproportionate transaction costs on employers (and customers). For example, a



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one-minute stoppage would legally obligate the employer to suspend pay to employees for that duration, despite there being considerable administrative costs in doing so. It is ironic that the ‘no strike pay’ measure, which was intended to reduce coercion, can be used to strengthen the bargaining power of the striking party. Similarly, a business may be advised of a strike and implement costly measures to address the disruption that it expects to ensue (for example, rescheduling deliveries or carriage of passengers), and yet the strike may then be called off. To reduce the use of this strategic ploy, employers that have engaged in a reasonable contingency response to what ultimately was an aborted industrial action should be given the capacity to stand down the relevant employees for the duration of that response. Where employees engage in protected industrial action that lasts less than 15 minutes, the employer should be permitted to choose to either deduct a 15 minute increment from employee wages, or pay employees for the brief period of industrial action, if the employer is willingly doing so to avoid the administrative costs of complying with prohibitions on strike pay.

- Secret ballots are an essential part of industrial dispute regulations since they reduce risks of coercion by employers or employee representatives, prevent hollow threats of disputes that do not actually have employee consent, and provide a clear point at which the FWC can intervene in circumstances where the parties have not genuinely been trying to reach an agreement. However, there are questions about the span of time that permits protected industrial action after a ballot decision, as well as the scope of the questions that can be put to employees. A few minor changes would simplify the process — increasing the efficiency of bargaining.
- Employers should have more graduated options for retaliatory industrial action, such as bans on overtime, than the ‘nuclear’ lock-out option.
- The penalties for unlawful industrial action (by any party) should be increased by a factor of three, as this would allow the FWC and the Federal Court more scope to apply penalties commensurate with the harm associated with such action.

There are also areas where employers have called for changes to industrial dispute regulations, but that are not warranted by the evidence.

- There should be no legislative requirement that protected industrial action can only proceed after an FWC assessment confirms that employee’s claims are not ‘excessive’, or will not have an adverse impact on the enterprise’s productivity. A test of this kind is both asymmetric (favouring employers over employees), but could run into a definitional quagmire about what was ‘excessive’ in the context of a particular enterprise’s commercial environment. It is inherently undesirable to have an industrial regulator effectively act as a commercial arbiter between two parties. The circumstances in which it exercises any such role should be minimised. *This is a broad principle that should inform any future development of the Fair Work Act.*
- There should be no restriction on industrial action by high-income employees. Incidentally, were it introduced, it would place Australia in an unusual position among most other countries, where no such restrictions apply.

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- There is not a strong case for adding further criteria to the test for whether employees are ‘genuinely trying to reach agreement’, not least because there is little substantive evidence that this is a significant problem, and because it would shift the balance of bargaining power greatly in favour of employers.

In the debates about regulation of industrial disputes, there is often a mantra that disputes are harmful to productivity and efficiency, and that there should therefore be more binding constraints on their use. Disputes may have such effects, although in aggregate there is little evidence that the effects are material. Many disputes are about who gets what portion of a cake, not the quantum of the cake. In fact, a missing story is that the toxic relationships that can surface between employers and employees are sometimes the result of poor relationship management — a key skill for both employers and employee representatives — not a fault of the WR system.

The provisions providing rights of entry by union officials to worksites are mostly sound, though at times both sides play games with each other. That said, the Fair Work Act should be amended to require the FWC to examine the impacts on employers and employees more closely before making any orders concerning disputes about the frequency of right of entry requests.

## **8 Sham contracting**

Independent contractors comprise an important share of the workforce (figure 1). This employment form provides workers with much more autonomy in their working arrangements, and enables them to change their wage rates to maximise their returns (including by decreasing the likelihood of unemployment in weaker labour markets). Employers often choose to use these employment forms because, in some circumstances, they can improve productivity or lower costs. They can act as more flexible sources of labour than ongoing employees, especially where skills are intermittently required.

Contractors generally receive different pay and entitlements to ongoing workers. This generally reflects the degree to which each employment form is regulated by the Fair Work Act. There is some concern that the differential application of the Fair Work Act creates incentives to misclassify employees as independent contractors (sham contracting). This can occur with a worker’s consent, or through misrepresentation or coercion. It is most prevalent in the construction, cleaning services, hair and beauty and call centre industries.

Some have argued that the current common law approach to determining whether a worker is an employee or an independent contractor lacks clarity. The lack of clarity associated with this approach — which balances multiple factors including the length of employment as well as the choice of work, manner of work, hours of work and payment for work rather than relying on a single indicator — makes it hard to identify the genuine status of employment arrangements, makes enforcement difficult and leads to inadvertent errors.

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While the existing common law definition of a subcontractor may not always be easy to apply, it is hard to develop a better legislative definition or test.

The requirement that an employer must have been ‘reckless’ for them to be prosecuted for misrepresenting the nature of an employment contract appears to be a high hurdle for legal action. Changing from a test of ‘recklessness’ to a test of ‘reasonableness’ would help discourage sham contracting, including through the regulators’ out-of-court actions. Such a change is also an important measure to limit the greater incentives for sham contracting that would arise when terms in enterprise agreements that excluded subcontractors were prohibited (as recommended by the Productivity Commission).

## **9 Public sector bargaining**

The circumstances of public sector bargaining often differ from bargaining in the private sector. The most obvious of these is that there are relatively few employers, but public sector employees account for a substantial amount — around 16 per cent — of the total workforce. Moreover, in some cases, government is also a legislator and a regulator — effectively making and enforcing the laws it uses to hire workers.

Governments may have market power because while individual agencies negotiate with their employees, the government can set rules for such agreement making, and close off certain bargaining options by simply tightening the purse strings. In some instances, governments are also the dominant hirer or funder of people performing certain jobs (teaching, nursing, emergency services, disability and aged care). Nevertheless, there is limited evidence that governments have systematically exercised any such power, though there may be exceptions for particular professions.

There are also many challenges in bargaining in the public sector that are less evident for private employers:

- One major difficulty is that the products of the public sector are not priced in markets and have quality dimensions that are hard to define clearly, with the result that productivity is hard to measure well. Notwithstanding this, linkages between pay rises and stated ‘productivity’ in enterprise agreements are far more common in public sector than private sector agreements.
- The agreements set by agencies also often involve what one public service commissioner referred to as the ‘adoption of interminable or excessively bureaucratic processes’ for managing underperformance.

There are no easy fixes for these challenges — and probably the best solutions need to be developed at the agency level.

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## 10 Migrant workers in Australia

Although covered under the Fair Work Act, permanent and temporary migrant workers face higher risks of exploitation. This can reflect lower proficiency in English skills, lack of awareness of their rights in the workplace and a reluctance to reveal exploitation in circumstances where the migrant is working in breach of the *Migration Act 1958* (Cth), for example, by exceeding the prescribed limit on hours. Revealing such exploitation could result in deportation.

Beyond improving information provision to migrant employees and increasing enforcement resources, there are several new approaches that should reduce exploitation:

- Subject to arrangements that ensure that it is lawful, the Fair Work Ombudsman should not share any identifying information with the Department of Immigration and Border Protection about a migrant who has only breached their employment-related visa conditions. To complement this, the Department should continue considering a migrant's circumstances when deciding whether to cancel their visa.
- There is confusion about whether the Fair Work Act covers an unlawfully working migrant. The Act should be changed to clarify that they are covered and could seek compensation if underpaid.
- Penalties for employees that keep false or misleading documents should be increased, since such conduct can be an effective strategy for escaping redress.
- There should be greater scope to pursue compensation from company directors of phoenix businesses that have engaged in exploitation, for example through the use of a Director's Identification Number (as recommended in the Productivity Commission's inquiry into Business Set-Up, Transfer and Closure). (This would assist any employees affected by phoenixing — migrant or otherwise.)

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# Recommendations and findings

All recommendations are detailed in the chapters, and readers are advised to read them in context. Accordingly, recommendations include a reference to the relevant section of the report in which they are located.

## OVERALL REPORT FINDING

Despite sometimes significant problems and an assortment of peculiarities, Australia's workplace relations system is not systematically dysfunctional. It needs repair not replacement.

## Chapter 3 Institutions

### RECOMMENDATION 3.1

(SECTION 3.3)

The Australian Government should establish new institutional arrangements for the regulation of minimum wages and modern awards.

- It should create a statutorily independent Workplace Standards Commission with responsibility for reviewing and varying the national minimum wage and modern awards (including the making of equal remuneration orders).
- As a less preferred alternative, the Australian Government should establish the wage regulator as a Minimum Standards Division within the Fair Work Commission. While this alternative may also work, it would offer more limited scope for early cultural change. Such a division should be established in statute and have clear statutory duties.

Other functions within the workplace relations system should continue to be performed by the Fair Work Commission and the Fair Work Ombudsman in accordance with current arrangements.

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RECOMMENDATION 3.2

(SECTION 3.3)

The Australian Government should amend s. 629 of the *Fair Work Act 2009* (Cth) to stipulate that the President, a Vice President, a Deputy President or a Commissioner of the Fair Work Commission, and the appointees of the proposed Workplace Standards Commission hold office until the earliest of the following:

- he or she reaches the tenth anniversary of their appointment;
- he or she attains the age of 70;
- he or she resigns or the appointment is terminated.

RECOMMENDATION 3.3

(SECTION 3.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to change the appointment processes for Members of the Fair Work Commission. The amendments would stipulate that:

- an independent expert appointment panel should be established by the Australian Government and state and territory governments
- the panel should make a shortlist of suitable candidates for Members of the Fair Work Commission
- the Commonwealth Minister for Employment should select Members for the Fair Work Commission from the panel's shortlist, with appointments then made by the Governor General.

The panel should also be charged with recommending individuals for appointment to the Workplace Standards Commission.

In making appointments to the panel, governments should avoid appointing people who, in the last ten years, have had professional experience displaying a significant involvement representing employees and employers in courts and tribunals, or active participation in public debates regarding workplace relations policy.

Appointments to the panel should be for a period of no longer than seven years.

RECOMMENDATION 3.4

(SECTION 3.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to strengthen the Fair Work Commission President's existing capacity to direct the work of the Fair Work Commission to set standards for its performance, and to oblige members to cooperate in seeking to meet the standards set by the President and the Fair Work Commission's Member Code of Conduct.

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RECOMMENDATION 3.5

(SECTION 3.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to allow for greater external scrutiny of the performance and conduct of Fair Work Commission Members. The establishment of a judicial review function for these purposes would provide for greater external oversight of Members and complement the proposed changes in powers of the Fair Work Commission President to direct Members and set standards for their performance.

RECOMMENDATION 3.6

(SECTION 3.3)

The Australian Government should require the Fair Work Commission to publish more detailed information about conciliation outcomes and processes. In the medium term, it should also commission an independent performance review of the Fair Work Commission's conciliation processes, and the outcomes that result from these processes.

RECOMMENDATION 3.7

(SECTION 3.3)

The Australian Government should commission an external review of the Fair Work Commission's *New Approaches* activity, at the end of the current pilot program. The review should consult widely and consider alternatives, such as the involvement of private conciliators in overcoming obstacles to better agreement making and averting prospective bargaining disputes.

RECOMMENDATION 3.8

(SECTION 3.3)

The Fair Work Commission and the proposed Workplace Standards Commission should ensure that the governance of its research activities gives consideration to the views of all parties, but does not include direct involvement by them in the selection of research topics or modes of research.

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## Chapter 4 Minimum wages

RECOMMENDATION 4.1

(SECTION 4.4)

In undertaking the annual wage review, the wage regulator should broaden its analytical framework to consider systematically the risks of variations in economic circumstances on employment and on the living standards of low paid employees.

## Chapter 5 Variations from uniform minimum wages

RECOMMENDATION 5.1

(SECTION 5.1)

The Australian Government should ensure that the wage regulator can consider claims of incapacity to pay and, if necessary, vary its modern award minimum wage decision (for example, for an individual employer or on an industry, sector or geographical basis) after an annual wage review has been completed.

RECOMMENDATION 5.2

(SECTION 5.3)

The Australian Government should request the Productivity Commission to undertake a comprehensive review into Australia's apprenticeship and traineeship arrangements. The review should include, but not be limited to, an assessment of:

- the role of the current system within the broader set of arrangements for skill formation
- the structure of awards for apprentices and trainees, including junior and adult training wages and the adoption of competency-based pay progression
- the appropriate design and level of government assistance to employers and individuals. The design of government assistance should take into account the factors that affect the supply and demand for apprenticeships and traineeships, including the impact of junior pay rates and immigration policy.



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## Chapter 8 Repairing awards

### RECOMMENDATION 8.1

(SECTION 8.1)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to:

- remove the requirement for continued four yearly reviews of modern awards
- add the requirement that the wage regulator review and vary awards as necessary to achieve the revised modern awards objective specified in recommendation 8.3.

In undertaking this role the wage regulator should:

- use robust analysis to set issues for assessment, prioritised on the basis of likely high yielding gains
- consult widely with the community on reform options.

### RECOMMENDATION 8.2

(SECTION 8.3)

The wage regulator should not be constrained by the current requirement to only vary award wages outside of an annual wage review when the change is justified by work value reasons. The Australian Government should amend the *Fair Work Act 2009* (Cth) so that the wage regulator has the same power to adjust award minimum wages in award reviews as the minimum wage panel currently has in annual wage reviews.

### RECOMMENDATION 8.3

(SECTION 8.7)

The Australian Government should replace the current modern awards objective in the *Fair Work Act 2009* (Cth) with a new objective requiring the wage regulator to ensure that modern awards, together with the National Employment Standards, provide a minimum safety net of terms and conditions, which promote the overall wellbeing of the community, taking into account:

- a. the needs of the employed; and
- b. the need to increase employment; and
- c. the needs of employers; and
- d. the needs of consumers; and
- e. the need to ensure modern awards are easy to understand.

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RECOMMENDATION 8.4

(SECTION 8.7)

The Australian Government should amend Part 2-3 of the *Fair Work Act 2009* (Cth) to allow variations to modern awards if necessary to achieve or improve outcomes according to the revised modern awards objective.

## Chapter 15 Policies for weekend penalty rates

RECOMMENDATION 15.1

(SECTION 15.1)

The Fair Work Commission should, as part of its current award review process:

- set Sunday penalty rates that are not part of overtime or shift work at the higher of 125 per cent and the existing Saturday award rate for permanent employees in the hospitality, entertainment, retail, restaurant and cafe industries
- set weekend penalty rates to achieve greater consistency between the above industries, but without the expectation of a single rate across all of them
- investigate whether weekend penalty rates for casuals in these industries should be set so that casual penalty rates on weekends would be the sum of the casual loading and the revised penalty rates applying to permanent employees, with the principle being that there should be a clear rationale for departing from this.

There should be one year's notice before these changes are made.

RECOMMENDATION 15.2

(SECTION 15.2)

In the event that the Australian Government does not modify the modern awards objective in line with recommendation 8.3, it should amend the *Fair Work Act 2009* (Cth) to clarify that in its award decisions, the wage regulator would not be obliged to provide additional remuneration for weekend work, though it would retain the discretion to do so if warranted by industry circumstances.

RECOMMENDATION 15.3

(SECTION 15.2)

The South Australian, Western Australian and Queensland Governments should remove anti-competitive remnant shopping hour restrictions.

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RECOMMENDATION 15.4

(SECTION 15.5)

The Fair Work Commission should not reduce penalty rates for existing public holidays.

## Chapter 16 National employment standards

RECOMMENDATION 16.1

(SECTION 16.3)

The Fair Work Commission should, as a part of the current four yearly review of modern awards, give effect to s. 115(3) of the *Fair Work Act 2009* (Cth) by incorporating terms that permit an employer and an employee to agree to substitute a public holiday for an alternative day into all modern awards.

RECOMMENDATION 16.2

(SECTION 16.3)

The Australian Government should amend the National Employment Standards so that newly designated state and territory public holidays are not subject to public holiday penalty rates or a paid day of leave.

RECOMMENDATION 16.3

(SECTION 16.3)

Periodically, the Australian, state and territory governments should jointly examine whether there are any grounds for extending the existing 20 days of paid annual leave in the National Employment Standards, with a cash out option for any additional leave where that suits the employer and employee. Such an extension should not be implemented in the near future, and if ultimately implemented, should be achieved through a negotiated tradeoff between wage increases and extra paid leave.

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## Chapter 17 Unfair dismissal

### RECOMMENDATION 17.1

(SECTION 17.6)

The Australian Government should introduce:

- non-refundable requirements on the fees for lodgment of unfair dismissal claims
- a subsequent fee, also non-refundable, and of an equivalent dollar amount to the upfront lodgment fee, for unfair dismissal cases going to arbitration.

The Fair Work Commission should also advise all parties that, based on recent decisions, a majority of arbitrated cases do not lead to compensation.

### RECOMMENDATION 17.2

(SECTION 17.6)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to give the Fair Work Commission clearer powers, in limited circumstances, to deal with unfair dismissal applications before conducting a conference or hearing, and based on forms provided by applicants and respondents (that is, 'on the papers').

### RECOMMENDATION 17.3

(SECTION 17.6)

The Australian Government should amend Division 3 of Part 3-2 of the *Fair Work Act 2009* (Cth) to introduce a two-stage test for considering whether a person has been unfairly dismissed. The first stage should determine whether there was a valid reason for the dismissal. If yes, the second stage test should determine whether any of the factors currently listed in s. 387 (b) - (h) result in the dismissal being deemed harsh unjust or unreasonable.

### RECOMMENDATION 17.4

(SECTION 17.6)

The Australian Government should change the penalty regime for unfair dismissal cases so that:

- employees can only receive compensation when they have been dismissed without reasonable evidence of persistent significant underperformance or serious misconduct
- procedural errors by an employer should not result in reinstatement or compensation for a former employee, but can, at the discretion of the Fair Work Commission, lead to either counselling and education of the employer, or penalties. In repeated or serious cases, the Fair Work Commission could seek penalties by making an application to the Federal Court or Federal Circuit Court.

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RECOMMENDATION 17.5

(SECTION 17.6)

The Australian Government should remove the emphasis on reinstatement as the *primary* goal of the unfair dismissal provisions in the *Fair Work Act 2009* (Cth).

RECOMMENDATION 17.6

(SECTION 17.6)

Conditional on implementation of the other recommended changes to the unfair dismissal system within this report, the Australian Government should remove the (partial) reliance on the Small Business Fair Dismissal Code within the *Fair Work Act 2009* (Cth).

## Chapter 18 General protections

RECOMMENDATION 18.1

(SECTION 18.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to formally align the discovery processes used in general protection cases with those provided in the Federal Court's Rules and Practice Note 5 CM5.

RECOMMENDATION 18.2

(SECTION 18.3)

The Australian Government should amend s. 341 of the *Fair Work Act 2009* (Cth) and related explanatory material to more clearly define the meaning and application of workplace rights.

- Modified provisions should indicate that the exercise of a workplace right in instances where a complaint or inquiry has resulted in alleged adverse action must involve instances bearing a direct and tangible relation to a person's employment.
- In this regard, consideration should also be given to a standard 'test' formulation, such as applies in Part 3-1 with regard to dismissals being 'harsh, unjust or unreasonable'.

RECOMMENDATION 18.3

(SECTION 18.3)

The Australian Government should introduce a provision within the *Fair Work Act 2009* (Cth) to allow the awarding of costs against an applicant who unsuccessfully pursues a dismissal claim under Part 3-1 in the face of a Fair Work Commission recommendation that the claim not proceed.

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RECOMMENDATION 18.4

(SECTION 18.3)

The Australian Government should amend Schedule 5.2 of the Fair Work Regulations 2009 (Cth) to require the Fair Work Commission to report more information about general protections matters. Adequate resourcing should be provided to the Fair Work Commission to improve its data collection and reporting processes in this area.

RECOMMENDATION 18.5

(SECTION 18.3)

If there is continuing growth in general protections case numbers reported by the Fair Work Commission, the Australian Government should further review the operation of the general protections within 18 months of the implementation of recommendations 18.1 to 18.4.

## Chapter 20 Enterprise bargaining

FINDING 20.1

(SECTION 20.4)

The case for imposing statutory requirements on employers and employees to discuss productivity improvements as part of the bargaining process, or for the mandatory inclusion of productivity clauses in agreements, is not strong. Voluntary agreements that promote productivity are highly desirable, but such agreements, and the gains they deliver, should arise from better management, not from a regulated requirement, which is likely to have perverse effects.

RECOMMENDATION 20.1

(SECTION 20.4)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to:

- allow the Fair Work Commission wider discretion to overlook minor procedural or technical errors when approving an agreement, as long as it is satisfied that the employees were not likely to have been placed at a disadvantage because of an unmet procedural requirement.
- extend the scope of this discretion to include minor errors or defects relating to the issuing or content of a notice of employee representational rights.

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RECOMMENDATION 20.2

(SECTION 20.4)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to:

- remove matters pertaining to the relationship between employer and employee organisations from the list of permitted matters in enterprise agreements
- specify that an enterprise agreement may only contain terms about permitted matters.

RECOMMENDATION 20.3

(SECTION 20.4)

The Australian Government should amend s. 203 of the *Fair Work Act 2009* (Cth) to require enterprise flexibility terms to permit individual flexibility arrangements to deal with all the matters listed in the model flexibility term, along with any additional matters agreed by the parties.

RECOMMENDATION 20.4

(SECTION 20.4)

The Australian Government should amend s. 186(5) of the *Fair Work Act 2009* (Cth) to allow an enterprise agreement to specify a nominal expiry date that:

- can be up to five years after the day on which the Fair Work Commission approves the agreement, or
- matches the life of a greenfields project. The resulting enterprise agreement could exceed five years, but where it does so, the business would have to satisfy the Fair Work Commission that the longer period was justified.

RECOMMENDATION 20.5

(SECTION 20.4)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to replace the better off overall test for approval of enterprise agreements with a new no-disadvantage test.

The no-disadvantage test would be conducted by the Fair Work Commission. It would assess that, at the test time, each class of employee, and each prospective class of employee, would not be placed at a net disadvantage overall by the agreement, compared with the relevant modern award(s).

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RECOMMENDATION 20.6

(SECTION 20.4)

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that a person could only be an employee bargaining representative if:

- they represent a registered employee organisation with at least one member covered by the proposed agreement, or
- they were able to demonstrate that they were nominated as a representative by a prescribed minimum number of employees (say, 20 employees) or 5 per cent of the employees to be covered by the agreement (whichever is smaller), or
- the employer agrees to recognise them as a bargaining representative.

## Chapter 21 Greenfields agreements

RECOMMENDATION 21.1

(SECTION 21.2)

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that if an employer and union have not reached a negotiated outcome for a greenfields agreement after three months, the employer may:

- continue negotiating with the union
- request that the Fair Work Commission undertake 'last offer' arbitration by choosing between the last offers made by the employer and the union
- submit the employer's proposed greenfields arrangement for approval with a 12 month nominal expiry date.

Regardless of the agreement-making process chosen by the employer, the ensuing greenfields arrangement must pass the no-disadvantage test specified in recommendation 20.5.



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RECOMMENDATION 21.2

(SECTION 21.2)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to allow for the establishment of project proponent greenfields agreements.

When seeking approval of a greenfields agreement, a project proponent (such as a head contractor) could seek to have its agreement recognised as a project proponent greenfields agreement.

Once a project proponent greenfields agreement is in place for a project, subcontractors that subsequently join the project, and that do not have a current enterprise agreement covering their employees on the project, should have the option of applying to the Fair Work Commission to also be covered by the project proponent greenfields agreement. To approve the application, the Fair Work Commission must be satisfied that:

- the subcontractor does not have an existing enterprise agreement that covers its employees on the project
- the subcontractor was not coerced by any party into joining the project proponent greenfields agreement
- the project proponent greenfields agreement would pass a no-disadvantage test for the employees of the subcontractor against the relevant award.

The Fair Work Ombudsman and Fair Work Building and Construction should periodically carry out investigations to audit compliance and ensure that parties are not being coerced into signing on to project proponent agreements. Sanctions should be put in place for parties found to be engaging in coercion, including financial penalties and exclusion from having future access to project proponent arrangements for a specified period of time.

## Chapter 22 Individual arrangements

RECOMMENDATION 22.1

(SECTION 22.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that the flexibility term in a modern award or enterprise agreement can permit written notice of termination of an individual flexibility arrangement by either party to be a maximum of 1 year if agreed by the employee and employer. The Act should specify that the default termination notice period should be 13 weeks.

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RECOMMENDATION 22.2

(SECTION 22.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to introduce a new no-disadvantage test to replace the better off overall test for the assessment of individual flexibility arrangements.

To encourage compliance the Fair Work Ombudsman should:

- provide more detailed guidance for employees and employers on the characteristics of an individual flexibility arrangement that satisfies the new no-disadvantage test, including template arrangements
- investigate the desirability of upgrading its website to provide a platform to assist employers and employees to assess whether the terms proposed in an individual flexibility arrangement satisfy a no-disadvantage test including non-monetary terms.

RECOMMENDATION 22.3

(SECTION 22.3)

The Fair Work Ombudsman should develop an information package on individual flexibility arrangements and distribute it to employers, particularly small businesses, with the objective of increasing employer and employee awareness of individual flexibility arrangements. It should also distribute the package to the Australian Small Business and Family Enterprise Ombudsman, the various state government offices of small business, major industry associations and employee representatives.

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## Chapter 23 Enterprise contract

RECOMMENDATION 23.1

(SECTION 23.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to create a new employment instrument, the enterprise contract (EC) that would allow businesses the flexibility to vary an award or awards for a class of employees (as nominated by the employer) to suit their business operations.

The employer would be able to offer the EC as a condition of employment for new employees, with existing employees able to join the EC if they choose (coercion would be unlawful). The EC could not be offered to existing employees who are, or new employees who would be, covered by an enterprise agreement.

The Australian Government should also amend the Act to provide the following protections to employers and safeguards to employees so that the employee's wages and conditions under the EC are not below those set out in the relevant award or awards in net terms:

- there would be a requirement that no employee is disadvantaged, in net terms, under the EC when compared with the award (the no-disadvantage test (NDT)) and that the EC cannot set a standard below the National Employment Standards or minimum wage
- employees to be covered by an EC would each be provided with a personal statement about how the EC meets the NDT compared with the award. The employee covered by the EC would sign the personal statement
- a personal statement from any incumbent employee joining an EC must accompany the EC template provided to the Fair Work Commission. The Fair Work Commission would apply the NDT, but only if the employer sought pre-approval or if the tradeoff to pass the NDT depends on non-cash benefits
- employers that use the EC, but choose not to have it approved against the NDT, must retain a list of all employees covered by the EC, for its full term. Failure to provide this list, on request, to the Fair Work Ombudsman would be an offence
- employers would be liable to pay an affected employee or employees the full amount of their lost wages, where the employer does not seek approval for the EC and is later found to have breached the NDT
- all ECs (approved and non-approved) would be available for scrutiny by the Fair Work Ombudsman and third parties, through the lodgment of all EC templates with the Fair Work Commission and publication on its website.

The Australian Government should also introduce penalties in the Act that may apply where there is wilful misconduct in the use of the new EC provisions.

ECs should operate for a nominal period of three years, although employees should be able to opt out and fall back to the relevant modern award after 12 months of joining the EC, as an additional protection.

Future use by an employer of an EC should depend on their proper use of any previous ECs.

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RECOMMENDATION 23.2

(SECTION 23.3)

The Fair Work Commission and the Fair Work Ombudsman should have joint responsibility for the enterprise contract. The Fair Work Commission should be responsible for developing and maintaining a lodgment and optional approval system for the enterprise contract. The Fair Work Ombudsman should be responsible for education, compliance, auditing of and monitoring enterprise contracts.

To assist employer compliance and employee awareness, the Fair Work Ombudsman should conduct a six-month information campaign prior to the enterprise contract system coming into force.

The Australian Government should provide additional resourcing to the Fair Work Commission and Fair Work Ombudsman to undertake these functions.

## Chapter 25 Alternative forms of employment

RECOMMENDATION 25.1

(SECTION 25.2)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to make it unlawful to misrepresent an employment relationship or a proposed employment arrangement as an independent contracting arrangement (under s. 357) where the employer could be reasonably expected to know otherwise.

RECOMMENDATION 25.2

(SECTION 25.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that enterprise agreement terms that restrict the:

- (a) engagement of independent contractors and labour hire workers, or regulate the terms of their engagement, should constitute unlawful terms under s. 194 of the Act
- (b) engagement of casual workers should constitute unlawful terms under s. 194 of the Act.

The Australian Government should also specify in the Act that enterprise agreement terms could not restrict an employer's prerogative to choose an employment mix suited to their business — for example by deterring or discouraging the use of casual workers by restricting their hours of work.

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## Chapter 26 Transfer of business

### RECOMMENDATION 26.1

(SECTION 26.3)

The Australian Government should give the Fair Work Commission more discretion to order that an employment arrangement (such as an enterprise agreement) of the old employer does not transfer to the new employer, where that improves the prospects of employees gaining employment with the new employer. This should be achieved by amending the object (at s. 309) of the transfer of business rules in the *Fair Work Act 2009* (Cth) to include the interests of continuing employment for employees of the old employer. Consideration should also be given to whether this should be echoed in the list of factors the Fair Work Commission must take into account in ss. 318 and 320.

### RECOMMENDATION 26.2

(SECTION 26.3)

The Australian Government should amend Part 2-8 of the *Fair Work Act 2009* (Cth) to make clear that a new employer can make an offer of employment to an employee of the old employer conditional on the Fair Work Commission granting an order under s. 318 that the employee's employment arrangement would not transfer to the new employer.

### RECOMMENDATION 26.3

(SECTION 26.3)

The Australian Government should amend Part 2-8 of the *Fair Work Act 2009* (Cth) to provide that a transferring employment arrangement automatically terminates 12 months after the transfer, except in transfers between associated entities. The transferring employees should be permitted to commence bargaining for a replacement enterprise agreement nine months after the transfer. If a replacement agreement has not been approved by the 12 month date, the transferring employees would automatically be covered by any other instrument covering the new employer, including the relevant modern award.

### RECOMMENDATION 26.4

(SECTION 26.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that when employees, on their own initiative, seek to transfer to a related entity of their current employer, they will be subject to the terms and conditions of employment provided by the new employer.

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RECOMMENDATION 26.5

(SECTION 26.3)

The Australian Government should amend Part 2-8 of the *Fair Work Act 2009* (Cth) so that an employment arrangement does not transfer between associated entities in situations where the employee is redeployed to avoid being made redundant.

RECOMMENDATION 26.6

(SECTION 26.4)

The Australian Government should monitor and evaluate the impact of the transfer of business provisions in Part 2-8 of the *Fair Work Act 2009* (Cth), including the collection of evidence on whether there is any noticeable change in the type of orders made, the degree to which restructuring occurs, employment movements and changes in employee conditions associated with transfers.

## Chapter 27 Industrial disputes

RECOMMENDATION 27.1

(SECTION 27.3)

The Australian Government should amend Part 3-3 of the *Fair Work Act 2009* (Cth) to:

- allow a protected action ballot to contain a single question authorising all forms of protected industrial action without specifying each type of action. Bargaining representatives would be permitted to voluntarily include ballot questions on specific types of action
- remove the requirement that industrial action be taken within 30 days (or 60 days with an extension) for a protected action ballot result to continue to be valid
- apply a 120 day expiry period to a successful protected action ballot result, regardless of whether protected industrial action is taken during the period, after which a new ballot must be held if further protected industrial action is to be authorised.

RECOMMENDATION 27.2

(SECTION 27.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to clarify that when determining whether to suspend or terminate industrial action under s. 423 or s. 426, the Fair Work Commission should interpret the word 'significant' as 'important or of consequence', subject to the relevant factors for consideration under s. 423(4) or s. 426(4).

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RECOMMENDATION 27.3

(SECTION 27.3)

The Australian Government should amend s. 423(2) of the *Fair Work Act 2009* (Cth) such that the Fair Work Commission may suspend or terminate protected industrial action where it is causing, or threatening to cause, significant economic harm to the employer or the employees who will be covered by the agreement, rather than harm to both parties (as is currently the case).

A party engaged in protected industrial action would not be able to seek to have its own industrial action suspended or terminated on the basis of significant economic harm to itself.

RECOMMENDATION 27.4

(SECTION 27.3)

The Australia Government should amend s. 424(1)(c) of the *Fair Work Act 2009* (Cth) to remove a threat to 'welfare' as grounds for suspending or terminating protected industrial action, while retaining the protections relating to life, personal safety or health.

RECOMMENDATION 27.5

(SECTION 27.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that where a group of employees have withdrawn notice of industrial action, employers that have implemented a reasonable contingency plan in response to the notice of industrial action may stand down the relevant employees, without pay, for the duration of the employer's contingency response.

RECOMMENDATION 27.6

(SECTION 27.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) so that where employees engage in protected industrial action that last less than 15 minutes, the employer should be permitted to choose to either:

- deduct a 15 minute increment from employee wages, or
- pay employees for the brief period of industrial action, if the employer is willingly doing so to avoid the administrative costs of complying with prohibitions on strike pay.

It should remain unlawful for employees or employee representatives to ask an employer to pay them for any period of industrial action.

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RECOMMENDATION 27.7

(SECTION 27.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to more explicitly allow employers to engage in more graduated forms of protected industrial action in response to employee industrial action.

Forms of employer response action that should be permitted include:

- instituting limits or bans on overtime (analogous to employee overtime bans)
- directing employees to only perform a particular subset of their normal work functions and adjusting their wages accordingly (analogous to employee partial work bans)
- reducing hours of work (analogous to employee work stoppages).

Where an employer restricts employees' work duties or hours of work, employees should be permitted in response to refuse to perform any work (as is currently the case for employers with respect to employee partial work bans).

Graduated forms of protected industrial action by an employer would still count as employer response action and be subject to employee response action and potential suspension or termination by the Fair Work Commission.

RECOMMENDATION 27.8

(SECTION 27.3)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to increase the maximum penalties for unlawful industrial action to a level that allows federal law courts the discretion to impose penalties that can better reflect the high costs that such actions can inflict on employers and the community. A level of three times current penalties would be likely to fulfil that purpose.



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## Chapter 28 Right of entry

RECOMMENDATION 28.1

(SECTION 28.3)

The Australian Government should amend s. 505A of the *Fair Work Act 2009* (Cth) for determining when the Fair Work Commission may make an order to deal with a dispute about frequency of entry by an employee representative to:

- repeal the requirement under s. 505A(4) that the frequency of entry would require an unreasonable diversion of the occupier's critical resources
- require the Fair Work Commission to take into account:
  - the cumulative impact on an employer's operations of entries onto the premises
  - the likely benefit to employees of further entries onto the premises
  - the employee representative's reason(s) for the frequency of entries.

## Chapter 29 Migrant workers

RECOMMENDATION 29.1

(SECTION 29.3)

The Department of Immigration and Border Protection and the Fair Work Ombudsman should improve the information available on their websites about migrant workers' workplace rights and conditions. They should also explore other ways of providing migrants with this information, ensuring that it is in easily accessible languages and formats.

RECOMMENDATION 29.2

(SECTION 29.3)

The Australian Government should give the Fair Work Ombudsman additional resources to identify, investigate, and carry out enforcement activities against employers that are underpaying workers, particularly migrant workers.

RECOMMENDATION 29.3

(SECTION 29.3)

Penalties for breaching Reg. 3.44 of the Fair Work Regulations 2009 (Cth) by keeping false or misleading documents as required under the Regulations and the *Fair Work Act 2009* (Cth) should be increased to be aligned with similar penalties under s. 234 of the *Migration Act 1958* (Cth).

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RECOMMENDATION 29.4

(SECTION 29.4)

The Australian Government should amend the *Fair Work Act 2009* (Cth) to clarify that, in instances where migrants have breached the *Migration Act 1958* (Cth), their employment contract is valid and the *Fair Work Act 2009* (Cth) applies.

RECOMMENDATION 29.5

(SECTION 29.4)

Subject to arrangements that ensure that this is lawful, the Fair Work Ombudsman should not share any identifying information with the Department of Immigration and Border Protection about a migrant who has only breached their employment-related visa conditions.

The Department of Immigration and Border Protection should share any information with the Fair Work Ombudsman about a migrant and their employer, when they suspect an employer has underpaid a migrant.

## Chapter 31 Competition policy

RECOMMENDATION 31.1

(SECTION 31.4)

The Australian Government should grant Fair Work Building and Construction shared jurisdiction with the Australian Competition and Consumer Commission to investigate and enforce the secondary boycott prohibitions of the *Competition and Consumer Act 2010* (Cth) in the building and construction industry.

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# 1 Introduction

## Key points

- This inquiry is a broad ranging assessment of Australia's workplace relations (WR) framework, considering current laws, institutions and practices. It uses an economywide approach, looking at possible reforms that, where merited, are likely to enhance the welfare of Australians as a whole.
  - In analysing the workings of the current system, the inquiry draws on the disparate views of the many participants who have provided information. However, a premium has been placed on considering topics that are often disputed, and on providing an evidence based viewpoint. In many cases this is based on the Productivity Commission's own research.
  - The inquiry takes into account that many features of the legal and institutional framework have developed over a long period, but asks whether these features are likely to serve Australia's future interest well, while taking into account the costs of change.
  - The inquiry recognises that a well performing WR framework must balance the needs of businesses within the economy with the requirement to adequately compensate, protect and develop the Australian workforce.
- The inquiry has not set out to cover a number of issues that intersect with the WR system, such as the separate arrangements for workplace health and safety, nor matters being considered by the Royal Commission into trade union governance.
  - There has been a deliberate attempt to focus the analysis on matters that most directly affect the operation of the WR system and that drive the most significant economic and social outcomes that it produces.

The workplace relations (WR) system has multiple influences on a very wide range of economic and social outcomes within the Australian economy. Along with market forces, accepted practices, cultural norms and the common law, the complex array of labour laws, regulations and institutions that make up the WR framework shape people's behaviour, the nature of their workplaces and their working lives.

At an enterprise level, the framework can influence innovation, profitability, the internal culture of the workplace, its hiring and dismissal arrangements and, more broadly its business strategies (such as business expansion or new investment). It can provoke or mitigate industrial conflicts. Since many of these factors are drivers of productivity, there is a link between the design of a system and its promotion or otherwise of growth and

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efficiency.<sup>3</sup> And of course, productivity has ripple effects on prices and thereby consumers.

For employees, the system affects wages, their hours of work, the conditions of the workplace (for instance, working time arrangements, working conditions and safety) and can stimulate or frustrate skill formation. It thereby has impacts on personal and household income distribution, as well as longer term life prospects. It can empower (or not) employees and their representatives in workplaces. It shapes the distribution of returns to and powers of the various parties in the system.

WR is not just about existing workplaces and employees. It can create barriers to employment of people without jobs, and create barriers to entry for new businesses and competition in the labour market from the self-employed.

Its effects can vary across regions, by the size and industry of firms, and by the age, skills and preferences of people. It can affect the way in which wages and prices move in an economy, and thereby influence overall macroeconomic performance and policy.

More broadly, a WR system has social effects beyond income distribution. In part, the origins of the system reflect social and community norms, such as the desirability of fairness. But the causal link can also go the other way. A system can also reinforce and sustain social norms because it provides legislative support for them. Changes to it can further support or undermine trust and cooperation between people, and the degree to which they regard a society as fair.

The Productivity Commission's analysis has aimed to reflect the diversity of the impacts of the WR system, and to understand how different configurations have varying impacts. The recommendations also reflect this approach, and consider the potential impacts — positive and negative — on a range of labour force participants and across a range of workplace types and locations.

## **1.1 The inquiry terms of reference**

The issues associated with assessing Australia's WR arrangements are deep and wide. Successive Australian governments have recognised that choices about the design of a WR system reflect not just its pre-eminence in economic policy, but also its equity and ethical objectives.

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<sup>3</sup> As noted later, assessing the impact of WR changes on aggregate productivity (and a host of other economic performance measures) is difficult when there are a myriad of other forces also at work (such as demand shocks, technological change, management practices, skill changes and competition). This does not mean these effects are absent.

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The Australian Government requested that the Productivity Commission undertake a wide ranging inquiry into Australia's WR framework, focussing on key social and economic indicators that are important to wellbeing, productivity and competitiveness. This report represents the Productivity Commission's assessments within the tight timetable for the inquiry.

The terms of reference ask the Productivity Commission to consider the impact of the WR framework on a range of matters including:

- unemployment, underemployment and job creation
- fair and equitable pay and conditions for employees, including the maintenance of a relevant safety net
- small businesses
- productivity, competitiveness and business investment
- the ability of business and the labour market to respond appropriately to changing economic conditions
- patterns of engagement in the labour market
- the ability for employers to flexibly manage and engage with their employees
- barriers to bargaining
- red tape and the compliance burden for employers
- industrial conflict and days lost due to industrial action
- the scope for independent contracting.

While the terms of reference cover an assessment of the performance of the framework's main regulatory instrument, the *Fair Work Act 2009* (Cth) (FW Act), the Government has requested that the Productivity Commission go beyond evaluating the current system to consider the type of system that might best suit the Australian community over the longer term.

The Productivity Commission has also been asked to recommend improvements to maximise outcomes for employers, employees and the economy and to identify and quantify the costs and benefits of its recommendations.

## **Past reviews**

This inquiry takes place against a background of previous reviews into WR. The most recent holistic review was that of the Hancock Committee (1985), although other reviews have periodically considered the legislation in place, such as in the most recent review of the FW Act (McCallum, Moore and Edwards 2012) (box 1.1). Senate Committees have examined particular parts of the system in response to proposed amendments to the

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principal legislation (such as the report into exemptions for small business from penalty rates).

### **Box 1.1      The 2012 post-implementation review of the Fair Work legislation**

The review assessed the operation of the FW Act and the extent to which it was consistent with the legislation's objectives, as well as its efficacy compared with the legislation it replaced. The panel concluded that outcomes under the Act were favourable to continuing prosperity (with the exception of productivity growth, where it did not accept that Australia's poor productivity performance had resulted from the legislative framework). The Panel made 53 recommendations aimed at improving the operation of the legislation to:

- encourage flexibility and productivity by extending the role of institutions to encourage productive workplaces, providing new powers for conciliation, supporting good faith bargaining and making individual flexibility arrangements easier to access
- increase workplace equity through changes such as removing the ability for employees to opt out of enterprise agreements, and extending the right to request flexible working arrangements.

Several important recommendations of that review were not adopted by the government of the time, but on further examination by the Productivity Commission in this inquiry, some should be implemented.

*Source:* McCallum, Moore and Edwards (2012).

## **Some issues are largely outside this inquiry**

The Productivity Commission has not examined in any detail a number of issues that intersect with or are part of the WR framework, including:

- governance arrangements of individual unions and concerns about specific instances of corruption and other criminally unlawful conduct by employers, employees and unions. Notably, criminal conduct is covered by the criminal law, not the FW Act
- institutional arrangements in the construction industry, which were addressed in the Productivity Commission's inquiry into Public Infrastructure
- financial assistance for legal representation for WR matters, a matter covered in the Productivity Commission's inquiry into Access to Justice (PC 2014a)
- separate Workplace Health and Safety (WHS) institutions and laws, including workers' compensation schemes. However, the more general impact of the WR system on WHS is relevant to this inquiry — and there are complementarities in issues like right of entry provisions and the new anti-bullying legislation in the FW Act

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- the Superannuation Guarantee. While it may have arisen as an industrial relations tradeoff, the Guarantee is now recognised as one of a set of interlocking retirement income policy measures, and consideration of it in any detail would therefore cover many issues not central to this inquiry
  - Australia’s vocational training system (although the issue of apprenticeships and trainees has again arisen, and a separate review seems essential)
  - the Fair Entitlements Guarantee, a statutory scheme that provides assistance to employees for unpaid entitlements following the insolvency of their employer. The Productivity Commission has examined this scheme in its inquiry into Business Set up, Transfer and Closure (PC 2015a).

The Productivity Commission notes that the Australian Government has proposed several changes to the FW Act via a number of Parliamentary Bills,<sup>4</sup> and recently made some amendments to the FW Act.<sup>5</sup> The inquiry’s primary focus will be on the preferred structure for WR in Australia and only directly assesses proposed amendments to relevant legislation, where that is necessary to conform to its proposed policy framework.

## 1.2 Australia’s workplace relations system

### The stated objectives of Australia’s workplace relations system

The FW Act is the primary legislative device governing the WR system in Australia, although the pre-eminence of a Commonwealth statute is relatively recent. Historically and constitutionally, the Commonwealth and the states have shared responsibility for WR. The FW Act cites objectives that are diverse and — as is often the case with such diversity — potentially in conflict. The FW Act is intended to deliver outcomes that are **fair, flexible, co-operative, productive, relevant, enforceable, non-discriminatory, accessible, simple and clear** (s. 3). It also provides for special arrangements for small businesses; preference for collective bargaining; balance between family and workplace responsibilities; minimum wage and employment standards; and the right of freedom of association.

State based laws still survive, albeit with reduced reach, and their objectives largely mirror those of the FW Act, though sometimes with greater elaboration. For example, the Queensland *Industrial Relations Act 1999* specifies 14 separate objectives, such as ‘meeting the needs of emerging labour markets and work patterns’, and ‘promoting and

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<sup>4</sup> Fair Work Amendment Bill 2014; Fair Work Amendment (Bargaining Processes) Bill 2014; Fair Work (Registered Organisations) Amendment Bill 2014; Building and Construction Industry (Improving Productivity) Bill 2013; Building and Construction Industry (Consequential and Transitional Provisions) Bill 2013.

<sup>5</sup> *Fair Work Amendment Act 2015* (Cth)

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facilitating jobs growth, skills acquisition and vocational training through apprenticeships, traineeships and labour market programs’ (s. 3).

One issue for this inquiry is whether any system can hope to achieve coherence across this diversity of objectives. By its nature, legislation often claims multiple objectives. But establishing what a system is meant to achieve is important for this inquiry, and the relevant legislation is an obvious starting point.

## **The architecture of the current system**

WR policy, institutions and regulation are now highly elaborate and broad ranging (figure 1.1). They have grown from a limited Commonwealth role in dispute settlement one hundred years ago to a position today where the Commonwealth regulates the bulk of industrial awards, sets minimum wages, and has created three specialist bodies that collectively mediate disputes, provide information, register agreements, check compliance with the law and adjudicate on some key matters of WR law.

The Fair Work Commission (FWC), the Fair Work Ombudsman (FWO) and Fair Work Building and Construction are the key national regulators. The Fair Work Federal Division of the Federal Court and the Federal Circuit Court are the principal parts of the judicial system that deal with WR matters, though some cases have, on appeal, progressed to the High Court of Australia (in some instances, with wide ramifications for the system).

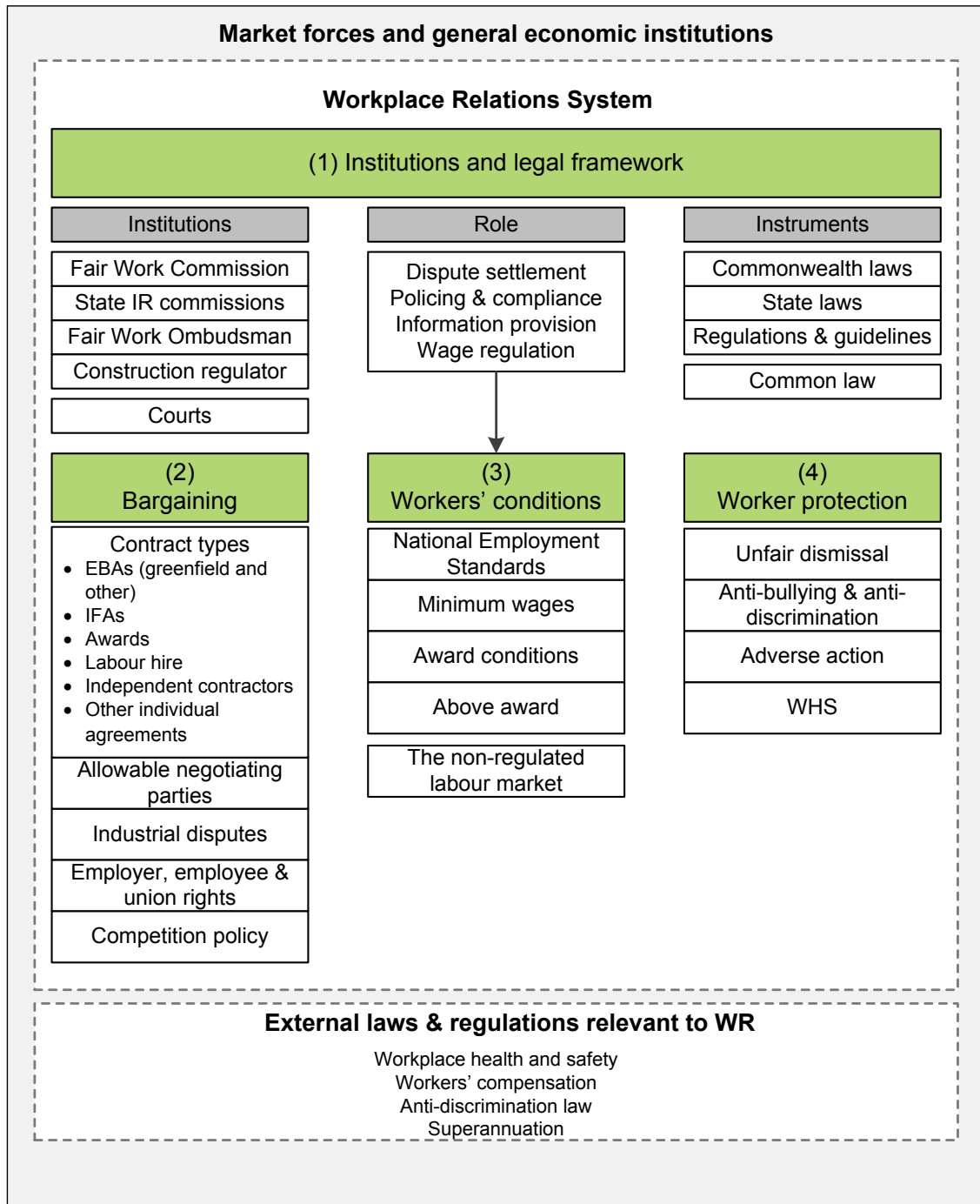
In this inquiry, the primary interest in institutional arrangements centres on the FWC and the FWO (chapter 3).

Various other institutions — state and territory work safety regulators, anti-discrimination bodies and the Australian Competition and Consumer Commission — also have specialist roles in parts of the WR system, for example in relation to regulation of secondary boycotts (chapter 31).

It is easy to overlook that this architecture does not dominate the economic landscape, but forms one component of it. The WR system sets floors not ceilings. Many aspects of the economy that are the target of WR policy are predominantly shaped by market forces. In buoyant economic times, wage dispersion increases across industries (which is not an adverse outcome). Increased over award wages and conditions are important signals for employees to move to areas of high demand. Similarly, when demand eases, there will be downward pressure over time on over award payments.



Figure 1.1 The main elements of the current workplace relations arrangements



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## Which employers and employees are covered by the national system?

Under the current system, coverage is provided by the various protections and processes of the FW Act to a range of employers and their employees (box 1.2, figure 1.2 and appendix D). The Productivity Commission estimates that just over 70 per cent of employed Australians are covered by the FW Act, and around 85 per cent of all employees. Even people outside the system — such as independent contractors — may be directly influenced by the system because enterprise agreements sometimes have attempted to control their role (chapter 25).<sup>6</sup>

### Box 1.2 Coverage of the *Fair Work Act 2009 (Cth)*

The overwhelming majority of private sector employees are covered by the FW Act.

- The bulk of such employees work for so-called ‘constitutional’ corporations (incorporated entities). This wide coverage reflects the change in the basis for the Commonwealth’s powers to regulate industrial relations from its industrial relations powers under s. 51 of the Constitution to its corporations power.
- Most private employees of non-constitutional enterprises are also covered by the FW Act because all states, bar Western Australia, referred their powers to regulate these employees.

The 2012 review of the WR system undertaken for the Australian Government estimated that the FW Act extends to approximately 96 per cent of private sector employees (McCallum, Moore and Edwards 2012), which is close to the Productivity Commission’s current estimates.

Coverage of public sector employees is less wide. Public sector employees are covered by the FW Act if they work in:

- the Australian Government
- the local government sector in Tasmania
- the public sector in Victoria, the Australian Capital Territory or the Northern Territory (except a law enforcement officer or an executive in the public sector in Victoria, or a member of the Police Force in the Northern Territory)
- public sector trading corporations (which are classified as constitutional corporations).

Employees of not-for-profit financial or trading corporations (which are also classified as constitutional corporations) are also covered by the FW Act.

All other employees, primarily state public sector employees in New South Wales, Queensland, South Australia, and Western Australia are regulated by state-specific legislation.

Some aspects of the FW Act also refer to matters specified in state legislation, such as state public holidays and long service leave (an area of some complexity — chapter 16).

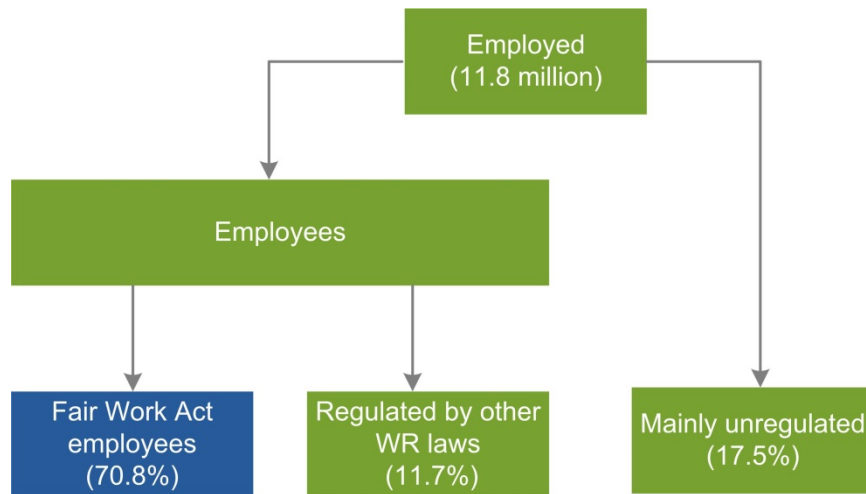
*Sources:* Adapted from Forsyth et al. (Forsyth et al. 2010, pp. 15–16); Department of Commerce (WA) (2015b) and information from the Fair Work Ombudsman.

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<sup>6</sup> It is hard to provide exact estimates because different survey datasets use different definitions of employment, some data are dated and counts of employees of unincorporated enterprises in Western Australia are imprecise.

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Figure 1.2 **Principal coverage in this inquiry, 2015**



Source: Appendix D.

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### All employees are covered by the common law

Every employee in Australia has a common law employment contract, whether formal, informal, written or oral. For 40 per cent of employees — many of whom have incomes substantially above average earnings (appendix E) — it is this arrangement, rather than an award or collective agreement, that sets their pay. The reach of a common law employment contract depends on the nature and coverage of the relevant statute (in this case the FW Act). Statutory law has precedence over the common law when they conflict. An implication of the common law’s residual role is that if statutory employment law widens or narrows its reach, the common law either retreats or advances in significance (Stewart and Riley 2007). In turn, this means that in examining changes to the FW Act, the counterfactual is implicit regulation through the common law (which can involve quite distinct costs and risks for all parties).

## 1.3 The past and the future cannot be ignored

The circumstances under which Australia’s WR laws and practices developed are unique to this country, but have adapted considerably over time. As this inquiry has discovered, the past has left indelible impressions on the current system that influences how it operates today. These need to be understood before policy changes are advocated.

Two significant events shaped the early development of the system in Australia:

- the debilitating strikes of the 1890s, which resulted in the creation of industrial arbitration tribunals at the state and Commonwealth levels and the introduction of a limited dispute settlement power into the Constitution at federation

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- the Harvester Judgment of 1907 in the Commonwealth Conciliation and Arbitration Court, which defined the minimum conditions under which a man would be able to support his family in ‘reasonable and frugal comfort’. The criteria for determining the minimum wage and its scope have since changed considerably. This was exemplified by the Commonwealth Conciliation and Arbitration Commission’s ‘equal pay for work of equal value’ decision in 1972, which among other things, removed the separate minimum wage for women. The decision was the first of many to come that set base level standards for the wages and conditions.

Gradually, the system of federal awards grew, mostly due to efforts by some unions to broaden their national application through the active use of the Commonwealth’s dispute settlement powers. These awards and the processes that determined them distinguish Australia from most other developed countries.

While their names and roles have changed, various specialist Commonwealth agencies have played an increasing role in regulating WR across all jurisdictions relative to their state organisational counterparts, in part due to the growing use by the Commonwealth of its constitutional powers and state governments’ willingness to refer their powers (Lucev 2008; McCallum 2005). The pessimism expressed by the Constitution Commission in 1988 about the capacity of the Australian Constitution to provide for a more national system was largely misplaced. As noted above, the main remaining exceptions to a national system are employees of unincorporated enterprises in Western Australia and many employees paid by state governments — which provide an example of the lingering presence of past arrangements in the current system.

Although changes in the system have mostly been gradual over the past few decades, these have cumulatively changed the system in quite fundamental ways.

- The shift from centrally determined wages and conditions to enterprise level bargaining has been the biggest break from the past. After almost one hundred years of centralised conciliation and arbitration, enterprise level bargaining was introduced as the centrepiece of the *Industrial Relations Reform Act 1993* (Cth). While awards still provide a floor for employment conditions, there is no longer a third party industrial tribunal that settles industrial disputes by making awards (Hamilton 2012, p. 2).
- Legislated minimum standards have taken greater precedence over arbitrated outcomes.
- There has been greater emphasis on productivity and flexibility at the enterprise level as goals of the WR system. (An aspect of this inquiry will be to assess whether these goals have been achieved and whether regulatory requirements for enterprise bargaining to extract commitments to these would be sensible.)
- Awards have been simplified — from many thousands of state and federal awards to 122 ‘modern’ awards in 2010 (McCallum, Moore and Edwards 2012). Greater flexibility has been introduced into such awards.
- The scope of the federal minimum wage has widened to encompass employees of all businesses except those employed by unincorporated enterprises in Western Australia.

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The FW Act specifies legislative criteria for setting the minimum through the ‘minimum wage objective’ (s. 284).

- Governments have introduced protections for individual workers (rather than collectives of workers) that exceeded the protections in particular awards, specific state and territory laws, and remedies at common law. The most important development was the inclusion of unfair dismissal arrangements into the federal WR system (Figgis 1998, pp. 1–2; Forsyth 2008, p. 509; Wheelwright 2001, pp. 173–176). In 2014, federal employment protection was extended so that workers subjected to alleged workplace bullying in constitutionally covered businesses could take the matter to the FWC, which could make an order to stop any proven bullying.
- Some key matters relating to working conditions (such as workforce health and safety) have been shifted to dedicated laws and institutions outside the WR system (although, in the case of anti-bullying, the shift has sometimes also been the other way).
- The system has accorded less weight generally to the powers of unions as negotiating parties for wages and conditions, and as monitors of workforce health and safety. This has been accompanied by a general decline in union membership (chapter 2).
- The creation of the Australian Building and Construction Commission (and its successor, Fair Work Building and Construction) — the first industry specific WR agency — has also reflected a major departure from historical practices.

At the end of this period of considerable change, there nevertheless remains some continuity. Safety net arrangements remain a fundamental part of the system (through awards covering a wide range of industries; National Employment Standards that must be reflected in all agreements; and a regularly re set minimum wage). There are still elaborate laws and administrative processes governing employment relations in all but a few pockets of the economy, and multiple specialist agencies still oversee the system. Even as the system has moved towards much greater use of enterprise bargaining, the requirements for review and registration of each agreement and the circumstances under which negotiations may proceed have remained within the (adapted) legal structure.

In some important respects, Australia’s WR system is not internationally unique. Most countries have safety nets of some form, use multiple specialist agencies for (quasi and actual) judicial and mediation purposes, and prescribe laws about the processes for negotiation between parties. No system is simple. Arguably, many other federations have more fragmented WR systems. However, notwithstanding a shift towards enterprise bargaining (and, to a lesser extent, individual arrangements), Australia appears to give more weight than other Anglo Saxon countries to elaborate rules about WR processes and, most particularly, to the centralised determination of minimum wages and conditions for many employees. This then requires a complex legal and institutional architecture that is distinctive to Australia.

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## The future

While there is an impression amongst some that labour markets have experienced major changes in the past few decades, that perception is largely misplaced. Indeed, in that period, labour markets have changed little. Labour mobility and tenure, casualisation, underemployment and unemployment have fluctuated slightly, but not by much (though there appears to be gathering risks in respect of the latter). There has been an expansion in the service sector and a temporary resources boom, but without significant labour market disruption.

However, recent experience may be a poor guide to future labour market developments — such as automation, further changes in social expectations of flexible working arrangements for people, greater online competition in services, the further reduction in union representation, and changes to the tax and transfer system (the latter of importance to the role of the safety net role of the regulated wage system). The impacts of such changes are unknown and there are risks in trying to anticipate future possible outcomes by changing legislation now.

## The swinging pendulum

Views about the need for major reform against an uncertain future and perceptions of current problems vary. Some advocate significant shifts in the WR landscape. Other key commentators have been sceptical about the need for further major changes, placing an emphasis on the value of stability (Borland 2012; Giudice 2014).

The current WR system reflected the rebalancing of the interests of employers and employees brought about with the implementation of the FW Act, and following the concerns with the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth). There was bipartisan support for some re-balancing.

The re-adjustment following the enactment of the FW Act does not necessarily mean there is no scope to improve outcomes from the WR system. But there is some sense in caution. Change is not costless, and drastic shifts would need to be warranted.

At the same time, a WR system should not frustrate desirable shifts in the economy and society, though inevitably legislation will have to adapt as new unforeseen problems emerge (as in ‘zero hours’ contracts in the United Kingdom — chapter 22). Legislation and decision making should avoid a circumstance where the past acts as a prison for new ideas. The Productivity Commission has given these concerns some weight, particularly in its recommendations for institutional reforms and a new type of employment contracts.

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## 1.4 The Productivity Commission's conceptual framework

Policy choices about the design of a WR system can affect economic performance and equity outcomes.

The stated objectives of the WR system are largely reasonable (if broad), and these operate through a variety of policy levers (figure 1.3). The key goal of the Productivity Commission is to ensure that those levers, and the drivers of outcomes are designed to achieve the best outcomes. Doing this requires a conceptual framework for understanding the WR system.

An immediate observation about policy in WR is that, unlike fiscal policy, government does not control the most responsive levers directly, and by their nature, legislative changes are often slow to make. Above all, the key decision-makers are the institutions created by the Australian Government, particularly the FWC. It interprets statute in its tribunal function, but above all is given broad discretion in wage determination. The performance and governance of institutions is therefore a critical design aspect of the system (chapter 3).

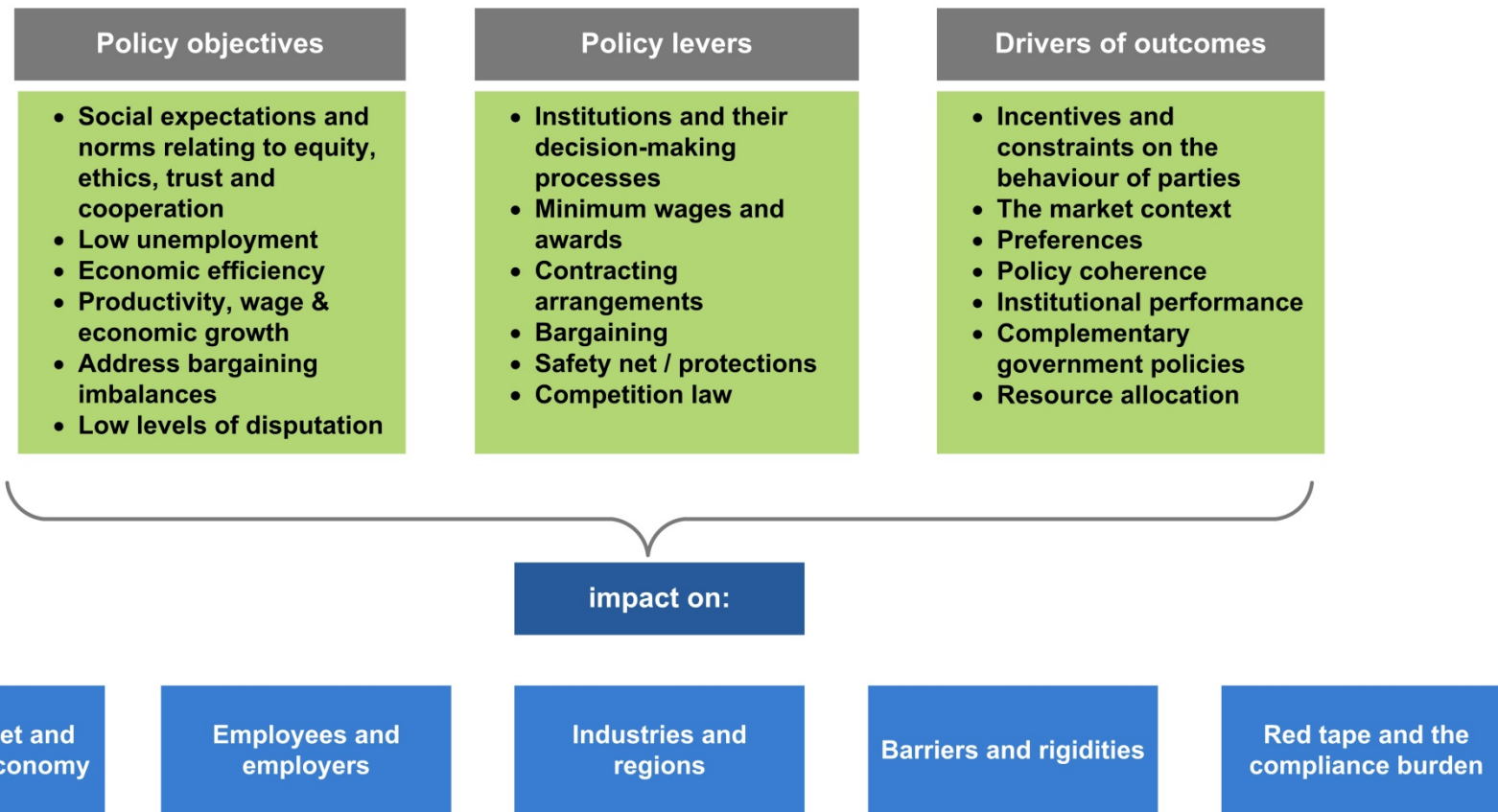
### **Ethical and social dimensions**

As the Productivity Commission has previously noted, labour is a distinctive 'input' to production (PC 2005b). Labour market outcomes do not just affect economic performance — they also have a substantial impact on equality of opportunity, the stability of family relationships and social cohesion more generally. The ethical and social dimensions of the labour market form the basis for many aspects of the WR system that differentiate it from the regulation of other markets.

For example, the 'price' of labour differs from the price of most other inputs in an economy. A broad principle underpinning Australia's competition policy framework is that lower prices from competition are almost always desirable. In labour markets it is less clear that a lower price is necessarily desirable, given that many people's incomes and wellbeing depend to a considerable extent on the price of labour and it can be costly to use alternative mechanisms to redistribute income. Indeed, the existence of a minimum wage — a 'floor price' set by regulation, which would usually be seen as contrary to the public interest for other goods and services — illustrates this distinction.

Figure 1.3 Objectives, policy levers and drivers of outcomes in the workplace relations system

The mechanics of the workplace relations system





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## Economic considerations

As discussed above, any framework for analysing Australia's WR system is underpinned by views about how labour markets operate, and the consequences these have for people's wellbeing and in understanding the outcomes of different policies.

### How do labour markets work?

Labour economists generally recognise that labour markets work somewhat differently from the pure competition model, though some see labour markets as 'workably' competitive. Of course, no market aligns completely with the basic and tractable model described in introductory economic textbooks, and some of the common divergences from the competitive model arise in labour markets too. However, labour markets additionally have some particularly distinctive features (which are discussed further in appendix H). These include:

- information asymmetries. Jobseekers may find it difficult to know the extent of competition for a job, the standard levels of remuneration and conditions for a comparable employment opportunity, and the non-wage conditions of a new workplace — such as workplace morale or the behaviour of managers. For employers, it may be similarly difficult to evaluate a potential employee's skills or personal attributes, and other opportunities or offers the employee is considering. These gaps in information increase the uncertainty of rejecting an offer during negotiations. Even where parties can overcome these information gaps, this is likely to come at a significant cost.
- search costs. Job searching is costly, as is recruitment. It is also an uncertain process — parties usually make and receive offers in a sequential fashion, and so must consider the likelihood of receiving a better offer or applicant in the future. For workers whose skills or knowledge are not easily transferable between jobs, the financial costs and time taken to switch between employers or job sectors may be particularly high.
- impediments to individuals freely entering and exiting the labour market. Many people do not have sources of non-labour income or savings to support themselves if they do not work. Even where safety nets such as unemployment benefits are available (though they can be difficult to access), the personal and social costs of unemployment mean that many people may not see exiting unsatisfactory employment as a viable alternative.
- barriers that limit the mobility of labour between segments of the labour market. People can find it difficult to relocate to areas where jobs are more available, due to influences such as family circumstances, housing and ties to local communities and infrastructure. While developments such as long-distance commuting, temporary immigration, and advances in transport and communication technology have improved labour mobility in Australia, there are still significant personal reasons that hold employees to locations.

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- employers that wield substantial purchasing power in the labour market (monopsonies). While monopsonies are historically associated with ‘one company towns’ where employees have little recourse to seek jobs nearby, they still persist in some sectors, for example government-provided services, or where the skills required by firms are sufficiently differentiated (sometimes referred to as monopsonistic competition). Behaviour to similar effect can also occur where employers in certain industries ‘cooperate’ to prevent wage bidding wars for talented employees.

These characteristics mean that in the absence of labour market regulations, wages are not necessarily set purely by reference to a competitive market rate, but rather through bilateral bargaining between employer and employee. The relative bargaining power of each party will determine their capacity to influence the final wage outcome (appendix H).

### Human complexities

In the real world, employers and employees are people with all their various flaws and virtues, and these can collide in workplaces in ways that have ramifications for how labour markets function:

- People make mistakes (for example, employers and employees may form an employment contract without any real due diligence).
- Employers and employees have values that are important to the way they do their work. An employee may want to work many additional hours at no cost because of professional pride. Employers may want to pay bonuses, provide better staff facilities or assist an employee facing family problems (say domestic violence) because they are dealing with human beings who they wish to help and please. Employers and employees dealing with each other are not merely doing so as part of a calculated business strategy, and in some cases this opens the door for one party to exploit the other’s goodwill and non-monetary motivations. (One less altruistic formulation of this is that employers may sometimes set higher prices for labour to motivate trust and to increase the cost of shirking — one example of so called ‘efficiency wages’.)
- There are few ‘representative’ employers and employees. People have heterogeneous tastes for workplace conditions and heterogeneous abilities, even when paid the same wage rate.
- Some businesses are poorly managed, and most are not at the technological and managerial frontier. An inadequately managed firm may provide poor training, treat people poorly, leave them bored or over busy with poor task scheduling, pay them too little for what they do, or provide no praise for good work — and yet people do not leave the first time they are ill-treated. On the other hand, there are model employers, with a spectrum of employers between the two extremes. The poorest performing employers may fail ultimately, but failure usually takes time, and damage in the interim may not be limited to just the employer. There is a persistent poorly performing tail in the distribution of firm performance in all countries and all industries (Bloom and Van Reenen 2010; Bloom, Sadun and Van Reenen 2012).

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Some of the above complexities suggest a need for regulation, others not. For example, regulation of unfair dismissal is justified, not only because the act itself is problematic but also because the potential to do it allows leverage by an employer to exploit vulnerable employees. Bullying would fall under the same category (whether by an employee or employer). Voluntary consent to work longer hours than the average is not an obvious problem, unless it is actually not ‘voluntary’, but obtained through coercion.

### Regulating imbalances in bargaining power

Bargaining power depends on the relative costs to each party of failing to reach an agreement — primarily their capacity to hold out from entering into an arrangement, and their ability to seek alternatives (appendix H). This dynamic generally favours employers — the greater the size of the employer and its resources, the more these inequalities in bargaining power are exacerbated. This can partly be explained by differences in the relative risks faced by the parties.

For example, if a large firm makes an employee an unreasonable offer, the firm faces the risk of a relatively small temporary reduction in its labour output, while the employee faces a potentially extended period of unemployment. Further, larger firms are more likely to be ‘repeat players’ in labour markets, with greater negotiating experience and access to relevant information than workers. There is reasonable empirical evidence of such employer bargaining power across different industries and countries, though comparatively little research in Australia (Ashenfelter, Farber and Ransom 2010; Booth and Katic 2011).

While the Productivity Commission agrees that workable competition can apply in some labour markets, it also considers that, on average (and particularly at lower wage levels), employers have stronger bargaining power than employees, with consequences for wages and conditions, unless countered by regulations or (constrained) employee collective bargaining. This provides an economic rationale for different aspects of labour market regulation (although, as is always the case for regulation to be warranted, it must still be ‘fit for purpose’, minimise adverse side effects and be able to pass a broad benefit cost test).

In order to overcome inequalities in bargaining power, the WR system sets regulatory floors to certain conditions — for example, minimum wages and annual leave (in the same way that the workforce health and safety system sets workplace safety standards).

The WR system also allows employees to organise and act collectively through enterprise bargaining (chapter 20) and industrial action (chapter 27). The endorsement of collective action is in stark contrast to competition policy<sup>7</sup> (chapter 31). Nevertheless, up to some

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<sup>7</sup> Competition policy generally regards collective behaviour as anticompetitive, and requires parties to act independently of their competitors when making decisions about the terms and conditions of doing business.

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point, collective action can act as an efficient countervailing power to the bargaining power of employers. Accordingly, unions and employees acting collectively can mitigate wage suppression, improve other protections for employees (such as safety), enhance the efficiency of bargaining, and provide a channel through which employees and employers can agree cooperatively on technological change (the latter a more European approach).

A well-functioning WR framework places limits on the countervailing power of employees. It also recognises that unions predominantly represent their members, not necessarily all employees or other potential employees and so, if possessing greater power than employers, may achieve conditions that adversely affect efficiency and equity.

Labour market regulation also has to recognise that the exact degree of a party's bargaining power is hard to establish, and that, unlike the past, minimum wages and awards are intended primarily to serve as a safety net, not to regulate wages and conditions for the majority of employees. Achieving the balance in bargaining power between employees and employers is one of the most critical objectives of a WR system — and a key area of examination by the Productivity Commission throughout this inquiry.

## **1.5 Considerations for assessing policy proposals**

The Productivity Commission's approach to this inquiry has been to recommend policies that maximise the wellbeing of the community as a whole, as it is required to do under its Act. The recommendations of this inquiry are not intended to single out the interests of any group of stakeholders in the WR system, but to serve the interests of the community as a whole.

This inquiry's approach has recognised the social as well as the economic aspects of wellbeing; and in the case of an inquiry into WR, the concepts of fairness and equitable treatment, the balance of negotiating strength and the ability of parties to remain well-informed and able to manage their own interests effectively have clearly been relevant, albeit sometimes difficult to balance.

In examining submissions and other material, a key consideration in the inquiry has been how any proposed changes:

- improve the overall use and allocation of resources in workplaces and around the economy (encompassing managerial as well as employee efficiency)
- enhance employment opportunities, matching of people to jobs and informed employment choices
- accommodate differences in the needs and circumstances and of different types of businesses and different regions
- promote efficient pricing and efficient investment in innovation, skill and capital

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- promote institutions that are efficient and effective and avoid undue administrative or compliance costs
  - ensure that any regulatory requirements are necessary and simple to understand and use
  - curtail the abuse of power that could add significantly to social and economic costs
  - achieve outcomes that are consistent with community norms, for example in relation to equitable outcomes and ethical behaviour
  - are consistent with complementary regulations and policies
  - are adaptable, particularly, but not solely, in the light of future demographic and global economic trends.

### **Issues in assessing the economic impacts**

In undertaking the assessment of impacts, the Productivity Commission has been mindful of the complexity of the linkages between WR and the economy as a whole, and the difficulties in isolating its effects from other factors driving economic performance:

- the impacts may be indirect, such as through training, innovation, distribution, the adoption of new information technologies and investment, and thereby hard to separate from other factors
- the desired impacts may require other complementary organisational changes or policy shifts
- even if gains from any change ‘only’ show up as a modest one off permanent upward shift in incomes, a possibility raised by Peetz (2012), these can be important to people’s lifetime incomes, but hard to discern empirically amongst the noise in the economy
- there may be opposing benefits and costs from reform, which make it hard to identify the effects separately. Related to this, there is no single measure by which to gauge whether a WR system has been successful (is it lower unemployment, anchoring low inflationary expectations, higher real net national disposable income, productivity, greater job security, job satisfaction, lower dispute rates, higher wages, more equitable outcomes, among many other possible measures?)
- there are limited observations in macroeconomic data, which may not be ideally suited to isolating the effects of reform (Borland 2012; Deakin, Malmberg and Sarkar 2014). Contrary to this more aggregate analysis, more disaggregated studies based on firm level data appear to be more promising in discovering effects, though this approach has its own limitations (Farmakis-Gamboni and Prentice 2011; Loundes, Tseng and Wooden 2003; Tseng and Wooden 2001). Many macroeconomists cite past labour relations reforms as a contributor to Australia’s improved macroeconomic performance since the mid-1990s (chapter 2)
- some WR policy reforms may impose short run costs on some groups (which may be immediately measurable), but lead to longer run gains (which are not). Trade reform

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and competition policy in the 80s and 90s are cases in point. This is another reason for examining how a system balances the powers of competing parties, and the extent to which any given design crowds out cooperative arrangements between employees and employers.

While there are measurement challenges in discerning aggregate impacts, the Productivity Commission has, as far as possible, attempted to assess the materiality of the impacts of its recommendations.

## **Data and analytical methods**

As specified in the terms of reference, this inquiry has drawn on a wide spectrum of evidence, including, amongst others:

- past overarching reviews of the system (most recently, the 2012 post-implementation review of the FW Act (McCallum, Moore and Edwards 2012)), analysis undertaken or commissioned by the FWC (including as part of its minimum wage and award reviews), and submissions to various recent Senate inquiries into changes to the WR system
- extensive ABS data,<sup>8</sup> including confidentialised unit record data from the Survey of Employer Earnings and Hours (2014) and the Survey of Income and Housing (2011-12)
- other non-ABS confidentialised unit record survey data, including the Survey of Household, Income and Labour Dynamics in Australia (HILDA), the Australian Workplace Relations Study (AWRS) and the Australian Work and Life Index (AWALI)
- information provided by certain businesses, such as the Shopping Centre Council of Australia and a major credit card provider
- survey data from the Chamber of Commerce and Industry Queensland
- data from the Department of Immigration and Border Protection on migrant workers
- data from NCVER on apprentices and trainees
- data held by the Australian Department of Employment, such as its Workplace Agreements Database
- data from the FWO and the FWC that shed light on specific aspects of the WR system (such as trends in unfair dismissal cases and their outcomes)
- key legal cases

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<sup>8</sup> For example, surveys such as the Population Census, Australian Industry, Forms of Employment, Working Time Arrangements, the Time Use Survey, the Survey of Employee Earnings and Hours, and various data from the Labour Force Survey.

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- submissions to this inquiry. The Productivity Commission also provided scope for stakeholders to make brief comments about WR matters on its website.
  - data on opening hours of restaurants and cafes in major cities in Australia and New Zealand
  - data on the contents of enterprise agreements in New Zealand
  - various international sources of evidence about WR systems, such as the United Kingdom Workplace Employment Relations Study (Van Wanrooy et al. 2013); the ILO NATLEX database, and data from the OECD (2014b), the World Bank (2013a) and the World Economic Forum (2014). These have several inconsistencies and other limitations (Aleksynska and Cazes 2014; Hall and Casey 2006), but have still been useful in this inquiry.

Various modelling and analytical methods have supported the findings of the inquiry, including econometric and microsimulation analysis.

## **1.6 Conduct of the inquiry**

The terms of reference for this inquiry were received from the Treasurer on 19 December 2014.

To assist interested parties to prepare submissions to the inquiry, the Productivity Commission released five extensive issues papers to reflect its initial view about the priority questions in the inquiry, informed by initial consultations. The Productivity Commission met with a wide range of inquiry participants and held roundtables with employer and employee representatives. Following the release of its draft report, the Productivity Commission conducted eight formal public hearings, located across several capital cities and regional centres.

The Productivity Commission received 373 submissions from diverse groups involved in the WR system (employee, employer and industry groups, WR practitioners and advisers, WR academics, large and small businesses, community sector representatives and many individuals). Governments and the key institutions (the FWC and the FWO) also contributed.

Many hundreds of personal views were provided through an online survey undertaken by the Australian Council of Trade Unions (ACTU). The Productivity Commission also sought comments from Australians generally — and received useful feedback from predominantly small businesses, employees, union representatives and community organisations. These added depth and personal insights to the inquiry.

Appendix A provides details of the individuals and organisations that formally participated in the inquiry.

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The Productivity Commission thanks all inquiry participants for meeting with Commissioners and staff, participating in the roundtables and public hearings, and making submissions to the inquiry.

## 1.7 Guide to the report

The current chapter presents relevant background information and definitions, the broad framework applied in this inquiry, and the basis for government involvement in WR. The major aspects of the Australian labour market are then outlined in chapter 2.

The remaining chapters are organised principally around several central policy themes:

The performance and structure of the two key institutions of the WR system (the FWC and the FWO) are integral to its effective functioning (chapter 3). Given the exceptional degree to which regulation is vested in these institutions, any response to the terms of reference must give substantial attention to how they are performing and whether they remain fit for purpose.

Following on from the institutions are the mechanisms used to apply the standards in workplaces. As in many other countries, Australia places regulated floors on the wages and conditions of employees. The adult minimum wage is the pre-eminent policy tool and is directly managed by the FWC (chapter 4), but its effects extend to wage floors for younger people, and some have suggested variants on the minimum wage, such as by region or state (chapter 5). There are potential complementarities between the minimum wage and other tax/transfer policies, such as earned income tax credits (chapter 6).

A feature of Australia's WR framework is the hundreds of additional minimum wages for people with given sets of skills or in particular industries — 'awards' (chapter 7), which pose some significant policy challenges (chapter 8). Two particular features of awards are sometimes highlighted — penalty rates and loadings for different working time arrangements. Penalty rates for long hours, night and evening work involve health and welfare issues (chapter 9). These issues are quite distinct from the more controversial issues surrounding weekend penalty rates (chapters 10 to 15). All of these rates are set under regulatory responsibilities ceded to the FWC.

A central component of any WR system is the basic levels of protection it provides for employees, such as its fundamental standards (the National Employment Standards (NES) — chapter 16), the avoidance of unfair dismissals of employees (chapter 17), a set of wider protections against adverse action (chapter 18), and measures that aim to discourage and remedy workplace bullying (chapter 19). All of these, except for the NES, are also primarily powers managed by the institutions.

While a significant part of Australia's WR system involves regulated protections and minimum standards, another critical part concerns the rules about how parties can arrange employment contracts on their own terms. There are diverse ways in which these contracts



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may be formed. Some are at the enterprise level, usually involving bargaining between an employer and representatives of its employees (chapter 20). In new ‘greenfields’ enterprises without any employees (for example, a proposed construction project), negotiations are carried out between employers and unions (chapter 21). Particularly among smaller businesses, employment contracts often involve an individual reaching an arrangement with an employer (chapter 22). The Productivity Commission has floated the idea of a new type of arrangement — the enterprise contract — which lies between these two arrangements (chapter 23). Bargaining in the public sector involves some special issues (chapter 24). Industrial disputes are a feature of the bargaining process. The Australian system provides a window between the expiry of an old enterprise agreement and the formation of a new one. In this period, employers and employees (collectively) can lawfully engage in industrial disputes to encourage settlement and to gain leverage. This is not a free for all contest between parties — there are strict rules about the nature and form of engagement (chapter 27). Employee representatives also have the right to enter workplaces to conduct discussions with employees and inspect suspected breaches of workplace laws (chapter 28).

Discussions about the WR system often tend to ignore particular subgroups of the employed. For example, contractors — who are not employees — play an important role as a source of labour, but there can be complex interactions between them and the WR system (chapter 25). Similarly, certain kinds of migrant workers are subject to the risk of exploitation (chapter 29).

Labour markets are always in motion, and inevitably (and mostly desirably), people have to sometimes move between jobs. One aspect of that dynamic process, largely confined to large businesses, is the arrangements that come into play when a business changes hands (‘transfer of business’ — chapter 26).

Australia is a signatory to various international conventions, the implications of which are addressed in chapter 30.

Much of a WR system concerns the desirability of ensuring that there is some balance of power between the contracting parties. In some cases, the arrangements that deal with the potential for excessive market power in labour relations is not part of the FW Act, but rather embedded in competition policy more generally (chapter 31).

The FW Act is an understandably complex piece of legislation (around 900 pages in length) and is accompanied by other important regulations (most particularly the stipulations in the 122 Awards). Inevitably, this complexity is accompanied by some compliance costs — and these do not only relate to employers (chapter 32).

This inquiry has recommended a range of policy reforms and considered their impacts (chapter 33) and implementation (chapter 27).

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There are also 10 appendixes of supporting material — mainly of a statistical or analytical nature — and several technical appendixes relating to minimum wage modelling and an earned income tax credit.

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## 2 Developments in Australia's labour market

### Key points

- Australia's contemporary labour market has been shaped by fundamental changes to the structure of the Australian economy, the workplace relations framework, and social norms.
- The distribution of jobs across industries has changed dramatically. While the manufacturing industry has experienced a decline in employment, many service intensive industries have seen significant growth.
- Australians are also working in different occupations, with more jobs requiring high skill levels.
- Security of work appears to have changed relatively little in recent years.
  - Increases in rates of casual employment have tapered off during the 2000s, the prevalence of independent contracting has been stable and average job tenures have not declined.
- Union membership has declined over time.
- There have been big changes in who works.
  - More women are in the workforce, more mature age people are participating and skilled migration has increased strongly in the past 15 years.
- While unemployment in Australia has generally fallen over the last two decades, there has been an upturn in recent years, with rising youth and long-term unemployment a particular concern.
- There are several indicators that the labour market has become more flexible, most notably through a greater tendency to adjust hours rather than employment during downturns in business demand, and the unresponsiveness of prices to strong labour demand. There is little evidence of change in the efficiency with which the unemployed are matched with job vacancies, though this may deteriorate if long-term unemployment rises.
- Labour productivity growth has outstripped wages growth in recent years.
- Income inequality has risen somewhat over the last two decades, with wage dispersion an important contributor.
- Anticipating future labour market trends is fraught with difficulty. However, it is possible to create workplace relations structures that respond to new economic developments and new social norms as they arise.

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Australia has undergone substantial economic and social change over the last 40 years, with significant implications for debates about the role and form of the best workplace relations system. At the institutional and regulatory level, the Australian economy has progressively opened to the global economy, with the reduction and removal of tariffs, along with the introduction of a floating exchange rate. Over the same period, the locus of wage setting has moved between extremes, from the centralised Prices and Incomes Accord to bargaining at the enterprise level. While some of these trends have now abated, others will continue for some time yet, and entirely new ones will emerge.

Market forces have been a major driver of change in the Australian labour market, however, regulatory developments have also had a substantial impact. Notwithstanding the different criticisms of the various industrial relations regimes in place over the last two decades, these regimes have coincided with positive developments in labour markets and economic performance:

Over ... two decades, the pertinent economic outcomes have been congenial. ... industrial disputes are uncommon, overall wages growth has been consistent with low consumer price inflation ... unemployment has steadily declined while participation in the workforce has increased ... and at the same time the profit share of incomes has increased. These are considerable achievements, not to be put at risk lightly. (McCallum, Moore and Edwards 2012, p. 21)

Several commentators have identified past changes in labour relations as supporting improvements in Australia's macroeconomic environment, although they are cautious about precisely quantifying their relative importance (Ballantyne, De Voss and Jacobs 2014; Battellino 2010; Borland 2012; Lowe 2012; Mallick 2014; PC 2013b).

The focus of much of this report will be on how to improve the system further. The Productivity Commission recognises the effectiveness of workplace relations reform over the last two decades, but will examine whether Australia can do better without sacrificing essential elements of what has been achieved to date.

This chapter outlines major features of the Australian labour market, including:

- a brief snapshot of work in Australia (section 2.1)
- trends in the gender, age, industrial and occupational/skill composition of the Australian labour market, as well as the role of unions (section 2.2)
- the increasing importance of non-traditional work and changing job tenure patterns (section 2.3)
- job stability and labour market transitions (section 2.4)

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- labour utilisation — one of the main goals of governments is to ensure that policy settings do not frustrate people's access to jobs and to their desired hours of work (section 2.5)
  - flexibility in adjusting to shocks. It may be that much of the stability apparent in recent years reflects better macro and microeconomic policy settings, including those relating to the workplace relations (WR) system. Or it may be that, in part, Australia has been lucky, and that the capacity of Australia's current settings to adapt to shocks has not been yet tested (section 2.6)
  - the degree to which wage pressures have changed, and associated with that, the degree of earnings dispersion (section 2.7)
  - the future of work and its implications for workplace relations policy (section 2.8)
  - a summary of the key labour market trends discussed throughout this chapter (section 2.9).

## **2.1 A snapshot of the Australian labour market**

Effective labour market regulations must take account of the large degree of variation in the working patterns of Australians (table 2.1). It is not possible to characterise a 'normal' pattern of work. Many people do not work in regular full-time long-tenure jobs in daylight hours on weekdays. Indeed, there are many part timers, shift and overtime workers, people in non-traditional forms of employment, and people with short-term tenure in their jobs. More than one in twenty people are multiple jobholders and close to one in three secondary students work.

There is also a tendency by some to see the labour market in static terms. Yet, there is a large amount of dynamism in Australian labour markets. Even over the very short term, many people change their labour force status. For instance, nearly one in five people who were unemployed in January 2015 were employed one month later. And, as shown in many of the sections below, there have been major long-run shifts in working patterns.

**Table 2.1 Patterns of working — a snapshot**

<i>Measure</i>	
Employed persons 2014 <sup>a</sup>	11 563 000
Unemployed persons 2015 <sup>a</sup>	747 000
Unemployment rate 2014 (%) <sup>a</sup>	6.1
Vacancy rate — vacancy to labour force ratio, November 2014 (%) <sup>i</sup>	1.2
Share of unemployed in January 2015 who were employed in February 2015 (%) <sup>e</sup>	22.8
Participation rate 2014 (%) <sup>a</sup>	64.7
Female (share of employed %) <sup>a</sup>	45.9
Employees (share of employed %) <sup>b</sup>	82.7
Independent contractors (share of employed %) <sup>b</sup>	8.5
Other business operators (share of employed %) <sup>b</sup>	8.8
Average hours per week worked by employees, 2014 <sup>a</sup>	32.7
Working part-time 2014 (share of employees %) <sup>a</sup>	29.7
With paid leave entitlements (share of employees %) <sup>b</sup>	76.5
Required to be on call (share of employees %) <sup>b</sup>	22.3
Did not have any say in starting/finishing time (share of employees %) <sup>b</sup>	58.7
Working shift time (share of employees %) <sup>c</sup>	16.1
Usually worked on weekends (share of employees %) <sup>b</sup>	31.8
Work overtime (share of employees who %) <sup>c</sup>	34.3
On a fixed term contract (share of employees %) <sup>b</sup>	3.8
Are multiple job holders (share of employees %) <sup>c</sup>	5.6
In the private sector (share of employees %) <sup>d</sup>	83.2
In large businesses (>200 employed) (share of employed %) <sup>f</sup>	31.7
Less than 1 year job tenure (share of employed %) <sup>g</sup>	18.2
1 to less than 5 years of job tenure (share of employed %) <sup>g</sup>	37.4
5 or more years of job tenure (Share of employed %) <sup>g</sup>	44.4
Share of school students aged 15-19 years who are employed (%) <sup>a</sup>	32.1
Experienced a change in work over past year (share of employees that %) <sup>g,h</sup>	22.0

<sup>a</sup> For January 2014 to December 2014 from ABS 2015, *Labour Force, Australia*, Cat. no. 6202.0. <sup>b</sup> All employed people with data from ABS 2013, *Forms of Employment, Australia*, Cat. no. 6359.0. <sup>c</sup> ABS 2012, *Working Time Arrangements, Australia*, Cat. no. 6342.0. <sup>d</sup> ABS 2013, *Employee Earnings, Benefits and Trade Union Membership*, Cat. no. 6310.0. <sup>e</sup> ABS 2015, *Labour Force, Australia*, Cat. no. 6202.0. <sup>f</sup> ABS 2012–2013, *Australian Industry*, Cat. No. 8155.0. <sup>g</sup> ABS 2013, *Labour Mobility, Australia*, Cat. no. 6209.0. <sup>h</sup> Where change in work may refers to occupations changes, change in usual hours worked, or a promotion/transfer. <sup>i</sup> Productivity Commission estimates based on ABS 2015, *Job Vacancies, Australia*, Cat. no. 6354.0.

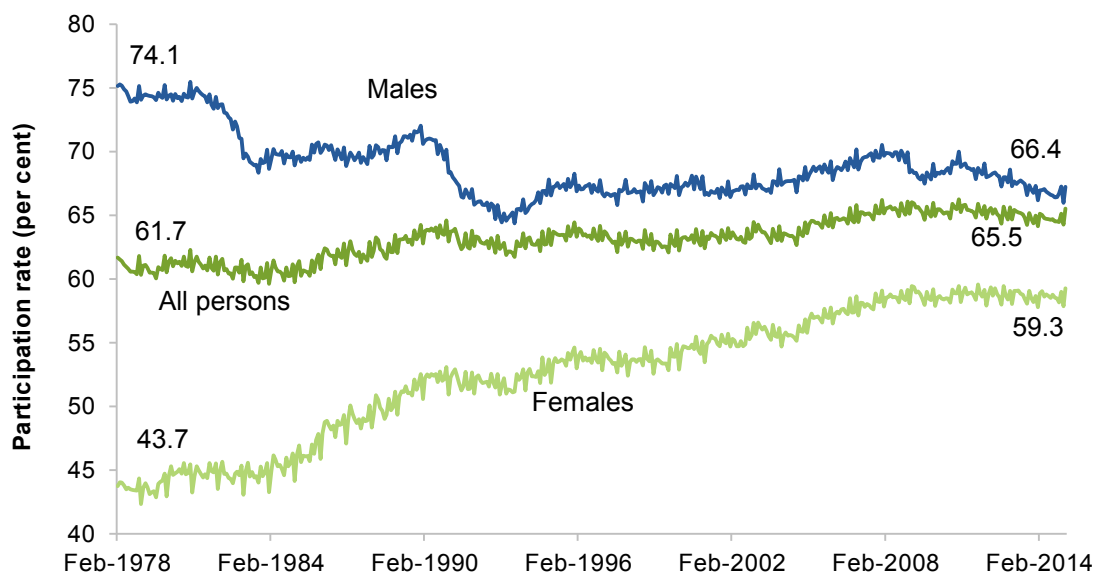
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## 2.2 Who works? Participation and the composition of the labour force

The composition of Australia's labour force has changed substantially over the past 40 years. Women who work are now the norm, rather than the exception (figure 2.1), more mature age Australians are participating in the labour force, and skilled migrants are forming an increasing share of Australia's migrant intake. These shifts have all contributed to an increased participation rate over time.

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Figure 2.1 **Female participation rates up, male rates down**  
February 1978 to February 2015



Source: ABS 2015, *Labour Force, Australia*, Cat. No. 6202.0, released 12 March.

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### More women are in the workforce

Female participation rates have increased over the last 40 years, both in Australia and other advanced economies. In Australia, they have risen from just under 45 per cent to almost 60 per cent. A number of factors have contributed to this increase, including several social and economic developments. Educational attainment has increased substantially among females since 1960, while fertility rates have declined over the same period. Moreover, increasing access to childcare has facilitated entry into the workforce. Such changes have been partly reflected in regulatory developments. For example, the equal pay cases in the

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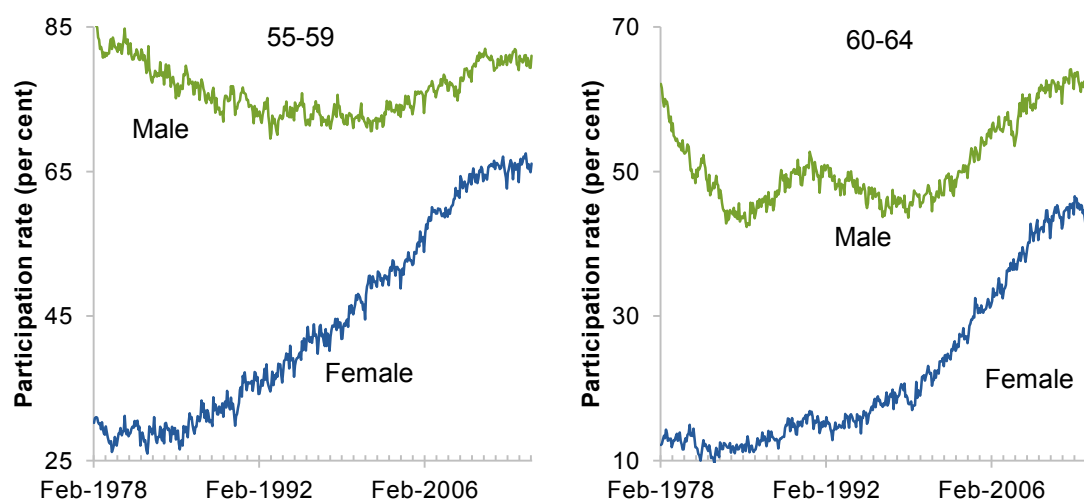
late 1960s and 1970s established the principle of equal pay for work of equal value, overturning the ‘Harvester Man’ view of the minimum wage.<sup>9</sup>

## More mature age people are working

Mature age workers (those aged 55–64 years) have been growing as a share of both the population and labour force. While female mature age workers have traditionally had lower rates of workforce participation, this has increased markedly over the last three decades. Moreover, the decline in male participation rates among mature age workers has reversed in the last 15 years (figure 2.2).

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Figure 2.2 **Mature age workforce participation has been increasing**  
February 1978 to February 2015, 55-64 year olds



Source: ABS 2015, *Labour Force, Australia, Detailed*, Cat. No. 6291.0.55.001, released 12 March.

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The trend of rising participation rates of older workers is likely to continue for some time — partly offsetting the decline in participation rates resulting from the shift in the age structure of the labour force (PC 2013a).

The increase in mature age workforce participation is attributable to a range of factors, such as increased life expectancy and improved health in the years before retirement. Additionally, mature age workers have had increasing access to flexible work practices, such as part-time and casual work, while the growth of employment in the services industries has allowed for work in less physically strenuous roles.

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<sup>9</sup> The Harvester decision in 1907 determined that the federal minimum wage should reflect an income level sufficient for a male breadwinner to meet the reasonable needs of his wife and three children; suggesting that a women could only ever be paid a portion of a man’s wage.



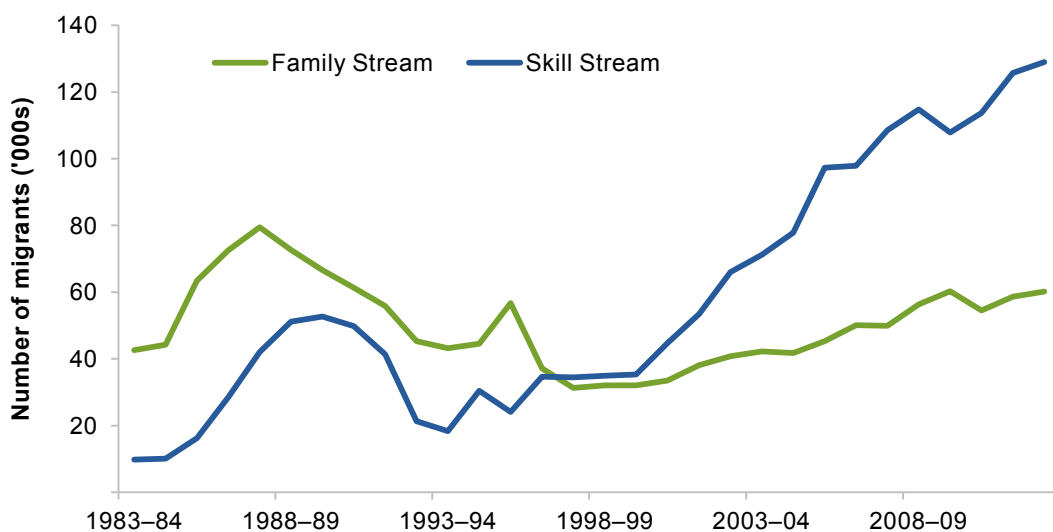
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## Skilled immigration has increased

Immigration is an important contributor to Australia's labour force. In the year to June 2014, Australia accepted around 190 000 permanent migrants through its Migration Programme and around 650 000 temporary migrant visas with some working rights (DIBP 2015a). Skilled migrants have become the largest proportion of Australia's Migration Program in the last 15 years (figure 2.3). Since 1996, migrants have increasingly entered through the skilled stream rather than the family stream.

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Figure 2.3 **Skilled migration has been increasing**



Source: Department of Immigration and Border Protection (2014a).

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## Growing employment in service industries

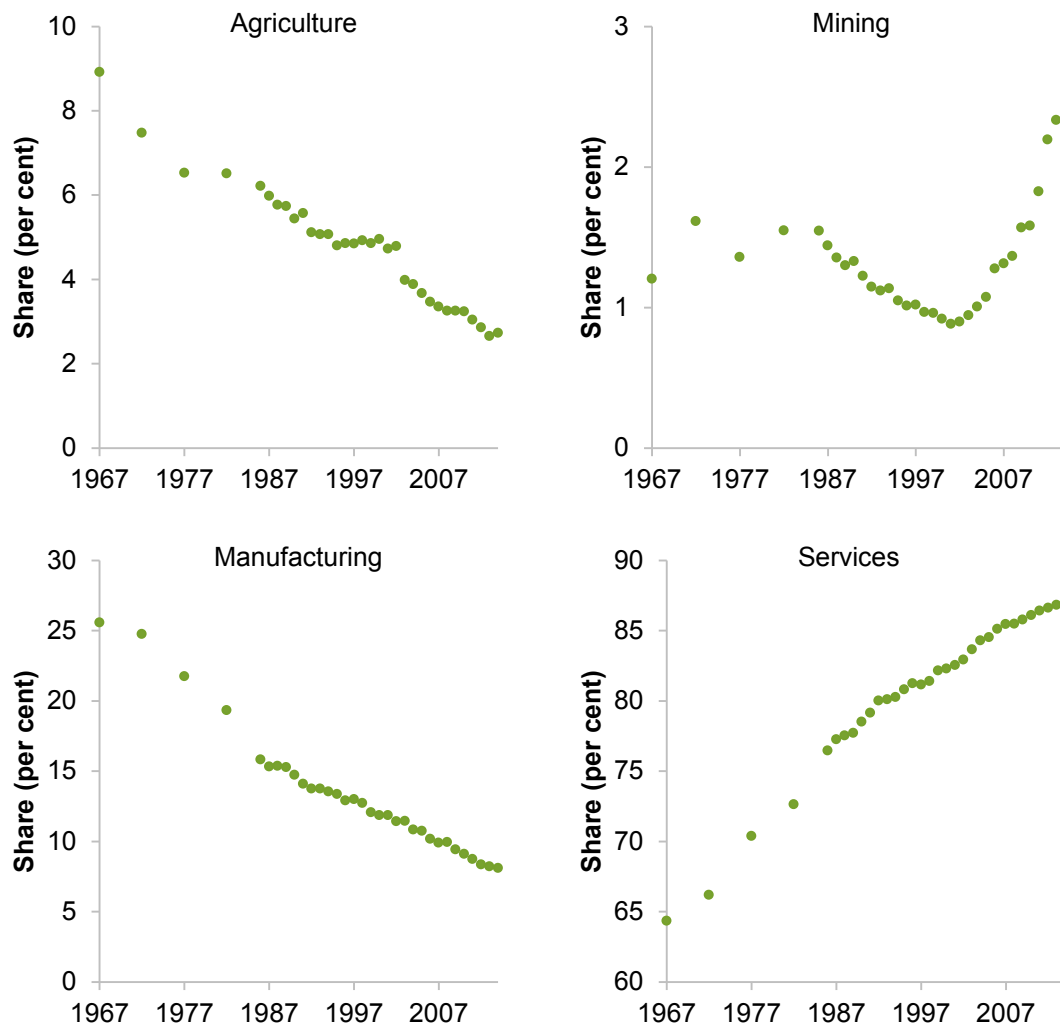
The composition of the Australian economy has changed markedly over the past half century. Like many other Western, developed nations, employment has shifted away from manufacturing and towards services (figure 2.4).

Employment in manufacturing has progressively declined (figure 2.5). In 1985-86, manufacturing employed around 16 per cent of Australian workers. This share fell to less than 8 per cent by 2013-14. In absolute terms, the industry lost 150 000 workers. The agriculture, forestry and fishing industry also experienced a decline in employment over the same period. Its share has fallen from just over 6 per cent to under 3 per cent, while absolute employment numbers have fallen by around 115 000 workers.

On the other hand, service industries have experienced robust employment growth over the past 30 years, growing by more than 4.6 million from 1985-86 to 2013-14. In terms of

overall employment, the fastest growing share of total employment was in the professional, scientific and technical services, followed by health care and social assistance.

**Figure 2.4 Services have increased markedly**  
Share of total employment by sector, 1966-67 to 2013-14<sup>a</sup>



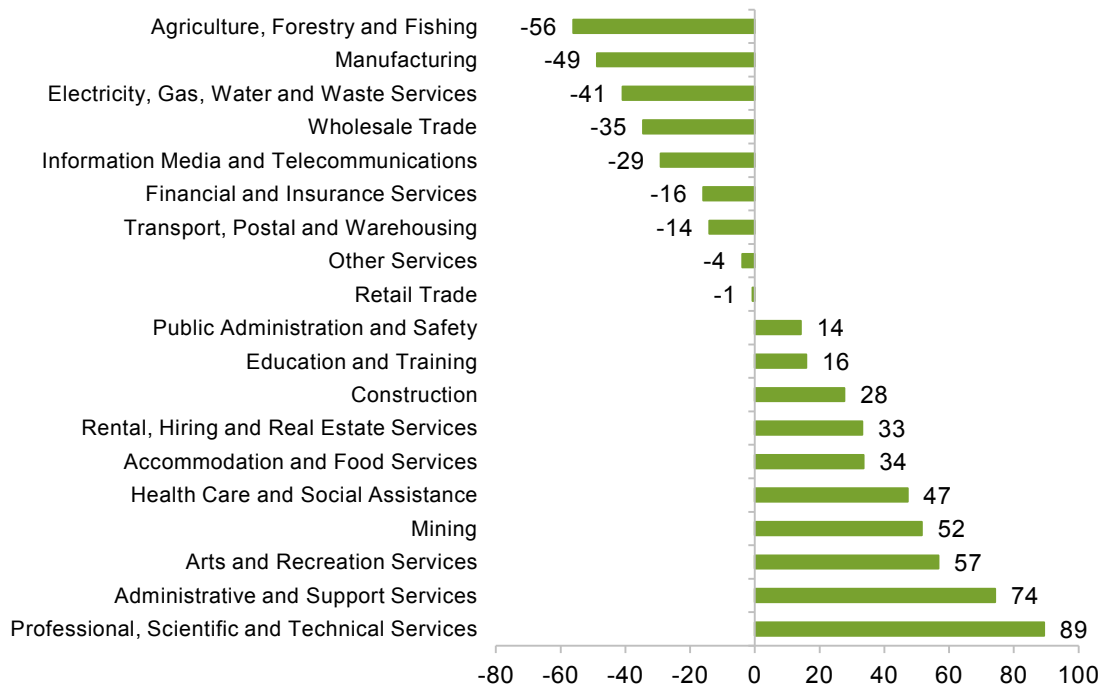
<sup>a</sup> From 1986-87, annual employment was calculated as the average of quarterly data.

Sources: Productivity estimates based on ABS 2014, *Labour Force, Australia, Detailed, Quarterly*, Cat. No. 6291.0.55.003, released 18 December; Productivity Commission (2003b, p. 27).

Demographic trends are likely to contribute to a continuation of these shifts. For example, those over the age of 65 consume services at a rate almost 10 percentage points above those aged 15-64. Given Australia’s ageing population, these age-specific patterns of consumption suggest an increasing shift toward services (Kent 2014a).

**Figure 2.5 The distribution of employed persons across industries has been changing**

Percentage change in employment shares, 1985-86 to 2013-14<sup>a</sup>



<sup>a</sup> Employment levels were calculated as averages of quarterly data ending May.

Source: ABS 2014, *Labour Force, Australia, Detailed, Quarterly*, Cat. No. 6291.0.55.003, released 18 December.

## More jobs require higher skills

Australians are not only working in different industries, they are also working at different skill levels. Highly skilled occupations are playing a more important role in economic activity, and there is broad consensus that this trend is likely to continue.

Since the early 1990s, the largest increase in share of jobs has been among professionals (figure 2.6). At the other end of the spectrum, the largest decline in job share has occurred for machinery operators and drivers, clerical and administrative workers and labourers. The Department of Employment (2014a) has forecast that these trends will continue.

Other research has proxied skill levels using hourly wage rates or ABS-defined skill levels. Such studies have consistently found higher rates of growth among high-skill occupations. On the other hand, trends in growth among low-skill occupations have been contested.

Figure 2.6 Share of employment by occupation<sup>a</sup>



<sup>a</sup> Data are average of quarterly data in the year ending May (and the three quarter average for 2013–2014).

Source: ABS 2014, *Labour Force, Australia, Detailed*, Cat. No. 6291.0.55.003, released 18 December.

While many agree that technological development is the main driver of this shift in occupational composition, the resulting pattern of change has been disputed. Some argue that developments in technology are favouring skilled workers over the unskilled. This phenomena has been coined ‘skill-biased technical change’. Others argue that technology is, more specifically, replacing easily routinised work, which is concentrated in the middle of the skill distribution. The corresponding growth in high and low skill occupations has been coined ‘job polarisation’.

International evidence has generally supported job polarisation, however evidence in Australia has been mixed. Wilkins and Wooden (2014) notes that job growth from 1993 to 2013 has favoured highly skilled occupations, and suggests that a relatively high minimum wage may be inhibiting job growth for low-skill occupations. More recently, Coelli and Borland (2015) have found that patterns of employment growth for high and low skill occupations have varied over time, with job polarisation occurring in the 1980s and 1990s, and job growth limited to high-skill occupations in the 1970s and 2000s. Further research is needed to ascertain the exact nature of these developments and their causes.

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## The decline of union membership

Unions have lost their pre-eminent role as employees' representatives, especially in key parts of the private sector.<sup>10</sup> This raises questions about the best ways to represent employee interests, especially where a power imbalance is present. At its height — from the 1940s to late 1970s — union membership covered roughly half of employees. However, from the 1980s onwards, union membership steeply declined, dropping from 41 per cent in 1990 to 19 per cent by 2007. Since then, membership has remained under 20 per cent (figure 2.7), and has been particularly low for younger people (table 2.2).

There are a number of explanations for Australia's decline in union membership.

Regulatory developments — prompted by change in social attitudes — have been a primary driver. Compulsory union membership was banned by five out of six state governments between 1990 and 1995. Additionally, governments have increasingly legislated employee rights and protections. The historical tendency to shift employee protections and benefits from negotiated arrangements to statute has seen the creation of the National Employment Standards, and stronger regulation of workforce health and safety. Awards are no longer formed as the arbitration outcome of industrial disputes. Government institutions, such as the Fair Work Commission and the Fair Work Ombudsman, provide a wider range of assistance to employees in seeking redress.

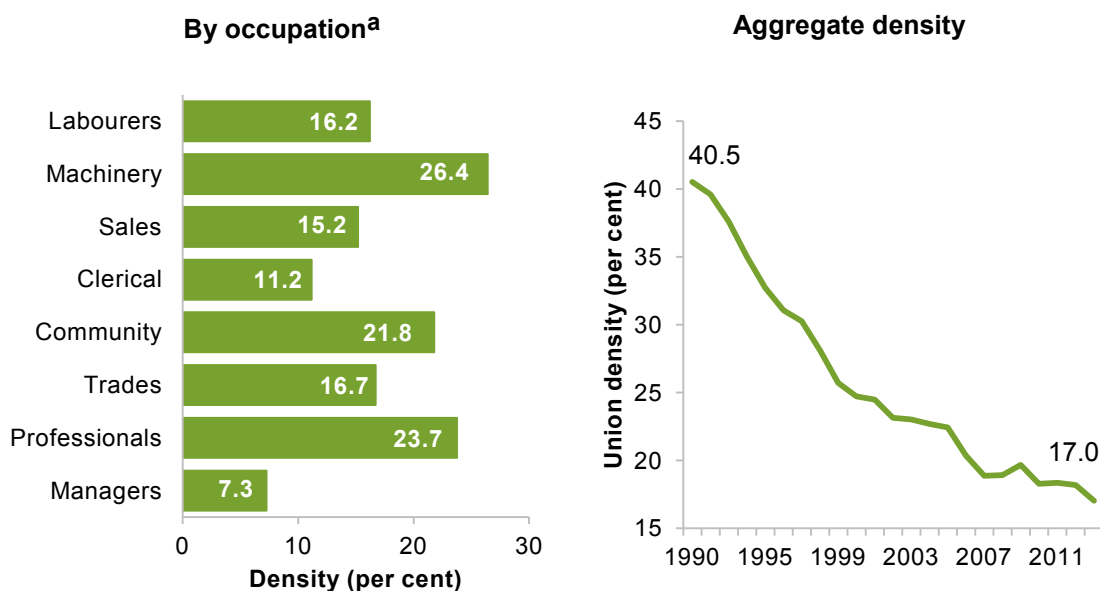
Moreover, potential benefits from union membership have dissipated. The progressive opening up of the Australian economy has increased the competition faced by Australian firms. As a result, a substantial portion of economic rents resulting from monopoly and oligopoly has been competed away. In the past, these rents were partially allocated to employees due to union pressure. Once these rents declined with the opening up of the Australian economy, so too did incentives for union membership. Moreover, employees who enjoy the benefits of a union negotiated enterprise agreement are not required to pay for union membership, resulting in a 'free rider' effect.

Finally, structural changes have reduced the relative importance of industries with higher rates of union membership, such as manufacturing.

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<sup>10</sup> Such as manufacturing, heavy and civil engineering construction, air transport, telecommunications and finance (based on data from 2006 to 2013 from ABS 2014, Employee Earnings, Benefits and Trade Union Membership, Australia - Trade Union Membership, Cat. No. 6310.0).

**Figure 2.7 Union density has declined sharply**  
 Union members as a proportion of employees, 1990 to 2013



<sup>a</sup> The occupational groups are abbreviated. The groups are (from bottom to top): Managers, Professionals, Technicians and trades workers, Community and services workers, Clerical and administrative workers; Sales workers; Machinery operators and drivers and Labourers. This graph uses data from 2013.

Source: Productivity Commission estimates based on ABS 2014, *Employee Earnings, Benefits and Trade Union Membership, Australia Trade Union Membership*, Cat. No. 63100TS0001, released 6 March.

**Table 2.2 Trade union membership rates by age group**

Age group	2013	Trend 1990 to 2013
	(per cent)	growth rate (per cent)
15–19	7.2	-6.0
20–24	9.0	-5.9
25–29	11.1	-5.6
30–34	14.2	-5.3
35–39	16.2	-4.7
40–44	18.3	-3.9
45–49	20.8	-3.3
50–54	24.9	-2.7
55–59	27.6	-2.5
60–64	24.2	-3.0
65 and over	17.9	0.1
Total	17.0	-3.9

Source: ABS 2014, *Employee Earnings, Benefits and Trade Union Membership, Australia Trade Union Membership*, Cat. No. 63100TS000, released 6 March.

## 2.3 Not just full-time employees — more variety in forms of work

There are many employment arrangements and associated differences in coverage of the WR system (table 2.3, table 2.4 and chapter 25).

Around 17 per cent of those employed are not covered by the protections of the *Fair Work Act 2009* (Cth), simply because they are either independent contractors or business owners. A further 20 per cent are casual employees, who have weaker rights (but receive pay loadings to reflect this).

There are differing views about the desirability of these forms of employment. By their nature, some have a greater likelihood of uncertain hours and tenure. These forms of work are sometimes described negatively as insecure or precarious. The Australian Council of Trade Unions (ACTU 2012a, p. 14) has defined insecure work as ‘poor quality work that provides workers with little economic security and little control over their working lives’. The strongest concerns relate to casual, fixed-term and some independent contracting jobs (where these are ‘sham’ in character — chapter 25). The concerns sometimes widen to include fluctuating pay and working time insecurity, which takes into account irregular, too few, and too many hours of work.

**Table 2.3 Forms of employment**  
2013

<i>Employment category</i>	<i>Number</i>	<i>Share of employed</i>
	('000)	(per cent)
<b>Employed<sup>a</sup></b>	11 573.8	100.0
<i>Owner managers</i>	1 938.8	16.8
Of incorporated enterprises	782.6	6.8
Of unincorporated enterprises	1 156.2	10.0
<i>Employees</i>	9 635.0	83.2
Permanent	7 332.7	63.4
Casual	2 302.3	19.9
<b>Alternative classification of employees<sup>b</sup></b>		
<b>Employed</b>	11 573.8	100.0
<i>Owner managers</i>	1 999.9	17.3
Independent contractors	986.4	8.5
Other business operators	1 013.5	8.8
<i>Alternative estimate of employees</i>	9 573.9	82.7

<sup>a</sup> From ABS 2014, *Australian Labour Market Statistics*, Cat. no. 6105.0. <sup>b</sup> The source is as in note a, but takes account of the underestimation of self-nominated independent contracting status. The result of the ABS's re-classifications is that there are fewer employees and more owner managers.

Source: See above.

The ACTU and others claim that insecure work is increasing over time and reflects a range of technological, regulatory and global trends (for example, Wilson 2013). Were there to be a sustained increase in work with inadequate protections under a workplace relations regime, this would be of policy concern (an issue examined more closely in chapter 25).

There is little question that some members of the workforce see work that is not performed within a permanent employment relationship as a one-sided bargain, with job insecurity affecting their own schedules, the capacity to bargain with employers and the ability to borrow and make plans for the future.

**Table 2.4 Fixed term contracts and labour hire**  
2013

<i>Employment category</i>	<i>Number</i>	<i>Share of employed</i>
<b>Fixed term contract prevalence<sup>a</sup></b>	('000s)	(per cent)
Employees on fixed term contracts	367.2	3.2
Employees not on fixed term contractors	9 267.8	80.1
Non-employees	1 931.6	16.7
<b>Labour hire prevalence<sup>b</sup></b>		
Employed people who are in labour hire	144.4	1.2
Employed people who are not in labour hire	11 429.3	98.8

<sup>a</sup> From ABS 2014, *Forms of Employment, Australia*, Cat. No. 6359.0, released 7 May <sup>b</sup> The share of total employment was obtained from ABS 2011, *Forms of Employment*, Cat. No. 6359.0, released 28 April and applied to total employment for November 2013.

However, this perspective on non-standard work is an overly negative one. Indeed employees on fixed-term contracts have been found to be more satisfied with their jobs than other workers (Wooden and Warren 2004). The same study found that while lower rates of satisfaction occurred among some casual workers, marked differences were limited to males working full-time. People in non-standard jobs are highly heterogeneous. Such jobs can suit people's circumstances well and may act as stepping stones for more secure employment (PC 2006). As the Productivity Commission has previously observed:

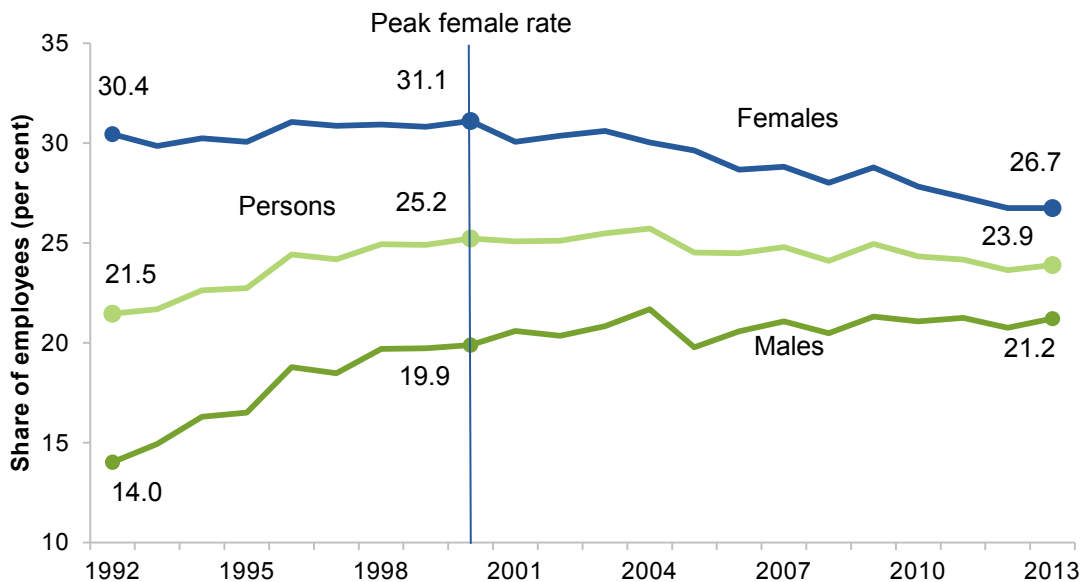
Whether non-traditional work is satisfactory or unsatisfactory, from a worker's point of view, can only be assessed in relation to individual forms of employment and to particular socio demographic groups within them. (PC 2006, p. xxv)



## Casual work — a now critical part of the labour market

The increase in employment share of non-standard forms of employment has abated, and to some extent even reversed. For example, the share of female employees without leave entitlements — the most commonly used description of a casual worker — scarcely grew between 1992 and 2000, and has since dropped significantly (figure 2.8). While male casual rates grew strongly from 1992 to 2000, they have since stabilised. The share of casuals working part-time has also stabilised (figure 2.9).<sup>11</sup>

Figure 2.8 **The casual job share has been falling in recent years**  
Share of employees, 1992–2013<sup>a</sup>



<sup>a</sup> Casual job status is identified as a person without paid leave entitlements. This is a commonly accepted definition, but there are others, including the existence of a leave loading or self-perceptions (Shomos, Turner and Will (2013)). The shares are based on August data from 1992 to 2007, and on November data from 2008 to 2013. Note that the difference between the casual share in this chart and in table 2.3 reflect that the former relates to the share of all employees and the former to the share of all employed.

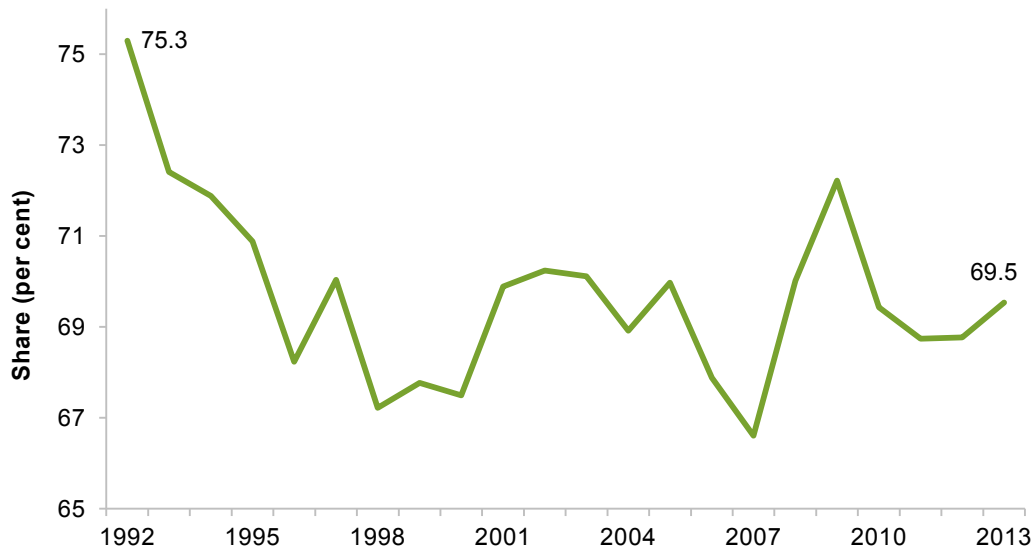
Source: ABS 2014, Australian Labour Market Statistics, Cat. No. 6105.0, released 8 July.

<sup>11</sup> There is little evidence that the proportion of workers operating as independent contractors — a form of work also often, but dubiously, cited as insecure — has increased in recent years (chapter 20).

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Figure 2.9 **Share of casuals working part time**

1992 to 2013



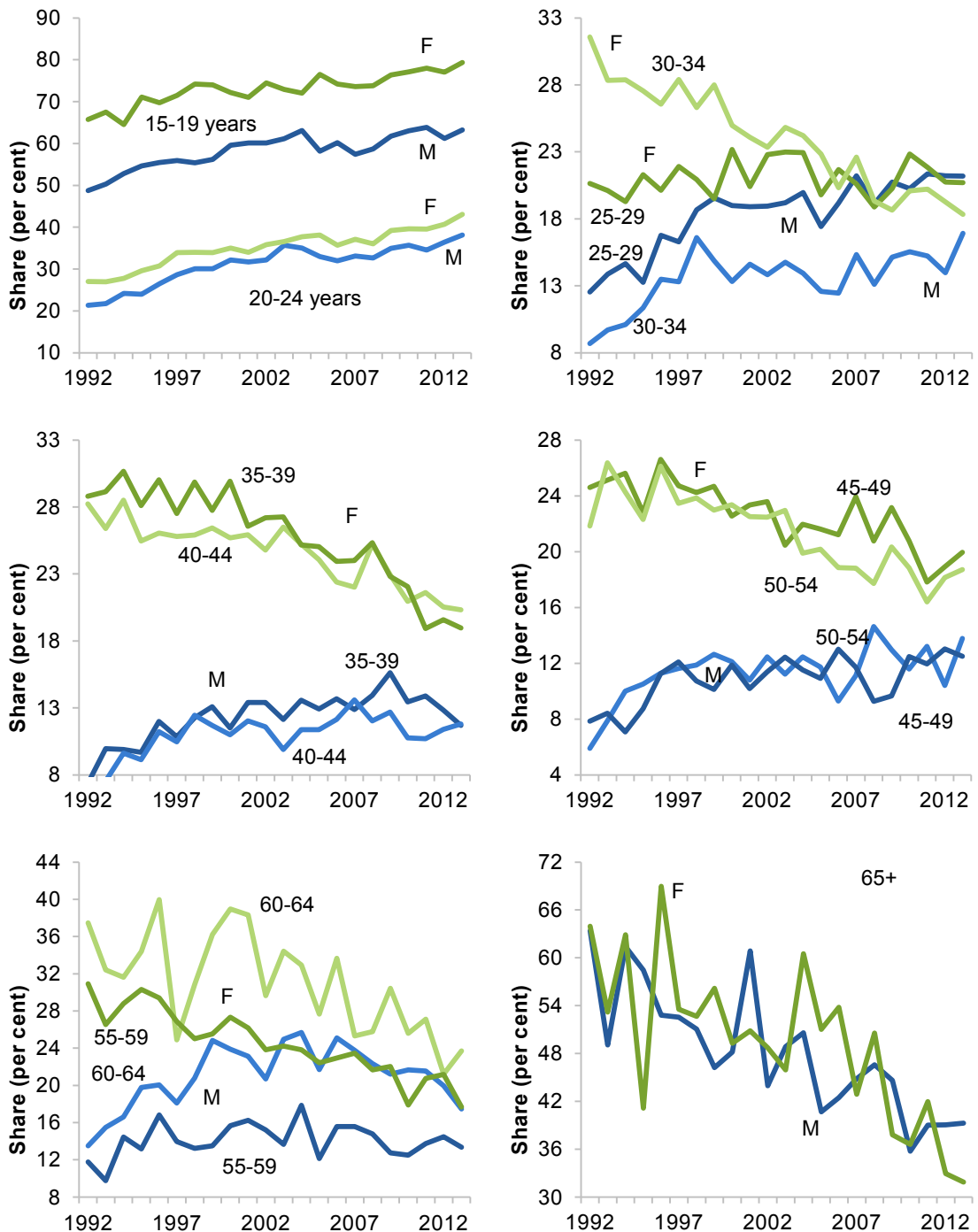
Source: ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0, released 8 July.

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More generally, understanding contemporary trends in casual work should not only take account of gender, but also age and cohort effects (figures 2.10 and 2.11):

- Casual work rates are highest among the very young — people aged 15-19 years — and become progressively lower (for a given gender) until age 60-64 years. Since school retention rates have risen (figure 2.12), the rising casual rates among young people suggests that more are combining employment with education. Employment rates for 15-19 year olds who are in full-time education have increased markedly since the mid-1980s, though after the global financial crisis, they have fallen back to the levels apparent in the late 1990s (figure 2.12). In contrast, employment rates for young people who are not in full-time education have not changed appreciably since the mid-1980s (though this outcome is strongly influenced by economic cycles).
- Were the youngest females to be excluded from the analysis, female employee casual rates would have fallen precipitously. As for many other labour market indicators, female casual rates are converging to male rates for many age groups.
- The implication of lower casual rates for older employees is that casual employment is often temporary, as shown in the cohort analysis (figure 2.11).

**Figure 2.10 Casual rates for employees**  
By gender, 1992 to 2013<sup>a</sup>

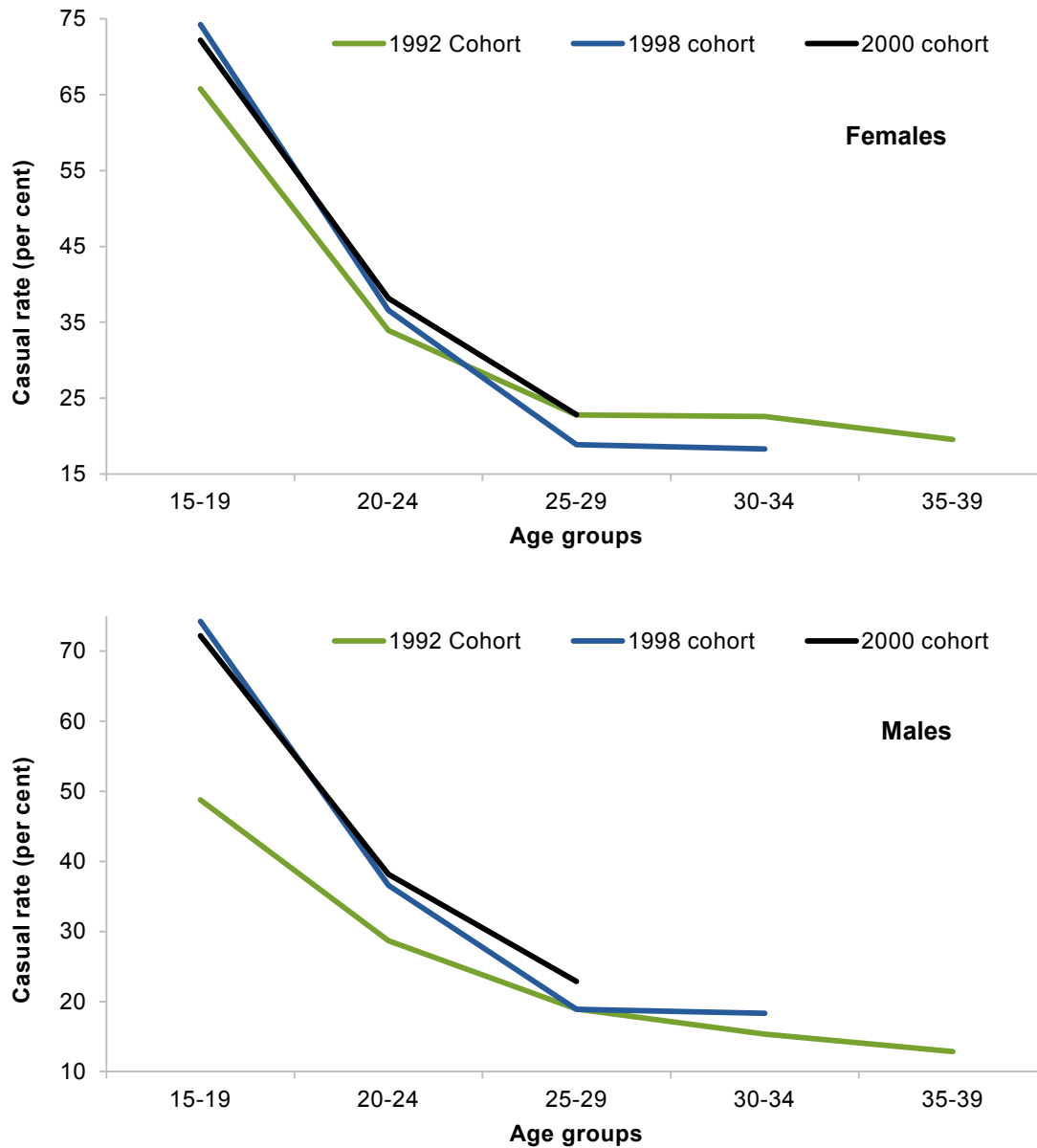


<sup>a</sup> See note of figure 2.8. F= female, M= male.

Source: ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0, released 8 July.

**Figure 2.11 Cohort casual rates for employees**

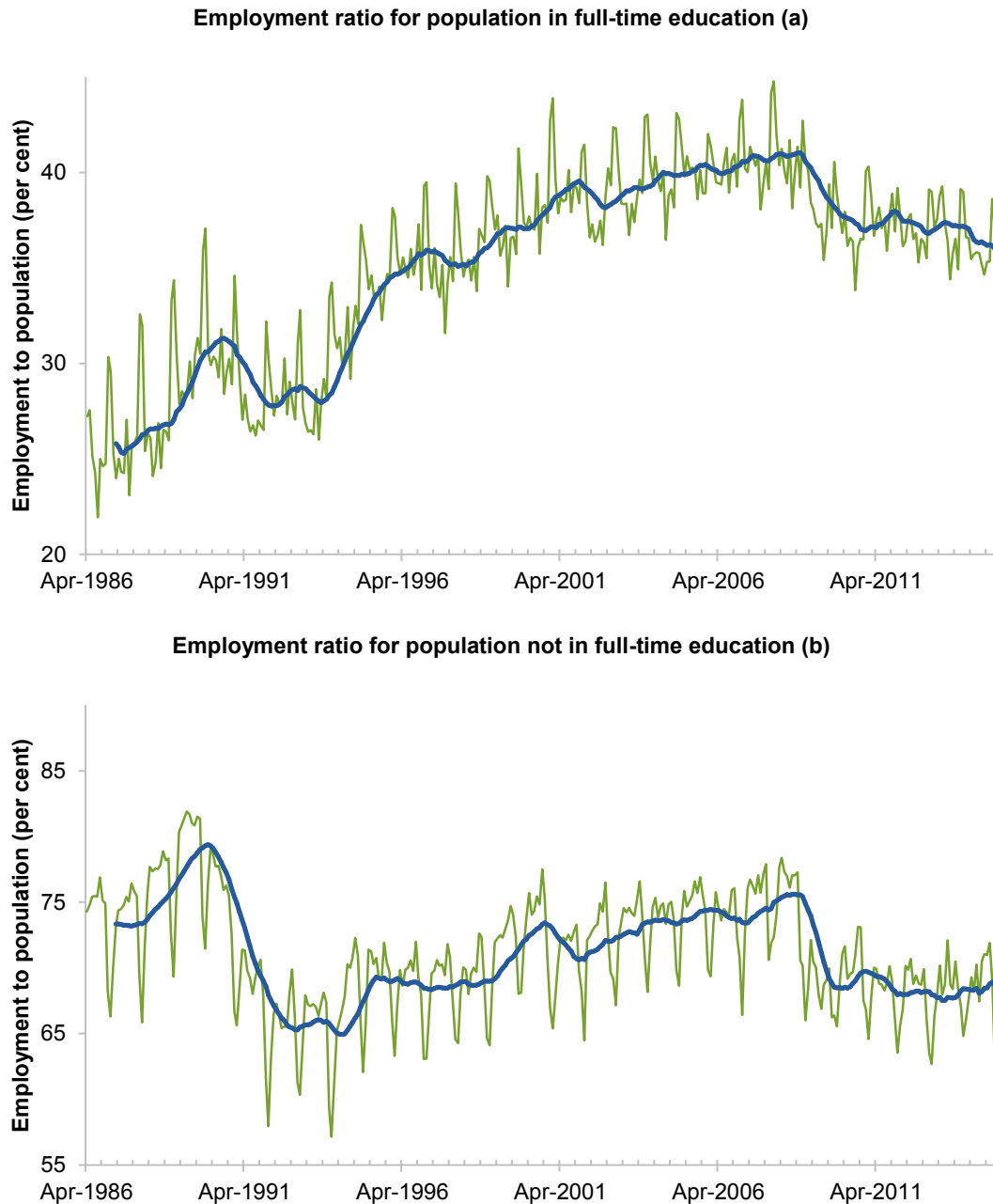
1992, 1998 and 2000 cohorts<sup>a</sup>



<sup>a</sup> Cohort rates are the casual rates for a cohort aged 15-19 at a given time, as they age over successive years. For example, the group of females aged 15-19 in 1992 are aged 20-24 five years later, and the casual rates for these two ages shows the extent to which their average casual rates shift as they age in the labour force. It is not possible to take account of exits to and entries from outside employment using this method, but it still provides an indication of likely cohort rates of casual employment.

Source: ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0, released 8 July.

Figure 2.12 **Education and employment among the young<sup>a</sup>**  
April 1986 to February 2015



<sup>a</sup> Chart (a) presents the share of full time students that are in employment. Chart (b) presents share of persons in employment among those not in full time education. All populations relate to people aged 15-19 years old only.

Source: ABS 2015, *Labour Force, Australia, Detailed*, Cat. No. 6291.0.55.001, released 14 May.

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As the ABS has noted:

The labour market in 2011 was much more flexible than in 1976. In 2011, a third (34%) of young adults who were employed, worked part-time hours (less than 35 hours per week), compared with 11% in 1976. ... Many students may need to work part-time in order to support themselves while studying, and the increased flexibility in the workplace has made it easier for them to do so. In 2011, over a third (38%) of young adults attending an educational institution also worked part-time hours, while only one in ten (10%) did so in 1976. The option to work part-time hours has also allowed young adults more flexibility when managing their work hours based on their study needs, or vice versa. These differences may be a reflection of the changes in the labour market. For example, since the 1970s, there has been a general fall in full time job opportunities for young people. In addition, there has been substantial growth in industries that offer part-time employment such as retail and hospitality services, while there has been a decline in industries that offer traditional full time employment such as manufacturing. (2013e)

## **Are employers providing more flexible workplaces for employees?**

One of the goals of workplace flexibility is to fashion arrangements that suit both parties to an employment contract. Various workplace arrangements — statutory agreements, such as Australian Workplace Agreements (pre-WorkChoices and during WorkChoices), individual flexibility arrangements and various other forms of common law contracts<sup>12</sup> — offer the scope for some flexibility (chapter 22), as do many informal arrangements between employees and employers that are invisible to regulators. However, data on an (albeit limited) range of workplace flexibilities suggests little change for employees over the last decade (figure 2.13).

## **Part-time work generally has increased**

While casual part-time rates have been relatively static in the last 20 years, the proportion of all employed persons working part-time (less than 35 hours) grew quickly from 1970 to 2002, but somewhat slower thereafter (figure 2.14). From 2002 to 2014, the share of part-time workers rose from 28.3 per cent to 30.6 per cent (or just 2.3 percentage points), whereas over the previous 12 year period, it grew by more than 7 percentage points.

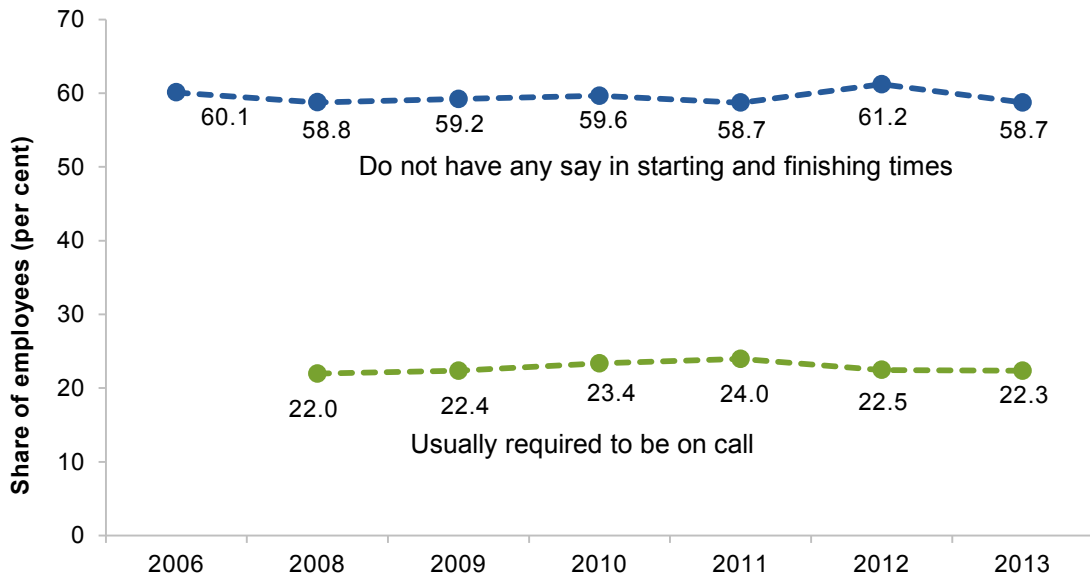
Average working hours among those employed part-time has also progressively increased (figure 2.15). In contrast, the steady lengthening of average hours worked by full-time workers apparent in the two decades from 1980 has since reversed. It is possible, that there has been some substitution between these forms of labour.

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<sup>12</sup> While the *Fair Work Act 2009* (Cth) and/or specific statutory arrangements may shape employment contracts, the common law fills any gaps left by Acts. In that sense, all employment contracts could loosely be referred to as common law contracts. The usage above covers contracts that are bespoke, but not AWAs or IFAs.

Figure 2.13 Flexibility for employees

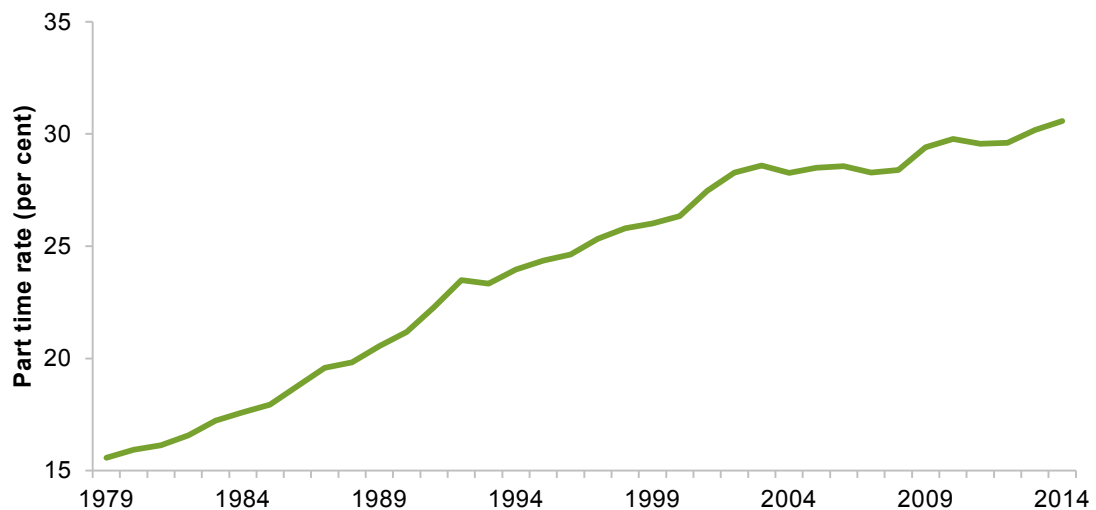
2006–2013<sup>a</sup>



<sup>a</sup> The figure for the share of people required to be on call in 2006 was not available from the Forms of Employment publication for that year.

Sources: ABS (various issues), *Forms of employment*, Cat. No. 6359.0; and ABS (various issues), *Working Time Arrangements*, Cat. No. 6342.0.

Figure 2.14 Part-time work, 1979–2014<sup>a</sup>



<sup>a</sup> Part-time employees are classified as those who work less than 35 hours in a usual week.

Source: Productivity Commission estimates based on ABS 2015, *Labour Force, Australia, Detailed*, Cat. No. 6291.0.55.001 (derived calendar year data), released 14 May.

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Figure 2.15 Average hours worked per week, 1979–2014



Source: Productivity Commission estimated based on ABS 2015, *Labour Force, Australia, Detailed*, Cat. No. 6291.0.55.001 (calendar year data).

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## 2.4 Job tenure and turnover

The notion that people are increasingly switching employers and jobs is not borne out by trends over the past two decades (table 2.5). More than 40 per cent of employed people have tenure of five or more years — and this figure has scarcely changed over two decades. Short tenures (of under three months) have almost halved over this period.



**Table 2.5 Job security has been rising**  
Length of tenure for employed people, 1994 to 2013

Tenure	1994	1996	1998	2000	2002	2004	2006	2008	2010	2012	2013
	%	%	%	%	%	%	%	%	%	%	%
<b>Under 12 months</b>	22.4	23.5	21.8	23.6	22.9	22.8	21.3	22.1	18.0	19.9	18.2
Under 3 months	8.9	8.9	8.4	9.4	7.6	7.5	6.5	6.6	5.5	5.7	5.0
3 and under 6 months	5.3	5.6	5.5	5.8	6.1	6.3	6.0	6.4	5.2	5.4	5.2
6 and under 12 months	8.2	8.9	7.9	8.5	9.2	9.1	8.8	9.0	7.3	8.8	8.1
<b>One year or more</b>	77.7	76.6	78.3	76.3	77.2	77.2	78.7	77.9	82.0	80.1	81.8
1 and under 2 years	10.5	12.2	12.3	12.7	11.9	11.7	11.8	12.1	11.9	11.4	11.7
2 and under 3 years	8.4	9.3	10.5	9.7	10.6	10.0	10.4	10.8	12.0	10.1	11.2
3 and under 5 years	15.0	12.3	14.0	13.1	13.7	15.0	13.9	13.7	15.6	14.6	14.5
5 and under 10 years	20.2	19.5	17.0	16.4	17.0	16.9	17.6	17.1	17.9	18.6	19.0
10 and under 20 years	15.1	15.1	15.9	16.1	15.3	15	15.7	14.8	14.6	15.3	15.2
20 years and over	8.5	8.2	8.6	8.3	8.7	8.0.6	9.3	9.4	9.9	10.1	10.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

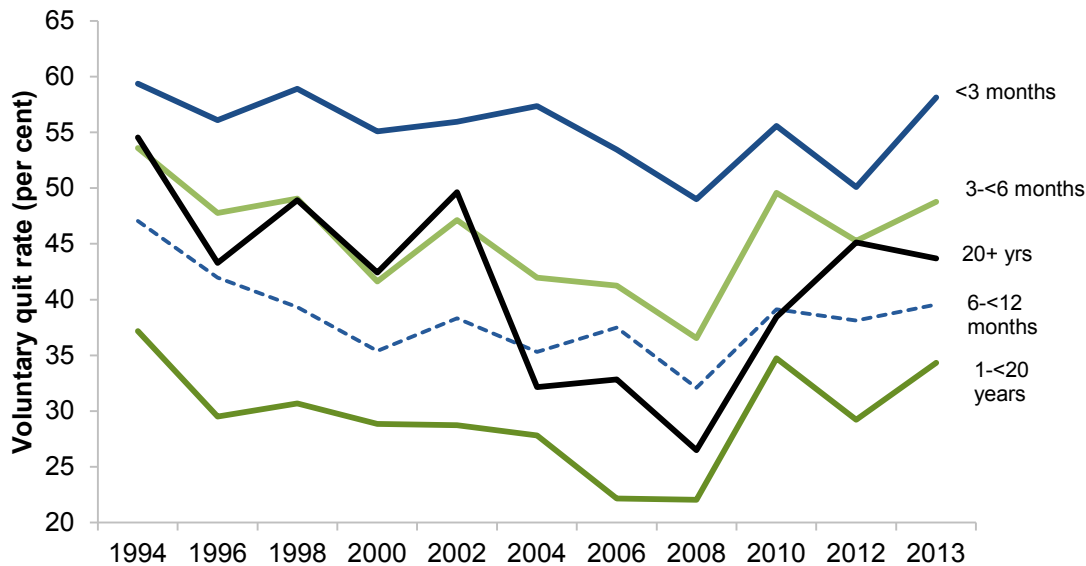
Source: Productivity Commission estimates based on ABS (various issues), *Labour Mobility, Australia*, Cat. No. 6209.0, released 21 August.

Similarly, involuntary exit rates do not appear to have change structurally over the past two decades. While an increase in involuntary quit rates was observed following the Global Financial Crisis, over the longer-term these rates do not exhibit a clear trend — again suggesting that jobs are not becoming more insecure.

Nevertheless, the likelihood that an exit is involuntary is much higher for people with short employment tenures (figure 2.16), primarily reflecting that:

- short tenure jobs are often seasonal or temporary
- the main reason for quits among long tenure jobs is voluntary retirement, necessarily reducing the relative prevalence of involuntary quits in comparison with short tenure jobs.

**Figure 2.16 Share of exits that are involuntary by tenure with the firm**  
1994 to 2013

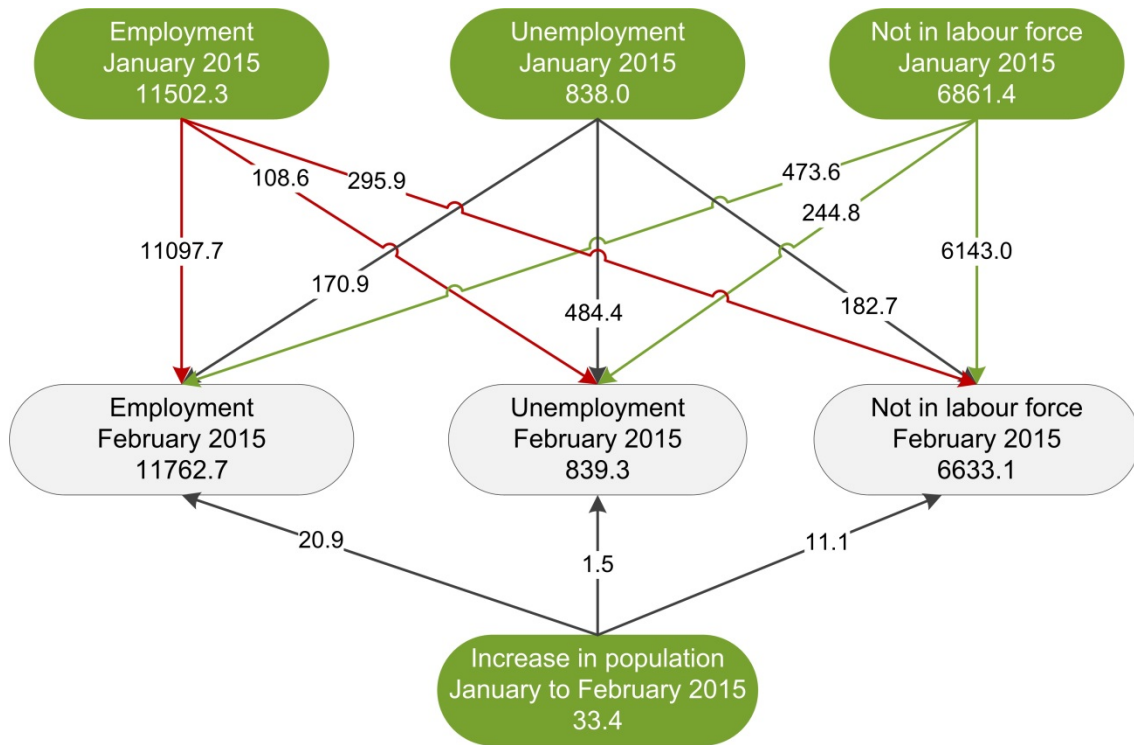


Source: Productivity Commission estimated based on ABS (various issues), Labour Mobility, Australia, Cat. No. 6209.0, released 21 August.

This stability in tenure and involuntary quits does not necessarily imply that Australia’s labour market is static. Notwithstanding that many people stay in jobs for long periods, labour market transitions are high as a share of total employment. In 2013, more than two million employed people left their jobs . (The two phenomena can be partly reconciled because some groups are constantly mobile.) There is also significant flow of people into work, even from month to month (figures 2.17 and 2.18). For example, of the 838 000 people unemployed in January 2015, around 171 000 were employed one month later.

Employment flows can offer valuable insights into labour market dynamics. Indeed, without a broad consideration of flows — not only between employment and unemployment, but also into and out of the labour market — the true effectiveness of workplace policies can be obscured. For example, increased labour force participation can result in higher rates of unemployment, despite increasing absolute levels of employment.

**Figure 2.17 Flows between labour force states in just one month**  
 Population aged 15 years or over ('000s), January 2015 to February 2015<sup>a</sup>

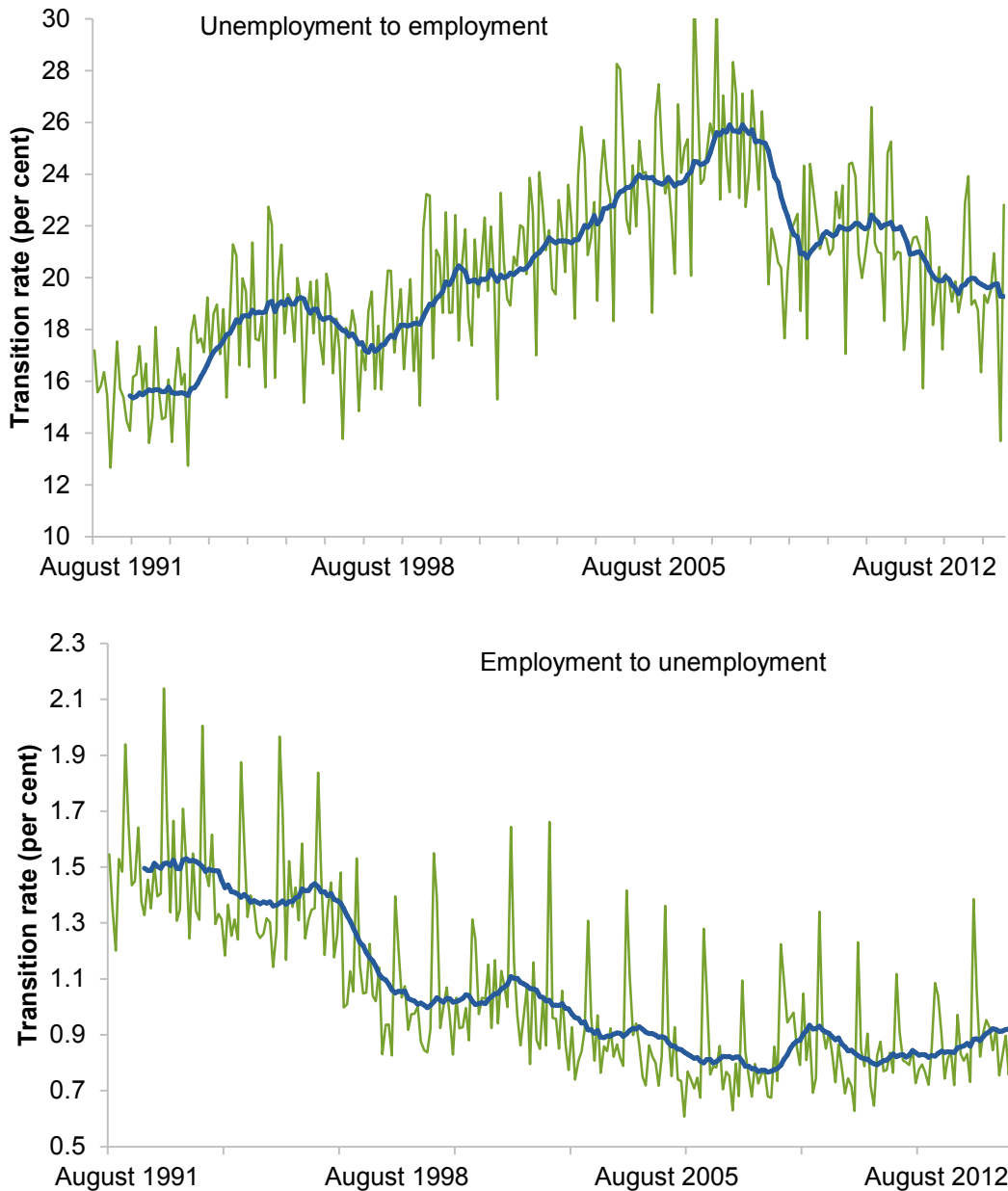


<sup>a</sup> The ABS gross flows data relate to a matched sample of people who change status from one month to the next. The start and end values of the various labour market states from the flow data do not match the stock data from the full labour force survey, reflecting different samples. Nevertheless, it is possible to estimate the flows that are consistent with the labour force stock data, by solving a set of equations (in a manner similar to that used by Dixon et al. (2014) — and these estimates are the basis for the numbers shown above. Difference between the stock levels presented and those implied by flows are due to population growth between periods.

Sources: Productivity Commission estimates based on Gross flows (ST GM1) from ABS 2015, *Labour Force, Australia*, Cat. No. 6202.0, released 12 February; and ABS 2015, *Labour Force, Australia, Detailed*, Cat. No 6291.0.55.001, 21 March.

Figure 2.18 **Inflows and outflows in the labour market<sup>a</sup>**

August 1991 to February 2015



<sup>a</sup> The transition rate from one labour market state to another is the share of people in an initial state who change to another state. For example, a transition rate from employment to unemployment at a particular point in time is measured as the share of people who were employed in the previous period who become unemployed in the current period.

Source: Productivity Commission estimates based on GM1 database from ABS 2015, *Labour Force, Australia*, Cat. No. 6202.0, released 11 September.

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The best labour market and workplace policies allow for a greater flow from unemployment to employment.<sup>13</sup> A workplace relation system that allows free flows in both directions between employment and unemployment can achieve lower average unemployment rates, lower duration of unemployment spells and better skill matching. Countries — like Australia — with higher average inflows from unemployment to employment and higher average quit rates tend to have less enduring unemployment. In that context, the future evolution of Australia's WR system should avoid creating excessive frictions that frustrate hires (and quits).

### Regulation can create barriers to businesses hiring employees

The stringency of employment protection measures (including unfair dismissal laws) must balance the benefits of greater protection for existing employees against the barriers created for hires (Blanchard, Jaumotte and Loungani 2013). On the one hand, protecting jobs creates greater certainty for employed people (important for financial security), strengthens the incentives for training, and reduces the risks of unfair dismissals. On the other hand, excessive barriers to firing and hiring employees frustrate efficient matching of people to jobs that suit their skills. It also poses barriers to the employment of people with less certain productivity — such as unskilled workers or those with long periods without employment.

Many European countries impose significant levels of employment protection compared with Australia. High levels of employment protection are associated with substantially longer durations of unemployment for those who lose their jobs, and for some younger people in search of a foothold in the labour market (Bassanini, Nunziata and Venn 2008).

### Regulation can create a disincentive for employees to quit

The existence of restrictions on hires also creates barriers to quits for people who have not already secured another job. Similarly, any regulatory measures or conventional practices (sometimes bargained by unions) that favour existing employees of a firm or those with longer job tenures, discourage people from quitting because of the forgone benefits of tenure when they move to another employer. Any changes in workplace regulations that

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<sup>13</sup> This notion is consistent with statistical simulation of labour market flows. Long-run numbers of people in different labour states can be estimated by multiplying the original populations in these states by  $MT$  where  $M$  is the transition matrix and  $T$  the number of periods ahead such that the new population is stable. This is an experiment only and provides a guide to the long-run effects. It would tend to exaggerate the actual labour market benefits because it is likely that as the relative numbers in future labour market states change, so do future transitions rates. This endogeneity reflects that shifts of people from one labour force category to another also change the average abilities of the people in the respective groups. For example, a shift from unemployment to full-time work is likely to leave less employable people among the remaining unemployed, and so the transition rate into future full-time work will not be as great. Nevertheless, the results provide a qualitative indicator of the directions in gross transition rates that reduce unemployment rates.

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preserved legacy arrangements for existing employees, while diluting the bargaining power or working conditions of aspiring employees to a business would tend to discourage quits.

## 2.5 Can people who want to work get a job?

Measures of labour force utilisation — such as unemployment and underemployment rates — are key indicators of labour market performance, and they have strong implications for social welfare. Long spells of unemployment can be particularly damaging and self-reinforcing as skills depreciate. Whilst some degree of unemployment associated with movement between jobs and entry into the labour force is inevitable, excessive unemployment is a concern for WR policy.

### Measuring labour force utilisation

The most common measure of labour utilisation is the unemployment rate — the share of people in the labour force who are currently without a job, but actively searching for one (box 2.1).

#### Box 2.1 Measuring unemployment

Measuring unemployment requires clear definition of employment and job search. Consistent with internationally agreed standards, the ABS classifies an unemployed person as someone who is:

- not working more than one hour in the reference week
- actively looking for work in the previous four weeks; and
- available to start work in the reference week.

Whilst these criteria may not accord with some notions of unemployment, other available measures gauge the underutilisation of labour more broadly. For example, the underutilisation and underemployment rates account for those who would like to work but have given up looking or are currently unavailable.

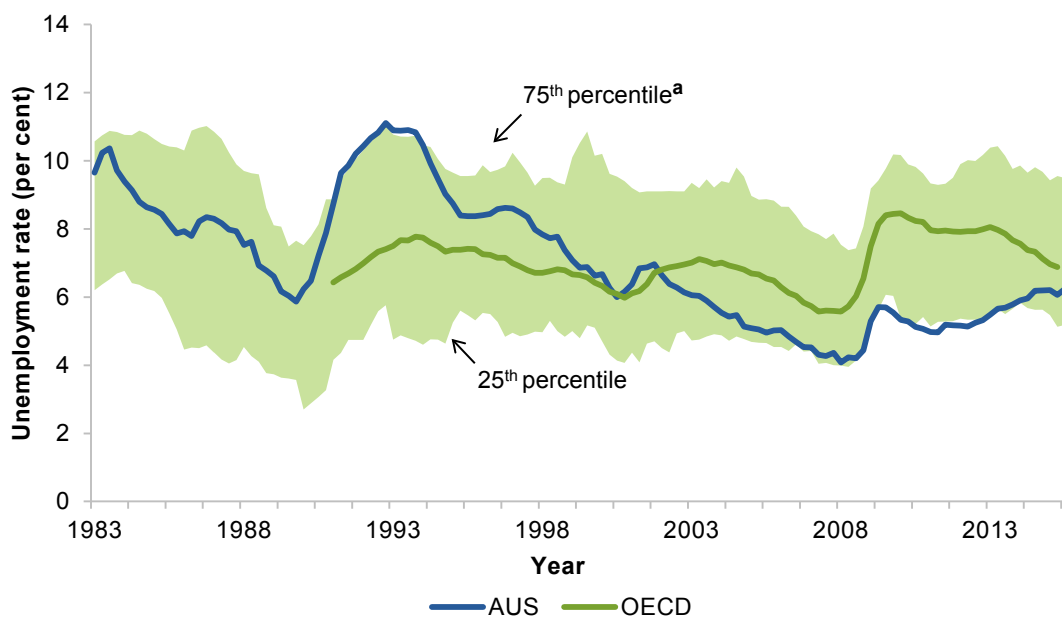
*Source:* ABS (2014f).

In the early 1970s, unemployment fluctuated at around 2 per cent, before increasing significantly (as it did for many other countries). Following the 1970s peak in the unemployment rate, Australia has experienced four further spikes (figure 2.19).

- In 1981, unemployment increased from 5.8 per cent to 10 per cent. Over time, the unemployment rate recovered to just over 6 per cent.
- The early 1990s displayed a similar pattern, with an increase in the unemployment rate from 6 per cent to just below 11 per cent by 1992, followed by a recovery to around 6.2 per cent by 2000.
- The upturns in unemployment since the early 1990s have been relatively mild. In 2001, unemployment increased only half a percentage point over the year.
- More recently, Australia experienced a downturn during the Global Financial Crisis in 2008. Unemployment increased from 4.3 per cent to 5.5 per cent.

The unemployment rate has been increasing for most of the period since 2008, with some reversal of this trend in the last year (figure 2.19). The increase in unemployment coincided with a declining terms of trade, reduced capital expenditure in the mining sector, and subdued investment in the non-mining sector. Overall, whilst Australia's unemployment rate remains low by international standards, it has increased significantly in recent years relative to comparable countries.

**Figure 2.19 Australian and international unemployment**  
Quarterly, 1983 to 2015

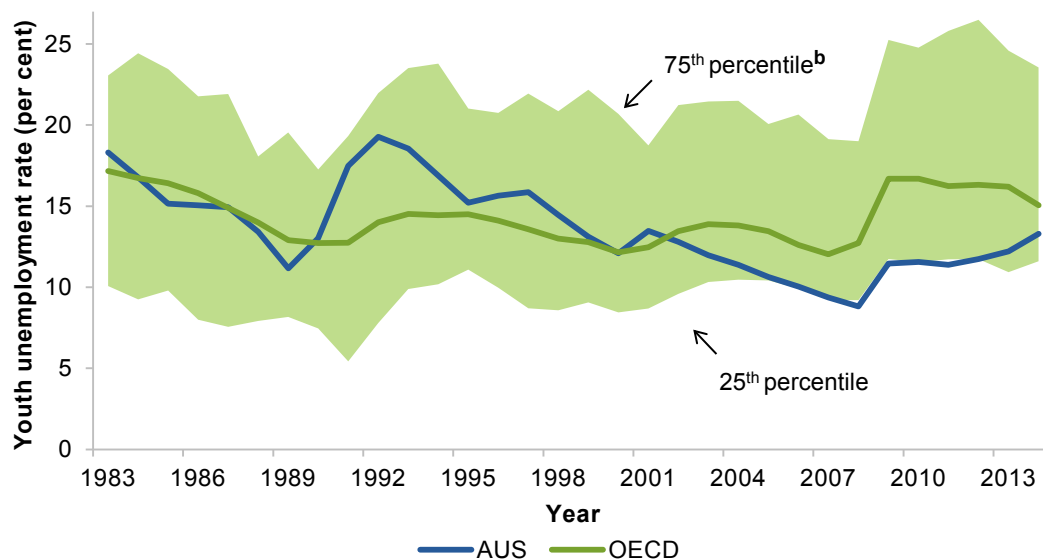


<sup>a</sup> Among OECD countries for which data are available.

Source: OECD (2015c).

Youth unemployment rates have declined over the last year, before which they had been increasing almost consistently since 2011 (figure 2.20). Youth unemployment rates are significantly above the average unemployment rate and there is a particularly large gap between these rates and that applying to workers aged between 35 and 44 years old (who tend to have the lowest unemployment rates).

**Figure 2.20 Australian and international youth unemployment<sup>a</sup>**  
Annual, 1983 to 2015



<sup>a</sup> The youth unemployment rate is the number of unemployed 15-24 year-olds expressed as a percentage of the youth labour force. <sup>b</sup> Among OECD countries for which data are available.

Source: OECD (2015f).

The gap between youth and prime-aged unemployment rates primarily reflects the time taken to match entirely new and often inexperienced workers to businesses. Some period searching for a job is not a sign of an inefficient market because it will often take time for matching to take account of the particular aptitudes and skills of new workers. On the other hand, those experiencing excessive search durations have a progressively lower likelihood of finding a job as they age. As noted earlier, this highlights the importance of limiting barriers to new hires — and has implications for the design of any WR system. There also appears to be a shift in the relationship between youth and prime aged unemployment rates (figure 2.21). Since 1993, the rate of youth unemployment has fallen by around 1.5 percentage points relative to the level of the prime aged unemployment rate. The source of this is unclear, but may reflect:

- greater labour market efficiencies following the 1993 industrial relations reforms and the change in the behaviour of bargaining parties following the scarring effects of the deep recession in the early 1990s

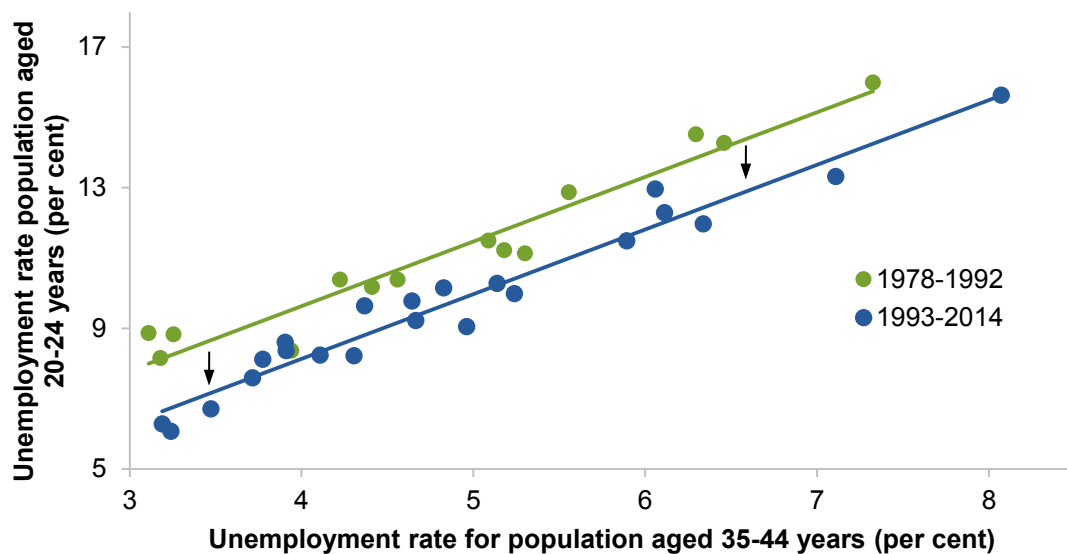


- the greater encouragement of continued education for young people, which means that they are more likely to exit the labour force when there is a demand shock than to continue to search for jobs
- the greater availability of casual work for young people, which is another reason for being cautious about characterising such jobs as ‘bad’.

As unemployment increases and the labour market tightens, the gap between youth and prime-aged unemployment widens.

Long-term unemployment rates have also increased since the Global Financial Crisis — another indicator of growing labour market vulnerability (figure 2.22). Not only is long-run unemployment problematic for the wellbeing of the people experiencing it, but it also tends to reduce search efficiency, as people in long-run unemployment find it increasingly difficult to secure employment.<sup>14</sup>

Figure 2.21 **A positive relationship between youth and prime age unemployment rates**  
1979–2014

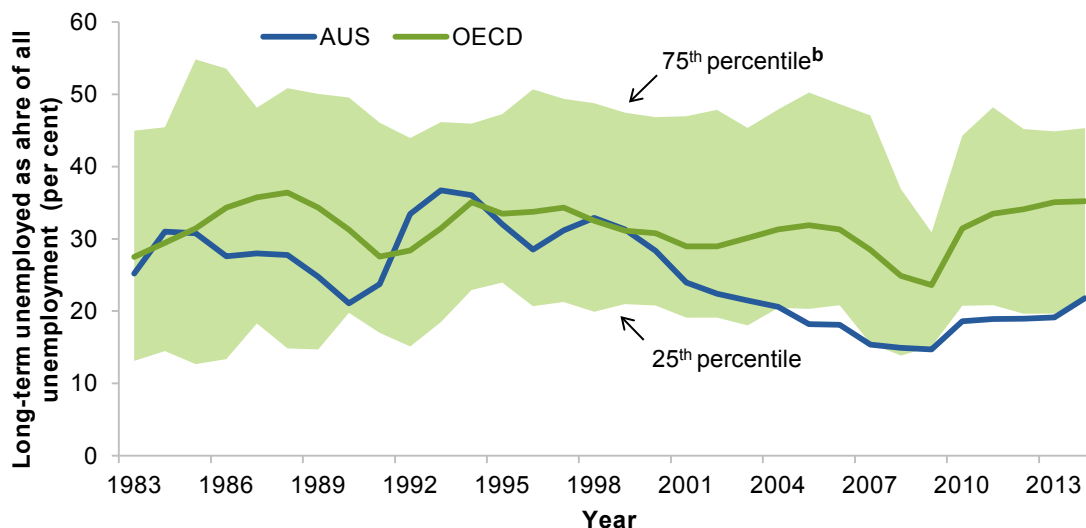


Source: Productivity Commission estimates based on ABS 2015, *Labour Force, Australia, Detailed*, Cat. No. 6291.0.55.001 (Data converted to quarterly values).

<sup>14</sup> High rates of long-term unemployment can result in higher levels of non-cyclical unemployment (sometimes referred to as the non-accelerating inflation rate of unemployment — NAIRU). The dominant view is that Australia's NAIRU is between 5 and 6 per cent (Ballantyne, De Voss and Jacobs 2014; Ray 2015).

**Figure 2.22 Australian and international long-term unemployment**

Annual, 1983 to 2014<sup>a</sup>



<sup>a</sup> Long-term unemployment refers to people who have been unemployed for 12 months or more. The long-term unemployment rate shows the proportion of these long-term unemployed among all unemployed. <sup>b</sup> Among OECD countries for which data are available.

Source: OECD (2015d).

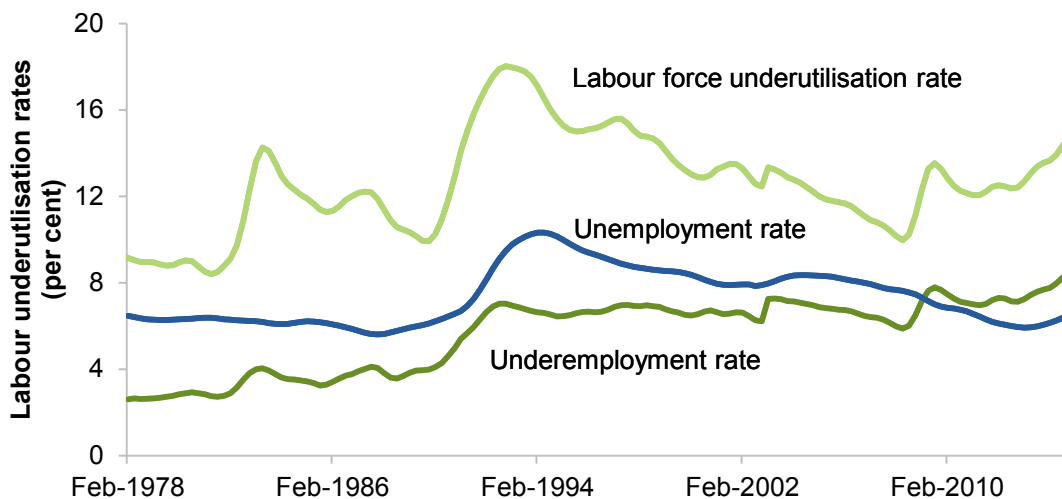
### Less tangible labour underutilisation

While the unemployment rate is the predominant measure of labour underutilisation, it has several limitations. Foremost, it does not capture hidden unemployment. The ABS defines an unemployed person — consistent with international standards — as an individual without work, actively seeking work and currently available for work. As such, those who would like to work but have given up searching (discouraged workers) are not counted in such measures. Moreover, the unemployment rate does not capture ‘underemployment’, or people who work less than 35 hours per week, but want to work more hours. As a result, the traditional head count measures of unemployment do not fully reflect the true degree of labour market ‘slackness’. The underemployment rate is a measure of the number of people underemployed persons as a proportion of the labour force. Additionally the labour force underutilisation rate expresses the unemployed, plus the underemployed, as a proportion of the labour force (figure 2.23).<sup>15</sup>

<sup>15</sup> The ABS also estimates the extended labour force underutilisation rate. This comprises the unemployed, plus the underemployed, plus two groups of marginally attached to the labour force: (i) persons actively looking for work, not available to start work in the reference week, but available to start work within four weeks (ii) discouraged jobseekers. This rate is around 1.4 per cent higher than the labour underutilisation rate from 1994 to 2013 (ABS 2014, *Australian Labour Market Statistics*, Cat. No. 6105.0), but is not shown in figure 2.22 due to the limited estimation period for this measure.

Figure 2.23 **Various measures of labour underutilisation**

February 1978 to February 2015, trend estimates



Source: ABS 2015, *Labour Force, Australia*, Cat. No. 6202.0, released 11 July.

Any workplace changes in the next few years will be taking place in the context of vulnerability to unemployment. The labour market vulnerability of young people who are not in full-time education is becoming particularly apparent.

## 2.6 Some measures of flexibility in labour markets

### Mismatch

Mismatch is the degree to which the skills and aptitudes of job searchers matches the types of jobs available. Poor mismatch tends to be associated with high unemployment and vacancy rates. Typically, vacancy rates are negatively related to unemployment rates. However, there have been some periods, when much the same vacancy rate has been associated with very different unemployment rates. For example, from August 1981 to May 1983 (and again from November 1990 to February 1993), unemployment rates rose significantly, but vacancy rates were much the same. People searching for jobs during these periods were not being matched into the available jobs (or the vacancy rate would have fallen). It appears that most of the shifts in relationship between the unemployment and job vacancy rate (a relationship referred to as the 'Beveridge curve') do not reflect enduring mismatches (which might reflect policy settings, including the workplace industrial relations system). Rather, shifts in the relationship may be explained by changes in long term unemployment rates, as noted above and in Borland (2011, p. 203). It is hard to discern any impacts of various industrial relations regimes on matching efficiency.

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## Has the Australian labour market's response to shocks changed?

Australia has experienced several major economic downturns in the last 30 years, which have always been accompanied by some increase in unemployment. Any demand shock reduces the need for labour input (measured in hours worked). The effect on employment depends on whether firms shed labour or reduce hours (figure 2.24). Over the past two decades, a given reduction in hours has been associated with a weaker reduction in employment than occurred in the previous 15 years — also a finding of Borland (2012, pp. 275–276). It is possible that this reflected the post-1993 changes to workplace relations.

In this respect, the ACTU noted:

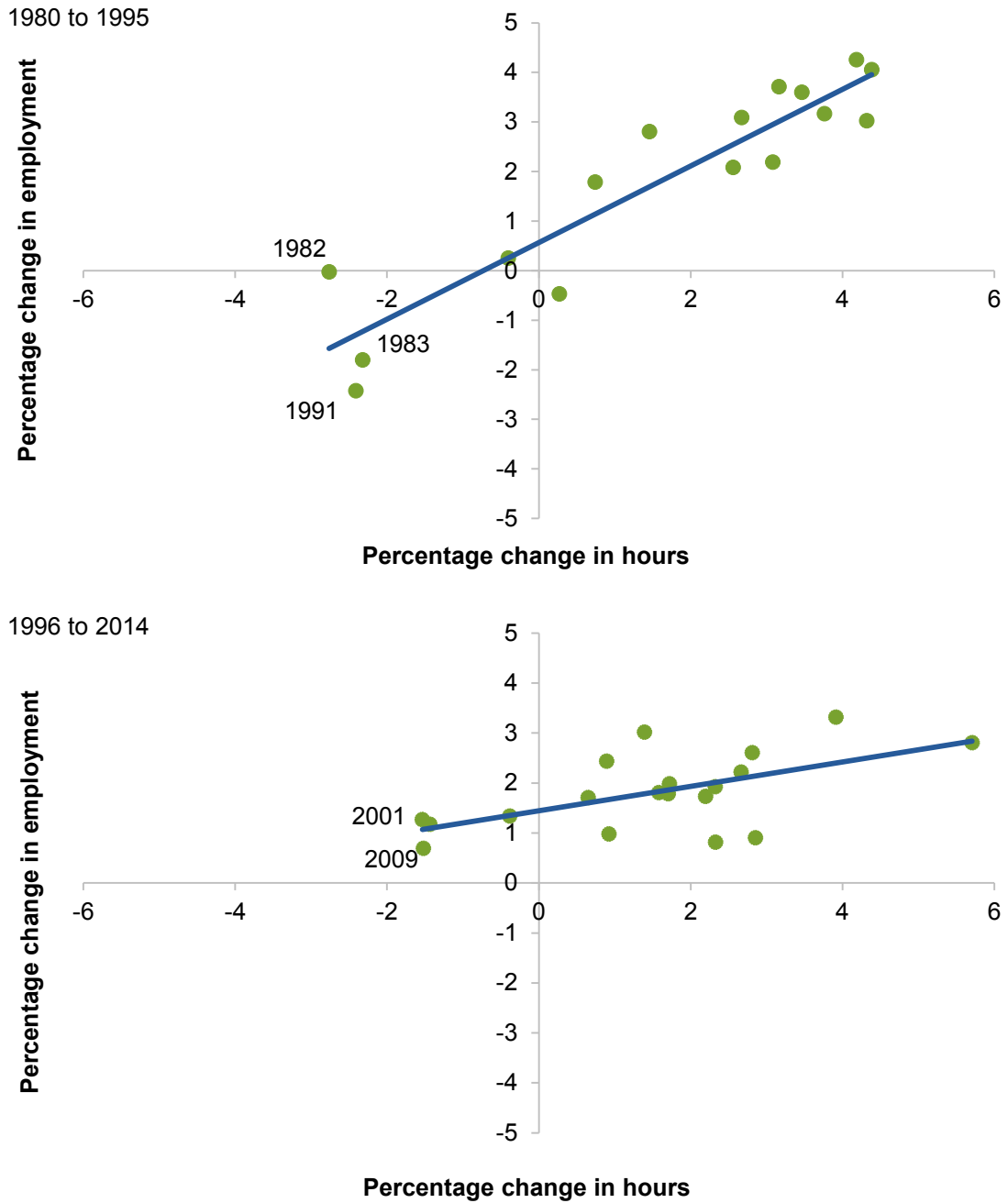
In terms of the industrial relations system, flexibility around hours appears to have played an important role in avoiding large employment losses. Faced with massive uncertainty in the wake of the collapse of Lehman Brothers, and a tottering banking system, employers faced a dilemma. They had just weathered several years of a tight labour market, with high vacancy rates and sectoral skills shortages, and many were loathe to begin large-scale retrenchments. Instead, many opted for shortening the working hours of their existing employees or engaging new workers on a part time basis. This strategy is evident in both the employment and hours [data]. It was a strategy facilitated by the industrial relations system, with both enterprise agreements and the award system sufficiently flexible to accommodate this situation. (sub. 167, p. 33)

The capacity to vary hours of work may also reflect the greater willingness of employees to retain a job (and for employee representatives to support this), even at the loss of some income.

It may also be the case that demand shocks from the mid-1990s have been shorter and shallower than those in the 1980s and early 1990s, so that a future larger and more protracted demand shock might elicit similarly large employment losses as in the earlier periods. The resilience of the contemporary labour market has yet to be tested for big shocks.

Moreover, as pointed out by the ACTU, underemployment does not seem to be very responsive to positive demand shocks, with weaker improvements this decade compared with the recovery from recession in the 1990s. This is puzzling, as wage pressures have been relatively low in recent years (suggesting people are not being priced out of extra work). The factors behind the relative unresponsiveness of underemployment to the business cycle are unclear.

Figure 2.24 **A change in the relationships between hours and employment**  
1980 to 2014



Source: Productivity Commission's estimates based on ABS 2015, *Labour Force, Australia, Detailed*, Cat. No. 6291.0.55.001, released 11 July.

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## 2.7 Wages

Wages are a central determinant of both the competitiveness of the Australian economy, and the standard of living and wellbeing of Australian workers. Wage levels, and their impact on price inflation, have been a key concern for policy makers over last half century.

### Wages and levels of inflation

The wage setting process has strong implications for the level of inflation. Across the business cycle, workers have varying degrees of bargaining power. The extent to which industry-specific booms lead to wage growth in other industries driven partly by the locus of bargaining. Throughout the 1970s and early 1980s, Australia's centralised wage setting processes allowed little flexibility to adjust relative wages across industries. With centralised wage setting, secular booms prompted widespread wage growth, leading to high levels of inflation.

The Prices and Incomes Accord was implemented in 1983 in response to the problem of stagflation (high inflation and high unemployment) in the 1970s.<sup>16</sup> There is evidence that the Accord delivered improved macroeconomic outcomes (for example, Chapman 1998).

However, the Accord was a policy response to a crisis, and there was tension between the Accord and the longer run direction of Australia's economic reforms in product markets, which intensified competition and opened up the Australian economy to global markets. Centralised wage-setting inhibited the efficient allocation of labour among industries and firms facing differing commercial environments. Enterprise bargaining was introduced in 1993, allowing the negotiation of wages and conditions at the enterprise level. Since the introduction of enterprise bargaining in 1993 and inflation targeting the following year, inflation has been less volatile and has not been a central issue for policymakers.

Wage shocks that affect one part of the economy (as in the resources boom) do not appear to now reverberate so greatly throughout the rest of the wage system (Borland 2012). An Assistant Governor of the Reserve Bank of Australia has noted:

During these earlier booms, inflation had been more variable and Australia's centralised wage setting system had the effect of spreading wage increases across the economy, to occupational categories for which the value of marginal product had not increased. Not surprisingly then, the result was a rise in inflation and unemployment. (Kent 2014b, p. 26)

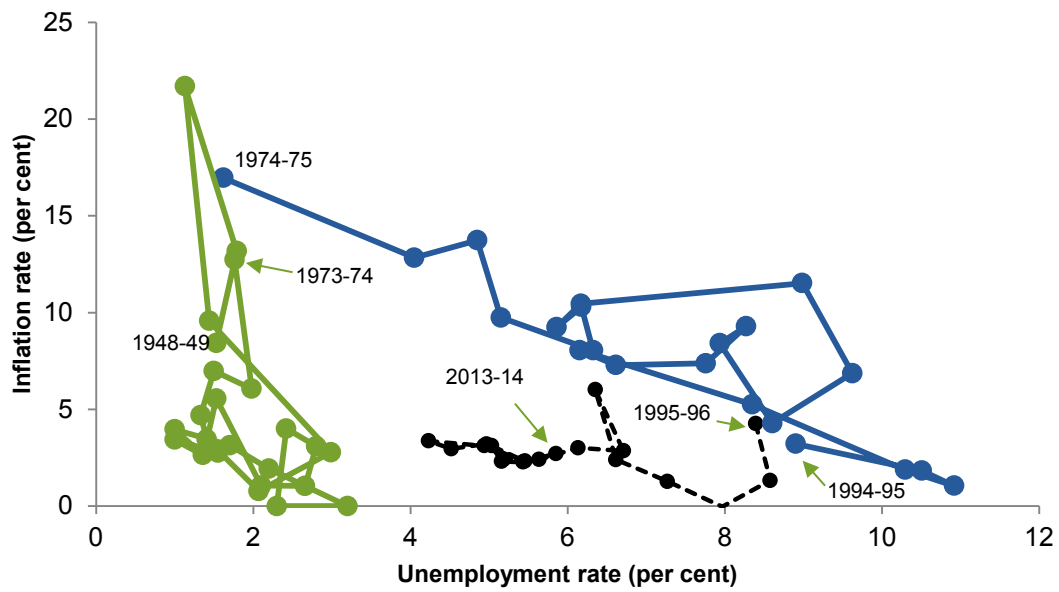
As the mining boom has abated, so have wages in the mining and construction industries. Indeed, in the latter case, a key union in Western Australia has suggested that it may accept a new enterprise agreement that reduces some wages by around 20 per cent (Barrett 2014).

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<sup>16</sup> The Prices and Incomes Accord involved an agreement between the Australian government and the ACTU to moderate wage demands.

More broadly, the distribution of wage growth has recently shifted toward lower increases, compared with the decade average (Kent 2014b).

**Figure 2.25 Prices are now less responsive to strong labour demand**  
1949-50 to 2013-14<sup>a</sup>



<sup>a</sup> The relationship is typically referred to as the ‘Phillip’s curve’ and is based on the premise that at some point lower unemployment creates inflationary pressures. Borland (2012) investigated the relationship between unemployment and wage pressures, finding a similarly flatter Phillips curve after the introduction of enterprise bargaining.

Sources: ABS 2014, *Labour Force Australia, Detailed*, Cat. No. 6291.0.55.001, released 18 December; ABS 2015, *Consumer Price Index, Australia*, Cat. No. 6401.0, released 28 January; Wither, Endres and Perry (1985).

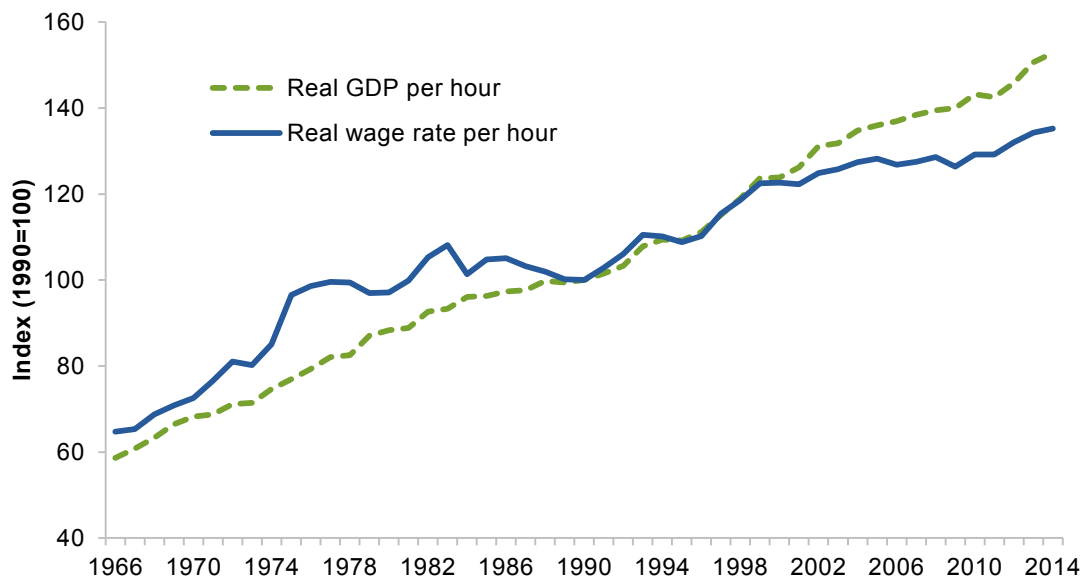
## Real wages and labour’s share of income

A high-wage economy is a natural aspiration of any country. However, real wages divorced from growth in productivity cannot be sustained in the long run. Wages that exceed productivity growth can lead to higher levels of unemployment or substitution of capital for labour at rates that would not otherwise have been experienced. Consequently, growth in labour market opportunities may be inefficiently restricted. Many have credited Australia’s relatively high levels of employment growth throughout the 1980s to the wage restraint associated with the Accord.

Claims of economywide wage breakouts (in excess of labour productivity) appear unfounded. Where wages growth exceeds labour productivity growth, the labour share of income increases. Over the last 50 years, Australia has seen periods where wage growth has outpaced, tracked and fallen behind labour productivity growth. Strong wage growth

from the early 1970s outpaced labour productivity growth, increasing labour share of national income from below 70 per cent to over 75 per cent in 1983. From the early 1980s, the introduction of the Accord mitigated wage growth, returning labour share of income to previous levels of around 70 per cent. Wages growth tracked productivity growth over the 1990s, before the two series departed from 2000 onwards, with increases in labour productivity outpacing wage growth (figure 2.26).

**Figure 2.26 Trends in real wages and labour productivity**  
1966 to 2014



<sup>a</sup> Both series are deflated by the GDP implicit price deflator.

Sources: Productivity Commission estimates based on ABS *Australian System of National Accounts*, 2013-14, Cat. No. 5204.0; ABS *Labour Force, Australia, Detailed, Quarterly*, Cat. No. 6291.0.55.003, released February 2015; RBA (1997) table 4.7 and 4.12.

## Rising income inequality

In Australia, inequality of income has been rising in recent years. In its report on trends in income distribution, the Productivity Commission found an increase in the Gini coefficient for both individual and equivalised household income from 1988-89 to 2009-10 (Greenville, Pobke and Rogers 2013).<sup>17</sup> However, Part-time workers were an exception, with no shift in inequality.

<sup>17</sup> The Gini coefficient is a measure of income inequality, taking a value between zero and one, where zero implies complete equality (all individuals receive the same level of income) and one implies complete inequality (all income goes to one individual). Equivalised household income controls for household size



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Several factors have contributed to this trend. A key determinant of increased inequality has been a widening dispersion of hourly wages for full-time employees and growth in part-time work. Higher growth in capital income among high-income households has further contributed to increasing household inequality.

On the other hand, the effect of wage dispersion and growth in capital income has been somewhat offset by a decrease in the share of jobless households. Moreover, growth in the value of government benefits have further mitigated the effects of increasing wage dispersion on income inequality.

This reflects the notion that the tax and social welfare systems are important means to address inequality of incomes. While aspects of the workplace relations system contribute to this — for example, the Federal Minimum Wage — they may not always be the most effective instrument. As noted above, the long-term relationship that matters is the linkage between labour costs and productivity. Inequality may be most observable in the labour market, but that does not indicate that it best managed by that market alone.

## **2.8 Workplace relations and the future of work**

A former high court judge has noted the power of the past in industrial relations:

The past is another country. It is a place safer for people like me to dwell than in the industrial present or the future. Judges live with the past, surrounded by its stories in their books, from which they seek to derive logical analogies and the great streams of principle that will promote consistency and predictability in decision making. (Justice Kirby 2004)

This backwards-looking perspective is a necessary feature of legal judgments, though not for wage determination, nor for policy development. Indeed, a number of stakeholders have raised the need for a WR system geared toward the future. The Business Council of Australia has noted:

The Business Council's strong view is that the workplace relations system of today does not position us well for the future. Our current workplace relations system does not create an environment where innovation is encouraged to thrive. Instead, it discourages innovation and risk taking. As a result, the system has created a class of conservative, risk-averse managers across many industries in our economy. (Business Council of Australia, sub. DR337, p. 3)

Similarly, Australian Industry Group has stated:

The reality is that Australia needs a workplace relations system that is consistent with the needs of 21st century workplaces. Many of the trends that will reshape the workplace of the future are already apparent. (Ai Group, sub. DR346, p. 9)

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by dividing total household income by a weighted sum of persons in the household. The first adult is allocated a weight of 1, while additional adults are weighted at 0.5 and children are weighted at 0.3.

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Demographic developments, technological change and increasing competition internationally have also all been raised as challenges for a future WR system. The certainty with which any predictions materialise is varied, and the implications for the WR system are in many cases unclear.

The question then is how a good workplace relations system can take account of current and impending labour market developments in a nuanced way. This involves several broad considerations, which are set out in greater detail below. But the essential narrative involves two themes:

- the institutions must function well and have sufficient discretion and powers to be responsive to changing circumstances, and the law should permit employers and employees to engage with each other in ways that cater for inevitable changes in business models and preferences of employees
- while useful, forecasts of what may actually happen over the longer run can distract policymakers from the more important task of creating a WR framework that:
  - provides a safety net and above that options for employees and employers to tailor outcomes to their changing circumstances
  - continually gathers intelligence about developments in workplaces and is then amenable to efficient change when that is needed.

## **The time horizon and the nature of changes**

The time horizon for any appraisal of the future, and the nature of the change being examined, influence the reliability of any views about future labour market developments.

Other than when there are abrupt shifts in the business cycle, short run forecasts of labour market trends are likely to be reliably inferred from recent trends. The technologies and new business models that can transform labour markets do not happen overnight (see below). As shown in this chapter, many aspects of the Australian labour have been relatively stable (such as tenure and casualisation), and for the next few years, it is unlikely that this will change dramatically. However, emerging developments in labour markets can still have an important bearing on workplace relations policies. For example, the ongoing shift to a ‘24/7’ economy, and growing preferences by consumers for services on weekends is likely to continue unabated.

For some aspects of the labour market, it is also possible to forecast over long horizons with reasonable certainty. The average age of the working population will increase with demographic change, therefore raising the share of people who are mature aged. The latter will be reinforced by the long running trend towards higher participation rates by older Australians. The ageing workforce is clearly closely connected to policies in the retirement income system, but less so to workplace relations, especially as one of the potentially significant issues — discrimination — is already covered by a variety of workplace laws. A concomitant aspect of an ageing population is that industrial structure will tend to shift

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to consumption patterns that reflect the needs of that population — such as in health and aged care services.

The trend towards greater female participation in the workforce is likely to also continue (albeit at a slower rate than previously) as it has been such a longstanding feature of the labour market, and that involvement is now strongly supported by other policies. The educational qualifications of the working age population are also likely to rise as the cohort of younger well-educated people ages.

Social changes that involve a greater role by men in caring for children also seem highly probable given that this growing role has been apparent for some time. The relevance of that change to the WR framework is less clear. The National Employment Standards are gender-neutral and so are already well geared to any such social trends.

Guessing future social trends is not always clearcut. For example, historically, discrimination against women (by statute and attitude) created barriers to employment and lower pay. In the 1950s, the basic wage for women was still set at 75 per cent of the male basic wage (Sheridan and Stretton 2004). Until the 1960s, married women in the Commonwealth public service could not occupy permanent positions. A survey of public attitudes of Woman's Day readers in the mid-1950s found them six to one against married women working in the paid workforce. But then attitudes and finally legislation changed, changing the face of Australia's labour market, and in turn, creating imperatives for future WR changes (such as rights for parental leave). The WR system had to respond to such attitudinal changes as they emerged.

Equally, it is difficult to anticipate the timing, character and impacts of long-run disruptive changes to labour markets and previous attempts at doing so have often been wrong. Prognostication often misses the big things, and anticipates radical changes that do not eventuate. For example, in 1985, one leading scholar said that the 30 hour week may be the norm in the next few decades. There were views that people would change job types and careers frequently. Neither has eventuated, despite their appeal at the time. More recently, the Economist noted:

The predictions sounded like promises: in the future, working hours would be short and vacations long. 'Our grandchildren', reckoned John Maynard Keynes in 1930, would work around 'three hours a day' — and probably only by choice. Economic progress and technological advances had already shrunk working hours considerably by his day, and there was no reason to believe this trend would not continue. Whizzy cars and ever more time saving tools and appliances guaranteed more speed and less drudgery in all parts of life. Social psychologists began to fret: whatever would people do with all their free time? This has not turned out to be one of the world's more pressing problems. (*The Economist* 2014)

It does seem highly likely that the trend towards automation — by no means a new phenomenon — will continue, but it is not clear in which industries and skills this will be most prominent. Notably, unemployment rates are not correlated with measures of multifactor productivity (an indicator of technological change). The implication is that while old jobs disappear, typically new ones emerge. That pattern might change, but it is

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hard to know with enough certainty that it could be used for policy purposes. By its nature, disruption surprises us. Serendipity is its usual hidden self.

There are likely to be many other conjectures about future changes in labour markets — some well-based, and others less so. However, the key design challenge is to develop a system that is responsive, rather than one that embeds (often mistaken) long run foresights into its structures.

## **Relevance of future labour market changes to the workplace relations system**

Some labour market and economywide developments have been established for some time and are likely to continue, but the WR system does not always adequately catch up with these quickly enough. The risk is that excessive inertia might then forgo future economic opportunities. An example is the continued trend towards a 24/7 and online economy, and the constraints represented by high weekend penalty rates in certain consumer oriented industries (chapters 10 to 15).

A critical source of flexibility in any WR system is the capacity of its key institutions to make decisions that reflect contemporary circumstances, rather than to be overly beholden to history and precedent. The Productivity Commission has recommended major reforms to the Fair Work Commission that would result in new institutions with greater intelligence gathering capacity and expertise, and that would facilitate a more systematic and principles-based approach to emerging workplace relations issues. These reforms, coupled with strong organisational capabilities and nimbleness, are one of the best ways of ensuring a WR system that can adapt to uncertain futures.

Ultimately, it is not possible or desirable to entirely future proof Australia's WR system. The most appropriate policy responses are to:

- ensure that the system is not so elaborate and cumbersome that it cannot readily change to suit new circumstances. The Productivity Commission has proposed a raft of changes that should make the system simpler and more flexible
- at least encourage debate on, and sometimes to set in train, changes that will take some time to implement. For example, the issue of people's preferences for leisure and the existing rigidities that form barriers to that (such as designated public holidays) may require orderly but slow reform. Further, while the notion of an earned income tax credit for Australia has been mooted in the past (Dawkins 2002; Potter 2014), re-visiting a debate where interest has waned can sometimes be useful
- have a range of work arrangements available to employers and employees that allows them to develop arrangements that suit their circumstances. The Productivity Commission has recommended a new type of agreement — an 'enterprise contract' — that would expand the menu of contracting options, and allow more flexibility into the system

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- investigate areas where there appears to be problems across complex interlocking systems (VET and apprenticeship arrangements, training wages and changing industry demands). Apprenticeship wages have been increased for older apprentices, while the Australian Government also provided incentive payments to employers and wage top ups. These affect the relative attractiveness of apprentices, and would-be apprentices, with unknown impact
  - adapt the system as new developments in technology, employment arrangements or social norms occur.

## **2.9 The bottom line**

The workplace relations system is one of many factors that affect labour market performance. Profound changes in Australia's labour market have seen shifts participation and industry structures. There is evidence that contemporary labour markets are more flexible than in the 1980s, which may partly reflect a shift towards enterprise bargaining (though other factors may have also contributed). There is little evidence that casualisation or other non-traditional forms of employment have been increasing in importance over the last decade, except among the young. On average, job security has been increasing. The biggest immediate risk is unemployment, particularly long-term and youth unemployment. While there is potential for the WR system to influence this, it is one of many factors that contribute.



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## 3 Institutions

### Key points

- While the institutional architecture of Australia's workplace relations system has been the subject of very significant recent changes, further change is required to deliver better outcomes.
- The Fair Work Ombudsman (FWO) is generally well regarded. Elements of the Fair Work Commission's (FWC's) conciliation activity are also often well regarded. However, the FWC's emphasis on legal precedent rather than analysed impact, and a continued attachment to precedent, is restricting its development as an effective institution. Inconsistencies in cases of individual disputes have also been identified.
- Given the volume of tribunal and other matters dealt with, and the contentious and subjective nature of many of these matters, some negative appraisal of the FWC was to be expected, and the Productivity Commission's overall judgment is that the FWC is, within its cultural limits, taking a modest but professional approach to internal improvement (although consistency remains an issue).
- Some of the inconsistency arises from choices made by governments, particularly the emphasis on appointing persons with a strong commitment to one side or the other of industrial relations debates. Better governance practices are essential for a body with determinative powers on economically important matters operating in a politically sensitive and highly technical space.
  - The processes for appointing Commissioners to the FWC should involve all Australian jurisdictions, be transparent, and ensure that appointments are based on merit.
  - Appointments should be determined by an appointments panel and be made for a period of ten years, or to the age of 70, whichever comes first. A reformed appointment duration would better balance the need for security of tenure with the requirement for performance incentives and review.
- The Australian Government should also introduce a new body, the Workplace Standards Commission, for determining the national minimum wage and, most particularly, continuing reform of awards.
  - Given this body would hear matters that have economy- and society-wide impacts, appointees should have wider expertise than workplace relations.
  - This function should not just involve impartially hearing evidence from parties, but also seeking out and engaging with parties that do not typically make submissions, and proactively undertaking data collection and systematic, high-quality empirical research as a key basis for decisions.
- The FWO is undertaking its education, compliance and enforcement activities in an effective and innovative manner. It is essential to the credibility of any future systemic reforms that sufficient resourcing is provided for the FWO.

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The operation of Australia’s workplace relations (WR) system is overseen by two key institutions, the Fair Work Commission (FWC) and the Fair Work Ombudsman (FWO). These are the main Australian Government workplace bodies and, given their importance in the current system, they form the focus of the present chapter.<sup>18</sup>

There are a range of other institutions in the current system which, while important, are not the main focus of this chapter. At the Australian Government level, these include the Fair Work Divisions of the Federal Court and the Federal Circuit Court; and the specialist construction-specific regulator (Fair Work Building and Construction) which has wider powers than the FWC (box 3.1). State and territory industrial relations commissions, which are present in all jurisdictions except Victoria (and of which the Western Australian Industrial Relations Commission has the broadest functions) also play an important, albeit diminishing, role. Considered more broadly, unions and employer associations are also important institutions in the current system.

**Box 3.1      The roles of the various other Australian Government WR agencies**

Other than the FWC and FWO, institutions with specific workplace relations (WR) functions include:

- the Fair Work Division of the Federal Court of Australia, which has jurisdiction over all civil and criminal matters under the *Fair Work Act 2009* (Cth)
- the Fair Work Division of the Federal Circuit Court of Australia, which provides a simpler, less formal alternative to employment litigation than the Federal Court of Australia, including a small claims proceedings option
- the Australian Competition and Consumer Commission, which is responsible for ensuring compliance with the secondary boycott provisions of the *Competition and Consumer Act 2010* (Cth)
- Fair Work Building and Construction (FWBC), which is responsible for workplace relations in the building and construction industry. While the FWO and the FWC remain relevant, FWBC assumes most of the functions of the FWO for the construction industry, and has special investigatory powers.
- the Road Safety Remuneration Tribunal, which, among other functions, approves road transport collective agreements, conducts research into pay and conditions, and deals with certain disputes between the parties in the industry. The Tribunal was evaluated in 2014, but the Australian Government has not announced its response to the review (with one central issue being the continued existence of the Tribunal).

*Sources:* Information from PC (2014c) and the Fair Work Ombudsman, Fair Work Commission, Road Safety Remuneration Tribunal and Fair Work Building and Construction websites.

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<sup>18</sup> As discussed in detail below, while the FWC is often described as ‘the tribunal’, and the FWO ‘the inspectorate’, in reality their role and functions are much more varied and diverse than these simple descriptors would suggest.



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The chapter is organised as follows.

- Section 3.1 discusses the current institutional setting and, in particular, the roles and functions of the FWC and the FWO as per Parts 5-1 and 5-2 of the *Fair Work Act 2009* (Cth) (FW Act).<sup>19</sup>
- Evidence on the performance of the FWC and the FWO is presented in section 3.2. This includes evidence and argument provided by participants to the present inquiry, as well as past analysis and reviews of performance.
- Reform options, including proposed changes to the institutional structure of the workplace relations system, the appointment process, and operating practices at the FWC, are assessed in section 3.3.

### 3.1 The current system

The current system of WR institutions in Australia is the result of significant recent change, although, at its core, there is also a high degree of continuity with the past. The FWC, known as Fair Work Australia from 1 July 2009 to 1 January 2013, took over the functions of several predecessor bodies, including the Australian Industrial Relations Commission (AIRC), the Australian Industrial Registry and the Australian Fair Pay Commission (Justice Iain Ross, sub. 171, p. 7). The FWO also has several predecessors, including the Office of Workplace Services and the Office of the Workplace Ombudsman.

In establishing the FWC and FWO, the government of the day placed a recurring emphasis in its public statements on proportionality, flexibility and greater smoothness of process. For example, it proposed that Fair Work Australia (and, by implication, the FWC):

... will be a modern institution with a user-friendly culture. It is not intended that it will adopt processes that are overly formal, legalistic or unnecessarily adversarial. (Australian Government 2008a, p. 340)

In regard to the FWO, the then Government foresaw a graduated approach to enforcement:

The functions of the FWO emphasise preventative compliance (e.g., through education and advice) and co-operative and voluntary compliance (e.g., through enforceable undertakings). However, in some circumstances it will be necessary for the FWO to enforce compliance more formally, through compliance notices or court proceedings. (Australian Government 2008a, p. 386)

While these objectives provide one useful broad metric with which to assess the performance of both institutions some six years on, the most important tests are whether the institutions are efficient and impartial, produce consistent and evidence-based decisions, have the confidence of stakeholders, and have governance and processes that support these outcomes.

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<sup>19</sup> The FWC also administers provisions of the *Fair Work (Registered Organisations) Act 2009* (Cth).

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## The Fair Work Commission's role and functions

### Main functions

The FWC's functions are many and varied, mixing what can be called individual, rights-based matters (such as dealing with unfair dismissal, general protections and bullying claims) with more collective matters (box 3.2):

The Commission's functions within the national workplace relations framework can be broadly grouped into three categories:

- Tribunal functions — exercised by the President and Members of the Commission under the Fair Work Act and the Registered Organisations (RO) Act;
- Regulatory functions — exercised by the General Manager of the Commission (or her delegate) under the RO Act;
- Administrative functions — exercised by the General Manager and staff of the Commission under the Fair Work Act ... and under the RO Act. (Justice Iain Ross, sub. DR357, p. 4)

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#### Box 3.2 The broad mandate of the FWC

The FW Act accords an extensive group of functions to the FWC, including to:

- resolve unfair dismissal claims
- deal with applications for orders to prevent bullying at work
- deal with general protections and unlawful termination disputes
- annually review and determine national minimum wages and minimum wage rates in modern awards
- make and regularly review and vary modern awards
- make orders to ensure equal remuneration for work of equal or comparable value
- make orders in relation to the transfer of business
- make orders to facilitate enterprise bargaining (including orders for ballots on protected industrial action and good faith bargaining) and deal with bargaining disputes
- make workplace determinations in certain circumstances in which enterprise bargaining parties have been unable to reach agreement
- approve, vary and terminate enterprise agreements
- make orders to stop or suspend industrial action
- deal with disputes brought to the Commission under the dispute resolution procedures of modern awards and enterprise agreements
- issue, suspend and revoke entry permits and deal with disputes concerning rights of entry
- deal with disputes about stand downs
- promote cooperative and productive workplace relations and prevent disputes
- provide assistance and advice about its functions and activities.

Source: Justice Iain Ross, sub. 171, p. 7.

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## Structure

The structure of the FWC reflects, in part, its quasi-judicial nature. The Commission comprises a group of ‘primary members’ that includes the President, two Vice Presidents, and 39 Deputy Presidents and Commissioners. Additionally, there are presently six members of state industrial relations tribunals who hold a dual appointment to the FWC and five Expert Panel members, appointed on a part-time basis, who sit on annual wage reviews and default superannuation fund assessments. The President has the same status as a Judge of the Federal Court of Australia. FWC Members, in performing their functions, have the same protection and immunity as a Justice of the High Court (FW Act, s. 580).

Appointment terms for Members vary. The appointment of the President, Vice Presidents, Deputy Presidents and Commissioners are until the age of 65, excepting resignation or termination. Expert Panel members can be appointed for a maximum of five years.

Members are supported in their work by administrative staff employed under the *Public Service Act 1999* (Cth). At 30 June 2015, there were 328 staff organised into four branches: Client Services, Corporate Services, Regulatory Compliance and Tribunal Services (Justice Iain Ross, sub. 171, p. 9; FWC 2015c, p. 143).

## Approach

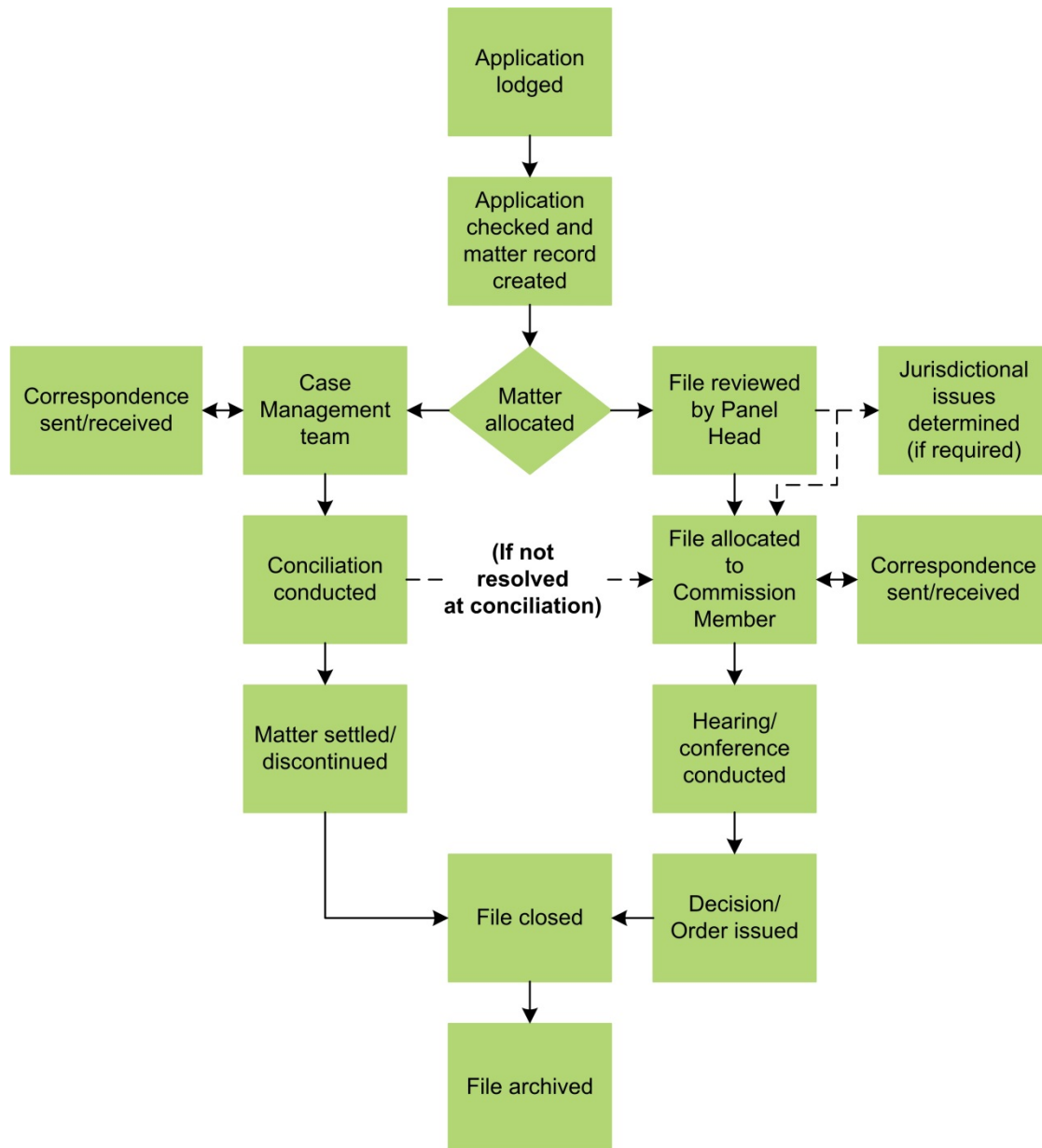
In keeping with the breadth of matters it deals with, the FWC’s approach mixes tribunal work with larger deliberations on issues such as awards and the minimum wage.

Much of the work of the FWC is administered through its panel system. There are a number of industry panels (including government services; media, ports, oil and gas; manufacturing and building; and services and mining) and several specialist panels (dealing with various matters, including anti-bullying, termination of employment, organisations and major resources/infrastructure projects). Two Expert Panels are constituted for annual wage reviews and assessment of default superannuation funds in modern awards (Justice Iain Ross, sub. 171, pp. 8–9). The President of the FWC has stated that he allocates Members into panels based on experience and expertise.

The FWC uses a triage system in considering most matters with an emphasis in many areas on the use of conciliation as an alternative to the more costly and time consuming alternative of arbitration (figure 3.1).

The FWC uses full benches in a number of contexts, including appeals on individual matters such as arbitrated unfair dismissal cases; and on award determinations.

Figure 3.1 FWC tribunal workflow



Source: FWC, pers. comm, 24 March 2015.

### Recent changes in workload

As noted elsewhere, there has been a substantial change in the balance of matters dealt with by the FWC. There is now a far greater focus on individual, rights-based matters, such as unfair dismissal and general protections cases. A much smaller relative share of work is now accounted for by collective matters, such as bargaining, disputes, awards and minimum wage determinations (figure 3.2). As the Law Institute of Victoria put it:

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Fourteen years ago, 65% of the Commission’s workload was collective disputes; now, 65% of its workload are individual disputes. The Commission is now, in effect, operating like a court for individuals. The old system of employer and employee associations appearing by right based on full or high membership is no longer valid. (sub 195, pp. 2–3)

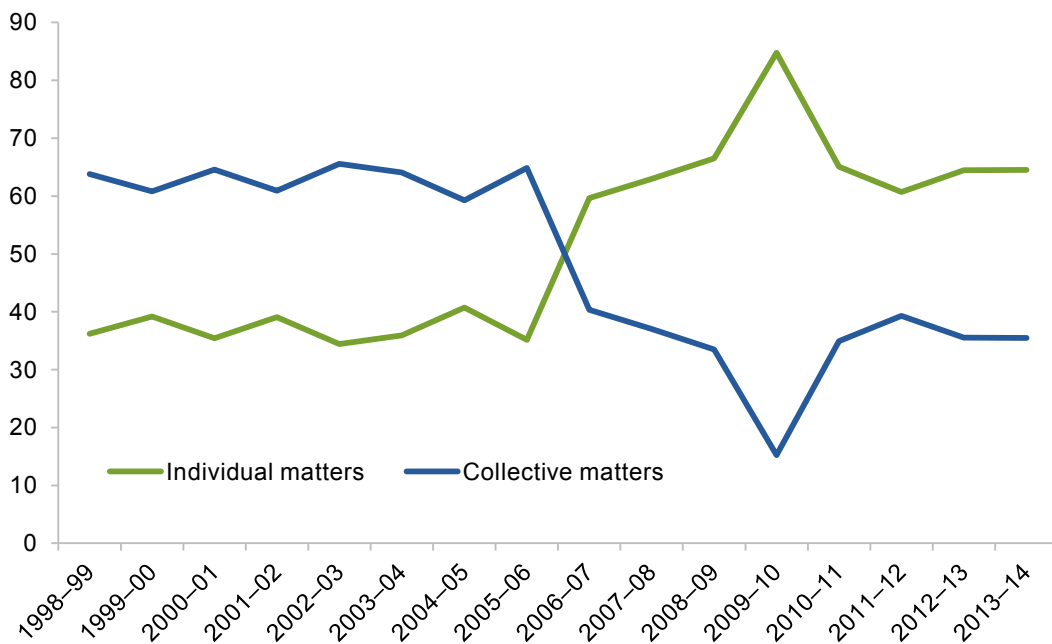
This change has been driven, at least in part, by broader changes in the workplace and in workplace law (as discussed in chapter 1). In turn, such changes have also meant that a far greater proportion of FWC matters involve individual disputes considered by individual Members.

Partly in response to such changes since mid-2012 the FWC has been implementing a program of organisational change under the banner of ‘Future Directions’ (box 3.3).

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**Figure 3.2 The changing nature of the Fair Work Commission’s activities**

Share of applications (per cent)



Source: Justice Iain Ross (sub. 171, p. 12).

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### Box 3.3 Future Directions

In October 2012, Fair Work Australia's President, Ian Ross AO, launched the Future Directions policy (FWA 2012b). Based on a process of internal and external consultation, this was intended to provide a multi-staged program of organisational change stretching over several years, grouped under four key themes:

- Promoting Fairness and Improving Access
- Efficiency and Innovation
- Increasing Accountability
- Productivity and Engaging with Industry.

The second stage of this program commenced in May 2014 and involves 30 initiatives to be implemented across 2014-15. These include: an enterprise agreements pilot involving the direct allocation of agreement applications to FWC staff for initial analysis and reporting; a general protections pilot whereby staff conciliators conduct conferences under delegation of the President of some general protections (FW Act, s. 365) matters; and a pilot program for dealing with certain applications for permission to appeal.

As part of the program, the FWC has also been considering a more expansive role in preventing workplace disputes (discussed further below). This follows amendment to the FW Act in 2013, adding s576(2)(aa) which provides FWC with a function to promote cooperative and productive workplace relations and prevent disputes.

A further notable initiative in the context of the current chapter involves proposed assessment of the FWC's performance against the Council of Australasian Tribunal's (COAT) International Framework for Tribunal Excellence. The FWC is proposing to complete this work in 2015-16.

*Sources:* FWC (2015f); Justice Ian Ross, sub. 171, pp. 18–27; Bray, Macneil, Stewart and Oxenbridge, sub. DR272, p. 2.

## The Fair Work Ombudsman

### Main functions

The FWO provides information about the roles, rights and responsibilities of actors in the system, monitors compliance with suspected breaches of workplace laws and regulations (for example, under-award payments), and can seek penalties for breaches (through the Federal Circuit Court and the Federal Court of Australia). It can also seek penalties for contraventions of civil remedy provisions in the FW Act in eligible State and Territory courts, such as the Magistrates Court of Victoria (Centre for Employment Law and Labour Relations, sub. DR313, p. 9).

In performing its work, the FWO is guided by Part 5-2 of the FW Act (box 3.4).

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### Box 3.4      **The FWO's main statutory functions**

The FW Act sets out the main strands of the FWO's role within the workplace relations framework, including:

- promoting harmonious, productive, and cooperative workplace relations and compliance with the FW Act and fair work instruments
- providing education, assistance, and advice to employees, employers, outworkers, outworker entities and organisations and producing best practice guides to workplace relations or practices
- monitoring compliance with the FW Act and associated instruments
- inquiring into, and investigating, any act or practice that may be contrary to the FW Act, instruments (including modern awards, enterprise agreements, workplace determinations or an FWC order) or safety net entitlements
- where necessary, commencing proceedings in a court, or making applications to the FWC, to enforce the FW Act, instruments or safety net entitlements
- representing employees or outworkers who are, or may become, a party to proceedings in a court or before FWC, if the FWO considers that representing the employees or outworkers will promote compliance with the FW Act or fair work instrument.

The FW Act also requires that the FWO consults with the FWC in producing guidance material that may relate to its functions.

### Approach

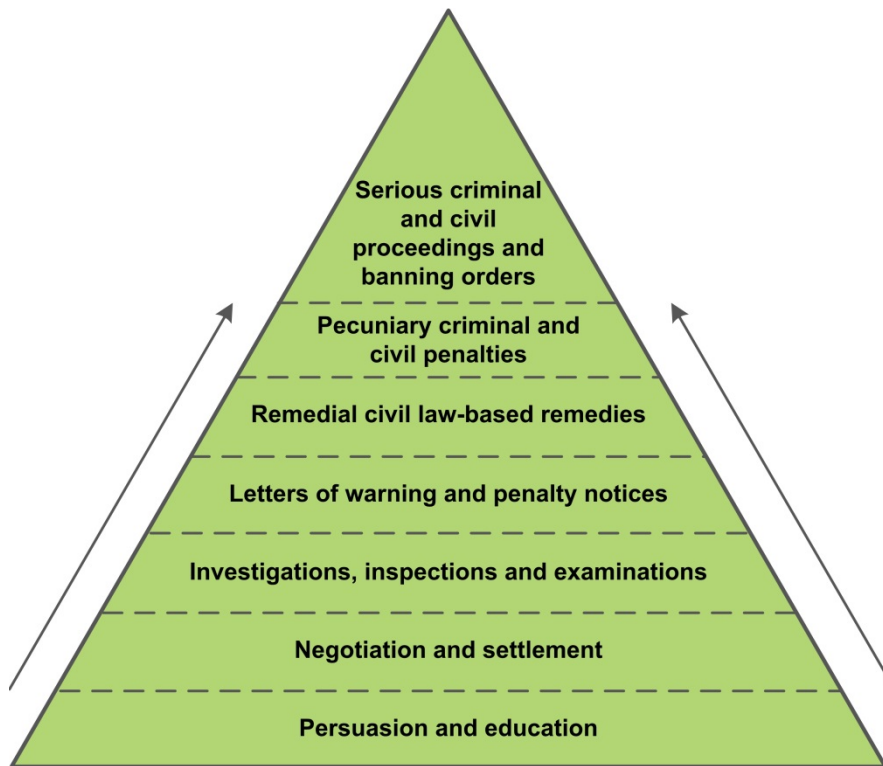
The FWO's approaches to its functions are set out in its latest Compliance and Enforcement Policy, and include:

- 'softer' measures, such as advice, support and assistant services, campaigns, compliance partnerships and pre-complaint intervention
- 'harder' measures, such as inquiries, investigations, notices, enforceable undertakings and litigation (FWO 2015i).

This varied approach is broadly consistent with good regulatory practice (figure 3.3), and represents a significant departure from the practices of its predecessor agencies. FWO has undertaken major changes in its delivery model for several reasons, including significant reductions in the agency budget, but also a recognition that the FWO could undertake its activities in a more effective and proportionate way (box 3.5). An important feature of FWO's revised approach is an emphasis on voluntary compliance (Hardy, Howe and Cooney 2013).

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Figure 3.3 Example of an enforcement pyramid



Source: PC (2010b).

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While an emphasis on voluntary compliance is apparent, the FWO has continued to use litigation as part of its approach where warranted:

Litigation is an essential action for three reasons:

1. enforcing the law and obtaining court orders sends a powerful public message to others not to engage in similar conduct (general deterrence)
2. stopping people from engaging in unlawful behaviour now and in the future makes the need to comply real for individuals (specific deterrence)
3. clarifying the law helps the community understand what are the various obligations and rights from Commonwealth workplace laws. (FWO 2015i, p. 26)

However, what differs greatly in regard to the FWO's more recent approach to litigation, is that it is used in a more targeted and strategic fashion, in conjunction with the suite of 'softer' approaches, such as dispute resolution:

As one [FWO] manager put it, a judgment was made internally 'that running a hundred litigations wouldn't necessarily get you twice the deterrence that running 50 would.' (Hardy, Howe and Cooney 2013, p. 582)

The use of test cases by the FWO is a good example of this more targeted approach.



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### Box 3.5 The evolution of the FWO's approach

The FWO discussed recent changes in the way it conducts its regulatory activities:

As a newly formed independent regulator in 2007 (as the Workplace Ombudsman) our focus was on responding to workplace complaints from workplace participants (mostly employees). Our primary response to such complaints was to commence an investigation, often at a point where the workplace relationship had already broken down.

This was a formal and detailed process that proved to be inefficient and very time consuming for all parties involved. Where the employee who had asked for our assistance was still employed, on many occasions, our investigation process also contributed to the deterioration of the employment relationship.

In our experience, the vast majority of employers want to comply with the law. Often, workplace issues arise from employers not understanding their obligations or being confused by the complexity of the workplace relations system. In the past 18 months, the FWO has focused on delivering practical workplace relations advice and on resolving disputes earlier and more efficiently.

We encourage self-resolution by intervening early in workplace disputes, particularly in situations involving employees who are still employed. Our focus is on resolving the dispute as quickly as possible and maintaining the employment relationship. Often, this will involve the FWO directly assisting both the employee and the employer and/or offering a mediation service.

The FWO is also focused on being proportionate and risk-based in our approach to compliance and enforcement. While the vast majority of requests for assistance are resolved through effective and efficient dispute resolution techniques, we continue to conduct investigations and use compliance notices, enforceable undertakings and litigations in cases of serious non-compliance. Specifically, the FWO directs these efforts where we can deliver the greatest impact and benefit, including situations where there is the exploitation of vulnerable employees, significant public interest concerns, blatant disregard for the law, the deliberate distortion of a level playing field to gain a commercial advantage or an opportunity to provide an educative or deterrent effect.

*Source:* Fair Work Ombudsman, sub. 228, pp. 2–3.

### Structure and governance of the FWO

Unlike numerous past Australian inspectorates, the FWO has a considerable degree of independence from government in regard to its location and day to day operations (table 3.1).

The FWO's structure aligns with its functions and also with its revised regulatory approach. As pointed out by Howe, Hardy and Cooney (2014, p. 12):

The FWO's emphasis on continual change, combined with the resourcing reductions, led to the development of a new organisational structure which appears to place a heavier emphasis on dispute resolution and compliance rather than investigation and enforcement.

Key sections of the organisation, as currently configured, deal with dispute resolution and compliance; advice, support and assistance; proactive compliance and education; and legal and business improvement.

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**Table 3.1 Institutional location of the enforcement inspectorate**

<i>Period</i>	<i>Institutional Location – title of agency</i>	<i>Government(s)</i>
1954–1977	Attached to department	Menzies Coalition; Whitlam Labor
1 March 1978–1983	Statutory authority – Industrial Relations Bureau	Fraser Coalition
1983–1985/86	Attached to department – Arbitration Inspectorate	Hawke Labor
1985/86 – 2006	Within department – Arbitration Inspectorate, Award Management Branch, Office of Workplace Services	Hawke & Keating Labor; Howard Coalition
March 2006 – June 2007	Executive agency – Office of Workplace Services	Howard Coalition
1 July 2007– current	Statutory authority – Workplace Ombudsman	Howard Coalition; Rudd and Gillard Labor; Abbott Coalition

*Source:* Adapted from Maconachie and Goodwin (2009, p. 6).

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By the end of 2014 the FWO had 794 employees, with a full-time equivalent staffing of 744. This included 253 Fair Work Inspectors and 106 Fair Work Infoline Advisors (FWO, sub. 228, p. 2).

## **3.2 How are the institutions performing?**

This section examines the effectiveness of the FWC and the FWO in performing the various roles discussed above, drawing on participant views and other evidence.

### **The Fair Work Commission: participant views**

Participant views on the work of the FWC were mixed, ranging from strongly supportive to critical. These views touched on various matters, but can be broadly grouped into three areas:

- the FWC’s roles and the structure and governance of the organisation
- its conciliation and arbitration processes and the resulting outcomes
- minimum wage and award processes.

Given the overlap of these areas with other chapters, in particular chapters 4 (minimum wages), 7 (role of awards), 8 (repairing awards), 17 (unfair dismissal), 18 (general protections), 19 (anti-bullying), 20 (enterprise bargaining) and 22 (enterprise contract), the following section should be read in conjunction with those later discussions.

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## Roles, structure and governance

The role of the FWC was discussed in many submissions. Some stakeholders, including some employers, unions and academics, argued that, while they sometimes disagreed with certain outcomes or approaches, they were nevertheless supportive of its role. For example, Clubs Australia Industrial (CAI) (sub. 60, p. 45) stated:

Generally, CAI is of the view that the bodies that administer and enforce the various workplace relations laws are performing their functions in a manner which is both efficient and effective, particularly the FWC in its handling of unfair dismissal matters.

Stewart, Gahan, McCrystal and Chapman (sub. 118, p. 13) said:

... FWC has earned the right to continue to play a central role in the regulation of employment and workplace relations.

The Australian Council of Trade Unions (ACTU) (sub. 167, p. 350) was also broadly supportive of the FWC and its work, contending:

Within the footprint of its present functions, the FW Commission is in our experience functioning highly effectively ... Unions report the FW Commission processes as generally user friendly, especially compared to other institutions.

This is despite several areas where, in the ACTU's view, improvements were required, including the award review process, the processing of Right of Entry matters, and the inflexibility and delay in the processing of unfair dismissal matters.

Other stakeholders were far less positive. For example, the Australian Federation of Employers and Industries (sub. 219, p. 6) argued that the provisions of the FW Act:

... were deliberately drafted to enable the FWC to embed itself further into the day to day running of businesses thus preventing business from making the thousands of decisions big and small which are an inherent part of trying to be productive, competitive and profitable.

Of course, to the extent it holds, this is more a criticism of the FW Act than the FWC, which is obliged to follow its enabling legislation.

The Australian Mines and Metals Association (AMMA) called for a complete overhaul of the system, using the model of the Advisory, Conciliation and Arbitration Service (ACAS) in the UK as a starting point, and dismantling the FWC in its current form. It said:

Fair Work is a failed organising concept for Australia's employment institutions and legislation ... Australia needs a new, properly organised system of tribunals, more specialised and targeted than the existing generalist FWC. (AMMA, sub. 96, p. 358)

The Victorian Employers' Chamber of Commerce and Industry (sub. 79) also made calls for a radical overhaul along similar lines.

Appointment processes and duration of appointments were a particular source of further adverse comment. One view in this regard was that, in line with the changing nature of its

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work, the appointment process for FWC members should accommodate appointees with a broader skill set than has previously been the case (see for example: AMMA, sub. 96, p. 362). A more general view was that the lengthy appointment tenure for Commissioners impinged upon accountability. For example, Brendan McCarthy (sub. 43, p. 7), until recently a Commissioner, stated that:

Another aspect of the absence of normal types of accountabilities for those that establish standards is the tenure of Members of the FWC. There are other bodies with a legislative or regulatory type role that have been given an independent role by parliament. Those bodies usually have persons appointed to them for a limited term.

COSBOA (sub. 115, p. 4) said:

The selection process for commissioners to the FWC needs to become much more transparent and much more competitive.

The Business Council of Australia (sub. 173, p. 72) also proposed:

The appointment process should be subject to public accountability, with roles advertised and information on the interview process and appointment made publicly available at the time of the appointment.

Consistent with other independent offices and good corporate governance, the appointment term for a Commissioner should be time-limited. Commissioners should resign at the end of the term with the option of nominating for another term.

Andrew Stewart et al. (sub. DR271, p. 4) presented an opposing view, and said:

The main check at present to partisan *decision-making* (as opposed to appointments) is the fact that members have tenure ... if a member's prospects of reappointment (or hopes of later governmental work or appointments) were to depend on the government of the day, or the party they expected to be in power at the relevant time, that would surely heighten the incentive to make decisions that would please those expected to make the reappointment decision.

Toll Holdings (sub. DR312, p. 20) also stated:

Members should be making decisions without fear or favour and the imposition of fixed terms creates a distraction that parties would be concerned about.

As will be discussed further below, criticisms of appointments to the workplace tribunal have a long history. What is of interest is whether:

- evidence exists of a demonstrable link between appointment processes and prior systematic bias in outcomes that could be avoided
- regardless of whether that is the case, governance changes might be justified on the grounds that a body must not only *be* impartial, but be *perceived* to be so
- whether a clear case can be made on other grounds that reform of such processes will deliver net improvements in outcomes.

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## Conciliation and arbitration processes and outcomes

The rebalancing of the FWC's workload towards dealing with far more individual matters has meant that conciliation processes are now a critical part of its work.

Several stakeholders were very positive about these processes, arguing that they saved time, reduced travel and other costs, and resulted in outcomes that were generally acceptable to all parties. Conciliation allows disputing parties to recognise that there are often two sides to any story. An early emphasis on conciliation is also in accord with the basic principles of alternative dispute resolution arrangements (Forsyth 2012), since it avoids an overly adversarial approach and allows parties to be heard, even if they do not get the outcome they like. For example, CAI (sub. 60, p. 29) submitted:

... CAI is of the view that as a whole, the telephone conciliations work very efficiently in these matters.

Others were critical of the conciliation process, arguing that it forced parties to an outcome that was not always fair, and that the FWC's focus on time limits during the process meant that it was a willing driver of this approach. For example, the Catholic Commission for Employment Relations (sub. 99, p. 34) said:

Based only on real-life experience and anecdotal accounts (as we understand data on merits are not kept for settled cases), it is reasonable to conclude that of the 79% of total cases settled at conciliation last financial year, a not insignificant portion were meritless, without reasonable prospects of success, or vexatious. This presents a public policy problem.

The virtues of conciliation — speed, low costs and compromise — may also sometimes be flaws if the compromises that are accepted undermine public acceptance of the unfair dismissal arrangements or create incentives for employees to seek redress when none should be given. For example, if an employee's expectation is that disputing a dismissal is unlikely to go to arbitration, and that there is a reasonable prospect of at least some compensation through the conciliation process, then this may encourage higher (and unwarranted) disputation rates. Testing the extent to which this holds is very difficult, and views about it often reflect anecdote.<sup>20</sup>

That said, it is doubtful that recourse to costly arbitration should be an easier avenue. The avoided costs of the current model are likely to outweigh the costs of the 'rough justice' that sometimes arises. However, some changes are warranted. An important focus in this

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<sup>20</sup> Nevertheless, there is some evidence on this issue, as discussed in chapter 10 and in TNSSR Consultants (2010). For example, the latter found that one of the grounds for settling a dispute was that the settlement was 'reasonable'. Some 55 per cent of applicants and 53 per cent of respondents agreed that this was one driver for not taking the matter forward to arbitration (TNSSR Consultants 2010, p. 51). On the other hand, 42 per cent of applicants (employees), but only 14 per cent of respondents (employers), reported that 'a feeling that their case would not stand up if it went any further had a medium or high influence on the decision to settle' (TNSSR Consultants 2010, p. 53).

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area needs to be on the processes used by the FWC, and on the public transparency of outcomes from these processes. As Southey (2012, p. 8) argues:

A further point worth investigation is the impact of the language used by the conciliator to bring about a settlement and what specific words and phrases trigger an association, in a participant's mind ...

While the FWC has commissioned past research that suggests broad satisfaction with the outcomes of conciliated matters (Inca Consulting 2015b; TNSSR Consultants 2010), there are further reforms that would improve conciliated outcomes and the transparency around such outcomes. These are discussed further in section 3.3.

Arbitration processes and outcomes were also discussed at length in several submissions (see, for example, ACCI, sub. 161, pp. 108–127; Paws a While Boarding Kennels, sub. 71, pp. 8–9; Major Events Consulting Australia Pty Ltd, sub. 38, pp. 1–2). A recurring theme was the tendency in many FWC decisions to place excessive weight on procedure over substance.<sup>21</sup>

For those stakeholders critical of the outcomes resulting from FWC arbitration, a frequent suggestion was that a dedicated appeals jurisdiction be established, either within the FWC or external to it. This reform is also evaluated in the following section.

### The minimum wage and award processes

The processes the FWC uses in undertaking its review of awards and minimum wage cases are discussed in chapters 4 (minimum wages), 7 (role of awards) and 8 (repairing awards). These discussions find that, while the FWC conducts its award reviews in a competent way, improvements are justified in several areas, including in the diversity of backgrounds of panel members, and regarding the conceptual frameworks and empirical evidence underlying decisions.

In contrast, the Expert Panel in annual wage reviews has a broader set of skills than the award panels, and gives significant weight to economic issues. It also undertakes some research and prepares a detailed statistical summary of the performance of the Australian economy as part of the wage review, to which it gives considerable weight when making its decision. It also sometimes examines empirical issues, where these arise from a requirement to consider a matter specified in the Modern Award Objective of the FW Act (s. 134). For example, in its Annual Wage Review of 2012-13, the FWC discussed the links between minimum wages and productivity (as required under s. 134(1)(f)). In doing so, it considered two pieces of (overseas) empirical analysis ([2013] FWCFB 4000, para 175). It may be that the FWC could have undertaken more in-depth analysis of what is a complicated issue, but clearly the panel was investigating the issue in a scientific way.

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<sup>21</sup> Similar claims were also made about the emphasis on procedural detail, in the context of FWC's consideration of disputes, in the submission by Teys Australia Pty Ltd and NPH Foods Pty Ltd (sub. 179).

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However, while less so than the award panels, it is still evident that the conceptual approach of the FWC's Expert Panel is to have a prior view (often established from past reviews) that must be dislodged by a fresh and compelling piece of evidence, and that absent that, the prior holds. Accordingly, in many cases, the FWC indicates that it is 'not persuaded' (or some similar kind of words) that some past proposition is untrue — effectively putting the onus of proof on a dissenting party. The requirement for new evidence to overturn a prior is reasonable if the prior has strong empirical and theoretical foundations but, in industrial relations as practiced for decades, this is not likely to be the case. It would often be better if the FWC Expert Panel itself re-investigated its priors, and did so, regardless of whether any party had adduced evidence on the matter. Nevertheless, the conduct and approach of the Expert Panel on the minimum wage review provides a useful starting approach for reforming award panels.

### **The Fair Work Ombudsman: Participants' views**

The views of participants on the FWO's overall performance were, in general, positive. A view expressed by several was that, given recent changes in roles and requirements with regard to such things as enforcement, the FWO had proved to be a nimble and innovative institution that had adapted well to the different demands placed on it across time by government and by the broader community.

Unions also highlighted the effectiveness of the FWO's approach. The ACTU (sub. 167, p. 347) stated in this context:

The FWO is a regulatory agency of substantial value in the industrial relations system. Its core functions are essentially education and enforcement, both of which it executes well in an objective sense, notwithstanding that we and our affiliates could point to examples of where we consider the advice given by the FWO is not correct. Even in those outlying cases, the FWO have engaged with us to discuss the areas of disagreement or how standard advice might be revised.

The Shop, Distributive and Allied Employees' Association (SDA) (sub. 175, p. 72) was also strongly supportive of the FWO, and said:

The SDA expresses its support for the Fair Work Ombudsman particularly for the transparency of its decisions and advice, its increased consultation with employee and employer representatives, its educative role and its prosecutorial function when flagrant infringements of workers' rights have occurred.

The SDA argued strongly that the transparency of FWO's processes stands in stark contrast with that of its predecessor, the Office of the Employment Advocate.

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## Criticism of advisory and regulatory roles

One notable criticism from some stakeholders concerned the FWO's decision to step out of its normal advisory and regulatory role to participate in the current 4 yearly review of modern awards. For example, Business SA (sub. 174, p. 18) submitted:

Business SA supports their [FWO's] role as educator and compliance monitor, but has concerns regarding the increasing initiatives by the FWO to provide interpretation on industrial relations matters. Blurring the lines of the educator and interpreter can lead to confusion for employers and employees alike.

Given the important role of the FWO in advising individuals regarding their award entitlements, this was seen by some as a case where the FWO should more appropriately have not been involved in providing such input to FWC.

This criticism ignores clear benefits from the FWO's involvement. To the extent that the FWO has expertise with regard to the operation of awards 'on the ground', it has valuable information and experiences of use in such processes. In its submission to the inquiry, the FWO (sub. 228, pp. 4–5) discussed this involvement as follows:

As a regulator who has extensive contact with millions of employers and employees each year, the FWO is uniquely placed to assist the FWC to simplify and clarify how awards operate. Our involvement is focussed on providing the FWC with information to clarify aspects of awards that, in our experience, cause complexity and ambiguity for business.

The FWO also stated that FWC appreciated its involvement in this space, and it is clear that there is a good working relationship between the two agencies.

Some broader criticisms were also made of the FWO's recent approach to enforcement. For instance, Legal Aid NSW (sub. 197, p. 18) argued:

The FWO seems to have retreated from using its investigative powers and making findings and determinations. Unscrupulous employers we encounter seem undeterred by the possibility the FWO could take enforcement action against them. Bodies such as WorkCover NSW seem much more adept at instilling and enforcing a culture of compliance.

Overall, though, such criticisms were not widespread across the broad swathe of commentary in submissions on the FWO's approach and performance.

## Enforceable undertakings: the FWO's approach

A further minor criticism of the FWO concerned its use of enforceable undertakings (EUs) (Ai Group, sub. 172, p. 95). The concern was that the FWO's approach was less flexible and imputed an actual, as opposed to potential, breach, in contrast to the use of EUs by other regulators, such as the Australian Competition and Consumer Commission (ACCC). However, the contexts are different, in particular given that FWO matters will more often involve an individual or individuals that are the aggrieved party. Overall, it appears that the FWO's recent increased use of EUs is measured and effective; although, as has been



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previously observed by Goodwin and Maconachie (2012), it may be too early to make a final call on the effectiveness of the FWO's approach in this area.

## **Past evaluations**

The performance of the FWO and, to a lesser extent, the FWC, has been the subject of several external reviews since 2009.

A comprehensive performance audit of the FWO's workplace services was undertaken by the ANAO in 2012. The report was generally positive regarding this aspect of the FWO's operations, but recommended greater use of risk management in prioritising service delivery offerings, and a more comprehensive reporting of the outcomes for users of the FWO's services (ANAO 2012). A broadly positive review was also undertaken of the FWO's approach to compliance and enforcement by the Centre for Employment and Labour Relations Law (Howe, Hardy and Cooney 2014).

The activities of both the FWC and the FWO were also considered as part of the 2012 post-implementation review of the FW Act (McCallum, Moore and Edwards 2012).

## **Technology and information management**

This inquiry has not examined the information systems and supporting technology of the FWC or the FWO in any detail. However, it is apparent that there is scope for increased sophistication in this area (for example, in recording conciliation outcomes at the FWC and the underlying factors that might inform those outcomes and the linking of data from calls to the FWO and its compliance functions).

Recent improvements, such as those made by the FWC to its CMS+ data system and discussed in O'Neill (2012a, pp. 4–6), are indicative of some much needed progress in this area. The relative sophistication of the FWC's systems when compared with many of the other courts and tribunals examined in the Productivity Commission's Access to Justice Arrangements inquiry (2014a), should also be noted.

## **Summing up**

There is a wide range of views about the performance of the two key institutions, and some external reviews. While both institutions are generally regarded with respect, the FWO received much more uniformly positive appraisals. There is no evident need for changes to the function of the FWO, except in relation to an expanded role for the FWO on unions' right of entry to enterprises and in regard to the Enterprise Contract — as discussed below and in chapter 23.

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Given the volume of tribunal, inspectorate and other matters dealt with by the FWC, and the contentious and subjective nature of many of these matters, some level of negative appraisals would be expected for this body. Losing inevitably begets dissatisfaction. It is also the case that some of the complaints about the FWC reflect flaws in the FW Act, not the FWC itself, and that in many instances the FWC is required by the FW Act to conduct matters in certain ways. For example, as formulated, the BOOT is an inherently hard test to apply.

Nevertheless, there are sufficient concerns raised by participants and arising from the empirical and qualitative analysis in other chapters in this report, to investigate possible institutional reforms.

### **3.3 Reform options**

This section considers a number of reforms, including the possible creation of a third main institution within the Australian system, and associated significant reforms applying to functions currently performed by the FWC. These are supplementary to reforms proposed elsewhere in the report, including in regard to the FWC's frameworks and practices in decisions on agreements. These are discussed in chapter 20 (enterprise bargaining).

#### **Changing the structure of the workplace relations system**

The institutional structure for dealing with workplace matters in Australia is the result of considerable historical change. While much continuity with past approaches and functions can be observed in the current working of the FWC and the FWO, there has also been a significant amount of innovation in the workings of both organisations that has ensured that they are very different bodies to their predecessors.

Participants in the present inquiry had at times diametrically different views on what further, if anything, needs to change regarding the main institutions. For example, Andrew Stewart and others (sub. 118, sub. DR271) and John Buchanan (sub. 131) argued that present arrangements were generally working well, with both institutions garnering widespread support for their work, netting out the occasional difference on specific decisions. In their view, more major changes would not be justified given the performance of the WR system since 2009.

Other participants, including the Business Council of Australia, AMMA and VECCI, called for more radical reforms. In the case of AMMA, their proposal would require the abolition of the FWO and the FWC in their present forms, with reconstitution of the system into a series of specialised institutions, including an Employment Conciliation and Arbitration Service, Employment Tribunal, Employment Appeals Tribunal, Employment Safety Net Commission and Employment Ombudsman (sub. 96, p. 360; sub. DR322, p. 201).

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Much of the analysis in this report touches on three main institutional functions within the workplace relations system:

- ombudsman functions (broadly defined, as is the case in the current FW Act)
- tribunal functions, as currently performed by FWC in regard, for example, to unfair dismissal cases
- broader determinations on matters with economy wide impacts, such as awards decisions and minimum wage setting.

Whereas the Australian system, as currently configured, has two key institutions sharing these roles, other countries, such as the United Kingdom, have chosen a more separated structure, of the type outlined in AMMA's submission.

### The need for change, and options to make it happen

While a wholesale overhaul of the current system, along the lines suggested by some stakeholders above, is not warranted by the evidence available to this inquiry, the Productivity Commission is also of the view that maintenance of the status quo is not an option.

There are some undoubtedly positive efforts to streamline process by the FWC with considerable effort from the President. But further changes are required. Improvements to the FWC's tribunal type functions are attainable and changes to garner such improvement are detailed below. Many of these reforms will provide the FWC President with more scope to manage and guide Members. Those Members will, further, face greater incentives to perform in a manner consistent with the President's guidance, and be drawn from a more diverse range of backgrounds.

But in the area of awards and minimum wages the accepted culture of the current Commission, with its emphasis on court-like behaviours, appears inconsistent with the needs and approach of a modern regulator. Indeed, the Commission does not view itself as such. This has led the inquiry to consider whether the functions that are consistent with being a regulator rather than an adjudicator should move to a different entity. As it presently stands, these functions are performed by the FWC and, as is discussed in greater detail in chapters 4, 7 and 8, with varying degrees of effectiveness.

A key question is, on balance, whether further improvements could be attained by either recasting some of the functions within FWC or, more fundamentally, by creating an entirely separate entity to undertake this role.

In the Productivity Commission's view, the first option, as outlined in the Draft Report, could be effective. An expansion in the role and functions of the Expert Panel (currently tasked with undertaking the annual wage review and review of default superannuation terms in modern awards), or establishment of a Minimum Standards Division within FWC, would have a number of benefits. First, it would minimise disruption and transitional costs

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and allow for a continuation of information and knowledge flows across areas within the FWC. Furthermore, it would result in the appointment of more members to the FWC with backgrounds outside of industrial advocacy or the law. A higher profile for the type of work presently undertaken by the Expert Panel may also occur, as befits its role in considering matters of significant economic importance. A further benefit may be the opportunity that such new expertise brings in informing other areas of the FWC's work.

The alternative - to create a distinct entity, the Workplace Standards Commission (WSC), to perform this work – would allow for more rapid culture change away from the form-over-process legalism observed and be more consistent with the role of being the largest price-setting entity in the Australian economy. Appointees to the WSC would not have the status of judges, making both recruitment and culture change simpler. The WSC could be given a defined mandate in support of reform and would have independent governance.

In undertaking its work, it would not be beholden to any other organisational needs or decisions that would attach to it were it to stay within the FWC. Separation would also signal to stakeholders that those matters of national significance would be determined in future more by objective evidence and analysis, and less by precedent, taking into account the national interest, and without giving predominant weight to the interests of the parties participating in the review.

While there is obviously some historical precedent here in the short-lived Fair Pay Commission, the Productivity Commission is not proposing a return to the past. Clear differences would arise through appointments to the WSC being made using a broader-based model, involving consultation with all state and territory governments (as discussed below). Its role would be wider than the Minimum Wage process, but it would retain the existing Expert Panel structure for that purpose; and extend it to deal with further award reform.

Culturally, the WSC would investigate, not adjudicate. The WSC would also be a potentially larger body, with greater resourcing than that which was provided to the Fair Pay Commission. And it could be given an explicit mandate towards transparency of analysis prior to hearings and decisions.

Regardless of which option is chosen, better governance practices of the type delivered by such change are essential for the consideration of economically important matters developed in a politically sensitive and highly technical area. Maintenance of the status quo would not be consistent with the obligation in this inquiry's terms of reference, to consider models that assist in meeting the future challenges of the WR system.

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#### RECOMMENDATION 3.1

The Australian Government should establish new institutional arrangements for the regulation of minimum wages and modern awards.

- It should create a statutorily independent Workplace Standards Commission with responsibility for reviewing and varying the national minimum wage and modern awards (including the making of equal remuneration orders).
- As a less preferred alternative, the Australian Government should establish the wage regulator as a Minimum Standards Division within the Fair Work Commission. While this alternative may also work, it would offer more limited scope for early cultural change. Such a division should be established in statute and have clear statutory duties.

Other functions within the workplace relations system should continue to be performed by the Fair Work Commission and the Fair Work Ombudsman in accordance with current arrangements.

### **Changing appointment processes at FWC**

Claims of ‘stacked’ appointments in the workplace tribunal have a long history in Australia, essentially dating back to inception (box 3.6).

The possibility of inconsistencies in unfair dismissal decisions is discussed in chapter 17 (unfair dismissal). The research found evidence of outcomes at the margin, which depended on the workplace background of commissioners involved (Booth and Freyens 2014). This is supported by earlier research finding that at ‘pinch points’ in decision making, the past professional history of decision makers can be a significant predictor of outcomes (Southey and Fry 2012).

Several submissions discussed this issue at some length. Stewart et al. (sub. 118) stated that the present composition of Commission members is not unbalanced and, in support of their view, presented a breakdown of current appointees by background (figure 3.4). The figure nevertheless shows that successive governments favour certain backgrounds over others, and that there are very few members who are not drawn from employer or employee groups.

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### Box 3.6 Allegations of tribunal stacking – a brief history

Allegations of stacking regarding the selection of tribunal members date back to the appointment of Justice Higgins in 1907 (Southey and Fry 2012). The following is a selection of past quotes on this topic.

The federal government must take much of the blame for the Commission's current problems. For some years now its appointments to the Commission have been biased in favour of the trade union movement, thus destroying the balance which had previously been so important in maintaining the Commission's credibility. (The Sydney Morning Herald 1994, p. 6)

The unions claimed Mr Reith had breached a longstanding political tradition of making balanced appointments to the Commission. They also claim he broke convention by failing to discuss the appointments with the trade union movement. (Shaw 2001)

The Government had stacked the AIRC to shore up its conservative workplace agendas and to suit its political purposes. They are trying to destroy the independent umpire and undermine bipartisanship and political neutrality in industrial relations. (Sharon Burrow, reported in Robinson 2001)

Kelty claimed that the National Wage cases were 'rigged' to favour employers. Kelty referred here to the role of the President in composing the bench for such cases. By his reckoning, there were fifteen members with employer backgrounds, seventeen with union backgrounds and thirteen 'independents', yet he found that those with employer backgrounds made up a majority of the bench in nearly half of the National Wage Cases. (Macintyre 2004, p. 94)

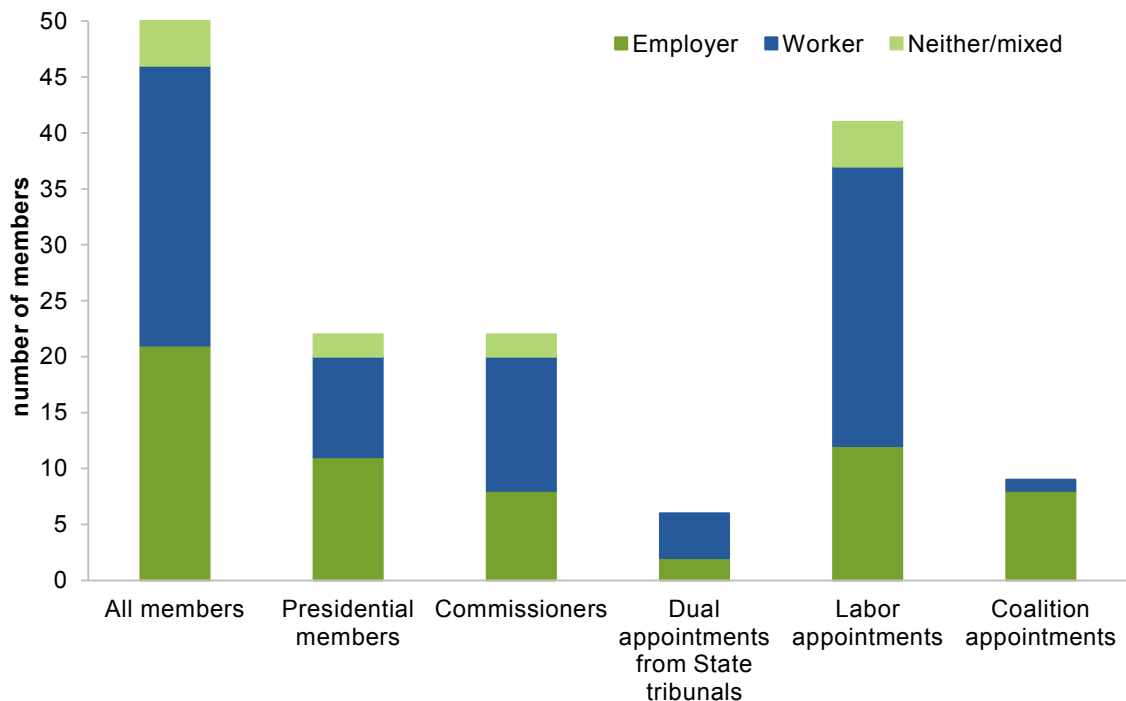
When Howard was in power, the ACTU strongly criticised the Coalition Government of political and employer bias in appointments to the Australian Industrial Relations Commission. It would seem the lessons of the past have not been learnt by this Labor government ... Let's hope that the future IR policy is not based on the whim of self-interest and a truly stable, independent and transparent FWA becomes the norm for Australia's interests. (Gollan 2013)

Some aspects of Booth and Freyen's research were questioned in submissions responding to the Commission's Draft Report. For example, Stewart et al. (sub. DR271, p. 5) argued that:

Even accepting the results, however, they reveal at most a slight propensity to come down on one side or other in what can often be the most difficult type of decision that an industrial arbitrator can face.

But even if the average direction of inconsistencies was zero, many decisions are made by a single member, which means that there will be inconsistencies in decisions across members. Further, the possibility of full bench or further Court appeal of such decisions, as noted by Justice Iain Ross (sub. DR357, p. 5), while providing some subsequent review, is cold comfort for many parties given the additional cost and time involved. The ideal would be that parties coming to the FWC would be indifferent to who was assigned their case.

Figure 3.4 **Pre-appointment background of FWC members as at March 2015<sup>a</sup>**



<sup>a</sup> All figures exclude part-time appointments to Expert Panel only.

Source: Andrew Stewart et al. sub. 118, p. 14.

## Appointment durations

As discussed earlier, several participants argued that the very long possible appointment periods for commissioners (until the age of 65 years) entrenched problems, and were not consistent with current practice in other key public institutions.

A number of current commissioners have had long running appointments. Data on existing members suggests that the average duration of appointments for the Commission's 41 primary appointments is 9.62 years, and the mode is 13.76 years (Justice Iain Ross, sub. DR357, p. 26)<sup>22</sup>. Given that most existing members can be expected to continue to serve for some time, it suggests that the average duration of tenures at the FWC will be considerably longer.

There are several tradeoffs in determining appropriate appointment lengths. Longer appointments allow the development of expertise and knowledge across the broad swathe

<sup>22</sup> This includes appointment within predecessors of FWC.

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of matters considered by the FWC. Tenure for judicial appointments is also intended to remove the risk of influence regarding reappointments. On the other hand, excessively long tenures must, by definition, limit the inflow of members with different perspectives and expertise. In addition, in practice, it is hard to dismiss an underperforming member (and there is no organisation that is free of the risk of some underperformance). Limited tenures provide at least a vehicle for addressing this (albeit rather slowly).

Long tenures may reduce the momentum for moving away from an overly legalistic approach however, as argued by several participants above, it may also safeguard the independence of decision makers.

A balanced solution would be the introduction of a system of ten year appointments for new Members, or until the age of 70, whichever comes first. This proposed approach would provide for terms of long enough duration for the development of skills and knowledge, and for decision making which does not occur with an eye to possible reappointment, while also providing limits to ensure greater accountability and to provide options for other talented people to become commissioners.

Similar appointment arrangements should also apply with regard to the proposed Workplace Standards Commission.

#### RECOMMENDATION 3.2

The Australian Government should amend s. 629 of the *Fair Work Act 2009* (Cth) to stipulate that the President, a Vice President, a Deputy President or a Commissioner of the Fair Work Commission, and the appointees of the proposed Workplace Standards Commission hold office until the earliest of the following:

- he or she reaches the tenth anniversary of their appointment;
- he or she attains the age of 70;
- he or she resigns or the appointment is terminated.

### Appointment processes

At present, appointments of Members of the FWC are made by the Governor General in Council on the recommendation of the Australian Government of the day (Justice Iain Ross, sub. 171, p. 8). Opening up this process to provide for a far broader range of skills, greater input from state and territory jurisdictions and a more balanced, less partisan representation seems highly desirable in the light of:

- the very significant shift of activity from collective to individual dispute resolution in recent years
- some apparent bias issues connected to appointment processes by Governments



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- the existence of a wide range of skills that are not represented on the Commission (for example, professional dispute resolution practitioners)
  - the likely future development of the FWC under the recommendations of this inquiry, in particular the greater use of research and analysis to arrive at decisions rather than persisting with an historical reliance on form and on precedent.

Drawing on features from appointment models such as those currently in use to determine membership of the ACCC (box 3.7) and, in New South Wales, the Statutory and Other Offices Remuneration Tribunal (SOORT), would be one way to achieve such improvements. In the case of ACCC appointments, where the input of multiple jurisdictions is a key consideration, this model has, over time, proven to be a successful way to obtain such input in regard to appointments. While not involving multiple jurisdictions, the SOORT model nevertheless also contains other features worthy of emulation. There are three members of the SOORT — a Chairman and two assessors, or Directors. All are appointed by the Governor-in-Council, on the recommendation of the Premier, and candidates are drawn from a shortlist of persons from across a wide spectrum. Traditionally, the NSW Public Service Commissioner has put together a shortlist of candidates for consideration by the Premier. The SOORT model has worked successfully for many years and across numerous governments of various political hue.

### **Box 3.7 Appointments to the ACCC**

The 1995 Conduct Code Agreement sets out the following process for ACCC appointments:

4 (1) When the Commonwealth proposes that a vacancy in the office of Chairperson, Deputy Chairperson, member or associate member of the Commission be filled, it will send written notice to the Parties that are fully-participating jurisdictions inviting suggestions as to suitable persons to fill the vacancy. The Commonwealth will allow those Parties a period of thirty five days from the date on which the notice was sent to make suggestions before sending a notice of the type referred to in subclause (2) or (3).

(2) The Commonwealth will send to the Parties that are fully-participating jurisdictions written notice of persons whom it desires to put forward to the Governor-General for appointment as Chairperson, Deputy Chairperson or member of the Commission.

(3) The Commonwealth will send to the Parties that are fully-participating jurisdictions written notice of persons whom it desires to put forward to the Commonwealth Minister for appointment as associate members of the Commission.

(4) Within thirty five days from the date on which the Commonwealth sends a notice of the type referred to in subclause (2) or (3), the Party to whom the Commonwealth sends a notice will notify the Commonwealth Minister in writing as to whether the Party supports the proposed appointment. If the Party does not notify the Commonwealth Minister in writing within that period, the Party will be taken to support the proposed appointment.

(5) The Commonwealth will not put forward to the Governor-General a person for appointment as a Chairperson, Deputy Chairperson or member of the Commission unless a majority of the fully-participating jurisdictions support, or pursuant to this clause are taken to support, the appointment.

(6) The Commonwealth will not put forward to the Commonwealth Minister a person for appointment as an associate member of the Commission unless a majority of the fully-participating jurisdictions support, or pursuant to this clause are taken to support, the appointment.

*Source:* National Competition Council (1995).

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Drawing on such models, the Productivity Commission's recommended approach would involve the following main features:

- All Australian governments would be consulted in jointly determining the members of an expert appointment panel, which would advertise positions, independently assess candidates on their merit and make recommendations on the appointments of FWC Members and Workplace Standards Commission appointees.
- The relevant Australian Government Minister would then choose appointees from the shortlist for a fixed tenure. Both the panel and the relevant minister would need to be satisfied that the person would be widely seen as having an unbiased and credible framework for reaching conclusions and determinations.
- The selection processes for appointees would stipulate that prospective applicants may include those with a broad experience, and be drawn from a range of professions.
- Written guidelines on conflicts of interest specific to the task are also highly desirable.

The above model would reduce the risks of partisan appointments, while giving state and territory governments a bigger say in a system that regulates most of the employees in their jurisdictions. In retrospect, it is surprising that in referring their IR powers, the states and territories sought no role in the governance arrangements.

This proposed approach was supported by a range of stakeholders. For example, the Centre for Employment and Labour Relations Law (sub. DR313, p. 1) said:

We believe the proposal for an independent expert appointment panel may have merit and deserves further attention, despite the practical problems associated with constituting a panel that is truly independent.

A panel system for appointments was also supported by VECCI (sub. DR339, p. 23); the Business Council of Australia (sub. DR337, p. 15); and Chamber of Commerce and Industry of Western Australia (sub. DR323, p. 7).

This system would, over time, lead to greater transparency and the capacity to use an expert panel to make appointments without fear or favour. The fact that a considerable number of current FWC members are reaching the end of their terms will also provide a window for appointing a number of members to that organisation.

While the above measures should reduce the risk of partisan decisions, the Productivity Commission is aware that no appointment process will be perfect (as also discussed by Andrew Stewart et. al., sub. DR271, p. 4). The goal is the more realistic one of reducing imperfection, rather than achieving perfection.

The Productivity Commission's institutional reform is not aimed at any given member, and does not repudiate the notion that the executive should have limited capacity to dismiss a member except under the circumstances typically applicable to tribunals (O'Connor 2013). Equally, the usual underpinning requirements for independence — security of remuneration, security of tenure for the designated legislated period, and control over the

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arrangements of the listing and case allocation — should all be preserved (O’Connor 2013, p. 74).

As mentioned above, the Productivity Commission’s proposed panel would also consider appointments to the separate Workplace Standards Commission, were this to be established, or to an expanded Division within FWC. Members of the WSC or relevant division should have well developed analytical capabilities and experience in economics, social science, commerce or equivalent disciplines. While the desired skill set for such appointments will differ from those required for FWC Members, the bi-partisan and consultative nature of the proposed appointments panel processes are required.

#### RECOMMENDATION 3.3

The Australian Government should amend the *Fair Work Act 2009* (Cth) to change the appointment processes for Members of the Fair Work Commission. The amendments would stipulate that:

- an independent expert appointment panel should be established by the Australian Government and state and territory governments
- the panel should make a shortlist of suitable candidates for Members for the Fair Work Commission
- the Commonwealth Minister for Employment should select Members of the Fair Work Commission from the panel’s shortlist, with appointments then made by the Governor General.

The panel should also be charged with recommending individuals for appointment to the Workplace Standards Commission.

In making appointments to the panel, governments should avoid appointing people who, in the last ten years, have had professional experience displaying a significant involvement representing employees and employers in courts and tribunals, or active participation in public debates regarding workplace relations policy.

Appointments to the panel should be for a period of no longer than seven years.

## Mechanisms for performance review

A further reform proposed by some stakeholders with regard to FWC Members was the introduction of greater oversight and more capacity to direct how members perform certain functions, by the President of the FWC and/or by an external body established for this purpose. For example, Toll Holdings (sub. DR312, p. 20) contended:

... there is room for greater oversight of member performance by the President. There should reasonably be standards set by the President to which all members should be held, and a breach of those standards should be subject of sanction including termination of the appointment in serious circumstances.

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Along similar lines, Andrew Stewart et al. (sub. DR271, p. 6) proposed a strengthening of the powers of the FWC President, but also suggested a second proposal:

... to create an independent mechanism to deal with complaints of misconduct or inadequate performance against FWC members ... An independent body could be tasked with the process of receiving and investigating complaints against FWC members, with the power to either dismiss them, refer those that appear to have substance to the President for further consideration, or in more serious cases that might warrant removal from office, prepare a report for Parliament. For the less serious cases, the President should be expressly empowered to do more than just ‘temporarily restrict’ the relevant member’s duties (see FW Act s. 581A(1)(b)), but to issue private or public reprimands.

The Productivity Commission is of the view that mechanisms of this type, subject to adequate safeguards, would improve matters with regard to Member performance and conduct. Some caution would need to be exercised in providing substantially extended powers to the President alone, but the present situation is untenable.

The addition of an external review process would provide some much needed balance in regard to performance review. As discussed in the Productivity Commissions recent report on access to justice (PC 2014a, p. 438), and also by Andrew Stewart et al. (sub. DR271, p. 6), design and location of any complaint and review mechanism of this type would need to be carefully considered, and would benefit greatly from delineation, ex-ante, of a set of best practice principles similar to those provided in the access to justice report. This could include designation of a complaints handling body separate from FWC and transparent standards of conduct and performance that are public and clear.

#### RECOMMENDATION 3.4

The Australian Government should amend the *Fair Work Act 2009* (Cth) to strengthen the Fair Work Commission President’s existing capacity to direct the work of the Fair Work Commission to set standards for its performance, and to oblige members to cooperate in seeking to meet the standards set by the President and the Fair Work Commission’s Member Code of Conduct.

#### RECOMMENDATION 3.5

The Australian Government should amend the *Fair Work Act 2009* (Cth) to allow for greater external scrutiny of the performance and conduct of Fair Work Commission Members. The establishment of a judicial review function for these purposes would provide for greater external oversight of Members and complement the proposed changes in powers of the Fair Work Commission President to direct Members and set standards for their performance.

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## A need for an enhanced appeals mechanism?

A related issue raised by several stakeholders regarding FWC decision making is the extent to which review and appeal of decisions is effective under current arrangements.

Appeals are presently dealt with by the FWC through the appeals full bench system and the Federal Court (table 3.2). As pointed out by Justice Iain Ross (sub. DR357, p. 5), only a small proportion of matters considered by the FWC are appealed in practice.

The rate of the appeals upheld is relatively high in some categories. This may reflect the need to establish, through the examination of cases, clear benchmarks, or inconsistencies or errors in treatment.

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**Table 3.2 Outcomes of appeals determined by FWC**

1 July 2014 to 30 June 2015

<i>Matter type</i>	<i>Appeals upheld</i>	<i>Appeals dismissed</i>	<i>Total appeals determined</i>	<i>Percentage upheld</i>
Unfair dismissals	32	102	134	24
Agreement approvals	8	11	19	
s. 739 disputes	11	22	33	42
Industrial action	1	5	6	17
Modern awards	1	0	1	100
Bargaining disputes	3	5	8	37
Right of entry	4	5	9	44
Miscellaneous	6	18	24	25
<b>Total</b>	<b>66</b>	<b>168</b>	<b>234</b>	<b>28</b>

*Source:* Fair Work Commission (2015c, p. 80).

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There have been some calls for the introduction of a dedicated appeals section, either as a separate area or entity within the FWC, or as a body independent from the FWC. In a submission to this inquiry ACCI (sub. 161, p. 148) argued that such a mechanism would:

... increase the capacity for parties and practitioners to anticipate likely decisions, which in turns helps inform management and litigation strategies. Certainty also serves to reduce the amount of litigation.

Subject to the implementation of the other proposed reforms in this chapter and other chapters, such a reform is not merited. There is a balance to be struck in this area between adequate oversight of, and transparency in, decision making, and the need to guarantee the independence of the FWC and the efficiency of its processes. The proposed mechanisms for oversight of Commissioner performance mentioned previously, together with greater transparency regarding conciliation and arbitration processes and outcomes, will go a large

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way towards solving the problems that those proposing a separate appeals mechanism are aiming to address.

## **Improving conciliation processes and transparency**

There is a need for greater transparency in, and internal and external analysis of, the FWC's conciliation processes.<sup>23</sup> This is particularly the case given that conciliation is becoming a more frequently used method for solving matters at the FWC. An imbalance currently exists between what occurs in conciliations and what is reported. The FWC should be more active in providing information both about the processes it uses for conciliation in various contexts, and on the aggregate outcomes of such conciliations.

The current information published by the FWC regarding unfair dismissal conciliation clearances, settlement amounts, and views on outcomes is useful. But there are good grounds for implementing further reporting of the conciliation process and of outcomes (whilst also acknowledging some limits on this possibility given the more private nature of conciliation processes). The commissioning of an independent performance review of this part of the FWC's operations may also be valuable, along the lines of the recent review of the FWO's performance completed by the Centre for Employment and Labour Relations Law (Howe, Hardy and Cooney 2014). This would provide more information about the use of conciliation at the FWC, provide an evidence base for further refinement in this area, and, potentially, allay some concerns about the ways in which conciliation is used at present. Consideration of the possible use of pre-claim conciliation as an additional approach could also be a point of focus for such a review.

The FWC should also publish more detailed information regarding conciliation outcomes and settlements. This should include information to a level of detail that is equivalent to that currently published in regard to unfair dismissal conciliations.

### **RECOMMENDATION 3.6**

The Australian Government should require the Fair Work Commission to publish more detailed information about conciliation outcomes and processes. In the medium term, it should also commission an independent performance review of the Fair Work Commission's conciliation processes, and the outcomes that result from these processes.

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<sup>23</sup> Recent publications, such as Fair Work Commission (2015i) and Inca Consulting (2015b), provide some much needed further detail.

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## Outreach and research activities

### FWC's workplace engagement strategy

As mentioned above, a somewhat recent development in the operations of the FWC has been a pilot outreach scheme involving FWC Members and members of some other state tribunals. The aim of this program is to assist businesses and employee representatives where there has been a long history of adversarial relationships and toxic workplace relations (resulting in costly industrial disputes). The goal of this activity has been to prevent disputes and create more productive relationships.

This activity is seen by its advocates as having a legislative basis via the recent addition of s576(2)(aa) in the FW Act, which provides FWC with a function to promote cooperative and productive workplace relations and prevent disputes. In this regard, Bray et al. (sub. DR272, p. 2) said:

It is this provision that gives the agency the function ... The FWC can now offer 'facilitation' services to an organisation at any stage in the workplace relations cycle, without risk of being accused of exceeding its powers. It does not need to wait for a dispute to be notified it under a dispute settlement procedure in an enterprise agreement or award, or during a bargaining round.

In the case studies presented to date on this approach, various triggers for FWC's involvement are noted. For example, Bray et al. (sub. DR272, p. 2) note that, while intervention to assist Sydney Water was triggered by an enterprise bargaining dispute, involvement in an intervention involving Orora 'arose from high-level discussion as to how the FWC could assist the company to turn its fortunes around'. The FWC involvement has been with the agreement of both parties.

FWC has signalled its intention to conduct a further pilot of this so-called *New Approaches* model across 2015 and 2016, and that it will evaluate the project prior to an expanded roll out. (Justice Iain Ross, sub. DR357, p. 16)

Initial outcomes suggest that the program has been relatively successful. Nevertheless, applying this approach at the economywide level would appear to have several major limitations:

- It is likely to be costly.
- It may involve conflicts of interest as it means that tribunal members become active parties in the bargaining process, rather than disinterested parties exercising a (hopefully vestigial) ex post role. Even when a member involved recuses themselves from a matter at a later stage in the EA approval (or dispute) process, their earlier involvement could influence, or be perceived as influencing, the outcome.
- It may discourage innovation as the opinion of the Commissioner is given weight in scoping negotiations.

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- Parties may actively seek assistance from the FWC as a strategic part of their bargaining.
  - It may crowd out private mediation.
  - Over time could see the FWC playing a larger role in what ideally should be left to bargaining representatives.

FWC's proposal for a thorough evaluation of this pilot has merit, and would benefit from being conducted by an external reviewer with the ability to consult widely with relevant stakeholders. Such a review would, by necessity, focus on the balance between benefits accruing from the activity and some of the possible limitations, such as those outlined above. Further consideration of a possible alternative role for private conciliators in bargaining matters would also merit consideration.

#### RECOMMENDATION 3.7

The Australian Government should commission an external review of the Fair Work Commission's *New Approaches* activity, at the end of the current pilot program. The review should consult widely and consider alternatives, such as the involvement of private conciliators in overcoming obstacles to better agreement making and averting prospective bargaining disputes.

## Research at FWC

Research activities undertaken by the FWC are discussed above and in the relevant chapters, including chapter 4 (minimum wages), 7 (Role of awards) and 8 (repairing awards). More broadly, possible future directions for labour market research in Australia are discussed in chapter 31 (impacts) and appendix K (research agenda).

The recommended reforms proposed above and elsewhere in the report will, if implemented, have a considerable bearing on the size and nature of both FWC's research program, and research undertaken by any other workplace relations body (such as the proposed Workplace Standards Commission).

A key issue in such developments will be the governance of research. As a broad principle, the Productivity Commission sees the involvement of organisations representing employers and employees as being critical to the continued production of high quality research on workplace relations issues and on labour market issues more generally. Yet such involvement should, in most instances, be at arm's length from the actual *governance* of research. In this regard, the Productivity Commission sees the current approach within FWC, which accords an important advisory and guidance role to a research steering committee consisting in part of representatives of business and unions, as a less than ideal model.



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#### RECOMMENDATION 3.8

The Fair Work Commission and the proposed Workplace Standards Commission should ensure that the governance of its research activities gives consideration to the views of all parties, but does not include direct involvement by them in the selection of research topics or modes of research.

### **Right of entry and the investigation role of unions**

Employee representatives (such as union officials) granted an entry permit by the FWC have the right to enter workplaces to investigate suspected contraventions of the FW Act, where these relate to a member of their organisation. Entry permit holders are also empowered to inspect workplaces for compliance with state and territory work health and safety (WHS) laws.

These rights of entry for investigative purposes mean that union officials occupy dual roles within the WR framework, both representing employees, as well as ensuring compliance with relevant employment and WHS laws. This latter role is also performed by government agencies, such as the FWO and state and territory WHS regulators.

Historically, unions have played an important role in the compliance and enforcement of labour and safety standards (Maconachie and Goodwin 2009). However, as the WR system has matured and the resourcing of workplace safety and standards has increased (over historical norms) it is reasonable to ask whether it is appropriate for private parties to be exercising the role of a public interest investigator, normally the responsibility of a government agency. There are arguments both for and against having employee representatives contribute to a compliance role already being undertaken by a government agency:

- On the one hand, by investigating workplaces where their members are employed, union officials are acting in the interests of their members to ensure that they are receiving the working conditions and safety standards they are entitled to. By having an ongoing relationship with members within a workplace, union officials may also be better placed than a government inspector to be informed of any potential breaches of workplace laws. If unions are willing to bear these investigation costs (for example, the salaries of union officials) instead of a government agency, to some extent they are subsidising the enforcement of laws and standards to the benefit of the wider community, as well as their members. Further, consigning enforcement duties entirely to government agencies runs the risk that governments, for example for fiscal reasons, may not be inclined to provide these agencies with the resourcing and powers required to adequately enforce workplace laws in the absence of union enforcement.
- On the other hand, it is unrealistic to expect a union representative, who has the primary duty of representing members' interests, to always act in the public interest.

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And the decline in union coverage (see below) also means less and less reliance can be placed on unions. Entry to investigate a workplace can impose costs on the employer, too, through disruptions and administrative costs, and thus may be used strategically as leverage in an industrial dispute (chapter 19). Even where entry rights are exercised with restraint, the enforcement role of unions may be a source of resentment in their relationships with employers. To the extent that the outcomes lead to excessive bargaining power, this is not only inimical to the interests of employers, but also the community as a whole.

The WR framework attempts to reconcile the conflict of interest between unions' industrial objectives and their investigative role by placing some conditions on rights of entry. For example, unions are currently required to provide employers with 24 hours' notice before entering a workplace to investigate a suspected breach. This notice requirement is aimed at minimising the disruption to employers, in effect reducing the ability to use inspections as a tool for leverage. However, the ACTU (sub. 167, p. 338) has argued that this can also alert an offending employer in advance, giving them the opportunity to alter, destroy or conceal evidence of breaches, effectively defeating the very purpose of the entry and investigation power.

Such conflicting arrangements will be inevitable in a WR system that affords 'quasi-regulatory' powers to parties that the system also recognises as having other potentially inconsistent objectives to pursue. By contrast, government agents, such as Fair Work inspectors or state workplace safety officers, do not have a bargaining agenda within a workplace. As such, they are not bound by the same restrictions and notice requirements as employee representatives.

The Productivity Commission has recommended that the FWC have greater scope to resolve disputes over the frequency of union entry for discussion purposes, to reduce the use of entries for strategic purposes in industrial or demarcation disputes (chapter 28). However, these changes would not affect the powers of unions to conduct bona fide investigations of workplaces, nor preclude a union from lodging complaints or from taking other steps consistent with their charter to support workers placed in unsafe circumstances. If an employee representative suspects that an employer is breaching the FW Act or relevant WHS regulations following a discussion with their members, they should (and already do) refer the grounds for their suspicion to the FWO or the relevant work safety authority.

Nonetheless, persistently declining rates of trade union membership in recent decades (ABS 2013a) mean that the prominence of unions within workplaces is likely to diminish into the future. This may require the FWO to expand its enforcement role — and would require commensurate funding commitments by the Australian Government — to adequately counteract any resulting loss of union contributions to enforcement.

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The Productivity Commission has also recommended in chapter 29 that the Australian Government should provide the Fair Work Ombudsman with greater resources to carry out its investigation and enforcement functions in relation to exploitation of migrant employees (recommendation 29.2). There are complementarities between these two strengthened compliance and enforcement requirements, so that the cumulative resourcing needed will be less than that what might be apparent for either alone.



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## 4 Minimum wages

### Key Points

- Australia's national minimum wage is high by international standards. It has risen in real terms over the last decade, although its growth rate has been constrained to reduce its 'bite' (the minimum wage as a share of median wages).
- There is an economic rationale for a regulated minimum wage that lifts the incomes of low-paid workers above the levels they would otherwise receive, to counter the effects of imbalances in bargaining power and other market distortions.
- There are also equity arguments, although some have raised concerns that minimum wages are not targeted towards low-income groups and, if set too high, can adversely affect employment and even worsen inequality. A threshold question is the degree to which the wages system should be used for handling equity issues.
- At present, it is not possible to pinpoint the impacts of minimum wages on employment. Economic theory and some international empirical studies suggest that increases in minimum wages can reduce jobs and hours worked, but they also indicate that employment gains are possible in some circumstances. There have been few clear-cut wage 'experiments' in Australia and many studies are dated and/or have data and methodological limitations. The indirect evidence is also not clear-cut.
- While not definitive, the Productivity Commission's assessment is that modest increases in Australia's minimum wage are unlikely to measurably affect employment, but that large increases in minimum wages would reduce employment. How, and at what rate, such effects manifest will vary depending on economic conditions and other policy settings.
- The benefits of minimum wage adjustments are spread throughout the income distribution, but favour middle income households. People in lower-income households benefit less, although for some people on lower incomes, the minimum wage is an important component of their total income.
- The wage regulator should systematically consider the risks of variations in economic circumstances on employment and on the living standards of the low-paid. To safeguard and expand job opportunities, it should moderate the growth in minimum wages whenever the employment outlook is weakening. In improved circumstances, minimum wages could rise at a faster pace.
- There are complementary measures that could supplement the pay of low-wage workers without putting pressure on employment, although these have their own costs and limitations.

Minimum wages are a persistent source of controversy. While the need for a national minimum wage is widely accepted in Australia, employer groups, unions and governments regularly disagree about its appropriate level. There are also ongoing disputes among economists about how minimum wages affect employment and poverty, and there has been

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debate about proposals (such as the ‘five economists’ plan in Australia — chapter 6) that would rely less on the minimum wage to achieve society’s equity objectives.

These debates have many angles and nuances.

- Some see strong minimum wages as a key means of making society fairer and more equitable, by helping to prevent worker exploitation, placing a floor under the incomes of the low-paid and thereby safeguarding or lifting their living standards. Proponents of higher minimum wages contend that they enhance the wellbeing of the low-paid without having any significant impact on employment or economic activity. Indeed, some researchers claim strong minimum wages, by counteracting the effects of employers’ stronger bargaining power and other ‘market failures’, can make the labour market more efficient, with benefits for the economy more broadly.
- Others consider that strong minimum wages do in fact price some people (including some of the more disadvantaged) out of jobs and actually worsen equity, disadvantage labour-intensive industries with a high share of lower paid employees, and reduce overall economic activity. Some proponents of lower minimum wages point to complementary policies, such as wage subsidies, measures to raise skills or tax credits for low-paid workers, that they believe could more effectively meet society’s equity goals while avoiding adverse effects on employment, business and economic activity.

Which viewpoints are most valid turns on several empirical matters, as well as value judgments about what weight should be given to the welfare of those who benefit from minimum wages as compared with those who lose, including any people they exclude from employment. These viewpoints also invoke a larger question: to what extent are concerns about equity best addressed through the wage setting system, which assists only people in jobs while placing a direct cost on employment, rather than through more dedicated and generally applicable mechanisms such as the taxation and social security systems?

This is a complex area, and the empirical issues as well as the value judgments are often contested. Public debate about minimum wages sometimes can also be clouded by claims that appear to be based more on conviction than on careful consideration of evidence, argument and current and evolving circumstances.

The Productivity Commission’s task through this inquiry has been to sort through these matters transparently and objectively, and to determine their implications for minimum wages in Australia and how they should be set in future. To provide background for the analysis, this chapter starts by outlining the origins of Australia’s national minimum wage, the institutional arrangements that govern it today, trends in its level over recent years and how it compares internationally (section 4.1). Subsequent sections then examine: how minimum wages affect employment (section 4.2); their impact on workers’ incomes and living standards, and the distribution of household income (section 4.3); and future directions for minimum wages policy (section 4.4). Chapter 5 examines some related matters, including youth and training wages and whether minimum wages should vary geographically, while chapter 6 looks at measures that could complement minimum wages, such as earned income tax credits and wage subsidies.

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## 4.1 Australia's minimum wages

Minimum wages have been part of Australia's workplace relations (WR) system for more than a century, although the institutional arrangements for setting them, the rationale for their level, and the coverage of the national minimum wage have varied and evolved during this period (box 4.1).

### Box 4.1 Evolution of the national minimum wage

Colonial Australia alongside New Zealand was the birthplace of minimum wage regulation. Following a campaign by the Victorian Anti-Sweating League to eliminate harsh and exploitative employment conditions, from 1896 the Victorian Government established several Wage Boards, comprising employers and workers, to determine minimum wages and piece rates for selected industries. Minimum wage regulation soon followed in other colonies/states of Australia.

A national minimum wage was effectively introduced with the Harvester 'basic wage' judgment of 1907, and was set at a level deemed sufficient to ensure that a male breadwinner's income could meet the reasonable needs of a family household (a man, his wife and their three children). Since then, women's social and economic roles have changed dramatically, family structures have evolved and the social welfare safety net has widened. Minimum wage provisions have partly adapted to these changes, most notably with the decision in the mid-1970s to require a common rate for males and females. At this time the Commonwealth Conciliation and Arbitration Commission declared that it was not a social welfare agency and that 'the care of family needs is principally a task for governments' (Bray 2013a, p. 16).

The national minimum wage has not always been the (near) universal minimum it is today. For much of the 20th century, most workers' pay was governed by state-based systems. With an increasingly centralised WR system, Western Australia is now the only state that has an independently-determined minimum wage, which applies to relevant employees of unincorporated enterprises (WAIRC 2014).

In addition, whereas aboriginal stockmen were initially excluded from coverage, and women were paid only a share of the rate, these groups have been entitled to the full minimum wage, since 1966 and 1975 respectively.

The real weekly value of the national minimum wage has increased substantially over the last century. For some of this period the value was indexed to inflation. At other times, it has been adjusted following ad hoc or annual 'living wage' or 'safety net' reviews by the Commonwealth Conciliation and Arbitration Commission and its successor bodies. In 2006 the Australian Fair Pay Commission was created as a specialist body to consider minimum wage adjustments. Since 2009-10, that role has been reintegrated into the main industrial tribunal — now, the Fair Work Commission (FWC) (box 4.2).

Source: Bray (2013a).

Today, an Expert Panel of the Fair Work Commission (FWC) sets the national minimum wage, and usually adjusts it each year following an annual review (box 4.2). The current national minimum wage rate is \$17.29 per hour for adults (or \$656.90 per week for a full-time employee). The FWC also makes annual adjustments to the rates of pay specified in modern awards, which mostly start at equal to or just above the national minimum. These minimums set a floor on the wage rates of most Australian workers, although there

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are lower rates for younger workers, apprentices and trainees, and some people with disabilities. However, the returns to labour of some important employment categories — independent contractors, working business operators and unpaid family members — are not influenced by the minimum wage and are entirely market-determined.

#### **Box 4.2 Annual wage reviews**

Under the *Fair Work Act 2009 (Cth)*, minimum wages for employees in the national employment system are adjusted each year following an annual wage review. The review is conducted by an Expert Panel that comprises four full-time FWC members and three part-time members, who must have expertise in workplace relations, economics, social policy and/or 'business, industry or commerce. During a review, the Panel draws on consultations and submissions from experts and interested parties, as well as commissioned research. It typically receives submissions from business groups, unions, community groups and the government of the day.

Based on the review, the Panel makes a 'national minimum wage order' which sets the base minimum wage applicable for employees not covered by awards or agreements. It also makes determinations for the rates of pay specified in modern awards. It normally lifts award minimums, as well as other (higher level) award pay rates, in unison with the national minimum wage.

In deliberating on minimum wage levels, the Panel is required (under s. 284 of the FW Act) to 'establish and maintain a safety net of fair minimum wages', taking into account:

- the performance and competitiveness of the national economy, including productivity, business competitiveness and viability, inflation and employment growth
- promoting social inclusion through increased workforce participation
- relative living standards and the needs of the low-paid
- the principle of equal remuneration for work of equal or comparable value
- providing a comprehensive range of fair minimum wages to junior employees, employees to whom training arrangements apply and employees with a disability.

In determining rates of pay to apply in awards, it must also consider the 'modern awards objective' (s. 134), which refers to a broader range of matters, although many are similar to those above. Some other matters include 'the need for bargaining', 'the need to provide additional remuneration for employees working overtime or unsocial, irregular or unpredictable hours', and 'the need to promote flexible modern work practices'. (The full modern awards objective is set out in chapter 7.)

There is no agreed estimate of the number of adult Australians paid at the hourly national minimum wage rate. Using a variety of surveys, one study reported that in 2010 and 2011 between 4.1 and 9.1 per cent of employees were paid below, at or close to the national minimum wage rate (Bray 2013a).<sup>24</sup> More recent estimates based on the ABS Survey of Employee Earning and Hours put the figure at around 7.2 per cent (section 4.3).

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<sup>24</sup> Some workers may be reported as receiving wages lower than the minimum wage because, for example, their reported hourly wages did not take account of salary sacrificing or because employers have not complied with the minimum wage obligations. The variations across surveys reflect sampling, measurement error and other methodological issues.



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While originating in Australasia, statutory minimum wages are now common among developed economies, with 27 of 34 OECD countries having minimum wages (OECD 2015a). Some OECD countries that do not have a *universal* minimum rate, including Finland, Denmark and Norway, still have disparate minimum rates covering many workers, with the rates determined on an industry or sectoral basis. Overall, the trajectory of international policy has been to establish universal minimum wages. For example, the German Government introduced a near-universal minimum wage in January 2015.

Australia's (adult) national minimum wage is high by international standards. In 2014, Australia had the third highest minimum wage rate among OECD countries (when measured on an hourly 'purchasing power parity' basis) (figure 4.1 and box 4.3). It also has a greater 'bite' — which in this report is measured as the minimum wage as a proportion of median wages or earnings — than in several other countries, notably the United States (figure 4.2).

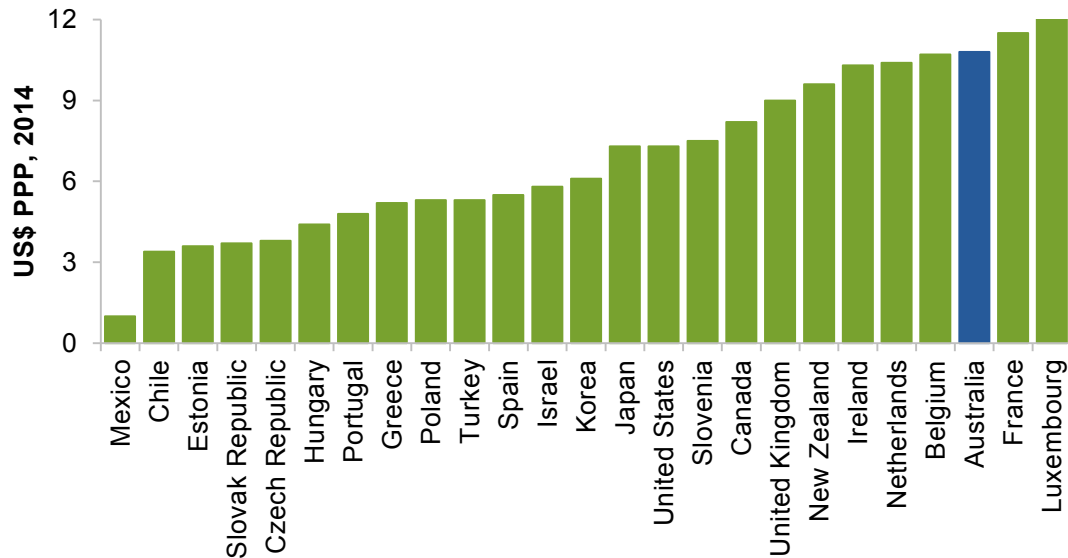
#### **Box 4.3 Comparing wages in different countries**

It is common to use the exchange-rate corrected values of adult minimum wages to measure the differences between minimum wages in different countries. Such comparisons may be misleading if exchange rates are volatile.

More problematically for comparisons of relative 'employment costs', they do not take account of differences in the extent to which minimum wages may affect the employment decisions of businesses. Factors like the relative productivity of the relevant employees, the tax/transfer system, and the industrial structure of the economies, may all have a bearing on this, and yet also vary significantly between countries. There is no straightforward measure that takes account of these differences, so some simple measures are often employed that escape the problems posed by exchange-rate corrected values, but still provide some guidance to the extent to which different countries' minimum wages are likely to have employment effects. The most commonly used measure is the ratio of minimum wages to median wages — the 'bite' (figure 4.2). The (reasonable) underlying premise is that there is a distribution of productivity levels between employees and that this affects the wage distribution. Of course, to the extent that one country is able to raise the productivity levels of its marginal employees (shifting the distribution of productivity among would-be employees), the effect of any given bite will be less. For that and other reasons, the bite is a useful guide only.

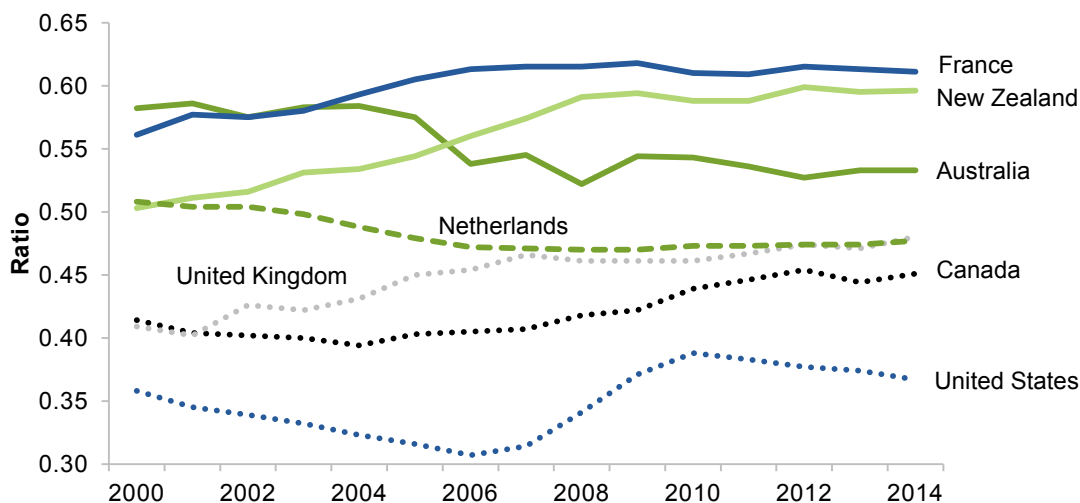
Exchange-rate adjusted wages also do not take into account differences between countries in the prices of consumer goods and services and so can exaggerate differences in the living standards in different countries. Adjusting wages or incomes on a 'purchasing power parity' (PPP) basis (figure 4.1) addresses this problem. Measured on a PPP basis, in 2014 Australia's minimum wage was US\$10.80 per hour (rather than US\$14.98 per hour as measured on an exchange-rate adjusted basis). By comparison, the minimum wage in the United States was US\$7.25 per hour. PPP-adjusted wages are relevant to international comparisons of wage earners' buying power, but do not necessarily have much relevance to the decision by businesses to employ people.

Figure 4.1 **Minimum wage rates in OECD countries**  
 \$US/hour PPP, 2014



Source: OECD Stat database.

Figure 4.2 **Changes in adult minimum to median wages for several OECD countries<sup>a</sup>**  
 2000–2014



<sup>a</sup> Based on adult national minimum wage to the median of full-time adult ordinary weekly cash earnings

Source: OECD Stat database.

However, the bite of Australia’s national minimum wage has declined significantly over time. Between 2004 and 2014, the bite fell from almost 60 per cent to less than 55 per cent

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(figure 4.2). This followed an earlier, more gradual, decline: Australia's minimum wage bite exceeded 65 per cent during the recession of the early 1990s. Data provided by Bray (sub. 32, DR261) show that the relative decline in the value of the minimum wage, evident in comparisons against median wages, has also occurred in comparison to other points in the wage range (and relative to growth in economywide productivity).<sup>25</sup>

The decline of the ratio of the minimum wage to median earnings in Australia mainly reflects strong growth in the latter. Median earnings increased by 12 per cent in real terms over the period 2004–2013. The minimum wage was also increased throughout this period (except in 2009), with its real value having grown 4 per cent by 2013.

## **4.2 What effect does the minimum wage have on employment?**

A key issue in debates about minimum wages is whether they have any effect on levels of employment and unemployment and, if so, in what direction. As Neumark (2014) has pointed out, were it found that the minimum wage had either no effect or a positive effect on employment, there would be a strong case for increasing it. On the other hand, if the minimum wage adversely affects employment, this would be a consideration in favour of constraining its growth or reducing it (albeit potentially in conjunction with the introduction of other measures for promoting equity).

The minimum wage is just one of many economic variables that can affect employment levels, and some of the others are likely to have more significant impacts. The level of aggregate demand and macroeconomic stability, and the workforce's levels of education, skills and experience, are likely to be particularly important. However, history suggests that there is no simple solution for achieving a low unemployment rate using these other levers. Any effects that changes in minimum wages have on hours worked, employment and unemployment thus remain particularly important in assessing appropriate minimum wage settings.

In assessing the effects, the Productivity Commission has drawn on a range of material, including economic theory, empirical studies from Australia and overseas, and other evidence and arguments provided in submissions.

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<sup>25</sup> 'Bite' is not the only relevant measure of the effects of minimum wages on employers, especially if the productivity of middle-earning employees exceeds that of low-skill, low-paid employees. In that context, another useful indicator of the possible pressures of minimum wages on businesses is the ratio of the minimum wage to product prices (although, in contrast to the bite, this will tend to overestimate such pressures.) Bray (2013a) reported that the national minimum wage grew slowly in real CPI-adjusted terms since the late 1970s, and the Productivity Commission has confirmed that this was also true when deflated by producer prices (based on FWC annual wage review and ABS National Accounts data).

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## Economic theory paints a complex picture

The economic literature on the employment effects of minimum wages does not provide a simple and universal answer. Some strands of theory suggest that imposing (or lifting) minimum wages could adversely affect employment levels, while others point in the opposite direction. The theory also covers a range of conditions in which these different outcomes might be more likely. Together with the varied results of empirical studies (discussed later), this suggests that effects of changes in minimum wages can be contingent on circumstances specific to them.

The literature is complex and covers many detailed matters, side-issues and possible exceptions to broader propositions. This section provides a general guide to matters of most relevance for the Productivity Commission's assessment.

### Characterising the role of wages in employment decisions<sup>26</sup>

The demand for labour depends largely on demand for business' output. To maximise profits, businesses would use more labour only if the extra expected revenue were to exceed the additional costs entailed. Businesses also need to determine the mix of factor inputs (different labour types, capital inputs, energy and intermediate inputs), given their relative costs.

From a business's perspective, wages paid are typically the key cost of employing labour (as well as a means of attracting and motivating people of different skill levels to work in the business). Businesses incur other employment costs, such as workers compensation premiums, provision for leave, superannuation and payroll taxes (many of which relate to the wage rate). There are also additional costs in hiring new staff, including the costs of recruitment and any initial training. Given these fixed hiring costs, employers requiring additional labour often increase the hours of work of existing staff (and vice versa). However, when existing staff are fully utilised, firms must engage new employees to increase output. In that instance, the costs of hiring, wage rates and on-costs are decisive factors in deciding how much (or whether) a business expands its workforce.

For employees, wages are often the main 'return' from working, such that an increase in wages induces more people to enter the labour force to seek work (and vice versa). People's decisions about whether to take a job, which job to take, and how many hours to work depend partly on the relative attractiveness of their net (post-tax) wages and the

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<sup>26</sup> This is a simplified characterisation of real world behaviour. For example, businesses have imperfect information about the performance of new employees, the nature of product demand, future technologies and prices. Employers may accordingly use heuristics and judgment when making employment decisions. That, and the fact that increasing output may require sudden discrete changes in inputs (buying half a milling machine is not feasible), means that for any given business, changes in labour demand associated with wage variations may not be smooth or instantaneous. However, when aggregated across many firms, this heterogeneity will typically not be relevant to analysis.

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income they would otherwise receive through social security benefits (as well as on other matters such as their prospects to gain promotion and/or acquire workplace skills and experience, and the non-monetary aspects of working).

Volunteering aside, below some wage level a person will not be willing to do a particular job. That wage level (the ‘reservation wage’) varies across individuals, depending on their preferences for work and leisure, their long-term job prospects, their eligibility for social security benefits (and any associated requirements for job searching). At certain wage levels, the binding constraint on employment will not be the level of demand for labour by employers, but the degree to which households are willing to supply labour.

### Potential for disemployment effects

‘Disemployment’ covers situations in which existing workers face reduced hours or unemployment, and/or fewer jobs or jobs of shorter duration are created as the economy grows over time.

There are several mechanisms by which binding minimum wages may cause disemployment. Faced with higher wages for lower-skilled workers, businesses have an incentive to reduce employment of such workers, and/or to invest in labour displacing capital, hire (or make more intensive use of existing) higher skilled workers, and seek to pass on costs. Minimum wage increases can therefore also have second-round ‘general equilibrium’ effects as, for example, price rises prompt a shift in demand away from domestically produced labour-intensive goods and services.

The magnitude of such disemployment will vary between firms and industries, being most acute where:

- the share of production costs accounted for by low-skilled labour is higher
- the less difficult or costly it is to use other inputs (such as high-skilled labour or machinery) as a substitute for low-skilled labour
- the more price responsive is demand for the product, and the greater the level of competition, as this limits the scope for firms to pass on higher costs to consumers.

Changes in employment from an increase in the minimum wage would be expected to vary over time. Some changes in employment decisions could occur in advance of a change in minimum wages, if that change was anticipated. Others may not occur for some months or years afterwards, as businesses reconfigure their production models by, for example, investing in more capital equipment to enable them to make do with fewer low-skilled workers, and as firms enter or exit the market.

The way in which employment or disemployment effects will manifest may also vary depending on macroeconomic conditions and expectations. For example, due to hiring and firing costs, in downturns employers may tend to ‘hoard’ workers and meet reduced demand by reducing employees’ hours, whereas disemployment during prolonged

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expansions may manifest more through the reduced uptake of extra staff. However, even just reduced inflows into employment can lead to permanent unemployment effects if some people exit the labour force ('discouraged workers') or if longer periods without employment erodes skills, reduces job search effectiveness and demotivates people.

There may be circumstances when people priced out of 'employee' labour markets due to minimum wage laws are not priced out of labour markets more generally. Such people may take up self-employed or contractor roles, or informal jobs where workers are paid 'cash-in-hand' or 'in-kind' (as in the case of a live-in housekeeper or nanny), which avoid the need to be paid at the rate of the minimum wage. Jobs such as housekeeping, household maintenance and care work appear particularly amenable to these arrangements. Activities within the illicit economy also provide alternatives some people may take where they are priced out of the formal labour market.

### Employment effects under imperfect competition and efficiency wages

Higher minimum wages (up to some level) could in theory increase employment in markets where individual businesses are able to exert control over the level of wages they pay rather than needing to pay a competitive market rate. In such markets, employers have an incentive to restrict employment and suppress wages. This would be expected to occur in standard 'monopsony' labour markets,<sup>27</sup> which today are most likely to exist mainly in relation to government-provided services such as health, education, policing and defence. However, as discussed in chapter 1, the economic literature suggests that individual firms more generally may have a degree of market power in labour markets, which can enable them to hold wages below the level that would arise in a fully competitive market.

In this context, the literature suggests that wage suppression and sometimes inefficient levels of staff turnover can arise due to relatively weak worker bargaining power, the costs of searching for or transferring to a new or better paying job that can inhibit employee mobility, and the costs of matching worker skills with business needs, and workers' (non-wage) preferences over where they work (Bhaskar, Manning and To 2002). There is some empirical evidence that even sectors with many small employers may exhibit the characteristics of what is loosely termed 'dynamic' monopsony or monopsonistic competition, meaning that a binding minimum wage, up to the level equivalent to the competitive market clearing rate, could increase employment in those

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<sup>27</sup> In orthodox models of labour market monopsony, businesses enjoy monopsony power over labour if they are the sole employer of a certain type of labour, or where the employees are in an isolated area and only have the choice to work for a single employer. An example (prior to the advent of fly-in fly-out operations) would be a workforce located near a major mine or dam project. In these circumstances, the businesses would have an incentive (and ability) to restrict employment so as to hold wages below the 'marginal revenue product', or the level that might occur were there several employers who needed to compete to attract workers. If the monopsony employer were required to pay a minimum wage, however, not only would all workers receive this higher wage but the incentives for the monopsonist to restrict employment would be nullified.

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sectors (Ashenfelter, Farber and Ransom 2010). However, there remains some uncertainty about the extent of such monopsonistic competition in practice.

Another strand of economic theory suggests that some firms might voluntarily pay higher wages to encourage greater motivation and effort from their staff (Yellen 1984).<sup>28</sup> If successful in lifting worker productivity, this strategy would not necessarily increase unit labour costs and may even reduce them. To the extent that imposing (or lifting) a minimum wage were similarly to increase low-skilled workers' productivity, this could counter any disemployment effects that might otherwise arise from the initial increase in unit labour costs<sup>29</sup> (although enhanced worker productivity could, in theory, either increase or decrease employment in particular industries).

Importantly, neither monopsonistic competition nor efficiency wage theories suggest that (higher) minimum wages must necessarily increase employment or hours worked. Under either theory, minimum wages that are too high will always harm employment. And even where the minimum wage is *below* the competitive market clearing level, increases in it can also potentially have *net* negative (rather than positive) employment effects, if it causes sufficient firms to become unprofitable and exit the market (Bhaskar, Manning and To 2002).

## **What can international empirical studies tell us?**

On top of these theoretical complexities, there are several empirical obstacles that together can bedevil attempts to gauge the effects of minimum wages on employment:

- individual changes in minimum wages are often small and incremental, albeit with the potential to have more significant cumulative effects
- there is often incomplete or 'noisy' data on the incidence of minimum wages and on job loss, take-up and changes in hours worked
- the timing of business responses to a change in minimum wages can vary considerably, but some responses can potentially be quite lagged while others could even occur in advance of a foreshadowed increase
- it is not straight-forward to disentangle the effects of changes in minimum wages from other factors, both in the labour market and the economy, that may affect employment

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<sup>28</sup> It is similarly argued that individual businesses might voluntarily pay higher wages to increase staff satisfaction and loyalty to the firm (Akerlof 1982), and/or to reduce staff turnover and thus rehiring and retraining costs. This seems less likely to be a significant consideration in relation to an increase in minimum wages that requires that all firms in an industry pay the higher rate.

<sup>29</sup> A related argument is that employers, facing a higher wage for their low-skilled employees, might invest in more training to lift their skill levels and productivity, so as to help offset the higher costs of employing them. Another way higher minimum wages may lead to off-setting skill increases is if they entice already skilled workers who have left the labour force to re-enter it.

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- aggregate findings and trends may conceal offsetting effects, given that theory suggests that minimum wages can have positive or negative employment effects, depending in part on the market(s) to which they apply.

Economists have devoted significant effort to overcome such difficulties in order to assess the effects of minimum wages on employment. A variety of data and methodologies have been used, and the literature is vast. Some have involved economic modelling; others have involved regression analysis using cross-sectional and time series data or both, and using different granularities of data (unit record information on individuals and enterprises, industry by industry data or economywide information). Some draw on standard statistical sources; others have utilised surveys or datasets developed specifically for the studies. Much of the most sophisticated research has been conducted in the United States, where geographical variations in minimum wages can enable more telling studies to be conducted, but there have also been studies in many other countries, including in recent times several studies commissioned in the United Kingdom on the (limited) employment effects of the introduction and increase in its minimum wage.

### Divergent results

Estimates of the impact of minimum wages on employment and hours worked vary in direction as well as in size and the conclusions drawn from this body of research can appear contradictory and are often the subject of dispute (Doucouliagos and Stanley 2009; Dube, Lester and Reich 2010; Sawhill and Karpilow 2014). The uncertainties about the importance of any employment effects are reflected in economists' opinions, most notably by the divergence of views by a sample of eminent economists from the United States (IGM Economic Experts Panel 2013). Asked whether raising the United States federal minimum wage to US\$9 per hour (an increase of almost 25 per cent) would make it noticeably harder for low-skilled workers to find employment, around one third of the economists surveyed agreed, one third disagreed, and the remainder indicated that they were uncertain or offered no opinion.

Nevertheless, there appears to have been some convergence in views over time on the size of the effects. Whereas many scholars used to posit that minimum wages had significant negative effects on employment, the more recent wave of research suggests that the effects in the United States, even if negative, are smaller than earlier thought (with the United States Congressional Budget Office (2014) settling on a 'central estimate' that a 10 per cent increase in minimum wages reduces employment among affected workers by up to 1 per cent in the United States (an 'elasticity' of -0.1 (box 4.4)). Similarly, according to the World Bank (2013b, pp. 261–262):

New data and more rigorous methodologies have spurred a wave of empirical studies over the past two decades on the effects of labor regulation. ... Based on this wave of new research, the overall impact of [employment protection laws] and minimum wages is smaller than the intensity of the debate would suggest. ... The majority of minimum wage studies do find



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negative employment effects, especially on young workers. But magnitudes tend to be small and a number of studies report no effect, or in some cases, even positive effects.

On the other hand, some prominent academics in this field (Neumark 2014) maintain that the most credible studies still suggest that minimum wages generally have significant disemployment effects on groups most affected by minimum wages (cf Kuehn 2014).

#### **Box 4.4 Understanding what employment elasticities relate to**

The empirical studies often report their results as ‘employment elasticities’, which measure the responsiveness of the level of employment to changes in another economic variable. For example, an employment elasticity with respect to the minimum wage of -0.5 would mean that a 1 per cent increase in the minimum wage would cause employment to fall by half a per cent.

Elasticities can relate to a variety of aspects of both wages and employment. Rigorous discussions need to compare like-with-like. Some important nuances to be aware of are:

- what is the numerator of the elasticity? For example, does the study estimate the change in *total* employment, or just the change in the employment of a subgroup (such as 15-20 year olds, or those on, or close to, the minimum wage, or those in particular industries)? Does it look at changes in employment in terms of hours, job gain, job loss or some aggregate of these? And does it look at employment per se, or at labour demand or labour supply?
- what is the elasticity’s denominator? For example, does the study examine the effects of changes in the minimum wage, or in minimum award rates, or in all wages? And is it a measure of the nominal wage rate, or for example a measure of the bite (the minimum wage relative to the median wage)?
- over what period is the elasticity calculated? Many studies report elasticities that capture short-run responses in employment (say, the change after a few months). However, some report long-run estimates, which show the change after there is enough time for capital to adjust to the change in wages.

Typically, the responsiveness of employment to wage changes is higher in the long run than in the short run, as is the responsiveness of people with lower skills (compared with employees in aggregate).

Employment elasticities can also vary as minimum wages change. So if the elasticity at the current level of the minimum wage is -0.4, it might be greater (say -0.7) were the minimum wage at a higher level (and vice versa).

#### **Some implications for assessing the employment effects of minimum wages**

The remaining differences in the estimates and conclusions noted above partly reflect disagreements about how best to analyse the employment effects of minimum wages and what weight to give to the results of different kinds of studies. They also reflect the inherent difficulties and complexities of empirical work in this area.

Beyond that, as Bray (2013a, p. 93) pointed out, the breadth of the theory and evidence on the minimum wage can be conceived as ‘being complementary and necessary components of an explanation of the complex set of interrelationships which exist in labour markets’.

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He argued that because the force of particular theories depend very much on specific circumstances and institutions:

... it is not surprising that there is diversity of findings in empirical analysis. That is, rather than identifying conflicting processes, the diversity of findings is better seen as illustrating the ways in which these different mechanisms are operating in different contexts. The contradictions arise when it is assumed that a single one of the theories wholly explains all labour markets under all circumstances and without bounds.

This in turn suggests that one should not expect to find a simple and universal answer to the employment effects of minimum wages, and that significant care is required in translating the findings of studies undertaken in one context to other contexts.

Most obviously, there are likely to be differences in the effects of changes in minimum wages from country to country, reflecting differences particularly in:

- the starting level and coverage of the minimum wages
- whether one or more minimum wage applies. (In some countries there are regional variations in minimum wages, differences in wage rates by age and training status and, as in Australia, hundreds of industry and occupational minimum wages in awards whose annual growth rates depend on the annual national wage case)
- the tax/transfer system and job search requirements for the unemployed, which will affect people's reservation wages and motivations to get a job
- other institutional arrangements, such as levels of unionisation and laws governing bargaining or wage setting, which may affect the extent to which minimum wage rises are passed on to other wages.

For Australia, this implies some caution in drawing lessons from studies in countries with significantly different institutional wage setting arrangements and lower minimum wages (such as the United Kingdom and especially the United States) or different social security systems (as many countries have, given Australia's highly targeted transfer payments system and the high effective marginal tax rates it creates).<sup>30</sup> As the Australian Council of Trade Unions (ACTU) observed:

Much of this international debate in the English speaking countries has focused on either the US labour market or the situation in the UK. In both cases, their historical, geographical and institutional arrangements differ markedly from that which prevails in Australia. (sub. 167, p. 115)

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<sup>30</sup> This does not mean that international labour market studies cannot provide useful insights. Some models can correct for institutional factors, and institutional and cultural variations can shed light on how such variations can affect employment elasticities. For example, if various international studies found that employment supports, and/or changing job search requirements, and/or social transfers altered the responsiveness of employment to the minimum wage, this could provide useful policy information in the Australian context. However, Australia's different conditions do mean that conclusions from international studies cannot automatically be transplanted here.

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## What do the Australian empirical studies reveal?

That context matters so much provides grounds to place most emphasis on Australian studies when assessing the employment effects of changes in Australia's minimum wages. The foregoing discussion also highlights the need to carefully investigate the robustness of different studies, and to recognise the potential limits of empirical analyses in this area to deliver definitive results.

### Previous studies

In contrast to the prolific research abroad, there have been relatively few Australian studies of minimum wages.

This may partly be because the broad coverage of Australia's national minimum wage and the generally modest and incremental changes have not provided rich 'natural experiments' for study. This contrasts with the United States in particular, where there have been significant changes in the minimum wage in some states and even cities, with no change in neighbouring areas.

The main exception to this has been changes in the Western Australian statutory minimum wage where they have occurred out-of-step with the changes in the federal system. Between 1994 and 2001, for instance, there were six such increases in the Western Australian minimum wage, of between 3.5 and 9.3 per cent.

Leigh (2003, 2004a, 2004b) studied the effects by comparing subsequent changes in the ratio of aggregate employment to population in Western Australia to the changes in the ratio for the rest of the country. Leigh found that this measure of employment in Western Australia fell after all but one increase, with the greatest effects on younger workers. Most annual effects were negative and statistically significant. Across the workforce as a whole, Leigh calculated an employment elasticity with respect to the minimum wage of -0.29 (which implies that a 10 per cent increase in the minimum wage would reduce employment by 3 per cent, other things equal). Leigh also considered how employment effects varied for different age cohorts and found that the effect was greatest for workers aged 15-24 (an elasticity of -1).

Leigh's study is widely cited but is now more than a decade old and was conducted when the minimum wage's bite was higher than today, which may reduce its relevance for current levels of the minimum wage. There has also been debate about the methodology employed and the resultant size of the estimates (appendix C; sub. 167).

There have been several other Australian minimum wage studies, using different methodologies, some of which have also found significant disemployment effects, some which have found little or no evidence of an effect, and one that suggested a small positive effect. Again, the studies often are dated and/or have data or methodological limitations that lessen the weight their findings warrant. The studies, and aspects of their approach and relevance, are listed in table 4.1 and examined in more detail in appendix C.

**Table 4.1 Australian empirical studies of the employment effects of minimum wages**

<i>Authors</i>	<i>Minimum wage event</i>	<i>Method of analysis</i>	<i>Description of data</i>	<i>Estimate of elasticity for all workers with respect to the minimum wage</i>
Mangan and Johnston (1999)	1: Variation in Queensland youth award wage relative to adult average weekly earnings for non-managerial occupations from 1980 to 1994 2: Minimum wage change in 1996	1: Generalised least squares regression of ratios of full-time and part-time employment to population of youth on the ratio of the youth award wage relative to the adult average weekly earnings, gross state product and a time trend 2: Multinomial logit model of a young person's labour market status (full-time, part-time, unemployed or not in the labour force)	1: ABS annual Queensland employment data 2: unit record census data for Queensland and Australia. Census year not stated, but personal communication with author indicates it was 1996	1: -0.08 (full-time, real, 1 year) and -0.19 (part-time, real, 1 year) 2: -0.07 to -0.28 (Queensland, real, 1 year) and -0.05 to -0.31 (Australia, real, 1 year)
Junankar, Waite and Belchamber (2000)	Variation over time in youth minimum wage relative to adult average weekly earnings from 1987 to 1997	Error correction model in which youth hours of employment depends on the youth minimum wage relative to the adult average weekly earnings and output. Estimated for retail trade and manufacturing; full-time and part-time; male and female and ages 16, 17, 18, 19 and 20 year olds.	ABS quarterly data of industry output, youth wages and adult average weekly earnings	Reported little to no effect
Leigh (2003, 2004a, 2004b)	Six increases in the Western Australian minimum wage from 1994 to 2001	Difference-in-differences analysis of the employment to population ratio in Western Australia relative to the rest of Australia	ABS monthly employment and population data for Western Australia and the rest of Australia	-0.29 (nominal, 3 month)
Harding and Harding (2004)	1. The 2003 national safety net adjustment; 2. hypothetical freeze in national safety net for five years	Respondents stratified so estimates would be representative of the Australian small and medium sized business sector	Survey of 1800 small and medium-sized businesses in October/November 2003 <sup>a</sup>	1. -0.05 (nominal, 1 year) 2. -0.25 (real, 5 year)

*(continued next page)*

**Table 4.1** (continued)

<i>Authors</i>	<i>Minimum wage event</i>	<i>Method of analysis</i>	<i>Description of data</i>	<i>Estimate of elasticity for all workers with respect to the minimum wage</i>
Lewis (2005, 2006)	Changes in wages in two industries (Accom., cafes and restaurants, and Health and community services) compared with the whole economy between 1994 and 2004	Compared wage and employment growth in the two industries (the 'minimum wage sector') with that of the total economy	Source not stated	-0.55 (nominal, 10 year) -0.72 (real, 10 year)
Plowman (2007)	Minimum wage changes affecting Western Australia between 1990 and 2006	OLS regression of employment on the minimum wage and state final demand. Analysis for: total WA labour force; two age groups (15–19 and 20–24); and three sub sectors (Retail trade; Accom., cafes & restaurants; and Personal & other services)	ABS data for employment in Western Australia. Source of minimum wage data not stated.	Reported that the effect on employment is 'small'. The sign of the test statistic implies the direction of change is positive.
Wheatley (2009)	Changes in the Federal minimum wage relative to average wages between 2001 and 2008	Error correction model in which changes in the ratio of national employment of high–skilled to low–skilled occupations depends on the Federal minimum wage, GDP and a time trend.	ABS data for national employment by occupation, GDP, and wages	n/a (Estimate a 1.44.6 per cent substitution away from low skilled labour and towards high skilled labour from a 1 per cent rise in the minimum wage relative to the average wage)
Lee and Suardi (2011)	1. Introduction of the Federal minimum wage in April, 1997 2. changes in Federal minimum wage between 1997 and 2007	Statistical test for a structural break in the youth employment to population time series for Victoria, Northern Territory and ACT.	ABS Labour Force Survey time series data from 1992 Q1 to 2008 Q1	No evidence of an effect on employment
Olssen (2011)	Effect of award minimum wage increases at each birthday for youths between 2001 and 2008	Regression discontinuity approach to measure the change in hours and wages that occurs upon the birthdays of young people	HILDA, wave 8	No evidence of an effect on hours worked

<sup>a</sup> Small–sized businesses are defined as those with between one and twenty full-time employees. Medium–sized businesses are defined as those with between 20 and 200 full-time employees. <sup>b</sup> Based on Healy and Richardson (2006).

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Appendix C also surveys several Australian studies that have looked at the employment effects of wages generally (rather than of minimum wages). These studies confirm that the level of real output is the main driver of employment over time. However, the studies also typically find that higher average wages are associated with reduced employment or higher unemployment, with an overall elasticity of employment with respect to average wages ranging from -0.2 to -0.9 in the shorter term, with larger impacts in the longer term. In the Productivity Commission's view, this provides some guidance as to the more likely effects on the employment of minimum wage workers of changes in minimum wages also, although there will of course be differences. For example, changes in wages at the higher end of the wage distribution are much less likely to prompt unemployment, but rather shifts to different employment forms that pay less wages.

Taken together, the Productivity Commission's reading of the Australian empirical studies is that increases in Australia's minimum wages are likely to have caused some disemployment, but that the effects have not been major relative to other influences. Further, while the studies provide an indication of the likely direction of change, they provide neither definitive evidence nor clear guidance on the magnitude of any employment effects that would result from future changes in Australia's minimum wages.

### The Productivity Commission's exploratory analysis of RED data

For this inquiry, the Productivity Commission has explored whether it is possible to gain additional, and more up-to-date, evidence on the employment effects of minimum wages in Australia by exploiting a newly-available administrative dataset: the Research and Evaluation Database (RED).<sup>31</sup> It was used to assess the impact of annual minimum wage increases between 2008 and 2013. The exercise applies a difference-in-differences approach to individual employment transitions, and uses a range of techniques to ascertain the robustness of the results obtained. The data, methodology and results are described in detail in a technical supplement (PC 2015c).

Notwithstanding its strengths, RED has proven to have some important limitations for this exercise and the results were inconclusive in parts, reflecting both positive and negative associations between employment and the minimum wage (box 4.5). Overall, the results suggest that adverse employment effects from minimum wage increases were felt more by 'would-be employees' (that is, the unemployed and those outside the labour force). For those already in jobs, the main consequence appears to have been a reduction in hours worked rather than job loss. However, concerns about the robustness of the results mean that the Productivity Commission can draw only limited conclusions about the employment effects of minimum wages from the study.

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<sup>31</sup> The RED data-set is constructed by the Department of Employment. It covers all recipients of federal income support payments (including, Newstart Allowance and Parenting Payments but not Family Tax Benefits or childcare subsidies) and their parents and children. The data-set contains longitudinal data on individuals' income, hours worked and labour earnings, together with some demographic details. RED has millions of observations on employment status over time, and therefore has the potential to provide rich insights into the effects of changes in wages on employment of low-paid workers.

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#### Box 4.5      **The RED econometric analysis: results and caveats**

The RED dataset was used to assess the impact of annual minimum wage increases between 2008 and 2013, but it has proven to have some important limitations for this exercise. In particular, the absence of information on whether pro-rated 'junior' rates apply meant that younger people (aged from 15 to 20 years) have had to be omitted from the sample, even though many studies suggest that minimum wages can have greater effects on this group. Moreover, in capturing those adult minimum wage workers who are part of households that receive income support payments, the data do not include the larger number of adult minimum wage earners who are not, and who may have different work preferences and incentives.

The study used the most recent data available in RED, which include periods of both significant wage rises and significant labour market uncertainty. There is a limit to what can be achieved quantitatively to control for shifts as dramatic as a record terms of trade rise, a world economic downturn or a major government financial stimulus package. Moreover, as in all minimum wage studies of this type, a major difficulty is ensuring that the control group is fit for purpose.

Perhaps unsurprisingly given the data issues, changing economic environment and technical complexities, the analytical results were inconclusive in parts, suggesting both positive and negative associations between employment and the minimum wage.

Job loss was the main area of ambiguity, with the relationship between the minimum wage increase and the probability of exit ranging from positive to negative, depending on the year and model variant considered. For 2010 and 2011, minimum wage increases were mostly associated with a heightened risk of job loss, whereas the association was invariably positive for 2008 and 2013. Paradoxically, a lower risk of job loss was also evident for 2009, when no minimum wage increase took place. Finally, the results for 2012 were evenly divided between positives and negatives. Across all years, the size of significant adverse effects ranged from 1 to 2 percentage points, while the size of favourable effects ranged from 1 to 3 percentage points. The analysis focusing solely on the non-payment partners of income support recipients displayed far less variation, with all significant results reflecting adverse employment responses.

These differing annual results for job loss may reflect several factors. Reasons why some minimum wage increases may increase employment are canvassed earlier in this chapter. Even when the minimum wage increases beyond the point where larger increases could start to cost jobs, it is possible that employers do not always (or in the main) respond via lay-offs, opting instead for alternative cost-lowering strategies. The reduced risk of job loss estimated for 2009 may, on the other hand, owe more to the special economic circumstances created at the time by the global economic downturn and the government fiscal stimulus package.

The analysis' results were far more consistent with regard to hours worked and entry into employment. Throughout the period considered, minimum wage increases were overwhelmingly associated with adverse employment effects in these two dimensions: six-monthly changes in hours worked by minimum wage workers were significantly more likely to be negative after minimum wages went up; and the prevalence of minimum wage workers among new hires invariably fell when the minimum wage was raised.

Overall, the results suggest that adverse job effects from minimum wage increases were felt more by the unemployed and those outside the labour force, with the main consequence for those already in jobs appearing to have been a reduction in hours worked. However, the fact that several results for 2009 were significant throughout the analysis appears counter intuitive, since a minimum wage freeze applied then. This raises concerns about the robustness of the results obtained for other years.

*Source:* PC (2015c).

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## Other arguments and indicators

In view of the limitations of empirical studies that seek to measure the employment effects of minimum wages changes directly, researchers have sometimes relied on other, less direct evidence and argument. Below, the Productivity Commission has examined a range of possible indicators to see what it might reveal. The matters examined include:

- qualitative studies of employer responses to minimum wage changes
- the effects of penalty rates
- the effects of youth wages
- effects of changes in gender wage relativities
- changes in the skill profile of Australian jobs
- the level and nature of unemployment and underemployment.

### Qualitative studies of employer responses to minimum wage changes

The FWC and the earlier Australian Fair Pay Commission commissioned two studies that sought to examine the responses of firms to wage adjustments.

The first study, by Wearne, Southwell and Selwun (2008), used online discussion boards to explore the impacts of changes in the national minimum wage and related pay scales on small and medium businesses within the retail, hospitality, and health and community services sectors. A majority of the 92 businesses that responded indicated that labour costs and pay rates were ‘very important’, tending to ‘critical’ in cases where labour costs represented a comparatively larger proportion of total costs. The study found that employers responded to wage increases in a variety of ways, some proactively but most reactively. The most common responses included:

- raising prices
- reducing staffing hours (or hours of overtime)
- seeking improvements in productivity and staff efficiency.

In some cases, business owners or managers worked additional hours themselves. Other, less common, responses included changes in opening hours, investing in capital to reduce labour needs, replacing experienced staff with staff at lower pay rates (such as juniors), and hiring freezes.

The second study, by Evesson et al. (2011), drew on interviews with 20 minimum wage-reliant enterprises in different sectors, before and after the July 2010 minimum wage adjustment. The firms used a number of the strategies for dealing with wage pressures evident in the first study. However, the second study’s authors found that, while there were large variations in the pressures confronting the firms and their employees, the increase in minimum wages had limited impact on enterprises and their business performance. Further:



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While there were differences in the type and extent of adjustments evident over the course of the study, they were rarely regarded by employers as exclusively and specifically driven by the minimum wages increase. In cases where adjustments were linked to the minimum wages increase, those adjustments were slight and tended to be continuations of pre-existing labour management, pricing and cost control strategies. (Evevsson et al. 2011, p. 151)

The studies' findings suggest that although wage pressures are often important in business decisions, some minimum wage adjustments will have little immediate impact on the decisions of many existing businesses as to how many staff to employ. This is consistent with the FWC's view that modest minimum wage adjustments will have little or no effect on employment.

However, the studies were not well equipped to examine the cumulative effects of multiple minimum wage adjustments, or to identify disemployment through slower uptake of new staff or expansion of hours, or reduced entry of new firms or new jobs into minimum wage intensive sectors. Nor do they reveal what the level of employment might be were the minimum wage to be substantially higher or substantially lower than its current level. Nor were they sufficiently robust to provide reliable evidence.

### Impacts of weekend penalty rates

Arguments about the employment effects of penalty rates in Australia, particularly in sectors with high levels of low-wage employment, may provide some indirect evidence of the effects of changes in minimum wages.

The Productivity Commission's assessment in chapter 14 is that, given their very high level, weekend penalty rates have caused disemployment in some industries, including in restaurants, accommodation and retail industries. Of course, lower weekend employment may have been offset to some extent by greater employment through the week, although as discussed in chapter 14, a net reduction in employment can be expected.

This suggests that substantial increases in the minimum wage above its current level would cause disemployment, although it does not provide evidence of the effects of more modest increases to minimum wages or the likely effect of reductions in minimum wages from their current level.

In addition, given that weekend penalty rates often apply to industries with many low-paid workers, increases in minimum wages could themselves translate into increases in weekend rates and, through that channel, may contribute to further disemployment.

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## Impacts of youth wages

Arguments about youth wages may provide some indirect evidence of the effects of changes in minimum wages more generally. (Youth wages are examined in chapter 5.)

It is notable in the Australian context that few claim that the wide disparity between junior minimum pay rates (currently starting at around \$6.20 an hour for a person aged below 16 years — or about 40 per cent of the adult rate) should be entirely eliminated. The size of the wage discount has long been justified on the grounds that younger workers have typically lower productivity (whether due to a relative lack of experience, skill or maturity) and would be disadvantaged in labour markets were they paid at the adult rate — a point of consensus among many unions, employers and wage regulators.

This suggests an acceptance that minimum wages can affect employment, but that views about the effects depend on the nature of the employee and the current level of the wage.

## Earlier changes in gender wage relativities

Keith Hancock (sub. 233) — who chaired the Committee of Review of Industrial Relations Law and Systems, which reported in April 1985 — drew attention to that committee's examination of whether more 'flexible' wages than the award system provided were necessary for the efficient operation of the labour market. Hancock pointed to the committee's discussion of the introduction of equal pay for women in the early 1970s. The committee observed that, so far as could be told from the employment statistics, there had been no adverse effect on the relative employment prospects of women.

These changes were also investigated by Gregory and Duncan (1981) who found:

The relationship between the change in wage relativities between the groups and the performance of employment is very confused. Institutionally determined wage changes alone cannot explain the changing employment patterns. Adult male employment, which should have been favoured by the changes in relativities, has grown least and adult female employment, which has been subject to the largest increase in wage relativities, has grown most. Junior male employment has done considerably better than junior female employment and this is consistent with the fact that junior females have increased their wages relative to junior males. This evidence does not disprove that the relative wage changes have affected the demand for labour in the expected way, but, if they have, it has to be conceded that other influences in the opposite direction — particularly in respect of adult males — have been more important. (pp. 307–8)

This evidence is of course dated and the subsequent and continuing declines in male employment relative to female employment, after implementation of the equal pay decision in the 1970s, is consistent with broader economic and societal shifts being at work. It nevertheless adds weight to the view that changes in relative wages levels will not necessarily have major and/or readily observed impacts on employment levels.

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## Changes in the skill profile of employment

If Australia's (relatively high) minimum wage bite has adversely affected employment of low-skilled workers, another indicator might be in the skills structure of Australia's jobs.

In this regard, Wilkins and Wooden (2014) argued that job growth from 1993 to 2013 has favoured highly skilled occupations more so here than in Europe and the United States, and suggested that our relatively high minimum wage may be inhibiting low-skill job growth:

Our only explanation lies in differences in the regulation of wages of low-paid workers. Minimum wage regulation applies to many more workers in Australia than is typical in other countries, with around 16 per cent of Australian employees dependent solely on award regulation. That, combined with relatively high wage minima, may mean that employment growth within relatively low-paid occupations has been less than it would have been under different institutional settings, such as those that prevail in the United States or most Western European countries. (p. 424)

However, Borland and Coelli (2015) found that, when defining skill in the same way as some key studies of the United States and Europe, the changes in the skill mix of work in Australia appear very similar to those in those countries. This raises doubt about the skills mix changes that Wilkins and Wooden suggested might be attributable to Australia's high minimum wage.

## The availability and skills of people not at work

A precondition for any policy change to increase employment is that there must be a group of people willing and able to take on additional jobs or hours of work.

The most obvious group available is the unemployed. There are more than 700 000 Australians who are classified as unemployed, around 150 000 of whom have been unemployed for more than 12 months.<sup>32</sup> Additionally, many people are available and willing to work but have given up looking because they believe they cannot find a job. There were almost 110 000 of these 'discouraged workers' as at February 2014 (the latest ABS data available).<sup>33</sup>

The capacity of this seemingly large pool of people to seize employment opportunities will be limited to some extent by structural mismatches and barriers that may impede their ability to take on available jobs. Structural unemployment can arise where potential workers live in the wrong area, are unable to work the requisite hours, or do not have the skills or qualities required for available jobs. There are also other barriers to obtaining employment that may not be overcome simply by increasing the number of available jobs,

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<sup>32</sup> ABS, *Labour Force, Australia, October 2015*, Cat. No. 6291.0.55.001.

<sup>33</sup> ABS, *Persons Not In the Labour Force, Underemployed Workers and Job Search Experience, Australia, February 2014*, Cat. No. 6226.0.55.001.

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such as health problems or disabilities, family responsibilities, or age discrimination by employers. These structural mismatches and other barriers to employment appear to be the main difficulty in finding work for around half of all unemployed people (based on self-reported data).<sup>34</sup> Without other forms of assistance to overcome these barriers, many of these individuals may not be able to take advantage of any additional jobs that might be made available by changes to the minimum wage. The social security system may also act as something of a floor on feasible wages that employers could offer to attract workers.

There nonetheless remains a large pool of unemployed Australians (just over 275 000 at February 2014), who claim to face either no barriers to employment, or who consider that the primary difficulty in gaining employment is that there are insufficient jobs available.<sup>35</sup> Of these, almost 36 000 were classed as long-term unemployed, with 240 000 having been out of work for less than 12 months. Of course, some of these people might still have had inadequate skills or qualities for particular minimum wage jobs. And this group of unemployed will also have contained many people in the process of searching for the ‘right’ job further up the income scale, rather than seeking an ‘entry level job’ on the minimum wage. There is also some evidence that employers can sometimes find it difficult to attract suitable workers to their businesses.<sup>36</sup> Even so, with the unemployment rate currently around 6 per cent and youth unemployment well above historical averages (chapter 2), there would appear *prima facie* to be a sizable number of workers in this group able to take up employment without significant additional training were there an increase in jobs on offer.

Moreover, as shown in chapter 2, the pool of unemployed is turbulent. Accordingly, it is important to consider the impacts of the minimum wage and other policies on transition rates between different labour market states (unemployment, a job, being outside the labour force). Shifts in those transition rates can affect the duration of people in the various

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<sup>34</sup> Just over one half (50.8 per cent) of unemployed people reported their main difficulty in finding work as ‘lacked necessary skills or education’, ‘insufficient work experience’, ‘no vacancies in line of work’, ‘too far to travel/transport problems’, ‘own ill health or disability’, ‘unsuitable hours’, ‘other family responsibilities’ or ‘considered too old by employers’ (ABS, *Persons Not In the Labour Force, Underemployed Workers and Job Search Experience, Australia, February 2014*, Cat. No. 6226.0.55.001). These data are ‘self-reported’ which may make them more open to subjective biases.

<sup>35</sup> This estimate of 275 000 people includes those who reported their main difficulty finding work as ‘too many applicants for available jobs’, ‘no vacancies at all’ or ‘no difficulties at all’ (ABS, *Persons Not In the Labour Force, Underemployed Workers and Job Search Experience, Australia, February 2014*, Cat. No. 6226.0.55.001).

<sup>36</sup> There is varying evidence on this matter. An employment search firm found over half of the 500 Australian small businesses it surveyed indicated that they struggle to find the right people for open roles, with the main challenges including to find workers who fit the company culture, and attracting candidates with the best skills (PCWire 2015). And the Department of Employment (2014a) found that only 16 per cent of applications for jobs covered by its ‘Survey of Employers who have Recently Advertised’, were deemed ‘suitable’ by the employers. However, the same report showed that there were very few pressure points in terms of employers’ ability to recruit skilled workers, with most having the choice of multiple suitable applicants, and that skill shortages have lessened over the last year. These reports do not necessarily address issues of whether unskilled workers are readily available.

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states and the long-run share of the working age population in any given labour market state (Lattimore 2007).

Minimum wage changes can have several, complex impacts on such transition rates. For example, were the minimum wage to grow at a reduced rate, then to the extent that this reduced job exit rates and raised job entry rates, it would decrease the unemployment rate and increase the employment-to-working age population ratio. However, higher employment likelihoods may encourage some people outside the labour force to commence job searching and, other things equal, this will tend to increase the unemployment rate, because this group has inherently lower probabilities of job entry than other unemployed people. Nevertheless, some of these people will acquire jobs, increasing the ratio of employment to the working age population. There are several insights from understanding the importance of transitions in the labour market:

- in empirical analysis it may be better to examine the effects of labour market policies, such as minimum wages, on the ratio of employment to the working age population, and not the ratio of employment to the labour force
- changes to minimum wages might have some of their biggest effects by reducing the number and duration of spells of unemployment
- as shown by multiple, but sporadic, episodes of lifetime employment, many people who are unemployed are employable.

Further, there are more than 1 million ‘underemployed’ Australians who would be willing to take on additional work if more hours were available to them (ABS 2015g). Among this group, those who work in jobs that are paid at, or close to, the minimum wage may be able to capture some of the benefits of any possible expansion in available working hours arising from a change to it.

Overall, the Productivity Commission does not see a lack of willing and able workers as being a major impediment to at least some expansion in employment in lower-skilled jobs in Australia. The Reserve Bank also noted recently that there appears to be spare capacity in the labour market (Ballantyne, De Voss and Jacobs 2014; RBA 2015). Equally, beyond some point, expansions in employment may require extra effort to ensure that prospective workers have the skills and aptitude for viable employment.

### **The Commissions’ conclusions on the employment impacts of Australia’s minimum wages**

The Productivity Commission’s examination suggests that it is not currently possible to arrive at a straight-forward and definitive conclusion about the effects of changes in Australia’s minimum wages on employment levels or hours worked. Economic theory points to a range of possible effects in different markets. Empirically, while Australia’s adult minimum wage is high by world standards, and the Australian econometric studies taken together suggest that minimum wages adversely affect employment, the number of

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studies is small, they are often dated and their findings are subject to methodological and other caveats. Internationally, the results of empirical studies are mixed and contested, and economists' views remain split on this matter. Some other Australian evidence examined (for example, in relation to weekend penalty rates) supports a finding that higher minimum wages can cause disemployment, although that evidence is indirect and some of it mixed. More generally, the employment impacts of any changes in minimum wages can be expected to vary at different times, depending on other policy settings and broader economic conditions.

Several participants, including unions, have argued that the various uncertainties identified by the Productivity Commission mean that it is not possible to draw policy-relevant conclusions on the employment effects of minimum wages. One submitted:

United Voice notes an important finding of the Productivity Commission in the draft report where the PC finds that it is unable to determine the link between minimum wages and unemployment. This is perhaps best summarised in this 'Key Point' of the draft report that ... 'At present, it is not possible to pinpoint the impacts of minimum wages on employment ...' United Voice believes that this finding has not been applied consistently throughout the report. If accepted, then many of the other findings in the report are not able to be sustained on the evidence. (United Voice, sub DR354, p. 5)

However, an inability to 'pinpoint' the employment impacts of minimum wages, or to draw a straightforward and definitive conclusion on the matter, does not mean that sufficiently robust, albeit nuanced, conclusions cannot be made. Rather, as the draft report noted, careful judgments about the effects (and the probabilities associated with different effects occurring) are required to help determine appropriate policies in relation to minimum wages. This has been the approach taken throughout this inquiry, with policy recommendations created and couched accordingly.

For its part, the Expert Panel of the FWC, which determines the national minimum wage in Australia, has concluded that 'modest and regular increases in minimum wages have a small or even zero impact on employment' (Annual Wage Review 2014-15 at 435). This is an unsurprising conclusion, particularly for times of economic stability, although it would be extremely unsafe to draw inferences from this about large increases or decreases in the minimum wage (say of 10 or 20 per cent in real terms).

Based on its examination of the available evidence, together with its understanding of the Australian economy, the Productivity Commission has concluded that large increases in the minimum wage bite (or indeed, steep rises in the minimum wage compared with product prices) would make lower-skilled, less experienced employees less attractive to employers and reduce employment on both an hours and headcount basis, particularly over the longer term.

The impacts of reductions in the minimum wage bite are less straightforward. It is likely that some reductions from current levels would increase employment at the economywide level but there are more caveats and uncertainty in this area. That is because, below some level, reductions in the minimum wage would have little effect on unemployment, due for

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example to skills mismatch issues, or could even see employment decline in some markets.<sup>37</sup> The government might also seek to use the tax/transfer system to offset any adverse income effects for households were wages growth to decline. However, this would increase marginal effective tax rates on wages and would require additional tax revenue, both of which can adversely affect employment (chapter 6).

### **4.3 What effect do minimum wage requirements have on workers' incomes and living standards?**

A key objective of minimum wages is to promote equity by placing a floor under the incomes of low-paid workers and thereby safeguard or lift their living standards. This section examines how many people are on the minimum wage, some characteristics of their employment, and the impact of minimum wages on their material living standards and the distribution of household incomes.

#### **How many people earn the minimum wage?**

There is no agreed estimate of the number of adult Australians paid at the hourly minimum wage rate. Previous estimates have ranged between 4 and 11 per cent of employees are paid up to or close to the national minimum rate (table 4.2). The differences in the estimates result from differences in the data and methodologies used to estimate minimum wage employment.

Each of the data sources listed in table 4.2 has its own strengths and limitations for gauging minimum wage reliance. Crucially, surveys differ according to who reports income, with all but the Survey of Employee Earnings and Hours (EEH) relying on employee-reported income and hours, which can be vulnerable to recall and rounding error. On the other hand, these surveys contain rich information on respondents' characteristics and attributes, such as demographics and household income, and are an important source of policy-relevant information. The EEH lacks this detail and omits agricultural workers, a sector with high rates of minimum wage reliance, as measured by other surveys.

While there are different definitions of minimum wage workers (box 4.6), applying the Productivity Commission's approach (as set out in that box) to the EEH data results in an estimate of around 7.2 per cent of employees paid at up to the hourly national minimum wage rate (or very close to it). Using a similar estimation procedure with data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey produces an estimate of 17.8 per cent. This is likely an overestimate and less reliable than the EEH.

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<sup>37</sup> Where the starting level of a 'minimum' wage rate is very high, as in the case of minimum wage rates increased by weekend penalty rates (chapter 14), reductions are likely to be associated with employment growth.

**Table 4.2 Surveys including wage information**

Survey	Sample size	Survey population	Estimated share of workers on minimum wages (per cent)	Upper threshold for minimum wage classification (per cent of NMW)
Survey of Income and Housing	18 298 households	Australian population	10.3 <sup>c</sup>	W ≤102%
			7.4 <sup>e</sup>	W <100%
The Household, Income and Labour Dynamics in Australia (HILDA) Survey	13 609 individuals	Australian population	7.2 <sup>b</sup>	W ≤110%
			9.5 <sup>c</sup>	W ≤102%
			11.2 <sup>d</sup>	W ≤100%
			6.8 <sup>e</sup>	W <100%
Survey of Employee Earnings and Hours (EEH)	Approx. 50 000 employees	Australian employees (excluding those in agriculture, forestry and fishing)	4.1 <sup>a</sup>	W ≤105%
			4.1–4.9 <sup>b</sup>	W ≤110%
Survey of Employment Arrangements, Retirement and Superannuation	26 972 individuals	Australian population (aged 15 years and over)	9.2 <sup>e</sup>	W <100%

<sup>a</sup> Bray (2013a). <sup>b</sup> McGuinness, Freebairn and Mavromaras (2007): full-time employees. <sup>c</sup> Healy and Richardson (2006). <sup>d</sup> Dockery, Seymour and Ong (2010). <sup>e</sup> Nelms, Nicholson and Wheatley (2011).

## Some characteristics on minimum wage workers

In view of its likely greater accuracy, the Productivity Commission has used the latest EEH data wherever possible. As well as providing an estimate of the total number of minimum wage workers (above), EEH data is used to estimate the industry in which they work and their occupation, their gender, whether they are permanent or casual, and whether they work full- or part-time. The Productivity Commission has augmented this information with data from HILDA wave 13, to examine patterns in the household characteristics of minimum wage workers. While HILDA may overestimate the number of workers on the minimum wage, it is less likely that the patterns it reveals would differ significantly with a ‘tighter’ sample of minimum wage workers.

Analysis of the EEH data reveals several characteristics of minimum wage earners:

- *Industry*: higher rates of minimum wage reliance are found in accommodation and food services; retail trade and other services (figure 4.3)
- *Occupation*: labourers and sales workers are the occupations with the largest shares of workers on minimum wages (figure 4.4)
- *Gender*: female employees (8 per cent) are slightly more minimum wage reliant than males (7 per cent)
- *Full-time vs part-time*: lower weekly hours correspond with higher rates of minimum wage reliance (figure 4.5). For example, employees working less than 15 hours



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per week are much more likely to be on the minimum wage, compared with employees working 30 to 40 hours per week.

#### **Box 4.6 Definitions and measures of minimum wage workers**

Estimates of the number of minimum wage workers can vary markedly depending on the definition and methodology used. The Department of Employment (sub. 158, pp. 8–9) observed:

Some commentators say that there are around 1.5 million employees who rely on the minimum wage. This is inaccurate. ... When some commentators give a figure for the number of employees receiving the 'minimum wage', they really mean to say the number of people receiving the award classification wage for their relevant classification. Some award classification wages can be as high as \$150,000 (for example, in the Air Pilots Award 2010). Accordingly, on some definitions and approaches, this amount is a 'minimum wage'. It is therefore important that the concept of 'minimum wage' that is used is clearly defined to avoid confusion.

A distinction can also be made between 'minimum wage workers' and 'the low paid'. The Department of Employment (sub. 158) defined low-paid employees as employees earning less than two-thirds of the median hourly wage (or \$18.67 per hour in May 2014). On this basis, the Department estimated that 13.3 per cent of all employees were low-paid in 2014.

By contrast, a very strict interpretation of minimum wage workers would be those who receive the national minimum rate. Using this benchmark, the Department (sub. 158, p. 8) estimated that in May 2014 around 1.6 per cent of all employees (or 157 100 employees) were paid the minimum wage rate. This figure included 62 800 award-reliant workers; 20 700 workers covered by a collective agreement, and 73 600 award and agreement free workers.

Some workers who are on slightly more than the national minimum wage may still be considered to be 'minimum wage workers'. This is because the base or entry level wage in many modern awards is slightly higher than the national minimum wage. Moreover, even where the minimum wage in a modern award is set exactly equal to the national minimum, this is often only a temporary wage, as the Department of Employment (sub. 158, p. 8) explained:

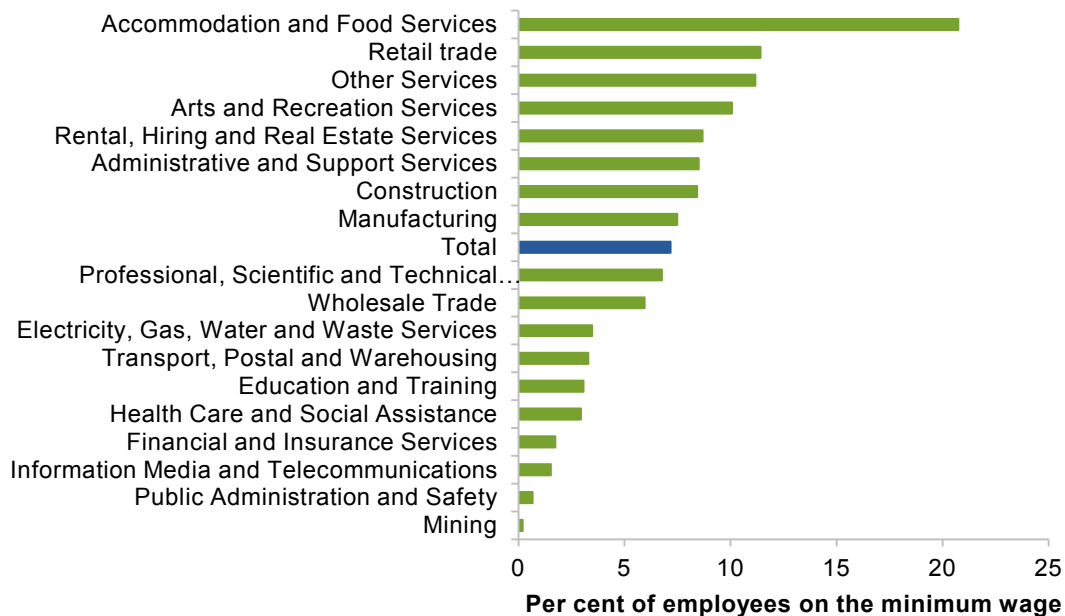
The national minimum wage rate of \$16.87 [in 2014-15] is contained in 45 of the 122 modern awards. In a number of these awards, the national minimum wage rate is paid as an introductory rate or a trainee rate. Under awards such as the Hospitality Industry (General) Award 2010 and the Restaurant Industry Award 2010, employees with little or no experience generally receive the introductory rate for up to three months while training to become a level 1 employee.

In the Productivity Commission's view, workers on entry level or similar levels of award wages, even if slightly above the national minimum wage, can reasonably be considered to be minimum wage workers. Data are not available to precisely identify the number of workers that fits these criteria. Researchers often include workers earning up to, say, 5 or 10 per cent above the national minimum wage in their measures of minimum wage workers.

The Productivity Commission has used EEH and HILDA data to examine the characteristics of minimum wage workers. For both datasets, a threshold of 10 per cent above the national minimum wage rate has been used, in part because this captures the base level minimum rates of a large share (more than 80 per cent) of modern awards. Junior rates are accounted for using those listed in the Miscellaneous Award 2010 — consistent with recent national minimum wage orders. For casual employees, a loading of 25 per cent has been applied. The Productivity Commission's EEH-based estimates use the standard hours and income to calculate an employee hourly wage, while the HILDA-based estimates have used income and hours across all jobs, top-coding hours at 60 for each job. The EEH-based estimates include only federal system workers. Neither dataset enables adjustments to account for penalty rate payments, such as shift and weekend loadings.

**Figure 4.3 Minimum wage reliance across industries**

Proportion of employees earning the minimum wage, 2014



Source: Productivity Commission estimates based on ABS, 2014 EEH CURF, Cat. No. 6306.0.55.001.

**Figure 4.4 Minimum wage reliance across occupations**

Proportion of employees earning the minimum wage, 2014<sup>a</sup>

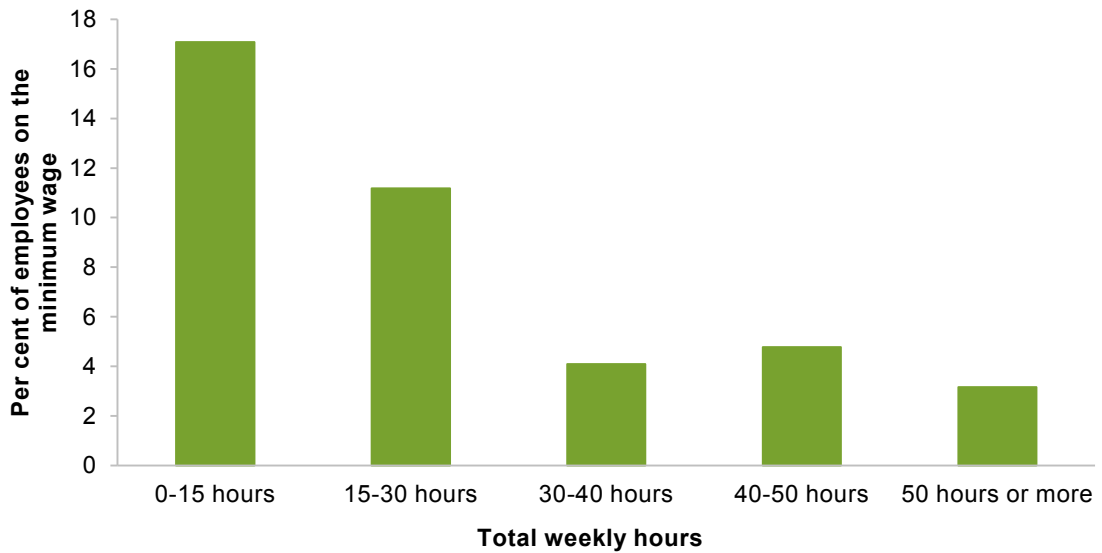


<sup>a</sup> The Productivity Commission’s estimates do not exclude professionals and managers from being classified minimum wage reliant. While it may be unlikely that these employees earn the minimum wage, their reported working hours and income imply an hourly wage within 10 per cent of the national minimum.

Source: Productivity Commission estimates based on ABS 2014 EEH CURF, Cat. No. 6306.0.55.001.

Figure 4.5 **Many minimum wage workers work short hours**

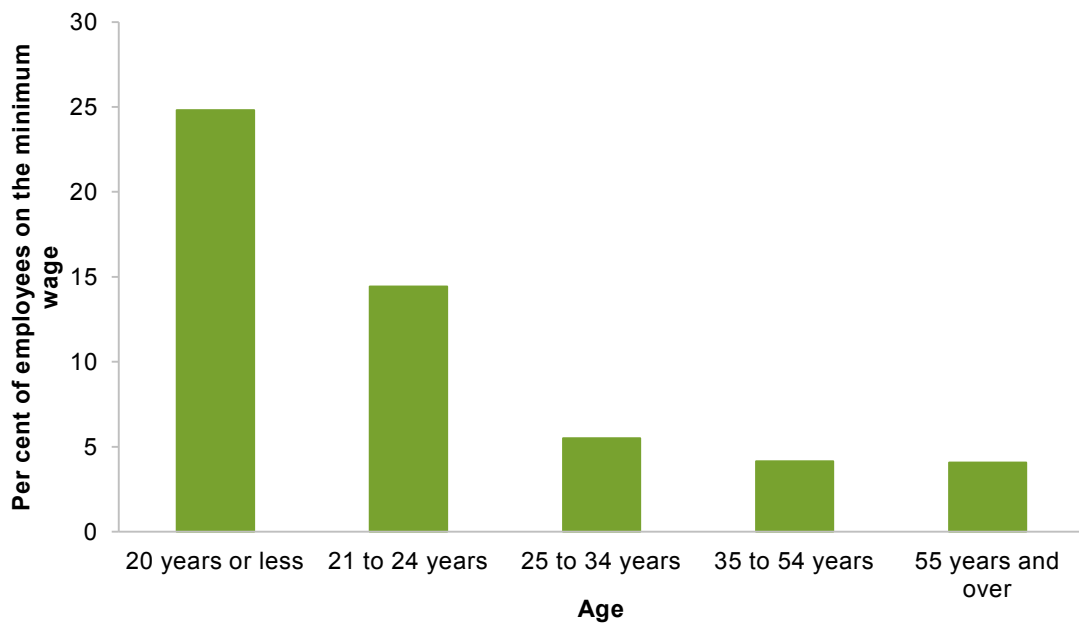
Hours worked per week by people earning the minimum wage, 2014



Source: Productivity Commission estimates based on ABS 2014, EEH CURF, Cat. No. 6306.0.55.001.

Figure 4.6 **Reliance on the minimum wage is often temporary**

Proportion of workers reliance on minimum way by age, 2013-14



Source: Productivity Commission estimates based on ABS, 2014 EEH CURF, Cat. No. 6306.0.55.001.

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## How does the importance of the minimum wage vary?

### Temporary or more permanent employment at the minimum wage?

In many cases, minimum wage jobs are entry level, providing (often young) employees with valuable experience (figure 4.6). This work is often temporary and part-time, providing employees with supplementary income while they are studying and/or representing a stepping stone to higher-skilled and better compensated work. This is revealed by the much higher rates of minimum wage reliance observed among employees aged less than 20 years (25 per cent) and between 21 to 24 years (14 per cent), compared with those aged 25 to 54 (roughly 5 per cent). Casual employees (20 per cent) are also more likely to be minimum wage reliant, compared with all other employees (4 per cent).

### The minimum wage and personal and household income

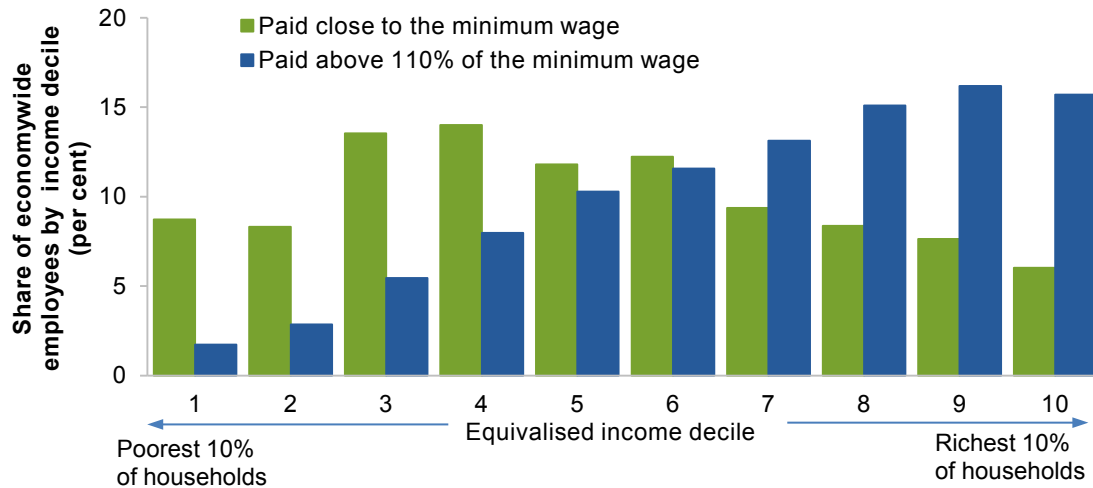
For a given individual, material living standards typically depend more on household income than individual income. For instance, the living standards of a dependent student on the minimum wage may be largely unaffected by a change in the minimum wage. At the other end of the spectrum, the living standards of households whose primary income is from minimum wages, and whose income is not significantly supplemented by social security payments, are obviously much more reliant on minimum wages.

The evidence on the distribution of minimum wage earners according to household equivalised income reveals two distinctive patterns:

- *Minimum wage earners* reside most frequently in middle income groups (Bray 2013a; Leigh 2007 and figure 8.7). This reflects several factors, including that minimum wage earners sometimes live with other, better-remunerated household members and that two minimum wage earners with full-time jobs and no children earn close to the median equivalised household income. Notably, minimum wage earners in higher income households tend to work longer hours than those in low-income households (figure 4.9), who often face high effective marginal tax rates as a result of welfare withdrawal rates. Another factor is that many people in the lowest income quintile are welfare dependent and not in work.
- *Employees* in the lowest income groups are more likely to be on the minimum wage than those in higher income groups (and by more than a fivefold factor) (figure 4.8). So, while most people in the lowest quintile are not in work (and therefore do not receive any wages), almost half of those who are in work are paid at a minimum rate.

**Figure 4.7 Many minimum wage workers live in middle-income households**

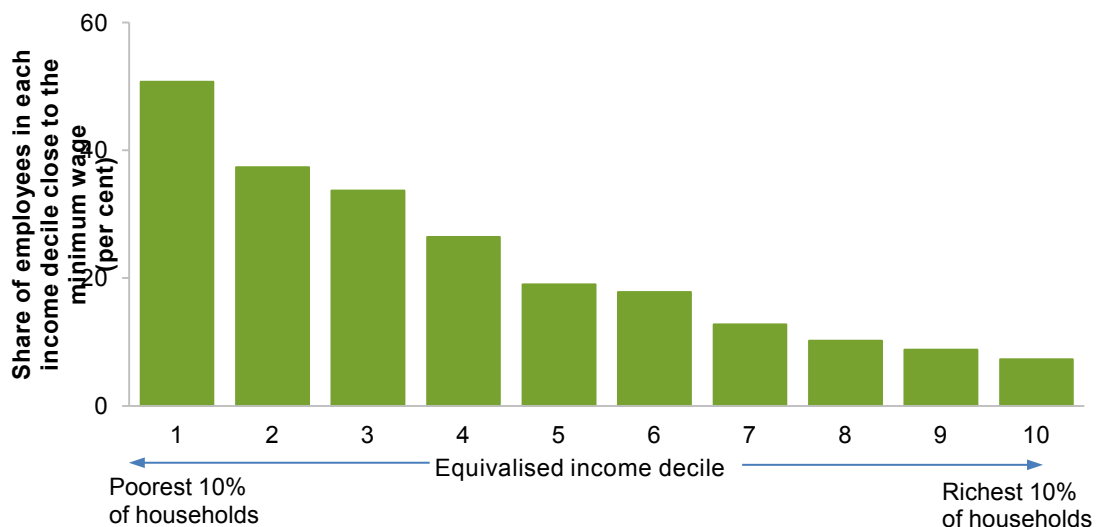
Distribution of minimum wage earners according to household equivalised income deciles, 2013-14



Source: Productivity Commission estimates based on HILDA Release 13.

**Figure 4.8 An employee in a low-income group is much more likely to be paid around the minimum wage rate**

Minimum wage reliance among employees according to household equivalised<sup>a</sup> income deciles, 2013-14



<sup>a</sup> Equivalised household income controls for household size by dividing total household income by a weighted sum of persons in the household. The first adult is allocated a weight of 1, while additional adults are weighted at 0.5 and children weighted at 0.3.

Source: Productivity Commission estimates based on HILDA release 13.

**Table 4.3 Share of population according to equivalised household income, minimum wage reliance and employment status**

All persons aged 15 years or more, 2013-14

Category	1 <sup>st</sup> quintile	2 <sup>nd</sup> quintile	3 <sup>rd</sup> quintile	4 <sup>th</sup> quintile	5 <sup>th</sup> quintile
	(%)	(%)	(%)	(%)	(%)
0 to 110 per cent of the minimum wage	1.5	2.5	2.2	1.6	1.3
Above 110 per cent of the minimum wage	2.0	5.9	9.6	12.4	14.0
Other employed persons	1.3	1.9	1.8	1.9	2.8
Unemployed	1.1	1.1	0.6	0.5	0.3
Not in the labour force	14.8	7.1	5.0	3.8	3.1

Source: Productivity Commission estimates based on HILDA wave 13.

**Figure 4.9 Minimum wage earners in low-income households work fewer hours than those in higher-income households**

Hours worked by minimum wage earners, by equivalised household income



Source: Productivity Commission estimates based on HILDA Release 13.

## Impacts on material living standards

Although many minimum wage workers do not reside in low-income households or work on the minimum wage for long, it is important to recognise the financial constraints and difficulties that arise for a proportion of people in minimum wage employment. Numerous participants on, or close to, the minimum wage commented on the difficulties they face in making ends meet, particularly where they have taken on mortgages, have dependents to

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support, incur difficult-to-predict costs, such as bills for health care, or are able to gain work on only an occasional or part-time basis (box 4.7). Many said that the minimum wage should be increased and/or at least keep pace with individual or family living costs.

#### **Box 4.7      Some low-paid workers' experiences**

Numerous participants on or close to the national minimum wage commented on the difficulties they face in making ends meet and/or voiced their views on the need for an increase in the minimum wage. Below is a selection of the comments, made through the ACTU comments facility (sub. 188) and the United Voice submission (sub. 224).

The lives of people on a low/minimum wage are so different from those on high wages. There is great mental and emotional stress placed on people and their families when they are struggling to pay the rent and food. Many people can no longer afford their own house — by paying rent they will never have an end to it, and will need more when they retire. I know many young families struggling to raise children, with the father working full-time, the mother part-time, and young children in day care when they can be. They still struggle to pay for essentials, as they are on minimum wages. It should not be like that. (Coburg, Vic, sub 188, line 327)

I could not live on the minimum wage for a disability worker. My mortgage payment takes a good piece of my salary. Then I still have to pay bills and live. Some savings would be a dream come true. (St Clair NSW, sub. 188, line 408)

My household finances have gotten much more difficult in the last few years. ... [T]here have been very few positions available over the last year and although I am registered with most employment agencies and go through every single job advertised on SEEK, I have only had 8 days' work in the past 3 months. At this stage, if I didn't get a Centrelink top-up, we would not survive. Imposing a pay cut or pay freeze on the minimum wage would be counterproductive because Centrelink would just need to top-up more. (Springwood Qld, sub. 188, line 103)

Power and utilities make it such a struggle. I can only put the heater on when it's really necessary. The last increase took our electricity bill from \$250 to \$400 and it seems to just keep rising ... In 2008, I had a car accident so not only am I a low-income earner, but I have medical expenses for chronic pain. (School Cleaning, WA, sub. 224, p. 5)

The cost of living is increasing and wages just aren't keeping up. To keep up, we need to raise the minimum wage as a start. I mean, look at the price of electricity! I don't think anyone should earn less than \$30 an hour no matter what job they're doing. (Catering, Vic, sub. 244, p. 13)

One issue these comments raise is the relevant living standards benchmark for assessing the adequacy of minimum wages. For example, should they address family or just individual needs? And should they provide a complete social safety net on their own, or is the contribution of other government support payments also relevant? Participants' views on these matters varied (box 4.8). For its part, the FWC has stated:

We affirm our use of the single-person household as the principal, but not the sole, reference point. We consider the position of many family types and take into account the interaction between wages and the tax-transfer system to produce equivalent household disposable income. (Annual Wage Review 2014-15 at 38)

The Productivity Commission notes the degree to which changes in minimum wages affect the lowest income households depends largely on household structures. Single-person

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working households with a part-time employee on minimum wages will be significantly affected, while working families in the lowest income groups receive considerable family benefits and other social security transfers, which partly shields them from the income effects of minimum wage movements.

In light of changing family structures and the availability of family assistance and other government support measures to address the needs of dependents and people in need, the Productivity Commission agrees with the focus adopted by the FWC for the purposes of assessing the effects of the minimum wage on the living standards of the low paid.

A further question is to what extent the regulated minimum wage is higher than the wage that affected workers would otherwise have received for their work. The extent of such a gap is dependent on the characteristics of the individual (for example, their skill, occupation, experience, and location). The smaller the gap, the less important is the minimum wage in raising living standards.

Identifying the magnitude of the gap is empirically challenging. Overseas data on relative wages between occupations in markets where minimum wages are lower and less binding might provide a rough basis for identifying those gaps, but no research of this kind has been undertaken.

The analysis in chapter 7 suggests that the operation of awards (including award minimum wages) over the last century has generally worked to compress wages and lift the relative employment-based incomes of low-paid workers, which accords with the Productivity Commission's judgment that Australia's minimum wages generally 'bind'. This suggests that regulated minimum wages are indeed likely to have directly increased the wage rates of low-paid workers. In this respect, regulated minimum wages are similar to supplementary financial assistance for low-paid workers, except that the cost is borne in the first instance by employers rather than taxpayers.

That said, the interactions between minimum wages, the tax and transfer system, and the labour market mean that there is not a one-to-one relationship between changes in the minimum wage and the material living standards of workers on the minimum wage.



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#### Box 4.8 **Participants' views on the role of minimum wages in safeguarding people's living standards**

Several participants argued that the objective of the minimum wage is, or should be, to meet at least basic family needs. Tom McDonald (Former National Secretary, Building Workers Industrial Union) (sub. 33) harked back to the principles underpinning the Harvester judgment and argued that 'protecting the family unit was the Arbitration Commission's principle consideration rather than economic and equity considerations' and that these principles remain relevant today. Similarly, the Catholic Commission for Employment Relations (sub. 99, p. 2):

... supports the payment of minimum wages — what may be termed a 'living wage' — that enable a worker and their family to achieve a decent standard of living, not wages merely sufficient to avoid poverty. ... minimum wages should be fixed by reference to community living standards to meet the needs of a family (couple or sole parent with two children) not a single person.

It went on to criticise the FWC's adoption of a single person household as the appropriate reference household for benchmarking minimum wages, commenting that existing safety net wages are inadequate for families. Likewise, the Employment Law Centre of WA (sub. 89) observed that the minimum wage was around two-thirds of the amount that a single-income couple with two dependent children would need to avoid poverty.

While also focusing on equity issues in relation to low-paid workers, ACOSS (sub. 165) argued that the minimum wage should be set at a level sufficient to enable a single individual to attain a decent 'basic' living standard. It considered that this should be well above poverty levels and developed in accordance with community expectations.

Other participants argued that poverty and equity as well as family needs are best tackled with instruments such as taxation measures, social security and other family assistance, and that the minimum wage should be focused on modern labour market conditions. Jobs Australia (sub. 221), which represents nonprofit organisations that assist unemployed people, argued:

[Jobs Australia] assumes that the purpose of the minimum wage is: *to ensure that workers with little bargaining power are guaranteed a fair minimum rate of pay, with that rate set on the basis of an appropriate, basic standard of living for a hypothetical worker who earns the minimum hourly rate through a standard working week.*

... Note that we do not assume that the rationale for the minimum wage is to reduce poverty, for instance, or to ensure a family with one 'breadwinner' can get by. The minimum wage would not meet such a rationale, because ... the poorest households in Australia have no breadwinners at all, while the one breadwinner family is becoming a rarity. (p. 6)

The Australian Federation of Employers and Industries (sub. 219, p. 20) submitted:

The distribution of disposable household income is determined by employment levels, income from assets, taxes, social welfare payments, household composition and so on.

Minimum wage increases which cannot be sustained by business output and revenue are unlikely to improve the situation of those on lower pay, especially for those at the bottom of income distribution. An increase in the minimum wage is only effective in improving their living standard if these lower -paid workers receive them by having sustainable jobs.

The minimum wage should be sufficiently low to encourage employers to recruit employees of low educational attainment, low skill levels and low employability but high enough to encourage participation in the labour market and out of the welfare system, even if only partially.

And the Australian National Retailers Association (sub. 216, p. 11) said:

ANRA has supported the use of minimum wage settings as one of several policy tools that can be used for maintaining the living standards of award dependent workers and their families. ... However, ANRA believes the tax and transfer system (tax system) is better suited to acting as a safeguard for household – which might include both workers and non-workers – living standards.

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## Modelling the distribution of the benefits of a minimum wage increase

To further explore the impacts of statutory minimum wages on people's living standards and the distribution of income, the Productivity Commission has modelled the direct effects on household finances flowing from a recent (2012) adjustment to the national minimum wage.

The model is based on 2012 HILDA survey data on personal and household incomes and characteristics, and is calibrated to take into account the effects of income taxes and transfer payments as they were in 2012-13. The modelling is described in box 4.9.

### Box 4.9 Modelling the distributional effects of minimum wages

The Productivity Commission has developed a microsimulation model to help assess the effects of changes in minimum wages rates on people's gross and net incomes and their distribution across households. Aspects of the modelling are outlined in this box; further details are provided in a technical supplement (PC 2015b).

The model database is based on the HILDA survey in 2012. As such, each of the 13 600 individuals whose income level and employment status are modelled represents a real person who was surveyed in 2012. The gross income of individuals in the HILDA database is calculated by summing income from all sources, including labour earnings and income support payments. This provides a baseline for evaluating the effects of an increase in the minimum wage on gross income.

The Productivity Commission has simulated the effects of an increase in the minimum wage to just 'minimum wage workers'. These workers are identified in the dataset based on the procedure outlined in box 4.6. As the microsimulations are based on the HILDA survey dataset, they capture more workers as 'minimum wage workers' than would be captured applying equivalent procedures to the EEH dataset.

The Productivity Commission Tax and Transfer model (PCTT) is then used to calculate the effects on net income. PCTT contains information on tax rates, offsets and rebates, and various allowances, pensions and other welfare provisions. The PCTT model was calibrated based on policy settings in 2012-13, and benchmarked against 2012 HILDA data (collected mainly during September and October of that year). It is used to calculate taxes and transfers for each individual based on their gross taxable income and personal and family circumstances (drawn from the HILDA survey).

### Basic scenario with no employment effects

The basic scenario modelled considers only the direct 'morning after' effects of a wage change; it does not consider broader or longer-term effects, such as changes in employment, product prices or the composition of the economy, that may flow from an increase in wage costs, and how these would affect real incomes.

In this scenario, minimum wage workers are granted an increase in wages of 2.9 per cent — the nominal minimum wage increase awarded in 2012 — while the wages of all other

workers are unaffected. In practice, under current institutional settings, it would be expected that an increase in the minimum wage would also raise the wages of people on higher starting wage levels too, as the FWC increased award rates in line with the change in the national minimum wage. This in turn would increase the wages of employees paid under enterprise agreements or other mechanisms that are directly linked or indirectly influenced by award rates. Higher flow-on wages further up the scale would benefit those higher-income workers. For this analysis, the Productivity Commission has not sought to model these impacts but, rather, has focused on the group earning minimum wages. (That said, as the exercise is based on HILDA data, it captures a larger number of ‘minimum wage workers’ than would be captured using the EEH survey, so the exercise can be seen as equivalent to modelling a significant degree of wage pass-on to workers earning above the national minimum wage.)

#### *Direct impacts on gross incomes*

The 2012 increase in the minimum wage of 2.9 per cent is estimated to increase the *gross* income of households with at least one minimum wage worker by around \$767 per year on average. Most households (around 85 per cent) do not contain minimum wage workers and in the scenario are unaffected (table 4.4).

**Table 4.4 Change in household gross income by equivalised household income quintile**

Average gain, 2.9 per cent increase in the minimum wage, no disemployment

Quintile	Beneficiaries		Unaffected		All households	
	\$/yr	%	\$/yr	%	\$/yr	%
1	509	8.39	0	91.61	43	100
2	735	17.87	0	82.13	131	100
3	847	20.49	0	79.51	174	100
4	846	18.05	0	81.95	153	100
5	805	9.68	0	90.32	78	100
Total	767	14.65	0	85.35	112	100

Source: Productivity Commission estimates based on HILDA wave 12.

The estimated impacts differ substantially across high and low-income households. The average gains of \$43 per year across all households in the lowest equivalised income quintile are the smallest in absolute terms, with this quintile receiving around 7 per cent of the total increase in gross income (table 4.5). The largest average gains are for households in the middle quintile, with an average increase of around \$174 per year (table 4.4).

The relatively small benefits accruing to households in the lowest quintile are primarily because they are less likely to contain minimum wage workers — around 8 per cent for the lowest quintile in 2012 compared with 20 per cent for the middle quintile.

**Table 4.5 Share of increase in total gross and net income by equivalised household income quintile**  
2.9 per cent increase in the minimum wage, no disemployment

Quintile	Gross income		Net income	
	\$m	%	\$m	%
1	71	7.4	64	9.1
2	219	22.7	151	21.4
3	289	30.0	204	28.9
4	254	26.4	190	26.9
5	130	13.5	97	13.7
Total	963	100.0	705	100.0

Source: Productivity Commission estimates based on HILDA wave 12.

### Net incomes effects

Household *net* incomes change in the same direction as household gross incomes, although the magnitudes of these changes are moderated.

The estimated increase in average household net income (that is, across all households, with and without minimum wage workers) was around \$82 per year (table 4.6), compared with \$112 per year in gross income (table 4.4). This is because higher wages trigger lower income support payments and higher taxes.

**Table 4.6 Change in household net income by equivalised household income quintile**  
Average gain, 2.9 per cent increase in the minimum wage, no disemployment

Quintile	Beneficiaries		Unaffected <sup>a</sup>		All households	
	\$/yr	%	\$/yr	%	\$/yr	%
1	459	8.39	0	91.61	39	100
2	511	17.77	0	82.13	91	100
3	596	20.49	0	79.51	122	100
4	630	18.05	0	81.95	114	100
5	597	9.68	0	90.32	58	100
Total	563	14.63	0	85.35	82	100

<sup>a</sup> In some quintiles, there is a very small proportion of instances where the increase in net taxes outweighs the increase in wage income, and net income falls for households with minimum wage workers.

Source: Productivity Commission estimates based on HILDA data.

The estimated gains are again smallest for households in the lowest quintile (\$39 per year) and largest for households in the middle quintile (\$122 per year). Overall, the tax and transfer system has little effect on the pattern of gains across and within quintiles, with the third quintile again emerging as the main recipient.

For context, average annual net household income varies from around \$20 000 for the lowest quintile to \$140 000 for the highest quintile. So although households in the lowest quintile receive the least benefit from the minimum wage change in absolute terms, this translates into a larger percentage increase in their gross incomes, although the modelled increase in their *net* incomes still does not exceed the increase enjoyed by households in the two quintiles immediately above them ('All households' columns, table 4.7).

**Table 4.7 Percentage change in household gross and net income by equivalised household income quintile**

2.9 per cent increase in the minimum wage, no disemployment

Quintile <sup>a</sup>	Gross income (%)		Net income (%)	
	All households	Working households	All households	Working households
1	0.78	0.79	0.18	0.45
2	0.47	0.31	0.21	0.22
3	0.24	0.19	0.18	0.16
4	0.14	0.11	0.13	0.10
5	0.04	0.04	0.04	0.04
Total	0.15	0.22	0.12	0.18

<sup>a</sup> The quintiles for 'Working households' are recalculated, for a different (narrower) group of households, compared with the quintiles for 'All households'.

Source: Productivity Commission estimates based on HILDA wave 12.

#### *The distribution of benefits among working households*

The above results pertain to all households and not just households with workers. If non-working households are excluded, the distribution of the gains from the minimum wage favour households in the lowest quintile of working households, both in gross and net terms (tables 4.8 and 4.9). Although workers in such households work fewer hours on average than those further up the income scale, a larger share of workers in this quintile are on minimum rates. These households also enjoy a lesser reduction in other transfers as their wage income increases. Overall, the minimum wage increase leads to a higher percentage increase in both the gross and net incomes of households in the lower quintiles of working households, with progressively smaller percentage gains for households in higher quintiles ('Working households' columns of table 4.7).

**Table 4.8 Change in household gross income by working household equivalised income quintile**  
Average gain, 2.9 per cent increase in the minimum wage, no disemployment

Quintile	<i>Beneficiaries</i>		<i>Unaffected</i>		<i>All households</i>	
	<i>\$/yr</i>	<i>%</i>	<i>\$/yr</i>	<i>%</i>	<i>\$/yr</i>	<i>%</i>
1	648	37.52	0	62.48	243	100
2	841	24.79	0	75.21	208	100
3	841	21.67	0	78.33	182	100
4	816	16.84	0	83.16	138	100
5	808	9.22	0	90.78	75	100
Total	767	22.15	0	77.85	170	100

Source: Productivity Commission estimates based on HILDA data.

**Table 4.9 Change in household net income by working household equivalised income quintile**  
Average gain, 2.9 per cent increase in the minimum wage, no disemployment

Quintile	<i>Beneficiaries</i>		<i>Unaffected<sup>a</sup></i>		<i>All households</i>	
	<i>\$/yr</i>	<i>%</i>	<i>\$/yr</i>	<i>%</i>	<i>\$/yr</i>	<i>%</i>
1	492	37.36	0	62.48	184	100
2	585	24.79	0	75.21	145	100
3	616	21.67	0	78.33	133	100
4	614	16.84	0	83.16	103	100
5	591	9.22	0	90.78	55	100
Total	563	22.12	0	77.85	125	100

<sup>a</sup> In some quintiles, there is a very small proportion of instances where the increase in net taxes outweighs the increase in wage income, and net income falls for households with minimum wage workers.

Source: Productivity Commission estimates based on HILDA data.

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### *Some implications*

The modelling confirms that, unsurprisingly, minimum wage increases lift the gross and net incomes of minimum wage households, and lead to some compression in incomes across working households.

However, it also illustrates that the impact on the living standards of people at the lower end of the household income distribution is likely to be relatively limited.<sup>38</sup> There are three reasons for this:

- the direct benefits of a minimum wage change increase will be spread throughout the income distribution because many minimum wage workers reside in higher income households
- for many lower income households, transfer payments represent a more significant share of net household income than do wages
- those minimum wage earners located in the bottom quintile tend to work relatively fewer hours on average.

### *Alternative scenario with disemployment effects*

The Productivity Commission has also modelled an alternative scenario to help explore the distributional implications of minimum wages when they cause disemployment. Under this scenario, all minimum wage workers are again granted an increase in nominal wages of 2.9 per cent but some are modelled as being displaced from their jobs. (In practice, and depending on economic conditions and other policy settings, disemployment may involve fewer new jobs or jobs of shorter duration being created as the economy grows over time, or existing workers facing reduced hours, rather than losing their jobs). Following Leigh (2007), the scenario uses an ‘upper bound’ employment elasticity of -1. (The technical supplement (PC 2015b) also contains sensitivity analysis using an employment elasticity of -0.5.)

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<sup>38</sup> United Voice (sub. DR354) expressed concern that, in reaching this conclusion, the Productivity Commission’s analysis ‘ignores the fact that there are many low-paid workers whose wages sit just above the minimum wage and whose incomes are substantially affected by changes in the minimum wage, which then flow-on into their Award rate’.

To clarify, the analysis captured workers on wages up to 10 per cent higher than the federal minimum wage, rather than just those on the minimum wage. The Productivity Commission (2015c) also conducted sensitivity analyses of different ‘footprints’ of minimum wage workers, including of workers earning wages up to 20 per cent and 30 per cent higher than the federal minimum wage of \$17.29 per hour. These footprints would capture many workers on award wages, but above the national minimum wage. These analyses also found a pattern of minimum wage increases benefitting mainly middle income rather than lower income households.

### *Distribution of modelled gains and losses*

Under the ‘upper bound’ scenario, the modelled gains in gross incomes to households with minimum wage workers who retain their jobs are offset by losses to households with minimum wage workers who are displaced from their jobs (table 4.10). Although fewer households lose than gain (0.5 per cent versus 14.2 per cent overall) in the modelling, the average magnitude of the change is much larger for households who lose (\$23 700 per year versus \$800 per year). This pattern is evident across all income quintiles. However, the low representation of minimum wage earners in the first quintile means that there are proportionally fewer beneficiaries and losers in that quintile.

**Table 4.10 Change in household gross income by equivalised household income quintile**  
Average gain, 2.9 per cent increase in the minimum wage, disemployment (elasticity -1)

Quintile	Beneficiaries		Losers		Unaffected		All households	
	\$/yr	%	\$/yr	%	\$/yr	%	\$/yr	%
1	509	8.14	-16 903	0.26	0	91.61	-2	100
2	732	17.31	-23 039	0.56	0	82.13	-3	100
3	845	19.81	-25 021	0.69	0	79.51	-5	100
4	844	17.47	-26 133	0.58	0	81.95	-4	100
5	803	9.36	-24 708	0.32	0	90.32	-4	100
Total	765	14.18	-23 692	0.47	0	85.35	-4	100

Source: Productivity Commission estimates based on HILDA wave 12.

The broad relativities across and within quintiles observed in terms of gross incomes — for example, the proportion of beneficiaries within each quintile — evident in table 4.10 are replicated in terms of net incomes, although the progressive nature of the tax and transfer attenuates the adverse financial effects on households that lose (not shown here; see PC (2015b)).

Focussing on working households only, those in the bottom quintile benefit most from the minimum wage increase (table 4.11), as they did in the basic ‘no employment effect’ scenario (discussed earlier). However, the quantum of net benefits accruing to that quintile in the modelling is reduced by approximately two thirds (\$56 dollars annually on average, instead of \$184 in the basic scenario).



**Table 4.11 Change in household net income by working household equivalised income quintile**

Average gain, 2.9 per cent increase in the minimum wage  
disemployment (elasticity -1)

Quintile	Beneficiaries		Losers		Unaffected		All households	
	\$/yr	%	\$/yr	%	\$/yr	%	\$/yr	%
1	518	36.37	-11 454	1.15	0	62.48	56	100
2	604	24.04	-16 199	0.74	0	75.21	25	100
3	640	21.08	-19 486	0.59	0	78.33	20	100
4	635	16.37	-19 972	0.48	0	83.16	9	100
5	606	8.95	-17 068	0.27	0	90.78	8	100
Total	586	21.50	-15 662	0.65	0	77.85	24	100

Source: Productivity Commission estimates based on HILDA wave 12.

### *Some implications*

The alternative scenario (together with the sensitivity analysis reported in the technical supplement<sup>39</sup>) highlights that the quantum and distribution of the direct increases in net income from an increase in the minimum wage can depend importantly on the extent of any associated employment effects. Even if there were sizeable disemployment effects, most households with minimum wage workers would still gain direct financial benefits from an increase in the minimum wage. However, a small proportion would lose significant earnings, only partially replaced by reduced taxes and increased transfers.

In interpreting the results, the Productivity Commission cautions that the microsimulation estimates are based on a simplified modelling experiment in which all disemployment occurs in the form of job loss, and with other aspects of the economy held constant. In practice, disemployment would partly be reflected in reductions in hours rather than just in the number of jobs, so the losses would be spread somewhat more evenly than represented in the estimates above. That is, there would be fewer people fully displaced from (or not able to gain) work but some of the ‘winners’ would face a decline in hours worked (and, for some, potentially a decline rather than an increase in earnings). Further, in practice, other wages, prices and economic conditions would vary in ways that also affect employment and income. As such, the estimates do not indicate what would happen to actual (or observed) employment or unemployment levels, or incomes, following a particular wage change.

<sup>39</sup> The results of the sensitivity analysis using an employment elasticity of -0.5 indicated that the modelled effects on net income are approximately linear over the range of scenarios analysed (that is, with elasticities from 0 to -1), which in turn suggests that modelling results reported here could be scaled to reflect different elasticity values (PC 2015b).

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Minimum wage regulation can also have broader and more indirect effects on the living standards of people on low incomes (and, indeed, on the broader community) than the ‘morning after’ and limited behavioural effects reflected in the microsimulation modelling. These can arise through changes to output and input prices, government finances, the incentives for workers to undertake education and acquire skills, and the composition of the economy. These induced effects give rise to wider resource allocation effects that may vary geographically and by industry. (Some of these potential broader effects are explored further in the ‘general equilibrium’ modelling reported in section 4.4).

## 4.4 The future of the minimum wage

Drawing on the earlier analysis, this section considers the continuing relevance of, and future directions for, Australia’s minimum wages.

### Is there a case for deregulating minimum wages?

A threshold issue is whether regulated minimum wages should be maintained. The Institute of Public Affairs (sub. 64), for instance, called for their abolition while the Commission of Audit (2014), although not going that far, advocated some changes that would significantly reduce the level of the minimum wage bite in some states (chapter 5). These calls raise the question of whether there is a valid rationale for regulated, binding minimum wages.

In the more-than-a-century since minimum wages were introduced, there have been marked shifts in family structures and women’s social and economic roles, a social welfare safety net has been introduced and progressively widened, and Australians’ living standards have increased dramatically. These changes have *largely* rendered redundant the original rationales associated with Australia’s minimum wages, to deal with ‘sweated labour’ and to ensure that the reasonable needs of a family with a single male breadwinner are met. In turn, there have been changes to the objectives ascribed to the minimum wage during this period, although concerns about employee exploitation and notions of ‘a fair day’s work for fair day’s pay’ and social equity considerations have remained central.

In the Productivity Commission’s view, it remains the case that a ‘free market’ for low-skill labour would not be economically justified. As noted earlier, the labour market, particularly for low-wage jobs, is characterised by significant imbalances in the bargaining power of employers and employees. These imbalances along with other market distortions mean that there remains an economic rationale for a minimum wage that lifts the incomes of low-paid workers above the levels they would otherwise receive. Accordingly, the Productivity Commission does not support abolishing or neutering the minimum wage.

Whether there is also a social equity justification to (further) lift the minimum wage — that is, to levels higher than the level necessary to respond to bargaining power imbalances and other labour market distortions — is less clear. Governments already have in place various

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dedicated mechanisms, most notably the progressive taxation and social security system, that are intended to directly address social equity issues. Higher regulated minimum wages could be separately justified on these grounds only if they are more ‘cost-effective’ for addressing genuine social equity objectives than alternative policies.

Of course, while Australia’s general taxation and social security system is highly targeted, it is not without its own limitations. The withdrawal of benefits often involves steep tapers, which create high effective marginal tax rates which in turn can discourage employment. There is also some evidence that recipients of some forms of welfare can feel stigmatised by them, and welfare provisions are amenable to significant change.

Australia’s regulated minimum wages do not have these latter features, and the earlier analysis shows that minimum wage adjustments provide some improvement to the living standards of low-income working households. Some key union and welfare groups (ACTU sub. 167, sub. DR355, ACOSS sub. 165) argued that regulated minimum wages are an important tool for addressing social equity. The ACTU contended that a fall in the relative value of the minimum wages, along with factors including technological change and globalisation, changes to the tax system and a fall in union density, have widened income inequality (sub. DR355). ACOSS stated:

There is a dynamic relationships between jobs, minimum wages, and income support, within which minimum wages both reduce poverty and provide an incentive for workforce participation. ... The minimum wage reduces poverty, both directly by improving wages for people in low-paid work, and indirectly by enabling an incentive-gap between the minimum wage and adequate social security payments for people who are unemployed. (sub. 165, p. 1)

However, while (higher) minimum wages can indeed increase incentives for people to seek work and their incomes once employed, the earlier analysis shows that regulated minimum wages also have important limitations as a tool for promoting equity. Minimum wages lift the incomes only of those in jobs, do not target poverty or equity directly, and have the potential to cause unemployment and underemployment. This suggests that, above some point, attempts to improve the outcomes for those households with the lowest incomes through minimum wages may not be particularly efficient or effective.

Some economists have further suggested that, contrary to popular perceptions, increases in the minimum wage in fact have the potential to detract from equity. Leigh (2007) showed that minimum wages have the potential to widen earnings and income inequality, depending on the nature and extent of the disemployment effects, and Wooden (2010) stated:

Minimum wage rises benefit low-paid workers at the expense of the unemployed. Any action that increases the cost of hiring low-wage labour reduces the likelihood of those without jobs finding one in the future. Moreover, it is the long-term unemployed whose employment chances are most damaged. This seems very unfair. And it certainly does not promote social inclusion through greater workforce participation, as is required under the Act. The decision [by FWA to increase minimum wages in 2010] looks even more unfair once you realise that

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many low-paid workers do not live in poor households, and that a low-paid worker has a much better chance of getting a better paid job than someone who doesn't have a job at all.

## **Should the minimum wage be complemented by other policies?**

The above discussion suggests that while there is a plausible rationale to retain minimum wages, there may also be a role for complementary measures that lift the incomes of people in low-income households, potentially in a more targeted way, while avoiding the risks to employment associated with higher minimum wages.

The FWC is already strongly cognisant of the joint role of the tax-transfer system and minimum wages on low-paid households with dependent children, and takes this into account when considering whether its decision meets the minimum wage objective of the FW Act. For example, in the 2014-15 decision it noted:

Evidence that the net effect of the various factors acting upon the ability of an employed family to meet their material needs has the consequence of increasing or reducing levels of unmet need among low-paid and award-reliant families would be one factor that we would take into account in our decision. (Annual Wage Review 2014-15 at 338)

Many countries use 'earned income tax credits' (EITCs) to address equity concerns while relieving the pressure on minimum wages, and some Australian economists have suggested that an EITC be introduced here as part of a wage-tax tradeoff. The scope for an EITC in Australia is canvassed in some detail in chapter 6. By design, EITCs encourage labour force participation, and the evidence usually suggests that they do this, especially for single parents, though their effectiveness depends on their exact design. However, they do have several drawbacks (some of which are shared with minimum wages), including the potential for high levels of payment errors, reduced incentives to work for second earners in some households, and barriers to working above certain levels of hours as household income rises. They must also be financed through taxes, which have their own adverse economic effects.

In an Australian context, any EITC would also interact with a well-developed tax-transfer system, which is also intended to improve the incomes of the low paid. The interactions between that system and an EITC would need to be carefully assessed. Microsimulation analysis by the Productivity Commission (2015b) shows that some types of EITCs, when applied in the current Australian context, still tend to provide transfers to more than low-income households.

While it is not clear at this stage that an EITC in Australia would be desirable, it might reasonably be part of a repertoire of options that could be revisited in the future if:

- there were systemic changes to the tax and transfer system — a matter beyond the scope of this inquiry

- 
- it proved not possible over the long run to maintain a minimum wage that provided a balance between adequate incomes for the low-paid and unemployment risk — a matter discussed further below.

Other policies examined in chapter 6 that can be used to support the incomes of the low-paid while taking the pressure off minimum wages include changes to tax thresholds and rates, wage subsidies and work-related social security payments, and in-work benefits. Measures that improve the employability of less skilled people should also be part of the policy mix.

Inevitably, improved social and economic inclusion requires more than a single policy. While it is outside the scope of this inquiry for the Productivity Commission to recommend changes to these other measures, it emphasises that governments need to use minimum wages and the other measures mentioned in chapter 6 as part of a policy suite.

### **The level of the minimum wage?**

As described earlier, the minimum wage is adjusted each year following an annual wage review conducted by the FWC Expert Panel. In doing so, it draws on research as well as submissions from interested parties, and considers various objectives as set out in the FW Act (box 4.2). Much of the most useful and detailed research is provided by the Australian Government in its submission, rather than undertaken by the FWC itself.

Australia's minimum wage is high by world standards although its bite is lower than in the 2000s. The minimum wage was frozen in 2009 (by the former Australian Fair Pay Commission) during the global financial crisis but has since been increased each year. Over the last five years, the FWC Expert Panel has awarded annual increases of between 2.5 and 3.4 per cent.<sup>40</sup> Business groups appearing before the FWC have typically called for smaller increases than have been awarded, while unions have typically supported larger increases. No groups appear before the FWC that specifically represent unemployed people. Nevertheless, bodies such as ACOSS and Jobs Australia have a particular concern for the unemployed as well as low-paid workers (although the interests of these two groups may not coincide if higher minimum wages decrease employment prospects).

### **Key considerations**

While the FW Act sets out an array of objectives the Expert Panel must consider in adjusting minimum wages, the Productivity Commission considers that employment impacts should be a primary focus. As noted earlier, without adverse employment effects,

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<sup>40</sup> In its last five annual reviews, the Expert Panel awarded the same percentage increase in award rates, thereby maintaining relativities between these rates. In 2009-10, it announced a flat dollar increase (of \$26 per 38 hour week) for all wage rates, contributing to some compression in percentage terms between higher and lower rates.

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there would be little reason not to increase the minimum wage and its bite. This would lift the incomes of the low paid and could improve equity (albeit imperfectly) at little or no loss of economic efficiency. But the likelihood that minimum wages cause some disemployment means that, in considering adjustments to minimum wages, there is a need to weigh up the potential benefits to low-paid workers who retain their jobs (and/or hours) against the potential losses to those ‘would be’ employees who fail to gain employment, or experience greater underemployment or job loss, as a result. The greater the assessed risk and extent of such disemployment effects, the greater would be the case for constraining the growth of minimum wages (so as to reduce the minimum wage bite) or even reducing them.

Determining ‘optimum’ minimum wage adjustments depends largely on how these gains and losses are balanced. This involves judgments about both the employment response to changes in the minimum wage and the relative size of the groups affected, and value judgments about whose welfare warrants the most weight. Several considerations are relevant.

As discussed earlier, although many people on the minimum wage live in middle- and higher-income households and minimum wage employment is often a temporary state, there remain many people on the minimum wage without these same supports and opportunities. Many of these people are clearly in tight financial circumstances and face personal stresses and hardships (section 4.3). While reducing the minimum wage bite could be achieved through a more modest *growth* in the minimum wage (rather than a reduction in it), the recipients would see their earnings would grow less quickly than other employed Australians. Moreover, the number of people currently on the minimum wage is much larger than the number of people who would stand to gain or retain employment from a reduction in the minimum wage bite.

However, the adverse effects of unemployment on the individuals experiencing it, as well as on society more broadly, can be considerable. The Department of Employment has drawn attention to the much greater ‘financial stress’ experienced by the unemployed relative to the low paid:

Government analysis shows that in general, while low-paid employees have a higher incidence of financial stress than higher paid employees, both groups of workers have a considerably lower level of financial stress than the unemployed. This suggests that employment, even if low-paid, is a far better aid to meeting financial needs and avoiding financial hardships than the alternative. (Australian Government 2014c, p. 53)

Moreover, joblessness can severely harm other aspects of people’s wellbeing (Lattimore 2007; McLachlan, Gilfillan and Gordon 2013). Employment is not only a source of income but also, often, provides an enhanced sense of purpose, self-worth and self-efficacy. Work is also a place where friends can be made and social capital developed. An early entry into the jobs market can also be an important stepping stone into the world of work and potentially more rewarding careers. While work for the majority of people is not an end in itself, within the current structure of society it is a key pathway for many

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people to a more complete and happy life. Beyond these important individual benefits, there are broader reasons for concern about unemployment: it can represent a waste of productive resources and can cause a drain on the public purse. As the McClure Review (Australian Government 2015a) stated:

There are many benefits of work. Most people gain health benefits associated with employment, both physical and mental. Work can be a vital part of recovery for people with mental health conditions. Intergenerational benefits of work accrue as children who grow up in employed households have better social, emotional, physical development and learning outcomes. The community also benefits. Increased employment supports economic growth, minimises the cost of income support payments and increases the amount of tax paid. (p. 7)

### Prudent policy when employment impacts are uncertain

These considerations suggest that significant weight should be given to employment impacts when determining the level of the minimum wage.

The conundrum is that there is considerable uncertainty about the responsiveness of employment and hours worked to changes in the current minimum wage. Moreover, as noted earlier, beyond some point, reductions in the minimum wage would have little effect on unemployment, due for example to skills mismatch, and could even see employment decline in some markets. That, combined with the transitional costs that would be imposed on currently low-paid employees from any immediate nominal reduction in the minimum wage, and the implementation difficulties in developing soundly-based alternative income replacement approaches (chapter 6), suggests that a reduction in the current levels is not warranted.

In considering these issues, Jobs Australia (sub. 221, p. 9) took a similar view and indeed supported (upwards) wage adjustments, albeit with the important proviso that other policies to support employment be adequate:

The question, really, is whether a potential (and contestable) small negative impact on employment is an acceptable trade-off for equity and other gains accruing to low-paid workers. In our view, it is – provided that other policies, such as concessional wages (youth wages, training wages), active labour market programs (such as Work for the Dole, relevant training) and wage subsidies (such as those available for the long-term unemployed) make up the difference for those who are disadvantaged by the minimum wage.

During periods of heightened unemployment and underemployment, there is less doubt that restraining minimum wage growth would yield material benefits through promoting employment. At present, the unemployment rate is around 6 per cent and many Australians are underemployed (including many minimum wage workers in the lowest quintile of equivalised household income). There are significantly higher rates of unemployment in some regions. Such conditions provide grounds to moderate the growth rate of the minimum wage. This approach should still allow for nominal increases in the hourly incomes of low-paid workers, avoiding the transition costs of any precipitous cut in minimum wages.

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Where greater employment ensued, it would be expected that most of the people to take up new work (and/or retain existing work) would come from the ranks of the underemployed and the short-term unemployed (section 4.2), whose wellbeing may be less at risk than the long-term unemployed. However, a reduction in short-term unemployment would also reduce the flow into long-term unemployment, and some existing long-term unemployed people could in any case be expected to find work directly because of a falling minimum wage bite.<sup>41</sup> As noted earlier, higher employment probabilities would be likely to encourage the re-engagement of people who have left the labour force.

There is also evidence that, where it is binding, the minimum wage tends to reduce hours worked by more than employment. As discussed in chapter 2, there is significant underemployment in Australia, with many people wanting to work more hours but unable to do so. Limiting growth in minimum wages would be more likely to better accommodate such employees' preferences.<sup>42</sup>

The Productivity Commission has used a dynamic Computable General Equilibrium (CGE) model to illustrate some potential economywide impacts of minimum wage moderation in conditions where there is involuntary unemployment and underemployment (box 4.10). A hypothetical policy scenario is modelled in which the wages of award-reliant workers continue to grow, but by 1 percentage point less annually, for 5 years, than under the counterfactual. As with all such exercises, the results need to be interpreted carefully, not least because models' structures, behavioural parameters and closure assumptions can influence the effects of a policy scenario and how they are projected as economic changes. This is particularly so in relation to the modelling of wages changes, including in regard to the extent to which variations in wages are realised as changes in the number of persons employed or in the intensity of work of those in employment. While the Productivity Commission has not based its policy advice on the modelling results, it recognises the potential under certain labour market conditions for minimum wage moderation to provide for an expansion in employment, accompanied by flow-on increases in economic activity and incomes more generally, over the longer term. The modelling illustrates the pathways by which such effects can arise.

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<sup>41</sup> A sustained reduction in short-term unemployment and underemployment would be expected to lead to fewer people transitioning to long-term unemployment, and provide greater opportunities for those in long-term unemployment to find work. However, skills mismatch issues and other impediments to employment may also need to be addressed effectively if this group were to make the most of the increased employment opportunities.

<sup>42</sup> The impacts on the underemployed are in fact mixed. As a group they might gain more hours of work, but would also suffer a reduction in their hourly income, including on the hours they originally worked.



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**Box 4.10 Modelling the longer-term economic effects of a hypothetical wage moderation scenario***The model*

The modelling uses the Victoria University Multi-Regional (VUMR) model in dynamic mode, adapted by the Productivity Commission to differentiate between workers whose wages are directly altered by minimum wage decisions and other workers. The former are identified using the ABS EEH data, which includes a variable identifying workers whose wages are set equal to the minimum award wages — these ‘award-reliant’ workers account for around 19 per cent of the workforce (chapter 7). The model database is based on ABS input-output tables and has considerable occupational and industry detail. The modelling projects effects over time, considers possible adjustment implications and the timescale over which changes may occur.

While the VUMR model is widely used and the modelling approach adopted has been subject to expert scrutiny, the modelling projections outlined below should not be interpreted as forecasts of actual changes. Different model structures, behavioural parameters and closure assumptions reflect different interpretations of real world institutions and forces and their underlying drivers, and can influence how the impacts of a policy scenario are observed.

*Main scenarios*

To establish a simple baseline for the modelling, in scenario 1, award wages are assumed to grow in line with other wages for each occupation.

In scenario 2, award wages are modelled as temporarily growing one percentage point each year slower than in scenario 1, from 2017-18 to 2021-22. While still increasing in real terms, award wages by 2021-22 and thereafter would be around 5 per cent below those in scenario 1.

*Aggregate impacts and main mechanisms*

- In the modelling, business responds initially to the moderation in award wages in scenario 2 by shifting toward more labour-intensive activities. With wage moderation, domestic industries also become more cost competitive, leading over time to an increase in exports, consumer demand and output generally. This in turn induces higher demand for labour (both award and non-award workers) and accompanying investment.
- Relative to the employment baseline in scenario 1 (the blue lines in figure 4.10), aggregate employment growth would be higher under scenario 2 (the green lines). Aggregate employment (measured in hours) is projected to be about 0.2 per cent higher in 2017-18 and, as the economy progressively adjusts, 1.2 per cent higher by 2024-25. If this increase were realised entirely through job creation, aggregate full-time equivalent employment would be around 150 000 persons larger by 2024-25. In practice, some of the increased demand would be met through existing employees working additional hours.
- As employment expands, national labour productivity is projected to decline relative to scenario 1. The inflow of new workers into the workforce is associated with a declining marginal product — each additional worker is modelled as contributing less than the previous worker. Compared with scenario 1, national labour productivity is projected to be -0.1 per cent lower by 2017-18, and 0.5 per cent lower in the longer term (although the expansion in employment more than offsets this decline to afford an increase in national output per person).

(continued next page)

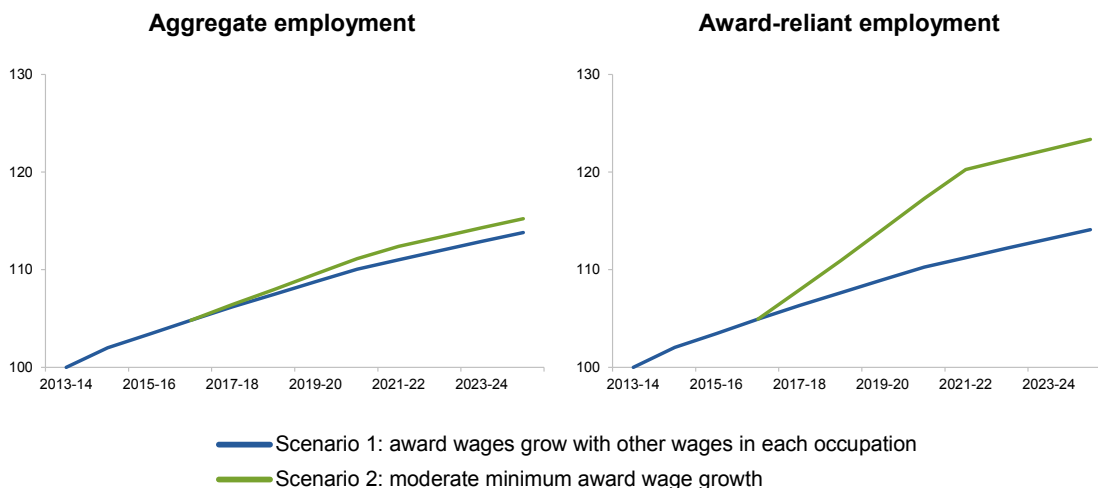
**Box 4.10** (continued)

- While the ‘morning after’ effect of wage moderation is to constrain the income of existing minimum wage workers, this effect is projected to be more than offset by the expansion in employment of minimum wage workers. At an aggregate level, the increased purchasing power is illustrated by a projected expansion in real household consumer spending, of 0.7 per cent above its baseline by 2024-25.
- Overall, gross domestic product is projected to increase to around 0.75 per cent above its baseline by 2024-25. This translates to an increase in GDP of around \$16 billion (in 2013-14 prices) under scenario 2.
- At the sectoral level, wage moderation effects vary somewhat between different production sectors, reflecting the importance of labour in each sector’s cost structure and the responsiveness of demand to any reduction in each sector’s price. In the modelling, services and manufacturing are projected to realise the largest increases in industry value added (almost 1 per cent above the baseline in 2024-25) and employment (1.3 per cent and 1.5 per cent respectively).
- It is also projected that the Australian Government’s fiscal position could be improved by up to around \$500 million in 2017-18 (in 2013-14 prices), reflecting a reduction in the payment of unemployment benefits, a rise in personal income tax revenue and a rise in corporate income tax revenue. The fiscal position of state and territory governments is also projected to improve as GST, property tax and payroll tax revenues expand with the level of economic activity more broadly.

Source: Productivity Commission analysis based on the VUMR-WR model.

**Figure 4.10 Modelled employment effects of wage growth scenarios**

Projected hours, Index, 2013-14 = 100



Source: Productivity Commission estimates based on the VUMR-WR model.

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## Enhancing the FWC's approach

In assessing the range of matters in the FW Act related to the minimum wage objective (and, for floor wages in awards, the modern awards objective), the FWC Expert Panel considers information, indicators and forecasts on a range of relevant matters under the headings 'economic', 'social' and 'collective bargaining'. Among the matters examined are economic conditions, the outlook for employment growth and the needs and living standards of the low paid. The annual wage reviews provide a degree of transparency around the judgments underlying the FWC's decisions.

The Expert Panel also makes qualitative assessments of the cumulative effect of increases in the minimum wage, and seeks to avoid the materialisation of significant, adverse employment outcomes in its considerations. It has indicated that it is 'mindful of the possibility that higher rates of growth of minimum wages could diminish the number of entry level and low-skill jobs over the longer term', and that it gives these and similar factors 'due weight' in its decisions (Annual Wage Review 2014-15 at 433).

The Productivity Commission sees scope for the FWC to enhance its approach to annual wage reviews. A more targeted approach to assessing and determining award wages and conditions is recommended in chapter 8. This includes more extensive use of, and reliance on, evidence and research, more explicit recognition and measurement of the tradeoffs between the different elements of the minimum wage and modern awards objectives, and better account taken of the effects of determinations on all affected parties. While the Productivity Commission considers that the Expert Panel takes a more rigorous approach to minimum wage setting than is adopted currently in modern award reviews, many of the points made in chapter 8 would also be relevant to some extent for annual wage reviews. The enhanced approach should also be the basis for annual wage reviews undertaken the Work Standards Commission, as proposed in chapter 3.

The Productivity Commission recognises that determining the level of the minimum wage that is 'just right' on a consistent basis is neither easy nor reducible to a simple formulaic approach. The OECD (2009) described that challenge as being to set minimum wages at a level that minimises the potential employment losses relative to the income gains of lower paid workers.

This would entail consideration of short-term exigencies as well as longer-term trends.

- Over the long run, the level of minimum wages that can sustain a particular level of employment depends on the skills and capabilities of the jobless and those employees paid close to the minimum wage, and on the relative demand for such people. For example, if the average skills of existing jobless people improved over a sustained period, or demand increased for people in industries intensive in the use of minimum wage employees — such as retailing, aged care and hospitality — there would be greater scope to increase minimum wages without significant adverse effects on their

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employment prospects. However, were the converse to occur, it *may*<sup>43</sup> be necessary to constrain growth in minimum wages to avoid such effects, which in turn could translate into a reduction in the minimum wage bite. If these circumstances were to eventuate, the case for complementary measures to supplement the incomes of the low paid — as outlined earlier and discussed in chapter 6 — would be heightened.

- Over the shorter run, another set of considerations come into play. Given the highly adverse outcomes of unemployment for people’s wellbeing, there are, as noted earlier, grounds for the FWC to temporarily adopt a conservative approach to minimum wage setting whenever the employment outlook is weakening. In improved circumstances, minimum wages could rise at a faster pace, to their appropriate longer-run level.

A particular issue in the context of annual wage reviews is how the FWC considers the issue of forecasting risks pertaining to unemployment. There is greater uncertainty surrounding the employment outcomes of any minimum wage increases when confidence about forecasts of output, productivity and wage is particularly low.

Internationally, central banks and treasuries routinely consider the uncertainty in their forecasts of inflation, unemployment, GDP and other key macroeconomic indicators (see, for instance, Alessi et al. (2014), Bank of Governors of the Federal Reserve System (2015) The Treasury (2015), and Tulip and Wallace (2012)). The Bank of England has developed a graphical way of presenting such uncertainty through the use of fan charts, which provide both a technically useful and intuitively appealing presentation of such uncertainty. Figure 4.11 provides an example.

The advantage of more formally assessing uncertainty in minimum wage decisions is that it allows the explicit consideration of the consequences for employment and household income of forecasting errors. Arguably, the FWC should care somewhat more about the risks of overshooting in its minimum wage increases (with the consequences this has for unemployment) and change its decisions to reflect this. (An analogy is that, when catching a train, it is best to arrive earlier than the expected departure time since the cost of a little waiting is much less than the cost of missing the train.)

Consideration of unemployment risks in minimum wage decision-making does not purely have to rely on technical forecasts, but can take into account expert opinion (Osterholm 2006). Currently, the FWC’s analysis of risk appears relatively simple. This suggests that there is scope for both more formal consideration of risk, and changes in its decision-making to reflect those risks.

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<sup>43</sup> Technically, an alternative would be to maintain the growth in minimum wages but provide wage subsidies (or payroll tax relief) to employers of low-wage workers (chapter 6).

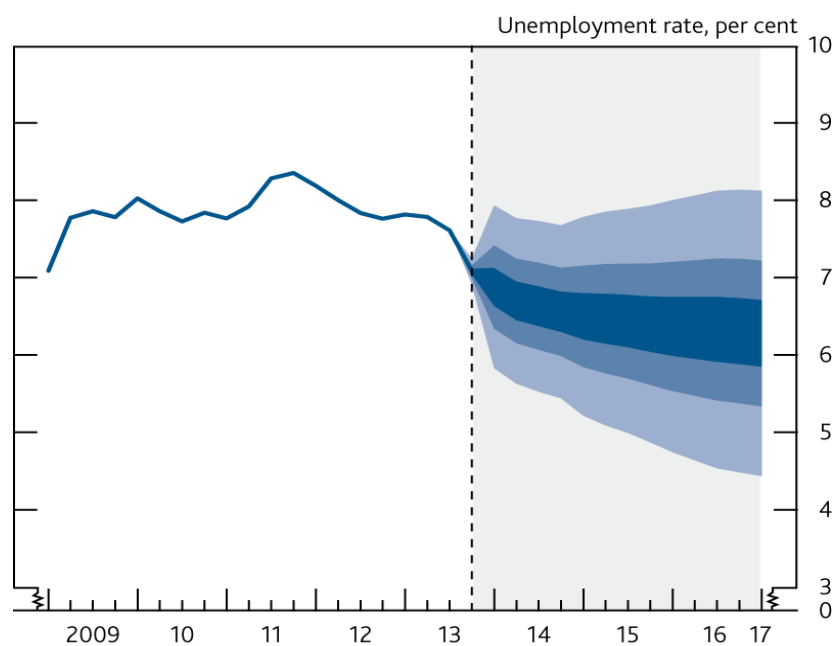
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RECOMMENDATION 4.1

In undertaking the annual wage review, the wage regulator should broaden its analytical framework to consider systematically the risks of variations in economic circumstances on employment and on the living standards of low-paid employees.

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Figure 4.11 **The depiction of uncertainty**  
Unemployment forecasts in the United Kingdom



<sup>a</sup> The different shades depict the different confidence intervals around the mean forecast.

Source: Bank of England (2014).

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## 5 Variations from uniform minimum wages

### Key points

#### *Geographical variations in minimum wages*

- Nationally uniform minimum wages do not account for differences in living costs and labour market conditions in different places.
- Moving to state-based minimum wages would do little to overcome this problem. Commonly-cited measures of differences in states' minimum wage 'bites' overstate the issue, and a state-based minimum wage would be a blunt instrument for targeting disadvantage.
- A regionally-based model would provide greater scope for tailoring minimum wages to areas of relative prosperity and disadvantage, although there are other, more targeted instruments available that potentially could better address pockets of labour market disadvantage.
- Both state and regionally-based models could have several drawbacks, associated with their interactions with the national tax-transfer system and with national awards, compliance costs and questionable constitutionality. The Productivity Commission does not recommend them.
- The *Fair Work Act 2009* (Cth) provides for temporary relief from minimum wage adjustments for businesses in exceptional circumstances. There are tight requirements to ensure this is not misused to permanently shield industries from structural change. Sectors temporarily affected by natural disasters can also find the requirements difficult to meet.

#### *Junior pay rates*

- Lower minimum pay rates for juniors should be retained given the risks to employment from raising wages. These risks are particularly steep for those who are not as productive as others and whose lifelong job prospects rely on early job experience.
- There could be merit in restructuring aged-based junior pay rates to give more emphasis to experience and/or competency.

#### *Arrangements for apprentices and trainees*

- Apprenticeships and traineeships provide an important pathway into work for many young people, and a retraining option for older workers.
- The Fair Work Commission's recent decisions to increase award wages and conditions for apprentices may have reduced participation rates, although it is difficult to disentangle this from other influences, including changes in government-provided financial incentives.
- Given the importance of coordinating policies to promote training and skills acquisition, and uncertainty about the impact of recent changes, the Australian Government should request the Productivity Commission to undertake a comprehensive review of apprenticeship and traineeship arrangements.

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Under the current workplace relations (WR) system, the Fair Work Commission (FWC) sets a National Minimum Wage as well as floor wages for all classifications in awards for national system employees throughout Australia. Following decisions in 2009 by all states, except Western Australia, to refer their WR powers for private sector employees to the Commonwealth, the FWC sets minimum wages for about 70 per cent of employed people in Australia.

The first issue examined in this chapter is whether there is a case for geographically-based variations from these national minimums. Section 5.1 addresses this first at the state level and then at the regional level.

The system of national minimums administered by the FWC includes special rates for younger workers, apprentices and trainees, and some people with disabilities. Section 5.2 examines aspects of youth wages. Arrangements for apprentices and trainees are canvassed in section 5.3.

## 5.1 Geographical variations in minimum wages

### Is there a case for state-based variations?

The idea that *uniform* minimum wages may not be appropriate arises because labour markets are geographically diverse. A particular concern is that minimum wages that are ‘optimised’ for some labour markets may be too high in others, effectively pricing some would-be employees in those markets out of jobs. A related consideration is that the cost of living can vary significantly from area to area. Thus, for example, a person living on the national minimum wage in a smaller state capital or in many country towns may enjoy a higher material standard of living than a minimum wage worker in, say, Sydney or Melbourne, due to differences in housing and transport expenses. A uniform national minimum wage means that economically depressed or declining areas that have low living costs cannot entice businesses to establish or remain in the area to provide employment by allowing them to offer relatively lower wages as a quid pro quo for lower living costs.

There have been several calls to re-introduce variations in minimum wages for Australian states and territories. Notably, the National Commission of Audit (2014) recommended that minimum wages vary across the states and territories, over time being set at a fixed proportion (44 per cent) of each jurisdiction’s average weekly earnings. In doing so, it stated:

Having a single national minimum wage disadvantages workers attempting to gain a job in states like Tasmania and South Australia where wages and the costs of living are generally lower than in other States. (p. 322)



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The Tasmanian Hospitality Association has also reportedly argued that there is a case for Tasmanian state award rates and allowances to be set below modern award rates, to reflect the relative strength of the state's economy (Clark 2015). Similarly, Primary Employers Tasmania have argued for different treatment for Tasmania, noting the state's low cost of living (Parliament of Tasmania 2015, p. 30). A small minority of participants in this inquiry, notably from Western Australia, supported the concept of there being some variation in state minimum rates. UnionsWA added a critical caveat about how state-based minimum wages should be set (box 5.1). Its support for Western Australia's separate minimum wage largely reflected the benefits to low-wage workers from higher minimum wages in a booming state. However, notwithstanding sometimes significant variations over recent years between the labour markets of Western Australia and Australia as a whole, the rates have varied little from each other (with a maximum difference of around 68 cents per hour) (figure 5.1).

#### **Box 5.1 Views from Western Australia**

Some Western Australian participants commented favourably on that states' retention of powers to set its own minimum wages (which apply for employees of unincorporated for non-national system employees). Jonathan Lukman (sub. 76, p. 3) said that the current split system should be retained or that the power to set minimum wages should be fully returned to the states. He saw several advantages of a system of state-based minimum wages:

Having such a system gives the states control to be more competitive where required; to lower or increase the minimum wage taking into account their state's economic health. Australia's states do not have equal division of resources, manufacturing capabilities, or people. As such, more often than not, one state may be economically suffering a mining bust while another state may be seeing a recovery in their manufacturing sector. States which retain their right to set their own wage rates allows such states to respond more quickly during economic crises and allows the benefits of economic booms to be also enjoyed by those on minimum wage.

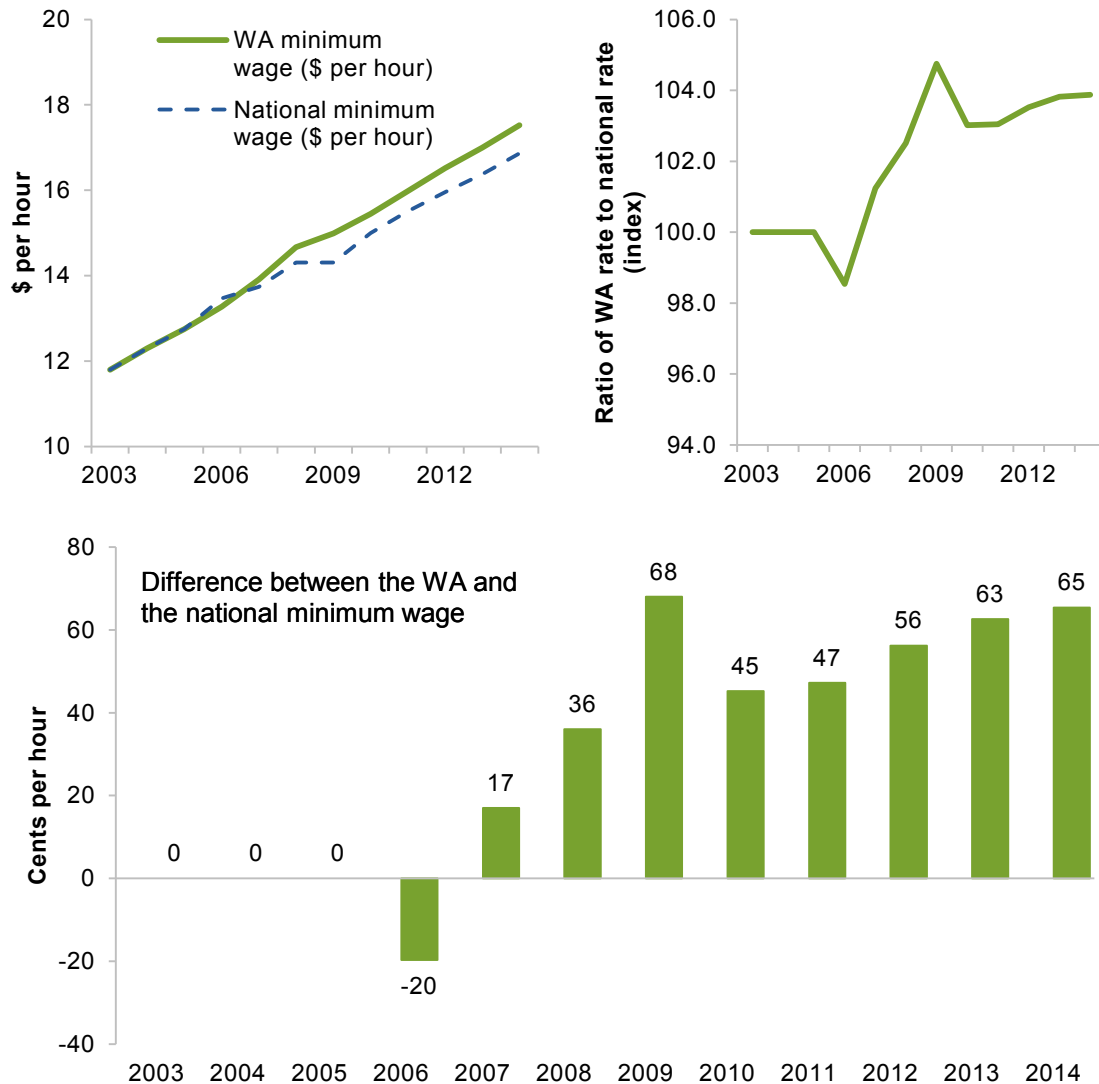
UnionsWA (sub. 112, pp. 1–2) also saw benefits from having a separately determined state minimum wage, although it emphasised that this does not imply support for a formulaic approach that would see state minimum wages adjusted to equate to a specific proportion of average weekly earnings in the state:

The Western Australian minimum wage began to diverge from the national minimum wage after 2005. UnionsWA argues that the WA state Industrial Relations Commission has correctly decided that a minimum wage set specifically for Western Australia should reflect the stronger economic conditions prevailing in WA, and provide for real wage increases to the low paid.

However, UnionsWA warns against using the existence of a WA state minimum wage as evidence that varying the minimum wage across Australia, such as proposed by the Audit Commission, should be considered a just or viable proposition for either Australian or WA workers.

In particular, what WA retains is not just a state minimum wage, but a state minimum wage case ... This process is in stark contrast to the Audit Commission's proposal for a 44 per cent 'benchmark', which would essentially do away with an evidence based hearing.

**Figure 5.1 Variations between the Western Australian and National minimum wage, 2003–2014**



Sources: Department of Commerce (WA) (2014, 2015a); various Annual Wage Reviews by the Fair Work Commission; Bray (2013b).

### Magnitude of the potential employment effect from state variations?

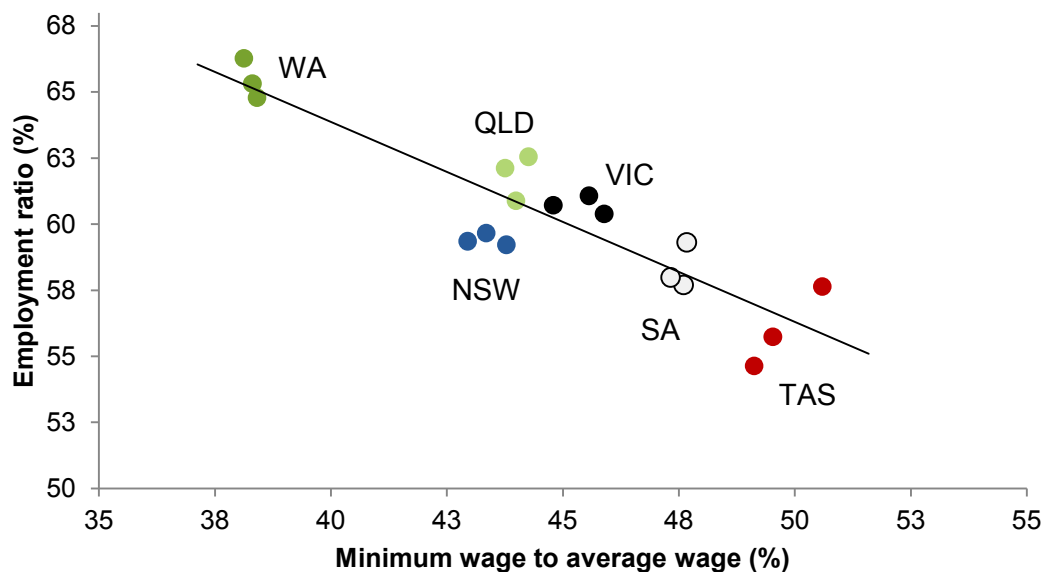
As in much of the empirical literature on minimum wages (chapter 4), it is difficult to draw definitive conclusions on the employment effects of geographical variations in minimum wages within countries. Many international studies find no robust employment effects from geographical variations in minimum wages, even for states that are contiguous and with quite different rates (Dube, Lester and Reich 2010). Australia has a uniform minimum wage (aside from the slightly higher rate in Western Australia), so there is limited evidence on the effects of different minimum wage rates within Australia.

An alternative approach is to examine the effects of variations in the level of the minimum wage ‘bite’ in different areas. One possible measure of the bite is the ratio of the minimum wage to the average wage. This measure was reported by the National Commission of Audit (2014) and in the Productivity Commission’s Issues Paper, and is constructed from published ABS data.

Figure 5.2 shows the relationships between the minimum-to-average wage ratio and the level of employment in the different Australian states using data for the years 2012–2014. It shows that higher state minimum-to-average wage ratios are associated with lower rates of employment (relative to population). Over recent years, unemployment rates in Tasmania, and to a much lesser extent South Australia, have deviated from average Australia-wide unemployment rates (Tasmania by around 2 percentage points from the average). These are the states where the ratios of the minimum wage to average adult weekly ordinary-time earnings are highest. The opposite is the case for Western Australia.

**Figure 5.2 Bigger bite, fewer jobs?**

National minimum wage to average state wage, and employment to population, by state, 2012–2014<sup>a</sup>



<sup>a</sup> Wage, employment and population data are for November each year. Minimum wage refers to that in force in July of each year. The line depicts the linear relationship between the ratio of the minimum wage to average earnings and the ratio of employment to population.

Sources: Productivity Commission estimates based on ABS, *Average Weekly Earnings, Australia*, Cat. No. 6302.0 and ABS, *Labour Force, Australia*, Cat. No. 6202.0.

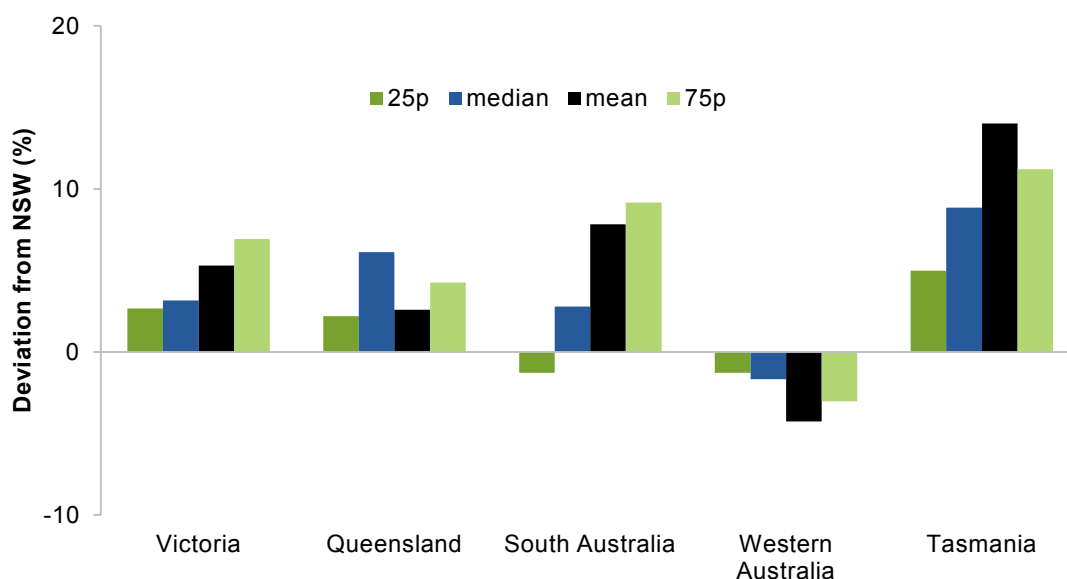
While prima facie this might suggest that measures to change the minimum wage could be effective in increasing employment in disadvantaged states, it is easy to draw too much from such analyses. There are three key complications or counterpoints.

First, different employment and unemployment rates in themselves provide only a limited guide to the potential effects of changing the minimum wage bite, because differences in unemployment rates reflect not only minimum wages, but also differences in skill levels, skills mismatch, structural change and the other characteristics of labour markets. To the extent that geographical variations in employment are explained by the traits of the unemployed and discouraged workers not participating in the labour force, this is likely to reduce the benefits of corresponding variations in the minimum wage. Measures that directly address an individual's employability, such as support for training and skills development (chapter 6), would better deal with these problems.

Second, the ratio of the minimum wage to the *average* wage is potentially problematic because the average can be disproportionately affected by very high wage earners. If the wage distribution in an area has a longer tail of high wage earners, that pushes up the average wage, but says nothing about the mid-to-low wage tail, which is where minimum wages bite.

Consequently, the Productivity Commission has used data from the ABS survey of Employee Earnings and Hours to derive estimates of the distributions of wages within states, including estimates of state median wages (figure 5.3). Using the more orthodox measure of the bite — the ratio of the minimum wage to the median — the divergence of Tasmania's bite falls.

**Figure 5.3 The Tasmanian results are affected by low mean wage rates**  
Deviation in quartile measures of the bite from NSW, May 2014



Source: Productivity Commission estimates based on unpublished data from the ABS, *Employee, Earnings and Hours, Australia, May 2014*, Cat. No. 6306.0.

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The ratio of the minimum wage to the 25<sup>th</sup> percentile is likely to be an even better measure of the bite because it concentrates on the relevant part of the wage distribution. Using this measure, the deviation of Tasmania's bite from other states is even lower. Moreover, the deviations in the bite using the 25<sup>th</sup> percentile as the benchmark hardly varies between NSW, Victoria, Queensland and South Australia. This implies that differential minimum wages at a state level are likely to have relatively small impacts on unemployment rates for most of Australia's population.

The third issue is that, even if minimum wage bites (appropriately measured) were to vary significantly across states, and employment in depressed areas was sufficiently responsive to the bite, varying the minimum wage by state would still be a relatively blunt instrument for tackling disadvantage. This is because all states contain many prosperous areas and many depressed areas, so a state-based minimum wage would still involve 'averaging' across quite disparate areas. Moreover, the variation in the level of prosperity *within* states is far larger than the variation in prosperity *between* states. A state-based minimum wage is therefore likely to be little better than a nationally-based minimum wage for targeting prosperous or depressed areas.

Other policy options (for example, targeted wage subsidies or support for educational attainment (chapter 6)) would likely have greater net benefits in such areas. For example, compared with other jurisdictions, a much larger share of the Tasmanian workforce (around 30 per cent in 2013) has not gone past year 10 at school (PC 2014f), with students performing significantly below the OECD average for reading and mathematical literacy (Thomson, DeBortoli and Buckley 2013). This suggests that measures to improve educational attainment in Tasmania may be warranted.

While a differential minimum wage rate might be still expected to promote greater employment (and, to a greater extent, hours of work) in Tasmania, the national benefits would be modest and would have to be set against the compliance and transitional costs of any shift in policy.

### Other implications of differential state minimum wages

State variations in minimum wages would intersect with national awards. Under the current system, the FWC's annual wage review relates to both minimum wages and awards. Where the FWC grants an increase in the national minimum wage, this is usually translated to all award wages through an equal percentage increase or through the addition of a fixed dollar amount to award wages. If the percentage changes in state minimum wages are not equivalent, there is no longer a single rate that can be applied to awards. If the FWC continued its current arrangement, then wage relativities between the state minimum wage and uniform national award rates would vary considerably, with complex and uncertain impacts on labour markets (and additional compliance costs for multi-state employers).

Minimum wages also interact with the tax and transfer system. Working involves various benefits to households (which can include not just wage income but also a sense of

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self-worth, opportunities for social engagement and the avoidance of any costs of complying with social security requirements, such as meeting job diary obligations) and costs (commuting costs, loss of leisure and untaxed home production, and lower social security entitlements). The combination of a geographically varying minimum wage and a uniform national tax and transfer system may discourage labour supply for some people in areas where the minimum wage is lower. The case of Japan (box 5.2) is an extreme example.

### **Box 5.2 Geographic variations in regulated minimum wages in other countries**

Geographical variations in the minimum wage apply in several, principally lower-income, countries (such as Mexico, Brazil, China, India, Mexico, Indonesia, Kenya, Malaysia, South Africa and Vietnam).

Among developed economies, the United States, Canada and Japan have adopted geographically-varying rates. Minimum rates within Canada do not vary significantly, and so its experience provides little guidance for a system where bigger variations in minimum wages might be contemplated. In contrast, large deviations can occur between regional rates in the United States and Japan. For example, the highest prefecture rate in Japan is 30 per cent higher than the lowest rate.

Japan's regional minimum wage setting arrangements are complicated (Nakakubo 2009) and involve some perverse features because, in a significant number of prefectures, welfare recipients earn more income than minimum wage employees (The Japan Times 2013). The Japanese system is also overlaid by an elaborate system of industrial wages akin to Australia's award wage system, albeit with even more categories.

In the United States, the US Federal Government sets the floor wage for most employees. State governments can set higher minimum wages for employees covered by the Federal minimum wage, and vary the minimum wage in any direction for non-covered employees. While many states have adopted the Federal minimum wage for all employees, very few have set lower rates, a few have no state laws, and a significant number have set higher rates (Bradley 2014). For example, California will set a minimum wage of US \$10 per hour on 1 January 2016, which is nearly 40 per cent higher than the Federal minimum.

Some US states set different rates for different industries and many vary the rate based on business employment size. They also use many different approaches for re-calibrating their minimum wages, from irregular legislated changes, regular indexation to various cost of living indexes, and formulas that regularly reference the federal rate. In other words, there is little coherence in setting minimum wages for a large share of US employees, and a diverse set of motivations are at work in determining rates. For example, for an employer, the cost of living for employees is not a relevant consideration for employing a person, while a large enterprise with low-skill, low-paid workers may have no greater capacity to pay a higher minimum wage than a small enterprise.

If the US experience provides any lessons, it is perhaps that state government control over minimum wages does not necessarily respond much to local labour market conditions. This is all the more so since, within states, such as California (a state with a population roughly equivalent to Australia), there are many diverse labour markets (although there are also some city-based variations in minimum wages).

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To reduce any such effects would require the adoption of a geographically-distinct tax and transfer system. State and territory governments already have some capacity to vary social security entitlements in their jurisdictions, for example through criteria for access to public housing, and various transport and other government concessions. However, there is currently no mechanism for fine tuning cash transfers. States have the constitutional power to do so, but this would involve a bold step for state and territory governments, which currently provide limited social security payments. Any significantly diverging state arrangements would further complicate Australia's tax and transfer system.

The compliance costs associated with geographically varying rates may also be a consideration. One of the motivators for referral of powers by most Australian states was to make Australia's WR system simpler. Common minimum wages and awards were one feature of this. In this context, the South Australian Government noted:

... the Government of South Australia also rejects the concept of different wage outcomes based upon particular circumstances in each industry or region. A core objective in establishing a national workplace relations system was to remove complexity and duplication and to ensure that Australian workers and employers were subject to consistent workplace laws irrespective of geographic location or size of business. (sub. 114. p. 9)

The legal issues surrounding a move to state or regionally-based minimum wages are relatively complex and, in some instances, not yet clear:

- There is no doubt that were state governments to withdraw their referral of industrial relations powers to the Commonwealth, they could set different minimum wages for non-national employees. This is already the case in Western Australia, but notably, few employees are non-national employees (appendix B) and so any effects on employment would probably be modest.
- An alternative might be that the Australian Government attempt to set state (or/and regional-based) minimum wages for all employees currently covered by the FW Act. Whether it would have the constitutional power to do so is a vexed issue (box 5.3), but any intention to introduce such a major change would need to examine the legal issues closely. And, of course, as noted above, were State governments to reject such a unilateral move, they could cease referral of their powers, and set their own, potentially different minimum wages for non-national employees. That itself would probably not matter a great deal, but it would also mean that non-national employees would not be covered by any of the other aspects of the FW Act.

Other than the few exceptions described earlier, there has been no call by business groups, individual employees or unions (including those in Tasmania) for different minimum wage rates for different states. This reflects the view that the minimum wage is now a safety net, and that many workers receive more than this. Some key Tasmanian employers consulted by the Productivity Commission acknowledged that they paid above award wages for employees in Melbourne, but that they saw the national minimum wage as right for their Tasmanian employees.

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The Productivity Commission has concluded that there is little basis for minimum or award wages to vary by state.

### Box 5.3      **Some legal issues**

All states except Western Australia referred their WR powers for private sector employees to the Commonwealth in 2009. While this enables the FWC to set a uniform national minimum wage for all such employees in the relevant states, it is less clear that the Commonwealth has the constitutional capacity to vary minimum wages by state.

Section 99 of the Australian Constitution represents one possible obstacle. The section states:

The Commonwealth shall not, by any law or regulation of trade, commerce, or revenue, give preference to one State or any part thereof over another State or any part thereof.

An initial question is whether s. 99 could extend to employment arrangements. If it did not, then that section would not seem to rule out state-varying rates. This is not a decided matter. On the one hand, the jurisprudence on the terms 'trade and commerce' in the Australian Constitution has come to be broadly interpreted (Gray 2008), including employment conditions of employees engaged in commercial activity (*R v Foster; Ex parte Eastern & Australian Steamship Co Ltd (1959) 103 CLR 256*). On the other hand, this interpretation has arisen for s. 51, but not expressly s. 99. A difficulty in drawing conclusions on this issue is that all recent cases involving s. 99 have been tax cases.

The meaning of 'preference' in s. 99 also has considerable importance, since if variations in regulated wages do not amount to a preference, then s. 99 would not have any application. This has only been partially clarified. The majority of the High Court accepted that in *Permanent Trustee (2004) (220 CLR 388)*, differential taxes could be imposed and yet still meet the s. 99 test. In that case, the Commonwealth was setting tax rates that were indeed different in different states, but that were equal to the tax treatment by each state for comparable assets. The dissenting judges in *Permanent Trustee* took a more literal interpretation of s. 99 and considered the conduct was preferential, and therefore in breach. Dissenting judgments can ultimately overwhelm precedent and have frequently done so in Australia (Lynch 2007). The Australian Government Solicitor has also indicated that the High Court did not elaborate on some key concepts underpinning its determination, raising the question of how a judgment might proceed in a different context.

A separate constitutional issue may arise from s. 92, which relates to free trade between the states. Setting different regulated wages for enterprises engaged in interstate trade may represent a barrier to such trade. The bottom line is that careful analysis of the constitutional issues would be an important precursor to any serious intention to introduce regional or state varying regulated wages.



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## Are more granular variations in minimum wage rates warranted?

Aside from calls for variations in minimum wages between states and territories, some other arguments have been made that might support more granular variations in minimum wages:

- the Chamber of Commerce and Industry Queensland (CCIQ, sub. 150) urged relief from minimum wage increases for regional businesses affected by natural disasters, such as droughts and cyclones
- some also argue that rural businesses' employment decisions are more sensitive to minimum wages (Lewis 2004)
- one participant argued for higher minimum wages in places like Sydney with high living costs (sub. 188, line 275), which in effect is equivalent to arguing for relatively lower minimum wages outside such places.

### General regional variations?

Prima facie, it appears that a model that allowed for regional variations has less severe deficiencies than one based on minimum wage variations across state borders:

- While the minimum wage bite (when measured appropriately) at the State level does not vary significantly, it could be expected to vary more between regions and between different cities and towns.
- While all states contain both relatively prosperous and relative depressed areas making targeting problematic, variations by region or location could, in principle, be tailored much more closely to areas of relative prosperity and disadvantage.

As in the case of state-based variations in minimum wage, there are other instruments available for addressing pockets of labour market disadvantage. These include support for training and skills development and transport and wage subsidies (chapter 6). Although not without their own costs and limitations, these could potentially target disadvantaged people more readily than a system of regional variations in minimum wages.

Nevertheless, for this inquiry, the Productivity Commission explored whether it is possible to use data on regional wages and employment to shed light both on the employment effects of the minimum wage and on the desirability of varying the minimum wage by geographic area (box 5.4). The analysis confirms that the wage bite (at least when measured using the minimum wage to average wage ratio) does vary more significantly between regions than between states. However, various data and technical issues rendered deeper analysis inconclusive.

**Box 5.4      Analysing the employment effects of regional differences in the minimum wage bite**

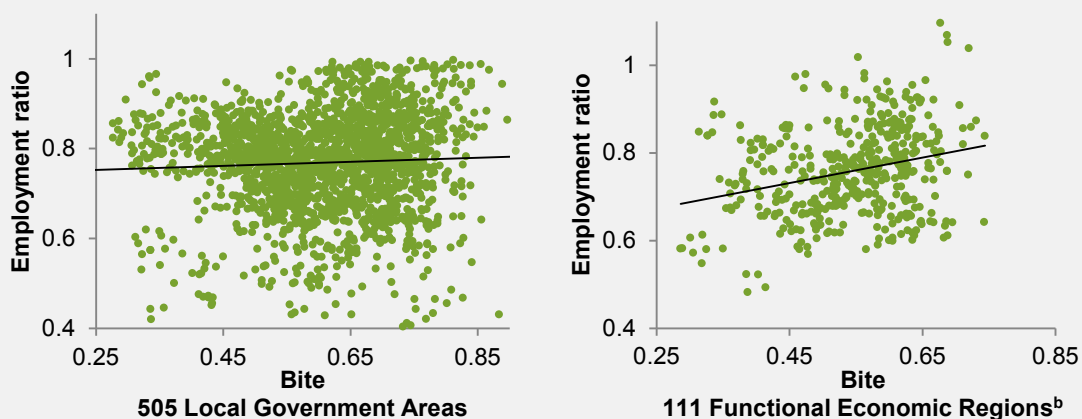
Several international studies have implemented a geographic ‘bite’ approach to the identification of employment effects from the minimum wage (Bryan, Salvatori and Taylor 2013; Dickens, Riley and Wilkinson 2009, 2012; Dolton, Bondibene and Stops 2012; Neumark and Wascher 1992). This approach exploits regional variations in the ratio of the minimum wage to the average or median wage, or in its coverage of the workforce.

The most common form of geographic bite analysis seeks to detect a link between a Kaitz Index (the ratio of the minimum wage to the average wage or median wage) and the employment-to-population ratio. Evidence on the existence of this link is mixed. This uncertainty is frequently attributed to the vast range of influences that can impact on a state’s or region’s labour market over time and, hence, its employment ratio and its Kaitz Index.

The Productivity Commission has explored the value of replicating the approach of some overseas studies of the minimum wage that used geographic bite analysis. A useful starting point is a visual examination of the Kaitz Index–employment ratios relationship at various levels of regional aggregation. As the two panels in the figure below illustrate, that relationship appears to be slightly positive at the two levels of regional aggregation shown, constructed using data available for the period 2008–2011. Regional data on median wages were available for only one of the years covered, so the analysis used average wage data for its Kaitz index measure.

However, this graphical approach is potentially misleading, as it does not account for the range of influences — some state- or region-specific, others time-related — that affect the two variables of interest. For example, the natural resources boom of the 2000s would have caused the bite of the minimum wage to fall and the employment ratio to rise in parts of Western Australia for reasons unrelated to the minimum wage.

**Kaitz Index and employment ratio, by region, 2008-2011<sup>a</sup>**



<sup>a</sup> In both the graphs above, the Kaitz Index is measured on the horizontal axis, and the employment ratio on the vertical axis. Some employment ratios are greater than 1, due to data inconsistencies.

<sup>b</sup> Functional Economic Regions are an amalgamation of contiguous Local Government Areas, based on a taxonomy devised by the Centre of Full Employment and Equity.

(continued next page)

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**Box 5.4** (continued)

The influence of local economic conditions is apparent when both the Kaitz Index and the employment ratio are summarised at the state level (see figure above). At that level of geographic aggregation, the relationship of interest appears negative. That result is strongly influenced by Western Australia on the one hand, and Tasmania on the other. In the former state, a low index and high ratio coexisted during the 2012–14 period. The opposite was true of Tasmania. This illustrates the potential for misinterpretation from ignoring state-level influences in figure 5.4. When the relationship between the Kaitz index and the employment ratio by region is estimated econometrically while controlling for time-invariant state and regional characteristics, the regional relationship is negative and significant.

However, when time-varying influences arising from events such as the Global Financial Crisis are accounted for, this estimated econometric relationship breaks down. The sensitivity of the model to changes in control variables and functional forms reflects the technical challenges posed by geographic bite analysis. One challenge — spatial correlation between contiguous regions — is addressed by choosing Functional Economic Regions as the geographic unit of analysis. A more fundamental issue, not able to be accounted for here, is the simultaneous determination of the Kaitz Index and the employment ratio, resulting in possible endogeneity bias.

Due to the difficulty of addressing this form of bias, the existence, let alone direction, of the relationship of interest remain uncertain. The issues around the use of average rather than median wage data for bite analysis (see text) and the quality of regional data concordances used are also potentially relevant. As a result, the Productivity Commission has not relied on results from its exploratory geographic bite analyses to inform its thinking.

*Sources:* Productivity Commission estimates based on data from ABS Cat. No. 6524.0.55.002 and Cat. No 3235.0, Department of Employment small area labour market publications and CoffEE (<http://e1.newcastle.edu.au/coffee/>).

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While the Productivity Commission would still expect that varying minimum wages at the regional level could have some employment benefits, many of the same difficulties that apply at the state level also apply at the regional level. These include problematic interactions with the national tax and transfer system, difficulties in determining award rates (were they also to vary in line with minimum wages in different regions), and the need for state governments to acquiesce to such an approach. Moreover, there would be greater complexities in adjusting regional minimum wages each year, given that: movements in the bite in local areas could vary significantly from year-to-year because of greater volatility in the wage distribution; and reliable data collection for such areas is intermittent. Businesses operating across different regions (whether within a state or across state boundaries) would face considerably greater complexity in managing payrolls, recruitment, and workforce planning.

An alternative to attempting to set regional wages according to year-to-year changes in the minimum wage bite would simply be to set district allowances (as contained in some awards) and/or district discounts that could be varied from time to time by the FWC. This process would have its own considerable challenges.

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Few participants advocated regional variations in the national minimum wage of this type, and the Productivity Commission does not see any compelling grounds to recommend them as a general approach.

### Temporary relief for struggling areas?

The question of deferrals or temporary exemptions for natural disasters, raised by the CCIQ, raises a slightly different set of issues. It argued:

Key impacts of natural disasters such as drought include a significant reduction in or no capital expenditure, loss of skilled staff and loss of crops and livestock. As the agricultural industry is a key economic driver in many rural communities, the impact of drought on the industry has significant ripple effects that can result in higher unemployment rates, reduced rural populations, and reduced economic activity. ...

At present, there is no capacity for the Fair Work Commission to take into consideration factors such as natural disasters, and our Organisations strongly argue that extenuating circumstances such as ongoing drought and exposure to the destructive effects of cyclones warrant exemption from the minimum wage adjustment for a given period. (sub. 150, pp. 20–21)

While delaying a minimum wage adjustment for workers in affected industries would undoubtedly provide some immediate financial relief for the employers, it would also deny already lowly paid workers funds at a time when, in some cases, they may also face unusual financial demands, and it could lessen the funds available for expenditure in the local community. Of course, where affected businesses scale back employment, this will reduce the workers' income and wellbeing, and local consumption, much more. However, governments already have an array of mechanisms they can and do use to assist affected businesses and communities subject to such disasters. It could be argued that, provided the minimum wage is playing a legitimate safety net function, these other mechanisms should be the first port of call for assisting affected business where appropriate.

Nevertheless, s. 286 and 287 of the FW Act provide some scope for the FWC to take into account 'exceptional circumstances' when adjusting minimum wages. In 2007, its predecessor, the Australian Fair Pay Commission, decided to defer the annual increase in minimum wages (for classifications above the basic National Minimum Wage) for all farmers in receipt of the exceptional circumstance interest rate subsidy payment for 12 months, following a request from the National Farmers Federation. The FWC has recently considered submissions from several industry groups seeking exceptional circumstances deferrals or exemptions in relation to a range of natural disasters, including droughts, floods and cyclones. Industry groups have also applied for deferrals or exemptions on a variety of other grounds, including poor trading conditions, the effects of a high Australian dollar and reduced tourism, high business failure rates in particular

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sectors, the effects of the former carbon tax, the effects of increases in minimum wages for apprentices, and the costs of the award modernisation process.<sup>44</sup>

In articulating its approach to the exceptional circumstances provisions, the FWC has said:

Consideration of differential increases or timing of minimum wage increases in relation to individual employers or specific industry sectors in exceptional circumstances should be primarily directed to addressing temporary issues and temporary relief from minimum wage increases, rather than to seek to hold back the ongoing process of structural change in the economy. (Annual Wage Review 2014-15 at 510)

It has further stated that the scheme of the FW Act is ‘more consistent with establishing adjustments across the range of modern awards and, in the absence of exceptional circumstances, taking the sectoral variations into account when determining the level and nature of adjustments that will apply to the modern awards generally’. It also notes that basing different wage outcomes on the particular circumstances in each industry, as they might vary from time to time, would lead to the loss of any relativity between the wages specified in modern awards, which could run afoul of the ‘equal remuneration for work of equal or comparable value’ principle (Annual Wage Review 2014-15 at 109).

The Productivity Commission agrees that annual wage reviews are not well suited to adjusting minimum wages (whether the national minimum wage or the floor wage rates set in awards) to deal with mid- to long-run changes in the viability and competitiveness of different industries. Moreover, if the national minimum wage is set correctly to play its legitimate safety net role, it would not be appropriate to provide ongoing ‘discounts’ from it to businesses that would otherwise not be viable. Put simply, businesses that could remain viable only by paying wages well below the relevant community standards reflected in the national minimum wage are probably not ones Australians would want to encourage.

However, as reflected by the existence of the exceptional circumstance provisions in the FW Act, there can be grounds for temporary exemptions or deferrals of adjustments to the national minimum wage (and/or the relevant award floor wages) for industries that are struggling temporarily.

To date, the FWC has not found cause to provide such an exemption or deferral. In rejecting the CCIQ’s recent request that such relief be provided in relation to drought and cyclones in Queensland, the FWC stated:

We readily accept that natural disasters have an adverse impact on business. Similarly, they are likely to have an adverse impact on employees engaged within the relevant affected areas. In many cases these employees may be among the lowest paid in the community and facing financial stresses because of the effects of those natural disasters on them and their families.

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<sup>44</sup> See, for example, Annual Wage Review 2011-12 [2012] FWAFB 5000 [1 June 2012] at 270-272, and Annual Wage Review 2013-14 [2014] FWCFCB 3500 [4 June 2014] at 539-540.

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We also accept that a deferral of any rise in minimum wages would make some contribution towards easing the burden on businesses. However, the difficulties observed by the Panel in the 2011-12 [regarding an exceptional circumstances request in relation to flooding] ... again face us in this Review.

The fact that an area is 'drought declared' of itself will not constitute exceptional circumstances for the purposes of ss. 286 or 287 of the Act. Similarly, a submission that cyclones have impacted some regions of Queensland will not of itself establish exceptional circumstances.

... The submission provides little material upon which we could make a finding that exceptional circumstances exist and that they are such as to warrant a deferral of any increases to minimum wages. (Annual Wage Review 2014-15 at 513-518)

The FWC went on to point out that, while the CCIQ had said that there should be a deferral of any wage increase for farmers and agribusinesses in the regions which have been affected by drought, it had not proposed any mechanism to properly identify the employers or employees affected. Identifying such groups in a way that meets the requirements of the FW Act, as interpreted by the FWC, has been an obstacle in several exceptional circumstances decisions relating to natural disasters. The FWC also identified several other requirements that would be needed to make the case for a deferral that it considered had not been made by the CCIQ.

The question that arises is whether the FWC's approach to exceptional circumstances claims is sufficiently tractable and allows a proper weighing of all relevant benefits, costs and risks to affected workers, employers and communities of allowing temporary relief. In the draft report, the Productivity Commission indicated that it had no firm view on these matters and would welcome further input, including any options for practical reform if they are warranted. While some participants reiterated the difficulties that industry can face in gaining relief from wage increases using the exceptional circumstances provisions (for example, National Farmers Federation, sub. DR302), the Productivity Commission did not receive any workable suggestions as to how the provisions in general could be improved, if in fact changes are warranted. The Queensland Council of Unions commented:

The FWC can already make temporary variations to its annual decisions ... . The problem is that all such applications have to date been so lacking merit that they have been unsuccessful. It is very easy for an employer or group of employers to say that they have an incapacity to pay for a wage increase but it is quite another to be able to prove incapacity to pay. (sub. DR305, p. 6)

Aside from the general operation of the exceptional circumstances provisions, the FWC has identified a specific difficulty with the FW Act which prevents it responding to requests for temporary variations in award wages on exceptional circumstances grounds *after* an annual wage review has been completed (Annual Wage Review 2014-15 at 78-79). So if adverse circumstances arise in, for example, August, the businesses affected would have to wait until the following year's annual wage review before they could seek relief. The FWC has drawn attention to this problem each year since 2011-12, but no legislative amendments have been forthcoming. Some participants (including the National Farmers Federation, sub. DR302) supported such an amendment, while others questioned the basis

for temporary variations on exceptional circumstances grounds generally and/or argued that expanding the provision to give it retrospective scope would be inappropriate (for example, Bray, sub. DR261; CPSU, sub. DR270; UnionsWA, trans., p. 808). In the Productivity Commission’s view, there is merit in retaining the exceptional circumstance provisions, and the Government should address the issue identified by the FWC.

#### RECOMMENDATION 5.1

The Australian Government should ensure that the wage regulator can consider claims of incapacity to pay and, if necessary, vary its modern award minimum wage decision (for example, for an individual employer or on an industry, sector or geographical basis) after an annual wage review has been completed.

This recommendation complements Recommendation 8.2 to remove the requirement that any variation to award wages outside annual wage reviews must be justified by work value reasons. Recommendation 8.2 will give the wage regulator more flexibility to permanently vary award wages to meet the needs of each industry or occupation, while Recommendation 5.1 will give the wage regulator authority to order temporary deferrals, including for a sub-set of the industry or occupation.

## 5.2 Junior pay rates

Federal junior pay rates specify minimum wages for people aged under 21 years as a proportion of the relevant adult rate. Around 50 per cent of OECD countries that set youth wages do so as a share of the adult rate (OECD 2015a).

Although the adult National Minimum Wage is high by world standards, the relevant junior rates for non-award or agreement employees (which are equivalent to the junior rates in the Miscellaneous Award 2010) start at just 36.8 per cent of it (\$6.36 per hour) for workers aged under 16 years. They then increase incrementally, with 20 year olds entitled to close to the full adult rate (table 5.1).

**Table 5.1 Examples of federal junior pay rates<sup>a</sup>**

Age	<i>Miscellaneous Award</i>		<i>Fast Food Industry Award</i>	
	<i>% of adult rate</i>	<i>\$/hr</i>	<i>% of adult rate</i>	<i>\$/hr</i>
Under 16	36.8	6.36	40	7.59
16	47.3	8.18	50	9.49
17	57.8	9.99	60	11.39
18	68.3	11.81	70	13.29
19	82.5	14.26	80	15.19
20	97.7	16.89	90	17.09

<sup>a</sup> As at July 2015.

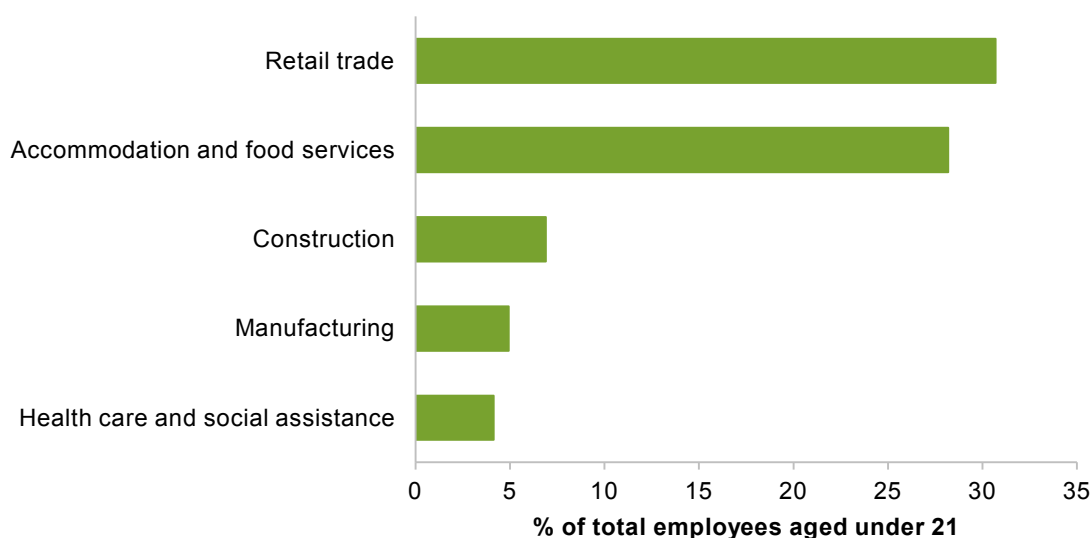
Sources: Annual Wage Review 2014-15, National Minimum Wage Order 2015, FWC.

As with adults, juniors' actual pay is more likely to be specified in other awards or enterprise agreements and to vary from those in the Miscellaneous Award. For instance, the minimum rate of pay for workers aged under 16 years and covered by the General Retail Industry Award 2010 is \$8.54 per hour. More generally, Stewart (2013, p. 201) notes 'a common (but by no means universal) arrangement in awards is for 16 year olds to receive 50 per cent of the relevant adult wage, 17 year olds to receive 60 per cent, and so on up to the full rate at 21'. However, 75 of the 122 awards — usually covering skilled qualifications that require more experience — do not specify junior wages.

The structure of junior wages can vary with each award. For example, junior wages in the Wine Industry Award apply only to people younger than 18 years. People aged under 17 years are paid 80 per cent of the adult wage, and 17 year olds are paid 90 per cent. In the General Retail Industry Award, 20 year olds who have worked for more than six months are paid at the adult wage. However, most junior wages in awards adjust with changes to adult award wages, which are generally linked to adult National Minimum Wage.

The Department of Employment estimates that 217 300 15 to 20 year olds in 2012 were paid a junior wage specified in an award (sub. 158, p. 11). Around 60 per cent of all junior employees work in the retail trade and the accommodation and food services industries (figure 5.4). Depending on age, the junior wages in some of the main awards that cover these industries are up to 36 per cent higher than the Federal Junior Pay Rate (figure 5.5).

Figure 5.4 **5 main industries in which juniors work<sup>a</sup>**



<sup>a</sup> Data are as at May 2014. Standard errors of shares for construction, manufacturing, and health care and social assistance are around 25 per cent. The data source excludes the Agriculture, Forestry and Fishing industry. Analysis of ABS *Labour Force, Detailed Quarterly, February 2015* Cat. No. 6291.0 suggests that the proportion of juniors working in this industry is below 3.5 per cent.

Source: ABS, *Employee Earnings and Hours, Australia, May 2014*, Cat. No. 6306.0.



Junior pay rates in enterprise agreements are determined through bargaining although, in many cases, they resemble the structure of the federal junior pay rates. For example, both McDonald's and Woolworths specify junior pay rates as a proportion of the adult wage rates in their enterprise agreements. Like federal junior pay rates, the proportion of the adult rates that juniors earn increase with the employees' ages.

**Figure 5.5 Junior wages in selected awards and enterprise agreements<sup>a</sup>**  
 Percentage of junior pay rates in the Miscellaneous Award 2010



<sup>a</sup> Data are as at July 2015. When applicable, rates are based on introductory positions in NSW.

Sources: General Retail Industry Award 2010; Fast Food Industry Award 2010; Restaurant Industry Award 2010; Hospitality Industry (General) Award 2010; McDonald's Australia Enterprise Agreement 2013; Woolworths National Supermarket Agreement 2012.

## Impacts on employment and education

Juniors' involvement with the labour market differs in some ways from that of adult workers. Many juniors live at home, are supported by their parents, and do not have dependents of their own. Many juniors (although again not all) have the discretion not to earn an income or may only work as a (part-time) adjunct to other activities, such as school

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or further education.<sup>45</sup> Young people can also receive income support payments from the Government — such as Youth Allowance — to help when they are studying or living independently.

Of course, at some point, all young people face a decision between continuing with study or other non-work activities and seeking to enter the labour force full-time.<sup>46</sup> Another consideration is that young people, at least when they first start work, can be expected to be less skilled, qualified and competent than more experienced workers (although this is not always the case as some young people can start with considerable work-relevant capabilities).

These differences have some ramifications for the employment effects of junior wages, although the impact of junior pay rates will, in many respects, mirror the (complex) effects of the adult minimum wage (section 4.2). To the extent that juniors are less productive than adults, employers would require commensurately lower pay to employ them. Regulated minimum pay rates for juniors that are higher than this level would adversely affect junior employment (although they may promote greater adult employment).

Junior pay rates can also indirectly affect some people's long-term job prospects. If junior wage rates are high, they increase the willingness of young people to search for jobs (the supply side), but discourage employers from hiring them (the demand side). Excessively high wage rates are most likely to affect the least productive of young employees, and may be particularly adverse for those young people who relinquish education or for whom education produces lower returns. There is evidence that young people who have been unemployed find it harder to obtain steady work compared with those who have been working (Richardson 2002). Unemployment for these groups of the young is particularly problematic because holding down a job early can be a 'stepping stone' to employment in adulthood. Working can develop people's work-related knowledge, skills and habits, and signal general work aptitude to prospective employers.

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<sup>45</sup> The SDA (sub. DR306) submitted that 'young workers in fact experience the same raft of living and financial pressures as older employees, pressures which are exacerbated by discounted wage structures'. It cited an FWC decision that noted that 'a majority of working 15-24 year olds are not financially dependent upon their parents', and also pointed to Census data showing that over 135 000 15-24 year olds identified as a carer in 2011 (which is around 4 per cent of the 15-24 year old population at the time) (ABS 2015g).

The cut-off age for junior rates is 20 years, and it is likely that a much lower share of 15-20 year olds (and even 18-20 year olds) lives independently, compared with those up to 24 years of age. For example, estimates based on HILDA data for 2008-13 indicate that the share of 21-24 year olds that lives with a parent or grandparent (including step, foster parents and in-laws) is around one third lower than the equivalent share of 18-20 year olds. The relativities are similar when the analysis is limited to those in work.

<sup>46</sup> ABS (2015e) shows that 37 per cent of 15-19 year olds in full-time education also worked.

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Importantly, even though most juniors who remain in education appear better off,<sup>47</sup> some juniors are likely to benefit from leaving school and entering the workforce early. For example, young people who underperform academically, but continue through to year 12, may struggle to find a job upon graduation as they must compete at a higher pay scale with candidates with stronger academic credentials or work experience (Lattimore 2007). Were such young people to leave school and seek work at an earlier age (and thus at a lower rate of pay), they are more likely to initially find a job, gain experience and may eventually fare better against year 12 graduates. This is likely to particularly hold for jobs where employers value practical work experience above education (or where employers are concerned that the more educated employees will have shorter tenures because they are more likely to move to higher-skilled jobs or further education).

A critical issue is therefore not just whether high junior wages affect young people's decisions to work or search for work, but the effects they have on the mix of those young people who obtain (or not) the jobs that are available.

Of course, for those young people who do obtain jobs (at the hours they want), higher youth wages provide an important source of income to meet living costs (and where studying, any educational costs). Nevertheless, as noted above, many young workers, particularly teens, are not as reliant on wages as are older workers.

Empirically, a number of the Australian studies surveyed in appendix C that assess the employment effects of changes in minimum wages are concerned with youth employment effects. Leigh (2003), for example, considered how employment effects of changes in the minimum wage in Western Australia varied for different age cohorts, finding that the effect was greatest for workers aged 15-24. Only three of the studies specifically considered the effect of changes to junior rates (Mangan and Johnston (1999), Junankar, Waite and Belchamber (2000) and Olssen (2011)), but with the methodologies and results varying.

Across the Tasman, a series of significant changes to New Zealand's junior pay scales during the 2000s have provided useful experiments that have been studied by economists (box 5.5). While the picture is somewhat complicated, it appears that increasing the rates payable to juniors had some disemployment effects. The New Zealand evidence also suggests that increases in youth wages may also have enticed some juniors away from

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<sup>47</sup> There is considerable evidence that education is generally beneficial for a junior's immediate and future employment. For example, Quintini et al. (2007) found that, in most OECD countries, young people with higher education qualifications were less likely to be unemployed one year after leaving education. ABS (2014b) data shows that, at May 2014, 9.6 per cent of adults who had not finished year 12 were unemployed, compared with 6.7 per cent of those whose highest level of education was year 12. More broadly, education affects juniors' future earnings, more qualified workers typically earning more. For example, Cassells et al. (2012) estimated expected lifetime earnings for a 25 year old Australian with postgraduate qualifications to be 1.8 times those of a person whose highest level of education was year 11 or below. However, such studies have to be carefully interpreted because more inherently able people tend to select further study (because of its higher returns). Meaningful results can only be obtained by controlling for such selection effects.

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schooling (although whether that is an adverse outcome would require follow-up evidence on its long-run effects).

### Box 5.5 Youth wages in New Zealand

New Zealand made a series of changes to its minimum wages for 16-19 year olds in the 2000s:

- In 2001, the minimum wage for 18-19 years olds was increased from 60 per cent to 100 per cent of the adult minimum
- From 2001 to 2002, the wage for 16-17 years olds was progressively increased from 60 per cent to 80 per cent of the adult minimum.
- In 2008, the wage for 16-17 years olds was increased to the adult minimum, and a *new entrants* rate at 80 per cent of the adult rate applied for 16-17 year olds' first three months or 200 hours of work (which was replaced by the *starting-out* wage in 2013 and applied for a 16-17 year old's first six months of work).

In an analysis of the 2001 changes, Hyslop and Stillman (2004) concluded that there was a slight increase in the employment of teenagers, and that 16-17 years olds worked more hours, but that the unemployment rate of teenagers increased. Related to this, the authors found evidence suggesting that 16-17 year olds had reduced educational enrolments.

In a subsequent review of the 2004 study, Neumark and Wascher (2006) concluded that there were in fact some net disemployment effects. The review authors noted that the changes to junior pay rates were announced in the base period of Hyslop and Stillman's analysis, and that their assessment of employment effects relative to this base may not have captured some adjustments by employers. The review authors also observed that the employment of 16-17 and 18-19 year olds fell immediately after the minimum wage changes. Moreover, the share of 20-21 year olds employed in successive years increased by more than the share of either 16-17 or 18-19 year olds (although their employment shares still increased), which might suggest a substitution towards the slightly older workers — with the adverse effects on teenage employment being nullified by broader economic factors boosting employment across all age groups.

In examining the 2008 minimum wage changes, Hyslop and Stillman (2011) found no evidence of adverse employment effects immediately following the change, but concluded that they caused some disemployment effects in following years which were compounded by the late 2000s financial crisis. The wage increases caused a fall in the share of 16-17 year olds employed of 3-6 percentage points in the subsequent two years, and a fall in the average number of hours worked by them. Despite this, the authors found no evidence of an increase in the share of 16-17 year olds who were unemployed as the fall in employment was attributable to fewer students working. They found some evidence of employers substituting 16-17 year old for 18-19 year old students.

The different effects of the two sets of wage changes may partly reflect changes in the share of teenagers employed at the minimum wage. In 2000, only 3 per cent of 16-17 year olds were employed at the minimum wage or less, but this share had increased to 30 per cent by 2007 (Maloney and Pacheco 2010). As a result, the 2008 minimum wage change was probably more likely to affect the employment of 16-17 year old workers.

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## Policy issues

The Productivity Commission sees good reasons for retaining some form of discounted wages for young workers. While there will be exceptions, young workers are likely to be less productive than adults. Without the scope for wage differences, employers would have a greater tendency to select only the most able juniors (who are the least likely to benefit from early job experience, as they intend to move onto subsequent study and higher-skilled jobs) or to employ adults. In effect, without discounted rates, many young workers would be priced out of the labour market, foregoing the benefits that some early employment, even if on a part-time basis, can bring. The net impact on overall employment is hard to estimate, but it is possible that discounted junior rates make viable some economic activities that could not proceed at adult rates.

In light of this, consideration could be given to including junior pay rates in awards which currently do not have them. For example, in regards to the absence of junior pay rates in the Building and Construction General On-site Award 2010, Master Builders Australia submitted:

... when confronted with employing an adult or a young person the employer's preference is more likely to be to employ an adult ... we submit that more should be said about ensuring that each significant industry (and building and construction clearly has that characteristic) should have junior wage rates prescribed ... (sub. DR290, p. 33)

While most inquiry participants who commented supported some form of discounted pay for young people, several were critical of the level and structure of junior pay in Australia. For example, against the backdrop of youth unemployment reaching its highest level since 1998 (chapter 2), the CCIQ suggested that ongoing increases in junior rates of pay are contributing to rising youth unemployment (sub. 150, p. 5). The Australian Council of Trade Unions (ACTU), on the other hand, considered that some junior discounts should be removed (at least for older 'juniors') and/or that rates should be restructured to shift the emphasis from age to skills, ability and work value (sub 167, p. 138).

### Level of junior pay rates?

Given the current age-based structure of junior pay rates in most awards, one question is whether the current levels of the rates, and the rate at which they increase with age, is appropriate.

As with the task of setting the level of the adult minimum wages (chapter 4), it is something of a Goldilocks' dilemma to determine the levels of junior minimum rates that are 'just right'. In theory, optimal rates would need to balance young people's productivity and employment prospects at particular ages against incentives for them to remain in education where the two are mutually incompatible, while also accounting for their material needs. Given the significant heterogeneity among young people, even of the same age, any one rate will necessarily involve some kind of rough 'average'. Moreover, information on the youth labour market, and particularly the share of young people paid

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near the junior pay rate, can be difficult to ascertain. Analysis of junior pay rates is also complicated by the many minimum rates prescribed in the awards for different industries and occupations. Any proposal to adjust the level of junior rates should also take account of the government support payments that are available to juniors (and of the potential for supplementation that could be made to such support, were there a view that the disposable incomes of junior workers needed to be increased).

The Productivity Commission has not sought to form a view on the appropriateness of specific junior pay rates but advises caution about any increases to the current rates, particularly where they put at risk the early employment of more vulnerable people with lower skills. The transition from education to work is one of the critical pathways, and changes that affected employment of the less academically-able could have adverse generational impacts.

### The appropriate age cut-off for 'junior' wages?

Against this background, the Productivity Commission does not concur with an argument, put by the ACTU, that because the community treats people as adults when they turn 18 years they should be paid 'adult' rates from that time. The ACTU (sub. 167, p. 138) stated:

Adults should be paid as adults, meaning that workers aged 18 and over should be entitled to the relevant adult rate for work they are performing, unless they are in a formal and genuine apprenticeship or traineeship arrangement that combines work with on-the-job and off-the-job accredited training.

... The ACTU and affiliated unions have long held the view that the provision of junior rates for workers over the age of 18 years is unjustifiable and discriminatory, and fundamentally inconsistent with the principle of equal remuneration for work of equal or comparable value.

Although 18 year olds are considered adults at law, governments still recognise their distinctive characteristics for many policy purposes, such as different age cut-offs for labour market policies. For example, the Youth Allowance provides financial support for young people looking for work up to age 21 years (or studying up to age 24 years). Moreover, given that individuals' maturation from youth into adulthood does not occur 'overnight' or at the same ages for all people, any specific age chosen to mark the start of adulthood for legal purposes will necessarily be arbitrary. In the Productivity Commission's view, it is more important to examine the practical effects of a policy on the opportunities and wellbeing of the people affected than to ensure that it aligns with an arbitrary legal benchmark.

In this respect, the key questions are whether raising the regulated minimum pay rate for 18 to 20 year olds to the full adult rate would inappropriately price some people out of jobs and into unemployment, and/or encourage some people to leave education and look for work at an unduly early age.

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While not addressing the issues of incentives with respect to education, the ACTU pointed to the 2015 decision of the FWC to vary the General Retail Industry Award 2010 to ensure that 20 year old retail employees receive the full adult rate of pay (provided that they have worked for the employer for more than six months).<sup>48</sup> The FWC found that there is little difference in the duties, responsibilities and required supervision for 20 or 21 year old retail employees.

What is not clear from the FWC decision is whether its findings for 20 year olds in the retail industry would apply more generally across industries; and the extent to which those findings would also apply to 18 year olds and 19 year olds. These matters are relevant to the question of whether the current structure of junior minimum pay rates based only on age is to change to take into account experience and/or competency (see below).

### Age, experience or competency?

The broader issue raised by the ACTU is on what basis discounted wages for younger workers should be offered. Its view is that ‘wages should be based on skills, abilities and work value and not on the age of the worker’ (sub. 167, p. 138).

The current age-based model is premised primarily on the view that worker productivity generally increases with age during the years that junior rates cover. The Shop, Distributive and Allied Employee’s Association challenged the view that young workers are generally likely to be less productive than adults, stating:

This traditional and unfortunate characterisation of young workers as unproductive and inexperienced has, to a large extent, contributed to the justification to pay discounted wages based purely on age. However, evidence and research demonstrates that many young Australians are active and productive citizens who combine education, work, domestic and caring activities, often from a very young age. (sub. DR306, p. 19)

Alternative models could be based on experience or competency, as for apprentice wages in awards, which are higher for apprentices who have completed year 12 compared with those who have not (section 5.3). Awards already have competency- or experience-based systems, where workers progress through different classifications based on their skills or experience, although these awards often also contain an age-based structure to differentiate between a junior and an adult. For example, a 17 year old under the Horticulture Award who progresses from a Level 1 classification to Level 2 is paid a minimum of 70 per cent of the adult wage at each level.

It is of course possible to envisage a range of hybrid models that would entail elements of both age and experience (for example, box 5.6), or even a model that offers a temporary

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<sup>48</sup> Fair Work Commission, Modern Award Review 2012 - General Retail Industry Award 2010 – Junior Rates [2014] FWCFB 1846 [21 March 2014].

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discount on minimum wage rates for the employment of groups other than juniors, such as the long-term unemployed.

Some participants supported changes to the current structure of junior pay rates. In a joint submission, Aged & Community Services Australia and Leading Age Services Australia stated:

... there are good reasons for maintaining some form of discounted wages for young workers to avoid being priced out of the labour market. We also agree to the introduction of a hybrid model ... which gives some weight to age and rewarding experience. (sub. DR328, pp. 9–10)

And National Disability Services, in comments that addressed the need for a review of apprenticeship and traineeship arrangements as well as junior rates, said:

Currently the disability sector has a workforce heavily weighted to the older age groups, and in particular people over 45 years of age. It is vital that the sector diversify its workforce in coming years by attracting more young people as well as more men and people from non-Anglophone cultural backgrounds.

For this reason, NDS supports the suggested direction in the Commission's report for a review that includes an assessment of the appropriate structure of junior and adult training wages, as well as government incentives. (sub. DR325, p. 6)

Other participants were more cautious about any change. Some noted that changing the structure would increase its complexity, including for employers, which they contended could adversely affect junior employment (Legal Aid NSW, sub. DR364; Motor Trades Organisations, sub. DR324). Some also noted that a shift to a competency- or experience-based system would be unnecessary because many awards already have one (National Farmers' Federation, sub. DR302; AMMA, sub. DR322). The Australian Small Business Commissioner warned that any precipitate increases in the levels of youth wages from regulatory change would present risks for small business, youth employment and consumers. The Commissioner said:

The ASBC appreciates the arguments for replacing youth wages with a more logical system based on skills and experience but, in doing so, cautions against steps that would reduce pay differentials and increase award complexity. The PC reports that 6 months on the job is often regarded as sufficient to acquire the competency of an experienced adult employee but we doubt this would be valid across all industries. Also, if a shift to a system based on skills and experience effectively increased junior pay rates to adult levels after 6 months, the advantages of the current system to both businesses and junior staff could be lost. Premature pay equalisation between junior and adult workers could lead to reduced employment opportunities for young people, restricted operating hours for some businesses and higher prices for consumers. (sub. DR366, p. 9)



### Box 5.6 Some alternative models for junior pay rates

The table below shows one hypothetical option for a hybrid junior pay rate structure.

This model is based on the current structure of junior minimum rates in the Miscellaneous Award, but adds a wage premium (of 20 percentage points of the adult minimum wage, with the total capped at 100 per cent of that wage) for junior workers who had accrued 6 months experience with an employer. An equivalent exercise could be undertaken for other awards with different adult rates, such as the Fast Food Industry Award shown in table 5.1.

#### Hypothetical hybrid junior minimum pay scale<sup>a</sup>

Percentage of adult rate

Age	No experience <sup>a</sup>	6 months or more experience <sup>b</sup>
	%	%
Under 16	36.8	56.8
16	47.3	67.3
17	57.8	77.8
18	68.3	88.3
19	82.5	100
20	97.7	100

<sup>a</sup> Based on Federal Junior Pay Rates as at June 2015, set as a proportion of the Federal Adult Minimum Wage. <sup>b</sup> Calculated as the current ('No experience') rate plus 20 percentage points, capped at 100 per cent of the Federal Adult Minimum Wage.

Alternative approaches could entail different lengths of experience necessary before qualification for the premium, or different base rates and experience premiums, or only introducing a premium from a particular age (say, from age 18). The model could also or alternatively include education attainment or other indicators of competency. As the draft report noted, the complexity of any model would need to be considered.

While it is desirable to minimise complexity, a competency- or experience-based system need not be overly complicated, as some models used in practice indicate. For instance, in New Zealand, 16-17 year olds start on 80 per cent of the adult minimum and transition to the full rate after working with an employer for six months (MBIE 2015). The United States has a similar system with a minimum wage of US\$4.25 (59 per cent of the federal adult minimum) for a person aged under 20 years, which applies for the 90 days from when they begin working for an employer (US Department of Labor 2008).<sup>49</sup> Both countries' systems appear easy for employers to navigate. They are similar to elements of some already in place at the award level in Australia, such as the General Retail Industry Award, which combines an age and experience requirement for 20 year olds. Nevertheless, other models (such as that in box 5.6) involve more rates. If a competency- or experience-based model were to be adopted, it would be important to balance the greater

<sup>49</sup> The federal wages form the minimum conditions in the United States. Individual states may choose to specify higher minimum wages, or not provide discounted wages, for young people (US Department of Labor 2015).

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tailoring of incentives available with a broader range of rates against the greater complexity entailed. (If adopted, any such model could be accompanied by a tool that assists employers calculate juniors' pay.)

However, given the many possible junior pay models, the varying impact of each on employers' and juniors' decisions, and the limited time and information available to this inquiry, the Productivity Commission has not formed a view on the appropriate structure of junior pay. In its longer-run examination of systemic award issues, the proposed Workplace Standards Commission (or, if it is not created, the Fair Work Commission) should investigate whether the pay rates system should give more recognition to juniors' experience or competency, taking account of the need to ensure the junior pay rates do not put at risk employment opportunities for juniors.

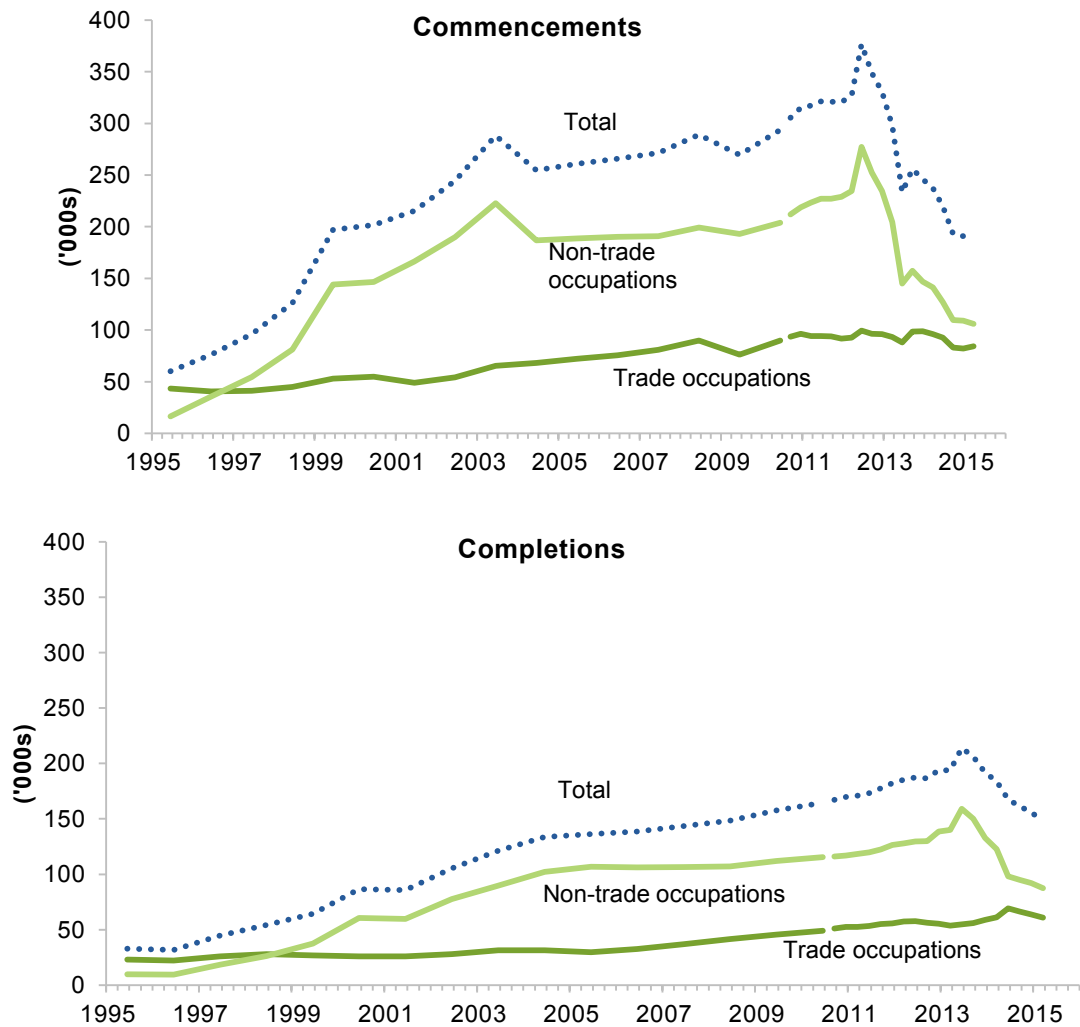
### **5.3 Arrangements for apprentices and trainees**

Apprenticeships and traineeships combine on-the-job training with formal study. They provide a pathway into work for many young people, a retraining option for older people looking to change careers, and, more generally, an important source of economywide skill formation (McDowell et al. 2011, p. 17). There were 319 700 apprentices and trainees in-training at the end of 2014. The numbers increased following a push commencing in the 1990s that saw many new traineeships introduced across industries and occupations, and a large increase in government-provided financial incentives (Knight 2012). However, in recent years, there have been large fluctuations in take-up, particularly for traineeships (figure 5.6).

The training system, of which apprenticeships and traineeships are a component, involves a complex set of interlocking arrangements. The FWC recently increased apprenticeship wages and conditions, and there have been changes to the level of government support available, which will have affected the relative attractiveness of training to employers and would-be trainees and apprentices.

This section outlines these arrangements and explores some possible ramifications of some of the recent changes. In view of the complexities and uncertainties entailed, and the importance of effective skills formation, the Productivity Commission recommends a comprehensive review of Australia's apprenticeship and traineeship arrangements.

Figure 5.6 Apprentices and trainees since 1995<sup>a</sup>



<sup>a</sup> Based on annual data to June from 1995, and rolling annual data from the September 2010 quarter onwards. The trade series counts the number of person undertaking an apprenticeship or traineeship in a *technicians and trade* occupation, including for example, metal and vehicle, electrical, building, painting, and food occupations. 'Non-trade' covers all other occupation groups.

Sources: NCVET (National Centre for Vocational Education Research and NCVET 2015; 2014).

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## Apprentice and trainee wages

Apprentice and trainee wages are clearly a determinant of the number of commencements and completions. Other things equal, higher in-training wages will make starting (and continuing) training relatively more attractive than alternative options that prospective and current apprentices and trainees may face. However, higher wages will increase costs to employers and, subject to broader economic conditions and business confidence, may deter employers from taking on apprentices and trainees.

As detailed in box 5.7, minimum trainee wages are specified in the National Training Wage Schedule, which is attached to nearly all 102 awards that explicitly refer to traineeships (Department of Employment, sub. 158). Minimum trainee wage rates increase with the number of years that a trainee is out of school and are adjusted each year (in line with the national minimum wage).

Minimum apprentice pay rates are included in the 48 awards that refer to apprenticeships. For the few apprentices not covered by a specific award or enterprise agreement, minimum rates are specified in the Miscellaneous Award 2010 and are reviewed by the FWC during each Annual Wage Review.<sup>50</sup> Pay rates increase the closer the apprentice is to completion, and vary according to age. Apprentices' pay rates increase with changes to the relevant qualified tradesperson's award rate or the Miscellaneous Award 2010 for those not on an award or agreement.

Apprentices and trainees may be able to negotiate higher wages with their employers or be paid higher wages if provided for in their enterprise agreement. Indeed, Oliver (2012) estimated that, in 2009, only around 20 per cent of trainees were paid award wages and around 36 per cent of apprentices were paid the award wage or close to it (up to 10 per cent more). Oliver concluded that over-award payments were commonplace for both trainees and apprentices.

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<sup>50</sup> The National Minimum Wage Order specifies that the minimum apprentice wages for apprentices not covered by an award or enterprise agreement are as reported in the Miscellaneous Award 2010 (FWC 2015j).

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## Box 5.7 Apprenticeships and traineeships

An apprenticeship is a requirement for most trade occupations (for example, to become a qualified electrician) and can take 3-4 years to complete. Traineeships are more common for non-trade professions — such as sales, clerical and administrative roles — and generally take less time to complete (typically 1-2 years).

Apprentices and trainees must enter a training contract with their employer that covers matters including the study component for their qualification (which must be undertaken at a registered training organisation, such as a TAFE). The employer normally pays for this study component, which, although variable, generally takes up around 20 per cent of apprentices' and trainees' time. (School-based apprentices spend part of their time in the workplace or training centre and the remainder completing school work). For the training and qualification to be recognised, the training contract must be registered with an appropriate state or territory training authority.

### Trainee wages

Minimum rates for trainees are set out in the National Training Wage Schedule, which categorises occupations into three broad groupings and specifies wages within the groups based on the highest level of schooling attained by the trainee and number of years since they left. Despite the Schedule containing no explicit age-related criteria, the structure of trainee wages mimics the age-based structure of Federal Junior Pay Rates. Training wages are, however, higher than the equivalent junior pay rates for individuals aged under 17 (and some 17 and 18 year olds), yet lower than the equivalent pay rates for those over 18 years (figure 5.7).

### Apprentice wages

Wages for award-and agreement-free apprentices are specified in the Miscellaneous Award 2010, but few are covered by this. Rather, apprentice wages are generally set as a proportion of the qualified tradesperson's wage in the relevant award, which varies between occupations (figure 5.7). A recent FWC decision introduced changes (phased in between 2014 and 2015) specifying that for apprentices commencing on or after 1 January 2014:

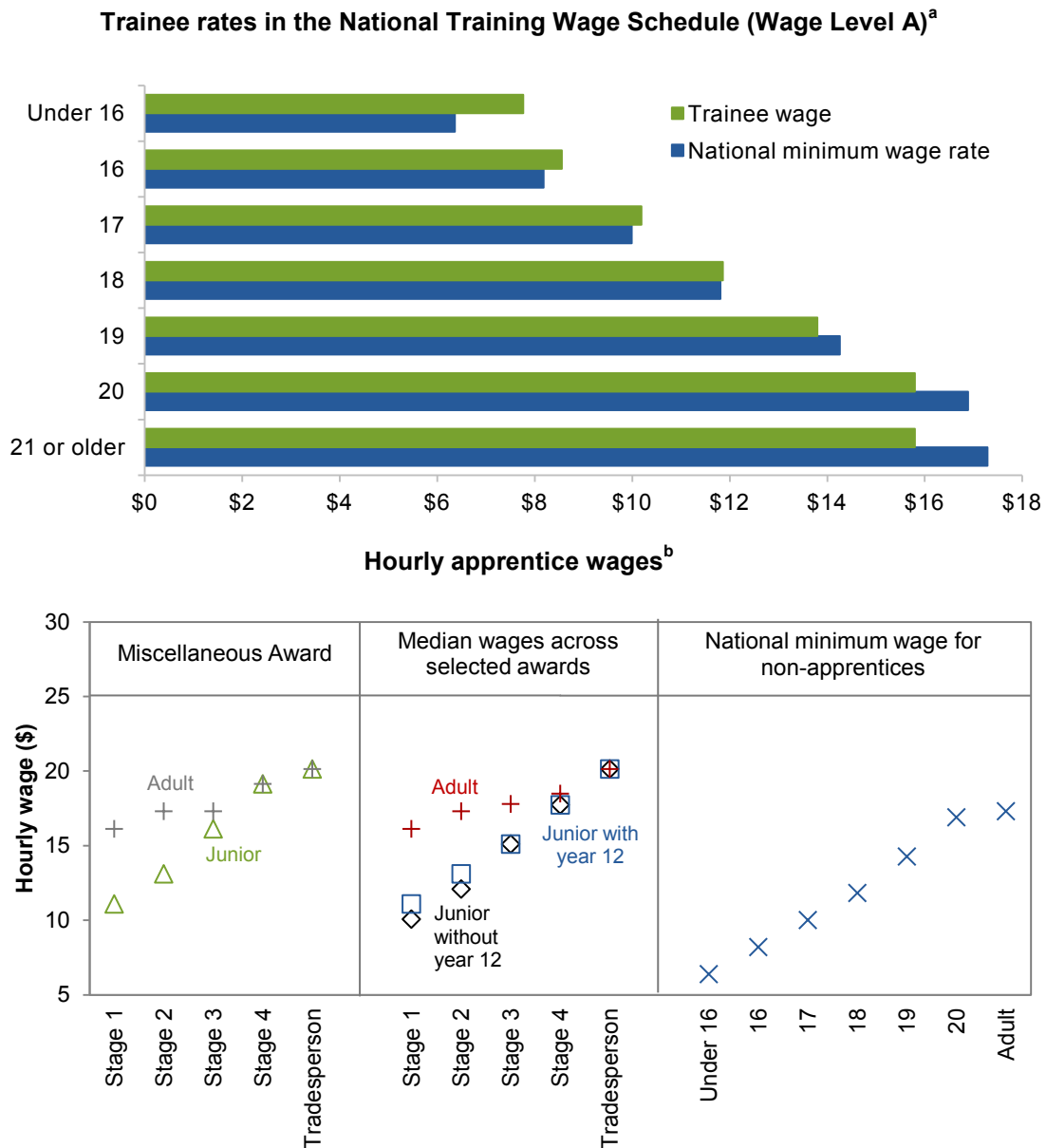
- junior apprentices (aged under 21) should be paid no less than: 50 per cent of the C10 qualified tradesperson's award rate (rising to 55 per cent for those who had completed year 12) in their first year; and 60 per cent in the second year (65 per cent for those with year 12 qualification) (section 7.3 has a discussion of the C10 rate)
- adult apprentices should be paid no less than 80 per cent of the C10 qualified tradesperson's award wage in their first year; rising to be the higher of the national adult minimum wage or the lowest adult classification rate in the award in their second year
- adult employees commencing an apprenticeship who have worked full-time for an employer for at least six months, or for 12 months on a part-time or casual basis, will not suffer a reduction in their minimum rate of pay.

Apprentice wages increase the closer the apprentice is to completion, assessable on either a time basis (that is, after working for a defined time period) or a competency basis (that is, after achieving a defined skill level or completing a training requirement.)

The bulk (68 per cent) of apprentices work under awards covering occupations in automotive and engineering, construction, and electrotechnology and telecommunications (National Centre for Vocational Education Research and NCVET 2015). Starting apprentice wages in these awards are slightly above the national junior pay rate for 17 year olds (figure 5.7).

*Sources:* Modern Awards Review 2012 — Apprentices, Trainees, and Juniors [2013]; FWCFB 5411 [22 August 2013].

**Figure 5.7 An illustrative comparison of hourly trainee and apprentice rates to the national minimum wage, July 2015**



<sup>a</sup> Training hourly wages account for time spent in training, approximated to be 20 per cent of total weekly working hours in the National Training Wage Schedule. Hourly trainee wages are based on minimum wages in the National Training Wage Schedule for full-time AQF Certificate Level I-III traineeships categorised under Wage Level A. Wages under Wage Levels B and C are slightly lower. <sup>b</sup> Apprentice wages in selected awards (see below) and the Miscellaneous Award increase by stages, which depend on an apprentice's time in training and qualifications attained or competency level achieved.

Sources: Annual Wage Review 2014-15 [2015] FWC FB 3500; Building and Construction General On-site Award 2010; Electrical, Electronic and Communications Contracting Award 2010; Electrical Power Industry Award 2010; Joinery and Building Trades Award 2010; Manufacturing and Associated Industry and Occupations Award 2010; Miscellaneous Award 2010; Vehicle Manufacturing, Repair, Services and Retail Award 2010.

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## Other factors affecting commencements and completions

While apprentices and trainees wages are important, many other factors will influence the number of commencements and completions in particular periods, as outlined below.

### Relative wages and employment opportunities

As with other education and training decisions, people considering whether to undertake or continue with an apprenticeship or traineeship are also influenced by their potential income and opportunities in alternative employment. This depends, in part, on prevailing economic conditions.<sup>51</sup> Other things equal, the lower are training wages relative to the wages in alternative employment, the less attractive undertaking and remaining in training will be. (As noted earlier, trainee and first year apprentice (in the Miscellaneous Award 2010) wages are set lower than the equivalent minimum pay rates for individuals over 18 years (figure 5.7)).

Even with relatively low training wages, individuals may undertake an apprenticeship or traineeship if the investment in their skills is likely to deliver a payoff in terms of higher future earnings. Wage premiums provide a signal to individuals about the type of skills valued in the labour market. Karmel and Mlotkowski (2011) found that the wage premium earned after finishing training in trade-related occupations is a significant factor in whether a person completes their training. However, wages in alternative employment were found to matter more than the wage premium on completion to trainees' decisions to withdraw or complete their training.<sup>52</sup> From the perspective of employers, the level and structure of training wages (including any offsetting government incentives) will arguably bear more weight in decisions about whether to take on an apprentice or trainee.

The supply of qualified workers, including migrant workers, is also likely to affect employers' incentives to invest in training an apprentice or trainee. The Productivity Commission's draft report *Migrant Intake into Australia* noted that skilled immigration may reduce incentives for investment in skills by employers and employees — especially if employers can promptly and inexpensively fill vacancies at the existing wage rate from abroad (PC 2015d). However, the draft report noted that existing arrangements require

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<sup>51</sup> Apprenticeship and traineeship commencements may decline during a downturn, as employers may be unable to afford to take on as many apprentices or trainees. At the same time, completions may rise as more apprentices and trainees continue their training due to fewer alternative job prospects. During the 2009 Global Financial Crisis, total apprentice and trainee commencements for the year to June 2009 fell by 7 per cent compared with the previous year, while completions rose by 6 per cent.

<sup>52</sup> Comparing the wages of apprentices and trainees nine months after completing their training with the wages of those that had dropped out and found 'alternative employment', Karmel and Rice (2011) found that 90 per cent of apprentices and trainees in trade occupations had a wage benefit from undertaking their training. In comparison, only around half of males and two-thirds of females in non-trade occupations had an expected wage benefit. These results should be interpreted with some caution, as they do not take into account the cumulative difference in wages over an individual's lifetime or the differences in employment rates between the two groups.

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employers to make a contribution to training in order to sponsor certain temporary workers, and that further evidence is needed to determine the effect of migration on skills investment.<sup>53</sup>

## Government incentives

Governments provide an array of financial incentives for apprenticeships or traineeships to employers and individuals. For some individuals, such support supplements their wages, making undertaking apprenticeships or traineeships more attractive. Financial incentives paid directly to employers, by offsetting some of the cost of taking on an apprentice or trainee, are also intended to help prevent skill shortages by increasing the number of employers offering training positions.

Those incentives provided by state and territories include commencement incentives, travel allowances and rebates for books for apprentices, and tax rebates for employers. Some are sizable — including, for example, Queensland’s School to Trade Pathway incentive for employers which provides employers with up to \$5000 to commence a school-based apprentice and retain them in a full-time apprenticeship after they have completed their schooling (Qld DET 2015b). Most of the larger incentives are targeted at specific groups such as school-based apprentices, the long-term unemployed and indigenous Australians.

The majority of state and territory incentives available to apprentices appear modest compared with those provided by the Australian Government, which include commencement and completion incentives for apprentices in skills needs groups (table 5.2). Some employers groups noted that the various state, territory and Australian government incentives can be difficult to navigate for some employers, with the Ai Group commenting:

A more coordinated policy approach with respect to payments or incentives provided to apprentices and their employers by Federal and State Governments, such as Trade Support Loans and Living Away From Home Allowance, is desirable. (sub. DR346, p. 28)

Evidence suggests that the impacts of government incentives are mixed and depend on the specific aspects of the incentive. A recent assessment concluded that payments to employers have only a marginal effect on hiring decisions (McDowell et al. 2011). Deloitte Access Economics (2012), however, found that government employer incentives of greater than \$1000 in the first year of an apprenticeship or traineeship had a significant positive impact on commencements. For apprentices and trainees, Deloitte Access Economics also found that the Living Away From Home Allowance and the Commonwealth Trade Scholarships lifted completion rates for apprentices and trainees.

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<sup>53</sup> In order to sponsor workers through temporary work (skilled) visas (subclass 457), employers that have been operating in Australia for at least 12 months must meet training benchmarks. The benchmarks include paying at least two per cent of their payroll annually into an industry training fund or spending at least one per cent of their payroll on training existing employees.



Table 5.2 Selected Australian Apprenticeship Incentives, 1 July 2015<sup>a</sup>

	<i>Certificate II</i>	<i>Certificate III or IV</i>	<i>Diploma or Advance Diploma</i>
<b>Commencement incentive</b> , specified apprentices <sup>b</sup>	\$1 250 (only 'new workers' in Nominated Equity Groups)	\$1 500	\$1 500 (only 'new workers' in priority occupations)
<b>Recommencement incentive</b> , specified apprentices <sup>b</sup>	na	\$750	\$750 (only 'new workers' in priority occupations)
<b>Completion incentive</b> , specified apprentices <sup>b</sup>	\$1 000 (only Group Training Organisations that support Nominated Equity Groups)	\$1 500 to \$3 000	\$2 500 to \$3 000 (only priority occupations)
<b>Australian School based Apprenticeships Incentives</b> (Cert II and above)	\$750 on commencement & \$750 on retention (at least 12 weeks after the student completes school)		
<b>Support for Adult Australian Apprentices</b> (aged 25 years or older) for National Skills Needs List apprentices, where the actual wage paid is equal to or greater than the National Minimum Wage. Paid to employer.	na	\$4 000 (once 1 year of training completed)	na
<b>Mature Aged Workers incentives</b> for employers that support a disadvantaged person 45 years or older (Cert II and above)	\$750 on commencement & \$750 on completion		
<b>Disabled Australian Apprentice Wage Support</b>	\$104.30/week (full-time)		
<b>Living Away From Home Allowance</b> (Cert II and above)	First year — \$77.17/week; Second year — \$38.59/week; Third year — \$25.00/week		
<b>Trade Support Loans</b> for NSNL & Agriculture and Horticulture occupations (Cert II to Cert IV). Loans are reduced by 20% for successful completion of the apprenticeship and are repayable through the tax system once minimum income threshold reached (\$53 345 in 2014-15)	First year — \$666.67/month (up to \$8 000) Second year — \$500.00/month (up to \$6 000) Third year — \$333.34/month (up to \$4 000) Fourth year — \$166.67/month (up to \$2 000)		na

<sup>a</sup> Apprentices and trainees may also be eligible to access fortnightly government income support payments including Youth Allowance, Austudy, and ABSTUDY.

<sup>b</sup> Incentives are available to: full-time and school-based apprentices, and in some cases part-time apprentices; *new and existing workers* in National Skills Needs List apprenticeships, and *new workers* in non-NSNL priority occupations (aged care, childcare, disability care worker and enrolled nursing); and non-NSNL non-priority occupations. An *existing worker* is one that has worked for the employer for at least 3 months on a full time basis, or for 12 months on a part time or casual basis (including seasonal and contract work).

Sources: Australian Apprenticeships (2015a, 2015b, 2015c).

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At the aggregate level, past changes in government incentive payments seem to have affected apprentice and trainee commencements and completions:

- participation in apprenticeships and traineeships increased substantially in the 1990s, coinciding with the large increase in government employer incentive payments in the mid-1990s. Knight (2012, p. 5) notes that this had ‘... a spectacular impact on traineeship numbers but much less effect on trades apprenticeships’
- changes to a number of government financial incentives between 2012 and 2013 — including the removal of employer standard commencement, recommencement and completion incentive payments for existing workers in training not on the Department of Education’s National Skills Needs List (NSNL) — appear to have contributed to a marked decline in the number of commencements in non-trade occupations from mid-2012 (figure 5.7).<sup>54</sup>

Significant changes to Australian Government incentives have been made recently — including the removal of Tools For Your Trade payments, the apprentice component of Support for Adult Australian Apprentices, and the introduction of Trade Support Loans. However, the impact of these changes on participation in apprentices and traineeships is not yet evident.

## **The impact of recent changes to apprentice wages**

From January 2014, the FWC increased minimum (or base) apprentice pay rates for juniors, in their first two years of an apprenticeship, and for adults (box 5.7). At the same time, it also improved employment conditions (relating to travel costs, training time, timely payment of training fees, and attendance at training).

In handing down its decision, the FWC argued that the increases to the base pay rate would attract more young people into apprenticeships compared with other training or employment options, improve completion rates and better support older apprentices’ living costs.<sup>55</sup>

On the other hand, several industry bodies have argued that these changes have reduced the willingness of employers to take on apprentices, which, if correct, could reduce opportunities for some prospective apprentices and undermine government policy objectives in the skills formation area (box 5.8).

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<sup>54</sup> The removal of some government commencement incentives as part of the 2012-13 Budget was announced in May 2012. The earlier announcement seems likely to have contributed to the sharp increase in non-trade commencements in the June 2012 quarter.

<sup>55</sup> Fair Work Commission, Modern Awards Review 2012 — Apprentices, Trainees, and Juniors [2013] FWCFB 5411 [22 August 2013].

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**Box 5.8 Business concerns about the impacts of recent FWC decisions on apprenticeship pay and conditions**

Submissions from a range of industry groups argued that recent changes to apprentice pay and conditions, and other aspects of the workplace relations system, have reduced the affordability of apprenticeships to business with adverse effects both on business and on aspiring apprentices.

Hair and Beauty Australia said:

Under the current workplace relations framework, our members have indicated that there are no structures in place to promote employment within the industry or to create jobs. This has further been hindered by the introduction of higher apprentice wage rates including adult apprentice classification and furthermore the current changes to apprenticeship conditions inclusive of the requirement to reimburse course fees and textbooks being brought onto the employer. As an industry largely made up of small businesses, this additional cost, on top of the current overheads, has made it impractical for many businesses to employ apprentices, leading to a skill shortage within the current industry.

It is our members and HABA's fear that youth unemployment rates will continue to climb unless a review of the apprenticeship system and pay rates is undertaken immediately. In the first 12-18 months of an apprenticeship, where no skill level exists, employers must invest heavily in transferring skills from senior employees to the apprentices. ... We believe the higher wage rates implemented are contributing largely to underemployment and unemployment within this specific industry. (sub 47, pp. 1-2)

Master Builders Australia contended:

The workplace relations system does not currently complement the Australian Apprenticeship system and has created potential barriers to the apprenticeship system being able to deliver maximum productivity benefits. For example, the inclusion of competency based wage progression into modern awards contemporaneously with large wage increases not based on additional work value has negatively impacted on employer's decisions to take on apprentices. This affects students undertaking VET in school programmes who may find themselves unable to find employment or an apprenticeship due to the increased cost of their wages as opposed to a student without any formal recognition of their skills. (sub. DR290, p. 34)

Australian Chamber of Commerce and Industry submitted:

There has been a concerning downturn or stagnant growth in apprenticeship and traineeship commencements across the country. While this cannot be attributed solely to the changes to apprentices' rates because there has been a series of changes to policy, funding and financial incentives which have resulted in a dramatic drop in traineeships and levelling off in apprenticeship commencements, the figures suggest that the new apprentice rates may be contributing to the problem. (sub. DR330, p. 53)

The Motor Trades Organisations said:

Faced with a significantly higher wage structure over the traditional four year period of an apprenticeship, employers are not prepared to employ adult apprentices because they realise that the higher wage will not necessarily mean higher productivity in a shorter period than junior apprentices. Employers are therefore placed in a situation where the field for suitable candidates has been reduced because employers are not prepared to accept the higher wage structure for the same productivity outcome as a junior apprentice and also bear the cost of training. (sub. DR324, pp. 10-11)

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## Higher minimum training wages for first and second year apprentices

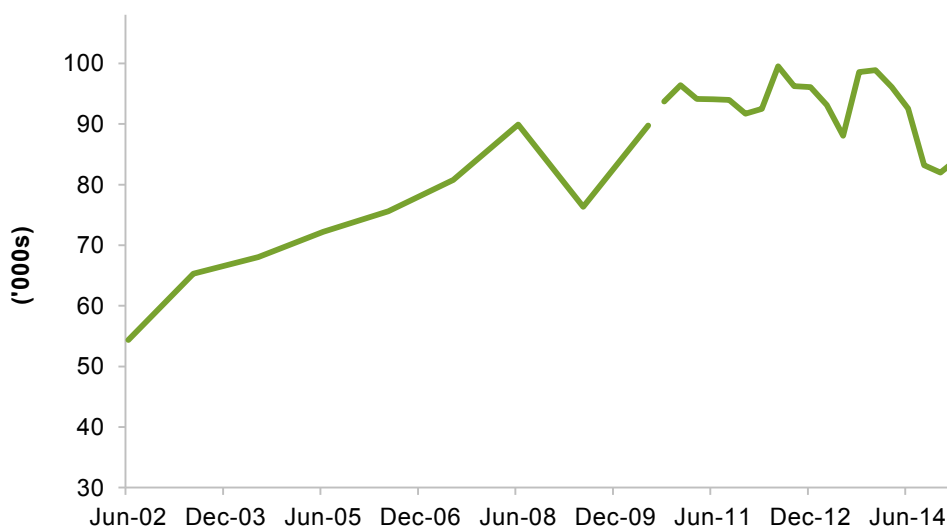
Assessing the effects of the FWC's changes to minimum wage settings on the number of apprentices is not straightforward, because higher rates encourage participation, while reducing employers' willingness to take on apprentices. Further, the FWC's changes to apprentice wages were phased in over two years, with the most recent increase only taking place in January 2015. Accordingly, anticipatory or lagged effects may affect outcomes. Moreover, as discussed in the preceding section, many other factors can influence participation in apprenticeships.

Somewhat dated evidence suggests that around one third of apprentices (and two fifths of junior apprentices) are paid the award rate, or close to it (up to 10 per cent more) (Oliver 2012). To the extent that a large minority of apprentices were still paid at, or close to, award rates just prior to the increase in award wages, it would be expected that some employers would have been less willing to hire apprentices due to the award wage increase. However, without more recent and robust evidence, the extent to which the minimum apprentice rates bind the actual wages paid is not clear.

After the first stage of the increase to apprentice wages — when first and second year youth apprentice wages were increased by at most 5 per cent and adult apprentice wages were introduced into a number of awards — commencements in trade related training (mostly apprenticeships) declined by nearly 17 per cent (or by around 17 000 individuals) between December 2013 and December 2014 (figure 5.8).

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Figure 5.8 **Commencement of trade occupations<sup>a</sup>**



<sup>a</sup> Based on figure 5.7.

Sources: NCVET (2015; 2014).

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This decline is consistent with a wage- induced reduction in employer demand for apprentices, a view put by the Chamber of Commerce and Industry Queensland (CCIQ) (sub. 161). Its recent survey found that close to a quarter of responding businesses who employ an apprentice decreased their overall intake of new apprentices as a result of the recent increase to apprentice wages over 2014 and 2015 (pers. comm. 16 September 2015).

On the other hand, commencements in training in non-trade occupations also declined markedly over the same period (falling by around 26 per cent), implying that other factors were contributing to the reduction in the number of apprentices and trainees during 2014. For instance, recent changes to financial incentives, such as the removal of completion payments in August 2013 for employers of apprentices and trainees in a number of occupations, may also explain some of the recent fall in apprentice and trainee commencements. In discussing the results of its February 2015 survey of businesses on workplace relations, the CCIQ acknowledged that other factors, including the removal of employer incentives, would have affected decisions to employ apprentices.<sup>56</sup>

### Higher training wages and ‘no loss of pay’ for adult apprentices

The 2013 FWC decision on apprentices also introduced higher minimum pay rates for adult apprentices (21 years and over) in all awards that include apprentice rates of pay, and a ‘no loss of pay’ requirement for existing adult employees commencing an apprenticeship.<sup>57</sup> Unlike hiring a new apprentice, the requirement limits employers’ ability to adjust wages for the additional cost of on-the-job training (typically highest in the first two years of the apprenticeship), and time spent in off-the-job training.<sup>58</sup> These changes were made largely in response to a substantial increase in the number and share of mature aged individuals undertaking apprenticeships and traineeships (figure 5.9) and concerns over the higher living costs of adult apprentices.

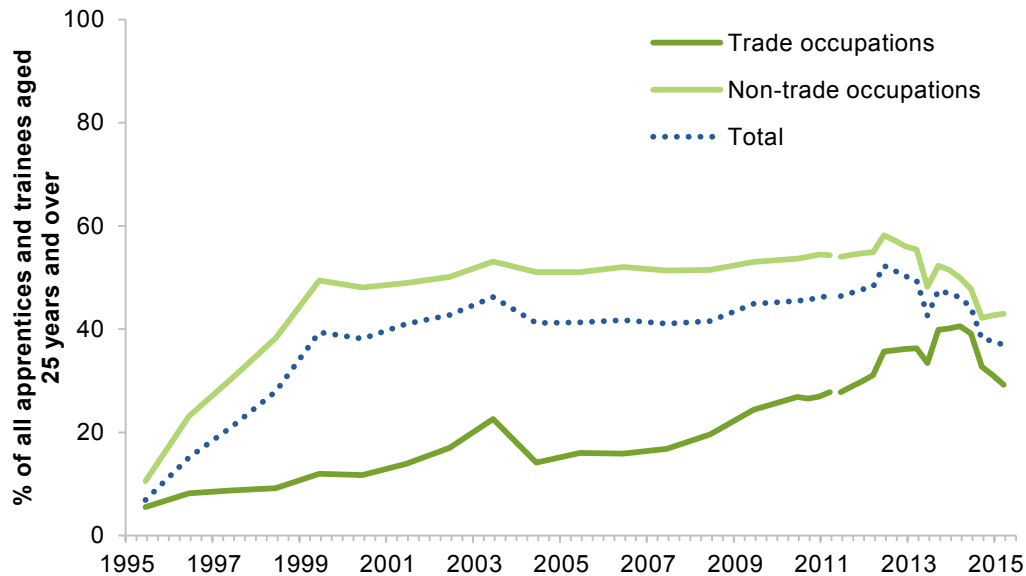
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<sup>56</sup> The CCIQ’s survey showed that apprentice and trainee wages were the item least mentioned as being of moderate, major or critical concern by the surveyed businesses. However, the survey’s broader focus meant that it did not also ask about changes to financial incentives for apprenticeships, which would have enabled comparison of these two potential sources of concern (sub. 150, p. 7).

<sup>57</sup> Prior to the 2013 FWC decision, the no loss of pay condition for existing employees was already included in a number of relevant awards. For example, the condition has been included in the Manufacturing and Vehicle Award for over 20 years (Modern Awards Review 2012 — Apprentices, Trainees, and Juniors [2013] FWCFB 5411 [22 August 2013]).

<sup>58</sup> The difference in the ‘minimum’ wage between new and existing workers is compounded by government employer incentive payments, which for some occupations apply only to new workers. This is because employers are not eligible to receive government commencement and recommencement and completion payments when taking on existing workers as apprentices, for those apprenticeships not included on the National Skills Needs List (NSNL) or in a specified priority occupation (table 5.2).

**Figure 5.9 Changing shares of mature aged apprentices and trainees<sup>a</sup>**  
Commencements



<sup>a</sup> Based on annual data to June from 1995, and rolling annual data from the September 2010 quarter onwards. The ‘trade’ series counts the number of persons undertaking an apprenticeship or traineeship in a *technicians and trade* occupation, including for example, metal and vehicle, electrical, building, painting, and food occupations. ‘Non-trade’ covers all other occupation groups.

Sources: NCVET (2014, 2015).

By increasing the (minimum) cost of taking on adults and existing adult workers, the changes could discourage employers from offering these workers apprenticeships. Figure 5.7 shows that there is now a sizable wedge between the minimum wage for employing and training an adult compared with a junior apprentice in the early stages of an apprenticeship. For instance, the first year apprentice wage for juniors is \$11.07 under the Miscellaneous Award 2010, which is around 70 per cent of the adult rate. At the time of the FWC decision, employer organisations submitted to the FWC that apprentice wages are training wages and that both junior and adult apprentices spend a considerable amount of time off-the-job and not in productive work.<sup>59</sup>

The FWC anticipated that the introduction of adult apprentice rates ‘is not likely to have a significant negative effect on business costs having regard to the incidence of over-award payments, the likelihood that adult apprentices will be more productive, and the relative proportion of the workforce constituted by such employees’.<sup>60</sup>

<sup>59</sup> Fair Work Commission, Modern Awards Review 2012 — Apprentices, Trainees, and Juniors [2013] FWCFB 5411 [22 August 2013].

<sup>60</sup> Ibid.

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At an aggregate level, in the year to December 2014, the number of adults (20 years and over) commencing training in trade occupations declined by 25 per cent (roughly 14 000 individuals). This was primarily due to a decline in matured-aged commencements (aged 25 years or older). This is notwithstanding the possibility that a relatively high proportion of adult apprentices were being paid above-award rates prior to the 2014, and that there was simultaneously an increase in award pay rates for junior apprentices.<sup>61</sup> Further, the recent CCIQ survey (pers. comm. 16 September 2015), found that around 23 per cent of responding businesses (comprised of small and medium-sized businesses) who employ apprentices reduced the number of adult apprentices they take on in response to the introduction of the ‘no loss of pay’ condition.<sup>62</sup>

While the above evidence raises concerns about the effects of the FWC’s decision, without more complete information on apprentice wages and commencements, and deeper analysis that seeks to control for changes in other relevant factors, it is not possible to determine the actual impact of the changes to adult apprentice wages on participation in apprenticeships.

## **Policy complementarity**

Whatever the actual outcomes of the recent changes to minimum apprentice wages and government incentives, the foregoing discussion points to the desirability of coordinating wages policy and the other arms of government policy that affect participation in apprenticeships and traineeships.

Apprentices, employers and policymakers alike recognise that the apprenticeship system must provide apprentices with an adequate income, particularly in the early stages of the apprenticeship and for those financially supporting a household. Equally, employers must be able to afford to provide apprenticeship and training opportunities.

In Australia, minimum training wage settings and targeted government income support and apprenticeship incentive payments, determine the income level of apprentices and trainees. Eligible apprentices and trainees can access a number of support payments, such as Youth Allowance, Austudy and the Living Away From Home Allowance. Several government wage top-up payments have also targeted participation of older individuals in apprenticeships. Until July 2015, full time apprentices aged 25 years and over undertaking

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<sup>61</sup> Oliver (2012) estimated that 81 per cent of adult apprentices in 2009 were paid greater than 110 per cent of the relevant award wage, and around 42 per cent were paid greater than 150 per cent. In comparison, 58 per cent of junior apprentices were paid greater than 110 per cent of the relevant award wage, and around 30 per cent were paid greater than 150 per cent.

<sup>62</sup> The CCIQ’s survey asked about whether the introduction of the ‘no loss of pay’ condition affected the number of adult apprentices that were employed. Of the 88 respondents to the survey question who employed an apprentice: 23 per cent said they took on fewer; 67 per cent said the condition had no effect; and 10 per cent indicated that they took on more adult apprentices. Given the nature and size of the survey, it is important to note that these results are likely to be associated with a high degree of uncertainty.

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an apprenticeship on the National Skills Needs List were able to access the Support for Adult Australian Apprentices of \$150 per week in the first year of their apprenticeship and \$100 per week in their second year. More recently income-contingent Trade Support Loans have been introduced to support individuals training in a number of occupations (table 5.2).

In view of these support payments, the case for using minimum training pay rates to provide a higher ‘living’ wage for adult (over junior) apprentices is not clear. A counterview is that that training wages should reflect the investment in on-the-job and off-the-job training provided and/or paid for by employers. Also relevant to setting minimum training wages is the evidence that:

- for trade occupations, it is the higher future earning (or the premium) attached to becoming a qualified tradesperson, rather than the wage during training, that is a significant factor to completion (Karmel and Mlotkowski 2011)
- adult and existing workers are likely to have relevant skills, knowledge and experience that may improve their productivity relative to other apprentices.<sup>63</sup> An effective system of competency-based pay progression can facilitate the recognition of relevant skills and experience on an individual basis.<sup>64</sup>

This raises the question as to whether targeted wage top-ups or concessional government loans — including the newly introduced income-contingent Trade Support Loans — may be a fairer and more effective mechanism for delivering a living income to eligible apprentices.

## **The need for a review**

Recent reforms to the level and structure of training wage rates and to government incentive payments have affected the traineeship and apprenticeship system. These changes have occurred in a somewhat piecemeal fashion. Elements in play include the introduction of adult apprentice award rates, competency-based pay progression, and a move away from wage top-ups for apprentices aged 25 years and over towards a system of income-contingent government loans. These changes have unknown net impacts on the attractiveness of apprenticeships to would-be apprentices and employers.

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<sup>63</sup> See Modern Awards Review 2012 — Apprentices, Trainees, and Juniors [2013] FWCFB 5411 [22 August 2013]. Also, a 2011 survey of Employers of Apprentices undertaken by the Department of Employment found that employers held a more positive view — in terms of apprentices’ attitude to work, consistency and reliability, and maturity — of adult compared with teenage apprentices (Department of Employment 2013, p. 126).

<sup>64</sup> The FWC in its decision to introduce competency-based wage progression into several modern awards, acknowledged that one of the benefits of competency-based pay progression was reduced completion times for mature individuals already working in the industry (Fair Work Commission, Modern Awards Review 2012 — Apprentices, Trainees, and Juniors [2013] FWCFB 5411 [22 August 2013]).



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There are other concerns about the training system that intersect with apprenticeships and traineeships. A recent review of school-based Trade Training Centres highlighted the views of some employer and industry groups that existing competency-based pay arrangements, by requiring school-based VET students holding a Certificate II to be paid as a second year apprentice on commencement, present a barrier to such students gaining employment as an apprentice after graduating (Scott 2014). An effective competency-based pay system that supports school-based pathways must strike a balance between recognising the qualification and level of workplace experience that students gain while at school with the perceived value of these skills to employers.<sup>65</sup>

Given the multiple, interlocking factors affecting the supply and demand of apprentices and trainees, the Productivity Commission (PC 2014c) recommended in its inquiry into Public Infrastructure that it should be commissioned to undertake a comprehensive review of Australia's apprenticeship and traineeship arrangements (as did the draft report in this inquiry). Several participants in this inquiry support a comprehensive review, although some expressed concerns that previous reviews had not led to worthwhile change, with one concern being the multiplicity of stakeholders involved (box 5.9).

In September 2015, the Minister for Education and Training announced the establishment of an 'apprenticeships reform advisory group', with members drawn from industry and government. It was asked to consider how apprenticeships could work more effectively, including the design of incentive programs, pre-apprenticeship programs, and alternative apprenticeship delivery models. Considering available evidence and industry views, the advisory group is set to report to the Australian Government later this year. Although the advisory group has been given a short timeframe, its findings should assist in addressing some of the problems evident in this area of government policy and provide useful input for a comprehensive review.

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<sup>65</sup> In September 2014, Skills Tasmania and the Tasmanian Training Agreements Committee introduced a credit system for new apprentices in the building industry in Tasmania (Housing Industry Association, sub. 169). Under this system, those entering an apprenticeship with a Certificate II are given six months credit towards their Certificate III qualification. Therefore, school graduates with a building-related Certificate II are now required to complete six months on-the-job work experience before progressing to a second year apprentice wages level in Tasmania.

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**Box 5.9 Participants comments on a review of the apprenticeships and traineeships system**

Several participants supported a review of the apprenticeship system (including, for instance, National Farmers' Federation (sub. DR302), Business Council of Australia (sub. DR337), Australian Higher Education Industrial Association (sub. DR297), Legal Aid NSW (sub. DR364), National Disability Services (sub. DR325), and the South Australian Government (sub. DR281)). Some agreed that the review should look at the broad factors affecting the apprenticeship system.

Aged & Community Services Australia and Leading Age Services Australia submitted:

We support this recommendation ... the aged care workforce is expected to increase significantly over the next few decades. To meet this workforce demand employers in the industry will need to look at all avenues available to attract a skilled workforce. (sub. DR328, p. 10)

The Queensland Government said:

The Queensland Government supports a review into Australia's apprentice and traineeship arrangements, given the considerable changes that have occurred in recent years. Whilst increasing the uptake of apprentices and trainees is desirable, this needs to be balanced against the living needs of workers. As such, the wage structure, tax and transfer system and government incentives provide fair remuneration and support to apprentices and trainees should be considered. Furthermore, regulatory simplification and consistency with State and Territory regulation and consideration of State and Territory policy/programs (for example the Queensland Government's Working Queensland Policy) should be considered as part of this review. (sub. DR338, p. 5)

The Electrical Trades Union said:

In principle we support a comprehensive review into Australia's apprenticeship and traineeship arrangements. ... to modernise, encourage and retain apprentices in various trade industries. (sub. DR300, p. 17)

Bray (sub. 261, p. 14) argued that the review should specifically consider the quality of training and transferability of skills, and the implications of Trade Support Loans including on future expected rates of earning for tradespeople.

Some participants did not favour a review with a few suggesting that the previous reviews of the system have not led to meaningful change. Master Electricians Australia submitted:

The Australian apprentice system hasn't changed fundamentally in 70 years despite numerous reviews. There are a number of major stakeholders in the apprenticeship area of employment; Federal and State governments, employers, apprentices, RTOs, Union and employer associations, skills councils and schools. Meaningful change with competing agendas and priorities reform in this area has been difficult to achieve. This change is also impeded by a lack of bipartisan support. (sub. DR304, p. 13)

The Motor Trades Organisations said:

The Motor Trades Organisations do not favour another general Australian Government review of apprenticeships and traineeships ... There have been enough reviews to date. These reviews have failed to understand that the automotive industry is made up of predominantly small business. (sub. DR324, pp. 9–10)

However, the Motor Trades Organisations added that a more directed review would be of use:

The Motor Trades Organisations support a review of the factors that affect the supply and demand for apprenticeships and traineeships, including the appropriate design and level of government, employer and employee incentives with a particular focus on the cost of employing apprentices over 21 years of age. (sub. DR324, p. 10)

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A comprehensive and independent follow-up review would have the capacity to undertake further research and analysis, including of the effects of recent changes. It would need to be constituted to assess the interests of all stakeholders, and the economywide and sectoral impacts. The review would need to take account of the role of apprenticeships and traineeships in skills formation, and in assisting people to transition to work or to retrain. It should assess the appropriate structure of training conditions and wages including specific arrangements for adults, the interaction with the tax and transfer system, and the appropriate design and level of government incentives. It should also consider alternative pathways and the ability of competency-based pay progression arrangements to take account of the value of the skills of existing workers and school-based VET students. The review would benefit from using longitudinal administrative data on Australian apprentices and trainees, among other analytical and research options. The review could also evaluate any options put forward by the apprenticeships reform advisory group.

#### RECOMMENDATION 5.2

The Australian Government should request the Productivity Commission to undertake a comprehensive review into Australia's apprenticeship and traineeship arrangements. The review should include, but not be limited to, an assessment of:

- the role of the current system within the broader set of arrangements for skill formation
- the structure of awards for apprentices and trainees, including junior and adult training wages and the adoption of competency-based pay progression
- the appropriate design and level of government assistance to employers and individuals. The design of government assistance should take into account the factors that affect the supply and demand for apprenticeships and traineeships, including the impact of junior pay rates and immigration policy.



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## 6 Measures to complement minimum wages

### Key points

- Given the risks to employment and limited ‘targeting’ of minimum wages, several economists have pointed to complementary measures that could mitigate the risks while improving living standards for those on low incomes.
- Earned income tax credits (EITCs) supplement the incomes people obtain for work and could be introduced as part of a wage-tax tradeoff.
  - EITCs are widely used overseas. They have the potential to improve work incentives and/or to be targeted to low-income working households or individuals. However, they may adversely affect the labour supply of certain types of employees, sometimes come at a high fiscal cost, and can involve other limitations.
  - The effects of an EITC scheme depend greatly on its design, implementation and interface with the tax and transfer system more generally. Design differences can materially alter the impacts on equity, work incentives and the budget. Those design issues (and the constitutional standing of the measure) would need investigation before any trial of an EITC in Australia.
- Wage subsidies, social security payments and other measures could also be used to relieve pressures on minimum wages while safeguarding the living standards of the low paid. These options have their own advantages and disadvantages. The Productivity Commission has not recommended their (further) adoption, but governments could reassess their relative net benefits as needs be in the future (including if unemployment should worsen significantly).

Regulated minimum wages have long been seen as a means of promoting a more equitable distribution of income, helping to limit the gap between the high income earners and those Australians in low-paid employment. The Productivity Commission’s analysis in chapter 4 shows that, among working households, minimum wage increases benefit those in lower quintiles the most. Similarly, chapter 7 concludes that the awards system has helped to compress wage dispersion in Australia.

However, the analysis in chapter 4 also shows that minimum wages do not target poverty or equity directly and, moreover, have the potential to cause unemployment and underemployment. Chapter 4 reveals that many people in the lowest quintiles do not have jobs or work for relatively few hours, while many people on the minimum wage in fact live in higher quintile households. This suggests that attempts to improve the outcomes for those households with the lowest incomes through minimum wages may not be particularly efficient or effective. The Organisation for Economic Co-operation and Development, in a

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review of measures to lift the living standards of the working poor in advanced countries, argued that the minimum wage by itself has:

... limited effectiveness in fighting in-work poverty as it is not well targeted. In particular, it does not offer much support to the large majority of the working poor who cannot find a full-time job, and is not well suited to address other important factors underlying poverty risk, such as specific family situations. (OECD 2009, p. 168)

And Leigh (2007) showed that minimum wage increases may even widen earnings and income inequality, depending on the nature and extent of the disemployment effects.

This raises the question of whether there are other measures that could address relevant equity issues more effectively and/or without the same risks to employment as increases in minimum wages. Governments already have in place various dedicated mechanisms, most notably the progressive taxation and social security system, which are intended to directly address equity issues. In principle, adjustments to tax rates and thresholds, or to existing rates of social security payments, could help redistribute incomes further towards the low paid, albeit potentially at some fiscal cost. Australia's income taxation and social security system has the advantage of being highly targeted, but this is not without its own limitations. The withdrawal of benefits often involves steep tapers, which create high effective marginal tax rates (EMTRs) that in turn can discourage employment. There is also some evidence that recipients of some forms of welfare can feel stigmatised by them, and welfare provisions are amenable to significant change. These observations raise the question of whether there might be other, more innovative measures that could better achieve relevant redistributive goals.

Additionally, it is important that policy makers — in considering any future increases in minimum wages, and the associated risks of disemployment — have an understanding of the effectiveness of policy measures governments can use to address employment issues.

This chapter therefore examines the merits of a range of policies that can either augment the minimum wage to enhance the living standards of people on low incomes and/or address employment and employability issues. They include the use of earned income tax credits (EITCs), as recently canvassed by some Australian economists (section 6.1), wage subsidies, in-work social security benefits and other welfare measures, and education and training (section 6.2).

## **6.1 Earned income tax credits**

### **The debate in Australia**

An EITC offers a credit on the taxes people pay on their labour income in order to increase their after-tax (disposable) income. As such, it supplements the incomes people obtain for work, and in practice is often used to help working families, in particular, on low incomes.

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The case for EITCs in the Australian context often starts with the limitations of minimum wage regulation as a means of delivering equitable outcomes, mentioned above.

Concerns that minimum wages do not directly target poverty and equity and may cause disemployment have led several economists to advocate EITCs or other policies that could, as Bray (2013b, p. 88) puts it, ‘relieve the burden on the minimum wage as an instrument to achieve improved living standards for those with low incomes’. In theory, an EITC could be used either in place of minimum wages or as a complement to lower minimum wages, although most debate has been about the latter approach (box 6.1). For example, the original ‘five economists’ plan for greater employment (Dawkins 2002) included a ‘wage-tax tradeoff’ proposal in which the nominal value of the minimum wage would be frozen for four years, thereby allowing its real value to fall, with workers in low-income households being compensated by means of an EITC. The issue of an EITC was canvassed by the original McClure Review<sup>66</sup> and also some submissions to the Henry Tax Review (Henry et al. 2008). The Henry Tax Review itself suggested that it could be used in certain circumstances, although it did not recommend its adoption (Henry et al. 2009). Four of the five original proponents for its adoption in Australia have called again for its consideration (Potter 2014).

The Productivity Commission therefore canvassed EITCs during the inquiry and sought input. Notably, both the ACTU (sub. 167) and Jobs Australia (sub. 221) recognised that in principle an EITC could be useful to enhance the living standards of the low paid in Australia (although both raised notes of caution, particularly about the likely cost of EITCs). Other participants also pointed to the fiscal costs, along with other aspects that led most to oppose the idea of an EITC (box 6.2). It is not clear, however, that all these same concerns would apply, and/or be seen as significant, for all possible designs that an EITC could take.

It would of course be open to governments in Australia to use an EITC as a tool to do more than just compensate low-income earners as part of a minimum wage-tax credit tradeoff. Depending on the weight society gives to addressing income inequality and the relative wellbeing of the low paid, the EITC could be made more generous. Indeed, there may be a case for an EITC (or a more generous EITC) independent of any changes to the minimum wage. Depending on its design, an EITC might alternatively be used to complement (or, to some extent, take the place of) existing family assistance measures. It has also been suggested that an EITC could be used to provide compensation for an increase in the GST, were one to be implemented (although by itself it does not seem especially suited to that role).

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<sup>66</sup> Although the most recent McClure Review (Australian Government 2015a) emphasised the importance of employment for people currently on benefits, it did not give consideration to an EITC.

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### Box 6.1 EITCs and minimum wages: complements or substitutes?

While it would be feasible to use an (appropriately designed) EITC in place of minimum wage regulation, the economic literature does not recommend this path. Rather, as Bray (2013b) states:

[T]his literature suggests that there is a strong case for using both in-work benefits such as an earned income tax credit in association with a binding minimum wage. Such a combination of instruments can allow increases in disposable income to be achieved by low earning households without putting pressure on labour demand, and permits a degree of targeting of these gains to low-income households, rather than to all low earning rate individuals. (p. 90)

Similarly, the OECD (2009) found that:

Fighting in-work poverty requires implementing targeted policy responses. In this respect, social transfers play a key role, precisely because they can be targeted towards the most vulnerable households ... Among these transfers, in-work benefit schemes can be particularly effective, if they are well conceived and combined with a binding minimum wage set — by law or collective agreements — to a moderate level. (p. 165)

No advanced country has sought to replace its minimum wages with an EITC; rather, the measures are seen as complementary. Notably, the OECD recommended that as the Great Recession recedes, the United States should expand its EITC and raise its minimum wage, indicating that hybrid policies are seen as appropriate (OECD 2014a). In Australia, the 'five economists' plan also involved retaining the minimum wage but topping it up with an EITC.

For these reasons, and because the Productivity Commission considers that there are valid economic grounds to justify retention of minimum wages to address bargaining power imbalances and other market distortions (chapter 4), it has also considered the case for EITCs only as a complement to the minimum wage.

For this inquiry, however, the Productivity Commission explored whether an EITC might be warranted essentially as a means of maintaining the real net incomes of low-paid workers while encouraging greater employment though slower growth in the minimum wage. To this end, the following discussion canvasses some of the in-principle strengths and weaknesses of EITCs for supplementing minimum wages. It also reports some Productivity Commission analysis of different types of EITCs, undertaken for this inquiry using the microsimulation model used to examine the effects of a change in minimum wages in chapter 4.



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## Box 6.2 Participants' views on an EITC

A small number of participants commented on the merits of an EITC, with a common thread being concern about the fiscal costs of such a scheme. The ACTU (sub. 167) said that such policies can help to boost living standards, but that they should be seen as complements to minimum wages, rather than substitutes. It said that the first priority should be to ensure that the minimum wage-setting framework gives better effect to the distributional purposes of the industrial relations system, and that:

... It is only once that objective has been fulfilled that one can have some confidence that intended beneficiaries of the in-work benefit will experience a net gain in their living standards. Furthermore, and at a more practical level, even without doing the sums it is readily apparent that the costs of implementing an EITC or other in-work benefit would be substantial. This factor alone is sufficient to make it unappealing to government based on its present policy positions concerning the budget. (p. 130)

Jobs Australia (sub. 221) said that it also supports investigating how an in-work benefit might work in the Australian context, but that it could be expected to be a very large expense to the Federal Budget and many other policy settings in the tax and transfers system would need to be adjusted to accommodate it.

The Australian Industry Group (sub. DR346, p. 29), while also acknowledging the budgetary costs, taxation requirements and resultant deadweight losses associated with EITCs, contended that:

[U]sing changes to minimum wages as a means of improving household income distribution and improving living standards for the low paid is likely to be of considerably higher social and economic cost than fine-tuning income support arrangements [including possible EITCs].

In opposing an EITC, the Queensland Council of Unions (sub. 73, p. 21) said that 'employers do and should have an obligation to pay a fair wage; this responsibility should not be handed to taxpayers'. Similarly, NSW Young Lawyers (sub. 198, p. 4) commented:

It should not be the role of the tax payer to support people who already have a fulltime job or have a part-time job but simply choose not to work as many hours as they could. Both the employer, through paying adequate wages to meet the costs of the worker living in a civilised society while allowing frugal comfort, and the worker, through bringing a committed attitude to the quality of their work including the improvement of skills, should come together on this point to alleviate the welfare system.

The National Federation of Australian Women (sub. 154, p. 39) was also opposed, contending:

- It is a costly option. If the minimum wage falls in real terms, it amounts to a wage subsidy for employers and draws a larger percentage of the population into the welfare system.
- EITCs could reduce work incentives in income ranges where the payment is phased out.
- EITCs do not address negative impacts on secondary earners because they are based on family income rather than personal income.
- EITCs can discourage upward mobility.

ACOSS (sub. 165, p. 4) raised questions about how an EITC in the Australian context would work with other elements of Australia's social security system:

An earned income tax credit or some other form of 'in-work payment' that extends to all minimum wage earners would be a costly option, especially if minimum wages fall in real terms and much of this low-wage subsidy is captured by employers. This has been the outcome over many years in the US ...

In countries like Australia and Britain which — unlike the United States — have comprehensive social security systems, it is inefficient and complex to add tax credits for low-paid workers to the existing social security and family payment systems. ... Indeed, due to these inefficiencies, and to strengthen work incentives for unemployed people entering part-time jobs, the British Government is replacing its existing Working Credit with a 'Universal Credit' which is a broadly based income support payment paid through the social security system.

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## The prospective benefits of a minimum wage-tax credit tradeoff

The promise of wage-tax tradeoffs involving freezing, or reducing the rate of growth of, minimum wages coupled with a top-up from an EITC is fourfold.

- Reducing the growth of minimum wages would reduce the cost of employing labour and could lead to greater employment. This could benefit people who would otherwise remain unemployed or underemployed, as well as overall economic activity.
- The EITC would compensate people in-work who would otherwise receive lower wages due to there being a lower growth in the minimum wage. In principle, these workers could be left in the same (or better) financial position as before the reduction in the growth of minimum wages. Alternatively, the benefits provided through the EITC could be targeted to those in low-income households only, or to other subsets of the low paid, thereby reducing the upfront fiscal costs entailed and/or potentially better targeting the moneys to the most needy.
- The risk that lower growth in minimum wages would cause some people to leave the labour force (because the minimum wage they face would be less than their reservation wage) could also be nullified by a tax credit tied to working that returned them to the equivalent financial position.
- While the EITC would have fiscal costs, the expansion in employment and economic activity brought about by the slower growth in minimum wages could mitigate those costs. This would reflect reductions in the total quantum of unemployment benefits and related welfare expenditures, and increases in the broader tax collections associated with economic expansion.

Importantly, some of these benefits depend on the assumption that higher minimum wages do cause disemployment. As discussed in chapter 4, there is some uncertainty on this matter although the Productivity Commission's assessment is that significant increases in minimum wages in Australia will come at some cost to employment.

Many countries have found an EITC scheme to be an effective instrument to achieve some social welfare objectives, which in Australia appear to be left to the wage-setting system. EITCs were used in 17 OECD countries in 2010, including the United States, United Kingdom (now as part of a Universal Credit and being phased out), Ireland, France, Denmark, and the Netherlands (OECD 2011, p. 68). Australia has its own (modest) low income tax offset (LITO — box 6.3) but the assistance it provides is not work-contingent and thus it does not qualify as an EITC.

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**Box 6.3 Australia's low income tax offset**

The LITO was introduced in 1993 and initially offered a maximum non-refundable tax offset of \$150. It was increased several times in the 2000s and, by 2010, provided a benefit of up to \$1500 for people earning less than \$30 000 per year.

Following recent changes, the maximum value of the LITO is currently \$445 per annum, which is available for incomes up to \$37 000. The value declines at a rate of 1.5 cents for every additional dollar earned, cutting out completely for incomes above \$66 667. The Tax Office automatically calculates the entitlement when processing tax assessments. There are some exceptions, including where taxpayers want upfront deductions from their PAYG instalments.

Qualification for LITO depends purely on individual income, however it is earned — there is no work test. Nor does LITO affect eligibility for other government payments or offsets.

### **Some design issues**

The incentives and equity effects created by any particular EITC will depend on its configuration and the circumstances of the nation in which it is applied. EITCs can vary in terms of the generosity of credits, income cut-offs and taper rates, eligibility criteria, methods for payment, and how they interface with other parts of the tax-transfer system (OECD 2011).

While a detailed EITC proposal was developed in conjunction with the 'five economists plan', there have been significant changes to Australia's tax and welfare system since then. The tax system is now much more targeted towards social policy objectives through changes to Family Tax Benefits and the provision of paid parental leave and other modifications (including a substantial lift in the tax-free threshold). More changes have been mooted following the McClure Committee's review (Australian Government 2015a). Accordingly, the five economists plan would require modification to suit Australia today.

Another possible model would be similar in some respects to the original LITO (box 6.3), but augmented inter alia by some form of work test. A key difference between LITO and the EITC recommended by the five economists is that the LITO is based on individual income; not on household income. (As discussed in box 6.4, there is some debate over which basis is the more equitable.)

Were the Australian Government to decide to implement a new EITC in conjunction with changes to minimum wages, it would need to decide on an appropriate model, including whether it would be based on individual or household income, and then fine tune the details. The design would need to take into account not just other aspects of the current tax and welfare system, but also proposals emanating from other reviews, including the recently completed McClure committee's review and the current taxation review.

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### Box 6.4      **The basis for EITC payments: individual or household income?**

In designing EITCs to supplement the incomes of low-paid workers, a threshold issue is whether they should be based on individual or household incomes.

Basing EITCs on household income is often seen as advantageous because many low-income earners in fact live in higher income households (chapter 4). Excluding those workers from EITC reduces the fiscal costs of a scheme and/or allows higher EITC payments for low-income workers who live in low-income households. Some also see it as more equitable than providing benefits on the basis of individual incomes, partly because it is sometimes assumed that a household with two low-income earners would enjoy the same standard of living as a single-income household on the same total income, yet that single (high) income earner would not receive a tax credit (and, indeed, would pay more income tax as they would be in a higher personal tax bracket).

However, Apps (2002) strongly challenges the basis for this view. She contended that it is well established that the assumption that living standards comparisons can be made on the basis of household income is a fallacy, stating:

Family living standards and household income (with or without an equivalence scale of adjustment) are poorly correlated, particularly in the case of two-parent families.

One of the most important reasons for this is that parents with the same number of children, in the same phase of the life cycle and with the same wage rates and non-labour incomes, make very different choices regarding the way in which they provide for their children. In some families one parent works in the market place while the other specialises in providing child care and domestics services at home. In other families, both parents work in the market place and buy-in child care and related services. In these circumstances, studies which use household income to make living standard comparisons confuse low-wage dual-income families working long hours with higher wage single-income families enjoying a much higher standard of living. Many of the dual-income families spread across the middle deciles of household income are found in the bottom deciles of a ranking defined on a more accurate measure of living standards.

Apps (2002) also pointed out that EITCs based on household incomes can result in larger work disincentives through their effects on EMTRs compared with those based on individual incomes (see further below).

From an economic viewpoint, non-monetary elements of living standards are indeed important. Whether dual-income families purchase domestic help or supply these services themselves (before and after their paid jobs), they will have either less disposable income or less leisure time, than otherwise equivalent single-income families, and thus will enjoy a lower standard of living.

However, there are other complexities to this debate. For example, dual-income families will often benefit from government subsidies for child-care whereas otherwise single-income families may not. Sorting through these issues and determining the optimal apportionment of taxes and subsidies between dual and single-income families is beyond the scope of this inquiry.

There is also a threshold issue with ramifications for possible EITC designs. Some have claimed that there may be constitutional constraints for an EITC designed to extend to single people as well as to families. This is a complex area of law and is untested in this context (box 6.5). If this was an obstacle, the design of an EITC might have to be narrower in its application or state and territory government cooperation would be required.

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## Box 6.5 Constitutional matters

Since several recent pivotal High Court judgments (*Pape v Federal Commission of Taxation* and *Williams v Commonwealth*<sup>67</sup>), it has been made clear that the Australian Government does not have the unfettered capacity to spend and make contracts (Leong, McDermott and Volling 2014; SDober 2012). The implication is that the Australian Government would need to find a constitutional head of power in order to introduce an EITC unilaterally.

The social services power — s. 51 (xxiiiA) of the Australian Constitution — includes the capacity for the Australian Government to make laws with respect to ‘family allowances’ among other transfers, but this section does not cover payments made to single persons. Although this has not been tested, some legal scholars argue that a guaranteed minimum income scheme might still be covered by this section if a broad definition of ‘family’ were adopted (Arup 1980). Even if not, some consider that the social services power might still provide the required head of power for an EITC oriented at families (the predominant focus of the United States variant of the EITC).

The Australian Government’s taxation powers under s. 51(ii) may also provide a more general basis for an EITC — though this would require a certain interpretation of that power, given that EITCs do not amount to levying taxes.

While the Productivity Commission has been alerted to some of the possible constitutional issues raised by an EITC, the matters are complex and the degree to which they would provide a genuine obstacle to the introduction of different forms of EITCs by the Australian Government has not been clarified. If necessary, however, state and territory governments could refer any relevant powers to the Australian Government for an EITC.

## Fiscal matters

In assisting the low paid through the tax system, an inherent feature of a wage-tax tradeoff proposal involving an EITC is that governments will become responsible for delivering some income to the low paid that would otherwise come from employers in the form of higher wages. As such, EITCs can be expected to entail fiscal costs (although these will be offset to the extent that lower wages lead to greater employment and, with it, reduced social transfers and higher income taxes). Several participants raised concerns about the fiscal aspects of EITCs, particularly in a tight economic environment.

### Direct fiscal costs

Although EITCs can be expensive for governments, the cost of different designs can vary significantly. Most countries with EITCs included in the OECD’s 2011 report spent less than 0.5 per cent of GDP on working credits, but Sweden spent more than 2 per cent in 2009 (OECD 2011), with its much broader coverage and generous rates.

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<sup>67</sup> *Pape v Federal Commissioner of Taxation* [2009] 238 CLR 1, *Williams v Commonwealth* [2012] HCA 23 (20 June 2012) (*Williams* (No 1)), *Williams v Commonwealth of Australia* [2014] HCA 23 (*Williams* (No 2)).

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There can likewise be variations in the efficiency costs of different schemes. In its study of 15 European countries, the OECD found that the introduction of a simple in-work benefit scheme would be highly positive in some countries, but questionable in others (Immervoll and Pearson 2009).

The direct fiscal cost of an EITC scheme depends on how many workers it covers, the size of the benefits it provides, and also the administrative and compliance costs entailed in its operation. The factors that would determine the cost of an EITC in Australia are:

- the extent of the reduction in minimum wages accompanying the EITC as part of a wage-tax tradeoff
- the coverage of the scheme. In particular, an EITC designed to fully compensate all minimum wage earners for a reduction in the minimum wage would be more expensive than one targeted on minimum wage earners in low-income households (or other subsets of low-income workers)
- other design aspects that would affect the size of credits paid, such as its eligibility requirements (for example, in relation to hours worked) and taper rates
- scheme ‘integrity’ costs — an issue would be the extent to which people are able to manipulate in-work tax credits or make mistakes in their reporting (Slemrod 2010). Overcompensation has been cited as an issue, not least in the United States,<sup>68</sup> and different countries adopt different approaches to minimise it (OECD 2011)
- claims processing costs.

As noted, the net fiscal cost of a policy to introduce an EITC as part of a wage-tax tradeoff would also depend on any reductions in income tax that resulted from the lower wages as well as what employment response would flow from slower growth in minimum wages, and how that extension in labour demand was met. Both the extent and the source of employment response are areas of some uncertainty that have ramifications for assessments of the fiscal effects of a scheme.<sup>69</sup>

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<sup>68</sup> Maag (2015, p. 28) reported estimates that between 22 and 26 per cent of all EITC payments in the United States in the fiscal year 2013 were ‘erroneous’. This figure includes some underpayments as well as overpayments.

<sup>69</sup> For instance, if all expanded employment came from the ranks of the unemployed, there could be fiscal savings as the unemployment benefits and other payments to the newly employed were stopped or wound back, and as they generated income tax. At the other extreme, if the expansion in employment were fully met by previously ‘discouraged workers’ who were not in receipt of social security payments, or by underemployed people already not on welfare who simply increased their hours of work, there would be no direct fiscal savings in the form of reduced welfare payments to offset the costs of the EITC payment (although there would still be higher income taxes associated with the expansion in employment). (An added complication in determining net fiscal impact is that any expansion in employment, while potentially increasing income tax and reducing some social security payments, may also necessitate increased government spending on child-care support and any other in-work benefits.)

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## Deadweight financing costs

A further issue relevant when assessing the merits of an EITC is how this net fiscal cost would be funded and what efficiency (or ‘deadweight’) costs would arise from the need to fund it?

Any in-work government payment (or any government expenditure that does not generate compensating revenue) must ultimately be funded through higher taxes or forgone government services and transfers. Some tax measures, such as Australian corporate and income taxes, can significantly distort labour and investment choices (KPMG Econtech 2010). Accordingly, if distributional objectives in relation to the low paid are partly met through an EITC, this might eliminate some of the inefficiencies of wage regulations but, unless well targeted, might raise (potentially greater) inefficiencies associated with taxes (OECD 2011).

Unless tax reform occurs, it appears that the marginal source of additional tax revenue for Australian governments is now income tax, which is a highly distorting tax source. Raising effective income taxes through fiscal drag would then require a further adjustment to EITC payments to return low-income workers to their initial (pre-reform) level of net income.

## Stability of an EITC

Another consideration is that, because of its high up-front fiscal costs, an EITC introduced to provide compensation for a lower minimum wage might be exposed to changes by future governments. The risk of future change of course applies to any taxation or savings measure, and indeed to minimum wages too. Social security payments can be particularly susceptible to change. That said, the EITC in the United States has come to garner significant public support and has been extended over time (Maag 2015). Even so, the current institutional arrangements for setting minimum wages in Australia are less susceptible to change than standard social security measures.

Were people to perceive significant risks that the government might rescind or weaken an EITC, that perception would itself have efficiency implications by reducing the confidence and predictability recipients would have about their future net income levels.

## Work incentives

A key aim of a hybrid minimum wage/EITC would be to sustain or lift the living standards of people on low incomes while encouraging employment. In explaining some of the thinking that led to original five economists proposal, Keating and Lambert (1998) pointed to the value of an EITC as a means of encouraging people to move from welfare to work without the downsides of other strategies:

Another key aim in any reform package to improve incentives for low-income people to pursue work rather than welfare is to ensure an adequate gap between their income from work and the

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Social Security safety net. This gap can be achieved by raising wages, particularly at the low end, by lowering the Social Safety net or by introducing an earnings credit. Higher wages will, however, not increase the gap by much as long as effective marginal tax rates remain high, and they risk creating higher unemployment (Richardson and Harding 1998). Equally, if the safety net is to do its job, any expansion of this gap should not be achieved by lowering the safety net. Instead pensions should remain at 25 per cent of male average weekly earnings. Thus the best option is to provide low-income earners with an earning credit. (p. 14)

The evidence suggests that EITCs usually encourage labour force participation (especially for single parents) although again their effectiveness depends on their exact design (Brewer, Duncan and Shephard 2005; Hotz and Scholz 2006; Hoynes and Patel 2015; De Luca, Rossetti and Vuri 2012; Meyer 2010; OECD 2011).

At the same time, introducing an EITC could also create some offsetting work disincentives due to its effects on the EMTRs facing workers (OECD 2011). In this respect, an EITC carries similar risks to many other measures aimed at benefitting the low paid (including, to some extent, regulated minimum wages themselves). For example, were an EITC based on household incomes there could be potentially substantial disincentives for second income earners. As Apps (2002) pointed out in her critique of the five economists proposal:

The withdrawal of the credit on the basis of household income usually means that a low-wage married mother who goes out to work does not receive the credit and she repays the primary earner's credit. And so both low-wage parents in a dual-income family are uncompensated for pay cuts, as is the single low-wage individual. (p. 2)

This is an inherent trait of certain EITCs based on household income alone, and would need to be given weight when considering the overall merits and detailed design of such a scheme. More generally, while supportive overall of the EITCs, the OECD (2011) noted:

In-work tax credits are a commonly used measure to address concerns regarding unemployment and inactivity traps. While they can be successful in reducing disincentives to enter the workforce (and in alleviating poverty), they have the potential to exacerbate poverty traps as targeting generally requires the tax credits to be withdrawn at higher income levels. They can also reduce second-earner work incentives where they are withdrawn on the basis of family income rather than individual income. Design is therefore a delicate balance. (p. 60)

## **Modelling some EITC variants**

To shed further light on the merits of EITCs, the Productivity Commission released a technical supplement in September 2015 (PC 2015b). This used a microsimulation model (as used for minimum wage simulations in chapter 4) to examine some effects of different EITC designs in an Australian context.

The modelling in the technical supplement considered three main EITC designs that together cover a range of design features, including whether the credits are calculated for individuals or couples, and whether they are calculated based on income or a combination



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of wages and hours worked. Two of the EITC plans were based on the ‘five economists’ proposal, while a third was one put forward by United States economists Thomas MaCurdy and Frank McIntyre. The Productivity Commission also briefly considered the effects of a hypothetical ‘direct compensation’ scheme. Details are set out in box 6.6.

The technical supplement examined the performance of the different designs against a range of criteria, including the share of the total payments provided by each scheme that would be received by lower quintile households, the designs’ fiscal costs, and some of their effects on EMTRs.

Importantly, the modelling was not able to consider all matters relevant for determining which, if any, EITC design would be ideal for Australia. That would depend not just on the matters modelled but also on other considerations, such as labour supply responses to different EMTRs, the extent of compliance costs under different EITC designs, and the dead-weight financing costs entailed in raising the tax revenue necessary to cover the net fiscal costs of different EITC schemes. As such, the modelling results are only a partial guide for understanding the merits of different instruments for maintaining or improving the living standards of the low paid and their families.

Within the limits of the modelling, the results show that each design had some strengths and weaknesses.

- A ‘direct compensation’ approach is clearly superior when the relevant indicators are:
  - the percentage of payments accruing to households in the bottom 40 per cent of the income distribution
  - the percentage of low-income households with minimum wage workers who are fully compensated for a pause or reduction in the growth of minimum wages.
- Short of direct compensation, the MaCurdy and McIntyre design provides a way to substantially compensate affected low-income households. In this respect, the two variants of the ‘five economists’ proposal are the least effective, even when adjusted to focus on low-income households.
- On the other hand, the ‘five economists’ approach is able to lower average EMTRs faced by all households, thus improving work incentives. That said, the MaCurdy and McIntyre scheme performs even better where only households already containing some workers are concerned.
- The ‘five economists’ proposal could be modified to improve EMTRs for second-earners by treating couples as though they were two (separate) individuals. However, this would increase its already-high fiscal costs further.

## Box 6.6 The Productivity Commission's EITC microsimulations

The main EITC designs modelled by the Productivity Commission are:

- Scaled 'Five Economists' — Proposed in 1998 by a group of five prominent Australian economists, this EITC scheme is linked to Family Tax Benefit Part A. The version modelled by the Commission is scaled down, relative to the original proposal. This is in order to provide the bottom two household income quintiles with exactly the amount of total additional net income that the 2012 increase in the minimum wage would have provided.
- Individual Scaled 'Five Economists' — This is a variant of the Scaled 'Five Economists' scheme, in which EITC entitlements are calculated on the basis of individual assessable income. This avoids the high EMTRs that can affect some second-earners under the original hybrid scheme (based on both individual and combined incomes).
- MaCurdy and McIntyre — This plan was specifically designed to improve the work incentives of minimum wage earners, by providing them with a fixed wage subsidy until they reach full-time worked hours (individually or as a couple). This approach avoids the pitfalls of other plans that can reward people on high wages working few hours each week.

In addition, the Commission considered the effects of fully and directly compensating minimum wage earners located in the bottom two household income quintiles for forgoing the 2012 increase in the minimum wage.

How these four designs perform in several dimensions is summarised below. Details are provided in the technical supplement.

### Some modelled effects of different EITC designs <sup>a</sup>

<i>Policy instrument</i>	<i>Share of payments received by households in the bottom 40 per cent of the equivalised income distribution</i>	<i>Fiscal cost</i>	<i>Average reduction in EMTRs facing bottom quintile households (all households / working households)</i>	<i>Households with minimum wage workers fully compensated in the bottom 40 per cent of income distribution</i>
	<i>%</i>	<i>\$m/year</i>	<i>percentage point</i>	<i>%</i>
Scaled 'Five Economists'	36	654	0.5 / 0.5	11
Individual Scaled 'Five Economists'	21	1 127	0.5 / nm	11
MacCurdy and McIntyre	44	387	nm / 1.0	68
Direct Compensation	100	224	nm / nm	100

<sup>a</sup> EITC instruments are all assessed by comparison with a 2.9 per cent increase in the minimum wage. nm Not modelled.

Sources: Productivity Commission estimates based on HILDA wave 12; PC (2015b).

These results indicate that, of those examined, no single design performs best across all the indicators, and that tradeoffs are inevitable. For example, budgetary expenditure is lower under some plans, but this is at the cost of higher EMTRs for some groups. While it would be possible to restrict the generosity of each plan to meet a pre-determined budgetary envelope, this would exacerbate differences across plans in other dimensions, such as compensation.

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It follows that designing an ‘optimal’ EITC for Australia would depend in part on government’s policy objectives and the weight given to, and thus the tradeoffs made between, different objectives and effects.

## **A future EITC?**

In principle, an EITC coupled with restraint in the growth of minimum wages has some attractions, having the potential to reduce disemployment while addressing concerns about the living standards of the low paid. Some EITC designs should also be able to better target the ‘assistance’ provided to people on low incomes than an equivalent increase in minimum wages.

However, several issues would need to be favourably resolved before it would be possible to recommend a move towards an EITC as part of a wage-tax tradeoff. These include its constitutional standing and various design issues, which would have implications for its costs, incentives and equity effects. The design would also need to be coordinated with other changes to the tax and welfare systems.

A key determinant of both the fiscal cost of the scheme and the benefits would be the employment response to the accompanying reduction in the growth of minimum wages. This is an area of some uncertainty.

Even if there were not scope to introduce an EITC in the near term, it may be an option governments could revisit in the future if, for example, labour market conditions were to deteriorate and involuntary unemployment increased markedly. In those circumstances, the uncertainties around the likely employment response to lower minimum wages would reduce, and the balance of benefits and risks of an EITC would shift. EITCs might also have a future role on equity grounds as a response to further polarisation in the labour market, should it occur, as it would help compress net in-work earnings. As noted earlier, an EITC might also be introduced for other purposes.

However, at this stage it is not clear that an EITC in Australia would be desirable. The modelling in the technical supplement sheds light on some broad economic aspects of different EITC designs in the Australian context, although it does not consider several of the problematic aspects associated with EITCs (noted earlier). More detailed investigation and design work would be required to develop an Australian EITC to the point that it would be suitable for full assessment. Such work would need to be informed by a broader analysis of (and the potential for changes to) other taxation, welfare and work incentives, as well as of legal and practical aspects, and the economic effects of a preferred EITC design itself.

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## 6.2 Other policies to enhance the wellbeing of low-paid workers and jobseekers

There are several other options that could take the pressure off minimum wages on businesses' decisions about employment and hours of work, while achieving similar distributional goals of the minimum wage.

One option would be a low-income employment-conditional social security payment. This would be similar to an EITC, except with the wage top-up delivered through the social security system rather than through the tax system. It would be possible to design a social security payment that had broadly the same impacts on the EMTRs of employees and with the same fiscal costs as an EITC. Many of the administrative arrangements would also be similar, as it is hard to see how either an EITC or a social security payment could be implemented other than jointly through the Australian Taxation Office and the Department of Human Services. Hence, such a payment has many of the same merits, flaws and complexities as an EITC as discussed in the previous section. One difference is that social welfare payments may be more likely to socially stigmatise recipients (Sykes et al. 2015).

Another approach would be some benefit-in-kind that relates to employment. Of such benefits, the most important current one is child-care subsidies provided by the Australian Government. However, these subsidies: only target families with young children; currently provide significant benefits up to relatively high incomes; are tested against household income (not the personal income of an employee); and are also available to some non-working parents. There are grounds for childcare assistance, but they are not well targeted at individuals with low hourly wage rates.

The other obvious non-cash payment that could supplement the effective income of low-paid employees would be transport subsidies. Existing public transport is highly subsidised in all jurisdictions for all users, and there are supplementary concessions for particular disadvantaged groups, but not generally for low-paid working households (as noted by NCOSS (2013) in scrutiny of NSW fare concessions). Some countries do provide transport subsidies as work incentives (for example, the Work Incentive Transport Subsidy Scheme in Hong Kong). However, there are particular problems in implementing an Australia-wide arrangement for such subsidies, given that concessions are matters for state and territory governments. The transaction costs of ensuring that recipients were indeed low-paid would not be trivial. Unlike measures such as an EITC, any practical subsidy would probably have to be either 'on' or 'off' (as with most other concessions), which means that they could create very high EMTRs around a given income threshold. Moreover, the implicit value of any such subsidy would depend on the proximity of workplaces to people, and so would provide little help to people who worked in jobs close to their homes or where public transport services are lacking.

Putting aside these options, there remain several other mechanisms for achieving the objectives of the minimum wage while limiting its impacts on the decisions of employers about people's hours worked and employment, as well as for addressing employment and employability issues more generally.

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## Wage subsidies

A wage subsidy allows minimum wages to serve their distributional goals, albeit with their lack of targeting, while reducing their impact on business employment decisions. Wage subsidies have been shown to be reasonably effective in increasing employment outcomes for disadvantaged workers (for example, Card, Kluve and Weber 2010; Heyer et al. 2011; Jaenichen and Stephan 2007; Sjogren and Vikstrom 2015).

The Australian Government has several wage subsidies in place, including:

- the Employment Pathway Fund (EPF), which includes provision for wage subsidies for job seekers registered with Job Services Australia (JSA). Around \$160 million in wage subsidies were paid to around 50 000 job seekers in the two years between October 2009 and October 2011, or around \$3100 per recipient (DEEWR 2012a, p. 5)<sup>70</sup>
- various wage subsidy arrangements for specific groups. Indigenous job seekers can qualify for the Indigenous Wage Subsidy, with special arrangements for young people that increase the likelihood of uptake for that group. The Restart Wage Subsidy, provides wage subsidies to employers that employ and retain job seekers aged 50 years or older who were formerly unemployed and on income support for six months or more. People registered with a Disability Employment Services provider are also eligible for a tailor made Australian Government wage subsidy.

The most recent evaluation of the Australian EPF suggested that it had relatively positive outcomes for qualifying job seekers (DEEWR 2012a). For example, employers reported that around one quarter of JSA wage subsidy job seekers obtained a job they would not have if not for the wage subsidy. Analysis of administrative data that controlled for the differing characteristics of recipients and non-recipients found that the odds of being off income support in 12 months were around 14 per cent higher for job seekers who received a wage subsidy compared with job seekers who received only a job placement in the same time period.

Nevertheless, as with any subsidy, wage subsidies involve several inefficiencies:

- employers obtain subsidies for people they were going to employ anyway or receive subsidies that were above the amount needed to encourage employment (low ‘additionality’)
- employers choose people qualifying for wage subsidies over other non-qualifying job seekers (displacement)
- they can create churn if people are only employed for periods commensurate with the wage subsidy. The goal of wage subsidies is to achieve sustained employment. Yet in

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<sup>70</sup> Another Australian Government wage subsidy program, Wage Connect, has been paused since December 2013.

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the survey used to evaluate the EPF, about 45 per cent of employers did not intend to retain the subsidised employees

- unless designed expressly to do so, they make no difference to the incentives for employers to increase the hours of work for existing employees.

Labour market intervention programs — including EITCs — share some of these problems. For example, an EITC may also involve problems with additionality. An EITC enables the government to set a minimum wage at a level lower than that required to achieve some income target for the individual. If a person would still have been employed at the latter wage, then the EITC is in this respect redundant for that person.

A wage subsidy could act as a partial alternative to an EITC for improving the attractiveness of ‘outsiders’ to employers. It may be particularly suited to temporary measures to reduce the cost to employers of hiring unskilled job seekers during economic downturns as it is relatively easy to ramp up existing programs.

However, unlike an EITC, wage subsidies are not usually intended to be permanent for any given individual, but rather to overcome the reluctance of employers to hire people with prior unemployment spells and to let people gain experience such that they can then sustain employment at an unsubsidised rate. In contrast, the combination of a lower minimum wage and a compensating EITC is intended to permanently reduce the cost of labour.

As there is a wage subsidy equivalent to an EITC, it is conceivable that a permanent wage subsidy could be instituted instead. It would have some inherently different characteristics, because its level would (desirably) vary with the employability of the recipient, and would act on the incentives of an employer to take a worker, rather than the incentives of an employee to work. Under an EITC, there is still a minimum wage, but it bites less, and so locks out only some from the labour market. In contrast, a wage subsidy calibrated to the labour market disadvantage of the employee amounts to setting multiple effective minimum wage rates for employers, with the lowest for the least employable. In theory, it could be designed to lock out few workers. However, it is not straightforward to design a wage subsidy of this kind (though attempts to do so have been made).

While permanent wage subsidies may motivate businesses to employ people with enduring labour market disadvantage who are priced out of the labour market by minimum wages, there are substantial risks with their adoption. There are few international schemes of this kind to test designs. Any permanent subsidy would involve high risks of low additionality, would be costly, and raise many design issues. Consequently, there should be substantial caution in adopting permanent wage subsidies as a policy option. A better policy strategy would be to obtain further information on how to improve the targeting of the *existing* (time-limited) wage subsidies, with pilot testing of any new variants of such time-limited arrangements. There should, in other words, be no assumption about the desirability of a permanent wage subsidy. From an employment system perspective, a subsidy of this kind may be no better or worse than an EITC, and any initiative to introduce the former should consider the latter as an alternative option.

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## **Payroll tax reductions**

All Australian state and territory governments levy payroll taxes on wages in enterprises with payrolls exceeding certain thresholds. (These thresholds and the applicable tax rate vary by jurisdiction.) A common feature of these taxes is that once the payroll threshold is exceeded, all of the payroll is taxed at the tax rate — thus creating an incentive for smaller employers to curb wages and/or employment growth.

As noted in the recent Tax Discussion Paper (Australian Government 2015c), businesses will respond differently over time to changes in payroll taxes. In the short run, businesses are unlikely to be able to change existing wages and prices and so bear any costs associated with increased payroll taxes. However, in the long run, the cost of the tax is likely to be passed onto employees (through lower wages) and consumers (through higher prices).

Cutting payroll tax is seen by some as a way of reducing wage costs and achieving stronger employment outcomes and has been raised as an alternative to an EITC. However, the employment effects of a reduction in payroll tax has been the subject of debate among economists for some time. An analysis of the original five economists plan suggests that the employment effects of an EITC were larger than those associated with a cut in payroll tax (Dixon and Rimmer 2001). Moreover, current exemptions and thresholds mean that a significant proportion of the payroll base is not subject to tax. The Business Council of Australia has estimated that close to half of the potential payroll tax is exempt.

## **Other mechanisms to encourage employment and employability**

There are a host of other approaches that attempt to increase the employability of marginal job seekers and thereby raise the likelihood that an employer will hire them at, or above, the minimum wage. Such mechanisms include training subsidies (either at training institutions or on the job) and targeted school programs for non-academically able children. The outcomes of such programs depend strongly on their design, the quality of the staff who manage them, and the duration of the interventions. In their meta-analysis of active labour market policies, Card et al. (2010) found that training interventions had relatively poor short-term benefits, but more favourable medium term impacts.

Australia already expends a large amount of public resources on training and education, but many see Australia's training and education system as deficient. The immediate reform task is not to expand that system to improve the employability of marginal job seekers, but to improve the efficiency and design of the system itself. That task — well beyond the scope of this inquiry — may well have a high benefit-cost ratio and might be preferred to any direct measures to lower the costs to employers of marginal labour.





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## 7 Role of awards

### Key points

- Awards are the regulations that describe the minimum wages and conditions of employment for the majority of employees in Australia. There are 122 modern awards including 107 awards that correspond to a broad industry classification, and 15 awards that correspond to occupational groups.
- Around 19 per cent of all employees have their wages and conditions set at exactly those contained in the relevant award. In addition, the wages and conditions of some employees who are part of an enterprise agreement, or are on individual arrangements, will nevertheless also largely reflect those in the relevant award.
- Awards have been part of the workplace relations framework in Australia for more than 100 years. They are unique to Australia. Their role and the process by which they are determined and reviewed have changed in the past two decades, but there are many distinctive features of awards that have remained the same.
- Awards are part of the safety net in Australia's workplace relations framework. Specifically, awards help to balance unequal bargaining power between employees and employers.
- As a part of the safety net, awards have reduced the dispersion of pre-tax employment income (especially in the lower half of household wage distribution) and increased the wages of low wage workers.
- Awards also create rigidities in wages and employment conditions and distortions (both positive and negative) in product and labour markets.
- Other countries use different mixes of employee protections and wage determination systems. While awards are distinctly Australian, some other countries have similarly rigid systems of wage determination coupled with employee protections.
- There are two broad policy options for awards — replace them or repair them. Replacement is probably not currently a practical option because:
  - the costs of transition would be significant
  - the current system of awards in general does not appear to be producing highly adverse outcomes, although there are well known exceptions
  - some of the distortions that awards create are positive while the costs of others could be reduced
  - few participants have suggested a complete shift away from awards. For example, the Business Council of Australia suggests a partial departure, but still recommends repairing rather than replacing awards.

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## 7.1 Introduction to modern awards

Awards are regulations that describe the minimum wages and conditions of employment for the majority of employees in Australia. There are 122 awards at present — known as modern awards — which mostly correspond to broad industry classifications. The Manufacturing and Associated Industries Award 2010 and the General Retail Industry Award 2010 are two examples. Award wages and conditions are the benchmark against which an enterprise agreement must leave employees better off overall (chapter 20).

The wages and conditions contained in the current set of awards were determined by the Fair Work Commission (FWC) (and its predecessors) between 2008 and 2010 with input from interested parties, including employer organisations, unions, and Australian and state and territory governments, among others. The FWC is required to undertake a systematic review of all awards every four years (the current review commenced in 2014) and to conduct annual reviews of the minimum wage rates contained in awards as part of the annual minimum wage reviews (Stewart 2013).

The rest of this chapter seeks to answer several broad questions.

- Whom do awards cover, where are they currently applied and how do award wages compare to average wages?
- Where have awards come from and to what extent does the long history of awards in Australia continue to influence the role and content of modern awards?
- What is the role of modern awards as part of a safety net and is there evidence that awards carry out this role successfully?
- Could an alternative to awards fulfil this role with lower costs or is the choice to repair awards a more sensible option?

The following chapter (chapter 8) starts with the premise — established in this chapter — that repairing awards is the more sensible option and discusses how awards, and the processes and rules followed to vary award minimum wages and conditions, could be improved to allow awards to more effectively fulfil their role.

### Awards under the Fair Work Legislation

The *Fair Work Act 2009* (Cth) (FW Act) gives the FWC the responsibility to make, vary and revoke modern awards, and also includes requirements for the content of awards.

#### Modern awards objective

The FWC is responsible for ensuring all awards achieve the modern awards objective at s. 134 of the FW Act, which states that:

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The FWC must ensure that the modern awards, together with the National Employment Standards, provide a fair and relevant minimum safety net of terms and conditions, taking into account:

- (a) relative living standards and the needs of the low paid; and
- (b) the need to encourage collective bargaining; and
- (c) the need to promote social inclusion through increased workforce participation; and
- (d) the need to promote flexible modern work practices and the efficient and productive performance of work; and
- (da) the need to provide additional remuneration for:
  - i. employees working overtime; or
  - ii. employees working unsocial, irregular or unpredictable hours; or
  - iii. employees working on weekends or public holidays; or
  - iv. employees working shifts; and
- (e) the principle of equal remuneration for work of equal or comparable value; and
- (f) the likely impact of any exercise of modern award powers on business, including on productivity, employment costs and the regulatory burden; and
- (g) the need to ensure a simple, easy to understand, stable and sustainable modern award system for Australia that avoids unnecessary overlap of modern awards; and
- (h) the likely impact of any exercise of modern award powers on employment growth, inflation and the sustainability, performance and competitiveness of the national economy. (FW Act s. 134)

This objective — possibly a misnomer, as it encompasses several potentially conflicting objectives — applies to the FWC’s decisions about any variation to awards.

### Permitted and mandatory terms in awards

The FW Act specifies terms that *must* be included in awards as well as terms that *may* be included. Awards are allowed to include terms that are ancillary or supplementary to the National Employment Standards (NES), but cannot include terms that would reduce those standards.

Modern awards must contain:

- coverage terms that explain which employers, employees, organisations and outworker entities are covered by that award. Enterprise awards and public sector awards must also include coverage terms

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- flexibility terms that allow employers and employees to vary the effect of some parts of the award. Most awards contain a flexibility term that closely resembles the model flexibility term that was developed as part of the award modernisation process. These terms specify which parts of awards can be varied, and how to ensure that the variations make the employee better off overall, which is a requirement of the FW Act. Flexibility terms allow an employee and their employer to make an individual flexibility arrangement (IFA) — these are discussed in detail in chapter 22.
  - terms requiring employers to consult employees about changes to rosters or hours of work
  - terms about settling disputes
  - terms to define ordinary hours of work
  - terms specifying base and full rates of pay for pieceworkers
  - terms about automatic variation of allowances, superannuation, and superannuation default funds.

Modern awards may include terms about any of the following matters:

- minimum wages
- type of employment, such as full-time employment, casual employment, regular part-time employment and shift work, and the facilitation of flexible working arrangements, particularly for employees with family responsibilities
- arrangements for when work is performed, including hours of work, rostering, notice periods, rest breaks and variations to working hours
- overtime rates
- penalty rates
- annualised wage arrangements
- allowances
- leave, leave loadings and arrangements for taking leave
- superannuation
- procedures for consultation, representation and dispute settlement.

Modern awards may also include terms that are ancillary or incidental to, or that supplement, the NES.

The FW Act also prohibits modern awards from containing specified types of terms, including terms that are objectionable, deal with right of entry, are discriminatory, contain state based differences, or deal with long service leave.

As part of the current four yearly review (see below), the FWC has developed an exemplar version of the Security Services Industry Award 2010 to show how the content in awards might be arranged and presented in a manner that is easy to understand. While this

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exemplar award does not represent the content that is contained in all the different awards, it does give a flavour of the types of issue that awards deal with. The table of contents from the exemplar award is reproduced in box 7.1 below.

**Box 7.1 Table of contents from a draft exemplar award**

Security Services Industry Award 2014

**Part 1 — Application and Operation of Award**

1. Title and Commencement
2. The National Employment Standards and this award
3. Coverage
4. Award flexibility

**Part 2 — Types of Employment and Classifications**

5. Types of employment
6. Classifications

**Part 3 — Ordinary Hours of Work, Minimum Wages and Allowances**

7. Ordinary hours of work and rostering
8. Breaks
9. Minimum wages
10. Allowances

**Part 4 — Penalties and Overtime and Allowances**

11. Penalty rates
12. Overtime

**Part 5 — Other award entitlements**

13. Superannuation

**Part 6 — Leave, Public Holidays and other entitlements under National Employment Standards**

14. Annual leave
15. Personal/carer's leave and compassionate leave
16. Parental leave and related entitlements
17. Public holidays
18. Community Service Leave
19. Termination of employment
20. Redundancy

**Part 7 — Consultation and Dispute Resolution**

21. Consultation regarding major workplace change
22. Dispute resolution

**Schedule A — Definitions and interpretation**

**Schedule B — Summary of hourly award rates of pay**

**Schedule C — National Training Wage**

**Appendix C1: Allocation of Traineeships to Wage Levels**

**Schedule D — 2013 Part day public holidays**

*Source: FWC (2014e).*

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However, within these types of content, there remain large variations between awards, which reflect the characteristics of the different industries or occupations to which they pertain.

#### Four yearly reviews of modern awards

The FW Act requires the FWC to undertake a review of all awards every four years, during which time it can make changes to awards, where warranted, to meet the modern awards objective. The FWC is in the process of undertaking the first of these reviews. As part of these reviews, the FWC can vary wage rates in awards, but only when changes can be justified by work value reasons.

Outside these reviews, the FWC can vary an award of its own initiative, or vary on application, but only where there is need to clarify an ambiguity or uncertainty, or to correct an error (s. 160), or if the change is necessary to achieve the modern awards objective (s. 157). The incidence of these applications was relatively high in the first two years after modern awards commenced. For example, in 2010-11 the FWC received 145 applications to make, vary or revoke a modern award to achieve the modern awards objective and 50 applications to vary an award to remove ambiguity or uncertainty or correct an error. Notwithstanding the scope of possible change and the willingness of parties to apply for changes, the FWC granted only one order under s. 157 in 2010-11 and only one again in 2011-12. The FWC is not required to publish information on the number of s. 160 orders it makes. One reason for the very low number of orders made is the FWC's determinations that variations must be *necessary* to achieve the objective and not 'merely desirable' (Stewart 2013). Since the transitional review of awards and later the first four yearly review of awards got underway, the number of applications for variations outside the four yearly review significantly reduced.

## 7.2 Coverage and application of awards

Most employees in Australia have their minimum wages and conditions set by awards. However, for many employees, these minimums sit below the actual wages and, to a lesser extent, the conditions that they receive. This is the difference between the coverage of award wages, and their *application*.

Employees (and employers) are covered by an award if they fit into one or more of the categories of employees or workplaces included in the coverage terms for that award. These terms usually include or refer to lists of occupations or types of employee (such as resort worker, cleaning services employee, market research interviewer, or retail employee) or types of activities (such as coating, painting, colouring, or varnishing). Sometimes the terms include coverage for all employers in a defined sub industry. Put together, the coverage terms in all the 122 modern awards include the majority of employees in Australia.

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Employees remain covered by awards even if another instrument applies to their employment (such as an individual contract or enterprise agreement). The only employees not covered by awards are those who:

... because of the nature or seniority of their role, have traditionally not been covered by awards (whether made under laws of the Commonwealth or the States)

... perform work that is not of a similar nature to work that has traditionally been regulated by such awards. (FW Act s. 143A(8))

Employees who fall into these non-covered categories often include managerial staff and employees in occupations that have not been covered by an award in the past, such as lawyers, financial advisors, accountants, public relations managers, human resources managers, or information technology specialists.<sup>71</sup> For these employees, their minimum wages are set by the annual National Minimum Wage Order and minimum employment conditions within the NES, but many are remunerated at levels well in excess of those.

While awards cover the majority of employees in Australia, the application of awards is less far reaching. An award *applies* to an employee if they are covered by the award and if there is no other provision that supplants the award. Therefore, awards do not apply to employees who are covered by enterprise agreements, or who earn above the high income earners threshold. The threshold until July 2016 is \$136 700 per year.

The extent of the application of awards is usually measured by identifying those employees whose wages and conditions of employment are exactly those set out in the award — referred to as award reliance. A looser definition of award reliance also includes those employees not covered by an enterprise agreement who have pay arrangements based on the award. For example, an employee's contract might specify that they receive the award wage rate plus 5 per cent and all other award terms and conditions.

The application of awards has fallen since its peak in the middle of the 20th century, when more than 90 per cent of employees in Australia had their pay and conditions directly set by an award (Mitchell 1998). In 1963, Commonwealth and state awards applied to 86.7 per cent of males and 90.7 per cent of females (Vernon 1965). However, by 1990 around 67 per cent of employees were paid at exactly the award rate, and by 2000 this had fallen to 23 per cent (Department of Employment sub. 158). In 2014, the Australian Bureau of Statistics (ABS) Employee Earnings and Hours (EEH) survey revealed that almost 19 per cent of employees have their wages and conditions set at exactly the award rate. The most recent Australian Workplace Relations Study (AWRS) and the Household, Income and Labour Dynamics in Australia (HILDA) survey also report similar levels of award reliance.

This fall in the application of awards is partly due to an increase in the use of enterprise agreements (especially in the last two decades). It also reflects a conscious effort by

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<sup>71</sup> Miscellaneous Award 2010.

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consecutive Australian governments in the 1990s and 2000s to shift the role awards play away from setting wages and conditions (that is, when awards are applied to employees) towards setting a safety net to stop wages and conditions from falling below a regulated floor (that is, when employees are covered by an award, but their employment wages and conditions are set using another method, such as an enterprise agreement).

However, as described in appendix D, a strict interpretation of the application of awards might understate their influence on wages and conditions more broadly. Awards also influence the wages and conditions of employees who are covered by both enterprise agreements, and over award individual arrangements, although it is difficult to know how far this influence stretches. The BCA (sub. DR337) suggests that awards set a minimum floor or a safety net for at least 60 per cent of the market. This is partly by design, since awards provide the benchmark for the better off overall test for enterprise agreements, and it is partly a reflection of the reluctance of some employers, especially in particular industries, to negotiate higher wages and conditions because they consider that awards are fair and provide appropriate remuneration (Wright and Buchanan 2013).

### **Who are award reliant employees and where do they work?**

Award reliant employees are more likely to work in the accommodation and food services, administrative and support services, retail trade, other services, and health care and social assistance industries. They make up a larger proportion of total employees in small and medium enterprises than in micro and large enterprises. Award reliant employees are more likely to be female, and are younger and less skilled on average than other groups – see appendix F for a more detailed discussion.

### **How do award wages compare to the average?**

Awards influence the relative pay rates of employees in three ways. They:

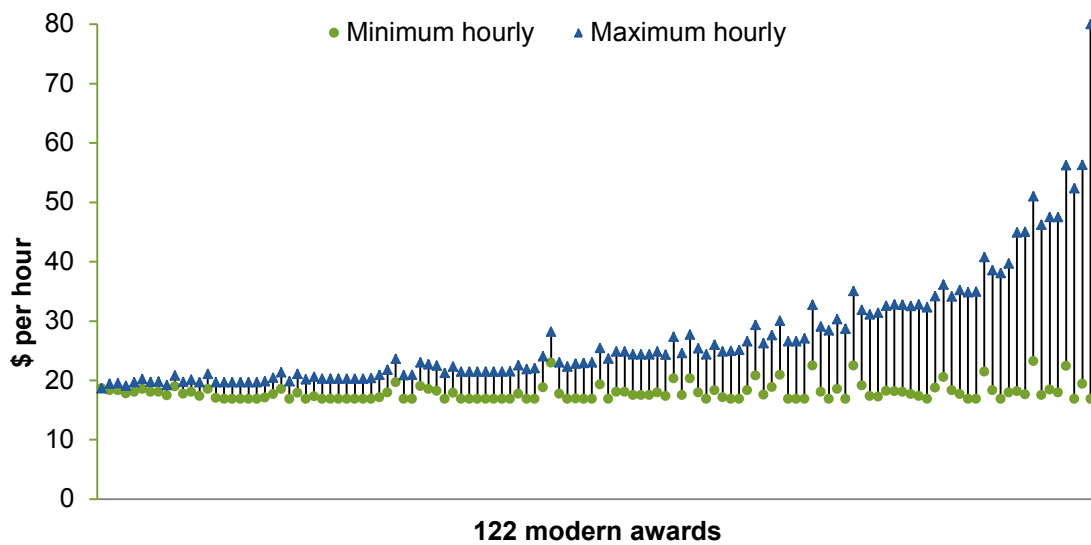
1. set the relative rates of pay between the classifications within an industry or occupation covered by a single award. For example, decisions to increase award wages by dollar increments have the effect of condensing the distribution of wages within an award
2. set the relative rates of pay between occupations in industries covered by different awards
3. influence the relative rates of pay between employees who are award reliant and those who are not. For example, where award reliant employees sit on an overall earnings distribution, relative to employees on collective or individual arrangements, will determine whether an increase in award wages shifts the aggregate earnings distribution up or down, or causes it to condense or expand.



There is little variation between the minimum wage rates in awards (which correspond to the base wage rate for the lowest classification in each award) (figure 7.1). Forty five of the 122 awards have a minimum wage rate equal to the national minimum wage (Department of Employment sub. 158), and the variation between the remainder is minimal (with a coefficient of variation of around 7.7 per cent).<sup>72</sup> The variation in the maximum rates is higher (the coefficient of variation is around 19 per cent).

**Figure 7.1 Minimum and maximum base wage rates in modern awards**

Dollars per hour, 2014

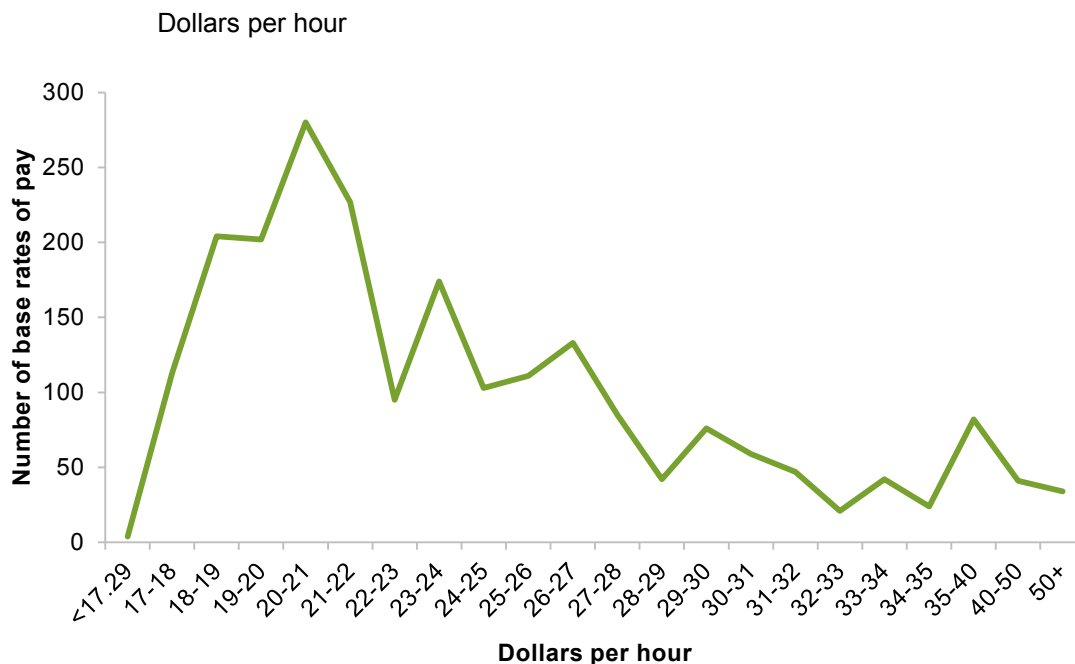


Source: Information from the Australian Government Department of Employment (December 2014).

Figure 7.1 shows that for the majority of awards, the base rates of pay for different classifications sit within a reasonably narrow band. Similarly, figure 7.2 below shows the number of base rates of pay in awards spread across different hourly rate brackets. More than 50 per cent of all classifications in these awards receive base hourly rates of between \$17 and \$23 per hour and the median rate of pay is \$22.84. These data suggest that wage rates in most modern awards display quite limited variation.

<sup>72</sup> The coefficient of variation is calculated as the standard deviation divided by the mean. It shows the extent of variation of observations in comparison to the mean of the population.

Figure 7.2 Incidence of base rates of pay across modern awards<sup>a</sup>



<sup>a</sup> Eighty-two awards (those in groups one to three of the current four yearly review) have had their base rates of pay increased by 2.5 per cent to approximate the increase contained in the 2015 annual wage review. The remaining forty awards (those in group four) have had the increase factored into the base rates exactly.

Source: Data provided by Fair Work Ombudsman, pers. comm., 13 April 2015 and 2 September 2015.

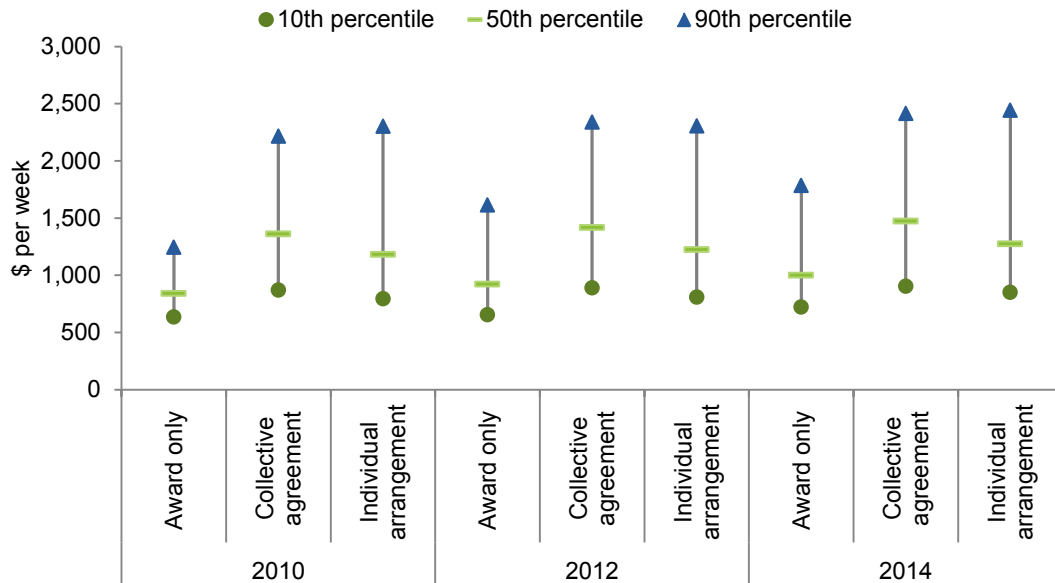
However, the base rates of pay in awards are only one driver of the dispersion in the earnings of award reliant employees. Other factors include:

- the number of hours worked and when in the week those hours fall. For example, working on weekends, at night, or outside of agreed regular hours can attract penalty rates and overtime rates of pay
- the type of employee (for example casual employees receive casual loadings)
- various allowances. These fall into two broad groups — those that reimburse actual expenses incurred (for instance, tools, travelling and meals) and those that relate to the nature or location of the work itself. For example, the latter includes payments for the special skills of an employee (such as first aid allowances), the remoteness of the work location and for various undesirable tasks, such as cold work disability allowances, hot work allowances, wet work allowances, and confined spaces allowances. Payments of allowances often vary from individual to individual because the daily tasks of people on the same basic wage may still vary.

Nevertheless, the dispersion of earnings for award reliant employees is narrower and sits below that for employees whose pay is set by another method (figure 7.3). Between 2010 and 2014, earnings for award reliant employees at all points on the earnings distribution

increased, but in each of those three years the distribution remained below those for the other methods of setting pay.

**Figure 7.3 Weekly earnings distributions by method of setting pay, 2010, 2012 and 2014<sup>a</sup>**  
2014 dollars per week



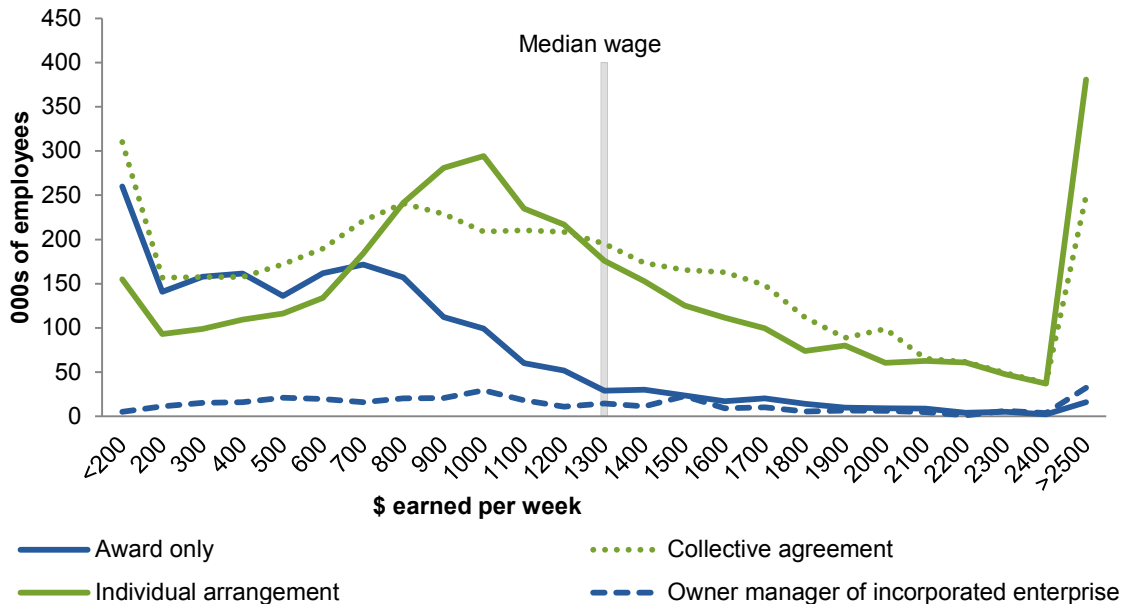
<sup>a</sup> Dollar values deflated using average annual rate of inflation of 2.5 per cent.

Source: ABS 2015, Employee Earnings and Hours, Australia, May 2014, Cat. No. 6306.0, released 6 November.

The median wages of award reliant employees (represented by the lines for the 50th percentile in the figure above) sit below those for all the other methods of setting pay, so that the earnings of the majority of award reliant employees are below the median for all employees captured in the ABS data.

The aggregate median wage and the income distribution of employees on different types of pay setting arrangements are depicted in figure 7.4 below. Most award reliant employees earn less in a week than the median weekly wage.

**Figure 7.4 Weekly earnings by method of setting pay**  
 Weekly earnings in dollars, and 000s of employees, 2014



Source: ABS 2015 Employee Earnings and Hours, Australia, May 2014, Cat. No. 6306.0, released 22 January.

### 7.3 History of awards

For most of their history, awards have been detailed and complex documents that contained the explicit details of how employers and workers were to relate to each other: how much employees would be paid, exactly what functions different workers were to perform, when they were to perform them, what responsibilities employers had to their employees and so on.

Understanding the history of awards and the successive responses to past decisions by the various bodies determining awards brings into relief two main features of Australia’s regulated wage determination system.

On the one hand, history matters. Modern awards still carry with them features inherited from the old award system.

On the other hand, while awards have been a building block in all the legislative variations of Australia’s workplace relations (WR) system over time, their prominence and use has changed. For instance, over time and often simultaneously, awards have been used as wage setting instruments, vehicles for dispute resolution, and benchmarks for enterprise level and individual bargaining. Similarly, the bodies determining awards have intermittently

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taken into account economic, political and social trends, depending on the consequences of not doing so at the time.

Unlike for the majority of the century of awards, the last three decades have seen the awards system begin to catch up to the flexibility required by the Australian economy. This is perhaps one reason why there has not been a general consensus among employer groups in this inquiry for something approaching radical change to awards. Most employer groups have advocated repairs (Australian Hotels Association and the Accommodation Association of Australia, Restaurant and Catering Australia, Clubs Australia Industrial, Australian Dairy Farmers, and the motor trades associations) with more radical reform being advocated by the Business Council of Australia (BCA), the Australian Chamber of Commerce and Industry (ACCI), Master Builders Australia (MBA) and the Victorian Chamber of Commerce and Industry (VECCI).

The fact that awards determine less and less the exact pay and conditions of employees and perhaps a better appreciation of the adjustment costs associated with any change may have also moderated enthusiasm for radical reforms.

The current collection and structure of awards in Australia are the result of a century of evolution, which began with the establishment of legally constituted bodies with the responsibility to settle industrial disputes over wages and conditions through compulsory arbitration (Chapman, Isaac and Niland 1984). In reviewing the scope of change that has occurred since that time, it is important to note that the system was born in dispute. Without a dispute there could be no award.

The Commonwealth Court of Conciliation and Arbitration (CCCA) was established through the *Conciliation and Arbitration Act 1904* (Cth). This first court was established so that an authority would exist that could settle the kinds of industrial disputes that resulted in the great strikes of the 1890s, which were considered to be the great social problem of the age (Hamilton 2012, footnote 22). Parliaments in Australia decided that a means of preventing and resolving conflict was needed. The CCCA was designed to have the power to not only conciliate disputes, but also eventually to arbitrate. Once the CCCA made a ruling, through either conciliation or arbitration, this ruling became law and was known as an award.

In the early twentieth century when the original awards were developed, it was not unusual for judicial bodies (like the CCCA) to perform administrative functions. In doing so, the CCCA was required to act according to equity, good conscience and the substantial merits of the case (Hamilton 2012, footnote 25).

The bodies responsible for the creation, termination and variation of federal awards have changed over the last century. The CCCA operated from 1904 to 1956, after which it was replaced by the Conciliation and Arbitration Commission from 1956 to 1973. The Australian Conciliation and Arbitration Commission then operated from 1973 to 1988, after which it became the Australian Industrial Relations Commission (AIRC) from 1988 to 2009. In July 2009, Fair Work Australia commenced as the new national WR tribunal

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and the AIRC finished operating in December 2009. In 2012, Fair Work Australia was renamed the FWC.

State level courts were also created at around the same time as the federal court, but the CCCA emerged as the most influential of these authorities. This was partly the result of a deliberate strategy by some trade unions to extend disputes across state borders, so that an award could be created under the federal court's jurisdiction (Stewart 2015). However, it also reflected the extensive coverage of the wages under its mandate. By the 1920s, more than half of all wage changes were affected by changes to its awards (Hancock 1984).

For most of the 20th century, awards were documents that contained the detailed resolution of a dispute over employment wages and conditions. One or more parties to the dispute would bring these disputes before the court. In some cases, the disputes were resolved through consensus, and the court's role was limited to approving the content of an award. These awards looked more like the enterprise agreements of today. In other cases, the disputes were heavily contested, and the court was required to arbitrate by balancing the differing views of the parties, and weighing the evidence provided.

Representatives for employees, most often unions, or representatives for employers typically brought disputes. From this process, awards were developed at the industry level, occupational level and often at the single or multi enterprise level. Organisations often responded to more than one award, since different classifications of employee could be covered by different awards. This was exacerbated by many small unions claiming rights to represent different groups of employees doing different tasks within an organisation — which also often led to demarcation disputes between unions. At their peak, more than 5000 awards operated in Australia at the one time.

## **Influences on award determinations over time**

### **Perceptions of what is fair have always been important**

From early on, the CCCA demonstrated that its objective was not only to mediate between parties to a dispute (and to arbitrate when an agreement could not be reached) to reduce their political, social and economic costs. Rather, the court also sought to ensure that outcomes were fair, especially when there was a significant difference in bargaining power between the parties to a dispute.

The first major manifestation of this occurred in 1907 in the case of *Ex parte H.V. McKay* (Harvester Case)<sup>73</sup> when Justice Higgins first described a fair and reasonable wage for workers in the Sunshine Harvester Works. This became the Harvester standard of a basic wage, and was subsequently applied in the Marine Cooks, Bakers and Butchers'

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<sup>73</sup> *Ex Parte H. V. McKay* [1907] 2 CAR 1.

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Association of Australia v The Commonwealth Steam Ship Owners' Association case in 1908, and later extended to all awards. Justice Higgins noted that 'one cannot conceive of industrial peace unless the employee has secured to him wages sufficient for the essentials of human existence' (Chapman, Isaac and Niland 1984, p. 5). In this way, the basic wage came to be regarded as the applicable wage for unskilled work.

### The concept of comparative wage justice

Until 1966, award wages contained the basic wage, plus a margin that was determined by the comparative skills, responsibilities and experience required to carry out each particular occupation. The relativities between the original set of margins for different occupations were set using a mixture of intuition, logic and, to some extent, the market determined relative wages of different occupations. Skills and expertise from professional or trade training, experience, and occupations that involved responsibility, physical strain, the exercise of authority, unavoidable danger or discomfort, and the need for care, alertness or intelligence were all considered to deserve higher margins (Hancock 1984). Skills, qualifications and experience continue to influence the differences in modern award classifications across occupations, and tasks that cause employees to experience discomfort, danger or physical strain are often still compensated through modern award allowances.

The margins above the basic wage were originally determined on an occupation by occupation basis, but as time went on, the relative wage rates between occupations became stable and were set and altered in reference to a fitter in the metal industry. By the end of World War II, it was generally accepted that a change in the margin of a fitter in the metal industry would signal a change for margins more broadly (Hancock 1984). In 1952, Justice Galvin remarked explicitly that:

... first the members of the Court and later Conciliation Commissioners have adopted the practice of treating the rate of pay prescribed for the general engineering fitter as the focal point or yardstick upon which to measure the rates of other skilled tradesmen, and to relate thereto the services of the semiskilled and unskilled class of workers ... That has been proved time and time again, and there is no more recent exemplification of it than what happened subsequent to the Full Court's 1947 Metal Trades decision, where notwithstanding the clear pronouncement that it was designed to cover the special circumstances of the Metal Trades industry, it was quickly imported into the awards of most other industries. (Hancock 1984, p. 87)

Due to this flow on between awards, there was little room for award adjustments to vary between industries, either to reflect productivity improvements in one industry or to relieve cost pressures that had reduced capacity to pay higher wages in another industry (Mitchell 1998). Similarly, wage relativities neither responded to the increasing demand for service skills (which were different from the skills required in manufacturing or construction), nor shifted to prompt workers to move away from industries experiencing slowing growth to those that were growing quickly. Once having established a set of wage relativities, the focus shifted to the overall wage increase that would flow through the system.

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The most notable feature of this system, at least where the public was concerned, was the practice that grew up of having ‘national wage cases’. These involved an application by one or more unions to seek a generalised increase in the wage rates set by a number of specified awards. These would be used as a test case for all other federal awards. The increase sought might be to compensate workers for the effect of price inflation over the period since the last wage case, and/or to ensure that workers shared in the benefits of any increases in national productivity. (Stewart 2013, p. 22)

By the 1980s, the AIRC was reluctant to allow award wages to depart significantly from the established relativities.

We have seen that there is a tendency for changes in industrial pay relativities over time to be fairly small, and not obviously related to economic variables. At least the former fact is probably due to the widespread use of comparability in negotiations over wages, whether these are played out in front of a body like the Arbitration Commission, or bargained between unions and employers. It is seen as fair by both sides if workers maintain their proportionate wage relativity with some perceived reference group, or in a more general sense their place in the pay ranking. (Norris 1983, p. 158)

This sentiment, coupled with an understanding that those doing work of comparable value and difficulty should be paid the same wage, is known as comparative wage justice.

### How comparative wage justice has been applied

Studies of award wage rates between 1965 and 1975 show that dispersion between award wages seemed to remain reasonably stable over time (table 7.1). The data suggest that while the relativities between awards did change from one year to the next, the regulatory system operated to keep overall relativities largely unchanged over the decade.

On rare occasions, wage relativities have been reappraised. The current relativities within and between awards were largely determined during an extensive review of award wages in 1989 at a time when the AIRC moved to consolidate and standardise the minimum rates of pay across awards.

Referred to as the Minimum Rates Adjustment, the objectives included:

- establishing skill related career paths to provide an incentive for workers to continue to participate in skill formation
- eliminating impediments to multiskilling and broadening the range of tasks which a worker may be required to perform
- creating appropriate relativities between different categories of workers within the award and at enterprise level
- ensuring that working patterns and arrangements enhance flexibility and the efficiency of the industry



- including properly fixed minimum rates for classifications in awards related appropriately to one another, with any amounts in excess of these properly fixed minimum rates being expressed as supplementary payments

**Table 7.1 Dispersion of award wages, 1965 to 1975**  
Coefficient of variation <sup>a</sup>

<i>Year</i>	<i>Per cent</i>
1965	16.7
1971	19.5
1974	17.6
1975	15.6

<sup>a</sup> The coefficient of variation is calculated as the standard deviation divided by the mean. It shows the extent of variation of observations in comparison to the mean of the population.

Source: (Norris 1977).

- updating and/or rationalising the list of respondents to awards
- addressing any cases where award provisions discriminate against sections of the workforce.<sup>74</sup>

The AIRC intended the adjustments to rectify irregularities that had developed through time, as changes to awards were determined without explicit consideration to changes in other awards. According to the AIRC:

[f]or too long there have existed inequitable relationships among various classifications of employees. That this situation exists can be traced to features of the industrial relations system such as different attitudes adopted in relation to the adjustment of minimum rates and paid rates awards; different attitudes taken to the inclusion of overaward (sic) elements in awards, be they minimum rates or paid rates awards; the inclusion of supplementary payments in some awards and not others; and the different attitudes taken to consent arrangements and arbitrated awards.<sup>75</sup>

Through this adjustment process and subsequent simplification processes (including that in the late 1990s), a set of relativities was established that used the structure of classifications in the Metal Industry Award (as is traditional) as the benchmark against which occupations in different awards were compared.

The Metal Industry Award included classifications ranging from C14 which was the lowest, to C1(b) at the top. Classifications between C14 and C11 were for low or semiskilled occupations. The C10 rate represented the minimum wage for a qualified tradesperson and classifications above C10 were for occupations requiring more advanced

<sup>74</sup> Review of the Structural Efficiency Principle [1989] AIRC February [Dec 340/89 M Print H8200].

<sup>75</sup> Review of the Structural Efficiency Principle [1989] AIRC February [Dec 340/89 M Print H8200].

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skills and qualifications, up to C1(b) for professional engineers. When the Federal Minimum Wage (FMW) was introduced in 1997, it was set at the C14 rate. In 2005, Justice Guidice (2005) remarked that most awards had a ‘classification structure consistent with the 14 levels operating in the metal industries award although very few awards have all 14 levels and most have fewer than 10 levels’.

The process the AIRC used during this review included, as a first step, identifying the classification in each award that best corresponded to the C10 rate. They did this by comparing the tasks and responsibilities that corresponded most closely to those in the C10 description in the Metal Industry Award. This classification then became the benchmark for the other classifications within the award. From there, the existing relativities within the award were considered, although it was not necessarily the case that these were changed. Qualifications frameworks were also used to compare skills between different types of occupation.

Under the FW Act, the FWC can make changes to award wage rates as part of the annual wage review. Outside of this review, the FWC can only make changes to award wage rates if those changes are justified by ‘work value’ reasons. Work value reasons, according to the FW Act include:

- the nature of the work
- the level of skill or responsibility involved in doing the work
- the conditions under which the work is done.

These requirements make it more difficult for the relativities in award wages to shift, without good reason being presented, and therefore effectively lock in the relativities that exist.

### The need to consider the economic capacity to pay

From as early as the 1920s, the wage determining bodies have considered the balance between setting a fair and reasonable wage and the capacity of businesses to pay. In 1931, the prevailing economic conditions of the Great Depression led to a real wage cut of 10 per cent. In the Court’s decision, it was noted that ‘[a]lways it has been necessary and always it will be necessary to entertain applications to vary awards on the ground of substantial change in economic conditions’ (Chapman, Isaac and Niland 1984, p. 6). Similarly, in 1952 Justice Galvin did not grant an increase to wages in the metal trades awards, due mostly to the assumption that any increase would flow onto other awards, and that, at that point in time, widespread increases in wages were likely to have adverse effects on the state of the national economy more broadly (Hancock 1984).

A more recent example includes the FWC’s consideration of an exemption of the minimum wage increase for employers under the Pastoral Award 2010 due to the effects of drought in 2013-14. In this case, the exemption was not granted, but it still underlines that

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the FWC considered the impacts of its decisions on businesses (and therefore on employment).<sup>76</sup>

A similar circumstance arose in the Australian Fair Pay Commission 2006 Wage Setting Review and the AIRC Wages and Allowances Review 2006 when the National Farmers' Federation (NFF) proposed an increase of no more than the consumer price index due to the difficulties faced by farmers experiencing drought (NFF 2006). The following year, the NFF requested that wage increases should be set according to one of two methods. The first was according to the capacity to pay wages of the lowest common denominator, having regard to the industries facing difficult economic conditions. The alternative was to allow any wage increases to be deferred for employers in the agriculture industry, especially those in areas declared as under exceptional circumstances (NFF 2007a). After two farm visits for three of the commissioners, the (then) Australian Fair Pay Commission, decided to defer the annual wage increase to all farmers in receipt of the exceptional circumstance interest rate subsidy payment for 12 months. Subsequently, the NFF described the decision as 'balanced, appropriate and consistent with current conditions across the economy as a whole' (NFF 2007b).

### Consideration for the needs of the low paid

Consideration for the needs of the low paid has consistently been reflected in award decisions through a greater willingness to adjust the rates of low-paid workers more often and by larger amounts (especially in proportional terms) than the wages of higher paid workers. Until 1966, this primarily occurred because changes to the basic wage were considered annually, whereas changes to the margins for different occupations in different industries occurred in a more piecemeal and less consistent fashion. As a result, the wage differentials between low skilled workers for whom the basic wage constituted a relatively large share of their total wage and the regulated wage floor for high skilled (and higher paid) workers were reduced over time by successive increases in the basic wage and less consistent increases in margins.

This erosion of differentials between low and high skilled workers persisted until the decision was made in 1966 to determine wage changes based on the 'total wage' of each award, that is, the sum of the basic wage and the relevant margin.

Between the early 1990s and 2005, the AIRC mostly awarded dollar amount increases to award wages during the annual safety net wage adjustments. These dollar amounts were often uniform across wage classifications<sup>77</sup>, which compressed the relativities between award minimum rates. In 1994, the AIRC noted that:

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<sup>76</sup> Annual Wage Review 2013-14 [2014] FWCFB 3500 [4 June 2014].

<sup>77</sup> There was an exception in 2001, when the AIRC granted a three-tier adjustment of \$13 per week for those earning up to \$490 per week, \$15 per week for those earning between \$490 and \$590 per week, and \$17 per week for those earning more than \$590 per week (Healy 2009).

... there is clearly a practical limit to the utility of using flat dollar increases to adjust the safety net as, over time, such increases will create unsustainable pressures to restore pre-existing relativities. However, we are not satisfied that we have yet reached that point.<sup>78</sup>

The change in the differences between the 14 classifications in the Metal, Engineering and Associated Industries Award 1998 (subsequently the Manufacturing and Associated Industries and Occupations Award 2010) exemplifies the compression of wage rates in awards. Over the period from 1993 to 2014, the wage rates at the lowest classifications have increased, while the highest rates have decreased in real terms (table 7.2 and figure 7.5). The C10 rate for a qualified tradesperson is often used as a marker between the low skill classifications below and the high skill classifications above. The wage rates for the lower classifications have increased as a proportion of the C10 rate, while the higher classifications have decreased.

**Table 7.2 Changes in award classification minimum weekly wage rates in the Metal, Engineering and Associated Industry Award<sup>a</sup> 1993, 2005 and 2014**

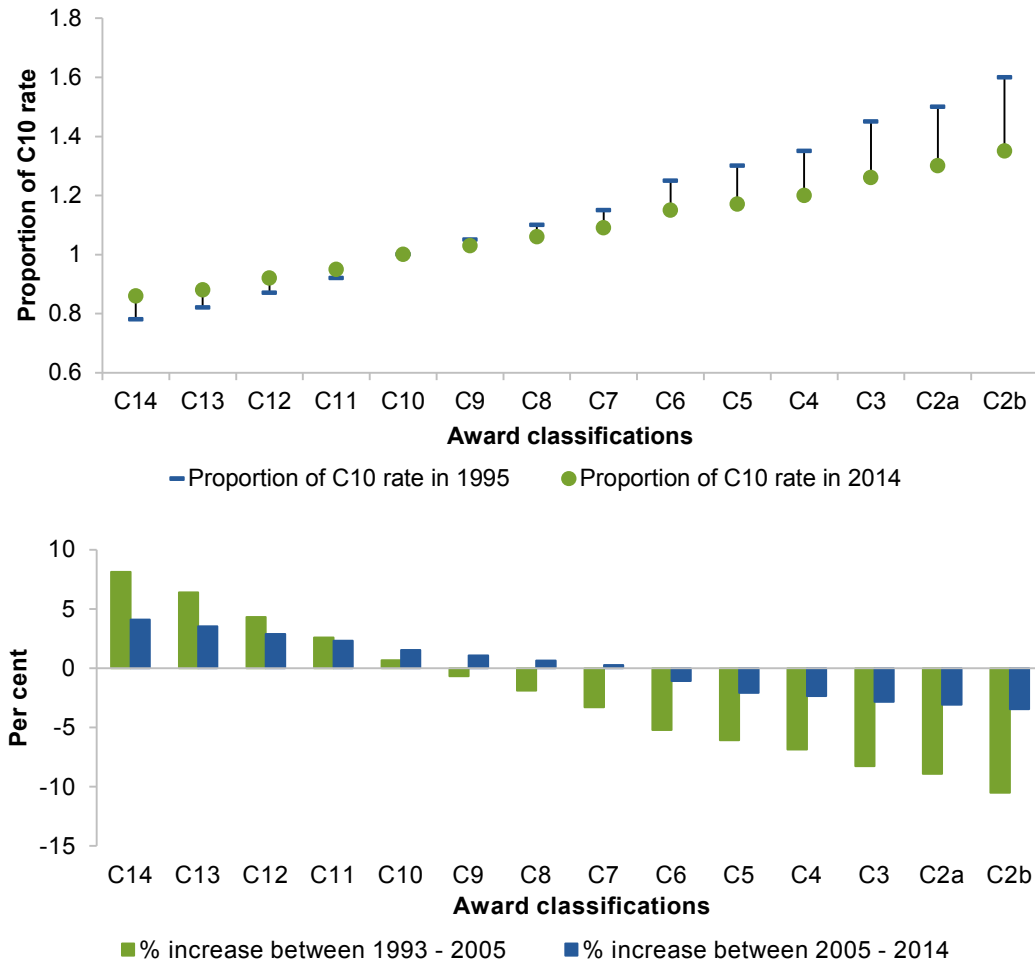
<i>Level</i>	<i>1993</i>	<i>2005</i>	<i>2014</i>	<i>Increase between 1993- 2005</i>	<i>Increase between 2005- 2014</i>	<i>Proportion of C10 rate in 1993</i>	<i>Proportion of C10 rate in 2014</i>
	\$2014	\$2014	\$2014	%	%	%	%
C14	569.37	615.66	640.90	8.13	4.10	0.78	0.86
C13	598.59	636.88	659.40	6.40	3.54	0.82	0.88
C12	637.96	665.48	684.70	4.31	2.89	0.87	0.92
C11	674.53	692.04	708.20	2.60	2.34	0.92	0.95
C10	730.00	734.87	746.20	0.67	1.54	1.00	1.00
C9	766.57	761.44	769.60	0.67	1.07	1.05	1.03
C8	802.97	787.87	793.00	1.88	0.65	1.10	1.06
C7	839.54	811.89	814.20	3.29	0.28	1.15	1.09
C6	912.50	864.89	855.50	5.22	1.09	1.25	1.15
C5	949.25	891.46	873.00	6.09	2.07	1.30	1.17
C4	985.47	917.89	896.40	6.86	2.34	1.35	1.20
C3	1058.43	970.89	943.30	8.27	2.84	1.45	1.26
C2a	1095.00	997.45	966.80	8.91	3.07	1.50	1.30
C2b	1167.97	1045.37	1009.10	10.50	3.47	1.60	1.35

<sup>a</sup> The Metal, Engineering and Associated Industries Award 1998 preceded the Manufacturing and Associated Industries and Occupations Award 2010.

Sources: Healy (2009, p. 94) and Manufacturing and Associated Industries Award 2010.

<sup>78</sup> Second Safety Net Adjustment and Review [1994] AIRC September [Dec 1634/94 M Print L5300].

Figure 7.5 **Changes in award classification minimum weekly wage rates in the Metal, Engineering and Associated Industry Award<sup>a</sup>**



<sup>a</sup> The Metal, Engineering and Associated Industries Award 1998 preceded the Manufacturing and Associated Industries and Occupations Award 2010. All values are in 2014 dollars.

Sources: Healy (2009, p. 94) and Manufacturing and Associated Industries Award 2010.

### Linking wage increases to productivity and efficiency

By the late 1980s, there was a growing consensus that the centralised wage determination system was not resulting in efficient wage outcomes. There was an increasing push towards allowing wages and conditions to be at least partly determined at the enterprise level.

In 1987, the AIRC briefly ventured into enterprise level wage determinations, in which a wage increase of up to four per cent could be directly negotiated between unions and employers at the enterprise level. However, it backed away from this in 1988. Nevertheless, the intent to tie wage increases to increases in productivity remained and led

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to the introduction of the Structural Efficiency Principle. Under this principle, wage increases needed to be negotiated to reflect improvements in the competitiveness and efficiency of the industry (Wooden and Sloan 1998). This was the start of the principle that wage increases under awards should be tied to improvements in industry performance.

## **Awards contain more than rates of pay**

The detail and complexity of awards is also partly a product of history. For example, in the 1980s, the Metal Trades Award contained more than 350 classifications of employee.

By the mid 1980s, awards had grown from relatively short instruments covering some basic terms and conditions of employment, into much longer documents often running into hundreds of clauses and sub clauses, finely detailing almost every aspect of employment. This process was assisted by decisions of the High Court in the 1970s and 1980s which helped to restrict the concept of managerial reserved rights and thus allowed the expansion of matters which might be covered by awards. (Mitchell 1998, p. 118)

Modern awards continue to reflect this history. They can include descriptions of occupations and duties, ordinary hours of work, breaks, allowances, superannuation, leave and other entitlements, and procedures for termination, consultation and dispute resolution. There are separate pay and conditions for trainees, apprentices, young employees and employees with disabilities.

These terms and conditions of employment are the result of more than 100 years of arbitration between employer and employee representatives. They have been built up as issues have arisen, and contested and refined over many years of review. They continue to be debated, including by participants in this inquiry.

However, despite their detail, modern awards are much simpler and provide more room for enterprise level flexibility than their earlier incarnations. Moreover, their adjustment need no longer be born in dispute. The modernisation and subsequent review process allows for change without first creating conflict. This may be a deeply underestimated benefit of changes in the last two decades.

Multiple review processes and changes to legislation have limited the content that is currently found in awards. Most businesses (76 per cent) now only respond to one award, and very few have to respond to more than three (3 per cent). However, a disproportionate number of large organisations respond to more than three awards (17 per cent of organisations) compared with only 2 per cent of medium organisations and less than 1 per cent of small and micro businesses (Wright and Buchanan 2013).<sup>79</sup>

The number of allowances is a good example of the role that history plays in current awards, but also demonstrates how much change has occurred (box 7.2). In recent reviews,

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<sup>79</sup> The survey covered non-public sector organisations in Australia.

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the FWC has committed to monitor allowances to make sure that awards only contain those that continue to be relevant.

### **Box 7.2      The role of allowances in awards**

Allowances in awards are payments that are made to employees when they undertake specific tasks or incur specific costs. Allowances have a long history, and until recently many allowances remained in awards despite being redundant. For example, during an examination of allowances in 2006 several redundant allowances were identified including an allowance for retail employees who rode a bicycle (to carry out their duties), and for employees who undertook specific tasks when a vessel was wrecked or stranded in the course of a voyage (Award Review Taskforce 2006). The Building and Construction General On-site Award 2010 also provides an example of an outdated provision in the form of an allowance for employees to have an x-ray every six months at their employer's expense if they have been working in a tuberculosis home or hospital; the last of which was closed in 1981 (MBA, sub. 157, p. 23).

Allowances are used for several reasons:

- to compensate employees for costs they incur. For example, a meal or a meal allowance is provided to some employees who have to work overtime without sufficient notice.
- to compensate employees for undertaking difficult or unpleasant tasks. For example, a hot work allowance is paid to some employees when they work for more than one hour in the shade when the temperature is raised artificially to between 46 and 54 degrees.
- to compensate employees for taking on extra responsibility or supervisory roles. For example, a leading hand allowance is paid to some employees who supervise two to five other employees.

Allowances introduce flexibility into awards by allowing targeted payments to certain groups of employees. However, they can also impose costs if they are numerous and complicated to apply, or if they are negotiated as a quasi-wage increase and could be easily rolled into award wage rates. Allowances in modern awards are also often changed during negotiations for enterprise agreements. The Department of Employment found that in more than half of the agreements examined, allowances were increased above the award, and in 18.5 per cent they were decreased. No other type of clause was decreased as often as allowances (Department of Employment, sub. 158, p. 14).

Allowances and penalty rates provide some wage flexibility to the extent that they take into account the variations in working patterns of employees at the same classification.

On the other hand, it can sometimes be in the interest of employers and employees to roll allowances into wages (for example, as in annualisation of penalty rates) or to allow people to tradeoff particular allowances against other benefits (for example, time off at a certain time in exchange for a reduced overtime rate at another time). Under the FW Act, tradeoffs under enterprise agreements and IFAs must meet the better off overall test, which implicitly requires some notion of the wage equivalent of any given allowance at the employee level. The extent to which this can be practically achieved affects the capacity of IFAs to introduce meaningful flexibility into awards and their application (chapter 22).

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## 7.4 Awards in the modern era — the shift to a safety net

The current set of modern awards is the culmination of a number of processes to review, simplify, modernise and consolidate awards. It also reflects a shift in the role that awards play more broadly in the WR framework.

The Keating Government's *Industrial Relations Reform Act 1993* (Cth) stipulated that awards should 'act as a safety net of minimum wages and conditions of employment underpinning direct bargaining' (s. 88A(b)) (Healy 2009). By the 1990s, the award system was viewed as providing a 'floor of minimum labour standards' (Campbell and Brosnan 1999, p. 355) and as a safety net above which employees would receive wage increases through enterprise level bargaining (Stewart 2013).

However, as a safety net in the 1990s, coverage of the award system excluded:

- around 15 per cent of the employed labour force who were not considered to be 'employees', including for example those who were self-employed
- around 20 per cent of employees, including workers in small, private sector workplaces who were often located 'at the bottom of the income and occupational hierarchy' (Campbell and Brosnan 1999, p. 356) and of course managerial and executive level staff (although in some cases, lower level supervisors were also excluded from awards).

The protections offered by the awards were also directed largely towards permanent, full time, waged employment. Those clauses directed towards casual employees, fixed term employees, part time permanent employees, apprentices and trainees were primarily designed to limit the numbers of people employed under these types of arrangements (Campbell and Brosnan 1999). This was because unions often saw these types of employment as undermining the primacy of full time waged employment (Campbell 1996), especially where there was a significant degree of substitutability between workers under different types of arrangements and potentially a wide variation in relative costs.

Clauses limiting the employment of certain types of employees, however, were classified as a 'not allowable award matter' and were removed under the *Workplace Relations Act 1996* (Cth) (s. 515). Coverage was also generalised (and expanded) in subsequent reforms as coverage terms were changed from being respondent based (including lists of unions, employers and employer organisations) to being industry based, with lists of occupations or tasks.

Nevertheless, while the role of awards as a safety net has been retained in legislative changes since the early 1990s, including most recently in 2009, the coverage of awards continues to exclude a significant minority of the employed workforce including those not considered to be employees and those who have not traditionally been covered by awards (s. 143(7) of the FW Act).



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Furthermore, while Prime Minister Keating in 1993 described awards as a safety net that was not ‘intended to prescribe the actual conditions of work of most employees, but only to catch those unable to make workplace agreements with employers’ (O’Neill 2005), awards continue to directly set the wages and conditions of employment for almost one in five employees. Consequently, while the shift to a safety net signifies an important change in emphasis for awards, and for the WR system in Australia more generally, the efforts to decentralise the system have reduced but not eliminated the role awards have always played as wage setting instruments and as a floor for negotiating above award wages and conditions.

### **Award modernisation**

The most ambitious update of awards commenced in 2008 with a request from the then Minister for Employment and Workplace Relations to the AIRC (box 7.3). Several other reviews and simplification processes preceded this, including: the Section 150A Review Process (1994 – 1997); the Section 151 Review of operation of awards (1994 – 2005); and Award Simplification (1997 – 2005) (FWC 2014a).

Work had also already been done by the Award Review Taskforce in 2006 as part of the intention to rationalise and simplify awards under Work Choices (Minister for Employment and Workplace Relations 2005). However, one of the key recommendations from that review — to rationalise awards according to Australian and New Zealand Standard Industrial Classification (ANZSIC) codes — was not developed under the award modernisation process. When requesting that the then President of the AIRC undertake award modernisation, the then Minister for Employment and Workplace Relations specified the AIRC ‘is to create modern awards primarily along industry lines, but may also create modern awards along occupational lines as it considers appropriate’ thereby not requiring the AIRC to stick firmly to the ANZSIC code as the basis for award coverage.

The request from the Minister placed several restrictions on how the AIRC was to modernise awards, including that, ‘as far as possible, the modernisation process should not either disadvantage employees or increase costs for employers’ (Stewart 2015, p. 120).

The process of award modernisation was complex and detailed, and involved extensive consultation with stakeholders and interested parties. It was also done remarkably quickly. During the process, both employer groups and unions expressed concerns about the timeframe for the modernisation process and the difficulty of providing input into the process within the tight deadlines.<sup>80</sup> Despite this, ‘[t]o the surprise of many, the massive and complex Part 10A award modernisation process was completed on schedule’ (Stewart 2015, p. 120).

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<sup>80</sup> Award Modernisation — Request from the Minister for Employment and Workplace Relations [2008] AIRCFB 618 [22 July 2008].

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**Box 7.3      Terms of reference for the AIRC to carry out award modernisation**

The request specified that the Commission was to have regard to the following factors:

- (a) promoting the creation of jobs, high levels of productivity, low inflation, high levels of employment and labour force participation, national and international competitiveness, the development of skills and a fair labour market;
- (b) protecting the position in the labour market of young people, employees with a disability and employees to whom training arrangements apply;
- (c) the needs of the low paid;
- (d) the desirability of reducing the number of awards operating in the WR system;
- (e) the need to help prevent and eliminate discrimination on the grounds of race, colour, sex, sexual preference, age, physical or mental disability, marital status, family responsibilities, pregnancy, religion, political opinion, national extraction or social origin, and to promote the principle of equal remuneration for work of equal value;
- (f) the need to assist employees to balance their work and family responsibilities effectively, and to improve retention and participation of employees in the workforce;
- (g) the safety, health and welfare of employees;
- (h) relevant rates of pay in Australian Pay and Classification Scales and transitional awards;
- (i) minimum wage decisions of the Australian Fair Pay Commission;
- (j) the representation rights, under this Act or the Registration and Accountability of Organisations Schedule, of organisations and transitionally registered associations.

*Source:* Award Modernisation — Request from the Minister for Employment and Workplace Relations [2008] AIRC 387 [29 April 2008].

The initial planning process that set out the process of review and key dates was discussed with ACCI, the Australian Council of Trade Unions and the Australian Industry Group before it was recommended by the AIRC.<sup>81</sup>

The process started with around 100 broad industry groups that were defined by the existing industry panel system in the AIRC. Within each of these industry (and, in some cases, occupational) groups, the existing federal award was used as the starting point for the drafting of a modern award. Similar state awards, and other federal awards were then allocated to one of the broad groups.<sup>82</sup>

Extensive consultation was carried out with interested parties and the review was conducted by a full bench of the AIRC. At the end of the process, the AIRC had drafted

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<sup>81</sup> Award Modernisation — Request from the Minister for Employment and Workplace Relations [2008] AIRC 387 [29 April 2008].

<sup>82</sup> A list of all the previous awards that fed into the first round of the award modernisation process can be found on the AIRC's website.

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and agreed to a set of 122 modern awards — a considerable achievement given that there were around 4000 awards in 2008 when the process began (Stewart and others, sub. 118, p. 24). The 122 modern awards were then reviewed in 2012 (as per the requirement of the original request from the government) ahead of the first four yearly review to ensure they were operating as expected and without any technical problems.

Some participants in this inquiry have expressed satisfaction in the modernisation process and suggest that it is now ‘far easier than it has ever been for a worker or small business to determine which award applies to them and what rates must be paid’ (Stewart and others, sub. 118, p. 24). Others submit that award modernisation failed (Housing Industry Association, sub. 169 and HopgoodGanim, sub. 225), and that due to the tight timeframe, the process consolidated and rationalised awards rather than modernised and adapted awards to contemporary settings (ACCI, sub. 161, Chamber of Commerce and Industry of Western Australia, sub. 134, and VECCI, sub. 79).

As a result, some participants have expressed regret that the exercise did not live up to their expectations and that there is still a need for urgent and real reform (ACCI, sub. 161, VECCI, sub. 79 and Housing Industry Association, sub. 169). Others have expressed a feeling more akin to exhaustion. The award modernisation process continues to influence the ongoing process for award reviews. For example, the consideration of the wage rates in awards (considered as part of the annual wage review) continues to be separated from the consideration of everything else (as part of the four yearly reviews of awards).

The scope of the first four yearly review is constrained by legislation and the approach adopted by the FWC. First, by a term in the *Fair Work (Transitional Provisions and Consequential Amendments) Act 2009* which provides a ‘modern award made in the Part 10A award modernisation process is, for the purposes of the FW Act (and any other law), taken to be a modern award within the meaning of that Act’.<sup>83</sup> Second, the FWC has adopted a very legalistic approach (used and well suited to its other functions) for award reviews — that ‘previous Full Bench decisions should generally be followed, in the absence of cogent reasons for not doing so’.<sup>84</sup>

By implication, anyone seeking to vary a modern award as part of the four yearly review must provide evidence that, since the award modernisation process, something has changed to reduce how effectively a modern award meets the objective, and that their proposed variation is necessary to achieve the objective.

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<sup>83</sup> Fair Work (Transitional Provisions and Consequential Amendments) Act 2009, Schedule 4, clause 4.

<sup>84</sup> 4 yearly review of modern awards: preliminary jurisdictional issues [2014] FWCFB 1788 [17 March 2014].

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## 7.5 What role do awards play?

The intent of the changes introduced under the FW Act was for awards to be ‘an important safety net and an effective floor for collective bargaining’ (Rudd and Gillard 2007, p. 10). By design, awards provide a floor for collective bargaining since they provide the benchmark for enterprise agreements, which must make employees ‘genuinely better off overall’ (Rudd and Gillard 2007, p. 10). As a safety net, awards also increase the wages and conditions for some employees above what they would otherwise be able to negotiate for themselves. This is evidenced by the almost one in five employees whose wages and conditions are set at exactly the award rate (and who are not under an enterprise agreement) — in this way the safety net can be said to ‘bind’. Awards therefore rectify some of the imbalance of bargaining power that can exist in employee-employer relationships. One effect of this is for income to be redistributed from employers and consumers to employees. Awards can also affect employers’ decisions about factors and technology used in production, and employees’ decisions about education and training (chapter 8).

The relative bargaining strength of parties to employment contracts has always been a defining aspect of industrial relations laws and regulations around the world. The view put by Otto Kahn Freund that the ‘main object of labour law [is] to be a countervailing force to counteract the inequality of bargaining power which is inherent and must be inherent in the employment relationship’ remains the dominant perspective (Creighton and Stewart 2010, p. 5). In support of this notion, a burgeoning economic literature has developed to demonstrate that even ‘vanilla’ firms have some capacity to set wages (appendix H).

This view has long been influential among Australian commentators:

It is unrealistic to postulate a world devoid of market power – of a multitude of separate employers and separate workers freely contracting with each other, each too insignificant to influence overall market outcomes. That kind of world affords no place for the large employer, nor does it encompass trade unions which seek to counter the employers’ market power and to establish power of their own. (Hancock 1982, p. 43)

In most situations which require negotiation over wages or other conditions of employment, employers enjoy a marked advantage both in terms of resources and bargaining skills. (Creighton and Stewart 2000, p. 4)

Two economists in the field, Borland and Woodbridge (1999, p. 91), argue that, at least where high costs of mobility for workers who exit from an employment relation exist, the bargaining power of those employees is expected to be lower. They also suggest that deregulating wage setting in Australia (at least to the extent necessary to see an increase in employment) would result in a substantial shift in bargaining power towards employers and away from employees.

The AIRC has also explicitly recognised that awards play a role when there is unequal bargaining power, and that the maintenance of a safety net is important for those for whom awards set their take home rates of pay (Healy 2009).

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... [N]o one would suggest that all employees are capable of bargaining. Bargaining is not a practical possibility for employees who have no bargaining power. It is to be inferred from the statutory scheme that the award safety net should be adjusted with the interests of these employees in mind.<sup>85</sup>

## **Is there evidence that awards have increased the wages received by workers?**

Research suggests that, at least until the 1990s, Australia had a relatively low dispersion of pre-tax employment income and that this was likely to be partly due to awards (since awards tended to raise wages in the bottom half of the household wage distribution).

- Among 25 countries in the 1960s, Australia and New Zealand (which still had awards at the time), and Czechoslovakia and Hungary (both part of the Soviet Bloc at the time) had the lowest degree of dispersion of income (Lydall (1968), as cited in Whiteford 2013).
- Whiteford (2013) considered that the most likely reason that Australia continued to have a less unequal distribution of earnings than the majority of OECD countries, even into the late 1990s, was the legacy of Australia's wage fixing institutions (awards), which compressed wage differentials.
- According to Borland and Woodbridge (1999, p. 97), 'earnings dispersion and the structure of earnings between skill and demographic groups in Australia are consistent with the hypothesis that the wage regulation system in Australia has acted to narrow earnings relativities, in particular for low wage workers'. Borland and Woodbridge (1999) estimated that, relative to the United States, the effect of wage regulation in Australia may be to increase earnings of low wage workers by around 15 per cent.

The proportion of employees for whom awards directly set pay has been declining. As awards have shifted from setting wages to setting a safety net, the earnings of those payed at award rates relative to all other employees have decreased. (figure 7.6). The decline has been largest at the higher end of the pay distribution. For example, the 90<sup>th</sup> percentile earnings among the award reliant has dropped almost 25 percentage points as a share of the same measure for all non-managerial employees. Nevertheless, award rates have retained substantial influence at the lower end of the earnings distribution given the persistence of a significant linkage of many employees' wages to awards.

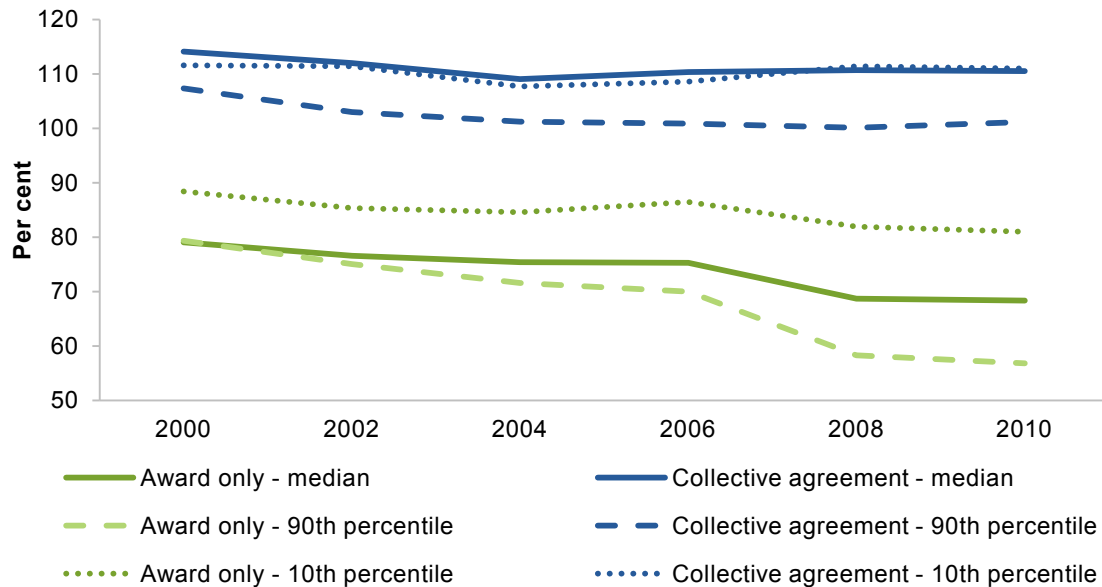
As a result of this influence, to the extent that award wages are excessive, they may create unemployment, and for some groups, exacerbate economic disadvantage — a problem they share with minimum wages more generally (chapter 4).

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<sup>85</sup> Safety Net Review – Wages [2004] AIRC [Print PR002004].

**Figure 7.6 Relative weekly earnings for full time adult non-managerial employees**

Measure of central tendency relative to the same measure for all non-managerial employees, 2000 to 2010 <sup>a, b</sup>



<sup>a</sup> The data for 2014 (not shown) are anomalous. The 2014 data show a reversion to 2000–2002 levels, but the reason for this is unclear.

<sup>b</sup> For example, the award and collective agreement median earnings are calculated as a percentage of the median earnings of all full time non managerial employees (for all methods of setting pay). For these data, employees on a collective agreement receive more than the average median earnings, and employees on award wages receive less. The same pattern holds for earnings at the 10th and 90th percentiles.

Source: ABS, *Employee Earnings and Hours, Australia*, Cat. No. 6306, table 5 (various issues).

### Is this role for awards as a binding safety net justified?

As part of the safety net in Australia’s WR framework (along with the national minimum wage and the NES), the role of awards is to put a floor under the wages and conditions employees receive, and to counter the poor bargaining power of vulnerable employees. Four conditions under which regulated award wages and conditions *may* be justified include:<sup>86</sup>

- when employers hold significant bargaining power, which can result in inefficient wages (or allow employers to capture any rents, rather than employees).

<sup>86</sup> These justifications, and evidence for them in Australia, are discussed in more detail in chapter 4 and chapter 1.

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- when increasing the wages of the low paid through minimum wages and conditions is a better method of income redistribution than the tax transfer system<sup>87</sup> — due to relatively higher costs and distortions in markets created by the tax transfer system, both in terms of economic efficiency and administration (chapter 6). This justification, while also resulting in redistribution in income to low paid employees, is quite separate to the redistribution required to rectify any bargaining power imbalance discussed above, and is just as likely to exist in a perfectly competitive labour market environment.
  - where awards overcome some of the biases against the acquisition of general skills. Business incentives to provide training are blunted for on the job training for skills that are readily transferable to other businesses (Brunello and De Paola 2004). While state subsidised education may substantially alleviate this, awards provide very strong and predictable signals to employees about the returns from training.
  - where awards address social biases against particular groups — most notably women. In a meticulous analysis of gender wage differentials (controlling for the observable characteristics of people, such as education), Wilkins and Wooden (2011, p. 20) found evidence that awards have an equalising effect on the pay of men and women.

Awards also provide a useful template for setting wages and conditions especially for smaller businesses.

Under these conditions, regulated award wages and conditions as part of a safety net help to create a better functioning labour market than would exist in their absence.

## 7.6 Is there another way?

### Alternative systems

Australia is the only country in the world that has supplemented a basic minimum wage, some standard employment conditions and employee protections by an additional layer of detailed minimum wages and conditions across multiple job classifications throughout the economy.<sup>88</sup> Since many other countries appear to have reasonable, if not better, basic working conditions and earnings than Australia, this might suggest that awards are no longer relevant.

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<sup>87</sup> In saying this, it should be noted that no system of re-distribution is perfectly targeted, and that many households that receive award wages are not in the lowest-income households (Wilkins and Wooden 2011).

<sup>88</sup> There are a few countries that have some skill-based wage tiers. However, these are simple in character. For example, Hungary has a skilled as well as unskilled minimum wage.

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However, this neglects some other aspects of WR systems. Other countries use a different mix of regulations to tilt the balance of power in employment relationships to ensure that workers receive reasonable wages and conditions of employment. Indeed, in some WR dimensions, most notably employment protection, many countries have far more stringent regimes than Australia. The Organisation for Economic Co-operation and Development, European Commission, and World Bank undertake cross country comparisons by collecting data on comparable types of employment protection around the world. Similarly, Anderson et al. (2011) compared the protection provided in Australia to that provided in New Zealand, Germany, the United Kingdom, France, India and the United States between 1970 and 2010. They found that in almost all years, the systems in France and Germany provided the highest protection, whereas the lowest protection was provided in the United States followed by the United Kingdom. The systems in India, Australia and New Zealand sat between these.<sup>89</sup>

While these employment protections do not necessarily lead to different wage determination outcomes,<sup>90</sup> they can still embed what are, de facto, quite rigid wages and conditions when combined with other regulatory aspects of a system. For example, collective bargaining between a major union (or unions) across an entire industry (as in Germany), when combined with strong employee protections, can lead to relatively regimented wages. In some sectors — most notably health services — multi-enterprise collective agreements (effectively pattern bargaining) have achieved much the same in New Zealand, even though that system is often seen as lightly regulated.<sup>91</sup> In other words, the processes for determining wages in many countries are different from those in Australia, but the outcomes may be less so.

For example, an analysis by the European Central Bank commented that:

Although it has been declining over the past decade in Europe, a large proportion of workers are still covered by some kind of collective wage agreement and collective bargaining coverage is still generally high. Coverage generally increases with firm size and is more common for high skilled employees, full time employees and in the case of industry, also manual workers. Furthermore, extension procedures (which make a collective bargaining agreement binding for all employees and employers within its usual field of application) are widespread in Europe. (Du Caju et al. 2008)

Deregulated negotiations in Europe are the exception, not the norm (Du Caju 2010). In many European countries, a large share of firms has union agreements, and bargaining arrangements cover a large share of employees.<sup>92</sup> This is true for Austria, Belgium,

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<sup>89</sup> Cross-country analyses of this type do, however, have some drawbacks. These are discussed in chapter 17.

<sup>90</sup> For example, someone might be on a low wage, but be nearly impossible to dismiss.

<sup>91</sup> Based on evidence from Multi Employer Collective Agreements (*DHB Shared Services* nd).

<sup>92</sup> Union membership densities are different from the penetration of union agreements. Higher union densities have independent effects on wage determination, and are much higher than Australia in many European countries (Du Caju et al. 2008, p. 11).



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France, Hungary, Poland and Spain, among others. In the Euro area, the second most important reason for downward rigidity in wages is labour regulation (Du Caju 2010).

Portugal provides a revealing example of how the interaction of labour law and institutions can lead to rigidities that, though less visible, are almost certainly higher than Australia:

According to the Portuguese law, a firm cannot reduce contracted wages, including other regular and periodic monetary or non-monetary pay components, unless this is permitted by collective agreements. Also, collective negotiations are usually conducted at the industry or occupation level, and collective agreements stipulate minimum working conditions, like the monthly minimum wage for each category of workers, overtime pay and the normal duration of work. Such collective bargaining covers a large part of the workforce resulting both from the presence of labour unions and the existence of mechanisms of contract extension, i.e., the Government normally uses extension mechanisms to broaden the coverage of the collective bargaining agreement to workers not covered by unions. This largely regulated institutional framework, as well as the existence of a compulsory minimum wage, which establishes a wage floor for many workers, introduces strong additional rigidity in the wage setting process. (Martins 2013, p. 3)

Ideally, comparisons between different international systems for wage determination would consider how they affected the wage distribution, employment, skill formation, inter-firm and inter-industry labour mobility, labour mismatch, productivity and other features of the labour market. Little systematic research has been undertaken in this arena, but the Productivity Commission's analysis of Australian labour market performance (chapter 2) suggests that it is more flexible and better functioning than might have been suggested by its regulatory underpinnings.

New Zealand provides a potentially insightful experiment in deregulation, as awards (similar in nature to Australia's) were abandoned in 1991 (chapter 10, chapter 22 and box 7.4). This decision appears to have increased wage disparities (as might be expected), but whether it improved overall economic and labour market performance is contested, partly because of other policy changes that accompanied workplace law changes. While a subsequent government strengthened minimum terms and conditions there has been no return to awards.

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## Box 7.4 Regulation in New Zealand

The WR framework in New Zealand shared many common features with the framework in Australia until around 1970, when commentators suggest the two systems began to diverge. The major break however, occurred in 1991 with the introduction in New Zealand of the *Employment Contracts Act* (the Act). The Act was introduced as part of a wide range of economic reforms that targeted financial and product market deregulation and reduced the protection from international competition that had been afforded to some industries. The Act:

- abolished the industrial conciliation and arbitration system, and removed all awards
- made industrial action taken during the term of a contract illegal
- removed the primary role of the unions as bargaining representatives for workers by forcing them to compete with other 'bargaining agents' for the right to represent the interest of workers in contract negotiations
- maintained, and in some cases improved, the minimum statutory entitlements that had previously existed, which covered conditions such as holidays, sick leave and minimum wages
- established an Employment Tribunal to provide mediation and arbitration in the case of employment disputes
- established an Employment Court to hear appeals from the tribunal and adjudicate on breaches of the Act (Brosnan, Burgess and Rea 1992).

The Act reduced the protective strength of the WR framework in New Zealand. Anderson et al. (2011, p. 161) describe '[t]he precipitous decline in labor law protection in New Zealand following the enactment of the Employment Contracts Act in 1991' and state that the Act took labor protection in New Zealand below that of Australia for the first time.

There is a lack of consensus around the economic effects of the Act due to it being difficult to isolate the effects of the Act from the other reforms and the improving global economic conditions more broadly. In general terms, in the years following the Act, there was a marked decline in union membership, an increase in the use of individual employment contracts, a downward trend in wages, an increase in employment, and an increase in wage dispersion (especially for those with low incomes due to less favourable conditions for some vulnerable groups). Labour productivity (which was low in New Zealand compared with other OECD countries at the time) had been increasing up to 1990 and continued to increase at a slightly slower rate from 1990 to 2000 (Conway and Meehan 2013).

In 2000, *the Employment Relations Act* was introduced. Anderson et al. (2011) describe the levels of protection under the Act and then under *the Employment Relations Act* after 2000. *The Employment Relations Act* strengthened the protection for workers through restrictions on employers using alternatives to the standard employment contract, and increased workers' rights to representation through recognition of unions and bargaining rights. The result was that the overall level of employee protection in New Zealand increased, although not to the level it was at in 1990. This suggests that there might be different combinations of instruments that provide similar levels of protection, but at different levels of cost.

*Sources:* Anderson et al. (2011); Brosnan, Burgess and Rea (1992); Conway (1999); Dixon (1996); Easton (1997); Evans et al. (1996); Hector and Hobby (1998); Kelsey (1995); Rasmussen and Deeks (1997).

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## Replace or repair?

The current system of awards in Australia is the culmination of a century of disputes and negotiations within a set of institutions that were initially designed more than 100 years ago. While the system has adapted, the lingering presence of that history makes it unlikely that awards closely reflect the type of regulatory settings that could be designed for today's economic environment.

However, the adaptations that have occurred — particularly the weight given to greater simplicity and the role of awards as a safety net — appear likely to have reduced the costs of the system. Moreover, some see awards as meeting some community expectations, though it seems possible that these might be achieved in other ways:

... it is important to appreciate that awards still play a crucial role in the federal industrial relations system, and in the broader society. This can be attributed to the interplay of a range of factors. These include a deep (and perhaps unconscious) community attachment to the award system, and its perceived benefits in terms of maintaining an equitable balance between the interests of employers and workers, and acting as a social safety net (Creighton and Stewart 2000, p. 122).

There are two broad policy options for awards — replace or repair. The deciding factor is whether the net benefits of replacement are likely to outweigh the benefits of repair.

### Replacement would be costly

Transitioning to a new framework would involve significant costs. Reports from business groups, the Fair Work Ombudsman and the FWC suggest that the costs of transitioning to the modern awards between 2009 and 2014 were considerable ('nightmarish' according to some stakeholders). Any major shift away from awards altogether would trigger costs of a higher magnitude again. In saying this, it is important to note that removing awards would require re-assessment of many other features of the WR system. For example, what benchmark, if any would be used for testing whether an enterprise agreement really met some 'reasonable' standards? A no-disadvantage test or a better off overall test are meaningless without a benchmark.

The likelihood is that a more detailed version of the NES (or similar model) would be needed if the awards system were replaced. In practice, this would effect a move away from negotiation for that (larger) part of the economy that presently takes advantage of either individual arrangements or enterprise agreements. The increase in Parliamentary standard setting would need careful consideration, which the Productivity Commission did not see addressed in submissions advocating radical change.

Whether such a shift would improve or reduce flexibility and certainty (mutually inconsistent concepts to a degree), is impossible to know for sure. However, given the partisan nature of WR, it is likely there would be an increase in policy instability in this area.

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## The current system works but needs improvement

The current system does not, despite its potential to do so, appear to be producing highly adverse outcomes. Indeed, the large majority of proposals for change were for changes inside the system, and can be loosely summarised as either outmoded limits on management ability to respond to market pressure, consumer need, or system deficiencies amounting to a triumph of form over substance.

The outcomes of any entirely new system are, by comparison, uncertain and would inevitably involve significant dissent plus implementation problems on a national scale. Moreover, the parties to employment contracts are not passive, but can be expected to respond (or attempt to respond) to circumstances that are not favourable to them. Further, if the re-distributive effect of awards were to be reduced, the tax-transfer system would almost certainly have to markedly extend its reach.

## Efficiency effects

Awards create distortions in both product and labour markets. Some of these are positive distortions since they address undoubted social ills (unequal pay between the sexes as an example), unequal bargaining power, and the high costs of contracting employees for small business (chapter 8, chapter 23). Others create significant costs, but at least some of these could be remedied within the existing system, and are not reasons in and of themselves to abandon awards altogether.

## Radical transformation is not required

Several participants in this inquiry including the BCA, ACCI, VECCI and MBA (box 7.5), have suggested a significant shift away from the current award system, but the majority have not.

MBA recommended replacing awards with one junior and one adult minimum wage (sub. 157) by sunseting awards over five years.

ACCI presented a spectrum of options for how to move to a more decentralised and deregulated system, and suggested that the Productivity Commission recommend a set of legislated minimum standards (against which a full suite of agreement making options would be assessed), a national minimum wage and industry rates of pay, and any award conditions that are agreed upon by parties to an agreement.

The BCA and VECCI recommended the continuation of awards, but in a significantly more streamlined form that accentuates their role as a safety net. All of these employer groups detail examples of costs and inefficiencies that awards create (and these are referenced in more detail in the relevant chapters).

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However, none questions the need for a safety net of some form, and in the case of the BCA and ACCI, while the degree of overhaul of the awards system is considerably greater than entertained by most stakeholders, the recommendations are still to repair, not replace the current system.

**Box 7.5      The BCA's proposal for a new award system**

The BCA supported the role that awards 'play in contributing to a safety net for workers' (p. 26). However, it argued that current awards lacked coherence and clarity, and that their legitimate role as a safety net was not always consistent with the contents of awards (which often have clauses that provide benefits above the minimum or specify details about job design that should be left for employers and employees to negotiate according to the needs in each enterprise). It proposed a more streamlined set of awards from the current 122 to one per industry, and the shift of common economywide entitlements into the NES.

The BCA argued that there should still be industry awards because some matters are specific to certain industries, such as the normal hours worked. It also argued that industry awards would be useful as templates for employment arrangements for small enterprises that did not want to negotiate an enterprise agreement.

Each industry award under the BCA proposal would be limited to specification of:

1. agreement in writing to pattern of hours of work (part time workers)
2. allowances for travel costs/times and transport
3. apprenticeship requirements
4. employment categories, including definition of a shift worker
5. industry specific redundancy schemes
6. national training wage, and allocation of traineeships to wage levels
7. ordinary hours of work
8. rostering issues, limited to maximum days of work, maximum hours per day, meal breaks, minimum break between times worked and minimum engagement
9. wage classifications (up to a maximum of five categories per award) and details about when employers are required to provide additional remuneration for overtime and shifts, or for work done during unsociable, irregular or unpredictable hours.

The BCA floated the idea that at some time in the longer run, there might only be a need for a single 'universal award', though it did not suggest a timetable for this more radical shift.

*Source:* BCA (subs. 173 and DR337, p. 55).

Therefore, in order to repair awards rather than replace them, the next chapter (chapter 8) discusses some of the effects of awards and explores what might need to change to reduce the costs that awards impose.



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## 8 Repairing awards

### Key points

- While modern awards are generally less rigid and costly than their historical predecessors, they remain relatively inflexible, imposing costs for employers and employees.
  - The level of reform needed cannot be achieved through individual flexibility arrangements. Awards should still play a key role in the workplace relations system, but their content must change.
- The Fair Work Commission (FWC) is making efforts to adapt and improve awards and the processes for determining them, but it is not enough. In many cases the *Fair Work Act 2009* (Cth) (FW Act) limits the improvement possible, meaning some parts of awards are more historical relics of the relative bargaining strength of past protagonists than a carefully thought out way of remunerating employees.
- To reverse this trend, responsibility for award reform should transfer to the Workplace Standards Commission (WSC) after completion of the current four yearly review.
- The four yearly review, in which the FWC is required to review every clause in every award, is hugely resource intensive for everyone involved. The WSC should instead be required to review awards on an ongoing basis, focussing its efforts on aspects of awards that are the source of greatest problems — ‘hotspots’.
  - These hotspots should be identified and resolved by rigorous research and analysis.
  - The WSC should use methodologies from economics, social science, commerce and equivalent disciplines, and seek public guidance on reform options.
  - Issues that make awards complex and difficult to understand, or that limit operational flexibility, should be a priority.
  - It is important not to undermine employee protections and safety net entitlements.
- To encourage greater scrutiny and possible variation of award wage relativities, the WSC should be able to vary award wages outside of the annual wage review without reference to work value reasons.
  - At present there is little movement in wage relativities within and across awards because of limited scope to make changes outside of the annual wage review, and weak enthusiasm by the FWC during annual wage reviews. But preserving these relativities makes little sense given the weak original basis for many of them (the relative bargaining strength of the participating parties) and changing conditions since then. This applies equally to conditions in awards.
- The goal of further award reform should be to improve outcomes for the community as a whole, rather than simply cutting costs for business.
  - To make this clear, the Government should streamline the modern awards objective to upgrade consideration of the needs of groups not generally represented in but nevertheless affected by award matters — specifically, the unemployed and consumers.

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The Productivity Commission has concluded awards should be retained to provide a safety net to address the imbalance of market power. That said, the Productivity Commission is not endorsing every wage rate and condition in every award; this level of analysis was not possible in the timeframe and would have duplicated a lot of work being undertaken by the Fair Work Commission (FWC) during the first four yearly review of awards. The Productivity Commission has, however, examined the process of review and some review decisions to consider how well the current rules (set by the Government) and approach (adopted by the FWC) for award reviews meet the needs of the community.

Having done this, the chapter below sets out some necessary changes to Part 2-3 of the *Fair Work Act 2009* (Cth) (FW Act), and building on the reforms in chapter 3, a new approach for the institution responsible for setting and reviewing awards. In particular, the approach should be more analytical in the search for balance between certainty and flexibility. Precedent is not an effective primary point of reference. The Australian economy is much more open to the world now than when awards were first developed, due to both technology shifts (digital disruption) and international exposure, meaning what was appropriate once, may not be today. Three conclusions have been reached and will be expanded upon in the remainder of the chapter:

- The current institutional framework in which awards and their minimum wages are determined uses decision making frameworks and relies upon expertise that are ill suited for assessing what are predominantly economic issues (chapter 3). The new Workplace Standards Commission (WSC) will be better suited to carrying out award assessments.
- The current four yearly review of modern awards should, as much as its scope allows, use the analytical and conceptual framework that the Productivity Commission proposes for future assessments. After completion of that review, a more focused, less resource intensive model of assessing awards is required.
- As a first priority within a new model of award assessments, issues that make awards complex and expensive to use should be addressed. A complementary stream of work would assess more complicated and critical issues that require more extensive empirical analysis. The focus should be ‘is this essential for a safety net?’ rather than preservation.

## **8.1 A new approach by a new institution**

The FWC and its predecessors have had significant responsibility for wage determination for a large (though much diminishing) share of employees for over a century. These institutions have brought a particular mindset to deliberations — of which a legalistic framework, an emphasis on fairness, and an arbitral function, appear to have been enduring features. The history of awards generally, and of past determinations specifically, often appear to remain a persistent influence.



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Both the analysis in this inquiry and submissions from participants suggest that awards include undesirable features. Such features are not a requirement by law, but rather an outcome of precedent and decision making by the FWC (and its predecessors). The WSC should adopt a more systematic and evidence-based approach to address the deficiencies in awards (chapter 3). This new approach should have its foundations in the frameworks and methodologies applied in the social sciences (most importantly, economics), and rely upon robust quantitative and qualitative research for decision making.

## **Evidence and research**

The use of evidence is referenced throughout the history of award reviews, and decisions frequently mention the need for parties to present evidence to support their claims. For example, the processes of the Australian Industrial Relations Commission (AIRC) prior to 2005 have been described as follows:

Justice Giudice ... explained that the AIRC was a quasi-judicial body and, as such, could not inform itself independently of formal hearings for fear of undermining the Commission's impartiality. The only research the AIRC ever saw was submitted to the Commission as evidence and then subjected to cross examination in open court (Harper 2009, p. 4).

This is no longer the case. The FWC can commission research to inform both award reviews and annual wage reviews, and undertake internal research where it sees fit. The current review process reflects a shift away from a largely adversarial system to one better described as inquisitorial. This could be partly a reflection of the processes adopted under the Australian Fair Pay Commission (AFPC), which relied more heavily on independent research, wide reaching consultation and 'accountability to evidence' (Harper 2009, p. 7). The FWC's expert panel on the minimum wage has inherited at least some of the AFPC's approaches.

However, the FWC does not appear to rely heavily on objective, robust research when making award review and annual wage review decisions, although the use of evidence is more apparent in the latter. The FWC does emphasise that parties participating in a review must provide evidence to support their claims. But this raises several concerns.

First, parties participating in both award and annual wage reviews are rarely objective and usually represent either employer, employee or government interests. As a result, these parties have an incentive to provide selective evidence that supports their position. Deficiencies in such evidence are often noted in decisions. The Full Bench decision from the four yearly review annual leave common matter is a recent example. In this decision the Full Bench criticised survey evidence gathered by the applicant and expert witness statements submitted in support of the applicant's claims, and distinguished this 'evidence' from more objective and robust evidence submitted for consideration. Sound practice though this may be, the scope of the matters being considered by the Full Bench was limited to those raised by the applicants, without consideration of whether there were other relevant matters affecting the wider community that required attention.

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Second, the fact that a party does not present detailed, robust evidence does not mean a problem does not exist, or is not worth examining. Several opportunities to carry out rigorous research on the impacts of changes to award conditions following award modernisation slipped by because the AIRC did not have the resources or disposition to undertake or commission research at the time.

Third, parties are required to provide evidence in order for the FWC to consider the merits of a proposition to change an award. As a result, a lack of evidence can become the reason not to do something. A scientific methodology would instead rely on the opposite approach, which is that having identified likely problems, the FWC would proactively collect the evidence about the effects of alternative decisions. The failure of advocates to provide evidence of their own would be at most a matter of interest, rather than decisive. The difference is subtle, but points to a different decision making process.

Finally, not all affected parties have the time, inclination or expertise necessary to participate in award reviews. The Australian Industry Group highlighted the burden of participating fully in the current four yearly review:

The resource burden upon Ai Group of the 4 Yearly Review is highlighted by the fact that in the 12 month period between 1 July 2014 and 30 June 2015, Ai Group participated in at least 125 days of FWC conferences and hearings and filed thousands of pages of submissions and evidence relating to the Review. The workload has not decreased since 1 July, and is set to continue at similar levels at least until the end of 2016. (Australian Industry Group, sub. DR346, p. 31)

Master Builders Australia (MBA) gave evidence that some of its members are reluctant to appear before the FWC in award reviews as an appearance may provoke reprisals from unions. MBA submitted that ‘reliance on independent research, and even witnesses being required under compulsion to provide evidence, would assist with the award review process’. (MBA, sub. DR290, p. 46)

The establishment of the WSC therefore provides an opportunity to revitalise the use of research and evidence in decision making. Impartial, self-initiated research undertaken (or commissioned) by the WSC would shed better light on many award determination and minimum wage matters that are the perpetual source of contention by partisan stakeholders. For example, there is ample room to carry out more extensive analysis of the effects of award variations (such as in penalty rates, spans of hours, allowances, and other entitlements and conditions), wage relativities, wage levels and the clarity and structure of awards. A new approach should therefore consist of:

- the deliberative collection and analysis of evidence relevant to the specific award matters under consideration (‘pointed’ rather than general research). Evidence presented by parties would of course still be considered, but that would be only a partial basis for decision making
- exploiting modern analytical techniques
- inviting public scrutiny

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- constantly seeking to improve and refine the research and analytical process.
  - no presumption in favour of past practice.

Given the importance of the WSC's deliberations it is imperative that it have considerable research capability. Just as the Productivity Commission and the Reserve Bank of Australia undertake independent research and analysis to inform their work, a strong research capability will be vital to the WSC (chapter 3).

### **Tradeoffs between elements of the modern awards and minimum wages objectives should be clearly articulated**

The modern awards objective and the minimum wages objective contain various elements that the FWC is required to take into account when deciding to preserve or vary a modern award. Sometimes it is clear from a decision which of these elements weighed most heavily on the outcome. For example, while discussing requests from several industries for industry specific minimum wage adjustments during the 2013-14 Annual Wage Review, the FWC cited previous reviews, which articulated that:

... the onus is on the party seeking to rely on economic incapacity and a strong case must be made out in order to warrant relief ... [and] any decision to provide different wage outcomes based upon the particular circumstances in each industry, as they might vary from time to time, would inevitably lead to the loss of any relativity between the wages specified in modern awards. This would not sit comfortably with the principle of equal remuneration for work of equal or comparable value.<sup>93</sup>

At other times, the FWC has simply acknowledged that it can be difficult to weigh the different parts of the minimum wages objective. In a hearing as part of the 2014-15 Annual Wage Review, Justice Ross remarked:

Beyond saying that we've taken them into account ... you can't reduce the set of statutory criteria into an algorithm ... [t]hat says we've given [0].2 to this and [0].3 to that. ... We can certainly perhaps indicate from year to year what factors have borne more heavily on the decision making in that particular context but a number of submissions seem to suggest almost a mathematical waiting (sic) exercise. For myself, I just don't see how that could be done.<sup>94</sup>

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<sup>93</sup> Annual Wage Review 2013-14 [2014] FWCFB V3500, 4 June 2014.

<sup>94</sup> Transcript of Proceedings, Fair Work Commission's Annual Wage Review 2014 15 Final Consultations, C2015/1, 20 May 2015.

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Elements of the minimum wages objective and the modern awards objective do, by their nature, conflict. Therefore, weighing the benefits of increased earnings for the low paid, against the potentially slower employment growth from more generous increases in minimum wages is vital. While judgment will always be necessary, scientific methodologies can provide the metrics and processes for assessing the consequences of different minimum wage and award review decisions, and can ensure that decisions are, as much as possible, informed, transparent, logical, substantiated and consistent.

The new WSC, having undertaken rigorous research to identify the trade--offs it is seeking to weigh, should therefore articulate exactly how its decisions *are* reached as well as the consequences of its decisions for all those affected, both positively and negatively. Quite deliberately, the new body must see its role as informing participants how it could be expected to arrive at decisions in the future, in order that they can improve the quality of evidence that the FWC has previously found wanting. A new modern awards objective is proposed below in section 8.7, and the methodology described above applies equally to the new objective.

## **Participation in modern award and annual wage reviews**

Participation from interested parties through submissions and appearances at hearings plays a prominent role in modern award and annual wage reviews. For example, more than 25 organisations have actively participated in the penalty rates matter during the four yearly review of modern awards so far (FWC 2015b). Open, transparent and participatory processes should remain an important element of any WSC review process since the WSC would be making decisions affecting large sections of the community.

However, despite the breadth of organisations participating in these reviews, the traditional interests of employer groups, unions and the Australian Government dominate the process. This is a reflection on the relative amount of resources each party can afford to invest in the reviews and the deep entrenchment of the tri-partite approach to workplace relations. If the current status of external parties (jobless and consumers) was such that they were relevant, by now there should be some evidence that their views were of influence. This does not appear to be the case.

Some commentators nevertheless suggest that this is slowly changing and that a wider range of parties are making submissions to recent FWC review processes (Bray 2011). Further, the FWC has commissioned research that seeks the views of small businesses on their use of awards to inform its work to simplify and clarify award content (Hodges and Bond 2014). However, annual wage review decisions still largely reflect the input of the three traditional groups of participants.

As a consequence, the needs of the unemployed and of consumers are underrepresented. In particular, no-one who participates does so expressly representing the views of the unemployed. Social advocacy groups, for example, usually span those with low paid jobs as well as the jobless.

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The WSC should encourage the participation and representation of all those affected by its decisions, and gather its own evidence (especially in relation to the interests of stakeholders who do not participate) and ensure that its decisions transparently and logically follow from an objective assessment of the evidence.

## **Focusing the award review process**

The FW Act requires the FWC to review every modern award every four years. Outside of these reviews there are still limited opportunities for change upon application by a party or at the initiative of the FWC. The Productivity Commission has received mixed views about the current four yearly review, some of which are contained in box 8.1 below.

### **Box 8.1 Most participants do not like the four yearly award reviews – but their reasons vary**

The four yearly award reviews were the subject of criticism from several participants in this inquiry. The FWC detailed the breadth of the task:

The conduct of the 4 yearly review is a very large body of work, both for external stakeholders as well as requiring extensive internal resources to support it. For example, more than 2 500 documents have been posted to the Commission's website, six decisions and 27 statements have been issued to date, and the process is expected to be completed in 2016. (FWC sub. 171, p. 47)

The National Farmers' Federation submits that the requirement to review all 122 awards every four years is excessive (National Farmers' Federation sub. 223, p. 15) and Master Builders Australia expressed pessimism about the outcomes of the reviews:

... the extent of the litigation generated by the review, the intensity of resource allocation and the polarisation of stances between unions and employer groups where all matters seem destined for adversarial outcomes, detracts from optimism that the outcome will bring any radical changes to the matters only touched on in this submission. (Master Builders Australia sub. 157, p. 25)

The Australian Council of Trade Unions suggested that the periodic reviews prompted unions and employer groups to contest award matters:

... simply because the review process provides a trigger for doing so. Employer organisations and unions are effectively bound by their charters to use the review mechanism as an opportunity to improve their position. As a result, elements of the safety net that were well entrenched and relatively uncontroversial prior to the creation of modern awards (such as penalty rates) have become a battleground for industrial parties. (Australian Council of Trade Unions sub. 167, p. 147)

This sentiment was echoed by the Victorian Automobile Chamber of Commerce (trans. pp. 245–246) and the Motor Trade Organisations (sub. DR324).

The Australian Federation of Employers and Industries similarly assert that the four yearly reviews give unions the opportunity to pursue improved employment conditions as award test cases to be applied as minimum safety net entitlements (Australian Federation of Employers and Industries sub. 219, p. 36).

Other participants, however, have expressed support for the reviews, such as the Catholic Commission for Employment Relations (sub. 99) and the Australian Services Union who submits that the reviews ensure that as industries evolve, the conditions for award reliant workers are maintained (sub. 128).

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Given the potentially enormous scale of the task, the President of the FWC has taken steps to limit the scope of matters considered in the first four yearly review and to streamline the process. First, the FWC has identified common issues that arise in numerous awards (for example, annual leave, casual employment, and public holidays) and rather than dealing with them on an award by award basis, it is dealing with them collectively. This will have the effect of ensuring greater consistency in similar clauses across awards. Second, the FWC has determined it is the responsibility of the parties to effectively demonstrate the need for reform. To limit the issues brought before the FWC as part of the review, President Ross instructed parties to provide ‘probative evidence’ to demonstrate the facts supporting a proposed variation, and to show that the variation is necessary to achieve the modern awards objective.<sup>95</sup>

Nevertheless, the current four yearly review appears to be an expensive exercise requiring extensive investment from interested parties. Due to the breadth of the issues before the FWC, the current review is likely to take at least two years to be completed. After this, the system should remain relatively ‘stable’ for two years before the next review is due to commence. To avoid repeating this process, the requirement for future four yearly reviews should be removed and replaced with a more targeted approach to reviewing awards.

As part of such an approach, the WSC should:

- continue the current approach in the FWC of dealing with small issues that intermittently arise and that need fixing (without much elaborate analysis or input from stakeholders). It would identify and address any remaining or emerging anomalies, technical problems and typographical errors in particular awards (such as those addressed in the Fast Food Industry Award 2010 as part of the Modern Awards Review 2012)<sup>96</sup> that frustrate the use of awards and that can be easily fixed (stream 1 in figure 8.1 below)
- identify and address issues that are relatively straightforward and uncontroversial (but important) and that once addressed, would make awards easier to use. Addressing these issues has the potential to significantly improve how easy awards are to understand and to reduce the costs of using and complying with awards. For example, there are problematic issues in awards that are well known and recognised by both employer and employee representatives. Ambiguous language and a lack of pay tables are examples of issues that could be quickly and easily addressed. The FWC has recognised this as part of the current four yearly review and has agreed that some proposed changes may be self-evident and can be determined with little formality.<sup>97</sup> These are discussed in section 8.2 and depicted in stream 2 of figure 8.1 below)

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<sup>95</sup> 4 Yearly Review of Modern Awards — Preliminary Jurisdictional Issues [2014] FWCFB 1788, [17 March 2014].

<sup>96</sup> Fast Food Industry Award 2010, [2014] FWC 1592, 17 March 2014.

<sup>97</sup> 4 Yearly Review of Modern Awards — Preliminary Jurisdictional Issues [2014] FWCFB 1788, 17 March 2014.

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- initiate a research agenda to identify more complex but critical issues. These issues include those that might improve awards so that they more effectively meet the new modern awards objective and improve the wellbeing of those affected by awards. Some of the commentary around the modern awards objective suggests that in any given award, the decisive test of its adequacy is whether collectively the set of minimum wages and conditions meets the objective or does not. This ignores the fact that an alternative set of wages and conditions might improve some of the outcomes within the objective without significantly reducing outcomes under others. Where there is scope, these kinds of improvements should be the focus of a targeted, thematic approach to award modernisation. This process is discussed further in sections 8.3, 8.4, 8.5 and 8.6 and depicted in stream 3 of figure 8.1 below.

Once these complex and critical issues have been identified, the WSC should:

- develop policy options for addressing these issues, and articulate how these options would impact all affected parties, and the costs of transitioning to each option
- consult with interested parties on the merits of the preferred options
- after consideration, incorporate the relevant improvements into all applicable awards and evaluate the effects of the changes.

Award assessments following the completion of the current four yearly review should adopt this new targeted approach by dividing the issues identified in awards into three work streams (figure 8.1 below). In all three streams of work, the WSC should accept proposed variations to awards from interested parties to inform their work agenda but have the discretion to determine which issues it pursues.

To the extent possible, the FWC should also adopt the principles of a targeted and evidence-based approach for the remainder of the current four yearly review of awards.

The benefits of this type of evidence-based prioritisation of issues in awards would include focussing the resources of both the WSC and participating parties on issues that have the potential to make the greatest improvements to outcomes under awards, and avoiding over reliance on participating parties to raise issues as part of award assessments.

#### RECOMMENDATION 8.1

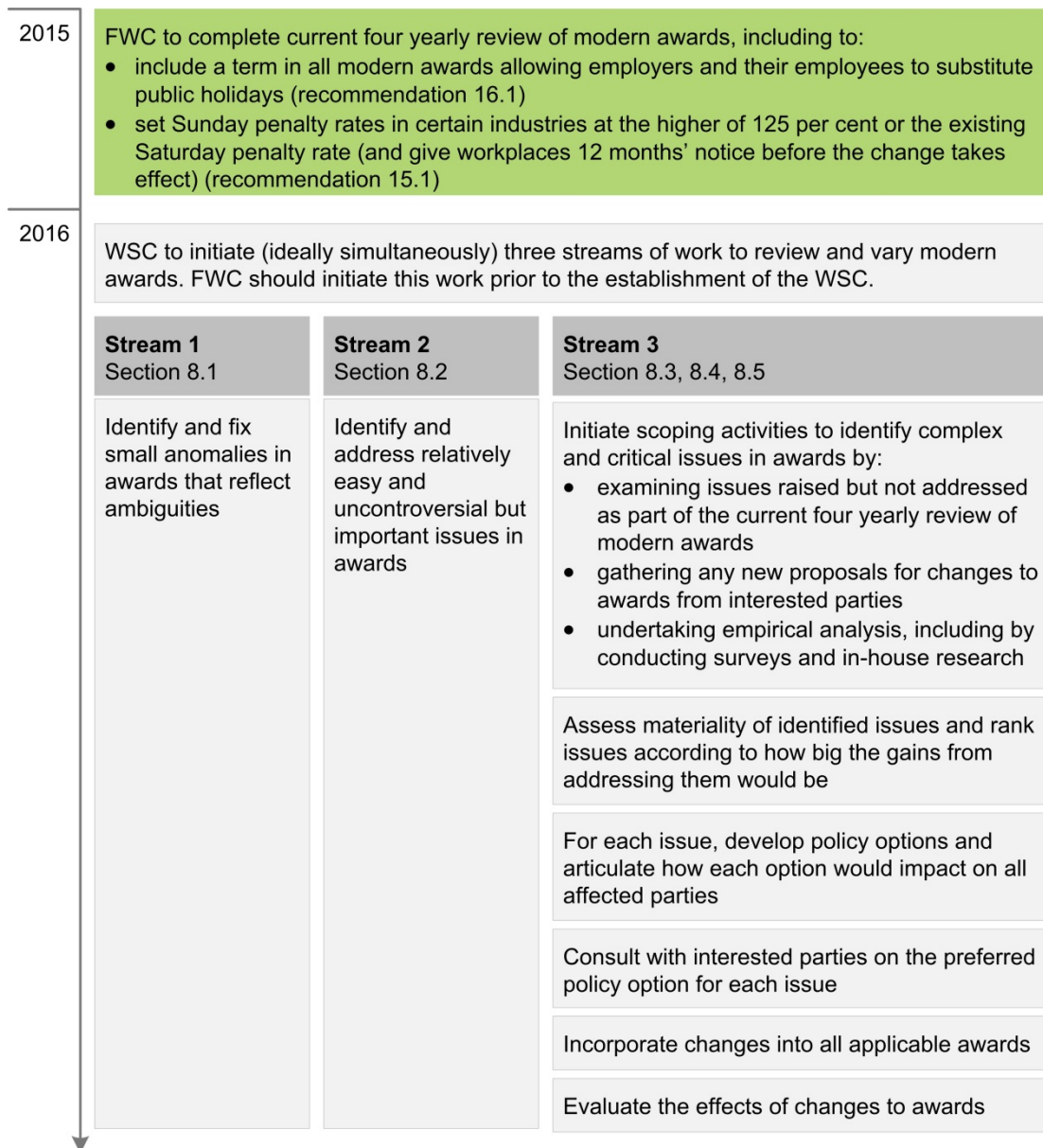
The Australian Government should amend the *Fair Work Act 2009* (Cth) to:

- remove the requirement for continued four yearly reviews of modern awards
- add the requirement that the wage regulator review and vary awards as necessary to achieve the revised modern awards objective specified in recommendation 8.3.

In undertaking this role the wage regulator should:

- use robust analysis to set issues for assessment, prioritised on the basis of likely high yielding gains
- consult widely with the community on reform options.

**Figure 8.1 A targeted approach to future award assessments**



## 8.2 Making awards easier to use

In labour markets that face a myriad of information gaps and transaction costs, awards can reduce the cost of negotiating employment contracts by setting a reference point for workers and employers to begin negotiating — both for those employees who are award reliant as well as many of those who are employed under another method of setting pay.



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Where an employee considers they have the skills or experience that warrant higher pay than that set out in the award, they may seek to have this recognised in an individual arrangement, for example in over-award payments (chapter 22).

Employers use awards to inform the terms and conditions that they offer their employees. Small business owners, in particular, have stated they value having a reference point for the contracts they offer their employees. Participants in this inquiry have provided examples of reasons why businesses like to use awards.

As well as protecting the rights of employees, awards provide certainty for employers in determining what conditions to apply as well as a ‘level playing field’ for organisations competing in the same industries. (Catholic Commission for Employment Relations sub. 99, p. 12)

[I]n this industry [automotive] our members, employers, are very comfortable with an award, because it’s a supply and demand thing. It’s market force. It’s a skill shortage area, so they know they have to pay over-award payments. (Victorian Automobile Chamber of Commerce, trans. p. 251)

The most recent Australian Workplace Relations Study research commissioned by the FWC found that 46 per cent of businesses using awards did not have an enterprise agreement because the award rates and conditions are adequate (FWC 2015d).

For those businesses with enterprise agreements, awards provide the benchmark above which agreements can incorporate terms that are more flexible and higher rates of pay. Awards therefore, provide a starting point for negotiations, especially when an enterprise agreement has not previously been in place. Agreements also often reflect the relativities between rates of pay found in awards.<sup>98</sup>

Awards can therefore, lower the transaction costs of forming employment contracts. While there are other sources of information that employers and employees could use to identify the ‘going pay rates’ in an industry (such as pay guide websites, or job vacancy search engines), awards provide economies of scale and scope that reduce the costs employers face when developing award based employment contracts.

The Fair Work Ombudsman plays a role in helping employers and employees understand the terms and conditions contained in awards by providing advice through its information line, as well as by posting resources on its website and further improvement in the useability of awards could provide additional benefits.

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<sup>98</sup> Safety Net Review – Wages, AIRC, [1997] [Dec 335V/97 S Print P1997].

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## Reviewing award structure, language and presentation

The usability of awards has improved considerably following award modernisation and some participants in this inquiry have remarked that, in some cases, the improvement has been considerable, and that the onus is now on employers to ensure they are complying.

Award modernisation was a major step forward for many small businesses because with it came the simplification of many outdated and complicated clauses that had developed over years of amendments and additional clauses. (Master Grocers Australia and Liquor Retailers Australia sub. 246, p. 10)

The consolidation of awards and transitional instruments and replacement with fewer modern awards is a significant improvement. The modern awards are generally well drafted and the consistency of provisions across modern awards makes them much easier to interpret. (Employment Law Centre of Western Australia sub. 89, p. 15)

Professionals Australia considers that employers need to educate themselves to ensure that they are award compliant and rejects arguments that suggest that the modern award system provides unnecessary regulation and is burdensome on employers. (Professionals Australia sub. 212, p. 17)

However, despite improvements, many participants submit awards are still overly complex and inflexible (box 8.2). A 2014 report commissioned by the FWC into the usability of modern awards for small business owners, recommended that awards should be shorter and simpler, use more examples and use less jargon (Sweeney Research 2014). FWC President Justice Iain Ross said the research would provide the FWC with some valuable insights to inform the four yearly review of modern awards (FWC 2014f).

To the extent that the structure, language, order, and overlap of provisions contribute to this complexity, awards can be improved further.

The FWC is making progress during the review in terms of improving the usability of awards. It has developed an exemplar award that presents award content in a structure that is clear and simple to follow. It has also committed to produce a plain language exposure draft of the Pharmacy Industry Award 2010 and to test how easy the draft is to understand with employers and employees covered by the award.<sup>99</sup> These initiatives suggest improvements that could be applied to all modern awards.

The Fair Work Ombudsman has similarly taken steps towards improving how easy awards are to use by:

- providing pay guides for each award. These guides outline hourly pay rates for work at various times, clarifying the application of penalty rates. Their inclusion in awards is being considered as part of the current four yearly review

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<sup>99</sup> 4 Yearly Review of Modern Awards [2015] FWC 6555, 22 September 2015.

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- developing an online Pay and Conditions Tool to help both employers and employees identify the rates of pay and some conditions that are included in awards for different occupations and classifications.

### **Box 8.2 Participants' concerns about the complexity of awards**

Several participants referred to the complexity of awards in their submissions to this inquiry. Examples include:

Many small business operators find the system to be complex and a major impediment to employing more staff or transitioning from being a sole trader to an employer. ... This is further compounded as employees in small businesses often wear many hats, and have a range of positions with varying levels of responsibility. In this situation it can be confusing to work out which modern award, position and classification an employee should be paid at. (Australian Small Business Commissioner sub. 119, p. 7)

Questions regarding award matters not only represent the biggest issue for our members, but are also the most complex to address, representing 45 per cent of the total time spent by this team in providing advice to members. Employers frequently contact the Employee Relations Advice Centre to seek assistance in interpreting the relevant award and applying it against the pattern of work performed by their employees. The most complex queries in this regard are in respect to determining an employee's entitlement to wages where they are required to work overtime or perform shift work. These issues frequently require employers to consider the application of multiple clauses which are not only difficult for small business to interpret but also frequently baffle experienced [industrial relations] and [human resources] practitioners. (Chamber of Commerce and Industry of Western Australia sub. 134, p. 31)

Small businesses find the complexity of awards overbearing and may try to find 'work arounds' that risk compliance breaches when considered against the technical prescription of award provisions. (Australian Chamber of Commerce and Industry sub. 161, p. 33)

Many Modern Awards present a set of complicated and complex provisions that are not reflective of flexible and modern work practices. (Housing Industry Association sub. 169, p. 20)

The system is legalistic, complex and rapidly changing. Therefore it requires a considerable investment in time and resources for an employer to be able to understand and comply with the system. This is particularly problematic for smaller businesses. (HopgoodGanim sub. 225, p. 3)

The Fair Work Ombudsman has also identified other areas where awards could be improved, such as the inclusion of directions for:

- when overtime and penalty rates apply
- whether overtime is calculated on a daily or weekly basis
- how the casual loading interacts with overtime and/or penalty rates
- the location/labelling of particular entitlements within modern awards
- whether annual leave loading or the applicable penalty rate should apply (FWO 2014e, p. 3).

As awards change and adapt over time, and as users of awards increasingly seek online platforms for accessing awards, this work will need to continue and the recommendations in this chapter are intended to build upon and further progress the work already initiated by

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the FWC and the Fair Work Ombudsman to make awards easier to use. In future assessments of awards, the WSC should therefore aim to:

- improve the accessibility and ease of use of all awards
- further develop interactive platforms to guide award users through award content
- consider other methods of providing support to users of awards, such as online chat functions, or award- and classification-specific pay calculators that calculate pay based on entered hours worked.

### **8.3 Assessing the complex and critical issues**

The FWC is examining a number of issues that have long been part of awards, such as terms around penalty rates, part time work, casual work, and award flexibility, as part of the current four yearly review of modern awards. The complaints with these conditions are often common across multiple awards and are often contentious and difficult to resolve through consensus between different parties.

The issues being addressed as part of the current four yearly review have been identified either at the discretion of the FWC, or by parties participating in the review. An alternative approach would use empirical analysis to identify the issues that are problematic first, and then consult on them once they have been prioritised. Within this approach, parties would still be able to apply to the WSC for a variation to an award but the WSC would have the discretion to choose which, if any of the proposed variations it examines further.

Besides receiving proposals for award variations, there is a variety of methods that could be used to identify issues in awards:

- carrying out a detailed, independently undertaken survey of employers to identify which aspects of each award affect their operations most, and garner suggestions for change.
- mapping how conditions and entitlements vary between awards, and undertaking empirical research to assess what effects the variations have
- systematically collecting data following any significant adjustments to awards (such as those that occurred as part of the award modernisation process) so that their effects can be measured and changes can be reassessed where problems have subsequently emerged
- systematically gathering information from employees about the effects of the work practices and complexities that can emerge from awards (for example, where rostering arrangements lead to tensions between employees). It should not be assumed that employer and employee interests are always at odds. Employees may also identify faults in awards that affect productivity and flexibility in workplaces. (The survey conducted by the FWC in relation to individual flexibility arrangements is one area

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where the FWC has proactively produced useful information from both employer and employee perspectives (chapter 22).)

A variety of research techniques would be needed to identify what aspects of which awards are either imposing unnecessarily high costs on employers (and potentially restricting employment) or are failing to provide adequate entitlements to employees. Once identified, these ‘hotspots’ could then be assessed in detail using a clear methodology to assess the merit of the case for change. The assessments would examine issues across the awards in which they emerge (this would be more of a ‘thematic’ approach) or on an award-by-award basis when an issue is award specific.

The objective of these assessments would be to ensure that awards provide an adequate safety net for employees at least cost to employers. This process is described in sections 8.4 and 8.5 below.

Currently, the FWC is constrained in its ability to carry out some of the reforms that might emerge from a research-driven award reform process. The FW Act prevents the FWC from varying minimum wages in awards outside of the annual wage review without those changes being justified by work value reasons. For example, the FWC would be unable to recommend rolling one or more rarely used allowances into base wage rates in an award to simplify the payroll for small businesses under the award. Similarly, the FWC is unable to vary minimum wages in response to obvious and dramatic shifts in demand within a particular industry as part of the four yearly reviews.

The FWC can vary minimum wage rates in awards as part of the annual wage review but, to date, the minimum wage panel has been reluctant to introduce changes that would have the effect of changing the current set of award relativities.

This should change. The WSC should consider amendment of wage relativities (including rationalising the number of classifications in any given award and broadening the range of duties per classification) where empirical evidence suggests that change is warranted either because the original basis for the relativities was flawed or the industry has changed since that time.

Allowing this additional avenue for considering changes to minimum wages in awards would require a change in the FW Act to remove the requirement that award reviews only vary minimum wages in awards when justified by work value reasons.

#### RECOMMENDATION 8.2

The wage regulator should not be constrained by the current requirement to only vary award wages outside of an annual wage review when the change is justified by work value reasons. The Australian Government should amend the *Fair Work Act 2009* (Cth) so that the wage regulator has the same power to adjust award minimum wages in award reviews as the minimum wage panel currently has in annual wage reviews.

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While the discussion below separates wages and classifications from other conditions in awards, any assessment of awards should not consider changes to one of these without reference to the other. Awards provide a set of wages and conditions that determine the terms of employment relationships. Sometimes new terms are added to awards to reflect changing societal expectations about what employment relationships should look like. The addition of parental leave might serve as an example.

The combination of wages and conditions received also define the ‘experience’ of employment, which is to say that while wages are important, moderate wage increases are unlikely to ever be able to compensate fully for the loss of some conditions. Therefore, while research might identify ‘hotspots’ that warrant further attention, and a detailed, systematic assessment might conclude that some change is warranted, a third equally important step would be to consider all proposed changes to an award to assess whether costs to employers, and remuneration and protection to employees would shift considerably in aggregate in one way or the other and to make sure this is justified if it is to occur.

## **8.4 Assessments of minimum wage rates and classifications in awards**

The FWC alters the award wage rates annually as part of the annual minimum wage review, usually by either one (or several) broadly applied percentage increase(s) or by several dollar amounts applied to brackets of award wage rates. Despite some applications to delay or reduce any annual increases in award wage rates for certain industries, award wage increases are generally applied consistently across awards. Consequently, the relativities between wages in different classifications within awards and between awards have not been explicitly assessed since 1989. One participant, defending the maintenance of the work value test suggested that ‘since 1989 a vast amount of work has been done in achieving consistency and equity in the classifications and wage rates within and across awards’ (Australian Industry Group, sub. 346, p. 34).

The assessment in 1989 was based on the premise of comparative wage justice (chapter 7) — a concept which now constrains changes to award wage rates by requiring that outside of an annual wage review, changes can only be made that are required for work value reasons (a constraint addressed in recommendation 8.2 above). Some participants have expressed concern about the Productivity Commission’s recommendation to remove this constraint including the Australian Industry Group (sub. 346), Master Builders Australia (sub. 290), Australian Higher Education Industrial Association (sub. 297), Electrical Trades Union (sub. 300), and Master Electricians Australia (sub. 304). However, there are several reasons why comparative wage justice is no longer a helpful concept to apply in an award wage assessment today (box 8.3).

Any assessment of award wages undertaken by the WSC should instead seek to answer three broad questions:

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- Given that awards make up part of the safety net in Australia’s workplace relations framework, what role should award wage rates play and to whom should they apply?
  - What other effects do award wage rates have?
  - Should award wage rates be improved?

### **Box 8.3 Equal pay for work of equal value – is it a workable concept?**

The concept of equal pay for work of equal value has had uneven application over time, and has been premised on the desirability of wage equalisation on fairness grounds:

- between men and women (currently applied and which may be both fair and efficient)
- between the same occupations in different awards (not currently applied)
- between occupations in different industries with similar levels of difficulty/required training (currently applied).

The concept is reasonable in some contexts. For example, it is widely regarded as unfair (and is now unlawful) to discriminate between people on the basis of their race or gender. It is almost certainly also inefficient to do so as prejudiced discrimination wastes talent. As noted in chapter 7, and supported by Household, Income and Labour Dynamics in Australia Survey analysis, awards appear to have reduced gender wage inequality.

However, in other contexts, the issue of fairness is far more vexed, and other considerations, such as efficiency, also play a role.

It is not possible to determine meaningfully that different occupations deserve equal pay simply because they share some common features, such as years to qualify or a requirement to supervise people. Common durations of training periods or the same basic level of qualification (a degree, for example) do not necessarily equate to any similarity in the complexity of a task, the level of responsibility and accountability attached to a position, the intensity and stress of a job the costs of errors in making decisions, the degree to which a job might be subject to shirking and principal-agent risks (as in efficiency wages), and innumerable other dimensions of jobs.

Further complications are that otherwise similar jobs may provide quite different non-pecuniary benefits for workers, and that the value (in terms of the wellbeing gained) of a particular quantum of pay is likely to vary from one person to the next, given differences in preferences and living costs. Thus, equalising monetary remuneration will not necessarily equalise the benefits people gain from work ‘of equal value’, assuming that could be determined.

It might be possible to use some qualitative judgments about what might be anomalous wage differences (such as that a plumber should not receive wages ten times higher than a carpenter), but making judgments that identify ‘equal work’ in a way that could genuinely inform precise wage differentials looks to be profoundly difficult.

Moreover, jobs and their requirements change. Wage relativities determined 25 years ago could still apply, but since technologies and knowledge required for different occupations have changed markedly in the intervening period, this may be an area for targeted review.

Market driven wage relativities serve many useful functions that help an economy grow. Economic growth has benefits for all people and provides the scope for re-distribution — an important aspect of fairness. Markets have the advantage that wage relativities can change to reflect: occupational demand, the encouragement for people to train (or to move), and the broad set of difficulties and complexities of a job — a point developed further in the main text.

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## **What role should award wage rates play and to whom should they apply?**

Awards set hundreds of wage rates that cover a substantial share of the labour market and hundreds of thousands of employers (chapter 7 and appendix E). Some of these wage rates will not bind — that is, act as a determination of price — (or not by much) because employers can pay above the award wage if they choose to. However, other award wages will bind and potentially limit resource reallocation. Whether this is desirable depends on the intended consequences. For example, a binding award wage that addresses unequal bargaining power or that redistributes income to lower paid workers without negative employment effects is likely to be a good outcome if this is the objective. Alternatively, a binding award wage rate that is divorced from the market realities of an industry may reduce growth, employment and productivity or force the use of substitute resources such as technology at a higher than efficient (competitive) cost. Some award wage rates most likely fall into the former category and some into the latter.

### **The role for award wage rates**

Under certain circumstances, awards that raise wage rates above what they would otherwise be create more efficient (and more equitable) outcomes. This role for awards should remain. Awards should not, however, raise wage rates so high as to create significant negative employment effects. Determining how high is too high is discussed further below.

Consideration should be given to whether award wage rates are likely to act as a starting point for bargaining (either at an enterprise or individual level) or are likely to be applied with minimal adjustment to the majority of a class of employee. In the latter case, it is more important to ensure that, where justified, award wage rates provide wages that look reasonably similar to those that would emerge if bargaining power between employers and employees were equal.

Detailed empirical analysis is therefore required to assess which employees, in which businesses, and in which locations, are paid award wage rates (or very close to them). Whether these employees are covered by an award dependent individual arrangement, enterprise agreement or a slightly above award individual arrangement is also important. Some of this analysis is presented in appendix E but more detailed analysis will be required if the WSC is to adequately identify who is paid what and where.

There are, however, circumstances where awards cannot rectify situations of unequal bargaining power. Two are discussed below.



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*When an employer is a single purchaser*

In Australia, there are industries and occupations in which government is the primary employer (or purchaser), such as in education and health services, policing and defence. These are examples of monopsony markets in the conventional sense, in that one employer (or funder) is dominant.

As is the case for other industries, awards in these industries are likely to improve on the base wages and conditions that employees would otherwise receive, but the distribution of earnings may be compressed because there are limited options for employees to move to seek out better wages and conditions *in the same job*. This is an empirical issue (for the public sector, it is addressed in chapter 24) and whether it holds or not at any given time will depend in part on any government budget settings and the countervailing power exerted by employee representatives and public sympathies. Participants in this inquiry (including the Queensland Nurses Union, Australian Services Union and the Australian Nursing and Midwifery Federation) have suggested that this issue arises in the aged care, nursing and social and community services sectors, where employers rely on government funding — a selection of views is in box 8.4 below.

**Box 8.4      Examples of participants' views on purchasing power in selected sectors**

Below are three examples of purchasing power in employment as provided by participants.

From the Queensland Nurses Union (sub. 86, p. 10):

As aged care is also largely dependent on the Commonwealth for funding it has been in the interests of successive governments to restrain wages in this sector, particularly in the context of the ageing demographic. Previous Labor government initiatives in this area such as the aged care supplement made only minimal difference in adjusting wages growth. The aged care wages gap relates not only to the nature of work performed in the sector (caring work where it is difficult to take industrial action to advance claims and therefore there is an inherent bargaining imbalance) but also the funding source.

From the Australian Services Union (sub. 128, p. 5):

When bargaining occurs in the social and community service sector it almost never deals with wages or wage related matters such as allowances, overtime and penalty rates. It is not possible to seriously bargain around these matters as employers are only funded to pay Award wages and conditions and no more. They do not “control the purse strings”, the funding bodies do and the funding bodies are never at the bargaining table as they are not the employer. This vicious circle has made enterprise bargaining a difficult exercise for most of the industry. This issue was the subject of extensive evidence and submissions in the Equal Remuneration Case 2012.

From the Australian Nursing and Midwifery Federation (sub. 132, p. 10):

It is estimated 70% to 80% of nurses and midwives are employed in workplaces that receive public monies to meet labour costs and, in sectors such as aged care and public hospitals, employers receive the bulk of their funding from government.

It has been broadly recognised the failure to appropriately fund services, coupled with an inability to generate revenue, has resulted in employers of nurses and midwives being slow to embrace enterprise specific bargaining and has also generally put downward pressure on wages and employment conditions, leading to recruitment and retention problems and declining health care standards.

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The FWC could, in principle, act to offset this monopsony power (although not for state government employees as they are generally outside the FW Act). However, government policy and budget settings would also need to be altered to ensure that employment and/or quality of service did not decline as a consequence of FWC award wage changes. Altering budget policy to address market power is as much a political choice as a policy choice, however, not providing the required funding to absorb the regulated wage outcomes of the FWC (and in future, the WSC) would seem a peculiar choice from both perspectives.

### *When imbalances in bargaining power favour employees*

Awards also have no ability to affect imbalances in bargaining power that favour employees. In some circumstances where there is excess demand for workers, especially when workers cannot be easily substituted (for example, in highly specialised professions), employees can hold more bargaining power than employers, and can demand higher wages than those that would result under equal bargaining power. Such power may be transitory, and will often be eroded by cycles in the demand for the specific form of labour (such as geologists in the mining industry) or when higher wages encourage new entrants into the labour market.

Where such power is prolonged, it will often reflect either statutory or other barriers to entry. In the latter case, the *Competition and Consumer Act 2010* (Cth) provides one remedy (an area of workplace relations that is addressed under generic competition law — chapter 31). If statutory, there are grounds for competition reforms of the professions of the kind recommended by the Productivity Commission in past reviews (Harris 2014; PC 2005a, 2005b, 2014e) and most recently by the Harper Review (Harper et al. 2015).

## **What other effects do award wage rates have?**

Award wage rates and conditions affect decisions about the mix of factors used in production

Awards, where they bite, change the cost of employing more workers by raising the minimum wages and conditions of employees, which might affect input decisions such as:

- capital versus labour (including decisions about automation)
- skilled versus unskilled labour
- the degree to which capital is utilised (for example, high regulated wage rates at certain times may make it optimal for a business to cease or reduce operations at these times)
- attempts to intensify work
- training of workers to raise their productivity
- substitution between juniors and adults

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- the extent of outsourcing. On the labour side, this might include the greater use of contractors, labour hire, and work by an owner manager (or his or her family). On the goods side, it might mean that a business purchases a good that it would otherwise have produced itself (for example, pre-fabrication is increasingly important in construction).

Changes to award wage rates and conditions might also affect employees' productivity, which may in turn increase the productive use of capital. For example, if employees have greater incentives to work harder because of a higher minimum wage or better working conditions, then capital will be used more intensively than otherwise.

### The connection between awards and inflation rates

There have sometimes been concerns about the flow-on effects from minimum wage and award wage adjustments to inflation, interest rates, and aggregate employment. The concerns were legitimate in the 1970s and 1980s, when large-scale strikes organised by unions led to wage increases as part of traditional award disputes (especially during periods of high inflation).

However, following the Prices and Income Accord (1983), changes to macroeconomic management, the advent of enterprise bargaining and a new framework for award determination, few now consider that award outcomes are likely to have any significant inflationary effects (although the flow-on effects are routinely assessed by the Reserve Bank of Australia and the Australian Government Treasury as part of their inflation forecasting procedures).

### Can award wage rates be improved?

While there are justifications for awards at an aggregate level, these are not uniform or universal. For example, bargaining power is likely to be more or less unequal at different skill levels, in different industries (including those expanding or contracting), in different size businesses and in different locations. The imbalances are also likely to change over time.

Identifying where unequal bargaining power would otherwise have particularly adverse consequences for employees would be a useful first step. This is not straightforward, but it is important: where evidence suggests employees would be likely to receive less than an efficient wage without regulation, there is a strong rationale for setting award wage rates that have the effect of redistributing income to these employees. Otherwise, award wages should provide a floor above which employees and employers collectively negotiate.

Since the data used for this sort of exercise will reflect the effects of the current set of award wages, an assessment of wage rates and classifications should start with the current set of wages and then ask whether and in which awards the evidence supports larger, smaller or zero increases in nominal wage rates.

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## What happens if award wage rates are set too low?

If bargaining power favours employers, the primary effect of setting award wage rates too low (or close to those that would exist in an unregulated labour market) would be that employees are paid a smaller share of any rents or less than the value of their labour to their employer (box 8.5 and appendix H).

### **Box 8.5 Unequal bargaining power**

Bargaining power differentials between employees and employers can arise through various avenues. As outlined in appendix H, wage setting in the labour market is often not a purely competitive process, due to information asymmetries, labour market purchasing power, impediments to labour mobility and a lack of voluntary entry and exit from the labour market.

#### **Information asymmetries**

Employees have limited information regarding the value of their labour, the distribution of wages in comparable jobs and the degree of competition from other employees. This uncertainty can make employees hesitant to move between jobs. Moreover, faced with sequential jobs offers, it can prevent employees from holding out for better opportunities.

#### **Lack of voluntary entry and exit from the labour market**

Many employees, particularly those paid at lower wage levels, do not face the 'labour vs leisure' tradeoff outlined in neoclassical models of the labour market. Most individuals lack a source of non-labour income, and do not view unemployment as a viable substitute for paid work. The presence of a social safety net provides some security, though unemployment benefits are restricted in many cases and long spells of unemployment can be stigmatising.

#### **Impediments of labour mobility**

Moving for employment introduces a number of costs. In addition to financial factors, ties to family, schools and community networks can prevent employees from relocating (PC 2014b; ACTU, sub. 167, pp. 76-77). These impediments narrow the options of employees when entering the labour market or changing jobs.

#### **Labour market purchasing power**

Limited competition in the labour market can result in monopolistic power among employers. Models of monopsony employers have traditionally centred on the notion of the 'one company town' — a concept many consider outdated. However, contemporary labour markets often share similar characteristics, particularly where governments are sole employers.

These factors mean that wages are (at least in part) determined by the relative bargaining power of the parties, particularly their capacity to hold out during negotiations and seek alternatives. While bargaining imbalances can sometimes favour employees, employers generally enjoy greater bargaining power, particularly at lower wage levels (chapter 1 and appendix H).

While highly skilled and well trained employees might be considered to be more able to negotiate better wages and conditions than the low skilled, as long as there are significant costs to changing jobs, market power can still exist for occupations with wage rates above the minimum wage (as the empirical evidence suggests). This is recognised by the tiered

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classifications within awards that set higher wages for jobs that require employees to be trained, qualified or highly skilled, or manage or take responsibility for other staff.

Without these multi-layered minimum wages, or with sets of wages that differ little from what they would be in the absence of awards, market power would have the effect of pushing wages down.

Award wages that are too low can also reduce investment in education and training. For the national minimum wage (and award wages that are close to it), the literature discusses two possible effects of raising minimum wages on the demand for further education and skills.

- One effect is to increase the demand for education and skills, especially by employees on the minimum wage who need to increase their productivity to match the increased wages. Similarly, those outside the labour market have more of an incentive to seek work at the higher wage, and to the extent that education or skills are required for minimum wage jobs, undertake the necessary training first.
- The second (and converse) possible effect is that increases in the minimum wage reduce the incentive for job seekers to undertake further education and training because the minimum wage provides a reasonable income and there is consequently less need to up-skill to obtain jobs above the minimum wage.

In Australia, award wages are most likely to elicit the first of these effects since they include a progression of wages that extend well above the national minimum wage and there is evidence that more skilled employees use minimum wage jobs as stepping stones into higher paid employment (often because the lowest classifications in awards are training wages that employees move off quickly) (chapter 4).

Award wages that are set too low for higher skilled occupations reduce the returns to more specialised training and skills since there is no certainty for prospective employees that their investment in education will be reasonably remunerated once they are employed.<sup>100</sup> The effect, therefore, of setting award wages too low and reducing the incentive for potential and incumbent employees at all levels of award classifications to undertake further education or training is to slow the growth in the stock of human capital making the economy less productive in the long run.

### What happens if award wage rates are set too high?

As discussed in chapter 4, at some point higher regulated wages must reduce the employment of labour (on a headcount and hours basis). Where there are multiple regulated wages and many different types of labour (by skill, experience, age, location, occupation and industry), these effects will vary (Healy et al. 2011).

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<sup>100</sup> This applies only to the extent that employers do not set above-award wages to attract such workers. This may occur if the employer has greater bargaining power and obtains greater benefits from lower wages than lost workforce skills.

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The incidence of any adverse employment effects will depend on the relative wages of different employees. For instance, employers might increase their demand for younger or less skilled workers, depending on the substitutability of such employees with more experienced, skilled workers. Alternatively, employers might respond by reducing training, hours, and overtime, and changing the way work is organised (Healy et al. 2011). Similarly, employers might choose to substitute labour for increased use of capital such as increasing mechanisation in place of employing labour (depending on how substitutable capital is for labour and the relative costs of each).

*The rigidity of award wage rates makes this problem worse*

Award wage rates are rarely changed (except for yearly adjustments as part of the annual wage review). The rigidity in award wage rates partly reflects a conscious decision by the FWC to keep relativities between awards largely consistent. For example, in the Annual Wage Review 2013-14 decision,<sup>101</sup> the Full Bench discussed the proposals put forward by a number of parties to justify different increases to wages in different awards. In its rejection of these proposals, the FWC referenced the 2011-12 Review decision which found insufficient evidence of an incapacity to pay in a given industry to warrant an award-specific wage determination, and also stated that:

‘any decision to provide different wage outcomes based upon the particular circumstances in each industry, as they might vary from time to time, would inevitably lead to the loss of any relativity between the wages specified in modern awards. This would not sit comfortably with the principle of equal remuneration for work of equal or comparable value, which forms part of the minimum wages objective’.<sup>102</sup>

Rigidities also exist because minimum wages are generally difficult to adjust down (chapter 4). If there is a strong case for downward adjustment of award wages, the FWC is effectively constrained to real wage decreases by approving increases that are smaller than inflation.

These rigidities may stop award wage rates from efficiently responding to changing economic circumstances in cases where market forces would otherwise push relative wages down. (There are few evident problems where there are upward wage pressures as awards create floors, not ceilings.) Where the existence of a wage floor impedes efficient wage adjustment, it may manifest in lower employment or reduced hours. Rigid wages may also mute the signals to would-be employees of the likelihood of vacancies and future unemployment in contracting industries and occupations. This could increase skill mismatches and frictional unemployment.

In contrast, enterprise bargaining facilitates downward flexibility in wages and conditions, as apparent in the negotiation of much lower wages in some Western Australian

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101 Annual Wage Review 2013-14 [2014] FWCFB 3500, 4 June 2014.

102 Annual Wage Review 2013-14 [2014] FWCFB 3500, 4 June 2014, at 518.

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agreements following the end of the mining boom. This recognised the unemployment effects of wages that could not be supported by the prevailing economic circumstances in that state. Even in other states, some new enterprise agreements have significantly cut wages and conditions (for example for Coca Cola Amatil and Woolworths). These cuts have sometimes applied just to new hires, which overcomes some of the incentives for businesses under stress to curtail recruitment (Salmon 2014). In addition, following clarification by the Full Federal Court that ‘no claims’ clauses in enterprise agreements have no effective legal force, it is possible for employers to vary enterprise agreements (with the consent of employees), if the commercial environment deteriorates.<sup>103</sup>

Of course, this flexibility is underpinned by the fact that many agreements provide wages and conditions above those set out in awards, so that there is room for downward movements after the expiry of an agreement (or indeed, in exceptional circumstances, even during the life of an agreement). However, the very willingness of employees to accept any reduced wages suggests that downwards flexibility can sometimes meet their preferences for job security. In theory, this preference could be partly and slowly realised through smaller increase to award minimum wages. In practice, this is unlikely because of the reluctance to use industry specific conditions to inform different award wage increases.

#### *How to tell if award wage rates are too high*

The FWC considers the capacity of industries to pay when deciding how much to increase the wage rates in awards in aggregate. When doing this, the FWC examines wage costs, levels of employment, award reliance, gross value added, gross operating profits and hours worked. Data on these indicators help the FWC to decide whether all industries, but especially those with high levels of award reliance, will be able to sustain the wage increase that year without risking business viability and unemployment.

The FWC also considers applications to postpone award wage increases determined as part of an annual wage review when particular industries are experiencing exceptional circumstances. This is discussed in more detail in chapter 5.

There are, however, many other types of information the WSC should take into account when considering the employment and business consequences of its decisions, such as:

- aggregate data on transition times into and out of employment
- evidence on unemployment at the granular level (for example, by occupation, skill level, location, and duration)
- flow rates out of the labour force by people at the lower end of the wage continuum in awards (‘discouraged’ workers)

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<sup>103</sup> Toyota Motor Corporation Australia Limited v Marmara [2014] FCAFC 84 (18 July 2014).

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- econometric evidence on the probabilities of job loss or gain associated with the characteristics of employees typical of the lowest skill levels in awards, for example, of the kind undertaken by Borland (2002)
  - surveys of perceptions by employees of job security in different awards (as collected in the Household, Income and Labour Dynamics Australia survey)
  - the characteristics of the relevant firms. Awards are more likely to bind in businesses that are part of a highly competitive industry, have a high elasticity of demand for their products, employ mostly low skilled labour, have a high wage share, have easily scalable processes of production and are subject to significant risks of labour displacing technological change (so that capital can more easily replace unskilled labour). Award increases in such businesses risk higher unemployment and reduced hours of work
  - skill mismatches — for instance, skill shortages in some industries or occupations might signal that there is greater room for increased award wages. Conversely, surpluses of particular skills or movements of people from one skilled occupation to another may reveal where awards are binding.

The nature of the wage distribution may also provide some insights. Where observed wages are well above the award rate, it can be assumed that small increases in the award rates are unlikely to result in employment effects, simply because the award is not a binding constraint. Awards are more likely to create negative employment effects in industries and occupations where awards set wages higher than would occur in a market with equal bargaining power between parties. Where that occurred, the distribution of observed wages would tend to bunch around the award rate, and a significant share of the workers in the relevant industry or occupation would be award reliant. (The relevant industries are described in appendix F, and typically involve lower skill jobs.) Of course, for any given business, the fact that employees may be paid at the award rate does not necessarily imply that regulated wages are too high. That the award wage rates ‘apply’ to employees is a prerequisite for assessing whether they impact employment, but it is not sufficient. For example, where a business has some market power in its local labour market, it could choose to pay the award rate even if the efficient wage were higher.

There are also grounds for exploring differences in wage outcomes for those covered by awards and those who are not. For example, qualified tradespeople often choose to work as contractors or subcontractors. While these workers demand higher wages to compensate them for the uncertain nature of their employment and for the cost of paying for their own insurance and tools, substantial increases in the gap between the returns to contractors and the award wage for a similar occupation might reveal that employers have a greater capacity to pay. Similarly, a small or decreasing gap might signal that the award wage rate for that industry or occupation is getting too high.

Enterprise agreements (and possibly the enterprise contract – chapter 20) could also provide information on award wages. Where enterprise agreements consistently offer higher wages (even after changes in conditions and entitlements have been compensated),



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it is possible that there is room for increases in award wage rates, although there is a risk of this becoming a self-perpetuating cycle if instituted as a rule.

Similar comparisons can also be made with ‘like’ groups overseas where it can be shown that those groups and the industries in which they work are broadly comparable to Australia. These types of comparisons might be particularly useful for assessing whether wages in a given industry should be compressed or allowed to expand. For example, if the percentage wage difference between those in the last year of their apprenticeship and those with their trade qualification is significantly smaller in New Zealand than in Australia, especially in one industry but not the others, this might (depending on other performance data) support a smaller dollar value increase to the wages in that particular award rather than a percentage change.

The implications of the above points are that the WSC should take a forensic approach to unemployment and business risks for different groups of awards, and be open to decreases (or slower increases) in wage rates if this is likely to have a sustainable effect on jobs. Such an approach could possibly be coordinated with government training initiatives and adaptations to the tax transfer system (chapter 6).

A more flexible, evidence-based approach to minimum wage and award decisions should be one plank of a new Australian labour regulation framework, but would require changes to the decision making norms currently used within the FWC (as recommended through the establishment of the WSC). Recommendation 8.3 below to amend the modern awards objective to make explicit the need to promote workforce participation should also help preserve and grow jobs.

## **8.5 Assessments of conditions and entitlements in awards**

Awards contain different types of entitlements and conditions of employment aside from minimum wage rates, including conditions that repeat or supplement terms in the National Employment Standards.

That awards contain similar material is a function of a number of factors. First, the content rules for all awards as set out in the FW Act are the same. Second, the parties that raise issues for review in awards often represent employers or employees covered by more than one award. Third, the conditions of employment negotiated in one award are picked up and applied during subsequent reviews of other awards. Fourth, the amalgamation of awards through successive processes (listed in chapter 7) is likely to have led to a consolidation of common content. Last, awards broadly and over time reflect community consensus on what constitutes fair and reasonable conditions of employment, and consensus on broad issues of workplace relations tends not to be demarcated by industry or occupational classifications.

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The conditions and entitlements in awards have different effects and are included for different purposes. For example, allowances compensate employees for undertaking undesirable or more difficult tasks or for incurring costs while working (chapter 7). Where the frequency of undertaking unpleasant tasks is spread non-uniformly through a group of otherwise similarly paid employees, it may be reasonable to have allowances for such tasks. Moreover, by raising the cost of particularly unpleasant tasks, allowances encourage employers to find substitute ways of working that avoid such tasks.

On the other hand, if unpleasant tasks are more generally spread across a class of employees, it may be more efficient to raise the wage rate for that class. This would recognise that allowances also impose costs on employers due to added payroll complexity, especially where the application of allowances changes between employees and from one shift to the next.

To some extent, this complexity was reduced during the award modernisation process as some defunct allowances were eliminated from modern awards. However, in other cases, the ‘amalgamation’ process in award modernisation simply created lists of allowances that only apply to distinct groups of classifications within a single award. This made it more difficult to identify which allowances should be paid to whom and when. Inconsistencies in allowances continue to persist between awards.

The complex and inconsistent treatment of allowances is not uncommon between awards. Other chapters provide more detailed examples of inexplicable or questionable variation between awards such as variation in penalty rates (chapters 10 to 15), overtime rates (chapter 9) and annual leave loadings (appendix F). There is not always an obvious rationale for the persistence of these variations.

Participants in this inquiry have raised concerns about conditions and entitlements in awards. For example, the Business Council of Australia (BCA) (sub. 173) and others have expressed concern about conditions and entitlements that constrain the ability of organisations to manage their operations efficiently. Some examples provided in submissions to this inquiry on this theme are included in box 8.6 below.

Some participants have also expressed concern that some conditions and entitlements in awards exceed levels required to provide a fair and relevant minimum safety net and that restrictions on management prerogative can reduce business efficiency and innovation. However, award conditions might also be necessary to ensure safe and healthy working conditions.

Nevertheless, to the extent that wages and different employment conditions can be substituted to provide protection for workers, there seems to be little justification for providing protections through conditions in awards that unnecessarily restrict operations and the ability of management to manage effectively — a consideration incorporated in the recommended assessment process for the WSC outlined below.

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**Box 8.6      Some clauses in awards affect management prerogative more than others**

The BCA (sub. 173, p. 28) pointed to conditions in some awards that created 'rigidities in the employment relationship that undermine the capacity of an enterprise and its workers to negotiate a balance that meets each of their needs'. The BCA includes several examples, including detailed prescription:

- of how a roster should be constructed (that goes beyond maximum hours to be worked in a day, or minimum break time between shifts)
- about when and how meal breaks should be taken.

Other participants also listed examples of what they perceive to be particularly restrictive conditions in awards, such as:

- restrictions on the flexibility of rosters for part time workers who have converted from casual employment in the Hospitality Industry (General) Award 2010 (Australian Hotels and Accommodation Associations of Australia sub. 164, p. 15)
- the requirement to pay employees covered by the Hospitality Industry (General) Award 2010 an extra 50 per cent of their usual hourly rate if they have not been given a break after six hours of work until a break is taken (VECCI sub. 79)
- casual conversion clauses, including in the Manufacturing and Associated Industries and Occupations Award (2010) which, according to the Australian Mines and Metals Association (sub. 96, p. 415):  
... are misguided, and fundamentally misunderstand the nature of employment through offer and mutual acceptance of terms. It should remain a matter for employers whether to offer jobs on a full time, part time or casual basis based on their assessment of their commercial and operational requirements and their chosen commercial, operational and employment strategies.
- the requirement in the Building and Construction General On site Award 2010 that wages be paid not later than the end of ordinary hours of work on Thursday of each working week (Civil Contractors Federation sub. 62, p. 2)
- the restriction in the General Retail Industry Award 2010 that an employee cannot work ordinary hours or any reasonable additional hours over more than six days in a row (Norris Park IGA sub. 23).
- frequency of pay clauses (South Australian Wine Industry Association, trans. p. 427).

In the meantime though, for many employers multiple avenues already exist (and others might in future exist) to implement less restrictive arrangements (while safeguarding the National Employment Standards), including through enterprise agreements or individual flexibility arrangements. Just recently, for example, the FWC developed a model time off in lieu (TOIL) of payment for overtime clause that may be inserted into modern awards. The clause will facilitate agreements between an employee and their employer to take TOIL instead of payment for overtime at a time or times agreed, subject to appropriate safeguards.

In the future, more award flexibility may also be achieved via the use of an enterprise contract (chapter 23). Moreover, as discussed in chapter 23, enterprise contracts may

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inform further award reform as they would illustrate to the WSC the types of award clauses that employers find too rigid and the alternatives clauses that better suit their needs.

Participants in this inquiry also raised several award-specific complaints that appear to have been resolved, at least to some extent, in other awards. Minimum shift clauses are discussed as an example in box 8.7 below.

### **Box 8.7      An example of award specific issues**

Several participants in this inquiry have raised award specific issues that they believe are creating undesirable constraints in their industries. For example, participants have raised concerns about minimum shift length restrictions that exist in several awards, including the General Retail Industry Award 2010, the Fast Food Industry Award 2010 and the Pastoral Award 2010. Selected comments include:

- One member respondent to the 2015 Member Survey in the fast food industry:  
“The Award is unable to provide flexibility for junior team member hours. We have had to let go of many of our junior staff as they could not work a 3 hour shift after school as the shopping centre closed. They could only work a 2 hour shift due to school commitments, which then requires me to find older (and more costly) staff to work these longer hours.” (VECCI sub. 79, p. 26)
- The three hour minimum engagement has had a number of negative ramifications on farm business operations. For instance, the clause removes any incentive for staff to milk in a time efficient manner, thus lowering productivity. Many dairy farm businesses choose to allow milkers to go home as soon as they have finished milking in order to motivate staff to work efficiently. However, this means that farmers often pay for time in which no actual work is performed, and these payments are higher on public holidays. (Australian Dairy Farmers sub. 56, p. 1)

In contrast, the underlying purpose of minimum shifts was reiterated by the National Working Women’s Centre (sub. 242), who claimed that regular hours and minimum shifts are important for casual employees.

The General Retail Industry Award 2010 includes an extra clause that allows school students to work shifts as short as 1.5 hours with parental/guardian permission. However, the Council of Small Business Australia (sub. 115, p. 5) consider this to also be too restrictive:

The current situation where an employee has a minimum time of 3 hours or where the employer has to seek approval to employ a school student for less than three hours is not reflective of the real world. By all means if an employer is obviously abusing employees (sic) time by demanding long travel times for short periods of work where the cost of getting to work makes the time spent at work not rewarding then fix that problem. Let the employee contact the regulator and have them sort that out.

But if a small business employs a school student after school for a short time than (sic) it is obvious this is acceptable and there should be no need to seek approval.

A minimum of one hour for people under 20 years of age who are in full time education should be a simple enough rule for employers.

It would seem though that this type of clause might alleviate some of the concerns in the fast food industry as raised by the Victorian Employers’ Chamber of Commerce and Industry (sub. 79). So too might the introduction of the shorter minimum shift time of two hours that is contained in the Hospitality Industry (General) Award 2010 for casual employees.

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This chapter does not seek to make an assessment of the merit or costs of various conditions and entitlements in awards or to determine whether they exceed the requirements of a ‘safety net’. Rather, this chapter suggests an approach that would have the WSC examine conditions and entitlements across awards using detailed, empirical research to identify problematic conditions or entitlements in awards (‘hotspots’), and then make a determination that relies on a considered and detailed assessment of the evidence of the effects of these provisions in different industries and types of businesses, and on their employees. Chapters 10 to 15 contains this type of analysis for penalty rates in several industries.

An assessment of this type would therefore undertake to answer the following questions with respect to conditions and entitlements in awards:

- What is the purpose of the type of condition or entitlement? Is this purpose still relevant? Does the effectiveness of the condition or entitlement to meet this purpose depend on how the condition or entitlement is applied? Is the type of condition or entitlement an appropriate inclusion in awards given their role in the safety net?
- Is there evidence that those conditions or entitlements of each type in awards are effectively meeting their purpose?
- What alternatives exist, and can they provide greater capacity for beneficial innovation?
- How would these alternatives alter both the overall income and protection provided to employees under the award, and the costs to their employers?

The FWC has already started to assess conditions and entitlements in awards thematically through its consideration of nine common issues as part of the current four yearly award review. The list of common issues includes:

- annual leave
- apprentice conditions
- award flexibility
- casual employment
- family and domestic violence clause
- family friendly work arrangements
- part time employment
- public holidays
- transitional provisions (FWC 2015a).

Since the first four yearly review of awards is still underway, it is not clear what the FWC will decide or whether its decisions will be applied consistently across awards. President Ross has signalled, however, that a consistent approach has merit:

... if the bench were minded to grant the claims in whole or a variant of them, in relation to cashing out and excessive leave, it raises a question, why shouldn't that be a standard modern

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award provision? ... There is something to be said for the proposition that, if you can standardise core provisions like annual leave, then that would make the modern award system simpler and easier to understand.<sup>104</sup>

After that review, the Productivity Commission proposes that the newly created WSC would use an evidence based approach to assess conditions and entitlements in awards consistently — since a problem identified in one award may well exist elsewhere. The Productivity Commission also recommends that the WSC promotes consistency in how conditions and entitlements are *applied* in awards, but only to the extent that any streamlining would not ignore industry- or occupation-specific requirements or unique situations that warrant (as verified through the assessment process) different entitlements or conditions (as raised by Hair and Beauty Australia sub. 47; Victorian Automotive Chamber of Commerce trans. p. 249). Simplicity for simplicity’s sake is not a good enough reason to streamline conditions and entitlements in awards. Nor is differentiation for the sake of precedent and tradition a good enough reason not to.

An assessment of problematic award conditions and entitlements should also be coupled with an overall assessment of each affected award to measure whether, in aggregate, the income and entitlements for employees contained in the award have significantly changed. As part of this assessment, the WSC should articulate to what extent the revised conditions and entitlements are substitutes both for increases in wages and for each other. In recommending this type of assessment process, the Productivity Commission does not envision that the aggregate monetary equivalent of wages and conditions of employees covered by each affected award would significantly change, but neither should the WSC be constrained by having to ensure that no one (neither employers nor employees) is worse off. Rather, the WSC should identify the rationale for each element of awards assessed and then verify whether there is a good reason to change it.

## 8.6 Assessing award coverage and overlap

Coverage terms in awards have also been raised by some participants in this inquiry as an additional source of award complexity and inflexibility. The Productivity Commission has heard evidence throughout the inquiry that single awards have such limited coverage that sometimes an employee of a small to medium business who performs a wide range of tasks is covered by multiple modern awards. The burden of this reality was summarised by the South Australian Wine Industry Association and the Winemakers’ Federation of Australia (sub. DR352 p. 31):

This means that a wine industry employer must be able to determine which of the 122 Modern Awards may or may not apply to their business, understand at what point the provision of an additional service may result in additional coverage and the expertise and skills to manage

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<sup>104</sup> Transcript of Proceedings, Fair Work Commission’s 4 Yearly Review of Modern Awards – Annual Leave, AM2014/47 [16 October 2014].

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instances of overlapping Modern Award coverage. From a practical perspective this means managing instances where an employee may perform work under multiple Modern Awards, ensuring compliance under both Modern Awards, reconciling often conflicting requirements.

On 9 October 2015 President Ross issued a statement announcing that the FWC intends to engage an external research provider to conduct research into the issues faced by employers that are subject to coverage by multiple modern awards. The research report will be due by February 2016 after which time the FWC will seek submissions from parties on the design of majority clauses which would prescribe that one, rather than many, awards apply in a workplace.

Equally, the enterprise contract (chapter 23) could be used by employers to perform this role. The Productivity Commission finds the concept of providing both options appealing, as it will increase the incentives for effective change.

Moreover, majority clauses are just one form of flexibility regarding award coverage. The WSC should continue to review coverage terms in their own right to ensure the clauses remain appropriate and that awards are easy to understand and apply.

## **8.7 The modern awards objective**

The changes in approach recommended above should, over time, lead to significant reform of the award system, and some complementary changes to the FW Act would assist in achieving the type of reform envisaged.

A number of participants representing the interests of employers submitted that the rules about what must and may be included in modern awards should be tightened to remove the type of clauses discussed in box 8.6 above. The dilemma in mandatorily excising various clauses from the ‘may be included in modern awards’ list in s. 139 is that they sometimes suit particular employers and employees. Furthermore, it would be difficult to draw the distinction that some participants recommend. For example, the Australian Industry Group said:

[A]n award should specify the average number of ordinary hours of work (usually 38) and provide broad parameters about the maximum number of ordinary hours that can be worked on a day, but it is not necessary to specify precise details about how those hours should be arranged. (Australian Industry Group, sub. DR346, p. 37)

This would provide significantly greater flexibility, but could incidentally undercut some employees’ conditions (such as through the introduction of unreasonable ‘take it or leave it’ notice of roster changes). There are other options for flexibility that do not pose that risk. Employers have various alternative options for greater flexibility that, subject to a no-disadvantage test, allow tradeoffs against the award. These include IFAs, the enterprise contract and enterprise agreements.

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Rather than being prescriptive about allowable content, the Productivity Commission recommends that the institution responsible for setting and reviewing awards be given new wide discretion to determine, *on the evidence*, what is reasonable for inclusion in any given modern award.

The other suggestion is a redrafting of the modern awards objective at s. 134 of the FW Act. The modern awards objective is central to any review of awards. The modern awards objective seeks to achieve certain distributional and equity goals (most notably ‘the needs of the low paid’, ‘the principle of equal remuneration for work of equal value’ and additional remuneration for work outside ordinary working hours), while taking account of their economic effects and regulatory burdens. The FWC notes there:

... is a degree of tension between some of the s.134 considerations. The Commission’s task is to balance the various considerations in s.134 and ensure that modern awards, together with the NES, provide a fair and relevant minimum safety net of terms and conditions’.<sup>105</sup>

At the outset of the first four yearly review of awards, the Full Bench of the FWC determined that ‘no particular primacy is attached to any of the s. 134 considerations and not all of the matters identified will necessarily be relevant in the context of a particular proposal to vary a modern award’.<sup>106</sup>

Despite this, the same Full Bench appears to give primacy to the requirements in s. 134(1)(g) to, among other things, ensure a ‘stable’ modern awards system. The Full Bench said:

The need for a ‘stable’ modern award system suggests that a party seeking to vary a modern award in the context of the Review must advance a merit argument in support of the proposed variation. The extent of such an argument will depend on the circumstances. We agree with ABI’s submission that some proposed changes may be self evident and can be determined with little formality. However, where a significant change is proposed it must be supported by a submission which addresses the relevant legislative provisions and be accompanied by probative evidence properly directed to demonstrating the facts supporting the proposed variation.<sup>107</sup>

Following this is a discussion of the rules of precedent as they apply to the FWC. ‘Although the Commission is not bound by the principles of *stare decisis*’<sup>108</sup> the Full Bench states, ‘it has generally followed previous Full Bench decisions’.<sup>109</sup> In support of

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105 4 Yearly Review of Modern Awards – Annual Leave [2015] FWCFB 3406, 11 June 2015, at 20.

106 4 Yearly Review of Modern Awards – Preliminary Jurisdictional Issues [2014] FWCFB 1788, 17 March 2014, at 32.

107 4 Yearly Review of Modern Awards – Preliminary Jurisdictional Issues [2014] FWCFB 1788, 17 March 2014, at 23.

108 *Stare decisis* is a legal principle that requires courts to decide a case in adherence to previous court rulings on the same point of law, commonly referred to as adhering to precedent.

109 4 Yearly Review of Modern Awards – Preliminary Jurisdictional Issues [2014] FWCFB 1788, 17 March 2014, at 25.



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this proposition the Full Bench quoted from a decision of the Full Bench of the then Australian Industrial Relations Commission in *Cetin v Ripon Pty Ltd*:

Although the Commission is not a court, as a non-judicial body, bound by principles of stare decisis, as a matter of policy and sound administration it has generally followed previous Full Bench decisions relating to the issue to be determined, in the absence of cogent reasons for not doing so.

The effect of the FWC's interpretation of 'stable' and its decision to follow previous Full Bench decisions in the absence of cogent reasons for not doing so sets a high bar for award variations. It also places all the burden of proving a variation would be beneficial onto the industrial parties. As stated earlier in this chapter, this raises several serious concerns, including that the evidence considered by the FWC is generally limited to that presented to it by employer and employee representatives.

The modern awards objective requires the FWC to consider the needs of the unemployed and outside the labour force through the requirement to take into account the need to 'promote social inclusion through increased workforce participation'. However, consideration of this requirement is usually based on the evidence of participants whose primary role is to represent the interests of groups *other than* those to whom this part of the objective is directed. The change in approach recommended earlier in this chapter should encourage the new WSC to empirically examine the impact of its decisions on these groups. Streamlining of the diffuse goals of the current modern awards objective would give much greater prominence to employment.

Consumers are another group whose interests are not just marginalised, but often forgotten entirely under the current modern awards objective. Labour costs affect service quality, availability and prices for consumers (as is apparent for Sunday trading in some industries). A community-wide perspective would give this group much greater weight.

Without some streamlining, the modern awards objective will remain confusing and unfocussed, while without the addition of 'the needs of consumers' it will not require the WSC to consider the impacts on all affected stakeholders when varying awards. The Productivity Commission considers the revised objective below captures the interests of all those affected by awards without an over-complicated, but still incomplete list of goals.

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#### RECOMMENDATION 8.3

The Australian Government should replace the current modern awards objective in the *Fair Work Act 2009* (Cth) with a new objective requiring the wage regulator to ensure that modern awards, together with the National Employment Standards, provide a minimum safety net of terms and conditions, which promote the overall wellbeing of the community, taking into account:

- a. the needs of the employed; and
- b. the need to increase employment; and
- c. the needs of employers; and
- d. the needs of consumers; and
- e. the need to ensure modern awards are easy to understand.

The Productivity Commission's recommended modern awards objective prioritises the overall wellbeing of the community. While analysis of potential impacts of awards is facilitated by aggregating individuals according to shared interests, the need of any particular group should not undermine those of the overall community.

Moreover, although Recommendation 8.3 lists the needs of employers, consumers, the employed and the jobless this list is non-exclusive. Award conditions have the potential to affect a broad range of individuals in the community, and the needs of any group significantly affected should be taken into account. The groups listed in Recommendation 8.3 have been included to broaden, rather than confine, analysis of award impacts.

Consistent with an emphasis on overall community welfare, the interests of any community group should not receive *presumptive* greater weight than any other. Rather, the consideration given to group interests should depend on the number of people affected, as well as the likely magnitude and persistence of potential impacts. Once these impacts have been assessed, the benefits of any change should be weighed against its costs.

This would not, as Justice Ross has previously noted, be an algorithm. Rather, it would be a deliberate set of judgments which avoided presuming that the role of the award system is limited to the interests solely to today's employers and employees.

### **Achieving the modern awards objective**

Section 138 of the FW Act provides that an award is able to include terms *only to the extent necessary to achieve* the modern awards objective. This restriction on award content is repeated in s. 157(1) dealing with variations to awards outside the four yearly reviews. On first reading, the wording of these clauses suggests a binary distinction between an award that achieves the objective and one that does not. This type of distinction seems to have been applied in the current four yearly review.

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In the Review the Commission will proceed on the basis that *prima facie* the modern award being reviewed achieved the modern awards objective at the time that it was made.<sup>110</sup>

In the current four yearly review, the onus is therefore upon parties to make the case for change. A party wishing to propose a variation to an award as part of the review seemingly must show evidence that the award currently does not achieve the objective, and that the variation proposed *is necessary to achieve* the objective. The phrasing of s. 138 and its strict interpretation constrains the evolution of awards as it implicitly favours the status quo.

In 2012 Justice Tracey of the Federal Court found on appeal, in relations to s. 157(1), that while a distinction must be drawn between ‘that which is necessary and that which is desirable ... it must also be acknowledged that reasonable minds may differ as to whether particular action is necessary or merely desirable’<sup>111</sup>. This interpretation allows conservative members to set a high bar for variations to an award.

On some occasions, however, the FWC has chosen to interpret s. 138 more broadly so that where convincing evidence is presented that an award variation would *improve* outcomes under an award, it can be said that those variations are *necessary to achieve* the objective. For example, as part of the 2012 Transitional Review, the FWC dismissed an application to delete a clause in an award because ‘the deletion of the clause will not achieve, or *better achieve*, that objective’<sup>112</sup>.

While the FWC has demonstrated a willingness to consider variations to awards that ‘better achieve’ the objective, *requiring* it to would encourage ongoing improvement of awards. Such an amendment would require the WSC to identify opportunities to improve awards (such as through different combinations of pay rates and conditions), not simply guard the status quo.

#### RECOMMENDATION 8.4

The Australian Government should amend Part 2-3 of the *Fair Work Act 2009* (Cth) to allow variations to modern awards if necessary to achieve or improve outcomes according to the revised modern awards objective.

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<sup>110</sup> 4 Yearly Review of Modern Awards —Preliminary Jurisdictional Issues [2014] FWCFB 1788, 17 March 2014.

<sup>111</sup> *Shop, Distributive and Allied Employees Association v National Retail Association (No 2)* [2012] FCA 480, 11 May 2012, paragraph 46.

<sup>112</sup> *Australian Municipal, Administrative, Clerical and Services Union*, [2012] FWA 9025, 22 October 2012.

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## 8.8 What does this chapter mean for the awards of the future?

This chapter contains a presentation of a new process and methodology of creating and varying awards that contains several key characteristics:

- awards assessments should be undertaken by suitably qualified and experienced individuals, initially of the FWC (while responsibility for awards resides with the FWC) and subsequently of the WSC
- decisions to vary awards should be based on prior extensive research and analysis, using high quality, independent quantitative and qualitative research. Precedent and attachment to the status quo should have much less influence on future award determinations
- WSC appointees should take account of, and explicitly describe the effects of award determinations (including transition costs) on all affected parties, whether those parties take part in assessments or not
- wage rates in awards may be varied both as part of annual wage reviews and award re-assessments)
- award conditions and entitlements should not constrain innovation and performance improvement other than where it is clear a workplace risk of genuine significance is being addressed
- where conditions and entitlements place high compliance costs on businesses, award assessments should explore whether practical alternatives (that retain a similar level of protection) exist.

The implications of this new process and methodology should not be underestimated, especially when considered in combination with the recommended changes to the FW Act including to the modern awards objective. Combined, these changes establish a system for making and changing awards that improves significantly the opportunity to focus awards on safety net issues and remove redundant or innovation-sapping provisions. This new system is built upon respect for the safety net concept, ensuring employment conditions and minimum wages are protected in situations where unequal bargaining power might otherwise lead to inefficiently low levels of pay and conditions of employment. And yet it can provide a clear pathway for award reform to eliminate constraints on workplace flexibility that have little to do with employee protection in the modern labour market environment.

Awards of the future therefore might look very different from those that currently exist. For example, future award assessments *might* result in:

- fewer, but wider-reaching awards, or alternatively, additional shorter and more targeted awards; there is no number that is optimal

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- more consistency in minimum rates and conditions across awards for some groups such as youth or apprentices, or conversely more variation such as where apprenticeships require higher levels of skill and experience (and consequently are more highly valued in the market)
  - fewer clauses in awards, or more specification around clauses to remove any ambiguity
  - variations in wage relativities both within and between awards
  - more flexibility in awards, including possibly giving employers more choice about which of several alternative employment conditions they might apply (for example, several options about how to schedule shifts might be made available, or options about tradeoffs between base wage rates and penalty rates).

The new system of making and changing awards described in this chapter is not designed to constrain award reform, but rather to facilitate it, make it more inclusive, and ensure that changes are made within a well-developed decision-making framework with clear and inclusive objectives and methodology. The safety net role of awards should not change as a result of this new system, but the effectiveness of awards within this role should be enhanced and the costs they impose should be reduced.



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## 9 Penalty rates for long hours and night work

### Key Points

- Many Australians work long hours and during nights.
- The working time regulations discussed in this chapter exist to protect employees. They do not apply to the self-employed or contractors.
  - Around 2.8 million Australian employees report working more than 40 hours per week and over 1.5 million reported working 50 hours or more per week.
  - Almost 1.2 million Australian employees report working schedules likely to involve night work.
- Current regulations of long working hours and night work for employees are contained within both the National Employment Standards (NES) and modern awards.
  - The NES specify a maximum weekly limit of 38 hours, giving employees the right to refuse unreasonable additional hours.
  - Most awards specify wage premiums for both long hours and night work.
- The case for working time regulation is strong where overtime is imposed on employees and they lack the bargaining power to negotiate wage premiums that reflect additional personal costs.
- There is strong evidence that sustained long hours and night work impose substantial costs on the health of employees.
- Given this, the current restrictions on hours worked (with a capacity to vary these when reasonable) and premium rates of pay for long hours or work at night are justified. Few participants contested this.

Many employees work non-standard hours, either more than the National Employment Standards (NES) maximum or at non-standard times, such as at night or on weekends. A substantial number of these employees are rewarded by regulated premiums on normal wage rates (sometimes generically categorised as ‘penalty’ rates).

Indeed, under the modern awards objective, the *Fair Work Act 2009* (Cth) (FW Act) requires that modern awards take into account the need to provide additional remuneration for overtime, weekends, public holidays, shift work and, more generally, ‘unsocial,

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irregular or unpredictable hours' (s. 134 (1)(da)).<sup>113</sup> Various awards specify premium rates for such work, with the premium rates depending on the industry and/or occupation.

Premium rates of pay are strongly dependent on when work is undertaken and the total time spent working. The three principal time related wage rates are:

- shift loadings, and weekend and evening pay premiums. These are requirements placed on employers to pay additional wages at certain times of the day or on certain days of the week, and are not dependent on how many hours in total a person has worked during the week
- overtime rates, which represent higher wage rates for hours worked greater than the usual ordinary hours listed under an award or an agreement
- holiday pay. Public holidays are a form of paid leave, with the exception that, unlike personal leave, they are prescribed for days with a cultural or religious significance that society has deemed should involve widespread community participation (with its implications for cultural identity). If people work on such days, they typically receive additional pay.

The Fair Work Ombudsman categorises all the above premium rates as 'penalty' rates, while the Fair Work Commission (and awards) distinguish between penalty rates and overtime rates.

The different types of work mean that there can be a complex set of overlapping time related payments (table 9.1). Unfortunately, the various debates about the determination of such rates, or their 'right' level, have sometimes intermingled the quite separate issues that relate to the different forms of non-standard hours. This chapter focuses on penalty rates for long hours and night (and associated shift) work, and explains why the Productivity Commission concludes that the preserving the status quo is largely justified and, if anything, the community should be more aware of the risks entailed by such work patterns.

The next six chapters have a quite distinct orientation. They concentrate on daytime penalty rates on weekends for consumer-focused industries (such as retailing and restaurants) where social changes and consumer preferences have increasingly prompted weekend trading. The application of penalty rates for weekend work requires the assessment of quite separate empirical, analytical and policy issues.

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<sup>113</sup> While the concept of compensation for asocial hours has a long legacy in WR legislation, s. 134(da) is a recent insertion (following the passage through Parliament of the Fair Work Amendment Act 2013, No. 73, 2013).



**Table 9.1 The types of work covered by this and the next chapter <sup>a</sup>**

	Weekend			Weekday		
	Ordinary daytime	Evening	Night and rotating shifts	Ordinary daytime	Evening	Night and rotating shifts
Not public holiday or overtime	B	C	A	N	D	A
Public holiday	C	C	A	C	C	A
Overtime	A	A	A	A	A	A

<sup>a</sup> 'A' describes the focus of this chapter — premium rates that relate to overtime at any time of the week and to night and rotating shifts. 'B' describes the focus of the following chapters — penalty rates that relate to normal daytime hours worked on a weekend. 'C' and 'D' relate to the other areas of interest of the following chapters. 'C' relates to public holiday pay arrangements on any day, except where there are night, long hour or rotating shifts in place. 'D' relates to evening work on any day of the week (excepting public holidays). Ordinary daytime work (N), a reducing norm, is not considered in either this chapter or those following.

## Working time regulations affect a wide range of employers and employees

Many Australians work long hours and during nights. In early 2015, 2.8 million Australian employees reported working more than 40 hours per week, while over 1.5 million employees reported working 50 hours or more per week (ABS 2015f). Although there are no current statistics that record the prevalence of night work per se, work schedules typically associated with night work are common. In 2014, almost 1.2 million Australian employees reported working schedules likely to involve night work (including night and rotating shifts, as well as irregular working patterns).<sup>114</sup>

Regulation of long hours and night work have multiple and sometimes conflicting objectives.<sup>115</sup> They aim to balance the needs of business with those of employees. On the one hand, extending the hours of existing employees avoids the fixed costs of hiring. Moreover, in some roles, employees may be more effective working long hours. On the other hand, employees can bear significant additional personal costs from working long hours. There is strong evidence that persistently working long hours increases the risk of a range of illnesses.

<sup>114</sup> Calculated from the HILDA Survey, Release 13.0.

<sup>115</sup> References to 'regulation' in this chapter relate to the NES and to award provisions, and not any other forms of regulation.

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Working time regulations apply to a heterogeneous body of employees and workplaces. Regulations aimed at employees most burdened by overtime and night work will invariably affect some who prefer such arrangements. As such, these regulations must balance the potential benefits of reducing the personal costs of long hours and night work against the inefficiencies from intervening in otherwise mutually beneficial arrangements.

In Australia, long working hours and night work are regulated by both statute and modern awards. Under the FW Act, the NES provide for maximum weekly hours, while modern awards define ordinary hours, along with overtime and shift loading rates.

The case for regulation rests on the existence and extent of detrimental effects to employees, and the degree to which market mechanisms minimise these costs and/or compensate those who bear them. Where the market fails to provide adequate compensation to affected workers, the effectiveness of regulations is a key consideration.

This chapter is structured as follows. It outlines past and present working time regulation in Australia to provide context and lessons for any future policy developments (section 9.1). The chapter then examines the prevalence of long working hours and night work, along with the characteristics of those who work these schedules (section 9.2). Finally, the chapter assesses the impact of long hours and night work regulation (section 9.3), and provides options for reform (section 9.4).

## 9.1 Current regulation of long hours and night work

Regulations targeting working hours use varied terminology. While the chief concerns in this chapter are long working hours and working at night, provisions that regulate ‘overtime’ or ‘shift work’ may or may not deal with these concerns (box 9.1).

### Box 9.1 Some terminology for this chapter

Working time regulation is generally concerned with how many hours an employee works, and when he or she works those hours. This chapter focuses on people who work long hours, and people who work at night.

#### **Overtime means working in excess of ordinary hours**

The terminology of working time regulation can be confusing. For example, the term ‘overtime’ has two distinct meanings. It refers to both the number of hours worked in excess of aggregates of ‘ordinary hours’ (specified within awards), as well as work outside the daily or weekly span of ‘ordinary hours’ (also specified within awards), which generally includes evening, night and weekend work. For part-time employees, the number ‘ordinary hours’ corresponds to an employee’s typical weekly hours. In this chapter, the term ‘overtime’ is used to refer to work in excess of ordinary hours. Weekend and afternoon/evening work are covered in chapters 10 to 15.

#### **Night work is work during nights, whether ‘shift’ or ‘overtime’**

Many awards contain specific provisions for night shift work. However, in industries where shift work is uncommon, ‘overtime’ provisions may contain wage premiums for night work. This chapter will consider all of the above as regulations pertaining to night work.

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For the purposes of this chapter, ‘overtime’ refers to hours worked in excess (rather than outside) of ‘ordinary hours’. This may refer to excess hours worked within a day, week, or number of weeks. Night work refers to work undertaken between roughly 7 pm to 7 am. While shift work provisions within modern awards generally apply to these hours, ‘overtime’ provisions may also apply where they refer to the span of hours.

## **A brief history of working time regulations in Australia**

Working hour regulations have long been a central component of Australia’s Workplace Relations (WR) law. Awards have historically regulated this area, though more recently, statutory provisions have arisen to provide an upper limit to working hours.

In the mid–19th century, Australia led the world in reducing the length of the standard working week. Following the 48–hour week negotiated by Victorian building unions in the 1850s, award conditions progressively reduced weekly hours. In 1947, the standard week was reduced to 40 hours.

By the turn of the 21st century, the majority of awards stipulated a 38–hour week. Following the Working Hours Case 2002, in which the Full Bench of the Australian Industrial Relations Commission mandated a maximum working week of 38 hours with reasonable additional hours, the 38-hour week became the national standard (box 9.2). These conditions, however, remained limited to employees covered by awards.

### **Box 9.2 The Working Hours Case (2002)**

The Working Hours Case 2002 114 IR 390 was brought by the Australian Council of Trade Unions (ACTU) to incorporate various working time related provisions within all awards. Specifically, the ACTU proposed that awards contain restrictions on the number of additional hours employees that may be asked to work, along with provisions for additional paid leave following periods of extreme working hours. The ACTU was successful with the former, but not the latter. The Australian Industrial Relations Commission Full Bench determined that the following be inserted into awards:

- 1.1 Subject to clause 1.2 an employer may require an employee to work reasonable overtime at overtime rates.
- 1.2 An employee may refuse to work overtime in circumstances where the working of such overtime would result in the employee working hours which are unreasonable having regard to:
  1. any risk to employee health and safety;
  2. the employee’s personal circumstances including any family responsibilities;
  3. the needs of the workplace or enterprise;
  4. the notice (if any) given by the employer of the overtime and by the employee of his or her intention to refuse it; and
  5. any other relevant matter.

*Source:* Working Hours Test Case [2002] PR072202 [23 July 2002].

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The conditions borne of the Working Hours Case were extended to all employees following the introduction of the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth), which contained the Australian Fair Pay and Conditions Standard (AFPCS). The AFPCS largely inherited its ‘ordinary hours’ conditions from the Working Hours Case, with its key provision that employers could not request or require employees to work unreasonable additional hours.

## Current arrangements

Current working time arrangements are a product of their history. Though statutory maximum hours provisions are now located within the NES under the FW Act, they closely resemble those of the AFPCS. Similarly, although awards have undergone substantial rationalisation and simplification, they remain the main vehicle for regulating long hours and night work by specifying ordinary hours, overtime and night shift loading.

For full-time employees, the NES specify that an employer must not request or require an employee to work more than 38 hours per week, unless the additional hours are reasonable. Similarly, part-time employees must not be asked to work more than their ‘ordinary hours’ — where the term ‘ordinary hours’ refers to the number of hours typically worked — unless the additional hours are reasonable. The NES specify various criteria for assessing whether additional hours are reasonable (box 9.3). These include factors such as the risk to employee health and safety, as well as the needs of employees and employers. Although the relevant provisions of the NES have rarely been invoked, the limited numbers of cases highlight the importance of context in the interpretation of the legislation.

### Box 9.3 What are ‘reasonable additional hours?’

Two notable cases provide some insight into the application of working time provisions in the NES. The outcomes of each case reveal the importance of context in the determination of whether additional hours are ‘reasonable’.

*MacPherson v Coal & Allied Mining Services* involved a judgment on the increase of an employee’s weekly hours from 40 to 44 per week. The Federal Magistrates Court found that the additional hours associated with the new rostering were reasonable given a number of compensating factors, such as an associated pay increase, the increase in day work, prior notice from the employer, industry norms around working hours and the potential for the mitigation of safety risks.

*Brown v Premier Pet* involved the dismissal of an employee following refusal to work additional hours. Mr Brown refused to work three additional hours on non-trading days to complete maintenance work. The court found that Mr Brown had the right to refuse additional working hours, and that his dismissal constituted adverse action. Relevant factors in this decision included Mr Brown’s circumstances, the needs of the workplace, lack of attempts to negotiate rostering arrangements and the fact that the additional work fell on weekends.

*Sources:* Stewart (2013, p. 224); *Brown v Premier Pet Pty Ltd* (2012) FMCA 1089 [6 November 2012]; *MacPherson v Coal & Allied Mining Services Pty Ltd (No.2)* (2009) FMCA 881 [9 September 2009].

Long working hours are also regulated by modern awards. Awards typically define ‘ordinary hours’ of work (which are separate and sometimes different from the 38 hours notional maximum contained within the NES) and provide some compensation for working in excess of these hours (table 9.1). As compensation for work beyond ordinary hours, awards generally offer either overtime premiums or time off in lieu. For example, the Nurses Award 2010 defines ‘ordinary hours’ to be 10 hours per day (exclusive of meal breaks) and 38 hours per week. Work in excess of 10 hours in a day accrues double time pay (a premium of 100 per cent). However, working hours can be averaged over four weeks such that hours worked in excess of ‘ordinary hours’ for a given week may not accrue overtime. The award also defines the span of ordinary hours, which allows for overtime due to work outside ordinary hours.

Modern awards also regulate night work. For industries and occupations in which shift work is common (that is, work that regularly takes place outside ‘ordinary hours’), modern awards generally define shift times (including night shifts) and their corresponding loadings (table 9.2). For example, the Nurses Award 2010 defines a night shift as beginning after 6.00 pm and finishing before 7.30 am the following day. A loading of 15 per cent is associated with night shift.

**Table 9.2 Long hours regulations are fairly consistent across awards**  
Working time regulations in various awards

<i>Award</i>	<i>Span</i>	<i>Hours per day</i>	<i>Hours per week</i>	<i>Averaging</i>	<i>Premiums (per cent)</i>
Aged Care Award 2010	6am – 6pm, Mon-Fri <sup>a</sup>	8 (day) 10 (night)	38	4 weeks	50 100 <sup>c</sup>
Social, Community, Home Care and Disability Services Industry Award 2010	6am – 8pm, Mon-Sun <sup>a</sup>	10	38	4 weeks	50 100 <sup>c</sup>
Building and Construction General On-site Award 2010	7am - 6pm, Mon-Fri <sup>a</sup>	8	38	4 weeks	100
Nurses Award 2010	6am – 6pm, Mon-Fri <sup>a</sup>	10	38	4 weeks	50 100 <sup>c</sup>
General Retail Industry Award 2010	7am – 9pm, Mon-Fri, 7am – 6pm, Sat 9am – 6pm, Sun	<b>g</b> <sup>b</sup>	38	4 weeks	50 100 <sup>d</sup>
Hospitality Industry (General) Award 2010	—	11.5	38	4 weeks	50 100 <sup>c</sup>
Mining Industry Award 2010	6am – 6pm, Mon- Sun <sup>a</sup>	10	38	26 weeks (for NES purposes)	50 100 <sup>d</sup>

<sup>a</sup> Separate conditions apply for shift workers. <sup>b</sup> One 11-hour day per week is permitted. <sup>c</sup> After two hours of overtime. <sup>d</sup> After three hours of overtime.

**Table 9.3 Night work regulations vary substantially across awards**

Night shift regulations in various awards

<i>Award</i>	<i>Commences</i>	<i>Finishes</i>	<i>Premiums (per cent)</i>
Aged Care Award 2010	4pm – 4am	—	15
	4am – 6am		12.5
Social, Community, Home Care and Disability Services Industry Award 2010	before 6am	after 12am	15
Building and Construction General On-site Award 2010	3pm-11pm	—	15
Nurses Award 2010	after 6pm	before 7.30am	15
General Retail Industry Award 2010	after 6 pm	before 5am	30 <sup>a</sup>
Hospitality Industry (General) Award 2010	7 pm	12am	10
Mining Industry Award 2010	—	12am – 8am	15

<sup>a</sup> For a permanent employee on a weeknight.

## Not all workers are covered

Although the AFPCS (and later the NES) vastly broadened the coverage of weekly hour limits, this did not extend to all Australian workers. The WR system does not stipulate any minimum conditions associated with hours of work or pay rates for genuine contractors. A contractor might include overtime or penalty rates in a service contract, but that would be a matter for the two contracting parties.<sup>116</sup> For obvious reasons, working business owners do not face any regulatory constraints on their hours of work or the compensation they receive for them.

## Arrangement overseas

Internationally, limits on weekly work hours and overtime pay are the most common forms of working time regulation. Over the last century, working hour limits across countries have broadly converged to a 40-hour working week. However, the application of limits varies across countries (table 9.4). Some jurisdictions (for example, Canada) stipulate a maximum number of hours above which wage premiums apply, while others (for example, New Zealand) specify a maximum which employers require written agreement to exceed.

<sup>116</sup> It is conceivable that a contract that required very long hours of work for little additional remuneration might be deemed as being harsh or unfair under the *Independent Contractors Act 2006* (Cth), but the case law is too limited to reach a firm conclusion about the interpretation of the Act.

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**Table 9.4 Overseas long hours regulation**

<i>Country</i>	<i>Long working hours regulations</i>
New Zealand	Employers and employees are not restricted in the hours of work to which they may agree, provided that these hours are reasonable and that they do not endanger the health of employees. In instances where an employment agreement does not specify weekly hours, the Minimum Wage Act applies, specifying 40 hours as a maximum working week. Compensation for work in excess of agreed weekly hours is also subject to the employment contract.
Canada	The Canada Labour Code outlines overtime provisions for industries over which the federal government has jurisdiction. In these industries, employees are entitled to overtime if their hours on average exceed 40 hours per week. Over the period of averaging, however, an employee may not work in excess of 48 hours in any week. Managers, superintendents, and employees who carry out management functions are exempted. Architects, dentists, engineers, lawyers, and medical doctors are also excluded.
United Kingdom	The United Kingdom's Working Time Regulations specify a maximum weekly limit of 48 hours, though employees may opt out of this through written agreement. A reference period of 17 weeks applies over which weekly hours may be averaged. No overtime premium is provided within the Working Time Regulations.

*Sources:* GOV.UK (2014); Immigration New Zealand (2013); Government of Canada (2010).

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## 9.2 The prevalence of long hours and night work

### Working hours have been falling on average

Over the last century, average annual working hours have declined in Australia and internationally (figure 9.1). In 1918, the average Australian employed person<sup>117</sup> worked just under 2600 hours per year. This figure had dropped to just over 1600 hours by 1998. Similar patterns are evident in comparable economies, such as Canada, New Zealand and the United Kingdom. The decline in average working hours was most pronounced in the first half of the 20th century, with a less marked decline observed more recently.

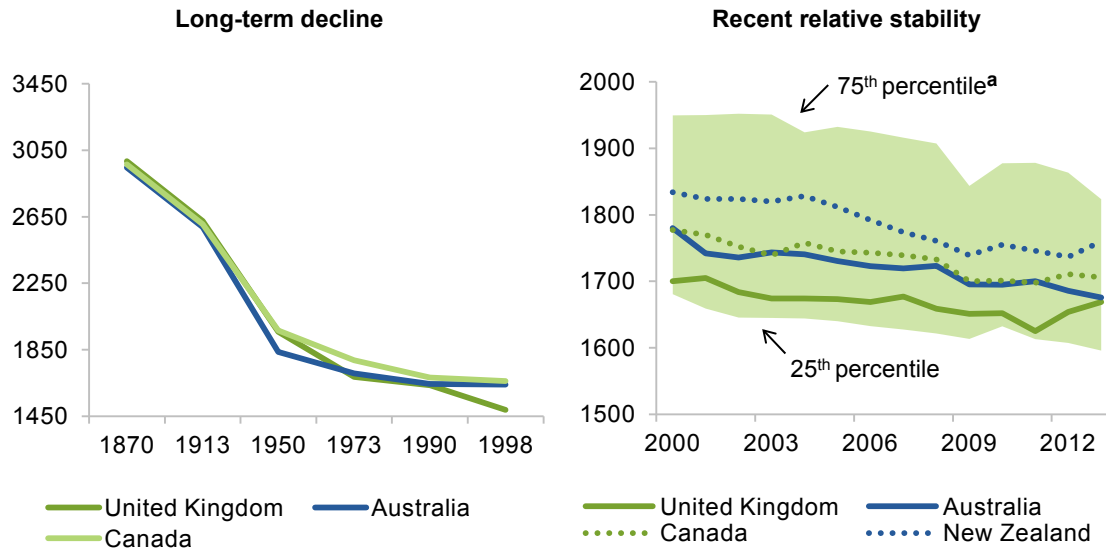
Several factors explain this fall in average working hours. These include norms about the appropriate balance of work and other activities, workplace health and safety issues, and union and employee pressures. Indeed, unions had a central role in the gradual reduction of 'ordinary hours' in Australia. This followed similar movements in other countries, particularly the United Kingdom (Cahill 2007).

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<sup>117</sup> These averages include the working hours of not only employees, but all employed persons. As non-employees, such as business owners, generally work longer hours, the average annual hours reported above are likely higher than those of the employee population.

**Figure 9.1 Average annual working hours have declined over time**

Average annual working hours of employed persons



<sup>a</sup> Among 34 OECD countries.

Sources: OECD (2001, 2015e).

## But some still work very long hours

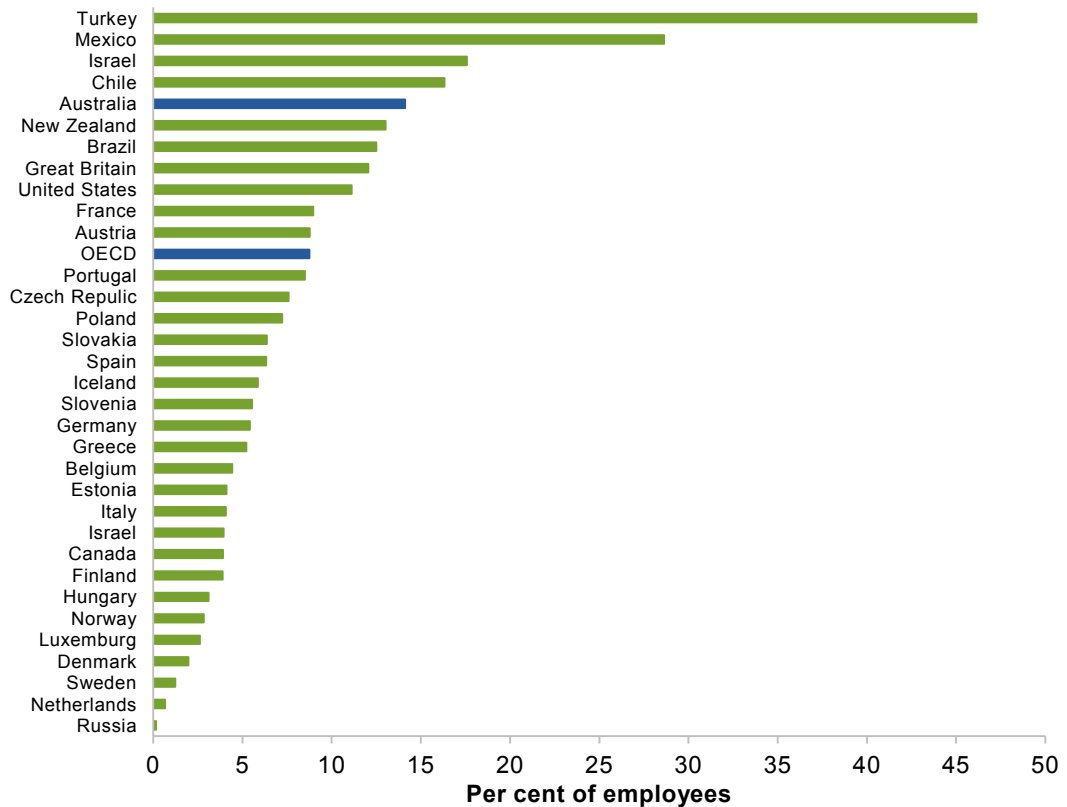
Australia’s average annual hours of work are not high by international standards. In 2011, it ranked only 19th highest among 34 OECD countries (OECD 2015e). However, aggregate annual working hours provide an incomplete story because they mask compositional changes in the ways that Australians are working. For example, part-time work as a proportion of employment has increased from around 16 per cent in 1980 to just over 30 per cent in 2014.

Supporting this notion, Australia has a particularly high proportion of employees working very long hours, as compared with other OECD countries (figure 9.2). According to OECD data, just over 14 per cent of Australian employees work 50 hours or more per week. This is much higher than the OECD average of just under 9 per cent, and exceeds many comparable economies such as the United Kingdom and the United States. That said, variations in reported long hours may reflect not only differences in actual hours worked, but also the data collection techniques of the various national statistical agencies.



**Figure 9.2 Australia has a high proportion of employees working very long hours**

Per cent of employees working more than 50 hours, 2011



Source: OECD (2013c).

### Who works long hours?

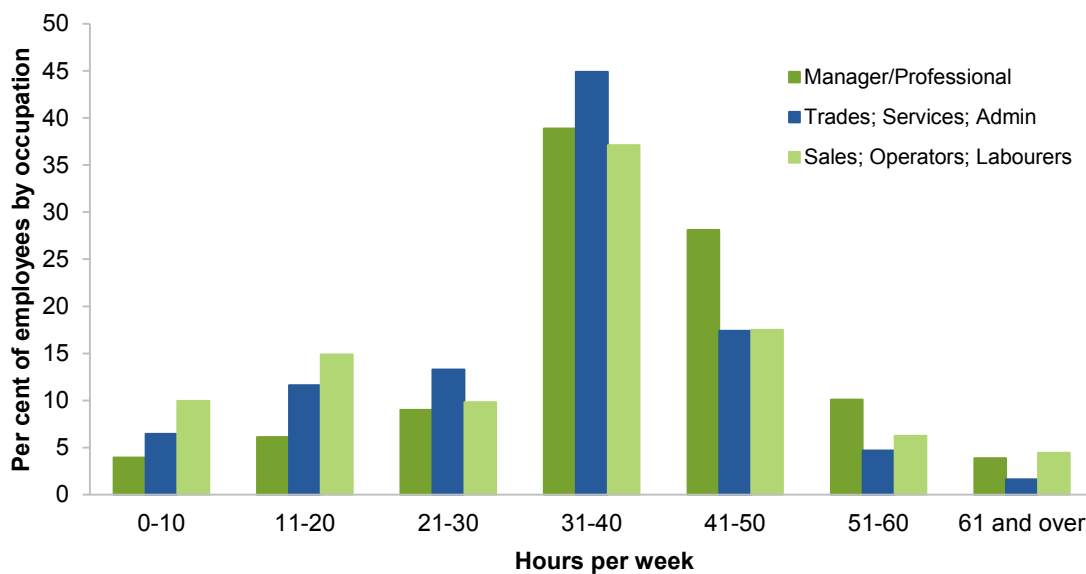
Long working hours are particularly common in high-skill occupations. People who work more than 40 hours per week are much more likely to be a manager or professional (figure 9.3). Several factors explain the prevalence of long hours by occupation:

- award-based overtime premiums create incentives for employers to avoid employing staff for hours in excess of their ‘ordinary hours’. For salaried employees that are not award based, no such premiums apply
- norms about working longer hours vary by occupation and workplace. In part, this may reflect employees’ perceptions that long working hours signal commitment to the enterprise (affecting job security and promotion). The non-pecuniary benefits of some types of work — its learning opportunities and job stimulation — may also lead to long hours

- the nature of work in some industries/enterprises is more conducive to employing many employees on short shifts than others. For example, it is relatively easy to coordinate the activities of many retail assistants working short hours in a retail outlet. This is not true for many professions, where it is difficult to transfer knowledge that is important to the efficient functioning of the business between different employees.

**Figure 9.3 Managers and professionals are more likely to work long hours**

Weekly hours worked, by occupation



Source: Productivity Commission estimates based on HILDA Release 13.

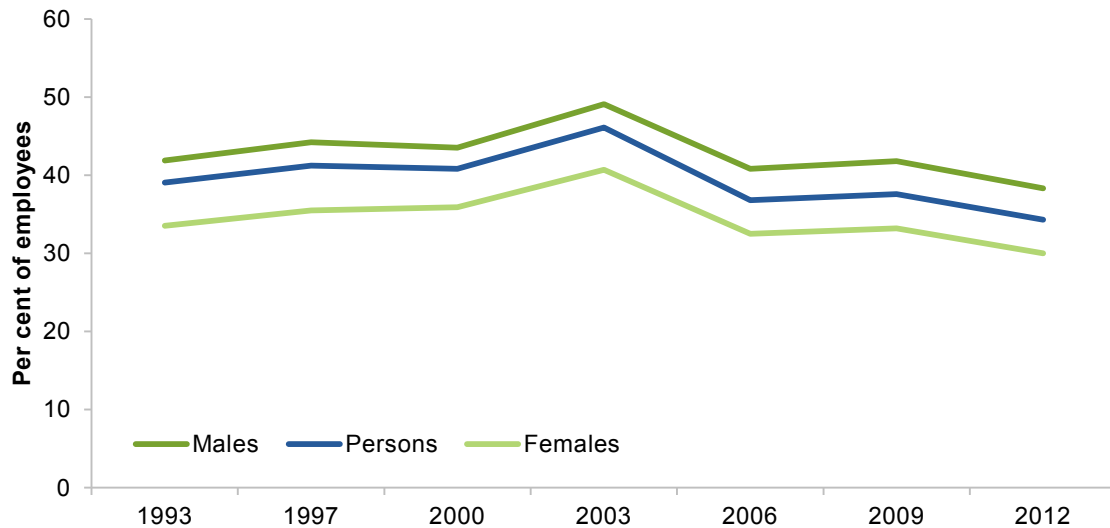
## Overtime

As discussed above (box 9.1), ‘overtime’ is an ambiguous concept, and although the data on overtime may capture more than long working hours, which are the focus of this chapter, they can provide some general insights for policy consideration.

The available data suggest overtime is common for many employees. In 2012, roughly a third of employees reported usually working overtime (both paid and unpaid) (figure 9.4), although this was substantially lower than the recent peak of just under one half of all employees in 2003.

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Figure 9.4 **Proportion of employees working overtime**  
1993–2012



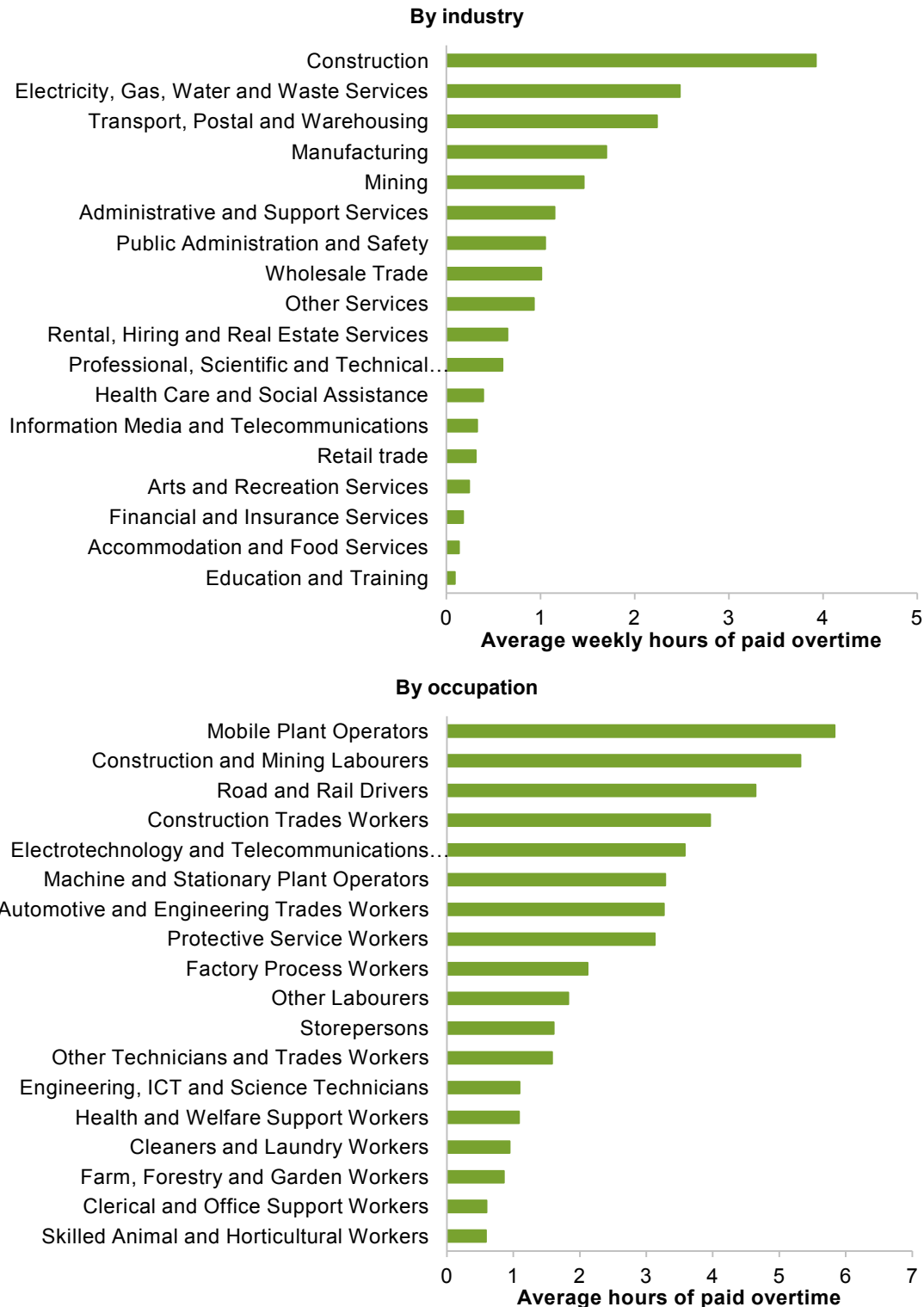
Source: ABS (various years), *Working Time Arrangements*, Cat. No. 6342.0, table 1.

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Overtime rates vary considerably by industry and occupation (figure 9.5). In terms of industry, the highest rates of paid overtime are seen in construction, followed by electricity, gas, water and waste services. In terms of occupation, mobile plant operators work the highest number paid overtime hours, followed by construction and mining labourers. The lack of overtime recorded among occupations traditionally associated with long hours — such as health workers and various types of managers — reflects that these employees are typically in salaried work, without defined ordinary hours.

**Figure 9.5 Overtime by industry and selected occupations**

Weekly hours of overtime

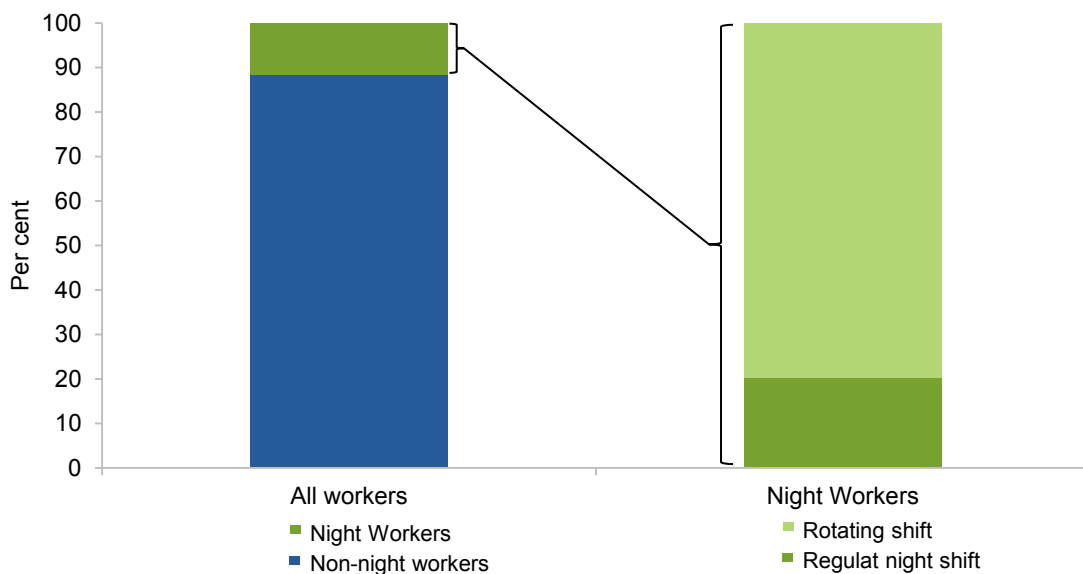


Source: Productivity Commission estimates based on ABS (2014) *Employee Earning and Hours*, Expanded CURF, Cat No. 6306.0.55.001.

## Night work

In 2013-14, almost 1.2 million Australian employees (around 11 per cent) reported working schedules likely to involve night work (including regular night shifts and rotating shifts) (figure 9.6). Among these workers, rotating shifts were most common. Only around 2.5 per cent of employees were involved in regular night shift work. This distribution of working schedules has remained fairly stable since 2001.<sup>118</sup>

Figure 9.6 **Night-working employees in Australia<sup>a</sup>**  
Proportion of workers, 2013 14



<sup>a</sup> Night workers includes those who work a regular night shift and a rotating shift. The figures do not count people who work irregular hours and split shifts or who are on call. Some work undertaken as part of these working patterns will involve working at night, and so the figures in the main text and the chart are likely to underestimate the actual prevalence of night work. If the former categories of work were included in the estimates then up to 2 million Australian employees (almost 20 per cent) could be involved in night work. The underestimate due to the omissions will be partly mitigated by the fact that rotating shifts may not always involve night work.

Source: Productivity Commission estimates based on HILDA Release 13.

<sup>118</sup> There is considerable uncertainty over these estimates because night shift work is not separately identified in any of the relevant surveys. The ABS recorded 1.5 million employees who worked on shift work in November 2012 (or 16.1 per cent of all employees), which included rotating shifts, regular shifts (covering any of regular evening or graveyard shifts, regular morning shifts and regular afternoon shifts), and irregular shift, split shift, on call arrangements (ABS 2013, *Working Time Arrangements, Australia*, November 2012, Cat. No. 6342, table 7, released 3 May). Many of these arrangements will not involve night shift at all. The 2014 Australian Work and Life Index (AWALI) survey undertaken by the University of South Australia found that 19.1 per cent of employees ‘often or always’ worked evenings or nights past 9 pm (based on Productivity Commission analysis of the survey).

## Who works nights?

The incidence of schedules likely to involve night work (regular night shift and rotating shifts) varies substantially across industries, ranging from just under 40 per cent of employees in accommodation and food services to around 5 per cent in financial and insurance services (table 9.5). Other industries with high proportions of night workers include agriculture, arts and recreation services, mining, transport and warehousing, and health and social assistance — all with over 25 per cent of employees regularly working nights.

In absolute terms, the health care and social assistance industry contains the largest number of night working employees, followed by accommodation and food services and retail trade — each with over 200 000 of these night workers.

**Table 9.5 Work schedule varies substantially by industry**  
Per cent of employees by work schedule, average from 2009-10 to 2013-14 <sup>a</sup>

<i>Industry</i>	<i>A regular night shift</i>	<i>A rotating shift</i>	<i>Irregular schedule</i>	<i>Other</i>
Accommodation and Food Services	7.6	17.6	13.6	61.2
Arts and Recreation Services	1.8	15.2	19.6	63.4
Mining	1.5	28.7	2.8	67.0
Transport, Postal and Warehousing	5.5	13.7	11.9	68.9
Health Care and Social Assistance	4.0	16.7	7.6	71.8
Agriculture, Forestry and Fishing	0.7	1.7	25.3	72.4
Retail Trade	2.8	8.9	9.4	78.9
Public Administration and Safety	1.8	11.4	4.8	82.0
Rental, Hiring and Real Estate Services	0.9	2.7	14.0	82.4
Information Media and Telecommunications	1.3	5.8	9.5	83.4
Administrative and Support Service	1.7	4.9	9.1	84.4
Manufacturing	3.3	6.4	4.7	85.7
Other Services	0.2	2.7	10.5	86.7
Professional, Scientific and Technician	0.0	1.3	10.9	87.8
Wholesale Trade	0.9	1.3	7.1	90.8
Electricity, Gas, Water and Waste Services	0.1	5.8	2.7	91.3
Construction	0.6	1.5	6.6	91.4
Education and Training	0.3	1.1	5.0	93.7
Financial and Insurance Services	0.4	1.4	3.5	94.7
All Industries	2.3	7.9	8.5	81.4

<sup>a</sup> Estimates are averages from the last 5 waves of the HILDA Survey.

Source: Productivity Commission estimates based on HILDA Release 13.0.

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## 9.3 Assessing long hours and night work regulation

Long hours and night work can be detrimental to employees, however regulatory responses that restrict work schedules must balance the potential gains from regulation against the impacts on individuals who genuinely benefit from long working hours and night work.

### The personal costs of working overtime and night shifts

There is a wide body of evidence suggesting that long hours and night work impose health costs on employees. The existence of such personal costs may justify regulatory intervention, such as working hour limits and wage premiums, to compensate employees.

#### The personal impact of working long hours

Studies of health effects for long hours primarily relate to coronary health, sleep behaviours and psychological and social wellbeing.

Both heart disease and its precursors have been linked to working long hours. Raised blood pressure has been attributed to both daily and weekly long hours, with work beyond 40 hours per week found to be detrimental (Nakamura et al. 2012; Nakanishi et al. 2001). Moreover, working 11–12 hours per day has been estimated to cause a 1.56 fold increase in incidence of coronary heart disease, and a 1.67 fold increase in incidence of coronary death or non-fatal myocardial infarction (heart attack) (Virtanen et al. 2010).

Disrupted sleep behaviours are also linked to long working hours. Both low duration of sleep and difficulty falling asleep appear to result from long hours (Virtanen et al. 2009). Moreover, long hours of work have been linked to lower sleep quality and reduced daytime function (Nakashima M et al. 2011; Sekine et al. 2006).

Psychological impacts of long working hours have been found for various measures of mental health. For example, Nash et al. (2010) found higher rates of psychiatric morbidity among Australian doctors working long hours. Other studies have linked long working hours to poor performance in cognitive measures, such as reasoning and vocabulary tests. A number of studies have found working long hours to be associated with increased likelihood of anxiety, depressive symptoms, and major depressive episodes (Virtanen et al. 2012).

Additionally, the social wellbeing of workers and their family can be affected by long hours of work. Skinner and Pocock (2014) found that employees who work more than 48 hours per week score substantially worse on a work-life interference index<sup>119</sup>. Other

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<sup>119</sup> The AWALI work-life index is a composite measure of five aspects of work-life interferences, including: time strain; work-to-community interference; satisfaction with overall work-life balance; feelings of being pressed for time; and general interference.

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Australian research has found harmful effects on the wellbeing of children in families where parents work long hours (Andrews et al. 2014) .

### The personal impact of working nights

The most obvious effects of night work are those relating to sleep. Night work can disrupt circadian rhythms and result in long-term sleep deprivation. Across a number of studies, night shift workers have been found to sleep less and have lower quality of sleep (de Cordova et al. 2012). Indeed, the International Classification of Sleep Disorders recognises Shift Work Disorder (SWD) as a condition characterised by excessive sleepiness and insomnia due to non-standard work hours.

However, the effects of night shift are not limited to sleep. Shift work has been linked to higher rates of smoking, increased stress, higher body mass index, and metabolic syndrome — a cluster of risk factors including elevated blood pressure, obesity, and problems with cholesterol (Bannai and Tamakoshi 2014). Furthermore, some research suggests a direct link between night work and cancer, supporting the notion that high exposure to light during the night suppresses secretion of melatonin, which in turn distorts the levels of other hormones and increases risk of cancer (IARC 2007; Stevens 1987).

Mental and social wellbeing can also be affected by working nights. Chapter 12 outlines links between evening work and several measures of work-life interference, finding reduced time spent with family and friends, reduced ability to engage with the community and increased feelings of time pressure.

### Impacts of regulation on employment, working hours and wages

The primary rationale for working time regulations examined in this chapter is to mitigate the detrimental effects of long hours and night work on employees. However, in addition, some argue that regulations have broader impacts, particularly on equilibrium levels of employment. These potential effects and their supporting evidence are discussed below.

#### *Overtime regulations and working hours*

There is strong evidence that long working hours decrease following regulation. For example, Hamermesh and Trejo (2000) compare rates of overtime work for males and females in California before and after the introduction of laws that increase overtime rates for men only. Their estimates of the relationship between overtime rates and overtime work suggest that 1 per cent increase in overtime premiums corresponds to a 0.5 per cent reduction in overtime hours, a hardly surprising outcome given that the demand for the total hours of work are inversely related to its price.



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### *Overtime regulations and equilibrium levels of employment*

Some consider that working hour restrictions and wage premiums increase overall levels of employment, even though they reduce the average hours of work for any given employee. However, the net employment impacts are uncertain.

- Some employers may hire new employees because of limits on overtime hours per employee or higher overtime rates. However, employers face fixed costs hiring additional employees, especially for higher-skill employees. Moreover, labour is not a homogeneous input, and additional employees may not be as effective as existing employees.
- Businesses may substitute away from employment to production equipment and technology, decreasing overall employment.
- As business costs rise, some firms may restrict their operating hours, which could also reduce employment.

Accordingly, regulations limiting hours or adding a premium to shift work may reduce overall labour demand (measured in hours) without increasing the number of jobs. Overall, there is little empirical evidence that levels of employment increase as a result of increased (or newly introduced) overtime premiums (Oaxaca 2014).

### **Further regulatory considerations**

Working time regulations appear effective in reducing the incidence of overtime. Both economic theory and empirical evidence suggest that overtime rates reduce the prevalence of long working hours. To the extent that they are complied with, by definition, working time limits reduce the prevalence of long working hours.

Given the health costs associated with long hours and night work, and the lack of bargaining power of many employees, there is a strong case for retaining a policy response. Current arrangements implement a mix of working time limits imposed by the NES, along with wage premiums contained within awards. The appropriateness of current regulations rests on answers to a number of questions:

- To what extent do long hours of work reflect the preferences of employees?
- Are long hours of work only a temporary issue for most employees?
- To what extent do employers (and employees) comply with current overtime regulations?

### **Volunteers or conscripts?**

While the NES stipulate a maximum 38-hour week for full-time employees, employers may request 'reasonable' additional hours of work. The subjective concept of 'reasonable'

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hours means that there is no specific cap on weekly hours, not only because reasonable additional hours may vary by circumstance, but also because employees may volunteer to work additional hours.

Multiple sources of evidence reveal a mixture of voluntary and involuntary overtime. Some inquiry participants have reported dissatisfaction with requests to work overtime, while others appreciate the opportunity to earn additional income (box 9.4). Figure 9.7 illustrates the variation in working preferences according to length of working week reported in HILDA (see appendix B for a summary of the HILDA survey). Employees are much more likely to prefer fewer hours when working in excess of 50 hours per week, while a minimal number of employees prefer additional hours from around 40 hours onwards.

#### **Box 9.4 Participant attitudes towards overtime varies**

A number of participants have expressed dissatisfaction with the hours that they work, and many indicate little control over these arrangements:

We are called in to work extra hours sometimes not given the right amount of notice and only paid at part time rates, we could turn it down but have to find someone else to take our place which makes you feel like you are a bad employee. (Group of individuals, sub. 188, p. 268)

76 hours per week. No say in the shift I get managers do rosters and You have to swap with co workers or have sickies to juggle personal life with work hours. (Group of individuals, sub. 188, p. 270)

On the other hand, some employees see welcome overtime work, and see it as opportunity to earn additional income.

I try to do as much OT as I can. I also try to work the Sunday shift they offer once a month to help with paying my bills. (Group of individuals, sub. 188, p. 264)

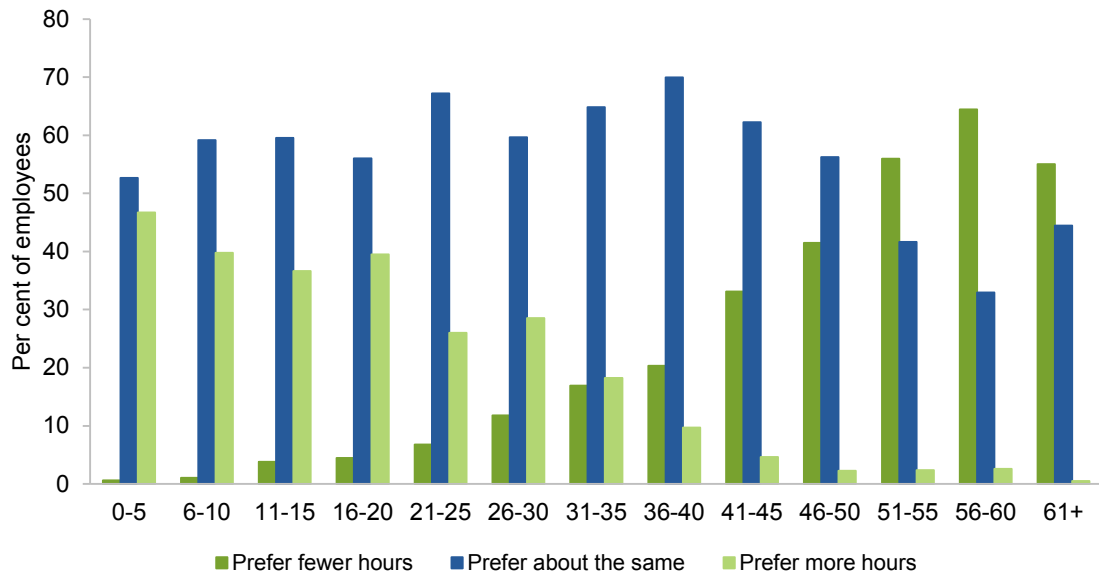
I work overtime every week at the moment, which is excellent as the penalty rates help with the cost of living. I am able to strike a fair balance currently between work and life, however I am concerned that this will soon change. (Group of individuals, sub. 188, p. 270)

I have contract hours which I'm obliged to complete and am often offered work beyond those hours, which I don't have to accept. Work can be offered literally hours before it's due to be done due to staff illness etc. If I'm available I'm happy to accept extra work. It supports clients and creates goodwill with the supervisors and colleagues. (Group of individuals, sub. 188, p. 271)

Drago, Wooden and Black (2006) differentiate long hours employees as either 'volunteers' or 'conscripts' using data from HILDA. Those who work long hours (more than 50 hours per week) and prefer to work less are termed 'conscripts', while the remaining long hours employees are labelled 'volunteers'. Importantly, HILDA respondents were asked to take into account the impact of their preferred hours on income. In 2013-14, 10.4 per cent of employees met the criteria of 'conscripts'.

**Figure 9.7 Working hours preferences**

Per cent of respondents working a given amount of hours indicating preference for fewer, the same or more hours, 2013-14



Source: HILDA Release 13.

### How long do conscripts persist?

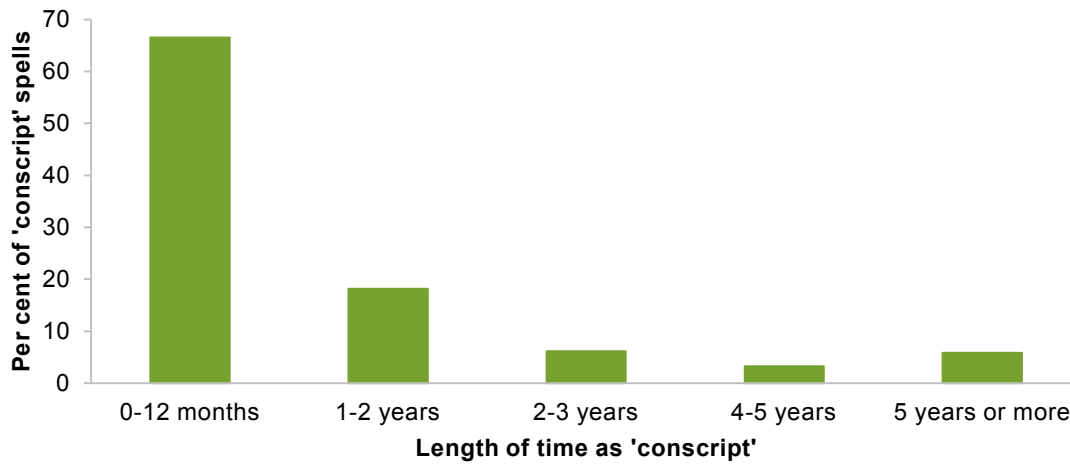
Mismatch between working hours and the preferences of employees is inevitable. However, a WR system should help to prevent extended periods of long hours in order to limit personal costs. That said, these costs must be balanced against the benefit of permitting long working hour arrangements where these are unavoidable and/or mutually preferred by employers and employees.

Moreover, there are common-sense limits to what can be achieved by regulatory intervention. Some individuals' preferences will incline them towards taking risks even where this may involve actions that medical advice indicates are against their longer term interests.

Evidence from HILDA suggests that employees tend to spend a short amount of time working more than 50 hours while preferring to work less. Among all conscript spells recorded in HILDA from 2001 to 2014, over 65 per cent lasted 12 months or less. Just over 90 per cent of spells lasted three years or less (figure 9.8). Around 50 per cent 'conscript' spells were followed by reduced hours in the same job, while around 30 per cent of 'conscripts' became long hours 'volunteers' (figure 9.9).

**Figure 9.8 How long do employees remain 'conscripts'?**

Distribution of conscript spells according to length <sup>a,b</sup>

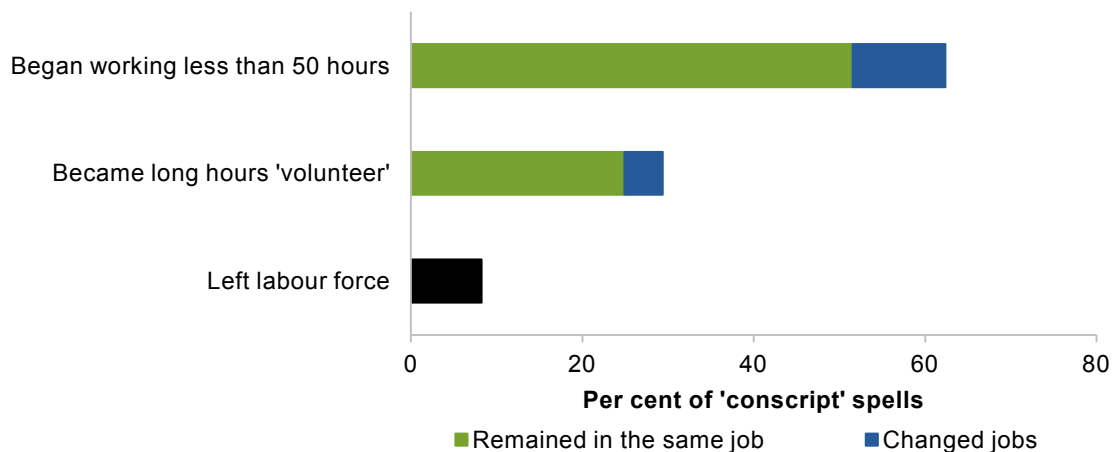


<sup>a</sup> Conscript spell refers to a period in which an employee works 50 hours or more while preferring to work less. <sup>b</sup> This figure refers to the distribution of all conscript spells recorded across the first 13 waves of HILDA. Employees can register multiple spells. For example, if an employee is a conscript in waves 2 and 3, and again in waves 7 and 8, both these spells will be counted in the figure above.

Source: Productivity Commission estimates based on HILDA Release 13.0.

**Figure 9.9 How do employees leave 'conscript' work schedules?**

Type of working schedule following spell as 'conscript' <sup>a</sup>



<sup>a</sup> See note for figure 9.8.

Source: Productivity Commission estimates based on HILDA Release 13.0.

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## Unpaid overtime

Several participants report working unpaid overtime (box 9.5). Indeed, nationally, just over a quarter of employees report working overtime with no additional explicit compensation (figure 9.10). However, this overtime work is not necessarily exploitative. For example, some employees may work long hours in exchange for implicit compensation in the form of better prospects of promotion. Several studies have found higher rates of pay to be associated with working long hours in earlier years, all other things equal (Anger 2005). Moreover, employees may be implicitly compensated in other ways, and content to occasionally work unpaid overtime given the nature of their work and overall conditions. However, in other instances, employees are required to work long hours against their preference, with no additional explicit or implicit compensation. The views of inquiry participants reflect the varied nature of unpaid overtime (box 9.5).

### **Box 9.5 Participant views on unpaid overtime**

A number of participants report working unpaid overtime. Many have expressed dissatisfaction with these arrangements:

I stay at work until my notes are written and I have safely handed over the care of my patients to the next nurse/midwife. Paid overtime is like hens teeth. (Group of individuals, sub. 188, p. 266)

I am contracted for 40 hours per week, although I often work 6-12 hours overtime each Fortnight- which is unpaid and I don't recoup 'time in lei'. (Group of individuals, sub. 188, p. 271)

My particular job is one which demands much of my time - I am paid for 35 hpw, but often work 50 hpw. I am only paid overtime for a small percentage of that - maybe one or two hours out of 15. This is typical of teachers (school and TAFE). (Group of individuals, sub. 188, p. 263)

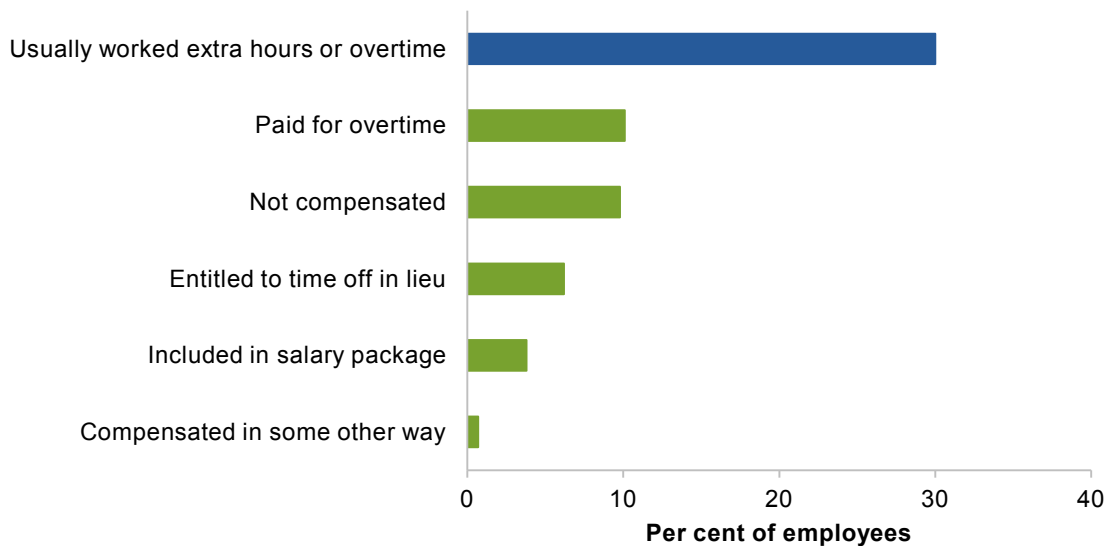
However, some participants consider work beyond 'ordinary hours' an implicit part of their remuneration:

As a former teacher I spent many nights and week-ends working - checking student reports/papers - preparing lessons etc. I saw that as part of my salary - and professional responsibility. But there were many over-and-aboves which I and my teaching colleagues performed which might properly have in other professional contexts attracted bonuses/extra considerations! (Group of individuals, sub. 188, p. 264)

The often subtle nature of compensation for overtime precludes quantification of what is exploitative unpaid overtime and what is not. Some unpaid overtime is undoubtedly exploitative, but some is the product of longer term career investment or a reflection of strong personal commitment beyond the expectation of the employer. Where regulation will struggle to identify let alone solve a problem, it may be preferable to rely on individuals applying personal judgment.

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**Figure 9.10 The prevalence of overtime and its compensation**  
Share of respondents that report usually working overtime, 2012



Source: ABS 2013, *Working Time Arrangements, Australia*, November 2012, Cat. No. 6342.0 (table 1).

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### Overtime — but not working long hours

Like full-time employees, part-time employees can be asked to work ‘reasonable’ additional hours, with their maximum weekly hours defined as their typical hours of work. As noted earlier (box 9.1), overtime rates can sometimes apply to these additional hours.

While some of the concerns outlined in this chapter relating to the effects of working long hours may not apply to such overtime, there are other implications to consider.

- Working in excess of ordinary hours can impose personal costs through the effects on caring arrangements or other responsibilities outside of work.
- Such employees may not have sufficient bargaining power to negotiate wage premiums that reflect these additional costs.

Unfortunately, the full extent of these sorts of overtime arrangements are unknown, and there is limited discussion in the literature around this issue.

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## 9.4 A case for reform?

### Maximum weekly hours of work?

The ‘maximum weekly hours’ provisions of the NES stipulate a 38-hour working week, and provide that employers may not request ‘unreasonable’ additional hours of work. This does not preclude outcomes where both the individual employee and employer agree to working greater than 38 hours, since this would typically pass a ‘reasonableness’ test. The allowance for ‘reasonable additional hours’ highlights a tradeoff between the ability of working time regulations to consider unique employee circumstances and the prevention of exploitative working arrangements.

A dilemma in this area is that the definition of ‘reasonable’ is subject to interpretations of the courts, and can be unclear. The inherent ambiguity of a reasonableness test means that some employers will avoid requesting additional hours of work if employees object, even if those requests were in fact reasonable.

In enterprise agreements, the issue becomes more complex as the working time arrangements apply to whole groups of employees, and the business’s operations may be planned around the expectation that employees are all able to work the designated hours. *MacPherson v Coal & Allied Mining Services Pty Ltd* has established that rosters affecting multiple employees can exceed the maximum weekly hours. However, how far such arrangements can go depends on context and therefore can be uncertain. Some employers and employer groups suggest that the ‘maximum weekly hours’ provisions are not flexible enough. In its submission, ALDI states:

ALDI recommends that the National Employment Standards (NES) be amended to enable employers and employees greater flexibility to determine reasonable additional working hours above the standard 38 hour week. This would allow employees to work the hours they wish and enhance the ability of employers to utilise labour more productively. If an employee seeks additional hours — as occurs regularly at ALDI — it is not clear why they should be denied the opportunity to boost their income. (ALDI, sub. 146, p. 2)

Some employee representatives conceived the problem in the opposite way, with the view that the flexible application of the ‘maximum weekly hours’ provisions undermine their enforceability. For example, the Australian Services Union states that:

... the ‘entitlement’ to a maximum working week of 38 hours per week is immediately qualified by the rider ‘unless the additional hours are reasonable’ which largely renders the entitlement unenforceable. (Australian Services Union, sub. 128, p. 7)

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Similarly, Professionals Australia state:

Professionals Australia considers that some employers are taking advantage of the fact that there is no legislative definition of what constitutes ‘reasonable’ additional hours. Instead section 62(3) of the Fair Work Act 2009 (Cth) lists a number of factors which must be taken into consideration when determining whether additional hours are reasonable. Whilst this is a practical approach to what can be a complicated issue and the outcome of a test case which was subsequently reflected in legislation, Professionals Australia submits that the concept of ‘ordinary hours’ needs to be clarified. (Professionals Australia, sub. 212, p. 12)

The relatively few disputes relating to the reasonableness test suggests that its subjective nature has created little uncertainty in practice. Indeed, Ai Group group notes that the provisions are ‘well-understood and work effectively’ (Ai Group, sub. DR346, p. 38). Courts use this test in many contexts, and a more definitive test might fail to take account of the varying contexts of workplaces and individuals.

Along with the evidence of additional personal costs associated with working long hours, the above suggests that current restrictions on hours worked (with a capacity to vary these when reasonable) and premium rates of pay for long hours are justified. However, it is possible that the Fair Work Commission could provide guidelines with simple examples. The existing case law (box 9.3) already provides some guidance, which could be converted into plain English explanations.

### **Changing regulation of night shift work?**

There is strong evidence that night work has adverse health costs. Moreover, these costs are unlikely to be factored into freely negotiated wages given the imbalance of market power between many employers and employees. Given that night shift loadings likely reduce the incidence of night work, and compensates employees for the additional costs associated with working these hours, there is a case for a regulated wage premium associated with night work.

As discussed in subsequent chapters, the established premiums for night shift work are relatively low compared with penalty rates for weekend work, which appears to involve far fewer risks.



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# 10 Regulated penalty rates for selected consumer services

## Key points

- Regulated penalty rate payments for weekend day work vary substantially across industries and the labour market. Around half of Australia's 122 awards do not stipulate them, and salaried employees and sub-contractors do not receive higher pay rates on weekends. Nevertheless, regulated penalty rates are common in some jobs.
- Many employers are concerned about the high rates of penalty rates on Sundays in a group of industries where incipient demand is strong on weekends, most notably the hospitality, entertainment, retail, restaurants and cafes (HERRC) industries.
- Sunday penalty rates for permanent employees are between 1.5 and 2 times the wage rate paid on a weekday. For example, a level one retail employee (the lowest skill level) earns \$18.99 per hour during normal working hours, but \$37.98 per hour on a Sunday.
- Penalty rates are a longstanding feature of the Australian workplace relations system, although their reach and levels have varied over time, between occupations, and across industries. These variations suggest that their levels are an art borne of history, precedent, compromise, and the lack of a coherent overarching set of principles. This is no different from many other features of awards.
- There were two main historical reasons for regulating weekend penalty rates. They were intended to act as a deterrent against asocial working times (the deterrence argument) and to compensate employees for working at inconvenient times when they were required to work (the compensation argument).
- They arose at a time when married women and students were hardly in the workplace, when Sunday work often also involved long hours, and when Sundays had a privileged role as a day for rest and religious observance.
- However, the economic environment and community attitudes that provided the original basis for penalty rates have changed. It is entirely consistent with the historical conduct of the industrial regulator to take as seriously a shift in community norms that is incidentally favourable to employers, as it has shifts that, in the past, have favoured employees.
- The various industrial regulators have accepted that the original basis for Sunday penalty rates have changed.
  - The regulator, employees, unions and employers have now rejected the deterrence argument.
  - There has been an emerging recognition by tribunals that the 'right' rates are hard to discern, and that the social and economic precepts that provided the original basis for penalty rates are not immutable. Therefore, nor should be the level and role of penalty rates.
  - Recent decisions by the Fair Work Commission have seen reductions in penalty rates for some employees on Sundays.

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There is very little contention about the justification for, or level of, penalty rates for overtime or shift work in any industry (chapter 9). Nor is there much controversy about the desirability of some premium rates for weekend work, even where that does not involve shift or overtime work. The Fair Work Commission (FWC) and its predecessors have justifiably accepted penalty rates as a legitimate and continuing feature of the safety net for all non-standard hours across all industries. Many,<sup>120</sup> but not all, stakeholders argued for the retention of regulated penalty rates.

However, the appropriate *level* for regulated penalty rates for weekend work — particularly on Sundays in a number of discretionary consumer service industries — has become a highly contested and controversial issue. The industries of greatest concern are hospitality, entertainment, retail, restaurants and cafes (HERRC).<sup>121</sup> These are industries where consumer expectations of access to services has expanded over time so that the costs of penalty rates affect consumer amenity in ways they did not when penalty rates were first introduced. Such industries are also important sources of entry-level jobs for, among others, relatively unskilled casual employees and young people (particularly students) needing flexible working arrangements. The provision of discretionary, and therefore demand responsive, services on weekends is less frequent in most other industries, which is a key (but not only) rationale for a focus of concerns on the HERRC industries. It is notable that the FWC is currently also considering appropriate penalty rates in awards, and that their focus almost exactly matches the group of industries that the Productivity Commission has identified as the most relevant.<sup>122</sup>

Accordingly, this and the next five chapters concentrate on daytime penalty rates on weekends in these industries. They also explain why the rationale for, and effects of, penalty rates in these industries is different from many others (such as essential services or industries where rotating rosters are the typical working arrangement).

*For ease of exposition, unless otherwise specified, this and the subsequent five chapters refer to ‘penalty’ rates as the premiums for pay associated with weekend work that is neither overtime nor part of ongoing shift work.*

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120 For example, see the Government of South Australia (sub. 114, p. 10), the Queensland Government (sub. 120, p. 2, 6), Australian National Retailers Association (sub. 216, p. 18), and NSW Young Lawyers (sub. 198, p. 5).

121 The Productivity Commission includes employees in the clubs industry, fast food, hairdressing, and pharmacy industries as part of HERRC (though these all have separate awards). The first two are akin to restaurants and cafes. Hairdressing is often termed as a retail function. Pharmacy is classified as part of the broader retail industry because the employees most affected by changes in penalty rates are pharmacy assistants, whose function is often more similar to retail assistants.

122 These are penalty rates in the Hospitality Industry (General) Award; the Registered and Licensed Clubs Award; the Restaurant Industry Award, the Dry Cleaning and Laundry Industry Award (not covered in this chapter), the Fast Food Industry Award, the General Retail Industry Award, the Hair and Beauty Industry Award, and the Pharmacy Industry Award (FWC AM2014/305 Penalty Rates Case).

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## The structure and fundamental arguments of the chapters

Since it is not possible to explore any problems with weekend penalty rate regulations without understanding their current form, this chapter examines these arrangements, their historical origin and recent developments.

Chapters 11 to 15 set out the principal arguments for preserving, but amending, existing penalty rates in the consumer services industries, but not in other industries. This represents the skeleton of the argument:

- The widespread provision of (discretionary) consumer services on weekends, such as retailing and restaurants, is a more recent feature of Australia's economy (chapter 11). Today, people commonly expect to be able to shop, eat at cafes, and purchase other consumer services on a seven-day basis. These services are seen as vital to lively cities and regional communities. The community attitudes and economic circumstances that underpinned high penalty rates in the HERRC industries — such as the importance of religious observance — have shifted, and yet penalty rate settings have not responded coherently to those changes across awards.
- It remains the case that many (but by no means all) people prefer weekends than weekdays for time off, reflecting the adverse social impacts of working on weekends (chapter 12). High regulated penalty rates on Sundays are premised on the existence of a large divergence in the social impacts of working on Sundays compared with Saturdays. There is little evidence for a substantial divergence. Policy should enable wages that attract people to work on weekends, but are not so high that there is under provision of services and adverse effects on hiring. While in the absence of any regulation, some premiums might be paid to attract people to working on Sundays, there is, nevertheless, a risk that markets might deliver lower than optimal weekend penalty rates. Accordingly, there are arguments for some regulated penalty rates for weekend work.
- It is hard to be precise about the right level of Sunday penalty rates (chapter 13). However, the existing empirical evidence about the impacts of bargaining power would only justify modest premiums for working on Sundays in the HERRC industries. There are other indications that current Sunday penalty rates are out of line with Saturday rates, such as their comparative asocial impacts (chapter 12), the relative rates of return to Sunday working compared with skill acquisition, and the fact that there is an excess demand by employees for Sunday jobs.
- A lower rate of penalty rates for discretionary consumer industries has implications for businesses, consumers, and employees, including those not working currently on weekends (chapter 14). While some parties lose, the overall community-wide gains from reforms are positive. Lower labour costs for discretionary weekend consumer services are likely to stimulate hours worked and employment, particularly on Sundays, and for consumers, to increase the variety and availability of services, and, to some extent, reduce prices. Existing employees working in the HERRC industries on Sundays will typically lose, but by less than many anticipate. The assumption that they necessarily come from low-income households is not substantiated.

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- Chapter 15 synthesises the analysis and discusses the policy options for penalty rates for the relevant industries. This chapter also briefly considers other approaches that would affect how employees and businesses deal with pay arrangements for variations in weekly (daytime) work patterns. This includes penalty rates for public holidays, which involve some distinctive issues (some of which are also addressed in chapter 16). There are few grounds for reducing penalty rates for public holidays for any industry, with this chapter explaining why this is the case. There are also few grounds for lowering penalty rates on Sundays in most other industries, although the workplace regulator should re-examine rates as it assesses awards using the processes set out in chapter 8.

## 10.1 Current arrangements for regulated penalty rates

Notwithstanding popular impressions that regulated penalty rates are ubiquitous, many industry awards do not specify weekend penalty rates. While awards typically involve some penalty for working on weekends, this is often part of overtime or shift arrangements, or incorporated into the average shift wage rate (as in the Maritime Offshore Oil and Gas Award 2010).

The Commission's analysis of awards and the Fair Work Ombudsman's pay guides, supported by comprehensive data supplied by the Department of Employment, shows that more than 60 awards include some provision for non-overtime or shift penalty rates on Saturdays and more than 70 awards provide some (more than trivial) provision for such penalty rates on Sundays. In some awards, these rates only apply to some occupational categories, reflecting the broad coverage of some modern awards. Accordingly, around half of Australia's 122 modern awards have provisions for weekend penalty rates. However, the Department of Employment database shows that only around one quarter of awards provide *universal* eligibility to their covered employees for work on Saturdays or Sundays.<sup>123</sup> Some suggested that changing Sunday penalty rates for the HERRC industries

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<sup>123</sup> The 25 per cent estimate is based on analysis from the Department of Employment (DoE), where the total count of awards with penalty rates is 31 for Saturdays and 30 for Sundays. The algorithm used by DoE excludes some awards that do provide penalty rates, but not to all employees on an equivalent basis. Its count excludes an award from its count under three circumstances. The first is if any category of an award-covered employee is not eligible for a penalty rate, even if many employees would be eligible. The second is where the penalty rates vary by the time of the day on a weekend day. So, in pharmacy, there are four penalty rates for Saturdays depending on the time they apply, and so the DoE database does not code Saturday as having a penalty rate. The third is that ordinary hours vary by the class of worker, or must require agreement by the employer and employee. For example, in some awards, ordinary hours are Monday to Friday for some employee categories, which means that there is no ordinary hour rate for weekend work and, therefore, no penalty rates for such employees (though there is scope for overtime). For other categories of employees in the same award, ordinary hours are from Monday to Sunday, with a penalty rate applying for weekends. Where these two types of ordinary hour definitions coexist in an award, the DoE approach records that there are no weekend penalty rates.

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alone would produce a two-tier system (Steve Walsh, Secretary of Unions Tasmania, trans. p. 135). In fact, Australia already has a *multi-tiered* system.

The principles that underpinned various decisions by workplace relations (WR) regulators have, to some extent, taken account of the usual working patterns of the various industries and occupations covered by various awards. This recognises that in some industries, shift or overtime arrangements are the typical pattern of working on weekends (with the special issues that these working arrangements pose — chapter 9).

The level of penalty rates varies considerably by award, particularly on Saturdays. Some awards also have tiered penalty rates in which there is an initial penalty rate for the first few hours, and a higher one for later hours. For example, work undertaken in the funeral industry on a Saturday is paid at 150 per cent penalty rates for the first three hours worked, and at 200 per cent for subsequent hours. While the data shown in figure 10.1 represent the typical rates by awards, in some awards there are many different penalty rates, depending on the occupation and the tasks of the employee. These complexities can be a significant source of confusion for employees and employers (chapter 15).

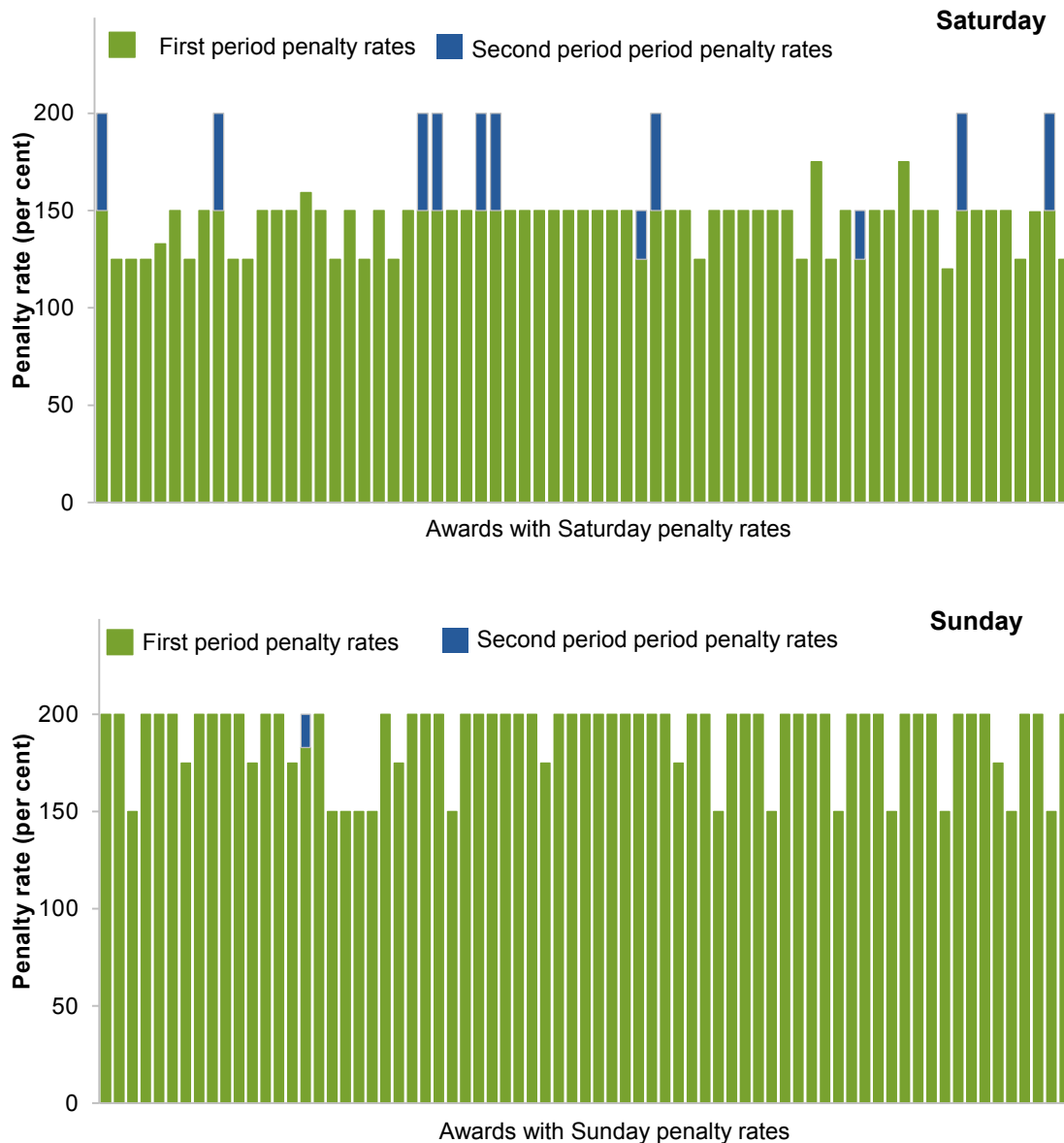
Where penalty rates apply, the most common rates are between 125 per cent and 150 per cent on Saturdays and between 150 per cent and 200 per cent on Sundays.

### Rates in the HERRC industries

There is considerable diversity of penalty rates in the HERRC industries. The rates are often at 125 per cent on Saturdays (table 10.1). However, there are marked inconsistencies for penalty rates on Sundays, and in a few instances, casual penalty rates do not take account of casual loadings (appendix F).

**Figure 10.1 Penalty rates for weekends (permanent employees)**

Rates for 67 awards (Saturday) and 73 awards (Sunday)<sup>a</sup>



<sup>a</sup> Penalty rates relate to additional payments during ordinary hours worked, when those ordinary hours fall on a Saturday or Sunday (and are shown using the third method described earlier). These rates do not include higher rates for overtime (hours in excess of ordinary hours) or shift work, which also attract premium rates of pay. In most awards, the penalty rate is the same regardless of the hours worked on weekends. However, some awards specify stepped rates, where the initial hours on a penalty rate day are paid at a lower rate, with payment rates rising if hours exceed the initial threshold. Where only a very small share of employees covered by an award would qualify for daytime weekend penalty rates, the award is not included above. For example, in the Live Performance Award, only striptease artists qualify for a Saturday penalty rate, and so this award is not recorded as having a Saturday penalty rate.

*Sources:* Information provided by the Department of Employment, Productivity Commission assessment of modern awards and the Fair Work Ombudsman (2015d).

**Table 10.1 Penalty rate arrangements for selected modern awards<sup>a</sup>**

Award applying in 2015	<i>Permanent</i>			<i>Casual</i>				
	<i>Percentage of permanent base rate</i>			<i>Percentage of permanent base rate</i>			<i>Relative business cost of casual to permanent employee<sup>b</sup></i>	
	Base rate	Sat	Sun	Base rate	Sat	Sun	Sat	Sun
	%	%	%	%	%	%	%	%
Restaurant Industry	100	125	150	125	150	150 (175) <sup>c</sup>	0	-14.3 (0)
Registered and Licensed Clubs	100	150	175	125	150	175	-14.3	-12.5
General Retail Industry	100	125	200	125	135	200	-10	-11.1
Hospitality Industry (General)	100	125	175	125	150	175	0	-12.5
Amusement Events and Recreation	100	100	150	125	125	175	0	0
Fast Food Industry	100	125	150	125	150	175	0	0
Pharmacy Award <sup>d</sup>	100	125, 150, 200	200	125	150, 175, 225	225	0	0
Hair and Beauty	100	133	200	125	133	200	-15.8	-11.1

<sup>a</sup> With the exception of the last two columns, the values shown are the percentage of the base rate for a permanent employee. Accordingly, the casual base rate is 1.25 times the permanent base rate. <sup>b</sup> The relative business costs of a casual is based on comparing the total labour costs for a business employing a casual worker for a given number of hours compared with a permanent employee (taking into account the extra costs of permanent employees and the casual leave loading). Wherever a weekend penalty rate for a casual is not equal to the sum of the casual loading and the permanent employee's weekend penalty rate, there is a bias in favour of one form of labour. In three of the awards, there is no bias, but in four, casuals do not receive the casual allowance on weekends and therefore there is a bias in favour of the employment of casuals. For example, in the hairdressing award in July 2015, the casual loading is \$4.75 per hour during weekdays so that the weekday rate is \$23.47 for casuals and \$18.99 for permanents. However, on a Saturday, the pay rate is \$25.26 for both types of labour (or a penalty rate of 133 per cent relative to the permanent rate). However, for neutrality of costs, the casual rate would instead be \$30.01 for a Saturday, so the effective casual employee cost is 15.8 per cent lower on a Saturday than permanent employees. <sup>c</sup> Level 1–2 employees receive a penalty rate of 150 per cent on Sundays, while Level 3–6 casual employees receive 175 per cent. <sup>d</sup> There are three penalty rates for Saturday, based on the time of working.

*Sources:* Restaurant Industry Award 2010; Registered and Licensed Clubs Award 2010; General Retail Award 2010; Hospitality Industry (General) Award 2010; Amusement, Events and Recreation Award 2010; Fast Food Industry Award 2010; Pharmacy Industry Award 2010; Hair and Beauty Industry Award 2010 accessed from the FWO (2015c, 2015d).

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## **There are already flexibilities in paying penalty rates**

While many characterise the treatment of penalty rates in awards as rigid, awards and enterprise agreements have some flexible features that mitigate this.

### **Annualisation**

One of the prime mechanisms for flexibility is that awards allow an employee to agree to be paid an annual salary instead of a weekly or hourly award pay rate, forgoing penalty and overtime rates (referred to as ‘annualised salary arrangements’).<sup>124</sup>

The implicit hourly rate of the salary must be such that the salary paid over a year would be sufficient to cover what the employee would have been entitled to if all their usual award overtime and penalty rates had been paid. For example, in the Restaurant Industry Award, salaried employees must be paid at least 25 per cent above the minimum wage as compensation.

Annualised salary arrangements provide some flexibility and certainty for employees and businesses. Employers currently often design work schedules to avoid weekend penalty rates. A business using an annualised salary can ensure that it can more flexibly allocate employees to weekend work depending on projected demand. Annualisation also reduces any incentives for an employee to reduce productivity during mainstream hours to obtain higher payments through weekend work or overtime (though the prevalence of such conduct is unknown). It is not clear how often these arrangements are used or if there are any obstacles to their take-up. The FWC does not have data indicating how often these arrangements are used, and nor has the Productivity Commission been advised of any obstacles to their take-up.

### **Using labour that does not require penalty rates**

Businesses also can use the labour of the owner manager, unpaid family members or employ subcontractors without any requirement for penalty rates.

The use of subcontractors in the key industries affected by penalty rates is limited because the terms of engagement will usually resemble that of an employee. Businesses in the relevant industries would typically set the hours of work, the manner in which it is undertaken, and provide any equipment, which collectively would be likely to fail the subcontractor test. So, while subcontracting arrangements may remove the need for paying

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<sup>124</sup> Annualisation must pass the BOOT. Arrangements that involve pay increases for workers in exchange for reduced penalty rates must not prejudice other classes of employees (most particularly casuals whose work is more likely to involve weekend work). This issue has arisen for an enterprise agreement formed between the Shop Distributive and Allied Employees’ Association (SDA) and Coles supermarkets.



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penalty rates to an IT consultant providing services to a major retailer on a Sunday, the scope to use them for routine tasks that involve a high degree of employer control (such as checkout services) is unlikely. Indeed, it is notable that subcontracting arrangements are rare in the retail, accommodation, and food services industries (comprising 2 and 1.1 per cent of employed persons respectively in these industries).<sup>125</sup>

Contributing family members (who are not paid) also play a small role in providing labour services (accounting for around 2 per cent of employment in the relevant industries).<sup>126</sup>

The owners of businesses are a more important source of labour, accounting for 8.6 per cent of labour in the retail industry and 9.6 per cent in accommodation and food services. They also play a more prominent role in weekend work (chapter 14 and appendix F). However, there is a limit to their role.

## 10.2 The origin of, and legislative basis for, weekend penalty rates

The modern awards objective of the *Fair Work Act 2009* (Cth) (FW Act) places some emphasis on the premise that weekend work is socially detrimental, as do various conventions of the International Labour Organization (ILO). The notion of Sunday as a desirable day of rest has also been commonly perceived as a labour relations matter in case law in Canada, the United Kingdom and the United States, as well as Australia (Law Reform Committee of South Australia 1987).

The history of the Australian penalty rate provisions, their logic and their role in preserving arrangements is important in understanding current laws and their interpretation by the workplace relations tribunal. They provide evidence about how industrial courts and tribunals have taken account of changing community expectations — a matter that has a significant bearing on this inquiry.

Regulated penalty rates for weekend work have been a longstanding feature of Australian industrial relations regulations. They arose as part of a broader objective to increase the scope for working people to engage in life beyond work and physical recuperation (Chapman 2010). They arose when long weekly hours were customary. For instance, standard full-time hours before overtime were 46 hours a week for both males and females in 1921 (Vamplew 1987). Weekend penalty rates, shorter standard working hours and overtime rates all originated from a similar social goal (though their incorporation in regulations occurred at different times and with varying scope).

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<sup>125</sup> This ranks as 17th and 19th among the 19 ANZSIC industries (ABS 2014, *Forms of Employment, Australia*, November 2013, Cat. no. 6359, released 7 May).

<sup>126</sup> Based on unpublished data extracted through TableBuilder from ABS (2015a).

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Penalty rates were intended to act as a deterrent against ‘long or abnormal hours being used by employers’ (the deterrence argument) and to compensate employees for working at inconvenient times where they were required to work (the compensation argument). As an adjunct, penalty rates have historically also been characterised as an incentive for businesses to avoid ‘slack management’ at times when people would reasonably have leisure.<sup>127</sup>

The early and pivotal decision was the decision by Justice Higgins of the Commonwealth Conciliation and Arbitration Commission (CCAC) in 1909 that penalty payments should be made at time and a half of ordinary hourly wages on Sundays, public holidays and for overtime (ACTU, sub. 167, p. 150 and the Australian Nursing and Midwifery Federation, sub. 132 p. 23).<sup>128</sup>

The true position seems to be that extra rate for all Sunday work is given ... because of the grievance of losing Sunday itself – the day for family and social and religious reunions, the day on which one’s friends are free, the day that is most valuable for rest and amenity under our social habits ... (Gas Employees Case (1919) 13 CAR 437 at 469 cited in Phillips 2012).

Subsequently, other decisions by various industrial tribunals extended penalty rates to Saturdays, increased Sunday rates and gave increasing emphasis to the compensation argument (DEEWR 2012b, pp. 4–5).

Sunday penalty rates up to 200 per cent applied in the Victorian retail industry from 1922.<sup>129</sup> In 1947, the CCAC determined that Saturdays should be paid at 1.25 times the ordinary rate under the benchmark Metal Trades Award and increased the Sunday penalty rate to 200 per cent, which widened the application of the Sunday rate (DEEWR 2012b; United Voice 2012b, p. 9). The CCAC noted the dual role of penalty rates in compensation and deterrence, but not in a doctrinaire sense:

... in one sense the use of the term ‘penalty’ as applied to such additional amounts is a misnomer, there is no question of punishment about the matter. But in another sense it expresses accurately enough the operation of the requirement of additional payment as, inter alia, a deterrent against calling upon employees to work in the circumstances in which the additional payment is required to be made. Most, if not all, of such requirements combine the element of compensation with that of deterrence. In some cases the one element predominates; in other cases the other: while yet in other cases there is no marked predominance of either. (CCAC Weekend Penalty Rates Case (1947) 58 CAR 610 cited in ACTU 2012b, p. 7)

In 1949, the CCAC reiterated the role of Sunday penalty rates in compensating for working unsociable hours ([1949] 62 CAR 558).

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<sup>127</sup> *Federated Marine Stewards and Pantrymen’s Association v. the Commonwealth Steamship Owners’ Association and Others*, (1909-10) 4 CAR 61.

<sup>128</sup> *Barrier Branch of Amalgamated Miners Association v Broken Hill Pty Company Ltd* (1909), (3 CAR).

<sup>129</sup> *Shop Distributive and Allied Employees Association v \$2 and Under* (2003), Full Bench of the AIRC PR941526, 17 January.

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These views were not peculiar to the Commonwealth. In 1950, the Industrial Commission of New South Wales enunciated its principle that:

In our opinion, additional rates for weekend work are given to compensate the employee having to work on days which are not regularly working days for all employees in the industry. The aim is to compensate for disturbance of social and family life and the full opportunity of religious observance, and in some cases to discourage employers working employees on non regular working days. Phillips (Re Engine Drivers General (State) Interim Award [1950] AR (NSW) 260 at 267 cited in Phillips 2012).

The increase in trading hours on weekends — an initiative that reflected changing community expectations about the role of weekends — had varying influences on judgments of the tribunal. In a major 1993 case, the Australian Industrial Relations Commission (AIRC) considered that:

While trading patterns, hotel and shop hours legislation and social habits have altered markedly over the last decade or so, the norm remains for evenings, weekends and public holidays to be the times when friends, families and social groupings, however constructed, are able to be together to enjoy social and recreational activities. Social dynamics are such as to mean that as religious observance on Sundays undergoes change so do some other forms of activity by way of supplementation. Shift work and work extending well outside the day time hours which thereby intrude regularly and substantially into such social, recreational or family/friend times and the many aspects of life akin to them, causes, in the long standing view of the Commission, an equivalently substantial deterioration in the amenity of life. It is this that is to be recognised. (AIRC [1993] 541/1993)

A notable aspect of this decision was that while the AIRC acknowledged that the religious observance had declined, it asserted that other equally important social interactions had taken their place.

In a 1999 AIRC decision, Commissioner Hingley ([1999] AIRC Q9229, p. 18) said that a concern of setting lower penalty rates would be that:

... current or future employees with little or no bargaining power may be obliged to work extended evening, Saturday or Sunday hours against their domestic responsibilities or personal convenience as ordinary hours to retain or gain their employment.

This is one of the few explicit acknowledgments by tribunals that the issue of bargaining power was a decisive issue (a question further considered in chapters 12 and 13). Hingley went on to conclude that:

While there is clear evidence of social change in respect of increased consumer desire to shop weekends especially Sundays and shopping becoming a part of contemporary leisure lifestyles, for a variety of reasons it does not follow that retail employees should or do acquiesce in jeopardising their preferred lifestyle. [Indeed] the evidence suggests full-time and regular part-time employees want and need protection from the requirement to work extreme or unsociable hours notwithstanding penalty rate entitlements.

Nevertheless, there has been an emerging recognition by tribunals that the ‘right’ rates are hard to discern and that the social and economic precepts that provided the original basis

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for penalty rates are not immutable and, therefore, nor should be the level and role of penalty rates. For example, Justice Giudice of the AIRC noted in a judgment relating to the retail sector that the lifting of trading hour restrictions to encompass a wider range of retailers was relevant to the desired rates:

There is a further reason why too much weight should not be given to the penalty which attaches to ordinary hours of work on Sundays in exempt shops [those not originally subject to trading hour restrictions] in the parent award. The penalty rate of 100% was fixed at a time when work was not permitted in ordinary hours on Sundays in non-exempt shops [those unable to trade on Sundays on an equivalent basis]. The decision to permit work in ordinary hours on Sunday for all shops is a relevant change in circumstances which should be given due weight. ... proposition that the disability of Sunday work is four times the disability of Saturday work cannot be accepted. For this reason, a penalty of double time is excessive. ([2004] AIRC PR941526)

He reached a parallel conclusion regarding the comparison between Sunday rates and weekday evening rates.

Similarly, the South Australian Industrial Relations Commission in a hearing into an award variation of the South Australian Retail Award concluded:

... that the evidence generally demonstrates a significant social disability associated with Sunday work. In many senses this has not been in dispute. The issue is the level at which it should be compensated, the effect of the 'voluntary' nature of Sunday work in this case and the need to balance the social disability against the other factors. (Retail Industry (South Australia) Award - Variation [2004] SAIRComm 54, 21 October 2004)

## **Deterrence has become an irrelevant argument for penalty rates**

While the early industrial cases emphasised the goal of penalty rates as a deterrent against employers opening at asocial times (Dawkins, Rungie and Sloan 1986, p. 565), this view is now largely seen as dated. The union movement itself has also agreed that deterrence is no longer a relevant motivation for penalty rates (ACTU 2012b, p. 7). Australian governments and the FWC have instead recognised the legitimacy of businesses opening on weekends. For example, in a 2004 AIRC decision, Watson and Raffaelli observed:

In our view, in the context of the reality that retailing in Victoria is a seven-day a week industry, as noted in the January 2003 decision,[44] the Sunday ordinary time penalty in the roping-in award should be directed to the compensation for the disabilities upon employees and should not be directed to deterring the working of Sunday ordinary time hours. ... There appears to be no significant divergence between the parties in the present matter in respect of that approach. (PR 941526 [2003] AIRC 1504).

In its recent assessment of penalty rates in the restaurant industry, the FWC ([2013] FWC 7840) drew on this judgment, reinforcing its application. Notably, the modern awards objective (s. 134 of the FW Act) only refers to a need for remuneration for asocial hours.

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In principle, there might have been downward pressure on penalty rates to reduce the deterrence effects that were once a principal rationale. However, rates have not fallen in response to the shift in the rationale, with the compensation argument still being perceived as a generally sufficient basis for current rates.

Indeed, from a legislative perspective, the scope for the imposition of penalty rates has widened. In 2013, a provision was added to the modern award objective of the FW Act, that specified the need for compensation for working at asocial hours (s. 134 (1)(da)). Section 134 of the FW Act states that:

(1) The Fair Work Commission must ensure that modern awards, together with the National Employment Standards, provide a fair and relevant minimum safety net of terms and conditions, taking into account: ...

(da) the need to provide additional remuneration for:

(i) employees working overtime; or

(ii) employees working unsocial, irregular or unpredictable hours; or

(iii) employees working on weekends or public holidays; or

(iv) employees working shifts ...

The FWC ([2014] FWCFB 1788) has characterised the proper construction of s. 134 (1)(da) as a ‘contentious’ issue among various stakeholders. The question of the desirability of the new provision is discussed in chapter 15, and its importance rests on whether it creates a presumption that penalty rates should apply across all awards.

## **Community expectations and the industrial umpire**

It is too simplistic to characterise the development of Australia’s industrial relations system as just the product of the competing interests of organised labour and employers, as important as this dynamic has been. Community norms — reflected in the political process, the decisions of courts and tribunals, and the perspectives of the various protagonists — have been a major driver of big shifts in the system. Increased standards for employees — for reduced hours, greater recreational and other leave, gender and racial equality, rights on employment termination, amongst others — have gradually emerged — in the main through the decisions of the relevant industrial umpires, rather than statute (table 10.2).

However, the economic environment and community attitudes that provided the original *basis* for penalty rates have changed. It is entirely consistent with the historical conduct of the industrial regulator to take seriously a shift in community norms that is incidentally favourable to employers, as it has shifts that in the past that have favoured employees.

There are a few signs that the industrial umpire is now moving in this direction, as suggested by some of its recent decisions.<sup>130</sup>

**Table 10.2 Industrial relations and social norms<sup>a</sup>**

<i>Benefit</i>	<i>Case or law</i>
The economic needs of employees	The Harvester Case CCAC (1907) 2 CAR 1
Partial recognition of gender equality	Fruit-pickers Case, CCAC (1912) 6 CAR 61
Penalty rates	Gas Employees Case (1919) 13 CAR 437
The 44 hour week	The 44 Hour Week Case, CCAC (1927) 24 CAR 755
One week paid leave	1935 (1936) 36 CAR 738 at 760
2 weeks paid annual leave	1944 (Annual Holidays Act 1944 NSW)
The 40 hour week case	Forty Hour Week Case, CCAC (1947) 59 CAR 581
3 weeks paid annual leave	1963, CCAC 1963 Annual Leave Inquiry
Equal pay for Aboriginal Stockmen	The Cattle Industry Case (1966) 113 CAR 651
Equal pay for equal work for women	The 1969 and 1972 Equal Pay Cases (1969) 127 CAR 1142 and (1972) 147 CAR 172
4 weeks paid annual leave	1974 (general ruling by the Industrial Commission of NSW)
Prohibited racial discrimination	Racial Discrimination Act 1975
Maternity leave	Maternity Leave Case (1979) 218 CAR 120
Redundancy and unfair dismissals	The 1984 Termination, Change and Redundancy Case (1984) 8 IR 34 and (1984) 9 IR 115) and the 1987 Ranger Uranium Case (1987) 163 CLR 656
Adoption leave	(1985) 298 CAR 321
Paternity leave	The Paternity Leave Test Case, AIRC J3596, 26 July 1990
Family Leave	The Family Leave Test Case (1994) 57 IR 121
National public holidays	1994 Public Holidays Test Case 1994, AIRC 1352/94, L4534
Superannuation	1994 Superannuation Test Case (1994) 55 IR 447
Personal/Carers' Leave	1995-96 Personal/Carers' Leave Test Case (1995) 62 IR 48 (1996) 66 IR 138, and (1996) 66 IR 176
Casual conversion to permanency	The 2000 Casual Case, AIRC, M1913 Dec 1572/00 S Print T4991
Parental leave for casuals	2001 Parental Leave for Casuals Case, AIRC, PR904631
Avoidance of unreasonable hours	2002 Working Hours Case, AIRC, PR072002
Severance Pay	2004 Redundancy Case, AIRC, PR032004 and PR062004
Anti-bullying	2014 (s. 789FD of the FW Act 2009)

<sup>a</sup> This is not intended to be comprehensive or to list only Commonwealth cases.

Sources: AIRC (2006), Australian Parliamentary Library (2015), Hamilton (2012), and the Sir Richard Kirby Archives, Kirby (1976, 2004).

<sup>130</sup> Some conflate community expectations based on opinion surveys of whether penalty rates should be paid or not with the changes in community and consumer preferences for commercial activities on weekends that *underpin* penalty rates. In the former context, it is easy to elicit different answers to the desirability of penalty rates for people, depending on the context of the questions and on whether it has been made clear to them the consequences of their choices in terms of costs or access to services. Community and employee preferences can be better examined by looking at their actual choices over time (chapter 11).

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## Recent changes to weekend penalty rates are revealing

The shift to modern awards in 2010 harmonised several state-based awards (excluding those in Western Australia) and collapsed many specific awards into ones with wider industry coverage. In turn, this led to significant changes in some penalty rates, although transitional arrangements meant that these changes were made over several years. The net impact on labour costs is not easily established because modern awards not only changed penalty rates, but also other costs (PC 2011a, pp. 334–336).

The variations in penalty rates between and within industry and state awards prior to award modernisation illustrates that a significant degree of subjectivity underpinned the earlier determination of penalty rates by state and industry.<sup>131</sup> This is exemplified by some striking differences over time and between the jurisdictions in various fast food industry awards (table 10.3):

- Prior to the modern award, for example, there was no difference in the penalty rates for permanent employees on Saturdays and Sundays in south-east Queensland (for employees covered by the Fast Food Industry Award South Eastern Division 2003) and, indeed, no difference in casual rates regardless of the day of the week worked. Yet the same award as applied to the rest of Queensland involved higher penalty rates for all employees and provided casual workers with weekend rates higher than usual hours of working on Mondays to Fridays. Unfortunately, there was no analysis of the impacts of these variations on employment or business outcomes.
- Different jurisdictions can treat casual workers quite differently. In the 2003 South East Queensland award, the pay rate for casuals did not vary by the day of the week — so the premium wage on Sundays was zero (or an effective penalty rate of 100 per cent).<sup>132</sup> In South Australia, the casual wage rate for working on a Sunday was twice that of a weekday (an effective penalty rate of 200 per cent)
- Rates could vary by whether work was undertaken before or after noon.
- Award modernisation sometimes led to decreased penalty rates (as in South Australia and the Northern Territory). If nothing else, this suggests that regulatory changes do not necessarily have to embed the highest conditions prevailing at the time of the reforms.

The existing differences between awards covering similar employees (as in table 10.1), and the historical differences in awards covering identical employees (table 10.3), shows that

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<sup>131</sup> While penalty rates are described in different ways, this report uses the most common nomenclature, which is 100 times the pay rate on a weekend relative to the pay rate on a weekday. That is, the penalty wage rate is calculated as the percentage of the base wage rate for a permanent employee.

<sup>132</sup> The effective penalty rate for a casual is the ratio of the relevant casual weekend wage rate to the casual weekday rate (times 100). Standard penalty rates are typically expressed as the ratio of the casual wage rate on a weekend compared with the weekday wage rate of a permanent employee (AHA 2015). There is nothing wrong per se with such a definition so long as it is understood that the casual penalty rate is inclusive of the casual loading.

the various industrial regulators have not given meticulous consideration of the social and economic impacts of the selected rates.

Penalty rate determination by the FWC and its predecessors is an art borne of history, precedent, compromise, and the lack of a coherent overarching set of principles. This is no different from many other features of awards. The FWC has already advocated a more coherent framework for considering some of the major features of awards (chapter 8).

**Table 10.3 Fast food awards over the years**

	<i>Casual loading</i>	<i>Saturday penalty rate (permanent)</i>	<i>Saturday [penalty rate (casual)</i>	<i>Sunday penalty rate (permanent)</i>	<i>Sunday penalty rate (casual)</i>
	%	%	%	%	%
Fast Food Industry Award 2010 (The current award)	25	125	150	150	175
Modern Award Shop Employees (State) Award NSW	15	125	115 plus a fixed \$ loading	150	150
National Fast Food Retail Award 2000 VIC	25	125	150	175	175
Fast Food Industry Award - State (Excluding South-East QLD 2003) <sup>a</sup>	25	150	175	150	175
Fast Food Industry Award - South Eastern Division 2003 (QLD)	23	125	123	125	123
QLD Retail Take-Away Food Award - South-Eastern Division 2003	23	150	173	150	173
Delicatessens, Canteens, Unlicensed Cafes and Restaurants etc. Award SA	20	125 up to midday; 150 after midday	145 up to midday; 170 after midday	200	220
Fast Food Outlets Award 1990 WA <sup>b</sup>	25	..	..	..	..
Restaurant Keepers Award TAS	25	125	150	175	175
Liquor and Allied Industries Catering, Cafe, Restaurant, etc. (Australian Capital Territory) Award 1998	25	125	150	175	175
Hotels Motels Wine Saloons Catering Accommodation Clubs and Casino Employees (Northern Territory) Award 2002	25	150	175	175-200 subject to duties	200

<sup>a</sup> For full time workers. No explicit specification for part time workers. <sup>b</sup> There is no specification of standard penalty rates. Overtime rates may apply. These are 150% for FT/PT employees on Saturdays until 12 noon, and 200% for FT/PT employees after 12 noon on Saturdays and any time Sunday. Casual employees receive an additional 25 percentage points on these loadings.

Sources: Various awards obtained from the Fair Work Ombudsman (2015c) and DEEWR (2012b, pp. 17–19).



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## There has been recent downward pressure on penalty rates in one key industry

As part of the transitional two year review of modern awards, the FWC recently examined the issue of penalty rates (amongst other conditions) for restaurant workers following an application for a variation to the Restaurant Industry Award 2010 from the Restaurant and Caterers Association and other business groups.

Business groups proposed that penalty rates should only apply for the sixth and seventh consecutive day of work — similar to systems in place in some OECD countries. The implication would be that any person working five days or less per week, regardless of when those days fell, would receive ordinary time pay rates. As an alternative, the proponents also advocated equalisation of Saturday and Sunday penalty rates of 125 per cent for non-casuals and 150 per cent for casuals ([2013] FWC 7840).

The FWC initially dismissed both proposals. It noted that the ‘disabilities’ associated with working weekends and evenings remained, and that this had not changed since the making of the award. The FWC also noted that such a change would have a significant negative effect on the relative living standards of those affected.

However, on appeal, the majority of the FWC full bench reduced penalty rates for the least skilled workers — level 1 and level 2 casual workers.<sup>133</sup> It held that the combination of the casual loading and weekend penalty rates overcompensated inexperienced and transient employees, and that the high rate at the time was ‘more than is required to attract them to work on that day’ (para 138 of the judgment). The FWC changed the award so that Sunday penalty rates for level 1 and level 2 casual workers were reduced from 175 per cent to 150 per cent of the ordinary rate, effectively eliminating the casual loading for Sunday work. The FWC stated that this reduction in penalty rates would be less likely to affect long-term career restaurant workers, who are generally not employed at lower levels.

In reaching its judgment, the FWC still maintained that there was a special disability associated with working on Sundays, and that reducing penalty rates for all classifications would not have significant positive employment effects. In that respect, the decision was not a qualitative departure from previous award decisions or their inherent logic — which embody some fundamental contradictions. Nevertheless, the decision showed a preparedness to move penalty rates down if the circumstances — as the FWC saw them — justified that.

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<sup>133</sup> See [2014] FWCFB 1996. The minority judgment considered Sunday penalty rates were too high for any employees in the industry.



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# 11 The shift to a seven day consumer economy

## Key points

- There has been growing demand for consumer services over weekends.
  - For some parts of the economy, Sunday is becoming the new Saturday.
  - Over the three decades from the early 1980s, the share of weekly retail trade on Sundays increased from 4.3 per cent to 12.3 per cent, reaching a share close to that of some weekdays.
  - For one large supermarket chain, Sunday trading now exceeds several weekdays.
  - Foot traffic on Sundays in major shopping centres throughout Australia grew by more than double the rate of any other day of the week from 2009 to 2014.
- All the evidence shows that weekend employment is far more important in the hospitality, entertainment, retail, restaurant and cafe (HERRC) industries.
  - For example, one dataset suggested that the prevalence of weekend working in each of the retail, accommodation and food, recreation and art, and personal services industries, was around double or more than other industries.
  - The likelihood of people *only* working on weekends can be as much ten times higher in the HERRC industries than in other industries (depending on the relevant HERRC industry).
- The greater prominence of weekend trading is not a sudden phenomenon, but has reflected a multitude of social and economic trends, including:
  - rapidly rising female participation rates, especially among married women, which has necessitated increased access to services outside the normal working week
  - the lifting of many of the most restrictive shopping hour regulations
  - the decline in religious observance. In 1911, only 4 in every 1000 people professed no religion. By 2011, this had grown to 220 per 1000, or a more than a fifty-fold increase.
  - rising household incomes, which has stimulated demand for discretionary consumer services, such as restaurant meals
  - a trend towards shopping as a recreational pursuit in its own right and the role of shopping centres as community hubs.
- Various disruptive technologies — such as automation and the online provision of consumer goods and services — are likely to affect the demand for weekend workers if their wage rates are too high.

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## 11.1 More demand on weekends for discretionary consumer services

For many years, the community did not accept weekend work where seven day operations were neither essential for the community nor required to avoid large costs. Several developments over the past 30 years have changed this historical pattern.

There has been a growing demand for the supply of HERRC services over the weekend. It is precisely in these industries where penalty rates are a controversial issue. In such industries, the customer is buying convenience and variety as much as the good itself, and cost increases frustrate the extent to which those consumer preferences can be met by businesses.

Indeed, even as far back as 1980, the Confederation of Australian Industry argued that there were ‘discernible social trends towards greater flexibility in life patterns generally, and working patterns in particular’ (CAI 1980, p. 13). As noted in chapter 10, such changing trends have also influenced the thinking of the various industrial relations tribunals, and have led to the rejection of the deterrence rationale for penalty rates, and on a few occasions, the reduction of Sunday penalty rates. Nevertheless, the industrial relations system has not sufficiently caught up with this shift in consumer expectations and social norms about the importance of access to discretionary consumer services, a point made by a variety of participants in this inquiry.<sup>134</sup>

In 1992, women used to spend 50 per cent more time buying goods and services on each weekday than each weekend day. The latest data (for 2006) suggest that gap has vanished, and in the case of men, weekend days are more important for this activity than in the past.

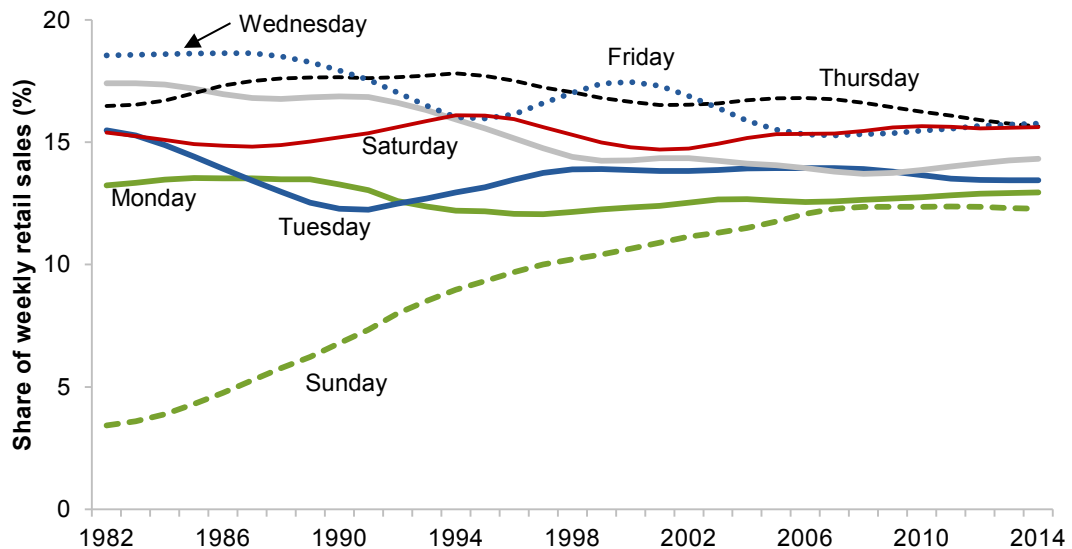
In retailing generally, Sundays have gone from a relatively small share of weekly sales to a share closer to other days (figure 11.1). Sunday trading for some retail outlets accounts for up to 25 per cent of revenue (ACRS 2012). Moreover, there is some evidence that people are making more frequent trips to supermarkets and taking advantage of their longer trading hours.

Information from a major credit card provider indicated that in 2014, the average daily transaction rate is now largely the same for weekdays and weekends. The share was very similar to that applying in 2012, consistent with the last few years of data in the ABS retail trends data above. Longer term transaction data were not available.

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<sup>134</sup> For example, the Busselton Chamber of Commerce and Industry (sub. 65, p. 2) and VECCI (sub. 79, p. 19).

Figure 11.1 **Retailing trends by the weekday**  
Share of weekly retail sales, 1982 to 2014<sup>a</sup>



<sup>a</sup> Based on estimating trading days effects on ABS monthly retail data.

Source: Unpublished data provided by the ABS and based on Campbell and Chen (2015).

In major shopping centres, foot traffic *growth* for Sundays has been far stronger than any other day (figure 11.2). Other evidence also suggests that where trading hour restrictions do not apply, the number and value of supermarket shopping trips on Saturdays is more important than any other day.

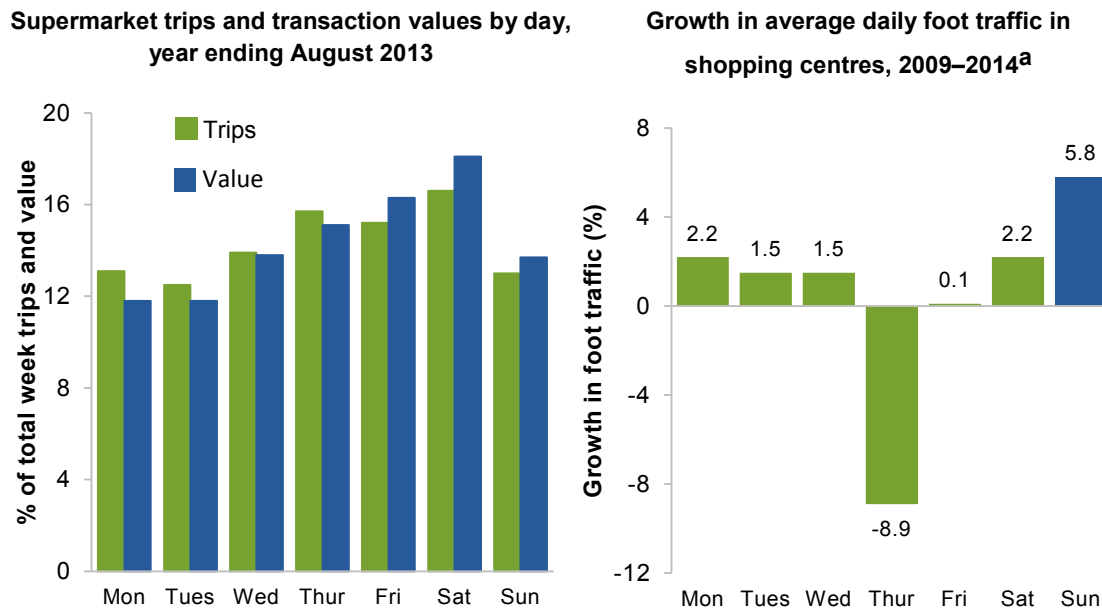
Data from Coles supermarkets in Victoria also suggest trading is highest on Saturdays, but show Sunday trading exceeds some weekdays (ERA 2014). Survey data for 2013 suggest that Sunday was increasingly becoming the ‘new Saturday’ for trips to the supermarket, with 18 per cent of Australians making Sundays their primary shopping day (KPMG, Quantum and Woolworths 2013). Restaurant and Catering Australia (sub. DR359, p. 14) indicated that for high-end restaurants, Sundays were the third busiest day by patronage, after Saturday and Friday. It said that average expenditures in high-end restaurants were \$51 compared with \$59 on a Saturday and \$56 on a Friday. It cited survey data that consumers see little differentiation between dining on Saturdays and Sundays, and that international visitors also expect seven day access to such services (*ibid*, p. 15).

Some participants noted that there was an incipient demand for Sunday trading that was only partly revealed in present statistics. The crux of the matter is that some jurisdictions continue to impose trading hour restrictions for earlier times on Sundays:

In addition to the general customer shift and demand towards Sundays noted above, our analysis of occasional ‘extended’ trading hours in certain jurisdictions highlights that there is also demand for earlier trading hours. As an example, while Sunday trading is limited for larger

retailers to 11am-5pm in Adelaide and Perth, these hours can be extended during the Christmas period. In this regard, the SA Government announced on 13 November 2014 that extra trading hours had been granted across Adelaide “to provide greater flexibility for shoppers in the lead up to Christmas”. This enabled a 9am opening time instead of the normal 11am opening for the following five Sundays: 30 November, 7 December, 14 December, 21 December and 28 December. We have analysed SA data from our members, and the snapshot (see below) highlights that an average 13% of daily customer foot traffic was from the ‘extended’ 9am-11am period. Demand during this earlier timeframe amounts to thousands of consumers across the five Sundays, who obviously found this earlier period convenient to visit shopping centres and do their shopping. (Shopping Centre Council of Australia, sub. DR342, pp. 1–2).

Figure 11.2 Growth and significance of shopping by weekdays



<sup>a</sup> The Shopping Centre Council of Australia obtained six years of data (between 2009 and 2014) pertaining to centre foot traffic for ‘stabilised’ centres, that is those that are unaffected by development from the beginning to the end of the analysis period, across most states. Further, data were used from centres that were already subject to seven day trade and therefore could be considered ‘super stable’ centres. Using 2009 as the ‘baseline’ for the analysis, the change in foot traffic was then calculated over the following five years. The data relate to shopping centres owned by one major shopping centre provider. The results exclude Western Australia, where Sunday trading has only been permitted since 2012, and also exclude the ACT, Tasmania and the Northern Territory either because they did not have stabilised centres, or the dataset was not sufficiently reliable.

Sources: Data from Aztec (2014) and information provided by the Shopping Centre Council of Australia (sub. DR342, p. 1) for supermarkets and shopping centres respectively.

The above data relate to the time taken for transactions, but ignores browsing for goods and services, and the time taken to consume some services (for instance, in eating lunch or going to a gym compared with the time taken in paying for such services). While there is no information about such demand patterns over time, there are official figures for one year (2006) by the day of the week. These show that the time spent by the average

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consumer in commercial enterprises is around one hour a day during weekdays, nearly two hours on Saturdays and 1.25 hours on Sundays.<sup>135</sup> Unfortunately, there is no contemporary matching data, but the data on sales and foot traffic shown above strongly suggest that time spent in commercial enterprises on weekends will have increased further in the subsequent nine years.

While online provision of some services (see below) has allowed some businesses to reduce their physical labour presence on weekends when labour costs are high, this is not true for all:

A particular issue for the Hardware, Building and Garden Supplies sub-category is that many customers prefer to make their purchases at a bricks and mortar store, as opposed to online. Indeed, 73 per cent of all hardware customers make every purchase in store, as opposed to the industry average of just 61 per cent. Further, 40 per cent of hardware customers do all of their product research in store, as opposed to 37 per cent for all other industries. Therefore, unlike other sectors of the retail industry, where consumers are spreading the research and purchasing experience across a multitude of channels, Hardware, Building and Garden Supplies, continues to be a labour intensive sub-category, with a proportionately high level of customer interaction, at all stages of the sales process. Based on this evidence, hardware stores have a customer that has a preference to shop at non-traditional hours, but also highly values the personal experience and customer support, of researching, and purchasing their products in store. This presents a unique challenge for hardware stores in the digital age, as they are not capable of maximising the efficiency and productivity gains from omni-channel shopping because customers in this category still prefer purchasing directly from a bricks and mortar retail. (Hardware Federation of Australia, sub. DR316, p. 7)

## 11.2 More workers on weekends

Growing consumer demand on weekends has been mirrored by increased overall employment at this time (appendix F). The HERRC industries that are the focus of this chapter have developed different employment patterns because of these shifting patterns of consumer demand. Unlike many other goods and services, many HERRC services must be delivered at the time of consumption and in person, such as eating a meal or going to a live musical performance. And convenience services — such as much of retail — are defined as ones that must be available at a time that suits the particular circumstances of a consumer. Accordingly, employment in the HERRC industries is much more strongly focused on weekends than most other industries (figure 11.3 and tables 11.1 and 11.2).<sup>136</sup> Not only does a greater share of their workforces work on weekends, but a non-trivial share of the workforce only works on weekends. The latter distinguishes them from industries — like health and mining — where weekend work is common, but is usually allied to working at routine times on weekdays too.

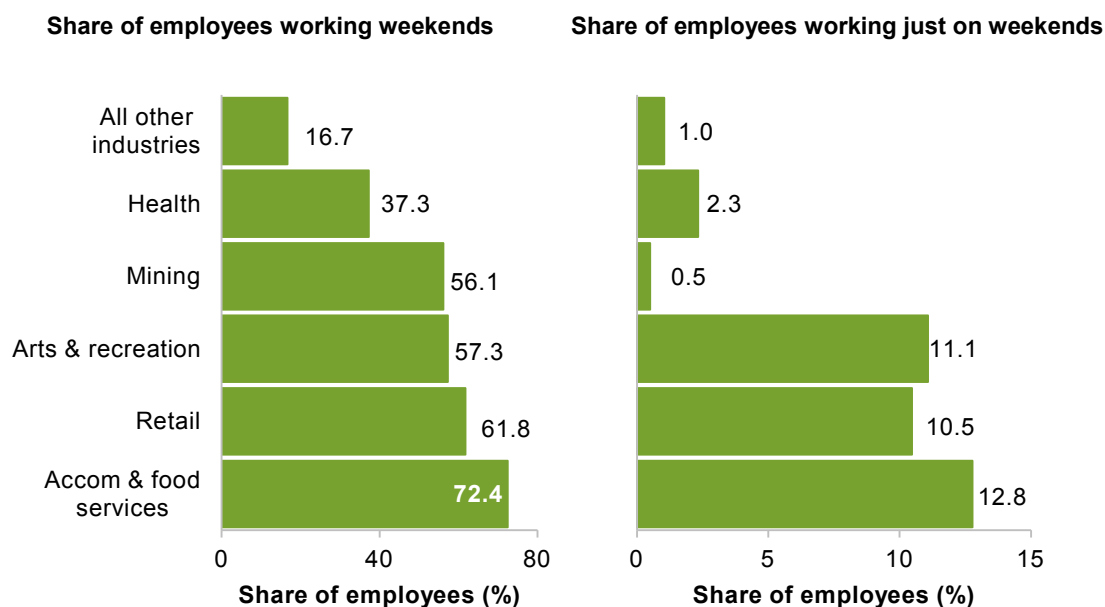
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<sup>135</sup> This is based on the 2006 ABS *Time Use Survey* and covers the time spent by people in ‘commercial or service areas’, establishments for ‘leisure, culture or sport’, and ‘eating and drinking locales’.

<sup>136</sup> The two different surveys show marked variations in the extent to which employees work *only* on weekends (but are very similar in terms of people working weekends).

**Figure 11.3 The importance of weekend work by industry**

Ratio of workers employed on weekends compared with weekdays, 2013<sup>a</sup>



<sup>a</sup> The data relate to one month of an employee's working time arrangements. Working weekends includes people working weekends only and people working weekends and weekdays. Industry groups are based on ANZSIC 2 digit codes.

Source: Analysis of wave 13 of HILDA.

**Table 11.1 An alternative viewpoint on weekend work in the HERRC industries**

Share of employees working on weekends<sup>a</sup>

Industry	Weekdays only	Weekends only	Both weekends and weekdays
	%	%	%
Retail	46.9	5.4	47.7
Accommodation & food	29.8	5.6	64.6
Arts & recreation	43.5	7.2	49.3
Rental & personal services	58.5	2.1	39.4
All other	78.2	0.6	21.2

<sup>a</sup> The retail industry is defined as the sum of the motor vehicle, parts and fuel retailing, food retailing, other retailing and retail trade nfd (based on ABS industry codes). The accommodation and food industry is defined as the sum of accommodation, food and beverage services, and accommodation and food services nfd. The arts and recreation industry is defined as the sum of heritage and arts activities, sports, recreation and gambling activities, and arts and recreation services nfd. The rental and personal services industry is defined as the sum of rental, hiring, and real estate services; and personal and other services. All other comprises all other industry groups.

Source: Analysis of unpublished data from the ABS 2008 *Forms of Employment* CURF.



**Table 11.2 Who works when?**

Share of employees working on given days by industry, 2008<sup>a</sup>

<i>Industry</i>	<i>Saturday</i>	<i>Sunday</i>	<i>Monday</i>	<i>Tuesday</i>	<i>Wednesday</i>	<i>Thursday</i>	<i>Friday</i>	<i>Varies</i>
	%	%	%	%	%	%	%	%
<b>ABS Forms of Employment Survey 2008</b>								
Retail	29.4	15.3	57.3	57.4	57.5	61.2	58.6	20.1
Accomm & food	37.7	27.1	37.3	42.7	46.5	49.2	52.8	28.8
Arts & recreation	23.9	14.2	53.1	54.2	54.7	54.8	53.4	28.6
Rental & personal services	27.8	10.7	67.8	71.5	75.8	77.4	71.9	12.0
All other	10.1	5.8	81.2	82.2	82.2	82.2	79.9	12.3
<b>ABS Time Use Survey 2006</b>								
All HERRC industries	43.1	27.9	58.1	61.1	63.2	67.5	67.1	na
Other industries	22.7	12.2	72.5	85.2	88.5	87.9	82.7	na

<sup>a</sup> The industry groups are defined as above. The ABS Time Use Survey will pick up people who sometimes work weekends because this captured under 'varies' in the Forms of Employment Survey.

Sources: Analysis of unpublished data from the 2008 ABS *Forms of Employment* and 2006 *Time Use CURFs*.

The share of employees working on Sundays (either just that day or, more usually, in combination with other days of the week) is also relatively high for the HERRC industries (table 11.2). Indeed more than 25 per cent of employees in the accommodation, food and beverages industry work on Sundays, a rate that is more than four times higher than that in non-HERRC industries.

A significant long-run shift in the labour market — as described in chapter 2 — is the growing rate of employment of people while they are studying. The contribution of students as a source of labour diverges by industry and by type of working arrangement. The expansion of the HERRC industries associated with relaxed trading hour restrictions and greater consumer preferences for these services has created a new labour market for flexible labour, which is ideally suited to students wanting part-time employment, especially during weekends (table 11.3) and to people with child-caring responsibilities during weekdays. Over 90 per cent of employees who only work on weekends in the accommodation and food services industry are students. The Australian Industry Group cited survey evidence about one segment of this industry, the fast food industry, which showed that 67.4 per cent of employees in this industry (working at any time of the week) identified as full-time students (AiG, sub. DR346, pp. 39–40). Many of these were still at school, as suggested by their age profile. 24.8 per cent were aged 15 years old, 54.5 per cent were 16 years or younger and 81.6 per cent were younger than 20 years.

The labour market represented by these types of employment arrangements is entirely different from the one in which penalty rates were first forged (when most jobs were male, full-time and when people did not generally work and study).

**Table 11.3 Role of students as suppliers of labour on weekends**  
By industry, 2013<sup>a</sup>

	<i>Both weekends and weekdays</i>	<i>Only weekdays</i>	<i>Only weekends</i>
	%	%	%
Accommodation & food services	43.5	34.6	92.5
Retail	32.6	15.3	88.8
Arts & recreational services	19.9	24.6	50.9
Mining	6.5	14.7	0.0
Health	18.8	16.0	30.7
Other industries	14.2	11.4	61.4
Total	23.6	13.2	76.0

<sup>a</sup> The shares are of the totals for a given industry and type of working arrangement. For example, 92.5 per cent of employees who worked only on weekends in the accommodation and food services industry were part or full-time students.

Source: HILDA wave 13, 2013.

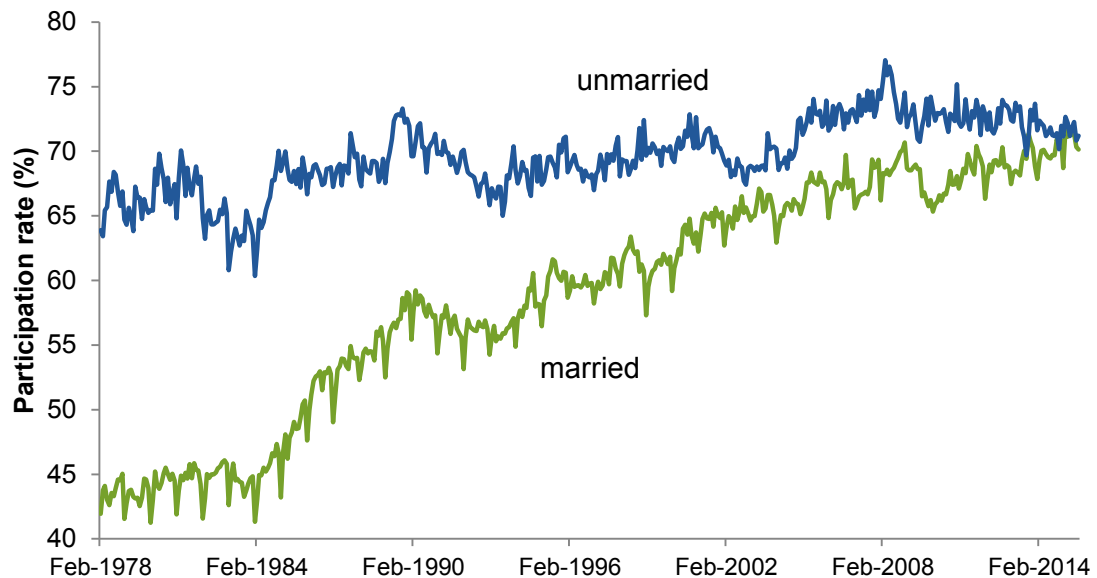
## 11.3 Many interrelated factors lie behind these changing patterns

*Female workforce participation* rates have increased steeply over the past decades (chapter 2), particularly for married females (figure 11.4). That is a continuation of a trend that has grown in impetus over a century. In 1921, females contributed less than one fifth of the workforce, it was close to half by 2015.<sup>137</sup> This is testimony to a massive change in labour markets that has not been fully recognised in modern workplace relations, a point made to this inquiry (Work and Family Policy Roundtable and Women and Work Research Group, sub. 130, p. 8). Women have long been the dominant purchasers of food and other weekly necessities. Their growing participation in the workforce has meant that families have needed other times to perform these domestic tasks.

In turn, this has provided greater *scope* for men to perform tasks that were once almost universally performed by women. Nevertheless, men have increased their time engaged in household errands (of which a prime component is shopping). This may have been partly caused by changing gender roles, but also by the capacity for them to also shop at times that do not clash with typical work times (Wilkins 2014, p. 99ff). Moreover, as norms about female workforce participation have changed, it has made it easier for businesses to find labour for weekend work.

<sup>137</sup> Based on ABS 2015, *Labour Force, Australia, Detailed*, table 3, Cat. no. 6291.0.55.001 and Withers, Endres and Perry (1985).

Figure 11.4 Participation rates by women aged 25-34 years



Source: ABS 2015, *Labour Force, Australia, Detailed*, Cat. no. 6291.0.55.001, released 17 September.

More generally, *social norms* about shopping times have shifted. Shopping has become a recreational pursuit in its own right for families and friends, while shopping centres are places for social interaction more generally. In one survey, 39 per cent of people nominated the local shopping centre as the most important gathering place in their community, compared with 11 per cent for the local community centre, 16 per cent for a community park or sports ground and 19 per cent for a local club or hotel (McCrinkle et al. 2014). Many commercial services are inherently social in character — such as having a meal or a drink with others. Consequently, the increase in the number of businesses open on weekends has its own social spillovers. The availability of entertainment, restaurant and cafe services on weekends and evenings produces lively social places and liveable cities (ACRS 2012).

In addition to the changing role of women and work, a likely contributor to these changing social mores has been a steady *reduction in religious observance*. The number of people reporting no religion in Australia has markedly increased over the past hundred years. In 1911, only 0.4 per cent of the Australian population chose the option ‘no religion’ on their Census form. This rose to 7 per cent in 1971, 15 per cent in 2001, and 22 per cent by 2011, or just under 4.8 million Australians (ABS 2013c). The trend was particularly strong for younger people, who contribute disproportionately to labour supply on weekends. Moreover, other religions for which Sunday is not a day of worship are becoming increasingly prevalent in Australia. Of those people who profess Christian belief, only one in seven actually attended church regularly in 2013, so religious belief and particular observance of it at a given time and place are different things. The average time spent by

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people on religious activities on weekends — whether communally or otherwise — fell by more than 25 per cent from 1992 to 2006 (ABS 2008a).

The changing prevalence of religious beliefs and the times when people seek to express their convictions communally is not just important because it has affected what people want to do on weekends. It is also relevant because industrial relations tribunals have given this issue considerable weight in their decisions to limit business activity on days of religious importance (particularly Sundays), or to require higher levels of wages as compensation for forgone religious observance (see below).

Changing norms about the acceptability of buying goods and services on weekends have both led to, and been further encouraged by, the softening of trading hour restrictions. Currently, all states but Western Australia, South Australia and Queensland have deregulated weekend trading hours. Trading hour restrictions have been progressively relaxed in states that still limit weekend trading (Harper et al. 2015, p. 156ff; PC 2014d). There is a continued impetus for further deregulation, which will further encourage the supply of HERRC services on weekends (chapter 15).

*Growing incomes* have also spurred the demand for discretionary services that complement people's leisure — particularly accommodation, recreational and cultural services.<sup>138</sup> Research from the HILDA survey shows that:

... time spent on household errands has increased over the period, rising by an average of 0.8 of an hour per week for both males and females. This increase primarily occurred between 2002 and 2006, with little change between 2006 and 2011. The increase may reflect an increase in the time spent on (discretionary) shopping, in turn deriving from the growth in household incomes over the period ... (Wilkins 2014, p. 100)

These various social and economic trends have also influenced, to some degree, the decision making of industrial relations regulators (chapter 10). The Productivity Commission is not aware of any major stakeholder that regards weekend trading as inherently undesirable. Indeed, by having penalty rates, the current Australian industrial relations system creates incentives to work at asocial times.

## **11.4 Technological change may disrupt employment with high labour costs likely to accelerate this**

Technological change also has several implications for service provision, which is one reason why a workplace relations (WR) framework must take into account emerging

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<sup>138</sup> The trend in current price value of accommodation services has exceeded the trend in total household consumption by around 0.5 per cent per annum. The comparable figure for recreational and cultural services is 1.6 per cent per year (ABS 2014, *Australian System of National Accounts, 2013-14*, Cat. no. 5204, table 42, released 31 October).

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trends, and not overemphasise the past. As noted by the Shop, Distributive and Allied Employees Association (SDA) there are:

... vast changes in technology which have and continue to have a detrimental effect on employment numbers. The Retail Industry is at the forefront of new technology. The latest is self-service checkouts. This greatly reduces the need of staff to work registers. Instead one Supervisor can look after 12 registers at once. Adoption of technology will continue to see a reduction in actual hours worked and number of employees engaged. (sub. DR306, p 5)

Another illustration is that some older forms of content, notably DVDs, are now increasingly dispensed from vending machines.

There are potentially equally disruptive changes to the provision of basic food services:

A further consideration is how automation in the cafe and restaurant sector is likely to impact employment prospects and service cultures in Australia. In the USA, fast food chains are rapidly replacing order staff with self-service kiosks, a trend that originated in Japan in the last decade. As robots acquire cognitive skills, food preparation is likely to be transformed. On-demand milk frothers and sensitive coffee dosers are appearing in airport lounges and will likely spread to cafés, reducing the need for baristas. ... If the cost pressure on labour remains, the incentive to invest in human capital will decrease even for small businesses. (Restaurants and Catering Australia, sub. DR359, p. 15).

The most sweeping change, however, does not involve physical provision of goods and services. *Online provision* is playing a much more important role for some goods and services:

- Even if the service is provided virtually, the growth of online provision of consumer goods and services — which are available 24/7 from throughout Australia and globally — will reinforce weekend consumer activity.
- Online provision creates further competitive pressures on bricks and mortar stores. Those that cannot open on weekends due to costs or trading hour restrictions will increasingly lose demand to virtual shops that are open all the time. Accordingly, failures to address regulatory impediments may shift demand from a physical shop to a warehouse (Busselton Chamber of Commerce and Industry, sub. 65, p. 2; the Australian Small Business Commissioner, sub. DR366, p. 7). Already, the online provision of music, books and video has strongly challenged old models of providing content to people.
- Successful operation of online stores in Australia providing global services requires a 24/7 workforce as the purchasers may be in quite different time zones to Australia.
- There are also complementarities between online supply and opening hours of some bricks and mortar stores. Department stores and supermarkets are offering ‘click and collect’ for their own products. There have also been other innovative collaborations between the online and bricks and mortar worlds, as in the partnership between Woolworths/BigW and eBay, which involves the former offering a parcel pickup service for the latter (Sadauskas 2015). An effective service requires staff and attractive opening hours for consumers. This may particularly apply to smaller retailers wanting to offer similar innovative services.



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## 12 The social effects of weekend work

### Key points

- Saturdays and Sundays remain a focal point for community and family interactions, with Mondays to Fridays still the dominant pattern of working.
- On average, people typically prefer not to work on weekends because of forgone recreational and social activities. Many people say they would need a premium wage to encourage them to work on Sundays.
- However, some people prefer to work on weekends because of study commitments, commuting is easier, flexibility around life commitments, or simply because they like weekend trade. Many people say that weekend working has modest or no adverse social effects.
  - For example, 75 per cent of Sunday employees say that they never, rarely or only sometimes experience reduced time with friends and families (almost the same as Saturday employees).
- There are no systematic differences between the asocial impacts of working on Saturdays and Sundays. There is no impact on self-reported wellbeing of working on either day. Comparatively, evening work seems to have worse impacts on various measures of work life balance and wellbeing.
- There is no persuasive evidence that working on Sundays has adverse health effects (unlike the evidence about long hours and night work).
- Sunday is not special anymore. By itself, the existence of adverse social effects of Sunday work does not justify *regulated* penalty rates. Businesses that face staff shortages on Sundays will always have some incentive to pay more to attract staff.
- The main justification for a regulated penalty rate is the presence of some unequal bargaining power — the pervasive concern in workplace relations policy.

### 12.1 The seven day economy has some adverse social impacts

As noted above, the quid pro quo to growing consumer demand on weekends is the requirement that someone must supply the labour to provide these services at these times. A longstanding claim is that working outside the ‘normal’ Monday to Friday routine has adverse effects on employees, their families and the wider community, and given that, justifies a premium wage rate on weekends and other asocial times (box 12.1). The policy-relevant question is the extent to which such working time patterns have adverse effects, how these arise, which periods have the worst effects, who they most affect, and whether the wages people receive provides sufficient compensation.

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**Box 12.1 Many participants pointed to the adverse effects of asocial working times**

Arguments put by employers to abolish penalty rates are based on spurious economic claims; accepting these claims would undermine established and cherished societal norms about the importance of compensation for time missed with family and friends. In this sense penalty rates are more than an economic tool, they are a reflection of the values of the Australian community. (United Voice 2012b, p. 30)

The very fabric of our society is held together by engaging with friends, family and the wider community and these times frequently occur in the evenings, on weekends and on public holidays. For those who work during these times, regardless of whether or not they have elected or been required to, they are deserving of recompense for missing out on valued and valuable social times, especially when they are amongst the lowest paid workers in the country. (SDA 2012, p. 3)

The principle underlying penalty rates concerns the need to compensate workers for the disabilities associated with work in unsociable hours. (Australian Catholic Council for Employment Relations, sub. DR335, p. 16)

It is fair and reasonable that Additional Payments are mandatory to compensate workers for the inherent anti-social, family 'unfriendly' and sometimes exhausting and unhealthy nature of these arrangements. (Legal Aid NSW, sub. 197, p. 9)

While the incidence of work at unsocial times has grown in recent years, a 24/7 working hours pattern is far from the general experience in the labour market. Work on weekends, nights and outside 8-6pm on week days is not the dominant pattern (Skinner and Pocock 2014). As a result common social time - which is critical to family life, community events, sport, cultural activities - remains important to most Australians. Penalty rates reflect the premium that citizens place upon weekend, night and evening time. (The Work and Family Policy Roundtable & The Women + Work Research Group, sub. 130, p. 11)

*Bar Manager:* I have been working Sundays for over 11 years — in that time I have missed literally hundreds of family events -soccer games, weddings, birthday parties, weekends away. I struggle to keep up friendships as most people meet up on weekends. Generally, I just miss out on hanging out with my wife and children. (extract based on a small sample survey from the UNSW Kingsford legal Centre, sub. DR278, p. 2)

*Fast food worker:* I am 15 and all of my friends meet up on Sundays — I miss out on that. Also, my family do stuff together on Sundays and I can't join in. For instance, my cousin is getting married next weekend at the Central Coast and I can't go. (*ibid*, p. 2)

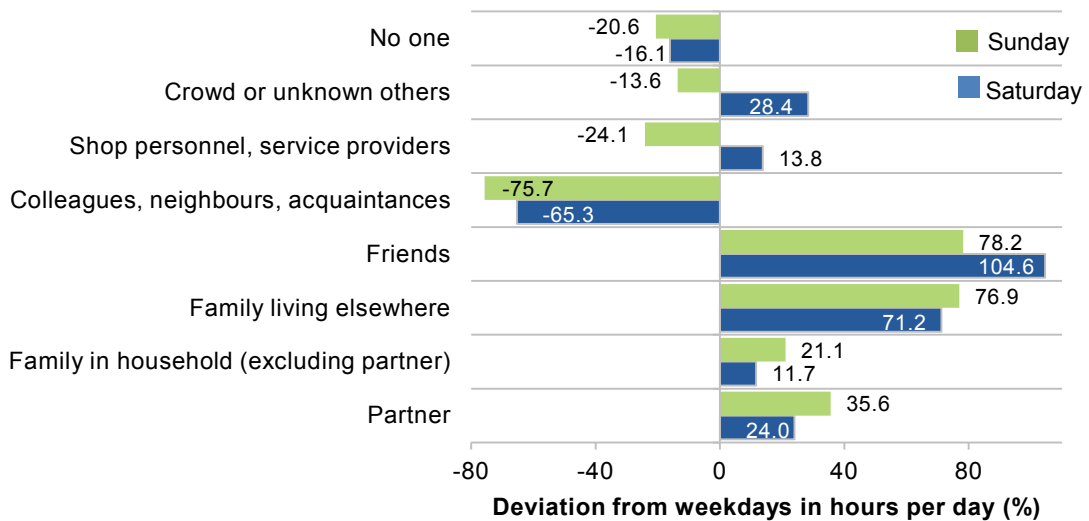
*Entertainment industry worker:* I feel I often miss out on friends & family members' birthdays, baby showers, christenings & events. My partner works some weekends also so often we get only one day a month or every 2nd month to spend together. This does strain our relationship. (*ibid*, p. 3)

Saturdays and Sundays remain a focal point for community and family interactions (figure 12.1 and 12.2), with Mondays to Fridays still the dominant pattern of working. Various institutional arrangements that support working are geared to a five-day working week, such as the availability of schooling and formal childcare services, and the regularity of public transport. Similarly, opportunities for certain leisure activities are oriented to weekends (and sometimes evenings), such as football games. As most partnered people enjoy each other's company, they are likely to coordinate their choice of working days. In effect, the timing and extent of the leisure of one person in a family is a complement to other family member's leisure choices (Alesina, Glaeser and Sacerdote 2006, p. 47).



**Figure 12.1 Who do people spend time with?**

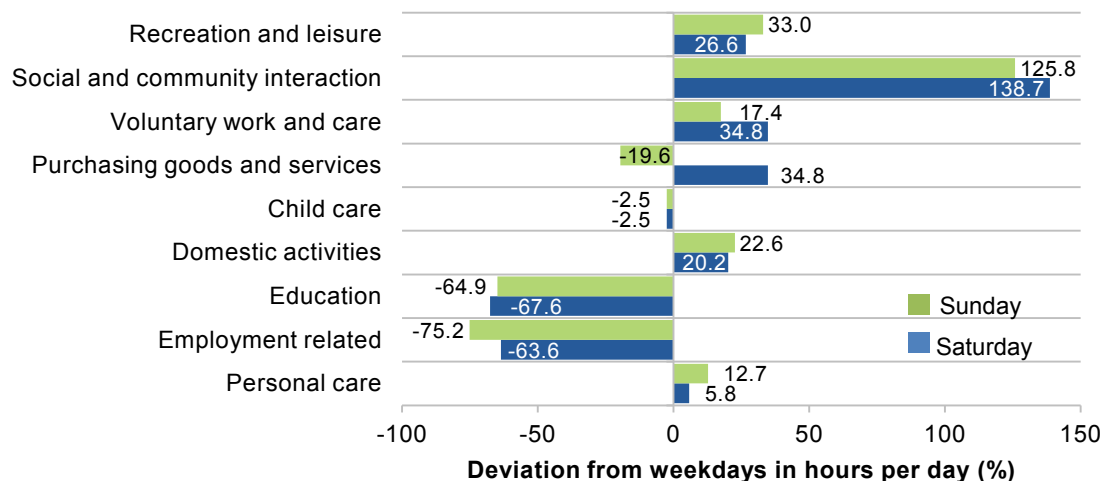
Deviation of hours per day on weekends from the average weekday (%)



Source: ABS 2008, *How Australians Use Their Time, 2006*, Cat. no. 4153.0, February.

**Figure 12.2 What do people do with their time?**

Deviation of hours per day on weekends from the average weekday (%)



Source: ABS 2008, *How Australians Use Their Time, 2006*, Cat. no. 4153.0, February.

However, there is relatively little difference in the degree to which people engage in social activities between Saturdays and Sundays (compared with weekdays). There is some difference in the types of engagements, but the largest deviation in social activities between weekends and weekdays — ‘social and community interaction’ — is actually higher on Saturdays.

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These are aggregate data and mask differences in the activities of different household types (for example, singles compared with couples). Moreover, the data in figures 12.1 and 12.2 also relate to the time use of all people, not those who work on weekends. In most cases, more disaggregated data show no differences in time forgone on social activities (with families or friends) on Saturdays and Sundays. For instance, a couple without children gives up around 4 minutes per hour with their family for every hour of weekend work regardless of the day of work. The comparable figure for a single is 7 minutes per hour of weekend work. Sundays involve bigger social costs for couples with children. They give up an additional 6 and 5 minutes on time per hour of work on Sundays with a spouse and children respectively — a relatively small difference between the two days (Craig and Brown 2014).

In many respects, it appears from the various data above that from an aggregate social perspective, Sundays do not occupy a distinctive social niche. Not only has religious observance, a previously important aspect of Sundays, declined significantly (chapter 11),<sup>139</sup> but broadly the degree of social interactions do not appear to be markedly different.

Moreover, while there is unquestionably a social disability associated with working on weekends, an open question is the extent to which weekend workers sometimes adopt strategies to reduce the asocial impacts of working (which would not be revealed in figures 12.1 and 12.2). For example, people working on a weekend may:

- increase some social activity during weekdays, which would weaken the asocial impacts of weekends. This is true for some types of activities for some types of households, but overall, most social interaction lost from working on a weekend is not recouped through weekday interactions. However, data from the Longitudinal Study of Australian Children on time spent with young children paint a complex story, with full recoupment of time displaced by weekend work by mothers of young children, but no recoupment for older children or men generally (Baxter 2009, 2010)
- give up non-social activities (such as housework). There is reasonably good evidence of this (Bitman 2005; Craig and Brown 2014). As an illustration, for every hour of work, a couple without children gave up 18 minutes of leisure with their partner.

A particular concern raised by some is the degree to which weekend work displaces sport and physical recreation. The participation rate in sport and physical recreation was highest for those whose work commitments (regardless of the time of the week working) allowed them to also meet other family and community responsibilities. Participation in sport and physical recreation was 84.1 per cent where work did allow people to meet such responsibilities compared with 75.5 per cent where work did not (ABS 2012, pp. 34–35). However, the number of people for whom work did not allow for family/community responsibilities *and* who did not participate in sport and physical recreation was around 130 000 in 2010 (or 1.2 per cent of employed people). At least some of the 130 000 people

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<sup>139</sup> On the former score, only 4 per cent of people ruling out working on a Sunday said that religious observance was the cause (ACRS 2012, p. 43).

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would not work on weekends and some weekend workers would not be employees. Accordingly, the number of weekend workers in this position must be small.

## 12.2 More direct evidence

The most prominent Australian evidence on the impact of weekend work is from the Australian Work and Life index (AWALI), a survey based instrument developed by the University of South Australia with funding from Safework SA and the Australian Research Council (Skinner and Pocock 2014). The index is based on responses to five (overlapping) areas where work may affect social life:

- the frequency that work interferes with responsibilities or activities outside work
- the frequency that work restricts time with family or friends
- the frequency that work affects workers' ability to develop or maintain connections and friendships in their local community
- satisfaction with overall work life 'balance'
- the frequency of feeling rushed or pressed for time.

These five items are summed to arrive at an overall work life index scaled from 0 (lowest work life interference) to 100 (highest work life interference). There are potentially some problems in using an unweighted sum of these five measures. It is not clear that each has the same impact on work-life quality.<sup>140</sup> Nevertheless, it has face validity and is less subjective than anecdote and conjecture. It also provides more recent evidence than the time-use survey.

High scores found for people working weekends suggest poorer work life outcomes (Skinner and Pocock 2014, pp. 10, 28).<sup>141</sup> The raw scores were seen by some as patently indicating that Sunday work had adverse effects (National Foundation for Australian Women, sub. DR288, p. 5).

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<sup>140</sup> Also, unlike many psychometric tests, there is no gold standard measure of work life quality that can assess the validity of the instrument.

<sup>141</sup> The AWALI scores were: 52.5 for people working regularly on Saturdays and Sundays, 51.4 for regular Sundays (but not regular Saturdays), 43.8 for regular Saturdays (but not regular Sundays), and 38.9 for people who do not work on regular Saturdays or Sundays. Differences in ordinal scores, like those produced by the AWALI survey, can be difficult to interpret. For example, is a difference of 5 points small or large in terms of its effects on wellbeing? One way of assessing this is to consider the difference between two working situations that, *prima facie*, are likely to involve a material change in people's work life balance, and then to use this as a benchmark when interpreting other working conditions. One such benchmark is the difference between part-time work (low expected interference with home life) and very long hours of work (high expected impacts on work-life balance). The AWALI score between working part-time (<34 hours a week) and long full time hours (48+ hours a week) is 18 percentage points. In comparison, the difference in AWALI scores between working on Saturdays and Sundays during normal hours and working weekdays at normal hours is nearly 14 percentage points, suggesting that the effects of weekends on work-life balance are significant.

However, the data can support a more sophisticated analysis.

First, these results are averages (box 12.2). In fact, most people do not experience major problems in their work life interactions regardless of their working arrangements (table in box 12.2). The partial exception is the experience of being rushed for time, which appears to be relatively frequent for all working arrangements.

### Box 12.2 What holds for many does not hold for all

While the overall evidence suggests that people prefer weekends for leisure not work, it is important to recognise that individual preferences vary and that some people do not find weekend work as problematic as others (see table below).

Indeed, as shown in figure 12.6, some prefer weekend work because of other responsibilities. It is notable that young people (aged 18-24 years) and singles with no children are disproportionately represented in weekend work (Daly 2014, p. 9). This is consistent with the greater likelihood that they are students, and do not have family responsibilities on weekends (as discussed in chapter 11). The fact that most people take account of their own personal circumstances when choosing a job should reduce the social impacts of asocial working hours, in that those who find it most problematic would be less likely to seek weekend jobs.

Furthermore, social engagement with colleagues and customers can be a positive aspect of working, and may even substitute for other types of social engagement. This appears to hold for even lower paid and relatively unskilled jobs (Watson 2011, p. 34). Of course, this is not true for all people and jobs (Holly Whittenbury, sub. DR263, p. 3).

The income from jobs may also increase the quality of out of work social interactions (for example, by allowing people to own and run a car or to go on holidays).

#### Share of people who never, rarely or only sometimes experience adverse outcomes by type of working arrangement<sup>a</sup>

Type of impact	Not regularly working weekends or evenings	Regularly working at asocial times		
		Saturday	Sunday	Evening
	%	%	%	%
Work interferes with responsibilities or activities outside work	86	83.3	75.2	72.9
Reduces time with family and friends	83.1	78.4	74.7	70.1
Reduces ability to develop or maintain connections and friendships in the community	88.6	85.9	81.1	75.6
Feels rushed or pressed for time	50.6	46.5	53.3	44.3
Adversely affects life balance	86	83.4	84.3	79.7

<sup>a</sup> These estimates were obtained from an econometric analysis of the frequency of adverse impacts using ordered logistic analysis (as described further in figure 12.3).

Source: Productivity Commission analysis of the AWALI database provided by the Centre for Work + Life at the University of South Australia.

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Supporting evidence from a population omnibus survey conducted by an industry association also suggested that 59 per cent of the general population believe there is no difference between working either weekend day. 33 per cent stated that Sunday was a more inconvenient work day than Saturday, while the remainder chose Saturday as the most inconvenient work day (Restaurant and Catering Australia, sub. DR359, p. 16). While subjective, as in many other surveys in this area, the results are not inconsistent with some of those in the AWALI survey and ABS time use data.

Second, work-life impacts result from a range of factors, and not only working time arrangements. For instance, total hours of work have a large impact (and Skinner and Pocock partially adjusted their results for this).

There are several approaches to address these issues, which avoid the possible misinterpretation of the data when simple comparisons are made. The Productivity Commission modelled the aggregate AWALI using a Poisson count model (the appropriate regression method for data of this kind) controlling for industry, single status, gender, age, hours worked, and the presence of young children.

As expected, working asocial hours had both a statistically and economically adverse effect on work-life quality using this approach. Nevertheless, the differences between days are highly instructive. The result was minimal difference between Saturday and Sunday, but a higher dissatisfaction with working regularly on evenings. There was around a 7, 10 and 22 per cent increase respectively above the norm (not working regularly at any time on weekends). Moreover, not only is the difference between regular Saturday and Sunday work small, the variations in the effects between people working regularly at these times are so great that the small difference has no statistical significance. The most distinctive result is that for both genders, adverse evening effects are much larger and are statistically significantly different from both Saturdays and Sundays.

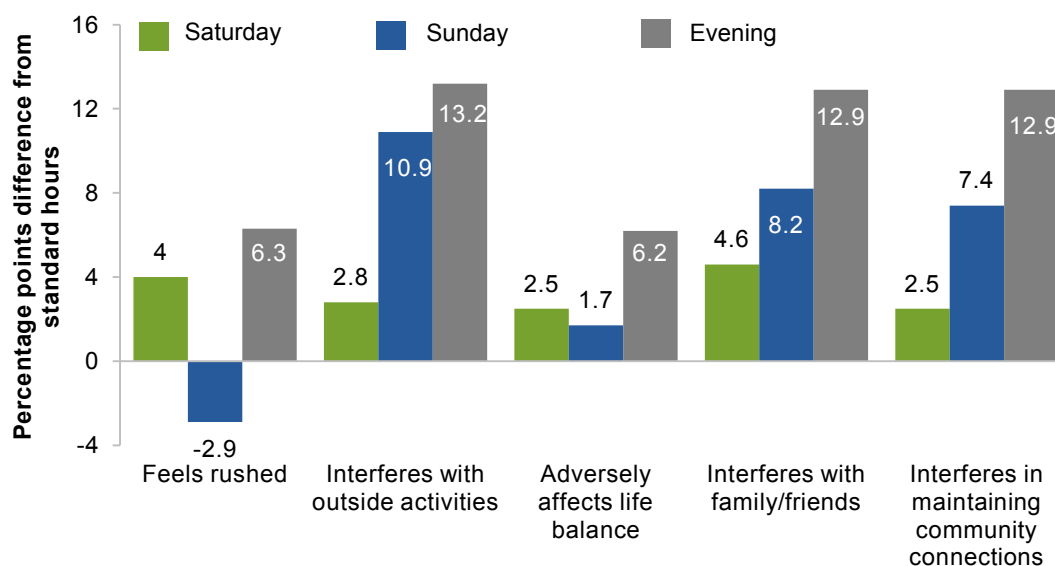
Third, gender differences have been emphasised in the debate over penalty rates, with female participation much higher in some of the affected industries. However, gender differences in work-life stresses — an important issue — are general in nature and affect women in a wide variety of working arrangements. The *difference* in the outcomes of working on Sundays and Saturdays is much the same for men and women.

Reductions in stresses for women should cover all working times, not just weekends. As one inquiry participant told us, the stresses on women from having to pick up children from childcare or school, while simultaneously facing employer expectations of a continued presence at work, is predominantly a weekday issue. She pointed out that there were no expectations that those stresses should be compensated through penalty rates from 3 pm to 6 pm on Mondays to Fridays.

Reductions in work-life stresses for women are likely to also involve cultural shifts in society that lead to greater involvement of men in domestic duties and childcare. They are not a predominantly ‘Sunday’ issue.

Fourth, examination of the separate dimensions of work-life quality that constitute the AWALI show a similar, if more nuanced picture. For three of the five dimensions of AWALI, regular evening work had bigger adverse impacts than Sunday work, which in turn had larger adverse impacts than regular Saturday work (figure 12.3). However, for two of the measures ('feeling rushed', and 'work life' balance), regular Sunday work had less impacts than regular Saturday work. Moreover, across all of these dimensions, the differences were not statistically different between regular Sunday and Saturday work.

**Figure 12.3 Degree to which employees 'often or almost always' experience impacts from work**  
Outcomes relative to standard hours<sup>a</sup>



<sup>a</sup> These results are estimates from an ordered logit of the various measures of work impacts against a series of independent variables, including whether a person works mostly (often or almost always) on Saturdays, on Sundays or on evenings. Other regressors included gender, age and whether an employee had young children. Each of the dependent variables were based on a Likert scale of never, rarely, sometimes, often or almost always (or in life balance terms, a satisfaction measure from very satisfied to not at all satisfied). The logit regression was used to estimate the likelihood that an employee was often or almost always experiencing some impact if they worked at a non-standard time compared with a standard time (Mondays to Fridays). For example, there was around a 4 percentage point difference between the share of people feeling often or almost always rushed for time if they worked on a Saturday (but not a Sunday or evening) compared with those working at standard times.

Source: Productivity Commission analysis of the AWALI database provided by the Centre for Work + Life at the University of South Australia.

Finally, the Commission also explored whether regular work at asocial times had effects on overall wellbeing — a possibly better summary measure of social impacts than AWALI (box 12.3). The results found no substantive difference in outcomes for people working regular Saturdays and Sundays, but again there was evidence that evening work produced worse outcomes than at other times. As in the analysis above, there were no substantive differences in the impacts of weekend work on males and females.

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The overall evidence points to adverse social impacts of frequent weekend and evening work compared with weekdays. However, the various strands of evidence do not sustain a rigorous argument that regular *Sunday* work has especially adverse social impacts compared with other periods of working at asocial times, or that these impacts are notably worse for women than men.

### **Box 12.3      The effects of asocial working times on wellbeing**

There is a large and complex literature that attempts to directly measure the impacts of people's life experiences and characteristics on their wellbeing (for example, Deaton and Stone 2013; O'Donnell et al. 2014; Steptoe, Deaton and Stone 2015). While evaluating this literature is not straightforward, it has the advantage of summarising the net effects of asocial working hours, rather than just simply looking at a particular dimension of wellbeing, such as being 'rushed'.

Using the AWALI dataset, the Productivity Commission estimated people's subjective level of 'happiness' (scaled from low=0 to high=10) as a function of the intensity of working on evenings, Saturdays and Sundays (and several other control variables, such as age, single status, hours worked and the presence of young children). The differences in the effects of any working intensity on Saturdays and Sundays on the distribution of happiness scores in the population were insignificant in economic and statistical terms.

For people almost always working on Sundays, more than 85 per cent of people report happiness levels of between 7 and 10. The share of people reporting a scale of 7 was virtually the same for Sunday versus other working times (22.2 per cent for people working almost always on a Sunday versus 21.5 per cent for people who did not work evenings or weekends at all). The comparable figures for happiness scales of eight, nine and ten were (40.6, 40.9 per cent), (17.7, 18.6 per cent) and (6.6, 7.0 per cent) respectively — all trivial differences. There were more marked impacts of frequent evening work on wellbeing, consistent with other evidence.

There were negligible differences in effects of work at asocial times for males and females when the samples were split by gender.

It might be that these results could be expected if penalty rate payments for people working at asocial times served their purpose of compensating for the disutility of such working times. However, the same ordered logit estimated for people who do not receive penalty rates gave nearly identical results, suggesting this is not true.

*Source:* Productivity Commission calculations based on ordered logit analysis of AWALI unit record data.

## **12.3 Despite claims, the seven day economy does not harm health or the community**

Some inquiry participants argued that working on weekends has negative impacts on physical and psychological health (United Voice DR354, p. 12). This argument would be more pertinent if the proposed change in policy related to elimination of penalty rates.

Moreover, while there are adverse effects of certain patterns of work, the most compelling evidence relates to rotating shift work, night work and long hours, regardless of the day of

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the week (chapter 9). Notably, in the hospitality, entertainment, retail, restaurant and cafe industries (HERRC), working times are lower than most industries. When scrutinised carefully, other arguments for higher Sunday penalty rates based on community and health grounds are not compelling.

## Community effects

Some are concerned that weekend working might have effects on the community's social fabric that are quite distinct from those applying to the families of employees.

For instance, the effects of aggregate uncoordinated decisions by many individuals to work on weekends might mean that local community activities dependent on widespread involvement (for example, fetes, community celebrations, amateur games, and volunteering) would be affected. Such communal activities have broader benefits for the social capital of the community.

Social capital has many potential social and economic benefits (PC 2003a), yet no individual can sustain it by themselves. As Putnam has put it: 'In the absence of coordination and credible mutual commitment, however, everyone defects, ruefully but rationally, confirming one another's melancholy expectations' (Putnam 1993).

The argument for penalty rates in this instance is that they act to 'tax' activities inimical to community activities. However, working on Sundays does not appear to displace such activities any more than Saturdays, and the concept of 'detering' weekend work is no longer seen as a legitimate goal.

Moreover, as the custom for a common set of rest days erodes, people are likely to find other ways in which they can share activities and create community networks. Such evolution has occurred in the past. In the mid-20<sup>th</sup> century, a common attitude was that female employment eroded the community, but this is not a contemporary social norm. For many Australians, it is hard to depict Sunday as having a *community* status different from Saturdays.

## Health effects

While most commonly raised for shift, overtime and night work, some international researchers are also concerned that working non-standard hours in daytime hours on weekends (particularly Sundays) raises mental wellbeing and other health issues (Costa et al. 2004; Lee et al. 2014; Nachreiner et al. 2010; Wirtz, Nachreiner and Rolfes 2011; Wirtz et al. 2008).

This European-centred research is considerably less compelling than research on shift and overtime work. It provides little information about the industries of primary interest in this inquiry. There are concerns about selection biases and confounding factors in this



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literature. As an illustration, there was no effect of working on Sundays in industries with generally high and medium risks of accidents, once confounding variables were taken into account (Wirtz, Nachreiner and Rolfes 2011, pp. 365–66).

Also, the countries that are the focus of such research tend to have less normalised patterns of weekend working in consumer services than Australia (where it is a socially acceptable form of employment). Germany for example, has very strict rules about working on Sundays. Few employers, employees or consumers in Australia would advocate a return to Sundays as a highly restricted working day.

Australian evidence on the health effects of weekend work is practically non-existent. Research on one aspect of positive mental health (the concept of ‘flourishing’) found that weekend work — especially on Sundays — had a negative effect on men, but no effect on women (Skinner and Pocock 2014, p. 48). The debate in Australia centres on the degree to which employees should be compensated for working on weekends and on their capacity to opt out of weekend work where it is unreasonable.

## **12.4 Willingness to work on weekends provides an indicator**

A further indicator of the special value of weekends is that people say that they would be less willing to work on weekends without some premium on standard weekly wage rates, although as outlined further below and in chapter 13, a decisive question is whether these premium rates need to be regulated or set by the market. Most unions, employers and employees agree that high wage rates attract workers to weekend and evening work.

United Voice cited employees’ perspectives that exemplified this concern:

It would make me rethink working in hospitality. The reason why I get those penalty rates is because I’m missing out on time with my family and friends and I would question why I would bother (2012b, p. 14)

Without penalty rates, I would have to change career completely, get out of the industry. I couldn’t make ends meet without penalty rates (*ibid* p. 18)

Some submitters to this inquiry made a similar observation about their own workplaces:

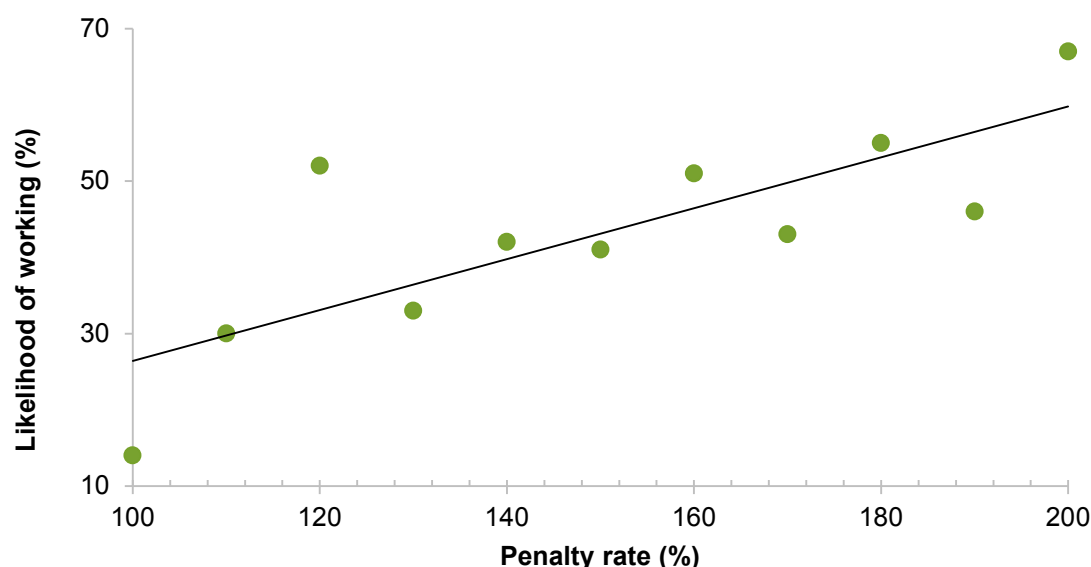
I can say with certainty, that in my workplace, no more staff within our kitchen would be employed on a Sunday if there was a further pay reduction. Our kitchen functions efficiently and no more staff are required or would be employed if the business was to reduce penalty rates to 150%. (Holly Whittenbury, sub. DR263, p. 2)

The evidence from the AWALI survey also implies that many people would not work on weekends if there were no premium rate for doing so (Daly 2014, pp. 14–17). Only 37.5 per cent of people who often or always worked Sundays (but not Saturdays) said that they would work on a Sunday without penalty rates. If employees’ subjective judgments

about their response to the withdrawal of Sunday penalty rates were correct, then given that penalty rates for Sundays are typically between 175 and 200 per cent, a very rough estimate could suggest that on average for every 10 per cent increase in wage rates, there is around a 14 per cent increase in the supply of people willing to work on a Sunday.<sup>142</sup>

This is a very high level of responsiveness of labour supply to wages compared with the usual results (Bargain, Orsini and Peichl 2012). The contrast may reflect the fact that if people do not get high wages on weekends, they would prefer to work weekdays. In that case, it is possible to reconcile a low labour supply elasticity for yearly labour supply with high elasticities for supply on Sundays.

Figure 12.4 **The willingness to work on Sundays depends on penalty rates<sup>a</sup>**



<sup>a</sup> The data are based on a survey of retail shop floor staff, regardless of the days they work during the week. They were asked whether they would be highly willing to work at penalty rates between 100 (no penalty rates) and 200 (double time), in ten percentage point increments. When the relationship between the likelihood of working is estimated in log form, the implied elasticity is 1.43. This means that a 10 per cent increase in the penalty rate increases the likelihood of someone working on a Sunday by around 14.3 per cent. The elasticity does not count the labour supply responsiveness of people outside the retail sector (probably upwardly biasing the estimate), but also does not account for the likelihood that hours as well as employment responds to wages (which counteracts the preceding bias).

Source: ACRS (2012, p. 48).

<sup>142</sup> This means that, under double time rates, labour supply (in employment terms) would be 2.67 times the level that would apply if Sunday wages were paid at ordinary time rates (that is, 100/37.5). Assuming a constant elasticity labour supply function (the usual assumption), this implies that the estimated uncompensated wage elasticity is  $\log\{37.5/100\}/\log\{100/200\}=1.4$ . Since it could also be expected that higher wage rates would elicit more hours for those who are already working, the implied own wage hour elasticity must be higher than 1.4.

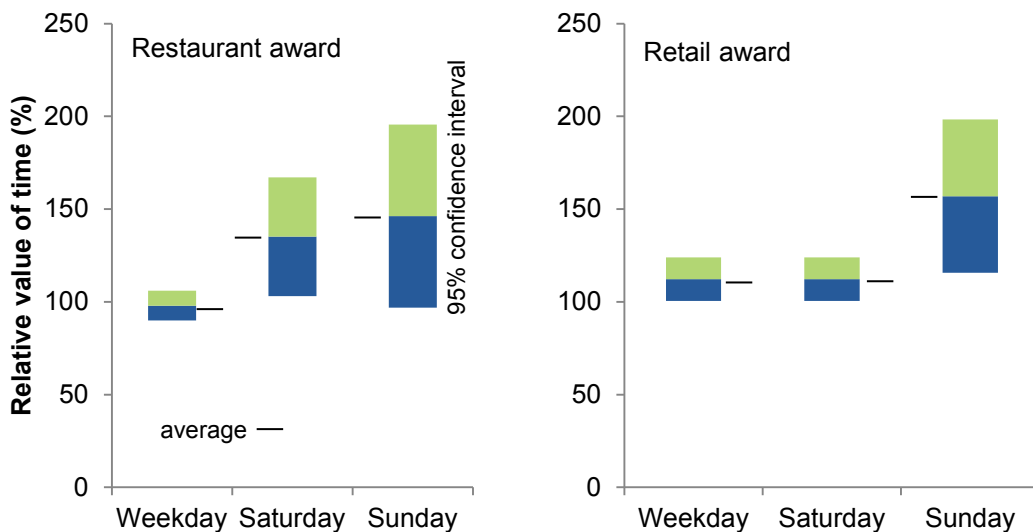
Another survey (with all the same caveats about subjectivity) invited retail floor employees to assess whether they would work at different penalty rates. It found a nearly identical degree of responsiveness in Sunday labour supply to penalty rates as the AWALI results (figure 12.4). It implied that penalty rate of 125 per cent would encourage only around 35 per cent of current retail employees to work on Sundays.

However, while the surveys provide credible evidence of a labour supply response, quantitative estimates of labour supply based on subjective assessments need to be treated very cautiously.

Other (more) rigorous research on the value of different hours of the day to people also suggests that the average dollar value of Sunday work varies by the award and is higher, at least in the retail sector than Saturdays (figure 12.5). The results suggested that restaurant and retail employees have different time preferences, notwithstanding that they share many traits as employees (such as age and earnings).

**Figure 12.5 The relative value of weekend work**

Value of time as a percentage of the current normal hourly pay rate<sup>a</sup>



<sup>a</sup> For example, the data suggest that the average dollar value for employees working under the Restaurant Award of giving up an hour of leisure on a Saturday is about 35 per cent higher than the current normal wage rate. The comparable figure for a Sunday is about 50 per cent. In this instance, there is a great deal of imprecision, so that the averages cannot be distinguished from each other statistically. For the Retail Award, only Sundays appear to be valued more than weekdays. These results have been critiqued by Altman (2015) as providing conservative estimates of the effects of weekend work, but Rose (2015a) has provided a robust defence.

Sources: Rose (2015a, 2015b) and Altman (2015).

Overall, these results provide credible qualitative evidence that people's choice of working on weekends responds to changes in wage rates, which reinforces the view that they do value their time at home during the weekends compared with time at work. However, the

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variations in outcomes do not robustly indicate that Sundays require different rates, and the quantitative estimates of labour supply responses to wage rates are inconsistent.

## **Labour markets are not just about labour supply**

Overall, the evidence that many people generally prefer not to work on weekends is uncontroversial. The question is then how labour markets could be expected to respond to this, and the appropriate role of regulation.

Some draw the conclusion from results like those above that reductions in regulated penalty rates would lead to undersupply of labour (for example, United Voice, sub. 224, p. 10; Vintage Reds ACT, sub. 163, p. 8; Health Services Union, sub. 203, p. 5; Queensland Government, sub. 120, p. 7). For example, United Voice noted that there were already shortages in the hospitality and restaurant industry, and that:

If this compensation [penalty rates] were to be removed, and these jobs were devalued as a result, employers would find their labour shortage problems would only increase. (United Voice 2012b, p. 18)

A glaring deficiency in arguments of this kind is that they ignore that regulated penalty rates do not set the market price for labour on Sundays. Regulated penalty rates are floors not ceilings. Yet much of the debate presumes that they are both.

Bargaining imbalances aside (an important issue addressed later) it is not clear why an employer would not respond to any enduring labour shortages by increasing weekend rates if the regulated penalty rate was not sufficient to attract adequate labour supply, a point made by several employers (for example, the Australian Retailers Association, sub. 217, p. 9). Empirical evidence suggests that persistent skill shortages trigger wage rises (for example, Mavromaras, Oguzoglu and Webster 2007). Businesses sometimes report that wages that are too high cause skill shortages, but by this they mean that the business cannot afford to employ the skilled worker (a demand effect), not that the labour supply itself is inherently insufficient (Healy, Mavromaras and Sloane 2012).

The critical point is that both labour demand and supply are important in considering the outcomes associated with some people's aversion to working on Sundays:

- On the labour supply side, would-be employees weigh up their decisions about the nature of jobs — their wages and conditions, the occupation, the hours worked, career prospects, the timing and location of work and the employer — against the impacts on their private social lives. The labour supply curve shown in figure 12.4 and the views of people about the advantages and disadvantages of working on weekends (figure 12.6) demonstrate that people balance the returns from working against the costs of doing so.
- On the labour demand side, employers would be willing to pay a wage premium to the extent that failing to do so would lead to labour shortages and that the profits of weekend trading justified these higher costs.

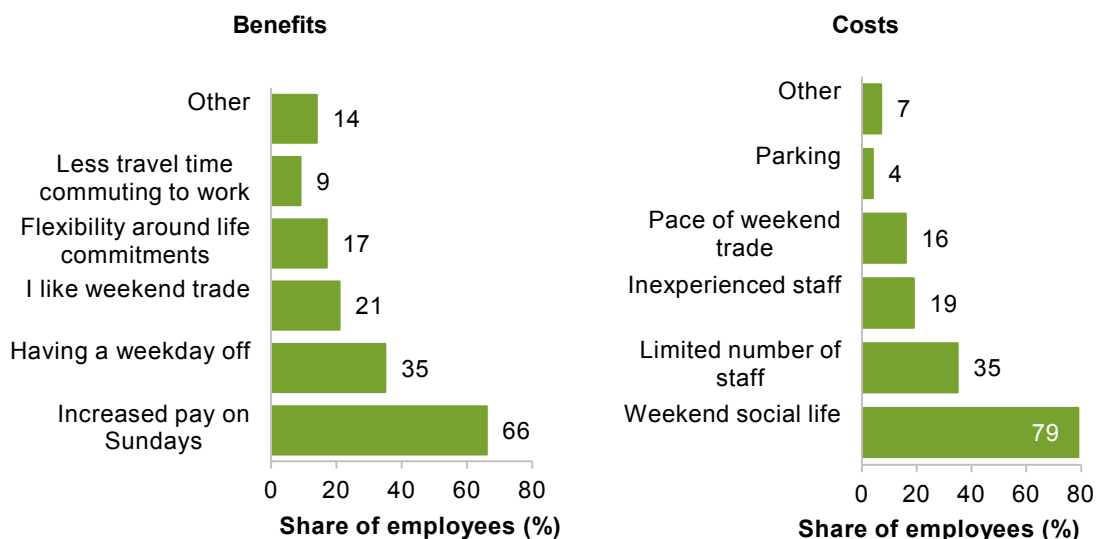
Accordingly, unregulated markets may partially compensate employees for the private social impacts of weekend working without regulated penalty rates because many people have choices about the nature and timing of their employment and employers need people to supply their labour at such times. This would be most likely for higher-skilled employees (and the New Zealand evidence, where there are no regulated rates, appears to substantiate this — chapter 13).

Some qualitative evidence also suggests that if there were no regulated Sunday penalty rates at all, some businesses would have to pay above award weekday rates to attract employees. A small sample survey of Western Australian employers revealed that 37 per cent believed they would need to pay some premium to attract employees for weekend work, although 55 per cent did not (chapter 14).

Moreover, the earlier measures of labour supply responsiveness are based on responses from existing employers, and do not take into account the degree to which people discouraged from job search might respond if wage rates were lower, and employers were able to offer more vacancies. Notably, weekend penalty rates are infrequent in the HERRC industries in New Zealand, where there are no regulated rates (chapter 13).

**Figure 12.6 Employees understand many of the tradeoffs of working on Sundays**

National survey of the retail industry, 2012



Source: ACRS (2012).

Accordingly, the undisputed fact that some people may want additional compensation on weekends than weekdays does not, by itself, require regulated wage floors. A well operating labour market would not need a regulator to set penalty rates to address the social disabilities associated with work — wages would adjust to achieve that outcome.

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However, labour markets do not always operate well or deliver what the community more broadly expects. It is primarily this fact, not the social disability associated with weekend work per se, that needs emphasis in understanding how penalty rates might be set. There are several reasons why unregulated labour markets might incompletely compensate people for the loss of social amenity on weekends.

### **Unequal bargaining power**

The existence of some bargaining imbalances between individual employees and employers is a defining premise of any workplace relations system. Absent a countervailing force exerted by regulations or (proportionate) collective bargaining by employees, many accept that wages and conditions would be inefficiently and inequitably low (chapter 1 and appendix H).

While these bargaining imbalances may be explained in several ways, in modern labour economics, the theory of ‘dynamic monopsony’ is one useful construct for understanding that wage suppression may still occur in businesses facing strong competition. (This model is not the simple ‘company town’ model of labour markets, whose unrealism and rarity is sometimes used as a straw man to dismiss out of hand more sophisticated versions of firm behaviour.) While dynamic monopsony is far from undisputed, and is unlikely to be an adequate model in all circumstances, its real insight is that real world labour markets with frictions can sometimes generate a sufficient degree of employer market power to warrant some regulatory action to avoid such wage suppression.

The implication of unequal bargaining power is that efficient wage rates need to be above the usual market rate. Labour supply functions are different on weekends than weekdays given the preferences of people to not work on weekends. Accordingly, the regulator would need to ensure that regulated rates in weekends exceeded those on weekdays.<sup>143</sup>

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<sup>143</sup> This is subject to the caveat that the regulator does not set excessively high award rates for weekdays.

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## 13 The level of weekend penalty rates

### Key points

- The strongest argument for a regulated penalty rate on Sundays is that employers still have more bargaining power than individual employees, and would be able to secure labour at a level that did not fully compensate people for the asocial impacts of such working arrangements.
- The degree to which this is true is uncertain. The available empirical evidence suggests that bargaining imbalances are likely to be modest in the hospitality, entertainment, retail, restaurant and cafe (HERRC) industries.
- Employees working on Sundays in these industries face fewer difficulties getting another job and are more willing to leave their jobs than other employees working in other industries or only working on weekdays. For example:
  - Only 4 per cent of employees working on Sundays in the accommodation and food services industries say that they would have a poor chance (less than a 20 per cent) of getting a similar job if they lost their job.
  - In comparison, in the non-HERRC industries, nearly one in five employees working on either a weekend or a weekday thought they would have a poor chance of getting an equivalent job.
- The existing empirical evidence about the impacts of bargaining power would only justify modest premiums for working on Sundays in the HERRC industries.
- There are other indications that current Sunday penalty rates are out of line with Saturday rates:
  - The asocial impacts are similar to Saturdays (as noted in the previous chapter)
  - The return to working on a Sunday far exceeds the return to the acquisition of skills associated with tertiary training
  - There is evidence that there is an excess demand for jobs on Sundays.

The strongest economic argument for regulating penalty rates on weekends, rather than letting markets determine the rate, is that employers would tend to use their greater bargaining strength to set weekend pay rates that were lower than the efficient level (chapter 12). Few have recognised the importance of this issue, with the AIRC<sup>144</sup> and WGroup (sub. 130, p. 12) being exceptions.

The extent to which businesses in the HERRC industries possess significant enduring bargaining power in respect of their employees is hard to discern empirically. In particular,

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144 [1999] AIRC Q9229.

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the degree of bargaining imbalance is not readily tested in a market where wage regulations are already ubiquitous. Some are sceptical of any bargaining power, at least in the restaurant industry, suggesting that this reflects high levels of competition between suppliers. Lewis (2014, p. 21) for instance, notes that the industry has great flexibility in employment ‘which implies a great deal of scope for employees to choose the hours and days they want to supply the labour.’

However, the flexibility in the hours *desired* by employers does not translate to the flexibility of employees to choose their hours of work. In the accommodation and food services industries only around 30 per cent of employees had some say in the starting and finishing times of their jobs (a degree of control that was close to the bottom of all industries).<sup>145</sup> While not separately available at the industry level, young people have much less control than others (18.5 per cent). While often needing more flexibility than men, women had only marginally greater control over time of work (31.9 compared with 29.6 per cent in the accommodation and food services industries). Individual bargaining without a regulated floor would reduce access to penalty rates.

Bargaining imbalances may be exacerbated by the fact that many jobs in the HERRC industries bundle week and weekend days together into a required rostering pattern. An employee’s capacity to reject working on a weekend is reduced if that also amounts to relinquishing the job altogether. There is some anecdotal evidence for this proposition. For example, in detailed qualitative research by RMIT University:

After the pay, a common response, especially from young people who were not studying, from experienced employees and from older workers was about lack of choice or other options, mainly because weekend work was a requirement of their employment. When asked about the main reason they worked on weekends some people talked about ‘the roster’ (Charlesworth and Macdonald 2015, p. 16)

Variations in minimum wages in the United States have enabled some empirical assessment of the degree of bargaining power and wage suppression for fast food outlets and restaurants (Addison, Blackburn and Cotti 2012; Card and Krueger 1994; Dube, Lester and Reich 2010; Ropponen 2011; Schmitt 2013). The results are contested strongly by several economists, but nevertheless provide some support for the notion that even businesses operating in highly competitive industries may still have *some* power to suppress wages where regulation does not limit this.<sup>146</sup>

A possible additional factor may be that the countervailing bargaining power of unions is relatively low in the relevant industries, particularly for accommodation and food services.

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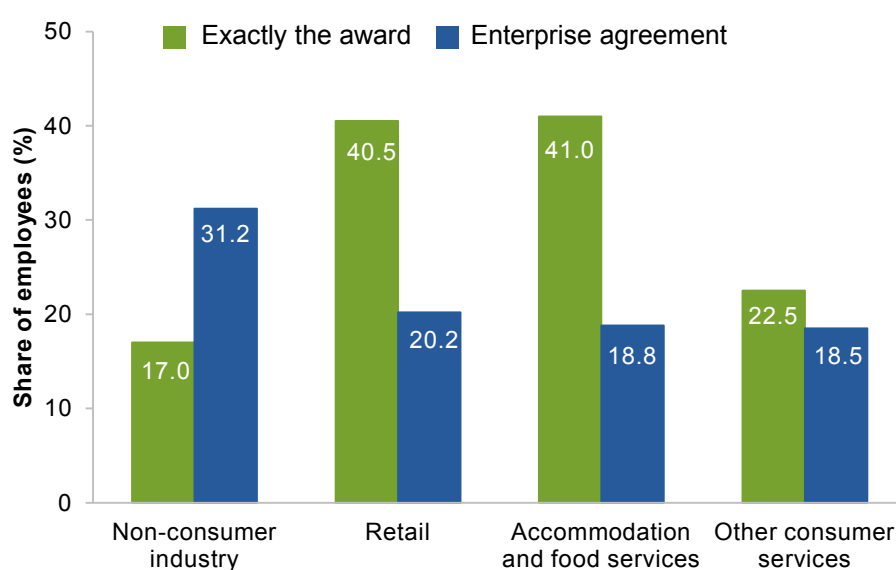
<sup>145</sup> ABS 2013, *Working Time Arrangements, Australia, November 2012*, Cat. no. 6342, table 5, 3 May.

<sup>146</sup> The United States evidence that even fast food outlets might have material bargaining power does not necessarily imply that raising (lowering) existing Australian regulated penalty rates would stimulate (lower) employment. To the extent that regulated minimum penalty rates have overshoot the level required to compensate for unequal bargaining power, lowering regulated penalty rates would initially increase employment.



Union penetration in the latter industry is only 4.6 per cent, less than a third of the average rate in non-HERRC industries (table 15.1 in chapter 15). Associated with this, collective agreements are less frequent, and the share of people receiving wages set exactly by the award more so. For instance, in 2012, collective agreements covered 18.8 per cent of employees working weekends in accommodation and food services, compared with 31.2 per cent for non-consumer industries (figure 13.1).<sup>147</sup> The comparable figures for people paid exactly at the award were 41 and 17 per cent.

Figure 13.1 **Award and enterprise agreements**  
HERRC and other industries, 2012<sup>a</sup>



<sup>a</sup> The data are indicative as employees are not always aware of how their pay and conditions are set.  
Source: HILDA wave 12, 2012.

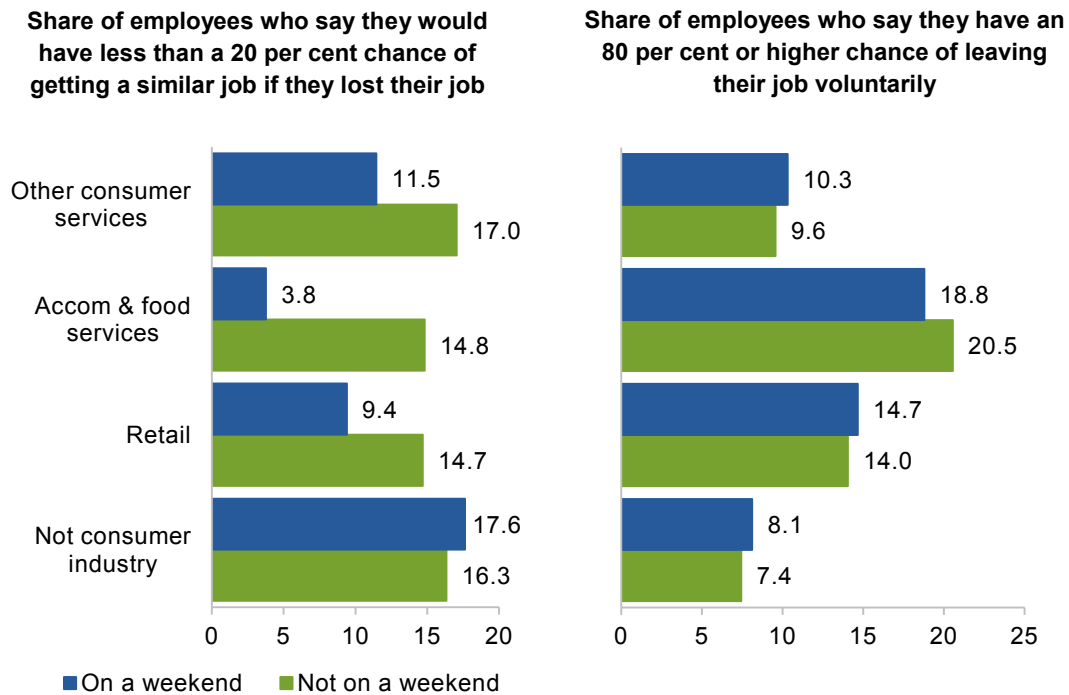
Nevertheless, even if employers in the HERRC industries could exercise some bargaining power in the absence of regulated rates, other evidence suggests that the extent of this power is likely to be modest.

This is because the long run search costs and other frictions appear to be lower in the HERRC industries.<sup>148</sup> The empirical evidence shows that, compared with other industries, employees have much less difficulty finding an equivalent job if they lose their current one (figure 13.2). Likewise, they are also much more willing to leave their job voluntarily. Job optimism and mobility are reasonable direct tests of the severity of bargaining imbalances.

<sup>147</sup> Based on HILDA wave 12 data.

<sup>148</sup> However, even in these industries, wage offers by competing providers are often not posted (raising search costs), and many aspects of a job that are important to a prospective employee remain unknown (for example, the nature of the workplace environment), which favours inertia.

**Figure 13.2 Weekend employees in the HERRC industries face fewer difficulties getting another job and are more willing to leave their jobs<sup>a</sup>**



<sup>a</sup> The HILDA survey asked for the likely probability of getting another, equally well paid, job in the next 12 months if they lost their current one. It also asked people for the probability that they would voluntarily leave their jobs over the next 12 months. The data relate to people who work on weekdays but not weekends and those who work on weekends (and who may also work on weekdays).

Source: HILDA (wave 12).

Even the relatively low rate of unionisation is not proof that employers are likely to wield significant bargaining power.<sup>149</sup> It is notable that in New Zealand, where there are no statutory requirements for weekend penalty rates, premiums are rarely included in collective enterprise agreements in the HERRC industries, whereas penalty rates are more frequently negotiated between parties in other collective enterprise agreements, typically in higher-skilled industries (table 13.1).

Several features of the jobs and the relevant workforce explain the likely lower level of labour market frictions. The jobs often involve relatively low skills with well-defined tasks, as shown by low average wages, the greater share of inexperienced workers and the higher prevalence of casual jobs. This suggests that skills are more readily portable across firms. The workforce is younger and has low average tenures, so that mobility is higher

<sup>149</sup> In addition, the low rates of union membership in restaurant services may reflect the paucity of the ‘rents’ that collective labour can extract through bargaining, lowering the motivation for unionisation.

(table 15.1 in chapter 15). The relevant markets are often densely populated with many prospective employers.

**Table 13.1 Penalty rates in New Zealand**

Penalty rates in New Zealand Collective Enterprise Agreements, 2014

Day of weekend	Share of agreements					2nd period rate <sup>b</sup>
	No penalty rate	Penalty rate below 150%	Penalty rate 150%	Penalty rate above 150%	Other <sup>a</sup>	
	%	%	%	%	%	%
<b>Saturdays</b>						
All private sector	60	3	30	5	2	15
Food retailing	95	0	5	0	0	1
Other retailing & wholesale trade	97	0	2	0	0	1
Accommodation & food services	99	0	0	0	1	0
<b>Sundays</b>						
All private sector	58	3	17	20	2	3
Food retailing	95	0	2.5	1	0	1
Other retailing & wholesale trade	97	0	0	2	1	1
Accommodation & food services	99	0	0	0	1	0

<sup>a</sup> This includes arrangements where premiums are paid in dollars rather than as percentage increases in ordinary rates, or where only certain levels of employees obtain premiums. <sup>b</sup> In some cases, a higher premium rate is paid after a certain number of hours in an earlier period. Penalty rates above 150 per cent are usually at 200 per cent.

Source: Centre for Labour, Employment and Work, Victoria Business School, University of Wellington.

While the empirical evidence on the degree of bargaining imbalances in the HERRC industries is incomplete, a regulated penalty rate commensurate with the commonly applied Saturday 125 per cent rate for permanent employees of HERRC services seems far more plausible than higher rates (box 13.1). The present Sunday rates for these industries seem to be much less clearly justified either on economic grounds or according to community norms compared with other working times (figure 13.3 for the hospitality industry). Rates for Sundays (usually around 175 per cent) appear at odds with rates for times that are also important for social activities (evenings), and to an even greater degree for times that pose clearly demonstrated health risks (night shifts and rotating shifts). Evening/afternoon shift penalty rates can be as low as 10 per cent and night shift loadings as low as 15 per cent. While public holidays are often paid at 250 per cent — seemingly much higher than Sunday penalty rates — permanent employees are paid their full wage if they do not work on a public holiday (100 per cent in effect). Paying 250 per cent amounts to an effective penalty rate of 150 per cent (that is, 250 less 100 per cent) — actually lower than the typical Sunday rate. Sundays overall appear to be extreme in their relative compensation.

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### Box 13.1 Putting a value on bargaining power

The wage elasticity of labour supply is the degree to which people are willing to provide their labour to a *given* business at different wages. The lower or higher the elasticity, the more or less bargaining power the business has. The features of the HERRC services described in the main text suggest that the long-run estimates of the wage elasticity of labour supply for the average firm in these industries would tend to be towards the higher end of those found in the international empirical research (for example, Ashenfelter, Farber and Ransom 2010; Depew and Sørensen 2013). Under certain bargaining models, a supply elasticity ( $\varepsilon$ ) of 5 to 10 (which are at the higher end of the estimates) implies that that an efficient wage rate would be 20 to 10 per cent higher than the counterfactual market outcome respectively, noting that the efficient wage is equal to  $(1+\varepsilon)/\varepsilon$  times the unregulated wage rate. The higher the elasticity, the closer the market is to one that is workably competitive.

The economically efficient outcome for weekend wages depends on the regulator's choice of *weekday* rates, and the wage setting behaviour of the business under (unobserved) counterfactual regulatory regimes for weekend and weekdays.

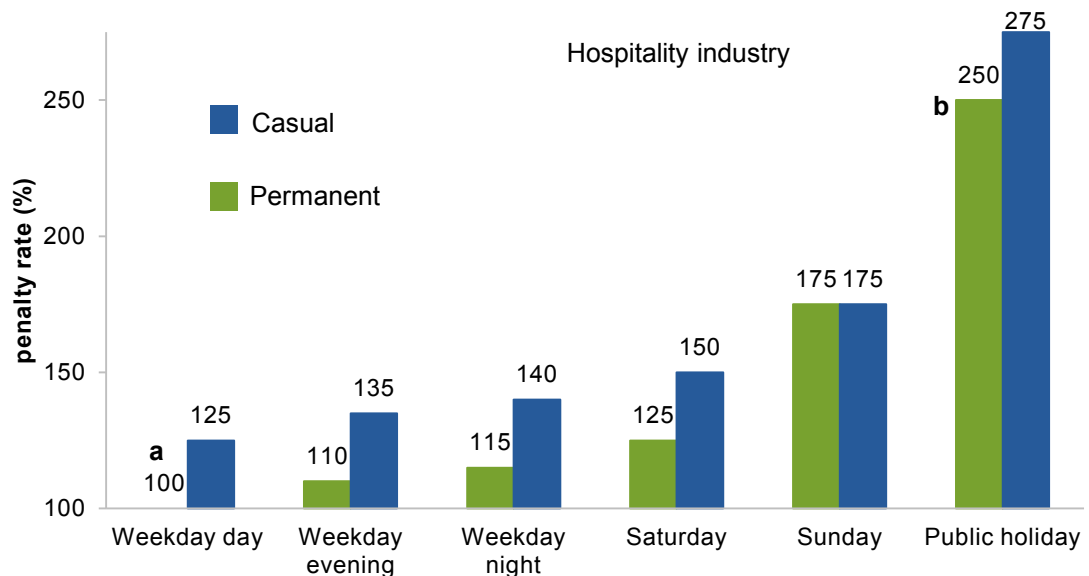
As an illustration, if  $\varepsilon$  is the same for weekend and weekday work, the regulator makes the efficient award wage rate decision for weekdays, firms exploit their bargaining power, and a business would have paid a 25 weekend premium over the unregulated weekday rate without any regulatory requirement to do so, then the 'optimal' penalty rate would be 125 per cent for  $\varepsilon=5$ . This is because if  $\varepsilon=5$ , the optimal penalty rate is 1.2 times the unregulated weekend wage rate divided by the regulated weekday rate. Under the above assumptions, the ratio of the unregulated weekend wage rate to the regulated weekday rate is 125/120 so that the optimal penalty rate is  $1.2 \times 125/120 \times 100 = 125$  per cent.

In other circumstances, the optimal penalty rate can be more or less than this. For example, if the regulator sets the award rate for weekday work at too high a level, then the efficient penalty rate would be lower than above. Indeed, if the regulator overshoots too much on weekday rates, the efficient weekend penalty rate could be zero.

Given the available empirical evidence, it would be hard to maintain anything like current penalty rates for the relevant industries based on bargaining power imbalances. In that case, the justification for high rates would have to rest on some other criterion.

There are other surprising anomalies, particularly in relation to Sunday penalty rates. Under the present award, an inexperienced level 1 pharmacy assistant with no or few qualifications will often receive higher wage rates than a pharmacist. For example, an assistant who worked ordinary hours on a Sunday is paid more than 50 per cent higher than the usual weekly rate for a pharmacist. It implies that the rate of return in wages from working outside normal hours is often far greater than the return to skill (figure 13.4). Pharmacists must complete four years of a university degree course, serve a one year internship, and pass registration tests to qualify to serve the public unsupervised. They must also undertake ongoing professional development. A pharmacy assistant has no equivalent training. The return to a pharmacist from such educational qualifications is 31 per cent. In contrast, the return from working on a Sunday is 100 per cent compared with a standard working time.

Figure 13.3 Penalty rates by day and time of the week



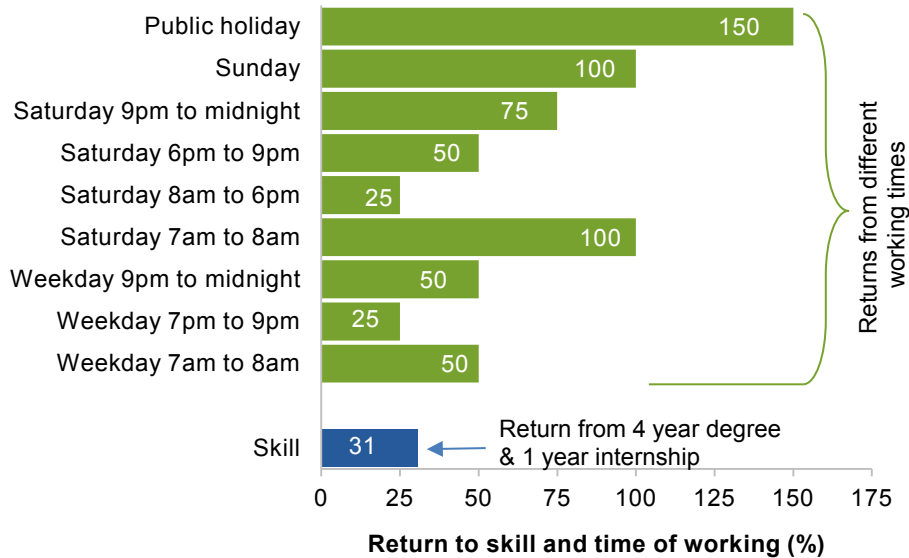
**a** The rates are relative to the weekday rate for permanent employees. The rate of 125 per cent for a casual worker on a weekday is the casual loading. As discussed in appendix F, the treatment of the loading in casual penalty rates is important for understanding relative incentives to employ permanent versus casual employees. **b** The effective penalty rate for public holidays is the amount extra that a business would have to pay for someone who works on a public holiday. Permanent full-time employees are entitled to a day's pay even if they do not work on a public holiday. Accordingly, a notional 'penalty' rate of 250 per cent (the award rate for permanent full-time employees on public holidays) actually provides an effective rate of pay for working of 1.5 times the ordinary salary (150 per cent), since the employee would have been paid their full daily wage even had they not worked on the given day. Casual employees do not typically receive public holiday pay when absent from work. In that case, their effective penalty rate is 250 per cent plus a 25 per cent casual loading (or 275 per cent). Part-time employees (not shown in the chart) who do not work routinely on a public holiday also do not receive a day's pay if they do not work on the public holiday, and so their effective penalty rate is 250 per cent (as they do not receive a casual loading).

Source: Hospitality Industry (General) Award 2010.

The Shop, Distributive and Allied Employees Association (SDA) observed that pharmacists working on weekends also receive penalty rates, so that the relativities between pharmacists and pharmacy assistants did not change on a weekend. This is true, but misses the point. It remains the fact that the rate of return to working on weekends for a relatively low-skilled employee is much higher than the return to prolonged tertiary education and professional training. (This issue also arises in considering relative wage levels more generally — and is discussed in chapter 14.)

**Figure 13.4 The returns from skill and different working times**

Pharmacy industry<sup>a</sup>



<sup>a</sup> A pharmacist must complete 4 years in a university degree course, serve a one year internship to qualify to serve the public unsupervised, pass registration tests and undertake ongoing training. A pharmacy assistant is not statutorily obliged to have any training. The additional standard wage rate for a pharmacist is 31 per cent higher than an untrained assistant. In contrast, the return from working a Sunday over a normal day is 100 per cent.

Source: Pharmacy Industry Award 2010.

Finally, the social disabilities associated with weekend work — for which there *is* sound evidence (chapter 12) — does not strongly support the large gap between penalty rates on Saturdays and Sundays. This finding is reinforced by the apparent excess demand for Sunday jobs in the fast food industry, which suggests that the penalty rate overcompensates for the asocial costs of working at this time (table 13.2). Penalty rates in this industry are relatively low compared with some other HERRC industries, so that excess demand might be expected to be greater in those.

The above considerations suggest that regulated minimum Sunday rates should be equal (or very close) to Saturday rates. While this represents a shift from the current award settings for the relevant industries, there have been occasions when the regulated Saturday and Sunday rates have been aligned, as in some previous Queensland and Western Australian Awards (FWCFB 2014, p. 102). Parity of regulated rates is a simple and easily followed rule. In a fanciful world of perfect regulators, penalty rates would change as skill shortages and demand shocks occurred. However, regulators must choose something reasonable and practical, and though guaranteed to be wrong, this is likely to be better than no regulation.

**Table 13.2 Views of employers about ease of obtaining employees on Sundays**

Survey of operators in the fast food industry<sup>a</sup>

<i>Response</i>	<i>Share responding in each category</i>
	<b>%<sup>b</sup></b>
It is difficult to get enough people to work on a Sunday to meet staffing needs	14.1
It is difficult to get enough people to work for as long as I need them on a Sunday	11.1
It is easy to get enough people to work on a Sunday	67.4
It is easy to get enough people to work for as long as I need them on a Sunday	30.4
More employees than I need ask to work additional Sundays	23.0
Employees request to work additional hours (or longer shifts) on Sundays	14.8
Other	3.0

<sup>a</sup> The sample size was 221 <sup>b</sup> Employers could nominate more than one response, so the total percentages exceed 100.

Source: AiG submission to the FWC regarding penalty rates (No. AM2014/305).





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# 14 The impacts of changing weekend penalty rates

## Key points

- Consumers (including tourists) would be major beneficiaries from reform of penalty rates in the hospitality, entertainment, retailing, restaurant and cafe (HERRC) industries. With lower Sunday penalty rates, consumers would gain access to more services for longer hours and with higher staffing ratios. Sunday surcharges would be likely to disappear, and average prices for consumer services throughout the week would be likely to be a little lower.
- As an indication of the value of convenience, few would wish to go back to an era when most commercial operations were closed on Sundays. Existing high Sunday penalty rates do not have the same effects as those that arose out of now dated social conventions and trading hour restrictions, but they still have significant adverse impacts.
- Just as the imposition of higher penalty rates on Sundays have no long-run effects on profitability, similarly their reduction will also have no long-run impacts. Competition in the HERRC industries is high — as suggested by the high rates of entry and exits, and the absence of any long-run shifts in profitability ratios. The short-run profits of existing businesses from reduced Sunday penalty rates will be competed away as businesses increased staffing ratios and reduce prices, and as new entrants add new variety to consumer options.
- Total hours worked by employees in the HERRC industries are likely to increase substantially on Sundays, as is the headcount of employees. The economywide employment effects will be less than this because some of the additional hours worked and employment on Sundays will draw on labour used on other days of the week or in other industries. Business owners are likely to reduce their very long working hours.
- Nevertheless, those jobless (either unemployed or not in the labour force) suited to the Sunday labour market should be particularly responsive to the opportunities presented by greater demand for labour on that day. Since joblessness is particularly adverse for people's wellbeing, any employment gains for this group would be particularly important. Stimulation of entry-level jobs can also give longer-term benefits for young people in integrating them into the labour market by building skills and experience.
- Lower Sunday penalty rates will reduce the labour income of *existing* employees in the HERRC industries. However:
  - only the minority of HERRC employees work only on weekends, which reduces the importance of lower wage rates on Sundays
  - the reduction in wage rates for casual employees is less than for permanent employees because of existing anomalies in the interaction of casual loadings and premium rates for Sunday work
  - the net effect would be lower given offsets through the tax and transfer system
  - many HERRC employees do not come from low paid households. Many are in households with two other income earners.
- Some people will be made much worse off if Sunday penalty rates fall. However, high Sunday penalty rates are not the best or fairest way of assisting people on low incomes. This is the primary role of Australia's tax and transfer system.
- The usual assumption of proceedings before the Fair Work Commission has been a requirement to prove that lowering penalty rates would have desirable impacts on consumers and employment. The onus of proof should be reversed so that proponents of the current high rates would have to demonstrate why what amounts to very high labour taxes are justified on Sundays.

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## 14.1 Impacts on consumers

Much emphasis is given to the employment effects of penalty rate changes. As discussed below, while they will be positive and beneficial, they are emphatically not the only, or most important, basis for reform.

As in so many other microeconomic reforms — such as policies concerning import barriers, competition laws, public infrastructure, and health — the long-run beneficiaries are mainly consumers. Their interests have been often mislaid in the discussions about penalty rates. This is easy to do because while the accumulated benefits for millions of consumers are large, each individual consumer gains only a modest benefit, and therefore often do not pressure for policy change.

Under reform, consumers would have access to many services for periods when these were previously unavailable. They would receive better services due to potentially higher staffing ratios, and would obtain more differentiated services. These may sound like small gains, but to give an illustration of the benefits of greater convenience and variety, suppose that historical trading hour restrictions had stayed in place, and that retail trading was not permitted on weekday evenings, Saturday afternoons or Sundays. That would not only have adversely affected the capacity for labour supply by students, people caring for children during weekdays and others during the only time they were available for work, but it would have represented a huge loss in access to services by consumers. It would have also acted to inefficiently constrain the size of the tourism sector.

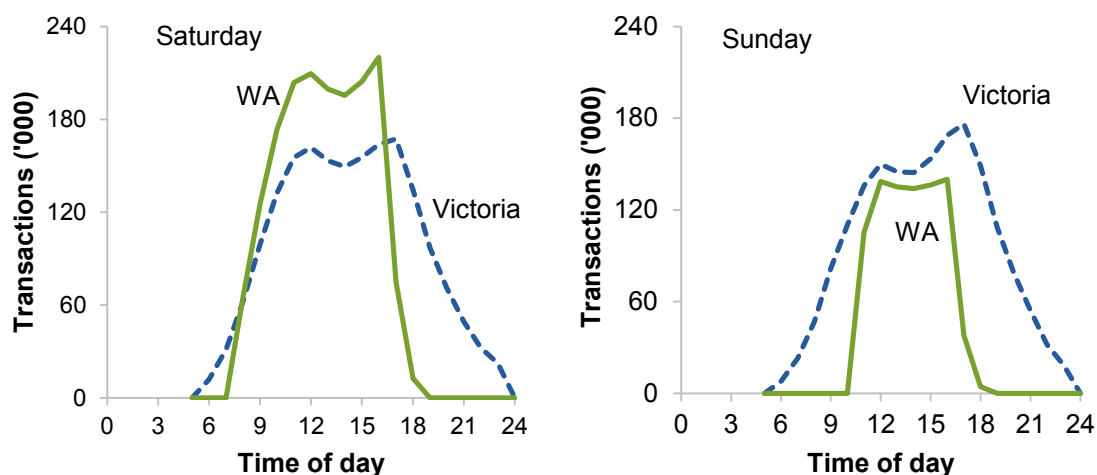
The value of consumer convenience is apparent by comparing transaction numbers and timing in jurisdictions with and without trading hour restrictions. It is notable that weekend trading hour restrictions in supermarkets not only confine transactions to a shorter period, but also reduce the aggregate number of weekend transactions (figure 14.1). Lowering penalty rates would have effects that partly mimic the relaxation of such restrictions.

While the changes associated with reduced penalty rates for Sundays will not be as great as those associated with relaxed trading hour restrictions, they are nevertheless likely to be large because of their effects on opening hours and staffing ratios. The changes are likely to also have other consumer and community benefits similar to deregulated shopping hour restrictions, such as more liveable cities, greater numbers of outlets, stronger competition, lower prices and less congestion (Kay and Morris 1987; Moorhouse 2008; PC 2011a, 2014d; Reddy 2012).

A comparison of opening times of restaurants in New Zealand (where penalty rates are not regulated) and Australia (where penalty rates are regulated) shows that Sunday trading is more frequent in New Zealand, and that the average available hours of restaurant services is higher, in some cases, by a substantial degree (table 14.1). The results are only indicative as other factors may partly explain the patterns.

Figure 14.1 **Longer weekend opening hours boost total transactions**

Victoria and Western Australia, 2012–2013<sup>a</sup>



<sup>a</sup> Average daily Coles' supermarket transactions. A transaction represents the purchase of any basket of goods that generates a receipt.

Source: Economic Regulation Authority (WA) (2014, pp. 285–286).

Table 14.1 **Opening hours of restaurants in Australia and New Zealand**  
July 2015<sup>a</sup>

	Sydney	Melbourne	Brisbane	Canberra	Auckland	Wellington	Australia	New Zealand
Open all week (%)	49.2	63.8	51.3	48.0	70.4	65.3	55.0	69.8
Open on Sunday (%)	68.8	69.3	76.7	67.6	77.2	73.5	70.6	76.9
Open on Monday (%)	71.4	89.9	68.3	71.6	87.3	84.2	77.7	87.0
Average hours open per Sunday (hours) <sup>b</sup>	5.8	6.7	6.9	5.5	7.2	7.1	6.3	7.2

<sup>a</sup> Based on a sample of outlets first listed in the tripadvisor listings of restaurants in the respective cities (undertaken in mid July 2015). Where opening hours were not disclosed, a web search was undertaken to find the opening hours. The sample size was 192 outlets for all cities bar Canberra and Wellington, which had sample sizes of 102 each. The Australian and New Zealand figures are the weighted average of the relevant cities, using city population shares as the weights. <sup>b</sup> Average hours open is an overall measure of hours of services available, including outlets that do not open. It is the single best measure of the availability of cafe and restaurant services on Sundays.

Source: PC data collection and data on city population from the ABS and Statistics New Zealand.

Several stakeholders questioned the implications of these results, but their objections are not decisive (Quiggan, sub. DR266; Bray, sub. DR261; box 14.1).

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### Box 14.1      **Unpacking the New Zealand and Australian results**

Several participants questioned the significance of the comparison of New Zealand and Australian opening hours:

Bray (sub. DR261, p. 18) notes that there are significant variations in Sunday (and Monday) opening hours between Australian capital cities, which cannot be due to different penalty rates as these apply nationally. This must therefore reflect sampling errors in the limited survey results or differences in patterns of consumption (due to culture, climate or other factors). These errors must also affect comparisons between Australian and New Zealand cities, and so the contrasting results between the two countries cannot solely be attributed to penalty rate differences. (In any case, it is apparent that for Brisbane, the Sunday opening rate is more than Wellington.)

Quiggin notes (sub. DR266 p. 2) that Monday trading is more frequent in New Zealand than in Australia and by a degree that is more substantial than the difference between Sunday trading. All other things being equal, it would be expected that the prevalence of Monday trading would be much the same in the two countries since there are no penalty rates on that day in either country. However, there are likely to be other factors at play that may explain the pattern, and in particular, the important role served by employers as suppliers of labour in many restaurants. Australian proprietors have around twice the propensity to work on weekends in food and beverages services (FBS) than other industries, and a much reduced likelihood of working on weekdays, especially ones early in the week. The share of employers working from Saturday to Friday in the FBS industry are 67, 49, 63, 66, 67, 69 and 72 per cent respectively, whereas the comparable figures for all industries are 35, 18, 78, 79, 79, 79 and 78 per cent (based on Commission calculations on the ABS *Forms of Employment* 2008 CURF — the FOE).

This is consistent with the combined effects of a greater level of demand for restaurant and café services on weekends, the impact of penalty rates on the costs of employees on weekends, and the capacity for the often small enterprises in this industry to substitute between employers and employees as sources of labour. To the extent that employers would like some leisure, then they may close their businesses during the early days in the week, and especially Mondays, which is often a less important trading day.

This is borne out by evidence showing that an employer (or employee) who works on a Sunday in the FBS industry is much less likely to work on Mondays compared with people in other industries. Around one in five employers in the FBS who work on Saturdays and/or Sundays do not work on Mondays (compared with only around one in 20 in all other industries). The likelihood that an employee working on a Saturday and/or Sunday does not work on a Monday is around two thirds for the FBS industry and 30 per cent for employees in other industries. The comparable behaviour of proprietors in New Zealand is unknown, so this is only indicative counter evidence.

A further factor is that relative weekday/weekend wage rates are not the only determinant of opening hours. There are no award wages in New Zealand and so the cost of low-skill labour in the restaurant industry may encourage a greater likelihood of all week trading, including on Mondays (as is apparent in the New Zealand data). Taken together, the observations by Bray and Quiggin are well made, but do not (without further evidence) invalidate the results in table 14.1.

The aggregate results still point to substantial differences in average Sunday opening rates in the two countries, which remain consistent with the dampening effects of penalty rates

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on weekend operations. To the extent that the differences reflect penalty rates, the results also imply employment effects in the relevant industries on Sundays. The comparison does not take account of any changes in staffing ratios, which may magnify the effect. The workplace regulator could examine this issue further by undertaking analysis using a better sampling frame and larger samples across more geographical locations, and encompassing a wider range of HERRC services to better assess overall effects (though this will still not capture any staffing ratio impacts).

### **Cost and price effects**

In the case of many HERRC services, a complicating factor in estimating the consumer benefits (and employment effects) associated with lower business costs on Sundays is that only some goods and services change their prices by the day of the week. Cafes and restaurants sometimes vary prices by imposing weekend surcharges, although the degree to which they do so is unknown and may not be transparent.<sup>150</sup>

However, in most instances, the prices of goods and services do not typically vary by the day of the week or time of the day. A shirt in a department store costs the same on Mondays and Sundays, as does a burger, a prescription from a pharmacy, or a box of cereal. The overall cost reductions associated with lower Sunday penalty rates (and any additional competitive pressures from entry of new businesses) in the HERRC industries are also likely to slightly lower average prices across the whole week, with further consumer benefits beyond that associated with convenience. Accordingly, even people who do shop on weekends are likely to benefit from penalty rate reductions on Sundays.

There would be potential productivity improvements from reform as the fixed costs of running a business would be spread over greater opening times and demand.<sup>151</sup> In 2006-07, such costs were around 16 per cent of total expenses for the restaurant and cafe industry (the most recent data). Better capital utilisation would put further downward pressure on average unit costs and prices. Moreover, the lower labour costs associated with reduced penalty rates may permit the payment of targeted incentive based payments that motivate staff and enhance productivity (Contact Centres Australia Pty Ltd, sub. 240, p. 2). All these effects will benefit consumers.

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<sup>150</sup> This was more difficult for such businesses prior to legislation in mid-2013 that exempted restaurants and cafés from the single pricing requirement in Australian Consumer Law. A business was previously obliged to provide separate menus when a weekend surcharge was applied. While accommodation providers also often charge more for weekends, this is usually a form of peak pricing to reflect that demand would otherwise exceed capacity.

<sup>151</sup> For example, leasing, rental costs, franchising fees, repairs, insurance premiums, software, and depreciation.

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## 14.2 Effects on business profitability

Some suggest that reduced penalty rates will not benefit consumers (or employment) because they will be reflected as higher profits. However, in looking at this issue it is important to distinguish between short-run and long-run impacts.

Any changes in the cost of any inputs — up or down — must have at least short-term impacts on the profitability of the relevant businesses as they do not usually instantaneously alter their input mix, drop prices or adapt in other ways. So the imposition of higher penalty rates resulting from award modernisation in some industries and jurisdictions would have had short-term adverse effects on profitability, while the reduction of penalty rates, as recommended in this inquiry, would also provide short-term additional profits to businesses. The duration of these profitability effects will depend on the specific circumstances of the market.

Many stakeholders identified significant effects of penalty rates on profitability (with positive effects from lower rates and adverse effects from higher ones), often with the implication that these effects would be enduring:

We support [that Sunday penalty rate could be lowered to the level of the Saturday penalty rate] as it would ... improve small business profitability. (Australian Small Business Commissioner, sub. DR366, p. 7)

Employers agitating for this change should be able to provide details ... to support their view that reductions in Sunday penalty rates will increase employment rather than merely increasing profitability. (United Voice, sub. DR354, p. 10)

It is trite to suggest that the Bill [to lower penalty rates] will do anything other than increase the profit margins of small businesses at the expense of low-paid, working Australians. (ACTU submission to *Fair Work Amendment (Small Business – Penalty Rates Exemption) Bill 2012*, 27 September 2012)

All this [lowered penalty rates] will do will give bigger profits to business owners. ... Many businesses that are currently affected by penalty rates are already highly profitable. Employees will be the ones that suffer, as business owners won't pass the extra profits onto workers. (Mitchell cited in Richards 2015)

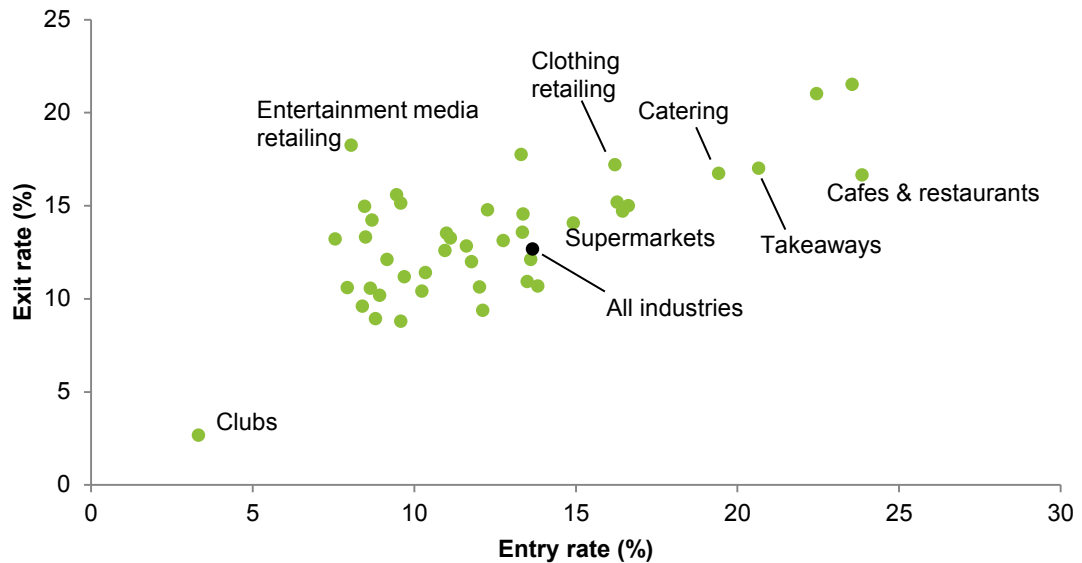
However, long run profitability is unlikely to be affected by penalty rate levels. Effects on profits are not enduring at the industry level because two processes tend to restore normal levels of profitability. Higher rates of return on capital attract entry in industries, such as those in the HERRC, that do not face substantial business entry and exit costs. (Exit and entry rates are high in most industries, and especially so in restaurants, catering, takeaways and cafes — figure 14.2 and table 14.2.) This spreads existing customers among a larger number of businesses, and tends to lower returns.

Equally, in a workably competitive market (as is clearly the case in the HERRC industries), existing businesses facing competition tend to lower average prices or increase the quality of the product to consumers by opening longer, increasing staff-to-customer ratios, or employing better qualified staff. Their business strategy will depend on market conditions. But, whether it is through price or quality effects, increased profits are

ultimately transferred to consumers. The converse process applies when a regulatory shock adversely affects profits, with the failure of some businesses and the adaptation by others (such as by opening for reduced hours on Sundays).

**Figure 14.2 Entry and exit rates in hospitality, retailing, restaurants and cafes**

June 2013 to June 2014<sup>a</sup>



<sup>a</sup> The exit rate is the number of exits over the following year from the stock of firms in June 2013. The data are at the subdivision level and, apart from 'All industries', only cover businesses in the HERRC industries.

Source: ABS 2015, *Counts of Australian Businesses, including Entries and Exits, Jun 2010 to Jun 2014*, Cat. no. 8165.0, 8 April.

**Table 14.2 Exit rate over four years in selected industries**

June 2010 to June 2014<sup>a</sup>

Industry	Exit rate (%)
Motor Vehicle and Motor Vehicle Parts Retailing	33.4
Fuel Retailing	34.1
Food Retailing	43.6
Other Store-Based Retailing	41.2
Non-Store Retailing and Retail Commission-Based Buying and/or Selling	60.2
Accommodation	33.5
Food and Beverage Services	48.3
All industries in the economy	38.3

<sup>a</sup> 100 minus the survival rate.

Source: ABS 2015, *Counts of Australian Businesses, including Entries and Exits, Jun 2010 to Jun 2014*, Cat. no. 8165.0, 8 April.

Long-run profitability of an industry is determined by the interaction of market competition, innovation and risk, and not by wage rates, a point also noted by the Fair Work Commission (FWCFB 2014 para 27). There is little evidence to suggest that measures of profits have any particular trend reflecting penalty rates (table 14.3).

**Table 14.3 Profits and losses in selected industries**  
2006-07 to 2013-14<sup>a</sup>

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
	<b>Index of profit margin (2006-07=100)</b>							
	Index	Index	Index	Index	Index	Index	Index	Index
Total retail trade	100.0	91.4	93.7	98.3	98.8	95.1	94.3	97.6
Accommodation	100.0	80.5	126.3	102.3	72.3	111.8	105.0	91.7
Food and beverage services	100.0	64.7	98.7	125.2	98.6	102.8	103.5	102.8
Total arts and recreation services	100.0	104.5	106.9	117.1	102.5	100.3	99.8	98.4
All industries	100.0	93.9	85.7	95.6	103.5	100.6	87.6	90.1
	<b>Share of enterprises making a loss</b>							
	%	%	%	%	%	%	%	%
Total retail trade	20.7	26.2	24.9	28.4	30.9	27.6	26.2	24.3
Accommodation	26.4	26.0	25.3	23.8	..	19.4	19.4	19.6
Food and beverage services	22.5	33.2	34.8	30.7	..	23.4	22.9	25.6
Total arts and recreation services	29.9	27.6	28.2	30.6	34.6	19.3	20.2	24.7
All industries	23.5	23.7	24.8	25.4	25.4	21.4	20.8	20.0

<sup>a</sup> Profit margins (operating profits as a share of revenue) vary from industry to industry because they have varying levels of capital. For example, an industry may have a high profit margin because it is a capital intensive industry, though its return on capital may be equivalent to another business with a lower profit margin. Accordingly, normalising the initial profit margin to 100 provides a better way of comparing the measures over time.

Source: ABS (various issues), *Australian Industry*, Cat. no. 8155.0.

Oddly, some of the key proponents of the view that lower penalty rates would merely increase profitability tend to repudiate that higher penalty rates lead to sustained losses (for example, as in the expert testimony to the Fair Work Commission (FWC) of Professor Mitchell ([2014] FWCFB 1996, p. 13), despite the fact that the same processes make neither a likely outcome. This is an important issue, which the FWC should consider as part of its current review of penalty rates.

Moreover, arguments that the FWC should lower regulated penalty rates because some businesses are unviable at those rates is not a compelling basis for such a change in its own right. In any industry, there is a share of businesses that are making losses or are close to doing so. Lowering wages may provide temporary respite, but competition will always lead to a tail of underperforming businesses (as ABS data on profitability across a



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multitude of industries attest).<sup>152</sup> Of course, business exits are costly in both human and resource terms (since there are transitional impacts), but these are only relevant in policy terms where the regulatory impost is not justified.

Others advance a different mechanism, suggesting that lower penalty rates actually decrease long-run profits (or that their increase would have the opposite effect):

A reduction in penalty rates runs into a national impact of billions of dollars less of expenditure on penalties, and the spin offs for national income. These effects are even stronger because many of those on penalty rates at awards spend all their income. This would have downward effect on consumption expenditure on goods and services, employment and profits. (Unions WA, sub. DR351, p. 8)

Textbook models that predict employment will grow if wages are cut have no evidential basis. Employment is driven by the strength of spending. Wage cuts reduce income and undermine spending (Mitchell in Lewis and Mitchell 2014, p. 2)

With less money in their pockets to spend, cuts to low-paid workers take home wages will result in businesses taking the second round of hits, usually small businesses in regional and rural areas who can least afford it. (Australian Services Union, sub. DR283, p. 6)

A McKell Institute report (Equity Economics and UMR Strategic Research 2015) on the effects of penalty rate reductions in rural areas applies the same premise to regions, suggesting that lower penalty rates would be harmful to activity in the regions.

Such apparent effects on economic activity ignore multiple automatic feedbacks in the economy, including adjustments in prices and demand, and movements of resources between industries and regions. To the extent that an economy is failing to use its available resources due to inadequate aggregate demand, then macroeconomic policies are the most effective option, not selective wage regulations. Such reasoning also invites the question of why further benefits would not be realised by increasing penalty rates by even more.

### 14.3 Effects on employment

There are strongly held views about the employment effects of penalty rates. Industry submissions to this inquiry (and to the FWC and other inquiries)<sup>153</sup> have generally claimed significant employment effects, while employees and unions have questioned this, or even claimed perverse outcomes (box 14.2). Indicative of the same tensions, the full bench of the FWC was equally divided in its view.

The following material covers some of these issues in detail, but the bottom line is that there are likely be some positive employment impacts, though less than those sometimes claimed by the proponents of reduced penalty rates. However, the benefits from reducing

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<sup>152</sup> ABS (various issues), *Australian Industry*, Cat. no. 8155.0.

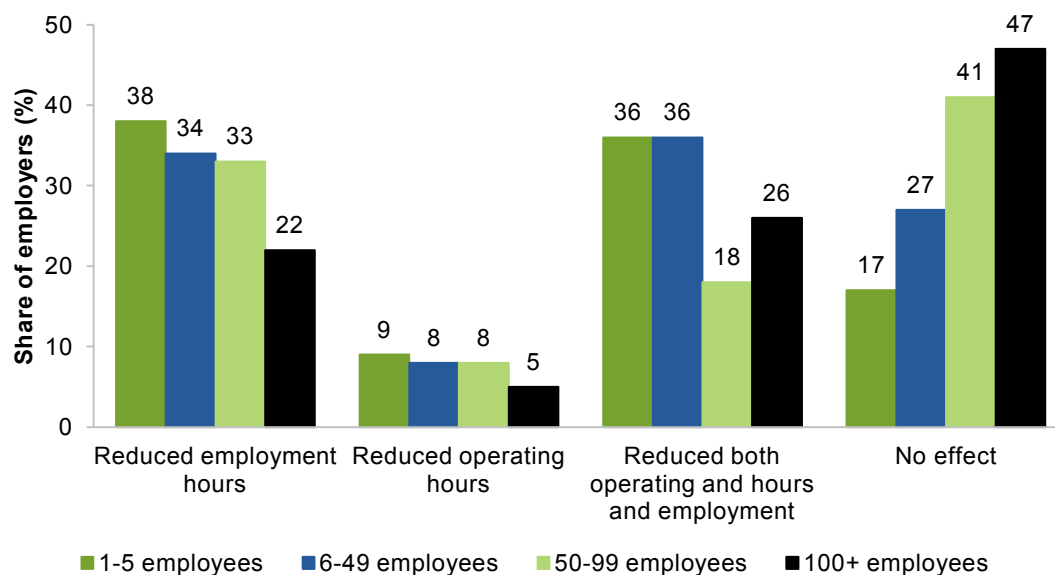
<sup>153</sup> For example, a Senate inquiry into a penalty rate exemption for small businesses (EEWRLC 2013).

penalty rates only partially rest on their employment effects, and so the prominence given to this in the policy debate misses the more important impacts on consumers and by giving greater choice to some employees about when they can work (section 14.1). Many of the major reforms made over the last three decades had their largest impacts on the efficient use of resources, not on expanding employment in any given sector.

## Evidence from business surveys

There is also some indicative survey evidence of the impacts of penalty rates on employment in the HERRC industries (for example, figure 14.3, and tables 14.4 and 14.5).

Figure 14.3 **Employment effects of penalty rates**  
Sample of Queensland businesses<sup>a</sup>



<sup>a</sup> The survey asked employers to rate the importance of penalty rates on employment and operating hours. Few other business stakeholders quantified the employment impacts of penalty rates, but instead provided subjective measures of concern about them.

Source: Chamber of Commerce and Industry QLD (sub. 150, p. 27).

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## Box 14.2 Participants' views on employment effects

### Big effects:

Although operating days and hours is a decision to be made by the business owner and is based on a range of factors, it is disappointing to think that Australia is in a situation where business turnover and employment opportunities are reduced due to penalty rates. This is not advantageous for employment levels, productivity or the economy. (Office of the Australian Small Business Commissioner, sub. 119, p. 7)

Penalty rates can be a deterrent to employment, particularly when combined with rules around minimum engagement of employees. In the pig breeding and raising industry ... on a Sunday, the combined effect of these provisions for one hour's work is equivalent to \$100 per hour. This is disproportionate to the inconvenience to the employee and a significant disincentive to employment. As the dairy example provided earlier shows, many farmers choose to undertake this work themselves because they cannot justify the cost. Ultimately, this dampens productivity by causing fatigue among farm owners and stifling job creation. (National Farmers' Federation, sub. 223, p. 15-16)

... employers have legitimate concerns that some aspects of the current system, for example penalty rates, excessively inflate labour costs and discourage job creation. In the present economic climate, it is particularly important that minimum and award rates of pay do not unduly constrain the ability of employers to retain staff or hire new employees. (Western Australian Government, sub. 229, p. 1)

44 per cent of [surveyed Queensland] businesses noted that they have decreased or substantially decreased the number of full time staff. Taken together, the results suggest that rising labour cost loadings are affecting business decisions about staffing hours and negatively impacting employment. (Chamber of Commerce and Industry Queensland, sub. 150, p. 25)

There is a concern that in a climate where many small to medium Clubs are struggling financially, that unsustainable penalty rates will have the effect of these employees suffering a reduction in hours or no employment all together. (Clubs Australia Industrial, sub. 60, p. 12)

On many occasions, we would have liked to give staff members the weekend work that they desire, but are instead unable to offer them ANY work on these days because we can't afford the overtime pay rate. This is a lose-lose for both the business and the employee. (Steven and Michelle Finger, sub. 142, p. 2)

### Limited or no effects:

I'd like to see evidence presented (of which a great deal exists) that finally puts an end to the furphy that reducing minimum wages or cutting penalty rates will solve business' 'problems'. Better management will solve business' problems. I'd also like to see an end to lazy blaming of the legislation for poor workplace relations — workplace relations don't rely on law, they rely on people knowing their jobs, working together, and behaving respectfully. (Respondent to survey of 813 members by Australian Human Resources Institute, sub. 46, p. 26)

... employers have provided limited evidence that penalty rates have had the negative effects claimed, such as causing them to employ fewer workers on a Sunday. In FWC's 2013 penalty rates decision, the Commission noted the 'significant evidentiary gap in the cases put [by employers]'. (Employment Law Centre of WA, sub. 89, p. 15)

There is no reliable evidence or economic analysis that removing penalty rates will boost employment and job creation in cases put before the FWC to date. Further, minimum wage earners and their families who rely on penalty rates to make ends meet would be disproportionately affected by reductions. (Catholic Commission for Employment Relations, sub. 99, p. 2)

As with the minimum wage, the argument for the abolition of penalty rates assumes that allowing lower rates of pay would mean that employers could employ more people to work more hours – thus resulting in a win for everyone. However, the Society disagrees with this argument for a number of reasons. Firstly, it places value on employment at the cost of all else, including an adequate standard of living. ... Secondly, the argument that deregulation of incomes will lead to better outcomes assumes that dissatisfied employees will be able to get more hours, or move on to better paid work elsewhere. However, in the current employment market, with rising unemployment and one job for every thirteen jobseekers, this seems highly unlikely ... Thirdly, the argument assumes that lowering pay will increase employment. As the Issues Paper points out, the reality is far more complicated, and in fact the reverse relationship might hold. In any case, the cost to individuals who are already struggling must be weighed, as well as the risk that increased business income would not be used to employ more staff but for other purposes. (St Vincent de Paul Society, sub. 78, p. 4)

**Table 14.4 Perceived impacts of penalty rates on small business**

Indicators from a small sample of Western Australian employers<sup>a</sup>

<i>Type of impact</i>	<i>Share of employers</i>
	%
Premium needed to attract employees on weekends if penalty rates completely removed?	
Yes	37
No	55
Any negative impact of penalty rates on hiring?	55
Any negative impact of penalty rates on weekend trading	61
Strategies used to address penalty rates	
Modified opening hours	22
Rostered staff who had least impact	25
Owner worked weekends/public holidays	40

<sup>a</sup> As acknowledged by the Western Australian Government (sub. 229, p. 8), the sample size was small, saying that: 'Despite the limited number of responses as a consequence of the time limitations required to ensure inclusion of the results in this submission, the responses are still insightful.'

Source: Western Australian Government (sub. 229).

**Table 14.5 Business views about the employment impacts of setting Sunday rates at Saturday rates**

Queensland HERRC businesses, 2015<sup>a</sup>

<i>Type of impact</i>	<i>Units</i>	<i>Effect</i>
Businesses open on Sundays	Share (%)	70
If not open, would you open if Sunday rates were equal to Saturdays	Share saying yes (%)	80
If the business was open on Sunday, and Sunday rates were set at the Sunday rate, would you:		
open for longer?	Share saying yes (%)	45
If yes, by how many hours?	Average	3.8
If yes, by how many hours?	Median	3
increase existing staffing while open?	Share saying yes (%)	60
increase share of permanent staff?	Share saying yes (%)	45
hire additional employees?	Share saying yes (%)	50
If yes, by how many people?	Average	5.2
If yes, by how many people?	Median	2
leave opening hours on other days the same?	Share saying yes (%)	90
increase opening hours on other days?	Share saying yes (%)	10
decrease opening hours on other days?	Share saying yes (%)	0

<sup>a</sup> The overall sample size is small, and so the results should be seen as only indicative. A much larger survey would be required to secure reliable results.

Source: CCIQ and QTIC (sub. DR311).

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Drawing on the results of a survey of local businesses, the Launceston Chamber of Commerce (sub. 124) estimated that employment in the retail and accommodation/hospitality sectors in their region would increase by 943 full time equivalents (or a 9 per cent increase) if penalty rates were ‘either significantly reduced or abolished’.

Another Australia-wide survey of 1000 restaurant and cafe services claimed that reduced weekend penalty rates would significantly increase employment and hours worked (Jetty Research 2015). For example, around half of the surveyed businesses said that they would increase employment on Sundays/public holidays (by an average of about three employees) and around 40 per cent indicated that they would open for longer. Of the 10 per cent of restaurants that do not currently open on Sundays and/or public holidays, 70 per cent said that this was because of penalty rates or an inability to trade profitably. Across the 1000 employers, the average predicted increase in staffing was 1600 employees and 2100 extra hours of opening. The study projected increases in employment of nearly 40 000 employees.

However, a major deficiency in this study is that it asked for employers’ views about the impacts of a reduction in penalty rates, but did not specify the actual magnitude of that reduction. Accordingly, the answers given would reflect different judgments by respondents on the magnitude of the hypothetical change. It may be that some would have considered that the reduction was from 150 to 125 per cent (the Sunday and Saturday penalty rates respectively for the relevant industries), but others may have made different surmises, such as from 150 to 100 per cent. This affects the meaningfulness of the results, and suggests that the results are likely to overstate any real impacts.

All of the business surveys cited above would fail the (overly) stringent tests of reliability proposed by Bartley (2015), an expert witness for the Shop, Distributive and Allied Employees Association (SDA). However, all surveys bar those from the Australian Bureau of Statistics would be likely to fail that test, including the AWALI and AWIRs surveys. Given the limitations in surveys of this kind, the numbers should be treated as suggestive more than definitive.<sup>154</sup> But they should not be disregarded. Evidence is always imperfect, and few conclusions about anything in the social sciences could be reached if only those

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<sup>154</sup> As an indication of the subjective nature of the answers, in contrast to the relatively high frequency of businesses identifying no effect from penalty rates shown in figure 14.3, an ACCI (2013a, p. 6) survey indicated that only around 10 per cent of businesses had no concern with penalty rates (and 45 per cent said that it was a major concern). A survey by the Australian Human Resources Institute (sub. 46, p. 17) indicated that 50 per cent of respondents considered that rates ‘required less regulation and realignment to today’s economy’ (a potentially leading question).

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studies that met the full set of conditions set by Bartley were given any weight.<sup>155</sup> Moreover, as discussed in section 14.5, one of the most ignored issues in this area is the onus of proof. Placing the onus on ‘proving’ that penalty rate reductions are beneficial and then pointing to any deficits in the methods used or deficiencies in data in support of change makes the task of repudiation an easy one.

## **The economics of employment responses**

The employment issues are far more nuanced than captured by the often partisan and diverging claims of the various parties, though businesses more often indicate better the variety of pathways that can affect the different dimensions of employment.

### **Employment effects for existing and new businesses**

Most business surveys of the employment impacts of lower penalty rates relate only to existing businesses, yet new businesses prompted to enter because of higher short-term profits will also increase employment. It may be that business surveys of employment effects still provide reasonable indicative evidence of the overall employment impacts in the HERRC industries on Sundays, but merely fail to realise those gains are partly distributed to other businesses. There is no empirical evidence on the importance of this effect, except to note that entry rates are very high in many of the relevant industries. (At the technical level, there may also be ‘general equilibrium effects’ because lowering regulations on penalty rates is likely not only to result in a medium-run shift in the demand for HERRC products for a given demand function, but to shift that demand function outwards, creating second round stimulating impacts on the overall level of required labour. The same process occurs if minimum wages have a binding effect on employment.)

### **Employment versus hours worked on Sundays**

Given hiring costs, it is typically easier for businesses to increase the hours of work of existing employees than to hire new ones. In much of the literature on the aggregate employment effects of changes in wages, the effects are larger for hours than employment, as in appendix C and Leigh (2003). The Chamber of Commerce and Industry Queensland and Queensland Tourism Industry Council survey — while only based on a small sample — suggested that the businesses concerned would increase existing staffing levels at times

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<sup>155</sup> For example, no regression would ever meet the strict assumptions she applies for ‘reliable’ regressions. The real question is the seriousness of any departure from the unrealistic benchmark, and what can be done about it. Some empirical analysis is poor, but failure to meet the benchmark is far from sufficient to dam research findings. In fact, in technical terms, the parameters in ordinary least squares are unbiased and weakly consistent even with non-constant variance of the errors. The problem is inference (commonly addressed through the use of White’s heteroscedasticity consistent standard errors or, in some cases, bootstrapping).

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when they were already open (table 14.5). This remains an employment effect, just not one characterised as ‘new’ employment.

### Substitution between days of the week

Demand for goods and services on any given weekday are partial substitutes for goods and services on other days. Consumers who are now able to shop or dine out on a Sunday may do so less on other days. Accordingly, there will be some displacement of demand and, in turn, employment in the industry from one day to another. ‘One day’ models that ignore this substitution effects will produce erroneous aggregate employment effects (Borland 2015; cf. Lewis 2014). That said, substitution is not perfect, as suggested by the outcomes from shopping hour deregulation, which indicates that there is increased overall demand from the greater convenience associated with longer opening hours (section 14.1).

There are also gains for employees even if all they do is simply switch days of the week. Many employees value flexibility in their working hours, and existing Sunday penalty rates are likely to price some people willing to work on that day out of the market. That may force them to work at a time less convenient to them. As noted by some employers:

Some staff actually are happy to work on a Saturday morning if they can have an afternoon or morning off during the week. It seems ridiculous to have to pay extra wages to open Saturday morning when it suits some staff to work then anyway. (Western Australian Government, sub. 229, p. 30)

Indeed, many employees are attracted to this [the hardware industry] segment of the retail industry because of their ability to work on Sundays. These people can include students, parents juggling child-minding responsibilities, those aspiring to managerial duties, and those seeking a second job to help with their finances. In many cases, these people are being denied opportunities because of the penalty rates associated with this work. (Hardware Federation of Australia, sub. DR316, p. 8)

The CCIQ and QTIC survey suggested that most businesses would not change the opening hours at other times of the week, and some suggested that they would open longer (table 14.5). However, businesses’ intended short-run supply intentions can vary from their responses once consumer demand patterns have changed. From the consumer perspective, there must be some substitution in demand between different times, and so lower staffing on other days seems likely.<sup>156</sup> Over time, an overall small net increase in activity could be expected across the full week.

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<sup>156</sup> However, there is a distinction between the days that a business is open, and the amount of trading activity and employment on any given day. As discussed in box 14.1 and further below, the mix of employees and business owners may also vary by the day of the week.

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## People will be partly drawn from other industries

Some people who would be able to obtain additional hours of work or a job on Sundays in the HERRC industries may have relinquished work in other industries that offered them less preferred conditions or times of operation. This is a standard outcome whenever there is a regulatory shock that expands one industry. It is similar to the effect that occurs when people move from one other day in the week to a Sunday within the HERRC industries, but involves movements from outside the HERRC industries. This is an efficient outcome and beneficial to the moving employees.

## The labour mix may change

It appears that sometimes penalty rates encourage business owners to employ casual and younger employees on weekends to reduce labour costs, noting that the Sunday penalty rate treatment of casuals can also sometimes favour their employment on weekends over permanent employees (appendix F). There is a view by some, including employees, that lower-cost ‘inexperienced staff’ are employed on Sundays (figure 12.6 in chapter 12). Lowering overall labour costs may encourage businesses to increase the share of permanent staff and some suggested that they would do so (table 14.5).

## Employment of proprietors and employees

Labour on Sundays is disproportionately provided by business owners and sometimes their family members across all industries, with this being especially prominent for the HERRC industries (appendix F and box 14.1). Several stakeholders noted that working proprietors and family members were often the only resort for weekend work.<sup>157</sup> Such people currently work much longer hours than other employees and more commonly on weekends. For example, a survey of 350 members by the Australian Newsagents Federation found that over 92 per cent of the proprietors worked every Saturday, and 87 per cent worked regularly on Sundays of those newsagents that were open (sub. 218, p. 10).

It can be expected that some businesses will rely less on business owners, and more on employees for weekend operating. As discussed in box 14.1, having been freed from the requirement to work on weekends, some business owners may contribute their labour at other times of the week. Either way, from an economic view, some of the hours of work provided by business owners may be reduced (quite desirably from their perspective), but this partly limits the total employment increases associated with reduced Sunday penalty rates in the relevant industries.

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<sup>157</sup> For example, Andrew Steers (sub. 5, p. 1), Western Australian Government (sub. 229, p. 26), and the South Australian Wine Industry and Winemakers’ Federation of Australia (DR352, p. 40)



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## How responsive is the demand for labour in the HERRC industries?

As noted in a recent landmark decision by the FWC on penalty rates (FWCFB 2014), the responsiveness of labour demand to changes in wage rates is a decisive issue for employment responses in the relevant industries.

The size of the wage change from lowering Sunday penalty rates to Saturday rates suggests a strong labour demand response at least on Sundays (table 14.6). For example, a reduction in the Sunday penalty rate of 175 per cent to the Saturday rate of 150 per cent in the restaurant industry for casual level 3 employees and above would imply a reduction in wage rates of just above 14 per cent. In the case of the retail industry, parity of the Sunday rate with the Saturday rate would imply a wage rate reduction of around 33 per cent were the new regulated penalty rate to bind.

It is possible that the actual wage reduction will be less than this if employers had to provide Sunday premiums above the Saturday rates to attract sufficient quality staff, noting that regulated penalty rates set a floor not a ceiling on wage rates. However, given the New Zealand experience for penalty rates (chapter 13) and the views of businesses (table 14.4), it seems likely that wage rates would still fall significantly. The views from unions and individual employees about the income distribution impacts of reduced regulated penalty rates are also consistent with this.

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**Table 14.6 Impacts on direct business employment costs of changes to Sunday penalty rates**  
Various industries, 2015<sup>a</sup>

<i>Industry</i>	<i>Permanent employees</i>	<i>Casual employees</i>
	<i>%</i>	<i>%</i>
Restaurant Industry	-14.3	-14.3
Registered and Licensed Clubs	-12.5	-14.3
General Retail Industry	-33.3	-32.5
Hospitality Industry (General)	-25.0	-14.3
Amusement Events and Recreation	-31.7	-28.6
Fast Food Industry	-14.3	-14.3
Pharmacy Award	-33.3	-33.3
Hair and Beauty	-29.8	-33.5

<sup>a</sup> Direct business costs for permanent employees takes account of any leave loading and leave entitlements. Note that no leave loading is available under the Amusement Events and Recreation award. In several of the awards there are multiple penalty rates on some weekend days. In the case of retail pharmacy, the usual Saturday penalty rates of 125 and 150 per cent for permanent and casual employees respectively have been used. In the restaurant industry, the penalty rate on Sundays relates to level 3 to 6 employees.

*Source:* Various awards from the FWO (2015c, 2015d).

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The degree to which such large wage rate changes affect employment, how quickly, for whom, when and where, is not easy to estimate. The broad empirical evidence suggests that, with the exception of youth wages, a 10 per cent decrease in wage rates could increase the *economywide* demand for labour (on both a headcount and hours basis) by around 5 per cent (appendix C).<sup>158</sup>

However, these economywide estimates may not be a good guide to the labour demand responses for Sunday labour in the HERRC industries (Borland 2015, p. 5):

- The type of labour is different from the average (the jobs tend to be more often entry-level, lower-skill jobs)
- The wage elasticity of demand for HERRC jobs on *Sundays* is likely to be higher than many others because owner-managers and family members can readily substitute for employees and because, increasingly, there are alternative less labour-intensive methods for meeting customer's needs (as through automation — chapter 11).
- The economywide employment responses to wage shocks relate to all days of the week, which are different from shocks just affecting one day.

Consumer demand also appears to be relatively responsive for some critical segments of the HERRC industry, noting that labour demand is a 'derived' demand and depends on consumer responses to lower prices or other positive attributes of a good.<sup>159</sup> An elasticity of -1 would imply that a 10 per cent increase in the price of fast foods would decrease overall demand for fast food by 10 per cent. Less is known about the responsiveness of shopping at physical retail outlets to prices (rather than to the specific goods they provide) or to access to entertainment in physical venues rather than remotely at home. It appears likely that consumer demand elasticities for brick and mortar services are rising with the advent of substitutes that were not previously available.

On the other hand, as discussed in section 14.1, the prices on Sundays of many services in the HERRC industries will not fall to reflect the changes in labour costs on that day, but will be spread throughout the week (though Sunday surcharges for restaurant meals will likely vanish). Accordingly, price reductions will not have many effects on demand on Sundays. Nevertheless, consumers value greater convenience in accessing services on Sundays, which represents a decrease in the quality-adjusted price of services.

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<sup>158</sup> This does not contradict the existing evidence that small changes to the minimum wage around their current levels have modest employment effects. That is to be expected given that the changes are small, that one of the prime goals of the expert group setting the minimum wage is to avoid any significant adverse employment effects, and that there are differences between aggregate demand elasticities and those for a subgroup.

<sup>159</sup> For example, studies have found demand elasticities of -2.5 and -0.9 for fast food (Jekanowski, Binkley and Eales 2001; Okrent and Kumcu 2014) and -5.4 and -0.8 for inexpensive restaurants and expensive restaurants respectively (Jekanowski, Binkley and Eales 2001). A more recent survey of the literature suggested elasticities of demand for the café, restaurant and catering services industry of between -0.9 and -3.8 (Lewis 2014).

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Accordingly, businesses that opened on Sundays or extended their trading hours could expect increased custom.

Given the characteristics of the demand for HERRC goods and services, and the high labour shares in these industries (chapter 11 and table 15.1 in chapter 15), it seems very likely that there would be considerable growth in hours worked and, to a lesser extent, employment *on Sundays* from lowering penalty rates on these days. If a labour demand elasticity for Sunday of -0.6 (a hypothetical, but probably conservative estimate) were to apply, the anticipated increase in hours from say a 33 per cent reduction in wage rates would be around 27 per cent.<sup>160</sup> The change would also be likely to reduce the trend towards capital substitution in the relevant industries (noting that the scope for automation and self-service is rising). A shift in total hours of this magnitude would take the form of greater hours for existing staff and hiring of new employees. The mix is unclear and would depend on the characteristics of labour supply and demand for would-be employees and existing employees in each sub-market.

The Productivity Commission's judgment that there would be a significant Sunday employment effect is at odds with the majority of the full bench of the FWC, who concluded that penalty rates 'have some effect, but not a significant effect, on employment on Sundays' (FWCFB 2014 para 139).<sup>161</sup> The relevant members cited uncertainty over labour demand elasticities and a view that minimum wage decisions had not had obvious employment effects. Both of the latter contentions are correct, but neither have much implication for the labour demand changes that could be expected when wage changes are large. The difficulty of identifying employment effects associated with the *small* real wage changes in annual wage reviews has no real relevance to real wage shocks of a completely different order of magnitude.

To put this in context, the real minimum wage (based on deflating by producer prices) increased by around 13 per cent over the nearly 40 year period from September 1978 to July 2015.<sup>162</sup> The wage shock represented by a *one-off* change in penalty rates from Sunday rates to Saturday rates is many times greater than that.

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<sup>160</sup> Based on a constant elasticity model of demand, with the log proportional change in demand for labour being equal to  $\epsilon \Delta \ln(135/200)$  where  $\epsilon$  is the demand elasticity (of -0.6 in this case). Borland (2015, p. 11) notes that the *market* premium for wages on weekends after reform may be higher than the *floor* set by regulation. In this calculation, it is assumed that the market clears at a premium rate of 135 per cent, rather than at the regulated floor of 125 per cent. (If the floor was binding, the demand effects would be around 33 per cent.) In his analysis of the impacts of changes to penalty rates, Lewis (2014) assumes a much higher degree of responsiveness, even to the degree that he regards it as possible that a 1 per cent increase in wage rates would reduce hours worked by 3 per cent (a labour demand elasticity of -3). This implies a very substantial (and, in the Productivity Commission's view, unrealistic) increase in weekend employment.

<sup>161</sup> If this were true, it would raise the question about why the FWC had not proposed *increases* in penalty rates. Were there only small employment consequences, then higher penalty rates would increase the earnings of the low paid.

<sup>162</sup> Based on data from Bray (2013b), wage reviews from the Fair Work Commission and GDP deflators from the ABS *National Accounts* (Cat. no. 5206.0).

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The *aggregate* effects on overall employment cannot be readily estimated given the competing effects of substitution between employment at different days in the same industry, substitution between business owners and employees, substitution effects with other industries, and consumer demand increases reflecting some price reduction across all days. The hierarchy of effects suggests that the increase in employment and hours worked in the HERRC industries on Sundays would be greater than the overall gains in the HERRC industries and the economy as a whole, though estimating the extent of this is not possible without more elaborate analysis.

That said, economywide employment increases are highly probable because some people are only available for Sunday work or have a strong preference for it over other days. Those jobless (either unemployed or not in the labour force) suited to this niche part of the labour market will be particularly responsive to the opportunities presented by greater demand for labour on that day. Since joblessness is particularly adverse for people's wellbeing, any employment gains for this group would be particularly important. Stimulation of entry-level jobs can also provide longer-term benefits for young people in integrating them into the labour market by building skills and experience.

Weekend employment also offers opportunities for skill development for some employees who, by virtue of their other studies, are not available on weekdays. For example, one employer noted that it wanted to provide employment for pharmacy students, but that penalty rates discouraged this (Master Grocers Australia and Liquor Retailers Australia, sub. 246, p. 12).

## **14.4 Impacts on the earnings of existing employees**

The degree to which the labour earnings change for people currently employed on Sundays depends on the:

- new regulated Sunday penalty rate for each relevant award
- extent to which some negotiated weekend wages might lie above a new lower penalty rate for Sundays. Even in New Zealand and the United States, where there are no legislated penalty rates for weekend work at all, they are still prevalent in some enterprise agreements
- timing of new enterprise agreements, as any penalty rates in existing agreements would continue to apply
- relative proportion of an employee's time spent working on Sundays
- extent to which lower wage rates induced greater demand for labour on Sundays. One labour economist has suggested that some existing employees might actually earn greater incomes on Sundays (Lewis 2014, p. 22), although that requires that the proportional increase in the hours of work they obtain would be sufficient to offset the proportional decline in wage rates. In any case, the models of the kind used by Lewis and others to assess the labour demand effects of wage changes do not distinguish

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between hours worked by current employees, hours worked by new employees, and headcount employment (and could not do so unless disaggregated data were available).

The Productivity Commission considers that it is improbable that, as a group, *existing* workers' hours on Sundays would rise sufficiently to offset the income effects of penalty rate reductions. As noted in chapter 12, many existing employees say they would actually give up working on that day with lower penalty rates (though that effect is also likely to be exaggerated).

In general, most existing employees would probably face reduced earnings, although new employees would receive additional income. Nevertheless, the adverse effects on existing employees would still be moderated to some extent by the availability of more hours of work, and potentially ones that suit their circumstances better. While as a group, employees more often want to work fewer hours, data from the AWALI survey showed that the share of employees preferring to work longer was significantly higher for people working on weekends than on regular days.<sup>163</sup>

### **The distributional effects of lower Sunday penalty rates**

Given the above results, the FWC, many employees and unions rightly identified the adverse effects of reductions in penalty rates on the earnings of low paid employees, whose welfare is a prominent goal of the Modern Award Objective (box 14.3).

Some argued that the Productivity Commission should analyse the distributional effects in more detail (St Vincent de Paul Society National Council, sub. DR280, p. 3), and the Commission has done so.

The prominence of the distributional concerns was a key motivation for the FWC's decision to preserve Sunday penalty rates for most employees in the restaurant industry. The FWC observed that:

The operating premise must be, therefore, that the full grant of the alternative application would reduce the take home pay of a large proportion of those employees covered by the Restaurant Award who already work on Sundays, and the extent of the reduction may be as high as approximately 17% for weekly employees and 14% for casual employees. Given that the modern awards objective requires the establishment of 'a fair and relevant safety net', taking into account among other things 'relative living standards and the needs of the low paid', any countervailing considerations concerning increased employment opportunities or productivity or other benefits to business would have to be clearly identified and demonstrated in order for the alternative application to be seriously entertained. (FWCFB 2014 para 295)

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<sup>163</sup> The effect was most pronounced for Saturdays, but also applied to Sunday employees.

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### Box 14.3      **Concerns about the income effects of lower penalty rates**

The QCU is also concerned with the plight of those workers for whom penalty rates are not a luxury, but rather allow them to make ends meet (rent, bills, food, etc.). An estimated 34.6% of employees in receipt of penalty rates rely upon them to meet their household expenses. (Daly as cited by Queensland Council of Unions, sub. 73, p. 3)

Many United Voice members are in insecure work arrangements and a large proportion rely on penalty rates to make ends meet and to compensate them for missing time off with family and friends on weekends, evenings and holidays. (United Voice, sub. 224, p. 2)

... a reduction in penalty rates would have detrimental and disproportionate impacts on female workers in these industries. (Textile Clothing and Footwear Union of Australia, sub. 214, p. 44)

... any suggestion of the removal of penalty rates for casuals and award based employees ... would have a significant impact on employees in retail, hospitality and nursing, which tend to be industries in which a large number of women work. (Women's Legal Services, NSW sub. 234, p. 1)

A reduction in penalty rates may disproportionately affect women who are award reliant, who are often employed in the hospitality, retail and community and disability care industries and who juggle their hours around family responsibilities and work hours where childcare is available via their partners or family. Quality affordable childcare is difficult to access on weekends so many women rely on family. (Working Women's Centres, sub. 242, p 13)

... those who rely on penalty rates to meet their household expenditure are far more likely to have any of the following characteristics: be single parents; women; in receipt of a household income less than \$30 000; not living in cities; be labourers; and be on contracts ... What this makes clear is that it is those Australians already doing it toughest who are relying on penalty rates to get by. Single parents, families living on less than the minimum wage, rural and regional Australians, and people in lower paid professions are the most financially vulnerable to the removal of penalty rates. This creates a very strong presumption that penalty rates should remain untouched. (St Vincent de Paul, sub. 78, pp. 3–4) (The submitter reiterated its concerns in a subsequent submission, sub. DR280, p. 5.)

Penalty rates supplement base wage rates and they are an important component of the income of award reliant workers. Many of these workers are the lower paid and use the opportunity to work for penalty rates to top up their wages to a reasonable level. (SA Government sub. 114, p. 10)

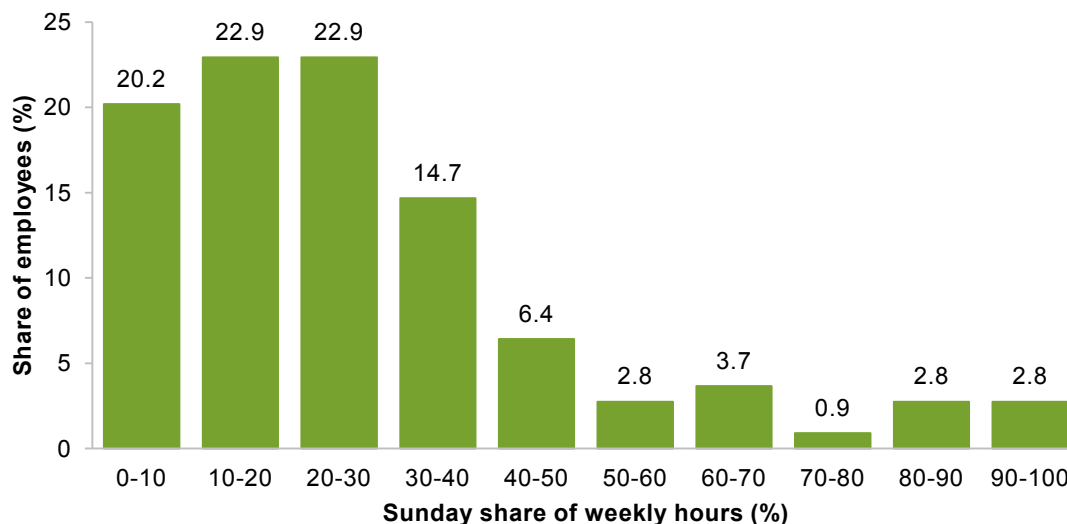
Workers in the hospitality, entertainment, retail, restaurants and café industries are already low paid in comparison to other industries. These workers are often vulnerable young people, students and low skilled workers in unstable employment. Many workers Legal Aid NSW advises and represents tell us that Sunday penalty rates are vital to help them achieve a reasonable take home pay. (Legal Aid NSW, sub. DR364, p. 7)

Even if we presuppose that lower wages will mean lower prices and employers will not pocket the savings from paying their employees less, the lowest paid will have their incomes reduced. The inequity in this type of exchange is staggering. Again those who can least afford it will lose out. (Queensland Nurses' Union, sub. DR309, p. 12)

A reduction in penalty rates would likely have a disproportionate effect on women and rural and regional workers, who are more likely to rely on penalty rates to meet their household expenses. (Employment Law Centre of Western Australia, sub. DR350, pp. 37–38)

A further slashing of my Sunday pay, one of the very few ways for me to accrue extra money to compensate for previous reductions and the irregular and unreliable nature of work within the hospitality industry (which is a significant factor in itself), would be disheartening and place me (and others within the industry) under more financial strain. It begs the question 'how hard does one have to work in order to not just make ends meet, but also to get ahead in life and improve one's opportunities?' (Holly Whittenbury, sub. DR263, p. 1)

Figure 14.4 The importance of Sunday work for HERRC employees<sup>a</sup>



<sup>a</sup> The data only relate to employees who work at least some time on Sundays.

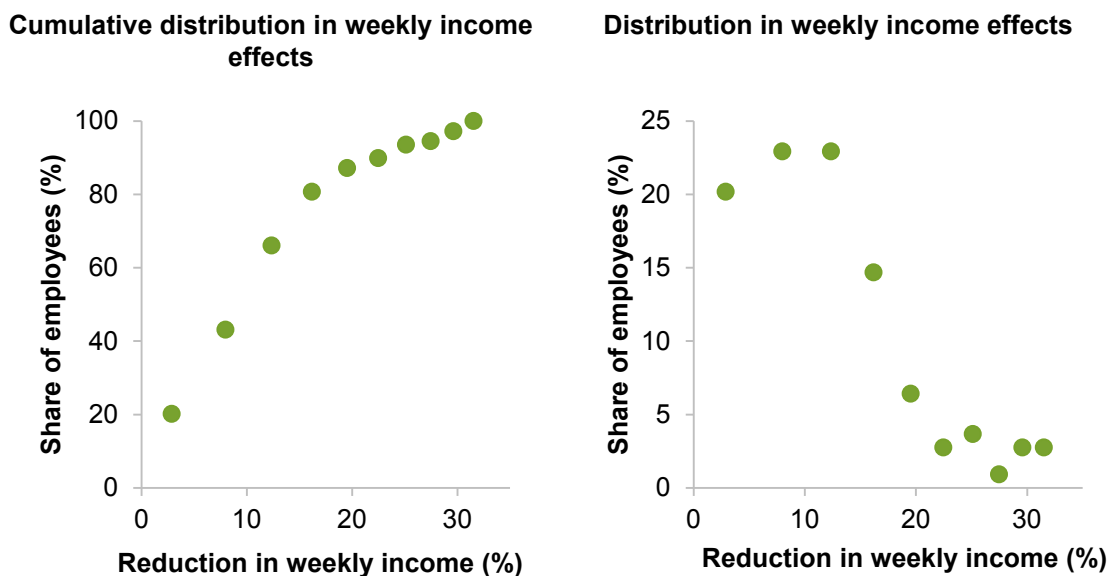
Source: ABS Time Use Survey CURF 2006.

For some other HERRC industries where Sunday penalty rates are higher — most notably, retailing — the income effects would likely be larger for employees working predominantly on weekends. Even so, only a minority of employees work only on weekends (chapter 11). Moreover, indicative analysis suggests that for around 65 per cent of HERRC employees, Sundays account for less than 30 per cent of time worked (figure 14.4). Only a very small share (2.8 per cent) have close to exclusive reliance on Sunday work. Most employees in the HERRC industries would have gross weekly income reductions of less than 10 per cent (figure 14.5). The net effect would be lower given offsets through increased social security benefits and reduced taxes.

The analysis in figure 14.5 takes no account of the impacts of changes to penalty rates for casual versus permanent employees in the HERRC industries (given data limitations). Other data show that casual employees working on Sundays tend to work fewer other days and, all things being equal, reduced penalty rates would more adversely affect them (figure 14.6). However, not all things are equal because the reductions in wage rates are not always the same for casuals. This is most stark for casuals in the hospitality industry, where adoption of parity for Saturday and Sunday rates reduces wage rates by 14.3 per cent compared with 25 per cent for permanent employees (table 14.6). Moreover, the Productivity Commission has recommended that the FWC closely examine the extent to which the currently lower effective penalty rates for casuals are justified (chapter 15 and appendix F). Were the FWC to increase casual rates on Saturdays for some awards by the amount required to remove the disparity in their treatment (appendix F), this would further reduce any income effects of the Productivity Commission's recommended reform of Saturday and Sunday rates.

Figure 14.5 **How much would penalty rate changes affect income?**

Indicative measures for the HERRC industries<sup>a</sup>



<sup>a</sup> Indicative measures were obtained as  $s(p1 - p0)/(1 - s + sp0)$  where  $s$  is the Sunday share of weekly hours,  $p1$  is the penalty rate after policy change and  $p0$  is the penalty rate before policy change (both divided by 100). In producing the estimates it is assumed that the share of weekly hours is the midpoint of the ranges shown in the previous chart. For instance, for the 20.2 per cent of employees having 0-10 per cent of their hours worked on Sundays, all are assumed to work 5 per cent of their hours on that day. The average Sunday rate is assumed to be 185 per cent before the reform (an averaged result based on the mixture of different non-casual penalty rates for Sundays for the relevant awards) and 125 per cent afterwards (which is the predominant rate for non-casual employees under the relevant awards). It is assumed that people work the same hours before and after the reform (so that they are 'day after' results). The results are not affected by pay rates or hours worked, since the only relevant factors explaining the percentage changes in income are the shares of weekly hours worked on Sundays and the relative penalty rates. Several sensitivity tests were undertaken for different assumptions about average penalty rates in the HERRC industries before and after reform, but these made little difference to the results. The results assume no casuals. Had they been included, the income effects would be smaller because the percentage reduction in penalty rates is less. For example, the Commission's recommendation would have no effect on incomes of level 1 and 2 restaurant industry casual workers (since they have the same Saturday and Sunday penalty rates).

Source: Productivity Commission calculations based on the ABS *Time Use Survey CURF* (2006).

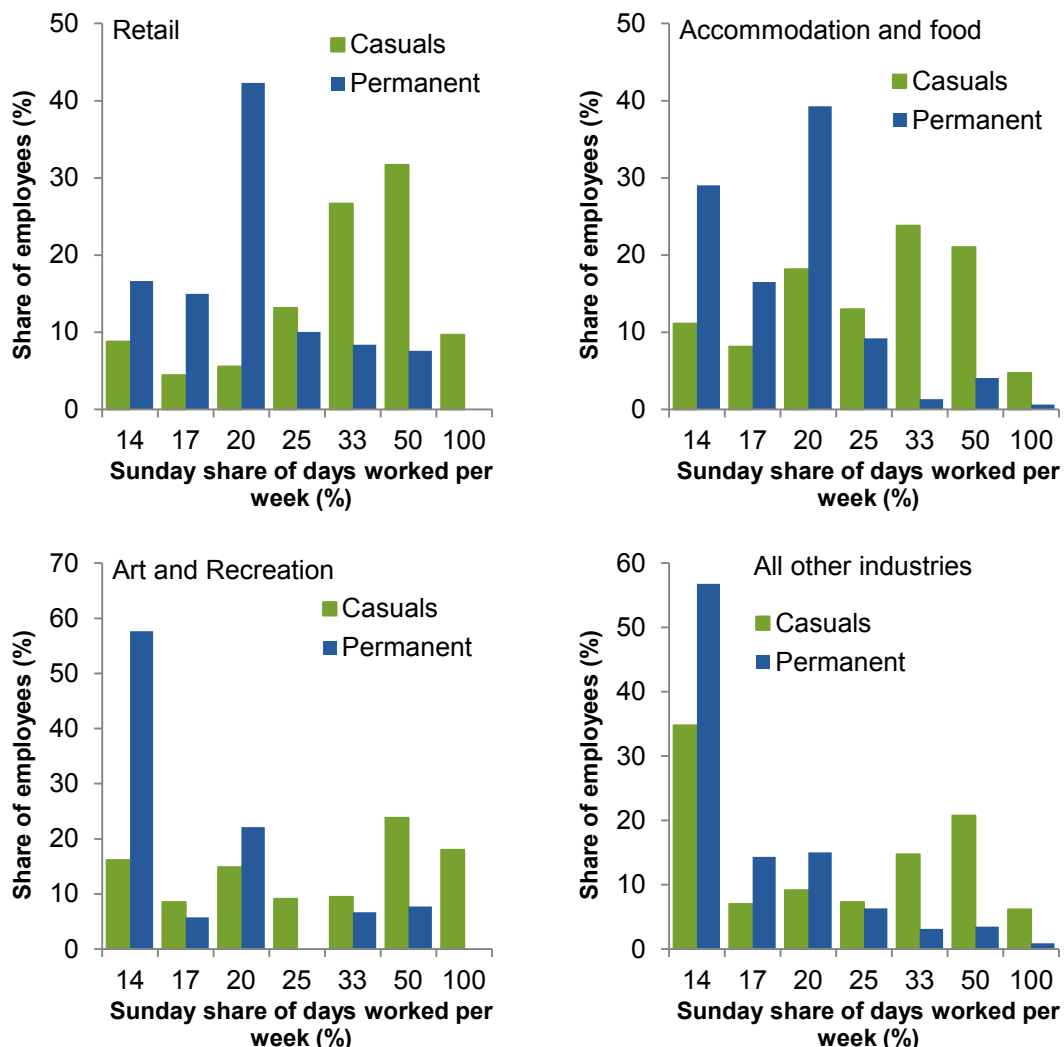
There are further considerations in making assessments of the ultimate income distributional effects of lower Sunday penalty rates and their relevance to penalty rate determination.

First, incomes would increase for those who do not currently have a job or for those whose preferred hours of weekend work are significantly below their current hours. This group may also benefit from improved lifetime participation in the labour market.



Figure 14.6 **Sunday work is more important for casual employees**

Sunday as a share of total days worked<sup>a</sup>



<sup>a</sup> Only relates to people working on Sundays. Casual status was determined by the respondent.

Source: ABS, Forms of Employment CURF 2008.

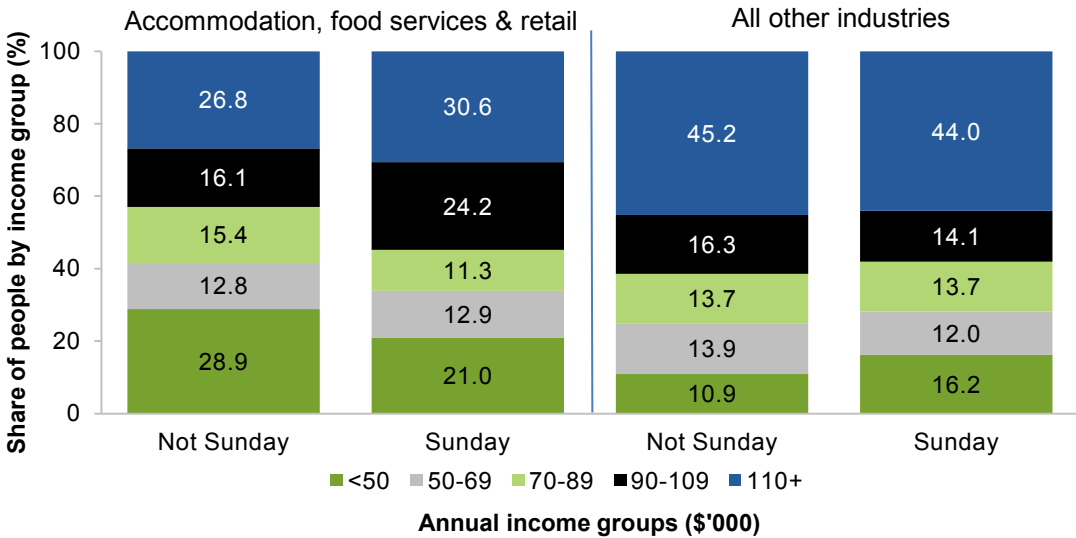
Second, regulated penalty rates apply to standard award rates. If an employee is on an above award wage rate, the employer is only required to pay them at the Sunday wage stipulated by the award. Accordingly, lowering Sunday penalty rates would have reduced impacts on the earnings of above-award employees (unless the practice of an employer was to apply the current Sunday premium rate to any above award standard wage).

Third, the adverse income effects may be partially offset by automatically increased transfers through the tax and transfer system for some households.

Fourth, households, not individuals, are the usual target for distributional policies. People earning penalty rates are spread across the household income distribution range. For

example, 47 per cent of people working often or nearly always on weekends in the accommodation, food services and retailing industries are in households earning more than \$90 000 a year, very close to the share applying to people in these industry groups who do not work on weekends. Results for people working often or nearly always on Sundays are less reliable because of lower survey samples, but show qualitatively similar results (figure 14.7).

**Figure 14.7 Household earnings of Sunday employees**  
2014<sup>a</sup>



<sup>a</sup> A Sunday worker is someone who often or almost always works on Sundays. Sample sizes are small for Sunday workers, so the results are less reliable than those who work on other days.

Source: Derived from the AWALI survey.

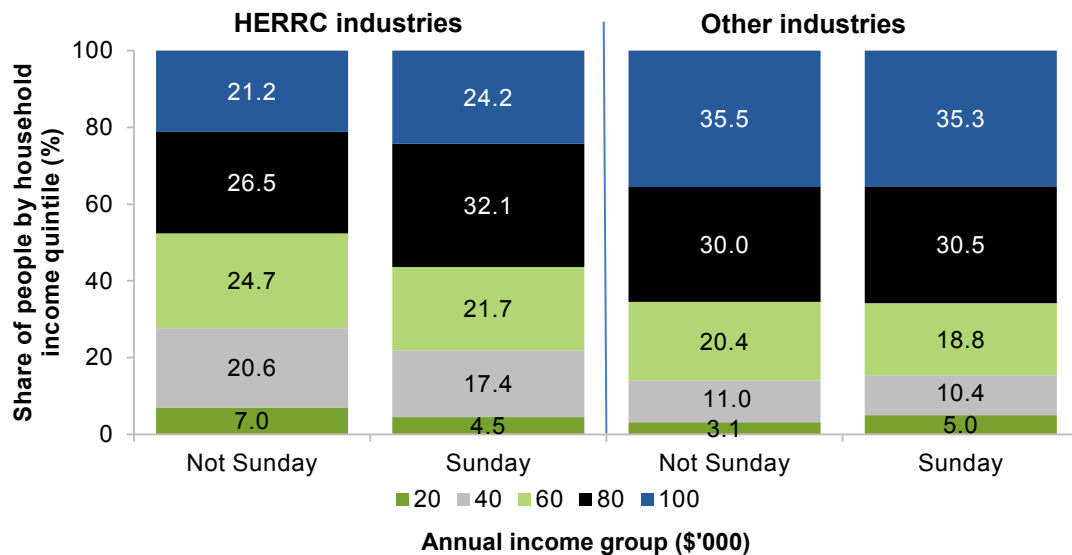
Other data based on equivalised household income (which takes account of household size and composition) suggest that people working in the HERRC industries are more likely to have lower income than others, as many have noted. Nevertheless, it remains that the majority of households in the HERRC industries have incomes above the 40<sup>th</sup> percentile, regardless of whether they work on Sundays (figure 14.8). Moreover, the evidence suggests that lowering penalty rates for Sunday workers in the HERRC industry would more closely align their income distribution with households where a person worked in the HERRC industry, but not on Sundays. Perhaps reflective of the importance of young people working in their parents’ households, there is also a higher likelihood that HERRC employees are in households with three or more earners (including the relevant HERRC employee) (table 14.7).

Fifth, some employees receiving penalty rates only engage in the relevant consumer services industry in the earlier years of their working lives and may have high lifetime expected incomes. For example, this would often be true for people undertaking tertiary

studies. That said, while some will have high lifetime incomes, many may face financial problems while studying (SDA, sub. DR306, p. 15).

Figure 14.8 **Household income distribution for Sunday employees**

Based on quintiles and equivalised income<sup>a</sup>



<sup>a</sup> Equivalised income takes account of the number of members in a household. The different quintiles are 20 (the share of people with in the lowest 20 per cent of equivalised household income) up to 100 (the share of people with in the highest 20 per cent of equivalised household income).

Source: ABS Time Use Survey 2006 CURF.

Table 14.7 **Number of earners in Sunday-working households**

Share of employees in each category

	HERRC industries		Non HERRC industries	
	Not Sunday employee	Sunday employee	Not Sunday employee	Sunday employee
	%	%	%	%
One income earner	9.3	9.0	14.2	19.0
Two income earners	46.0	39.8	57.2	49.4
Three income earners	25.9	27.9	16.8	19.6
Four income earners	14.6	17.1	9.4	10.4
Five income earners	3.1	5.6	1.9	1.6
Six income earners	1.0	0.0	0.4	0.0
Eight or more income earners	0.2	0.5	0.1	0.0

Source: ABS Time Use Survey CURF 2006.

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Finally, relative wage *rates* are an important metric in their own right when considering appropriate levels of wage dispersion. Looking at the average incomes of people working in the relevant industries can be misleading unless it takes into account the number of hours worked. Employees tend to work fewer hours in the HERRC industries, which is one explanator for their low average earnings. Few would suggest that a measure of income dispersion should not take account of factors such as the duration of work, the experience of a person or their skills (and indeed the FWC took account of skills when adjusting penalty rates in the restaurant industry for level 1 and 2 employees). Wage rates for anyone are an outcome based on their skills, experience, health, motivation, work effort, the demand and supply conditions in their industry, and working time arrangements, among other factors. As shown in chapter 13, the regulated return from working on a Sunday can far exceed the acquisition of major skills.

More generally, wage equations estimated by the Productivity Commission (Forbes, Barker and Turner 2010) suggest that:

- a university degree adds about 46 per cent to average hourly wage rates compared with a pre-year 12 qualification
- 20 years of experience adds 25 per cent compared with a person with one year of experience
- being 45 years old or more adds around 15 per cent to wage rates compared with someone aged 15-24 years old.

In comparison, the penalty rate on a Sunday adds 50-100 per cent to an average weekly wage rate. From that perspective, the degree of wage dispersion associated with Sunday penalty rates appears quite out of kilter with other factors that justify such dispersion.

An associated issue is how to take into account the ‘relative living standards of the low paid’, a prominent criterion in both the modern awards and minimum wage objectives. This criterion has been given considerable weight by the FWC in examining changes to awards, including penalty rates. However, there is a tension between the role of this criterion, on the one hand, in assessing minimum wages, and on the other, in setting award wages that are well above those. The minimum wage rate is intended to set a benchmark necessary for an adequate standard of living, and so it is not clear why the needs of the low paid could justify wage rates that are often double or more than the minimum wage rate.

Nonetheless, there is little question that for some employees in adverse circumstances, working on weekends at higher wages avoids some extreme consequences (say foreclosure on the family home, the loss of custody of a child or simply very low household incomes). The Productivity Commission has taken a close interest in submissions from people facing problems like these. The apparent alternative of finding a different job is a very hard and daunting prospect even in positive economic times. For instance, Kingsford Legal Centre (sub. DR278, pp. 2–3) cited the views of several employees about whether they would look for other work to supplement their income were Sunday penalty rates to be reduced:

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I would try, but I don't think I would find one - Not much point as a young person cause there aren't a lot of different types of work for us beyond retail and that are the industries you are going to cut the penalty rates for.

I would try, but I am in my 50s, my job prospects are very limited.

I would try to get other work, but I don't think it is likely I would be able to find other work.

High penalty rates appear to be a solution to these problems. However, this overlooks other dimensions associated with addressing the needs of the lowpaid.

In part, the likely stimulation of employment opportunities in the HERRC industries would provide a partial mechanism for supplementing income. Moreover, as emphasised throughout this report, it is easy to overlook people whose income is low because they do not have jobs at all. The regulation of wage rates should take into account the net benefit for those seeking work as well as those in work, and the ability to meet consumer needs.

More generally, the employment system is not necessarily the best mechanism for addressing truly adverse personal circumstances. The social security system has expanded significantly since penalty rates were introduced and additional social support choices are now available (such as increased family payments and income-tested concessions for some public services). Tailored solutions can be more readily designed (or are already available) via Commonwealth and state programs government.

## 14.5 The burden of proof

The question of where the burden of proof should lie when considering the effects of penalty rates has received little attention, and might appear to be an academic distraction. In fact, it is fundamental when evaluating evidence about penalty rates put to the FWC.

The Modern Award Objective reinforces the value of the status quo, with its reference to stability. Consistent with this, much of the assessment of regulated penalty rates centres on whether there is sufficient evidence that lowering their rates would be beneficial, rather than on whether there is sufficient evidence to sustain the current high levels. For example, the FWC has emphasised to parties in the four yearly award review that if they want to change the status quo, they need to demonstrate this with evidence:

The need for a 'stable' modern award system suggests that a party seeking to vary a modern award in the context of the Review must advance a merit argument in support of the proposed variation. The extent of such an argument will depend on the circumstances. ... [W]here a significant change is proposed it must be supported by a submission which addresses the relevant legislative provisions and be accompanied by probative evidence properly directed to demonstrating the facts supporting the proposed variation. ... In the Review the Commission will proceed on the basis that *prima facie* the modern award being reviewed achieved the modern awards objective at the time that it was made. ([2014] FWCFB 1788, paras 23 and 24, 4 Yearly Review of Modern Awards: Preliminary Jurisdictional Issues)

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All evidence is subject to statistical and other errors, and this leads to uncertainty about its relevance. Parties opposed to change inevitably focus on defects in evidence on the benefits of change — and in likelihood will find some, because robust evidence about the effects of something that has not happened (lower penalty rates) is hard to find. Moreover, it can be *expected* that partisan advocates for lower penalty rates will provide evidence that is incomplete, biased or flawed, that exaggerates impacts, and that omits counter evidence and caveats. They leave themselves open to easy repudiation, though the invalidity of some arguments for a claim does not invalidate that claim.

In the current four year award review, several economists (Borland 2015; Quiggin 2015) gave expert testimony for United Voice about the flaws in the arguments and evidence put by another economist (Lewis 2014) engaged by employer interests. Borland and Quiggin correctly identified several deficiencies in Lewis’s evidence for policy change, and indeed so does the Productivity Commission in this chapter.

Similarly, others providing expert testimony for the relevant unions indicated that statistical tests showed that penalty rates did not affect employment using conventional significance tests (for example, Yu 2015). Such tests make it easy conclude that existing penalty rates have no statistically ‘significant’ effects on employment (or any other relevant variable), because such tests are focused on avoiding a false positive (deciding that high penalty rates adversely affect employment when they do not). However, setting a high standard for avoiding a false positive increases the likelihood of a false negative (deciding that high penalty rates have no effect on employment, when they do). Whether that standard is desirable depends on the consequences of errors — a much overlooked issue (McCloskey 1985). For instance, fire alarms often generate false alarms (false positives), but most people would be concerned to avoid failure of an alarm to detect a real fire (a false negative). There is no *prima facie* reason to give primacy to a burden of proof in favour of the regulatory status quo.

Ideally, the burden of proof should take account of the risks of being wrong (for example, for consumer convenience and jobs) and would also take into account priors about the economic impacts of price regulations. The conservative assessment of material variations is premised on the view that the modern award modernisation process was evidence-based and coherent, when that is far from clear.

In this context, it is notable that Australia is atypical among its peers in its regulation of weekend penalty rates. Accordingly, a key question is whether, given our understanding about the impacts of price regulations generally, policymakers should require a reasonable standard of evidence in *favour* of existing regulated penalty rates to maintain them at their current rate in the relevant industries.

This is not to say that the analysis of researchers such as Yu (2015), Quiggin (2015) and Borland (2015) is wrong. It is useful to identify gaps and deficiencies in evidence about the impacts of a policy change because policymakers want to understand the likely outcomes of reform. For example, Yu’s results suggest that *large* aggregate employment effects in the relevant industries from penalty rate changes are unlikely. However, gaps and other

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weaknesses in evidence on the benefits of reduced regulated rates does not substantiate that rates should be maintained at their current level. Notably, neither Borland nor Quiggan have argued that high penalty rates are justified by evidence.

Another challenge for those who argue for high penalty rates is why their current level should not be higher. If, for example, regulated penalty rates have no impacts on employment or consumer amenity, and only assist the low paid, then arguably penalty rates should be much higher. Submitters to this inquiry and to the FWC have not argued for higher penalty rates, although given their reasoning in defence of the status quo, it is unclear why they have not done so.

In summary, existing penalty rates appear to be granted the same innocence as parties accused of a crime. A presumption of innocence always make the prosecutor's task challenging, and fair enough too, if the costs of a wrongful conviction are high. It is not clear that regulated penalty rates appropriately belong in this category, though the strictures of the Modern Award Objectives appear to place them there ([2014] FWCFB 1788). As it stands, the capacity for the current four yearly review to make penalty rate variations is somewhat restricted, although there is still reasonable evidence that there would be gains from changing arrangements.

If the FWC does not make substantial changes as part of the current review, penalty rates should be re-examined as part of the 'hotspot' review processes discussed in chapter 8, and with a change in the burden of proof. Given the predictions of conventional economics, in any such review processes, the workplace relations regulator should give more weight in its decision-making to a requirement for more evidence that penalty rates are *not* injurious, than to evidence requiring demonstration that lower rates would be beneficial.

There should be no illusion that a regulator can set a 'correct' penalty rate for any given industry, because that rate would depend on the characteristics of the job, employer and employee, and on macroeconomic conditions. Settling for a given rate simply reflects the lack of information to support any kind of exact rates and the transaction costs of continually adjusting regulated rates. This means, however, that any regulated penalty rate will be precisely wrong. In contrast, markets continually do adapt wage rates, and so where the industrial regulator sets an incorrectly high regulated penalty rate, they eliminate many of the benefits of such market variations. While the Productivity Commission is not proposing a shift to market rates (having assessed that some market power exists even in the HERRC industries), this is an additional factor suggesting that it may be appropriate to err on the side of lower rates than higher ones.

The above observations are not minor methodological quibbles, but a central issue for setting penalty rates and the way in which the workplace regulator should use evidence to underpin its decisions.





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# 15 Policies for weekend penalty rates

## Key points

- Some levels of regulated penalty rates are justified for weekend work. The desirable level needs to balance their role in adequately compensating people for working at asocial times and the costs such penalty rates impose on consumers and employment. That balance depends on the nature of the relevant industries.
- There is now strong demand at any time of the week for discretionary consumer services — the hospitality, entertainment, retail, restaurants and cafe (HERRC) industries (including fast food). In particular, social trends and community norms have shifted so that the historically distinctive role of Sundays as a time when people did not shop or engage in other consumer-oriented activities has changed. Sundays now resemble Saturdays. These changes have undermined the original basis for regulated penalty rates in these industries.
- In light of these changing preferences, existing penalty rates for Sundays now reduce consumer convenience and product diversity in a way that would not have occurred when penalty rates were first introduced. They also mean that unemployment and underemployment are higher. Trading hours are likely to be lower and capital underutilised.
- The wage regulator should set Sunday penalty rates that are not part of overtime or shift work at the higher of 125 per cent and the existing Saturday award rate for permanent employees in the HERRC industries.
- In some awards, penalty rates for casual employees fail to take into account the casual loading, which distorts the relative wage cost of casuals over permanent employees on weekends (and particularly Sundays). The wage regulator should reassess casual penalty rates on weekends, with the goal of delivering full cost neutrality between permanent and casual rates on weekends, unless clearly adverse outcomes can be demonstrated. This would imply that casual penalty rates on weekends would be the sum of the casual loading and the penalty rates applying to permanent employees.
- There are grounds for greater consistency (short of uniformity) between penalty rates across the HERRC industries.
- Remnant anti-competitive shopping hour restrictions act to reinforce the current adverse effects of high penalty rates for Sundays. They should be lifted Australia-wide.
- There is no case for common penalty rates across all industries. The Commission is not recommending a reduction in the Sunday penalty rates beyond HERRC. Regulated penalty rates as currently constructed for essential services and many other industries are justifiable. The original justifications have not altered materially: they align with working arrangements that often involve rotating shifts across the whole week, are not likely to reduce service availability meaningfully, are commensurate with the skills of the employees, and are unlikely to lead to job losses.
- As part of the new award determination process, the wage regulator should undertake research and seek input from employers and employees to assess whether there are grounds for changes to penalty rates in any other industries. This should only be a medium-term priority.

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## 15.1 The key policy reform

There is good justification for some weekend penalty rates — the issue is the ‘right’ levels. Making a judgment on those levels should take into account the objectives of, and contemporary rationale for, the existing arrangements and evidence about their effects. A coherent assessment of the levels should consider their broader employment and community-wide effects, and not just the impacts of reductions on those who are the current beneficiaries of such rates.

It is easy to overlook the widely dispersed small gains to consumers and the benefits for those seeking employment from reform in this area (as in incremental technological changes) and to concentrate on the smaller group bearing the adjustment costs. Governments should not stand in the way of technological change to maintain outdated jobs (telephonists) or have terms and conditions that are out of step with the times. Whole sectors have, and are, adjusting with massive technological change (for example, media). Social change can be just as transformational. Finally, the intent of the modern award system is to provide a safety net. The rates for Sundays appear to extend far beyond that ‘safety net’ role.

The evidence in previous chapters suggests that the penalty rates for a Sunday in the hospitality, entertainment, retail, restaurant and cafe (HERRC) industries are excessive when assessed against their stated purpose and other premium rates for work that have adverse impacts on people’s social lives, such as Saturdays and evenings. There is now strong demand for discretionary consumer services at any time of the week. In particular, social trends and community norms have shifted so that the historically distinctive role of Sundays as a time when people did not shop or engage in other consumer-oriented activities has changed. These changes have undermined the original basis for regulated penalty rates in these industries.

In light of these changing preferences, existing penalty rates for Sundays now reduce consumer convenience and product diversity in a way that would not have occurred when penalty rates were first introduced. They also mean that unemployment and underemployment is higher. Trading hours are likely to be lower and capital underutilised.

Despite the similar characteristics of these industries, the mere variety of contemporary Sunday penalty rates and the variable treatment of casual employees among them is testimony to the expediency underpinning current arrangements.

It is also not the case that disturbing the current arrangements represents the dismantling of long-enduring arrangements. Some rates in some jurisdictions were lower not so long ago, only to be raised with award modernisation. Even now, around one half of awards do not have penalty rates for Sundays. The Fair Work Commission (FWC) has already recognised that penalty rates for some employees are too high in one of the key HERRC industries (as in lower skill level 1 and 2 employees in the restaurant industry). One of the old justifications for them — deterrence of work on weekends — has vanished as a legitimate

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basis for their existence. They do not serve well in alleviating poverty. Claims that they have no adverse effects on employment or community amenity are not convincing, and begs the question of why they should not be doubled again.

Nevertheless, a particular concern in making any changes to penalty rates is that there will be significant income effects for some people (chapter 14). That suggests an adjustment process so that people can seek other jobs, increase their training and make other labour market choices. An extended transition that involves staggered small changes to Sunday rates would replicate some of the uncertainties and compliance costs associated with award modernisation. Moreover, it would reduce the scope for new employment, increased hours of work for existing employees, workload relief for owners, and the benefits from permanent/casual substitution. A preferred approach would be to give advance notice of a change so that employers and employees can review their circumstances, and then introduce the change in a single step.

Part of this notice period will arise naturally from the workload associated with the FWC's broader suite of award assessment (chapter 8). It appears unlikely that any decision could be practically implemented before early 2017. If an adjustment period of a year was added, this would provide more than two years before changes were made.

### **More consistency in rates between the HERRC industries is warranted**

Notwithstanding award modernisation, there appears to be many inconsistencies in penalty rate settings. Wide disparities in rates persist in industries with similar structural characteristics and employee skill levels (table 10.1 in chapter 10). For example, casual penalty rates are 150, 175, 200 and 225 per cent for Sunday work in the restaurant, hospitality, retail and pharmacy industries respectively. Various participants noted these inconsistencies across the HERRC industries and more generally (for example, BCA, sub. 173, p. 48; COSBOA, sub. 115, p. 5).

Differences in rates create compliance costs and uncertainty for employers and employees. Even though the transitional arrangements associated with award modernisation are now complete, the compliance costs associated with penalty rates appear to be significant. The Fair Work Ombudsman (2014a, p. 23) noted that:

In our experience, there are three main areas where employees and employers often encounter difficulty in applying awards, these are: interpreting coverage provisions, especially where more than one award may apply; calculating rates of pay, especially overtime and penalty rates; understanding the interaction with the National Employment Standards.

It was evident in the Commission's consultations that even the most sophisticated stakeholders did not know how to calculate the penalty rates that should apply in certain circumstances. In this context, there should be some bias towards simplicity.

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## There may be grounds for some casual ‘penalty’ rates to rise on Saturdays

The representation of casual weekend penalty rates in awards can be confusing because they are often described as inclusive of casual loadings, despite the significant difference between a casual loading (which applies at any time of the week) and a premium for asocial times of working.<sup>164</sup> The conflation of the casual loading and the premium rate for weekend work can hide the anomalous treatment of weekend rates for casuals in some awards. In principle, a wage system should not favour the employment of a person with identical competencies over another, yet this occurs in some awards for weekend work.

The crux of the issue is that casual employees receive the casual loading to take account of forgone entitlements, such as leave and leave loadings. For example, a level 1 retail assistant is paid \$18.99 per hour if employed permanently and \$23.74 per hour if employed as a casual (or 25 per cent more). While it may seem that the cost to the business of a casual is \$4.75 more per hour, the permanent employee receives other entitlements that are at least as great as this. The casual loading of \$4.75 ensures that when all employee benefits are included, the full costs of employing a casual and a permanent employee are the same. This neutrality of treatment occurs for work at ordinary hours, but it does not do so for weekend employment in some awards. For example, in the retail award, the same level of permanent employee working on a Saturday receives \$23.74 and the corresponding casual employee \$25.64, or now only a \$1.90 difference.

For neutrality of treatment, the casual loading should be *added* to the penalty rate of a permanent employee when calculating the premium rate of pay over the basic wage rate for weekend work. This would make an employer indifferent, at the margin, between hiring a permanent employee over a casual employee. It would also be consistent with the desirability of ‘equal pay for equal’ work. Only one of the three different methods in use in awards for calculating penalty rates provides such neutral incentives for employing casuals (appendix F).

Achieving neutrality would require that penalty rates for casual employees would rise on Saturdays for some awards (as in the Retail Award). Neutrality would expressly not require that casual rates fall, as some participants erroneously supposed (Employment Law Centre of Western Australia, sub. DR350, p. 38). Some of the support by employer groups for neutrality is likely to have reflected a similar misunderstanding.

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<sup>164</sup> Several participants criticised the Productivity Commission’s description of penalty rates for casuals when these included the casual loading (for example, Bray, sub. DR261, p. 18 and the Electrical Trades Union of Australia, sub. DR300, p. 6), but misunderstood that this is the customary way in which the Fair Work Commission describes casual penalty rates. The Productivity Commission has adopted the Fair Work Commission’s terminology to avoid confusion for those familiar with awards. As an illustration, the Restaurant Award describes casual penalty rates as inclusive of the casual loading. Awards are written this way so that employers know what they should pay employees in dollar terms at any time of the week, but it can lead to confused discussions about what constitutes the effective penalty rate for casual employees.

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The neutral treatment of casual penalty rates would diminish or, in some cases, eliminate the impact of income effects of the Productivity Commission's other penalty rate reforms affecting casual employees.

### Take care in changing casual penalty rates

However, a major proviso is that the current regulated pay levels set for casual employees are 'rough and ready' and may not take into account the generally lower average skills and experience of those employees. Were this to be true, achieving parity in the employer costs of employing casuals compared with permanent employees might only have the appearance of 'equal pay for equal' work and would disadvantage the employment of casuals. That would be unfortunate given that casual jobs are an important vehicle for gaining entry to the labour market for the disadvantaged, the young, and those needing flexible working arrangements. In that context, the wage regulator should make the presumption that casual penalty rates should fully take account of the casual loading, but should not adopt that principle without closely considering its impacts on such workers.

Regardless, the lack of neutrality predominantly occurs for Sundays rather than Saturdays (table 10.1 in chapter 10), so setting Sunday rates at Saturday rates would more often create neutral incentives for choosing between permanent and casuals employees anyway.

#### RECOMMENDATION 15.1

The Fair Work Commission should, as part of its current award review process:

- set Sunday penalty rates that are not part of overtime or shift work at the higher of 125 per cent and the existing Saturday award rate for permanent employees in the hospitality, entertainment, retail, restaurant and cafe industries
- set weekend penalty rates to achieve greater consistency between the above industries, but without the expectation of a single rate across all of them
- investigate whether weekend penalty rates for casuals in these industries should be set so that casual penalty rates on weekends would be the sum of the casual loading and the revised penalty rates applying to permanent employees, with the principle being that there should be a clear rationale for departing from this.

There should be one year's notice before these changes are made.

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## 15.2 Some other reforms would complement penalty rate changes

### Changing the modern awards objective

The modern awards objective in the *Fair Work Act 2009* (Cth) (FW Act) has an extensive list of considerations that the FWC must weigh up when making its decisions. In 2013, the need for compensation for working at asocial hours (s. 134 (1)(da) of the FW Act) became a new item in that long list. The Productivity Commission has recommended modernisation of the modern award objective so that it is more likely to increase the overall wellbeing of the Australian community (chapter 8). However, in the event that this change is not promptly made as part of the legislative package proposed by the Productivity Commission (chapter 34), then the question arises about the role of s. 134 (1)(da) of the FW Act.

In its submission to the four yearly award process, the Australian Government interpreted the section in relatively broad terms, with the implication that the FWC would not be obliged to include penalty rates in any award that did not already have them, and that the FWC would have the latitude to determine:

... whether the additional remuneration and the hours and/or days in which it is provided in modern awards are appropriate in a particular industry. (Australian Government 2014b para 3.6)

Nevertheless, in practice, it seems that the FWC has not slavishly adhered to the ‘need’ to provide additional remuneration for working at asocial times, since it has not rushed to incorporate penalty rates into the multitude of awards that do not include them. However, the FWC (FWCFB 2014 para 295) has interpreted its freedom as partial, noting that the modern award objective ‘requires additional remuneration for working on weekends’.<sup>165</sup> It would be quite damaging if over the longer run, the FWC felt the need to more widely insert requirements for weekend penalty rates into awards, even in circumstances where the context of other industries did not require that. For example, awards can provide compensation through average wage rates, rather than through special time-dependent wage rates.

If the Modern Awards Objective is not simplified more broadly in line with the Productivity Commission’s recommendation (chapter 8), then the FW Act should be amended so that it is clear that the wage regulator (the FWC or preferably the recommended Workplace Standards Commission) would not be obliged to incorporate weekend penalty rates into all awards, taking account of the fact that awards should be seen as a package of benefits.

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<sup>165</sup> On the other hand, in a decision relating to overtime, the FWC (FWCFB 2015b para. 172) observed that ‘s. 134(1)(da) of the FW Act does not amount to a statutory directive that modern awards must provide additional remuneration for employees working overtime’.

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#### RECOMMENDATION 15.2

In the event that the Australian Government does not modify the modern awards objective in line with recommendation 8.3, it should amend the *Fair Work Act 2009* (Cth) to clarify that in its award decisions, the wage regulator would not be obliged to provide additional remuneration for weekend work, though it would retain the discretion to do so if warranted by industry circumstances.

### Individual flexibility arrangements

All modern awards include (or are deemed to include) a flexibility clause that allows employees to make agreements with employers that vary the conditions of the award (or enterprise agreement).

In principle, individual flexibility arrangements (IFAs) could allow an employee to relinquish penalty rates in exchange for other benefits so long as the exchange met the better off overall test (BOOT) (or a no-disadvantage test after implementation of recommendation 22.2). Flexible working hours and penalty rate changes figure prominently in the relatively few IFAs that have been formed. For example, employees reported that nearly 60 per cent of IFAs related to arrangements for when work was performed (especially important for females) and around one in five to penalty rates (O'Neill 2012b, p. 69). Employers had similar views (*ibid* pp. 61–62 and p. 66).

There are several obstacles to the wider use of IFAs, including the manner of their negotiation, the BOOT, the duration of agreements, the degree to which they are genuinely flexible, and their lack of awareness (chapter 22). In the latter case, it is notable that awareness is particularly low for younger employees, who are overrepresented in the HERRC industries (O'Neill 2012b, pp. 31–32). The reforms recommended in chapter 22 to IFAs and the creation of enterprise contracts (chapter 23) will remedy many of these deficiencies, and should address, on the one hand, some employees' preferences for working times suited to them and, on the other, some employers' frustrations with rigid arrangements for penalty rates. A win-win option may be available to some.

Enterprise agreements also currently permit variations to award conditions so long as the majority of employees support the agreements and that the variations meet the BOOT. Shifting to a no-disadvantage test would further promote the creation of agreements allowing tradeoffs between penalty rates and other employee benefits.

### Time off in lieu

Time off in lieu (TOIL) provisions for overtime are common in awards, but are not universal, with 83 of the 122 modern awards providing such provisions (FWCFB 2015b

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para. 199).<sup>166</sup> TOIL arrangements depend on the nature and timing of work, with 59 of the 83 awards providing one hour off for each hour of work ('time for time'). The remaining 24 awards provide time off equal to the time worked overtime multiplied by the overtime penalty rate. Many awards also allow for TOIL for public holidays.

However, there do not appear to be provisions for TOIL instead of penalty rates *for weekend work* (as compared with overtime) for any of the HERRC industries.

Overall, the diversity of arrangements for TOIL highlights inconsistencies of awards and the desirability of the assessment process set out in chapter 8. The FWC (FWCFB 2015a) has approved the wider use of TOIL arrangements for overtime across most awards on a 'time for time' basis, but not as substitutes for weekend penalty rates.

### **The role of preferred hours clauses**

Outside of IFAs, enterprise agreements may include clauses that enable an employee to nominate (with employer consent) preferred hours of work because they suit the employee's circumstances. Where these hours fall on a Saturday or Sunday, the employee would not be paid penalty rates. These are referred to as 'preferred hours' clauses, although some use this term in reference to any arrangement in which an employee can decide to work different or additional hours without attracting penalty or overtime rates (which would therefore include some IFA and TOIL arrangements). This chapter uses the more narrow description of such clauses in enterprise agreements.

While some agreements have included such clauses,<sup>167</sup> the current practice of the FWC is to reject agreements that incorporate them (Cameron 2012). The concern is that such clauses may erode employee benefits and thus fail the BOOT. Preferred hours clauses may still be permitted in exceptional circumstances (requiring that a public interest test be passed). However, under current arrangements, preferred hours clauses provide negligible scope for employers and employees to trade off higher wage rates at some times for a preferred roster.

Nor do they generally provide the scope for employees to obtain additional hours of work during particular seasonal peaks, while giving up penalty rates or other premium rates of pay for these transitory periods. There has been one notable exception — a potato farm with a peak picking period (the Black Crow agreement).<sup>168</sup> However, the approval by the FWC was based on a rarely applied 'public interest' test, and dismissed the principle that

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<sup>166</sup> Amongst the key HERRC industries, TOIL in these circumstances is available in the Restaurant Industry Award, the Fast Food Award, the General Retail Industry Award and the Pharmacy Award. There are no provisions for TOIL for overtime in the Hospitality Industry (General) Award.

<sup>167</sup> The *Milbag Pty Ltd T/A Eagle Boys Pizza Adamstown & Eagle Boys Pizza Belmont* enterprise agreement (AG2009/23877) was seen as a landmark agreement that included a preferred hours clause.

<sup>168</sup> *Black Crow Organics Enterprise Agreement 2009* [2010] FWAA 5060.



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obtaining additional hours of work in exchange for less benefits could pass the BOOT (Cameron 2012, pp. 50–51). Fonterra Australia (a dairy producer) has called for more general flexibility in being able to match working hours with seasonal supply cycles without the need for penalty rates — a capacity that already applies in New Zealand (Lynch 2014). (However, penalty rates are not regulated in New Zealand at all, so it is not clear whether the comparison is a valid one.)

One lateral approach to a preferred hours clause would be for a permanent employee to forgo any penalty rates for their preferred hours even if these fell on a weekend, but to receive penalty rate payments where an employer requested them to work at a time not preferred by the employee (an idea floated in the draft report). This would amount to choosing their own ‘unsociable hours’.

This could provide employers with some flexibility, but also create a strong incentive for them not to deviate from an employee’s preferred hours. Unlike present arrangements, this would recognise that times deemed asocial by some, are quite social for others. This arrangement could mean that a penalty rate might apply to any day of the week, depending on the preferences of employees. Some employer associations and employee representatives could see benefits in such an approach:

The NFF considers that preferred hours arrangements can be adopted in a way that promotes greater workplace flexibility and with appropriate safeguards. Employers and employees need to be able to tailor working arrangements that suit them if they are to find the most productive ways of working. The [Fair Work] Commission has traditionally taken a very dim view of the arrangements because of the potential for them to be misused to the detriment of the employee. In our view, there is no reason why appropriate safeguards cannot be adopted to facilitate preferred hours arrangements so that they can be made when it is a win-win for both parties. (NFF, sub. DR302, p. 21)

NWWCs can see that this may have positive outcomes for women with caring responsibilities but would need to be carefully managed and monitored. (National Working Women’s Centres, sub. DR345, p. 11)

However, while an employee’s consent to a preferred hours clause would be voluntary, there is a risk that they would still lose significantly were a preferred hours option included in enterprise agreements (or awards, in a manner similar to TOIL arrangements). The problem arises principally for casual employees on flexible rosters in industries (such as the HERRC industries) where peak demand is on weekends, and where employers face few problems in meeting weekday demand. Many such casual employees prefer weekend work because no other time is available due to full-time study, caring responsibilities, or multiple job holding. Accordingly, weekends are their preferred hours by default. An employer has two avenues to encourage casuals to ‘lock-in’ their preferred hours through a preferred hours arrangement. First, it can reduce the hours of work on weekends for an employee who has not agreed to the adoption of a preferred hours agreement. Second, it could set (or merely indicate that it might sometimes set) roster times that are at the times that are very inconvenient to the employee. Neither requires explicit coercion — but merely the awareness by an employee that the employer will tend to do this for people who

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have not expressly nominated weekends as their preferred time. The relevant employees are also often young and vulnerable, and therefore open to more manipulation than others in the workplace. The fact that some casuals can only work hours on weekends also does not obviate that working at this time may have adverse social costs for them. The essential problem in the above circumstances is that the employer could have readily accommodated the employee's need to work at certain times without a preferred hours arrangement. Accordingly, for some classes of employees and industries (particularly the HERRC industries), preferred hours clauses could risk eliminating penalty rates altogether, despite the merit of some additional payment on weekends (chapter 13).

There could be circumstances where preferred hours could genuinely provide win-win options for employees and employers, but unlike other flexible working time arrangements, such as TOIL and annualisation, it is hard to envisage simple ways of precluding the misuse of a more expansive form of preferred hours clause in enterprise agreements and awards.

Nevertheless, the concept of preferred hours remains a useful one, and should not be entirely abandoned. Enterprise agreements and contracts could permit some types of such arrangements, while maintaining employee protections. Chapter 23 cites a hypothetical example of a group of employees in a hot climate who would prefer to commence work at an earlier time to reduce the time working in hot conditions, giving up a loading on earlier morning starts in exchange for better quality working conditions. IFAs also offer some scope for flexible working times and could, in principle, include the imposition of penalties on employers that requested them to work at the employee's non-preferred time. However, any reasonable arrangement would have to pass a no-disadvantage test (Cameron 2012).

## **Remnant shopping hour restrictions**

The Productivity Commission in various other reports (PC 2011a, 2014d), the Harper Review (Harper et al. 2015), the Shopping Centre Council of Australia (sub. DR342, p. 2), and Restaurant and Catering Australia (sub. DR359) have recommended that remnant anti-competitive shopping hour restrictions be lifted in Australia. The Australian Government has recently urged states to implement the recommendation of the Harper Review (Australian Government 2015b, p. 12). As in the case of the 'deterrence argument' for penalty rates, these restrictions are anachronistic and reinforce the adverse effects of penalty rates on employment. Lifting these restrictions would enhance the employment and consumer benefits associated with penalty rate reforms.

### **RECOMMENDATION 15.3**

The South Australian, Western Australian and Queensland Governments should remove anti-competitive remnant shopping hour restrictions.

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## 15.3 Holiday pay

Many employers also argued that penalty rates for public holidays are too high. For example, the Australian Chamber of Commerce and Industry (ACCI) considered:

... that there is a case for penalty rate reform beyond revising the rates applicable on Sundays and noted ... [that] particularly problematic for service sector businesses is the application of excessive penalty rates on public holidays when there is an expectation of trade. A minimum payment at the rate of double time and a half for people working in service sectors which are expected to trade on public holidays does not distinguish these industries from those that do not ordinarily trade on public holidays. The needs of businesses outside of the industries identified in the draft recommendation that trade and are expected to trade during non-standard working times should also be the target of penalty rate reform. (sub. DR330, p. 62)

However, by definition, genuine public holidays are intended to serve a special community role and, as such, there are strong grounds to limit the expectation that they are for working. In that sense, the original concept of deterrence continues to have relevance.

Current penalty rates for public holidays are typically 250 per cent, although a select few offer more.<sup>169</sup> To put holiday pay rates in perspective, a penalty rate for a permanent employee who would normally work on a public holiday would have to be at least 200 per cent to ensure that the employee was not working at a discount over a typical working day. Adding a further charge to provide deterrence would lead to penalty rates commensurate with the rates that are typical in awards.

Australia is not exceptional in relation to holiday pay. In New Zealand, where the workplace relations system is much less regulated than Australia, minimum holiday penalty rates have long been specified by statute (under the *Holidays Act 2003*). The typical arrangement is a penalty rate of 1.5 times ordinary pay, plus a later day off in lieu at ordinary pay (or equivalent to a penalty rate of 250 per cent in Australian terms). Some enterprise agreements offer more.

Current penalty rate arrangements for public holidays do not need to change, except where they relate to the additional days of leave that State and Territory Governments may announce in the future.

### RECOMMENDATION 15.4

The Fair Work Commission should not reduce penalty rates for existing public holidays.

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<sup>169</sup> For example, the rate is 300 per cent in the Black Coal Mining Industry Award and the Oil Refining and Manufacturing Award. In some instances, the 300 per cent rate only applies to specific holidays (Christmas day and Good Friday), as in the Waste Management Award and the Road Transport and Distribution Award. In one award, the Stevedoring Industry Award, the rate is 350 per cent (or an effective rate of 250 per cent). The latter is not for ordinary daytime hours, but for the night shift component of a double header, and therefore constitutes a special case.

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## 15.4 Other industries

Many stakeholders — employees, unions, academics, community organisations and some employers and their representatives — questioned the justification of any ‘special’ treatment of the HERRC industries (boxes 15.1 and 15. 2).

In fact, there are good reasons to take different approaches to different industries. The grounds for lowering Sunday penalty rates in any given industry depend on the adverse consequences flowing from high penalty rates. As shown in chapters 10 to 14 and in table 15.1, the HERRC industries have some distinctive features in their business environments, labour markets and the nature of their employees, which need to be considered when assessing the outcomes of different penalty rates. These are industries where penalty rates appear most likely to have adverse outcomes for employment, consumer convenience, and to some extent, prices. They are also industries where the role played by penalty rates in frustrating consumer convenience has increased as other barriers have fallen (most particularly, trading hour restrictions) and as community preferences for consumer services on weekends have grown. With those changing preferences and norms, the original basis for high regulated penalty rates in these industries has disappeared. Maintaining them comes at a considerable cost.

In contrast, in some other industries, the community-wide costs of high penalty rates are likely to be low for several reasons — and, accordingly, so too would be the dividends of any changes to those rates. A targeted approach is consistent with the ‘hotspots’ approach to award reform recommended in chapter 8. It is also compatible with the approach that the FWC has increasingly been adopting when assessing award provisions, as demonstrated by its current review into penalty rates in a similar group of industries.

The prime basis for an immediate focus on the HERRC rather than other industries is that the costs that penalty rates impose on consumers and employment depend on the varying cost structures, characteristics of demand, and the nature of their employees across different industries.

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**Box 15.1 Many employees, unions and community organisations argued that special treatment of the HERRC industries was unjustified**

The proposal to introduce lower Sunday penalty rates for particular classes of workers (who are largely low-paid workers) is contrary to principle and to the fair and equitable treatment of workers. The disabilities are the same and different levels of compensation should not apply. (ACCER, sub. DR335, p. 16)

... the focus on some limited sectors of the economy is not justified. The draft report explains that there is a trend to a seven day consumer economy- why did the draft report not take a wider approach? It would appear that the productivity commission is responding and making recommendations based on a particular industry rather than looking a national approach to address this matter. (Electrical Trades Union of Australia, sub. DR300, p. 7)

The decision to pick on the most defenceless, to remove their penalty rates, has rightly been criticised as creating industrial apartheid. Moreover, any suggestion that the removal of penalty rates is in anyway relevant to skill levels defies logic. The base rate upon which the penalties are applied, varies according to skill, whereas the disadvantage to the employee of working unsociable hours is the same, regardless of skill levels. (Queensland Council of Unions DR305, p. 10)

It is worth noting that in proposing a two tiered approach to penalty rates, the Productivity Commission is effectively saying that some people's weekends are more important than someone else's. (Australian Services Union, sub. DR283, p. 6)

The elitism of the Productivity Commission is unjust and horribly insulting. You are arguing that retail and hospitality workers do not deserve Sunday penalty rates because we are less educated, have completed less training. You are arguing that we should not be equal under the law. You are arguing for inequality. (Giuretis, sub. DR256, p. 1)

Additionally, removing Sunday rates only in certain industries creates a two-tiered system. We note that workers in the hospitality, entertainment, retail, restaurant and café industries are in lower paid work than many other professions. Workers in these professions are often unable to secure alternative employment. (Kingsford Legal Centre, sub. DR278, p. 4)

I could, however, find no explanation given for why the Sunday rates of hospitality and retail workers should be cut while Sunday penalty rates in other industries should remain as they are. I suspect that the unstated reason is that retail and hospitality workers tend to have a low level of power in the workplace and the economy in general. We are highly casualised and easily replaceable and therefore 'easy pickings'. I do not believe that the family and social time of a worker in one industry is any more or less valuable than that of someone in another industry. Shopping and enjoying restaurants on Sunday may be desirable but it is not necessary. (Scott, sub. DR259, p. 1)

Regardless of their attitudes to weekend shopping and recreation, all Australians expect access to emergency services on a 24-7-365 basis. Yet the report does not suggest the removal of penalty rates for these services. (Quiggin, sub. DR266, p. 2)

However it is a peculiarly political – rather than economic, moral or social – rationale that led the PC to create two classes of workers ('emergency' and non-emergency). The idea that consumption of services is a 'need' on weekends is a modern invention. Emergency services have always been a 24/7 societal 'need'. If emergency workers require special dispensation or encouragement, that should be bundled in their base rates and conditions, rather than erecting a rule that treats certain days/times as sacrosanct for one group of waged employees and not another. (Orr, sub. DR264, p. 2)

The focus on just some limited sectors of the economy 'selected consumer services' is not justified. If there is a trend to a seven day consumer economy, which is the justification given in the draft report, why isn't a much wider focus being taken? (Bray, sub. DR261, p. 19)

... we are concerned about the proposal to retain current penalty rates in some industries but not others. This could give rise to a situation where the work at unsociable hours of some workers is intrinsically more valuable than the work of others. This approach ignores the dignity of work performed by all workers who give up their weekends and family life to serve others, and hope to earn a fair living wage by doing so. (Legal Aid NSW, sub. DR364, p. 7)

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**Box 15.2      Some employers also considered the focus on the HERRC industries was too narrow**

With regard to Draft Recommendation 14.1 however the AFGC questions why the scope is limited to the hospitality and retail sectors given that the supply chain required to support the food retail and hospitality sectors is also subject to rising demand and cost pressures in responding to shifting consumer preferences. In the AFGC's view, a change to bring Sunday penalty rates into line with Saturday penalty rates should be applied through the whole food and grocery sector. The increasing efficiency of supply chains, under 'just in time' principles, combined with the consumer trend towards shorter shelf life and chilled product, mean that suppliers to food retailers and food service are having to match the work patterns of the consumer-facing retail and hospitality sectors, and should therefore be treated the same under IR regulation. (Australian Food and Grocery Council, sub. DR279, p. 2)

The need for change is most clearly evident in the case of the hospitality, entertainment, retail, restaurants and café industries. However, it is not an issue limited solely to this group. We therefore support the Commission's conclusions that the FWC also needs to consider the issue of weekend penalty rates across other industries to ensure that they remain relevant. We would expect that there will be little call to move away from existing structures within a number of industries. However, there are clear examples of some industries in which there is a demand for more flexible service delivery, which is hampered by current penalty rate structures. (Chamber of Commerce and Industry of Western Australia, sub. DR323, p. 13)

However, the Business Council does not believe this [penalty rate reform for the HERRC industries] is an enduring reform proposal, as it does not provide room for similar changes in other industries. (Business Council of Australia, sub. DR337, p. 20)

However, the focus in the Draft Report on traditional services industries including hospitality, entertainment, retailing, restaurant and cafe industries (referred to as HERRC industries in the Draft Report) fails to recognise the wine industry's seven day operations providing a tourism and food and wine experience in the Cellar Doors located in rural and regional Australia and the impact of excessive Sunday penalty rates on the industry. ... Apart from traditional wine tasting and wine sales, cellar doors are increasingly providing a number of other services and products to attract visitors, including tutored tastings, tours of cellars and production facilities, tasting plates, degustation, coffee and tea, merchandise, functions and lunches. Given that most domestic visitors are only able to visit cellar doors during their weekends or public holidays, cellar doors must be open and available on Saturdays and Sundays and Public Holidays. A national wine industry survey conducted in January 2015 demonstrated that over 75% of all respondents trade seven days a week. While wineries are aware of the potential benefits of operating cellar doors, in reality during weekends and public holidays the employment costs are prohibitive. This has resulted in a reduction in trading hours of cellar doors, owner operators working weekends and public holidays rather than employed staff and wineries coordinating their opening hours by taking turns operating on weekends and public holidays. (South Australian Wine Industry Association and the Winemakers' Federation of Australia, sub. DR352, pp. 40)

The Australian economy, like all economies, is evolving. In times past there was very little commercial activity undertaken on weekends. That is no longer the case, with many employees in many industries being required to work Saturdays and Sundays. It follows that there seems nothing inherently logical in identifying those industries that the Productivity Commission has nominated for alignment as between Saturday and Sunday rates, and not others. Toll suggests that all weekend and public holiday penalties be set at 1.5 times the ordinary hourly rate of pay, for all industries. (Toll Holdings, sub. DR312, p. 21)

**Table 15.1 Characteristics of the key industries**

	<i>Retail</i>	<i>Accommodation &amp; food services</i>	<i>Arts and recreation services</i>	<i>All other industries</i>
Number of non-managerial employees, 2014 ('000) (and share of total employment %) <sup>a</sup>	1 081.6 (15.2)	697.3 (9.8)	158.2 (2.2)	7 122.8
Share of non-managerial employees on award, 2014 (%) (and rank) <sup>a</sup>	29.6 (3 <sup>rd</sup> )	45.4 (1 <sup>st</sup> )	23.2 (6 <sup>th</sup> )	16.5
Share of employees not on adult rate, 2014 (%) (and rank) <sup>a</sup>	17.6 (2 <sup>nd</sup> )	25.1 (1 <sup>st</sup> )	7.2 (5 <sup>th</sup> )	3.5
Share of employees aged under 25 years, 2014 (%) (and rank) <sup>a</sup>	36.4 (2 <sup>nd</sup> )	45.1 (1 <sup>st</sup> )	26.2 (3 <sup>rd</sup> )	10.4
Average weekly hours paid for award non-managerial employees, 2014 value (and rank) <sup>a</sup>	24.5 (14 <sup>th</sup> )	22.7 (16 <sup>th</sup> )	18.2 (18 <sup>th</sup> )	32.4
Average weekly non-managerial cash earnings, 2014 (\$) (and rank) <sup>a</sup>	\$554 (15 <sup>th</sup> )	\$518 (17 <sup>th</sup> )	\$427 (18 <sup>th</sup> )	\$1 149
Average hourly cash earnings, 2014 (\$) (and rank) <sup>a</sup>	\$24.90 (17 <sup>th</sup> )	\$23.10 (18 <sup>th</sup> )	\$31.20 (15 <sup>th</sup> )	\$35.50
Small business share of employment (%) (and rank) in 2012-13 <sup>b</sup>	36.1 (9 <sup>th</sup> )	45.5 (6 <sup>th</sup> )	38.2 (8 <sup>th</sup> )	43.7
Union membership rate 2013 (%) <sup>c</sup>	13.9 (9 <sup>th</sup> )	4.6 (15 <sup>th</sup> )	10.4 (11 <sup>th</sup> )	18.5
Responsiveness of operating profit to 10% wage increase, 2012-13 (% change) (and rank) <sup>d</sup>	-20.6 (11 <sup>th</sup> )	-26.8 (5 <sup>th</sup> )	-15.7 (15 <sup>th</sup> )	-8.0
Share of income from the general public directly (%) (and rank), 2012-13 <sup>e</sup>	78.2 (2 <sup>nd</sup> )	86.6 (1 <sup>st</sup> )	74.0 (5 <sup>th</sup> )	<45
Part time share of employees 2013 (%) (and rank) <sup>f</sup>	53.2 (2 <sup>nd</sup> )	63.3 (1 <sup>st</sup> )	46.5 (4 <sup>th</sup> )	24.7
Casual share of employees 2013 (%) (and rank) <sup>f</sup>	40.2 (4 <sup>th</sup> )	64.6 (1 <sup>st</sup> )	41.6 (3 <sup>rd</sup> )	17.0
Share of employed with business for less than 12 months (%) (and rank), 2013 <sup>g</sup>	21.7 (3 <sup>rd</sup> )	31.6 (1 <sup>st</sup> )	19.8 (7 <sup>th</sup> )	16.6

<sup>a</sup> Based on EEH, May 2014. The rank is from high to low out of 19 industries. <sup>b</sup> Based on AI, 2012-13. Small business are businesses employing less than 20 employees. The rank is from high to low out of 18 selected industries. <sup>c</sup> EEBTUM August 2013. The rank is from high to low out of 19 industries. <sup>d</sup> Based on AI and calculated as the percentage change in the operating profit before tax of a 5 per cent increase in the costs to businesses of wages, salaries and superannuation contributions. A higher rank means a larger degree of sensitivity of profits to wage increases. The rank is out of 18 selected (private sector) industries. <sup>e</sup> Based on SCAB for 2012-13 for 17 industries. <sup>f</sup> Based on FE November 2013. The rank is out of 19 industries. <sup>g</sup> Based on LM for all employed (including managers and self-employed) working in February 2013. The rank is out of 19 industries.

Sources: AI= ABS 2014, *Australian Industry 2012-13*, Cat. no. 8155.0, released 28 May 2014; EEBTUM = ABS 2014, *Employee Earnings, Benefits and Trade Union Membership, Australia*, Cat. no. 6310.0, released 4 June 2014; EEH = ABS 2015, *Employee Earnings and Hours, Australia*, May 2014, Cat. no. 6306.0; SCAB = ABS 2014, *Selected Characteristics of Australian Business, 2012-13*, Cat. no. 8167.0 released 18 September 2014; FE = ABS 2014, *Forms of Employment, Australia*, November 2013, Cat. no. 6359.0, released 7 May 2014; LM = ABS 2013, *Labour Mobility, Australia*, February 2013, Cat. no. 6209.0, released 21 August 2013.

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## The differing nature of demand across different industries

### The difference between discretionary and involuntary demand

Sunday work has been an enduring necessity for some parts of the economy because failure to provide the relevant goods and services would be either excessively costly or unacceptable to the community. Hospital and ambulance services, aged and disability care services, policing, and fire services *must* be provided on weekends as the use of those services is not a choice in any real sense.<sup>170</sup> For example, a person does not choose to be injured on a weekend, but must still receive assistance. Cows must be milked. Glass furnaces cannot be closed down (they crack and must be re-built). Power lines must be repaired if they are broken. Accordingly, the goal of ‘deterrence’ that applied to some weekend work has never been relevant to some activities. Given the often involuntary nature of demand for essential services, higher penalty rates have few adverse effects on customers.

### Demand responses to penalty rates are lower in non-HERRC industries

Most people still work only on weekdays (appendix F). As a consequence, whatever services are supplied on Sundays must make very little differences to overall costs, and therefore also to demand. A low rate of Sunday work (and indeed, often associated with this, low rates of Saturday work) in a given industry reflects that:

- for some services (such as teaching), the customary patterns of demand are concentrated on Monday to Friday
- employees sometimes have sufficient market power to avoid supplying services on Sundays unless they wish to, or there is an emergency (for example, dentists)
- the provision of a service by one occupation requires other associated occupations to also be at work (for example, office managers and other administrative staff). Given the social cost of working on Sundays, both parties have an interest in isolating service provision to weekdays
- demand and supply do not have to be aligned on a day by day basis because of inventory management. (In contrast, in a café, a cup of coffee on a Sunday must be made and consumed at much the same time.) Some industries can use technology to meet weekend peak demands without much additional labour (for example, the services provided by utilities and automated services, such as ATMs and online account management). Consequently, many businesses outside the HERRC industries have a

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<sup>170</sup> A further factor in the case of many such services is that the Commonwealth industrial regulator has no decision-making power for various important awards, most particularly essential services provided by some state governments. Were the industrial regulator to set a penalty rate for an employee who is part of the national system at a lower rate than a comparable employee in the state system, this would create market pressures for equalisation of national market based rates to the state rate anyway.



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capacity to shift their output to times when wage costs are lower (weekdays), and that suits the lifestyle preferences of their employees.

Moreover, for some other industries where Sunday work is involved, demand will be unresponsive to penalty rates because the labour share of costs are lower, and so the impacts of any given premium on total costs and profits are also lower. As noted in table 15.1, a 10 per cent increase in wages outside the HERRC industries reduces average profits by around 8 percentage points. In contrast, the comparable figure for accommodation and food services and retailing is 27 and 21 per cent respectively. Where a good or service is a non-tradeable input into the production of other goods and services, then the impact of any Sunday penalty rate on the costs of the final good is even lower (all other things being equal).

HERRC businesses typically set prices that smooth cost variations across the week (chapter 14) instead of setting prices that reflect the different costs at a given time. Consequently, a simple indicator of the likely repercussions of penalty rates on total costs is the share of employees working on weekdays versus weekends. A negligible share of employees work on weekends alone outside the HERRC industries, and even the prevalence of joint weekend/weekday work is much less likely (figure 11.3 and table 11.1 in chapter 11). A similar gap is apparent for separate patterns of work on Saturdays and Sundays (table 11.2 in chapter 11).

The latter data — when combined with assumptions about hours worked and the coverage of penalty rates, among other factors — provide an indicative measure of the relative impacts of penalty rates on labour costs across different industries (figure 15.1). In considering these data, the focus should not be on the actual estimates for each industry, as this is likely to be biased upwards, but on their *relative* magnitudes. These show that the cost pressures posed by penalty rates are much smaller outside the HERRC industries. The estimates assume that weekend workers in non-HERRC industries actually receive weekend penalty rates. In fact, many do not (as they are not set in awards) and, as a result, the relative disparities in cost pressures between HERRC and non-HERRC industries will be larger than those shown.

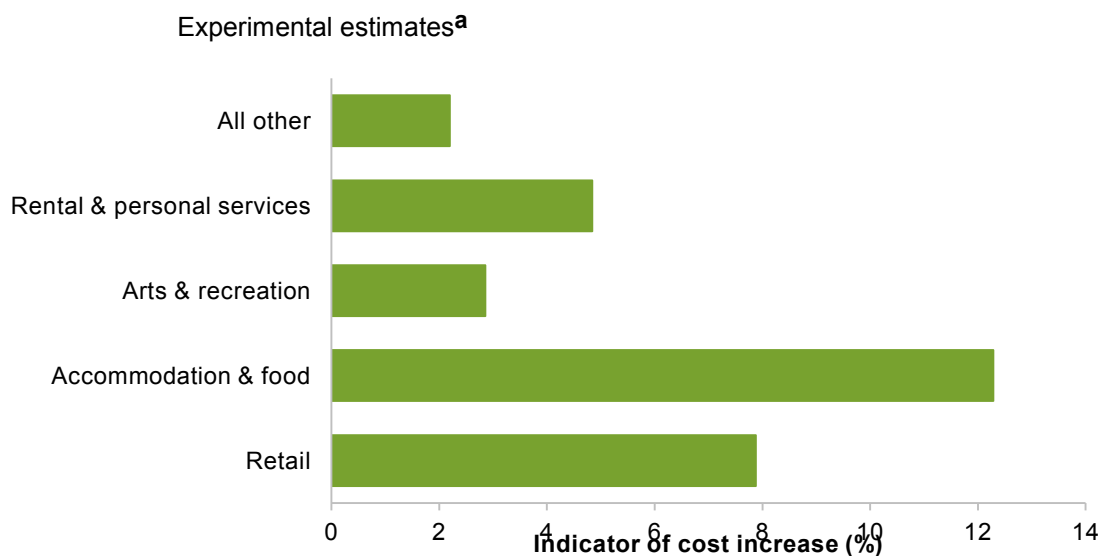
### **Few adverse employment effects**

It is also unlikely that in many non-HERRC industries there would be any economywide employment consequences of existing high penalty rates.

- If demand for the services is not very responsive to labour costs then neither can be employment.
- The employees concerned are often relatively skilled and would have the attributes that would allow them to obtain jobs elsewhere, even if it was not in the same industry.
- In some such industries — especially those requiring specialist skills — attracting employees to Sunday work is likely to require penalty rates anyway, or higher average

weekly wages where the customary pattern of work includes regular weekends as part of a fortnightly cycle of work. Notably, the share of weekend work that takes the form of rotating shifts (which typically involves a shift that rotates through the week from week to week) is much higher outside the consumer industries (table 15.2). Such types of work are particularly common in essential services — notably, hospitals, residential care services, and public order and safety. An additional issue for such rotating shifts is that, regardless of market wage outcomes, there are also persuasive arguments for steeper premiums because of the health impacts of such work (chapter 9). The requirement to pay penalty rates or a compensating fortnightly wage premium in the non-HERRC industries is accentuated by the higher level of enterprise bargaining in many of such industries (figure 15.2 and figure 13.1 in chapter 13). Notably, in New Zealand, awards do not specify penalty rates, but they still occur in some non-HERRC industries. Accordingly, penalty rates are less likely to be binding, and hence lowering the regulated rate cannot have significant impacts on actual wages or employment.

**Figure 15.1 An indicator of the impact of penalty rates on annual labour costs**

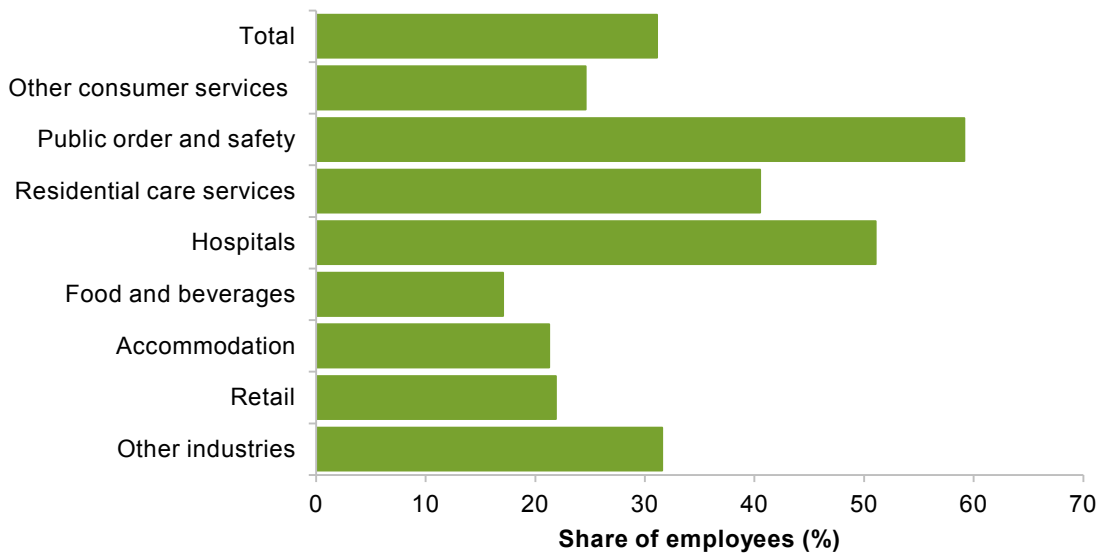


<sup>a</sup> The industries are as defined above. The estimates should be seen as indicating a rough order of magnitude because they require several underlying assumptions. These are that the number of hours worked by the average employee in any given industry is the same each day of the week, that all weekend employees are able to receive penalty rates, that the age structure of employees stays fixed over the week, that the penalty rates for retailing are 125 and 200 per cent for Saturdays and Sundays respectively, with comparable rates of 125 and 175 for accommodation and food services; 100 and 150 for arts and recreation; 125 and 200 for rental and personal services, and 125 and 200 for all other services. All estimates will overstate the actual cost effect because hours worked are likely to be less on weekends and more junior workers will be employed on weekends. The estimate for all other industries is likely to be most seriously overstated because so many of the awards covering these industries have no penalty rates. Accordingly, the ratio of the effects on the HERRC industries and other industries — an indicator of their relative responsiveness to penalty rates — is likely to be much higher than suggested in this chart.

Source: Analysis of unpublished data from the ABS 2008 *Forms of Employment CURF*.

Figure 15.2 **Penetration of enterprise agreements**

Selected industries



Source: HILDA wave 12.

Table 15.2 **Employees undertaking night and rotating shifts**

Selected industries

	<i>Rotating shift</i>	<i>Regular night</i>
	%	%
Retail	12.3	2.5
Accommodation	18.5	4.9
Food and beverages	15.4	7.5
Hospitals	35.1	6.4
Residential care services	20.1	17.3
Public order and safety	37.6	8.4
Other consumer services	9.8	1.0
Other industries	4.5	1.2
Total	8.7	2.5

<sup>a</sup> A rotating shift is one that changes from days to evenings to nights over a given time period.

Source: HILDA wave 12.

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## **The bottom line on non-HERRC industries**

In many industries outside the HERRC industries, penalty rates do not exist or the pattern of weekend working tends to favour rotating rosters where they are justified. Where they do exist, they will often make little difference to the market outcomes for wages, demand and employment because of the nature of the relevant labour markets, bargaining arrangements and working time patterns. Effective policy initiatives aim to make a difference to outcomes, and should be prioritised accordingly. Given their trading circumstances, it is not an accident that the HERRC industries have been most active in seeking regulatory change — this is not ‘special pleading’ (as suggested by Bray, sub. DR261, p. 19).

Between these two poles lie a range of industries where the case may, or may not, be strong enough to seek change equivalent to that proposed for the HERRC industries. The uptake of wage averaging and the tradeoffs available under enterprise bargaining may also be a source of achieving more flexible working time arrangements in other industries. If not, then based on the improved practices and experience with conducting the award assessments recommended in chapter 8, the wages regulator should undertake research and seek proposals from other industries in the medium term, and assess whether a similar case can be made for changes to penalty rates.

But the case for change in HERRC is very clear.

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# 16 National Employment Standards

## Key points

- The National Employment Standards (NES) specify minimum requirements for 10 conditions of employment, including hours of work, various forms of leave and redundancy pay. Awards, enterprise agreements and employment contracts cannot exclude any elements of the NES, or provide less favourable employment conditions.
- Enhancing or constraining employment entitlements can have much more varied effects than simply redistributing benefits from employers to workers or vice versa. It can also affect employment levels, consumer prices and the ability of firms to sustain or increase workers' wages over time. Increases in workers' entitlements do not come for free.
- The NES as a whole have attracted little controversy. There are some concerns about the details of particular entitlements and some suggestions for new entitlements.
- In the absence of a national standard for long service leave (LSL), national employers must deal with a diversity of qualifying periods and entitlements for LSL across the different arms of their national operations. This creates complexity for some businesses and variations in leave entitlements among Australian workers.
- This is a longstanding complaint, and the last review of the *Fair Work Act 2009* (Cth) (FW Act) recommended the development of a uniform national approach. However, there remains some uncertainty about the net benefits of moving to a uniform system and the appropriate transition to any such standard.
- Some stakeholders have proposed a national scheme to provide portability of LSL entitlements. A compelling case has yet to be made that the benefits of a universal scheme would be sufficient to offset the costs.
- Public holidays can yield community benefits by enabling coordinated social activities, particularly on days of genuine cultural or spiritual significance. However, many people treat some national public holidays as just normal days off, which throws doubt on their community function.
- There are arrangements in many awards for employers and their employees to substitute a public holiday recognised in the NES for another day. The Fair Work Commission (FWC) should include these arrangements in all awards. As well as giving greater choice for employees about the timing of holidays, this would also provide employers with some flexibility over when they choose to incur the costs associated with public holidays.
- The NES should also be amended so that employers are not required to pay for leave or any additional penalty rates on any newly designated state and territory public holidays.
- Some have argued for two new workplace entitlements, one to support employees experiencing family and domestic violence and, the other to facilitate breastfeeding in the workplace. The issue of domestic violence is currently being reviewed by the FWC. Breastfeeding is relatively easily accommodated in most workplaces, but the full impacts of any mandatory requirements should be examined before adoption.

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Introduced in 2009 as part of the *Fair Work Act 2009* (Cth) (FW Act), the National Employment Standards (NES) are work-related entitlements that employers covered by the national system must provide for their employees.<sup>171</sup> They cover 10 matters including hours of work; flexible work arrangements; public holidays; sick, annual, parental and other forms of leave; and redundancy pay and procedures (box 16.1).

### Box 16.1 **What are the National Employment Standards**

The NES currently comprise 10 minimum standards, specifying entitlements to:

- maximum working hours — a maximum of 38 hours' work per week, plus reasonable additional hours
- request flexible working arrangements — where the circumstances meet the criteria set out in the FW Act
- parental leave and associated entitlements — up to 12 months unpaid leave per employee, plus a right to request an additional 12 months unpaid leave, plus other forms of maternity, paternity and adoption related leave
- annual leave — four weeks paid annual leave per year (plus an additional amount for certain shift workers)
- personal, carer's and compassionate leave — 10 days paid personal or carer's leave, two days unpaid carer's leave and two days compassionate leave (unpaid for casuals)
- community and jury service leave — unpaid leave for voluntary community and jury service, with an entitlement of up to 10 days paid jury service
- long service leave — a transitional entitlement derived from pre-reform awards and enterprise agreements. (For most other employees access to state and territory statutory long service leave entitlements is guaranteed elsewhere in the FW Act.)
- public holidays — a day off with pay on a public holiday, except when reasonably requested to work
- notice of termination and redundancy pay — up to five weeks' notice of termination and 16 weeks redundancy pay depending on the length of service
- the provision of a Fair Work Information Statement — which contains information on the NES, modern awards, agreement making, individual flexible agreements, the right to freedom of association, termination of employment, union rights of entry, transfer of business and the roles of the Fair Work Commission (FWC) and the Fair Work Ombudsman (FWO).

The FWO has a role in ensuring adherence to the NES. Where the FWO determines that an award, agreement or contract offers entitlements less favourable than the NES, it can issue a non-compliance notice to the employer. Ongoing non-compliance can result in the pursuit of penalties through the court system.

Source: Fair Work Ombudsman (2015m).

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<sup>171</sup> While full-time employees must be provided with conditions that meet all 10 standards, casual workers are paid a loading in lieu of some of the entitlements.

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The NES operate as a ‘safety net’: federal awards, agreements and employment contracts can offer conditions that improve on the NES, but they cannot exclude any element of the NES or offer a less favourable condition.

The concept of a set of minimum national employment standards, and the particulars of several of the current standards, attracted little controversy (box 16.2). This is partly because a number of the NES entitlements, such as four weeks annual leave and 10 days paid personal leave, were aspects of the preceding ‘Australian Fair Pay and Conditions Standards’ and were already common to many employment contracts.

### **Box 16.2 Participants’ views on the National Employment Standards**

A number of submissions to this inquiry were broadly supportive of the NES. Participants such as the Employment Law Centre of WA (sub. 89), Qantas (sub. 116), the Sydney Symphony Orchestra (sub. 100) and the Catholic Commission for Employment Relations (sub. 99) suggested that the NES, as currently stipulated, was either appropriate or effective. For example, the Employment Law Centre of WA commented that ‘the NES as a whole strike a balance between the needs of both employers and employees, and generally operate effectively, in accordance with the legislative intent’ (sub. 89, p. 11).

The Australian Mines and Metals Association went further. It suggested there may be scope to expand the NES. By moving some content that is consistent across modern awards to the NES, it may be possible to simplify awards and improve the clarity around a range of matters (sub. 96).

Other submissions reaffirmed the value in legislating minimum standards, rather than leaving them in awards or enterprise agreements. Because they are consistent across workplaces and not subject to periodic revision, having the NES incorporated into legislation creates a measure of certainty and transparency for both employers and employees. BlueScope Steel noted that:

... [t]he introduction of the NES harmonised these minimum standards in a way that could be more readily understood by the people they were designed for — the Australian employee and employer (sub. 58, p. 3).

Rather than object to the rationale or content, submissions critical of the NES tended to focus on aspects which, in their view, required attention. In this spirit, the Australian Council of Trade Unions noted that:

... [t]he content of the National Employment Standards is largely based on safety net standards developed by the [Australian Industrial Relations Commission] through the Award system. In broad terms that content is uncontroversial and unobjectionable, however there are some particular features of the National Employment Standards that warrant further development (sub. 167, p. 168).

The most commonly cited problem areas include long service leave and public holidays. Concerns about these are developed in more detail in the chapter.

Further, two recent reviews have examined the NES or elements of them. These were the 2012 post-implementation review of the FW Act (box 16.3), and a Fair Work Australia review of the provisions relating to requests for flexible working arrangements and extensions to unpaid parental leave (O’Neill 2012c).

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**Box 16.3      The 2012 post-implementation review's recommendations on the National Employment Standards**

The 2012 post-implementation review of the FW Act made a number of recommendations, of which seven pertained directly to the NES. They were that:

- employees do not accrue annual leave while absent from work and in receipt of workers' compensation payments
- the employer and the employee meet to discuss a request for extended unpaid parental leave, unless the employer has agreed to the request
- taking unpaid special maternity leave should not reduce an employee's entitlement to unpaid parental leave
- the right to request flexible working arrangements be extended to a wider range of circumstances and, unless the employer has agreed to the request, a meeting be held to discuss the request
- annual leave loadings not be payable on the termination of employment, unless a modern award or enterprise agreement expressly specifies otherwise
- the development of a national long service leave standard be expedited
- the number of public holidays under the NES on which penalty rates are payable be limited to a nationally consistent number of 11.

Of these, only the recommendation that unpaid special maternity leave not affect an employee's entitlement to unpaid parental leave was implemented in full, although the Australian Government did widen the range of circumstances under which flexible working arrangements can be requested.

*Source:* McCallum, Moore and Edwards (2012).

Accordingly, this chapter does not critique the existence of the NES or most of the current elements. Nor does it revisit issues related to the NES explored in previous Productivity Commission inquiries (such as how it relates to adoptive parents and to parents who have children with disabilities).<sup>172</sup> Another issue not covered here is whether there is scope to reduce duplication and complexity by transferring some entitlements from awards to the NES or vice versa. That matter is discussed in chapter 7.

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<sup>172</sup> The Productivity Commission explored these matters in its inquiries into *Paid Parental Leave: Support for Parents with Newborn Children* and *Disability Support and Care* (PC 2009, 2011a) and recommended that the unpaid leave entitlements be extended to all parents adopting children aged under 16 years, and that parents with a disabled child over 18 years of age, but requiring a substantial amount of care, have the right to request flexible working arrangements. To date, only the first of these has been incorporated into the NES.



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This chapter instead assesses elements of the NES around which there is more contention and/or where prima facie there appears scope for material improvement. To aid that assessment, section 16.1 outlines some characteristics and effects of employment standards. Subsequent sections then look at possible changes to the NES in relation to:

- long service leave (LSL) provisions (section 16.2)
- public holidays and annual leave entitlements (section 16.3)
- entitlements for employees experiencing family and domestic violence and for breastfeeding employees (section 16.4).

## **16.1 Some economic aspects of job conditions and entitlements**

### **Types of benefits and costs**

Workplace entitlements provide benefits for workers, typically at some cost to employers.

The benefits of more generous conditions to employees can take many forms. For example, they may include better health and work/life balance (in the case of working hours and flexibility provisions); more personal, family or community time (in the case of leave and public holidays); or greater peace of mind (in the case of minimum termination notice periods and redundancy pay provisions).

While such employee benefits are not financial, in principle, the worth of most entitlements can also be expressed as a wage or salary equivalent. This notion is most obvious for entitlements that can be ‘cashed out’ — that is, where workers can elect to transform certain entitlements, such as annual leave, into extra pay.<sup>173</sup> Yet there is still some implicit monetary value for entitlements that cannot be cashed out, such as long service leave, minimum termination notice periods and redundancy pay. This is because, in the absence of such entitlements, employees would require additional wages to make them no worse off.

When employers provide more generous conditions for their workers, the cost entailed is broadly equivalent, from their perspective, to a wage or salary increase. The cost of providing some entitlements will be minimal (for example, providing staff with the Fair Work Information Statement), while others (such as providing annual and long service leave) impose a more substantial cost. Productivity Commission estimates suggest that, on

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<sup>173</sup> Where a worker elects to cash out an entitlement, the implication is that the worker values the entitlement at no more than the money received. However, for other workers who do not elect to cash out their entitlements, the implication is that they value the entitlement more highly than the money they could have received.

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average, the cost of a worker taking an extra day away from work as a part of an increased annual or sick leave entitlement is around 0.5 per cent of that worker's annual output. For shift workers with increased annual leave entitlements, the cost is slightly higher.

Of course, some employers may voluntarily offer generous conditions as a means of attracting, retaining and motivating employees, which provides benefits to the employer.

### **Simple models of labour markets can hide important features**

In a simple model of labour market behaviour, employees and employers would prefer to have purely cash based employment contracts rather than ones involving a mix of entitlements and cash. The underlying assumption is that employees have different preferences (for example for leave) and that employers could construct contracts that minimised the costs of attracting employees to the business. This model, taken in isolation, would imply that the conditions set down by the NES are inefficient because employees would choose (and the employers agree) to a mix of conditions and wages that best suited them as individuals. This is analogous to arguments about consumer choice, where it is often thought better to give people cash than to hypothecate particular expenditures. Were such a model to apply, employees would 'purchase' the amount of leave that suited their needs. This would sometimes be in excess of the standard and, on other occasions, less, in the same way that people's preferences for many other 'services' vary.

However, much observed employer or employee behaviour does not accord with this simple model. For example, in the United States, where there is no statutory minimum leave, firms usually voluntarily provide the same leave entitlements to all employees, despite the fact that worker preferences for such leave varies (Altonji and Oldham 2003). In Europe, where relatively long leave entitlements are mandated, the hours of work given up during holidays are not made up through multiple job holding or other ways of increasing hours (which would be the strategy used by employees who did not value extended leave as much as others).

Likewise in Australia, while until recently there have been limitations on the cashing-out of leave<sup>174</sup>, people can purchase leave in excess of the usual NES, but where data are available for given industries, this practice is very rare. For example, in the Queensland Public Service, only 5.6 per cent of employees purchase additional leave (Queensland Government 2010, p. 79). Moreover, there is some evidence that many Australians would prefer more leave than a pay rise (Denniss 2003).

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<sup>174</sup> Under Australian law, cashing out leave is only permitted when an award, enterprise agreement or any other agreement allows it (FWO 2015g). While around a third of enterprise agreements approved between 1 March 2011 and 31 March 2014 contained provisions dealing with the cashing out of annual leave (with some additional safeguards), prior to the 2014 review, only one modern award — the Seafood Processing Award 2010 — offered something similar. However, on 11 July 2015, the Full Bench of the FWC decided to incorporate a model clause permitting the cashing out of annual leave into *all* awards (FWO 2015r). This decision may still be contested as a part of the review process.

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This highlights that the simple model does not capture some important features of real world labour markets. These features are important in understanding the NES.

- Mandatory long service leave may be important in maintaining employees' productivity by reducing the risk of 'burnout', especially where it is hard to observe where particular employees might be at risk. Were these leave entitlements customarily cashed out, employees might not take the time off that is important to their long-run productivity.
- Employees may be reluctant to request carers' and personal leave or seek flexibility in their working arrangements if it is seen as signalling a lack of commitment to the business, or if it is seen by colleagues as counter to the workplace culture. This would result in generally excessive hours and insufficient flexibility for employees. A recent study conducted at a consulting firm where its employees routinely logged 80-90 hours per week found that 31 per cent of men and 11 per cent of women did not wish to formally request flexible working arrangements, but instead found other ways to achieve flexibility that were not visible to management (Reid 2015).<sup>175</sup> As a result, statutory entitlements can make it easier for workers to access leave and flexible work arrangements.
- Some of the entitlements of the NES address real imbalances in the bargaining power of employees compared with employers.
- Given their simplicity, it is easier for employees to verify whether they have received a well-known non-pecuniary benefit under the NES — such as annual leave — compared with their wage entitlements in what are a complex set of pay rates in a regulated workplace relations (WR) system. The NES may therefore improve employer compliance.
- It may be less costly, given contracting costs, for there to be a simple set of uniform standards for employment that are implicit in all employment contracts.
- The NES may provide efficient risk pooling, where cash in lieu would not.<sup>176</sup>
- The NES is not just an economic instrument, but one that also seeks to establish or shape social norms (for example, that working and caring for children are compatible). There may be some costs associated with realising those norms, but it is common for a government to use laws in this way.

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<sup>175</sup> This phenomenon was corroborated by the Work and Family Policy Roundtable and the Women + Work Research Group which noted that '[r]ecent research shows that most workers (and their managers) do not know about the right to request. It also shows that men are less likely than women to make a request, and men are more likely to be refused' (sub. 130, p. 10).

<sup>176</sup> For example, it is costly for individual employees to purchase income protection in the event of enduring illness, but less costly for businesses to do so.

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## Some broad effects of changing entitlements

It follows that while changes in worker entitlements have effects similar to an increase or decrease in workers' wages (chapter 4), the overall effects will be more complex. Nevertheless, to the extent that there are tradeoffs between entitlements and wages, the effects of changing entitlements principally occur through re-distribution from one party to another, effects on employment, and wage and price effects.

The extent to which these effects (either alone or in combination) occur depend largely on whether a change to entitlements affects the total cost of employing a worker and the capacity of the employer to absorb the additional cost. In some markets (technically, those yielding economic 'rents'), increases in entitlements are likely to have largely redistributive effects rather than impacts on the prices of goods and services (although businesses may change their capital intensity in response to an increase in the relative cost of labour). In more competitive goods markets (as is the case with a substantial proportion of Australian markets), increases in entitlements are likely to reduce labour inputs, reduce future wage growth (to the extent that the WR system permits this) and raise consumer prices. Given that *some* NES requirements act more like fixed costs than ones related to the hours of work, increases in entitlements may also affect employment numbers by more than they do hours of work (unlike minimum wage requirements, which tend to have the opposite effect — chapter 4).

Assessments of increasing entitlements need to take account also of the more subtle social and economic roles of the NES — as outlined above. The upshot is that enhancing or constraining workers' conditions or entitlements (whether through the NES or other means) can have more varied effects than redistributing benefits between employers and employees. A key challenge in appraising proposals to improve the NES is to recognise these potential effects and, accordingly determine whether a potential change likely delivers a benefit to employers, workers *and/or* other members of the community that exceeds its cost.

## 16.2 Long service leave

Paid LSL is a leave type unique to Australia and New Zealand (although Finland has a lowly paid sabbatical option for employees). LSL provides a paid break of up to three months to workers who have spent a lengthy period (usually 10 or 15 years) with the same employer. It was conceived in Victoria in the 1860s to allow a predominately immigrant workforce ample time to make the lengthy voyages necessary to visit their home countries, without jeopardising their employment (Thornthwaite and Markey 2014).

Whereas the NES provisions on other leave entitlements are quite specific and self-contained — for instance stipulating that all full time national system workers are entitled to four weeks paid annual leave per year or up to 12 months unpaid parental leave — the NES provisions on LSL are neither. They provide only for a 'transitional'

entitlement to LSL for the workers who would have otherwise been covered by a pre-reform award or enterprise agreement. Most employees in the national system derive their LSL entitlement from state and territory legislation (preserved by s. 27(2)(g) of the FW Act) (Stewart 2015, p. 252).<sup>177</sup>

This complicates the task of determining the specifics of a worker's entitlement. The employer must first check whether the worker is covered by an agreement made either prior to January 2010 that remains in effect, or by an 'award based transitional instrument'.<sup>178</sup> Where an agreement has lapsed, and so does not cover the worker, and/or where the relevant instrument does not specify the worker's LSL entitlement, as is commonly the case, the employer must abide by the relevant state or territory's legislation instead. The reliance on state and territory legislation has resulted in considerable variation in LSL arrangements and entitlements across Australia (table 16.1).

Several submissions to this inquiry (box 16.4) have expressed concern about LSL entitlements. The concerns centre on the lack of portability of LSL entitlements (a concern of employee representatives) and the compliance and other costs for business of the divergent arrangements between jurisdictions. These concerns, and potential solutions to them, are considered in turn below.

**Table 16.1 Long service leave entitlements<sup>a</sup>**

<i>State</i>	<i>Legislation</i>	<i>Qualifying Period</i>	<i>Entitlement</i>
New South Wales	Long Service Leave Act 1955	10 years	2 months
Victoria	Long Service Leave Act 1992	15 years	13 weeks
Queensland	Industrial Relations Act 1999	10 years	8.667 weeks
Western Australia	Long Service Leave Act 1958	10 years	8.667 weeks
South Australia	Long Service Leave Act 1987	10 years	13 weeks
Tasmania	Long Service Leave Act 1976	10 years	8.667 weeks
Australian Capital Territory	Long Service Leave Act 1976	7 years	6.06 weeks
Northern Territory	Long Service Leave Act 1981	10 years	13 weeks

<sup>a</sup> This table does not show the rate at which additional entitlements accrue for service in excess of the qualifying period. There are also some exceptions. For instance, in most states, there is separate legislation for the construction industry, while Commonwealth public servants are covered by the *Long Service Leave (Commonwealth Employees) Act 1976* (Cth) rather than LSL legislation in the ACT.

Sources: Casey, McLaren and Passant (2012); Workplaceinfo (2015a).

<sup>177</sup> The exception to this is employees of the Commonwealth public service who derive their entitlement from the *Public Service Act 1999* (Cth).

<sup>178</sup> These instruments were formerly 'pre-modernised awards' or 'notional agreement preserving state awards'. Modern awards cannot include terms that deal with LSL. Enterprise agreements can but the terms of these agreements for any single worker must not be inferior to the terms in either the transitional instrument or the state or territory legislation. A worker is covered by an award-derived transitional instrument if, before the award modernisation process, their entitlements were specified by the award.

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## Box 16.4 Participants' views on long service leave

Submissions to this inquiry were highly critical of the current long service leave (LSL) arrangements. These criticisms centred on the jumble of transitional entitlements that have prevailed in place of an explicit standard. The Australian Industry Group noted:

... Australia's long service leave laws are a mess. The interaction between the long service leave provisions in the NES [National Employment Standards], State and Territory laws and enterprise agreements is so complex that employers and employees find it difficult to navigate and determine entitlements' (sub. 172, p. 76).

The Victorian Government elaborated on the breadth of the concerns. It submitted:

... [t]he interim LSL NES can be very complex for employers and employees to apply because it may require them to look at the interaction between the Fair Work Act, old award entitlements and State or Territory LSL laws. Secondly, the interim LSL NES appears to lock in any award derived entitlements, without any mechanism for these eventually to be phased out or overridden through enterprise bargaining. Thirdly, the rules largely lock in the differences in LSL entitlements under State and Territory LSL laws, without any mechanism for State and Territory laws to be overridden through enterprise bargaining. In addition, the LSL NES provides only very limited means for employers operating businesses across jurisdictions to introduce uniform LSL arrangements for their employees. (sub. 176, p. 68)

No submissions spoke in favour of the current arrangements, although the Queensland Government did commend them for 'ensuring the maintenance of LSL entitlements' (sub. 120, p. 8) or effectively acting as a placeholder.

Many submitters recognised the benefits of moving to a uniform national standard. The Australian Council of Trade Unions (ACTU) argued that 'the missing element in the comprehensive suite of minimum standards set out in the [National Employment Standards] is long service leave' (sub. 167, p. 174). Without agreeing on the specifics of any entitlement, the Australian Workers' Union, the Australian Industry Group, the Australian Mines and Metals Association and the Victorian Government joined the ACTU in endorsing, in principle, a national approach.

There were, however, some concerns about the challenges associated with establishing a national standard. The South Australian Government argued that the development of a national uniform standard is unlikely, and that the simplifying the current arrangements to reference state and territory legislation only would be a more practical alternative (sub. 114, p. 7).

Other submitters warned of the impact on employers. BusinessSA argued that 'a national approach to LSL will be ineffective, particularly as the establishment of a national standard could lead to increased costs for employers' (sub. 174, p. 18). The Australian Chamber of Commerce and Industry noted that it 'would not be able to support the establishment of a national long service leave standard that would impose additional costs on businesses which would be in no better position as a result' (sub. 161, p. 166), a sentiment echoed by the Australian Hotels Association and the Accommodation Association of Australia (sub. 164, p. 25).

The Housing Industry Association went further. It submitted that 'a broader approach needs to be taken by considering the merits and ongoing utility of long service leave in its entirety' (sub. 169, p. 63).

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## Portability of long service leave entitlements

In most instances, when an employee moves from one business to another, LSL entitlements are either cashed out or forfeited. An employee that moves jobs frequently may never accumulate LSL entitlements. Portability schemes enable employees to maintain their entitlements when they change employer, generally within the same industry.<sup>179</sup> The usual rationale for such schemes are:

- Whether employees receive benefits is dependent on the survival of the business and on whether it is practically feasible for an employee to stay with a given employer for the qualifying period. For example, women often have fractured employment histories associated with having and caring for children, and thus will often leave their employment before they become eligible for long service leave.
- Where LSL acts as an incentive for loyalty, in principle it must also discourage labour mobility. Labour mobility and efficient matching of the skills and attributes of individual employees to businesses may contribute to dynamic efficiency in an economy.<sup>180</sup>
- LSL provides people with the scope to have a protracted break from work to rejuvenate (with potentially long-term productivity gains) as well as aiding work life balance (Thorntwaite and Markey 2014). These benefits may apply as much to a person who is engaged in continuous work with multiple employers as one who is engaged with a single employer, but under current arrangements, they miss out.

However, some of these benefits may not be large. Notwithstanding the goal of providing a time for recuperation, employees under portable schemes do not necessarily take the leave. For example, in a submission to a review of a New South Wales scheme for contract cleaners, the Australian Industry Group argued that:

... the experience in other States shows that it is rare for employees to actually take leave under these schemes; rather the emphasis has been on the employees accumulating money. ... [The schemes] do not, in practice, have the effect of giving workers a period of rest and recuperation. (Ai Group 2013)

Similarly, according to the NSW Industrial Relations Advisory Council, ‘in many cases, LSL is not regarded as an opportunity for career renewal, but rather as an economic asset’ (2013).

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<sup>179</sup> There are variety of (state-based) industry portability schemes, including in the building and construction, coal and contract cleaning industries. The desirability of such schemes (and broader LSL issues) are being examined by the Education and Employment References Committee. The committee’s report is due in February 2016. A Victorian Parliamentary committee is also inquiring into LSL portability, with a final report due by 1 May 2016.

<sup>180</sup> There are circumstances where it may be advantageous for businesses to engender longer-term relationships with parts of their workforce, particularly where the workers have essential skills that are costly or difficult to acquire. However, there is little to suggest that businesses could not tailor a contract with a more targeted incentive structure than a blunt statutory instrument.

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While there are still likely to be some benefits from making LSL portable, those benefits must be compared with the costs entailed in any scheme:

- (i) While LSL may not be an efficient measure for creating employer loyalty, it must have some effect, which would be diluted with full portability.
- (ii) Some employers may be reluctant to hire workers with accumulated entitlements, as these would be more likely to request protracted leave close to their commencement date.
- (iii) A move to mandate portability *at the current level of LSL entitlements* would entail a significant increase in LSL costs to business. Under current arrangements, the total costs of LSL for an employer depend on the tenure distribution of its workforce. As many employees leave before the qualifying period, the total claims under the current arrangements are much smaller than would apply under a portable scheme (where employees' tenure would be based on their working lives, not their specific tenure with an employer).<sup>181</sup> The greater coverage of employees would be reflected in the levy imposed on employers, with one estimate suggesting that portable LSL costs could be up to 2.5 per cent of wage costs (McKell Institute 2012).<sup>182</sup> In the absence of any counteracting wage reductions, this would have some dampening effect on employment and encourage businesses to use more capital instead of labour.

### An alternative design

An alternative design could address concerns about the excessive cost to business of portable LSL in (iii) by scaling back the average portable entitlement such that the overall costs to business were similar as under the current system. For example, if the average employee received the equivalent of two days per year from current arrangements, then a portable scheme could simply add two days to the current NES provision for four weeks of annual leave.

Under this alternative proposal, a benefit would be extended to employees who failed to reach the eligibility trigger of 10 or 15 years in the workforce in total. The key beneficiaries would be people who move between employers without ever accruing sufficient tenures to qualify for LSL, and those who take breaks from the labour force for purposes like raising children. This would better address the equity concerns associated

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<sup>181</sup> The Australian Workplace Relations Study found that, of a sample of over 5000 people, just over 40 per cent had been with their employer for over 5 years. Depending on the instrument which governs their entitlement, a large proportion of these employees would be eligible for the full entitlement, or a pro-rata entitlement.

<sup>182</sup> Depending on the qualifying period and the duration of the entitlement, and making some other assumptions, the McKell Institute (2012) estimates the levy to be of the magnitude of between 1.67 and 2.5 per cent of remuneration. This is broadly in line with state and territory industry-based schemes.



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with LSL. It would also provide a form of LSL portability without a levy or an interposed third party — a key departure from current portability scheme. This would make it simpler than a full portability option (although costs for firms with high labour turnover would increase compared with the status quo).

However, any such approach would still have some of the features outlined in (i) and (ii) above. In particular, by removing LSL, businesses that value longer duration working relationships would have to find and fund other ways to promote tenure, while also providing improved annual leave entitlements (although it is likely that many such firms would have other mechanisms). To maintain cost neutrality, this would need to be factored in to any decision to replace LSL with more days of annual leave. Moreover, shifting some LSL benefits to those previously unable to access them would remove benefits from employees who would have qualified for full LSL benefits under the current arrangements.

## Assessment

Overall, the Productivity Commission is not convinced that the benefits from portable LSL schemes would be sufficient to justify the costs and complications entailed. Submissions to this inquiry have not provided compelling evidence of major and widespread concerns about the present *non-portability* of most LSL arrangements or include widespread support for greater flexibility or the alternative design.

## Towards a nationally uniform standard?

The combination of multiple LSL instruments and legislation clearly creates complexity and costs, particularly for businesses operating across state borders. Several participants highlighted such costs in submissions to this inquiry (box 16.4).

National employers may need to comply with not only the arrangements in several states, but also the entitlements specified in multiple award-based transitional instruments. Indeed, a business that operated nationally would have to comply with at least eight different types of LSL arrangements — and potentially more if any of its workers could have been covered by pre-reform state or federal awards that featured LSL entitlements. Employers, in these instances, face costs in determining who is covered by which instrument and in complying with a number of entitlements.

Compliance costs aside, nationally operating businesses can, depending on where their operations are located, face higher labour costs than their competitors from meeting LSL entitlements (all other things being equal) in several jurisdictions (table 16.2).

Multi state or national employers have only limited scope to mitigate these costs. Since new enterprise agreements *cannot* supersede state or territory laws, these employers' only option to realise consistency across their workforce is to offer all workers the entitlements that prevail in the most generous award or jurisdiction. The alternative is to provide

otherwise equivalent employees in their business with different entitlements depending on where they work.

**Table 16.2 Significance of long service leave labour costs**

<i>State</i>	<i>Ratio of weeks of leave per week of work</i>	<i>State share of total Australia-wide labour costs</i>
	%	%
New South Wales	1.54	33.1
Victoria	1.67	23.9
Queensland	1.67	18.5
Western Australia	1.67	12.6
South Australia	2.50	6.3
Tasmania	1.67	1.8
Australian Capital Territory	1.66	2.6
Northern Territory		1.1

*Sources:* Table 4.1 and ABS 2012, *Labour Costs, Australia*, 2010-11, Cat. No. 6348, released 7 May 2012.

The 2012 post-implementation review of the FW Act recommended that ‘Commonwealth, state and territory governments should expedite the development of a national long service leave standard with a view to introducing it by 1 January 2015’ (McCallum, Moore and Edwards 2012, p. 104).

However, there has not been significant progress towards a national standard since the review, largely because the adoption of a standard will entail losers as well as winners. Businesses operating mainly in one state would not want to emulate higher cost arrangements in another, while employees (and their representatives) in a state with more generous entitlements would not want to relinquish these to achieve uniformity.

While there would be some benefits from achieving a simplified system, their scale is less clear. Gauging the costs that divergent LSL arrangements pose for businesses is difficult, but several factors are likely to mitigate their size:

- Most enterprises operating across a number of states typically have sophisticated management of payroll and entitlement obligations. Since LSL arrangements do not change frequently over time, it is likely that the compliance costs associated with meeting LSL requirements across different states are relatively modest.
- Most businesses do not operate across state borders.
- The differences in the implicit wage premium associated with LSL are not substantial. Only the Northern Territory and South Australia have LSL provisions that provide many more benefits than other jurisdictions. All other things being equal, the additional generosity of their LSL arrangements adds less than 1 percentage point to labour costs in those states’ relative to others. Moreover, this estimate assumes that all employees

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ultimately receive long service entitlements, when in fact many people leave their workplaces before they are eligible for their entitlements.

- Most Australian labour markets are unaffected by interstate differentials in LSL. The share of Australia-wide total labour costs provides a rough indication of the size of different labour markets in Australia. The results suggest that there are negligible differences in implicit premiums for over 90 per cent of Australia's labour market. Accordingly, even if there were some incentives to shift resources due to implicit wage differentials, this would relate to only a small share of the labour market.
- Nationally operating businesses tend to pay above award wages or use enterprise bargaining. They therefore have greater scope to adjust wages if they wished to reduce the implicit wage differential between states with different LSL arrangements.
- The costs of higher entitlements in various states may be costs to businesses, but some of these are transfers to employees. From an economic perspective, the relevant cost is the net cost.

A further complicating factor is that changes in regulatory arrangements between states require considerable political commitment, and bureaucratic, business and union resources. To justify the use of these resources, the case for a uniform standard has to be compelling.

There may nevertheless be merit in pursuing more modest changes in the short term, simply to alleviate some of the complexity, without taking the possibility of a national standard off the table.

The Productivity Commission sees a case for ensuring all employees derive their LSL entitlements from state and territory based legislation only (except Commonwealth public sector employees, who are not covered by such legislation).<sup>183</sup> This would strip away a layer of complexity for business. In calculating a worker's entitlement, a business would not have to consider award-based transitional instruments. The workers covered by these instruments would find their LSL entitlements reverting to the level enjoyed by most other workers in their state or territory. However, since LSL entitlements appear in only some of these instruments,<sup>184</sup> a limited number of workers would be affected (who in principle could bargain over compensating wage adjustments), while the benefit of reduced complexity would span all employers.

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183 This would require removing the transitional entitlement in the NES and replacing it with a reference to section 27(2) of the FW Act which preserves an entitlement to state and territory statutory LSL schemes.

184 FWC estimates suggest that 21 of the 1560 instruments considered as part of the award modernisation process (and leaving aside the 1625 instruments that covered a single enterprise) provided for LSL only while 239 instruments contained a specific LSL entitlement while a further 563 referred to the relevant state or territory legislation.

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One option, which may bring any proposal for a nationally uniform LSL entitlement closer to consensus, would be to agree to ‘grandfather’ existing entitlements. Grandfathering would mean that the new national standard, once agreed, would apply only to new hires, *not* to existing jobs. This would remove the prospect of current workers losing their present entitlements, and of employers having to countenance sudden increases in what they might owe to their workforce. The proportion of workers initially covered by the new national standard would be low. However, it would expand over time, as some workers move to new jobs and as new workers enter the labour force and others retire.

The main concern with this approach is that it would trade one source of complexity for another, with associated compliance burdens for businesses. However, if implemented in concert with simplification of the transitional entitlements, a business would only need to know when a worker commenced their employment, and which state they work in, to determine their LSL entitlements.

For once, a national issue is not really the responsibility of the Commonwealth Government. It is very difficult to envisage effective simplification without some form of in-principle willingness to cooperate amongst them. States should give consideration to collective action perhaps via the Council of the Australian Federation.

## **16.3 Public holidays**

Public holidays are an additional leave entitlement established by Commonwealth or state law. On these days, all permanent employees can take a day off with pay. If they are reasonably required to work, they are compensated with a higher wage, or a penalty rate<sup>185</sup> depending on their award or enterprise agreement (for a discussion of penalty rates, see chapters 10 to 15). Several submissions claimed that statutory provisions for public holidays were flawed (box 16.5).

### **The balance between public holidays and leave**

The NES currently discriminates between leave entitlements taken as public holidays and as normal leave. There are grounds for shifting the balance between the two in the NES.

The main rationale for (paid) leave on specially designated days is that there is some genuine social benefit associated with widespread community engagement in events, especially on days of cultural or spiritual significance. This rationale generally holds for days where people often engage with the wider community (good examples are Anzac and New Year’s Day, but there are others too). Public holidays such as Christmas that affirm important cultural beliefs might also help bind communities together.

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<sup>185</sup> Casual workers are entitled to a day off on a public holiday, but without pay. If they are called in to work, they may receive penalty rates depending on the terms and conditions of their employment.

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## Box 16.5 Participants' views on public holidays

Employers and their representatives were the predominant source of concerns about public holidays. While no submitter argued for the abolition of public holidays, several commented on the need for consistency across jurisdictions and consideration of the business costs of new public holidays. The Australian Hotels Association and the Accommodation Association of Australia stated:

... [t]he concept that a reasonable amount of public holidays is a valid reward for employees is supported. It is also agreed that rates of pay are warranted for those working public holidays. However:

- there is no consistency regarding the number of public holidays
- business bears the cost when excessive numbers of dates are sanctioned. (sub. 164, p. 11)

The majority of the concerns about public holidays centred on the role of the states and territories in creating additional public holidays, and, as a result, additional obligations for businesses that operate under the national workplace relations system. In outlining the two main ways in which this occurs, Clubs Australia Industrial argued:

... [o]ne area identified as having a deleterious effect on employers are the public holiday provisions under the National Employment Standards (NES). The difficulty appears to arise as a result of the duplicity of State and Federal laws in this area. In particular, the individual States gazetting 'additional' public holidays, with the effect on employers effectively paying two separate days of public holiday rates arising out of the same public holiday, or simply gazetting a number of public holidays that are in excess of those defined within the meaning of section 115(1)(a) of the Act. (sub. 60, p. 4)

New public holidays can be costly for businesses. In its analysis of the effects of a new public holiday across Victoria on the eve of the AFL Grand Final, the Victorian Employers' Chamber of Commerce and Industry estimated that 'the cost to pay many of Victoria's almost 2 million full-time employees not to come to work could reach \$543 million for the day' (sub. 79, p. 34).

The Queensland Council of Unions, on the other hand, noted that the Queensland Government found it useful, in 2013, to declare that a day in November 2014 would be a public holiday in the Brisbane metropolitan area, to alleviate traffic and assist with security measures associated with the G20 summit (sub. DR305, p. 3).

There may be other benefits too.

- The common timing of public holidays typically provides people with a greater opportunity to share their time off with their family. Normal leave arrangements may not always provide that opportunity because children may be at school and both partners may not be able to obtain consent from their employer for time off on the same day. This potential problem generally does not arise on public holidays as employees are entitled to a day off — except where reasonably requested to work. Christmas, in particular, is a series of public holidays traditionally devoted to gatherings with family and, indeed, with extended family. However, other one-off holidays through the year may also enable families to coordinate and spend extra time together. (That said, many people are still able to coordinate their leave to suit their families.<sup>186</sup> And most people are already able to share time with their families on weekends.)

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<sup>186</sup> In August 2013, 73 per cent of employees could choose when to take holidays, and a further 16 per cent said that they could sometimes choose (ABS 2013a).

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- There is also empirical evidence that more shared days of leisure enrich the relationships of people with their friends and acquaintances, which then improves the quality of leisure on other days, such as weekends (Merz and Osberg 2006). (Of course, for people without available family or friends, public holidays may be an especially lonely time).

In many cases, a public holiday is not necessary to achieve considerable community coordination. Increasingly Australia's communities have found ways to recognise and celebrate their contributions to society. Special days like Chinese New Year, the Sydney Gay and Lesbian Mardi Gras and National Tree Day (among others) thrive without being officially designated a public holiday. Moreover, some public holidays (for example, those that create long weekends) typically lead to significant traffic congestion and delays on roads out of/in to capital cities, as well as peaks in demand and 'premium' charges for other transport, accommodation and entertainment services during those periods.

While there is a strong case for public holidays, it is also clear that for any total leave entitlements (the sum of public holidays and annual leave entitlements), there is a tradeoff between leave days that are legislatively prescribed for given days (public holidays) and leave days where employees have a degree of choice about the timing of days off (annual leave). Few Australians would prefer a system in which all of their annual leave entitlements were fixed dates, as is the case with public holidays. This would prevent people from having leave in a continuous form, placing constraints on family holidays away from home and many types of recreational activities (for instance, overseas holidays).

Further, deciding (and agreeing on) which days are genuine public holidays is not an easy exercise, particularly given that state sovereignty is involved (discussed in more detail below). It may be the case that the people in some regions or states place a high value on a special day, and would balk at it losing its status as a public holiday under the FW Act, particularly if there were some doubt about whether they could access their annual leave to celebrate it. For example, Melbourne Cup Day is highly valued by a large number of Victorians (particularly those who choose to attend the festivities in person) while some businesses (for example, the racing industry) may lose some revenue if it is changed to 'normal leave' and subject to the employee's discretion.

Conversely, some employees may have a preference for the government to specify the days on which they can take leave. This could be the case for workers who struggle to get leave from their employer or whose annual leave entitlement is partly exhausted by a shut down by the business. For example, childcare sector workers are often forced to take a large amount of their leave over Christmas when the centre is closed.

There has been no public debate about the tradeoff, because the underlying framework for thinking about public holidays neglects the possibility that a society could choose more annual leave and fewer public holidays, without reducing the overall amount of days off. An important starting point in that debate is that only some public holidays have a common cultural significance, and that other public holidays are decided on much less compelling rationales. In the latter case, many people treat such holidays as just another day off.

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## The swap option

There is some flexibility for employees and employers to vary public holiday arrangements, but not everyone has access. The FW Act (at s. 115(3)) permits a modern award or enterprise agreement to include terms providing for an employer and employee to agree to substitute public holidays for the purposes of the FW Act. The substitution may be of a day or part-day that would otherwise be a public holiday under the NES.

Notwithstanding that the drafting implies the swap term only permits swaps on an individual basis — an employer and ‘an employee’ — some awards and agreements permit the swap on a collective basis. For example:

- General Retail Industry Award 2010: An employer and a majority of employees may agree to substitute another day for a public holiday. If employees work on either the public holiday or the substitute day, they must be paid penalty rates. If both days are worked, one day must be paid at public holiday rates, at the election of the employee.
- Manufacturing and Associated Industries and Occupations Award 2010: By agreement between the employer and the majority of employees in the enterprise or part of the enterprise concerned, an alternative day may be taken as the public holiday instead of any of the prescribed days.<sup>187</sup>
- Mining Industry Award 2010: An employer and a majority of affected employees *or an individual employee* may reach agreement in writing to substitute a day or part-day for a day or part-day that would otherwise be a public holiday under terms of the NES. [emphasis added]
- Australian National University Enterprise Agreement 2013–2016: In order to minimise disruption to teaching and other University business, the University may substitute for Family and Community Day public holiday a day off in lieu for specified teaching and teaching/student support areas, where such a holiday falls in a teaching period. Such substituted day would be taken in conjunction with the Christmas closure. Students and staff must be given reasonable notice of the substitution.
- David Jones Enterprise Agreement 2012: At the store level, by agreement between David Jones and a majority of employees, another day may be substituted for the actual days listed.

Swap arrangements are essentially available to any workplace that selects to negotiate an enterprise agreement (and includes such a term in the enterprise agreement). The same is not true for award-reliant businesses. These businesses will only have access to a swap arrangement if the FWC includes a term permitting a swap in the relevant modern award.

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<sup>187</sup> Following an enterprise-level swap, this award permits ‘an employer and an individual employee’ to agree to an individual swap, whereby the employee would take another day as the public holiday instead of the day which the enterprise has agreed be observed as the public holiday.

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Analysis by the FWC suggests 87 of the 122 modern awards have a provision for the substitution of public holidays. While data are not available on the prevalence of such terms in current enterprise agreements, the Department of Employment's Workplace Agreements Database indicates around 23 per cent of enterprise agreements current up until 2009 contained clauses allowing for the variation of public holidays by mutual agreement.<sup>188</sup> These terms were more prevalent in agreements involving larger businesses.

When surveyed, a significant portion of the Chamber of Commerce and Industry Queensland's members (52 per cent) reported they are unable to allow their employees to swap public holidays with another day. When asked if the opportunity to swap public holidays with another day was permitted, a majority of the 52 per cent indicated they were strongly in favour of such a reform (sub. DR311, p. 17).

Given the swap option provides employees and employers with flexibility, and may encourage some businesses to open on days when they otherwise would not have done so, the Productivity Commission considers that all businesses should have access to swap arrangements. Therefore, the FWC should include a term permitting swap arrangements in all modern awards.

Providing access to swap arrangements in all modern awards would be beneficial for both employers and employees.

Overall, employees would not be financially worse off because of a swap. If a swap occurs, all affected employees would receive a day's leave on the day that they or their workplace has agreed to observe as the public holiday. Like on any other public holiday, permanent employees would be paid for this day and casuals would not. Permanent and casual employees who are required to work on the new public holiday, rather than have a day's leave, would receive public holiday penalty rates.

The main benefit of a swap for most employees is not financial. The swap option allows employees to observe the public holiday entitlement conferred by the NES on a date that suits most of their needs better. For example, employees may favour an additional public holiday around Christmas over a day off in June for the Queen's Birthday.

The effect on businesses of such swaps is more complex, but ultimately positive. To the extent that greater numbers of employees are willing to work on a public holiday (and take a paid day off or earn the penalty rate on another occasion), businesses may see increased trading gains on public holidays. This would primarily relate to industries where demand on public holidays was high, such as retailing and restaurants. There is some evidence that consumer spending on such days is high (for example Boxing Day sales). The net effects on overall trade for an entire year may or may not change, as they depend on a wide range of factors. Regardless, consumers would benefit from greater convenience. These benefits

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<sup>188</sup> Unilateral swaps, either on the part of the employer or the employee, is not permitted.



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would not apply across the entire economy because demand for some services — such as banking and finance — are typically low on public holidays.

Since there is no obligation to open when it is unprofitable to do so, employers do not have to acquiesce to an employee's preferences to work on a public holiday. In a similar vein, because it would require their consent, employees could not be compelled to agree to a substituted public holiday that greatly inconveniences them. By this logic, businesses can only benefit from this proposal.

#### RECOMMENDATION 16.1

The Fair Work Commission should, as a part of the current four yearly review of modern awards, give effect to s. 115(3) of the *Fair Work Act 2009* (Cth) by incorporating terms that permit an employer and an employee to agree to substitute a public holiday for an alternative day into all modern awards.

## State and territory public holidays

Since the majority of states referred their workplace relations powers to the Commonwealth in 2009, most employers are covered by the FW Act rather than state workplace relations systems (with the notable exception of most state public sector workers). However, the FW Act specifically leaves some matters to be determined in accordance with state and territory laws, including the declaration of public holidays. Section 115(1)(a) of the NES prescribes eight public holidays on which the public holiday entitlements in federal awards and enterprise agreements are invoked, and s. 115(1)(b) provides that those entitlements are also invoked on any public holiday declared by the states and territories. So, by declaring new holidays (say Grand Final Eve in Victoria), state and territory governments can unilaterally create obligations under the NES for any employer in their state or territory to provide further leave days with pay (table 16.3).

### There is considerable variation across jurisdictions

The National Retailers Association has questioned the role of state and territory governments (most particularly, the South Australian Government in relation to two part day public holidays that it declared in 2012) in creating holidays, with pay consequences that would otherwise be determined by the FWC in awards or by businesses in enterprise agreements:

... NRA submits that the SA Government should not countenance a practice of declaring public holidays purely for the purpose of increasing the remuneration of employees. The level of remuneration paid to employees is a matter either for Fair Work Australia in terms of private sector employers or is a matter for enterprise bargaining (National Retailers Association 2011).

**Table 16.3 State and territory public holidays over and above the NES**  
2016 (green = public holiday)

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Regatta / Recreation Day						✓ <sup>a</sup>		
Canberra Day								✓
March Public Holiday					✓			
8 hours Day						✓		
Easter Saturday	✓	✓	✓		✓		✓	✓
Easter Sunday	✓							
Easter Tuesday						✓		
May Day							✓	
WA Day				✓				
Bank Holiday	✓							
Picnic Day							✓	
Family and Community Day								✓
AFL Grand Final Eve		✓						
Labour Day	✓	✓	✓	✓	✓			✓
Melbourne Cup Day		✓						
Christmas Eve					✓ <sup>b</sup>			
Christmas Day	✓ <sup>c</sup>	✓ <sup>c</sup>	✓ <sup>c</sup>	✓ <sup>c</sup>		✓ <sup>c</sup>	✓ <sup>c</sup>	✓ <sup>c</sup>
Proclamation Day / Boxing Day					✓ <sup>d</sup>			
New Year's Eve					✓ <sup>b</sup>			
Cup Days	✓ <sup>e</sup>							
Show Day			✓ <sup>f</sup>			✓	✓ <sup>a</sup>	
Total	6	5	4	3	6	5	5	5

<sup>a</sup> Different days, depending on the region. <sup>b</sup> Part-day holiday. <sup>c</sup> Substitute for a public holiday which falls on a weekend. <sup>d</sup> Christmas Day moved to Boxing Day, and an additional day taken for Boxing Day. <sup>e</sup> Cup Days in NSW are generally part day holidays that fall on different days, depending on the region. <sup>f</sup> Brisbane area only.

Sources: Australian Hotels Association (2015); Fair Work Ombudsman (2015n).

There are many holiday variations across jurisdictions (table 16.4), including some interesting peculiarities. For example, while most states will celebrate the Queen's birthday on 8 June in 2016, Western Australia will celebrate it on 28 September.<sup>189</sup> The birthday was first celebrated in Australia in 1788 in honour of the birth of King George III, although in fact his birthday was 3 June. So, Australia's Queen's birthday celebrates the birthday of a long dead king, and on different days in different states and in no instance actually aligns with a monarch's birthday.<sup>190</sup> So long as people value a given public holiday as serving a valuable community role, the fact that its origin and name might have limited historical

189 Western Australia does not celebrate the Queen's Birthday in June because the first Monday in June is already a longstanding public holiday (sub. DR286, p. 4)

190 The Queen's birthday is recognised in the NES as a public holiday (without any reference to an actual date because the dates vary by jurisdiction).

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validity is largely immaterial. However, once the date is arbitrary, it is unclear why the dates should not be the same across jurisdictions, particularly when it creates costs (typically by making it more difficult to conduct business across state lines).

The lack of uniformity concerning public holidays and the dates on which they are celebrated was recognised as an issue by the Council of Australian Governments as far back as 1993. Despite the Council agreeing to establish a working group (COAG 1993), there is little evidence to suggest that it was ever set up, and nor was any progress report made. The Council has not considered the issue since.

Though not shown in table 16.4, there are several other oddities in state and territory holidays:

- Some public holidays are only paid when they fall on a weekday, though in others, the paid day off switches to the closest weekday. This means that the number of paid public holidays varies by the year.
- There are variations in public holidays within states (for example, various show days in different towns and regions) and variations in days depending on the industry ('bank' holidays).
- Some states have declared Easter Saturday and Sunday as public holidays, which means that penalty rates on those days are higher than they would otherwise be.
- South Australia's March holiday was in May prior to 2006, and there have been pressures by some groups to move it back to May (Rau 2013), suggesting that the day does not have a distinctive community value.
- South Australia is also unique in that under the *Holidays Act 1910* (SA), all Sundays are designated as public holidays, though in practice this is often not observed (box 16.6).
- For the overwhelming majority of employees in the Australian Capital Territory, Anzac Day is only a paid day off when it falls on a weekday. However, for ACT public servants, Monday 27 April 2015 was declared a public holiday (in lieu of the previous Saturday), meaning that schools closed and public transport ran on a weekend schedule, with disruptions for the bulk of the workforce and workplaces.

**Table 16.4 Public holidays in Australia**

2015 (green = weekdays, blue = weekends)

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT	NES
1 January	✓	✓	✓	✓	✓	✓	✓	✓	✓
26 January	✓	✓	✓	✓	✓	✓	✓	✓	✓
9 February						✓ <sup>a</sup>			
2 March				✓					
9 March		✓			✓	✓		✓	
3 April	✓	✓	✓	✓	✓	✓	✓	✓	✓
4 April (Saturday)	x	x	x		x		x	x	
5 April (Sunday)	x	x							
6 April	✓	✓	✓	✓	✓	✓	✓	✓	✓
25 April (Saturday)	x	x	x	x	x	x	x	x	x
27 April				✓					
4 May									
1 June				✓					
8 June	✓	✓	✓	b	✓	✓	✓	✓	✓
24 July							✓ <sup>c</sup>		
3 August	✓ <sup>d</sup>								
12 August			✓ <sup>e</sup>						
28 September				✓ <sup>f</sup>				✓	
5 October	✓		✓		✓			✓	
2 November						✓ <sup>g</sup>			
3 November		✓							
24 December					✓ <sup>h</sup>				
25 December	✓	✓	✓	✓	✓	✓	✓	✓	✓
26 December (Saturday)		x	x		x	x			x <sup>i</sup>
28 December	✓	✓	✓	✓	✓	✓	✓	✓	✓
31 December					✓ <sup>h</sup>				
Total days	13	13	12	12	13	12	12	12	8 <sup>j</sup>

<sup>a</sup> Only some regions. <sup>b</sup> Western Australia does not celebrate the Queen's birthday (consistent with the NES requirement), but does so on 28 September. <sup>c</sup> Show day Darwin. Other areas in the NT have other days for their show day. <sup>d</sup> Financial institutions only. <sup>e</sup> Brisbane only. <sup>f</sup> Western Australia's Queen's Birthday holiday. <sup>g</sup> Only some awards/enterprise agreements. <sup>h</sup> Part-public holiday for Christmas and New Year's Eves. <sup>i</sup> Under the FW Act, a state or territory can elect a substitute day for an NES-specified day, which is why for some states, the 26<sup>th</sup> is not designated as a public holiday. Some states have chosen to designate the 28<sup>th</sup> December as a public holiday, as well as retaining 26 December as a holiday. <sup>j</sup> There are only eight holidays named in the NES, but it does recognise additional public holidays established by state and territory governments.

Sources: Fair Work Act 2009 (Cth); Fair Work Ombudsman (2015n).

### Declaring a new public holiday has consequences

State and territory governments can choose to designate public holidays that have some particular cultural significance for their jurisdictions. However, in doing so, they should

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take into account the total number of public holidays in the jurisdiction relative to the national benchmark of eight national public holidays, and the impacts, which vary depending on whether the public holiday is on a weekend or weekday. Declaring additional days as public holidays may be politically appealing, but comes at significant economic costs.

A public holiday declared on a weekday will often lead to closure of an enterprise on that day, with losses in output, reduced convenience for customers, and reduced capital utilisation. If the enterprise decides to operate on a weekday public holiday, the cost per employee will generally rise by 150 per cent above the standard weekday rate.

For days declared on weekends, the cost implications are reduced because many employers do not open on weekends anyway. Nevertheless, for those that do typically open — such as hotels and retail outlets — the penalty rates increase substantially as a result, especially for Saturdays. For example, in many cases this would increase the penalty rate for a Saturday from 125 per cent to 250 per cent. As is the case for weekday holidays, this can affect the behaviour of such enterprises (such as opening hours, staffing and so on).

Changes to public holiday arrangements can also involve tricky compliance issues for businesses, such as managing state variations for national businesses, and in the case of part-day holidays, a variety of complexities about appropriate payments under the FW Act (WorkplaceInfo 2015b). The declaration of the two half-day holidays in South Australia in 2012 led to an exhaustive examination of part-day payments by a Full Bench of the FWC,<sup>191</sup> which in turn required changes to most awards, with the compliance costs and misunderstandings for businesses and employees that such amendments entail.

Finally, casuals only benefit partially from the declaration of new public holidays. They are entitled to a day off from work, unless reasonably requested to work on the public holiday. Regardless, if they take the day off, they will typically not be paid given the day-to-day character of employment arrangements for casuals. Such employees would still benefit from the higher penalty rates imposed on such days, but only to the extent that businesses continued to employ them on those days.

The implication is that newly designated public holidays will often involve no effective pay increases for the most low-paid employees.

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<sup>191</sup> Modern Awards Review 2012 — Part-day public holidays [2012] FWAFB 10738.

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## Box 16.6 Sunday public holidays in South Australia

One of the more unique, and enduring, characteristics of the South Australian workplace relations landscape is that every Sunday is a public holiday. A remnant of an earlier time — Sunday public holidays were originally written into the *Holidays Act 1910* (SA) to ensure that institutions such as banks and state government departments would not open on what was regarded as a day of rest.

Since the referral of industrial relations powers to the Commonwealth in 2009, most employers in South Australia have been moved into the national workplace relations system, meaning that they are subject to regulation under the FW Act, rather than under state industrial laws. However, since the FW Act recognises any other day or part day declared under state or territory legislation as a public holiday (s. 115(1)(b)), all employers across the state — whether they are in the state or national systems — are affected.

In principle, the implication is that workers should receive public holiday penalty rates rather than Sunday penalty rates. Given the former is generally higher than the latter, so this would mean a greater impost on employers. Moreover, it could also mean that, in accordance with the NES, employees have the right to a paid day off on Sundays.

In practice (and with the exception of the restriction on authorised deposit taking institutions and state government departments), there appears to be an informal *détente*, where neither employers nor employees regard Sundays as public holidays (SACES 2013, p. 8). This is reinforced by the notion that, at the state level, awards and enterprise agreements specifying Sunday rates of pay supersede public holiday penalty rates.

At the national level, the situation is even more perplexing. There is little evidence on the degree to which national system employers operating in South Australia treat Sundays as public holidays and pay their workers accordingly. A number of Commonwealth agencies operating in South Australia have been caught by the century old Act, with some, but not all, back paying public holiday penalty rates (Robertson 2012). Some advice has suggested that this problem may diminish over time as new enterprise agreements nullify the problem by expressly specifying that employees earn Sunday rates, rather than public holiday rates (AGS 2012).

The position of the Fair Work Ombudsman (FWO) is that state and national system employers should face similar obligations. In this sense, the national system regulator takes its lead from established practice in South Australia. The FWO does note, however, the absence of test cases establishing case law precedent in this regard. Moreover, while it will not seek rectification or bring a claim against employers for paying Sunday, rather than public holiday, rates, there is nothing to stop another party from doing so.

While it is not clear to what extent workers in South Australia are able to pursue claims for unpaid penalty rates on a Sunday, at the very least, without a decision by the South Australian Industrial Relations Tribunal in the state system, or by the Federal Court in the national system, the prospect of retrospective claims cannot be entirely disregarded. That is, businesses found to have paid Sunday, rather than public holiday penalty, rates over a long period of time may face a substantial liability for backpay.

While the *Holidays Act 1910* (SA) has been reviewed since — a recent example being its amendment in 2012 to provide for two part day holidays on Christmas Eve and New Year's Eve — the designation of every Sunday as a public holiday remains unaltered.

Source: SafeWork SA (2011).

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Notwithstanding all of these problems and costs, sometimes the benefits of coordinated leisure may outweigh the overall costs of newly designated public holidays (some of which are transfers between parties anyway). As with any new regulation entailing large burdens on business (and consequences for others), state and territory governments should analyse these costs and benefits before any declaration.

### A better approach for the future

The 2012 post-implementation review of the FW Act recommended limiting the total days that would attract regulated penalty rates to just 11. However, the effectiveness of this change depends on the timing of such days.

In cases where a state or territory government declared a new public holidays on weekdays, the market rate would approach the regulated penalty rate anyway. This is because employers would still be required to pay an employee absent on a state public holiday. Employers wanting an employee to work on a public holiday would, for commercial reasons, have to pay them at least what they would get on a normal working day (so the *effective* penalty rate for a person at work on a weekday public holiday would already be at least 200 per cent, even if there was no regulated penalty rate).<sup>192</sup> To the extent that people would like to enjoy whatever community activities occurred on any designated holiday, then an employer might need to pay an additional amount to attract them to work.

In contrast, the review's recommendation would be effective for new public holidays falling on weekends because employees are not entitled to a day off at such times.

Accordingly, in practice, implementation of the review's recommendation would only partly address the cost implications of newly designated public holidays.

An alternative might be that the s. 115(1)(b) of the FW Act could be amended to remove any obligation for an enterprise to pay for an employee's absence on newly designated state and territory public holidays (unless for sick, annual or other forms of existing leave). In this case, employees would have to negotiate with their employers — either individually or through enterprise agreements — to be paid for absence on these days.

To avoid reductions in the current level of employees entitlements, were this proposal to be adopted, it would need to still permit jurisdictions (if they so wish) to declare substitute days when an existing public holiday falls on a weekend (as can currently occur if the state wishes).

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<sup>192</sup> The exception to this is salaried workers who are generally expected to work reasonable extra hours in order to execute the tasks outlined in their contract of employment. Employers would not have to pay these workers extra should they require them on a public holiday.

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#### RECOMMENDATION 16.2

The Australian Government should amend the National Employment Standards so that newly designated state and territory public holidays are not subject to public holiday penalty rates or a paid day of leave.

This recommendation would not stop a state or territory government exercising their sovereignty to declare a public holiday. Doing so would still result in higher payments to any public sector employers that are not covered by the national system, but at least some additional accountability might be encouraged.

### **Do workers get enough leave?**

A broader issue is a public debate about the desirable number of days available as holidays (regardless of their form) to Australian employees. Some countries have more legislated annual leave entitlements than Australia (such as Sweden and Austria with 25), while others like Canada (10 days) and the United States (zero) have less. Given that the demand for leisure generally rises with income, it could be expected that over the longer term, the preferences of people would be for implicit pay rises to take the form of more annual leave rather than just more dollars.

In theory, the same objective for more time off work could be achieved by allowing people to take unpaid annual leave funded by accumulated savings from a higher average hourly wage rate, leaving existing leave entitlements alone. However, while it is acceptable (and even expected) that people request standard annual leave, this is not true for unpaid leave. Around 25 per cent of employees requesting changed employment arrangements have these refused by their employers, and a substantial number of employees wanting arrangements that are more flexible did not request them because of concerns about the responses from their employers.<sup>193</sup> In that instance, longer paid annual leave times, with a cash out option, would establish an expectation that the leave would be provided, but still leaving some flexibility. As is the case for all annual leave, the exact time chosen for leave would be determined consensually between the employer and employee.

Changing the NES paid annual leave entitlements is not warranted at this stage (beyond those that would arise from transferring some public holidays to annual leave). Nevertheless, Australian governments should periodically assess whether there are grounds for increasing current annual leave entitlements in the NES. It would be preferable for a

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<sup>193</sup> For example, in Victoria for every 100 people requesting a change in work arrangements, around 20 people did not request changes because they thought their employer would not allow it, they were worried about job security or thought their workplace was not flexible (ABS 2011, *Workforce Participation and Workplace Flexibility*, Victoria, December 2010, Cat. No. 6210.0, released 11 August 2011).



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coherent discussion of that issue, rather than the creation, haphazardly, of public holidays by state and territory governments that result in the same total leave amounts, but in a form that is less valuable to employees and more costly to employers. Any future policy initiative to raise the NES annual leave entitlements should not come at a higher total cost of labour, with an explicit tradeoff between the wage rate growth and any additional leave entitlements.

RECOMMENDATION 16.3

Periodically, the Australian, state and territory governments should jointly examine whether there are any grounds for extending the existing 20 days of paid annual leave in the National Employment Standards, with a cash out option for any additional leave where that suits the employer and employee. Such an extension should not be implemented in the near future, and if ultimately implemented, should be achieved through a negotiated tradeoff between wage increases and extra paid leave.

## 16.4 Potential additions to the NES

Some stakeholders proposed the inclusion of new entitlements or changes to some existing entitlements in the NES.

One of the reasons the NES has been largely uncontroversial is that its content is either consistent with strongly-affirmed social norms about workplace entitlements or reflects much of what was already consistent across awards, enterprise agreements and employment contracts. The scope for further additions to the NES will depend in part on the degree to which further inconsistencies in awards can be eliminated. The more systematic analysis by the FWC of common issues in awards, such as weekend penalty rates and leave loadings, may pave the way for further consolidation of entitlements in the NES.

Moreover, the NES can be expected to adapt as social norms evolve. As noted earlier, in past inquiries, the Productivity Commission itself has recommended changes to the NES that were consistent with clearly apparent community norms. Any decision to amend the NES to include additional workplace entitlements would need to ensure that the entitlements had broad public acceptability as well considering their more tangible costs and benefits entailed.

A further factor that affects the evolution of the NES is that it creates a set of obligations that, by design, are not intended to be negotiated away through individual agreements or enterprise agreements. As argued earlier, the incapacity to relinquish entitlements for other benefits can sometimes be warranted because of a commonly agreed social goal or where for various reasons, people do not take advantage of entitlements due to their signalling effects, even if they would prefer to do so. However, in other cases, employees negotiating

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enterprise agreements may wish to determine the repertoire of entitlements that suits them, trading off one against another. This would be precluded if such entitlements are incorporated into the NES.

Moreover, the further the NES departs from established social norms, the greater the risk of it becoming widely controversial or objectionable. This can bolster the argument for legislative amendments and put a number of the entitlements contained in the NES at risk.

Against this background, the Productivity Commission examines three sets of proposals to expand or modify the NES.

## Flexibility for employees

Several inquiry participants recommended adaptations to the NES to achieve further flexibility for employees with family responsibilities (box 16.7). It is clear that most people have increasingly favoured a workplace framework that gives employees more scope for work-life balance (INSEAD, Universum and HEAD Foundation 2014).

### Box 16.7      **The right to request a change in work arrangements and the extension of parental leave**

Some participants have claimed that there are flaws in the FW Act provisions relating to the right to request a change in work arrangements (s. 65) or to obtain an extension of parental leave (s. 76).

The ACTU argued that the current provisions make it far too easy for employers to deny these requests. The ACTU submitted that:

... [t]he provisions are drafted so that:

- No obligation is placed on employers to reasonably accommodate a request;
- Employers are only required to give an employee (in writing) the reasons for the refusal which can be on a very wide range of 'reasonable business grounds'; and
- Under s. 739 of the [Fair Work Act] employees are specifically denied a right to appeal an employer's unreasonable refusal of a request for both sections 65(5) and 76(4), unless they have the bargaining strength to reach agreement with their employer to do so in a workplace agreement (sub. 167, p. 169).

The ACTU suggested that the FW Act require employers to reasonably accommodate employees' requests for flexible work arrangements or to extend a period of parental leave. It proposed that the FW Act provide guidance about how an employer should appraise any request and that there should be an appeals mechanism where an employer refused (sub. 167, pp. 173–174). The Work and Family Policy Roundtable and the Women + Work Research Group proposed a similar arrangement (sub. 130, p. 10).

In 2003, United Kingdom lawmakers made it a statutory duty for employers to follow certain procedures in considering similar requests. In addition, they established a right of appeal, which appears to have increased the likelihood that employers approved requests (ACTU sub. 167, p. 171).

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However, in making judgments about the desirability or best timing of any such changes to the NES, several (sometimes overlooked) considerations are relevant.

The likely behavioural responses by people to any such measures needs be assessed, since these responses can sometimes undermine their prime objectives. A particular concern is that any obligations perceived to be costly by employers and that predominantly affect only one group of employees, may unwittingly lead to employment discrimination. In the particular, proposals for improved leave access discussed in box 16.7, the ACTU noted that ‘... [d]espite the issue being significant to all working parents, it is mostly women who are affected by the need to balance work and family’ (sub. 167, p. 170). There is therefore a risk that women may find their career and hiring prospects reduced by some employers without any real capacity to detect this. Moreover, to the extent that the provisions are seen as largely oriented to women, men may be reticent about even requesting to use such provisions.

Solving this dilemma would require a number of changes. These include addressing any misperceptions about the actual costs of such flexibility measures, increased public awareness of employers that use flexibility as a strategy to attract talented people, the diffusion of such flexibility arrangements in enterprise agreements, advocacy more generally, and changing social mores that make it acceptable for men also to request such leave. Regulatory measures that provide avenues for complaints or appeals by people denied reasonable flexibility (box 16.7) could help, but this may arise primarily from the fact that such regulations would signal the unacceptability of certain conduct by employers. The regulations themselves would most likely be only weakly enforceable given the difficulty of establishing what is reasonable.

## **Employment protections for victims of family and domestic violence**

There are increasing calls for changes to the WR system (for example, a new leave entitlement) to address the needs of employees subject to domestic violence. The desirability and form of any policy responses depends on a range of matters — as discussed below.

### **Current regulatory arrangements**

Aside from the policies of individual firms and employers, the FW Act provides some entitlements and protections for employees experiencing family or domestic violence. These include a range of general protections, statutory minimum entitlements to personal/carer’s leave and compassionate leave to support a family member with a serious personal injury or illness (box 16.8).

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**Box 16.8 Entitlements and protections in the FW Act that may be used by employees experiencing, or caring for someone experiencing, family or domestic violence**

*Personal/carer's leave* (ss. 95 – 103) — ten days paid leave for each year of service, available to employees, other than casual employees. This is typically used by people for illness or injury to themselves or their family members. Accordingly, it could be used by an employee who is:

- not fit for work because of an illness or injury sustained from family or domestic violence
- providing care or support to a member of their family or household who requires care or support because of an illness or injury sustained from family or domestic violence, or because of an unexpected emergency relating to family or domestic violence.

Thus, while personal/carer's leave can be used by a carer to support a member of their family or household in an unexpected emergency (possibly for example, escaping a threat of violence, seeking an Apprehended Violence Order), the victim of the violence can only use it if, and when, they sustain an injury.

*Compassionate leave* (ss. 104 – 107) — two days of paid leave when a member of the employee's immediate family or household sustains an illness or injury that poses a serious threat to his or her life, or dies. This is available to all employees, other than casual employees. A precondition is injury or death, meaning this type of leave cannot be taken to support the member with activities linked to the experience of domestic violence (such as attending court or finding new housing).

*Annual leave* (ss. 86 – 94) — generally, four weeks of paid leave for each year of service available to employees, other than casual employees. This would provide victims with paid leave to attend any activity associated with the experience of family or domestic violence (such as attending court). However, the usual intent of annual leave is to provide opportunities for leisure, not to deal with crises (such as illness, domestic violence or other traumas in people's lives). This is why, for example, people have access to personal leave for illness, and are not expected typically to use annual leave for that purpose. Because annual leave is generally used for planned absences, it requires agreement between the employee and their employer about the particular choice of dates.

*Right to request flexible working arrangements* (ss. 65 – 66) — an employee (including long-term casuals) can request a change in working arrangements (for example, changes in hours of work, patterns of work or location of work). This provides an opportunity for ongoing flexibility for employees experiencing, or caring for someone experiencing, family or domestic violence. The employer can only refuse such a request if there are reasonable business grounds for doing so (for example, the arrangement would be too costly, or there is no capacity to change the working arrangements of other employees to accommodate the request).

*General protections* (Part 3-1) — it is unlawful for an employer to take adverse action against an employee for a discriminatory reason, such as the employee's physical or mental disability or family and caring responsibilities. 'Disability' has generally been broadly interpreted by relevant courts and tribunals, so that a victim of domestic violence who suffers psychological consequences as a result of such violence, may fall into this category. Depending on the circumstances, the ground of 'family or caring responsibilities' may also be relevant.

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Employers and employees may negotiate additional family and domestic violence provisions at the workplace through enterprise agreements, although the share of agreements incorporating such provisions is relatively small (box 16.9).

**Box 16.9 Domestic violence clauses in federal enterprise agreements**

- 840 (3.7 per cent) agreements approved between 1 January 2012 and 30 June 2015, covering an estimated 630 592 employees (21.8 per cent) of employees covered by agreements approved in this period, contained a clause regarding domestic violence that provides a related provision.
- As at 30 June 2015 there were 759 current (that is, not nominally expired) agreements that contained a domestic violence clause, covering 586 585 employees.
  - Together, the Education and training industry and the Accommodation and food services industry account for 50 per cent of those 586 585 employees.
  - 58.8 per cent of the 586 585 employees are covered by private sector agreements but access to domestic violence provisions is still skewed in favour of public sector employees.
- A full text analysis of 468 domestic violence clauses from agreements made in 2014 and 2015, and categorised them based on the entitlements available to employees shows that:
  - the most common type of domestic violence clause is one that offers leave (either as a new separate leave entitlement, or as access to existing leave entitlements) for employees suffering from domestic violence, with 84.9 per cent of employees covered by a domestic violence clause having access to leave;
  - the right to request flexible working arrangements was another common entitlement, with 40 per cent of employees covered by a clause that granted this entitlement.
- Other noteworthy data about agreements with domestic violence clauses include:
  - agreements with domestic violence clauses are more likely to cover unions.
  - agreements with domestic violence clauses are more likely to cover businesses operating solely in Victoria or New South Wales.

*Source:* Department of Employment's Workplace Agreements Database.

**Some have called for strengthened legislative workplace relations arrangements**

A 2011 inquiry by the Australian Law Reform Commission (2011) made three recommendations regarding family violence and the FW Act, indicating that the Australian Government should consider:

- family violence-related amendments to the FW Act in the course of the 2012 post-implementation review of the Act.

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- amending s. 65 of the FW Act to allow victims of domestic violence and those caring for them to request flexible working arrangements.<sup>194</sup>
  - amending the NES to include provisions for additional paid family violence leave.

Several participants in this inquiry also advocated more statutory employment protections for victims of family and domestic violence. There were two broad concerns.

First, some said that employees experiencing family and domestic violence were sometimes subject to discrimination. They considered that discrimination on the grounds of family or domestic violence should be a ground for adverse action and unlawful termination applications under the FW Act.<sup>195</sup> Victorian Legal Aid noted:

... our discrimination lawyers and family law practitioners report that people who experience family and domestic violence are indirectly discriminated against by employers who fail to provide flexible work conditions. Moreover, clients have reported a reluctance to report family violence to their employers for fear of embarrassment or being treated differently. (p. 15)

The National Working Women's Centre (sub. 242) argued that the protection should also cover employees who provide care or support to a member of their family or household that is experiencing family or domestic violence.

Second, some parties sought to have universal regulatory requirements for paid family and domestic violence leave, either through the inclusion of a provision in all awards (ASU sub. 128, trans. p. 265 and the ACTU)<sup>196</sup> or in the NES.<sup>197</sup> The view was that this might better enable victims to seek help, and provide scope for people to re-adjust their lives (for example, obtaining secure accommodation, and dealing with court and police matters). The Working Women's Centre SA also emphasised that an entitlement in the NES could have a symbolic effect:

It would be good to have something in the NES to flag the issue ... I guess there's something symbolic about having something embedded in a law that signals to people this is a serious issue at your enterprise, you need to do something to make sure you don't run foul of the law. (trans. p. 416)

Many of the proposals put to the Productivity Commission are similar to international developments in this area. For example:

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<sup>194</sup> This recommendation was implemented by the then Australian Government in 2012.

<sup>195</sup> For example, the National Foundation for Australian Women (sub. 154), Victorian Legal Aid (sub. 200), the National Working Women's Centres (sub. 242) and Economic Security 4 Women (sub. 250).

<sup>196</sup> Australian Council of Trade Unions correspondence to the Fair Work Commission Award Modernisation Team, 15 June 2015. The ACTU sought 10 days of leave for domestic violence-related reasons (and the right to unpaid leave if paid leave is exhausted).

<sup>197</sup> These included the Women's Legal Service NSW (sub. 234), the ASU (trans. p. 265), Economic Security 4 Women (trans. p. 484), and the Working Women's Centre SA (trans. p. 416).

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- In the United States, Federal contract workers can use their paid sick leave to care for themselves or a family member for absences resulting from domestic violence, sexual assault or stalking (The White House, Office of the Press Secretary 2015).
  - In Spain, victims of domestic violence are entitled to take an unpaid leave of absence for an initial period of six months, which can be extended up to a maximum of 18 months. Victims are also entitled to reduce their working hours (with a proportional salary reduction), work schedules and to transfer to another job within the company (Baker and McKenzie 2015).
  - In the Philippines, a victim of domestic violence is entitled to up to 10 days paid leave (in addition to other paid leave) to attend to medical and legal concerns (Quisumbing Torres 2013).
  - Other countries such as the United Kingdom and Turkey have had recent high profile campaigns to encourage the business community to recognise domestic violence as an important workplace issue.

### The effects on work

Family and domestic violence is a crime. It can seriously affect employment. Data from 2005 show that two-thirds of Australian women who report violence by a current partner are in paid employment (McFerran 2012). In 2011, the Australian Domestic and Family Violence Clearinghouse conducted the National Domestic Violence and Workplace Survey (McFerran 2011). The survey found that, of those who reported experiencing family violence:

- nearly half reported that the violence affected their capacity to get to work. This was mainly due to the abuser inflicting physical injury or restraint (67 per cent), followed by hiding keys and failing to care for children
- nearly one in five respondents who experienced domestic violence in the previous 12 months reported that the violence continued at the workplace. This commonly took the form of abusive phone calls and emails (12 per cent) and the partner physically coming to work (11 per cent)
- the main reported impact was on work performance, with 16 per cent of victims reporting being distracted, tired or unwell, 10 per cent needing to take time off and 7 per cent being late for work.

Victims of family and domestic violence have been found to ‘have a more disrupted work history and are consequently on lower personal incomes, have had to change jobs more often and are employed at higher levels in casual and part time work’ (Franzway, Zufferey and Chung 2007, p. 5). Increased staff turnover can lead to loss of organisational knowledge, reduction in productivity, and recruitment and retraining expenses.

## Prevalence and incidence of family and domestic violence

The evidence on the prevalence and incidence of family and domestic violence is incomplete, but the best estimate is that around 1.5 per cent of females aged 15 years and over have experienced violence from a partner or ex-partner at least once in the last year (table 16.5). The corresponding figure for men is around half this at 0.6 per cent. Of course, lifetime rates of such violence are much higher, but the most relevant estimate for considering the implications of any leave entitlements is the annual prevalence rate. Other ABS evidence also suggests high lifetime rates of emotional abuse (2014a).<sup>198</sup>

**Table 16.5 Experience of violence**  
2012

	<i>Males</i>	<i>Females</i>
	% of population	% of population
<i>Past 12 months</i>		
Experienced violence from partner or ex-partner	0.6	1.5
Experienced any form of violence	8.7	5.3
<i>Since age 15 years</i>		
Experienced violence from partner or ex-partner	5.3	16.9
Experienced any form of violence	49.0	40.8

Source: ABS, 2013, *Personal Safety, Australia, 2012*, Cat. No. 4906.0, released 11 December.

There is little evidence about the frequency in a given year of such violence for any person experiencing family or domestic violence. The *lifetime* prevalence rate indicates 74 per cent of women (and 94 per cent of men) who experienced violence by a current partner did so just once or, if more than once, infrequently.<sup>199</sup> In relation to previous partners, the corresponding figures are 42 per cent of women and 69 per cent of men (table 16.6). Given these are lifetime measures, a significant share of annual cases of partner domestic violence will involve one incident. Nevertheless, a single incident may trigger a chain of major events, including interactions with the health and legal systems and needs for new housing and new schools. All of these interactions take time, are stressful and can affect a victim's ability to work. They can have repercussions in workplaces.

<sup>198</sup> Emotional abuse is defined as abuse that occurs when a person is subjected to behaviours or actions (often repeatedly) aimed at preventing or controlling their behaviour, with the intent to cause them emotional harm or fear through manipulation, isolation or intimidation.

<sup>199</sup> 'Infrequently' refers to those persons who the ABS reports as experiencing violence 'a little of the time'.



**Table 16.6 Lifetime frequency of partner violence since the age of 15**  
For persons who experienced violence by a current or previous partner, 2012

	Current partner				Previous partner			
	Males		Females		Males		Females	
	'000	%	'000	%	'000	%	'000	%
Once	41.8 <sup>a</sup>	35.0	82.7	34.9	166.1	49.4	342.1	27.0
More than once	77.8	65.0	154.5	65.1	170.1	50.6	925.1	73.0
If more than once:								
A little of the time	70.7	59.1	93.2	39.3	66.2	19.7	197.2	15.6
Some of the time	np <sup>b</sup>	np <sup>b</sup>	45.9	19.3	75.2	22.4	380.0	30.0
All of the time/most of the time	np <sup>b</sup>	np <sup>b</sup>	15.4	6.5	28.8	8.6	347.9	27.5
Total persons who experienced violence	119.6	100.0	237.1	100.0	336.3	100.0	1 267.2	100.0

<sup>a</sup> Estimate has a relative standard error of 25% to 50% and should be used with caution. <sup>b</sup> Not available for publication, but included in totals where applicable, unless otherwise indicated.

Source: ABS 2013, *Personal Safety, Australia, 2012*, Cat. no. 4906.0, released 11 December 2013.

As limited as they are, the evidence on incidence still gives some guidance about the likelihood of any leave claims — which is an area where some parties are seeking extended workplace entitlements (see above). All things being equal, the lower the incidence, the lower the total costs of interventions to assist people, whether they be by employers, governments or other parties. Beyond discovering more about the frequency of the actual annual incidence of family and domestic violence, there is also a need to understand more about the extent to which people use their domestic violence leave entitlements when agreements include these, and if not why not (an area flagged by the Productivity Commission for further research — appendix J).

A further indicator of the annual extent of the problem is that New South Wales Police attend over 126 000 incidents of domestic violence each year, while Victorian Police attended 60 829 incidents of family violence in 2012-13 (Gendered Violence Research Network 2015). These measures understate the number of cases of violence since most incidents are not reported. For example, in 2012, around 80 per cent of females experiencing violence from their current partner did not report it to the police (ABS 2013d).

### The role for the workplace relations system

There is widespread acknowledgment by employers that family and domestic violence has workplace impacts, and that employers can assist (for example, Ai Group 2015b, pp. 3–4). In 2014-15 it was estimated that about one-third of major private sector employers have a family and domestic violence policy or strategy in place (Workplace Gender Equality Agency 2015a). *Models for providing workplace support to affected employees are emerging, such as the one developed by the Male Champions of Change. The Workplace Gender Equality Agency (2015a) judged this to be a ‘practical model for action on workplace support for employees experiencing domestic violence’ (Workplace Gender Equality Agency 2015a).*

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Workplaces can support employees experiencing family and domestic violence in several ways. First, employment may provide victims with the economic independence necessary to leave their violent partner or family member. Second, perpetrators of domestic violence can harass victims at work, and employers can provide measures that reduce those risks and their impacts. Third, employers can allow their employees to take leave to recover from and deal with family or domestic violence. Fourth, the workplace can provide an environment in which victims feel comfortable to talk to someone about their experiences of family and domestic violence and to seek help. The evidence shows that women are reluctant to formally report family and domestic violence, and that they are more likely to talk to someone they know than they are to tell the police or staff at a specialised agency (Mouzos and Makkai 2014). Employers can help by demonstrating a willingness to support employees who disclose they are victims of family and domestic violence.

On the other hand, employer organisations have been generally opposed to (or silent on) the imposition of a *regulatory* obligation on employers to provide entitlements related to family and domestic violence. In part, this reflects the availability of generic forms of leave that are available for many lifetime crises.

Decisions about the scope for the WR system to assist employees experiencing domestic violence would need to take into account several considerations:

- Requiring additional financial obligations on employers (for example, to provide paid domestic violence leave) would have cost impacts, especially for a smaller employer facing a claim for the maximum leave entitlements favoured by some participants.<sup>200</sup> The information currently available does not provide a good indication of the likely magnitude of those costs and business risks, which would be relevant to the desirability and design of any legislated leave provision. As noted earlier, evidence on the actual use of leave provisions that are already included in some enterprise agreements would be particularly useful in this regard as would evidence on the use of other types of leave for purposes related to domestic violence.
- There may be productivity benefits from providing more generous leave entitlements, although there are private incentives to realise these without necessarily requiring legislation.<sup>201</sup>
- There may be alternative instruments, such as government-funded initiatives (including financial assistance), noting that governments are playing a more significant role in this area (box 16.10). An important factor in determining the party that should primarily bear the costs of addressing family and domestic violence is their capacity to reduce the

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200 In Massachusetts in the United States, employers must now provide provision for domestic violence leave, but have exempted businesses with less than 50 employees (Office of the Attorney General 2014). While that reduces some of the risks of unexpected costs for smaller enterprises, it also means that people employed in smaller businesses do not get access to domestic violence leave.

201 In a similar vein, the UNSW Gendered Violence Research Network also notes that there will likely be an increasing commercial advantage for employers to distinguish themselves from their competitors by the design of their family and domestic violence policy.

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risks. Governments have a relatively strong capacity to reduce the risks because of the wide range of measures they can bring to bear (policing, information provisions, counselling, financial assistance, housing and other means). Nevertheless, businesses may also be able to reduce risks through the adoption of guidelines and internal policies about supporting staff experiencing family or domestic violence.

**Box 16.10 Some recent Australian initiatives to highlight and address domestic violence**

- *Australian Senate inquiry* — on 26 June 2014, the Senate referred the issue of the prevalence and impact of domestic violence in Australia to the Senate Finance and Public Administration References Committee for inquiry. The final report of the inquiry was released on 20 August 2015.
- *Queensland Special Taskforce on Domestic and Family Violence* — the taskforce examined Queensland's domestic and family violence support systems and made recommendations to the Premier on how the system could be improved and future incidents of domestic violence could be prevented. This included the provision of 10 days of leave for public sector workers for any purpose related to domestic and family violence. The Queensland Government announced in August 2015 that it would implement or support all 140 recommendations.
- *Second Action Plan of the National Plan to Reduce Violence against Women and their Children 2010–2022* — containing 26 actions that the Australian, state and territory governments agree are critical to improving women's safety.
- *Council of Australian Governments (COAG) Advisory Panel on Reducing Violence against Women and their Children* — the advisory panel, established in January 2015, will provide expert advice to COAG to address the problem of violence against women at a national level. The advisory panel's final report, due in early 2016, will advise on the future direction of the *National Plan to Reduce Violence against Women and their Children 2010–2022*.
- *Women's safety package to stop the violence* — on 24 September 2015, in a joint media release, the Prime Minister and others announced a \$100 million package of measures to provide a safety net for women and children at high risk of experiencing violence. The package is intended to improve frontline support and services, leverage innovative technologies to keep women safe, and provide education resources to help change community attitudes to violence and abuse (Turnbull and et al. 2015).
- *Change the Story: A shared framework for the primary prevention of violence against women and their children* — this report was launched on 10 November 2015 by the violence-prevention organisation Our Watch. It was developed jointly by Our Watch, VicHealth and the Australian National Research Organisation for Women's Safety. The report argues 'that gender inequality is the core of the problem and it is the heart of the solution'. In terms of the role for workplaces, the report recommends workplaces promote and support gender-equity to help modify social norms and relationships (Our Watch, VicHealth and Australian National Research Organisation for Women's Safety 2015).

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The role of the WR system in this area is already being examined closely. Under the current four yearly review of awards a full bench of the FWC is considering whether a family and domestic violence leave clause should be included in awards. The clause proposed by the ACTU would provide 10 days paid leave for any employee (including a casual employee) experiencing family or domestic violence. The FWC is expected to issue a final decision on this matter before the conclusion of the four yearly review in late 2016.

Others have proposed that the NES include five days of paid family and domestic violence leave for permanent employees and five days unpaid leave for casuals.

A decision on whether any other WR entitlements or protections (for example, the NES) should be used to address the problems posed by domestic violence, and their nature, extent and availability, should await the outcome of the award review process. By this time, the findings and recommendations of a Victorian Royal Commission into Family Violence will also be available.

## **Breastfeeding in the workplace**

In submissions to this inquiry, the Australian Breastfeeding Association (ABA) advocated for the inclusion of a range of rights and protections in the FW Act for women returning to work while breastfeeding (sub. DR334 and trans. from p. 720). Specifically, the ABA recommend that there be:

- an entitlement to paid breastfeeding or lactation breaks and access to facilities
- a duty of employers to consider all viable options to accommodate a breastfeeding employee and a right of appeal for the employee
- a review of the FW Act and related legislation to specifically refer to ‘breastfeeding’ including ‘expressing breast milk’ and to specific circumstances of breastfeeding employees
- a positive requirement for employers to provide information about breastfeeding entitlements and rights
- protection from redundancy, dismissal and non-renewal of contracts
- workplace bullying laws to include or incorporate specific references to women who breastfeed.

In support, the ABA submitted:

Studies show that the longer a mother and baby breastfeed, the better the health outcomes for both the mother and the baby. Premature weaning (cessation of breastfeeding) due to factors such as return to work, may prevent such women and babies from better health outcomes throughout their lives. (sub. DR334, p. 3)

In its 2009 inquiry into Paid Maternity, Paternity and Parental Leave, the Productivity Commission examined the evidence for the health benefits of breastfeeding, the

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effectiveness of interventions to promote and support breastfeeding, and the impact on breastfeeding of returning to paid work (2009). The report found that while there is an extensive literature on the health benefits of breastfeeding, many are based on observational studies where causality can be hard to substantiate. Nevertheless, the report notes that overall the evidence suggests significant benefits from exclusive breastfeeding up to six months. This aligns with the current clinical orthodoxy on the recommended period for exclusive breastfeeding.

Despite this recommendation, only 14 per cent of Australian infants are exclusively breastfed at six months (Australian Health Ministers' Conference 2009). The primary reasons Australian women give for discontinuing breastfeeding are problems in producing adequate milk (30 per cent); 'felt it was just time to stop' (23 per cent), resuming work (8 per cent) and 'other problems' with breastfeeding (10 per cent) (ABS 2003). There is some evidence that workplace support increases the likelihood of exclusive breastfeeding for six months (Smith et al. 2013). However, the sample size and scope of the survey underpinning this evidence means that its results may not be reliable. For example, while the results suggested access to lactation breaks helped women to exclusively breastfeed at least until six months, the number of responses was too low to be statistically significant.

As noted by Australian health ministers in 2009, the workplace has an important environmental impact on breastfeeding rates, but the relationship between return to work and breastfeeding is complex, with other interplaying factors impacting on the decision to breastfeed (Australian Health Ministers' Conference 2009).

Employers themselves have some incentive to consider the provision of breastfeeding and expressing facilities, and policies to accommodate the needs and preferences of their workforce, including mothers returning-to-work. Nevertheless, a report from the Australian Human Rights Commission (box 16.11) found that many Australian workplaces do not accommodate breastfeeding well (2014). This is notwithstanding that the typical requirements are simple — possibly as little as a short break, a temporary private space, a chair and a power point.

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### Box 16.11 The Australian Human Rights Commission report

A 2014 report from the Australian Human Rights Commission (AHRC) — *Supporting Working Parents: Pregnancy and Return to Work National Review – Report* — found that Australian workplaces are not breastfeeding friendly.

Despite longstanding prohibitions against pregnancy/return-to-work discrimination, the AHRC found that such discrimination is pervasive, with one in two mothers reporting they had experienced discrimination in the workplace at some point during pregnancy, parental leave or on return to work. More than a third reported experiencing discrimination when returning to work after parental leave. Of this group, one in five reported discrimination related to breastfeeding or expressing milk. The types of discrimination encountered were classified as:

- Negative attitude — ‘You received inappropriate or negative comments about breastfeeding or expressing milk’
- Health and safety — ‘You were not provided with appropriate breastfeeding or expressing facilities’

Some mothers returning to work while breastfeeding or expressing told the AHRC of not being provided with lactation breaks and adequate facilities at work. The report notes some participants ‘were using their lunch breaks to express in toilets, car parks and offices with glass walls or without locks because their workplace did not provide suitable rooms and storage for breastfeeding and expressing’ (2014, p. 73).

The AHRC National Review also found that many mothers are not aware that the actions and behaviours in relation to their pregnancy, taking leave and family responsibilities that they experienced, could constitute discrimination under the *Sex Discrimination Act 1984* (Cth) (Sex Discrimination Act). Section 7AA of the Sex Discrimination Act specifically prohibits discrimination on the grounds of breastfeeding and expressing milk.

The AHRC drew on data from an international study which suggests ‘targeted strategies such as providing breastfeeding facilities have ... demonstrated benefits such as high retention ... and high loyalty levels, as well as reduced absenteeism’ (2014, p. 18).

Source: AHRC (2014).

Given the barriers to breastfeeding breaks and facilities that women reportedly face, it is somewhat surprising guaranteed access is not included in many enterprise agreements. Data from the Department of Employment’s Workplace Agreement’s Database shows clauses about breastfeeding breaks and access to breastfeeding facilities are rarely included in enterprise agreements (box 16.12). While the reasons are unclear, this might be due to the limited number of affected employees and the short-term nature of each affected woman’s interest.

The lack of access to short paid breaks and simple breastfeeding facilities in a business has one of two problematic consequences. Mothers must give up breastfeeding, with adverse consequences for child welfare, or they must give up work, with adverse consequences for her and the labour force. Accordingly, support for breastfeeding arrangements at work (for instance, through a right under the NES ‘to request paid breastfeeding breaks and access to basic facilities’) has the potential to improve workforce retention and female workforce participation, both desirable outcomes.

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There may be other factors — for and against — that should also be taken into account. A more in depth review of it should precede further consideration by government — whether in the context of the NES, via award modernisation or anti discrimination law. Employers should take note of the relatively simple facilities required in most workplaces to make this option a reality; and the desirability from a staff attraction and retention perspective of doing so.

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**Box 16.12 Incidence of breastfeeding clauses in federal enterprise agreements**

Clause providing access to paid or unpaid **breastfeeding breaks** are rare in federal enterprise agreement. Key observations for the period 1 January 2010 to 30 June 2015 include that:

- 324 agreements (0.9 per cent) covering 206 361 employees (4.1%) contained some form of breastfeeding breaks (paid or unpaid) clause)
- 113 private sector agreements (0.3%) covering 28 429 employees (0.8%) contained some form of breastfeeding breaks (paid or unpaid) clause
- 211 public sector agreements (17.5%) covering 177 932 employees (13.2%) contained some form of breastfeeding breaks (paid or unpaid) clause.

Although slightly higher than breastfeeding breaks, the number of enterprise agreements with clauses on **access to facilities** for breastfeeding women is also low. Key observation for the period 1 January 2010 to 30 June 2015 include that:

- 514 agreements (1.4%) covering 547 343 employees (10.9%) contained some form of breastfeeding facilities clause
- 213 private sector agreements (0.6%) covering 189 830 employees (5.2%) contained some form of breastfeeding facilities clause
- 301 public sector agreements (24.9%) covering 357 513 employees (26.6%) contained some form of breastfeeding facilities clause.

*Source:* Department of Employment's Workplace Agreements Database.

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