

# The Living Wage Case: How Tight were the Economic Constraints on Equity?

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## Abstract

*The Australian Industrial Relations Commission (AIRC) brought down the first stage of the 'Living Wage' Case decisions on 22 April 1997. For the first time in nearly 30 years the decision was split. This article analyses the economic rationale for both majority and minority decisions and argues that the majority decision was overly cautious and conservative in its assessment of the economic constraints on the Commission's capacity to award a pay increase to low paid workers.*

## 1. Introduction

The Australian Industrial Relations Commission (AIRC) brought down the first stage of the 'Living Wage' Case decision on 22 April 1997 (see AIRC (1997) *Safety Net Review – Wages* decision, Print P1997). For the first time in nearly thirty years the Bench was split between the 'majority' decision of President O'Connor, Vice President McIntyre, Senior Deputy President's Hancock and MacBean, Commissioners Oldmeadow and MacDonald, and the 'minority' decision of Vice President Ross (referred to hereafter as the majority and minority decisions). When referring to the first of the two provisions of the *Workplace Relations Act 1996*, section 88B(2), which

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directs how the Commission must perform its functions under the Act, the majority decision acknowledges that equity is of great importance. 'The key factor governing our consideration here is in our view, fairness', [majority decision, p. 20 and p. 69]. The majority decision went on to state in an almost apologetic manner that

the factor of greatest concern (to them was) the deterioration which has occurred in the relative position of workers who depend on the award rate 'wage increases should be granted' (p. 49). However in awarding the \$10 they regretted that they could not now go further (p. 50).

'Fairness' in relation to award wages, in the context of a system in which enterprise bargaining is the primary means for generating productivity growth and improving wages and where the Act refers to 'needs' of low-paid workers, entails, at least in our view:

- award wages which have a positive relationship to movements in wages generally as measured by average weekly ordinary time earnings (AWOTE);
- the gap between award wages and wages generally being narrowed significantly;
- the needs of low-paid workers and the deficiencies of the social welfare system being addressed positively.

None of these elements were addressed by the majority decision.

However, it could be argued further that even if this central issue of fairness is put aside, the majority decision reflects a more cautious and conservative approach than even a strict application of economic considerations warranted. For example, the merchant bank Bankers Trust Australia (BT), in their April 1997 Bulletin, issued just prior to the date the decision was handed down, indicated that the money market would be unconcerned with an amount between \$11 to \$14. In the event the majority of the Living Wage Full Bench awarded only \$10 per week.

The considerations which, in the mind of the majority, limited their capacity to address and meet a key statutory requirement, were the direct and indirect costs of the claim in relation to both unemployment and inflation, including the weight given to the Reserve Bank of Australia's (RBA) monetary policy response, and the level of wage settlements outside the award safety net and the space available to protect low paid workers.

## **2. Direct Costs of the ACTU Claim: Direct and Indirect**

The Full Bench had before it a range of estimates of the direct costs of the ACTU claim, including 1% by the ACTU, 1.6% estimate by Reserve Bank and 1.84% by the Commonwealth Government. The majority decision concluded that two percent addition to AWOTE was its best estimate of the direct cost, (p. 25). The reasoning underlying this 'best estimate' reveals some significant errors, which likewise affected the majority's conclusions on the cost of other amounts.

First, the majority confused the technique of discounting any calculation of an addition to AWOTE from a particular award increase for what costs are in the system already with a counterfactual approach. On page 25, the majority stated that 'We do not know how the Reserve Bank calculated the discount of 0.4%.' This is an extraordinary statement since a great deal of submission was devoted to explaining that, in estimating the true addition to AWOTE of the claim, the cost of the third \$8 safety net adjustment from the 1994 Principles, which still had to flow through the system, must not be included in the estimates of additions to the wages bill if we are focusing on the cost of the claim.

Instead, the majority confused this with a counterfactual assuming that the Reserve Bank discount of 0.4% represented the Commonwealth Government's \$8 offer. It stated:

the 2% estimate of the direct cost of the ACTU wage claim represents a comparison with a zero increase, rather than with an increase of the order granted in recent safety net reviews. (p. 24)

This confusion resulted in an arbitrary estimate of an addition to AWOTE of 2% which would include the \$8 already awarded under the 1994 Principles (p. 25).

Second, the majority's direct costing was an overestimate because it ignored an industrial reality, again dealt with in submissions, that the actual impact on AWOTE of the increase granted could be expected to vary from one year to the next.

The minority decision of Vice President Ross is instructive on this point. In commenting on the Commonwealth's estimate of a \$10, \$12 and \$15 increase (which the Full Bench, during the case asked them to prepare), he said:

Implicit in such an approach is an assumption that the number of employees dependent on award increases has not changed since late 1995. In my view such an assumption is flawed. (p. 66)

This is because, as His Honour pointed out (p. 67), the spread of enterprise agreements since 1993 has resulted in declining numbers depend-

ent on the award rate and the new Workplace Relations Act will increase the numbers covered by (collective and individual) enterprise agreements. Thus, the majority's 'best estimate' 2% direct cost is, in our view, an arbitrary over-estimate, not supported on the evidence. The flaws underlying the majority's direct cost estimates would no doubt have influenced its view of the Commonwealth costing of other flat increases.

The Commonwealth (p. 76 minority decision) costed a \$12 increase at 0.4%, i.e. only a 0.4% addition to AWOTE and this assumes constant numbers receiving the adjustment. If this benchmark is used a \$20 adjustment would directly result in a modest addition to AWOTE of something less than 0.8%. The extreme caution shown by the Commonwealth is revealed by the estimates made by Bankers Trust Australia of \$15 representing a 0.2% addition and \$20 representing a 0.4% addition to wages growth (see Bankers Trust Australia 1997, p. 9).

At the time of the Living Wage Case AWOTE was growing at 3.9%, thus leaving scope for a 0.6% addition to AWOTE without pushing wages growth above the Reserve Bank's comfort zone of 4.5% additional to AWOTE.

### **3. Indirect Costs of the ACTU Claim**

The notion of indirect costs and its relevance to costing of nationally granted wage increases formed the basis for the cautious and conservative approach by the Commission.

These indirect costs were identified by the majority (pp. 24-25) as:

- (a) Increases in award rates raising the level of settlements negotiated under enterprise agreements.
- (b) Both employers and employees agreeing to maintain overaward payments and thus failing to absorb any increase in award payments into overawards.
- (c) Professional and executives salaries being higher because of an award increase.

Each of these will be dealt with in turn, in order to demonstrate that the notion of 'indirect costs' as defined by the majority, and the limitations they impose on the adjustment of award rates was not supported on the evidence.

### *(a) Impact on Level of Settlements in Bargaining Sector*

The majority stated (at p. 71) that:

increases above \$10 per week – say \$12 or \$15 – would represent a significant risk ... that such increases would (1) raise the levels of settlements in future workplace and enterprise bargains, (2) raise the growth rate of AWOTE to a level inconsistent with the Reserve Bank's inflation target; and (3) diminish the incentive for unions and employees to engage in bargaining.

This conclusion ignores the industrial reality of enterprise bargaining, the factors which influence bargaining outcomes and the statistical evidence before the Commission on the relevant wages base for enterprise negotiations.

As Vice President Ross stated:

I do not accept the proposition that moderate increases in award rates will impact on enterprise bargaining outcomes. In my experience in facilitating enterprise bargaining, debate between the parties is generally directed to actual rates bargained in comparable enterprises or to the prevailing level of increase in actual rates being achieved at other enterprises at the time. Bargaining is also influenced by the bargainers' expectations as to the rate of inflation over the life of a prospective agreement. Increases in award rates are seldom a consideration. (p. 73)

In fact, as outlined by the ACTU and unions in their Living Wage submissions, other factors which are relevant include profitability, productivity improvements as well as executive salaries.

His Honour concluded:

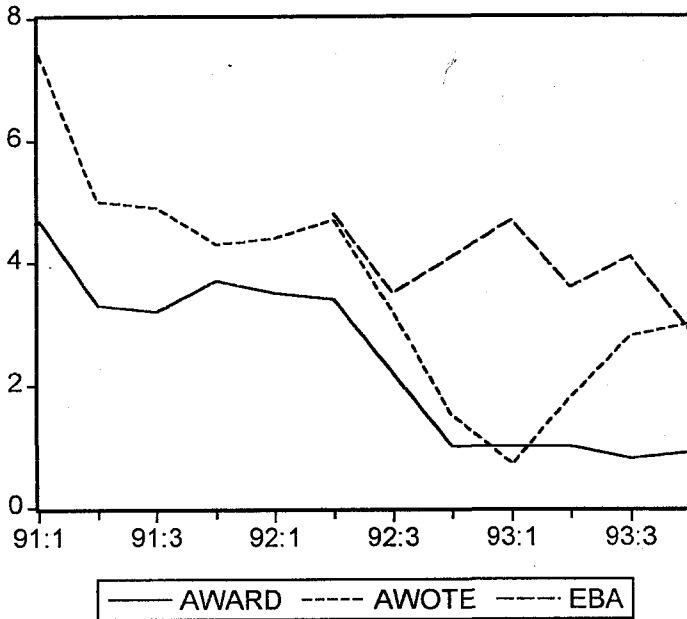
Accordingly I do not agree with the submission by the Joint Governments that a safety net increase of \$15 would have 'a substantial impact on the starting point for many wage negotiations'. Given the level of the wages base for enterprise bargaining it is likely that a substantial part of such an increase would have already been factored into the negotiating framework. (p. 75)

The ACTU, in its submissions, presented evidence on the wage base or actual rates which formed the starting point for enterprise negotiations.

As an illustration, in the manufacturing sector the average minimum weekly wage rate in Enterprise Agreements in the June Qtr 1996 was \$468.10, whilst the maximum was \$678.91. This compares with the (then) Metal Industry Award rate, at the first process worker classification level (C13) of \$366.10, and at the Tradesperson level (C10) \$441.20.

The majority took account of the RBA's views on the alleged indirect effects of award adjustments on enterprise bargaining but did not refer to a

Figure 1: Annualised Percentage Rate of Growth of Wages



Source: Reserve Bank of Australia Bulletin, December 1996

Table 1: Movement in Executive Salaries and Wages

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

Source: Exhibit ACTU 5, Table 5 at Appendix 1 to Section C

chart contained in the RBA Bulletin, December 1996, which the ACTU submitted as evidence that the relevant wage base for enterprise negotiations was not percentage adjustments in award wages but actual rates within the bargaining sector. Part of this chart is reproduced as Figure 1. The chart was relied on by Vice President Ross in rejecting the Commonwealth's submission on indirect effects of \$15 adjustment (p. 51). It shows the relationship between growth in enterprise bargaining and movements in awards.

### *(b) Reaction of Employers/Employees to Absorption*

Employers argued that little absorption would occur but never substantiated this by evidence. Despite this the majority accepted this argument without critical analysis.

The majority had before it a well documented history of wage fixation which showed that:

- unions and members had regularly delivered on absorption;
- employers regularly argued there would be no absorption but never produced evidence during a National Wage Case or after one involving absorption, that non-absorption was a live issue.

Further, when employers were asked to support their assertions only the BCA responded with limited detail of four disputes, each one of which were resolved by employees accepting absorption (p. 72 of the minority decision).

It is worth noting that the majority, nevertheless, have required a commitment to absorption to access the \$10 award variation.

As to the failure of employers, on their own volition to absorb, as Vice President Ross points out:

it would be unfair to limit safety net increases directed to the low paid on the basis that employers, of their own initiative, pass on wage increases in a manner contrary to the terms and spirit of a decision of the Commission and notwithstanding union commitments to absorption.

### *(c) Impact on Executive Salaries*

The ACTU presented evidence as to the movement in Executive Salaries compared to award rates, including a table reproduced as Table 1.

This evidence supports what must surely have been intuitively obvious or common industrial sense, that in negotiating salary packages executives do *not* have regard to adjustments in award rates.

Nevertheless, without referring to any particular evidence or developing a convincing argument, the majority identified the reaction of professional and executive salary settlements to award adjustments as an indirect cost.

#### **4. A New Reserve Bank Driven Wages Policy for Australia**

The overestimates of costs resulted in the majority taking a cautious view as to whether the economy could support a wage increase. These overestimates heightened the majority's sensitivity to the RBA's reaction to any award adjustment, a major theme running throughout their decision.

In this case, in the absence of a wages policy (such as the Accord), the RBA played an extraordinarily active role (through its Bulletins and its Governor's speeches) in exhorting the Commission to exercise restraint in relation to low-paid workers in the context where the Government has deliberately encouraged a market deregulated system. This was unprecedented, given the RBA's traditional role as a central bank with no policy responsibility for Australian wage determination.<sup>2</sup>

The RBA stated that any additions to AWOTE that would put it above a 4.5% annual growth rate would push inflation above the crucial 2-3% 'comfort' zone. Any increase in inflation, the Reserve Bank warned, above this level would cause a tightening of monetary policy with a resultant increase in interest rates. The AIRC accepted this warning from the Reserve Bank (pp. 28-29) and decided that it should help the Bank meet its inflationary target (at the cost of low-paid workers).

The majority concluded:

We give weight to the Bank's view in reaching our decision. We do so, of course, because we acknowledge its role in the shaping of macro-economic policy; but also because of our concern that a rise in interest rates would adversely affect employment and unemployment. (p. 30)

Three criticisms can be made: First, the earlier discussion on the cost overestimates and reference to independent analysis shows that the majority could have awarded significantly more and nevertheless be within Reserve Bank parameters. Second, the AIRC is also assuming that the Living Wage is the key factor affecting wage growth and hence price stability and the level of interest rates. There are clearly other factors affecting interest rates of a domestic and international economic nature. Third, furthermore, the AIRC has accepted the RBA's view of monetary policy being the key determinant of inflation and employment. It does not consider other economic factors or other available economic instruments; in particular the role of Government labour market or industry policy. Yet the majority failed to



translate the change in the economic, intellectual debate into something of substance for low-paid workers. \$10 is not a moderate increase – but an extremely modest increase.

The conclusion easily reached is that despite a low-inflationary environment, high profit levels, productivity increases and recovery in the terms of trade; in an environment where the Federal Government has eschewed the use of fiscal policy and industry policy to address unemployment, low-paid workers are to carry the burden of wages policy (administered predominantly through the exhortation of the RBA) and of preventing unemployment rising as interest rates rise to reduce inflationary pressure.

## **5. The ‘Space’ Argument for Award Increases**

In regretting that it could not award a higher award adjustment the majority held out a prospect that it might be able to be more generous provided bargaining settlements are lower in the future.

The majority stated:

.... there is a prospect that the progressive recognition of the new, non-inflationary environment will lower the level of settlements so as to leave ‘space’ for a more generous treatment of workers fully or substantially dependent on award wages. Unless this occurs, the Commission may be faced with either accepting the growing disparity between wage levels in the two sectors or seeking to reduce the disparity in a manner which might prove incompatible with national inflation and employment objectives. Neither course commends itself to us. (p. 50)

This concept of ‘space’ is not internally consistent and is at odds with the new supposedly deregulated system of industrial relations. First, as indicated earlier in reference to the RBA Chart (Figure 1) the relationship between movements in enterprise bargaining, AWOTE and award wages is not a simple one; it is certainly a more complicated one than the ‘space’ argument would suggest.

Second, in effect the majority is calling for a wages policy (comparable to the Accord where aggregate movements were agreed to in commitments by key parties), but in this case aggregate movement targets are being set by an outside institution with responsibility for monetary policy. This attempt to have the trade union movement police bargaining outcomes or face the prospect of low-paid (most often non-union members) missing out on other than extremely modest adjustments is contrary to the move to a ‘deregulated’ labour market.

The Coalition Government has eschewed an Accord type wages policy, has deliberately embarked on a predominantly deregulated or market based wages system in the conviction that it would lead to greater productivity growth. It has set out to deliberately reduce unions role in the system, but has, at the same time, obliged the Commission to maintain a genuine, fair safety net in the new Act.

The majority has, through this concept of space, placed the union movement in an invidious position. In effect they require the union movement to commit to aggregate outcomes (set unilaterally by the RBA) without any guarantee as to a level of safety net adjustment for low-paid or for social wage improvements.

In this regard, it should be noted that the ACTU tendered a report prepared by D. Johnson and O. Hellwig (1997). This report models the impact on Australian households of measures announced in the 1996-97 Federal Government budget. It provides estimates of the impact on the purchasing power of a range of different household types and income levels of changes to government benefits, taxation and the financing of community services which were announced in last year's budget.

The report was referred to by the minority judgement but ignored by the majority (p. 40-45 of the minority decision). In summary, it showed that in households with wage and salary earners, there would be a loss of, on average, \$2.40 per week.

Finally, there is no logical consistency as between the 'space' concept and the one introduced by the majority in relation to indirect costs; that is, the 'raising the floor' argument.

As noted earlier, the Commission concluded that any increase above \$10 would 'raise the floor', underpinning enterprise bargaining. Setting aside our criticism of this concept that award adjustments bear on enterprise bargaining outcomes, this concept is at odds with the 'space' view of how the labour market operates.

If the Commission believes that raising the safety net will raise bargaining outcomes proportionately, then how can 'leaving space' for a larger award increase not have the same effect in future periods? If larger Safety Net Adjustments (SNAs) lead to larger bargaining outcomes then the benefits of 'leaving space' will surely be negated in the future. The assumption is not logical nor has the Commission referred to any evidence on bargaining behaviour such as that referred to in the minority decision (pp. 77-78).

## 6. Conclusion

The majority decision of the Living Wage Case is flawed because of its assessment of direct and indirect costs of the ACTU claim and because of its misunderstanding of industrial realities concerning the award and bargaining sectors. The theoretical and methodological approach to the calculation of direct and indirect costs lacks consistency and logic, is at odds with industrial reality and was not supported by evidence. The arbitrary overestimates involved acted to unnecessarily limit the capacity of the Commission to address what it identified as a real concern, the gap between those dependent on award rates and those in the bargaining sector.

The majority decision's argument about 'leaving space' for the award sector by wages restraint in the bargaining sector misunderstood the industrial reality of bargaining behaviour (as shown in the evidence provided in the minority decision) and seeks to impose wage restraint on unions without any commitments from employers or other salaried groups in the labour market. Further the argument was heavily influenced by the unwarranted intervention from the Reserve Bank of Australia. Such intervention by a monetary authority in industrial relations is both unprecedented and unwarranted in Australia. Finally, the majority decision was well summed up by ACTU President Jennie George, who commented on the day of the judgement:

In its 93 year history, the Commission has made many important, historic and courageous decisions this is not one of them.

## Notes

1. The historical relationship between the RBA and the Commission and its predecessors was noted in the case by the ACTU in its submissions in reply. A highlight was the written advice given by the then RBA Governor Dr. H.C. 'Nugget' Coombs to the then President of the Commission, Sir Richard Kirby. It was noted that whilst the Commission has always been required to balance equity, industrial and economic considerations, the RBA's charter is much narrower. For a full account see Coombs (1981).

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