Ai GROUP SUBMISSION

Fair Work Commission

Annual Wage Review 2018-2019

15 March 2019

About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak industry association in Australia which along with its affiliates represents the interests of more than 60,000 businesses in an expanding range of sectors including: manufacturing, engineering, construction, automotive, food, transport, information technology, telecommunications, call centres, labour hire, printing, defence, mining equipment and supplies, airlines, health and other industries. The businesses which we represent employ more than one million people. Ai Group members operate small, medium and large businesses across a range of industries. Ai Group is closely affiliated with many other employer groups and directly manages a number of those organisations.

Australian Industry Group contact for this submission

Stephen Smith, Head of National Workplace Relations Policy
Telephone: 0418 461183 or 02 9466 5521
Email: Stephen.smith@aigroup.com.au

Contents

1. Introduction

The Australian Industry Group (Ai Group) submits that a modest wage increase of 2% is warranted in this year's Annual Wage Review. This equates to an increase of about $14.40 per week in the National Minimum Wage and about $16.75 per week at the base trade level.

The Australian economy moved back into the slow lane in the second half of 2018 and looks set to stay there for some time. While employment has been strong in recent years and is still holding up, deceleration is evident in business conditions, confidence, building approvals, retail sales, car sales and most crucially, job vacancies. Company insolvencies increased through late 2018 in the construction, retail and hospitality industries.

Businesses are struggling to cope with high and rising input costs, especially energy costs. Also, productivity growth is weak nationally and in industries with mainly low-wage employees.

Inflation remains weak which means that even a small rise in the minimum wage will deliver a real increase in household spending power.

In addition, low wage employees have benefited from tax changes introduced in last year's federal Budget. The Low and Middle Income Tax Offset has increased disposable incomes for many low wage earners. While the impacts vary across low and middle-income groups, the increase in disposable income for a person earning the current National Minimum Wage of $719.20 a week is 0.63 per cent which equates to a change in pre-tax income of $6 per week which is nearly 1% (0.83 per cent). The Expert Panel should take this into account, consistent with previous Annual Wage Review decisions which have recognised the relevance of changes to the broader social safety net when determining minimum wage increases.

These factors all support the view that a modest wage increase of 2% would be in the best interests of employees, businesses and the economy. Now is not the time for risky movements in minimum wages. The minimum wage increases awarded by the Expert Panel in the last two Annual Wage Reviews (3.3% and 3.5% respectively) were exceptionally high and out of step with overall wage movements and economic settings. It is essential that the increase awarded by the Panel this year is much more modest.

2. Australian economy and incomes in 2018-19

The following trends in the Australian economy currently support the provision of a modest rise in Australia's minimum wage in 2018-19:

1. Dramatic slowing in Australian economic activity and conditions in late 2018 and continuing into the first quarter of 2019. As of Q1 2019, deceleration is evident in business conditions, confidence, building approvals, retail sales, car sales and most crucially, job vacancies. Company insolvencies increased through late 2018 in the construction, retail and hospitality industries.

2. Ongoing problems in dealing with high and rising input costs and especially energy costs among many Australian businesses. Concerns are also growing about emerging trends in local activity (due to downturn in construction industry cycle) and global trade that may reduce demand.

3. A highly variable labour market across Australia, with strong jobs growth in industries supported by public-sector spending (e.g. healthcare and public administration) and low unemployment rates in Melbourne and Sydney. Elsewhere however, jobs growth is weak and the unemployment rate is over 6%. The industries that predominantly employ low-wage workers have experienced weak jobs growth through 2018 and have high rates of underemployment.

4. The employment outlook is deteriorating as of Q1 2019. The ANZ job advertisements index plunged a further 0.9% m/m in February 2019 (latest available data), to be down by 4.3% p.a. Fewer job vacancies will mean significantly slower jobs growth ahead for the remainder of 2019.

5. Structural changes in the Australian economy mean that business income growth has not spread across the non-mining industries and small to medium businesses that predominantly employ low-wage workers. Disparities in income performance between mining and non-mining sectors are large. As of Q4 2018, the mining sector was earning around 38% of national aggregate GOP but it directly employed less than 2% of the national workforce (albeit at very high wages).

6. A mild acceleration in wages growth through 2017 and 2018. The wage price index (WPI) and other measures are up, indicating the trough has passed in this current wage and inflation cycle.

7. Weak productivity growth nationally and in industries that mainly employ low-wage workers.

8. Weak background inflation of just 1.8% p.a. (as of Q4 2018). This means that even a small rise in the minimum wage will beat the cost of living and deliver a real increase in household income.

9. High labour costs and lower competitiveness in Australia compared to similar countries. On a PPP basis (which adjusts for differences in 'purchasing power' or cost of living), Australia's national minimum wage per hour was behind only Luxembourg and equal to France in 2017. For full-time workers who are paid the minimum wage, Australia's minimum pay per year was below only Luxembourg and the Netherlands in 2017 but well above all other comparable countries.

10. A rapidly weakening outlook for Australia's economy and global economic influences in 2019.

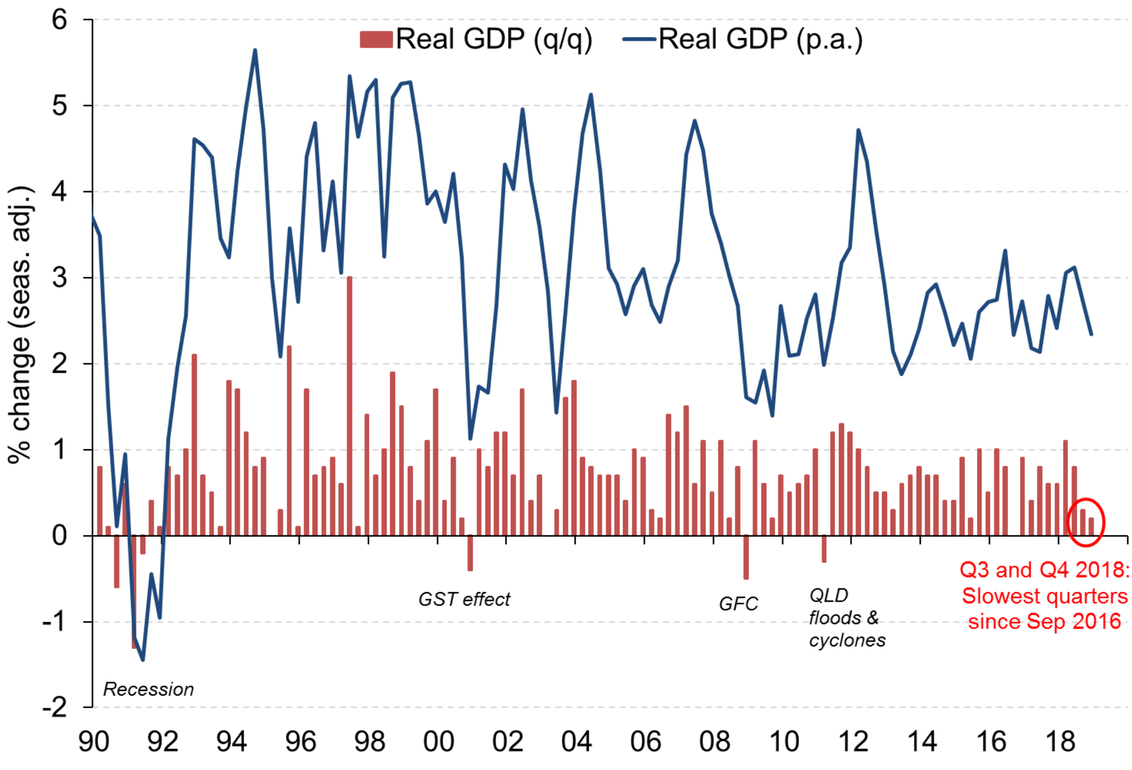
2.1 Economy moving back into the slow lane in 2018-19

As of early March 2019, Australia's economy was static or slowing across a range of key indicators. The Reserve Bank of Australia (RBA) left the cash rate on hold at a record low of 1.50% in March, where it has been since August 2016. The RBA's accompanying statement remained cautiously positive, although it noted the economy had slowed significantly since mid-2018 and the risks to the outlook were increasing, locally and globally. Australia's strong public spending program and export sales are supporting activity, but further progress toward inflation of 2 to 3% "is likely to be gradual".

The *National Accounts* released in March by the ABS confirm that the economy slowed markedly in Q3 and Q4 of 2018. This is consistent with Ai Group's monthly performance indicators and other data over the same period. Australia's real output growth (real GDP) slowed to 0.2% q/q and 2.3% p.a. in Q4 (table 1), which was the slowest quarterly growth rate since Q3 2016 (zero) (chart 1).

Quarterly GDP growth fell below estimated resident population growth (0.4% q/q) in Q3 (0.3% q/q) and Q4 (0.2% q/q) of 2018 and so real GDP per capita fell in both quarters. Real GDP per hour worked (a rough proxy for national productivity) also declined by 0.2% q/q in Q4, to be up just 0.7% p.a. This fragility in national output and productivity performance underscores the importance of population growth to Australia's headline growth mix at present. This has been the case for the past decade, with population growth averaging 1.7% p.a. (0.4% q/q) since 2008.

Chart 1: Real GDP growth, annual and per quarter, to Dec 2018



Source: ABS *National Accounts*, Dec 2018.

Table 1: Key components of GDP, Q4 2018

seasonally adjusted	% q/q	% p.a.	ppt, contribution to growth
Real GDP	**0.2**	**2.3**	**0.2**
Household consumption	0.4	2.0	0.2
General government consumption	1.8	5.6	0.3
Total investment	-1.0	1.2	-0.2
Dwelling investment	-3.4	2.5	-0.2
Private business investment	0.4	0.9	0.0
New building	0.1	-4.6	0.0
New engineering construction	1.0	-6.8	0.0
New machinery and equipment	0.2	3.9	0.0
Intellectual property investment	1.8	7.5	0.0
Public (government) investment	0.3	4.7	0.0
Domestic final demand	**0.3**	**2.5**	**0.3**
Change in inventories	na	na	0.2
Exports	-0.7	4.7	-0.1
Imports	0.1	1.5	0.0
Terms of trade	3.2	6.1	
Real GDP per capita	-0.2	0.7	
Real GDP per hour worked	-0.2	0.7	
Real income			
Real gross domestic income	0.9	3.7	
Real net national disposable income	1.2	3.7	
Real net national disposable income per capita	0.8	2.1	
Nominal GDP	**1.2**	**5.5**	
Compensation of employees (wages & incomes)	0.9	4.3	
Private profits - total	3.0	9.6	
Private profits financial corporations	1.4	6.8	
Private profits non-financial corporations	3.8	10.9	

Source: ABS *National Accounts*, Dec 2018.

On the expenditure side, growth was heavily supported by government recurrent spending in Q4 (up by 1.8% q/q and 5.6% p.a.) due to growth in federal and state government programs (including the NDIS, healthcare, aged care, security and education programs). Government investment spending was up more modestly in Q4 (+0.3% q/q and 4.7% p.a.), after a sizeable jump in Q3.

Household consumption grew relatively weakly in Q4 and over the year to Q4, but its large size meant that it still contributed 0.2 percentage points to growth in the quarter (see table 1, charts 2 and 3). At 0.4% q/q in Q4, consumption growth was probably on par with growth in the estimated resident population (1.7% p.a. and 0.4% q/q), implying zero growth in household consumption per person in Q4. Dwelling investment and export volumes both detracted from real growth in Q4.

Business investment grew very weakly across most categories of spending in Q4, with growth evident over the year in machinery and equipment but not in buildings. The single bright spot was business spending on ‘intellectual property investment’ (mainly computer software) which rose a further 1.8% q/q to be up 7.5% p.a. (table 1 and chart 3). This type of business spending augurs well for future productivity growth inside the businesses that are investing in digital technologies.

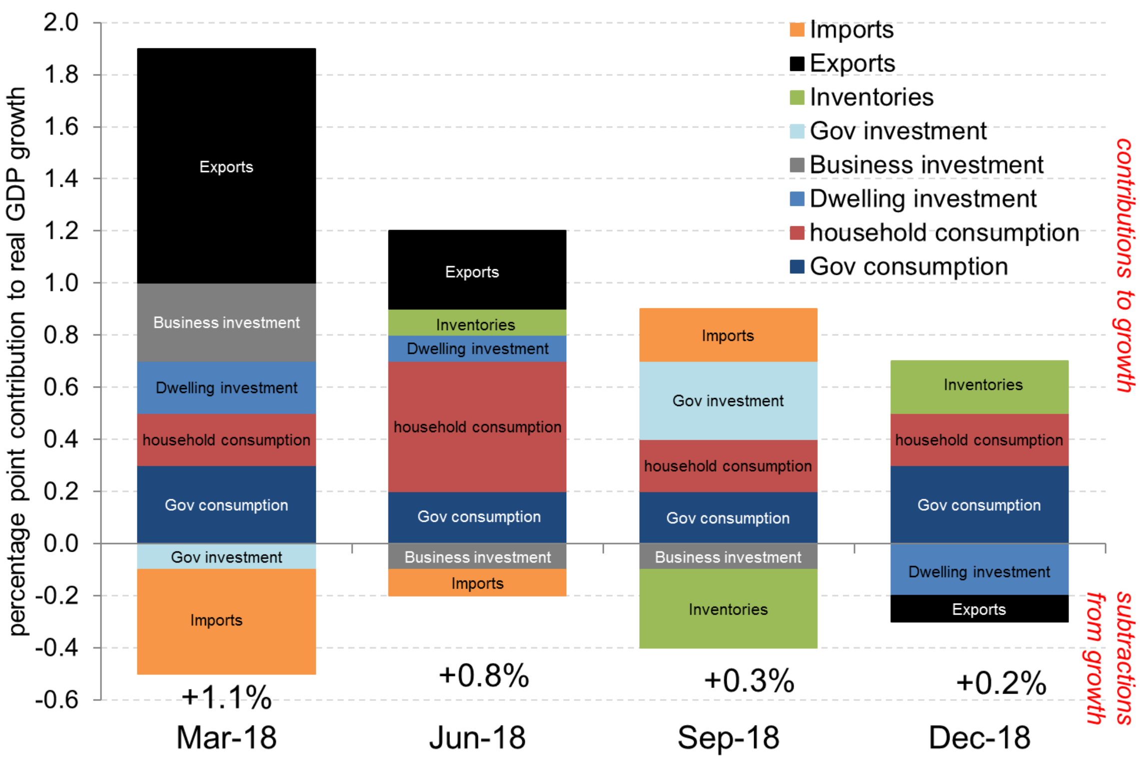
On the production side of the National Accounts, the support from government recurrent spending was evident in very strong real output growth from healthcare (+2.3% q/q and 8.1% p.a. and contributing 0.2 percentage points to growth) and public administration (+2.4% q/q and 6.1% p.a.) in Q4 (chart 4). Mining output volumes were also up strongly in Q4 (+1.2% q/q and 6.7% p.a.).

Outside of government-supported services and mining, output weakness was widespread in Q4 but was especially weak in the non-mining industrial sectors. Manufacturing, construction and utilities more than reversed the gains made in the first half of 2018, with output falling over the quarter and over the year to Q4 in each of these industries. The effects of the long drought were more than evident in another sharp drop in agricultural output volumes (-3.2% q/q and 5.9% p.a.).

Elsewhere, real output growth was extremely weak (again) in Q4 in industries related to local consumer spending, including retail trade, wholesale trade, hospitality (food and accommodation services) and personal services. Retail trade sales data for this period from the ABS and Ai Group's PSI confirm that local discretionary spending remains extremely cautious, as households grapple with the effects of relatively flat incomes growth and more recently, falling home values.

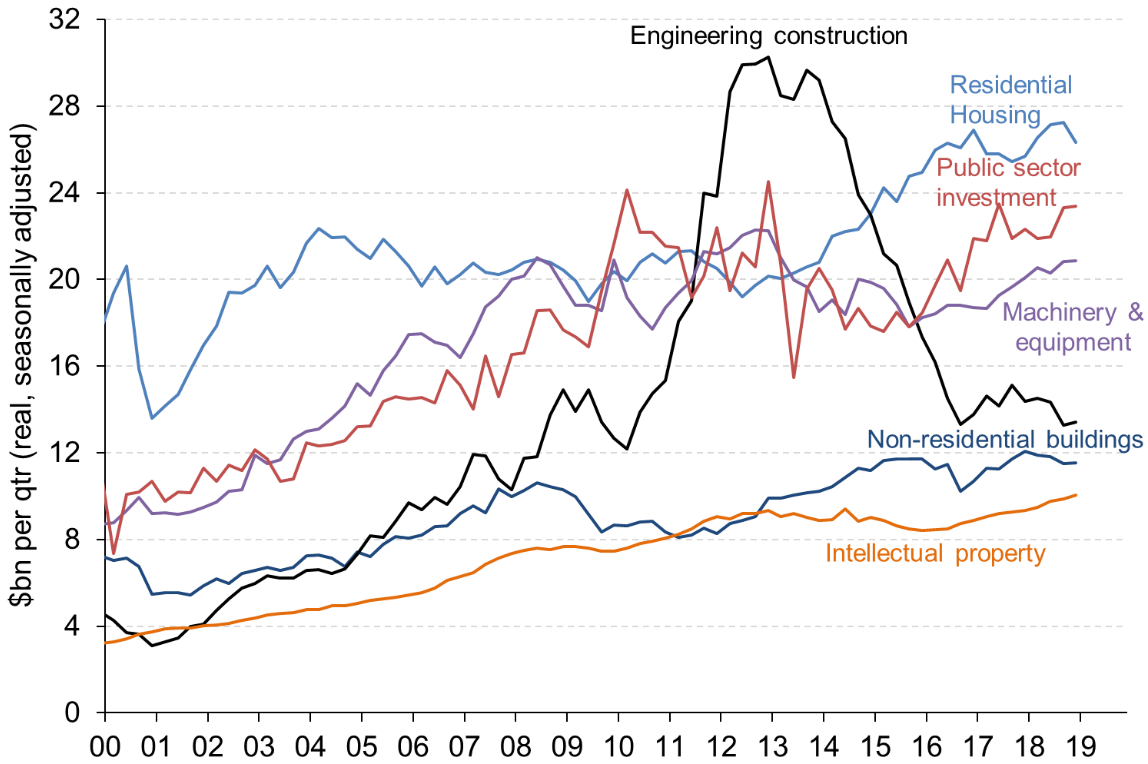
The effects of the housing market downturn were evident in Q4 in the construction industry itself (output volumes down by -1.9% q/q and 3.7% p.a.) but also in real estate, professional services and financial services. In a housing market downturn, these services would be affected by declines in the number and value of property transactions, loans and sales.

Chart 2: Components of real GDP growth per quarter, 2018



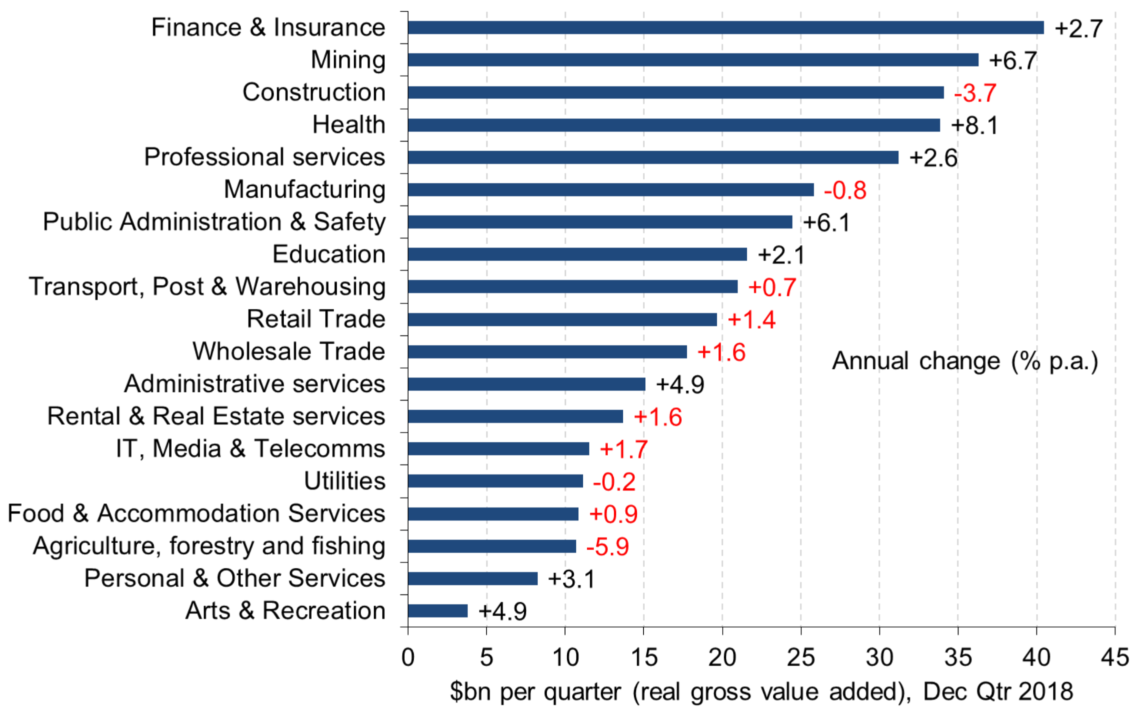
Source: ABS *National Accounts*, Dec 2018.

Chart 3: Components of national investment, to Q4 2018



Source: ABS *National Accounts*, Dec 2018.

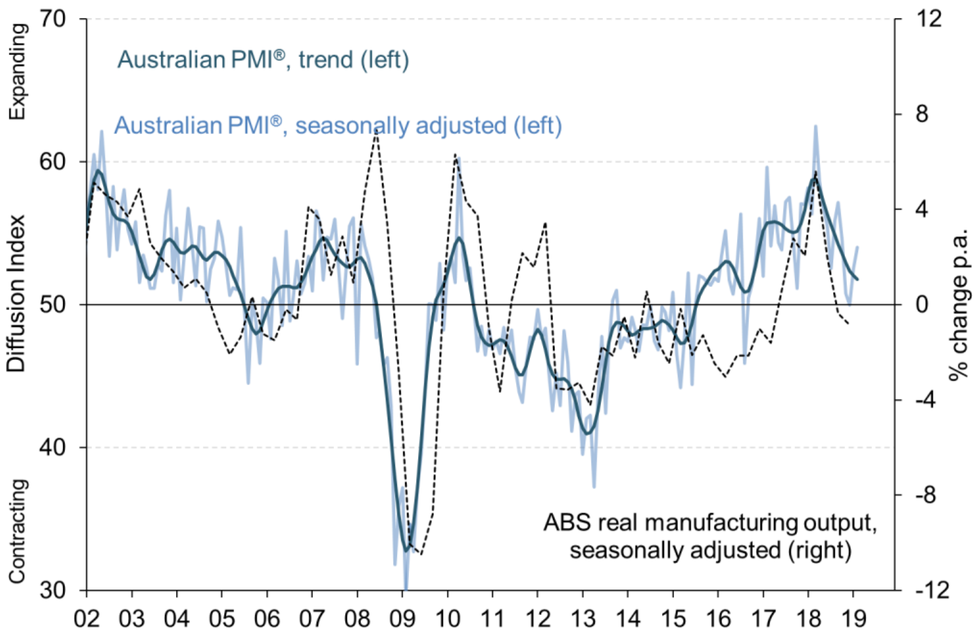
Chart 4: Real output by industry, Q4 2018



Source: ABS *National Accounts*, Dec 2018.

The early data for 2019 indicate another slow quarter of growth in Q1 2019. The Ai Group Australian Performance of Services and Construction Indexes (Australian PSI® and Australian PCI®) both improved slightly in February 2019 but continued to indicate contraction across the services and construction sectors (results above 50 points indicate expansion with higher results indicating a stronger expansion in all three indexes). More positively, Ai Group's Performance of Manufacturing Index (Australian PMI®) recovered to 54.0 points in February, indicating expansion across the manufacturing sectors in Q1, after a sharp deceleration in Q3 and no growth in Q4 2018 (chart 5).

Chart 5: Ai Group Australian PMI (to Feb 2019) and ABS manufacturing value-added output (to Q4 2018)



Sources: Ai Group and ABS, National Accounts, Dec 2018.

In combination, these three indexes are indicating sharply slower – but so far still mildly positive - economic conditions for Australian businesses in Q1 2019, compared to one year earlier (chart 6). The same trend is apparent in the NAB monthly survey of business conditions. The NAB index of conditions fell dramatically in December 2018 (from 11 to 3 points, with results above zero indicating a 'net positive' score) and has remained below 10 points and well below the long-run average for this index in each of January (7 points) and February (4 points) of 2019. This has taken both the Ai Group and NAB indexes of business conditions firmly back to the very weakly positive results last seen in 2015 and 2016, as of Q1 2019.

These reported business conditions are in line with other data confirming further weakness in local consumer spending, the residential construction cycle, business confidence, job vacancies and consumer sentiment in Q1 of 2019:

- Nominal retail trade sales recovered by just 0.1% m/m (+2.7% p.a.) in January, after falling by 0.4% m/m in December. Nominal sales were flat or lower in January and over the three months to January 2019, for household goods, clothing and department store retailers.

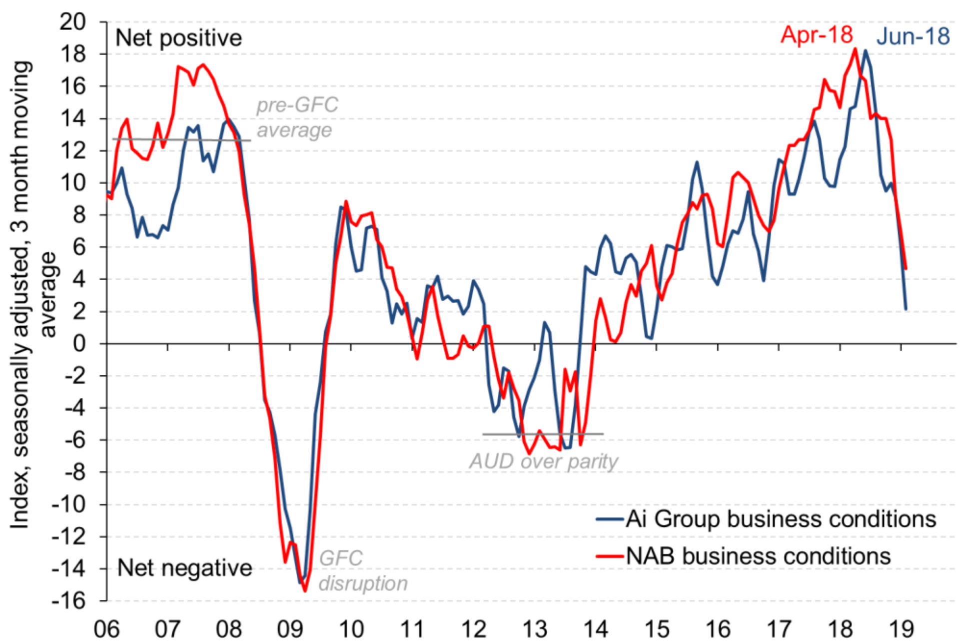
- New car sales have slowed since mid-2018. As of February 2019, passenger vehicle sales were down by 21.3% p.a. and SUV sales were 6.3% p.a. lower. In contrast, sales of new light commercial vehicles (mainly utes and small vans) rose by 6% p.a. to February 2019.

- Residential building approvals have been trending lower since reaching an all-time peak in late 2017. Nationally, the value of residential building approvals was down by 23.3% p.a. in January 2019 (and 37% lower than its all-time peak in late 2017), while the value of non-residential building approvals was down by 8.8% p.a. With 9.2% of the workforce directly employed in construction activity (and many more employed in its supply chain and related services), this cyclical decline has major implications for labour demand in 2019.

- NAB business confidence fell a further 2 points to +2 index points in February. This index remains very weakly positive (above zero) but it has now been declining through most of 2018 and has been below its own long-run average since August 2018. The NAB business survey indexes of employment intentions over the next 3 months and 12 months passed their recent peak in mid-2018 and are now trending lower.

- Westpac-MI consumer confidence index fell by 4.8% in March 2019 to 98.8 points and back into negative territory (below zero indicates net pessimism). This was the strongest monthly percentage decline since September 2015. All components of this index recorded falls in March but the biggest shift was in consumers' near term expectations for the economy.

Chart 6: Ai Group and NAB business conditions indexes, to Feb 2019



* weighted and fitted composite of Ai Group PMI, PSI & PCI indexes. Sources: Ai Group and NAB, to Feb 2019.

2.2 Another disappointing year for Australian business in 2018

Australian businesses experienced 2018 as a year of two distinct halves. The first half of the year saw a welcome acceleration in business-output, sales, employment and investment in response to improving global and local conditions. The second half of 2018 saw some of the shine come off as the pace of improvement eased and as the global and domestic outlook deteriorated (table 2).

The ABS *Business Indicators* data reveal a growing gap between mining and non-mining industry performance with regard to company sales, wages and profits growth (table 2 and chart 7). In Q4 2018, the mining industry increased its nominal sales by 22.6%, its company GOP by 26.3% and its total wages by 7.0% p.a. In contrast, for non-mining companies**, aggregate sales rose by 3.9% p.a., aggregate GOP rose by 2.5% p.a. and aggregate wages rose by 3.4% p.a. In the non-mining industries, all of the annual increase in aggregate company GOP occurred in Q1 of 2018 (+3.6% q/q), with falls in GOP in both Q3 (-0.2% q/q) and Q4 of 2018 (-1.0% q/q).

Table 2: Aggregate nominal company profits, business sales and wages, Q4 2018

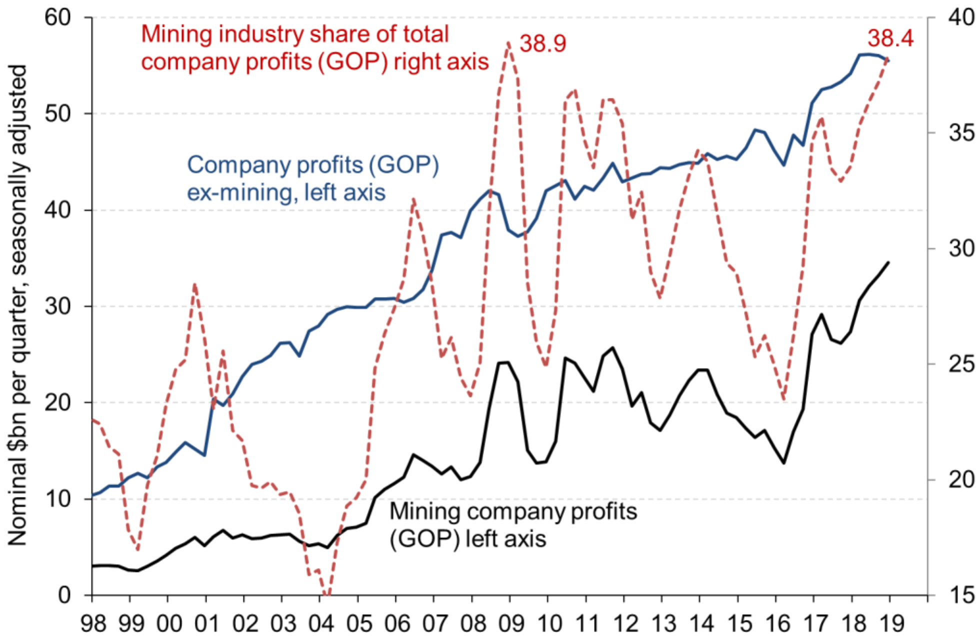
Nominal $ per quarter Seasonally adjusted	**Level** $bn per qtr	**Growth to Q4 2018** % q/q	 % p.a.	**Share** % of total	**Average annual growth** 10 years 2009-18, % p.a.
Mining					
Company profits (GOP)*	34.5	4.0	26.3	38.4	10.4
Business sales **	73.5	6.1	22.6	10.2	7.0
Business wages **	6.1	1.1	7.0	4.4	5.8
Manufacturing					
Company profits (GOP)*	7.8	-3.6	-2.9	8.7	0.3
Business sales **	89.3	-0.2	3.9	12.4	-1.2
Business wages **	13.3	-0.8	2.9	9.5	0.0
Non-mining industries **					
Company profits (GOP)*	55.5	-1.0	2.5	61.6	3.4
Business sales **	648.2	0.1	3.9	89.8	2.7
Business wages **	133.5	0.5	3.4	82.7	3.1
All Industries **					
Company profits (GOP)*	90.0	0.8	10.5	100	4.5
Business sales **	721.7	0.7	5.5	100	3.0
Business wages **	139.6	0.8	4.1	100	3.2

* Company gross operating profits for industries that are included in the *Business Indicators* dataset. "Selected items are excluded from company profits before income tax to provide a measure of underlying company profits. These items include interest income and expenses; depreciation and amortisation; and selected items which do not involve the production of goods and services such as net foreign exchange gains/losses, gains/losses arising from the sale of non-current assets, and net unrealised gains/losses from the revaluation of current or non-current assets".
** Nominal aggregate sales and wages for businesses in all industries that are included in the *Business Indicators* dataset, excluding healthcare and education. Source: ABS, *Business Indicators,* Dec 2018.

The contrast between mining and manufacturing profit performance is especially stark. Aggregate nominal profits for manufacturing companies fell in each of Q3 and Q4 2018, unwinding all of the modest recovery experienced in 2017 and early 2018. As of Q4 2018, aggregate GOP in manufacturing ($7.8bn) remained 23% below the industry's all-time peak in 2008 ($10.2bn). The same data show that nominal aggregate sales were up by 3.9% p.a. for the manufacturing industry in Q4 2018, but all of this rise was due to rising prices (+5% p.a.) and not volumes (-1.2% p.a.)

Looking at the longer term trends, aggregate nominal GOP for mining companies grew by an average of 10.4% p.a. over the decade from 2009 to 2018, compared to 3.4% p.a. for non-mining companies (chart 7). With inflation averaging 2.1% p.a. over this ten year period, this implies average real growth of just 1.3% p.a. in non-mining GOP. Aggregate GOP in manufacturing has grown by just 0.3% p.a. over the past decade, implying a sizeable fall in real terms. The rapid growth of mining income has seen its share of total company GOP rise to a peak of 38% in 2018 (also briefly in 2008, as profits in other industries fell), up from around 23% in 2008 and 17% in 1998 (chart 7).

Chart 7: Aggregate nominal company profits (GOP), mining and non-mining industries, 1998 to 2018



Ai Group's own annual national survey of Australian CEOs across all industries (excluding agriculture and mining) indicates that although 2018 was a better year for many Australian businesses, it was not the stellar year for which they had hoped. One third of CEOs said their general business conditions improved in 2018 versus one quarter who saw a deterioration, relative to the previous year. For many businesses, higher input costs - and especially higher energy costs - ate into their margins in 2018. Although 57% of CEOs reported an increase in turnover in 2018, only 41% of businesses surveyed improved their profit margins and 39% reporting a fall in margins in 2018 (chart 8).

This can be at least partially explained by a high proportion of respondents reporting increased inputs costs, especially for energy. Market prices for gas and electricity increased to record highs in 2017, before easing slightly in 2018. Most businesses commit to energy contracts of more than one year, and market price increases take time to filter through, so many businesses may find themselves negotiating energy contracts that are substantially higher than their previous contract.

Rising energy price costs are proving difficult to pass on as price increases to customers and are squeezing margins across a wide range of industries.

Regarding employment, 37% of CEOs reported employing more people in 2018 than they had in 2017, but 20% reported falling employment in their businesses, giving a 'net balance' of +17%. This 'net balance' is slightly below the record high in 2017 of +23%, which also coincided with an Australian record for calendar year employment growth, at 412,000 jobs added nationally. Employment growth averaged 22,900 per month in 2018 (up 2.3% p.a. to November). Although weaker than in 2017 (34,400 per month and up 3.4% p.a. to Dec), 2018 was still a relatively strong year for jobs growth by recent Australian standards. Consistent with weakening national productivity performance (see section 2.10 below), labour productivity improved for fewer businesses in 2018 than it had in 2017, with the 'net balance' of labour productivity improvement falling from +26% in 2017 to +16% in 2018 (Chart 9).

Chart 8: Business Performance Indicators In 2018: Performance, Investment, Pricing

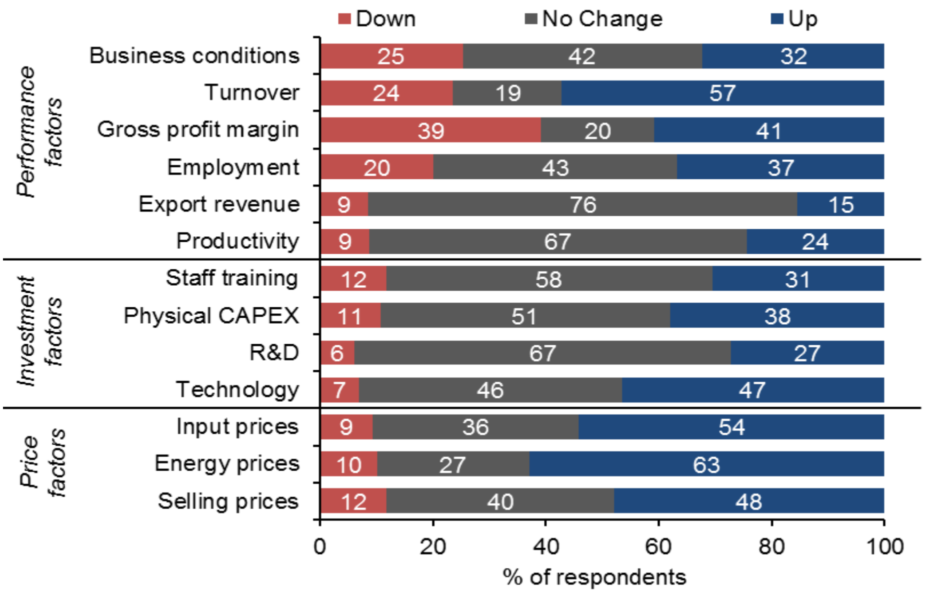
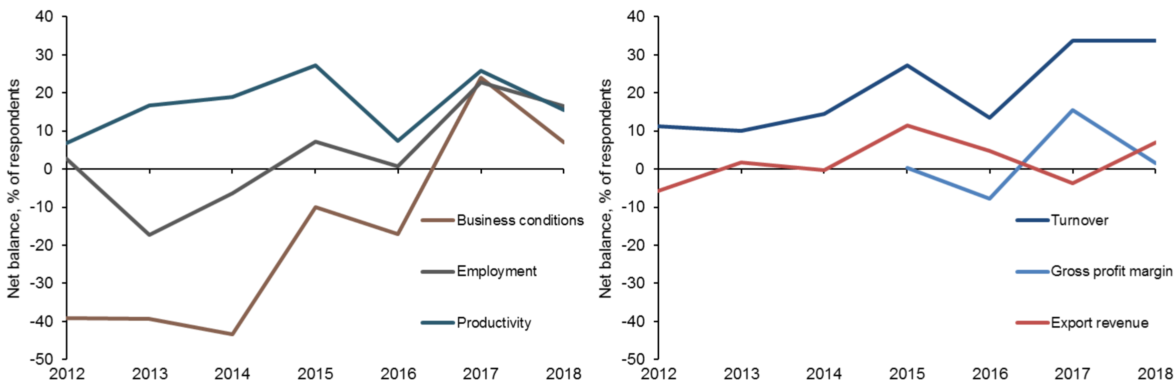


Chart 9: Business Performance Indicators, 2012-2018

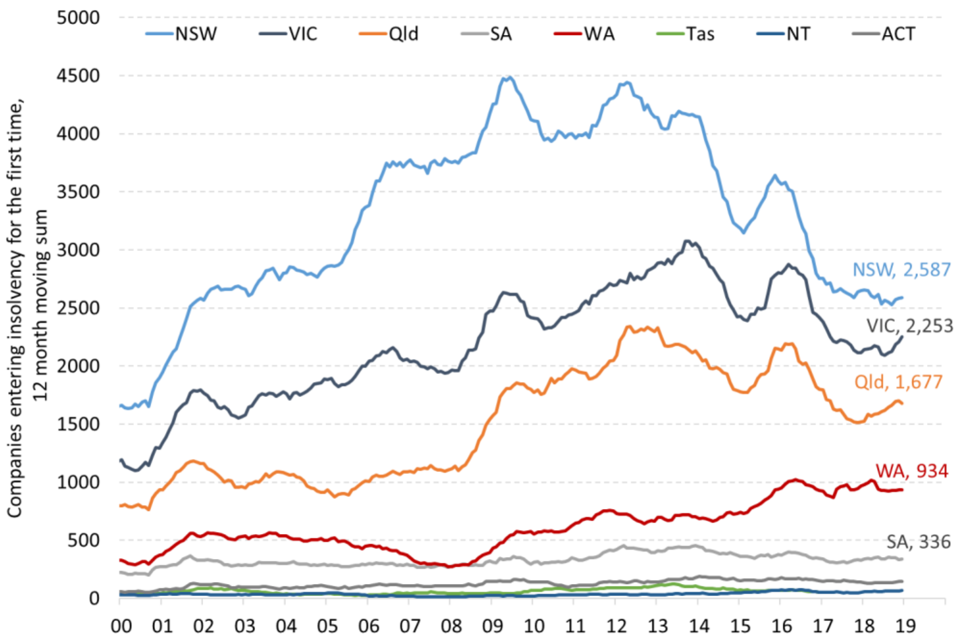


ˈNet balance' is the proportion of all survey respondents that reported an improvement minus the proportion that reported a deterioration in each indicator. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry

2.3 Rising business insolvencies in 2018

The number of companies entering insolvency increased in 2018, after falling sharply in 2016-17. 8,044 companies entered insolvency for the first time during the 12 months to December 2018, which was the highest total number since March 2017. The upward trend in 2018 was strongest in Victoria but is also apparent in NSW and Qld (chart 10).

Chart 10: Business insolvencies by state, 2000 to 2018

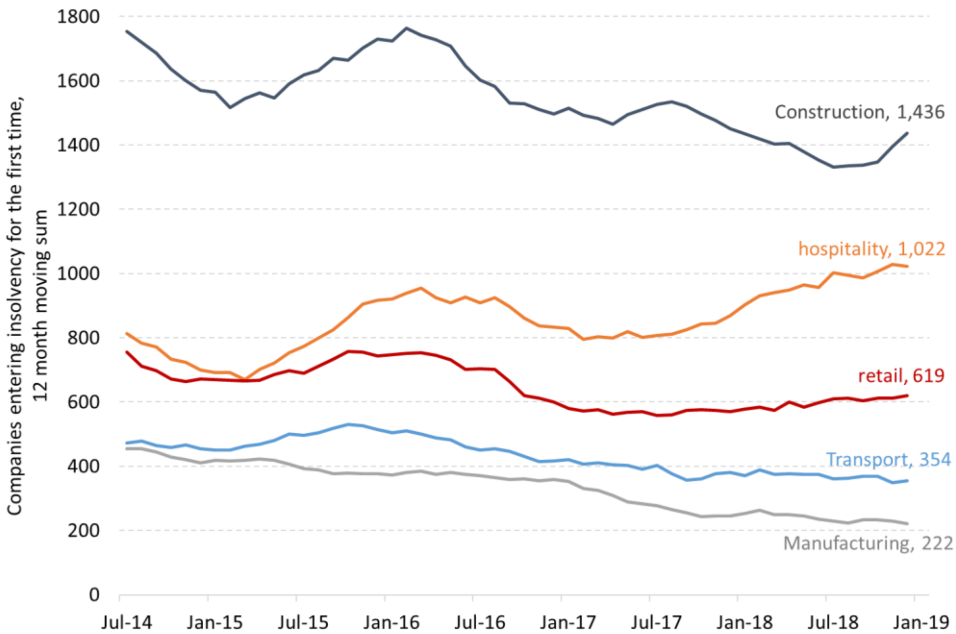


Source: ASIC, *Table 1.2 - Companies entering EXAD (external administration) –Region summary, MONTHLY,* to Dec 2018.

Company insolvency data are currently available on a consistent basis across industries from July 2013. These data show that insolvencies are more prevalent in industries with high numbers of small to medium businesses and are highest in construction, retail and hospitality (food and accommodation services) (chart 11). The number of insolvencies in the construction industry rose to 1,436 companies in the 12 months to December 2018, which was the highest such number since December 2017. In the hospitality industry, 1,022 companies entered insolvency in the 12 months to December 2018, which was the highest such number since this data series commenced. In retail trade, the number of companies entering insolvency rose to 619 in the 12 months to December 2018, which was the highest such number since October 2016. In other industries that have been under significant cost and sales pressures however, the number of insolvencies continued to fall throughout 2018 (chart 11).

Annual ABS data about the performance of Australian industries indicates that over the three years to June 2017 (latest data available), 20% of all businesses ran at an operating loss in each year (table 3). These companies are not insolvent, but they are clearly not thriving. This indicates a high level of vulnerability (and potential insolvency) among these businesses, even in these relatively better years (that is, years with lower numbers of company insolvencies). The proportion of businesses making a loss rose over these three years in retail, hospitality, transport and administrative services.

Chart 11: Business insolvencies by industry, 2014 to 2018



Source: ASIC, *Table 1A.2.2 - Companies entering external administration (EXAD) for the first time – Appointment type and industry summary, MONTHLY,* to Dec 2018.

Table 3: Businesses that made a loss, selected industries, 2014 to 2017

% of businesses that made an operating loss	2014-15 %	2015-16 %	2016-17 %
Agriculture	22.3	24.9	22.8
Mining	59.4	58.8	56.9
Manufacturing	22.4	21.4	22.9
Construction	19.0	16.7	17.5
Wholesale trade	42.6	41.7	25.8
Retail trade	20.8	25.3	31.6
Food & accommodation	22.6	25.0	43.7
Transport	10.6	10.5	11.7
Administrative services	13.9	13.0	18.2
Healthcare and social servs	12.4	9.8	9.5
Arts & recreation servs	23.5	21.7	26.5
Personal and other servs	23.3	17.9	20.7
All industries	**19.1**	**18.8**	**20.2**

Source: ABS, 81550DO002_201617, *Australian Industry, 2016-17,* released May 2018.

2.4 Australian business expectations for 2019: cautious at best

As of late 2018 when Ai Group's annual CEO survey of business expectations was conducted, general business conditions were expected to be mildly positive in 2019, but not as strong as expected one year earlier for 2018. CEOs expect 2019 to be a touch slower for Australian businesses than was experienced in 2018. This reflects the very recent deceleration that is evident across local and global indicators in recent months plus the increasing range of risks on the horizon. This moderation in the outlook is apparent in the economic forecasts as well as in business leaders' expectations, plans and strategies.

Heading into 2019, Ai Group's annual CEO survey reveals fewer business leaders are feeling optimistic about their general business conditions in 2019 than was the case one year ago. Indeed, on a net balance basis (optimists minus pessimists), fewer CEOs expect an improvement in business conditions in 2019 than in any year since 2015. This largely reflects their experiences in 2018 and especially the second half of the year.

In this year's Ai Group CEO survey of Business Prospects:

- General business conditions are expected to be better in 2019 for one third of CEOs, which is a lower proportion than had expected an improvement for 2018 (42%) but similar to the proportions of CEOs who had expected better business conditions for 2017 (33%) (chart 12).

- One quarter of CEOs expect their business conditions to deteriorate in 2019, which is the highest such proportion since 2014 (35% of CEOs surveyed at the end of 2014 had expected worse conditions for 2015). On a 'net balance' basis (optimists minus pessimists), 7% of CEOs expect better conditions in 2019, which is the lowest such net balance number since 2015. (chart 12).

- Business turnover is expected to increase for 58% of businesses in 2019, with 24% expecting no change from 2018 levels and 18% expecting a decline in sales in 2019. Although the majority of CEOs expect their total turnover to grow in 2019, most (72%) expect no growth in their export revenue. This suggests that much of the turnover growth will be sought within Australian domestic markets rather than offshore in 2019.

- Profit margins are expected to grow in 46% of businesses in 2019 and fall in 24% of businesses (giving a net balance of +22%), suggesting that businesses are less optimistic about profit margins for 2019 than they were for 2018.

- The majority of CEOs expect prices to rise for both their inputs (63% of CEOs) and their outputs (52% of CEOs). On the selling side, a higher proportion of businesses plan to implement price rises for their own goods and services in 2019 than in any of the preceding six years. Just 10% of businesses plan to cut their selling prices in 2019, which is a lower proportion than had planned to cut prices in the past six years. This suggests a mild pickup in inflation is likely.

- On the input costs side, a higher proportion of businesses expect their input costs to rise in 2019 (63%) than in any of the previous six years, but there is also a higher proportion (6%) who expect their input prices to fall in 2019. This increase in input price volatility adds an additional layer of uncertainty to business planning that may not have been present previously.

- This concern about input price changes relates largely (but not solely) to energy pricing. Over two-thirds of CEOs (68%) expect their energy input costs to rise further in 2019. This will be on top of energy price increases reported by 63% of businesses in 2018. Higher energy prices and reliability of energy supply have become key risks for Australian business across an increasing range of industries and locations.

- Employment (headcount) is expected to increase for 42% of businesses in 2019, with 40% expecting no change and 18% expecting to reduce their business headcount. On a net balance basis, employment expectations are lower than for 2018 but are higher than in previous years. This suggests slower aggregate employment growth is likely in Australia's private-sector in 2019 than was experienced in 2018 or 2017, but higher than in previous years.

- Most CEOs plan to maintain or increase their spending on various types of business investment in 2019. A majority (57%) of CEOs expect to spend more on technology, while 39% also expect to spend more on staff training, 33% expect to spend more on physical capital (buildings, plant and equipment) and 23% expect to spend more on R&D. Very few CEOs intend to spend less on investment in 2019 than they did in 2018, with lower proportions of businesses planning to cut back on various types of investment in 2019 than in the previous six years. The strong focus on investing in technology is a long-term trend, with expectations of spending on new technologies rising at a faster pace than other forms of investment since 2013.

Chart 12: Expected Business Conditions*, 2013-2019

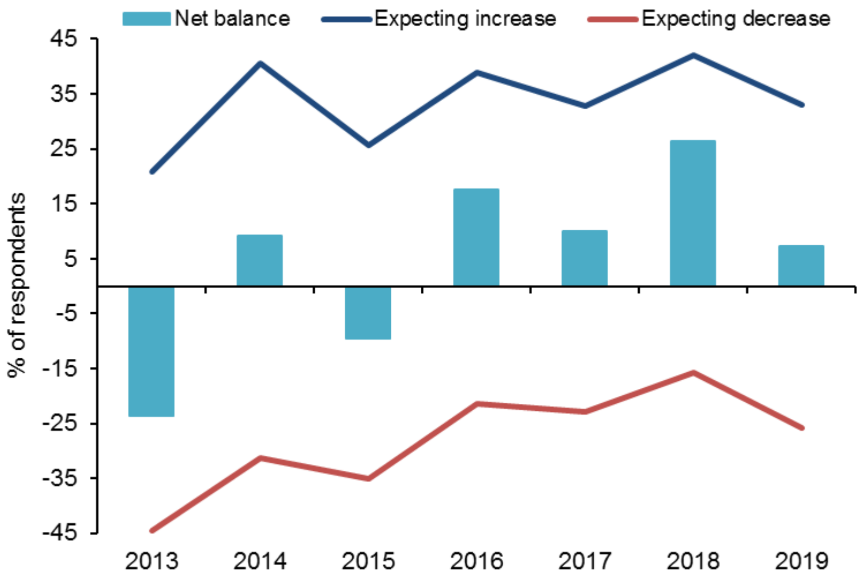
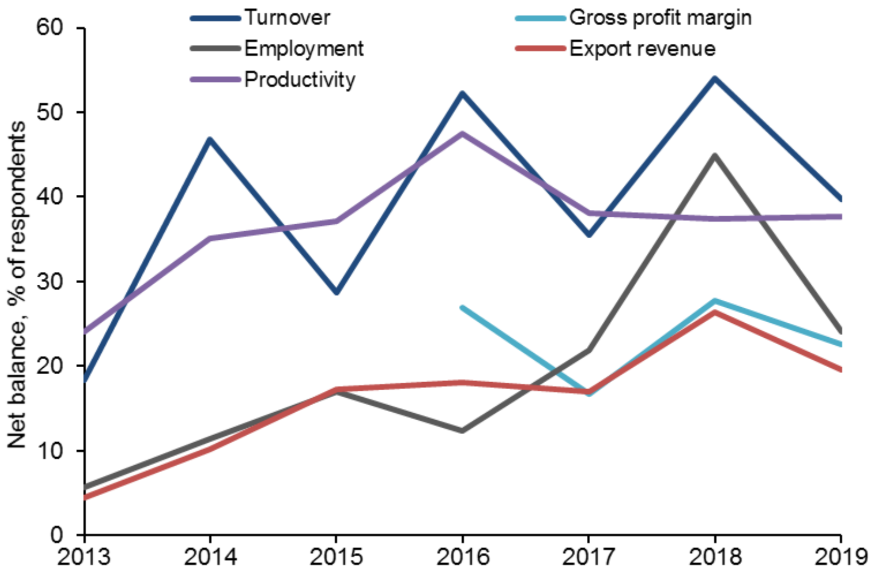


Chart 13: Expected Business Performance Indicators*, 2013-2019



* 'Net balance' is the proportion of all survey respondents that improved minus the proportion that deteriorated. Aggregate results include respondents from all surveyed industries and are weighted by ABS estimates of output from each industry.

Another key indicator of business expectations is their capital expenditure (CAPEX) investment intentions. Looking ahead to 2019 and 2020, the fifth estimate of annual CAPEX intentions for 2018-19 were higher than estimate 4 and higher than the same estimate from one year earlier, but they suggest a fairly flat CAPEX year, compared to 2017-18. Based on an average of the realisation ratios of the past five years, this fifth estimate of CAPEX for 2018-19 implies that total CAPEX will be largely unchanged from the actual level of CAPEX one year earlier, at $119.5 bn in nominal terms. Mining CAPEX is likely to fall by a further 10% p.a. but non-mining CAPEX likely to rise by 8% (based on five-year average realisation ratios).

The first (very preliminary) estimate of CAPEX intentions for 2019-20 suggests mining CAPEX will be flat, manufacturing CAPEX could fall, and CAPEX for all other industries could rise by 2.2% p.a. This implies a slower rate of growth for nominal annual CAPEX in 2019-20, for services industries and for total CAPEX, than is estimated for 2018-19 and was experienced in 2017-18.

If it were to eventuate, such a slow rate of nominal CAPEX growth in 2019-20 would imply extremely low (or no) growth in CAPEX in real (inflation-adjusted) terms. This would present a real risk to economic growth more broadly. And after many years of relatively weak CAPEX in Australia's non-mining sectors, it would also present a new challenge to achieving better long-term productivity growth, which is required in order to boost real output and incomes per capita.

A key reason for the increasingly cautious outlook among Australian businesses in 2019 is the obvious downturn in the residential construction cycles (and in the housing pricing cycle). The ABS estimates that the total volume of all construction work done fell by 3.1% q/q and 2.6% p.a. in Q4 of 2018 (table 4). This included falls in the quarter in all types of building and engineering construction except for non-residential building work (including hospitals, schools, hotels, shops, offices, warehouses and factories). Non-residential building work increased by 1.9% q/q to $10.7bn, up 0.4% from one year earlier but still below the peak of $10.9 bn in 2010.

Another drop in residential building work had been expected in Q4 because the housing cycle passed its peak in early 2018. The volume of all types of residential building work fell in Q4, but remained higher than one year earlier due to strong growth in the first half of 2018. So, although the residential building cycle has definitely passed its recent peak (with 'peak' house construction occurring at different times in each state), the volume of residential construction work under way remains at relatively high levels. Residential construction work is expected to slow further in 2019, in line with recent falls in forward indicators such as residential building and finance approvals.

The sharp drop in engineering work in Q4 – and especially public sector engineering work – was more surprising, given the high number of large public sector infrastructure projects being undertaken in NSW and Victoria at present (see chart 15). The large size and finite nature of these civil engineering projects means they can be quite 'lumpy' in these data from quarter to quarter. This latest drop might be related to delays to some stages of existing projects or a temporary lull in actual construction work while planning, design and other pre-construction tasks are undertaken for new projects that are about to commence.

Looking ahead, building approvals data to January 2019 indicates construction activity will slow further from here, as the residential construction cycle moves further down from its peaks in all states. Nationally, the value of residential building approvals was down by 23.3% p.a. in January 2019, while the value of non-residential building approvals was down by 8.8% p.a.. The outlook for non-residential construction remains mixed across the states, with stronger levels of activity looking set to continue in NSW and Victoria through 2019 but weaker elsewhere (charts 16 and 17).

Table 4: Construction work done, key numbers in Q4 2018

Real volume of work done per qtr Seasonally adjusted	**Size** $mn per qtr	**Growth rate** % change q/q	**Growth rate** % change y/y
new houses	8,836	-3.7	2.3
new multi-unit dwellings	7,825	-3.3	1.0
alterations and additions	2,219	-4.2	5.8
Residential building	18,881	-3.6	2.1
Non-residential building	10,719	1.9	0.4
Building work done	**29,600**	**-1.7**	**1.5**
Private sector engineering	12,946	-1.3	-9.1
Public sector engineering	8,547	-10.3	-5.8
Engineering work done	**21,493**	**-5.0**	**-7.8**
All construction work done	**51,092**	**-3.1**	**-2.6**
Private sector	39,168	-2.2	-3.2
Public sector	11,925	-6.0	-0.8

Source: ABS, *Construction work done,* Dec 2018.

Chart 14: Building work done, by state, to Q4 2018

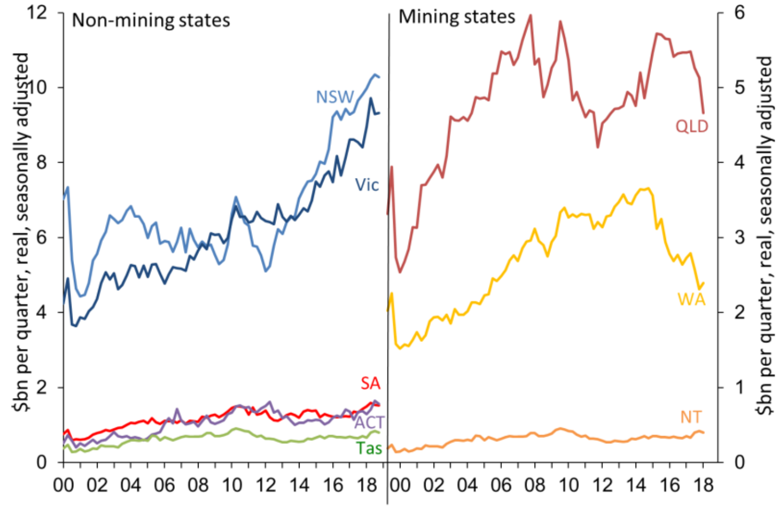
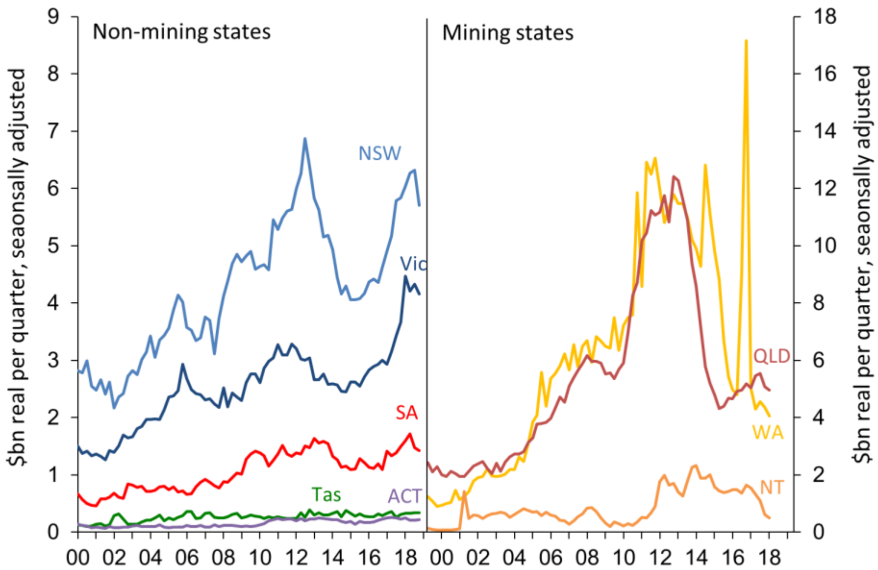


Chart 15: Engineering work done, by state, to Q4 2018



Source: ABS, *Construction work done,* Dec 2018.

Chart 16: Residential building approvals by state, to Jan 2019

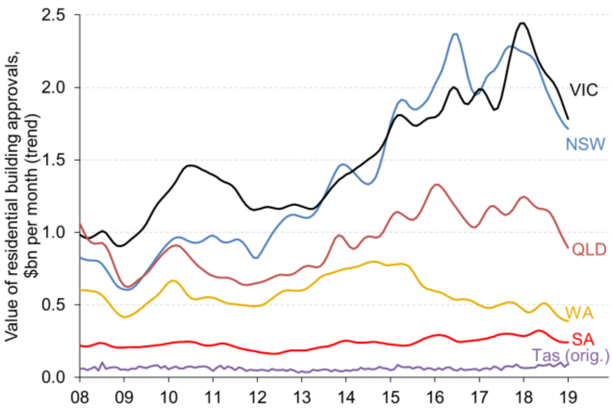
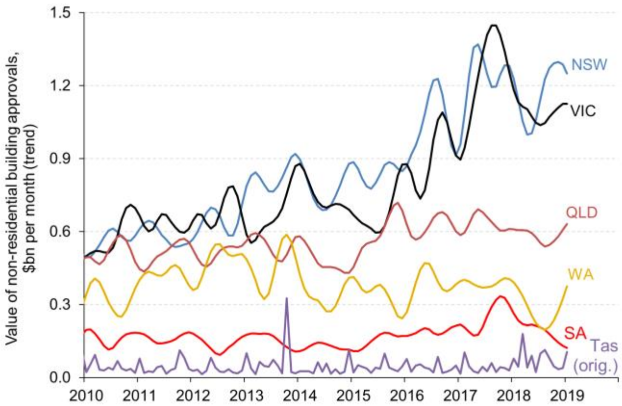


Chart 17: non-residential building approvals by state, to Jan 2019



2.5 Key concerns for business in 2019: energy costs, future growth and workforce skills

In Ai Group's monthly business surveys and in regular discussion with members and other businesses, a key policy concern raised by business in 2018-19 is the problem of high energy costs and how to mitigate and respond to these essential business costs.

The ABS producer prices indexes (PPI) confirm that input costs continue to rise, on average, more strongly than output prices for producers of Australian goods and services. Price growth in preliminary (+4.3% p.a.) and intermediate (3.8% p.a.) inputs again outpaced price growth in outputs (+2.0% p.a.) in Q4 of 2018 (table 5). For businesses relying on imported inputs, the lower Australian dollar in 2018 saw prices for imported preliminary products rise by 7.4% p.a. and prices for intermediate imported products rise by 7.1% p.a. This 'growth gap' between price rises for final products versus preliminary and intermediate inputs indicates business margin compression in 2018, with an especially big jump in input prices for businesses that utilise imported inputs.

Table 5: Producer price index (PPI) changes for all industries, Q4 2018

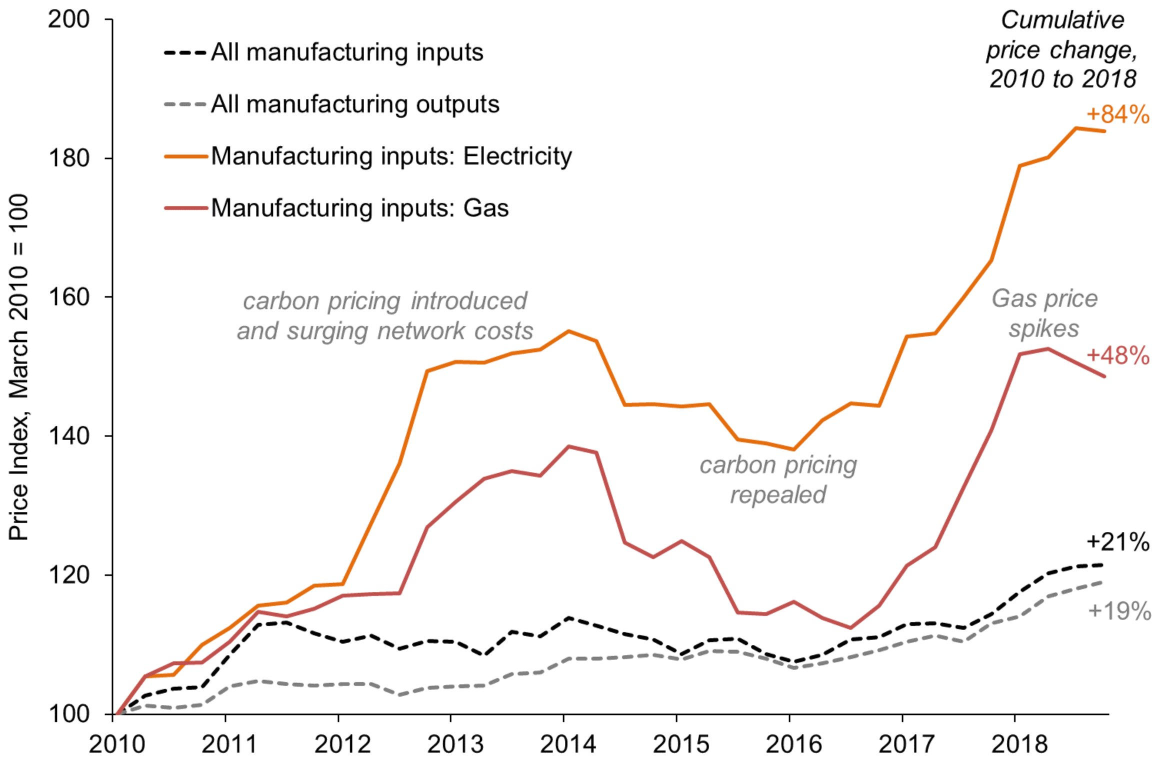
Seasonally adjusted	**Quarterly % change**	**Annual % change**
Preliminary producer prices	**0.4**	**4.3**
Domestic	0.4	3.8
Imported	0.5	7.4
Intermediate producer prices	**0.4**	**3.8**
Domestic	0.4	3.4
Imported	0.7	7.1
Final producer prices	**0.5**	**2.0**
Domestic	0.4	1.8
Imported	0.6	4.0

Source: ABS *PPI,* Dec 2018

For manufacturers, the gap between input price increases and output (selling prices) price increases was especially large in Q4 2018, probably reflecting their relatively high share of imported inputs. Over the year to Q4 2018, manufacturing input prices rose by 6.2% p.a., with prices for imported inputs up by 9.7% p.a. In contrast, average output prices were up by 5.4% p.a. This was due to a combination of a lower Australian dollar during 2018 and price rises for key commodities utilised as inputs by many manufacturers. The drought appears to have pushed up input prices for some agricultural inputs also. In the case of gas and electricity, the latest round of price increases came on top of mounting costs over the past decade.

As of Q4 2018, input prices for electricity for manufacturing businesses were 84% higher than they had been in 2010, while gas input prices were 48% higher than they had been in 2010. This compares to price increases for all manufacturing inputs of 21% over the same period, and price rises for manufacturing outputs (i.e. their selling prices) of 19% over the same period. This demonstrates a substantial degree of margin compression due to rising energy input costs, for manufacturing businesses operating across Australia (chart 18).

Chart 18: electricity and gas input price indexes for manufacturing, cumulative change from 2010 to 2018



Note: Producer price indexes rebased to March Quarter 2010 = 100. Source: ABS *PPI*, Sep 2018.

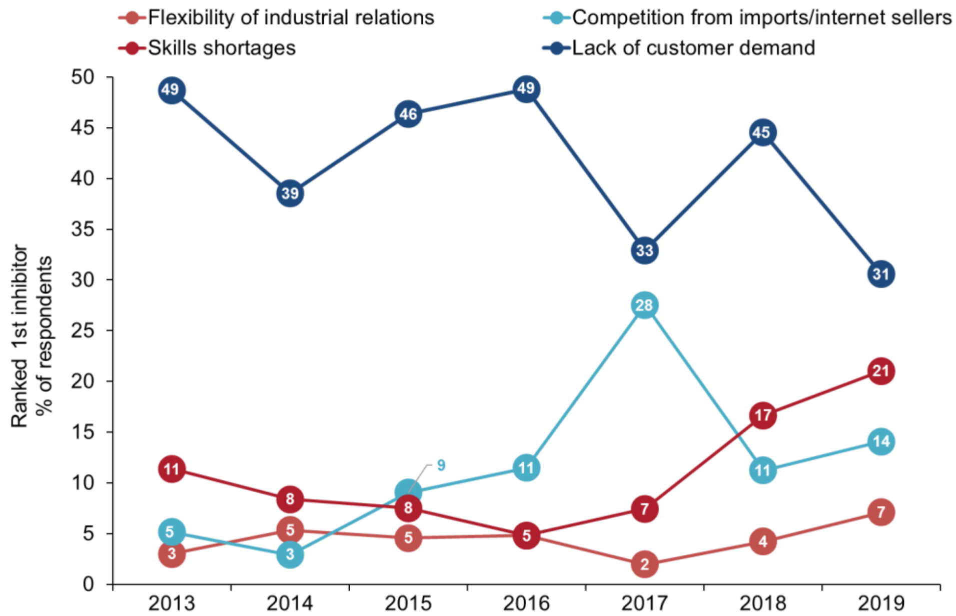
When asked which factors would provide the biggest inhibitors to business in 2019, 31% of CEOs identified a 'lack of customer demand' as their most significant constraint, down from 45% of CEOs who said the same for 2018 (and down from most previous years, since 2013). Labour market concerns feature prominently for businesses in 2019. The second most pressing concern for CEOs is skill shortages, with 21% of businesses nominating this as their top concern. This is up from 17% of leaders that identified skill shortages as an impediment for 2018 and triple the proportion in 2017 (7%). A further 7% of CEOs said the flexibility of industrial relations is their top concern in 2019, up from 4% in 2018 (chart 19).

In response to these challenges, 30% of CEOs plan to concentrate on improving sales of current products and services to their customers in 2019, down from 34% who ranked this as their top planning priority in 2018. Around 23% of CEOs will focus on introducing new products to the market in 2019 down from 40% in 2018 and 33% in 2017. This switch in focus from 'new' to 'existing' products and services suggests that those who introduced new products and services in recent years, will now progress from the development phase to focus on consolidating their markets (chart 20).

In terms of investment priorities, in 2019 half of businesses (49%) plan to concentrate their investment spending on either staff training & development or information & communication technologies (chart 21). When asked what their highest priorities were for business investment spending in 2019, just over a quarter (26%) of CEOs stated that improving employee capability was their focus for investment. This reflects the very high priority that the majority of Australian businesses place on their workforce, their skills development and their productivity improvement.

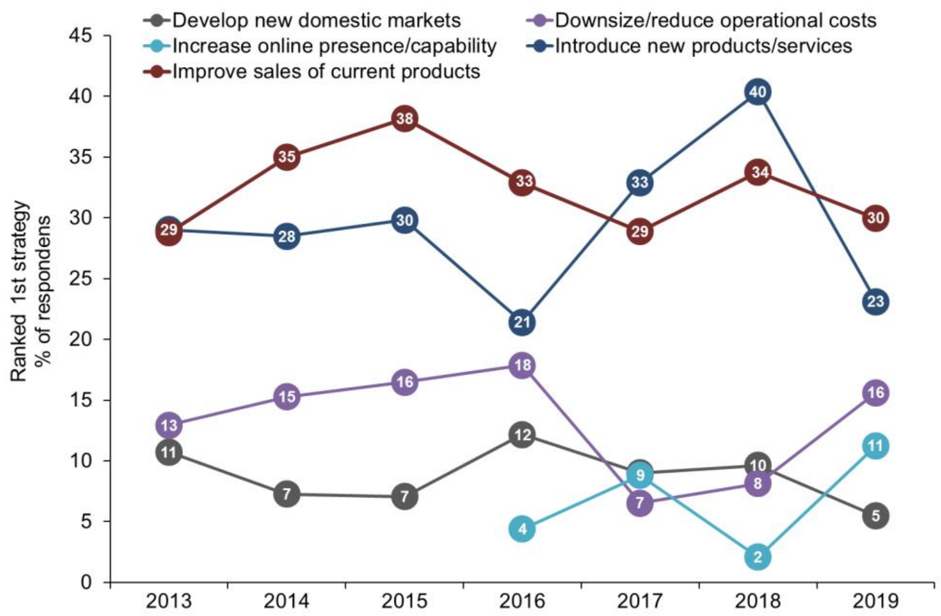
Just under a quarter (23%) of respondents said their first priority was information and communication technologies (ICT). These two factors are likely linked as the introduction of new technology generally necessitates an upgrade of employee skills. The third most important area for investment spending for Australian CEOs is new equipment with 19% of respondents planning to prioritise this area of investment in 2019. Research & development and physical capital expenditure were each important to 11% of CEOs reporting on their investment intentions, while just five per cent of businesses plan to focus on new technologies other than ICT.

Chart 19: Expected Inhibitors To Business Growth*, 2013 To 2019



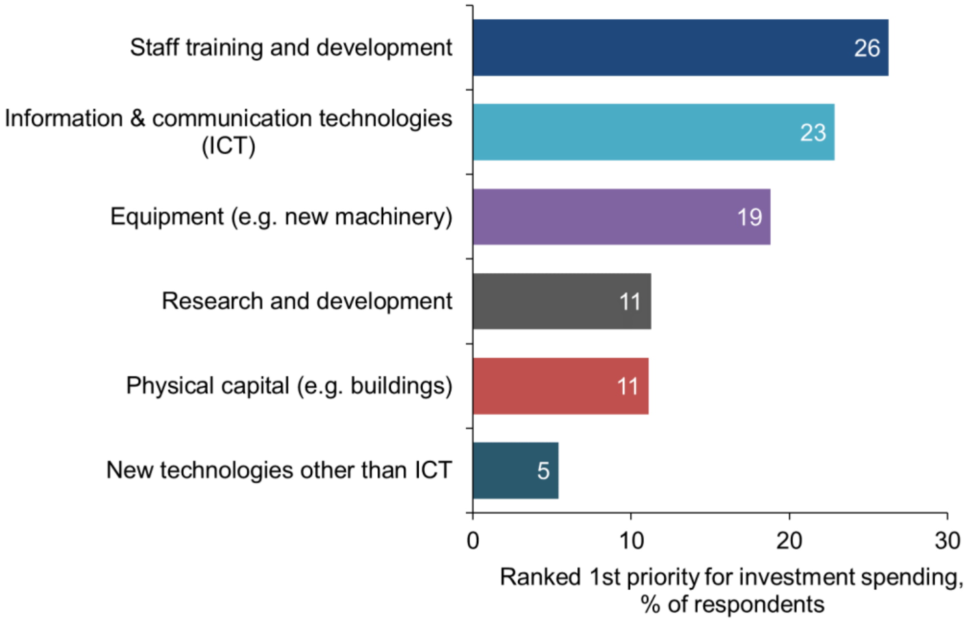
* Percentage of respondents who ranked each factor first in each year, out of a list of possible inhibitors.

Chart 20: Top Strategies for Business Growth, 2013 To 2019



* Percentage of respondents who ranked each factor first in each year, out of a list of possible strategies.

Chart 21: Investment Priorities for Business*, 2019



* Percentage of respondents who ranked each category first, out of a list of possible types of business investment spending.

2.6 Australian labour market is highly variable in 2018-19

Australia's labour market has performed remarkably well in recent years, at a national headline level, with relatively strong employment growth, falling unemployment and rising participation throughout 2018 (table 6). In January 2019 (latest data available at the time of finalizing this submission), total employment increased by 24,900 (+0.2% m/m) in the month and 295,500 (+2.4% p.a.) over the year to January 2019. Growth in full-time work (2.6% p.a.) is tracking more strongly than part-time work (+2.0%) at present, although the monthly full-time jobs growth has slowed (from 30,000 per month in August and September 2018 to 16,800 in January 2019). As a result, the share of work that is part-time work has fallen to 31.5% of the workforce, from a recent high of 31.8% in May 2018 and a record high of 31.9% in early 2017.

The national labour force participation rate reached an historical high of 65.7% in January (trend). During 2018, female labour force participation has held relatively steady at a very high rate, while male labour force participation has risen from 70.4% in February 2017 to 71.0% in January 2019 (chart 22). This suggests that in a climate of relatively high (but variable) labour demand, current wage rates are sufficient to attract many more people into active participation in the labour market.

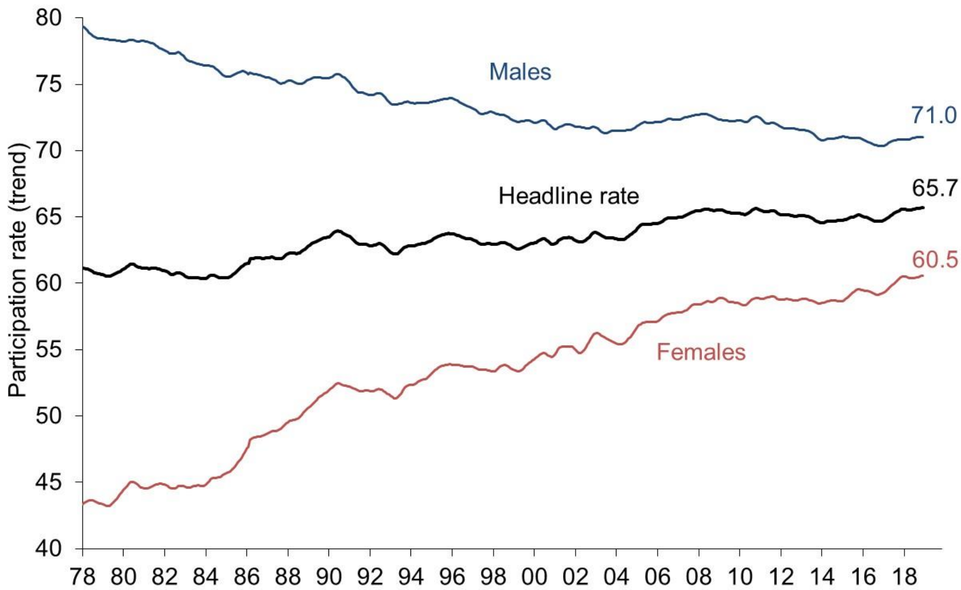
As of January 2019, the national unemployment rate had fallen to 5.1% (trend), which was the lowest rate since early 2012 (chart 23). Despite strong growth in the adult population (+1.7% p.a.) and in the labour force (+1.9% p.a.), the number of unemployed people fell by 5.7% over the year to January, to 680,000 people nationally (trend).The national underemployment rate fell to 8.3% (trend), which was the lowest rate since mid-2014 but is still relatively elevated compared to longer-term history (chart 23).

Table 6: Key labour market numbers, January 2019 (trend)

	Number	Change per month		Change per year	
	'000	*'000 m/m*	*% m/m*	*'000 p.a.*	*% p.a.*
Total employed persons	12,748	24.9	0.2	295.5	2.4
full-time (35+ hours p.w.)	8,737	16.8	0.2	218.6	2.6
part-time (under 35 hours p.w.)	4,010	8.1	0.2	76.8	2.0
Aggregate hours worked	1,763,168	1,567.9	0.1	26,205.7	1.6
Labour force	13,428	26.8	0.2	253.8	1.9
Adult civilian population	20,428	38.4	0.2	342.8	1.7
	Number '000	*% of labour force*		*Change from one year ago Percentage point change*	
Unemployment	680.1	5.1		-0.4	
looking for full-time work	460.1	3.4		-7.8	
looking for part-time work only	220.0	1.6		-1.2	
Underemployment	1,109.3	8.3		-0.3	
Underutilisation	1,789.3	13.3		-0.7	
		% of adult population		*Percentage point change*	
Participation rate		65.7		0.1	
Employment to population ratio		62.3		0.4	

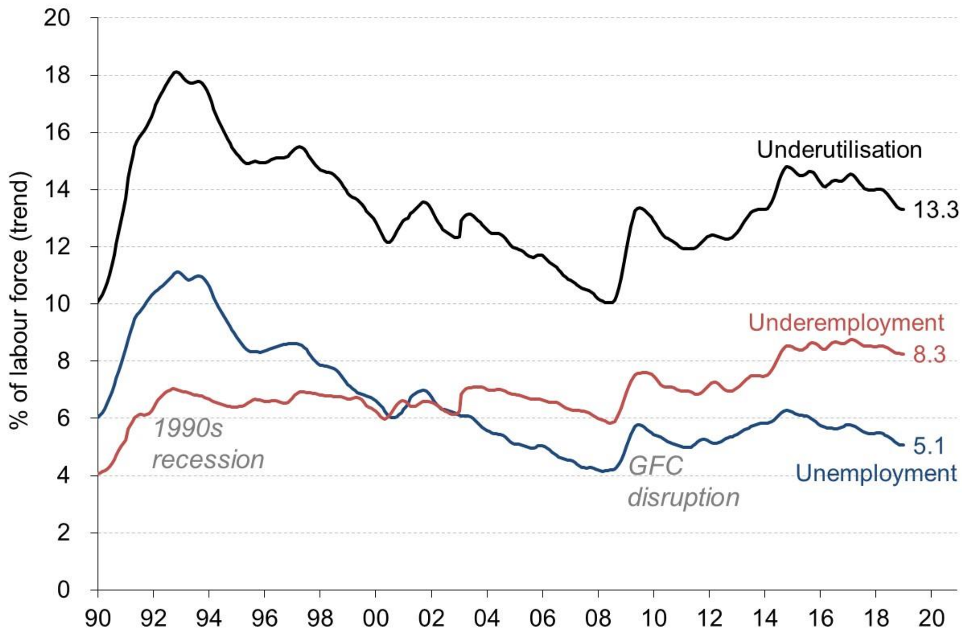
Source: ABS, *Labour force Australia*, Jan 2019.

Chart 22: Labour force participation rates, by sex, to Jan 2019 (trend)



Source: ABS, *Labour force Australia*, Jan 2019.

Chart 23: unemployment, underemployment and underutilization rates, to Jan 2019 (trend)



Source: ABS, *Labour force Australia*, Jan 2019.

Beneath these headlines however, considerable variation is apparent across industries and locations. In particular, the labour market appears to be relatively tight in some locations - particularly parts of Melbourne and Sydney - and in some industries - particularly higher skill and higher wage pockets such as civil engineering and advanced manufacturing. These are the locations, industries and occupations that Ai Group is seeing rising reports of skill shortage and wage pressure.

The labour market appears to be significantly less tight at present in the predominantly low-wage, low-skill service industries such as retail trade, hospitality (food and accommodation services), arts and recreation and personal services. These had relatively high rates of underemployment and weak jobs growth during 2018 (see rows highlighted in red in table 7). The labour market weakness in these industries reflects the ongoing weakness in aggregate consumer spending, as well as structural changes arising from new service delivery preferences, technologies and new goods and services that are disrupting traditional ‘bricks and mortar’ businesses across these industries. Other industries with weak employment growth in 2018 included transport and administrative services. These industries also employ relatively higher numbers of low-skill and low-wage workers.

The relatively high rates of underemployment in these industries is significant, because it indicates a higher degree of spare labour capacity at the lower wage and skill levels. The national underemployment rate appears to be very closely correlated to movements in the average wage at present. Indeed, it may be having a stronger effect on average wage movements than have recent unemployment or underutilization rates (charts 24 and 25). Recent trends in underemployment are examined in more detail in the FWC’s Research Report 2/2019 *Insights into underemployment.*

Table 7: Key labour force numbers, by industry, Nov 2018

Trend and original data	Employment Level (trend)		Employment change p.a. (trend)		Average hours per worker (original)	Part-time workers (original)	Under-employment ratio (original)
	'000 people	% of total	'000	%	hours per week	% of industry	% of industry
Agriculture	327	2.6	1	0.4	41.5	25.6	5.6
Mining	256	2.0	36	16.4	43.9	3.6	1.2
Manufacturing	966	7.6	74	8.3	36.5	15.8	5.1
Utilities	153	1.2	9	6.4	36.9	11.1	2.4
Construction	1,167	9.2	-6	-0.5	37.9	14.5	5.8
W'sale Trade	382	3.0	14	3.8	36.1	17.8	3.7
Retail Trade	1,272	10.0	-24	-1.8	27.7	51.6	17.0
Hospitality.	900	7.1	9	1.0	26.6	60.3	21.3
Transport & Warehousing	649	5.1	4	0.6	36.7	21.5	5.8
IT & Telecomms	227	1.8	6	2.8	34.7	24.3	7.1
Finance & Ins.	449	3.5	24	5.6	34.8	17.5	2.8
Real Estate	218	1.7	4	2.1	36.5	23.6	4.3
Professions	1,082	8.5	61	6.0	34.8	24.1	5.3
Admin. services	407	3.2	2	0.6	30.1	39.8	11.5
Public Admin.	838	6.6	106	14.5	33.2	17.2	3.7
Education	1,035	8.2	12	1.2	31.4	38.5	9.7
Health	1,685	13.3	12	0.7	29.5	44.0	10.2
Arts & Recreation	244	1.9	-4	-1.5	28.7	48.0	17.6
Personal Services	485	3.8	-13	-2.5	33.2	31.0	9.0
All Industries	**12,686**	**100**	**263**	**2.1**	**33.0**	**31.5**	**8.9**

Source: ABS, *Labour force Australia*, *Detailed quarterly*, Nov 2018.

Chart 24: underemployment rate and WPI (trend)

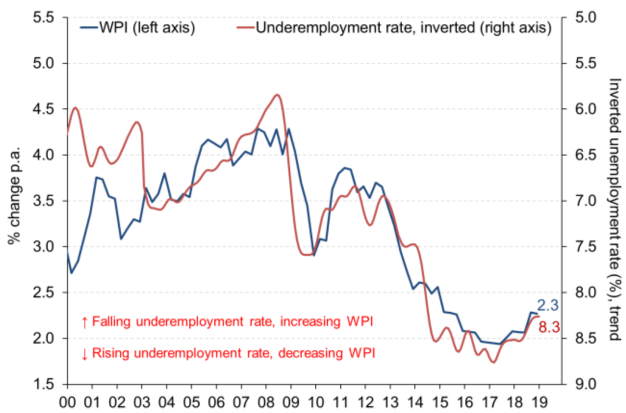
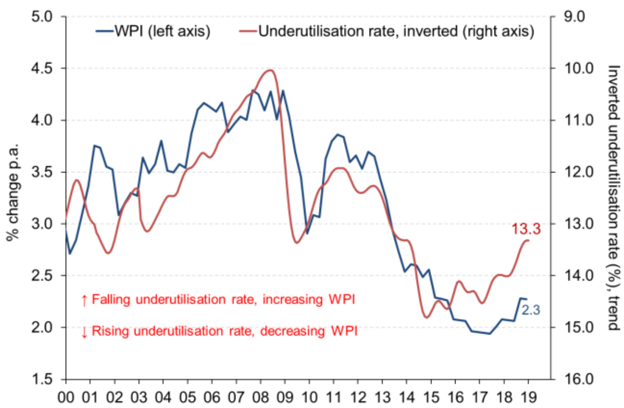


Chart 25: underutilization rate and WPI (trend)



Source: ABS, *Labour force Australia,* Jan 2019.

The latest labour market data are also indicating considerable variation in labour market conditions around the country. Across the states, the largest employment increases in January were in NSW (+11,200 persons), Victoria (+10,300) and Queensland (+3,500). The other three states shed jobs in January 2019 (trend) while the two territories managed a small rate jobs growth in the month of January but still had fewer employed people than one year earlier (trend, table 8). This gap between strong jobs growth in NSW and Victoria but weak elsewhere widened through late 2018, whether measured in terms of total numbers of jobs added or employment growth rates (chart 26).

Unemployment rates are showing a growing gap across states, with very low rates in NSW (4.1%), Victoria (4.5%) and the ACT (3.5%) as of January 2019 but all other states remaining at or above 6% (table 8 and chart 27). Tasmania stands out as having especially high part-time work and underemployment rates plus a lower participation rate compared to other states in 2019.

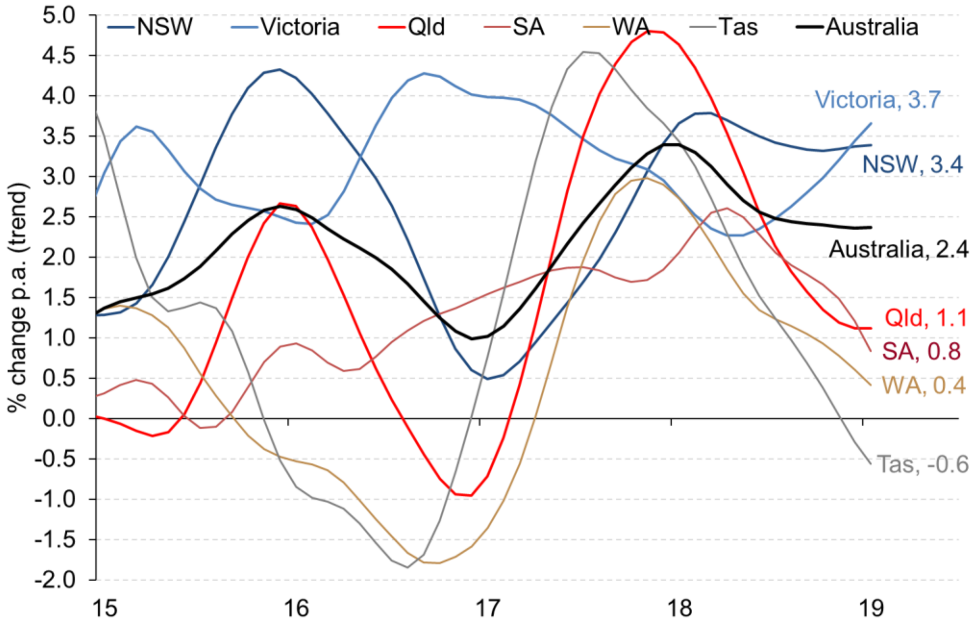
These differences in labour market conditions across states reflect reports to Ai Group of skill shortages at present. These reports are increasing but they remain concentrated in only some locations and some industries (e.g. in advanced manufacturing and heavy construction in parts of Melbourne and Sydney).

Table 8: Key labour market numbers by state, January 2019 (trend)

	Employment growth			**Part time workers**	**Unemployment**	**Under-employment**	**Participation**
Trend	'000 m/m	'000 y/y	% p.a.	%	**rate** %	**rate** % (orig)	**rate** %
NSW	11.2	133.9	3.4	30.9	4.1	7.7	65.1
VIC	10.3	118.8	3.7	32.0	4.5	8.2	65.9
Qld	3.5	27.8	1.1	30.8	6.1	8.8	65.6
SA	-0.2	7.0	0.8	34.6	6.0	9.1	62.8
WA	-1.7	5.6	0.4	31.0	6.6	9.2	68.5
Tas	-0.3	-1.4	-0.6	37.9	6.2	9.6	60.1
NT	1.0	-2.5	-1.8	20.9	5.0	5.0	74.8
ACT	0.4	-2.3	-1.0	28.8	3.5	6.3	69.6
Australia	**36.1**	**297.3**	**2.4**	**31.5**	**5.1**	**8.3**	**65.7**

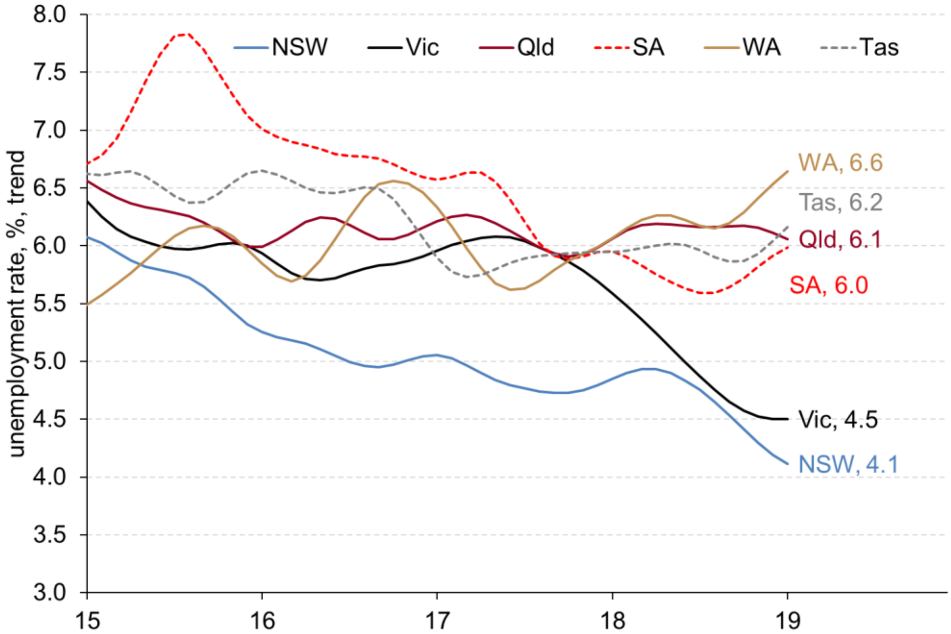
Source: ABS, *Labour force Australia*, Jan 2019.

Chart 26: Employment growth rates by state, 2015-2019 (trend)



Source: ABS, *Labour force Australia,* Jan 2019.

Chart 27: Unemployment rates by state, 2015-19 (trend)



Source: ABS, *Labour force Australia,* Jan 2019.

Looking ahead, the NAB quarterly business survey indexes of employment intentions 3 months and 12 months ahead both peaked in mid to late 2018 and are now trending lower. Of even greater concern to the employment outlook, the ANZ job advertisements index plunged at the end of 2018. The number of job vacancy advertisements fell a further 0.9% m/m in February 2019 (latest available data), to be down 4.3% p.a. This was the fourth monthly decline in a row and the largest annual decline since 2014. This indicates slower labour demand during 2019. ANZ economists conclude 2019 will see a stable unemployment rate “at best”, with an increasing risk of rising unemployment.

2.7 National income trends remain uneven across industries

As noted in section 2.1 above, nominal national aggregate income increased across all of the key categories of total factor income in Q4 2018:

- Nominal aggregate compensation of employees (wages and incomes) grew by 0.9% q/q and 4.3% p.a.

- Nominal aggregate private profits for financial corporations (banks, pension funds, superannuation funds etc) grew by 1.4% q/q and 6.8% p.a.

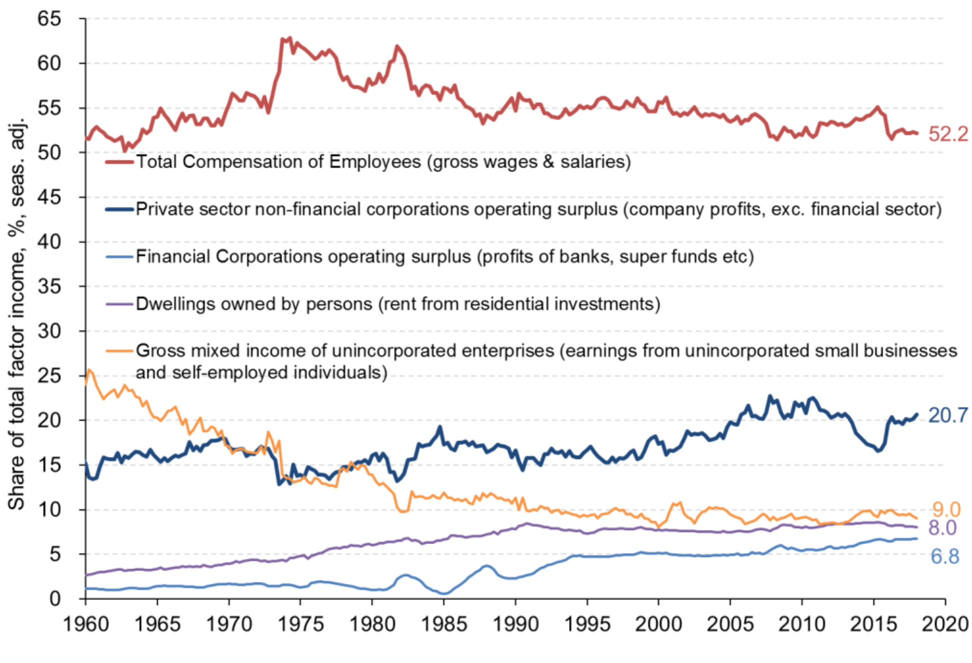
- Nominal aggregate private profits for non-financial corporations (companies other than banks, pension funds, superannuation funds etc) grew by 3.8% p.a and 10.9% p.a.

- Real aggregate net national disposable income grew by 1.2% q/q and 3.7% p.a.

- Real aggregate net national disposable income per capita grew by 0.8% q/q and 2.1% p.a.

This growth in incomes across wages and profits occurred despite drops in Q3 and Q4 2018 in real GDP per capita (-0.2% q/q and +0.7% p.a.) and real GDP per hour worked (-0.2% q/q and +0.7% p.a.).

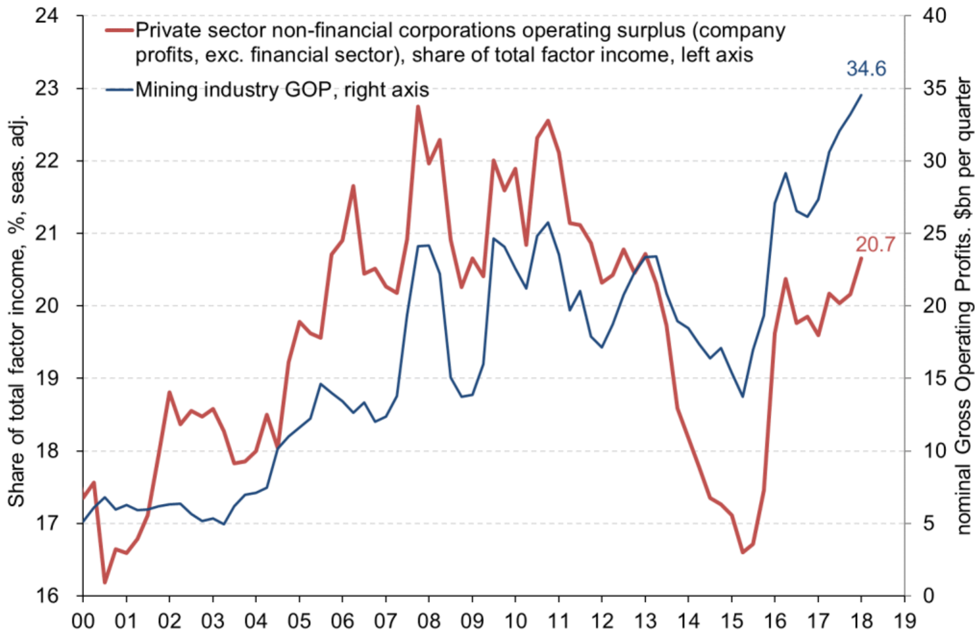
Chart 28: Nominal total factor income, % shares, 1960 to 2018



Source: ABS *National Accounts*, Dec 2018.

Growth in all categories of nominal income meant that the shares of total factor income earned by (or accruing to) various categories remained broadly stable, with a slight uptick in the aggregate income earned by non-financial corporations (chart 28). This reflected growth in company Gross Operating Profits (GOP, a different but related ABS measure of company profits) of 26.3% p.a. for mining industry companies and 2.5% p.a. for non-mining industry companies. This performance gap is significant because it is typical of industry experiences over the past decade and because it has a direct bearing on income shares across the economy, at a national aggregate level. Mining industry profits are of a sufficient size (38% of all GOP earned in Q4 2018) to affect these measured income shares, all on their own. The relationship between mining company GOP and private sector non-financial corporations share of total factor income is not precise (because GOP is not identical to total factor income and because income from other industries also fluctuates), but it is close enough to demonstrate the relevance of mining industry performance to national income shares (chart 29).

Chart 29: Nominal total factor income share of non-financial corporations, and mining industry gross operating profits (GOP), 2000 to 2018



Sources: ABS *National Accounts* and *Business Indicators*, to Dec 2018.

In the longer term, the rise (and role) in the shares of total factor income derived from (or accruing to) financial corporations and 'dwellings owned by persons' should also be considered. These categories of income do not fit neatly into the traditional dichotomy between company profits v wage income; financial corporations income includes the returns earned on our (massively growing) pot of national superannuation funds which are mainly paid out to retirees, while 'dwellings owned by persons' includes the real and imputed rents paid to the nation's individual home owners. Both of these categories of income have been rising slowly but steadily over time, in size and in importance to aggregate household incomes. Much of the income from these categories accrues to households that are no longer working, but many working households also derive some of their income from one or both sources. Together, these two categories accounted for 14.8% of total factor income in 2018, up from around 10% prior to the last recession in 1991.

Research conducted by staff of the Department of Jobs and Small Business in 2018 argues that 'rent from dwellings' (plus the effects of depreciation of assets) should be excluded from calculations of national income shares, since much of it is imputed, and because none of it accrues to companies in the form of profits. They conclude that when these items are excluded from total factor income, the strong (but volatile) performance in the mining industry accounts for most of the recent fluctuations observed in shares of total factor income accrued by wage and salary earners compared with other categories of income:[1]

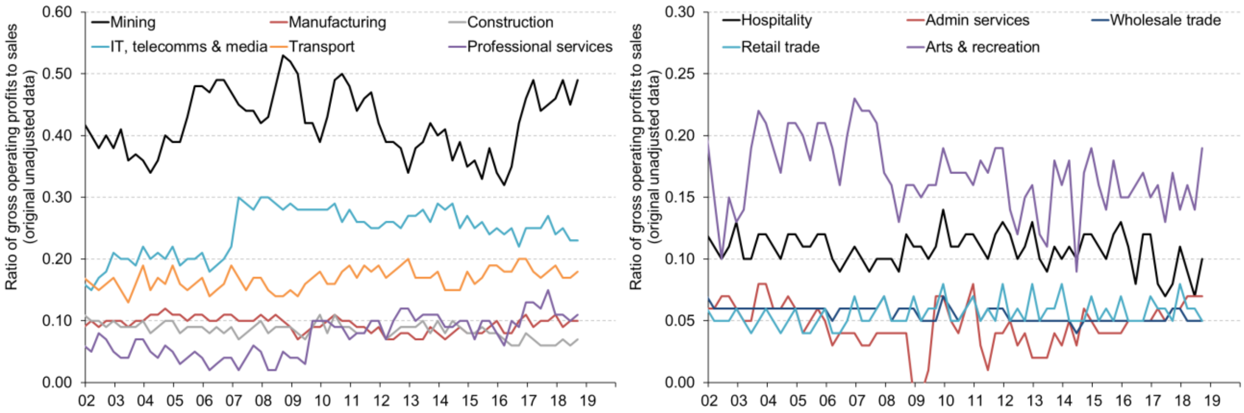
> "Both in Australia and overseas, concerns have been raised that the profit (capital) share of income has increased at the expense of the wage (labour) share, or equivalently, that employees have been left out of the benefits of productivity growth (e.g. Cowgill 2013, OECD 2015, IMF 2017). ….
>
> Some recent research, however, has questioned this narrative. Bridgman (2014) and Rognlie (2015) argued that the apparent shift in favour of profits has been exaggerated by the rising importance of depreciation and housing in modern economies, and by beginning the analysis in the 1970s when the wage share was at an all-time high. While increases in depreciation and imputed housing income will tend to reduce measured wage shares, they do not represent a true shift of income from employees to employers. Depreciation is not counted as profit or income at a corporate or individual level, while housing is often owner-occupied, its 'income' is largely notional imputed rent, and in any case is a separate issue from the labour market. Therefore, wage shares should be calculated net of depreciation, and excluding housing.
>
> … In this paper, we estimate adjusted wage shares for Australia for (financial years ending in) 1960-2016, based on the methods of Rognlie and PZ, with some alterations to deal with Australian data issues. We use three different methods to adjust for self-employment ('mixed' or unincorporated business) income: allocating 75% to wages (following PZ), allocating 50% to wages, and excluding the farm sector. In all three cases, net of depreciation and housing, the wage share in Australia was around its historical average at the end of our period. We further estimate wage shares for the business and private sectors, with similar results, using data for general government and public sector wages where available, and proxying with general government consumption before this date. Our overall conclusion is robust to these alternative approaches."

Profit rates, ratios and wage ratios within industries can help to illustrate broad income distribution trends that affect the individuals and households that work in those industries. With regard to profit margins, ABS data indicate no clear pattern of change in profit margins (that is, the ratio between aggregate nominal sales and company gross operating profits, GOP) across any of the major industries that are included in the *Business Indicators* dataset from 2000 to 2018 Some industries experienced a sudden movement (up or down) in margins in 2008 or 2009 that appear to be associated with the sudden disruptions of the GFC. The mining industry generally has a higher margin than other industries (reflecting its extremely high capital intensity), but it fluctuates greatly. Arts and recreation services also has a higher margin, possibly due to high gambling sector margins (charts 30 and 31 and table 9).

With regard to wage ratios (that is the ratio between aggregate nominal sales and aggregate nominal wages), some industries display volatility (e.g. mining and hospitality) but no clear trend up or down over time. The aggregate sales to wages ratio appears to have fallen very slowly over a long period in the retail trade industry, which might reflect changes to capital intensity in this sector.

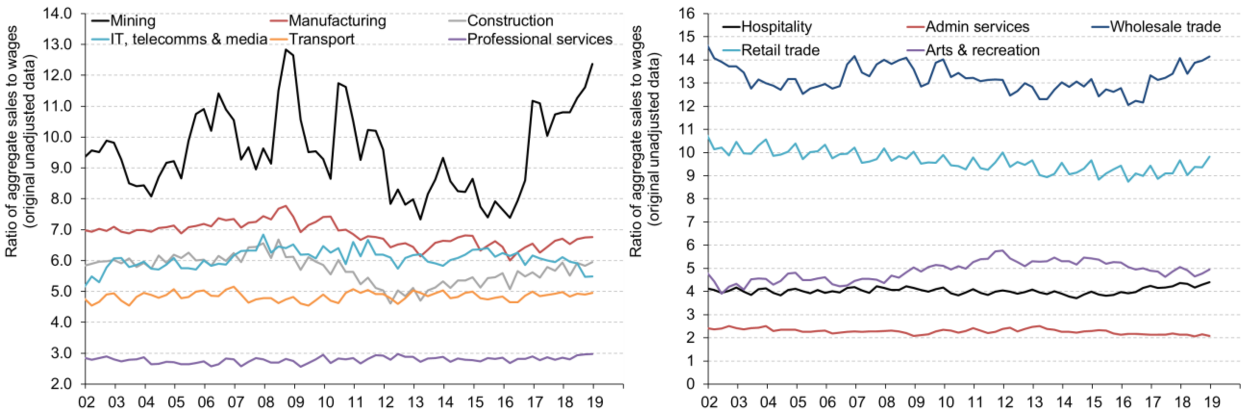
[1] Declan Trott and Leo Vance, "Adjusting the Australian wage share for depreciation, housing, and other factors, 1960-2016" *Department of Jobs and Small Business Staff Discussion Paper Series*, 7/03/2018.

Chart 30: Industry profit margins* by industry, 2000 to 2018



* aggregate nominal company GOP to aggregate nominal sales. Source: ABS *Business Indicators*, to Dec 2018.

Chart 31: Industry wage ratios* by industry, 2002 to 2018



* aggregate nominal sales to aggregate nominal wages. Source: ABS *Business Indicators*, to Dec 2018.

Table 9: Business profit margins and wage ratios, selected industries, 2014 to 2017

	Profit margin, %			Wages and salaries to sales ratio, %		
%	**2014-15**	**2015-16**	**2016-17**	**2014-15**	**2015-16**	**2016-17**
Mining	7.6	3.8	15.7	12.4	13.3	10.8
Manufacturing	5.5	7.0	6.8	14.8	14.8	15.0
Construction	9.7	10.2	9.7	16.2	16.4	16.2
Wholesale trade	2.7	3.1	3.4	7.4	7.7	7.6
Retail trade	4.8	4.3	4.6	10.6	10.5	10.5
Food & accommodation	8.2	7.9	6.9	25.4	25.9	25.9
Transport	11.7	10.2	9.2	21.7	21.8	21.7
Administrative services	8.7	8.4	7.7	50.3	49.9	49.4
Healthcare (private)	27.7	26.9	25.3	54.0	54.3	55.0
Arts & recreation servs	13.3	12.1	12.8	20.6	20.9	21.4
Personal and other servs	13.1	13.4	13.8	31.7	33.6	33.3
All industries	**10.6**	**10.8**	**11.6**	**17.8**	**18.1**	**17.8**

Source: ABS, 81550DO002_201617, *Australian Industry, 2016-17,* released May 2018.

2.8 Wage rates accelerating mildly in 2018-19

A bigger, stronger labour market in early 2018 supported a further lift in wage rates, albeit very mildly and with a time lag. In the December quarter of 2018 (Q4), the national wage price index excluding bonuses (WPI) rose by 0.5% q/q and 2.3% p.a. This was unchanged from Q3 in annual terms but a weaker quarterly rise than in Q3 (0.6% q/q seasonally adjusted), which had included this year's minimum wage increase of 3.5% from 1 July 2018. Annual growth in private sector WPI accelerated mildly to 2.3% p.a. in Q4, up from 2.1% p.a. in Q3 and a recent low of 1.8% p.a. in 2016 and 2017. A separate measure of wage growth, average weekly earnings of ordinary time full-time adult employees (AWOTE) also rose by 2.3% p.a., for the year to November 2018.

Two key measures of wage growth have been released in 2019 to date, both of which indicate that average national wage growth is accelerating very mildly but remains relatively subdued. The ABS Wage Price Index (WPI) grew by 0.5% q/q in the December quarter (Q4) of 2018 following growth of 0.6% q/q in Q3 2018, which had included the effects of last year's minimum wage rise of 3.5% from 1 July. The annual rate of growth in the WPI held steady at 2.3% p.a. in Q4 2018 (chart 32).

Annual growth in private sector WPI accelerated mildly to 0.6% q/q and 2.3% p.a. in Q4, up from 0.5%q/q and 2.1% p.a. in Q3, and a recent low of 1.8% p.a. in 2016 and 2017. This was the fastest rate of annual growth in private sector WPI since Q4 2014. Growth in private sector WPI has been accelerating mildly since 2017. This may be due to several factors including a mildly tighter labour market in some industries (lower unemployment and underemployment rates) and the effects of two relatively large rises in the statutory minimum wage in 2017 and 2018 (chart 32).

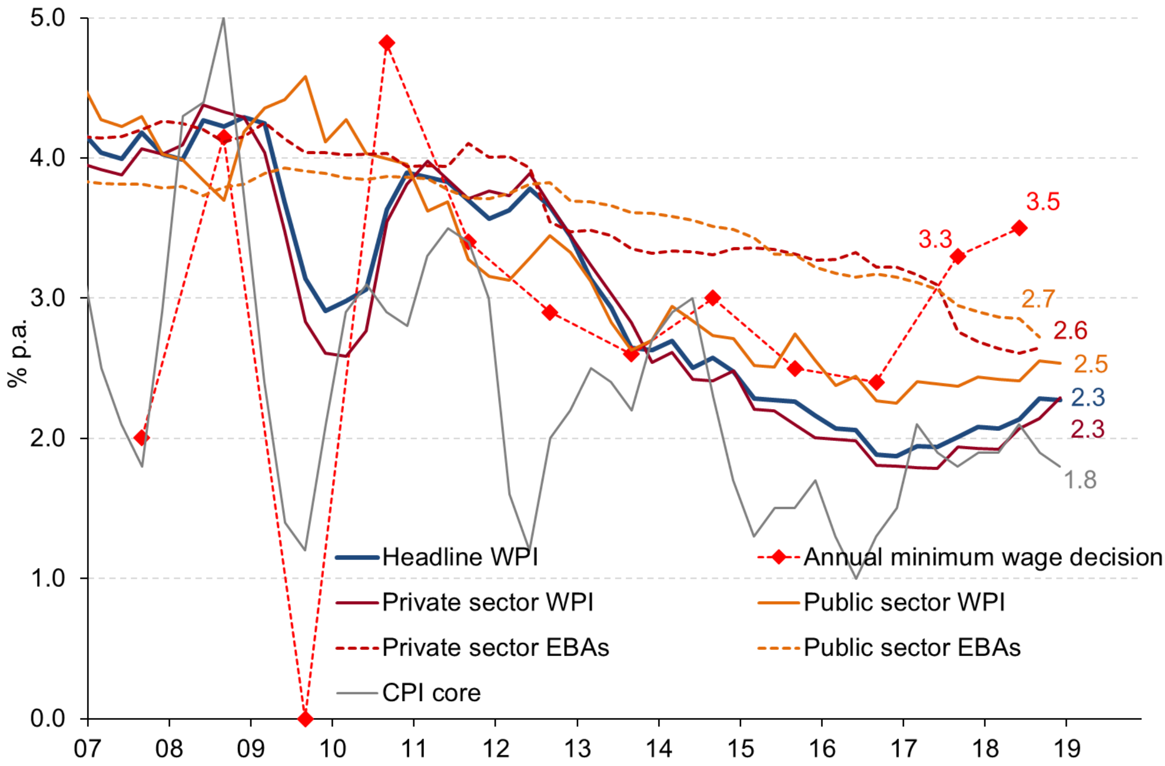
Public sector wages grew by 0.6% q/q and 2.5% p.a. in Q4 2018 and have been stronger than wage increases in the private sector since 2014, although the gap appears to be narrowing (see chart 32).

Wage rises in new Enterprise Agreements (EAs) continue to track higher than WPI wage growth, due to the conditions surrounding some of the larger EAs and the industries in which they apply. EAs are more prevalent in the public sector and in higher-wage sectors such as manufacturing, construction, healthcare and education than in lower-wage industries.

With headline and core inflation at just 1.8% p.a. in Q4 2018, these latest wages data confirm that in real terms, average wages are growing across most industries. In Q4 2018, only the IT and telecommunications industry experienced average wage growth lower than current CPI (chart 33).

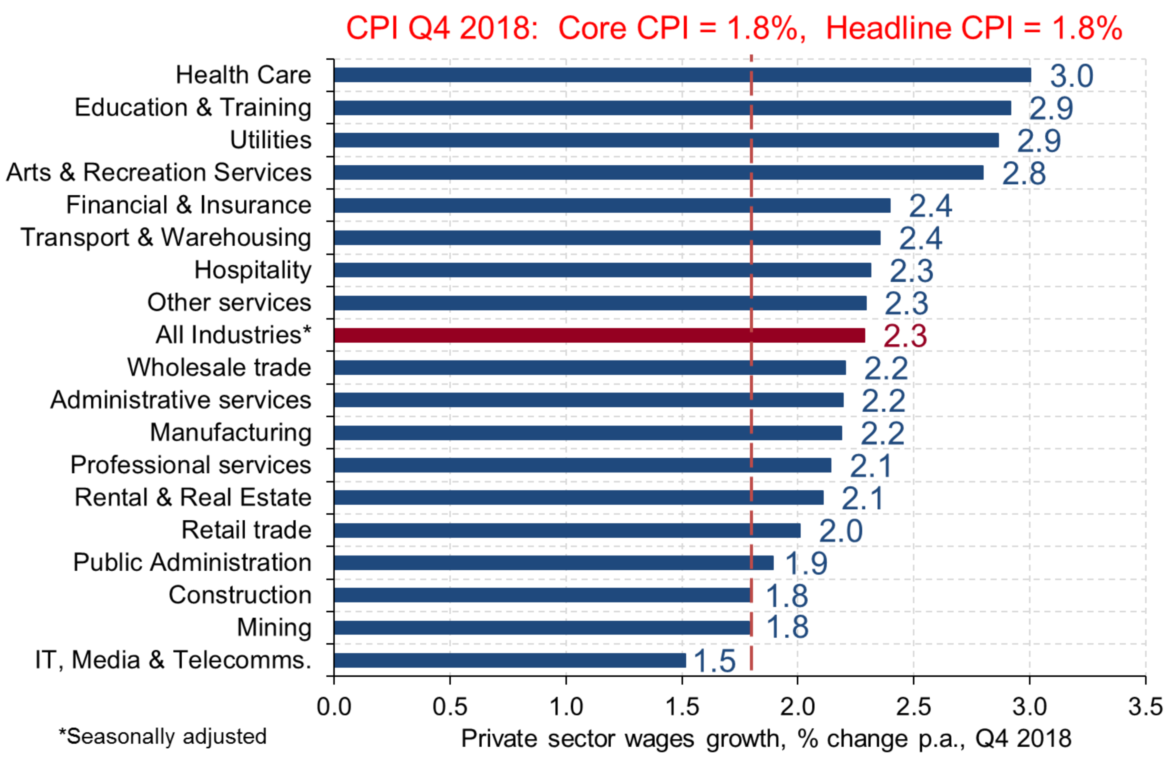
In the industries which employ large numbers of low-wage workers (e.g. retail, hospitality and administrative services), private-sector wage price indexes indicate wage rates accelerated in 2018 and are now firmly past their troughs in this pricing cycle (chart 34). Wage growth rates in these low-wage industries (at 2.0% to 2.3% p.a. in Q4 2018) continue to lag behind the growth rates that are implied by the minimum wage rises of the past two years (3.3% and 3.5% p.a.).

Chart 32: CPI, WPI, EA and minimum wage measures, 2007 to 2018



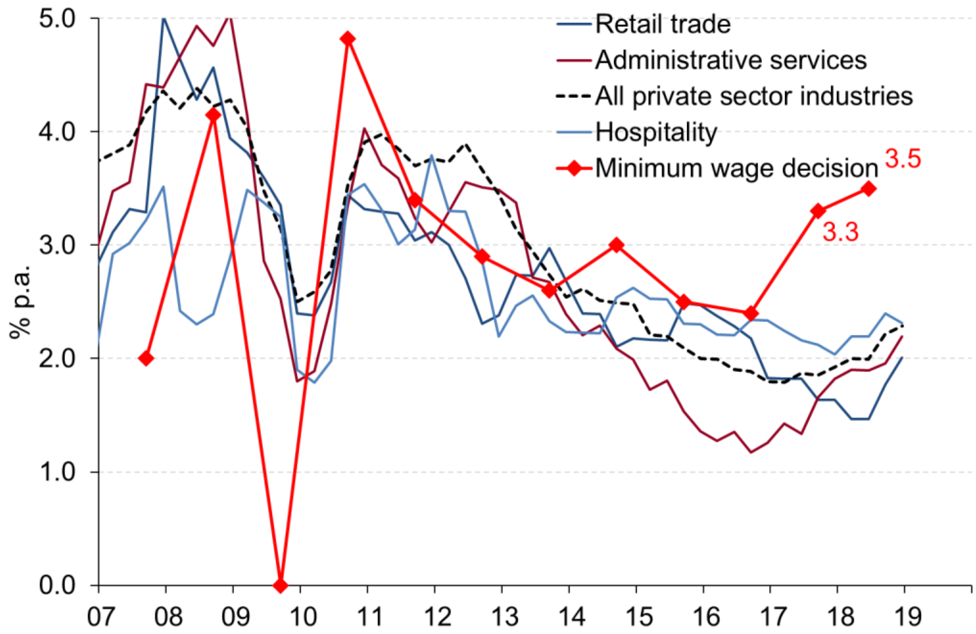
Source: ABS, *Wage Price Index*, Dec 2018; *Consumer Price Index*, Dec 2018; Fair Work Commission; Dept Employment.

Chart 33: Private sector wage price index changes, Q4 2018



Source: ABS, CPI and Wage Price Index, Dec 2018

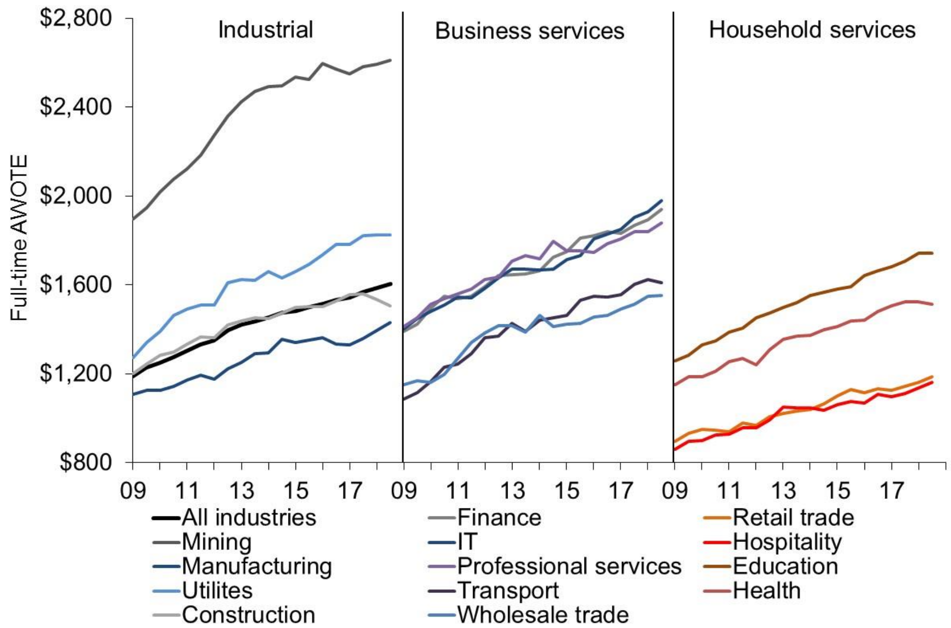
Chart 34: Private sector WPI changes, selected 'low-wage' industries, 2007 to 2018



In nominal dollar terms, the ABS estimates that nominal Full-time Average Weekly Ordinary Time Earnings for full-time workers (AWOTE) increased to $1,605.50 in November 2018, up by 1.3% over the previous six months and by 2.3% over the previous year. The annual rate of growth was slower than six months earlier (+2.7% p.a. over the year to May 2018).

Nominal AWOTE rose in most industries over the year to November 2018. AWOTE fell in construction (-3.3% p.a.) and healthcare (-0.8% p.a.) and was stable in utilities (chart 35). On average, private sector employees in mining remain the highest paid workers, even though their average pay rises have flattened since the recent mining boom (chart 35).

Chart 35: Nominal full-time AWOTE by industry, to Nov 2018



Source: ABS, Average Weekly Earnings, November 2018.

2.9 Australian inflation remains extremely weak in 2018-19

The headline consumer price index (CPI) slowed to 1.8% p.a. in Q4 of 2018. This was despite inflation in the quarter picking up slightly to 0.5% q/q in Q4, from 0.4% q/q in Q3 of 2018. Headline CPI has only exceeded 2.0% p.a. twice temporarily since 2014 (2.1% p.a. in Q1 2017 and 2.2% p.a. Q2 2018).

When volatile items such as fresh food (affected by drought) and petrol (affected by global oil prices and the dollar) are excluded, inflation remained even weaker over the year, at just 1.6% p.a. for 'CPI ex-volatiles'. This 'ex-volatile' measure has not exceeded 2.0% since Q4 2015. Underlying or 'core' inflation (the RBA's preferred method of excluding the temporary effects of overly volatile pricing) came in at 0.4% q/q and 1.8% p.a. in Q4. It remains well below the RBA target band of 2-3% over the cycle Core inflation has been below 2.0% since Q4 of 2015 (chart 36).

The ABS 'employee living cost index' decelerated to 1.9% p.a. in Q4 2018. This index has grown by 2.0% p.a. or less in every quarter except Q2 2018 (2.3% p.a.) since Q2 of 2014.

Inflation in Q4 of 2018 was affected by:

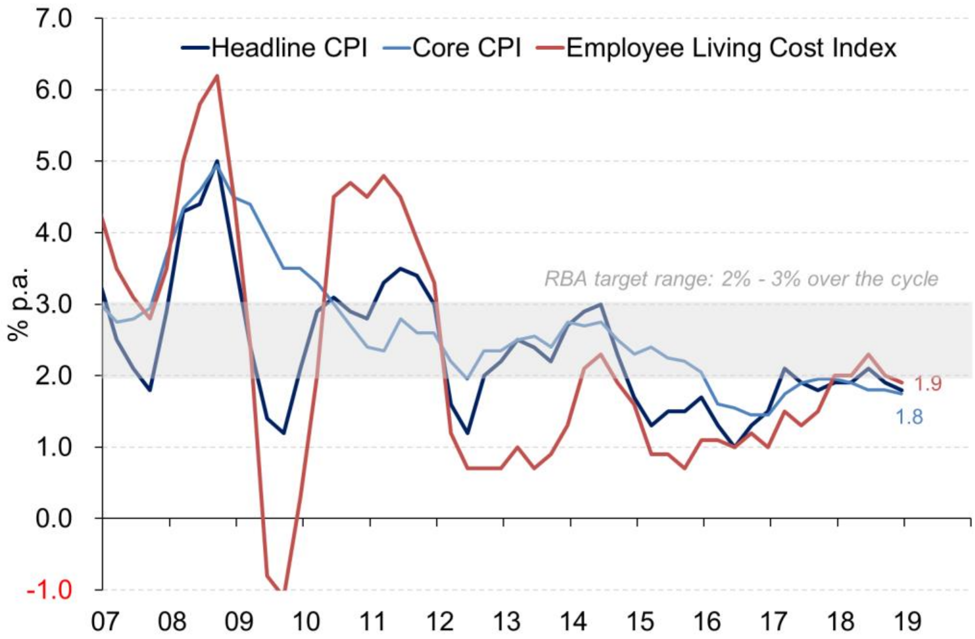
- ***Drought:*** Prices spiked for various fresh foods in Q3 and Q4 but these are expected to be temporary. These price spikes have probably prompted product substitution by consumers as they seek cheaper alternatives (swapping between fruits or vegetables). Although fresh food inflation strengthened in Q3 and Q4, it remains low on an annualised basis.

- ***Government:*** stronger price rises (again) in Q4 for 'government administered' items (that is, federal or state governments can influence their price) such as tobacco, electricity, gas and childcare. Although gas prices fell from recent peaks in Q4 they remain 3.2% higher than a year earlier. Retail electricity prices increased by a further 0.9% q/q in Q4. Childcare prices increased by 1.4% q/q in Q4 but remained 8.3% lower than one year earlier due to price cuts related to changes to childcare subsidy arrangements earlier in 2018.

- ***Dollar:*** the lower Australian dollar during 2018 is pushing prices higher for some types of tradable goods and services such as travel and household equipment (e.g. televisions). These prices had more often fallen in previous periods (chart 2). Taking the edge off these price rises for some tradeable goods, the retail petrol price fell by 2.5% in Q4. It remained 6.7% higher than one year earlier however, due to big price increases in early 2018.

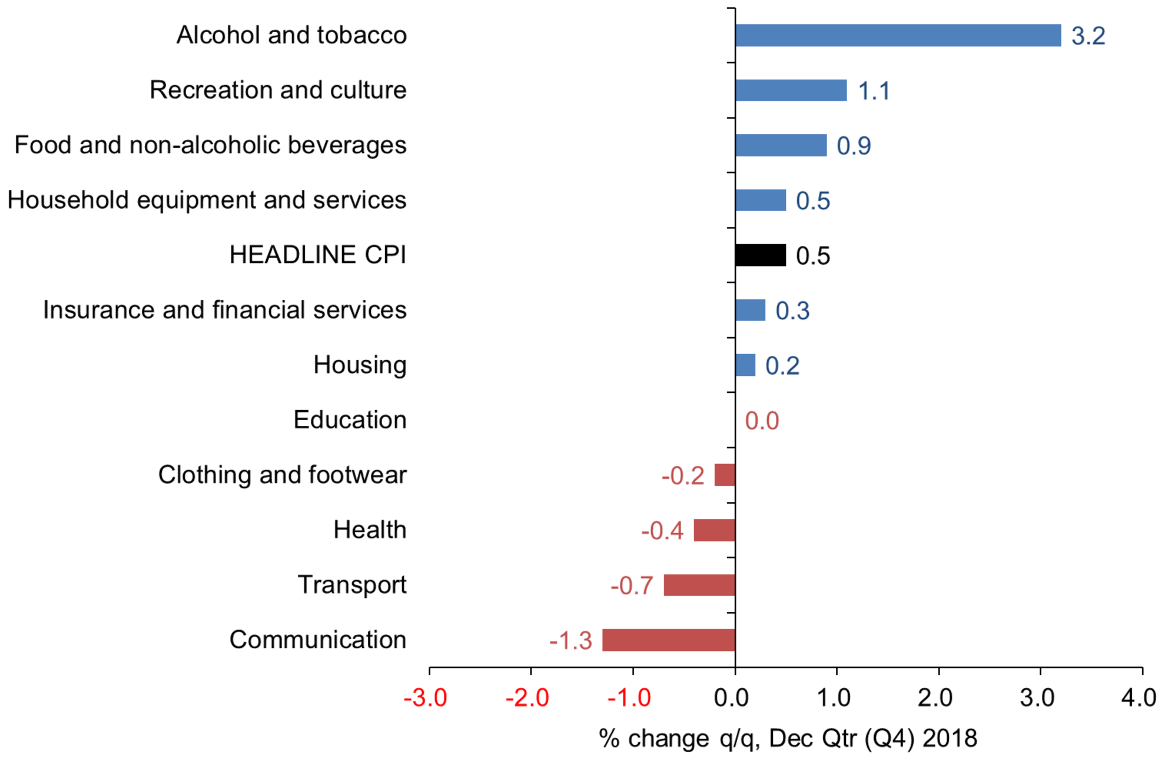
- ***Housing market cycle:*** Residential property prices are not directly included in the CPI (since purchasing a residence is an asset purchase and not a consumer item), but the effect of decelerating house prices is evident in the CPI indexes for 'rents' and 'new dwelling purchases by owner-occupiers', which slowed to 0.5% p.a. and 1.8% p.a. respectively in Q4 2018, their slowest in two years. Rents have been rising by less than 1.0% p.a. since Q1 of 2016. Property rates (administered by local councils and based on estimated property values) were flat in Q4, after increasing by an average of 2.3% in Q3. Rates grew by 2.3% p.a. in each of Q3 and Q4, which was the slowest annual growth for this index since at least 2000.

Chart 36: CPI and employee living cost index changes, 2007 to 2018



Sources: ABS, CPI, LCI, December 2018

Chart 37: Quarterly inflation for major product categories, Q4 2018



Source: ABS *CPI,* Dec 2018.

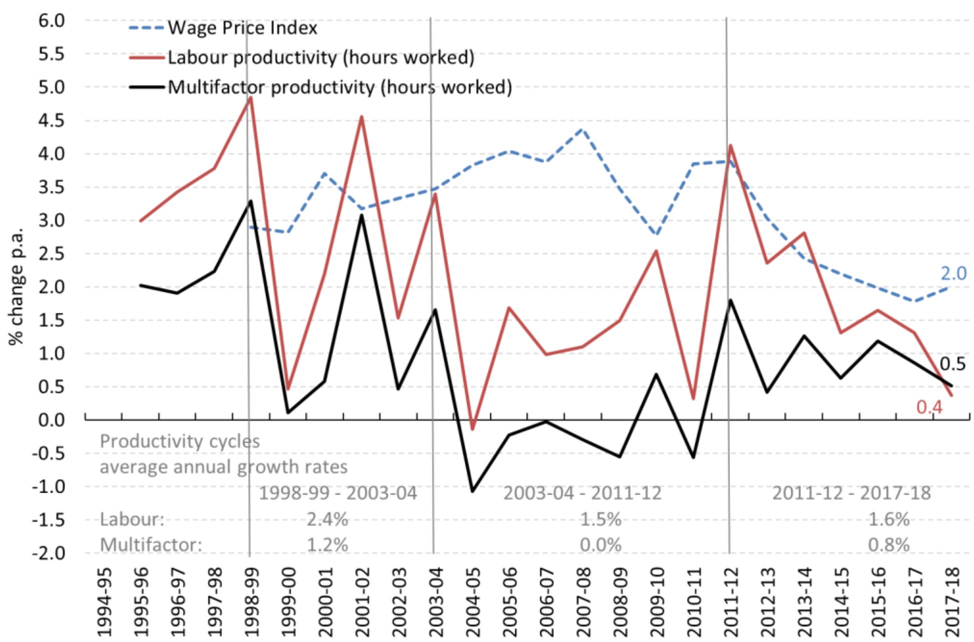
2.10 Australian productivity growth is not improving

The single biggest challenge for the Australian economy at present is generating stronger rates of productivity growth than can, in turn, support stronger and more broad-based growth in real incomes. Productivity growth has remained unusually – and on many counts surprisingly – weak in Australia this century, despite being slightly stronger than in many other advanced economies.

The ABS estimates that over the current productivity cycle (2011-12 to 2016-18), labour productivity change (in the market sectors for which estimates are available and on an hours worked basis) has improved by an average of 1.6% p.a., up slightly from 1.5% p.a. on average in the previous cycle. Most recently however, productivity change has decelerated markedly. In 2017-18, labour productivity improved by 0.4% p.a. and multi-factor productivity improved by 0.5% p.a. (chart 38). On a quality-adjusted hours worked basis, market-sector labour productivity improved by an annual average of 1.0% p.a. since 2003-04, which is half the average rate of improvement from 1998-99 to 2003-04 (the previous cycle identified by the ABS). In the most recent year for which 'quality-adjusted hours worked' estimates are available, labour productivity in the market sectors declined by 0.2% p.a. while multi-factor productivity improved by just 0.2% p.a. (chart 39).

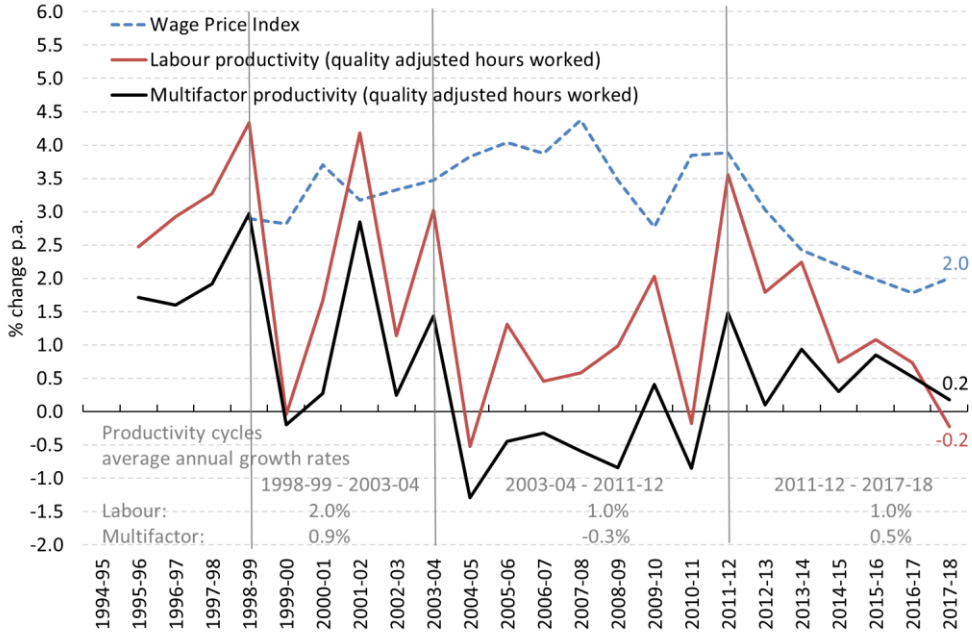
Looking specifically at the market-sector industries in which minimum wage workers are often employed (and therefore abstracting from factors that affect national productivity trends but might not be relevant to these sectors, such as capital investment in mining and utilities), annual average labour productivity growth has been significantly weaker in every sector with the exception of 'administrative services' in the latest (incomplete) productivity growth cycle and since 2003-04 than it was in the cycle from 1998-99 to 2003-04 (chart 40). These trends do not lend themselves to stronger real income increases in these industries, for either businesses (profits) or workers (wages).

Chart 38: Productivity growth estimates and private sector WPI: hours worked basis, market sectors



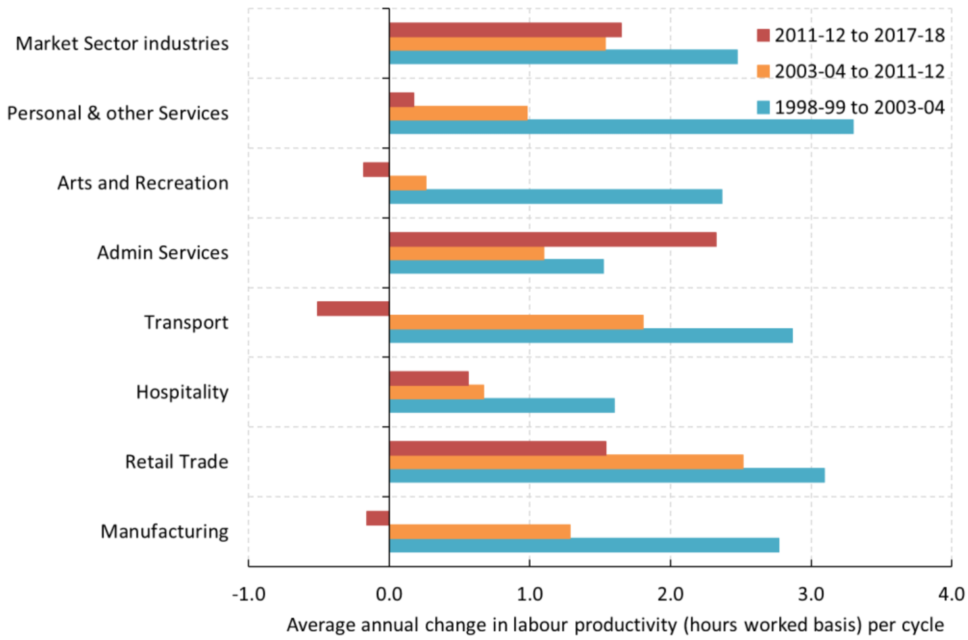
Source: ABS *estimates of productivity 2017-18*, Dec 2018 and ABS wage price index, Dec 2018.

Chart 39: Productivity growth estimates and private sector WPI: quality adjusted hours worked basis, market sectors



Source: ABS *estimates of productivity 2017-18*, Dec 2018 and ABS wage price index, Dec 2018.

Chart 40: Labour productivity changes*, selected 'low wage' market industries



* annual average change in labour productivity, hours worked basis, for productivity growth cycle periods identified by the ABS. Source: ABS, *Estimates of industry multifactor productivity, 2017-18,* Dec 2018.

2.11 Australia is 'expensive', less competitive internationally

Australia's global competitiveness received a boost through 2018 from a sustained drop in the trading range for the Australian dollar to values below its long-run average of around 75 US cents. This drop was influenced by external factors including lower global commodity prices, rising perceptions of global risk as well as rising US interest rates and bond returns relative to Australia's during 2018. In Q1 of 2019, the Australian dollar moved lower still (to around 71 US cents in early March). Recovering commodity prices could push the Australian dollar higher later in the year.

Looking past the effects of movements in the dollar, the World Economic Forum (WEF) ranked Australia as the 14th most competitive business environment in 2018 in its (revised) annual Global Competitiveness Report, up one place since 2017. Australia scored 78.9 points out of a possible 100 points in 2018, up slightly from 78.2 points in 2017. This suggests a modest improvement in Australia's absolute competitive performance (the score) as well as its relative performance (the rank). Australia's ranking of the 14th most competitive economy in 2018 continues to lag behind Canada (12th), the UK (8th), the US (1st) and Singapore (2nd) but ahead of New Zealand (18th).

In the WEF's 12 'pillars' of performance, Australia shared top spot with 31 other countries for 'macroeconomic stability' and obtained a near perfect score for public health. Australia also obtained high scores for the size and stability of the national financial system and for national workforce skills (based on average education attainment, literacy rates and other metrics). Compared to 2017, the WEF results for 2018 indicate Australia's performance deteriorated most notably in infrastructure (transport, communications and energy). This was balanced out by improvements in ICT adoption, product markets and innovation capability (chart 41).

Australia's lowest scores are in the pillars for 'labour market' and 'innovation capability'. Australia's innovation capability score is almost 20 points below that of best-ranking Germany, and Australia is ranked 18th for this 'innovation' pillar. Relatively poor labour market scores and rankings for Australia in the WEF global competitiveness index reflect Australia's continued use of centralised wage-setting arrangements through national minimum wage setting and industry awards. These tend to get lower scores than enterprise and individual agreements, due to their lack of flexibility for individual workers and businesses. Australia also scores relatively poorly in the labour market pillar due to lower gender diversity across industries and occupations and (related to this) larger gender wage gaps than in other countries.

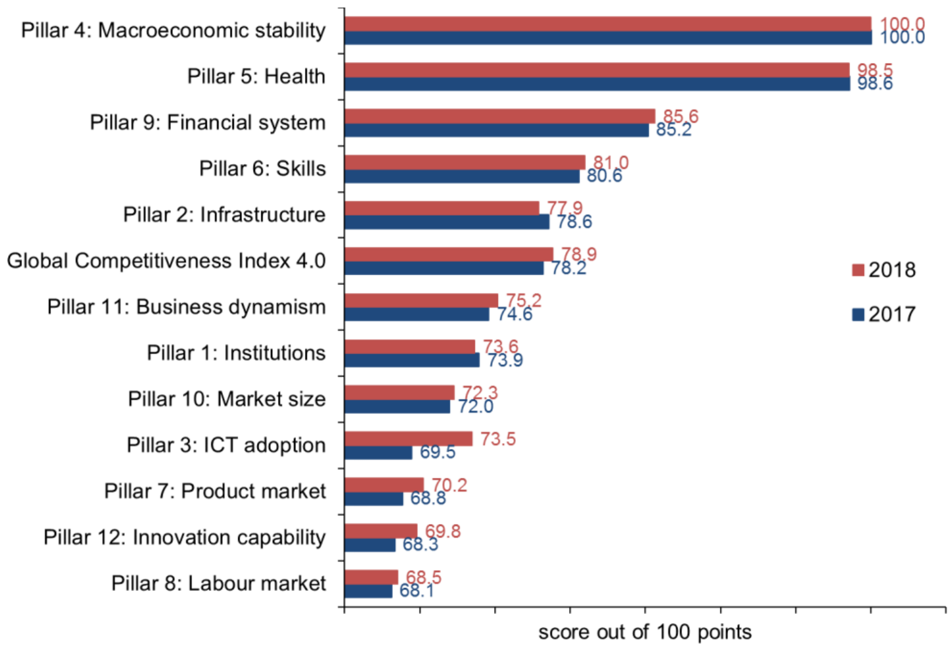
These rankings are echoed in the OECD's latest assessment of Australia's economic, personal and community well-being (chart 42). In December 2018 the OECD concluded that Australia ranks highest for 'health status' and 'civic engagement' (due to compulsory voting and other metrics) with a lower score for 'personal security' (due to perceptions of urban safety) and 'work-life balance' (due to the proportions of the workforce working very long or very short hours and various indicators of work-life flexibilities). In summary, the OECD concluded that "life is good" in Australia:

> "Australia's long span of positive output growth continues, demonstrating the economy's resilience to shocks. The labour market has been equally resilient, with rising employment and labour-force participation. Life is good, with high levels of well being, including health, and education. …Scores are

favourable on many other indicators of well-being. Australia scores particularly well in health status, ranking first among OECD countries with life expectancy of 82.5 years compared with an OECD average of 80.1 years and a high score in self-reported health. It also scores well in terms of air pollution, ranking 5th in the OECD, subjective well being and social connections (both 7th place in the rankings). Immigration has played a fundamental role in the demographic, economic and cultural development of Australia, and continues to do so with broadly successful integration."

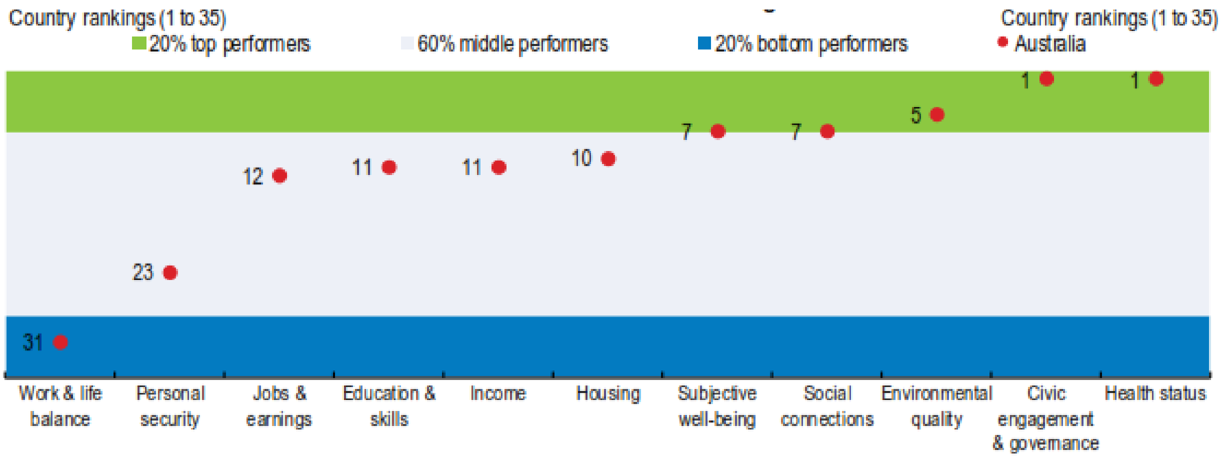
In response, the OECD recommends Australian policy priorities should focus on "improving framework conditions for businesses and strengthen competition [by] building capacity for productivity growth", including in transport, ICT and infrastructure. (OECD 2018, Reform Agenda)

Chart 41: Australia's Competitiveness in 2017 And 2018: The WEF Index & 12 'Pillars'



Source: WEF October 2018, *Global Competitiveness Report 2018*.

Chart 42: Australia's ranking on OECD indicators of national well-being, 2018



Source: OECD 2018, *OECD Economic Surveys: Australia*. December 2018.

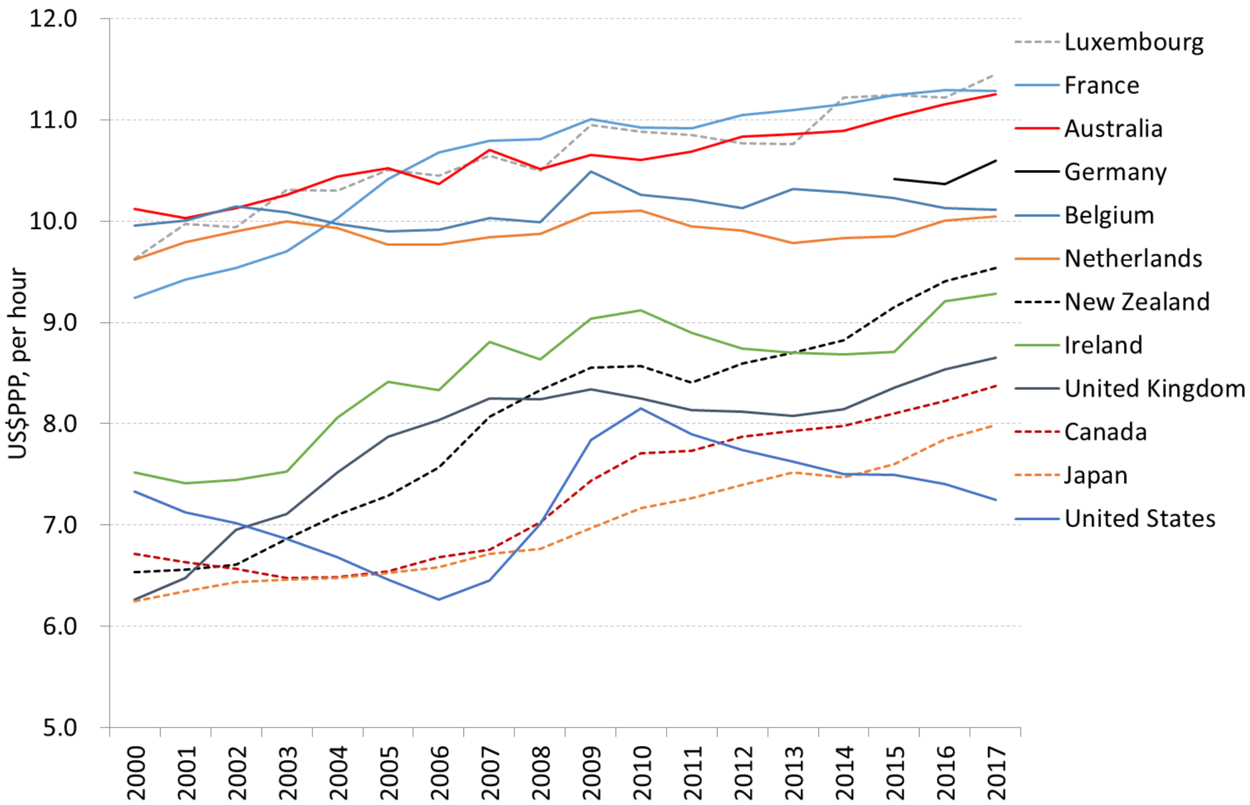
Neither the WEF global competitiveness indexes nor the OECD national well-being indexes (nor the World Bank's influential 'Doing Business' annual reports) compare direct business costs or labour costs across countries as part of their assessment of 'competitiveness'.

Cost comparisons can change markedly over time due to fluctuations in exchange rates, purchasing power and relative living costs across countries. To address this issue, the OECD compares wage rates using 'purchasing power parity' (PPP) rates instead of current or average exchange rates. This method takes into account local 'spending power'.

On this basis, Australia continues to track at the highest end of global labour costs. As of 2017, Australia's minimum wage was the second highest globally, among countries that have a national minimum wage. It was equal with France and behind only the tiny principality of Luxembourg (see Chart 43). Since then, Australia's minimum wage has risen by a further 3.5% (on 1 July 2018).

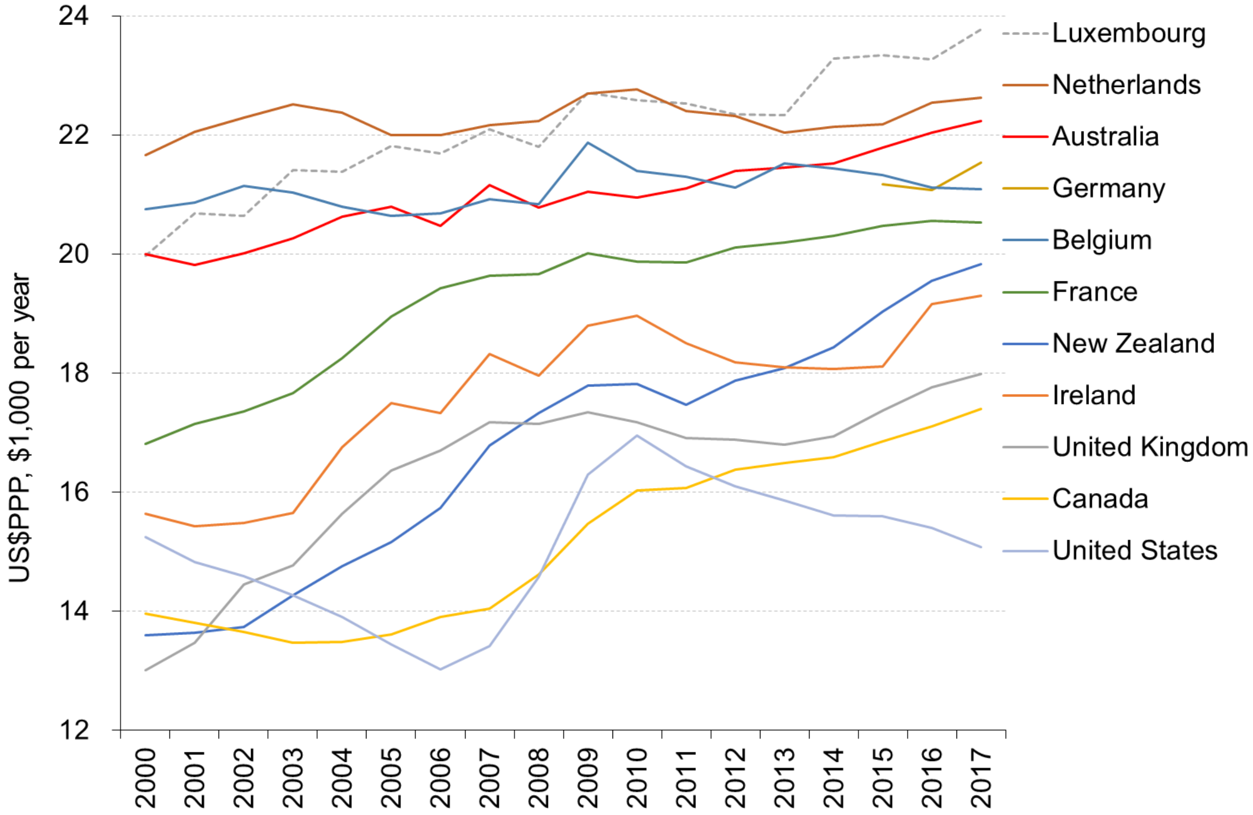
For minimum wage workers who are employed full-time, the annual minimum pay in Australia in 2017 was below only the Netherlands and Luxembourg, on a US dollar PPP basis. It was well above the annual full-time minimum wages paid in Germany, Belgium, France, Japan, South Korea and all of the English-speaking countries with whom Australia competes and trades for the provision of goods and services (chart 44).

Chart 43: Real Minimum Wages per hour, 2017 Constant Dollars, USD PPP



Source: OECD Employment and Labour Market Statistics database, www.oecd-ilibrary.org/

Chart 44: Real Minimum Wages per year, 2017 Constant Dollars, USD PPP



Source: OECD Employment and Labour Market Statistics database, www.oecd-ilibrary.org/

2.12 Weak outlook for Australian economy in 2019 and beyond

Australia's economic outlook has deteriorated rapidly over the past six months. Almost every piece of data released in 2019 to date has confirmed that Australia is now on a slower growth path. The national labour market has proved relatively resilient, but employment growth, unemployment rates and underemployment rates differ significantly across sectors and locations; job vacancies are declining and many of the industries that employ low-wage workers are already looking vulnerable.

In its latest assessment of the Australian economy, the RBA (*Statement on Monetary Policy*, Feb 2019) acknowledged this very recent 'softness' in Australian economic indicators. In response to this deceleration, the RBA revised down its forecasts for Australian GDP and inflation for 2019 and 2020. Australian GDP growth will be 3.0% p.a. or slower for the forseeable future. For 2018-19, the RBA now expects GDP to grow by just 2.5% p.a. (previously 3.25%) and in 2019-20 it expects GDP to grow by 2.75% (previously 3.25%) (table 10). This suggests no material improvement in growth from here, and little improvement on the average annual GDP growth rate of 2.6% over the decade to 2018. In March the OECD also downgraded its expectations for global economic growth and trade (again), including its expectations for future growth in Australia and its major Asian trade partners.

The RBA says the risk of even slower growth in 2019 and 2020 is rising because:

- GDP growth in Australia's major trading partners (China and Japan) is projected to moderate, as is growth across all of the major advanced economies. Ongoing trade tensions between the US and some of its key trading partners have already lowered the outlook for global trade and remain a significant downside risk;
- weaker-than-expected consumption growth and slower growth in Australian household income, despite accommodative monetary policy and tighter labour market conditions;
- falling housing prices could affect household decision-making (the so-called 'wealth-effect');
- a lower starting point for farm output, exports and income and for expected growth in these farm measures, primarily due to the drought and climate impacts;
- lower activity, employment and income for companies and unincorporated businesses involved in the residential building sector, as dwelling investment volumes decline;
- possible declines in global LNG and iron ore prices which could see the terms of trade – and hence national income – fall, despite increases in the volumes being produced and exported;
- currently strong support from public sector infrastructure construction activity will peak and then begin to decline after 2020, as the large pipeline of projects is reduced and completed;

For the labour market, the RBA says "*employment growth will remain above growth in the working-age population over the next six months. Further out, employment growth has been revised down marginally, consistent with the downward revision to GDP growth. The participation rate is expected to increase further, encouraged by strong labour market conditions*."

Table 10: Latest Full-year Growth Rates and Australian Government Forecasts

RBA SoMP (Feb 2018)	**Jun 17 e**	**Jun 18 e**	**Jun 19 f**	**Jun 20 f**	**Jun 21 f**	
GDP, % change p.a., year end	1.8	3.1	2.5	2.75	2.75	
Unemployment rate, %, year end	5.6	5.4	5.0	5.0	4.75	
Inflation (CPI), % change p.a., year end	1.9	2.1	1.75	2.0	2.25	
Treasury MYEFO 2018-19 (Dec 2018)	**2016-17 e**	**2017-18 e**	**18-19 f**	**19-20 f**	**20-21 p**	**21-22 p**
GDP, % change p.a., year average	2.1	2.8	2.75	3.0	3.0	3.0
Household consumption, % p.a., year average	2.6	2.8	2.5	3.0		
Dwelling investment, % p.a., year average	2.8	0.1	1.0	-4.0		
Business investment, % p.a., year average	-4.0	6.0	1.0	5.0		
Employment growth, % p.a., year end	1.9	2.7	1.75	1.75	1.5	1.5
Unemployment rate, %, year end	5.6	5.4	5.0	5.0	5.0	5.0
Inflation (CPI), % change p.a., year end	1.9	2.1	2.0	2.25	2.5	2.5
Wages (WPI), % change p.a., year end	1.9	2.1	2.5	3.0	3.5	3.5
Terms of trade, % change p.a., year end	14.4	1.9	1.25	-6.0		

f = forecast. p = projection. Sources: ABS data; RBA *SoMP*, Feb 2019; Australian Treasury, *MYEFO 2018-19*, Dec 2018.

3. Statutory considerations

The Expert Panel is required to conduct each Annual Wage Review in accordance with the *Fair Work Act 2009* (FW Act).

In previous Annual Wage Reviews, a number of important observations have been made by the Panel in respect of the manner in which it is to carry out its statutory task, including:

1. The following legislative provisions are particularly relevant: the object of the FW Act in section 3; the modern awards objective in subsection 134(1); and the minimum wages objective in subsection 284(1).

2. There are differences in the expression of the economic considerations that the Expert Panel is required to take into account under the modern awards objective and the minimum wages objective. But the underlying intention of the various economic considerations referred to in ss 134 and 284 is that the Panel takes into account the effect of its decisions on national economic prosperity and in so doing gives particular emphasis to the economic indicators specifically mentioned in the relevant statutory provisions.[2]

3. The Expert Panel's task is to consider relevant statutory matters in the context of the prevailing economic and social environment.[3]

4. No particular primacy is to be given to any of the specific factors that the Expert Panel must take into account.[4]

5. The relative living standards of employees are affected by the level of wages that they earn, the hours they work, tax-transfer payments and the circumstances of the households in which they live. It is therefore necessary to have regard to a range of measures of the relative living standards of the low paid and the household circumstances in which they live.[5]

6. In determining the award wage increases that would be consistent with the need to provide a 'fair and relevant safety net of terms and conditions'[6] (s.134), fairness is to be assessed

[2] *Annual Wage Review Decision 2017-2018*, [10].

[3] *Annual Wage Review 2015-2016 Decision*, [4].

[4] *Annual Wage Review 2016-2017 Decision*, [129].

[5] *Annual Wage Review 2015-2016 Decision*, [397].

[6] s.134 of the FW Act.

from the perspective of both employees and employers, and the term 'relevant' is intended to convey that modern awards should be suited to contemporary circumstances.[7]

7. Even though the 'need to encourage collective bargaining' is not an element of the minimum wages objective, this is an important consideration for the Expert Panel because it is an element of the modern awards objective.[8]

8. While the statutory provisions relating to the Annual Wage Review are properly characterised as 'remedial or beneficial provisions', the extent to which they are to be given 'a fair, large and liberal' interpretation in pursuit of that broad purpose is constrained by the fact that the relevant provisions seek to strike a balance between competing interests.[9]

9. The considerations which the Expert Panel is required to take into account do not generally set a particular standard against which a modern award or the 'safety net of fair minimum wages' can be evaluated; many of them may be characterised as broad social objectives.[10]

10. The range of considerations the Expert Panel is required to take into account calls for the exercise of broad judgment rather than a mechanistic or decision rule approach to wage fixation. It is on this basis that past Review decisions have rejected proposals for the adoption of real wage maintenance; a medium term target for the NMW; and the variation of modern award minimum wages based on trends in market wages.[11]

11. Broadly speaking, differently constituted Expert Panels should evaluate the evidence and submissions before them in accordance with a consistent and stable interpretation of the legislative framework. Justice requires consistent decision making unless a difference can be articulated and applied.[12]

12. As part of its decision-making process, the Expert Panel must first form a view about the proposed increase to the NMW and then take that proposal into account in exercising its powers to vary award minimum wages.[13]

13. There is no justification to increase the NMW by a higher rate than modern award minimum wages. To do so would create a significant risk of disemployment effects—thus putting low-paid workers at risk of unemployment and poverty. Nor would it be fair to

---

[7] *Annual Wage Review 2016-2017 Decision*, [123] – [125].

[8] *Annual Wage Review 2015-2016 Decision*, [519].

[9] *Annual Wage Review 2016-2017 Decision*, [142].

[10] *Annual Wage Review Decision 2017-2018*, [15].

[11] *Annual Wage Review Decision 2017-2018*, [44].

[12] *Annual Wage Review Decision 2017-2018* [58].

[13] *Annual Wage Review 2015-2016 Decision*, [5].

those on higher modern award minimum wages as it would erode the recognition of their higher skill and relative 'work value.'[14]

4. A fair and relevant safety net

The Expert Panel is tasked with determining and maintaining a fair and relevant safety net for employees working in Australia.

Clearly fairness in this context should consider not just the rates of minimum wages paid to employees but also the amount of work available at different wage rates. It is the combination of these that determines individuals' income from wages. The Panel should be mindful of the unfairness that would arise when an increase in minimum wages resulted in lower quantities of work available particularly for the most vulnerable members of the workforce (relative to the levels that would have been the case in the absence of the wage rise or in the event of a smaller wage rise).

In a dynamic labour market, fairness in the determination and maintenance of a fair and relevant safety net for employees should, in addition to existing employees, also consider potential employees whose opportunities of finding work would be reduced as minimum wages rise. This applies to potential new entrants to the labour force; people actively looking for work; and people who, because of their experience of not being able to find a job, have been discouraged from actively looking for work.

It is instructive to note[15] that the employment growth of around 295,000 in the year between January 2018 and January 2019 was associated with generally moderate growth in wages. While this is clearly a positive outcome it is considerably less than the employment growth of approximately 409,000 in the previous year. This slower growth of employment has meant that rates of unemployment and underemployment have fallen by less than they would have fallen had job creation continued at the same rate as it had in the year to January 2018. Thus, the rate of unemployment fell from 5.5% to 5.1% (trend data) in the year to January and the underemployment rate which fell from 8.5% to 8.3% over the same period still remains at close to historic highs.

According to the latest ABS Labour Force data:[16]

- The unemployment rate is 5.1 per cent and the number of active jobseekers stands at 680,100 (which is only 5.7% fewer than a year earlier).
- In January 2019, the number of underemployed people was 1,109,300 - a reduction of merely 1.1% on a year earlier.

[14] *Annual Wage Review Decision 2017-2018,* [105].

[15] The data in this paragraph are trend data drawn from ABS 6202 *Labour Force Australia*, February 2019.

[16] The data below are trend data drawn from ABS 6202.0, *Labour Force Australia*, February 2019.

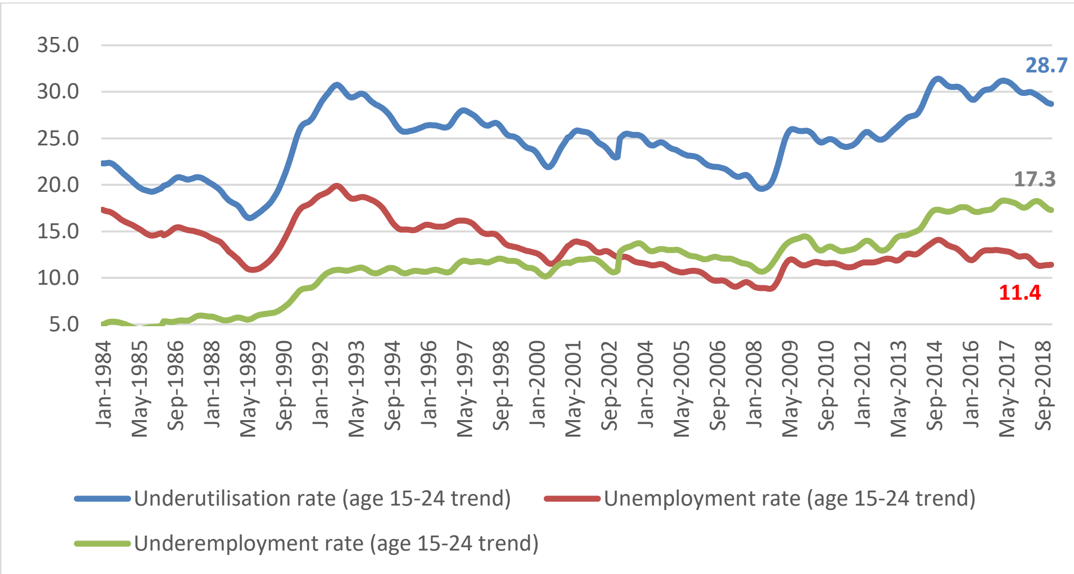
- The labour force underutilisation rate, which is a broader measure of underutilisation than either the unemployment rate or the underemployment rate stood at 13.3 per cent of the workforce in January 2019. This rate is less than seven 10ths of a percentage point lower than it was a year earlier.

- In January 2019 one in every 7.5 people in the workforce were either unemployed or underemployed.

Particular note should be made of the extent of youth unemployment, underemployment and underutilisation. Recent ABS data show that for each measure, labour market outcomes are more than twice as bad for people aged between 15 and 24 than they are for the workforce as a whole. The latest ABS data (for January 2019) are included in Chart xx. The underutilisation rate of 28.7% means that, for 15 to 24 year olds, close to one in every 3.5 members of the labour force are either unemployed or underemployed.

While this rate has edged down somewhat, it remains at roughly the same level as it attained at the peak of the last Australian recession. Were labour market outcomes to deteriorate over the course of 2019, youth unemployment and underemployment would, in all likelihood, grow from this already high base.

Chart 45: Youth Unemployment, Underemployment and Underutilisation (%)
January 1984 – January 2019



Source: ABS, 6202.0 *Labour Force Australia*, February 2019, Table 22.

In short, notwithstanding the strong, though slower, employment growth over the previous year, there remains considerable underutilisation of the Australian labour force. And what is true of the workforce as a whole is twice as bad for people in the 15-24 age group. There are clear risks in this environment that a high increase in minimum wage rates would slow employment growth and contribute to a reversal of the all-too modest recent inroads into labour force underutilisation.

With the Australian economy slowing, and with growing expectations of sluggish growth in the period ahead, these risks are higher than has been the case in recent years. The risks could be eased if the Expert Panel were to award a moderate increase in minimum wage rates as proposed in this submission.

5. Relative living standards and the needs of the low paid

The FW Act charges the Fair Work Commission with establishing and maintaining a safety net of minimum wages, taking into account, among other things, questions relating to 'relative living standards and the needs of the low paid.'

Relative living standards and the needs of the low paid are shaped by a very wide variety of factors. These include wage rates, availability of work, hours worked, continuity of employment and the family/household situation of low paid employees. They are also shaped by individuals' and households' access to the broader social safety net which, in addition to the public health and education systems, the public-funding of childcare, public assistance in relation to housing and also includes Australia's well-developed and highly-progressive income tax and transfer systems.

In this section we draw on Fair Work Commission research to reinforce the growing importance of underemployment in considerations in relation to the needs of the low paid; we highlight key findings of a recent Productivity Commission Report on inequality and we examine some of the implications of that Report for how relative standards of living can be assessed; we draw the Panel's attention to the latest ABS measures of redistribution, inequality and changes in inequality in Australia; and we examine the impact on low-wage earners of personal income tax changes announced in the 2018 Budget.

High underemployment and the needs of the low paid

In our Annual Wage Review submissions of the past few years, we have emphasised the significance of the high incidence of underemployment in Australia. We have suggested that high levels of underemployment are clearly relevant to both relative living standards and the needs of the low paid employees whose opportunities to find additional hours of work are at risk of being diminished if minimum wage rates rise to deter employers from offering additional hours of work.

The increased importance of underemployment in overall underutilisation is supported in FWC Research Report 1/2019 *Developments in wages growth,* which looked at the slower pace of nominal wages growth in recent years and in particular at the apparent break in the historical relationship between wages growth and rates of unemployment (pp.31-33).

This relationship is often captured by the Phillips Curve which, traditionally, has recorded more pressure on wages growth as unemployment falls. The Research Report notes that in recent years nominal wage outcomes have been lower than would be expected at prevailing rates of unemployment. However, the Research Report also finds that when broader measures of spare capacity in the labour market (rather than just the rate of unemployment) are taken into account, recent levels of nominal wages growth are much less suggestive of a break in the traditional relationship between nominal wages growth and spare capacity in the labour market (this is illustrated starkly in Chart 6.1 FWC Research Report 1/2019 *Developments in wages growth,* p. 32).

What this analysis suggests is that over the past five or so years the rate of underemployment (and by extension the rate of underutilisation) rather than the rate of unemployment has become more closely associated with the pace of nominal wages growth that the market can bear than was previously the case. On reflection this makes considerable sense because of the increased incidence of underemployment (and the growing share of underutilisation that is accounted for by underemployment). While underemployment has been rising in relative terms for well over two decades, in the past five or so years, the Australian labour market appears to have passed a tipping point where it now the case that underemployment rather than unemployment is the more relevant indicator of labour market outcomes.

The increased importance of underemployment is clearly very relevant in considering the impacts of changes in nominal wage rates on labour market outcomes and on the needs of low paid employees. It suggests very strongly that the key sensitivity to consider is the impact of changes in wage rates on the of hours of work available to part-time employees.

With an underemployment rate currently at 8.3 per cent of the overall workforce (and 8.7 per cent of employed persons), underemployment remains at recession-like levels and large increases in nominal wage rates carries the risk of reducing hours of work available in the market and dampening the market incomes of part-time employees (relative to the levels that would prevail if more modest wage rises were granted).

Relative living standards

In August 2018 the Productivity Commission (PC) released its important report *Rising Inequality; A Stocktake of the Evidence*. The PC report is an insightful rethinking of inequality, its numerous dimensions, its measurement and its interactions with social and economic mobility over time and with areas of entrenched disadvantage.

While considerable value would be added to the way the Panel looks at relative living standards by a thorough examination of the PC report, the key findings of Chapter 3 of the Report “Income and consumption inequality” are particularly relevant in the context of a widespread misconception of rapidly worsening inequality in Australia over recent years. These key findings (from p.37) are reproduced below.

- “Income inequality has increased modestly since the late 1980s, but the extent of the increase is contested, and since the global financial crisis the trend indicates a slight decline.
- Most developed countries have also experienced rising income inequality, and at a faster pace than in Australia.

  - Australia's level of inequality is close to the OECD country average.
  - The fact that inequality levels are so different among developed countries hints at the scope for policies, institutions and political environments to shape inequality.
- Unlike some other developed countries, Australia had relatively strong growth in incomes across all deciles. However, the sources of income growth (capital, labour and transfers) have fluctuated in ways that sometimes favoured those on high incomes and sometimes favoured those on low incomes, affecting 'point in time' measures of inequality.
  - In Australia, the increase in inequality occurred during the mining boom, an era that favoured high-income earners and capital income.
- More generally, when the economy was strong, all age groups benefited from higher income growth and when the economy was weak, all age groups endured lower income growth. But at different times, some age groups have benefited more or less than others.
  - Most recently, young people's incomes have grown relatively slowly. On average, however, each new generation has earned more income than the last at a given age, and reaches the same level of income earlier in life.
- Part of income inequality is also explained by life cycle effects.
  - People are most likely to have high household disposable income late in their working lives. This is when their labour earnings peak, their accumulated assets increase capital earnings and their children start earning income or leave home.
- Australia's progressive income tax and highly targeted transfer system has a powerful equalising effect on household incomes.
  - On average, income tax and transfers reduce income inequality by about one third.
  - Redistributive tax policies can, however, also have unintended negative consequences on economic efficiency, for example, by encouraging a reduction in labour supply.
- While income is usually given prominence in debates about inequality, consumption is a better measure as it contributes more directly to wellbeing.
  - Inequality of private consumption is only slightly lower than that of disposable income, but once in-kind government transfers (such as education and healthcare are accounted for, final consumption inequality is 30 per cent lower than that of disposable income.
- The benefits of in-kind transfers are also felt over time. They can open the door to greater opportunities, lift future incomes and in this way bear on future inequality."

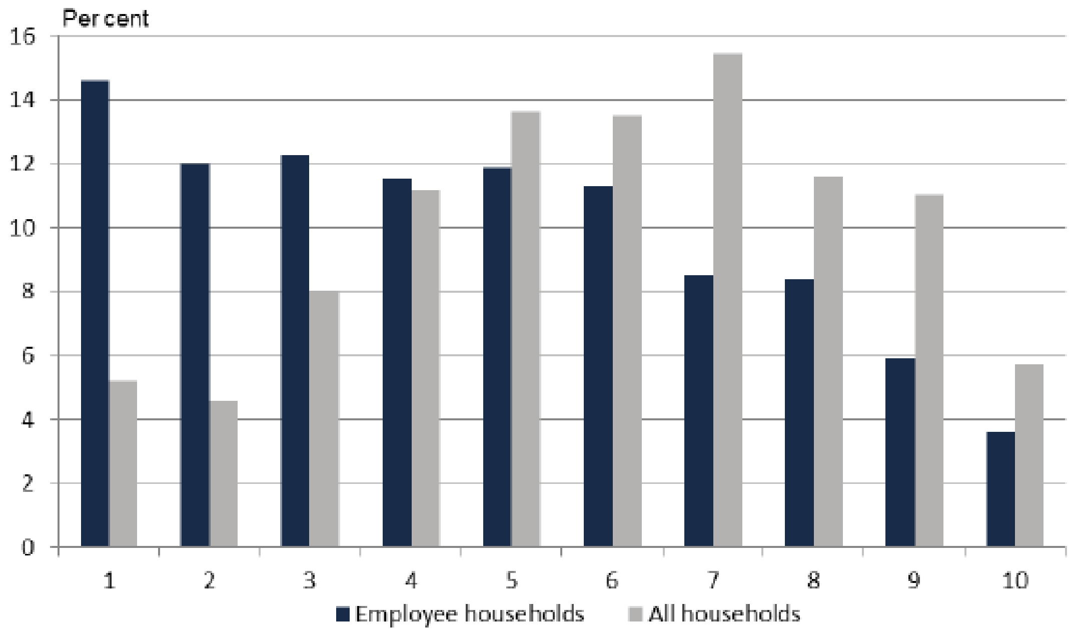
At an early point in the PC Report the following observation is made (p.2):

> "Among the various forces acting on inequality and poverty, the one constant that matters is having a job."

It is a point that resonates throughout the PC report not the least because the majority of those with the lowest relative standards of living are in households in which there is no person in employment. This can include aged people, single-parent families with younger children and households where its members are not in employment including (but not limited to) for health reasons.

A population-wide view on relative living standards is clearly broader than the view obtained if only relative living standards among employee households are taken into account. This can be highlighted with reference to Chart 3.1 at paragraph [275] in the *Annual Wage Review 2017-18 Decision*. This is reproduced below.

Chart 46: Distribution of low-paid employees across equivalised household disposable income for employee and all households, 2015–16



Source: FWC *Annual Wage Review 2017-18 Decision*, [275]

In the broader context of Australia's relative living standards, it is instructive to note that:

- Over 57 per cent of low-paid employees live in households in the top half of the income distribution;

- A low-paid person is considerably more likely to live in a household in the top three income deciles than in the bottom three income deciles (in 2015-16 28.5 per cent of low-paid employees lived in top-three income decile households compared with the 17.6 per cent of low-paid people lived in bottom-three income decile households).

Ai Group maintains that this broader conception of relative living standards provides an important perspective on the impacts of adjustments to wages paid to low-paid employees on relative living standards in Australia. Tellingly, most of such adjustments benefit the top half of Australia's income distribution and more rich households benefit than poor households.

These insights call into question the ability of minimum wage decisions to reduce inequality in Australia, whatever their other merits. They also point to the need for a reconsideration of the utility of assessing the impact of minimum wage adjustments on relative living standards in Australia with reference only to those households with at least one employee member.

The PC Report highlights the importance of taking into account the full range of redistributive measures available to Australian households in considering inequality or relative living standards in June 2018, the ABS released its latest report recording the impacts of redistribution on Australian households.[17]

Like the PC, the ABS found that the distribution of income across households becomes more equal once the impacts of government benefits and taxation have been taken into consideration.

The report calculated Gini coefficients for the distribution of equivalised private household income, equivalised gross household income, equivalised disposable household income with and without social transfers in kind and equivalised final household income. According to the Report, in 2015-16, the Gini coefficient reduced from 0.442 for equivalised private household income to 0.249 for equivalised final household once the impact of benefits and taxes was taken into consideration.

Critically, it concluded that:

> "There has been no change in inequality, either before or after the allocation of government benefits and taxes between 2009-10 and 2015-16."

The key findings in relation to inequality and the change in inequality between 2003-04 and 2015-16 are reproduced below in table 11.

Table 11: Gini Coefficient by Equivalised Income(a)

	2003-04	2009-10	2015-16	Change from 2009-10 to 2015-16
	no.	no.	no.	%
Equivalised private household income	0.434	0.446	0.442	-0.9%
Equivalised gross household income	0.335	0.357	0.361	1.1%
Equivalised disposable household income	0.292	0.320	0.316	-1.3%
Equivalised disposable household income including social transfers in kind	0.217	0.243	0.241	-0.8%
Equivalised final household income	0.228	0.252	0.249	-1.2%

(a) Net imputed rent for owner occupied dwellings and subsidised housing is included in all estimates of income. Government benefits for housing are allocated as part of social transfers in kind.

Source ABS; 6537.0 - *Government Benefits, Taxes and Household Income, Australia*, 2015-16, June 2018.

[17] ABS 6537.0 - *Government Benefits, Taxes and Household Income, Australia*, 2015-16, 20 June 2018.

Changes in personal income tax arrangements

Changes in income tax arrangements applied in respect of income earned in the 2018-19 year. These were announced in the 2018 Budget and subsequently legislated. In its decision last year (at [291]-[291]) the Expert Panel noted that the changes had not been legislated at that time and that one of the changes would not be payable until the close of the 2018-19 financial year. As a result, the Panel decided not to take these changes into account in its 2018 decision.

The legislated changes applying to income earned in the 2018-19 year are an increase in the threshold at which the 37 per cent tax bracket cuts in (an increase from $87,000 to $90,000) and the introduction of a new tax offset – the Low and Middle Income Tax Offset (LAMITO). While many low wage earners live in households that have benefited from the change in the threshold, the new tax offset is more directly relevant to low wage earners in general.

In the remainder of this section, the impacts of the introduction of LAMITO are explored in depth. In summary, LAMITO delivers material increases in the disposable incomes of low and middle-income wage earners. The LAMITO delivers larger increases in post-tax incomes than would be delivered by the same dollar increase in the NMW.

While the impacts vary across low and middle-income groups, the increase in disposable income for a person earning the current NMW of $719.20 a week is 0.63 per cent which equates to a change in pre-tax income of 0.83 per cent. This is a material impact and should be taken into account in the determination of the change in the NMW.

The LAMITO reduces the income tax payable on 2018-19 low and middle-income earners' income by up to $530.

- For people earning a taxable income of up to $37,000, the maximum offset available is $200.
- Between $37,000 and $48,000, the LAMITO increases (at a rate of 3 cents for each dollar above $37,000) to the $530 maximum level.
- The $530 amount applies up to incomes of $90,000 after which it reduces (at a rate of 1.5 cents per dollar above $90,000).
- The LAMITO ceases to be available to people on incomes above $125,333.
- The LAMITO is not refundable so the maximum available is the amount that reduces income tax payable to zero.

Table 12 below summarises the impacts of the new income tax arrangements for a range of income earners. For example, as shown in the row in bold font, for a single person working full time and earning the national minimum wage of $719.20 per week (or $37,499 annualised), the introduction of the LAMITO has:

- Lifted annual disposable income by $214.97 – an increase in disposable income of 0.63 per cent.

- More relevantly for purposes of comparison, given the marginal tax rate at this level of income of 31 per cent, this equates to a lift in pre-tax income of $311.55 – an increase of 0.83 per cent.

The equivalent increase in pre-tax income delivered by the change in tax arrangements are higher than the impacts on disposable income because an increase in pre-tax income (for example as might be delivered by an increase in the NMW) is subject to tax.

Table 11: Illustrative[1] Impacts of Low and Middle-Income Tax Offset (LAMITO)

% of NMW	Pre-tax income		LAMITO	Tax payable	Disposable income after LAMITO	Change in disposable income due to LAMITO		Marginal Tax Rate	Equivalent increase in pre-tax income	
%	$ per week	$ pa	$pa	$pa	$pa	$pa	%	%	$pa	%
50	359.60	18,750	200.00	0	18,750	0.00	0.00	0	0.00	0.00
53	381.86	19,910	200.00	0	19,910	0.00	0.00	0	0.00	0.00
60	431.86	22,517	200.00	175	22,342	200.00	0.90	19	246.91	1.10
67	481.86	25,124	200.00	671	24,454	200.00	0.82	19	246.91	0.98
86	619.20	32,285	200.00	2,031	30,254	200.00	0.67	19	246.91	0.76
93	669.20	34,892	200.00	2,526	32,366	200.00	0.62	19	246.91	0.71
100	**719.20**	**37,499**	**214.97**	**3,072**	**34,427**	**214.97**	**0.63**	**31**	**311.55**	**0.83**
107	769.20	40,106	293.18	3,880	36,226	293.18	0.82	31	424.90	1.06
114	819.20	42,713	371.39	4,688	38,025	371.39	0.99	31	538.25	1.26
133	956.54	49,874	530.00	6,964	42,910	530.00	1.25	34	803.03	1.61
150	1078.80	56,249	530.00	9,132	47,117	530.00	1.14	34	803.03	1.43
167	1201.06	62,623	530.00	11,299	51,324	530.00	1.04	34	803.03	1.28

1. The Impacts are illustrative in that they do not take into account that an individual is often a member of a household in which the net impacts of the LAMINTO and indeed other income tax changes may also affect living standards of household members; they rely on the annualization of weekly payments assuming the person is paid the same weekly amount for the full 52.14 weeks of the year; and they they do not include any income from other sources.

Two features of the impacts set out in table 11 can be highlighted.

- For income earners without a tax liability pre-LAMITO, the introduction of LAMITO has no impact on disposable income. Prior to the introduction of LAMITO the effective tax-free threshold for low-income earners was $20,542 due to the combination of the generally available tax-free threshold and the availability of the Low Income Tax Offset (LITO) which remains in place in the 2018-19 year.

  It is worth noting in this context that the same income earners who do not benefit from the introduction of the LAMITO will get higher proportional benefits from any increase in the NMW relative to taxpayers on higher incomes because the impact of rises in pre-tax incomes on disposable incomes will not be diluted by income taxation.

- The proportional impact of LAMITO on changes in disposable income depends on the amount of LAMITO for which the income earner is eligible and the level of their previous disposable income. Thus, for income earners eligible for the $200 level of the LAMITO, the higher proportional changes in disposable income are delivered to those with lower pre-LAMITO disposable incomes. Similarly, for income earners eligible for the $530 level of the LAMITO, the higher proportional changes in disposable income are also delivered to those with lower pre-LAMITO disposable incomes.

6. Promoting social inclusion through increased workforce participation

The FW Act charges the Fair Work Commission with establishing and maintaining a safety net of minimum wages, which requires consideration of, among other things, the objective of 'promoting social inclusion through increased workforce participation'.

As we have made clear in previous submissions, Ai Group recognises the importance of participation in the paid workforce for social inclusion. Participation in the paid workforce can be closely linked to individuals' sense of self-worth and it can signal the contributions people make to the well-being of the broader community. In addition, of course, participation in paid work can provide the financial means by which people can participate in many aspects of social life.

It is sometimes suggested that raising minimum wage rates is a means by which social inclusion can be promoted by encouraging people to participate in the workforce (or to lift their participation in the workforce from existing levels). However, as we have argued in previous Annual Wage Review submissions, such encouragement would only have a positive impact on social inclusion if it leads to actual increases in participation in paid work.

As we have previously argued, lifting minimum wage rates may reduce participation in paid work (below the level that would otherwise apply) if, by making labour more costly, it reduced employers' demand for labour (again, relative to the levels of demand that would apply if wage rates were lower).

As discussed in section 2 above, while wage growth has been relatively low in historical terms, participation rates have been maintained at high rates over the past year. This is clear evidence that, at current wage rates, there are already strong incentives for people to look for work and that the extra participation is closely linked to the relative strength in demand for labour (and the prospects of finding a job).

Current levels of unemployment and underemployment indicate that there is still a considerable underutilisation of the labour available at current wage rates. With supply still exceeding demand in aggregate, there is certainly no need to lift minimum wage rates in order to unearth additional labour supply.

There is a very strong opportunity in the period ahead to further lift participation in paid work and the quantity of hours of work offered to existing members of the workforce by further encouraging strong demand for labour. Across the economy this encouragement will be best achieved by further moderate wages growth. For employees paid minimum rates, their greater participation in paid work and through this, their greater social inclusion, will be facilitated by a moderate increase in minimum wages rates as proposed in this submission.

7. Encouraging collective bargaining

The Expert Panel must take into account the need to encourage collective bargaining, as set out in s.134(1)(b) of the modern awards objective.

It is important that the level of increase in minimum wages awarded by the Panel does not limit the scope or motivation for bargaining over wages at the enterprise level. It is Ai Group's experience that the level of the minimum wage increase granted in the Annual Wage Review is a factor considered by employers and employees when deciding whether to pursue the making of an enterprise agreement; the higher the minimum wage increase granted by the Panel, the less likely an employer and its employees will seek an enterprise agreement.

For this reason, the level of any minimum wage increase should generally be set at a level that is lower than average annualized wage increases in enterprise agreements. On 20 December 2018, the Department of Jobs and Small Business released its report on *Trends in Federal Enterprise Bargaining* for the September 2018 quarter. The results are summarised in the following table.

Table 12: Average annualised wage increases (AAWI) in enterprise agreements – Agreements approved in the September 2018 quarter.

Industry Sector or Type of Agreement	AAWI (%) in September 2018	Change from June 2018 (%)
All sectors	3.2	+0.5
Private sector	3.0	+0.2
Public sector	3.4	+0.9
Manufacturing	2.7	+0.1
Retail trade	3.0	+0.1
Construction	5.9	Same
Accommodation and Food Services	3.8	+1.6
Mining	2.2	Same
Transport, Postal, Warehousing	2.6	- 0.1
Health and community services	3.9	+1.4
Union/s covered	3.2	+ 0.5
No Union/s covered	2.2	- 0.2

In last year's Annual Wage Review, the Panel gave consideration to the reasons why, over recent years, there has been a significant decline in the number of employees covered by collective agreements and a significant increase in award reliance. No firm conclusions were reached by the Panel on the reasons for this:

> "[94]...while we accept that there has been a decline in current enterprise agreement making, a range of factors impact on the propensity to engage in collective bargaining, many of which are unrelated to increases in the NMW and modern award minimum wages.
>
> [95] We are not persuaded that the gap between modern award minimum wages and bargained wages, to the extent it can be identified with any precision, has reached a level where it is encouraging or discouraging collective bargaining.
>
> [96] We maintain the view expressed in past Review decisions that given the complexity of factors which may contribute to decision making about whether or not to bargain, we are unable to predict the precise impact of our decision. We cannot be satisfied that the increase we have determined will encourage collective bargaining and this is a factor to be weighed along with the other statutory considerations. However, we are also of the view that it is likely that the increase we have determined in this Review will impact on different sectors in different ways and will not, in aggregate, discourage collective bargaining."[18]

There is no doubt that numerous employers are very frustrated with the enterprise agreement making process due to the fact that it has become a technical "minefield", and that this has contributed to a marked decline in the number of enterprise agreements. The enactment of the *Fair Work Amendment (Repeal of 4 Yearly Reviews and Other Measures) Act 2018* will assist in overcoming some of the problems

We agree with the view expressed by the Expert Panel in the 2016-2017 Annual Wage Review that there are many complex factors that may contribute to decisions of employers and employees about whether or not to bargain.[19]

8. The principle of equal remuneration for work of equal or comparable value

Subsection 284(1) of the FW Act set out the minimum wages objective, which the Expert Panel is required to consider when setting minimum wages. Paragraph (d) of the objective requires the Panel to turn its mind to "*the principle of equal remuneration for work of equal or comparable value"*, a principle which is included within the modern awards objective at s.134(1)(e) of the Act.

Ai Group supports the principle of equal remuneration for work of equal value and the importance of improving gender equality in the workplace. We have been a vocal advocate for realistic, practical and targeted measures to eliminate the causes of gender inequality in the workplace.

[18] *Annual Wage Review 2017–2018 Decision*, [94]-[96].

[19] *Annual Wage Review 2016-2017 Decision*, [634]-[637].

In the *Annual Wage Review 2017-2018 Decision*, the Expert Panel acknowledged the applicability of the definition of 'equal remuneration' in s.302(2) of the Act for the purposes of ss.134 and 284 and that hence, the correct approach to the construction of ss.134(1)(e) and 284(1)(d) is to read the definition into the substantive provision. As such, the consideration is to be read: "the principle of equal remuneration for men and women workers for work of equal or comparable value".[20] The Expert Panel also accepted that the expression 'work of equal or comparable value' refers to equality or comparability in 'work value.[21]

In the *Annual Wage Review 2017-2018 Decision*, the Panel observed that:

- The application of the principle of equal remuneration for work of equal or comparable value is such that it is likely to be of only limited relevance in the context of a Review. Indeed it would only be likely to arise if it were contended that particular modern award minimum wage rates were inconsistent with the principle of equal remuneration for work of equal or comparable value; or, if the form of a proposed increase enlivened the principle.[22]

- Review proceedings are of limited utility in addressing any systemic gender undervaluation of work. Proceedings under Part 2-7 and applications to vary modern award minimum wages for 'work value reasons' pursuant to ss.156(3) and 157(2) provide more appropriate mechanisms for addressing such issues.[23]

- The broader issue of gender pay equity, in particular the gender pay gap is relevant to the Review as it is an element of the requirement to establish a safety net that is 'fair.'[24]

- The issue of gender pay equity may arise for consideration in respect of s.284(1)(b), because it may have effects on female participation in the workforce.[25]

- The causes of the gender pay gap are complex and influenced by factors such as: differences in the types of jobs performed by men and women; discretionary payments; workplace structures and practices; and the historical undervaluation of female work and female-dominated occupations.[26]

- Moderate increases in the NMW and modern award minimum wages would be likely to have a relatively small, but nonetheless beneficial, effect on the gender pay gap.[27]

---

[20] *Annual Wage Review 2017-2018 Decision*, [33].

[21] *Annual Wage Review 2017-2018 Decision*, [34].

[22] *Annual Wage Review 2017-2018 Decision*, [35].

[23] *Annual Wage Review 2017-2018 Decision*, [35].

[24] *Annual Wage Review 2017-2018 Decision*, [36].

[25] *Annual Wage Review 2017-2018 Decision*, [36].

[26] *Annual Wage Review 2017-2018 Decision*, [38].

[27] *Annual Wage Review 2017-2018 Decision*, [38].

When the above observations are considered, it is evident that the increase that Ai Group has proposed in this submission is consistent with the principle of equal remuneration for work of equal or comparable value.

9. Penalty Rates Decision

On 23 February 2017, a Full Bench of the Fair Work Commission issued the *4 Yearly Review of Modern Awards - Penalty Rates Decision.*[28] The Decision:

- adjusts Sunday penalty rates in the *Fast Food Industry Award 2010*, the *General Retail Industry Award 2010*, the *Hospitality Industry (General) Award 2010*, and the *Pharmacy Industry Award 2010*; and

- adjusts public holiday penalty rates in the above awards and in the *Restaurant Industry Award 2010*.

The Full Bench determined that the existing Sunday penalty rates in the four relevant modern awards did not achieve the modern awards objective, as they did not provide for a fair and relevant safety net. The statutory considerations required of the Expert Panel in the current proceedings were considered by the Full Bench in the *Penalty Rates Decision*, including: the objects of the FW Act (s.3); the modern awards objective (s.134); and the minimum wages objective (s.284).

The *Penalty Rates Decision* applies only to a small number of awards in the hospitality and retail industries. In this regard, the Full Bench said:

> [76] It is important to appreciate that the conclusions we have reached in relation to the weekend and public holiday penalty rates in the Hospitality and Retail Awards is largely based on the circumstances relating to these particular awards. The Hospitality and Retail sectors have a number of characteristics which distinguish them from other industries.

The adjustments to Sunday penalty rates in the relevant awards are being phased-in over 3-4 years. The first two increments are currently operative. The next increment will be operative from 1 July 2019. Even though the *timing* of the adjustments has been sensibly aligned with the operative date of any minimum wage increase in Annual Wage Review decisions, it would be inappropriate for the *quantum* of any minimum wage increase to be any higher as a result of the *Penalty Rates Decision*. This would negate the intended beneficial effects of the *Penalty Rates Decision* in the relevant industries. This would also be unfair to businesses in other industries that have not received the benefit of adjusted penalty rates.

In this regard, we note the following observations of the Expert Panel in the *Annual Wage Review 2017-2018 Decision*:

> "The *Penalty Rates* decision provides for the phased reduction of Sunday penalty rates in certain awards in the hospitality and retail sectors which will reduce the employment costs of some employers covered by the modern awards affected by the decision. We note that there have also been other

[28] [2017] FWCFB 1001.

changes to modern awards that have increased employment costs. It is not appropriate to take account all of these matters in some quantifiable or mechanistic way to support a particular outcome in the Review. But these matters form part of the broad context in which the Review is conducted and are relevant considerations."[29]

10. Minimum wages for adults

In setting minimum wages this year, Ai Group proposes a 2% wage increase for all classifications. This equates to an increase of about $14.40 per week in the National Minimum Wage and about $16.75 per week at the base trade level.

The proposed minimum wage increase takes into account the following factors:

1. The Australian economy moved back into the slow lane in the second half of 2018 and looks set to stay there for some time. While employment has been strong in recent years and is still holding up, deceleration is evident in business conditions, confidence, building approvals, retail sales, car sales and most crucially, job vacancies. Company insolvencies increased through late 2018 in the construction, retail and hospitality industries.

2. Businesses are struggling to cope with high and rising input costs, especially energy costs. Also, productivity growth is weak nationally and in industries with mainly low-wage employees.

3. Inflation remains weak which means that even a small rise in the minimum wage will deliver a real increase in household spending power.

4. The single biggest challenge for the Australian economy at present is generating stronger rates of productivity growth than can, in turn, support stronger and more broad-based growth in real incomes. Productivity growth has remained weak in Australia this century.

5. Low wage employees have benefited from tax changes introduced in last year's federal Budget. The Low and Middle Income Tax Offset has increased disposable incomes for many low wage earners. While the impacts vary across low and middle-income groups, the increase in disposable income for a person earning the current National Minimum Wage of $719.20 a week is 0.63 per cent which equates to a change in pre-tax income of $6 per week which is nearly 1% (0.83 per cent).

6. An excessive increase would reduce the job security of low paid workers and would reduce employment opportunities for the unemployed and underemployed.

7. Global competitiveness is a key risk for Australian businesses. Australia already has one of the highest national minimum wage rates in the world, and most Australian workers are entitled to minimum award wage rates that are higher than the National Minimum Wage.

[29] *Annual Wage Review 2017-2018 Decision*, [93]

8. The minimum wage increases awarded by the Expert Panel in the last two Annual Wage Reviews (3.3% and 3.5% respectively) were exceptionally high and out of step with overall wage movements and economic settings. It is essential that the increase awarded by the Panel this year is much more modest.

9. The need to provide a fair and relevant safety net;

10. The relative living standards and the needs of the low paid;

11. The promotion of social inclusion through increased workforce participation;

12. The need to encourage collective bargaining; and

13. The principal of equal remuneration for work of equal or comparable value.

When all of the above factors are taken into account and weighed up, it can be seen that a 2.0% minimum wage increase is appropriate.

11. Modern award wages for junior employees, employees to whom training arrangements apply, employees with disability and pieceworkers

Consistent with previous Annual Wage Review decisions:

- The minimum wage rate resulting from this year's Annual Wage Review should flow through to the minimum award wages of junior employees, employees to whom training arrangements apply, employees with disability and pieceworkers, through the operation of award provisions relating to these employees.

- The minimum weekly payment in the Supported Wage System Schedule of awards should be adjusted to reflect any increase to the disability pension's income free threshold. This is consistent with the Panel's decisions in previous years.

12. Special national minimum wages for award / agreement free employees with disability (Special National Minimum Wage 1 and 2)

In its *Annual Wage Review 2017-2018 Decision,* the Expert Panel decided to maintain the approach it had adopted in previous years in respect of setting special minimum wages for award / agreement free employees with disability.[30]

[30] *Annual Wage Review Decision 2017-2018*, [478].

This approach is twofold. For employees, whose productivity is not affected, a special national minimum wage is set at the level of the National Minimum Wage (Special National Minimum Wage 1) and for employees whose productivity is affected a special national minimum wage is paid in accordance with an assessment under the supported wage system (Special National Minimum Wage 2).

Ai Group supports the continuation of the existing structures for award / agreement free employees with disability in the *National Minimum Wage Order 2019.*

13. Special national minimum wages for award / agreement free junior employees (Special National Minimum Wage 3)

In its *Annual Wage Review 2010-2011* decision, the Expert Panel decided to use the scale in the *Miscellaneous Award 2010* to set the special national minimum wage for award/agreement free junior employees. The Panel has followed this approach in subsequent Annual Wage Review decisions.

This approach remains appropriate for setting rates for award/agreement free junior employees.

14. Special national minimum wages for award / agreement free apprentices (Special National Minimum Wage 4)

In its *Annual Wage Review 2013-2014 Decision*, the Expert Panel reached the following conclusions and decision on special national minimum wages for award / agreement free apprentices, consistent with Ai Group's submissions:

> "**[613]** We have decided to adopt the provisions of the *Miscellaneous Award 2010* as the basis for the special national minimum wages for employees to whom training arrangements apply. The national minimum wage order will incorporate, by reference, the apprentice and NTWS provisions of that award.
>
> **[614]** We also accept Ai Group's submission that the adult apprentice national minimum wage in the order should now be set in accordance with the *Miscellaneous Award 2010* which, since 1 January 2014, has specified a rate for adult apprentices…."

The Panel adopted this approach in subsequent annual wage reviews, including the *2017-2018 Annual Wage Review*.[31] Consistent with the above conclusions of the Panel, and its decision last year, the wage rates for apprentices in the *Miscellaneous Award 2010* should be adopted for the purposes of the *National Minimum Wage Order 2019*.

15. Special national minimum wages for award / agreement free employees to whom a training arrangement applies who are not apprentices (Special National Minimum Wage 5)

In the *National Minimum Wage Order 2012*, the Expert Panel decided to adopt the minimum wage rates in the National Training Wage Schedule of the *Miscellaneous Award 2010* for the special national minimum wage for award / agreement free employees to whom training arrangements apply, other than apprentices. The Panel adopted the same approach in its subsequent Annual Wage Review decisions.

Ai Group supports the continuation of the above approach in the *National Minimum Wage Order 2019*.

16. Casual loadings in modern awards

Paragraphs 285(2)(a)(i) and 284(3)(b) of the FW Act requires that the Expert Panel review casual loadings in modern awards.

In the *Metal Industry Casual Employment Case*,[32] a Full Bench of the Australian Industrial Relations Commission (**AIRC**) decided to increase the casual loading in the *Metal, Engineering and Associated Industries Award 1998* from 20% to 25%.

After the *Metal Industry Casual Employment Decision* was handed down, the 25% quantum flowed into many other awards. During the Award Modernisation process in 2008-09, the Award Modernisation Full Bench of the AIRC in the *Priority Stage Award Modernisation Decision*[33] relevantly said: (emphasis added)

> "**Types of employment**
>
> **[47]** In our statement of 12 September 2008 we indicated that we intended to adopt a standard loading of 25 per cent for casual employees. We received many representations in relation to that indication.

---

[31] *Annual Wage Review Decision 2017-2018*, [477].

[32] Print T4991, 29 December 2000.

[33] [2008] AIRCFB 1000

For example, a number of employer representatives submitted that we should not adopt a standard casual loading or that if we did so 25 per cent was too high.

[48] There is great variation in the casual loadings in NAPSAs and federal awards. In some cases the situation is complicated by the fact that casuals receive an annual leave payment, usually through an additional loading of one twelfth, although in most cases casuals do not receive annual leave payments. To take some examples, a casual loading of 25 per cent is common throughout the manufacturing industry, casual loadings in the retail industry vary from 15 per cent to 25 per cent. A loading of 25 per cent is very common, although not universal, throughout the hospitality industry. A number of pre-reform awards currently provide for a 33⅓ per cent loading and higher when the annual leave payment is taken into account. It seems to us to be desirable to standardise provisions to apply to casuals where it is practicable to do so to avoid claims in the future based on unjustified differences in loadings. We appreciate that there are casual employees in some industries in some States receiving loadings less than 25 per cent and we understand that employers of those employees will experience an increase in labour costs if the loading is standardised to 25 per cent. Equally, there will be reductions in labour costs where the loading, including the annual leave loading where it applies, exceeds 25 per cent currently.

[49] <u>In 2000 a Full Bench of this Commission considered the level of the casual loading in the *Metal, Engineering and Associated Industries Award 1998* (the Metal industry award). The Bench increased the casual loading in the award to 25 per cent. The decision contains full reasons for adopting a loading at that level. The same loading was later adopted by Full Benches in the pastoral industry. It has also been adopted in a number of other awards. Although the decisions in these cases were based on the circumstances of the industries concerned, we consider that the reasoning in that case is generally sound and that the 25 per cent loading is sufficiently common to qualify as a minimum standard</u>.

[50] <u>In all the circumstances we have decided to confirm our earlier indication that we would adopt a standard casual loading of 25 per cent. We make it clear that the loading will compensate for annual leave and there will be no additional payment in that respect</u>. Also, as a general rule, where penalties apply the penalties and the casual loading are both to be calculated on the ordinary time rate."

The current standard casual loading in modern awards of 25 per cent is already relatively high and should not be increased.

17. Casual loading in the Business Equipment Award

The Expert Panel in its *Annual Wage Review 2015-16* decision at paragraphs [638] to [640] determined that the casual loading in the *Business Equipment Award 2010* (**Award**) should be increased from 20 per cent to 25 per cent incrementally over the course of five years, commencing 1 July 2016.

We do not oppose the casual loading in the Award being increased to 24 per cent as of 1 July 2019, consistent with the phasing-in approach determined by the Expert Panel in 2016.[34]

[34] *Annual Wage Review 2015-2016 Decision*, [637].

18. Casual loading for award / agreement free employees

Paragraph 294(1)(c) of the FW Act requires that the Expert Panel set the casual loading for award / agreement free employees.

The casual loading in the *National Minimum Wage Order 2018* is 25 per cent, and a similar loading should be reflected in the *National Minimum Wage Order 2019*.

19. Copied State awards

Ai Group does not oppose the provisional view expressed by the Expert Panel in its decision issued on 4 January 2018[35] and confirmed in the *Annual Wage Review 2017-2018 Decision*, that Annual Wage Review adjustments should generally apply to copied State awards.

The Expert Panel's position is explained in the following extracts from the *Annual Wage Review 2017-2018 Decision:*

> "**[444]** The method for adjusting wages in copied State awards was the subject of a decision by the Panel issued on 4 January 2018. In that decision, the Panel expressed the following provisional view:
>
> > 'It is our *provisional view* that AWR adjustments should generally apply to copied State awards, subject to a different outcome being determined in respect of particular copied State awards. In other words, rather than seeking to apply a tiered approach as a decision rule to mitigate 'double dipping' we propose to address any 'double dipping' on a case by case basis. We invite submissions on our *provisional* view in the context of the 2017–18 Review proceedings.'
>
> - - -
>
> **[452]** We confirm the *provisional* view expressed in our decision of 4 January 2018. The adjustment to the rates in modern awards that we have determined in this Review will be applied to copied State awards."

The default period of operation for a copied State award is 5 years.[36] A copied State award is taken to include the same terms as were in the original State award immediately before the transferring employee's termination time.

Depending upon when a particular copied State award came into operation, applying the Annual Wage Review adjustment unaltered to the copied State award may be inappropriate in a particular case. State Wage Cases will not always result in an immediate adjustment to the minimum rates of pay in all awards in the relevant State. For example, on 18 December 2018, orders were made by the Industrial Relations Commission of New South Wales to vary the *Transport Industry (State) Award* (NSW) to reflect 2.5% increases made in the State Wage Cases for 2016, 2017 and 2018.[37] As

[35] [2018] FWCFB 2 at [43].

[36] *Fair Work Act 2009* (Cth) s 768AO(2),

[37] Industrial Relations Commission of New South Wales, *Notice of Orders Made* (Case Number: 2018/00289568) – 19 December 2018.

a result, a significant increase was applied to the rates applicable in this award from the first full pay period on or after 16 December 2018.

Parties should retain the capacity to make submissions to the Expert Panel in any Annual Wage Review about the impacts associated with the timing or quantum of wage increases in a particular State award, that have flowed into a copied State award. The approach determined by the Expert Panel in the *Annual Wage Review 2017-2018 Decision* provides for this. Ai Group is not arguing for a different level of wage increase in any copied State awards in the current Annual Wage Review

20. Process for varying modern awards to reflect the Annual Wage Review Decision

In previous years, the Commission has issued draft Determinations and a draft National Minimum Wage Order following the Annual Wage Review Decision to allow interested parties, such as Ai Group, to check the Commission's calculations and provide feedback before the final Determinations and National Minimum Wage Order were published. Ai Group urges the Expert Panel to implement the same consultative approach in this Review.

A very large number of employers rely on industry organisations, such as Ai Group, to advise them of the wage rates and allowances payable under modern awards. Ai Group provides a specific information service on most modern awards and it is a huge task for our staff to check the draft Determinations, prepare written advice on each award and distribute the advice to thousands of employers.

Keeping this in mind, we urge the Commission to publish the final Determinations with as much lead-time as possible before 1 July 2019 to enable industry associations to advise employers and then for employers to make the necessary payroll adjustments.

There are substantial direct and administrative costs associated with back-paying wage and allowance increases.

21. The form of the National Minimum Wage Order 2019

In Ai Group's experience, the form of the *National Minimum Wage Order 2018* did not lead to any difficulties.

We suggest that the same model be used for the *National Minimum Wage Order 2019.*

22. Request to participate in final consultations

The Directions for the Annual Wage Review 2018-2019 state that parties wishing to participate in the final consultations are requested to express interest by 7 May 2019.

Ai Group hereby advises that it wishes to participate in the final consultations.

AUSTRALIAN INDUSTRY GROUP METROPOLITAN OFFICES
SYDNEY 51 Walker Street, North Sydney NSW 2060, PO Box 289, North Sydney NSW 2059
WESTERN SYDNEY Suite F, Level 1 Octagon Building ,110 George Street Parramatta NSW 2150
CANBERRA Ground Floor, 42 Macquarie St, Barton ACT 2600, PO Box 4986, Kingston ACT 2604
MELBOURNE Level 2, 441 St Kilda Road, Melbourne VIC 3004, PO Box 7622, Melbourne VIC 8004
BRISBANE 202 Boundary Street, Spring Hill QLD 4004, PO Box 128, Spring Hill QLD 4004
ADELAIDE Level 1, 45 Greenhill Road, Wayville SA 5034
PERTH Suite 1, Level 4, South Shore Centre, 85 South Perth Esplanade, South Perth WA 6151

REGIONAL OFFICES
ALBURY/WODONGA 560 David Street Albury NSW 2640
BALLARAT Suite 8, 106-110 Lydiard St South, Ballarat VIC 3350, PO Box 640, Ballarat VIC 3350
BENDIGO 87 Wills Street, Bendigo VIC 3550
NEWCASTLE Suite 1 "Nautilos", 265 Wharf Road, Newcastle 2300, PO Box 811, Newcastle NSW 2300
WOLLONGONG Level 1, 166 Keira Street, Wollongong NSW 2500, PO Box 891, Wollongong East NSW 2520

www.aigroup.com.au