Ai GROUP SUBMISSION

Fair Work Commission

Annual Wage Review 2021 – 2022

Reply Submission on National Accounts data for the March quarter 2022 and Conclusions of Professor Borland

3 June 2022

1. Introduction

On 1 April 2022, Ai Group filed its initial submission. On 10 May, we filed our reply submission and on 19 May 2022 we provided responses to questions which arose from consultations relating to the Annual Wage Review proceedings.

This submission makes some additional supplementary points concerning the National Accounts for the March Quarter 2022 and responds to the conclusions reached by Professor Borland in the Information Note published by the Commission on 26 May 2022.

We have also provided some updated information on various economic indicators referred to in our earlier submissions.

The latest economic data supports the awarding of a modest wage increase of **2.5**%, as proposed by Ai Group. This equates to an increase of about **$19.30 per week** in the National Minimum Wage (bringing it to $791.90 per week) and about **$22.50** at the base trade level. When the proposed 2.5% wage increase is considered alongside the **0.5% Superannuation Guarantee increase** that is operative from 1 July 2022 and the equivalent of a **1.3% increase in pre-tax income** that an employee on the NMW will receive in coming months as a result of the announced increase in the Low and Middle Income Tax Offset, our proposal would result in the equivalent of a **4.3% increase** in pre-tax remuneration for low paid employees.

As set out in our initial submission, we propose a delayed operative date for wage increases in relevant awards in the aviation and tourism sector, the accommodation and food services sector, the arts and recreation services sector and the retail trade sector, consistent with the approach in last year's Annual Wage Review decision. 'Exceptional circumstances' still exist in these industries, justifying a delayed operative date.

The ACTU has proposed a wage increase of 5.5%. Such an increase would add substantially to the risks of entrenching inflation and greater increases in interest rates. It would have adverse impacts on the economy, on unemployment, on underemployment and on sentiment, and would be a setback for many low-income households

2. ABS National Accounts in Q1 2022

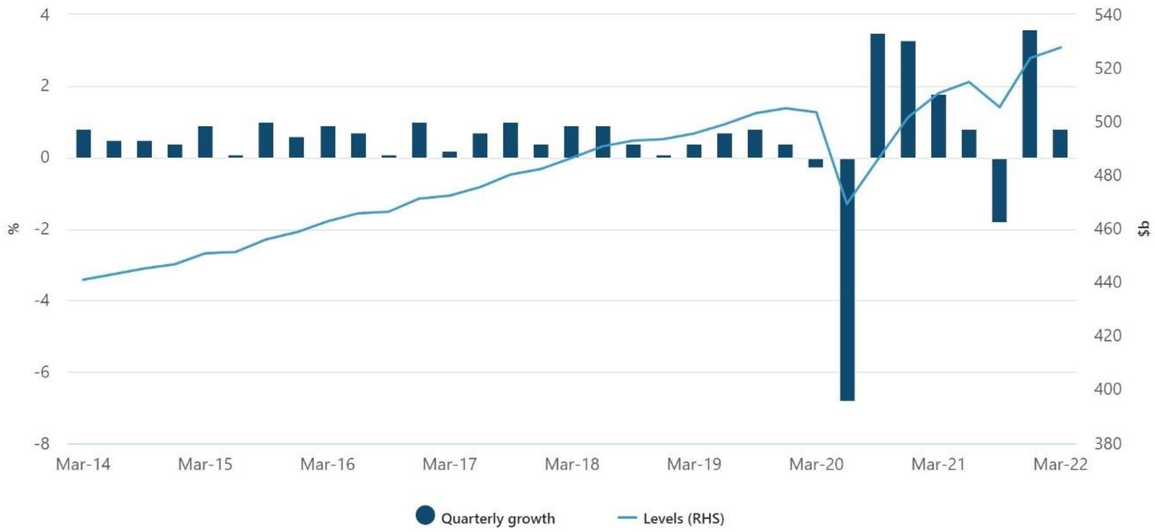
This section summarises points of relevance from the ABS National Accounts publication, published on 1 June 2022. It reports:

- an increase in GDP by 0.8% (seasonally adjusted chain volume measures);
- an increase in nominal GDP of 3.7%;
- a 3.7% increase in the terms of trade;
- a decrease in the household saving ratio from 13.4% to 11.4%; and

- June quarter national accounts are expected to continue to show volatility.

The increase in GDP of 0.8% in the march quarter comes after an increase of 3.6% in the December quarter, likely indicating a slowdown in Australia's economic recovery (chart 1).

Chart 1: Gross Domestic Product



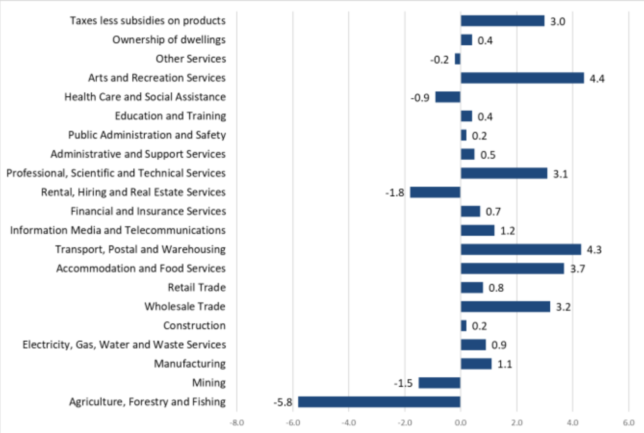
Source: Australian Bureau of Statistics, National Accounts, March Quarter

On an industry level, several industries witnessed falling production, including: Agriculture; Mining; Rental, Hiring, and Real Estate Services; Health Care and Social Assistance; and other services (chart 2).

Furthermore, while changes in all industry gross value added (GVA), gross operating surplus (GOS), and compensation of employees (COE) seem to indicate that there has been a converging of the ratio of GOS to GVA and COE to GVA (chart 3), i.e., both owners and employees likely benefit from increases in profits, further investigation reveals that in certain sectors, particularly retail and arts and recreation services, there has been a shift from GOS to COE (charts 4 and 5). A significant portion of increases in GOS are skewed towards the mining sector, with the change in mining sector GOS accounting for 102.4% of the economy-wide change in GOS over the last quarter by sector (including ownership of dwellings) (chart 6).

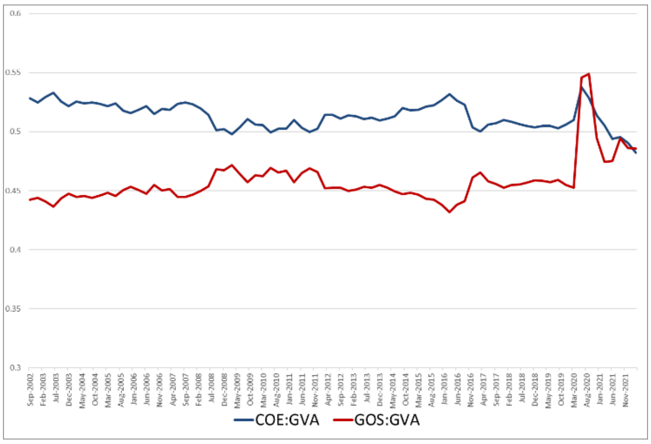
In addition, wage growth has largely been driven by the private sector (chart 7), indicating that the growth in wages is being fuelled by inflationary market pressures (i.e., labour shortages), as also evidenced by the growth in individual bargaining as the method of setting pay (chart 8).

Chart 2: Production changes by industry



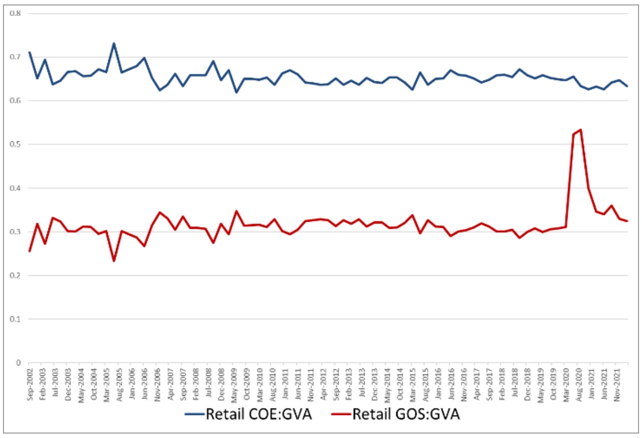
Source: Australian Bureau of Statistics, National Accounts, March Quarter.

Chart 3: Changes in COE and GOS vs. GVA



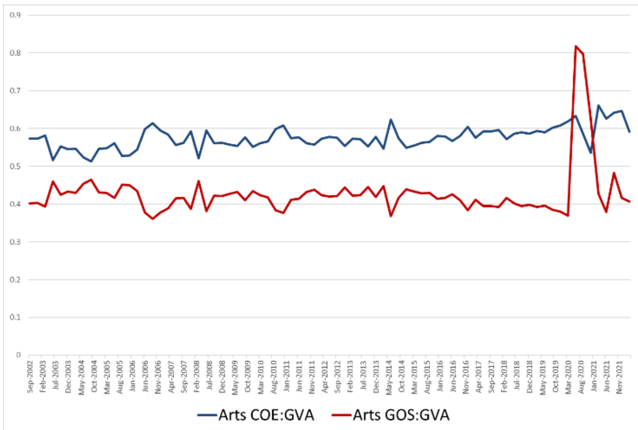
Source: Australian Bureau of Statistics, National Accounts, March Quarter.

Chart 4: Changes in COE and GOS vs. GVA in Retail



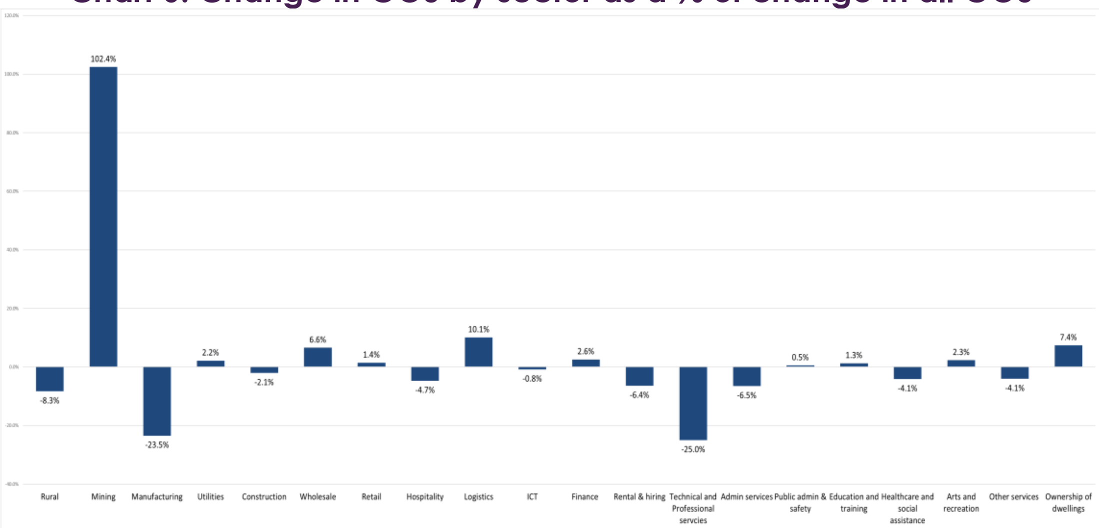
Source: Australian Bureau of Statistics, National Accounts, March Quarter.

Chart 5: Changes in COE and GOS vs. GVA in Arts and Recreation Services



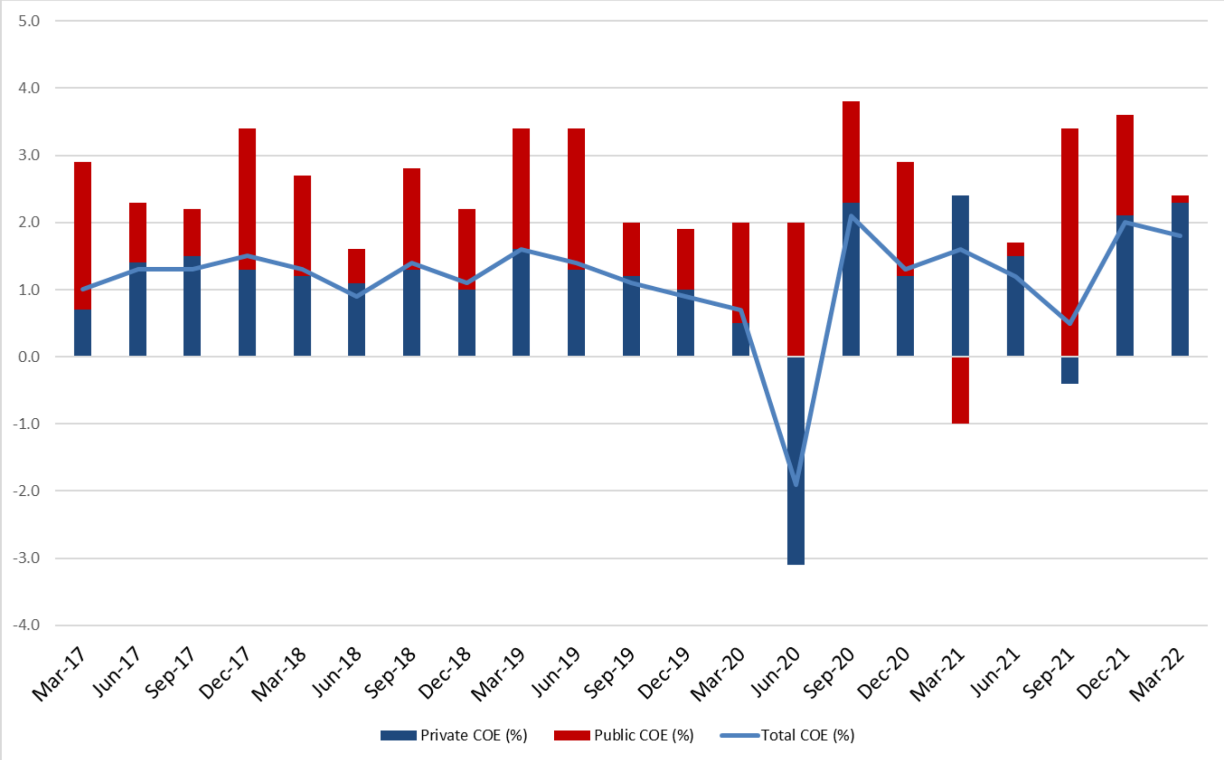
Source: Australian Bureau of Statistics, National Accounts, March Quarter.

Chart 6: Change in GOS by sector as a % of change in all GOS



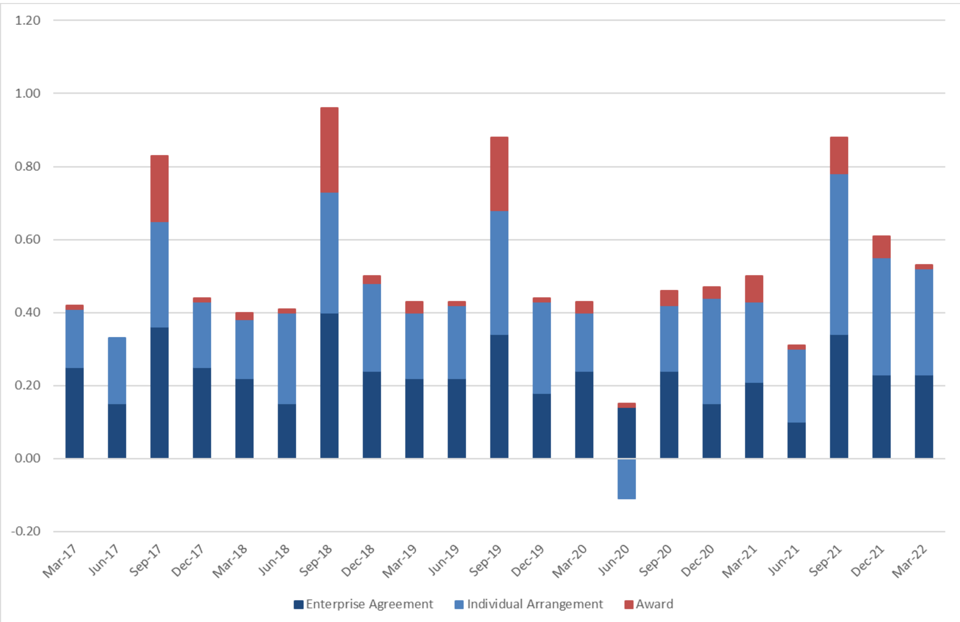
Source: Australian Bureau of Statistics, National Accounts, March Quarter

Chart 7: Quarterly growth in compensation of employees



Source: Australian Bureau of Statistics, National Accounts, March Quarter

Chart 8: Contributions to wage price index, by method of setting pay



Sources: ABS, Wage Price Index, March 2022

The aforementioned developments with regards to falling cash surpluses as a proportion of gross value added by industry (particularly in retail and arts and recreation services) indicate the worsening cash position of businesses and are representative of issues that businesses are facing with regards to supply chain crises, labour shortages, and extreme weather events. Such issues, if not resolved, will have greater long-term consequences for the Australian economy in the form of deterred/lagging private sector investment (i.e., falling reinvestments).

Considering the supply chain shortages, rising energy prices, stagnant profit growths, slowing increases in production, rising wages, labour shortages, and the fact that most of these inflationary pressures are structural and unlikely to dissipate in the foreseeable future, large wage increases are likely to have disemployment consequences for the economy. This is especially the case because the RBA will meet these inflationary pressures with increases in the cash rate, leading to increases in debt servicing costs for individuals and businesses, and other contractionary economic effects mentioned below.

3. Delayed operative date for increases in certain sectors

In Section 11.2 of our main submission, we argued that 'exceptional circumstances' continue to justify delayed operative dates for increases to modern award minimum wages in the following sectors:

- Aviation and tourism;
- Accommodation and food services;
- Arts and recreation;
- Retail trade

Supporting materials were provided which pertained to the relative state of employment and economic health of each sector.

The Information Note published by the Commission and annexed to the 26 May 2022 Statement concludes that of the sectors impacted by the present proceedings, only 'Transport, Postal and Warehousing' is in the 'lagging recovery' category and only two sectors, specifically 'Accommodation and Food Services' and 'Wholesale Trade', fall into the 'almost recovered' category.

Ai Group maintains that the delayed operative dates for minimum wage increases in the relevant sectors referred to in our 1 April 2022 submission are needed.

Aviation industry awards

The Information Note and Professor Borland's conclusions lend support to Ai Group's argument that delayed wage increases should be granted for the following modern industry awards in the transport industry:

- *Air Pilots Award 2020*
- *Aircraft Cabin Crew Award 2020*
- *Airline Operations – Ground Staff Award 2020*

- *Airport Employees Award 2020*

Awards in the accommodation and food services sector, the arts and recreation sector and the retail sector

With respect to the Accommodation and Food Services industry, the job and employment indicators in Table 1 of the Information Note suggest a 1.6% improvement in employment and a 1.1% increase in hours actually worked. However, the benchmark utilised for determining these increases are the relevant figures for the May quarter 2021. If the starting point utilised for this purpose is set prior to the onset of COVID-19 (the February quarter 2020), the following changes can be noted:

- There was a 3.8% drop in employment between the February quarter 2020 and the February quarter in 2022 (seasonally adjusted);[1]

- There was a 4% decrease in hours actually worked between the February quarter 2020 and the February quarter 2022 (original).[2]

The Information Note and Professor Borland's conclusions suggest that higher vacancy rates within an industry sector are indicative of recovery. For example, Table 3 provides (emphasis added):

- Accommodation and food services - Payroll jobs and business performance indicators are lower, however employment is higher and the change in the vacancy rate and wages growth are above average.;

- Arts and recreation services - Payroll jobs are higher and the change in the vacancy rate and wages growth are above average, however employment and profits are lower;

A higher vacancy rate than that which existed prior to the onset of the COVID-19 pandemic is not necessarily a sign of industry health. For the industries in relation to which Ai Group sought a delayed increase in modern award minimum wages, lower immigration levels have generated significant difficulties for employers in sourcing staff. Increasing cost pressures by allowing for a sudden increase in minimum rates of pay would likely expose enterprises in these sectors to significant difficulties in continuing their recovery. An existing labour and skills shortage is being exacerbated by increased labour mobility and turnover, thereby increasing competition for employees. This has no doubt contributed to the increase in the Wage Price Index (WPI) for all industries by 3.9% between the March quarter 2020 and the March quarter 2022.[3] The stronger bargaining position of employees in more recent times is further evinced by the increase in individual arrangements as the method of setting the rate of pay.

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[1] ABS, *Labour Force Survey, Australia, Detailed,* April 2022 (Table 4).

[2] ABS, *Labour Force Survey, Australia, Detailed,* April 2022 (Table 11).

[3] ABS, *Wage Price Index, Australia*, March 2022 (Table 1).

The high rates of job vacancies are indicative of larger structural issues around Australia's skill shortages which are being exacerbated by the aftermath of COVID border closures. This is particularly the case in sectors like retail and arts and recreation which engage a significant number of part-time and casual employees as well as award-dependent workers.

Despite growing vacancies, 97% of retail operators report they have sufficient staff levels (up from 82% in Feb 2022), meaning they are unlikely to increase the staff levels and the vacancies are aimed at replenishing staff levels affected by the high labour mobility and turnover that is characteristic of a tight labour market. Similarly, 86% of arts and recreation services operators say they have sufficient staff levels (up from 69% in Feb 2022). Given the ongoing labour shortages, it is also likely that individuals employed in retail and arts and recreation services have found employment in other sectors, either to obtain more regular working hours or, for example, in the case of students (who also form a large part of the retail workforce) to obtain more permanent roles in other sectors once they graduate. This would provide an explanation for the current high vacancy rates. Given the low levels of inbound migration and the historic low international student levels, it is likely that relevant sectors of the economy will continue to suffer from labour shortages.

The retail sector and the arts and recreation services sector are facing supply chain issues, rising labour costs, labour shortages, and other input cost pressures. Characterising them as recovered and discontinuing delayed increases in modern award minimum wages would be premature and would adversely affect business survival rates, inflationary pressures and, in the long-term, employment levels.

Delayed operative dates last year should be taken into account

Unless a delayed operative date is granted for those sectors which were granted a delayed operative date last year, employers will be required to pay two wage increases in close succession. The Panel highlighted the significance of this issue in the *Annual Wage Review 2019-20 Decision*:

> ***[192]*** *Finally, we also acknowledge that the different operative dates we have determined for the 3 award clusters may have implications for the timing of any variation in modern award minimum wages in the 2020–21 Review.*

We acknowledge that the mere fact that there was a delayed operative date for a wage increase in a particular modern award last year is insufficient for a finding that exceptional circumstances exist justifying a delayed operative date this year. However, this is one of the factors that should be taken into account in in determining whether an operative date of 1 July 2022 would cause hardship for employers covered by particular awards.

4. Further economic considerations

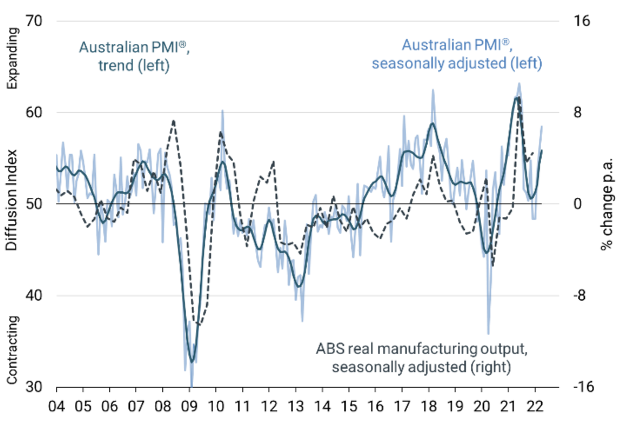
Updates to Ai Group business performance measures

In this section we summarise some insights into the state of the Australian economy as provided by the most recent releases of Ai Group's business performance indices.

- The Australian Industry Group Australian Performance of Manufacturing Index (Australian PMI®) (charts 9 and 10) moderated by 6.1 points to 52.4 points in May (seasonally adjusted). This indicates a slowdown in expansion in the sector, however, the measure is above its long-term average of 59.1 points. More importantly, the index for average wages increased by 7.9 points to 74.8 points (almost 50% above the long-term average), which is the highest the measure has ever been, indicating increasing wage cost pressures. Businesses also report facing extensive cost pressures from energy input prices and supply chain issues.

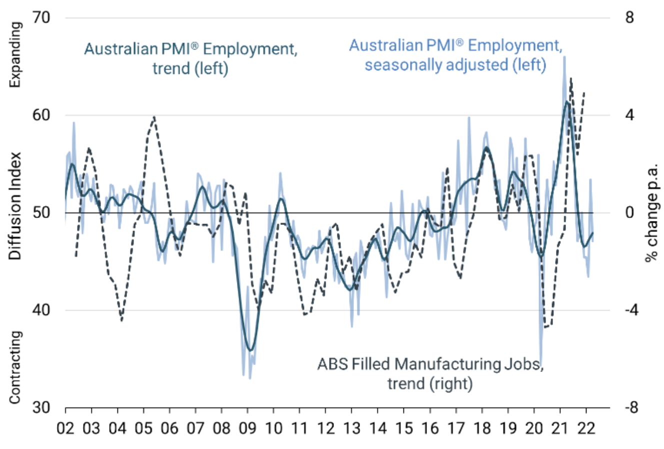
- The Australian Industry Group and HIA Australian Performance of Construction Index (Australian PCI®) moderated by 5.5 points to 50.4 points (charts 11 and 12). House builders reported concerns about increasing building costs, combined with higher interest rates as dampening customer demand. Labour shortages and delays in supplier deliveries continued to constrain activity and labour and input prices are growing very fast.

Chart 9: Aust. PMI® and ABS real manufacturing output



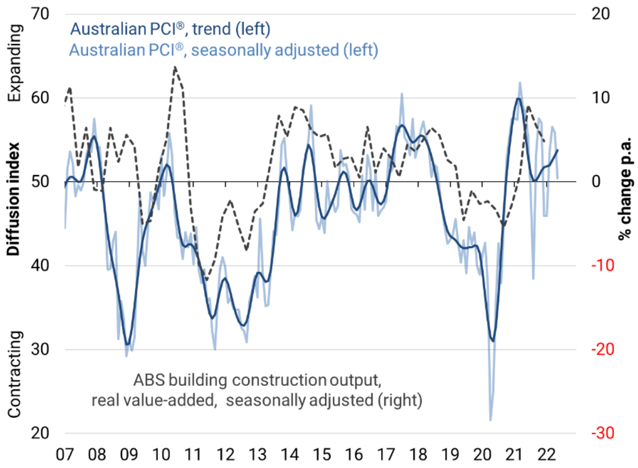
Sources: Ai Group and ABS, *National Accounts*.

Chart 10: Aust. PMI® employment index and ABS manufacturing employment



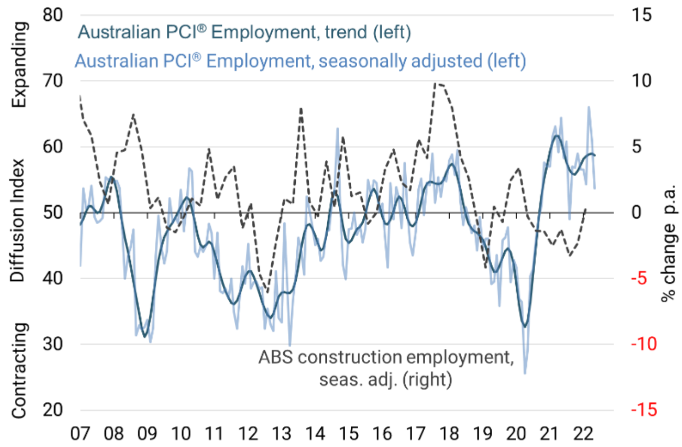
Sources: Ai Group and ABS, *Labour account*.

Chart 11: Aust. PCI® and ABS real building industry output



Sources: Ai Group and ABS, *National Accounts*.

Chart 12: Aust. PCI® employment index and ABS construction employment



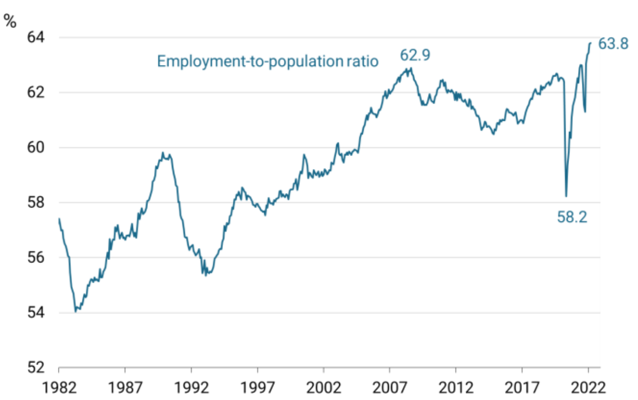
Sources: Ai Group and ABS, *Labour force Ausrtalia, detail*.

The changes in Ai Group's performance indices point to the further progress that is being made in making up for the ground lost during the previous two years due to the COVID-related disruptions. They also show rising cost and wage pressures and little capacity in the near-term for expansions in supply to meet strong demand growth.

State of the Australian Economy

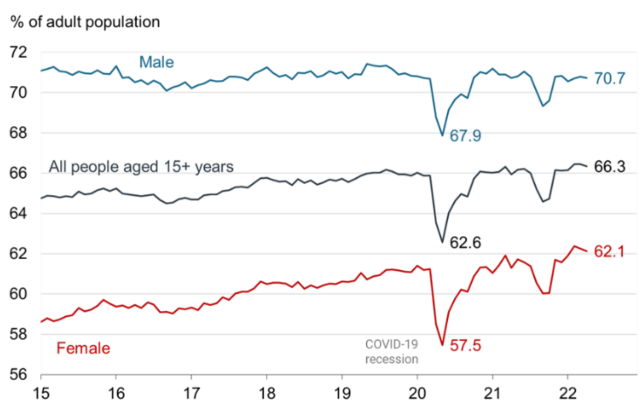
Employment levels in the Australian economy are at an all-time high, with employment as a share of the population (charts 13 and 14) at 63.8% and participation rate at 66.3%. Despite the high level of participation and the continued increase in wage growth (charts 15 and 16), with WPI growing at 2.4% over the year, vacancies continue to rise (charts 17 and 18). The large number of vacancies is the cause of continued labour shortages, exacerbated by the COVID-19 related border closures. The shortage is extremely likely to continue into the future given the very low level of inbound migration (chart 19).

Chart 13: Employment to population ratio, 1982 to March 2022



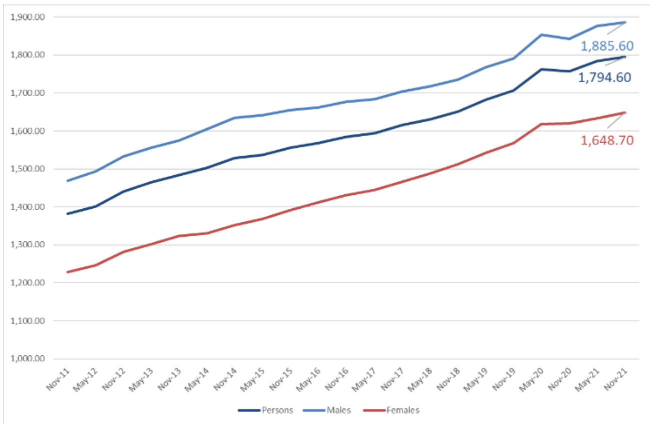
Sources: ABS.

Chart 14: Participation rates by sex, 2015 to March 2022



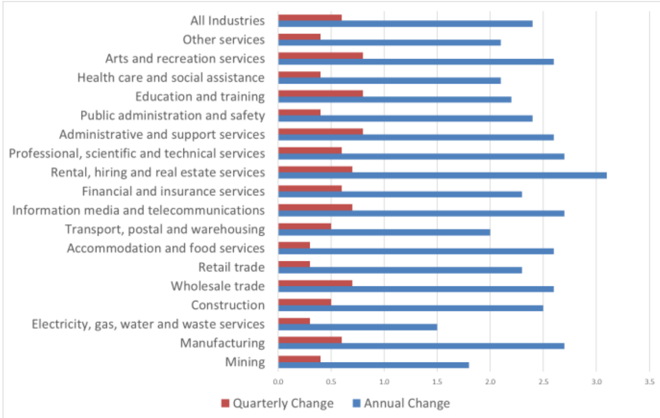
Sources: ABS.

Chart 15: Average weekly ordinary time cash earnings, full time adults



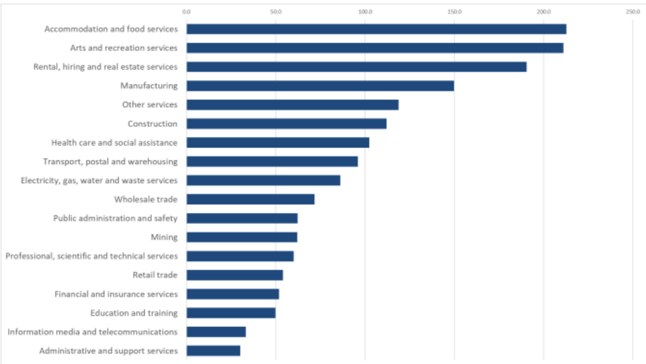
Sources: ABS, Average Weekly Earnings, November 2021.

Chart 16: Annual and quarterly % changes in total hourly rates of pay excluding bonuses – industry



Sources: ABS, Wage Price Index, March 2022.

Chart 17: Industries with highest levels of vacancies, February 2022

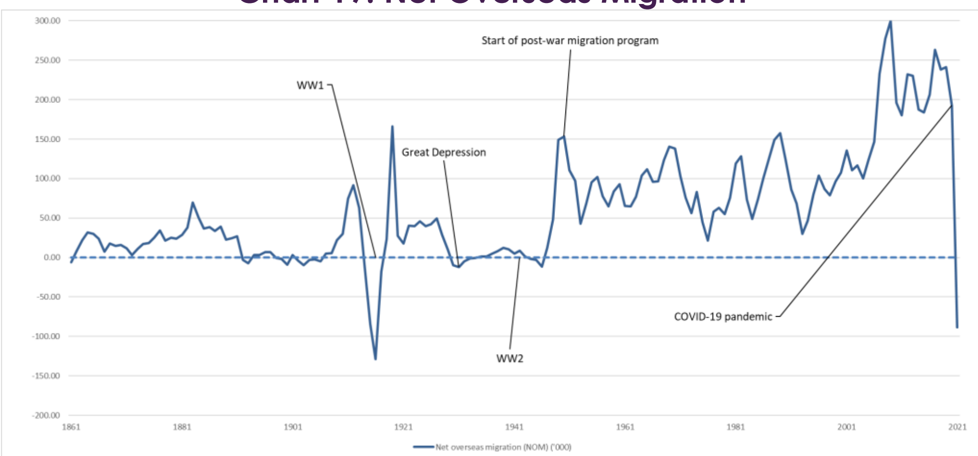


Source: Australian Bureau of Statistics, Job Vacancies, Feb 2022

Chart 18: SEEK job ads by state Monthly % change, March 2022 to April 2022

Source: SEEK Employment Report, April 2022

Chart 19: Net Overseas Migration

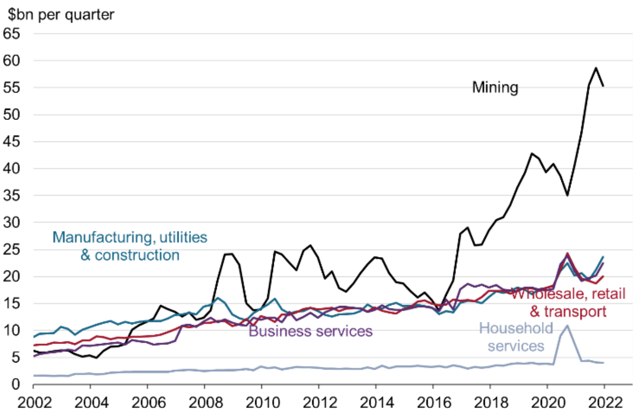


Source: Australian Bureau of Statistics, Overseas Migration, 2021

Given the consistent increases in wages, despite the stagnant growth in profits[4] (chart 20) and decreasing labour productivity, we have to consider how an increase in the national minimum wage will affect business survival which has significantly decreased over the last few years (chart 21). Businesses also continue to report increasing cost pressures because of supply chain, energy input, and wage costs (charts 22 and 23). The shortage of skilled labour and large increases in average wage levels have resulted in an extremely competitive labour market, as can be seen from the increase in individual bargaining as the method of setting pay (chart 24).

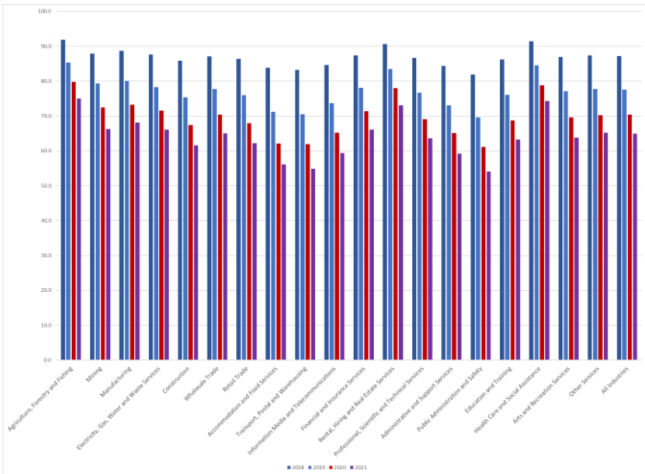
Large minimum wage increases would result in substantially increased wage pressure for employers, particularly given the worsened cash positions faced by many Australian businesses (chart 25). In February 2022, only 39% of businesses reported that they had enough cash to cover three months or more of business operations, down from 43% in May 2021. This cash position means that businesses will have to make careful judgements on staff levels and hours of work offered. Keeping in mind that increases in minimum wages translate into increases in superannuation and other on-costs, it is highly likely that significant increases in minimum wages, would have disemployment consequences.

Chart 20: Business gross profit by sector



Source: ABS*, Business Indicators,* Dec 2021.

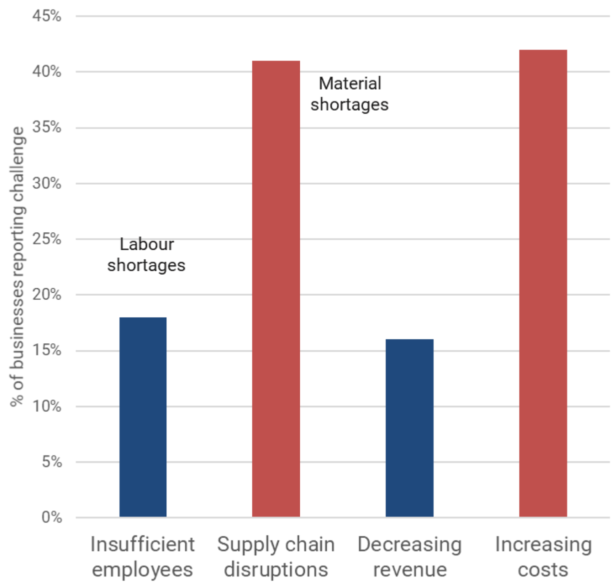
Chart 21: Business survival rates by industry



Sources: ABS, Count of Australian Businesses, 2021

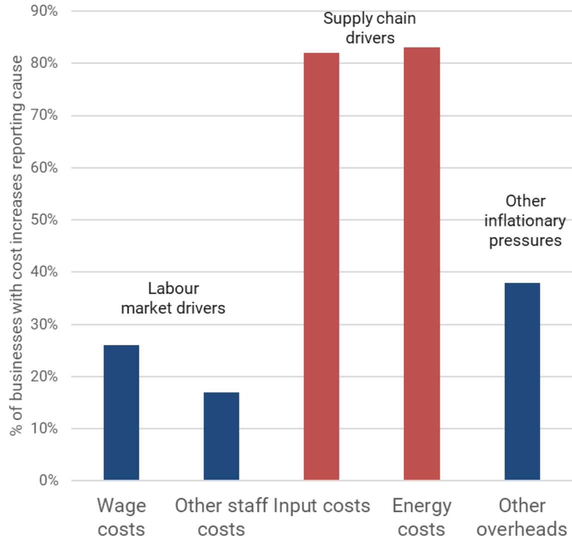
[4] A closer examination of the gross operating profits reveals that while gross operating profits have increased by 2.0% (seasonally adjusted) over Q4 2021, the growth in 2021 is largely skewed towards finance and marketing businesses (Chart 20). The finance and insurance services sector reporting a 77.3% increase in gross profits.

Chart 22: What challenges are businesses facing?



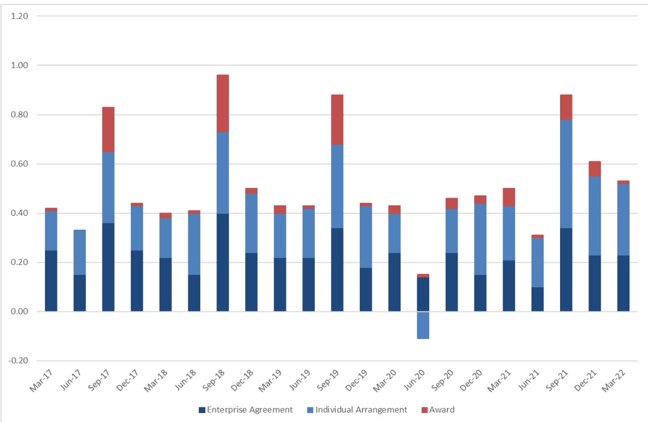
Source: ABS Business Conditions and Sentiments, April 2022

Chart 23: Why are business costs increasing?



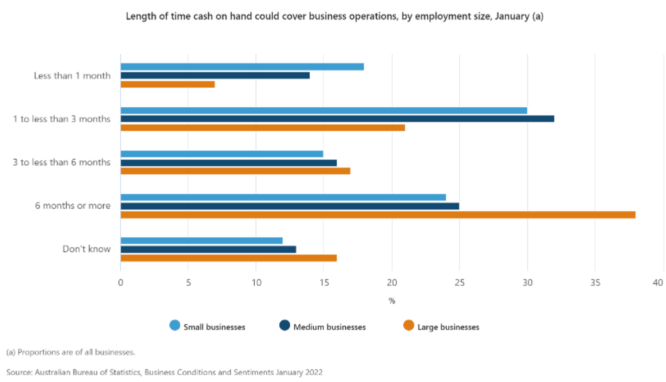
Source: ABS Business Conditions and Sentiments, April 2022

Chart 24: Contributions to wage price index, by method of setting pay



Sources: ABS, Wage Price Index, March 2022

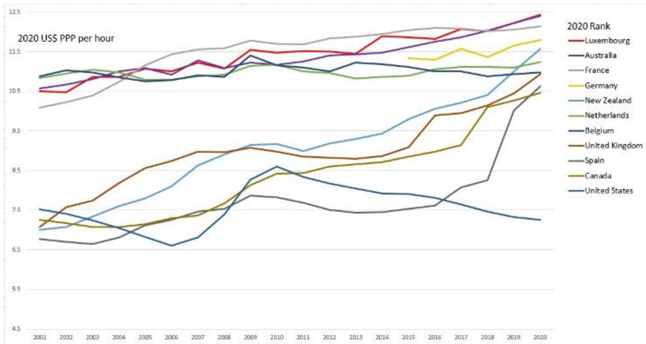
Chart 25: Length of time that 'cash on hand' can cover operations, Feb 2022



Source: ABS Business Conditions and Sentiment, Feb 2022

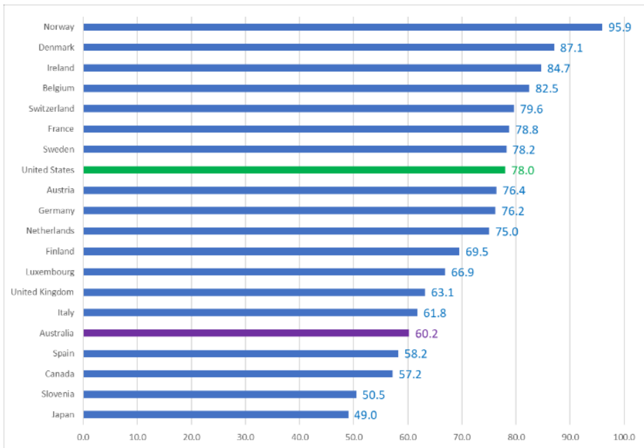
Traditionally, minimum wage increases are a way of distributing gains from productivity. Despite Australia having one of the world's highest minimum wages (chart 26), Australia has low levels of labour productivity, particularly compared to other high income OECD countries (Chart 27).

Chart 26: Minimum wages per hour, 2001 to 2020



Source: OECD Stat database

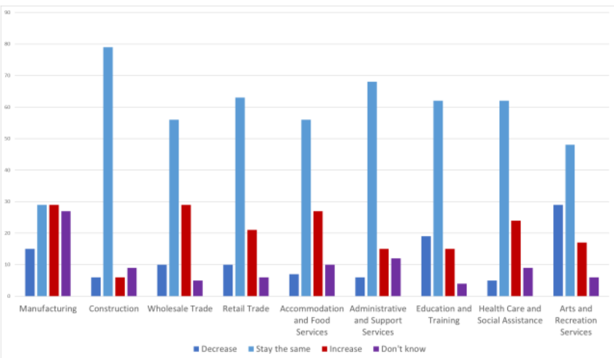
Chart 27: Labour productivity



Source: OECD Compendium of Productivity Indicators, Jul 2021

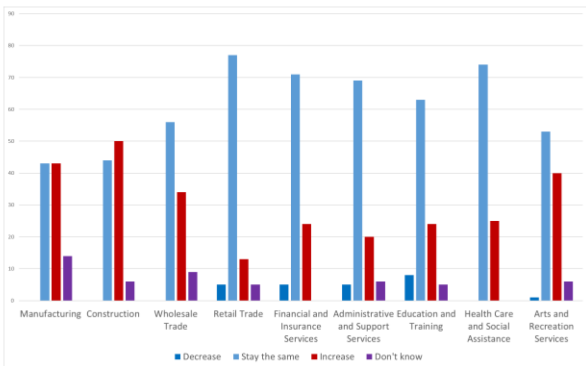
Given that businesses will face rising wage pressures, given stagnant gross profit growth, low productivity, other input cost pressures, worsened cash positions, and already dwindling survival rates, businesses will be forced to pass input cost pressures to consumers in the form of price hikes (59% of retail operators expect prices to rise). Such price hikes could result in rampant inflation and the RBA will respond with increases in interest rates. Such increases in the cash rate will have two prominent consequences. First, it will directly increase the cost of living, by increasing the cost of debt servicing for households in the form of interest paid on credit cards, or long-term loans including mortgages. Second, increases in the cash rate will also lead to higher debt servicing for businesses, meaning that businesses with worsened cash positions could be forced to lay off staff rather than resort to bridging loans or overdrafts to meet short term finance needs, generating a disemployment effect. Also, such rises will negatively affect business borrowing and growth and thus potential employment outlook and growth. Large increases in minimum wages are likely to have long term effects on Australia's economic activity. It is notable that at the present time, businesses are reporting expectations of revenue stagnation or decrease (chart 28) and cost increases (chart 29).

Chart 28: Business expectations of changes in Revenue



Source: ABS Business Sentiments and Conditions, May 2022.

Chart 29: Business expectations of changes in Expenses



Source: ABS Business Sentiments and Conditions, May 2022.

ABOUT THE AUSTRALIAN INDUSTRY GROUP

The Australian Industry Group (Ai Group®) is a peak employer organisation representing traditional, innovative and emerging industry sectors. We are a truly national organisation which has been supporting businesses across Australia for nearly 150 years.

Ai Group is genuinely representative of Australian industry. Together with partner organisations we represent the interests of more than 60,000 businesses employing more than 1 million staff. Our members are small and large businesses in sectors including manufacturing, construction, engineering, transport & logistics, labour hire, mining services, the defence industry, civil airlines and ICT.

Our vision is for thriving industries and a prosperous community. We offer our membership strong advocacy and an effective voice at all levels of government underpinned by our respected position of policy leadership and political non-partisanship.

With more than 250 staff and networks of relationships that extend beyond borders (domestic and international) we have the resources and the expertise to meet the changing needs of our membership. We provide the practical information, advice and assistance businesses need. Our deep experience of industrial relations and workplace law positions Ai Group as Australia's leading industrial advocate.

We listen and we support our members in facing their challenges by remaining at the cutting edge of policy debate and legislative change. We provide solution-driven advice to address business opportunities and risks.

OFFICE ADDRESSES

NEW SOUTH WALES

Sydney
51 Walker Street
North Sydney NSW 2060

Western Sydney
Level 2, 100 George Street
Parramatta NSW 2150

Albury Wodonga
560 David Street
Albury NSW 2640

Hunter
Suite 1, "Nautilos"
265 Wharf Road
Newcastle NSW 2300

VICTORIA

Melbourne
Level 2 / 441 St Kilda Road
Melbourne VIC 3004

Bendigo
87 Wil Street
Bendigo VIC 3550

QUEENSLAND

Brisbane
202 Boundary Street Spring Hill
QLD 4000

ACT

Canberra
Ground Floor,
42 Macquarie Street
Barton ACT 2600

SOUTH AUSTRALIA

Adelaide
Level 1 / 45 Greenhill Road
Wayville SA 5034

WESTERN AUSTRALIA

South Perth
Suite 6, Level 3 South Shore Centre 85
South Perth Esplanade
South Perth WA 6151

www.aigroup.com.au