SUBMISSION TO THE AUSTRALIAN INDUSTRIAL RELATIONS COMMISSION

REGARDING THE ACTU LIVING WAGE APPLICATIONS

by Leigh Harkness

1. INTRODUCTION

1.1 Economic rational

1.1.1 This submission contends that wages generally, and award wages in particular, have been too low and that it is inappropriate for award wages to be restrained in an attempt to:

- reduce the current account deficit;
- improve the international competitiveness of the nation;
- reduce unemployment;
- make the nation more prosperous;
- reduce inflation; and
- reduce interest rates.

1.1.2 It is not rational to assert that the Commission will contribute to the wealth and prosperity of Australia by restraining the nation's income, particularly the income of its poorest workers.

1.2 Paradox of wages

1.2.1 There are paradoxes in economics. For example, the paradox of thrift which holds that while it may be good for one person to save, if everyone in the economy saves, such saving would cause a recession. This is because the expenditure of one person is the income of another. If everyone stops spending, everyone stops earning. We as a nation earn only what we spend.

1.2.2 Similarly, if one employer obtains free labour, he may prosper with high profits because of his low costs. But if all employers were to obtain free or cheap labour, who will have the money to purchase the products they produce? It is likely that most of these businesses would go out of business.

1.2.3 Wages are not only a cost of production, they generate the demand to produce and generate income. Therefore, restraining the income of workers can restrain the incomes of the whole economy.

1.2.4 I am not saying that increasing wages, on its own, will increase economic prosperity. The economy is not that simple. But, continuing to reduce real wages will not improve national prosperity.

2. WAGE POLICY FAILURE

2.1 Wages policy ineffective instrument of macro-economic policy

2.1.1 Wages policy in Australia has not had the desired outcome. Lower award wages have not:

. reduced inflation;
. increased employment; nor
. made Australia more internationally competitive.

2.2 Income redistributed from wages and salaries to profits

2.2.1 If the lower cost of wages were passed on in lower prices, and employers were willing to accept commensurate cuts in profits, we could expect that the relative shares of national income going to workers and profits would have stayed the same. However, the lower wages have not gone to reduce costs but to increase profits. The share of the nation's income going to workers has fallen relative to profits as shown in Figure 1.

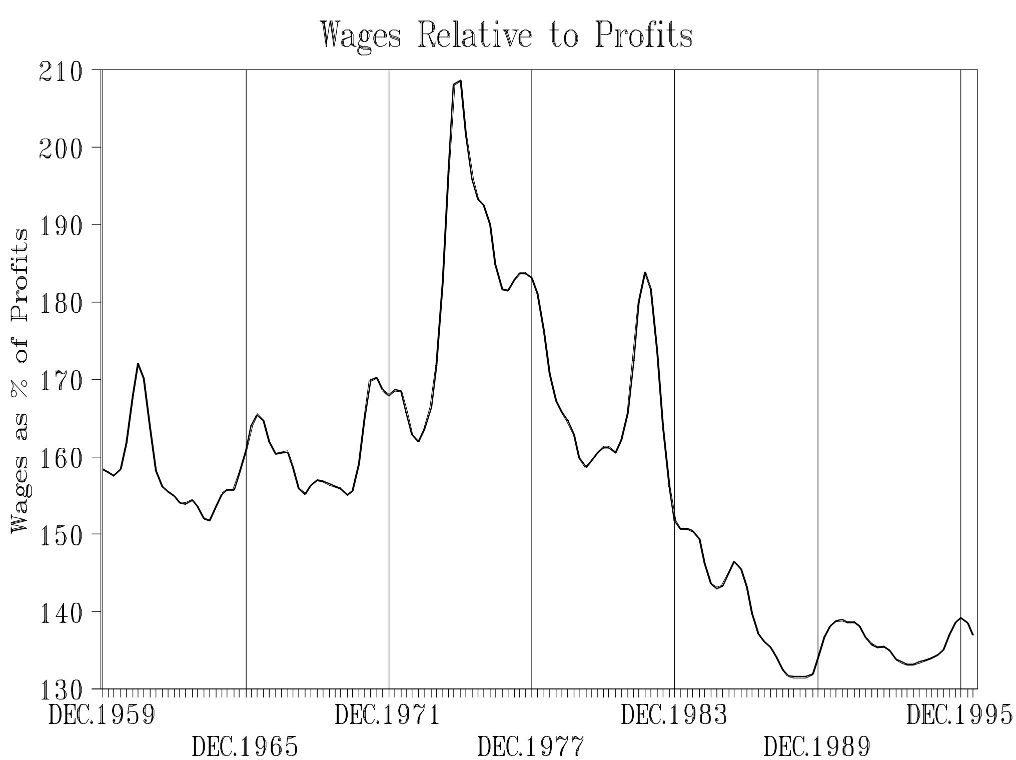

Figure 1 Source: ABS Cat No 5206.0 Table 66

2.2.2 Wages may have been too high in the mid 1970's but they are too low in the mid 1990's. In the 1960's and early 1970's, when Australia had rapid growth and high employment levels, the share of national income going to wage and salary earners was equivalent to between 150% to 170% of that going to profits. For the last ten years, it has dropped to between 130% to 140% of profits. That is, the relative share of national income going to profits has increased and the share going to workers has declined significantly.

2.3 Workers on Award Wages have suffered a major reduction in real income

2.3.1 Award wages have not kept pace with inflation. Since July 1981, male full time award wages have fallen 35% in real terms. Male full time award wages are now 26.5% below the average from 1974 to 1984[1]. Despite the rises in productivity, men on award wages had higher real incomes in the 1970's and 1980's than they do today. This is clearly shown in Figure 2 which displays both the rise in nominal and the decline in real wages since 1973.

2.3.2 Real award wages have declined so much that Australia now has a new class of people, the *working poor.* This condition has occurred because award wages have not kept pace with inflation, despite the improvement in labour productivity.

2.4 Transfer of income from poor to rich

2.4.1 Up until 1983, average weekly wages and award wages generally moved together. Since 1983, real average weekly earnings for full time adult males have increase while real award wages have declined. This is clearly evident if Figure 3.

2.4.2 The estimates of average weekly wages include the wages of workers on award wages. For real average weekly wages to have increased while real award wages have been decreasing implies that those workers not on award wages have increased their real wages to the extent that they have offset the lower real wages of workers on award wages. This outcome suggests that the falling real award wages have been used to redistribute income from the poorer workers (on award wages) to more highly paid workers (on above award wages and salaries).

2.4.3 So, not only has the share of national income going to salary and wages declined, the poorer sectors of the community (on award wages) have received a smaller part of this reduced share. Award wages would need to rise 35% just to maintain their pre 1983 relativity with average weekly wages.

[1] Figures for female award wages for this period were unavailable.

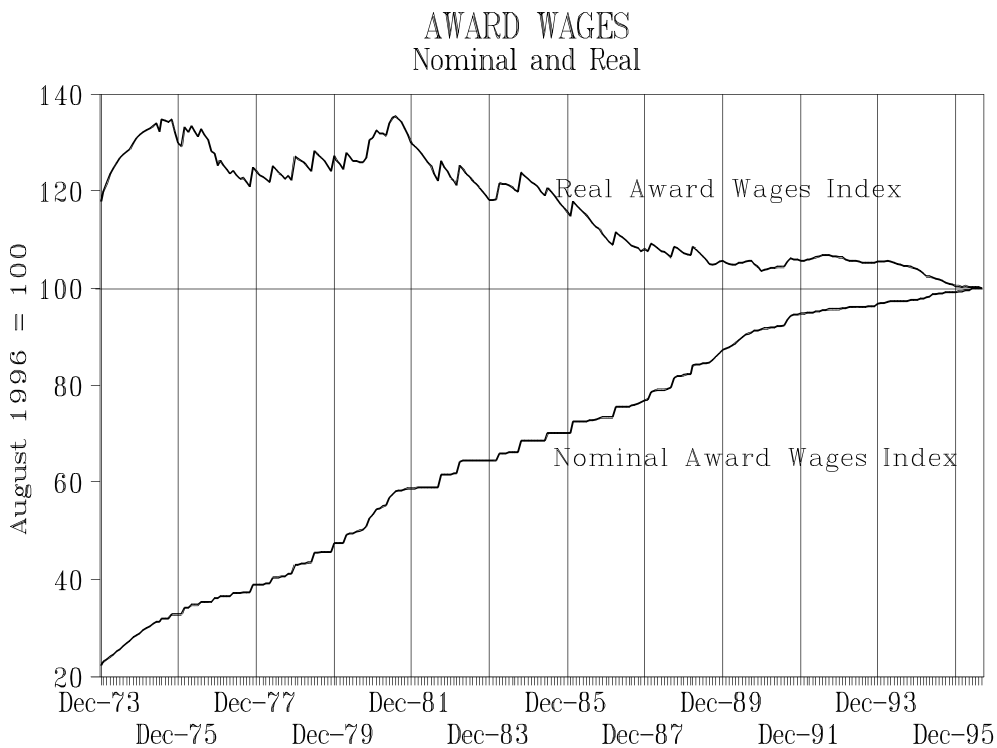

Figure 2 Source: RBA Bulletin Dec. 1983, ABS Cat No.s 6302.0 and 6401.0

2.4.5 The restraint of award wages in the past has been used to facilitate a massive transfer of wealth from the poorer sectors of the economy to the richer sectors. These higher incomes together with the higher profits have not been earned by increasing national productivity. Rather it has been earned at the expense of the workers. They have suffered a reduction in income to provide an increase in profits and executive salaries.

2.5 Contrary to the objectives of the Industrial Relations Act

2.5.1 This is contrary to the principle objective of the Industrial Relations Act which is "*to provide a framework for the prevention and settlement of industrial disputes which promotes the economic prosperity and welfare of the people of Australia by . . . providing the means for . . . establishing and maintaining an effective framework for protecting wages and conditions of employment through awards.*"

2.5.2 It is time that the Industrial Relations Commission rectify this situation and restore the wages and conditions of workers.

Figure 3. Source: Reserve Bank Bulletin Dec. 1983, ABS Cat. No.s 6302.0, 6312.0 and 6401.0

3. WAGES AND THE ECONOMY

3.1 The Current Account Deficit

3.1.1 The current account deficit has been raised in previous submissions to the Commission as a reason why wages must be restrained. However, the current account deficit is not caused by high wages. It is caused when the nation spends more than it earns.

3.1.2 To understand what causes current account deficits, it is necessary to understand how the economy works. The money people earn from selling products in the economy entitles them to buy products up to the value of what they have produced. In this way, money prevents the nation from spending more than it earns or buying more than it has produced.

3.1.3 If someone were to create additional money, they would be able to buy products without producing products. This would cause the nation to spend more than it earned and, if this were significantly large, it would cause a current account deficit. This additional money pillages products from the economy. This is why forgery is a crime. The forgers acquire products without first having produced products.

3.1.4 People can borrow money from other people to increase their spending above their income. However, this does not cause the nation to spend more than it earns. The lender would have reduced their spending (saved) by the same amount that the borrower has increased theirs.

3.1.4 However, when people borrow from a bank, the bank does not need corresponding savings before it lends. The bank does not take money out of one person's account and put it in another's. When a bank lends, it gives the borrower a deposit, which is a negotiable bank liability; an asset to the borrower. The bank treats the borrowers liability to it as an asset. When a loan is repaid to a bank, the bank reduces its loans (assets) and it reduces its deposits (liabilities).[2]

3.1.5 Bank deposits are money. When bank lending exceeds loan repayments to banks, the amount of money in the economy increases. It is this additional money that finances national spending above national income and causes the current account deficit.

3.1.6 Money can also be created by increasing foreign reserves either of the commercial banks or the Reserve Bank. This money is usually earned and does not contribute to excess spending and the current account deficit.

3.1.7 The other form of money is currency (notes and coins) but this accounts for only about 7% of the growth in the money supply. When government uses the proceeds from the issue of this currency to finance expenditure, it causes national expenditure to exceed national income and contributes, albeit in a small way, to the current account deficit.

3.1.8 There is ample evidence of this relationship. Figure 4 plots the accumulated current account deficit and the growth in the money supply, adjusted for monetary growth from foreign reserve transactions of the Reserve Bank and the acquisition of foreign assets by the banks. This adjusted money supply comprises[3]:

- currency in circulation;
- total A$ liabilities of the banks;

less:

- saving bank deposits;
- bank bills held by other banks (borrowing from other banks);
- other borrowing from banks (other than savings banks);

[2] For a more detailed explanation, see Section 3.2 of the my Submission to the Financial Systems Inquiry (Attached).

[3] See table attached.

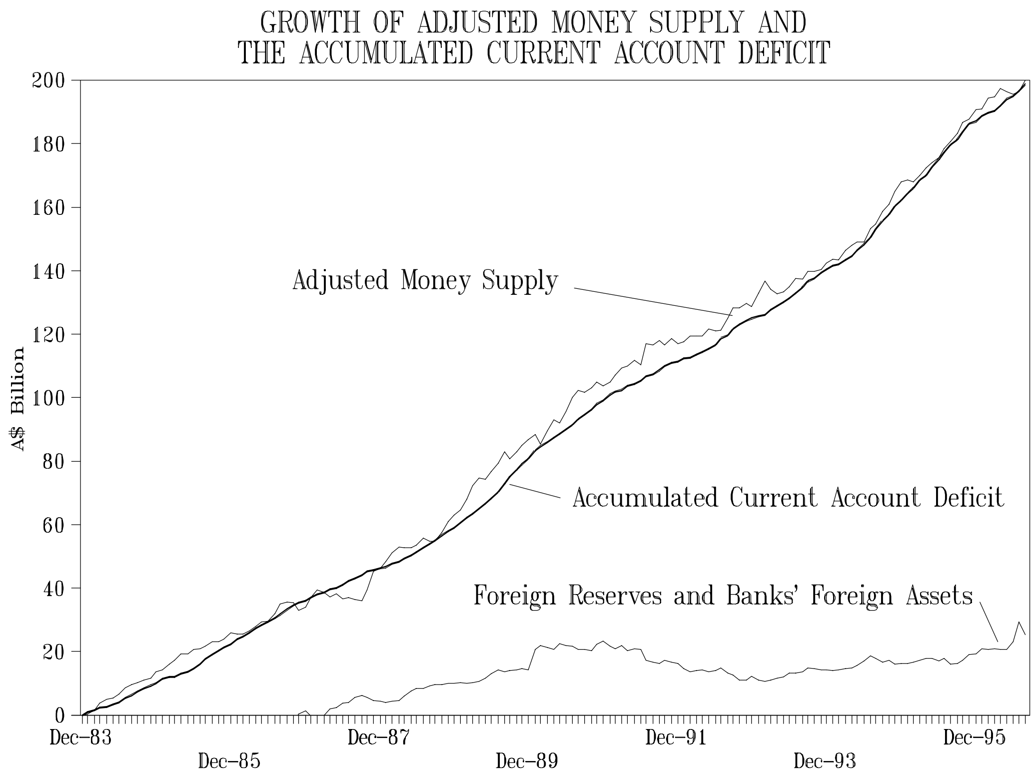

Figure 4 Source: RBA Bulletin and ABS Cat No 5301.0

- deposits of new banks on formation (not from bank lending);
- foreign reserves (acquired from trading); and
- private bank foreign assets.

3.1.9 It is clear that all of the current account deficit can be explained by the growth in the adjusted money supply. The level of wages does not influence the current account deficit.

3.1.10 Therefore, the current account deficit should not be an issue that influences the Commission's decision on the ACTU's Living Wage claim.

3.2 Inflation

3.2.1 The Reserve Bank claims that wages growth is a major cause of inflation. It threatens to raise interest rates if wages rise too rapidly. However, wages appear to have no direct effect on inflation. Inflation can be shown to be related to the growth in the money supply relative to the growth of real national income. The exchange rate does have some effect on prices but its effect appears to be relatively minor.

3.2.1 A simple explanation of inflation can be given by the following relationship:

$$\frac{P_t}{P_0} = \sqrt{\left(\frac{L_t}{L_0} \cdot \frac{Q_0}{Q_t}\right)} \qquad (1)$$

where ***P*** is the average level of prices;
L is liquidity, or the money supply; and
Q is gross national product (at real prices).
$_0$ specifies the base year value of a variable; and
$_t$ specifies the values of the variable for each year.

3.2.2 Figure 5 plots this relationship where the money supply is defined as above for the current account deficit but including the money created from foreign sources.[4] This is compared to the consumer price index as estimated by the Australian Bureau of Statistics.

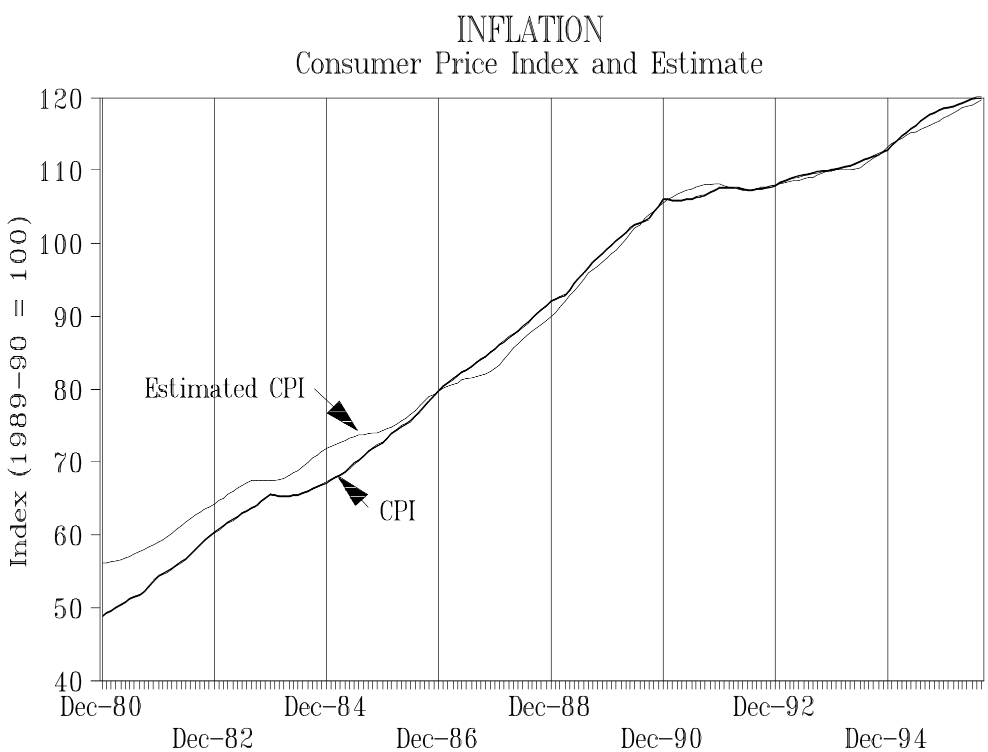

Figure 5 Source: RBA Bulletin and ABS Cat No 6401.0

[4] Column "L" in the attached table.

3.2.3 The graph reveals that since 1985, the relationship presented in equation (1) explains the inflation that has occurred in Australia. Inflation before 1985 was greater than revealed by this simple equation. However, most of that difference can be explained by the rapid devaluation of the Australian dollar against the United States dollar up to 1985.

3.2.4 We can conclude that excessive monetary growth has been the main cause of inflation in Australia. This is the responsibility of the Reserve Bank, not the Industrial Relations Commission. Therefore, the Commission does not need to consider the implications of its wages decision for inflation in the Australian economy.

3.3 Interest Rates

3.3.1 The Reserve Bank has threatened to raise interest rates if wages growth is excessive. One possible reason for this threat is that the Reserve Bank considers that there are two sources of inflation; cost push (from wages), and demand pull (from excessive monetary growth). The Bank appears to be proposing to raise interest rates to restrict demand pull inflation if wages growth is excessive causing cost push inflation.

3.3.2 This submission has shown that most of the inflation in Australia has been of the demand pull variety from excessive monetary growth. The restraint of award wages has not had any effect upon inflation. Its only effect on inflation been used to inflate profits and the incomes of other more highly paid sectors of the economy.

3.3.3 The Reserve Bank's own figures reveal that its policy of raising interest rates to reduce monetary growth and inflation are not only ineffective, they exacerbate the problem. The reason for this is that the growth in the money supply is equal to new lending less loan repayments. In Australia, most loans have variable interest rates. When the Reserve Bank raises interest rates, it reduces new lending. However, existing borrowers also have to pay higher interest payments. This reduces the amount of the principal that they can repay. If the reduction in loan repayments is greater than the reduction in new lending, then the higher interest rates increase the money supply. Hence, raising the interest rates can exacerbate inflation and the current account deficit.

3.3.4 This effect can be clearly seen in the late 1980's in Australia. Figure 6 illustrates the level of bank lending, the growth of bank deposits, the level of loan repayments, and interest rates. It shows that when the Reserve Bank raised interest rates in 1988, bank lending declined. However, the money supply increased despite the decline in new lending. This indicated that the higher interest rates were reducing the loan repayments of existing borrowers.

3.3.5 When the Reserve Bank saw that the money supply was rising despite the higher interest rates, it raised interest rates further in the mistaken belief that this would reduce the growth of the money supply. However, it only exacerbated the situation. The higher

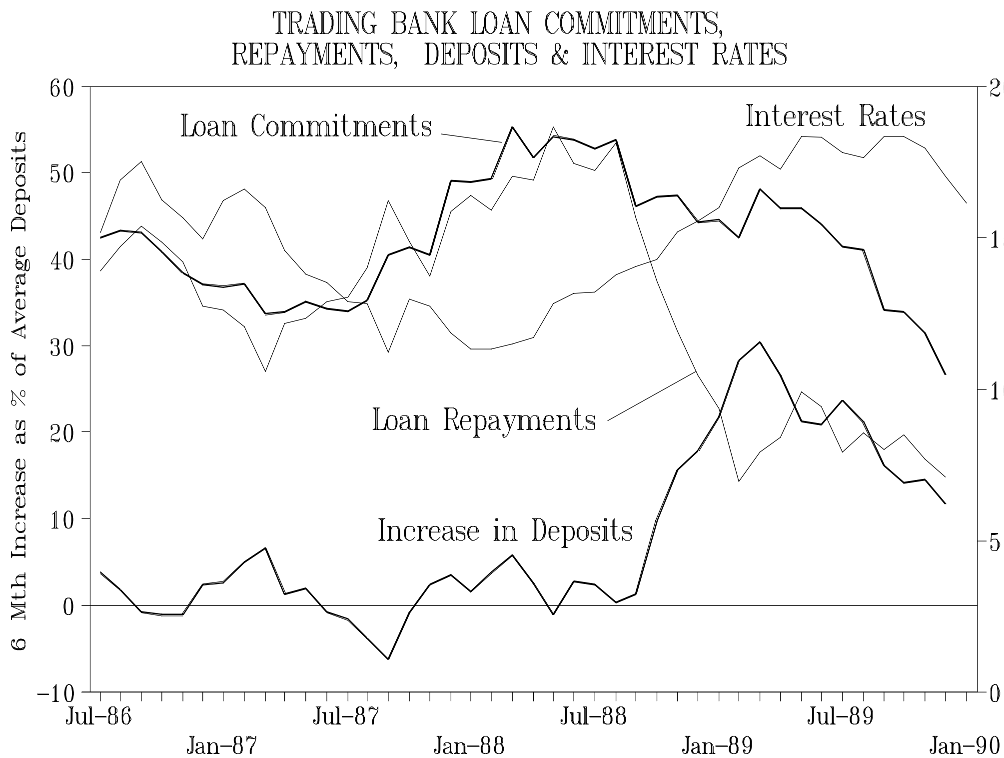

Figure 6 Source: RBA Bulletin

interest rates further reduced the capacity of borrowers to repay their loans and increased the money supply. Eventually, this inability of borrowers to repay their loans threatened the solvency of the banks. They started to restrain their lending in an attempt to limit their exposure to further bad debts. It was this action that reduced the growth of the money supply and reduced the rate of inflation and the current account deficit. However, it also brought about the worst recession in 60 years, causing massive unemployment.

3.3.6 Hence the use of interest rates to regulate monetary growth, inflation and the current account deficit in Australia is ineffective and inappropriate.

3.3.7 Another explanation for the Reserve Bank threat to raise interest rates if wages growth is too high is that the Bank is using interest rates in an attempt to regulate wages outcomes. We have seen that wage costs have not had a significant effect upon inflation. Even if the Reserve Bank's threats do restrain wages growth, they are unlikely to reduce inflation. All they are likely to achieve is a transfer of income from low income earners to profits.

3.3.8 To understand how this occurs, consider the following example. Assume that an company manufactures tennis balls that it sells for $2.00. We will assume that $1.00 goes on wages and $1.00 goes to the company. We then assume that inflation raises prices 50% in the economy so that the manufacturer can sell the tennis balls for $3.00 each. If the worker's share is restrained to $1.00, then the company's share is doubled to $2.00. The worker would have suffered a 33% reduction in real income and the company would have achieved a 33% increase in real profits.

3.3.9 It is inequitable for employers to benefit from inflation at the cost of workers, particularly those workers on award wages. Wages need to rise with inflation. Anything less implies the use of inflation to redistribute income from the poor to the rich. If wages are to be increased because of improvements in productivity, these increases should be in excess of any increase attributable to inflation.

3.4 International competitiveness

3.4.1 One of the major issues that has been raised in relation to wages has been the international competitiveness of Australian industries. However, this issue is one of prices rather than wages. That is:

- the price of Australian products relative to the price of imported products; and
- the price of Australian products exported relative to the price of similar products overseas.

3.4.2 The price of Australian products relative to foreign products is determined by the exchange rate. When Australia had a fixed exchange rate, restraining wages costs to make Australian products more internationally competitive may have made sense. Lower domestic prices may have increased exports and shifted demand from imports to Australian products.

3.4.3 But under the floating exchange rate system, the exchange rate adjusts to bring about equality at all times between international payments and receipts. If Australia were to reduce its domestic prices to increase exports and reduce imports, the exchange rate would rise to restore the previous equality between receipts and payments.

3.4.4 When Australia had a fixed exchange rate system, if it increased exports, it would earn additional income. Australia's foreign reserves would rise, the amount of money in the economy would increase and the multiplier effect would generate increased incomes for the whole economy. Thus, when exports doubled in the 1960's, national income also doubled. Australia's exports have doubled again in the last ten years. However, this time national income has increased by only one third. The different effect of exports on national income is attributable to change in the exchange rate system.

3.4.5 Figure 7 illustrates the effect of an increase in exports on a country with fixed exchange rates. The export schedule is given by the X1-X1 line and imports by the M1-M1 line. The equilibrium national income schedule is given by the Y1-Y1 line. If the exchange rate is fixed at e, export equal imports at the amount X1 and national income would be at equilibrium at the amount Y1.

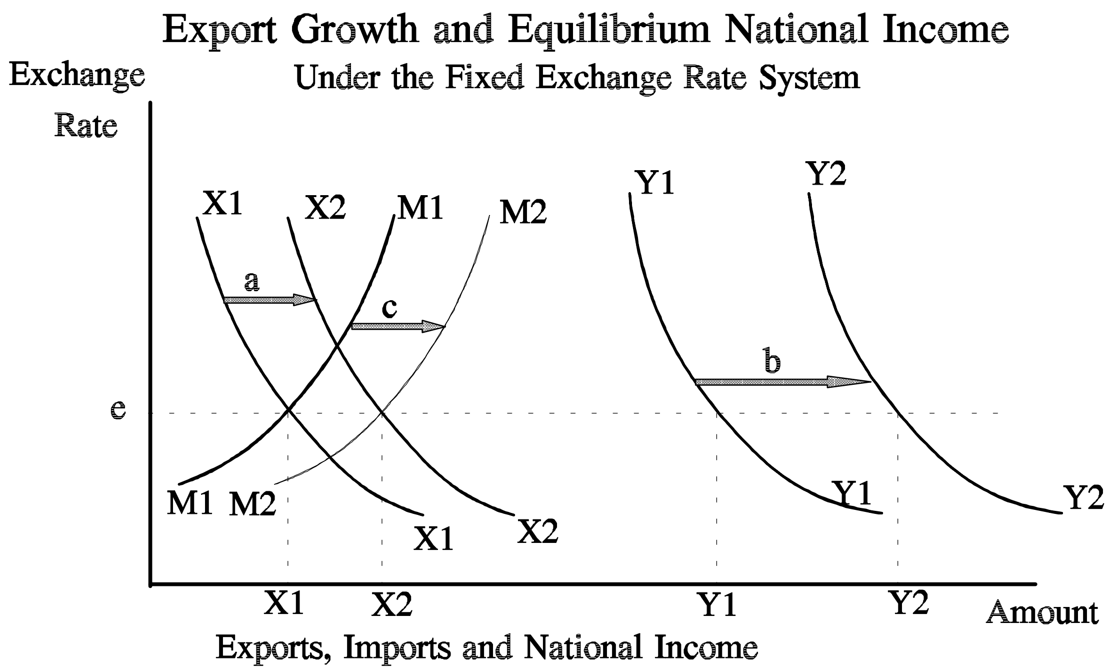

Figure 7

3.4.6 From this initial equilibrium position, we will assume that exports rise from the X1-X1 to X2-X2 as shown by the arrow "a". With fixed exchange rates, exports will rise to X2. These additional exports raise national income. As national income rises, as shown by the arrow "b", national expenditure rises also, and with it the expenditure on imports, shown by the arrow "c". That portion of increased expenditure not spent on imports is spent on domestic products. Such expenditure raises national income further. The increased exports will continue to raise national income while the injections of additional income, and money, from exports is greater than the leakages expenditure, and money, on imports.

3.4.7 When national income rises to Y2, imports would have risen to the level X2. At that point, the additional injection of income from exports is equal to the leakage of expenditure on imports. At that point, national income would cease to grow further and would again be in equilibrium.

3.4.8 Therefore, under the fixed exchange rate system, a rise in exports raises national income.

3.4.9 Under the floating exchange rate system the effects are different as illustrated in Figure 8. In this example, initially exports and imports are equal and at X1, as in the previous example, and national income is at Y. The rise in exports is depicted as the shift from the X1-X1 schedule to the X2-X2 schedule shown by the arrow "a". The increased exports increase the demand for domestic currency on the foreign exchange market. This raises the exchange rate as shown by the arrow "b". As it rises, expenditure on imports rises as shown by the arrow "c". As expenditure on imports rises from the amount X1 to the amount X2, expenditure on domestic products falls from the amount represented by the interval X1-Y to the amount represented by the interval X2-Y. Hence the increased income gained by exporters X1-X2, is offset by a corresponding reduction in the income of import competing industries. Therefore, increased exports do not increase national income and consequently, do not provide additional employment. Any growth in employment in the export sector is offset by a reduction in income in the import competing sector.

Export Growth, Equilibrium Exchange Rate & National Income
Under the Floating Exchange Rate System

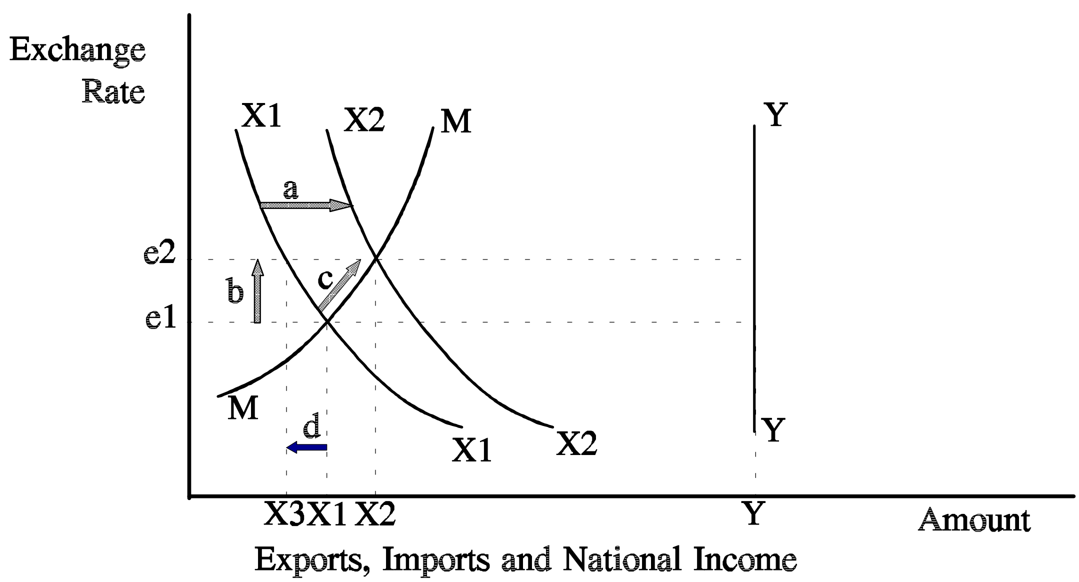

Figure 8

3.4.10 For Australia, this has meant that efforts to increase foreign income, such as from mining and tourism, only cause a reduction in income in import competing sectors, such as manufacturing. This effect is clearly seen in Figure 9. Up until December 1983, imports stayed generally between 11% and 15% of gross domestic product. After the exchange rate was floated, imports have increased to 23% of GDP.

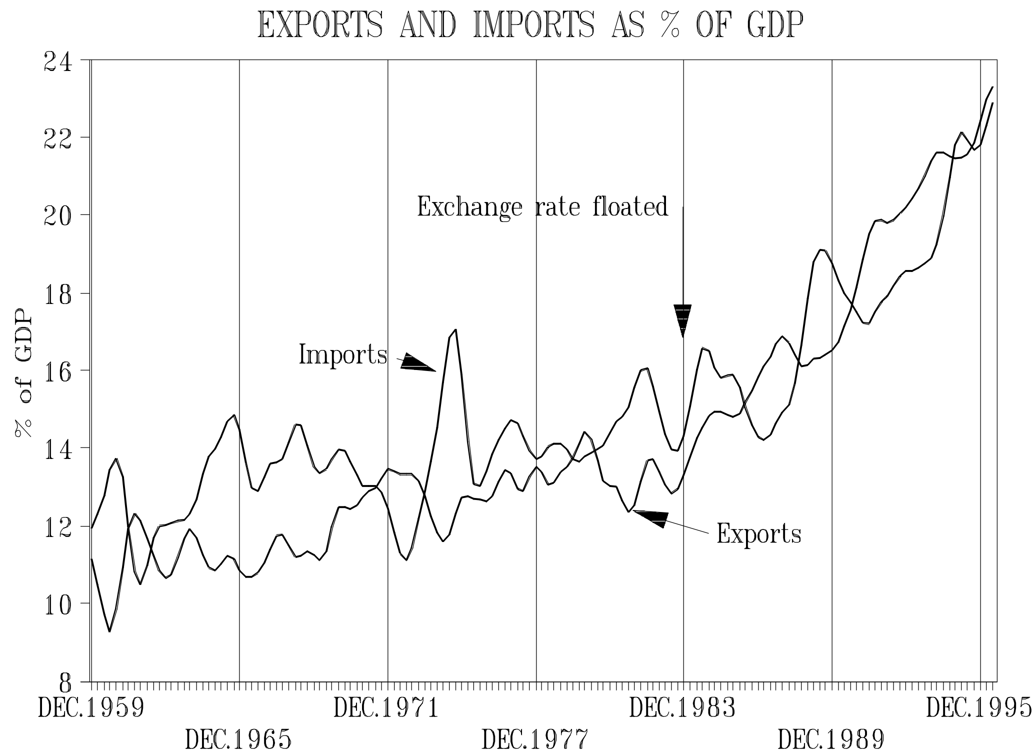

Figure 9 Source: ABS Cat. No. 6206.0 Table 14

3.4.11 If Australia is to reduce its unemployment, it will need to reverse this trend and increase the proportions of national expenditure spent on Australian products. But this is a matter that is not the responsibility of the Industrial Relations Commission. It is a matter for the Government, the Reserve Bank and the Wallis Inquiry.

3.4.12 Also shown in Figure 8 is the effect of increased exports on existing exporters. Before the increase in exports, exporters would have earned the amount X1 for their exports. After the increase in exports, the income of existing exporters falls as shown by the arrow "d" from X1 to X3.

3.4.13 Existing exporters such as farmers have experienced large reductions in their incomes because of this effect. Even some miners find that they are extracting coal and minerals for little more than the cost of mining.

3.4.14 The floating exchange rate system essentially makes Australian exporters compete against each other, not against the rest of the world. If one sector raises its exports, it raises the exchange rate and reduces the income of the others, driving many of them out of business. To be able to compete in this environment, exporters need to be highly efficient and productive. This efficiency is not required to compete against the rest of the world but to compete against other Australian businesses. Only those with the lowest costs can survive in this environment. The floating exchange rate system works against improving the competitiveness of Australian industry.

3.4.15 The introduction of the floating exchange rate system was intended to make it easier for the Reserve Bank to control the money supply. The American economist, Milton Friedman, described it as follows:

> *In effect, flexible exchange rates are a means of combining interdependence among countries through trade with a maximum of internal monetary independence; they are a means of permitting each country to seek for monetary stability according to its own lights, without either imposing its mistakes on its neighbours or having their mistakes imposed on it.*[5]

3.4.16 While monetary stability may be a desirable objective, the system also stabilises national income. While countries may avoid the mistakes of their neighbours, they also avoid the benefits of raising national income through export growth.

3.4.17 The introduction of the floating exchange rate system has been followed by a decline in the rate of economic growth in all countries that have adopted the system, not only Australia. For example, the following table shows the average growth rates of gross domestic product (GDP) for selected OECD countries before and after the adoption of the floating exchange rate system by the USA and other countries in 1973:

	1960 to 1973	1973 to 1995
Australia	5.5%	2.9%
Canada	5.9%	2.9%
Europe (OECD '63 - Sept 95)	4.7%	2.3%
France	4.9%	2.2%
Japan	10.2%	3.2%
UK	3.4%	1.8%
USA (to Sept '95)	4.3%	2.4%

Source: OECD

3.4.18 The above countries suffer similar problems of slow economic growth and high, or rising, unemployment. Japan, a net exporter of capital, is the only country that is not experiencing rising foreign debt. The Industrial Relations Commission can not overcome the problems of slow economic growth and high unemployment by continuing to hold award wages at historically low levels. International competitiveness should not be an issue when considering the merits of the ACTU's Living Wage claims.

[5] FRIEDMAN, M. 1966. *The Case for Flexible Exchange Rates* in *Essays in Positive Economics*, University of Chicago Press, Chicago, Ill.

4. IMPLICATIONS FOR THE LIVING WAGE CLAIM

4.1 Living wage and the economy

4.1.1 Australia does have economic problems that are causing current account deficits, rising foreign debt, slow rates of economic growth, and high rates of unemployment. However, these problems can not be solved by continuing to reduce the real wages of the most lowly paid workers in our economy.

4.1.2 The economic problems need to be addressed. But they are not caused by high wages. Nor would a policy of continuing to restrain award wages assist in alleviating the problem. Instead it may exacerbate the problem.

4.1.3 Workers on award wages have been treated as the scape-goat for Australia's economic problems. This has been institutionalised in government policy through programs such as the wages accord and industrial relations reform.

4.1.4 Workers are among the victims of successive Australian government programs of "economic reform." The wages policies of these governments have only exacerbated the suffering of workers.

4.1.5 While governments continue to treat the wages of low income workers as the cause of our economic problems, they avoid dealing with the real causes. By doing so, they prolong the problems for the whole Australian community.

4.2 Living wage and employment

4.2.1 If Australia is to raise its level of employment, it must spend more of its income, on Australian products. The reduction in award wages, relative to average wages, since 1983 has been associated with a rise in the proportion of national income spent on imports (see Figures 3 and 9). If award wages are raised relative to average wages, it may assist in reversing this trend and generate more employment.

4.2.2 People on low incomes spend a larger proportion of their income. Hence, raising their wages is likely to create more demand for products and generate more employment than if the profits and the incomes of the more highly paid workers are raised.

4.3 Living wage in an open economy

4.3.1 Australia's Manufacturing, Engineering and Construction Industry Association (MTIA) has raised the issue of whether it is appropriate to have a living wage concept in an open economy. We have seen award wages decline dramatically since the Australian economy was "opened". As we have seen, this has not gone to reduce prices or make Australia more internationally competitive. It has gone to raise profits and executive salaries.

4.3.2 It has become clear that the market will not protect low income workers. There is a real need for the Industrial Relations Commission to intervene and protect the real incomes of these workers.

4.3.3 The MTIA does have a case that manufacturing industries in Australia are suffering in this economic climate. However, that climate is caused by other factors, such as the exchange rate system. Australia's economic problems have not been causes by excessively high wages for low income workers.

4.4 Living wages affordable

4.4.1 The Victorian Automobile Chamber of Commerce (VACC) claims that the retail motor industry cannot sustain further wage increases at this time. However, its perception of higher wages is one sided. It considers only the effect on costs. It does not appreciate that if workers have higher incomes, they will buy more products including more cars.

5. CONCLUSION

5.1 The Economy

5.1.1 In the process of considering the Living Wage Claim, the Industrial Relations Commission is required to take account of the state of the economy and the likely effect of its decision on the economy.

5.2.2 This submission has shown that the restraint of award wages in the past has not reduced inflation, has not reduced the current account deficit or foreign debt, and it has not reduced inflation. Each of these problems has its own causes and those causes need to be addressed with specific policies if they are to be rectified. None of these problems are caused by excessive award wages.

5.2 Protection of wages and conditions of employment

5.2.1 One of the principle objectives for which the Industrial Relations Commission was established is to protect wages and conditions of employment through awards. This submission has also shown that the share of gross domestic product going to workers has declined. It has also shown that award wages have not maintained their relativity with average wages. Furthermore, it has shown that award wages have declined in real terms.

5.2.2 If the Commission is to achieve its principle objective, it must raise award wages. The proposals presented in the ACTU's living wage claim should be considered as just one step in the process of restoring the wages and conditions of employment for workers on award wages in Australia.

5.2.3 Award wages are so low that even workers on the top skill levels of the proposed award pay scales qualify for special social security assistance. For example, the Department of Social Security advertise that ". . .a couple with two children under 13 who rent privately can earn up to $34,724 and still get more than the minimum rate of family payment."[6] The family payments in addition to the minimum rate were previously called "additional" family payments. This assistance implies government recognition that a salary under $35,000 per annum is not a living wage for an average family.

5.2.4 There is a poverty trap caused by the combination of income tax and sliding scales for social security benefits. To escape this trap, award wages need to be significantly higher than the levels that attract social security benefits.

5.3 Responsibilities of the Commission

5.3.1 This submission has shown that the Industrial Relations Commission can not be held responsible for all the problems in the economy. Australia does have real economic problems but most are the responsibility of the Government and the Reserve Bank. These institutions need to cease using low income workers as a scape-goat and accept responsibility for the outcome of their own policies.

5.3.2 If all parties are to meet their responsibilities, then the Commission must accept its obligation to protect wages and conditions of employment, and grant the ACTU's living wage claims in full.

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6 DEPARTMENT OF SOCIAL SECURITY, December 1995. *You and Your Family*