

Briefing Note:

A “Transition” to Nowhere:

On the Impossibility of Avoiding the Social Costs of Reduced Penalty Rates

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March 23, 2017

Government and business leaders have proposed a range of possible “transition” mechanisms to ease the economic hardship, and defuse political anger, following the Fair Work Commission’s decision to cut penalty rates for work on Sundays and public holidays in the retail and hospitality industries. The Commission’s order would reduce payment for Sunday and holiday workers by 25 to 50 percentage points of base wage rates, ultimately affecting hundreds of thousands of workers.

The Fair Work Commission is now considering proposals for implementing reduced penalty rates. Its initial decision acknowledged that affected workers would face hardship in “adjusting” to this change, and hinted it could be phased in through two or more step adjustments over some unspecified time period. Government and business leaders are also advancing various proposals for “phasing in” or deferring the reduction in penalty rates.

This briefing note critically reviews several of these proposals. Whether they are motivated by sincere concern for affected workers, or by more cynical interest in managing a challenging political issue, proposals for “transition” and “adjustment” cannot alter the ultimate regressive effects of the Fair Work Commission’s decision. After all, the essence of the decision is to reduce compensation for a large group of workers – who already experience lower-than-average wages, and great instability in hours and incomes. These workers are disproportionately female, young, and immigrant.¹ Significantly cutting their incomes, and/or requiring them to work many more hours to earn the same incomes, will inevitably impose financial and social costs on them and their families. This is true no matter how long it takes to phase in the wage reductions.

¹ For example, see our fact sheet on the disproportionate impact of lower penalty rates on women workers: *Women’s Wages and the Penalty Rate Cut* (Canberra: Centre for Future Work), March 8 2017, https://d3n8a8pro7vhm.cloudfront.net/theausinstitute/pages/1437/attachments/original/1488949016/Womens_Wages_and_the_Penalty_Rate_Cut.pdf?1488949016.

Moreover, deferring or phasing in the change cannot avoid the negative macroeconomic impacts of lower penalty rates. Significantly reducing wages for Sunday and holiday workers in these two large sectors of the economy will exacerbate wage stagnation, further undermine personal incomes, and incrementally widen inequality. These factors are posing significant constraints to Australia's national economic performance, and they will be made worse by the Fair Work Commission's decision – no matter how slowly it is phased in.

In short, a gradual transition to a bad place, still leaves you in a bad place.

This briefing note will consider four scenarios for phasing in lower penalty rates for work on Sundays and public holidays. It finds that none are successful in neutralising the negative effects of lower penalty rates on workers, their families, and national wage trends.

Proposal #1:

Phase in the Reduction Over Several Years, to Allow Base Wages to “Catch Up”

Prime Minister Turnbull himself proposed this transition mechanism. He suggested that if the cut in penalty rates was phased in over several years, normal annual increases in base wages for retail and hospitality workers would offset the impact of lower penalty rates on the earnings of Sunday workers. “As the base pay goes up every year with the minimum wage ... the employee's overall pay packet increases and offsets the phased in reduction in penalty rates,” he claimed.²

There are several problems with this strategy. First, it is not clear that Mr. Turnbull has grasped the full magnitude of the wage reduction which will be imposed on Sunday workers – nor how long it would take for base wages to “catch up” to that shock. For full-time and part-time workers under the General Retail Industry Award,³ for example, pay for Sunday work would fall by one-quarter: from 200 percent of the base rate to 150 percent. That is equivalent to a wage cut of just under \$10 per hour for Level 1 employees, and close to \$12 for those at the top of the award pay scale. Simple maths implies, therefore, that to offset the impact of these lower premiums on total hourly income on Sundays, the base rate would have to increase by one-third in order to maintain final pay at the same level.

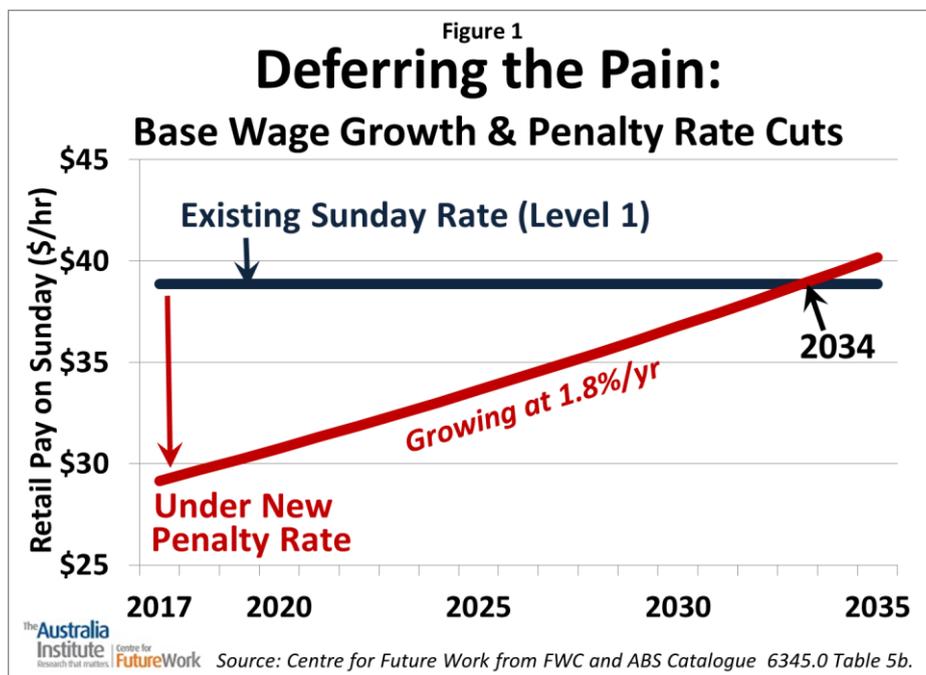
Hourly wages are growing more slowly at present than at any time in Australia's postwar history. This wage stagnation reflects both the generalised weakness of macroeconomic and labour market conditions, and the erosion of wage-supporting institutions (such as minimum wages, employment standards, trade union activity, and others). Most recent ABS data

² Stephen Dziedzic, “Penalty Rates: Malcolm Turnbull Calls on Fair Work Commission to Lessen Impact of Cuts,” ABC News Online, March 2 2017, <http://www.abc.net.au/news/2017-03-02/fair-work-commission-malcolm-turnbull-penalty-rates/8317556>.

³ Fair Work Commission, Pay Guide: General Retail Industry Ward 2010 [MA000004], June 28 2016, <https://www.fairwork.gov.au/>.

confirms this unprecedented weakness in hourly pay: its Wage Price Index reported private sector wage increases of just 1.8 percent over the past year.⁴

If wages continue to grow at that pace (and if anything, the pace of wage increases continues to decelerate), then it would take 17 years until the base rate increases sufficiently (by one-third) to offset the impact of the decline in the Sunday penalty. This “break-even point”: would not be reached until 2034 (see Figure 1).⁵ It is quite unlikely that the retail industry leaders who pushed for lower penalty rates would be willing to wait 17 years for the full implementation of their victory.⁶



But even this extraordinary deferral would not fully protect the incomes and purchasing power of Sunday workers. In effect, Mr. Turnbull’s “transition” proposal would impose a 17-year wage freeze on Sunday retail workers: increases in their base rate during that period would be perfectly offset by reductions in their penalty premium. During that 17-year period, of course, consumer prices continue to grow. With no net wage increases over such an

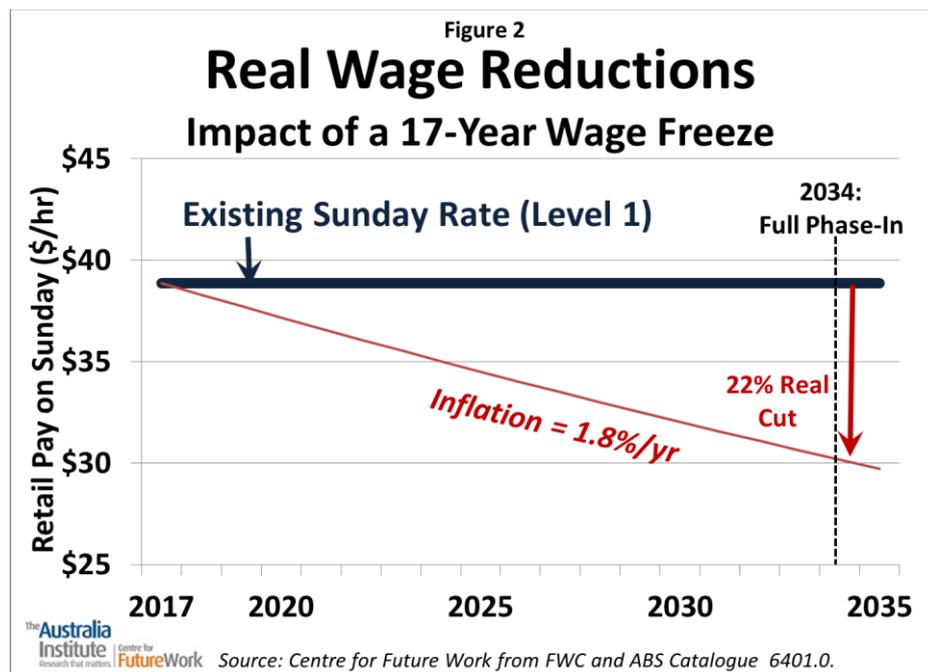
⁴ From ABS Catalogue 6345.0, <http://www.abs.gov.au/ausstats/abs@.nsf/mf/6345.0>.

⁵ Of course, if normal annual wages increases were faster than the current pace, then it would take somewhat less than 17 years to reach “break-even”; if they were slower, it would take even longer. The required phase-in period for hospitality workers, who would receive a 25-point reduction in Sunday pay, would be shorter. Minimum wages have tended to lag behind overall wage growth in recent decades (which is why the minimum has declined as a share of median wages, from 65% in 1985 to 53 percent 30 years later; data from OECD Labour Market Statistics database); so our use of the rate of average wage growth in this simulation is, if anything, conservative.

⁶ The Australian Retailers Association, for example, is not so patient: it suggests cutting the penalty rate in two equal 25-point increments: one on July 1 of this year, and another on July 1, 2018. See David Marin-Guzman, “Retailers Back Sunday Penalty Rates Cut by 2018,” Australian Financial Review, March 14, 2017, <http://www.afr.com/news/policy/industrial-relations/retailers-back-sunday-penalty-rates-cut-by-2018-20170314-guxwb8>.

extended period, the real purchasing power of retail wages on Sundays would be steadily eroded.

Figure 2 illustrates the dramatic effect of that real wage cut over such an extended period, on the assumption of the continuation of current inflation rates.⁷ By 2034, when the penalty rate reduction is fully phased in, the real purchasing power of the existing retail wage would be cut by 22 percent – almost equivalent to the full impact of the penalty rate reduction on the total wages for Sunday retail work (25 percent). So “transitioning” the wage reduction through an extended deferral of lower penalty rates has no effect in protecting the ultimate purchasing power of wages for work on Sundays and public holidays.



Proposal #2:

Special Increase in Base Wages to Offset Lower Penalty Rates

Instead of waiting many years to allow base wages to “catch up” sufficiently to offset the impact on Sunday workers of lower penalty rates, an alternative transition could involve accelerating increases in minimum base wages in affected industries. That would allow the penalty rate reduction to be implemented immediately (or perhaps over a much shorter phase-in period), while still protecting total incomes for Sunday work.

⁷ Inflation data from ABS Catalogue 6401.0, <http://abs.gov.au/AUSSTATS/abs@.nsf/productsbyCatalogue/938DA570A34A8EDACA2568A900139350?OpenDocument>. This assumption that existing inflation rates would continue into the future is comparable to the previous assumption that current wage inflation trends would also be sustained. Faster inflation would imply a greater reduction in real wages, and vice versa.

Once again, the scale of the adjustment in underlying base wages required to accomplish this goal is enormous, and would produce unintended consequences that would surely be rejected by the initial proponents of lower penalty rates. To protect total incomes of Sunday retail workers from an immediate 50-point reduction in the penalty for Sunday work, would require an immediate 33 percent increase in the underlying base rate. For workers in the Level 1 general retail classification (the same one used in the preceding simulations), this would result in an increase in the base rate from \$19.44 per hour to \$25.92. For workers in the highest classification, the base rate would need to increase immediately from \$23.79 to \$31.72.

Retail employers, of course, would be apoplectic over this sort of “transition.” They would experience no reduction in labour costs for Sunday operations. Worse yet, from their perspective, they would incur a substantial increase in compensation expenses for all the other days of the week – since that higher base rate would apply to work on other days.

We have simulated the impact of a 33 percent increase in base rates, combined with a reduction in Sunday penalties (by 50 percentage points), on the total labour costs of a typical weekly retail roster.⁸ This combination results in an increase in total labour costs over the week in excess of 25 percent. While increasing base wages for retail work on any day of the week is a general goal we would support (in light of the low and precarious incomes experienced by most retail workers), this is neither a convincing rationale nor an appropriate mechanism for accomplishing it. At any rate, the idea would be a non-starter with employers.

Proposal #3:

Combination of Regular and Special Increases in Base Wages

The two extreme strategies described in the sections above – phasing in penalty rates while base wages gradually “catch up,” and immediately adjusting base wages to offset the effects of the penalty rate cut – could be combined. That would allow a faster reduction in penalty rates, as well as a more gradual phase-in of the corresponding increases in base wages. But differing permutations of policies that are themselves ill-advised and impractical, simply produce more incarnations of unsuccessful policy.

Consider, for example, a 5-year transition period. Net wages for Sunday workers (considering both the base rate and the penalty) would be frozen at the existing level (\$38.88 for Level 1 retail work). Keep in mind, this 5-year freeze itself will reduce real wages for Sunday retail work by 8 percent, due to the inexorable effect of inflation. Then, the underlying minimum base wage would need to be boosted by \$1.30 (or about 7 percent) in each of those 5 years. The reduction in penalty rates would also be phased in, through five equal steps. By 2022, the penalty rate has reached the new threshold (150 percent of the

⁸ Our example assumes 51 opening hours Monday through Friday, 11 hours on Saturday, and 9 hours on Sunday. Other configurations are possible, and produce similar results.

base), but minimum wages have increased accordingly to preserve nominal incomes for Sunday work.

This combination of two ill-advised transition strategies, results in a situation in which *both* Sunday workers and employers are worse off. Real wages for Sunday work have declined. And overall labour costs across the week (since the higher base rate must also be paid on other days) have also increased significantly. The purported goal of “protecting workers during the transition” has in fact damaged both sides of the employment relationship.

**Proposal #4:
Protect Wages for Existing Sunday Workers**

A final proposal for facilitating the reduction in penalty rates, in a manner that supposedly avoids the hardship of lower incomes, would be to “grandfather” the existing wage rates paid to individuals already working in the sector.⁹ In this manner, no existing workers see reductions in their (nominal) hourly earnings on Sundays, but the new lower penalty rates could still be phased in as new workers are hired. The logic is similar to other “two-tier” wage structures, whereby employers try to engineer lower long-run wages, while defusing opposition from their existing employees.

There are many principled and operational reasons why such an approach is neither feasible nor desirable. Freezing the nominal hourly earnings of Sunday workers does not protect their real earnings, for the same reasons discussed above: the steady forward march of inflation undermines the real purchasing power of their incomes (at present, by about 1.5 percent per year). There are many organisational and management challenges associated with such an approach: including requiring employers to keep track of existing workers, maintain multiple pay structures, and more. The impact of enforced wage inequality on cohesiveness and effectiveness within the workplace – two workers, with similar qualifications, would receive substantially different pay for doing the same work, side by side – is very negative. And for future workers in these industries, of course, the burden of significantly lower wages for Sunday and holiday work would still be experienced in full force. Lower pay, and greater difficulty balancing household budgets, still constitutes a significant hardship for retail and hospitality workers, even if they have not yet started their careers in these industries.

The bigger risk to the incomes of existing Sunday workers under this scheme, however, arises from the flexibility of employers to adjust staffing schedules for Sunday work. Workers in retail and hospitality are already subject to irregular work schedules; many do not know when they are working from one week to the next, and employers have virtually unlimited flexibility to adjust the timing and amount of scheduled work. Facing a situation where new hires would earn 25 percent less per hour than existing employees, employers would easily be

⁹ This proposal has been advanced, for example, by Small Business Ombudsman Kate Carnell and by Senator Eric Abetz; see David Marin-Guzman, “Small Business Ombudsman Says Legislate ‘Take-Home Pay Orders’ for Sunday Cuts,” Australian Financial Review, March 2, 2017, <http://www.afr.com/news/policy/industrial-relations/small-business-ombudsman-says-legislate-takehome-pay-orders-for-sunday-cuts-20170302-gup13k>.

able to replace existing workers with their cheaper counterparts. Existing Sunday workers would lose many or all of their scheduled hours, likely imposing an even greater hardship than the direct 25 percent cut in hourly earnings.

Conclusion

The Fair Work Commission's decision to reduce the penalty rate paid for work on Sundays and public holidays, in two of the largest industries in Australia's economy, cannot but impose a significant economic cost on the people who perform that work. Our review of various proposals for phasing in that change, and supposedly helping workers "adjust" to the loss of income, suggests that none are capable of truly avoiding the resulting hardship. When workers are paid less for work, they inevitably receive less income. That, after all, is the point of this measure – in line with so many other policy decisions in recent decades which have cumulatively undermined wage-supporting institutions across Australia's economy. It is no coincidence that current wage growth is at the slowest pace ever recorded in our statistics, and that household incomes and aggregate demand are suffering accordingly: that was the ultimate goal of the business-friendly deregulation of so many labour policies and institutions over the last generation. Plans for a more gradual implementation of these measures, at best can only defer the inevitable economic and social hardship.