Briefing Note:

Penalty Rates, Minimum Wages, and Purchasing Power

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The Fair Work Commission released two major decisions this week: its order regarding the timing for the implementation of reductions in penalty rates for Sunday and public holiday work in four major retail and hospitality awards, followed by its annual review of the general minimum wage. Both decisions will take effect on July 1. It is interesting to review the combined impact that the two decisions will have on the wages of workers in sectors affected by the penalty rates decision. In particular, does the Fair Work Commission's decision to phase those cuts in over two or three years somehow protect the workers who will now receive lower wages for work on Sundays and holidays? Our previous research suggested this was not possible;[1] we can re-examine that question in light of the Fair Work Commission's two actual decisions.

We consider the case of the Retail Award, for which the Sunday penalty rate is being cut from 200 percent of the base rate to 150 percent.[2] This is equivalent to a reduction of 25 percent in hourly wages for Sunday work. For workers in the lowest wage category, this translates into a pay reduction of almost $10 per hour; for workers in higher categories, the pay reduction is larger. The Fair Work Commission's decision on Transition Arrangements will see that reduction implemented in 4 steps: with the penalty rate lowered by 5 percentage points of the base rate this July 1, then 15 percentage points on July 1 of each of the following three years (2018, 2019, and 2020).

Meanwhile, the base rate itself will increase on July 1 by the same 3.3 percent increase that the Fair Work Commission has determined for the general minimum wage. Presumably, the minimum wage will also increase in subsequent years, although it is uncertain by how much. Those increases in minimum wages are intended to reflect the impacts of inflation, productivity growth, and other factors as determined by the Commission.

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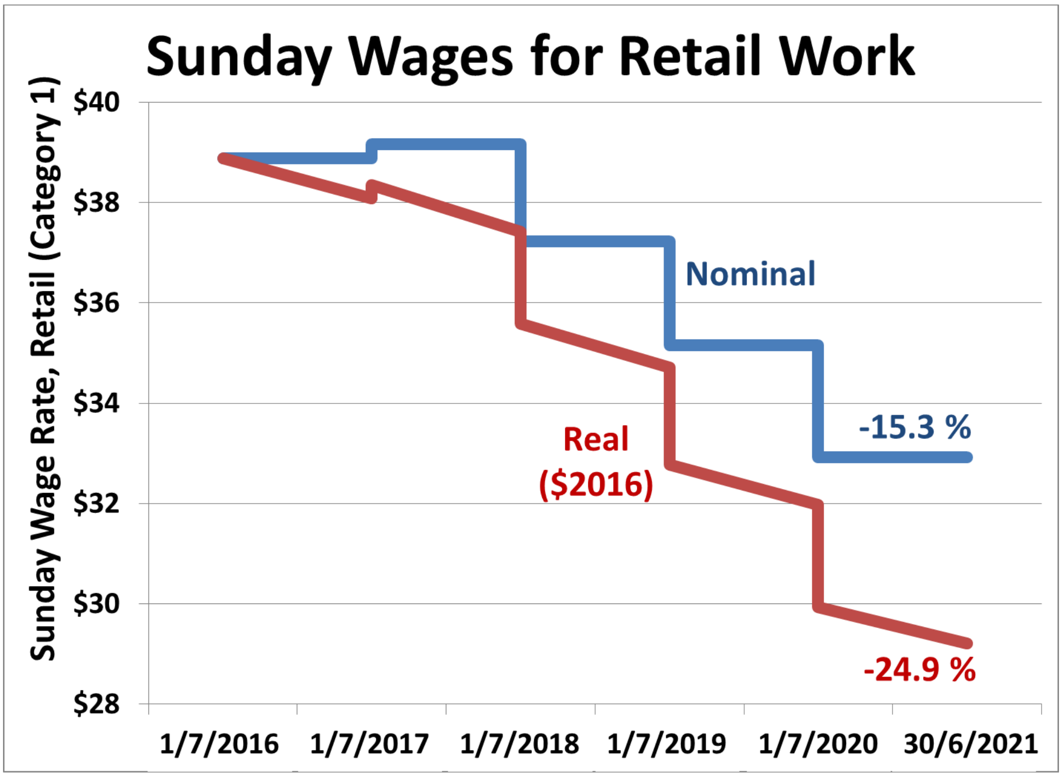
[1] See our Briefing Note, "A 'Transition' to Nowhere: On the Impossibility of Avoiding the Social Costs of Reduced Penalty Rates," March 23, 2017, available at https://d3n8a8pro7vhmx.cloudfront.net/theausinstitute/pages/1444/attachments/original/1490163619/Transition_to_Nowhere_Final.pdf?1490163619.

[2] The Sunday penalty rate is being reduced by an equivalent amount in the Pharmacy Award, and by 25 percentage points of base wages in in the Hospitality Award (175 to 150 percent) and the Fast Food Award (150 to 125 percent). The Fair Work Commission's decision to reduce penalty rates is being appealed.

Figure 1
Projected Hourly Wages for Sunday Work, Retail I



Source: Centre for Future Work calculations from Fair Work Commission, "4 Yearly Review of Modern Awards, Penalty Rates: Transitional Arrangements AM2014/305," June 6, 2017, and ABS Catalogue 6401.0.

Figure 1 illustrates the combined impact of the staged reductions in the penalty rate, combined with annual adjustments to the minimum wage, and the ongoing impact of inflation on the real purchasing power of the combined wage. The figure portrays the Category I hourly wage rate for a full-time or part-time worker on Sunday under the Retail Award, shown both in nominal dollars (blue) and adjusted for inflation (red).

The nominal Sunday rate was set at $38.88 (200 percent of the base rate) effective July 1, 2016. Since then inflation has reduced the purchasing power of that wage by 2.1 percent. On July 1 of this year, the penalty rate will be cut to 195 percent of base, but the base itself is increased by 3.3 percent. That results in a small net increase (of about 0.7 percent) in the nominal rate – although the real rate is still lower than at the outset.

The larger reductions in penalty rates scheduled for the next three years (15 percentage points of the base rate per year) vastly overwhelm the offsetting impact of any likely changes in the minimum wage. Figure 1 assumes the minimum wage is increased by 3 percent in each of those years.[3] By July 1, 2020, we expect the combined nominal rate for Sunday work to have declined to under $33 – a cut of over 15 percent from the current level.

[3] This assumes that the Fair Work Commission continues to increase minimum wages faster than both inflation and average wages in the coming 3 years. If it does not, then the wage increases illustrated in Figure 1 would be even worse.

Over the same period, however, the ongoing impact of inflation continues to erode the real value of the wage.[4] By June 30, 2021, the real minimum wage for Sunday retail work will have declined to just over $29 (in 2016 dollar terms), a reduction of almost 25 percent from the initial level. Annual increases in minimum wages for these workers are overwhelmed by the corresponding reductions in the penalty rate, and hence the negative impact of inflation on real purchasing power is experienced in full force.

In our initial research on this subject, we evaluated the suggestion (made by Prime Minister Turnbull, among others[5]) that the negative impact of lower penalty rates on weekend workers could be abated by phasing in the reduction over several years – so that normal increases in the minimum wage during that time could offset the damage on incomes. We argued that this was not possible: it would take many years' of minimum wage increases to offset the impact of the halving of penalty rates, and moreover the real value of the wage would be badly eroded in the interim by the effects of inflation.

This simulation confirms that the same problem besets the Fair Work Commission's plan to stage the penalty rate reductions over an intermediate period of two or three years. Except in the first year (when the penalty rate falls by only 5 percentage points), the annual reductions in the penalty rate vastly outweigh the positive impact of higher minimum wages. And during the intervening years, the real purchasing power of the Sunday wage is eroded by normal inflation. (After all, annual increases in the minimum wage are supposed to offset those annual price increases.) By the end of the phase-in period, therefore, the real value of an hour's retail work on Sunday is just under 25 percent lower than at the outset of our simulation. That is almost the same as the full impact of the 50-point reduction in the penalty rate on the nominal rate.[6]

The Commission has specified a range of different transition timelines for the various categories of employment in the four affected awards, and so the specific impacts on nominal and real wages will also vary. But the same general finding is true in every case: nominal wages fall significantly (since increases in minimum wages over the transition period cannot offset the larger decline in penalty rates), and real wages fall even further – by almost as much as if the whole reduction in penalty rates were implemented immediately.

In summary, it is clear that phasing in the reductions in penalty rates merely delays the inevitable loss in real incomes that the Commission's decision will impose on weekend workers in all of these sectors. In every case, by the end of the relevant phase-in period both the nominal and real wages of Sunday workers are significantly reduced.

[4] Figure 1 assumes an average inflation rate of 2.5 percent per year, equal to the midpoint of the Reserve Bank of Australia's target band

[5] See 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.

[6] As noted above, 50 points of foregone penalty rate equals 25 percent of the 200 Percent Sunday rate.