



## **THE BRITISH LOW PAY COMMISSION AND THE PROPOSED AUSTRALIAN FAIR PAY COMMISSION**

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The Federal government's decision to overturn Australia's century old system of wage determination, and replace it with a 'Fair Pay Commission' supposedly modelled on the system introduced by the Blair government, makes a focus on the British system timely. In May 2005, announcing some details of the proposed industrial relations changes, Workplace Relations Minister Andrews commented on the government's responsibility to the unemployed as well as to the maintenance of the minimum wage. He said, 'the UK Low Pay Commission would appear to have been striking the right balance between the needs of the low paid and unemployed. Since 1999 the minimum wage in the UK has increased by over 30%' (Andrews, 2005). So looking at the background to the introduction of the British minimum wage, and the subsequent impact of the minimum wage, may indicate what the policy proposals for Australia portend. We can also examine similarities between the British system and the Australian proposal, and whether claims of similarity or 'modelling' by the Federal government are reasonable.

This paper examines the background to the establishment of the British Low Pay Commission (LPC) and the national minimum wage (NMW). It then looks at the detail of the British NMW and summarises the emerging academic research on the question of impact. The focus then shifts to what is known about the Australian Fair Pay Commission

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proposals and key similarities and differences with the UK. Finally attention turns to what a Fair Pay Commission might mean for Australian workers.

### **Background – Britain**

Up until 1979 Britain's industrial relations system operated largely outside the law, reflecting trade unions' origins as illegal organizations. In the early 1900s unions were granted immunities from the law, rather than positive rights, and a statutory platform of minimum rights and standards only emerged in the 1960s. Voluntary collective bargaining was underpinned by industry wages councils which set wages floors by industry, covering up to 2 million workers prior to their abolition. It was a system, however, with many gaps in the protections it offered workers, particularly the low paid. These gaps were split wide open by the Thatcher government when it came to office in 1979, vowing to reduce union power. Thatcher's free market ideology was closely aligned to the economic philosophies spelt out by Frederick von Hayek, who proclaimed 'there can be no salvation for Britain until the special privileges granted to trade unions three quarters of a century ago are revoked' (Hayek, 1984:58 in Dunn & Metcalf, 1996).

Using intervention in industrial relations on an unprecedented scale for Britain, Thatcher enacted no fewer than 10 separate pieces of legislation attacking what she saw as excessive union power. The impact on union membership was dramatic and devastating. Four million members were lost in a decade, not helped by the harsh economic climate of the time. Within a decade of Thatcher's election Britain's industrial relations had been transformed, and collective bargaining covered less than half the workforce (Metcalf, 1994). Growing inequality was compounded by growing unemployment and the 1980s saw a large growth in wage inequality and a relative decline in the labour market position of the unskilled (Nickell, 2005).

In 1980 the legal duty of employers to recognise and bargain with a union representing the majority of its workforce was abolished. Wages Councils were abolished in 1993 (although one Wages Council remained

in the agriculture sector). For six years Britain operated a completely 'competitive' labour market in that there was no wages 'floor'. For some sectors, particularly private services, this meant a race to the bottom. Stories of workers working for as little as one pound an hour were not uncommon. Effectively the state was subsidising uncompetitive and inefficient businesses, as these very low paid workers needed and relied upon state assistance to survive. This fact was recognised by the LPC, noting in their first report to Government in 1998 that, 'Because in work benefits exist to supplement low earnings, it has been possible for some employers to depress wages to unacceptable levels and thereby transfer unreasonable costs onto the benefits system. As a result, the taxpayer ends up subsidising wage exploitation and unfair competition' (LPC, 1998:17).

When the Labour Party, led by Tony Blair came to office in May 1997 it did so with a policy to establish a minimum wage. This policy had come from Labour Party conference and did not enjoy the wide support of the party leadership, and it had been the source of much attack from Conservatives during the election campaign (Brown, 2002). The Conservatives argued vehemently that such a policy would cost jobs. Interestingly, not all in the union movement supported the minimum wage concept either, with some, notably the then Engineers Union (now Amicus), arguing that this was something unions could and should achieve for workers in the workplace by using industrial muscle. The precipitous fall in membership during the Thatcher years meant, however, that most unions realised they could not reinstate decent wages on their own and thus actively supported the minimum wage proposal.

The Low Pay Commission (LPC) was established shortly after the Blair Government's election, and its initial brief was to recommend to government a level at which the NMW might be introduced, and to make recommendations on lower rates or exemptions for those aged 16-25 (Metcalf, 1999). In making recommendations the LPC was to 'have regard to: wider economic and social implications; the likely effect on employment and inflation; the impact on competitiveness of business, particularly small firms; and the potential impact on costs to industry and the Exchequer' (Metcalf, 1999). The LPC comprises nine commissioners, three each from backgrounds in unions, employer

organisations and academia. The commissioners sit as individuals, not as representatives of their constituencies. The initial three academic members, of whom two remain on the LPC, are all Professors of Industrial Relations and active researchers and internationally recognised experts in the field of industrial relations, rather than economics<sup>1</sup>.

As with much of the policy thrust of Blair's 'New Labour' government, the Commission was charged to operate with a 'social partnership' approach, and to endeavour to reach consensus. Both the Trades Union Congress (TUC) and Council of British Industry (CBI), Britain's peak union and employer bodies respectively, were consulted on the appointment of Commissioners (Brown, 2002). In undertaking its tasks the Commission accepts submissions, undertakes research, and visits various communities and workplaces in order to have the greatest understanding about issues surrounding their brief. The Commission appears acutely aware of treading a delicate tightrope in setting the NMW. It says, 'a prudent approach is needed when the NMW is introduced to minimise the risk to employment' (LPC, 1998:19), noting also the concern that 'poverty wages cannot encourage people to move from benefits to work...The introduction of a statutory floor for wage levels must encourage feelings of belonging not to the margins, but to the mainstreams of society' (LPC Chairman, 18/6/98).

The first minimum wage was introduced in April 1999, set at £3.60 per hour (approx A\$8.80 per hour), with Government accepting the LPC recommendation. The rate was around half the median rate of pay at the time, for those aged 22 and over (Metcalf, 1999). The LPC recommended a 'development rate' (youth wage) of £3.20 for those aged 18-20; but the Government decided to set the rate at £3.00 and apply it to those aged 18-21, with a rise to £3.20 in 2000 (Metcalf, 1999). Table 1 shows the full adjustments thus far. No up-rating mechanism has been established by the LPC. The increases during 1999-2002 were based on the average earnings index. During 2003-2004 the increase was double the average earnings index (LPC, 2005). For the period 2005-2006 the

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<sup>1</sup> They are Professor David Metcalf, Professor of Industrial Relations, London School of Economics; Professor William Brown, Professor of Industrial Relations, University of Cambridge; and Professor George Bain, Professor of Industrial Relations and formerly Vice Chancellor, Queens University before retirement in 2004.

proposed movement is again above the average earnings index, with the intention that the NMW will increase in real terms. For the period since its introduction until the proposal for October 2006 the total increase in the NMW will be some 46%.

Interestingly, LPC Commissioners have reported publicly that the initial minimum wage was set too low as a result of incorrect statistics given to the Commission by the Office of National Statistics, which overstated the numbers of low paid workers quite significantly (see Metcalf, 2002, Brown, 2002). First estimates were that the initial minimum wage would affect some 2 million workers, whereas in fact the coverage ended up being closer to 1.2 million, at a cost of less than 0.25% of the total wages bill (Metcalf, 2002:569). The initial conservatism has, however, justified larger jumps in recent years and, it is argued, contributed to a high level of confidence in the NMW (Brown, 2002).

**Table 1: British National Minimum Wage, hourly rate: 1999-2006**

	Adult Hourly Rate (£)	18-21 years Hourly Rate (£)	Increase in Adult Rate Since 1999
April 1999	3.60	3.00	
June 2000	3.60	3.20	
October 2000	3.70	3.20	
October 2001	4.10	3.50	
October 2002	4.20	3.60	
October 2003	4.50	3.80	
October 2004	4.85	4.10	35%
October 2005	5.05	4.25	40%
October 2006 (proposed)	5.35	4.45	46%

Source: Low Pay Commission report, 2005

### **Impact: the Evidence so Far**

Two thirds of those affected by the introduction of the British NMW in 1999 were private service sector workers (Metcalf, 1999). In particular, the greatest beneficiaries of the NMW have been women, the young, part

time workers, ethnic minority workers and those with health problems. Now, some five years into the operation of the NMW, there is an opportunity presented to assess its impact, and some important findings have been made. First, and of great significance, is that there has been no adverse impact detected upon aggregate employment growth (Stewart, 2004). This was found for the introduction of, and subsequent up-rating of, the NMW (Stewart, 2004). This finding backs up earlier findings in the US on the impact of a minimum wage (eg. Card & Krueger, 1995) and challenges the orthodox economic view that setting and improving minimum wages causes job losses. Indeed as the LPC notes, 'overall employment has increased among the groups of workers and in the sectors most affected by the NMW' (LPC, 2005:xii).

Researchers also found that the NMW was able to be introduced and increased with little 'knock-on' effects to workers further up the income scale (Dickens & Manning, 2004). This finding challenges the orthodoxy that pay increases for the low paid are necessarily inflationary. The British experience shows that it is possible to target the effects of NMW increases to the low paid. It may be, of course, that low paid workers are much less likely to be unionised, thus limiting any capacity for flow-on.

The NMW on the incidence, and extent of training is also of significance. Here too there is good evidence showing that the introduction of the NMW increased the probability of training incidence and intensity by eight to eleven percentage points (Arulampalam, Booth & Bryan 2004). It is speculated that a higher wage rate gives the firm an incentive to improve the worker's productivity via training (Metcalf, 2004). This is a very important finding, suggesting that higher wages are consistent with a skilled workforce and that the low paid labour market is not properly described by the standard competitive economic model, as Metcalf (2002:580) notes, 'the low paid labour market is more complex than the straightforward text book model would have us believe'. A further interesting finding was made by Hansen and Machin (2002) who looked at the impact of the NMW on crime rates across a number of areas in England and Wales. Their research found that where the NMW had its strongest positive effect on wages there was also a relative fall in crime, particularly property and vehicle related crime.

### Australia's 'Fair Pay Commission'

On 26 May 2005 the Australian Prime Minister announced details of the Government's plans for wide ranging industrial relations change. Further details were announced in October. Among the series of radical changes was a plan to establish a new body, the Australian Fair Pay Commission, which would be given powers to set and adjust the federal minimum wage. The new body would also adjust minimum rates for juniors, the disabled, piece workers, those in training and set award classification wages and casual loadings (Andrews, 2005). In October 2005 it was announced that the AFPC would be Chaired by Professor Ian Harper, a financial economist from Melbourne Business School. The four other, part time Commissioners have yet to be announced at the time of writing. These Commissioners will need to fit the criteria, 'must have experience in one or more of business, community organizations, workplace relations or economics' (Andrews, 9/10/05). All Commissioners are to be appointed on a fixed term basis, five years for the Chairman and four years for the four Commissioners. Comments by Andrews that 'importantly, the AFPC will apply greater economic rigour to its determinations and take into account the impact of any decisions on the low paid and unemployed' (Andrews, 2005) set the tone for future appointments. The AFPC will be in charge of setting the timing, scope and frequency of wage reviews and how those reviews will be conducted. The AFPC will be able to commission its own research or conduct monitoring (Andrews, 2005).

Notwithstanding the lack of detail around the AFPC proposal, we have enough information to glean some key differences between what is proposed here and the activities of the British Low Pay Commission. First, some obvious but nonetheless key differences. The LPC was established to introduce a minimum wage system from a clean slate, that is, where none previously existed. The LPC was required to make recommendation to government, not formally set the rate, as the AFPC will do. Further, the British NMW is simply one adult rate. There is no award system or classification system as such; rather the NMW underpins voluntary collective bargaining and individual arrangements. In the UK collective bargaining sets pay and conditions for less than 40% of the workforce (Kersley *et al.*, 2005:19).

The LPC has an expansive brief. As well as economic considerations, it must take into account wider social implications (LPC, 1998), and its various reports show it has taken the issues around low pay very seriously. The AFPC, on the other hand, has as its primary objective 'to promote the economic prosperity of the people of Australia' (Australian Government:14) and, in doing so, it must consider, 'the capacity for the unemployed and low paid to obtain and remain in employment' (p14). Whatever 'balanced judgement' (Harper, 2005) the new Chair might claim to want to make, his point of reference is clearly set for him, wages at the lower end of the labour market must be set competitively in accordance with the competitive model, with the strong inference that they are already set too high. Given the Government's opposition to the wage rises set by recent national wage cases, it is reasonable to assume that the impact of the AFPC will be to lower the minimum wage over time, principally by holding the level constant (in accordance with the government's promise not to cut the existing minimum wage), thus reducing its real value.

The UK went without a minimum wage for six years after Wages Councils were abolished in 1993 whereas Australia already has in place a system for minimum wage setting. Indeed, the LPC in its most recent report notes that Australia has the highest minimum wage of the countries it examined, both in terms of purchasing power parity, and in comparison to full time median earnings. In mid 2004 Australia's minimum wage was 58.8% of full time median earnings, where as the UK minimum wage was 43.2% and the US 32.2% (LPC, 2005:236-7). The AIRC, as well as setting the minimum wage, has been the vehicle for advancement in employment standards (for example, equal pay, parental leave, termination change and redundancy), given Australia's lack of statutory regulation. This is not to suggest, however, that Australia's current regulatory system is without gaps, nor in need of some updating. The spread of managerial unilateralism (Campbell, 1996), rapid growth in casualisation, and lack of enforcement (Lee, 2005) suggest that the current minimum standards are not universally applied.

Second, the most critical difference is that of context and political intent. The British LPC was established within a broad 'social partnership' context; and the establishment of the NMW was part of wider social

policy changes, including broad measures to reduce poverty. Notwithstanding the contested nature and understandings of 'social partnership' (see Undy, R, 1999) and New Labour's philosophy of the 'third way' (Giddens, 1998), the Government's *Fairness at Work* White Paper, which contained the minimum wage proposal, also included a number of important industrial relations policy changes. The most significant of these was a legislative process for trade union recognition. Again, within the social partnership context, the intention was that the legal provisions be used as a last resort, and parties were encouraged to reach agreement. This has proved successful, with most union recognitions occurring voluntarily, in the 'shadow of the law' (Moore, 2004:11). The Blair government also reduced the qualifying period for unfair dismissal to one year and removed the cap on upper limits for compensation. Furthermore a number of key EU directives were adopted, including the Works Councils Directive (requiring works councils to be established in pan-European companies with greater than 1000 workers), the parental leave directive (which includes the right to request part time work on return from maternity leave) and the working time directive.

This contrasts sharply with the agenda of the Howard Government. Whilst the public pronouncements argue that awards will remain and be protected, that workers will retain the right to union protection and the right to a collective agreement (see Andrews, 2005), the practical effect of the proposals suggest otherwise. The removal of the 'no disadvantage' test and the underpinning of AWAs to a minimum wage and four basic entitlements only (the so called, 'Australian Fair Pay and conditions standard') suggest a quick race to the bottom for many sectors. Those in the services sector, where wages form a large part of total cost, eg. contract cleaning, will be particularly vulnerable. Effectively, all that will protect over-award conditions enjoyed by many workers will be collective activity, and this will be severely curtailed by an array of punitive provisions designed to remove any exercise of union power. Indeed, unions and employers will be expressly prohibited from agreeing on a range of provisions that are currently commonplace in many awards and agreements, such as trade union training leave, union involvement in dispute resolution, as well as prohibited from including provision for remedies for unfair dismissal, and prohibition of AWAs

(Australian Government:23). There will be a penalty of up to \$33000 for 'seeking to include prohibited content in an agreement' (p24).

As with the effect of Thatcherism in Britain, the current proposals for Australia will likewise drive a truck through what remains of the regulatory system after the last two decades of changes. As Campbell & Brosnan (2005) argue, the patchwork nature of the award system as it currently stands, with its many gaps in coverage, a lack of basic rights floor and lack of an effective enforcement regime (see Lee, 2005), leaves precariously employed workers such as casuals particularly vulnerable to exploitation. The proposals contained in *'Workchoices'* widen the net for such exploitation and provide the capacity for widespread degradation of employment standards to those currently applicable in the 'flexible' world of the casualised sector (see May, Burgess & Campbell, 2005).

The Howard Government's defence to this argument is that somehow the 'market' will guard against employers being able to exploit workers, as workers are supposedly in a good bargaining position at the present. Such ideological adherence to the theoretical competitive model of the labour market is at odds with the experience of workers in the real world. Ehrenreich's (2001) account of low paid work in the world's most affluent and market driven economy, the US, uncovers some compelling reasons why the 'market', particularly for low paid workers, just doesn't work like that. High and hidden costs of job search, imperfect information about pay, combined with the relative security of the job held despite the fact that it may be poorly rewarded, mean that labour mobility is never a straightforward matter.

### **Conclusion: Implications of the AFPC for Australian Workers**

There is no 'one way' to design a minimum wage system. The British model and what is proposed for Australia are only two of several possible methods of dealing with low pay. Indeed, not all OECD nations have a minimum wage, Germany being one such example. When looking at the British NMW and the activities of the LPC in the wider context, it becomes clear, however, that this is a significantly different

model to that proposed for Australia. The British NMW sits firmly within a more broadly progressive social agenda, underpinned by an array of social protections and minimum standards. The function of the AFPC and the context within which it will sit is a different one which will have qualitatively different outcomes for Australia's low paid. Rather than being an instrument to improve low pay, the AFPC, with its narrow economic and ideological focus, seems to be designed as an instrument for intensifying low pay.

It is incorrect for the Minister and the new AFPC Chair to attempt to link the AFPC with the British LPC. By bringing the British LPC into this discussion the Government is introducing another smokescreen behind which to hide its harsh, ideologically driven agenda and the lack of evidence in favour of the proposals. As labour economist, Harvard Professor, Richard Freeman (2005) argues in a recent paper analysing the debate on flexibility and labour market performance, 'the best summary of the data – what we really know – is that labour institutions reduce earnings inequality but that they have no clear relation to other aggregate outcomes, such as unemployment' (Freeman, 2005:12). It is clear that earnings inequality and other such matters are beyond the brief of the AFPC. It is also clear that the Government sees that the 'price' for the unemployed to get a foothold in the labour market is to take a job, (a la Billy in *Workchoices*, 2005:15) at less than accepted community and industry standards, that is at lower than the 'going rate'. If this is allowed to occur, the one sure outcome is growth in inequality, low pay and poverty, and the loss of long-held notions of the right to decency and dignity in work. The AFPC will be at forefront of this agenda, an agenda that has far more in common with Thatcherism and the Britain of the 1980s than the Britain of today.

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