# Penalty Rate Cuts Will Boost Inequality, Not Employment

*Public Letter from Economists, April 6 2017*

Australia's Fair Work Commission has recently decided to reduce penalty rates for work on Sundays and public holidays in the retail and hospitality sectors. Rates would fall by 25 to 50 percentage points of base wages, for most employees covered by the retail, pharmacy, fast food, and hospitality awards. For some workers this would result in a one-quarter reduction in hourly compensation for Sunday work (equivalent to a pay cut of $10 per hour or more).

Workers covered by individual contracts or Enterprise Bargaining Agreements will also see downward pressure on their own rates of pay for Sundays and holidays, since the awards system establishes an overall floor for compensation; hence those workers will eventually be asked to agree to reductions in their own penalty rates and/or offsetting compensation provisions. We also expect that the precedent established in these sectors will be extended to other parts of the economy, as employers invoke the same rationale for lower penalty rates as was accepted by the Fair Work Commission for retail and hospitality work.

We do not expect that lower wages for work on Sundays and public holidays will result in significant net job creation in retail and hospitality, for several reasons:

1. Economic research indicates that overall business activity in retail and hospitality, and hence overall employment in those sectors, depends most importantly on the level of consumer expenditure on retail and hospitality services, which in turn is determined mostly by aggregate economic performance and personal incomes. Lower wages for work on Sundays and holidays cannot increase the overall budget constraint that limits consumer spending. (To the contrary, by undermining incomes for a group of workers, it will marginally reduce aggregate personal disposable incomes.)

2. While the impact of lower penalty rates on individuals who regularly work Sundays and public holidays would be significant, the impact on overall average compensation costs across retail and hospitality will be very small (since most work in those sectors is performed on other days of the week, and will not be affected by this decision). Therefore, the impact on overall hiring decisions in these sectors cannot be large.

3. By reducing the relative costs of operating on Sundays versus other days of the week, lower penalty rates will likely encourage a shift of activity from other days to Sundays and holidays. New demand for lower-cost labour on Sundays will be at least partly offset by reduced demand for labour on other days. And by shifting consumer demand from other days to Sundays, lower penalty rates could actually reduce productivity and operating margins on those other days of the week, with unpredictable effects on overall employment levels.

4. Modern economic research confirms that the impact of changes in statutory minimum wages on employment is very small, and often indeterminate in direction. The traditional assumption that higher minimum wages necessarily result in less employment has been disproven by exhaustive peer-reviewed research; it is equally illegitimate to conclude that lower minimum wages will result in more employment. Economists have discovered several channels through which minimum wages affect business decisions (including through their impact on productivity, retention, recruitment, and training), in complex ways that make it impossible to predict even the direction of the final impact on employment. Moreover, at lower wage rates, workers will be less inclined to supply their labour, which could have a detrimental effect on workforce participation.

While it is doubtful that lower penalty rates will result in any measureable increase in total employment in the retail and hospitality industries, there is no doubt that this decision will reduce incomes for some of the most insecure and poorly-paid workers in the economy. Statistical data confirm that the retail and hospitality workforce is disproportionately reliant on women, immigrants, and youth: groups which already earn below-average incomes and are already likely to face precarious, unstable work arrangements. By reducing wages for this low-income segment of the workforce, lower penalty rates would incrementally widen income inequality in Australia, and exacerbate its varied economic and social consequences. It would also undermine government fiscal balances, by both reducing tax revenues and increasing welfare payments.

More broadly, the penalty rate decision (and other policy actions which effectively suppress wage levels) will also aggravate a more important and damaging problem in Australia's macroeconomy: namely, the unprecedented stagnation of wage and salary incomes, and resulting weakness in household finances. Growth in hourly wages and weekly earnings has decelerated to the slowest pace in postwar history: below 2 percent per year at present. Total labour incomes have fared even worse, in part because of the shift to part-time and casual work (and resulting decline in average hours worked per week). Total nominal labour incomes actually declined by 0.5 percent in the most recent quarterly national income statistics; this unusual and damaging result reflects the erosion of institutional supports for wage-setting (as well as chronic weakness in demand conditions). The decision to reduce penalty rates for work on Sundays and public holidays contributes to this trend, and hence would further undermine the performance of household incomes and national growth.

*Signed by over 75 Australian professionals working in economics and related disciplines.*

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