Australian Institute for Business and Economics (AIBE)

A Review on Australia's Penalty Rate Cuts

Vu Minh Thu Hoang

A Student Work Experience Program paper

August 2017

THE UNIVERSITY OF QUEENSLAND AUSTRALIA

AUSTRALIAN INSTITUTE FOR BUSINESS & ECONOMICS

Table of contents

Abstract....3
Introduction....3
Benefits to consumers, businesses, and employment rate....3
A critique of support arguments....5
Negative impacts on inequality, economic growth, employment rate, labour supply side and other social aspects.5
Conclusion....8
References....9

Abstract

There is widespread concern over the reform in 2017 that aims to reduce Sunday and public holiday penalty rates in the Hospitality, Retail, Restaurant, Fast Food and Pharmacy industries. Despite certain benefits this might bring to consumers and businesses in the short term, its long-run gains are disputable. This paper is going to conduct an extensive review of the advantages and disadvantages of the penalty rate cuts as well as argue the reform can have adverse effects on the economy in terms of inequality, economic growth, unemployment, labour supply and other social respects.

Introduction

According to Fair Work Ombudsman (2017), in Australia, 'penalty rate' refers to an increased pay rate to employees who work outside the ordinary business hours, including weekends, public holidays, overtime, late-night or early-morning shifts. In February 2017, the Fair Work Commission (FWC) ruled Sunday and public holiday penalty rates would be reduced for workers in the Hospitality, Retail, Restaurant, Fast Food and Pharmacy sectors. They justify these industries are the target of the change because a reduction to their employee awards can make a difference to market outcomes for wages, demand and employment (Productivity Commission (PC) 2015). Consumer demand is especially strong at any time during a week for services provided by these industries.

The changes to public holiday penalty rates will take effect on 1 July 2017, while the cuts to Sunday rates have not yet been finalised (Fair Work Ombudsman, 2017). This ruling has provoked widespread controversy among different affected and interested parties, from the Federal Opposition, Unions to employer groups. Accordingly, this paper is to analyse arguments supporting as well as opposing FWC's decision and to demonstrate why it is going to have negative implications for the Australian economy.

Section II shows the possible positive aspects of the reduction in penalty rates, while Section III will critically analyse the arguments made in support of the reform. Finally, Section IV points out the adverse ramifications for the economy the policy is bound to have, which then leads to a conclusion on the issue.

Benefits to consumers, businesses, and employment rate

Consumers will benefit from the penalty rate cuts as shops will be open for longer hours. Dawkins, Rungie and Sloan (1986) explains the penalty rates act as a *compensation* for employees who work during abnormal hours and a *deterrent* to employers' scheduling work in these hours. However, the Fair Work Commission (2017) argues the deterrence element is the consequence of the imposition of penalty rates rather than the objective. Thus, with the penalty rate cuts, consumers can shop during hours that were previously unavailable in that the reform enables businesses to extend their opening time. The PC (2015) also indicates the shifts in social norms and preferences have stripped Sundays of their distinctive role as a time when few people would shop or be involved in consumer-oriented activities. Slashing the existing Sunday penalty rates will increase the convenience value to consumers, product diversity, and lower capital under-utilisation since more services will be open for longer hours. Longer opening hours will induce higher aggregate transaction[1] volume. This notion can be generally depicted by comparing data from Coles stores across Victoria, New South Wales (NSW) and Western Australia (WA) (Economic Regulation Authority, 2014) (Figure 1). In the figure, in jurisdictions where restrictions on trading hours are imposed, such as WA, the increases and decreases in transactions after opening and before closing hours

1 A transaction represents the purchase of any basket of goods that generates a receipt.

are less smooth than those in jurisdictions not constraining trading hours (Victoria, NSW).

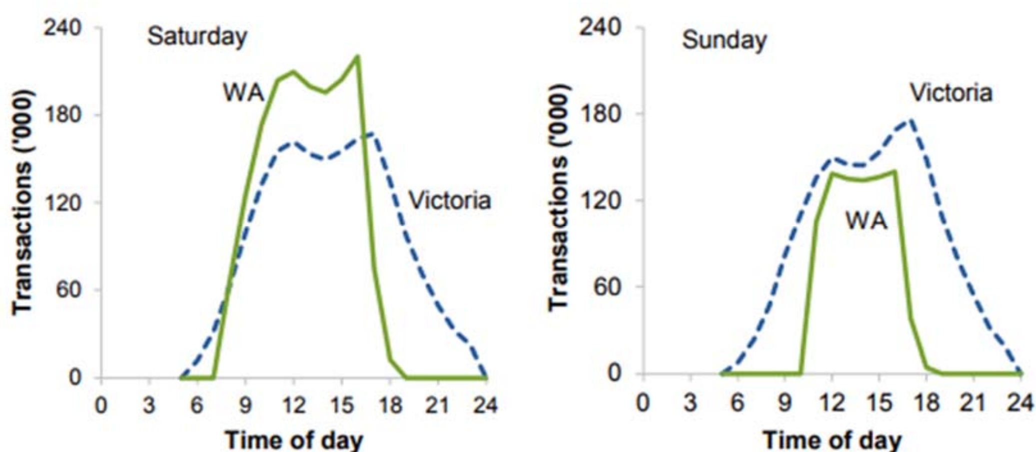

Figure 1: Purchasing behaviours in Victoria and WA (Source: PC & Economic Regulation Authority)

Furthermore, the profitability of businesses, especially small businesses, is another beneficiary of the penalty rate cuts. The reform will have an immediate positive effect on businesses' bottom line because input costs from labour will be reduced, as discussed by the PC (2015). This will improve businesses' short-term profitability. Productivity would also be likely to be enhanced when a business can spread its fixed costs (leasing costs, franchising fees, insurance premiums, and others), which reportedly comprised about 16% of total expenses in the restaurant and cafe industry in 2006-07, over longer opening hours and higher demand. Heightened capital utilisation could put down average unit costs and prices as well. In addition, lower labour costs give businesses more room for manoeuvre to invest in their staff motivation or productivity enhancement programs.

Some doubt might arise about the effectiveness of the reform on the profitability of the Retail and Pharmacy sectors given their industry structures. However, despite the advent of automation and online commerce, the Retail industry remains labour intensive (PC 2011, Department of Industry, Innovation and Science 2015). This means small and medium retailers still gain from the cuts to labour penalty rates. Further, although the Pharmacy industry appears to be dominated by certain groups such as Chemist Warehouse, this is because of the ownership rules allow pharmacies owned by different pharmacists to operate under a common brand or name. Additionally, a pharmacist can only own a limited number of pharmacies (Richardson 2017). Individual operators prevail in the industry; therefore, they can benefit from the penalty rate reform.

In addition, with the extra savings from the cut, businesses will arguably hire more staff. Across industries, the employer groups claim the penalty rates have deleterious effects on job creation. For instance, according to National Farmers' Federation (2015), farmers in the pig breeding and raising industry undertake the work by themselves to avoid the unjustifiably high labour costs due to the penalty rates on Sundays. This might be indicative of a work-life imbalance and a disincentive to employment. Moreover, based on certain assumptions on the elasticity of substitution for labour and the price elasticity of demand for cafe, restaurant and catering services, Lewis (2014) constructs the elasticities of demand for labour and finds penalty rates for Sunday work can reduce labour demand by 75 – 100%. Labour demand for public holidays is also projected to be nearly eliminated by penalty rates. Other empirical evidence suggests the economy-wide labour demand goes up by 5% for a 10% decrease in wage rates, except for youth wages (PC 2015). In addition to the macroeconomic impact, more hiring implies better services to consumers owing to increased staffing ratios, which again adds to consumers' benefits.

A critique of support arguments

First, penalty rate cuts do not necessarily bring more benefits for consumers through longer opening hours and increased staffing or spur employment as indicated by the PC (2015). The gains from extended opening hours might be limited due to particular jurisdictions' regulations on trading hours. For instance, in WA, all general retailers must be closed on Christmas Day, Good Friday and ANZAC Day (Department of Mines, Industry Regulation and Safety 2017). Further, in response to the employers' surveys and testimony, McIvor and Markey (2017) questions the credibility of their claims to hire more upon penalty rate cuts. In general, the claims lack details and are inconclusive whether net employment would rise ensuing the reform. More consideration should be given to whether employers' interest in lowering penalty rates is motivated by employment concern or merely profit purposes.

McIvor and Markey (2017) also dismiss Lewis' (2014) findings on the employment effects of the penalty rates because the approach in Lewis (2014) is mainly based on theory and hypotheses, without support from relevant empirical data. Further, regarding broad empirical evidence, although the economy-wide labour demand is projected to increase by 5% for every 10% decline in wage rates, Borland (cited in PC 2015) states these economy-wide estimates cannot be applied to industry-specific demand elasticities for Sunday labour. Additionally, through a quasi-experiment wherein NSW retail employees witnessed their Sunday penalty rates double, while Victorian counterparts' rates saw no change, Yu (2015) demonstrates Sunday penalty rate rise in NSW did not have a negative impact on the aggregate employment or total hours worked. The converse be deduced for the case of decreased penalty rates.

Second, despite the evident increase in the short-term bottom line for small businesses, their long-term profitability is likely to be unaffected by the penalty rate reform. The entry and exit barriers in the affected industries are low, or at least surmountable for the case of pharmacies. As decreased penalty rates raise the rates of return on capital, those outside these industries will be attracted into the industries. Businesses will thereafter compete away the profit through price or quality strategies. Either way, the profit generated from lower wage rates (or penalty rates) will be transferred to consumers.

Lastly, there is strong evidence against the PC's (2015) indication that Sunday is no longer special. McIvor and Markey (2017) largely argue Sunday still preserves its distinctive role as an important day of the week for family times. Generally, Sundays are more significant than Saturdays; work-life imbalance is worse for those who work particularly on Sundays (Skinner and Pocock 2014). Other studies demonstrated in McIvor and Markey (2017) also point out workers place more value to their time on Sundays than on Saturdays.

Negative impacts on inequality, economic growth, employment rate, labour supply side and other social aspects

1- Inequality

The penalty rate cuts can have severe consequences for the inequality among income earners across industries. Retail and hospitality workers are often characterised as the low income earners in Australia. According to Australian Bureau of Statistics (2017), the accommodation and food services industry sees the lowest level of full-time adult average weekly ordinary time earnings ($1,098.50), whereas the retail industry witnesses the second lowest (Figure 2). As such, penalty rates provide a financial safety net for the low-paid and enable them to maintain an adequately high standard of living. Once the Sunday penalty rate cuts are implemented, the estimated loss to some employees is $100 per week, with full-time workers who work 8 hours on Sunday losing from 4.3 to 8.1% in their annual income (Rajadurai 2017).

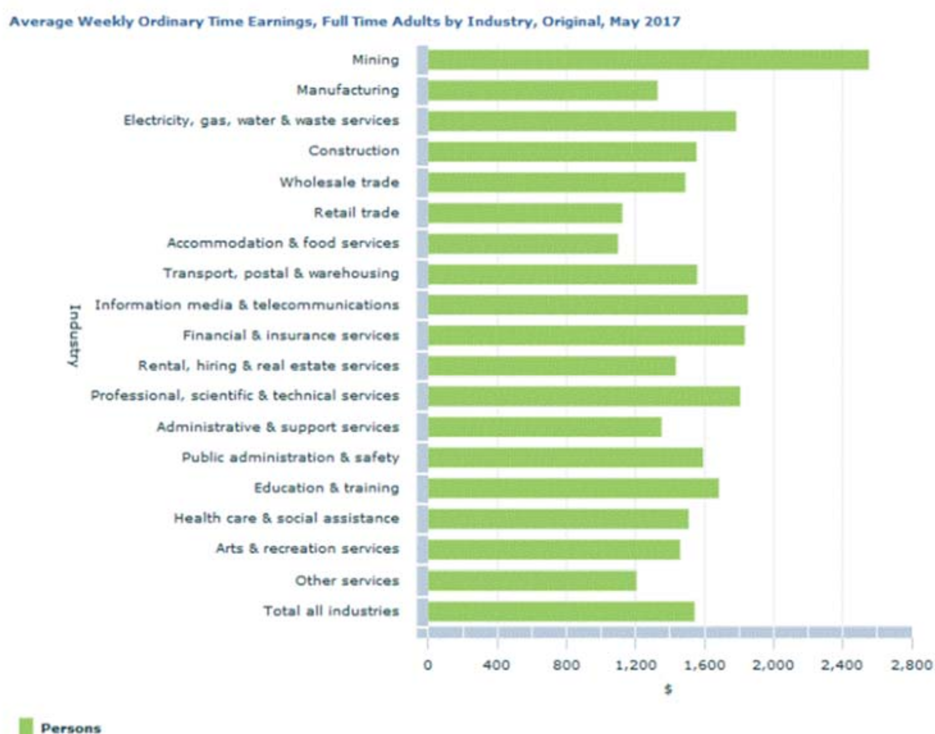

Figure 2: Average Weekly Ordinary Time Earnings, Full Time Adults by Industry (Source: ABS)

Further, inequality will potentially be deepened between rural and urban workers. In total, workers in the urban electorates who are working on the affected awards could lose more than $760 million in income each year (Equity Economics & UMR Strategic Research 2015). The cut could disproportionally inflict the burden on rural retail workers as on average the earnings they make are already less than those of their urban counterparts. From 2011 Census data, across the retail sector, rural and regional workers earn roughly 7% less than their urban counterparts (ABS cited in Rajadurai & Canavough 2017).

Gender pay gap is another by-product of the reform. Women represent 71.6% of the part-time labour force, 36.7% of full-time labour force, and 54.7% of casual labour force (Workplace Gender Equality Agency 2016). Hence, they will be most influenced by the penalty rate cuts in the highly-casualised sectors. This might worsen the pay gap between men and women, given that the female average wage was 87% of the male average wage in 2014, and the gap has remained steady over the past 10 years (ABS 2016). Overall, lowering the penalty rates is liable to distort the distribution of income across the nation.

2- Economic growth and unemployment rate

The shrink in disposable income among the bottom earners can also adversely affect the living standards of low-income households and individuals, stunting the economic growth and raising the unemployment rate. The reduction in disposable income resulted from the penalty rate reform will leave the low-paid with less to spend. Participants in a research conducted by Equity Economics & UMR Strategic Research (2015) inform they would reduce their expenditure on activities that could have been otherwise undertaken, such as dining out, home renovations, social events, and others. These types of consumption are ones of the major contributors to the aggregate demand in the economy. Data from the World Bank (2017) show Australia has consumption make up approximately 60% of its GDP, whose growth is an indicator for economic prosperity. Thus, a reduction in penalty rates can hamper the economic growth. Consequently, slackened business activity will lessen the need for labour, hence raising the unemployment rate.

The Keynesian argument that higher wages can boost aggregate demand and thus augment employment has widely received empirical support from recent research (Apergis 2008; Alexiou & Tsaliki 2009; Howell 2010). Figure 3 summarises the Keynesian growth model that is useful in explaining the impact of

wage growth on demand growth, and in turns on growth of the economy (Palley 2011). In general, the theoretical and empirical evidence provided is in stark contrast with the weakly founded claim of employer groups that reducing penalty rates will spur employment.

Figure 3 Keynesian virtuous circle growth model (Source: Palley)

3- Labour supply side and other social aspects

Setting the right level of compensation for non-standard hour work should also take into consideration the labour supply side. Deery and Mahony (1994) contend work time flexibility should not be entirely controlled by employers as it entails intruding upon employees' life outside employment. Therefore, policy-makers need to maintain a balance between economic efficiency and workers' social needs. In their case study of retail employee attitudes towards a workforce strategy, full-time workers preferred working during standard hours, while part-time and casual employees were willing to work during non-standard hours conditional on penalty rate payments. Accordingly, work satisfaction will be negatively affected ensuing a reduction or abolishment of penalty rates, which potentially leads to high staff turnover.

Reduced penalty rates can also damage work morale. Theory has showed employees' work morale responds to the deviations from the reference wage, which can be positive or negative. They will exert more or less effort depending on whether they interpret the change in the reference wage as kind or unkind (Bewley 1999; Akerlof 9182). Kube, Marechal and Puppe (2013), using a field experiment, find wage cuts undermine work morale, which in turns lowers productivity, with average output dropping by more than 20%.

Furthermore, prolonged working hours after the reform can have detrimental social impacts. As workers employed in the affected industries are the low-paid, to compensate for the loss due to the cuts, they might have to work longer hours on public holidays and Sundays. This means less time for friends, family and the wider community. Thereby, besides being an economic tool, penalty rates are also "a reflection of the values of the Australian community" (United Voice 2012, p. 30).

Conclusion

The reduction to penalty rates can be justified by benefits to consumers, businesses' short-term profitability and the claim made by businesses to increase staffing. However, these claims are deficient in proof and induce contention nationwide. Broad theoretical and empirical evidence has showed reduced penalty rates can have adverse effects on inequality across income earners, regions and genders; economic growth and employment through the channel of weakened aggregate demand; as well as the labour supply side and other social aspects. It is therefore utterly essential for policy-makers to take all stakeholders into account when deciding on the right levels of industry-specific penalty rates.

References

ABS 2016, *4125.0 - Gender Indicators, Australia, August 2016*, viewed 27 September 2017, <http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/4125.0~August%202016~Main%20Features~Economic%20Security~6151>.

Akerlof, G 1982, 'Labor contracts as partial gift exchange', *Quarterly Journal of Economics*, 97(4), pp.543–569.

Alexiou, C & Tsaliki, P 2009, 'Unemployment revisited: empirical evidence from 20 OECD countries', *Contributions to Political Economy*, 28, pp.23–34.

Apergis, N 2008, 'The employment -wage relationship: Was Keynes right after all?', *American Review of Political Economy*, 6(1), pp.40–50.

Australian Bureau of Statistics [ABS] 2017, *6302.0 - Average Weekly Earnings, Australia, May 2017*, viewed 27 September 2017, <http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/6302.0Main%20Features4May%202017?opendocument&tabname=Summary&prodno=6302.0&issue=May%202017&num=&view=>.

Bewley, TF 1999, *Why wages don't fall during a recession*, Harvard University Press.

Dawkins, P, Rungie, C & Sloan, J 1986, 'Penalty rates and labour supply: Employee attitudes to non-standard hours of work', *Journal of Industrial Relations*, 28(4), pp.564–587.

Deery, SJ & Mahony, A 1994, 'Temporal flexibility: Management strategies and employee preferences in the retail industry, *Journal of Industrial Relations*, 36(3), pp.332–352.

Department of Industry, Innovation and Science 2015, *Australian industry report,* Australian Government.

Department of Mines, Industry Regulation and Safety 2017, *Retail trading hours,* Government of Western Australia, viewed 27 September 2017, <https://www.commerce.wa.gov.au/consumer-protection/retail-trading-hours>.

Economic Regulation Authority 2015, *Inquiry into microeconomic reform in Western Australia,* Final Report, Western Australia.

Equity Economics & UMR Strategic Research 2015, *Who loses when penalty rates are cut?,* McKell Institute.

Fair Work Ombudsman 2017, *Penalty rates & allowances*, viewed 27 September 2017, <https://www.fairwork.gov.au/pay/penalty-rates-and-allowances>.

Fair Work Ombudsman 2017, *Penalty rates changes 2017*, viewed 27 September 2017, <https://www.fairwork.gov.au/pay/penalty-rates-and-allowances/penalty-rates-changes-2017>.

Howell, D, 2010, 'WP 2010-5 Institutions, Aggregate demand and cross-country employment performance: Alternative theoretical perspectives and the evidence', IDEAS Working Paper Series from RePEc, pp.IDEAS Working Paper Series from RePEc, 2010.

Kube, S, Maréchal, MA & Puppe, C 2013, 'Do wage cuts damage work morale? Evidence from a natural field experiment', *Journal of the European Economic Association*, 11(4), pp.853–870.

Lewis, P 2014, 'Paying the penalty? The high price of penalty rates in Australian restaurants', *Agenda: A Journal of Policy Analysis and Reform*, 21(1), pp.5–26.

McIvor, J & Markey, R. 2017, 'Scrutinising the argument for reducing penalty rates', *Journal of Industrial Relations*, p.002218561770401.

National Farmers' Federation 2015, *Submission to Productivity Commission Inquiry into the Workplace Relations Framework,* Australia.

Palley, T 2011, 'The economics of wage-led recovery: Analysis and policy recommendations', *International Journal of Labour Research*, 3(2), pp.219–243.

Productivity Commission 2011, *Economic structure and performance of the Australian retail industry,* Report no. 56, Canberra.

Productivity Commission 2015, *Workplace relations framework,* Productivity Commission Inquiry Report No. 76, Final Report, Canberra.

Rajadurai, E & Cavanough, E 2017, *Unfair burden: The impact of Sunday penalty rate reductions on regional and rural Australia,* McKell Institute.

Rajadurai, E 2017, *Counting the cost: The impact of Sunday penalty rate reductions on urban Australia,* McKell Institute.

Richardson, A 2017, 'Aspirin for more: Changing business models are forecast to support revenue growth', *IBISWorld Industry Report G4271a Pharmacies in Australia,* IBISWorld.

Skinner, N & Pocock, B 2014, *The persistent challenge: Living, working and caring in Australia 2014,* Centre for Work & Life University of South Australia, Adelaide.

United Voice 2012, *Submission to the Education, Employment and Workplace Relations Legislation Committee Inquiry into the - Fair Work Amendment (Small business penalty rates exemption) Bill 2012*, October, Sydney.

Workplace Gender Equality Agency 2016, *Gender workplace statistics at a glance,* Australian Government.

World Bank 2017, *Household final consumption expenditure (% of GDP),* viewed 27 September 2017, <https://data.worldbank.org/indicator/NE.CON.PETC.ZS>.

For more information, please contact

Australian Institute for Business and Economics

T: +61 7 3316 0628
E: enquiries@aibe.uq.edu.au
W: aibe.uq.edu.au
A: Level 3, GPN3 Building (39a)
Corner Campbell Road and Blair Drive
The University of Queensland
St Lucia QLD 4072, Australia

THE UNIVERSITY OF QUEENSLAND
AUSTRALIA

CRICOS Provider Number 00025B