

Indicators of living standards for minimum wage-setting

ACOSS has consistently called in its minimum wage submissions for Fair Work Australia to undertake and review research into measures of relative living standards as a guide to its decisions on minimum wages. Specifically, we have argued that:

- Decisions on the level of minimum wages should be informed by ‘benchmark’ estimates of the cost of attaining a ‘decent basic living standard’ for a single adult according to contemporary Australian standards.
- These benchmarks should be well above poverty levels, for two reasons. Australia has traditionally set wages well above poverty levels so that employees can live in dignity. Also, if social security payments for unemployed people are to be set above poverty levels, there is a need to set minimum wages at a higher level than this to preserve work incentives.
- Research should be commissioned and consultations held with key stakeholders to develop a robust set of indicators of a minimum adequate living standard for low paid workers. This should include the updating and revision of ‘Budget Standards’ research and regular assessment of the living standards of workers on minimum wages against this benchmark as well as poverty lines, deprivation indicators and financial stress indicators.
- The combined effect of the minimum wage and family payments on the extent of poverty among families should also be taken into account in setting minimum wages.

The Commission released a discussion paper on ‘Relative living standards and needs of low paid employees’ which provides a good starting point for this work.

Steps to develop indicators of relative living standards

The adequacy of living standards can only validly be measured by comparing those of the target group with those of a reference group, usually within a single country at a point in time. Although some indicators are on the face it absolute or universal (for example a nutritious diet) the standards by which they are benchmarked in each country vary according to local customs and circumstances¹. Community views on what constitutes an adequate living standard (for example adequate to avoid poverty) are an important element of this.

¹ For example, Sen argues that while the capabilities required to avoid poverty (adequate nutrition, housing and so on) are universal, the outcomes or functionings from which these are inferred vary from country to country and over time and the resources required to achieve them (e.g. incomes) also vary. Similarly, a poverty line indexed to the cost of living is not ‘absolute’ since what constitutes a minimum adequate living standard within a country changes along with overall living standards. Thus, it is more appropriate to index poverty lines to typical (for example median) community incomes.

Submission to Fair Work Australia

Indicators of living standards

October 2011



A crucial first step in setting an adequacy benchmark is to determine the desired 'level of living' on which it is based. For example, the objective of poverty lines is to identify those people whose living standards fall below a minimum level of acceptability. A 'modest but adequate' Budget Standard benchmarks a 'modest but adequate living standard' that is likely to be well above poverty levels. ACOSS has consistently argued in our minimum wage submissions that minimum wages should be set well above poverty levels for the reasons previously outlined.

To the extent that resources are shared among household or family members, the most appropriate unit for measurement of living standards is the household or family (this paper uses the term household to describe both, for convenience). However, if a single adult living alone is used as the benchmark family type then assumptions about resource sharing do not need to be made.

Another key issue to resolve is which population forms the reference group against which the living standards of low paid households should be compared. In our view, it is appropriate to compare their living standards with those of other households of working age. The reasons for this include that minimum wages impact upon the labour market and also on policy decisions affecting the incomes of people of working age and their children (for example the level of unemployment benefits and family payments)². Comparisons of the living standards of people of working age and retired people are also confounded by different levels of asset holdings (especially homes) and expenditure requirements (such as children and the costs of employment or job search).

Goals and trade-offs

The relative living standards of different groups including low paid workers and their families can be measured either directly (as living standard outcomes) or indirectly (through input or proxy measures such as household income). To inform decisions on the adequacy of wages it is necessary to either 'convert' these measures into income or to locate them within an income distribution. Further, living standards can either be measured objectively (by observing inputs or outcomes) or subjectively (by asking people to give their perceptions of their own or other people's living standards).

The table below groups key methods for measuring living standards into four categories depending whether they are predominantly direct, indirect, objective or subjective in nature. There is much blurring of these boundaries: for example deprivation surveys and financial stress surveys use both objective and subjective indicators (such as whether the respondent misses meals and whether they struggle to make ends meet).

² Wage levels are also used to benchmark pensions but those are average rather than minimum wages.

Approaches to measuring living standards

<p>Objective and direct 'Level of living' surveys (e.g. New Zealand's ELSI survey) Deprivation surveys (e.g. SPRCs PEMA survey)</p>	<p>Subjective and direct The use of consensual indicators to develop indicators for level of living or deprivation surveys (eg SPRCs PEMA survey) Surveys of people's perceptions of the adequacy of their living standards (eg aspects of the ABS financial stress indicators)</p>
<p>Objective and indirect Poverty lines Budget standards, such as the SPRCs Budget Standards</p>	<p>Subjective and indirect Opinion polls on the minimum income required to get by The use of these to set 'consensual poverty lines' The use of consensual indicators (eg through focus groups or surveys) to develop household budgets (eg SPRCs Budget standards)</p>

Since no single measure captures the complexity of living standards and no single measure is likely to attract overwhelming support among experts or the community, it is best for the Commission to 'triangulate' between the best available measures when assessing the relative living standards of low paid workers and their families. This approach also avoids the rigidity of setting a single 'target' for minimum wages.

Desirable qualities of measures of living standards for the Commission's purposes include:

- They should correlate reliably with key outcomes in important spheres of life such as health, housing and nutrition and social participation;
- They should correlate reliably with possession of what the community would generally regard as 'necessities of life';
- It should be possible to standardise each measure in a simple, readily understood form (for example, an index, income or expenditure level or income range that represents the 'typical' or 'minimum' needs of a single adult wage earner living alone) without loss of validity, notwithstanding the diverse needs and living costs faced by households;
- They should be either 'convertible' into income, or at least it should be possible to locate those with inadequate living standards within the household income distribution;
- Researchers should be able to regularly update the measures in a robust way so that trends in living standards can be identified and compared.

There are trade offs between these goals. 'Direct' measures which capture the diversity of living standards across the community may be difficult to standardise or to convert into income. On the other hand, 'indirect' or income based measures that are readily updated and compared with wage levels may not be strongly correlated with living standard 'outcomes'.

Subjective measures have biases which render them less reliable than objective measures. Respondents to financial stress surveys may indicate high levels of stress but this may be due to their expenditure preferences (for example to buy a home in a nice part of town) rather than their needs or lack of access to essential items. We therefore focus here on objective measures.

Nevertheless, the indicators used in objective measures also have an element of subjectivity (even if based on ‘expert’ opinion) and subjective approaches are often used to validate them. Examples include deprivation surveys where the indicators are selected on the basis that at least a certain proportion of people consider the item essential, and consensual poverty lines. These forms of validation are also likely to strengthen public acceptance of the measure.

The pros and cons of three key measures

The table below identifies some of the key pros and cons of three measures which we consider are the most likely to meet the majority of the above goals.

	Pros	Cons	Options to overcome weaknesses
Budget standards	Can be benchmarked to income Transparent, easy to understand A direct connection between expenditure items and actual living standards	Costly/difficult to update Yet correlations between a given expenditure level and living standards may not be strong Subjectivity of many expenditure items	Use budgets to locate a benchmark in income distribution, then index like a poverty line Take account of confounding factors such as asset holdings Validate expenditure items using focus groups, opinion polls or expert assessments
Poverty lines	Easy to understand, at least in principle Relatively easy to update Identifies target households’ position in the income distribution	Arbitrary unless grounded in direct living standard research Correlations between income and living standards may not be strong Unclear whether an appropriate benchmark for minimum wages	Validate poverty lines using deprivation surveys or ‘consensual poverty lines’. Move towards a ‘full income’ measure of poverty that accounts for asset holdings, etc Add a margin to poverty lines for wage fixing purposes
Deprivation surveys	Robust direct measure of living standards Captures the diversity of needs and resources in the community	Definition of essential items can be arbitrary Difficult to update Correlations between deprivation and income may not be strong Unclear whether an appropriate benchmark for minimum wages	Validate essential items using an opinion poll or focus groups Examine relationship between a deprivation index and the income levels of different groups in the community Adjust the deprivation index to a level ‘above poverty’, or broaden the scope of the survey by including non-essential items