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ECONOMIC, EDUCATION, JOBS AND SKILLS COMMITTEE

Inquiry into portability of long service leave entitlements

Melbourne — 9 November 2015

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Professor John Freebairn, Ritchie Chair of Economics, University of Melbourne.

The CHAIR — Good afternoon, Professor. I would like to thank you for agreeing to extend your time for another half an hour; we really appreciate it. I have to read this to you as part of the procedure.

Welcome to the public hearing of the Economic, Education, Jobs and Skills Committee's Inquiry into the portability of long service leave entitlements. All evidence taken at this hearing is protected by parliamentary privilege. Any comments you make outside the hearing are not afforded such privilege.

Hansard is recording today's proceedings. We will provide a proof version of the Hansard transcript so that you can correct any typographical errors. We will listen to you, and then we will have some questions to ask you. Please state your name for Hansard just before you start.

Prof. FREEBAIRN — John Freebairn from the University of Melbourne, but these are my personal comments. As you know, we are the place where great minds collide, apparently. We often disagree.

The CHAIR — The floor is yours.

Prof. FREEBAIRN — As I understand it, you are concerned about long service leave portability?

The CHAIR — Correct.

Prof. FREEBAIRN — To start it off, why don't I look at it in terms of what it means for employers and what it means for employees, and then I will flip the two together in the labour market. If I start with employers, long service leave is really just another labour on-cost. If you think of if a business wants to hire somebody, they have to pay some wages, they have got to pay some annual leave, they have to provide them some sickness leave and some may or may not provide long service leave, and they have also to pay workers compensation and so on. Basically, if long service leave is added to their cost of employment, or you are going to make it more portable so that it can be used more frequently, that is an increase in labour on-costs.

Any rational business would say, 'If I say I'm spending $100 a day on wages, annual leave and so on, and I am now asked to put aside the equivalent of $10 a day for long service leave', most employers will say, 'Well, over time I'm going to bring that wage rate down from $100 to $90'. To them, a dollar is a dollar. When we think about that as economist, we think about a labour demand curve. Businesses will employ more people if labour costs per hour go down. For a given wage rate, if they have to pay more in long service leave, in time they will offer a lower wage rate. In our jargon, it will shift downwards the demand curve for labour in terms of the wages employment space. That is the employer's side of the story.

Then if I flip over to the employee's side, what I am interested in as an employee is what wages I get. I can spend that any way I like. I am also interested in what sort of annual leave I get, and let us suppose I am also interested in long service leave. It is a bit down the track. To make it even simpler, let us assume that I regard a dollar of wage as equivalent to a dollar of annual leave to a dollar of long service leave. You might want to muck around with that assumption. Then the story would be, if I am offered, say, $100 in wages and zero long service leave, I am willing to work for that $100. But, now I am going to be given $10 equivalent of long service leave. If I regard a dollar as a dollar, I am indifferent between the wage or the long service leave. Over time I would be willing to have my wage cut from $100 with no long service leave to $90 with $10 of equivalent long service leave.

What that would do for a labour supply curve? My willingness to work in terms of wage employment space, would shift down my labour supply curve. I am willing to accept lower wages for a given amount of work because I am being compensated down the track with long service leave.

If I put those two together, when I did not have long service leave, it was not a cost to the employer, there was not a break for the employee. Then all of a sudden I give long service leave, and both sides regard that as a dollar is a dollar. The employer's labour demand curve shifts down, the employee's labour supply curve shifts down and I go back to a new equilibrium where exactly the same amount of hours are worked but the wage rate has come down to offset the extra long service leave.

That is the really simple story. If a dollar is a dollar, it really has no impact on total employment. It changes the mix of employer payout. They pay out a little less in wages, a little more in long service leave. I as an employee accept a little less in wages, but it is made up in terms of long service leave. That is the simplest story; no problems.

Then the question is: what if a dollar is not a dollar? A dollar is clearly a dollar to the employer, although they may well consider, 'If I've got long service leave, I might go broke, the person might leave me, they might retire, they might get run over', or whatever. If the labour demand curve of the employer shifts down more than the labour supply curve of the employee—that is, the employer sees it as a bigger cost than the employee sees it as a benefit—then the net outcome will be that you will get a slight fall in employment, but not quite as big a drop in the wage rate. The quantity side of the market will wear some of the increased payment for long service leave. If I go the other way around and the employee values the long service leave as more than the cost to the employer—I think that is unlikely, but if that does happen—then the supply curve shifts down more than the demand curve. The wage rate still falls, but employment goes up.

That is the basic framework as I see it. What I do not know is the details of this portability of long service leave and so on that you people are looking at, and so I cannot really tell you without more information what I think will be the net effects. But basically the clear thing in the story is: if you are making long service leave a bigger part of remuneration and of labour costs, the labour market will squeeze the wage rate a little bit. Depending on how much the demand and supply curve shifts, whether it affects employment much depends on the relative shifts of those curves—that is, how much employers see the cost of long service leave provision relative to how much I as an employee value it. That is my opening stance.

The CHAIR — Thank you, Professor. We will ask questions and in the end if you would like to add something, we will accept that as well, so you will be free. Which sectors or industries would be the most likely to benefit from portable long service leave, in your opinion, and which would be the least likely to benefit if that goes on?

Prof. FREEBAIRN — That I find very hard to answer. I would have thought that employers of different sectors regard a dollar as a dollar. They are not really uptight whether they have to pay out money in wages or workers compensation or annual leave or long service leave. It is an amount they have to shell out. To the extent that labour turnover is much higher in some industries and occupations than others, and they do not at the end have to pay long service leave, then if you are extending long service leave to those industries, they are going to cop it more than, say, in the industry I am in. I am at a university where we all get long service leave and we get it pro rata paid out if we have done, I think, at least five years. I am pretty sure there are a lot of industries where that does not happen. Making it compulsory and portable is not going to do much to the university industry that I am in, but I suspect it is going to do quite a lot to casuals who work in Vic Market or whatever. But again, I do not know the details of all that stuff. Again, my guess is that turnover varies quite a lot from one industry to another, so again you will get differences depending on those make-ups.

Ms RYALL — Thanks for your presentation, Professor. I want to pick up the point that you said that wage costs would come down—so if it were dollar for dollar. If there are awards that fix the wage costs, and therefore it becomes an additional on-cost because what the organisation, be it a not-for-profit or a private sector business, would normally pay in long service leave is actually more under a portable long service leave scheme, I want to understand and clarify that therefore, if it is an additional on-cost, implementing portable long service leave, given it is a fixed wage, my understanding from what you said therefore is that it will affect employment so we would actually end up with an increase in unemployment as a result of that.

Prof. FREEBAIRN — Yes, that is right. What is important is to think about the context. This is something that is fairly long term. If you do it tomorrow, it is not going to be flipped away on Monday; it is going to be something that is going to go for maybe decades. My understanding is that awards will generally take into account things like that. The classic example we have is superannuation. The superannuation guarantee came in from zero in the early 1990s, and it has slowly been ratcheted up to 9.5 per cent. The arbitration commission and fair work et cetera have ultimately taken that into account. Except for those who are at the absolute minimum wage, where it is the story you just described, it is an additional cost that cannot be factored into lower wages, then you are right: it will push up labour cost to the employer and it will be taken out in further unemployment. My reading of the way arbitration tribunals and so on work in this country is that over time they will slow the rate of increase of the award wage to recognise that super, long service leave, annual leave et cetera is taken into account. I would argue that for the majority of people the textbook long-run equilibrium model is pretty close to the mark.

Ms RYALL — Essentially it will come back to equilibrium, so in a sense the additional incentive, if you like—'I'll get long service leave when I didn't have it before, but I'm staying the same on wage'—will actually come back to lesser wage increase over time to account for the fact that the organisation is paying more in that.

Prof. FREEBAIRN — That is right. The kind of challenge here is: how do people value long service leave that is sort of way down the track? But of course it is not as far down the track as superannuation, and in general long service leave is not subject to all the tax traps, but super really gets you taxed on getting access to the age pension and so on. While long service leave will do that to an extent, it is a lump sum, I guess. I think a kind of interesting question is: how do employees value taking their remuneration in wages today versus some sort of long service leave down the track?

Ms RYALL — It is an interesting question. There is very little research available for us to look at.

Prof. FREEBAIRN — There certainly is. But I guess what we do know is that most of us use a fairly high discount rate. We kind of live for today and tomorrow will look after itself, whereas I suspect employees are using a high discount rate than business. That is kind of leading me to say I think the demand shift down is going to be greater than the supply shift down and that employees are not going to be all that delighted by this gain, but it depends on the assumption.

Mrs FYFFE — Do you have any knowledge of what impacts other mandated imposts have made on employment, such as the superannuation? Did it effect the overall level of employment when it was first brought in?

Prof. FREEBAIRN — No, because the main reading is that submissions to the commissions were, 'Here is an increase in employer costs'. There is a general consensus that at the aggregate level if labour costs go up, business will cut down their level of employment. Again I think you can track back data that when workers compensation fees go up and down that in due course gets built into wages as well. It is more in affecting rates of wage change, so instead of pushing wages up by 4 per cent they will go up 3.5 per cent, and this might be done over a couple of years to offset the jump in the superannuation. Super is the best example, because for most people that was zero in 1990 and now it has been upped to 9.5 for anybody except casuals who work less than—I do not know—a couple of hundred bucks a month, a fortnight, isn't it?

Mr NARDELLA — It is 450 a month or something.

Prof. FREEBAIRN — Okay.

Mr MELHEM — Basically we are looking at the pro rata obligation impact on business and also people moving between jobs and between industries. The current figures, I think, from memory, were about 60 per cent of employees in Victoria tend to be able to access long service leave. Do not hold me to these figures—it was something like that. We are looking at those in the remaining 30 or 40 per cent who are not able to access long service leave for various reasons. One is that they leave the employer in less than five years. In most agreements it is seven years—I think that is in the Act; if you leave before that, you miss out. They are the ones who are going to have a real cost on the economy. You mentioned something about the ups and downs and how the cost of labour will go up.

The other thing is the absorptions. You talked about the first 3 per cent—it was absorbed in wage increases, but after that it was not. Even long service leave when moved in some industries from 0.866 weeks per year to 1.3 was an absorption and a wage outcome. It is a model to be considered. Should these factors—absorptions, phasing in, taking all these things into account, tax deduction or reduction—these are the real costs we are talking about. When someone talks about the full cost of long service leave—2.7 per cent, I think it was quoted as—that is still not getting the full amount, but you need to discount that because some of it already has to be paid by employers. Any way they do it now is saving 60 per cent; it is the 40 per cent component of the 2.7 per cent. What are your thoughts on that? Are they options we should look at or consider?

Prof. FREEBAIRN — That is part of the complete model, yes, so the debate is: how much is passed on and how much is absorbed? My reading of the super is that most of it gets passed on. Then there is an interesting question of how much is absorbed and how does business react to that. There is a really interesting debate now going on about minimum wages and penalty rates, and there is quite a bit of data emerging, particularly from the US studies, that when minimum wage is pushed up in the US, business suddenly reorganise for more efficient use of the now more expensive labour to hold down production costs per unit output.

Mr MELHEM — That was a long time ago.

Prof. FREEBAIRN — No, in recent years it has been pushed up in a number of cities.

Mr MELHEM — Yes, you are right. In the States, yes.

Prof. FREEBAIRN — They have done things in stuff like San Francisco but not in Oakland et cetera. The puzzle has been: minimum wages are being pushed up in various cities or States, and employment does not seem to have fallen. Economists say to ourselves, 'Hey, listen, guys, you've been fitting these demand curves where employment is sensitive to the wage rate'. We still get that coming out quite clearly to average labour costs and average employment. We are now finding in a number of studies at that low wage, when it gets pushed up, that business suddenly pull their finger out and say, 'I want to use you much more productively'. They have reorganised their business and largely employed the same number of people. That is plausible and it fits survey data. The question I ask myself is: why do business want a kick in the face to reorganise this low-skill labour to be used more productively? Because most of these industries are competitive—the low-skill wages are in hospitality and restaurants and that sort of thing.

Where there are lots and lots of firms competing against each other, you would think that if I have a smart reorganisation trick up my sleeve, I would get cracking, but these studies coming out of the US are saying, 'No, while wages are cheap; I just don't care very much'. When they are suddenly very expensive, I say to these employees, 'I really love you. I want you to hang around. I want you to learn this job. I want you to be much more productive. You're getting a higher wage. Let's have a deal', and that works.

That is the sort of argument one would want to make if there was an increase in long service leave cost and they could not quickly get that offset by a slower rate of wage increase. Otherwise will they get cracking on improving the way they utilise their labour? So it is holding people for longer periods and cashing in on hiring costs and training costs and all that sort of thing. But why were they so slow to do it?

Mr MELHEM — It's human nature, isn't it?

Prof. FREEBAIRN — Yes. It may be; that is right. So those are some of the things that leave open those options. I am not game enough to definitively say they are not there. We have seen it. In fact I think we are seeing that same debate going on with the Productivity Commission with its proposal to bring Sunday penalty rates into line with Saturday penalty rates. My guess is that if that happens, it will be an interesting debate about whether wages for the low skilled will be increased somewhere else and how much will be 'I'm really going to improve the way I utilise my labour'. There may well be a bit of both of those.

The Productivity Commission has been given evidence that says, 'One way is the only way it's going to happen'. Others are saying, 'It's going to go this way' and there are some of us saying, 'I can't rule those two extremes out'. I think that is an unresolvable issue, and ultimately an empirical question, that this Committee may have to come to grips with.

Mr NARDELLA — You make an assumption in your evidence today that there is no cost for long service leave at the moment, but in actual fact there is an accumulation of the entitlement depending on, in theory—you are an academic, so we can talk about theory ...

Prof. FREEBAIRN — Yes, it illustrates the issue.

Mr NARDELLA — In theory you have employed somebody today and you start to accumulate the long service leave as of today. Whether you put money away or you do not put money away—and Dee is always talking about this—when it comes up, whether you then borrow money to do it or you have actually put it away to accumulate it, depending on which way you look at it, the cost is already there, is it not? It is just if an employer puts it away at the moment or does not put it away.

Prof. FREEBAIRN — They probably have options. As far as I know they are not compelled to put it away, so it is a bit like you can think of the two types of superannuation. Initially we had a defined benefits scheme.

Mr NARDELLA — I was in one of those ones when I started work at John Lysaght, BHP, back in 1978.

Prof. FREEBAIRN — That is right. So in theory the employer was putting money aside to pay your super down the track. Some did and many did not, including government. Now we have moved—most of us are on an accumulation scheme, where effectively it goes in as accrued. One could think of long service leave as being those two extremes. That has been one of the scary things. If a business goes bust, and it has not put money aside for long service leave, then that is something the business owes its employees and there may not be enough money to pay that.

Mr NARDELLA — And they will never get it.

Prof. FREEBAIRN — That is right. As I understand it, that is part of the Commonwealth Government's back doorstop; in fact the Prime Minister bailed his brother out.

Mr NARDELLA — Correct.

Prof. FREEBAIRN — So again I would imagine on this long service leave you have options of just saying to a business, 'You have to pay long service leave, but I am not going to tell you how you're going to fund it'. They could put money aside, but they might not. Or you could say, 'You've got a contingent liability. You're building up long service leave. You're going to have to stack some money away somewhere', and that is the very first call if it goes bankrupt or whatever.

Mr NARDELLA — The other matter that you raised was in terms of the offset. So, for example, when super first came in, there was an offset under the accord, and that is what I think you were talking about and through the arbitration commission ...

Prof. FREEBAIRN — This also happened subsequently as well.

Mr NARDELLA — Yes, and subsequently as well—absolutely. In such a dispersed and national system—and understanding that our awards system is in essence controlled by the Commonwealth—how do you see that as being offset? How do you offset that? I do not see this as a national issue as such, where back in the 1980s you had the federal government working in with the ACTU, with Bill Kelty and others, to then work through that offset to then pay for super and also to deal with the wages growth at that time. But I do not see that happening in this case. Or do you see that as the individual employer then trying to reduce their costs by either reducing wages or reducing hours? How would you get that offset?

Prof. FREEBAIRN — The first attempt by an employer would be to slow down the rate of wage increase. Essentially they would negotiate either with the union or the employees and say, 'Listen, you've been given this extra remuneration in terms of long service leave. If we're going to keep you on, I can't give you quite as big a wage increase'. The interesting one is I think payroll tax. That is a labour on-cost and that varies from state to state. Somehow that has been negotiated around national awards. I do not quite know how all that fits in, but what we do know ...

Mr NARDELLA — I have never heard of that being negotiated around national awards.

Prof. FREEBAIRN — No, that is right.

Mr NARDELLA — Because it is different. You have a threshold of 550 000. Once you hit the salary of 550 000, then you start paying payroll. There are a range of thresholds and sizes of businesses ...

Prof. FREEBAIRN — That is right, and the rate varies from about 7 point something to about 5 per cent across the different states.

Mr NARDELLA — Yes. And Victoria has got the second-lowest behind Queensland. But I have never heard of that being negotiated through the Industrial Relations Commission ...

Prof. FREEBAIRN — That is right. What I am trying to draw out of that example is that if Victoria were to play with long service leave, using the payroll tax as a comparator, you might say that is not going to feed into national wage case decisions. So that might then say that employers are going to have to pick up most of the cost, and where they are bound by national awards, you are not going to be able to do much about it; where they are paying over awards and negotiating with their own people, then they will do something, and quite a big part of the workforce is like that. We have seen what the mining boom did. To attract people in particular areas they paid astronomical salaries. They are now running these down.

Mr NARDELLA — And you have a number of EBAs where you can have that discussion and that negotiation.

Prof. FREEBAIRN — That is right.

Ms RYALL — One of the requirements we need to look at is the impact on Victorian jobs, employment and investment. I know it is hard to say not knowing the model up front. The minimum, I think, is about 1.6 per cent of payroll per person up to 2.7 per cent, which is the CoINVEST one. So the ACT program is 1.6. This is more than what a company might put away, given that they may manage this themselves and the average length of stay of somebody might be 5 years, not 10 years. So the cost is uncertain. But if we said it was somewhere between 1.6 and 2.7 per cent as the model, what would be the economic impact on jobs, employees and tax? Sorry, I am reading the wrong part. What would be the financial impact on the benefit of portable long service leave to employment entitlements on employees but also the impact on employment investment, given the global situation at the moment and given the national financial situation at the moment, but also given the state financial situation? So taking those things ...

Mr NARDELLA — Which is in really good shape.

Ms RYALL — We would expect Don to say that. The economic impact on Victorian jobs, employment and investment—what do you consider that would be?

Prof. FREEBAIRN — I told a very simplistic story in which it would have zero impact. That is, the employer's demand would shift down by a jump from 1.6 to 2.7. The employee's willingness to accept a wage increase would jump down from 1.6 to 2.7, you would get the same level of employment. You would get the same level of labour costs. Wages would come down a little bit. More would be taken in terms of the leave. The costs of labour and capital would not have changed. Our competitiveness, Australia versus the rest of the world, would not have changed. That is a neutral story.

But if we say that because of stickiness in awards and the high long service leave cost cannot all be passed on there is a net increase in labour costs to employers that is greater than the perceived benefit by employees, you are going to get some reduction in wages but not to fully offset the extra cost. That is going to have some adverse effect on employment, labour has become more expensive, some marginal jobs will be cut and some overtime will be reduced. Labour has become slightly more expensive relative to capital. You will get a bit more impetus to substitute machines for people.

To the extent that that substitution cannot completely offset the higher labour costs to employers, our international trade position has got a little bit more pressure on it. That will partly be offset in due course by a bigger depreciation on the currency than otherwise, which kind of modifies that a bit. Whether tax will go up or down, we have got two effects. Employer wage-per-hour work has gone up, including the long service leave, but they are working less hours, so whether the total wage bill goes up or down ...

Ms RYALL — So they would compensate, is that what you are saying?

Prof. FREEBAIRN — Yes.

Ms RYALL — They would compensate in one way or another.

Prof. FREEBAIRN — Yes.

Ms RYALL — Victorian jobs—you have mentioned that. Employment—you have mentioned that. Just the overall economic impact on the state—what do you think that might be in that scenario?

Prof. FREEBAIRN — The question I have asked myself is, 'Why would employees prefer to have more of their remuneration in long service leave than in cash up front?'. If I am indifferent, I do not care. It may be that some people want flexibility in their lifestyle, and so they put a big plug on, 'If I've got to work in this bloody place for 10 years, then at least I can have six months off to do what I want to do'.

Mr NARDELLA — Yes, with academics it is sabbaticals, but we are not going there.

Prof. FREEBAIRN — Oh, we are working. We are working on sabbatical.

Mr NARDELLA — Of course you are.

Mrs FYFFE — I do not think the employees have been asked.

Prof. FREEBAIRN — Okay.

Ms RYALL — To add on to what Christine just said, I think the employer groups that we have talked to would not perceive that that would happen. I think—correct me if I am wrong—their view would be that everything stays the same, that wage increases would happen as normal and therefore it would be absorbed in some other way, but the total outcome would be an increase in benefit to the employee.

Prof. FREEBAIRN — I disagree with that. That is a typical employer statement. Employers, for example, all argue they pay payroll tax. They are really schizoid. They are quite happy with the pay-as-you-go tax, as borne by you and I, the worker, but when it comes to payroll tax, 'Oh, no. We pay it'. We have plenty of studies. A long-run equilibrium model says it does not matter whether you tax on the demand side or the supply side, in the long-run equilibrium it will go to the side of the market that is less price responsive, and that is the labour supply side.

Ms RYALL — The union groups that have spoken to us have said, 'Things will stay the same, plus this needs to happen'. Ultimately the equilibrium will result from an economics perspective.

Prof. FREEBAIRN — Yes. That is right. But then we have that discussion. If you take super, which was a national story, the national wage-setting bodies took it into account. You have been making the argument that this is a state story. The national does not take that into account, and so it will only come to those arrangements between employers and employees where the state—the union or the employees and the employer—have some discretion. That will come through. So you might well argue fairly strongly that for the minimum wage, which I think affects about 14 per cent or something directly and another 20 indirectly, that might not happen.

Ms RYALL — With our not-for-profits, who as Christine said earlier run on the smell of an oily rag, particularly in the community services area—disability, community health services, homelessness and those sorts of areas—there is no fat in their operating costs or in their budget, so in this situation what do you anticipate would happen there if they had a 1.6 to 2.7 on-cost?

Prof. FREEBAIRN — I think they would initially try to slow the rate of wage increase to offset it.

Ms RYALL — And if they could not?

Prof. FREEBAIRN — If they have a fixed wage bill, their only option is that they are going to have to let people go or slow the rate of hiring. We had the discussion on the low wage stuff in the US and so on. I am sure the non-profits can run themselves much more effectively in their use of labour. They will all tell us they cannot, 'We're squeezed. We're making the best we can'. We know in due course you can do things better. We all have crazy bureaucratic procedures that are partly there to protect health and safety and customers.

Mrs FYFFE — The other way, of course, is that most of these not-for-profits are funded from government, state or federal, but they would have to receive extra funding to cover these extra costs.

Prof. FREEBAIRN — And state governments do not have an unlimited bucket.

Mrs FYFFE — On some formula or other they receive state or federal funding.

Prof. FREEBAIRN — Yes, that is right. But what we know is that all governments are in structural deficit problems.

Mr NARDELLA — Not this one.

Ms RYALL — Yes, it is.

Mr NARDELLA — No, it is not.

Ms RYALL — Structurally, yes.

Mr NARDELLA — No, it is not.

Mrs FYFFE — All right, we are not going to get into a political debate. Stop it, you two.

Prof. FREEBAIRN — One of your problems is that you have a thing like NDIS that everybody loves.

Mrs FYFFE — Which we are still working through.

Prof. FREEBAIRN — Canberra is not going to pick up the bill for it all.

Mrs FYFFE — So, who is?

Prof. FREEBAIRN — And you have got Gonski, and we know that health is creeping up as a share of expenditure.

Mr NARDELLA — No, that is not the case either, but anyway. It has remained steady at about 8.9 per cent—about 9 per cent. It has not crept up at all. Well, private health insurance has.

The CHAIR — Are there any further questions?

Mrs FYFFE — When you employ people and you have been operating a business for, let’s say, 30 years, and your staff turn over every three or four years because it is low pay and the job gets tedious, and you have never had to consider long service leave, then all of a sudden this is brought in and you probably have, let’s say, 15 per cent of people who have stayed with you because of the altruistic method, and so on—you have got to budget for them—and then all of a sudden you have got an extra 60 per cent who are eligible for long service leave; it is going to be extremely difficult for any business to cope with that.

Prof. FREEBAIRN — Yes. If you are in a non-profit, you do not have the option of putting your price up.

Mrs FYFFE — No.

Prof. FREEBAIRN — If you are in a for-profit and all your competitors have got to face this extra cost, you do at least have the option to push your price up and recapture it. Then of course the people who pay for it are the consumers.

Ms RYALL — Or the government.

Mr NARDELLA — Or there is option 3, is there not? That is what you talked about, and that is you look at your processes and you make them more efficient and you build in some savings. Because what you are saying happened in America. That occurred there. The minimum wage was static for a generation virtually. When that has gone up, the employers have had to work through how to make things more efficient. So there is a third option, isn’t there?

Prof. FREEBAIRN — Yes.

Mr NARDELLA — You look at your processes even if you are a not-for-profit. You may then be able to find efficiencies that you did not think about before because that pressure may not have been there. Most the time it is. So there is a third option.

Prof. FREEBAIRN — You are right. That is right. The trick is you bring the wage down, improve your productivity —

Mrs FYFFE — And you cut back on staff.

Prof. FREEBAIRN — and you push your product prices up.

Mr NARDELLA — Certainly with the 2010 legislation there was an understanding by the state government at that time that there would need to be an increase in the rate given to the not-for-profit or the private sector to take this into account. That was the understanding back then. We had a discussion about Bronwyn Pike and those types of things earlier.

Prof. FREEBAIRN — To the extent that the non-profits are government funded, they will be cushioned, but to the extent that they are depending on donations and so on, they will not be cushioned.

Mr NARDELLA — Correct.

Ms RYALL — Productivity. There are some suggestions from some that having a portable long service leave system would improve business productivity. Others say that is not necessarily the case. So I am interested in if, for the record, you could explain what productivity is to the Committee, how it is measured, and how a portable long service leave might or might not impact on productivity, given the cost of changing staff, obviously, in employment, training and all of those sorts of things? I am not sure how someone could come to the view that productivity would be improved by people who could take their long service leave elsewhere and go off to another business or organisation.

Prof. FREEBAIRN — Okay, so labour productivity is essentially measured as output per hour of work. It can be driven by two factors. One is working with better machinery and equipment. The second is what we call multifactor productivity. It is new technology, better management skills, better work practices and so on. That was also referred to by Robert Solow as a measure of our ignorance—what we cannot measure. Now what does long service leave do about that? I think you can stick up some positive and some negative arguments. A positive argument would be that I want some flexibility in my life, so I am willing to work really, really hard for the seven of the nine years because I know I am going to have six months off to do the fabulous things I wanted to do.

Ms RYALL — So that is long service leave as it stands, not being able to take it somewhere else?

Prof. FREEBAIRN — That is right. Now making it portable, you might say, 'I hate working this place, but if I hang in for another year I am going to get long service leave, so I am just going to do the time'. Whereas if it is portable, 'Hey, I want to be employed by somebody else. I am going to work really effectively. I am going to get out of this crummy job and get over to there where I am going to be happier'. And my productivity went up in the place I wanted to get out of because I wanted to be employable, and I went over here where I was more productive. There is an example where portability could make stuff work your way. The other one I gave as an example: 'I am just going to bloody hang in there. I am going to make this employer pay me out. I will just keep above the line of not being fired'. I suspect that if I thought a bit harder, I could add some more arguments pro and con. I would reckon it would be impossible to do any study to sort that out. It is very individualistic. It depends very much on individual employer/employee relations. There are lots of dynamics.

Ms RYALL — So for anybody essentially, based on what you have just said there, who said that having portable long service leave would actually improve productivity, there is not really a basis upon which to say that it would either not improve productivity or that it would improve productivity.

Prof. FREEBAIRN — I reckon one could run that debate fairly well. I think if you put that to a debate, you would have a lot of trouble sorting out who won.

Mr NARDELLA — But within an industry, if you retain your skilled workers within an industry ...

I worked in the metal industry and back in 1979, 1980 and 1981, and we brought in portable long service leave, not only super, but in construction as well. So you would want to keep your best skilled workers in the industry rather than them going off becoming teachers or doing something else.

Mrs FYFFE — Or politicians.

Mr NARDELLA — Absolutely—very poor ones at that. But you would rather as an employer, I would imagine, retain your best skilled employees, your best skilled workers. But also one of the things that occurred within the metal industry, within construction, quite often was that people would go and work in different shops and then gather new skills and new techniques through changing and actually improving their skills. That is one of the other things that I see as a benefit, rather than just a cost to employers. I actually see it as a way of improving an industry and sharing some of that internal training for a lot of people as well. Rather than you training someone up and they are coming up to five years or seven years, as you were talking about, and you have to come up with the long service leave—you are going to lose that anyway—and you shoot off out of the industry so the industry becomes, I think, poorer after all that training and all that investment into a person. That is even in the agricultural industry, I reckon. You can always put two cases towards this, because in what you talked about there were a number of assumptions there as well. Certainly from what I saw you want to keep those people in those industries.

Prof. FREEBAIRN — Yes. Well, again, think about portability within an industry but between employers. There are a few industries where there is only one, but not many firms. So you have got movement within the industry and then you have got movement between industries. But also we are in such a hugely dynamic, changing world that I do not know whether there are many jobs where you are going to be able to do roughly the same thing for 10 years. Clearly in your metals industry the new equipment and the digital revolution are making those jobs vastly different almost every couple of years. So I do not know that long service leave is a big player in that game.

Mrs FYFFE — But in the community services sector, where the demand is looking after the ageing, the disabled and so on, that unfortunately is a growth industry.

Prof. FREEBAIRN — Yes. But one imagines the technology in that industry is going to change dramatically. You can think of slightly old-style where you have a person who looks after a disabled or an aged person with almost 24/7 personal attention. We are moving to a stage now where we are going to have gadgets that are going to take blood pressure, and, I do not know, every damn thing under the sun is going to be fed into a computer. It is going to interpret it ...

Mrs FYFFE — So human contact gets less and less.

Prof. FREEBAIRN — Yes. All that goes. It will be different, but we will get cuddly robots in due course. We might not like it, but sometimes ...

Mrs FYFFE — I hope my nursing home does not have robots.

Prof. FREEBAIRN — Sometimes my better half says she ...

Mr NARDELLA — And ones that you do not have to blow up—oh, sorry!

Ms RYALL — Can we just scratch that from the record?

Mr NARDELLA — No, no.

Prof. FREEBAIRN — You see: that is what you get in the metal industry.

Mr NARDELLA — It is very molten.

Mrs FYFFE — The thought of a robot looking after an aged person is ...

Prof. FREEBAIRN — It is just going to change though, is it not?

Ms RYALL — Professor, if the crux of the problem were that the outsourcing of government services results in contracts that could be changed every three or four years to a different organisation, so somebody working within that contract essentially cannot accrue, and if the problem lay with the outsourcing—this is a hypothetical because I want you to perhaps elaborate on what you see as being in this hypothetical situation—then what might be a solution as opposed to or as an alternative to a portable long service leave scheme whereby those people could perhaps accrue time, given that the contractor might change?

Mrs FYFFE — So the benefits are carried forward with you?

Ms RYALL — So doing the same job, say, at the National Gallery of Victoria. A person was the security person there for 9, 10, 12 years, but there were three different contracts because government outsources it. What solution might there be, as opposed to a portable long service leave scheme, at the contract level that might assist that?

Prof. FREEBAIRN — That is certainly giving the employee more confidence that he or she is going to get their long service leave, and it may mean that the short-term employers can attract better people because they know, 'I can offer you long service leave as part of your package in reality', rather than they will go to the construction industry where 'I can be sure of 10 years of keeping the crooks out of these buildings', or whatever the case may be. So there you could argue that is an example of how portability of long service leave could give you a better matching of skills.

Ms RYALL — In the instance of not having portable long service scheme but having something that dealt at the contractual level with assuring that their time accrues, could you see an opportunity where that could happen, perhaps at the contractual level where that can be assured in some way?

Mrs FYFFE — So it was a condition of someone getting the contract?

Prof. FREEBAIRN — Yes. To go against that model I would use my textbook story.

Ms RYALL — Yes, go ahead.

Prof. FREEBAIRN — If I am an employee and an employer in this industry where I know I am going to be turfed in and out every three years, I would say, as both an employer and employee, long service leave is just something we talk about and it does not mean anything. So when I negotiate my wages and my labour costs, I just ignore long service leave. Then if I bring in transferability, when I do these renegotiations and realise I have a package of wages plus long service leave that means something, I can roughly offset it. That is an extreme model that says either scenario will give me roughly the same outcome. But if you start to draw stuff in between, then you will get some action.

Ms RYALL — If, once again hypothetically, there was a requirement for government outsource contracts to include long service leave in them and that was either deposited with the government or deposited by the organisation themselves and then transferable if the contract changed to another supplier or something like that, how would that impact? I am just thinking you would not have the 1.6 per cent to 2.7 per cent; you would just have the actual. How would that impact on the contract in terms of cost? Also would it eventually drive up the cost of the contract—the cost to government, essentially? And therefore would it perhaps be cheaper than having a scheme and all the administrative costs and the cost to the company being 1.6 per cent to 2.7 per cent as opposed to just putting it away themselves?

Prof. FREEBAIRN — If I went to my extreme textbook example where the wage and the super were treated as a dollar for dollar and offset, unless it has an effect on willingness to work and worker productivity, nothing happens. If, at the other extreme, the rate of growth of wage rates is not slowed down, then it is a net increase in labour costs and somebody is going to have to pay for that. We then go back to the three points: you either find some way of getting productivity improvements or passing on as the higher price of your product or, as your labour costs have gone up and there is no productivity, you are going to have to squeeze employment and there is going to be some loss of jobs. The relative importance of those three we have been struggling to put our finger on.

Ms RYALL — So it would depend on how valuable long service leave is to the individual—the employee?

Prof. FREEBAIRN — Yes.

Ms RYALL — I guess what is in my mind is that if we went to an overall scheme and you have got between 1.6 per cent and 2.7 per cent as additional costs as opposed to something alternative that might have a lesser cost for the contractor or the employer, which would be more desirable in an economic sense?

Prof. FREEBAIRN — Again, what does the employee want? My gut feeling is that an employee would sooner have a dollar in the hand …

Mrs FYFFE — Absolutely, particularly on these low wages.

Prof. FREEBAIRN — Yes, and she or he can make up their own mind what they want to do with it. To some extent you can do that now. You get your extra leave, but you do not have to take it as leave; you can take another job somewhere. Some people will; some people will not. Then you have this sort of unknown argument that if we work for 10 years, we sort of burn out and we really should be put out to pasture for a while to revitalise us. We should be compelled to take it. That is the message I get from my HR—'Listen, Freebairn, you've got too much bloody leave. For your own health and safety, please take it'.

Mrs FYFFE — Take your holidays!

Prof. FREEBAIRN — Whether that is PR or whether that is good—again I think you can find sociologists ...

Mr BOURMAN — Actually I think you will find the answer to that one in the balance sheets. They do not like the debt to the employees. Where I have worked, I have had people who have had 90 days and have been told to get rid of it because they do not want the debt. As I said, it is an actuarial debt.

Prof. FREEBAIRN — Yes, that is right. That is certainly true of many employers.

Mrs FYFFE — Unless you are the owner of a small business and you do not get it.

The CHAIR — Professor, I do not think we have any further questions. We really appreciate your time and thank you for your contribution and for giving evidence to the Committee.

Prof. FREEBAIRN — Thank you.

Committee adjourned.