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Slow wage growth

by Chris Angus

1. Introduction

Conventional economic wisdom expects wage growth to respond in a certain manner to changes in other economic indicators (Table 1).

Recent data indicates that wage growth is slowing *despite* a reasonably robust economy. This phenomenon is being observed in a number of developed countries,¹ and has left analysts vexed as to what exactly is causing this slowdown.

Table 1: Economic factors affecting wage growth

Factor		Impact on wage growth	
Unemployment rate	↑	Wage growth	↓
Terms of trade	↑	Wage growth	↑
Inflation	↑	Wage growth	↑
Productivity	↑	Wage growth	↑

This e-brief outlines recent wage growth trends in NSW and Australia, and the potential contributing factors. While observers believe that this recent stagnation may be related to cyclical factors and does not justify panic,² it nevertheless creates challenges for policymakers due to the increased risk of negative economic and social consequences if low wage growth continues: for example, lower incomes and government revenue, and rising inequality.

The paper concludes with summaries of key policy proposals that stakeholders claim could stimulate wage growth.

2. Recent wage growth trends

2.1 Down down, wage growth is down

Wage growth is a perennial public policy issue. Invariably, the vigorous debates that ensue tend to boil down to one of two propositions: (i) wage growth is growing at too fast a pace, or (ii) wage growth is growing at too *slow* a pace. Both scenarios have their own range of potential negative social and economic consequences.

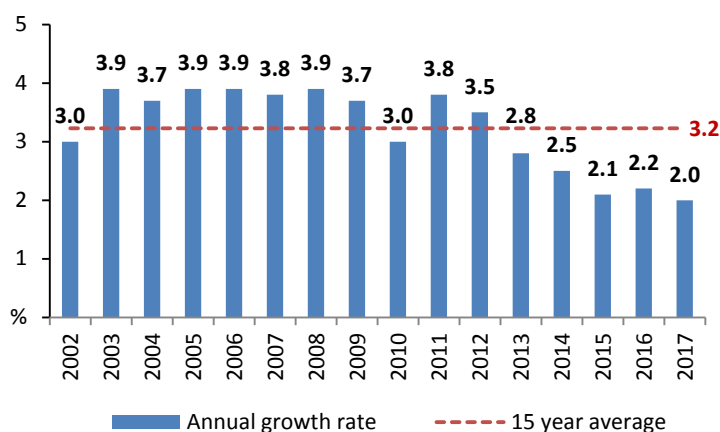
In terms of excessively fast wage growth, the 1970s and early 1980s saw a number of ‘wage breakouts’.³ In contrast, over the course of the 2010s wage growth has *slowed* to record lows.

The ABS’s [Wage Price Index](#) (WPI) measures changes over time in the price of wages and salaries unaffected by changes in the quality or quantity of work performed.⁴ While it excludes some wage changes (for example, increased rates of promotion in tight labour markets), the WPI is subject to less volatility than alternative measures and so is generally the preferred means of measurement.⁵

As of June 2017, the most recent WPI results report a national wage growth rate of 1.9% per annum. This result was recorded for every quarter since September 2016, and is the *lowest result* recorded since the series commenced in the late 1990s. Furthermore, the Reserve Bank of Australia (RBA) has commented that between 2012 and 2015, WPI growth declined by more than twice the rate expected over the period, and appears to be an unusually large decline compared to the fall in the unemployment rate.⁶

NSW wages have fared little better than the national average. ABS data shows that over the past three years the State’s annual WPI growth rate has fallen from 2.5% to 2.0%. This is the lowest rate recorded since the series began in 1997, and remains 1.2% below the 15 year average of 3.2% (Figure 1):

Figure 1: Annual NSW Wage Price Index growth, June 2002 to June 2017, original (%)⁷

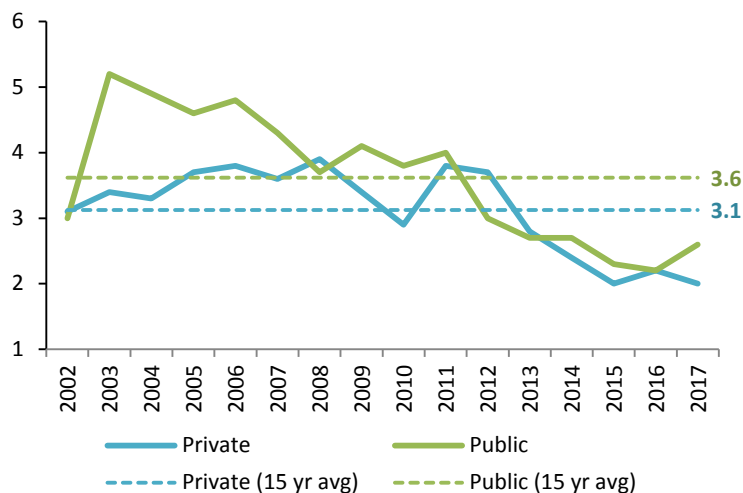


This wage growth slowdown is being experienced by both the private and public sector (inclusive of all local, NSW and Commonwealth authorities) in NSW.

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According to ABS data, WPI growth over the 12 months to June 2017 was 2.0% for the private sector and 2.6% for the public sector. Both of these results were well below the sectors' respective 15 year average wage growth rates: 3.1% for the private sector and 3.6% for the public sector (Figure 2).

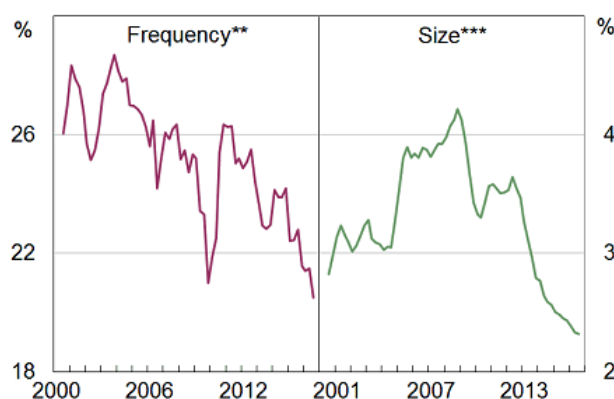
Figure 2: Annual NSW WPI growth, public vs private sector, June 2002 to June 2017, original (%)⁸



Joint research by the RBA and Australian Bureau of Statistics (ABS) has [investigated](#) the frequency and size of wage changes. As summarised in a March 2017 RBA research paper (Figure 3):

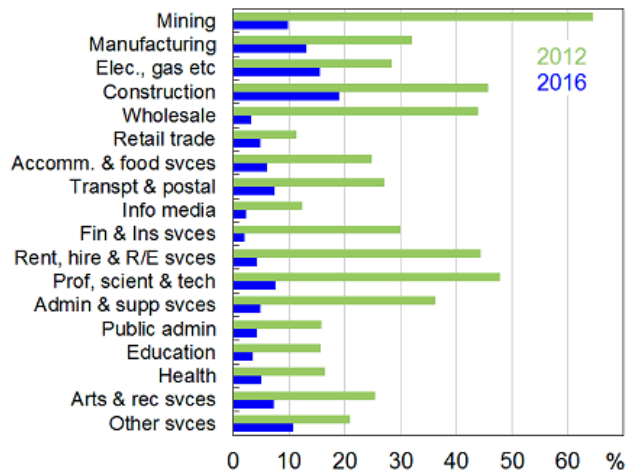
Since 2012, both the average frequency and the average size of wage changes have declined. Overall, the declining size of wage increases has contributed more than two-thirds of the overall fall in wage growth since 2012, and the reduction in the frequency of wage adjustments has contributed the remainder. This pattern is similar across public and private sector wages.⁹

Figure 3: Frequency and size of wage changes, RBA and ABS analysis¹⁰



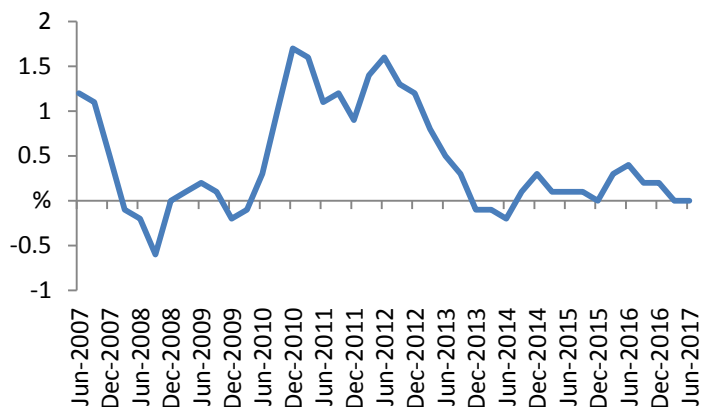
Further, the share of jobs that experienced wage growth rates in excess of 4% has fallen sharply over the past five years (Figure 4).¹¹

Figure 4: Share of wage rises larger than 4% by industry, RBA and ABS analysis¹²



In real terms (where wage growth is adjusted for inflation), the RBA reported that Australian wages barely grew between 2013 and the end of 2016.¹³ Analysis by Greg Jericho shows that this trend has continued into 2017, with the March and June quarters seeing zero wage growth after wages are adjusted for inflation (Figure 5).

Figure 5: Real annual wages growth, Australia, June 2007 to June 2017¹⁴



Slow wage growth is also an issue for much of the rest of the world. The RBA commented in 2015 that wage growth in several developed economies has been lower than forecast in recent years, including some where labour markets have tightened considerably.¹⁵ Similarly, in its *Global Wage Report 2016/17*, the International Labour Organisation (ILO) reported that real wage growth “has decelerated since 2012, falling from 2.5% to 1.7% in 2015, its lowest level in four years”.¹⁶ However, if China, which has seen faster wage growth than elsewhere, is not included in the global average, real wage growth fell even further from 1.6% in 2012 to 0.9% in 2015.¹⁷

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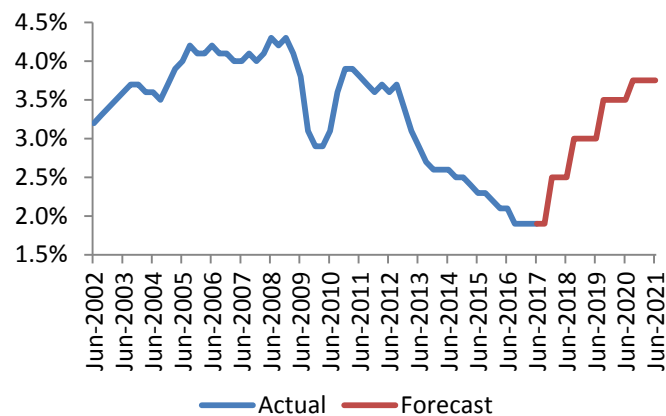
2.2 Forecasts and their shortcomings

Due to the many factors that potentially influence wage growth (see section 3), forecasting future changes presents a significant challenge for analysts and government agencies alike.

The NSW Budget 2017-18 commented that State WPI growth is forecast to increase by a mere 0.25% to 2.25% during 2017-18, before rising to 2.5% in 2018-19.¹⁸ As is evident from Figure 1 though, this growth rate is still well below the long term average.

In contrast, the Commonwealth Government has projected a much higher rate in future: one that Treasurer Scott Morrison has [claimed](#) is “conservative”. In its 2017-18 Budget, the Commonwealth Government claimed that, partly as a result of its proposed company tax cuts, wage growth will nearly double in the coming four years, from 1.9% now to 3.75% by 2020-21 (Figure 6).¹⁹ This growth rate would enable the national budget to return to surplus in 2020-21.²⁰

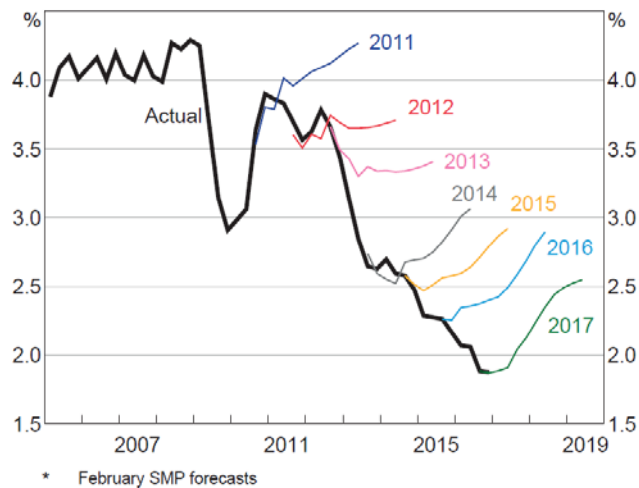
Figure 6: Australian Wage Price Index, actual results and Commonwealth Budget forecast, June 2002 to June 2021²¹



Many observers have argued that these forecasts are unrealistic. Financial institutions such as the Commonwealth Bank have said that, while a wage growth rate of 2.5% during 2017-18 is credible, the estimated 3.75% growth rate by 2020-21 is “an optimistic assumption and represents a best case scenario”.²²

Other analysts have drawn attention to inaccurate wage growth forecasts from the [Commonwealth Treasury](#) and the RBA;²³ the latter has described its own forecasts as having been “persistently too strong” for most of the decade (Figure 7):

Figure 7: RBA Wage Price Index forecasts, year ended²⁴



3. Why is wage growth slowing?

Experts cannot fully explain the current weakness in wage growth.²⁵ Nevertheless, a range of factors have been identified which, at the very least, partly account for recent trends. The most commonly cited are economic in nature, and include:

- Spare capacity in the labour market; essentially, that there are more workers than available jobs for them to fill;²⁶
- Underemployment;²⁷
- Low inflation;
- Declining terms of trade;
- Modest productivity growth;²⁸ and/or
- Inequality.²⁹

Other factors which may be contributing to the slowdown are mass migration and a decline in employee bargaining power.

3.1 Selected economic factors

Recent RBA publications have reported that low wage growth is a result of several nationwide economic and labour market conditions.³⁰ Table 2 overleaf provides a summary of the conditions identified by RBA analysts, as well as the reasons why each factor accounts for at most only part of the lower wage growth.

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Table 2: Selected economic factors influencing wage growth³¹

Factor	Impact on wage growth
Spare capacity in the labour market	<p>Although the unemployment rate is a traditional indicator of spare capacity, recent falls in unemployment have not led to any appreciable change in wage growth levels. According to the RBA, “[t]his lends itself to a question of whether there is more slack in the labour market than the unemployment gap would suggest or whether the relationship between wage growth and the labour market has changed.”³²</p> <p>Indeed, both the ABS and Commonwealth Bank argue that current high rates of <i>underutilisation</i> (the sum of the unemployment rate and the underemployment rate) may indicate that, despite a low unemployment rate, the economy is operating below its capacity.³³</p>
Low inflation	<p>As summarised by the RBA:</p> <p>Employees are ultimately concerned with the purchasing power of their wage in terms of the goods and services it affords, rather than its monetary value (i.e. they are concerned about their real as opposed to nominal wage). Accordingly, lower wage growth might be partly explained by temporarily lower inflation expectations for consumer prices.³⁴</p> <p>However, even after accounting for temporarily lower inflation expectations, the RBA found that real wage growth has still declined to near zero, suggesting that inflation expectations account for only a small part of the overall decline.³⁵</p>
Declining terms of trade	<p>The rise in Australia’s terms of trade during the mining boom led to many firms’ output prices (the basic price received by producers, excluding taxes, margins and other charges³⁶) increasing by more than prices paid by consumers. When this occurs, firms can afford to pay higher wages while also increasing profits.³⁷</p> <p>However, as the mining boom began to unwind, Australia saw a decline in its terms of trade, leading to lower profitability for firms and placing pressure on them to contain costs. Consequently, this has reduced the incentive for firms to offer higher wages to workers.³⁸</p>

3.2 The impact of immigration

The link between high immigration and low wage growth is not clear-cut. On one hand, some researchers have been unable to find any connection between immigration and the labour market outcomes of Australian workers. For example, in 2017 Breunig et al reported on a study which explored ABS and Household, Income and Labour Dynamics in Australia (HILDA) data and found little evidence that the labour market outcomes of Australian workers are negatively related to immigration.³⁹

On the other hand, while acknowledging that there may be some positive impacts on wage growth from immigration (for example, higher consumer demand), a number of analysts and commentators argue that Australia’s high immigration levels are having a negative impact on wage growth. This is because, as explained by the Productivity Commission in its 2016 inquiry report, *Migrant Intake into Australia*, “immigrants unambiguously increase the supply of labour, generating downward pressure on wages (and wage

growth) in the short term, all else remaining equal.”⁴⁰ Analysts at the Commonwealth Bank argue that Australia’s high levels of immigration have dampened wage growth pressures in the years after the mining boom:

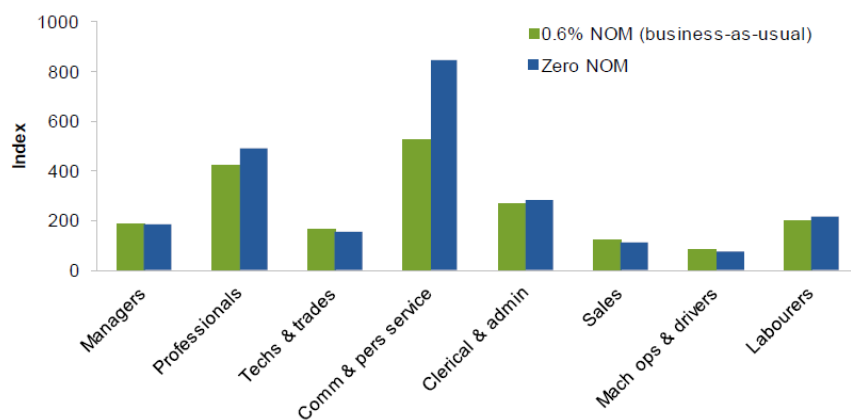
Labour market underutilisation is high in Australia because the supply of labour has exceeded the demand for workers. Given the policy decision to grow the population at a faster rate than most developed nations, around 200k jobs a year (which is a sizeable 1½% of the workforce) need to be ‘created’ to absorb the new entrants into the labour market. If the economy is not generating enough jobs to cover the lift in the population then labour market slack will increase which keeps a lid on wages growth regardless of the rate of productivity growth. This has been the case in Australia since the mining boom ended.⁴¹

A more nuanced position can be found in the Productivity Commission’s 2016 report, which conducted economy-wide modelling that examined the impact of immigration on different sectors of the economy by comparing the long-term historical average annual rate of net overseas migration (NOM; 0.6%) with a zero NOM scenario. As part of its findings, the Commission reported that real wages for a number of occupations would increase at a faster rate under a zero NOM scenario than a migration scenario (see Figure 8 overleaf):

[I]n the zero NOM scenario labour is relatively scarce which puts upwards pressure on real wages and causes a substitution towards capital, contributing to the marginally higher labour productivity relative to the business-as-usual scenario. Higher rates of labour force participation through immigration in the business-as-usual case is projected to moderate such wage pressures. While immigration is projected to reduce the extent of real wages growth to 2060, it is important to note that real wages are still projected to rise substantially over the period.

Moderation of wage pressures through higher immigration is greatest in the areas where higher growth is projected to place substantial upward pressure on wages – notably for professional and community and personal service workers.⁴²

Figure 8: Projected real wages by occupation in 2060, Productivity Commission analysis (index: 2014 = 100)⁴³



3.3 Declining employee bargaining power

Some analysts have argued that the bargaining power of employees has eroded substantially in recent decades, which has consequently affected wage growth outcomes.

Labour law scholars have commented that, in general, employers wield substantial bargaining power over employees in the labour market.⁴⁴ While there are exceptions to this, bargaining power is ultimately subject to the relative costs each party incurs when failing to reach an industrial agreement, and their ability to seek alternatives. For employees, the cost of failing to reach an agreement—namely, a period of extended unemployment—is dearer than the comparatively small (and temporary) reduction in a firm's labour output.⁴⁵

Observers have put forward several hypotheses for a fall in employee bargaining power, all of which are occurring across global labour markets. One potential factor is the increasing levels of self-employment, casualisation and other types of 'flexible' labour market practices. The Commonwealth Bank has made the following commentary in relation to these changes:

In a period of jobs market slack with high levels of underemployment, employees tend to “cop it on the chin” and accept lower wages in return for heightened job security. ... The accompanying “casualisation” of the workforce (where many employers aren't required to pay holiday pay, sick and long service leave etc.), underemployment, and the decline of organised labour have all contributed to feeble wage pressures in recent years.⁴⁶

To this point, RBA Governor Lowe has commented that the *perception* of greater competition in the labour market as a result of globalisation and automation may be discouraging workers from calling for higher wages.⁴⁷

The rise of the so-called 'gig' or 'sharing economy', which refers to people using apps to sell their labour as self-employed workers,⁴⁸ is of particular concern to some stakeholders. While many individuals enjoy the flexibility of gig economy work,⁴⁹ Australian academics have commented that because of their status as independent contractors, gig workers fall outside existing labour laws and are therefore vulnerable to exploitation.⁵⁰ As of August 2017, the Fair Work Ombudsman is conducting an investigation into whether the engagement of Uber drivers complies with Commonwealth workplace laws.⁵¹

Some commentators also claim that falling union membership has reduced employee bargaining power.⁵² This view appears based on Australian and international academic literature that has found that union workers generally enjoy a wage premium over non-union workers.⁵³ As previously shown in Figure 2 in section 2, WPI growth has been higher for the NSW public sector (with 38.4% of employees in a union) than their State private sector counterparts (with a union density of only 9.3%).⁵⁴

Others are not convinced that falling wage growth is due to lower employee bargaining power. For example, the RBA has commented that, although international literature suggests that low wage growth may reflect a decline in workers' bargaining power, such changes to bargaining power are difficult to observe and, as a result, the evidence of this occurring in Australia is limited.⁵⁵ Furthermore, the RBA noted that it is difficult to

distinguish the effect of declining employee bargaining power on wage growth due to the number of other determinants of wages.

4. Potential consequences of slow wage growth

Not all of the impacts of the recent wage growth slowdown have been negative. The recent slowdown came at the end of the mining boom, as the economy was experiencing lower terms of trade and falls in mining investment. Subsequently, slow wage growth (alongside faster growth in labour productivity) helped moderate growth in labour costs for firms, allowing the economy to better adjust to changing economic circumstances.⁵⁶

Nevertheless, an extended period of stagnating wage growth may bring a range of negative outcomes. The ILO has summarised these impacts:

On the social side, the disconnect between economic growth and wage growth means that workers and their families do not feel that they are receiving a just share of the fruits of economic progress, which fuels their frustration. On the economic side, low wage growth dampens household consumption, which can reduce aggregate demand, particularly when wages stagnate in many large economies at the same time.⁵⁷

Key economic and social consequences arising from low wage growth are outlined in the following sub-sections.

4.1 Economic consequences

Low inflation, high house prices: Ongoing low inflation is a key economic problem that is being exacerbated by stagnating wages. The RBA has commented that, because wages are the largest component of business costs, the decline in wage growth has contributed to lower-than-expected inflation outcomes.⁵⁸ In a July 2017 speech, RBA Governor Lowe observed that this link between wage growth and inflation is creating a challenge for central banks:

In years gone by, the more standard challenge was to keep wage growth in check, so as to stop upward pressure on inflation, which could lead to restrictive monetary policy. No advanced economy faces this challenge at present. ... For a central bank with a single objective of inflation, the answer is relatively straightforward. Inflation is too low, so you do what you can to get inflation up. If inflation doesn't increase, you need more monetary stimulus.⁵⁹

Attempts to lower interest rates as a means of stimulating inflation, and subsequently boosting economic performance, have caused a range of unintended consequences for the national economy, the most notable of these being a significant rise in Australian house prices (particularly in Sydney and Melbourne).⁶⁰ The Commonwealth Bank has further explained how low interest rates have affected property prices, and why the RBA is reluctant to cut rates further in order to stimulate inflation:

History now shows that in 2016 the RBA, under Stevens, underestimated the impact that rate cuts would have on the property market. Lending growth to investors and dwelling price growth took off again in Sydney and Melbourne after the RBA cut rates. It appears that this time they may have learnt their lesson. With Governor Lowe now at the helm, the RBA is placing a greater

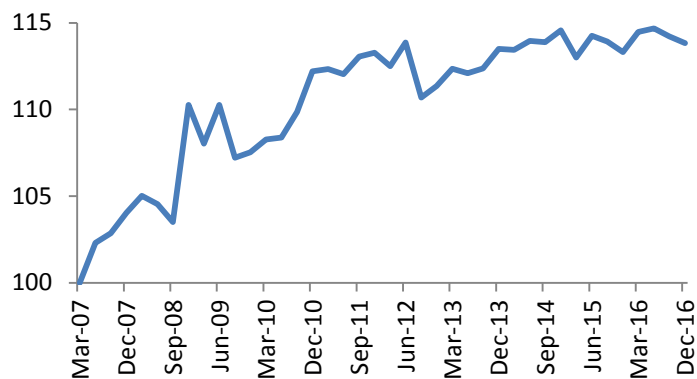
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emphasis on financial stability. Indeed, the housing market looks to be a very important factor in monetary policy deliberations. As does the rising level of household debt to income.⁶¹

Lowe has affirmed the Bank's analysis, commenting that investors are likely to find it attractive to borrow money to buy assets in a low-inflation environment, subsequently posing a medium-term risk to financial stability.⁶²

Lower income: Accompanying low wage growth has been a fall in household gross disposable income, which includes all income received by families and individuals (wages, investments, other income streams).⁶³ OECD data indicates that per capita real household gross disposable income in Australia has not grown since mid-2012 (113.9 in June 2012, 113.8 in December 2016): a change observers claim has arisen partly because of low wage growth (Figure 9).⁶⁴

Figure 9: Australian real household gross disposable income per capita, OECD Index⁶⁵



According to Governor Lowe, this fall in household income is more than a temporary occurrence, and is affecting household spending and debt:

As households have revised down their expectations of future income growth, they have adjusted their spending too. A downward revision to expectations of income growth also means debt obligations stay higher for longer than was originally expected.⁶⁶

Despite its comparatively strong economic position, NSW is also affected by this decline: the Commonwealth Bank has commented that the State's per capita income growth is relatively weak at around 2.5% in nominal terms in the year to June 2016.⁶⁷

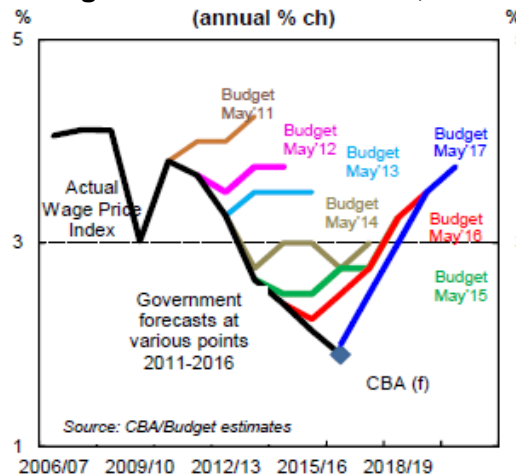
Lower government revenue: Lower wages and household incomes, and the subsequent reduction in consumer spending, result in lower levels of revenue for Australian Governments. Columnist Peter Martin has summarised the negative impacts as follows:

Lower wage growth means less tax revenue than expected, higher government payments, including Family Tax Benefits, and less consumer spending and perhaps even less economic growth.⁶⁸

As discussed in section 2.2, the Commonwealth Government's forecast wage growth increase (from 1.9% to 3.75% by 2020-21) has been

dismissed by most observers as highly improbable. Past Budget forecasts have failed to accurately predict the WPI trajectory (Figure 10), and if current forecasts are wrong, there may be future budget shortfalls.

Figure 10: Budget Wage Price Index forecasts, Commonwealth Bank⁶⁹



4.2 Social consequences

While low wage growth creates problems for State and national economies, it arguably creates greater problems for individuals and households.

Housing affordability: A key issue on the community’s mind in recent months has been housing affordability, particularly in Sydney and other major metropolitan cities. A March 2017 paper by the NSW Parliamentary Research Service, [Demand, deposits, debt: Housing affordability in Sydney](#), reported that, among other factors, the low inflationary and wage environment has exacerbated housing affordability issues. Analysis of ABS data shows that Sydney’s Residential Property Price Index (RPPI) began decoupling from the NSW WPI in mid-2013: an indication that house prices are outpacing wages (Figure 11).

Figure 11: NSW WPI vs Sydney RPPI, Mar 2007 to Mar 2017⁷⁰



The practical impact of this decoupling is an increasingly larger deposit gap between what a household on average weekly earnings could afford to borrow and median house prices: a gap that has worsened as Sydney’s house prices experience sustained capital growth, which in turn has led to

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increases in transfer duty that further increases the savings needed to purchase property.⁷¹

Perceived cost of living pressures: In general, the low inflationary environment means that total cost of living expenses are rising roughly in line with wage growth. Nevertheless, the substantial increase in some areas—notably housing, but also utility prices⁷²—means that there is a strong community *perception* that cost of living pressures are worsening.

Fears for personal financial wellbeing are a recurring theme in recent surveys. The August 2017 [Westpac Melbourne Institute Index of Consumer Sentiment](#) reported that the consumer mood has deteriorated over the last year, with increased pressures on family finances, and concerns around interest rates and housing affordability in NSW and Victoria.⁷³ The future wellbeing of today's youth is a particular area of concern, with a 2017 Pew Research Centre [survey](#) reporting that 69% of respondents believed Australian children would grow up to be worse off financially than their parents.⁷⁴

Rising inequality: Some analysts have argued that there is a link between low wage growth and rising inequality. The ILO has explained how increased levels of inequality risk creating far-reaching consequences for society:

Excessive inequality tends to contribute to lower economic growth and less social cohesion. It can also lead to political polarization: a recent IMF report pointed out that in some countries the nature of political discussions had shifted as a result of “growing income inequality as well as structural shifts, some connected with globalization, that are seen as having favoured economic elites while leaving others behind”.⁷⁵

The ILO further commented that “wages are about more than money; they matter from the point of view of fairness and human dignity.”⁷⁶ Should the community view ongoing sluggish wage growth as unfair, and/or a violation of their human dignity, existing anxieties and fears risk evolving into political and social instability.

The rise of global populism,⁷⁷ and associated disillusionment and angst, has been linked to globalisation and economic liberalisation,⁷⁸ as well as financial insecurity in the wake of the Global Financial Crisis.⁷⁹ While populism is not especially entrenched in Australia,⁸⁰ Denniss contends nonetheless that ignoring issues of financial security and wellbeing—whether they be slow wage growth, rising inequality or otherwise—increases the risk of unexpected political consequences, with Brexit and the election of Donald Trump two high-profile examples.⁸¹

5. How can we address slow wage growth?

As with debate over the causes of slow wage growth, there is considerable argument over the best way for policymakers—and workers themselves—to instigate higher wage increases.

There are a number of risks and shortcomings associated with some proposed solutions, with potentially serious consequences should rash action be taken. The RBA has made it clear that, although existing circumstances are not good, an attempt to *rapidly* boost wage growth could

lead to negative outcomes for the overall economy. Accordingly, as explained by Governor Lowe, a slower, more sustainable approach will be taken by the Bank:

We have not sought to stimulate a rapid lift in inflation. The fact that the labour market has been generating sufficient jobs to keep the unemployment rate broadly steady has allowed us to be patient. Our judgement has been that seeking a more rapid pick-up in inflation through yet further monetary stimulus was likely to add to the medium-term risks. Our central scenario remains for underlying inflation to pick up gradually as the economy strengthens. ... Our decisions will continue to be made within the framework of our medium-term inflation target. We are intent on delivering Australians an average rate of inflation over time of between 2 and 3 per cent. We are seeking to do this in a way that supports sustainable growth in the economy and that best serves the public interest. To do this we need to understand developments in Australia's labour market and to take account of our decisions on balance sheets in the economy.⁸²

A number of proposed responses are discussed below.

5.1 Cuts to corporate tax

The Commonwealth Government has argued that its [Enterprise Tax Plan](#), which intends to progressively reduce the corporate tax rate for Australian businesses over ten years from 30% to 25%, will lead to, among other benefits, wage growth rates of 3.75% by 2020-21.⁸³

In a 2014 [Economic Roundup](#) paper, the Commonwealth Treasury estimated that for every percentage point cut to the corporate tax rate, two-thirds of the benefits would flow to households primarily through higher wages.⁸⁴ The Centre for Independent Studies has also referred to modelling that estimated a 0.4 to 1.1% increase in wages as a result of a five percentage point tax cut.⁸⁵

However, other stakeholders are more sceptical about the impact of tax cuts on wage growth. University of Melbourne economics professor John Freebairn has argued that although tax cuts could benefit individuals, "higher wage rates will take some years to materialise, and the magnitude of increase attributed to the lower corporate tax rate, versus other factors, is open to debate."⁸⁶ The Grattan Institute has criticised the Treasury's modelling, arguing that firms that are part of oligopolies in Australia may not increase wages by the levels Treasury has assumed.⁸⁷ Furthermore, academics at Victoria University's Centre of Policy Studies contend that company tax cuts favour foreign owners of capital: this means that large companies are most likely to benefit from any tax cuts, while small businesses are unlikely to receive any tax-related benefits to offset higher wage growth.⁸⁸

5.2 Ask (for higher wages) and it will be given you?

A number of stakeholders, including RBA Governor Lowe, have called on employees to call more assertively for higher wages, based on the view that this would benefit workers while stimulating economic growth.⁸⁹ Some critics have commented that it is too simplistic to assume that employee timidity is holding wages growth back.⁹⁰ Others note that there are a range of difficulties involved in negotiating pay increases:

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First, for a whole lot of workers in Australia, cutting a better deal is very hard. They are either on an award or their wages are determined by an enterprise bargaining agreement. In neither case do the workers actually do the bargaining themselves. And it is far from clear that the outcome of deals cut – or edicts handed down – by unions or the Fair Work Commission are going to deliver significant overall pay rises.⁹¹

Illustrating these difficulties, the ABC reported in July 2017 that, despite the RBA Governor encouraging workers to demand higher pay, RBA staff received a sub-inflation pay increase in its most recent salary negotiations:

RBA staff who "meet expectations" in their job will only receive annual pay rises of between 1-2 per cent, meaning they could suffer considerable real wage cuts after inflation.

High performers can get annual pay rises of between 2-5 per cent and there is also capacity to give lump sum payments to workers who exceed expectations under the performance management process.

...

It appears that the need to adhere to the Federal Government's Australian Public Sector bargaining framework constrained the ability of the RBA to grant higher pay rises, despite the views of its boss.

The APS bargaining framework caps pay rises at 2 per cent per annum, and then only in return for "productivity improvements" achieved by removing clauses from enterprise agreements.⁹²

5.3 Productivity increases

Productivity is a measure of how efficiently a workforce produces goods and services.⁹³ The best measure of productivity is **multi-factor productivity** (MFP); MFP measures the amount of output based on a combined input of multiple factors (e.g. labour and capital), and accordingly reflects the skill and cleverness with which inputs of capital and labour are combined to produce a given amount of output.⁹⁴ Other commonly used measures of productivity include:⁹⁵

- **Labour productivity:** The amount of output produced for an hour of work; and
- **Capital productivity:** The amount of output per unit of capital.

According to the 2016 [NSW Intergenerational Report](#), State labour productivity grew by an average of 1.5% per year in the 25 years since 1989-90. However, there has been considerable variation in productivity gains over this period: annual productivity growth slowed to 1.1% in the 2000s and increased to 1.3% per annum in the five years to 2016.⁹⁶ At the national level, productivity has followed similar trends.⁹⁷

In terms of wage growth, modelling conducted for the *NSW Intergenerational Report* estimated that a 1.5% increase in labour productivity could lead to a 73.0% increase in income by 2056, with real gross state product (GSP) per capita rising from \$67,000 in 2016 to \$116,000.⁹⁸ The *NSW Intergenerational Report* has argued that a number of actions should be taken to help stimulate long-term labour productivity, including the following:

Table 3: Policies to increase long term labour productivity ⁹⁹	
Policies	Example actions
Enabling competition and innovation	<ul style="list-style-type: none"> • ‘Light touch’, flexible regulation that encourages firms and non-government organisations to be more responsive to consumer needs. • Implementation of competition reforms at all levels of government.
Investing in skills	<ul style="list-style-type: none"> • Improved training and education can enhance employment prospects, raise workforce participation levels and increase productivity.
Infrastructure investment	<ul style="list-style-type: none"> • Reform of the NSW planning system to allow for effective investment project selection in the long term. • Investment in infrastructure that helps improve living standards, workforce participation and productivity.

While there appears to be little controversy surrounding these recommendations, there may be too much focus on labour productivity at the expense of capital and multi-factor productivity. A 2016 research paper by KPMG reported that, since the mid-1990s, labour productivity has remained consistently higher than both capital productivity and MFP (Figure 12):

[M]easured labour productivity growth has been stronger than measured capital productivity growth since the mid-1990s. Over this period, labour productivity growth has dipped into negative territory on just two occasions whilst small positives were recorded for capital productivity growth on just three occasions. Since around 2004-05 MFP growth has generally been negative, with negative growth in capital productivity more than offsetting the positive growth in labour productivity.¹⁰⁰

Figure 12: Labour, capital and multi-factor productivity for market sector industries, KPMG¹⁰¹



Other productivity measures, such as the ABS’s [Estimates of Industry Multifactor Productivity](#) publication and Productivity Commission [research](#), also report higher levels of labour productivity compared to MFP.¹⁰²

Observers have also noted that wage growth has failed to keep pace with labour productivity. Data from the OECD’s [Compendium of Productivity Indicators 2017](#) shows the development of a significant gap between productivity growth and worker compensation in Australia between 1995

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and 2011; larger than most other developed countries and a phenomenon Jericho attributes to Australia's changing industrial relations system and the rise of part-time employment.¹⁰³

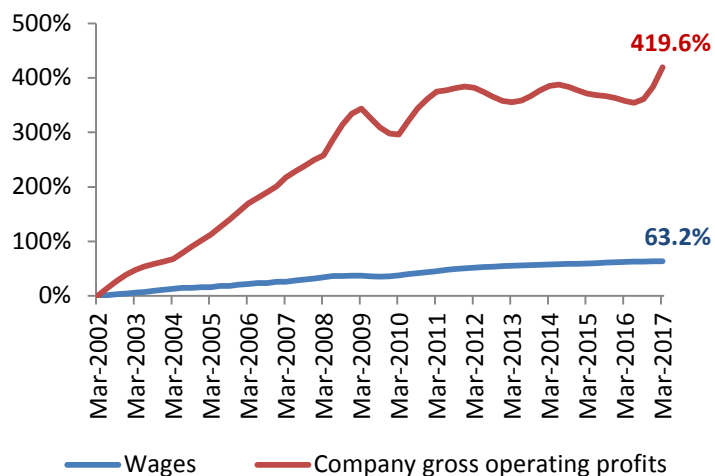
In June 2017 Business Council of Australia President Grant King stated that while businesses would "love to pay people more money," they could only do so if productivity and profits improved:

Mr King warned that globalisation and the rapid encroachment of technological disruption and offshore competition meant businesses were unable to simply pay for wage hikes by hiking prices.

Unless the terms of trade rebounds sustainably - rather than only for one quarter - and productivity growth strengthens businesses should resist Dr Lowe's belief that it would be a good thing when workers begin demanding higher wages.¹⁰⁴

The ABS's [Quarterly Business Indicators Survey](#) reports on company profits. It shows that, between March 2002 and March 2017, company gross operating profits rose by a cumulative rate more than six times greater than wages and salaries, including a 36.1% increase over the 12 months to March 2017 (Figure 13). By way of comparison, the Australian WPI saw a cumulative increase of 201.9% over the same period.

Figure 13: Company gross operating profits vs wages and salaries, cumulative increase, Mar 2002 to Mar 2017¹⁰⁵



6. Conclusion

Experts remain uncertain as to the exact causes of recent record low wage growth across Australia. While a range of economic factors undoubtedly play a role, other factors such as high immigration and a decline in employee bargaining power have also been posited as contributing to this stagnation.

Possible solutions that could reverse this ongoing trend are diverse and subject to strong debate amongst experts and stakeholders. It remains unclear whether any one response is best placed to increase wage growth in the long term, but given the potential economic and social disruption this problem is causing Australia, it remains an issue of great importance to Australian governments, businesses and, of course, workers themselves.

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