AUSTRALIA'S FUTURE LABOUR MARKET
MYTHS AND REALITIES

FACTSHEET
WILL WEAK WAGES GROWTH CONTINUE?

WWW.WORKINGFORTHEFUTURE.COM.AU

Business Council of Australia

Business Council of Australia

WILL WEAK WAGES GROWTH CONTINUE?

KEY POINTS

- Since 2012, all measures of wages growth have slowed. Real wages have stagnated in recent years as nominal wages increases have not, in many cases, been enough to exceed cost of living increases.
- People understandably are frustrated when they see their incomes stagnate or even decline, at the same time as prices for many essential services, such as energy and health care, rise faster than headline inflation.
- But the link between productivity growth and wages growth is not broken. Since the last recession, real consumer wages have increased by 54 per cent while labour productivity rose by 51 per cent.
- Labour is not missing out on productivity gains: the main problem is that recently productivity growth has been relatively weak.
- Below par labour productivity growth, reflecting lacklustre investment and multifactor productivity growth (more effectively using people's skills and physical capital), has also coincided with the adjustment of the economy to the end of one of the largest and most sustained commodity price booms Australia has seen.
- Policies and interventions that undermine or ignore productivity growth, such as arbitrary wage increases or increased regulation, will only hamper future income growth.
- Competitive tax and regulatory settings that encourage dynamic, competitive businesses and stronger investment and innovation, will be vital for strengthening productivity and wages growth across the board.

BY ANY MEASURE, WAGES GROWTH HAS BEEN DISAPPOINTING FOR SEVERAL YEARS

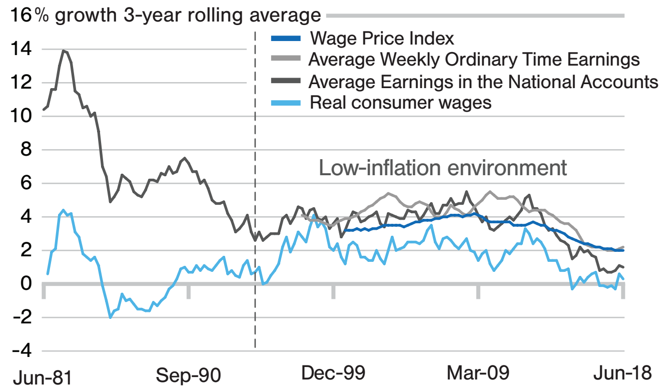
Since 2012, all measures of national wages growth have slowed *(Figure 1)*.

The real consumer wage is arguably the most insightful measure from a national perspective, as it captures changes in total labour remuneration paid and hours worked. It is also adjusted for changes in the cost of living. Workers are more interested in what their total pay packet buys than the nominal dollar amount.

Real wages have stagnated in recent years as nominal wages increases have not, in many cases, been enough to exceed cost of living increases.

People understandably are frustrated when they see their incomes stagnate or even decline, at the same time as prices for many essential services, such as energy and health care, rise faster than headline inflation. It is small wonder that cost of living pressures top community concerns.

Figure 1
Wages growth has stalled but is starting to show signs of improvement



Sources: *ABS cat. no. 5206.0, 6302.0 and 6345.0*

Note: AWOTE data are bi-annual.

More recently there has been some improvement in real consumer wages, largely reflecting an increase in hours worked rather than stronger growth in wage rates (nominal wages growth is a little over 2 per cent).

WAGES GROWTH HAS SLOWED DUE TO THE END OF THE MINING BOOM AND LOW PRODUCTIVITY GROWTH

There are two main interrelated reasons for slow wages growth in recent years – adjustment following the mining investment boom and low productivity growth.

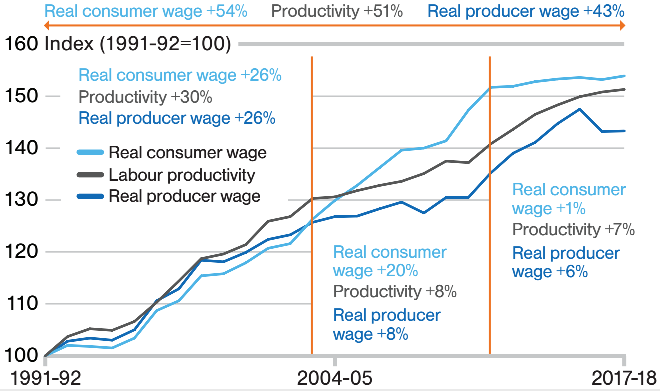
For several years, the Australian economy has been adjusting to the legacy of the terms of trade boom and heightened risk and uncertainty created by the GFC.

Growth in average real wages and labour productivity tracked closely over the 1990s, virtually one-for-one *(Figure 2)*. But wages and productivity growth diverged during the mining investment boom with real consumer wages outstripping productivity growth as the benefits of the boom were spread throughout the country. Since the end of the mining investment boom, it has taken time to close this gap and realign productivity growth with real wages growth once again.

During the mining boom, nominal wages grew at around 4 per cent a year spreading income gains across the community. Businesses benefiting from high export prices could afford this as higher prices outstripped wage rises.

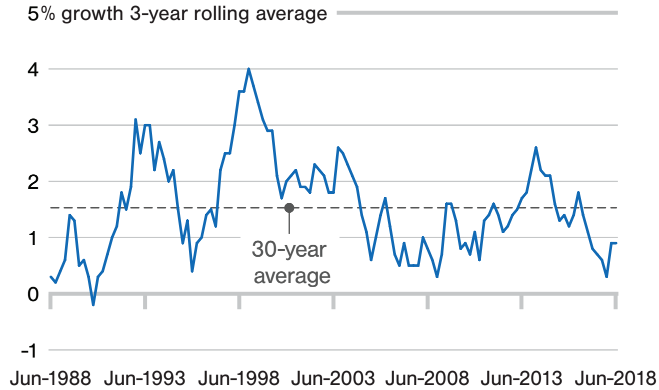
The abrupt (but inevitable) drop in export prices in 2011 left an old-fashioned real wage 'overhang' – which, coupled with only modest productivity growth since, has seen wage moderation.

Figure 2
Real wages growth has been rebalancing with productivity growth following the mining boom



Source: *ABS cat. no. 5206.0*

Figure 3
Labour productivity growth is at a low ebb



Source: *ABS cat. no. 5206.0*

Restoring the balance has taken some years, with slow labour productivity growth placing more of the adjustment burden on (slower) wages growth.

PRODUCTIVITY GROWTH IS LANGUISHING

For several years, labour productivity growth has been below the long-term average of 1.5 per cent. While labour productivity growth has improved slightly this year, it remains lower than longer-term average *(Figure 3)*.

The latest estimates of multifactor productivity growth – the residual that essentially captures the gains from innovation in all its forms – is positive but not strong.

Weakness in the core drivers of labour productivity growth – subdued business investment and low multifactor productivity growth – should therefore be of paramount concern.

Nonetheless, it is important to recognise that the current weakness in wages growth appears to be supporting strong employment growth. In aggregate, this will contribute to growth in household incomes.

THE LINK BETWEEN WAGES AND PRODUCTIVITY GROWTH REMAINS CLEAR

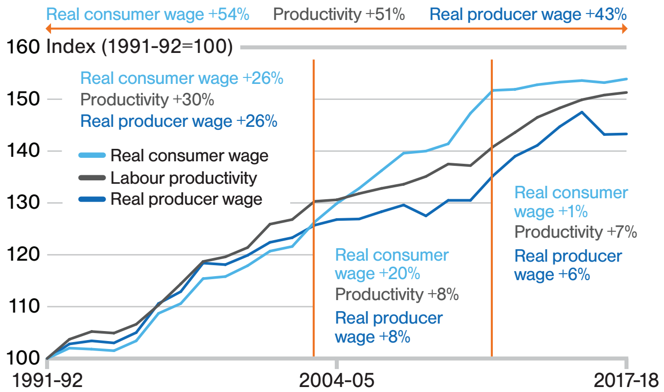
While there will be difference between sectors and some businesses will take different adjustment paths, the aggregate, economy-wide link between labour productivity and wages is clear. Since the last recession, real consumer wages have increased by 54 per cent while labour productivity rose by 51 per cent *(Figure 2)*.

Economy-wide wages growth is likely to increase as spare capacity in the labour market continues to fall and (if) productivity growth strengthens.

Policies and interventions that undermine or ignore productivity growth, such as arbitrary wage increases or increased regulation, will only hamper future incomes growth.

Competitive tax and regulatory settings that encourage dynamic, competitive businesses and stronger investment and innovation, will be vital for strengthening productivity and wages growth across the board.

Figure 2
Real wages growth has been rebalancing with productivity growth following the mining boom



Source: *ABS cat. no. 5206.0*