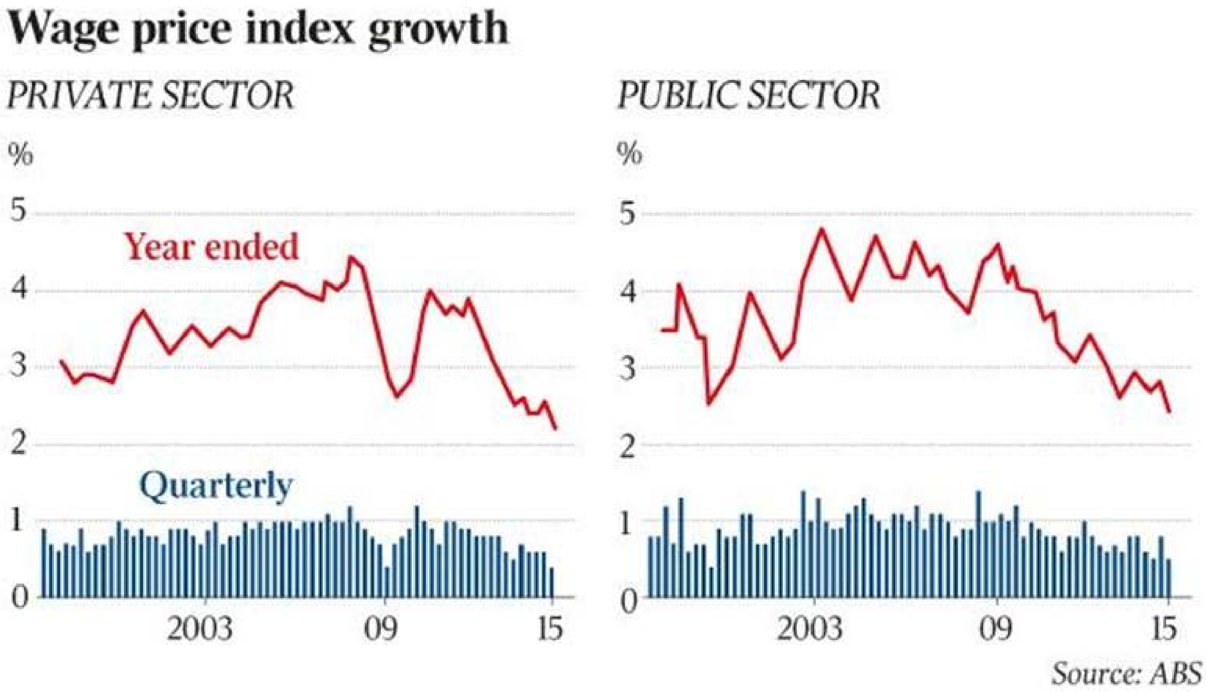
Our pay packets reflect the trying economic times

The Australian, August 25, 2015



If you are feeling as though you haven't had a decent pay rise for a while, you are probably not wrong. It may cheer you up to know that you are not alone.

If we look at the most recent figures on average weekly earnings, we can see that in the year ending in May, full-time average weekly ordinary time earnings grew by 2 per cent. If we consider all employees, average weekly total earnings grew by only 1.3 per cent. In real terms, wages have fallen.

Of course, most of my readers will immediately point out that after the end of the mining investment boom and falling mining employment (workers in mining are the highest paid of all workers), changes in the composition of jobs will be altering the observed growth of average weekly earnings.
The more reliable figure is the wage price index, which accounts for differences in industries and occupations. The latest WPI figures are from June and they show an annual increase of 2.3 per cent, with wages growing slightly faster in the public sector (2.5 per cent) than in the private sector (2.2 per cent).

In the chart, we see there has been a marked slowing in wage growth in recent years. During the turmoil of the global financial crisis, private-sector wage growth fell markedly but then bounced back; public-sector wages were much less responsive. Since 2010, however, the wage growth has fallen noticeably, slightly more so in the private than in the public sector. Now just in case you are thinking that you might try your luck overseas in pursuit of higher wage growth, I should point out that subdued wage growth is a common characteristic of many advanced economies.
In Britain, for instance, the most recent figures on wage growth indicate an annual rise of 2.4 per cent. For the eurozone, the figure is 2.2 per cent, with Italy recording a figure of only 1.1 per cent, The Netherlands 1.5 per cent and Germany 2.5 per cent. In Japan, wages actually fell across the year ending in June.

The only country that has recorded significant wage growth is the US, with the most recent figure coming in at 4.14 per cent, in line with that country's improving economy and labour market. Mind you, wage growth in the US had been subdued for a long time.

So what explains the very low rates of wage growth? In the Australian case, we need to note that the exchange rate is around 30 per cent below its peak of mid-2011. The effect of a lower real exchange rate is to reduce real wages and to improve labour cost competitiveness. This is good for trade-exposed businesses but makes us feel poorer — going overseas has become more expensive, for example.

One good thing about the slow pace of wage growth is the avoidance of a destructive wages breakout in which a tussle could have occurred about a diminishing national income as the terms of trade decline. In that event, the Reserve Bank would have stepped in to prevent inflation from rising above the target range by increasing interest rates, with adverse consequences for the labour market and economy.

At the same time, the sluggish growth of wage growth reflects the slowdown in productivity growth that has been apparent since the turn of the century. While there have been some ups and downs in the observed growth of productivity, the average rate of growth of labour productivity is now significantly below the rates achieved in the 1990s. And the picture in terms of the more comprehensive measure of total factor productivity paints a particularly bleak picture in Australia, with no net gain during the past 15 years or so.
We can see also the impact of productivity at the sector level, with rates of growth of wages reflecting what is happening to industry productivity.

From the point of view of the government, sluggish wage growth not only makes consumers grumpier than they might otherwise be but affects income tax receipts, which are mainly related to the growth of wages and salaries. While slow wage growth lessens the impact of bracket creep, in turn, there is a negative impact on the budget that is significant because the process of budget repair is so reliant on bracket creep.

This week, the National Reform Summit will consider means of improving productivity as one of the central challenges facing policymakers. The answer will not come in the form of a single bullet. Rather, there needs to be consideration of the underlying factors that affect productivity growth such as the regulatory environment, industrial relations, education and training, as well as the immediate sources of higher productivity, including competition, innovation, new technology and start-ups.

A road map leading to higher productivity is needed to achieve the gains in real wages we enjoyed until a few years ago.