THE MCKELL INSTITUTE

Stuck in Neutral

The Policy Architecture Driving Slow Wage Growth in Australia

Edward Cavanough, Director of Policy

June 2021

About the McKell Institute

The McKell Institute is an independent, not-for-profit research institute dedicated to identifying practical policy solutions to contemporary challenges.

www.mckellinstitute.org.au

Contents

Introduction

Australian workers are enduring a sustained period of low wage growth, in both the private and public sectors, in all Australian jurisdictions.

Slow wage growth is an economic problem created at least in part by deliberate government policy. In March 2019, then Federal Finance Minister, Mathias Cormann, described low wage growth as "a deliberate design feature of our economic architecture."[1]

Remedying sustained low wage growth requires substantial change in Federal Government policy. Yet the current Federal Government continues to enact a suite of policies that have contributed to slow wage growth, and to the real wage reductions forecast in the 2021-22 Budget.

This report examines the features of that economic architecture, identifying seven policy positions and priorities that the Federal Government has pursued that are contributing to sustained low wage growth, and will continue to suppress wage growth if not addressed.

The report begins by describing trends in wage growth in Australia over the last 13 years. It then identifies the policy positions of the Federal Government since assuming office in 2013 that have contributed to slow wage growth.

Key findings

Finding 1: Australian workers are experiencing a sustained period of low wage growth, with the 2021-22 Budget Papers forecasting reductions in real wages in the period ahead.

Finding 2: Wage growth has weakened since 2013, when the current Federal Government assumed office. A comparison between two observation periods – 2007-2013 and 2014-2020 – confirms a marked slowing in wage growth in the second period.

Finding 3: The average annual increase in Average Weekly Ordinary Time Earnings (AWOTE) under the first observation period was 4.6 per cent, compared with 2.5 per cent in the second observation period.

Finding 4: An average worker would be earning an additional $254 per week if the rate of wage growth in the period 2007-2013 had been sustained through 2014-2020.

Finding 5: Males have been particularly affected by slow wage growth, their Average Weekly Ordinary Time Earnings being $310 lower today than they would have been if the growth in earnings under the previous Federal Government had been maintained.

Finding 6: The slow wage growth since end-2013 has been due in large part to seven deliberate policy choices of the current Federal Government. Each of these policies has had an adverse effect on wage growth but in combination they constitute a coordinated program of wage suppression. These seven policies are:

- support for a reduction in penalty rates;
- overseeing a surge in work visas for low-paid temporary migrant workers;
- inaction on wage theft and underpayment;
- opposition to increases in minimum wages;
- public sector wage freezes;
- allowing the growth of the gig economy without sufficient regulation; and
- changes in the composition of the Fair Work Commission (FWC).

Part 1: The story of wage growth in Australia

Wage growth is at its slowest in a generation

Wage growth is at its slowest since the Wage Price Index (WPI) was established in 1997. Figure 1.1 confirms the dramatic slump in wages over the last few years. The WPI began to dip at the tail end of the mining boom, from a post-GFC high of 3.8 per cent to 2.6 per cent. Since the change of government in late-2013, the downward trend of the WPI has accelerated.

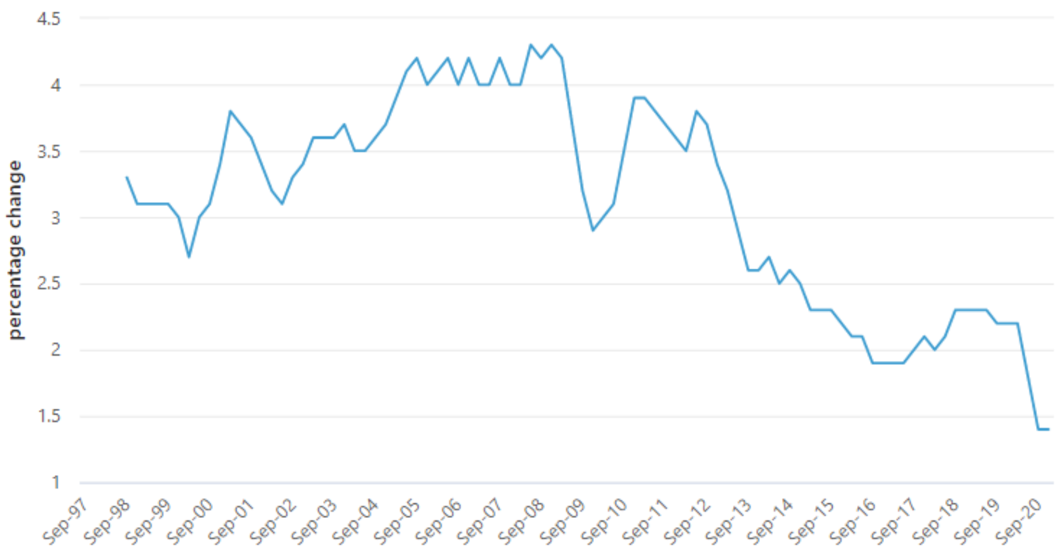

Figure 1.1: Wage Price Index in Australia, 1997-2021. Source: Australian Bureau of Statistics.

For many Australian workers, recent increases in pay have barely matched the rate of inflation, meaning that average households often feel no material cost-of-living benefits from modest adjustments to their take-home pay.

The Budget papers confirm that record-low wages growth is expected to continue over the period 2020-21 to 2024-25, with the Consumer Price Index (CPI) forecast to outpace the WPI over the forward estimates.[2] The result is a forecast reduction in real wages over the period.

These forecasts are consistent with the views of the Reserve Bank. In its latest Statement on Monetary Policy, the Reserve Bank forecasts the unemployment rate to be at or above 4.5 per cent over the next few years (Table 5.2, p. 79). Yet the Reserve Bank has suggested that the unemployment rate will need to be in the high 3s or low 4s before wages begin growing significantly.[3]

Wage growth over two observation periods

This report examines wage growth in Australian over two six-year observation periods: 2007-2013 (OP1) and 2014-2020 (OP2).

During each period Australia was governed by different political parties, each with different approaches to wages policy. Both periods experienced an exogenous economic shock: the GFC and its aftermath that affected the Australian economy from 2008 to 2010, and the COVID-19 pandemic that triggered a recession in 2020. In addition, Australia experienced a mining boom in the latter part of the first observation period and a surge in iron ore prices in the last year of the second observation period.

Notwithstanding these exogenous influences in the two observation periods, Figure 1.2 reveals that wage growth was consistently stronger during the first period than during the second period.

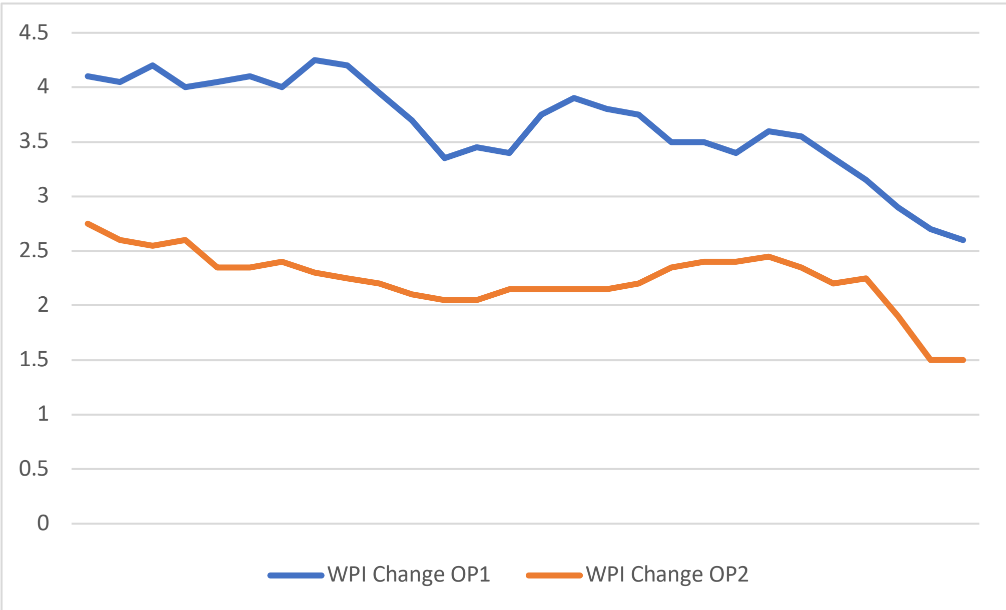

Figure 1.2: WPI, comparison of two observation periods. Source: Australian Bureau of Statistics.

In addition to the WPI, the measurement of *Average Weekly Ordinary Time Earnings* (AWOTE) provides insights into the wages of Australian workers.

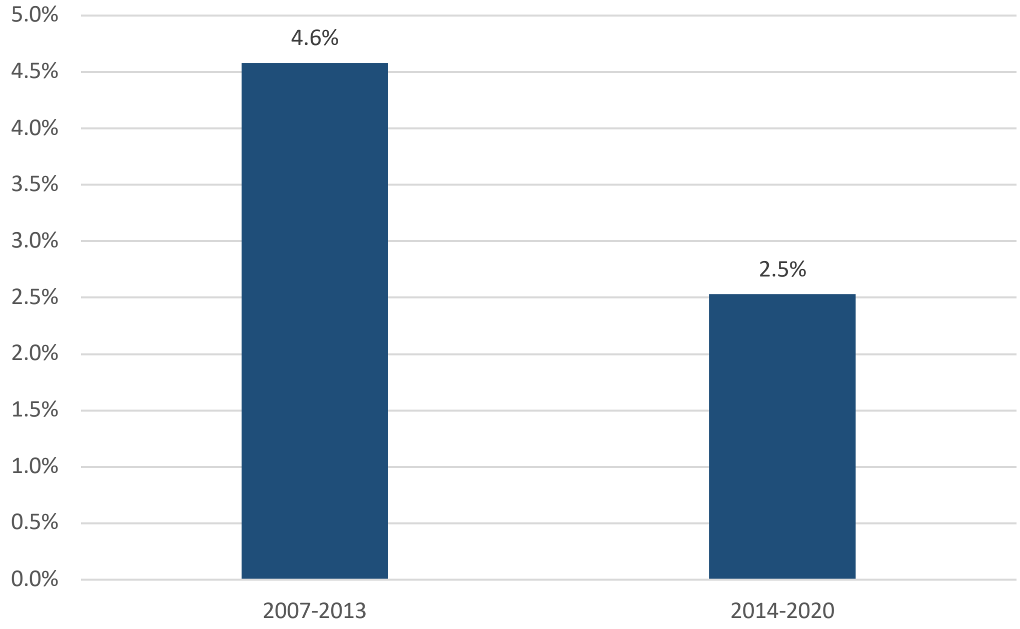

Figure 1.3: Average Weekly Ordinary Time Earnings (AWOTE), all employees, annual percentage growth in the two observation periods. Source: Derived from AWOTE, Australian Bureau of Statistics.

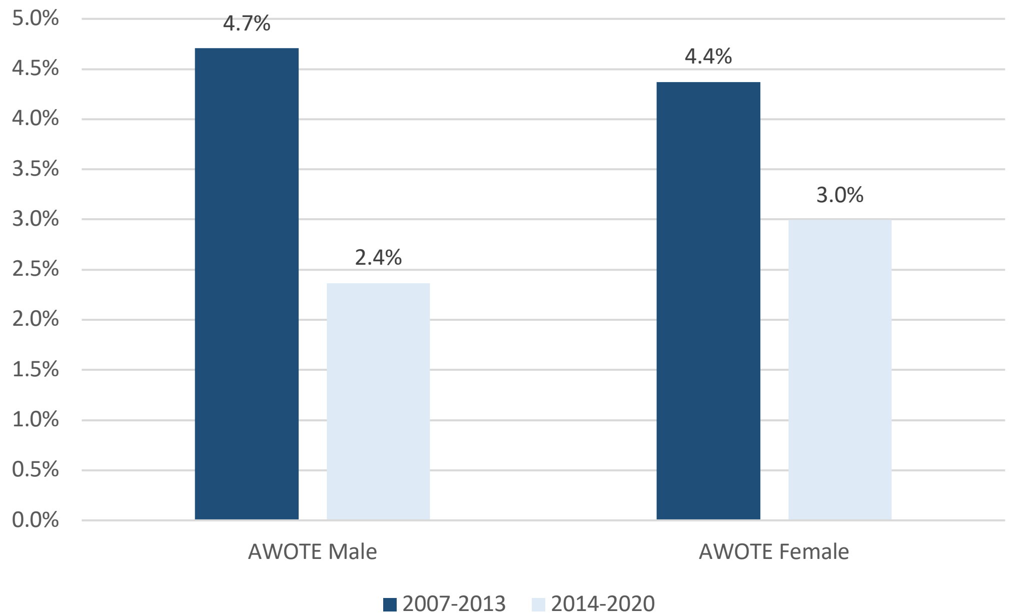

Figure 1.4: Average Weekly Ordinary Time Earnings (AWOTE), male and female employees, annual percentage growth in the two observation periods. Source: Derived from AWOTE, Australian Bureau of Statistics.

For all employees, AWOTE grew by an average of 4.6 per cent per annum during the first observation period and 2.5 per cent per annum during the second observation period (Figure 1.3).

For male employees, the average annual growth rate in AWOTE was 4.7 per cent during the first observation period and 2.4 per cent during the second observation period, while for female employees the respective growth rates were 4.4 per cent and 3.0 per cent (Figure 1.4).

If AWOTE growth had continued at 2007-2013 rates, AWOTE would be at $1965.67 per week, compared with the 2020 figure of $1711.60 per week. This results in the weekly difference of $254.07. That is, If the rate of AWOTE growth from 2007-2013 were sustained through the period 2014-2020, the average worker today would be earning $254.07 more per week (Table 1.1).

For male workers, AWOTE in 2020 would have been $2,113.86 per week if the growth rates of 2007-2013 had been maintained. Actual AWOTE for males in 2020 was $1,804.20 per week, giving a difference of $309.66 per week. For female workers, AWOTE would have been $1,714.23 per week in 2020 compared with actual AWOTE of $1,562.0, giving a difference of $152.23 per week.

Observation period	***Average annual AWOTE growth***
2007-2013	4.6% pa
2014-2020	2.5% pa
Difference ($ per week)	
All workers	$254.07
Male workers	$309.66
Female workers	$152.23

Table 1.1: Average Weekly Ordinary Time Earnings (AWOTE), average annual percentage growth during the two observation periods, and effect on weekly earnings.

To summarise, if the growth in average weekly ordinary time earnings during the period 2007-2013 had been maintained, workers on average would have been $254 per week better off. Males have been particularly affected by the wage slowdown, their average weekly ordinary time earnings being $310 lower than they would have been if the growth in the previous observation period had been maintained.

Part 2: The policy architecture driving low wage growth

During its time in office the current Federal Government has implemented a set of policies that have had the effect of suppressing wages. These policies include:

1. Support for a reduction in penalty rates;
2. Overseeing a surge in work visas for low-paid temporary migrant workers;
3. Inaction on wage theft and underpayment;
4. Opposition to increases in minimum wages;
5. Public sector wage freezes;
6. Allowing a sharp expansion of the gig economy without adequate regulation; and
7. Changes in the composition of the Fair Work Commission (FWC).

Each policy on its own has affected wages but in combination they have constituted a deliberate program of wage suppression.

1. A reduction in penalty rates

In 2017, the Fair Work Commission (FWC) decided to reduce Sunday penalty rates for more than 450,000 award-reliant workers in the retail, hospitality, fast-food and pharmacy industries. These reductions occurred in four stages: in 2017, 2018, 2019 and 2020. The Federal Government supported these reductions in penalty rates.[4]

2. Overseeing a surge in temporary work visas

Australia is a migration nation – it has benefited enormously from the great post-war immigration program. Permanent immigration has refreshed the age profile of the Australian population, adding skills and enhancing cultural diversity, enriching both the economy and society.

A concerning recent trend in the immigration intake, however, has been an over-reliance on temporary migrants to fulfil less-skilled labour market functions, often in industries with a high prevalence of nefarious employment practices such as wage underpayment. An OECD report has found that Australia is host to one of the largest temporary migrant workforces in the developed world, second only to the US (OECD 2019). The report estimated that temporary migrants account for the equivalent of more than 200,000 full-time jobs.[5]

A McKell Institute analysis of temporary migration (Rizvi 2020) has found that:

> *"In December 2019 there were more temporary visa holders living and working in Australia than at any time in the nation's history"* (p. 35).

The report of the Migrant Workers Taskforce, chaired by Professor Alan Fels, found that, as at mid-2018, the number of temporary visa holders with work rights had reached almost 880,000.

3. Inaction on wage theft

Since the 7-Eleven underpayment scandal was first reported in 2015, the underpayment of Australian workers, and foreign nationals working in Australia, has emerged as a major policy issue. Wage theft, or intentional underpayment, is inherently challenging to quantify and to track, given its often hidden nature.

Numerous analyses of Fair Work Ombudsman (FWO) audit data, however, present a picture of a growing wage theft crisis. PwC (2019) has argued that underpayment of Australian workers was one of the 'five sleeper issues' facing businesses, conservatively estimating that 13 per cent of Australian workers are underpaid, costing at least $1.35 billion in foregone wages. Yet even these figures almost certainly underestimate the extent of the problem. The McKell Institute (Cavanough 2018), in similar analyses of FWO audit data in South Australia and Queensland, estimated that 18-20 per cent of workers were being routinely underpaid, costing up to $500m in lost wages in South Australia, and up to $1.2 billion per year in Queensland.

The McKell Institute's 2020 report *Blue Harvest* (Cavanough and Wherrett 2020) documents instances of Working Holiday Makers in the horticultural industry of NSW being paid as little as $3 an hour, and subject to other forms of abuse. The Fair Work Ombudsman (FWO) routinely identifies instances of similarly egregious underpayment in the hospitality industry, particularly in segments of that industry that utilise temporary migrant workers. For most of these workers, temporary migration provides no clear path to citizenship.

In addition, the penalties associated with intentional underpayment remain modest, and do not subject the employer to criminal sanctions unless they're operating in Queensland and Victoria. This regime allows a minority of nefarious employers to act with impunity, knowing that they're unlikely to ever be exposed for underpaying their staff, and if they are, the costs of their punishment will often be smaller than the economic benefit of having engaged in underpayment.

The McKell report on temporary migration (Rizvi 2020) found:

"There is growing evidence that certain categories of temporary entrants are disproportionately vulnerable to workplace exploitation, particularly underpayment. It is likely the vast majority of incidences of underpayment are not reported or resolved. Temporary entrants in some categories have a uniquely small degree of bargaining power in the workplace, leaving them exposed" (p. 36).

The report of the Migrant Workers Taskforce observed:

"Wage exploitation of temporary migrants offends our national values of fairness. It harms not only the employees involved, but also the businesses which do the right thing. It has potential to undermine our national reputation as a place for international students to undertake their studies and may discourage working holiday makers from filling essential gaps in the agricultural workforce. This problem has persisted for too long and it needs concerted action to overcome it" (p. 6).

A key recommendation of the report of the Migrant Workers Taskforce is that the Federal Government should legislate to criminalise wage theft. In fact, chair of the Migrant Workers Taskforce, Professor Alan Fels, issued a media release in 2019 welcoming the Government's announcement that it would prepare legislation to criminalise wage theft. In early 2021, however, the Government withdrew its own wage-theft bill from the Senate.

4. Opposition to minimum wage rises through the Fair Work Commission

In conducting its Annual Wage Review, the FWC issues determinations that directly affect award-reliant workers, including those earning the minimum wage, and indirectly affects the wages of workers whose pay has been set through collective agreements or individual arrangements. The Annual Wage Review invites all interested parties to submit advice and recommendations to the FWC to assist the Commission in reaching a decision.

The current Federal Government made its opinion on wage setting known in its 2016 submission to the Annual Wage Review, arguing:

"*Excessive increases in minimum wages are likely to reduce employment in award-reliant industries, particularly for youth, and especially when wages growth elsewhere in the economy remains moderate. While one wage decision may not have a large effect on employment, the cumulative impact of multiple decisions will be greater."*[6]

In 2017, the Federal Government continued to make similar arguments, cautioning against significant increases in the minimum wage:

> *"Wage increases that are not supported by higher productivity or higher prices for customers and consumers will most likely cost jobs. Excessive increases in minimum wages are likely to reduce employment in award-reliant industries, particularly for youth, and especially when wages growth elsewhere in the economy remains moderate and inflation is low."*

In its 2017 submission, the Government further expanded on its reasoning for caution, arguing that increases in the minimum wage would not substantially help the lowest-paid workers:

> *"Similarly, increasing the national minimum wage is not an efficient way to address relative living standards or the needs of the low-paid. Low-paid employees are often found in high-income households. The tax-transfer system also provides considerable support to low-income households."*

In its 2019 submission to the FWC's Annual Wage Review, the Government cautioned against significant minimum wage increases, suggesting that an increase in the minimum wage would disadvantage "low skilled" workers, such as indigenous Australians:

> *"Risks to employment from increasing the minimum wage are likely higher for youth, long-term unemployed people and those who are low skilled – as well as other disadvantaged groups, such as Indigenous Australians."*

The RBA, in an analysis of wage growth by pay-setting methods (Bishop and Cassidy 2019), notes that approximately 80 per cent of Australian employees' pay is set by either collective agreements or individual arrangements, with approximately 22 per cent set by the relevant award. It notes that, while there is "not necessarily full pass-through of FWC award wage decisions to the wages of those workers in award-reliant jobs … the job level data suggest there is considerable pass-through of award wage changes to wages for award-reliant jobs." The RBA also estimates that "around 12 per cent of all wage changes in EBAs and 8 per cent of all wage changes in individual arrangements … are influenced by award decisions."

By continually urging caution on wage setting decisions, the Federal Government's recommendations to the FWC's Annual Wage Review have contributed to a wage-setting approach by the FWC that has led to a near-stagnation of wage growth for millions of Australian workers.

5. Public sector wage freezes

The current Federal Government has been reticent to grant public sector wage increases. An analysis on the drivers of wage growth in Australia released by the Australian Treasury (2017) notes that "public sector wage growth is low by historic standards." The report observes:

> *"The weakness in public sector wage growth is broad-based across the industries for which data on the public sector industry splits are available. Only education and training has meaningfully outstripped overall public sector WPI growth in the past few years. The professional, scientific and technical services industry has experienced especially weak growth in the public sector since 2013, broadly consistent with the experience of the industry overall."*

Numerous studies have found that increases in public sector wages have causal effects on private sector wages. Lamo et al (2008), in a European Central Bank analysis of wages in most OECD nations between 1960 and 2008, identify a "strong correlation between public and private sector wages."

The authors find that, while private sector wages have historically exerted a stronger influence on public sector wages than the other way around, "[our] analysis also suggests an important influence from the public sector on private wages both directly and indirectly via prices". The authors continue:

> *"This has important policy implications in that private but also public sector wage setting are important for overall wage and competitiveness developments."*

A comparison of public sector wage growth over the two observation periods 2007-2013 and 2014-2020 shows a marked slowing in the second period (Figure 2.1).

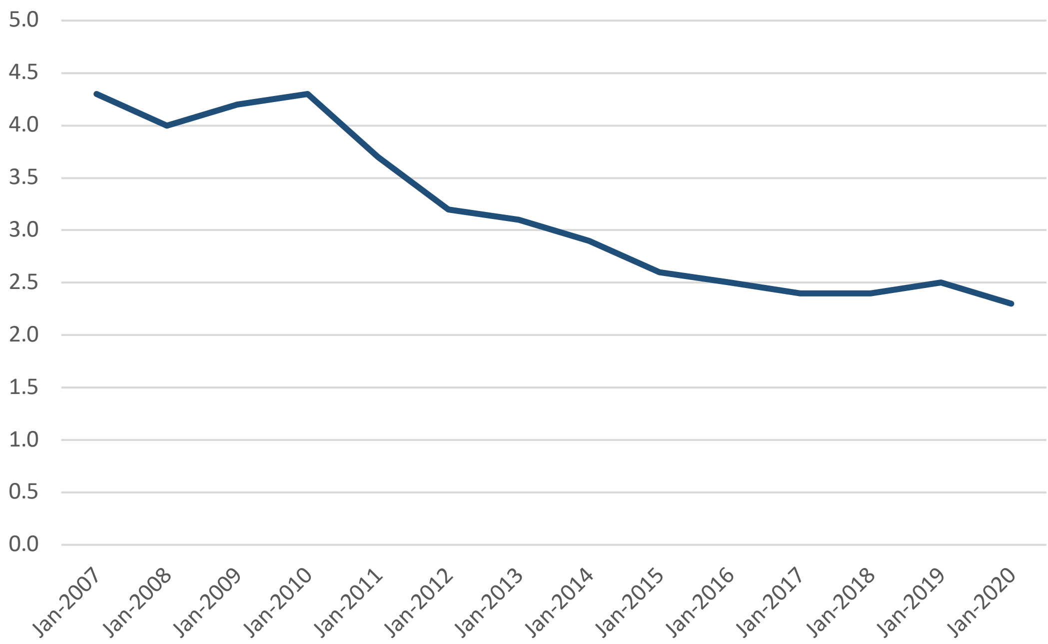

Figure 2.1: Public sector wage growth in Australia across the two observation periods. Source: Australian Bureau of Statistics.

6. Allowing the growth of the gig economy without sufficient regulation

In the last few years, the Australian economy has experienced an explosion of 'gig work' – jobs in which workers typically have less bargaining power and job security, and which often sits outside the reaches of the Fair Work Act.

Analysis by the RBA (Bishop and Cassidy 2017) has identified that a shift towards this form of work is likely affecting wage growth:

> *"New arrangements,* ***such as a restructuring of work processes due to technological progress, an increase in contract work, and increased competitive pressure from growing internationalisation of services trade, may be weighing on wage growth.*** *These factors, alongside spare capacity in the labour market, may be making workers feel less secure about their jobs and, in turn, they may be less inclined to push for larger wage increases [emphasis added]."*

Gig workers do not have the rights provided by the Fair Work Act and have very weak bargaining power. This is suppressing wages. A recent decision of the FWC in the Deliveroo case might be the beginning of a change in the legal status of gig workers from contractors to employees, which would potentially grant this growing cohort of workers greater bargaining power and alleviate this handbrake on wage growth.

7. Changing ideological composition of the Fair Work Commission

The FWC is charged with making decisions on Australian wages through its Annual Wage Review and its deliberations on other awards rates. The FWC is composed of 43 individuals, including Commissioners, Deputy Presidents, two Vice Presidents, and the President. The current Federal Government has appointed 28 of the 43 individuals now serving on the FWC. Appointees are typically well regarded and have demonstrated considerable success in their respective careers.

In assessing the FWC's composition by the appointees' primary career background, this report notes that:

- 40 per cent (n15) of FWC appointees have business backgrounds.
- 22 per cent of FWC (n8) appointees primarily have public service backgrounds.
- 22 per cent of FWC (n8) appointees primarily have legal backgrounds.
- 11 per cent of FWC (n4) appointees primarily have trade union backgrounds.
- 5 per cent of FWC (n2) appointees primarily have a background working within the Liberal Party system, as an adviser or an elected member of parliament.

Without questioning the individual capacity of any member of the FWC, this report notes an increasingly limited professional diversity within the body. Appointments made by the current Federal Government have been increasingly skewed towards those from professional circles, in which similar ideological predispositions to the Government are often observed. Since this time:

- 60 per cent (n15) of FWC appointees primarily have business backgrounds.
- 24 per cent (n6) of FWC appointees primarily have legal backgrounds.
- 8 per cent (n2) of FWC appointees primarily have public service backgrounds.
- 8 per cent (n2) of FWC appointees primarily have backgrounds working within the Liberal Party system.
- Zero per cent of appointees have primary experience working within trade unions.

Commissioners from different backgrounds are more likely to bring their experiences and biases with them. In increasing the representation of businesspeople compared to representatives of workers, the FWC has a smaller number of representatives for which wage growth is likely to be a priority.

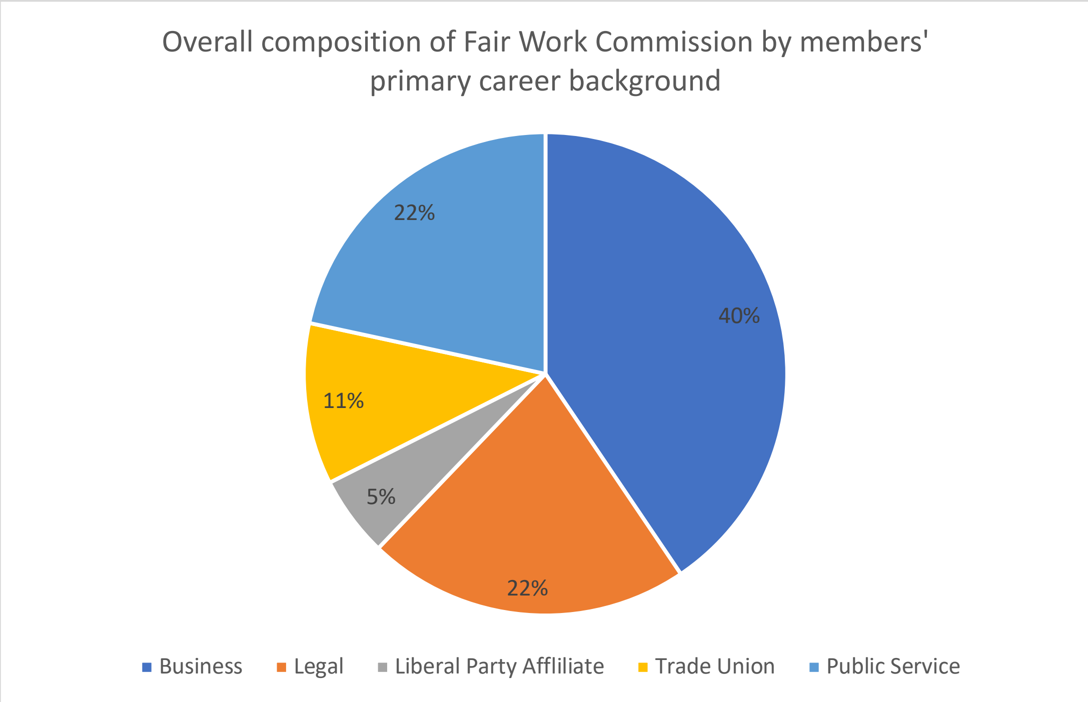

Figure 2.4: FWC members categorised by members' primary career background. Source: Author analysis.

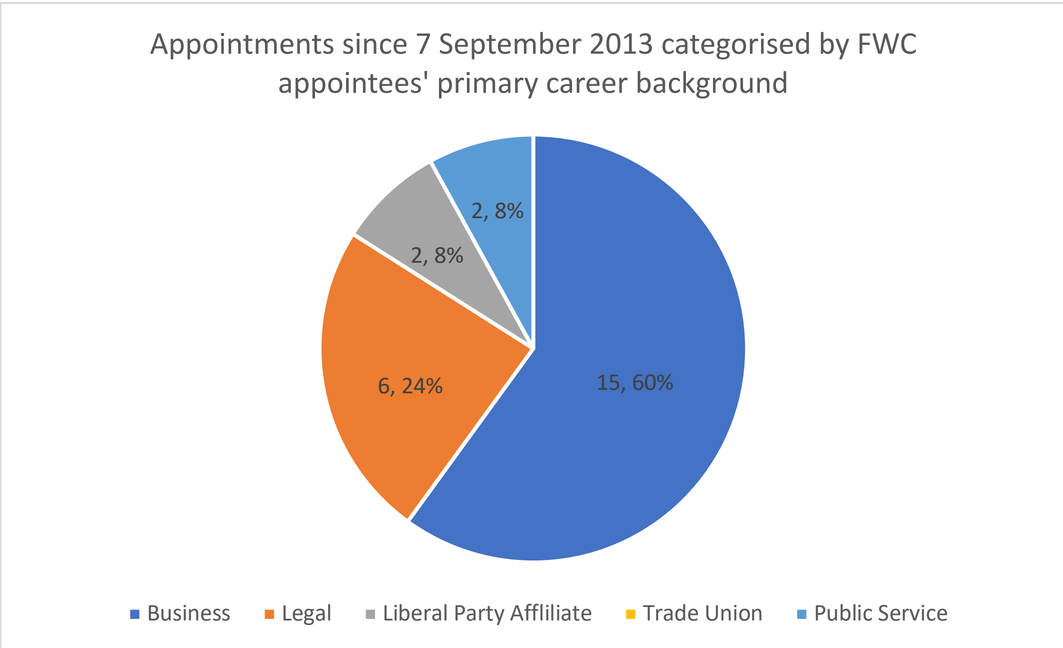

Figure 2.5: FWC appointments since 7 September 2013 categorised by appointee's primary career background. Source: Author analysis.

Conclusions

This report has assessed the state of wage growth in Australia, identifying differences in wage growth under two observation periods. Australia is today facing the slowest rate of wage growth since the wage price index was first established in 1997.

The report has identified seven policies of the current Federal Government that have contributed to downward pressure on Australian wages.

Since 2013, the Federal Government has implemented policies, advised the Fair Work Commission and neglected to address systemic issues in a manner that, in totality, have resulted in a sustained period of wage suppression across the Australian economy.

This has intersected with the rise of the unregulated gig economy. Without proper regulation and protections, wages will continue to fall, as forecasted by the Budget papers. This will have material impacts on Australian households, and undermine Australia's economic recovery from COVID-19.

References

Australian Treasury (2017). *Analysis of wage growth.* Accessed online: https://treasury.gov.au/sites/default/files/2019-03/p2017-t237966.pdf

Bishop, J and N Cassidy (2019). *Wages growth by pay-setting method.* Reserve Bank of Australia. Accessed online: https://www.rba.gov.au/publications/bulletin/2019/jun/wages-growth-by-pay-setting-method.html

Cavanough, E and C Wherrett (2020). *Blue Harvest: Wage theft & other labour infringements in the NSW Mid-North Coast's 2019/20 Berry Harvest*. The McKell Institute. Accessed online: https://mckellinstitute.org.au/wp-content/uploads/McKell-Institute-Blue-Harvest-Final.pdf

Lamo, A, L Perez and L Schnuknecht (2008) 'Public and private sector wages: co-movement and causality'. *European Central Bank*. Accessed online: https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp963.pdf

Migrant Workers Taskforce (2019), *Report of the migrant workers taskforce*, Commonwealth of Australia, March, at https://www.ag.gov.au/sites/default/files/2020-03/mwt_final_report.pdf

O'Brien, M, R Markey and E Pol (2018), *The short run impact of penalty rate cuts on employment outcomes in retail and hospitality sectors in Australia*. Econ Pap, 37: 270-286. https://doi-org.proxy.library.adelaide.edu.au/10.1111/1759-3441.12221

OECD (2019), *International migration outlook 2019*, Paris. Accessed online: *https://doi.org/10.1787/ec98f531-en*

Rizvi, Abdul (2020), *A fairer pathway: improving Australia's temporary migration program.* The McKell Institute, Accessed online: https://mckellinstitute.org.au/wp-content/uploads/McKell-A-Fairer-Pathway-3.pdf

Endnotes

[1] Cormann, Mathias (2019), Sky News, 7 March.

[2] Australian Government (2021). 'Budget Paper No. 1 2021-22', Table 1.2, p. 9. Accessed online: https://budget.gov.au/2021-22/content/bp1/index.htm

[3] Kehoe, John (2021). *What the RBA needs before it thinks of raising rates*. Australian Financial Review. Accessed online: https://www.afr.com/policy/economy/interest-rate-rise-will-need-jobless-rate-to-drop-to-4-pc-or-less-rba-20210325-p57e1x

[4] Remeikis, Amy (2017) *Malcolm Turnbull says the government supports penalty rate cuts.* The Sydney Morning Herald, 17 March. Accessed online: https://www.smh.com.au/politics/federal/malcolm-turnbull-says-the-government-supports-penalty-rate-cuts-20170317-gv04as.html

[5] See Wright, S (2019), *Australia home to one of world's biggest temporary migrant workforces'*, The Sydney Morning Herald, 18 September. Accessed online: https://www.smh.com.au/politics/federal/australia-home-to-one-of-world-s-biggest-temporary-migrant-workforces-20190918-p52slj.html

[6] Australian Government (2016). *Submission to the Fair Work Commission Annual Review 2016.* Accessed online: https://www.fwc.gov.au/documents/sites/wagereview2016/submissions/austgovt-sub-awr1516.pdf