THE MCKELL INSTITUTE

Stalling Wages, Falling Growth

GETTING AUSTRALIA *out of* THE WAGE SUPPRESSION TRAP

MAY 2018

ABOUT THE MCKELL INSTITUTE VICTORIA

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For more information phone (02) 9113 0944
or visit www.mckellinstitute.org.au

AUTHOR

JAMES PAWLUK

James is the Executive Director at the McKell Institute in Victoria. Prior to taking on the role at McKell, James was Manager of Business Development for Australia Post. James has also served as Senior Advisor and Deputy Chief of Staff to various Federal cabinet ministers with experience across areas such as government service delivery, digital transformation, budget processes, policing and customs.

James completed a Bachelor of Arts & Bachelor of Commerce at the University of Melbourne majoring in Economics and Political Science.

BACKGROUND

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FOREWORD

> Australia, like many developed nations post the Global Financial Crisis, is enduring a period of declining wage growth and increasing inequality in income, resulting in living standards falling and stagnant economic growth. Access to fair wages has been facing a relative decline in the past few years, challenging social mobility and the egalitarian society that Australia has prided itself on being.

This report is the first of a series of reports that will underline the current problems impacting wages and inflation in Australia and will identify ways through which employers, industries and the government can collaborate to change the industrial relations framework to give all Australians an opportunity to earn a decent income and improve their living standards.

This suite of reports will seek to highlight how the nation's poor performance on wages and inequality are the products of a system that has allowed employers to exploit low-income workers and continue to practice non-compliance with awards and the minimum wage regulations; resulting in progressive degeneration of the remuneration system. This series will identify problems at both a micro-economic and macro-economic level and seek to offer recommendations that will help in addressing the contemporary challenges that the Australian economy is facing.

This report aims to highlight the importance of sustainable and healthy wage growth with inflation responding accordingly ,in order to facilitate smooth transitions in the economy from one business cycle to the other.

It also highlights key factors that must be considered when awards and minimum wage regulations are set by industry and government in order to make sure all Australians are paid a decent wage.

It is crucial that measures are taken to improve the access to fair earnings across the nation and create a workforce that is suitable to meet the demands of an ever changing, globalised world.

HON STEVE BRACKS AC
CHAIR,
MCKELL INSTITUTE VICTORIA

JAMES PAWLUK
EXECUTIVE DIRECTOR
MCKELL INSTITUTE VICTORIA

EXECUTIVE SUMMARY

Australia has been experiencing historically low levels of wage growth across a wide variety of sectors in the past decade. This is illustrated by the Wage Price Index growing only by 1.9% through 2017 which is the lowest it has been since the beginning of the series in 1997.[1] This stagnant wage climate has been coupled with an inflation rate of 1.9% as of January 2018, which is below the recommended target of 2-3% and has remained consistently low over the past few quarters.[2]

Inflation expectations affect nominal wage growth and at a time where the benefits of sustained nominal wage growth are substantially undervalued, it is important to recognise that various sectors of the economy not just rely, but work best when nominal wages are growing on a consistent basis.

Reliable increases in nominal wages provide the necessary injection needed to turn around the lack in consumer demand. It can also underpin medium term household confidence, enabling longer term decisions to be made. Further, employers in the past have argued for the need for more time to factor in changes to budgets. Predictable and sustained wage growth help to provide exactly that.

The effectiveness of fiscal and monetary policies to boost the economy out of its current stagnant wage growth is quite evident when the impact of subdued wage growth on the Federal Budget is analysed. A closer look at the Treasury's documents show cumulative write downs in revenue of up to $98 billion since 2013-14 due to downward revisions in wage growth. This amounts to one sixth of the expected peak in net government debt, and is considerably more than the $52 billion spent in stimulus packages during the GFC. The path back to a fiscal surplus is now contingent on the most optimistic levels of wage growth since 2010. This means even with higher wage growth than last year's all-time low of 1.9%, Australia could still be exposed to further write-downs of a similar magnitude. It's time to recognise that a big boost to the national minimum wage is not only necessary to help families struggling with the cost of living, but is critical to restoring the health of our nation's finances. It is the most efficient tool available to ensuring the Government's forecasts can be achieved.

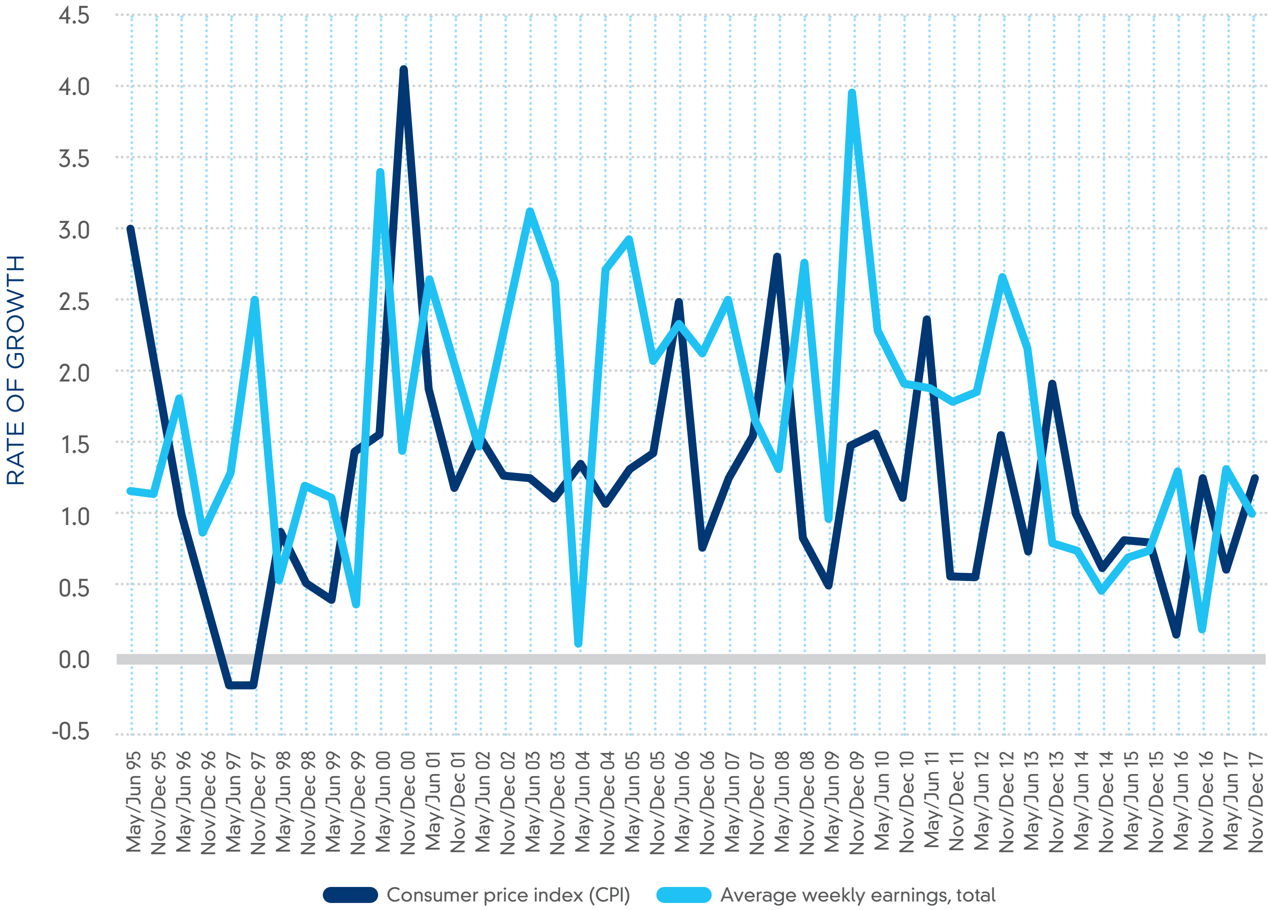
Even more destructive than the impacts of low wage expectation, is the damage being done by wage theft and wage suppression. Worryingly, an increasing number of firms that prosper are those that are most effective at suppressing wages, or in many cases, overtly underpaying their staff. Non-compliance to awards is driving a wedge between employers that genuinely want to continue to do the right thing, and those that intentionally underpay wages, penalty rates and superannuation.

Institutions and the government must collaborate to rectify wage growth in order to pave the way for a more equitable and sustainable workforce and economy.

PART ONE: THE IMPORTANCE OF GROWING WAGES

Wage growth in Australia has reached record lows in the past decade.[3] It is now a highly contentious topic among the media and major institutions such as the Reserve Bank, the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD),[4] among others. As shown in the graph below, for the past five years, wage growth has barely kept pace with inflation.[5]

FIGURE 1 GROWTH IN AVERAGE WEEKLY EARNINGS VERSUS INFLATION



Nominal wage increases are vital to economic growth

Real wage growth (increases in actual spending power after inflation is accounted for) has always been regarded as a vital indicator of living standards since it represents consumers' ability to purchase goods and services and experience a material increase in living standards. While real wages might be what matter most to an individual on any given day, they aren't what drives the system from a macro-economic point of view over the long run.

Sustained and predictable increases in nominal wages (increase in monetary terms before inflation is accounted for), facilitate a smoother transition as the economy moves from one shock to the other and helps to move capital and labour towards full employment.

The RBA has identified the current low nominal wage growth as "insidious" and identified it, along with low inflation, which has been exacerbated by this low growth — as one of the two key challenges facing the Reserve Bank.[6] The IMF has also expressed concern at Australia's low inflation rate and described the current second longest consecutive streak of bettering RBA inflation targets as "persistent disinflation".[7]

A boost to nominal wage growth within healthy bounds, will have significant positive benefits for the national economy by both increasing inflation to targeted levels, whilst simultaneously driving an increase in consumption and household living standards.

Aggregate demand increases when wages are growing

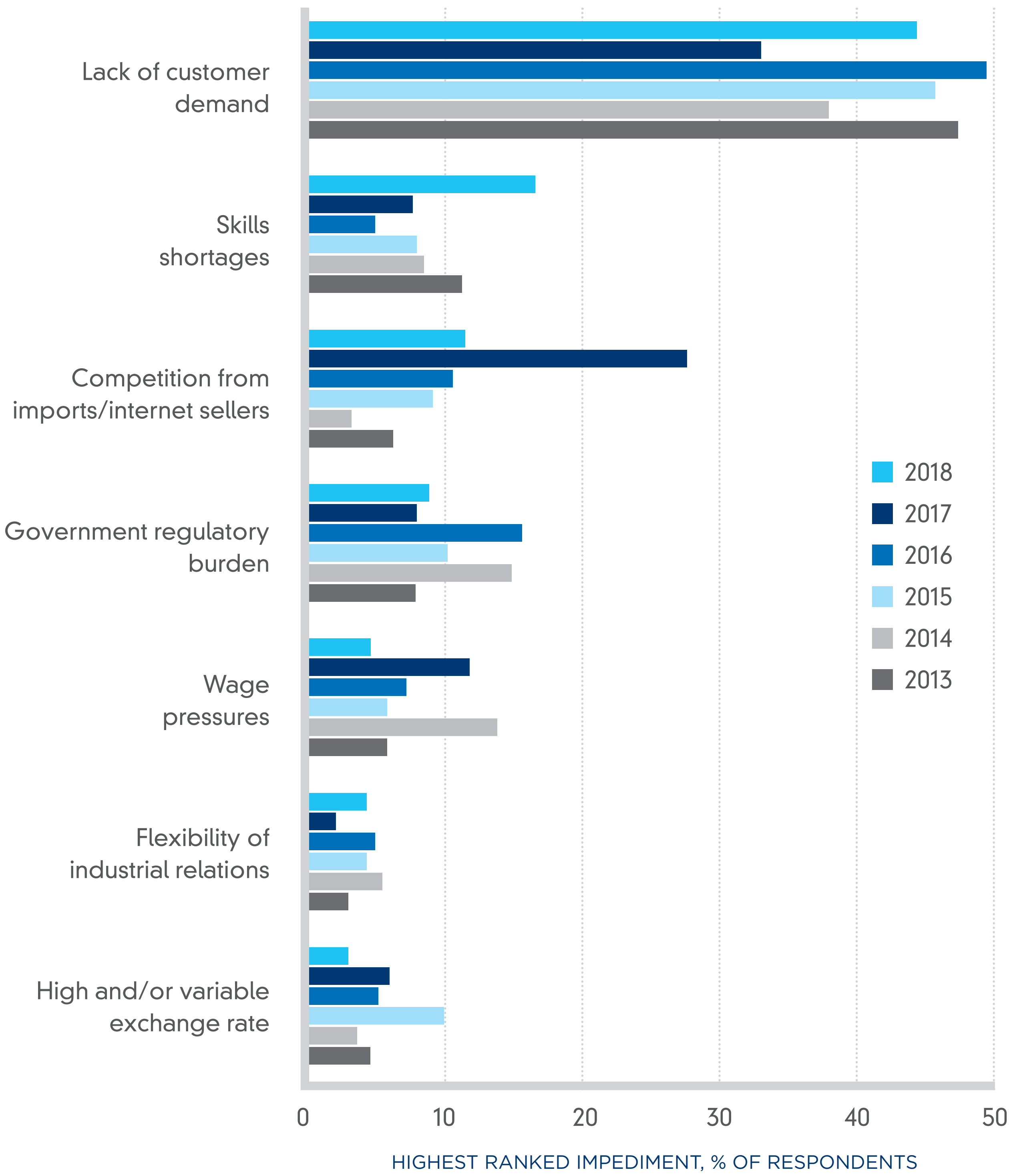
From a macroeconomic perspective, an increase in nominal wages to sustainable levels, helps to boost consumption and increase aggregate demand without the economy over-heating and causing excessive inflation due to a wage-price spiral. For instance, in the case of casual workers, prior research conducted by the McKell Institute has shown that a cut in penalty rates significantly reduces the earnings of workers in the retail and hospitality sector.[8] As a consequence, these workers are likely to 'pass the cut on' and respond by reducing their participation in economic activities such as dining out, expenditure on goods and services or home renovations.[9] This leads to aggregate demand falling, causing economic growth to follow suit.[10]

The impacts of these changes tend to disproportionately affect workers on the lowest incomes and are especially significant among regional and rural economies, further contributing to economic and geographic stratification in Australia.[11]

The lack of growing demand is documented as a major impediment to business growth by employer groups themselves. In its last six surveys, Ai Group recorded a lack of customer demand by respondents as the top inhibitor to business growth, with ongoing weakness in employee compensation on per capita basis, being identified as a contributing factor.[12]

In the absence of renewed nominal wage growth, household consumption and demand are likely to remain weak, hurting businesses and in turn damaging the Australian economy. If businesses and investments in innovations are to grow , it is essential for wage growth to return to healthier levels.

FIGURE 2 AI GROUP'S NATIONAL CEO SURVEY: BUSINESS PROSPECTS IN 2018



Highest ranked answer in response to 'What factors do you expect will inhibit your business growth in 2018?'
Source: Ai Group, National CEO Survey: Business Prospects in 2018, January 2018

Confidence increases with sustained wage growth

Wage increases that are predictable and sustained over a period of years, can have a significant impact on an economy, driving domestic consumption upwards; than those negotiated on a short term basis. Workers who receive increases that are locked in for a sustained period, and as a result are more confident of their future prospects, may likely be prepared to take on more risk, invest and even pay off long-term debts. Just as consumer confidence can be built due to expectations of wage increases, businesses are also able to make better decisions with predictable wage increases in their budgets.

Employers in the past have argued for more time to factor in changes to budgets[13] and predictable wage growth helps to provide exactly that. Certainty regarding forthcoming wage increases for a firm and its competitors, will definitely influence calculations regarding capital expenditure and training. Conversely, uncertainty or perceived opportunity to re-litigate wage increases can only encourage employers to devote more resources to developing strategies for wage suppression rather than productivity enhancement itself.

Low wage growth contributes to financial instability

Though Australia managed to successfully avoid the worst of the GFC, it now has one of the highest levels of household debt to GDP in the OECD. Debt growth has outpaced that of incomes and assets and in the decade leading to 2016, the proportion of households who are over-indebted rose to 29% of the population.[14] These concerns were echoed in the most recent Financial Stability Review from the Reserve Bank, which noted that Australia's household debt to income ratio has now increased to almost 190%.[15]

The IMF has concluded that Australia's high debt service ratios and levels of household debt make national growth fragile and unpredictable. It fears it has the potential to multiply the negative effect of income or credit shocks throughout the economy.[16] In previous decades, rising wages has been one of the main enablers of households getting ahead of their mortgage, and in doing so has helped in keeping debt under control at the individual household level. This has become much more difficult in the current economic climate.

Low inflation and reduced wage growth has resulted in average monthly home loan repayments as a percentage of income, to increase significantly each decade from the commencement of the loan and throughout the course of its life.[17]

Coupled with the current context of house prices soaring and affordability waning, this stagnant economy proves a serious threat to the middle class, and the 'fair-go' ethos that has been characteristic of the modern Australian economy.

Balancing the budget is predicated on sustainable wage growth

Personal income taxes account for up to 54% of revenues to the Commonwealth (excluding GST which is paid to the states and territories).[18] When nominal wages rise, income tax revenue for the government also increases thus providing a more stable tax base than some taxes that are more cyclical in nature - such as capital gains tax.[19] This has meant that wage growth has typically played an important role in budget repair with the path back to surplus warranting a 3% growth in wages as stated in the recent budget. Further, Parliamentary Budget Office (PBO) analysis of the 2017-18 Budget found that projected increases in tax receipts by the government would be largely reliant on this predicted wage growth driving increases in personal income tax receipts.[20]

The sustainability of the tax cuts are heavily reliant on the most optimistic wage growth since the Wage Price Index was reinstated as a major economic parameter in the 2013-14 Mid-Year Economic Outlook.[21]

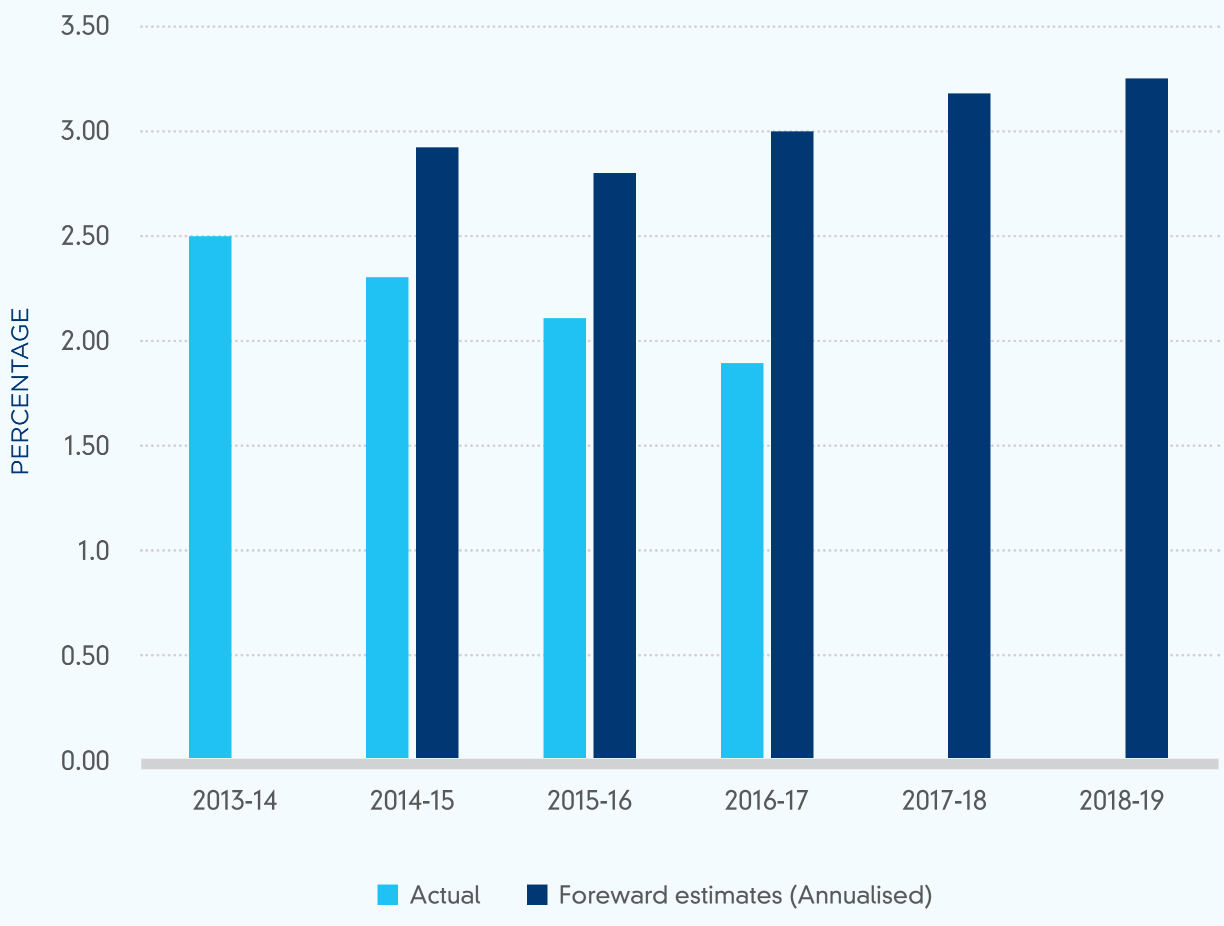
Over this same period, 'lower than expected' or 'subdued' wage growth has, according to the Commonwealth Treasury, been the "primary"[22] driver of cumulative write-downs of $98.3 billion in gross income tax withholdings. This amounts to 28.1% of the expected peak in net government debt of $349.9 billion in 2018-19, additional debt that might have been avoided if the economy had achieved the original budgeted forecasts.

So if Australia's low wage growth cannot be rectified, the latest return to surplus will most likely fail to be realised and further debt will be added unless a disproportionate contribution from other forms of tax revenue are expected or significant new taxes or cuts in expenditure are carried out. It would be in the government's best interests to prioritise sustainable wage growth and urge employers to increase salaries in order to contribute to healthy GDP increases and economic growth.

Wage growth and the 2018-19 Federal Budget

The 2018-19 budget assumes over the forward estimates period that the Wage Price Index will grow at a faster rate than any preceding budget since the index was re-instated as a major economic parameter. This is despite the overall downward trend in the actual outcomes of the Wage Price Index:

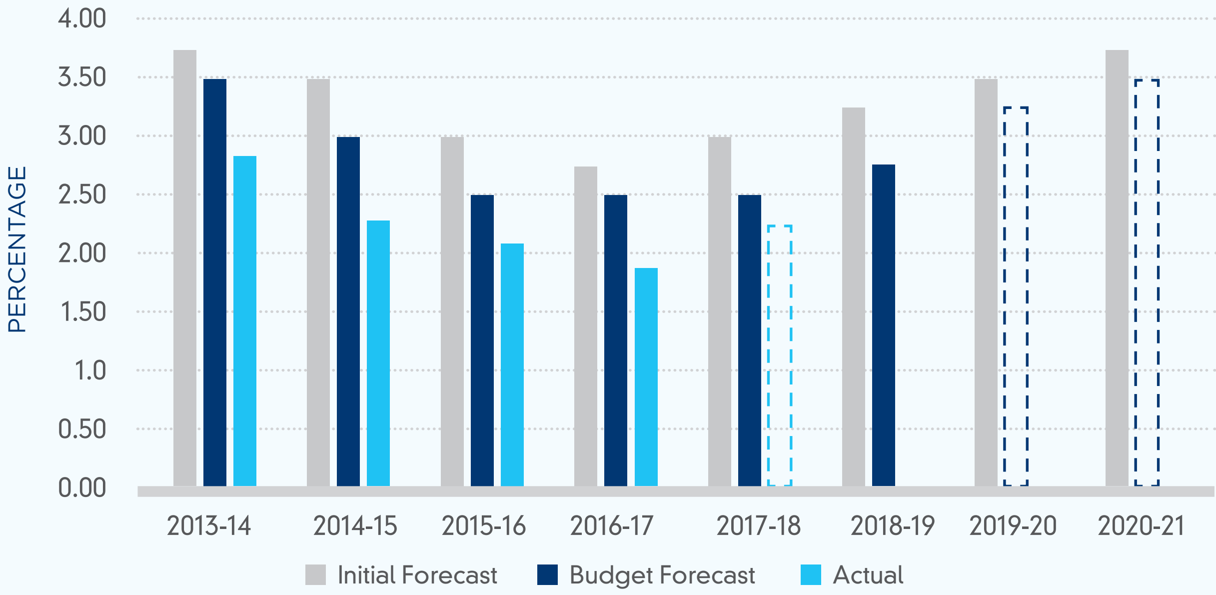
FIGURE 3 PROJECTED GROWTH IN THE WAGE PRICE INDEX OVER THE FORWARD ESTIMATES COMPARED TO ACTUAL[23]



Source: Derived from ABS statistics

The accuracy of these forward projections are being questioned[24] based on how 'reliably' they have been revised down over this period. On average, growth in the Wage Price Index has been progressively downgraded by an average of 1.05% from the time a forecast was first made culminating in a near-term low in 2016-17 of just 1.9% growth in the index. Meanwhile, despite a small expected improvement for 2017-18 the overall pattern shows signs of continuing decline.

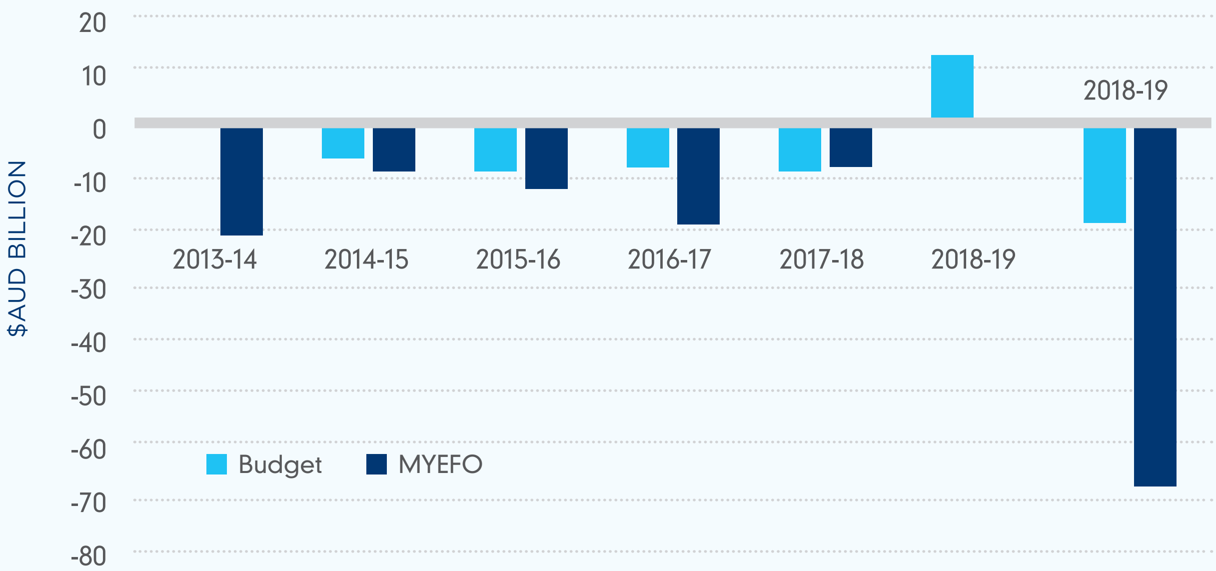
FIGURE 4 WAGE PRICE INDEX FORECASTS VS ACTUALS (2013-14 TO 2020-21)[25]



Source: Derived from ABS statistics

If past revisions to revenue are anything to go by, the implied vulnerability of the budget from continued wage stagnation is significant. The cumulative value of successive downgrades to Gross Income Tax Withholdings in every Budget over this period, attributed to lower than expected wage growth, are in the order of $98.3 billion. If future wage growth were to miss the budget's targets by similar magnitudes, then there is the possibility that we will see repeated downward revisions to income tax receipts of $14 to $20 billion over the forward estimates for each year the trend persists.

FIGURE 5 DOWNWARDS REVISIONS TO INCOME TAX RECEIPTS[26]



Source: Derived from ABS statistics

Reshaping the economy on the move

A significant part of Australia's economic success as a mid-sized economy can be attributed to the flexibility with which the country has been able to shift scarce resources from one part of the economy to another in response to an ever-shifting global economy. Most notably was the deployment of engineering and construction capability into supporting the minerals boom.

Price signals are key to driving these changes as they provide information to participants, allowing them to efficiently respond to temporary fluctuations or shocks. In Australia's current low-inflation environment, prices are not providing information to participants because the price changes are quite insignificant. Economists have long thought that prices are sticky downwards, for a variety of reasons, from market power, or even from fear of a consumer backlash, if prices are too volatile.

In this context, the boost provided by increased household demand could play a key role in bringing inflation in-line with the Reserve Bank's target band, thus 'greasing the wheels' of the economy and helping the price mechanism to truly coordinate the forces of demand and supply to make sure all factors of production in the economy are functioning at full potential.

The impact of wage expectations on productivity

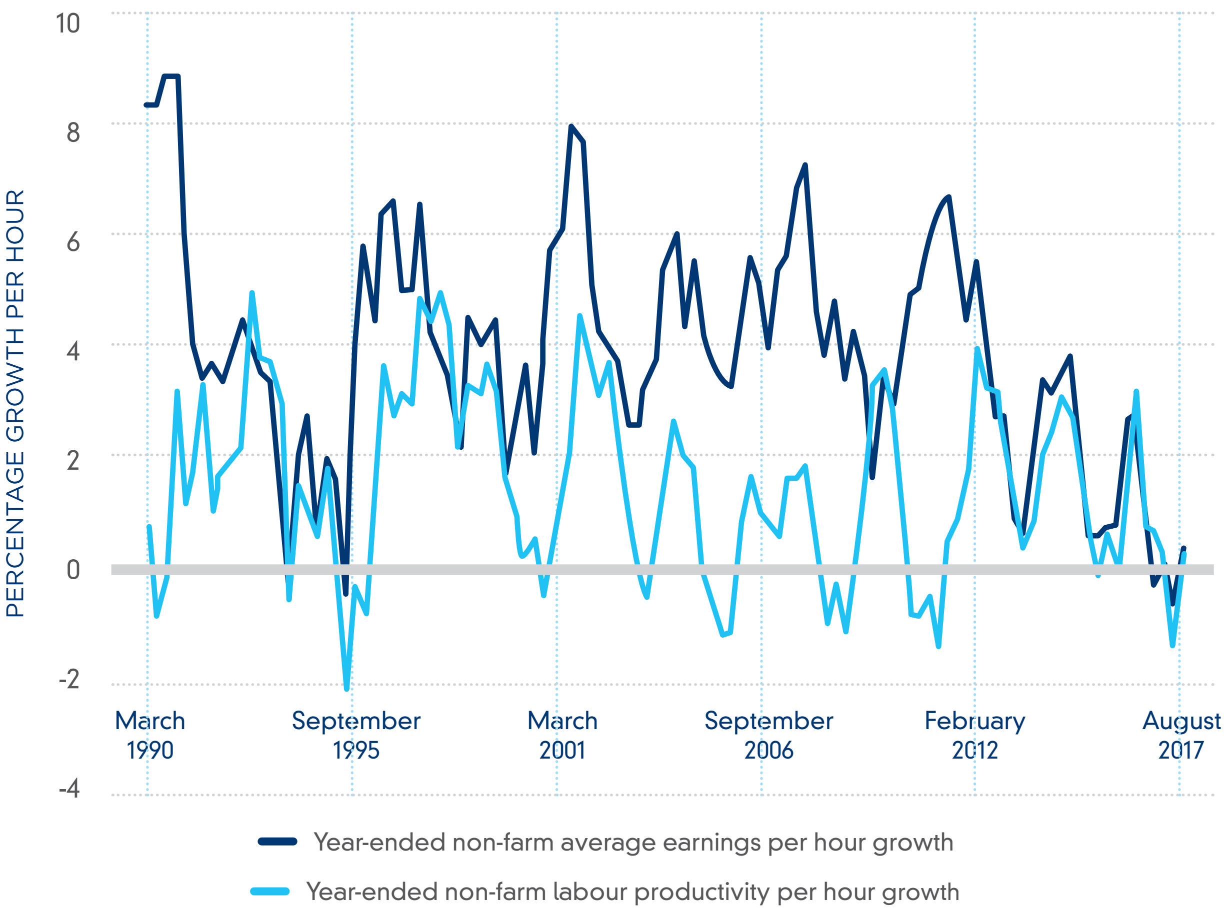
There is a clear positive relationship between wage growth and productivity growth. As illustrated by the trend lines, when the effect of wage growth from the prior quarters is considered, the correlation is even stronger.

Economic research has long since illustrated that higher wages are positively correlated with higher productivity, known as 'efficiency wages'. Theoretically there are two channels through which one might expect higher wages to lead to higher productivity.

In managerial terms any increase in the price of an input, such as labour, is likely to incentivise managers to increase the efficiency with which inputs are allocated, increasing productivity .

From the perspective of workers, higher wages may lead workers to increase their efforts because they feel valued as employees. Additionally, a number of studies have found that higher wages reduce employee turnover, providing another channel through which higher wages increase productivity.

FIGURE 6
UNIT COSTS GROWTH (TIME-SERIES, NON-FARM SECTOR)

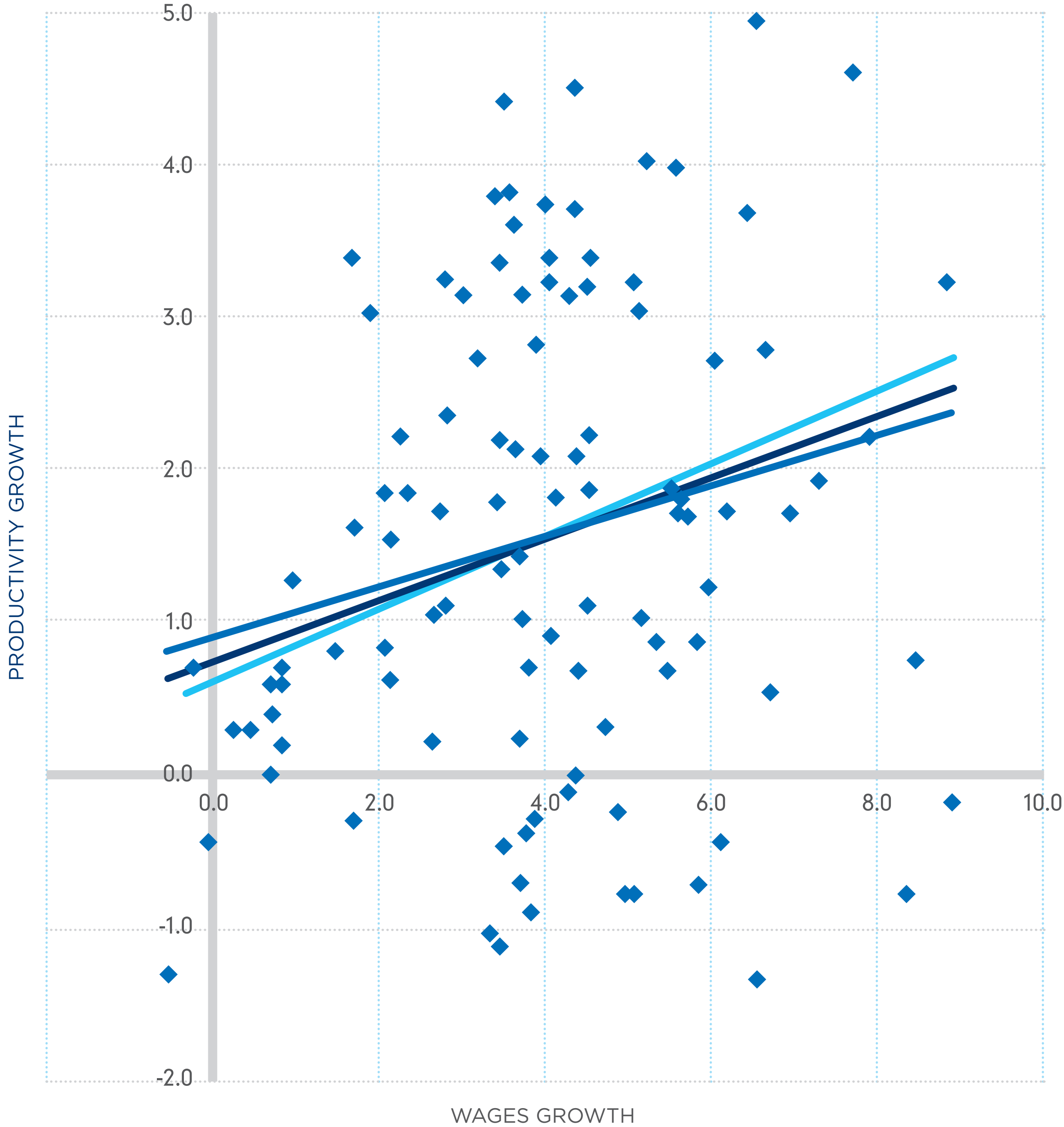


Source: RBA 2018 Chart Pack

As the graph (Figure 7) derived from ABS statistics shows, as wages grow, productivity levels also increase accordingly. The regression analysis conducted in the graph clearly demonstrates that productivity growth simply follows on from wage growth and the effect follows a lagged pattern with the positive correlation between wage growth and productivity growth pervading throughout consecutive quarters.

FIGURE 7

UNIT COSTS GROWTH (AVERAGE EARNINGS PER HOUR VS LABOUR PRODUCTIVITY PER HOUR)



Source: RBA 2018

Note: The lighter blue lines in the graph show the relationship between wage growth and productivity growth with wage growth lagged by one quarter, and then two quarters. The darkest blue regression line shows the current relationship between wage growth and productivity growth.

The future role of wage expectations

If Australia intends to reach a point where it recognises that individuals are its biggest asset and businesses seek to maximise the productivity of their workforce, then the focus must be directed towards the role wage expectations play, in driving firms towards that outcome.

This includes a better understanding of the opportunity to use increasing wages as a lever to accelerate productivity growth in a market economy like Australia. In competitive sectors of the economy, where all firms face rising wages, the businesses that will thrive are those that are best able to innovate to increase either sales or productivity to offset a higher wage bill. On occasion there will be some managers and business owners that will not be able to survive increased wages, but provided the capital markets function effectively to replace them, this need not lead to adverse employment outcomes for their staff.

In the case of firms that are exposed to international trade, it may be argued that increased wages will make Australian businesses relatively less competitive in the global market. However, this is when wages reach dangerously high levels that are simply unsustainable, leading to the economy over-heating due to excessive inflation levels.

What this report argues for instead, is a healthier increase in wages as recommended by major institutions, that will help in overcoming the slump that the economy is in, currently. Moreover, trade occurs between countries for a number of reasons, and Australian wages have been comparatively high for some time. Australia's trade success over the past few decades therefore has not been negatively impacted by the wages of domestic workers versus those overseas. Instead it is largely due to the fact that our flexible exchange rate has operated as a buffer between domestic firms and those overseas, thereby ensuring we remain competitive.

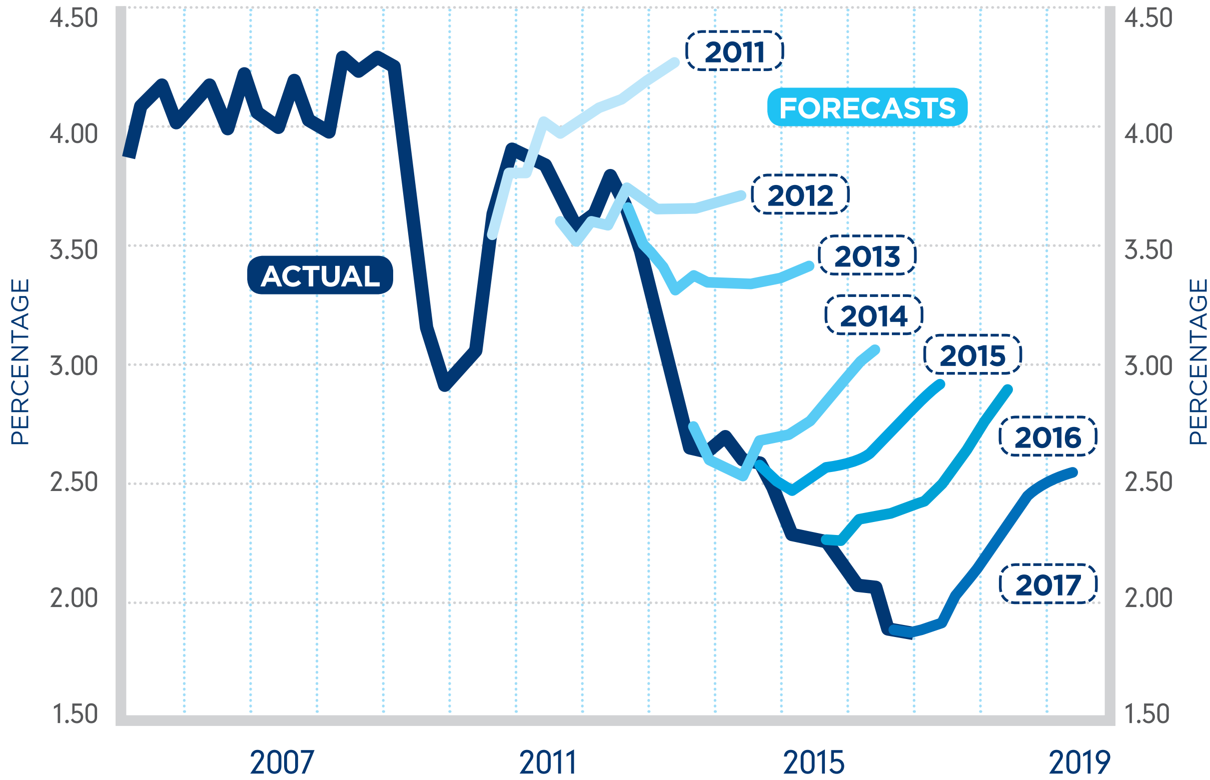
PART TWO:
NON-COMPLIANCE AND WAGE-SUPPRESSION

Increasingly, the firms that prosper are those that are most effective at suppressing wages, or in many cases, those that are underpaying their staff, and these firms tend to undercut the businesses that are prepared to invest in their staff over the long run.

They are able to do so because rather than setting up institutions and market forces to create a positive cycle of productivity and wage growth, the current economy has somehow managed to engineer the opposite. Since 2011 the Reserve Bank has continually forecast improving or at the very least steady wage growth only to subsequently downgrade these forecasts dramatically the following year.[27]

It has been identified that a lack in workplace compliance plays a significant role in the unmet expectations of increased wages, by these economic institutions.

FIGURE 8 WAGE PRICE INDEX FORECASTS BY THE RESERVE BANK OF AUSTRALIA



Sources: ABS, RBA.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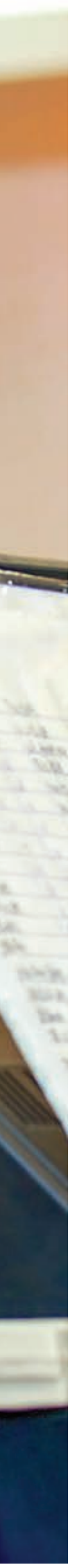
The role of wage-theft in driving wage-suppression

Award non-compliance is driving a wedge between employers that genuinely want to do the right thing, even give their staff a pay rise, and those that intentionally underpay wages, penalty rates and superannuation. The same applies to those businesses that pay their fair share of taxes as opposed to those that employ sham contracting, agency workers, and who exploit workers on temporary visas in order to avoid their obligations to workers.

It is important to recognise that the negative impacts of these practices go beyond the staff that are the recipients of this behaviour and actually undermine the competitiveness of firms that want to do the right thing and indeed the legitimacy of the entire industry.



For those firms with limited opportunity to shift their operations offshore, resisting wage increases or taking active steps to cut wages and conditions increasingly becomes the principal means of remaining competitive or in some cases, even simply to stay in business. After years, sometimes decades, of being "A-Grade Employers", more and more firms are being drawn into non-compliance. This domino effect of wage suppression is not a new phenomenon. In 1909 a young Winston Churchill introduced the *Trades Board Bill*, which established a national minimum wage for selected trades and named the condition of employers becoming more and more non-compliant with wages, progressive degeneration. Almost 110 years on this has unfortunately become all too relevant in Australia, with our worst employers engaging in outright wage-theft, undercutting the bad employers engaged in wage-suppression and both of whom undercut the good firms who would like to pay a decent wage to their employees.

In a somewhat perverse outcome, past reforms aimed at promoting competition across Australia can end up promoting wage-suppression and even wage-theft. For instance, in government tendering where price is the major determinant, firms that are willing to pay decent and reliable wages supported by an enterprise agreement, stand less of a chance in winning against a competing bidder, all things being equal, whose workforce is on the award. Further, in consumer markets, households have become more price-conscious than ever within this climate of low wage growth. The exercise of choice in favour of the lowest cost provider means that consumers are often unwittingly rewarding the behaviour that is undermining their pay rises by purchasing items that non-compliant businesses have played a role in producing.

Inequality is worsening

A direct consequence of both wage-suppression and non-compliance has been to exacerbate income inequality. This is in the context of researchers from the IMF declaring that widening income inequality is the "defining challenge of our time".[28] This forms part of a growing body of research conducted by economists which finds that inequality is responsible for lowering medium-term economic growth while also reducing the likelihood of economic growth being sustained.[29] In contrast, lower net inequality, is found to be robustly correlated with "faster and more durable growth".[30]

Australia has not been immune from these trends, with the level of inequality within the country coming under increasing scrutiny, sparking debate among policymakers about what needs to be done to address it.

The Gini coefficient measures economic inequality and wealth distribution within a population and the Gini coefficient for Australia has shown a rise in inequality from 0.27 in 1981-92 to 0.33 in 2013-14; falling behind comparable nations like Germany, France, Netherlands, etc. Discussion has not just focused on income inequality, but more so on wealth inequality with the top 1% growing dramatically and getting richer, while current young Australians are unable to even afford their first home. The wealth share held by the top 1% in Australia has been on the rise over the past two decades, while the wealth share held by the poorest 50% of Australians has seen a consistently dramatic decline.[31]

Further, inequities between generations, between places in Australia, and between races or ethnicities has grown widely in the recent decade.[32] These issues demand attention, although this report is not broad enough in scope to address them.

The evidence, however, is clear. Addressing income inequality between Australians is both a moral and economic necessity. Wage-suppression and non-compliance cannot be allowed to continue to worsen income inequality. If this economy is to continue to flourish and run at record growth, all Australians must experience the benefits equally and have the opportunity to earn a decent wage for their work.

PART THREE: BREAKING OUT OF THE WAGE SUPPRESSION TRAP

If non-compliance isn't addressed properly then wage suppression will repeat itself.

The answer is not to claim that awards, penalty rates and entitlements are too difficult to enforce and so the playing field should simply be levelled for businesses by removing them altogether. While it is possible to acknowledge that many employers with a proven track record of being fair are being dragged into the grey area of wage suppression, to respond with the removal of penalty rates is tantamount to giving a stamp of approval to the shameful behaviour of non-compliant firms.

Firms should be competing with one another and contributing to both growing the standards of living for their employees and reducing income inequality. However, the positive benefits of competition can rapidly turn negative when compliance is absent. Competitive forces on their own aren't capable of ensuring compliance with Australian laws, particularly when it comes to labour related issues.

A simultaneous wage boost and compliance crackdown is necessary

It is not wise to simply wait until compliance is under control before wage growth can be rectified as income inequality is worsening. Further, an isolated focus on compliance could risk undermining the short-term viability of too many businesses and therefore jobs.

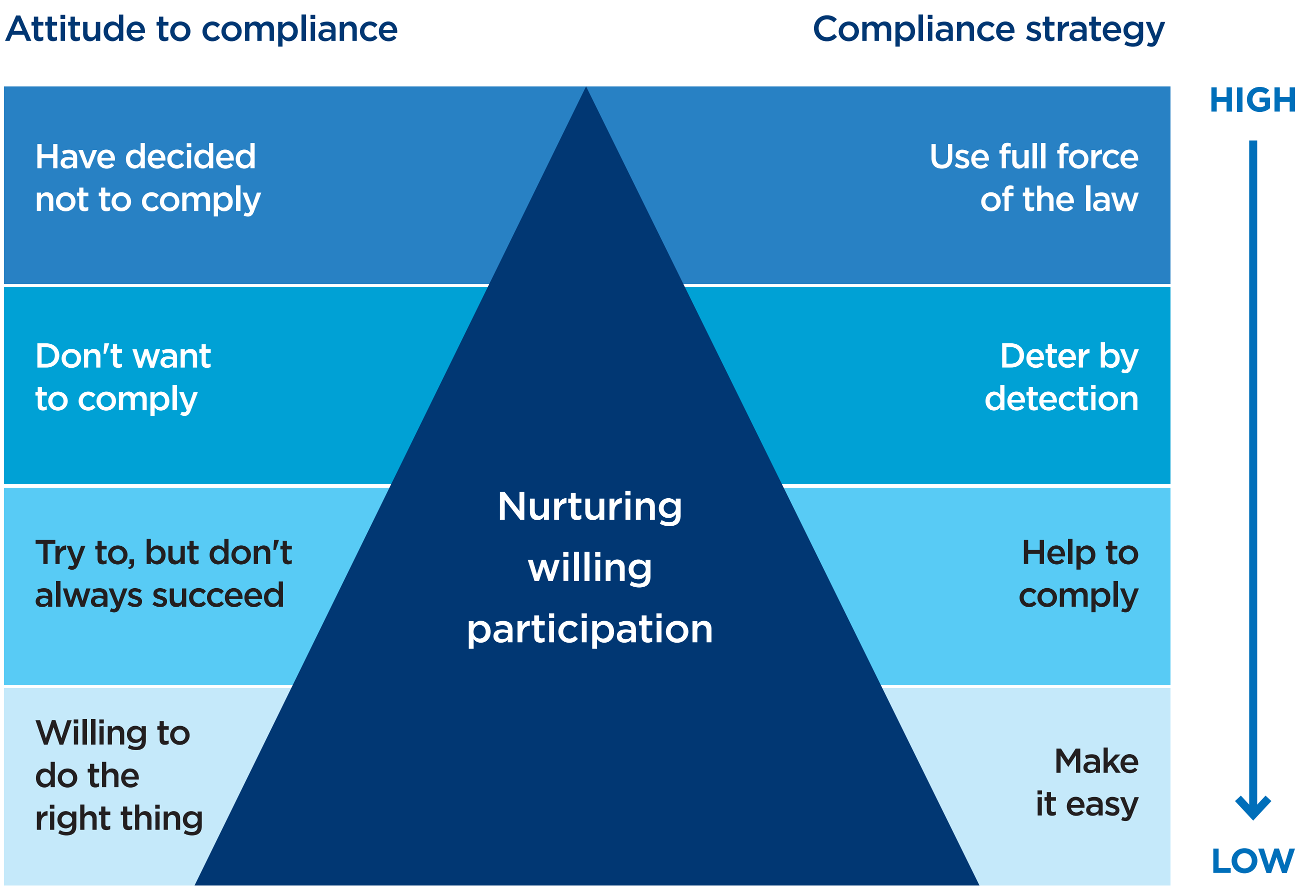
A two-pronged approach is necessary that combines increasing wages with a crackdown on underpayment and non-compliance. Executing both simultaneously will support those firms that have always done the right thing, and want to continue paying decent wages, without fear of being unfairly undercut. Further, rising wages will help boost aggregate demand and promote economic growth. It will also make it easier for firms whose behaviour has slipped into the grey area of non-compliance, to pass on any price increases that might result from an adjustment back to a compliant cost base, to their customers.

In the short-term, the quickest and most effective way to improve compliance in any system is to encourage it to occur voluntarily.[33]

However, when it does not happen organically, there needs to be clear signals from the Australian community, labour organisations and ultimately representatives in parliament, that compliance will no longer be optional. It would be naïve to think that the voluntary actions of non-complying firms would be the solution to the problem of non-compliance.

That is why it is essential that when any signal is delivered, it must be supported by clear and unambiguous measures — tangible measures that are adequately resourced.

FIGURE 9 THE AUSTRALIAN TAXATION OFFICE COMPLIANCE MODEL



Source: The ATO

This will not only provide confidence to those employers that are, or want to pay decent wages to their staff — but will also indicate to those who are law breakers that they are under serious and increasing threat through increased compliance assessments or fines, for instance.

It will also help instil confidence in the Fair Work Commission itself, in relation to the capacity of the national economy and businesses, to be able to afford a boost to the minimum wage and other awards.

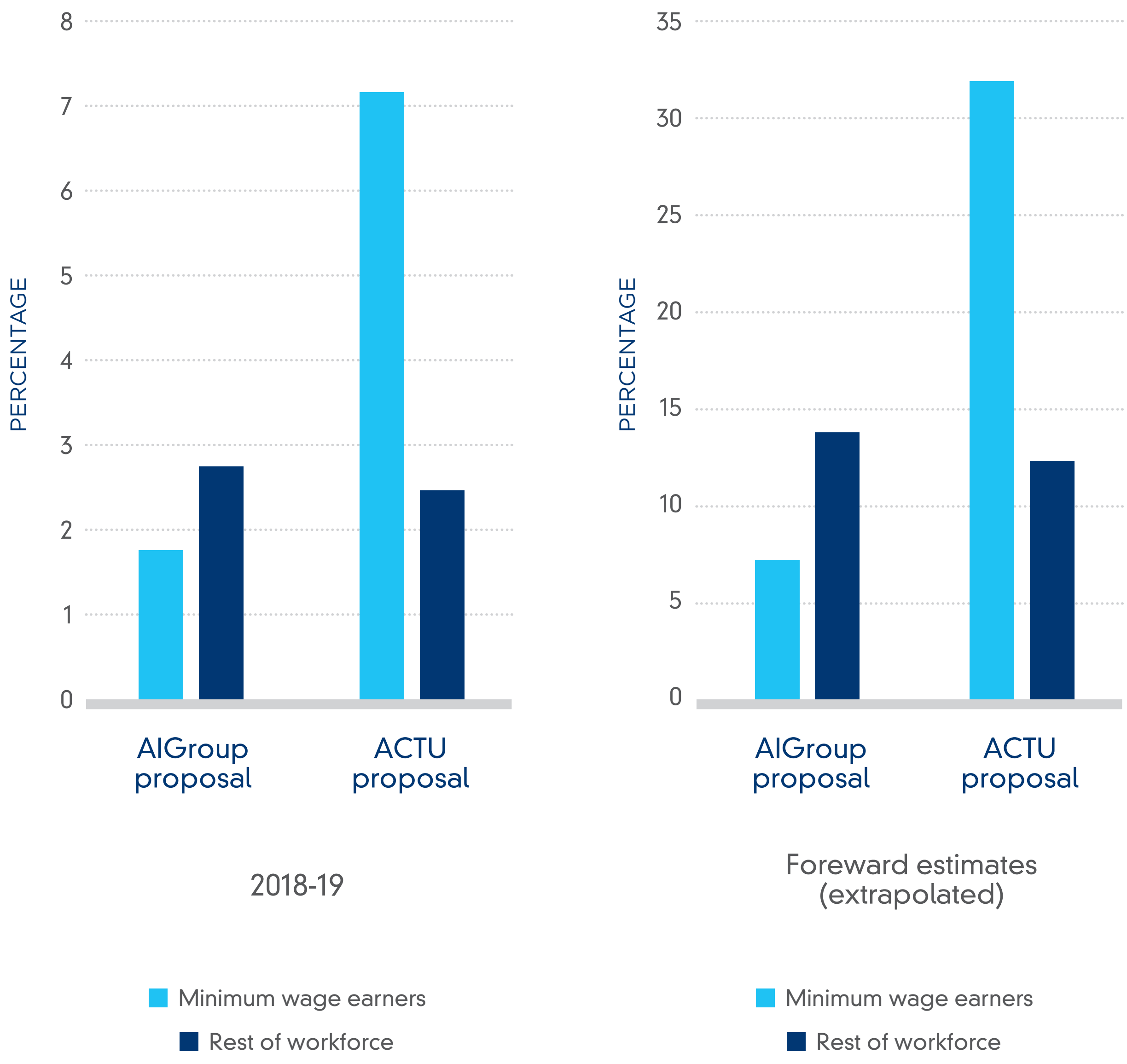
This report recommends that any credible crackdown must at minimum include stronger enforcement by relevant authorities and transparent access to employment records for workers and their representatives.

Kickstarting wage growth via an increase to the National Minimum Wage

Employees on low incomes are among those that are most severely impacted by non-compliance to awards, wage suppression and low wage growth. For any approach aimed towards compliance and wage increases to be effective, it makes sense that wage increases would be targeted heavily towards workers on low and middle incomes. This will help reverse the increased inequality and will also maximise the macroeconomic boost to aggregate demand as the affected households on lower incomes have a higher propensity to spend additional marginal income, than those on higher incomes.

The most practical way to achieve this outcome is via a significant increase to the minimum wage, given it will flow through directly to 2.3 million workers and their households.[34] Given that the budget is dependent upon ambitious wage growth for its pathway back to a surplus, a boost to the minimum wage at the start of the financial year is an opportunity to support the government's fiscal strategy.

FIGURE 10 WAGE INCREASES REQUIRED TO MEET BUDGET'S FORECASTS BASED ON PROPOSED INCREASES TO THE NATIONAL MINIMUM WAGE[35]



Source: McKell Institute calculations

The bigger the increase in the National Minimum Wage, the less the other wages will have to rise in order to meet the forecasts in the budget. For instance, if the FWC awards an increase of 1.80% as proposed by the Ai Group, then wages for the rest of the workforce will need to go up by 2.81% in order to meet the budget's forecast of 2.75%.

However, if the increase is 7.20% as proposed by the ACTU, the rest of the workforce would only need to secure wage rises of 2.49%. This is not only more realistic, given the subdued wage growth over recent years, but is also healthier and more sustainable, as wages will not reach dangerously high levels and thus will help in bridging the inequality gap. These trends would naturally be compounded over time.

For instance, if the minimum wage were increased by just 1.80% for the next four years, then wages would need to rise by 3.33% each year for everyone else to meet the budget's even higher forecasts for wage growth in later years. Cumulatively, this would mean an increase in wages for the lowest paid of 7.40% compared to 14% for the rest of the workforce.

An urgent and substantial boost to the minimum wage is necessary to restore Australia's living wage and ensure that the economy can contribute most effectively towards the Government's fiscal strategy.

It is time to rethink how Australia sets its minimum wages and awards

It is clear that the overall policy framework in Australia must be revised in order to achieve healthy and positive fiscal and monetary outcomes that support higher income for the low income sectors of the economy. One aspect of wage-setting within Australia that needs to be updated is how the FWC is directed to set the national minimum wage and modern award wage levels. In particular, the manner in which the FWC is expected to "balance" the various factors that make up the minimum wages and modern award objectives of the *Fair Work Act 2009*, including: the "relative living standards and the needs of the low paid" and "the performance and competitiveness of the national economy, including productivity, business competitiveness and viability, inflation and employment growth".[37]

At face value these 'factors' sound reasonable enough, but in practice can become an obstacle to wage growth, particularly when more than one institution has been charged with managing the same factor under statutory independence. There is no better example of this than inflation.

The RBA has an explicit target of managing inflation within 2-3% over the medium term.[38] Awareness of this target is economy-wide, and the attention given to it so significant, that it has effectively become a de facto target for other institutions. This includes the FWC, where its published decisions on the minimum wage regularly cite the RBA's target range in justifying the increase it awards.[39] Indeed, the FWC appears to have become so wedded to this target, that is has adopted an even less flexible approach than the RBA itself, where in each of its last four decisions it explicitly mentioned that the decision will not lead to inflationary pressures:

"The level of increase we have decided upon will not lead to inflationary pressure" (2016-17 Decision)[40]

"The level of increase we have decided upon will not lead to inflationary pressure" (2015-16 Decision)[41]

"The increase in minimum wages we have determined will not bring inflationary consequences" (2014-15 Decision)[42]

"The continuing moderate inflation and historically low aggregate wages growth provide scope for increasing minimum wages without inflationary consequences" (2013-14 Decision)[43]

This begs the question as to why the FWC believes that the increases it awards, should not have any inflationary pressure, particularly in the context of subdued inflation and historically low wage growth that is concerning most policymakers. Moreover, the RBA has the predominant role in addressing inflation and employs much more suitable measures through monetary policy tools to manage healthy inflation levels and no Australian parliament or government has ever provided the FWC with a target for inflation. This report recommends that the FWC places less weight on inflation risk when awarding increases to the NMW, and instead considers broader factors that affect consumers, such as the cost of living pressures on individuals.

If the FWC cannot find the flexibility to adjust it on its own accord, then legislative change will inevitably be required if we are to have wage-policy settings that are suited to tackling the economic challenges we face today.

CONCLUSION

There can be no question to the benefits of sustained and healthy levels of wage growth– not just for employees, but for employers, industry, government and the wider economy. When nominal wages are growing, so is business and consumer confidence. Consumption and demand is boosted and it can help balance the budget. In doing this, inequality is reduced, a move that is beneficial to the economy.

The IMF found that inequality is responsible for lowering medium-term economic growth, reducing the likelihood of economic growth being sustained. However, they discovered that if inequality was managed well, it led to "faster and more durable growth".[44]

The way out of non-compliance isn't to claim that awards, penalty rates and entitlements are too difficult to enforce and therefore should be removed altogether. This is just rewarding the shameful behaviour — let alone actually aiding the nefarious firms who have created this culture of non-compliance and exploitation.

A two-pronged approach that combines increasing wages with a crackdown on underpayment and non-compliance is necessary. Compliance must be supported and enforced by clear and unambiguous measures — tangible measures that are adequately resourced. If compliance is to be adhered to, and wages increase where they are needed most — where it will impact income inequality — it makes sense that the increases are heavily targeted towards those workers on low and middle incomes.

Australia has an opportunity to break free from this stagnant economy riddled with non-compliance, underpayment and overall low wage growth.

It will require commitment from all sectors of the economy and a choice by employers and the government, to establish sustainable and successful economic policy that benefits all Australians equally and paves the successful way forward for future generations.

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CONTACT THE MCKELL INSTITUTE

T. (02) 9113 0944 **F.** (02) 9113 0949 **E.** mckell@mckellinstitute.org.au
PO Box 21552, World Square NSW 2002
@McKellInstitute www.facebook.com/mckellinstitute
www.mckellinstitute.org.au