

## Senate Standing Committee on Economics

### ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

31 May – 2 June 2011

Question No:           BET 284

Topic:                    Wages growth

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Senator Cormann asked:

**Senator ABETZ:** It has been put to me that in the past four decades or so, 80 per cent of wages growth is in fact related to increased productivity. Is that in general terms a view that the Productivity Commission would share?

**Mr Banks:** It sounds plausible to me. I do not know if my colleagues would comment.

**Senator ABETZ:** Take it on notice. I do not want to make you commit to anything.

**Senator Wong:** Senator, I did not intervene. If you are going to put it on notice, we can take it on notice, but you are asking Mr Banks to give an opinion in that question.

**Senator ABETZ:** No. A professional assessment as to whether or not in the past four decades 80 per cent of wages growth has related to increased productivity. If we are able to measure these things, hopefully an answer can be forthcoming. It has been put to me that in this century or millennium—whatever we want to call it—over the last 11 years, this has not continued. In case the minister or anybody else thinks I am making a political point, the simple fact is that in the last 10 years or so both the coalition and Labor have been in government. The chances are that my side of politics has been in a little longer. So it is not a political comment that I am seeking to make. I am seeking to obtain data as to whether our productivity in the wages area has in fact slipped over the past decade or so.

**Senator CAMERON:** I have made a number of speeches on this, drawing attention to Peter Costello's failure in productivity.

**Senator ABETZ:** And if I had wanted to ask you, Senator Cameron, I would have. But I am actually asking the experts.

**Senator CAMERON:** Just making the point.

**Mr Banks:** The commission has looked fairly closely, as you would expect us to, at the productivity history. We made a submission to the House of Representatives committee at the time it was looking at the question of productivity. In that, we had an analysis of what happened to us both on the way up and on the way down. When you look at it in multifactor productivity terms and in terms of the productivity cycles that the Australian Bureau of Statistics uses to define and allow us to make proper comparisons over time, we found that a large proportion of the productivity decline that has occurred this millennium so far could be attributed to particular developments in a few sectors. One of them was mining, another one was agriculture and a third one, broadly, was public utilities. We have done work since then to try to burrow down and find out what was going on in those sectors.

To some extent, the productivity decline is, I guess, the other side of the coin from our economic success over that period in terms of our quite strong income growth. For example, in the mining sector case, we have seen very strong terms of trade, very strong export demand and we have seen the mining sector engaged in very substantial investment and use of additional inputs. There is a lag before that comes on stream. In the meantime, productivity is seen to have fallen. In the case of mining, there is also a secular decline, I think, in terms of the quality of deposits but probably compounded by the fact that even a lower quality deposit that costs more to get out of the ground, if the price has gone up three times, is still a very profitable thing to do. So part of what we did in that work was to show that we have had historically very high rates of sustained per capita income growth coinciding with, as you say, quite a drop-off in

productivity growth. There is some relationship between the two, but not entirely. So currently we are looking at the public utilities sector—

**Ms Gropp:** Electricity, gas and water.

**Mr Banks:** Electricity, gas and water, and trying to get an understanding of what has been happening there. Again, I think it is not unrelated to the drought and some of the short-term circumstances there and some of the heavy capital investments that have occurred, again, and then the way that output is measured in that sector. So I would be happy to send you a copy of the analysis that we have conducted, Senator, in that area.

**Answer:**

Economic theory suggests that in general, growth in labour productivity should be matched by growth in what is referred to as the *real (hourly) product wage*. This can be measured by deflating the nominal wage by the GDP deflator. Sustained periods of higher growth in the real product wage than in labour productivity can lead to impediments to jobs growth (as was the case with the wages overhang of the 1970s).

An alternative but related measure of the real wage is *the real consumption wage*. This is measured by deflating the nominal wage by the CPI deflator (rather than the GDP deflator as is the case for the real product wage). The real consumption wage reflects the real consumer-value of the nominal wage.

During times of significant change in the terms of trade (as has been the case over the past 7 years or so) these two measures of real wages growth will differ.

The rates of growth in each (average) real wage series and in labour productivity are compared for different periods in table 1. The recent higher growth in the real consumption wage than in labour productivity reflects the real income gains from the rapid rise in our terms of trade. However, the table shows that growth in the real product wage has been and continues to be somewhat less than 80% of labour productivity growth.

**Table 1 Wage growth, productivity growth and the ratio of the two**

Per cent per year

	<b><i>Growth in real product wage (deflated by GDP deflator)</i></b>	<b><i>Growth in Labour Productivity</i></b>	<b><i>Growth in wage measure as share of growth in labour productivity</i></b>
	%	%	%
1978-79 to 2009-10	1.2	1.6	75
1978-79 to 1999-00	1.3	1.7	78
1999-00 to 2009-10	0.9	1.4	68
	<b><i>Growth in real consumption wage (deflated by CPI deflator)</i></b>	<b><i>Growth in labour productivity</i></b>	<b><i>Growth in wage measure as share of growth in labour productivity</i></b>
	%	%	%
1978-79 to 2009-10	1.1	1.6	69
1978-79 to 1999-00	1.0	1.7	56
1999-00 to 2009-10	1.4	1.4	103

Source: Productivity Commission estimates based on ABS (Australian System of National Accounts, 2009-10, Cat. No. 5204.0; Labour Force, Australia, May 2011, Cat. No. 6202.0; Consumer Price Index, Australia, Mar 2011, Cat. No. 6401.0).