Downward pressure on Australian wages becoming the “new normal”

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The continued downward pressure on wages, which has led to the lowest growth rates in more than 50 years, is not a cyclical downturn but is rapidly becoming a permanent feature of the Australian economy.

While this outlook was not explicitly spelled out, it was the central conclusion to be drawn from a speech delivered by the governor of the Reserve Bank of Australia, Philip Lowe, to a group of business economists in Sydney on Tuesday evening.

Lowe began his remarks by expressing something of the bewilderment which characterises central bankers and economic authorities around the world in the post-global-financial crisis environment. They confront a situation in which all their models of how the capitalist economy is supposed to work—supplying rising wages and living standards—have broken down.

Lowe began by recalling that in an address to the Australian Business Economists annual dinner five years ago he had addressed the subject of “What is Normal?”

“Five years on, we are still searching to understand what is normal,” he said. Around the world, real income growth has been unusually slow in many countries and not surprisingly “these households, including many here in Australia, wonder whether this slow growth in incomes is now the new normal.”

Lowe left the question open but the content of his speech made clear that the decline in wages is going to continue.

He presented an upbeat assessment on investment in the non-mining economy, saying business was “feeling better than it has for some time and it is lifting capital spending and creating more jobs.”

But this is not translating into improved living standards with growth in consumer spending remaining “fairly soft,” Lowe said. “For some years, consumption growth has been weaker than forecast and it has not exceeded 3 percent for quite a few years.”

This was “most likely” the result of the combination of “weak growth in real household income and the high level of household debt.” The RBA’s own forecast is for consumption spending to pick up to around 3 percent, above the average growth for the last decade, “but below the average for the period prior to the financial crisis.”

Low growth in wages had been “distinguishing feature” of the Australian economy with the wage price index increasing by just 2 percent over the past year compared to increases of between 3.5 to 4 percent in earlier years.

“Growth in average hourly earnings has been weaker still: in trend terms it is running at the lowest rate as least since the 1960s. Not only are wage increases low, but some people have been moving out of high-paying jobs associated with the mining sector into lower-paying jobs.

“We have heard from our liaison program that there has been downward pressure on non-wage payments, including allowances, and an increase in the proportion of new employees on lower salaries than their predecessors.”

While he did not elaborate, Lowe pointed to the mechanism by which low wages growth leads to a redistribution of wealth up the income scale. “Low growth in wages means low inflation, which means low interest rates, which means high asset valuations.”

In other words, significant holders of property, land and financial assets benefit directly from the low-interest rate regime which is itself in part a product of low wage growth.

Lowe’s speech pointed to one of the central reasons

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for the ongoing downward pressure on wages—lower economic growth and the consequent increased competition leading to the outsourcing of jobs to cheaper labour areas and the introduction of new technology.

"In the past, the pressure of competition from globalisation and from technology was felt most acutely in the manufacturing industry. Now, these same forces of competition are being felt in an increasingly wide range of service industries," Lowe stated.

"One response to this competitive pressure is to have a laser-like focus on containing costs. Over recent times there has been a mindset in many businesses, including some here in Australia, that the key to higher profits is to reduce costs."

The same phenomenon was noted in a speech earlier this month by the deputy governor of the RBA, Guy Debelle, on the subject of business investment.

One of the key effects of the global financial crisis has been a long-running decline in business investment, despite the fall in interest rates to record lows. For some time, this did not show up in aggregate data for the Australian economy because of large investment in mining fueled by the stimulus measures introduced by the Chinese government. But with the end of the mining boom, the Australian economy is more closely reflecting global trends.

According to Debelle, investment spending in the non-mining sector has been weaker than predicted by the RBA's models and past relationships. Investment by small firms "has been unusually weak since the crisis."

Since the global financial crisis, larger companies have been more risk averse and have tightened their investment criteria, preferring to hold on to cash and pay down debt rather than undertake expansion, despite falls in borrowing costs because of low interest rates.

Debelle pointed to "indications that the stock market is rewarding cost reduction rather than investment spending where payoffs are multi-year rather than immediate."

This is an international phenomenon, most starkly reflected in the US where investment is at historic lows. The finance corporations, speculators and hedge fund that dominate shareholdings are demanding that profits be used to boost shareholder value rather than expand productive capacity.

While share buybacks in Australia are not nearly as prevalent as in the US, there is a rising trend of dividend payouts. "There appears to be a desire to have 'excess' capital returned to shareholders through buybacks and dividends, rather than utilising that capital with uncertain returns," Debelle said.

This means that workers' wages and the living standards of their families are hit in two ways. Pressure from financial investors brings relentless cost cutting through wage cuts in order to boost profits. At the same time, those profits are handed over to shareholders in the form of increased dividends rather than being used to expand productive capacity which would increase output, employment and wages.

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