Wage-Price Spirals: What is the Historical Evidence?

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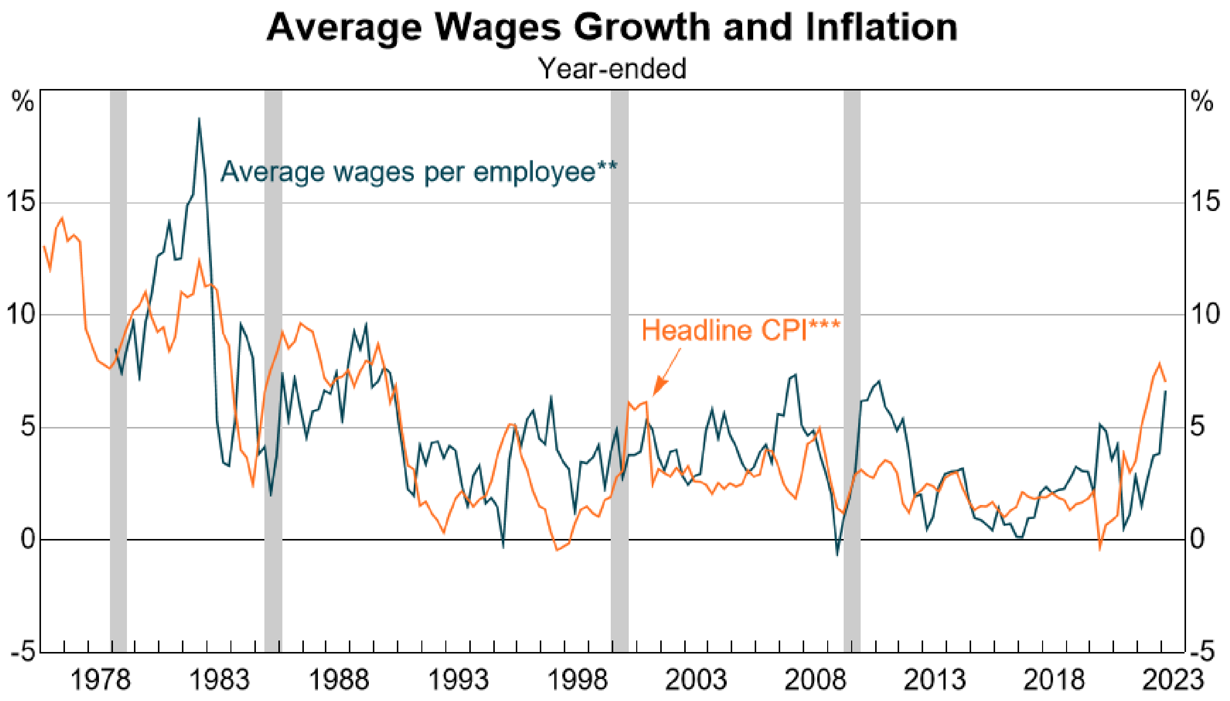
DISCUSSANT REMARKS

IAIN ROSS

The paper defines a wage-price spiral as an episode where both price inflation and nominal wages growth (year over year) increase successfully for at least 3 out of 4 consecutive quarters. For Australia, the paper identifies 4 different episodes as wage-price spirals: 1979, 1986, 2000 and 2010 (shaded in grey in Chart 1).

Chart 1



* Shaded ares are wage-price spirals classified by Alvarez et al (2022)

** Includes employers social contributions prior to 1983

*** Not adjusted for the tax changes of 1999–2000 or interest charges

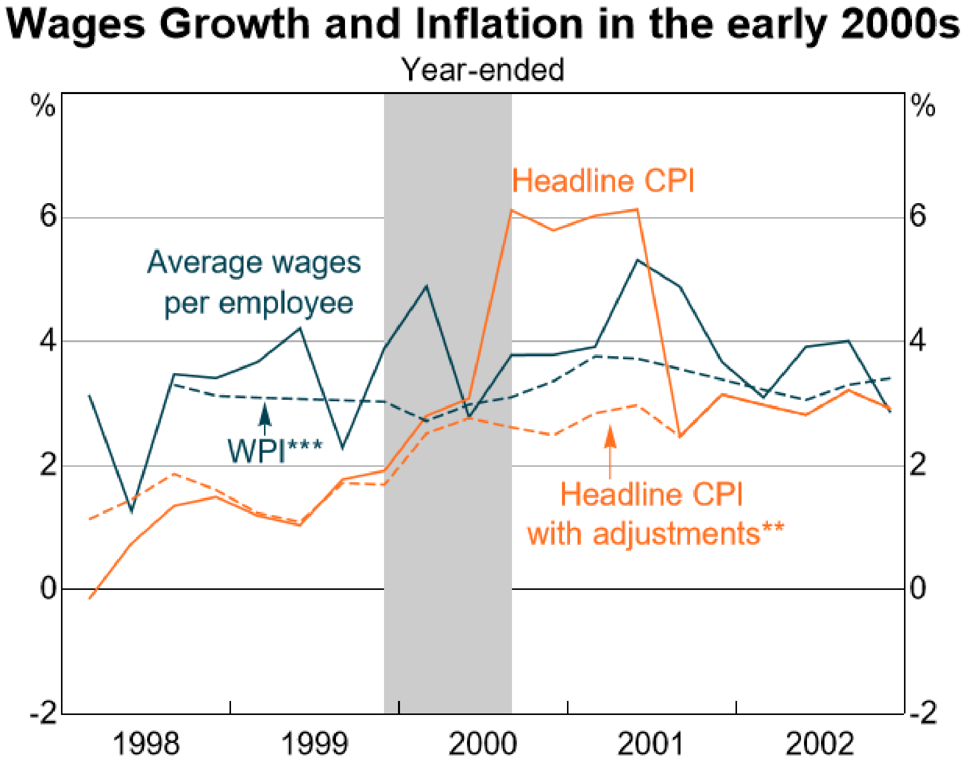
Sources: ABS; RBA.

Measurement Matters …

How the paper identifies inflation and wages growth is important. Inflation is headline inflation – with no adjustment for the effects of the introduction of the GST in the early 2000s. Wages growth is growth in wage income per employee, and thus affected by changes in average hours worked by each employee and other compositional changes.

Adjusting for the effects of the GST the paper's criteria for a wage-price spiral are no longer met. Also, the wages growth criteria adopted appears to be affected by volatility. Growth in the WPI during this period was broadly flat, at 3 per cent.

Chart 2



* Shaded area is wage-price spiral classified by Alvarez et al (2022)

** Excludes interest charges prior to September quarter 1998 and adjusted for the tax changes of 1999–2000.

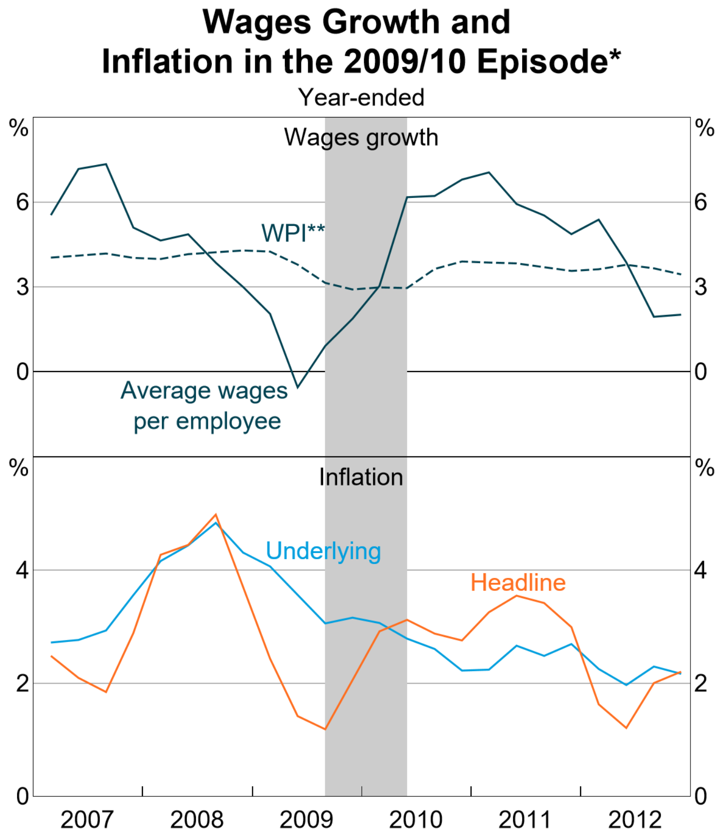
*** Total pay excluding bonuses; public and private

Sources: ABS; RBA.

Measurement Matters …

The increase in year ended inflation reflected the fact that earlier sharp declines in fuel and deposit/loan facilities started to drop out of year end calculations. Underlying inflation mostly abstracts this volatility growth in average wage per worker rebounded in 2009-10, after slowing during the GFC and there were changes in the composition of employment. This muddies the interpretation of the wage measure used in the paper. Compare the average wages per worker measure with the WPI in the top panel of Chart 3.

Chart 3



* Total pay excluding bonuses; public and private

** Shaded are is a wage-price spiral classified by Alvarez et al (2022)

Sources: ABS; RBA.

The 1970s and 1980s

There is a broad consensus in the research as to the potential causes of this episode of stagflation; with the debate focussed on the relative importance of those causes. There seems little doubt that the strong growth in nominal wages in the 1970s was an important contributing factor to inflation.

As Borland (2022) notes, the main explanations for what was known at the time as the ‘1974 wage explosion’ appear to have been:

- The strength of labour demand
- Increasing inflationary expectations
- Institutional features of wage setting. Large award wage increases granted to metal trade workers subsequently flowed to much of the rest of the workforce based on the application of the principles of ‘comparative wage justice’ (Plowman 1980).

The 1970s and 1980s

To these one could add the equal pay decisions of 1969 and 1972 which had the effect of raising the minimum wage for women from 75 percent of that of males to 100 percent. As Glenn Stevens (1992,p14) notes : ‘The moral and social aspects of this issue aside, it seems clear that moves to increase females’ wages to be commensurate with males’ resulted in a substantial rise in aggregate labour costs’.

The impact on real wages of the nominal wage increases up to the mid 1970s was ‘locked in’; to some extent by the introduction of quarterly wage indexation from early 1975 (shifting to partial indexation, then 6 monthly indexation before being abandoned completely in early 1980.

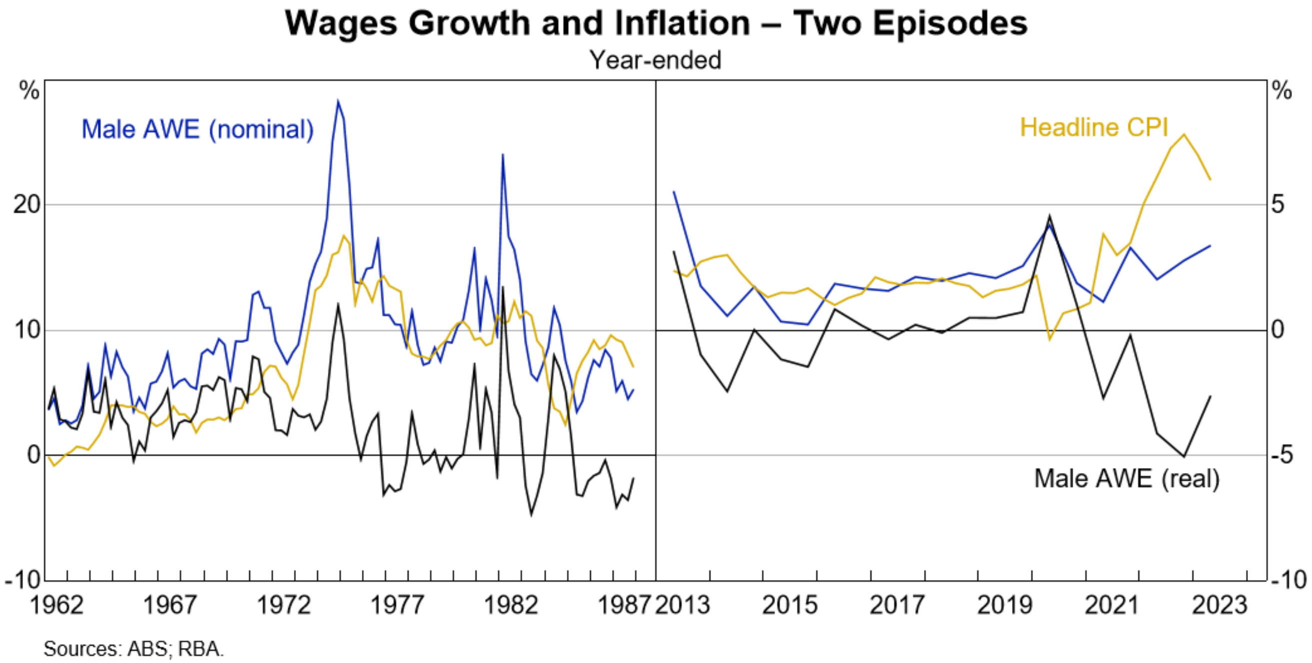
The 1970s and today

The risk of a similar wage price spiral in the present circumstances has been the subject to media speculation and commentary. For example, on 1 June 2022, shortly before the 2021-2022 AWR decision the AFR's John Kehoe wrote:

'Indexing wages to inflation would risk repeating the mistakes of the 1970s when an oil price shock - which we are again experiencing- collided with the Whitlam government approving large pay rises.

Stagflation arrived with inflation surging to 15 percent in 1974 from 3.5 percent in 1970, and the jobless rate jumping to 5 percent by 1975 from just 1.6 percent. Hence, the Fair Work Commission must be responsible in weighing up the real cost of living pressures facing employees and the broader macroeconomic consequences of its decision.'

Chart 4



The 1970s and today

In his June 2022 Labour Market Snapshot Jeff Borland addresses this debate, concluding that, ‘very different circumstances today mean that it should be possible to sustain steady wage growth without this happening as it did in the 1970s’. As to the ‘different circumstances’ Borland pointed to 3 broad considerations:

- labour market factors, namely, upward pressure on wages is being limited on the supply side by drawing extra hours of work from under-employed workers and increases in participation;
- changes in the institutional environment since the 1970s with a reduced emphasis on the principle of comparative wage justice and the scope for it to affect wage setting; and
- a decline in union density and a range of other factors have reduced worker bargaining power, limiting the size of wage increases likely to be obtained.

As Borland correctly observes the concept of ‘comparative wage justice’ was pervasive in the 1970s and 1980s.

The 1970s and today

The changes in the institutional environment since the 1970s have been profound and substantially reduce the likelihood of a wage-price spiral. In the 1970s the institutional settings had the effect of facilitating the transmission of wage increases bargained at the enterprise level across the relevant sector and ultimately to the economy more generally.

Metal unions – enterprise campaign – deal with MTIA – Metal Trades Award varied, by consent – comparative wage justice – increases spread through the award system.

Similar pattern in other sectors, Meat Industry Employees Union, FSPU and the TWU.

The 1970s and today

The present institutional arrangements are very different:

- Modern awards operate as a minimum safety net and the circumstances in which modern award minimum wages may be adjusted are limited. There is effectively no scope to adjust minimum award rates to reflect the outcome of collective bargaining at the enterprise level.

- The Fair Work Act limits the general adjustment of all modern award minimum wage rates to one annual wage review.

- Enterprise agreements acquire legal force upon approval by the Commission. The average nominal term of agreements lodged from 1 January to 11 August 2023 was 3 years (weighted based on the number of employees covered by each agreement) during that term the employees covered by the agreement cannot lawfully engage in industrial action in pursuit of further claims.

- The sanctions for engaging in such industrial action are readily accessible and effective.

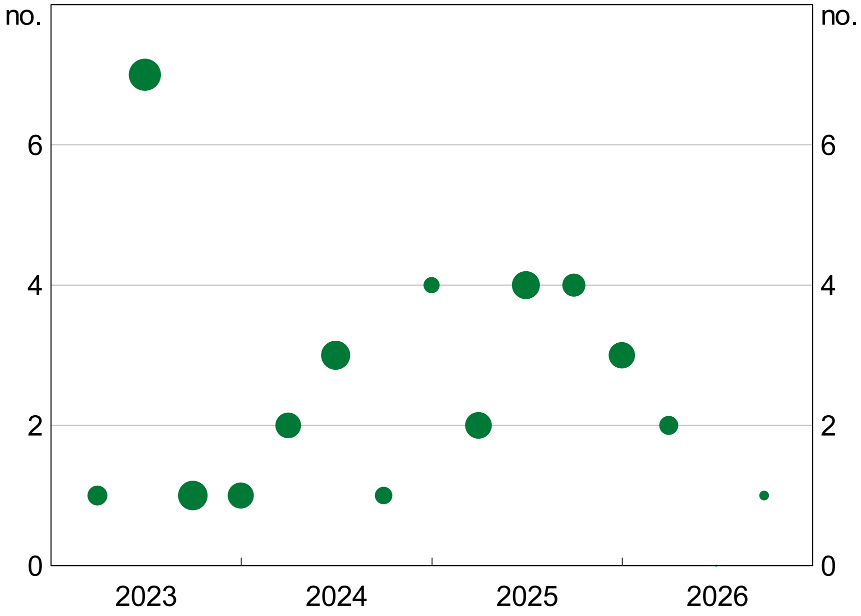
The 1970s and today

The current enterprise bargaining arrangements effectively operate as a shock absorber by constraining bargaining capacity. Employees subject to enterprise agreements are effectively unable to pursue claims for ↑ wages until the agreement has passed its nominal expiry date. Chart 5 illustrates this point. It shows the number of employees covered by major state public sector agreements, by quarter of expiry.

Chart 5

Number of Major Public Sector EBAs Expiring*

Dot size indicates average number of employees covered



* Where available, EBAs covering the public service, teachers, nurses and other health professionals, police officers and transport workers. Excluding federal government EBAs.Over the 5-year horizon some types of agreements would be expected to expire more than once, and the graph does not capture the second and subsequent expiry dates.

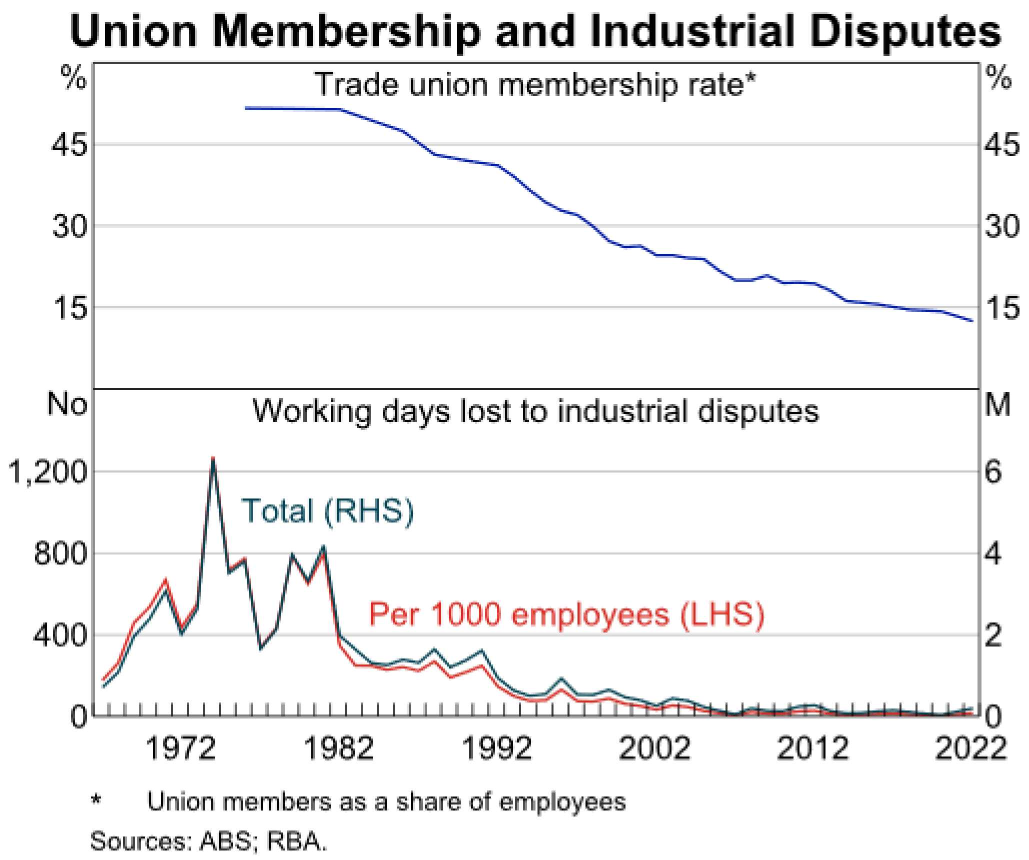
Sources: Department of Employment and Workplace Relations; FWC; RBA; various state and territory governments and Industrial Relations Commisssions.

The 1970s and today

Union density, the share of all employees who are members of a union, has fallen dramatically since the 1970s. It was slightly above 50 per cent in the late 1970s, has trended down since and is now 12½ per cent (Chart 6). Only 8.2 per cent of private sector employees were members of a union members in 2022, while union density in the public sector was higher, at 33.6 per cent.

The number of working days lost due to industrial disputes has also fallen sharply over time, essentially flatlining since 2012 (Chart 6).

Chart 6



The risk of a wage-price spiral in Australia

There is, as yet, no evidence of the emergence of a wage price spiral in the present circumstances and recent data suggests that such an outcome is unlikely. Four points may be made in this regard:

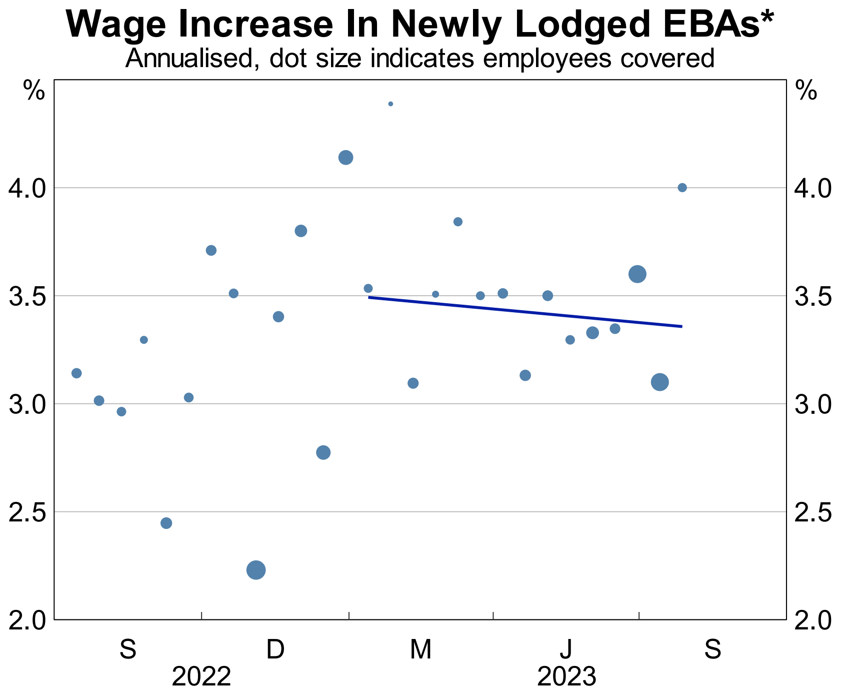
1. Wage increases in newly lodged EBAs are flat or trending down.
2. The data on wage increases in EBAs lodged with the FWC in the first six months of this year shows that 24% of those agreements provide a higher wage increase on commencement than in subsequent years. [1.]
3. The data on EBAs lodged with the FWC in the first six months of this year shows that 4.4 per cent of those agreements stipulated wage increases linked to rises in the CPI. [2.]
4. Most medium- and long-term inflation expectations measures remain consistent with the Bank's inflation target.

1. Weighted by the number of employees covered by each agreement.
2. Weighted by the number of employees covered by each agreement.

1. Wage increases in newly lodged EBAs are flat or trending down

Chart 7 shows the average annualised wage increase in lodged agreements over time. The size of the bubble is proportionate to the number of employees covered by agreements lodged in the fortnight.

Chart 7



* The line of best fit is weighted by the number of employees covered per fortnight.
Source: FWC, RBA

2. EBAs with lower wage increases

A quarter of all agreements lodged with the FWC in the first half of 2023 had lower wage increases in the years after commencement (or 22.2 per cent of employees covered by lodged agreements).

For enterprise agreements with a higher wage increase on commencement, the average wage increase was 3.6 per cent, with an average wage increase on commencement of 4.5 per cent and an average wage increase of 3.1 per cent for all subsequent increases.

3. Agreement wage increases linked to the CPI

EBA's lodged in the first six months of this year wage increases linked to the CPI:

- 5.1% of agreements
- 4.4% of employees covered

Table 4: Enterprise Agreements with Wage Increases Linked to the CPI[(a)]
1 January 2023 to 30 June 2023

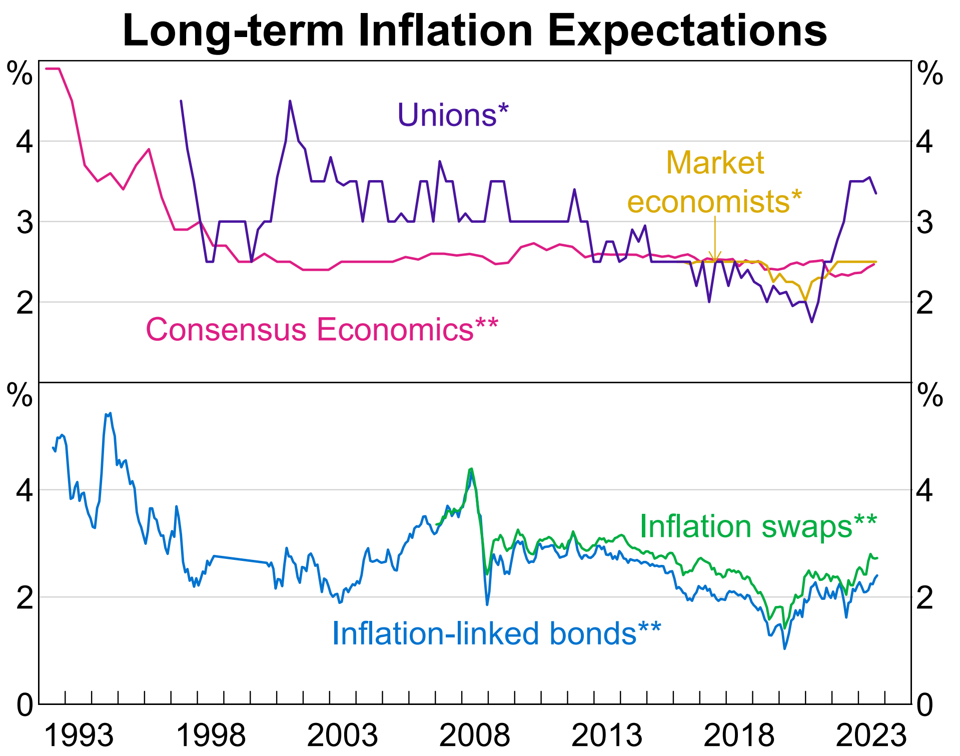
	Total No.	With wage increases linked to the CPI No.	Proportion %
Agreements	1 744	89	5.1
Employees covered	294 772	12 958	4.4

Notes (a) Agreements lodged with the FWC. Total includes 143 greenfields agreements lodged for which there were no employees at the time the agreements were made, including 2 with wage increases linked to the CPI.
Sources: Fair Work Commission (unpublished analysis provided by FWC staff)

4. Inflation Expectations

Most medium and LT inflation expectation measures remain consistent with the RBA's inflation target.

Chart 8



* Average over the next 5 to 10 years.

** Average over the 5 years starting from 5 years ahead.

Sources: Australian Council of Trade Unions; Bloomberg; Consensus Economics; RBA; Workplace Research Centre; Yieldbroker.

Concluding remarks

The circumstances of the 1970s and early 1980s which contributed to the stagflation of that period are very different to our present circumstances. The institutional arrangements are very different and the current enterprise bargaining arrangements effectively operate as a shock absorber by constraining the bargaining capacity of employees while subject to an enterprise agreement (within the nominal term of that agreement). Union density has fallen sharply, from just over 50 percent to 12½ percent and decreasing competition and increased labour market concentration among employers is likely to have exerted downward pressure on wages.

To date there is no evidence of the emergence of a wage-price spiral in the present circumstances and recent data suggests such an outcome is unlikely.