Wrap-up Panel Discussion

The conference was concluded by a panel discussion focused on identifying the underlying cause(s) of low wages growth and *how to address it*. The discussion was moderated by Ian Harper, Dean of Melbourne Business School and Member of the RBA Board, and included the following panellists:

- Jeff Borland, Truby Williams Professor of Economics at the University of Melbourne
- Andrew Charlton, Director at AlphaBeta
- Sue Richardson, Emerita Professor of Economics at Flinders University

Panellists were asked by the moderator to draw from the 'evidence' presented at the conference to solve the 'murder mystery' of low wages growth: Who did they think were the most likely suspects, do they have alibis, and was there enough evidence to convict them?

Panellists and other conference participants examined the characteristics of the recent episode of low wages growth, surveyed the wide range of possible explanations, and also raised broader questions about what aspect of wages growth economists should be focusing on.

As the conference and panel were conducted under the Chatham House rule, no individual's comments are attributed.

1. The 'crime scene'

There was broad agreement on some of the characteristics of the current episode of low wages growth as outlined by one of the panellists: that nominal wage growth *had slowed*, that the slowdown *had happened suddenly*; that it had been *broad-based across industries*; that *other countries had experienced similar episodes* of low wages growth, and finally, that it had been *persistent*.

However, views differed on the significance and implications of these characteristics. One panellist discussed whether the focus should be on real or nominal wages. While nominal wages growth is relevant for central banks' inflation targets and government revenue, too little attention had been paid to real wages growth as a measure of households' purchasing power and firms' labour costs. However, it was noted that focusing on real wages growth raises the problem of how to deflate nominal wages.

Panellists and other conference participants highlighted the challenges with viewing the problem through the simple lens of the above characteristics. The case was made that the 'sudden' slowing in wages growth in 2012 may not mean that there was a structural change that occurred precisely at that time; wage inflation due to the mining investment boom may have masked an earlier structural change that is now driving low wages growth.

Similarly, a panellist suggested that despite the similarities between Australia's episode of low wage growth and those in other countries, Australia-specific factors should not be discounted. Australia is unique in that it had a mining investment boom, a relatively smooth passage through the global financial crisis (GFC), and has a highly regulated labour market. It would be reasonable to expect that these factors would be having an effect on wages growth in Australia.

One panellist highlighted that the 'crime' may not be as mysterious as suspected. Back-of-envelope calculations and statistical models have found a 'crime' of low wages growth. But it was questioned whether the size of this 'crime' could justify the amount of resources being spent on investigating it. The panellist cautioned against exaggerating the unexplained components of low wages growth, especially when we can already explain a lot of low wages growth.

2. The suspects

Panellists and participants generally agreed that the potential 'suspects' that could be behind low wages growth are numerous. One panellist speculated that, given the 'evidence' available based on the characteristics of the period of low wages growth, it is unlikely that a single suspect is at fault.

Economic cycles

One panellist noted that the timing of the low wages growth episode is a key piece of evidence, and that the significance of recent economic cycles – the GFC from a global perspective and the mining investment boom from an Australian perspective – suggests that cyclical factors must play an important part in the explanation of recent labour market developments. This thinking was echoed throughout the session by panellists and conference participants alike.

All panellists agreed that something had happened around the time of the peak in mining investment in Australia. One panellist highlighted that in 2011 a key concern was whether employees would be able to adjust to lower wages growth post-mining-boom. Up until that point real compensation was growing faster than labour productivity, implying an increase in the labour share of income. However, since 2011 this relationship reversed. Another panellist drew attention to the decoupling between real net disposable income per capita growth and gross domestic product growth, noting that the former has not grown since 2011.

A number of participants noted the danger in only looking at the mining boom. The mining boom may have masked the effects of the GFC, such as increased risk aversion or changes in the financial system. Alternatively, the apparent cyclical effects of the mining boom or the GFC might have been masking deeper structural changes.

Other observations on the nature of the problem were made by participants. It was highlighted that since the GFC, internationally there has been a larger level of risk aversion, estimates of the NAIRU (non-accelerating inflation rate of unemployment) have come down and it appears that traditional expansionary macroeconomic policy has less efficacy, suggesting that something has impaired the financial sector from stimulating the economy. It would appear that these factors may point to the relevant driver of lower wages growth.

The changing industrial landscape

The theme of technological change in the workplace arose several times, eliciting spirited discussion between panellists and other conference participants. One panellist emphasised the pervasiveness of this topic in businesses – 'artificial intelligence', 'robots', and 'automation' have entered the 'zeitgeist'. One participant also suggested that the combination of technology and globalisation is facilitating the outsourcing of an increasing range of roles to countries with lower wages. There was a general scepticism about the 'hype' of technology, however, with little evidence of a productivity effect of these new technologies to date. Relatedly, one panellist highlighted the importance of pursuing research on the cost of worker displacement in Australia, as in other countries it has been found that displaced workers tend to be retrained and re-enter the workforce.

The role of 'wage norms' was also cited as a key suspect in solving the wage slowdown mystery. One participant highlighted that businesses appear to give conflicting messages. On the one hand they have trouble attracting workers in a tight labour market, yet on the other hand they refuse to pay more to attract workers. This demonstrated businesses' reluctance to embed higher cost structures due to uncertainty and a need to compete with overseas firms. This dynamic has driven down wage norms. It was also noted that foreign competition and uncertainty surrounding technology are often cited by businesses as barriers to raising wages.

The role of the public sector in setting wage norms was raised by a panellist. The freezes to public sector wages was hypothesised as powerful influence in driving down wage norms. It was also asked if these changes can be placed into empirical models.

The question of whose expectations matter was also raised. A panellist observed that changes in real wages depends on the perspective you take. For consumers, their real wages have been falling when measured against CPI (the consumer price index). For producers, labour costs have actually increased when you deflate wages by the PPI (the producer price index).

The changing competitive balance between firms within industries was also discussed as a suspect for low wages growth. The view that frontier firms were adopting technology and increasing productivity while most were left behind was seen by some as less relevant for Australia. One panellist highlighted that mining firms are the main Australian firms at the global frontier but that the mining industry doesn't have the same 'sub-population' of inefficient firms.

A panellist suggested that the changing nature of work could be driving down wages. Micro data shows that the number of people in highly flexible 'gig' work were larger than some might think. It was noted that there was a qualitative difference between this type of work and more traditional jobs, namely the low barriers to entry and extreme flexibility. Surveys of these workers reveal that they place a high value on the additional flexibility, suggesting they are willing to trade off higher pay for flexibility. There was some debate around how material the increase in non-standard and flexible work was, especially in the context of Australia's existing casual workforce of 2.5 million people.

A power shift?

While there was some scepticism about the direct wages implications of these aspects of the changing industrial landscape, there appeared to be more sympathy for the view that employees' bargaining behaviour might have changed. Workers' fears about being replaced by robots, or the sense that there is increasingly someone who can do their job at a lower rate of pay overseas may make them more hesitant to seek wage increases. Further, a couple of participants thought that the fear of 'robots' could reflect an environment of elevated risk aversion and fear about structural change in the economy. As more evidence that there had been a behavioural shift, one participant pointed to the fact that job mobility was uncharacteristically low for a relatively tight labour market.

There was also some acceptance among a number of participants that changes in the way wages are set could be part of the answer to low wage growth. While research presented at conference cast doubt on the thesis that declining union membership was the cause, a couple of panellists highlighted that labour bargaining power may have declined in other ways, referencing the example of the public sector wage freeze instigated by the federal government. One panellist also suggested that the cross-country differences between the institutions that mediate shocks in labour demand and supply (e.g. wage setting bodies and unions) present an interesting opportunity to investigate their effect on wages.

The discussion of suspects also included the possibility that employees are less confident about wage bargaining because there is still spare capacity in the labour market. One panellist admitted surprise that labour underutilisation adds little value in wages growth models, especially given the significant increase in part-time work over recent decades, and questioned whether there is a problem with our measurement of underutilisation, for example due to practical difficulties surveying particular cohorts.

The decline in the rate of job mobility was also identified as a key piece of evidence in explaining low wages growth. This decline has been observed in both New Zealand and Australia. One participant suggested that the decline in job mobility coupled with a tight labour market indicates that there is structural force driving the low wages growth. Another participant suggested that job mobility may be lower as employers have simply become better at managing employees. A lot of job movement is about people wanting to leave their current role. If employers have improved their management of employees then maybe this has driven a downward shift in the desire to move jobs. However, it was questioned how the timing of this trend lines up with the slowdown in wages growth.

Others suggested that the nature of Australia's migration could be contributing to lower wages growth by affecting labour supply at the margins. A panellist noted that Australia now has inflows of skilled young individuals looking for lower paying jobs. This type of migration has been especially strong during the period of low wages growth. It was hypothesised that these young migrants have crowded out local workers in low paying areas, by potentially offering to work below minimum wage. One participant tempered this argument, adding that while these trends in migration are unlikely to have caused low wages growth in the aggregate, they possibly contribute to lower wages growth to the younger demographic.

3. A challenge for economists

In this session, panellists and participants surveyed the 'crime scene', created a 'line-up' of suspects, and expressed their views on which ones were likely to have caused the current episode of low wage growth. As noted by John Simon, Head of Economic Research at the RBA, in his concluding statements, there is clearly not enough evidence to single out one cause 'beyond reasonable doubt'; even on a 'balance of probabilities' standard of proof it would be challenging.

However, as highlighted by a participant, the conference has presented evidence to acquit a range of suspects: changing industry shares, less secure employment arrangements, decline of trade union membership, and heterogeneity of technological adoption in Australia.

Discussions in this final session also highlighted the conflict between discussions at a conference for economic research and discussions in corporate board rooms, on the street, and on the election campaign trail. Throughout the session, participants questioned why households had relatively dismal views of their own wages growth and the future of work. Is this a case of 'fake news', in which case there is a communication challenge, or is there something that we are missing?

Dr Simon wrapped up the conference noting that the murder mystery of low wage growth was being prosecuted in the media, as well as in economic research, and that economists' responsibility is to 'bring facts to the table'. In closing, he challenged all participants to contribute more to the public debate.