Briefing Paper:

The Same Mistake Twice:
The Self-Defeating Consequences of Public Sector Pay Freezes

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Summary

In recent days, governments at all levels have announced or proposed unilateral measures to freeze pay for public servants.[1] Given the vital role that public sector workers are playing in all aspects of Australia's response to the COVID-29 pandemic, and the personal risks that many of those workers are facing as a result of their dedicated service, this is a morally questionable moment to launch another attack on public sector pay. But further suppressing incomes for public servants would also be economically destructive, not just ethically misguided, at this dangerous moment in Australia's economic history.

This paper reviews the consequences of pay freezes for both the workers affected by them, and the broader economy. Its main findings include:

- Freezing pay for even short periods of time reduces the lifetime income and superannuation savings of public sector workers by tens of thousands of dollars, because it permanently reduces their lifetime wage trajectory.
- A 6-month pay freeze for a typical federal APS worker will reduce career earnings by an estimated $23,500, and superannuation accumulations by another $4000 or more. The longer 2-year freeze contemplated for Brisbane municipal workers would reduce career earnings by over $100,000, and superannuation accumulations by $17,500.

[1] For examples, see: *Workplace Express*, "Public service pay rises put on hold," April 9, 2020; Lachlan Moffet Gray, "Coronavirus: Annastacia Palaszczuk puts 2.5 per cent pay rise for state public servants 'on hold'," *The Australian*, April 2, 2020; Alexandra Smith, "Plans to stop pay rise for NSW public servants but not health workers," *Brisbane Times*, April 10, 2020; and Lucy Stone, "Two-year pay freeze for Brisbane councillors and council staff," *Brisbane Times*, April 1 2020.

- Pay freezes in the public sector are known to spill over into weaker economy-wide wage growth through three key channels: a composition effect, a demonstration effect, and a macroeconomic effect.[2]
- At least 35% of the purported 'savings' from freezing pay is offset by the loss of direct tax revenues that would have been collected as a result of higher income and spending by public servants. And considering other tax revenue losses from the resulting slowdown in broader wage growth, even more of those 'savings' are never realised.
- Misguided public sector wage restraint in the aftermath of the GFC short-circuited an initial recovery in private-sector wage trends in 2010-11, and helped lock in a lasting deceleration of national wages after 2013. Since then Australia has experienced the slowest sustained wage growth in the entire postwar era.
- Australia's macroeconomy now faces a serious risk of deflation as the COVID-19 recession takes hold. Nominal wage and price trends were already dangerously close to zero when the pandemic hit. There is far less of an inflationary cushion now than when the GFC hit in 2008-09, yet this downturn will be far deeper. In this context, it is vital that governments move forcefully to anchor nominal price levels and prevent deflation. Preserving normal wage determination patterns, and ensuring that nominal wages keep growing at a healthy pace, will be crucial to economic stabilisation and recovery.
- The motivation for public sector wage austerity seems more ideological than fiscal or economic: pay freezes are justified with appeals to 'shared sacrifice,' and a symbolic desire to look 'tough' on finances at a moment when governments, of all political stripes, are about to incur their largest deficits in history. But government policy should be driven by economic reality, not political optics. These arbitrary pay freezes are both unfair and economically counterproductive.

Introduction

Australia has already an unprecedented economic contraction due to the COVID-19 pandemic. Entire sectors of the economy have been deliberately shut down. The resulting recession will wreak financial havoc for all parts of the economy: workers, families, small and large businesses... and governments.

There's no doubt that government deficits at all levels will swell dramatically. This is inevitable, given the size and speed of the shutdown. In fact, government deficits play a positive role during recession, by sustaining incomes and spending power even as other sectors cut back. If governments try to cut spending in a downturn in order to offset those automatic negative fiscal outcomes, then the downward momentum of the broader economy is only amplified.

[2] This analysis was originally developed by Troy Henderson, "Public Sector Austerity and its Spill-Over Effects," in Andrew Stewart, Jim Stanford, and Tess Hardy, eds., *The Wages Crisis in Australia: What It Is and What To Do About It* (Adelaide: University of Adelaide Press, 2018).

Yes, all that red ink will require extraordinary budget measures. Strategies like the Reserve Bank's new 'quantitative easing' program (buying government bonds to keep interest rates low), and special fiscal transfers from the Commonwealth to the states, will be crucial. But at the end of the day, there is no doubt that our governments have the capacity to pay for whatever is needed to help us through this emergency. The deficits that result from the COVID-19 shutdown will be managed with the help of proven financial and monetary policy levers. Trying to incrementally reduce those deficits by cutting government spending will have a perverse impact: deepening what is already proving to be the fastest, sharpest downturn in Australia's history.

Unfortunately, a knee-jerk temptation to respond to any economic challenge with fiscal austerity still lurks in the thinking of many commentators and policy-makers. Right now our lives literally depend on the skill and courage of public servants: health care workers, first responders, social service providers, and others. Yet some still view public sector employees as wasteful, coddled, and superfluous. They've never encountered a problem that couldn't be solved by downsizing the public sector.

So it was predictable that the crisis would spark new demands for punitive wage restraint in the public sector. Conservative commentators and business lobbyists want to impose pay cuts on private sector workers – and they cheer on similar medicine for the public sector. Decisions to unilaterally freeze pay for public servants have already been announced by governments at all levels. In some cases it is not even clear that the politicians making those announcements have the authority to unilaterally rewrite contracts and cancel planned wage increases; but why should that interfere with a good opportunity to look fiscally 'prudent' before the cameras.

Once it might have been politically popular to single out 'fat cat' public sector workers for tough medicine. That conventional wisdom does not seem valid today (if it ever was). Australians are very grateful to public servants for their extraordinary efforts and sacrifices during the pandemic. These attacks on public sector pay may have little political resonance.

But scapegoating public sector wages would be a mistake economically, not just politically. For individual employers, it is always attractive to pay less for their labour, rather than more. For the economy as a whole, however, the combined effect of widespread wage-cutting is disastrous: after all, the consumer market for all businesses depends on the collective flow of wages. Therefore, sales and profits for virtually all businesses shrink when wages are broadly reduced. Governments also suffer, as stagnating incomes and weak consumer spending undercut their own tax revenues.

Australia has seen this self-defeating logic play out in the past, with terrible consequences. During the Great Depression of the 1930s, with unemployment above 30%, employers (and misguided economists) claimed unemployment would disappear if only workers would work for less. Wages did fall, inflation turned into deflation – and the economy languished in depression for a decade.

Even more recently, after the Global Financial Crisis of 2008-09, wage austerity had similar unintended consequences. Austerity-minded governments, invoking fear of deficits, imposed wage caps on their own employees (just as the macroeconomy was rebounding from the initial financial shock), and public sector wage growth faltered. But this cast a cold chill on private sector wage determination – which had been bouncing back strongly after 2010. In subsequent years Australian wages have grown at the slowest sustained rate in the entire postwar era. As shown in detail below, the needless decision by governments to single out public sector workers for unique wage restraint after 2010 was a key factor in the subsequent deceleration of *all* wages.

The starting assumption that jobs can be saved or expanded by cutting wages has been disproven in other settings, too. For example, promises that cutting weekend and holiday penalty rates for hospitality and retail workers would spark strong job-creation in those sectors proved illusory.[3]

This is an especially dangerous moment for Australia's macroeconomy. The country was already teetering on the brink of deflation even before being slammed by the double shock of bushfires and coronavirus. Wage growth, long in the doldrums, weakened further throughout 2019. Falling general prices can quickly turn a recession into a depression: consumers put off purchases (anticipating lower prices in the future), real debt burdens explode, and confidence collapses. The price of labour is the most important price in the economy; and governments are by far the biggest employers in the land. Freezing or cutting public sector wages would thus substantially exacerbate the dangerous deflationary risk we already face.

Governments have a responsibility to look at the big picture in their economic decision-making. Deficits at all levels of government will be large in coming years; that is an expected and healthy outcome, given the dramatic recession we are already in. A short-sighted infatuation with trying to shave small margins from those deficits with extraordinary interference with normal wage determination sends a terrible signal to other employers: namely, that they, too, should cut their wages, thus sparking a downward spiral of austerity and deflation.

Federal, state and municipal governments should all proceed with the normal, negotiated pay increases that were in course before this crisis hit. And they should encourage other employers to do the same – instead of ratifying and reinforcing the natural urge of employers to shift the burden of the downturn onto their employees.

[3] See Jim Stanford, "April Holiday Cluster Highlights Income Losses From Reduced Penalty Rates," Centre for Future Work, Sydney, April 2019, for a review of job-creation trends after the penalty rate cuts.

Deficits will be solved not by austerity, but by putting the economy back to work (as soon as it's safe to do so). Scapegoating the public servants who are doing do much to help us through this crisis, and suppressing their incomes, will make things worse, not better.

This briefing paper reviews the dangers of public sector pay freezes: to both public sector workers themselves, and to the broader economy. First, the paper explains why even temporary pay freezes have a long-lasting effect on lifetime incomes for affected workers. Then it models the ultimate costs to public sector workers under four illustrative examples of pay freezes (that have been actually proposed or announced in recent days). Then we explain how arbitrary wage restraint in the public sector quickly spills over into overall wage trends in the labour market – reviewing in detail the negative broader impacts of wage austerity after the GFC of 2008-09. Finally, the paper considers evidence that Australia's economy already faces a significant risk of deflation, which would greatly amplify the damage of the current recession. Given that heightened risk, it is all the more important that governments act to support nominal price anchors and prevent a downward spiral of wages and prices. Preserving normal wage practices in the public sector would thus be an important contribution to averting depression.

Permanent Income Losses from Temporary Wage Freezes

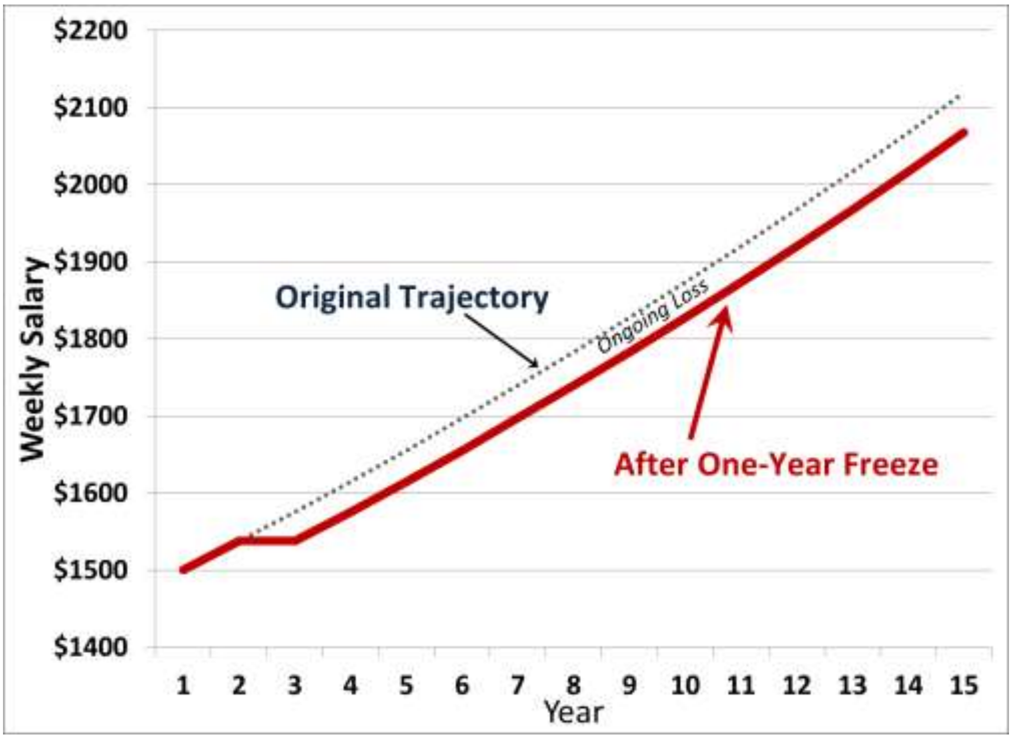
Employers typically describe a pay freeze as a temporary sacrifice: short-term restraint, supposedly justified by difficult financial conditions, to be followed by a return to 'normal' compensation patterns. But this claim that pay freezes cause only temporary financial losses for workers is false. Even if nominal wages do begin to grow again at the end of the freeze period,[4] in reality workers continue to experience cumulating annual losses. This is because the reduction in wage levels due to the wage freeze is reflected in a permanent reduction in the nominal wage base. Hence workers continue to incur income losses long after the wage freeze has been lifted. The only way to prevent these continuing, compounding losses, and ensure that income losses are truly temporary, is if the employer offers extra 'catch-up' wage increases to lift the base wage fully back to the same level it would have reached under a 'normal' wage trajectory (without the wage freeze). However, those catch-up increases are rare. Instead, what usually occurs is that nominal wage growth is restored once the wage freeze is lifted, with no catch-up.

The scale of long-term income losses resulting from even a temporary wage freeze is illustrated in Figure 1, which demonstrates a hypothetical one-year freeze in nominal wages. The simulation assumes a 'normal' rate of wage increase of 2.5%, applied to an

[4] Promises of a return to 'normality' in wage patterns cannot be accepted at face value, given the proclivity of employers (including governments) to ratchet down wage expectations for many years. Consider, for example, the NSW state government's imposition of a supposedly temporary 2.5% wage cap for public servants beginning in 2011, justified by a large deficit in the state budget. Nine years later, with the state generating consecutive multi-billion-dollar surpluses, the cap was still in place – and in fact the state government began to speculate about tightening the wage cap further, to just 2%.

assumed weekly salary of $1500. But in the third year of the simulation, nominal wages are frozen for one year. Then, when the freeze is lifted, wages recommence growing at the 2.5% rate. No catch-up wage increase is implemented when the freeze is lifted.[5] Wages begin to grow again, but remain *permanently* at a level 2.5% lower than what would have prevailed without the wage freeze (indicated by the dotted line in Figure 1). The cumulative loss of income resulting from the wage freeze thus grows each passing year, despite the restoration of normal increases.[6] In the illustrated example, the worker's cumulative losses during just the first 10 years after the freeze total almost $23,000, and that loss continues to accumulate through the rest of the worker's career.

Figure 1
Cumulative Losses from a One-Year Wage Freeze



Source: Author's calculations as explained in text.

Even a temporary wage freeze, therefore, imposes a growing lifetime economic burden on affected workers. Indeed, even when those workers retire, they experience an additional loss of income that extends into retirement. Because Australia's superannuation system is financed through contributions paid on workers' nominal incomes as they progress through their work lives, the permanent reduction in annual

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5 To return to the previous wage trajectory (and thus cap the cumulative amount of lost income), workers would need a one-time 5.1% wage increase when the freeze was lifted, followed by normal 2.5% annual increases in subsequent years. That would cap the total income losses experienced by the workers at $2000 (the amount lost in the year the wage freeze was in effect).

6 In fact, the vertical distance between actual wages and the "no freeze" path (equivalent to the loss of weekly income) actually expands gradually over time: from $38 per week in the first year of the wage freeze, to $52 per week after 15 years. This widening gap reflects the compounding effect of future annual wage gains being applied to a lower starting point.

wages resulting from even a temporary wage freeze causes an accumulating loss of superannuation contributions.[7] The impact of lower contributions is then amplified by the loss of investment income on those foregone contributions. And in turn, lower superannuation balances upon retirement result in a permanent reduction in the pension incomes which can be financed from those superannuation savings.

Modeling Current Public Sector Pay Freezes

With this understanding of the lasting and substantial effects of even temporary pay freezes on the lifetime income of workers, we now consider the impact of some of the pay freezes that have been proposed in recent days by various governments in Australia. A non-exhaustive list of these proposals includes:[8]

1. Imposition by the Commonwealth government of a 6-month pay freeze on members of the Australian Public Service, deferring wage increases of 2% (which had already been constrained under the federal government's Workplace Bargaining Policy).[9]
2. The NSW state government's stated intention to freeze pay for state public sector workers (possibly excluding health workers) for one year, cancelling wage increases of around 2.5% (which were already curtailed by that state's 9-year-long wage cap).
3. A suggestion by the Queensland Premier to freeze pay for state public sector workers, for an unspecified period of time,[10] cancelling wage increases of around 2.5%.
4. A unilateral announcement by the Lord Mayor of Brisbane that wages for municipal employees will be frozen for two years, cancelling negotiated annual wage increases of 2.5%.

How these proposed pay freezes will be implemented is not clear; in some cases it is not at all apparent that the government or politician in question even has the legal authority to unilaterally override negotiated enterprise agreements in this fashion. The general goal of these measures is to enforce wage restraint on public sector workers, justified by rhetoric about the need for 'shared sacrifice.' The impact of freezing pay for public sector workers on fiscal balances seems secondary to the political optics of governments which want to look 'fiscally prudent' at a time of unprecedented (and inevitable) deficits.

We simulate the long-term losses for affected workers from these proposed pay freezes utilising the following methodology:

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[7] The impact of wage suppression on long-run superannuation accumulations is considered in more detail in Jim Stanford, "The Consequences of Wage Suppression for Australia's Superannuation System," Centre for Future Work, Sydney, 2017.
[8] See fn 1 above for references to media reports of these various announcements.
[9] See Australian Public Service Commission, "Workplace Bargaining Policy," for more details on the 2% wage cap: https://www.apsc.gov.au/workplace-bargaining-policy-2018.
[10] In the simulation of this case, reported below, we assume the freeze is imposed for one year.

- We identify the approximate current average level of wage and salary compensation per public sector employee at each level of government considered, on the basis of published ABS data (ABS Catalogue 6248.0.55.002, *Employment and Earnings, Public Sector*). Average compensation per employee is reported for the 2018-19 financial year; our simulations thus understate the true loss of income, since in most cases current compensation will be slightly higher than was reported for 2018-19. For the APS simulation, we use average compensation for federal public servants across the country. For the two state-level simulations, we utilise average compensation figures for state public sector workers in each state. For City of Brisbane workers, we use average compensation for municipal employees in Queensland.[11] Workers who earn more than the average salary reported for their category would experience even larger cumulative lifetime income losses from the pay freezes.
- We assume that in the absence of the pay freeze, wages would have continued to grow at the specified rate of increase otherwise prevailing (2% per year for APS workers, 2.5% for all other cases). We assume that rate of growth is maintained in years after the pay freeze is lifted.[12]
- We assume a mid-career worker, with 20 years of service remaining in their job before retirement. Younger workers, with more years of service ahead of them, would experience even larger cumulative income losses.
- We assume superannuation contributions are paid by each employer at the current minimum requirements of the Superannuation Guarantee (9.5% of wages).[13] That assumed rate is maintained in future years, as well.[14]
- We assume other parameters for superannuation performance and payouts that are conservative relative to realised performance of most industry super funds. We assume a net nominal rate of return (after management expenses) of 6% per year, less than long-run experience of industry superannuation funds.[15] We convert the worker's simulated superannuation balance on retirement into an annual flow of pension income assuming the same net nominal interest rate (6%) and a 25-year

[11] Since average compensation for municipal workers in Brisbane likely exceeds the state-wide average for all municipal workers, this simulation further understates the actual loss of income expected.
[12] This is also a conservative assumption: current wage growth in Australia is unusually low (in fact, average public sector wages in the December quarter of 2019 grew at their slowest average rate in recorded data; ABS Catalogue 6345.0). If wage growth recovers in future years, then the long-term income losses from a pay freeze this year would be even larger than reported here – since the initial loss of base income would be compounded in future years at a faster rate.
[13] Many public sector workers receive superannuation contributions above the 9.5% minimum SG rate. For example, many federal APS members receive super contributions equal to 15% of salaries. In that case, foregone superannuation accumulations would be half-again larger than indicated in Table 1.
[14] We do not consider the impacts of the legislated increases in the SG rate, from 9.5% to 12%, to take effect beginning next year. Considering the impact of those increases would produce even larger losses in superannuation accumulations than are reported in Table 1.
[15] According to APRA statistics, the 5-year average annualised investment return for all funds s over the 5 years to 31 December 2019 was7.1%; see *Quarterly Superannuation Performance Statistics Highlights*, p.4 (https://www.apra.gov.au/sites/default/files/2020-02/Quarterly%20superannuation%20performance%20statistics%20highlights%20December%202019.pdf). Higher investment returns would imply even larger losses from foregone superannuation than indicated in Table 1.

lifespan after retirement; the pension flow is calculated as a declining balance annual annuity that is exhausted after 25 years.

The results of the simulations of the four cases listed above are summarised in Table 1:

Table 1
Cumulative Income and Superannuation Losses from Illustrative Wage Freezes

	Commonwlth. APS	NSW State	Queensland State	Brisbane Municipal
Average Salary[1]	$91,500	$80,000	$83,600	$76,500[2]
Length of Freeze	6 months	1 year	1 year?[3]	2 years
Foregone Wage Increase(s)	2%	2.5%	2.5%	2.5%
Initial Annual Loss	$915	$2000	$2090	$3873[4]
Cumulative 20-Year Loss	$23,592	$54,367	$56,813	$100,842
Reduction in Super Balance[5]	$4217	$9617	$10,050	$17,583
Loss Annual Pension Income	$311	$710	$742	$1298

Source: Authors' calculations as described in text, from ABS Catalogue 6248.0.55.002.
1. 2018-19 financial year average.
2. Average for all Queensland municipal public servants.
3. Length of freeze was not specified in the Queensland announcement; we assume 1 year.
4. Annual loss after wage freeze fully implemented (in second year).
5. On retirement, assuming 20 years remaining service, 9.5% contribution rate and 6% net return.

In every case considered, the supposedly temporary pay freeze produces a permanent and growing reduction in annual incomes long after the pay freeze is lifted, and cumulating to tens of thousands of dollars in lost income for each worker. Those losses are larger the bigger is the foregone wage increase, the longer the pay freeze is imposed, the higher is the base salary, and the younger is the worker (hence the more years of subsequent service they will experience lower income). A 6-month pay freeze for an average federal APS member will reduce their cumulative 20-year remaining career income by $23,500. The 1-year pay freezes simulated for typical state public sector workers will reduce their career incomes by over $50,000. And the 2-year wage freeze imposed on municipal workers would have the biggest impact: reducing career incomes by over $100,000.

The impacts on superannuation balances and post-retirement incomes would also be severe. Due both to lower employer contributions and lower investment income, the typical worker affected by a pay freeze will experience a loss in accumulated balances on retirement worth several thousand dollars. Those losses, in turn, translate into permanent reductions in their retirement income (depending, of course, on how they choose to convert their superannuation accounts into pensions). Typical federal APS workers would lose over $300 per year in income throughout their entire retirement due to the 6-month pay freeze. Brisbane municipal workers would lose much more: about $1300 per year.

In short, the supposedly temporary pay freezes imposed on public sector workers, in a mostly symbolic and ideological effort to prove that government workers are "sharing the pain," will significantly reduce their lifetime incomes: right through the rest of their careers, and indeed until they die.

The Spillover Effects of Public Sector Pay Freezes[16]

The federal and state governments are the largest employers in the Australian economy. Together they employ over 2 million workers, constituting around 16% of national employment. When the public sector suppresses compensation, the impacts on overall wage growth in the economy as a whole are substantial – and not limited to the public sector. Rather, the negative 'example' set by governments in suppressing normal wage increases for their own employees has a contractionary influence on broader labour market functioning.

There are three major channels via which public sector austerity can spread into the rest of the economy: the 'composition effect', the 'demonstration effect' and the 'macroeconomic effect'.

The 'composition effect' is the direct impact of lower public sector wage growth on the overall weighted average wage growth of the total labour market. If lower wages are paid to the substantial share of the labour force employed in public sector occupations, then overall wage growth is reduced accordingly (by a fraction of the reduction imposed on public sector workers).

The 'demonstration effect' is experienced via the impact of suppressed public sector compensation on expectations and wage determination by private sector employers. Public sector wage policies function as a highly visible benchmark for wage patterns in private sector workplaces. Since they are implemented by the largest employers in the country, they have a natural 'trend-setting' effect. Private firms that supply government will be especially eager to invoke government wage targets as justification for their own

[16] This section draws on arguments first developed in Henderson, op cit.

wage restraint measures: employers will claim this is necessary to 'stay competitive' with a major customer. Even firms that have no direct business with public agencies will invoke the government's highly visible wage targets as a convenient guide for their own wage offers. The general sensibility that 'belts must be tightened' and 'sacrifices must be shared' that is reinforced by public sector wage austerity also provides convenient ideological and normative support for private sector wage restraint.

Finally, there is a negative 'macroeconomic effect' that arises from public sector wage suppression. By suppressing wage growth and hence undermining incomes and consumer spending (including through the demonstration effect on private sector wage settlements), public sector wage austerity undermines overall aggregate demand conditions. This in turn saps the vitality of private-sector activity – especially in retail trade and other consumer-sensitive industries. This negative impact on aggregate demand arises immediately from the significant section (around 16%) of the workforce employed in the public sector, and hence directly impacted by the pay freeze; but it is also experienced via private sector workers whose own employers mimic restrictive public sector benchmarks. With less spending power in the pockets of millions of Australian workers, market conditions for tens of thousands of Australian businesses are undermined – and this in turn undermines their own employment decisions and wage offers. Private sector wage growth is thus incrementally undermined even further by the contractionary macroeconomic effects of public sector pay freezes.

The macroeconomic spillover from public sector pay freezes in turn feeds back negatively on the budget positions of the governments which imposed those pay freezes in the first place. Less income for their own employees translates directly into reduced income tax and GST revenues. Indeed, that direct impact immediately offsets a substantial proportion of the supposed 'savings' that were supposed to result from the pay freeze.[17] Most public servants pay a marginal income tax rate of at least 32.5% on the incremental income from a wage increase (and many pay 37%). Assuming typical spending patterns, they also pay GST on half or more of their remaining disposable income (when they spend it on GST-taxable goods and services), implying that total taxes from public servants alone directly recover at least 35% of the 'cost' of wage increases. Lost tax revenues resulting from the multiplied negative impacts of pay freezes on wage growth in the rest of the labour market (via the demonstration and macroeconomic impacts described above) add to the revenue losses. In short, the fiscal savings from distorting normal wage determination and suppressing public sector pay are largely illusory. And by pursuing this short-sighted strategy, the government risks locking in a permanent downward shift in the trajectory of future wage growth.

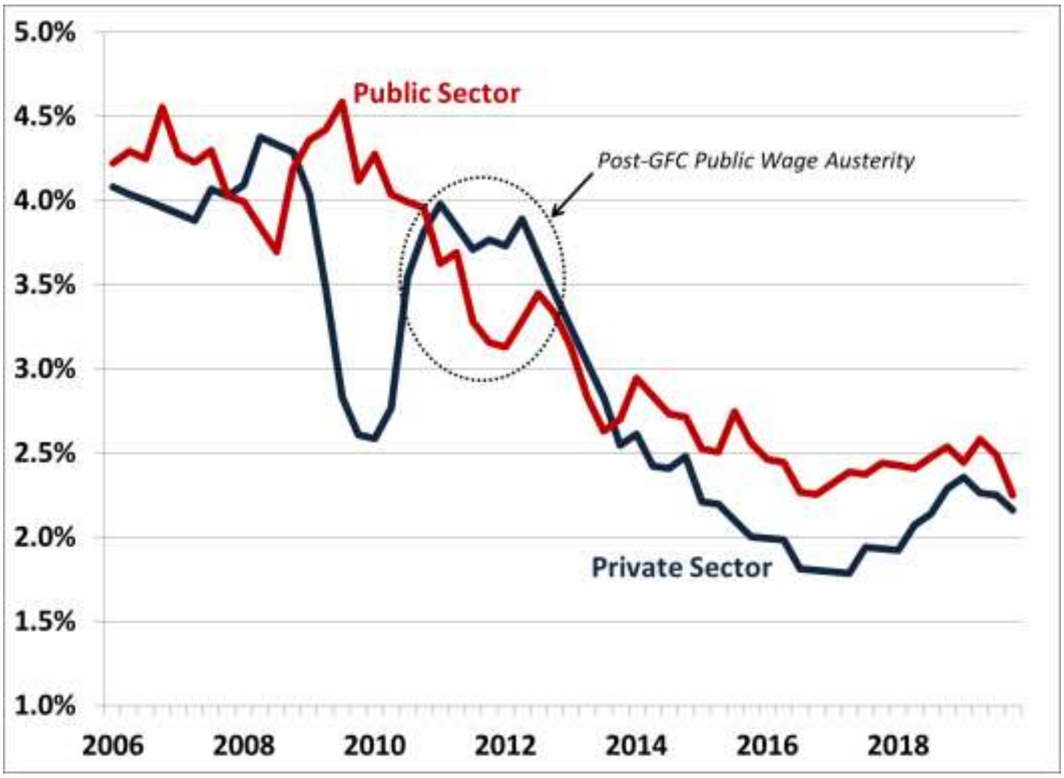
[17] Those savings would be insignificant in the context of broader budgetary aggregates in any event. Consider the proposed 6-month pay freeze for members of the APS. That would reduce total labour costs for the Commonwealth government this year by slightly over $200 million (1% of total wage and salary expenses that equaled $22.2 billion in 2018-19; ABS Catalogue 6248.0.55.002). That equals just 0.04% of the government's budgeted 2019-20 expenses, and just 0.07% of the $320 billion in emergency support it has announced to help fight the coronavirus pandemic.

Public Sector Wage Austerity and the Post-2013 Slowdown in National Wages

In fact, there is a powerful and recent historical precedent that confirms the negative impact of wage austerity in the public sector on broader wage trends across the labour market. The Global Financial Crisis (GFC) hit Australia's economy in 2008 and 2009. In the face of financial turbulence, falling exports, and shocked business and consumer confidence, economic growth slowed dramatically, and unemployment began to increase. It turns out, however, that Australia was the only OECD country to avoid experiencing a recession at that time, thanks to an aggressive and effective stimulus program enacted by the Commonwealth government.

Nevertheless, wage growth in the broader economy decelerated markedly in the initial months of the GFC. This wage slowdown was initially confined to the private sector. As indicated in Figure 2, from 2006 through 2008 public and private wages were both growing at 4-4.5% per year (as measured by the ABS's Wage Price Index, Catalogue 6345.0). With the advent of the GFC, private sector wage growth slowed dramatically, but temporarily. Private sector wage growth fell below 3% in late 2009 and early 2010. However, public sector wages continued to grow at the previous pace (over 4% per year), in part because of the inertial effect of enterprise agreements. And as the economy stabilised and growth recommenced, private sector wage growth also recovered quickly: bouncing right back to 4% per year by late 2010.

Figure 2. Year-over-Year Growth, Wage Price Index, Australia, 2006-2019



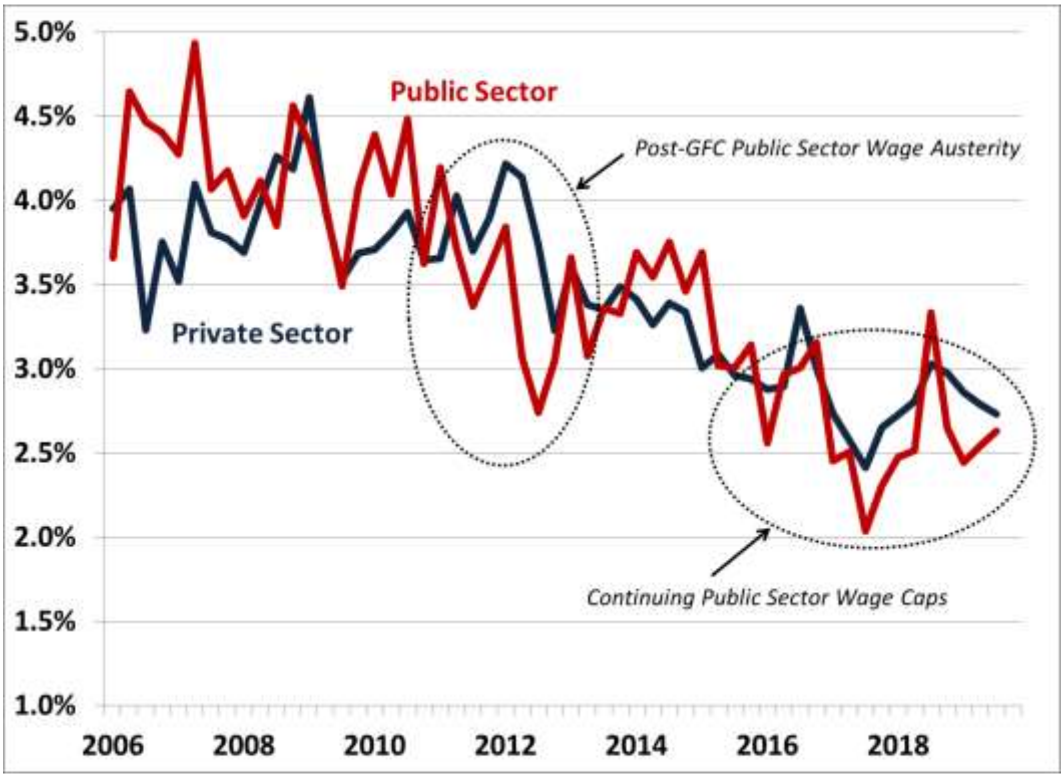
Source: Authors' calculations from ABS Catalogue 6345.0.

On its own, that experience would have constituted a remarkable success of counter-cyclical economic policy. However, in the years following the GFC, Australian political discourse then came to be dominated by a misplaced focus on deficit reduction. Naturally, the federal and state levels of government experienced deficits as an automatic result of the GFC slowdown. Those deficits were predictable, manageable, and in fact healthy: public sector deficits during economic downturns play a critical role in supporting aggregate demand and moderating the depth of the downturn. However, some policy-makers seized on those deficits to fan fears of large debts, pledge a fast return to balanced budgets, and justify contractionary policies. And the first target of fiscal austerity is usually the public sector workforce – for political more than economic reasons. So governments began to target public sector wages for aggressive and unilateral restrictions.

The result was a sharp deceleration in wage growth in the *public* sector (falling from above 4% to barely 3% by end-2011), even though *private* sector wage growth had already recovered to pre-GFC rates (running at nearly 4% in 2011 and 2012). It is clear that public sector wage restraint 'led the way' in a more serious and lasting deceleration of wage growth that started 3 years *after* the GFC first hit. For almost 3 straight years beginning in early 2011, wage growth in the public sector was suppressed well below the private sector. The negative example set in the public sector, founded on the assumption that reducing wage growth somehow helps the economy, then became entrenched in the private sector, too. By end-2012, the initial post-GFC recovery in private sector wage growth was cut short: wage trends in the private sector then began to follow public sector trends down. Through 2012 and 2013 wages decelerated sharply in both the public and private sectors. And after 2014, private sector wage growth fell even lower than in the public sector. But due to the continuing application of unilateral wage caps and other forms of wage austerity by many governments, public sector trends consistently reinforced and 'locked in' wage weakness. Indeed, even after private sector wage increases bounced back slightly from their record 2016 lows (under 2%), public sector pay hikes remained in the doldrums – with governments still refusing to relax strict pay caps. More recently, in 2019, wage growth in both sectors began to slide again. In the December quarter of 2019, public sector pay increases fell to the lowest pace in the history of the ABS WPI series: just 2.25% year over year. This only reinforced the stagnation of private sector wages, which also began to decelerate again.

It is clear from the timing of post-GFC wage trends that public sector wage restraint in the aftermath of the GFC played a crucial and leading role in establishing new, austere expectations for wage growth that became concretised across the whole labour market. This conclusion is reinforced by an analysis of a second source of data on wage trends: the average annualized wage increases (AAWI) specified in newly-negotiated enterprise agreements. The pattern of those wage agreements is pictured in Figure 3.

Figure 3. Year-over-Year Growth, Newly-Lodged Enterprise Agreements, Australia, 2006-2019



Source: Authors' calculations from Attorney-General's Department, Trends in Federal Enterprise Bargaining*. Includes federally registered agreements only.*

Prior to the GFC, and even through the initial slowdown, wage growth in both public and private sector agreements fluctuated between 3.5 and 4.5%. Pro-active restraint in new public sector enterprise agreements beginning in 2011 – with politicians warning darkly about deficits and targeting public sector workers for belt-tightening – then led a broader deceleration in wages. That was eventually reflected in a parallel downturn in private sector wage settlements – even though the immediate effects of the GFC were long past. Public sector AAWIs fell from over 4% at end-2010 to just 2.7% in the September quarter of 2012. Private sector wage deals, in the meantime, had initially strengthened from 2009 through 2012, reaching over 4%. But then private sector wage deals also slowed, and wage negotiations in both parts of the economy entered a long downturn – reaching record lows in 2017. The negative influence of continuing wage austerity in the public sector is visible in Figure 3: even over the last 3 years, public sector wage deals have consistently undercut private sector trends.[18]

There is a consensus among analysts from many different perspectives that Australia's economic performance in recent years has been held back by unprecedented weakness

[18] The only exception was September 2018 when the public sector average was pulled up by two large pay deals reached with Victoria health workers, featuring 4.5% wage increases.

in wage growth.[19] Since 2013, wages have grown at the slowest sustained pace of any period since the end of the Second World War: an average rate of barely 2%. The many consequences of that wages slowdown include stressed household finances, weak consumer spending (with negative implications for GDP growth and job-creation), wider inequality, and a chronic failure of monetary policy to hit inflation targets.[20] Public sector wage austerity has not been the only cause of that sustained weakness: other factors include a slowdown in business investment spending after 2013, and continued erosion of traditional wage-supporting institutions (such as rapidly declining enterprise bargaining coverage). But it is clear in retrospect that misplaced determination by governments after the GFC to reduce spending, with a focus on restraining compensation for their own employees, played a major and leading role in cementing a very austere wage trajectory across the broader labour market – one that has been very difficult to escape.

Pay Freezes and the Risk of Deflation

Australia is now entering a moment of immense macroeconomic instability, with an unprecedented shutdown of several sectors, a dramatic rise in unemployment, and a collapse in incomes and aggregate demand. One of the greatest risks during a severe economic downturn is deflation: that is, a generalised fall in price levels. Deflation causes consumers to further defer purchases (as they await even lower prices in the future); it causes the real burden of debts to explode; and it wreaks havoc with investment expectations and intentions. Deflation is typically associated with depression – and Australia already enters this downturn perilously close to it. Indeed, measured by the average price of GDP output, Australia was already experiencing economy-wide deflation in the December quarter of 2019, when output-weighted prices fell at an annualised rate of 3.0% (ABS Catalogue 5206.0).

The nominal wage is the most important price in the economy. It serves as an effective anchor for nominal price levels. If wages are growing slowly, then prices will grow slowly, as well. In fact, if wages are not growing at all, then prices will start falling: flat wages combined with productivity growth produce falling nominal unit labour costs, which in turn translate into falling prices. For this reason, it is essential, despite the worrying macroeconomic and fiscal climate, that normal increases in wages proceed wherever that is possible. The heightened danger of deflation in the present moment is confirmed by a comparison of current nominal price trends, to the trends that prevailed at the time of the GFC in 2008-09. Our analysis above showed that post-GFC wage austerity in the public sector played a key leading role in ushering in several years of

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[19] For more details on the extent, causes and consequences of weak wage growth, see Andrew Stewart, Jim Stanford, and Tess Hardy, eds., *The Wages Crisis in Australia: What It Is and What To Do About It* (Adelaide: University of Adelaide Press, 2018).
[20] As of end-2019, inflation had remained below the Reserve Bank's 2.5% target for 22 consecutive quarters, undershooting desired inflation by an average of three-quarters of a percentage point. This is by far the longest-lasting one-sided error in the history of Australia's inflation-targeting regime.

economy-wide wage stagnation. Pay freezes in the public sector would have a similarly counter-productive role in the present moment – except that the risk of tipping into outright deflation is much greater than after the GFC. As summarised in Table 2, all major measures of inflation have decelerated markedly since December 2008.

Table 2 Measures of Inflation, 2008 v. 2019		
Measure	**Year-over-year Growth (%)**	
	Dec. 2008	**Dec. 2019**
Consumer Price Index	3.70%	1.84%
GDP Implicit Deflator	7.26%	1.85%
Wage Price Index	4.29%	2.22%
Source: Author's calculations from ABS Catalogues 5206.0, 6401.0 and 6345.0.		

This suggests there is almost no inflationary cushion in the economy today, in contrast to when the GFC was having its impact. Moreover, it is already apparent that the impact of the coronavirus pandemic on domestic employment and output is going to be far worse than the downturn that followed the GFC. All this enhances the risk of tipping wages, and the overall economy, into outright deflation. Pressure for pay freezes is growing in other parts of the economy: including from employers demanding freezes or rollbacks in wages (even those already specified in enterprise agreements), and calls from business groups to freeze the national minimum wage and wage rates in Modern Awards.[21] The unilateral imposition of pay freezes by the largest employers in the country will serve to ratify and encourage those dangerous pressures.

Knee-jerk arguments that freezing or reducing labour costs can somehow restore economic confidence and preserve employment (even as entire sections of the economy effectively shut down) are not credible. It is more important, at this dangerous moment, to anchor nominal price levels in the economy, and then provide needed support to employment (and employers) through alternative means (such as the unprecedented $130 billion JobKeeper wage subsidy program). The public sector has a special responsibility in this regard, given the greater capacity of the state to sustain normal employment practices (including regular annual wage increases), and its importance in setting visible benchmarks that naturally influence private sector practices.

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[21] See, for example, Ewin Hannan, "Coronavirus: Business calls to delay minimum wage rise," *The Australian*, March 16, 2020; John Gray, "Why we need to freeze the minimal wage," *The Spectator*, March 24, 2020; and David Marin-Guzman, "Fair Work agrees to axing pay rises despite JobKeeper," *Australian Financial Review*, April 3, 2020.

Conclusion: An Ideological Distraction

Austerity-minded governments might attempt to portray the implications of a pay freeze as both modest and temporary. They are wrong on both counts. Because it locks in a permanent reduction in the future wage trajectory, with knock-on effects on the value of future wage increases, superannuation accumulations, and retirement pensions, even a temporary wage freeze imposes lasting costs on affected workers worth many tens of thousands of dollars. The spill-over damage to broader wage trends, potentially sparking a slide into devastating deflation, would be even more costly.

The motivation for the governments' infatuation with wage austerity for their own employees seems to be more political, than fiscal. Political leaders surely understand that the purported 'savings' from pay freezes will have a tiny impact on the scale of the deficits which they will inevitably confront in coming years – never mind that most of those 'savings' disappear as a result of the negative feedback impacts of wage austerity on future tax revenues. But they still believe that singling out their own employees for pay freezes may provide political advantages for them with certain constituencies: proving somehow they are 'tough fiscal managers' despite the coming deficits that are an inevitable (and essential) response to the pandemic. This commitment to political symbolism is exemplified in comments by Ben Morton, Assistant Minister to the Prime Minister and Cabinet in the Commonwealth government, who invoked a spirit of 'shared sacrifice' to justify his government's attack on the wages of the public servants – who he himself acknowledged are playing a vital role in responding to the pandemic:

> "Every APS employee will have someone in their families, or know someone, affected by the current economic circumstances. While communities are doing it tough, it's important the APS helps share the economic burden."[22]

Whether it's somehow 'fair' to make public servants suffer financially, just because others in the economy are also suffering, is economically irrelevant. Mr. Morton does not explain how a pay freeze is either fiscally necessary or economically helpful. He seems motivated, instead, by ideological optics. The fact that many of those public servants are literally risking their lives to provide essential services to Australians during this crisis is ignored. So, too, are the dangerous economic consequences of this arbitrary, knee-jerk intervention to prohibit normal wage gains for people whose jobs and sacrifices are being proven vital to our collective well-being.

There is no economic or fiscal case for freezing public sector pay at this moment when Australia faces unprecedented health and economic dangers.

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[22] Rosie Lewis, "Public servants to have pay frozen under coronavirus conditions," *The Australian*, April 9 2020.