



Wage Norms and the Link to Public Sector Salary Caps



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Executive Summary

1. This report addresses the nature and effects of wage norms and their links to public sector salary caps. Questions addressed include: what are the recent patterns of nominal and real wages growth? What is the role of wage norms in explaining these patterns? What influences does public policy have on those norms, particularly through public sector pay. What would be the result of changing those policy settings? It pays particular attention to the role of public sector 'salary caps', and makes special reference to the situation in the New South Wales (NSW) public sector. (page 6)
2. The most useful indicator of wages growth is the wage price index (WPI). Change in the purchasing power of employees is best measured by the *real WPI*, that is the WPI discounted by growth in the consumer price index (CPI). The original WPI (not discounted by the CPI) is referred to as *nominal WPI*. As inflation is at 5.1% and the nominal WPI grew by 2.4%, *real wages* (measured by the real WPI) fell by 2.6% in the year to March quarter. (page 7)
3. Growth in the purchasing power of wages appears to have been declining even before the most recent, large rise in inflation and substantial fall in real wages. Nationally, real wages are lower than they were at the end of 2014. Real WPI have declined for six of the past seven quarters (that is, for most of the past 21 months). (pages 7-8)
4. The general pattern in New South Wales is broadly similar to that nationally. (pages 7-8)
5. Overall, there is no evidence of any clear relationship between hourly wage growth patterns in the OECD and in Australia. Hourly wage growth in the OECD was lower than in Australia in the first half of the last decade but higher than Australia in the second half. While there is a lot of variation between individual OECD countries, it cannot be persuasively claimed that the decline in Australian wages growth simply reflects international forces. (pages 8-9)
6. Real wages have grown more slowly on average than productivity. (pages 9-10)
7. The prospects for the near future do not suggest an improvement in real terms. Most of the federal Budgets since 2014-15 overestimated nominal wages growth and the most recent federal budget underestimated real wage declines. State budgets have tended to rely on, but not replicate, federal forecasts, and so have also consistently overestimated wage growth, though not by as much. The most recent forecasts by the Reserve Bank of Australia imply a real wage decline of 2.7% in the year to December 2022. A real wage fall of 1.0% between June 2022 and June 2023 is forecast. (pages 10-13)
8. In the NSW public sector, the median public sector employee subject to the public sector pay cap would experience a real shortfall in pay (the difference between projected inflation and projected pay rises) of over \$30 per week and over \$1600 annualised by June quarter 2022. The shortfalls increase in later years, such that by the end of 2024-25, the median public sector employee will have lost almost \$48 per week, which has an annual

equivalent of nearly \$2500. The total amounts foregone by public sector employees add to over \$6000 for the median public sector employee (pages 13-18)

9. The most recent decline in real wages comes at a time when the economy is experiencing strong economic and employment growth. It is very unusual for these things to happen simultaneously. Job vacancies are at their highest on record and the ratio of unemployed people per vacancy at its lowest. In such circumstances, it would normally be expected that employers would be competing for workers, and this would push up wages. Yet the evidence that this is happening is very limited. (pages 18-20)

10. A key factor in this is the resetting of wage norms. Employers choose, within constraints, the wage they pay their workers. They tolerate a higher rate of unfilled job vacancies alongside low wages because of lower wage norms. (pages 20-21)

11. Wage norms are influenced by several factors. These include: collective organisation amongst employees and their ability to engage in collective bargaining and action; reference points set by institutions such as industrial tribunals' setting of awards; pressure from other institutions such as employer organisations or government agencies; the operation of product markets; employer actions within labour markets; wage stickiness; and macroeconomic circumstances. The most important factor shaping wage norms that state governments can influence is public sector pay policy. (pages 21-22)

12. Analysis of wage movements in the public and private sectors suggests that: public and private sector wages are closely related to each other, and likely ultimately influenced by similar forces; but also that private sector wages are likely influenced by developments in the public sector. It also seems likely that private sector wages growth influences what happens in the public sector, though the evidence in favour of this is not as consistent as that for the earlier observations and it is probably influenced by institutional developments. (pages 22-25)

13. The extent to which administratively-driven higher wages (e.g. higher minimum wages) lead to higher employment depends on the level of unfilled vacancies. In an economy with high unfilled vacancies, the gross rise in employment from an administratively-driven increase in wages will be relatively large and, as it increases, it comes to exceed the gross loss in employment from layoffs of unprofitable workers. (page 26)

14. Several factors are likely to have influenced the decline in wage norms. These include the decline in the power of organised labour, job insecurity, and increasing monopsony in labour markets. The most relevant at the state level is the imposition of low public sector salary caps. The Reserve Bank has also recognised the impact that these caps have had in slowing wages growth, in 'cementing low wage norms across the country'. (pages 26-28)

15. Policy makers have differing abilities to influence the forces that have lowered wage norms. While these include competition policy, labour supply policies and industrial legislation, it is public sector salary caps that are the major relevant factor that state governments have the power to influence. (page 28)

16. The first effect of removing the salary cap would be to reduce or offset (depending on the wage outcomes from public sector bargaining in the absence of the salary cap) the decline in real wages that would otherwise occur if the present salary cap is maintained for the workers concerned. A second effect would be a reduction in real wage declines in the private sector. (pages 28-29)

17. The third main effect would be the filling of a number of present and future unfilled vacancies in the public sector, as higher wages attract more workers into public sector employment and into training for the occupations concerned. A fourth effect, arising from the increase in wage norms in the private sector, would be an increase in the number of filled vacancies in the private sector. While some people would lose other jobs because they were now costing more to hire than they were worth to that employer, it is likely that many, perhaps most, would find new work anyway, as there are so many unfilled vacancies. (Pages 30-33)

18. A fifth effect of a removal of the salary cap would be an increase in state income, consumption and product. Finally, it could also be expected that there would be an improvement in the quality of services provided by the public sector. (pages 33-34)

WAGE NORMS AND THE LINK TO PUBLIC SECTOR SALARY CAPS

Introduction

This report addresses the nature and effects of wage norms and their links to public sector salary caps. Questions addressed include: what are the recent patterns of nominal and real wages growth, what is the role of wage norms in explaining these patterns, and what influences does public policy have on those norms, particularly through public sector pay. It also considers the possible effects of changing those policy settings. It addresses these issues by reference to data on developments in the labour market and in economic theory, as well as policy on public sector salary caps. It makes special reference to the situation in the New South Wales (NSW) public sector.

The report commences by discussing recent patterns in nominal and real incomes in historical, economic and international context, including the situation for NSW public sector occupations, then considers the nature of wage norms and their links to monopsony in labour markets, the influence of public sector pay upon wage norms, the effects of wage norms on policy, changes in wage norms, the role of public sector pay in raising wage norms and the effects of removing public sector salary caps. As public sector salary caps are the focus of this report, but just one element in shaping wage norms, discussion of the relationship of wage norms to several other important factors is concentrated in an Appendix.

Recent patterns in nominal and real incomes in historical context

The most useful indicator of wages growth is the wage price index (WPI). The ABS introduced this measure in 1997 to supplement and effectively replace the average weekly earnings (AWE) series, since the AWE was being distorted by compositional change in the labour force (eg as the number of jobs in higher-paid occupations increases).¹ The WPI is a fixed-composition index, meaning it directly compares over time hourly wages for workers in the same job at the same level.

Since 2011-12, growth in the nominal wage price index has averaged 2.2% per annum. The WPI grew by just 2.4% over the year to the March quarter 2022. This was up only slightly from the 2.3% in December quarter 2021. Yet over this time there had been a sharp acceleration of inflation.

Figure 1 shows growth rates in the WPI in the decade since 2011-12, alongside growth in the consumer price index (CPI). Estimates for 2021-22 have only been published to March 2022, so the estimate of WPI and CPI for that final financial year are based on projections by the Reserve Bank of Australia (RBA), discussed later, but these are almost identical to the numbers that would be used if the estimates for three quarters had simply been annualised.²

¹ The ABS releases the WPI each quarter, usually on the day before releasing AWE, so that attention focuses on WPI rather than AWE as the indicator of wages growth. However, it continues to collect and publish the AWE as it serves other purposes regarding the average *level* of wages.

² For example, the real wages growth to June quarter 2022 would be 2.8% if annualised from the 2.1% over the three quarters to March quarter, and is 2.7% if inferred from RBA projections, discussed below and shown in Table 1.

That is, the RBA projections for the fourth (June) quarter are more or less equivalent to the just a continuation of the experience over the past three quarters.

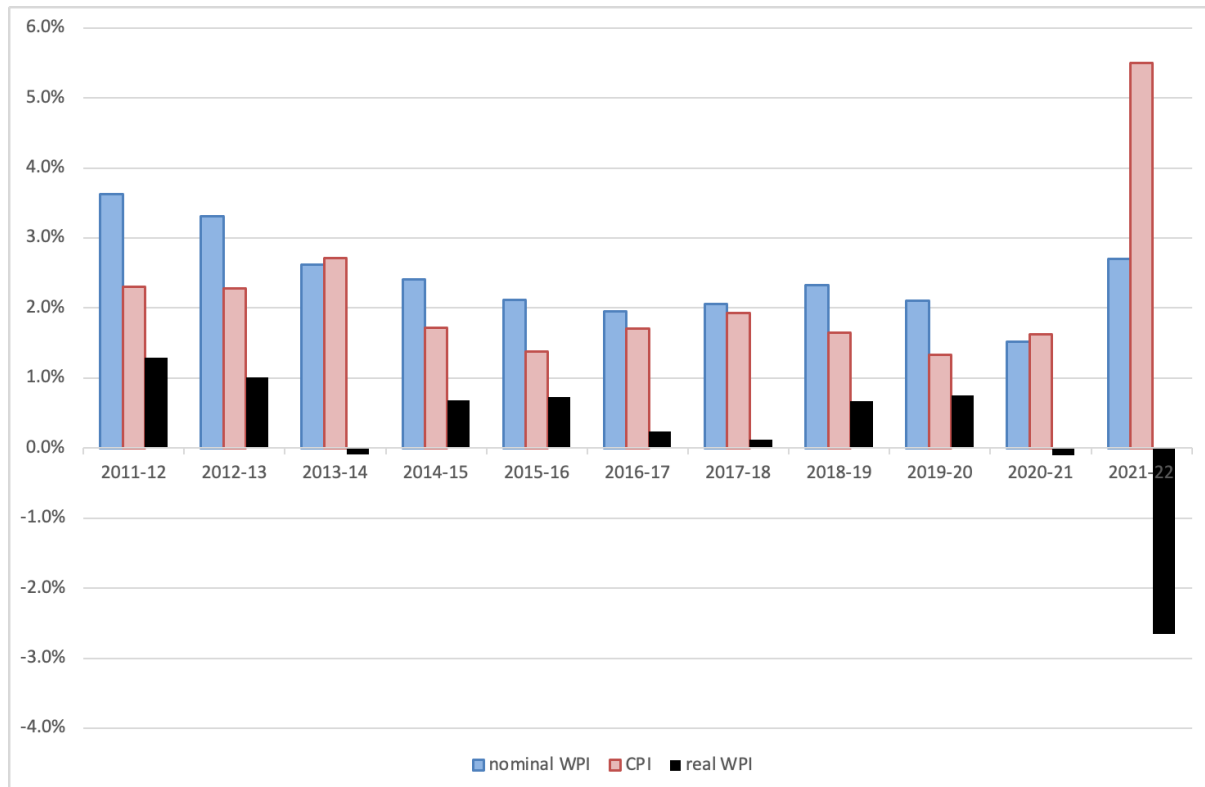


Figure 1: Nominal and real WPI and CPI, Australia, 2011-22

Source: ABS, Cat Nos 6345.0 Wage Price Index, Australia, and 6401.0 Consumer Price Index, Australia

Change in the purchasing power of employees is best measured by the *real WPI*, that is the WPI discounted by growth in the CPI. That is also shown in Figure 1, and so the original WPI (not discounted by the CPI) is referred to as *nominal WPI*. As inflation is at 5.1% and the nominal WPI grew by 2.4%, *real wages* (measured by the real WPI) fell by 2.6% in the year to March quarter.

One thing apparent from Figure 1 is that there had probably already been trend declines in both nominal and real WPI over the decade preceding the most recent data.³ That is, growth in the purchasing power of wages had been declining even before the most recent, large rise in inflation and substantial fall in real wages. The burst in inflation in 2021-22 might only have brought forward a decline in real wages that Australia was heading towards anyway, albeit with a much greater fall. In effect, it may not have been an aberrant outlier but rather a substantial acceleration of a trend that was already underway.

³ This is confirmed by an estimation of simple OLS trends line, excluding 2021-22, which have the formulae $W_r = -0.0008t + 0.0095$ and $W_n = -0.0018t + 0.0341$ where W_r = real wages, W_n = nominal wages and t = time in years.

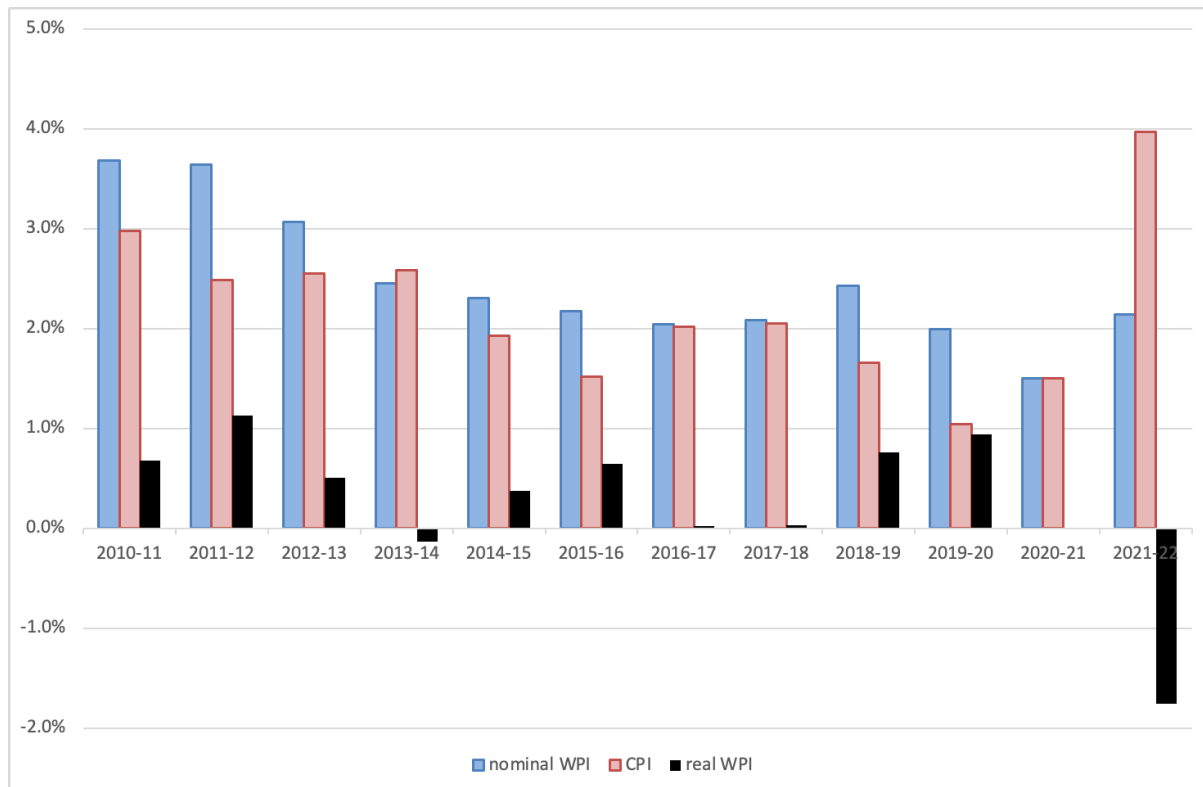


Figure 2: Nominal and real WPI and CPI, NSW, 2011-22

Source: ABS, Cat Nos 6345.0 Wage Price Index, Australia, and 6401.0 Consumer Price Index, Australia

The general pattern in New South Wales (NSW) is broadly similar to that nationally. This is in no small part due to the fact that NSW accounts for almost a third of the Australian population and economy. Changes in nominal and real WPI and the CPI are shown for NSW in Figure 2, and have resemblance to the national patterns shown in Figure 1.

Most recently, there has been a decline in real wages such that, nationally, real wages are lower than they were at the end of 2014. Movements in real wages were irregular for several years after that but they have consistently fallen more recently. Over the seven quarters from June quarter 2020 to March quarter 2022, nominal WPI grew by only 3.9%, but the CPI grew by 8.3%, so real WPI declined by 4.1%. Real WPI have declined for six of the past seven quarters (that is, for most of the past 21 months). Indeed, since June quarter 2013, the quarterly real WPI has gone down (on 18 occasions) more often than it has gone up (17 occasions).

International trends

This pattern of declining nominal wages is not a global phenomenon. As shown by Figure 3, which depicts average growth in hourly wages across the Organisation for Economic Cooperation and Development (OECD), the general trend in the OECD through the decade has been of stability (in fact, on average an increase) in average hourly wages (the closest measure on the OECD database to the WPI).⁴ Overall, there is no evidence of any clear

⁴ The OECD data used here refer to calendar years rather than financial years, and so for consistency the WPI data are also in calendar years, which makes them slightly different to those used in Figure 1.

relationship between hourly wage growth patterns in the OECD and in Australia. Hourly wage growth in the OECD was lower than in Australia in the first half of the decade but higher than Australia in the second half. While there is a lot of variation between individual OECD countries, it cannot be persuasively claimed that the decline in Australian wages growth simply reflects international forces.

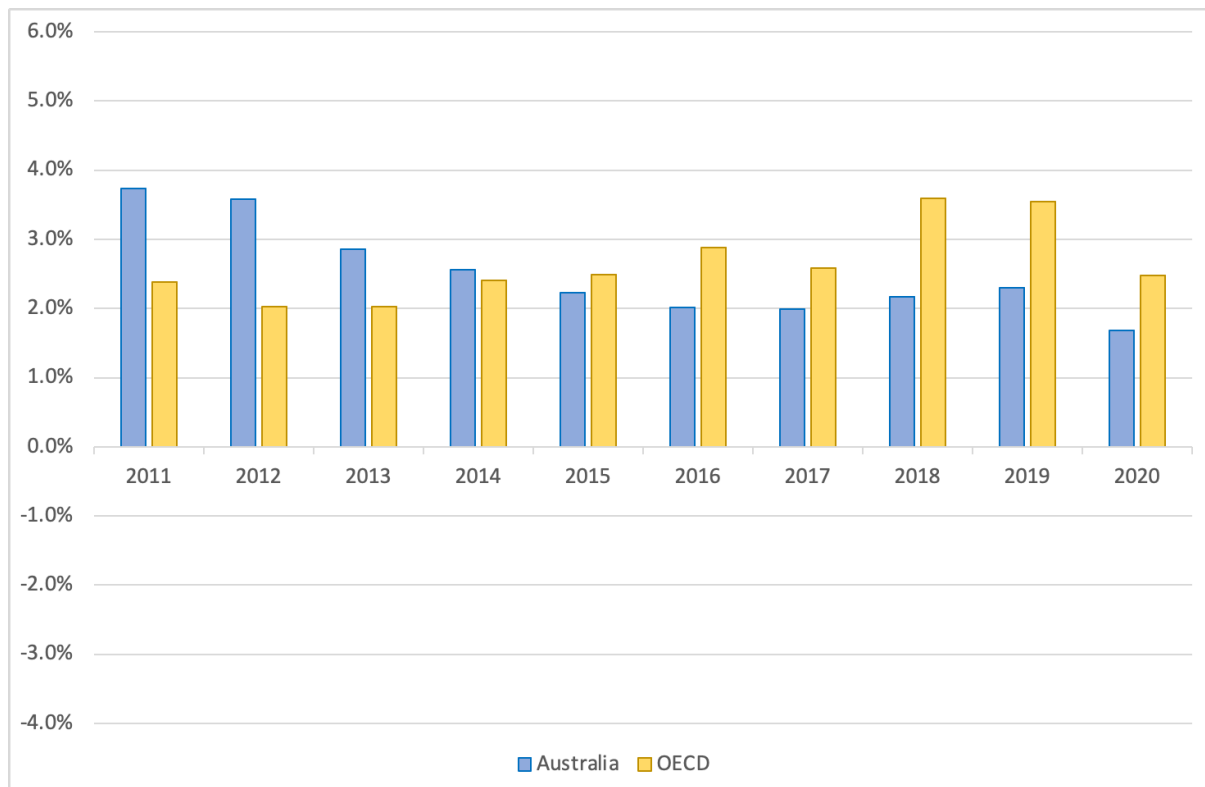


Figure 3: Average hourly wages, OECD, and WPI, Australia, 2011-22

Source: ABS, Cat No 6345.0 Wage Price Index, Australia and OECD, OECD.Stat online database, https://stats-3.oecd.org/index.aspx?DatasetCode=EAR_MEI accesses 11/5/22

Productivity

The decline in real wages growth is especially noticeable when compared to trends in productivity. Broadly speaking, wage increases have a neutral impact on inflation if they are equal to the amounts of inflation plus growth in labour productivity, as growth in labour productivity leads to lower production costs by employers. This was an idea underlying national wage fixation through parts of the twentieth century, and broadly speaking real wages grew in line with productivity for much of that century.

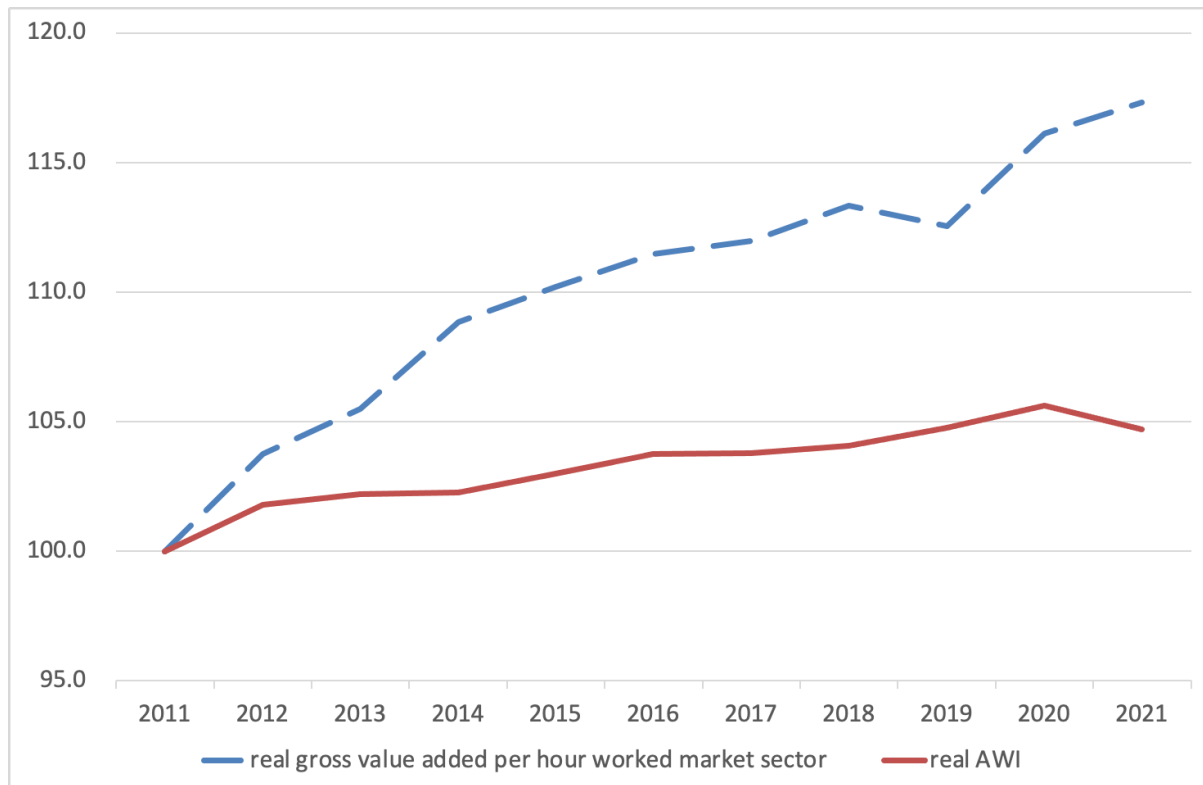


Figure 4: Labour productivity and real wages indexes 2011-2021

Source: ABS, Cat Nos 6345.0 Wage Price Index, Australia; 6401.0 Consumer Price Index, Australia; and 5206.0 Australian National Accounts: National Income, Expenditure and Product

Figure 4 shows the levels of labour productivity and real AWI in each calendar year since 2011. Labour productivity growth since 2011 has exceeded growth in real AWI, by a considerable and broadly consistent amount. While growth in labour productivity has been lower in recent years than in earlier decades — it was fastest in the 1950s and 1960s, and broadly speaking has slowed down in most decades since then — and slower at the end of the decade than at the beginning, the more notable aspect has been the disconnect between wages and labour over the past decade (and indeed over the past four decades). That is, real wages have grown more slowly on average than productivity.

Forecasts for wages and prices

The prospects for the near future do not suggest an improvement in real terms. The Federal Budget, released on 29 March 2022, briefly suggested that real wages would grow again in 2022-23. The Budget forecast real wages growing by just a quarter of a percent in 2022-23. However, this forecast depended on the Budget's assumption of falling inflation, and even at the time this seemed very unlikely. This was because, for the first time in almost half a century, Treasury was estimating that the rate of unemployment would be below the 'non-accelerating-inflation rate of unemployment' (NAIRU). That term meant we should expect inflation would accelerate, not fall, so the assumption of a fall in inflation seemed unlikely, and any significant acceleration of CPI growth would have implied a fall in real wages.

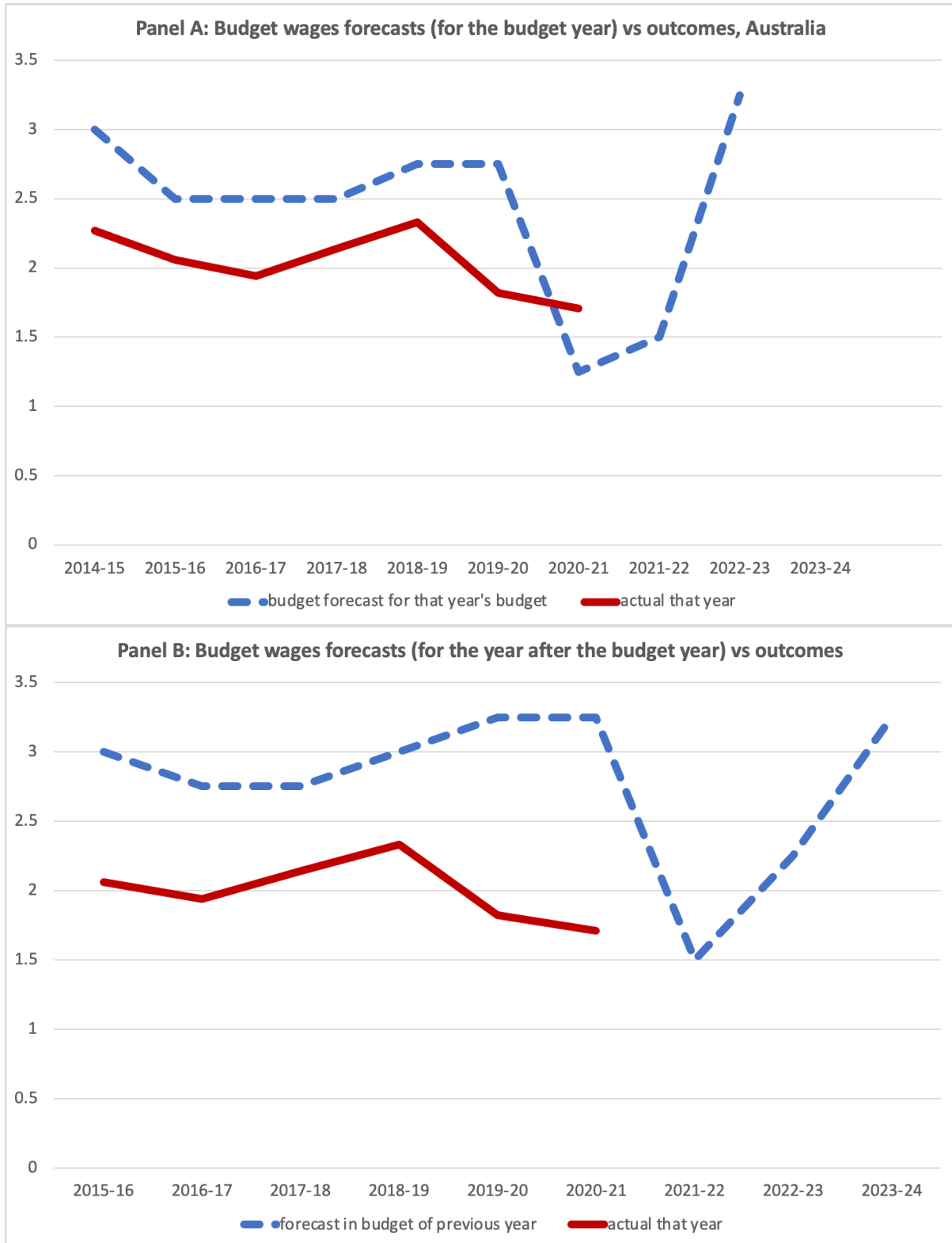


Figure 5: Budget WPI projections and outcomes, Australia, 2014-2020

Source: Budgets. ABS WPI.

Moreover, as shown in Figure 5, most of the federal Budgets since 2014-15 overestimated nominal wages growth, in both the budget year (Panel A) and the year beyond (Panel B). This may reflect the difficulty of accurately modelling changes in labour market behaviour in the context of changes in wage norms and monopsony, discussed below and in Appendix A.

Not surprisingly, when the Reserve Bank of Australia (RBA) published its *Statement on Monetary Policy* two months later, containing updated forecasts for the Australian economy, the wages projections in the Budget were rendered irrelevant. These updated forecasts are shown in Table 1, while Table 2 shows a comparison with the Budget forecasts.

As can be seen in Table 1, the 5.1% CPI growth recorded in the year to March quarter 2022 is forecast by the RBA to increase to 5.9% annual growth by December quarter 2022. Inflation is then forecast to slow to approximately 3 per cent by the end of 2023-24. Calendar year 2022 looks to be a particularly significant year for real wage declines. Forecast nominal wages growth of 3% through 2022 is expected to be barely half the growth in prices over that year. The combined effect is a forecast real wage decline of 2.7% in the year to December 2022.

In interpreting these forecasts, account should be taken of there being less sign than expected in the most recent data of any surge in wages. Markets were expecting 2.5% for this quarter (above the 2.4% achieved). Expectations regarding wage growth in and beyond June quarter 2022 therefore might not quite be reached.

Table 1: RBA Economic forecasts, WPI and CPI, December 2021 to June 2024

| Year to: | Nominal | | Real |
|----------|---------|------|-------|
| | WPI | CPI | WPI |
| Dec-2021 | 2.3% | 3.5% | -1.2% |
| Jun-2022 | 2.7% | 5.5% | -2.7% |
| Dec-2022 | 3.0% | 5.9% | -2.7% |
| Jun-2023 | 3.3% | 4.3% | -1.0% |
| Dec-2023 | 3.5% | 3.1% | 0.4% |
| Jun-2024 | 3.7% | 2.9% | 0.8% |

Source: Reserve Bank of Australia, *Statement on Monetary Policy*, Sydney, May 2022. Date columns 1 and 2 are from the Appendix ('Forecast table') to the report at <https://www.rba.gov.au/publications/smp/2022/may/forecasts.html>, while column 3 is directly calculated from the first two data columns.

Table 2: Budget and RBA wages and inflation forecasts, 2021-22 to 2023-24

| Year to: | nominal WPI | | CPI | | real WPI | |
|-----------|-------------|------|--------|------|----------|-------|
| | Budget | RBA | Budget | RBA | Budget | RBA |
| June 2022 | 2.75% | 2.7% | 4.25% | 5.5% | -1.4% | -2.7% |
| June 2023 | 3.25% | 3.3% | 3.0 % | 4.3% | 0.2% | -1.0% |
| June 2024 | 3.25% | 3.7% | 2.75% | 2.9% | 0.5% | 0.8% |

Source: Reserve Bank of Australia, *Statement on Monetary Policy*, Sydney, May 2022; Australia, Budget Statement No 1 in *Budget Strategy and Outlook: Budget Paper No. 1, 2022–23*, Canberra, March 2022.

Data columns 1 & 3 are from Table 1, page 6 of Budget Statement No 1, columns 2 and 4 are calculated from the Forecast table cited in Table E above, and columns 5 and 6 are calculated from the first four data columns.

Note that in the Budget, forecasts are rounded to the nearest quarter of a percent, whereas the RBA rounds its forecasts to the nearest tenth of a percent.

Table 2 shows how seriously the Budget forecasts were repudiated in barely two months. In particular, the decline in real wages of approximately 1.4%, forecast through the Budget for the year to June 2022, was almost doubled to 2.7% in the RBA Statement on Monetary Policy, while the small growth in real wages of 0.2%, forecast through the Budget for the year to June 2023, was replaced by a 1.0% forecast decline in real wages in the RBA Statement on Monetary Policy. Something closer to normality resumes in 2023-24, when the RBA is forecasting real wages growth slightly more than that in the Budget (by 0.3 percentage points), perhaps due to the wages trying to catch up for earlier inflation and/or the greater uncertainty associated with forecasts further into the future. Still, that projected growth in real wages remains below the growth in productivity implied in the Budget (of approximately one percent in GDP per employee), meaning that employees even then would receive less in real wages than an 'inflation plus productivity' rule would deliver.

State budgets have tended to rely on, but not replicate, federal forecasts, and so have also consistently overestimated wage growth in their forecasts. The comparison of forecasts and outcomes for the NSW state budget is shown in Figure 6. That said, the extent of underestimation is not as great as for the federal budget, mainly because of differences in the forecasts, not the outcomes. On average (over the 2015-16 to 2019-20 period) the NSW error is only about three-fifths as large as the federal error for the budget year (Panel A of Figure 6) and only seven tenths as large for the year after budget year (Panel B). That the state budget comes down later than the federal one is a likely factor, especially in the same-year forecasts.

To summarise, after a decline in real wages for Australian employees averaging 4.1% between June quarter 2020 and March quarter 2022, it is likely that in June 2022 there will be a further decline of 0.2%. An additional real wage fall of 1.0% between June 2022 and June 2023 is forecast. These numbers are national averages, and of course mostly encompass employees not covered by public sector wage caps, who would be worse affected if those caps are below future WPI growth.

Real wages for state public sector employees

Neither the RBA nor the Treasury provide forecasts for wages or inflation at the state level. However, the experience with inflation over the past decade indicates that federal estimates of inflation are very good proxies for inflation at the state level. The growth of prices as measured by the CPI for the eight capital cities has been very similar over the past 12 years to that measured by the index for Sydney alone ($r=.96$).⁵ On average, over the period from March 2010 to March 2022, CPI growth averaged 2.22% per annum nationally and 2.21% per annum in Sydney. On that basis, we can take the RBA forecasts in Tables 1 and 2 of national inflation as being appropriate for projecting inflation in NSW.

⁵ N=48, correlation between quarterly estimates of annual CPI growth (over the year to the current quarter), June 2010 to March 2022.

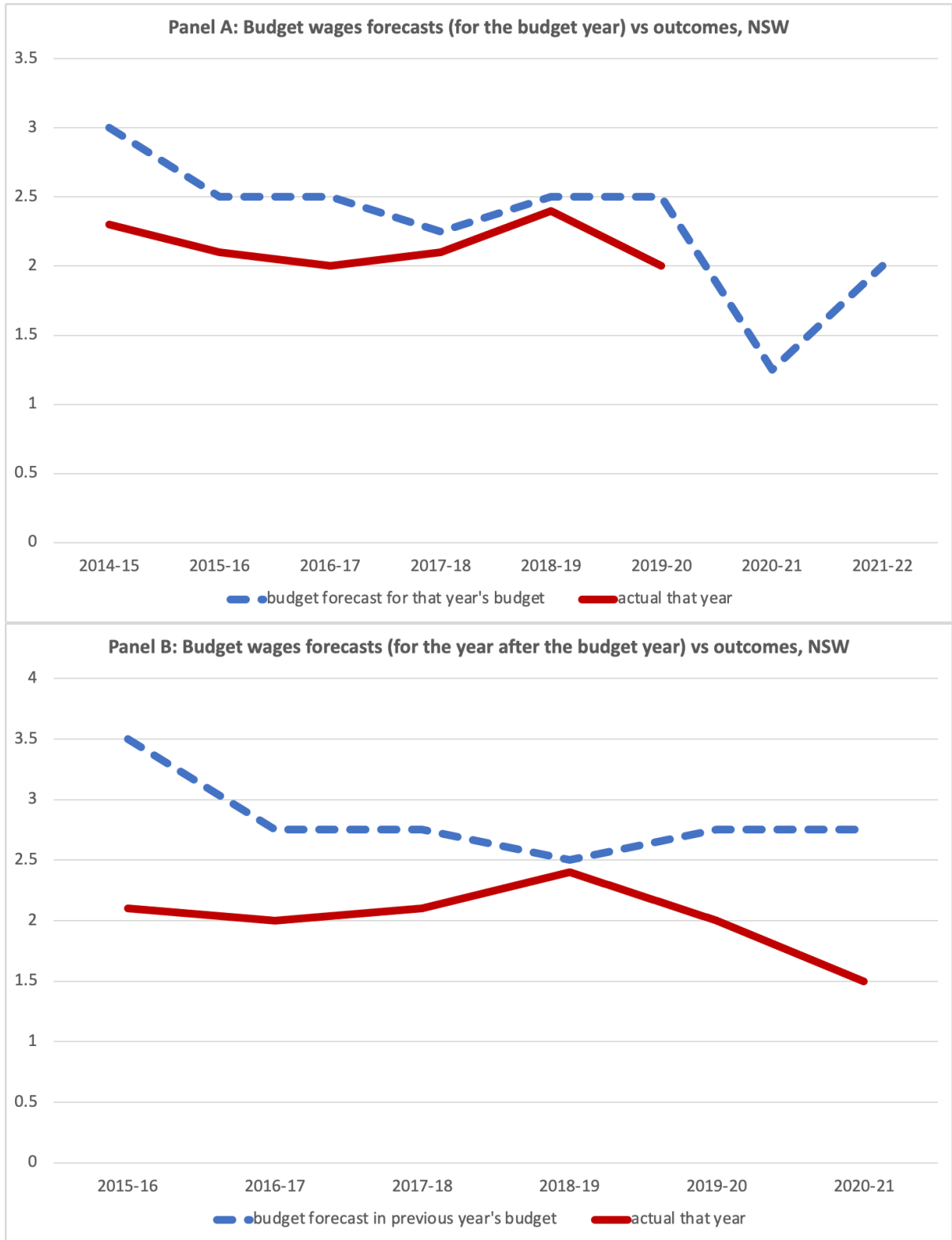


Figure 6: Budget WPI projections and outcomes, NSW, 2014-2020

Source: NSW Budgets (*Budget paper No 1* to 2019-20; *How to Read the Budget Papers* from 2020-21).

Table 3: Past and projected pay rates under the public sector pay cap, selected NSW public sector occupations, at current inflation rate

| | current weekly wage | weekly wage with real wage maintenance (based on CPI growth of 5.1%) | weekly wage equivalent with wage cap of 2.5% | weekly shortfall (\$) | annual shortfall (\$) |
|---|---------------------|--|--|-----------------------|-----------------------|
| Bus driver: Senior Bus Operator | 1,129.20 | 1186.79 | 1157.43 | 29.36 | 1526.68 |
| Prison officer : Correctional Officer 2nd year | 1,312.42 | 1379.35 | 1345.23 | 34.12 | 1774.39 |
| Nurse: Registered Nurse/Midwife Year 4 | 1,469.30 | 1544.23 | 1506.03 | 38.20 | 1986.49 |
| Paramedic: Paramedic Year 2 (Division 2 (iii)) | 1,490.45 | 1566.46 | 1527.71 | 38.75 | 2015.09 |
| Firefighter: Qualified Firefighter | 1,639.26 | 1722.86 | 1680.24 | 42.62 | 2216.28 |
| Median public sector employee | 1,738.35 | 1,827.00 | 1,781.80 | 45.20 | 2350.24 |
| Teacher: Teacher Band 2.1 Salary | 1,856.37 | 1951.04 | 1902.78 | 48.27 | 2509.81 |
| Police officer: Senior Constable Level 3 Step 1 | 1,941.15 | 2040.15 | 1989.68 | 50.47 | 2624.43 |

The ABS publishes biennial national estimates of average hourly and weekly earnings for approximately 100 occupations. The limitation of these data for state-level analysis is that they are based on surveys of employers, and hence subject to sampling error, which is even greater when data disaggregated to the state level are sought. The existence of sampling error and their infrequency makes it difficult to use ABS estimates for analysing real wage movements for public sector occupations at the state level.

We can, however, make precise estimates of the real wage movements for NSW public sector employees, by reference to the content of their awards or enterprise agreements and by projecting future wage increases subject to the public sector pay cap applying in that state. Pay rates for a selection of occupations are shown in Table 3, along with the reportedly ‘median’ public sector employee.⁶

The table compares the wage rates that would apply if workers in the selected occupations received a wage increase of 5.1% (the actual increase in prices over the year to March quarter 2022) with the equivalent wage rates that would apply if those workers received an increase equal to 2.5%. This could be interpreted as the value of the real wage cut that would apply if the 2.5% wage cap remained in place. Note also that economic projections (see Tables 1 and 2) are that price increases for 2022-23 would exceed the 5.1% amount modelled, and indeed that inflation would peak at 5.9% in the year to December 2022.

The third data column contains the ‘wage equivalent’ numbers that are greater than the actual wage rates that would apply under the wage cap, as the value of the wage cap includes the superannuation rise due to occur in 2022-23. As a result, the wage rates paid into people’s

⁶ Based on the reported estimate at p37 of NSW Public Service Commission, *Workplace Profile Report 2021*, State of New South Wales, Sydney, 2022.

wages would be only 2.04%. To put this in context, Table 4 shows the gross wage into the pay packet, and the wage equivalent when superannuation is taken into account, when a wage cap of 2.5% is applied.⁷

Returning to Table 3, we see that for the lowest paid occupation in that list, bus drivers (at the level of senior bus operator), the impact of the public sector pay cap is equivalent to a real wage cut of over \$29 per week, equivalent to an annual loss of just over \$1,500. This real wage reduction of 2.5% would be substantially greater than that in the private sector. The losses for the selected occupations range up to \$50 per week, equivalent to over \$2,600 per annum, for a police officer paid as a senior constable level 3, step 1. The occupations in between include nurses and paramedics, the former experiencing an equivalent real wage loss of approximately \$38 per week, or about \$2,000 per annum, for a registered nurse or midwife in year 4.

Table 4: Projected pay rates under the public sector pay cap with and without superannuation effects, selected NSW public sector occupations

| | current weekly wage | gross wage into pay packet with wage cap of 2.5% | wage equivalent with wage cap of 2.5% |
|---|---------------------|--|---------------------------------------|
| Bus driver: Senior Bus Operator | 1,129.20 | 1,152.24 | 1157.43 |
| Prison officer : Correctional Officer 2nd year | 1,312.42 | 1,339.19 | 1345.23 |
| Nurse: Registered Nurse/Midwife Year 4 | 1,469.30 | 1,499.27 | 1506.03 |
| Paramedic: Paramedic Year 2 (Division 2 (iii)) | 1,490.45 | 1,520.86 | 1527.71 |
| Firefighter: Qualified Firefighter | 1,639.26 | 1,672.70 | 1680.24 |
| Median public sector employee | 1,738.35 | 1,773.81 | 1,781.81 |
| Teacher: Teacher Band 2.1 Salary | 1,856.37 | 1,894.24 | 1,902.78 |
| Police officer: Senior Constable Level 3 Step 1 | 1,941.15 | 1,980.75 | 1,989.68 |

Another approach, shown in Table 5, would be to look ahead over a three year period, comparing forecast inflation with wages under the salary cap. So, for example, Table 5 first compares wages for designated occupations with 2.5% growth per annum with the RBA's projected CPI growth for the year to June quarter 2023, which is 4.3% (as per Table E), and then 2.9% in the year to June quarter 2024. The RBA does not publish inflation forecasts for the year to June quarter 2025, so we assume that the forecasts for the year to June quarter 2024 are repeated in the year to June quarter 2025. Note that this reflects the same relationship between the two years as is evident in the federal Budget, in that the Budget forecasts the same inflation rate in the year to June quarter 2025 as in the year to June quarter 2024. Table 6 then shows the 'real shortfalls' for each occupation listed in Tables 3 and 4, calculated for the June quarter in each year, that is the extent to which the wages of

⁷ To simplify the exposition, the calculation of superannuation only applies to the 2.04% increase, not to the whole of the wage. While this affects the total values in the weekly wage cells, it does not affect the relativity between them or the real change.

employees subject to the salary cap fall in real terms. These ‘shortfalls’, it should be noted, do not include any allowance for productivity gains (that is, if it assumed that productivity gains should be shared between employers and employees, and that productivity continues to improve through the forecast period, then these data would underestimate ‘shortfalls’ of real wage losses against real productivity gains).

Under the above scenario, for the lowest paid occupation in that list, bus drivers (at the level of senior bus operator), the impact of the public sector pay cap would amount to a real wage cut of over \$20 per week, equivalent to an annualised loss of over \$1,000, by the end of 2022-23 alone. This would be a real loss of 1.7%, somewhat greater than the loss of 1.0% for average employees, as reflected in the projected WPI. The losses for the selected occupations range up to \$35 per week, equivalent to over \$1,800 annualised, for a police officer paid as a senior constable level 3, step 1. A registered nurse or midwife in year 4 experiences an equivalent real wage loss of approximately \$26 per week, or approaching \$1,400 annualised, by June quarter 2023. For a median public sector employee, the shortfall is over \$30 per week and over \$1600 annualised in June quarter 2022.

Table 5: Past and projected pay rates under the public sector pay cap, selected NSW public sector occupations, compared to projected inflation rate for 3 years to June quarter 2025

| | (5.1) current weekly wage, June quarter 2022 | (5.2) real wage maintenance June quarter 2023 | (5.3) wage with salary cap, June quarter 2023 | (5.4) real wage maintenance June quarter 2024 | (5.5) wage with salary cap, June quarter 2024 | (5.6) real wage maintenance June quarter 2025 | (5.7) wage with salary cap, June quarter 2025 |
|---|---|---|--|---|--|---|--|
| Bus driver: Senior Bus Operator | 1,129.20 | 1,177.76 | 1,157.43 | 1,211.91 | 1,186.37 | 1,247.06 | 1,216.02 |
| Prison officer : Correctional Officer 2nd year | 1,312.42 | 1,368.85 | 1,345.23 | 1,408.55 | 1,378.86 | 1,449.40 | 1,413.33 |
| Nurse: Registered Nurse/Midwife Year 4 | 1,469.30 | 1,532.48 | 1,506.03 | 1,576.92 | 1,543.68 | 1,622.65 | 1,582.28 |
| Paramedic: Paramedic Year 2 (Division 2 (iii)) | 1,490.45 | 1,554.54 | 1,527.71 | 1,599.62 | 1,565.90 | 1,646.01 | 1,605.05 |
| Firefighter: Qualified Firefighter | 1,639.26 | 1,709.75 | 1,680.24 | 1,759.33 | 1,722.25 | 1,810.35 | 1,765.30 |
| Median public sector employee | 1,738.35 | 1,813.10 | 1,781.81 | 1,865.68 | 1,826.35 | 1,919.78 | 1,872.01 |
| Teacher: Teacher Band 2.1 Salary | 1,856.37 | 1,936.19 | 1,902.78 | 1,992.34 | 1,950.35 | 2,050.12 | 1,999.11 |
| Police officer: Senior Constable Level 3 Step 1 | 1,941.15 | 2,024.62 | 1,989.68 | 2,083.33 | 2,039.42 | 2,143.75 | 2,090.41 |

Note: Calculated using RBA inflation forecasts for 2022 and 2023, and assuming 2023 forecast is same as 2024 projection, to calculate columns (5.2), (5.4) and (5.6) from column (5.1). Columns (5.3), (5.5) and (5.7) are calculated from column (5.1) using a 2.5% salary cap in each year.

Table 6: Real shortfalls under public sector pay cap, selected NSW public sector occupations, to June quarter 2025

| | (6.1) weekly shortfall June quarter 2023 | (6.2) annualised shortfall June quarter 2023 | (6.3) weekly shortfall June quarter 2024 | (6.4) annualised shortfall June quarter 2024 | (6.5) weekly shortfall June quarter 2025 | (6.6) annualised shortfall June quarter 2025 | (6.7) Sum of annualised shortfalls 2023-25 |
|---|---|---|---|---|---|---|--|
| Bus driver: Senior Bus Operator | 20.33 | 1,056.93 | 25.54 | 1,328.33 | 31.03 | 1,613.61 | 3,998.87 |
| Prison officer : Correctional Officer 2nd year | 23.62 | 1,228.43 | 29.69 | 1,543.86 | 36.07 | 1,875.43 | 4,647.72 |
| Nurse: Registered Nurse/Midwife Year 4 | 26.45 | 1,375.26 | 33.24 | 1,728.40 | 40.38 | 2,099.61 | 5,203.27 |
| Paramedic: Paramedic Year 2 (Division 2 (iii)) | 26.83 | 1,395.06 | 33.72 | 1,753.28 | 40.96 | 2,129.84 | 5,278.18 |
| Firefighter: Qualified Firefighter | 29.51 | 1,534.35 | 37.08 | 1,928.33 | 45.05 | 2,342.48 | 5,805.16 |
| Median public sector employee | 31.29 | 1,627.10 | 39.32 | 2,044.90 | 47.77 | 2,484.08 | 6,156.08 |
| Teacher: Teacher Band 2.1 Salary | 33.41 | 1,737.56 | 41.99 | 2,183.73 | 51.01 | 2,652.73 | 6,574.02 |
| Police officer: Senior Constable Level 3 Step 1 | 34.94 | 1,816.92 | 43.91 | 2,283.46 | 53.34 | 2,773.88 | 6,874.26 |

Note: Calculated from table 5. Column (6.1) = (5.2) – (5.3), column (6.3) = (5.4) – (5.5), and column (6.5) = (5.6) – (5.7). Columns (6.2), (6.4) and (6.6) are calculated by multiplying (6.1), (6.3) and (6.5) respectively by 52.

The shortfalls increase in later years, such that by the end of 2024-25, the shortfalls for the bus driver mentioned above rise to over \$30 per week, or \$1600 annualised. For the registered nurse they become \$40 per week or \$2100 annualised, and the median public sector employee will have lost almost \$48 per week, which has an annual equivalent of nearly \$2500.

Over three years, the total amounts foregone by public sector employees, proxied by the last column in Table 6, add to over \$6000 for the median public sector employee.⁸

Overall, then, it is apparent that a range of public sector occupations have experienced declines in real wages in most quarters since June quarter 2020 and that further declines can be forecast. Indeed, since June quarter 2013, the quarterly real WPI has gone down more often than it has gone up. The most recent decline comes at a time when the economy is

⁸ The numbers presented in columns (6.2), (6.4) and (6.6) of Table 6 are annualised equivalents of the June quarter shortfalls, which are slightly different to (i.e. smaller than) the total real annual losses. This is because the total losses in each financial year would be calculated by reference to the year-on-year inflation rates, rather than the year-to-June quarter inflation rates, but these are not separately published by the RBA. However, as CPI growth is predicted to peak at the beginning of this period and then decline through it, the year-on-year inflation rates could be expected to be higher than the year-to-June-quarter inflation rates that refer to the end of the financial year. Based on movements in the quarters preceding the forecast period, and interpolations of data for quarters for which the RBA does not publish forecasts, the year-on-year inflation forecasts can be estimated at 5.2% for 2022-23 and 3.2% for 2023-24, compared to 4.3% and 2.9% for the year-to-June-quarter forecasts for the ends of those years, shown in Table 1, so the year-on-year forecasts likely imply *greater* shortfalls than indicated in Table 6.

experiencing strong economic and employment growth. It is very unusual for these things to happen simultaneously. A range of factors explain this situation, and they form the basis for the rest of this report, which will conclude with consideration of the effects of removal of one of these constraints.

The labour market context

An important aspect of the situation of declining real wages is the labour market context. That is the focus of this section.

The latest quarterly job vacancy estimates relate to February 2022. The ABS estimated that Job vacancies grew to 423,500: the highest on record. This is illustrated in Figure 7.

In March 2022, unemployment had fallen to 4.0%. The RBA forecasts it will fall to 3.8% by June 2022 and 3.6% in each of June 2023 and June 2024. So there are now only 1.3 unemployed people per vacancy (the U:V ratio). That is, by far, the lowest this ratio has been since these series commenced. Figure 8 shows this ratio since 1979.

While it is commonplace to view labour shortages as being a COVID-19 phenomenon, this is not uniquely so. The growth in job vacancies and the fall in the U:V ratio are both long term trends. There was a break in the ABS job vacancies series in late 2008 and early 2009, making it hard to directly join the series before and after this period. Nonetheless, it is apparent that the number of job vacancies shortly, before the pandemic hit, was already at an all-time record, while the U:V ratio was at almost the lowest it had been since the new series started and similar to the lowest it had reached before the break in the series. There is a long-term trend decline in the U:V ratio and rise in the number of job vacancies that existed before the pandemic and will continue after it.

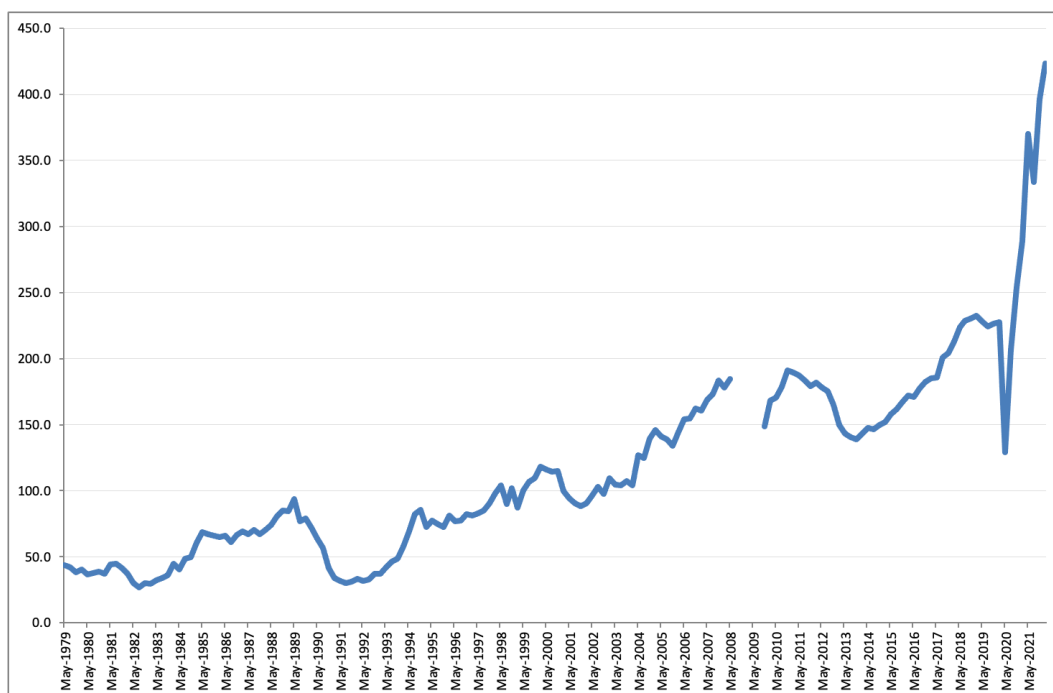


Figure 7: Job Vacancies ('000), Australia, 1979-2022

Source: ABS, Cat No 6354.0 Job Vacancies, Australia.

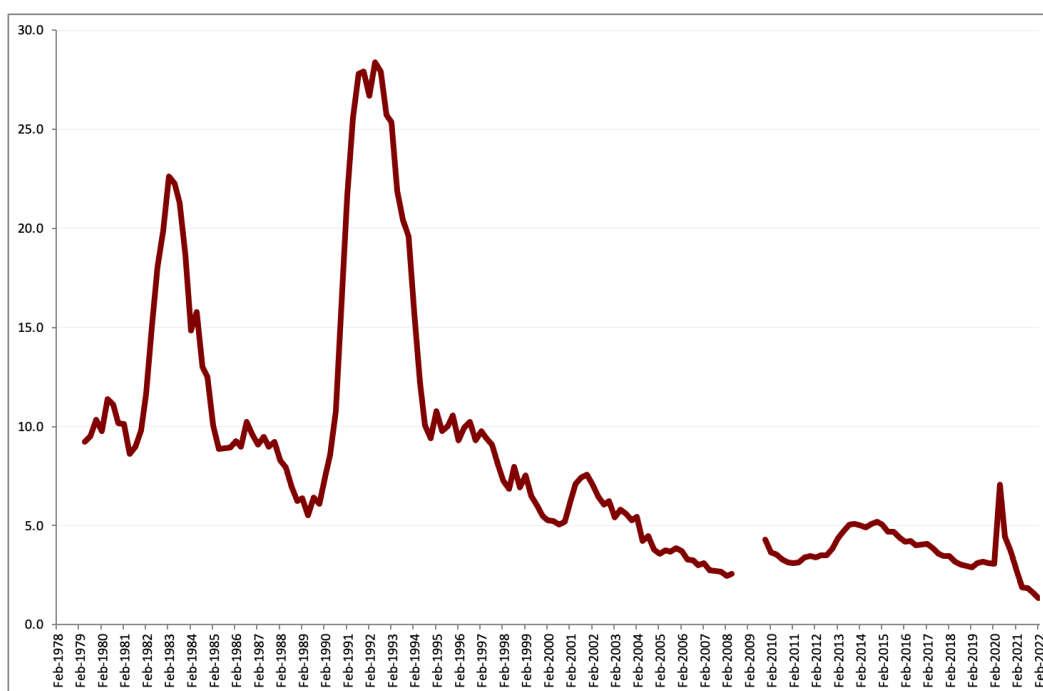


Figure 8: Unemployed workers per job vacancy, 1979-2022.

Source: ABS, Cat No 6354.0 Job Vacancies, Australia; ABS, 6202.0 Labour Force, Australia.

Nor is there just a shortage of skilled workers, for which training or immigration might be seen as policy remedies. Even in 2021, agricultural employers were complaining of a shortage of unskilled workers, but were unwilling or unable to increase wages to deal with it.⁹

With few unemployed per vacancy, it would normally be expected that employers would be competing for workers, and this would push up wages. Yet there is limited evidence that this is happening. Instead, during the tightest labour market in decades, real wages are declining. Although the proximate cause of this might be seen as the rapid rise in inflation, it remains the case that, in such a tight labour market, it might otherwise be expected that real wages would be rising significantly.

In the next section, we explore the reasons for this contradiction between expectations and reality.

⁹ See Appendix A.

Monopsony and wage norms

What is apparent from the above data is that the labour market has changed, in a major way. A key factor in this is the resetting of wage norms. The concept of 'monopsony', that has grown in popularity amongst economists in recent years, helps tell us how this has occurred and why it matters.

Monopsony

'Monopsony' means one buyer, just as 'monopoly' means one seller. In most 'monopsonistic' models of labour markets, there is more than one buyer of labour, but the number of buyers is limited for practical purposes.

The core idea of monopsony is that employers choose, within constraints, the wage they pay their workers. It may sound obvious, but it is very different to the perfect competition model of the labour market, once loved by economists, in which the wage is set by the market, and the employer has no say.¹⁰ In the conventional monopsony model, firms can exercise choice because there is not perfect competition and perfect knowledge in the labour market. Instead, there are a limited number of purchasers of labour.

In monopsonistic labour markets, firms exercise a choice as to which wage they pay, and those choices bring varying levels of vacancies, labour turnover, absenteeism and job quality, which the employer effectively chooses between according to their own strategy. An employer that wants high quality products with low defect rates might pay high wages, one that wants to compete on low labour costs may pay low wages, and so on. There are upper and lower limits (outside of which a firm will indeed cease to operate) but there are a range of viable choices within those bounds.

The choices employers make as to where to pitch their wages have been changing. Once it was much easier for firms to choose to pay higher wages. Now the environment is so competitive on price that many feel that they have to offer the lowest wages possible in order to survive. Workers find that difficult to resist.¹¹

These choices made by employers are influenced by factors specific to their organisation as well as broader factors that are common to multiple organisations. Critical amongst the latter are wage norms.

The concept and role of wage norms

A wage norm is a view common to a group of employers regarding the appropriate wage to pay worklers. It is analogous, but not identical, to the equilibrium wage in neoclassical models of the labour market. Its similarity lies in the fact that it is a prevailing wage, paid by many employers. It is not, however, just a function of supply and demand for labour curves. It is also influenced by shared beliefs amongst employers about what is right, appropriate or

¹⁰ RG Ehrenberg and RS Smith, *Modern Labor Economics: Theory and Practice*, Reading, MA: Addison-Wesley, 1997.

¹¹ Appendix A.

necessary. However the biggest difference to the neoclassical understanding of labour markets is that firms do not go out of business if they diverge from the wage norm. In the neoclassical model, firms which pay above the equilibrium wage go out of business because they are unable to compete with other firms, while firms which pay below the equilibrium wage are unable to attract labour and go out of business for that reason. In the monopsonistic model, there are limitations to how much or how little employers can pay (if you pay way too much you really will go broke), but within permissible bounds employers exercise discretion on the level of wages.

Beliefs about what is right or appropriate or necessary may be relatively benign, or they may be discriminatory. For example, it is widely known that wages for female workers have long been lower than wages for male workers doing equivalent work. This cannot be satisfactorily explained in the neoclassical model of the labour market, which instead posits that firms pay a 'premium' for the right to discriminate against (pay lower wages to) workers of a particular gender or race,¹² but is unable to explain how they then stay in business. The neoclassical model would predict employers are willing to reduce profits in order to discriminate by choosing a less efficient production function, and while this may be the case for some employers, it does not explain the persistence over centuries and continents of discriminatory wage practices. If non-discriminatory wage practices were more profitable, they would have disappeared quickly as it would only take a small number of firms running non-discriminatory wage policies to drive other firms out of business. A different model, in which firms, within bounds, choose wages for various segments of the workforce¹³ better explains reality as observed across time and space.

In recent time, employers are tolerating a high rate of unfilled job vacancies alongside low wages because of lower wage norms. The wage norm may refer not only to views about the appropriate *level* of wages for a particular type of labour, but also to views about the appropriate *rate of increase* of those wages over time. These two are closely related, the former explaining patterns across space at a particular point in time, the latter explaining patterns over time.

The relationship between public sector salary policy and wage norms

Wage norms are influenced by several factors. These include: collective organisation amongst employees and their ability to engage in collective bargaining and action; reference points set by institutions such as industrial tribunals' setting of awards; pressure from other institutions such as employer organisations or government agencies; the operation of product markets; employer actions within labour markets; wage stickiness; and macroeconomic circumstances.

¹² '[D]iscrimination by firms or workers is measured by how much profits or wages they forfeit to avoid hiring or working with members of a group that is disliked': G S Becker 'The Economic Way of Looking at Behavior', *Journal of Political Economy*, 101(3), June 1993, 385- 409

¹³ This body of literature is referred to as labour market segmentation theory. E.g. P Brosnan 'Labour markets and social deprivation', *Labour and Industry*, 7 (2), 1995.

The important institution that we focus on here, though, is the public sector as employer. Wage outcomes in the public sector can set the tone for wage outcomes in the private sector, including by sending a message about what is 'fair' pay. This is partly through the greater role of the public sector as a purchaser rather than a provider of public services and partly through incidental or deliberate demonstration effects. The question of whether the public sector has any role in setting wage norms for the private sector is addressed empirically below.

Quantitative links between public and private sector pay

It is useful in this context to consider the relationship of public sector wage norms to private sector wages. Do public sector wages follow or lead private sector wages, or are they unrelated? Various views can exist about the relationship between public and private sector wages. Broadly these can be said to fall within four categories or hypotheses:

- (a) public sector wages provide a demonstration for private sector wages (they 'set the pace for private sector wages'), and so movements in the former will lead movements in the latter;
- (b) public sector wages are set principally by reference to private sector wages, and so movements in the former will follow movements in the latter;
- (c) public and private sector wages are set by the same forces; or
- (d) there is little or no relationship between private and public sector wages.

International evidence supports hypotheses (a) to (c), with a major cross-national econometric study of OECD countries through the period 1973-2000 finding that 'A 1% increase in public sector wages raises the wages in the private sector by 0.3 percent'.¹⁴

For Australia, the four propositions above can be assessed by looking at correlations between public and private sector wages, to see whether a correlation exists and which leads or lags the other. If (d) is true, the correlation will be small. If (c) is true, the correlation will be large, and will be at its highest when there are no lags in observations. If (b) is true, then public sector wages will correlate well and most strongly with a lagged estimate of private sector wages. If (a) is true, then private sector wages will correlate well and most strongly with a lagged estimate of public sector wages.

Table 7 shows the results from testing these hypotheses using published data. The left-hand data column uses data from the ABS wage price index (WPI) series, in effect looking at whether and to what extent actual wage rates in the public and private sectors lag or lead each other. The right-hand data column uses data from the federal government Workplace Agreements Database, in effect looking at whether and to what extent apparent average annualised wage increases (AAWI) through federal enterprise agreements in the public and private sectors lag or lead each other. They cover slightly differing periods (AAWI data has

¹⁴ A Afonso and P Gomes 'Interactions between public and private sector wages', *Journal of Macroeconomics*, 39(1), March 2014, 97-112.

been collected for longer than WPI data), but each have roughly 100 observations and the method in each case is otherwise similar.¹⁵ The WPI series has wider coverage than AAWI, relating to all employees rather than just those for whom a new federal enterprise agreement was finalised in the relevant quarter which contained a quantifiable wage increase (those without quantifiable wage increases are excluded). NSW public sector employees are encompassed in the WPI data but not the AAWI data (as pay rates from bargaining are mostly embodied in state awards), though AAWI provides a useful reality check on the WPI data. The top row of data shows the correlations between wage increases in the public private sectors in the current quarter, in effect testing hypotheses (c) and (d). The next four rows show private sector wages correlated with lagged public sector wages, in effect testing hypothesis (a). The bottom four rows show public sector wages correlated with lagged private sector wages, in effect testing hypothesis (a).

Table 7: Correlations between public and private sector wages growth, with various lags,

| | WPI | AAWI |
|---|-------|-------|
| Private sector v public sector , same quarter | 0.808 | 0.621 |
| Private sector v public sector , lagged one quarter | 0.819 | 0.649 |
| Private sector v public sector , lagged two quarters | 0.815 | 0.592 |
| Private sector v public sector , lagged three quarters | 0.798 | 0.637 |
| Average private sector v public sector , lagged one to three quarters | 0.811 | 0.626 |
| Public sector v private sector , lagged one quarter | 0.791 | 0.676 |
| Public sector v private sector , lagged two quarters | 0.781 | 0.628 |
| Public sector v private sector , lagged three quarters | 0.781 | 0.556 |
| Average public sector v private sector , lagged one to three quarters | 0.784 | 0.620 |

WPI = wage price index: increase on same quarter of previous year, June 1991 to Dec 2022, N=109
 AAWI = average annualised wage increase, new agreements in quarter, Sept 1998 to Dec 2021, N=93.
 Sources: Calculated from ABS, Cat No 6345.0 Wage Price Index, Australia, Table 1. Total Hourly Rates of Pay Excluding Bonuses: Sector, Original, Seasonally Adjusted and Trend; Attorney-General's Department, Trends in Federal Enterprise Bargaining Report, December quarter 2021 and previous quarters.
 Grey cells indicate cells where the correlation coefficient, r , is higher than the coefficient for the same-quarter correlation, shown in the top cell of the column.

Turning first to the WPI data, the top row shows a strong correlation ($r=.808$) between wages growth in the public and private sectors, providing support for hypothesis (c) and largely rejecting hypothesis (d). However, most of the correlations in the next four rows are above that. In other words, in a bivariate analysis, private sector wages are slightly better predicted by a lagged measure of public sector wages than by its value in the current quarter. This provides some support for the idea that private sector wages are following public sector wages, in support of hypothesis (a).

On the other hand, the final four rows show that correlations between public sector wages growth and lagged measures of private sector wages growth are all slightly lower than the current-quarter correlations. While the difference is small, it nonetheless provides little

¹⁵ AAWI dataset commences March quarter 1991, N=106. WPI commences September quarter 1998, N=93.

evidence in support of hypothesis (b). Overall, the WPI data provide stronger data for hypothesis (a) than (b), and reject hypothesis (d).

The similarities between the correlation coefficients across varying lagged or unlagged scenarios also suggests a high level of path dependency — that is, a heavy influence on what happens in one quarter is what happened in the previous quarter.

The story from the AAWI data, in the last column, is more complex. Again, there is a strong correlation between EBA outcomes in the public and private sectors ($r=.621$, though not as high as in the WPI data), so again there is support for hypothesis (c) over (d). Again, in most of the next four rows, the lagged versions of public sector measures perform better than the same-quarter measure, again providing support for hypothesis (a), that public sector wages lead private sector wages. This time, though, there is also support for the idea that public sector wages may also be influenced by private sector wages, as per hypothesis (b), since several lagged measures of AAWI outperform the current-quarter measure. In both data series, the lag effects in either direction appear strongest after one quarter.

Taken together, these data suggest the following. First, public and private sector wages are closely related to each other, and likely ultimately influenced by similar forces. Different studies explain wages growth through variation in factors like unemployment, inflation, economic activity, capacity utilisation, unemployment benefits and/or institutional factors such as tribunal decisions, union density or legislation.¹⁶ Wages growth also shows path dependency, with one quarter's outcomes being a heavy influence on the next quarter's.

Second, private sector wages are likely influenced by developments in the public sector. When public sector wages growth is higher, this facilitates higher wages growth in the private sector, and lower public sector wages will facilitate lower wages growth in the private sector. It may be that the 'demonstration effect of the public sector as a wage leader depends on how tight the market is',¹⁷ in which case, given the tight state of the labour market mentioned earlier, the demonstration effect may be presently high. At least over the period covered by these data, the public sector looks to have some influence in shaping wage norms.

Third, it seems likely that private sector wages growth influences what happens in the public sector, though the evidence in favour of this is not as consistent as that for the earlier observations. At times there may be institutional reasons why the public sector follows the private sector (for example, pay surveys of private sector employees may be used at various times to influence pay rates in the public sector), so we should not expect these relationships to be stable over time.

¹⁶ P E T Lewis 'Testing for Equilibrium in the Australian Wage Equation', *Economic Record*, 69(206), September 1993, 295-304; E Stockhammer *Why have wage shares fallen?* A panel analysis of the determinants of functional income distribution, Geneva: International Labour Office, Conditions of Work and Employment Series No 35, 2012.

¹⁷ P Gomes, 'Heterogeneity and the Public Sector Wage Policy', Bonn: IZA - Institute of Labor Economics, IZA Discussion Paper No. 11091, October 2017.

Effects of different wage norms on policy

Under the perfectly competitive labour market model, an exogenous increase in wages (caused, for example, by an increase in the minimum wage) leads to a reduction in employment and an increase in unemployment. However, this view has been successfully challenged in recent years. Starting with the work of Card and Krueger, who observed a natural experiment in adjacent US states in which one raised the minimum wage and one did not, the theory of monopsony in labour markets predicts that, in some circumstances, rising wages can lead to an increase in employment. This is essentially because, in forcing employers to raise wages, it enables more jobs to be filled.

The extent to which higher minimum wages lead to higher employment depends on the level of unfilled vacancies. In an economy with few unfilled vacancies, the gross rise in employment will be small and will be more than offset by the fall in employment arising from employers laying off workers whom it is no longer profitable to employ. (The total net effect, however, will also depend on the effects of demand impacts from higher wages, which are not considered here.) In an economy with high unfilled vacancies, the gross rise in employment will be large and, as it increases, come to exceed the gross loss in employment from layoffs of unprofitable workers. Indeed, some if not many of those workers who are laid off will either move into some of the presently unfilled vacancies or into jobs that have been vacated by workers who, in turn, have moved into jobs now on offer with higher wages.

Explaining changing wage norms

In ordinary circumstances, wage norms would be expected to rise in value during periods of tightening, and to slacken¹⁸ in periods of economic downturn. That nominal and real wages growth have shown trend declines during a period of rising vacancies and falling unemployment suggests that there has been a structural shift downwards in wage norms underway. Several factors are likely to have influenced this. These include the decline in the power of organised labour, job insecurity, and increasing monopsony in labour markets. These are discussed in Appendix A.

The factor specifically discussed here, though, is public sector wage caps. The most important factor shaping wage norms that state governments can influence is the role of public sector pay policy — in particular, public sector salary caps. In 2011, the NSW government introduced the Industrial Relations Amendment (Public Sector Conditions of Employment) Act 2011 (NSW) and Industrial Relations (Public Sector Conditions of Employment) Regulation 2011 (NSW), which gave legal effect to the ability of the NSW government to place caps on wages growth for public sector employees, precluding the NSW Industrial Relations Commission (IRC) from awarding increases above that amount unless they contained sufficient ‘employee-related cost savings’ to fully offset them.¹⁹ The extent to which wage restraint was differentially applied to ‘public servants’ and other occupations such as nurses, ambulance officers and police varied over space and time. In 2012, for example, the NSW government wages policy limited pay increases to 2.5% per annum, and in July 2012 the NSW IRC awarded

¹⁸ without necessarily declining in nominal terms, depending on the power of the existing workforce

¹⁹ G Carabatta, Public Sector Wages ‘Cap’: The New Framework for the Determination of Public Sector Wages and Conditions in New South Wales, *Australian Journal of Labour Law*, 25, 2012, 65-75.

2.5% in July to employees under the main public sector award.²⁰ In contrast, in September 2012 police were awarded 3.5% for the first year, and 3.2% for the following two years. In 2013, the NSW government, saying it could only afford 2.27%, discounted its earlier 2.5% salary rise cap by the July 0.25% increase in the federal superannuation guarantee levy.²¹ The approach of discounting for superannuation increases has been repeated at various times, including for the 2022 round. The salary cap was briefly reduced to 1.5%, and to almost a wage freeze (the NSW IRC awarded a 0.3% increase during the pandemic) but is now back at 2.5%.

Since 2011, most state and territory governments (and the federal government) have introduced forms of these public sector salary caps, typically in the range 2% to 2.5%. Overall, there appeared to be a strong degree of 'policy emulation'²² across the states, indicating that the wage norm established in the NSW public sector was applied with modifications across the state public services over subsequent years. Some state governments were engaged in efforts similar to those in the UK²³ to change long-standing systems of public sector employment relations.

The Reserve Bank has recognised the impact that this has had in slowing wages growth. In testimony in 2019, the Governor, Philip Lowe, said

Caps on wages growth in public sectors right across the country are another factor contributing to subdued wage outcomes. At the aggregate level, my view is that a further pick-up in wages growth is both affordable and desirable...the wage caps in the public sector are cementing low wage norms across the country, because the norm is now two to 2½ per cent, and partly that's coming from the decisions that are taken by the state governments.²⁴

He later added

The public sector, directly and indirectly, employs roughly one-third of the labour force, and they're saying wage increases across the public sector may be averaging two per cent. That has as indirect effect on the private sector, because there's competition for workers and it reinforces the wage norm in the economy at two-point something.²⁵

Overall, there are indications that firms *can* pay lower wages than they otherwise needed to (because of the declining power of organised labour), they believe that they *need* to pay lower wages that otherwise (because of changes in labour and product markets) and, importantly,

²⁰ Crown Employees (Public Sector - Salaries 2008) Award [2012] NSWIRComm 70 (29 June 2012).

²¹ Re Crown Employees Wages Staff (Rates of Pay) Award 2011 & Ors (No 2) [2013] NSWIRComm 76 (6 September 2013).

²² Colley L (2012) How did public services fare? A review of Australian state public service labour markets during the Global Financial Crisis. *Journal of Industrial Relations* 54(5): 612-636.

²³ Bach S (2012) Shrinking the state or the big society? Public service employment relations in an era of austerity. *Industrial Relations Journal* 43(5): 399-415.

²⁴ P Lowe in House of Representatives, *Hansard*, Standing Committee on Economics, Reserve Bank of Australia annual report 2018, Canberra, 9 August 2019, 2,15.

²⁵ *Ibid*, 19.

they are told that they *can and should* set wages at a low level, through public sector wages caps, that ‘cement low wage norms across the country’²⁶.

Means and effects of raising wage norms

With wage norms having declined, the distribution of income between labour and capital has shifted in favour of capital and inequality has increased. Attention turns to how the decline in wage norms can be reversed and the effects of doing so.

Means of reversing the decline in wage norms

Policy makers have differing abilities to influence the forces that have lowered wage norms. These include competition policy, labour supply policies and industrial legislation, all discussed in Appendix A. However, those matters are mostly (not entirely) outside of the control of State governments.

The major factor that is within the power of state governments to influence is public sector salary caps. An increase in or removal of salary caps would indisputably raise wage norms in the public sector, and have a flow-on effect to wage norms in the private sector. As this report is focused on NSW, the effects of doing this in NSW are considered in the next section.

Effects of reversing the decline in wage norms through public sector salary caps

The effects can be categorised into impacts on wages, turnover and employment, consumption and state product, and service quality.

Wages in the public and private sectors

The first effect of removing the salary cap would be to reduce or offset (depending on the wage outcomes from public sector bargaining in the absence of the salary cap) the decline in real wages that would otherwise occur if the present salary cap is maintained for the workers concerned. Table 5 showed that the present salary cap would lead to declines in real pay equivalent to a range of \$1000 to \$1800 per annum in the year 1 (2022-23) for the selected occupations if the forecast rate of CPI growth to June quarter 2023 were applied, with a benchmark nurse experiencing a real decline of approaching \$1400 per year.

It is not simple to determine the counterfactual, ie what would be the growth of public sector wages in the absence of a salary cap. It clearly would depend on the outcome of EBA negotiations that have yet to occur. To illustrate a couple of possibilities, one can take the currently projected level of WPI growth to June 2023 (3.3%), or the projected level of CPI growth to June 2023 (4.3%). The effect of these two possible scenarios is shown in Table 8.

²⁶ Ibid, 15.

Table 8: Impact of removal of salary cap on selected occupations under different bargained wage outcome scenarios

| | Assumes 3.3% bargained outcomes | | Assumes 4.3% bargained outcomes | |
|---|---------------------------------|------|---------------------------------|------|
| | \$ per annum | % | \$ per annum | % |
| Bus driver: Senior Bus Operator | 469.75 | 0.8% | 1056.93 | 1.8% |
| Prison officer : Correctional Officer 2nd year | 545.97 | 0.8% | 1228.43 | 1.8% |
| Nurse: Registered Nurse/Midwife Year 4 | 611.23 | 0.8% | 1375.26 | 1.8% |
| Paramedic: Paramedic Year 2 (Division 2 (iii)) | 620.03 | 0.8% | 1395.06 | 1.8% |
| Firefighter: Qualified Firefighter | 681.93 | 0.8% | 1534.35 | 1.8% |
| Teacher: Teacher Band 2.1 Salary | 772.25 | 0.8% | 1737.56 | 1.8% |
| Police officer: Senior Constable Level 3 Step 1 | 807.52 | 0.8% | 1816.92 | 1.8% |

We see from Table 7 that removing the public sector pay cap results in an increase in annual wages of 0.8% (under a 3.3% EBA outcome) to 1.8% (under a 4.3% EBA outcome). This is equivalent to increases of \$470 to \$1060 for bus drivers, \$610 to \$1380 for nurses, and \$810 to \$1800 for police officers in the designated classifications.

These numbers only concern the first year. Including second and subsequent years, the increases would be doubled or more.

A second effect of a lifting of the public sector salary cap would be a reduction in real wage declines in the private sector. This would arise from an increase in private sector wages due to the raising of wage norms. This would not be as large as the impact on public sector wages, bearing in mind that wage norms are shaped by other forces as well, including forces outside NSW — though it would clearly be larger if other state jurisdictions followed NSW in abandoning salary caps, as they followed NSW in introducing salary caps. We do not attempt to quantify that impact, not least because it depends on a number of institutional responses that are difficult to model. However, it would be potentially important because of the existing decline in average real wages across all employees of 4.1% between June quarter 2020 and March quarter 2022, rising to a prospective cumulative real wage fall of 5.3% (equivalent to \$92 per week for an average employee)²⁷ by June quarter 2023.

²⁷ Based on AWE of \$1748.40 for full-time adult employees. ABS, Average Weekly Earnings, Australia, November 2021. This is equivalent to an annual amount of just under \$4800.

Filled vacancies and employment

The third main effect would be the filling of a number of present and future unfilled vacancies in the public sector, as higher wages attract more workers into public sector employment and into training for the occupations concerned. This is both a short-term effect (more people applying for present vacant jobs) and a long-term effect (more people of adequate quality entering training for the occupations). This is a phenomenon that would be observed to varying degrees across the board, but would perhaps be most obvious in nursing, where there is widespread reportage of labour shortages across the country.²⁸ These labour shortages are likely to intensify in coming years. For example, the number of registered nurses in Australia is projected by the Australian Department of Education, Skills and Employment to grow from 298,400 in 2020 to 344,800 in 2025, an increase of 46,400 or 16% in just five years.²⁹ Other occupations also face labour supply issues. The number of primary school teachers (expected to increase by 10,900 to 2025) and secondary school teachers (9,200) are also expected to grow, having grown ‘strongly’ over the last five years.³⁰ The numbers of police and of bus and coach drivers grew ‘very strongly’ and are ‘expected to grow strongly’,³¹ while the number of prison officers ‘grew very strongly’.³² The number of ambulance drivers and paramedic fell but nonetheless ‘is expected to grow strongly’ and firefighter numbers are ‘expected to grow’.³³

Another way of looking at occupational vacancies is to consider data from the federal government’s Internet Vacancy Index. The most recent five years of data for the occupations discussed above are shown in Figure 9, which depicts vacancies in each occupation as an index with the value set at 100 in 2017. The steadiest pattern of growth is shown for the largest occupation, registered nurses, as large size makes it subject to less variability. For that occupation, job vacancies advertised on the internet rose by 83% between 2017 and 2021 (an average of 16.3% per annum compounded). For the other occupations shown, vacancies advertised on the internet rose by between 42% and 106% over that period.

²⁸ e.g. A Dow and M Cunningham, “‘There are vacancies everywhere’: State battles dire nursing shortage”, *Age*, 14 August 2021.

²⁹ Australian Government, ‘Registered Nurses’, *Job Outlook*, <https://joboutlook.gov.au/occupations/occupation?occupationCode=2544>

³⁰ Australian Government, ‘Primary school teachers’ and ‘Secondary school teachers’, *Job Outlook*, <https://joboutlook.gov.au/occupations/teachers-primary-school?occupationCode=2412> and <https://joboutlook.gov.au/occupations/teachers-secondary-school?occupationCode=2414> (Note there are other teacher classifications as well.)

³¹ Australian Government, ‘Bus and coach drivers’ and ‘Police’, *Job Outlook*, <https://joboutlook.gov.au/occupations/bus-and-coach-drivers?occupationCode=7312> and <https://joboutlook.gov.au/occupations/police?occupationCode=4413>

³² Australian Government, ‘Prison officers’, *Job Outlook*, <https://joboutlook.gov.au/occupations/prison-officers?occupationCode=4421>

³³ Australian Government, ‘Ambulance Officers and Paramedics’ and ‘Fire and emergency workers’, *Job Outlook*, <https://joboutlook.gov.au/occupations/ambulance-officers-and-paramedics?occupationCode=4111> and <https://joboutlook.gov.au/occupations/fire-and-emergency-workers?occupationCode=4412>

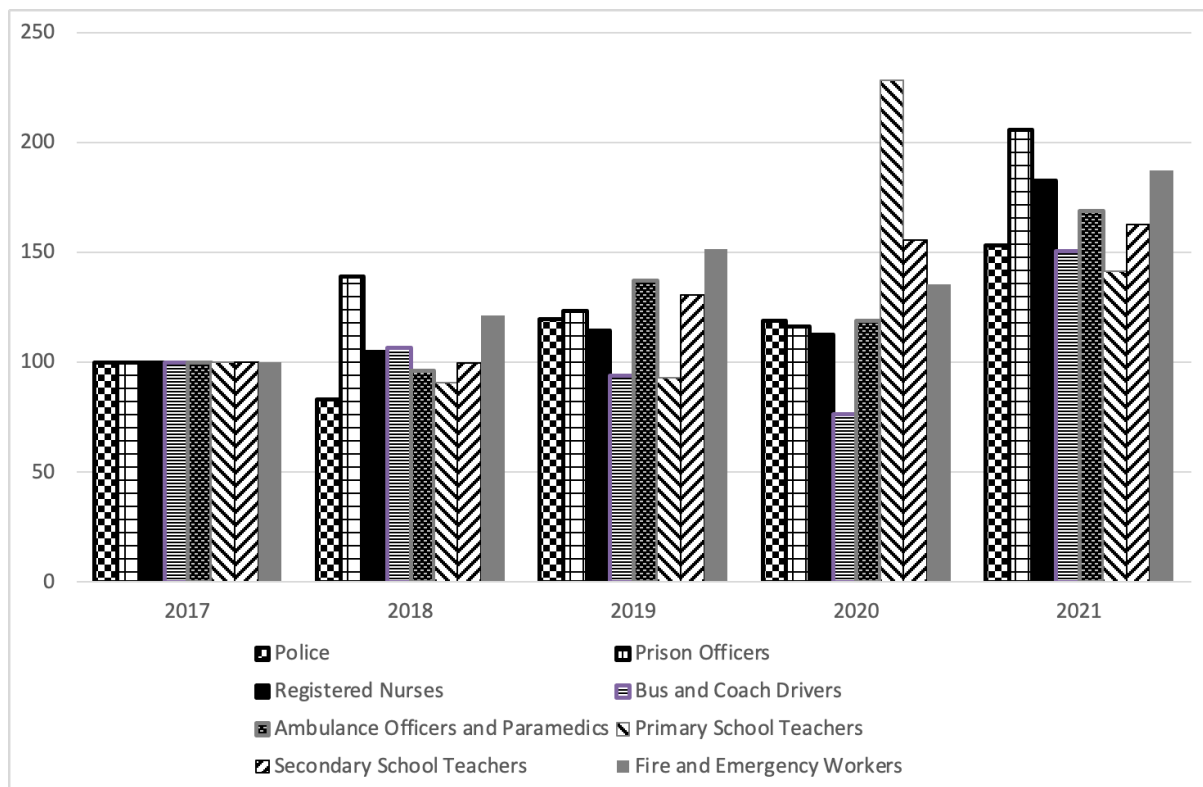


Figure 9. Internet Vacancy Index, Selected occupations, 2017-2021 (2017 = 100)

Source: National Skills Commission, Internet Vacancy Index, <https://labourmarketinsights.gov.au/our-research/internet-vacancy-index/>, accessed 19/5/22.

The positive impact that increased wages has in increasing labour supply has been established (and indeed is a foundation of economic theory) and affects not just applications for current vacancies but also entry into training pathways. For example, a report to the OECD said:

In 1979- 1980, the United States was experiencing a shortage of registered nurses. As a result, wages of registered nurses started to climb in the early 1980s, leading to an increased number of new entrants into the profession and falling vacancy rates... [in the mid-1980s] hospitals raised wages to alleviate shortages, with the real earnings of registered nurses rising almost twice as much from 1985 to 1989 as from 1981 to 1985. In consequence, enrolments of registered nurses rose in 1988, reflecting wage gains...

Evidence from the United States suggests that higher wages have a significant positive effect on attracting new students to first-degree nursing programmes. Additionally, regression equations of the number of future graduations from registered nurse programmes on a number of explanatory variables found a statistically significant coefficient of lagged wage changes...indicating that the change in past wages is a key determinant of changes in the enrolment and graduation rates of registered nurses.³⁴

³⁴ S Simoens, M Villeneuve and J Hurst, Tackling Nurse Shortages in OECD Countries , OECD Health Working Papers, DELSA/ELSA/WD/HEA(2005)1, Paris: Organisation for Economic Co-operation and Development, 2005, 33, citing YA Chiha and CR Link, 'The shortage of registered nurses and some new estimates of the effects of wages on registered nurses labor supply: a look at the past and a preview of the 21st century', *Health Policy*, 64(3), June 2003, 349-75; and J Spetz and R Given, 'The Future of the Nurse Shortage: will Wage Increases Close the Gap?' *Health Affairs*, 22(6). 2003, 199-206.

It also notes that 'If hospitals exercise monopsony (single buyer) power in their local labour market for nurses, profit-maximising behaviour will lead to a lower wage and nurse employment level than would occur in a competitive labour market,'³⁵ and that 'Studies in Norway, the United Kingdom and the United States suggest that a higher wage does reduce the level of nurse turnover'.³⁶

That said, the size of the labour supply effect is difficult to quantify in advance, because estimates of the wage elasticity of labour supply vary substantially between studies. For example, the estimates cited in the OECD study suggested the wage elasticity of supply of nurses was around 0.3.³⁷ A more recent analysis of the Australian workforce put the wage elasticity of labour supply at 0.7, similar to UK estimates.³⁸ One international meta-analysis estimated the number at 0.1 for men and 0.5 for women,³⁹ while another said that the main factor consistently affecting estimates was time, with wage elasticity of labour supply declining over time while varying between demographic groups.⁴⁰ To gain an idea of the order of magnitude of the potential effects, if the wage elasticity of labour supply was 0.3, then a 0.8% to 1.8% wage increase on a labour supply of 431,350 (the number of people working in the NSW public sector) would lead to a 0.25% to 0.55% increase in labour supply (equivalent to an increase of 1000 to 2300 filled jobs). But given the uncertainty of wage elasticity of labour supply, the actual effect could be significantly smaller or larger than this.

A fourth effect, arising from the increase in wage norms in the private sector, would be an increase in the number of filled vacancies in the private sector. More people would find jobs. This would especially affect private sector jobs that have public sector counterparts (such as nursing and teaching) but would have some impact on wage norms for most jobs.

On the other hand, some people would lose other private sector jobs because they were now costing more to hire than they were worth to that employer. But it is likely that many, perhaps most, would find new work anyway, as there are so many unfilled vacancies. The impact of administratively-driven wage rises on employment at a time of high capacity utilisation and high unfilled vacancies is potentially very different to the impact of wage rises on employment at a time of low capacity utilisation, few vacancies and high unemployment. This is particularly the case in the context of changes to labour markets that have increased monopsonistic tendencies, reduced worker influence and lowered wage norms. A situation

³⁵ Ibid, 42.

³⁶ Ibid, 47, citing: DA Ahlburg and CB Mahoney, "The effect of wages on the retention of nurses" *Canadian Journal of Economics*, 29, 1996, S126-S129; A Gray and V Phillips, "Labour turnover in the British National Health Service: a local labour market analysis" *Health Policy*, 36, 1996, 273-289; and TH Holmas, "Keeping nurses at work: a duration analysis" *Health Economics*, 11, 2002, 493-503.

³⁷ Simoens, Villeneuve and Hurst, *Tackling Nurse Shortages in OECD Countries*, p39, citing E Antonazzo, A Scott, D Skatun and RF Elliott (2003), "The Labour Market for Nursing: A Review of the Labour Supply Literature" *Health Economics*, 12, 2003, 465-478; and MA Shields, *The Global Shortage Of Registered Nurses: What Can Policy-Makers Learn From The Econometric Evidence On Nurse Labour Supply?* Melbourne: Report Prepared for the Victorian Department of Treasury and Finance, 2003.

³⁸ A L Booth & P Katic, *Estimating the Wage Elasticity of Labour Supply to a Firm: What Evidence Is There for Monopsony?*, Bonn: IZA DP No. 5167, September 2010

³⁹ M Evers, R de Mooij and D van Vuuren, The Wage Elasticity of Labour Supply: A Synthesis of Empirical Estimates, *De Economist*, 2008, 156:25-43, DOI 10.1007/s10645-007-9080-z

⁴⁰ O Bargain and A Peichl, Own-wage labor supply elasticities: variation across time and estimation methods, *IZA Journal of Labor Economics* 5:10, 2006, 1-31, DOI 10.1186/s40172-016-0050-z

when labour markets are tight and vacancies high is the time when it is most likely that higher wages will lead to rising employment.

State income and product

A fifth effect of a removal of the salary cap would be an increase in state income, consumption and product. In June 2021, the 431,350 people employed in the NSW public sector were equivalent to 360,190 FTE (full-time equivalent employees),⁴¹ and they reportedly received a median (full-time) remuneration of \$90,394 per annum.⁴² Median remuneration will be significantly below mean (average) remuneration, but information on means is not published. Across the economy, mean earnings are 19.3% above median earnings, but the gap is greater in the private than the public sector, with the gaps in the main public sector industries being 10.3% in public administration and safety, 10.1% in education and training and 16.9% in health care and social assistance,⁴³ with the first being the one used here to estimate mean earnings in the NSW public sector.

Multiplying the number of FTE by an estimate of mean FT remuneration (calculated as the reported median plus 10.3%) by 0.8% gives an increase in income for state employees of \$290 million above that of wage increases up to the current salary cap in one year, on the assumption of a 3.3% EBA increase. For a 4.3% EBA increase, the increase in remuneration would be worth \$650 million above the cap in one year. Increases would be significantly greater over three years. The above estimates are just in relation to existing employees, and take no account of increased employment due to a greater proportion of vacancies being filled. As at least 65% of gross personal income is spent personal consumption,⁴⁴ this is equivalent to an increase in state consumption of \$190 million to \$420 million under those two scenarios. The increase in state product would then depend on the multiplier effect of this increase in state consumption.

All the effects on state income, consumption and employment mentioned here derive solely from the higher earnings of existing employees in the state sector. Again, to these impacts would need to be added the more difficult-to-quantify effects on state incomes, consumption and product of higher wages in the private sector and of increased employment in the public and private sectors. These things could potentially be greater than the effects arising simply from the higher incomes of existing employees in the state sector.

Service quality

Finally, it could also be expected that there would be an improvement in the quality of services provided by the public sector. It is widely acknowledged that higher wages are associated not just with an increased quantity of labour but also an increased quality of it — employers experience not only lower labour turnover and absenteeism, but also higher

⁴¹ Of these, 127,521 worked in the NSW Health Service, 71,415 in teaching, 49,484 in the NSW public service, 21,041 in police, 14,562 in transport and 46,737 in other Crown services.

⁴² NSW Public Service Commission, *Workplace Profile Report 2021*, State of New South Wales, Sydney, 2022.

⁴³ ABS, Cat No 6333.0 Characteristics of Employment, Australia, August 2021, Table 3.1 Distribution of weekly earnings for employees by industry, December 2021.

⁴⁴ Calculated using ABS Cat No 5206.0 Australian National Accounts: National Income, Expenditure and Product, Canberra by T Henderson & J Stanford, *False Economics*, Canberra: Centre for Future Work, 19.

productivity and quality of work, as employees are more motivated and put more effort and care into their work. This is why some employers choose to pay higher wages — they are after this combination of commitment and performance from employees. The impact on public services in NSW would vary according to the work area, and for the occupations mentioned above could include better health care, improved policing, and higher quality teaching, in turn with positive implications for the death rate, crime rate and educational quality of the population.

Conclusions

In recent years there has been a slowing rate of growth in nominal and real wages, more severe than has occurred on average across the OECD. Real wages have fallen in six of the past seven quarters, despite growth in labour productivity. The latest forecasts, issued by the Reserve Bank, are for further declines in real wages. Maintenance of the NSW public sector salary cap would see significant drops in the real wages of NSW state public sector occupations such as nurses, paramedics, teachers, bus drivers, prison officers, and police. These real wage cuts would be even greater than those applying to the rest of the workforce. Unusually, this comes at a time when the economy is experiencing strong economic and employment growth. The number of job vacancies is at a record high. The number of unemployed people per job vacancy (the U:V ratio) is at a record low. In such a tight labour market, we would expect to see employers competing aggressively to offer higher wages to attract workers to fill those vacancies. The low growth of wages suggests that this is muted at best.

It is clear that the labour market has changed, in a major way. Wage norms have declined, and one of the factors in that decline in the last decade has been public sector salary caps that have prevented wage increases above a defined amount. Abolishing the salary caps would raise wage norms in both the public and private sectors to varying degrees. It would also enable the filling of many current and future vacancies, by attracting more people to apply for vacant jobs or to enter training for occupations in short supply. This is an issue not just for the immediate term, when real wage declines are forecast to continue, but also for the future, given the longer-term demand growth for several of the occupations, including nursing, within the public sector. Removing salary caps would also likely lead to higher employment, through that greater filling of vacancies, and job losses in part of the private sector would likely be offset by displaced people filling jobs already or foreseeably vacant. Removing salary caps could also be expected to lead to increased incomes, consumption, and state product and improved quality of public services, including in education, health and public safety.

Appendix A:

WAGE NORMS AND MONOPSONY: CONSIDERATIONS BEYOND PUBLIC SECTOR SALARY CAPS

1. *Influences upon wage norms*

The wage norm is fundamentally a concept about employers. This is not to say that it is uninfluenced by employees' attitudes or behaviour. Wage norms are heavily affected by what employers think they can get away with paying, and this in turn is shaped by employee resistance. When employees undertake industrial action, and withhold their labour until the employers agree to pay a higher wage, that helps establish a new wage norm. Indeed, the credible threat of industrial action, even if never realised, may be enough to maintain or increase the real value of the wage norm over time. In other words, power shapes wage norms.

Collective bargaining exists as a counter to monopsony — to employers' tendency to offer wages lower than marginal productivity — and raises wage norms. Collective bargaining is a way by which workers join into a collective of labour to bargain with a collective of capital called a corporation — individual shareholders know that they can make more money by being in a collective called a corporation than just trying to do something on their own with their money. The extent to which legal arrangements encourage or hamper collective bargaining, union organisation and the taking of industrial action all influence the level of wage norms.

Other institutions can set a reference point which is used to establish a wage norm. In Australia, award wages are determined by tribunals and these in turn set a reference point that many people use, some because they know it is the legal minimum and some because they think that, by definition, the award rate is 'fair'.

An important institution here is the public sector as employer, but this is discussed in the main text of this report and so not expanded upon here.

Other institutions, not all public, may also influence wage norms. For instance, when New Zealand's Employment Contracts Act was introduced in 1991, employer organisations (encouraged by the government and officials from its key departments) spread the idea that employers should reduce or abolish 'penal rates'.⁴⁵ This idea was particularly strong in the retail and hospitality sector and now penal rates have effectively disappeared from those sectors. A new norm was created, about an aspect of pay (the premium for non-standard hours) that was equivalent to lowering the wage norm.

Several influences on monopsony and hence wage norms relate to the way in which markets work. Some employers connive to prevent competition between them, through non-poaching agreements, or by forcing employees to sign non-compete clauses (which about 25% of current US workers are or were bound by).⁴⁶ This combination by employers is something even Adam Smith wrote about.⁴⁷ This

⁴⁵ The Australian term was 'penalty rates'. D Peetz, D Quinn, L Edwards & P Riedel, 'Workplace Bargaining in New Zealand: Radical Change at Work', in D Peetz, A Preston & J Docherty (eds) *Workplace Bargaining in the International Context*, Workplace Bargaining Research Project, Department of Industrial Relations and Australian Government Publishing Service, Canberra, 1993, 195-328.

⁴⁶ AB Krueger and EA Posner 'A Proposal for Protecting Low-Income Workers from Monopsony and Collusion', Washington DC: Hamilton Project, February 2018, 8.

⁴⁷ A Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, University of Michigan Library, 2007 Reprint of the 1776 London edition, 81. <http://name.umdl.umich.edu/004861571.0001.001>.

does not require formal collaboration. In most labour markets, some firms are just larger than others. Some firms dominate. Moreover, workers cannot move jobs seamlessly. Some vacancies are not seen. There are barriers to information about wages. Even if the alternatives would be better paid, there are opportunity costs to job search, and to actually moving jobs. Childcare might be difficult. All these and other barriers increase employer opportunities to lower wages further below a perfect-competition market-clearing level — that is, to establish lower wage norms.

The macroeconomic circumstances of labour markets also influence wage norms. Labour shortages may be another mechanism that influences employers to believe that they should pay more for a particular type of labour. If many employers are competing for the same labour, this may increase the wage that employers believe they need to pay for that labour.

But while supply and demand influence wages, there are many factors that prevent employers from raising or lowering wages in line with movements in supply and demand. While the perfectly competitive model of the labour market would suggest wages would go up and down quickly, this is rarely the case. Employers do not suddenly drop wages when there is a fall in labour demand (or a surge in labour supply) because it would alienate the existing workforce, causing one or more of absenteeism, quits, a drop-off in productivity or product quality and/or industrial action. This is referred to as ‘downward wage stickiness’. But employers are reluctant to substantially increase wages as well when labour shortages occur. One factor may be the implications for the existing workforce. If high wages are offered to attract new recruits, and they are flowed on to the rest of the workforce, the costs could be prohibitively high and damage profits. But if they are not flowed on, they can cause resentment in the existing workforce, manifest again as absenteeism, quits, a drop-off in productivity or product quality and/or industrial action. So employers will often use non-wage means of trying to deal with labour recruitment issues (one-off bonuses, secret payments, over-classification, promotion promises, payment of matters like tuition fees, spousal expenses or the like).

2. *Changing Wage Norms*

First and foremost among the factors leading to diminishing wage norms has been the decline in the power of organised labour. Union membership fell from one half of the workforce in 1980 to one seventh in 2020, and was its lowest in over a century. The rate of industrial disputation fell from 649 to 11 working days lost per thousand employees between 1980 and 2020, and was also at its lowest in over a century. This decline in industrial disputation reflects the reduced confidence and power of workers to undertake industrial action. Reducing the power of organised labour shifts wage norms downwards over the medium term.

Related to this is the high level of insecurity of work, which reduces workers’ power. Workers face casual employment, contracting, labour hire, franchises, and underemployment. However, these things do not increase indefinitely. Some manifestations of insecurity have built-in limits to them, because it is against the interests of individual employers to go further. For example, while casual employment rose substantially in the 1980s and 1990s, it has been fairly stable overall since the 2000s. The rise in casualisation reaches a limit because casualisation makes for low commitment by employees and it limits employers’ ability to get workers to do what they want. That is, it limits control. If employers cut job duration too short, employees become too focused on external labour markets and not enough focused on employers’ internal labour markets. Employers do not want everyone to be a casual or to be in a job for only a few months, as it goes against employers’ individual interests.

Labour market monopsony is increasing. An Austrian study suggests that just one aspect of it accounts for two fifths of the decline in the wages share there over two decades.⁴⁸ Other overseas research also points to increasing domination by a small number of buyers of labour—that is, employers.⁴⁹ In Australia, Treasury has estimated that job switching has reduced and it attributed the decline in wages growth to this phenomenon.⁵⁰ A decline in job switching, after controlling for other factors, is symptomatic of rising monopsony. More monopsony means lower wage norms.

The character of monopsony is changing — from what can be called simple monopsony, in which large firms do the hiring, to agentic monopsony, in which agents, or peripheral firms, are responsible for labour.⁵¹ The manifestations of this phenomenon vary between sectors and industries. These can include franchises, spinoffs, contractor firms, owner drivers, homeworkers, subcontractors and so on. Atkinson called it the flexible firm.⁵² David Weil called it the fissured workplace.⁵³

Peripheral firms frequently compete with each other on cost. The cheapest bidder wins the contract. So at that end of the supply chain, competition is more severe, and focused on cost reduction. The firm that chooses to offer the lowest wages wins the tournament, and their competitors aim to replicate that strategy for the next tournament. Firms have to offer low wages, because they are now competing against each other on price, in the face of financialisation and government market reforms of the past, and in the environment of new product market strategies by large corporations. At the top of a product market, a small number of firms are able to increasingly dominate. They move closer to monopolies in their own product markets, but require increased product market competition from their suppliers. The competition between suppliers is a way for the core firm to get access to labour at the lowest price. In effect, the peripheral firms are agents for the core firm, they are a way by the which the core firm can offer a very low wage for labour — and it is not required to take on the human resource management responsibilities, or liability if the work is offered at an illegally low rate. Monopsony power for the core firm exists *even when* there is the appearance of many competitors attempting to purchase labour.

Some may have thought that competition between employers would boost wages. But these firms are competing to sell products, often to large firms who dominate markets. Those large firms insist on the cheapest goods, and either implicitly or explicitly demand their suppliers pay low wages. So farmers complain about labour shortages, but will not pay higher wages to attract the workers. They will not because they want to keep their contracts with large retailers. As one farmer said recently, ‘our price of fruit, what we sell to the retailer, it hasn’t changed in quite some time, but all our costs have’.⁵⁴

⁴⁸ G Jarosch, JS Nimczik and I Sorkin, *Granular Search, Market Structure, and Wages*. IZA Discussion Paper No 12572. Bonn: IZA Institute of Labor Economics, 2019.

⁴⁹ D Autor, D Dorn, LF Katz et al., Concentrating on the Fall of the Labor Share. *American Economic Review* 107(5), 2017, 180-185.

⁵⁰ N Deutscher, *Job-to-job transitions and the wages of Australian workers*. Treasury Working Paper 2019-07. Canberra, November 2019.

⁵¹ D Peetz, Collective bargaining and unions – still an effective tool for determining wages, hours and working provisions?, CLEW Symposium, Wellington, 14 April 2021, https://www.wgtn.ac.nz/_data/assets/pdf_file/0004/1932817/Peetz_Collective-bargaining-and-unions_text.pdf

⁵² J Atkinson, ‘Manpower Strategies for Flexible Organisations’. *Personnel Management*, 1984, 28–31

⁵³ D Weil, *The Fissured Workplace: Why Work Became So Bad for So Many and What Can Be Done to Improve It* Cambridge: Harvard University Press, 2014.

⁵⁴ Daniel Niceforo, interviewed on Jane Bardon, ‘Farmers want solution to labour crisis’, *AM*, ABC Radio, 9 May 2022, <https://www.abc.net.au/radio/programs/am/farmers-want-solution-to-labour-crisis/13872706>.

3. Means of Reversing the Decline in Wage Norms

To the extent that lower wage norms result from greater tendencies towards concentration and monopsony in labour markets, policy can tighten competition policy, making it harder for corporations to increase the concentration of product markets. The logic of capitalism, however, which is towards increased monopolisation of product markets, will make this challenging, though no less necessary. Anyway, as mentioned high apparent competition can coexist with market concentration. Laws limiting or prohibiting formal or informal non-compete agreements between employers would reduce monopsony tendencies in labour markets. Reducing barriers to labour mobility, for example through relocation and retraining assistance, universal provision of child care, and tighter restrictions on bad employer behaviour (a spouse will be less willing to leave a job and move cities if she fears discrimination in a new labour market) would reduce some of the natural forces promoting monopsony.

As power in the workplace is a key driver of wage norms, then changes to the laws shaping that power will influence wage norms. These include laws affecting the capacity for employees to engage in collective bargaining, the methods by which collective agreements are reached and implemented, the ability of employees to establish, join or be active within trade unions, the rules surrounding the taking of lawful industrial action, the conditions under which workers are classed as permanent or casual employees or contractors, the treatment of workers in the 'gig economy', the situations in which labour hire is permitted and the conditions under which it occurs, and the minimum conditions of employment available to employees.