

Viewpoints: should the government intervene to fix low wages?

Written by James Morley, Professor of Macroeconomics, University of Sydney

There have been a few suggestions lately on what policies the government should take up in order to fight slow wage growth.

Former Prime Minister [Paul Keating suggested](#) the superannuation guarantee – the amount employers must contribute to workers' super – be increased to 12% to compensate workers for a lack of wages growth.

While the Australian Council of Trade Unions [is calling on the government](#) to lift the minimum wage and “recalibrate” the industrial system to ensure fair incomes for workers.

In this Viewpoints, James Morley argues government intervention could cause unforeseen problems, while Beth Webster notes the need for the government to re-balance the economy.

James Morley: Slow wage growth reflects two key aspects of [the “secular stagnation” phenomenon](#) sweeping the industrialised world: low productivity growth and low inflation expectations. Addressing slow wage growth should go to these causes, not to the symptom.

If the government was to intervene directly in the setting of wages to increase their growth, it would be reminiscent of the wage/price controls put in place in many countries in the 1970s. These were an attempt to stem high inflation by mandating exactly how wages and prices could be set. They were a mistake [then](#) and would be a mistake now, even if only for wages and not prices.

Read more: [The benefits of job automation are not likely to be shared equally](#)

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One problem is that such policies distort what is already the most complex of all economic markets - the labour market. “Insiders” (those with steady jobs) might win something on a one-off basis with higher wages. But “outsiders” (those without jobs or changing jobs) will surely lose, as firms ration labour given too many controls.

The labour market is notable for its complicated contracts designed to encourage high performance and effort. Because of these contracts, and issues such as confusion about adjusting wages for inflation (a surprisingly high proportion of wage changes are exactly zero, even though it makes no economic sense), wages already do not adjust enough as it is.

These distortions occur even though the labour market has high turnover rates, with flows between jobs vastly outnumbering flows between employment status. Introducing more controls would put sand in the wheels of the labour market by distorting relative wages across industries and decreasing employment.

Beth Webster: A well-functioning economy is all about balance. In Australia, we have a situation of profits being a high share of GDP, low wage growth, low investment spending and low interest rates. The problem is not inflation, but a lack of willingness by people with incomes to buy goods and services.

It's not a problem of lack of funds for investment. Nor is it a problem of high labour costs.

[Economists know](#) that a reliable way to increase spending in the economy is to raise the incomes of the least wealthy. In our case, this could involve enforcing the payment of the minimum wage (for example, in the hospitality industry); raising benefits and pensions, such as unemployment and family benefits; and tax cuts at the low end.

Read more: [*Is faster profit growth essential for a pick-up in wages growth?*](#)

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[There is ample evidence](#) that a market economy will not invest enough to fully employ all people who want a job, if left to its own devices. The result is low productivity growth and a boom-bust economy. So government action is warranted, and that depends on the position of the economy.

Given the current economic settings, a rise in wages at the low end of the market could lead to higher investment and therefore employment (with the bonus of higher productivity growth). And it may well move towards income equality.

James Morley: I agree that government policy can be important to stimulate a weak economy. But its [effectiveness depends on exactly how much slack there is in the economy](#). Currently, increased government spending or tax cuts are unlikely to be as stimulative, as they would be in a weaker economy.

To address low productivity growth, it's better to go to the underlying determinants of labour productivity. The Productivity Commission investigates what these are and makes recommendations based on their findings. Notably, it explicitly [recommends against a re-balancing between regulation and flexibility in the Australian labour market](#).

The commission is now examining [access to higher education](#). It will be interesting to see the findings on this.

It's worth noting that the shares of GDP to labour and capital have been quite stable in Australia at around 55% and 45%, respectively, over the past 40 years. This stability is exactly as predicted by the [Solow-Swan model of economic growth](#). This model also suggests that lower productivity growth, rather than changes in income shares, has been more important for the recent slow wage growth.

Another cause of slow wage growth is low inflation expectations. Responsibility for addressing this lies with the Reserve Bank of Australia, which has been [factoring low wage growth into its recent decisions to keep interest rates low](#).

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Beth Webster: There is has been a trend of falling wages as a share of GDP in Australia. [According to the ABS](#), in 2016-17, wages as a share of GDP was only 52.8%, which continues the long term decline from 57.1% in 1984-85. A difference of 5 percentage points is huge.

With [730,400 unemployed people](#) and about an equal number who would like to work more hours, there is a strong case for saying we have a weak economy.

The market is not delivering the balance of demand and supply forces that we need to achieve full employment and raise GDP. Government intervention is needed.

James Morley receives funding from the Australian Research Council.

Beth Webster receives funding from the ARC and the Victorian Department of Industry.

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