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President Gerardine (Ged) Kearney
Secretary Dave Oliver

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Justice Iain Ross, AO
President
Fair Work Commission
Level 4, 11 Exhibition Street
Melbourne Vic 3000

Dear Justice Ross

Thank you for the opportunity to appear at the consultations for the Annual Wage Review 2013-14 on 20 May. During the consultations, we took a question from Professor Richardson on notice. Our answer appears below.

The question appears at paragraph number 343 of the transcript of proceedings:

> PROF RICHARDSON: *Thank you. Just one more question, I think it's the Commonwealth, forgive me if it's another party, but I make the point that the amount of increase in labour productivity that can be reasonably shared with labour is reflected in movements in the wage price index. I'd just be interested if you have given that point any thought and, if you have, what your response might be.*

We understand that Professor Richardson's question pertained to the post-Budget submission by the Australian Chamber of Commerce and Industry (ACCI) at page 12. The relevant passage of the ACCI submission reads:

> *As ACCI emphasised in its initial submission, the appropriate relationship between productivity growth and wages is complex and is often best interpreted through the response of the broader economy as measured in the Wage Price Index.*

It is not clear to us exactly what ACCI is arguing when it says the "appropriate relationship between productivity growth and wages… is often best interpreted through the response of… the Wage Price Index."

The WPI controls for compositional change in the labour market. Commonly-used measures of labour productivity (such as GDP per hour worked) do not. Where there is a shift over time towards higher skilled jobs, this will be reflected in higher labour productivity but not necessarily higher WPI growth.

Growth in the WPI is only relatively weakly correlated with labour productivity growth. Since September 1997 (when the WPI began), labour productivity as measured by real GDP per hour worked has risen by 28.4%. Over the same period the real WPI, deflated by the GDP chain price index, has risen by 6.6%. The real WPI, deflated by the Consumer Price Index, has risen 11.8%.

The National Accounts already includes a measure that provides a clear, succinct summary of the relative rate of growth in labour productivity and labour costs. This measure is real unit labour costs. When the real average cost of employing an hour of labour rises faster than the value of what is produced in an average hour of work, real unit labour costs will rise. Conversely, when labour costs do not keep pace with labour productivity, real unit labour costs will fall.

Real unit labour costs have fallen over the past decade, including a fall in 2013. This is shown at chart 5.2 of the FWC Statistical Report and is discussed in our main submission from paragraph 203. We submit that the relative rate of growth in labour productivity and wages (as the main component of labour costs) is best assessed by reference to movements in real unit labour costs as recorded in the National Accounts.

Yours sincerely,

Tim Lyons
Assistant Secretary