# Canada needs to address a weak wage-growth conundrum

By Craig Alexander
October 18, 2018 – *The Globe and Mail*

The unemployment rate may be close to a four-decade low, but wage growth is surprisingly absent in today's job market. Average hourly wage growth for permanent employees has dropped steadily over the past four months and in September was only 2.17 per cent above its year-earlier level. This is below the rate of inflation, meaning that living costs are rising faster than wages.

Many economists have long believed there is an inverse relationship between the unemployment rate and wage growth. It makes perfect sense since an increasing scarcity of workers should mean that firms raise wages to competitively attract talent to their company. So why isn't this happening?

It is not one, but rather several forces that are restraining wage growth.

First, there may be more slack in the labour market than the low unemployment rate suggests. In resource-rich provinces, unemployment rates remain higher than before the commodities crash in 2015. So, the pool of available workers varies across the country.

Second, demographic factors could be having an impact. Baby boomers are retiring, but they are living longer, healthier lives, so could be re-entering the labour market, creating a hidden source of labour supply. Older, higher-paid baby boomers are also leaving and are being replaced by younger, lower-paid individuals. This demographic churn is always transpiring, but the baby-boom cohort is very large, with the result that their retirement could affect wage numbers. Meanwhile, a rising share of labour-force growth is coming from immigration, but immigrant skills, education and experience are not properly valued in the Canadian labour market. The immigrant wage gap could be pulling down wage growth.

Third, workers have limited bargaining power. There are many reasons for this.

Technical change may be creating a skills mismatch challenge. Many businesses are reporting that they cannot find the high-skilled workers they need, but the decline of jobs in traditional sectors, such as manufacturing, has created a pool of middle-skill workers that are unemployed or underemployed. It may be the case that high-skill workers are seeing wage gains, but limited wage gains for middle-skill workers are pulling down wages nationally. Meanwhile, low-skill workers are experiencing compensation growth from higher minimum-wage rates.

Globalization now means that there is a global pool of workers, not a domestic pool. So, you can have tight domestic labour markets but little wage growth because there are workers abroad that can be hired. Globalization has also increased competition between firms, with the result that companies are constantly looking to keep costs down even during good economic times.

The changing nature of jobs is also at play. There has been an increase in gig, temporary, contract positions. These jobs may not have the bargaining power of permanent positions.

Fourth, labour compensation should reflect the productivity of workers, reflecting how much a worker can produce or deliver in services for every hour of work. Regrettably, Canada has a productivity-growth problem, so weak wage gains reflect Canada's poor innovation and competitiveness performance.

Put it all together and the assessment is that tectonic forces of technical change, globalization, demographics and competitiveness are all acting to constrain wage growth. And the first three of these forces cannot be reversed, so Canada must adapt.

How should policy-makers respond?

Monetary policy has been supporting workers. Weak wage growth has limited the risk of inflation, so the Bank of Canada has kept interest rates low even as unemployment dropped significantly.

However, more could be done to improve wage prospects. Up-skilling the work force to better match the skills required by businesses would help. For youths, more co-op and apprenticeships could aid skill development by creating practical work experience. For adults, more and better training programs are called for. Efforts to reduce the immigrant and gender wage gap would be beneficial. And policies aimed at boosting Canadian business competitiveness could produce more wage growth. This would include incentives to invest in machinery and equipment and setting competitive tax rates. The Canadian experience has been that higher labour productivity does indeed lift compensation growth.

The laws of economics have not been repealed. In the Deloitte Economic Outlook published this week, we project an improvement in wage growth next year, but the pace of compensation gains will be modest. If Canada wants its workers to have a better outcome, it needs investments in skills and productivity-enhancing capital.

*Craig Alexander is chief economist at Deloitte Canada.*