

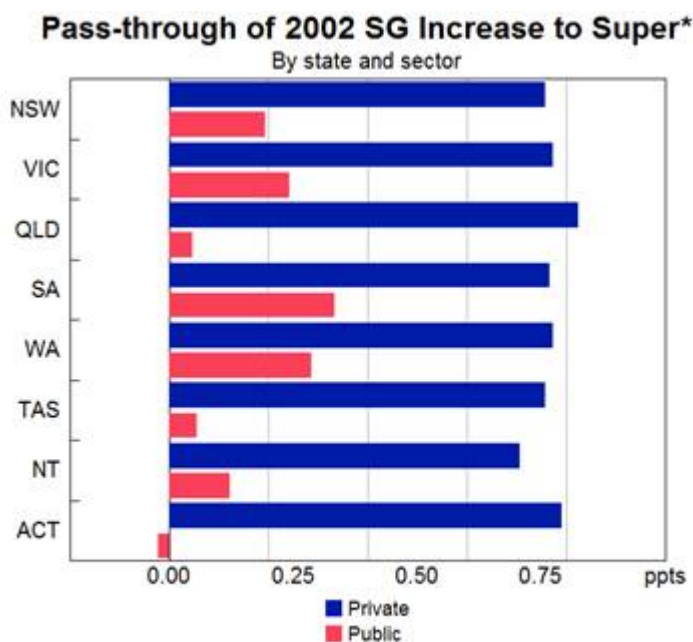
From: BISHOP, James
Sent: Thursday, 16 January 2020 10:16 AM
To: NUGENT, Taylor
Cc: CASSIDY, Natasha
Subject: Pass through of SG in the public sector [SEC=UNCLASSIFIED]

Hi Taylor,

A little-known fact about the WPI survey is that it used to collect information on super, payroll taxes and workers comp. These 'non-wage' indices were collected from 2001/02, but discontinued in 2011.

These data might be useful for thinking about the impact of the planned SG increases. Data from the early 2000s suggest that the rise in the SG from 8% to 9% was largely passed through to super payments across the private sector (graph). Pass-through was noticeably lower in the public sector, which may reflect that many governments were already paying >9% or using DB pension schemes. It's possible that pass-through in the public sector has risen over time – given the shift to DC pension plans – but I think this gives further support to the assumption that the legislated increase won't actually bind for much of the public sector. The slightly less-than-full pass through in the private sector is also interesting, and might explain why Grattan estimate less-than-full pass through to wages ...

James



* Full pass through is a 1ppt increase
 Sources: ABS, RBA

THE EFFECT OF THE INCREASE IN THE SUPERANNUATION GUARANTEE ON WAGES GROWTH

The Superannuation guarantee is legislated to increase from mid 2021...

The super guarantee is legislated to increase from its current level of 9.5 per cent of ordinary time earnings to 12 per cent by 2025. The adjustment will be phased, with 0.5 percentage point increases on 1 July each year, beginning on 1 July 2021 and ending on 1 July 2025.

Given that these policy changes now fall within our forecast horizon, this brief note details our proposed approach to incorporating them into our forecast for wages. A more detailed note will be sent to a broader audience after the forecast implications are considered.¹

The increase will be largely passed through by lower wage increases from 2021...

The timing and size of any pass through from a higher super guarantee into wages growth is inherently uncertain. The literature tends to find that most of the cost of an increase in mandated benefits gets passed on to employees in the form of lower wage rises. One reason is that labour supply is generally found to be less price elastic than labour demand, especially in the long run. As a result, any 'wedge' driven between cost to employers and the benefit to employees will fall mostly on employees. In addition, super is a benefit employees value, so aggregate labour supply is likely to increase when that benefit becomes more valuable.

Historically, the consensus among Australian policy makers has been that super contributions are paid for out of wages growth. The Treasury also generally expects pass through to wages in their analysis of retirement funding adequacy. The Treasury's approach to incorporating the super guarantee increase into their wages forecasts is yet to be determined, as it remains outside their budget forecasting horizon.

There has been little domestic empirical work into the effect of superannuation on wages. Part of the reason for this is the difficulty in separating the effect of the super guarantee from other determinants of wages growth. Recent studies by the McKell Institute ([Taylor 2019](#)) and the Centre for the Future of Work at the Australia Institute ([Stanford 2019](#)) argue that an increase in the guarantee does not affect wages. Both use time series models in support of their conclusions. Stanford, uses annual data and the analysis suffers from wide confidence bands, while Taylor uses quarterly data and looks for complete pass-through in the September quarter, which misses the staggered nature of wage setting.

In a forthcoming paper, Grattan Institute use the enterprise agreements data from the Attorney-General's Department's Wage Agreements Database to suggest that around 80 per cent of any increase in the guarantee is passed through into lower wage increases.² The authors regress average annual wage increases in enterprise agreements on the annualised size of any increase in the guarantee occurring during the life of the agreement and a range of control variables. The finding is stable across a range of model specifications.

We broadly support the methodology used by Grattan Institute and use it as our baseline assumption for the private sector. It is likely we will revisit our current assumptions sometime over the year ahead, as well as incorporate any information from liaison (to date, there has been nothing noted from contacts).

Private sector

Given that PWL's wage Phillips curve models do not 'see' the forthcoming increases in the super guarantee, we propose adjusting the model forecasts (including judgement) downwards. Graph 1 shows two alternative assumptions for the effect of the super guarantee increases on quarterly private WPI growth.³ Long-run wages levels under each of these profiles are about 1.75 per cent below what they otherwise would have been.⁴

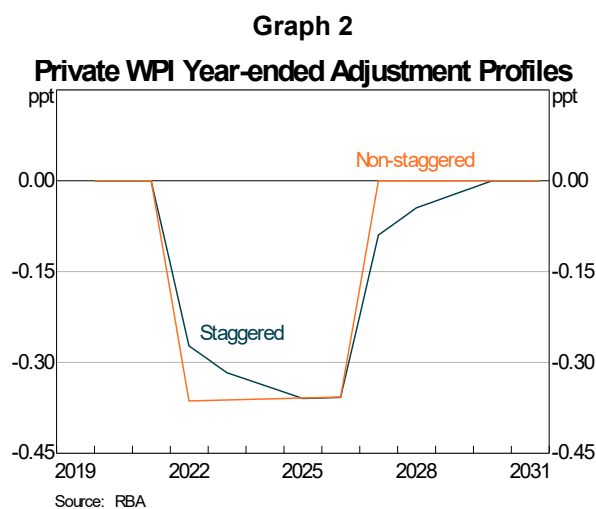
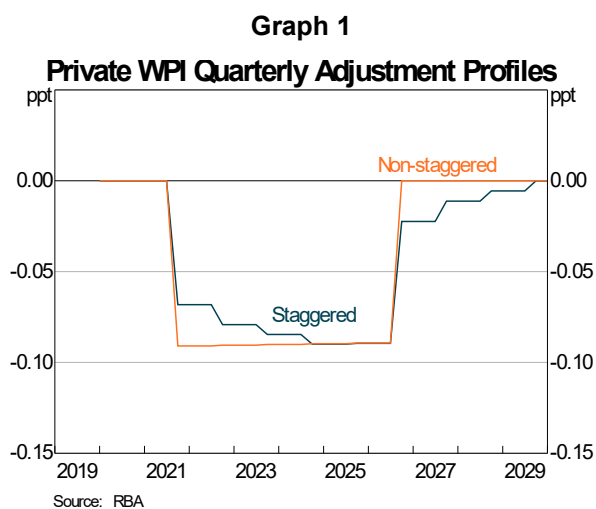
1 The increases are currently legislated. Having said that, the government has previously delayed the increase to the guarantee, and a review into retirement incomes is currently being undertaken by the Productivity Commission.

2 These estimates only pertain to pass-through over the life of an EBA agreement; pass-through in the long run will be higher if firms make adjustments in subsequent EBAs.

3 Both profiles assume the effect on wages growth is distributed uniformly across all quarters in each financial year. Although most wage adjustments tend to occur in the September quarter, these will be spread out by seasonal adjustment.

4 Even with full pass through, a 1 percentage point increase in the super guarantee will not lead to a 1 per cent decline in wages. The effects are nonlinear. To keep labour costs constant from time $t-1$ to time t , the current wage would need to decrease by $\left(\frac{1+SG_{t-1}}{1+SG_t} - 1\right) \times 100$, where SG_t is the superannuation guarantee rate at time t . For example, full pass through of the scheduled 2½ percentage point increase in the super guarantee between 2021 and 2025 would entail a 2¼ percentage point fall in wages.

1. **Non-staggered:** Assumes 80 per cent pass through in the year following the increase. This would shave 0.36 percentage points from year-ended private WPI growth in June 2022.
2. **Staggered:** Assumes a more gradual pass through, with 60 per cent occurring in the first year, a further 10 per cent in the second year, and an additional 5 per cent in each of the third and fourth years. This would shave 0.27 percentage points from year-ended private WPI growth in June 2022.



Our central forecast is for a more staggered pass through. The presence of nominal and real downward rigidities could mean that for those on wage freezes or receiving low increases, pass-through via lower wages growth could take more time. The international empirical literature is also consistent with lower pass-through to wages in the short run than would be expected in the longer run.

In each of these profiles, there is a risk that wage outcomes are lower in advance of the increase as firms preempt the policy change. This would pull forward the effect on wages growth. We implicitly assume that only wage changes after the policy change will be affected. Instead, it could be the case that wage increases in the lead up to the increase in the guarantee will be lower to reflect the fact that part of the period before another wage adjustment will have higher employer super payments. So far, liaison evidence suggests that the policy change is not an active consideration for firms.

Another key uncertainty is whether the higher labour costs will affect the wages of award-reliant jobs (13 per cent of the wage bill). Although firms cannot unilaterally lower the wages of award-reliant employees to offset a super guarantee increase, the FWC has tended to account for changes to the super guarantee when handing down their award wage decisions. For the purposes of our forecast profile, we assume the same pass-through to awards as other wage-setting methods.

Public sector

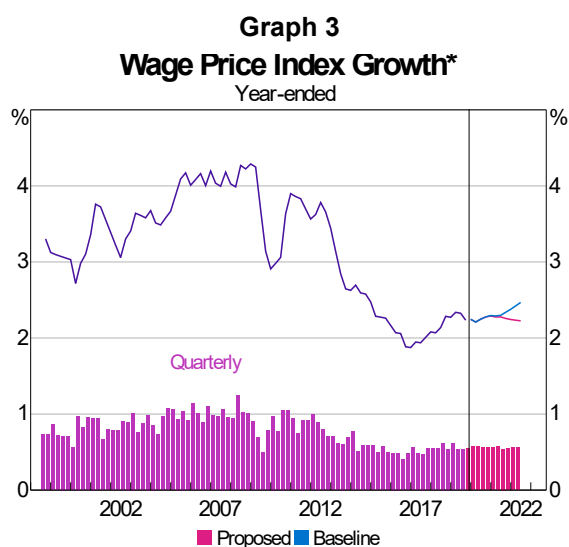
PWL's forecasts for public sector wages growth are based on EBA-level data for the public sector, rather than a Phillips curve ([Chan 2018](#)). To the extent that public sector EBAs have already 'priced in' the cost of the higher super guarantee in the form of lower wages growth, then this will already be captured in our profile.

For EBAs that are due to be renegotiated during the forecast horizon, we assume that new agreements will contain wage rises that are consistent with government wage policies (which in turn, could have been calibrated to account for the legislated super guarantee increases). In most cases, this means we assume no explicit wage offset from the higher super guarantee. This assumption reflects that federal employees, academics and many state government employees already receive above 12 per cent superannuation, which means they are already compliant with the legislated increases. Additionally, most state government wage policies exclude the legislated increases in the super guarantee from their wages growth caps. The main exception is NSW, where the 2.5 per cent wage growth cap applies to total employee compensation, including super. For NSW, we assume full pass-through to base wages, implying base wages growth of around 2 per cent for EBAs.

In general, the impact of the super guarantee on public wages is more uncertain than for private wages. Coates, Mackay and Cowgill's (2019) analysis excluded most state agreements (60 per cent of all public-sector

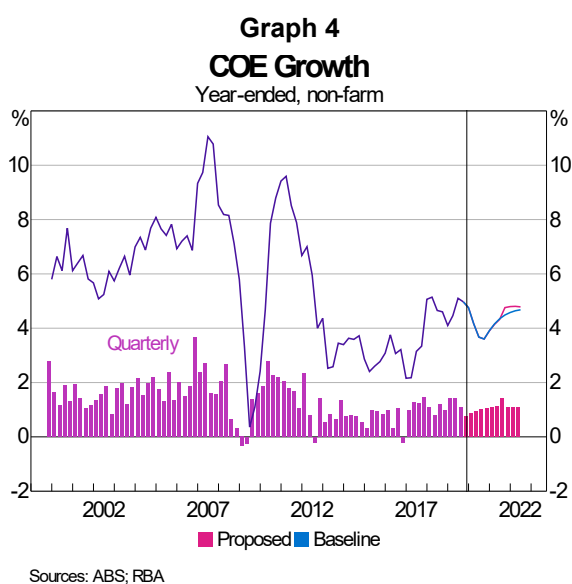
EBAs) due to data limitations, although they argue that pass through to public sector wages is likely to be one-for-one.⁵

The proposed forecast for total WPI growth is now a little lower



WPI growth is now forecast to be 2.3 per cent in 2020/21 and 2.2 per cent in 2021/22 (end of the forecast horizon; Graph 3). The small decline in WPI growth in 2021/22 is because the SG increase offsets the modest decline in labour market spare capacity on total WPI growth.

...although CoE is largely unaffected



Our forecasts for national accounts labour income measures build from the WPI profile directly. We forecast *underlying* AENA, which excludes employer social contributions (ESC)⁶ and so would be affected similarly to the WPI. We then make an offsetting adjustment to our projections for ESC to arrive at a COE forecast. We assume that, in the long run, pass through to ESC is only slightly higher than pass through to wages. However, in contrast to our assumption of staggered pass-through to wages, pass through to ESC is assumed to be instantaneous. This difference in the speed of pass through provides a small, short-run boost to COE relative to baseline of no SG increase. It is also worth noting that if pass-through to wages is less than we are expecting (holding pass-through to ESC constant), COE and ULCs will be higher than suggested by our current profile.

The implications for inflation and household spending...

A less-than-complete pass-through to wages growth results in a small boost to COE growth. There is uncertainty around how households' saving and consumptions patterns react to the increase in the SG, which requires further analysis.

Further, if there is less than complete pass through to wages growth, this will push up unit labour cost growth (although this won't necessarily flow through in our mark up model to after the forecast horizon).

5 In their sample of public EBAs (mainly federal agreements and state agreements for Victoria, ACT and NT) they estimated one-for-one pass through to wages. They also argue that there is no reason to expect that the effect on other state agreements will differ from this.

6 Compensation of employees is made up of wages and salaries and employer social contributions. Employer social contributions is almost entirely made up of employer superannuation payments.

Taylor Nugent/ Prices Wages and Labour Market Section
17 January 2020

PWL Forecasts

Domestic Forecast Meeting 21 January 2020

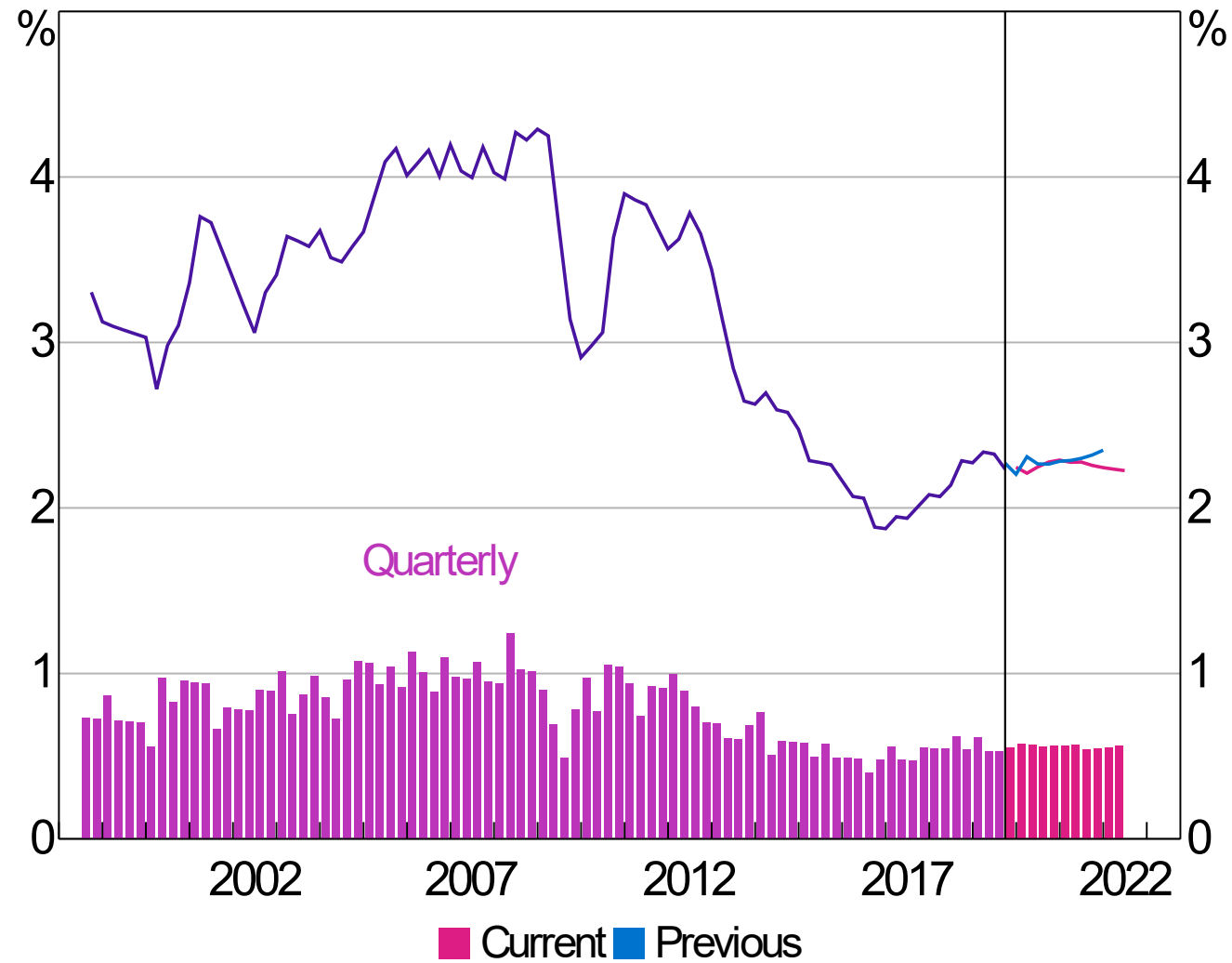
Summary

- Wages growth forecasts have been revised lower from mid 2021
... due to planned increase in super guarantee

Wages

Wage Price Index Growth*

Year-ended

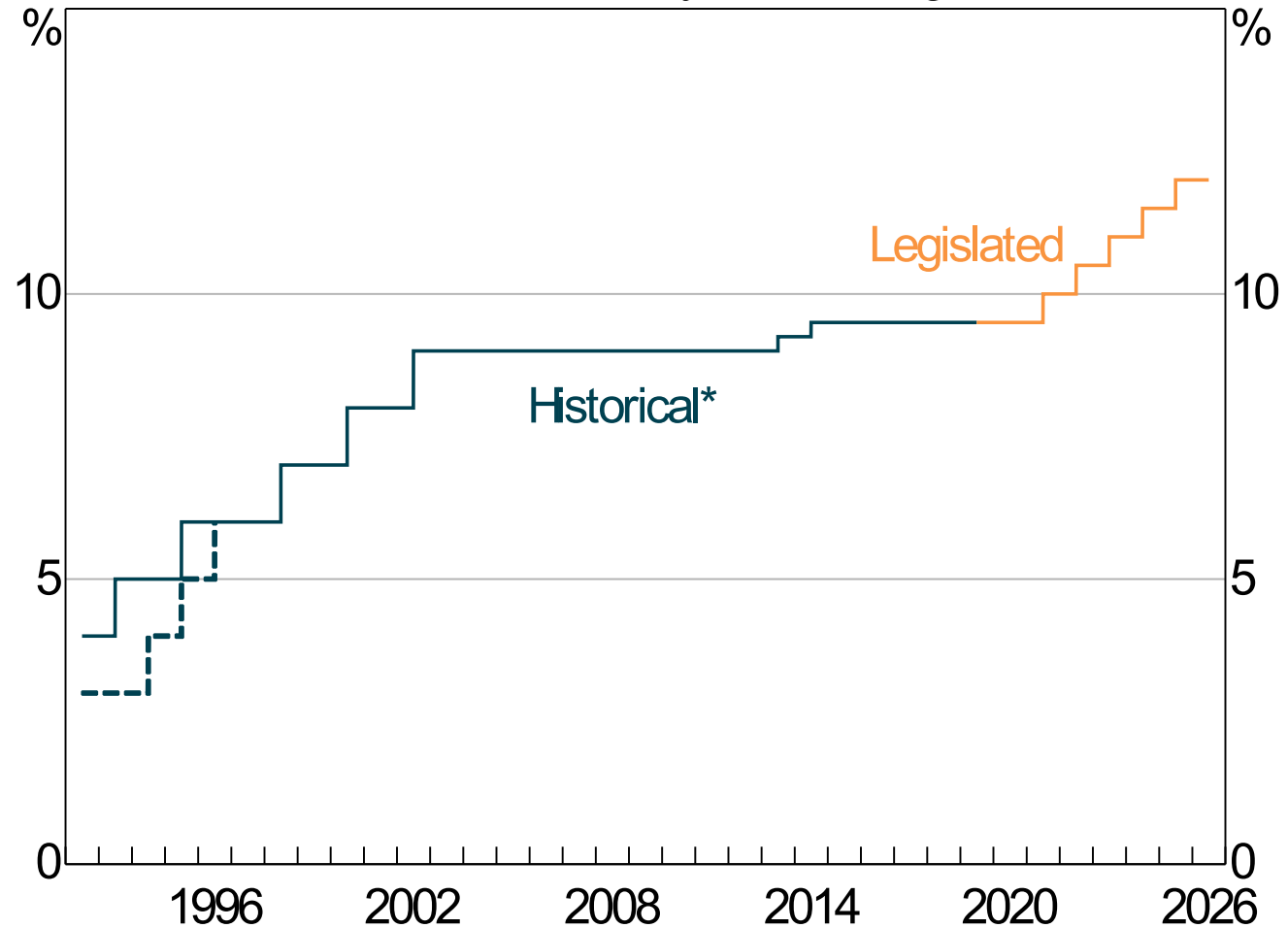


* Excluding bonuses

Sources: ABS; RBA

Super Guarantee

Per cent of ordinary time earnings



* Dotted line indicates lower rate for employers with a payroll below \$1 million in 1991-92

Source: Superannuation Guarantee (Administration) Act 1992

Rise in super guarantee

Private

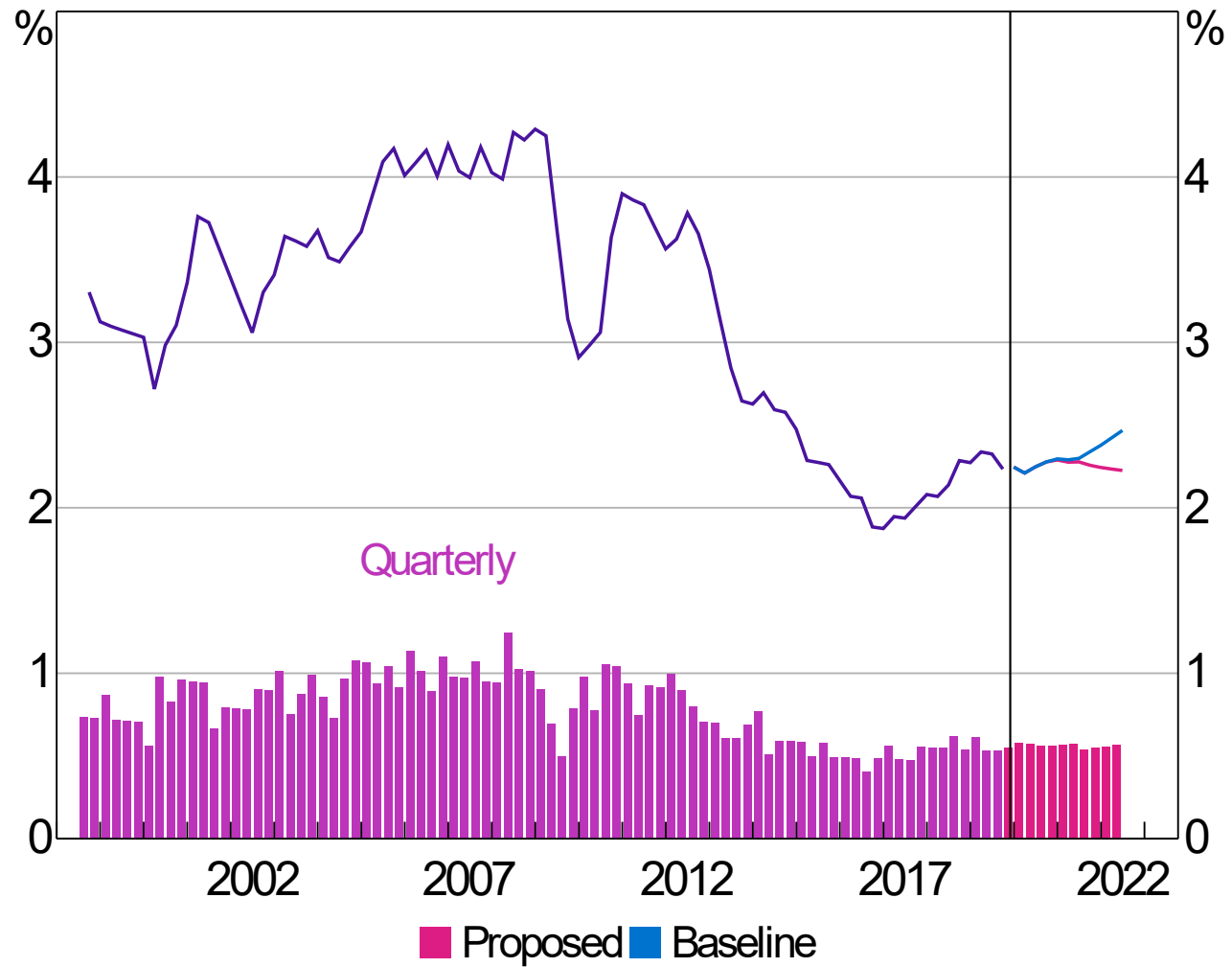
- 80 per cent pass-through to wages
 - Staggered over four years
- 90 per cent pass-through to super payments
 - Immediate

Public

- Smaller pass through due to existing benefits and wage policies

Wage Price Index Growth*

Year-ended



* Excluding bonuses

Sources: ABS; RBA

Rise in super guarantee

Private

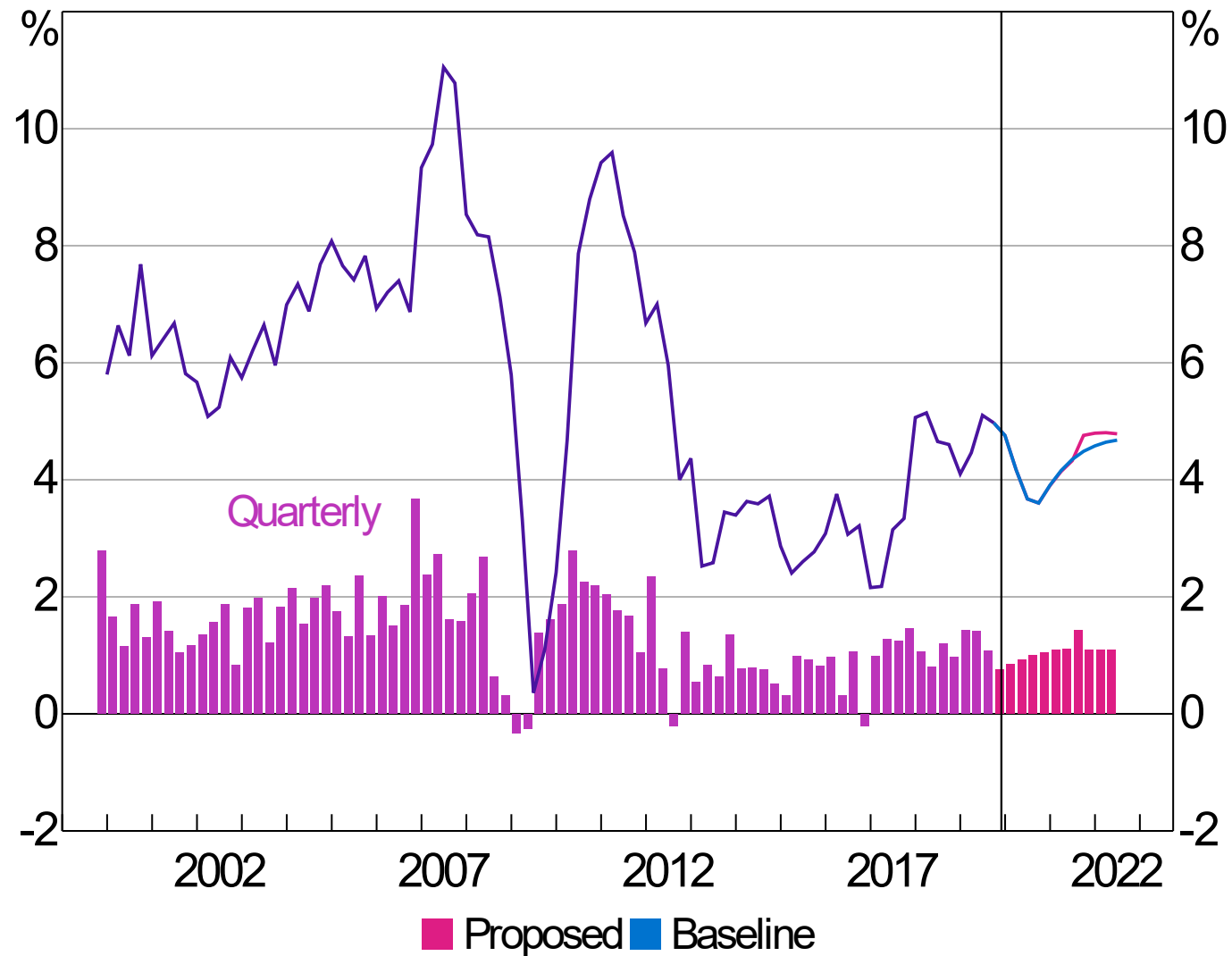
- 80 per cent pass-through to wages
 - Staggered over four years
- 90 per cent pass-through to super payments
 - Immediate

Public

- Smaller pass through due to existing benefits and wage policies

COE Growth

Year-ended, non-farm



Sources: ABS; RBA

Rise in super guarantee

Private

- 80 per cent pass-through to wages
 - Staggered over four years
- 90 per cent pass-through to super payments
 - Immediate

Public

- Smaller pass through due to existing benefits and wage policies

Appendix Table – February 2020

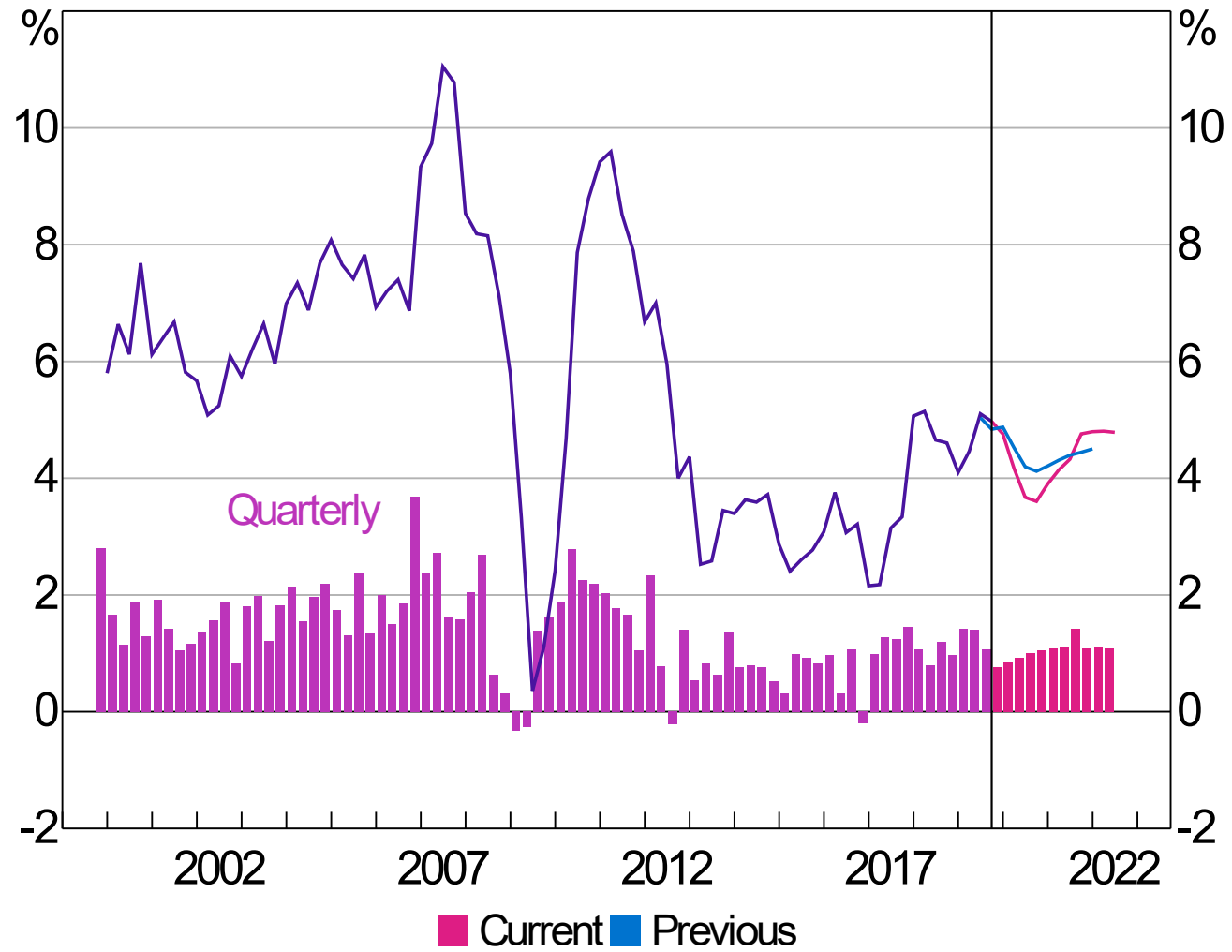
Percentage change over year to quarter shown, change from previous SMP in parentheses

	Dec-19	Jun-20	Dec-20	Jun-21	Dec-21	Jun-22
Wage price index	2.2 (0.0)	2.2 (-0.1)	2.3 (0.0)	2.3 (0.0)	2.2 (-0.1)	2.2 --
Nominal (non-farm) average earnings per hour	3.1 (0.5)	2.6 (0.3)	2.4 (0.0)	2.5 (0.0)	2.8 (0.2)	2.8 --

Spares

COE Growth

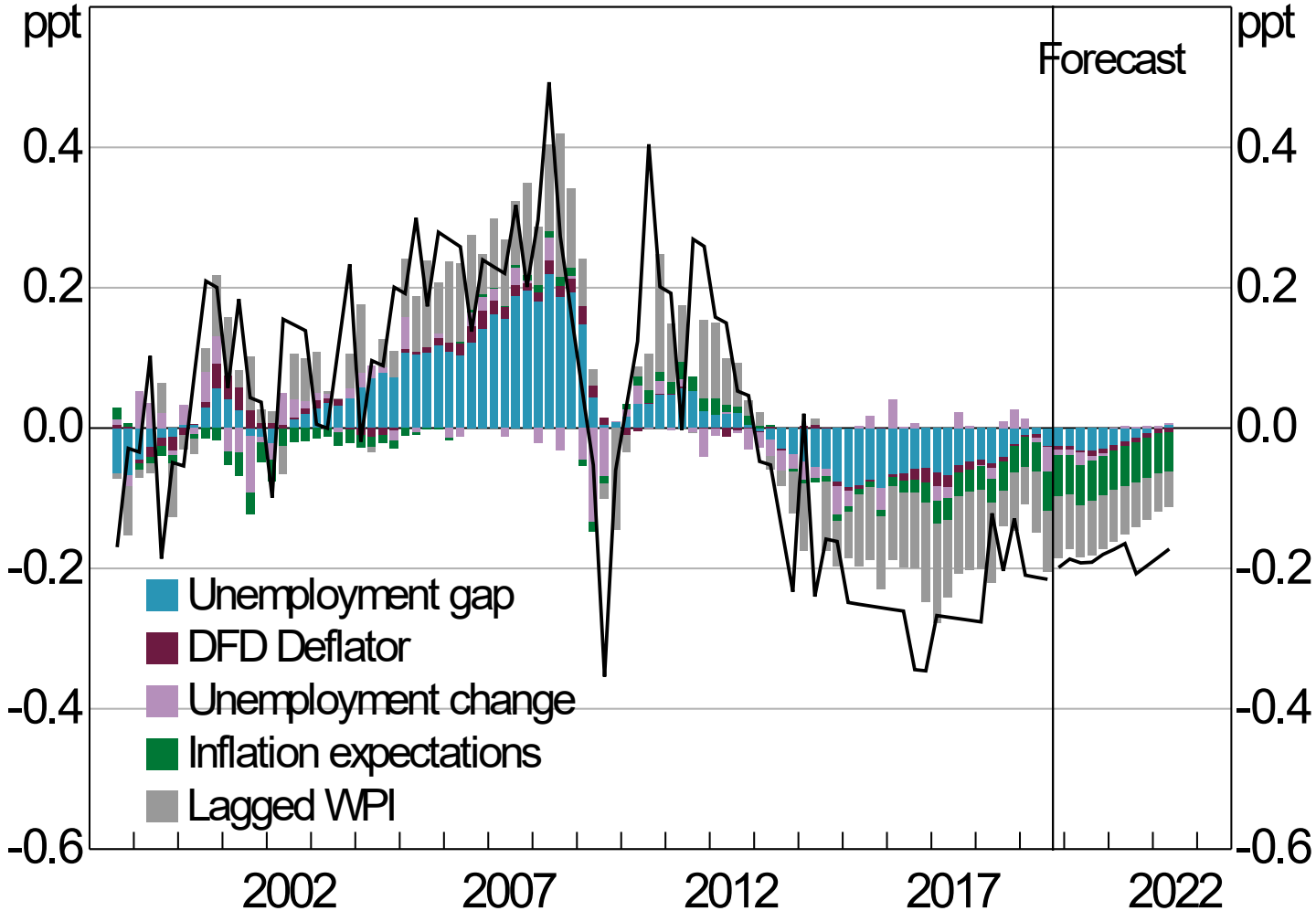
Year-ended, non-farm



Sources: ABS; RBA

Private WPI Model Decomposition

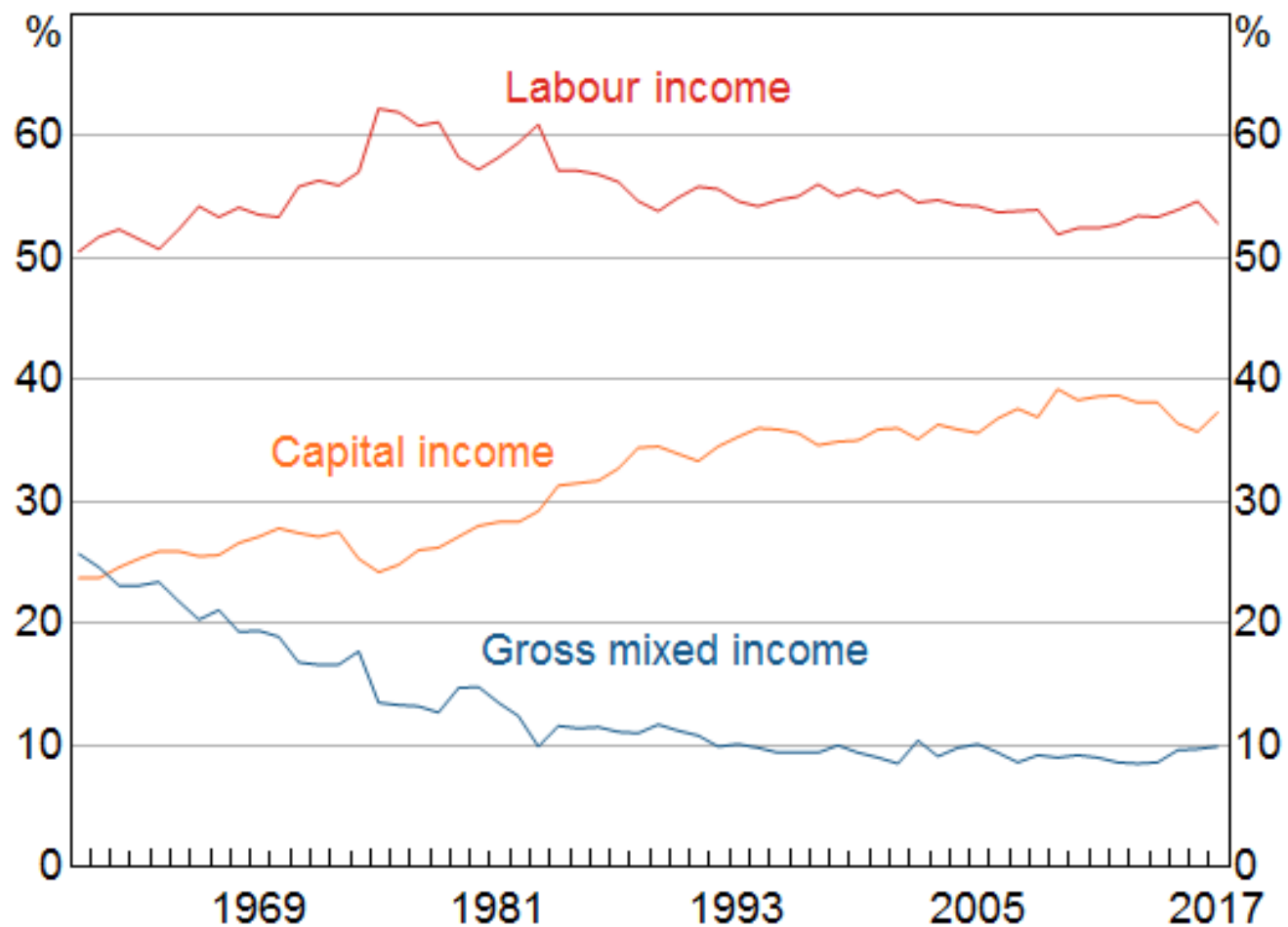
Quarterly deviations from own mean



Sources: ABS; RBA

Labour and Capital Income*

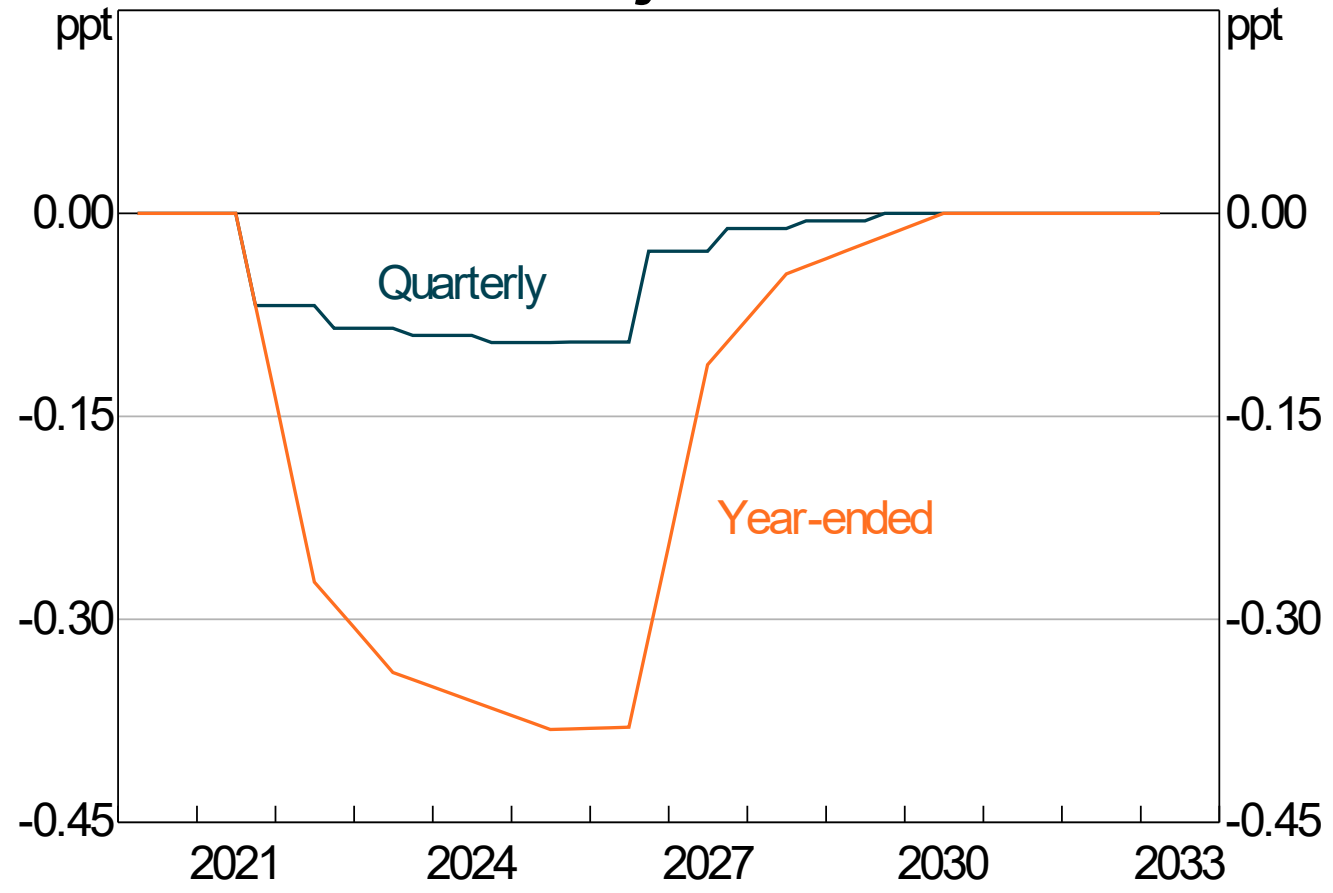
Share of total factor income



* Labour income is measured by compensation of employees. Capital income is measured by gross operating surplus

Source: ABS

Private WPI Adjustment Profiles



Source: RBA

Labour Costs

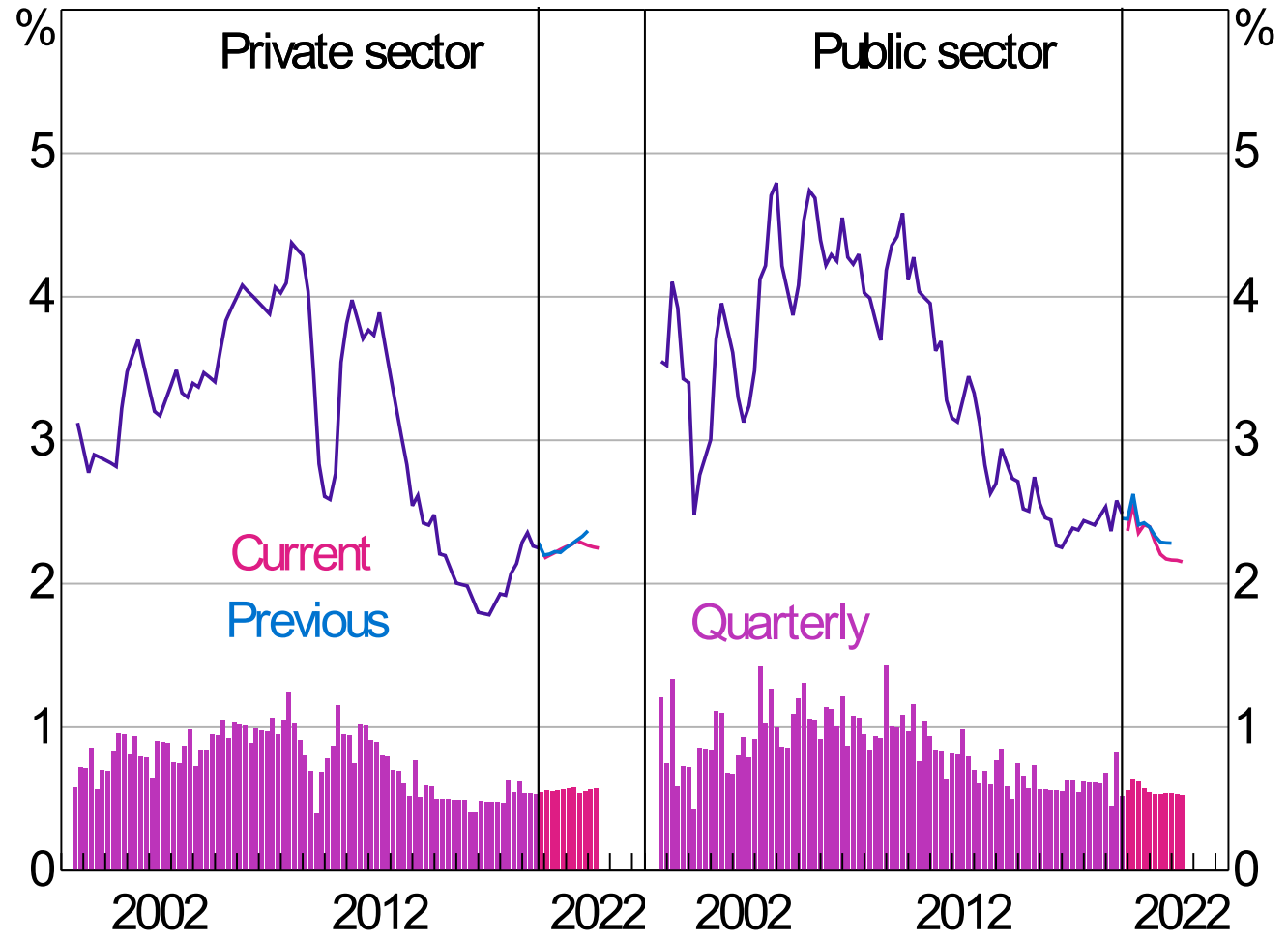
Year-ended growth



* Non-farm
** Total hourly rates of pay excluding bonuses
Sources: ABS; RBA

WPI Growth by Sector*

Year-ended



* Excluding bonuses

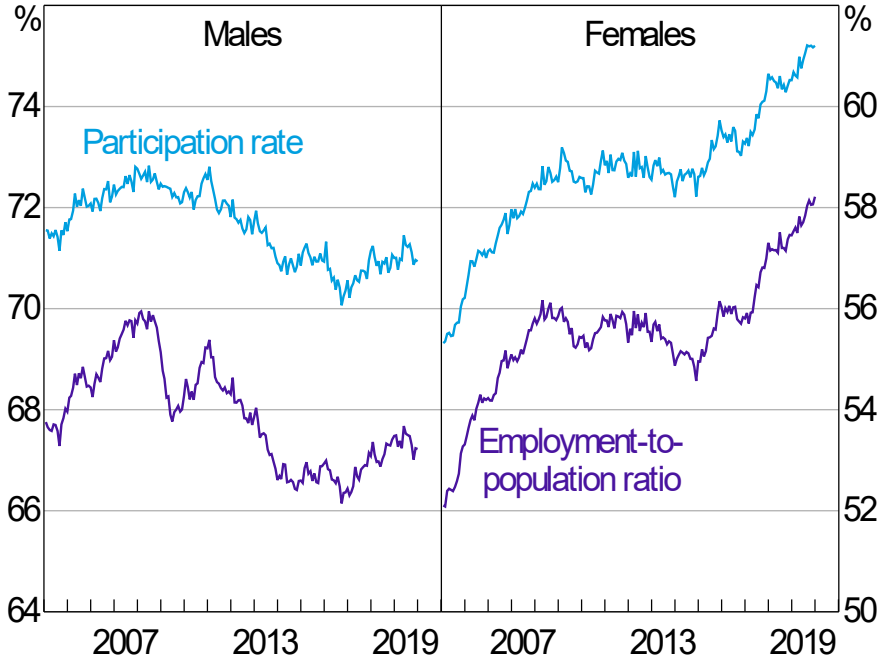
Sources: ABS; RBA



Employment composition & earnings

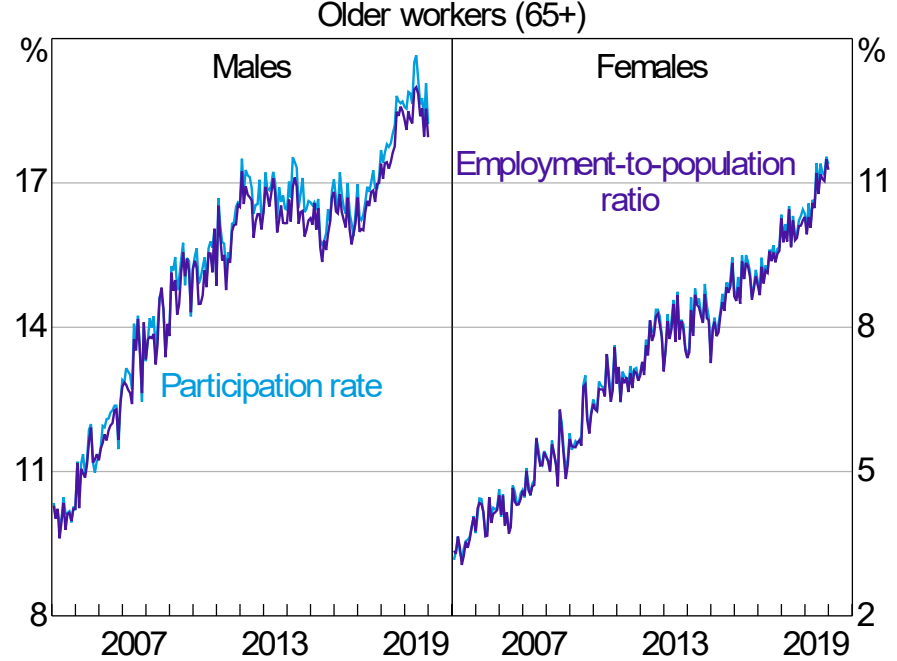
Taylor Nugent – PWL

Labour Market Outcomes by Sex



Source: ABS

Labour Market Outcomes by Sex



Source: ABS

Motivation

- Two facts:
 - Earnings are lower for females
 - Earnings growth is lower for older workers
- Does this affect aggregate wages growth?

Measures wages growth

- WPI
 - Wage inflation
 - Returns to L from K deepening
- AENA/HILDA
 - Change in the wage bill/hours(heads)

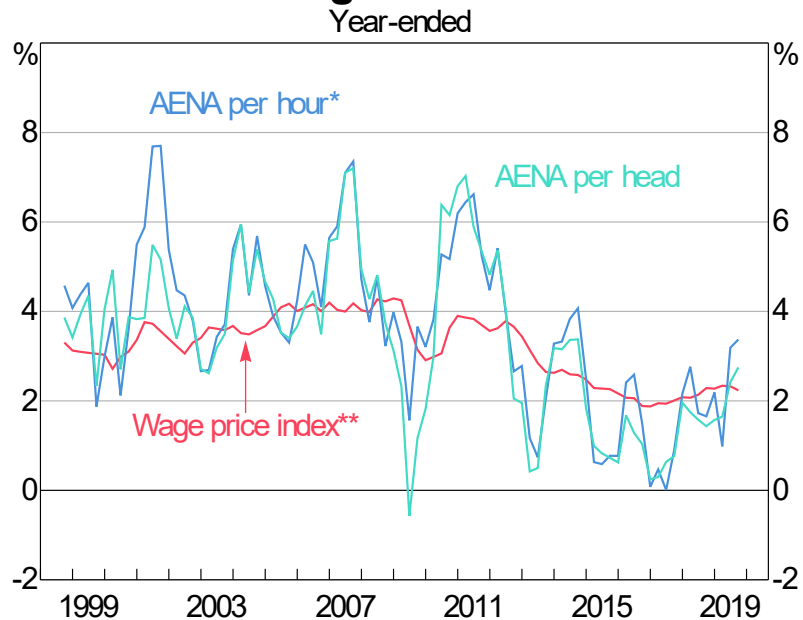
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Material on the following pages 98, 99 to 104, 109 to 113, 126 to 129 and 131 is subject to this disclaimer.

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This document uses unit record data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey. The unit record data from the HILDA Survey was obtained from the Australian Data Archive, which is hosted by The Australian National University. The HILDA Survey was initiated and is funded by the Australian Government Department of Social Services (DSS) and is managed by the Melbourne Institute of Applied Economic and Social Research (Melbourne Institute). The findings and views based on the data, however, are those of the authors and should not be attributed to the Australian Government, DSS, the Melbourne Institute, the Australian Data Archive or The Australian National University and none of those entities bear any responsibility for the analysis or interpretation of the unit record data from the HILDA Survey provided by the authors.

Wages Growth

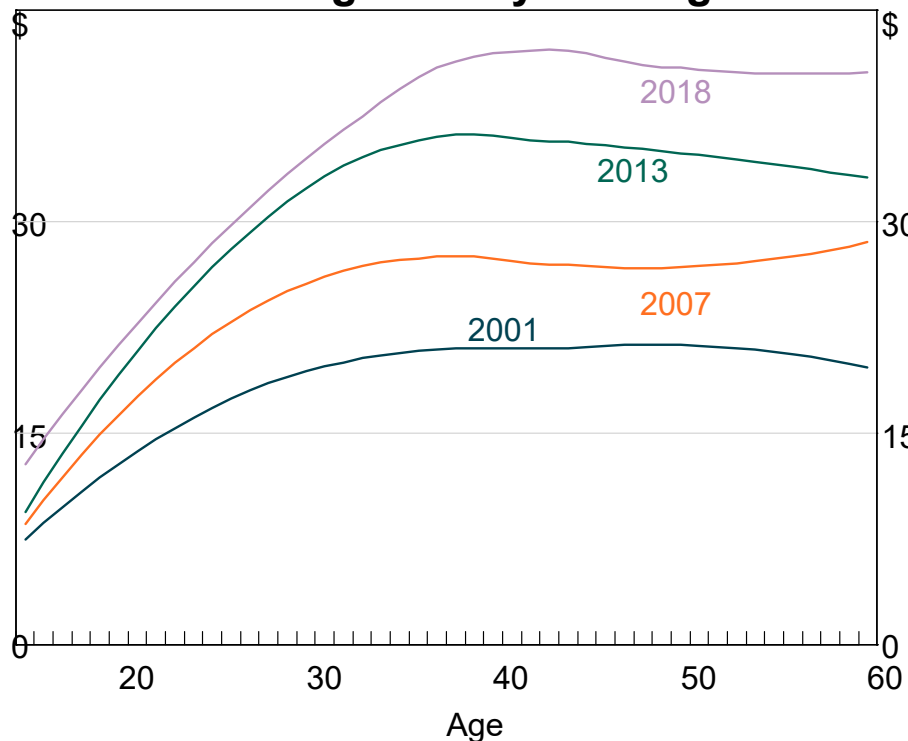


* Non-farm

** Excluding bonuses and commissions

Source: ABS

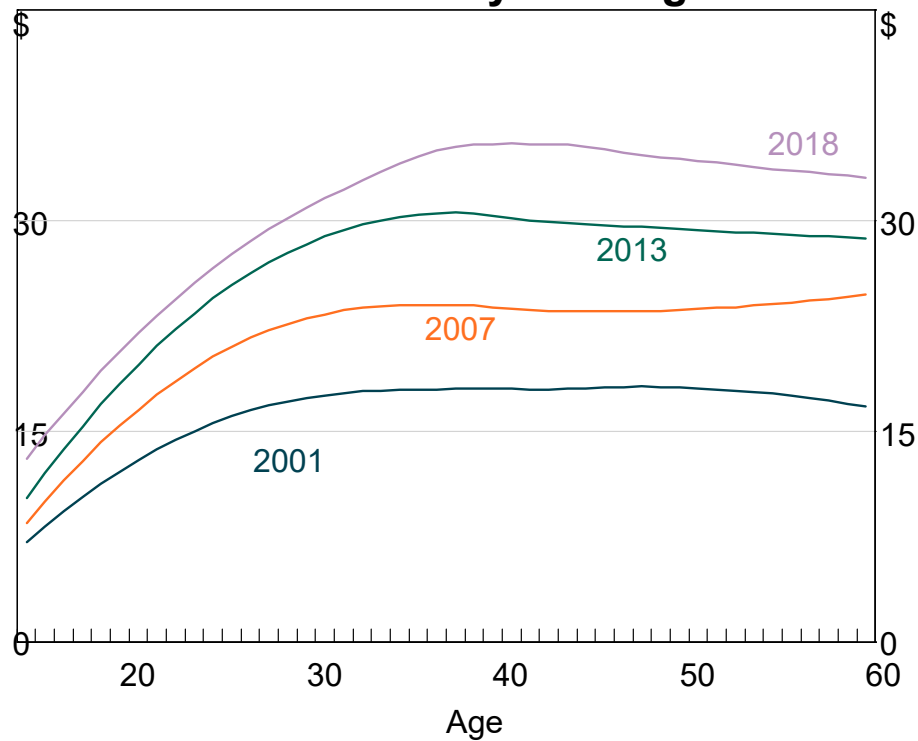
Average Hourly Earning



* Smoothed using local polynomial regression fitting

Source: HILDA Wave 18

Median Hourly Earning

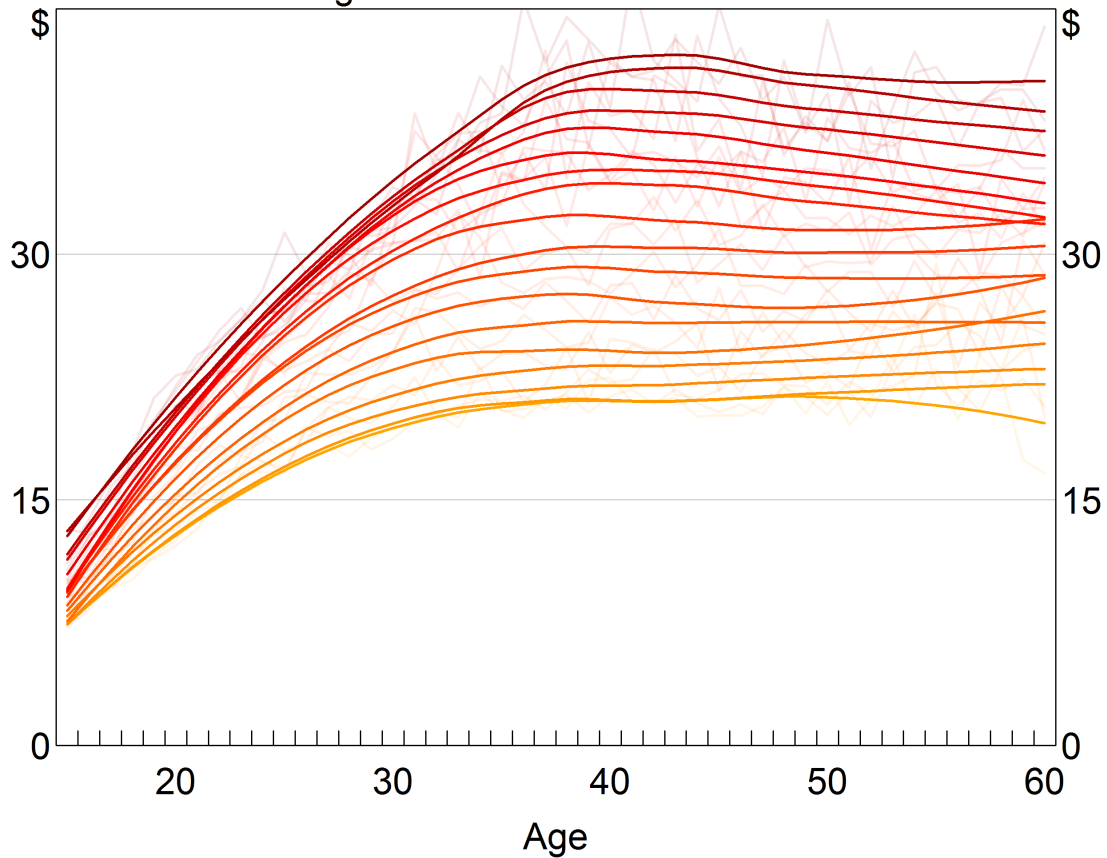


* Smoothed using local polynomial regression fitting

Source: HILDA Wave 18

Average Hourly Earnings by Age*

Orange to red indicates 2001 to 2018

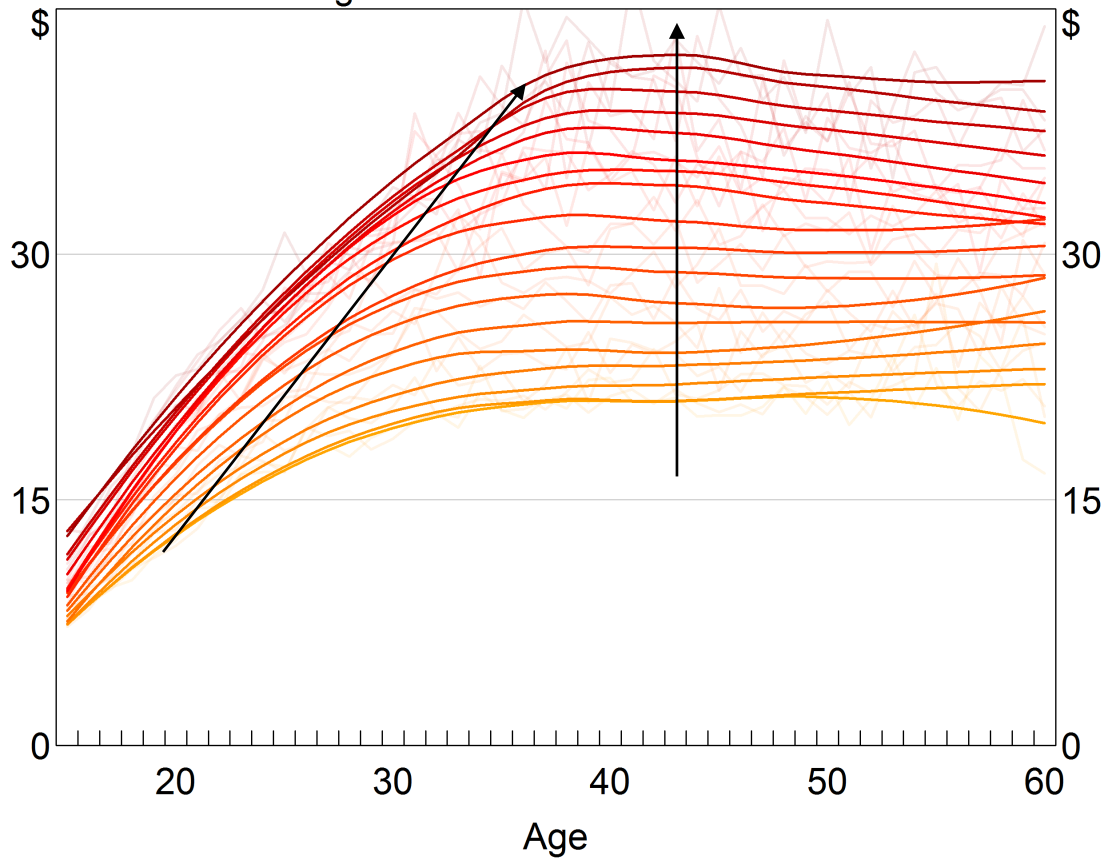


* Smoothed using local polynomial regression fitting

Source: HILDA Wave 18

Average Hourly Earnings by Age*

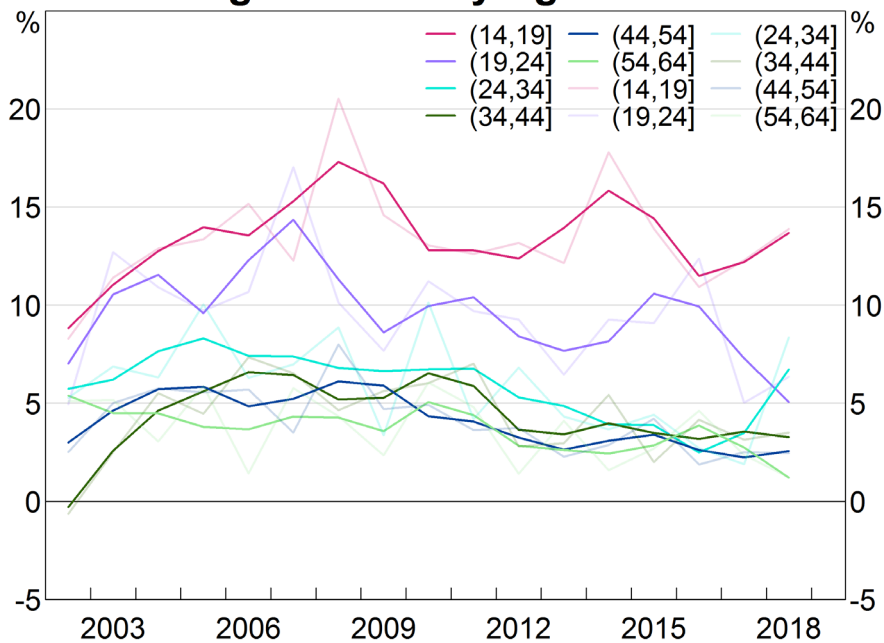
Orange to red indicates 2001 to 2018



* Smoothed using local polynomial regression fitting

Source: HILDA Wave 18

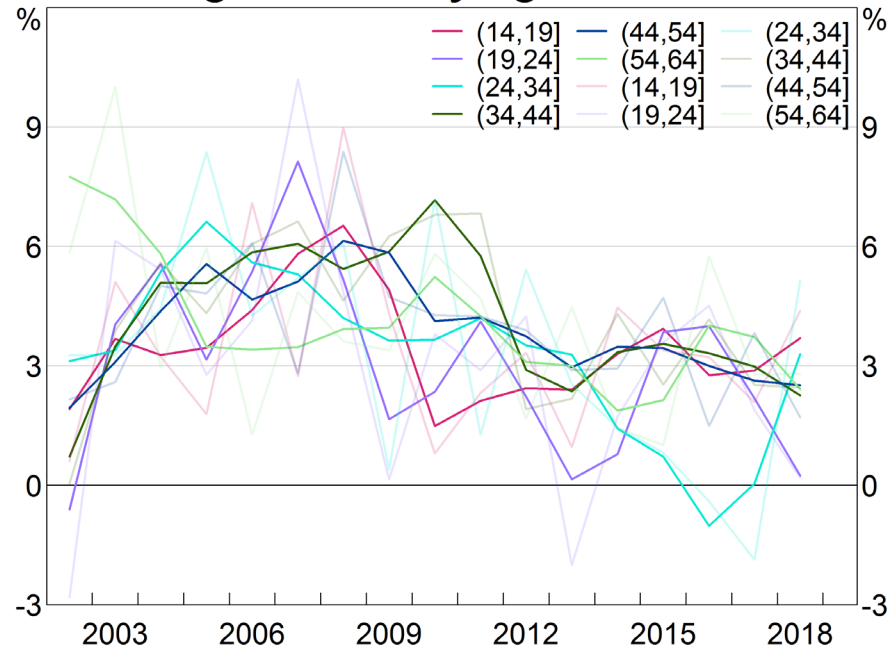
Earnings Growth by Age: Matched*



* 5-term henderson trend

Source: HILDA

Earnings Growth by Age: Unmatched*

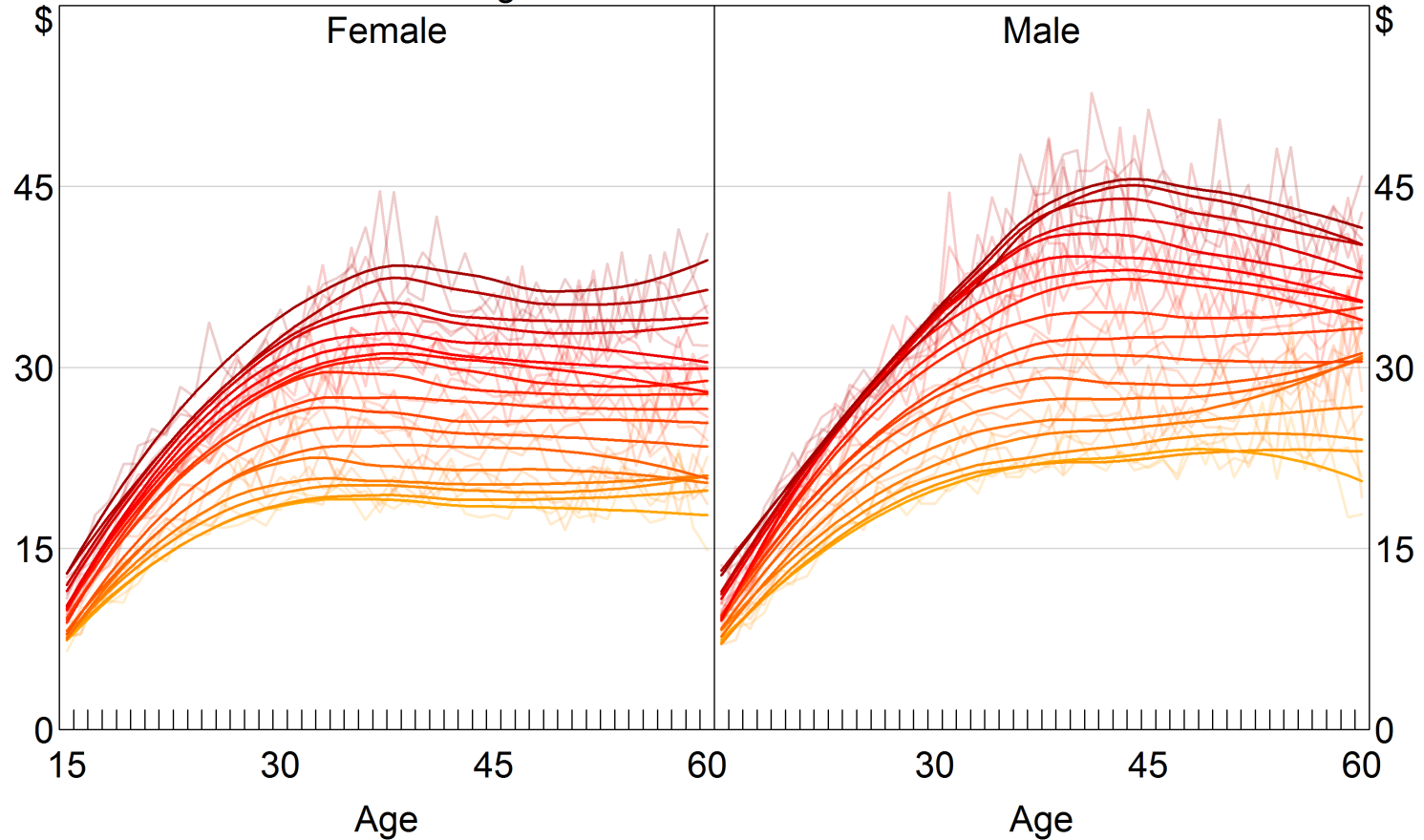


* 5-term henderson trend

Source: HILDA

Average Hourly Earnings by Age*

Orange to red indicates 2001 to 2018

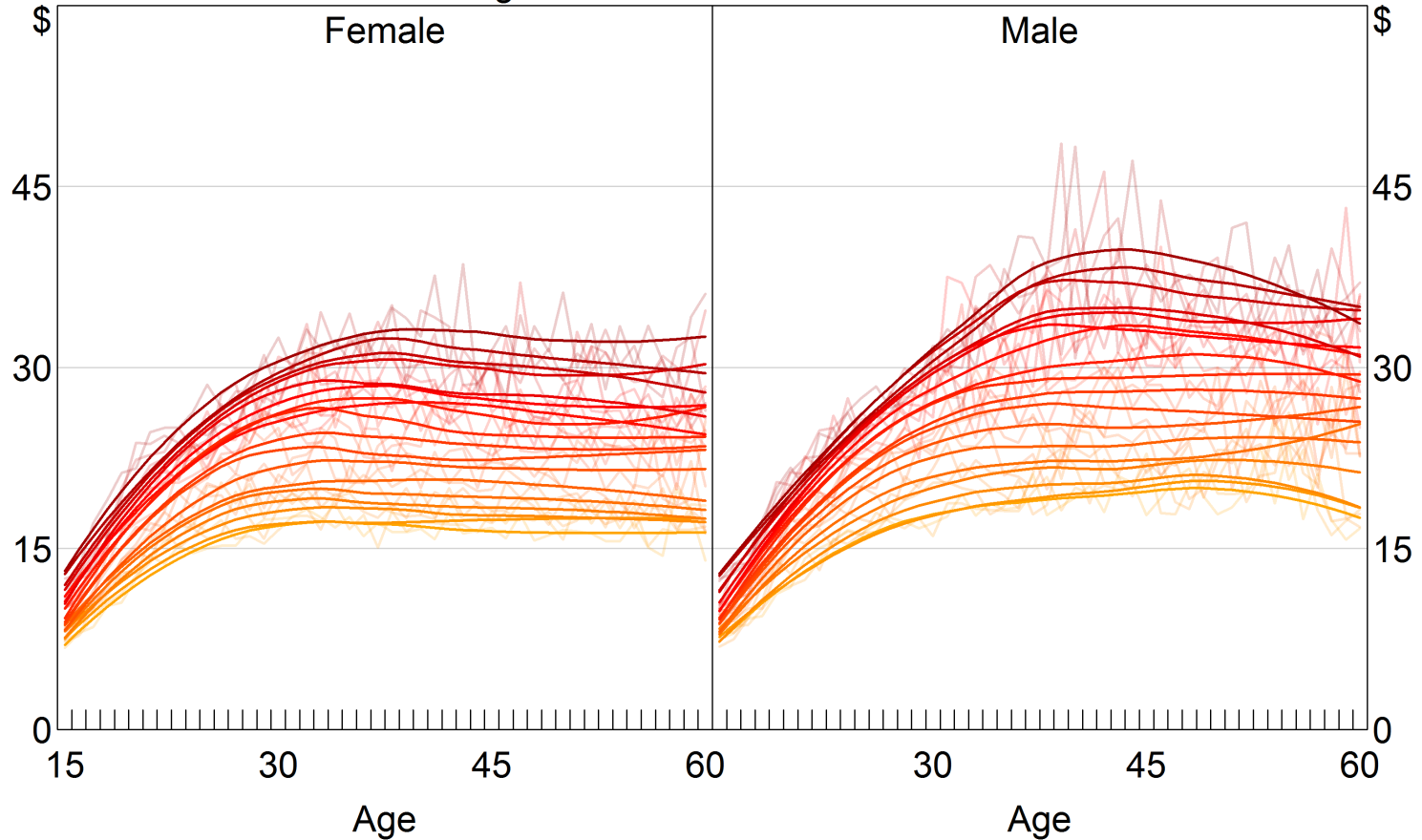


* Smoothed using local polynomial regression fitting

Source: HILDA wave 18

Median Hourly Earnings by Age*

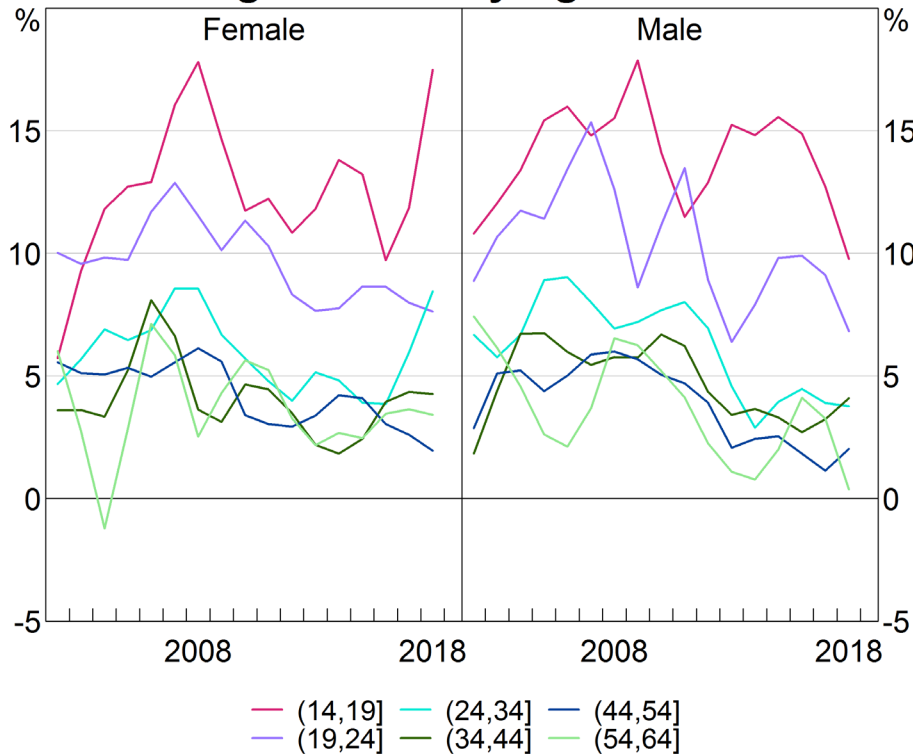
Orange to red indicates 2001 to 2018



* Smoothed using local polynomial regression fitting

Source: HILDA wave 18

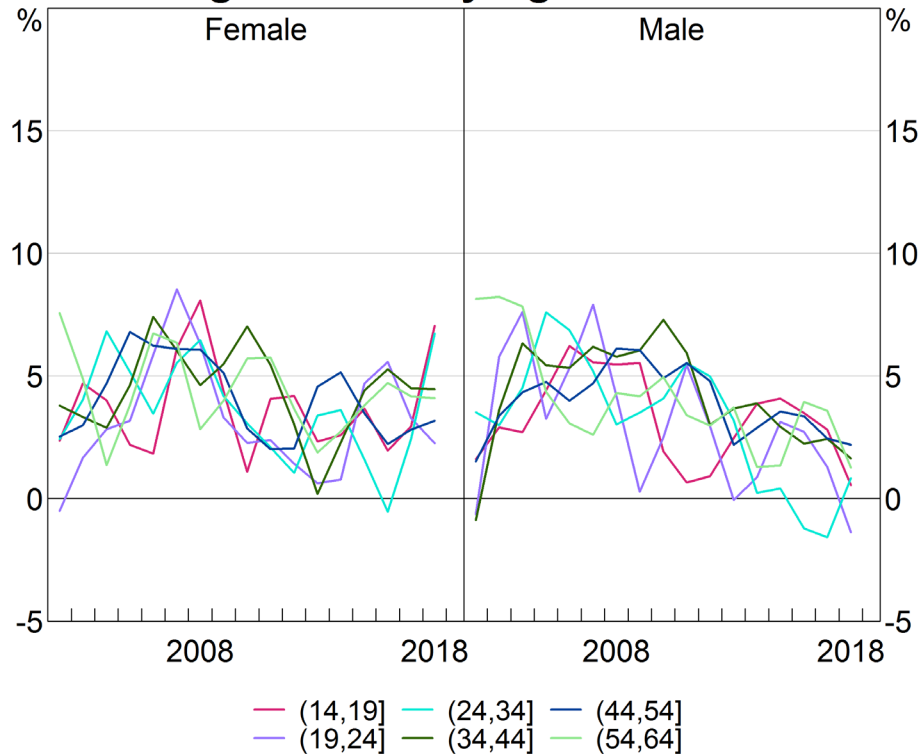
Earnings Growth by Age: Matched*



* 5-term henderson trend

Source: HILDA

Earnings Growth by Age: Unmatched*

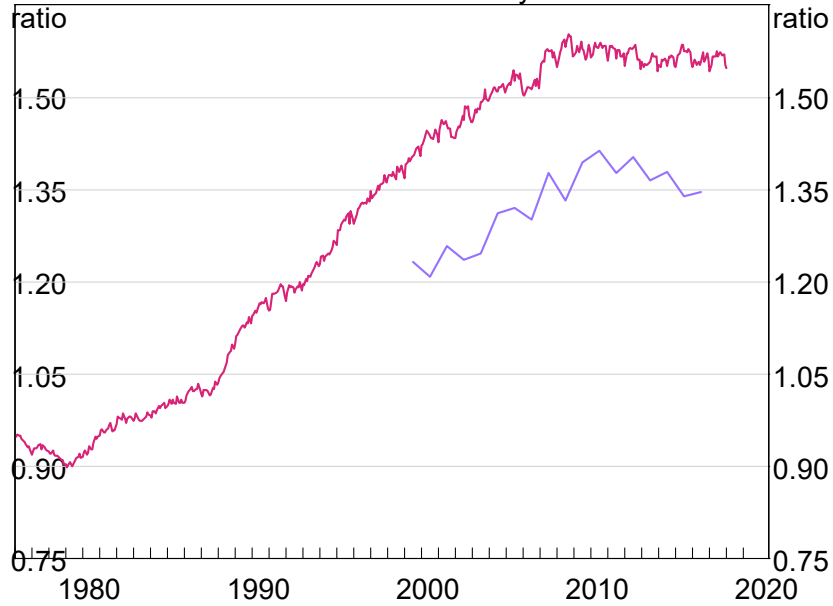


* 5-term henderson trend

Source: HILDA

Wage and Salary Earners

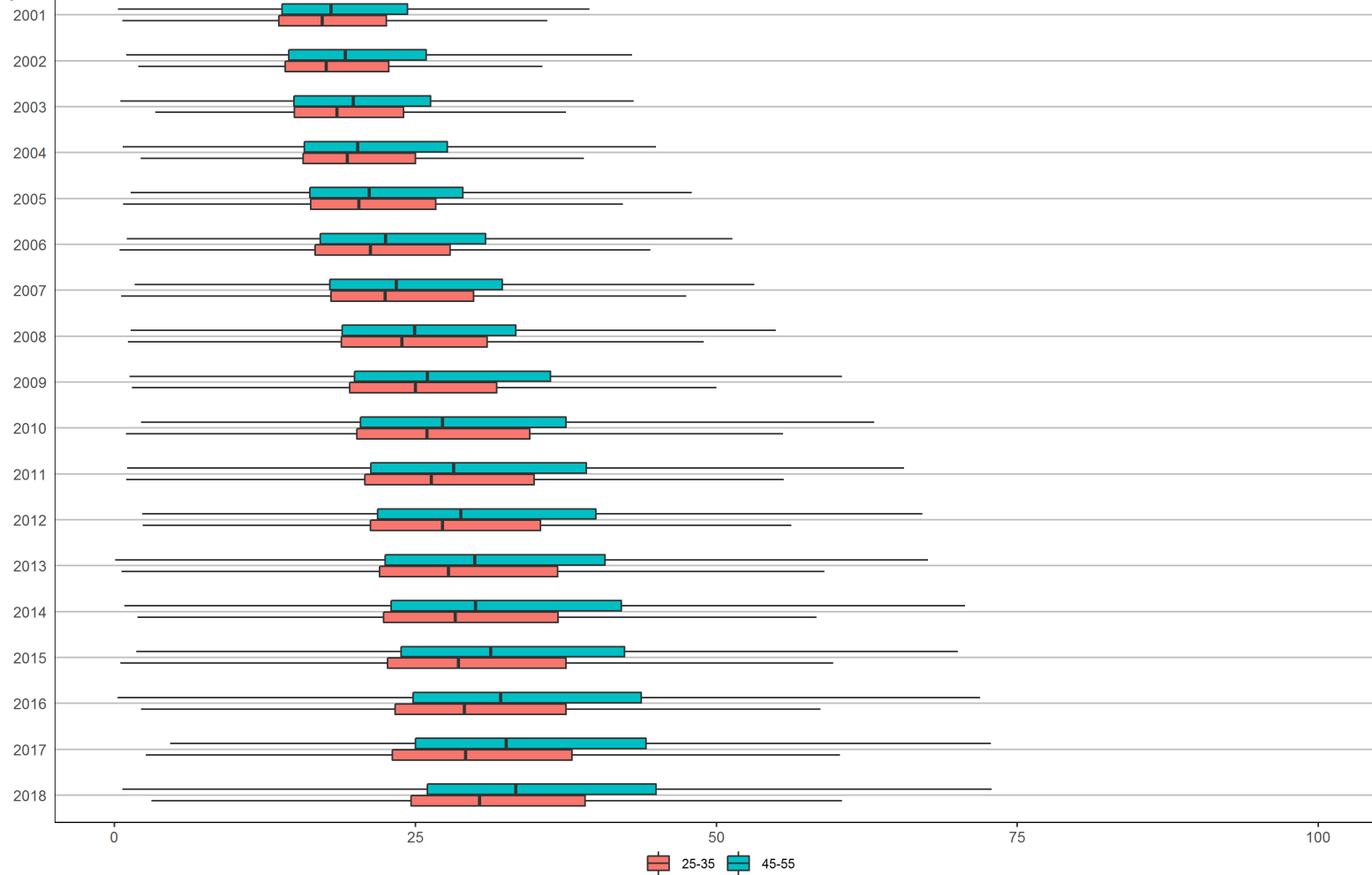
Ratio of over 35 to under 35 year-ol



Source: ABS

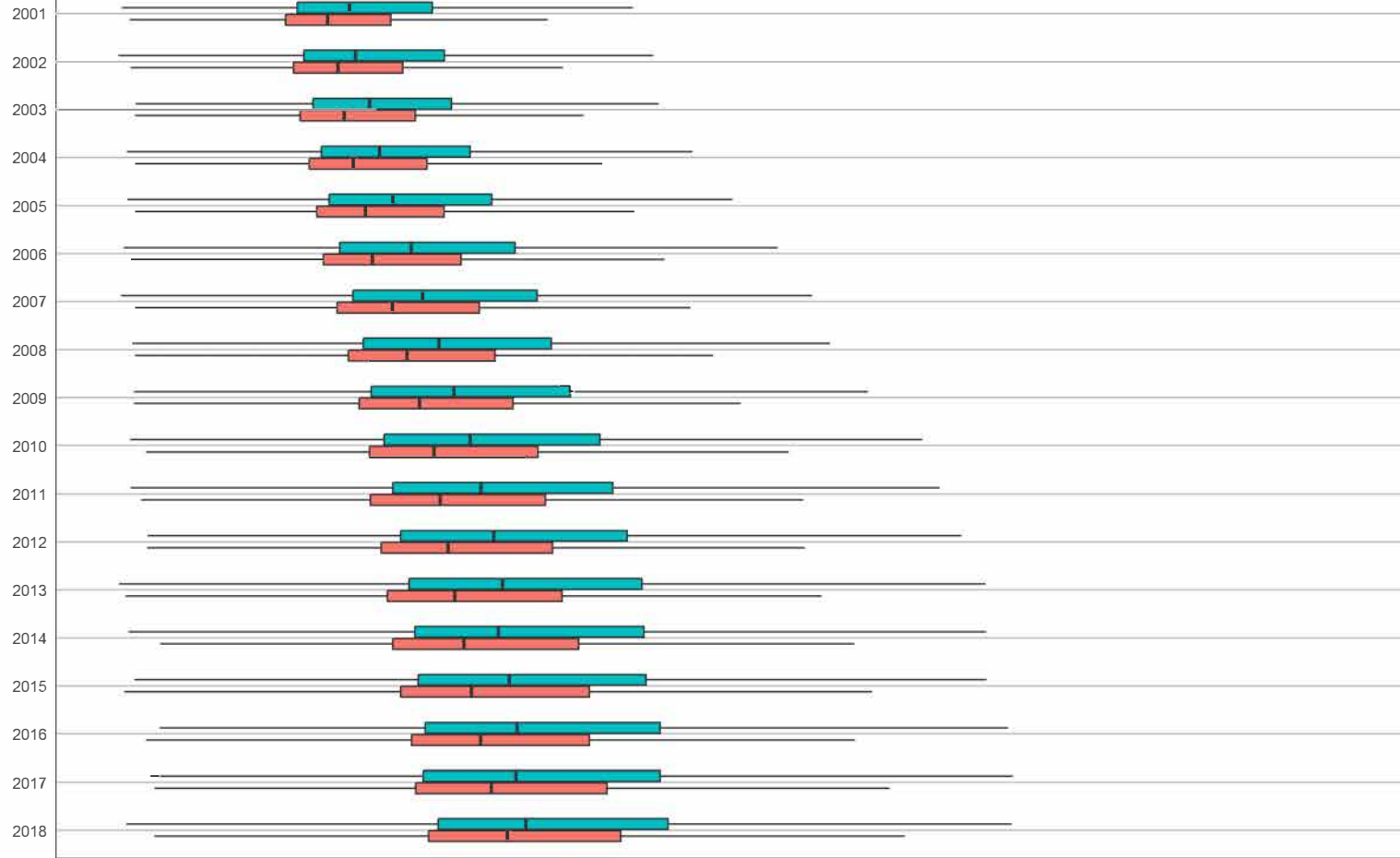
Hourly Earnings by Age

Hourly wage



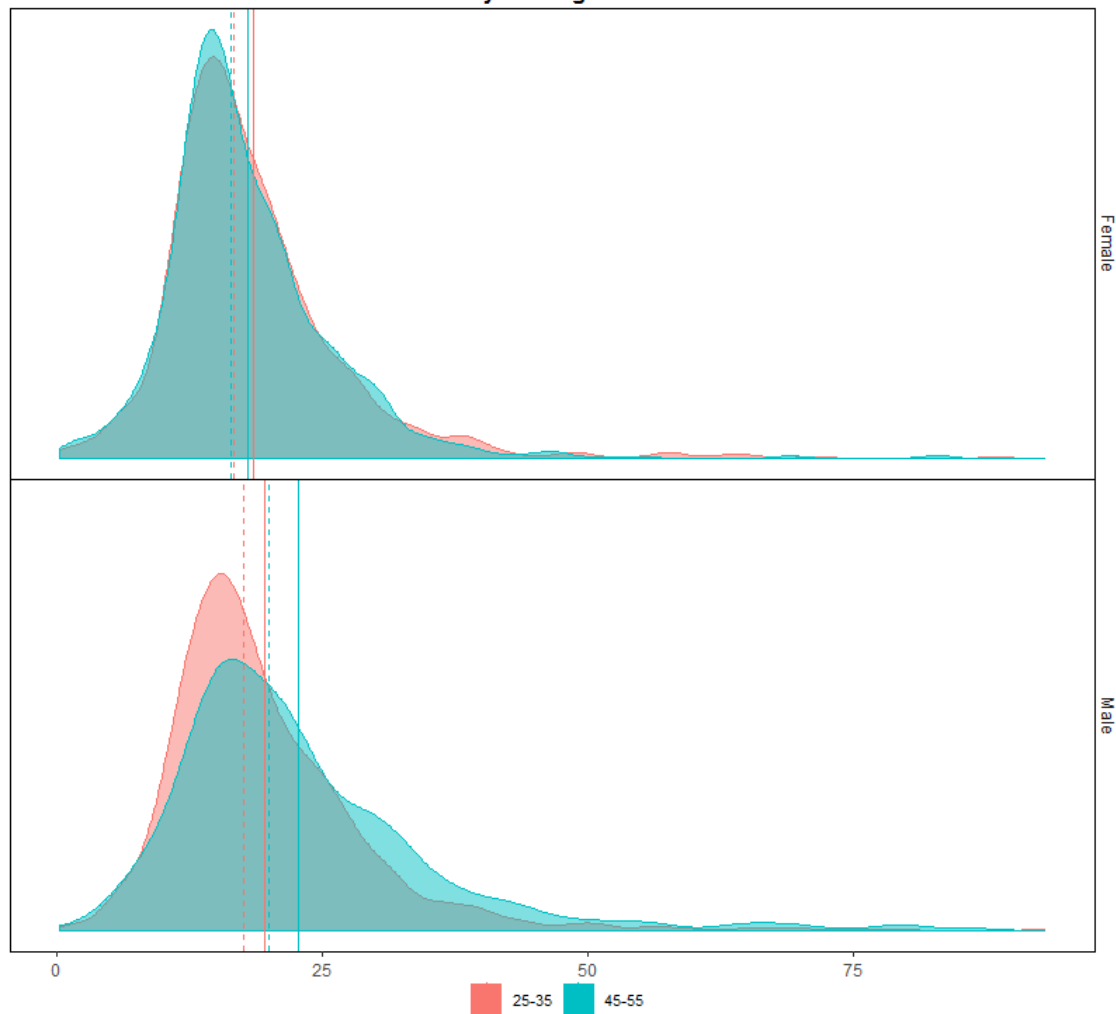
Hourly Earnings by Sex

Hourly wage



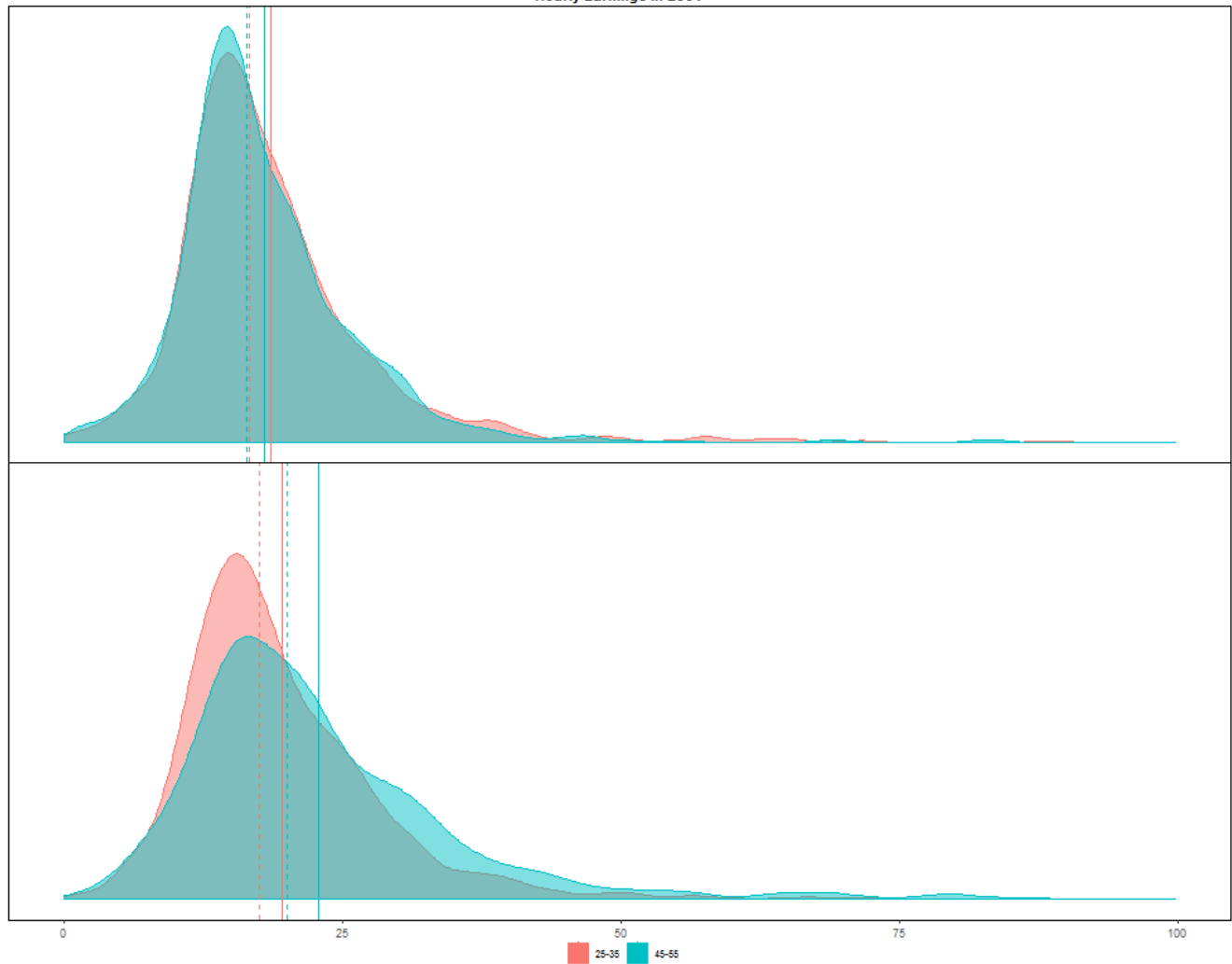
Female Male

Hourly Earnings in 2001



Vertical lines indicate mean (solid) and median (dashed)

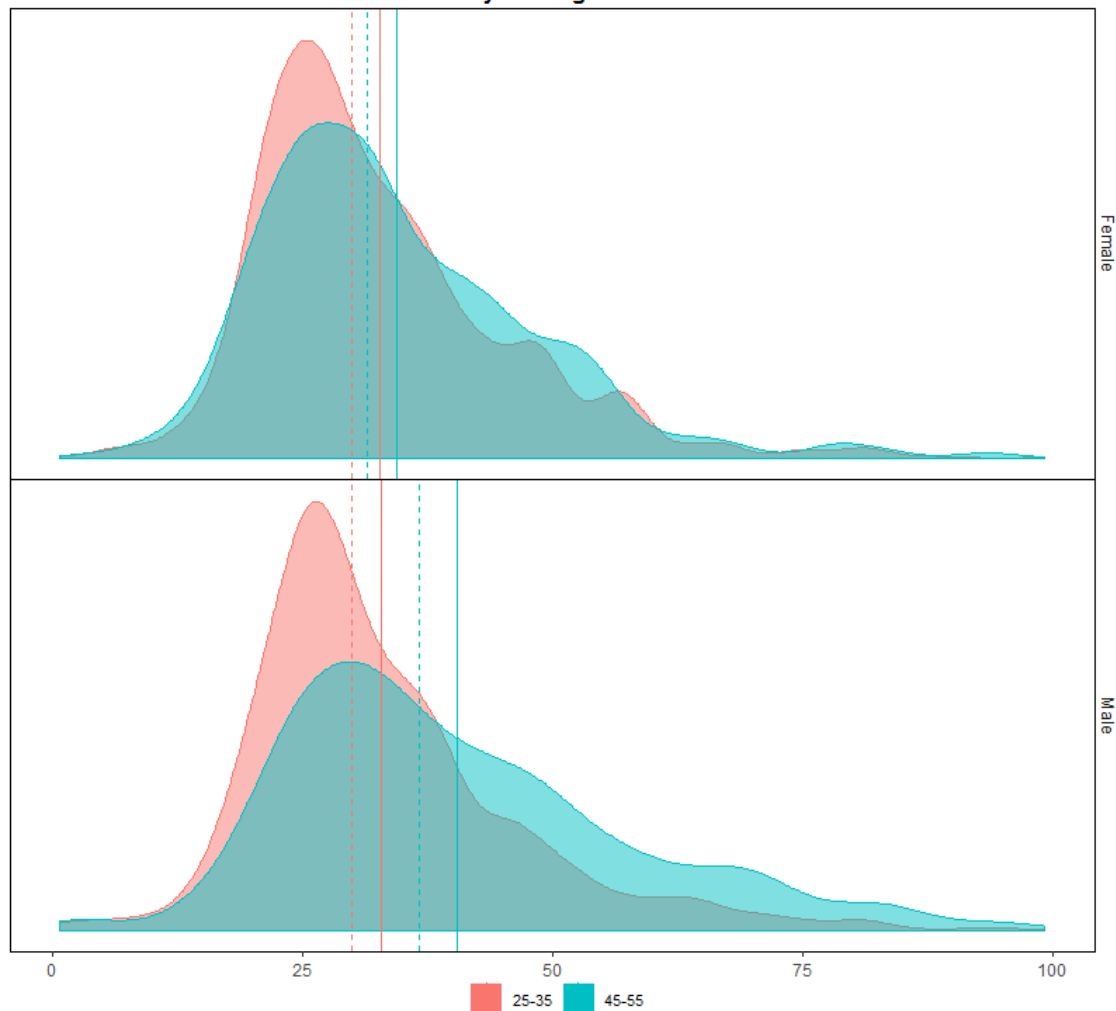
Hourly Earnings in 2001



Vertical lines indicate mean (solid) and median (dashed)

25-35 45-55

Hourly Earnings in 2018



Vertical lines indicate mean (solid) and median (dashed)

Approach

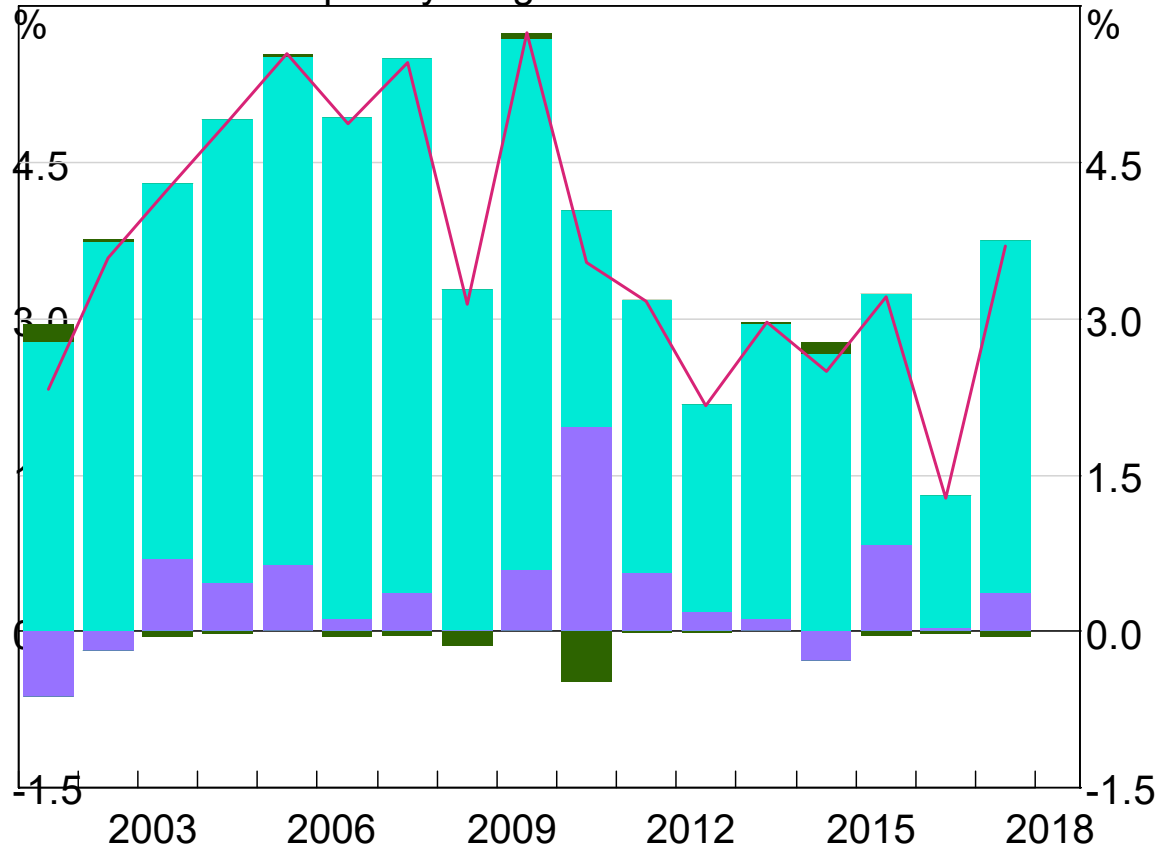
- Follow Christodouloupoulou and Kouvavas (2019)
 - Oaxaca Decomposition
 - Panel regression with year fixed effects

Oaxaca Decomp

- $$\Delta E(\text{wage}) = \underbrace{[E(X_{t+1}) - E(X_t)]' \beta_t}_{\text{composition effect}} + \underbrace{E(X_t)(\beta_{t+1} - \beta_t)}_{\text{return to characteristics}} - \underbrace{[E(X'_{t+1}) - E(X'_t)](\beta_{t+1} - \beta_t)}_{\text{interaction term}}$$

Hourly Earnings Growth

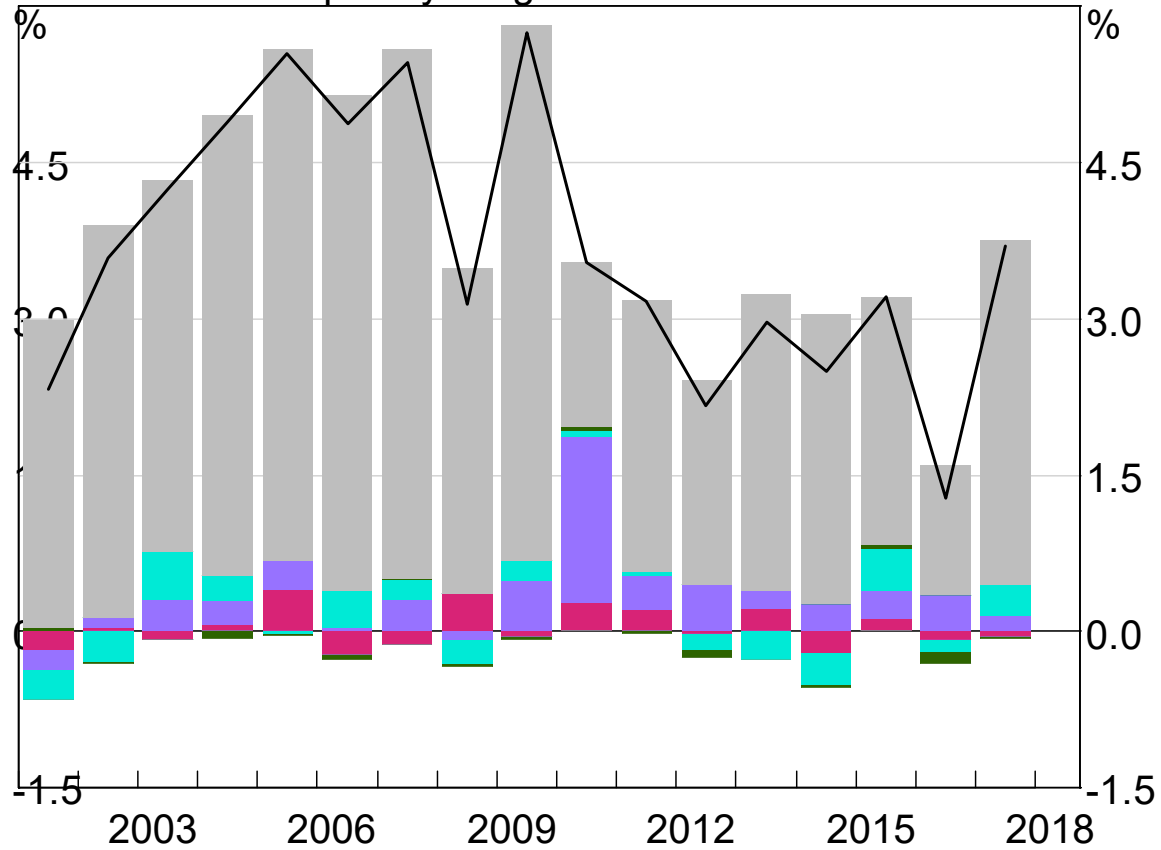
frequency weighted



— diff
■ Composition ■ Skill
■ Interaction

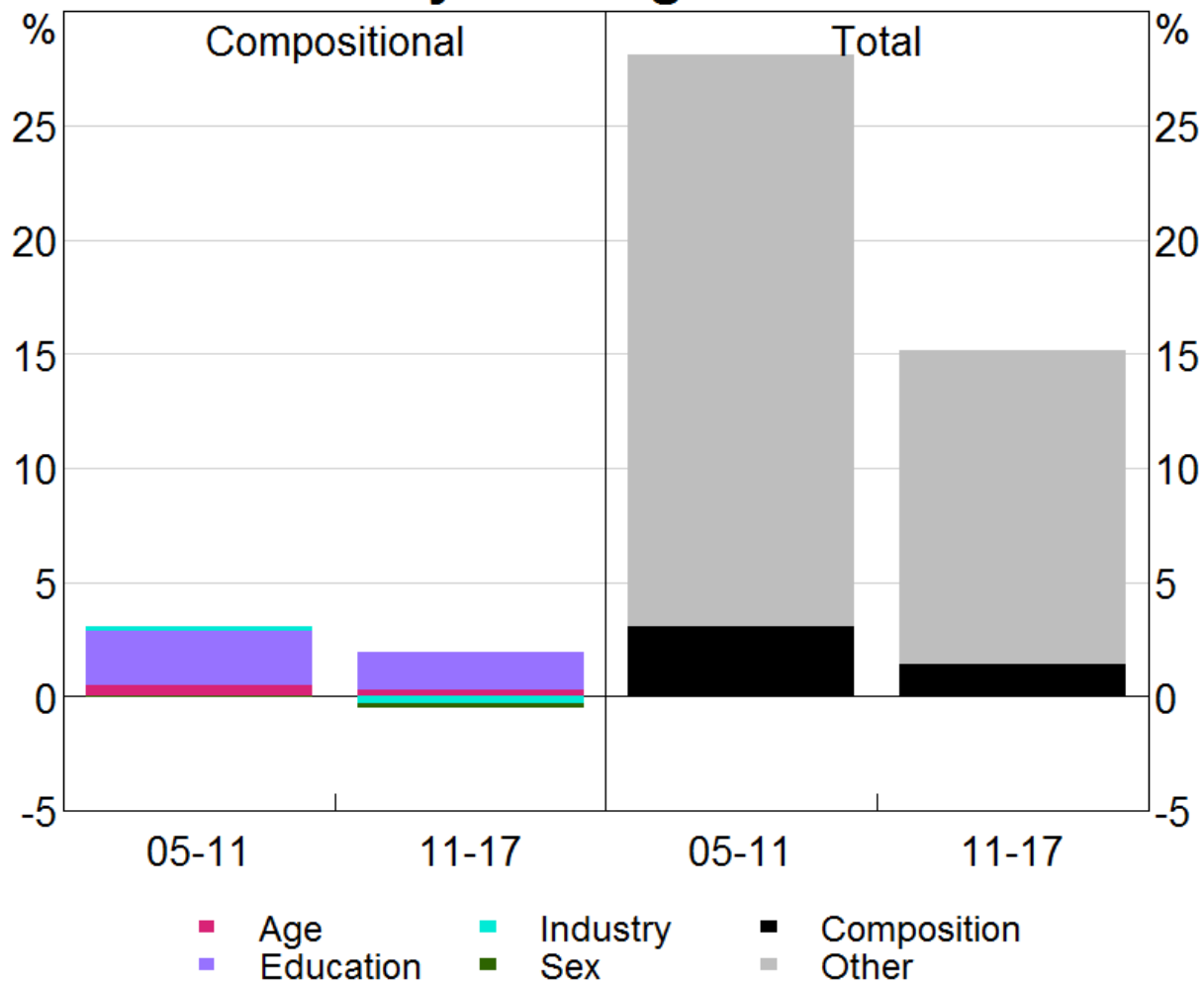
Hourly Earnings Growth

frequency weighted



Age Education Industry Sex Total Other

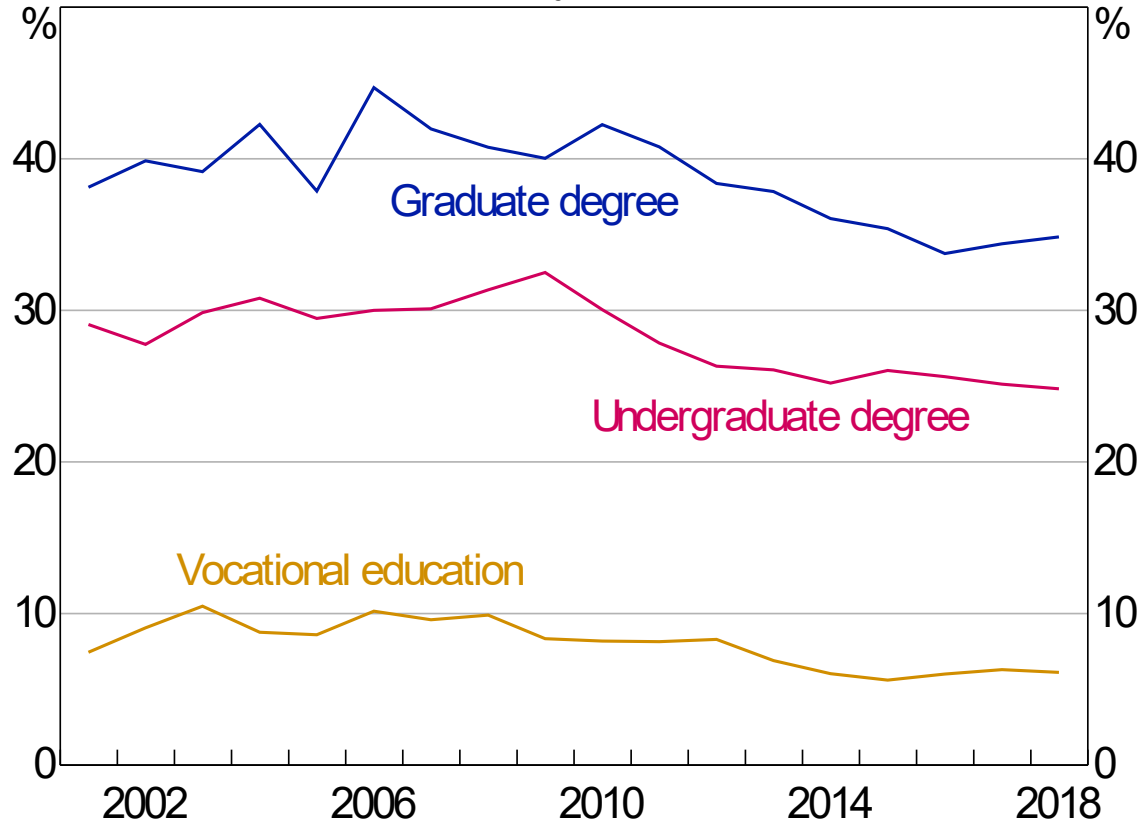
Hourly Earnings Growth



Model 1								Model 2							
Number of obs = 7,182								Number of obs = 9,553							
F(28, 7153) = 83.35								F(28, 9524) = 94.77							
Prob > F = 0								Prob > F = 0							
R-squared = 0.2723								R-squared = 0.3207							
Root MSE = 0.45171								Root MSE = 0.42893							
Robust								Robust							
loghourlyw~e	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]		loghourlyw~e	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]	
hgsex								hgsex							
[2] Female	-0.092	0.014	-6.790	0.000	-0.119	-0.066		[2] Female	-0.072	0.013	-5.410	0	-0.09847	-0.046	
age	0.111	0.012	9.320	0.000	0.087	0.134		age	0.082	0.012	6.610	0	0.057431	0.106	
age2	-0.002	0.000	-6.980	0.000	-0.003	-0.002		age2	-0.001	0.000	-4.410	0	-0.00202	-0.001	
age3	0.000	0.000	5.300	0.000	0.000	0.000		age3	0.000	0.000	3.000	0.003	2.66E-06	0.000	
ind								ind							
1 Agriculture, Forestry and Fishing	-0.22	0.05	-4.54	0.00	-0.31	-0.12		1 Agriculture, Forestry and Fishing	-0.35	0.05	-7.60	0	-0.44489	-0.26	
2 Mining	0.34	0.05	7.50	0.00	0.25	0.43		2 Mining	0.38	0.05	7.28	0	0.274751	0.48	
3 Manufacturing	-0.02	0.03	-0.91	0.37	-0.08	0.03		3 Manufacturing	-0.03	0.03	-1.14	0.255	-0.08001	0.02	
4 Electricity, Gas, Water and Waste Services	0.08	0.04	2.14	0.03	0.01	0.16		4 Electricity, Gas, Water and Waste Services	0.17	0.08	2.06	0.039	0.008363	0.32	
5 Construction	0.01	0.03	0.39	0.70	-0.05	0.08		5 Construction	0.02	0.03	0.65	0.514	-0.0422	0.08	
6 Wholesale Trade	-0.05	0.04	-1.48	0.14	-0.12	0.02		6 Wholesale Trade	-0.06	0.03	-1.95	0.052	-0.13046	0.00	
7 Retail Trade	-0.16	0.03	-5.56	0.00	-0.21	-0.10		7 Retail Trade	-0.19	0.03	-7.45	0	-0.23876	-0.14	
8 Accommodation and Food Services	-0.15	0.03	-4.28	0.00	-0.22	-0.08		8 Accommodation and Food Services	-0.19	0.03	-6.40	0	-0.24231	-0.13	
9 Transport, Postal and Warehousing	0.01	0.03	0.23	0.82	-0.06	0.07		9 Transport, Postal and Warehousing	-0.02	0.04	-0.46	0.644	-0.0851	0.05	
10 Information Media and Telecommunications	0.13	0.04	3.39	0.00	0.06	0.21		10 Information Media and Telecommunications	-0.02	0.05	-0.45	0.653	-0.13082	0.08	
11 Financial and Insurance Services	0.17	0.04	4.59	0.00	0.09	0.24		11 Financial and Insurance Services	0.15	0.03	4.93	0	0.091515	0.21	
12 Rental, Hiring and Real Estate Services	-0.06	0.06	-0.98	0.33	-0.17	0.06		12 Rental, Hiring and Real Estate Services	-0.03	0.07	-0.41	0.685	-0.16133	0.11	
13 Professional, Scientific and Technical Services	0.13	0.03	4.31	0.00	0.07	0.19		13 Professional, Scientific and Technical Services	0.06	0.03	2.26	0.024	0.008117	0.12	
14 Administrative and Support Services	-0.16	0.05	-3.52	0.00	-0.26	-0.07		14 Administrative and Support Services	-0.13	0.04	-3.54	0	-0.20016	-0.06	
15 Public Administration and Safety	0.10	0.03	4.10	0.00	0.05	0.15		15 Public Administration and Safety	0.11	0.03	3.69	0	0.05339	0.17	
16 Education and Training	-0.03	0.03	-1.05	0.29	-0.08	0.02		16 Education and Training	-0.02	0.02	-0.81	0.42	-0.0541	0.02	
18 Arts and Recreation Services	-0.21	0.05	-4.17	0.00	-0.30	-0.11		18 Arts and Recreation Services	-0.10	0.04	-2.70	0.007	-0.17197	-0.03	
19 Other Services	-0.26	0.04	-7.18	0.00	-0.33	-0.19		19 Other Services	-0.16	0.03	-4.60	0	-0.22573	-0.09	
ed								ed							
2 Grad diploma, grad certificate	-0.06	0.04	-1.61	0.11	-0.13	0.01		2 Grad diploma, grad certificate	-0.04	0.03	-1.15	0.252	-0.1015	0.03	
3 Bachelor or honours	-0.11	0.03	-3.31	0.00	-0.18	-0.05		3 Bachelor or honours	-0.12	0.03	-4.64	0	-0.17658	-0.07	
4 Adv diploma, diploma	-0.24	0.04	-6.75	0.00	-0.31	-0.17		4 Adv diploma, diploma	-0.26	0.03	-9.56	0	-0.31264	-0.21	
5 Cert III or IV	-0.38	0.03	-11.47	0.00	-0.44	-0.31		5 Cert III or IV	-0.34	0.03	-13.65	0	-0.39179	-0.29	
8 Year 12	-0.31	0.03	-9.13	0.00	-0.38	-0.24		8 Year 12	-0.32	0.03	-11.54	0	-0.372	-0.26	
9 Year 11 and below	-0.43	0.03	-13.16	0.00	-0.50	-0.37		9 Year 11 and below	-0.46	0.03	-15.98	0	-0.51824	-0.40	
_cons	1.49	0.15	10.09	0.00	1.20	1.78		_cons	2.33	0.15	15.43	0	2.037219	2.63	

Education Wage Premium*

20–64 year olds



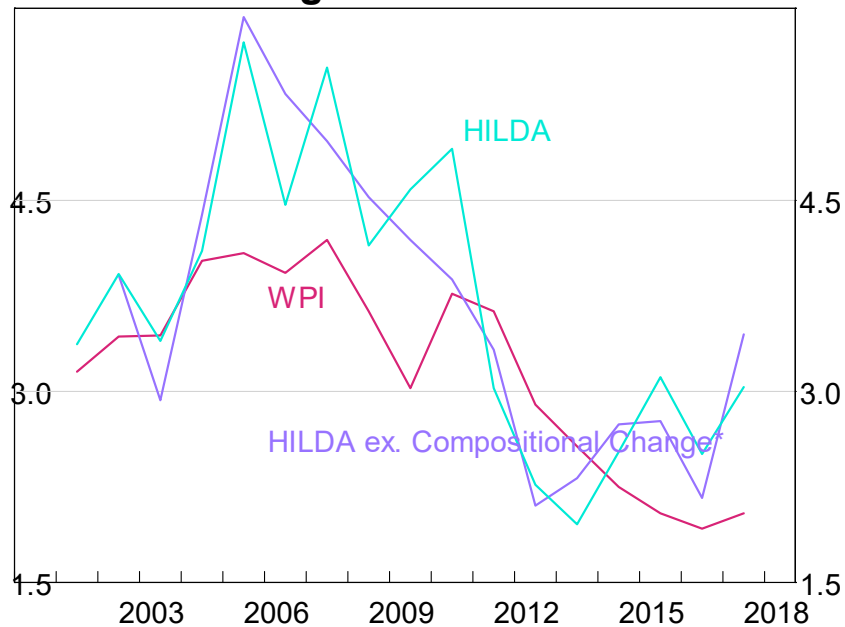
* Wage premiums expressed relative to wages of those holding Year 12 or below

Source: HILDA Release 18.0, RBA

Panel approach

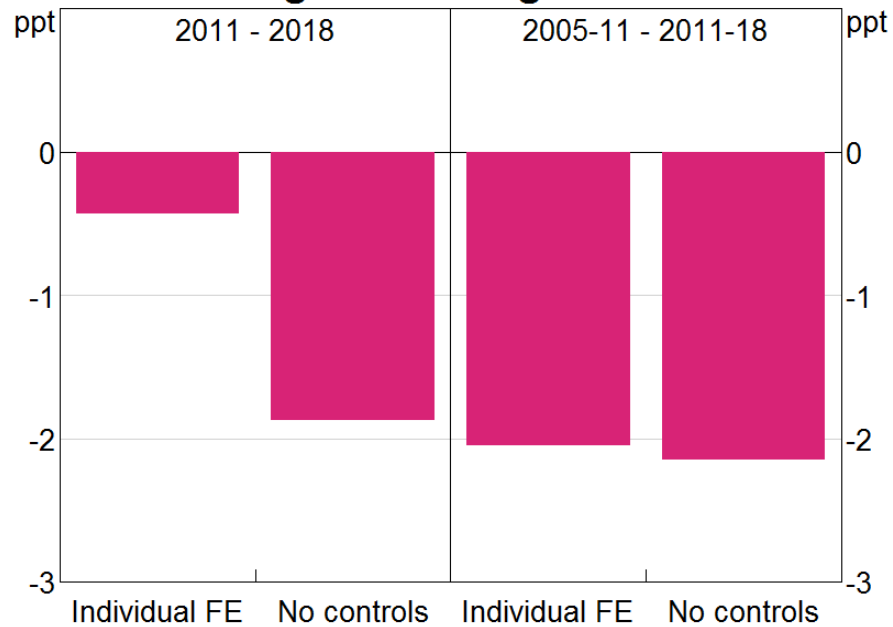
$$wage_{it} = X'_{it}\beta + \alpha_j + \gamma_t + \varepsilon_{it}$$

Earnings Growth Measure



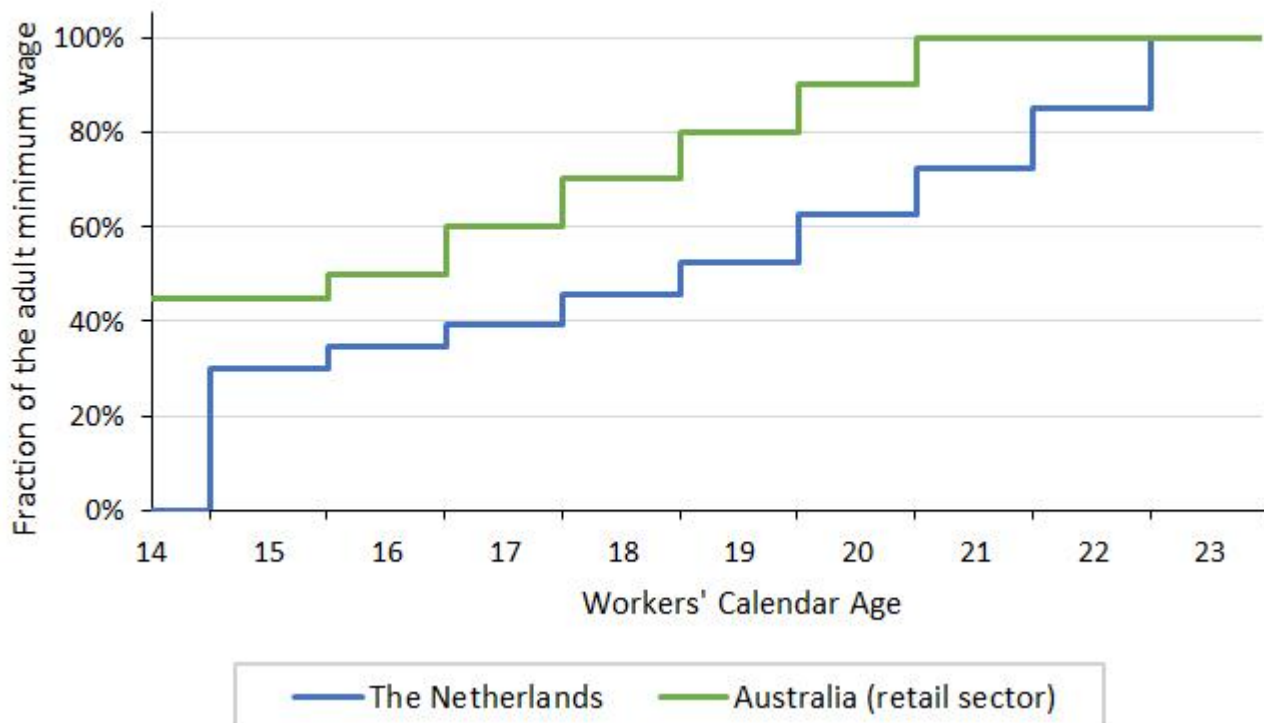
* Scaled to have zero average compositional effect

Change in Earnings Growth

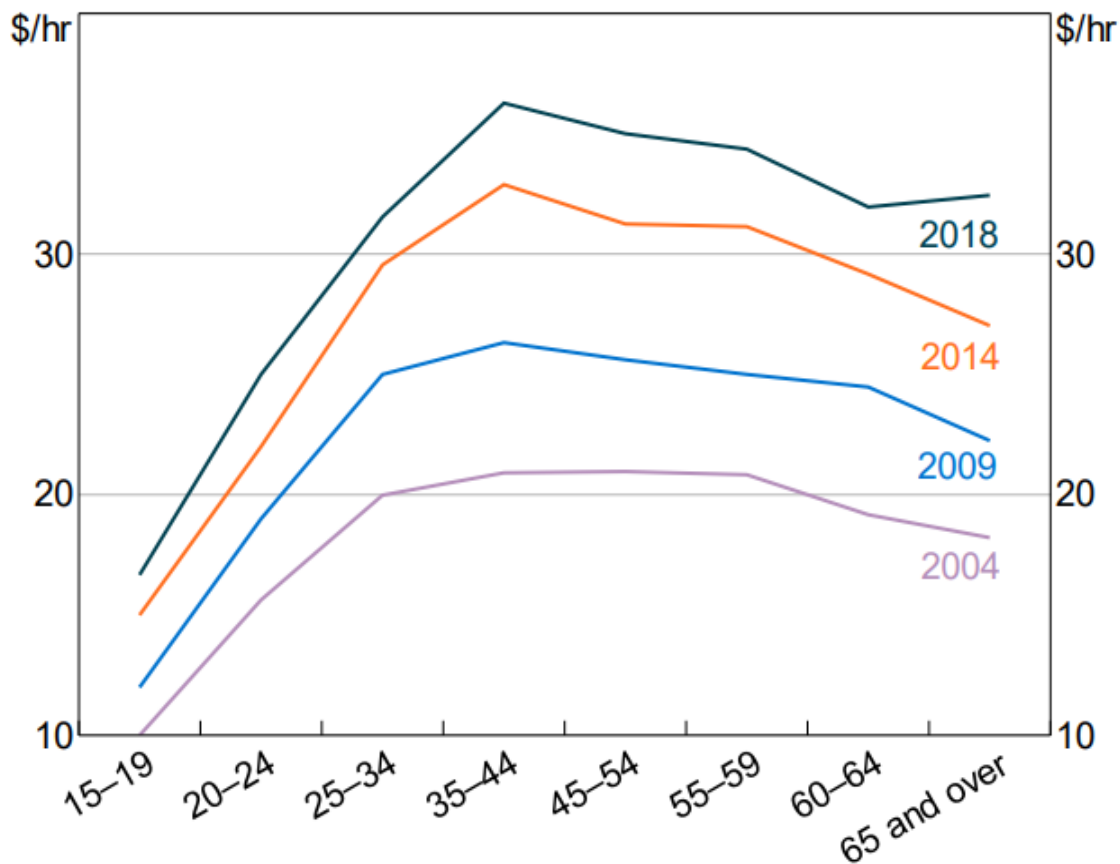


Spares

Minimum wage rates in Australia and in the Netherlands

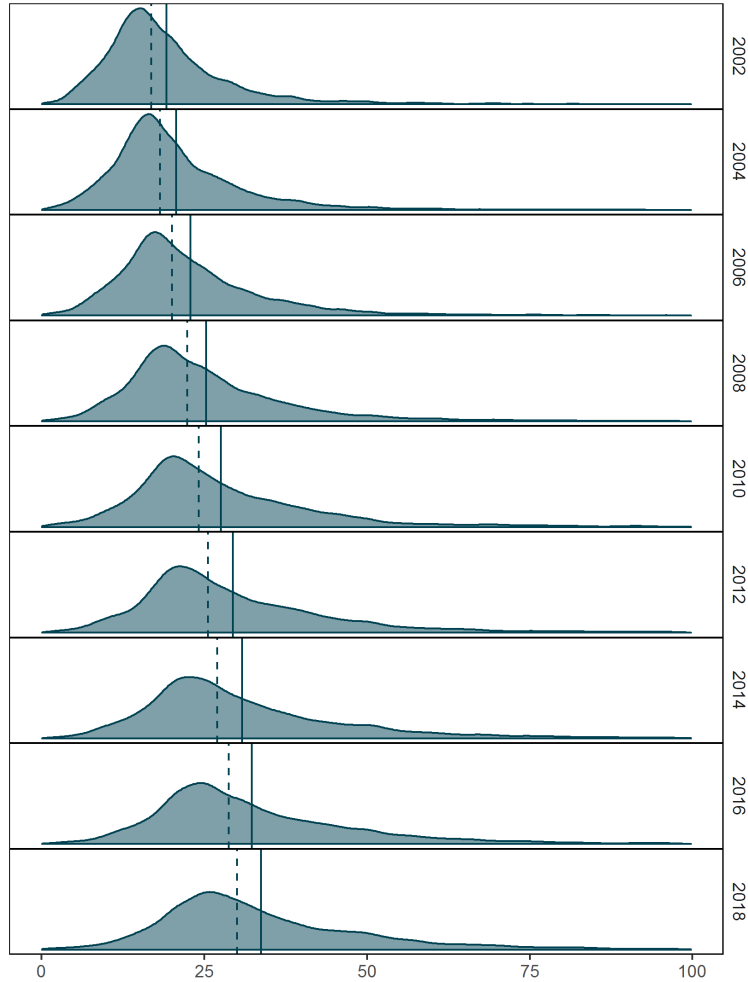


Median Hourly Earnings by Age



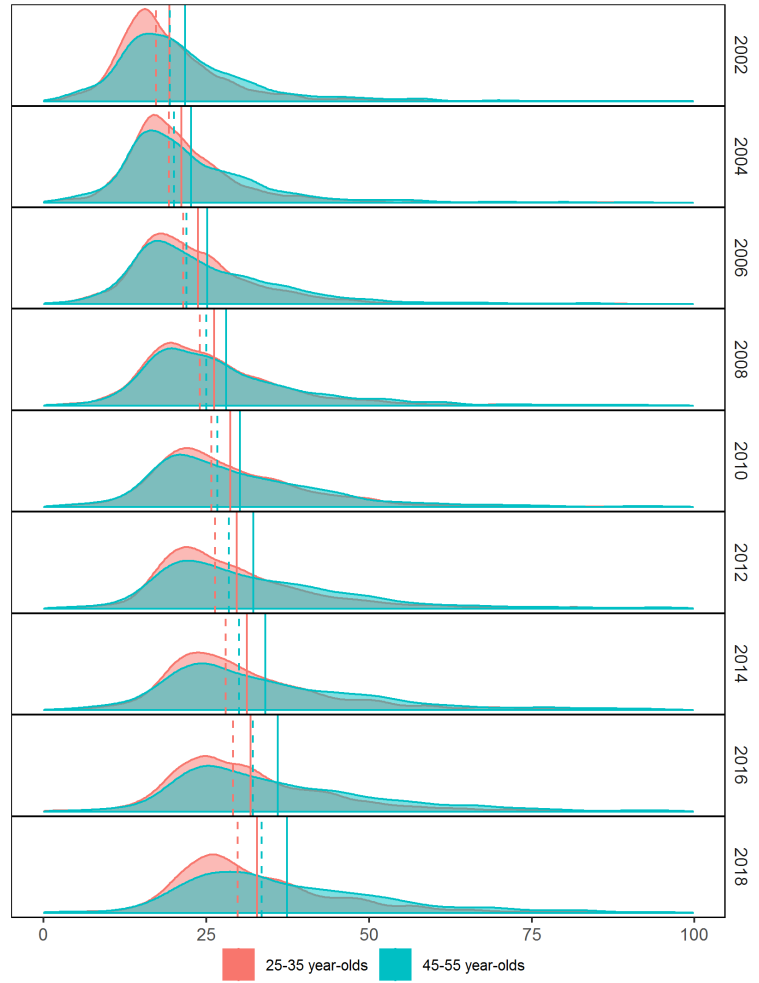
Sources: ABS; RBA

Distribution of Hourly Earnings by Year



Vertical lines indicate mean (solid) and median (dashed)

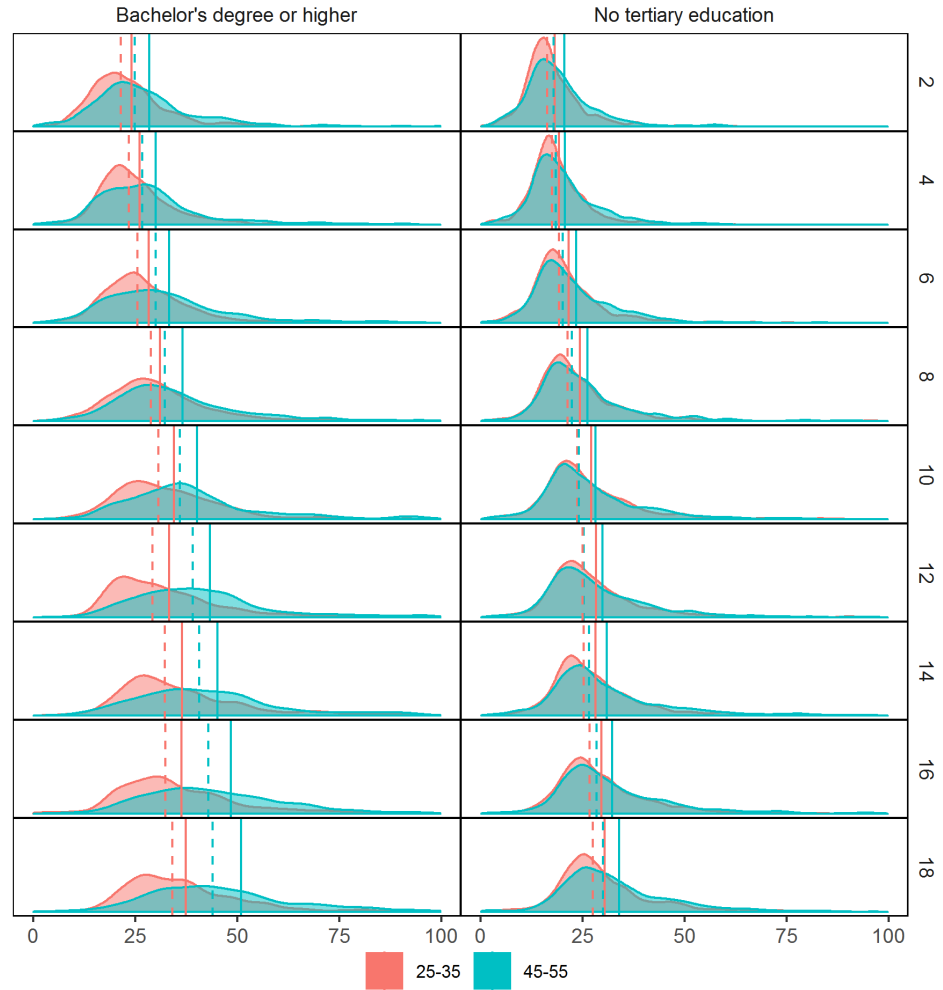
Distribution of Hourly Earnings by Year



25-35 year-olds 45-55 year-olds

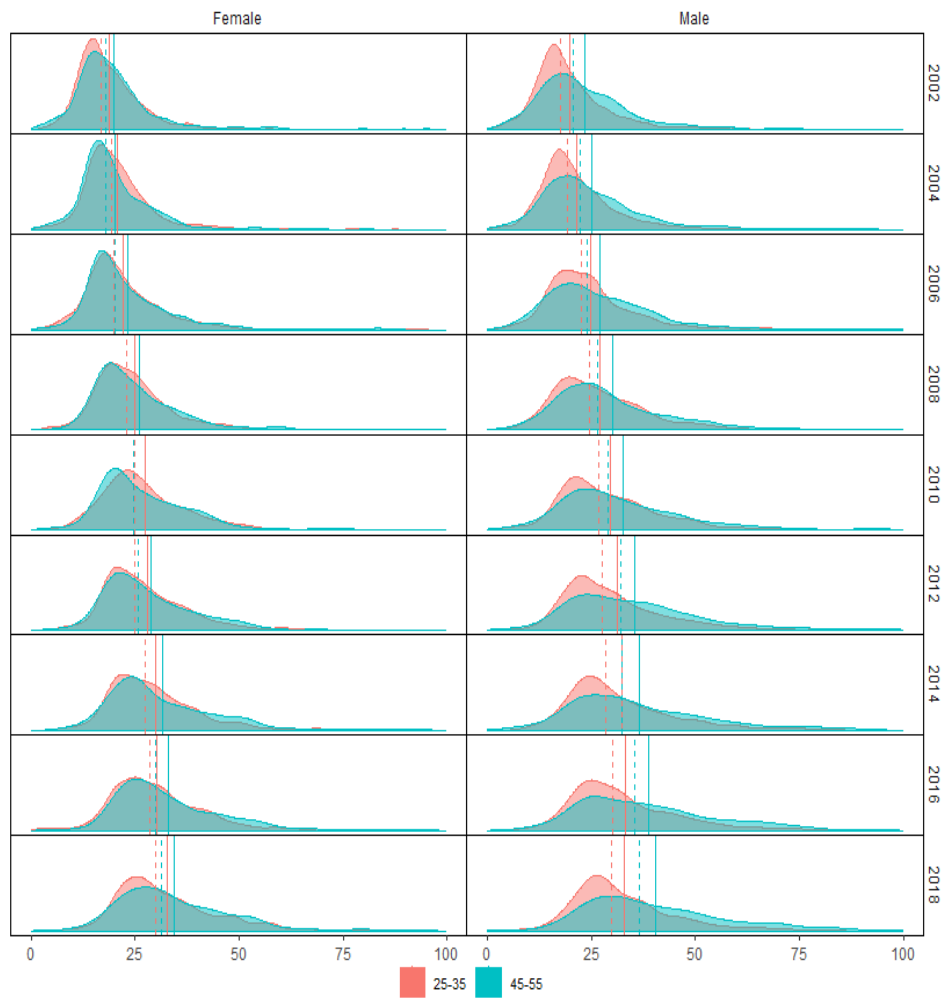
Vertical lines indicate mean (solid) and median (dashed)

Hourly Earnings by HILDA Wave



Vertical lines indicate mean (solid) and median (dashed)

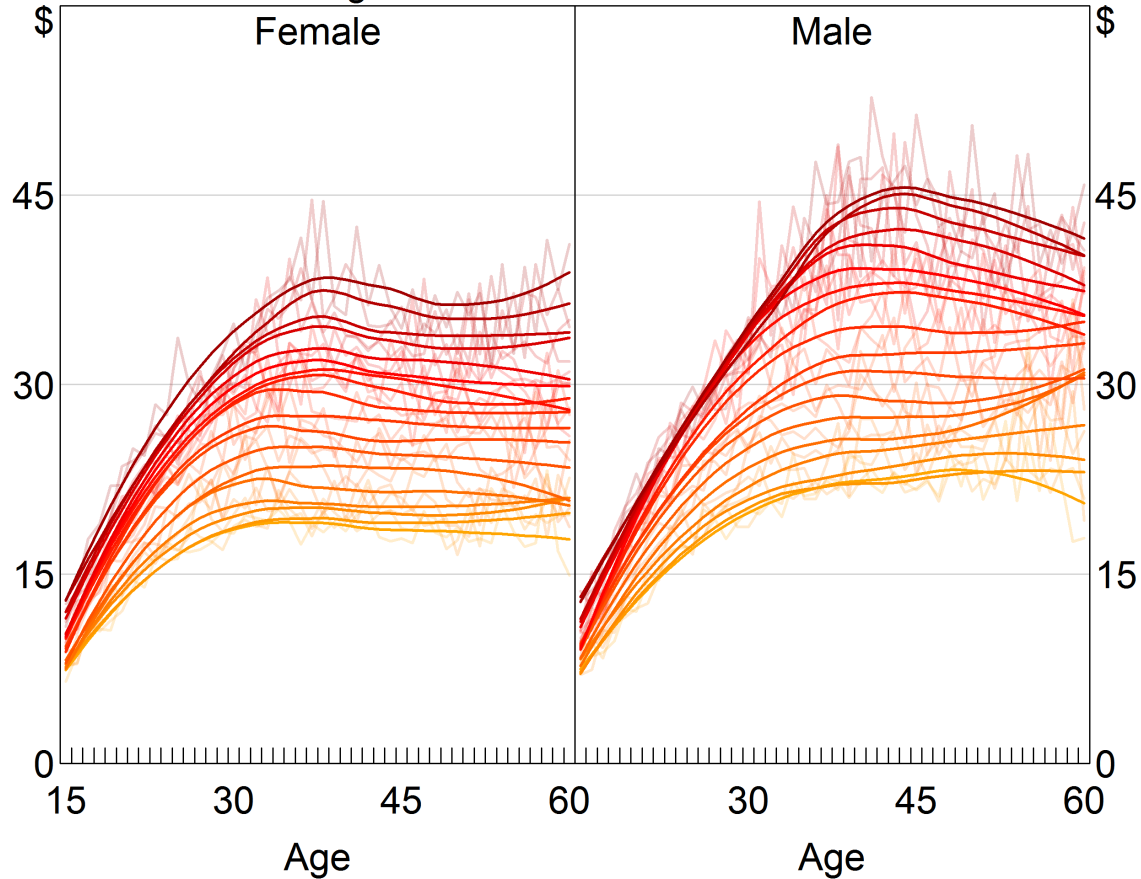
Hourly Earnings by HILDA Wave



Vertical lines indicate mean (solid) and median (dashed)

Average Hourly Earnings by Age*

Orange to red indicates 2001 to 2018



* Smoothed using local polynomial regression fitting

Source: HILDA

From: BLESSING, Tania
Sent: Wednesday, 22 January 2020 11:28 AM
To: EC - Economists; EA - Regional and Industry Analysis; LOWE, Phil; DEBELLE, Guy; ANDERSEN, Michael; DUMOVIC, Marija; ASHDOWN, Emma
Subject: Note EA: Wages: The View From Liaison – December Quarter 2019 [SEC=UNCLASSIFIED]

Liaison evidence suggests that year-ended private sector wages growth declined in the December quarter. On the outlook, our central case is that private sector wages growth will remain broadly steady in coming quarters. The proportion of firms that expect stable wages growth in the year ahead remains high and the proportion of firms expecting stronger and weaker wages growth are now similar. The risks to the outlook appear to be balanced. Continued attempts to limit average wages growth via a broad range of strategies are expected to offset the upward pressure on wages caused by ongoing tightness in certain skilled labour markets.

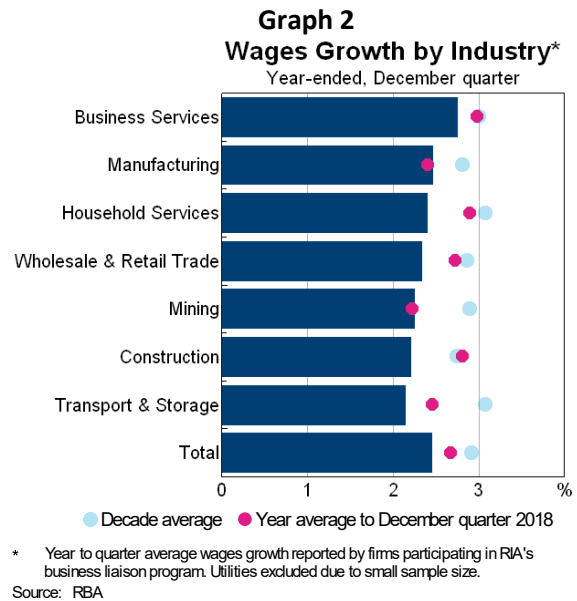
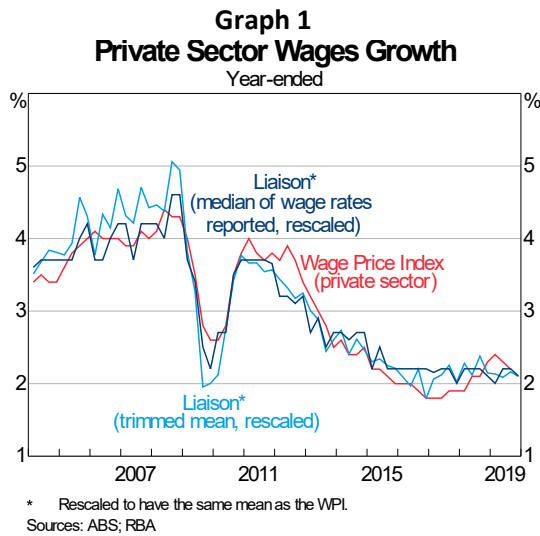
For more information, please see: [Wages: The View From Liaison](#).

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WAGES: THE VIEW FROM LIAISON – DECEMBER QUARTER 2019

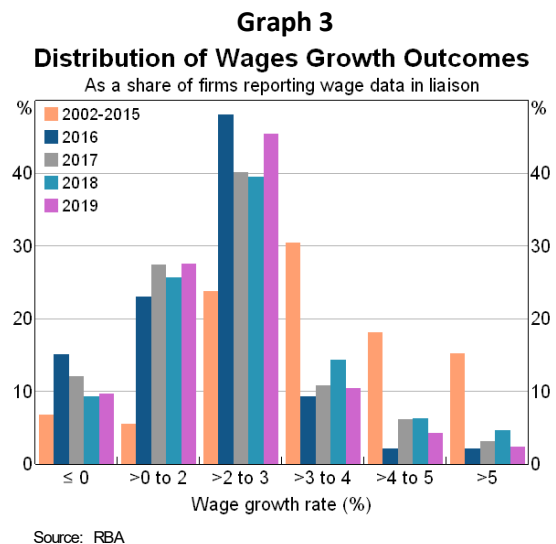
Liaison evidence suggests that year-ended private sector wages growth declined in the December quarter. On the outlook, our central case is that private sector wages growth will remain broadly steady in coming quarters. The proportion of firms that expect stable wages growth in the year ahead remains high and the proportion of firms expecting stronger and weaker wages growth are now similar. The risks to the outlook appear to be balanced. Continued attempts to limit average wages growth via a broad range of strategies are expected to offset the upward pressure on wages caused by ongoing tightness in certain skilled labour markets.

Liaison evidence suggests that year-ended private sector wages growth declined a little in the December quarter (Graphs 1 and 2).¹ Most sectors reported a decline in wages growth relative to a year ago. The decline was most marked in the construction and household & services sectors. The mining and manufacturing sectors reported similar wages growth to the previous year.

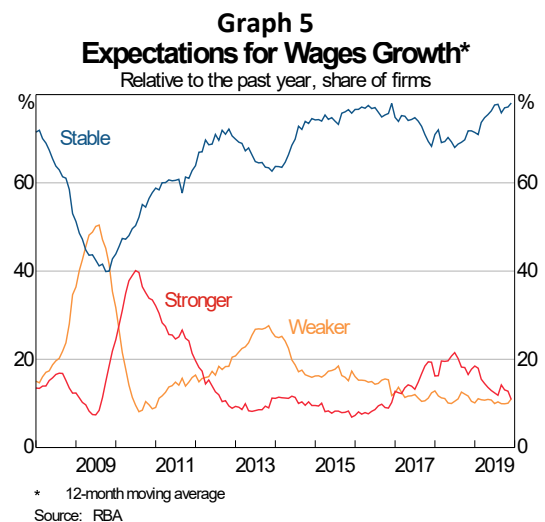
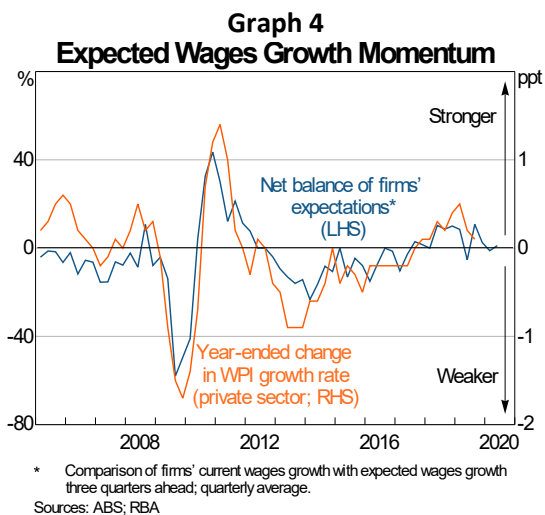


The proportion of firms reporting wages growth of 2 to 3 per cent in 2019 has increased relative to 2018 and the proportion of firms reporting wages growth above 3 per cent declined (Graph 3). Reports of wage freezes in the December quarter were similar relative to the same period a year ago.

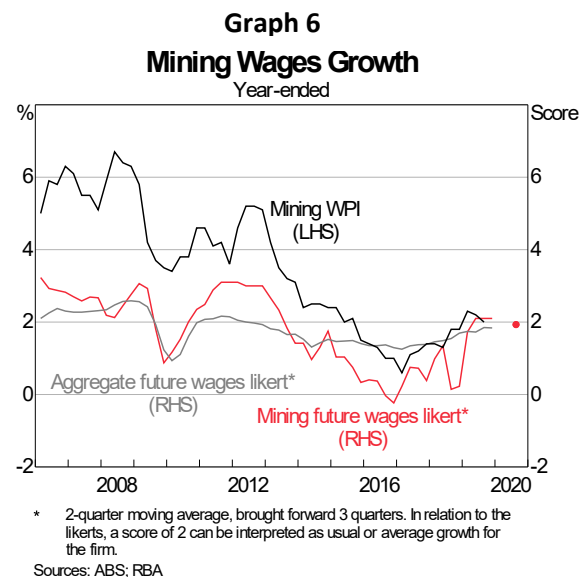
On the outlook, liaison suggests that private sector wages growth will be broadly stable in coming quarters (Graph 4). The proportion of firms that expect steady wages growth in the year ahead remains high and the proportion of firms expecting stronger and weaker wages growth over the year ahead are now similar (Graph 5). Risks to the wages outlook appear to be balanced. Upside risks include:



¹ RIA seeks to measure wages growth on the same basis as the WPI, though it is sometimes difficult to disentangle wage growth outcomes with other measures of labour costs reported by contacts. Further, contacts often report wage outcomes in fairly general terms, which makes it difficult to detect modest changes in wages growth. Differences in industry composition compared with the WPI do not appear to bias the liaison measures of wages.



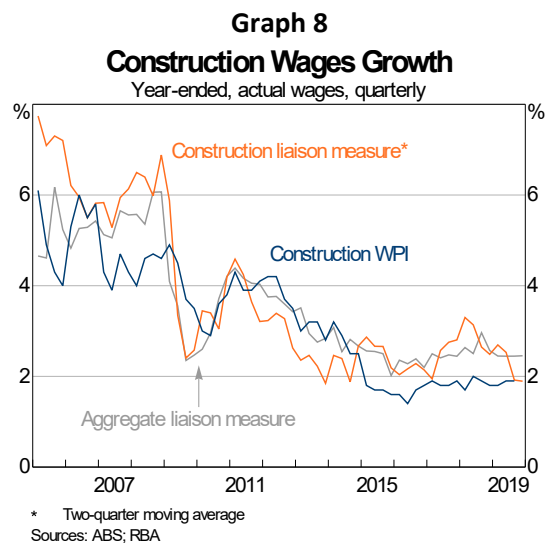
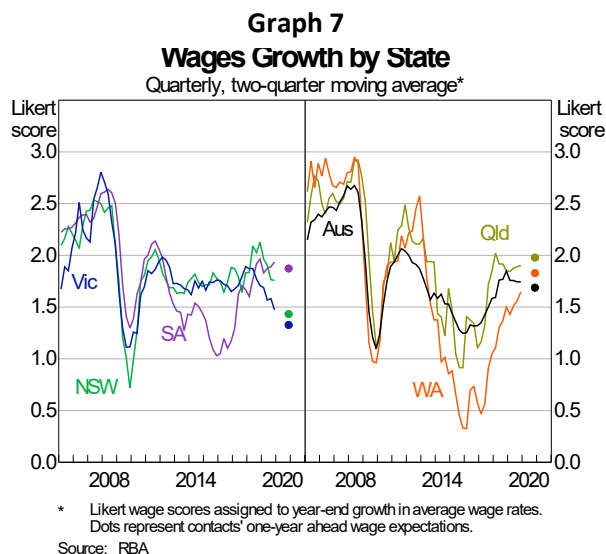
- Reports of labour shortages continued in the December quarter and were similar in proportion to the September quarter.² Three fifths of firms interviewed in the three months to December reported some labour shortages, though the range of skills identified continued to be broadly the same.
- Contacts continued to identify changes to 457 and other visas as contributing to skill shortages in some industries.
- Consistent with reports of tightening labour markets, there is some evidence that upward pressure on wages has broadened in the mining, mining-related and defence-related sectors. Despite this pressure, total wages growth remains contained in the mining industry (more on mining [below](#)). More broadly, an increasing number of firms report that they are paying higher wages in order to retain staff with in-demand skill sets, and several contacts report that new hires are being paid a higher rate of pay than incumbents or exiting staff in response to a tightening labour market.
- Many mining and mining-related firms continue to report that labour markets have tightened for certain skills, in particular heavy diesel fitters/mechanics and engineers, and there are concerns that wage pressures will increase over the coming year. Reports of upward pressure on mining-related contractor and supplier rates also continued in the December quarter. However, major mining companies are looking to contain aggregate wage increases by limiting strong growth to those with niche skills in high demand and expected wages growth in the mining sector for the year ahead is broadly similar to a year ago (Graph 6). Non-wage benefits are also being used/considered in order to retain staff while limiting wages growth.



The downside risks to the outlook include:

- Expected wages growth in the year ahead has declined markedly in New South Wales and to a lesser extent in Victoria (Graph 7), largely driven by firms exposed to the residential construction sector and weakness in the household services sector in Victoria.

- Upward pressure on labour costs in the residential construction sector has eased due to a decline in activity and a resulting increase in labour supply (Graph 8).



- Firms continue to report broadly flat or low voluntary turnover rates and reports of poaching have eased a little relative to previous quarters.
- A weak business environment and margin pressure is limiting some firms' ability to pay higher wage increases, and has resulted in wage freezes at some firms.
- Although reports of wages freezes remain limited in number, the proportion of firms anticipating a wage freeze in the year ahead increased over 2019 (Graph 9). Reports of wages freezes were most common in the construction industry during 2019.

- Businesses continue to apply a range of approaches to restrain wages growth as part of a pervasive focus on costs:

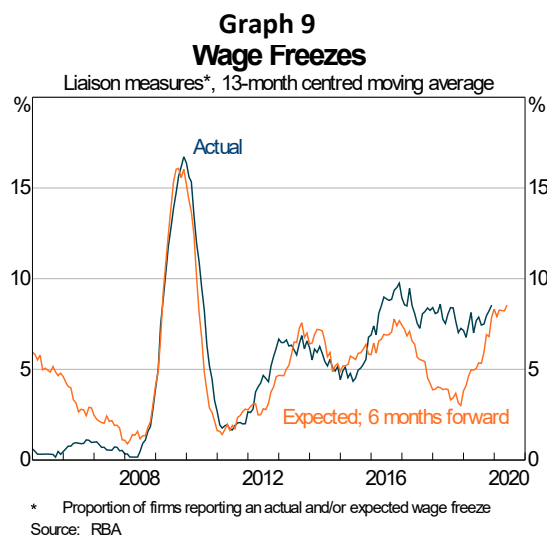
- Many firms link wages growth outcomes to individual performance, providing employers the flexibility to reward and retain strong performers and valued skill sets while keeping average wages growth contained.

- Firms continue to introduce bonuses in lieu of pay increases or higher pay, for retention purposes or to reward good performers. Some firms are also paying higher allowances to certain staff at risk of seeking alternate employment. These strategies may reflect firms' unwillingness to add permanent increases to their cost base.

- A broadening range of non-wage incentives to attract and retain staff, including flexible work arrangements, professional training and development, and additional leave continues to be a focus for firms.

- Some firms report limiting growth in labour costs by paying higher wage increases to only junior or low-paid staff or employees who had not received an increase over the past few years.

- An increasing number of firms report that they are employing more graduates or junior staff in order to contain wage bills. Others are employing inexperienced workers and providing the training needed.



- A small number of firms report offshoring roles in response to labour shortages or to contain their wages bill.
- Plans to move contract or casual labour to permanent staff in a bid to retain staff and lower labour costs have been reported by some mining and mining-related firms.
- Many firms report ‘around or in line with CPI inflation’ when discussing actual and expected wages growth. Additionally, a number of firms report that they consider inflation outcomes when determining wage increases, though fewer contacts directly link increases to ‘CPI’.³

Public sector WPI forecasts

Most WPI forecasts recently released by state treasuries have been revised down by $\frac{1}{4}$ - $\frac{1}{2}$ per cent in comparison to figures published in the 2019/20 Budget Papers, with the exception of the Queensland Treasury (Table 1). The Australian Treasury also lowered its WPI growth forecasts for 2019/20 and 2020/21.

Table 1: State Wage Price Index Forecasts by State Treasuries*

	Year-average percentage change								
	2018/19	2019/20	2019/20	2020/21	2020/21	2021/22	2021/22	2022/23	2022/23
	Actual	Budget	MYR	Budget f	MYR f	Budget f	MYR f	Budget f	MYR f
New South Wales	2.1	2.50	2.25	2.75	2.50	3.00	2.75	3.00	2.75
Victoria	2.7	3.00	3.00	3.50	3.25	--	3.25	--	3.50
Queensland	2.3	2.25	2.25	--	2.50	--	--	--	--
Western Australia	1.6	2.25	2.00	2.75	2.25	--	2.50	--	2.75
Australia	2.3	2.75	2.50	3.25	2.50	--	2.75	--	3.00

* No revisions are available for remaining states and territories and some states in the out years.

Sources: ABS; Department of the Treasury; State Budgets

Tania Blessing
Regional and Industry Analysis
Economic Group
22 January 2020

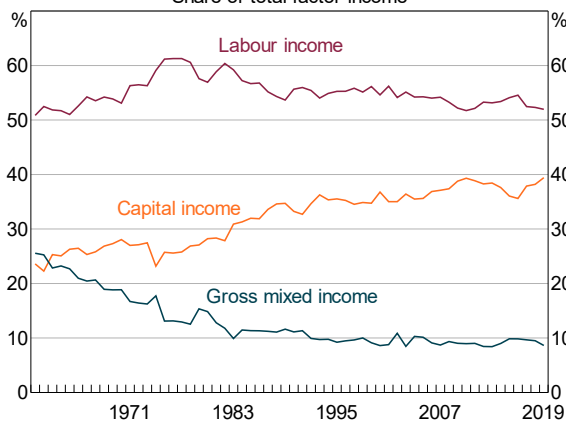
³ See [Wiltshire, 2015](#) for further details on firms’ wage setting behaviour. An update on wage setting methods is forthcoming.

WAGES AND LABOUR SHARE

Labour share

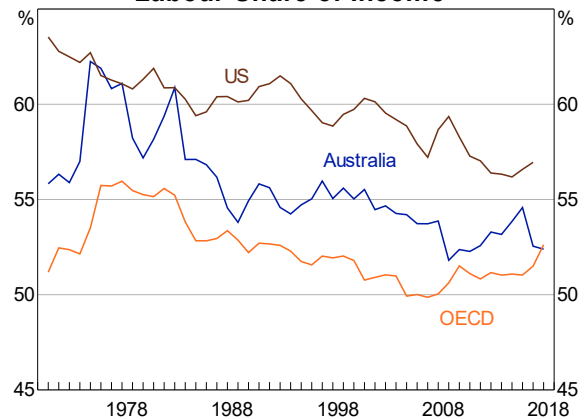
- The labour share of income rose over the 1960s and early 1970s but has gradually declined since then
- Other countries have experienced similar declines
- Longer-run trends depend in part on how the labour share is measured, though the overall conclusion that the labour share has declined since the 1970s is not affected.
 - [La Cava's \(2019\)](#) measure, which captures trends in the factor shares including income accruing to land and dwellings, suggests a smaller decline in the labour share than [Weir's \(2018\)](#) measure, which restricts attention to the corporate sector.

Graph 1
Labour and Capital Income*
Share of total factor income



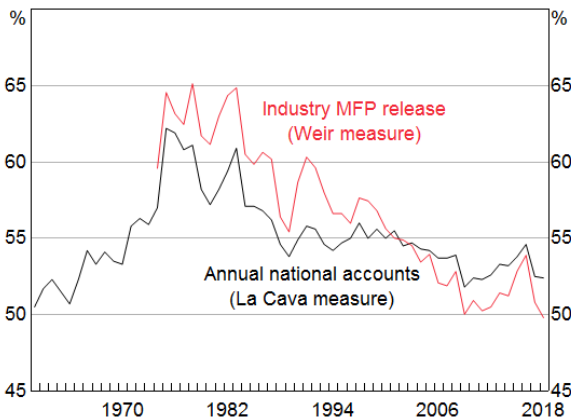
* Labour income measured by compensation of employees; capital income measured by gross operating surplus
Source: ABS

Graph 2
Labour Share of Income*



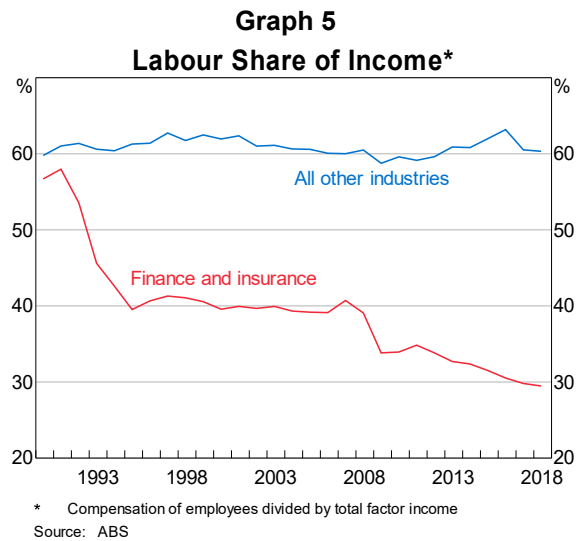
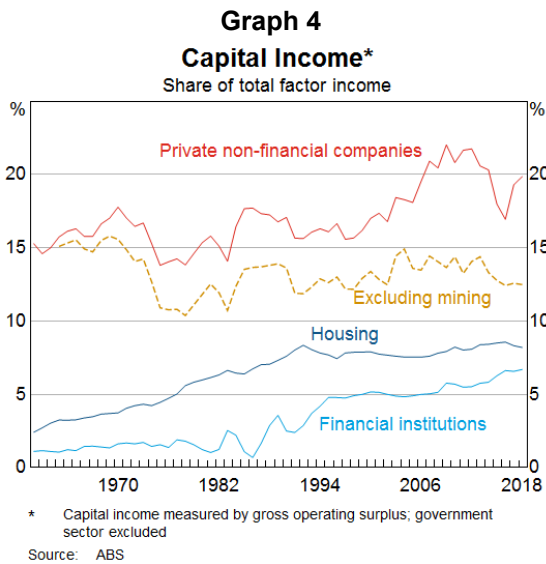
* Compensation of employees divided by total factor income
Sources: OECD; RBA

Graph 3
Labour Share of Income

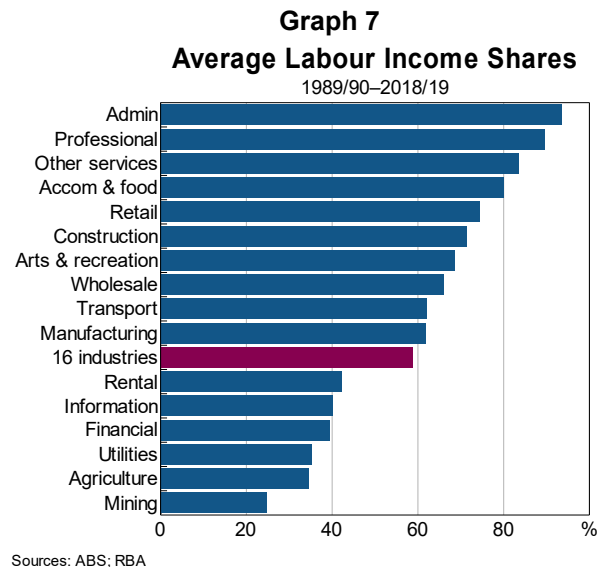
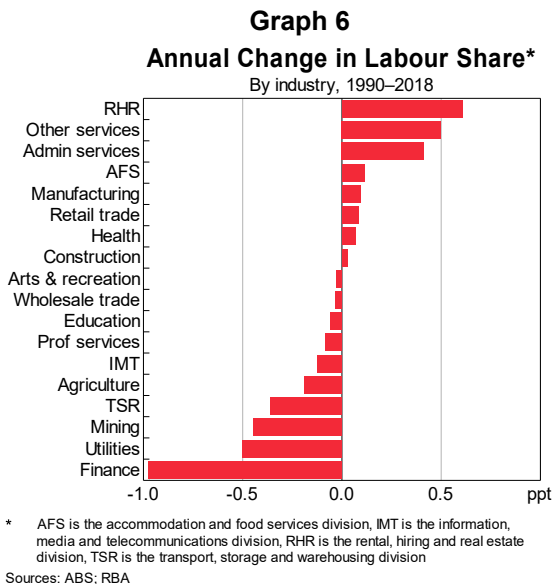


Source: ABS

- La Cava:
 - The long-run increase in the capital share largely reflects higher returns to owners of housing (mainly **imputed rents** to owner-occupiers, esp. before the 1990s). ½ of this reflects the higher relative price of housing and ½ is ‘real’ factors such as increases in the size and quality of housing.
 - The capital share in the **finance industry** has risen strongly since deregulation in the 80s. Capital share estimates for finance are affected by measurement issues, though structural factors (such as a high rate of investment in IT) have reduced employment (e.g. bank tellers) and increased capital (e.g. ATMs). Excluding the finance sector, the labour share has been broadly flat for two decades.
 - The **mining boom** led to a temporary rise in the capital share during the 2000s as mining profits rose. It also contributed to the overall upward trend because commodity prices remained elevated.



- The labour share rose in some industries and fell in others. The shift from manufacturing to services had little effect on the labour share, as those two sectors had similar labour shares in the early 90s.



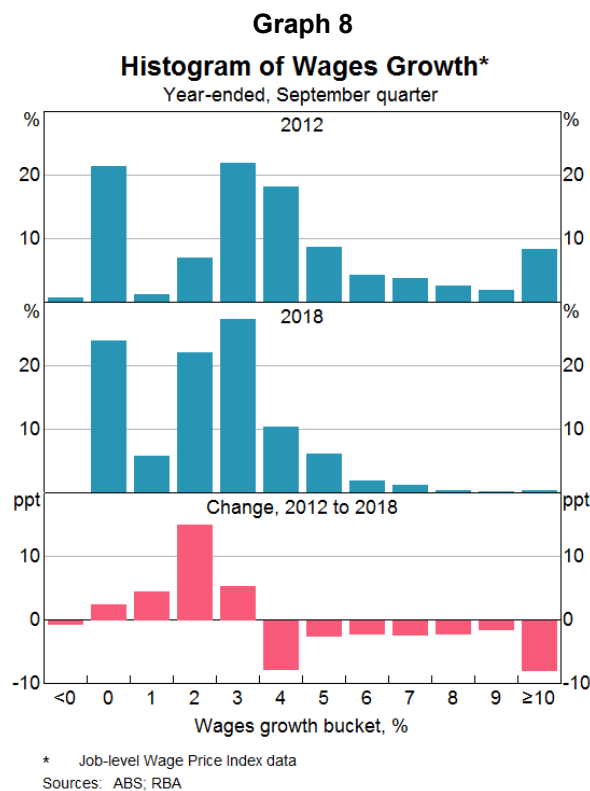
Theory/international research

Economic theory and overseas research points to three leading explanations for declining labour share:

1. Technology: increased automation or a decrease in the cost of capital
2. Globalisation: decrease in the cost of foreign labour relative to domestic labour
3. Market power: decrease in worker bargaining power

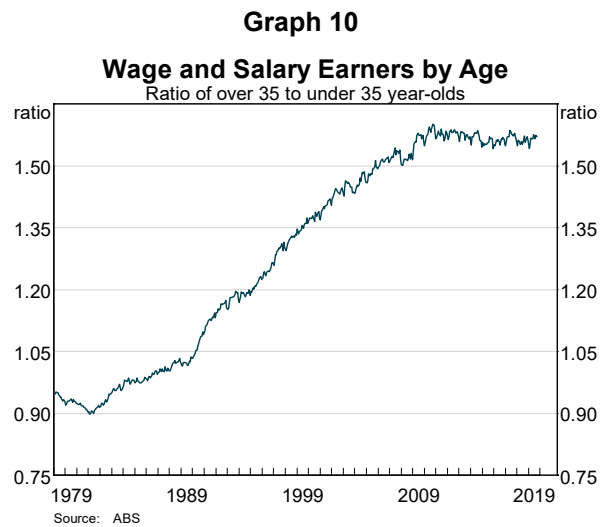
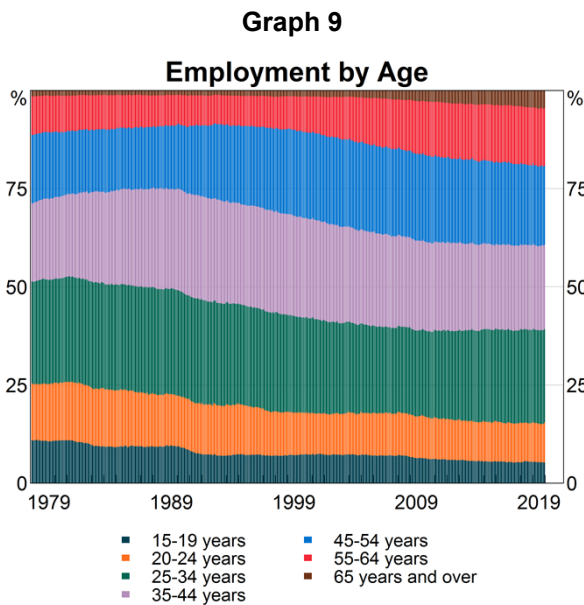
Distribution of wages growth across the labour market

- As wages growth has fallen, the distribution of wages growth has also become increasingly compressed. This fall in dispersion across jobs mainly reflects a sharp fall in the share of jobs receiving 'large' wage rises. The vast majority of wage growth outcomes are now tightly clustered in the range of 0–4 per cent.
- Analysis by [Treasury \(2017, 2019\)](#) and [Kalb and Meeks \(2019\)](#) (RBA conference 2019) using microdata also finds that the slowdown in wage growth has been broad based and has been experienced across income, education, age and occupation categories.
- Wages growth is low across all three methods of setting pay.

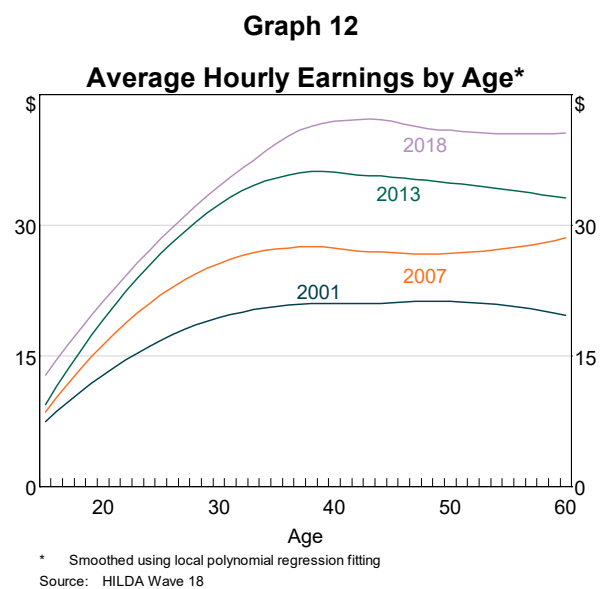
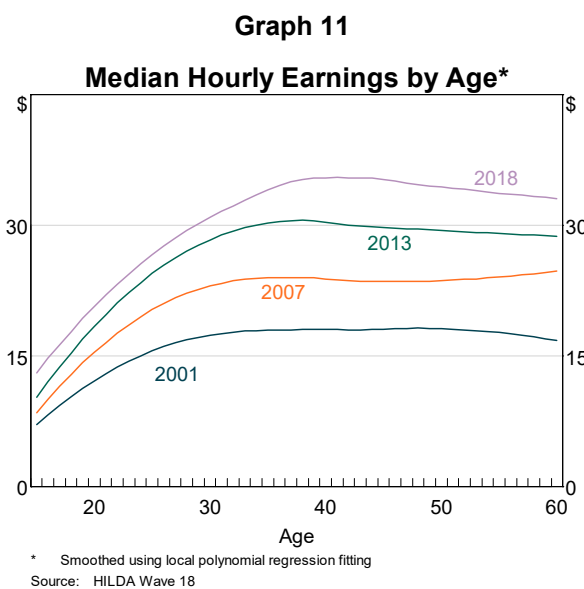


Labour market composition and earnings

- The share of workers aged over 35 years old increased steadily from around 1980
- Since around 2011, the share above 35 has been stable, though the share of employees above 55 has continued to increase.



- By age, earnings increase steeply at first, before flattening or gradually declining.
- The age at which the increase in earnings by age tapers has been increasing.
- The dispersion of hourly earnings has increased over time (Graph 13)
- The increasing dispersion of earnings is much more pronounced for later-career workers (Graph 14)



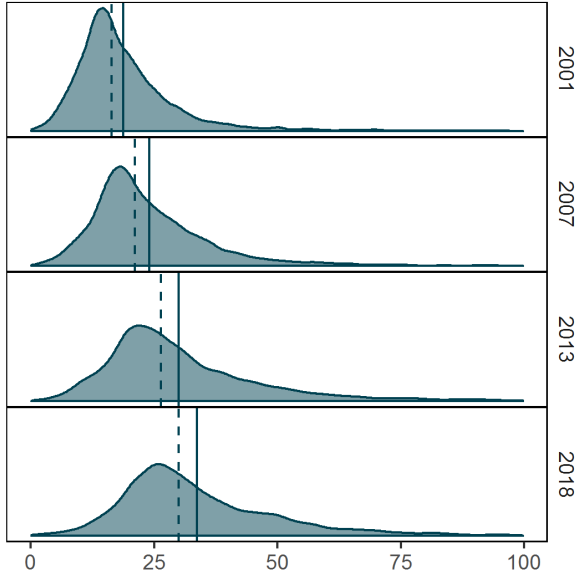
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Graph 13

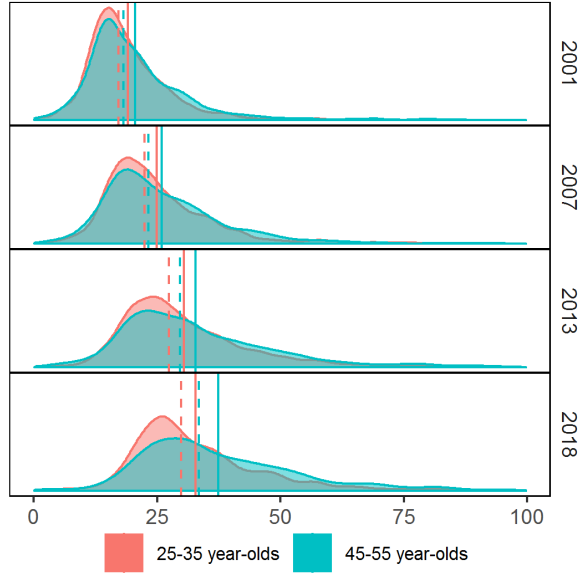
Distribution of Hourly Earnings by Year



Vertical lines indicate mean (solid) and median (dashed)
Source: HILDA Wave 18

Graph 14

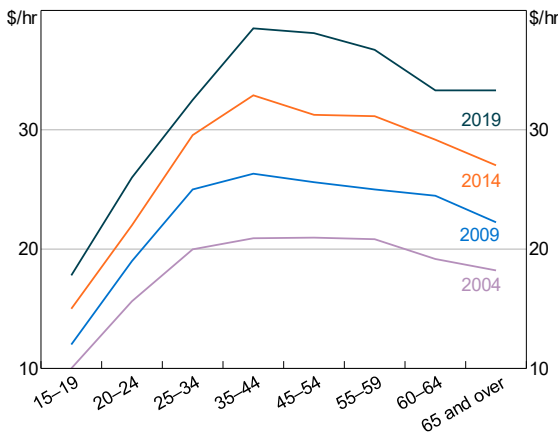
Distribution of Hourly Earnings by Year



Vertical lines indicate mean (solid) and median (dashed)
Source: HILDA Wave 18

Graph 15

Median Hourly Earnings by Age

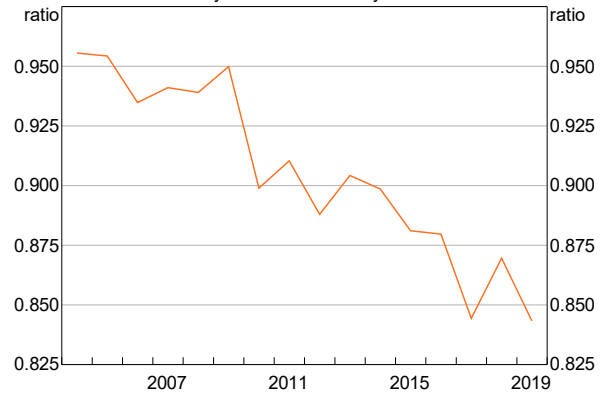


Sources: ABS; RBA

Graph 16

Relative Median Hourly Earnings

25-34 year olds vs. 35-44 year olds



Sources: ABS; RBA

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[Summary]

We've made a downward revision to our employment growth forecast in the near-term.

- On top of the weaker GDP profile that Dave just discussed, we've also taken some signal from weak employment data that we've seen for DQ so far.
- Been hard to gauge underlying momentum – mixed signals from leading indicators.

The wage growth forecast has been revised lower from mid-2021 onwards – due to the legislated increases to the super guarantee, which we assume will lead firms to rein in wage growth a bit.

Today I'll run you through each of these profiles and also discuss some of the risks to the outlook.

[Wages]

Turning now to **wages**

- The forecast for WPI growth has been revised a little lower from mid-2021 onwards.
- Although we still expect wages growth to remain stable for next 18 months, we're now forecasting it to dip down a little after that.
- The near-term forecast for flat growth is in line with our models + information we've been getting from liaison that a large share of firms continue to expect stable wage outcomes.
- Further out, the decline spare capacity is putting some upward pressure on wages growth

But that's being more than offset by the impact of the increases to the super guarantee, which we've now incorporated into our profile.

[SG – legislated increases]

At the moment, an employer is required to make super contributions equivalent to 9½ per cent of your wage.

Over the next 5 years that's set to rise to 12 per cent.

As you can see, this change is being phased in gradually– with ½ppt increase happening on the 1st July every year, starting from next year.

This will represent an additional cost to firms.

The main question for our forecasts is: how will firms adjust to this increase in costs?

Will they reduce wages by an offsetting amount? Or will they absorb it in their margins? Or maybe raise prices

Taylor has been doing some great work thinking through the implications of this for our wage growth forecasts. I'll summarise here:

[Impact of SG]

On balance, the evidence suggests that firms will pass on most of the cost through to wages.

We've assumed 80 per cent pass through in the long run.

That's consistent with some soon-to-be-released analysis by the Grattan Institute ... which looked at the effect of the previous increases in the SG on wage growth. Also consistent with:

- International evidence
- Theory³
- Eyeballing long-run trends in the labour share

That's our assumption for long run pass through. But we've also had to think about how quickly that pass through will happen.

The literature gives us a rough guide, but we've also had to apply a fair bit of judgement.

We're assuming that pass through happens fairly gradually – $\frac{3}{4}$ of total amount in the 1st year, rest spread out over next 3 years.⁴

Because we're assuming pass-through takes some time, we're effectively pushing some of the impact out beyond the end of our forecast horizon.

[Impact on WPI]

Our Phillips curve model for private sector wage growth doesn't 'see' these upcoming changes to the super guarantee.

So what we do is we use our PC model to create a baseline profile (can see here in blue).⁵

Then we make an adjustment to that profile for the effect of the super increase (gives us magenta).

³ Valuation of super likely close to \$1, and estimates suggest that demand more elastic than supply in LR.

⁴ Informed by our understanding of wage-setting in Australia, and a nod to the large stock of wage freezes.

⁵ The blue profile is not just the model output. It has judgement too. We're leaning on the model a little in the near term as a nod to the negative bias of our recent forecast errors, but fade that judgment towards the end of the horizon.

As you can see, this shaves $\frac{1}{4}$ ppt from year-ended growth in the WPI at end of our forecast period (June 2022)⁶

[\[back\]](#)

We've also had to make some assumptions about how the policy change will affect the actual super payments made by firms.

We know they'll go up, but we also know that not all wage income attracts a super payment.

We've assumed that the higher super rate will apply to 90 per cent of all wage income in the private sector

In the national accounts, this shows up as 'Employer Social Contributions', which is a component of COE.

[\[Impact on COE\]](#)

That's important to note:

We have wages going down, super payments going up, so these offsetting movements largely neutralise the effect on COE.⁷

Just a change in the composition of COE.

That's important because what ultimately matters for inflation is **unit labour costs** – based on the broader COE concept rather than the narrower WPI concept. So there is little impact on inflation.⁸

Now, you can see a very small positive effect on COE on impact.

[\[back\]](#)

... this just reflects our assumption that firms start paying the higher super rate immediately. (need to comply with law)

But that it takes them longer to pass those costs through to wages.

[\[back\]](#)

In the public sector, we're expecting less of an impact.

⁶ 24bps; private is 21bps, public 3bps (NSW)

⁷ Tash: worth spelling out here that without full pass through we do get some pick up in CoE

⁸ Notwithstanding impact on consumption/saving and GDP

In part that's because many people in public sector are already paid well above the current 9½ super guarantee (some 12 per cent+).⁹ So the increases over the next few years won't actually bind for those employees.

And for a big chunk of those it does bind for, we don't think there will be much pass through above what's already built into the profile.

That mainly reflects our reading of current government wage policies (and how those policies will interact with a higher super guarantee).

The only exception is NSW, where we are factoring in full pass through to wages.¹⁰

⁹ Only affects super for 60% of the public sector.

¹⁰ Should also point out that our forecasts for public sector wage growth largely keys off EBAs that have already been agreed to. Many of those EBAs span the increase in the in the super guarantee ... in that sense, any effects on wages will already been 'priced in'. So, if we make another adjustment on top of that, we'll be double counting.

[Table]

- So to reiterate, overall:
- The outlook for wages growth now accounts for the impact of the super guarantee – so, for that reason it's softer in the out years; and

¹¹ Output gap revision also inflationary.

From the perspective of economic theory, the extent to which firms pass this cost on to wages depends on whether the demand curve for labour is more elastic than the supply curve for labour, or vice versa.¹²

But it also depends on how much people actually value super. If they think of an extra \$1 of wage income as being pretty much the same as an extra \$1 in their retirement account, then theory tells us that the entire cost of a higher super guarantee rate will be borne by employees ...

...passed on in the form lower wage growth.¹³

¹² SR vs LR; similar to tax analysis (economic incidence vs legal incidence) in that respect.

¹³ Depends on individual discount rates and interactions with tax system and pension benefits.

But if people value super less than they value wages, then there won't be full pass through to wages, which means that employers will bear some of the cost.

Ultimately, it's an empirical question.

Taylor has been doing some great work thinking through the implications for our wage growth forecasts.

PWL Forecasts

Policy Meeting

23 January 2020

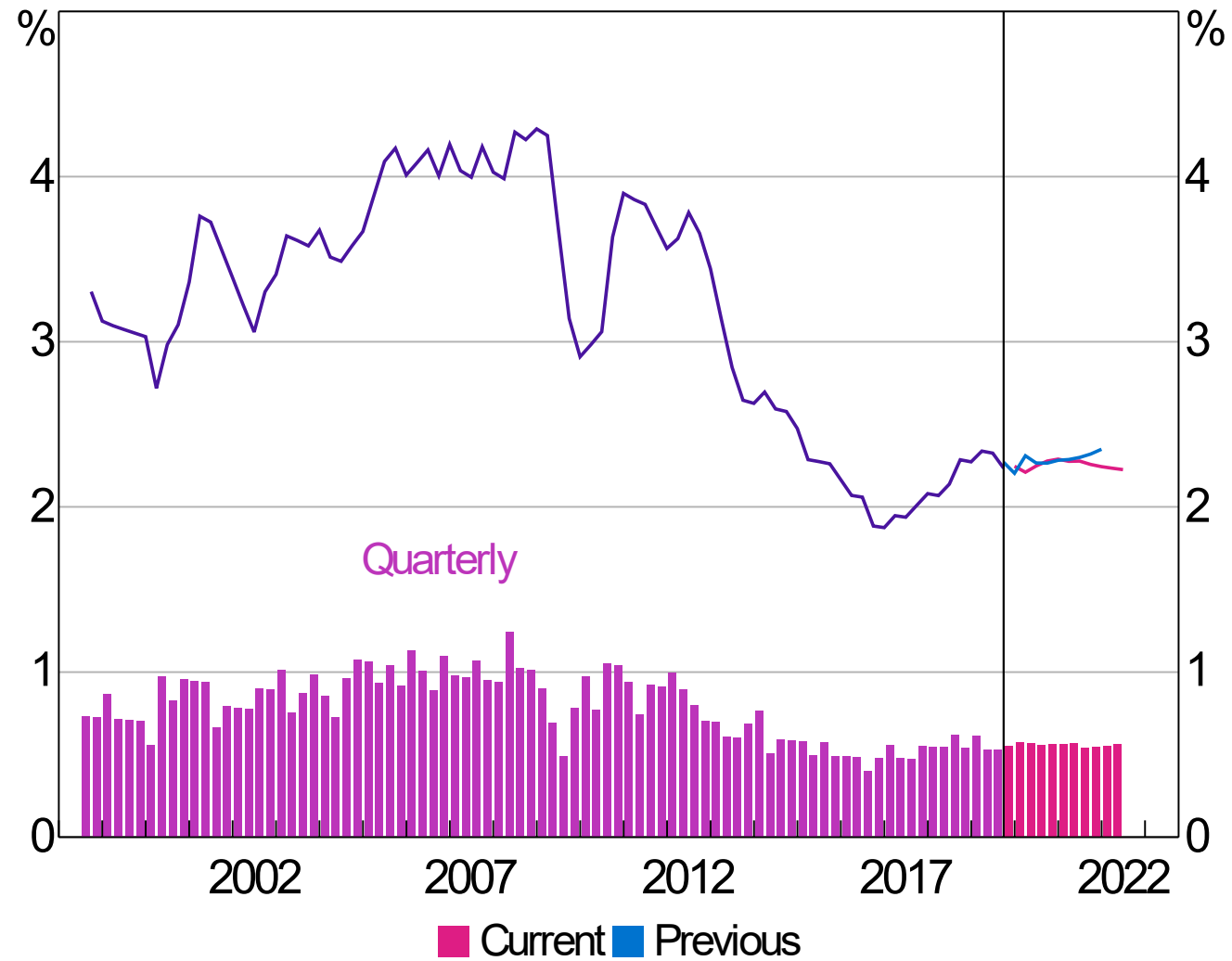
Summary

- Wages growth forecasts have been revised lower from mid 2021
... due to planned increase in super guarantee

Wages

Wage Price Index Growth*

Year-ended

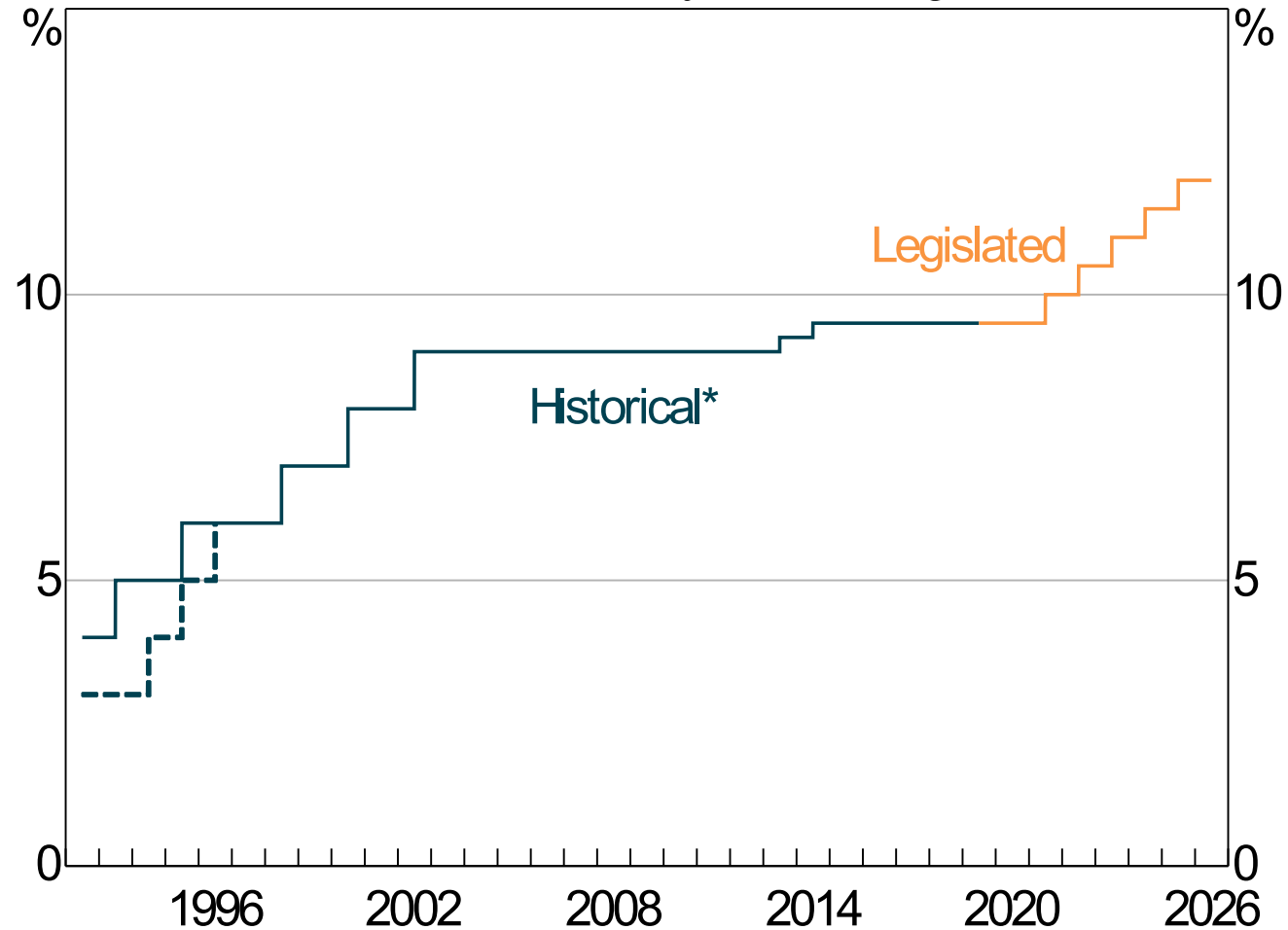


* Excluding bonuses

Sources: ABS; RBA

Super Guarantee

Per cent of ordinary time earnings



* Dotted line indicates lower rate for employers with a payroll below \$1 million in 1991-92

Source: Superannuation Guarantee (Administration) Act 1992

Rise in super guarantee

Private

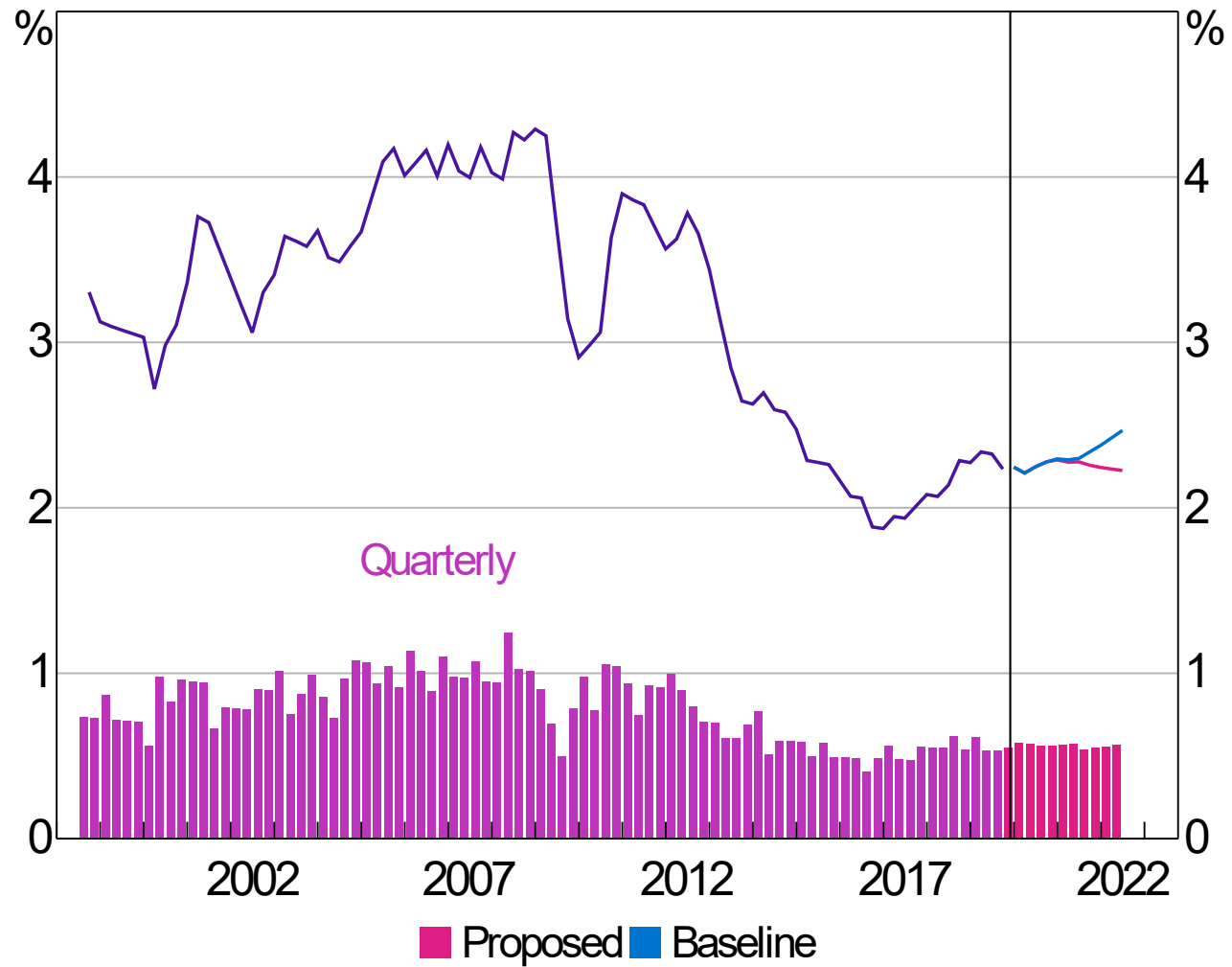
- 80 per cent pass-through to wages
 - Staggered over four years
- 90 per cent pass-through to super payments
 - Immediate

Public

- Smaller pass through due to existing benefits and wage policies

Wage Price Index Growth*

Year-ended



* Excluding bonuses

Sources: ABS; RBA

Rise in super guarantee

Private

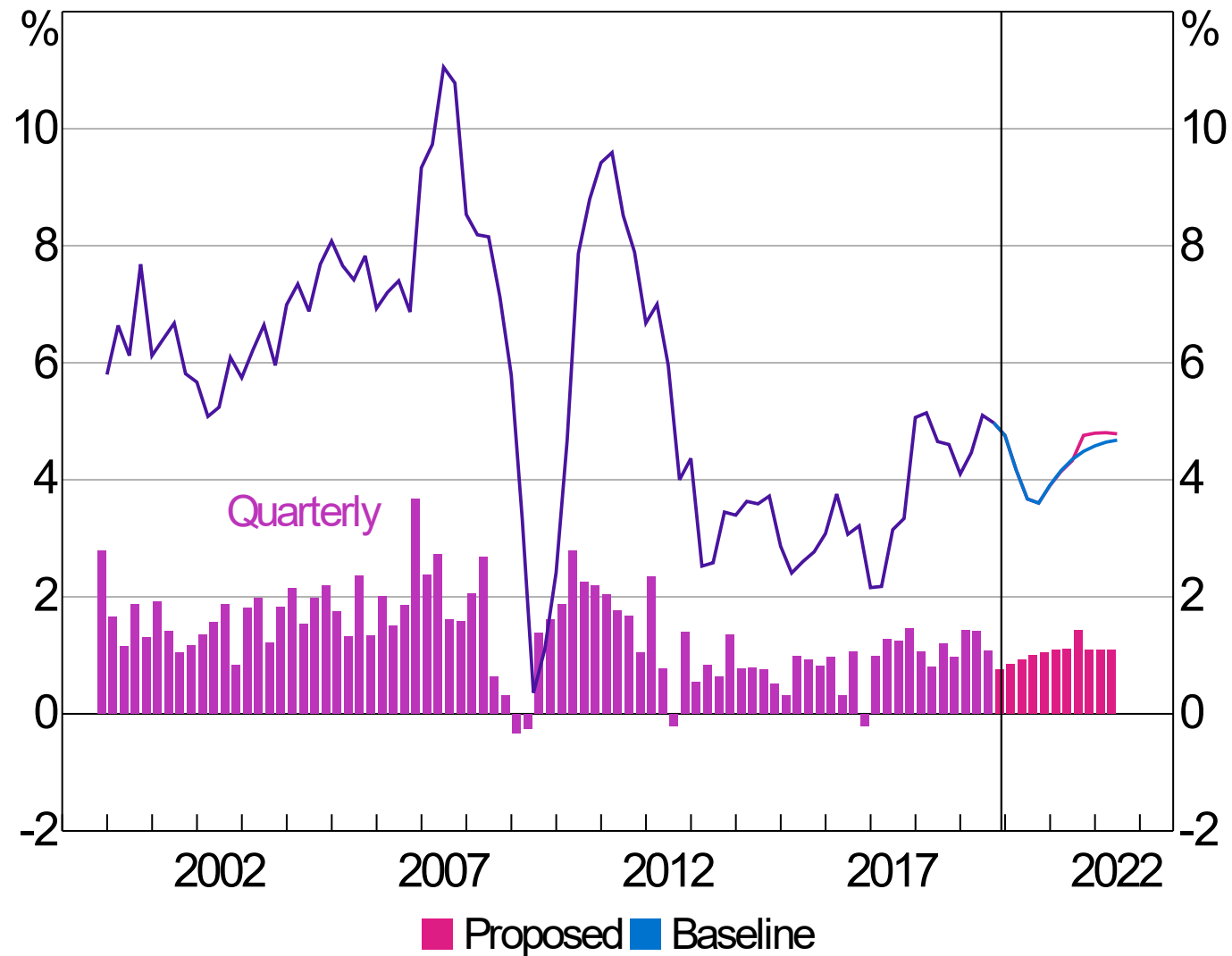
- 80 per cent pass-through to wages
 - Staggered over four years
- 90 per cent pass-through to super payments
 - Immediate

Public

- Smaller pass through due to existing benefits and wage policies

COE Growth

Year-ended, non-farm



Sources: ABS; RBA

Rise in super guarantee

Private

- 80 per cent pass-through to wages
 - Staggered over four years
- 90 per cent pass-through to super payments
 - Immediate

Public

- Smaller pass through due to existing benefits and wage policies

Appendix Table – February 2020

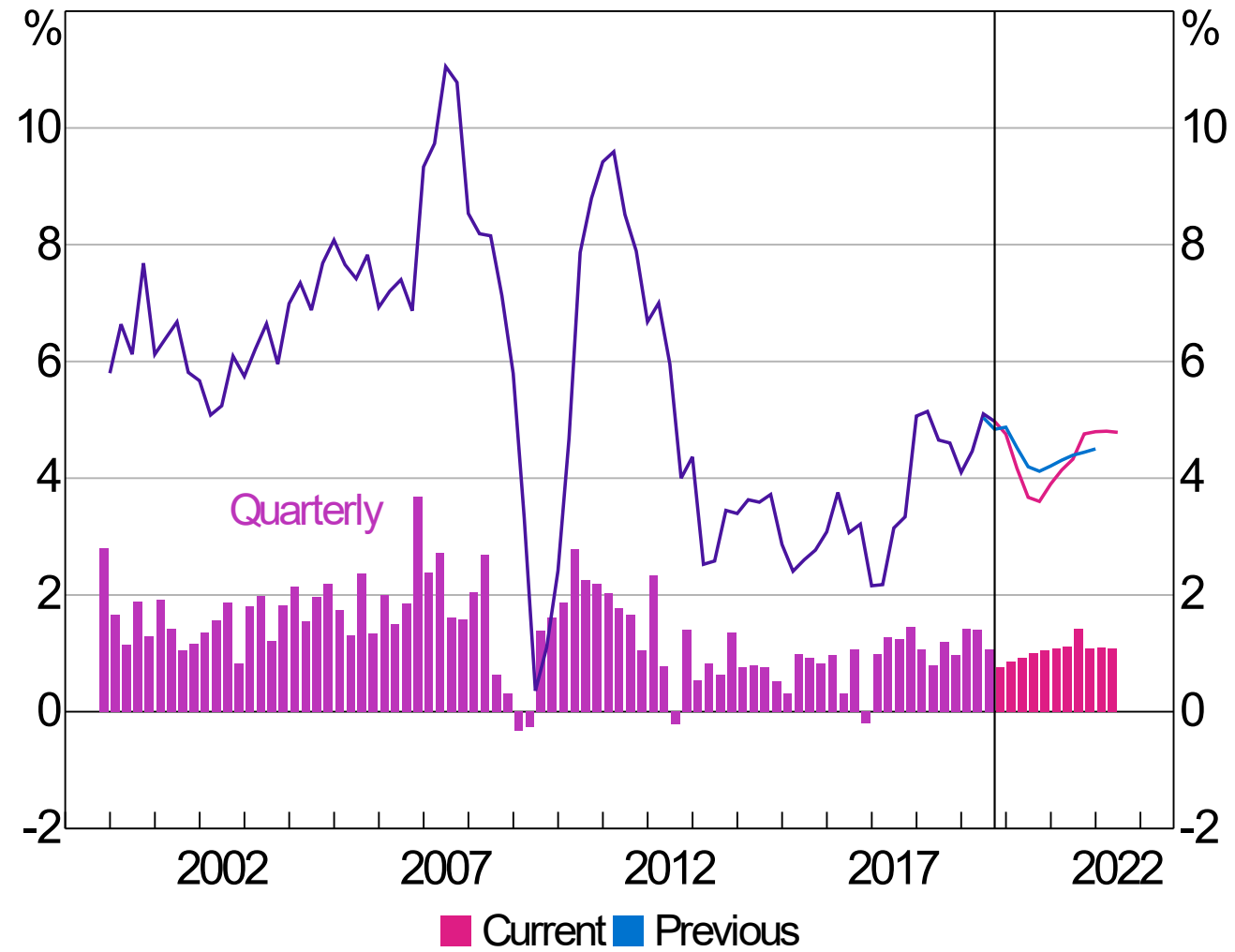
Percentage change over year to quarter shown, change from previous SMP in parentheses

	Dec-19	Jun-20	Dec-20	Jun-21	Dec-21	Jun-22
Wage price index	2.2 (0.0)	2.2 (-0.1)	2.3 (0.0)	2.3 (0.0)	2.2 (-0.1)	2.2 --
Nominal (non-farm) average earnings per hour	3.1 (0.5)	2.6 (0.3)	2.4 (0.0)	2.5 (0.0)	2.8 (0.2)	2.8 --

Spares

COE Growth

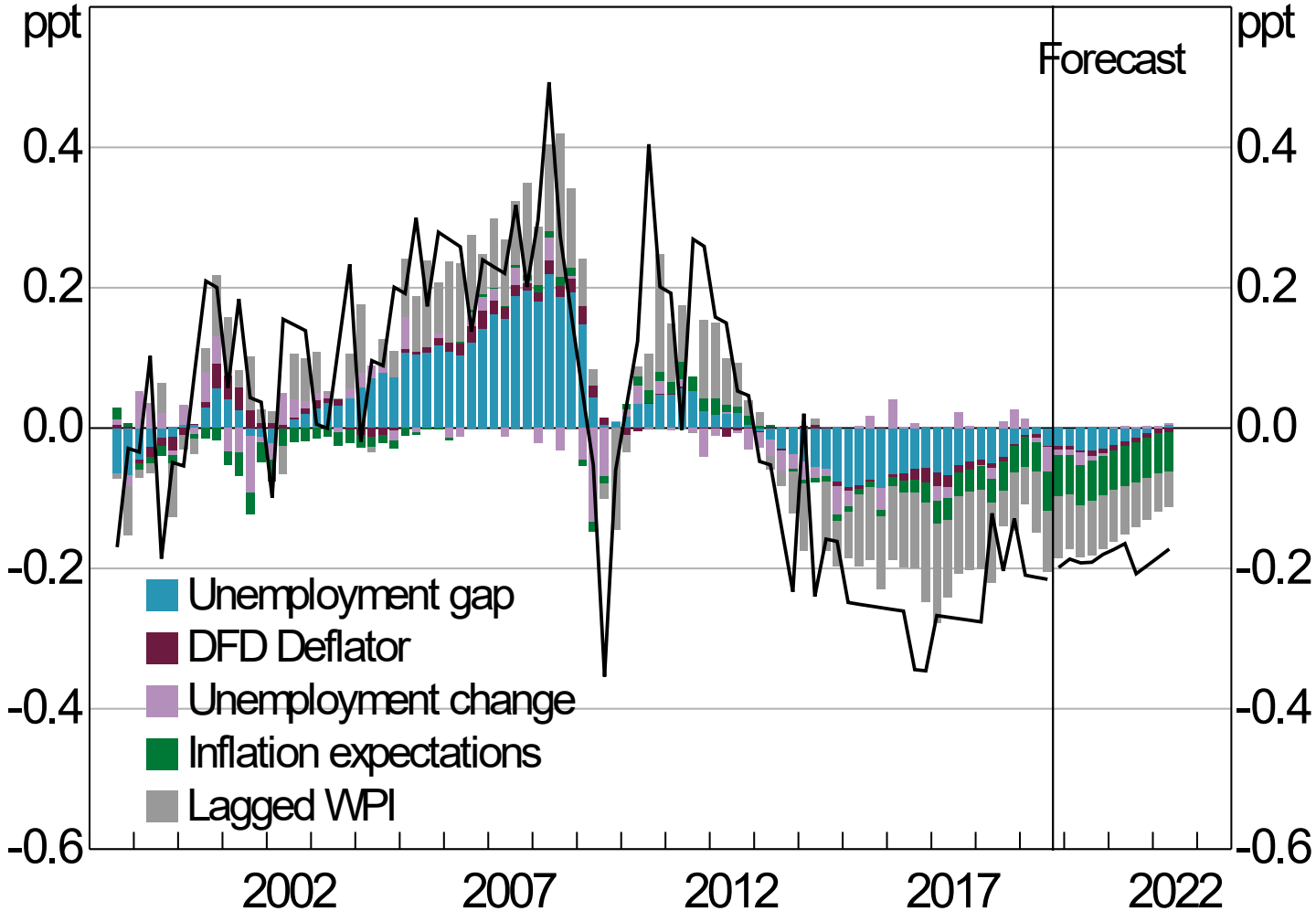
Year-ended, non-farm



Sources: ABS; RBA

Private WPI Model Decomposition

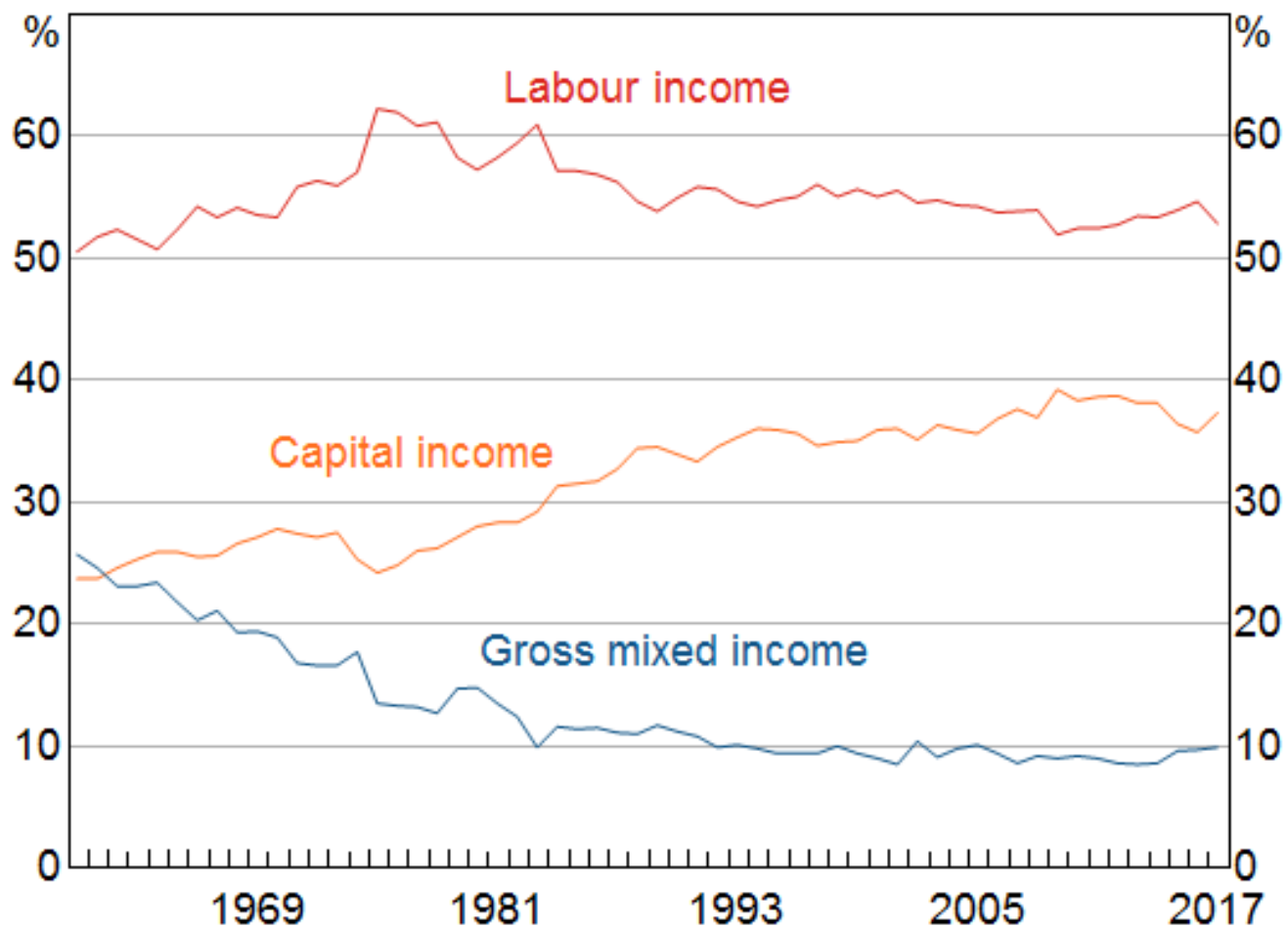
Quarterly deviations from own mean



Sources: ABS; RBA

Labour and Capital Income*

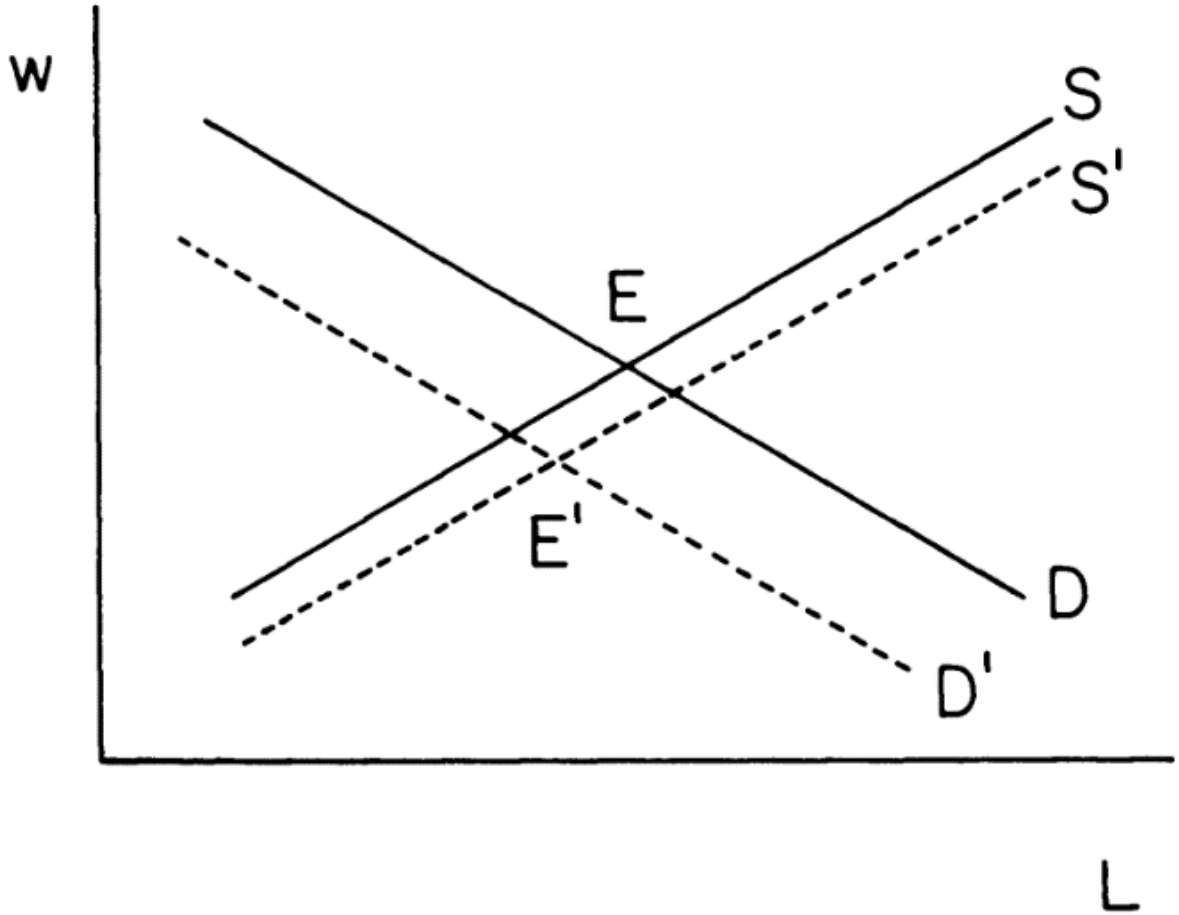
Share of total factor income



* Labour income is measured by compensation of employees. Capital income is measured by gross operating surplus

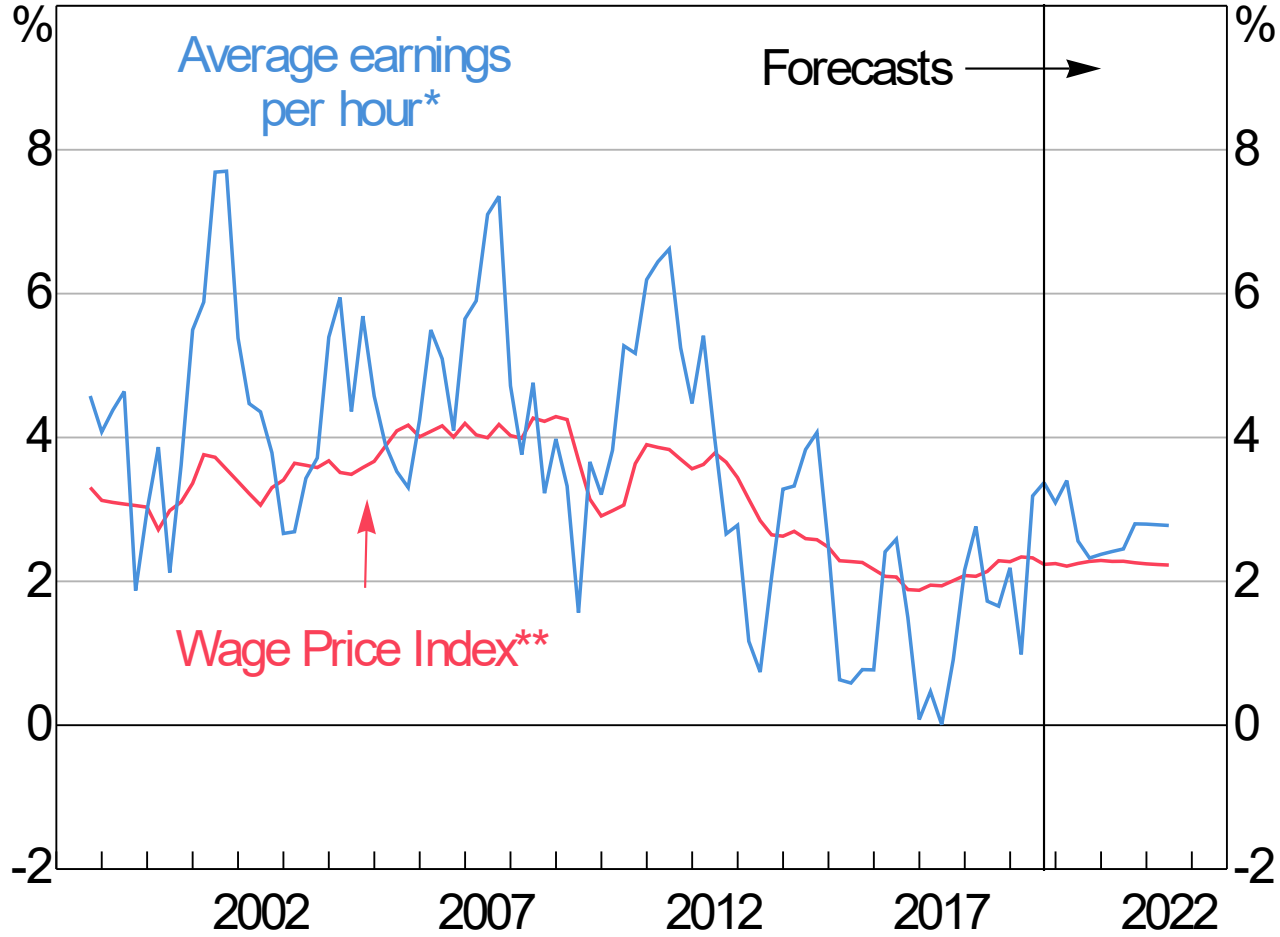
Source: ABS

Summers (1989)



Labour Costs

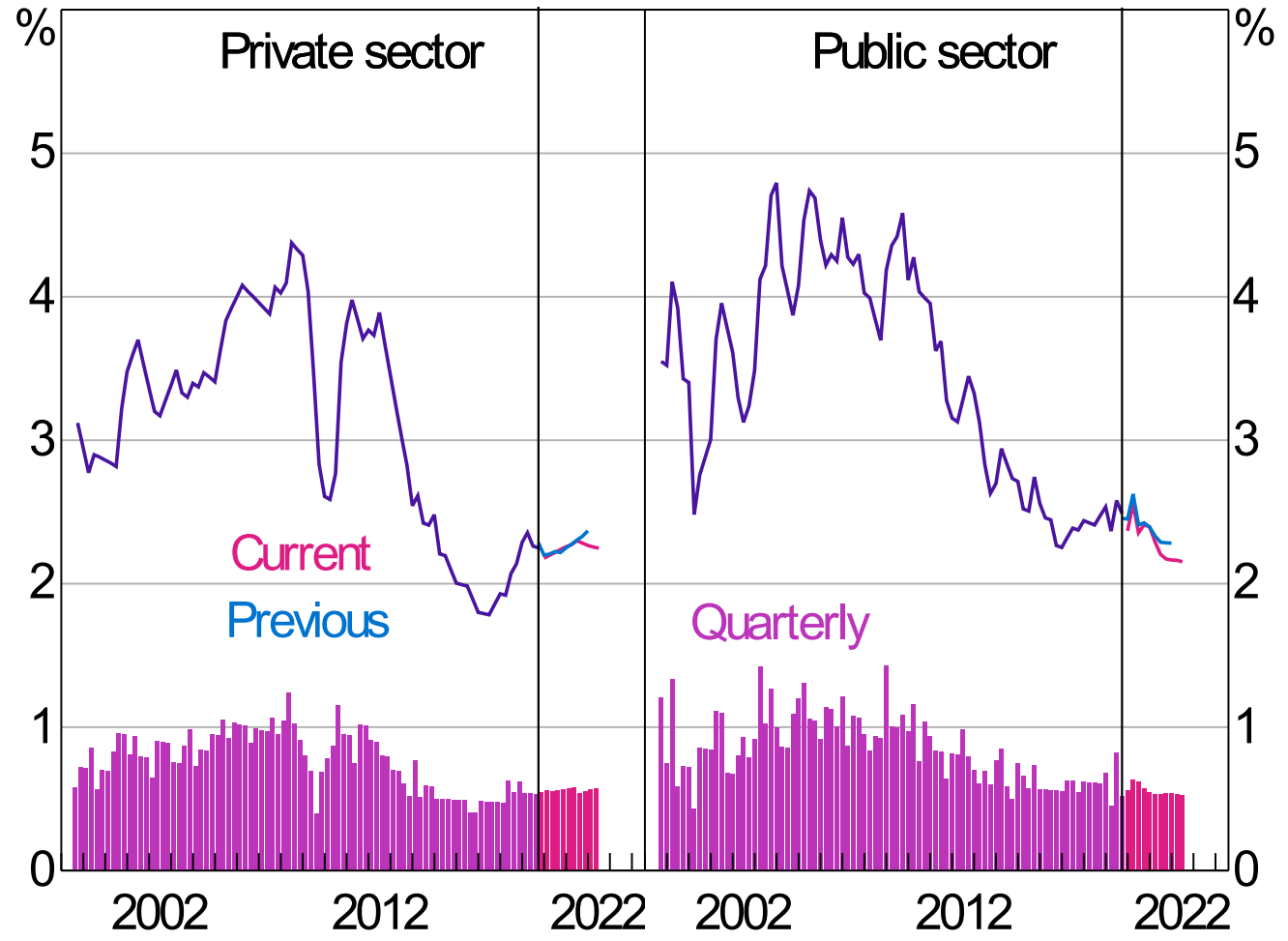
Year-ended growth



* Non-farm
** Total hourly rates of pay excluding bonuses
Sources: ABS; RBA

WPI Growth by Sector*

Year-ended



* Excluding bonuses

Sources: ABS; RBA

From: NUGENT, Taylor
Sent: Wednesday, 29 January 2020 5:54 PM
To: SCHWARTZ, Carl
Cc: CASSIDY, Natasha; BISHOP, James
Subject: RE: Implications of the super guarantee on wages forecasts [SEC=UNCLASSIFIED]

Hi Carl,

There was a link included in the forecast summary ahead of Pre PDG so he may have seen it already, but no problems forwarding this on.

We have put together a parliamentary testimony briefing that has a broader focus that is worth including as well.

I have saved it in TRIM here: [D20/27112](#) - same attachment to document #11

Regards,

Taylor Nugent

From: SCHWARTZ, Carl
Sent: Wednesday, 29 January 2020 5:28 PM
To: NUGENT, Taylor
Cc: CASSIDY, Natasha ; BISHOP, James
Subject: FW: Implications of the super guarantee on wages forecasts [SEC=UNCLASSIFIED]

Hi Taylor

Guy showed an interest in this issue at PDG.

I thought it would be good to share your work with him.
 Is it OK to share this email/trim link with him?
 Or is the more detailed note available/ soon forthcoming?

Cheers, Carl

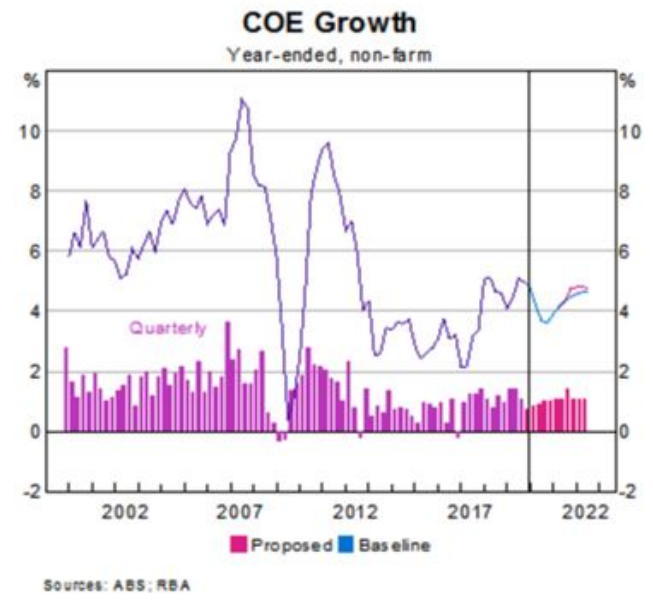
From: NUGENT, Taylor
Sent: Friday, 17 January 2020 5:41 PM
To: EC - Senior Management
Cc: FLANNIGAN, Gordon ; EA - Prices, Wages & Labour
 ; ROSEWALL, Tom
Subject: Implications of the super guarantee on wages forecasts

The superannuation guarantee is legislated to increase in July 2021. This brief note explains our proposed forecast profiles for labour income variables, accounting for the effect of the increase.

- We assume less-than-complete pass-through to wages immediately following the increase, and the profile is weighed toward the end of the horizon.
- In contrast, Compensation of Employees is broadly unchanged.

For more information, see: [D20/16859](#)

Proposed February SMP forecast profile against a baseline excluding the change to the superannuation guarantee.



Taylor Nugent | Graduate Economist | Prices, Wages and Labour
Reserve Bank of Australia | 65 Martin Place Sydney NSW 2000
| w: www.rba.gov.au

From: SCHWARTZ, Carl
Sent: Wednesday, 29 January 2020 6:02 PM
To: DEBELLE, Guy
Cc: NUGENT, Taylor; BISHOP, James; CASSIDY, Natasha; ELLIS, Luci
Subject: More info: Super Guarantee and Wages Growth [SEC=UNCLASSIFIED]

Guy

Further to today's discussion on the super guarantee increase and wages growth, here's some material Taylor prepared that may be of interest.

- Parliamentary Testimony briefing [D20/27112](#) - same attachment to document #11

Cheers, Carl

From: HEATH, Alex
Sent: Thursday, 30 January 2020 4:04 PM
To: NUGENT, Taylor; CHAMBERS, Mark
Cc: CASSIDY, Natasha; BISHOP, James
Subject: RE: Wages and labour share briefing

Dear Taylor,

I found the content of this briefing very interesting.

Alex

From: NUGENT, Taylor
Sent: Thursday, 30 January 2020 11:36 AM
To: HEATH, Alex ; CHAMBERS, Mark
Cc: CASSIDY, Natasha ; BISHOP, James
Subject: Wages and labour share briefing

Hi Alex, Mark

Apologies this one is a little late.

Parliamentary briefing 1g on Wages and Labour Share is here:

<https://portal.rba.gov.au/sites/ea/ECParliametaryTestimony/1%20Inflation%20Labour%20and%20Productivity/1g%20Wages%20and%20Labour%20Share%20v2.docx?d=wda3c926910e944f4ba1789299b980730>

It covers some high level detail on the labour and capital share, and touches on the distribution of wages growth and earnings, which hopefully meets the brief.

One caveat: the charts on earnings using HILDA in the final section are drawn from some work in progress.

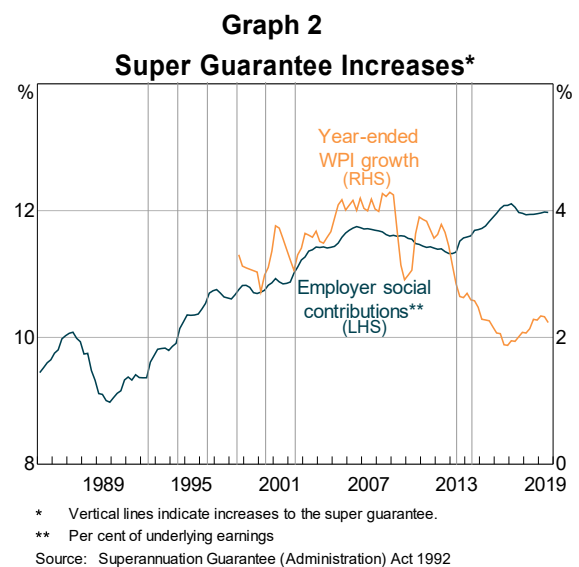
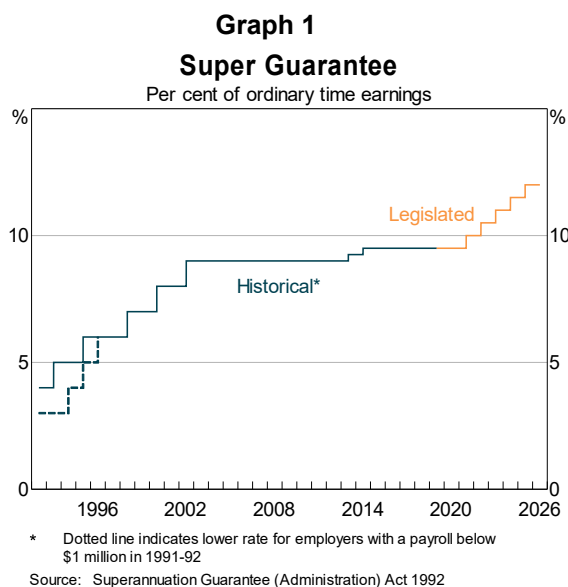
Regards,

Taylor Nugent | Graduate Economist | Prices, Wages and Labour
Reserve Bank of Australia | 65 Martin Place Sydney NSW 2000
w: www.rba.gov.au

Impact of Super Guarantee on Wages Growth

The Policy

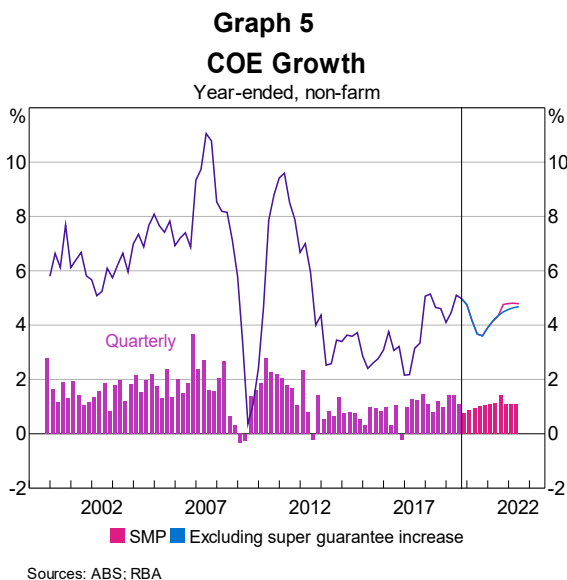
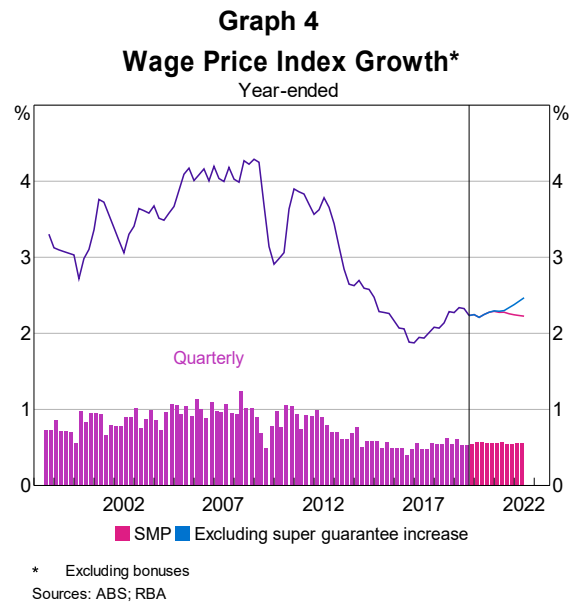
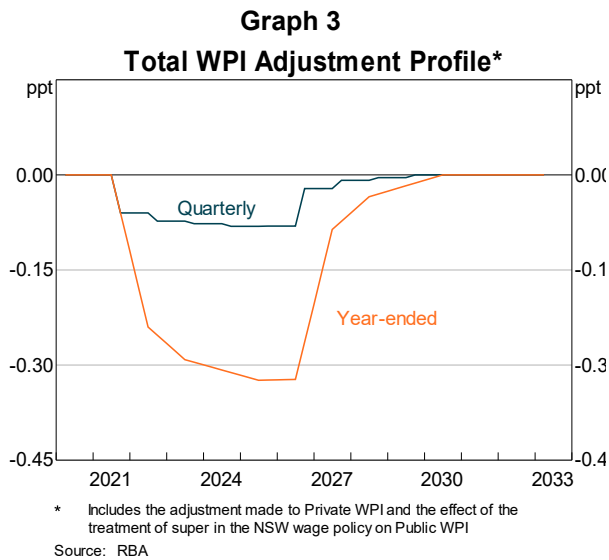
- The super guarantee is legislated to increase from 9.5% of ordinary time earnings to 10% on 1 July 2021, and then increase by 0.5 pts each year until it reaches 12% on 1 July 2025.
- The Government has recently stated that there are no plans to change the policy or change the timetable. However, the Retirement Income Review currently underway will look at the age pension, compulsory superannuation and voluntary savings and their distributional impacts. It is scheduled to report to the Government by June 2020:
 - Tim [Wilson](#): the case for increasing the contribution rate to 12% "has always been questionable compared to increasing wages now"
 - Jim [Chalmers](#): "Super was conceived as a trade-off between wages and savings but most Australians will not be convinced that much or any of the 2.5% of forgone super in today's climate will find its way into the pockets of low-income earners as wages."



Impact on wages and household income

- The impact on CoE will depend on the degree to which the increase in SG is passed through to lower wages growth.
- In response to the SG increase, firms can pass it through or offset it in other ways (e.g. raise prices, reduce profits etc).
- The literature suggests that employees may bear more of the incidence because employees value superannuation payments highly, even if a little less than wage payments today.
- McKell Institute ([Taylor 2019](#)) and Australia Institute/Centre for Future Work ([Stanford 2019](#)) have argued there is **no evidence** the increase will be passed onto employees.
- Grattan Institute analysis (forthcoming) estimates that **around 80% of SG increase will be passed through** based on historical increases on EBA wage outcomes.

Impact on wages in the forecasts



- Year-ended WPI growth around $\frac{1}{4}$ ppt lower at mid 2022, assuming a staggered and gradual pass through (about $\frac{3}{4}$ to take effect in 1st year) due to the staggered way some wages are set. Impact will be largely on private sector wages growth, as public sector wages policies are largely on wages and not total employment costs.
- *Risks:* In our central forecast, there is no adjustment until the SG increases. It is possible some firms may adjust wage in advance. FWC decision will likely take increase into consideration (2013 award outcome was “lower than it otherwise would have been” given SG increase). Information from liaison contacts will be important to re-evaluate our assumption.
- The effect on CoE, which includes super contributions, is expected to be immediate in the September quarter 2021. By the end of the horizon, the lower wages growth mostly offsets the impact on CoE.

Debate on whether the current level is appropriate

- The Treasury is currently undertaking a review of retirement income that will address this question.
- Grattan Institute analysis finds that median earners entering the workforce today will have replacement rates (the percent of pre-retirement income available in retirement) of around 90%.
- Henry Tax review concluded that 9% “strikes an appropriate balance for most individuals between their consumption opportunities during their working life and compulsory saving for retirement”
- Khemka, Tang and Warren (2020) find that under most sets of assumptions, the optimal super guarantee is not higher than the current level, including with only partial pass-through to wages. They find a higher guarantee could be justified if it is desirable to:
 - displace the age pension as a source of income for retirees
 - promote self-insurance against the risk of poor investment returns or longer-than-expected retirement
- Khemka, Tang and Warren (2020) also note the asymmetric effects of setting the rate too high. Individuals can save more through voluntary contributions if the rate is too low for their personal circumstances. They can’t contribute less than the guarantee if it is too high.
- Treasury modelling in 2013 suggests that in an increase of the guarantee to 12%, the revenue losses from tax incentives in superannuation schemes outweigh the cost savings from reduced pension outlays
- Arguments in favour of a higher level tend to emphasise lower balances for females or those with interrupted work histories

Impact on Consumption and Saving

- Higher SG represents more compulsory saving.
- Some may reduce voluntary super contributions or non-super savings in response.
- Analysis of First State, Sunsuper, and VicSuper data suggests only around 12% of members make additional employee contributions. (Vanguard 2019)
 - Members who make additional contributions tend to be older and have higher incomes.
- Connolly (2004) estimated an offset of compulsory superannuation of around 38 cents on the dollar from other private savings.

Table 1: Contributions to Super Funds 2017/18

	Entities with more than four members	Small APRA funds	Self-managed superannuation funds	Total
Total contributions	107,331	17	40,559	147,907
Employer	87,525	4	7,320	94,849
Member	19,806	13	33,239	53,058

Source: [APRA](#)

From: CASSIDY, Natasha
Sent: Thursday, 6 February 2020 11:09 AM
To: FLANNIGAN, Gordon; LAI, Sharon
Subject: RE: Can you please let me know if you see any errors in this asap? [SEC=UNCLASSIFIED]

Yep

From: FLANNIGAN, Gordon
Sent: Thursday, 6 February 2020 11:05 AM
To: LAI, Sharon ; CASSIDY, Natasha
Subject: RE: Can you please let me know if you see any errors in this asap? [SEC=UNCLASSIFIED]

Thanks Tash,

Just to confirm, were you thinking something like ‘Information from the Bank’s liaison program suggests that the share of workers that are receiving wage growth outcomes above 3 per cent has declined to around 20 per cent’. That would align with what we are hearing.

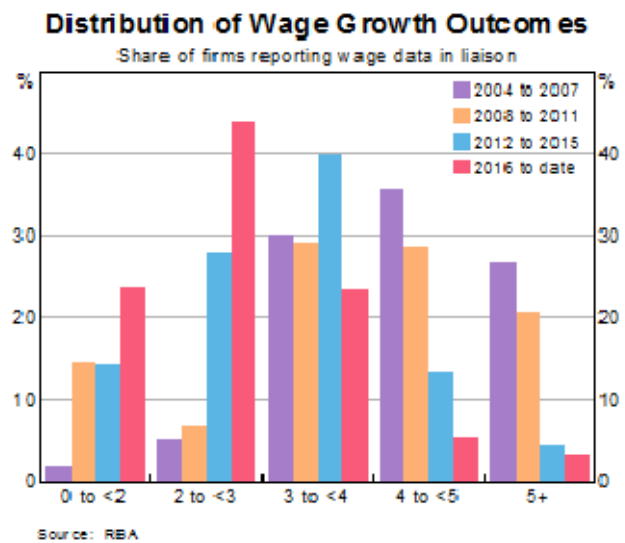
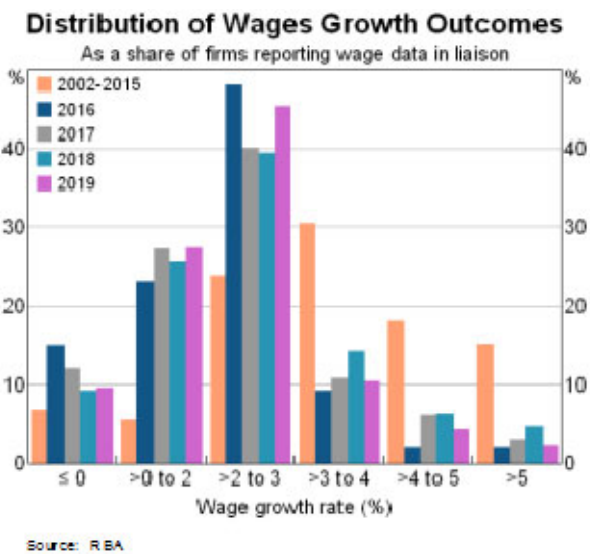
It’s 17 per cent to be exact, so around 20 per cent is all good.

Thanks
 Gordon

From: LAI, Sharon
Sent: Thursday, 6 February 2020 10:52 AM
To: CASSIDY, Natasha ; FLANNIGAN, Gordon
Subject: RE: Can you please let me know if you see any errors in this asap? [SEC=UNCLASSIFIED]

Hi Tash

We’ll give you a quick call in a sec – just sending through some graphs first for context.



From: CASSIDY, Natasha
Sent: Thursday, 6 February 2020 10:35 AM

To: LAI, Sharon

; FLANNIGAN, Gordon

Subject: Can you please let me know if you see any errors in this asap? [SEC=UNCLASSIFIED]

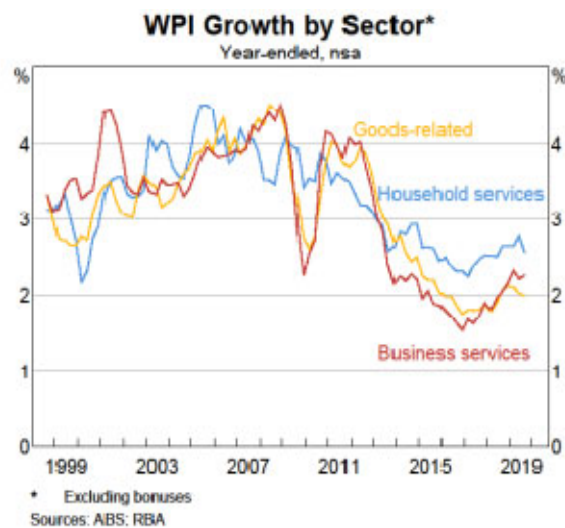
Private sector WPI growth edged lower to 2.2 per cent in year-ended terms (Graph 4.15). However, private sector wages growth including bonuses & commissions rose to 3 per cent over the year. This measure, while more volatile, has tended to be above the measure excluding bonuses over recent years. The share of jobs that receive a bonus has increased steadily in recent years, with information from the liaison program suggesting that businesses may be using bonuses to reward workers without locking in larger changes to base pay. Public sector WPI growth has been steady at around 2½ per cent in recent years, consistent with wage policies across federal and state governments.

Graph 4.15



Wages growth remains strongest in the health care industry, consistent with strong employment outcomes over recent years. Wages growth is lowest in goods-related industries such as construction, manufacturing and mining (Graph 4.16). While there are some clear differences across industry wage outcomes, the distribution of wages growth across jobs has been more compressed over the prolonged period of low wages growth than it was during the 2000s. Information from the Bank’s liaison program suggests that the share of workers that have been receiving wage growth outcomes above 3 per cent has declined notably over recent years. Instead, close to half of the wages outcomes are now between 2–3 per cent. This is also consistent with the wage outcomes in current private sector enterprise bargaining agreements (EBAs).

Graph 4.16



Over recent years, annual wages growth for award-reliant workers has been between 3–3½ per cent as a result of annual decisions by the Fair Work Commission (FWC). This directly affects wages growth for around 20 per cent of employees who are on an award wage. There has also been an increase in recent years in the number of wages outcomes in EBAs that are in some way linked to the FWC decision.

... but broader measures of earnings growth have picked up

Growth in average earnings per hour in the national accounts (AENA) has increased to around 3 per cent over the year to September. AENA is a broader, but more volatile, measure of labour costs because it captures non-wage payments such as allowances, superannuation and bonuses, as well as changes in the composition of employment. Over recent years, AENA growth had tended to be lower than WPI growth, which is consistent with workers moving away from higher-paying jobs in mining-exposed industries over this period. The share of people voluntarily changing jobs or receiving a promotion has also declined. Data from the Household, Income and Labour Dynamics in Australia (HILDA) survey show that wages growth is typically higher for workers that change jobs or receive a promotion (Graph 4.17). Furthermore, the gap between the wages of those already working and those entering into employment, whether from unemployment or outside the labour force, had widened over the years to 2017/18. However, the most recent pick-up in AENA growth is consistent with stronger growth in bonuses and may also suggest that the drag on average earnings growth from these compositional effects has started to wane.

Graph 4.17



Wages growth is expected to remain stable

The proportion of firms in the liaison program expecting stable wages growth in the year ahead is close to 80 per cent, and only around 10 per cent anticipate stronger wages growth.

The proportion of new EBAs with a term of three years or more has also increased; the average wage outcome in these agreements is around 2½ per cent. By locking in lower wage outcomes for longer, these EBAs could contribute to wages of EBA-covered workers being slower to pick up than was the case in the past.