

**Briefing Note:**

**The Importance of Minimum Wages  
to Recent Australian Wage Trends**

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Tomorrow the Australian Bureau of Statistics will release its quarterly Wage Price Index: the most commonly-reported measure of wage growth in Australia's labour market. Given the importance of public debates about wages and wage policy in the current federal election campaign, this release is timely and politically important.

This briefing note reviews some methodological issues related to the WPI. It also considers recent data confirming the visible impact on the WPI of last year's strong increase in the national minimum wage. The minimum wage was increased 3.5% effective 1 July 2018 – the biggest increase since 2010. That large minimum wage increase accounts for all of the modest uptick in the WPI experienced in 2018. In other words, it was active policy (namely, the decision by the Fair Work Commission to boost the minimum wage faster than either overall wages or consumer prices), not a reflection of underlying "market forces," that explains why this indicator of wage growth slightly improved. Without that increase in the minimum wage, overall wage growth would remain below 2%.

This perspective should be considered when interpreting tomorrow's release of new WPI data.

***Wage Price Index Methodology***

The WPI is the ABS's most commonly-reported measure of wage inflation. It is published quarterly, and measures the weighted change in wages paid in a constructed "basket" of jobs, held to be representative of the composition of total employment at any point in time; that basket is held constant from one period to the next. Its methodology is similar to the Consumer Price Index, with its representative "basket" of consumer goods and services; the CPI basket is also held constant from one period to the next (but regularly re-based to reflect changes in the composition of consumer spending).

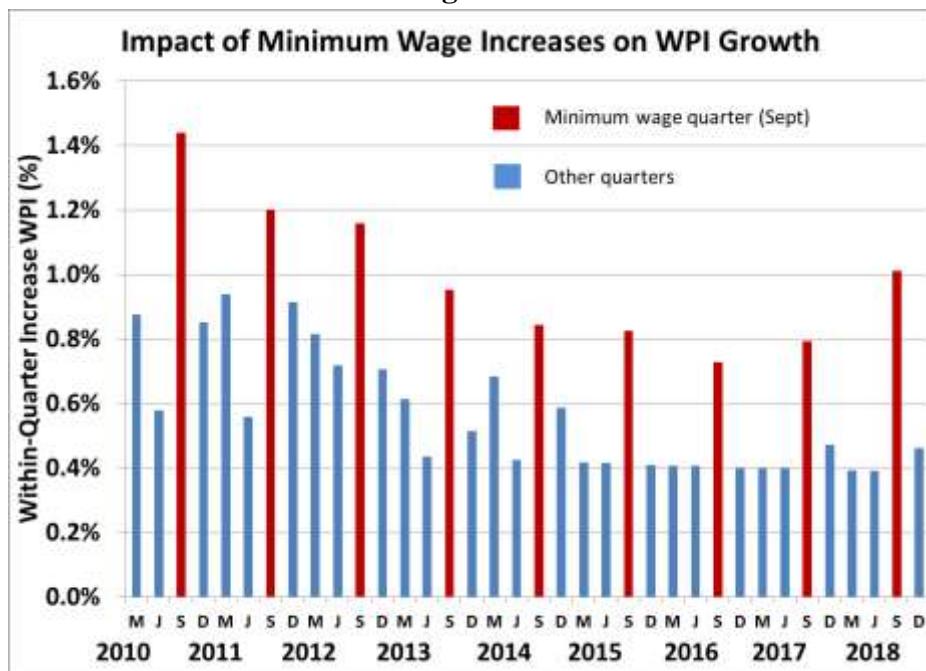
Because it holds the composition and quality of jobs constant from one period to the next, the WPI does not capture the wage impacts of changes in the composition of jobs over time. In Australia in recent years, employment has become more dependent on part-time work; average hours worked per employee have declined; and other forms of insecure or low-paid work have also become more common. These effects are excluded by definition from the WPI, and hence it has overstated the true growth of realised wage income. Other measures (like average weekly wages, labour compensation per employed person, or average wage data from ATO personal tax returns) suggest realised wage growth has been slower (by as much as 0.5% per year) than the WPI.<sup>1</sup>

### ***Seasonality in the WPI***

The WPI is reported in original (unadjusted), seasonally adjusted, and trend versions. There is a strong seasonal pattern in the WPI arising from the concentration of wage increases around 1 July (the beginning of the financial year). The original WPI series regularly shows a large jump in the September quarter (the first after July 1). Changes in the national minimum wage also come into effect on 1 July, and this further accentuates that seasonal spike.

Figure 1 illustrates this strong seasonal pattern in (unadjusted) WPI data, using the within-quarter percentage change in the original WPI series:

**Figure 1**



Source: Author's calculations from ABS Catalogue 6345.0; unadjusted data.

<sup>1</sup> For a detailed comparison and discussion of alternative methodologies for measuring wage growth, see Jim Stanford, "Charting Wage Stagnation in Australia," in Andrew Stewart, Jim Stanford and Tess Hardy (eds.), *The Wages Crisis in Australia: What It Is and What To Do About It* (Adelaide: University of Adelaide Press, 2018), pp. 21-40, <https://www.adelaide.edu.au/press/titles/wages-crisis/>.

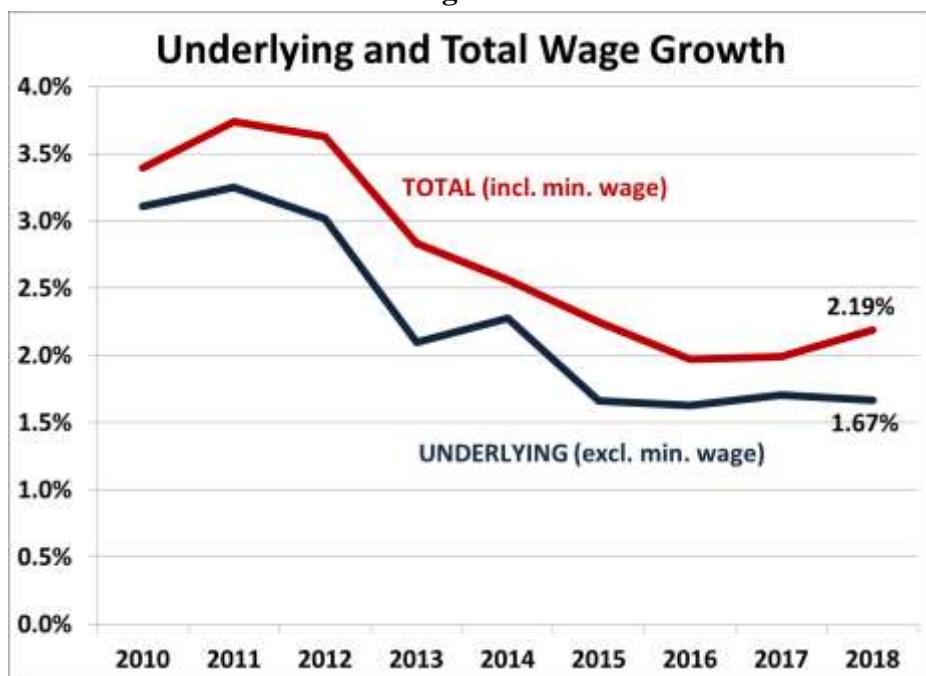
## **Minimum Wage Increases and the WPI**

The Fair Work Commission announced a relatively large increase in the minimum wage effective July 1, 2018, boosting it by 3.5%. That was the largest increase in the minimum since 2010 – when the Commission delivered a large increase to make up for a one-year freeze in the minimum wage the previous year (amidst the economic downturn associated with the global financial crisis). The increase in the national minimum wage affects over one fifth of Australian employees; it thus contributed to a significant uptick in the within-quarter increase in the WPI for September 2018, which rose to over 1% for the quarter.

Because of that strong September spike, the overall WPI increase for calendar 2018 was slightly higher than in the previous two years. The average 2018 WPI was up by 2.19%, compared to increases of 1.99% in 2017 and 1.97% in 2016 (the lowest experienced in the recent episode of wage stagnation). Some observers have interpreted that modest rebound in the WPI as evidence that wage growth has bottomed out, and is turning around.

However, it seems that last year's relatively large increase in the minimum wage – which is a regulated price, not directly reflective of “market forces” – statistically accounts for essentially all of the modest rebound in the WPI last year. There are two different ways to confirm that conclusion. Figure 2 decomposes annual changes in the WPI into two groups: the total increase (averaged across all 4 quarters in a calendar year), and what is termed the “underlying” increase. The underlying increase is the average annualised increase experienced in the 3 *other* quarters of the year: that is, all quarters other than the quarter in which the annual increase in the minimum wage pushes up the annual average.

**Figure 2**



Source: Author's calculations from ABS Catalogue 6345.0, as explained in text.

The overall WPI increase for 2018 bounced back slightly from its 2016 and 2017 low points – although remaining far below traditional wage increases (which averaged between 3.5% and 4% per year from 2000 through 2013). Considering quarters without the minimum wage increase, however, underlying wage growth remained at recent lows (below 1.7% per year annualised). In fact, that estimate of underlying wage growth actually *weakened* fractionally in 2018 compared to 2017 – even as the total WPI accelerated slightly. This suggests there has been no generalised rebound in wage pressure. Instead, last year's uptick in the WPI reflects the impact of a larger increase in the minimum wage on the overall level of wages.

This finding can be visually verified by referring back to Figure 1. Note that the three blue bars for calendar 2018 (excluding the September quarter) are actually slightly lower than the corresponding bars for calendar 2017. This indicates a weakening, not strengthening, in underlying wage pressure in the Australian labour market. Without last year's bigger increase in the minimum wage, therefore, annual growth in the WPI would have declined in 2018.

### ***"Backing Out" Non-Award Wage Increases***

Another indicator of the dependence of the recent WPI uptick on last year's larger-than-usual minimum wage increase is summarised in Table 1. In 2018, over one in five employees in Australia had their wages set in accordance with the terms of a modern award.<sup>2</sup> Those award pay grids are generally indexed in line with changes in the national minimum wage. Since we know the size of the national minimum wage increase and the proportion of workers it applies to, we can "back out" the implicit rate of wage increase experienced by other workers in the labour market. This calculation is summarised in Table 1.

<b>Table 1</b>		
<b>"Backing Out" Non-Award Wage Growth: 2018</b>		
1	Minimum Wage Increase (1 July 2018)	3.50%
2	Share of Workforce Affected	21%
3	Weighted-Average Contribution (1*2)	0.74%
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4	Total Calendar Year Growth WPI	2.19%
5	Residual Without Minimum Wage (4-3)	1.46%
6	Workforce Covered (100% - 2)	79%
7	Implied Rate of Wage Growth (5/6)	1.84%

Source: Author's calculations from ABS Catalogues 6306.0 and 6345.0 as explained in text.

The overall WPI increased by 2.19% in calendar 2018. Over one-third of that overall increase can be attributed to the direct impact of the national minimum wage increase, which applied

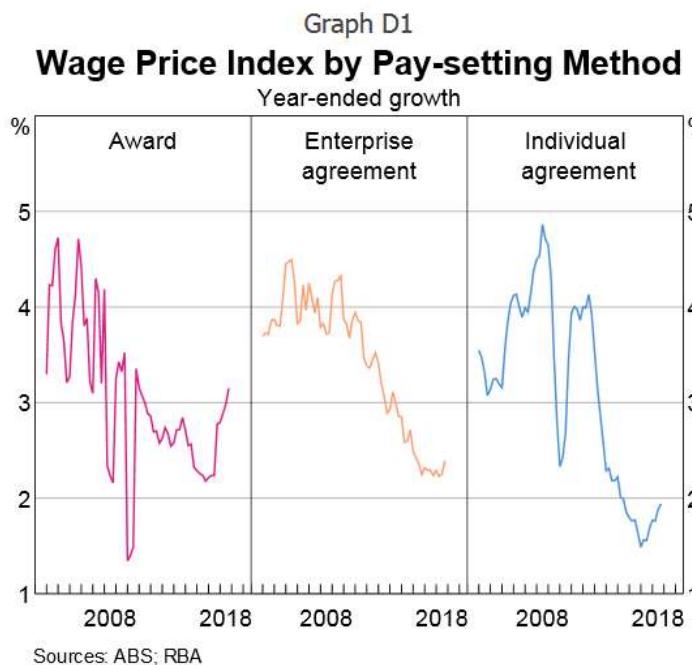
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<sup>2</sup> See ABS Catalogue 6306.0, Data Cube 9, Table 1; excludes owner-managers of independent enterprises.

to the 21% of employees whose pay is determined by a modern award. The remaining increment in the overall weighted-average wage increase (1.46 percentage points) is shared across the 79% of workers whose wages are determined by collective agreements or individual contracts. This implies an average wage increase for those workers of just 1.84% for the year: still in line with the rock-bottom increases in overall wages experienced in Australia in 2016 and 2017. This further confirms the importance of last year's minimum wage hike to the modest uptick in overall wage inflation as measured by the WPI.

### **New RBA Data on Wage Increases by Method of Pay-Setting**

A final insight into the impact of last year's minimum wage increase on the overall labour market can be gleaned from new data reported by the Reserve Bank of Australia in its *Statement on Monetary Policy*. The latest statement, issued on 9 May, featured a sidebar which decomposed (using unpublished detailed ABS data) changes in the WPI for different types of pay-setting mechanisms.<sup>3</sup> The relevant chart is reproduced below.



The RBA disaggregation of WPI data confirms that the significant increase in the national minimum wage last year, with its flow-through impact on most workers who are paid according to an award, is the dominant source of the modest rebound in overall WPI growth recorded last year. Wage growth recorded among workers on individual contracts remains below 2%. Workers covered by enterprise agreements received faster wage growth (above 2%). Without the faster wage increases experienced for award-dependent workers, overall WPI growth would remain stuck at around 2%.

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<sup>3</sup> See Reserve Bank of Australia, *Statement on Monetary Policy* (May 2019), <https://www.rba.gov.au/publications/smp/2019/may/box-d-trends-in-wages-growth-by-pay-setting-method.html>, pp. 67-68.

In addition to pulling up the overall level of wage growth experienced across the labour market, the faster increase in minimum wage (and flow-through increases for award-dependent workers) has beneficial impacts for income equality and poverty – by channeling the biggest wage increases to the lowest-paid workers in the labour market.

### ***Conclusion***

Wage increases for Australian workers have decelerated to postwar lows, averaging around 2% since 2013. The most commonly-reported statistical indicator of that slowdown, the ABS's Wage Price Index, has overestimated wage growth (and hence understated the extent of that slowdown), because of its failure to account for negative changes in the composition of employment (and in particular the shift toward part-time and other lower-pay forms of work).

There was a modest rebound in 2018 in the pace of overall wage growth according to the WPI: rising from below 2% in 2017 and 2017, to 2.19% in 2018 (on a calendar year basis). However, that modest improvement seems to be overwhelmingly due to a large increase in the national minimum wage announced by the Fair Work Commission effective 1 July 2018. Underlying wage pressure, excluding that effect, has been as weak as ever. Wage increases for workers not directly affected by the minimum wage increase continue to languish below 2% per year.

This analysis suggests that active policy decisions, rather than so-called “market forces,” continue to exert a dominant influence on the direction of wages in Australia’s labour market. Interpretations of tomorrow’s important (pre-election) release of the WPI will need to consider these continuing impacts of minimum wage policy, in order to accurately describe the direction of underlying wages.