The Superannuation Guarantee and wages: ASFA Policy & Research Paper

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ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $3 trillion in retirement savings.

Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 16.5 million Australians with superannuation.

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Executive Summary

The Superannuation Guarantee (SG) rate is legislated to increase from 9.5 to 10 per cent on 1 July 2021. This will affect around 8 million workers – the vast bulk of whom are private sector employees.

Business generally has capacity to absorb the increase in the SG rate without cutting wages. Over the last two decades, employees (on average) have not been fully compensated for productivity increases in the economy – reflected in a persistent wedge between labour productivity and real wages. The increase in the SG rate will only marginally reduce this gap.

History shows that private sector wages have fallen only under extremely adverse economic conditions. The Australian economy is currently in the midst of a strong and broad-based recovery from the COVID-19 crisis, with labour market slack down to around pre-crisis levels and expected to continue to dimmish.

Firms should be reluctant to cut wages with the labour market expected to continue to tighten. Indeed, anecdotal evidence points to staff shortages already emerging with respect to some regions and professions – with firms having to pay a wage premium to attract new staff. Firms that move to cut wages could, in effect, be pricing themselves out of the labour market. Such firms may find it more difficult to retain existing workers, or new attract staff, relative to competitors as the economy continues to recover.

The fact that business should be able to absorb the SG rate increase is supported by the Fair Work Commission's recent (annual) National Minimum Wage decision. Effective from 1 July 2021, minimum wages in all modern awards will increase by 2.5 per cent.[1] Given that inflation is expected to be around 1.25 per cent over the coming financial year, the wage decision amounts to an expected real wage rise of around 1.25 per cent for 2021-22.[2] This will directly affect millions of workers on awards but will also flow through to other workers' wages.

In justifying its decision, the Commission identified the strong economic recovery from the COVID-19 shock, and high business profits. When taking into account the 0.5 per cent increase in the SG rate, the Commission's decision clearly suggests that business should be able to afford to pay workers the SG rise in full, as well as an increase in take-home pay.

1 Fair Work Commission, *Annual Wage Review 2020–21* (https://www.fwc.gov.au/documents/decisionssigned/html/pdf/2021fwcfb3500.pdf)

2 Reserve Bank of Australia, *Statement on Monetary Policy: May 2021* (https://www.rba.gov.au/publications/smp/2021/may/pdf/statement-on-monetary-policy-2021-05.pdf)

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Mainly private sector workers will be affected by the scheduled SG rate increase

The increase in the SG rate will boost compulsory superannuation contributions for millions of private sector workers.

The scheduled increase in the SG rate will directly boost the value of compulsory superannuation contributions of around 8.3 million Australian workers.

This is equivalent to around 77 per cent of all employees, or around 64 per cent of the broader Australian workforce. Affected workers mainly comprise private sector employees.[3]

Around 20 per cent of all employees already receive SG contributions at a rate of at least 10 per cent, and so will not be affected by the SG rate increase. This group largely comprises public sector employees, but also includes private sector employees in industries that were once dominated by the public sector.[4]

A small number of employees (around 3 per cent) are not currently covered by the SG – in particular, employees who earn less than $450 per month. However, the recent *2021-22 Commonwealth Budget* foreshadowed the abolition of the income threshold – to come into effect on 1 July 2022. From that date, affected workers will receive SG contributions at the legislated rate.

The other major group of Australian workers who are not covered by the SG regime, and so will not be affected by the SG rate increase, are owner-managers – including independent contractors. This group accounts for around 17 per cent of the workforce.[5]

3 ABS, *Labour Force*, May 2021; ABS, *Employee Earnings and Hours*, May 2018 and ASFA calculations.
4 ibid.
5 ibid.

3

Business should be able to afford the increase in the SG rate

On average, business has the capacity to pay the increase in the SG rate in full, as well as higher wages.

The SG rate is scheduled to increase from 9.5 to 10 per cent on 1 July 2021.

The cost to an employer of the SG rate increase for a median wage earner (on $60,000 per annum) is only $5.75 per week, and only $6.50 per week for an employee who earns average earnings ($68,000 per annum).[6]

In broad terms, Australian business should be able to absorb the scheduled increase in the SG rate.

Over the last two decades, employees (on average) have not been fully compensated for increases in productivity in the economy – reflected in a persistent wedge between labour productivity and the (producer) real wage. The scheduled increase in the SG rate will represent only a small increase in average employee remuneration, and so will only marginally reduce this wedge.

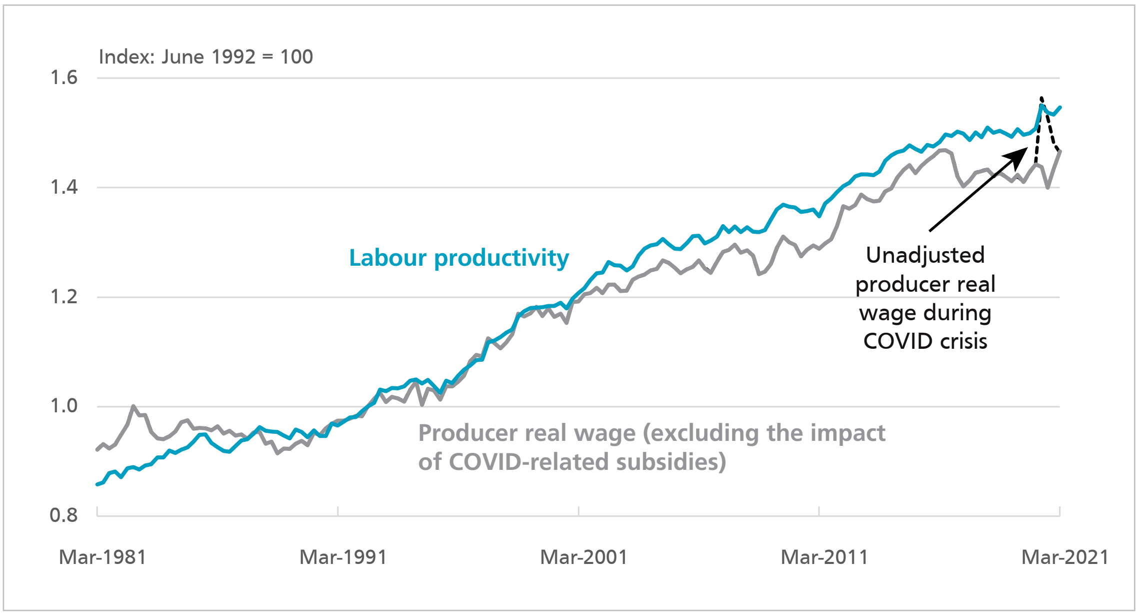
The real wage has lagged labour productivity over the last twenty years

It has long been established in economic theory that average real wages in the economy (or more broadly, average worker remuneration) should track average labour productivity over longer time periods. For a firm, an increase in labour productivity – that is, more output per worker – means that labour, in effect, becomes 'cheaper' (all other things being equal). This is likely to incentivise the firm to hire additional workers. If productivity improvements are broadly-based across the economy (or within particular sectors), and there is a broad increase in demand among firms for labour, then this will tend to put upward pressure on real wages (Box 1).

6 ABS, *Labour Force*, May 2021 and ASFA calculations.

Since June 2002, the producer real wage has been tracking lower than labour productivity (Chart 1).[7] The calculated (producer) real wage shown in Chart 1 is a broad measure of employee remuneration that includes wages/salaries and SG contributions. The calculated real wage in Chart 1 also abstracts from the estimated impact of COVID-related subsidies paid to employers, which (for the portion that was passed on to employees) boosted average employee remuneration during the height of the crisis.

Chart 1: Labour productivity and the producer real wage



Source: ABS, National Accounts, March 2021 and ASFA calculations.

For the twenty years to December 2019 (prior to the COVID crisis), labour productivity increased by 27 per cent, while the producer real wage increased by only 20 per cent. The fact that the producer real wage grew slower than labour productivity over the past two decades, means that labour became 'cheaper' for employers (on average) during this period.

An equivalent way to present this data is as the shares of national income attributable to labour and profits. Chart 2 shows that the share of national income attributable to the total compensation of employees (which includes SG contributions) has been declining for a number of decades – as is now around record lows. In contrast, the share attributable to profits is around record highs.

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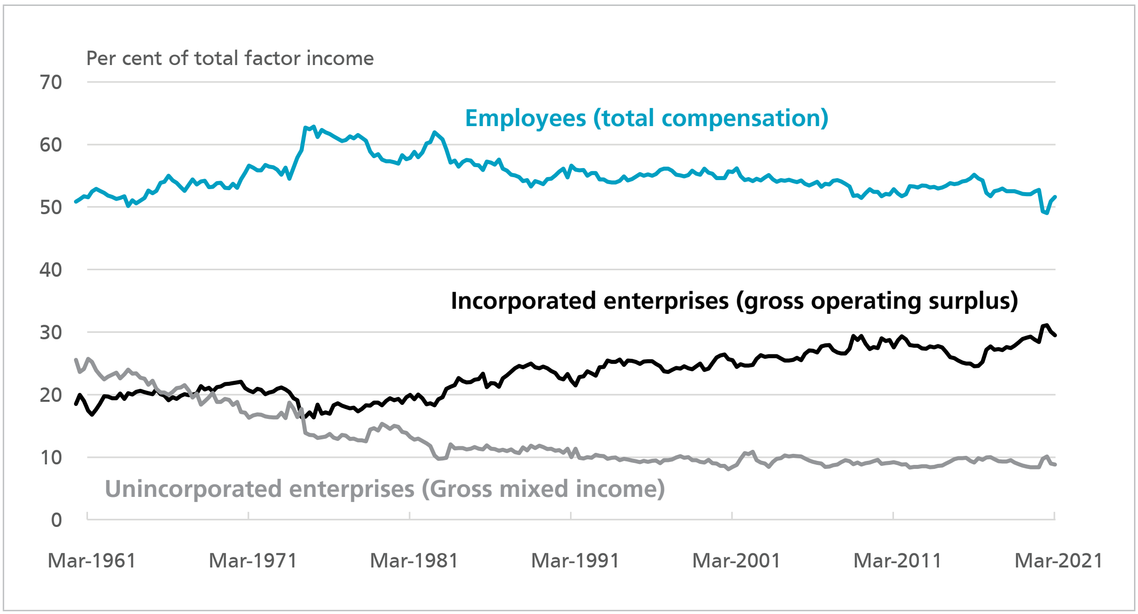
7 Of the main measures of real wages, the producer real wage is most relevant in this case. In essence, the producer real wage measures the average cost of labour from the perspective of employers, in terms of the price of goods and services produced. The producer real wage is a broad measure of the cost of labour – it includes wages and salaries but also other labour-related costs such as employer superannuation contributions and premia for workers' compensation insurance.

Chart 2: Shares of national income



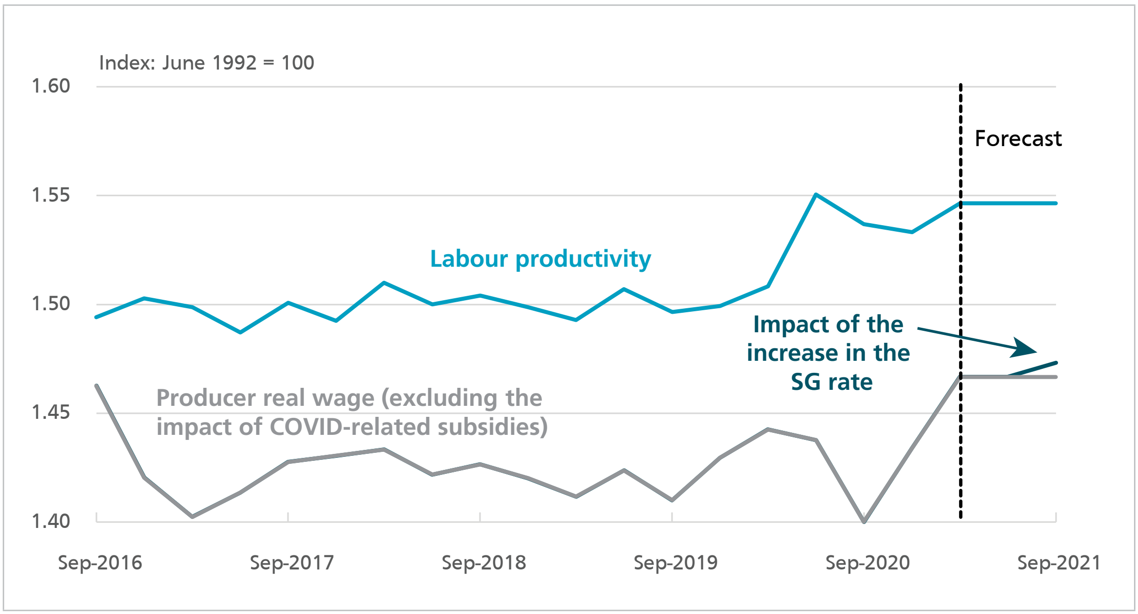
Source: ABS, National Accounts, March 2021 and ASFA calculations.

The scheduled SG increase will increase remuneration, but only marginally close the gap

The SG rate is scheduled to increase by 0.5 per cent on 1 July 2021. The current wedge between the producer real wage and labour productivity suggests that, on average, employers would be able to absorb the increase in the SG rate.

Chart 3 is similar to Chart 1, but it starts at the September quarter 2016. The chart shows the expected impact of the SG increase on the producer real wage in the September quarter of 2021. The analysis assumes that all other variables remain constant between the latest data point (March quarter 2021) and September quarter 2021.

Chart 3: Labour productivity and the producer real wage – impact of the SG rate increase



Source: ABS, National Accounts, March 2021 and ASFA calculations.

The story is similar across major industries in the Australian economy. For the majority of major industries, the sector-specific producer real wage has been tracking lower than the corresponding measure of labour productivity over an extended period. That said, the size of the wedge between labour productivity and the producer real wage differs across industries, in part due to the effect of sector-specific structural factors – including the degree of bargaining power of employees in wage negotiations, and the degree of market competition between firms.

4

History shows that private sector wages fall only under extremely adverse conditions

Wage growth increased following recent rises in the SG rate.

As noted above, it will mainly be private sector employees who will be affected by the scheduled SG rate increase.

In the private sector, employer discretion in adjusting remuneration of their employees depends on the particulars of the wage setting arrangements. For private sector employees, around half have their wages and conditions determined by an award or an enterprise agreement, while half have their conditions primarily determined by individual common law contracts (but subject to certain minimum conditions and pay rates set by the Fair Work Commission).

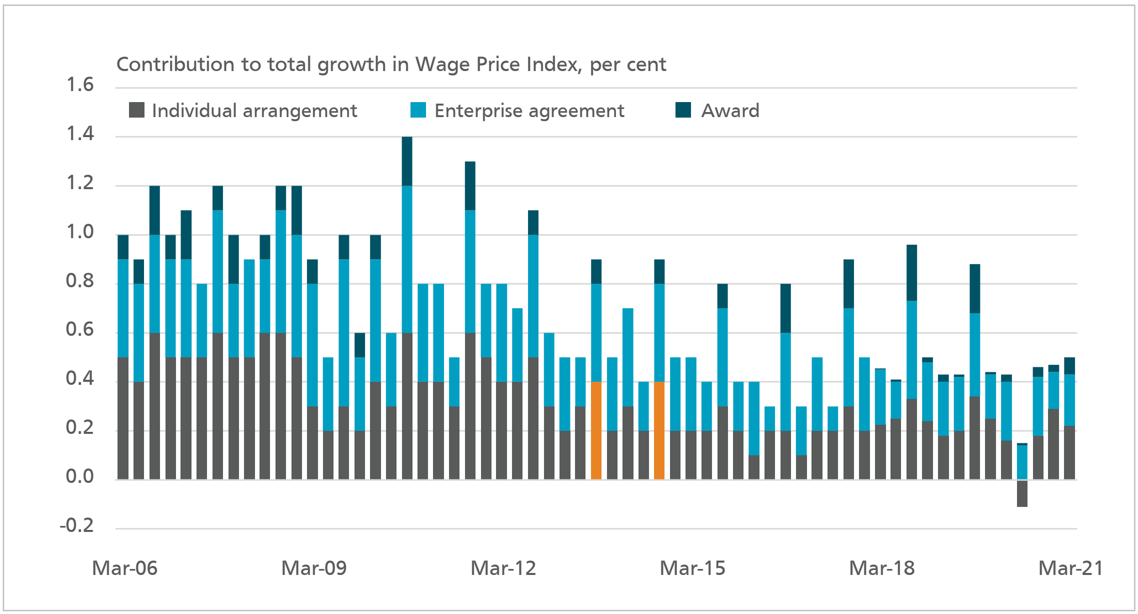
For employees on awards, the recent (annual) National Minimum Wage decision is for minimum wages in all modern awards to increase by 2.5 per cent from 1 July 2021. Given that inflation is expected to be around 1.25 per cent over the coming financial year, the decision amounts to an expected real wage rise of around 1.25 per cent for 2021-22. This will directly affect around 2 million private sector workers on awards, but will also influence wage outcomes for workers under other wage setting arrangements – given its role as a basis for wage negotiations in the broader labour market.

For employees on individual agreements, wages are more responsive to economic conditions than wages for employees under other methods of pay setting. In particular, for those on individual agreements, wages are more akin to a market price for labour – where changes in wage rates reflect, to a greater degree, changes in the underlying demand for, and supply of, labour. Of course, the broader labour market is composed of numerous sub-markets (that can be defined in terms of regions, industries or professions).

That said, it is rare for nominal wages determined under individual agreements to fall – even during an extreme economic or financial shock (Chart 4). Indeed, over the last 15 years, average nominal wages (for individual agreements) have fallen only once – during the height of the COVID-19 shock. In the June quarter 2020, GDP dropped by an unprecedented 7 per cent, which was the largest recorded economic contraction on record. This coincided with a 0.1 per cent decline in wages. By contrast, wages did not fall during the period of the global financial crisis (GFC)/great recession (mid-2007 to mid-2009), although wage growth was at a higher rate going into the GFC.

With respect to the impact of SG rate increases, wage growth (for individual agreements) actually increased in quarters immediately following previous increases (September quarters 2013 and 2014 – the orange bars in Chart 4). It is also worth noting that wage growth is currently around the same rate it was at the time of the previous SG rate increases.

Chart 4: Quarterly growth in Wage Price Index – contributions to growth by wage setting



Source: ABS, Wage Price Index, March 2021 and ASFA calculations.[8]

8 Also, ABS (2018), *Wage-setting Methods and Wage Growth in Australia*.

5

Business should be reluctant to cut wages with the labour market expected to continue to tighten

The Australian labour market is tightening quickly in the aftermath of the COVID-19 shock, and will continue to do so as the economic recovery continues.

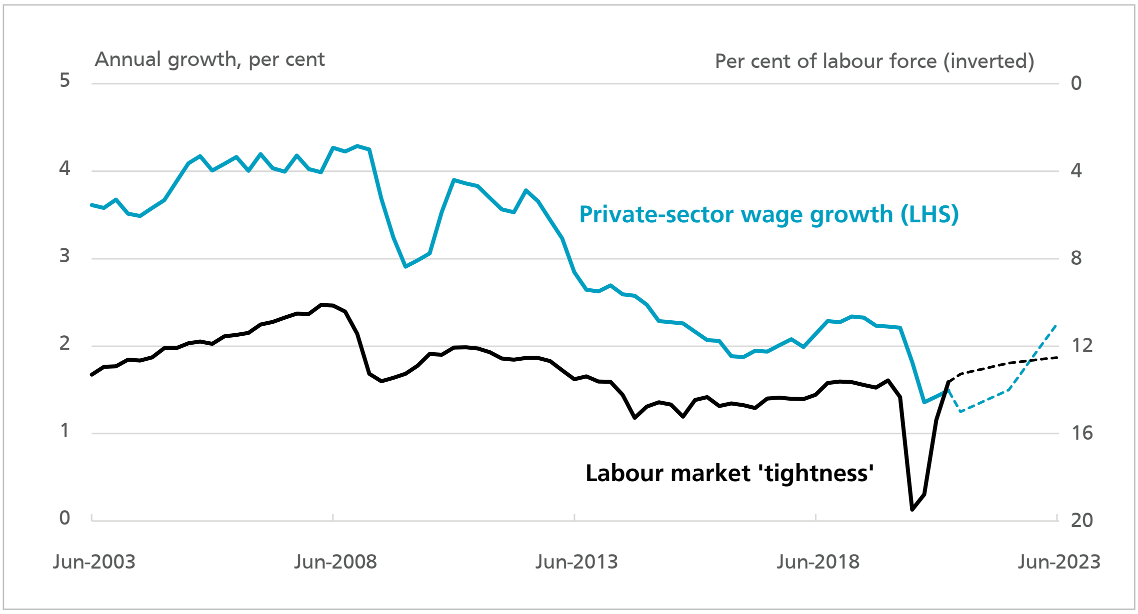
The unemployment rate has fallen to near pre-crisis levels already. The unemployment rate is currently at 5.1 per cent (of the labour force), down from a peak of 7.4 per cent in July 2020 and around the pre-crisis rate of around 5.2 per cent. The forecasts in the *2021-22 Commonwealth Budget* foreshadow ongoing falls in unemployment – down to 4.5 per cent.[9]

An extended measure of labour market slack includes employees who want to work more hours (those who are under-employed). The under-employment rate (as a percentage of the labour force) is currently at 7.4 per cent, which is already below the pre-crisis rate of 8.3 per cent. Together with the unemployment rate (above), total under-utilisation of labour is at 12.5 per cent – which lower than the pre-crisis rate of 13.5 per cent.[10]

A long-observed economic relationship is that private sector wage growth tends to be higher when the labour market is 'tighter' – that is, when underutilisation of labour in the economy is lower. In Chart 5, growth in private sector wages tends to track labour market 'tightness' (which is the inverse of the underutilisation rate), with a slight lag. The dotted lines in the chart show forecasts derived from the *2021-22 Commonwealth Budget,* which show a further tightening of the labour market, and a pick-up in wage growth.

9 ABS, *Labour Force*, May 2021.
10 ibid.

Chart 5: The labour market



Source: ABS, Labour Force, May 2021; ABS, Wage Price Index, March 2021 and ASFA calculations.

As the labour market continues to tighten, staff shortages across the economy will become increasingly prevalent. Indeed, recent anecdotal evidence points to staff shortages already emerging with respect to some regions and professions – with firms having to pay a wage premium to attract new staff. The most recent statement by the Governor of the Reserve Bank on monetary policy notes reports of staff shortages in some parts of the economy.[11]

In this environment, a firm that moves to cut wages could, in effect, price themselves out of the labour market. Such firms may find it more difficult to retain existing workers, or new attract staff, relative to competitors as the economy continues to recover.

On the flip side, as noted in the above section, business generally has the capacity to absorb the SG increase. A forgotten element of the debate around the SG increase is that as the economy continues to recover, business income and profits will pick-up – which are already at record highs (Chart 2). This will continue to support the affordability of the SG increase for business.

11 https://www.rba.gov.au/media-releases/2021/mr-21-09.html

6

Conclusion

A range of factors suggest that the scheduled increase in the SG rate should not see cuts in wages.

- The SG rate increase represents a very small cost to business: around $6 a week for a worker on average wages.
- Business generally has the capacity to pay: employees (on average) have not been fully compensated for productivity increases in the economy over the last two decades, and the increase in the SG rate will only marginally reduce this gap.
- History shows that private sector wages have fallen only under extremely adverse economic conditions. The Australian economy is currently in the midst of a strong and broad-based recovery from the COVID-19 crisis, with labour market slack down to around pre-crisis levels and expected to continue to dimmish.
- Firms should be reluctant to cut wages with the labour market expected to continue to tighten. Anecdotal evidence points to staff shortages already emerging. Firms that move to cut wages could, in effect, price themselves out of the labour market in a recovering economy.

BOX 1: THE LINK BETWEEN REAL WAGES AND LABOUR PRODUCTIVITY

At the economy-wide level, *labour productivity* is defined as gross domestic product (GDP) per employed person, or per hour worked. Labour productivity can also be calculated for the various sectors of the economy.

Ongoing increases in labour productivity are a feature of a dynamic market economy. Typical sources of measured productivity improvements include improvements in workforce skills, increases in the quantity of capital per worker, and wide-spread adoption of new technologies and new business practices and processes. In practice, firms can achieve improvements in labour productivity by training their staff, investing in new more advanced equipment, making workflows more efficient, and generating efficiency gains through scale.

At the firm level, all other things being equal, an increase in labour productivity means that the firm will produce more output per worker, and that labour, in effect, will be 'cheaper' for the firm in real terms. This means that the firm has a greater incentive to hire additional workers.

If productivity improvements are broadly-based across the economy (or within particular sectors), and there is a broad increase in demand among firms for labour, then this will put upward pressure on market wages. If realised, wage increases ultimately increase the cost of labour for firms.

Of course, whether it is profitable for a firm to hire additional workers, at going wage rates, depends on the prices of the goods and/or services that the firm produces. For example, if market wages increase relative to output prices then, all other things being equal, labour will become 'more expensive' in a relative sense.

At an economy-wide level, the level of wages relative to output prices is defined as the *producer real wage*. It measures, in average terms, the cost of labour (for firms and all other producers) in real terms – that is, in terms of the prices of goods and services produced.

Over the long term, at the economy-wide level, the producer real wage should track labour productivity.

Deviations can occur over shorter periods. Actual real wage outcomes depend greatly on labour market conditions. Where there is significant slack (spare capacity) in the labour market, the pass through of improvements in labour productivity to real wages may be relatively slow.

Real wages can also lag productivity due to structural factors. These include where firms' capital investments replace workers (rather than complementing their work), or where there is a relatively low degree of competition between firms. Both cyclical and structural factors can be industry specific. This means that similar increases in labour productivity across different sectors could lead to quite different wage outcomes in the short term.

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