

Deloitte Access Economics

A response to submissions
on AER's preliminary
decision for a
Regulatory Proposal

Australian Energy Regulator

11 September 2015

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11 September 2015

Dear Toby,

A response report on AER's preliminary decision on labour cost escalation rates

The Australian Energy Regulator (AER) has asked Deloitte Access Economics to provide detailed responses to issues raised by SA Power Networks in their July 2015 response to the AER's preliminary decision on SA Power Networks 2015-16 to 2019-20 Regulatory Proposal.

This report discusses the appropriate method for measuring and forecasting labour cost escalation in the price of labour in the utilities sector.

Deloitte Access Economics has previously responded to a range of similar arguments put by other regulated entities, and those responses remain relevant here.

As requested, this response also covers a range of additional matters.

Yours sincerely,

Chris Richardson
Director
Deloitte Access Economics Pty Ltd

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Glossary

ACCC	Australian Competition and Consumer Commission
ABS	Australian Bureau of Statistics
AER	Australian Energy Regulator
DAE	Deloitte Access Economics
EBA	Enterprise Bargaining Agreement
EGWWS	Electricity, gas, water and waste services
GDP	Gross Domestic Product
SA	South Australia
WPI	Wage Price Index

1 Background

The Australian Energy Regulator (AER) commissioned Deloitte Access Economics (DAE) to provide forecasts for labour cost growth to inform a preliminary decision on SA Power Networks' 2015-16 to 2019-2020 Regulatory Proposal. DAE provided forecasts for the electricity, gas, water and waste services (utilities) industry to 2019-20 for New South Wales, Queensland, South Australia, Tasmania and the Australian Capital Territory, as well as for Australia as a whole.

In July 2015, SA Power Networks provided a response to AER's preliminary decision. SA Power Networks also provided additional analyses prepared by Frontier Economics and by NERA on the labour escalation forecasts used and the AER's preliminary decision.

This report is a response to the material provided by SA Power Networks. It is organised as follows:

- Chapter 2 includes some discussions on the specific impacts of particular factors on the forecasts of the WPI. Four points are examined:
 - The impact of **industry specific labour productivity** changes on the labour price for that industry,
 - The impact of **supply and demand imbalances**,
 - The impact of **wage negotiation outcomes for the same industry** in other jurisdictions, and
 - The impact of the **specialist nature of labour** for the industry.
- Chapter 3 includes our response to matters raised by **Frontier Economics**.
- Chapter 4 includes our response to matters raised by **NERA**.

2 Forecasting the WPI – theory and practice

The AER requested that DAE respond to a number of points put forward by SA Power Networks in response to a preliminary decision on SA Power Networks' 2015-16 to 2019-20 Regulatory Proposal. In addition to responding to the firm's specific response, the AER sought discussion of the drivers of change in the labour price index at the electricity, gas water and waste services (EGWWS) industry level in both the short and long term. This section covers four key issues:

1. The effect of productivity changes on the labour price.
2. The effect of supply and demand imbalances on the labour price.
3. The effect of the outcomes of industry wage negotiations in other jurisdictions.
4. The effect of specialist skills in an industry on the labour price.

2.1 Productivity and the labour price

Deloitte Access Economics' view on the impact of labour productivity and wages is that, over the long run, they should rise in line together.

When workers are more productive, they are also more valuable, and markets ultimately reward that.

More formally, economic theory indicates that, over the long term, wages will reflect the marginal product of labour. Competitive firms will choose the mix of labour that minimises their input costs while maximising their production revenues so to maximise profitability. Linked to that, regulators typically focus on the rate of labour cost escalation that ensures the long term viability of the regulated firm and encourages the most productive, efficient labour mix.

That said, the connection between productivity and wages is a longer run condition. In the shorter term wage growth may deviate to a degree from reflecting productivity growth as firms adjust their decisions and labour mix to new market conditions.

2.1.1 Australian productivity growth has recovered

Australia's productivity growth stagnated over the 2000s as high growth in investments, driven by the mining boom, decreased the productivity of labour, and as a range of one offs had other important effects at the sectoral level (including the impact of mandated renewable energy targets in the utilities sector).

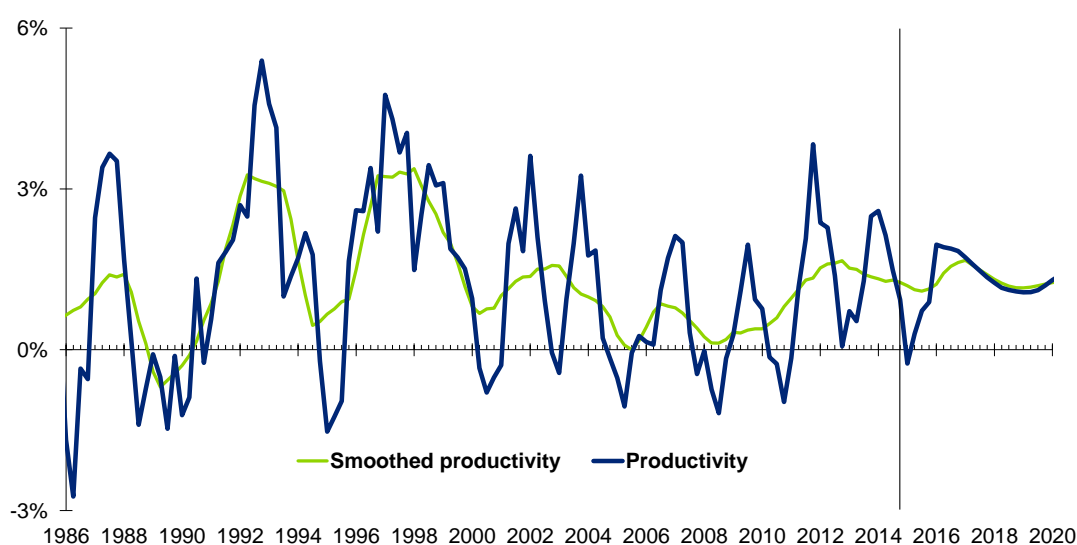
DAE maintains the view that these are not influences that will persist going forward:

- Most particularly, the relatively recent increase in the level of business investment generated a larger capital stock in the Australian economy and in the mining (and

related) industries in particular. As that investment moves from construction into production it has been contributing to a return to stronger productivity gains, and is projected to produce higher rates of labour productivity growth over the decade ahead compared with the recent past.

- In addition, the tighter business environment of recent years has acted as a spur to industry level efficiency, and so has also contributed to a pick up in the pace of measured labour productivity growth.

Chart 2.1: Australian labour productivity growth



Source: Deloitte Access Economics *Business Outlook*, June 2015

As a result of these two factors, a broad-based recovery in productivity growth has been evident since late 2010 (see Chart 2.1).

2.1.2 Sectoral stories tend to be more mixed – as mining shows

While economic theory would suggest that wage growth is an indicator of rising productivity over the long run, available data at the industry level is affected by important compositional changes. ABS measures of productivity are aggregated to the national level and are too broad for the AER's purposes because they are driven by compositional changes in the whole economy.

Comparatively, the WPI accounts for compositional changes relating to:

- changes in the nature of work performed (such as different tasks or responsibilities)
- changes in the quantity of work performed (such as the number of hours worked)
- changes in the characteristics of the job occupant (such as age, apprenticeship year, successful completion of training or a qualification, grade or level, experience, length of service, and the like)
- changes in the location where the work is performed.

For example, on a quality adjusted hours worked basis, the ABS reported that labour productivity in the mining sector declined throughout the last decade, but the WPI for that

sector increased consistently over the same period. The productivity of labour in that sector was distorted by the large increase in investment as well as the compositional effect of construction of new, large assets as opposed to the operational phase of resources project, which requires a different skill mix. During the last decade measures of labour productivity growth in the mining sector did not accurately reflect the value that labour was adding to businesses as they went through expansion and adjusted to new market conditions.

Rather, the value of labour across that period was very much driven by the enormous profits earned in the mining sector as 'the China boom' boosted commodity prices.

The result was that wage gains surged across a time when productivity fell.

Ultimately, however, business cycles average out. Across the period of the mining boom DAE's consistent view was that this trend of rising wages amid falling productivity would not continue. Mining industry wage growth has now slowed and the sector's labour productivity has increased.

2.1.3 The link from sectoral productivity to sectoral wages

The link from sectoral productivity to sectoral wages is more complicated than the matching links at the national level, because a wider range of factors can have an impact.

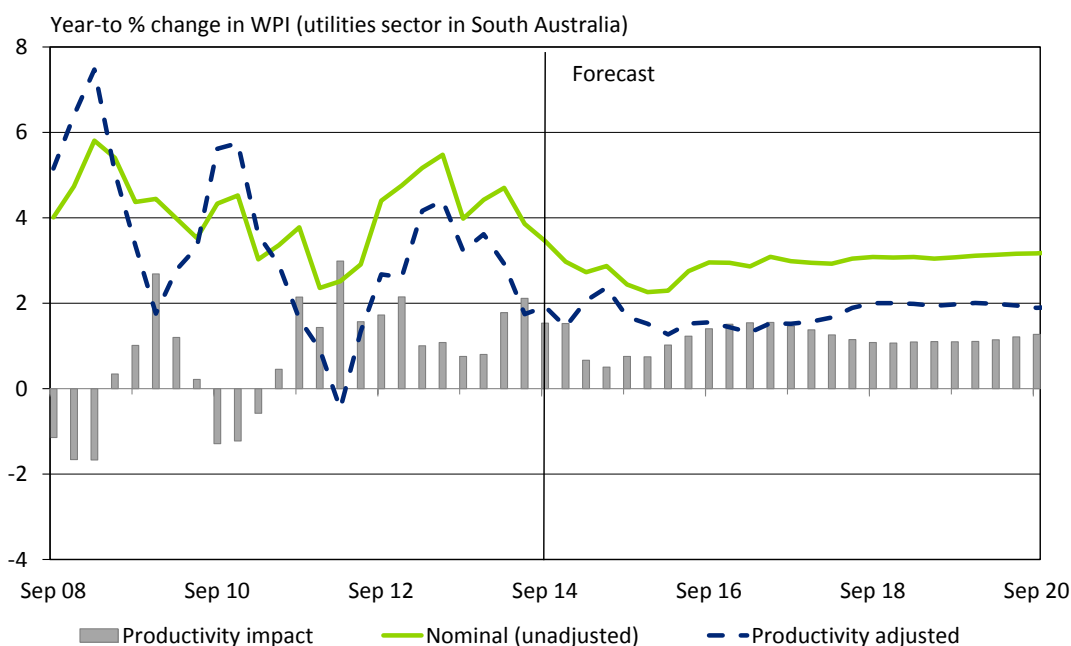
For example, wages in the utilities sector can deviate from trends in sectoral productivity not merely because of what is happening in the sector itself, but also because of what is happening in other sectors. Accordingly, the utilities sector saw a stage where one of the reasons why the sector's weak productivity performance was not being reflected in a weak wage outcomes was because for some time both mining and construction were seeing strong wage gains, and these sectors compete with the utilities sector for some types of workers.

That said, the DAE methodology allows for a link from sectoral productivity gains to sectoral wage gains, while also allowing for a number of other factors noted above.

Other things equal, an increase in sectoral productivity will imply an increase in sectoral wages. However, the effect is muted, as the measure of sectoral productivity we use also includes a proportion of national (as well as sectoral) productivity trends.

Our reason for doing so is that measures of both sectoral output and sectoral employment are relatively volatile, and hence we are cautious not to rely too much on sectoral productivity swings that may reflect statistical noise.

Our forecast discussions typically show the 'productivity impact' allowed in our forecasts, as per the chart below.

Chart 2.2: SA utilities sector wage growth and productivity impacts

Source: Deloitte Access Economics

2.2 Supply and demand imbalances

The AER requested that DAE provide a discussion on the impact of labour supply and demand imbalances on measures of wage prices. As discussed above, there is a long term relationship linking wages and the productivity of labour.

However, in the short term changes in market conditions can result in an imbalance in the supply and demand for labour until the market adjusts.

For example, during the last decade a rapid period of expansion in Australia's gas sector increased demand for skilled labour in upstream and downstream gas operations:

- As labour tends to be sticky or slow to respond to price signals (due to location and training constraints, among other factors), the supply of labour did not increase immediately to meet the required demand for labour in the gas sector.
- Businesses in Queensland reported shortages in skills for the construction and operation of LNG facilities for a number of years and increased wages to attract people to the industry.

Similarly, as noted above, the wider mining sector saw a massive cycle over the past decade in which the demand for workers surged and subsequently fell back. Similarly, wage growth surged and then fell back as the imbalances in demand and supply of workers in the sector played out.

Past reports by DAE for AER have discussed this in terms of imbalances across States and regions rather than industries and occupations, but many of the following points are still relevant – markets adjust to imbalances: *“Similarly, there are some natural limits to the*

extent or period to which wages and prices can be notably higher or lower in one State or region versus another. For example:

- *Workers can move between and within States (“we’ll leave Hobart and try our luck in Brisbane”).*
- *Workers can move to Australia from other nations.*
- *Permanent and temporary (visa 457) migration may be bureaucratically slow to move, but has the potential to ease a transition period.*
- *As do shifts by permanent residents.*
- *Shifts by New Zealanders (who face less restrictions on migration than do those from other nations).*
- *Shifts in wages can and will see people substitute into growing areas related to their existing skills (“I’ll leave construction and try my luck in mining”).*
- *Ditto shifts in relative wages can delay retirements or exits (“We’ll have baby next year”), as well as encourage new entrants (“I’m going to study electrical engineering, because wages in that occupation are good”).*
- *Shifts in the use of labour due to changes in relative costs (“We’ll use more Enrolled Nurses and less Registered Nurses because wages for Registered Nurses have risen relative to those for Enrolled Nurses”).*

Many of these ‘equilibrating factors’ can be very slow to operate, meaning that divergences in wages across States (and, for that matter, across sectors and occupations within a State) can persist for long periods.”¹

DAE’s wage forecasting methodology indirectly picks up this effect by allowing a channel of influence for relative sectoral output growth rates. Accordingly, if a sector grows faster (as it will tend to do along the path to labour shortages), then its wages grow faster too.

That said, the evidence of a shortage of skilled labour in South Australia’s distribution businesses and increasing wage pressure is not strong. The *Skills Shortage List* published by the Department of Employment does not list South Australia’s distribution network industry or the electricity, gas, water and waste services (EGWWS) industry more broadly as experiencing a skills shortage².

However, some occupations that are involved in electricity distribution are listed as in shortage, and that may have an impact on wage growth faced by the regulated firm. The *Skills Shortage List* lists Electrical Linesworkers as in shortage nationally in regional areas as at November 2014. In the context of a large workforce the effect on wage growth of the shortage in regional linesworkers is not likely to be significant in South Australia.

¹ Deloitte Access Economics, 3 December 2013, *Forecast growth in labour costs in Victoria*, p45

² Department of Employment, Skills shortage research report South Australia, <http://docs.employment.gov.au/node/31453>

2.3 EGWWS EBA wage negotiations in other jurisdictions

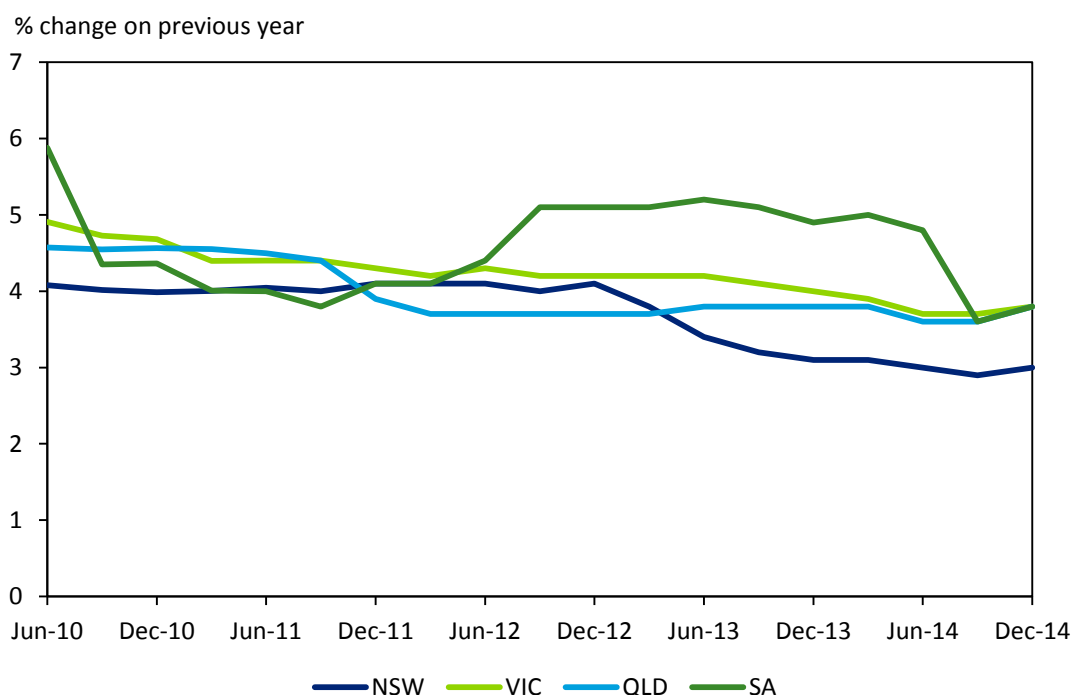
Overall WPI wage gains in South Australia have been slightly stronger than those of the nation as a whole over the past year. Growth in South Australia's WPI was around 0.2 percentage points above the national figure over the year to March 2015.

Yet the same cannot be said of the utilities sector, where South Australia's estimated 1.8% growth figure suggests that the State is running below national utilities wage growth:

- The notable easing in utilities sector wage growth in South Australia comes after relatively strong increases over the two years to early 2014. That relative slowdown looks to have some way further to go given the strong increases seen over recent years.
- The relative slowdown in utilities sector wage growth also reflects the weakness expected in both the State's economy and in broader wage growth across all industries over the next few years.

What of wage outcomes in the utilities sector in other States? EBA wage growth in South Australia's utilities sector has also been outpacing other States at a time when the outlook for South Australia's economy has been deteriorating. In a 2012 response report to the AER, DAE predicted that utilities EBA wage growth would fall back to below the All Industries growth rate. The latest EBA data appears to show this correction is well underway (see Chart 2.3), while the latest ABS WPI data also appears to show slowing growth in the national WPI for utilities.

Chart 2.3: Utilities sector EBA results for agreements that are current in the period



Source: Department of Employment, 2015

As an important element of wage-setting in Australia, recent EBA outcomes have important implications for the short term outlook for wages.

As our reports for AER regularly note, *“Deloitte Access Economics’ forecasts are developed using a more formal modelling approach rather than a more ‘institution-based’ approach.*

The latter focuses on:

- *increases in the **Federal Minimum Wage / Fair Pay Commission decisions**,*
- *increases in **collective agreements** under enterprise bargaining,*
- *increases in **individual agreements**.*

That said, close attention to such institutional factors can assist in short term forecasting (as opposed to longer term forecasts), given that most such decisions have lingering effects on wage outcomes.

Accordingly, Deloitte Access Economics notes developments in the Department of Employment’s Trends in Federal Enterprise Bargaining reports, and takes account of these in its short term forecasting if they appear likely to have a material impact.”³

In that light, DAE’s wage forecasting methodology does take account of EBA trends in a given sector and in competing sectors (including in other States). However, this linkage is judgemental rather than mechanical.

2.4 Specialist skills and wage outcomes

The AER has also requested that DAE provide a discussion on the impact of specialised labour supply and the impact on wage prices over time.

As discussed in Section 2.2 of this report, over the long term wages reflect the marginal product of labour, and firms will chose their labour mix taking into account the high productivity of specialist skilled labour versus (say) a mix of less skilled labour.

However, in the short term, changes in market conditions can result in an imbalance in the supply and demand for skills leading to short term price fluctuations due to shortages in specialist skills.

If there is a sharp increase in the demand for a particular skill, in the short term wages will rise as firms try to attract more workers into the industry or occupation. However, highly skilled work often requires training that takes time and so the supply of labour is delayed in its response to higher wages. This can result in wage growth outpacing the average in a particular region or industry that is experiencing the increased demand for skilled labour. However, over the long run it is DAE’s consistent view that the market will adjust and wage growth will return to a long run level in line with the value of the skilled labour.

Given that there is currently little evidence of a shortage of skilled labour in South Australia’s distribution businesses (see Section 2.2), the pressure on wages due to specialised labour supply is correspondingly weak.

³ Deloitte Access Economics, 24 July 2014, *Forecast growth in labour costs in NSW, Tasmania and the ACT*, p86

DAE's wage forecasting methodology doesn't specifically allow for particular 'cost push' around specialist skills. That said:

- First, it is important to judge the size of this effect. Unless the numbers of workers / differential wage pressures are high enough, then the overall impact may be small.
- Second, compositional change in skill mix is a business choice. If a business chooses to pay for a skill mix with a higher (or lower) average wage, then it also gets the associated productivity benefit (loss) of that decision. If the AER compensates a business for compositional effects that have seen a shift to a more skilled workforce, then the AER would be effectively adjusting twice (and businesses would be left with an incentive to move to more skilled workers over time). Accordingly, any business choice to move workforce composition towards a higher skilled workforce needs to be seen in that wider context.

3 Response to Frontier report

3.1 Representativeness of EBA data

Frontier argue that EBA wage outcomes are representative of wage growth in South Australia, and that forecasts of wage growth based on EBA data are better than WPI-based forecasts. Frontier further state that the majority of SA Power Networks' employees are covered by Enterprise Bargaining Agreements and imply that EBA growth is the best measure for wage growth:

“Contrary to the AER’s assertion that EBA outcomes are unrepresentative of the wage outcomes for privately-owned electricity networks, we understand from SA Power Networks that approximately 95% of its workforce is covered by its EBA agreement.

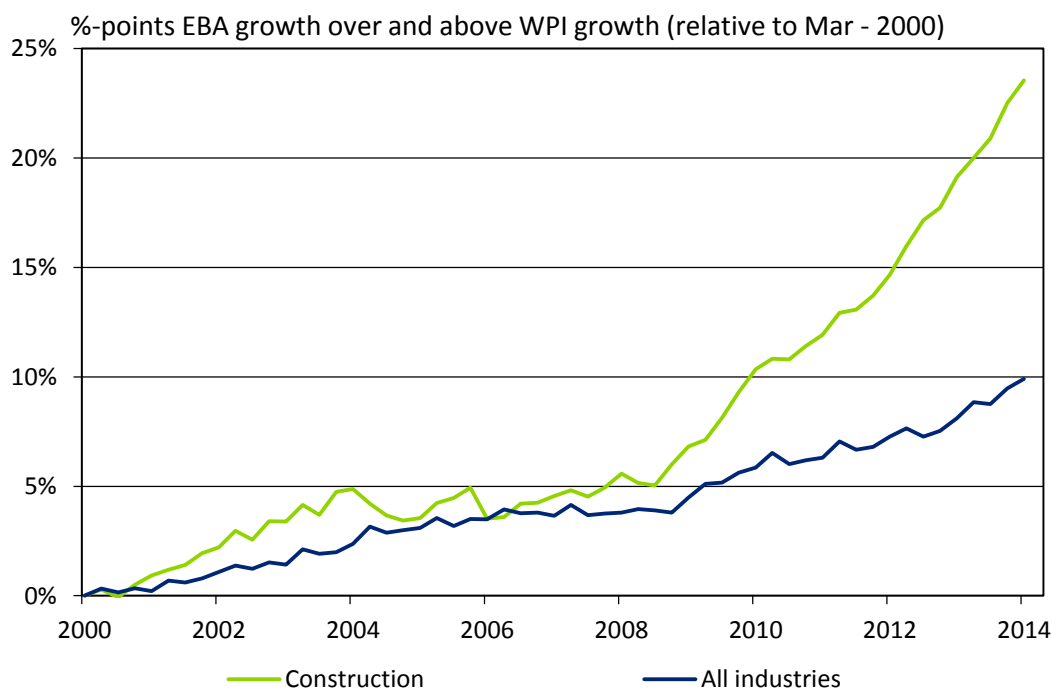
*... The EBA-based approach is clearly better, conceptually and in practice, than the EGWWS WPI based approach”.*⁴

It is worth noting that DAE’s forecasts are for sectors within States (such as the South Australian utilities sector) rather than specific to a particular enterprise (such as SA Power Networks). Deloitte Access Economics forecasts use official data sourced from the Department of Employment’s Enterprise Bargain Agreement database for December 2014. This database shows that 1,700 employees or an estimated 16.4% in South Australia’s EGWWS industry are covered by EBA arrangements. DAE acknowledges that this dataset appears to not include all EBAs known to be lodged in 2014 (primarily SA Power Networks EBA), and the issue has been raised with the Department of Employment. However, even with the inclusion of the SA Power EBA, the total number of employees covered by an EBA in the EGGWS sector in South Australia would be significantly less than 95%.

Equally, it is also worth noting that EBAs are often more evident where the market power of bargainers is greater, with a related tendency for EBA outcomes in a sector to be higher than WPI outcomes in a sector over the longer term. For example, the chart below notes the faster pace of EBAs than wages more generally, showing that to be true for Australia as a whole, and even more true for the construction sector.

(We have not done the matching analysis for the utilities sector, though the gap is likely to be smaller.)

⁴ Frontier Economics, 3 July 2015, *SAPN H.1_ Frontier Economics_Review of AER’s Preliminary Decision on Labour Escalation Rates*, pVI

Chart 3.1: The national EBA wage ‘gap’— growth in EBA wages minus growth in WPI

Source: Department of Employment EBA data, ABS 6345.0, Deloitte Access Economics

Frontier also disagrees with AER’s claim that labour requirements in the EGWWS industries are similar:

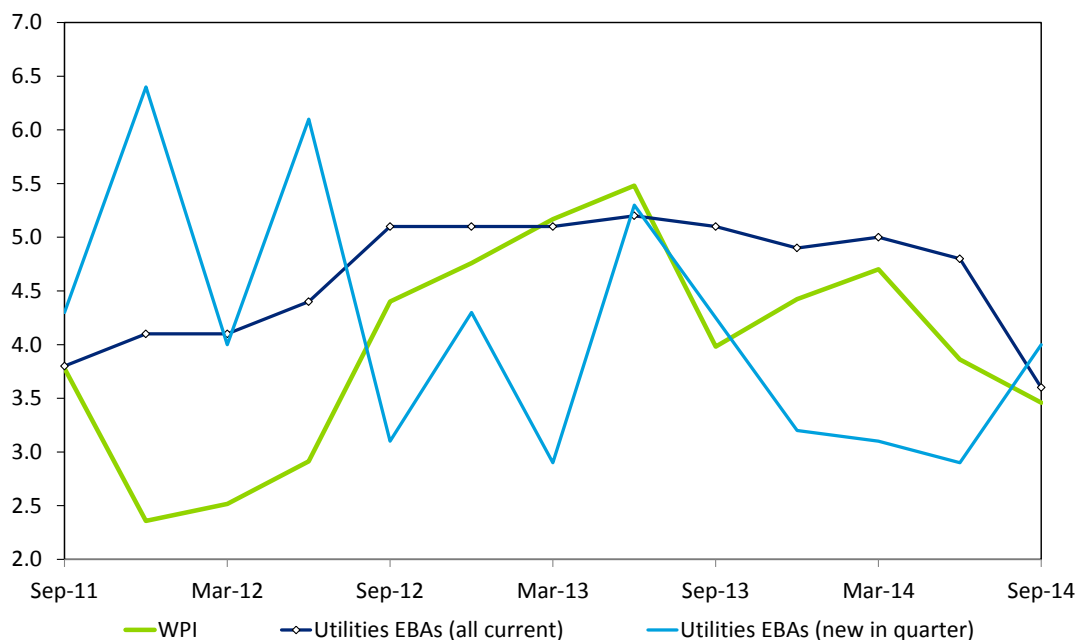
“On the basis of the degree of overlap in occupations within the EGWWS, the EGWWS WPI is very unlikely to be representative of the labour costs of DNSPs. There are many disparate industries within the EGWWS Division and the degree of overlap in occupations between DNSPs and other industries within the EGWWS Division is very low.

...there is very weak overlap between occupations employed by distribution networks and other constituents of the EGWWS”.⁵

This essentially argues that electricity networks are very different to the rest of the utilities sector. Of itself, that statement is neutral as to wage implications – if true, it may point to wage pressures being either higher or lower than the sector more generally.

That said, labour force data indicate that, of the wider utilities sector in South Australia, those in the ‘electricity’ component account for an average of just under 40% of the total workforce. As a large component of the total sector, the electricity component is therefore – by definition – having a notable impact on the WPI series.

⁵ Frontier Economics, 3 July 2015, SAPN H.1_ Frontier Economics_ Review of AER’s Preliminary Decision on Labour Escalation Rates, p6

Chart 3.2: Utilities sector wage growth rates in South Australia (% on a year earlier)

Source: ABS, Department of Employment and Deloitte Access Economics.

3.2 Extent to which EBA forecasts represent current market conditions

Frontier argue that, particularly in recent years, the rate of change in labour costs experienced by privately-owned and publicly-owned networks have diverged.

The AER compared EBA rates for privately-owned electricity networks with rates implied by an EGWWS index. Frontier states that this is misleading because the WPI reflects privately-owned and publicly-owned electricity networks.

The gap between EBA rates used to develop SA Power Networks' forecasts and the EGWWS WPI, over the period June 2013 to June 2014, is large (estimated to be 1.5 percentage points by the AER). Frontier argues that:

“The AER’s analysis on this point is incorrect. It has made a false comparison between the EBA rates in the sample we used as the appropriate comparator group for SA Power Networks and the WPI. This is because the comparator sample we used to forecast labour cost escalation rates for SA Power Networks was based on the EBA rates for privately-owned electricity networks. By contrast, the AER’s figure for the EGWWS WPI for the period June 2013 to June 2014 (which it says is 3.0%) appears to be based on the national EGWWS WPI.

The AER is not making a like-with-like comparison because it is comparing the average EBA rate for privately-owned electricity networks to a national EGWWS WPI, which includes privately-owned and publicly-owned electricity

networks. A more appropriate comparison would be the average EBA rate for all electricity networks in Australia against the national EGWWS WPI.”⁶

This essentially argues that public and private operators may face different wage pressures. Of itself, that statement is once again neutral as to wage implications – if true, it may point to wage pressures being either higher or lower than the sector more generally.

More importantly, it does not provide a reason to switch back from using the WPI to using EBAs.

For the AER’s purposes of setting a price for electricity distribution that is in the interest of electricity consumers over the long term, EBA outcomes are useful for understanding the short term constraints that a regulated firm is experiencing.

However, if regulators simply compensate a business for its commercial negotiations with employees, then they would be effectively undercut or even remove the incentive for businesses to move to the most productive workers over time, and to the long term efficient outcome for electricity consumers.

On balance, the WPI is a better measure for the purposes of regulators, and also has clear advantages in terms of both coverage and availability. Deloitte Access Economics sees the WPI as the more conceptually appropriate measure.

3.3 Changes in labour costs and productivity

Frontier argues that SA Power Networks’ forecast of rising real labour costs is not inconsistent with its forecast of zero productivity over the regulatory period. Frontier argues that at an industry level, growth in wages and productivity can be unequal at times.

Frontier updated analysis performed by Professor Borland using recent data and found that:

- The relationship between the rate of change in AWOTE, CPI and productivity holds at the economy-wide level.
- However, Frontier find that the result does not hold at the EGWWS level, stating the average rate of increase in AWOTE for the EGWWS industry is above the sum of the rates of increase in CPI and labour productivity.

As this report noted earlier, there can indeed be divergences between sectoral productivity and sectoral wage gains, and those divergences can persist for some time.

The limitations of productivity data was discussed in section 2.1 of this report and remains true for this discussion. In the short term, as the Australian economy adjusts to the rapid expansion in investment that occurred during the mining boom, labour productivity measures may be impacted by changes in composition of the work done and the skills mix. The WPI removes these changes and is a better indicator of the true value that labour is adding to production during times of structural adjustment in the economy.

⁶ Frontier Economics, 3 July 2015, *SAPN H.1_ Frontier Economics_Review of AER’s Preliminary Decision on Labour Escalation Rates*, p11

3.4 The best wage measure for forecasts

Deloitte Access Economics' view on the choice of WPI data as a base for wage forecasts has been covered in numerous reports to the AER, and has also been touched on again in this report.

DAE acknowledges that the WPI is not a perfect measure, and that some of the criticisms of it are reasonable.

That said, it remains the best measure of wage growth in the utilities sector, and one that is suited to use by regulators.

Our view is consistent with that of the Australian Bureau of Statistics (ABS), which noted in the October 2005 issue of *Australian Labour Market Statistics* (catalogue 6105.0):

“Information on changes in the price of labour is available from the quarterly Labour Price Index (LPI). The LPI is compiled from information collected from businesses on changes in wage and non-wage costs. Information collected on wages is used to produce a Wage Price Index (WPI).”

“The WPI was first compiled for the September quarter 1997 and is the main ABS measure of changes in wages. The WPI measures quarterly changes over time in the cost to an employer of employing labour, and is unaffected by changes in the quality or quantity of work performed.”

As the above discussion from the ABS suggests, they see the LPI as their preferred measure for “changes in the price of labour”. That is the task at hand here, and hence the WPI (excluding bonuses) is Deloitte Access Economics' preferred measure for this type of analysis.

3.5 The DAE forecasts

Frontier argued the basis for a forecast decline in wage growth in the State was unclear:

“So it remains unexplained why DAE is forecasting a sudden and significant decline in the EGWWS WPI over the forthcoming regulatory period.”⁷

DAE reported in its July 2015 forecasts of WPI for the AER that:

- Weakness in the broader South Australian economy was likely to have a cooling effect on the growth of utilities wages in the State. The forecast results suggest a period of relatively soft growth in wages for utilities workers in South Australia, continuing a trend seen since 2014 for slowing wage growth (Chart 3.3).
- That weakness comes amid an easing of competition for workers emerging from both the construction and mining sectors, which will help to reduce wage pressures in the utilities sectors.

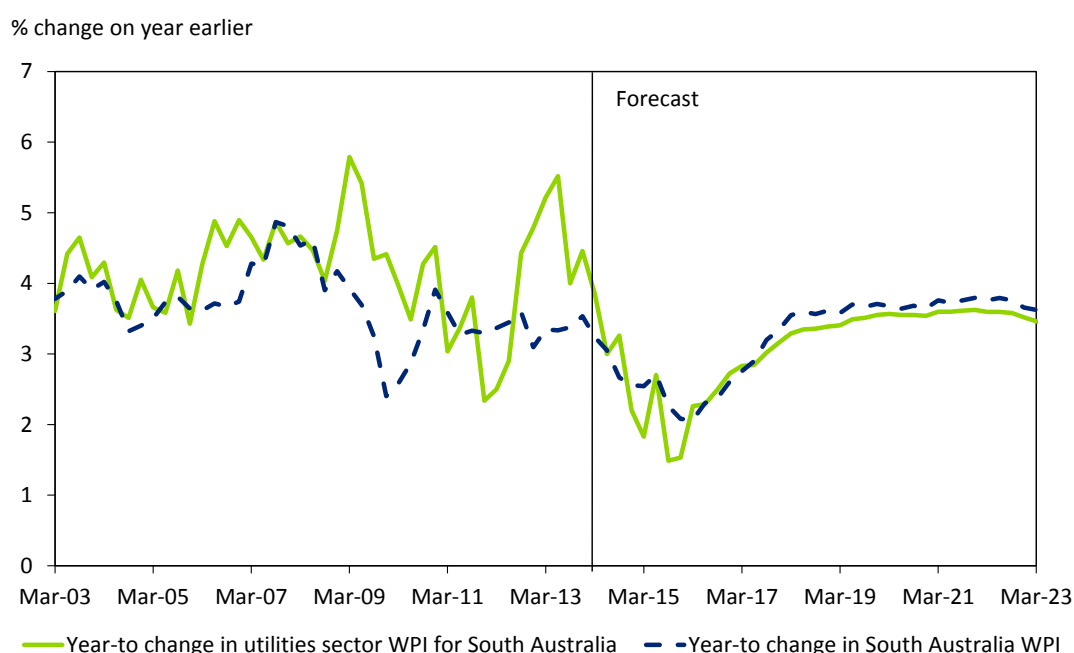
⁷ Frontier Economics, 3 July 2015, *SAPN H.1_ Frontier Economics_ Review of AER's Preliminary Decision on Labour Escalation Rates*, pVIII

- It is also a reflection of relatively weak business investment in the State. With businesses reluctant to expand their capacity, that suggests less demand for the electricity and gas needed to power growth in South Australia's heavy industries such as manufacturing.

It is also worth noting that there has been an additional WPI release subsequent to our report (and that of Frontier). Although the WPI is not released for the SA utilities sector, it is released for both South Australia as a whole, and the national utilities sector.

As the ABS commentary accompanying that release noted, wage growth in South Australia in the June quarter 2015 was the equal lowest of any State (at 0.2%), while the wage gain in the utilities sector nationally was just 0.3%.

Chart 3.3: South Australia's forecast wage growth, all sectors and utilities sector



Source: ABS, Deloitte Access Economics estimates, Deloitte Access Economics' labour cost model

Or, in other words, latest data confirm DAE's forecast, which remains that utilities WPI growth will fall below the All Industries growth during 2016 after an extended period of above average growth (see Chart 3.3).

3.5.2 Data availability

Frontier raised the lack of availability of WPI data at the 'by State by sector' level as an issue for reliability of wage price data. At the State level, WPI data is only available for the utilities sector for New South Wales and Victoria.

Deloitte Access Economics' approach to estimating the data where it is unavailable is to incorporate known data. Previously, this approach relied on the use of AWOTE information, which was available at the 'by State by sector' level, as well as drawing on information from relevant EBAs.

DAE also assesses this information in deriving a final estimate of unavailable historical State by sector WPI movements. Since the discontinuation of State by industry AWOTE and AWE figures from the start of 2012, the methodology now relies on specific EBA growth rates, and only whole of State or whole of industry AWOTE measures.

4 Response to NERA report

NERA argues that EBA data is a more accurate measure of wage costs faced by SA Power Networks than the WPI-based growth proposed by DAE.

DAE agree that EBA data provides an important gauge of the specific costs that an individual firm faces in the short term. However:

- The WPI remains a conceptually superior measure for the reasons set out in the previous chapter of this report, and
- There is a risk of circularity here. If regulators simply compensate a business for its commercial negotiations with employees, then they would be effectively undercut or even remove the incentive for businesses to move to the most productive workers over time, and to the long term efficient outcome for electricity consumers.

Some of the latter concerns are recognised by NERA, who note that the lack of independence of the EBA data increases the regulatory risk and lack of information faced by the AER in the long run. NERA acknowledges this risk in its response to the preliminary decision, stating:

“One potential shortcoming in relation to the use of EAs to forecast opex is that setting allowances based on companies’ own costs may undermine the incentive provided to the firm through the regulatory control to minimise its operating costs.”⁸

The AER’s role is to ensure the long term interest of electricity consumers through setting the prices charged for using energy networks (which are regulated monopolies).

EBA data provides an important insight into the current and potential future wages of those covered under enterprise agreements. EBA data is available at a State level by industry and to this extent, the EBA data provides insight into current wages faced by SA Power Networks than WPI measures. While it is true that WPI data is not available for South Australia for every industry, DAE have derived State data from a combination of known WPI totals by State and industry, as well as EGWWS EBA data.

However, Deloitte Access Economics would note that while EBA data, particularly for current EBAs, provides a good indication of the level of wages, it does not provide good indication of wage growth trends over the medium and longer term. DAE uses EBA data to inform a starting point for South Australia’s utilities sector and growth is based on the ABS WPI.

Were the AER to adopt the distributor’s own enterprise agreement wages as the sole source of wage data, then it would remove some of the incentive to achieve the most efficient prices over time. Over time, the AER’s wage price growth should represent the realities of the broader economy in which the regulated monopoly operates. DAE remains of the view that the WPI, supplemented by EBA data, is the best basis for the AER to forecast growth in wages for its purposes.

⁸ NERA, 3 July 2015, *NERA - expert report on labour escalation rates*, p11

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