Box A: The impact of the pandemic on the composition of the workforce and compensation of employees

The pandemic has been an uneven shock for the Irish economy. Sectors that rely heavily on face-to-face contact, such as hospitality, food, and arts, have been severely affected, with significant output and job losses. However, sectors with higher earnings, including more export-oriented and high-tech sectors, have recorded a strong performance in terms of both output and wages.

These compositional aspects resulted in a sharp increase in real average hourly earnings in 2020 compared to 2019, as hours worked fell sharply (-10 per cent), but real (HICP-deflated) aggregate employees' compensation was flat. However, *Budget 2022* projects a sharp fall in real average hourly earnings in 2022, and forecasts this to remain below its pre-pandemic trend over the medium term. This is in contrast to the implied projection for a broader measure of productivity — real GNI* per hour worked — which returns to its pre-pandemic trend over the medium term.

Lower real average hourly earnings would be consistent with lower activity in sectors with above-average hourly pay, alongside a strong and rapid recovery in sectors with below-average hourly pay. Given the strength of sectors with above-average hourly earnings since the pandemic began, and projections for broad productivity relative to its pre-pandemic trend, this box notes that there are upside risks to *Budget 2022* forecasts for aggregate employees' compensation over the short and medium term.

Comparing the earnings performance of different sectors during the pandemic

Box D in the Council's May 2021 *Fiscal Assessment Report* (Fiscal Council, 2021a) drew on figures published by the Revenue Commissioners (Collins and O'Rourke, 2021) to explain the resilience of PAYE income taxes in 2020, despite the pandemic. The broad finding was that sectors on which PAYE receipts are most reliant, were the same sectors whose earnings were least affected by the pandemic in 2020.

This finding is corroborated by considering the development of (implied) hourly earnings by sector.[3] Table A1 lists the sector-level earnings per actual hour worked prior to the pandemic.

Table A1: Ranking pre-pandemic earnings per actual hour worked

€ compensation of employees per actual hour worked in 2019

Financial, insurance, and real estate activities	43
Information and communication	36
Public administration, education, and health	32
Professional, administrative and support services	30
Average	28
Industry (excl. construction)	26
Distribution, transport, hotels, and restaurants	20
Construction	14
Arts, entertainment, and other services	12
Agriculture forestry and fishing	3

Sources: CSO, and Fiscal Council workings.
Notes: Some sectors are combined due to data availability; for example, compensation of employees is available separately for real estate services and financial and insurance services, but actual hours worked data groups these sectors together. Agricultural, forestry and fishing hourly earnings are strikingly low, in large part due to the classification of many persons engaged in the sector as self-employed workers, meaning their earnings are included separately in household income as gross operating surplus/mixed income.

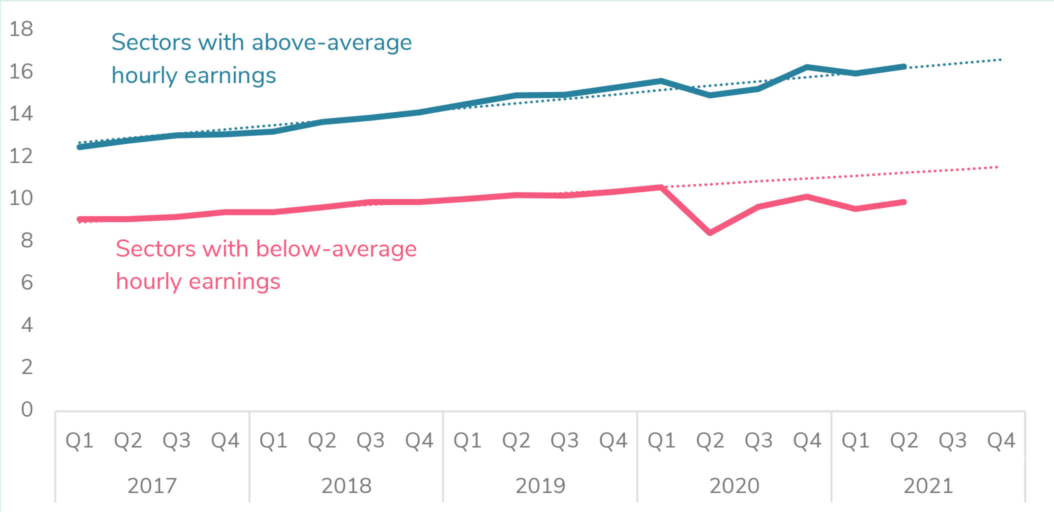
[3] This analysis uses the CSO's new data series on actual hours worked by sector, available here: https://data.cso.ie/table/QLF36

Four sectors had hourly earnings more than the weighted average of €28 per actual hour worked in 2019: financial, insurance, and real estate activities; information and communication services; public administration, education, and health; and professional, administrative and support services.

In Figure A1, sectors from Table A1 have been combined in two groups: those with above- and those with below-average hourly earnings. Comparing these two groups with their respective pre-pandemic (2014 Q1 – 2019 Q4) trends shows a limited impact from Covid-19 on the higher-paid sectors, where compensation continued to grow, with average hours worked broadly flat (-0.4 per cent) for 2020 and the first half of 2021 compared to 2019, and hourly earnings rising by 6.3 per cent for the same period. By contrast, an ongoing gap to trend is visible for sectors with lower hourly earnings, mainly reflecting a fall in hours worked of close to 16 per cent since 2019.[4]

Figure A1: Sectors with above-average hourly earnings have been resilient in terms of aggregate employees' compensation

€ billion values, seasonally adjusted



Sources: CSO, and Fiscal Council workings.
Notes: These sector groups are constructed based on the figures shown in Table A1. Trends shown are based on a sample of 2014 Q1–2019 Q4. Get the data.

Assessing the Budget 2022 implied projections for real hourly earnings

Compensation of employees, total hours worked, and HICP inflation can be used to assess the implied *Budget 2022* forecast for real hourly earnings.[5] This provides a consistency check for forecasts of aggregate employees' compensation.

Real average hourly earnings increased sharply in 2020, reflecting the composition effects of the pandemic. As discussed above, this was primarily due to sectors that were most adversely affected by Covid restrictions, where a sharp rise in hourly earnings took place. As employment and hours worked recover in such sectors, this composition effect should unwind, either in part or

[4] Compensation of employees in 2020 included about €4 billion of earnings supported by the Government's wage subsidy schemes, introduced last year due to Covid-19. Firms eligible for wage subsidy supports are more likely to be in sectors with below-average hourly earnings, especially tourism/hospitality, construction, and arts/entertainment sectors. As a result, the finding that sectors with above-average hourly earnings have been more resilient is unlikely to be as a direct result of wage subsidy schemes. For more on wage subsidy scheme supports, see: https://www.cso.ie/en/releasesandpublications/fp/fp-c19isar/covid-19incomesupports-ananalysisofrecipientsmarch2020tomay2021/employmentwagesubsidyscheme/

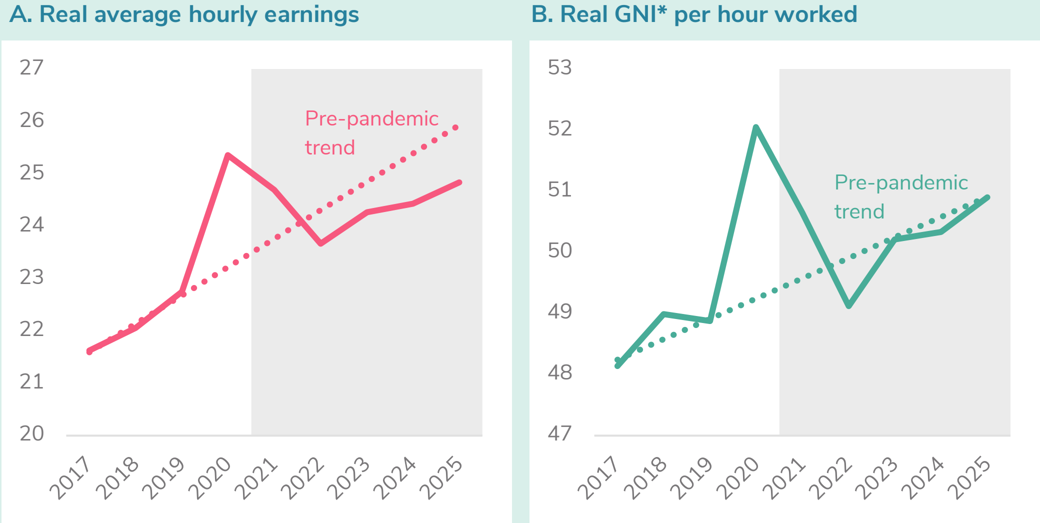
[5] Compensation of employees = real hourly earnings * hours worked * HICP deflator. Hours worked = employment * average weekly hours worked * number of weeks in a year.

in full. This could result in a return of real average hourly earnings toward their pre-pandemic trend from above.

However, as shown in Figure A2.A, *Budget 2022* forecasts a sharp fall in real average hourly earnings below its pre-pandemic trend next year, remaining on a lower trajectory over the medium term. By 2025, *Budget 2022* forecasts are over 4 per cent lower than the pre-pandemic trend.

By comparison, a broader measure of productivity in *Budget 2022* projections, such as real GNI* per hour worked (Figure A2.B), shows no difference compared to its pre-pandemic trend by 2025. As the path for real hourly earnings could be expected to evolve in a similar manner relative to overall productivity in the real economy, this suggests a relatively weak trajectory in *Budget 2022* for real hourly earnings.[6]

Figure A2: Budget 2022 projects a fall below trend for real hourly earnings, but not for broader productivity



Sources: CSO, and Fiscal Council workings.
Notes: Pre-pandemic trends are based on a sample period of 2014–2019. Get the data.

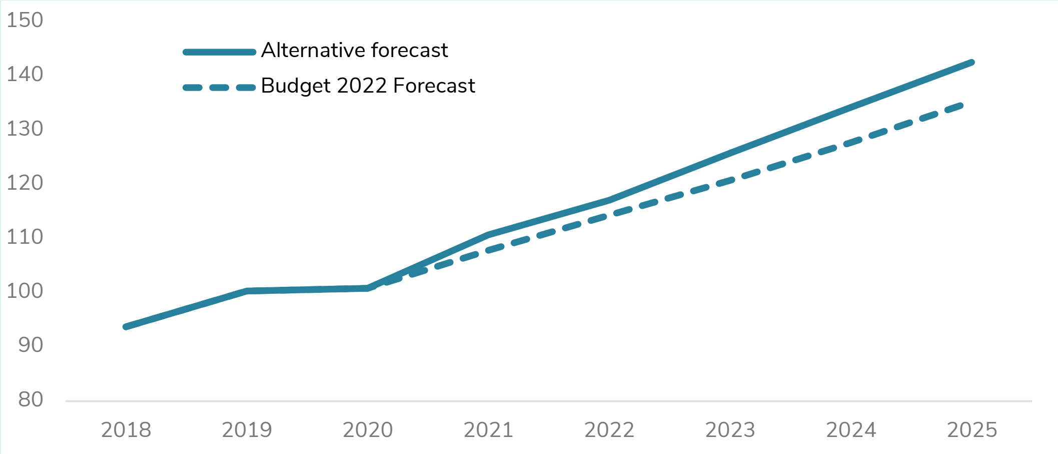
Budget 2022 projections for real average hourly earnings effectively imply lower activity in sectors with above-average hourly earnings, alongside a strong and rapid recovery in sectors with below-average hourly earnings. As a result, the above analysis suggests upside risks to aggregate employees' compensation over both the short term and the medium term.

A higher path for real hourly earnings — for example, getting close to trend from 2022 onwards — would be more consistent with recent developments in the labour market and overall earnings by sector, as portrayed in Figure A1. Figure A3 shows the difference to *Budget 2022* forecasts of aggregate employees' compensation as a result of this adjustment.

[6] See Box C in Fiscal Council (2021a) for further analysis of productivity during the pandemic. A strong performance for real average hourly earnings suggests a positive productivity shock has occurred, whereas a weak performance is more consistent with negative productivity developments.

Figure A3: Adjusting Budget 2022 forecasts for aggregate employees' compensation

€ billion



Sources: Department of Finance and Fiscal Council workings.

Notes: The alternative projection for compensation of employees takes the Department's *Budget 2022* forecasts for employment, average hours worked, HICP, and adjusts implied real hourly earnings such that they return to close to pre-pandemic trend. Get the data.