

Real price escalators – Gladstone Area Water Board



Response to QCA Draft Report | 13 February 2025

1.1 Introduction

In May 2024, Frontier Economics provided a report to the Gladstone Area Water Board (GAWB) on forecast price escalation rates for the period 2025-26 to 2029-30 (inclusive).¹ That report informed GAWB's submission to the Queensland Competition Authority (QCA) for a price monitoring investigation for proposed bulk water prices from 1 July 2025.

The QCA's draft report, dated November 2024, sets out its preliminary findings on GAWB's bulk water prices.² The draft report addresses GAWB's proposed real price escalators as recommended by Frontier Economics.

This note responds to the QCA's draft report as it applies to price escalators.

1.2 QCA's preliminary positions on price escalators

The QCA's draft report includes its preliminary positions on GAWB's proposed price escalators as summarised in **Table 1**. The QCA accepted GAWB's proposed approaches with one exception: forecasts of the Wage Price Index (WPI).

Table 1: Summary of QCA's preliminary positions on price escalators

Escalator	QCA position
Forecast Consumer Price Index (CPI)	QCA accepted GAWB's forecast CPI approach because it reflects the 2021 Inflation Forecasting position paper methodology, consistent with its referral notice.
Forecast WPI	QCA did not accept GAWB's forecast WPI approach because it considered it inconsistent with the 2021 Inflation Forecasting position paper methodology required by the referral notice. QCA's preferred approach is to use the Queensland Treasury WPI forecasts for 2025-26 and 2026-27, and the 10-year historical average of the Australian Bureau of Statistics (ABS) WPI for Queensland for the remaining years — without a glide path.

¹ Frontier Economics, *Real price escalators – A report for Gladstone Area Water Board*, 23 May 2024.

² QCA, *Gladstone Area Water Board price monitoring investigation 2025–30 Draft report*, November 2024, available at: <https://www.qca.org.au/wp-content/uploads/2024/12/qca-draft-report-public-version.pdf>, accessed 16 January 2025.



Escalator	QCA position
Gladstone premium above forecast WPI	QCA considered that GAWB did not provide sufficient evidence of materially different underlying cost drivers to support applying a premium over forecast WPI. As such, QCA did not consider it reasonable to apply a premium over WPI, as this would not be consistent with the 2021 Inflation Forecasting position paper.
Council rates escalator	QCA accepted GAWB's forecast Council rates escalator because it reflects the 2021 Inflation Forecasting position paper methodology, consistent with the referral notice, in that it is an appropriate input specific escalator. However, it didn't accept the use of the Gladstone premium above forecast WPI within the council rates escalator.
Application to operating cost categories	QCA accepted GAWB's proposed application of the above forecast escalators to various operating cost categories.

Source: Based on QCA's draft report, pp 45-46.

1.3 Our response

We have focussed on the main area of discrepancy with the QCA, the WPI. There are two aspects of GAWB's proposed approach to forecast WPI that the QCA did not accept:

1. The inclusion of a linear glide path from the 2026-27 forecast of WPI to the 10-year historical average of the ABS WPI, and
2. The inclusion of a 0.15% premium above WPI, which declines linearly to zero over the 2025-30 price monitoring period.

Our response to each of these is provided below.

1.3.1 Using a linear glide path for WPI

The QCA's Position Paper notes that:

For labour cost escalation, we have previously used Queensland Treasury's most recent forecasts of the Queensland wage price index (WPI) for up to three years ahead, with the long-term (10- year) historical average Queensland WPI thereafter. We consider that the Queensland Treasury is a reliable source of information, and its data is publicly available and therefore transparent. We consider the WPI to be the best estimate of wage cost escalation, as it measures the pure price change in labour costs independent of compositional changes such as variations in the quality or quantity of work performed.³

GAWB's proposal was consistent with the Position Paper in that it uses Queensland Treasury's most recent forecasts of the Queensland WPI, along with the long-term historical average of the Queensland WPI. The use of a linear glide path to 'link' the short-term WPI forecasts with the

³ QCA, *Final position paper Inflation forecasting*, October 2021, p 15



long-term WPI average is consistent with the Position Paper's use of a linear glide path for expected CPI inflation.⁴ This would help to smooth any transition between the short-term WPI forecast and assumed rate for year 5, which was based on the long-term historical average annual rate of change in the WPI.

The QCA's Position Paper contains considerable discussion on the merits of using a glide path to estimate expected inflation. For example, the QCA notes:

However, we agree with stakeholders that, to the extent that we retain the use of an RBA-based approach, a version incorporating a glide path from short-term to long-term expectations might be necessary to ensure that the transition path from short-term to longer-term expectations reflects, as far as practical, market and broader economic considerations.⁵

We agree with the QCA's reasoning in this regard and considered that the same logic would apply in respect of the WPI forecast.

Given that the QCA disagrees with the approach we adopted, it would be helpful to all stakeholders if the QCA could clarify why a glide path approach is appropriate for CPI forecasts but is not considered appropriate for WPI forecasts. The QCA's approach to WPI forecasts are prone to similar limitations as expected inflation would be without a glide path. For example, should short-term forecasts of WPI be materially higher or lower than the long-term average, the use of a glide path would ensure a smooth transition between short-term and long-term expectations. This is more likely to reflect market and economic conditions than a sudden step change (up or down) between the year 3 Treasury forecast and the long-term average assumed to apply from year 4 onwards.

1.3.2 Including a premium above WPI

The reasons for proposing a premium of 0.15% above WPI were outlined in the Frontier Economics report:

For GAWB's employee and contract labour expenses, we consider that underlying costs drivers are materially different to CPI. We recommend including a premium over general WPI growth to reflect labour shortages GAWB is projected to continue to face over the 2025-30 price monitoring period. This is largely due to competition for labour from the construction industry, which is experiencing rapid growth from major infrastructure and resource projects in the Gladstone region, across Queensland and nationally. As there is no publicly available data measuring wages growth in the Gladstone region, we have used a proxy based on the construction sector WPI growth less the general WPI growth over the last two years. This equates to a premium of 0.15%.

There is considerable uncertainty around how long skilled labour shortages will persist for GAWB. While skilled labour shortages may continue through the entire 2025-30 pricing period, given the

⁴ Ibid, p 2.

⁵ Ibid, p 33.



uncertainty we have conservatively assumed the premium of 0.15% declines linearly to zero over the 2025-30 price monitoring period. This is consistent with the QCA's previous decision.⁶

The QCA's draft report noted that while wage levels may differ in regional areas, it was not presented with evidence to suggest that the growth trend in regional wage levels is expected to outpace the general WPI growth in the coming years.⁷

We note GAWB commissioned Deloitte Access Economics (DAE) to report on cost pressures in the Gladstone region. DAE concluded that competition for skilled labour in the Gladstone region is likely to continue over the 2025-30 period due to large infrastructure projects in the mining and energy sectors, further tightening labour supply within the construction industry.⁸ DAE referred to key upgrades to the port and road networks in Gladstone, as well as Australian and Queensland governments investigating the potential extension of inland rail from Toowoomba to the Port of Gladstone to improve the efficiency of freight and transport services in the region.⁹

The DAE report noted that:

.... Surging public sector investment in transport and health infrastructure, coupled with the boom in residential construction, constricted the supply of labour for smaller construction projects. Though supply chain disruptions are easing, labour shortages in the construction sector are unlikely to subside completely in the 2025-30 regulatory period, particularly as overseas immigration declines. Competition with major construction projects in the Gladstone region are expected to prolong GAWB's challenges in securing skilled workers.

Skilled labour shortages and procurement challenges are also likely to continue in GAWB's 2025-2030 regulatory period. A combination of changes to Australia's migration strategy and sustained strong demand for workers from domestic firms may prolong the supply-demand imbalance until 2030. This is especially true for regional areas, with Jobs and Skills Australia noting that current skills shortages are particularly acute in regional areas, especially for highly skilled occupations.¹⁰

It would be useful if QCA could provide further guidance to GAWB on what would be considered reasonable evidence, beyond the opinion provided by DAE.

This guidance would be particularly important for GAWB given:

- There is no region-specific wage data produced by independent and reputable sources and that is readily available to all stakeholders, and
- It seems likely that wages growth will continue to exceed the general WPI measure in the Gladstone region over the 2025 to 2030 period, and potentially beyond, for the reasons explained in the DAE report.

⁶ Frontier Economics, *Real price escalators – A report to the Gladstone Area Water Board*, 23 May 2024, p 2.

⁷ QCA, *Gladstone Area Water Board price monitoring investigation 2025–30 Draft report*, November 2024, p 47.

⁸ Deloitte Access Economics, *Price Investigation: Regional Cost Pressures Report - Gladstone Area Water Board*, May 2024, p 2.

⁹ Ibid, p 3.

¹⁰ Ibid p 7.

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