

FEATURE

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The effect of bonuses on earnings growth in 2008

SUMMARY

This article examines the effect of bonus payments on the Average Earnings Index (AEI). The AEI is the National Statistic measure of short-term earnings growth. A separate article published last year in *Economic & Labour Market Review* (Duff 2007) describes the relationship between the AEI and the experimental series Average Weekly Earnings (AWE). AWE was the subject of a recent review (Weale 2008) and will remain as an experimental series until the recommendations of the review have been implemented.

Bonus payments are a major influence on earnings growth as measured by the AEI. Changes in their level or the month in which they are paid can have a significant effect on growth rates. The majority of large bonuses are generally paid in the period December to April each year, and nearly 60 per cent of the total for that period is paid by the financial services sector. This article looks at the impact of bonuses on earnings growth during the period December 2007 to April 2008.

Since 2001, there has been increased interest in how bonus payments have been affecting earnings growth. The Office for National Statistics (ONS) responded to this interest by publishing information on how earnings growth for the whole economy was affected by changes in the level and timing of bonus payments. This information was first published in 2002, covering the period December 2001 to April 2002, when the majority of large annual bonuses were paid. Following feedback from users, ONS improved the format of the information, outlined in Freeman (2002). The information is now available for 2008, and this article looks at what this shows about the effect of bonus payments on the Average Earnings Index (AEI) between December 2007 and April 2008. **Box 1** describes the calculations underlying the AEI.

Bonus effects on AEI

The main measure of earnings growth is based on the seasonally adjusted AEI series and compares average earnings in the latest three months with the same period a year earlier. Calculating growth in this manner removes some of the fluctuations caused by changes in the timing of bonus payments and/or pay settlements. **Figure 1** shows the seasonally adjusted three-month average growth rates, both including and excluding bonuses. To see how individual companies affect growth, though, the non-seasonally adjusted series needs to be considered. From the AEI methodology, it is possible to calculate the approximate effect of a single company on the single-month growth, that is, earnings in the latest month compared with the same month a year ago. **Figure 2** shows the non-seasonally adjusted growth rate for the whole economy, both including and excluding bonuses.

Figure 1
Three-month average earnings growth, including and excluding bonuses, seasonally adjusted



Box 1

How the AEI is calculated

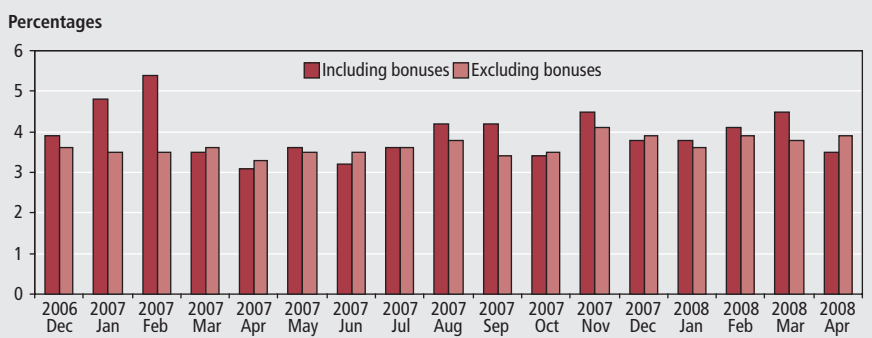
The AEI is the main measure of how levels of pay are changing in the Great Britain economy. Information is collected from a sample of around 8,500 companies each month in the Monthly Wages and Salaries Survey. Data are collected on the number of employees and the total pay bill for the month. Companies are also asked to supply the amount of bonus payments and arrears payments contained in total pay.

To calculate the AEI, the percentage change on the previous month in the average weekly pay per employee is calculated for each company in the sample (for example, the change

from March to April). This means that only companies that have provided data for the current and the previous month are included in the calculation of the AEI. The percentage changes for each company are then weighted together to give a monthly change for the whole economy. The whole economy change is applied to the index value for the previous month to give the latest index value. Separate index values are calculated for pay including and excluding bonus payments, which can indicate if bonus payments are changing at a different rate from other elements of pay.

Figure 2

AEI annual growth, including and excluding bonuses, non-seasonally adjusted



Earnings growth in 2008

Looking at the non-seasonally adjusted figures in Figure 2, for the months from December 2007 to April 2008, there were some quite large fluctuations in earnings growth including bonuses, whereas growth excluding bonuses was more stable. Earnings growth excluding bonuses lies within the range 3.6 to 3.9 per cent, while earnings growth including bonuses fluctuates between 3.5 and 4.5 per cent. This difference is less marked than in previous years but still quite noticeable.

The next section looks at what caused these fluctuations in growth.

Bonus payments in 2007/08

There are three main effects that cause fluctuations in the earnings growth rate including bonuses:

- changes in the level of bonuses paid in the same month as the previous year
- changes in the timing of bonus payments, and
- changes in the level of bonuses paid earlier or later than the previous year

Figure 3 shows how these effects impact on the level and timing of growth rates between December 2007 and April 2008. The biggest effects were on the data for

January, when the level of bonuses was 0.2 percentage points higher than that also paid in January the previous year. Timing effects were, however, much larger, adding 0.7 percentage points to the growth in January, so that the net increase in growth was 0.9 per cent. In contrast, in March, the level of bonuses was 0.5 percentage points higher than that paid in March the previous year, while timing effects reduced growth by 0.2 percentage points, bringing the net increase in growth to 0.3 per cent.

The level of bonuses can be calculated from the AEI annual growth rate (see Freeman 2002). Applying this technique to the latest data, bonuses in the period December 2007 to April 2008 were approximately £1.5 billion higher than in

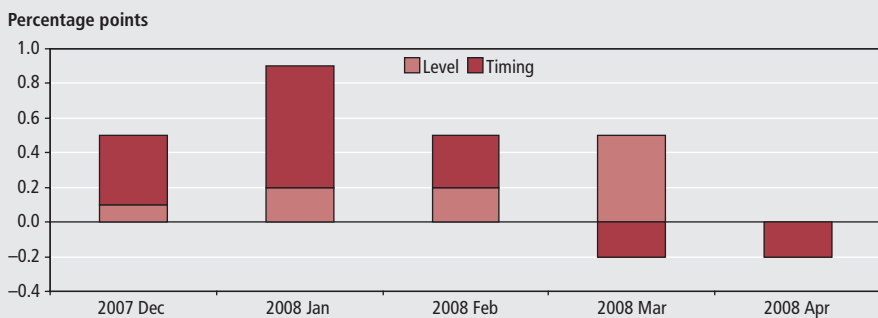
the same period a year earlier. This growth is somewhat less than in the previous two years, when bonuses grew by around £3 billion.

Looking at the data in more detail, it is important to recognise that not all bonuses are paid in the financial sector (sometimes very loosely described as ‘the City’). As noted previously, bonuses in the financial sector comprised around 60 per cent of total bonuses during December 2007 to April 2008. In terms of growth, the financial sector was broadly flat between the two years, that is, the £1.5 billion growth in total bonuses occurred in other sectors.

Box 2 describes how the supplementary information breaks down the month-on-month effects of bonuses on the AEI growth rate between timing and levels effects.

Figure 3

Contributions to changes in earnings growth, including bonuses



Box 2

Interpreting the data

To produce the bonus analysis, only companies that have a significant effect on the published growth rate for the whole economy are included. Due to the way that the AEI is constructed, it is possible to calculate the contribution of a single company to the whole economy month-to-month growth rate, that is, the percentage growth between two consecutive months. For the purposes of the analyses in this article, a company is included if, when it paid its bonus, it had an effect of more than 0.01 percentage points on the whole economy month-to-month growth rate.

Table 1 shows the aggregate effect of companies that paid large bonuses in the period December 2007 to April 2008 and in the same period 12 months earlier. The figures show the contribution to the AEI month-to-month growth in the months that they paid their bonuses, for example, growth from January to February 2008. Figures in the white areas show effects on the AEI in the 2007/08 period; figures in the shaded areas in brackets show effects on the AEI in the 2006/07 period.

Reading across the rows of the table shows what happened to the companies that paid bonuses in 2006/07. For instance, most of the companies paying bonuses in March 2007 also paid their bonuses in March 2008. Looking at the effects, bonus payments in March 2007 contributed 6.8 percentage points, and

companies also paying their main bonus in March 2008 contributed 5.9 percentage points in March 2008 compared with 5.4 percentage points in March 2007. However, there were some companies paying bonuses in March 2007 that paid their main bonuses in February 2008. The contribution in February 2008 was 0.4 percentage points, compared with 0.5 percentage points (the figure in brackets immediately below the 0.4) in March 2007. Looking at the totals in the final column, companies paying bonuses in March 2007 had an effect of 6.8 percentage points. When they paid their bonuses in 2007/08, they had an effect of 6.9 percentage points, that is, companies paying bonuses in March 2007 paid slightly higher bonuses in 2007/08.

Reading down the columns of the table shows which companies were affecting growth in 2007/08. Looking at the column for March 2008, there were contributions from companies that had previously paid their bonuses in December 2006 (0.2 percentage points compared with 0.1 in 2007), January 2007 (0.3 points compared with zero) and February 2007 (0.4 points compared with 0.2), as well as those that had paid their bonuses in March 2007 and in the same month a year later (5.9 percentage points in 2008 compared with 5.4 in 2007). There was also a contribution from companies that had previously paid their bonuses in April 2007 (0.3 percentage points compared with 0.1 in 2007) and made payments earlier.

Table 1
Bonus matrix for 2007/08

2006/07 annual bonus paid in:	Contributions to month-to-month growth from firms which paid large ¹ bonuses between December 2007 and April 2008								
	Whole economy growth 2006/07	Main bonus contri- butions 2006/07	2007/08 annual bonus paid in:					April 2008	'Like-for- like'
			December 2007	January 2008	February 2008	March 2008	April 2008		
December 2006	3.9	2.4	2.0	0.2	0.1	0.2	0.1	2.6	
			(1.9)	(0.3)	(0.0)	(0.1)	(0.1)	(2.4)	
January 2007	4.1	6.5	0.1	6.6	0.1	0.3	0.0	7.1	
			(0.0)	(6.4)	(0.1)	(0.0)	(0.0)	(6.5)	
February 2007	4.1	9.5	0.3	0.2	9.1	0.4	0.2	10.3	
			(0.1)	(0.3)	(8.9)	(0.2)	(0.1)	(9.5)	
March 2007	-0.7	6.8	0.3	0.2	0.4	5.9	0.1	6.9	
			(0.4)	(0.3)	(0.5)	(5.4)	(0.2)	(6.8)	
April 2007	-7.2	1.2	0.2	0.2	0.2	0.3	0.6	1.5	
			(0.1)	(0.3)	(0.0)	(0.1)	(0.6)	(1.2)	
Total observed			2.9	7.4	10.0	7.1	1.0		
Whole economy growth 2007/08			3.2	3.0	4.4	-0.2	-8.1		

Note:

1 Includes all firms which made a contribution to the month-on-month growth of the AEI of more than 0.01 percentage points between December 2006 and April 2007 or December 2007 and April 2008.

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