



AUSTRALIAN CAPITAL TERRITORY

**SUBMISSION TO THE
COMMONWEALTH GRANTS COMMISSION'S
STAFF DISCUSSION PAPER 2008/01-S:
ASSESSING LOCATION DISABILITIES IN THE 2010 REVIEW**

APRIL 2008

VIEWS ON THE COMMISSION'S ASSESSMENT PROPOSALS

GEOGRAPHY

Are States satisfied with the proposed use of SARIA as a measure of geography?

The ACT supports the use of SARIA as a measure of geographic remoteness. Discussion at the Tuesday 18 March 2008 location working group meeting highlighted that some jurisdictions believed that they faced increased locational costs driven solely by the distance from the capital city, whereas others argued that distance from other major towns and density are more important drivers of costs. The SARIA index appears to provide a balanced trade-off between density and distance, and as such SARIA seems to be a reasonable method for assessing geographic remoteness within a State.

As SARIA is based on ARIA, a measure developed under a steering committee which included the Australian Bureau of Statistics and widely adopted by governments across Australia to measure geographic remoteness, we believe that it represents the most accepted measure and is robust and reliable.

Notwithstanding this, caution should be taken when assessing some costs in less accessible areas which have large more accessible cross border regions, such as Albury-Wodonga. Conceivably, goods and services flow between porous borders in these regions which would thereby cause SARIA to overstate the costs associated with remoteness. It is likely that such affects would not be material, and as such, the ACT would support a materiality analysis being conducted on such effects (using disability placeholders) and the results presented to a future meeting of the location working group.

INTRASTATE LABOUR COSTS

Is the proposed approach to measuring the impact of location on intrastate labour costs appropriate?

Questionable conceptual case

The data presented in the discussion paper has not substantiated whether a standard policy for higher intrastate per capita labour costs exists, or whether the higher aggregate costs are policy tainted through the non-standard policies of one or two jurisdictions that provide an above average level of service to the population living in less accessible areas. Further information should be provided to the States which gives a clear indication that there is a standard policy in relation to higher staffing levels in very remote areas.

For example, data presented in Table 2 of the discussion paper (*Assessed labour costs*), provides aggregate Australian wage expenses on a per capita basis and indicates that the standard labour cost per capita is relatively higher in less accessible areas. However, when viewed in relation to Figure 7 (*Average public sector wages by State SARIA region*) it shows that three jurisdictions pay significantly above average wages to staff in very remote regions. There is a concern that, given their population weightings, one or two of these jurisdictions may be driving the average intrastate labour cost aggregates. Specifically, it is unclear whether the higher labour cost per capita in very remote areas are being unduly influenced by the staffing policies of a minority of States and does not reflect national average staffing levels and pay by region.

Therefore, before the conceptual case can be supported, it is requested that the Commission provide evidence confirming that the differences in intrastate labour costs are policy neutral.

As such, the ACT requests State level data on per capita labour costs by location in order to ascertain whether a standard policy exists.

Measurement and allocation of labour cost data

Provided such evidence is forthcoming, the ACT supports the use of data provided by the Australian Tax Office (ATO) to measure the aggregate assessed labour costs, on the basis that the data are robust, and fit for purpose.

However, concerns exist regarding the allocation of assessed labour costs. Paragraph 22 of the Discussion Paper states that: “*location is determined by the residential postcode of the taxpayer.*” This suggests that assessed labour costs for ACT Government employees that reside in New South Wales, are allocated to New South Wales.

According to ACT wages data, 11.7% of total ACT government wages payments went to New South Wales residents. If labour costs are allocated on the basis of residential postcode, assessed labour costs for highly assessable areas will be understated relative to less accessible areas. The ACT proposes that where such cross-border impacts are identified, that adjustments be undertaken using State based payroll data.

Alternatively, it is possible that the general government entity ABN data the Commission is collecting from States could be used to measure the assessed labour cost with greater accuracy. We understand that the data are being collected to categorise employees, however, it could also be used as a simple and accurate basis to allocate labour costs.

Should the Commission calculate a single combined assessment and apply it to all affected categories, or calculate separate assessments for each category using a common approach?

The ACT supports the use of a common approach which can be applied to separate assessments for each category. This approach maintains a degree of transparency by linking location related costs directly to the affected categories, rather than aggregating them into the one assessment.

Applying the location disabilities to separate assessments increases transparency, and whilst it involves a degree of complexity in the method, it actually simplifies the reported relativities as the locational impacts can be easily related back to the individual expenditure categories.

Is the method of adjusting for central office effects appropriate?

The ACT does not support the proposed adjustment for ‘central office effects’ in its current form. Conceptually, central office services should be excluded from the assessment (if material). Furthermore, more detailed data are required to ascertain the breakdown between central office functions and local services to residents within the CBD, such as, policing.

Questionable conceptual case

Whilst it may be that having populations in remote locations increases the cost of central office functions, it is not clear to what degree such increased costs occur. Typically central offices are tasked with producing services that are consumed across the entire jurisdiction, such as

developing school curriculums or drafting child safety legislation. Such services are non-rival in nature, which means that they can be enjoyed simultaneously by an unlimited number of consumers without diminishing the value. In this way the majority of central office functions can be scaled across the entire jurisdiction with little or no additional cost, irrespective of the geographic remoteness of its population.

Rather than assessing the actual apportioned cost of delivering services across SARIA regions, the ACT views the assessment's intent as being to measure any additional cost impediments to the delivery of State services due to geographically remote populations. Given central office functions are mainly concentrated to capital cities, there can be (by definition) no additional central office costs incurred due to having a geographically dispersed population structure – as central office functions do not generally take place in less accessible areas. The proposed apportionment of central office expenses on an equal per capita basis fails to recognise that such services are not comparable with those services provided in both accessible and less accessible areas.

All States provide central office functions mainly through their capital cities, so adjusting for remoteness effects for these functions does not reflect 'what States do'. Additionally, the wages paid to central office staff are higher than for remote regions (capital city versus remote wages) and combined with the different roles and responsibilities means that any re-allocation to remote areas would overstate the intent of the adjustment, so it must be conservatively applied.

It should also be borne in mind that the NT is provided with additional fixed cost allowances in regard to Indigeneity, which is also largely reflective of remoteness costs. Introducing a central office adjustment may lead to 'double dipping'.

As such, any central office services should be excluded from the assessment, rather than treated as EPC. Such a treatment would serve to significantly increase the comparability of labour costs by comparing relatively similar services.

Determining central office services

The discussion paper identifies that around 11% of services produced in highly accessible areas are central office services. The ACT believes that the proposed method for determining central office services is overstated. Difficulty exists in accurately measuring the net amount of services being provided from the CBD to external regions. Whilst uncertainty surrounding how well the adjustment reflects the central office effect remains, measures could be taken to increase the reliability of the assessment. This includes (if material) adjusting central office labour costs by the proportion of services produced and consumed in the CBD.

For example, Sydney's City Central Police Station is located at 192 Day Street, which is roughly 400 metres from the Town Hall Shopfront Police Station, located at 570 George Street. Although both of these stations are located in the CBD of Sydney (and we would anticipate are classified as being within a central office location), it is unlikely that their services are consumed in less than accessible areas. In fact, given there are more than ten police stations located within five kilometres of each other in central Sydney, it would seem that classifying all services in this area to 'central office' fails to recognise that there would appear to be significant drivers of demand for police services within the vicinity and near vicinity of the CBD area.

In terms of the allocation of costs to remote areas, a net rather than gross cost needs to be derived. For example, while there are central office costs in a capital city related to curriculum and policy analysis (which could be allocated across remote regions), staff are also employed in

remote areas to collect data on age, sex, outcomes etc. that are in effect, central office functions, so these should be allocated to capital cities too.

The ACT can provide a breakdown of what proportion of wages in central offices should be allocated to central office versus local services.

Are States able to provide information on the number and costs of central office staff?

The ACT can provide data on the number and cost and function of central office staff.

Is the method of adjusting for intensity of use appropriate?

The ACT strongly supports the intensity of use adjustment to ensure that double counting does not occur. Given that undoubtedly the Commission will assess certain Socio-Demographic Composition (SDC) groups as using services more intensively, and where such groups are more prevalent in less accessible areas, conceptually, the SDC disabilities should not be counted again as part of the location assessment.

Although it is noted that for the purposes of the discussion paper the Commission only used assessed students to demonstrate how an intensity of use adjustment could be assessed, the ACT supports the Commission's proposed method of measuring intensity across a broad range of service delivery categories.

Are other adjustments required?

At this stage the ACT does not propose any additional adjustments.

INTERSTATE LABOUR COSTS

It is noted that two jurisdictions questioned the conceptual case for policy neutral differences in interstate labour costs. The ACT is of the view that localised conditions related primarily to competition for labour between other governments (State and Commonwealth) and the private sector, and cost of living effects impact on differences in interstate labour costs.

Competitive pressures

Competitive pressures for labour between governments and the private sector is multifaceted and depends upon profession type driven by differing sectors.

Whilst anecdotally some States have argued that competitive pressures exist between State Governments for labour (and hence, the argument goes that States operate in a national wages market) the wages outcome data for both the public and private sectors paints a vastly different picture.

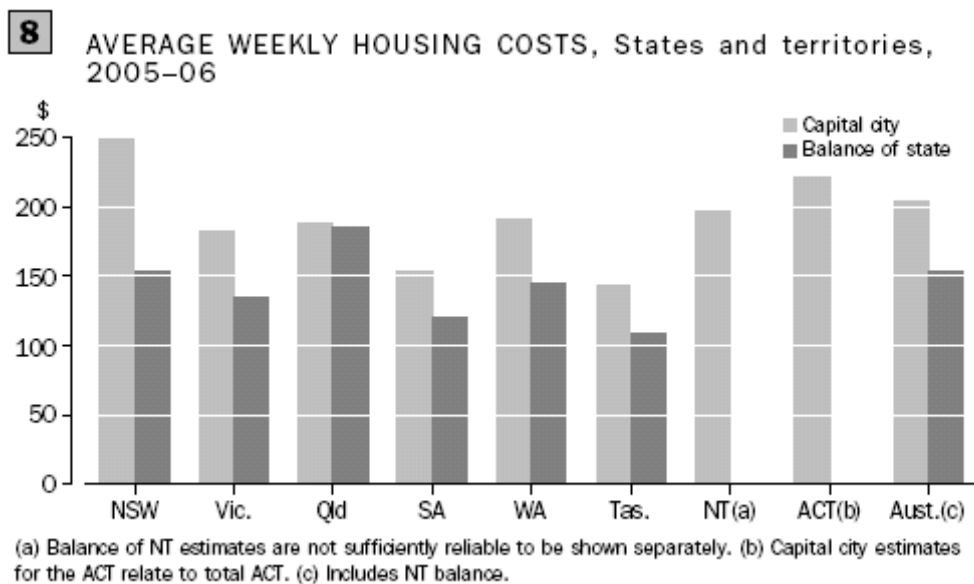
It seems that different individual preferences regarding the trade off between the 'attractiveness' of an employment locality and the social and economic costs of interstate migration place a limit on the 'wage arbitrage' which occurs in Australia. In fact, it would seem that competitive pressures within a city or region are most pronounced particularly, where individuals are not forced to relocate themselves and their families.

As such, the wages paid to private sector or Commonwealth employees within a region play a more important role in the competitive pressures faced by State Governments than the wages paid to employees outside the region.

The ACT believes that the discussion paper has accurately substantiated this and hence the conceptual case for policy neutral interstate labour cost differentials.

Cost of living considerations

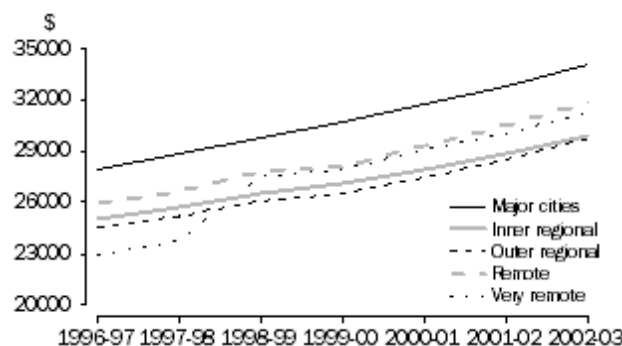
States are forced by competitive pressures to ensure that real disposable income keeps pace with the localised cost of living, which is itself largely a function of past aggregate wage growth. The ABS provides a measure of average weekly housing costs, which the ACT would contend provides a good proxy for overall cost of living influences. The variance in the cost of living across the States, and between capital city and the rest of the state indicates that factors outside the control of State Governments are impacting on the market price of labour.



ABS Cat: 4130.0.55.001 - Housing Occupancy and Costs 2005-06

Additionally, the average weekly housing costs data indicates a divergence in the wages paid to staff located in highly accessible areas relative to less accessible areas. This is reinforced by the ABS data on median annual wage and salary income by geographic remoteness which shows a distinct gap between wages in major cities in comparison to regions outside major cities.

MEDIAN ANNUAL WAGE AND SALARY INCOME by Remoteness Area, 1996-97 to 2002-03



Combined with the competitive impacts of direct competition with the Commonwealth Government and the role played by cost of living considerations, the ACT's unique lack of a non-urban setting explains much of the relatively higher aggregate wage levels faced by the ACT.

For example, higher aggregate labour costs in the ACT may in some part be explained by the highly urbanised city-State nature relative to other less urbanised States. The above graph shows that median wages in capital cities are higher relative to median wages in other less accessible areas. This would indicate that a combination of local competition and cost of living influences impact on the level of wage rates free from policy influence.

This evidence points to each State facing a different labour supply, with unique characteristics, and disproves the claims that States operate within a national labour market.

Which of the three models best captures interstate differences in wage levels?

The ACT supports the use of ABS EEBTUM data as a broad indicator of interstate wage differentials. The EEBTUM data is a fit for purpose and robust measure which has been accepted for use by the Commission in the past. It provides a better measure than the use of Census data given the highlighted deficiencies, such as the failure to include non-monetary wages and the inclusion of non-wage related income such as dividends and interest payments.

The Tax-SEFIA model would be the ACT's second preference.

In terms of contemporaneity, both the SET and Census models face a significant deficiency in that the long time frames between surveys reduce the model's reliability.

Do differences in wage levels exist only between capital cities or between all SARIA regions? Should the adjustment for differences in wage levels be calculated using capital city wages data or should separate adjustments be calculated using each region's wages data?

The ACT's city state nature does not provide an opportunity to demonstrate differential wage expenses in areas outside the capital city. However, the data provided in *Figure 7: Average public sector wages by State by SARIA region* indicates that the standard policy of the States is to have higher relative public sector wages in capital cities than less accessible areas.

Whilst it is acknowledged that some public sector wages are set centrally and include locational allowances, it has not been substantiated whether the impact of such allowances flows through into higher overall wage costs. Plausible alternative explanations could include faster bracket creep in capital cities or a younger age/less experienced profile of employees in less accessible areas (and thus they may be on a lower increment) who later move into capital cities once they have more experience.

As such, the use of separate adjustments for SARIA regions is supported.

INTRASTATE NON-LABOUR COSTS

Is the approach to measuring the impact of location on intrastate non-labour costs appropriate?

The ACT is supportive of the Commission undertaking further work in this area to develop a more reliable measure of intrastate non-labour costs. It is unclear whether the regional build cost index produced by Rawlinson is biased by labour costs as well as materials.

Do States have evidence as to the size of the gradient (8% was used in the Commission's paper)

Given its city-State nature, it is not possible to provide ACT specific information on intrastate labour costs in order to determine the size of the gradient.

The ACT is concerned that there is a dearth of data that allows the gradient to be developed robustly. Furthermore, the gradients shown in Table 11 based on a range of indexes are disparate. For example, while the current dispersion assessment implies that for each SARIA point, non-labour costs increased by around 8%, the WA regional index suggests an increase of only 0.5% (noting that this captures price effects only).

Do States have evidence about whether non-labour costs continue to increase with remoteness or plateau after a certain point?

The regression analysis provided by the Commission in *Attachment B: Potential Non-Labour Costs Indicators* of the working paper indicates there is a mild, positive linear relationship between costs / price and SARIA score of locality up to the index score of 15. Once this point is reached, costs / prices appear to moderate and plateau. In all four regressions, observations above the index score of 15 appear to exhibit no positive linear relationship, likely due to the low number of localities within these regions.

Are any other adjustments required?

The ACT proposes that the Commission assess an intensity of use adjustment for intrastate non-labour costs in order to maintain symmetry and consistency with the proposed approach to adjusting intrastate labour costs. The adjustment factor acknowledges that higher use groups are disproportionately located in very remote areas and that alternate assessments would capture these disabilities.

Where the intrastate labour costs intensity of use adjustment factor implies that in less accessible areas there are higher staffing levels, relative to the Australian average, due to non-location related factors (such as SDC) it follows that those higher levels of staffing would require a correspondingly higher level of non-labour related goods. For example, the higher level of staff would require more office space, IT equipment, building materials etc. in order for them to achieve comparable levels of efficiency as their colleagues in more accessible areas.

Accordingly, we believe there is scope for the Commission to include an intensity of use adjustment to intrastate non-labour costs.

For simplicity, the Commission could use the same adjustment factor applied to intrastate labour costs. We believe this would be appropriate because the additional labour costs would reflect or drive the associated non-labour costs.

INTERSTATE NON-LABOUR COSTS

Conceptual Case for Isolation

The ACT has previously provided the Commission staff with a considerable volume of data regarding the cost of freighting fuel and medical equipment/supplies into the ACT. Given the landlocked geography of the ACT the data provided substantiated the conceptual case that an isolation type factor led to increased costs in the Territory. These data were provided in response to Staff Discussion Paper 2006/05: *New Issues for the 2007 Update*.

Is the approach to measuring the impact of location on interstate non-labour costs appropriate? Are the goods selected from within the CPI basket appropriate?

Notwithstanding the above detailed data which has been provided to the Commission, a broad indicator for interstate non-labour costs is not apparent. The proposed use of the ABS' CPI basket of goods is not fit-for-purpose, given that the basket is not reflective of state type expenses. As such, the ABS' CPI basket is not considered to be the most appropriate measure of the disabilities arising from differentials in interstate non-labour costs. However, given the move to simplicity as part of the 2010 Review, a proxy measure may be required as calculating actual isolation costs for individual States is a complex exercise.

OTHER ISSUES

Should the Commission multiply intrastate and interstate factors and add labour and non-labour factors? Is reliable data available that determine the proportion of their expenses that are labour related and non-labour related?

As labour and non-labour factors apply to different expenses, their addition within the assessment methodology is supported. The assumption that 70% of expenses are labour appears to understate the labour component, particularly if on-costs (rent allowances, travel allowances, superannuation, leave loading, and the like) are taken in to account.

If required, the ACT can provide data on the proportion of expenses broken down by labour and non-labour.

Should the Commission develop category specific assessments using a common approach or a single location assessment?

The development of category specific location assessments using a common approach is supported. Such an approach increases the transparency of the assessment methodology as it links the assessed disability with the expense category.