



AUSTRALIAN CAPITAL TERRITORY

**SUBMISSION TO THE
COMMONWEALTH GRANTS COMMISSION'S
STAFF DISCUSSION PAPER 2007/09-S:
*ASSESSING SCALE DISABILITIES
(PART ONLY - INDEXATION AND BLOCK
ASSESSMENTS)***

August 2007



VIEWS ON THE COMMISSION'S ASSESSMENT PROPOSALS

Introduction

This submission provides the ACT's views on the administrative scale indexation issue put forward by the Commission in *Staff Discussion Paper 2007_09-S Assessing Scale Disabilities*. It also addresses the matter of whether scale disabilities should be assessed using a block assessment approach.

The ACT is exploring data sources for calculating fixed costs and will provide further advice to the Commission as soon as possible. Notwithstanding this, at this point in time we generally agree with the view of the Commission that *Option 3 – basing the estimate on the existing measure of fixed costs* (with an adjustment for changes in fixed costs since the 2004 Review) is the most appropriate course of action. The alternatives, as suggested by Commission staff, face a number of difficulties and would lead to considerable work.

Indexation

How should scale affected expenses be updated each year?

In the 2004 Review the Commission concluded that the cost of basic administrative structure did not change in response to changes in State service provision and so it was not appropriate to index this cost to State expenses. Instead, it was considered more likely that the cost was linked to the movement of salaries and/or prices.

The Commission, therefore, decided to update the fixed costs each year for the movement in both wages (80%) and prices (20%). That is, the labour part of assessed expenses were indexed to labour price movements and the non-labour part were indexed to consumer price movements.

For the 2010 Review, the Commission is inclined to update only the non-labour part of fixed costs for movements in consumer prices. This is because it is contended that the current system of wage bargaining provides for wage increases in return for productivity gains and this might suggest that no indexation should be made for labour price movements. Under this approach, there would be no indexation for the labour part of assessed expenses but the non-labour part of assessed expenses would be indexed for movements in consumer prices.

Indexing the non-labour part of assessed expenses based on movements in consumer prices is supported on the premise that States have to pay current prices for non-labour services such as accommodation and electricity.

However, the view that current wage bargaining provides for wage increases in return for **full** productivity gains and therefore no indexation should be made for labour price movements is not supported.

In regard to the statement that: *'The current system of wage bargaining provides for wage increases in return for productivity gains'*, it is noted that this represents an general objective only, and does not occur in reality. Wage increases are not provided in return for full, offsetting productivity gains as suggested by the Commission staff.

There are several streams of concern with this proposition, which ignore the fact that:

- productivity can be achieved via non-labour means;

- wage competition exists and the view that wage increases are offset by productivity does not reflect reality, as wages growth has, particularly in recent times, outpaced productivity gains; and
- other forms of remuneration contribute to the overall cost of labour, but not to the growth in wages.

Furthermore, the ACT does not support the view that the application of efficiency dividends to departmental budgets can be used as an effective way of capping or even reducing wages.

These issues are discussed in the following paragraphs.

Ways of Achieving Productivity

Commission staff's proposal assumes that productivity and labour costs have a one for one relationship. This fails to take into account the fact that productivity can also be increased through the use of capital (particularly involving technology and/or skills development). It can also involve procedural change and more efficient and streamlined practices.

The reality is that increased output per person can be attributed to a number of causes and cannot be uniquely attributed to labour.

The shares of labour and capital in achieving a particular level of output are not fixed and it is a populist and rather simplistic notion in our view to suggest that labour costs should only rise in tandem with productivity, presumably to thereby deliver a flat unit labour cost and remove any pressure on the cost of providing State government services.

Dependent on local conditions and pressures, productivity does not rise smoothly across or even within, jurisdictions. The effect of the policy proposed would be to, depending on the factors affecting productivity in a particular State, depress relative wages by whatever factor was limiting productivity growth. This would most likely have the effect of restricting, if not fixing, labour's share of income in those sectors where productivity growth will be below average. This, however, does not occur in reality.

This inequality would be further exacerbated by the productive potential that exists at any one time in a particular industry. For example, should an industry have significant opportunities for increased productivity through, say, technological change or through some other use of capital, the Commission's proposed model (premised on wages only increasing to the level of productivity achieved) would allow wages in that industry to rise significantly faster than those in an industry that did not have the same productive potential due to technology. This would simply add to inflationary pressure in that industry and within the public sector in that jurisdiction, or more likely, between jurisdictions in that industry, regardless of whether the other jurisdictions have access to the same technological opportunity. In this situation, the cost of the service to the community is likely to rise as 'windfall' productivity goes to wages, rather than the community.

The proposal also does not take account of standard, or community, driven changes that may impact upon traditional measures of productivity. For example, school class sizes. As a way of increasing wages under the Commission staff's model, there would be significant pressure to achieve productivity by simply increasing class size. The lower ratio of teachers to students would result in higher wages on the basis of improved productivity, however, overall outcomes are likely to suffer. This does not represent good policy, and does not reflect 'What States do' – the move by States to reduce class sizes, particularly for the early years of schooling.

Wage Competition and Other Drivers of Wage Increases

Public labour costs are not insulated from the broader economy, regardless of the jurisdiction involved. Increasing shortages of labour obviously impact on labour costs.

The current proposal assumes that increased labour costs can be completely recouped by increased productivity. States will need to pay higher wages simply to be able to deliver a service. The alternative is to reduce the quality or the quantity of the output, and in turn, the quality of the outcome for the residents of that jurisdiction.

The actual practice of all jurisdictions is that increased productivity funds only a proportion of wage increases, usually that component above the relevant CPI figure, and other adjustments.

The current ageing of the ACT (and Australian Government) workforces, spurred on by the CSS superannuation system (where employees are encouraged to retire at 54 years and 11 months), has led to wage and non-wage increases that are well over and above productivity gains. This has been necessary because of the need to remain competitive with other sectors and maintain adequate staffing levels in the ACT public service, which has been made difficult by the recent expansion of Australian government positions in Canberra.

The public sector also needs to compete with the private sector and be responsive to market forces. A State that considered itself to be immune from outside wage pressures, and which did not increase its wages, would find itself losing staff.

All other States are in a similar position, and offer wage increases that are above productivity increases. It is common practice for all States to index their future wages bills for budgetary purposes to reflect the increasing cost of providing services and the need to remain competitive.

It is clear that wages increase beyond productivity gains, particularly during periods of strong economic growth, for a number of reasons. A large proportion of wage increases are driven by other parameters such as market forces, skills shortages and cost of living increases. According to work conducted in 2001 by the Melbourne Institute of Applied and Social Research:

*“Evidence in support of the link between enterprise bargaining and productivity is not convincing. Much promised productivity gains from enterprise bargaining have provided extremely elusive”.*¹

That is, wage growth in recent times has been driven by factors other than productivity.

As the Commission is assessing the minimum cost of government (minimum number of staff/resources), any productivity offsets are limited for these functions as they represent the ‘bare bones’ of service delivery and are unlikely to contain ‘any fat’ to trade-off for productivity increases.

Productivity gains are not consistently applied to wage negotiations across States and evidence suggests that wage increases reflect both cost of living and productivity adjustments:

- in the ACT, recent Collective Agreement wage negotiations for the 2007-2010 Agreement led to a 4% per annum increase, of which less than 1% was related to productivity gains;

¹ *Enterprise Bargaining and Productivity: Evidence from the Business Longitudinal Survey*, Yi Ping Tseng and Mark Wooden, July 2001, Melbourne Institute of Applied and Social Research, Melbourne University, page 3.

- the Victorian Treasurer made recent comments in the media (The Age, 23 April 2007) that any wage increase above the cost of living would need to be offset by spending cuts, job losses or productivity gains; and
- the objective of NSW' public sector wages policy is to provide future wage increases in line with inflation (NSW 2006-07 Budget, BP.2 pg 1.10).

The Victorian comments also highlight that there are various means of achieving wage increases, and that productivity gains are only one way of achieving this. States often opt to apply spending cuts to certain programs, amalgamate more services to make them more economic (such as personnel and human resources management, or contract out services at lower cost, with resultant savings used for wage increases. Additionally, job losses are another option by which wages can be increased, however, it is more likely that governments would restrict the growth in jobs, or not fill positions as a way of achieving savings.

Wage increases are not limited to the productivity gains achieved. Market forces and other parameters also drive wage increases:

- under the NT Public Sector wages policy, the quantum of salary increases is to be based on the consideration of five factors: CPI; productivity improvements; market forces; Government's fiscal position; and Government policy; and
- widespread skills shortages (evidenced by relatively high turnover, the number of job vacancies and problems retaining staff) are fuelling wage pressures, as employers are forced to bid up wages to attract the retain workers:
 - according to the Australian Institute of Management's National Salary Survey 2007, large companies were struggling to hold onto staff in the tight labour market with voluntary staff turnover rising to 12.6% in 2006-07, up from 11.5% in 2005-06 and 9.9% in 2003-04.

The Australian Bureau of Statistics also notes that rising wages can also indicate the presence of a skills or labour shortage, and that wages are driven by a number of variables, including the need to pay higher wages to retain or attract workers:

*“ When the labour market is 'tight' or the demand for labour (including skilled labour) is well above supply, the price of labour rises. During these times, workers are in a stronger position to bargain for larger wage increases and businesses tend to pay higher wages to retain or attract workers. ”*²

While this reference is in regard to the current boom in WA, it applies equally to Australia as a whole and to the government sector given that all sectors compete for labour. As such, employers (government and non-government) are forced to compete for staff, and wages rise well above what productivity increases can provide.

There is a range of evidence that indicates that as labour competition and skill shortages rise (reflective of rising vacancy rates), relative wages rise in response as employers use this to improve terms and conditions as a means of attracting more workers. Employers do not limit themselves to productivity increases as suggested by the Commission.

The National Centre for Vocational Education Research, together with the National Institute of Labour Studies at Flinders University notes that in regard to the minerals sector, skill shortages are

² ABS Catalogue 1367.5 - Western Australian Statistical Indicators, December 2005.

prevalent and there is evidence of rising vacancy rates and of 'salary-bidding' leading to relative wages growth.³ This has flow-on effects to other sectors in the Australian economy.

In the case of the ACT specifically, the ACT government has been under pressure to compete with the Australian government, which has led to wage growth far outpacing productivity increases. The extent of the demand is shown by research undertaken by the Department of Employment and Workplace Relations (DEWR).

DEWR notes that the demand for skills in the ACT is mainly driven by Government Administration and Defence (28% of employment), and that annual employment growth has averaged 6.9% for the five years to November 2006 and there has been a significant increase of 16.5% from November 2005 to November 2006.⁴

Non-wage Remuneration

The proposal also ignores the fact that wages are only one component of remuneration. Other forms of remuneration, particularly through generous conditions of service and other non-wage benefits contribute to the overall cost of labour, but not to the growth in wages.

Many States now offer mobile phones, car parking, access to motor vehicles, laptops and other benefits as a way of attracting and retaining staff, particularly during times of labour shortage. These benefits do not flow through to wage increases, but do impose an ongoing cost on government.

Efficiency Dividends

In the past, the Commission has considered reducing the indexation of fixed costs on the basis that efficiency dividends have the effect of capping or reducing wages growth.

The standard policy of the ACT has not been to apply an efficiency dividend to agencies. In the sixteen years since self-government, in only a few instances has an efficiency dividend been applied to specific departments. They were always considered to be 'one-offs' and never ongoing. Additionally, it should be noted that efficiency dividends were never applied to Health or Education services given their social importance.

The application of efficiency dividends has never been put in place for an extended period given the demand and cost pressures that have been faced in many areas. For example, the current shortages of nurses, teachers and specialists has never allowed efficiency dividends to be applied over a period of time. The ACT is also unable to apply efficiency dividends to the Australia Federal Police (AFP) as it is a non-ACT body.

While the ACT could try to implement an efficiency dividend in this sector, it has been unwilling to do so given that this may lead to reduced numbers of police officers, which for the ACT, are already the lowest in Australia in per capita terms because of the relatively high wages paid to the AFP.

³ *Prospecting for skills: the current and future skill needs in the minerals sector*, executive summary of final report May 2005, The National Centre for Vocational Education Research and The National Institute of Labour Studies at Flinders University.

⁴ *Overview of demand for trades skills Australian Capital Territory* - December 2006, Department of Employment and Workplace Relations.

In this context, the ACT does not believe that the use of efficiency dividends results in an ongoing policy mechanism that is capable of limiting wage increases over time, particularly given current staffing shortages

There is clear evidence available demonstrating that State government do not limit wage increases to productivity gains, and that other factors, such as wage competition and the need to remain competitive drives wages growth well beyond productivity increases. In this context, there are strong grounds for indexing the labour part of fixed costs by an appropriate wages index, such as the Labour Price Index.

The indexing of the non-labour part of fixed costs by inflation is also supported.

Should scale-affected expenses be assessed as a block assessment or spread across expenses categories?

Assessing scale disabilities as a separate block **is not supported** as, amongst other things it:

- reduces transparency – it would be unclear as to which specific services the ACT is receiving administrative scale fixed costs for, and to what extent they are received for each service;
- significantly diminishes the expense ratios produced by the Commission for the assessment categories, and therefore, largely removes the ability of the States to use the data for rigorous benchmarking purposes; and
- reduces the strength of the current assessment framework.