



AUSTRALIAN CAPITAL TERRITORY

**SUPPLEMENTARY SUBMISSION TO THE
COMMONWEALTH GRANTS COMMISSION**

Location Assessment

April 2009



LOCATION - WAGES

Data Validation

The Commission has requested that States validate data provided to them in respect of schools education expenses by region. The ACT can confirm that senior officials from the Department of Education and Training have reviewed the data provided in the Territory's return to the *Location school data request* and confirmed its comparability and reliability. The ACT's expense data contain only those elements identified in paragraph 5 of the request.

How should a schools wage gradient be determined for each SARIA region?

The ACT supports the Commission determining a schools wage gradient using its traditional, population-weighted approach.¹ The population-weighted approach has been consistently applied in other assessments, and with the exception of location, the appropriateness of its use has not been disputed by States, or the Commission. This includes questioning it on the basis of whether a population-weighted average accurately reflects State policies. It is considered that discarding population weights, through the use of State indices with equal weightings, delivers a wage gradient that fails to reflect the *national average policy* in respect of actual wages paid by SARIA region.

The conceptual case that *some* States pay higher wages in very remote regions is not disputed. However, adopting an alternate approach using population-adjusted data, with the sole intention of delivering a greater level of recognition to select States that pay higher wages in remote regions, appears on the data available, not to be justified.

Based on the data collected by the Commission, it can not be disputed that the average State employee operating in a highly accessible region earns more, on average, than an employee in a very remote region. While population weightings influence this outcome, this reflects the national average employee expenses outcome.

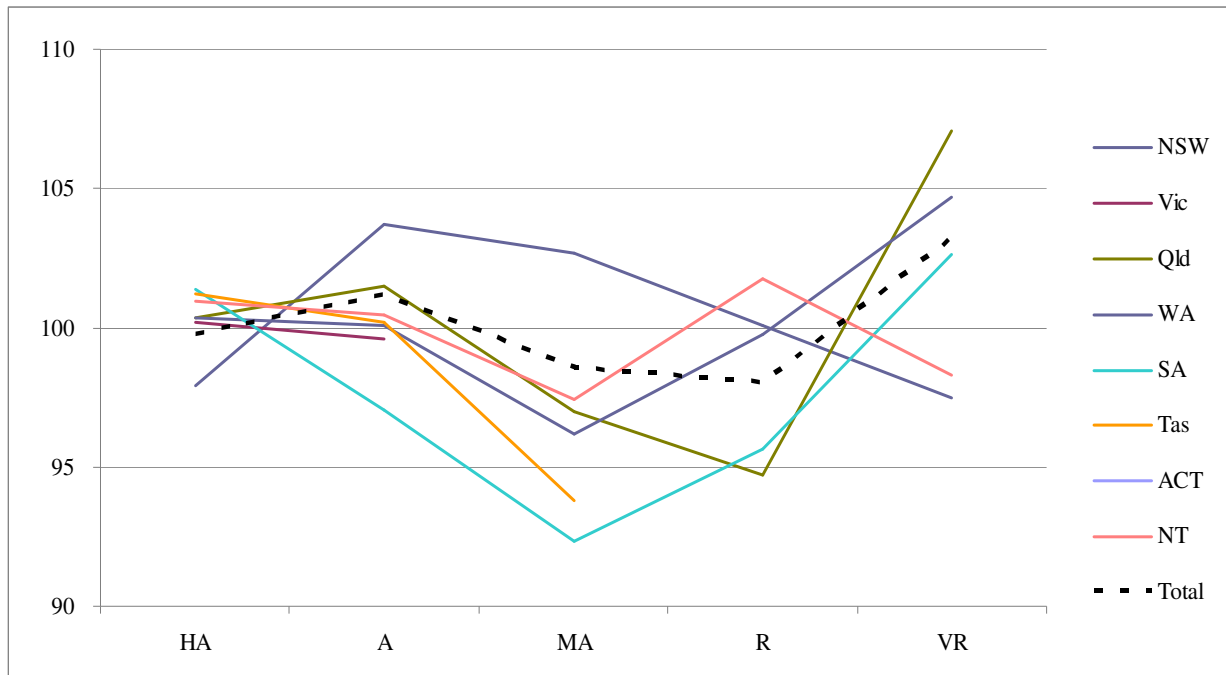
Should compositional effects be removed before calculating a gradient?

The ACT considers that removing compositional effects will lead to a number of inconsistencies and concerns. For example, such an approach is inconsistent with the Commission's adoption of population-weighted approaches used in other assessment categories. More importantly, however, it is doubtful that such an approach would deliver a more robust or appropriate outcome than the traditional population-weighted approach.

The ACT is concerned that adopting the 'weighted average' gradient approach fails to *better* capture State policies than the traditional approach. This can be demonstrated using a diagram the Commission provided at the Location Working Party Meeting of 2 April 2009.

¹ It should be noted that the Commission's slide titled 'Weighted average of gradients' is misleading. The ACT considers that the 'Weighted average of gradients' should be renamed the 'Unweighted average of gradients' as the data are not population weighted nor are any other weightings applied. Instead, each jurisdiction is essentially given an equal weighting, which does not reflect State population shares.

Weighted average of gradients



Source: Commonwealth Grants Commission: *Location – Final LWP*, slide 13.

From this diagram, it is clear that on average, States pay employees *less* in accessible regions compared to those in highly accessible regions. *Five* of the *seven* jurisdictions that provided data on average wages in these two regions have a downward sloping gradient from highly accessible regions to accessible. Two jurisdictions pay their employees more. One would question why then, the total average gradient slopes up?

Similarly, when comparing moderately accessible with accessible, the average gradient is downward sloping, which reflects the average State policy. However, the total average rate of decline appears to understate the severity of decline of *four* of the *six* States. This raises concerns that wages paid to employees in moderately accessible regions are being overstated.

When comparing wage costs in remote regions relative to moderately accessible regions, three of five jurisdictions pay higher wages. Yet the average gradient is downward sloping. Again, such an approach fails to reflect State policy.

Similarly, one questions how accurately the upward sloping gradient from remote to very remote reflects State policies.

The ‘weighted average’ approach thus produces perverse results, with the ‘errors’ being amplified because costs in one region are influenced by the prior region. Where an error occurs (be it an over or understatement of the average gradient), its impact flows through each of the gradients in subsequent SARIA regions.

It is considered that removing the compositional effects and revising the gradient delivers the following questionable outcomes:

- equally weighted gradients fail to reflect standard State policies because the gradient is susceptible to large variations driven by a steep gradient in one or two States; and

- inherent uncertainties in an appropriate rate of incline or decline in the gradient slope occur and are magnified as the gradient moves from highly accessible to very remote regions.

The outcome of the proposed approach, although attempting to capture the average State policy *in theory*, fails to actually reflect average State policy and introduces considerable bias across most SARIA regions. The ACT appreciates the work undertaken by the Commission to derive an appropriate assessment for regional schools education wages, but considers it impossible to conclude with certainty that the gradient calculated in this instance provides a better proxy for average State policy than the traditional population-weighted method.

Regional wage assessment for categories other than schools and police

The ACT supports a differential wages assessment being undertaken for other categories when reliable and robust data that captures Australian average policy are available. Where these data are not available for the majority of States, no differential assessment should be made.

If the Commission makes an assessment, should it use Queensland data or State data on police and education?

The ACT does not support the use of Queensland cost data, or other State data on schools and police costs, being extrapolated to calculate a regional cost gradient for other assessments. Both of these methods have significant shortcomings and their use can not guarantee a more appropriate outcome than would be achieved otherwise. In the absence of other States' data, no differential assessment should be made.

Queensland Data

The ACT notes that the use of one State's data to determine average State policy has not previously been an acceptable approach to the Commission. A parallel can be drawn with the reluctance of the Commission to base an assessment of CALD disabilities on one State's data.

Aside from this, the ACT considers the variation between Queensland's cost data and Australian average cost data for both schools and police to be sufficiently large as to render it an unreliable proxy. If Queensland's gradient more closely mirrored the Australian average, use of its cost data for other categories may have been reasonable. However, given the magnitude of variation, for example, the variation between the cost gradients for both school and police is approximately 10 per cent in the very remote region, the ACT can not support the use of Queensland cost data to develop other categories' cost gradients.

State data on police and education

The ACT considers that weighting or averaging police and education data is not an appropriate method for determining regional costs for other assessments.

An easily observable characteristic of the Australian regional cost gradients for schools and police is the significant divergence in their gradients across SARIA regions. This characteristic is clearly evident when comparing moderately accessible costs to accessible costs. When moving between these regions, police costs increase but school costs decrease. Similarly, between remote and very remote, the cost gradients again move in opposite directions.

The disparity in regional cost gradients for schools and police reflect the different regional cost pressures States face when delivering different services in different SARIA regions. To assume that one gradient was more reflective of these pressures than another would require an inordinate amount of judgement.

Similarly, the assumption that an *average* or *weighted-average* of the two could be used faces the same difficulties in respect of how accurately an average can proxy an assessment category where the methods used to deliver services are different. It is almost certain that such an approach would either overstate or understate the cost pressures faced by individual States.

Additionally, it could not be concluded, with any certainty, that States faced upward sloping regional cost curves for all assessment categories. For example, with regard to services to industry, the level of services provided in very remote regions may be less intensive and require lower skilled staff. In such a situation, an inverse regional cost gradient may be observed.

Applying schools and police gradients to like-services is also not supported because these services are 'all pervasive' – typically being provided throughout remote and accessible regions. Post-secondary education and corrective services on the other hand, which may be considered like-services, are typically provided in larger towns with students and prisoners outside these regions having to travel to access these services.

The ACT considers that cost gradients derived from a particular service delivery sector can only appropriately be used *in that sector*. Any broadening of its application would result in an assessment which is neither robust nor reliable.

Service delivery scale

The ACT notes that the Commission has limited data from the States on school and police services. Consistent with what has been said with regard to wages data, the ACT does not support Queensland data being used to determine Australian average service delivery scale impacts.

Similarly, extrapolating school or police service delivery scale data and applying these staffing level factors to other assessments would be unreliable and produce over or under stated cost disabilities.

Interstate freight assessment

The ACT has previously provided Commission staff with a considerable volume of data demonstrating the cost of freighting fuel and medical equipment/supplies into the Territory. The ACT considers that this evidence substantiates the conceptual case that the landlocked nature of the Territory contributes to its above average freight costs. These data were provided in response to Staff Discussion Paper 2006/05: *New Issues for the 2007 Update*.

The ACT is unaware of any further data that it could provide to assist in informing the Commission's judgement on this assessment.

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