AUSTRALIAN CAPITAL TERRITORY

2017 Update

ACT Response to Commonwealth Grants Commission Staff Discussion Paper

CGC 2016-18-S
The Wage Costs Assessment

November 2016

Chief Minister, Treasury and
Economic Development Directorate

RESPONSE TO NEW ISSUES FOR THE 2017 UPDATE – THE WAGE COSTS ASSESSMENT

Introduction

The ACT welcomes the opportunity to provide comment on the treatment of the residual issues remaining from the review of the Wage costs assessment, undertaken as part of the 2016 Update.

The ACT consulted extensively with areas within both the Chief Minister, Treasury and Economic Development Directorate and ACT Government line agencies as part of the 2016 Update review of the assessment. The ACT has drawn on this consultation in forming its response to CGC Staff Discussion Paper CGC-18-S, with a position given on each item below.

CoES VARIABLES THAT ARE NOT AVAILABLE EVERY YEAR

Recommendations

Staff propose to recommend to the Commission that it:

- continue to include the education variables in its econometric model because they are material
- exclude the trade union membership variable from its econometric model as it is not material.

The education variables

1 The ACT considers that education variables should be included in the assessment. We consider that on the evidence CGC staff have provided, the variable is material and there is a sound conceptual case for its inclusion in the regression model.

2 However, we argue that, with the inclusion of the education variables, the 12.5% discount is no longer valid.

The trade union membership variable

3 The ACT agrees this variable is immaterial and should not be included in the regression.

STATE SUBMISSIONS ON THE WAGE COSTS ASSESSMENT

Recommendations

Staff propose to recommend to the Commission that it:

- not change the level of the general discount
- not introduce a State specific adjustment for Tasmania
- remove the CSS adjustment as it is no longer material.

The general discount

4 The ACT opposes the view put forward by the CGC staff and considers that the discount should be discontinued with the introduction of the CoES dataset containing education variables.

5 The decision on whether the general discount is to be continued or not is a matter of judgement on the part of the CGC. In forming this decision consideration should be given to:

- the relative improvements resulting from the introduction of the CoES data; and
- the subsequent enhancement made by the inclusion of education variables.

6 The ACT considers that the inclusion of the education variables and the improved contemporaneity of the data warrant the discontinuation of this discount.

7 The 2016 Update Report stated that the CGC considered the lack of education variables was offset by the increased contemporaneity in the assessment and that the next few updates would incorporate higher quality contemporaneous data.

8 The view of the CGC was that the uncertainty caused by the lack of education variables in the dataset used in the 2016 Update was balanced by the increased contemporaneity. The improving contemporaneity and inclusion of education variables should then continue to increase the accuracy and reliability of the model and its results, eliminating the justification for discounting the assessment in any way.

9 In the 2015 Review the ACT presented its position on the general principle of discounting. We stated that discounting should be used to address concerns over reliability of data, not to deal with conceptually unsatisfactory approaches to assessment, or to meet objectives other than equalisation.

10 We agree with the current CGC approach, where if the CGC determines that data are not sufficiently reliable, but is confident that the data signals the direction but not the size of the effect, then a discount is applied. The discount is applied in a manner that reflects either the lower confidence in the outcome of an assessment or the greater uncertainty attached to the information underlying the assessment.

11 The issues raised by those States arguing for an increase in the discount are not related to how reliable the data are, but rather to the conceptual approach of the assessment, which was thoroughly debated and resolved as part of the 2016 Update. Discounting is not an appropriate means of dealing with issues relating to the conceptual basis of the assessment.

12 In its first submission to the 2016 Update review of the Wage costs assessment, the ACT argued that "if the new [CoES] dataset produces a more reliable and accurate outcome than the data previously used, CGC staff should consider the removal of the discount currently applied to this assessment".

13 The ACT reiterates that position here. We see no reason to continue the discount given the improvements since the 2016 Update through inclusion of the education variables in the CoES data and the progressive phasing out of the indexed SET data. .

A State specific adjustment for Tasmania

14 The ACT agrees with the CGC staff recommendation.

The CSS adjustment

15 The ACT does not agree with the view of CGC Staff on removal of this adjustment.

16 Our initial response to the CGC Staff issues paper on this matter was premised in the first instance on responding to the technical application of the HFE assessment materiality thresholds, whether disability or data specific, overlaid by what could or could not be done in an Update according to agreed protocols.

17 The Staff position has rejected the technical approach argued by the ACT, citing the rationale for the adjustment as an assessment of unavoidable legacy costs of self-government that are in addition to, but separate from, the wage costs differentials of comparable employees.

18 In that context, CGC Staff have reiterated the crux of the issue. These legacy costs are indeed, exactly what that implies - unavoidable costs transferred to the ACT at self-government and beyond the power of the ACT to change in any way and <u>at any point</u> in the future. They will remain with the ACT until the final departure of a staff member with a CSS entitlement.

19 As such, the adherence by CGC staff to a rigid interpretation and application of a formulaic approach to this issue, one specific to the two territories, is not supported. It fails, in our view, the application of a reality test as to whether equalisation is effectively applied.

20 It is not the quantum of the allowance ($12 million in 2016-17 or 0.00 per cent of the GST pool) at issue, but rather the specific undertakings offered to the ACT as it transitioned during the early years of self-government under the fiscal equalisation principle:

- The role of the Commonwealth Grants Commission, *inter alia*, in the case of the ACT is premised on an undertaking set out in the *ACT (Self-Government) Act 1988* which states inter alia:

  'The Commonwealth shall conduct its financial relations with the Territory so as to ensure that the territory is treated on the same basis as the States and the NT, while having regard to the special circumstances arising from the existence of the national capital and the seat of government of the Commonwealth in the Territory'.

21 It is against that background that the CGC saw fit, following exhaustive analysis as part of the *Report on General Revenue Grant Relativities 1999,* to introduce a five per cent disability for the ACT and the NT to account for their higher superannuation costs for employees with access to the Commonwealth Superannuation Scheme:

- The adjustment reflects the legacy created at the time of self-government when APS staff transitioned into the ACTPS, while keeping their CSS entitlements.

22 The ACT contends that this disability should be allowed to run its natural course, which would see the complete removal of the adjustment with the departure of CSS staff from its staffing profile.

23 The CGC staff paper refers to other examples where the Commission foreshadowed how its assessment methods would evolve in upcoming updates giving the examples of the ending of the transitional arrangements to bring States' unfunded superannuation liabilities into the equalisation process, and the ending of the ACT's national capital allowance for the additional cost of wider roads. The ACT does not dispute the merit of those decisions, but contends that they are substantively different, the first example being a transition which applied to a majority of jurisdictions, and the second being a matter over which the ACT now has policy control, as witnessed by the current policy of introducing light rail down the central road axis to the National Capital – Northbourne Avenue - one of the key arterial roads originally cited in the development of this disability. On the other hand, the CSS adjustment is specific to the two territories, and not something over which the ACT has policy control.

24 Removal of this CSS allowance, in concert with that for wider roads, would see the overall national capital allowances reduce to a total of approximately $19 million - for National Capital Plan only (Justice Services is not a National Capital Allowance, more again, a legacy issue).

Estimated National Capital Allowances, 2016-17

Category	2016-17 Budget $m
Justice services (AFP salary effect)	9
Roads	4
National Capital Plan	19
Commonwealth Superannuation Scheme	5
Total	37

25 As the CGC and Staff would be aware, the ACT Government is regularly called to account for the financial implications of administering its responsibilities as a unique city-state within the bounds of Canberra as the National Capital and Seat of Government surrounded 100% by a separate jurisdiction.

26 This progressive unwinding of undertakings which underpinned the ACT's successful transition after self-government under the equalisation framework needs to be managed in a more pragmatic manner than simple application of generic thresholds set across the entire framework.

27 The ACT requests that any final recommendation to the Commission on this matter reflect our call for it to be considered as an integrity issue, not one premised on the application of a formula.

28 There are much wider issues at play in the application of the HFE framework with much larger redistribution implications at stake than the removal of this very specific past undertaking, but at the same time it is just as important to the ACT Government to be able to demonstrate to the community in a transparent way the funding arrangements which reflect its unique settings.

State access to CoES data

29 The ACT was satisfied with the level of support received from CGC staff during the review of the Wage costs assessment in the 2016 Update.

30 We agree with the recommendation made by CGC staff and do not see a need to access the ABS data.