Government of **Western Australia**
Department of **Treasury**

Western Australia's Submission to the Commonwealth Grants Commission's 2025 Methodology Review

Wage Costs

November 2023

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Further information relating to this report may be obtained by emailing igr@treasury.wa.gov.au

Key Points

Issues of concern to Western Australia

Use of the Characteristics of Employment Survey (CoES) data

We appreciate Professor Alison Preston's review of the model's econometric specification. However, we feel that not enough emphasis was given to consider methodology that would use an alternative dataset.

- Our concerns about the use of CoES remain.

The low-level discount (12.5%) applied to the assessment should be removed.

- Commonwealth Grants Commission (CGC) uncertainty about how well private sector wages proxy public sector wages is not well founded, as the association has been consistently supported by consultants.
- Further, we believe the proposed changes should appreciably improve the model and logically reduce (negate) the need for a discount.

CGC consultation paper

Q1. Do States (i.e., States and Territories) agree on continuing to use private sector wages as a policy neutral proxy for the market pressures faced by public sector employers?

We agree. Actual public sector wages are policy influenced, and this alters service provision standards.

Q2. Do States agree that the Commission should continue to use all private sector employees to proxy for public sector drivers of costs?

We agree. We believe that using the female portion as a proxy is not representative, as it excludes a third of the sample size. For example, the mining industry is male dominated. Therefore, a large proportion of mining wages would be excluded from the assessment. However, wage pressures in the Western Australian mining industry are high and apply directly on public-sector wages. In addition, there are State agencies that are male dominant (e.g., Police and Corrective Services) and are particularly sensitive to private sector competition, including from mining.

Q3. Do States support the continued use of the CoES data?

As per above, we acknowledge the consultant's view that the CoES data remains appropriate for the CGC's current modelling approach, but we still believe the CGC should investigate alternative simpler models using an employer-based survey such as Average Weekly Earnings (AWE). It could then adjust for structural State differences based on industry composition.

Q4. Do States agree the Commission should use hourly wages rather than weekly wages as the dependent variable?

We agree.

Q5. Do States support including usual hours of work in the model as three categories, part-time, full-time and more than full-time hours?

We support this proposal.

Q6. Do States support replacing imputed work experience and imputed work experience squared with five-year age groups?

We support this proposal.

Q7. Do States agree with the Commission's proposed criteria for including control variables in the model?

We agree.

Q8. Do States support using a less complex model by replacing industry group categories with industry division categories and removing the interaction terms with gender and every other independent variable?

We support this proposal.

Q9. Do States agree with the proposed approach to combine estimates of relative differences in States' wages across years?

We agree. Over the years, we have consistently argued the assessment is too volatile and we welcome any changes to decrease the volatility. However, although we note the statistical validity of the improvements, we consider the proposed approach is unnecessarily complex.

Q10. Do States agree that a 12.5% discount remains appropriate?

We disagree. We think the discount should cease.

This submission responds to the CGC's *Wages* consultation paper (including its addendum).

Proposed changes to the wages regression model

We support the assessment of wage differences across States.

We believe the changes proposed by the CGC in the consultation paper, following Professor Alison Preston's evaluation, will address some of the concerns that we have brought to the CGC's attention over the years. For example, the proposed changes should improve the current model's accuracy and reliability, and reduce the volatility of the regression analysis.

Despite the improvements, some concerns remain.

Use of the CoES dataset

We appreciate Professor Alison Preston's review on the model's econometric specification. However, we feel that not enough emphasis was given to consider methodology that would use an alternative dataset in the wages assessment.

While we acknowledge Professor Preston's view that the CoES data remain appropriate for the CGC's current modelling approach, her comments regarding the unsuitability of AWE data are in relation to that approach. The reliance on employee characteristics leads to complexity in the model, and the need to use CoES data. Our concerns remain regarding the reliability of a household survey such as CoES and whether the dataset is fit for purpose.

Informal discussions with the Australian Bureau of Statistics (ABS) have reinforced our view that the AWE data is more robust and would be a viable alternative as the data is more accurately reported and obtained from employers' payrolls.

Different ABS wage indicators are measured in different ways and for different purposes. Employer surveys such as the AWE survey provide superior earnings and industry data, whereas household surveys such as CoES rely on householders' memories and perceptions (including reporting for other household members), which is challenging to quality assure. The CGC could adjust AWE data for structural State differences based on industry composition. This would avoid the judgments required in regression analysis and would capture the most important variable.

We still believe the current wage model produces results that are not consistent with labour market observations and State circumstances. We consider this merits analysis on the possibility of an AWE-based model.

Discounting

The CGC discounts the estimated State wage factors by 12.5% due to its concerns with data quality and the strength of the relationship between private and public sector wages.

We do not support the continuation of the discount in this assessment, both because the use of private sector wages as a proxy for public sector wage costs is corroborated by various consultants, and the CGC's proposed changes will improve the assessment.

The consultant report from Professor James Morley, commissioned by New South Wales Treasury, did not raise any issues on the use of private sector wages as a proxy for public sector wage costs. Professor Preston's evaluation further endorses that public and private sectors are responsive to the same underlying influences in labour markets.

> *Wages are different between the states in both public and private sectors, and the directions of these differences rarely conflict.*[1]

Although States have substantial capacity to apply policies to set pay levels in the public sector, doing so will have consequences for their ability to recruit and retain skilled staff, which will alter the standard of their service provision. However, the horizontal fiscal equalisation principle requires the CGC to enable States to provide the same standard of services, so it must be assessed based on States following market pressures.

As noted, we believe the changes that the CGC proposes to implement should appreciably improve the model's accuracy and reliability, and reduce the volatility. Such improvement should logically reduce (negate) the need for a discount.

For the reasons above, the 12.5% discount should be removed.

CGC consultation questions

Reflecting the above comments, our responses to the CGC's consultation questions are provided in the *Key Points* at the start of this submission.

1 Professor Alison Preston, *Wage Costs Consultant Report*, August 2023, page 19.