



**Australian Government**  

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**Commonwealth Grants Commission**

**2020 REVIEW**

**WAGE COSTS**

**STAFF DRAFT ASSESSMENT PAPER**  
**CGC 2018-01/22-S**

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## WAGE COSTS

- 1 The paper provides the Commission staff proposals for the assessment of wage costs for the 2020 Review.

### 2015 REVIEW APPROACH

- 2 State governments employ about one in ten Australian workers. Wages and salaries represent the largest component of State expenditure and account for a significant share of expenditure in nearly every expense category. The wage costs assessment addresses a global disability, rather than the expenses associated with an individual category of service delivery (such as schools or health spending).
- 3 The Commission models the wages of the average private sector worker in each State, controlling for differences in the characteristics of that worker that are known to affect wage levels, such as work experience and qualifications. The model also adjusts for States' composition of industry and occupations.
- 4 An additional variable for State of residence allows us to estimate the influence that State of residence has on the wages of comparable individuals. The wages paid to comparable private sector workers are used as a proxy for the pressures on public sector wages in each State. Our estimate of this wage costs disability in 2016-17 ranges from 8.4% below to 7.2% above the national average wage level.
- 5 Due to the timing of the release of a new data set, the ABS Characteristics of Employees survey (CoES), the Commission deferred the 2015 Review of the wage costs assessment. The Commission undertook a comprehensive review of the wage costs assessment in the 2016 Update. It decided the best HFE outcome would be produced by retaining the indexed ABS Survey of Employment and Training (SET) results for 2012-13 and 2013-14 (these results were also used in the 2015 Review) and using 2014 results from the new CoES, without qualifications variables, for 2014-15 and CoES, with qualifications variables, for future years.<sup>1</sup>
- 6 Table 1 shows the modelled outcomes for each State between 2014-15 and 2016-17.

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<sup>1</sup> SET was discontinued after 2009. CoES contains many of the same variables that SET contained.

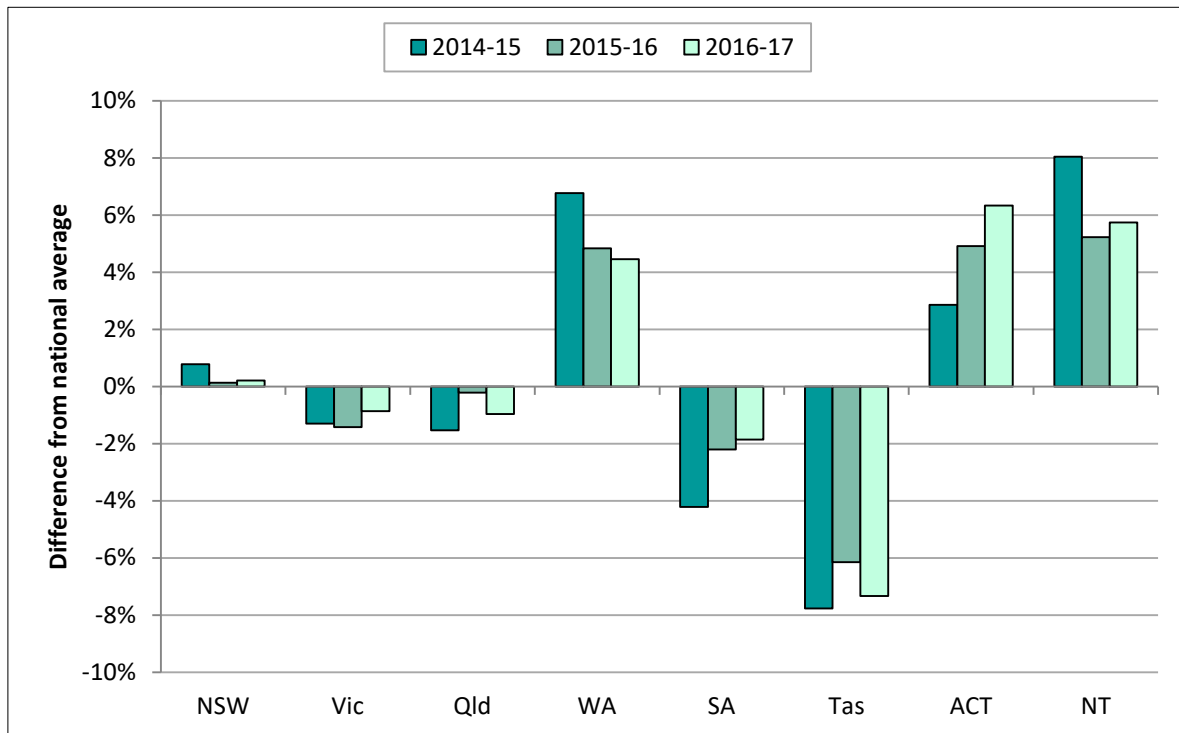
**Table 1 Relative private sector wages, 2018 Update**

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	%	%	%	%	%	%	%	%
2014-15	0.9	-1.5	-1.7	7.7	-4.8	-8.9	3.3	9.2
2015-16	0.2	-1.6	-0.2	5.5	-2.5	-7.0	5.6	6.0
2016-17	0.2	-1.0	-1.1	5.1	-2.1	-8.4	7.2	6.6

Source: Commission staff calculation.

7 The modelled outcomes are then discounted by 12.5%.<sup>2</sup> Figure 1 shows the discounted modelled outcomes produced in the 2018 Update. New South Wales, Western Australia, the Australian Capital Territory and the Northern Territory were assessed to have above average wage costs in all years. The other States were assessed to have below average wage costs.

**Figure 1 Discounted modelled outcomes, 2018 Update**



Source: Indexed SET results for 2013-14. CoES results for 2014-15, 2015-16 and 2016-17.

8 The discounted modelled outcomes are applied to the proportion of expenses in each category attributable to labour costs. In its review of the assessment in the 2016 Update, the Commission decided to calculate those proportions using GFS data for

<sup>2</sup> The Commission applies a low discount to the modelled outcomes because of some uncertainty about how accurately the data capture wage costs, how accurately the model controls for productivity differences and how well private sector wages proxy public sector wage pressures.

2011-12 to 2013-14. It decided to keep the proportions fixed in subsequent updates, since they were relatively stable over time.

- 9 Table 2 shows the wage costs proportions for each category. The Commission decided to set the wage proportions in the Housing, Roads and Transport categories to the average of the other categories, because it considered a significant amount of wage expenses in these categories were classified as other types of expenses, such as payments to contractors.
- 10 The Commission decided to set the wage proportion of administrative scale expenses at 80%.

**Table 2 Wage costs by category, 2013-14 to 2015-16 averages**

Category	Wage expenses	Non-wage expenses	Proportion	Assessed proportion
	\$m	\$m	%	%
School education	25 687	8 324	76	76
Post-secondary education	3 479	1 435	71	71
Health	38 786	20 841	65	65
Housing(a)	519	2 045	20	59
Welfare	4 543	7 286	38	38
Services to communities	1 588	3 303	32	32
Justice	12 767	4 785	73	73
Roads(a)	1 530	5 221	23	59
Transport(a)	749	5 215	13	59
Services to industry	2 486	2 612	49	49
Other expenses	7 595	18 263	29	29
Total exc housing, roads and transport	96 932	66 849	59	59

(a) Proportions for Housing, Roads and Transport have been set to the average of all other categories.  
Source: GFS expenses from the ABS.

- 11 In addition, the Investment assessment uses a capital cost price index derived from a combination of the recurrent factors produced by this assessment, the recurrent Regional costs assessment and the Rawlinson's construction costs index.

## GST redistribution

- 12 Table 3 shows the effect on the GST distribution of the wage costs assessment. New South Wales, Western Australia, the ACT and the Northern Territory are assessed as having higher than average wage costs. These are the States that have the highest private sector wages after adjusting for various human capital attributes, as shown by their above average modelled outcomes in Figure 1.

**Table 3** GST redistribution, wage costs assessment, 2018 Update

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Redist
Dollars million	157	-390	-228	712	-242	-188	100	79	1 048
Dollars per capita	20	-60	-45	272	-139	-358	239	322	42

Source: 2018 Update.

## ISSUES AND ANALYSIS

- 13 There are no major issues in the wage costs assessment for the 2020 Review. The assessment is supported by a sound conceptual case and evidence that public and private sectors are responsive to the same underlying influences in labour markets. The econometric model uses reliable data and has been found to be fit for purpose by several consultants previously engaged by the Commission.

## Recommendations

Staff propose to recommend that the Commission:

- retain its approach to estimating differences in wage costs using the 2016 Update econometric model, updated with new CoES data each year
- update the wage proportions of service delivery expenses based on GFS expense data in the review, but not update these proportions in subsequent updates.

## Other issues considered

- 14 **National markets.** During the review of the assessment undertaken in the 2016 Update, some States argued that they have to respond to national labour market pressures and that they explicitly compare their wage levels with those in other States. To the extent that this was average policy and results in more uniform interstate wage levels, it could mean that the fiscal capacities of States do not diverge for wage related reasons.
- 15 The Commission did not consider that the available data were consistent with uniform interstate wage levels, nor did it accept the view held by some States that

there exists a significant suite of public sector roles where wages are set at a purely national level.

- 16 It engaged an external consultant to review the conceptual basis of the assessment and econometric model.<sup>3</sup> The consultant found some evidence that States compete in both a national and a local labour market simultaneously, implying that States set wage levels with reference to the wages of private sector workers in their own State as well as to the wages paid to comparable public sector workers in other States.
- 17 The relative importance of these two influences was difficult to determine. Analysis of Census data showed that 60% of people joining the State public service between 2006 and 2011 moved from the private sector in their State, while only 3% moved from the State public service in another State. The Commission concluded that the direct impact of competition for labour from other sectors within a State appeared to be stronger than the impact of a national labour market for State public service employees.
- 18 Staff have not found any additional data that suggest the wages for some groups of State public servants are set mainly with reference to national wage levels, or give an indication of the relative importance of national markets in State wage setting.
- 19 State views are sought on data or methods that might allow the Commission to measure the influence of national markets on the level of wages paid.

## CONCLUSION AND WAY FORWARD

- 20 Staff propose to recommend that the Commission retain the wage costs assessment methodology it adopted in the 2016 Update, and update the results each year with new CoES data. We also propose to update the wage proportions of expenses to which the wage costs factors are applied.

### Proposed assessment structure

- 21 Table 4 shows the proposed assessment for wage costs in the 2020 Review.

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<sup>3</sup> Mavromaras, K; Mahuteau, S; Richardson, S, and Zhu; R. *Public-private wage differentials in Australia: What are the differences by State and how do they impact GST redistribution decisions*. 19 February 2016, National Institute of Labour Studies, Flinders University.



**Table 4**      **Proposed wage costs assessment, 2020 Review**

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Disability	Influence measured by disability
Wage costs	Recognises the additional cost to States with higher wage levels for reasons beyond their control. These costs are estimated using an econometric model run on ABS CoES data.

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