

COMMONWEALTH GRANTS COMMISSION (CGC) 2016 UPDATE
WAGE COSTS ASSESSMENT
STAFF DISCUSSION PAPER CGC 2015-05-S
NSW TREASURY COMMENTS
JANUARY 2016

Summary

CGC Staff support the conceptual case for continuing the Wage costs assessment. NSW Treasury considers there is considerable evidence of wage differentials between jurisdictions.

NSW Treasury notes the Commission staff view that the new data from the ABS Characteristics of Employees (CoE) Survey support the conceptual case for continuing the assessment. NSW Treasury also notes that the draft consultants' paper supports this conceptual case.

Staff indicate that the 2014 CoE Survey contained questions on education and qualifications, but that this information is not available for the 2016 Update. Staff canvass two options to deal with the missing qualification data:

- delay the introduction of new data and continue to index the SET 2009 estimates until the CoE Survey data include qualifications (i.e. no method change/data type)
- decide that the contemporaneity of the CoE/EEBTUM Survey outweigh their lack of qualification data, due to the inclusion of more detailed occupation and industry data (i.e. a change in the data source but no change in method).

NSW Treasury would have serious concerns with the use of EEBTUM data as indicated in the staff options. EEBTUM data has not been used by the CGC previously, given the lack of detailed occupation and industry data. Staff say this data is now available for use. However, the EEBTUM data appears to us to show more unstable results between years raising questions about the integrity of the EEBTUM data set for equalisation purposes.

NSW Treasury agrees that the indexed SET data should continue to be used for 2012-13 and 2013-14 combined with CoE data for 2014-15. CGC staff note that the uncertainty of this assessment has not markedly changed, and recommend the Commission not change the current 12.5 per cent discount applied for uncertainty in the data.

NSW Treasury agrees there are no grounds on which to increase the discount beyond the current level. However, we continue to believe no discounting is warranted for this assessment.

Since it cannot be concluded that any uncertainty in the data will work in the same direction for all States, it cannot be concluded that discounting necessarily achieves a result closer to horizontal fiscal equalisation.

NSW Treasury notes the CGC staff view that empirical results currently are not compelling enough to support a change to using private sector wages in the capital city rather than the whole of a State as a better proxy for the community wage pressures affecting public sector wages.

Despite previous discussion of this issue in the 2015 Review, and the CGC's evidence and conclusions in its earlier 2016 Update paper on this issue, NSW Treasury understands that such a

change of method would perhaps best be considered in a review of methodology rather than an Update.

NSW Treasury continues to consider that an assessment based on capital city private sector wage differentials rather than whole-of-State averages would be more appropriate. Major NSW public sector occupational awards generally determine rates of pay on a state-wide basis, some with supplementary allowances based on location.

NSW Treasury considers that a much more detailed analysis of the consultants' draft report will be needed before it can be concluded that its findings on relative city/rest of State public sector wage rates counter the view that States set public sector wage rates on a State-wide basis.

This submission responds to the Commonwealth Grants Commission's request for State comments on CGC Staff Discussion Paper 2015-05-S, *2016 Update Wage Costs Assessment*. In this update, Staff intend to recommend the Commission:

- use the 2009 Survey of Education and Training (SET) indexed forward for the 2012-13 and 2013-14 assessment years
- use the Characteristics of Employees Survey (CoE) derived estimate for the 2014-15 assessment year
- continue to discount the assessment by 12.5 per cent
- make no adjustments for state specific influences
- retain a whole-of-state approach to the assessment.

Public and private relationship

NSW Treasury notes that CGC Staff support the conceptual case for continuing the assessment which measures the interstate differences in the cost of delivering State services brought about by differences, due to influences beyond the policy control of States, in public sector wage costs between jurisdictions. NSW Treasury considers there is considerable evidence of wage differentials between jurisdictions.

NSW Treasury notes the Commission staff view that the new data from the ABS Characteristics of Employees Survey support the conceptual case for continuing the assessment, i.e. that public and private sector wage levels appear to be strongly influenced by the same community wage pressures.

NSW Treasury also notes that the draft consultants' paper – Kostas Mavromaras, Stephane Mahuteau, Sue Richardson and Rong Zhu, 'Public-private sector wage differentials in Australia: What are the differences by State and how do they impact GST redistribution decisions?' – also supports this conceptual case.

That study – based on data from the Household, Income and Labour Dynamics in Australia (HILDA) survey from 2001 to 2013 – showed that for the period 2000-2013 as a whole, and for

the two sub-periods 2001-07 and 2008-2013, after allowing for the compositional differences in private and public sector workforces included in the study, States where private sector wage rates were higher than the Australian average also were characterised by higher public sector wage rates than the Australian average.

The draft consultant report notes that states ‘must pay attention to the pay of private sector workers in their own state’ and that the ‘same levels of labour quality are remunerated differently by State governments’.

Missing qualification data

The 2014 CoE Survey contained questions on education and qualifications. However, this data is not available due to a data processing failure by the ABS. Staff have indicated that the ABS has now resolved this issue, and that future CoE data will contain this information.

The CGC notes that models which do not include education and qualification variables but which instead include detailed industry and occupation data perform very similarly to the former models. However, given the complexities involved in the models, staff cannot confidently measure or predict the impact on State estimates, and so cannot recommend any adjustment be made for the lack of education and qualifications data in the CoE survey.

Due to the missing qualification data the CGC has suggested two possible strategies for measuring wages in this update:

- delay the introduction of new data and continue to index the SET 2009 estimates forward until the CoE Survey data include qualifications (i.e. no change to the method or data used)
- decide that the contemporaneity of the CoE/EEBTUM Surveys outweigh their lack of qualification data, given the improved results due to the inclusion of more detailed occupation and industry data (i.e. a change in the data source but no change in method).

Staff are particularly concerned about the age of the SET data – the last SET survey was 2009, and results since then have been indexed using ABS Labour Price Index data. On balance, staff consider the best overall HFE result is produced using indexed SET data for 2012-13 and 2013-14 and CoE data in 2014-15.

NSW Treasury is not as concerned about the age of the SET data as CGC staff. In other assessments redistributing significant amounts of GST revenue, much older data is used, e.g. the administrative scale assessment which redistributed \$896 million in the 2015 Review uses 1999 data manipulated and indexed in numerous ways, and despite changes in the definition of administrative scale, since then.

Nevertheless, we understand the concerns of the Commission with the age of the SET data and therefore are prepared to support a shift to the use of CoE data for 2014-15. We would be more concerned if the Commission sought to use the EEBTUM data which appears to us to show

more unstable results between years. In our view, this instability calls into question the integrity of the EEBTUM data set for equalisation purposes.

Discounting

In the 2010 Review, the CGC applied a 12.5 per cent discount to the private sector wage relativities derived from the SET regression to reflect a low level of uncertainty concerning:

- whether the SET data are sufficiently reliable
- whether the regression model controls for all relevant factors affecting private sector wage differentials between States and
- whether private sector wages are a good proxy for public sector wages.

The Staff paper notes that the uncertainty of this assessment has not markedly changed, and recommend the Commission not change the discount. Any marginal increase in uncertainty by not including education variables is offset by the increased contemporaneity.

The CGC also notes that it expect in the next few updates to incorporate higher quality contemporaneous data, and so increasing the discount for a single year appears unwarranted.

NSW Treasury agrees there are no grounds on which to increase the discount beyond the current level.

We continue of the view that, since it cannot be concluded that any uncertainty in the data will work in the same direction for all States, discounting for uncertainty in the wage costs assessment will not necessarily produce a result closer to horizontal fiscal equalisation.

NSW Treasury considers no discounting is warranted for this assessment.

Capital city versus whole of State wages

CGC staff do not currently consider the empirical results compelling enough to support a change to using private sector wages in the capital city as a better proxy for the community wage affecting public sector wages. Staff consider that, in particular, evidence was not conclusive in regards to:

- public sector employees receiving the same wage everywhere in the State
- private sector wage levels in capital cities producing a better measure than State wide wage levels of the community wage levels affecting the public sector.

These conclusions are reached despite evidence and conclusions provided in previous CGC papers that:

- ‘States generally pay comparable public servants a single wage set in a State-wide agreement....A State...negotiates a constant wage across the State.’ (Staff Discussion Paper CGC 2013-07-S, October 2013)
- ‘While it is a policy choice for a State to negotiate constant wages across the State, it appears to be one shared by most States.’ (Staff Discussion Paper CGC 2013-07-S, October 2013)
- ‘Our research of State policies has shown, at least for teachers and nurses, State-wide agreements set a single wage for the entire State.’ (Staff Discussion Paper CGC 2013-07-S, October 2013)
- ‘Public sector wages are more homogenous between capital cities and the remainder of the State than private sector wages, suggesting that States do use whole of State agreements considerably more than the private sector does.’ (Staff Discussion Paper CGC 2013-07-S, October 2013)
- ‘In most States, the capital cities have the highest private sector wage level. In States where regional private sector wages are high (Western Australia), public sector employees are offered regional loadings....Analysis of NSW and WA teacher certified agreements shows that is what at least some States do.’ (Staff Discussion Paper CGC 2013-07-S, October 2013)
- ‘We observe that State governments generally negotiate and set wages on a State-wide basis, so a Sydney teacher and an equivalent regional teacher generally earn the same salary (location loadings notwithstanding).’ (CGC Staff Discussion Paper CGC 2015-03S, July 2015, p. 21)
- ‘We observe that what States do is to have centralised wage setting for their public servants.’ (CGC Staff Discussion Paper CGC 2015-03S, July 2015, p. 22)

CGC staff now consider that issues raised by States opposing the proposed change should be further explored before any change is made, noting in particular Western Australia’s view that basing the assessment on private sector wages in the capital city rather than a whole-of-State average may conflict with the principles of HFE.

NSW Treasury notes this view. Despite previous discussion of this issue in the 2015 Review, and despite the CGC’s view in CGC 2015-03S that Western Australia’s arguments regarding conflicts with HFE are unjustified, NSW Treasury understands that a change of method of this significance would perhaps best be considered in a review of methodology rather than an Update.

However, NSW Treasury is not convinced that making such a change requires ‘a much more detailed investigation of State service delivery models’, rather than simply further information on States’ public sector wage setting practices, if the current information is deemed inconclusive.

NSW Treasury continues to consider that an assessment based on capital city private sector wage differentials rather than whole-of-State averages would be more appropriate. Major NSW public sector occupational awards generally determine rates of pay on a state-wide basis, some with supplementary allowances based on location. These awards include:

- Crown Employees (Public Sector - Salaries 2015) Award
- Crown Employees (Teachers in Schools and Related Employees) Salaries and Conditions Award 2014
- Public Health System Nurses' and Midwives' (State) Award 2015
- Crown Employees (Police Officers - 2014) Award and
- Sydney Trains Enterprise Agreement 2014.

The teachers' award, for example, establishes basic salaries and rates of pay that apply across the State (in Schedules 1A to 6), with locality allowances in Schedule 8, including:

- a Climatic Disability Allowance in western NSW and cold climate areas (clause 2, Part A) and
- an Isolation from Socio Economic Goods and Services Allowance (clause 3, Part B) at different rates in ten school groups (listed in Appendix A to Schedule 8).

Similarly the nurses' award sets out minimum salaries for the whole State in Table 1 of Part B, with climatic and isolation allowances for two zones in western NSW set out in Item 10 of Table 2 of Part B. The police award established State-wide rates of pay for non-commissioned officers, detectives, police prosecutors and commissioned officers in Tables 1 to 4 of Part B, with allowances (at three levels depending on location in western NSW) for increased cost of living and climatic conditions in remote areas (paragraph 12 of Part A, with monetary values in Table 6 of Part B).

These general arrangements suggest that wages for like teachers, nurses and police should be slightly higher in more remote areas of New South Wales, given the existence of climatic, cost of living and isolation allowances in remote areas supplementing the common whole-of-State pay rates.

In their analysis, the CGC's consultants divided the workforces in each jurisdiction into those employed in a major city and those employed in the rest of the State. (This analysis excluded Tasmania and the NT, where there is no major city under HILDA definitions, and the ACT, where there is no 'rest of State'.)

The authors found that for each State the average rate of pay is higher in major cities than elsewhere in both the private and public sectors. Most of the public sector gap – 82 per cent in NSW, 69 per cent in Victoria, 56 per cent in Victoria, 75 per cent in South Australia and 43 per

cent in Western Australia – is not attributable to compositional differences (i.e. higher quality workforces) in the major city workforces compared to the rest of the State.

The consultant's summary view is that 'both the public and private sectors pay more for city workers and the premium each sector pays for a constant quality workforce is about the same within each jurisdiction.'

This finding in relation to the public sector is surprising¹ given:

- the belief that States need to pay higher wages in rural and remote areas to attract public sector workers to those areas
- the major public sector award arrangements in New South Wales noted above
- the CGC's observation that 'State governments generally negotiate and set wages on a State-wide basis, so a Sydney teacher and an equivalent regional teacher generally earn the same salary (location loadings notwithstanding)' (CGC Staff Discussion Paper CGC 2015-03S, July 2015, p. 21) and
- the CGC's analysis of the 2009 public sector SET results showing 'that the differences in wages between capital city and rest of State are not as large in the public sector as in the private sector. In fact in most States, the differences between capital city and regional public sector wages are not statistically significant.' (Staff Discussion Paper CGC 2013-07-S, October 2013).

Further analysis of the consultants' study will be needed before it can be concluded that States do not set common wages for public servants in State-wide agreements (with some allowances paid in regional and remote areas). For example:

- the consultants' study uses hourly wage rates rather than weekly or annual wages. It is not clear from the study how the weekly wage rates are derived. However, if there is any bias in the methods suggesting city workers work fewer hours than workers in the rest of the State, hourly wage rates in the major city would be increased relative to those in the rest of the State, for the same annual wage
- the industry/occupation data used in HILDA would need to effectively delineate public sector workers grades/levels. This would be necessary to ensure that the concentration of higher grade public sector workers in capital cities – given the location of line agency headquarters and central agencies in capital cities – is not artificially inflating capital city public sector wages. In other words it may be that the consultants' study is not picking up

¹The consultants' summary view is perhaps not so surprising for the private sector given the CGC's finding that 2009 private sector SET results show 'that there are significant differences between the private sector wage levels in capital cities and those in the rest of the State, with private sector wages generally higher in capital cities than in regional areas.' (Staff Discussion Paper CGC 2013-07-S, October 2013)

adequately possible compositional differences between major city and rest of State public sector workforces.