



2016 UPDATE

**SUBMISSION ON WAGE COST
ASSESSMENT**

**STAFF DISCUSSION PAPER
CGC2015-05-S**

**SOUTH AUSTRALIAN DEPARTMENT OF
TREASURY AND FINANCE**

DECEMBER 2015

Summary of key points:

- **South Australia believes that the National Institute of Labour Studies report *Public-private sector wage differentials in Australia: What are the differences by state and how do they impact GST redistribution decisions* (NILS Report) provides evidence to discontinue, or at least significantly modify, the wages assessment in its current form.**
- **The findings of the NILS report cannot be ignored until the next methodology review or the next update and must be reflected in the 2016 Update.**
- **The NILS report provides support for positions previously argued by South Australia including that:**
 - **public sector wages are strongly influenced by national, sector-specific labour market pressures rather than being predominantly influenced by local labour market pressures;**
 - **private sector wages alone are not a good proxy for movements in public sector wages;**
 - **the true comparability of public sector employees across jurisdictions is questionable; and**
 - **state public sector wages do vary between regions within a state and vary to a similar extent as private sector wages.**
- **If the Commission is inclined to retain the wage cost assessment in the 2016 Update, South Australia believes that**
 - **the absence of education and qualifications data in the 2014 CoE data make this data source unsuitable for use at the current time;**
 - **the assessment should be based on indexed Survey of Education and Training data in all assessment years;**
 - **a maximum discount (50%) should be applied to the assessment to reflect the findings of the NILS Report which question a number key assumptions on which the assessment is based;**

- a “whole-of-state” assessment approach should be retained; and
- A full review of the wage cost assessment must be undertaken prior to the 2017 Update to determine if the conceptual case for the assessment is valid following the findings in the NILS Report
- South Australia has also provided metropolitan vs non-metropolitan public sector wage data from our Office for the Public Sector that does not support a move to capital city based assessment.

Introduction

The CGC released a staff discussion paper on 20 November 2015 outlining what staff propose to recommend to the Commission for the wages assessment in the 2016 Update. In summary Commission staff propose to:

- use the existing 2009 SET data indexed forward for the 2012-13 and 2013-14 assessment years
- use the new CoE data for the 2014-15 assessment year
- continue to discount the assessment by 12.5%
- make no adjustment for state specific influences
- retain a whole-of-state approach to the assessment
- not reflect the findings/conclusions from the NILS Report in the 2016 Update.

Conceptual case for the wages assessment

As part of its consideration of the conceptual basis for the wages assessment, the CGC commissioned the National Institute of Labour Studies (NILS) at Flinders University to consider public-private wage differentials and several key assumptions that underpin their assessment approach.

On 13 November 2015, the CGC provided states with a draft report prepared by NILS titled *Public-private sector wage differentials in Australia: What are the differences by state and how do they impact GST redistribution decisions*.

The NILS Report has several key findings of direct relevance to the conceptual underpinnings of the wages assessment:

- State governments do pay different wages to their respective employees but there is no conclusive evidence that they have to pay different amounts.
- States differ in the wages typically earned by same quality private sector worker. However, if they only competed with their own private sectors there would be greater differences in public sector premiums paid.
- States compete with public sectors in other states and this leads to some convergence in public sector wages nationally.
- Wages in the private sector are more sensitive to external market pressures/events than the public sector. Public sector wage movements tend to lag movements in private sector wages.
- Public sector wages do vary between regions in a state and, on average, to the same extent as private sector wages.
- The smaller states (South Australia and Tasmania) do not attract as high a quality public sector worker as the rest of Australia which suggests that the

composition of public sector workforces is not directly comparable between jurisdictions.

The findings question some of the fundamental assumptions of the wages assessment in its current form and are too strong to ignore in the current update.

National labour market

The Commission has held the view that public sector wages are predominantly driven by regional labour market influences with national wage pressures being less of a driver.

South Australia has consistently argued that regional labour market factors may have some impact on public sector wages but that for the majority of public sector employees, the labour market has a predominantly national job-specific character.

Wage levels of public sector employees in one jurisdiction are more heavily influenced by developments in job specific labour markets in other jurisdictions, rather than by generic local or regional labour market influences.

In nearly all public sector wage negotiation processes (especially for teaching, nursing and police) relevant unions refer to interstate wages as a key justification for pay rises and changes in working conditions.

The NILS Report provides support for the view that public sector wages are heavily influenced as a result of competitive pressures from public sector wage outcomes in other Australian jurisdictions.

South Australia would contend that underlying public sector wages are strongly influenced by national factors in each job specific market.

The NILS Report provides more than sufficient evidence to question the conceptual basis of the assessment and warrants an additional discount to the wages assessment (on top of the current 12.5% discount for data quality) in the 2016 Update prior to a full review of the assessment prior to the 2017 Update.

Public sector productivity differences

South Australia has previously expressed concerns about the true comparability of employees across jurisdictions. Jurisdictions with larger labour markets can offer greater and more diverse employment opportunities than smaller jurisdictions. This can lead to highly skilled and ambitious individuals leaving smaller jurisdictions and moving to the larger cities.

The result of this is that governments in larger jurisdictions may have access to a labour pool that is relatively more productive than the labour pool available in smaller jurisdictions.

From discussions with the authors of the NILS Report (on 4 December 2015), it was clear that they considered that the human capital composition (education and qualifications) of public sector workforces varied between jurisdictions. This immediately raises the issue that workforce compositional differences will lead to differences in the standard or quality of services provided between jurisdictions.

The NILS Report provides support for the South Australian view as it found that despite paying a much higher public sector premium than the larger states, South Australia and Tasmania do not manage to attract as high quality public sector workers as the rest of Australia.

This factor is outside of the control of smaller jurisdictions and is further justification to moderate distributions for this assessment.

Capital city vs whole of state assessment approach

In their staff discussion paper issued in July 2015, Commission staff proposed basing their wage cost assessment on capital city wages rather than whole-of-state wages. Due to a lack of supporting evidence, Commission staff now propose not moving to a capital city approach for the 2016 Update.

South Australia supports this proposal.

Commission staff previously suggested that for most parts of the public sector, wages were determined through state-wide agreements, the outcomes of which are influenced by the need to attract and retain staff in all locations. Usually the highest cost locations will be capital cities, therefore, wage outcomes will be determined with primary reference to capital city wages. Commission staff noted that this approach does not hold for states where regional wage costs are generally higher than capital city wage costs (like parts of Western Australia).

Commission staff also suggested that there were significant differences in private sector wages between capital cities and the rest of the state, with private sector wages higher in capital cities, while public sector wages remained more uniform.

The NILS Report concludes state public sector wages do vary between regions within a state and to the same extent as private sector wages. The direction of variation is the same with the regional wage premium for a comparable quality worker very similar between the private and public sectors (with some jurisdictional variation).

This finding does not support the view that public sector wages are set with reference to capital city labour market pressures.

In addition to the findings of the NILS Report, South Australia has been able to extract data from our Office of the Public Sector on metropolitan and non-metropolitan public sector wages (copy provided for review by CGC staff only).

The data collates average metropolitan and non-metropolitan public sector salaries for over 250 occupations (at different levels) as at June 2014. The data does not include any regional or other allowances.

The data shows that the average metropolitan salary was \$76,960 per annum compared to an average non-metropolitan salary of \$66,197 per annum. When looking at the more detailed data there are metropolitan and non-metropolitan wage differentials for nearly every specific occupation.

Although this data has obvious limitations, it does provide evidence that public sector wages do vary between capital cities and the rest of the state.

Given the findings of the NILS Report and our own metro/non-metro public sector wage data, South Australia believes that there is no conceptual case to move away from a whole-of-state assessment approach to a capital cities assessment approach.

2014 Characteristics of Employees data

Commission staff are proposing use of the existing 2009 SET data indexed forward for the 2012-13 and 2013-14 assessment years and use of the new 2014 Characteristics of Employment (CoE) data for the 2014-15 assessment year.

The new CoE data produces 2014-15 wage factors that, when compared year-on-year, are vastly different for some jurisdictions (especially South Australia and Tasmania) from factors derived from either indexed SET data or ABS Employee Earnings, Benefits and Trade Union Membership (EEBTUM) data. The reasons for these variations are not clear.

The 2014 CoE survey collected education and qualification sub-data, however, this data is not available for the 2016 Update due to ABS processing issues.

While Commission staff are proposing use of the 2014 CoE data for the 2014-15 assessment year, they note the following in relation to the absence of qualification and education sub-data on wage factors:

“...while changes in State coefficients are relatively small, they may be material. 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 it.”

Commission staff also note that the “*new (CoE) data are well short of ideal*” but due to the age of the SET data (2009) are inclined to use it.

Commission staff appear to be comfortable using the CoE data, notwithstanding the lack of education and qualification data, as it *appears that information on detailed occupation is as effective in predicting an individual’s income as broad occupation such as “medical profession” along with qualification information.* South Australia would like to see a higher level of assurance that the lack of education and qualification data is compensated by occupational data.

If adopted for the 2016 Update, wage factors incorporating the 2014 CoE data would produce major changes to existing HFE transfers, especially for South Australia and Tasmania.

In the ABS *Education and Work, Australia* survey, May 2015 (Catalogue 6227.0), 25.7% of the South Australian population aged 20 to 64 had a bachelor’s degree or above compared to the national average of 29.3%. The figures for New South Wales and Tasmania were 30.7% and 20.5% respectively. The omission of education and qualification information in the 2014 CoE data could be producing materially different wage cost factors.

Given the significantly different and uncertain results produced by the new CoE data and its non-inclusion of key education/qualification sub-data, 2009 SET data (indexed) should be retained in all assessment years for the 2016 Update. The new CoE data should only be used when the data is complete and the CGC has a greater level of confidence in its reliability.

If the Commission is inclined to support the use of 2014 CoE data in the 2016 Update, the uncertain implications resulting from the unavailability of education and qualification data justify further discounting of this assessment.

**South Australian Department of Treasury and Finance
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