Tasmania
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2016 Update

Wage Costs Assessment

Tasmania's Response to Staff Discussion Paper CGC 2015-05-S

Department of Treasury and Finance

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Introduction

This paper contains Tasmania's response to the Staff Discussion Paper CGC 2015-05-S and draws mainly on the consultant's draft report, titled, *Public-private sector wage differentials in Australia: What are the differences by State and how do they impact GST redistribution decisions*.

Commission Staff are proposing in the Discussion Paper to continue the current Wages assessment method with the only change being the use of new Compensation of Employees data. Tasmania considers that the assessment should be changed in light of the consultant's findings, including an increase in the general discount in recognition of the evidence that states are competing in the local and national public sector market for the skills they need.

Tasmania also considers that the Compensation of Employees data are not suitable for use at this stage. If a Wages assessment is to continue, there should be a delay in the introduction of new data until the CGC has CoE survey data that includes qualifications.

If the Commission chooses to use the new CoE data there should be a reintroduction of the Tasmania-specific discount given the unrealistic results the Commission's model produces for Tasmania.

Tasmania's response

The consultant employs Oaxaca-Blinder decomposition to identify the two components of the average wage gap between the public and private sectors. The decomposition calculates the gap in hourly pay between the public and private sectors and then estimates what portion of this gap is attributable to the different qualities of the two workforces (composition) and what portion is attributable to the fact that the same qualities are rewarded with different rates of pay in the public and private sectors (the premium).

The consultant stated that the table below provides some evidence that the states are competing in a national market for their public sector workers and cannot diverge too much from the national norms as they all need very similar and specific types and quality of workers.

Table 1 Private sector pay and public sector premium

Jurisdiction	Private sector pay ($)	Public sector premium over private pay, log points	Public sector pay ($)
Australia	27.32	0.042	33.68
WA	28.98	0.025	35.07
NSW	28.52	0.033	35.15
Vic	27.98	0.017	32.33
QLD	25.62	0.039	31.98
SA	24.83	0.075	31.39
Tas	23.45	0.087	32.00
NT	26.56	0.24	36.55
ACT	29.61	0.099	39.50

The consultant stated that the states differ in the wages typically earned by same quality private sector workers. If they competed only with their own private sectors, we would see greater differences in the public sector premium. But they also compete with the public sectors in other states and this leads to some convergence in public sector wages across the country.

The consultant also stated that the public sector has a particularly high proportion (45 per cent) of professionals in its workforce compared to the private sector (16 per cent). These professionals are likely to be geographically mobile in a way that means that individual states are competing with each other as much as, or more than, with the private sector to recruit and retain them.

General discount

The implications of these findings is that the Commission’s model needs to have the general discount increased to reflect the greater uncertainty around using private sector wages as a proxy for the pressure on public sector wages. The current general discount reflects the Commission’s judgement around the uncertainty of whether: the SET data are sufficiently reliable; the econometric model controls for all relevant factors; and the extent to which private sector wages are a good proxy for the pressures on public sector wages. The current discount is the lowest available reflecting the Commission’s view that there is a low level of uncertainty.

In our view the consultant’s report correctly highlights the significant role that the national market for public sector workers plays. This is an important finding and one that Staff have considered to be an issue of lesser importance in the past when considering the current general discount.

The report prepared by Dr Tom Karmel and Patrick Lim (January 2014) for South Australia during the 2015 Review showed that the public sector is a very big employer for some groups of people, in particular, the public sector is more important than the private sector for those employees with bachelor and post-graduate qualifications particularly in the areas of health and education. In those areas where the public sector is the dominant employer it is likely that public sector wages will influence private sector wages, that is, private sector wages are not free of policy influences.

Staff have also stated that, conceptually, the optimum approach would be to measure wage differences of private sector employees with characteristics similar to public sector employees as such an approach would mean that the assessment would reflect the pressures faced by states on wages for the types of people employed by states. However, the Commission is reluctant to use this optimum approach as there are data reliability and policy neutrality issues in pursuing an approach of identifying private sector workers comparable to public sector workers.

Staff do not consider the uncertainty has markedly changed and do not recommend the Commission change the discount. However, the evidence and arguments above add further weight to the argument that the general discount is too low.

Compensation of Employees data

The Discussion Paper states that the 2015 CoE survey contained questions on education and qualifications but that these data are not available due to a data processing failure by the ABS. Staff state that they have found that models which do not include education or qualification variables, but which instead include detailed industry and occupation data, perform very similarly to the former models. Staff state that it appears that information on detailed occupation is as effective in predicting an individual's income as broad occupation along with qualification information.

However, Tasmania agrees with Commission Staff that the lack of qualifications means that the new data are well short of ideal. Education and qualifications are crucial explanatory variables. Tasmania is concerned about the lack of information on the "processing failure" and what the implications are for the survey.

Tasmania considers that the best option is to delay the introduction of new data until there is survey data with qualifications.

Tasmania-specific discount

As the Commission stated in the 2004 Review, the effects of "isolation" on wages is one of the causes of the location effect that the CGC are trying to measure in the Wages assessment. A small and isolated jurisdiction in a federation may need to offer a premium to attract the necessary staff to provide the full array of state services. A major difference between the public and private sectors in a jurisdiction, in terms of the effects of isolation, could affect the assessment.

There is a major difference between the public and private sectors in Tasmania (more so than any other state). For Tasmania, low interstate movement into Tasmania's private sector (low private sector labour mobility) means the private sector wages will not contain an isolation premium (that the public sector faces).

To the extent that the state government needs to attract interstate employees into the public sector, the CGC's method, which uses private sector wages as a proxy, understates Tasmania's underlying public sector wage levels.

In 2004, the CGC set Tasmania's location effect equal to that for the state with the next lowest location effect because it considered that the low mobility of labour in the private sector in Tasmania meant the analysis might understate the wage levels required to attract staff needed to provide state services.

However, the 2009 SET results prompted the CGC to change their approach. The CGC stated that they previously applied the Tasmanian adjustment because relative public sector wages could not fall as low as Tasmania's relative private sector wages, i.e. there are bounds within which public sector wages lie. According to the CGC this assumption was no longer sustainable since relative public sector wages paid in Victoria were comparable with Tasmania's relative private sector wages in the 2009 SET. The Tasmania-specific discount was removed.

The Discussion Paper states that, with the release of the CoE data, Staff again find that Tasmania's private sector wages (8.8 per cent below average) are well outside the range found for any public sector wage relativities (Victoria being the lowest at 5.6 per cent below average). Tasmania considers that if the CoE data are used then the Tasmania-specific discount needs to be reintroduced.

It is still the case that the depth and breadth of Tasmania's economic activity is more like a regional area of other states. The Accessibility-Remoteness Index of Australia and the HILDA survey both consider that Tasmania does not have any major cities when the Tasmanian population dispersion is compared on a national scale. Nevertheless, Tasmania is a state in the Commonwealth and must provide the necessary public sector staffing and infrastructure to provide the full range of state services.

Tasmania has the highest ratio of departures to arrivals for working age people of all states (1.18) with the ratio even higher for the age cohort 15-44 years (1.35)[1]. While there was some improvement in the ratio in the 2000's, the improvement was only temporary, and the ratio has returned to the long run trend of low inward private sector migration.

Tasmania's economy remains over-represented by primary industries and community services and under represented by the business and finance sector.

Further evidence supporting the Tasmania-specific discount can be found in the consultant's report. The next section will discuss the evidence in the consultant's report that Tasmania's private sector is significantly different to that in other states while the public sector in Tasmania is very similar to other state's public sectors.

Tasmania's public and private sectors

The consultant's analysis shows that Tasmania is not the lowest public sector wage state, stating that four states (Victoria, Queensland, South Australia and Tasmania) have very similar average hourly pay within the range $31.4 to $32.3 with Queensland and South Australia paying their public service workers the lowest average pay, and ACT paying the highest.

[1] Migration, Australia 2013-14 (Cat No. 3412.0).

The data show that, while the Tasmanian average public sector wage is close to the national average, its private sector average wage is the lowest for any jurisdiction at $23.4 resulting in the third highest public-private gap.

According to the report, the public sector is substantially more educated than the private sector. For Australia, 28 per cent of private sector employees had year 11 or less as their highest qualification compared with 13 per cent for the public sector. For Tasmania, the results are even starker with 40 per cent of the private sector employees with year 11 or less as their highest qualification compared with 18 per cent for the public sector.

Tasmania's private sector result is, by far, the highest percentage for the private sector, followed by South Australia and NT (both with 32 per cent). At the same time, Tasmania's public sector result was similar to Western Australia (16 per cent) and Queensland (15 per cent).

The national results for university graduates are 48 per cent and 20 per cent, that is, almost half of the public sector are graduates compared with one fifth for the private sector. Again, for Tasmania, the results are striking with 51 per cent and 14 per cent respectively, the lowest private sector result (equal with Queensland) and the third highest public sector result behind the ACT (58 per cent) and Victoria (52 per cent).

The Tasmanian results for "Certificate", "Diploma" and "University" are almost identical to the national average. Tasmania has a similar to national average qualified public service and a well below average qualified private sector.

The report shows that public sector employees have much longer tenure (9.7 years on average in Australia) than private sector workers (4.8 years). Tasmania has the highest private sector tenure (5.7 years) consistent with relatively low labour mobility in Tasmania's private sector. The Tasmania average public sector tenure (9.4 years) is similar to the national figure.

The consultant's report shows that the total pay gap is 26 log points for the whole of Australia, with the small jurisdictions of Tasmania, NT and the ACT having the highest pay gaps, while Victoria has the lowest and that the differences are large. The consultant states that the overall positive and large composition estimate suggests that public sector workers in Australia possess human capital of higher market value than their private sector counterparts.

Tasmania's composition estimate is the second highest (25 log points) after the ACT, followed by NSW and Queensland. This result is not surprising and is consistent with Tasmania's long held view that its public sector is fundamentally different to its private sector in terms of human capital.

The average premium for Australia is estimated at 4.2 log points with the main outliers in these estimates being NT, ACT, Tasmania and South Australia. It is no coincidence that they are all small jurisdictions. The consultant suggests that this is due likely to firstly remoteness (NT) and relatively low private sector pay (South Australia and Tasmania), which makes it harder to attract and retain constant quality workers.

Pre and Post GFC

The consultant also calculated the decomposition pre and post GFC. For Australia as a whole, the private sector human capital has improved relative to the public sector and therefore the composition effect, while positive, has reduced. However, Tasmania is different to the national trend. Tasmania is the only state where the total pay gap has increased (pre and post GFC) due to both higher quality of its workers and a higher premium. Tasmania did not see a relative improvement in the quality of its private sector.

TAS	**2001-2007**	**2008-2013**
Total	0.33	0.35
Composition	0.25	0.26
Premium	0.08	0.10
AUS	**2001-2007**	**2008-2013**
Total	0.26	0.27
Composition	0.23	0.21
Premium	0.03	0.06

The Tasmanian public sector followed the national rise of 11 per cent while its private sector only rose by 9 per cent and therefore the Tasmanian public sector pay gap increased by 2 per cent. This is due to 1) a one per cent relative improvement in the quality of public sector employees (relative to the private sector) and 2) a two per cent increase in the premium paid by the public sector for equally qualified workers.

All jurisdictions, except Tasmania, saw a decline in the relative quality of their workforces. Tasmania is the only state to have a quality improvement (relative to the private sector). These results are consistent with Tasmania having a relatively low qualified private sector that does not change over time given the depth and breadth of Tasmania's economic activity.

Tasmania has long argued that there is a large difference between its public and private sectors and strong similarities between its state public sector and other state governments. The HILDA data, and the consultant's regression work, are consistent with the 2004 Review analysis by the Commission which concluded that Tasmania's location effect was overstated and not realistic due to the regional nature of Tasmania's economy and low inward migration.

Also, Tasmania's public sector wages are not the lowest and Tasmania has one of the highest premiums consistent with a small isolated jurisdiction having to offer an isolation premium.

The Discussion Paper states that, with the release of the CoE data, Staff again find that Tasmania's private sector wages (8.8 per cent below average) are well outside the range found for any public sector wage relativities (Victoria being the lowest at 5.6 per cent below average).

Commission Staff state that they consider using the indexed SET numbers for the first two assessment years mitigates the effect of the new data, putting the average Tasmanian private sector wage for the three years at 6.7 per cent. Staff state that given that Victoria appears to pay wages 5.6 per cent below the national average, Staff do not consider there is sufficient evidence that Tasmania is unable to pay wages 6.7 per cent below.

Commission Staff appear to recognise, at least implicitly, that there is an issue with the method for Tasmania. However, the Staff proposal does not represent an adjustment. If the Commission chooses to use the new Compensation of Employees data there should be a reintroduction of the Tasmania-specific discount. In recognising Tasmania's unique situation, the Commission should set Tasmania's location effect equal to that for the State with the next lowest location effect.

To be consistent with the model, public sector wages are not used due to significant policy influences. If private sector wages in Tasmania are an appropriate policy neutral proxy for the pressures on public sector wages, except insofar as they are not reflecting an isolation premium that the public sector faces, then the logical step would be to refer to a state with a similar private sector labour market but one that does not have a long term trend of low inward migration for working age people. This is the state with the next lowest modelled effect. This is more appropriate than speculating that Tasmania should be able to recruit and retain adequate staff with wages a certain percentage below the national average.