



The  
Treasury

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**NSW Treasury response to *New Issues*  
for the 2017 Update Wage Costs  
Assessment (CGC 2016-18-S)**

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## 1. Introduction

This submission responds to the Commonwealth Grants Commission's request for State comments on *New Issues For The 2017 CGC Staff Discussion Paper 2016-18-S, Wage Costs Assessment*. The Commission has indicated that it is particularly interested in:

- whether the Commission's economic model should continue to include the education variables because they are material
- whether the Commission's economic model should exclude the trade union membership variable as it is not material
- whether Tasmania's modelled outcomes fall outside the bounds within which public sector wages lie and require an adjustment in addition to the general discount.

This submission will follow the above structure followed by a brief summation of NSW Treasury's general views on the wage costs assessment.

## 2. Issues Arising for the 2017 Update Wage Costs Assessment

### 2.1 Include the education variables

The commission noted in the 2017 new issues paper that the education variables has been included in the Commission's econometric model in every year except 2014-15. Information on education qualifications was omitted in 2014-15 due to issues with ABS processing. It is expected that this information will be included in future datasets.

The Commission seeks the State's view on whether the Commission's econometric model should continue to include the education variables because they are material.

Given the education qualifications data are material (Table 2) in the wage costs econometric model, NSW Treasury agrees with the Commission Staff's recommendation to use the education qualifications data in the econometric model this year and in future calculations.

### 2.2 Exclude the trade union membership variable

The Commission seeks the State's view on whether the Commission's econometric model should exclude the trade union membership variable as it is not material.

NSW Treasury notes the trade union membership is collected every second year by the ABS and was included in the 2014 CoES. After omitting the variable in the 2014-15 outcomes (Table 3), the change was less than \$10 per capita for all the State's GST outcome.

Given this is not material and it is collected every second year, NSW Treasury supports the Staff's recommendation that the Commission leave this variable out of its econometric model in the future, even when the data are available.

### **2.3 A State specific adjustment for Tasmania**

In the New Issues for the 2017 Update, the Commission seeks the State's view on whether Tasmania's modelled outcomes fall outside the bounds within which public sector wages lie and require an adjustment in addition to the general discount.

NSW Treasury notes in 2010, the Commission applied a 25% discount to Tasmania's modelled outcome as it indicated:

*there are constraints on the variation of public sector wages, and ... there are likely to be bounds within which public sector wages lie<sup>1</sup>.*

The adjustment was discontinued in the 2011 Update as the Commission assessed that the Surveys of Education and Training (SET) data were no longer so extreme that it warranted an adjustment.

In past Reviews, NSW Treasury agreed with the staff recommendation to continue to not adjust Tasmania's modelled results. In the 2017 Update, we note that Tasmania's modelled outcome for 2015-16 is 7% below average which is less than its 2014-15 modelled outcome of 8.9% using indexed SET estimates. While it is below average, NSW Treasury agrees with the Commission's stance that this figure is not entirely infeasible and so a discount would not be necessary.

NSW Treasury has no reason to change that view at this time.

## **3. Further NSW Treasury comments**

The wage costs assessment reflects non-policy interstate differences in public sector wage costs which impact on the cost of delivering State services.

The Commission notes its usual approach when considering whether differences between States should affect the GST distribution is to ask:

- is there a conceptual case supported by evidence that, putting aside policy differences, States face different costs in the delivery of services and

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<sup>1</sup> GST Revenue Sharing Relativities, 2010 Review, Volume 2, Chapter 24 Location costs, Page 505, paragraph 27.

- can a reliable assessment of the differences in costs be developed from the available evidence, and if so what is the most appropriate way to make the assessment?

NSW Treasury considers there is considerable evidence of wage differentials between jurisdictions.

- ABS Survey of Education and Training and Average Weekly Earnings data show the existence of wage differentials between States in both the public and private sectors over two decades (Figures 2, 3 and 4 of the Staff Discussion Paper CGC 2015-03-S).
- Comparable public sector employees in the same occupation in different States are paid different wages (Tables 1, 2 and 3 of the Staff Discussion Paper CGC 2015-03-S).

NSW Treasury considers there is a substantial conceptual case that these differentials are attributable to factors beyond the control of States.

As the Commission notes, various strands of economic theory – equalising real wages but differing nominal wages to take account of differing costs or ‘amenity’ of living, differing macroeconomic conditions, labour force immobility – suggest plausible reasons for the existence of wage differentials between different regions in Australia unrelated to State government policies.

NSW Treasury agrees the conceptual case that such differentials are influenced by factors other than State government policy is strengthened by:

- Wage differentials that exist in the private sector are not attributable to State government policies. In all jurisdictions other than the Australian Capital Territory, private sector employment accounts for the majority of total employment. State government policy influence on private sector wage setting is limited.
- Though the strength of the relationship may vary in certain periods, over time State governments cannot divorce themselves from the realities of the wider labour market in which they operate. The ability of State governments to attract labour is undermined if the wages and conditions offered to public sector employees remain below general labour market and community standards for a significant period.

### **3.1 Discounting**

A discount of 12.5% continues to be applied to the econometric model in the wage costs assessment and NSW Treasury notes that the discount was applied to take into consideration some uncertainty around the SET data and whether the model controls for all relevant factors. We note also that in the 2016 Update, the Commission moved to the ABS annual Characteristics of Employment Survey (CoES) as its source of information for the wage cost differences between States.

In the Report on GST Revenue and Sharing Relativities 2015 Review, the Commission indicates:

*We have applied the relative growth in the LPI from the SET survey year to the assessment year for each State. To allow for concerns about data quality and changes in the relationship between public and private sector wages since the SET year, these factors were discounted using the low discount (12.5%)<sup>2</sup>.*

Given this and adopting the updated CoES ABS data in the econometric model, we believe the discount should be removed or lowered in the future as we move further away from the 2009 SET data and new data becomes available.

In addition, NSW Treasury's view remains unchanged from previous responses to the wage costs assessment: the discount is not warranted since it cannot be concluded with any certainty that the discount will produce a result closer to horizontal fiscal equalisation (HFE).

We have no reason to believe that the uncertainties used to justify the discount would work in the same direction for all States. The possible unreliability of the data, the possible non-inclusion of all relevant factors that influence wage levels in the econometric model's calculation of comparative wage levels, the possibility that private sector wages are an inadequate proxy for public sector wage pressures, would affect different States in different directions.

Furthermore, we continue of the view that the private sector are a suitable proxy for the wage costs assessment given both the public and private labour market should in principle compete in the same employment market pool in each State and any interstate differences in public sector wages should be seen as a result of pressures from the private sector market. As such, our view is that the discount should be reduced or removed from the assessment.

NSW Treasury notes some States has argued for the continual application of the 12.5% due to factors other than private sector wages affecting public sector wages, as well as concerns over reliability of the data. Our view is that if there is ongoing uncertainty, suggestions around what this uncertainty may be should be put forth and used where possible to further improve the wages assessment model. In addition, the new CoES data should provide greater data reliability and remove some of the assumed uncertainty around the age of the SET dataset which some States have.

Using the Average Weekly Earnings (AWE) ABS data, we can observe movements in public sector wages follow private sector wages quite closely. From the GST Revenue Sharing Relativities 2015 Review, the Commission remarked:

*Even if a particular occupation were 100% public sector employees, a State would still face external pressures on wages stemming from cost of living, attractiveness of the location, or other factors outside of State control such as other occupations. While we accept that, at times,*

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<sup>2</sup> Report on GST Revenue Sharing Relativities 2015 Review, Volume 2 – Assessment of State Fiscal Capacities, Paragraph 57, Page 473

*States act in the short term to place limits on public sector wage growth, our observations of the AWE data suggest these actions merely result in lags in public sector wages following private sector wage trends. Our view is that, over time, the link between private and public sector wages holds<sup>3</sup>.*

The AWE data between public and private sector wages illustrates that despite a general lag in the public sector wages relative to private sector wages, there is a strong correlation between the two sectors as the public sector eventually follows. This is exemplified in Appendix A of the 2015 review.<sup>4</sup> Using updated AWE data from November 1994 to May 2016, the relationship remains throughout the States.

We can further observe this relationship by breaking the Average Weekly Earnings data down by periods; pre GFC (1994-2007) and after GFC (2008-2016). The global financial crisis adversely affected the Australian economy and the private sector saw a reduction in its rate of growth of wages in response. The relationship between public sector wages and private sector wages however remains strong through the GFC. Evidence of this relationship is further supported by the National Institute of Labour Studies research paper conducted by Flinders University which found that:

*the private sector reduced its rate of growth of wages after the GFC rapidly and substantially. The public sector took several years longer to come to a similar position, and by doing so raised public sector wages relative to private sector wages.*

Through their interpretation between the two periods, they concluded that:

*the jurisdictions do pay at different rates to attract the same quality of labour. The key evidence is the public sector premium identified in the FE and QR FE estimations. The evidence supports the view that the states compete for workers in two labour markets simultaneously. One is the national labour market for public sector workers. In this case they must pay attention to the pay of comparable public sector workers in other jurisdictions. The other is the local labour market. In this case, they must pay attention to the pay of private sector workers in their own state<sup>5</sup>.*

Using an estimation model and observing by periods; pre GFC (2001-2007) and after GFC (2008-2014), the Flinders research paper shows the global financial crisis affected the private sector severely but the public wage sector caught up relatively quickly. This is illustrated by the log points between the two periods where the wage gap pre GFC is at 26 log points and 27 log points after GFC.

The research paper provides strong empirical evidence as it considered factors external to State policy decisions including Age and Highest Qualification which are

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<sup>3</sup> Report on GST Revenue Sharing Relativities 2015 Review, Volume 2 – Assessment of State Fiscal Capacities, Paragraph 26, Page 462

<sup>4</sup> Report on GST Revenue Sharing Relativities 2015 Review, Volume 2 Assessment of State Fiscal Capacities, Appendix A, Page 473

<sup>5</sup> Public private sector wage differentials in Australia, NILS working paper series 222/2016, Flinders University

similarly available in the CoES ABS data. For ease of reference, the result of the paper's finding is shown below<sup>6</sup>.

Table 8: Public-Private pay gap – overall decomposition, 2001-2007 (pre-GFC)

	Australia	NSW	VIC	QLD	SA	WA	TAS	NT	ACT
<b>Public sector</b>									
Log pay	3.37	3.42	3.33	3.32	3.29	3.36	3.34	3.45	3.55
<b>Private sector</b>									
Log pay	3.11	3.16	3.15	3.04	3.04	3.12	3.01	3.07	3.06
<b>Total gap</b>	0.26***	0.26***	0.18***	0.27***	0.26***	0.24***	0.33***	0.37***	0.49***
	(0.00)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.03)	(0.04)	(0.03)
	[100%]	[100%]	[100%]	[100%]	[100%]	[100%]	[100%]	[100%]	[100%]
<b>Composition</b>	0.23***	0.24***	0.19***	0.25***	0.19***	0.22***	0.25***	0.16**	0.39***
	(0.00)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.06)	(0.04)
	[88%]	[92%]	[106%]	[93%]	[73%]	[92%]	[76%]	[43%]	[80%]
<b>Premium</b>	0.03***	0.02	-0.01	0.03***	0.07***	0.02	0.08***	0.22***	0.10**
	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.03)	(0.07)	(0.04)
	[12%]	[8%]	[-6%]	[7%]	[27%]	[8%]	[24%]	[57%]	[20%]
<b>Observations</b>	44,821	13,180	11,275	9,516	3,886	4,178	1,320	389	1,077
<b>Public sector</b>	11,571	3,445	2,680	2,320	996	992	377	170	591
<b>Private sector</b>	33,250	9,735	8,595	7,196	2,890	3,186	943	219	486

Note: \*\*\* p<0.01, \*\* p<0.05, \* p<0.1. The statistical tests show a) that the total public/private sector pay gap is significantly different from zero for all jurisdictions and b) that the composition of the workforces are significantly different: with the exceptions of NSW, Vic and WA, so too are the premiums paid. The ratios of effects over raw gaps are reported in squared brackets.

Table 9: Public-Private pay gap – overall decomposition, 2008-2013

	Australia	NSW	VIC	QLD	SA	WA	TAS	NT	ACT
<b>Public sector</b>									
Log pay	3.49	3.52	3.44	3.44	3.42	3.52	3.45	3.56	3.66
<b>Private sector</b>									
Log pay	3.22	3.24	3.22	3.19	3.16	3.30	3.10	3.27	3.32
<b>Total gap</b>	0.27***	0.28***	0.22***	0.26***	0.26***	0.22***	0.35***	0.29***	0.34***
	(0.00)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.02)	(0.04)	(0.03)
	[100%]	[100%]	[100%]	[100%]	[100%]	[100%]	[100%]	[100%]	[100%]
<b>Composition</b>	0.21***	0.23***	0.18***	0.21***	0.18***	0.19***	0.26***	0.025	0.26***
	(0.00)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.06)	(0.03)
	[78%]	[82%]	[82%]	[81%]	[69%]	[86%]	[74%]	[86%]	[76%]
<b>Premium</b>	0.06***	0.05***	0.04***	0.05***	0.08***	0.03	0.10***	0.27***	0.08**
	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.03)	(0.07)	(0.03)
	[22%]	[18%]	[18%]	[19%]	[31%]	[14%]	[26%]	[14%]	[24%]
<b>Observations</b>	47,552	13,851	11,877	10,291	4,174	4,212	1,493	474	1,180
<b>Public sector</b>	12,081	3,468	2,802	2,467	1,049	1,017	398	219	661
<b>Private sector</b>	35,471	10,383	9,075	7,824	3,125	3,195	1,095	255	519

Note: \*\*\* p<0.01, \*\* p<0.05, \* p<0.1. The statistical tests show a) that the total public/private sector pay gap is significantly different from zero for all jurisdictions and b) that in almost all cases both the composition of the workforces and the premium paid are significantly different. The ratios of effects over raw gaps are reported in squared brackets.

### 3.2 Capital city versus whole of State wages

On the topic of utilising capital city wages as a proxy for State wages, NSW Treasury views remain the same to the Second Submission to the CGC 2015 Methodology Review (January 2014, pp. 155-157). For ease of reference, those views are summarised here:

<sup>6</sup> Public private sector wage differentials in Australia, NILS, Flinders University, Table 8 and 9, Page 18



*Given common State policy seems to be to set wages for the whole State based on capital city wage pressures, New South Wales considers private sector capital city wage differentials should be used as the proxy for public sector wage differentials between States.*

*In New South Wales, wage negotiations for Sydney-based employees exert a strong influence on public sector wages across the State. New South Wales public sector wage agreements generally have uniform State-wide base rates of pay for the same employees in the same occupations across the State, however there are often allowances or other conditions which are provided to employees in regional areas. The base pay rates are influenced by wages needed to attract and retain labour to public employment in Sydney, with its relatively high living costs, particularly for housing.*

*CGC staff note that SET data suggests that States use whole of State agreements considerably more than the private sector. The SET data shows that public sector wages are more homogenous between capital cities and the remainder of the State than are private sector wages.*

*New South Wales agrees that, provided data of sufficient quality is available, using private sector wage differentials in wages paid in capital cities as the proxy for public sector wage differentials between States makes sense since capital city wage pressures are reflected across States<sup>7</sup>.*

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<sup>7</sup> Comments also provided in the 2016 Review