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Commonwealth Grants Commission

HISTORY OF THE WAGE COSTS ASSESSMENT

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CONTENTS

INTRODUCTION 1

EARLY COMMISSIONS 1

MODERN COMMISSIONS 2

REDISTRIBUTIVE IMPACT OF ASSESSMENT 10

THE MEASUREMENT APPROACH 11

Limits to the variation in wages 12

Discounting 12

Updating of the disability factors 13

CONCLUSION 14

ATTACHMENT A: Summary of State Views from the 1993 Report 15

ATTACHMENT B: Wage Costs Assessment History 17

INTRODUCTION

1 Differences in the level of private and public sector wages among States have been a feature of the economic conditions of States for as long as records exist.

2 From the first Commission, if and how these differences should enter into the calculation of equalisation payments has been a feature of Commission deliberations, albeit with varying importance.

3 This paper provides a history of those deliberations to provide a historical context for future Commission and State consideration of an assessment of wage input costs. Its main focus is on the period from the 1981 Review, when the Commission was asked to recommend equalising payments for all States.

EARLY COMMISSIONS

4 In coming to a decision on what special grants should be provided to claimant States to equalise their fiscal capacity with those of standard States, early Commissions examined the difference between the recorded budget deficits of claimant and standard States. The equalising grant was determined so as to close the gap between these deficits. They did however adjust recorded deficits for a range of factors including 'extravagance of administration'.

5 If a claimant State's recorded deficit was considered high because it paid wages above the standard States, or employed excessive numbers of public servants, the impact of those differences was determined and recorded deficits reduced by that amount before a grant was assessed. There was a symmetrical approach if wages were below those of standard States.

6 The early Commissions recognised a link between public and private wages within a State.

> It is obviously impossible for a government to pay its servants much below the corresponding rates for private employment. (1936 Report)

7 However, they did not make an allowance for differences in community wages when adjusting recorded deficits. Implicitly all States were considered to be able to employ sufficient public servants at the wages of the standard States regardless of the level of community wages in their State, with any variations in actual rates of public sector pay in claimant States attributed to their policy choice. This may have been a reasonable analytical approach, given that in early claimancy cases public sector wages in standard States appear to have been higher than in claimant States.

MODERN COMMISSIONS

8 The inclusion of allowances for interstate differences in wages has been one of the most contentious issues since the very first review of State relativities in 1981.

9 The general case for recognition of wage cost difference was initiated by New South Wales. It said the following.

> In order to provide a comparable standard of service and maintain equal efficiencies, governments must be able to recruit and retain comparably qualified and experienced employees. To do this requires that government wage and salary levels to be competitive with the private sector. Ample evidence exists to indicate that community wage levels in New South Wales are above the six State average…

10 Failure to allow for this wage price differential would be ignoring one of the major factors affecting relative costs, and would place high cost States in a position where the financial resources available to them would not permit them to provide a level of governmental services comparable to those of other States. (1981 Report Submissions, pg. 245-246)

11 New South Wales also noted in this submission the inconsistency between assessing a higher payroll tax capacity in States with high private sector wages, without assessing any flow on impact to the cost of providing government services in those States.

12 Other States generally rejected the New South Wales position. Queensland said there was no clear evidence that New South Wales wage levels were higher. Victoria argued that any differences were totally due to policy.

13 South Australia, on the other hand, accepted that rates of pay of government employees could not be allowed to slip behind the general standards of a particular community. However, it argued there were national markets for teachers and police and governments must match rates set in other States. In fact, it considered States to be market leaders not price takers. It said the higher rates of pay in New South Wales were due to a more permissive wage and salary policy rather than the difficulty in attracting employees. It noted the considerable element of discretion in wage policy evidenced by New South Wales agreeing in 1979 to increase wages for its rail employees, resulting in industrial disputes in other States until similar increases were granted. It also noted that many railway unions operated under Federal awards which did not differ between States. (July 1980 submission p52, 58-60)

14 Deliberations on this issue, and others in the context of the first comprehensive review of relativities, were influenced by several factors.

- The move to an equalisation system involving all States, where a higher grant to one because of a recognised disability meant lower grants to others, created a climate where all States would naturally seek to identify all the disabilities which would preserve or increase their grants and argue against disabilities which did not favour them. This differed from the special grant process, where the financial implications involved only the claimant State and the Commonwealth. The range of State views and the volume of supporting information increased the difficulty of discriminating between opposing analytical positions and deciding on appropriate disabilities to include in equalising payments.

- In the case of wages, the Commission also needed to move from a model where it compared one or two States to the standard States to one where it could form a view about the relative wages that all States would face, having adjusted for any policy influences that States might themselves exert. This was a quantum change in the analytical task before the Commission.

15 The Commission's consideration of this issue also occurred at a time when wage determination was heavily centralised through Federal and State Tribunals. States played a role influencing those Tribunals; for example, through the cases they presented when State Tribunals considered changes to State awards, including for private sector employees. (1995 Report on Research in Progress, Volume 2, p67)

16 The Commission decided not to make an adjustment to reflect the impact of differing community wage levels on the cost of delivering government services in the 1981 Review for two reasons:

- It was not satisfied that differences in community wages could be regarded as determined by influences beyond the control of State Governments.
- It was not satisfied that there was a close connection between the average wage in a State and the wages State Government had to pay.

17 It reached this decision when considering how to deal with public sector wages in State business undertakings, but its impact was carried over into the assessment of other service delivery costs.

18 In subsequent reviews, States continued to propose or oppose an adjustment for differences in State wage levels. By the 1993 Review, the analysis had become quite sophisticated, dealing with both the conceptual case for such an adjustment and how to construct an appropriate measure, should the Commission consider an adjustment was justified. Some States argued the attitude of governments, past and present, had an impact on current community wage levels. However, as this could not be measured and removed from observed differences, they considered it would not be equitable for the Commission to include such a disability. Further, some States noted that different industry mixes were an important influence on observed differences in average wages among States.

19 The key conceptual issues considered were the following.

- Whether after allowing for differences in factors like industry structure and the impact of State policy, there were any grounds to consider that community wages could differ, given the interstate mobility of labour.
- Whether States competed for labour in national or local labour markets. Where national markets operated, any observed wage differences would reflect policy choice, while local labour markets allowed for policy neutral wage differentials. State could have employees in a blend of local and national labour markets, depending on their occupational characteristics.
- Whether observed differences in nominal community wages reflected productivity differences, and if so whether those differences applied equally to public sector employees.
- Whether differences in average wages among States related to differences in industry structure or the skill composition of their workforces and the extent to which public sector wages in those States were affected.

20 In all cases, theoretical arguments were provided to support both sides of the question, supported by limited evidence. The Commission's deliberations were compounded by a secondary set of issues relating to how to construct a reliable policy neutral indicator of community wage levels. For example:

- Private sector data on relative wage levels could be contaminated by State policy in those occupations where States were the dominant employers; for example, teachers and nurses; or where for a particular State the public sector was a large employer relative to the private sector.
- As data for small States were based on survey information, they were inherently less reliable than for larger States, especially when disaggregated to allow for differences in economic structure.

21 The summary of State views at Attachment A, taken from the 1993 Report, shows the nature of State positions.

22 In the 1993 Review, the Commission agreed to the introduction of a wage input cost adjustment. It did so because it thought the change in economic and industrial relations circumstances since 1981 had ameliorated the concerns of previous Commissions.

23 In particular, the evolution of wage setting arrangements including the spread of enterprise bargaining, which reduced the role of State Tribunals and State Government dealings with them on private wage levels, had seen State Governments become as much price takers as price makers in relation to wages. They also considered that the available statistics on the private sector, though far from perfect, were policy free enough to allow at least for an indication of relative wage costs.

24 The Commission however was very cautious in its approach.

- It measured the differences in wage levels across States in the private sector, removing the impact of differences in occupational mix between States and sectors.
- To reflect concerns about the possibility of indirect policy influences on the data and about the quality of the data itself (for example, disaggregated data were not available to remove the impact of differences in skill levels among States on average wage levels among States) the Commission decided to scale back (or discount), round and cap measured difference in wages among the States before incorporating them into its estimates of the cost of service delivery.
- More importantly it sought to resolve some of the conceptual and statistical issues by embarking on a program of applied economic research on reasons for differences in wages. That work involved both the Commission's own staff analysis and a range of external academics working in the area of labour market economics. (Reports on Research in Progress, 1995 Volume 2, 1996, Volume 2)

25 That work produced a range of findings and conclusions which informed Commission thinking in the 1999 Review. Chief among them were the following.

- The presumption of unavoidable differences in wages and salaries among States was well grounded in economic theory.
- Differences in industry and occupational structure, skill endowment etc. explained a little more than half the observed differences in wages and salaries.
- Some of the differences in industry and occupational structure, skill endowment etc. may be relevant to fiscal equalisation and hence should not all be abstracted from the statistics to achieve interstate comparability.
- While a State-specific component of the opportunity cost to a worker of supplying labour is differences in housing costs, the evidence of a relationship between costs of living differentials, including housing costs, and differences in wage levels were not significant or integrated.
- Average wage levels in each State were strongly correlated with a State's average productivity, measured by average gross State product at factor cost per employee in selected industries.
- There was a link between private and public sector wages but no conclusive evidence of causality. The direct influence of State policies on the level of wages paid to their employees could probably best be avoided by basing a wages input cost factor on interstate differences in average wages per employee in the non-State sector.
- Because of the dominant employer effect, States have greater policy control over wages and salaries paid to teachers, nurses and police than other occupations but national benchmarking for salaries paid to these groups has not been implemented.

26 These findings and conclusions were used by the Commission in its deliberations in the 1999 Review. They were not universally accepted and States continued to express concerns at the conceptual validity of the assessment and its statistical reliability.

27 The Commission concluded that there were differences between the States in the general level of public sector wages and, to the extent that those differences were not the result of State policies, they should be reflected in the assessed disabilities. Thus, it assessed a disability based on interstate differences in average weekly earnings in the non-State sector which it considered were unaffected by State government policies and reflected the general levels of wages with which State governments compete. To improve the comparability of the data, average wages in the State were adjusted so that differences in occupational mix were removed and State average wages reflected the occupational mix of the average State public sector.

28 However, it decided to average the assessments over 10 years and halve measured interstate differences on the basis of judgment for two reasons.

- While it agreed that States compete in local markets, and the impact that different industry compositions and labour force characteristics had on average wages should be recognised in its assessments, it sought to moderate the impact of these differences in industry composition and labour force characteristics.
- It also wished to allow for variability and uncertainty in the data.

29 No capping or rounding was applied, as it had been in the 1993 Review, because the Commission considered that this could result in small changes in measured differences having a relatively large and uneven effect on State grants.

30 The Commission took the view that the wages factor was intended to reflect differences between States in the generally prevailing wage levels for similar occupations in the local markets where the States competed for the bulk of their employees. It said that, even in the professions of teaching, police and nursing, where State governments are the major employers, wage levels are still subject to broad market forces. Given the Australian industrial framework and the general absence of institutional barriers to labour mobility, it would be difficult for State governments to set wages for any professions without reference to the prevailing labour costs. Hence, it did not allow for any dominant employer effect and continued to apply the wages input cost factor in the education, health and police categories.

31 In the 2004 Review, the Commission continued to assess wage cost differentials but modified its conceptual approach and its estimation of policy neutral wage differentials.

32 It noted that the theory of labour market economics strongly supported the view that wages were influenced by features of the locations where work was performed (such as the cost of living and relative inherent attractions of the location), as well as by the

productive characteristics of employees. It concluded that the influence of those 'location effects' on wages was beyond the control of individual State governments and presented a strong conceptual case for the continued assessment of a wage cost disability.

33 While these location effects were always part of the observed difference in nominal wages between States used in earlier calculations, the shift in emphasis to this aspect of wage differentials at the expense of recognising the impact of local labour market factors such as industry composition marked a change in the approach of the Commission.

34 To test the theory, the Commission undertook extensive econometric analysis of the causes of wage differentials between States using data from the ABS Survey of Education and Training (SET) and had this work refereed by an independent expert. He confirmed that the theory on which the analysis was based and the technical specifications of the quantitative model used in it were sound.

35 The econometric analysis reinforced the view that after allowing for differences in industry composition, occupation and labour market characteristics there were ongoing regional wage differentials in non-State sector wages that were significantly different between States.

36 While this work showed that there were regional differences in non-State wage rates, how the Commission should use this in making an assessment of public sector wage costs was still the subject of differing State views. One view was that States were increasingly competing for staff from the same labour pool and that any wage differentials were rapidly disappearing, eroding any regional differences for this labour market sector. Another view was that there were material differences in wages between States and that these differences were not narrowing, even for occupations where States were the dominant employers. States that held this view argued that States compete for labour in their regional labour markets.

37 The Commission considered it had established a clear conceptual case for the wage cost disability and that the econometric analysis provided adequate empirical evidence of ongoing wage differentials between States. It used the results of the econometric analysis to quantify those wage differentials and to estimate disabilities. It made some judgment-based adjustments to the model; for example, to recognise the model understated the wage levels for the ACT (impact of Commonwealth wage levels not recognised) and Tasmania (impact of low labour mobility not recognised).

38 In the 2010 Review, the Commission indicated that it proposed to start with a clean slate for all assessments, including wage input costs, as part of the process of ensuring that assessments were as simple as possible, as directed by its terms of reference. The Commission therefore considered both the conceptual case for an

adjustment and, should an adjustment be warranted, the best way of determining its size and distribution.

39 The States continued to hold divergent views. New South Wales and the ACT argued they competed in the market for employees and that the observed differences were reflected in the wages they must pay their employees. However, other States (such as Queensland, South Australia and Tasmania) argued the Commission should not assess a disability because:

- there was no economic theory that would explain such differences in the medium or longer term
- the observed differences in wages arose because the methods used to measure them did not adequately compare like with like — for example, the processes did not appropriately control for all structural differences between the States, and
- differences in the public sector reflected policy choice, not an underlying disability, because State wage bargaining paid close attention to the wages paid in other States.

40 The Commission noted that some economic and labour market theories supported the view that the wages paid to comparable employees in competitive markets may vary as a result of features of the location where people work while others did not. Nevertheless, it noted that the analysis of data from the ABS Survey of Education and Training (SET), spanning some 12 years, consistently revealed correlated interstate differences in wage levels in both the private and public sectors, after removing the influence of differences in State industrial structure and employee characteristics, such as education and experience. It concluded that including an adjustment for wage input costs was appropriate.

41 Before deciding on an approach to estimate wage differentials, the Commission proposed two alternate approaches to the econometric approach developed in 2004:

- a geospatial model based on Australian Taxation Office tax data and the ABS Socio-Economic Index for Areas (SEIFA), or
- a Census data model based on average incomes cross classified by industry, occupation, qualification, and sector.

42 All States expressed a preference for the SET approach. States that did not accept the existence of a wages disability said that, if the Commission was to measure it, the econometric model approach based on SET was the better approach.

43 The Commission decided to retain the econometric model approach developed in 2004. It again engaged an independent expert to review State criticisms of the approach. He found no substantive issues with the model, noting it was consistent with other studies that attempt to model wages and that the technical specifications of the model, including the choice of variables, were appropriate.

44 The Commission made no changes to the wage input assessment in the 2015 Review because it occurred at a time when the ABS was changing the basis on which it provided the wages data used in the 2004 methodology and new data would not be available until the review had concluded. The Commission decided to revisit the assessment in the later part of 2015 when the new ABS data series would allow it to re-examine the relationship between public and private wage differentials. There was some evidence that the relationship between these had weakened in recent years and Queensland provided evidence in the course of the 2015 Review which lead that State to conclude that no significant statistical relationship between the two existed.

45 The box below summarises the main conceptual issues raised over the history of this assessment.

Box 1 Conceptual issues raised by States in relation to the wage cost assessment

Underlying economic theory. Queensland disputed whether comparable private sector employees would earn different amounts in different States. It considered that with free movement between States, wage levels should equalise. While it accepted that there were some circumstances where this may not occur, it did not consider that such circumstances apply in the Australian labour market.

National market. South Australia and Tasmania argued that public sector employees were recruited from a national pool, and that external pressures on their wages, if any, were national in nature and not particular to any one State. This implied that the observed wage differences resulted purely from policy choice on behalf of the States, and that therefore no assessment was required. In recent reviews, South Australia accepts the conceptual case of regional compensation differentials in certain situations, but not others. Tasmania continues to hold its original views.

Productivity. South Australia has also in recent reviews argued that differences in productivity between the workers in a State account for most or all of the observed differences in wages; effectively, all Australian workers are being paid commensurate with their individual productivity. South Australia therefore considers that the overall wage differential derived from the SET overstates the pure wage differential that the Commission is trying to capture. The Commission has expressed a low level of uncertainty around whether the econometric model controls for all relevant factors to an individual's wages, considering that this forms part of the case for the current 12.5% discount.

Segmented labour markets. Victoria and Queensland's concerns have largely been centred on the argument that parity with the private sector has not formed an explicit part of the wage setting process in any State. Rather, States' primary focus has been on the wages paid to comparable employees in other States, especially in an era of increasingly mobile workforces, and on their budgetary constraints.

Economic efficiency. Some States, again often led by Queensland, have argued that compensating States with high wages is slowing economic growth. States have argued that:

- If wage differentials reflect cost of living differences, in particular housing prices, it sees no justification for any 'compensation' to locals as that would represent a redistribution of wealth from taxpayers in low house price areas to those in high house price areas (Queensland, 1993 Review).
- The Albury-Wodonga situation (different wages paid by different public sectors in the same labour market) means that the New South Wales wage level is economically inefficient. This is something that the nation should aim to eliminate, rather than sustain by subsidising New South Wales (Queensland, 2010 submission).
- There is a potential grant design inefficiency whereby States which make a greater effort in keeping private sector wages low would be assessed as having greater relative input cost disability (South Australia 1993).

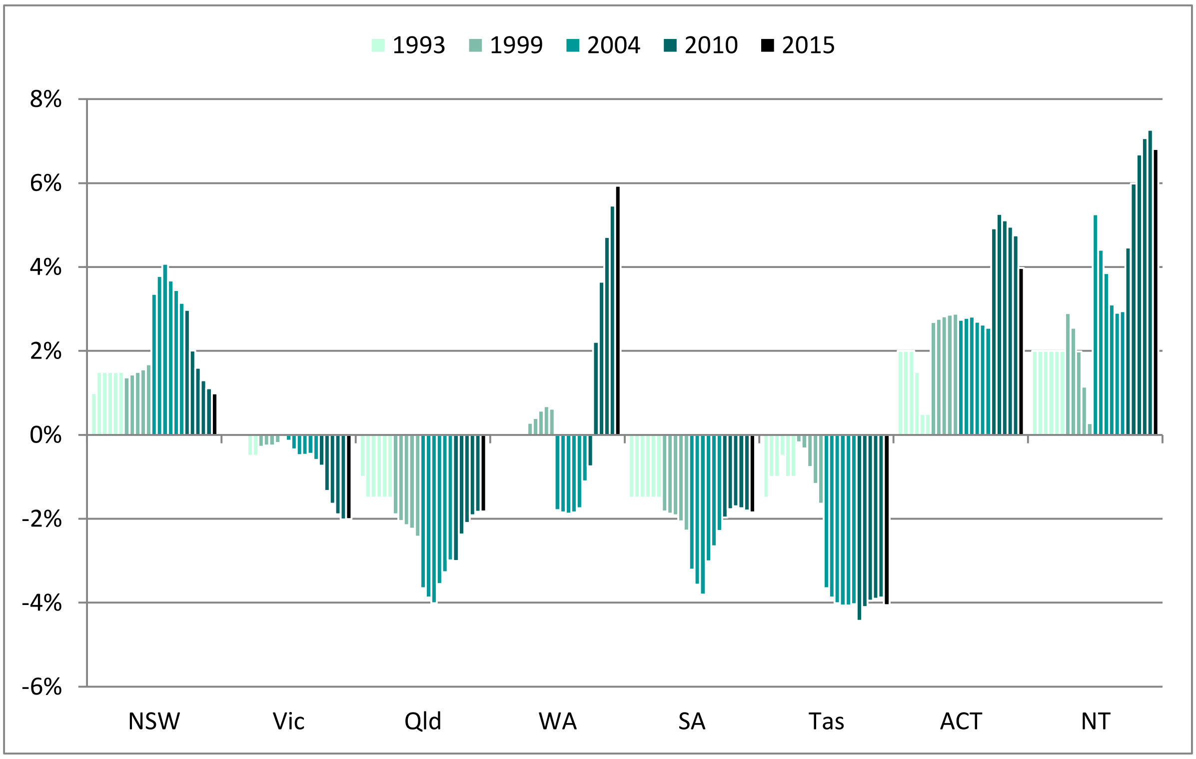
Convergence. Throughout the 20 year history of this debate, States fighting the assessment have frequently implied that while a disability may have existed historically, any differences in wages have now disappeared, as wage levels converge.

- The level of wages and salaries for the same jobs in different States will tend to converge. With enterprise bargaining policy differences will become more apparent (Queensland 1993).
- With teachers moving onto national awards along with nurses, there is likely to be a convergence of teachers' salaries between States as well (Tasmania 1999).
- Queensland disputes the reliability of the current assessment and considers there is no longer evidence indicating the assessment actually measures wage cost disabilities (Queensland 2015).

REDISTRIBUTIVE IMPACT OF ASSESSMENT

46 Figure 1 shows how the estimated State disability factors have changed over time. Since the introduction of the assessment, in 1993, New South Wales, the ACT and the Northern Territory have always been assessed as having above average wages. Victoria, Queensland, South Australia and Tasmania have always been assessed as having below average wages. Only Western Australia has changed direction, initially being slightly above average, then below, and more recently well above average as the flow-through impacts of a mining boom in that State became more evident.

Figure 1 Wage cost factors, 1993-2015



Source: Commission calculation.

47 Wages represent one of the State's largest recurrent expenses, and accordingly the wage costs factor impacts significantly on HFE. In the 2015 Review, the assessment was estimated to redistribute $1.3billion, around 2.3% of the pool.

THE MEASUREMENT APPROACH

48 Since acknowledging the existence of a wage costs disability, the Commission has sought to measure it using private (or non-State) wage levels after removing the effects of occupation (and other) differences in the structure of State labour forces.

49 The Commission applied two different approaches to do this. In the 1993 and 1999 Review periods, it used private sector Survey of Employee Earnings and Hours (SEEH) data standardised for eight occupations to estimate the level of private sector wages in each State if their employment structure matched that of the average of all States public sectors. This meant that occupations with low prevalence in the public sector had little impact on the wages assessment.

50 States repeatedly argued that the Commission should control for more than just occupation as 'interstate differences in average earnings by occupation may be due to differences between States in the average level of worker skills…' In the 2004 Review, the Commission developed a regression approach which, in addition to occupation, removed from observed wage differences the effects of qualifications,

age, sex, industry, education, experience and other employee characteristics known to influence wage levels. This approach measured the relative wage that would be paid to a national average profile private sector worker in each State.

51 The post-2004 approach attempted to measure the pure locational impact: the influence of State of residence in isolation on earnings. This is contrasted with the pre-2004 approach which also incorporated some element of the structural differences between the State economies.

Limits to the variation in wages

52 The Commission has considered at times that there are limits to how much a State's wage level can deviate from the national average. In the 1993 Review, after discounting and rounding, South Australia's wages were found to be 3% below average, and the ACT's 3% above. The Commission considered these estimates 'extreme'. This was in part acknowledgement of possible deficiencies in the data. These two States were given the wages of the next lowest or highest States (Tasmania 1.5% below) and the Northern Territory (2% above). In subsequent updates other States were constrained to these caps. These caps were removed in the 1999 Review, as the Commission considered they represented an instance of 'selective discounting'.

53 The Commission said that 'the State government has to attract interstate employees into the public sector if the State pool is inadequate in productivity terms. In this case, the proposed method will overestimate Tasmania's negative deviation from the Australian average.' . It made adjustments to their disability factors from 2004 to 2011. The Commission also made upward adjustments to the ACT factor for the same time period, in recognition of the role of the Australian Government in influencing wages, discussed below.

Discounting

54 The use of judgment in the wage costs assessment has always been a major issue. The Commission has over time reduced the discounts applied to the assessment as its level of uncertainty has fallen.

55 The initial assessment was subject to a 50% discount and caps on the wage costs factors, due to the Commission holding a number of concerns about policy neutrality, accuracy, data quality and the impact of the assessment. By 1999, the Commission was concerned by the asymmetry and arbitrariness of the capping, and discontinued the practice.

56 In 2004, in response to both a growing confidence in the conceptual case, and a more robust measurement of the disability, the Commission decreased the discount to 5% for the 1997 SET survey and 15% for the 2001 survey. The lower discount was applied

to the 1997 SET factors, as the Commission considered on the basis of the data that they were likely to be understating wage pressures and required a lower discount.

57 In the 2010 Review, the Commission introduced a standardised discounting framework, and decided wages disabilities had a low level of uncertainty over the accuracy of the wage costs assessment, discounting it by 12.5%. This was maintained in 2015, subject to a review deferred until new wages data are available.

Updating of the disability factors

58 The contemporaneity of the assessment has only really been an issue since the 2004 Review, as the SEEH data used prior to the regression model were available on an annual basis. The move to a regression modelling approach, however, meant that disability factors could only be calculated for some years, limited by the regularity of the ABS SET surveys. This led to the problem of what disabilities to apply in the intervening years.

59 At various times, the latest assessment years have been updated:

- by freezing the latest SET estimates. (2004-2007 inquiries)
- using a similar regression approach using the ABS Employee Earnings, Benefits and Trade Union Membership (EEBTUM) survey (2008 Update)
- using the ABS' Wage Price Index (WPI) (2009-2015 Inquiries).

60 While the EEBTUM approach is conceptually more appropriate than the WPI approach, the data quality is considerably worse.

61 In the 1998 Update, Queensland, Western Australia and the ACT supported the use of EEBTUM in updating the model, while other States were opposed. They cited the volatility of the data, and that the results for some States were not credible, as well as the complexity of splicing the SET and EEBTUM data together.

62 In the 2009 Update, the Commission considered that the labour markets of the States, in particular the mining States, were changing at a relatively rapid pace, and so some adjustment was required. The complexity and data reliability of the EEBTUM model meant that inaccuracy in that approach was likely to be greater than the conceptual inaccuracy associated with using WPI.

63 Queensland, South Australia and Tasmania considered that the conceptual differences between SET and the WPI meant that the WPI approach was inappropriate. Victoria, Western Australia, the ACT and the Northern Territory were not concerned by the conceptual differences between the SET and the WPI.

CONCLUSION

64 The Commission's assessment of wage input costs has evolved over the period since 1981 and three phases can be distinguished. See Attachment B.

- From 1981 to 1993 when no adjustment was made because the Commission considered State policies on wages to be the main determinant of wage differentials and because of concerns that the data available were not free of the influence of State policy.
- From 1993 to 2004, when an allowance was introduced because the Commission considered circumstances had changed and an extensive program of economic analysis, both theoretical and applied, was undertaken to support and improve its appropriateness.
- From 2004 to 2015, when a new method focused on locational influences on wages was utilised.

65 In reaching its decisions over this period, the Commission has had to consider the same series of sequential questions.

- Do States need to pay differential wages to provide the average level of services to their residents?
- If so, are variations in private sector wages among States the best guide to these unavoidable wage differences?
- What if any influences on average private sector wages should be removed from statistics to improve the usefulness of that indicator and how should that be done?

66 The position reached by the Commission on these questions has changed over time for the following reasons.

- State circumstances have changed. For example, the move to a less centralised wage fixation process saw the Commission change its position on whether differences in private wages were free of State policy influence.
- The Commission became better informed of the relative importance of some of the postulated drivers of public sector wages because analysis extended over a longer period of time and it initiated new research into this area of applied economics.
- The nature and quality of statistical data available changed, allowing for new analytical approached to be developed.

ATTACHMENT A: SUMMARY OF STATE VIEWS FROM THE 1993 REPORT

Those States which supported the introduction of a factor for wages and salaries costs believed that they were constrained to pay higher salaries to their employees because of the higher cost of living in those States and because the private sector in those States pays higher salaries to its employees.

New South Wales argued that the Commission's previous assessments were inconsistent. It pointed out that on the revenue side the Commission assessed it as having the capacity to raise higher per capita revenue from pay-roll tax collections due to its higher private sector wages but the Commission did not take into account the flow on effects to public sector wages. It suggested that disabilities could be assessed using private sector data as the non-policy variable.

Those States opposed to the introduction of this component argued that the basis of assessment was conceptually flawed, the source data were suspect (particularly in relation to the smaller States), and any disability could not be reliably estimated. Some thought that private sector salaries were not a suitable non-policy variable and that adjustments should be made to take account of differences in managerial and qualification mix. They believed that an allowance, if assessed, should not apply to occupations where a national benchmark operates or where there is an effective equivalence of salaries.

Queensland opposed the assessment of input cost factors. It argued that the basis of assessment was conceptually flawed. It rejected the assumption that private sector wages and salaries affected public sector wages and salaries. It believed that differences in house prices were not a basis for assessing wage and salary input costs disabilities. It argued that it was inappropriate to assess disabilities on this basis because it would represent a redistribution of wealth from taxpayers in low house price areas to those in high house price areas. It considered this to be inappropriate because mortgage payments were a means of asset acquisition and the wealth implicit in properties can be realised by their owners.

Queensland criticised the suggestion that private sector wages should be used as the non-policy variable. It argued that there was a segmented labour market between the private and public sectors, with some occupations being largely concentrated in the public sector (police, nurses and teachers), and this made the use of private sector data inappropriate. If private sector wages and salaries were to be used as the basis of this factor, the data should be disaggregated so as to ensure that we were comparing 'like occupations with like'. Using broad aggregated data would not take into account differences in the compositional mix of industry, occupation and qualification. Queensland also argued that, if disabilities were to be assessed, they should not be applied to occupations where uniform or national salaries presently exist.

Western Australia opposed the assessment of wage and salaries input cost disabilities based on private sector data as no account was taken of productivity differentials. It argued that an adjustment for differences in qualification mix should also be made. It believed that wage differentials have a minimal impact on interstate cost variations and pointed to the Commonwealth's decision not to offer differentiated regional wages for its employees as evidence of this contention. It argued that use of private sector data could reflect policy influences as States which emphasised the private sector role in providing services had higher private sector salaries.

While South Australia agreed in principle with the assessment of input costs differentials, it had reservations on whether disabilities could be assessed. It raised concerns about the relativities between States. It believed that adjustments should be made to take account of differences in composition and level of qualifications. It agreed with Queensland, saying that input costs should not be applied to occupations where uniform or national salaries presently exist or where the State Government is the dominant employer.

South Australia suggested that input costs factors should be separately derived for the major expenditure categories.

Tasmania did not accept that one jurisdiction had to offer higher remuneration to achieve the same standard of employee. It argued that it had to offer more because of the lower pool of qualified people in its State and because of the non-wage benefits of living in Sydney or Melbourne. It did not support the use of private sector data as the benchmark. It cited the effect of the number of higher-order executive and specialist positions in Sydney on that New South Wales data, particularly if broad aggregated data were used. It argued that the primary cause of private sector salary differentials was differences in qualifications.

The Northern Territory supported the assessment of input costs differentials and their application to a wider range of non-labour inputs.

ATTACHMENT B: WAGE COSTS ASSESSMENT HISTORY

Year	Scope	Basis for assessment	Updating	Discount	Smoothing	States affected by adjustments
1993	Private-sector	SEEH standardised for occ.	Annual assessment	50%		SA & ACT
1994	Private-sector	SEEH standardised for occ.	Annual assessment	50%		SA & NT
1995	Private-sector	SEEH standardised for occ.	Annual assessment	50%		Qld, SA, NT, ACT
1996	Private-sector	SEEH standardised for occ.	Annual assessment	50%		Qld, SA, NT
1997	Private-sector	SEEH standardised for occ.	Annual assessment	50%		Qld, SA, NT
1998	Private-sector	SEEH standardised for occ.	Annual assessment	50%		Qld, SA, NT
1999	Non-State sector	SEEH standardised for occ.	Annual assessment	50%	5 year	
2000	Non-State sector	SEEH standardised for occ.	Annual assessment	50%	5 year	
2001	Non-State sector	SEEH standardised for occ.	Annual assessment	50%	5 year	
2002	Non-State sector	SEEH standardised for occ.	Annual assessment	50%	5 year	
2003	Non-State sector	SEEH standardised for occ.	Annual assessment	50%	5 year	
2004	Private-sector	SET - econometric regression	Linear interpolation	5 & 15%		ACT & Tas
2005	Private-sector	SET - econometric regression	Linear interpolation	5 & 15%		ACT & Tas
2006	Private-sector	SET - econometric regression	Linear interpolation	5 & 15%		ACT & Tas
2007	Private-sector	SET - econometric regression	Linear interpolation	5 & 15%		ACT & Tas
2008	Private-sector	SET - econometric regression	EEBTUM 2004 & 06	15%		ACT & Tas
2009	Private-sector	SET - econometric regression	LPI	15%		ACT & Tas
2010	Private-sector	SET - econometric regression	LPI	12.5%		ACT & Tas
2011	Private-sector	SET - econometric regression	LPI	12.5%		
2012	Private-sector	SET - econometric regression	LPI	12.5%		
2013	Private-sector	SET - econometric regression	LPI	12.5%		
2014	Private-sector	SET - econometric regression	LPI	12.5%		
2015	Private-sector	SET - econometric regression	LPI	12.5%		
2016	Private-sector	CoE - econometric regression	Annual assessment			

Source: Commission Review Reports and Working Papers, 1981 – 2015