South Australian Treasury Staff Submission: ***2023 Update – Seeking state views on wages data***

We thank the Commission for engagement on this issue and appreciate the time constraints that the Commission are working within.

We note that given the time to review this matter, the views expressed reflect that of DTF staff only. It is not a formal South Australian DTF submission.

South Australia has longstanding concerns with the wage cost assessment, including the conceptual basis for the current assessment and more relevant to this issue, the increasing volatility of the underlying data in the wage cost model. These issues are not repeated in detail here given they are covered in previous submissions.

In terms of volatility, previous assessments have been impacted not just by the incorporation of new data into the assessment, but also revisions to prior year's data. South Australia's submission on the 2021 New Issues Paper covered this issue in some detail. The small sample size used in the regression model causes a number of these issues, which is particularly relevant for smaller jurisdictions and the potential options raised to address issues with the 2021 data.

The Commission staff paper notes that the 2021 wages data has introduced a higher level of variability in estimates, on average, than previous years. However, the average increase in variability between years appears to be primarily driven by an increase in variability for NSW. While that is the case, the level of variability in the 2021 data is only 3% for NSW (see figure 2 Absolute difference to previous year estimate), a level of variability between years that regularly occurs for a number of smaller jurisdictions. South Australia notes that previous concerns raised with the Commission about excessive volatility and inadequate sample sizes for smaller jurisdictions have not influenced a change in approach in recent Updates.

There are issues with each of the alternative approaches for the 2021 data that are raised in the Commission's Staff paper, and these are discussed further below. Given these issues and the limited time to appropriately review and consider the proposed changes, **South Australia's position is that the 2021 wage cost data should be incorporated into the regression model with no adjustment. If the Commission is concerned about the increased volatility, the discount applied to the assessment should be increased to reflect these concerns.**

Adoption of a higher discount does not change the underlying methodology of the assessment but does moderate the distributional impacts of the existing assessment approach to address the significant data uncertainty. While the application of a discount is usually considered as part of a methodology review, the application of a higher discount minimises changes to the current assessment approach and is a simple and transparent way of addressing the current data issue. The adoption of a different data source (ie a new measure of hours work) would represent a methodology change.

More broadly, this highlights the need to review the wage cost assessment as part of the 2025 Methodology Review. The review is the appropriate place to revisit the overall assessment, providing time for a complete assessment of alternative options and their conceptual validity, plus adequate time to test and review the results of any revised model.

Comments on each of the alternative options raised in the staff discussion paper are outlined below.

While South Australia does not support these alternative approaches, if the Commission is inclined to make an adjustment to the data, an amendment to the hours worked measure is preferred over the removal of respondents identified as having worked fewer than their usual hours. Any adjustment should only apply to the 2021 data.

Analysis of alternative options identified

Alternative measure of hours worked

The 2020 Review method uses "hours usually worked' as a predictor of wages in the regression model. The Commission Staff have identified an alternative measure of the hours worked, being the 'hours covered by the most recent payslip' as an alternative to the hours usually worked.

In general terms, this change in approach would be considered a method change as it is fundamentally changing how the assessment is undertaken.

Given the limited time to consider this issue, it is not possible to ensure that the proposed approach is conceptually valid and test that this isn't introducing alternative issues into the assessment.

It is also noted that introducing an alternative measure of hours worked for 2021 just increases the disconnect in the assessment between years. If this approach was adopted the 2023 Update it would essentially include:

- 2019 wages: 2020 Review method approach
- 2020 wages: adjusted to remove people receiving $750. This resulted in an approximate 6%[1] reduction in respondents/sample size. Considerably shrinking an already small sample
- 2021 wages: based on an alternative method of hours worked in the regression

Applying a higher discount overall would be preferable to these ad hoc adjustments that vary between years and would be more consistent with not changing the underlying methodology between Reviews.

Adjust the data to remove identified responses

An alternative option raised is removing the 12%[2] of private sector employees who worked fewer than their usual hours because there was no work, not enough work, they were stood down, or 'other reasons'.

There is already significant within year variability in the wages assessment particularly for smaller jurisdictions. This is primarily due to the small sample size of the underlying Characteristics of Employment Survey assessment data. The ABS already cautions the use of this data at a state level due to high sampling error. Excluding 12% of the sample from the analysis will potentially compound these existing issues.

It is also noted that the proposal would remove all respondents identified in the proposed categories. There are a baseline of people work fewer than usual hours for these reasons each year not related to COVID-19. By removing all respondents within these categories, you are potentially biasing results.

[1] *2022 Update New Issues: Staff Discussion Paper CGC 2021-01-S*, pg 12.
[2] *2023 Update – seeking state views on wages data*