AUSTRALIAN GOVERNMENT EXECUTIVE REMUNERATION

SUBMISSION TO SENATE EDUCATION AND EMPLOYMENT COMMITTEE INQUIRY

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Overview

The Public Governance, Performance and Accountability Amendment (Executive Remuneration) Bill 2017, introduced in the Senate in November 2017, proposes setting a 'remuneration cap' for 'senior executives' by both Commonwealth entities and Commonwealth companies. The remuneration cap would be equivalent to five times Average Weekly Earnings.

This submission opposes such a blunt instrument to constrain the distribution of remuneration paid by Commonwealth entities and companies. Nonetheless, it questions the way remuneration of executives is now set and whether the current approach may lead to the remuneration of some executives exceeding what is required to attract and retain the skills and experience the Australian Government needs.

The Remuneration Tribunal was established to de-politicise the fixing of remuneration for a range of senior executives and to get away from the appearance of politicians and senior officials helping themselves. In fact, political pressures had long unreasonably constrained senior executive remuneration within the Commonwealth public sector. The Tribunal was intended to ensure an independent and expert approach to assessing the remuneration appropriate to the work involved and the skills and experience needed. The report of the Priestley Royal Commission into the Civil Service in the UK in the 1950s provided a long accepted framework for setting remuneration in the public sector, with the primary principle being 'a fair comparison with the current remuneration of outside staff employed on broadly comparable work'. It also advised that account be taken of internal relativities, both horizontal and vertical, where outside comparisons could not readily be made. The Royal Commission's approach aimed to balance the interests of the community in general, those responsible for administering the civil service and individual civil servants.

The underlying objective should be the attraction and retention (and development) of people with the skills and experience required for a high performing public sector. This was a key point in my previous submission to a Senate inquiry into Australian Public Service enterprise bargaining.

Unfortunately, in its more recent determinations, the Remuneration Tribunal has given too much weight in my view to private market comparisons which are not particularly relevant or involve comparable work, and insufficient weight to remuneration in the State public sector which is more clearly relevant and with which the Commonwealth is increasingly linked including through executive movements. Given increasing community unease about the remuneration of some senior executives in the private sector, both in Australia and internationally, linking Commonwealth senior executive remuneration to that of senior executives in the top Australian companies also undermines the very purpose of the Tribunal to de-politicise the process as evidenced by this proposed legislation.

The Tribunal's approach has also led to pay differentiations that are not consistent with the way the public sector operates and how senior executives are allocated to their offices. In part, this is the result of successive governments inappropriately applying private sector practices to the appointment of secretaries.

Remuneration of SES officers in the Australian Public Service is outside the scope of the Remuneration Tribunal, but has rightly been the subject of Tribunal criticism. Much firmer action is required to control the way SES remuneration is set, and to ensure a consistent 'one-APS' approach.

While I have not included any recommendations regarding the remuneration of senior executives in Commonwealth companies, I note the responsibility of boards to ensure independent assessment of remuneration, and the capacity of the shareholder ministers to give some guidance to boards regarding the exercise of their responsibilities. This is consistent with the approach recommended by the Productivity Commission in its 2010 report on Executive Remuneration in Australia.

Recommendations

1. The Committee not support the PGPA Amendment (Executive Remuneration) Bill or its proposed 'remuneration cap' for senior executives in the Commonwealth public sector.
2. The Committee endorse the role of the Remuneration Tribunal to set remuneration for selected senior executive positions independently of the political process.
3. The Committee note the long-standing expert view that remuneration policy be based on a reasonable relationship with the relevant market comparable work, and proper and workable internal relativities; the key objective is the attraction, retention and development of people with the skills and experience needed for a high performing public sector.
4. The Government ask the Remuneration Tribunal to reconsider remuneration for secretaries based primarily on relevant comparisons with State public services, with much less weight given to private sector practice.
5. The Government also ask the Remuneration Tribunal to reconsider the differentiations it now makes between secretaries to ensure any such differentiation takes fully into account the way the Commonwealth administration actually works.
6. The composition of the Remuneration Tribunal include members with significant public sector management experience.
7. Further consideration be given to the processes for appointment and termination of secretaries to place more emphasis on merit and less on political considerations noting that this would reduce the risk of loss of tenure and the compensation required in recognition of that risk.
8. Control of SES remuneration in the Australian Public Service be strengthened, and a consistent whole-of-APS framework be re-established.

Secretaries Remuneration

It is more than 20 years since secretaries remuneration was at around the Bill's proposed cap of five times AWE. In 1994, a 20% loading was provided to secretaries in compensation for the loss of tenure resulting from the introduction of fixed term contracts. Since then, secretaries' total remuneration has generally exceeded six times AWE, with further increases with the introduction of performance bonuses in the late 1990s (later absorbed back into the basic remuneration) and, more significantly, following a major review by the Remuneration Tribunal in late 2010 (see Table 1).

Table 1: Secretaries' Total Remuneration relative to AWE

	Level 1 $pa	**Level 2** ($pa)	**Level 1** (times AWE)	**Level 2** (times AWE)
1998	248,130	233,968	6.6	6.2
1999	276,000	258,000	7.1	6.6
2000	305,000	285,000	7.5	7.0
2010	503,220	470,790	7.7	7.2
2011	612,500-620,000	570,000-575,000	9.0-9.1	8.4-8.5
2014	698,880-802,820	649,280-691,200	9.2-10.6	8.6-9.1
2017	745,770-878,940	692,500-745,770	9.3-10.9	8.6-9.3

While both sides of politics continue to support fixed term appointments of secretaries determined by the Prime Minister (albeit after a report from the Secretary of the Department of Prime Minister and Cabinet in consultation with the Australian Public Service Commissioner), there is in fact a strong case for a less political process. The New Zealand practice is for appointments by the State Services Commissioner after consultation with the Prime Minister. Fixed term appointments are still used but terminations, like appointments, are the responsibility of the Commissioner, largely removing political factors from the assessments and providing greater security of tenure (subject still to performance as assessed by the Commissioner). Such an arrangement might well allow some curtailment of the 20% loading that has applied to secretaries' remuneration since 1994. Alternatively, the fixed terms could be removed or a presumption of re-appointment at the end of a term introduced (similar to the sensible presumption of five years - rather than the more common three years under the Howard Government - that came in from 2008 and since set in legislation). All these options would give more emphasis to merit, reduce the risk of political chicanery, and provide greater security of tenure allowing the 20% loading to be reduced (but perhaps not entirely removed, given the remaining added employment risk over that faced by other APS employees).

As revealed in Table 1, the greatest increases have taken place since the major review by the Remuneration Tribunal in 2010. That review recommended the phasing in of new remuneration arrangements between 2011 and 2014, sharply increasing pay and differentiating much more firmly between different secretary positions. Special Level 1 rates were introduced for the Secretary of PM&C and the Treasury Secretary, and a number of secretaries were added to the Level 1 group. Differentiation within Levels 1 and 2 was also introduced based on assessments of work value.

The review drew heavily on a report commissioned from Egan and Associates (the Egan Report), that highlighted the much faster increase in private sector executive remuneration over the previous decade (around 360% in the top 20 firms) than experienced by secretaries (which at around 100% had broadly been in line with AWE as confirmed by Table 1 above). The Tribunal in its own report drew attention to its 'consistent view' that 'while movements in senior executive remuneration in the private sector are relevant, they are not the key determinants of the remuneration of public offices'. But it is hard not to see its recommendations as other than being strongly influenced by the Egan Report's comparisons with the private sector and its recommendation to peg secretaries remuneration at the second level in Australia's top companies. Yet the Egan Report notes that only three appointments to secretary offices in the previous fifteen years came from outside the government sector. While the Tribunal may be right that 'it would be to the disadvantage of

government were the remuneration of senior offices to lose touch with developments in remuneration more generally', this might have been more properly achieved by a much more focussed market comparison, concentrating on public sector and related executive remuneration.

Such a market comparison would include in particular State and Territory public sector remuneration given not only the similarity of much of the work but also the increasing mobility of senior executives across these public sectors. This market comparison may indirectly encompass influence from private sector practice to the extent that State and Territory practice takes into account more frequent movement of executives between public enterprises (where comparisons with the private sector may well be relevant) and the public service.

The Egan Report, and the Tribunal's own report, do canvass other more relevant comparators, including the remuneration of other Commonwealth entities within the portfolios managed by secretaries, and the remuneration of SES officers in the APS (secretaries' direct reports). In both cases, however, there are reasons for much caution given the weaknesses in the way those comparators' remuneration levels are set. The decision nearly thirty years ago to set the Reserve Bank Governor's remuneration more closely to that of private bank's CEOs disregarded the fact that no Governor had been appointed from outside the Bank itself or the Treasury; that remains the case. While subsequently some Treasury Secretaries and Governors have moved on to become bank CEOs, there is little evidence that this has affected attraction or retention of suitable people as Governors (though it is now impossible to determine the counterfactual had the Governor's remuneration not been so greatly increased). Understandably, however, remuneration of the Treasury Secretary must take into account the Governor's remuneration given the mobility between the two organisations and their close working relationship.

The Egan Report draws attention to some narrowing of the gap between SES Band 3 remuneration and Secretaries' remuneration. As shown further below, however, proper control of SES remuneration has been absent now for twenty years and SES Band 3 remuneration varies within the APS by more than 20%. The average, however, has not grown much faster than AWE. Moreover, the gap between the average Band 3 remuneration and the lowest of the Level 2 secretary remuneration is now over 60%, a gap that may apply at times in the private sector but is probably far greater than ever applied in the public sector.

More generally, remuneration of senior executives needs to take into account internal relativities and cultures as well as relevant market comparisons. Notwithstanding the Tribunal's effort to gain useful perspectives on the role of departmental secretaries from a former Secretary of the Department of Defence (Ric Smith), and factual background from the then Public Service Commissioner and Department of Finance, it does not seem to have given sufficient weight to the way the public service operates. It refers to the 'prestige' of high public service, but not to the much broader and widely researched notion of 'public service motivation' and a culture that inevitably emphasises service, public goods and equity. These all may moderate the need for remuneration to follow private sector practice, albeit that it is essential to attract and retain the best and the brightest.

More specifically, the attempt to distinguish work value amongst different secretary offices takes insufficient account of how those offices are structured and how appointments are made. Administrative Arrangements Orders are made by the Prime Minister frequently, at least once every term of government office, reflecting the Government's prevailing policy priorities and other political factors. Secretary positions are rarely filled in isolation, but mostly in some reshuffle, often linked to a new AAO and changes in ministerial appointments. Trying to apply through some

independent, expert assessment the 'value' of each position that emerges from these processes is essentially an artifice as most positions are effectively equal and the people involved regularly move from one to another. In any case, 'work value' in this context is a very difficult concept, and certainly not dependent on the departmental budget or staffing level. As Smith emphasises, policy advising responsibility can be very substantial. A highly competent secretary may also succeed in making an apparently lesser office more effective and influential across government and a less competent secretary may cause an apparently greater office to be less effective and influential.

Perhaps this issue is best illustrated by my own career experience:

- I was first appointed as secretary to the then Department of Arts and Administrative Services in late 1993;
- Within two months, the Arts component of the portfolio moved to the Department of Communications (becoming the Department of Communications and the Arts);
- Early in 1994 I was transferred to the new Department of Housing and Regional Development, whose responsibilities had previously been within the Department of Health and Community Services: my new department had a fraction of the responsibilities of the previous department, but was held to be of such importance politically that the Deputy Prime Minister was my portfolio minister;
- In 1996, following the election of the Howard Government, the Department of Housing and Regional Development was abolished with its responsibilities scattered amongst no fewer than five other portfolios. I was appointed secretary of the new Department of Health and Family Services;
- In 1998, following an election, my department lost responsibility for children's services and services for people with a disability (including the Commonwealth Rehabilitation Service), and was renamed the Department of Health and Aged Care;
- In 2000, the department was renamed again, this time the Department of Health and Ageing, with the same program responsibilities but additional policy responsibilities including the impact of Australia's ageing population;
- In 2001 after another election, Prime Minister Howard issued substantial new Administrative Arrangements Orders with associated changes in appointments of many secretaries and equivalent positions. I was appointed Public Service Commissioner, taking that office in January 2002.

Over my twelve years as a secretary or equivalent, I had seven different sets of responsibilities, with each new set associated with some wider AAO change. That experience was by no means unique: indeed, it remains illustrative of common practice today.

It would have been totally impractical for the Tribunal to reassess the 'work value' of my responsibilities with each of these moves, and that of all the other changes taking place at each of these points. And it is hard to believe that any such assessment could have properly reflected the responsibilities as seen by the government-of-the-day.

Moreover, the Tribunal's approach of setting so many different levels of remuneration can only present a further challenge for the Prime Minister and his advisers (the Secretary of PM&C and the APS Commissioner) when making the relevant secretary appointments. The Tribunal's approach, rather than responding to the decisions of government and ensuring remuneration reflects secretary responsibilities, imposes an additional consideration: should this secretary be 'promoted' or should that one be 'demoted', when what they are simply trying to do is to appoint people (including by transfer) to the most appropriate positions. A recent column by experienced public service observer,

Verona Burgess, highlights the point in its reporting of a new 'pecking order' (*The Mandarin*, 19 December 2017). I should be very surprised if the Secretary of PM&C endorsed her 'pecking order' even though it is based directly on the Tribunal's remuneration determinations.

Looking at the way the Commonwealth Government actually operates, far fewer distinctions than now made by the Tribunal can be made with any reliability. The added whole-of-government responsibilities of the Secretary of PM&C and the Treasury Secretary may be clearly evident and, in terms of long-term practice, it is rare that the Defence Secretary is not someone with prior secretary experience, signifying a seniority over most other secretaries. It is hard to be firm about differences in work value of other portfolio secretaries – all serve a Cabinet Minister (or two) and have portfolio-wide responsibilities as well as departmental responsibilities. There are dangers in emphasising those at the centre (such as Finance) over those implementing major programs, as demonstrated by the management reforms in the 1980s which removed the pay difference for SES in central and line agencies. In any case, mobility across departments can be important, and is in fact highly common practice amongst secretaries. There may be a case for a secretary who is not a portfolio secretary to receive lower remuneration (e.g. Secretary of the Department of Veterans Affairs), though even that distinction may not always be sufficient a difference to justify a difference in remuneration (e.g. Secretary of Human Services who now has direct management responsibility for Centrelink and Medicare Australia, each previously headed by a secretary-level officer). The Tribunal might take into account the Priestley Royal Commission's view that no attempt should be made to mark minor differences in the content of work.

The Tribunal's limited understanding of the public sector suggests the need for change in its membership. For many years now members have had an almost exclusively private sector background. Surely some public sector experience and expertise is required.

Senior Executive Service

Controls over the SES in the APS were phased out in the late 1990s, firstly by allowing agency heads to create positions and to make appointments (the latter subject to 'certification' by the Public Service Commissioner) and then by allowing agency heads to set pay and conditions (through Australian Workplace Agreements until these were abolished in 2008, and subject only to broad remuneration policies managed by the Department of Employment until the APSC took over responsibility in 2008).

In the 1980s and early 1990s there were tight controls over both numbers and pay, as well as over appointments. Indeed, for some time the Department of Finance used 'SES budgets' that required agencies to reduce SES numbers if they wished to increase SES pay to the levels then applying in central agencies. Since 2000, however, both numbers and pay have increased, and variations in remuneration have become wide.

Table 2: SES Numbers

	2000	**2017**
SES Band 1	1147	1982
SES Band 2	350	560
SES Band 3	103	124
Total	1600	2666
Total as % of APS	1.3%	1.8%

Table 3: SES Total Remuneration

	2000 ($)	2000 (times AWE)	2016 P5($)	2016 P95($)	2016 Average ($)	2016 Average (times AWE)
Band `1	135,962	3.3	212,898	275,113	243,395	3.1
Band 2	166,043	4.1	274,072	353,399	311,803	4.0
Band 3	205,559	5.0	346,003	475,575	419,229	5.3

The increase in numbers shown in Table 2 arguably understate the longer-term shift in the upper levels of the APS structure over decades. The number of Band 3 equivalent staff in 1974 was 20, when the APS (then including the PMG) had 267,000 employees.

The Remuneration Tribunal has rightly been critical of the way SES remuneration has been set in the APS over the last two decades. While the APSC has been trying to impose more consistent discipline over classification standards and the setting of SES pay, it is evident that more action is still needed to regain proper control. While the average total remuneration levels have stayed reasonably steady relative to AWE, the numbers of SES have grown suggesting the average level of responsibility, or work value, has probably decreased, a point made implicitly in Ric Smith's contribution to the Remuneration Tribunal's review of secretaries remuneration.

The pressure on secretaries' remuneration referred to by the Tribunal is only clear if considering the pay levels above the average (some of which, of course, exceed those shown above for the 95th percentile), and/or by ignoring the implicit reduction in SES work value.

The pay variations run directly counter to the demands of various APS reviews for increased mobility in the APS (e.g. the 2010 Moran Report) and a stronger 'one-APS focus. Indeed, there is every reason to suspect that some of the variations are the result of agencies trying to coerce their SES to stay rather than move.

Principal Executive Officers

The proposed legislation includes some exemptions from the remuneration cap, including judges and the Governor General. The rationale for this is not clear. Leaving aside the unique position of the Governor General, the basic principle applying to all senior executive positions including principal executive offices should be the same – to use a fair comparison with others doing comparable work – with the objective of ensuring attraction and retention of the best people to the offices concerned. Central to meeting this principle is to offer remuneration consistent with the relevant market practice. In a number of areas, that market is a highly specialist one so that the remuneration required may vary significantly from that of offices with arguably equal or greater management or policy responsibilities. That may well be the case in the legal profession, and has been the case at times in other fields such as accounting and actuarial skills.

Comparisons with the private sector is also entirely appropriate in the case for the heads of the ACCC, ASIC and APRA, who are frequently appointed from the private sector.

Notwithstanding the portfolio responsibilities of most secretaries, however, it is not necessarily the case that they receive higher remuneration than any of the principal executive offices in their portfolio. That might be arguable if there was evidence of movements between the principal executive offices and the secretary positions, but that is not the case with the heads of the ACCC, ASIC or APRA.

Senior Executives of Commonwealth Companies

Since the Walsh reforms in the 1980s, Commonwealth Government Business Enterprises (GBEs, or companies) have had governance arrangements based on corporations law. Boards have been given considerable authority to oversee management of the GBEs including the setting of executive remuneration, subject to accountability for the GBEs' performance and the strategic direction agreed by the shareholder ministers. The commercial nature of the businesses requires boards to have regard for the relevant private market practice in setting the remuneration of senior executives, to ensure they can attract and retain the skills and experience required.

It is true, however, that some private practice has not only been out of keeping with public expectations but has also been the result of insufficiently careful assessments by the boards concerned including because of conflicts of interest and insufficient consideration of shareholder interests. This was the subject of a Productivity Commission inquiry in 2010. The Commission found that much of the relative increase in private sector executive remuneration was the result of legitimate market pressures including from globalisation, but that there were also other contributors including inadequate governance. The Commission recommended closer scrutiny by boards including through more independent assessments, more careful design of performance rewards and termination payments, and greater capacity for shareholders to have a say.

The public, as the real shareholders of Commonwealth companies, should also have some say over the remuneration of executives in Commonwealth companies, but not via such a crude instrument as a remuneration cap. That would only put at risk the shareholder value of the companies. More consistent with the Productivity Commission recommendations is to require boards to pursue careful and independent assessment through an appropriately formed remuneration committee using qualified expert advice, and to be guided by the shareholder ministers in some broad fashion (e.g that remuneration of executives not be pace-making and not be amongst the highest in the relevant private sector comparisons).