Industrial Relations Commission of
New South Wales

Case Title:	Re Crown Employees Wages Staff (Rates of Pay) Award 2011 & Ors (No 3)
Medium Neutral Citation:	[2013] NSWIRComm 109
Hearing Date(s):	13 and 28 November 2013
Decision Date:	17 December 2013
Jurisdiction:	Industrial Relations Commission of New South Wales
Before:	Boland J, President
Decision:	The awards that are the subject of these proceedings are to be varied to provide for an increase in wages and relevant allowances by 2.5 per cent from the beginning of the first pay period to commence on or after 1 July 2013.
Catchwords:	AWARDS - Claim by Secretary of Treasury as nominal employer of public sector employees that any wage adjustment to public sector awards from 1 July 2013 should be 2.27 per cent and not 2.5 per cent - Whether public interest, economic and fiscal considerations justified Secretary's claim - STATUTORY INTERPRETATION - Whether ss 10, 17(3)(d) and s 146(2) of Industrial Relations Act 1996 were displaced or qualified by s 146C of that Act and the Industrial Relations (Public Sector Conditions of Employment) Regulation 2011
Legislation Cited:	Fair Work Act 2009 (Cth) Industrial Relations Act 1996 Industrial Relations (Public Sector Conditions of Employment) Regulation 2011
Cases Cited:	Annual Wage Review 2011-2012 [2012] FWCFB 5000

	Annual Wage Review 2012-2013 [2013] FWCFB 4000 Australian Education Union v Department of Education and Children's Services [2012] HCA 3; (2012) 285 ALR 27 Board of Bendigo Regional Institute of Technical and Further Education v Barclay [2012] HCA 32; (2012) 220 IR 445 Bolton & Others; Ex parte Beane, Re [1987] HCA 12; (1987) 162 CLR 514 Broken Hill Commerce and Industry Consent Award (No 2) Re [2002] NSWIRComm 309 Byrne v Australian Airlines Limited [1995] HCA 24; (1995) 185 CLR 410 Certain Lloyd's Underwriters Subscribing to Contract No IH00AAQS v Thelander [2012] HCA 56; (2012) 293 ALR 412 Crown Employees (Police Officers - 2009) Award (No 2) [2012] NSWIRComm 104 Crown Employees (Public Sector - Salaries 2008) Award, Re [2012] NSWIRComm 70 Crown Employees (Teachers in Schools and TAFE and Related Employees) Salaries and Conditions Award (No 3), Re [2004] NSWIRComm 134; (2004) 133 IR 254 Crown Employees Wages Staff (Rates of Pay) Award 2011 & Ors, Re [2013] NSWIRComm 53 Crown Employees Wages Staff (Rates of Pay) Award 2011 & Ors (No 2), Re [2013] NSWIRComm 76 Farah Constructions Pty Ltd v Say-Dee Pty Ltd [2007] HCA 22; (2007) 230 CLR 89 Harrison v Melhem [2008] NSWCA 67 Public Hospital Nurses (State) Award (No 4), Re [2003] NSWIRComm 442; (2003) 131 IR 17 Public Service Association and Professional Officers' Association Amalgamated [Union] of NSW v Director of Public Employment [2012] HCA 58; (2012) 293 ALR 450 Quinn v Leatham [1901] AC 495
Texts Cited:	
Category:	Principal judgment
Parties and Intervenors:	Australian Manufacturing Workers' Union

("AMWU")
Australian Salaried Medical Officers' Federation (New South Wales) ("ASMOF")
Australian Workers Union NSW Branch ("AWU")
Construction, Forestry, Mining and Energy Union (New South Wales Branch) ("CFMEU")
Electrical Trades Union, NSW Branch ("ETU")
Fire Brigade Employees Union ("FBEU")
Health Services Union NSW ("HSU")
Landcom
NSW Ministry of Health
NSW Nurses and Midwives Association
NSW Teachers Federation
Public Service Association and Professional Officers' Association Amalgamated Union of New South Wales ("PSA")
Secretary of the Treasury
The Association of Professional Engineers, Scientists and Managers, Australia (NSW Branch) ("APESMA")
Transport Workers' Union of New South Wales ("TWU")
Unions NSW
United Services Union ("USU")
United Voice

Representation	
- Counsel:	Mr S Crawshaw SC with Mr M Gibian of counsel for PSA in all matters Mr J Nolan of counsel for Unions NSW, ASMOF, APESMA, CFMEU, ETU, FBEU, HSU, NSW Teachers Federation, TWU, AWU, USU, United Voice Mr P Kite, SC with Mr A Britt of counsel for the Secretary of the Treasury
- Solicitors/ Representatives:	Mr N Keats for W G McNally for Public Service Association and Professional Officers' Association Amalgamated Union of New South Wales Mr T Craft for Director General, NSW Ministry of Health Mr D Lloyd for Landcom Ms C McGuigan for Roads and Maritime Services

Mr J Lavelle-Wilson for Australian Manufacturing Workers' Union
Mr M Wright for NSW Nurses and Midwives Association

File number(s): IRC Matters 256, 257, 259 - 263, 342, 324, 325, 352, 357, 367- 387, 401, 403 - 406, 452, 453, 591, 737, 738 of 2013

Publication Restriction:

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DECISION

1 This decision concerns the amount of increase that may properly be awarded by the Commission in salaries and allowances in public sector awards from 1 July 2013 to apply for a period of 12 months. The matter arises because the Secretary of the Treasury ("the Secretary"), on economic and fiscal grounds, opposes any increase to award rates of pay beyond 2.27 per cent, whereas public sector unions claim the increase should be 2.5 per cent in accordance with what they contend is available to be awarded under s 146C of the *Industrial Relations Act* 1996 ("the Act") and the Industrial Relations (Public Sector Conditions of Employment) Regulation 2011 ("the Regulation").

Background

2 The background to these matters is set out in *Re Crown Employees Wages Staff (Rates of Pay) Award 2011 & Ors (No 2)* [2013] NSWIRComm 76 (*"Crown Employees (No 2)"*), a decision given on 6 September 2013. Briefly, in *Re Crown Employees Wages Staff (Rates of Pay) Award 2011 & Ors* [2013] NSWIRComm 53 ("*Crown Employees (No 1)*") the Full Bench of the Commission rejected the contentions of the Secretary that the 2.5 per cent per annum increase allowable under the Regulation was to be discounted by the 0.25 per cent increase in superannuation contributions under Commonwealth legislation effective from 1 July 2013.

3 Following that decision of the Full Bench, the Regulation was amended by the Government to require the Commission, in making awards and orders under the Act, to take into account increases in superannuation contributions promulgated by federal legislation.

4 As noted in *Crown Employees (No 2)*, following the amendment, negotiations occurred between the industrial parties as to what was the

appropriate amount by which rates and allowances should be adjusted in light of the amended Regulation. It was agreed the amount was 2.27 per cent and, accordingly, the parties began the process of amending the unions' original applications to vary to substitute 2.27 per cent for 2.5 per cent. It had been agreed that the increase would operate from 1 July 2013.

5 However, on 21 August 2013 the Legislative Council disallowed the amended Regulation, which meant that the Regulation was restored. That is, inter alia, an increase in rates of pay and allowances of not more than 2.5 per cent per annum was available to be included in awards, agreements and determinations in the public sector.

6 In *Crown Employees (No 2)* the Commission referred to the developments that then followed:

> [5] On 6 September 2013, union parties, led by the Public Service Association and Professional Officers' Association Amalgamated Union of New South Wales ("the PSA"), pressed the Commission to vary the awards that are the subject of the proceedings by increasing rates and allowances by 2.5 per cent. The Secretary, as the employer of staff in the public service for the purposes of industrial proceedings, opposed the course proposed by the PSA and other unions.
>
> [6] The Secretary submitted that he should be given an opportunity in proceedings to present a case based on budgetary and economic considerations that any increase beyond 2.27 per cent was not sustainable. Reference was made to an affidavit of Maryanne Mrakovcic, Associate Secretary, Fiscal and Economic Group with the NSW Treasury that had been filed on 5 September 2013. It was indicated that Ms Mrakovcic's affidavit would constitute the Secretary's evidence in the proceedings.

7 In deciding to provide the Secretary with the opportunity of making out his case for an increase of only 2.27 per cent, the Commission stated:

> [9] Notwithstanding the unions' understandable concern at the Secretary's shifting position, it seems to me he has to be given the opportunity to present his economic and budgetary case opposing the 2.5 per cent increase. The *Industrial Relations Act* requires the Commission to take into account the public interest in the exercise of its functions and, for that purpose, must have regard to the state of the economy of New South Wales and the likely effect of its

decisions on that economy (s 146(2)). If the employer of public sector employees has submitted, as he has, that an increase of 2.5 per cent is not sustainable without negative consequences for, inter alia, the budget and employment and wishes to present evidence and make submissions in that respect, he cannot be denied that opportunity.

[10] However, the view I take in light of s 146C and the Regulation is that *prima facie*, an increase of 2.5 per cent per annum is available to public sector employees and the onus is on those parties opposing such an increase to show why a lesser amount is warranted.

Directions were made for the filing and serving of evidence and the matter listed for hearing.

Legislative Context

8 The legislative context in which the decision in this matter is required to be made is the Act and specifically ss 10, 17(3)(d), 146(2) and 146C and the Regulation, in particular cl 6. Those provisions are, respectively, in the following terms:

(A) Industrial Relations Act 1996

...

10 Commission may make awards

The Commission may make an award in accordance with this Act setting fair and reasonable conditions of employment for employees.

...

17 Variation or rescission of award

...

3) An award may be varied or rescinded in any of the following circumstances only:

...

d) after its nominal term if the Commission considers that it is not contrary to the public interest to do so.

...

146 General functions of Commission

...

2) The Commission must take into account the public interest in the exercise of its functions and, for that purpose, must have regard to:

(a) the objects of this Act, and

(b) the state of the economy of New South Wales and the likely effect of its decisions on that economy.

...

146C Commission to give effect to certain aspects of government policy on public sector employment

(1) The Commission must, when making or varying any award or order, give effect to any policy on conditions of employment of public sector employees:

(a) that is declared by the regulations to be an aspect of government policy that is required to be given effect to by the Commission, and

(b) that applies to the matter to which the award or order relates.

(2) Any such regulation may declare a policy by setting out the policy in the regulation or by adopting a policy set out in a relevant document referred to in the regulation.

(3) An award or order of the Commission does not have effect to the extent that it is inconsistent with the obligation of the Commission under this section.

(4) This section extends to appeals or references to the Full Bench of the Commission.

(5) This section does not apply to the Commission in Court Session.

(6) This section extends to proceedings that are pending in the Commission on the commencement of this section. A regulation made under this section extends to proceedings that are pending in the Commission on the commencement of the regulation, unless the regulation otherwise provides.

(7) This section has effect despite section 10 or 146 or any other provision of this or any other Act.

(8) In this section:

award or order includes:

> (a) an award (as defined in the Dictionary) or an exemption from an award, and
>
> (b) a decision to approve an enterprise agreement under Part 2 of Chapter 2, and
>
> (c) the adoption under section 50 of the principles or provisions of a National decision or the making of a State decision under section 51, and
>
> (d) anything done in arbitration proceedings or proceedings for a dispute order under Chapter 3.

conditions of employment—see Dictionary.

public sector employee means a person who is employed in any capacity in:

> (a) the Government Service, the Teaching Service, the NSW Police Force, the NSW Health Service, the service of Parliament or any other service of the Crown, or
>
> (b) the service of any body (other than a council or other local authority) that is constituted by an Act and that is prescribed by the regulations for the purposes of this section.

(B) Industrial Relations (Public Sector Conditions of Employment) Regulation 2011

...

5 Paramount policies

The following paramount policies are declared:

(a) Public sector employees are entitled to the guaranteed minimum conditions of employment (being the conditions set out in clause 7).

...

6 Other policies

(1) The following policies are also declared, but are subject to compliance with the declared paramount policies:

> (a) Public sector employees may be awarded increases in remuneration or other conditions of employment that do not increase employee-related costs by more than 2.5% per annum.

(b) Increases in remuneration or other conditions of employment that increase employee-related costs by more than 2.5% per annum can be awarded, but only if sufficient employee-related cost savings have been achieved to fully offset the increased employee-related costs. For this purpose:

(i) whether relevant savings have been achieved is to be determined by agreement of the relevant parties or, in the absence of agreement, by the Commission, and

(ii) increases may be awarded before the relevant savings have been achieved, but are not payable until they are achieved, and

(iii) the full savings are not required to be awarded as increases in remuneration or other conditions of employment.

(c) For the purposes of achieving employee-related cost savings, existing conditions of employment of the kind but in excess of the guaranteed minimum conditions of employment may only be reduced with the agreement of the relevant parties in the proceedings.

(d) Awards and orders are to resolve all issues the subject of the proceedings (and not reserve leave for a matter to be dealt with at a later time or allow extra claims to be made during the term of the award or order). However, this does not prevent variations made with the agreement of the relevant parties.

(e) Changes to remuneration or other conditions of employment may only operate on or after the date the relevant parties finally agreed to the change (if the award or order is made or varied by consent) or the date of the Commission's decision (if the award or order is made or varied in arbitration proceedings).

(f) Policies regarding the management of excess public sector employees are not to be incorporated into industrial instruments.

(2) Subclause (1) (e) does not apply if the relevant parties otherwise agree or there are exceptional circumstances.

(3) The ***relevant parties*** in relation to a matter requiring agreement under this clause are the employer and any other party to the proceedings that is an industrial organisation of employees with one or more members whose interests are directly affected by the matter.

...

7 The guaranteed minimum conditions of employment

(1) For the purposes of this Regulation, the *guaranteed minimum conditions of employment* are as follows:

...

(c) Employer payments to employee superannuation schemes or funds (being the minimum amount prescribed under the relevant law of the Commonwealth).

...

9 The effect of these provisions, insofar as they are relevant to these proceedings (which involve applications to vary awards), may be summarised as follows:

(1) In making an award the Commission is to set fair and reasonable conditions of employment for employees.

(2) An award may be varied or rescinded after its nominal term if the Commission considers that it is not contrary to the public interest to do so.

(3) In varying an award the Commission must take into account the public interest and, for that purpose, must have regard to:

(a) the objects of the Act, and

(b) the state of the economy of New South Wales and the likely effect of its decisions on that economy.

(4) The Commission must, when varying an award, give effect to the government policy that:

(a) public sector employees may be awarded increases in remuneration or other conditions of employment that do not increase employee-related costs by more than 2.5% per annum;

(b) increases in remuneration or other conditions of employment that increase employee-related costs by more than 2.5% per annum can be awarded, but only if sufficient employee-related cost savings have been achieved to fully offset the increased employee-related costs;

(c) changes to remuneration or other conditions of employment may only operate on or after the date the relevant parties finally agreed to the change (if the award or order is made or varied by consent) or the date of the Commission's decision (if the award or order is made or varied in arbitration proceedings).

(5) The policy that public sector employees may be awarded increases in remuneration or other conditions of employment that do not increase employee-related costs by more than 2.5% per annum, is subject to the paramount policies identified in cl 5 of the Regulation and, relevantly, that includes guaranteed minimum conditions of employment, one of which is "Employer payments to employee superannuation schemes or funds (being the minimum amount prescribed under the relevant law of the Commonwealth)."

10 An important issue to be determined in these proceedings is the relationship between ss 10, 17(3)(d) and 146 on the one hand, and s 146C on the other. As it will have been seen, s 146C(7) provides that s 146C has effect despite ss 10 or 146 or any other provision of the IR Act or any other Act. The unions have argued that s 146C(7) expressly excludes the application of ss 10, 17(3)(d) and 146 of the Act.

Secretary's evidence in chief

11 The Secretary's evidence consisted of an affidavit in chief and an affidavit in reply of Maryanne Mrakovcic, Associate Secretary, Fiscal and Economic Group with the NSW Treasury. Ms Mrakovcic has overall responsibility for macroeconomic monitoring and forecasting, economic modelling, and fiscal strategy for the State. Ms Mrakovcic dealt with her affidavit evidence under six headings:

(1) Economic developments and prospects.

(2) Recent CPI outcomes and forecasts.

(3) NSW fiscal position and strategy.

(4) NSW public sector rates of pay.

(5) The cost of super increases.

(6) Consequences.

Economic developments and prospects

12 Ms Mrakovcic described a number of developments that pointed to general concerns about prospects for economic growth and the likelihood that inflation pressures will remain subdued. These developments were that:

(1) The global outlook had weakened further since 2013-14 NSW Budget was framed with the IMF, OECD and World Bank all revising down their forecasts for global growth by between 0.2 and 0.3 percentage points for calendar 2013.

(2) Since mid-May 2013, when 2013-14 Budget economic forecasts were finalised, financial market volatility has increased, sovereign bond yields have risen (in both major advanced economies and developing economies), credit spreads have widened and developing economies have seen capital outflows.

(3) Uncertainty around global growth forecasts also remains high and risks remain firmly tilted to the downside. These risks include: whether there will be a smooth unwinding of unconventional monetary stimulus in the United States; negotiations in Congress regarding the increase in the debt ceiling to avoid a US default; the need to repair public and private balance sheets in Euro zone countries working against a recovery; and the extent of the slowing in China's growth.

(4) Slower global growth will affect Australia through lower commodity prices (including thermal coal prices which are important for NSW) and potentially lower export volumes which will feed through to lower national income and royalties revenue for NSW.

(5) The impact of a weaker global and domestic economic outlook had led to downward revisions to domestic inflation forecasts for 2012-13.

(6) The RBA has responded to these developments by lowering the cash rate by 1.5 percentage points since April 2012, with a further 0.25 percentage points cut in August 2013.The cash rate now stands at an historic low of 2.5 per cent and underlies the RBA's view that actual inflation and expected inflation are well under control and that there are risks to economic growth that need to be addressed.

(7) The RBA's August 2013 Statement of Monetary Policy indicated that the "Year-ended rates of inflation continue to be affected by the introduction of the carbon price in July 2012. Abstracting from this effect, underlying inflation appears to be close to the lower end of the inflation target range [of 2 to 3 per cent]... and the outlook for the domestic economy is a little weaker in the near term than it was in the May *Statement*" (RBA Statement of Monetary Policy, August 2013, p 5).

Recent CPI outcomes and forecasts

13 Ms Mrakovcic's evidence in this respect was that:

(1) The 2013-14 forecasts of inflation by the Commonwealth Treasury, the RBA and NSW Treasury, remain stable around the mid-point of the RBA's target band of 2 to 3 per cent, notwithstanding the recent depreciation of the Australian dollar. The forecasts include the effects of the Commonwealth's carbon pricing mechanism, which was implemented on 1 July 2012.

(2) Commonwealth Treasury originally estimated the carbon tax would contribute about 0.7 percentage points to the CPI in 2012-13. The Commonwealth Government designed a compensation package of income tax cuts and other benefits to offset estimated carbon emission related price increases. The Commonwealth Government estimated on average, households would see cost increases of $9.90 per week, while the average compensation package assistance would be $10.10 per week (Commonwealth Government, Supporting Australian Households - Clean Energy Future, 2011, p 4).

(3) Abstracting from the estimated carbon tax impact on the CPI (which households were compensated for), the national and NSW CPI have risen by less than 2 per cent through 2012-13.

(4) The RBA's August 2013 Statement of Monetary Policy noted that their CPI forecasts incorporated a move from a fixed to floating price for carbon on 1 July 2015 as per current legislation. That 2015 move to a floating scheme was widely expected to see the carbon price fall to around $12 in 2015-16, down from the fixed price of around $25 in 2014-15. This change was expected to subtract slightly less than ½ per

cent from CPI inflation in 2015 (RBA Statement of Monetary Policy, August 2013, p 57).

(5) The Commonwealth Government subsequently announced that it will bring forward the move to a floating scheme from 1 July 2014, which is the reason that Commonwealth Treasury forecasts CPI inflation of 2.0 per cent through 2014-15. The Federal Opposition has announced that it will abolish the scheme, which would see a larger detraction from the CPI in 2014-15.

NSW fiscal position and strategy

14 Ms Mrakovcic stated that the fiscal challenges in New South Wales include structural repair of the budget deficit position, weaker than expected revenue growth, and creating fiscal space for a high level of necessary infrastructure spending. In this respect, Ms Mrakovcic's evidence was that:

(1) In March 2011, the current Government inherited a budget position with underlying budget deficits due to recurrent expenditure growth outpacing revenue growth for a substantial period of time.

(2) At the same time capital spending had risen substantially. This combination led to Non-Financial Public Sector net debt rising substantially from $20.5 billion as at 30 June 2007 to over $32.6 billion by 30 June 2010, and projected to be more than double at $52.8 billion by June 2013 according to the previous Government's 2009-10 Half-Yearly Review.

(3) The Government's strategy to address these developments has included:

(a) returning to a sufficiently large operating surplus, on average over the business cycle, to finance a substantial portion of the capital expenditure program and provide headspace in the balance sheet as a buffer against adversity

(b) ensuring that, on average over the business cycle, state net debt and net unfunded superannuation will decline towards 100 per cent of revenues

(c) fiscal management that anticipates and responds effectively to risks to fiscal sustainability (2011-12 Budget Statement, Budget Paper No. 2, p 1-12)

(4) By the time of the 2012-13 Budget weaker than expected economic conditions, along with low growth in consumer spending affecting GST receipts, saw cumulative write downs to tax, GST and royalty revenue forecasts of $6.1 billion over the four years to 2014-15 since March 2011 (2012-13 Budget Statement, Budget Paper No. 2, p 1-2).

(5) The Government responded to the structural deterioration in revenue growth by introducing the Labour Expense Cap in the 2012-13 Budget.

(6) In August 2012, the Government enshrined its fiscal strategy through the enactment of the *Fiscal Responsibility Act (2012)*. The Act's principal objective is to maintain sound financial management and a sustainable fiscal position which is externally recognised by the retention of the State's triple-A credit rating.

(7) The credit rating agency Standard and Poor's placed NSW on negative outlook in October 2012 which means there is a one-in-three chance that the State could lose its triple-A credit rating over the next two years.

(8) The negative outlook by S&P was triggered by their view that the State faces a challenging revenue environment and the commitment to delivering productivity enhancing infrastructure projects may limit budget flexibility and performance.

(9) Losing the triple-A rating would mean significant increases in interest payments on debt, money that would otherwise go to improving schools, hospitals and infrastructure. The 2013-14 Budget estimated that losing the triple-A rating for ten years would come at a heavy cost of around an extra $3.75 billion in interest payments.

(10) The Government's response to the challenges faced entail substantial savings, the bulk of which are yet to be delivered. The total savings task amounts to nearly $19 billion over the six years to 2016-17. Only $1.9 billion of those savings are projected to be delivered by 2012-13, so the task confronting agencies remains large in the years ahead. However, without these savings, net debt would increase by at least $19 billion, which would almost certainly mean that the State's triple-A credit rating would be lost.

(11) As employee expenses make up nearly half of all General Government expenses, the limiting of remuneration increases to 2.5 per cent is a vital component to ensuring the delivery of the Government's fiscal strategy.

NSW public sector rates of pay

15 It was Ms Mrakovcic's evidence that from the September quarter 1997 to the June quarter 2013, a period of 15¾ years, in nominal terms:

- In the NSW public sector, wages have increased by a compounded 85.7 per cent or at an annual average rate of 4.0 per cent.
- In the NSW private sector, wages have increased by a compounded 69.2 per cent or at an annual average rate of 3.4 per cent.

And that in real terms for the same period:

- In the NSW public sector, real wages have increased by a compounded 24.1 per cent or at an annual average rate of 1.4 per cent.
- In the NSW private sector, real wages have increased by a compounded 13.2 per cent or at an annual average rate of 0.8 per cent.

16 Since the introduction of the *NSW Public Sector Wages Policy 2011* (i.e. June 2011 to June 2013), Ms Mrakovcic said rates of pay in the NSW public sector have increased by an average of 2.8 per cent per annum, while the adjusted Sydney CPI has increased by an average of 1.6 per cent per annum (from June 2011 to June quarter 2013). Real wages have, therefore, increased by around 1.3 per cent per annum.

The cost of super increases

17 Ms Mrakovcic said no additional provision has been made in the 2013-14 Budget for increases to superannuation contributions above the 2.5 per cent cap.

18 It was stated that if a 2.5 per cent increase was applied to rates of pay, a further increase to superannuation contributions by 0.25 percentage points would increase:

(1) General Government employee-related expenses by $62 million in 2013-14 ($52m relating to members of accumulation superannuation schemes and $10 million to members of defined benefits schemes)

(2) Total State Sector employee-related costs by $71 million in 2013-14, being the cost for General Government plus an additional $10 million in Public Trading Enterprise ($8million related to accumulation scheme members and $2 million related to defined benefit members).

Consequences

19 Ms Mrakovcic said that providing increases in remuneration to public sector employees above 2.5 per cent has not been budgeted for and will increase employee costs faced by the Government. Further that:

> With no policy actions, these payments adversely affect the Budget result and increase net debt. Higher debt at a time when the State's credit rating from Standard and Poor's is on negative outlook will place further pressure on the triple-A credit rating.
>
> To maintain the fiscal strategy and ensure the retention of the triple-A credit rating, the Government will have to choose from reducing expenses, raising taxes or reducing the infrastructure program. When considering any reduction to government expenses it should be noted that employee expenses account for close to half of all expenditure.
>
> The Government is committed to deliver sustainable savings of $18.9 billion in the period 2011-12 to 2016-17. Additional expenditure of $860 million would add to these already large savings targets in order to maintain the Budget targets.

Secretary's submissions

20 The Secretary's submission may be summarised in the following terms:

(1) The *Superannuation Guarantee (Administration) Amendment Act 2012* (the "2012 Act") gradually increases the Superannuation Guarantee ("SG") charge percentage from 9 to 12 per cent in 2019-20 income year.

(2) The Commission should have regard to all factors relevant to the determination of the general claim including economic and, more specifically, fiscal considerations and then make a global assessment of what is a fair and reasonable wage to be determined in the circumstances: see *Crown Employees (Police Officers - 2009) Award (No 2)* [2012] NSWIRComm 104 at [72].

(3) The quantification of any salary adjustment warranted, in accordance with the interactions between ss10, 17(3)(d) and 146(2) should not be undertaken by means of a "mathematical exercise" and will include a "value judgment" in order to determine appropriate increases in all the circumstances. The assessment of an appropriate remuneration adjustment involves, in those circumstances, a matter of "broad judgment based on a range of relevant circumstances": see *Crown Employees (Police Officers - 2009) Award (No 2)* at [73].

(4) The increase in award rates of pay of 2.27 per cent from 1 July 2013 when coupled with increasing superannuation contributions provides fair and reasonable remuneration for public sector employees and is affordable for the State.

(5) Since 1997 until June 2013 NSW public sector wages have increased at an annual rate of 4 per cent when compared with the NSW private sector of 3.4 per cent. Over this period (when considering the Sydney CPI and excluding the impact of the GST and the Carbon Tax) real wages have increased 1.4 per cent per year for NSW public sector employees. In the period June 2011 to June 2013 under the *NSW Public Sector Wages Policy 2011* rates of pay in the NSW public sector have increased at an average of 2.8 per cent per annum with a real increase of 1.3 per cent per annum (when adjusted by the Sydney CPI). In such circumstances the increase of 2.27 per cent when coupled with previous increases ensures that the relevant awards continue to set fair and reasonable conditions of employment.

(6) The impact of a weaker global and domestic economic outlook had led to downward revisions to domestic inflation forecasts for 2012-13.The Reserve Bank has lowered the cash rate by 1.75 percentage points since April 2012. The cash rate now stands at an historic low of 2.5 per cent and its actions underlie the view that while inflation is well under control, risks to economic growth need to be addressed. Official forecasts of inflation for 2012-13 have all been revised down to the mid-point of the RBA's target band of 2 to 3 per cent. These forecasts include the price increase effects of the carbon pricing mechanism for which

households received a compensation package. The proposed removal of the carbon pricing mechanism will put further downward pressure on the inflation rate.

(7) The credit rating agency Standard and Poor's placed NSW on negative outlook in October 2012 which means there is a one-in-three chance that the State could lose its triple-A credit rating over the next two years. The 2013-14 Budget estimated that losing the triple-A rating for ten years would come at a heavy cost of around an extra $3.75 billion in interest payments.

(8) The Government's total savings task amounts to nearly $19 billion over the six years to 2016-17. Only $1.9 billion of those savings were delivered at the end of 2012-13, so the task confronting agencies remains large in the years ahead. However, without these savings, net debt would increase by at least $19 billion, which would almost certainly mean that the State's triple-A credit rating would be lost.

(9) The modest operating surpluses achieved in 2011-12, and the modest surpluses currently in prospect in the latter years of the forward estimates reflect a positive difference between recurrent revenue and expenses. They fall well short of the funding required to fully fund the significant infrastructure spending that is vital to lifting productivity and economic growth prospects for NSW. This funding requirement is better understood via the net lending aggregates (which adjust the operating result for net capital expenses). They were in deficit by $2 billion in 2011-12 and range between $2 and $3 billion in each of 2012-13, 2012-14 and 2014-15. Unless a significant portion of capital expenditure for infrastructure is funded by budget surpluses at least the size of those in prospect, the corollary will be a significant increase in net debt levels, which in turn will threaten the state's fiscal position and triple-A credit rating.

(10) Providing increases in remuneration to public sector employees above 2.5 per cent (including increases in superannuation) has not been budgeted for and if this were to occur the government would be need to consider other options to maintain its fiscal position. To maintain the fiscal strategy and ensure the retention of the triple-A credit rating, the Government will need to choose from reducing expenses, raising taxes or reducing the infrastructure program. When considering any reduction to government expenses it should be noted that employee expenses account for close to half of all expenditure.

(11) The Government is committed to deliver sustainable savings of $18.9 billion in the period 2011-12 to 2016-17. Additional expenditure of $860 million related to the increase of superannuation contributions would add to these already large savings targets in order to maintain the Budget targets. When the 12 per cent superannuation rate is reached in 2019-20 the increases in General Government employee expenses would add $865 million to expenditure in 2019-20 alone. An increase of that order is equivalent to around 8,000 jobs.

(12) It is not in the public interest that the State:

(a) loses its triple-A credit rating;

(b) raises taxes to fund additional wages and superannuation costs;

(c) reduces services to fund additional wages and superannuation costs; or

(d) reduces infrastructure spending to fund additional wages and superannuation costs.

NSW Ministry of Health, Landcom, Roads and Maritime submissions

21 The Director-General, NSW Ministry of Health, Landcom and Roads and Maritime Services adopted the evidence and submissions of the Secretary.

PSA's evidence

22 The Public Service Association and Professional Officers' Association Amalgamated Union of New South Wales ("PSA") tendered an affidavit of Richard Robinson. Mr Robinson is a Senior Economist and Associate Director (Economics) with BIS Shrapnel Pty Ltd ("BIS Shrapnel"). He has been with BIS Shrapnel since 1986 and is that organisation's principal economic forecaster. The PSA's solicitors, W G McNally Jones Staff, requested Mr Robinson to prepare a report for the purpose of these proceedings. The 32-page report, titled "Outlook for the Economy, Inflation and Wages to June 2016 in Australia and New South Wales" ("the BIS Shrapnel Report"), was annexed to Mr Robinson's affidavit.

23 The evidence of Mr Robinson and the BIS Shrapnel Report were tendered on the basis that it was expert evidence. No objection was taken to that being the case.

BIS Shrapnel Report

24 Mr Robinson explained in his affidavit that Dr Kishti Sen, Dr Frank Gelber and Ms Kristen West had assisted him in the preparation of the Report. Further that:

> In the preparation of this report, I was responsible for preparing the CPI and wage forecasts for Australia, and the general economic forecasts and commentary for Australia and New South Wales. I was also responsible for overseeing the report, editing and proofing. Kishti Sen provided the research and calculations for the Sydney CPI and the text on CPI inflation and wages. Frank Gelber provided advice and consultation.

25 Dr Gelber is BIS Shrapnel's Chief Economist. Dr Sen is a Senior Economist with BIS Shrapnel. Ms West is a research analyst with BIS Shrapnel. She holds an Honours degree in Economics. The Report described the business of BIS Shrapnel:

> BIS Shrapnel is Australia's leading provider of industry research, analysis and forecasting services. BIS Shrapnel is a completely independent firm with no vested interests in any of the industry sectors and markets which we research and forecast....

26 The Report consisted of five chapters:

1. Introduction
2. Macroeconomic forecasts: Australia and New South Wales
3. Trends in Consumer Price Index Inflation and Forecasts
4. Outlook for Australian All Industries Wages
5. Why a wage increase of less than 2.5 per cent cannot be justified on economic grounds?

27 Mr Robinson helpfully provided a summary of his Report. The summary is set out below in full:

> **The Australian and New South Wales Economy – Recent Conditions and Outlook**
>
> 1. The Australian economy is in transition, in a soft patch with underlying growth running at 2.8 per cent compared with 3.4 per cent a year ago, awaiting a switch from mining and investment-led growth to a new set of growth drivers.
>
> 2. Thanks to the interest rate reductions by the Reserve Bank, the residential property recovery has finally taken root, albeit only in the undersupplied markets (Sydney, Brisbane, Perth and Darwin). It will build into an upswing and make positive contributions to growth. However, Adelaide, Melbourne, Canberra and Hobart will miss this cycle as their markets have an oversupply of housing stock. The upswing in these cities will be deferred until excess stock is absorbed and a deficiency emerges.
>
> 3. But Australia's increased capacity to produce and export minerals (a legacy of the recent resources investment boom) and the housing recovery alone will not be a sufficient offset for declining government expenditure and resources investment.
>
> 4. For the Australian economy to experience growth above 3 per cent, non-mining business investment will need to come through. That, we think is another two years away. Meanwhile, all levels of government are in fiscal repair mode. They will be constrained by the need to bring budget deficits under control. Long-term expenditure commitments are locked in with pressure on government revenue in a soft economy.
>
> 5. However, with strong growth in mining production and exports, there is little risk of recession — just a soft economy. We expect the economy to grow at a moderate pace, 2.4 per cent this year picking up to 2.9 per cent in 2014/15. We expect the Australian economy to grow above trend (by 4.1 per cent) in 2015/16 before easing over the following two years as the Reserve Bank is likely to raise rates to dampen domestic demand.
>
> 6. Meanwhile, the New South Wales economy has underperformed against the national average over the last decade and early this decade. A combination of factors contributed to the underperformance of the state economy.
>
> 7. New South Wales did not benefit from the mining investment boom as much as the mining intensive states of Western Australia, Queensland and more recently Northern

Territory. In addition, the states trade exposed industries such as manufacturing, tourism and education has been affected by the high dollar especially in mid 2007 to September 2008 (when GFC hit) and from mid-2009 to now. During the GFC, non-mining private investment also stalled with commencements collapsing sector by sector. But the biggest drag on the states economic performance has been the weak residential construction segment. So much so that a significant deficiency of stock has built up due to home building remaining well below demographic demand for a long period, particularly since the second half of last decade.

8. But the New South Wales economy is now lifting its game. We expect the state economy to grow solidly and outperform the national average over the next three years.

9. We are comfortable that the long-awaited recovery in residential activity in the state has taken root, and that momentum will build from here. Hence, we are forecasting dwelling building to increase solidly over the next two-to-three years. The recovery in dwelling building will increase demand for the industries that support the dwelling building industry, including real estate agents, professional and business services, some parts of the manufacturing industry, and retail trade. This will underpin demand in the wider economy supporting employment growth.

10. Overall, we are forecasting growth in state final demand (SFD) which is the sum of consumer and government expenditures of 2.3 per cent in 2013/14, 3.7 per cent in 2014/15, and 4.5 per cent in 2015/16. A growth performance like that has not been seen in New South Wales since early last decade – the last time dwelling building was increasing.

11. The forecast cycle in Gross State Product (GSP) growth is less marked than the cycle in SFD, but still notable, with growth of 2.5 per cent and 3.6 per cent forecast for 2013/14 and 2014/15 respectively. The recovery in growth in New South Wales, combined with some slowing in the mining-intensive states, will see New South Wales growing faster than the overall Australian economy for the next few years.

Outlook for Inflation and Wages Growth – Australia and New South Wales

12. Inflationary pressures remain contained, reflecting weak conditions in the non-mining economy. BIS Shrapnel is forecasting headline CPI inflation to stay subdued at 2.3 and 2.4 per cent in 2013/14 and 2014/15 respectively.

13. The New South Wales economy is Australia's largest economy. Hence at the New South Wales level, price

increases have generally followed national trends. However, over the past two years, the rate of inflation in Sydney has outstripped the national average. In 2011/12, Sydney's CPI inflation was 2.5 per cent, 0.2 per cent higher than the 2.3 per cent for the national average. This divergence widened to 0.3 per cent last financial year, with Sydney's CPI inflation recording 2.6 per cent compared to the 2.3 per cent for the national average.

14. We are forecasting Sydney to continue to have higher inflation than the national average with Sydney's CPI inflation forecast to be 0.1 per cent higher in 2013/14 at 2.6 per cent compared to the national average of 2.5 per cent. Underpinning this is our expectation of stronger rental and utilities inflation in the state (ie relative to the national average). In addition, the stronger economic and employment growth in the state compared to the national average will also contribute to the relatively higher inflationary pressures in the state in the short-to-medium term.

15. Calendar year 2012 saw moderate growth in wages reflecting subdued labour market conditions, consistent with a soft economy. Wages growth remained modest in the first half of 2013 — rising by 3.3 per cent through the year to June 2013 quarter. This was due to sluggish employment growth owing to a delayed recovery in dwelling and non-mining investment.

16. We expect a slow build in wage pressures from 2015 as the economy remains soft with the economic recovery only expected to gain traction from late 2015 with a broadening in employment, profits and investment as the next set of economic drivers (ie residential building and non-mining business investment) slowly come through.

17. As mentioned, the New South Wales economy is expected to do better than the national average over the next three years. Hence, we expect increased wage pressures in New South Wales relative to the All Industries average. Overall, we forecast wage inflation to average 3.6 per cent per annum over the next three years, 0.2 percentage points higher than the national average.

Why a wage rise of *at least 2.5 per cent*, in addition to the 0.25% superannuation charge, *can* be justified on economic grounds?

18. BIS Shrapnel believes that a wage rise of **at least 2.5 per cent**, in addition to the 0.25% superannuation rise, for employees dependent on the Award **can** be justified on economic grounds as

(i) a wage rise of 2.5 per cent, in addition to the 0.25% superannuation charge, is affordable from a macroeconomic perspective a wage increase of less than 2.5 per cent will be further below the overall average for wages growth across all industries, as measured by the Wage Price Index (see Summary Table below), making retention of employees difficult in a tight labour market.

(ii) a 2.5 per cent wage increase will not add to inflation.

19. Indeed, a wage rise of less than 2.5 per cent would adversely impact on household income growth affecting spending and growth, compounding the problems of a soft economy.

28 As part of the summary the Report included a Table of CPI and wage inflation forecasts:

Please see table below

Summary Table: CPI and Wage Inflation Forecasts

(Annual Percentage Change)

	Jun-10	Jun-11	Jun-12	Jun-13	Forecasts Jun-14	Jun-15	Jun-16
Through-the-year annual percent change (June-on-June)							
Australia - BIS Shrapnel CPI and Wage Inflation Forecasts							
'Headline' Consumer Price Index Inflation	3.1	3.5	1.2	2.4	2.8	2.5	3.0
BIS Baseline Inflation (a)	2.7	2.6	1.8	1.9	2.8	2.7	2.9
Wage Price Index	3.1	3.8	3.7	2.9	3.3	3.5	3.9
Average weekly earnings (AWOTE)	5.2	4.4	3.4	5.3	3.9	4.4	4.4
Sydney - BIS Shrapnel CPI Inflation Forecasts							
'Headline' CPI Inflation for all groups	2.9	3.8	1.3	2.6	2.9	2.5	3.1
Australia - Reserve Bank of Australia CPI Inflation Forecasts							
RBA 'Headline' Inflation (b)	3.1	3.5	1.2	2.4	2.5	2.5	n.a.
RBA Underlying Inflation (b,c)	3.0	2.8	2.1	2.4	2.3	2.5	n.a.
Year Average (end of June) annual percent change							
BIS Shrapnel CPI and Wage Inflation Forecasts							
'Headline' CPI Inflation - Sydney	**2.3**	**3.0**	**2.5**	**2.6**	**2.6**	**2.5**	**3.0**
'Headline' CPI Inflation - Australia	2.3	3.1	2.3	2.3	2.5	2.4	2.9
BIS Baseline Inflation (a) - Australia	3.1	2.6	2.1	1.8	2.6	2.6	2.8
Wage Price Index - Australia	3.1	3.8	3.6	3.3	3.1	3.4	3.8
Average weekly earnings (AWOTE) - Australia	5.6	4.2	4.3	4.6	4.1	4.0	4.4

Source: BIS Shrapnel, ABS, RBA

a) Baseline inflation excludes fuel, fruit and vegetables

b) For June 2015, we have taken the midpoint of the Reserve Bank's 2 to 3 per cent forecast.

c) Average of weighted median and trimmed mean inflation

n.a. Not available

29 In the body of the Report, Mr Robinson set out a Table (Table 2.3) entitled "New South Wales – Key Economic Indicators, Financial Years". The Table is extracted below:

	Annual Percentage Change							
Year Ended June	2009	2010	2011	2012	2013	2014	2015	2016
NSW								
Total Construction Activity[(a)]	7.0	6.2	6.9	-0.2	7.2	1.0	6.8	6.3
State Final Demand	-0.1	3.1	3.1	2.2	2.1	2.4	3.7	4.5
Gross State Product (GSP)[(b)]	**1.0**	**2.0**	**2.6**	**2.4**	**2.8**	**2.7**	**3.5**	**4.4**
Employment Growth	0.7	0.8	3.1	0.6	1.6	1.2	2.3	2.6
Unemployment Rate (%)	5.7	5.7	5.0	5.2	5.2	5.9	5.7	5.4
AUST								
Total Construction Activity[(a)]	9.1	3.9	6.9	14.1	3.9	-1.7	-0.6	-1.4
Australian Domestic Demand	1.4	2.0	3.6	5.3	2.4	1.1	2.5	3.4
Gross Domestic Product (GDP)	**1.6**	**2.1**	**2.4**	**3.4**	**2.8**	**2.4**	**2.9**	**4.1**
Employment Growth	1.7	1.1	2.5	1.2	1.3	0.8	1.4	2.3
Unemployment Rate (%)	4.9	5.5	5.0	5.2	5.3	6.0	6.2	5.7

Source: BIS Shrapnel and ABS

(a) Total Construction work done (constant prices), equals sum of new dwellings, building, alterations and additions activity over $10 000, non-residential building and engineering construction by private and public sectors.

(b) 2013 figures are estimates.

Response to Ms Mrakovcic's evidence

30 In the body of his affidavit, Mr Robinson responded to Ms Mrakovcic's affidavit. His main points of disagreement with that affidavit were as follows:

(1) Risks around global growth forecasts now tilt to the upside.

(2) World Gross Domestic Product (**GDP**) growth will accelerate over the next three years. There is little chance of "potentially lower" export volumes. On the contrary, export volumes growth is expected to remain strong over the medium term, especially coal. Over the next three years BIS Shrapnel forecasts NSW coal production to increase 12.8 per cent or an average of 4.2 per cent each year.

(3) A lower Australian dollar, if realised as per BIS Shrapnel's forecasts set out in the economic report, would also help boost Australian dollar (A$) coal prices. Accordingly, given rising coal export volumes and prices, coal royalties revenue flowing to the NSW government have potential upside, helping the overall NSW budget balance.

(4) Ms Mrakovcic argued that the official national and Sydney CPI in 2012/13 should be discounted by the estimated effect on the CPI of the introduction of the Commonwealth's carbon pollution reduction scheme (CPRS) on 1 July 2012, based on

the notion that households were compensated for the "estimated emission related price increases" via "a compensation package of income tax cuts and other benefits". Ms Mrakovcic uses this discount in her measurement of real wages growth for the NSW public sector, claiming the (CPRS) "adjusted Sydney CPI has increased by an average of 1.6 per cent per annum (from June 2011 to June quarter 2013). Real wages [for the NSW public sector] have therefore increased at around 1.3 per cent per annum". There are three issues with this proposition:

(a) Ms Mrakovcic is using through-the-year figures, when she should be using year average figures;

(b) there is some doubt as to whether the CPI should be discounted for the estimated CPRS effects when measuring real wages growth for a select group of wage earners. The 0.7 per cent addition due to the CPRS was an *estimate* based on the *average* household and the *average* compensation package. But the compensation package was designed to provide a higher relative compensation for lower income households and much less for higher income households. Not all wage earners in the NSW public sector received the same compensation package, because there are large disparities in incomes across this sector. There were differential degrees of compensation and also likely different degrees of price effects, the latter due to different patterns of energy usage. Furthermore, the headline or total CPI should be used to measure movements in real wages or to deflate certain costs for businesses and governments. It should not be 'adjusted' to reflect changes to taxation rates or adjusted to remove changes to subsidies or movements in exchange rates.

(c) Ms Mrakovcic is using Wage Price Index (WPI) data for all of the NSW Public Sector. This includes not only state government employees covered by the Crown Employees Award, but also state government employees covered by other awards (such as police and nurses), and employees working in state Government Business Enterprises (GBEs). In addition, the WPI data relating to the NSW Public sector also includes those working in local and Commonwealth agencies and GBEs. So the wage comparisons she uses are not representative of the government employees in relation to the *NSW Public Sector Wages Policy 2011.*

(5) When one compares the wage movements for only those employees covered by the *Crown Employees Wages Staff (Rates of Pay) Award* in 2011/12 and 2012/13 (2.5 per cent per annum) with movements in the Sydney CPI (2.5 per cent in 2011/12 and 2.6 per cent in 2012/13) the wages growth for these employees has not kept pace with Sydney CPI inflation – they have in fact experienced a reduction in real wages by an average of 0.05 per cent over those two years. This is significantly below the 1.3 per cent reported by Ms Mrakovcic.

(6) BIS Shrapnel forecasts annual CPI inflation for Australia to be 2.5 per cent in 2013/14 with Sydney CPI inflation forecast at 2.6 per cent. If this forecast is realised, a 2.5 per cent base increase in wages will *not* maintain real wages — it would lead to a further erosion of real wages of 0.1 per cent in 2013/14. This cut in real wages will be larger if the wage rise granted is less than 2.5 per cent.

(7) The approach adopted by the NSW Government is to rely on the Reserve Bank to achieve its agreement with the Commonwealth Government to maintain national CPI inflation within a range of 2 to 3 per cent over the cycle, i.e. an average of 2.5 per cent. But this target objective is in practice a medium-term objective which allows for the CPI to go outside the target range, as long as the RBA pursues a monetary policy to bring the CPI back within its target range over the medium-term. That is, BIS Shrapnel and most other economists understand that 'over the cycle' implies a time period of 3 to 5 years. The NSW Treasury needs to consider the reality that CPI inflation can be higher than the 2.5 per cent mid-point, and indeed up to 3 per cent for an extended period. Indeed, over the past seven years, the CPI has averaged 2.8 per cent per annum.

(8) In outlining her concerns for a 2.5 per cent wage rise, Ms Mrakovcic ignores the potential upside to revenue from stronger growth in Growth State Product (**"GSP")**, employment and transfer duty which can offset the non-budgeted salary costs. The accompanying table shows that both BIS Shrapnel and the Commonwealth Bank are forecasting higher GSP.

NSW Real GSP Growth

Yr end	NSW	BIS	Access	Commonwealth	Average
2014	2.75%	2.7%	2.3%	2.8%	2.7%
2015	2.8%	3.5%	2.8%	3.0%	3.0%
2016	2.8%	4.4%	2.4%	-	3.2%

(9) The upswing in dwelling construction combined with healthy growth in Sydney house prices should see transfer duty make a strong contribution to state revenue over the next three years. Since the preparation of the 2013/14 NSW Budget, residential sales activity has been strong, with recent reports revealing stamp duty on residential transfers in July and August were up by more than 30 per cent compared to the same months last year. The 2013/14 state budget projected a 20.5 per cent increase in stamp duty. BIS Shrapnel forecasts further strong sales activity to continue, along with further healthy rises in average house and unit prices.

(10) In addition, stronger gross state product growth than that assumed in the budget will deliver a higher revenue outcome for the NSW State Government. If one assumes that state government revenue is proportional to GSP, higher GSP growth of 0.25 per cent would add around $300 million to state revenue by 2015/16.

(11) Assuming higher GSP growth in NSW (than the NSW Treasury's conservative forecasts), the expectation that coal royalty revenues will hold up and the current strong growth in transfer duty revenue is higher than Treasury projections, and given the lower cost of the superannuation over the next three years, then a 2.5 per cent wage increase, in addition to the 0.25% superannuation charge, is affordable from a budget perspective i.e. the likelihood of higher-than-budgeted revenues will cover the 'extra' costs of the superannuation charge. As such the state's triple-A credit rating would be maintained.

(12) Any rise in debt should be eventually compensated for by higher economic growth and government revenues.

Secretary's evidence in reply

31 Ms Mrakovcic responded to Mr Robinson's evidence in a further 19-page affidavit. The main points in reply may be summarised as follows:

Economic prospects

(1) Official forecasters continue to both revise global growth down as well as emphasise the significant downside risks to the global economy. Developments in the global economy, and most notably in Australia's trading partners, can be

expected to weigh heavily on the national and NSW economies. Mr Robinson's optimism is unwarranted.

(2) The domestic labour market remains weak.

(3) The Australian Treasury revised down national growth in 2013-14 to 2½ per cent and 2014-5 to 3 per cent. NSW is anticipated to fare somewhat better than the national economy during the economic transition away from mining to non-mining sources. However, the risks remain finely balanced, and much will depend on creating the conditions that enable that transition way from mining to non-mining to proceed smoothly.

(4) BIS Shrapnel is very much an outlier in its forecasts for growth in 2014-15 and 2015-16. Mr Robinson's optimism around either global prospects or domestic prospects do not appear to be broadly shared.

Coal royalties revenue

(5) Further downside risks and weaker expected global economic growth, have emerged since the preparation of the 2013-14 NSW Budget. While Treasury remains broadly comfortable with the forecasts, equally, it believes it would be unwise to assume higher royalty revenue growth given future risks in Japan (where about 47 per cent of NSW coal exports are destined) and the challenges in predicting exchange rate developments.

Transfer duty

(6) While Mr Robinson may regard his forecasts for higher than expected revenues to mean that higher wages are affordable, it should be noted that any above budgeted tax revenues, should they occur, have been committed by the Government to be paid into *Restart NSW* to fund the State's major infrastructure projects. Therefore, above budgeted revenues, whether higher royalties, transfer duty or other NSW own source revenues are not available, on current policy settings, for recurrent expenses such as wage costs.

Sydney CPI and carbon price influences

(7) Mr Robinson states that Sydney CPI rose by 2.6 per cent not 2.5 per cent for 2012-13. The difference between the two figures arises from different rounding methodologies used in calculating the change over the period. Indices are compiled from a variety of data sources and require considerable

reliance on a range of statistical estimation techniques. While they can be a useful product for analysing broad trends, attempting to draw analysis from a 0.1 percentage point difference is unlikely to be productive.

(8) The critical point is that under the Government's wages policy that allows for up to 2½ per cent growth, wages have kept up with prices and therefore there has been no deterioration in real wages even before the effects of the Commonwealth's compensation package introduced with the carbon pricing mechanism are taken into account.

(9) The Commonwealth Government designed a compensation package to offset the estimated 0.7 per cent effects of the carbon emission related price increases such that on average, households would see cost increases of $9.90 per week, while the average assistance would be $10.10.

(10) Those that received less than average assistance would be on higher than average incomes. Their compensation is relatively lower because those higher income groups generally have a greater ability to adapt (that is, change the nature of their purchases) to price changes. Also carbon price related effects are likely to be a smaller proportion of their total income compared to lower income households.

(11) So when the compensation package is taken into account, real wages have actually risen with most households better off.

(12) Historical averages of CPI growth will obviously be sensitive to the time period chosen. In the absence of any particular bias, using the mid-point of the RBA's target for inflation of 2.5 per cent is considered a reasonable approach for ensuring that real wages are maintained over the medium to long term.

Wage Price Index

(13) Mr Robinson stated that the Wage Price Index in my previous affidavit includes data relating to Commonwealth agencies. This is incorrect.

(14) The matters Mr Robinson addresses relate to around 80,000 employees covered by the *Crown Employees (Public Sector – Salaries 2008) Award*. However, these proceedings relate to more than 190,000 public sector employees covered by more than 60 public sector awards.

(15) As there is no wage index available which is specific to the employees who are the subject of these proceedings, I have selected the Wage Price Index (state/local) series (WPI) as a measure of changes to rates of pay for purposes of comparison within my affidavits. While the WPI includes a broader group of employees than those who are subject to the proceedings, it can reasonably be expected to be less volatile than relying on a series that relates to movement in rates of pay for only a single industrial instrument – and one that covers considerably less than half of the employees in question.

(16) In any event, the movements in rates of pay are comparable when measured by either proxy measure (the *Crown Employees (Public Sector Salaries 2008) Award* or the WPI). This is also the case for other significant awards which are included in the proceedings (e.g. *Health Employees' (State) Award* and *Public Health System Nurses' and Midwives (State) Award 2013*). See chart.

2012-2013 State Accounts

(17) There is on-going pressure on the State's revenues, especially from lower GST revenues as consumers remain cautious and spending on GST exempt items continues to increase as a percentage of total consumption. Transfer duties remain vulnerable to the state of the housing cycle in NSW, payroll taxes vulnerable to the employment situation in NSW, and coal royalties to developments in the global economy and trade growth.

(18) The 2013-14 Budget was calibrated to these developments and risks. It recognised the importance of the current period for NSW, given both global growth developments and their implications for the transition from mining to non-mining taking place in the national Australian economy. It recognised the importance of enabling and facilitating that transition, and the role that infrastructure investment in the state could play in such facilitation, but also the importance of funding more of that infrastructure investment from higher budget surpluses given the debt situation and current outlook. The net lending deficit, that takes account of the Government's capital spending, was deliberately targeted to decline over the budget and forward estimates to reduce the rate of increase in net debt and therefore place the State's finances on a sustainable footing.

(19) It is for this reason that the emphasis was placed on funding important infrastructure from rising budget surpluses, and focus on constraining expenses rather than relying on lifting

tax revenues at a time when consumer confidence is vulnerable.

(20) While infrastructure improvements should lift productivity and thus future economic growth prospects, there are long lags from infrastructure spends to these delivered improvements and subsequent tax flows to government.

Credit rating

(21) While Standard and Poor's (S&P) reaffirmed NSW's triple-A credit rating on 24 October 2013, the negative outlook that was initiated one year ago remains in place. S&P stated that "the negative outlook continues to reflect [their] views that [the State's] debt burden may be pressured from weaker-than-anticipated budgetary performance or a higher capital spend."

(22) Now is clearly not the time to allow any slippage in expenditure control. According to S&P, "the negative outlook reflects our view that there is a one-in-three chance of a downgrade in the coming 24 months."

Consequences

(23) Providing increases in remuneration to public sector employees above 2.5 per cent has not been budgeted for – and therefore will increase employee costs faced by the Government.

(24) Higher employee costs will adversely affect the Budget result and thereby result in higher than otherwise net debt levels. Higher debt at a time when the State's credit rating from Standard and Poor's is on negative outlook will place further pressure on the triple-A credit rating.

(25) To maintain the fiscal strategy and ensure the retention of the triple-A credit rating, the Government will have to take policy actions to offset these higher employee costs. The choices are reducing expenses, raising taxes or reducing the infrastructure program. Raising taxes risks undermining consumer and/or business confidence necessary for growth, while reducing the infrastructure program is counterproductive to lifting the productive potential of NSW – and hence its future prosperity. When considering any reduction to government expenses it should be noted that employee expenses account for close to half of all budget expenses.

PSA's submissions

32 There were two principal limbs to the PSA's opposition to the Secretary's position:

(1) It is not open to the Commission to award increases of less that 2.5% on the basis of economic or fiscal considerations. The policy to which the Commission is required to give effect dictates that "fiscal restraint" and "fiscal discipline" is to be maintained by ensuring the Commission awards increases that increase employee-related costs by 2.5% each year.

(2) In any event, if the Commission retains a discretion, no basis has been established by the Secretary of the Treasury upon which the Commission would award increases in salaries of less than 2.5% this year.

33 As to the first limb, the PSA's submissions may be summarised as follows:

(1) Section 146C of the IR Act limits the jurisdiction of the Commission to make or vary awards it otherwise possesses under sections 10 or 17 of the Act. The Commission is no longer able, so far as public sector employees are concerned, to set fair and reasonable conditions of employment for those employees.

(2) The explicit purpose of s 146C and the Regulation is to deprive the Commission of the "broad-ranging discretion" it previously possessed to fix wages and conditions of employment insofar as public sector employees are concerned.

(3) The stated rationale for the Government's Wages Policy as reflected in the Regulation policy is to provide for maintenance of the real value of public sector salaries over the medium term by linking wage increases to the Reserve Bank target range for inflation.

(4) The Wages Policy does not purport to ensure that the real value of wages is maintained every year. Nor does it permit increases in salaries based upon improvements in productivity or changes in work value except where the stringent requirements for savings in "employee-related costs" to be realised for the purpose of clause 8 of the Regulation are met. Rather, the Government has determined that "fiscal sustainability" and "fair working conditions" will be achieved "over the cycle" by linking increases in employee-

related costs that can be awarded by the Commission to the midpoint of the Reserve Bank target range for inflation.

(5) The policy enunciated in the Regulation is that there will be guaranteed increases of 2.5% per annum. Because it is required to give effect to that policy, it is not open to the Commission to discount salary increases in a particular year having regard to the type of economic and fiscal considerations now relied upon by the Secretary. The policy required to be given effect to by the Commission has determined that the asserted need for "fiscal discipline" and "fiscal restraint" is met by ensuring the Commission awards increases in wages of 2.5% per annum.

(6) The reliance by the Secretary upon the requirement otherwise imposed upon the Commission by s 146(2) of the Act to have regard to the public interest, including the state of the economy of New South Wales and the likely effect of its decisions on that economy is misplaced. Section 146C expressly excludes the application of s10 and s 146 of the Act.

(7) It is not open to the Commission to award an increase in salaries and allowances of less than 2.5% on grounds that it is necessary to achieve "fiscal restraint" or as a result of economic considerations. The policy to which the Commission is required to give effect by s 146C dictates that "fiscal restraint" and fair wages are to be achieved by ensuring the Commission awards increases in remuneration or other conditions of employment that increase employee-related costs by 2.5% each year.

34 In relation to the second limb of the PSA's argument, it may be summarised as follows:

(1) The Secretary seeks to rely on the historically anomalous lack of CPI inflation in the December 2011 and March 2012 quarters. However, following the publication of that data, increases of 2.5% in salaries of NSW public sector employees were granted by the Commission on the basis of consent of their employers: *Crown Employees (Public Sector - Salaries 2008) Award* [2012] NSWIRComm 70 and *Crown Employees (Roads and Traffic Authority of New South Wales - Salaried Staff) Award* [2012] NSWIRComm 71. In any event, rates of CPI inflation across Australia, and specifically in Sydney, have hovered around 2.5% over recent years and are forecast to continue at around that level in the 2013-2014 financial year. An increase in salaries and allowances of

2.5% from 1 July 2013 represents an appropriate and reasonable increase to maintain the real value of the salaries prescribed by the awards.

(2) The increases in superannuation contributions of 0.25% provide no basis for refusing the applications to increases salaries by 2.5%. Increases in superannuation contributions, whilst of benefit to employees in the long term, do nothing to assist employees to meet the rising cost of living experienced by employees in recent and coming years.

(3) The intention of the Government's own Wages Policy is to maintain the real value of wages "over the cycle" not in each year. If inflation is 3%, 5% or 10% in future years, the capacity of the Commission to award increases in salaries will remain limited by cl 6(1)(a) of the Regulation. The intention of the Policy is to maintain the real value of wages by providing for increases in salaries of 2.5% in each year.

(4) Economic considerations are merely part of the consideration of the public interest. So much is made clear by the terms of s 146(2) itself. The terms of s 146(2) require no more than that consideration be given to the economic consequences of a decision in the light of the paramount requirement of s 10 of the Act to set fair and reasonable conditions of employment.

(5) A respondent that contends increases in wages or conditions should not be awarded as a result of economic or fiscal considerations bears a considerable burden.

(6) The Commission is not assisted by the crude and simplistic analysis that, since 1997, "NSW public sector wages" have increased at a faster rate than private sector salaries and public sector employees have experience increases in real wages:

(a) the Wage Price Index data relied upon by the Secretary for changes in public sector wages is based upon wage earnings in all levels of government as well as any government controlled entity or corporation. It includes data for employees outside the NSW Government employees, let alone employees covered by awards that are before the Commission;

(b) to the extent that increases in salaries have occurred for relevant public sector employees, it is of little assistance to simply record aggregate changes over an arbitrary period. Some increases have been awarded as a result of arbitrated work value determinations taking into account changes in work value that have occurred over decades. More recently, increases have frequently occurred on the basis that employees have or will contribute to cost savings;

(c) the data relied upon by the Secretary does not attempt to compare public sector employees with overall wages movements in the private sector and not with employees undertaking comparable occupations. In any event, such an approach is comparative wage justice and not a proper approach for fixing salaries;

(d) to the extent that the Government has asserted that some public sector employees have experienced excessive increases in salaries, it has sought to address its stated concern by adopting enacting s 146C and promulgating policy contained in the Regulation. That is, the remedy the Government has prescribed to address past increases it regarded as excessive was to limit future increases in employee-related costs awarded by the Commission to 2.5% per annum.

(7) The New South Wales economy is expected to grow solidly and outperform the national average over the next three years supported by the recovery of housing and engineering construction and a strengthening of business investment.

(8) The State is in a solid financial position. The State Government recorded a budget surplus of $660 million in 2011-2012 with smaller than expected deficits projected for 2012-2013 and 2013-2014. The budget is projected to return to strong surplus at least in 2014-2015 financial year. The positive outlook for economic growth, including in the housing sector, is likely to support growth in Government revenue.

(9) The New South Wales Government retains a Triple-A credit rating from the three major credit rating agencies, Fitch, Moody's and Standard and Poor's. Standard and Poor's confirmed NSW's Triple-A rating on 25 October 2013 with the outlook revised to negative. However, subsequently Fitch confirmed NSW's Triple-A rating with a stable outlook on 21 March 2013 and Moody's reaffirmed the Triple-A rating also with a stable outlook on 14 May 2013. There appears no basis to believe that NSW's Triple-A credit rating is under threat as a result of an increase in salaries of 2.5%.

(10) Increased superannuation contributions resulting from the amendments to Commonwealth superannuation guarantee

legislation and the *State Authorities Non-Contributory Superannuation Act* 1987 (NSW) will increase "General Government" employee-related expenses by $62 million in 2013-2014 and "Total State Sector" employee-related expenses (apparently incorporating "public trading enterprises") by $71 million. The basis of those figures is not disclosed.

(11) The evidence relied upon by the Secretary refers to the foreshadowed costs of increases in superannuation contributions in future years. The only applications currently before the Commission seek variations to existing awards to provide for a single increase in salaries and allowances of 2.5% from 1 July 2013. Increases in subsequent years will be determined at a future time. There is no foundation for the contention that lower salary increases should be awarded in 2013 because increases in superannuation contributions may occur in the future.

35 In his oral submissions Mr Crawshaw SC, with Mr Gibian of counsel, reiterated what was in the PSA's written submissions and emphasised the following matters:

(1) What the Full Bench said in *Crown Employees (No 1)* regarding the residual powers in s 146(2) of the Act was *obiter dicta* and non-binding. It was, therefore, open to the Commission to find that s 146C and the Regulation displaced s 10 and s 146(2) of the Act and that those sections were inoperative.

(2) The Commission may accept that the Secretary has the onus of showing why a 2.5 per cent wage increase should not be awarded.

(3) Regardless, however, of where the onus lies, the Commission has a discretion to reject the Secretary's case given that it was clearly stated to be the government's intention of "ensuring that wage increases of 2.5 per cent were available each year to our hardworking public sector employees".

(4) The Secretary's argument that fiscal and economic considerations mean the wage increase should be limited to 2.27 per cent was a thinly veiled substitute of the Secretary's original argument that was rejected by the Commission in *Crown Employees (No 1).*

(5) Whilst Ms Mrakovcic agreed that "real wages are worked out is looking at nominal wages and adding into that or deflating it or inflation increases measured by CPI", she sought to deduct from the CPI - contrary to the definition of 'real wages' - the original estimate of the effect of the carbon tax of 0.7 per cent. Moreover, in asserting the Sydney CPI was less than 2.5 per cent Ms Mrakovcic confined herself to a consideration of only two years of CPI increases. In combination this led to a contrived result as to CPI increases.

(6) If the CPI is to be reduced by carbon tax compensation why should 'bracket creep', for instance, not be taken into account. The idea of relying on carbon tax compensation introduces the notion of the social wage and one cannot simply confine that to carbon tax compensation.

(7) If one considers CPI movements beyond the two year limit adopted by Ms Mrakovcic, for example three or four years, the average exceeds 2.5 per cent. BIS Shrapnel's forecast for 2013/14 is an increase in the CPI of 2.6 per cent, consistent with figures of other forecasters;

(8) in relation to Ms Mrakovcic's evidence that since 1997 public sector increases in NSW have outstripped real wage movements, three points should be made:

   (a) the Wage Price Index figures used by Ms Mrakovcic are not confined to public sector award movements, but contain movements in the local government sector and government controlled entities and corporations;

   (b) the figures include "work value increases, increases for attraction and retention difficulties, increases based on cost savings and the like";

   (c) it is not permissible to compare wage movements in the private sector with wage movements in the public sector: Re Crown Employees (Teachers in Schools and TAFE and Related Employees) Salaries and Conditions Award (No 3), [2004] NSWIRComm 134; (2004) 133 IR 254 [79]-[81];

(9) The evidence supports the conclusion that the global economy is improving.

(10) Treasury has consistently underestimated the budget outcome. Each year of the last four years there has been an amount of surplus contrary to Treasury forecasts.

(11) Whilst the Secretary submitted he has not budgeted for any increase in employee related costs of $60m (the cost of the

unions' claim), the government's employee expenses budget forecasts have been a significantly lower amount for the last two years than the amount involved in the claim. In 2012-13 employee expenses were $346m lower than budget.

(12) Whilst the Secretary relied on Standard & Poor's negative outlook, the rating continues to be AAA+ along with the other agency ratings and the positive aspects of S& P's rating of the government's performance were not addressed by Ms Mrakovcic.

(13) The estimate of the cost impact of the unions' claim ($62 million in 2013-14 for general government sector and $71 million in 2013-14 for total State sector) was an exaggeration because it is based on the superannuation costs of the public sector as a whole whereas the PSA's claim relates to only 190,000 employees. Moreover, the claim does not encompass teachers, who make up a significant proportion of the public sector.

Submissions of Unions NSW and its affiliates

36 Mr J Nolan of counsel for Unions NSW and its affiliates contended that the New South Wales Government had, through s 146C and the Regulation, introduced a system whereby the Industrial Relations Commission had been "sidelined to a significant degree so far as the setting of public sector wages was (and is) concerned." It was submitted that as a consequence of the changes to the legislation the Commission was "limited... to superintendence of specific, highly regulated, and strictly cost-controlled wages outcomes" and that it was "delegated to a role of auditing and 'signing off' on the delivery of wages outcomes that had already been paid for by the beneficiaries - in the form of productivity trade offs."

37 The import of the submission was that the Government had, for all practical purposes, determined a fixed amount that could be awarded by the Commission (namely, 2.5 per cent) as an annual wage increase. That amount was described as being assured by the responsible Minister and, in effect, constituted the minimum 'safety net' of wages. Further, any employer payment to employee superannuation schemes or funds was

declared to be a "guaranteed minimum employment condition" (see cl 7(1)(c) of the Regulation).

38 This legislative arrangement, it was submitted, embodied "a definitive statement of the public interest - so far as public sector wages are concerned - as Parliament saw it." As I understand this submission it was that the parliament saw it as being in the public interest to have a wages policy "designed to ensure fiscal discipline and to protect the budget bottom line...." (see Hansard and the second reading speech introducing the Industrial Relations Amendment (Public Sector Conditions of Employment) Bill 2011). The effect of this arrangement was to make ss 10 and 146 otiose (as reflected in s 146C(7)), and the parliament saw this as necessary because these provisions allowed the Commission to render the Government's fiscal strategy ineffective (see second reading speech).

39 However, it was submitted, in the face of increases to the superannuation guarantee charge, the Government now wanted to perform an about face and contend that s 10, but particularly s 146, had a role to play in ensuring the public interest was protected by ensuring increases in labour costs caused by wage increases and increases in the superannuation guarantee charge did not, in total, exceed 2.5 per cent per annum.

40 In other words, the submission was to the effect that in the interests of having direct control over public sector wages the parliament had done away with s 10 and s 146 for that sector, but now the Government wanted to revive those provisions in order to advocate a position contrary to the government's intention in sponsoring the legislation and inconsistent with that legislation.

41 It was next submitted that use of the drafting expression 'despite' in s 146C(7) made it clear that s 146C prevails over s 10 and s 146. It followed, it was submitted, that a requirement to give effect to government policy as declared by the Regulation prevails over any otherwise existing or residual public interest or economic considerations

and - by definition - 'subjects' those considerations to the declared policy. This last point, it was submitted, was made clear in relation to this very legislative scheme in *Public Service Association and Professional Officers' Association Amalgamated [Union] of NSW v Director of Public Employment* [2012] HCA 58; (2012) 293 ALR 450 at [17] where the Court stated:

> [17] Sections 10 and 146 of the IR Act are **expressly subordinated to s 146C by operation of s 146C(7) and thereby to any declared policy upon conditions of employment**. That is to say, the constraint imposed on the award-making power by s 10, that it relate to "fair and reasonable conditions of employment", may be displaced or qualified. **So, too, may the requirement, in s 146, to have regard to the objects of the IR Act, the state of the economy of New South Wales and the likely effect of the Commission's decision on that economy.** In effect, a policy declared by a regulation made under s 146C may pre-empt judgments by the Commission of those matters. It was not suggested that s 146C is invalid on that account. A parliament can confer a decision-making power on a body of its own creation, and authorise regulations which limit or qualify the exercise of that power in particular circumstances. (footnotes omitted, emphasis added by counsel)

42 Counsel for Unions NSW submitted that in light of the above, the place of s 17(3)(d) of the Act in the wage-setting scheme must also be doubted as having any relevance to this matter. It assumed a power to vary awards unaffected by s 146C and could operate only in a manner consistent with s146C.

43 It was further submitted that even if it were accepted that s 146 had some role to play, the reference in it to "the state of the economy of New South Wales and the likely effect of [the Commission's] decisions on that economy" must be read in the context of economy-wide repercussions of any decision. Further, that:

> Such an impact cannot be demonstrated. Any suggestion that the marginal increase at stake here could have such an impact, is hyperbole. There can be no economy wide impact as a result of the granting of the additional wages increase sought here. Nor, thanks to the Wages policy is there any prospect

whatsoever of a wages flow on of the kind traditionally guarded against in wages decisions under *the* old system.

44 In relation to the economic evidence, Unions NSW submitted that:

(1) If the Commission is disposed to entertain the 'economic case' advanced by the Government, its evidence would not persuade the Commission to award increases in salaries of less than 2.5 per cent.

(2) It relies on the affidavit of Mr Robinson and the BIS Shrapnel Report.

(3) In relation to the State's credit rating, it was maintained by all three agencies at AAA. The NSW Treasury website states:

> New South Wales is rated Triple-A by the world's three major credit rating agencies. Fitch confirmed NSW's Triple-A credit rating with stable outlook on 21 March 2013 while withdrawing future coverage for commercial reasons. Standard & Poor's (S&P) confirmed NSW's triple-A credit rating, with the outlook revised to negative on 25 October 2012. Moody's reaffirmed NSW's triple-A credit rating with stable outlook on 14 May 2013.

(4) In contrast to the economic picture portrayed by the Secretary in the present proceedings, in its submission to the Fair Work Commission *Annual Wage Review* (earlier this year), the NSW Government stated:

> 'The NSW economic outlook is for growth returning to trend, underpinned by:
>
> • solid trading partner growth and an anticipated modest recovery in global activity;
>
> • strong growth in mining investment and non-rural commodity exports;
>
> • strong demand from resource-intensive states for NSW services and manufactured goods;
>
> • lower interest rates;
>
> • solid fundamentals for the housing construction sector including a high level of new housing completions, a low rental vacancy rate and firm growth in household incomes and the population;
>
> • a strong outlook for farm production and exports; and

• public investment picking up over the next two years, consistent with the Government's capital spending profile'.

(5) The Fair Work Commission awarded an increase of 2.6% per week to all federal minimum wage workers, which workers also receive the increase in superannuation under the 2012 Act: *Annual Wage Review 2012-13* [2013] FWCFB 4000 June 3, 2013.

(6) Notwithstanding the fact that the then proposed increases to the SGL were known about and specifically addressed in the 2013 Fair Work Commission Annual Wage Review proceedings, the NSW Government nevertheless stated that:

> ...current economic forecasts point to some improvement of economic conditions in 2013-2014, continuing uncertainty as to global economic conditions may mitigate this longer term outlook.' [NSW Submission to Annual Wage Review 2012-13].

(7) Thus, in early 2013 there was forecast an improvement (not a deterioration) of economic conditions in 2013-4 and only a conditional qualification of this trend over the longer term. Had the position been as dire as that now sought to be painted by the NSW Government, its earlier submissions were at odd with such a picture. There is no explanation offered for this apparent change of position.

(8) Contrary to the picture painted by the NSW government, BIS Shrapnel expects the NSW economy to perform better over the medium term than the national average and the position assumed in the NSW 2013/14 budget papers. It suggests that private dwellings construction will be one of the key drivers of Gross State Product over the medium term. Stronger Gross State Product growth is anticipated to deliver higher revenues to the State government.

(9) The expert opinion of BIS Shrapnel is that the increases sought by the unions (2.5% in addition to the SGL increase) are not only justified on economic grounds but are more soundly based from an economic perspective than the lesser amount advanced by the Government. A wage increase of less than 2.5% (and the SGL) will be below the overall average for wages growth across all industries, as measured by the Wage Price Index. The lesser increase would adversely impact household income growth and thus affect spending and growth, compounding the 'problems of a soft economy'. In the light of these conclusions, any vestigial public interest argument (if there is one) diminishes if not evaporates.

(10) Unions NSW relies upon the entirety of the Robinson affidavit and BIS Shrapnel Report. It is useful to emphasise that portion of the report [Ch 5] that deals specifically with the rationale for the present claim by the unions. BIS Shrapnel points out that the increase is economically justified - indeed it has more to commend it on economic grounds than a lesser amount. It will have no impact that would excite the kind of 'public interest' concerns traditionally associated with economic claims made before the Commission. It will be 'affordable', have no inflationary impact and fall short of anticipated wages growth over 2013/2014. In short, none of the characteristics of a case that raises genuine and credible 'public interest' on economic grounds are present. The economic case present by the Government must be regarded as falling well short of convincing.

Secretary's submission in reply

45 The Secretary's submission in reply may be summarised as follows:

(1) The Commission does in fact maintain a discretion to award increases in remuneration or other conditions of employment that increase employee related costs by less than 2.5%: *Re Crown Employees Wages Staff (Rates of Pay) Award 2011 & Ors* [2013] NSWIRComm 53 at [10] and [41]; *Re Crown Employees (Public Sector - Salaries 2011) Award (No 3)* [2011] NSWIRComm 104 at [34]; *The Public Service Association and Professional Officers' Association Amalgamated of NSW v Director of Public Employment* [2012] HCA 58; 293 ALR 450 at [17].

(2) The evidence shows that real wages have at least been maintained over an extended period.

(3) Official forecasters continue to see downside risks to the expected global recovery. The lowering of growth expectations is consistent with the views of the Reserve Bank of Australia.

(4) A key risk to growth forecasts remains a possible disorderly exit from extraordinary unconventional monetary policy. Central banks in the major advanced economies may face challenges as they attempt to tighten monetary policy. Furthermore, the transmission of conventional monetary policy (the setting of the overnight cash interest rate) could be quite unpredictable with central banks holding large

volumes of long term debt. The US fiscal situation also adds to downside risks.

(5) The domestic labour market remains weak.

(6) BIS Shrapnel's forecast for economic growth appears to be an outlier at 4.4 per cent.

(7) With weaker expected global economic growth, it would be unwise to assume even higher coal royalty revenue growth given the unpredictable directions that the exchange rate has taken in the past. Furthermore, the Government has committed to paying better than anticipated revenue outcomes into Restart NSW which will fund the State's major infrastructure projects.

(8) There remains on-going pressure on NSW Government revenues, especially from lower GST revenues as consumers remain cautious and spending on GST exempt items continues to increase as a percentage of total consumption.

(9) While Standard and Poor's (S&P) reaffirmed NSW's triple-A credit rating on 24 October 2013, the negative outlook that was initiated one year ago remains in place. S&P stated that "the negative outlook continues to reflect [their] views that [the State's] debt burden may be pressured from weaker-than-anticipated budgetary performance or a higher capital spend."

(10) To maintain the fiscal strategy and ensure the retention of the triple-A credit rating, the NSW Government will have to choose from reducing expenses, raising taxes or reducing the infrastructure program.

(11) These factors point to the need for caution in imposing further cost pressures on the State's fiscal position. With employee related expenses representing almost half of all Government expenditure, an increase in employee costs above the 2.5% budgeted for will not be in the public interest.

(12) The Secretary acknowledges that, having regard to its earlier findings, the Commission must balance a number of considerations including the public interest in fiscal restraint and the desire to maintain real wages. In the circumstances presently applying, it is submitted that balance is best achieved by decline to further increase rates.

46 In his oral submissions for the Secretary, Mr Kite SC, with Mr Britt of counsel, stressed the following matters:

(1) Any increase in employee related costs above 2.5 per cent is unbudgeted.

(2) The Commission should take a conservative approach to the likely world economic growth and its impact on Australian growth and New South Wales growth in particular.

(3) Both Ms Mrakovcic and Mr Robinson agree that infrastructure spending is vital to the well being of the State economy in the future.

(4) One risk identified in the evidence is that of the credit rating. Two of the rating agencies have indicated a positive AAA credit rating, whereas one has a negative outlook and has maintained that position in recent times. The assessment is that there is a one third possibility of a downgrade in the next couple of years. That is risk of increased of interest costs to Government.

(5) Despite making concessions in his evidence that there are constraints on the economy and it is experiencing a "soft patch", Mr Robinson is more bullish about the future than the consensus view of agencies such as the Reserve Bank and the IMF. The more conservative consensus view would be the one to be preferred.

(6) If employee related expenses increase beyond what has been budgeted it may become necessary to reduce the number of State Government employees by cutting programmes;

(7) Mr Robinson accepted in cross-examination that his criticisms of Ms Mrakovcic's analyses of real wage increases were unfounded.

(8) Mr Robinson accepted that it is appropriate (or at least not inappropriate) to take into account the carbon pollution reduction scheme compensation package and take it out of the CPI in measuring real wage increases.

(9) Public sector wage increases have since 1997 outstripped private sector increases and having regard to the carbon pollution reduction scheme compensation it is not necessary for an additional 0.23 per cent to be awarded by the Commission to maintain real wages.

Supplementary submissions

47 In the course of considering the matters that are the subject of these proceedings, I requested the parties to make short written supplementary submissions regarding the treatment of the effect of the carbon price by Full Benches of the Fair Work Commission in their two most recent Annual Wage Reviews ([2012] FWAFB 5000 and [2013] FWCFB 4000) and by the Full Bench of this Commission in *Police Officers (No 2)*.

48 In its 2012 Review Decision the Full Bench of the Fair Work Commission stated at [163]-[166]:

> [163] The Australian Government will introduce a carbon price from 1 July 2012 which is expected to increase consumer prices by 0.7 per cent in 2012–13, as measured by the CPI. The Household Assistance Package of tax cuts and increases to transfer payments announced in May 2012 is said to be targeted at low- and middle-income households to help with the impact of the carbon price and to ensure that the most vulnerable households are not left worse off.
>
> [164] Under these arrangements about 90 per cent of low-income households will receive assistance that exceeds, by around 20 per cent, their expected average price impact. The Australian Government submitted that this additional assistance:
>
> > "provides a buffer to protect low income households who face higher costs than the average for that household type (for example they may live in an older building and hence have higher heating costs than average, or they may live in a region of Australia with higher than average heating or cooling costs). It also ensures that sufficient assistance is available to meet the average expected price impact for all pensioners, including part rate pensioners."
>
> [165] Given the level of assistance provided through the tax-transfer system, the Australian Government submitted that the Review should not be used as an avenue to provide further assistance. No party contended otherwise, though some parties submitted that the degree of overcompensation provided in the Household Assistance Package should be taken into account in these proceedings so as to reduce the level of increase that the Panel would otherwise determine. In particular, Ai Group submitted that:
>
> > "[i]n short, [the household assistance measures] will boost real disposable incomes for low and middle income

households and these impacts should be taken into account in the consideration of the role changes to minimum wages [have] in addressing the needs of the low paid and relative living standards."

[166] We agree with the proposition that this Review should not provide any additional assistance to compensate for the anticipated price effects associated with the introduction of a price on carbon. Compensation has already been provided through tax cuts and transfer payments and further compensation by minimum wage adjustments would amount to double dipping. It follows that we will, in effect, abstract the projected 0.7 per cent increase in the CPI from our deliberations.

49 In its 2013 Review Decision the Full Bench of Fair Work Australia stated at [27]-[28]:

[27] The Panel considered the impact on the CPI of the introduction of a price on carbon and assistance to employees to compensate those price effects in its decision in the 2011–12 Review, deciding:

"We agree with the proposition that this Review should not provide any additional assistance to compensate for the anticipated price effects associated with the introduction of a price on carbon. Compensation has already been provided through tax cuts and transfer payments and further compensation by minimum wage adjustments would amount to double dipping. It follows that we will, in effect, abstract the projected 0.7 per cent increase in the CPI from our deliberations."

[28] We have not been persuaded to change the position taken by the Panel in the 2011–12 Review decision. We have had regard to the effect of the carbon price on the CPI in 2012 in arriving at our decision in this Review.

50 In *Police Officers (No 2)* the Full Bench relevantly said at [11]-[12]:

[11] In Police Award (No 1), the Full Bench made findings as to various forecasts for inflation based upon the expert evidence of two eminent economists, Mr Christopher Richardson (who was called by the Commissioner) and Dr Frank Gelber, Chief Economist and Director with BIS Shrapnel Pty Limited (who was called by the Association).

[12] That evidence was given initially in the form of individual reports but later updated by the preparation of a joint report and concurrent evidence. The evidence was given for the purposes of consideration of the Association's case that wage adjustments

were required in order to maintain the purchasing power of wages in the light of evidence as to known and expected inflationary pressures. The experts agreed that the best measure for that purpose was the CPI index and, in particular, the headline Sydney CPI, year average, with the effect of the carbon tax excluded. Based on these considerations, the Full Bench reached conclusions as to CPI inflation in relation to time periods which were relevant to the general claim.

51 The position of the Secretary was that the approach he had submitted in this case was in conformity with the approach followed by the Full Benches in the Annual Review cases and *Police Officers (No 2).*

52 The PSA, supported by Unions NSW and its affiliates, submitted that it was not appropriate to follow the federal decisions or *Police Officers (No 2)* in relation to the treatment of the effect of the carbon price. This was so, it was submitted, for the following reasons:

(1) To the extent the effect of the introduction of the carbon price was discounted in the federal decisions and *Police Officers (No 2)* it involved a single discount of a projected 0.7 per cent in the 2012-13 year. The NSW Government consented to an increase of 2.5 per cent from 1 July 2012 notwithstanding the introduction of the carbon price. It could be inferred the Government then accepted that increases under the Regulation should not involve the Commission making a fresh assessment each year of minor variations in the economic environment. The Government has now changed its mind contrary to its own policy.

(2) The federal decisions and *Police Officers (No 2)* did not involve a focus on the maintenance of real wages as is the focus of the NSW Wages Policy. It is no part of an assessment of what is necessary to maintain real wages to take into account changes in the tax system which affect after-tax income. If changes to taxation measures are to be taken into account in setting wages it would be necessary to have regard to such matters as bracket creep and the flood levy.

(3) Even if the effect of the introduction of the carbon price upon the CPI was discounted for the purpose of the Commission's consideration the CPI has still increased on a year average basis over the four year period from July 2010 by approximately 2.5% per annum. Given the focus of the

Wages Policy upon maintaining real wages "over the cycle", this outcome confirms that an increase in salaries and allowances of 2.5% from 1 July 2013 is appropriate to maintain the real value of wages even if the effect of the introduction of the carbon price is discounted from the CPI result.

(4) The decisions in the Annual Wage Reviews and in the Police Officers Award were unconstrained by the limitations of the Regulation. That is, the decisions were not constrained to increases in remuneration that increase employee-related expenses by 2.5% per annum. The Fair Work Commission and the Commission were, respectively, making decisions in a context in which they were not constrained (year to year) as to the increases to be awarded and not operating under a Regulation which limited wage increases in a manner designed to maintain real wages by prescribing increases of 2.5% each year.

(5) In the context of the application of the Regulation, it is artificial and inappropriate to have regard to the fact that CPI increases may be less than 2.5% in a particular year. As has been made clear in the PSA's earlier submissions, the Commission is unable to increase salaries by an amount that would increase employee-related expenses by more than 2.5% per annum should CPI increases be more than 2.5% in a particular year. Assuming that the Commission retains any discretion, the Commission would not discount wages increases in a particular year having regard to modest variations in the rate of inflation in circumstances in which it is unable to compensate for higher rates of inflation in future years.

Consideration

53 The PSA's primary submission, supported by the other union parties, was that it was not open to the Commission to award increases of less that 2.5 per cent on the basis of economic or fiscal considerations. The Secretary submitted to the contrary, that is, the Commission maintains a discretion to award increases in remuneration or other conditions of employment that increase employee-related costs by less than 2.5 per cent. The Secretary's submission did not derive from any opinion he held or the parliament held about the Commission maintaining a discretion to order less that 2.5 per

cent on fiscal or economic grounds. Despite the extensive parliamentary discussion on the purpose of the Industrial Relations Amendment (Public Sector Conditions of Employment) Bill 2011 (which I shall shortly refer to) nowhere is it mentioned that s 10 or s 146(2) of the Act maintained a role in fixing rates of pay for public sector employees.

54 The Secretary's submission was based primarily on a statement by the Full Bench in *Crown Employees (No 1)* where the Full Bench stated at [41]:

> [41] It is not our position that increases in employee-related costs from a source other than an award or order of the Commission cannot be taken into account in determining increases in remuneration or other employment conditions. In addition to s 146C and the Regulation, the Commission retains a residual discretion to set fair and reasonable conditions of employment pursuant to s 10 of the Act and s 146(2) of the Act imposes the following obligations:
>
> > (2) The Commission must take into account the public interest in the exercise of its functions and, for that purpose, must have regard to:
> >
> > > (a) the objects of this Act, and
> > >
> > > (b) the state of the economy of New South Wales and the likely effect of its decisions on that economy.

55 The observation by the Full Bench at [41] was not essential to its decision. What the Full Bench was required to determine was whether the annual limit of net increase in employee-related costs was 2.5 per cent regardless of whether that flowed from an award or order or from some other source of "employee-related costs" as defined in cl 8 of the Regulation. The Full Bench recorded its finding at [53]:

> [53] We find that having regard to our textual analysis of cl 6(1)(a) of the Regulation, the context in which that text appears in the Regulation, the purpose of s 146C and the Regulation and the extrinsic materials that assist in elucidating the purpose of cl 6(1)(a), the increases in remuneration or other conditions of employment referred to in that provision are only those increases resulting from an award or order made or varied by the Commission either by consent or in arbitration proceedings.

56 The observation at [41] was entirely incidental to the matter required to be determined and is to be properly regarded as *obiter dicta,* that is, an expression of opinion not necessary to the decision in a case. The opinion, therefore, is not binding. In *Quinn v Leatham* [1901] AC 495 at 506 the Earl of Halsbury LC said:

> [E]very judgment must be read as applicable to the particular facts proved, or assumed to be proved, since the generality of the expressions which may be found there are not intended to be expositions of the whole law, but governed and qualified by the particular facts of the case in which such expressions are to be found. The other is that a case is only an authority for what it actually decides. I entirely deny that it can be quoted for a proposition that may seem to follow logically from it. Such a mode of reasoning assumes that the law is necessarily a logical code, whereas every lawyer must acknowledge that the law is not always logical at all (applied by McHugh J in *Shepherd v The Queen* [1990] HCA 56; (1990) 170 CLR 573 at 593).

57 What is more, the application of s 10 and s 146(2) and their relationship with s 146C was not raised nor argued by any party. In those circumstances it would be unjust on the union parties to treat the observation in [41] as anything other than *obiter*: see *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89 at [132].

58 A real issue, therefore, arises in the present proceedings as to whether the Commission's power is limited to the extent it may not award increases of less that 2.5 per cent per annum on the basis of economic or fiscal considerations as contended for by the Secretary.

59 The issue falls to be determined according to the rules governing statutory interpretation. These rules were referred to in *Crown Employees (No 1)* and I respectfully adopt what was there said at [21]-[22].

60 The process of determining this issue must begin with a consideration of the ordinary and grammatical meaning of the words of the provision having regard to their context and legislative purpose: *Australian Education Union*

v Department of Education and Children's Services [2012] HCA 3; (2012) 285 ALR 27 at [26] per French CJ, Hayne, Kiefel and Bell JJ; *Board of Bendigo Regional Institute of Technical and Further Education v Barclay* [2012] HCA 32; (2012) 220 IR 445 at [41] per French CJ, Crennan, Gummow and Hayne JJ; *Certain Lloyd's Underwriters Subscribing to Contract No IH00AAQS v Thelander* [2012] HCA 56; (2012) 293 ALR 412 at [23] per French CJ and Hayne J. Context may also be considered "in a broader sense as including the general purpose and policy of the legislation, in particular the mischief to which the statute is directed and which the legislature intended to remedy.": *Certain Lloyd's Underwriters* at [88] per Kiefel J. Whilst consideration of extrinsic materials should not displace the clear meaning of the text of a provision, the purpose of a provision may be elucidated by appropriate reference to them: *Certain Lloyd's Underwriters* at [70] per Crennan and Bell JJ.

61 Prior to the introduction of s 146C in 2011, the Commission had a broad discretion in making awards about industrial matters. Section 10 enabled the Commission to make an award "setting fair and reasonable conditions of employment for employees." In doing so, however, s 146(2) of the Act required the Commission to take into account the public interest in the exercise of its functions and, for that purpose, required the Commission to have regard to: "(a) the objects of this Act, and (b) the state of the economy of New South Wales and the likely effect of its decisions on that economy."

62 Additionally, s 17(3)(d) of the Act provided:

> (3) An award may be varied or rescinded in any of the following circumstances only:
>
> ...
>
> (d) after its nominal term if the Commission considers that it is not contrary to the public interest to do so.

63 As the PSA submitted, when setting salaries and conditions of employment, the Commission has traditionally taken into account the public interest, including the state of the economy of New South Wales and the likely effect of its decisions on that economy: *Re Public Hospital Nurses (State) Award (No 4)* [2003] NSWIRComm 442; (2003) 131 IR 17 at [233] ("*Nurses (No 4)*"); *Crown Employees (Teachers in Schools and TAFE and Related Employees) Salaries and Conditions Award* [2004] NSWIRComm 114; (2004) 133 IR 254 at [432] ("*Crown Employees (Teachers)*"); *Crown Employees (Police Officers - 2009) Award (No 2)* [2012] NSWIRComm 104 at [70]-[72] ("*Police Officers (No 2)*"). The Commission took economic or fiscal considerations into account as part of the broad discretion it then had to set wages and conditions of employment.

64 In *Nurses (No 4)* the Full Bench held at [233] that:

> [233] As the HAC contended, the Commission is required, pursuant to s 146(2) of the Act, to take into account the public interest in the exercise of its functions and, for that purpose, must have regard, inter alia, to the state of the economy of New South Wales and the likely effects of its decisions on that economy. Hence, even though wage increases may be justifiable under the work value principle, if to grant them were to have an adverse impact on the economy, a case may exist for restraint. The onus of demonstrating the need for restraint would fall on those opposing the increase because unless it can be convincingly demonstrated that real harm will be done to the economy by the granting of any increase, the employees concerned are entitled to receive remuneration commensurate with the value of their work.

65 In *Crown Employees (Teachers)* the Full Bench held at [432]:

> [432] We note that these statements of principle were adopted in *Health Employees Pharmacists (State) Award*, and we also adopt them in this matter. The economic and financial position of the State and the effects of our decision on the New South Wales economy have played a significant role in our decision, but not a determinative one. It is our statutory duty to fix fair and reasonable rates of pay and conditions. In a matter, such as this one, where a compelling basis for increases in rates of pay has been demonstrated, then the Commission must give recognition to that conclusion even though it may temper the final result in recognition of economic considerations. The terms of s146 of the Act require

> no more than this, particularly in the light of the paramount requirements of s10 of the Act. It is those duties that we will discharge in this matter. We shall exercise those duties without fear or favour and in order to do justice between the parties in the light of the evidence and submissions in the proceedings.

66 In *Police Officers (No 2)*, the Full Bench stated at [70]-[72]:

> [70] When taking into account the public interest, the Commission must also, for that purpose, have regard to "the state of the economy of New South Wales and the likely effect of its decisions on that economy". Whilst that requirement (which is found under s 146(2)(b) of the Act) might not always operate in favour of restraint, the long history of jurisprudence in this Commission and its predecessors would indicate that the provision more often operates as the limitation or restraint in the award making function (particularly in relation to wage fixing) and, in that respect, may, to some extent, be seen as a juxtaposition of the provisions of s 10 of the Act.
>
> [71] There is a long line of cases in this Commission considering the reconciliation of those provisions. We consider that the observations of the Full Bench in *Re Public Hospital Nurses (State) Award (No 4)* [2003] NSWIRComm 442; (2003) 131 IR 17 at [233] ('*Public Hospital Nurses (No 4)*') amply set out the relevant principles:
>
> > [see Public Hospital Nurses (No 4) above]
>
> [72] It follows from this authority that the submission of the Commissioner to the effect that the Commission should have regard to all factors relevant to the determination of the general claim including economic and, more specifically, fiscal considerations and then make a global assessment of what is a fair and reasonable wage to be determined in the circumstances, should be accepted. In this context, the state of the economy, including fiscal considerations (see *Crown Employees* (2004) at [471]) will be taken into account in the overall assessment but will not be determinative of the Commission's decision: *Crown Employees* (2004) at [432].

67 In 2011, the parliament removed the Commission's wide discretion to fix fair and reasonable conditions of employment for employees in the public sector. In doing so, the Minister responsible for the Industrial Relations Amendment (Public Sector Conditions of Employment) Bill 2011, which introduced s 146C into the Act, made it clear that the very purpose of the bill was to remove what he described as the Commission's "broad-ranging discretion when it comes to wage fixing." This was "the mischief to which

the statute is directed and which the legislature intended to remedy." In the second reading speech (*New South Wales Parliamentary Debates (Hansard), Legislative Council,* 24 May 2011, p889 et seq) the Minister stated:

> Underpinning the need for fiscal restraint is the Government's wages policy. The policy was first introduced by the previous Labor Government in 2007, but that Government failed to implement it. The New South Wales Coalition Government will continue the key provisions of the wages policy introduced by the former Labor Government. However, the Coalition Government has proposed changes to the way the wages policy operates to ensure that the key requirements of the wages policy are actually followed. Our policy and legislative response will ensure that wage increases of 2.5 per cent are available each year to our hard-working public sector employees. Increases in excess of 2.5 per cent are available but will be required to be funded through employee-related savings.
>
> Key elements of the policy require that any increases to employee-related expenses exceeding 2.5 per cent per annum, including wages, allowances, superannuation and conditions of employment, must be funded through employee-related cost savings that have been achieved. Details of the savings measures used to fund increases in excess of 2.5 per cent are to be detailed in the award or agreement where that is appropriate....
>
> ...
>
> The Industrial Relations Commission has rejected key aspects of the 2007 wages policy on a number of occasions. In the 2008 public servants salaries case the Government accepted the Industrial Relations Commission's strong recommendation for the settlement of the Public Service Association's claim. The recommendation provided for increases of 4 per cent per annum over three years and committed the Government and the union to achieving a range of employee-related cost offsets that were not identified at the time. The Government and the union then reflected the commission's recommendations in a memorandum of understanding. A subsequent decision by the commission in 2010 regarding the interpretation of the memorandum constrained the areas of employee-related cost savings the Government was able to pursue, severely limiting the opportunity for public sector agencies to pursue significant savings through industrial reforms.
>
> In the December 2010 State Wage Case decision the Full Bench of the Industrial Relations Commission specifically rejected the basis for the Government's wage policy requirement to limit wage increases that did not contain additional offsets to 2.5 per cent. At the same time the commission also created a new productivity and efficiency wage fixing principle to allow unions to seek potential

wage increases independent of the need to identify employee-related savings, and that is directly at odds with the former Government's policy and our Government's policy. Presently, the Industrial Relations Act 1996 provides the Industrial Relations Commission with broad discretion to determine public sector wage outcomes that do not accord with government wages policy.

I now turn to elements of the bill. The primary amendment to be made to the Industrial Relations Act is the insertion of a new section 146C containing the explicit requirement that when making or varying awards or orders the commission must give effect to the Government's policy on conditions of employment for the public sector as declared under the regulations....

Under the current framework of the Industrial Relations Act, the Industrial Relations Commission is required to have regard to a range of matters in the exercise of its functions. These include the objects of the Act in section 3, the instruction in section 10 to make awards setting fair and reasonable conditions of employment for employees, the public interest provisions in section 146, and the state of the economy of New South Wales and the likely effect of its decisions on that economy, also in section 146. That is already in the Act. The commission also applies a set of wage fixing principles that set out the circumstances in which wage increases can be awarded. These are applied when the commission deals with public sector awards, which are not affected by the minimum wage increase set in the general State Wage Case.

As can be seen, the commission exercises a broad-ranging discretion when it comes to wage fixing. This environment is conducive to submissions that the Government's wages policy should be disregarded or that other considerations are more significant than the wages policy. As outlined earlier, the Government's wages policy is designed to ensure fiscal discipline and to protect the budget bottom line, therefore ensuring that services and other commitments of the Government to the citizens of this State are able to be delivered. It is not a good outcome for New South Wales when government wages policy is disregarded. That is why the bill includes the new requirement in section 146C (1) that in public sector matters the Industrial Relations Commission's prime objective is to give effect to the Government's wages policy. This will support the achievement of the Government's budgetary objectives.

The objective is supported and strengthened by subsection (3) of proposed section 146C, which provides that any award or order that is inconsistent with the declared wages policy of the Government will be of no effect. The amendment also includes very specific words to ensure that its intention may not be subverted by reference to section 146 or any other provisions of the Act. This is found in proposed subsection (7). In order to make it clear to the commission what the amendment requires it to do, the relevant elements of the policy will be declared in the regulations....

...

> The amendments in this bill will ensure that the Industrial Relations Commission of New South Wales has a central role in providing New South Wales public sector workers with fair and reasonable wage increases, while also ensuring that the New South Wales Government contains expenses, provides efficient service delivery and invests taxpayers' money wisely.

68 It is abundantly clear that as a consequence of the 2011 amendments to the Act and the promulgation of the Regulation that the Commission is no longer able to apply the test of "fair and reasonable" in s 10 to the task of public sector wage fixing according to the Commission's assessment of what that test entails. Instead, the Commission is required to give effect to the Government's wages policy as declared under the Regulation, which for all practical purposes limits any increase in remuneration to 2.5 per cent per annum.

69 This effect was described by the then Minister in his second reading speech as providing "New South Wales public sector workers with fair and reasonable wage increases." In these circumstances, there is no scope to apply a "fair and reasonable" test that is in any way inconsistent with what is required under s 146C and the Regulation. To that extent the award making power under s 10 is qualified by s 146C.

70 The practical effect of this is that where there is contest about whether the annual wage increase to be awarded to public sector employees should be 2.5 per cent or less, the Commission will be required to apply the fair and reasonable test and the tests in s 146(2). I say more about this below in my consideration of the applicability of s 146(2).

71 That is not to say s 10 of the Act (and s 146) may no longer be applied in the manner it was prior to the s 146C amendment. Local Government awards, for example, remain within the Commission's jurisdiction. In fixing conditions of employment under those awards the Commission is bound to apply s 10 (and s 146) of the Act.

72 As is the case with s 10, s 146C and the Regulation have qualified the public interest test in s 146(2) of the Act insofar as public sector awards are concerned. However, I am unable to agree with the PSA's submission that s 146C and the Regulation wholly displaces s 146(2).

73 In pursuit of its contentions, the PSA referred to the "NSW Public Sector Wages Policy 2011" (see Premier's Memorandum M2011-10) ("the Wages Policy"), which was said to underpin s 146C and the Regulation. The Wages Policy provides that:

> 1.1. The primary aim of this policy is to ensure better services and value for the public. In this context, the Government is committed to a policy of fair working conditions and allowing increases in remuneration and other conditions of employment that do not reduce services and are consistent with maintaining fiscal sustainability.
>
> 1.2. Since 1997 real average wage increases in the NSW public sector have increased by 21.9 per cent. The policy is designed to maintain the real value of public sector wages over the medium term in line with the mid-point of the Reserve Bank of Australia's target range for inflation over the cycle.

74 Consistent with the Regulation, the Wages Policy provides:

> 3.1.3. Public sector employees may be awarded increases in remuneration or other conditions of employment that do not increase costs by more than 2.5 per cent per annum.
>
> 3.1.4. Increases in remuneration or other conditions of employment that increase employee related costs by more than 2.5 per cent per annum can be awarded, but only if sufficient employee related cost savings have been achieved to fully offset the increased employee related costs.

75 The aim of the Wages Policy is self-evidently to strike a balance between providing "fair working conditions" and ensuring that increases in remuneration and other conditions of employment do not reduce services and are consistent with maintaining fiscal sustainability. As paragraph 1.2 of the Wages Policy states:

> The policy is designed to maintain the real value of public sector wages over the medium term in line with the mid-point of the Reserve Bank of Australia's target range for inflation over the cycle.

76 According to the PSA that Wages Policy, which is reflected in the Regulation, would not permit the Commission, as it has previously done under s 146(2)(b), to have regard to changes in work value, or improvements in productivity, or inflation, or changes in the cost of living, or the effect of salary increases upon the economy, or the fiscal position of the State Government on each occasion a claim is made for an increase in wages or other employment conditions in public sector awards.

77 The PSA submitted that the rationale for a regulation that makes available increases in remuneration or other conditions of employment that do not increase employee-related costs by more than 2.5 per cent per annum is to "maintain the real value of public sector wages over the medium term in line with the mid-point of the Reserve Bank of Australia's target range for inflation over the cycle." Any annual adjustment to public sector award wages that takes into account the Government's fiscal position, or annual movements in the CPI, would be inconsistent with the policy underpinning the Regulation.

78 In other words, as I understood the PSA's submission, in striking a balance between fair working conditions and fiscal sustainability, the Government has determined this is to be achieved by maintaining the real value of wages "over the medium term" (not year on year) in line with the Reserve Bank's inflation target "over the cycle". The balance is to be achieved by making available increases in remuneration or other conditions of employment that do not increase employee-related costs by more than 2.5 per cent per annum. If the Commission were to give unqualified effect to s 146(2)(b) and discount the 2.5 per cent based on the Government's fiscal position in any one or more years, it would be inconsistent with the policy rationale underpinning the Regulation and real wages could not be maintained in accordance with the Policy over the medium term. The

balance sought to be achieved under the Policy would be placed out of kilter.

79 The PSA's further submission was that it is evident from the Minister's second reading speech that the Government regarded the public interest as being to "ensure fiscal discipline and to protect the budget bottom line, therefore ensuring that services and other commitments of the Government to the citizens of this State are able to be delivered" whilst at the same time ensuring that "wage increases of 2.5 per cent are available each year to our hard-working public sector employees." According to the PSA, that necessitated removing the Commission's "broad-ranging discretion when it comes to wage fixing..." In removing that discretion the parliament, in effect, modified the public interest test in s 146(2) so that the test is subordinated or made subject to the Government's policy referred to in s 146C and the Regulation the effect of which is described above. This was said to be confirmed by s 146C(7), which provides:

> (7) This section has effect despite section 10 or 146 or any other provision of this or any other Act.

80 If I could commence in dealing with this aspect of the PSA's submission by referring to the decision of the High Court in *Public Service Association and Professional Officers' Association Amalgamated [Union] of NSW v Director of Public Employment* at [17], where French CJ stated:

> [17] Sections 10 and 146 of the IR Act are expressly subordinated to s 146C by operation of s 146C(7) and thereby to any declared policy upon conditions of employment. That is to say, the constraint imposed on the award-making power by s 10, that it relate to "fair and reasonable conditions of employment", may be displaced or qualified. So, too, may the requirement, in s 146, to have regard to the objects of the IR Act, the state of the economy of New South Wales and the likely effect of the Commission's decision on that economy. In effect, a policy declared by a regulation made under s 146C may pre-empt judgments by the Commission of those matters....

81 The PSA's submission would have it that s 146C and the Regulation "displaced", that is, replaced or rendered inoperative s 10 and s 146,

rather than qualified those provisions. That cannot be so because to adopt that construction would render s 146(1) nugatory, which cannot have been the legislature's intention given that provision identifies the general functions of the Commission.

82 However, I think the main flaw in the PSA's submission is that it relied too heavily on extrinsic material, namely parliamentary statements, instead of the words of the legislation, to contend s 146(2) had been displaced.

83 I referred earlier to the second reading speech where it was said the government would ensure "wage increases of 2.5 per cent are available each year to our hard-working public sector employees." In August 2011, in a debate regarding a motion to disallow the Regulation (Hansard, Legislative Council, 3 August 2011), it was stated by the then Minister for Industrial Relations in opposing the motion:

> We have guaranteed minimum conditions in relation to annual/eave (sic), sick leave, long service leave, public holidays, parental/eave, superannuation and part-time work entitlements.
>
> The regulation also makes clear that existing conditions of employment in excess of the minimum conditions can only be reduced with the agreement of the relevant parties in the proceedings. Labor's 2007 wages policy had no protections for conditions of employment. Despite the scaremongering from the Opposition, our policy is more transparent than Labor's 2007 policy by clearly guaranteeing the 2.5 per cent increase and minimum conditions.

84 Nothing could be stated more clearly about the government's intentions, namely that a *wage increase* of 2.5 per cent per annum would be *guaranteed* for public sector employees, as would *minimum conditions*, including superannuation. That such a guarantee might be made is not surprising given that price increases may vary within the Reserve Bank's target range of 2-3 per cent over the medium term (or even outside the range), thus creating losses and gains in real wage movements. So that whilst public sector employees might be better off with a 2.5 per cent increase where inflation is running at less than that figure and real wages

may increase, the employees will be worse off if inflation runs above 2.5 per cent. In choosing the midpoint of the Reserve Bank's target range as the basis upon which wages might increase, presumably it was considered an appropriate amount given that prices were likely to fluctuate above and below this amount, although I note in the past seven years CPI increases have averaged 2.8 per cent per annum.

85 However, the guarantee of an annual increase of 2.5 per cent wage increase did not find its way into the legislation. In interpreting legislation the courts must determine what parliament meant by the words it used, not what parliament intended to say: *Re Bolton & Others; Ex parte Beane* [1987] HCA 12; (1987) 162 CLR 514 at 518; *Byrne v Australian Airlines Limited* [1995] HCA 24; (1995) 185 CLR 410 at 459; *Harrison v Melhem* [2008] NSWCA 67 per Spigelman CJ at [14] and [16].

86 The policy that the Commission must give effect to in accordance with s 146C is relevantly cl 6(1)(a) of the Regulation, namely, that subject to compliance with the declared paramount policies:

> (a) Public sector employees may be awarded increases in remuneration or other conditions of employment that do not increase employee-related costs by more than 2.5% per annum.

87 The Regulation does not guarantee an annual wage increase of 2.5 per cent. It states public sector employees "may be awarded increases in remuneration... *that do not increase employee-related costs by more than 2.5% per annum.*"

88 The Commission cannot award more than 2.5 per cent (subject to cl 6(1)(b) of the Regulation), but it is open to it to award increases in remuneration of 2.5 per cent or less. Within that narrow scope it seems to me the Commission is bound to apply the provisions of both s 10 and s 146(2) of the Act and there is nothing in s 146C or the Regulation that would make it inconsistent for the Commission to apply those provisions.

89 I acknowledge the PSA's submission that underpinning the Regulation is a Wages Policy that is aimed at striking a balance between fair working conditions and fiscal sustainability, and in that respect the government has determined this is to be achieved by maintaining the real value of wages "over the medium term" in line with the Reserve Bank's inflation target "over the cycle". As I have already observed, according to the PSA that objective is inconsistent with applications to the Commission on a yearly basis to fix wage increases at a level less than 2.5 per cent. That is to say, because the government has fixed on 2.5 per cent to maintain the real value of wages "over the medium term", if the Commission were to interfere with that amount on the basis of fiscal and economic considerations, the objective of striking a balance between fair working conditions and fiscal sustainability would not be achieved.

90 However, it is only if the government's Wages Policy and the Regulation *guaranteed* an increase of 2.5 per cent per annum, would the PSA's submission about putting the government's balance between fair working conditions and fiscal sustainability out of kilter, be valid. This would be so because the balance, according to the Wages Policy and Regulation, would be maintained by a guaranteed annual increase of 2.5 per cent. Any interference with that guaranteed increase by the Commission awarding less than 2.5 per cent would be inconsistent with the Policy by upsetting the pre-ordained balance. As I have found, however, the legislation does not provide for a guaranteed wage increase of 2.5 per cent per annum.

91 This is not to say the government's policy objective of striking a balance between fair working conditions and fiscal sustainability by maintaining the real value of wages "over the medium term" will necessarily be achieved by applying the Regulation. To maintain real wage levels over the medium term in line with the Reserve Bank's inflation target of 2 to 3 per cent over the cycle, then nominal wages would need to be adjusted (presumably annually) for the effect of prices and this would need to be done in the absence of any arbitrary ceiling on the amount of wage increase that could be made available. If inflation runs at the upper end of the Reserve Bank's

target range, between 2.5 per cent and 3 per cent per annum, or exceeds 3 per cent, real wages may not be maintained over the medium term because the maximum wage increase available (subject to cl 6(1)(b) of the Regulation) is 2.5 per cent.

92 In those circumstances the government's Wages Policy is merely aspirational and subordinate to the statute and Regulation. That does not mean it is unimportant because as a matter of public interest the Commission should have regard to the objective of maintaining real wages over the medium term in line with the mid point of the Reserve Bank's inflation target of 2 to 3 per cent over the cycle, within the parameters set by the Act and Regulation.

93 I find that s 146 and, in particular s 146(2), is not displaced by s 146C. Further, that in determining whether there should be an annual increase of 2.5 per cent or less the Commission, in exercising its wage fixing function, is required to take into account the matters in s 146(2) of the Act, subject to the provisions of s 146C and the Regulation.

94 In relation to s 17(3)(d), it provides that an award may be varied or rescinded "after its nominal term if the Commission considers that it is not contrary to the public interest to do so." That provision is not displaced by s 146C, but in applying any public interest test under that provision it must be done in a manner consistent with the policy referred to in s 146C and the Regulation.

The public interest

95 Section 146(2) of the Act requires the Commission to take into account the public interest in the exercise of its functions and, for that purpose, must have regard to:

(a) the objects of this Act, and

> (b) the state of the economy of New South Wales and the likely effect of its decisions on that economy.

96 The objects that the Full Bench in *Police Officers (No 2)* considered apposite were:

> (a) to provide a framework for the conduct of industrial relations that is fair and just,
>
> (b) to promote efficiency and productivity in the economy of the State,
>
> ...
>
> (e) to facilitate appropriate regulation of employment through awards, enterprise agreements and other industrial instruments,
>
> ...
>
> (h) to encourage and facilitate co-operative workplace reform and equitable, innovative and productive workplace relations.

97 In *Police Officers (No 2),* the Full Bench accepted the Police Commissioner's submission that the Commission should have regard to all factors relevant to the determination of the Police Association's general claim including economic and, more specifically, fiscal considerations and then make a global assessment of what is a fair and reasonable wage to be determined in the circumstances. In doing so, the Full Bench stated at [72] that the state of the economy was not determinative of the claim, but may "temper" any final result: see *Re Crown Employees (Teachers)* at [432].

98 In *Nurses (No 4),* in the context of considering claims for increases based on changes in work value, the Full Bench stated at [233] that even though wage increases may be justifiable, if to grant them were to have an adverse impact on the economy, a case might exist for restraint. Further, that:

> The onus of demonstrating the need for restraint would fall on those opposing the increase because unless it can be convincingly demonstrated that real harm will be done to the economy by the granting of any increase, the employees concerned are entitled to receive remuneration commensurate with the value of their work.

99 The present case is not concerned with work value. However, the case does take place against the background of clear ministerial statements guaranteeing annual wage increases of 2.5 per cent and guaranteeing minimum conditions in the knowledge that the total savings task for the government amounted to nearly $19 billion over the six years to 2016-17. Given the submissions of the unions in these proceedings representing public sector employees, it may be accepted the ministerial statements created a real expectation amongst those employees that each year a wage increase of 2.5 per cent would be made available regardless of whether cost of living increases were less than 2.5 per cent. But, importantly, they would not receive any more than 2.5 per cent if annual cost of living increases exceeded 2.5 per cent unless a case could be made out under cl 6(1)(b) of the Regulation.

100 In *Re Broken Hill Commerce and Industry Consent Award (No 2)* [2002] NSWIRComm 309 at [8] the Full Bench observed that:

> It is extremely important in industrial and employment relations that parties adhere to considered agreements entered into by them. The serious circumstances created by the present difficult, regrettable and preventable industrial dispute are demonstrative of the problems which result from such conduct.

101 The parliamentary statements in 2011 by the then Minister guaranteeing annual wage increases of 2.5 per cent were not statements made in the context of agreement-making. But they were statements public sector employees were entitled to take at face value. To discover that what was said was not reflected in the legislation, but that it was open to the government to contend for less than 2.5 per cent, is not conducive to the maintenance of harmonious industrial relations.

102 In observing the requirements of s 146(2) I am bound to take into account the objects of the Act, which are, relevantly, to provide a framework for the conduct of industrial relations that is fair and just and to encourage and

facilitate equitable, innovative and productive industrial relations. These are relevant considerations in the exercise of my discretion as to what is an appropriate amount to award. Moreover, in determining the amount of increase, it is to be fair and reasonable within the constraints imposed by s 146C and the Regulation. Within the scope of these discretionary considerations I am entitled to take into account the fact that, despite the terms of cl 6(1)(a) of the Regulation, the former Minister promised annual wage increases of 2.5 per cent for public sector employees.

Competing evidence regarding economic and fiscal matters

103 I turn to the evidence regarding fiscal and economic conditions. The Secretary relied mainly on the evidence of Ms Mrakovcic. Ms Mrakovcic was well qualified, possessed a strong background in senior positions in the Commonwealth Treasury and was obviously a highly competent economist. However, she is also a senior NSW Treasury Officer and so, in that respect, unlike the unions' witness, Mr Robinson, Ms Mrakovcic cannot be regarded as independent, nor can her evidence be treated as impartial.

104 The Secretary urges on the Commission that it should limit any wage increase for public sector employees to 2.27 per cent rather than 2.5 per cent because an increase of 2.5 per cent plus the additional cost to government of funding the increase in superannuation contributions was not budgeted for. Unless the unbudgeted cost was offset by the government adopting some other policy option, such as reducing the number of employees, reducing infrastructure spending (improving the State's infrastructure being a high priority for the government), raising taxes or reducing services, it was contended the additional cost will increase net debt and put further pressure on the State's credit rating, which already has a negative outlook according to one of three credit rating agencies. The evidence underpinning this submission is summarised in the earlier part of this decision, as is the evidence of Mr Robinson.

105 The main differences between Ms Mrakovcic's evidence and that of Mr Robinson were as follows:

(1) Mr Robinson had an optimistic - "bullish" - view regarding global growth prospects, whereas Ms Mrakovcic took the view that the global economic recovery was finely balanced and vulnerable to difficult fiscal and monetary policy adjustments. Ms Mrakovcic said the downside risks are "significant".

(2) Mr Robinson's optimistic view regarding the global economy was reflected in his view about domestic prospects. Ms Mrakovcic, on the other hand, considered this was not a time for "unwarranted optimism" in the Australian and NSW economies. Rather, what was needed was "...discerning caution that recognises the risks in the current situation and need for careful policy steering." Ms Mrakovcic also observed that Mr Robinson's optimism did not appear to be broadly shared by other forecasters including the Commonwealth Bank, Access Economics and the NSW Treasury.

(3) Mr Robinson forecast higher than expected revenues from transfer duty and other sources, thus meaning that higher wages were affordable. Ms Mrakovcic noted that any above budgeted tax revenues, should they occur, have been committed by the Government to fund the State's major infrastructure projects.

(4) Ms Mrakovcic stated that under the government's wages policy, wages have kept up with prices and, therefore, there has been no deterioration in real wages even before the effects of the Commonwealth's compensation package introduced with the carbon pricing mechanism are taken into account. Her view was that when the compensation package is taken into account, real wages have actually risen with most households better off by about $10.00 per week. Mr Robinson's view was that there was some doubt as to whether the CPI should be discounted for the estimated carbon pollution reduction scheme (CPRS) effects when measuring real wages growth for a select group of wage earners, i.e. workers in the NSW public sector, the 0.7 per cent addition due to the CPRS being an estimate based on the average household and the average compensation package. Moreover, Mr Robinson said the compensation policy was more an incomes or social allocative policy aimed at improving equity across the community, rather than a

straight compensation package for the CPRS-related price increases. Further, the objective of the CPI index is to measure movements in the prices of a weighted basket of representative goods and services. The headline or total CPI should be used to measure movements in real wages or to deflate certain costs for businesses and governments. It should not be 'adjusted' to reflect changes to taxation rates (which can be adjusted frequently), or adjusted to remove (or discount) changes to subsidies (such as the Pharmaceutical Benefits Scheme) or excise (such as tobacco excise), or movements in exchange rates (which will impact on consumer prices via the impact on import prices).

(5) There was disagreement between Ms Mrakovcic and Mr Robinson regarding the basis upon which to measure movements in NSW public sector wages. Whilst Ms Mrakovcic acknowledged there was no wage index available which is specific to the employees who are the subject of these proceedings, it was her opinion the data relied upon (Australian Bureau of Statistics (2013) Wage Price Index, New South Wales, State/local (unpublished data), September 1997 to June 2013) could "reasonably be expected to be less volatile than relying on a series that relates to movement in rates of pay for only a single industrial instrument – and one that covers considerably less than half of the employees in question".

(6) Mr Robinson was of the opinion that transfer duty will make a strong contribution to state revenue over the next three years and that stronger gross state product growth (GSP) than that assumed in the budget will deliver a higher revenue outcome for the NSW State Government. Mr Robinson further stated that assuming higher GSP growth in NSW (than the NSW Treasury's conservative forecasts), the expectation that coal royalty revenues will hold up and the current strong growth in transfer duty revenue is higher than Treasury projections, he concluded that a 2.5 per cent wage increase, in addition to the 0.25 per cent superannuation charge, was affordable from a budget perspective i.e., the likelihood of higher-than-budgeted revenues will cover the 'extra' costs of the superannuation charge. As such, the state's triple-A credit rating would be maintained. Ms Mrakovcic's response was that transfer duties remain vulnerable to the state of the housing cycle in NSW, payroll taxes vulnerable to the employment situation in NSW, and coal royalties to developments in the global economy and trade growth. She said the 2013-14 Budget was calibrated to these developments and risks and that the Budget recognises the importance of funding more infrastructure investment from higher budget surpluses given the debt situation and current

> outlook. In relation to the credit rating, Ms Mrakovcic emphasised what Standard & Poor's had said, regarding its negative outlook, namely, it "reflects our view that there is a one-in-three chance of a downgrade in the coming 24 months."

106 I deal with these differences below.

The economy

107 It was not submitted by the Secretary that the state of the global or domestic economies was a reason, of itself, to limit any wage increase to 2.27 per cent. Nevertheless, the tenor of the Secretary's submission was one of caution because of what were described as significant downside risks to any recovery in the global and domestic economies.

108 On the evidence available to me in these proceedings I consider the economic outlook, both globally and domestically, justifies a more optimistic rather than pessimistic slant. That is, growth prospects are tilted to the "upside". At the same time, I accept there are risks to economic recovery and that the Secretary was right to submit a cautious approach was appropriate. That is the approach I have taken in considering whether harm would be caused to the economy by awarding a wage increase to public sector employees of 2.5 per cent from 1 July 2013.

109 In relation to the global economy I was referred to remarks by the Reserve Bank Governor on 29 October 2013 where Mr Stevens stated:

> [T]he US economy appears to be healing.... The biggest remaining problems are how to put the US budget onto a sustainable long-run footing, and how to manage the exit from extraordinary monetary policy settings.
>
> In Europe, numerous downside risks that were top of mind a year ago have not, in fact, materialised – which is no small achievement. Moreover, there are signs of a modest cyclical upturn in economic activity. That said, those downside risks still exist and the recovery has been described by ECB President Draghi as weak, uneven, fragile and starting from very low levels.

> China, meanwhile, has continued to grow, more or less in line with the objectives of the Chinese authorities. This is more moderate than the double-digit rates China recorded in earlier times. But it is still a robust performance and China is now a big economy whose performance matters for the rest of the world. The key question in China would be whether the 'shadow-banking' system, where much of the growth in financial activity has been occurring, can be adequately controlled and kept stable.
>
> ...

110 In its June 2013 Decision in the *Annual Wage Review 2012-2013* [2013] FWCFB 4000, after an extensive review of conditions in the Australian economy, the Full Bench stated at [29]:

> [29] In summary, the economic outlook remains favourable, notwithstanding some easing of growth and an increase in unemployment forecast in 2013–14. However, the outlook for growth remains uneven, with continuing pressures on the businesses in the trade-exposed sectors of the economy outside of the resources sector...

111 In relation to the Australian economy, what Mr Robinson said in his Report, quoted below, was not inconsistent with Ms Mrakovcic's evidence:

> For the Australian economy to experience growth above 3 per cent, non-mining business investment will need to come through. That, we think is another two years away. Meanwhile, all levels of government are in fiscal repair mode. They will be constrained by the need to bring budget deficits under control. Long-term expenditure commitments are locked in with pressure on government revenue in a soft economy.
>
> However, with strong growth in mining production and exports, there is little risk of recession — just a soft economy. We expect the economy to grow at a moderate pace, 2.4 per cent this year picking up to 2.9 per cent in 2014/15....

112 The New South Wales economy is vulnerable to developments in the global and national economies. Revenue drawn from GST, property transfer duty, mining royalties and payroll tax are sensitive to developments in the international and domestic economies. Notwithstanding that fact, and in the knowledge of the risk posed by the global and national economies, the outlook for the New South Wales

economy is generally portrayed as optimistic. It is showing some softness, but looking forward the economy is seen to be in positive territory. In the NSW Budget 2013-14 Statement No 2 it was stated at 2.1:

> Looking ahead, given that New South Wales has a diversified industry structure, the State should face a less difficult transition over the forecast period than the national economy. Low interest rates are expected to underpin solid household consumption growth, strong dwelling investment growth, and a gradual improvement in non-mining-related business investment growth. A modest depreciation of the Australian dollar, an improving global economy, and ongoing demand from resource-intensive states, are also expected to assist in this transition.

113 In the NSW Treasurer's Economic Update for September 2013 it was stated that:

> The broader housing market is in structurally better shape than it has been for a decade.
>
> Modest house price growth (Sydney up 6.1 per cent over year to June) is not only spurring activity in the housing sector but giving rise to the important wealth effect and boosting household and consumer confidence. Increased activity is also helping the NSW Budget position, with NSW stamp duty revenues increasing strongly in recent months.
>
> The NSW housing recovery is now underway. With the appropriate policies now in place, combined with a lift in confidence, I am positive that housing will be an important driver of our economy over the medium term.

114 Consistent with the Treasurer's view, Mr Robinson in his report stated:

> But New South Wales economy is now lifting its game. We expect the state economy to grow solidly and outperform the national average over the next three years. Initially, growth will be driven by housing investment. We are comfortable that the long-awaited recovery in residential activity in the state has taken root, and that momentum will build from here.
>
> We forecast dwelling building to increase solidly over the next two-to-three years, underpinning demand in the wider economy and supporting employment growth. Initially, this is being driven by increases in new building, but we expect alterations and additions activity (which account for more than 40 per cent of dwelling building) to start recovering — albeit from a very low base —

> reflecting improved confidence of both investors and owner occupiers.
>
> Underlying this view is that population growth has run well ahead of the supply of houses in the state. The recovery in dwelling building will be critical to the state's economic performance, given continued forecast declines in public investment, lower mining-related investment, and the impact of the high Australian dollar on the manufacturing, tourism and other trade-exposed industries.
>
> ...
>
> The forecast cycle in GSP growth is less marked than the cycle in SFD, but still notable, with growth of 2.7 per cent and 3.5 per cent forecast for 2013/14 and 2014/15 respectively. The recovery in growth in New South Wales, combined with some slowing in the mining-intensive states, will see New South Wales growing faster than the overall Australian economy for the next few years.
>
> This should underpin a gradual recovery in employment growth in New South Wales, to 2.3 per cent in 2014/15, which should be sufficient to keep the unemployment rate under 6 per cent. This, combined with ongoing population growth, means that household expenditure will also be an important driver of economic growth in the state over the next two to three years.

115 In *Police Officers (No 2)*, a decision handed down in September 2012, the Full Bench addressed the state of the New South Wales economy at [137]-[141]:

> [137] Turning to the New South Wales economy, it is appropriate to observe, at the outset, that the New South Wales economy continues to represent a substantial proportion of the national economy, although not experiencing the same record growth from mining investment as Queensland and Western Australia.
>
> [138] The Budget Statement accompanying the 2012-2013 New South Wales Budget indicated that growth in New South Wales will be lower than expected in 2011-2012 but is expected to accelerate through 2012-2013 and reach a position above trend in 2013-2014.
>
> [139] This broadly conforms with the expert evidence in these proceedings. Mr Richardson referred to the poor performance of New South Wales over the last decade due to a series of factors; most particularly the shift in resources to the "north" and "west" and the consequences of the resource boom on the State's manufacturing base (given high exchange rates). However, he concluded that many of the "negatives" had faded and performance had lifted over the 2010-2011 period. The State's short term outlook was said to be "solid", although growth would

> remain less than the wider Australian economy for the 2011-2012 and 2012-2013 periods. The challenges of exchange rates remained a problem for the State and the growth of resource rich States was said to hold back New South Wales in the medium term.
>
> [140] Dr Gelber referred to the New South Wales economy coming out of an economic malaise. State Financial Demand ('SFD') accelerated through the 2010 calendar year, particularly with growth in public investment, dwellings and business investment. He predicted SFD growth of 3.3 per cent in 2010-2011, below the calendar year growth of 3.8 per cent in 2010. Moderate to strong growth was expected for 2011-2012 and 2012-2013 "although both Gross State Product and SFD growth is projected to lag national GDP and domestic growth". Dr Gelber predicted Gross State Product ('GSP'), SFD and employment growth in New South Wales would be below the national average in 2011-2012 and 2013-2014, but will match the national average in 2012-2013.
>
> [141]The upshot of this review is that economic circumstances in New South Wales should be treated as considerably improved over the previous decade but, at least for the first year of any award (now the past year), relatively constrained. The economy is predicted to be stronger over the 2012/2013 and 2013/2014 periods. There are a number of positive indicators for the economy in that period including a return to a stronger fiscal position...

116 Against the backdrop of its consideration of the economy, the Full Bench concluded that the salaries of police officers should be increased by 3.5 per cent from 1 July 2011; 3.2 per cent from 1 July 2012; and 3.2 per cent from 1 July 2013. It does not seem to me that in the period since the Full Bench handed down its decision there has been any material deterioration of economic conditions.

117 Mr Nolan of counsel for Unions NSW referred to the New South Wales government's submission to the Annual Wage Review 2012-13 undertaken by the Fair Work Commission earlier this year in which a Full Bench of that Commission awarded an increase in minimum wages of 2.6 per cent ([2013] FWCFB 4000). No exception was taken to Mr Nolan's quoting from that submission or that his quote was inaccurate. The submission was as follows:

> The NSW economic outlook is for growth returning to trend, underpinned by:

• solid trading partner growth and an anticipated modest recovery in global activity;

• strong growth in mining investment and non-rural commodity exports;

• strong demand from resource-intensive states for NSW services and manufactured goods;

• lower interest rates;

• solid fundamentals for the housing construction sector including a high level of new housing completions, a low rental vacancy rate and firm growth in household incomes and the population;

• a strong outlook for farm production and exports; and

• public investment picking up over the next two years, consistent with the Government's capital spending profile'.

118 A consideration of the state of the economy is, of course, only one aspect of the public interest considerations the Commission is required to take into account under s 146(2) of the Act. Any decision in the present case about whether the wage increase should be 2.27 per cent or 2.5 per cent for 12 months will be made in an environment of a reasonably positive outlook for the State's economy. The risks referred to in the evidence that was adduced do not suggest an imminent, sudden or early reversal of that outlook and are not, of themselves, such as to warrant the lesser increase.

Revenue

119 In his affidavit, Mr Robinson stated:

> In outlining her concerns for a 2.5 per cent wage rise, Ms Mrakovcic ignores the potential upside to revenue from stronger growth in Growth State Product ("**GSP"**), employment and transfer duty which can offset the non-budgeted salary costs....
>
> ...
>
> The upswing in dwelling construction combined with healthy growth in Sydney house prices should see transfer duty make a strong contribution to state revenue over the next three years. Indeed, since the preparation of the 2013/14 NSW Budget, residential sales activity has been strong, with recent reports revealing stamp duty on residential transfers in July and August

were up by more than 30 per cent compared to the same months last year. The 2013/14 state budget projected a 20.5 per cent increase in stamp duty. BIS Shrapnel forecasts further strong sales activity to continue, along with further healthy rises in average house and unit prices. In effect, I believe there is upside to the transfer duty revenue projections, and the NSW Treasury projections could turn out to be conservative.

In addition, stronger gross state product growth than that assumed in the budget will deliver a higher revenue outcome for the NSW State Government. If one assumes that state government revenue is proportional to GSP, higher GSP growth of 0.25 per cent would add around $300 million to state revenue by 2015/16.

Assuming higher GSP growth in NSW (than the NSW Treasury's conservative forecasts), the expectation that coal royalty revenues will hold up... and the current strong growth in transfer duty revenue is higher than Treasury projections, and given the lower cost of the superannuation over the next three years, then I would conclude that a 2.5 per cent wage increase, in addition to the 0.25% superannuation charge, is affordable from a budget perspective i.e. the likelihood of higher-than-budgeted revenues will cover the 'extra' costs of the superannuation charge. As such the state's triple-A credit rating would be maintained.

120 On the question of transfer duty, Ms Mrakovcic responded in the following terms:

Stamp duty revenue for 2012-13 was about $174 million higher than expected at the time of the 2013-14 Budget. Revenue in this year included one-off factors such as $215 million for the sale of Port Botany and Port Kembla. Strong rates of growth are already factored into the forward budget estimates, with transfer duty expected to grow by a further 13 per cent in 2013-14 before moderating to growth of between 7½ and 8 per cent per year to 2016-17. Residential transfer duty is forecast to grow more rapidly, rising by over 20 per cent in 2013-14 due to the strengthening conditions in the housing sector.

It should further be noted that the strong growth in residential transfer duty reflects a range of positive indicators including historically low interest rates, rising house prices and rents, strong underlying demand and low vacancy rates. The associated strength in revenue is not necessarily reflective of broader economic trends or other revenue heads. Transfer duty is also a very volatile source of revenue, with annual movements exceeding 25 per cent not uncommon.

It is important to note that, in aggregate terms, revenues in 2012-13 grew by only 2.0 per cent on 2011-12 revenues. Moreover, while total revenues were 0.7 per cent higher than budgeted, taxation was $131 million lower than originally budgeted with land tax, payroll tax and GST revenues all coming in weaker than expected. A bring forward of Commonwealth funding provided some offset.

Overall, the subdued revenue growth experienced in 2011-12 and 2012-13 means that the lower revenue base negatively affects revenues throughout the forward estimates period to 2016-17.

Further, while Mr Robinson may regard his forecasts for higher than expected revenues to mean that higher wages are affordable (Mr Robinson paragraph 25), it should be noted that any above budgeted tax revenues, should they occur, have been committed by the Government to be paid into *Restart NSW* to fund the State's major infrastructure projects.

Therefore above budgeted revenues, whether higher royalties, transfer duty or other NSW own source revenues are not available, on current policy settings, for recurrent expenses such as wage costs.

121 On the broader question of the State accounts, Ms Mrakovcic stated:

The 2012-13 result was a surplus of $239 million which represents a modest improvement on the estimated 2012-13 deficit of $374 million in the 2013-14 Budget. The result included higher stamp duties but also unexpected grants from the Commonwealth that will mean lower than otherwise grant revenues in 2013-14.

There is on-going pressure on the State's revenues, especially from lower GST revenues as consumers remain cautious and spending on GST exempt items continues to increase as a percentage of total consumption. Transfer duties remain vulnerable to the state of the housing cycle in NSW, payroll taxes vulnerable to the employment situation in NSW, and coal royalties to developments in the global economy and trade growth.

The 2013-14 Budget was calibrated to these developments and risks. It recognised the importance of the current period for NSW, given both global growth developments and their implications for the transition from mining to non-mining taking place in the national Australian economy. It recognised the importance of enabling and facilitating that transition, and the role that infrastructure investment in the state could play in such facilitation, but also the importance of funding more of that infrastructure investment from higher budget surpluses given the debt situation and current outlook. The net lending deficit, that takes account of the Government's capital spending, was deliberately targeted to decline over the budget and forward estimates to reduce the rate of increase in net debt and therefore place the State's finances on a sustainable footing.

It is for this reason that the emphasis was placed on funding important infrastructure from rising budget surpluses, and focus on constraining expenses rather than relying on lifting tax revenues at a time when consumer confidence is vulnerable.

122 Even accepting that Treasury had projected a 20.5 per cent increase in stamp duty in its 2013/14 budget projections, Mr Robinson considered those projections could turn out to be conservative. Consistent with Treasury's approach to budget forecasting, Ms Mrakovcic in her evidence has adopted a conservative approach in reliance, amongst other considerations, on the proposition that revenue sources remain vulnerable.

123 According to the NSW Reports on State Finances for the years 2009-10 to 2012-13 Treasury has in each year erred on the conservative side as to its estimates. This is shown in the following table:

Year	**Actual Budget outcome**	**Improvement on Budget estimate**
2009-10	$994m surplus	$1,984m
2010-11	$1,340m surplus	$567m
2011-12	$680m surplus	$1,398m
2012-13	$239m surplus	$1,063m

124 These consistent underestimates lend some weight to the view that NSW Treasury projections for 2013-14 could turn out to be conservative, as Mr Robinson suggested, with the unbudgeted cost above 2.5 per cent easily absorbed into the improvement in the budget estimate. Moreover, the history of budget underestimates should be seen in the light of the projected cost to the government of the superannuation increase of 0.25 per cent being $62m in 2013-14 in a budget involving expenses of $62,000m, with employee-related expenses accounting for about half that amount. Further, I note that employee expenses in 2012-13 were $346m lower than budget.

125 The decision by the Full Bench in *Police Officers (No 2)* is relevant here. In that case the Full Bench was considering a claim by the Police Association of 5 per cent per annum for three years. This claim was allowable under cl 10 of the Regulation, which provided:

> **10 Exception for pending proceedings concerning police officers**
>
> This Regulation does not apply to the following proceedings:
>
> (a) proceedings pending on the commencement of this Regulation before the Commission in respect of police officers and designated IRC 325/2011 (limited to those proceedings as in force on the commencement of this Regulation),
>
> (b) proceedings on a cross-claim or counter application made in connection with those pending proceedings.

126 An issue in the proceedings, identified at [53], was:

> Whether the claim should be granted having regard to its economic and, in particular, financial consequences (it being contended that the grant of any wage increase above the 2.5 per cent already awarded by the Commission would "drive the surplus budget into deficit").

127 Evidence of a senior Treasury official in the proceedings was that New South Wales faced significant, ongoing deficits and that wage increases above 2.5 per cent without realised productivity savings make that position "more untenable" (at [29]).

128 Having regard to evidence as to the cost of the claim, the Full Bench in *Police Officers (No 2)* referred at [31] to a table produced by the senior Treasury official. It was estimated that the cost of an annual increase of 3.5 per cent would be $122m and an annual increase of 4.0 per cent would be $183m. The average increase awarded by the Full Bench was 3.3 per cent, which would amount to a cost of about $150m, two and a half times the cost of the claim in the present proceedings.

129 Despite the claim by Treasury that it faced ongoing deficits, and that any increase above 2.5 per cent would drive the budget into deficit, that did not occur, either in 2011-12 or 2012-13.

130 It does not seem to me that the government's budgetary position would be placed under unacceptable strain, or that its endeavour to achieve sustainable savings over the long term would be jeopardised, by the Commission awarding an increase in wages to public sector employees of 2.5 per cent from 1 July 2013.

Wages growth

131 It was Ms Mrakovcic's evidence that since the introduction of the government's wages policy in 2011 (i.e., June 2011 to June 2013), rates of pay in the NSW public sector have increased by an average of 2.8 per cent per annum, while using through the year figures the adjusted Sydney CPI has increased by an average of 1.6 per cent per annum (from June 2011 to June quarter 2013). Real wages, it was asserted had, therefore, increased by around 1.3 per cent per annum.

132 There are a number of things to be said about Ms Mrakovcic's approach.

Inflated figure of 2.8 per cent

133 First the figure of 2.8 per cent is, in my opinion, an inflated figure because it includes local government. The Local Government (State) Award, which covers about 52,000 employees, provides for the following relevant increases:

(1) a 2.15% increase in rates of pay with a minimum payment of $17.00 per week to operate from the first full pay period to commence on or after 1 July 2011.

(2) a 3.25% increase in rates of pay with a minimum payment of $23.00 per week to operate from the first full pay period to commence on or after 1 July 2012.

134 The Local Government Award provides for a further increase of 3.25 per cent with a minimum payment of $23.00 per week to operate from the first full pay period to commence on or after 1 July 2013.

135 Additionally, there are other factors that would have inflated the figure of 2.8 per cent. For example, something in the order of 16,000 police officers were awarded 3.5 per cent from 1 July 2011 and 3.2 per cent from 1 July 2012. Police officers received a further 3.2 per cent from 1 July 2013. Further, if employees of statutory state owned corporations, such as Macquarie Generation were included in the Index used by Ms Mrakovcic, I note that those employees received an increase of 4.2 per cent from 1 July 2010 and a further 4.2 per cent from 1 July 2011.

136 By contrast, the 80,000 employees covered by the Crown Employees (Public Sector – Salaries 2008) Award, which is the subject of these proceedings, received 2.5 per cent from 1 July 2011 and a further 2.5 per cent from 1 July 2012. Another award the subject of these proceedings, the Health Employees (State) Award, covering a large number of employees in the public hospital system, has been varied to increase rates of pay by only 2.5 per cent per annum since July 2011.

137 Even if it were to be accepted that the average increase in public sector rates of pay between 2011 and 2013 was higher than 2.5 per cent, it would not be a fair outcome to award less than 2.5 per cent to what I would estimate to be at least more than 100,000 public sector employees, whose average increase was 2.5 per cent, if to do so meant that their real wage level was not maintained in accordance with the government's wages policy.

Discounting CPI for effects of carbon price compensation

138 The second thing to be said about Ms Mrakovcic's approach concerns the discounting of the Sydney CPI in 2012-13 by the estimated effect on the

CPI of the introduction of the Carbon Pollution Reduction Scheme (CPRS) on 1 July 2012, based on the notion that households were compensated for the "estimated emission related price increases" via "a compensation package of income tax cuts and other benefits". Ms Mrakovcic's evidence was that the Commonwealth Government designed a compensation package to offset the estimated 0.7 per cent effects of the carbon emission related price increases such that on average, households would see cost increases of $9.90 per week, while the average assistance would be $10.10.

139 As I earlier indicated, in the course of considering the matters that are the subject of these proceedings, I requested the parties to make short written supplementary submissions regarding the treatment of the effect of the carbon price by Full Benches of the Fair Work Commission in their two most recent Annual Wage Reviews (2011-12; 2012-13) and by the Full Bench of this Commission in *Police (No 2)*. The summary of the position of the parties is earlier set out.

140 The objective of the federal Commission in undertaking an annual wage review is, in large measure, to establish and maintain a safety net of fair minimum wages (see s 284 of the *Fair Work Act* 2009 (Cth)). There is no policy objective to maintain the level of real wages over the medium term. The federal Commission took the view that as mainly low paid workers had been compensated for the effects of the carbon price through the tax system it would be double dipping to provide further compensation through minimum wage adjustments. This did not appear to be the subject of any contrary view.

141 In *Police Officers (No 2)* the claims were based primarily on changes in work value and improvements in productivity and efficiency. Economic and fiscal considerations entered the picture because of the provisions of s 146(2). As part of its economic consideration the Full Bench had regard to submissions concerning the maintenance of the purchasing power of wages. There was, therefore, a mix of considerations. However, there was

no obligation on the Full Bench to have any regard to the objective of maintaining real wages "over the medium term" in line with the Reserve Bank's inflation target "over the cycle" and it did not do so other than in the broadest possible sense.

142 On the other hand, as part of my consideration of the public interest, I am required to take into account the objective of maintaining real wages "over the medium term" in line with the Reserve Bank's inflation target "over the cycle".

143 It was agreed by Ms Mrakovcic in cross examination that real wage movements are determined by "looking at nominal wages and adding into that or deflating it for inflation increases measured by CPI." Ms Mrakovcic also agreed if one were to take this formula literally as the means of determining movements in real wages, the impact of the carbon pricing would not be abstracted.

144 In consenting to an increase in wages and allowances for public sector employees of 2.5 per cent from 1 July 2012, the Secretary seems to have accepted on that occasion it was unnecessary to make any adjustment for the impact of the carbon price: see *Crown Employees (Public Sector - Salaries 2008) Award* [2012] NSWIRComm 70. No explanation was provided as to why the Secretary had changed his position.

145 If I am to depart from the accepted method of determining movements in real wages for the purpose of having regard to the objective of maintaining real wages over the medium term, then it will be necessary for the Commission in future cases to have regard to not only compensation for the carbon price, but other matters affecting the purchasing power of wages. The PSA submitted this would include such tax-based increases as the flood levy and bracket creep, which might arise for consideration over the medium term.

It does not seem to me that it was the intention to introduce such complications into assessing whether annual wage increases should be 2.5 per cent or something less in the context of an objective maintaining real wages over the medium term in line with the Reserve Bank's inflation target over the cycle. Neither, it seems, did the Secretary in agreeing to 2.5 per cent increase in 2012.

146 I agree with Mr Robinson that the objective of the CPI index is to measure movements in the prices of a weighted basket of representative goods and services. The headline or total CPI, using year average figures (the approach adopted in *Police Officers (No 2)*), should be used to measure movements in real wages.

147 Further, as Mr Robinson stated in his affidavit, the headline or total CPI:

> [S]hould not be 'adjusted' to reflect changes to taxation rates (which can be adjusted frequently), or adjusted to remove (or discount) changes to subsidies (such as the Pharmaceutical Benefits Scheme) or excise (such as tobacco excise), or movements in exchange rates (which will impact on consumer prices via the impact on import prices).

148 I further agree that the compensation for the CPRS:

> [W]as more an incomes or social allocative policy aimed at improving equity across the community, rather than a straight compensation package for the CPRS-related price increases.

There is a further consideration. As I earlier observed, even though inflation might exceed 2.5 per cent per annum over the medium term, wage increases may not. Given that the Commission is unable to compensate for higher rates of inflation, real wages in those circumstances could not be maintained. It seems to me somewhat inequitable, therefore, that the Commission would discount wage increases in a particular year for the one-off effect of tax cuts or household assistance measures. The figure of 2.5 per cent was obviously chosen as being at the midpoint of possible price fluctuations over the medium term. Over that term, the expectation seems to be that, despite swings and roundabouts, real wages would be maintained. If the CPI is discounted for the one off effect of tax cuts and the like, the bias over the medium term will swing negatively and real wages will not be maintained.

149 Finally on this point, if the Commission were to accept that the CPI should be discounted for the carbon price compensation in 2012-13 it would mean a CPI figure of 1.9 per cent. If one were to adopt a medium term outlook of, say, five years from 2011 and:

(a) accepting inflation increased by 2.5 per cent in 2011-12 and by2.6 per cent discounted by 0.7 per cent in 2012-13, and

(b) assuming CPI increases of 2.5 per cent in years 2013-14, 2014-15 and 2015-16,

the average annual increase in prices would be about 2.4 per cent. The above assumption is not baseless because the government's wages policy assumes real wages will be maintained over the medium term in line with the midpoint of the Reserve Bank's target range of 2-3 per cent.

150 If wages for public servants are increased by only 2.27 per cent in 2013-14 and by 2.5 per cent in each of the other years in the hypothetical five-year period, real wages will not have been maintained over the medium term.

151 I do not propose to discount the 2012-13 CPI figure by 0.7 per cent for the purpose of these proceedings.

Period over which CPI increases measured

152 The third thing to be said concerns Ms Mrakovcic's choice of looking at only two years of CPI increases (2011-12 and 2012-13) for the purpose of determining real wage growth. I understand the rationale for this was because the government's wages policy as reflected in the Regulation was introduced in June 2011 and that should be the starting point. However, as senior counsel for the PSA pointed out, confining it to those two years

gives a distorted picture because the period contains very low quarterly changes in CPI (for example, -0.1 per cent for the December 2011 quarter and 0.1 per cent in the March 2012 quarter), which do not reflect the norm. Moreover, two years between 2011 and 2013 is a short timeframe over which to measure movements in the CPI. Ms Mrakovcic herself noted in her affidavit in reply:

> Historical averages of CPI growth will obviously be sensitive to the time period chosen, while according to Mr Robinson, CPI growth over the last 7 years has averaged 2.8 per cent, it is noteworthy that this period includes some high inflation rates and that an average taken over the last 4 years (reflecting more recent outcomes) is 2.5 per cent. The earlier period included a time of stronger inflation driven by demand pressures in the economy at a time of limited capacity and a tight labour market leading to solid growth in nominal unit labour costs. Given the state of the economy at the present time, such factors will almost certainly not be in play in the near future. Household consumption is more subdued as households continue to rebuild their balance sheets, with consumption growth more in line with income growth. A softening labour market is also likely to moderate demand pressures.

153 The approach taken by the Full Bench in *Police Officers (No 2)* when deciding the amount of increase that should be awarded was to have regard, prospectively, to the changing value of money over time. In that respect, the Full Bench stated at [121]:

> [121] Given the conclusion that we shall reach later in this decision that the ultimate award made in this matter will operate for a period of three years, and, further, given that any additional salary adjustments (over the interim award) arising from the general claim will operate from 1 July 2011, then, having regard to the approach adopted in *Police Award (No 1)* at [545], the Commission will have regard to, for the first year of the award, the inflation rates operating in the period 1 July 2010 to 1 July 2012 and, for the balance of the period of operation of the award, to inflation forecasts corresponding to each successive actual year of the operation of the award; namely, in the second year, the financial year 2012-2013 and for the third year, the financial year 2013-2014.

154 In *Police Officers (No 2)* the rates of inflation to which the Full Bench had regard in fixing the increases in wages for the three years 2011, 2012 and

2013 were 3.1 per cent (having regard to the whole of the period from the last salary adjustment in 1 July 2010 through to the end of the financial year to 2011), 2.5 per cent and 2.5 per cent respectively.

155 In the absence of being able to measure real wage movements over a period that might be regarded as "medium term" because the starting point is June 2011, I have adopted the approach of the Full Bench in *Police Officers (No 2)*. If one accepts any measurement should be from 2011 and takes the increase in the Sydney CPI for 2011-12 (2.5%), 2012-13 (2.6%) and the NSW Treasury's forecast for 2013-14 (2.5% - noting Mr Robinson's forecast is 2.6%), then an adjustment to the Crown Employees Salaries Award of 2.27 per cent from 1 July 2013 will not maintain the level of real wages over the period 2011 to 2014.

Comparison with private sector wage movements from 1997

156 Ms Mrakovcic asserted that from the September quarter 1997 to the June quarter 2013, a period of 15¾ years, in real terms (that is the nominal indices deflated by the Sydney CPI, excluding the introduction of the GST on 1 July 2000 and carbon tax on 1 July 2012):

- In the NSW public sector, real wages have increased by a compounded 24.1 per cent or at an annual average rate of 1.4 per cent.
- In the NSW private sector, real wages have increased by a compounded 13.2 per cent or at an annual average rate of 0.8 per cent.

157 I do not understand the relevance of making retrospective comparisons between public and private sector wage movements if the contention is (according to Ms Mrakovcic's evidence) that the relevant starting date for measuring whether real wages have been maintained is July 2011; that is, the starting point for the government's wages policy. One may not approbate and reprobate. In any event, such comparisons are overly simplistic, rely on an arbitrarily chosen timeframe and cannot be fairly

made unless comparing like with like. There was no evidence as to the basis upon which the wages were adjusted, either in the public sector or the private sector: whether work value was the basis, whether the increases were related to productivity and efficiency improvements, whether the adjustments were based purely on inflation, whether the increases were by consent or arbitration, or whether the occupations of the wage earners that were compared were in fact comparable.

Credit rating

158 It was submitted for the Secretary that awarding the claim would adversely affect the Budget result and increase net debt. Higher debt at a time when the State's credit rating from Standard and Poor's is on negative outlook will place further pressure on the triple-A credit rating, it was submitted.

159 The rating by Standard & Poor's was affirmed on 23 October 2013 at "AAA/A-1+", but that the outlook remains "negative". In May 2013, another major credit rating agency rated New South Wales "AAA" with a stable outlook. In March 2013, Fitch affirmed the rating as "AAA" with a stable outlook.

160 The rating report by Standard & Poor's was a confidential exhibit and it would not be appropriate to quote from it. However, by indicating a negative outlook that should not be taken as a condemnation by Standard & Poor's of the government's management of the economy or that there are no positive aspects, because the report clearly suggests otherwise. The Treasurer referred to the report in a media release on 24 October 2013 and quoted from the report, relieving me of that responsibility. The quote was in the following terms:

> We consider NSW's financial management as positive in an international context, supported by the institutional settings and the state's tightened management of its operating expenditure and government businesses.

161 The Treasurer considered Standard & Poor's report to be an endorsement of the government's "strong financial management" and noted that New South Wales was one of only two States to retain a "AAA" rating. Nevertheless, the Treasurer accepted that the State would continue to face the challenge of getting New South Wales back into a "sustainable surplus position."

162 The rating by a credit rating agency appears to be important because a downgrading may have an effect on interest payments. Whether or to what extent that would occur in circumstances where two other major agencies maintained a "AAA" rating with a stable outlook was not expanded upon. At its highest, the Secretary's submission was that increased debt would place further pressure on the rating.

163 Whilst an increase in expenses of $62m as a consequence of granting the claim might seem a large amount in absolute terms, in the context of the State's budget of about $62,000m it is quite small and its impact is likely to be relatively minor. Increased pressure on the "AAA" rating is but one factor to be considered in the mix of considerations and, in my view, a case has not been made out that it should be treated as the dominant consideration.

Consequences

164 It was Ms Mrakovcic's evidence that to maintain the fiscal strategy and ensure the retention of the state's triple-A credit rating, the Government will have to take policy actions to offset employee-related cost increases above 2.5 per cent. The choices, she said, were reducing expenses, raising taxes or reducing the infrastructure program. Ms Mrakovcic said that none of these options were palatable.

165 Within the constraints of the framework imposed by the parliament on the Commission's powers to fix wage rates, the Commission is bound to ensure the wages are fair and reasonable and, in exercising its discretion

in that respect, is required to take into account the public interest including the effects of its decisions on the economy.

166 There is an inevitable and unavoidable tension between the exercise of that discretion and the responses available to government. It cannot follow that because the government may have to reduce expenses, raise taxes or reduce spending that the Commission is forestalled from increasing wages in order that they are fair and reasonable. It must only be, as the Full Bench held in *Nurses (No 4),* if real harm were likely to flow from any decision to increase wages that the Commission would exercise the necessary restraint.

167 Neither the New South Wales economy nor the government's fiscal position is in such a parlous state that an increase of 0.23 per cent threatens real harm.

Conclusion

168 I have concluded that the employer parties have not made out a case to limit the increase to 2.27 per cent for public sector employees for the 12 months period from 1 July 2013. I intend to increase wages and allowances by 2.5 per cent.

169 In arriving at that conclusion I have considered the respective parties' cases in the context of the requirements of the Act and in particular, ss 10, 7(3)(d), 146(2), 146C and the Regulation.

170 A public interest consideration has been the expectation created by parliamentary statements guaranteeing a wage increase of 2.5 per cent. That cannot be the only or dominant consideration and as I have pointed out it cannot prevail over the terms of the legislation, which refers to "increases in remuneration or other conditions of employment *that do not increase employee-related costs by more than 2.5% per annum.*"

171 The legislation requires the Commission to set fair and reasonable wages. In doing so, as I have explained, the Commission is constrained by s 146C and the Regulation. But within those constraints s 10 continues to apply. The Commission is also required to have regard to the public interest in that it must have regard the state of the economy of New South Wales and the likely effect of its decisions on that economy, again, within the constraints imposed by s 146C and the Regulation.

172 In relation to the case brought by the employer parties I have found:

(1) On the evidence available there exists a reasonably positive outlook for the State's economy. The risks referred to in the evidence do not suggest an imminent, sudden or early reversal of that outlook and are not, of themselves, such as to warrant the lesser increase of 2.27 per cent.

(2) The government's budgetary position would not be placed under strain nor would its endeavour to achieve sustainable savings over the long term be jeopardised by the Commission awarding an increase in wages to public sector employees of 2.5 per cent from 1 July 2013.

(3) It is not appropriate to discount the CPI for compensation granted through the tax system in respect of the impact of the carbon price.

(4) If one takes the increase in the Sydney CPI for 2011-12 (2.5%), 2012-13 (2.6%) and the NSW Treasury's forecast for 2013-14 (2.5% - noting Mr Robinson's forecast is 2.6%), then an adjustment to the Crown Employees Salaries Award of 2.27 per cent from 1 July 2013 will not maintain the level of real wages over the period 2011 to 2014.

(5) The negative outlook by one credit rating agency in an otherwise positive report is not a reason to limit any wage increase for public sector employees to 2.27 per cent from 1 July 2013.

Orders and directions

173 The awards that are the subject of these proceedings are to be varied to provide for an increase in wages and relevant allowances by 2.5 per cent

from the beginning of the first pay period to commence on or after 1 July 2013. I understand the operative date is a matter of agreement between the parties.

174 I further understand the fact that most, if not all, of the awards that are the subject of these proceedings have already been varied to provide for an increase of 2.27 per cent from 1 July 2013. It is not my intention they receive an additional 2.5 per cent, but only that any increase from 1 July 2013 be limited to 2.5 per cent.

175 That may involve applications to vary the relevant awards to delete reference to the earlier increase and substitute an increase of 2.5 per cent or it may mean a variation to increase 2.27 per cent to bring it up to 2.5 per cent. It is a matter for the parties to determine the most appropriate form of variation.

176 The parties are to confer as to how this decision is best implemented. The Commission as presently constituted will reconvene at 9.30 am on Friday 20 December 2013 to hear further from the parties in that respect and to consider any orders in respect of implementation.

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