

WAGES AND ALLOWANCES REVIEW 2006

Outline of Submission



December 2006

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1. Parties which Ai Group is appearing for

1. The Australian Industry Group is appearing in these proceedings on behalf of its members generally, and on behalf of its affiliate - the Engineering Employers Association, South Australia.
2. Ai Group is also appearing on behalf of the following organisations in relation to the applications listed:
 - Australian Air Express Pty Ltd: (Re. C2006/293 – Pre-reform – *Australian Air Express Consolidated Award 2004* and C3830 – Transitional – *Australian Air Express Consolidated Award 2004*);
 - Bluescope Steel Limited: (Re. C2006/3491 – Pre-reform – *BHP Steel Products – Technical Employees (Western Port) Award 1998* and C2006/3516 – Transitional – *BHP Steel Products – Technical Employees (Western Port) Award 1998*);
 - CSR Limited: (Re. C2006/3893 – Pre-reform – *CSR Staff (Consolidated) Award 2000* and C2006/206 – Transitional – Gypsum, Plasterboard and Plaster of Paris Manufacturing Industry Gypsum Products Industry Award – 1999 (CSR) and C2006/266 – Pre-reform – *Gypsum, Plasterboard and Plaster of Paris Manufacturing Industry Gypsum Products Industry Award – 1999 (CSR)*);
 - Nissan Motor Company (Australia) Pty Ltd: (Re. C2006/3608 – Pre-reform – *Nissan Motor Co. (Australia) Pty Ltd Clerks Award 1998*);

- Virgin Mobile (Australia) Pty Ltd: (Re. Virgin Mobile (Australia) Pty Ltd Award 2003 – Pre-reform – *Virgin Mobile (Australia) Pty Ltd Award 2003*).
3. The 135 applications in which Ai Group (and those which we represent) have an interest are set out in **Annexure A**.

2. Summary of Ai Group's position

4. These proceedings relate to a very large number of applications filed by various unions to increase:
- Wage rates in transitional awards;
 - Wage related allowances in pre-reform awards;
 - Expense related allowances in pre-reform awards;
 - Wage related allowances in transitional awards; and
 - Expense related allowances in transitional awards.
5. Ai Group submits that, despite the substantial effort and resources devoted by Ai Group and other parties to these proceedings over the past two weeks the approach of having a Full Bench deal with a very large number of applications for increases in wage rates and allowances in individual awards has proved to be unworkable for the reasons set out in Section 3 of this submission.
6. Ai Group submits that the following approach should be adopted by the Full Bench:
- The applications which were filed with draft orders by 24 November, and in respect of which there is consent to the variation (other than the operative date), should be settled by the Full Bench and orders issued arising from these proceedings;

- Other applications should be referred to individual members of the Commission to deal with - including determination of an appropriate operative date, which is prospective of the date when the matter is heard and determined by the individual member.
7. The above approach is fair and logical. It is important that the Commission deal with applications for award variations in the same calm and sensible way that it has traditionally done. The WorkChoices legislation does not require that the Commission depart from such an approach.
 8. The Australian Fair Pay Commission handed down its first wage-setting decision on 26 October 2006, awarding a very generous increase to employees. The increase became operative in all Australian Pay and Classification Scales from 1 December 2006.
 9. Ai Group is of the view that this generous increase carries with it substantial risks.
 10. While the economy is continuing to grow at a moderate pace, capacity constraints, skill shortages, high oil prices and the drought create risks for the economy. In addition, the combination of a poor export performance and a rapid growth in imports has seen the trade deficit grow appreciably. There are also growing inflationary pressures within the economy.
 11. Notwithstanding the risks the AIRC is required by the *Workplace Relations Act* to ensure that its decision in these proceedings is not inconsistent with the Fair Pay Commission's decision.
 12. Ai Group strongly submits that the AIRC should not grant retrospectivity in respect of any of the applications. If the Commission grants retrospectivity a very dangerous precedent would be set which would greatly disadvantage employers in the future. There are compelling and obvious reasons why retrospectivity in respect of operative dates for wage and allowance increases

is inappropriate.

13. Our concerns about retrospectivity are greatly magnified given that the unions appear to be proposing that an operative date of 1 December 2006 apply even for applications made well into the future. Such a position would be extremely unfair on employers.
14. Ai Group submits that a prospective operative date should apply. The date should be at least two weeks in advance of the date when the orders are issued by the Commission varying the relevant award. This allows some time (albeit it a very short period) for employers to be advised of the variation.
15. A prospective operative date is consistent with the decision of the Fair Pay Commission, which determined that an operative date more than a month in advance of the decision was warranted. Similarly, a retrospective operative date would not be consistent with the Fair Pay Commission's decision.

3. Approach that the Commission should take in dealing with the applications

16. The Directions issued by the Full Bench required that the unions:
 - File and serve an outline of submissions by 24 November; and
 - File and serve draft orders for each application by 24 November.
17. The Directions were fair and reasonable. If an application is made to the Commission by a union for an award variation, employers bound by the award are entitled to know the specific changes sought with sufficient time to check the wording and calculations before the matter is heard and determined by the Commission.

18. It is evident that draft orders were not filed and served in respect of a high proportion of the applications by 24 November.
19. At around 9.00am on Thursday 30 November, Ai Group sent a facsimile to the ACTU (**Attachment B**) advising of 37 draft orders which we had not received directly from the unions or been able to obtain from the AIRC's website by that time. The facsimile requested that the draft orders be provided by no later than close of business on Thursday 30 November. The ACTU's reply is also set out in **Attachment B**.
20. In addition, in many cases problems were identified with the calculations in the unions' draft orders and discussed with the relevant union but an amended draft order reflecting the agreed wage rates and allowances has not yet been filed with the Commission or received by Ai Group. These include, for example, the following applications made by the AMWU:
- C2006/3413 – Pre-reform – *Metal Engineering and Associated Industries Award 1998*;
 - C2006/3443 – Transitional – *Metal Engineering and Associated Industries Award 1998*;
 - C2006/3429 – Pre-reform – *National Metal and Engineering On-site Construction Industry Award 2002*;
 - C2006/3431 – Transitional – *National Metal and Engineering On-site Construction Industry Award 2002*;
 - C2006/3457 – Pre-reform – *Vehicle Industry Award 2000*;
 - C2006/3456 – Transitional – *Vehicle Industry Award 2000*;
 - C2006/3483 – Pre-reform – *Vehicle Industry – Repair, Service and Retail – Award 2002*;
 - C2006/3484 – Transitional – *Vehicle Industry – Repair, Service and Retail – Award 2002*;
 - C2006/3466 – Pre-reform – *Food Preservers Award 2000*;
 - C2006/3475 – Transitional – *Food Preservers Award 2000*;

- C2006/3422 – Pre-reform – *Metal Trades (Australian Capital Territory) Award 2000*;
- C2006/3420 – Transitional – *Metal Trades (Australian Capital Territory) Award 2000*.

21. Ai Group submits that, despite the substantial effort and resources devoted by Ai Group and other parties to these proceedings over the past two weeks the approach of having a Full Bench deal with a very large number of applications for increases in wage rates and allowances in individual awards has proved to be unworkable, for the following reasons:

- The unions have not complied with the Directions (which were entirely fair and reasonable) in respect of a very large number of applications;
- It is a waste of public resources for a Full Bench to deal with issues relating to the calculation of individual rates and allowances in hundreds of individual awards;
- The Full Bench proceedings have been scheduled and dealt with over a very short timeframe and accordingly there is significant risk that the legislative requirements relating to service and notification have not been adequately complied with. Almost certainly, with a large number of the applications made, no employer party has considered the application or checked the draft order (that is, if a draft order has even been provided by the unions). Ai Group has of course only focussed on the applications in which it has an interest. No doubt the other parties represented in the proceedings have adopted a similar approach;
- The ACTU is not directly involved in making applications to vary awards and therefore is not able to adequately respond to any issues raised by employers relating to individual award variations;

- Ai Group has an interest in a very large number of awards and despite devoting significant resources to these proceedings over the past few weeks it has been very difficult to adequately represent the interests of our members, given the huge amount of work which has needed to be carried out over a very short time-frame and the failure of the unions to provide many of the draft orders;
- The longstanding prior approach of utilising a small number of awards as vehicles for Full Bench proceedings, with other awards being dealt with later by individual members of the Commission via the panel system, remains the sensible approach. With such approach:
 - The parties to individual awards are better able to address issues relating to their awards;
 - Adequate time and attention can be paid to service and notification requirements;
 - Applications are able to be heard and determined by members of the Commission assigned to the relevant panel who have knowledge about the relevant industry and award; and
 - It avoids the wastage of resources which results from having five members of the Commission engaged in handling matters best dealt with by one member of the Commission.

22. We further submit that it would be unworkable for the Full Bench to issue a general form of order varying all awards involved in these proceedings and to leave employers, employees and their representatives to work out what the relevant wage rates and allowances are, consistent with that order. Such an approach would not be in the public interest for the following reasons:

- This approach has been adopted by the Australian Fair Pay Commission and has resulted in confusion and uncertainty, given the diverse approaches adopted within different awards regarding remuneration. Debates are still taking place between representative bodies and other

interested parties regarding the wage rates and other elements of many Pay Scales;

- Unlike the Fair Pay Commission's current approach with Pay Scales, the AIRC publishes copies of awards and consequently needs to know with certainty what the relevant wage rates and allowances are.

23. Ai Group submits that the following approach should be adopted by the Full Bench in these proceedings:

- **The applications which were filed with draft orders by 24 November, and in respect of which there is consent to the variation (other than the operative date), should be settled by the Full Bench and orders issued arising from these proceedings;**
- **Other applications should be referred to individual members of the Commission to deal with - including determination of an appropriate operative date, which is prospective of the date when the matter is heard and determined by the individual member.**

24. The above approach is fair and logical.

25. It is important that the Commission deal with applications for award variations in the same calm and sensible way that it has traditionally done.

26. The WorkChoices legislation does not require that the Commission depart from such an approach. In fact s.553(2) of the Act should lead to even greater attention being paid by the Commission to service and notification requirements when an application is made to vary an award. S.553(2) requires that the Commission "take such steps as it thinks appropriate to ensure that each employer, employee and organisation bound by the award, and any other interested persons and bodies, are made aware of the application".

4. Relevant legislative provisions

Applications to vary transitional awards

27. Schedule 6 of the *Workplace Relations Act* deals with transitional arrangements for parties bound by federal awards.
28. The objects of this Schedule include ensuring that during the transitional period, “*transitional awards continue in operation and are maintained by the Commission, within the limits specified in this Schedule.*”¹
29. Furthermore, it is an object of Schedule 6 that “*the Commission’s functions and powers to vary transitional awards are exercised so that wages and other monetary entitlements are not inconsistent with wage-setting decisions of the AFPC*”²
30. This is reinforced in Clause 8 of Schedule 6:

“8 Performance of Commission’s functions under this Schedule

(1) *The Commission must perform its functions under this Schedule in a way that furthers the objects of this Schedule.*

(2) *In performing its functions under this Schedule, the Commission must ensure that minimum safety net entitlements are maintained for wages and other specified monetary entitlements, having regard to:*

(a) *the desirability of high levels of productivity, low inflation, creation of jobs and high levels of employment; and*

(b) *the principle that the wages and other monetary entitlements of transitional employees should not place them at a disadvantage*

¹ Schedule 6, section 1 (2)(a)

² Schedule 6, section 1 (2)(c)

compared with the entitlements of employees (within the meaning of subsection 5(1)); and

(c) the principle that the costs to transitional employers of wages and other monetary entitlements should not place them at a competitive disadvantage in relation to employers (within the meaning of subsection 6(1)).

(3) In having regard to the factors referred to in paragraph (2)(a), the Commission must have regard to:

(a) wage-setting decisions of the AFPC; and

(b) in particular, any statements by the AFPC about the effect of wage increases on productivity, inflation and levels of employment.

(4) In performing its functions under this Schedule, the Commission must have regard to:

(a) the desirability of its decisions being consistent with wage-setting decisions of the AFPC; and

(b) the importance of providing minimum safety net entitlements that act as an incentive to bargaining at the workplace level.”

31. Clause 29 of Schedule 6 sets out various requirements and limitations on the Commission’s power to vary transitional awards. The Commission has the power to vary transitional awards “to provide minimum safety net entitlements” about the matters referred to in paragraphs 29(2)(a) to (h). These matters include (a) rates of pay and (d) monetary allowances.

Applications to vary allowances in pre-reform awards

32. The *Workplace Relations Act* sets out certain conditions which the Commission must be satisfied are met, before it can make an order varying an award. Various key requirements are set out in s.553(4) of the Act as follows:

“(4) The Commission may make an order under this subsection varying the award only if the Commission is satisfied that:

(a) the variation is essential to the maintenance of minimum safety net entitlements; and

(b) all of the following conditions are met:

(i) the award as varied would not be inconsistent with decisions of the AFPC;

(ii) the award as varied would provide only minimum safety net entitlements for employees bound by the award;

(iii) the award as varied would not be inconsistent with the outcomes (if any) of award simplification and award rationalisation;

(iv) the making of the variation would not operate as a disincentive to agreement-making at the workplace level;

(v) such other requirements prescribed by the regulations (if any) for the purposes of this paragraph have been satisfied.”

33. There have been a number of recent decisions of AIRC members varying expense related allowances in pre-reform awards. In such matters, the Commission was satisfied that the variations were “*essential to the maintenance of minimum safety net entitlements*”.

34. In a decision given in transcript on 20 September 2006, Commissioner Cribb said:

“With respect to section 553(4)(a) on the basis of the submissions put before the Commission the Commission is satisfied that the variation is essential to the maintenance of minimum safety net entitlements under this Award as allowances are an intrinsic part of the safety net that is provided by the Award”.³

35. Another aspect of the legislative framework that the Commission needs to be mindful of in these proceedings is that the allowable matter pertaining to allowances has been narrowed under the WorkChoices legislation.

36. Prior to the reforms, the relevant allowable matter was set in s.89A(2) as follows:

“(j) allowances”

37. Under the WorkChoices legislation, the relevant allowable matter is set out in s.513 as follows:

“(h) monetary allowances for:

- (i) expenses incurred in the course of employment; or*
- (ii) responsibilities or skills that are not taken into account in rates of pay for employees; or*
- (iii) disabilities associated with the performance of particular tasks or work in particular conditions or locations”*

38. Paragraph 17(1)(j) of Schedule 6, which sets out the allowable matters for transitional awards, mirrors the above wording.

³ C2006/2801 – Application by Australian Nursing Federation under s553(1) for variation of award at PN 27

39. In considering applications to vary allowances, the Commission will need to ensure that elements of remuneration which are now incorporated within Pay Scales are not varied in awards and hence would be subject to a double increase. It is not always clear what is and what is not an “allowance”.
40. Section 178 of the Act gives some guidance on this issue. In this section the term “basic periodic rate of pay” is defined as follows:

“Basic periodic rate of pay means a rate of pay for a period of work (however the rate is described) that does not include incentive-based payments and bonuses, loadings, monetary allowances, penalty rates and other similar separately identifiable entitlements”.

41. Basic periodic rates of pay are included in Pay Scales and hence the AIRC has no jurisdiction to vary any elements of such rates of pay in pre-reform awards.
42. The uncertainty which can arise regarding what elements of remuneration have remained in an award as allowances and what elements are now incorporated within the relevant Pay Scale requires that the Commission ensure that careful consideration is given to the draft orders prepared by the unions in respect of all applications to vary awards. This careful consideration is best assured through the approach which Ai Group has proposed in Section 3 of this submission.

5. Wage-setting decision of the Australian Fair Pay Commission

43. The Australian Fair Pay Commission handed down its first wage-setting decision on 26 October 2006. The key elements of the decision are:
- The Federal Minimum Wage was increased by \$27.36 per week (bringing the rate to \$511.86);
 - Minimum wage rates up to and including \$700.00 were increased by \$27.36 per week;
 - Minimum wage rates over \$700.00 were increased by \$22.04 per week.
44. With regard to Pay Scales derived from federal and former state awards that were not adjusted for the 2005 Safety Net Adjustment, the wage rates in the Pay Scale were increased by a further \$17.00 in the following circumstances:
- Where the wage rates in the Pay Scale were increased for the 2004 Safety Net Adjustment;
 - Where the wage rates were not increased for the 2004 adjustment but were increased for an earlier safety net adjustment during the 12 months prior to the commencement of the WorkChoices reforms in March 2006; and
 - Where the award from which the Pay Scale was derived took effect after the AIRC's 2004 Safety Net Review Decision.
45. The maximum wage increase which any employer was required to pay was \$44.36 (ie. \$27.36 plus \$17.00).
46. The increases became operative in all Australian Pay and Classification Scales from 1 December 2006 (defined in the decision as from midnight on 30 November 2006).

47. Ai Group is of the view that this generous increase carries with it substantial risks.
48. Australia is currently experiencing a two speed economy, where some states and sectors are booming while others are struggling.
49. This decision will be much more easily absorbed by companies operating in Western Australia and Queensland and enjoying the benefits of the resources boom. In contrast, employers in states such as New South Wales, Victoria and South Australia and those in industries such as manufacturing, tourism and the rural sector could be particularly hard hit.
50. The small business sector, which employs 3 million Australians, is more vulnerable as a result of the decision as a high proportion of employers paying minimum rates of pay are small businesses.

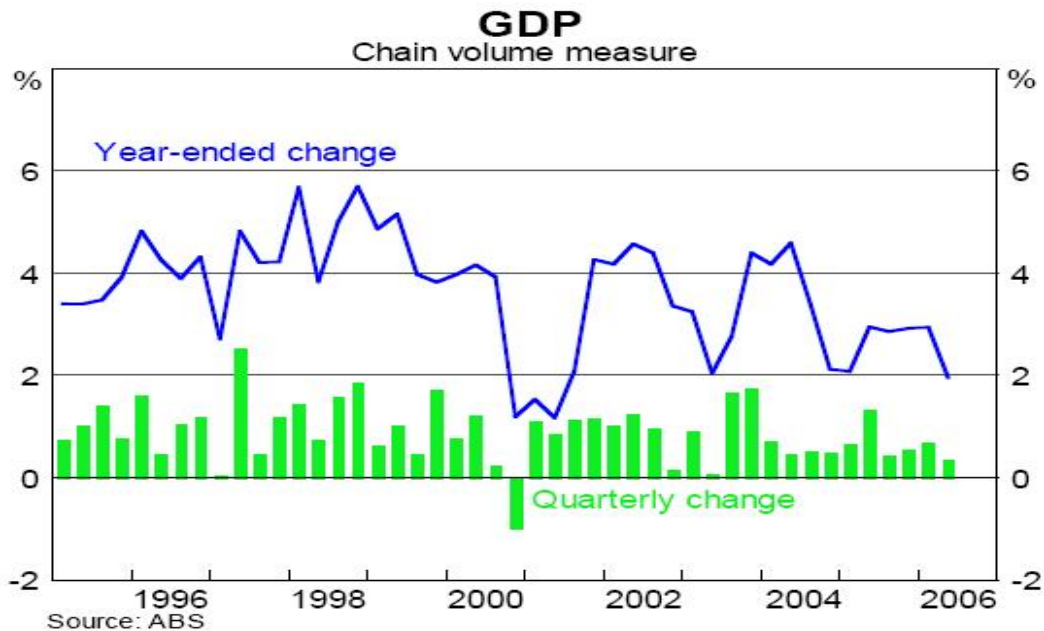
6. Economic conditions and outlook

51. In performing its functions, the Commission must have regard to the objects of the Act and “*the state of the national economy and the likely effects on the national economy of any order the Commission is considering, or is proposing to make, with special reference to the likely effects on the level of employment and on inflation*” (s.103).

The Australian economy

52. As **Chart 1** highlights, the rate of economic growth slowed (1.9% in seasonally adjusted terms) over the year to June quarter 2006. Strong business investment, moderate consumption demand, and to a lesser extent, public demand, have contributed to the recent growth in activity. Average growth since 2002 (running at 3.0%) has under-performed the experience between 1996 and 2002 (averaging 3.9%).

Chart 1 Annual and quarterly change in GDP growth



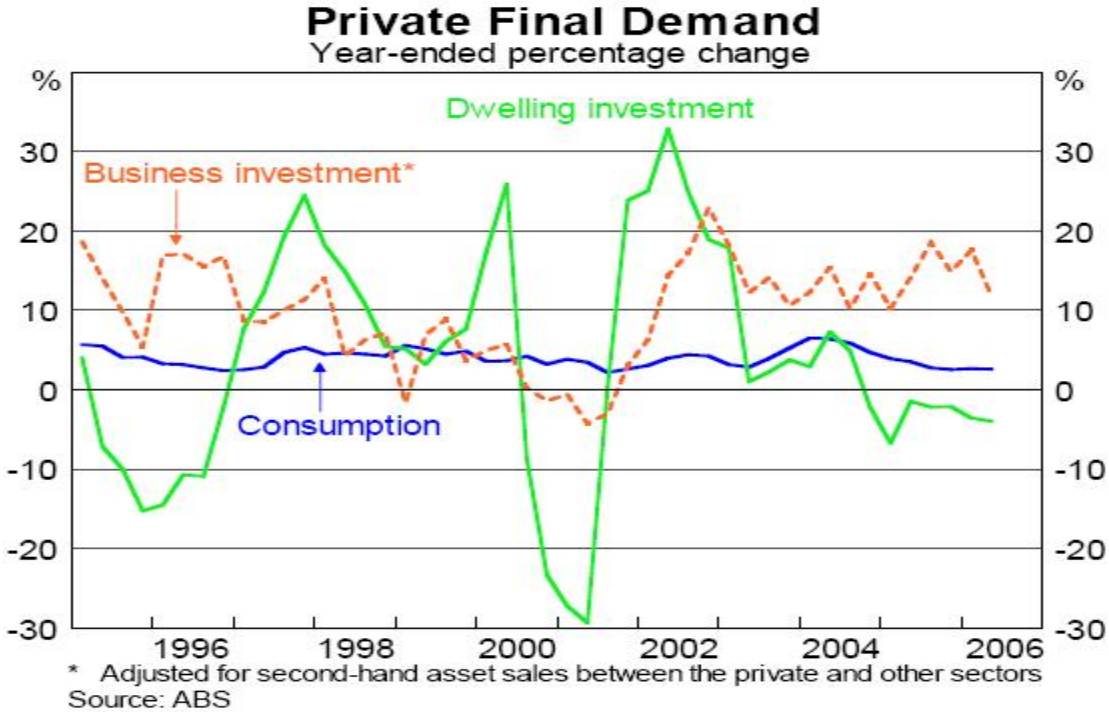
53. In its recent Statement on Monetary Policy (November 2006), the Reserve Bank of Australia noted, the strength of the world economy over recent years “has added to demand for commodities and contributed to significant upward pressure on a wide range of resources prices”⁴.
54. Over the past three years, Australia's terms of trade have increased by more than 30 per cent, and this has had a significant expansionary effect on domestic incomes and spending.
55. While consumers have benefited from higher real incomes, the outcomes across industry sectors have been mixed. In particular, it has contributed to output in the resources sector rising, while output in the manufacturing sector fell. And as the Secretary of the Australian Treasury recently acknowledged, the “loss of manufacturing jobs is, no doubt, precisely what theory predicts would be the consequence of an increase in the terms-of-trade”⁵.

⁴ Reserve Bank of Australia, Introduction, Statement on Monetary Policy, November 2006

⁵ Ken Henry, “The Fiscal and Economic Outlook”, Address to the Australian Business Economist, 16 May 2006

56. Household spending and dwelling investment played a key role in driving growth during the later part of the 1990s. However, over the last few years, the momentum has shifted more towards business investment (**Chart 2**). Business investment has increased at an average annual rate of 12% since the middle of 2002. Investment in the resources sector has been the fastest growing component of business investment, although growth has been broadly based across industries.

Chart 2 Composition of private final demand



57. The main down-side to Australia’s economic performance has been our poor export performance, given the favourable international conditions. While export earnings have increased substantially, this has been mainly due to higher prices rather than growth in volumes. The consequence of this poor export performance, and a rapid growth in imports, has seen the trade deficit grow appreciably, and this has acted to detract from overall economic growth.

58. Australia now suffers from having a sizeable deficit in the trade sector and considerable personal debt in the household sector. But unlike other developed nations, it is one of the few nations that maintain a healthy fiscal surplus.
59. The main risks to the maintenance of Australia's economic growth record appear to be from four sources – capacity constraints (particularly in the resources sector); labour and skills shortages in a tight labour market (where unemployment has fallen to a record thirty year low); high global oil prices; and the drought.
60. Overall, Ai Group broadly concurs with the Federal Government's and Reserve Bank's assessments of the year ahead, noting that there are considerable downside risks to the economy, the most pressing being the drought. As the RBA in its most recent Statement on Monetary Policy concluded:

Looking ahead..., the Bank's assessment is that domestic demand can be expected to record moderate growth over the next year or two, with continued expansion in consumer spending, a noticeable easing in investment growth and a gradual pick-up in housing construction. Exports should pick up as capacity expansions in the sector come on stream, and will contribute more to overall growth than in recent years. These forces are expected to produce a gradual return to trend growth for the non-farm economy, associated with the easing of some capacity constraints. Farm output could fall by around 20 per cent, which would directly reduce GDP growth in the year ahead by around half a percentage point....

61. **Table 1** outlines the main forecasts for the Australian economy for 2006-07, as presented by the Australian Government in its budget papers. The Australian economy is expected to strengthen in 2006-07, with the world economy continuing to provide significant impetus to Australia's economic

growth and business investment, particularly in the resources sector. Gross national expenditure growth is forecast to remain moderate, with growth in business investment offsetting slower growth in household consumption and a modest decline in dwelling investment. After a period of strength, employment growth is forecast to ease in 2006-07, and while the Treasury has forecast inflation to moderate, more recent data points to a significantly higher inflation outcome (see below).

62. In its latest Economic Outlook⁶, the OECD reveals that growth in 2006 could well be below that forecast by the Federal Treasury (which were released earlier in the year). The combined impact of the drought, our continuing trade deficit, soft consumer spending and housing activity in the wake of three interest rates increases this year, a weaker US housing market and economy feeding into the global economy, are all likely to contribute to Australian GDP growth showing to 2.6% in 2006, before lifting to 3.0% in 2007. If the US market slow further than currently anticipated, growth prospects for 2007 could well be revised down again.

63. In considering the capacity of the economy to absorb adjustments to minimum wages, the AIRC needs to be mindful of Australia's current poor productivity record which could impact on the capacity of employers to absorb such increases. Labour productivity, measured by GDP per hour per worker, fell substantially in manufacturing in 2004-05, despite a small rise in labour productivity across the broad economy. While labour productivity grew both in the broad economy and in manufacturing in 2005-06, it is difficult to determine whether this was caused by cyclical or structural factors. (See **Chart 3**)

⁶ OECD Preliminary Economic Outlook (for Australia), www.oecd.org.au, November 2006

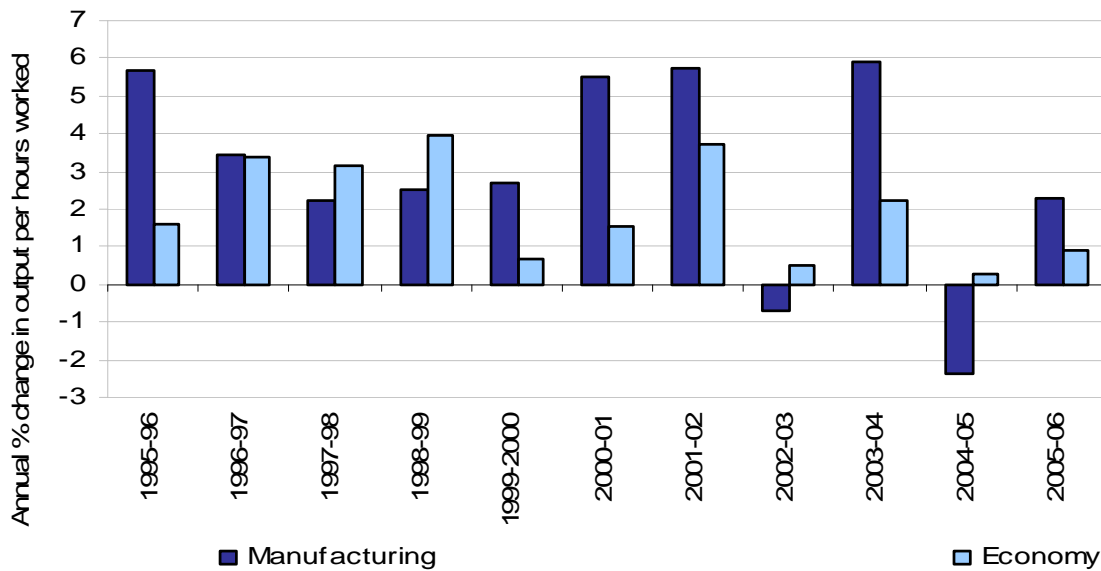
Table 1: Domestic economy forecasts^(a)

	Outcomes ^(b)	Estimates	Forecasts	
	2004-05 year average	2005-06 year average	2006-07 year average	Four quarters to June 2007
Panel A - Demand and output^(c)				
Household consumption	4.2	2 3/4	3	3
Private investment				
Dwellings	-1.5	-3	-1	2
Total business investment ^(d)	11.7	14	8	11
Non-dwelling construction ^(d)	7.7	14	6	8
Machinery and equipment ^(d)	15.4	15	9	13
Private final demand ^(d)	4.5	4 1/4	3 3/4	4 1/2
Public final demand ^(d)	4.3	3 1/4	3 1/4	2 1/4
Total final demand	4.4	4	3 1/2	4
Change in inventories ^(e)				
Private non-farm	-0.3	0	0	0
Farm and public authorities ^(f)	0.0	0	- 1/4	- 1/4
Gross national expenditure	4.1	4	3 1/2	4
Exports of goods and services	2.6	2	7	6
Imports of goods and services	12.0	6	7	9
Net exports ^(e)	-2.0	-1	- 1/2	-1
Gross domestic product	2.6	2 1/2	3 1/4	3 1/4
Non-farm product	2.6	2 3/4	3 1/4	3 1/2
Farm product	-0.5	-1	2	-1
Panel B - Other selected economic measures				
External accounts				
Terms of trade	10.0	10	0	-1 1/4
Current account balance				
\$ billion	-57.8	-68 1/4	-62 1/2	
Percentage of GDP	-8.4	-6	-6 1/4	
Labour market				
Employment (labour force survey basis)	3.0	2	1	1 1/4
Unemployment rate (per cent) ^(g)	5.3	5 1/4	5 1/4	5 1/4
Participation rate (per cent) ^(g)	64.0	64 1/2	64 1/4	64 1/4
Prices and wages				
Consumer Price Index	2.4	3	2 3/4	2 1/2
Gross non-farm product deflator	3.9	4 1/2	2 1/2	2 1/4
Wage Price Index	3.8	4	4	3 3/4

- Percentage change on preceding year unless otherwise indicated.
- Calculated using original data.
- Chain volume measures.
- Excluding transfers of second-hand assets between the public and private sectors.
- Percentage point contribution to growth in GDP.
- For presentational purposes, inventories held by privatised marketing authorities are included with the inventories of the farm sector and public marketing authorities.
- The estimates in the final column are the forecast rates in the June quarter 2007.

Source: Australian Bureau of Statistics (ABS) cat. no. 5206.0, 5302.0, 6202.0, 6345.0, 6401.0, unpublished ABS data and Treasury.

Chart 3 Labour productivity in manufacturing and the economy



Source: Australian Bureau of Statistics

64. The impact of the Fair Pay Commission's decision to increase the minimum wage rate by \$27.36 per week (for minimum wage rates up to \$700) is yet to be seen. If the increase in minimum wages leads to these being passed onto final selling prices, contributing to higher inflation, it could put pressure on the RBA to adjust the official cash rate again. If this was to occur, the benefits of a minimum wage adjustment would be lost to the low paid through higher mortgage payments.
65. Equally, if companies are forced to absorb the increases in wages, this will weaken margins and make business conditions tighter, particularly in an environment where demand remains soft across most sectors of the economy, excluding mining. These conditions are examined in the following sections.
66. Both the official Consumer Price and Producer Price Indexes highlight the inflationary pressures within the economy. Inflation is currently running at 3.9%, based on the September quarter CPI. The quarterly increase of 0.9% reflected the effects of growing food and housing costs. Even using the RBA's

preferred “trimmed mean” measure of inflation, the September quarter outcome (0.7%) was strong⁷.

67. Upstream pressures also remain strong. Producer prices at the final stage of production rose a further 1.0% in the three months to September, following a 1.6% increase in the June quarter (which, in turn, was the largest increase since the June quarter 2000). The increase over year-earlier levels was also strong at 4.0%.
68. The release of these inflation measures appears to have influenced the RBA’s decision to lift the official cash rate in November 2006.

The manufacturing sector

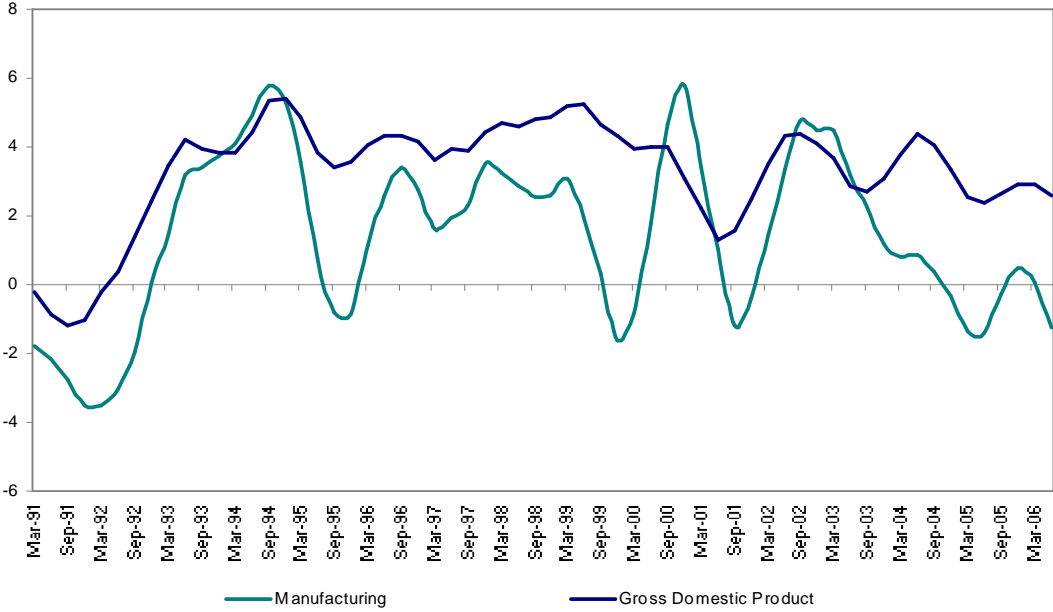
69. The manufacturing sector is going through a period of significant restructuring.
70. While the economy grew by 1.9% in seasonally adjusted terms (year ending June 2006 quarter), the manufacturing sector declined by 2.4%. The quarterly change for the manufacturing sector was the fourth weakest in the economy, as measured in the National Accounts.
71. In addition to the weak economic conditions, manufacturing is experiencing the effects of a cyclical slowdown in activity, as well as significant restructuring arising from global competition.

Cyclical slowdown

72. The latest National Accounts, for the June quarter 2006, highlights the weak conditions currently being experienced by the manufacturing sector (**Chart 4**).

⁷ Australian Bureau of Statistics, Consumer Price Index, no 6401; Producer Price Indexes, no 6427; and RBA, Measures of Consumer Price inflation

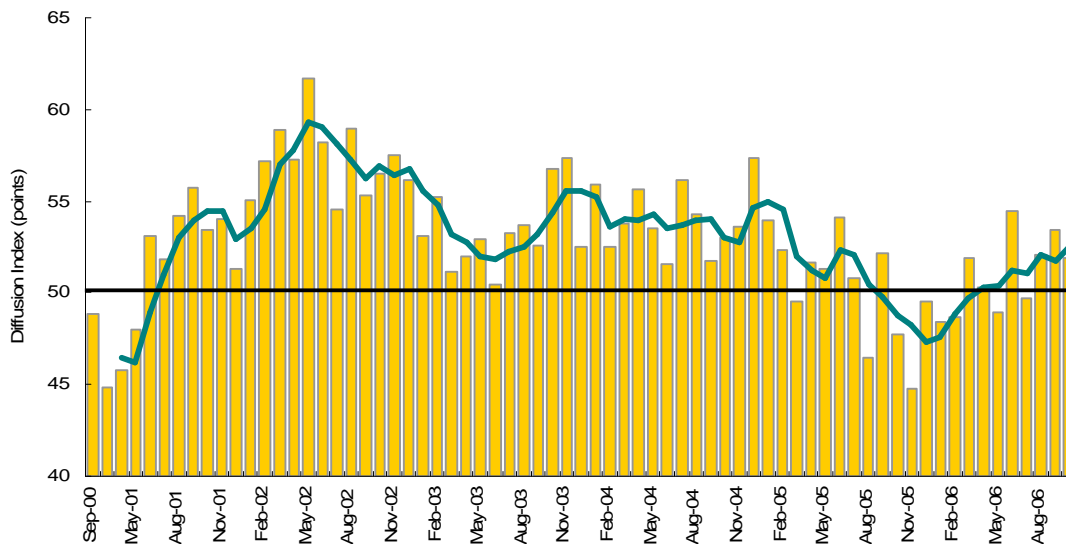
Chart 4 Quarterly change in gross value added (sa)



Source: Australian Bureau of Statistics, Table 6, 5206

73. The Australian Industry Group - PricewaterhouseCoopers' Australian Performance of Manufacturing Index[®] (PMI), which provides a monthly measure of business activity, shows that this weakness has eased somewhat in the September quarter 2006 and in the first month of the December quarter. October saw the third consecutive monthly rise in manufacturing activity across Australia, with the Australian PMI at 51.9 points. (**Chart 5**)

Chart 5 Australian Performance of Manufacturing Index®



Source: Australian PMI®, October 2006

74. Despite the slight improvement in manufacturing activity in the September quarter, difficult business conditions continue. This leaves little scope for employers to accommodate higher wage adjustments.

Restructuring

75. This situation is compounded by the substantial restructuring being experienced by industry. This restructuring process is seeing many companies downsizing their number of employees, becoming more capital intensive, moving production offshore, and looking to use more imported materials in domestic production.

76. This restructuring is an outcome of globalisation, a strong Australian currency, a faster pace of import competition, and the emergence of China.

77. In terms of the currency, the World Economic Forum (WEF) in its 2005-06 release of the *Global Competitiveness Report* stated that despite Australia's solid performance, rising four places to tenth out of 117 countries, "a possible source of concern in this otherwise bright outlook is the strength of the

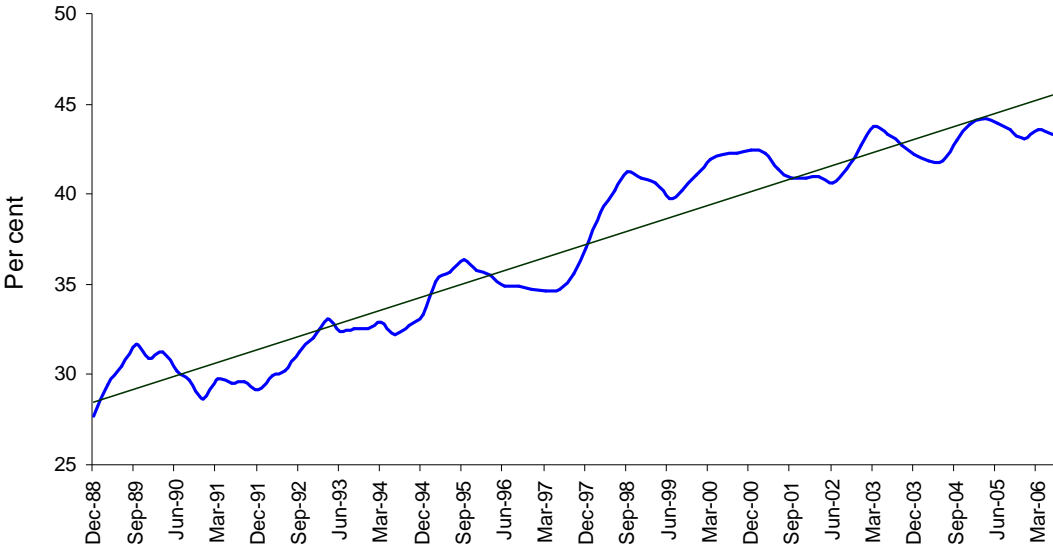
currency which suggests the need to continue to implement structural reforms to improve productivity”⁸.

78. Compared to the average level of the Australian dollar since 1990, the WEF noted that in 2005 the Australian dollar was 14.7% higher than its average level since 1990. It ranked Australia’s currency as 113 out of 117 in terms of being a competitive currency, a significant drag on Australia’s performance.
79. The implications of a high Australian dollar for manufactured exports and growth was highlighted in an Ai Group report, *Aussie Dollar Challenges Manufacturing Competitiveness (2004)*⁹. The study found the US\$0.70 mark was a critical point for the manufacturing sector as a whole. At this level our most sophisticated manufactured exports become uncompetitive on world markets, and for basic manufacturers, the exchange rate threshold is even lower.
80. The study found that for each one cent appreciation of the Australian dollar against the US dollar, export earnings for manufacturing overall were reduced by around 0.3 per cent. This amounts to an annual loss of \$210 million for every one cent appreciation.
81. The higher Australian dollar has been doubly felt by manufacturing through its impact on import penetration. In 2006, Australian manufacturing faced much stronger global competition than it did a decade ago. **Chart 6** shows how imports of manufactured goods have grown: equivalent to about 43% of manufacturing sales in early 2006 compared with 35% a decade ago and 27% two decades ago.

⁸ Australian media release to World Economic Forum, *Global Competitiveness Report*, 28 September 2005

⁹ Australian Industry Group, *Aussie Dollar Challenges Manufacturing Competitiveness*, 2004

Chart 6 Imports as a percentage of manufacturing sales



Sources: Derived from ABS publications, Business Indicators, Australia, 5676.0 and International Merchandise Imports, 5439.0

- 82. The rapid increase in import penetration has been driven by falling prices. Since the start of 2002, prices of imported final products have fallen in 11 of the 14 quarters (to June quarter 2005). For manufacturing, over the same period, the price of manufactured goods (SITC 6) has declined by 9.8%; chemical products (SITC 5) by 11.5%; machinery and transport equipment (SITC 7) by 27.5% and miscellaneous manufactures (SITC 8) by 25%.
- 83. Finally, the emergence of China is transforming the nature of manufacturing in Australia. The transformation underway in the Chinese economy, while providing Australian manufacturers with opportunities, has also presented major challenges.
- 84. China’s manufacturing sector has been growing rapidly over the last decade, on average around 12% a year¹⁰ since 1990 compared with around 2% for Australia (measured in annual value terms). China’s manufacturing sector constitutes about 39% of its economy compared to around 13% in the case of Australia.

¹⁰ World Bank. Note: data relates to the period 1990 to 1997

85. In August 2006, Ai Group released an updated report examining the implications of China on Australian manufacturing, *Australian Manufacturing and China: Deepening Engagement*¹¹. This report showed that the financial impact of China on Australian manufacturing has deepened appreciably since the original report was released in August 2004. The study found that 84% of firms surveyed had been affected by China in either customer or supplier markets, up from around 70% in the 2004 report. The report found that Australian manufacturers lost an estimated \$2.5 billion in 2005-06, through the competitiveness of China in the domestic and export markets of Australian firms. The study also found that around \$1.6 billion of this loss was clawed back through gains in sales from increased competitiveness.
86. Firms are implementing a range of strategies in response to China and other global pressures. The recently released *Manufacturing Futures*, outlines these strategies, including developing new products and services; using global supply chains; moving production offshore; and upskilling of staff. As well, companies are looking to be lean in their operations and more capital intensive¹².
87. In an environment where companies are rapidly making adjustments to respond to heightened global competition, considerable care is needed in determining wage outcomes. Excessive wage adjustments could force employers to make deeper adjustments, resulting in greater cuts to domestic activity and jobs.

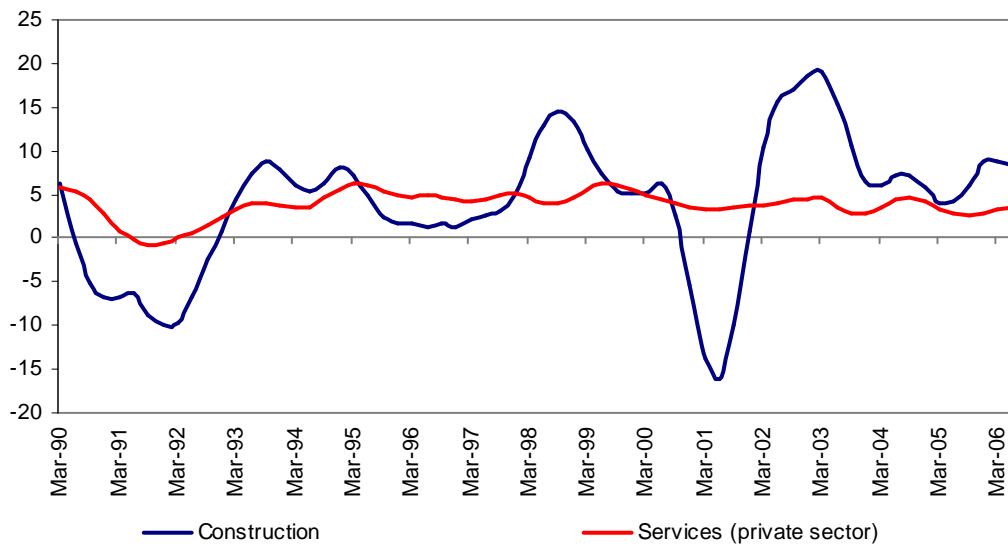
Construction and the services sector

88. Construction activity has grown at a moderate rate in recent times, while conditions are considerably weaker in the services sector. **Chart 7** shows the seasonally adjusted, annual movement in gross product for each sector.

¹¹ Australian Industry Group, *Australian Manufacturing and China: Deepening Engagement*, forthcoming August 2006

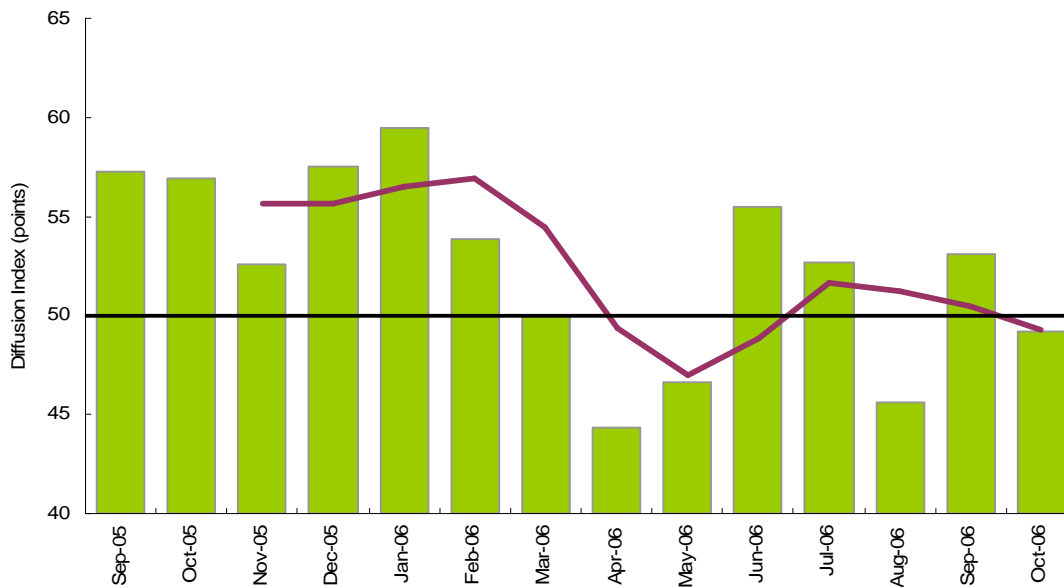
¹² Australian Industry Group, *Manufacturing Futures: Achieving Global Fitness*, April 2006

**Chart 7 Annual change in construction and services gross product (sa),
1990/91 – 2005/2006**



89. In the construction sector, annual growth is running at 7.2% (in seasonally adjusted terms). The sector is made up of four major activities – housing, apartments, commercial and engineering.
90. The Australian Industry Group - Housing Industry Association’s Australian Performance of Construction Index™ (PCI) shows that construction activity has improved somewhat in recent months, despite a deterioration in August brought about by earlier interest rate rises. Underpinning the improved performance of the construction sector has been robust growth in commercial and engineering construction activity. Interest rate increases in 2006 have had an impact on house-building activity, while apartment activity remains depressed. (**Chart 8**)

Chart 8 Australian Performance of Construction Index™



91. The table below shows that engineering construction is expected to drive overall growth in 2006-07 and 2007-08, underpinned by strong mining-related construction. Growth in commercial construction appears to have peaked however, and the apartment building sector is expected to remain a drag on total construction activity.

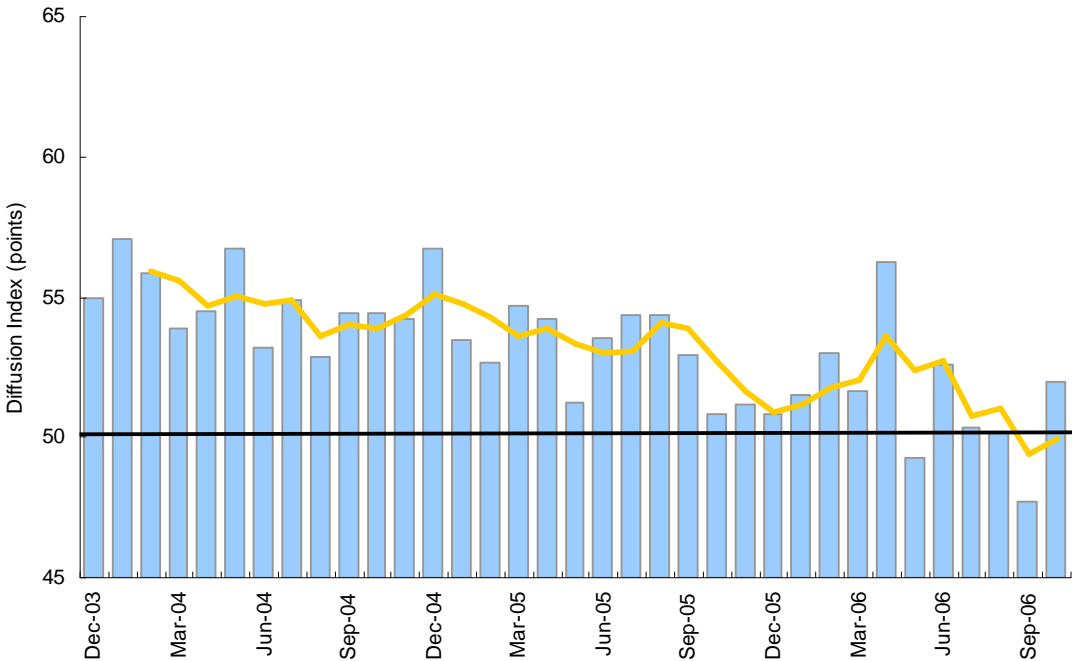
CONSTRUCTION TURNOVER - AUSTRALIA OUTLOOK BY MAIN SECTOR AT A GLANCE TO '07/08

SECTOR	% CHANGE (CURRENT DOLLARS)		
	05/06	06/07(F)	07/08(F)
INFRASTRUCTURE	13.3	13.2	7.4
MINING	27.8	16.4	9.2
HEAVY INDUSTRIAL	3.0	11.9	7.8
TOTAL ENGINEERING	16.0	14.0	8.0
COMMERCIAL CONSTRUCTION	6.0	5.7	3.5
APARTMENTS	0.6	-26.9	-20.7
OVERSEAS BUSINESS	9.7	1.0	1.4
TOTAL CONSTRUCTION	12.3	9.2	5.7

Source: Australian Industry Group-Australian Constructors Association, Construction Outlook, November 2006

92. In the service sector, growth has moderated over previous years. In the June quarter 2006, activity in (market sector) services grew by 3.6% on an annualised basis. While this was an improvement on the previous quarter, growth is appreciably lower than two years ago, when services were growing by over 5.0%.
93. More recent data collected by Ai Group and the Commonwealth Bank, as part of the Australian Performance of Services Index[®] (**Chart 9**), suggests that growth in services activity has been weak since the March quarter 2006. Interest rate increases and high fuel prices have dampened demand for services. The key distribution sectors of wholesale and retail trade have been the hardest hit by these adverse business conditions in 2006. As well, the property market continues in most states to act as a sobering influence on household spending, as wealth accumulation from higher property prices is no longer acting as a significant influence on consumer behaviour.

Chart 9 Australian Performance of Services Index[®]



Source: Australian PSI[®], October 2006

94. Overall, Ai Group's analysis of economic conditions highlights that while growth conditions remain moderate, there are significant differences across sectors. In parts of the manufacturing and services sectors, where employees on minimum wages predominate, business activity remains well down on previous years.

7. Operative date and the importance of avoiding retrospectivity

95. Ai Group strongly submit that the AIRC should not grant retrospectivity in respect of any of the applications.

96. Paragraph (2) of section 572 – Commencement of awards, of the Act states that:

“Unless the Commission is satisfied that there are exceptional circumstances, the day specified in an award or award-related order for the purposes of subsection (1) must not be earlier than the date of the award or order”.

97. A similar provision was contained within s.146 of the pre-reform Act.

98. The Commission has had a very longstanding approach of not granting retrospectivity unless there are compelling reasons for doing so, as described by a Full Bench in a case relating to the *Hotels, Resorts and Hospitality Industry Award* (Print K6815, 26 February 1993):

“The Commission has developed a clear approach of not granting retrospectivity unless there are compelling reasons, in the circumstances of a particular case, for so doing. No such compelling reasons were present in this case. Moreover, even that approach of

the Commission must be considered against the requirements of the wage fixation principles. In our view, it is clear from the discussion of those principles in the relevant National Wage Case decisions - and the nature and basis of the increases made available under them - that they preclude the awarding of retrospectivity.”

99. The Statement of Principles arising from the 2005 Safety Net Review Case contains the following paragraph 8(a):

“The operative date will be no earlier than the date of variation to the award”.

100. We submit that this approach should be maintained.

101. In a Full Bench decision relating to several award variations sought by employers to address an unusual interpretation which the Federal Court had placed on some long-standing shift provisions in various automotive industry awards (Print T1300, 3 October 2000), the issue of retrospectivity was considered. The following extracts are relevant:

“[38] In the ordinary course, any such variation should operate prospectively. The Commission must weigh carefully the effect of any retrospective operation . The Commission's capacity to grant retrospective operation must also be considered. Section 146 provides that:.....

[42] We are satisfied that the circumstances of the case are sufficiently rare and singular to justify a conclusion that they are exceptional for purpose of section 146. The main grounds of employers' applications have been made out. The intention of the Commission in making the primary antecedent award may be inferred from past history, from the decision in Jarrad and from the consistent application of an industrial

standard approach prior to challenge in Federal Court. That finding is subject to Ford's minor departure from the general rule. However, that departure does not reflect an acceptance of what has been described as a "double dipping" principle to allow in effect a public holiday and a penalty rate for a full shift. We could find nothing in industrial arbitral precedent to support the introduction of such a principle in relation to any of the awards covered by the applications. The submissions of the AiG point to the desirability of acting to ensure that the scope of the award provision is consistent with the industry standard as it has been understood since at least 1952." (Emphasis added).

102. We submit that there is nothing "rare and singular" about the retrospectivity sought by the unions in these proceedings.
103. If the AIRC grants retrospectivity a very dangerous precedent would be set which would greatly disadvantage employers in the future.
104. There are compelling and obvious reasons why retrospectivity in respect of operative dates for wage and allowance increases is inappropriate and should only be contemplated in very exceptional, ("rare and singular") circumstances. Such reasons include:
 - There are substantial administrative and direct costs associated with back-paying employees to take account of retrospectivity of wage and allowance increases; and
 - These days a significant percentage of the workforce is employed by labour hire companies and in other contract labour situations. Typically, the employers in these situations have no ability to recover retrospective wage and allowance increases from their clients.
105. Our concerns about retrospectivity are greatly magnified given that the unions appear to be proposing that an operative date of 1 December 2006 apply even

for applications made well into the future. Such a position would be extremely unfair on employers.

106. It is evident from the large number (more than 400) of applications which were filed prior to the Mention on Monday 20 November 2006, that the ACTU advised all unions to file their applications prior to 20 November. Indeed, Mr Watts has acknowledged this. Therefore, any union party that failed to do so can have no complaint if a later operative date applies than the date applicable to those applications which complied with the Commission's Directions in these proceedings.
107. If the Commission makes a decision in this case shortly after the conclusion of the hearings on 5 December and grants a retrospective operative date of 1 December this will be unfair on employers. But the unfairness will be magnified many times over if an operative date of 1 December 2006 is granted for all applications – including those which have not yet been filed – or the decision is able to be interpreted by individual members of the Commission dealing with subsequent applications as encouraging such an outcome. For example, a union could file an application in 6 months or 12 months or two years time. Given the unions' tardiness in the past in applying for safety net adjustments in numerous awards this will undoubtedly happen. It is obviously highly unfair on employers for an operative date of 1 December 2006 to apply in such instances.
- 108. Ai Group submits that a prospective operative date should apply. The date should be at least two weeks in advance of the date when the orders are issued by the Commission varying the relevant award. This allows some time (albeit it a very short period) for employers to be advised of the variation.**
- 109. A prospective operative date is consistent with the decision of the Fair Pay Commission, which determined that an operative date more than a month in advance of the decision was warranted. Similarly, a**

retrospective operative date would not be consistent with the Fair Pay Commission's decision.

110. With regard to the operative date, the Commonwealth's position is set out in paragraphs 2.27 to 2.31 of its submission. The Commonwealth "supports an operative date as close as possible to 1 December" (2.28).
111. Unlike the ACTU's unworkable and unfair approach of having a common retrospective operative date for all applications, the Commonwealth's proposal does not appear to be in total conflict with Ai Group's approach - although Ai Group strongly opposes any retrospectivity.
112. There is no logical reason why the same date needs to apply for allowance adjustments, for the wage increases in the transitional awards and for the wage increase awarded by the Fair Pay Commission. The ACTU's argument that a 1 December 2006 operative date is needed because of uncertainty about which employers are constitutional corporations, we submit is significantly overstating the importance of this issue.
113. Employers need to know whether they are constitutional corporations for many important reasons, including what sick leave provisions apply, what annual leave provisions apply, what they need to do to comply with the Act and within what timeframe. It is not just an issue which relates to the operative date for a wage increase.
114. It could be that in subsequent years it may be possible to align the operative dates of a large number of potential award variations with the operative date of the wage increase awarded by the Fair Pay Commission, without any retrospectivity. Of course, that will be dependent upon the operative date of the Fair Pay Commission's wage increase and how much lead time it gives, and also how quickly the unions move to make applications to vary awards to flow on the Fair Pay Commission's decision.

115. We submit that it would be entirely inappropriate and not in the public interest for the AIRC to determine (or even imply) through its decision in these proceedings that there should be an alignment between the operative dates of the wage increase awarded by the Fair Pay Commission and the operative date of award variations for wage and allowance increases in transitional and pre-reform awards.
116. It is easy to think of realistic examples where it would be impossible to vary a large number of awards prior to the operative date of a wage increase determined by the Fair Pay Commission. For example, the Fair Pay Commission might not award a prospective operative date in a given year or might award a date which is prospective by only a week or two.
117. In the future if the Fair Pay Commission gives enough lead time in its decision it may be workable to have the same operative date for the wage increase arising from that decision and the operative date of a large number of award variations. But that is an issue, we submit, for another occasion.

8. Importance of the concept of the “first full pay period to commence on or after”

118. The concept of increases in wages and allowances becoming operative on the first full pay period to commence on or after the relevant operative date is a longstanding and practical approach of the AIRC and it is important that it be retained.
119. The implementation of a pay increase from midnight on a certain date causes a multitude of problems and additional administration costs for employers. Payroll calculations are made more complex for all employees who receive increases, with one rate applying for part of the pay period and another rate applying for the remainder of the pay period. Employers would even be

required to pay shift workers whose shifts span midnight two different rates of pay for the one shift.

120. The retention of this concept by the AIRC, we submit, would not be inconsistent with the Fair Pay Commission's decision. It is an issue of detail which the Fair Pay Commission does not specifically address in its decision. Even though the Fair Pay Commission adopted an alternative, more problematic approach, there is no evidence in the decision that this issue was given any consideration.

9. Importance of the economic incapacity principle

121. The economic incapacity principle has been a very longstanding and important feature of Safety Net Review / National Wage Case decisions and Ai Group submits that it should be retained.
122. The retention of the principle would not be inconsistent with the Fair Pay Commission's decision. It is an issue of detail which the Fair Pay Commission does not address in its decision.
123. The Fair Pay Commission awarded wage increases of over \$40 in some cases and such an increase could be crippling for a small employer bound by a transitional award.
124. It is in all parties' interests to retain the flexibility provided by this principle. Experience over the years has shown that the criteria set out in the principle only applies in exceptional circumstances.
125. The retention of the principle is consistent with the AIRC's obligations under s.103 of the Act to ensure that it remains mindful of the need to avoid negative employment effects, when making decisions.

10. Formula for adjusting wage related allowances

126. For the past 10 years the method of adjusting wage related allowances in accordance with Safety Net Review decisions has been derived from the Commission's *Furnishing and Glass Industries Allowances decision* [Print M9675; (1996) 40 AILR 3–399].

127. The Statement of Principles arising from the 2005 *Safety Net Review Decision* explains the method of adjustment as follows:

“Such allowances and service increments should be increased by a percentage derived as follows: divide the monetary safety net increase by the rate of pay for the key classification in the relevant award immediately prior to the application of the safety net increase to the award rate and multiply by 100.”¹³

128. This method of adjustment is workable and appropriate on this occasion because the Fair Pay Commission has awarded an increase to all classifications.

129. In future years, this method of adjustment may or may not be appropriate on a given occasion, depending upon the approach which the Fair Pay Commission takes in awarding a wage increase on that occasion. For instance, if the Fair Pay Commission decided to only award a wage increase to those receiving the Federal Minimum Wage (and not all classifications) the formula might not be appropriate.

¹³ PR002005 *Safety Net Review – Wages June 2005* – Attachment A, Principle 5, pg. 124

11. Adjustments to expense related allowances

130. A well accepted formula tends to apply within each individual award in relation to the adjustment of various expense related allowances - typically based on movements in the relevant Consumer Price Index.
131. Ai Group can see no reason why the same approach should not generally apply under the WorkChoices legislation.

12. Supported wage provisions

132. The Commonwealth's submission proposes that the AIRC adopt a policy to provide access to the Supported Wage System (SWS) in all transitional awards:

"The policy would require the AIRC when considering applications to implement any decisions of the Full Bench to increase wages, to insert provisions for the SWS in transitional awards wherever they are absent. This action would be taken whether or not the application for wage increases specifically sought the inclusion of SWS provisions."¹⁴

133. Ai Group supports the adoption of this policy by the AIRC.

¹⁴ Commonwealth Submission, *Wage and Allowances Review 2006*, pg. 15

13. School based apprenticeships and school based traineeships

134. The Commonwealth has proposed that the AIRC fill gaps in the coverage of minimum wages and conditions for school-based apprentices and trainees in transitional awards:

“The policy would require the AIRC when considering applications to implement any decision of the Full Bench to increase wages, to insert provisions for school-based apprentices and trainees, where there is potential for employees to be engaged under the provisions but the award does not include such provisions already.”¹⁵

135. Ai Group supports the adoption of such a policy by the AIRC.

¹⁵ Commonwealth Submission, *Wage and Allowances Review 2006*, pg. 25