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Some Observations on Wage-Setting Practices In The Australian Labour Market System

by
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Abstract:

The Theme of this paper is that an inherent conflict exists both for those who want to radically reform the Australian institutional wage-setting system and for those who want to maintain the status quo. There is evidence from theory, supported in the main by empirical evidence, consistent with the view that wage regulation has inhibited the attainment of on-the-job training, with concomitant implications for the development of technological change and economic growth. On the other hand, a centralised wage settlement system facilitates the adoption of a concensual incomes policy, such as the Accord, which has apparently helped deliver favourable wage and industrial disputation outcomes. The challenge is to find processes that promote movements towards establishment-based wage bargaining without threatening the benefits of economy-wide income settlement.

Keywords:

INCOMES POLICY; AUSTRALIAN LABOUR MARKET; WAGE REGULATION.

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The paper benefitted from discussion with Steve Dowrick, Peter Drysdale, George Fane, Bob Gregory, Fred Gruen, Keith Hancock, Terry O'Brien, Don Rawson and Sue Richardson. There is no way they all will agree with the contents. Tina Nalty and Marti Pascall demonstrated superb efficiency and flexibility in this pocket of the Australian labour market.

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1. Introduction

It is an honour to be invited to speak on the occasion of the retirement of Malcolm Fisher. The organisers of today's conference have chosen one of the most complex of contemporary economic policy concerns: reform of the Australian labour market regulatory system. I begin by quoting Paul Samuelson:

> . . . when the economic theorist turns to the general problem of wage determination and labor economics, his voice becomes muted and his speech halting. If he is honest with himself, he must confess to a tremendous amount of uncertainty and self-doubt concerning even the most basic and elementary part of the subject.[1]

This is an important observation and a theme underlying the presentation set out below. Indeed, the complexities inherent in analysis of the Australian labour market system become clear, given the recognition of the following dilemma. From theory, there are arguments for the view that the nature of the Australian institutional environment discourages the maximum possible attainment of micro-economic efficiency in a dynamic sense. On the other hand, an implication of the centralised nature of our labour market arrangements is that they make possible the institution of consensual incomes policies—such as the Accord—which apparently help deliver favourable wage and strike outcomes. If the above observations are accurate, the dilemma is clear: while a case may be make that some changes are desirable in terms of micro-economic wage-setting processes, it is important to recognise that movements in this direction potentially undermine the macro-economic benefits of the Australian system. The theory and data pertinent to this issue are the subject of what follows.

2. Microeconomic Inefficiencies

All industrial relations environments can be improved upon. In the Australian case debate focuses on, among other things, employer–employee relationships, restrictive work practices (RWP), the consequences of craft-based unions and the implications of binding occupational minimum-wage legislation. Recent developments in labour market theory may be used to demonstrate some potentially deleterious consequences of the last of these. Employer–employee relationships, RWP, and craft unionism will not be examined in this paper. Binding occupational minimum-wage legislation has been chosen for analysis here because of its importance and the fact that very little of what follows has been accorded attention in the Australian literature or public debate.

It is assumed that the presence of the Commonwealth and various state arbitration commissions has facilitated the institution of, and changes in, occupational minimum wages. Further, it is presumed that minimum wages are

1. As quoted by Keith Hancock (1985), from J.E. Stiglitz (1966).

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higher than would be the case under alternative assumptions concerning institutional arrangements. This is tantamount to saying that the Australian system compresses wage relativities, an empirical issue examined cursorily below. If this is not the case, the analytical points developed have far less relevance, an observation highlighting the importance of empirical evidence in the area.

Much of the discussion of Australian minimum-wage legislation is concerned with the consequences of regulation for unemployment (Porter 1987; Fane 1988). There is, however, a different issue pertinent to wage regulation that may have more significant implications for dynamic efficiency than does unemployment. This concerns the acquisition of job skills from informal on-the-job training (OJT), and may be best understood through a simple exposition of human capital theory (Becker 1964).

In this model, workers "invest" in the acquisition of skills by taking relatively low wages in the training period, receiving returns to the investment after the training period in the form of relatively high wages. The implication is that the imposition of binding minimum wages leads to reduced skill acquisition (Hashimoto 1981; Leighton and Mincer 1981). The reason is that if the firm is forced to pay relatively high wages to workers undergoing OJT that is useful in other firms, then, once skilled, these workers will command increased wages elsewhere. Firms "paying" for the training can only recoup the returns by offering less-than-market wages post -OJT, but such a strategy guarantees the loss of trained workers to other firms. Rational behaviour is for firms to reduce the time workers spend learning and to increase the time workers allocate directly to production in the training period. If this is the case, it follows that binding occupational wages may have encouraged lower acquisition of OJT skills in Australia that would otherwise have been the case.[2]

Tan (1980) provides an extra dimension to the training–wage nexus which should be of more than passing interest for Australian commentators. In his view, technological change starts in one firm and slowly diffuses through the industry. Workers acquire technology-specific skills which are eventually useful in alternative employment. Such investments will be paid for in large measure by workers (by taking relatively low wages in the training period), who will be rewarded through the payment of relatively high rates of wage growth. If minimum wages are imposed, one consequence may be the reduction of incentives for firms to introduce technological change at the shop floor. This may have important long-run consequences for labour productivity growth.

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2. It is important to understand that the ability and propensity of employers to pay over-award wages is not relevant to the argument developed above. What matters is the possibility that firms would have paid less than the award to workers undergoing training in the absence of the institutions.

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The empirical evidence related to the above takes several forms. The prediction from the training model of a negative relationship between starting wages and rates of wage growth has been supported with U.S. micro-data (Chapman and Tan 1980) and Australian aggregate industry data (Chapman and Alston 1987). As well, a myriad of examples of indirect evidence related to labour turnover support the thrust of the human capital story (Chapman 1982; Viscusi 1980). As far as the more complicated hypothesis of the connection between technological innovation and OJT is concerned, Tan offers compelling evidence for this relationship, using both U.S. and Japanese data (Tan 1980). It should be noted, however, that no direct tests of the rôle of minimum wage legislation on technological change have been undertaken because the issue has not previously been aired.

In the Australian context the above observations, if both theoretically correct and empirically important, imply the following. Binding occupational minimum-wage legislation may have led to a more compressed wage structure than would otherwise have been the case through the raising of the lowest wages. This has disquieting implications for analysts of our system. One possible effect of such regulation is to decrease OJT and skill acquisition, a process which ensures that compression operates also at the high-wage end of the structure, through workers being less skilled than otherwise. Importantly, compression may have discouraged technological change and, concomitantly, reduced the potential for labour productivity and economic growth. A major question, thus, is whether or not labour market institutions in Australia have led to higher unskilled wages than would otherwise have been the case.

There is little doubt that the initial consequence of the (1907) Harvester case—the payment to adult males of a so-called "living wage" (Macarthy 1967)—was to decrease pay relativities. It is not obvious that relative compression has been maintained, in part because of the large number of changes to awards that have been instituted since then. Typically, as a consequence of these changes, the approach taken in analysis of the question is to invoke contemporaneous international comparisons.

Several pieces of research are pertinent to the proposition that the Australian wage structure is compressed relative to other countries. Mitchell (1984) examined coefficients of variation in industry wages in the U.S. and Australia, finding significantly greater variation in the former. Norris (1986, p.183–202) compared Australian wages with those in the U.K., using a variety of approaches, and concluding that (p.183):

> The results are consistent. There is not a great difference overall between wage relativities in the two countries whatever the basis of comparison, but virtually every difference identified is of the same sort: relativities are more compressed in Australia.

Hughes (1973) also argues that the differences between the two countries are small, particularly with respect to low-wage industries but, if anything, high-wage

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industries pay a little more in Britain.

As well as these fairly aggregate comparisons, it is useful to note that the size of experience coefficients in wage equations—the rate at which wages increase with age for individuals, another way of interpreting dispersion—are fairly low in Australia by international standards [compare, for example, the results of Chapman and Mulvey (1986) with both Chapman and Tan (1980) and Tan (1980)]. The bottom line is that the evidence can only be interpreted as consistent with the view that the Australian wage system is somewhat, although not necessarily markedly, compressed. Again, this doesn't mean that the institutional environment has *caused* the outcome.

The other research relevant to this assessment concerns the process of technological change, since if this has been inhibited by wage regulation Australia should have poor records of both innovation and growth. Elek, Camilleri and Nelson (1987) argue that technological progress in Australia has been relatively poor, but Dowrick and Nguyen (1987) suggest that Australian economic growth this century has been neither abnormally high nor abysmally low.

From the above, the following points emerge. In theory there are reasons to believe that the Australian system has lowered incentives for OJT, technological change and, consequently, for economic growth, *but only if it has increased low wages*. Thus, the important assumption is that pay relativities are more compressed than they would otherwise be, a point that has yet to be demonstrated unequivocally. The empirical evidence supports the conjectures developed from the human capital model, but this does not imply that the Australian labour system has necessarily significantly diminished the growth process.

A caveat to the analysis concerns the rôle of immigration, particularly skilled immigration, in the Australian growth process. There is evidence to suggest that Australian policy has been to import labour in areas of skill shortage (Withers 1987), a process which tends to ameliorate the problems of a lack of domestic training. While this may be true—and should be treated as a caveat to the thrust of the theoretical conjectures developed above—immigration of skilled labour does not per se solve the problems implied by minimum wages, given the OJT–technological change nexus. The greater the degree of specificity of training to the firm, the less the relevance of immigration as a solution to skill shortage.

It should be kept in mind that it is very difficult to determine the rôle of various causal factors in influencing the Australian wage structure, and conclusions must be careful. However, on the basis of available evidence, it is easier to make rather than to deny the case that our institutions have inhibited the attainment of dynamic labour market efficiency. But, as will become clear below, this does not establish the proposition that changing the institutions necessarily improves Australian labour market performance.

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3. Macroeconomic Arrangements

Proponents of close variants of the current system typically allude to the view that centralised decision-making delivers favourable macroeconomic outcomes (Hancock 1985). In the discussion following, both the theoretical basis and the empirical evidence for this proposition will be explored.

The theoretical framework is as follows. "Atomistic" bargaining units do not bear the costs of their action borne by outsiders to the system. Under so-called "corporatism" (defined as "wage-setting by central organisations, commanding the obedience of individual workers and employers, to achieve a high level of employment"[3]), the needs of the outsiders—the unemployed—are taken into account. The conjecture from this model is that "laissez-faire is likely to produce an insider–outsider problem and possibly prolonged spells of high unemployment"[4] and that, by implication, corporatism is preferable.

A (somewhat) different way of analysing this issue is provided by Crouch (1985, p.107), who promotes the importance of public interest wage systems (PIWS), or corporatism:

> Social interests that are organized on a small, localised scale receive in full any gain from distortions they produce in market processes but bear only a minute proportion of the general cost; indeed, they share in the general cost of other similar action, even if they fail to participate. Their only rational course is therefore to try to be sure of their own possibilities for gain through disruption. The position of an interest organised at a national or near-national level will be completely different, as it will experience directly the negative effects of its disruptions it can therefore be expected to take these effects into account.

There is considerable evidence concerning macroeconomic outcomes under different institutional settings, most of which involves international comparisons and somewhat ad hoc categorisations of systems. Debate tends to place countries in one of three groups: strong union countries (as measured by coverage) adopting PIWS, such as Austria and Sweden; strong union countries not adopting PIWS, such as the U.K; and decentralised low-coverage union countries, such as the U.S. The consensus emerging is that the first and third groups have recently performed well compared to strong-union countries not adopting PIWS. The OECD (1987) summarises the evidence as follows:

> Labour market outcomes have been consistently poorer in those countries, notably the United Kingdom, France, Italy and Belgium, where collective bargaining structures fall between extremes, where outcomes have been

3. Newell and Symons (1986, p. 17).
4. Newell and Symons (1986, p. 17).

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> neither subject to the direct restraints of decentralised bargaining and competition in labour markets nor guided by a wider recognition of economic and social responsibility.

This finding is supported by Freeman (1987).

In the Australian context the institutional machinery has long been in place for the operation of a PIWS, but the only unambiguous application of the model is that of the prices and income Accord, negotiated between the ALP and the ACTU in 1982, and instituted with the change in government in March 1983. This policy change allows a very simple test of the efficacy of different institutional arrangements on labour market performance. Australian experience under the Accord can be assessed with reference to different variables and counter-factuals. Discussion concerns macroeconomic and industrial disputation outcomes. Taking first macroeconomic conditions, Australian experience in the period to and after the beginning of 1983 can be compared with reference to other countries. These data are presented in Table 1.

The data reveal, among other things, that Australia experienced relatively rapid growth in employment and GDP post-1982, relative to both the six-year period prior to the Accord and to an (unweighted) average of nine OECD countries. Perhaps more significantly, nominal and real hourly earnings growth declined relatively substantially, and real unit labour cost decreases became similar to the average of other countries. In short, in terms of macroeconomic outcomes the aggregate data imply improvements in Australian performance given the transition to a PIWS.

Of course, data such as these can never be fully convincing. It is not possible to determine what wages would have been without the Accord,[5] and there are good reasons to believe that circumstance were propitious for wage restraint without a consensual incomes policy. The outgoing Liberal government had influenced the institution of a wages freeze (their own variant of a PIWS), and the (measured) unemployment rate was around 10% in 1983. Because of these circumstances it is useful to offer alternative comparisons, one of which is presented in Table 2.

The data of Table 2 allow a comparison of wage outcomes in 1984–85 in Australia with similarly rapid periods of employment growth, 1950–51, 1953–55 and 1963–65. The statistics show that, of the four post-WWII periods of rapid job creation, only in the Accord period did real wages not increase. Moreover, real unit labour costs fell most at this time. A difficulty for unambiguous conclusion is that this is not just a reflection of policy, since both outcomes would be, in part, a consequence of the very low level of economic activity in 1981–83. This implies,

5. For recent econometric analysis supportive of the proposition that the Accord has helped deliver decreased wage outcomes, see Lewis and Kirby (1987). Simes and Richardson (1987) argue otherwise.

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Table 1

Australian and OECD[1]

Macroeconomic Outcomes: 1977–82 and 1983–86

	(Annual Average Percentage Change)					
	CPI	Nominal Hourly Earnings	Real Hourly Earnings	Employment	GDP	Real Unit Labour Costs
Australia 1977–82	12.38	15.33	2.95	1.25	2.37	–0.25
OECD 1977–82	9.47	10.45	0.98	0.79	2.07	–0.94
Australia 1983–86	7.99	6.82	–1.17	2.15	3.15	–0.82
OECD 1983–86	4.80	5.88	1.08	0.83	2.81	–1.09

Note: 1. Unweighted average of U.S., Japan, West Germany, Austria, Canada, France, U.K., Sweden and Italy.

Source: *OECD* (1978–1986)

again, the limitations of comparative exercises.

The difficulties inherent in directly and confidently relating macroeconomic performance to institutional arrangements and government policy are apparent from the above. There are at least two conceptual problems. The first is that judgements concerning policy effectiveness are necessarily relative assessments. This implies that, to be compelling, evaluation postulates outcomes associated with alternative scenarios for which data are necessarily not available. For the exercise at hand, one such counter-factual would be collective bargaining under the existing Australian institutional framework, or that of a strong union country without a PIWS. This approximates the 1981–82 experience in which economic experience was unambiguously poor relative both to overseas and to other periods in Australian economic history. Such a reference is unfair, however, for the reasons related to the second conceptual problem inherent in policy assessment, outlined below.

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Table 2

Australian Wage Experience in Recoveries (per cent)

Period	Annual Increase in Employment	Annual Increase in Real Average Weekly Earnings	Annual Increase in Real Unit Labour Costs
1950–51	4.51	3.25	–2.54
1953–55	3.82	3.90	–0.79
1963–65	4.36	4.10	–1.67
1984–85	4.30	0.00	–2.90

Source: Chapman (1986)

Economic variables, including expectations, change continually. In no two periods of time are enough factors sufficiently similar to facilitate confident policy comparison. For example, the following are pertinent in the Accord context. First, the dramatic deterioration of the economy in 1982–83 probably affected the attitudes and expectations of the principal economic agents profoundly. Second, the Accord was preceded by a wage pause which directly influenced some economic outcomes and may have indirectly impacted upon others. Third, in the Accord period the state of the labour market per se may have resulted in similar experience with a different government stance.

Even given these caveats and qualifications on judgements of the macroeconomic success or otherwise of the Accord, some conclusions are in order. The most obvious is that, in absolute terms and relative both to previous experience and to other OECD countries, Australian wage cost outcomes have been favourable since 1983. These data suggest that the case for a PIWS in Australia is more easily made than is the case against it, at least on short-term macroeconomic grounds. Those arguing the desirability of alternative approaches must come to terms with the difficulty that the Accord apparently has "the runs on the board", no matter how obvious are the problems associated with directly attributing causality.

The argument concerning the effectiveness of a PIWS in Australia vis-à-vis industrial disputation, as measured by strike activity, is more clear-cut than the above, although assessment is characterised by similar conceptual difficulties. John Beggs and I (1987*a*) have recently tested the proposition that working days lost per unionist changed after the institution of the Accord in a way not explainable by variations in economic conditions usually associated with strike

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activity. From theory (Aschenfelter and Johnson 1969) and previous empirical analyses (Bentley and Hughes 1970; Phipps 1977; Perry 1979), the incidence, timing and duration of strikes are influenced by a range of variables, such as price inflation, profits, inventories, and measures of labour demand. Without control for the influence of these factors, little can be said about the effect on disputation in Australia of the Accord.

Our method involved the estimation of econometric models explaining working days lost per unionist from strikes, using quarterly data from 1959(III) to 1983(I). The models were subjected to a broad range of diagnostic tests until we were satisfied that the final equations used were statistically healthy. The factors of importance influencing strikes were changes in the CPI, overtime, inventories, profits as a proportion of GDP, the vacancy rate, and a number of political factors, such as the gaoling of Clarrie O'Shea in 1969 and the Medibank strike of 1976.

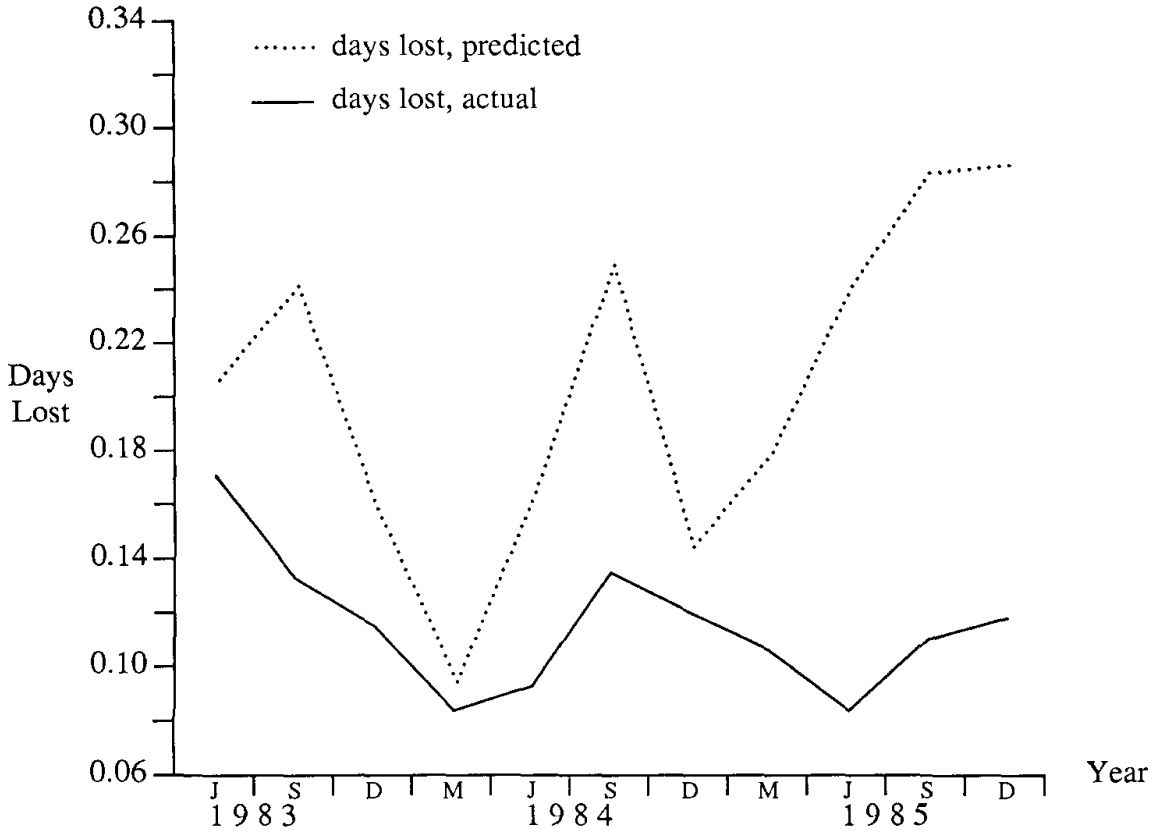

Figure 1

Working days lost per unionist

The models were then used to predict strike activity over the period of the Accord (1983(II)–1986(I)) for which data were then available. The results are illustrated in Figure 1, which should be interpreted as follows. The dotted line is strike

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activity predicted from the models based on the macroeconomic experience of 1983(II)–1986(I) and the solid line is actual working days lost per unionist from disputation over this period.

The data presented above show, unambiguously, that strike activity decreased markedly after the beginning of 1983 in a way not explainable by changes in economic variables. On average the extent of the decrease was of the order of 60%. It is noteworthy that at no time in this period did actual working days lost per unionist exceed that predicted, which constitutes compelling evidence of a structural break in measured disputation after the beginning of 1983.

A typical criticism of this research is the argument that Australian strike activity decreases were part of an international phenomenon and, by implication, unrelated to changes in the Australian institutional environment (Clark 1987). Our response (Beggs and Chapman 1987*b*), was to estimate the following model of strike activity determinants for thirteen OECD countries for which annual data were available for the period 1964–85:

$$\log WDL/E_{ij} = a + b\,INF_t + c\,UN_i + d\,TIME_t + \sum_{j=1}^{n} e_n I_j + \sum_{k=1}^{p} f_k I_{j\,D8385} + \varepsilon, \quad (1)$$

where, for country j in year i, WDL/E is working days lost from strikes per employee, INF is the annual rate of change in the CPI, UN is the unemployment rate, $TIME$ is time, I_j is the country dummy and $I_{j\,D8385}$ is the country dummy interacted with a dummy for the period 1983–85. The results are presented in Table 3.

The results of Table 3 reveal that, for the thirteen countries considered:

- inflation and unemployment, the effects of which were constrained to be the same across countries, were respectively positively and negatively related to strike activity;
- strikes increased over the period; and
- there were significant international (measured) differences in industrial disputation.

Most importantly for the question at hand, in no country other than Australia was there a significant diminution in strike activity after the beginning of 1983. If less turbulent industrial relations were a world-wide phenomenon in this period, this is not revealed in the data. Apparently, the Australian experience was unique.

The above, of course, does not prove that the institution of a PIWS in Australia caused a large decrease in strike activity. The research implies, however, that it is implausible to argue that there was no change in the Australian industrial relations environment after the beginning of 1983. As with the data presented on macroeconomic outcomes, this poses a difficulty for the argument that a consensual incomes policy in Australia—given the nature of the existing institutions—is not beneficial to aggregate labour market experience.

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Table 3

Dependent Variable is the Logarithm of Working Days Lost Per Employee

Variable		Coefficients and Absolute *t*-statistics Model (1)		Model (2)	
Log Inflation Rate		0.544	(8.25)	0.506	(6.87)
Log Unemployment Rate		–0.499	(3.64)	–0.562	(3.88)
1983–85 Dummy:	Australia	–0.667	(2 51)	–0.663	(3.52)
	Canada	–0.246	(0.89)		
	Finland	–0.403	(0.44)		
	France	–0.352	(0 80)		
	Germany	0.062	(0.04)		
	Ireland	0.580	(1.23)		
	Italy	–0.410	(0 99)		
	Japan[1]	–0.367	(0.95)	–0.109	(0.62)
	Norway	–0.861	(0 93)		
	Spain	–0.912	(1.74)		
	Sweden[1]	–0.793	(0.52)		
	UK	0.515	(0.93)		
	US	0.327	(1.24)		
Linear Trend:	Australia	0.062	(2.95)	0.070	(3.36)
	Canada	0.002	(0.14)	0.003	(0.21)
	Finland	0.102	(2.01)	0.098	(2.39)
	France	0.003	(0.12)	0.003	(0.15)
	Germany	0.108	(1.25)	0.123	(1.77)
	Ireland	–0.033	(1.25)	–0.006	(0.23)
	Italy	–0.42	(1.75)	–0.046	(2.18)
	Japan	–0.091	(4.47)	–0.097	(5.38)
	Norway	0.118	(2 37)	0.097	(2.39)
	Spain	0.263	(8.17)	0.246	(8.13)
	Sweden	0.047	(0.61)	0.033	(0 52)
	UK	0.054	(1.72)	0.082	(2.89)
	US	–0.104	(6 39)	–0.085	(5.40)
Intercept:	Australia	–1.899	(11.04)	–1.846	(11.11)
	Canada	–0.396	(1 60)	–0.246	(0.97)
	Finland	–3.168	(5.46)	–3.013	(5.65)
	France	–2.377	(8 55)	–2.261	(8 77)
	Germany	–6.611	(6.83)	–6.681	(7.58)
	Ireland	–0.440	(1 20)	–0.457	(1 25)
	Italy	0.406	(1.20)	0.610	(1 85)
	Japan	–2.454	(9 73)	–2.327	(9 26)
	Norway	–6.090	(10.48)	–5.832	(10.89)
	Spain	–4.898	(14.16)	–4.621	(13 86)
	Sweden	–5.457	(6 16)	–5.254	(6.39)
	UK	–2.180	(6 08)	–2.230	(6.47)
	US	–0.036	(0 15)	–0.018	(0 07)

Notes: R^2 from Model 1: Australia 0.69; Canada 0.55; Finland 0.18; France 0.28; Germany 0.30; Ireland 0.10; Italy, 0.26; Japan 0.86; Norway 0.33; Spain 0.83; Sweden 0.21; U.K. 0.29; U.S. 0.80.

1. Data for Japan and Sweden do not include 1985.

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4. Conclusions and Some Perspectives on the Australian Debate

It is fashionable in some quarters to point to the inadequacies of Australian labour market institutions as if these inadequacies, by themselves, make the case against our system. But it is paramount in policy assessment to recognise both costs and benefits of social and legal organisation before coming to strong conclusions as to the desirability of alternatives. The obvious point from the issues raised in this paper is that no simple, or necessarily desirable, solution exists to our current dilemma.

In theory, backed in the main by empirical analysis, there are reasons for concern about the microeconomic implications of our institutional environment. It is plausible to suggest that it tends to diminish on-the-job skill acquisition and, potentially, the initiation of shop-floor technological innovation. Binding occupational minimum-wage legislation is arguably a consequence of centralised dispute-settling procedures, and may have limited Australian potential for labour productivity growth. By itself, this constitutes an argument for some reforms in our labour market arrangements, although the evidence concerning the rôle of our institutions in compressing wages is not overwhelming.

On the other hand, macroeconomic argument and evidence tend to support the view that important benefits exist for countries that adopt consensual incomes policies, given the existence of broadly based union movements. It is not sensible to argue that the Australian system is characterised by other than a strong union movement, so it is important to take this evidence seriously. Data relevant to the Accord period support, with caveats, the conjecture that the post-1983 policy approach delivered favourable growth and wage outcomes. As well, econometric analysis suggests, fairly unambiguously, that the Accord has helped deliver markedly lower levels of strike activity.

The bottom line is that there is no straightforward option available that easily delivers a nirvana of microeconomic dynamic efficiency and favourable macro-economic outcomes. Given this complexity, the challenge is to find processes that promote movement towards establishment-based wage bargaining without threatening the benefits of economy-wide income settlement.

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