

This version: Mar 12, 2005

IR Reforms

John Quiggin

Australian Research Council Federation Fellow

School of Economics and School of Political Science and International Studies

University of Queensland

EMAIL j.quiggin@uq.edu.au

PHONE + 61 7 3346 9646

FAX +61 7 3365 7299

<http://www.uq.edu.au/economics/johnquiggin>

I

IR Reforms

The 2004 Australian election placed the Howard government (a coalition of the conservative Liberal and National Parties) in the unexpected position of controlling both the House of Representatives and the Senate, with effect from July 2005. The government was therefore in a position, rare in recent Australian political history, to pass legislation without relying on support from minor parties or independents.

Among the top priorities has been reform of the industrial relations system. One element of reform, long advocated by the government, is the removal of small businesses from the scope of unfair dismissal laws. More ambitiously, the government is seeking changes that would radically reduce the role of the Australian Industrial Relations Commission and the system of awards it administers.

The aim of the present paper is to describe the reforms proposed by the government, to evaluate, as far as possible, their likely impact, and to consider possible alternatives

Background

The 19th century starting point for employment relationships was one in which the employers (then called ‘masters’) held the upper hand, both because they were more powerful than individual employees and because the state and the common law was at their command. Not surprisingly, the outcomes included very high levels of inequality. Australia was one of the first countries to develop an alternative to the old law of master and servant.

The key features of Australia’s system of industrial relations were developed in the leadup to, and immediate aftermath of, Federation in 1901. The central

principle was the idea that judicial arbitration should be used to resolve industrial disputes. Under the Constitution, the Commonwealth had the power to legislate with respect to Arbitration of disputes affecting more than one state.

As a result, parallel arbitration systems were developed at State and Federal levels, and these remain in place. The standard outcome of arbitration was an award, setting out wages and a wide range of conditions for workers covered under the award.

The second key innovation was the basic wage, introduced as a result of the Harvester decision in 1907. The result is that Australia does not have a legislative minimum wage, this being determined by the Arbitration Commission (s). For much of the 20th century, award wages were set on the basis of basic wage plus margins.

By the middle of the 20th century, the rise of legally protected trade unions, and government intervention through the arbitration system had changed the balance of power dramatically. In combination with the full employment that characterised the long boom after World War II, this produced a great reduction in inequality. Unfortunately, there were plenty of instances where unions abused their power, setting the stage for the subsequent reaction.

In most of the English-speaking countries we've seen, since about 1980, a move back towards the 19th century system, with 'employment at will' based on individual bargains between workers and employers becoming the standard form of employment relationship. The US was furthest in this direction at the beginning of the period, and went even further over the 1980s and 1990s. The UK and New Zealand made the most radical changes.

In Australia, over the period since 1980, a combination of legislative reform and changes in the labour market has eroded many aspects of the Arbitration/award

system. The most important developments have been the decline in union membership and in the frequency of industrial disputes, the partial replacement of industry awards by a system of enterprise bargaining and, particularly since the election of the Howard government, the development of non-union alternatives such as Australian Workplace Agreements and individual contracts.

The general effect of these changes has been to move Australia closer to the kinds of labour market institutions prevailing in the United States, United Kingdom and New Zealand. The characteristics of these institutions are:

- Low (or no) minimum wages
- Individual contracts between employers and employees as the primary
- Employment at will
- State intervention in industrial disputes primarily on the side of employers (for example through common law actions, emergency laws, anti-boycott provisions)

Given that the state retains an extensive role in systems of this kind, terms like 'deregulated' are inappropriate. It seems better to refer to such systems by some term such as 'neoliberal', reflecting their association with the market-oriented ideological frameworks that came to prominence in the 1980s.

The reform proposals

The reform proposals announced by the Howard government (May 26, 2005) have two main elements. The first is the amendment of unfair dismissal laws, so that they no longer apply to enterprises with less than 100 employees.

The second, and, in the long run, more significant element, is a substantial extension of previous trends, aimed at reducing the role of unions, awards and arbitration, while increasing that of direct contracting between employers and individual employees. In particular:

1. A number of conditions are to be removed from the scope of awards, including jury service, notice of termination, long service leave and superannuation;
2. Minimum conditions will be set by legislation rather than through the awards

process;

3. Minimum wages will be set by the Australian Fair Pay Commission, rather than by the Australian Industrial Relations Commission;

4. State industrial tribunals will be abolished and replaced by a single national system

Analysis

It is very difficult to make definitive predictions about the results of particular changes in industrial relations systems. There are a number of reasons for this, including the inherent complexity of employment relationships, the fact that industrial relations systems differ between jurisdictions and over time in ways that cannot easily be measured and the confounding effect of other changes in the labour market, including those associated with macroeconomic cycles.

Unfair dismissal

This point can be illustrated in relation to unfair dismissal laws. *A priori* arguments don't yield anything useful. Supporters of such laws make the obvious point that, other things equal, the easier it is to dismiss employees, the higher will be the rate of dismissal, and therefore the higher the level of unemployment. Opponents counter that employers will be unwilling to take on staff if they are unable to dismiss those who turn out to be unsatisfactory.

In economic terms, the problem starts with the fact that an employment contract has a lot of implicit or hard-to-verify terms. The worker promises to turn up on time, work diligently, be competent, and not cause trouble and dissension in the workplace. The boss promises to act fairly, not to harass or bully the workers and so on. Once both parties have committed to the relationship, they each have the opportunity to cheat on these commitments. How this works out depends on the institutional rules, the state of the labour market and so on. Whatever happens there are going to be plenty of people who perceive the outcome as unfair, and plenty of cases where this perception is accurate.

The aim of unfair dismissal laws is to set up a clear procedure that employers

must follow to dismiss underperforming employees. This is widely seen as acceptable for large employers with organised HR departments to keep track of such things. But for small businesses, it's a burdensome process. On the other hand, anyone who's dealt with small business employers knows that they vary a lot. The good ones are much better than big corporations, the bad ones a lot worse.

What about the empirical evidence? As with many things in economics, the literature on unfair dismissals starts out with a big publication finding clear-cut results, only to descend into a morass of agnosticism. A paper by Lazear in 1990 found strong negative correlations between the strength of employment protection laws, proxied by severance pay, and desirable labour market outcomes such as employment and participation rates, hours worked and so on. But Lazear's results have not stood the test of time. Here's the abstract of a recent paper *What have we Learned About the Employment Effects of Severance Pay? Further Iterations of Lazear et al.*

In this study we examine the contribution of severance pay to employment and unemployment development using data on industrialized OECD countries. Our starting point is Lazear's (1990) empirical dictum that severance payment requirements adversely impact the labor market. We extend his sample period and add to his parsimonious specification a variety of fixed and time-varying labor market institutions. While the positive effect of severance pay on unemployment garners some support, there is no real indication of adverse effects for (the three) other employment outcomes identified here. Moreover, with the possible exception of collective bargaining coordination, the role of institutions is also more muted than suggested in the literature

This ILO study gets similarly unclear results. Generally speaking, employment protection laws lower the variance of employment and unemployment but have no clear effect on the average levels.

Contracts, bargains and awards

The other big development is the rise of contract-based work. This is really two developments. The first is the replacement of awards and enterprise agreements by individual contracts for employees. If there are any benefits from this process for employees, I find it hard to discern them. In most large enterprises, employees are offered a standard contract with no negotiation regarding terms, except for starting salary (it's very hard to get data on this kind of thing, so if anyone has evidence about the frequency of contract variations, I'd be glad to see it). So, there's no individual customisation and employees lose the protections that are commonly inserted in awards or enterprise bargains.

More radical is the shift from employment to self-employment as an individual contractor. It's hard to get accurate figures on this. It seems clear that, in some sectors of the economy, there's a significant expansion of the role of individual contractors, but aggregate figures don't show an increase in those who class themselves as self-employed.

In many cases contractors are just employees under a new name, with the same employer, usually worse working conditions, offset by a greater capacity to avoid/evade tax. This kind of conversion is even worse than a shift to employment contracts. And for professional workers, self-employment as a 'consultant' or 'freelance' is commonly a euphemism for unemployment.

There's little to suggest that large numbers of Australians have suddenly embraced the entrepreneurial spirit and no longer need or want the protection of unions. The growth of self-employment in some sectors of the economy owes more to the push out of secure employment than to the pull of the free market. There was a lot of overheated optimism about the 'free agent' nation during the dotcom boom, but the realities of self-employment became glaringly apparent during the subsequent crash.

A single national system

The push for a single national system of wage-setting is another instance of the Howard government's centralism. It's produced some opposition from state leaders of the Liberal and National parties, who have traditionally been the

strongest defenders' of 'states rights'.

I don't believe in state's rights as such, but I prefer a federal system with divided power in most cases. Partly this is because it's better when possible to make decisions at a local level, taking account of local conditions and responding to differences in the character of different cities and states.

In addition, I think it's easier for the right than for the left to use a strong national government to push through policies that lack popular support: left-wing governments pushing radical policies will always face powerful opposition from business, and will need popular support as well as legislative majorities. By contrast, Thatcher was able to push through radical free-market reforms with the support of 40 per cent of voters.

In this case, though, I'm sympathetic to the idea of a single national framework. In part this is because I think we now have something close to a single national labour market, with the main differences being urban/regional/rural rather than between states.

In addition, though, I think the only hope of retrieving the ground lost in the last twenty-five years is through national legislation. This is one instance where I think relying on divided government is misguided as a defensive strategy. The underlying trends are so adverse that only a substantial change in institutions can halt or reverse them.

General effects of neoliberal labour market institutions

In a comparison between neoliberal labour market institutions and alternatives involving either collective bargaining or centralised wage fixation, one feature is clearly evident. Neoliberal institutions produce substantially more unequal outcomes. This is evident both from comparisons over time and from comparisons between countries. Figure 1, from Smeeding (2001) illustrates developments over time.

The United States, where the labour market has always had most of the main neoliberal characteristics displays easily the highest inequality. The radical

neoliberal reforms undertaken in New Zealand and the United Kingdom in the 1980s and early 1990s show up clearly in rising levels of inequality, overtaking European countries that were initially less egalitarian.

Figure 2 gives more detail on developments in the US since 1970, where declining rates of unionisation and a general shift towards even more extreme forms of neoliberalism have produced a dramatic shift in the distribution of income. Low-income families have experienced almost no income growth since 1970. Wages for workers with high-school education or less have actually fallen, but this has been offset by longer hours of work and increased female participation.

Figure 1.
Changes in Income Inequality

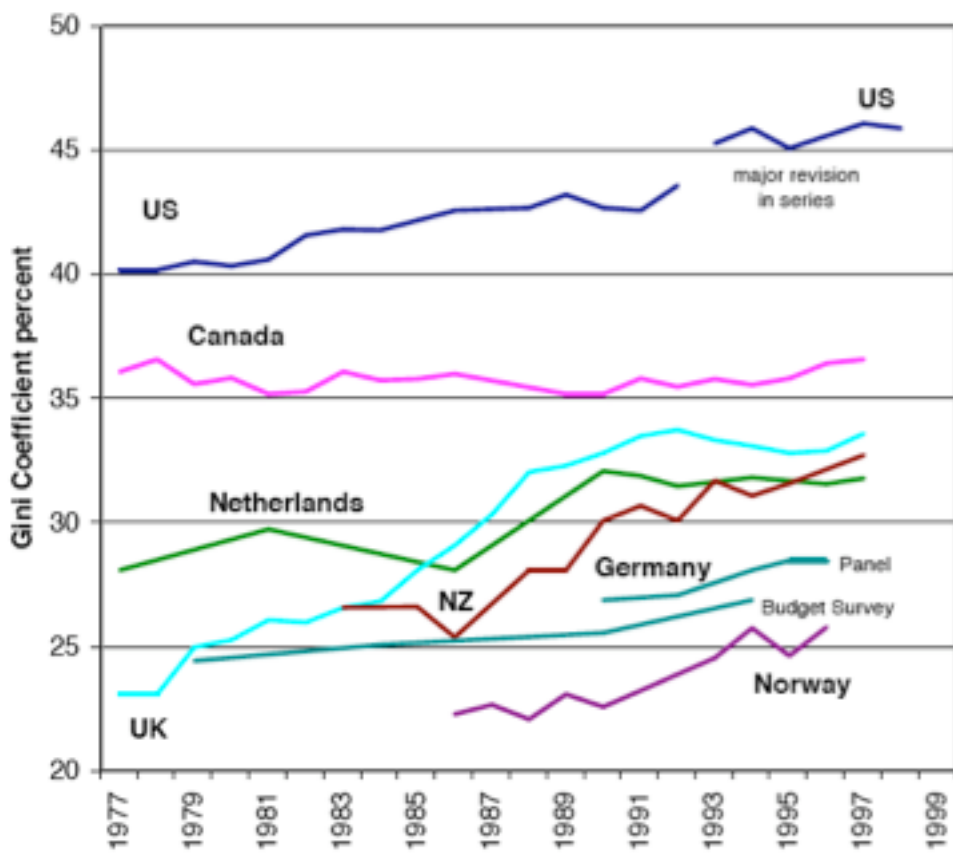
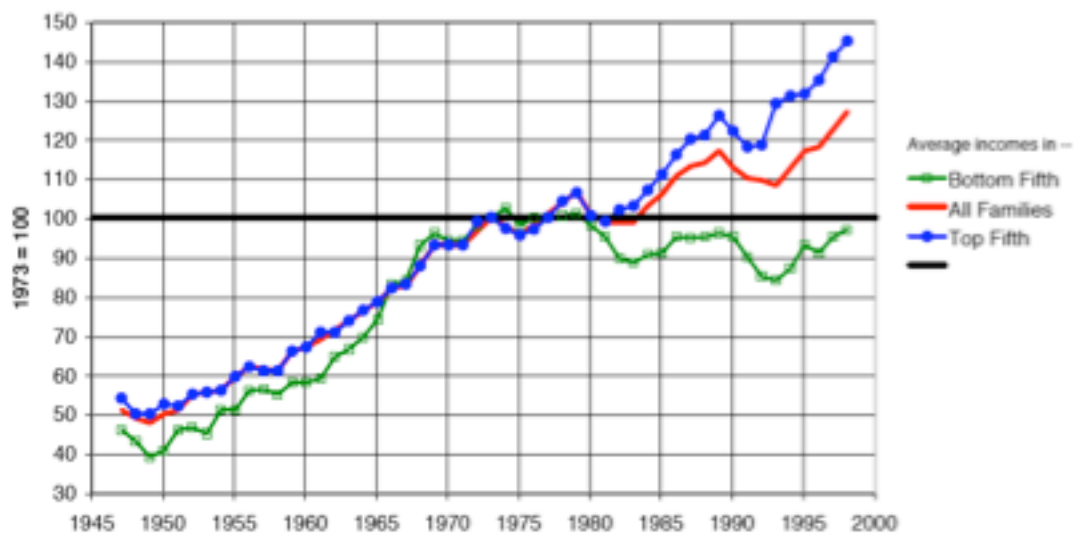


Figure 1. Trend in Real Average Family Income, by Rank in the Income Distribution, 1947-1998



Defenders of neoliberal institutions argue that this growth in inequality has been offset by stronger employment growth resulting from more flexible labour markets. The evidence here is decidedly mixed. Until the present business cycle, beginning in the early 1990s, there was little evidence to support it. For most of the past decade, however, the English-speaking economies have outperformed those of the Eurozone and Japan. It's still too early to judge whether this is merely the outcome of cyclical timing, or whether there is a sustainable gain in employment here. My view, based on the huge current account deficits being run by all the English-speaking countries is that a severe cyclical correction lies ahead. Only when the macroeconomic imbalances have been resolved will it be possible to make a clear judgement on this issue

Summary

Employment relationships are complex, but the outcome of bargaining over employment depends on two main factors. The first, is the state of the labour market. The second is the balance of bargaining power. Usually, but not always, the state of the labour market is more important, but it's largely determined by exogenous macroeconomic shocks originating not in the labour market but in the financial sector or the world economy.

The reforms proposed by the Howard government will tilt the balance strongly in favour of employers. The likely outcome is a substantial increase in inequality of incomes, and in day-to-day relationships within the workplace.