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Chapter 10

The Economics of Industrial Relations Reform

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Introduction

The federal Government's macroeconomic policy stance (an obsession with budget surpluses and tight monetary policy) has meant that the Australian economy has failed to produce enough jobs. Instead of recognising this, the Government has established pernicious compliance regimes to ensure that the 'victims' – the unemployed and marginalised workers – are blamed and 'punished'. The attack on fairness within Australia, however, is now accelerating. Ignoring the macroeconomic realities of having close to 1.8 million workers without sufficient work (Keating 2005), the Government has now demonstrated its intention through the WorkChoices legislation to eliminate one of the last symbols of our fair society, namely the judicially-determined conciliation and arbitration system and wage-setting machinery. These changes will impact on a much wider constituency than previous industrial relations changes and the political consequences are likely to be more profound. The changes will clearly hurt the low-skilled the most, but few workers will avoid the impact of the radical transformation of the way in which we earn income, work, take leisure and engage in social relationships.

The origins of WorkChoices can be traced to the neoliberal economic reform agenda that emerged in response to the inflation breakout that followed the first oil price shock in the mid-1970s. This agenda gained additional impetus following the publication of the *Jobs Study* by the Organisation of Economic Cooperation and Development (OECD 1994). This work provided a blueprint for the developed economies which was designed to improve their capacity to respond to change. Akin to the 'Washington Consensus' which was force-fed to the developing world, the reforms were founded on the primacy of markets, and the imperative to remove the institutional fetters which allegedly inhibited their operation.

In this chapter we provide an integrated theoretical and empirical critique of the WorkChoices package, which is informed by economic principles. In section 2 we outline the emergence of the new consensus macroeconomics paradigm, which has shaped economic debate and policy development over the last two decades, yet has failed to deliver sufficient economic growth to sustain full employment in developed economies. In the following section we reflect on the tension between long-established industrial relations practices in Australia and this broad neoliberal reform agenda. We argue that the subsumption of the labour market within the market reform process not only represents a fundamental misunderstanding of how labour markets operate, but, more broadly, is not grounded in rigorous macroeconomic principles.

In section 4 we highlight a number of key features of the proposed reforms and draw on international research to argue that the major contentions that have been used by the Government and the business lobby to justify WorkChoices are spurious. We suggest that the changes are more motivated by an ideology founded on the elimination of trade union influence and the concentration of bargaining power firmly in the hands of the employers, rather than addressing the persistent underutilisation of labour. We argue that the dynamic that will follow from that redistribution of power will not deliver sustained improvements in economic competitiveness or underpin a high wage, high productivity economy.

The macroeconomic realities of the neoliberal reform agenda

The experience of World War II showed governments that full employment could be maintained with appropriate use of budget deficits. Following World War II, the problem that had to be addressed by governments was how to translate the fully employed war economy with extensive civil controls and loss of liberty into a fully employed peacetime model. The emphasis of macroeconomic policy was on achieving full employment by generating enough jobs. The control of inflation was a secondary concern.

The rise in inflation in the mid-1970s deteriorated into stagflation when governments failed to develop appropriate macroeconomic responses to the oil price impulse. The emergence of stagflation revealed ideological fissures among Keynesians that were previously masked by the prosperity of the post-war consensus between government, labour and business. The rift led to the development of 'New-Keynesianism' with its obsession with economic rigidities, such as trade unions and minimum wages, which, in turn, was a precursor to the neoliberal labour market flexibility agenda (Palley 2004). The balkanisation of Keynesian macroeconomics opened the way for neoliberals to impugn the post-war labour market reforms that had underpinned the return to full employment and the expansion of the welfare state. The reforms were reconstructed as market distortions rather than corrections of chronic market failure. In turn this led to the articulation of a broad macroeconomic consensus among leading western nations which was supported by a reform paradigm that was outlined by the OECD in its 1994 *Jobs Study*.

Arestis and Sawyer (2003, 2-3) outline the new macroeconomics paradigm which can be summarised as follows:

- Monetary policy is the primary macroeconomic instrument and should be set to maintain price stability. Monetary policy should be independent of the political process to ensure that the independent central bank maximises credibility with financial markets in its pursuit of low inflation.

- Fiscal policy should passively support the aims of monetary policy and aim for budget balance averaged over the business cycle. The Australian Government has redefined this goal in terms of the imperative to achieve persistent surpluses (and extensive fiscal drag).

- The economy settles at the NAIRU (the rate of unemployment at which inflation is stable) and economic growth is maximised given the supply conditions. Stimulatory policy to reduce the unemployment rate below the NAIRU is eschewed due to fears of inflation.

- The restoration of Say's Law means that there can never be generalised overproduction and an excess supply of labour.

This macroeconomic paradigm was buttressed by specific microeconomic reform proposals, particularly focused on the labour market to rid the OECD economies of what was considered to be a sclerosis which reflected years of regulation and income transfer policies that had eroded individual incentive and institutionalised high unemployment rates.

In the *Jobs Study* (1994, 43) the OECD advocated a broad range of reforms to address this alleged inflexibility and reduce the NAIRU: namely, growth-enhancing, sustainable macroeconomic policy; the creation and diffusion of technological know-how; increasing the flexibility of short-term and lifetime working-time; nurturing an entrepreneurial climate; making wage and labour costs more flexible and responsive to local conditions and individual skill levels; reforming employment security provisions; strengthening the emphasis on active labour market policies; improving labour force skills and competencies; and reforming unemployment and related benefit systems. Clearly the WorkChoices legislation lies within the broad policy framework of the 'new macroeconomic consensus' and the OECD *Jobs Study* agenda.

Before investigating the weaknesses of the changes to the industrial relations legislation, it is helpful to acknowledge some stylised facts that challenge the alleged macroeconomic success of the present neoliberal campaign in Australia. The change agenda must be seen against a backdrop of moderate inflation, growing wage inequality (Australian Government 2003, Figure 9.1), record-high household indebtedness and persistently high levels of labour underutilisations. While the official rate of unemployment of 5.2 per cent (October 2005), which is well above the rate experienced in the immediate post-War period, a broader hours-based measures of labour underutilisation (incorporating hidden unemployment and underemployment) calculated by the Centre of Full Employment and Equity at the University of Newcastle indicate that 9.8 per cent of willing labour resources were unused in August 2005. The quality of the work experience has also deteriorated given the characteristics of many part-time 'non-standard' jobs – precarious tenure, low pay and non-standard working hours (Borland, Gregory & Sheehan 2001).

The persistent labour wastage is a sign that net government spending is too low (Mitchell & Mosler 2001) and the preoccupation with budget surpluses has introduced significant fiscal drag into the growth cycle. The willingness of households to become increasingly indebted has driven economic growth for some time. This growth strategy is unsustainable and eventually will lead to an entrenched recession as households resume saving and reduce their debt exposure.

Freeman (2005, 1) notes that the debate about the determinants of economic performance has shifted from the conduct of macroeconomic policy to the degree of deregulation of labour market institutions. This is a key point which is largely neglected in the literature with the result that empirical studies will be flawed, unless they recognise that outcomes (particularly employment and productivity) will be influenced by the macroeconomic policy settings. Nevertheless, the new orthodoxy views the extent of employment and wage flexibility as central to macroeconomic outcomes.

Firms hire workers to produce goods and services that they can sell. Additional workers are only hired if firms anticipate being able to sell extra output. Thus, at prevailing wage levels, employment is a function of the demand for the output that workers produce. Consequently, the implementation of WorkChoices could only bring about the putative employment gains if the envisaged reductions in wage growth and erosion of working conditions somehow increased household consumption, leading to increased aggregate demand and demand for labour. Clearly, such a proposition is unlikely. Wage erosion is likely to reduce aggregate demand, and further undermine the demand for labour.

The important point to note is that the persistent unemployment has no basis in a lack of labour market flexibility. Instead, the macroeconomic stance of the Australian Government, characterised by the pursuit of on-going budget surpluses, is the major reason for the labour market slack. There is also a failure to understand that government expenditure is not subject to the financing constraints that characterise households. Deficits which are calibrated to provide enough fiat currency to finance the private sector's desire to net save in the currency of unit are necessary to achieve full employment, unless alternative employment policies are introduced. In this regard, the Centre of Full Employment and Equity advocates a Job Guarantee, which provides a minimum wage job to all workers who want one. It is the minimum extra spending that is required by the Federal Government to ensure that everyone who wants to work can get a job (see Mitchell & Wray 2004).

A conceptual framework

The theoretical perspective which underpins the WorkChoices legislation appears to be that the removal of current rights and protections with respect to wages and conditions and pressure to engage in individual bargaining will provide both parties with a broader range of meaningful choices about how the workplace should be organised. Furthermore, these altered employment arrangements, when combined with a long-term decline in real minimum wages, will lead to the superior labour market outcomes of improved productivity, higher real wages and greater employment. That there is an extensive body of research challenging the new macroeconomic consensus is largely ignored by Australian policy makers.

The neoliberal policy approach draws on the textbook model of perfect competition for its authority. Orthodox economics textbooks argue that the establishment of market-clearing equilibrium is guaranteed by the presence of wage and price flexibility. *Ipso facto* the failure of markets to clear is a result of prices and/or wages being inflexible, which would reflect market imperfections, including labour market regulations, impinging on the exercise of free choice by economic agents. The model of perfect competition is devoid of the institutional, social and political context in which asymmetries of power and information, bounded rationality, tradition, myopia and a myriad of other influences bring about so-called imperfections in the functioning of markets. In particular, no power is assumed to be

exercised by the large number of autonomous agents who interact in impersonal product and labour markets, with the labour exchange indistinguishable from the exchange for lemons or any other commodity.

A growing number of economists have recognised the difficulties involved with the commodification of labour in modelling the labour market. Nobel Laureate Robert Solow notes that the subject matter of the social sciences is starkly different from that of the natural sciences. In labour markets in particular, preconceived notions of fairness and justice assume importance. We live in a:

> society in which social status and self-esteem are strongly tied both to occupation and income ... once you admit to yourself that wage rates and employment are profoundly entwined with social status and self-esteem you have already left the textbook treatment of the labor market behind. (Solow 1990, 10)

Therefore, a different mode of analysis is required that recognises three distinct characteristics of labour: it cannot be separated from its provider; it cannot be stored; and it possesses the quality of self-consciousness (Prasch 2004).

Since labour is inseparable from its provider, the buyer of labour enters a caretaker relationship with the worker which is quite distinct from the relationship between the buyer and seller of an inanimate commodity. Decisions the employer makes regarding the health, safety, well-being and productivity of the worker have important personal and social consequences during and after the employment contract. Since both individuals and the state have an on-going interest in working conditions, the state should arguably be viewed as a vested third party to every labour contract (Stabile 1996, 151).

As labour cannot be stored if a worker fails to consummate an exchange, lost labour represents a component of the social costs of unemployment (see Clark 1923, 553). Since employment is central to the livelihood and well-being of households, workers are seldom in a position to 'hold out' for better work. Consequently, individuals rarely have the same influence over employment decisions as employers. John Commons, the chief architect of the New Deal labour policy in the US, noted that the typical worker's reservation wage was quite low, because her/his labour today has no value if not sold today. Commons defined withholding power to summarise the asymmetry. Common's arguments are still apposite today: without union or government assistance 'the inequality in withholding power between employer and employee is so great that the term bargaining is a misnomer' (Commons & Andrews 1936, 372).

Finally, since labour has a capacity for reflection or self-consciousness, it considers the fairness and quality of treatment in determining how much loyalty and effort to supply. Judgments regarding working conditions, fairness and equity determine how and if people will work in particular job arrangements. Unlike machines or mules, workers tend to object when treated unfairly and adjust their work effort accordingly. The notion of employment being an 'effort bargain' over wages and working conditions has gained considerable currency within mainstream labour economics, including efficiency wages (Akerloff &

Yellen 1990), insider-outsider models (Bulow & Summers 1986) and transaction costs (Williamson 1985). These contemporary theories signify a gradual acceptance of what heterodox economists have long known – that labour markets operate differently than product markets.

The power imbalance in the employment relationship has been codified in the Australian industrial relations system since the 1907 *Harvester* decision. This decision recognised that the anarchy of the market would rarely generate a fair distribution of wages, due to the imbalance of bargaining power between employers and workers and therefore defined a Basic Wage as a social minimum living wage. The Basic Wage was not market-determined and market constructs such as the capacity to pay were subjugated by this social wage concept. A fair society, which, by definition, would exclude the creation and perpetuation of an under-class, required that the distributional system be legally regulated. For this reason industrial relations were given a specialised judicial process. The development of labour-specific, union-oriented arbitration and conciliation processes in Australia reflected a need for labour law to redress the power imbalance, which placed workers in a subordinate position to employers.

The clear intent of the WorkChoices Bill is for wages and conditions to be determined by market forces with equity and social justice issues being ignored. The question is whether the negotiation of individual contracts is appropriate within an equitable industrial relations system. Until recently Australian legal practice has not regarded labour market relations as being best regulated by commercial law. Labour or employment law was seen as being distinct with certain rights and responsibilities that transcend commodity exchange. Common law, in particular, leaves unorganised labour vulnerable.

It is also important to recognise that successive rounds of industrial relations changes since the acceptance of enterprise bargaining in 1991 and the enactment of the *Workplace Relations Act* 1996, encompassing the promotion of Australian Workplace Agreements, have not created a *de facto* competitive labour market. The WorkChoices legislation provides increased powers for employers to impose AWAs on unwilling employees. With bargaining at the enterprise level increasingly likely to devolve to individual rather than collective agreements, the determination of wages and conditions cannot be construed as the direct outcome of impersonal market forces, given that employers exercise considerable discretionary power with labour underutilisation approaching 10 per cent. Thus individual bargaining within enterprises is not a real world representation of the textbook model of impersonal market forces.

Orthodox economists extend microeconomic market clearing principles to the operation of the macroeconomy, asserting that all markets clear, including the labour market, assuming wage and price flexibility. Keynes (1936) and later the Post-Keynesians demonstrated that the presence of perfect competition is neither necessary nor sufficient for the achievement of full employment (Davidson 1994). The leap from microeconomic market clearing propositions to full employment involves a fallacy of composition that is omnipresent in the public policy debate and the economics literature. As explained in the previous section, unemployment is the consequence of governments failing to run a sufficient fiscal deficit to meet the preferences of the private sector to net save.

Theoretical and empirical research

There are many parallels between the objectives of WorkChoices and the disastrous industrial relations experiment conducted in New Zealand during the 1990s. The outcomes of the *Employment Contracts Act* offer relevant evidence of the relationship between unions and labour productivity. Although the 1991 legislation was successful in accelerating the decline of unions – with union density falling by 50 per cent in less than a decade (May, Walsh, Harbridge & Thickett 2002) – it also took a heavy toll on the national economy. While labour productivity growth in Australia averaged 3.2 per cent per year from 1993 to 1998, New Zealand achieved a paltry 0.5 per cent per year during its experiment with labour market deregulation. Such lacklustre productivity statistics are not surprising under an industrial relations model that jeopardises morale, trust, loyalty, and good faith in the workplace (see Harbridge & Crawford 1998; and Dalziel 2002). Since the passage of the *Employment Relations Act* in 1999, and the gradual restoration of unions, labour productivity has averaged nearly 1.5 per cent and New Zealand has also enjoyed higher economic growth rates.

Regulative constraints – do they damage employment?

Under WorkChoices, employers with fewer than 100 employees will be exempt from unfair dismissal laws and will be able to summarily dismiss their workers with relative impunity. For larger firms, vaguely defined operational reasons will suffice as justification for employment reduction. The incentive for capricious behaviour will be compelling. While workers may be able to pursue common law claims for unlawful dismissal, in reality, the expense, legal complexity and time lags of common law claims, coupled with the fact that these actions do not offer reinstatement, means that few workers will seek legal redress. The Government will also tighten access to the anti-discrimination tribunals to avoid these arenas being clogged up with work-related disputes. Most firms will realise it is counterproductive to behave capriciously, but some will not. Further, while a tight labour market may discipline rogue employer behaviour, the real hardships for many workers will arise next time the business cycle turns down. Calling on the authority of the textbook competitive model, the Government argues that the elimination of unfair dismissal protection is justified on the basis that regulative constraints impact negatively on economic performance, particularly employment growth. Following the *Jobs Study*, researchers have attempted to assess the impact of institutional arrangements on economic performance, and specifically the proposition that market reform would improve the capacity of economies to adjust, innovate and be creative (OECD 1994, 43). These claims have been challenged by a number of authoritative labour economists, including Baker, Glyn, Howell and Schmitt (2004) and Freeman (2005). In addition, recent publications of the OECD (1998; 1999a, b) are equivocal about the impact of their proposed reforms.

In their study of 19 OECD countries, Baker, Glyn, Howell and Schmitt (2004, 41) found no correlation between levels of unemployment and the six most commonly employed institutional variables: the unemployment benefit replacement rate, unemployment benefit duration, employment protection laws, union density, bargaining coordination and tax incidence. Following OECD (1999a), Baker, Glyn, Howell and Schmitt (2004) also measured the relationship between the extent to which countries pursued the OECD prescription of deregulation and the decline, if any, of structural unemployment. No relationship was found. Baker, Glyn, Howell and Schmitt (2005, 13) quote an OECD survey (1999b) which reports that Bertola (1992), Nickell and Layard (1997) and the OECD (1999a) were unable to find a statistically significant relationship between employment protection legislation and the unemployment rate. In the empirical work of Baker, Glyn, Howell and Schmitt employment protection and unemployment benefits have perverse or weak effects, whereas coordinated bargaining was shown to reduce unemployment, which is at odds with the view that individual contracts, rather than pattern bargaining, represent optimal workplace arrangements. Baker, Glyn, Howell and Schmitt (2004, 41) conclude that the other studies examined in their paper lack unanimity in their estimates of the impact of the standard institutional variables on unemployment. Further, a number of these papers refer to this lack of robustness of their results across specifications and variable definitions. Thus the case in favour of the reform agenda is problematic.

Like the OECD, the World Bank is now more cautious in its policy analysis. It reported that:

> Countries with highly-coordinated collective bargaining tend to be associated with lower and less persistent unemployment, lower earnings inequality, and fewer and shorter strikes than uncoordinated ones. In particular, coordination among employers tends to produce low unemployment. In contrast, fragmented unionism and many different union confederations are often associated with higher inflation and unemployment. (World Bank 2003)

Juniper, Mitchell and Myers (2004) used the Australian Bureau of Statistics Business Longitudinal Survey to examine whether key industrial relations and/or regulative constraints affected the rate of small business job creation and destruction. They concluded that job creation rates are insensitive to these influences while job destruction rates are lower in firms with higher wage rates, wider awards coverage, more unions in the workplace and higher worker compensation and employer contribution to superannuation as a percentage of total expenses.

Wages and unemployment

In Australia there has been a long-running debate about the causes of unemployment. For a time the dominant view was that increasing real wages in 1973-74 caused the sudden increase in unemployment (Commonwealth of Australia Treasury 1979; Corden 1979). The minority view ascribed higher unemployment to a depressed product market environment brought about by factors including the stance of macroeconomic policy and across-the-board tariff reductions (Riach & Richards 1979).

Following the introduction of the Accords in 1983 and the resulting moderation of money wage growth, the OECD shifted the debate by questioning whether the distribution of money wages was too narrow. This was alleged to result from the Australian Industrial Relations Commission setting minimum wages at levels that prevented low productivity workers from securing employment. This argument is curious in that it views the level of productivity as intrinsic to the individual worker and largely independent of social and economic influences,

and, most importantly, divorced from the workplace and its level of capital intensity and technical sophistication.

In addition to providing a rationale for foisting 'flexibility' upon disenfranchised groups, the productivity argument has intuitive appeal, because workers with the lowest level of educational attainment have the highest rates of unemployment (Watts 2001). However, an examination of the relationship between educational attainment and occupational status in Australia suggests that either the skill demands of jobs have significantly increased or credentialism is having a strong impact on hiring decisions. Thus, rather than less qualified workers having insufficient productivity to warrant employment at the current minimum wage, they are condemned to stay at the end of the labour queue and do not obtain employment due to deficient labour demand.

WorkChoices will decimate the award system, particularly the effectiveness of the inter-industry safety net wage, which protects the most disadvantaged and organisationally weak workers. It is most likely that the appointees to the Australian Fair Pay Commission will be sympathetic to the Government policy stance that minimum wages should rise at a lower rate than has occurred under the annual AIRC reviews. The AFPC cannot cut nominal wages but it can choose the frequency of wage adjustment. Modest and infrequent adjustment of nominal wages will probably see real wages decline over the medium to long-run.

With the scrapping of the no disadvantage test the 'race to the bottom' will be possible within the limits defined by the Australian Fair Pay and Conditions Standards. This means that the most disadvantaged workers, who lack bargaining power, will be forced to accept AWAs and other individual agreements with terms and conditions below the relevant award standard. Employers have significantly more power under WorkChoices and take-it-or-leave-it contracts are likely to become widespread.

WorkChoices can be characterised as a wage-cutting strategy, but lower wages also present a host of socioeconomic problems. Progressive employers have long recognised the tendency of inefficient firms to compete by paying low wages. Long ago Boston retailer Filene (1923, 412) wrote:

> I would answer that it is better for any business or any industry not able to pay the minimum wage to leave the state. ... Any business that cannot pay a living wage – a wage that will produce profitable consumers – is not good for the state and has no place in it. By not paying its employees an adequate wage, it forces them to be supported, at least in part, by their relatives, friends, or by the public.

In highlighting the effects on aggregate demand, Filene displayed an astute understanding of the macroeconomic influence of wage floors which is not shared by many contemporary employers and mainstream labour economists.

The periodic adjustment of minimum wage levels forces low wage firms to raise labour productivity through new investment, rather than competing on the basis of reducing wage levels. If properly implemented, statutory minimum wages reduce earnings inequality, ensure a fairer distribution of economy-wide productivity gains and build prosperity from the bottom up by increasing incentives to work at a living wage, particularly for welfare dependent youth (Palley 1998). This is important because countries, such as Britain, the USA, Australia and New Zealand have pursued a policy of trickle-down economics (Palley 1998).

Despite abundant international evidence (Card & Krueger 1994, (USA); Borland & Woodbridge 1999 (Australia), and Machin & Manning 1994 (UK)), the public debate is still dominated by concerns over the adverse employment consequences of minimum wage increases. Card and Krueger found no adverse impact on employment and in some instances, such as the fast food industry in New Jersey, a positive employment impact due to what they call the 'hungry teenager' effect. They also showed that the earnings distribution became more compressed (see also Bhaskar & To 1999).

In analysing minimum wage increases in Western Australia, Leigh (2003)attempted to recreate the 'natural experiment' that gave the Card & Krueger studies such credibility by making difference-in-difference comparisons in the changes in the employment-to-population ratio for WA versus the rest of Australia during six increases in the minimum wage between 1994 and 2001. Four of the six minimum wage increases had no significant impact on employment. Although the employment-to-population ratio did fall in WA relative to the rest of Australia following the minimum wage hikes, critics of the Leigh study note that most of the declines were statistically insignificant and were likely to be caused by other factors (Watson 2004).

The OECD (1998, 57) is equivocal about the role of minimum wages on employment, although arguing that (unspecified) high levels of minimum wages will be detrimental to employment. In particular, the OECD (1998, 45) acknowledged that a rise in the minimum wage has not unambiguously led to job losses for youth. In the 2005 Safety Net case, the AIRC (2005, para. 281) reasserted its view that the ongoing controversy about the employment effects of minimum wage increases was unresolved. Many studies explored minimum wage increases in circumstances which were quite different than those in Australia where the Safety Net Decision involved the adjustment of a whole ladder of minima, not merely the minimum wage.

The AIRC (2005, Table 11) notes the variance of estimated wage elasticities, with recent papers by Leigh (2003) and Harding and Harding (2004) finding elasticities of -0.15 and -0.21 respectively and earlier studies finding much higher elasticities. If a modest wage elasticity of demand for labour is accepted, then the use of infrequent, small AFPC adjustments of the minimum wage as an employment generation strategy would have limited effect, because, in a low inflation climate, the reduction in the real wage will be slow and the direct impact of wage moderation will fall on relatively few low income workers.

Under the WorkChoices legislation the unemployed will still be required to take any work that is offered to them, irrespective of the contractual arrangements, or have their unemployment benefits suspended. It is clear that many jobs will be downgraded by capricious employers who will then have the threat of dismissal to enforce these desires. These changes unambiguously enable employers to slow down and even reduce the real

wages and conditions offered to employees. Demographic trends may well lead to a long-term tightening of the labour market, and increased bargaining power for more highly skilled workers. Low-skilled workers will always be very vulnerable to reductions in wages and conditions, due to their limited bargaining power, irrespective of the state of the business cycle. In the modern labour market the low-wage worker serves as a macroeconomic buffer for both inflation and unemployment.

Again New Zealand's experiment with labour market reform is instructive in anticipating the impact of WorkChoices on wages. In 1991, the *ECA* ended the award system which ensured minimum pay and conditions and replaced it with individualised contracts between workers and employer, supported individual contracts over collective bargaining, outlawed strikes for multi-employer agreements, supported 'take it or leave it' bargaining, and undermined the role of unions. Conway (1999), McLaughlin, Rasmussen and Boxall (2000) and Easton (1997) show that low-wage workers bore the brunt of these changes as employers took the low-road approach to industrial relations. Conway (1999) found a significant and sustained reduction in wages of supermarket workers – with new workers sustaining the largest wage reductions. Along with the McLaughlin, Rasmussen & Boxall survey of other retail workers, the Conway study corroborates the argument that a lack of voice at work had a detrimental impact on lowest-paid workers with marginal labour force attachment.

In summary, there is little if any evidence from the international research or the recent experience in New Zealand to suggest that shifting the balance of power in favour of the employer in labour negotiations will lead to improvements in real wages, productivity and employment, as is argued by supporters of WorkChoices.

Wages and welfare

A number of writers (for example, OECD 1997b & Wooden 2005) note the importance of the interaction of the minimum wage with the social welfare system. Wooden (2005, 15) argues that the minimum wage system is no longer the appropriate manner to deal with the income needs of households which are no longer reliant on one income earner. In particular, not all minimum-wage workers are concentrated in low-income households, so that increasing minimum wages is an ineffective form of income redistribution. The irony is that unless minimum wages are indexed in line with social welfare benefits, the work incentive will be diminished, as the income margin between work and continued unemployment further narrows. The prevailing tax-transfer system means that low-income households face high effective marginal tax rates which allegedly deter labour market participation. Equally a labour underutilisation of about 10 per cent is also a strong deterrent to participation as there is little prospect of finding a job, let alone enjoying high wages and good working conditions.

While we acknowledge the potential for poorly-designed tax systems to reduce the poverty-fighting effects of minimum wages, we do not agree that equitable labour market policy should be held hostage to imperfect social policy. In a submission to the 2004 Safety Net Case, the Australian Council of Social Service argued that the minimum wage should be sufficient to maintain the individual recipient, while the social welfare system should be designed to meet the additional costs of raising children in low-income families. By separating the needs of the individual from her/his family, all minimum-wage workers are justified in securing the annual increases, irrespective of family circumstances. The annual adjustment of award minimum wages has not been an act of charity, but rather an appropriate economic policy to ensure the most disadvantaged award-dependent workers benefit from the productivity growth of the economy. This process has allowed Australia to avoid creating an underclass of working poor.

Wage inequality

The impact of minimum wage adjustment can also be analysed within the context of the distribution of wages. Full-time non-managerial adult real wages in Australia have exhibited a long term increase in inequality since 1975, with a sharp increase over the period 1996-2002, although there has not been a steady increase in real wages across the different percentiles over the sample period (Commonwealth of Australia 2003, Figure 9.1). In the period 2002-04 the trend increase in inequality has moderated with nominal wages associated with the 10th percentile growing almost as fast as that associated with the 90th percentile (ABS 2005). Wage cutting through the bargaining process and the fall in the annual rate of adjustment of the nominal minimum wage by the AFPC will inevitably reinforce the long run trend.

The Australian Government's submission to 2003 Safety Net case made a virtue of growing wage inequality, arguing that it enhanced the productivity and flexibility of the workforce by promoting incentive. The Government concluded that these processes were similar to those occurring in 'other advanced and dynamic economies such as the United States and the United Kingdom' (Australian Government 2003, 87). The acceleration of inequality has been greatest in those countries with deregulated and decentralised labour markets. The orthodox argument is that low productivity workers are priced out of the labour market by high minimum wages and that greater wage inequality will promote higher levels of employment is unsupported.

Most studies have examined trends in either total or ordinary time weekly earnings. Given the growing dispersion of working hours over the last decade or so (Burgess, Mitchell & Preston, 2003; Drago, Black & Wooden 2005), it is appropriate to examine trends in hourly total earnings to test whether rising wage inequality is mainly a manifestation of polarised hours, which would reflect in part the operation of the business cycle, rather than polarised hourly earnings. Unfortunately, hourly data is unpublished but earlier work by Watts (2001) found that the change in the distribution of weekly hours worked, even for full-time employees, appears to be significant with respect to trends in the polarisation of average weekly earnings, as measured by the Median Relative Polarisation Index.

A different theoretical perspective on the relationship between employment and wage inequality is provided by Okun's upgrading hypothesis (1973), in which increased economic activity compresses the wage distribution as low-paid workers enjoy higher earnings. At the same time, skilled workers, who were bumped down the job distribution in the downturn, are attracted into better-paid jobs without a higher wage (Cornwall 1983). Thus, the direction of causation is from the level of (un)employment to the extent of wage inequality, with rising

activity not necessarily pushing up the wages of more senior positions at least in the first instance.

Using the decomposable Theil *T* statistic, Galbraith and Garcilazo (2005) investigate the evolution of interpersonal pay inequality within and between three distinct geographical delimitations: regions, countries, and across the whole of Europe for the period 1995-2000. They find a positive relationship between the unemployment rate and regional and country pay inequality, a result which confirms an earlier study of the period 1984-2000 (Galbraith & Garcilazo 2004). Thus they find no support for the view that Europe's continuing unemployment problem stems from a high degree of pay equality.

Earnings mobility

OECD (1996a, 20) argues that earnings inequality should be seen in a dynamic context: 'many of those who are in the lowest earnings decile in any year move into higher groups in subsequent years'. Thus low wages now may not necessarily condemn a worker to a working life of low pay and it can be argued that cross-sectional wage inequality, *per se*, overstates the extent of lifetime wage inequality. The wage reduction strategy underpinning WorkChoices is based on the premise that any job is better than no job.

The OECD (1996b, 77) acknowledges that about two-thirds of the cross-sectional variance in annual earnings in six European countries and the USA reflects persistent differences in relative earnings. In a later study (OECD 1997a) persistent and recurrent low-paid employment was found amongst women, older and less-educated workers. Also, countries with more deregulated labour and product markets did not appear to have higher relative mobility, nor did low-paid workers in these economies experience more upward mobility.

Blondal and Scarpetta (1997) suggest that the benefits of higher employment outweigh the costs of greater wage flexibility and more restrictive social benefits, but they note that some workers alternate between low-paid jobs and unemployment. Burgess and Campbell (1998) and Dunlop (2000) fail to find a link between casual employment and permanent employment in Australia. Gaston and Timcke (1999) find some contrary evidence, but their study is confined to data from the Australian Youth Survey. Drawing these threads together, there is little substance to the Government's proposition that any job is better than no job, as the prospects for wage mobility appear quite limited.

Training, investment and productivity

The Federal Government claims that WorkChoices will lead to higher employment, productivity and real wages (Australian Government 2005). Prima facie, institutional arrangements which enable wage cutting in a macroeconomic environment of underutilised labour will not promote on-the-job training and increased productivity. The international research literature also is unsupportive of these claims.

Scarpetta and Tressel (2002, 6) argue that the industrial relations regime of a country will influence the human resource strategy of an innovating firm. Under decentralised bargaining and in the absence of coordination between employers, firms tend to recruit adequately skilled workers from the external labour market. In effect poaching is widespread. On the other hand, under centralised or sectoral wage bargaining systems, wages are more compressed and firms gain from training their own workers, because there is a greater wedge between productivity and wages at high skill levels. In addition, countries that have centralised or sectoral wage bargaining systems also tend to have comparatively high hiring and firing costs, which could reflect the presence of unfair dismissal laws.

The two models have different repercussions for wage growth and the provision of training by firms. Under the decentralised model, there is an extra impetus to the growth of wages of skilled workers resulting from the external labour market competition. Under the centralised model, workers are essentially trained into the demands and productivity of the job, which addresses the orthodox criticism that high minimum wages prevent the employment of low productivity workers.

Further, while the current claims about skill shortages in Australia are overstated (see Mitchell & Quirk 2005), WorkChoices fails to provide a framework for a dynamic training culture. Mitchell and Quirk (2005) argue that the persistently high levels of labour underutilisation and emerging skills shortages in some specialised areas reflect 'two-sides of the same coin' – a lack of governance, exemplified by the reduction in public sector employment and training structures. WorkChoices entrenches the belief that the private market can provide dynamic training responses to occupational demands, despite significant evidence to the contrary (see Mitchell & Quirk 2005 for a summary).

Conclusion

The WorkChoices legislation represents a continuation of the neoliberal reform agenda, which is based on the discredited premise that the removal of constraints to the operation of markets will lead to full employment. This chapter has argued that the underlying cause of persistent unemployment is the failure of macroeconomic policy, not labour market inflexibility.

By shifting the balance of power between capital and labour, the legislation promotes competitiveness by labour cost minimisation. Paradoxically, not only will this strategy fail to achieve full employment, but the economy will be characterised by allocative inefficiency because a low-wage regime represents a subsidy to inefficient firms, enabling them to remain viable and competitive. In addition, the failure to promote physical and human capital formation to raise productivity signifies dynamic inefficiency and is a recipe for ongoing stagnant real wages and living standards and declining international competitiveness (Buchanan & Callus 1993, 528-29). This chapter has argued that the underlying cause of persistent unemployment is the failure of macroeconomic policy, not labour market inflexibility. The macroeconomic policy settings adopted by a government are a key driver of economic performance and competitiveness, and in this process investment is pivotal to achieving a high level of economic activity and productivity (Mitchell 1996; Rowthorn 1999).

The changes implemented by the Federal Government since 1996 and the recently enacted amendments to the *Workplace Relations Act* are congruent with the reform agenda articulated by the OECD (1994). Of all the changes wrought by the Howard Government, the 'de-regulation' of the labour market is likely to have the most widespread impact, although the economic and social consequences may take some time to play themselves out.

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