Individual Contracts: What Do They Mean for Australia?

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Abstract

Collective bargaining can be of benefit to both employees and employers. Nevertheless, there is growing interest in individual contracts, as part of a broader agenda for labour market flexibility. In particular, individual contracts are being pursued by some companies as part of a human resource management strategy to increase productivity by reducing the role of third parties and promoting 'common purpose' between the firm and its employees. There is some evidence that individual contracts can indeed contribute to higher productivity. The challenge for policy makers is to provide sufficient flexibility in the area of individual contracts while preventing employers from using them to reduce wages and conditions.

Introduction

The debate about industrial relations in Australia in recent years has largely been about the extent to which Australia should embrace enterprise bargaining, whether the existing award system should be retained, and if so, what the relationship should be between awards and enterprise agreements. However, the recent dispute concerning individual contracts at CRA's Weipa operations has shifted the debate on to some fundamental issues that go to the very heart of industrial relations, in particular, whether our system for determining conditions of employment should be based on collective,

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representative processes or whether the system should place greater emphasis on the relationship between the individual employee and employer.

Australia already has a system which involves elements both of collective bargaining and individual employment contracts, as well as compulsory arbitration. All employees have a contract of employment with their employer. However, for the majority of employees, the pay and conditions contained in that contract are determined largely by awards, often supplemented by a collectively negotiated enterprise agreement.

This paper considers some of the implications of a possible shift in the balance between collective and individual regulation that could arise, for example as a result of changes to federal industrial relations legislation designed to facilitate individual contracts.

Collective Bargaining

Traditionally, collective bargaining is defined as taking place where an employer, a group of employers or an employer association determines the wages and conditions of employment to apply to a given group of employees by negotiation with a union or unions representing those employees. It is generally an integral part of the process that the employer employs new employees under the terms of the collective agreement.

Collective bargaining appeared at the early stages of the industrial revolution and met with varying degrees of resistance from employers. However, by the mid 20th century, it was accepted by most Western governments as the preferred model for determining wages and conditions.[1] The Australian industrial relations system has been unusual in the extent to which it has relied on compulsory arbitration, rather than collective bargaining, though in fact collective bargaining has always played an important role, both in negotiating awards and in determining overaward pay and conditions. Moreover, compulsory arbitration has been based on collective forms of representation.

The last decade has seen a shift away from arbitration with terms and conditions of employment increasingly being determined by enterprise level negotiations. In the 1980s, critics of the system generally stressed the need to move towards an enterprise focus. As support for enterprise bargaining grew, the main arguments became about how untrammelled the enterprise focus should be – for example, to what extent agreements should be subject to scrutiny by the Industrial Relations Commission.

However, in recent years, more attention has been placed on who the bargaining should actually be between. The traditional understanding of collective bargaining is that it, by definition, means bargaining with unions.

However, as the industrial relations system has increasingly embraced an enterprise focus, it has became harder to ignore the fact that many enterprises – at least in the private sector – are non unionised.

The Federal Labor Government gave some recognition to this fact when it introduced provision for Enterprise Flexibility Agreements (EFAs) to be reached directly with employees, as part of the Industrial Relations Reform Act 1993. EFAs are essentially a modified form of collective bargaining. There is still considerable scope for union involvement. Moreover, EFAs must be approved by a majority of employees and must cover all the (federal award) employees at the enterprise.

By contrast, there is a growing interest on the part of some employers in moving away from collective bargaining altogether, and embracing a system where employees' pay and conditions are settled by individual contracts of employment. The 'traditional view' is that most employees lack sufficient bargaining power genuinely to negotiate individual contracts.

The Webbs in their classic 'Industrial Democracy'[2] regarded collective as opposed to individual bargaining as a means of preventing management from taking advantage of competition between workers eager for a job to drive down the price of labour. This view of individual bargaining is still common amongst industrial relations academics today. As a popular and highly regarded labour law text book puts it:

> The realities of the capitalist mode of production are such that very few workers are in a position to 'agree' terms of employment with an employer on anything like an equal footing. Indeed the only element of 'agreement' to be found in most employment contracts, is the initial decision to enter into the relationship of employer and employee. The corollary of the power imbalance is that the employer is in a position unilaterally to determine the content of most employment relationships. It was in response to this reality that workers first sought to establish trade unions which could represent their interests in negotiations with employers, and through the exercise (actual or potential) of collective strength, to strike a more equitable bargain on their behalf.[3]

Thus collective bargaining recognises the conflict of interest between employers and employees and provides a means to enable employees to bargain in an equitable way with their employer.

However, collective bargaining can also be seen as having benefits for employers as well as employees. Especially in large organisations collective bargaining can be seen as conducive to greater 'industrial stability'. To quote the UK academic Alan Fox,

> [Collective bargaining] has come to be seen by many as a valuable and even indispensable mechanism for negotiating and preserving order

> over the large aggregates of employees and complex occupational structures increasingly characteristic of industrial society.[4]

On this view, collective bargaining not only reflects the conflict of interest between employer and employee, but helps regulate it in an orderly fashion. In particular, collective bargaining, by giving employees a say through their representatives in decisions of importance to them, increases their willingness to comply with the rules governing the workplace.

Collective bargaining can also be seen to benefit management by providing a 'collective voice'. Arguably employees will be loath to tell management of their concerns about the workplace as individuals, because of fear of victimisation – but if management doesn't hear these concerns and has no chance to respond to them, there is a risk that employees will simply leave and that there will generally be poor employee commitment. This can lead to lower productivity and higher costs.[5]

The Rationale for Individual Contracts

Given the alleged benefits of collective bargaining for employers, why does there appear to be growing support for individual contracts? The push for individual contracts can be seen as part of a broader agenda of achieving greater labour market flexibility, in response to growing competition in both domestic and international product markets. According to Paul Barratt, the Executive Director of the Business Council of Australia:

> In a rapidly changing world, enterprises must be enabled to respond quickly to changing circumstances, without the intervention of outside parties.[6]

According to this perspective, the aim is not to reduce wages:

> It cannot be emphasised too strongly that wage rates are not the main issue – the main issues are the efficient utilisation of plant and equipment, the efficient organisation of work, the enhancement of management and shopfloor skills, and the development of a focus on the needs of customers, relating to price, quality, delivery and service. These can only be achieved in a climate in which employers and employees have a genuine sense of common purpose, and in which employees feel motivated to give of their best, including the ideas which only they can produce regarding how improvements can be made.

Barratt goes on

> The key requirement for common purpose to be established is for all of the terms and conditions of employment to be settled directly between the parties ...[7]

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According to this view, traditional collective bargaining is rejected as reflecting an adversarial 'them and us' view of the world at odds with the principles of co-operation and 'common purpose'.

This approach to reform sees changing the way pay and conditions are determined as leading to a more fundamental change in the relationship between management and employees. Thus it is not necessarily the explicit content of the individual contract that is most important, but that there has been mutual agreement to set aside a role for third parties and deal directly with each other. This it is claimed will lead to a greater sense of 'common purpose', greater flexibility and a higher level of employee commitment to the goals of the organisation.

So for example, those advocating individual contracts as opposed to collective bargaining see the former as more likely to encourage employees to contribute to improvements in work practices. To quote CRA's counsel in the Weipa hearings:

> ... the employee ceases to be in a work environment in which improvements in work have a tradeable value in the collective context and are therefore to be hoarded up and sold in the collective negotiations ... In a staff relationship ... the inbuilt constraints on the free flow of work improvements are removed because each individual knows that he or she will be subjectively judged on his or her work performance ... We know that that form of employment is more productive for the company and therefore more cost effective, more enjoyable for employees, and enables the company to grow, to be more internationally competitive, and to make a greater contribution to the Australian economy.[8]

Firms such as CRA see individual contracts, which involve a direct relationship with their employees, as an integral component of what can be termed a 'high trust' strategy. This philosophy is firmly based on the notion that the interests of employers and employees have more in common than separate them. It sees collective bargaining as unnecessarily adversarial – *creating* unnecessary conflict between workers and their employers, rather than as simply *expressing* and *regulating* that conflict.

This 'high trust' strategy is consistent with an approach based on total quality management (TQM), which places a great emphasis on tapping the creativity and commitment of the work force, to ensure that products and services consistently meet or exceed customer expectations. TQM and related human resource management (HRM) strategies tend to emphasise giving workers much greater responsibility and discretion, with less supervision, flatter hierarchies and the greater use of self managing teams. It is generally accepted that 'the greater degree of discretion extended to a person

in his work, the more he feels that the relevant rules and arrangements embody a high degree of trust.'[9]

If modern human resource management really involves giving workers more discretion, then the pursuit of 'high trust' relationships, with a stronger sense of 'common purpose' should be attainable. At CRA it appears that the policy of putting all employees on to staff contracts is closely linked to a substantial reduction in the number of organisational layers.[10] The intention is to devolve more responsibility to workers down the hierarchical chain, to ensure that every job adds value, to improve information flow, and to create a more efficient and rewarding work environment. Breaking down 'artificial barriers' between management and blue-collar workers is seen as a necessary part of this management philosophy. In principle, this should help engender a greater degree of trust between management and employees.

There appears to be two broad types of employers who are most likely to be interested in individual contracts. The first is made up of larger companies pursuing a deliberate strategy to reduce the role of third parties, as part of an overall HRM philosophy. In practice, it would probably only be a minority of larger firms that would pursue such a strategy. For example, a survey conducted in mid 1992 of Chief Executive Officers of BCA members[11] found that only 25 per cent agreed with the proposition: 'Truly achieving world class productivity in my company requires individual employment contracts', whereas 42 per cent disagreed.

The second category is made up of companies that are already non unionised. Most of these businesses would be small or medium sized, and are likely to prefer individual contracts over non union collective bargaining as represented, for example, by Enterprise Flexibility Agreements. It is worth noting that a 1994 Small Business Index survey conducted by Yellow Pages, Australia[12] indicated that 48 per cent of small business proprietors preferred individual contracts over both awards and enterprise agreements.

Individual Contracts in Practice

The following features would be typical of individual contracts offered by a firm in the HRM category:

- no distinction is made between blue and white collar workers (that is, 'single status');
- annualised hours (that is, no additional payment for overtime);
- greater managerial discretion over conditions such as sick leave;

- generally greater managerial discretion over the way in which work is organised, and individual workers deployed;
- individual performance assessment, with pay rises linked to the company's perception of the employee's performance and economic factors;
- an individualised grievance procedure, possibly without any recourse to outside arbitration.

A key feature of this type of arrangement is clearly an increase in management discretion. Employees have less protection than in an arrangement which is regulated by a third party. Usually, however, there will be some wage premium to encourage employee acceptance of this arrangement. Ultimately, however, this set up is only likely to work effectively if the employee can trust his or her employer not to abuse their position.

In the second small business category, the contracts offered are likely to be simpler. Smaller employers are most likely to use individual contracts to introduce greater workplace flexibility, especially in relation to issues such as penalty rates, working hours etc., and to simplify payroll administration (for example, by rolling leave loading into base salary). From the evidence, employers will generally offer individual contracts that do not vary between different employees – at least at the same classification level (though pay rates may differ as a result of individual assessments). Moreover, in practice, there is likely to be little actual negotiation about the content of the contracts.

A survey conducted by McAndrew[13] over the first year of the Employment Contracts Act in New Zealand found that of those firms that put new individual contracts in place under the Act, 88 per cent reported that the move to individual contracts was initiated by management. In the remainder, individual contracts were either first or simultaneously suggested by employees. However, few of the firms that implemented individual contracts reported that either employees or unions had suggested having a collective contract instead. Moreover, 59 per cent of employees responding to a 1993 survey conducted by the Heylen Research Centre for the NZ Department of Labour considered that they had a choice about whether to have a collective or individual contract.[14]

In other words, the New Zealand experience is that the decision to negotiate individual, rather than collective contracts was generally a management decision, and generally reflected whether the work force was unionised or not. However, where management sought to negotiate individual contracts, this appeared to have generally been accepted by the employees concerned.[15] A small majority of firms (56%) reported that the firm's initial proposals for individual contracts were developed by management

without consultation with employees. The remainder generally consulted staff either informally, or through staff meetings.

The McAndrew survey suggested that there did not appear to be many changes to management's proposed contract when presented to employees. Only 6 per cent of firms with new individual contracts reported that there were significant modifications made to management's initial position as a result of individual negotiations with some or all employees. 62 per cent made some minor modifications during individual negotiations, though generally only in relation to a quite small percentage of employees. However, while the New Zealand experience suggests that the content of individual contracts is likely to be largely determined unilaterally by the employer – this does not mean that employers will use individual contracts simply to cut pay and conditions. Interestingly, it does not appear that employers pursuing individual contracts in New Zealand were as aggressive in pursuing employee concessions as firms engaged in collective bargaining.[16] On the other hand, employers negotiating individual contracts were generally far more successful in having their proposals accepted, particularly in relation to what might be termed 'flexibility' issues.[17]

Firms engaged in introducing individual contracts may consult with the work force prior to offering contracts, and will try and make a 'good first offer' that should be acceptable without much alteration. This is in contrast with the dynamics of traditional collective bargaining and arbitration, with its emphasis on ambit claims etc., followed by a gradual process of narrowing the differences through hard two way bargaining.

An analysis of the 1993 Heylen Report by Whatman, Armitage and Dunbar[18] sought to establish a typology of enterprise responses to the New Zealand Employment Contracts Act. This included a category of 'cutters' who pursued widespread cuts to terms and conditions of employment. However this group represented only 4 per cent of firms, employing 4 per cent of employees. The largest category (employing around half of all employees) were defined as 'inactives', making relatively few changes to wages and conditions. Another category (employing about 11% of employees) was defined as 'reformists'. These employers focused on reducing the role of trade unions, increasing the use of individual contracts – and improving pay and conditions. This category clearly includes firms pursuing a strategy based on a strategic human resources management philosophy, with an emphasis on promoting the commitment of employees through improving employer-employee relations, while minimising the role of third parties.

While the experience in New Zealand is that *some* employers may use individual contracts to cut pay and conditions, this is only likely to be

confined to a relatively small minority. Obviously, the extent to which individual contracts could be used simply to cut pay and conditions in Australia would depend on the nature of any changes to the legislative framework. In a system where individual contracts operate either on an over award basis or as an alternative option to award conditions (that is, the so called opting out model) the chances of contracts being associated with a reduction in pay and conditions are clearly much lower.

If greater scope for individual contracts will not necessarily lead to cuts in pay and conditions, will it lead to higher productivity? The empirical evidence is certainly not conclusive. CRA claimed in its submission to the AIRC during the recent hearings on the Weipa dispute that there had been a clear increase in productivity following the introduction of staff contracts at its New Zealand and Tasmanian aluminium smelters, together with an improvement in quality. It also claimed that similar productivity improvements had occurred at Hamersley Iron, following the introduction of individual contracts. There also appears to be some recent empirical evidence from the UK to support the assertion that non union firms employing HRM policies may indeed have better productivity performance than firms with collective bargaining.

Fernie and Metcalf[19] have used establishment level data from the 1990 British Workplace Industrial Relations Survey to assess the link between different models of workplace governance and six economic and industrial relations indicators. In particular they look at three types of workplace governance: 'collective bargaining', 'employee involvement', and 'authoritarian'. Collective bargaining workplaces are defined as those with either a closed shop, or where management recommends union membership. Employee involvement workplaces are those with no union, but a range of HRM policies (eg. performance appraisal, contingent pay systems, and formal communication between management and employees.) Authoritarian workplaces have no union and no HRM characteristics.

The analysis found that the non union, 'employee involvement' workplaces performed better than their counterparts with collective bargaining in relation to absenteeism, the industrial relations climate, jobs growth and productivity performance. There is also empirical evidence that the higher productivity that seems to be associated with non union HRM strategies is likely to go together with greater demands on employees, greater work intensification and less room for 'managerial slack and for indulgency patterns.'[20]

Issues for Management

Whether it is a good strategic decision for large firms to deliberately seek to individualise industrial relations remains to be seen. Certainly, the evidence is that TQM and HRM techniques designed to boost productivity are by no means incompatible with unionisation. Indeed, where unions are present, it is likely to be much easier to introduce such changes with their support, than without it.

It is reasonable to assume that much depends on whether the particular unions in question are likely to be receptive to the sorts of reforms being pursued by the company. If the unions are willing to co-operate with the introduction of greater flexibility, then there may be real benefits for the company in working with the unions. In particular, the active involvement of the unions may increase the willingness of the work force to participate in change.

It is also fairly clear that de-collectivisation by itself will not do anything to increase trust and employee commitment. While marginalising unions may remove the most obvious forms of employer-employee conflict (eg. industrial action), there is a danger that removing collective bargaining will simply drive mistrust and conflict below the surface, leading perhaps to worsening employee commitment and high labour turnover.

This strongly suggests that firms should be wary about pursuing individual contracts unless there is *already* a reasonably high degree of trust between management and employees, and management is willing to invest significant resources in maintaining effective and meaningful two-way communication and improved management systems.

Issues for Unions

There is no doubt that the trend towards individual contracts poses a very real threat to unions. While there is a theoretical role for unions in representing employees under individual contracts, for many companies, at least part of the point of individual contracts is to marginalise the role of third parties – including unions. Union opposition to individual contracts is understandable. However, unions need to think very clearly about how they respond to individual contracts. A speech by Tony Maher, Vice President of the Construction, Forestry, Mining and Energy Union's Mining and Energy Division, to that union's 1995 national conference described individual contracts as part of a push by employers to impoverish and exploit workers. He described individual contracts as leaving 'you as naked as a newborn baby at the mercy of your employer', and linked them to a strategy

based on 'pure unadulterated *hatred* of workers and particularly the organisations that empower them'.

Much of the rhetoric surrounding the Weipa dispute was in similar terms. If that is really what individual contracts were about, unions would probably not need to worry. Their membership would be growing, and employees would be rejecting individual contracts at every work site where they were offered. However, there are clearly problems in arguing that management in companies like CRA is out to attack workers, when employees are in fact being given better pay and conditions.

Unions need to develop a far more sophisticated understanding of individual contracts, including the fact that they are *not* about taking the workplace back to the nineteenth century, but in many cases are part of a sophisticated HRM strategy. Moreover, there is clearly a danger in over reliance, in the longer term, on sympathetic legislation and the support of the AIRC. Otherwise they run the risk of winning the battle and losing the war.

Policy Considerations

The macro-economic implications of individual contracts will clearly be highly dependent on the context within which they are introduced, in particular, what is happening to the award system at the same time.

If the claims of their proponents are accepted (and there is at least some empirical evidence to support these claims) then the spread of individual contracts alongside a retention of the award system could lead to both higher wages and higher productivity. If the productivity improvements outweighed the benefits in higher wages, then the reduction in unit costs could help reduce inflation and increase employment.

While the evidence does not suggest that individual contracts can generally be equated with exploitation, the New Zealand experience suggests that without adequate safeguards at least some employers would use them to downgrade pay and conditions.

Very few of those proposing greater scope for direct bargaining do so on the basis that there should be a reduction in wages and conditions. Organisations such as the Business Council consistently argue that their aim is higher productivity. Accordingly, they should have little difficulty in accepting some form of protection to prevent the use of contracts to downgrade pay and conditions.

The challenge would be to design a form of protection that effectively prevented employers taking advantage of individual contracts to reduce

wages and conditions, while providing sufficient flexibility not to undermine the rationale for permitting the contracts in the first place.

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