Implications for Wages Policy in Australia of the Living Wage Case

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Abstract

This paper considers the implications of the decision of the Australian Industrial Relations Commission in the April 1997 wage case (the 'Living Wage Case') for wages policy. The recent history of wages policy in Australia is analysed in terms of competing goals for wages policy and the changing priorities for these goals. The Living Wage Case decision is a continuation of developments in the Australian labour market that worsen the relative income position of the low paid, tend to create a two-tier wage structure, and worsen the prospects for reductions in unemployment because responsibility for the control of wage based inflation has been given to restrictive monetary policy.

The aim of this paper is to consider implications of the AIRC decision of April 1997 (Safety Net Review) for the future of wages policy in Australia.

For this purpose wages policy is broadly defined to include all economic and industrial relations policies aimed at achieving goals with regard to wage outcomes (in levels and in rates of change). Thus this broad definition encompasses both the 'deregulated labour market' policies which aim to provide the framework within which market forces can operate, as well as, at the other extreme, the interventionist, centralised incomes policy approaches which were popular in Europe in the late 1970s and early 1980s and which characterised the early versions of The Accord in Australia.

Part 1 of the paper discusses the goals of wages policy and the debate about the sort of wage outcomes seen as necessary to help achieve these

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goals. Part 2 discusses the economic and policy context for the 1997 wage case and the elements of the ACTU claim, and Part 3 considers the decision and the implications for wages policy.

1. The Goals of Wages Policy

Inflation Control v Allocative Efficiency

The history of wages policy in Australia over the last decade and a half can be interpreted in terms of shifting priorities for policy goals and the adjustment of the wages system to accommodate these changing priorities.

On coming to power in 1983 the new Labor Government, faced with both high unemployment and high inflation, sought to finesse the Phillips Curve trade-off between the two problems by pursuing pro-growth fiscal and monetary policies and using the ACTU – Government Accord to directly control wage based inflation. The primacy of the goal of control over the general level of wages and its rate of increase implied the need for a centralised system with norms or principles for wage increases applied generally and strict limits on the ability of wage and salary earners to achieve increases outside the norms by bargaining. From 1983 to 1985 this approach proved successful, wages drift was negligible, inflation averaged 6.9% p.a. over the period compared with 10.3% p.a. for 1980-82, employment grew strongly and the profit share of aggregate income recovered from its 1982-83 slump (see Stegman 1987). However by 1895 this pro-growth policy had run into the traditional problem for Australia – the balance of payments constraint. A substantial currency devaluation in 1985 was accompanied by the adjustment necessary to the Accord principles of wage indexation so as to allow the depreciation to be translated into increased international competitiveness. In the event the currency depreciation failed to generate sufficient gains in competitiveness or incentives for industry restructuring to provide relief for the balance of payments.

From 1986, as the policy focus on constraints on achieving the GDP growth rates necessary to reduce unemployment shifted from inflation to the balance of payments, the wages policy priorities began to shift from the macroeconomic goal of inflation control to the microeconomic goals of productivity enhancement, allocative efficiency, and industry restructuring. Wages policy was now being asked to deliver more in terms of incentives for workplace reform and improvements in productivity. In line with the general philosophy in favour of deregulation of markets, a decentralised wages system was seen as necessary to provide an environment in which market forces induce the efficient allocation of labour resources.

On a more practical level, the argument was that since changes to work practices and conditions of employment must be negotiated and implemented at the workplace level, if the wages system is to provide incentives for these changes, an enterprise or workplace based system is required. The call for 'flexible labour markets' is code for the breaking of the alignments and relativities of comparative wage justice.

In the development of the enterprise bargaining system, from an initial add-on in the two tiered approaches of the 1987-1989 versions of The Accord, to its domination over awards as the major source of wage increases by 1996,[1] the Commission has been a reluctant accomplice. (This contrasts with the ACTU which was even more enthusiastic about an end to centrally determined wages than some employer groups – notably the Metal Trades Employers.) In the watershed decisions of April and November 1991, the Commission identified two major problems with the emerging enterprise bargaining system. The first was that the absence of any power by the Commission to subject agreements to public interest or economic circumstance tests would mean that there could be no centrally imposed ceiling on agreements or their resultant effect on the aggregate wage outcome. Wage based inflation would once again have to be fought with restrictive aggregate demand policies at the cost of increased unemployment.

The second problem was that the system would deliver wage increases according to the relative bargaining strengths of employees and employers. Workers unable to bargain successfully would be left reliant on a system of minimum awards which would not keep pace with the agreements made by their industrially stronger brethren. Rather than a system of standard rates preserving comparable worth principles, the award system would be reduced to a few core minimum rates. Australia would run the risk of developing the bifurcated wage structure of the U.S. labour market, with all the social implications of the existence of a 'working poor'. This brings us to the issue of income distribution.

Income Distribution and Employment

While it is useful to contrast centralised versus decentralised approaches to wages policy in terms of their respective principal goals of inflation control and allocative efficiency, wages policy has other goals to which it is expected to make an appropriate contribution (see Stegman 1987). These other goals relate to income distribution and employment objectives.

With regard to personal income distribution the Commission has a long history of responsibility and concern for the effects of its decisions on the relative income position of the low paid. Under the new Workplace Relations and Other Legislation Amendment Act 1996, the Commission feels that it retains this responsibility (under the Safety Net provisions of Part VI, see AIRC 1997, p 16), and its concerns for the relative income position of the low paid have been increased by the development of the enterprise bargaining system.

While orthodox economics has long been sceptical about whether increases in legislated minimum wages have any success in improving the relative distributive position of low paid workers, Nevile (1996) provides analysis of the importance of the wage distribution in determining overall income distribution in Australia, and the contribution of labour market deregulation to increasing income inequality. Nevile also notes that the argument that relative wages should be left to the market and that social welfare goals should be the responsibility of the taxation and transfer payment system come from the same voices calling for a smaller government sector and smaller government receipts and expenditures (Nevile 1996, p 210, n 2).

The relationship between the general level of wages and the general level of prices determines, with average labour productivity, the division of the national income cake between the aggregate factor shares of wages and profits, and this functional distribution has been a recurring issue in Australian wages policy. Because there are causal relationships between the profit share and investment, and between the wage share and consumption expenditure, the macro distribution has implications for both the level and composition of aggregate demand and hence aggregate employment. This brings us to the role of wages policy in achieving employment goals.

The relationship between wages and employment, the role of inappropriate wage levels in causing unemployment, and the efficacy of wage reductions as a cure for unemployment, are issues of enduring controversy in economic theory. Despite it featuring in several submissions to the 1997 wage case,[2] the relevance of the wage-competition model of neoclassical theory – in which the very existence of unemployment (carefully defined to exclude 'voluntary natural rate' unemployment) is evidence that the level of wages is 'too high' -to analysis of aggregate employment is dubious.[3] Nevertheless the general level of wages, and its relationship to the general level of prices, matters in determining employment and unemployment levels even for 'Keynesians'.[4] The awful arithmetic of unemployment implies that with usual rates of growth in the labour force and productivity, Australia needs GDP growth of at least 3.5% p.a. to stop the unemployment rate increasing, and higher GDP growth rates to reduce unemployment. The mechanisms by which large or rapid general wage increases constrain the achievement of these GDP growth rates are clear. If the general level of wages rises faster than labour productivity, then, on average across the economy, unit labour costs of production rise. Businesses can be expected to pass on this cost increase in higher prices – the result is inflation. Since inflation results in a loss of international competitiveness, and consequently less demand for domestically produced goods and services in relation to overseas produced goods and services, the result is unemployment particularly in the exposed sectors of the economy. Additionally (and of great significance in the context of the 1997 wage case), wage based inflation may provoke governments and central banks into imposing contractionary demand management policy, in the belief that increased unemployment is necessary to bring about a moderation in wage demands.

If employers are not able to pass on increases in money wages by raising prices, and *real* wages rise faster than labour productivity (i.e. real unit labour costs rise), then the result is a squeeze on profit margins and a fall in business profitability. The experiences of 1974-5 and 1982-3 in Australia have shown that when a squeeze on business profitability occurs, the consequence is a fall in business investment, a fall in economic growth, and a resulting rise in unemployment (See Stegman 1990, 1997).

On the other hand it is not necessarily the case that a fall in real wages and a consequent increase in business profitability will reduce unemployment. Reduced real wages may mean reduced aggregate consumption expenditure which may deter business from increasing employment levels or investment expenditure. Increased profitability provides the wherewithal but not necessarily the incentive. The Australian experience of the late 1970s and mid 1980s demonstrates that increased business profitability does not necessarily lead to investment in appropriate employment generating areas.

With regard to the effects of changes in relative wages between labour market groups on relative employment, as discussed above, the Commission has a continuing concern for the welfare of the low paid. In relation to this concern the crucial employment issue facing wages policy is the extent to which any benefits from relative increases in the wages of the low paid are offset by resultant falls in their employment – an issue with a long history in the literature (See Nevile 1996).

The Commission in its deliberations considered a number of submissions on this issue presenting economic argument and empirical evidence.[5]

The orthodox view, as summarised by the Commission (AIRC 1997, p 27) was that:

> Wage increases which impose or accentuate a pattern of wage relativities different from that which would emerge in an unregulated market will cause structural unemployment. Administratively- imposed relativities are contrasted with 'flexible' or 'market-clearing' relativities. Inasmuch

as the Commission raise the relative wages of particular groups, it is likely to exacerbate unemployment among the groups which the Commission wishes to assist.

Against this view, the Commission considered submissions citing theoretical arguments and empirical studies purporting to show that rises in minimum wage rates have at worst only a very small effect in reducing employment and may increase it. The Commission noted the views of Nevile and of Gregory (AIRC 1997, Appendix G) criticising the casual international comparisons that have been used to support the argument that minimum wage rates can result in massive unemployment – in particular the comparison between Western Europe, where there are high minimum wages and high unemployment, and the U.S., where both minimum wage rates and unemployment are much lower. Nevile warns against the dangers of comparing unemployment rates – when 'non-employment' rates (which include hidden unemployment) are considered, the apparent superiority of the U.S. labour market disappears. Gregory concludes his comparison of U.S. and Australian labour markets thus: 'it seems unlikely that greater relative wage flexibility will significantly reduce Australia's unemployment problem ... the restoration of full-employment will lie in a direction other than reducing the wages of the low paid'.

In support of its submission the ACTU placed great store in the 'empirical evidence in the USA with the "New Economics of the Minimum Wage"' and 'the positive employment developments for women following the Equal Pay cases of 1969 and 1972' (AIRC 1997, p 137).The former, based around the studies of Card and Kreuger (1995) of the experiences of particular groups of U.S. workers, must be considered of doubtful relevance to the issues of the 1997 wage case. Furthermore the Australian experience with Equal Pay emphasises the dominance of the effects of differences in sectoral growth rates in industries with differing female representation over relative wage effects. In the current context, the argument that significant increases in minimum awards would not damage the employment of low paid workers requires a belief that the industry sectors in which these workers are over-represented will maintain relative growth. A relevant consideration might then be the fact that industries having an above average incidence of low paid employees include Textiles, Footwear and Clothing. An industry in competition with imports from low labour cost countries, precariously supported by decreasing tariffs, *is* likely to see the cuts in employment from rises in minimum awards that orthodox theory predicts.

The larger issue here, however, is whether there is any real benefit in Australia pursuing lower wage competition in particular industries against countries with very different labour market systems and social values. The preferred route to future employment growth must surely be in the growth of industries and enterprises with higher skilled, higher wage employment. The appropriate level and sectoral composition of investment necessary for this structural development is likely to require a more positive and pro-active industry policy, rather than mere reliance on the allocative signals of appropriate relative wages.

Consideration of lower wage competition draws attention to a logical flaw in the argument that an enterprise based wage system, which can reflect differences in enterprise capacity to pay, is necessary for allocative efficiency. In the competitive models which provide the theoretical basis for this argument, assumed mobility of labour provides a tendency towards equalisation of wage levels for comparable labour – competitive firms face similar wage rates. However, in an imperfect world, enterprise capacity to pay outcomes will not only allow 'sweetheart' wage agreements for firms with monopoly product market power, they will also allow lower productivity firms to pay lower wages, thus prolonging the survival of inefficient firms and providing no incentive for investment to improve productivity. The operation of an enterprise capacity to pay system therefore can be detrimental to the achievement of efficiency and productivity goals (See Salter 1966, p 153).[6]

2. The Context for the Wage Case and the ACTU Claim

The 1997 case provided the opportunity for the AIRC to carve out a niche for itself (a 'toehold' may be a more appropriate metaphor) in the implementation of the recently elected Liberal-National Party Government's vision for wage determination under its new Workplace Relations Act.

The Commission sees its responsibilities under the new Act to include ensuring that:

- wages and conditions are protected by a system of enforceable awards established and maintained by the Commission;
- awards act as a safety net of fair minimum wages and conditions; and
- the Commission's functions and powers in relation to making and varying awards are performed and exercised in a way that encourages the making of agreements between employers and employees at the workplace or enterprise levels. (AIRC 1997, p 16)

The Commission interprets the Act as:

(i) requiring that the priority in this system is on enterprise agreements (SNR 1997, p 18);

(ii) providing no power to refuse endorsement to enterprise or workplace agreements for public interest considerations (AIRC 1997, p 70);

(iii) implying that the award system provides safety net protection only to those employees who are unable to reach an enterprise agreement (AIRC 1997, p 20);

(iv) requiring that the Commission have regard in its safety net adjustments to economic factors, in particular, the effects on inflation and employment (AIRC 1997, p 17).

The Commission provides its perceptions of the economic context for the 1997 wage case in Chapter 6 of its review (AIRC 1997, Ch 6.5). The principal feature of recent Australian experience is 'the failure of the economy in recent years to sustain a growth rate sufficient to reduce unemployment or even prevent an increase in under-employment' (AIRC 1997, p 49).

While the private corporate profit share has continued at the historically high levels of recent years, private sector investment (as a proportion of GDP) has not fully recovered from the slump of 1989-1991 – indeed there seemed to have been a pause in investment's recovery in 1994.

Both the CPI and Treasury 'underlying rate' measures suggest a recent slackening in inflation, which remained within the Reserve Bank's target range of 2-3% (AIRC 1997, p 37).

The Commission concluded its analysis of the economic constraints on the capacity to award increased wages by stating that it was unwilling to grant increases that might directly or indirectly obstruct an increase in the growth rate of GDP (or even cause a decrease), and thus impact adversely on unemployment (AIRC 1997, p 49).In this respect the most influential 'submissions' considered by the Commission (as evidenced by the frequency of their citation) were the statements and Bulletin editorials emanating from the Reserve Bank of Australia. In pointed statements by the Governor of the Reserve Bank on 28 November and 11 December 1996, and in the Reserve Bank Bulletin of October 1996, the Bank made it clear that while current developments in the general level of wages were consistent with the Bank's inflation target '... if wages growth were to rise appreciably, either because of enterprise bargaining or centralised decisions ... monetary policy would, in such circumstances, be set to preserve the favourable inflation outlook' (AIRC 1997, p 29). The Commission was rightly concerned that if the Reserve Bank viewed increases in the general level of wages as higher than that which is consistent with its inflation target, interest rates would be increased adversely affecting employment and unemployment (AIRC 1997, p 30).

The problem for the Commission is that its leverage and influence over the general wage outcome is declining as the number of workers reliant on awards for their wage increases declines. (Currently only about one-third of employees are federal award wage-earners, down from about one-half in 1994 and about two-thirds in 1993 – see AIRC 1997, p 70.)

The higher the rate of increase in wages through Workplace Agreements, the less scope the Commission has for increasing awards without triggering a tightening of monetary policy. However, without increases in awards which keep pace with wage increases generally, the gap between those on awards (predominantly low paid workers) and those achieving wage bargains would widen, a gap already viewed by the Commission as too wide.

This was the dilemma facing the Commission as it considered submissions to the 1997 wage case.

The ACTUs entitled its submission to the AIRC as a Living Wage Claim:

> We have an objective to establish a minimum of $12 per hour for work within ordinary hours. We have an objective to achieve a minimum of $456 per standard 38 hour week. We have an objective to sustain a schedule of minimum rates of pay consistent with previous Commission decisions in terms of the relativities; and we have an objective to achieve in three annual minimum safety net adjustments of $20 a week for those employees who have not received enterprise bargaining increases. They are our objectives ... we believe that those objective should be progressed in three stages as specific claims before the commission in each of the next three years ... we accept that the claim and our objective should be phased in over that period. (AIRC 1997, p 4-5)

Some of the detail of the increases in award rates which would give effect to the first element of the ACTU claim – 'percentage increases to minimum award rates of pay' – is provided in the majority decision (AIRC 1997, p 5). (The second element is the flat $20 increases.) For the Metal Industry Award for example the first element seeks percentage increases in all rates of 8.75%, 10%, and 9.1% respectively in the three stages.

In general terms the ACTU claim if granted would seek to close the gap between awards and workplace agreements while preserving Comparative Wage Justice in terms of the award relativities painstakingly reformed in 1989 (Green 1996).

The Commission was concerned about the direct and indirect effects on the general level of wages of both elements of the ACTU claim. The direct effects depend on the number of workers reliant on awards and the extent to which the increases are absorbed in existing over award payments. The Commission took various submissions with varying estimates of the direct effects on Average Weekly Ordinary Time Earnings. More difficult to estimate are the indirect effects. These relate to the use of the general increase in awards as a basis for flow-on increases to workplace agreements and other wage bargaining outside the award system. (The Commission lists six mechanisms by which wage increases may flow on to employees who are not direct beneficiaries of a Commission order (AIRC 1997, p 24)).

One thing the Commission was sure about was that if the increase in AWOTE was to be maintained within a level consistent with the RBA's target inflation range (a rate of increase of around 4% in AWOTE) then, with workplace agreements providing Average Annualised Wage Increases of 4.4% and higher over 1996, there would need to be continuing considerable offset from lower rates of increases in award rates – lower than those implied by the Living Wage Claim, which the Commission estimated would entail a rate of growth in AWOTE of above 6% (AIRC 1997, p 49).

3. The Decision and its Implications

The Commission in its judgement on the Living Wage Claim produced the first split decision in twenty years. While all members of the Commission rejected the ACTU claim, they were prepared to grant an increase in safety net awards. The majority decision granted a flat rate increase of $10 per week (subject to absorption of wage rises from other sources), thus continuing the approach to protecting low paid workers of previous decisions which between 1983 and 1985 granted three separate flat $8 increases to award workers who had been unable to obtain increase by agreements. This amount represented the majority's assessment of the maximum amount that could be given to award workers without generating a general wage outcome which would trigger Reserve Bank action on interest rates (AIRC 1997, p 74). The Commission acknowledges that this flat rate approach cannot be continued without placing unbearable strains on award relativities. The decision might therefore be seen as a holding operation to keep the AIRC in the game with regard to wages policy while the Government's vision of the wage system is implemented.

The majority also established a Federal Minimum Award wage of $359.40 per week.

The minority decision of Vice President Ross placed greater weight on social and equity considerations than on economic constraints, and would have awarded an increase of $15 for workers on less than $503.80 and 2.5% for workers above this level.

The processes of this wage case make it clear that the operation of anti-inflation wages policy in Australia is currently in the hands of the Reserve Bank, through its statements as to what it sees as acceptable wage outcomes, and its threat to raise interest rate to deter and punish if the combination of award and bargained increases generate increases in the general level of wages which the Bank regards as inflationary.

This approach to anti-inflationary wages policy is similar to that of the German and Austrian wage determination systems of the late 1970s and early 1980s.[7]

The problem with this policy approach is that in the Australian context it does not seem compatible with strong economic growth and high aggregate employment. The successful use of the threat of Bundesbank monetary policy punishment to keep German wage outcomes within policy targets in the late 1970s and early 1980s was assisted by a strong exchange rate and a highly centralised bargaining structure ('Concerted Action'). It is therefore of great concern that Australia has moved to embrace this form of wages discipline at the same time as it has dismantled the apparatus of centralised wage determination. Without some sort of peak council 'Accord' to ensure that workers appreciate and accept responsibility for the macroeconomic outcomes of individual enterprise wage bargains, this approach requires the threat of continuing high levels of unemployment. Without any central institutional arrangements for monitoring and containing aggregate wage outcomes, any situation of improving employment growth will generate fears of wage based inflation. In any pre-emptive role to control wage based-inflation, the RBA will have to threaten rises in interest rates. Moreover, the threat will sometimes have to be made good.

In addition to boding ill for the short and medium term prospects for unemployment, the use of restrictive monetary policy to discipline wage demands has debilitating long term effects on the economy. This is because restrictive monetary policy impacts most heavily on investment demand, reducing cash flow and therefore the capacity of firms to internally finance investment and making external finance more expensive and more risky (See Stegman 1997). When, in the face of falling investment and hence employment, policy makers eventually yield to the cries for a loosening of monetary policy, the easing of the financial constraint and increased cash flow provide the financial wherewithal for an investment led recovery. However, without any incentive from final product demand to increase productive capacity, real investment remains stagnant. Firms use increased liquidity to restore balance sheet positions and 'invest' in existing and financial assets. The resulting inflationary boom in these asset prices inevitably brings a re-imposition of monetary policy tightening. This cycle provides a downward-ratcheting effect on the level of investment in real productive capital accumulation with consequent detrimental effects on the long term productive capacity of the economy.

In this decision the Commission perhaps had little choice – to grant the ACTU claim would have posed a direct challenge to the direction of the Government's wages policy. And to preside over a decision which resulted in increases to the general level of wages outside the Reserve Bank's target would have provoked a contactionary, employment – damaging monetary policy response. Nevertheless the decision is an unhappy one for the Commission. It has inadequately compensated low paid workers for the decline in their relative income position with a flat rate mechanism which the Commission concedes cannot be continued; and it has acquiesced in the further development of a policy approach to wage based inflation which has unemployment costs of which the Commission has itself often warned.

Notes

1. This change is documented in Reserve Bank of Australia (1996) and also in AIRC (1997) p 34.
2. For example in the submissions by the NFF citing estimates of wage effects from the ORANI model (AIRC 1997, p 144); and in submissions from the ACCI and the BCA citing articles by Freeman (AIRC 1997, p 139), and by Dawkins and Freebairn (AIRC 1997, p 149).
3. Nevile 1996 provides a summary of criticisms of the competitive labour market model)
4. See for example Keynes 1936, p 262.
5. The various submissions are summarised in AIRC 1997, Appendix G.
6. See also the article by G.C. Harcourt in this issue (ed).
7. For a discussion of German, Austrian and other European experiences with wages policy see B. Hughes (1982) and J. Fallick and R. Elliott (1981).

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