Alternative Wages and Industrial Relations Policies: Pressures for Change

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Introduction

I was originally asked to say something about "Alternative Wages and Industrial Policies". I would like to modify the topic somewhat, and focus upon the pressures that give rise to demands for alternative industrial relations systems. My reasons for that modification are as follows:

1. Obviously, we are not—or should not be—interested in industrial relations systems regardless of their results. Rather, we should be most concerned with alternative systems from the perspective of how they perform in the environment in which they must operate.

2. It follows that industrial relations systems must be viewed as more or less appropriate responses to the environment. It makes more sense to pursue the main features of that environment, and draw out the implications of those features for the industrial relations system, than to start with the system and try to rationalize it virtually in isolation.

3. I take as a central premise the proposition that man-made institutions are less immutable than some of the broader economic and other forces that shape the environment within which they operate. While it is often asserted that we cannot throw away 80 years or so of industrial relations tradition, I assert that that course is more practicable than changing broad aspects of the economic environment. Of course, whether we are prepared to embark upon that institutional change is largely a function of our preparedness to accept the net costs—if any—of not doing so.

For these reasons, I believe it is more instructive to focus upon the economic and other pressures that Australians must accept as more or less immutable economic realities, and explore appropriate responses to their realities. I suggest that those responses will convey important messages about the desirable nature of industrial relations arrangements in Australia. I also believe that this approach should avoid the charge that proposals for alternative systems are simply the doctrinaire "wish lists" of this or that school of thought.

As two sub-themes, I would also like briefly to explore:

(i) The role of the industrial relations system as a help or hindrance to the process of durable structural adjustment.

(ii) The economic merits of the charge levelled against proponents of change that they are being "unrealistic".

The following analysis is very simple, and is organized as follows. First, I briefly review the implications for wage and labour cost outcomes of assuming the perfect goods and labour markets that feature in much text-book analyis. Second, I examine the implications of relaxing some of the key assumptions required for market perfection. Third, I examine briefly the congruence, or otherwise, of those results with outcomes insisted upon by proponents of the industrial relations system "status quo". Lastly, I consider the important issue of structural adjustment, with particular reference to the question of which signals—price or quantity—are better stimuli to adjustment.

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The Case of Perfect Markets

I do not propose to spend much time on the case where markets are perfect. However, some useful lessons can be obtained from brief consideration of their implications.

By perfect markets, I mean those markets where participants are all-knowing, homogeneous, perfectly adaptable and mobile, and where power is dispersed amongst large numbers of atomistic entities, in a perfectly competitive environment.

In goods markets, we could go to the extreme of collapsing all products into one product, or we could allow a variety of different goods and services to be produced and sold. In that "n goods" case, we could, and usually would, allow for differential performance over time, requiring a more disaggregated analysis than in the one good model.

In factor markets, we can distinguish between different factors of production (labour, land, capital, etc) but the strongest perfect market assumptions do not really allow us to go very much beyond that point. Thus, for labour, to take the factor of most concern in the context of this analysis, it is still necessary to assume wide dispersion of market power, omniscience, and perfect mobility, both occupationally and geographically, if we are to describe the labour market as perfect.

What are the relevant results from analysis using such simplified models? In particular, what are the implications for rates of return to labour? The results are well known, and some of them are highly significant for debates about wage fixation and industrial relations arrangements. Two particularly important results or implications are as follows:

1. The "law of one price" prevails. That is, the wage rate for labour is forced by the processes of competition to be the same, regardless of the number of goods produced and regardless of differences in performance across different sectors. In growth models, that wage rate, in real terms, would be geared to some notion of marginal labour productivity at the national level (which would also be the same for all enterprises).

2. "Comparative Wage Justice" (CWJ) and centralized processes of wage fixation would appear to have some justification at first blush. In some senses, that would be true. Provided that CWJ was consistent with marginal labour productivity which would be the same across the economy, and provided that the centralized wage fixing agency merely ratified the results of market forces *ex post*— a process which some commentators claim takes place in Australia (e.g., Dr Mike Keating, recently Secretary of the Department of Employment and Industrial Relations)— then that conclusion would be correct. But there is no basis, even in the case of a perfect world, for *ex ante* decisions on a CWJ basis by a centralized authority. That follows because such *ex ante* decisions operate to prevent price and wage signals operating for the admittedly very brief periods necessary to secure appropriate quantity adjustments that restore equilibrium. The trouble with that conclusion is, of course, that such centralised wage fixing agencies, by definition, would be totally redundant. I suppose in the purest of perfect markets, the distinction between *ex ante* and *ex post* really disappears, but the point about the role of an arbitral authority remains.

So, if we had perfect (or near-perfect) markets, including perfect (or near-perfect) factor markets, we have the ironical situation that highly centralised processes of wage fixation—provided that they focused on marginal labour productivity across the economy for purposes of real wage adjustments—could be non-harmful. We cannot say they would be necessary— the *ex post* appropriateness of such arrangements indicates that they are not— but at least they would do no major economic damage in terms of weakening underlying performance to any great degree. Of course, resources allocated to such agencies could be better used elsewhere.

Introducing Some Market Imperfections

Suppose we relax some of the assumptions made in order to go some way to bridging the enormous gap between perfect markets and the real world. For example, suppose we assume a multi-product world, with cost-plus pricing policies for products and imperfect mobility of labour. Assume differential productivity performance between industries producing different products. Suppose some authority—e.g., the Government or the Arbitration Commission—wishes to set wages so as to ensure minimal inflation and unemployment, both nationally and sectorally. Here, average labour productivity-based wage fixing rules can be shown to be appropriate, albeit more complex, at least in terms of equilibrium-state outcomes. Lancaster did some work with such models as long ago as 1958. He concluded that appropriate wage fixing rules for each sector or industry geared wage increases to a weighted average of growth in average labour productivity in that sector and for the economy as a whole. The weights for each component in the average depended upon the elasticity of substitution in demand between the products in question, and the elasticity of labour mobility with respect to a change in wage relativities. In the special cases where the elasticity of substitution equals unity, or where mobility is very high (approaching infinity) then the appropriate wage rule gears wages in each sector to average labour productivity in the economy as a whole.

Professor Pitchford refined this analysis in 1967 to allow for substition between factors of production, technical change of various types and so forth. The required wage fixing rules in his models are extremely complex, and impose even more severe information demands upon the authorities making those rules.

What are the main conclusions from this less theoretical—but still very abstract—analysis?

1. In general, differential wage increases or reductions across different sectors, industries and enterprises, rather than uniform treatment, are the rule.

2. The information required of some central authority to allow it to determine the appropriate quantum of adjustment to wages in each sector, industry or enterprise is very large. Apart from the already vexed question of how to measure at the national level how average labour productivity is changing and will change into the future, information about enterprise productivity, and about a large number of parameters (e.g., elasticities of demand substitution and labour mobility) is needed as well. Getting the right answer will be at best a hit or miss exercise.

3. There is certainly no presumption that a centralized wage fixing authority will be superior in terms of implementing such wage rules. Indeed, because most of the required information bears on disaggregated behavioural relationships, a substantial input from decentralized information gathering agencies, and ultimately enterprises themselves, is essential. Grass roots input is increasingly necessary as the assumptions needed for perfect markets are stripped away.

4. While it becomes increasingly difficult to generalize as the models become more realistic, it appears that, other things being equal, the weighting that should be given to enterprise-level conditions increases as labour market imperfections increase. That is so at least on the assumption that sectoral unemployment is not acceptable as an avenue forcing market adjustment (see below).

So, the conclusions that seem to follow from relaxation of the perfect market assumptions are consistent with the following proposition. Increasing attention to fundamental economic realities necessitates reducing reliance upon centralized processes of wage fixation and the presumption of uniformity of treatment. Failure to observe that requirement only ensures that the wage fixing system, and labour market institutions generally, will do economic damage, retarding economic growth and living standards by raising unemployment

and inflation rates, both on average and, especially, sectorally.

I should emphasize that I do not believe that enterprises will have available all the information needed about various elasticities, etc., as thrown up by various more or less theoretical models—at least not in that form. But I do assert that enterprises will be better placed to gauge the net effect of all those forces in terms of changes in the supply of the required types of labour relative to their demand for them, and the direction and rough size of price changes needed to clear those particular segments of the labour market. In that sense, at least, a decentralized approach seems to be more economically realistic than a highly structured centralized system.

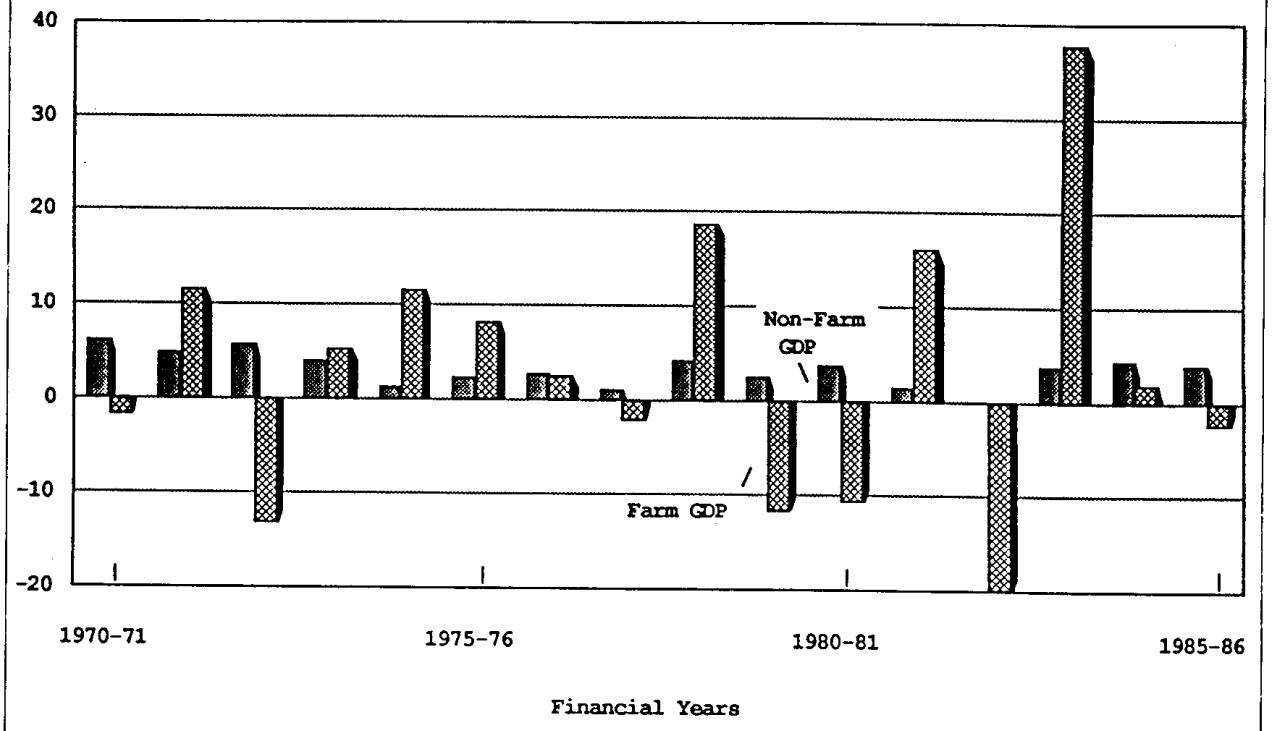
The Real World

The manifestations of market imperfections in the real world are very obvious. It is not simply a matter of different economic performance (e.g., growth or productivity) across different sectors of the product markets. Indeed, that could be consistent with very well functioning product markets. But such differences in sectoral performance, combined with labour market imperfections, require differentiated adjustment signals to labour markets. Those signals can come via price or quantity (see below). Charts 1 to 4 illustrate both differences of economic performance across sectors and over time, and also uneven labour market pressures, both geographically and by type of labour.

The implications of these economic realities are very clear. They suggest the presumption of differentiated labour market treatment by sector, not the presumption of uniform national or even State-level treatment. Realistically, they require a decentralized approach to wage fixation rather than a structured centralized system. The present system operating in Australia is closer to a fully

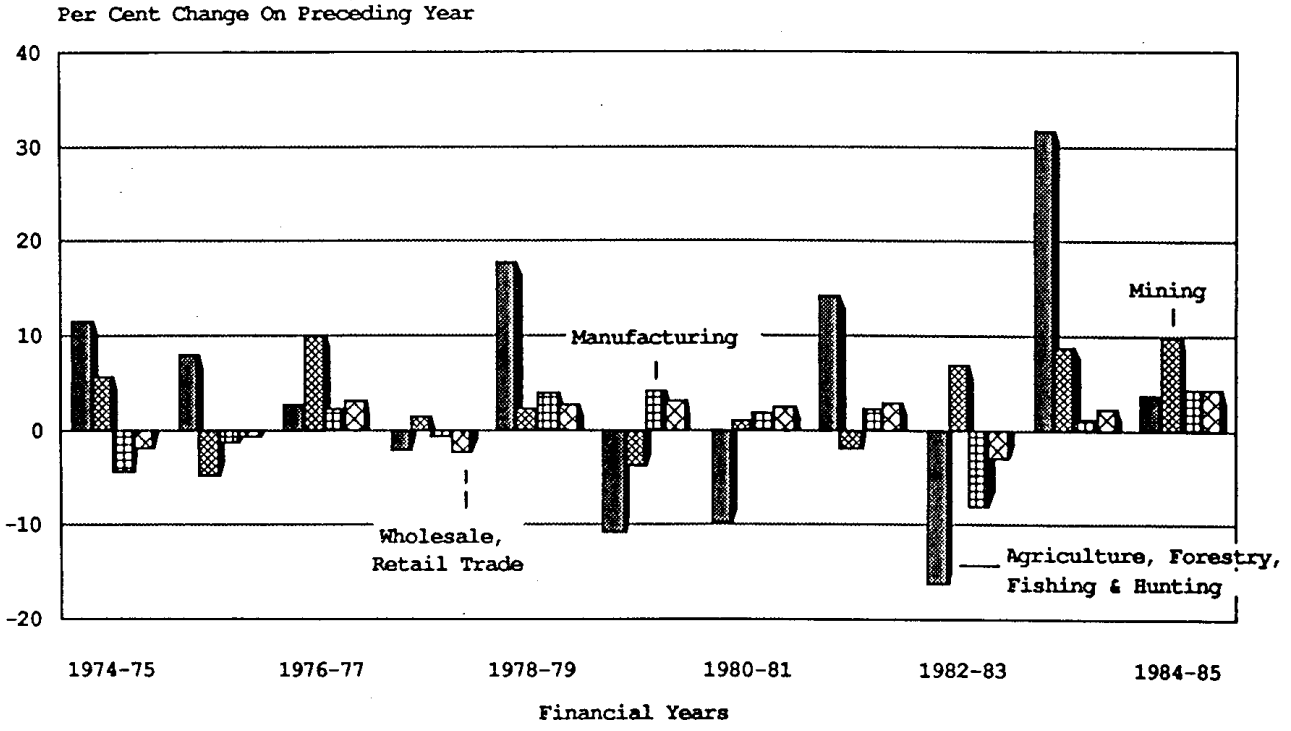
Chart 1 NON-FARM AND FARM GDP GROWTH: A COMPARISON

(Growth in Constant Price Non-Farm and Farm GDP Estimates: Average 1979-80 Prices)



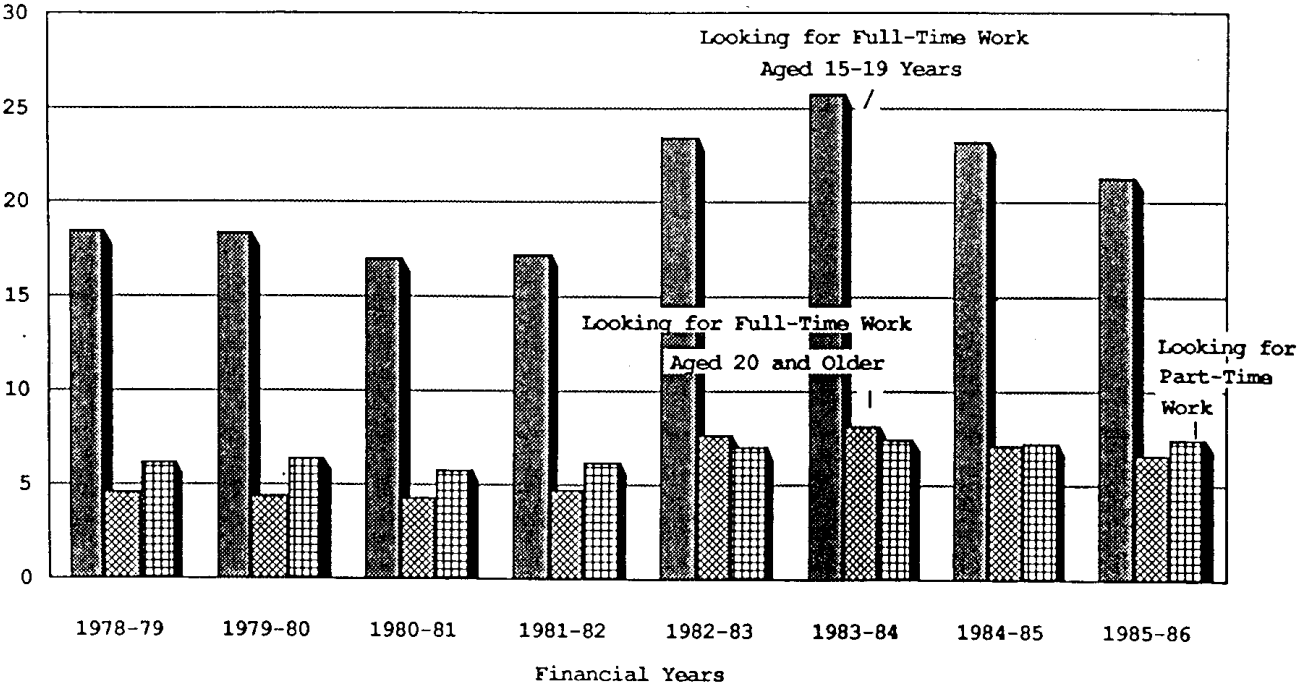
Source: Australian Bureau of Statistics (1987), *Quarterly Estimates of National Income and Expenditure Australia, June Qtr*, p. 34.

Chart 2 GROSS PRODUCT BY INDUSTRY: DIVERSITY OF PERFORMANCE
(Selected Industries: Gross Product at 1979–80 Prices)



Source: Australian Bureau of Statistics (1984–85), Catalogue No. 5211.0.

Chart 3 UNEMPLOYMENT RATES FOR DIFFERENT CATEGORIES OF JOB SEEKERS



Source: "The Round-Up", July, 1986, The Treasury, Canberra.