# Australian Labour Market Institutions, 'Deregulation' and the Open Economy.

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**ABSTRACT**

*Labour market 'deregulation' is a major economic policy issue in Australia. Some of the desire for deregulation has been part of a worldwide trend in OECD countries whilst some comes from more localised disquiet about the alleged effect of Australia's industrial relations institutions on the economy. This article looks at the evidence on Australian labour market regulation and its relation to economic performance. The article finds that Australian labour market institutions have had little effect on efficiency have provided important distributional outcomes. Furthermore it is argued that with 'globalisation' there is more reason to continue labour market protection not less to enhance Australia's capacity to trade and invest in the global economy.*

# Australian Labour Market Institutions, 'Deregulation' and the Open Economy.

**Peter Gahan* and Tim Harcourt***

## 1. Introduction.

What is labour market 'deregulation'? Of course, it means different things to different people in the policy debate. Some argue that it means the removal of all 'interventions' in the labour market, such as minimum wage laws, trade unions, occupational health and safety laws, leave provisions, and so on. Others think it refers to the decentralisation of wage bargaining; for others, to the diminution of industrial tribunals. Some argue that they are for 'deregulation' but ironically, in practice, they advocate 're-regulation' (for example in the case of having individual contracts replace awards or collective bargaining agreements) (for a discussion, see Dabscheck 1995 and Buchanan and Callus 1993). There are many definitions, but for our purposes labour market 'deregulation' refers to the removal or marginalisation of collective industrial relations institutions such as trade unions and industrial tribunals (and with them minimum wage laws, awards, occupational health and safety laws and collective bargaining agreements etc.) in favour of individual arrangements and a general 'free for all' in the labour market.

This form of labour market deregulation (or re-regulation) has been described as a panacea for much of Australia's economic ills (particularly unemployment) since the mid-1980s. Dabscheck (1987) has written about the political economy of labour market 'deregulation' in Australia with the rise of the 'New Right'. A major criticism by the 'New Right' was that Australia's labour market institutions were run by the 'industrial relations club' and hence did not produce economic and employment outcomes that were

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in the public interest. This form of labour market 'deregulation' has also been advocated by major media interests, especially the editorial page of the *Australian Financial Review* (see for example "Get tough on IR reform," 14 October 1998). Ironically the critics of the 'club' have themselves formed a network of individuals who have influenced the current Government's industrial relations policies and attempts to re-regulate the labour market.

The demand for labour market deregulation also emanates from beyond Australia's shores. The reaction to the oil shocks in the 1970s and the persistence of unemployment not seen during the post-war 'golden age' created new policy approaches by official policy makers. Many of these officials noted the rise of the 'NAIRU' (the non-accelerating inflation rate of unemployment) and saw labour market deregulation rather than macroeconomic policies as the only way of reducing it. This position became particularly prevalent amongst central bankers in industrialized economies. The international popularity of the notion of labour market deregulation gave heart to its local advocates who argued that it was even more necessary as Australia became integrated with the world economy.

This paper does three things. Firstly, it tracks the demand for labour market deregulation in international economic circles in the 1970s and 1980s which has persisted in the 1990s. Secondly, it compares Australian debate on labour market deregulation to those elsewhere in the OECD. It tracks the argument and evidence about decentralism and centralism in Australian industrial relations and the impact of Australian institutions on the labour market compared to other countries. It finds from the evidence surveyed that overall, Australia's institutions have little effect on efficiency and labour market 'flexibility' in terms of labour market outcomes. However it does find that Australian institutions have played a distributional role in making labour market outcomes more egalitarian than they might have been. The implication of the evidence is that labour market 'deregulation' may have disastrous implications for equity in the labour market without any improvement in economic efficiency (that is, labour market deregulation is not a *'Pareto efficient'* policy).

Thirdly, the paper looks at the evidence on globalisation and labour market institutions. We ask, 'Does a more open economy mean that Australia can no longer 'afford' social protection through its labour market institutions?' The evidence surveyed shows that the efficacy of Australia's labour market institutions does not rely on the condition of a closed economy. Furthermore, we argue that the emergence of globalisation has increased the need for social protection through labour market institutions. We argue that social protection is a much better policy instrument than trade protection if nation states wish to minimise the adverse effects of globalisation on workers.

The conclusion follows with a warning to those who advocate labour market deregulation as a way to eliminate Australian unemployment and associated economic problems.

## 2. The Demand for Labour Market Deregulation

After the steady growth rates and low unemployment rates of the 1950s and 1960s, the 1970s was a decade of turmoil for most OECD economies, including Australia. Although most of this turmoil subsided in the 1980s, certain economic problems were perceived as being more intractable. For example, the worldwide slowdown in productivity and the rise in unemployment, which were widely regarded as transitory in the 1970s, came to be viewed as more permanent. While the economic history of this period is well known there is as yet no agreed interpretation of what happened. Following the first oil price shock many economies experienced rising unemployment and, in an attempt to ameliorate this, faced the problem of rising inflation. The OECD's *Jobs Study* charts the seemingly inexorable upward movement of estimated Non-accelerating Inflation Rate of Unemployment (NAIRU) for the European economies over this period (OECD, 1994). Most governments eventually responded to rising inflation with strongly contractionary monetary policies in the late 1970's (the 'Volcker deflation') or the early 1980's (as in the UK) following the second oil price rise, which seemingly led to a further rise in unemployment. During the 1970s most economists attempted to explain the macroeconomic instability and assumed that unemployment would revert back to its previous level once these shocks to the system had died down.[1] This view seemed plausible given the variety of shocks. Apart from the rise in oil and commodity prices there was the advent of the era of floating exchange rates, as well as large fluctuations in real interest rates and government budget deficits (Bean 1997)

The prevalent economic theories of output and employment fluctuations also suggested that these macroeconomic problems would be temporary. Both Keynesian theories, which rested on price inflexibility, and monetary misperceptions models (following Lucas, 1972) suggested this. Elements of the economics profession including key policy officials had gradually accepted the notion of an equilibrium rate of unemployment (the 'natural rate' proposed by Friedman, 1968) which was essentially impervious to business cycle phenomena. However, these views could not withstand the persistence of unemployment during the 1980's. All OECD economies had implemented deflationary policies, and while most models predicted that disinflation could cause temporary increases in unemployment (at least if the contractionary policies were unanticipated or not credible), none were capable of accounting for the extreme *persistence* of

[1] Some studies also attempted to demonstrate that corporatist countries were able to adjust to such shocks more effectively. See Bruno and Sachs (1985), Flanagan, Soskice and Ulman (1982) and Soskice (1990)

unemployment.[2] These phenomena launched a concerted research initiative to account for it.

### 3. The Deregulation Debate in a Comparative Context

Much of this research on unemployment has focused on the efficacy of labour market regulation, particularly of the type associated with European corporatist states (Bean 1994). This view has been reinforced by a simple comparison with the US where, following the period of adjustment after the oil shocks, unemployment has fallen to much lower rates of unemployment than in Europe (see in particular the OECD's *Job Study* report). Most economists have taken the view that the highly regulated nature of European labour markets increased the costs firms faced in hiring additional workers, lowered the level of employment and slowed the rate of structural adjustment, such that labour allocations between sectors has become increasingly inefficient.[3] The conclusion drawn from this argument is summarised by Nickell (1997):

> Here is the received wisdom. The European job market is rigid and inflexible. Result: high unemployment. The North American job market is dynamic and

[2] Estimates for 1996 show just over 36 million people unemployed in the OECD, representing around 7.5 percent of the labour force in member countries. Where these numbers are estimated for the European Community (EC) alone, the problem is more acute: some 18.7 million persons, representing 11.3 percent of the EC labour force, were unemployed. (These estimates are calculated from the OECD's *Economic Outlook* (1997a), 'Statistical Annex'.)

[3] We have already alluded to this body of research in the context of reformulations of the perfectly competitive model (also see Gahan and Harcourt 1998 for a more complete discussion). This general view owes much to the work of Layard, Jackman and Nickell (1991). In their model, unemployment exists because of imperfectly competitive wage setting institutions and the generosity of social insurance, which induces a high 'reservation wage' and makes the decision to work unattractive. Much of this is reduced to the relative bargaining power of unions who in turn have the capacity to impose wage demands on firms and place pressures on governments to introduce policies which reflect the sectional interests of employed union members. Using cross-sectional regression analysis, Layard, Jackman and Nickell claim their model is supported by empirical data. A similar story is put forward by 'Insider-Outsider' models of the labour market (Lindbeck and Snower 1988). In these models labour market imperfections allow 'insiders' to influence wage outcomes to the extent they have a detrimental effect on the employment prospects of unemployed 'outsiders'. The power of insiders also extends to influence political decisions over labour market regulations, most notably restrictions on firms' recruitment and dismissal decisions. However, some basic facts seem to defy the claims of both theories. First, the relatively low level of unionisation (insiders) in some European economies (for example, France) has not been associated with lower unemployment. In addition, the general decline in union membership (insiders) during the period of rising unemployment is at odds with the general argument of both models. For a general critique, see Gahan (1998).

> flexible. Result: low unemployment. So Europeans had better do some thing about their labour markets unless they want permanent double-digit unemployment.

This rationale has also been applied to the Australian context, where the system of wage regulation has been heavily criticised as generating the same types of inflexibilities and efficiencies as European labour market institutions (see for example, BCA 1989, Brook 1989, and Drago, Wooden and Sloan 1992). The legitimacy of labour market deregulation has been predicated on two sets of arguments. The first concerns an historical evaluation of Australian labour market institutions, and the second consists of a comparative assessment of Australian economic performance with those of deregulated economies.

The Australian system of industrial relations has been dominated by a complex structure of state and federal tribunals which has played a significant role in the regulation of the *process* of wage determination and the *form* of any agreement made between firms and workers. The traditional framework also sought to influence the wage regulation by encouraging the formation of unions and employer associations (Borland and Woodbridge 1998). A number of economists have argued the arbitral model has unduly interfered with efficient labour market processes and has been the cause of a number of economic problems. This is said to have happened in a number of ways. The tendency for industry and nation-wide wage comparisons (comparative wage justice) has reduced the responsiveness of the Australian labour market to changes in demand and supply conditions at the level of the firm. In addition, the uniformity which established wage relativities impose across industries is said to have impeded allocative efficiency by distorting the signalling role of wages in the labour market (see Norris 1996 and Dabscheck 1995).[4]

[4] These institutional arrangement were the subject of a concerted campaign by 'new-right' politicians and some employer groups as evidence of an 'industrial relations club' who were capable of controlling the system for their own benefit. For a useful critique of this view see Dabscheck (1987).

The advocates of this view have not, however, provided convincing evidence to support these hypotheses. This is in part due to the difficulty in establishing with any degree of confidence the counterfactual of how labour market would behave in the absence of arbitration. No direct test is possible. However, a number of studies have attempted to gather indirect evidence of the effects of arbitration on the Australian wage structure.[5] Few of these papers demonstrate arbitration (or incomes policies such as the Prices and Incomes Accord) had significant effects on the Australian wage structure. At best, the effects of arbitration on the Australian wage structure were found to be relatively small; few (statistically) significant differences were evident (Norris 1986).[6] Moreover, Norris (1996) concludes that despite any effects of arbitration on the wage structure, efficient labour reallocation is by no means dependent on changes in the wage structure.

The view that we should expect large and significant differences in the wage structures in Australia and elsewhere is based on an exaggerated sense of the historical differences in the institutions of wage determination or a general failure to appreciate the historical evolution of arbitration. While the institution of compulsory arbitration is often thought to be unique to Australia and New Zealand, the role of alternative institutional arrangements (such as wage councils in Britain) has performed similar functions (Machin 1997). Industrial relations scholars have long been aware of the problems of comparing institutions with seemingly different or similar structures, names or functions (see Bamber and Lansbury 1998). The view that arbitration will have such a detrimental effect on the wage structure and relativities is also based on an idealised view of arbitration and how it has functioned. In general, compulsory arbitration has been viewed as consisting of a highly centralised system of wage determination, or that Australia has always had one kind of wages system and this has somehow led the Australian labour market to perform different than labour markets in other countries. Yet, as industrial relations scholars have been at pains to document (for instance, see

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[5] There is now an extensive body of research which compare Australian wage structure and outcomes with other countries. See Brown, Hayles, Hughes and Rowe (1978) and (1980), Coelli, Fahrer and Lindsay (1994), Hancock and Moore (1972), Hughes (1973), Norris (1980 and 1986), Rowe (1982), Watts and Mitchell (1990a and 1990b), and Whithers, Pitman and Whittingham (1986).

[6] The most significant effect of arbitration on the wage structure relate to gender based wage differentials and labour market segmentation (see Blau and Kahn 1996, Kidd 1993 and Vella 1993).

Dabscheck 1994), the Australian arbitration system has gone through a number of historical developments, both centralised and decentralized. Isaac (1993: 10-11) notes:

> Industrial relations reform is not a new phenomenon in Australia. It has been going on through most of our history in order to deal more effectively with industrial disputes and economic requirements.
>
> An historical view of the Australian IR system shows it to be a flexible institution in which changes in policies, principles and procedures - sometimes generated by legislation - have taken place. These changes reflect attempts to adapt the operation of the system to the changing social, economic and political environment.

This flexibility within the system is reflected in the changing principles employed by tribunals in wage determination as well as the importance of arbitration itself. For instance, Macklin, Goodwin and Docherty (1992) demonstrate the historical importance of enterprise bargaining and awards in the Australian system. The Australian system of labour market deregulation has also been evaluated by a comparison with those economies which have in the past decade adopted deregulationist policies within the OECD (see Mükenberger and Deakin, 1989 and Pencavel 1991). What have we learned about the effects of labor market reform in the OECD economies? The evidence suggests that changing labor market institutions have ambiguous effects. In some cases it appears to have relatively little effect on unemployment, different measures of the efficiency of the labor market, or on productivity growth. In other cases, particularly the US, UK and New Zealand, the effects are large, but not the ones anticipated. Changes in institutions have had a significant effect on changes in the distribution of wages and incomes.[7] These institutional changes are driven by policy designed to create, either directly or indirectly, an environment for firms to initiate change.

Virtually all European countries attempted to increase the degree of labor market flexibility during the 1980s, albeit to differing degrees (Emerson, 1988 provides an overview.) Belgium, France, Britain and Spain weakened dismissal laws. The

Netherlands reduced, and Britain removed, the minimum wage. Italy eliminated wage indexation and France, Netherlands, Spain and Sweden all decentralized wage agreements (see OECD, 1990 for more specific details on these reforms). With respect to firing restrictions Treu (1992) concludes 'most European governments… have promoted concerted measures to increase the flexibility of the labour market.' By this he means an increase in the ease and a reduction in the costs to firms incurred in changing their workforce. Treu goes on to stress 'the introduction of different types of employment contracts... has played a leading role in increasing labour market flexibility.'[8] The precise form of deregulation has varied considerably between countries. For example, while short-term contracts have become very important in Spain, they have not been adopted by German firms (Büchtemann, 1989). Overall, employers in most of Europe have far more freedom to organize work time and production (for example by subcontracting out tasks) in a firm-specific manner than was previously the case (Blanpain and Kohler, 1988).

The results of this change in the legislative environment have been disappointing for their proponents. In an important survey of 'changing labor market rules', Blank and Freeman (1994) conclude,

> …reforms to increase flexibility by weakening welfare state programs did not deliver what they had promised. The conventional wisdom of the 1980s – that social protection impairs flexibility in ways that harm economic performance – deserves a serious rethink.

A companion volume edited by Blank (1994a) contains a series of empirical papers which detail the effects of various social insurance and welfare spending programs (an important part of the structure of labor market institutions in different countries) on labor market equilibrium. The findings of this research are uniform: 'these papers give little

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[7] While the US has remarkably few labor market regulations compared to European countries, it has witnessed a dramatic fall in unionization since the 1960's and significant falls in the real minimum wage, changes which are qualitatively similar to labor market reform in Europe.

evidence that labor market flexibility is substantially affected by the presence of social protection programs, nor is there any evidence that the speed of labor market adjustment can be enhanced by limiting these programs' (Blank 1994b)[9]. More recently, Solow (1997) has made similar conclusions.

> Almost uniformly, in public discussion of what is after all a high-visibility issue, the blame for this failure falls on rigidities in the labour market. That response has already achieved the status of a reflex, exhibited by any central banker you might care to ask. The same knee-jerk reaction appears also as the conclusion of the OECD Jobs Study (though it might more appropriately be described as the assumption of the OECD Jobs Study)…
>
> [W]eakness in job creation is most likely the result of excessive and anti-competitive product-market regulation, restrictive macroeconomic policy, especially monetary policy, and inadequate discipline from the capital markets. This is quite different from the conventional picture (Solow 1997: 3, 29)

These conclusions are supported by other comparative evidence on the effects of labour market reforms within the OECD. After a decade of reform, the recession of the early 1990's saw unemployment rates rising to levels as high as that experienced in the 1980s.[10]. At the same time policies to reform the labor market do seem to have had the desired effect of reducing the bargaining position of workers. The large rise in wage inequality which took place during the 1980's has been well documented (Freeman,

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8 He argues that this has resulted in a large expansion in part-time employment and short-term contracts. The position in Britain is evidence of this. Gregg and Wadsworth (1995) analyze the fall in job tenure and rise in turnover which resulted during the 1980's and 1990's.

9 Summing up the findings of this large research project Blank (1994b) comments,

> …a possible explanation (for the conclusions of the project) is that the analysis of social protection programs as a primary cause of inflexibility and high unemployment was simply flawed from the beginning. The best counterexample is Japan, a country with extensive job security provisions and with less inter-regional mobility than the US that has consistently outperformed the US as well as its European competitors. Japan provides evidence that there is no inherent correlation between poor economic performance and the presence of welfare state programs and/or slower labor market adjustment in terms of employment and mobility. It is possible that the sluggish economies of Europe over the 1980s were due to quite different factors, such as a lack of useful cooperation and communication between the political system and the private sector.

10 Gregg and Manning (1995) summarize their empirical work by arguing 'if the conventional analysis of labor market regulation is correct, we would expect to find labor market performance to be negatively correlated with benefit duration, replacement ratios, trade union density, the minimum wage…, yet when one looks at the results (of their regressions) the most striking thing is that it is very rare to find any significant relationship at all.'

1993a), while this occurred in most OECD economies, the largest effects were in the UK and US (OECD 1993, Freeman and Katz 1994, Lemieux 1993 and Leslie and Pu 1996)[11]. Although part of this phenomena can be traced to technological change favoring workers with higher skills (though Katz (1992) argues there is no independent evidence that this effect is important and there has also been large increases in inequality between classes of workers with homogeneous characteristics), and the effects of increased international competition, the evidence suggests a large proportion of this is the result of changes in labour market institutions. Blanchflower and Freeman (1994) and Freeman (1993a and b) both suggest that this may be directly related to labor market reform. Freeman and Pelletier (1991), Gosling and Machin (1995), Gregg and Machin (1994), and Leslie and Pu (1996) analyze the role of the decline in the power of organized labor on the wage structure and find it to be highly significant. This result has also been reproduced for the Australian case (Borland 1996)). Freeman's (1990) examination of international movements in unionization rates illustrates the precipitous decline of unionization in the US and UK since 1970, and the OECD reports that it fell in many member countries during the 1980's (particularly the Netherlands and France). Card (1996) estimates at least twenty percent of changes in the variance of wages in the United States from the 1970s to 1987 is explained by the decline in unionization. Lemieux (1993) has estimated that 40 percent of the differences in wage inequality between Canada and the US can be accounted for by their different union densities. DiNardo, Fortin and Lemieux (1996) find that both de-unionization and falls in the real value of the minimum wage have had a significant and large impact on the increase in wage inequality in the United States. They conclude that 'labor market institutions are as important as supply and demand considerations in explaining changes in the US distribution of wages from 1979 to 1988.' Pontusson (1996) also finds that those OECD countries which experienced de-unionization in the 1980s were those which experienced large increases in wage inequality.

[11] Only in the US was this rising inequality accompanied by absolute falls in the real wage of low paid workers although, as Gregg and Wadsworth (1995) document, the real wage of new hires has been constant in the UK since 1980.

In summary, the countries where institutions were weakened the most (including Australia) therefore experienced the largest increase in wage inequality (Nevile 1996). Other countries where institutions changed in the same direction also experienced the same inequality trends (for example Sweden).[12] There is also a significant body of other evidence that standard models of unemployment are highly incomplete. Freeman (1988) documents that there is no relationship between union density and the proportion of the working age population that is employed. Indeed, there seems to be no robust evidence linking unions to unemployment despite the profusion of theoretical models with this result. The same seems to be true with respect to the generosity of unemployment compensation (see Burtless 1987, and the authoritative survey of Atkinson and Micklewright, 1991).[13] This evidence, we argue, suggests, does not support the case for deregulation as an appropriate policy to overcome Australia's economic problems. Rather, the evidence confirms our hypothesis that institutions perform positive economic functions. Deregulation unambiguously generates greater inequality. This has, we argue, important implications for assessing the efficiency of labour market reform. As Solow (1997: 32) points out, the rise inequality which results form deregulation is at odds with standard Pareto criteria used in economics:[14]

> If pure unadulterated labour-market reform is unlikely to create a substantial increase in employment, then the main reason for doing it is the anticipated gain in productive efficiency, however large that may be. But if we respect the wage earner's desire for job security, and it seems at least as respectable as anyone's desire for fast cars or fat-free desserts, then an improvement in productive efficiency gained that way is not a Pareto-improvement.

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[12] However, there are exceptions. Italy, France and the Netherlands changed institutions to some degree but experienced no deterioration in wage inequality. The likely reason for this is that the effects of some institutional changes on labor market outcomes may not be large unless they occur simultaneously with other complementary changes. Since it may not be politically feasible for all changes to happen simultaneously the types of effects seen in the US and UK have not yet emerged in these economies.

[13] Barrell, Pain and Young (1994) find that in the UK, despite significant changes, for example a fall in the replacement ratio from 43 percent to 25percent of average earnings, this seems to have had no positive effect on employment. This may be because of the effect of the benefit system on bargaining power and the productivity of workers, or because benefits may aid the process of matching and job search (as suggested by Wadsworth 1991).

[14] Indeed, if deregulation will lead to gains for everyone (that is, deregulation is Pareto improving) it is difficult to rationalise the degree and intensity of opposition to it from any particular group or set of labour market participants.

## 4. Labour Market Institutions and Globalisation

The conclusion that there is no identifiable historical relationship between labour market regulation and labour market outcomes does not of itself prove labour market regulations will not have adverse effects in the future. An alternative approach has been to view labour market regulations and institutions as 'time bombs'. From this perspective, labour market regulations viewed as benign during the 1950s and 1960s, became more costly and dysfunctional to employment growth during the 1970s and 1980s. This occurred as a direct result of radical changes in the economic environment in which labour market institutions were embedded. The changes in the economic environment have been viewed as sources of instability and uncertainty. In an uncertain economic environment, the potential hiring and firing costs generated by labour market regulations make employing additional workers costly or prohibitive.

This growth in economic uncertainty is said to derive from a number of possible sources. Prominent among them is the idea of 'globalisation'. The argument goes that because Australia's industrial relations institutions were developed behind protective tariff walls, then these institutions are not suitable for Australia in a 'globalised' economy (Hilmer 1989, Plowman 1992). It is often argued for instance, the operation of the arbitral system relied on the simultaneous existence of tariff protection. Reductions in tariffs are therefore said to make arbitration untenable (see for example, Kelly (1992) and Hewson (1992)). Both argue about a triumvirate of restricted immigration (the 'White Australia' policy), tariff protection and the conciliation and arbitration system. However, the historical association does not imply that arbitration is no longer a sustainable institution. This may be so for a number of reasons.

First, the institutions, even if they have a common starting date need not have the same finishing date. A focus on the original objectives of certain institutions ignores the fact that, over time, the role and impact of an institution changes. This is perhaps nowhere more so than in relation to the role of tribunals. Moreover, as the institution of arbitration has evolved it has taken on a range of objectives at any point in time: the resolution of impasses in bargaining, reduction of bargaining costs, and so on (see Gahan 1996 for a more complete discussion of this point)

Second, the historical dependency between tariff protection and arbitration is in some ways questionable in the first place. Wages boards and industrial tribunals (and votes for women) in the colonies in fact pre-dated federation and extensive tariff protection (see Macintyre and Mitchell 1989). Some have argued that protection was explicitly introduced to make higher wages possible (see Plowman, 1995). The use of the 'Stolper-Samuelson' model ( see Stolper and Samuelson, 1941) showed that real wages could be increased when the scarce factor of production, labour, was being used to produce goods which benefit from tariff protection. However, this is an argument about the size of the wage adjustment that could occur not what <u>institutional mechanism</u> (in this case the Australian conciliation and arbitration system)should transmit the wage adjustment. This argument was over wage levels not wage fixing instruments.[15]

Third, the Hewson/Kelly hypothesis ignores the fact that trade unions in the Australian colonies were themselves not entirely convinced of the merits of tariff protection. The labour movement itself was split into free trade and protection camps at the time of federation (see Costa,1991). Moreover, this occurred at a time of strong support by trade unions for conciliation and arbitration.

On the examination of the evidence, the historical link between the debate over free trade and protection and the introduction of arbitration at the beginning of the century is not as clear as the Kelly/Hewson hypothesis would have us believe. These debates occurred at the beginning of the twentieth century. Now at the end of the century we have a recurrence of the debate in the form of the argument over globalisation. The acceleration and intensity of international trade, foreign direct investment and cross-border flows of capital have been loosely termed 'globalisation'. Much of the debate

[15] In relation to arbitration, there is some doubt about its true effects on wages, both after its introduction in 1904 and more recently. MacCarthy's (1969) important analysis of the Harvester case suggests that it was some time after that decision that the 7-shilling-a-day decision became the norm. For an analysis of the wage effects of arbitration more recently see Norris 1992.

about globalisation and its effects on workers concerns trade liberalisation (the reduction of tariff and non-tariff barriers). Considerable debate has taken place in economics over the impact of trade between industrialised and developing countries and the impact on the wages of unskilled labour in the industrialised world (see Wood,1995 Freeman,1995 , Bhagwati and Kosters, 1994, Singh, 1997 and Slaughter and Swagel, 1997 for a taste of the debate). The Trade-Wages debate remains controversial with significant social and political implications (summarized by Rodrik, 1997). However, globalization's impact does not just emanate from trade liberalisation. The increased mobility of capital has produced an acceleration of foreign investment (see Kozul-Wright, 1995). Similarly, the deregulation of financial markets has had enormous impact on many domestic economies particulalry in Asia and Latin America. The Asia financial crisis, for instance, which began with the devaluation of the Thai baht in July 1997, spread to economies even outside Asia such as Russia and Brazil, highlighting the interdependence of world capital markets under globalisation. Also technological developments have magnified the effects of trade and investment liberalisation by reducing the costs of transport and communication (see Lee, 1996). Changes in technology have also assisted a growing tendency of companies to engage in sub-contracting and outsourcing (see OECD,1997b).

Globalisation has also been viewed by many as undermining national systems of regulation and the role of the nation-state (see Weiss 1998). More competitive product markets and greater uncertainty about the nature and level of demand have been assumed to make labour market regulation more costly as inflexible labour laws impede the capacity of firms to respond to changes in 'global markets' (see for example, Hilmer 1989). Yet there is little convincing evidence that globalization has altered either the efficient or politically sustainable structure of institutions. Garrett and Lange (1995), Garrett (1995) and Rodrik (1997) have all found a strong relationship between globalisation and activist government policy including well developed labour market institutions.

Garrett and Lange (1995) examine the role of industrial relations institutions in the open economy. They find that when industrial relations institutions are centralised, when workers are organised under a single umbrella union confederation (such as the ACTU) and can bargain nationally that 'this institutional arrangement mitigates the deleterious consequences of differences in wage setting dynamics across sectors.' This is due to, 'The leaders of centralized labour movements have an interest in maximizing total employment in the economy' (Garrett and Lange, 1995:639). An Australian example can be found in some aspects of the Accord, particularly Accord Mark II, where an external shock to the economy via a devaluation of the exchange rate, was absorbed via an adjustment in incomes policy (see Chapman, 1998). Garret and Lange also consider the interaction of labour market institutions with the monetary policy stance of the central bank. They conclude that: 'the effects of these institutions are likely to be independent of each other – the impact of central bank independence on wage setting, economic policy and macroeconomic performance is likely to be influenced by other labour market institutions that accompany it' (Garret and Lange, 1995; 654-55). They refer to the interaction between wage bargaining in Germany and the German Bundesbank. The interaction between the Reserve Bank of Australia and the Australian Industrial Relations Commission in the first ACTU 'Living wage' case in 1996-7, an unprecedented event in Australian economic history, is discussed in the June 1997 issue of this journal by Stegman (1997) and Jones and Harcourt (1997).

In a companion study, Garrett distinguishes between the effects of trade and capital mobility on domestic policy. Garrett finds that 'countries with strong leftist parties and trade unions have long been exposed to trade' and that should lead to more activist public policy (Garrett, 1995: 660). Contrary to the accepted view in much contemporary debate, he argues that, 'One should not therefore be reticent to claim that increased exposure to trade will inevitably result in a scaling back of the public economy.' With respect to capital mobility, Garrett believes that domestic policy will be more affected by 'the constraints of financial integration than by trade growth' (p682). He does not, however, see this outcome as necessarily pessimistic for those who argue that labour market institutions and other forms of social protection because 'higher trade will also increase political pressures to compensate those segments of society that are adversely affected by market forces' (p683).

In similar vein to Garrett , Rodrik (1997) finds that economic 'openness' is associated with denser social institutions to assist those adversely affected by globalisation. Contrary to the speculative literature (of both left and right) he finds that the most efficient and equitable responses to globalisation have been associated with strong trade unions, labour market institutions, and 'solidaristic'-type wage policies.[16] He also finds that a greater level of public expenditure to be found in countries that practice free trade and open economic policies. Rodrik suggests that globalisation has caused the most public policy headaches for governments when it conflicts with 'social norms'. Accordingly, he suggests that international trade policy institutions should allow governments to make policy adjustments to reflect a nation's social norms and values.

The argument for combining an open trade policy with comprehensive labour market institutions and other social protections is also supported by recent OECD evidence on the effects of trade and labour standards, where a positive relationship was found between trade expansion, competitiveness and the development of labour market institutions. The OECD (1995:21) concluded:

> …it can be said that in order to raise people's material living standards, countries should seek economic growth, using trade and labour market policies as appropriate means to that end. *Labour standards and international trade can be complementary.* Such complementaries should be sought by countries and by companies and fostered by the international community (emphasis added).

The World Bank, too, sees the presence of labour market institutions such as unions and collective bargaining as beneficial to a nation's productivity and its trade performance and international competitiveness. It concluded,

[16] We in fact support a stronger argument than this. We argue that no matter what its trade policy stance, a nation must develop social institutions (including labour market institutions) to ensure fairness and social stability. Whether an economy is 'closed' or 'open' it must deal with questions of income distribution, social welfare and labour market adjustment policy. A fair and efficient set of labour market institutions is necessary for a small open economy to flourish with economic growth *and* social stability. This is not only demonstrated by recent Asian experiences, but is supported by a considerable body of evidence which

> Trade union activities can be conducive to higher efficiency and productivity. Unions provide their members with important services. At the plant level, unions provide workers with a collective voice. By balancing the power relationship between workers and managers, unions limit employer behaviour that is arbitrary, exploitative, or retaliatory. By establishing grievance and arbitration procedures, unions reduce turnover and promote stability in the workforce – conditions which, when combined with an overall improvement in industrial relations, enhance workers' productivity' (World Bank 1995: 80).[17]

## 5. Conclusion

In conclusion, this paper has evaluated the labour market 'deregulation' debate in the Australian context. The paper has stepped outside the polemical debate to see what economic evidence is available on the issue of labour market deregulation in the open economy. The evidence, in our view, points to three major conclusions.

Firstly, there is no evidence that Australia's labour market institutions have had adverse effects on labour market efficiency. In fact, as noted by Isaac (1993) our institutions have been shown to be adaptable and flexible in responding to changed economic and social circumstances. The allegations of rigidity made against the Australian system have been grossly exaggerated (perhaps for effect?) and found to be seriously wanting when the economic evidence is examined.

Secondly, the Australian labour market institutions have been important in terms of fairness and equity. The distribution of income can be influenced by Australian institutions. Any move to minimize their influence through 'deregulation' (or re-

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shows unions and labour market institutions are consistent with an open economy, and can in fact improve an economy's trade performance (see for example, Mishel and Voos 1992).

[17] This report went on to say:

> There are very few studies of the relationship between trade unions and productivity in low-and middle-income countries, but a recent analysis of Malaysian data provides some support for the view that unions can enhance productivity and efficiency... Unionised Malaysian firms tended to train their workers more and to use job rotation to enhance flexibility and efficiency... Unionised Malaysian firms tended to train their workers more and to use job rotation to enhance flexibility and efficiency. They were also more likely to adopt productivity-raising innovations relating to technological change, changing product mix, and reorganisation of work (World Bank 1995: 80).

regulation) has the potential to harm equity in Australia's labour market (with no benefit in terms of efficiency and economic performance).

Thirdly and finally, the fact that Australia's economy is more internationalized is no reason why our labour market institutions can no longer perform their functions. In fact globalisation provides a stronger rationale for more social protection in the labour market not less. As shown by Rodrik (1997), social protection is needed to minimise the adverse effects of globalisation on low skilled workers and is a first best policy option compared to trade protection or other economic isolationist positions.

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