PRODUCTIVITY COMMISSION INQUIRY INTO THE WORKPLACE RELATIONS FRAMEWORK

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DISCLAIMER: All views expressed in this submission are my own.

The standard economic rationale for increasing the flexibility of employment conditions is that doing so will increase the efficiency of the labour market. Such reforms remove the legal barriers that prevent a subset of employers and employees from reaching mutually beneficial arrangements. To the extent that this rationale is correct, increasing labour-market flexibility will tend to increase employment and productivity.

There are, however, two important caveats to this argument. I outline these caveats, and their significance to this enquiry, below. Full derivation of the results, and a more extensive discussion, can be found in Byford (2013).

1. WINNERS & LOSERS

The first caveat concerns the distribution of any gains generated by labour-market reforms. By permitting a wider variety of employment contracts, increased labour-market flexibility systematically advantages those workers who place a low value on the existing rigidities. That is to say, workers who are happy to work irregular hours, or take fewer holidays, become more competitive in the labour market. It follows that these workers are likely to be amongst the winners.

The converse is also true. Workers who value the existing rigidities — for example parents, who benefit when work hours are aligned with school hours — become relatively less competitive. Consequently, they will face downward pressure on their wages. These workers are likely to become worse off if more flexibility is introduced into the Workplace Relations Framework.

In short, it is to be expected that reforms aimed at increasing labour-market flexibility will produce both winners and losers. It would be valuable for the inquiry to carefully examine the impacts of any proposed reforms on a range of households within Australian society.

2. WELFARE LOSS AND THE MINIMUM WAGE

The second caveat is, arguably, more troubling than the first. Where the minimum wage imposes a binding constraint on the labour market, relaxing non-wage minimum conditions of employment can result in a loss of welfare. The mechanism by which this occurs is a classic example of the theory of second best (Lipsey and Lancaster, 1956).

A binding minimum wage implies that some people, willing to work for the minimum wage, are unable to find employment. Absent the minimum wage, competition between potential employees would drive the wage lower, until the number of potential employees equals the number of available positions.

Relaxing non-wage minimum conditions of employment provides potential employees with a means to circumvent the minimum wage constraint. Workers can instead offer to sacrifice negotiable entitlements, such as penalty rates or a period of annual leave. What is troubling here is that a worker may be willing to sacrifice an entitlement, even if the compensation the worker receives is less than the value the worker places on the entitlement. The potential welfare loss is bounded above by the slack the minimum wage creates in the labour market.

It follows that the case for requiring firms to provide non-wage entitlements is much stronger in the neighbourhood of the minimum wage. Retaining rigid labour-market conditions for the lowest paid workers may be welfare enhancing.

CONCLUSION

It has been understood for some time that empirical evidence on the economic benefits of enhanced labour-market flexibility is, at best, ambiguous (see for example Freeman, 2006). More recent developments in economic theory indicate that such reforms may have adverse distributional and welfare effects.

REFERENCES

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