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Australia's workplace relations framework: Institutional considerations

Castalia Strategic Advisors

POLICY PAPER



Australia's workplace relations framework: Institutional considerations

Castalia Strategic Advisors is an international economics and financial advisory firm that helps clients understand and influence the policy and market environment in which they operate. Its mission is to improve the organisation of business affairs and the delivery of public services by applying intelligence and practical experiences.

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Executive summary

Institutional structures for collective bargaining by workers – typically trade unions – play an important role in the performance of labour markets. This paper examines the proposition that greater competition in the provision of bargaining services would better serve the interests of Australian workers.

While the promotion of competition to enhance economic performance has characterised past microeconomic reforms in Australia, in general this philosophy has not been accepted with respect to collective bargaining institutions. The view has tended to be that labour markets are different and that employees require the ‘collective muscle’ of trade unions for effective negotiation. However, there is an equally valid concern that measures which on the face of it protect the collective muscle of workers simply serve to empower trade union officials at the expense of members’ interests.

All institutions face the tension between serving the needs of those on whose behalf they ostensibly operate and resisting capture by self-interested insiders. Economists call this the ‘principal-agent problem’: the pervasive difficulty of ensuring that organisations perform for the benefit of the intended beneficiaries.

Evidence arising from the Royal Commission into Trade Union Governance and Corruption has highlighted some of the unintended consequences of protecting collective bargaining organisations from competitive pressures. However, corruption is simply an extreme expression of the inevitable pursuit of self-interest by organisational insiders when the pressure to perform is weak. In labour market institutions, as in other human endeavours, it is necessary to keep the insiders on their toes.

Competition causes organisations to innovate and to develop new products, services and technologies. Where there are no entrenched positions and guaranteed

privileges, the incentive to pursue self-interested behaviours is weakened.

Australian labour market arrangements restrict meaningful competition between collective bargaining organisations. The entrenchment of insiders operates primarily through the granting of various default rights to trade unions such as the right to act as a bargaining agent, the right to negotiate an award or the right to govern default superannuation funds. The *Fair Work Act* has strengthened union rights and preferences, for example by removing the non-union enterprise bargaining stream originally introduced by the Keating Government in 1993.

In thinking about collective organisations and strategies to influence their performance, the analytical framework developed by Albert O. Hirschman – ‘exit’, ‘voice’ and ‘loyalty’ – provides valuable insights. In essence, Hirschman shows that for collective organisations such as trade unions to function effectively, members should be able to exercise voice (i.e. internal communication such as complaints or voting mechanisms) and exit (i.e. withdrawal from the organisation to take up other options).

Voice alone does not work. Trade union members need the option to exit to alternative service providers; rights that consumers exercise all the time in other markets. This conclusion is supported by economic literature and by evidence unearthed by various public inquiries. It is also supported by new analysis in this paper on the effects of trade unions on worker incomes.

Trade unions that genuinely act in the interests of their members should be able to achieve better outcomes through enhancing productivity and by more nuanced bargaining focused on the needs of their members. If trade unions are effective as collective bargaining organisations, we should be able to observe their ability to increase the employee 'share of the pie' and/or increase the 'size of the pie' by promoting greater productivity.

Interestingly, analysis of Australia's labour market performance shows that:

- Employee share of income over time has not changed materially, despite changes in industrial laws and declines in union membership
- At the industry level, employee share of income bears no relationship with union membership. It is more likely that the share of income is better explained by factors which have nothing to do with collective bargaining, such as capital intensity, risk and skill shortages
- Enterprise agreements (largely negotiated by unions) do not consistently yield better earnings than individual agreements
- Pay rises are similar across both union and non-union members.

In practice, Australia's labour market arrangements provide union members with little opportunity to exit to alternative providers of collective bargaining services. The only meaningful exit option is to opt out of trade union membership altogether. However, this does not necessarily provide an opt-out from union coverage. In other words, the capacity to exit from trade union influence over terms and conditions is constrained.

While union membership has been declining, the proportion of workers covered by union-negotiated enterprise agreements has been increasing. The share of employees in union-covered enterprise agreements has risen from 75 per cent in 2009 to 86 per cent in 2012. It is estimated that trade unions negotiate enterprise bargaining agreements for almost 400,000 more people than belong to unions. With little opportunity to exit to a competing bargaining agent, the exit option available in Australia poses only a limited threat to union insiders.

There is evidence that greater competition in the provision of collective bargaining services would enhance the performance of Australia's labour market. While no country offers a ready-made model that can be imported into Australia, there are lessons to be learned from countries that have created a genuine and useful exit option for workers.

Opening up competition for collective bargaining services is not an anti-union position. Indeed, some employers may find a competitive market for collective bargaining an uncomfortable experience. The experience in New Zealand in the 1990s, for example, is instructive. The removal of entrenched union powers led to a market-shakeout that ultimately benefited both workers and some trade unions.

Introducing greater competition into the market for collective bargaining in Australia would entail:

- Replacing awards with a safety net system of minimum standards, without a special role for unions
- Removing special union rights and preferences in a bargaining context, with equal footing given to alternative bargaining agents
- Removing entrenched union rights in relation to governance of superannuation funds.

1 Introduction

The Productivity Commission's inquiry into Australia's workplace relations framework provides an opportunity to assess if our labour market institutions are working well.

Institutional structures for collective bargaining by workers – typically trade unions – play a particularly important role in the performance of labour markets.

All institutions – such as government agencies, corporations and trade unions – face the tension between serving the needs of those on whose behalf they ostensibly operate – voters, customers, investors, workers – and resisting capture by self-interested insiders. Economists call this the 'principal-agent problem': the pervasive difficulty of ensuring that organisations perform for the benefit of the intended beneficiaries.

More than two decades ago, Australia began a process of devolving greater power and control in workplace bargaining to the level of the enterprise. This was part of a larger process of microeconomic reform aimed at increasing the competitive pressures in the Australian economy, improving its flexibility, responsiveness and productivity. Competition causes organisations to innovate and to develop new products, services and technologies. This is because a truly competitive environment creates a real penalty on managers for not serving the interests of their customers and investors: as both customers and investors leave for alternative organisations, managers lose income, reputation, current jobs and future employment prospects.

However, while the promotion of competition to enhance performance has become pervasive on the employer side of the bargaining table, in general this philosophy has not been accepted with respect to collective bargaining institutions. Various mandated powers, rights and preferences entrench the position of insiders within trade unions and reduce the pressure on the 'agents' – trade union officials – to serve the interests of the 'principals' – workers.

In the Australian collective bargaining system, the entrenchment of insiders operates primarily through the granting of various default rights to trade unions, whether it be the right to act as a bargaining agent, the right to negotiate an award or the right to manage the default superannuation plan. Australia's Fair Work Laws have strengthened such provisions. For example, the 2012 Act explicitly removed the non-union enterprise bargaining stream. The privileged position of incumbent trade union officials in the default superannuation funds further reduces the pressure on officials to perform.

The evidence arising from the Royal Commission into Trade Union Governance and Corruption has highlighted some of the unintended consequences of protecting collective bargaining organisations from competitive pressures. However, corruption is simply an extreme expression of the inevitable

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pursuit of self-interest by organisational insiders that occurs when the pressure to perform is weak. In labour market institutions, as in all other human endeavours, it is necessary to keep the insiders (officials) on their toes.

The common argument against greater openness and competition in the provision of bargaining services is that labour markets are different: trade unions provide a public good on behalf of all employees (regardless of trade union membership) and employees require 'collective muscle' for effective negotiation. The concern is that such collective muscle would be weakened if trade unions did not enjoy entrenched positions. However, there is an equally valid concern that measures which on the face of it protect the collective muscle of workers simply serve to empower the officials at the expense of members' interests.

This paper applies standard institutional analysis to assess the alignment of incentives within Australia's labour market institutions (recognising as John Hicks observed 80 years ago that 'the best of all monopoly profits is a quiet life').¹ On the evidence from Australia's labour market, we examine the proposition that greater competition in the provision of bargaining services and less entrenchment of incumbent positions would better serve the interests of Australian workers. In other words, we ask whether labour markets are really all that different, and whether the lessons learned throughout the economy should be applied in those markets.

The Australian approach to solving the principal-agent problem within collective bargaining institutions has been to focus on giving members an effective *voice* in voting for leadership. However, economic literature, the evidence unearthed by various public enquiries and evidence on the effects of trade unions on worker incomes presented in this paper show that such voice alone does not work. Further pressure on insiders must be provided by giving trade union members greater option to *exit* to alternative service providers, rights that consumers exercise all the time in other markets.

Compared with some other economies, Australia has limited genuine exit options for members dissatisfied with the performance of the institutional insiders in the market for collective bargaining services. The view has tended to be that competitive mechanisms that allow for effective member exit cannot (or

should not) work in relation to trade unions. In practice, exit is primarily the option to opt out. And indeed, union membership has declined, suggesting members are no longer getting value from union services.

Yet despite loss of union members, union influence is increasing. In this paper, we present evidence showing that as union membership has been declining, the proportion of workers covered by union-negotiated enterprise agreements has been increasing. To put it bluntly, the more workers vote with their feet, the more incumbent trade unions are reliant on entrenched rights and preferences to keep them in the market and to ensure their financial viability.

We believe there is strong evidence both from Australia and from other jurisdictions that greater competition in the provision of collective bargaining services would enhance the performance of Australia's labour market. In practice, this means removing the legislated entrenchments and default positions, and exposing incumbent trade unions to the threat of entry by other bargaining agents or other forms of collective organisation (such as the successful non-union track introduced under the Keating Government). Trade unions that genuinely act in the interests of their members should be able to achieve better outcomes both through enhancing productivity and by more nuanced bargaining focused on the needs of their members.

We also firmly believe that this is not an anti-union position. In fact, in our view, the classification of labour market policies as being either pro-employer or pro-labour is fundamentally misleading. Rather, policies with respect to all institutions fall into two categories: those that promote the interests of insiders and those ensuring that no one is safe from the pressure to perform in the interests of the ultimate stakeholders. Exposing collective bargaining organisations to competitive pressure will ensure that they better reflect the long-term interests of members rather than the self-interest of officials. To some extent, this may be in the interests of employers, in the sense that both workers and investors have a common interest in growing the business and enhancing productivity. However, it would be easy to imagine how more competitive and focused bargaining organisations may give employers a run for their money.

This paper is organised as follows:

In section 2, we set out traditional arguments for trade union power and preference in a bargaining context and various institutional features of Australia's workplace relations system whereby union power and preference are maintained.

In section 3, we examine labour market performance in Australia in light of these arguments and these institutional features.

In section 4, we outline a useful framework for thinking about institutions and what they require to function effectively – Albert O. Hirschman's Exit, Voice and Loyalty framework.

In section 5, we examine what international evidence might suggest about competitive bargaining arrangements.

We finish with a summary of our recommendations.

2 Labour institutions in Australia

The common argument against greater openness and competition in the provision of bargaining services is that labour markets are different.

In general, arguments for the entrenchment of union rights found in legislation such as the *Fair Work Act* (and similar laws in other countries) fall into two broad categories:

- Trade unions provide a public good on behalf of all employees, regardless of union membership. Competitive arrangements threaten the financial viability of unions, which will therefore impact all employees. This is the **‘free riding’** argument.
- Employees require collective muscle for effective negotiation. Competition between unions will increase the number of employee representatives and reduce employee bargaining power. This is the **‘collective muscle’** argument.

In this section we take a critical look at these arguments and then review the recent history of the laws governing collective bargaining in Australia against the ebb and flow of concerns about ‘free riding’ and ‘collective muscle’.

2.1 Free riding

Advocates for the special legal position of trade unions argue that unions provide a public good on behalf of all employees, regardless of union membership. Their services include:

- Advocacy for the national employment standards
- Advocacy for awards
- Negotiating enterprise agreements
- Education on national employment standards, awards and enterprise agreements.

Free riding indeed may occur if there is a genuine public good. However, the argument that the outcome of collective bargaining is a public good is not convincing. Since employers have no incentive to pay more than necessary, there is little reason to think they would resist contract provisions which secure better outcomes for those who voluntarily participate in the collective bargaining process, while paying less to those who choose to bargain individually. Hence, in the absence of legislative barriers, trade union services would largely be private goods. An argument that something is a public good can often be less of an analytical observation and more of an attempt to impose that good. What appears to be free riding may actually be an unfulfilled desire to exit from the coverage of union activity.

However, let us assume that there is an element of public good in collective bargaining and that some free riding would occur. Such free riding would mean that a desirable activity would be under-provided. On the other hand, an open competitive environment would enhance performance through providing a genuine exit option (we explain the concept of genuine exit and its relevance to an institutional analysis of labour markets in section 4). So, even if free riding is a problem, the magnitude of the problem needs to be compared with the likely benefit of competition.

The evidence seems to suggest that free riding is a minor problem. Despite rapidly declining union membership, unions continue to provide various services. In part, this is because active provision of these services is their best defence against even further loss of membership. Moreover, one

could argue that the current arrangement is the worst of both worlds: it actually encourages free riding by extending coverage to non-members, while eliminating the benefits of competition.

In practice, we think the free riding problem would reduce if there was genuine competition between providers of collective bargaining services. Workers are reluctant to pay fees to unions that are perceived as being unresponsive to their needs, self-serving and pursuing political agendas. Workers would be more likely to join and pay fees to organisations that were focused on delivering specific collective bargaining services that workers require.

Moreover, the elimination of entrenchment is likely to drive innovation, including innovation in new revenue sources and services. It is particularly inefficient and ineffective to try to subsidise trade unions by giving them special rights to money-making activities, such as provision of superannuation and health services.

2.2 Collective muscle

A second argument for empowering trade unions through special legislative rights is that they use collective muscle to minimise low-cost labour alternatives for employers, improving the overall negotiating power of employees. Arguably, the more 'collective' the agreement – i.e. the wider the coverage right granted to the union – the lower the ability of employers to set workers off against each other. This is precisely why trade unions fought such strong rear-guard action against the introduction of enterprise agreements, as sector-wide awards were seen to reduce competition both between workers and between firms (competition between firms makes them less able and willing to employ workers on the same basis).

There is a fear that without collective muscle capital holders will exploit competition between employees. Employees who compete with other workers ('scabs') won't have negotiating power, and will therefore have no choice but to accept any agreement offered by employers. The effect will be that capital holders would take more than their 'fair share' of income at the cost of the employees.

The argument is that by implementing a policy that allows for effective 'exit' from trade unions, collective muscle will be undermined.

While the collective muscle argument appears to make intuitive sense, it ignores the reality of how labour markets work. If employers compete for

workers with required skill across different sectors, the ability to force more workers into a collective agreement will make little difference to bargaining power. The workers' bargaining power is determined by the underlying market conditions. Instead, the more 'collective' the agreement, the less nuanced it will be to the needs of particular workers and their employers. In other words, the wider the coverage of an agreement the lower is the ability of the participants to identify mutually beneficial solutions.

On the other hand, if there is a genuine over-supply of labour such that employees need to keep workers from competing with each other, then any exercise of collective muscle to the extent that it helps incumbent employees does it at the expense of unemployed workers.

In practice, our analysis of the Australian labour market over the long term (presented in section 3) shows that collective muscle is the least important component of collective bargaining. Increased competition between businesses, including competition for workers, has largely eliminated any benefit to be derived from uniformity in bargaining, and has instead turned such uniformity into a cost both to workers and their employers.

2.3 Labour market 'design' in Australia and union preference

The middle of the 20th century in Australia following the Second World War was generally a time of entrenchment of incumbent positions, both in labour and goods markets. Reforms over the past two decades have altered, and in some areas lessened, the formal power of unions in Australia's industrial relations system. Even so, unions retain a number of special powers, rights and preferences within Australia's workplace relations framework. While Australian businesses have been progressively exposed to more competition, there have been both forward and backward steps in relation to the position of insiders in collective bargaining.

Until the early 1990s, individual employees had no voice in Australia's industrial relations. Unions were the 'parties principal' to award negotiations, regardless of actual membership. Employees had no choice over their involvement in the union or the outcomes it lobbied for. Compulsory unionism through 'closed shop' employment contracts was common.

Keating Government reforms under the *Industrial Relations Reform Act 1993* saw a move from a tribunal-based to a more negotiation-based framework, with an opportunity for enterprise agreements with unions operating as representatives of employees. The 1993 Act established a two-stream agreement framework. The first stream facilitated the making of union certified agreements, while the second stream provided for the making of non-union enterprise flexibility agreements (EFAs) between corporations and their employees.

The Howard Government's *Workplace Relations Act 1996* facilitated a further shift towards enterprise bargaining. It maintained the union and non-union agreement streams while also introducing statutory agreements (called Australian Workplace Agreements) between an employer and individual employee. In addition, new 'freedom of association' provisions ensured that earlier provisions granting preference to unions and union members were now unlawful.

Further changes by the Howard Government under the *Workplace Relations Amendment (Work Choices) Act 2005* took deliberate steps towards instituting a national system of workplace relations. It provided for new types of agreements (notably, employer greenfields agreements), buttressed the role of individual statutory agreements and no longer used awards as the benchmark for agreements. Certain statutory minimum conditions applied to the parties to a workplace agreement.

The *Fair Work Act 2009* solidified the move towards a national framework but, unlike Work Choices, it decreed that collective bargaining would be at the heart of the system with unions having default bargaining status. The Rudd Government changes not only abolished any possible recourse to individual statutory agreements, they also abolished the distinction between union and non-union enterprise agreements that had been in place since the Keating Government reforms of 1993.

There are currently 45 unions, or 'employee associations', registered under the *Fair Work (Registered Organisations) Act (2009)* (RO Act). Their unique rights include, but are not limited to:

- **The right to apply for a permit to enter the enterprise premises** to represent their members in the workplace, hold discussions with potential members and investigate suspected contraventions (FW Act s480). Workers cannot engage a support person

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(like a parent, friend or relative) to enter the workplace to conduct interviews or inspect documents unless they are a member of a registered organisation

- **The right to take protected industrial action if they are 'covered' by an enterprise agreement** (FW Act s409(b)(i)). Individuals or small groups of employees theoretically have the right to apply for protected industrial action. However, in practice, ready access to the Fair Work Commission (FWC) and knowledge of the Act mean that trade unions are the only entities in a position to take advantage of this legislative framework
- **In the case of greenfield sites, the right to represent the industrial interests of a majority of the employees who will be covered by the agreement**, in relation to work to be performed under the agreement (FW Act s187, s53(2))
- **The right to act as the default bargaining representative** of its members (FW Act s176) and for employees in a proposed multi-enterprise agreement if the employee organisation applied for the low paid authorisation
- **The right to apply to vary, revoke or make modern award** (FW Act Vol 1 s158)
- **The right to appear before the FWC on behalf of an employee**. A lawyer or paid agent representing an employee may only appear with permission (FW Act s539, s596).

In a bargaining context, the default position is that a union will be a member employee's bargaining representative unless the employee appoints someone else. An employee may represent him or herself, but must go through the formal process of nomination in writing to do so.

Where an employee appoints a bargaining representative outside the default arrangements, the appointment is effected by an 'instrument of appointment' which sets out in writing the party's nominated representative and the date on which the appointment is to come into force (FW Act s178).

In effect, trade unions face little competitive pressure from other forms of collective or individual bargaining. While there is theoretical potential for competition among the unions, the culture of the union movement (as well as formal integration through the national union bodies) and the fear among employers of destructive demarcation disputes prevent such competition.

3 Labour market performance

Notwithstanding the central role labour institutions play in our economy, surprisingly little economic analysis has emerged in recent times to inform the Productivity Commission inquiry into Australia's workplace relations framework.

This section tests some of the untested assumptions surrounding the role and impact of trade unions in our labour market.

If trade unions are effective as collective bargaining organisations, we should be able to observe their ability to:

- Increase the employee 'share of the pie'. In other words, the stronger the collective bargaining institutions, the greater the proportion of total factor income that should be captured by labour compared with capital
- Increase the 'size of the pie' by promoting greater productivity.

In our view, Australia's labour market evidence strongly suggests that, despite their celebrated history, trade unions have only made a limited contribution to helping workers to capture a greater share of available income or to promote greater economic growth. Moreover, there is no obvious evidence that periods when trade unions enjoyed greater protection of their 'collective muscle' were periods when workers received a greater share of the pie.

3.1 Capturing share of the pie

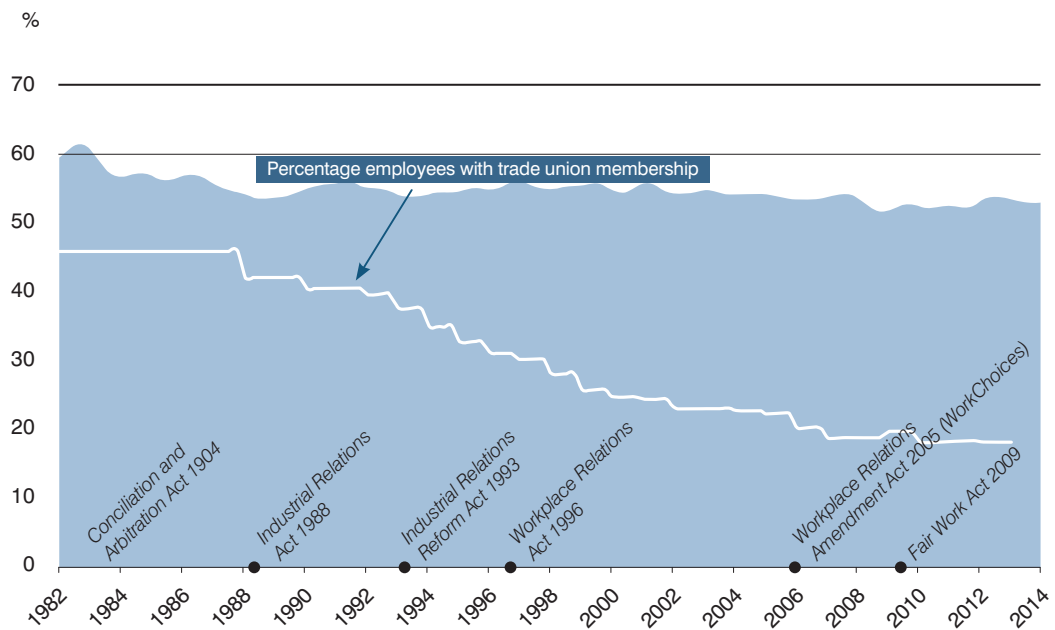
Income will always be shared between employees and capital owners. Unions exist, in part, to ensure that capital owners do not extract an 'unfair' share of this total factor income. However, there is very little evidence to suggest that unions increase the share of compensation for employees.

In summary:

- Employee share of income over time has not changed materially, despite changes in industrial laws and declines in union membership
- At the industry level, employee share of income bears no relationship with union membership. It is more likely that the share of income is better explained by factors which have nothing to do with collective bargaining, such as capital intensity, risk and skill shortages
- Enterprise agreements (largely negotiated by unions) do not consistently yield better earnings than individual agreements
- Pay rises are similar across both union and non-union members.

Employee share of total factor income is a useful indicator of union effectiveness. Chart 1 shows that since 1984, the share of employee compensation as a proportion of Australia's total income has been relatively stable at 55 per cent, despite the to-and-fro of labour market reforms and a decline in union membership. Since 1984, the Australian economy has gone through wide-ranging economic reforms. Most sectors of the economy have been opened to substantially greater competition. A common narrative is that this period has seen the triumph of 'neo-liberalism', which promotes the interests of capitalists at the expense of the workers.

Chart 1 Employee compensation as share of total factor income



Source: Australian Bureau of Statistics, Cat. nos. 5206.0 and 6310.0

Clearly, the remarkable constancy in how national income is shared between workers and capital owners belies this narrative. More importantly from the perspective of our analysis, over this period various reforms have ‘nudged’ labour market institutions in different directions: sometimes giving trade unions somewhat greater power, sometimes reducing it.

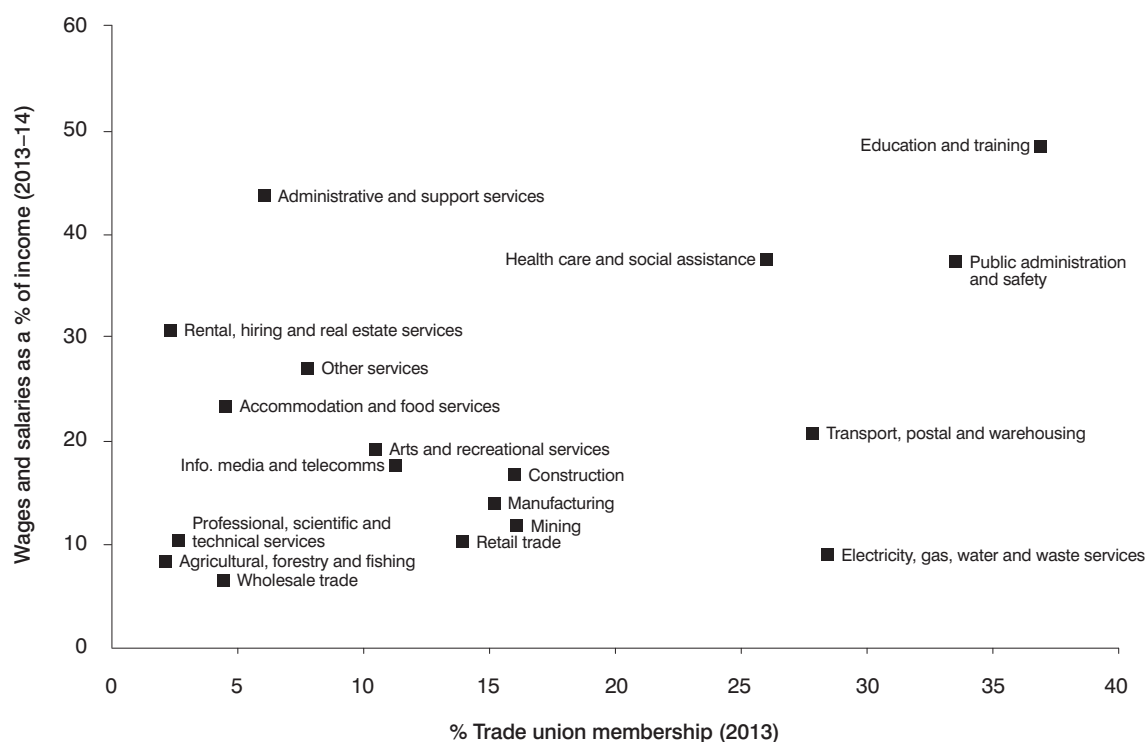
Yet there is no correlation between the share of income captured by workers and the supposed periods of pro-union (Labor governments) or anti-union (Coalition governments) bias. Employee share of total factor income over time has not changed, despite changes in industrial laws and declines in union membership.

Similarly, there also appears to be no correlation between employee share of income and union membership across different industries.

If trade union use of industrial muscle was effective, we would expect that a greater share of income would be captured for workers in sectors with greater union strength. Chart 2 plots trade union members as a proportion of all employees in an industry against wages and salaries as a percentage of industry income.

- The two industries with the highest proportion of wages to return on capital have vastly different union membership. The share of income is relatively similar in ‘Administrative and support services’ (47 per cent and 49 per cent, respectively), yet union membership is starkly different (6 per cent and 37 per cent, respectively)
- Two industries with the lowest proportion of wages also have vastly different union

Chart 2 Association between trade union membership and wages and salaries as a percentage of industry income



Source: Australian Bureau of Statistics, Cat. nos. 6310.0 and 8155.0

membership. The share of income is similar in 'Wholesale trade' and 'Electricity, gas, water and waste services' (7 per cent and 9 per cent, respectively), yet union membership is of different scales (29 per cent compared with 4 per cent).

One possible explanation for the lack of correlation between income shares and union strength is that various labour market policies that entrench trade union positions even if their membership is low serve to equalise industrial muscle, so that the level of trade union membership in a sector does not matter. In that case, the share of income captured by workers in each sector would simply depend on underlying market conditions and the capital intensity of that sector.

However, while entrenchment of bargaining

rights gives trade unions significant powers even with low membership, it would be reasonable to expect that strong membership should systematically enhance those basic powers.

Again, the cross-sectional data seems to agree with the longitudinal data in indicating the limited effectiveness of trade unions. At the industry level, employee share of income bears no relationship with union strength.

Another striking result emerges from our analysis of Australia's labour markets. Earnings data disaggregated by occupation and industry reveal that collective bargaining does not always yield a superior outcome to individual agreements, regardless of the proportion of employees engaged through this arrangement.

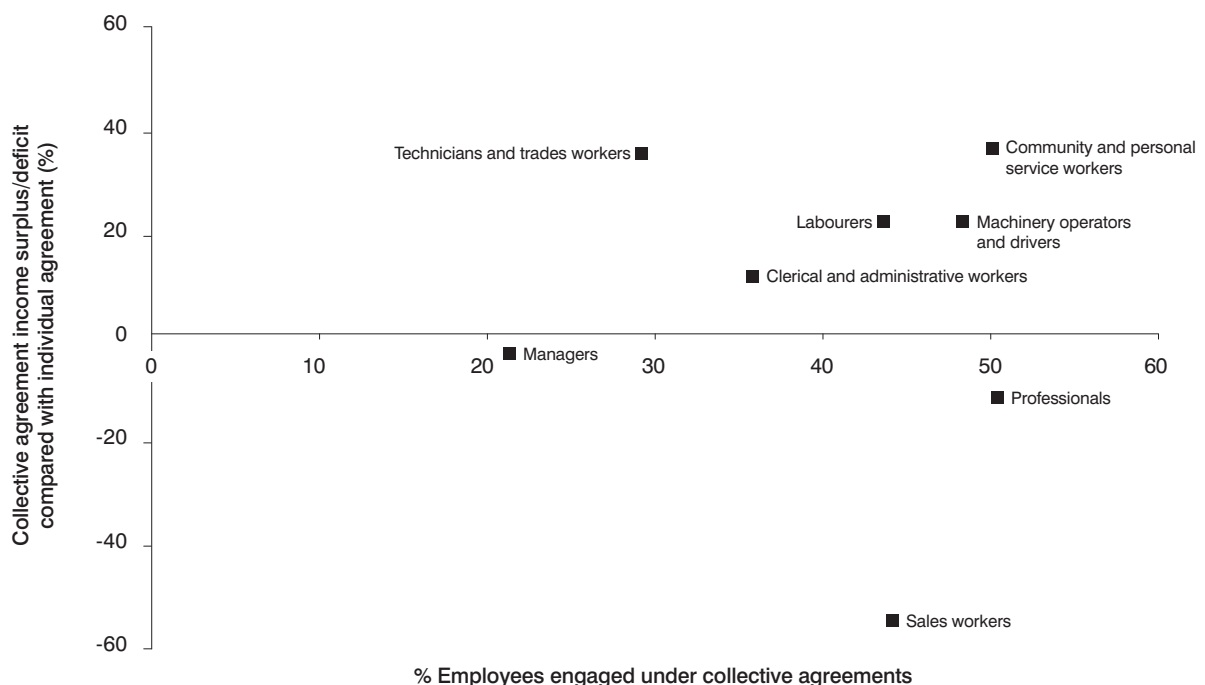
Chart 3 shows the differences in incomes across occupations for individuals involved in collective bargaining compared with individual agreements. As an example, it shows how a significant number of 'Sales workers' are engaged through a collective agreement (44 per cent), but their weekly earnings are 54 per cent lower than those engaged under an individual agreement. 'Managers', 'Professionals' and 'Clerical and administrative workers' appear to achieve similar outcomes under individual agreements as they do under collective ones.

Earnings across industries also reveal mixed outcomes (Charts 4 and 5). In a number of industries, there is a small difference between earnings for employees engaged under an enterprise agreement compared with employees engaged under an individual agreement. For employees in the education and training sector, with similar union

membership and equivalent overall wages, the earnings of those under an enterprise agreement are significantly higher than those under an individual agreement. In mining, the opposite is true.

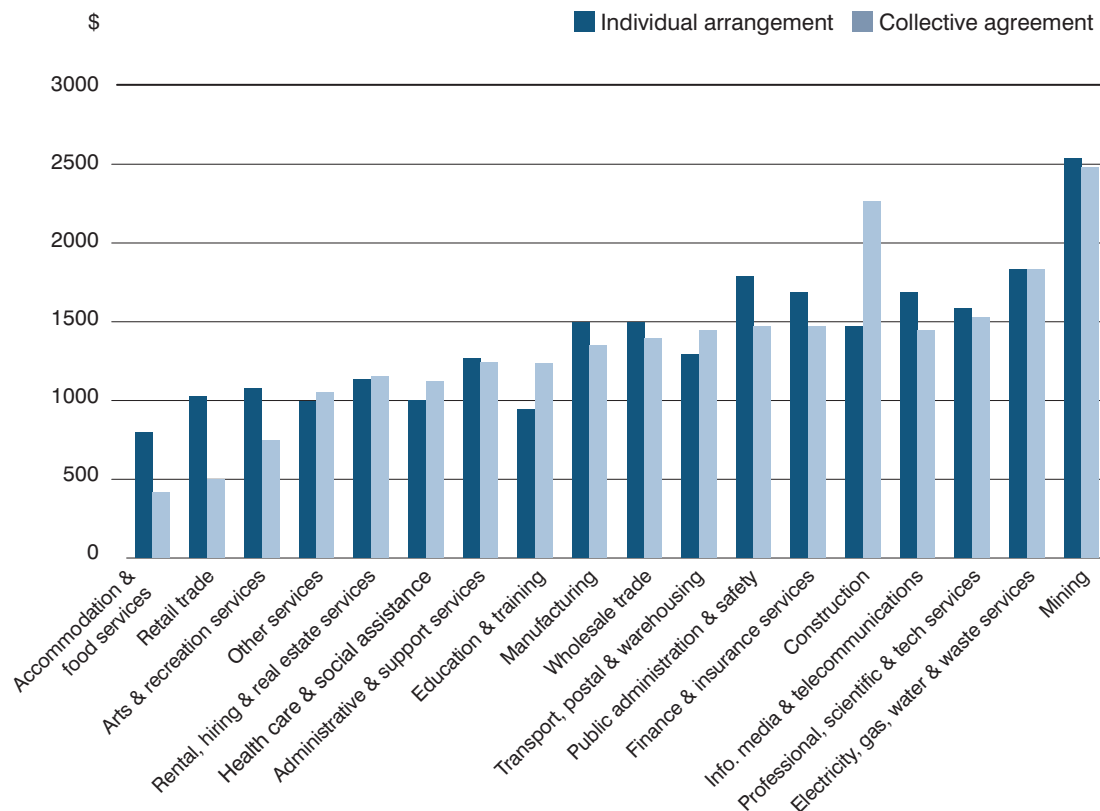
It is possible to argue that trade unions set the floor for conditions through collective negotiations, so that individual agreements are marked to collective agreements. In other words, the lack of systematic differentiation between the success of workers under collective and individual agreements may reflect the wider externality of trade union performance, rather than their relative ineffectiveness. However, if that were the case, we would still expect to see stronger correlations. For example, if collective agreements set the floor, all workers on individual agreements should systematically earn more.

Chart 3 Occupations, collective agreements and incomes (2014)



Source: Australian Bureau of Statistics, Cat. no. 6306.0

Chart 4 Weekly earnings across industries, sorted by earnings (2014)

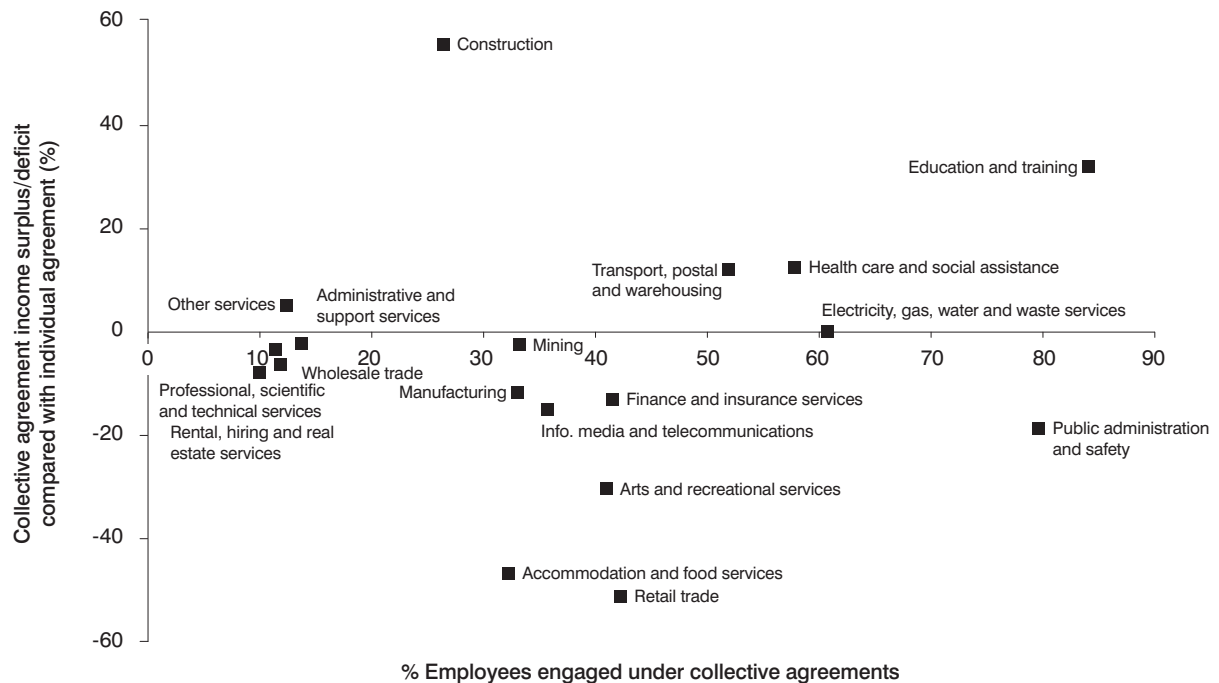


Source: Australian Bureau of Statistics, Cat. no. 6303.0

In our view, the evidence that workers outside union-based collective agreements often earn more than their unionised colleagues is telling and belies arguments about industrial muscle. We think it is reasonable to assume that employers would not willingly pay more than they have to. By paying more to workers outside the collective bargaining system, employers are signalling that there is value created by dealing directly with workers and keeping the unions out, and that this value is shared between the two sides to the bargain. In other words, the exercise of ‘collective muscle’ – if it works at all – appears to work against the workers’ interests by reducing efficiency.

“
...the evidence that workers outside union-based collective agreements often earn more than their unionised colleagues is telling and belies arguments about industrial muscle.
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Chart 5 Industries, collective agreements and incomes (2014)



Source: Australian Bureau of Statistics, Cat. no. 6306.0

3.2 Growing the size of the pie

What about the potential for unions to increase the size of the pie? In fact, there is little evidence to suggest trade unions have been effective in contributing to the growth of their members' incomes over time.

The first point to note is that pay rises across both union and non-union members have been similar.

Over the last 15 years, the weekly earnings of union members have increased at similar rates to non-union members: 94 per cent for trade union members compared with 97 per cent achieved by non-trade union members.² There is further evidence of benefits from not being a trade union member. As shown in Chart 6, increases in union earnings appear to lag non-union member earnings by one year. This makes intuitive sense. Securing pay rises

through collective bargaining often involves lengthy negotiation processes.

We also find no long-term correlation between growth and union strength.

Chart 7 shows the average annualised change in total factor income, adjusted for inflation. Australia's labour reform policies and union membership numbers have not had a marked impact on overall income.

The premise for the expectation that trade unions should be able to enhance worker incomes is that industrial relations is, in essence, a battle over economic rents and collective muscle is required to ensure that labour secures a 'fair share'. There was a time when there was a logic to this thinking, but economic reforms – trade liberalisation, competition policy, privatisation, effective regulation of monopolies – have all resulted in increased competition and

Chart 6 Annual increase in average weekly earnings



Source: Australian Bureau of Statistics, Cat. no. 6310.0

therefore the elimination of rents across much of the economy.

The constancy in the share of labour income to the income of capital suggests that the elimination of rents has affected labour and capital about equally. Trade unions could claim that they have played an important role in protecting workers as market competition intensified. However, the evidence appears to indicate that unions have not been as effective in securing better incomes for workers as the labour mythology would suggest.

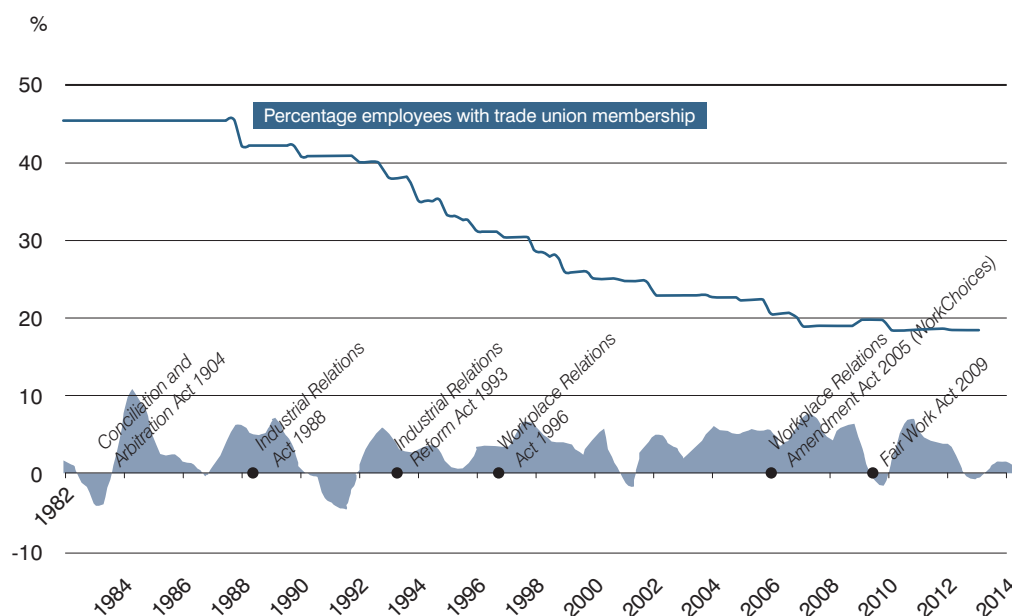
To some extent, this can be explained simply by underlying economic forces. Since capital is highly mobile, it would only be attracted if it can earn its opportunity cost: the amount it could earn elsewhere after adjusting for risk. No amount of effective bargaining would give workers a greater share of income than would be possible without driving the return on

capital below its opportunity cost. If that were the explanation—that labour market outcomes were simply driven by labour market conditions rather than the participating institutions—then there would be little argument for retaining the complex structure of collective bargaining arrangements.

However, we think it is more likely that collective bargaining does make a difference. Depending on the performance of the collective bargaining agents, this difference could be both positive and negative. The performance of the agents, in turn, depends on their incentive to perform. The Australian labour market evidence is consistent with relatively poor performance by trade unions compared to what could be possible.

As we do throughout this paper, we think it is valuable to draw logical parallels with other economic sectors. In the absence of competitive pressure, companies do not

Chart 7 **Average annualised change in total factor income, adjusted for inflation**



Source: Australian Bureau of Statistics, Cat. no. 6310.0

innovate or seek to capture new opportunities as much as they would otherwise. Conversely, firms that fail to innovate in a highly competitive environment die: note, for example, the respective share prices of BlackBerry and Apple today versus 10 years ago. Similarly, there is a significant risk that, in the absence of competition, trade unions aim for a comfortable life. For example, if trade union bargaining power is entrenched regardless of the level of membership, the fear of loss of membership associated with relatively poor bargaining performance would not be such a powerful motivating factor for union officials as it would have been if loss of membership directly translated into them losing their position.

It is not surprising that the battlegrounds of modern day industrial relations are sectors where rents are still perceived to be available (such as the public sector) or where the characteristics of the enterprise facilitate coercive behaviour (such as construction sites). However, even in sectors without

significant economic rents, effective bargaining organisations may still be able to influence the allocation of gains to some extent, and should be able to promote income growth through greater productivity.

The absence of evidence for such effectiveness from Australian trade unions supports the view that current institutional arrangements are more likely to serve the interests of the insiders than of the ostensible beneficiaries of trade union activities.

4 Institutional performance: an analytical framework

To interpret the effects of labour market institutional arrangements and their changes over time, we need an analytical framework that helps us see what these arrangements are achieving.

The framework developed by Albert O. Hirschman in his book *Exit, Voice, and Loyalty* provides a particularly useful way of thinking about institutions and what they require to function effectively.³

Hirschman's key insight is that members of an organisation/relationship, whether in a market or non-market setting, have two possible responses when they believe that the relationship is deteriorating in terms of quality or benefits to members. These are:

- **Voice:** attempt to improve the organisation/relationship through various means of communication including complaints, grievances or proposals for change
- **Exit:** when the member withdraws or removes themselves from the organisation/relationship.

For example, customers can complain to companies about the service they receive, or they can just go to another service provider. Switching to a competitor (exit) can influence a company in a way that complaints may not. Similarly, in the political sphere, citizens can vote to change government policies or they can migrate to other countries. In some instances, emigration (exit) may influence governments in ways that voting (voice) cannot.

Hirschman suggests that there are two determinants for a member's readiness to resort to voice when exit is possible:

- The extent to which customer-members are willing to trade off the certainty of exit against the uncertainties of an improvement in the deteriorating products

- Customer-members' assessment of their ability to influence the organisation.

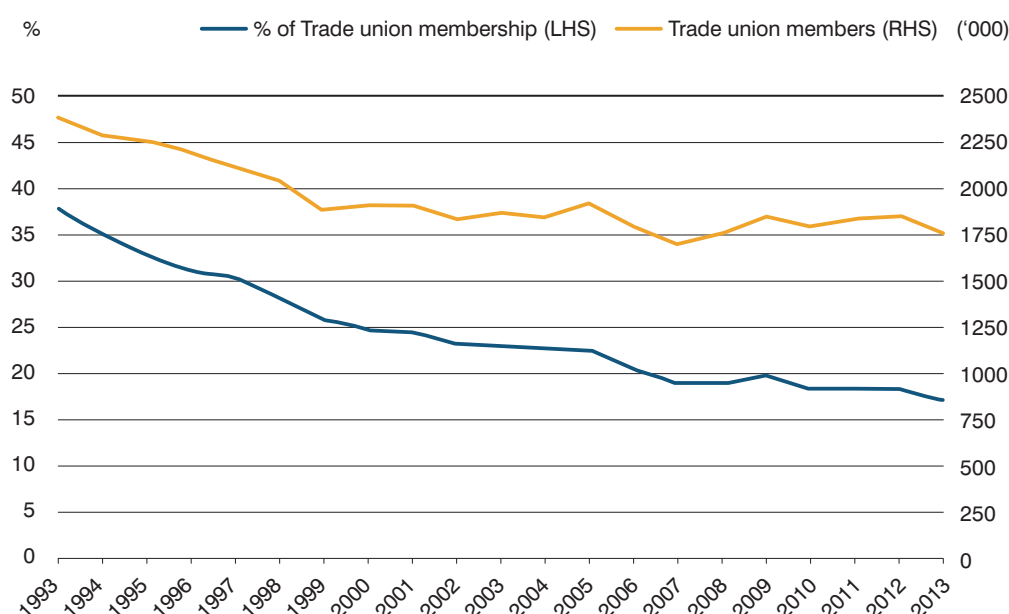
Loyalty is a key feature of the framework, since it affects the readiness of a member to resort to voice when exit is an option. Members with low loyalty would more likely exercise the exit option, while those with high loyalty would seek to exercise voice before exiting.

Hirschman argued that collective organisations such as trade unions require exit *and* voice to coexist in a functional manner. Thus, a member of a union should be able to exercise either one of these responses when they are dissatisfied with the union. Effective exit opportunity, together with loyalty, will lead to high-quality exercise of voice. In Hirschman's framework, voice alone does not work.

4.1 Voice and exit in Australian trade unions

A key and consistent feature of the Australian institutional framework for collective bargaining is that it has focused on providing channels for the exercise of voice by trade union members, while leaving little opportunity to exit to alternative providers of collective bargaining services. The only meaningful exit option is to opt out of trade union membership altogether. However, there is only limited practical ability to exit from trade union influence over terms and conditions. At present, trade unions negotiate enterprise bargaining agreements for 400,000 more people than belong to the unions.

Chart 8 Employees with trade union membership in main job



Source: Australian Bureau of Statistics, Cat. no. 6310.0

Voice

The RO Act encourages members to express their voice in Australian unions. Union members can either exercise their voice through elections or, at the extreme, through plebiscites.

The RO Act states that the rules of an organisation must provide for the election of office holders.⁴

- Under subsection 182(1) of the RO Act, elections for offices in registered organisations or their branches must be conducted by the Australian Electoral Commission (AEC) at the expense of the Commonwealth.
- Under section 186 of the RO Act, the General Manager of the Fair Work Commission may exempt a registered organisation, on specific grounds, from the requirement that the AEC must conduct the elections held by that organisation. The General Manager can revoke the exemption on application from an organisation's committee of management or on the grounds of dissatisfaction with the rules, but otherwise the exemption continues indefinitely.

- Section 190 of the RO Act states that a registered organisation must not assist one candidate over another.

In extreme cases, plebiscites can be used to control the decisions of the union. For example, disaffected members of the international division of the Flight Attendants Association of Australia secured majority support for a 12-point plebiscite in November 2014. The points included a 25 per cent discount on union fees for lower paid Qantas Cabin Crew Australia staff working part-time, as well as a ban on all communication with Qantas by the union's divisional secretary.⁵

Exit

Freedom of association has existed for more than 20 years. Over the time, union membership has declined, suggesting members are no longer getting value from union services. In the early 1990s, about 40 per cent of wage and salary earners in Australia were union members. By 2013, only about 17 per cent of wage and salary earners (less than 1.8 million people) were members of unions, as shown in Chart 8.

Again, the key point to note is that exit is primarily the option to opt out of union membership altogether. There is little opportunity to exit to a competing bargaining agent. In other words, the exit option available in Australia places only a limited threat over insiders.

Union cover

Despite loss of union members, union involvement and influence in labour market arrangements seems to be increasing. By 2012, the share of employees in union covered enterprise agreements was 86 per cent, up from 75 per cent in 2009 (Chart 9).

The number of employees covered by a union enterprise agreement now exceeds the number of union members in Australia. This is a reversal of what had been the case until recently. In 2009, there were almost 300,000 more union members than employees covered by union enterprise agreements. By 2012, there were almost 400,000 more employees covered by a union enterprise agreement than union members.

A further aspect of union cover is the ability of workers to exit from trade union-dominated industry superannuation funds. While clearly the

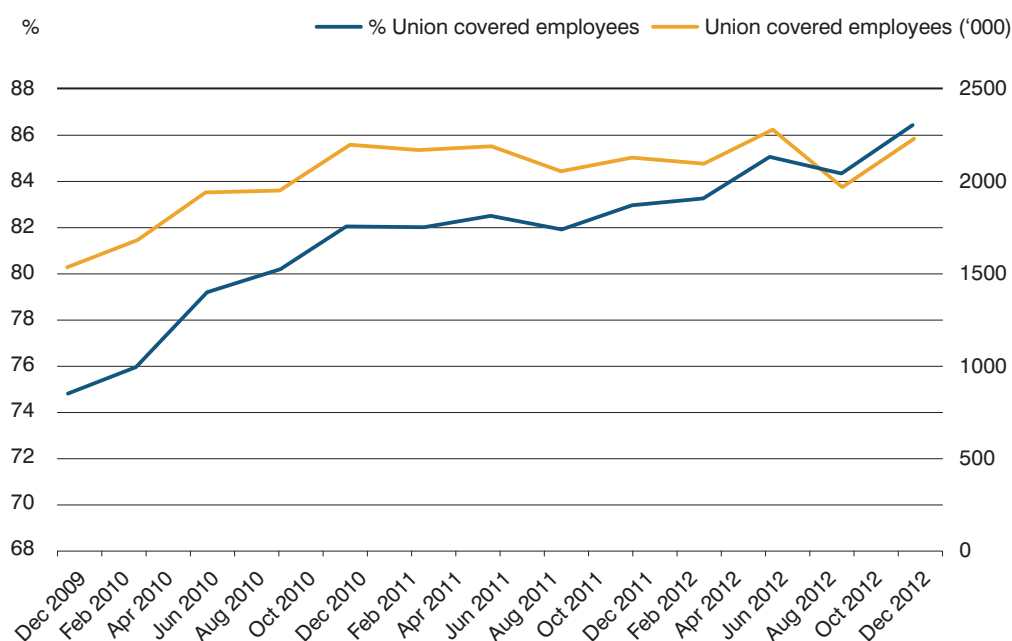
Australian framework places no restrictions on a workers' right to choose their superannuation fund, it is also clear that most workers struggle to make an informed choice and tend to rely on the default fund offered by their employer. To the extent that enterprise agreements require that the industry superannuation fund be the default fund, they tend to entrench insiders (including union insiders on super fund boards).

As Chart 10 shows, for about half of Australian employees effective choice with respect to their superannuation fund is curtailed through their employment agreement.

We would argue that requiring the industry fund to be the default superannuation fund is akin to product bundling and tying: measures which fall afoul of our competition laws.

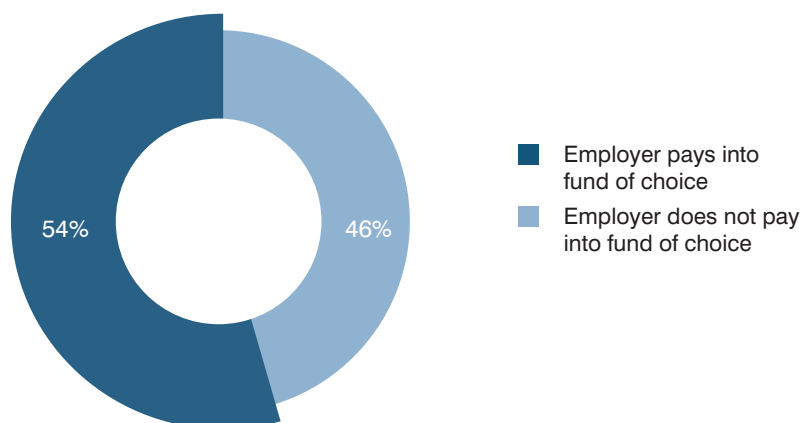
In general, the institutional framework for Australian labour markets restricts meaningful competition between collective bargaining organisations. In fact, it is almost deliberately designed to allocate protected patches to various incumbents. Valid concerns about demarcation disputes (which have accounted for a proportion of industrial action in the past) have resulted in a virtual allocation of franchises to various trade unions.

Chart 9 Employees in union covered enterprise agreements



Source: Department of Education, Employment and Workplace Relations (at Dec Qtr 2012)

Chart 10 Choice in superannuation funds (2009)



Source: Australian Bureau of Statistics, Cat. no. 6361.0

In this environment, the exercise of voice becomes the only tool to influence non-performing organisations. However, as various public inquiries have revealed, voter manipulation techniques make voice a very weak tool. The Australian experience confirms Hirschman's insight that voice is not a substitute for exit. Rather, voice only becomes truly effective when supported by the threat of exit. In the Australian labour market, the only exit option is to opt out from union membership, which does not necessarily provide an opt-out from union coverage.

Overall, we find that Australian institutional design, which gives limited effective ability to workers to influence the performance of trade union insiders (as opposed to nominal voting arrangements and apparent external supervision), is consistent with the evidence on the apparent poor performance of trade unions as bargaining agents.

4.2 Institutional alternatives

The starting point for this analysis is that competition causes organisations to innovate and to develop new products, services and technologies. In turn, customers are given greater choice and better products. The key purpose of competition in markets is to ensure that no insider has a comfortable life. Where there are no entrenched positions and guaranteed privileges, the incentive to pursue self-interested behaviours is weakened.

At a high level, it is easy to see how this concept can be translated to labour markets. There is a demonstrable need to keep the institutional insiders on their toes and to stop them from pursuing self-interested or political agendas.

Competition between trade unions (and other collective bargaining agents) would provide genuine exit options for workers: workers could choose which bargaining agent to use, or whether to have a bargaining agent. Competition for bargaining services would allow for constant churn of alternatives and genuine innovation.

We hold strongly to the view that open competition for collective bargaining services is not an anti-union concept. Introduction of competition inevitably leads to a shake-out, so it is tough on incumbents. But once the old non-performers are cleaned out, competitive markets tend to consist of much stronger participants than the non-competitive ones. We would expect those trade unions that make it in the face of genuine competition would be stronger and more effective than existing unions.

In fact, we would expect that some employers may find a competitive market for collective bargaining an uncomfortable experience.

More importantly, managers at firms often develop cosy relationships with trade union officials. Just as trade union officials are imperfect 'agents' for their principals – workers – so managers are imperfect 'agents' for the shareholders. Both sets of agents prefer the quiet life. Increasing

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A key and consistent feature of the Australian institutional framework for collective bargaining is that it has focused on providing channels for the exercise of voice by trade union members, while leaving little opportunity to exit to alternative providers of collective bargaining services.

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pressure from the ‘principals’ to perform could be uncomfortable to both sides of the relationship.

Activism of union members may increase with genuine competition. For example, shareholder activism has evolved because of competition between investment options.

In a practical sense, what measures would be needed to create genuine competition in the provision of collective bargaining services?

We would highlight the following:

- Trade unions and bargaining agents should only be able to negotiate agreements for their members or for employees who have, in some way, actively opted into that agreement. In this sense, there could be no ‘award’ or ‘enterprise’ agreement as an abstract negotiation that does not involve people (or businesses) who would be affected by it. This does not mean that there is no role for modern awards as sector-specific sets of minimum terms and conditions. However, the process for setting such awards should take into account that numerous bargaining agents representing different groups of potentially affected workers may have an interest, including a wide range of unions that are not necessarily currently representing members in that sector, but wish to enter the market competitively. In other words, the setting of award terms would be led by a public body, with wide consultations with the affected workers and businesses, and their current and potential representatives.
- In practice, the Fair Work Commission currently operates as a mix of an arbitration body, overseeing award negotiations between employers and employees, and an independent regulator. Experience from other sectors of the economy suggests that an independent regulator model – where minimum conditions are set against clear criteria with stakeholders able to make submissions to the regulator – would be a better approach.
- Similarly, while no single union or bargaining agent should be able to negotiate a binding enterprise agreement that applies to all workers whether they are members or not, employers should be free to use the results of a negotiation with a union to apply to all workers at the enterprise, unless such workers explicitly choose to negotiate separately.
- No enterprise agreement or award should include terms that give preference to any particular union or bargaining agent, such as rights of access, leave for union representatives or provision of the default superannuation fund.
- An employer should be obligated to negotiate with any agent or union nominated by its employees or a group of employees.

5

International experience

Australia is not unique in struggling to find the right institutional design for its labour markets. Other countries have faced similar challenges.

No country offers a ready-made successful model that can be imported into Australia. Yet we can learn from the experience of other countries in promoting open competition between providers of collective bargaining services to workers – that is, in creating a genuine and useful exit option for workers.

This section looks at two countries. First, we examine labour market reforms and performance in New Zealand. New Zealand is interesting because it shares a common labour market with Australia and until about 20 years ago had a very similar approach to institutional arrangements in the labour market. For example, both countries maintained a structure of awards.

Unlike Australia, New Zealand underwent radical labour market reforms in 1991, in effect creating an open competitive market for bargaining agents and putting collective and individual bargaining on a similar footing. While those reforms were rolled back to some extent by the Clarke Labour Government, the experience of that period provides an interesting indication of what is possible in Australia. Moreover, even with the Clarke roll-back, New Zealand provides greater competition for bargaining agents and has eliminated the award structure.

Second, we compare labour market outcomes across the United States between the so-called ‘right-to-work’ states and other states. The United States has its own unique legal and institutional arrangements which cannot be transplanted to Australia. However, given the similarity in other institutional arrangements between states, as well as the role of the Federal regime, the difference in labour market performance between states with and without right-to-work legislation is a natural experiment on the effects of open competition for the provision of bargaining services.

5.1 New Zealand

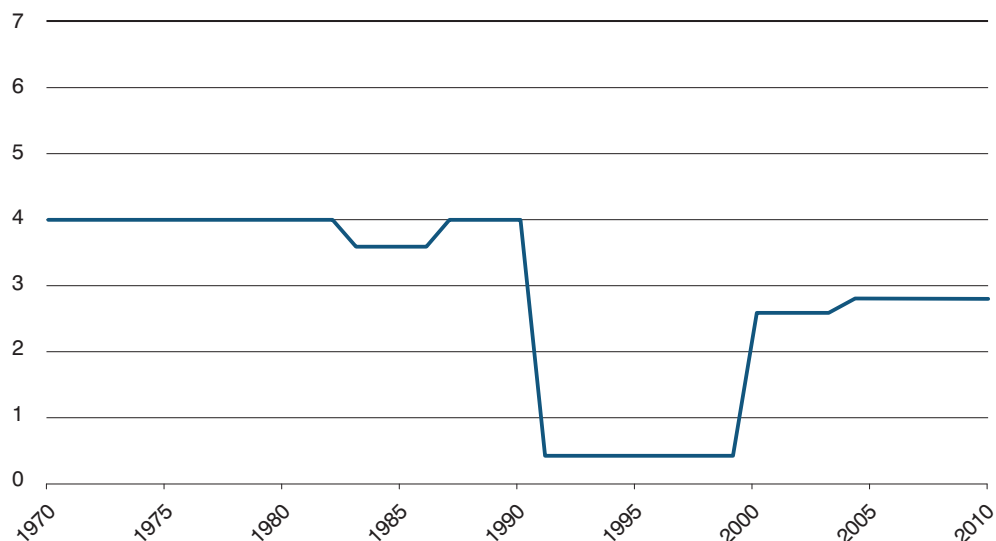
New Zealand has experienced a succession of major reforms to its labour law since the 1970s.

New Zealand operated systems of compulsory arbitration since the late 1800s with the primary legislation being the *Industrial Conciliation and Arbitration Act 1894*, which was in force up to 1974. It was enacted by the Liberal Government of New Zealand and was the world’s first compulsory system of state arbitration. It gave legal recognition to unions and enabled them to take disputes to a Conciliation Board, consisting of members elected by employers and workers. It was amended twice – 1936 and 1961. Amendments focused on the right to strike and whether unionism and arbitration should be compulsory.

The *Industrial Relations Act 1973* was introduced to distinguish and manage disputes of interest and disputes rights. It also reinstituted the basic structure of the conciliation and arbitration system and allowed registered employee representatives and unions to opt to bargain directly with employers and to allow courts to enforce any agreement reached. The Act was amended in 1984 (*Industrial Relations Amendment Act 1984*) and compulsory arbitration abolished. In 1985, compulsory unionism was introduced again and was subject to regular ballots of workers (*Industrial Relations Amendment Act 1985*).

The *Labour Relations Act 1987* replaced the *Industrial Relations Act* and increased unions’ relative power while at the same time decentralising bargaining to the ‘enterprise’ (firm) level. Specifically, unions could choose whether to cover their workers with either an award or registered agreement, with return to the parent award being subject to the

Chart 11 Employee representation sub index (1970-2010), New Zealand



Source: G. Anderson et al. (2011), see endnote 8

consent of the employer. The one exception to this rule was the case of composite bargaining where a reduction in the number of bargaining units could be demonstrated. In effect, the statute sought to encourage the rationalisation of bargaining structures, which had been based on the highly fragmented, craft configuration of New Zealand trade unions. Registered unions were also required to have a minimum membership of 1,000, which led to a number of amalgamations between unions. The right to strike lawfully was also created.⁶

The most significant of New Zealand's labour law reforms was the *Employment Contracts Act 1991* (ECA). Under this Act, the system of industry and occupation awards was eliminated, compulsory union membership and union preference outlawed, and non-collective bargaining was introduced. The scope to lawfully strike was restricted to those who would be covered by a proposed agreement and industrial action was permitted only after an existing agreement had expired.⁷

The *New Zealand Employment Relations Act 2000* (ERA) replaced the ECA. The Act:

- Strengthened the role of unions by

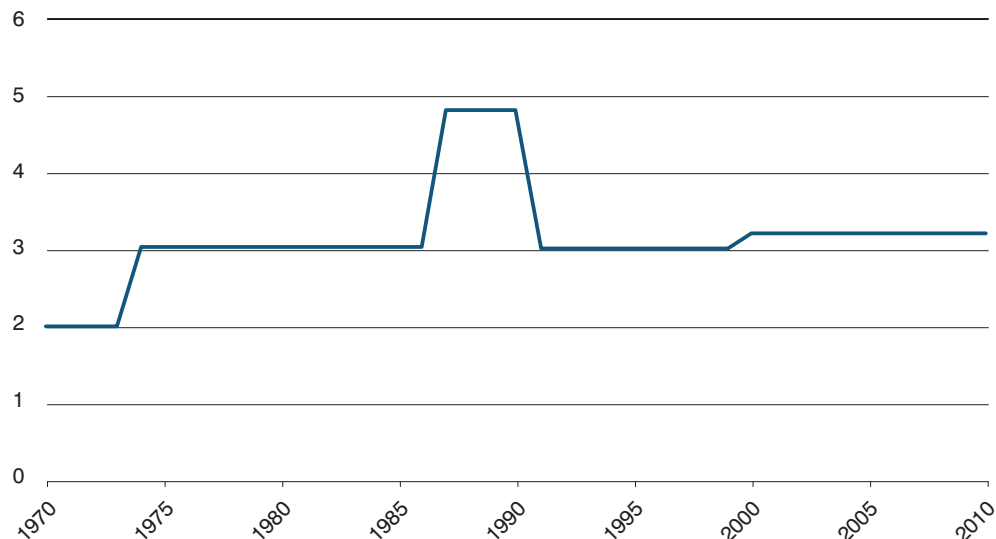
reintroducing union monopoly on collective bargaining

- Promoted collective bargaining via means such as requiring employers to provide union representatives with information and workplace access
- Kept union membership voluntary
- Introduced 'good faith' bargaining
- Promoted mediation
- Established the Employment Court, the Employment Relations Authority and the Mediation Service.

While there have been further amendments to the Act in 2001, 2004 and 2008, it has retained its core features. In essence, under the ERA, the New Zealand system of collective bargaining runs broadly in parallel with the system established in Australia under the *Fair Work Act*, but with two significant exceptions:

- There is no system of awards
- Collective agreements must include a 'coverage clause' which specifies who is to be covered. This clause itself is negotiated

Chart 12 Industrial action sub index (1970-2010), New Zealand



Source: G. Anderson et al. (2011), see endnote 8

and, as a result, there is no presumption that it will enable a trade union to cover all workers in an enterprise automatically.

A paper by Gordon Anderson and his colleagues charts the development of labour law from 1970 to 2010 using a Longitudinal Labour Regulation Index.⁸ The Index models the protective strength of labour law across five areas including employee representation and the capacity to take industrial action.

The introduction of the ECA in 1991, which outlawed compulsory union membership and union preference, was followed by a drop in employee representation as signified with the index dropping close to zero. It remained close to zero until the ECA was replaced with the ERA in 2000. The best way to interpret this index is as showing that New Zealand had almost no entrenched preference for trade unions from 1991 to 2000, with any bargaining power deriving from the voluntary participation of members.

Similarly, various reforms affected the right to take industrial action. Until 1987, common law courts deemed strikes as unlawful, thus the right to take industrial action was restricted as highlighted in Chart 12. However this

restriction was lifted in 1987 when the right to strike lawfully was introduced under the *Labour Relations Act*. In 1991, the ECA restricted the scope to strike lawfully as represented by the drop in the index. This remained stable until 2000 when the use of replacement labour was allowed by the ERA in 2000.

We next examine how changes in the legal framework may have impacted on labour market performance in New Zealand.

The evidence suggests that the share of total factor income in New Zealand captured by labour relative to capital has been more volatile than in Australia. Moreover, there appears to be more correlation between changes in that share and reforms to the power of trade unions.

For example, Chart 13 shows that in 1973 there was a spike in the percentage of compensation received by employees. This coincided with the introduction of the *Industrial Relations Act* which increased the power of trade unions by reinstituting the basic structure of the conciliation and arbitration system and allowed registered employee representatives and unions to opt to bargain directly with employers with courts permitted to enforce any agreement

reached. Similarly, the re-introduction of compulsory unionism in 1985 appears to be correlated with a period of increasing income share going to labour.

However, this volatility needs to be seen in the broader context of New Zealand economic policies. Prior to the microeconomic reforms in the second half of 1980s, New Zealand was a much more closed and uncompetitive economy compared with Australia. To put it simply, the rents were higher and the tussle for these rents more consequential.

It is more interesting to look at the effect of the ECA on the sharing of the economic pie in New Zealand. By 1991, dramatic microeconomic reforms had allowed New Zealand to catch up and, in some cases, overtake Australia in terms of product market competition. During the 1990s – while the ECA was in force – further reforms largely abolished tariff protections for New Zealand businesses. Chart 14 shows the pattern of GDP and employment growth just prior to the introduction of the ECA and during the period it was in effect.

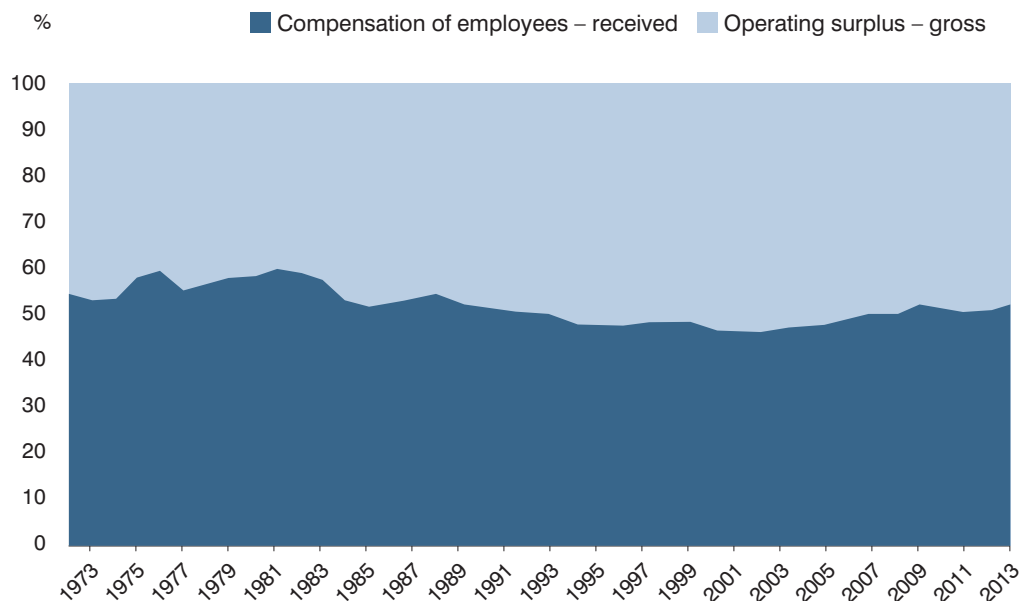
Interestingly, the proportion of factor income received by employees remained largely stable following the introduction of the ECA,

which was considered a radical neo-liberal measure. There was a fall in labour's share after 1987, which coincided with the *Labour Relations Act* that increased unions' relative power. That decline had more to do with major macroeconomic adjustment and a period of high unemployment between 1987 and 1992, rather than with any changes to collective bargaining arrangements.

The key lesson from New Zealand is that the creation of an open, competitive environment for collective bargaining under the *Employment Contracts Act* did not lead to the feared weakening of workers' bargaining position. And while the number of strikes continued to decline as the New Zealand economy became more competitive, the mid-1990s was a period of relatively vigorous action as trade unions and other collective bargaining agents pushed for advantage in a growing economy (Chart 15).

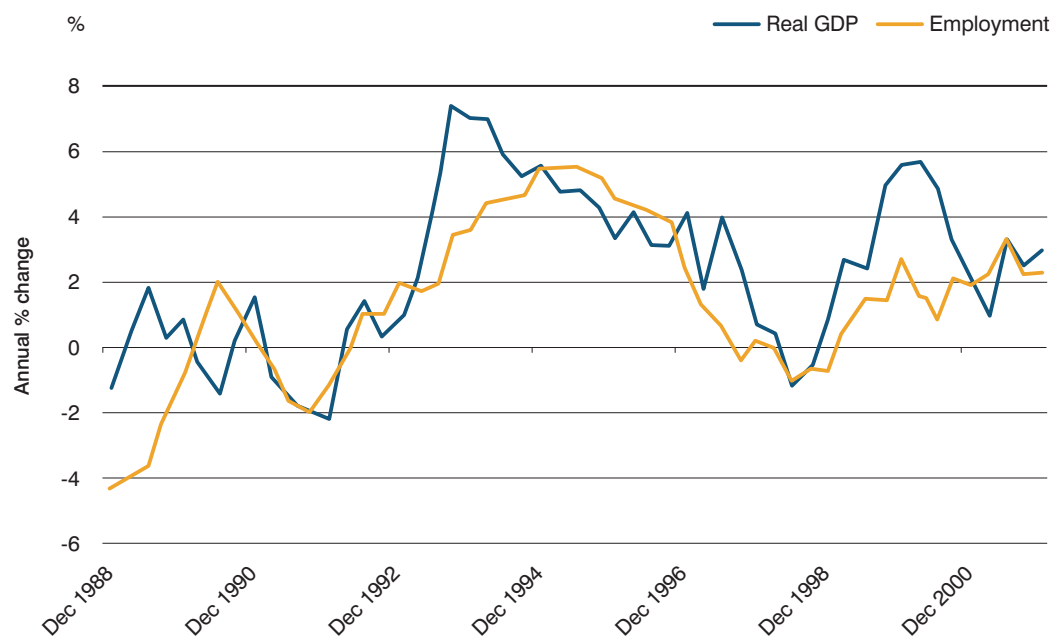
To the extent that institutional arrangements for collective bargaining had any influence on the allocation of income between labour and capital, improved performance from a more competitive economy appears to have offset any loss of industrial muscle (as measured by the Anderson index).

Chart 13 Compensation of employees as a percentage of New Zealand operating surplus



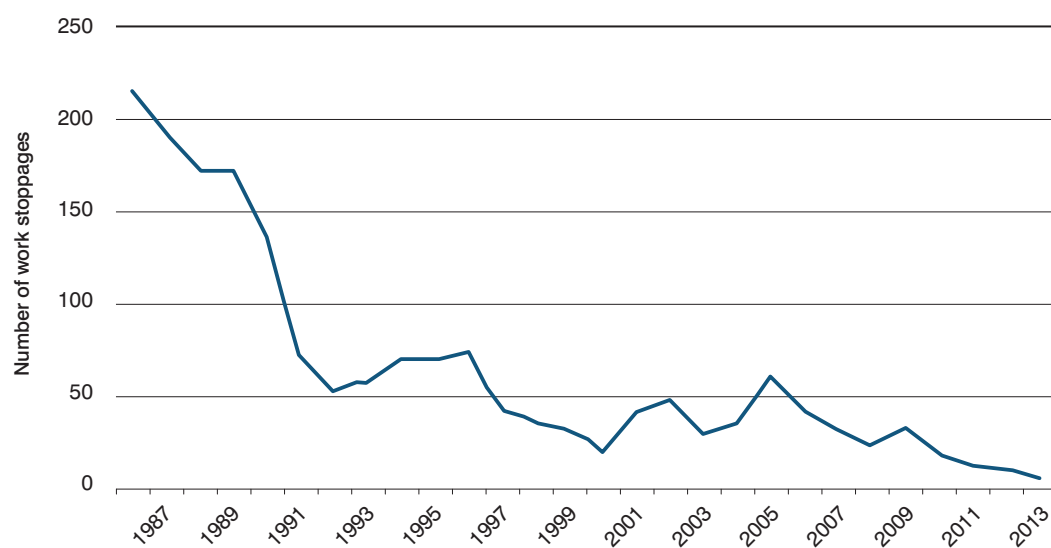
Source: Statistics New Zealand

Chart 14 New Zealand economic growth and employment growth



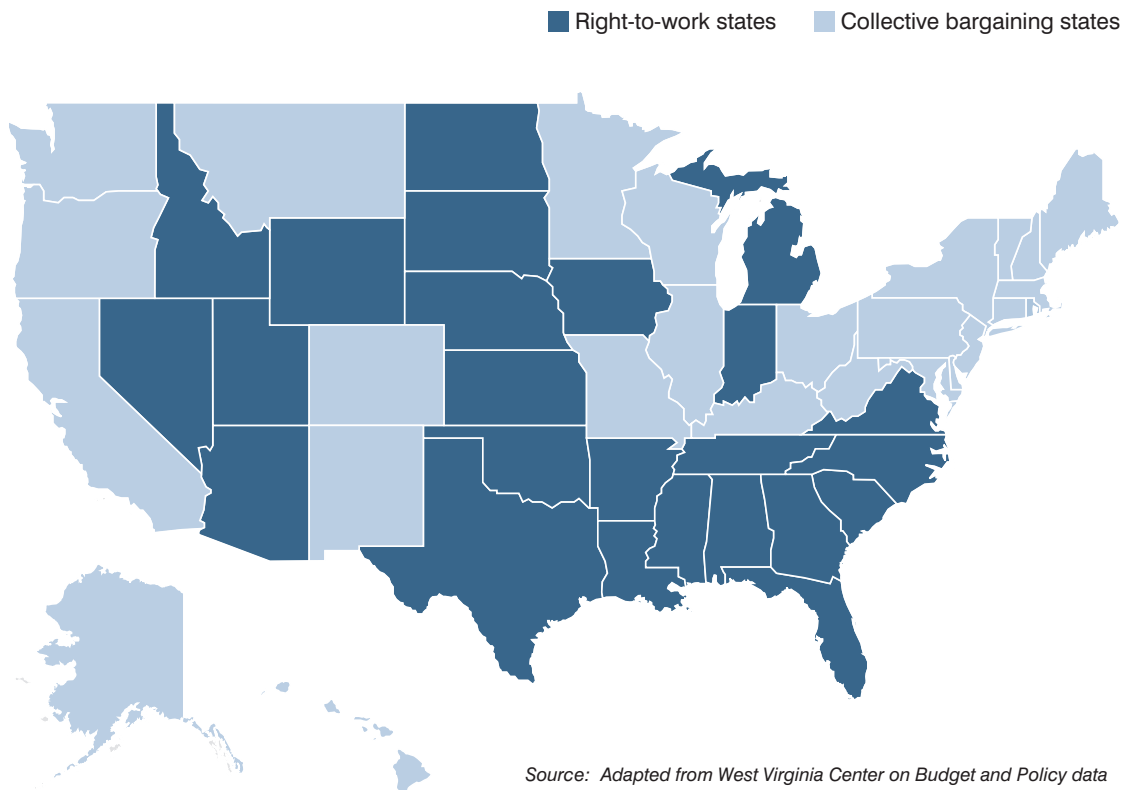
Source: New Zealand Department of Labour

Chart 15 New Zealand industrial disputes (1986-2013)



Source: New Zealand Ministry of Business, Innovation and Employment

Chart 16 Right-to-work and collective bargaining states



5.2 United States

Right-to-work (RTW) laws forbid unions and employers from entering into agreements requiring employees to join a union and pay dues and fees to it in order to get or keep a job. Twenty-four states, mostly in the South and West, have right-to-work laws.

In contrast, states which do not enforce RTW laws are known as collective bargaining (CB) states. In such states, employers and labour unions are free to negotiate a range of union security clauses. Typically, a union security clause requires all persons covered by the contract to pay dues or fees to cover the cost of bargaining activities. As of January 2014, there were 26 CB states plus the District of Columbia.

Opponents of RTW laws argue that they lead to lower wages for both union and non-union workers and lower safety and health standards

that protect workers on the job. As in Australia, under RTW, a worker may be covered by a collective agreement without incurring any cost for such union representation. The opponents claim that by weakening unions and collective bargaining, these laws are harmful for job security protection that comes via a union contract.

On the other side of the spectrum, advocates for RTW believe that these laws create jobs by attracting businesses, lead to higher wages, reduce work stoppages, improve union accountability and are morally right because they prevent individuals from having to support a cause in which they do not believe.

Findings on the wage effects of RTW laws are mixed. Some studies find significant positive effects while some others find no or negative effects of RTW laws on average wages.⁹ A 2014 research report by Frank Manzo IV from the Illinois Economic Policy Institute and Robert

Table 1 Impact of RTW on earnings and employment growth indicators, regression results (2011-2013)

Right-to-work annual 'growth' compared to collective bargaining states	Regression
Wage and salary income (2012 US\$)	No effect
Total income, all sources (2013 US\$)	No effect
Weekly hours worked	No effect
Annual weeks worked	No effect
Employment rate	0.03%
Labor force participation rates	– 0.06%
Union membership	– 0.29%

Source: Manzo and Bruno (2014), see endnote 10

Bruno from the University of Illinois looked at the impact of RTW laws on earnings and employment growth indicators compared with CB states between 2011 and 2013. Results of their analysis, highlighted in Table 1, indicate no difference in annual wage growth in RTW states compared with CB states.¹⁰

This appears in line with conclusions from a study by Michigan State University researchers which examined state economies from 1998 through 2000. They concluded that right-to-work laws 'seem to have no effect on economic activity'. Moreover, they found unions in general seem to have little impact, despite conventional wisdom.¹¹

Overall, the US experience confirms the broad picture that emerged from the Australian evidence: trade unions appear to make little difference to labour market outcomes. In the RTW states, unions have to work a little bit

harder to secure their position. This seems to translate into a modest improvement in outcomes (mainly in the form of higher employment growth).

Again, the US labour market system is no model for Australia – in particular, the link between employment and access to health care as well as the provision of superannuation on the balance sheet of employers create conditions for union participation that are dramatically different to what would be the norm in Australia. However, holding all other things constant across states, the increased competition provided by RTW laws appears to improve performance.

6 Conclusion and recommendations

The economy suffers when its institutions do not function well.

Many economists firmly pin the long-term differences in economic performance between different countries not on their resource endowments or other factors, but on differences in the quality of their institutions.

The ability of economic institutions to unleash the creative power of competition is one of the key requirements for success. Stagnant economies consistently are the ones that entrench incumbent positions and insulate institutional insiders from external pressure.

The arguments that labour markets are a 'special case' are not compelling. As in other markets, entrenched positions that protect incumbent institutions from competition only benefit the insiders. The folly of trade protectionism, for example, demonstrates what happens when certain markets are considered worthy of special treatment.

Opening up trade unions to greater competition is not an anti-union measure. Rather, as New Zealand's experience following the introduction of the *Employment Contracts Act* in 1991 showed, removal of entrenched powers led to a market shake-out that ultimately benefited both workers and some trade unions. Trade unions that proved to be effective bargaining agents, and that gained a reputation for helping employers to achieve productivity growth that was shared with their members, managed to grow their membership despite the underlying decline in unionisation.

Productivity Commission issues papers separate minimum standards from bargaining arrangements. Our analysis suggests this distinction is not helpful, since the role of unions in the setting of the minimum standards is part of the entrenchment of the institutional insiders which affects bargaining arrangements.

The general theme of this paper is that better outcomes can be achieved by reducing

entrenchment of insiders and ensuring that union officials feel the heat from their members and are incentivised to serve the interests of those members.

In summary, the introduction of greater competition into the market for collective bargaining would entail:

- Replacing awards with a safety net system of minimum standards, without a special role for unions
- Removing special union rights and preferences in a bargaining context, with equal footing given to alternative bargaining agents
- Removing entrenched union rights in relation to governance of superannuation funds.

These changes would best be accompanied by changes to the functioning of the Fair Work Commission. Its key role would be akin to that of an independent regulator – it would set minimum conditions and ensure compliance with the law. This can also include acting as a specialist independent arbitrator for employment contract disputes. The difference between this model and the existing approach is that the Commission would no longer have a role in the negotiation of awards or agreements. As a consequence, unions would have no unique standing in the regulatory process.

It has not been the intention of this paper to describe these institutional changes in detail. However, Australia has a rich experience of successful independent regulation which could usefully serve as a template for change. Such a model would be particularly effective for the setting of minimum conditions against clear criteria, since there is likely to be considerable overlap across industries, with stakeholders able to make submissions to the regulator.

Endnotes

- ¹ John R. Hicks, 'Annual survey of economic theory: The theory of monopoly', *Econometrica*, January 1935, p. 8.
- ² ABS, Employee Earnings, Benefits and Trade Union Membership, August 2013, Cat. no. 6310.0, 4 July 2014.
- ³ Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, Harvard University Press, Cambridge MA, 1970.
- ⁴ Royal Commission into Trade Union Governance and Corruption, *Issues Paper 3: Funding of trade union elections*, 13 June 2014.
- ⁵ 'Airline union split over plebiscite', *The Australian*, 28 November 2014.
- ⁶ Peter Boxall, *Towards the Wagner framework: An interpretation of the direction of change in New Zealand industrial relations*, Monash University Graduate School of Management, Management Paper No. 31, August 1990.
- ⁷ Mark Wooden and Judith Sloan, 'Industrial relations reform and labour market outcomes: A comparison of Australia, New Zealand and the United Kingdom', in Reserve Bank of Australia, *Unemployment and the Australian Labour Market*, Conference volume, August 1998.
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- ¹¹ Dale Belman, Richard Block and Karen Roberts, *Economic Impact of State Differences in Labor Standards in the United States, 1998-2000*, Michigan State University, 2009. Trade union members represent approximately 10 per cent of wage and salary earners in the United States.



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