

Senate Economics Legislation Committee
ANSWERS TO QUESTIONS ON NOTICE
Treasury Portfolio

Supplementary Budget Estimates, 2 - 3 November 2005

Question: SBT 32

Topic: Research into Industrial Relations Reforms

Hansard Page: E86

Senator Sherry asked:

Senator SHERRY—Is Treasury aware of any empirical research that would support an argument that industrial relations reforms will increase productivity? Can you refer me to any research that has been carried out?

Mr Tune—There has been a lot of research done over the years, some of it overseas research.

Senator SHERRY—I am specifically talking about Australia, the Australian context.

Mr Tune—I cannot recall any off the top of my head, but I know there has been some.

Senator SHERRY—Could you take that on notice?

Mr Tune—Yes, certainly.

Senator SHERRY—Also, in respect to employment, can you point me to any empirical research now?

Mr Tune—We will check that as well.

Answer:

Set out below is information on a number of research papers on the impact of workplace relations in the Australian context.

- A comparison of productivity in Australia and the United States found that the gap between productivity in Australia and the United States could be reduced by one sixth by further reforms of product and labour market regulations. This would increase GDP per capita by around \$1,300 per year.¹
- An Access Economics report² found that a 10 percentage point reduction in award reliance in an industry between 1990 and 2002 was associated with an increase in the average annual productivity growth of 0.5 percentage points.

Other independent Australian studies have also identified significant gains from workplace relations reforms:

- Research by the University of Melbourne in 2002³ concluded that if small business was exempted from unfair dismissal laws for new staff, there could be 70,000 new jobs created in Australia;

¹ Rahman, Jyoti (2005) "Comparing Australian and United States productivity" *Treasury Economic Roundup* Autumn 2005.

² Access Economics: *Workplace Relations – The Way Forward* (February 2005), p.21.

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- In their August 2005 National Business Expectations Survey of businesses in the wholesale, retail and manufacturing industries, Dunn and Bradstreet found that 14 per cent of surveyed businesses indicated that they were likely to employ more staff in response to the Government's unfair dismissal changes.
- At a Reserve Bank conference entitled *The Australian Economy in the 1990s*, a paper by Charles Bean from the London School of Economics examined the interaction between Australian labour market institutions and economic shocks. He found that:
 - “A low degree of nominal rigidity [in employment contracts] reduces both average unemployment and the response to shocks. Finally, high levels of employment protection have a very strong statistical effect in reducing the speed of adjustment and thus in raising unemployment persistence.”⁴
- In another paper to the Reserve Bank conference, Professor Peter Dawkins argued that the introduction of enterprise bargaining was associated with higher productivity, and “most of the benefits of rising productivity growth have gone in the form of higher wages.”⁵
- The Productivity Commission has found, in a series of case studies in the whitegoods, automotive, rail, clothing, textile clothing and footwear, water and wholesale and retail trade industries⁶, that workplace bargaining facilitated significant improvements in productivity.
- Tseng and Wooden⁷ discovered that firms whose employees were on workplace agreements were estimated to have around 9 per cent higher productivity levels than comparable firms whose employees were award-reliant.
- Fry, Jarvis and Loundes⁸ found that firms adopting workplace relations reform reported significantly higher levels of self-assessed labour productivity relative to their competitors.

³ ‘The Effect of Unfair Dismissal Laws on Small and Medium Sized Businesses’, Don Harding, Melbourne Institute of Applied Economic and Social Research. The University of Melbourne, 29 October 2002.

⁴ Bean (2000) ‘The Australian Economic ‘Miracle’: A View from the North’ in D Gruen & S Shrestha (eds) *The Australian Economy in the 1990s*, Reserve Bank of Australia.

⁵ Peter Dawkins *The Australian Labour Market in the 1990s* p. 341.

⁶ Productivity Commission, *Microeconomic Reforms and Australian Productivity: Exploring the Links, Volume 2: Case Studies*, Research Paper, Ausinfo, Canberra, 1999; A Johnston, D Porter, T Cobbold, and R Dolamore, *Productivity in Australia's Wholesale and Retail Trade*, Productivity Commission Staff Research Paper, Ausinfo, Canberra, 2000.

⁷ Y-P Tseng and M Wooden, *Enterprise Bargaining and Productivity: Evidence from the Business Longitudinal Survey*, Melbourne Institute Working Paper No. 8/01, July 2001, page 28.

⁸ T Fry, K Jarvis and J Loundes, *Are Pro Reformers Better Performers?* Melbourne Institute Working Paper No 18/02, September 2002.

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- Further research by the Productivity Commission into the stevedoring⁹, black coal mining¹⁰ and meat processing¹¹ industries found that inefficient work practices often reflected perverse incentives built into awards.
- Connolly et al¹² present a comprehensive analysis of the aggregate relationship between federal certified agreements (CAs) and Australian Workplace Agreements (AWAs) and labour productivity.
 - Connolly et al¹³ find that, in the long-run, a one percentage point increase in federal CA and AWA coverage (lagged by two years) increases labour productivity by around 0.25 per cent. The authors argue that it is possible that the total effect could be higher than this, since a higher coverage of enterprise and individual agreements could induce rises in labour or capital inputs.

In a recent report on National Competition Policy, the Productivity Commission¹⁴ said:

- “Labour market arrangements are characterised by significant restrictions on competition which can reduce productivity and constrain the scope for reforms in other markets. For these reasons alone, notwithstanding considerable reform over the past two decades, further policy changes to increase the flexibility and responsiveness of the Australian labour markets remain a high priority.”¹⁵

and:

- “Suffice to say that building on the labour market reforms of the past two decades is vital to support further improvements in productivity and sustainability, including through easing ageing-related constraints on future labour supply and complementing reforms in other areas. It is also critical that

⁹ Productivity Commission, *Work Arrangements in Container Stevedoring*, Labour Market Research Report, Canberra, 1998.

¹⁰ Productivity Commission, *The Australian Black Coal Industry*, PC Inquiry Report, Canberra, 1998.

¹¹ Productivity Commission, *Work Arrangements in the Australian Meat Processing Industry*, Labour Market Research Report, Canberra, 1998.

¹² G Connolly, A Herd, K Chowdhury and S Kompo-Harms, *Enterprise Agreements and Other Determinants of Labour Productivity*, Paper presented at the Australian Labour Market Research Workshop 2004, University of Western Australia, Perth, 6-7 December 2004, <http://www.clmr.ecel.uwa.edu.au>

¹³ G Connolly, A Herd, K Chowdhury and S Kompo-Harms, *Enterprise Agreements and Other Determinants of Labour Productivity*, Paper presented at the Australian Labour Market Research Workshop 2004, University of Western Australia, Perth, 6-7 December 2004, <http://www.clmr.ecel.uwa.edu.au>, p.32.

¹⁴ Productivity Commission, *Review of National Competition Policy Reforms*, PC Inquiry Report, No. 33, 28 February 2005.

¹⁵ Productivity Commission, *Review of National Competition Policy Reforms*, PC Inquiry Report, No. 33, 28 February 2005, p xxxviii.

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the much needed flexibility and capacity to adapt to changed circumstances provided by previous reforms are not compromised by any backsliding.”¹⁶

The OECD released *Innovations in Labour Market Policies – the Australian Way* in 2001. It noted that:

- During the 1980s (before enterprise bargaining was introduced), real wages fell, “particularly for low-wage workers”, while during the 1990s (after workplace relations reform was started), real wages have increased across the earnings distribution.¹⁷
 - This report also cited evidence showing: “...the presence of enterprise agreements is indeed associated with productivity improvement.”¹⁸
- Stricter employment protection rules were associated with larger and longer increases in unemployment, with the relationship much stronger when the interaction between policies and shocks was accounted for.¹⁹

In the Australian context, there have also been a number of recent studies suggesting that increases in the minimum wage have adversely affected employment. In particular:

- A 2003 study of the impact of six increases in the Western Australian minimum wage between 1994 and 2001 by Andrew Leigh suggested that a one per cent increase in the minimum wage leads to a 0.15 percentage point fall in employment.²⁰
- Don and Glenys Harding in a survey of the impact of ‘safety net’ adjustments on small and medium businesses found that a one percentage increase in the minimum wage reduced employment by about 0.2 per cent.²¹

Reference to these and other relevant studies are set out below:

Australian academic research on the relationship between wages and employment

| Author(s) | Year | Elast-icity | Methodology | Time period |
|-----------|------|-------------|-------------|-------------|
|-----------|------|-------------|-------------|-------------|

¹⁶ Productivity Commission, *Review of National Competition Policy Reforms*, PC Inquiry Report, No. 33, 28 February 2005, p xxxix.

¹⁷ OECD *Innovations in Labour Market Policies – the Australian Way*, p.258.

¹⁸ OECD *Innovations in Labour Market Policies – the Australian Way*, p.262.

¹⁹ Blanchard & Wolfers (2000) “The Role of Shocks and Institutions in the Rise of European Unemployment: the Aggregate Evidence” *Economic Journal* Vol 110 Issue 462, also Blanchard (2004) “Explaining European Unemployment” *NBER Reporter*.

²⁰ A Leigh, ‘Employment Effects of Minimum Wages: Evidence from a Quasi- Experiment’, *Australian Economic Review*, 2003, Vol 36, No 4, pages 361-373.

²¹ D Harding and G Harding, ‘Minimum wages in Australia: an analysis of the impact on small and medium sized businesses – A report to the Department of Employment and Workplace Relations’, 2004, Turning Point Research Pty Ltd’.

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| | | | | |
|--------------------------------------|------|----------------|---|-----------|
| G Debelle & J Vickery ²² | 1998 | -0.7 (-0.4) | Used Layard-Nickell type model to estimate the employment (hours) elasticity with respect to real wages | 1979-1997 |
| M Dungey & J Pitchford ²³ | 1998 | -0.4 | Used a disequilibrium model to estimate the elasticity of total employment to real wages | 1984-1997 |
| K Bernie & P Downes ²⁴ | 1999 | -0.6 | Used the Treasury Macroeconomic Model to estimate the employment (hours) elasticity with respect to real wages | 1971-1998 |
| P Lewis & G MacDonald ²⁵ | 2002 | -0.8 | Re-estimated the aggregate demand for labour, estimating the elasticity of the demand for labour with respect to real wages | 1959-1998 |
| A Leigh ²⁶ | 2003 | -0.15 | Estimated the elasticity of labour demand with respect to the Western Australian statutory minimum wage | 1994-2001 |
| D Harding & G Harding ²⁷ | 2004 | -0.21 | Based on a survey of small and medium employers, estimated the short run elasticity of employment demand with respect to the minimum award rate | 2003 |

²² G Debelle and J Vickery, 'The Macroeconomics of Australian Unemployment', RBA Annual Conference Volume 1998-15, 1998, Reserve Bank of Australia.

²³ M Dungey and J Pitchford, 'Prospects for Output and Employment Growth with Steady Inflation', RBA Annual Conference Volume 1998-15, 1998, Reserve Bank of Australia.

²⁴ K Bernie and P Downes, 'The macroeconomics of unemployment in the Treasury Macroeconomic (TRYM) model', 1999, RBA seminar series.

²⁵ P Lewis and G MacDonald, 'The Elasticity of Demand for Labour in Australia', *Economic Record*, 2002, Vol 78, No 240, pages 18-30.

²⁶ A Leigh, above n 20.

²⁷ D Harding and G Harding, above n 21.