

## Chapter Eight

# Why Regulate the Labour Market?<sup>1</sup>

*The appropriate extent and nature of regulation of the labour market in Australia is controversial. Currently there is a dominant view in public debate that deregulation has been and still is needed in order to improve the functioning of the economy. This chapter challenges that view. It does so on a number of grounds. It looks at the purposes which regulation was intended to serve and argues that markets left to themselves are unlikely to achieve these purposes. The purposes include reducing the degree of subordination of the individual worker to the direction of the employer, and providing for some degree of fairness in the conditions of employment of low wage workers and those who are not prime age males in secure jobs. It briefly explores whether such protections can be achieved in other ways and concludes that this is unlikely. Reliance on the social welfare system, for example, would require a large increase in the willingness of taxpayers to fund low wage workers, including single people without dependents. Skills enhancement to raise the market power of the unemployed can help but where there is substantial unemployment it will not be enough to provide protection for all. The arguments for deregulation rely heavily on the belief that this is necessary to increase productivity and economic growth. The basis for this belief is shaky. The chapter also argues that issues of who benefits and who suffers from any such growth is an important and separate question: over the past 15 years, high wage earners have benefited and low wage earners have paid the costs.*

*“Let it be granted, then, that as a rule workman and employer should make free agreement, and in particular should freely agree as to wages; nevertheless there is a dictate of Nature more imperious and ancient than any bargain between man and man, that the remuneration must be enough to support the wage-earner in reasonable and frugal comfort. If through necessity or fear of a worse evil, the workman accepts harder conditions because an employer or contractor will give him no better, he is the victim of force and injustice.”*

Rerum Novarum (1891)

<sup>1</sup> This chapter draws substantially from Richardson, S., (1999), “Regulation of the Labour Market”, in Richardson, S. (ed), *Reshaping the Labour Market*, Cambridge University Press, Melbourne.

## 8.1 The Distinctive Character of Labour

The labour market is a metaphor. There is in fact no market place for labour of the classic form, where buyers and sellers come to transact over reasonably homogeneous goods. And the employment relation is much more complex than is implied by the market metaphor. Labour is different from computers or fruit. The employer buys not a specific skill or contribution to output, but worker time and the right to command the application of that time. Hence the employee relation is inherently one of subordination. The quality and quantity of work done by an employee depends on her or his motivation as well as abilities. Society has a legitimate interest in whether high levels of motivation are accomplished by a climate of fear or by engendering willing co-operation. The experience of work has consequences also for the development of the skills and personality of the worker. As Alfred Marshall put it 60 years ago, “... *the business by which a person earns his livelihood fills his thoughts during by far the greatest part of those hours in which his mind is at its best: during them his character is being formed by the ways in which he uses his faculties at work*”. (Alfred Marshall, 1938:1-2.).

Workers also have an acute sense of what is fair treatment (including that people doing similar work should receive similar pay) and an appreciation that pay levels signify social status as well as providing purchasing power. Finally, society cares about the physical well-being of workers and hence limits the power of employers to command workers to do things which may be injurious to them.

None of the characteristics of workers which are presented above is true of machines or of goods and services purchased in other markets. These

distinctive characteristics provide good reasons for expecting that the best form and extent of regulation of the labour market will differ from that for other markets.

## 8.2 Problems in the Labour Market

The labour market is the most problematic part of the economy today, not only in Australia but also in most West European countries. Only the USA, with its long and vigorous economic expansion, has a labour market which seems to be producing good outcomes for most people. But even there, it is only in the last year or two that the real wages of lower paid workers have begun to rise, after 20 years of decline. All is not well in a country where, over a 15 year period, more than all the growth in real GDP went to families in the top 5 per cent or 10 per cent of the income distribution. Those in the bottom half saw part of their income being transferred to those at the top, with the effect that the many losers were worse off in real terms. And workers in the US continue to work very long hours on average, with consequent severe strains on families.

The major problems in the Australian labour market include:

- persistent high (though now falling) levels of unemployment;
- even worse, very high levels of long-term unemployment (over 300,000 people have been out of work continuously for more than a year);
- the difficulty that young people face in establishing themselves in reasonable jobs with reliable earnings;
- the many older men who have been pushed out of the workforce (the proportion of men aged 55-64 who are in the labour force has

fallen from 88 per cent in 1960 to 62 per cent in 1995);

- rising extremes of working hours— both very long and very short;
- rising insecurity in employment, through growth of part-time/casual/contract work in place of continuing full-time jobs; and
- a substantial rise in the inequality of wages, which is particularly pronounced for men.

Because of the unique features of labour, regulation of the terms and conditions of employment is ubiquitous among Western nations. The employment relation is not just a private matter; but the role of regulation and its optimal design are under challenge. Regulation of the employment relation has evolved over time in response to changing social values about the rights and equality of ordinary people, the nature of the economy and the consequences of the tussle for power between labour and capital. It continues to evolve, with contemporary pressure for fewer restrictions on the employers' rights unilaterally to determine the terms and conditions of employment, often referred to as deregulation.

### **8.3 Protection of Vulnerable Workers**

Regulation has primarily (though not always) been used to enhance the position of the worker. There has also long been recognition that the competitive pressures of supply and demand may generate inefficiently low wages and investment in the development of worker skills. But even if unregulated labour markets were efficient, they need not thereby be fair. As Amartya Sen (Nobel Prize winner in Economics) put it so pithily, market outcomes may be both perfectly efficient and perfectly disgusting.

Four hundred years ago, workers in Britain who felt that the pressure for lower wages had become intolerable called on the government "... to appoint certain grave and discreet persons to view the straitness of works, [and] to assess rates for wages according to the desert of their works".<sup>2</sup>

The Australian industrial tribunals can be seen as the contemporary embodiment of such grave and discreet persons.

An alternative to regulation as a way to take care of workers is the development of trade unions. These seek to limit the extent of employer power by confronting it with worker power. The subsequent clashes of two powerful groups can be costly and even dangerous, not only to the parties involved but to citizens at large. As with any locus of power, that power is constantly at risk of being abused, and in the case of both employers and unions, has been abused. Regulation is a means to protect workers from the consequences of unequal power which does not require them to collect equivalent power in their own hands.

Whether by design or by evolution, during the course of the twentieth century Australia developed a system for the protection of workers' incomes and other interests which, with hindsight, appears to have been integrated and quite effective. The system has been characterised by Castles and Mitchell (1993) as 'the workers' welfare state'. Its key features were:

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<sup>2</sup> A Petition to Fix Wages Addressed to the Justices by the Textile Workers of Wiltshire, 1623, quoted in Bland, Brown and Tawney, 1914: 357.

- legal minimum wages which varied with the demands of the job (and, for much of the period, with the sex of the worker);
- hours of work and other minimum conditions of employment determined by independent tribunals;
- a substantial positive role for trade unions;
- tariff protection, which provided an opportunity for firms to pay these wages and remain profitable;
- wages which were sufficient to enable a full-time male employee to maintain himself and his family adequately according to the standards of the day (but were inadequate to enable a woman to maintain a family);
- basic levels of support through the social welfare system for those who were unable to provide for themselves due to old age, unemployment or disability; and
- with the exception of payments for dependent children, those in employment and those in receipt of social welfare payments were seen to be distinct groups.

For those in employment (especially full-time males), this system produced a relatively fair and adequate pay structure, restrictions on the employers' rights to command and the employee self-confidence that came with a robust trade union movement. The trade unions, among other things, played an important role in ensuring that regulated pay and other conditions of employment were enforced in practice. This, together with the expansion of the social welfare system, removed two major sources of harsh treatment of workers. One was the 'race to the bottom', whereby firms which adhered to award conditions might be put out of business by those which breached them. The other was

the need for workers to accept any terms, legal or not, because they had no alternative source of income: the welfare system increasingly came to provide a 'reservation wage', below which workers need not sink.

Over the past twenty years there have been three significant developments which have altered the system described above.

The first is the reduction in the protection of capital and product markets from international competition, and an increase in competitive pressures in domestic markets. Employers have responded by seeking to reduce the regulated restraints on the terms on which they employ their workers.

The second is the blurring of the distinction between households which rely on earned income and households which rely on social welfare payments. Government financial support for children, students and the costs of rental housing has been extended to families which rely predominantly on earned income. This intersection has been enlarged by the fall in the real earnings of low wage, fully employed, men over the past 20 years. Working families are increasingly finding themselves eligible for means tested social welfare benefits, partly because their incomes have been falling and partly because the range and eligibility conditions of social welfare benefits has been expanding.

The third is the decline in the strength and coverage of trade unions and the expansion of employer prerogative in the determination of the conditions of employment.

One result of these changes has been the gradual replacement of the wage determination system by the social welfare system as the instrument for protecting the living standards, if not

other conditions of employment, of low paid workers.

*suck more blood*". (1997, pp. 16-17).

#### 8.4 Arguments About Deregulation

The reasoning behind the call for more deregulation of the labour market in Australia includes the increasing product and capital market competition referred to above. It also includes the disappointing productivity performance of the Australian economy in the period from 1975 to the early 1990s. It is argued that regulation of the labour market imposes a set of restrictions which make it difficult for firms to respond rapidly and in innovative ways to changes in the product market. Despite the wide support for this view, there is in fact very little evidence to support it as an important phenomenon. Among OECD countries there is no correlation between the degree of regulation of the labour market and overall economic performance. Guy Standing's views on this matter apply, in my opinion, with equal force to Australia:

*"An influential variant of the supply-side school has postulated that Europe has been suffering from a virulent disease known as "Eurosclerosis"—a tightening of the arteries, a flabbiness of the muscles and an inability to move caused by excessive security and protective regulations. This delightful imagery has sunk deep into the European policymakers' psyche. The mildly odd fact is that after a decade and a half of explicit and implicit erosion of protective and pro-collective labour regulations, unemployment is much higher than when the disease was diagnosed and the treatment started. One is constantly reminded of medieval quackery and the leeches: the patient has not recovered, so*

A further argument, put forward by libertarians and some other economists is that a contract freely entered into by adults is always efficient and fair because if there was not gain to both parties then the bargain would not be struck. Regulation which inhibits such bargains diminishes the freedom of action of the people involved and prevents mutually advantageous arrangements. It is thus patronising and inefficient. But the force of this argument depends crucially on the starting position of each party. Justice Higgins put the point succinctly when he interjected in the Harvester Case of 1907 to describe freedom of contract in the workplace as being:

*"like the freedom of contract between the wolf and the lamb",*  
(McCarthy, 1969:23).

Any argument for or against regulation of the labour market must first take account of whether regulation has any discernable effects. Has the system of labour market regulation in Australia actually affected, for example, the structure of pay? The strongest evidence that it has can be seen in its influence on the gender differences in pay; at first by keeping female wages substantially below those of males doing comparable work and later by largely removing this bias. Where the tribunals have explicitly sought to alter the structure of pay, it has usually been to compress that structure, especially at the bottom end. It seems that they have had some modest success in this, and greater success in improving the wages and conditions of particular vulnerable groups, such as part-time and casual workers (many of whom are women).

A controversial dimension of the effects of the tribunals is whether, by excessive

compression of the wage structure, they have caused unemployment among the unskilled and among youth. The various Australian estimates of the wage elasticity of demand for labour, both in aggregate and for particular groups, all find it to be positive but the range of estimates is large and no single result can be accepted with confidence. Even if the relatively high elasticity estimate of -0.75 is adopted (and many would argue that this estimate is too high), research by Borland and Woodbridge (1999) concludes that adoption of US style minimal regulation of wages would increase employment of low wage workers by only 25,000 to 50,000 (at a time when unemployment stood at 800,000).

Who are the low wage workers whose wages may be increased by the work of the tribunals? There are several types of low wage worker. One type has her or his foot on the bottom of the wage ladder and is preparing to climb it. These tend to be young people who are in the process of becoming established workers. A second type is on the snake coming down. These workers are often middle aged and male and many have trade qualifications. They are likely to have lost relatively well paid jobs in manufacturing and to have accepted low wage jobs as better than nothing at all (others of their type have indeed found nothing at all and have left the workforce). The third type of low wage worker (probably the majority) is on the merry-go-round. They are of prime age, not very well educated and are not going anywhere, in a wage sense. They are typically, but not exclusively, married women. Thus one cannot dismiss the low pay of workers at the bottom end of the wage distribution as unimportant, because they go predominantly to young people who are just getting established in the labour market and will be only a short-term experience.

## 8.5 Alternatives to Regulation

The question should be asked whether the object of regulation, such as a floor to wages, can be accomplished in a better way. One alternative is to ensure that all workers are sufficiently productive so that the market will generate wages which are above the floor. A second is that the social welfare system may provide an alternative source of income which enables workers to refuse to accept wages which are below the floor.

Chapman (1999) looks closely at whether, through targeted skills enhancement of the long-term unemployed or through an extension to their general education, it is possible to increase their employment substantially, within the prevailing wage structure. He concludes that some labour market programs work better than others. When the most effective programs are used, they can make a substantial difference to total unemployment and employment. A program targeted on the long-term unemployed could feasibly halve their number. But labour market programs are unlikely on their own to provide a full solution to delivering jobs to the unemployed, especially to the long-term unemployed. It is inescapable that the overall level of demand for labour has a strong impact on the job prospects of the unemployed.

If everyone of working age were able to receive an acceptable income regardless of whether or not they were employed, then employers would not be able to entice anyone to work for less than this income (unless substantial skills development was offered as part of the employment). Such an alternative income would provide an effective floor below which wages would not fall, even if there were no external regulation of wages. Does the social welfare system in Australia provide such a floor? Gregory

et al (1999) answer this question. They conclude that for some groups of workers, specifically, parents with dependent children on medium level wages, the interaction of the personal income tax and the income tests on social welfare payments are such as to make the disposable income of the family almost independent of the level of wages earned. The range of earnings for which this is true encompasses that received by a full-time low wage worker. On the one hand, this makes the worker indifferent to the level of wage received, within a range: a fall in payment from the employer is almost fully offset by a rise in payment from the government. On the other hand, the worker has no incentive to work more hours, in terms of the income received. Both these effects have important implications. In the first case, an employer can reduce the wage offered in the knowledge that the obligation to provide an adequate income will be picked up by the taxpayer. This will effect a redistribution from the taxpayer to the owners and customers of such firms, which in turn are likely to multiply as a result of competition in the product market. In the second case, the disincentive to work more than modest part-time hours may engender resentment in taxpayers, welfare dependency in the worker and intrusive, expensive application of work tests by the social welfare system.

One major advantage of reliance on the welfare system to provide an effective floor to what workers will accept from employers is that it obviates the need for enforcement of employer compliance with regulation of their wage and conditions offers. Employers may be left largely to themselves, in the knowledge that no-one is forced to agree to unacceptably harsh employment terms '*through necessity or fear of a worse evil*' (Rerum Novarum, 1891). This is an important point in the current

environment, when trade union membership is in decline. Australia has traditionally relied upon (privately funded) trade unions to enforce industrial law, or at least to bring breaches of such law to the attention of the authorities. Regulation which is unenforced is worse than no regulation at all.

The challenge is to protect workers from harsh employers while enabling good employers to flourish. One valuable path to pursue is to take advantage of the antiseptic properties of light. The conditions of employment at each workplace should be comprehensively exposed to public gaze. The conditions should include not just wages and hours actually worked, but also average days of leave actually taken, accident rates, the rate at which workers quit, the rate at which workers are fired, any successful actions for unfair dismissal or sexual harassment, average tenure in the job and so on.<sup>3</sup> This information should be posted on the equivalent of the employer's front door, to inform both the public and potential employees. These disclosure requirements would be comparable to those imposed on companies to disclose financial information if they wish to raise money from the public. The public display of such information is likely to have a strong salutary effect on its own. People mostly do not like to be seen as public pariahs. In addition, a requirement that it be provided to all actual and potential employees would help overcome the large information asymmetry which otherwise exists between employer and employee, and which in part justifies a role for trade unions in the employee relation. In this regard, it is highly regrettable that individual terms of employment determined under Australian Workplace Agreements, and

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<sup>3</sup> Our thanks to Nick Gruen for raising these ideas.

State equivalents, are kept secret, revealed only to the Workplace Advocate. It is also regrettable that employee ombudsmen and advocates can, at least in some jurisdictions, act only upon the complaint received by an individual.

But the employment relation is about more than wages. A second reason for regulation is to enhance the dignity of the employee, by reducing the extent of the employer's power to direct. The master: servant relation, or one where the employer has a wide domain over which arbitrary power may be exercised, has no place in a decent and socially egalitarian society. Unless trade unions are strong, it is the State which must place limits on the employers' power over workers.

## **8.6 Conclusion**

Less regulation of the labour market is almost certainly associated with (and most probably causes) more inequality in earnings and lower relative wages for those at the bottom of the pay distribution and those who are not main-stream workers. Its consequences for employment, unemployment and productivity are most uncertain. Deregulation thus involves a very probable increase in inequality and a very uncertain gain in efficiency and employment. For this reason alone, regulation can be, and in the view of the author, is, justified. It may well be justified even if it could be shown to reduce efficiency, because the distribution of the dividend as well as its size are each to be taken into account in assessing the consequences for overall welfare. To repeat, market outcomes can be perfectly efficient and perfectly disgusting.

Over the past twenty years the rising tide of economic growth has not lifted all boats. The big ones have risen fastest of

all and many little ones have remained stuck in the mud - swamped, not lifted, by the incoming tide. I am unconvinced that the tide has risen faster for those countries with less regulated labour markets. What is clear is that the uneven tide has propelled forward the biggest and fattest boats the fastest. Economic growth which rewards the already affluent with still higher incomes, while diminishing the incomes, dignity and prospects of many at the bottom, is not worth sacrificing important social values for. The purpose of the economy is to enhance the well-being of the people. It is not the purpose of the people to provide the lowest cost inputs for the economy. An already rich nation should give a high purpose to ensuring that work is adequately paid, is not physically harmful, and enriches the human capacities of the people who do it. It is not progress to have a workforce in which increasing numbers are paid too little and are afraid, insecure, and treated as readily disposable.

Good institutions will not substantially inhibit growth. But they will also pay attention to who is benefiting from that growth. There is nothing in unregulated markets which ensures that the gains from growth are reasonably fairly distributed or that the costs of change are tolerable for those who lose. That has been the function of the industrial tribunals and the trade unions, as well as government more directly. Ill-treatment of workers must not be allowed to become profitable, or the forces of competition will ensure that it spreads. The economic environment has not changed so much that the best we can do to enhance the well-being of the workforce is to stand by and watch the market at work. The market alone will not remove unemployment and nor will it ensure that the distribution of its product is fair and that the experience of work is enriching rather than shrivelling



for the workers. The market needs a hand.

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