TAXATION, SOCIAL WELFARE AND THE ROLE OF LABOUR MARKET REGULATION: COMPLEMENTS OR SUBSTITUTES?

An Industrial Relations Perspective on the ‘Five Economists’ Plan’
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“Let me say, at the outset, that you should be sceptical of anyone who suggests that there
are any easy solutions. Solutions which most economists would agree could enable a
return to “full employment” or very low unemployment, are either socially or politically
unacceptable, or we do not know how to implement them. The best solution is to achieve
a large increase in the rate of economic growth (Dawkins, 1996, p. 16).

INTRODUCTION

Shortly after the re-election of the Howard government in October 1998 a group of five prominent
economists proposed a plan to ‘cut the jobless rate’ in an open letter addressed to the Prime Minister
(The Australian, October 26 1998). In the letter the five economists – Peter Dawkins, John Freebairn,
Ross Garnaut, Michael Keating and Chris Richardson1 – offered ‘some ideas for policies that could
complement’ the Prime Minister’s ‘tax reform package, to help substantially reduce unemployment

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Caroline Jordan for comments on earlier drafts. All errors of omission and interpretation remain our own.
1 The five economists’ affiliations are as follows: Peter Dawkins (Professor, Institute of Applied Economic and
Social Research, University of Melbourne), John Freebairn (Professor, Economics, University of Melbourne),
Ross Garnaut (Professor, Economics, Australian National University), Michael Keating (Visiting Fellow,
Research School of Social Sciences, Australian National University) and Chris Richardson (Consultant, Access
Economics).
The letter was timely in that it was published in the wake of the Coalition’s comprehensive tax package, which proposed radical taxation reforms and the creation of a “new tax system”.

Central to the Plan was the need to limit growth in real labour costs in order to promote employment growth and reduce unemployment. In their letter the economists argued that:

The growth in jobs necessary to substantially reduce unemployment will require higher economic growth and lower growth in wage costs. Tax reform will lead to a more robust economy and improve the chances of realising higher economic growth. Evidence suggests, however, that enhanced economic growth alone will not be sufficient to reduce unemployment much below 7 per cent in the long run. Economic growth will need to be complemented by policies directed at improving the relationship between growth and unemployment, involving a linking of your industrial relations and tax and welfare reforms. The linkage would include an attempt to achieve a lower growth in real labour costs, alongside an integrated approach to reforming the labour market programs (The Australian, October 26 1998).

In this context the Plan made specific industrial relations recommendations, focusing on the need for a reduction in the real value of award wages to promote employment growth. This was to be achieved through the Commonwealth’s arguing before the Australian Industrial Relations Commission for a Living Wage freeze. Those effected by the wage freeze would then be compensated by the provision of tax credits to low income families through the tax system. In the sense the Plan sought to provide for labour market efficiency and equity, by shifting the institutional balance through which these objectives were pursued.

In addition to its specific industrial relations implications, the economist’s proposal was interesting because it foreshadowed the emergence of a much broader reform agenda. Beginning as a specific industrial relations proposal, the economists sought to link the wage freeze to the broader taxation and social security reform agenda. The last section of their letter argued for a ‘rationalisation of our complicated tax and social security system and a move towards a negative income tax.’ The letter further implied that the wage freeze would be a first step towards a longer-term alignment between industrial relations arrangements and broader tax-transfer institutions, and a policy goal of ‘labour market deregulation’. The letter therefore added momentum to the growing interest in negative

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2 The essence of the Plan was, however, pre-empted by Peter Dawkins (1998a) at a Reserve Bank conference held in June 1998.

3 Also see John Freebairn’s Opinion piece in The Age, 28 October, 1998, p. 17 and Peter Dawkins (1996 and 1998) for a more direct statement of the need for labour market deregulation.
income taxes as one possible solution to the unemployment problem (Dawkins 1996a, Dawkins et al. 1997, Dawkins and Buckingham 1999).\(^4\)

Despite being rejected by the Minister for Workplace Relations, Peter Reith (1998), the Plan was quoted extensively in the media and fuelled the economic and political debate within Australia as to the relationship between labour market regulation and unemployment. The economists have since addressed the Prime Minister and, most recently, the Labor Opposition in their employment conference in Melbourne. This response suggests that the issue of tax-transfer reform, and its relationship to industrial relations institutions, is likely to become an increasingly important policy issue in the next century.

This article seeks to critically consider the economist’s Plan from an industrial relations and political economy perspective. We argue that its assumptions and foundations are inconsistent with what is known about labour markets and industrial relations dynamics, and political economy more generally. Consistent with the view of Dawkins (ironically one of the Plan’s authors) summarized in the quote which heads this paper, we also suggest that the Plan is unlikely to succeed in its current form due to its unrealistic and naïve view of the political process and the union movement’s need for labour market regulation. We go further and suggest that once a more realistic understanding of these factors is taken into account, then the likely effects of taxation reform on the labour market – particularly the hypothesized equity effects – require a substantially different approach and linkage between the two. Notwithstanding these problems, the Plan does raise important questions about the future of industrial relations institutions and their relationship to tax-transfer mechanisms, which should be explored. Specifically, tax credits may improve the position of the low paid in conjunction with appropriate labour market regulation which ensures that risk is efficiently and equitably distributed between firms and workers or adequately socialized.

The paper will proceed as follows. The next section (2) begins by isolating the themes and assumptions underpinning the Plan, which are neoclassical in approach. Section 3 will then focus on the implicit model of labour market on which the Plan relies. In light of these issues, Section 4 considers some of the political economy and industrial relations implications of the Plan. Then in Section 5 we use the Dutch ‘employment miracle’ to suggest that an appropriate policy to meet Australia’s labour market problems does not require radical labour market deregulation of the type advocated by the Five Economists. We instead use the concepts of risk and decommodification as two concepts which provide a framework for re-examining the linkages between taxation, social welfare and labour market regulation. The final section makes a number of conclusions.

The Five Economists’ Plan: Themes and Proposals

\(^4\) Bettina Cass (1996) has recently argued for a similar, participation income.
The Plan is informed by a number of themes and assumptions which attempt to establish linkages between taxation and the behaviour of labour market participants (firms and workers). While the nature of these linkages is made explicit, the predictions that derive from them are based on implicit assumptions about how labour markets work and the effects of industrial relations institutions. This section therefore seeks to outline briefly the nature of these themes and assumptions.

The central theme of the Plan is that existing taxation regimes have provided a major impediment to economic growth and therefore the necessary demand for labour to meet labour supply. Taxation arrangements, such as payroll tax and arrangements which contribute to non-wage labour costs (e.g., annual leave loadings) are viewed as reducing the demand for labour and potentially distorting the role of wage signals to both firms and workers. Thus, in the view of the five economists, taxation reform is expected to ‘lead to a more robust economy’ and ‘enhanced growth’ by removing the impediments and disincentives of existing arrangements.

This is, however, viewed as only one side of the equation. An equally important theme is that existing labour market regulation and institutions are substantially responsible for the relatively high level and persistent rate of unemployment in Australia. ‘Evidence suggests’ they claim, ‘that enhanced economic growth alone will not be sufficient to reduce unemployment much below 7 percent in long run.’ For economic growth to produce job growth, they argue that stronger linkages between industrial relations and tax and welfare reforms are needed. Specifically, they propose:

- Complementing recent changes to family payment schemes and social security arrangements with the introduction of a negative income tax arrangement in which low-wage workers receive tax credits. This was intended to act as both a means to ensure equity concerns were met and to reduce the perceived disincentive to work effects of current social security arrangements;

- An application to the Australian Industrial Relations Commission (AIRC) to freeze the minimum wage (Living Wage adjustment) at existing levels for a period of four years. This is intended to reduce the real wage and costs of hiring labour and, therefore, increase the overall demand for labour; and

- In contrast to the Prices and Incomes Accord, the plan rejects any attempt to control or limit aggregate wage demands. Thus the plan proposes no restrictions on the capacity of unions or employees to negotiate for wage increases directly with employers. This is intended to allow wage differentials to perform their perceived market clearing and signalling roles, thereby ensuring efficient (re)allocation of labour over time.

Assumptions and Themes

5 See Freebairn (1998) for a statement to this effect. Also see Freebairn and Dawkins (1997) and Dawkins, Beer, Harding, Johnson and Scutella (1998)
The Plan takes its conceptual cues from a neoclassical interpretation of the labour market problem faced by Australian policy makers. In contrast to the perception that other non-market institutions (such as the firm) exist for efficiency reasons, the prevailing view of neoclassical labour market theory holds a general antipathy towards labour market regulations and institutions. Such institutions are seen to impede the efficient equilibration of the labour market, preventing a reduction in unemployment (Gahan and Harcourt 1998). Consequently, it is argued, labour market ‘deregulation’ is justified on the grounds that is likely to lead to an increase in output and employment. In the context of the Five Economists’ Plan, the proposed freeze on Living Wage adjustments is intended to ensure that minimum wages and awards become irrelevant or are directly applicable to a shrinking pool of workers. In the absence of a relevant minimum wage then supply and demand are expected to lead to wage outcomes that are more consistent with full employment.

Consistent with this view, the Plan also suggests a more general need to limit the influence of labour market regulations and institutions through additional labour market deregulation. While the five economists specifically focus on wage regulation the proposal also points to longer-term labour market reforms. For example, the economists conclude by discussing the potential of negative income taxes to play a greater equity role in the labour market in the future. Dawkins (1998b, 1996a and 1996b) has elsewhere argued for the benefits of additional labour market deregulation in conjunction with a negative income tax to offset any inequities. ‘There are,’ Dawkins (1996a, p. 17) suggests,

“two reasons… for believing that some degree of deregulation of the labour market could prove beneficial. First, there are good reasons to believe that reducing the constraints on the ways in which employers hire their employees and manage their workforces could contribute to workplace productivity and… economic growth. This includes for example, removing constraints on working hours arrangements, greater use of individual rewards for higher productivity etc… Secondly, there are reasons to believe that a more flexible wage system would result in a larger number of jobs. International evidence suggests, for example that the ability of employers to offer lower paid jobs in the US than is possible in Australia has contributed to the lower level of unemployment in the US.”

This touches on the third theme informing the proposal – that equity concerns will be better met through the tax and transfer systems, rather than the industrial relations framework. The economists take particular pains to stress the equity potential of their proposal. Invoking the “spirit” of the Harvester decision, the proposal pre-empts community concern over the award wage freeze by stressing its equity advantages over awards. Dismissing awards as a cumbersome and inefficient

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6 Neville (1996, p.201) cites Freebairn, one of the five economists, who has elsewhere argued that ‘the challenge should be to let wages do their labour market equilibrating role. Society’s equity goals then would be met more directly and more effectively via the taxation and social security systems.’
source of equity, the economists cite research by Richardson and Harding\(^7\) that low award wage earners do not necessarily come from low-income households. On this basis awards are said to be poorly targeted mechanisms for meeting equity goals and have the added disadvantage of creating unemployment by raising the price of labour. In contrast, tax credits can be targeted to specific households in need and additionally help reduce high effective marginal tax rates, improving work incentives and contributing to further reductions in unemployment. The Five Economists argue that it would make sense, therefore, to reduce the influence of existing labour market regulations, allowing labour market forces to find their own equilibrium, reducing unemployment and catering for equity concerns through the tax system.

A final and related theme is an underlying acceptance of the importance of equity concerns within the labour market reform debate. The proposal is sensitive to the need for future labour market reforms to be politically acceptable, changing tack from the deregulatory debates of the 1980s and early 1990s that called for comprehensive reform such as Hewson’s *Jobsback* package, which argued for radical and immediate deregulation. As such, and in spite of the deregulatory preferences of the economists, the proposal has an eye to the politically achievable. Attempting to allay community concerns about additional industrial relations reforms, the plan seeks to work *within* the existing industrial relations framework by calling for a wage freeze rather than the abolition of the AIRC. At the same time, the proposal seeks to shift the institutional balance through which equity concerns are met by compensating employees for wage restraint through tax credits. In the process, the plan attempts to facilitate a longer-term movement away from the industrial relations system towards the taxation system as a source of equity. The remainder of this article seeks to critically evaluate the Plan and its central themes outlined here. We begin with what we see as the central idea on which the plan is based – and what we argue is its major flaw – the assumptions it makes about the functioning of labour markets and industrial relations institutions.

**How Do Labour Markets Work?**

As noted above, the Plan assumes that labour markets can be adequately characterized as analogous to other markets and can be expected to behave in ways consistent with standard market analysis. This approach begins from the model of perfect competition from which extensions and complexities are introduced by ‘relaxing’ the various assumptions made by the model and in order to close the gap between the predictions and dynamics of the basic model and what is empirically observed (see Hausman 1989).

The standard model of perfect competition assumes both firms and workers are ‘rational maximizers’. For the firm this is usually interpreted to mean they make production decisions to maximize profits;

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\(^7\) Being a newspaper article the “Open Letter” does not cite the actual source. Presumably the economists refer to a paper delivered by Richardson and Harding (1998) at the 25th General Conference of the International Association for Research in Income and Wealth.
while workers are assumed to maximize the utility from a trade-off between the use of their time as leisure and work. In addition to these basic behavioural axioms, the predictions of the perfectly competitive model rely on a number of additional assumptions. Most importantly, it is assumed that workers and productive resources are perfectly mobile; that all labour market participants have complete information about wages, job opportunities and worker productivity; that both firms and workers are ‘price-takers’; and that there are no externalities of the wage and employment decisions of workers or firms.

Implicit in all of the above is the idea that it will not be costly for firms and workers to adjust to any external ‘shock’. Worker mobility will be perfect, and firms are capable of adjusting capital-labour ratios and other inputs into production easily. Search and mobility for both firms and workers, and hiring and firing decisions are assumed not be costly, and so on. This leads to the prediction of full employment at the prevailing wage rate (or wage structure): all workers willing to supply labour will be offered employment. Where this is not the case, the prevailing disequilibrium will work to generate a labour market adjustment to full employment through changes in the wage rate. That is, unemployed workers should be able to bid down the prevailing wage until all workers seeking work are employed.

It is difficult to believe that this view of how labour markets work could be thought of as an accurate description of the real world and, indeed, few economists of any persuasion would argue that that the perfectly competitive model adequately describes real world labour markets. Put simply, the model fails to explain a number of fundamental economic phenomena. The most important of these are the existence and persistence of unemployment and the failure of wages to adjust downwards in periods of unemployment (Kaufman, 1997). The perfectly competitive model also fails to account for real world phenomena such as discrimination, the formation of unions the persistence of a union/non-union wage differential, internal labour markets and labour market segmentation. Indeed, as many economists have long recognised, it rules out as irrelevant many of the institutions central to the operation of a market economy, such as the firm. Despite these obvious shortcomings the standard model – or some approximation of it – is still accepted within the academic economics profession, albeit in newer, more sophisticated forms (Gregg and Manning, 1997). It is associated with what is commonly referred to as the ‘new classical’ approach (Lindbeck and Snower, 1988).

The deficiencies of the standard model relate to all the assumptions with which it commences. Specifically, the model fails to account for information and mobility problems, the nature of the wage setting behaviour, and externalities (see Gahan and Harcourt (1998) for a more extensive discussion of these issues). All three sets of issues have profound implications for how labour markets work and provide some rationale for the existence of labour market institutions. They further suggest that imbalances in labour market power and ‘imperfections’ pervade labour markets.

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8 Gregg and Machin (1997) note that many economists have begun from these assumptions when interpreting empirical regularities in labour markets. For one very influential example see Lucas and Rapping (1969)
Notwithstanding the importance of the various theoretical extensions made to the basic model, the neo-classical model has, in the last decade or so, faced a renewed challenge from institutional economics and industrial relations scholars. This has focused, in particular, on a critique of the view that the employment relation is best modelled as a market-mediated exchange (Lazonic, 1991).

These alternative approaches have been to view the employment relation as a ‘mixed exchange’ in which both market and non-market aspects are viewed as important, or to focus entirely on the internal characteristics of the firm’s employment structure and policies. Central to these approaches is the view that a market paradigm is inappropriate to understand employment relationships and labour market dynamics. Here, the employment relation is described as a two-stage exchange. The first stage, which is characteristically a market exchange, is the procurement of labour. This does not however complete the process as the procurement of labour involves the hiring of ‘raw labour’ (see Rubery 1997). The second stage involves the conversion of raw labour, or the capacity to work, into effective labour, or actual work effort. This phase does not involve a market exchange, but occurs within the confines of the firm and the authority relation which defines it (Bray 1986). From this perspective the exchange occurs, not within a market relation in which the price mechanism forms the basis for allocation and coordination decisions between separate economic agents, but within the context of an authority relation. The allocation and coordination functions normally assumed to be performed by the market are instead the province of managerial decision-making and the wage-effort bargain (struggle) between workers and managers (Rubery 1997, Rubery and Wilkinson 1994).

Within industrial relations this approach has been dominated by labour process theory and the analysis of management strategy (see Thompson and McHugh 1995), and in economics with segmented labour market theory and internal labour market theory (Doeringer and Piore, 1971). Unlike much of the standard economics literature, these approaches do not assume that the employment relation is likely to be structured in way which reflects both firm and worker preferences or efficiency concerns. Rather, the internalization of the employment relation reflects management preferences for profit maximization through minimization of labour costs and increasing intensity of worker effort (Gospel 1992), and is likely to be the outcome of struggles for control between workers and firms. In this context it is hardly likely that the structure the employment relation can be described as efficient (see Rebitzer, 1993 and Bowles 1985, Gordon, Edwards and Reich 1982). Or that wages are likely to perform the allocative or signalling functions that neoclassical economists associate with them (Picchio, 1981, Rebitzer 1993, Rubery 1995).

A second important element of these alternative approaches is the view that the employment relationship is not analogous to other forms of economic exchange irrespective of whether it is market mediated or within the context of the firm. For many economists, particularly those of the transaction-costs school, recognition of the non-market dimension of the labour exchange does not distinguish it from a range of other economic exchanges where transaction-costs imply a non-market governance
structure.

However, there are strong arguments in favour of distinguishing ‘labour market transactions’ from other types of economic exchange (see Blyton and Turnbull 1998, Brown and Nolan 1988, and Mückenberger and Deakin 1989). First, the employment relationship is characterised by real uncertainties and asymmetries not found in most exchange relations (see Blyton and Turnbull 1998, Brown and Nolan 1988 and Mückenberger and Deakin 1989). While the employer’s obligations are specific in the form of a given wage, the employee’s obligations are uncertain and unspecified. Second, the employment relation distinguishes itself from other exchange relationships because of the nature of the object of exchange and the characteristics of the exchange itself. Unlike other exchange relations, labour markets involve the exchange of human services, not inanimate objects or inputs into the production process. It is these human aspects that reflect the ‘psychological contract’ between firms and workers in which norms of behavior are implicitly established (Klass and Ullman 1995, McFarlane, Shore and Tetrick 1994, Rousseau 1989, Robinson and Rousseau 1994). Moreover, the employment relation is unique in that the object of exchange, the mental and physical capacities to work, is inseparable from the subject of exchange, workers themselves (Blyton and Turnbull 1998). As Isaac (1992) points out, the implications for analyzing labour markets are profound:

Those of us who look more closely at the labour market know that there is an important difference between the human factors of production, labour, and other factors which are used in cooperation with labour in the productive process. Labour is not a commodity. Labour is subject to complex social and psychological forces. People are less receptive to direction than a piece of equipment. They react to their environment… In their working environment, they are not individuals but form part of a group, open to group pressures and values. The place of work is not merely part of an economic process but also a social institution. And so is the labour market. In such a context, people develop norms about what is right and wrong and fair. Work is not merely to earn an income. It has meaning in itself. The size of payment for work reflects on the worth, status and self-esteem of the person concerned. People measure their worth not in absolute terms but relative to one another. But while the financial incentive is important, people are also motivated by non-financial considerations.

The incomplete nature of employment contracts and the human dimensions of the exchange combine to make the employment relation unique, both in terms of the governance structures which define them, the terms of the exchange and the actual exchange itself (Brown and Nolan 1988).

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9 Mückenberger and Deakin (1989: 188) note three sources of uncertainty: the length of service, the exact content or tasks required, and the intensity of work. Some obligations imposed on employers by common law, are by their nature, imprecise. Most notably, the implied duty of care the employer has to their employee (see Creighton, Ford and Mitchell 1993).
This perspective raises two important questions. First, what are the mechanisms through which labour markets adjust? And second, is it likely that labour market outcomes will be efficient? Both have obvious and important consequences for understanding the precise nature of the linkages between taxation, welfare and labour markets. An initial observation is that the preceding discussion suggests the neoclassical focus on the ‘price mechanism’ as the primary source of labour market adjustment is inappropriate. Both firms and workers are able to alter the terms of the exchange through a range of other dimensions: ‘there are too many margins, but not enough prices’ (Bazzoli, Kirat and Villeval 1994). This is certainly not to suggest, however, that market dynamics play no role. As Hancock (1999) has recently pointed out, this is a point of emphasis. While neo-classical economists have held to the view that the supply of and demand for labour are generally (wage) elastic, the focus on the functioning of internal labour markets and firm-level processes suggest in fact that these are likely to be inelastic. ‘Markets of this kind,’ he notes, are congenial to the non-economic influences which are central to the study of industrial relations’ (Hancock 1999, p. 4).

Moreover, the unique aspects of the employment relation imply that a range of psychological and social determinants of worker behaviour and management practice will influence labour market dynamics. There is now a large and impressive literature which examines the important role of fairness in wage determination, which economists such as Akerlof (1984), Solow (1990), Rees (1994) and Yellen (1984) have argued the most important of these is the norm of fairness.

These non-market and unique aspects of the employment relation have important consequences for the efficiency and equity characteristics of labour markets. It is to a consideration of these in relation to the claims made in Five Economists’ Plan that we now turn. Then in the section that follows, we go one step further and attempt to re-conceptualize the problem of employment and unemployment policy, and then offer an alternative policy proposal to deal with these issues.

**A Critical Evaluation of the Five Economists Plan**

In Section 2 we noted that the plan was justified on the basis of a number of claims about the role of labour market regulation and how it was likely to affect labour market outcomes. In this section we shall critically assess each of these in turn. Here we will be concerned with four issues. First, the role of labour market institutions; second, the relative effectiveness of labour market and taxation as competing means to address equity issues; third, the efficacy of substituting tax credits for award wage increases, and fourth, the political acceptability of the proposal and union responses to the plan.

**Theme #1: Labour Markets Institutions and Labour Market Outcomes**

The Five Economists’ rationale for targeting industrial relations institutions was that these institutions prevented the labour market functioning in manner consistent with normal market processes. Thus, they suggest, the full employment benefits of taxation reform and economic growth was more likely to translate into wage increases inconsistent with full employment. As the previous section noted,
however, these effects were predicated on a very specific set of assumptions about the role of
ingustrial relations institutions and their likely effects on labour markets. These assumptions, it was
oted, do not accord well with what we know about labour markets and industrial relations processes.

This analysis raises two important questions. First, what is the empirical evidence to support the claim
that labour market regulations – especially in the form which currently exist – have detrimental effects
on labour market outcomes? Second, if the evidence does support the claim that regulations produce
‘bad’ outcomes, how can we begin to understand the effects of institutions?

The empirical evidence on the relationship between labour market institutions/regulation suggests that
at best the Five Economists have limited foundation for their claim that existing labour market
regulations have had detrimental effects on labour market outcomes. The evidence has been more
comprehensively discussed elsewhere (see Gahan and Harcourt, forthcoming and Freeman 1994,
Blank and Freeman 1994). Here we shall simply note two important pieces of empirical evidence,
which bear directly on their claims. First, there is little evidence that awards and arbitration have had
large effects on the functioning of the labour market or distorted labour market outcomes (Coelli,
Fahrer and Lindsay 1994; Withers, Pitman and Whittingham 1986, Brown, Hayles, Hughes and Rowe
1978, OECD 1986, NLCC 1987: Rowe 1982). Overall the arbitration system has proved to be
relatively flexible and responsive to the changing demands of firms and unions; at worst, the net
effects have been slight. Second, much has been made of the centralizing tendencies of Australia’s
system of arbitration. Here again, the evidence suggests that this has produced few, if any, adverse
effects, particularly where institutions perform a coordination function between bargains made at
various levels of the economy (national, industry, firm levels); see Elster (1989) and Soskice (1990)
for theoretical discussions of this point.

How then can the effects of labour market institutions be best understood? It is a somewhat curious
anomaly that while many institutional and organizational features of the economy are viewed by
economists as efficient responses to market imperfections, labour market institutions are generally
viewed as having more pernicious effects.

The major role of institutions in a society, North (1991, p. 6) suggests, ‘is to reduce uncertainty by
establishing a stable (but not necessarily efficient) structure to human interaction.’ Markets are just
one set of rules – or institution which structures behaviour and exchange between economic agents.
From this perspective, labour market institutions – or the rules that govern the interactions between
agents in the labour market and within the context of employment relationships – are best understood
to serve this function.

Using a rational choice framework consistent with the neo-classical approach adopted by the Five
Economists, Tsebelis (1990) distinguishes between institutions which have efficiency enhancing
characteristics and institutions which arise out of social conflicts over the distribution of resources. In
this context labour market institutions cannot be assumed a priori to have efficient or distributional effects. Their effects will in fact be dependent on a range of issues relating to their design and the context in which they operate. Tsebelis (1990) argues that efficient institutions will arise where uncertainty about the future position of any social actor prevents them from knowing the effects of any social institution on their own welfare in future periods. Uncertainty therefore favours the formation of efficient institutions. Knight (1991) takes this analysis further and argues that most institutions will in fact reflect both efficiency and distributional concerns. From this perspective, the relative bargaining power of social actors will effect both the design of institutions and extent to which either efficiency or distributional considerations dominate. Following this framework and the work of Coat and Morris (1995), Robinson (1996) has argued that many of the labour market reforms undertaken elsewhere during the 1980s and 1990s – most of which followed the deregulationist path favoured by the Five Economists – reflect distributional concerns rather than efficiency issues (also see Pontusson and Swensen 1996 and Pontusson, 1995). The evidence concerning the effects of labour market reforms in Britain during the 1980s provide considerable support for this view. In the Australian case, the evidence is more speculative. However, in a comparison of labour market trends in the US and Australian, Gregory (1996, p. 100, emphasis added) concludes that:

>The comparison of Australian and US experience relates to the current emphasis on changing labour market institutions. It suggests that the most likely effects of institutional changes will be to impact adversely on income distribution rather than generate employment growth at low wages. A comparison of recent job growth in the United States suggests that a greater dispersion of relative wages did not lead to the creation of [a] proportionately larger number of low paid jobs, relative to Australia. The restoration of full employment will lie in a direction other than reducing the wages of the low paid.

**Theme #2: How to Tackle Poverty: Labour Market vs. Social Welfare measures.**

The second major justification made by the Five Economists in favour of their plan concerned the capacity of labour market and social welfare measures to adequately meet equity concerns associated with labour market deregulation. This argument in fact takes two tacks. First, the use of minimum wage measures –such as Living wage adjustments – are rejected as being blunt instruments to reduce poverty, while tax transfers are to be preferred. Second, minimum wage adjustments are viewed as being undesirable because they are, contrary to their intentions, likely to create unemployment. We shall respond to each of these claims in turn.

In their letter to the Prime Minister, the Five Economists argue that: ‘The use of the tax transfer system to improve the income of low-income families which include wage earners, would be better than Living Wage adjustments.’ They cite with approval research by Richardson and Harding (1998) which finds that persons on low incomes are not only concentrated at the lower end of the income
distribution. They therefore conclude that, ‘This makes Living Wage adjustments a very blunt equity device.’

Their argument, we suggest, requires further scrutiny and empirical work before strong conclusions can be made. In a related piece of research which examines where low-wage workers are situated in the distribution of households by income, Richardson’s (1998) own conclusions about the data are far more equivocal than the Five Economists. While noting that ‘one of the key arguments against the use of enforced minimum wages to raise the living standards of low-wage workers is that to override the outcomes of the market in this way causes unemployment,’ Richardson (1998: 554) warns against making the conclusion that this implies minimum wages should be reduced or removed. Rather, she argues, ‘a cut in low wages that focuses on the those around the Australian Industrial Relations Commission minimum would be regressive’ (Richardson 1998: 554). Moreover, she concludes that, ‘the circumstances necessary to make the gain to the unemployed exceed the losses to the low-wage workers who have a low income appear to be quite implausible’ (Richardson 1998: 554). Importantly, Richardson (1998) also stresses that while there are many low-wage workers who do not live in low income households, for those who are in low income households – most of whom are women with dependents10 – minimum wages continue to make a significant difference to living standards. Nonetheless, her work suggests there are limits to the efficacy of minimum wages in reducing poverty. There is little empirical evidence, however, to evaluate this within the Australian case.

What is the international evidence on the effects of minimum wages? In the most recent study on the effects of poverty reducing effects of minimum wage laws in the US, Addison and Blackburn (1999, p. 407-8) concluded:

Our results provide evidence that increases in minimum wages in the 1990s have served to reduce poverty… In contrast, our results suggest that minimum wage increases in the 1980s did not reduce poverty… It may be that we are seeing a continuation of a trend pointed out by Wellington (1991), who noted the dissipation through time of the negative employment effects of minimum wages.

On the basis then of the existing evidence, it is hard to accept the claim made by the Five Economists that minimum wages are inevitably a blunt device to attack poverty.

We would note one further objection to the argument that tax transfers are to be preferred to minimum wage adjustments which relates to the argument made in Section 2 concerning the nature of the employment relationship. There it was noted that the employment relation was governed by a range of social norms and psychological contracts in which notions of fairness and dignity played an important role.

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10 This is in contrast to the claim by the Five Economists that the proposal would improve the position of low-income families, particularly those with children.
To this end Richardson (1998: 568-9) defends minimum wage provisions on the basis that income from wages is not perfectly substitutable with other sources of income, such as tax transfers.

Being able to earn one’s own income is a mark of being able to function as a competent and independent adult (not the only mark, of course – many women and a few men exercise their competence in the domestic sphere). It would be a sad development in Australian society if a person working full-time were not thereby able to support herself or himself independently and at an adequate standard of living.

A second objection to minimum wage increases concerns its perceived employment effects: higher minimum wage increases, it is assumed will have disproportionate unemployment effects. The Five Economists argue in favour of a freeze in the Living Wage at its current level on the basis that as inflation erodes its real value over time, the real decrease will necessarily induce employment growth. To support this claim they cite work by Debelle and Vickery (1998) who estimate that ‘a 2 percent fall in the growth of real wages, for one year, could lead to a permanent reduction of unemployment of about 1 percentage point. Lower growth in wage costs lead directly to a higher demand for labour’ *(The Australian, 26 October, 1998)*.

The evidence on the effects of wage increases is, however, more complex that this simple statement implies. Once again, the claim rests on an assumption that the standard competitive model adequately describes real world labour markets. The theory of monopsony, however, suggests that wherever any one of a number of frictions and imperfections exist (such as mobility and information costs) firms may be able to exert some influence over wage setting (see Boal and Ransom 1997). Recent empirical research on the employment effects of minimum wage increases provide strong evidence to suggests that this theory of monopsonistic competition has wider validity than most economists have recognized. In the most comprehensive study to date, Card and Krueger (1995) re-examine a number of studies on the employment effects of minimum wage increases, and also conduct new studies using data form the US fast food industry – the very labour markets assumed to be the closest to the textbook model of the competitive labour market, and the very group targeted by the Five Economists’ plan. Rather than reducing employment Card and Krueger find that increases in the minimum wage had no or insignificant effects on employment; in some cases the effect was to increase employment, a finding consistent the theory of monopsonistic competition. Dickens, Machin and Manning (1993) and Machin and Manning (1992) report similar results for Britain, while Manning reports similar effects following the passage of the 1970 Equal pay Act in Britain. In the most recent research examining the employment effects of minimum wage increases in the US Belman and Wolfson (1999, p. 162) conclude,

‘our research supports the view that moderate increases in the minimum wage which have been acceptable to the political processes of the United States do not affect employment
in a consistent and systematic fashion. Judging by the acrimony of recent debates about
the minimum wage, it strikes us that the minimum wage’s bark is worse than its bite.’

We would also question the view that a Living Wage freeze for a period of four years would have the
desired effects on wages or employment. This is so for three reasons. First, it is questionable that a
four-year wage freeze is likely to produce a 2 percent fall in the real value of average weekly earnings
(AWE), as is claimed by the Five Economists. The Australian Council of Trade Unions (ACTU) has
calculated that the time period required to affect such a decrease would in fact require a wage freeze
for a substantially longer period. Given that only 30 to 40 per cent of employees are reliant on awards
for their wage increases, the ACTU argued that:

To achieve a cut in real AWE therefore would require a much larger cut in award rates –
which low paid workers depend on. A one per cent cut in AWE would require a cut in
award rates in the order of 5 percent or more; to achieve a cut of 3 percent – 4 percent in
AWE would require award rates to be cut by something like 15 percent to 20 percent.
This would require a freeze in Living Wage increases for a decade or longer – twice the
period assumed by the plan’s five proponents (ACTU 1998: 1).

Second, the claim that freezing the minimum wage and hence award wages, would lead to a
substantial moderation in AWE is open to question. Using data from the Australian Workplace
relations Survey (AWIRS95) along with an analysis of general labour market developments during the
1990s, Peetz (1998, pp. 551-2) finds that ‘the relationship between the award safety net and actual
wages has changed substantially during the 1990s… [as] the barriers that impeded the Commission
from more actively fulfilling obligations to maintain fair minimum standards in the context of
prevailing community standards have largely disappeared.’ It cannot, therefore, be concluded that
safety net austerity will translate into the requisite decline in AWEs necessary to make the plan
successful.

Third, even were such a fall in real wages achievable, there is some evidence to suggest that such
schemes are often associated with substantial displacement effects and longer term effects which
undermine the original intention of the policy. In the case of displacement effects, there is now
widespread recognition that such schemes provide firms with incentives to displace existing jobs with
subsidized jobs (in this case subsidized through the tax credit scheme), rather than employ additional
workers at the lower, subsidized rate of pay. This has obvious consequences for equity which appear
contrary to the Plan’s stated goals (for an analysis of displacement effects, see various contributions in
Snower and DeHesa, 1997). Recent work by and Colling and Dickens (1998) further suggest that the
creation of these have a strong gender dimension and contribute substantially to gender inequality (as
does deregulation). This analysis, however, may underestimate these more deleterious effects by
ignoring important longer-term effects. Most notably, as Arulampalam and Booth (1998) show, the
tendency for the creation of low-wage jobs to be associated with low levels of formal and on the job training, thus creating a low wage-low productivity dynamic which, in a longer run perspective, is unlikely to be conducive to further employment growth.

In conclusion, the evidence to support the claim that tax transfers are likely to provide a more effective means to target poverty is simply not supported by the available evidence, particularly in terms of what we know about the effects of relatively modest minimum wage increases on both the reduction of poverty and employment. Even where it can be concluded that tax transfers can more closely target low-wage earners in low-income households, the equity considerations which supposedly motivate this proposal demand that the potential effects on individuals self esteem and sense of dignity are taken into account. We also question whether the minimum wage freeze is likely to have the desired effect in lowering real wages and reducing employment. Finally, we question whether the proposal is in fact in the spirit of the Harvester judgement, as the authors’ claim. In stark contrast to their implicit claim that a firm’s incapacity to pay requires a reduction in wages, Higgins based his decision squarely on the argument that these concerns were secondary.

My function is to settle disputes … and, incidental to this function, I have power to fix the minimum rates of wages to be paid to the employees of the different classes … No guidance is given as to the principles on which I am to act in settling a dispute or in fixing wages; and I have to find out principles for myself. No doubt the issue is not precisely the same as that which I had to deal with in the Harvester Case … and yet the same considerations are necessarily involved. I must settle the dispute on terms which seem to me just – on terms which I deem to be “fair and reasonable between the parties” … and I cannot conceive any terms to be fair and reasonable which do not at the very least allow a man to live from his labour, to live as a human being in a civilized community. (our italics, 2 CAR [1907] 55 at 60).11

Theme #3: A Politically Acceptable Plan

The Five Economist’s Plan was not only drafted with an eye to what they saw as the primary economic considerations, but also to with an eye to devising a politically acceptable plan which met community concerns over the equity effects of a wage freeze for low-wage workers (see Freebairn’s explanation and defence of the plan in the Melbourne Age, 28 October, 1998). In an earlier paper, Dawkins (1996a, p. 18), for example, is far more explicit about how these political contingencies have

11 Later statements made by Higgins render his view unambiguous. In the Broken Hill Miner’s case (3 CAR [1909] 1 at 32) Higgins argued:

   If a man cannot maintain his enterprise without cutting wages which are proper to be paid to his employees – at all events, the wages which are essential for their living – it would be better that he abandon his enterprise … Unless great multitudes of people are to be irretrievably injured in themselves and in their families, unless society is to be perpetually in industrial unrest, it is necessary to keep the living wage beyond the reach of bargaining.
shaped the plan when he questioned whether ‘the effects on income distribution of a deregulated wage system, of the kind experienced in the US’ would be acceptable:

The answer is probably no. …Australians are understandably uncomfortable about the prospect of a substantial “working poor”. We must recognize, however, that there are tradeoffs here… Is there a way of getting some of the best of both worlds? Can we achieve greater wage flexibility, create more jobs, but avoid a major problem of a large working poor? …An alternative is to allow the labour market and its associated institutions to be concerned primarily with the distribution of work, and thus allow more lower paid jobs, and essentially give the tax and transfer system the role of averting poverty’ (p. 18-19).

One of the most important industrial relations issues to emerge from the Five Economists’ Plan concerns the likely durability of the policy. We suggest, however, there are in fact several reasons why the proposal presented in the plan is unlikely to prove durable or stable. Two main issues are of concern. First, the issue of how the real value of the tax transfers is to be maintained over time given the nature of the budgetary process. And second, whether the proposal is likely to have a neutral affect on the bargaining power of the parties, and hence their future capacity to protect their political and economic interests.

The claim that income delivered through tax credits rather than through award wages constitutes an improved source of equity rests on the assumption that existing social security provisions are likely to be maintained. Yet, the fiscal experience under the Howard government has demonstrated the difficulties political parties encounter in maintaining credible policy positions. In opposition, Howard took particular pains to allay community fears that a Fightback! style “slash and burn” fiscal policy would be implemented. The Coalition promised to not make significant cuts to existing programs, promised not to introduce a GST and denied that such commitments were contingent on the budgetary balance he inherited (Dullard and Hayward 1998 pp. 23-4, see also Williams 1997). After winning the 1996 election Treasurer Costello promptly announced a revised forecast deficit for 1996-7 of $7.6 billion (the “$8 billion Beazley black hole”) which was further revised upward to $9.6 billion in the 1996-7 budget. After appointing a National Commission of Audit to advise the government on resolving the budgetary “crisis”, Costello then embarked on a process of fiscal austerity designed to reign in the deficit through significant expenditure cuts. Costello’s cuts for the three years ending

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12 For a theoretical treatment of the importance of credible policy positions, see Cukierman and Tommasi (1998). An equally important issue, but one which is not developed here, concerns the general problems faced in maintaining current levels of welfare state expenditures. For an analysis of this issue see O’Connor, Shola Orloff and Shaver, 1999, Jordan 1998, and Esping-Andersen, 1999)

13 During the Second Great Debate Howard promised that “Every single dollar of the promises that I made to the Australian people are [sic] going to be kept” (cited in Dullard and Hayward 1998, p.24).

14 Despite a significant cause of the budgetary problem being reductions in anticipated revenue (Dullard and Hayward 1998, p.26).
1998/9 reduced Commonwealth outlays by $12.4 billion or $7.2 billion when considering new expenditures and tax cuts (Dullard and Hayward 1998, pp.26-7).

Central to this process of fiscal “consolidation” was the abolition of a range of social policy programs which made important equity contributions similar to the proposed objectives of the economist’s tax credits. These included: $1.8 billion worth of cuts to labour market programs (which the economists noted in their own letter were a necessary element of a comprehensive plan to reduce unemployment) over four years; abolition of operating subsidies to community-based day care (outlays cut by $42 million per annum); $527 million worth of cuts to AUSTUDY funding over four years; capping the level of childcare assistance, tightening eligibility and freezing rebate payments for two years; cutting State public hospital funding by $800 million over four years; and reducing the number of public sector jobs by 30,000 by 1998 (Office of the Leader of the Opposition 1996).

This experience makes us highly sceptical of the long-term reliability of a tax-based approach to equity. The ability of any government to make such significant cuts stands in contrast with the permanency of awards that have the effect of law and are implemented by an independent industrial umpire. Seen in this context, the recommendation that tax credits be substituted for Living Wage adjustments may constitute a short-term equity benefit, gradually whittled away without awards being replaced.15

The political problem of maintaining the real value of tax-transfers over time suggests one reason why union and other interested parties have not been so enthusiastic about the plan. On the day the letter was published the ACTU (1998) asked who was going to fund the tax credits given the ‘cost of a system of tax credits which compensated for a wage freeze would be huge?’ The ACTU cynically noted that ‘the proponents of the wage cut plan do not say how this would be funded’ and ask if it would be paid for by Howard ‘running down his erstwhile budget surplus?’ Such concerns are particularly pertinent given the budgetary challenges that will be raised by the GST tax package, which offered significant tax cuts as a sweetener.

Given the Five Economists’ concern to construct a proposal that was politically acceptable and meet concerns about its equity implications, it is perhaps surprising that community groups were not consulted. This is particularly so given the role that unions have historically played in shaping the wages system and the Australian welfare state (see Castles 1985 and Esping-Anderson 1990). This is

15 This is not to deny that the tax-transfer system is an important source of equity. In a recent Living Wage case decisions the tribunal itself acknowledged the growing importance of social security and taxation policies in addressing the needs of the low paid in conjunction with the award safety net. In the 1997 Living Wage case the AIRC quoted the Australian Confederation of Commerce and Industry’s submission arguing that ‘equity issues should be addressed “through an appropriate focus on the needs of the low paid, recognising the limits of the Commission’s power to address the needs of the lower paid and the way in which their needs are addressed through taxation and social security systems”’ (Print P1997, p.49). The key issue that arises from this argument is whether tax credits are substitutes or complements to labour market regulation and institutions.
especially so given the symbolic and functional importance the Australian labour movement has historically attached to arbitration and labour market regulation more generally.\textsuperscript{16}

Arguably, it is unlikely that unions would be receptive to the Plan, even if they were included in a more constructive way.

More recently, Australian unions have embraced a much more expansive approach to social protection. The Accord experience evidenced a broadening of the Australian union movement’s social security and taxation strategies. Under Accord the ACTU sought to complement traditional industrial relations policies with a more active social security policy, with particular emphasis placed on the social wage as a means of improving worker’s living standards and offsetting the consequences of wage moderation (Mendes 1998). Such an approach opened up new possibilities for macroeconomic management and facilitated a more cooperative relationship between the state, unions and employers. At the same time the social wage, working in conjunction with industrial relations institutions, provided an equitable resolution of the economic challenges facing the Australian economy (Johnson, Manning and Hellwig 1998).

Given the benefits such a collaborative approach had it is unfortunate that the tax credits proposal avoided any consideration of the union movement. Unions are highly sceptical of the tax credit recommendations (ACTU 1998, Costa 1998) but tax credits may in fact provide interesting possibilities for resolving the challenges of labour market change. Tax credits and negative income taxes, for example, could act as effective mechanisms for supplementing variable incomes in the context of increasing non-standard employment. Supplementation could occur in conjunction with existing industrial relations protections. Negative income taxes could also give employees space to leave the labour market for training by ensuring a guaranteed minimum income, thus providing a long-term dynamism in the Australian labour market.

By working with unions and accepting that industrial relations institutions are important sources of employment security, tax-transfer reforms could strengthen the social safety net. Approaching tax credits as a means of avoiding and undermining industrial relations institutions prevents an exploration of the possible advantages a more creative approach to tax-transfer systems may have. Marginalising and alienating unions from the reform process also diminishes the political likelihood of securing change.

Recasting the Linkages Between Taxation and Industrial Relations Policy

\textsuperscript{16} It is perhaps not so surprising that they ignored unions in their proposal. One can speculate that the economists see unions as part of the problem, representing yet another institutional obstruction to the reduction of unemployment. Alternatively, declining unionisation may have given them confidence that a weakened union movement will be unable to prevent such a proposal before the AIRC, and that unions may be safely marginalised in the process of policy formulation.
In this final section, we wish to offer an alternative basis for considering what would be an optimal set of linkages between taxation, labour markets and industrial relations policies. Before we outline our alternative, however, we wish to make a number of preliminary points, which form the basis for our alternative. Three issues are of particular concern. First, the role of regulation, second, how best to define ‘the policy problem’ of employment and unemployment, and third, what are the most appropriate criteria to evaluate policy processes and outcomes.

The Role of Labour Market Regulation. From the argument that has been developed in the preceding sections it should be patently clear that we object to the view that labour market regulations and industrial relations institutions should be viewed a priori as sources of labour market rigidities and inefficiencies. Following Tsebelis’ (1991) characterization of the efficient contracting hypothesis of most mainstream analysis of transaction costs, we refer to this as the naïve view of institutions. Instead, we begin from the view that institutions and regulations serve both efficiency and distributional functions and emerge in response to both market failure and as outcomes of social and political conflicts (see Knight (1991) for a formal discussion of this approach). In contrast to neoclassical economics, this perspective derives from a long tradition of industrial relations research on the role of regulation (see Buchanan and Callus 1993 for a discussion of this tradition).

Thus, our starting point is to say regulation can either be “good” or “bad” in that it meets/fails to meet our efficiency and equity goals. But in the end, this can only be known empirically. Moreover, as Buchanan and Callus (1993) note, any “good” regulatory regime must take account of the balance between regulatory mechanisms which derive from sources external to the firm (statute, collective agreements) and those that derive from sources internal to the firm (work rules, managerial prerogative, custom and practice). As is long recognized in labour law research, “regulation” has both private and public sources (see Hepple, 1986). Finally, it is unlikely that there is one unique solution to this problem of locating a proper balance between external and internal sources of regulation (Boyer and Hollingsworth 1997). This will be context driven and historically contingent as social actors learn and find new ways to interact with each other in a given regulatory context in order to pursue their goals (see North 1991 for a more detailed discussion of how this occurs).

Defining the (Un)employment Problem. A core argument against the Five Economists Plan has been that, for a host of reasons, labour markets do not ‘behave’ in the way predicted by standard neoclassical models. Consequently, the plan does not provide a very realistic diagnosis of the causes of unemployment. It was argued, therefore, that it is unlikely that the Plan will have the intended effects on unemployment. Our discussion of the nature of labour markets and the employment relationship in Section 3 suggested that a range of labour market dynamics needed to be accounted for if a proper understanding of how firms are likely to react to a plan such as that proposed by the Five Economists. In particular, we draw attention to the many ways in which labour markets adjust. Firms can, for example, adjust their labour demand, not simply by increasing or reducing the number of workers
hired, but through a host of ‘margins’: overtime, the combination of full-time, part-time and casual workers, the intensity of work, and so on.

These factors suggest that shortcomings of the Plan’s view of the ‘unemployment-employment problem’ are more fundamental than simply a misdiagnosis of its likely effects. Most importantly, we argue the Plan is problematic in that it oversimplifies the nature of the many labour market challenges facing policy makers and which contribute to both economic growth and employment. The plan portrays the labour market challenge facing policy-makers as a dichotomous one in which there is a choice between employment and unemployment, and in which labour market deregulation or a short-term freeze of the minimum wage is likely to generate a strong and sustained labour demand effect and thereby reducing unemployment.

More recent academic work looking at the demise of standard employment suggests that the labour market problem is much more complex than the diagnosis made by the Five Economists. Firstly, there is an issue of underemployment. The most direct measure of underemployment – part-time work – has increased dramatically over the last three decades, growing by approximately 5.5 percent per annum from 1966 to 1994, compared to 1.5 percent per annum for full-time employment (ACCIRT 1999, p.136). In 1995 part-time employment accounted for approximately 25 percent of total Australian employment, giving Australia one of the highest recorded levels of part-time work (OECD 1996).\footnote{This is not to dismiss the worth of part-time employment. Significant numbers of part-time workers prefer part-time employment. This is especially the case for women (Romeyn 1992: 40-1). One reason frequently suggested for this is that part-time employment offers possibilities for combining work and family, although this may represent a “constrained choice” for women given the inadequate provision of affordable child-care (Romeyn 1992; Rimmer 1994, p.78). However, part-time employment also has disadvantages compared to full-time employment, such as the degree to which it is disengaged from ILMs and career paths (Harley 1993).}

Of this total, a significant number of part-time employees preferred additional hours, increasing from 17 percent to 26 percent over the period 1986 to 1996.

Of equal concern is the growth of precarious forms of employment such as casual work and contract work, all of which poses challenges to the existing regulatory framework and constitutes an important source of labour market insecurity.\footnote{There is considerable overlap between part-time work and casual employment, with around 65 percent of all part-time employees being employed on a casual basis in 1996 (Campbell 1996: 574).} Estimates suggest casual employment now accounts for over one-quarter of total employment in Australia (which, it should be noted, provide for considerable flexibilities \textit{within} the existing regulatory framework jobs; see Romeyn 1992). Similarly, temporary work – or short-term employment – has increased dramatically over the last two decades with Australia having the second highest level of temporary employment in the OECD after Spain (OECD 1996, p.8). Reflecting the consolidation of a much broader process of labour market restructuring across all advanced industrial societies, the growth of casual and contract employment has fuelled the emergence of an “irregular” workforce in Australia characterised by increasing precariousness (see Quinlan 1998 for an overview).
An understanding of the inadequacies of precarious employment relative to permanent employment requires us to question the assumption underpinning the Five Economist’s proposal that all employment is unambiguously preferable, or more precisely provides for greater equity in the labour market. Levels of job insecurity, for example, are significantly higher amongst casual and temporary employees (ACIRRT 1999, p.140-1). Casual employment generally has inferior training, earnings and unionisation levels (Burgess and Campbell 1998). In addition, AWIRS data suggests that casual employees are systematically excluded from consultation and job variety (ACIRRT 1999, p.141). The irregularity of casual and temporary employment may also translate into financial uncertainty and a consequent diminution of life options. (Eligibility for bank loans, for example, requires a stable income flow; see ACIRRT 1999, p.140). Consequently, the growth of casual and temporary employment has prompted important questions about an emerging “ghettoisation” within the Australian labour market, constituting an important form of social and economic exclusion for such employees from the benefits of stable employment (Brosnan 1996, Burgess and Campbell 1998). The work by Buchanan and Allen in this symposium also evidences how the growth of non-standard, precarious employment poses particular challenges for linking taxation, welfare and industrial relations policy.

The growth of precarious employment has been justified on the basis that it has important dynamic benefits for the economy and contributes to beneficial long-term labour market outcomes. It is frequently asserted, for example, that precarious work provides the low skilled with a ‘bridge’ to better quality employment after human capital has been amassed (Freebairn implied this was one of the benefits of the proposal in the Melbourne Age, 28th October 1998: see also Valentine 1996, Becker 1996, Hashimoto 1982). Arguments that precarious employment may be equitable in the long run because it leads to permanent employment are, however, questionable. Evidence suggests that casual employment fails to lead to better quality permanent employment down the track (Brosnan 1996), and frequently leads back to unemployment. Precarious employment is viewed as problematic in that it is de-coupled from stable, core labour markets. Campbell and Weber (1996, pp. 112-3) warn that:

Current labour market policy seems to hinge on the assumption that any employment is valuable to a job seeker. Indeed in the recent period policy has been largely concerned both with sponsoring new forms of precarious employment via employment schemes and encouraging targeted groups to move into these and other forms of precarious employment. Insofar as precarious employment is acknowledged as a problem, it is suggested it can act as a ‘bridge’ to better employment. But information on the extent to which and the way in which precarious employment can act as a bridge is elusive… It may operate as a bridge for some workers, though in the favoured example of young workers it seems more accurate to describe precarious employment as a ‘parking lot’ rather than a ‘bridge’. For other categories of workers precarious employment can be a ‘cul de sac’ or ‘trap’, in which individuals become locked into a cycle of rotation in and
out of precarious employment. In this last case precarious employment can entail a distinctive pattern of participation marked by intermittent employment – employment for limited periods, interspersed with bouts of unemployment and withdrawal from the labour force.

If the definition of the employment problem is expanded to include a consideration of the quality of work in addition to the quantity, then the Five Economists Plan is problematic in that it fails to consider how regulatory mechanisms (including taxation arrangements) influence both aspects of employment and unemployment. The adage ‘a job is better than no job at all’ does not always hold true. Undermining labour market regulation and industrial relations institutions may in fact contribute to unemployment as well as exacerbating the job security of those in employment and contributing other aspects of ‘the labour market problem’.

**Defining Appropriate Criteria.** This discussion about defining the problem impinges directly on defining what are the best criteria for measuring the effects of policies. By suggesting that the quality of jobs is an important part of the problem that should be addressed, we have implicitly suggested that a simple arithmetic reduction in unemployment does not adequately meet our efficiency or equity criteria. It is to a clearer definition of these that we now turn.

The standard measure of efficiency used by economists is that of Pareto Efficiency. This criteria dictates an outcome is deemed to be efficient if no one can be made better off without making others worse off. We reject this as an adequate basis on which to measure the efficiency of labour market outcomes; it is too narrowly focused and is inherently conservative. As Rebitzer (1993, p. 1395) has noted, ‘existing economic structures are the contingent result of particular historical developments and therefore have no a priori claim to optimality or efficiency.’

In addition, we adopt a broader conception of equity to that used by the five economists. Their concept of equity concerns the extent to which all persons in employment have access to a minimum post-tax income consistent with what society views as an adequate minimum wage. While this is clearly an important dimension to equity, we argue that a much broader conception is required. To begin with, we argue that an equitable outcome requires us to be concerned with the full distribution of income and from where that income derived. We have also suggested a second important dimension of labour market equity: the distribution of employment security and the allocation of job rights. From this perspective, labour market regulations and institutions provide for equity in a myriad of ways, of which minimum wages is only one. For example, labour market regulations provide for job quality by creating a floor of employment rights above which employers and employees must relate (Champlin 1995).

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19 There is insufficient room to consider the topic of property rights and job rights here, but we argue that the distribution of these is an important element contributing to both efficiency and equity in the labour market. For an explicit analysis see Wallis (1992).
Industrial relations and labour law research has highlighted a range of equitable consequences of labour market regulation, most importantly the provision of procedural equity (including unfair dismissal provisions, rights to collective protection and industrial democracy). These rights have the capacity to contribute to an appreciably higher quality of working life, and reflect an acknowledgment that issues such as employment security and industrial democracy may be as important as income adequacy for employees (Ford, 1992 and Mitchell, 1997). In this tradition, McCallum (1998, 1996) has talked of the importance of labour market institutions as expressions of citizenship. The conciliation and arbitration system, for example, has contributed to an effective citizenship by restoring some degree of balance to an otherwise asymmetrical power relationship in the labour market between employers and employees. In this light, equity may not necessarily be improved by reducing the influence of labour market regulations and institutions.

Having outlined these preliminaries, we are left with the question of the alternatives to the Plan proposed by the Five Economists. In a related debate, Buchanan and Watson (Australian Financial Review, 30 April, 1999) argue against adopting the US labour market as the model to emulate. Instead, they suggest a more appropriate starting point is to examine

‘the new and exciting ideas coming out of Europe which seek to integrate industrial and social rights over a person’s life cycle. These new ideas aim to reduce unemployment in responsible ways, without recourse to… notions of “deregulating” the labour market.’

We therefore propose to briefly consider the Dutch case, which has been one of the few European economies that has successfully responded to the problem of high and persistent unemployment without recourse to a policy of deregulation (Visser, 1998 and Gahan, 1998).

A little over ten years ago, Therborn (1986) described the Netherlands as ‘perhaps the most spectacular employment failure in the advanced capitalist world’ (cited in Visser 1998). Unemployment had reached a record 13 percent and participation rates were among the lowest in Western Europe; an even larger percentage of the population were supported by welfare and labour market programs (Visser, 1995).

Within a decade, however, the Netherlands has proved to be one of the most spectacular employment creation success stories. ‘In the past ten years 1 million jobs have been added to the 5 million that exited in the Netherlands in 1985, The employment ratio rose from 52 per cent in 1985 to 64 per cent in 1995. The job creation rate averaged 1.8 per cent per year, against 1.5 per cent in the USA and 0.4 per cent in the EU’ (Visser 1998). Unemployment in the Netherlands (the US) currently stands at 3.5 (4.3) percent, while the rate of job creation for 1997 and 1998 was 3.4 and 2.9 (1.9 and 1.1) per cent,

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respectively (OECD 1999).\(^{21}\) (Crucially, participation rates in the Netherlands was broadly similar to that in the US and Australia (71.5, 77.4 and 72.5 percent respectively) in 1997, and have risen substantially over the period of job growth from just 59.0 per cent in 1983 (OECD 1998).

Most important has been the growth in part-time employment and the redistribution of working hours (Becker 1999, Visser 1998). Between 1983 and 1996, part-time employment rose form 21.0 to 36.5 percent of the labour force (this compares with 25 percent in Australia and 18.3 percent in the United States in 1997, OECD 1997). There has been a redistribution from full to part-time work in the Netherlands with an average Dutch employee working around 1400 hours in 1995, compared to nearly 2000 hours in the United States and approximately 1900 hours in Australia (OECD 1996, p. 190).

What has accounted for the turnaround in the performance of the Dutch labour market? Visser (1998) suggests three factors have been crucial to the turnaround: wage moderation and the restoration of profits as a precondition for job creation, social security reform and innovative labour market reforms. These in turn, he argues, rested on revival of corporatist institutions base on consensual policy-making. In contrast to the policy of imposed reform advocated by the Five Economists, the Dutch experience involved the voluntary use of wage moderation through a political framework, which encouraged consensus and inclusion of the key industrial parties. This framework, similar in some respects to the Accord arrangement, can best be described a system of bargained corporatism (Rhodes 1998). Previous attempts at imposing wage restraint of the form advocated by the Five Economists had in fact proved unsuccessful (see Visser, 1995, 1998).

Given the arguments advanced in this paper, the crucial feature of the Dutch employment success is that it has been achieved without radical deregulation of the labour market or the wholesale removal of welfare protections, but has instead occurred within the existing framework of ‘consensual-style’ corporatist policymaking and active labour market policy. Whilst Dutch corporatism has delivered significant wage restraint over the last two decades – which was a core component of the Five Economists plan – other aspects of the Dutch industrial relations framework also distinguish its logic from the deregulationist approach of the Five Economists (Becker 1999, p.6-7).\(^{22}\) Firstly, the Dutch approach recognises unions as legitimate participants in the economic debate. This recognition has engendered a degree of economic responsibility in Dutch unions (sometimes criticised for being too moderate) who accept that industrial responsibility is desirable if it underpins stronger job growth. Secondly, the Dutch employment policy has sought to provide for job security through a range of

\(^{21}\) For the period 1985 to 1998 the employment ratio for the Netherlands (the US) was ??? (???) per cent, the job creation rate was 2 (1.6) per cent, and the average unemployment rate was 6.6 (6.0) per cent (Calculated from data provided in OECD 1999)

\(^{22}\) Becker (1999, p.15-6) also identifies the ability of Dutch taxpayers to offset the whole of their mortgage interest payment against taxable income and their ability to reduce their taxable income by the amount paid for second mortgages based on the “overvalue” of their house as an important lubricant underpinning Dutch wage moderation. Furthermore, Becker argues that these concessions may have acted as an important Keynesian stimulus which has fuelled a real estate boom and underpinned strong employment growth.
employment protection mechanisms, including extensive regulation of dismissals,\textsuperscript{23} and relatively high minimum wages (OECD 1998).

Even more compelling about the Dutch experience is that it has occurred in the context of a comparatively generous welfare state, which is seen as being an important complement to an effective labour market policy. One often unstated but important implication of the labour market deregulation policies espoused by neoclassical economists is that they require parallel reductions in social security benefits in order to force the unemployed to accept low-wage work (Moore 1997, McGavin 1992; for a critical view of this relationship, see Atkinson and Micklewright 1991). The Dutch employment experience shows that this is not necessary, with job growth having occurred in conjunction with a relatively generous social security system which reinforces the generally high level of social protection evident in the Netherlands.\textsuperscript{24} The Dutch welfare system is a hybrid that draws on paternalist, social democratic and liberal principles with the majority of its provisions financed and related to social contributions with underpinning universalist basic pensions (Becker 1999, p.22). Dutch welfare benefits are relatively generous – the percentage replacement rate for an average production worker in a standard two child family one month after unemployment was around 84 per cent (OECD 1996) – and are calibrated to cater to the needs of various household types. All basic provisions are related to the value of the Dutch minimum wage such that in 1999 maximum social assistance for couples equalled the value of the net minimum wage, and for different household types provided from 50 to 70 percent of the minimum wage with additional supplements of up to 20 percent (Becker 1999, p.23). According to the OECD (1996, p.31) the Dutch replacement rate is also comparatively high, being 84 percent for an unemployed, standard family after one month.

Furthermore, there are important symmetries between the Dutch labour market and welfare frameworks that reinforce the Dutch employment experience and may in fact provide for improved, holistic employment outcomes. The Dutch system allows for unemployment benefits to be used to accommodate temporary downturns in business for some employers (Van Peijpe 1998). Specifically, unemployment benefits can be drawn on for periods of short-term working and bad weather (such as natural disasters) to ease businesses through particular difficulties. For circumstances “other than the normal risks of business” Dutch companies can get permission to temporarily stand down employees who will then receive benefits at 70 per cent of their previous wage until normal business circumstances return. For bad weather conditions in the Dutch construction industry, for example, agreements have been struck such that employers will supplement the 70 per cent unemployment

\textsuperscript{23} Rather than provide employers with a capacity to hire and fire at will the Dutch system places a social premium on employment. Most notably, the Dutch system requires employers intending to dismiss an employee to first obtain permission from the Public Employment Service (PES) or district court before a dismissal can take place. The governing authority first investigates the employer’s reason for the dismissal and ensures that the employer bears the costs of redundancy. This process can take several months to complete (see van Peijpe, 1998).
benefit received by employees so that they continue to receive their 100 per cent salary. In this sense the Dutch system accommodates employer desires for greater flexibility, but does so not at the expense of Dutch employees. Rather, the tax and social security floor is used creatively to provide for a general floor of security, above which flexibilities are obtained.

While a number of labour market problems remain (particularly in the form of long term unemployment), this brief outline suggests possible alternatives to the Five Economists Plan which places some weight on the quality of labour market outcomes as well as the overall employment performance. This view is succinctly summarized by Becker’s (1999, p. 30) summation of the Dutch experience: ‘probably the most important question… is: what do we want? Employment growth at any rate? [or] Very cheap labour – where necessary – easy to hire and fire?’

The Dutch experience suggests that it is possible to provide for substantial social protection through complementary taxation and social policies and labour market regulations. The Dutch system has acted to accommodate significant labour market changes such as the growth of part-time work, but has done so in a manner that seeks to ensure that workers are not overly disadvantaged. This is achieved by retaining important job protections to provide for employment security, and by buttressing these with an active and generous tax and social security framework that seeks to complement rather than replace labour market arrangements. Here, the Dutch welfare state seeks to provide a floor of economic security on which labour market flexibilities may be explored. In this context Dutch poverty has remained relatively stable over the last two decades, particularly when compared to the Anglo-Saxon economies.

An Alternative Approach

How then can the linkages between the labour market, taxation and social policy be recast to account for the nature of the problems we have highlighted so far? Here we offer an alternative approach, which uses two concepts to characterize the nature of existing labour market problems: risk and decommodification.

It will be recalled from section 3 above that a number of features were viewed as characteristic of employment relationships. The employment relationship was defined by first its open-ended nature, which in turn reflects the existence and pervasiveness of uncertainties about states of the world. These uncertainties can be viewed as sources of risks to both employers and employees. For employers, there exists a risk that future demand for their output will require less labour, which makes

24 The Dutch social security system has been refined over the last decade (Van Peijpe 1998) but this has been on the margins and has not compromised the Dutch welfare state as one of the most generous in Europe (Becker 1999).
25 The share of involuntary part-time employment in the Netherlands was 5.5 percent compared to 11.2 percent in Australia and 7.8 percent in the United States (OECD 1999, p.33). In 1994, only 8 percent of Dutch part-time employees preferred full-time work (European Commission 1995).
26 This section draws heavily on Esping-Andersen (1990), Breen (1997) and Mitchell and Erickson (1995).
investments in recruitment and human capital open to the risk of a negative return. For employees, the acquisition of firm specific human capital may be associated with like risks. In addition, and in contracts to the position of the firm, it is difficult for employees to hedge against the risks associated with uncertainty by investing in a ‘portfolio’ of diverse human capitals. This can be viewed a source of risk averseness. Internal labour market arrangements in which the firm and employee shared risks associated with future possible fluctuating fortunes in the labour market and the protect of unemployment can be viewed as one mechanism by which the employment contract sought to manage risk. In the context of an asymmetric power relationship and given the difficulties in specifying a contractual form which protects against such risks, this mechanism is unlikely to provide an adequate means to hedge against risk (Gahan and Harcourt 1998). In this sense the distribution of risk between the firm and employee is unlikely to be efficient or equitable.

Protection against such risks in the form of an implicit contract is not the only means, however, by which risk associated with the employment relationship is distributed or hedged. Both the family and the welfare state can be viewed as two important mechanisms by which risk is socialized in market economies, and hence, by which labour is decommodified (Breen 1997, Esping-Andersen 1999). These mechanisms act to transfer risk (from the individual to the family unit or to the population at large) and hedge against uncertainty. Unemployment insurance and publicly funded retraining schemes are classic cases of risk-sharing arrangements. Collective bargaining and labour market regulations, which, for example, limit the capacity of the firm to dismiss workers, can also be viewed in this light (Mitchell and Erickson 1995). The reappoiont of risk and exposure to market fluctuations acts as an important means to ‘decommodify’ labour (Esping Andersen 1990) by seeking to make individual life chances independent of market forces (Breen 1997). This may act to improve both the efficiency and equity properties of labour market outcomes (Esping Andersen 1990).

In contrast to the capacity to hedge against risk – that is, by sharing or redistributing risk between contracting parties – an alternative mechanism for managing risk is the use of options. This form of risk sharing is usually associated with financial markets, and is defined by an inherent asymmetric distribution of risk between buyer and seller, or what Breen (1997) describes as ‘contingent asymmetric commitment’. Faced with increasing uncertainty about the future and increased volatility in product markets, the use of hedging arrangements, such as internal labour markets, may become costly. This inevitably generates incentives to redistribute risk and as far as possible, reallocate the costs associated with risk to employees through more flexible work arrangements. This, Breen (1997, p. 477) suggests,

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27 Seniority rules are the classic mechanism by which risk among employees is distributed through collective bargaining. Dismissal laws, which restrict the capacity of firms to fire employees at will are the classic statutory form.

28 An option consists of an arrangement whereby the buyer is provided with an option to buy at a given price at future point in time. The buyer is not required to exercise the option if markets prices are lower than the option
'has meant that, in effect, employers have acquired an option over the supply of labour, retaining employees when they are needed (thus profiting from upside risk), getting rid of them when they are not (and so avoiding downside risk). This option has shifted risk onto employees and would be employees, and because of high unemployment, the weakening of trade unions and employers greater willingness to exploit the provisions of employment law... it has been acquired without any compensating exchange, monetary or otherwise.'

Space precludes the possibility of outlining a detailed alternative to the Five Economists Plan. The concept of risk is, however, useful for examining the role of linkages between taxation, social welfare and labour regulation and potentially provides a framework for guiding policy formulation. This is most usefully illustrated in the Dutch case examined earlier. In the Dutch case, where more contingent forms of employment have been utilized as a means to combat unemployment, labour market regulations, social welfare policy and active labour market policy act as important mechanisms to regulate the apportioning of risk in an efficient manner. The linkages between taxation regime and labour market regulation also serve this broad purpose, most notably those taxation provisions to raise real disposable income and facilitate wage moderation. These provisions have, in effect, allowed both employers and employees to socialize and redistribute private risks emanating from labour market uncertainty.

By accommodating risk in this fashion, a number of objections we have made to Five Economists Plan can be more adequately addressed. Firstly, they ensure that the extent to which labour is commodified is constrained to that which employees would freely choose in the absence of constraints imposed by the inherent asymmetries in the employment relationship. Second, and related to the first point, the explicit inclusion of risk and its commodifying effects, allows for a more efficient and equitable apportioning of the inherent risks associated with employment. Third, an examination of risk suggests that, rather than being a labour market problem which generates inefficiencies, labour market institutions may act as important mechanisms to deal with them efficiently and equitably. Finally, we suggest this provides an important means by which policy formulation can reconsider the appropriate role of taxation as a complement to labour market regulation, rather than a substitute for it (and vice versa). To the extent that taxation policy provides such a substitute for regulation and the maintenance of an adequate institutional framework, it is unlikely to be adequate or a stable one. Thus a negative income tax arrangement proposed by the Five Economists may indeed be one element in a price, but where the buyer wishes to do so, the seller is compelled to deliver the good at the optioned price. In this sense, there is an asymmetric apportioning of risk between the seller and the buyer.

This is not to suggest however that this has been undertaken in a perfect manner, but that the recasting of the linkages has broadly ensure that this is the case. As we pointed out earlier a number of labour market challenges remain in the Dutch case, which in turn imply an imperfect redistribution of risk; most importantly in the case of long term unemployment. However, social welfare and active labour market policy act broadly to counter these problems.
policy designed to meet labour market problems (although see Ingles and Oliver in this symposium). It cannot, however, be viewed of itself as an adequate response.

CONCLUSION
This paper has sought to provide an industrial relations and political economy perspective on the Five Economists’ Plan. The Plan’s broad intentions are to provide a policy formula for combating Australia’s high level of unemployment. The core mechanism by which this is to be achieved is the establishment of closer links between taxation arrangements and industrial relations institutions. This consists of a negative income tax arrangement, coupled with a wages freeze for minimum wage earners. The Plan also advocates a need for a more general program of labour market deregulation in order to promote labour market flexibility and to facilitate a greater responsiveness of wages to the needs of individual employers. This, they claim, would create a closer link between economic growth and employment growth.

The basic thrust of the paper was to challenge the assumptions upon which the Plan is built. In short, we argued that these assumptions were inconsistent with what is known about labour market dynamics, and mis-specifies the nature of the employment relationship as analogous to a market exchange (say, fish, to use Solow’s (1997) analogy). We have argued, in contrast to this approach, that the employment relationship cannot simply be viewed as a market relation, but rather is more realistically viewed as a two-dimensional exchange (both a market and authority relation). Viewed from this perspective it was not obvious that the Plan would have the desired effects. Moreover, we contend that a focus on unemployment oversimplifies the nature of the ‘employment problem.’ Using insights from the industrial relations literature, we argued for a focus on both the quality of labour market outcomes as well as the quantity of jobs created.

Rather than favouring a model of deregulation – or more precisely one in which the role of external regulation is limited to taxation and limited social welfare functions – we have argued that labour market, social welfare and taxation policies must be seen as more complementary. First, because they cannot be viewed as substitutes, and second, because any attempt to do so faces a number of political economy constraints which are likely to render them unstable or enduring. We have used the Dutch example to demonstrate that an effective policy response is unlikely to include the deregulatory approach. In this case, an ‘employment miracle’ rested on consensual policy changes which did not involve radical labour market deregulation or the diminution of social welfare policy. Rather, it involved an attempt, through the revival of a bargained corporatist arrangement, to recast the relationship between these three areas of policy to promote employment outcomes consistent with both efficiency and equity objectives.

Finally, we introduced the concepts of risk and decommodification for the purpose of suggesting a general approach to recasting the linkages between labour market, social welfare and taxation policy.
Used in conjunction with our model of the employment relation as a two stage exchange, such an approach, we argued, provides a more realistic basis to examine the most appropriate linkages between labour market, social welfare and taxation policies.
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