Cut union privileges for better outcomes for workers

AFR, Alex Sundakov and Michael Schur, 10 Aug 2015

The Productivity Commission's draft report into Australia's workplace relations framework contains one fundamental assumption and an observation. It assumes an inherent imbalance in bargaining power between employers and employees. The main policy challenge is thus to intervene as much as needed to correct that power imbalance while enabling a reasonable degree of wage flexibility and minimum industrial conflict.

The observation is that Australia's labour market is characterised by wage flexibility and industrial peace. Put these thoughts together and the conclusion appears inevitable: all that is needed is some tinkering around the edges.

In a policy paper for the Minerals Council of Australia, we question the conventional wisdom that labour markets are all about the differential in bargaining power. Weak bargaining power would mean that with weaker intervention, workers would capture a lower share of the economic pie (proportion of gross domestic product).

However, the available evidence does not show any sustained relationship. In fact, the evidence shows that, while union membership has fallen, the proportion of workers covered by union-negotiated enterprise agreements has risen.

Employee share of national income has not changed materially over time despite changes in industrial laws and declines in union membership. Periods of supposed "pro-employer" policies did not enable employers to increase their share; similarly, periods of claimed "pro-worker" policies had no effect.

At the industry level, employee share of income bears no relationship with union membership. The division of the pie does differ between industries but is more likely to be explained by capital intensity, risk and skill shortages.

Enterprise agreements do not consistently yield better earnings than individual agreements.

Pay rises are similar for union and non-union members.

Labour markets perform as you would expect markets to perform: wages over time balance the supply and demand for skills and provide compensation for inconvenience and other forms of commitment required of workers. Both workers' and employers' bargaining positions depend on the alternative options available to them and the investments they have sunk. There is no inherent battle for the sharing of some fixed economic pie that requires interventions to preserve workers' bargaining position.

Growing the pie

Does this mean that the workplace relations framework plays no role? Not at all! This is because the primary effect of collective bargaining organisations and processes is not on dividing the pie but on increasing the size of the pie. This is where the Australian framework falls short. By focusing on wage flexibility as a measure of success, the Productivity Commission appears to be ignoring (or at least downplaying) the effect of bargaining arrangements on productivity and on the value of choice.

Our analysis shows that the key issue in the labour market is not an imbalance of bargaining power but the presence of what economists call the "principal-agent problem": ensuring that organisations perform for the benefit of the intended beneficiaries and resist capture by self-interested insiders. The entrenchment of insiders in Australia's labour market operates primarily through the granting of various default rights in the Fair Work Act to trade unions, including that of acting as a bargaining agent, negotiating an award or governing default superannuation funds.

The Royal Commission into Trade Union Governance and Corruption has highlighted some of the unintended consequences of protecting collective bargaining organisations from competitive pressures.

The principal-agent problem in labour market institutions manifests in the same way as it does in other settings: to make agents perform in their interests, principals (i.e. workers) must be able to exercise the threat of withdrawing from the organisation to take up other options. Simply being able to complain or vote is not enough.

Yet, Australia's labour market arrangements provide union members with little opportunity to turn away from underperforming agents. Yes, workers are free to opt out of trade union membership. However, this does not necessarily provide an opt-out from union coverage. While union membership has been declining, the proportion of workers covered by union-negotiated enterprise agreements has been increasing. With little opportunity to exit to a competing bargaining agent, union insiders feel only limited pressure to perform in the interests of growing the pie.

Opening up competition for collective bargaining services is not an anti-union or anti-worker position. Rather, it is about addressing the key issue so surprisingly ignored by the Productivity Commission.

In our paper, we suggest possible steps to solve the principal-agent problem in the labour market, including:

Replacing awards with a safety net system of minimum standards, without a special role for unions

Removing special union rights and preferences in a bargaining context, with equal footing given to alternative bargaining agents.

Removing entrenched union rights in relation to management of superannuation funds.

In essence, labour market organisations behave just like every other economic institution. If they are not subjected to competition, they underperform.

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