THE APPROPRIATE DESIGN OF COLLECTIVE BARGAINING SYSTEMS: LEARNING FROM THE EXPERIENCE OF BRITAIN, AUSTRALIA, AND NEW ZEALAND

John Pencavel*

I. Introduction

The purpose of this paper is to bring conventional economic analysis to bear on the issue of the desirable legal framework to regulate collective bargaining and unionism. The goal is not to specify an exact legal code, but to draw on the experience of certain developed economies to offer some general principles that should guide the general thinking on this class of issues. The language of the previous sentence - “should guide” - signifies that there is a clear normative element to this paper. It is an explicit purpose of this essay to draw some inferences from the economic performance and institutional structures of three countries’ labor markets about how the law on collective bargaining ought to be designed.

The general issue of the consequences of collective bargaining systems for macroeconomic performance has a long history. In the last fifteen years or so, the issue has been the subject of cross-country econometric research where variations in certain economic outcomes in different countries are related to indicators of these countries’ bargaining systems and union movements.1

* This paper has benefitted from comments on previous drafts by Nicola Acocella, Lewis Evans, Robert Flanagan, James Heckman, Sanford Jacoby, Robert McMillan, David Metcalf, Paul Ryan, Bryce Wilkinson, and three anonymous referees. The views here are my own.

1 This recent research was stimulated by Bruno and Sachs’ work (1985) that entered an index of “corporatism” to a regression equation (p. 229) designed to account for variations across seventeen countries in inflation. Corporatism was envisaged in terms of “the extent to which wage negotiations proceed on the national level rather than the plant level; the power of national labor organizations vis-à-vis their constituent members; the degree of organization on the employer side; and the power of plant-level union stewards (the more powerful they are, the less corporatism there is)” (pp. 222-3).
Unfortunately, this econometric literature on the relationship between economic performance and the structure of collective bargaining has yielded very few robust results. There are several reasons for this.

First, this research takes the collective bargaining system as given and asks how it affects various macroeconomic indicators. In fact, of course, countries choose their collective bargaining structure as much as their macroeconomic performance and the factors affecting their choice of structure are also likely to affect their choice of macroeconomic outcomes quite independently of the collective bargaining system itself. Thus, as shown below, one of the important factors inducing New Zealand and Britain to reform aspects of their collective bargaining systems over the past fifteen years or so was their disappointing macro-economic performance. In this case, the line of causation runs not simply from the structure of collective bargaining to macro-economic performance but also from macro-economic performance to the collective bargaining system. Macro-economic performance and the system of collective bargaining are jointly determined variables.

Second, this research focuses on only a few features of the collective bargaining system - such as the degree to which wage determination is centralized or bargaining is coordinated - and there are serious shortcomings in the measurement of these variables. Each researcher measures these collective bargaining indicators slightly differently and there is ample opportunity for arbitrary choices in the values of these indicators. Some of the industrial relations factors emphasized below - such as the degree to which government is an active party

---

2 See the recent assessment by the OECD (1997) which, after a careful examination of the evidence, concludes, “While it is sometimes hazardous to make global statements, the statistical results presented, whether based on simple correlations or multivariate analysis, are best viewed as “negative” in the sense that there seems to be little robust evidence for either a U-shaped relation between the structure of collective bargaining and employment or a hump-shaped relation with the unemployment rate. Indeed, in many instances, the analysis has not found statistically significant relationships between measures of economic performance and collective bargaining whether the latter is proxied by measures of trade union density, collective bargaining coverage or the centralization and co-ordination of bargaining” (p. 82). Another sound critical review of this research is provided by Flanagan (1998).

3 For instance, it is routine to rank countries by their collective bargaining centralization or coordination and to use that rank as a regressor in a stochastic equation in which some macroeconomic variable serves as the dependent variable. This imposes the restriction that differences in rank matter in accounting for variations in economic performance across countries, not differences in the real collective bargaining structure. For example, in Calmfors and Driffill’s (1988) well known work, their centralization index ranks Canada 1 (least centralized), the U.S. 2, France 7, and New Zealand 8. The use of this ranking as a regressor contains the assumption that the difference between Canada and the U.S. is equivalent to the difference between France and New Zealand. In what sense is this meaningful when the collective bargaining systems of France and New Zealand are so fundamentally dissimilar while those of the U.S. and Canada overlap so much?
in arbitrating labor market disputes and the extent of competition in product and nonunion labor markets - are rarely included in the variables summarizing the nature of a country’s collective bargaining system.

Third, in this class of research, it is common for macro-economic outcomes such as inflation, unemployment, and economic growth to be related to a set of variables that includes indicators of collective bargaining structure, but excludes any information about the conduct of monetary or fiscal policy. The values of monetary and fiscal policy variables may be uncorrelated with the structure of collective bargaining, but there is considerable anecdotal evidence to suggest otherwise. For instance, in the experience of the countries described below, on a number of occasions governments resorted to inflationary policies to offset the unemployment-increasing consequences of arbitrary wage increases that the collective bargaining and arbitration systems precipitated.

Therefore, little in the way of substantive results has emerged from this research. There are ways to improve upon this econometric research, but at present the enterprise has not been enlightening. However, it would be incorrect to infer that collective bargaining does not matter as far as the economic performance of a country is concerned. The correct inference, I believe, is that to date econometric methods - that serve well in certain other contexts - have not proved the best tools to date for addressing the question of the relationship between collective bargaining and macro-economic outcomes. For this issue, an alternative research method is a historical analysis augmented by insights from conventional economic reasoning. I illustrate this approach with the study of three countries with quite different postures toward unionism and collective bargaining. These countries are Australia, New Zealand, and Britain.

For most of this century, the collective bargaining systems in Australia and New Zealand entailed extensive regulation by agencies of the state that had the power to impose wages on unions and employers and that, at times, prohibited strikes. By contrast, the British system of collective bargaining has involved very much less direct state intervention, notwithstanding legal changes in the last fifteen years, and it is commonly described as a system where the law has made few encroachments into unionism and collective bargaining. I shall

---

4 More formally, my criticisms of this econometric research are that the estimates suffer from simultaneous equation bias (first point), from errors-in-variables bias (second point), and omitted variable bias (third point). Also I have concerns about the additive functional form specifications used in this work, but this is another matter. My strictures do not apply to a different class of econometric research that exploits large data sets on individuals or firms in each country to address questions such as the magnitude of union-nonunion wage gaps or the correlation between the presence of unions and turnover. A good example is Blanchflower and Freeman (1992). However, this work largely avoids claims about the relationship between collective bargaining structures and macroeconomic outcomes.
argue that this view is misleading, that the British system involves extensive intrusion by the state, but the intrusion is indirect. In particular, Britain provides an excellent illustration of the role of the state in championing unionism and collective bargaining through government policies toward labor markets (both union and nonunion) and product markets.

The argument in the paper may be summarized as follows:
1. Countries can engage in excessive regulation of collective bargaining and unionism. This regulation may be direct (as in the case of New Zealand and Australia for much of this century) or indirect (as in the case of Britain).
2. This regulation was by no means the only or perhaps even the principal cause of poor macroeconomic outcomes in these countries. However, excessive regulation of collective bargaining complemented other economic policies that contributed to inferior economic performance.
3. The economic reforms in New Zealand and Britain over the past fifteen years indicate that this regulation has been recognized as excessive. The consequence of these reforms is likely to be improved macro-economic performance. The changes in Australia have been less radical.
4. The lessons for economic policy are that superior macro-economic performance is easier to attain when collective bargaining is regulated not by an assortment of mandates and constraints set down in a written legal code, but by allowing managements and workers to design bargaining protocols that suit them and by promoting competition in factor and product markets. In specifying the framework for collective bargaining and in particular bargaining contests, the state should not be partisan and should encourage the resolution of disputes at the level of the firm or place of work.

The paper begins with a description of the collective bargaining systems in Australia and New Zealand as they operated for much of this century.

II. The Quasi-Judicial Systems in Australia and New Zealand

New Zealand’s and Australia’s industrial relations systems emerged about a century ago in response to some ugly and acrimonious strikes. The stated goal of the industrial relations legislation was to replace what was described as the “barbarous expedient of strike action” with a compulsory arbitration system. By the 1970s, the Australian and New Zealand industrial relations systems were a complex assortment of collective bargaining structures with some bargaining taking place at the national level, some at the industry level, and some bargaining at the enterprise level. However, underpinning this union-management bargaining were quasi-judicial systems to which the parties could appeal to settle differences. These differences were resolved by labor courts that were endowed with remarkably broad authority to
set wage minima and other aspects of the employment contract in a wide range of occupations. As the courts’ decisions (or “awards”) specified only necessary terms of employment, a second tier of bargaining to raise wages above these minima (sometimes called “over award payments”) emerged in certain industries. The courts’ awards often came in the form of elaborate tables that made fine distinctions among detailed occupations.

A union had to register with the arbitration bodies so that it had access to them and so it might enjoy the privileges accompanying registration. In Australia, one such privilege was that, once registered, a second union could not be registered if there already existed another to which employees could “conveniently belong”. Evidently, existing unions were largely protected from competition from new unions. In New Zealand, for many years, union membership was mandatory so unions were not required to tailor the services they provided workers by the need to compete for new members. In general, a registered union operated in an environment where the dominant controls came from above, not below: that is, once registered, a union did not have to show support among the employees it represented nor did it need the recognition of its members’ employers to represent these workers; on the other hand, the law strictly regulated many of the union’s internal operations including its finances, any proposed merger with another union, and the rules governing the election of officials. The result was that in both Australia and New Zealand the typical union looked first not to its members and the workplace as the source for its authority, but to regulatory bodies dominated by civil servants.

---

5 The minimum wage rates were often justified as providing a safety-net function. In fact, they were ill suited to this task. There was not a single safety-net, but a multitude because of the complex interlocking of industry awards and occupation awards. Moreover, the minima were much higher for some workers than for others so they did not apply simply to low paid workers.

6 Both Australia’s Conciliation and Arbitration Act of 1904 and New Zealand’s Industrial Conciliation and Arbitration Act of 1894 provided a considerable stimulus to union membership, therefore.

7 In New Zealand, a registered union claiming membership of at least fifty percent of the potential membership in a sector could seek and would be granted the right of exclusive coverage and representation of a given occupation with no right accorded any competing group to represent the same workers. As Vranken writes of both New Zealand and Australia, “..... registered organizations have their membership base statutorily protected through the grant of exclusive representation rights. Specifically, once registered, the organization can object to the registration of a competing union by invoking the so-called “conveniently belong” rule. That rule provides that the registration of an applicant association shall take place if, and only if, there is no already registered organization to which the members of the applicant association might conveniently belong. The privileged position of the registered also entails the denial of direct access by individual workers to the chief statutory body for the resolution of interest disputes.....” (Vranken, 1994, p.5).
and lawyers. 8 The system did not engage a plant’s union and employer in the joint resolution of ongoing problems at the workplace, but pitted the union and the employer as adversaries in litigation. 9

The compulsory arbitration legislation not only stimulated the growth of unionism, but also led to the creation and spread of employers’ associations. There was little incentive for an employer to avoid belonging to such an association as non-membership conferred no advantages. In submitting claims to the tribunals, a typical union’s practice would be to serve very many employers and this tactic automatically made these employers a party to the claim whether they wanted to be involved or not. Expressed differently, the legislation’s stimulus to unionization also provided an impetus to cartelization among employers whose effects are unlikely to have been restricted to the labor market, but probably manifested themselves in more product market cartel-like agreements as well. 10

8 The 1991 Australian Workplace Industrial Relations Survey illustrated this by reporting that only 26 percent of all unionized workplaces exhibited meaningful union activity (such as having officers engaged in union work or holding regular meetings). See Davis and Lansbury (1993, p. 105).

9 In most countries, unions emerged as an expression of worker discontent, to give voice to workers’ interests and concerns. However, one view of twentieth century unionism in Australia is that it is a creation of the state’s arbitration system. Thus, Howard (1977) writes, “The Australian trade union can be regarded in general as an institution called into existence by a bureaucratic mechanism (the arbitration system) to enhance the functioning of that mechanism. Unions generally have not succeeded in carving out for themselves an industrial role that is independent of the arbitral system, and the efforts they have made in this direction have not been sustained.” Only slightly different is Scherer’s (1983, p.175-6) view: “It is no great revelation to observe that union principals have ‘captured’ the arbitration tribunals. The tribunals were established not to control unions but to encourage them....The existence of the tribunals makes long strikes unusual and makes it unnecessary for unions to acquire large reserves and a disciplined approach to strike action. Thus an attenuated form of [State] syndicalism lives on in one of the most bureaucratically regulated trade union movements in the Western world.”

10 The statement in this paragraph about the arbitration legislation encouraging the growth of employers’ associations is supported by a number of close observers such as Plowman (1989). The concluding statement about the stimulus given to cartel-like behavior in product markets is a conjecture consistent with Adam Smith’s elegantly expressed observation, “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or some contrivance to raise prices” (1776, p.128). An example is provided by the Australian retail industry: “...... the establishment of the arbitration system indirectly contributed to the more effective organization of the retail industry in particular and local capital in general by forcing employers to acknowledge and unite in protecting their common interests in the face of labour mobilization. The intense and personal rivalry characteristic of the late nineteenth-century drapery houses was replaced, over the first two decades of the twentieth century, with guarded cooperation, industry organization and a growing monopoly of the State’s softgoods trade. While the arbitration system was clearly not the sole agent of this change, it helped the process by facilitating the organization of capital and labour into discrete interest groups and thus provided the impetus for the formation of a self-conscious employer class in the retail industry.” (Reekie (1989, pp. 282-3).)
The fraction of workers who belonged to unions understated the reach of unionism.\textsuperscript{11} This was because the wage decisions realized in the principal labor courts diffused quickly throughout labor markets as other courts applied the same wage increases to the workers (whether unionized or not) in their jurisdiction.\textsuperscript{12} As the courts’ decisions were guided principally by the notion of maintaining wage differentials among workers, any wage increase secured by one group of workers would soon be communicated to all workers in the economy including the public sector. Hence, variations among workers in their wage increases were small.\textsuperscript{13} When the courts were asked to certify a prior agreement between unions and employers’ associations, they often applied an “extension” to a wage decision so that it covered all firms in an industry.

The express purpose of Australia’s 1904 legislation and New Zealand’s 1894 legislation was to design a system that made strikes unnecessary.\textsuperscript{14} Indeed, for many years, strikes were categorically forbidden and (on paper, at least) subject to specific penalties. Nevertheless, these penalties were rarely applied and the various regulations covering strikes were enforced infrequently. As a result, Australia and New Zealand have been characterized by a large number of strikes. Though frequent, the strikes were usually short as they were intended not to extract concessions out of recalcitrant employers, but to make a statement to the arbitration commissions. This statement took the form of exhorting the commission to bring forward a pending case or of protesting a recent decision of the commission. The original intent of the legislation - to replace strikes with quasi-judicial procedures of dispute resolution - was long forgotten and, perversely, the system promoted the use of brief strikes to publicize complaints.\textsuperscript{15}

\textsuperscript{11} The OECD (1994) reports the fraction of workers belonging to unions in 1990 was 40.4 percent in Australia and 44.8 percent in New Zealand. On the other hand, the coverage rates (the fraction of workers whose wages are directly affected by union activity) were 80 percent in Australia and 67 percent in New Zealand. Among public sector workers, the coverage rates were 98 percent and 94 percent, respectively.

\textsuperscript{12} In New Zealand, the typical procedure was for the President of the Federation of Labor to file a case for a wage increase in the name of a union with members in many different industries and, consequently, the court’s decisions were felt throughout the economy.

\textsuperscript{13} For instance, in New Zealand in 1979-80, the key occupation were the fitters in the metal trades. About 92% of workers receiving settlements had wage increases within one percent of the increases awarded the metal fitters (Williams (1993), p. 127).

\textsuperscript{14} “From its inception [by the 1894 Industrial Conciliation and Arbitration Act], this system was hostile to strikes. The concept of the right to strike was fundamentally at variance with the principal aim of the legislation; the resolution of industrial conflict by compulsory third party legislation. Although the legislation never totally prohibited strikes, strikes by unions registered under the Act were unlawful in almost all circumstances......it soon became evident that attempts to enforce a prohibition on strikes were largely self-defeating” (Anderson (1994), p. 125).

Did the Courts Make a Difference?

Because the courts often ratified agreements that had already been reached by unions and employers’ associations, it has been argued that the tribunals in Australia and New Zealand followed rather than guided industrial relations. According to this argument, the courts were the vehicle for delivering the same employment contracts that would have obtained in their absence in which case the arbitration methods were simply expensive window-dressing.

This reasoning is unpersuasive. It would be equivalent to the argument that, because a majority of legal cases are resolved by the plaintiffs and defendants themselves before they are tried in court, the law has no effect on out-of-court settlements reached. The fact that an unresolved dispute will be handled by the courts has important consequences for the content of the out-of-court agreements reached. Similarly, in the old New Zealand and Australian industrial relations systems, at the last resort, quasi-judicial authority may be introduced into the bargaining between the parties and impose settlements covering many workers without regard to the circumstances of particular firms or the productivity of the particular workers. The negotiations that take place prior to or separate from the arbitration system may be described as “bargaining in the shadow of the law”. This means that the substantive content of the collective bargaining agreements (in addition to the very fact that agreements were reached) is determined in part by (1) the knowledge that, ultimately, one or other party could take the dispute to arbitration and (2) each party’s expectations of how arbitration would settle the dispute.

In those cases where a second tier of bargaining over pay took place over and above the wage level stipulated by the courts, an economic analysis of this bargaining would interpret the award wage or court-determined wage as the union’s “threat point” or “security level”. Without the involvement of the courts, the threat point would almost certainly have been lower. Most bargaining solutions have the feature that each party’s share of the payoffs is a positive function of its threat point. Therefore, the fact that wages may exceed the court-prescribed minima does not mean that the court’s awards are irrelevant. Far from it, by providing the union with a floor or fall-back position in wage bargaining, the courts play a key part in raising wage levels.

The Labor Standard

The recourse that unions had to the courts to press their claims made wages the fixed point in the system to which all other prices and quantities had to adjust. Instead of being on a Gold Standard, Australia and New Zealand were on a Labour Standard. For good reason,

---

16 I use deliberately the evocative phrase of the admirable article by Mnookin and Kornhauser (1979) on divorce settlements reached outside of the courtroom.

17 The label comes from Hicks’ (1955) description of British labor markets. It is, in fact, a more accurate characterization of the Australasian labor markets than of Britain’s. Hicks wrote,
a principal arbitration judge described himself and his colleagues as the “economic dictator of Australia”.¹⁸

One should expect at least two types of adjustments to the wages set by this Labour Standard. One is a tendency for cheaper imports to substitute for higher priced domestic products. To counteract this tendency, high tariff barriers and other import controls were needed to protect Australasian manufacturing.¹⁹ Though tariffs predated the compulsory arbitration legislation, both Australia and New Zealand became much more protectionist after the legislation was passed.²⁰ Indeed, tariffs were augmented by other impediments to trade such as import licensing, exchange controls, and export incentives.

A second consequence of the Labor Standard was for unemployment to rise as consumers substitute away from products especially those with high labor content. These unemployment-increasing consequences were negated by expansionary monetary and fiscal policies whose undesirable side-effects were countered by foreign exchange restrictions, budgetary deficits, and economy-wide controls on prices, interest rates, and rents. In short, the Labour Standard fostered an economy buffeted by government controls, regulations, and protection in most markets - financial, product, foreign trade.

As a result, the Labour Standard retarded the growth in New Zealand’s and Australia’s standard of living. In 1938, New Zealand’s GNP per capita was 92 percent of that of the U.S. By 1950, it had fallen to 70 percent and, by the beginning of the 1980s, to about 50 percent. At the turn of the century, Australia’s GNP per capita was the highest in the world; it

“....the world we now live in is one in which the monetary system has become relatively elastic, so that it can accommodate itself to changes in wages, rather than the other way about. Instead of actual wages having to adjust themselves to an equilibrium level, monetary policy adjusts to the equilibrium level of money wages so as to make it conform to the actual level. It is hardly an exaggeration to say that instead of being on a Gold Standard, we are on a Labour Standard” (p. 391).

¹⁸ This quote is taken from Dabscheck and Niland (1987, p. 162).

¹⁹ “By 1970, Australia, after its neighbor New Zealand, had clearly the most highly protected manufacturing sector amongst the industrial countries. The high Australian manufacturing protection in 1970 was strongly biased towards labor-intensive industries. This was partly a reflection of the motives of income redistribution towards labor, and employment creation or preservation, in Australian protection decisions. It also reflected the strength of the protectionist ideology in Australia, which at times supported protection to any level necessary to secure the commercial viability of an industry: protection had to be highest for the labor-intensive goods in which Australia’s comparative disadvantage was strongest.” (Garnaut, 1983, p. 321).

²⁰ There was a close interaction between the compulsory arbitration system and protectionism: “..... the payment of high wages became grounds for appeals for extra tariff protection; in turn, employers in industries enjoying higher rates of protection found themselves subject to claims for higher wages” (Pincus (1995, p. 61)).
stood at 174 percent of that of the U.S.A. By 1976, the ratio of Australia’s per capita GNP to that of the U.S. was 79 percent. And the comparison here is not with an economy that was growing fast! By the 1980s, the need for reform was evident. The two Australasian countries reacted differently: New Zealand’s reaction was to initiate a series of radical reforms that together constitute the most comprehensive economic reforms by any economy with representative government over the past fifteen years; Australia proceeded at first in the opposite direction.

**Australia’s Reforms**

At the beginning of the 1980s, Australia engaged the ACTU (the union federation, the Australian Council of Trade Unions) in a series of incomes policies. Although the pre-1980 industrial relations model was amended to allow for wage increases at the enterprise level that were tied to productivity gains, the key features of the Labour Standard - the use of quasi-judicial agencies to adjudicate on wages and the need for other variables in the system to adjust to these mandated wages - were retained.

The Australian industrial relations system came under increasing criticism for being inflexible and, ultimately, the federal government responded with an attempt at reform in the form of the Industrial Relations Reform Act of 1993 (which came into effect in March 1994). The stated goal was to reduce the influence of the arbitrated National Wage Cases and to increase the importance of plant-level agreements by allowing for “enterprise-flexibility” agreements that modify the general awards to suit the particular circumstances of the plant. These agreements need not involve any union. However, the enterprise-flexibility agreements must be approved by the Australian Industrial Relations Commission before becoming legal and a registered union may present a case before the Commission regarding a particular agreement even if the union has no members at the workplace.

Although the Act favored decentralization of collective bargaining agreements, it left in place the Commission’s ability to set minimum employment conditions and, therefore, retained the Commission’s influence on the content of collective bargaining agreements.21 As

---

21 Specifically, the 1993 Act established two branches within the Commission. One was an award branch that continued the traditional arbitration functions of the past. The other was a bargaining branch that endorsed agreements negotiated between unions and employers and that promoted bargaining between workers (whether unionized or not) and employers. What guidance did the Act provide the Commission in setting minimum wages? The Commission was to consider “....so far as possible and appropriate to Australian practice and conditions....(a) the needs of workers and their families, taking into account the general level of wages in Australia, the cost of living, social security benefits and the relative standard of living of other social groups; and (b) economic factors, including the requirements of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment”. It might have been more useful to specify what the Commission need not consider in setting minimum wages.
argued above, even if the Commission were used infrequently to resolve disputes and even if most agreements were negotiated directly between employers and unions, the fact of the Commission’s existence as an arbiter of last resort will affect the incidence and content of collective bargaining agreements. Moreover, in those instances where the Commission set minimum wages and where union-employer bargaining took place on top of this, the courts continue to provide unions with the threat points that enhance their bargaining power.\(^\text{22}\)

Although the move toward plant level bargaining is desirable, Australian industrial relations remains a system where legal regulation is much too intrusive. This encourages the politicization of bargaining and disputes and results in a tendency for bargaining outcomes to bear only a loose connection to the actual conditions at workplaces. This is indicated by the growth of real wages and synchronous slump in employment in Australia in the 1970s and the lack of adjustment in real wages in the subsequent decades in the face of high and rising unemployment.\(^\text{23}\) Some Australians believe the changes in the last decade have been profound. In fact, by leaving the courts as the key element of the system, the changes in the collective bargaining framework have been half-hearted.\(^\text{24}\) The recent assessment by Hawke and Wooden (1998, p. 86) is well worth stating: “......whether the volume and nature of change [in Australian industrial relations] experienced to date can be judged as transformational is still questionable. The Commission, for example, despite legislative change designed to limit its influence, continues to act as an arbiter of national and award-based minima in pay and conditions and as a means of conciliation and arbitration. Furthermore, while the introduction of enterprise and individual agreements within the awards system is a significant change, it does not

\(^{22}\) It might be thought that, in explicitly providing an option for enterprise-level bargaining that involves non-union employees, the 1993 Act curbed the influence of unions on nonunion wages. In fact, unions were permitted several opportunities to influence these non-union wage agreements. Moreover, in part because the rules governing its operation are complex, there has been little use made of the non-union bargaining “stream”. See Coulthard (1996) on the opportunities available to unions to become involved in wage-setting in the non-union sector and on the reasons for the small numbers of non-union contracts.

\(^{23}\) See Gegory and Vella (1995) on these changes of real wages and employment.

\(^{24}\) In 1996, a new Liberal/National Party coalition government declared that reform of industrial relations was a high priority. A Workplace Relations Act (1997) addressed the determination of wages in nonunion (or close to nonunion) plants. In these circumstances, an employer may reach agreements with his employees either individually or collectively, but there is a requirement that the wages so negotiated are not less than those established by an award (unless the business is in crisis conditions). A newly established state agent, an Employment Advocate, would check to ensure this requirement is satisfied. In other words, the role of the awards as a floor on wages remains. The 1997 Act also made illegal employment preferences for union members and compulsory unionism. All in all, the Act does no more than tinker with the basic features of the system.
yet constitute a break with past centralized practices since agreements remain subject to approval...” The Australian system has edged toward a less regulated system, but some critical elements of the previous regime remain.

New Zealand’s Reforms

New Zealand’s reforms have been much more thorough and radical than Australia’s. At the heart of the 1991 Employment Contracts Act (ECA) is the goal of allowing workers and employers in a particular establishment to choose their bargaining method. The Act introduced the notion of a bargaining agent. This agent could be a labor union or it could be any other entity or person selected by a worker or it could be the worker himself. The intent is to inject competition in the market for representation of workers in bargaining. Union membership is, therefore, no longer compulsory. An employer is required to “recognize the authority” (Section 12) of the agent a worker has chosen for himself although no contract is allowed that would establish a preference for or against union workers.

An Employment Court and an Employment Tribunal are empowered to address complaints about breaches of contract and have the power to correct these breaches. Indeed, several of its employment decisions in the last few years have seemed more in the spirit of the pre-1991 law and in this respect it “...has partially undermined the intentions lying behind the ECA” (Evans at alia, (1996)). Strikes and lockouts at the end of an employment contract are fully legal (though subject to some conditions). An employer has the right to suspend striking workers. Apart from matters covered by statute (such as nondiscrimination rules, minimum holiday entitlements, and minimum wages), employment contracts may embrace any issues.

The consequence of the Act has been a growth in enterprise-level bargaining. Union membership has fallen although in some sectors of the economy (such as the public sector and in large firms) collective bargaining remains the dominant method of determining the terms of employment. It is significant, however, that a larger nonunion sector is emerging that will operate to discipline wage-setting in the union sector without the need for government controls.

---

25 In the past, union membership was a necessary condition for access to courts that dealt with complaints over the operation of employment contracts. The new courts removed this requirement.

26 In New Zealand’s statutory law, there are no mandatory severance payments in the event of layoffs comparable to Europe’s job protection legislation though there is nothing preventing an employer and the worker’s (or workers’) agent from negotiating such payments. With respect to individual dismissals, Part III of the ECA establishes procedures to settle personal grievances (including unjustifiable dismissal) and the Employment Court’s decisions have granted dismissed employees considerable rights.

27 In 1990, 59 percent of all employees were covered by multi-employer collective bargaining contracts. By August 1993, this figure had fallen to 6 percent. See Evans at alia (1996, p.1882).
or offsetting measures. The coverage of collectively bargained contracts fell from over 70 percent in the late 1980s to about 40 percent in 1994. There has been a sharp fall in the extent of strike activity: in the first half of the 1990s, New Zealand had about one-fifth the days lost through strikes that it experienced in the last half of the 1980s. More disputes have been resolved at the level of the enterprise.

Whereas at one time there was little variation among workers in their wage increases, there has been a noticeable increase in the range of wage increases with some workers in the recession years of 1992-93 receiving zero or even negative wage increases, while other workers have enjoyed substantial raises. This is one manifestation of a greater variation in work and compensation arrangements. For instance, there has been a growth of contracts specifying workweeks shorter than the traditional forty hours and there have been more performance-related compensation schemes.

Because all sectors of New Zealand’s economy have been the subject of reform over the past decade, it is impossible to determine the particular contribution made by the Employment Contracts Act. Indeed, as will be argued below, the positive impact of any labor market reform such as the ECA will depend upon the degree of competition in other markets so that, in the presence of such complementarities, it is inherently impossible to parcel out the separate effects of different types of reform. However, surveys of employers identify the ECA as responsible for a significant positive impact on productivity.

The immediate indications are that New Zealand’s ECA will inspire unions to be more responsive to their membership, it will foster different types of employment contracts reflecting the wide variation in the preferences and interests of both workers and employers, and

---

28 This is why Kasper’s (1996) evidence of the effect of ECA is unconvincing. He contrasts New Zealand’s labor market performance from 1990 to 1995 with that of Australia and claims that New Zealand’s faster growth in employment and in real GDP “....offers fairly convincing evidence that decentralized labour markets yield more employment, growth, and, over time, wage income than a regulated, centrally coordinated industrial order” (p. 49). While I agree with Kasper’s views regarding the benefits of decentralized labor markets, I am skeptical that the experience of the two economies over the expansion phase of their business cycle testifies to the ECA alone. Even if no other aspects of New Zealand’s economy had been reformed, four years of a business cycle recovery hardly constitute “fairly convincing evidence” of the effects of one piece of legislation. Also, it should be remembered that New Zealand (unlike Australia) still has a national minimum wage. In 1996, it stood at a little over 40% of average earnings. Maloney and Savage (1996) also draw inferences about the ECA from a comparison of New Zealand’s and Australia’s experiences. They seem more equivocal about the effects of the ECA on productivity growth and wages.

29 Evans et alia (1996) refer to a survey of employers that classifies 80 percent reporting improvements in productivity since the ECA and a third singling out the Act as the most important cause of this increased productivity.
it will effect outcomes that are conducive to the growth of productivity. However, much more time needs to elapse before more confident statements about the Act are warranted.\textsuperscript{30}

III. Britain: The Importance of Indirect Regulation

Britain’s Voluntary System

While New Zealand and Australia provide examples of systems where (until recently) collective bargaining was extensively regulated by the state and where the state’s arbitration mechanisms underpinned wage determination throughout the economy, Britain appears as something of a contrast - a system which, except for some critical issues, has evolved largely independent of regulation by the state. It is often called a “voluntary” system in that employers and unions have found it in their interest to reach agreements without the law compelling them to do so.\textsuperscript{31} Writing in 1959, Phelps Brown (1959, p. 355) wrote, “When British industrial relations are compared with those of other democracies they stand out because they are so little regulated by law”. Consequently, it is sometimes argued that Britain’s collective bargaining system provides an example of what happens to industrial relations when little is regulated by the state.

The labor union movement, the collective bargaining arrangements, and the internal management of unions have developed with little statutory regulation.\textsuperscript{32} There is no law obliging private employers to bargain with unions nor anything that makes collective bargaining agreements enforceable in a court. There is no statement in law giving workers the right to strike. Some collective bargaining agreements cover all workers in a particular industry while others are restricted to a group of workers within a particular plant. Some unions represent workers in a large number of different industries while other unions organize a small number of workers. The general position taken by the law on these issues is that they are best determined by the parties concerned and there is little need for regulation by the state.

Although there are some sound reasons for accepting the proposition that Britain’s system of industrial relations illustrates what can happen when the state adopts a hands-

\textsuperscript{30} For a passionate statement by a labor lawyer opposing the ECA, see Dannin (1997).

\textsuperscript{31} There was a brief period (other than during the two World Wars) in which the law was more intrusive. In 1971, the Conservative Government passed an Industrial Relations Act that made collective bargaining agreements legally enforceable contracts unless the parties specified otherwise. This was, in fact, what happened: contracts routinely inserted disclaimer clauses of the form “this is not a legally enforceable agreement”. The Act was largely inconsequential because it was boycotted by most unions and it was repealed by the Labour Government in 1974.

\textsuperscript{32} The distrust of judicial entanglements in collective bargaining is exemplified by Winston Churchill’s remark, “It is not good for trade unions that they should be brought in contact with the courts, and it is not good for the courts”. (Quote taken from Wedderburn (1986, p. 272).)
off posture, it is better to view the British system as one where the influence of the state has been indirect, not direct. Britain’s system illustrates the critically important role of indirect regulation of collective bargaining and unionism by the state and the consequences of the state occupying a partisan posture with respect to collective bargaining. In particular, by encouraging the recognition by employers of labor unions, by discouraging product market competition, and by frustrating the competitive workings of nonunion labor markets, the tone of British legislation has not been neutral or hands-off when it comes to collective bargaining. That is, the ability of unions and employers in unionized markets to raise prices and divide the rents between themselves is constrained by the degree of competition in the product markets and by competition from nonunion labor markets. In practice, the rent-seeking potential of unions and unionized employers has been enhanced by a host of government policies.

**Indirect Regulation**

First consider labor markets. Until recently, there have been rules that required non-union firms with government contracts to pay “prevailing” wages which, in practice, meant union-negotiated wages. Given the extensive role of government expenditures in the economy, these rules affected a number of employers. Industry-specific minimum wage regulations were common in industries employing predominantly unskilled workers where collective bargaining was poorly developed. By the early 1990s, these were dismantled, but a new national minimum wage is to be introduced in April 1999.

Successive governments were not neutral in their posture toward unionism: governments actively encouraged collective bargaining and the unionization of its work force and of private employers’ work forces. Many governments implemented “incomes policies” in

---

33 The 1946 Fair Wages Resolution was regarded by Otto Kahn-Freund as “one of the cornerstones of British labour law” and by Wedderburn as “at least a prop for the British structure of collective bargaining” (Wedderburn (1986, pp.347-9). (The 1946 Fair Wages Resolution was preceded by analogous Resolutions in 1891 and 1909.) The extension of collectively-bargained wages to workers not covered by the collective agreements was effected by arbitration by the Ministry of Labour between 1940 to 1959. The same principle was enshrined in the Terms and Conditions of Employment Act of 1959. (See Royal Commission (1968), pp. 60-1.) The Employment Protection Act of 1975 set up the Central Arbitration Committee which had the power to oblige employers of nonunion labor to observe those terms of employment obtaining in similar unionized activities or in the same district. This was rescinded in the 1980 Employment Act. In September 1983, the Fair Wages Resolution was annulled.

34 For instance, Wedderburn writes, “Recognition [of unions for bargaining] has for decades been customary in the public sector. Public policy after the Whitley Reports (1917–19) has promoted recognition in the private sector too, not least during the two world wars......Parliament placed on the nationalized corporations that took over coal, steel, electricity and some other services after 1945 a legal obligation to consult and bargain with trade unions....” (Wedderburn 1986, p. 278). Also consider the following conclusion from the classic study of white-collar unionism in Britain: “...most white-collar union recognition in private industry has come about, directly or indirectly, as a result of government policies and the favorable climate they created for trade
attempts to reduce the pace of wage and price inflation and, in operating these policies, they frequently induced union cooperation by granting the unions various favors. The result was that the scope of unionism in the economy was encouraged while the competitiveness of the nonunion labor market was compromised, providing little check on monopolistic practices in the unionized market.35

Perhaps more important has been government policy with respect to competition in product markets. Since approximately the First World War, successive governments have been suspect of competition in product markets and have actively supported the monopolization of markets. In the 1920s, under the label of “rationalization”, governments encouraged mergers among competitive firms believing the resulting firms would be more successful in international markets. After the Second World War, a whole gamut of industries were placed under public ownership so that, until the 1980s, major industries were state monopolies including coal, gas, electricity, railways, urban transport, airlines, telecommunications, and (for much of the period) steel. The nationalization of these industries was vigorously supported by the labor unions who recognized that public ownership tended to politicize collective bargaining. Government ministers often found themselves embroiled in disputes over wage negotiations where collective bargaining outcomes were frequently removed from the financial performance of the industries and were much closely tied to preserving relative wage differentials regardless of the productivity of workers.

Being monopolies, strikes in these nationalized industries imposed heavy costs on consumers. After a winter of extensive strikes in 1978-79, an unhappy electorate returned to power a government committed to denationalizing many of these industries and, indeed, some of these industries were privatized in the 1980s. However, privatizing industries is not the same as ensuring a competitive environment so that strikes against private monopolies have the same

unionism.....[these] were also the major factors bringing about the recognition of white-collar unionism in the public sector of the economy....The industrial strength of white-collar unions, as determined by the size of their memberships and their willingness and ability to engage in industrial warfare, has generally not been sufficient in itself to force employers to concede recognition. This has also required the introduction of government policies which have made it easier for unions to exert pressure for recognition and harder for employers to resist it” (Bain (1970), pp. 181-4).

35 Roy Adams (1993, p. 295) expresses it well when he writes, “Despite the absence of extensive legislation, the policy of British governments in the 20th century has not been neutral, as the policy of voluntarism is sometimes interpreted to imply. In fact, British policy has been to encourage collective bargaining. It has done so by notifying all public servants that collective bargaining is the preferred means of establishing conditions of work, by requiring government suppliers to recognize the freedom of their workers to join unions and engage in collective bargaining, and by directly intervening in many disputes in order to pressure intransigent employers to recognize unions and to negotiate with them”.


opportunity for imposing costs on consumers as strikes against public monopolies. Moreover, a number of these industries are still in the state’s hands so the unions in these sectors retain considerable leverage.

Does the degree of competition really matter for collective bargaining? Stewart (1990) has provided evidence that it does by showing that, in Britain, where firms operate in competitive product markets, wages paid to union workers are little different from those paid to nonunion workers. On the other hand, in firms with product market power and especially where there exists a pre-entry closed shop (i.e., where union membership is a prerequisite for application for the job and for employment), union-nonunion wage differentials are as high as 19 percent.36

Changes in the Past Nineteen Years

Therefore, although there may have been little explicit regulation of collective bargaining and unionism in Britain, indirectly the state has been far from neutral and has lent its considerable authority to support unionism. This changed upon the assumption of power of the Conservative Government of Margaret Thatcher in 1979. Her administrations reduced the state’s indirect support of unionism and collective bargaining by denationalizing a number of industries, by eliminating minimum wage floors in specific industries, and by suspending the rules extending union wage scales to nonunion employers.

Curiously, although Thatcher’s administration declared itself supportive of laissez faire, it introduced new regulations in the union sector. Foremost among these new regulations were rules concerning strikes. The Trade Disputes Act of 1906 established that a union could not be sued by an employer for damages resulting from a strike.37 Thatcher’s administrations qualified this legal immunity from damages: a union became liable for damages if striking against a secondary employer; an employer could sue a union if the strike was not over industrial relations issues that the employer could address, but over, say, political issues or inter-union feuds that the employer had no control over; and a union would lose its immunity if the strike

36 His conclusion is worth reporting: “.....of the establishments in which unions are found to have been able to achieve wage differentials over non-union pay levels, only 5 percent face generally competitive product market conditions. The vast majority of the establishments face only limited competition and hence possess some degree of market power. It is this “monopoly” power in the product market on the part of the firm that provides the main source of rents of which unions are then able to bargain a share” (Stewart (1990), p. 1136). The data in his study cover semi-skilled manual workers in private establishments. Also, note these are estimates of the gap between the wages of union and nonunion workers. These are not estimates of the increase in wages that unions have secured for their members over what would have prevailed in the absence of unionism.

37 This had also been the practice until the decision by the House of Lords in 1901 in the Taff Vale case. The 1906 Act restored that right in law.
had proceeded without first secretly balloting its members and obtaining the support of a majority for strike action.

In those circumstances where the union lost its immunity, its financial liabilities for damage were proscribed by law. In instances where the union undertook strike action without first balloting its members and ignored court injunctions to desist, the union’s funds can be sequestered. The number and importance of strikes in Britain over the past thirteen years has fallen considerably and it is tempting to attribute this decline in strike incidence to these legal changes. However, there are many competing explanations for this change (strike activity has fallen in many countries) and it is difficult to determine the particular contribution of the law.

The Conservative Governments since 1979 also changed the law to make closed shops more difficult to maintain. In particular, the 1988 Employment Act prohibited firms from dismissing workers (at the behest of the unions) who were not union members while the 1990 Employment Act made it illegal to deny a nonunion worker access to employment. In addition, laws were introduced strengthening the rights of rank-and-file union members in dealing with their own organization. It was stipulated that direct, secret, elections of union officials must occur within every five years while every ten years ballots must be held to approve any political expenditures the union makes. Union members were given rights to examine their union’s accounting records.

There is wide agreement that, since 1979, the arbitrary power of unions in Britain has fallen and part of the increased growth in productivity over the past eighteen years or so has been attributed to a decline in the obstructionist power of unions. For instance, this is the guarded conclusion of Bean and Crafts who conclude that “the changed industrial relations scene of the recent past has not only allowed a once-and-for-all productivity gain, but also improved future growth potential” (1996, p. 161). However, it would be more interesting if we could identify those particular public policy changes that have contributed most to the growth in efficiency. On this, the legislation against closed shops is likely to have been of moot relevance as closed shops are more a symptom than a source of union strength. Similarly, the union democracy legislation may be thought desirable to make the unions more accountable to their members, but it is difficult to imagine how the legislation could have enhanced workplace productivity.

Bean and Crafts (1996) conjecture that a key feature raising Britain’s productivity growth was the decline in multi-unionism, that is, the presence of more than one union at a place of work. Their research and that of Machin, Stewart, and Van Reenan (1993) exploiting data on industrial relations practices from the Workplace Industrial Relations Surveys are compatible with the argument that, where management bargain separately with each of the unions- a so-called “fragmented bargaining structure” - the firm’s financial performance and productivity
suffer and strikes are more frequent. However, where the unions form a single bargaining committee and management bargains with this committee “around a single table”, these unfavorable outcomes are not apparent. In other words, where management insist on the unions joining together for purposes of bargaining with them, there are no untoward effects of multi-unionism. This is an important finding as there is a long history of groups of workers wanting to preserve their identity in separate organizations and in finding it more effective to pursue their aspirations in their distinct associations. This evidence suggests such multi-unionism does not damage the productivity and performance of firms provided the unions band together for the purposes of collective bargaining with management. In creating an environment in which managements had greater authority to insist upon the elimination of fragmented bargaining structures, public policy in the 1980s made British industrial relations less of a drag on economic growth.

However, fragmented bargaining structures did not describe anything like the majority of workplaces in the early 1980s so explanations for the boost to productivity must be sought in more encompassing factors. Natural explanations are the efforts to denationalize major industries and to introduce more competition in product and labor markets. In other words, the legal changes that have contributed significantly to the growth in productivity have been less those dealing with the union sector and collective bargaining in particular and more those concerning all labor markets and product markets. On this, it is relevant to note, among workers covered by collective bargaining agreements, there has been a notable increase in the fraction of workers covered by agreements negotiated at the plant level and a decrease in multi-

38 According to the 1984 Workplace Industrial Relations Survey, 62 percent of establishments recognized unions for manual workers and, of those establishments, about 18 percent had more than one bargaining unit. See Millward and Stevens (1986,Tables 3.5 and 3.7). Thus, among manual workers, only some 11 percent of establishments were characterized by fragmented bargaining.

39 This is also the judgment of Brown and Wadhwani (1990) who conclude, “...the driving force behind changes in industrial relations practices in the 1980s...has been increased product market competition, precipitated by a variety of circumstance, which has obliged employers to put their own houses in order” (p. 68). Similarly, Dunn and Metcalf (1996) judge that “....unemployment, including two deep recessions, and stiffer product market competition remain of paramount importance in weakening unions and stimulating management.....where we can pinpoint the law’s impact, legislative intrusion does not automatically bring the expected economic changes. Notably, when management eliminated closed shops in favour of merely recommending union membership, some economic consequences of ‘compulsory’ unionism survived.” (p.93). I read Brown, Deakin, and Ryan’s (1997) recent assessment as also consonant with my evaluation as is Haskel’s (1991) empirical analysis of labor productivity growth in 81 manufacturing industries from 1980 to 1986. Oulton’s (1990) study of 94 manufacturing industries between 1973 and 1985 attributes between a quarter and a half of the improvement in productivity growth in the 1980s to unionization.
employer agreements.\(40\) This tends to make bargaining agreements more sensitive to the particular circumstances of the employer and the plant and to increase the likelihood that pay increases will be linked more closely to changes in the firm’s or plant’s productivity. With respect to product markets, the promise and onset of deregulation and privatization were associated with increases in the rate of change of productivity. (See, for instance, Koedijk and Kremers (1996) and Parker and Martin (1995).)

Lessons

In general, notwithstanding the changes introduced by the Conservative Governments between 1979 and 1996, the direct impact of the law in shaping British collective bargaining remains modest. This has many benefits especially in that it has permitted a variety of different institutional responses to dissimilar situations. In effect, the system lets managements and workers determine the particular type of representation and contracts that suit them without obstacles created by the law. This means also that new firms are able to craft the system that best suits them and their workers without the need to tailor the structure to existing law.

A good example is provided by the experiences of the new plants set up during the past fifteen years in Britain by certain Japanese corporations. Typically, the new plants have specified a single union to represent all the workers and, occasionally, an important aspect of the agreements has consisted of the promise by the union not to strike but to settle all disputes during the operation of a contract by final-offer (or pendulum) arbitration. And preliminary evidence suggests that final offer arbitration has worked well in discouraging impasses (Metcalf and Milner (1992)). Such innovations in collective bargaining are easy to introduce in British collective bargaining and it represents one of the strengths of the system. The principal shortcomings have been and remain the consequence of indirect effects of the legal framework that tilt the system toward one that encourages unionism and non-neutrality in collective bargaining.

IV. Lessons Learned for the Regulation of Collective Bargaining

\(40\) By the 1990s, multi-employer agreements represented about one-quarter of all collective bargaining contracts. There has also been a decrease in the fraction of workers whose wages are covered by collective bargaining agreements. In 1970, the wages of about 70% of employees were covered by collective bargaining agreements. This had fallen to 64% in 1985 and to 47% in 1990. The fraction of employees who are members of unions fell from 39% in 1989 to 32% in 1995. In other words, there has been a steady erosion in the extent of unionism and in union-negotiated agreements in the economy. Legal changes contributed to this decline although there are other very important factors at work: the effect of two sharp recessions, the growth in product market competition, and the change in general attitudes toward employment contracts in general.
Labor unions have the potential of being a productive force in society. At a most basic level, they are a mechanism (not the only possible mechanism) permitting workers to participate in determining their work environment and there are reasons to believe that participation does not harm - and, more likely, enhances - productivity. Moreover, given the opportunities available to owners or managers to further their interests at the expense of rank-and-file workers, employees have a legitimate case for an organization that represents their interests. In addition, as an ingredient of a society’s social capital, labor unions are one manifestation of civic engagement that raise the quality of social intercourse and representative government. The challenge for public policy is how these beneficial aspects of unionism can be enjoyed without bringing into being some undesirable features. There are two principal classes of undesirable features. One follows from the monopolistic wage effects of unionism: when unions push up their wages, product prices tend to rise reducing the real incomes of consumers and encouraging a reallocation of labor that puts downward pressure on the wages of some nonunion workers. Because the employer of unionized labor is trying to pass along his wage increases to consumers and nonunion workers, it is appropriate to think of this situation as one in which union workers and the employer of union workers together are imposing costs on consumers and nonunion workers.

The employer will try to offset the union-induced wages not only by raising prices but also by substituting (where possible) other factor inputs (such as supervisory labor, materials, and physical capital) for union labor and by subcontracting certain separable activities to other firms. In response, the union may attempt to limit the employer’s offsetting actions and thereby

---

41 For a statement on the importance of organizations such as labor unions in contributing social capital, see Putnam (1995).

42 The wage activities of unions may provoke higher wages for some nonunion workers - those in what I have called elsewhere (Pencavel, 1991, p. 181) the administered-wage sector - but not all workers can benefit in this way. If the size of the pie is approximately fixed and if the rate of return to capital is unaffected, union-induced wage increases must be paid for by some nonunion workers and by consumers.

43 If product markets were completely competitive and the unionized employer were unable to pass along to consumers his higher wage costs, then the union wage gains could be enjoyed at the expense of the employer’s profits. However, this can only be a transitory situation as the lower rate of return on capital invested in this firm would encourage capital to move to nonunion employers and, in time, the unionized employer would go out of business. In other words, when a single firm bargains with a union, the union needs some element of imperfect competition in the product market or some nontransferable rent for its wage gains to be more than temporary. If all firms in a competitive industry are unionized, then product market competition and unionism are compatible. Here the union’s wage increases are taken at the expense of the consumers’ surplus. However, there are very few lasting cases of entire competitive industries being organized without the assistance of government supporting industry-wide unionism.
extend the provisions of the collective bargaining contract to cover such issues as the operation of machines and the work performed by nonunion labor. In this way, an initial contract restricted to wages becomes a device to regulate many of the firm’s internal operations and productivity may suffer.44

The second undesirable feature of unionism occurs when unions act in concert as a pressure group on democratic government and, by swaying public policy, extract benefits at the expense of those groups in society with little influence on government. The activities of unions as a pressure group are sometimes justified as offsetting - perhaps neutralizing - the pressure group activities of employers, but this supposes that the welfare of employers is set against that of unions. In fact, there are many areas of economic policy - such as government regulation of industry and the conduct of international trade - where the interests of employers and unions may coincide. Their common goal is to increase the rents to their firms and industries before determining how these rents should be split among the various groups of workers and owners.45

Every democratic country faces this challenge of fashioning a system to minimize the undesirable aspects of unionism and to maximize unionism’s potential as a constructive element in society. The design of any system involves drawing the line between those issues regulated by law and those issues regulated by the market. Then, within the class of those issues regulated by law, it has to be determined whether the role for the law is to “hold the ring” in which bargaining takes place or to specify closely the terms of the employment relationship and the mechanism of bargaining. For an open society, given the very nature of the exchange of labor services, legal regulation can never be complete and stipulate all aspects of labor

44 Collective bargaining contracts that cover issues relating to employment as well as wages are sometimes described as “efficient”. (See, for instance, Pencavel (1991, Ch. 4).) However, in that literature, efficiency is being used in the narrow sense of Pareto-optimal contracts that leave no opportunity for one party to enhance its welfare without damaging the welfare of the other party. Contracts that cause wages to diverge from the value of labor’s marginal product are always inefficient in the sense of not optimizing society’s allocation of resources.

45 Not only in matters of national economic policy may the interests of labor unions and employers coincide. In multi-employer collective bargaining agreements, some employers may welcome and support the union principle of extending a common wage rate to all employers in the industry. That is, the practice in multi-employer collective bargaining agreements of imposing relatively high wage costs on potential competitors may act as a barrier to entry and serve the interests of entrenched employers as well as the existing workers as represented by their labor union. As Williamson (1968, p. 114) notes, “....if the unions in oligopolistic industries key their wage demands to the profit performance of the largest firms and insist on substantially identical terms from all members of the industry, wage barrier effects which reinforce the oligopolistic structure of the industry can result”. Also see Phelps Brown (1959, p.278).
relationship. Nor, in such a society, can we envisage labor markets without any role for the legal underpinning of employment contracts. The issue is where to draw the line.

In addressing these questions, there is sometimes a tendency for labor lawyers to concentrate on the conflict of interests between workers and management and to urge precepts that derive from this adversarial perspective. Thus, Kahn-Freund wrote, “The main object of labor law has always been, and we venture to say will always be, to be a countervailing force to counteract the inequality of bargaining power which is inherent in the employment relationship” (Kahn-Freund (1983, p. 18)) while Mr. Justice Higgins, the major architect of Australia’s compulsory arbitration system, wrote, “the war between the profit-maker and the wage-earner is always with us”.46 From this perspective the employment relationship is antagonistic, one where management seeks to maximize each worker’s effort per money cost while each worker minimizes effort per money cost. In this contest, it is argued, the worker depends almost entirely on his job for his livelihood whereas management’s profits are rarely dependent on the work performed by one single person. From this disparity is derived the inequality of bargaining power that labor law is designed to remedy and that collective bargaining aspires to alleviate.47

The discipline of economics recognizes this perspective in its models of bargaining that describe the division between the worker (or workers) and management of the surplus from the employment relationship. However, workers and management have a common interest in maximizing this surplus before settling on its distribution. In this sense, the employment relationship is characterized not only by conflict of interest, but also by a complementarity of interests between management and workers. The legal perspective stresses the adversarial aspect of the employment relationship and tends to give short shrift to the fact that management and workers also have interests in common. If the interests of management and workers are partly opposing and partly complementary, it is not obvious why labor law should be “based on anything other than conflicting interests” (Wedderburn, (1986, p. 26)).

46 The quote from Mr. Justice Higgins comes from Kahn-Freund (1983, p. 27).

47 Writers from a legal perspective sometimes emphasize the fact that employment is typically an authoritarian relationship in which the worker follows the directives of management or management’s representatives. The inequality of status follows from the fact that one party is giving orders and the other party is obeying them. This is undeniably the case. However, in most instances, the employment relationship also embodies elements of delegation in that each employee is granted a certain freedom in how he furthers the interests of the firm. To ensure these freedoms do not conflict with the organization’s goals, management has to spend resources to monitor the worker. This endows the worker with bargaining leverage: if management treats the worker arbitrarily, the worker will tend to be uncooperative and thus require more supervision (greater monitoring costs) by management.
As far as collective bargaining is concerned, the laws governing its regulation should be judged by the degree to which the system is successful in nourishing unionism’s desirable features. This will depend upon many factors, but three general principles to guide the design of an effective regulatory system are evident from the experience of Australia, New Zealand, and Britain.

1. Decentralization

Australia’s and New Zealand’s old systems of dealing with collective bargaining involved centralized agencies of the state intruding heavily into the operation of employment contracts. The intrusion took the form of extensive rules and regulations that covered workers in diverse types of employment and with different concerns in a variety of situations. By their very nature, such broad edicts emanating from a body removed from the place of work do not reflect the particular circumstances of an employer or the particular preferences of a worker. The system was determining the terms and conditions of work for the vast majority of workers with little regard for their productivity or their wishes. Decisions that are naturally left to the employer and the individual worker or the union to determine were usurped by the agencies of the state. This sapped the enterprise of the union movement.

The quasi-judicial procedures recognized the maintenance or restoration of relative wages as the principal factor determining wages, not issues of economic efficiency. Quantities and other prices in the economy were expected to adjust to judicially-determined wages - the Labour Standard - and when these adjustments had unsatisfactory consequences (such as foreign trade imbalances or growing unemployment) so further offsetting measures needed to be taken. The result was one of the most protectionist and state-intrusive economies in the non-Communist world. Over time, Australia’s and New Zealand’s relative standard of living declined. This was not the result of the centralized wage determination system alone. But the industrial relations system was an element of a complementary set of economic policies that resulted in misaligned prices, dulled incentives, and pressure group economic management.48

The consequences of these economic policies (of which centralized wage determination was one aspect) were not so apparent in inflation or in unemployment or in economic growth in a given year or a given decade - these are the sorts of variables that have been used in the econometric

48 Preston, a Treasury official, described New Zealand as a “pressure group economy” defined as “the vigorous participation of organised lobbies in the debate on policy formulation and in helping to shape the nature of government interventionist activities in fields as diverse as industrial protection, wages policy, and farm income stabilisation......[While] pressure groups play an integral part in a modern democracy ......the need to accommodate to the views of a diversity of entrenched interests inhibits the ability of governments to promptly implement policies which may be seen to be in the interests of the country as a whole.” (Preston (1978, pp.112-3).
research on economic performance and collective bargaining systems. The consequences became evident in a generation or more.

This gives rise to the first principle for a productive collective bargaining system: the greater the extent of decentralization of unionism and collective bargaining, the greater the tendency for the desirable features of unionism to outweigh the undesirable aspects. Collective bargaining at the enterprise level is less likely to generate monopolistic wage increases than collective bargaining at the industry-wide level or higher. Also, productivity-enhancing work arrangements at an enterprise are more likely to be reached when the union has the authority for bargaining over wages at that enterprise than when collective bargaining is at the level of the industry or higher. Furthermore, the leverage that unions exert as a pressure group on government is minimized if the locus of power in the union is at the local level, not at the economy-wide level.\footnote{For an appraisal and rejection of the argument that more effective economic reforms can be undertaken when the locus of union power is embodied in a central confederation, see Pencavel (1997).} Finally, unionism’s part in cultivating social capital is more effective when authority within the union movement is invested at the local level where members participate and interact in networks to further their interests, not when the critical decisions affecting the members are taken by agents whom rank-and-file workers are less likely to have met and when the principal act of membership may be simply the routine payment of union dues.\footnote{Using Putnam’s (1995) taxonomy, local unionism is a “secondary association” while regional or national unionism comes closer to a “tertiary association”, an organization akin to the Sierra Club and Oxfam.}

\section{The State’s Disengagement}

There are many different ways in which the state can be involved in collective bargaining. For instance, the state can play an active or passive part in determining the ease with which workers are organized into unions and in stipulating whether unions are recognized by employers for the purposes of bargaining. The state can play an active or passive role in shaping the bargaining and in affecting the resolution of collective bargaining agreements and on what terms. The enormous literature on labor law testifies to the complexities and subtleties of these issues.

One possible role for the state is to be very invasive: to specify precisely by statutory law or by judicial ordinance the factors determining union recognition, the procedural rules for bargaining, and the terms regulating the substantive content of agreements. In this instance, procedures may be carefully codified and, on paper, the industrial relations framework
may have the appearance of a tidy, fully-specified, system, something that has had considerable appeal to some lawyers. However, such an interventionist role has serious defects.

First, the state is drawn into taking a position on the merits of alternative mechanisms for determining employment contracts. Thus, for most of this century, in the three countries examined above, the state took a clear stand on the appropriate system of wage and employment determination: in Australia, New Zealand, and Britain, the state actively encouraged the growth of unionism and, in one way or another, decided that labor contracts are best determined either by collective bargaining or by compulsory arbitration. Yet, as argued above, there is no compelling evidence on the workings of collective bargaining in Britain and compulsory arbitration in Australia and New Zealand to support the notion that these systems of determining employment contracts merited the state’s preference. On the contrary, there are sound reasons to believe that the systems had major defects in terms of efficiency and economic growth. The principal advantage of conventional unionism - that of providing workers with an agent to represent and defend their interests - may be effected by other mechanisms such as works councils, company unions, and worker ownership schemes so, even on the narrower grounds of devising instruments for worker representation, it is not clear that traditional unionism should receive the sort of preferential treatment that these countries conferred upon it.

The second shortcoming with a policy of the state adopting an interventionist stance in labor relations is that such a posture makes it more difficult for the state to avoid being seen as an active participant in affecting the terms of labor contracts and resolving industrial disputes. Though government may want simply to “hold the ring” and be an impartial referee in union-management contests, it cannot avoid the fact that, when it sets the rules and when it is called upon to adjudicate them, the state profoundly affects bargaining methods and outcomes. And once the state is seen as a participant, it is a short step to be viewed as partisan. Thus, in the three countries studied, having encouraged unionism, successive governments of all political persuasions wrestled with the consequences of this decision: the labor relations systems were denounced for inhibiting the efficient allocation of resources, for encouraging inflation, and for imposing burdensome strikes on the public.

The old systems in Australia and New Zealand actively promoted the formation of unions and employers’ associations and the setting of wages by labor tribunals through mandatory arbitration.51 Because their decisions affected so many workers and firms, the labor arbitrators’ wage awards had far-reaching consequences so the retirement of an arbitrator or the

---

51 New Zealand’s Act of 1894 explicitly referred to itself as “an Act to encourage the formation of industrial unions” (Phelps Brown, 1983, p.49).
appointment of a new one could be of considerable significance in a particular sector.52 The
determination of wages had less to do with the economic circumstances of the firms and more to
do with the arbitrators’ perceptions of fairness. The arbitrators themselves were not beholden to
the government’s economic policies and, therefore, were at liberty to render decisions that were
not part of an overall coherent economic policy.53 Even when contracts were settled by the
unions and employers themselves and not by arbitrators, as argued above, the terms of these
collectively bargained settlements were affected by the knowledge that either party could take
the dispute to arbitration.

Although British legislation adopted a less explicit interventionist posture, the
implications of government policies (at least during both World Wars and from the Second
World War until Thatcher’s administrations) were to endorse the growth of unionism and
collective bargaining as the approved method of determining wages and other aspects of
employment.54 The state was acutely involved in some of the larger disputes because it played
the part of employer - either directly when the disputes were in nationalized industries (such as in
coal or health care) or indirectly when the disputes involved private employers that were
receiving extensive subsidies from the state (such as in steel and motor cars). In these
circumstances, when presented with union demands, the state’s representatives were confronted
with the awkward position of either being improvident with the public’s purse or appearing
unsympathetic to the underdogs’ plight. A dispassionate assessment of employment contracts
was rarely possible and collective bargaining became politicized confrontations.

---

52 Akin to judges in conventional courts, those appointed to Australia’s Conciliation and
Arbitration Commission were supposed to have judicial independence and protection from
arbitrary dismissal from office. However, this has not prevented government from repeatedly
attempting to intervene in the operation of the arbitration tribunals and to put pressure on
arbitrators. Examples are provided by Kitay and McCarthy (1989).

53 For instance, in Australia, “Although the [Conciliation and Arbitration] Commission is set up
by Act of federal Parliament, the government is constitutionally precluded from specifying the
outcome of tribunal decisions. This has been a source of frustration to Australian governments,
but repeated constitutional amendments designed to increases the Commonwealth’s industrial
relations powers have failed. The commission can have a significant effect on the economy, and
federal governments are always concerned that decisions should not unduly contravene their
economic policy..... At times the commission and the government have been sharply at odds”
(Kitay and McCarthy (1989, pp. 314-5)).

54 As the Donovan Report noted, “.....it has been Government policy [in Britain] generally to
support collective bargaining at least since the last decade of the 19th century” (United Kingdom,
1968, p. 55). Labor lawyers often approach the analysis of labor law with the same
predilections. Thus, in the concluding chapter of his analysis of Britain’s labor laws,
Wedderburn (1986, p. 835) is admirably candid about his inclinations: “The preceding chapters
evince an open positive preference for collective bargaining, both as a realistic recognition of
conflicts of interest and as machinery for the peaceful mediation of social change......”.
Instead of adopting partisan positions, a superior public policy is one of disengagement. Collective bargaining is neither endorsed nor denounced. Government neither promotes nor thwarts the settlement of contracts. This implies that the state does not encourage union recognition by employers nor does it encourage employers not to recognize unions. It also implies that the state does not instruct the parties whether to bargain and how they bargain. It does not mandate that a party go to arbitration if that party does not want to.

Government (in all its various guises) should not act in a discretionary manner. Such discretionary acts occur when government intervenes to help settle a strike or when it grants favors to one party. In these circumstances, once government has intervened, the probability exists that it will intervene again. This, in turn, affects the behavior of the union and management, one of whom will become more intransigent in bargaining believing that, at last resort, it may be able to call upon government authority for help. When government goes beyond establishing and enforcing the rules of the game and becomes involved in particular bargaining contests, collective bargaining tends to become politicized with the consequence that bargaining outcomes become tied less to the economic circumstances of the bargaining setting and more to the political exigencies of the moment.

To minimize this, government’s role should be to put in place a legal framework that does not champion collective bargaining nor proscribes it as a method for the determination of employment contracts. And, in those areas where collective bargaining is the mechanism for determining the terms of employment, the government’s framework should favor neither party nor intrude upon their actions except when those not expressly represented in bargaining will suffer egregious harm. Government should leave as much as possible for the bargaining parties to determine rather than to specify the content and manner of bargaining. This is because the sort of agreements and procedures that suit one pair of bargainers may not be at all appropriate for another. Whereas an efficient system is likely to be characterized by diversity in bargaining structures, legislation is apt to prescribe one model or a few models of collective bargaining for

55 Not only is this posture different from the one characterizing government policy in Britain, New Zealand, and Australia for most of this century, also it differs from the position taken by the governments of many other countries. For instance, in the United States, the National Labor Relations Act of 1935 declares the policy of the U.S. to encourage “the practice and procedure of collective bargaining”. Several Conventions have been passed by the International Labour Organization “to promote collective bargaining” (such as Convention No. 154 that came into force in 1983) and a number of governments have not wished to appear unsympathetic and hence have ratified such Conventions.

56 Usually it is in the public sector where disputes run the risk of imposing heavy costs on consumers so it is in the public sector where the case is strongest for mechanisms to protect consumers from these costs. I have argued elsewhere that final-offer arbitration offers itself as an attractive dispute resolution procedure in these circumstances. See Pencavel (1997).
all circumstances. Let the collective bargaining structure and the content of collective bargaining agreements conform to what each firm’s workers and management find convenient and efficacious.

3. Competitive Markets

The third principle guiding the legal framework on collective bargaining concerns public policy with respect to all labor, product, and financial markets. An important argument in this paper is that the degree to which unions act in a constructive fashion depends not only - or even, not principally - on the regulations covering unions and collective bargaining, but on the manner in which nonunion labor markets, product markets, and financial markets operate. In other words, the most effective constraints on monopolistic wage practices by unions and monopolistic price practices by unionized employers are provided by a competitive market environment. Hence, we must look to rules and regulations throughout the economy and not merely in the unionized sector of the economy to produce a framework that maximizes the prospect for unions to be a productive force in the economy.

All three countries analyzed in this paper have violated this principle. In Britain, Australia, and New Zealand, at least until recently, many product markets have been monopolized (often in the form of state ownership or, in the Australasian case, through high tariff barriers) so that union and management monopolies were not confronted by the discipline of competitive markets.

Complementarities among these Principles

The returns from complying with any one of these three principles may be meager without also putting into effect the others. In other words, these principles are highly complementary and they yield their highest returns when applied together. Thus, the benefits from decentralized bargaining (the first principle) will be small if markets are non-competitive (the third principle) because, with non-competitive markets, even if collective bargaining takes place at the level of the firm, unionized firms can transfer monopolistic wage bargains to vulnerable consumers. Or the gains from a legal code that refrains from specifying what firms and unions may bargain about and how they may bargain will be undermined if the executive branch of government is inclined to intervene and influence collective bargaining outcomes. In this instance, what is gained in the content of the legal code is lost by the activities of another arm of government. A policy of disengagement should apply to the legislative and the executive branches of government. So the real advantages from applying these three principles are reaped when all operate and supplement one another.

V. Conclusions

Unions function in different ways in the economies analyzed in this paper. They engage in collective bargaining to help determine the terms and conditions of employment for
certain workers. They act as a pressure group on government. They provide an opportunity for working people to collaborate in an organization to protect and express their interests at their place of work. It is in this last activity that unions have the best case for meriting state support and assistance. This is because any gains they achieve in their collective bargaining and pressure group activities are primarily at the expense of other workers and consumers and it is not obvious that those sectors of the economy where the costs of unionizing happen to be least (i.e., those sectors of the economy where unions are able to organize and become effective) should be those areas of the economy benefitting from income redistribution. Moreover, some of these collective bargaining and pressure group activities harm productivity and, therefore, squander wealth.

On the other hand, the argument that workers should have not only an organization that defends them from arbitrary actions of management, but also an opportunity to help shape their work environment has considerable appeal. As industrial relations scholars have argued for a long time, there are instances in which the presence of an agency in a firm to represent the interests of workers may yield efficiency gains rather than efficiency losses. In addition, some of the conventional arguments in politics in favor of representative democracy have been applied also to the representation of employees at the workplace so, it is argued, an active and vibrant social order is enhanced when people participate in decision-making in a variety of organizations including (or especially) their place of work.

Labor unions may be a vehicle for such worker participation, but they are by no means the only vehicle nor perhaps the most effective. Cogent arguments have been made on behalf of other mechanisms - works councils, profit-sharing schemes, worker-owned firms, employee representation plans - to involve workers in shaping their work environment so, even if it should be decided that it is desirable to foster employee participation in decision-making at work, it is not at all obvious why labor unions should be the particular beneficiary of this judgment to the detriment of other mechanisms of participation. And even if it were determined

---

57 For instance, on the basis of observing a large number of working places, Slichter (1941, p. 575) inferred: “The very fact that the workers have had an opportunity to participate in determining their working conditions is in itself favorable to efficiency.... [Efficiency depends upon consent. Even though the specific rules and policies adopted in particular instances may not be ideal, the process of joint determination of working conditions at least offers the possibility of achieving greater efficiency than could be obtained under rules and conditions dictated by one side.” Duncan and Stafford (1980) supplied evidence that, where the public goods features (such as assembly lines that move at a uniform pace) of workplaces are especially important, mechanisms that give expression to worker preferences (such as unions) may be cheaper than conventional market mechanisms in identifying workers’ values. This perspective on unionism finds expression in Freeman and Medoff’s (1984) well-known work.

58 For example, see Dahl (1985) and Bowles and Gintis (1993).
that unions should be specially favored, this argument would call for the locus of authority within unionism to be at the place of work, not at some multi-employer or national level.

Public policy in all countries has recognized that unionism and collective bargaining need to be regulated. The fundamental issue is not whether to regulate or not to regulate, but rather how is this regulation best effected. There are two general approaches to regulate collective bargaining: one is to invoke the legal sanction and specify in law an array of rules, prohibitions, rights, and immunities that unions and collective bargaining must conform to and enjoy; the other approach is to allow competitive markets to provide the regulation and to use statutory law and judicial mandate as little as possible.

For most of this century, Australia and New Zealand provide an example of the former approach to regulation. An extensive legal code emerged that defined exactly how the parties should conduct themselves in various circumstances and what the content of collective bargaining agreements should and should not be. The collective bargaining system was largely co-opted by lawyers and civil servants with the result that rank-and-file workers felt removed from the system and that wage outcomes often had a loose relation to the underlying productivity of the resources.

Britain has provided an example of the importance of indirect regulation of industrial relations by the state. By endorsing the unionization of workers and by encouraging the monopolization of product markets, the state has supported collective bargaining and partly neutralized the natural competitive pressures that would check the discretionary power of labor unions and the employers of unionized labor.

What would unionism look like in an economy that designed its law on collective bargaining in accordance with the principles sketched in this paper? Probably only a minority of workers would be covered by collective bargaining contracts. This is because competitive markets are not normally conducive to the formation and survival of unions. In all markets, organizing workers into unions is costly and some employers are unwilling to bargain with them, but these hurdles are particularly high when firms operate in competitive product markets. Moreover, some workers prefer not to pay dues to unions. However, unions will be an enduring feature of some labor markets and, in these cases, their strength would derive from the members themselves at their place of work, not from a union confederation leader or from a state regulatory body. The state would not protect established unions from competition in the market for representation services. The consequence will be a more vigorous union movement, one

---

59 Authority within a union is closely tied to where and at what level collective bargaining negotiations are conducted. As Clegg (1976, p. 41) expressed it in his review of union government in six countries, “union constitutions vary almost infinitely, but in most instances the distribution of power within unions can be read off from the structure of collective bargaining”.


whose energies would be directed to its members’ workplaces and not to the agencies of the state. Unions would take up again activities such as providing for their members insurance for unemployment, illness, and accidents in addition to designing retirement benefits. In some instances, powerful workers’ organizations would be likely to strike tough (i.e., lucrative to the workers) bargains with employers. Where rents exist, workers would have the opportunity to appropriate them.

This paper has used the device of analyzing the framework for collective bargaining in Britain, Australia, and New Zealand for much of the twentieth century to offer a prescription for regulating collective bargaining. This prescription involves the state refraining from endorsing or obstructing unionism, but assuring that, when workers are unionized, the locus of collective bargaining is at the place of work, not at a more centralized level. The power and generality of these arguments should be assessed by asking how they fare in the light of the experiences of other countries such as the United States, Japan, Germany, and Sweden. This major project provides the agenda for future research.
References


Scherer, Peter, “Nature of the Australian Industrial Relations System: A Form of State Syndicalism?”, in Keith Hancock, Yoko Sano, Bruce Chapman, and Pamela Fayle, eds.,


