

Chapter 8: Productivity and workplace bargaining

Introduction

- 8.1 The principal object of the WR Act identifies the importance of cooperative workplace relations arrangements as a means of promoting the economic prosperity and welfare of the people of Australia. This is emphasised in s.3(d) which specifically states the arrangements:

ensur[e] that, as far as possible, the primary responsibility for determining matters affecting the employment relationship rests with the employer and employees at the workplace or enterprise level.

- 8.2 The promotion of cooperative workplace relations arrangements recognises that the shift towards greater workplace bargaining over the past decade and a half has helped to underpin Australia's improved productivity performance.
- 8.3 One of the aims of the recent legislative changes is to build on the strong productivity gains of the 1990s and ensure that Australia improves and narrows the gap in its productivity performance with other advanced economies.
- 8.4 This chapter details Australia's productivity performance, highlighting the importance of workplace bargaining in helping to secure the strong productivity gains of the 1990s and ensuring these gains continue.

Productivity gains of the 1990s¹

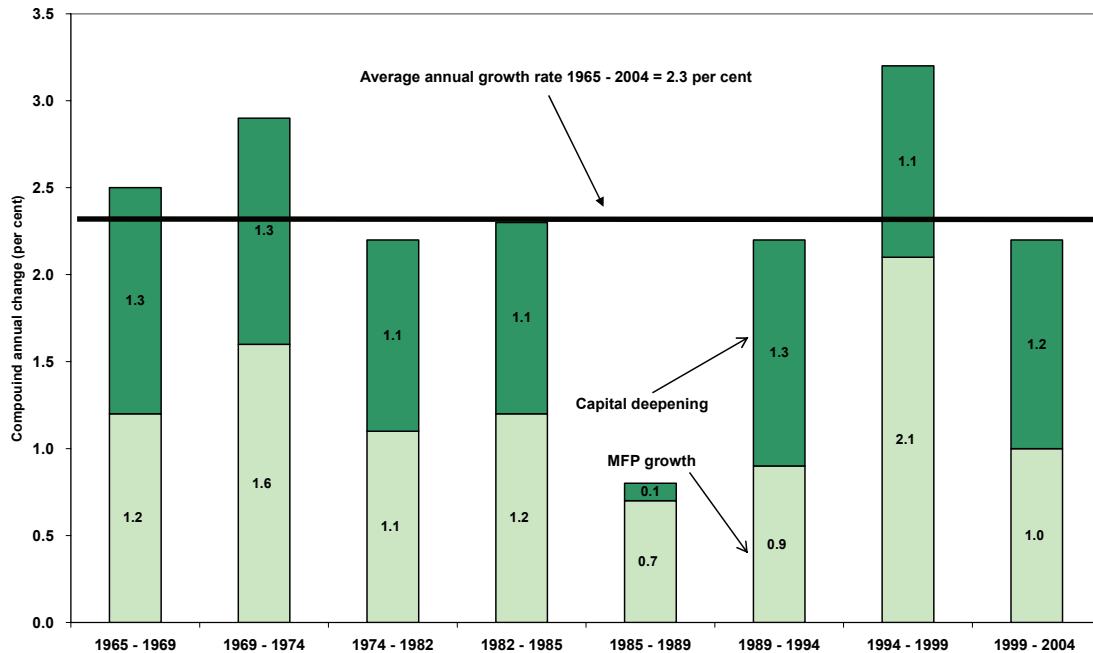
- 8.5 The 1990s was an era of strong productivity growth both from an historical and international perspective. The historical perspective can be seen in Chart 8.1 which shows average annual changes in productivity growth based on growth cycles from 1964-65 to 2003-04.² The Chart shows that during the 1993-94 to

¹ For a more detailed account of the information provided in this section see ABS, 'Estimates of Productivity in the Australian National Accounts', Feature Article, *National Accounts* (Cat No 5206.0), September 2005.

² Growth cycle peaks are identified as the peak deviations between the original and corresponding long-term trend estimates. The productivity cycle approach adjusts for much of the cyclical influences on productivity. The latest productivity estimates from the national accounts confirm that 2003-04 is the latest productivity growth cycle.

1998-99 growth cycle, labour productivity grew by 3.2 per cent, the highest rate on record and well above the long-term average of 2.3 per cent.³

Chart 8.1: Contributions to labour productivity growth of the market sector for growth cycles: 1964-65 to 2003-04



Source: ABS, *Australian System of National Accounts 2004-05* (Cat No 5204.0), Table 23.

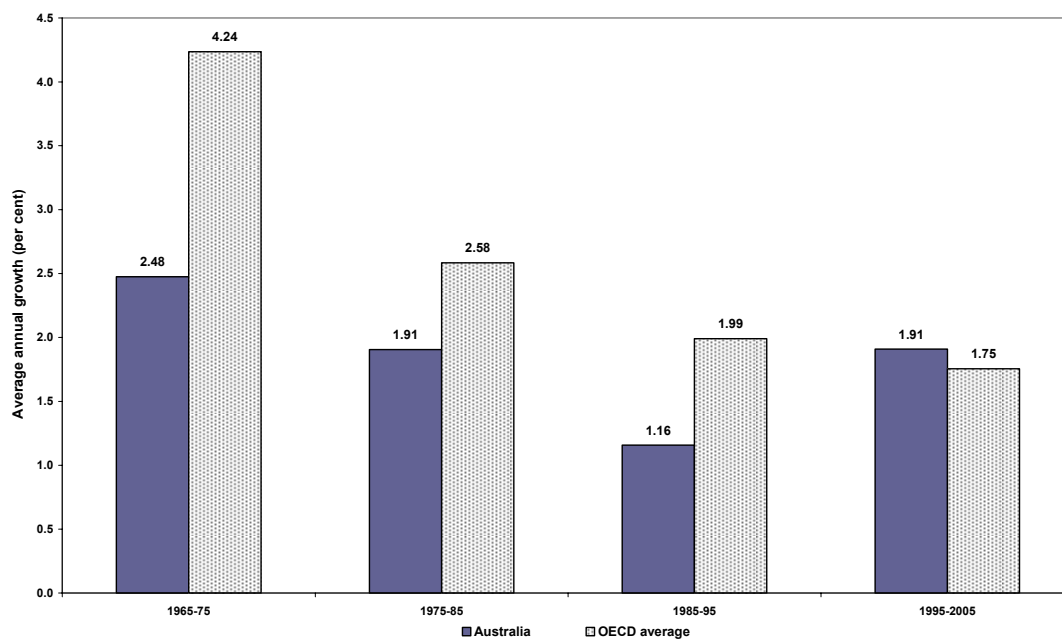
- 8.6 Chart 8.1 also shows, more importantly, that in terms of the two main components of labour productivity growth, capital deepening and multifactor productivity, it was the latter that was the key driver of the increase. Whereas the contribution of capital deepening has been relatively stable (with the exception of 1984-85 to 1988-89) multifactor productivity has been far more variable.
- 8.7 The increase in multifactor productivity growth during the 1990s is important because it provides an indication of the factors underpinning the changes in productive efficiency. Multifactor productivity basically removes the effect of changes in capital per person employed. While it cannot isolate the individual drivers of productivity growth, multifactor productivity nevertheless provides the best measure possible of the effects of technological change, increases in the workforce's skills and improvements in work and management practices.

³ ABS, *Australian System of National Accounts, 2004-05* (Cat. No. 5204.0), Table 23.

Multifactor productivity thus includes the productivity improvements facilitated and assisted by greater workplace bargaining.

8.8 Australia's gains in productivity during the 1990s were also strong from an international perspective. Evidence suggests that the acceleration was not simply part of an international phenomenon but one unique to Australia. More specifically, the resurgence occurred prior to that experienced by the United States and despite a productivity deceleration elsewhere in the OECD.⁴ Indeed, only two OECD countries recorded multifactor productivity growth higher than Australia's during the 1990s.⁵ Moreover, as Chart 8.2 shows, the period from 1995 to 2005 was the first, since the mid 1960s, in which Australia's overall productivity growth was higher than the OECD average.

Chart 8.2: GDP per hour worked, average annual growth rate Australia and the rest of the OECD average (a)



Source: Groningen Growth and Development Centre and the Conference Board, *Total Economy Database*, May 2006, <http://www.ggdc.net> (accessed 30 June 2006).

(a) OECD average calculated across the 23 high income countries, West Germany is used until data became available for a unified Germany in 1989, Original data in 2005 \$US.

⁴ B Dolman, L Lu and J Rahman, 'Understanding Productivity Trends', *Economic Roundup*, Summer 2006, page 39.

⁵ G Nicoletti and S Scarpetta, 'Regulation, Productivity and Growth: OECD Evidence', *Economic Policy*, 2003, Vol 18, No 36, page 7.

Relationship between productivity and bargaining

- 8.9 The strong productivity gains of the 1990s were driven by a wide-ranging microeconomic structural reform programme. The reduction of external barriers to trade, floating of the currency and increased access to essential infrastructure through the National Competition Policy began the process of increasing competition and improving labour productivity in the early 1990s.
- 8.10 Australia stepped up the reform process in the second half of the 1990s. Agreement-making at the workplace level increased in importance, partly replacing the centralised setting of wages and conditions of employment. As a result, wage rises were increasingly set in a more decentralised environment with a stronger link to productivity improvements in the workplace. This combination of reforms operated within a stable macroeconomic policy framework to further improve productivity.
- 8.11 The productivity enhancing effects of workplace bargaining are confirmed in numerous case studies. The Productivity Commission undertook case studies in the whitegoods, automotive, textile clothing and footwear, NSW rail freight and wholesale and retail trade industries to investigate the drivers and outlook for productivity growth.⁶
- 8.12 The studies showed that flexibility in work arrangements had increased through enterprise bargaining agreements. Specifically, workplace bargaining was seen as providing a framework to assist the redesign of working arrangements to ensure that workers were employed in ways where they were most productive. Productivity improvement was therefore an explicit feature of many of these agreements.
- 8.13 Other workplace-level studies confirm the link between productivity and enterprise bargaining. Tseng and Wooden found that firms where all employees were on enterprise agreements had almost 9 per cent higher levels of productivity than comparable firms where employees relied upon conditions specified in an award.⁷

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

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

- 8.14 Fry, Jarvis and Loundes also found that organisations adopting workplace relations reform, such as entering into agreements with their workers, reported substantially higher levels of self-assessed labour productivity relative to their competitors.⁸
- 8.15 In a survey of employers, the Office of the Employment Advocate (OEA), found that the main reasons for introducing AWAs were to increase hours flexibility, simplify employment conditions and obtain better organisational outcomes – all productivity enhancing matters.⁹ Of the respondents, 58 per cent indicated that labour productivity had improved from introducing AWAs.
- 8.16 Employers entering into federal enterprise agreement-making also identify productivity improvement as a major motivation. Information obtained from DEWR's Workplace Agreements Database (WAD) indicates that improvements in workplace productivity have been pursued in several ways, including provisions in current agreements for new or revised classification structures, the introduction of performance indicators and flexible working hours.¹⁰
- 8.17 Connolly et al present an analysis of the aggregate relationship between federal certified agreements (CAs) and Australian Workplace Agreements (AWAs) and labour productivity.¹¹ The study found that, in the long-run, a one percentage point increase in federal CA and AWA coverage (lagged by two years) increases labour productivity by around 0.25 per cent. The authors argue that it is possible that the total effect could be even higher than this, since a higher coverage of enterprise and individual agreements could induce rises in labour or capital inputs.

The benefits of strong productivity growth

- 8.18 Productivity growth is important because, as a key driver of real GDP growth, it improves the prosperity and living standards of Australians. The benefits of

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

⁹ Department of Employment and Workplace Relations and the Office of the Employment Advocate, *Agreement Making in Australia under the Workplace Relations Act 2000 and 2001*, Ausinfo, Canberra, 2002.

¹⁰ See for example the biennial reports on Agreement making in Australia under the Workplace Relations Act by the Department of Employment and Workplace Relations and the Office of the Employment Advocate.

¹¹ G Connolly, A Herd, K Chowdhury and S Kompo-Harms, *Enterprise Agreements and Other Determinants of Labour Productivity*, Paper presented at the Australian Labour Market Research Workshop 2004, University of Western Australia, Perth, 6-7 December 2004, page 32.

productivity growth can be distributed in three ways - higher wages to workers, higher profits to employers and lower prices to consumers.

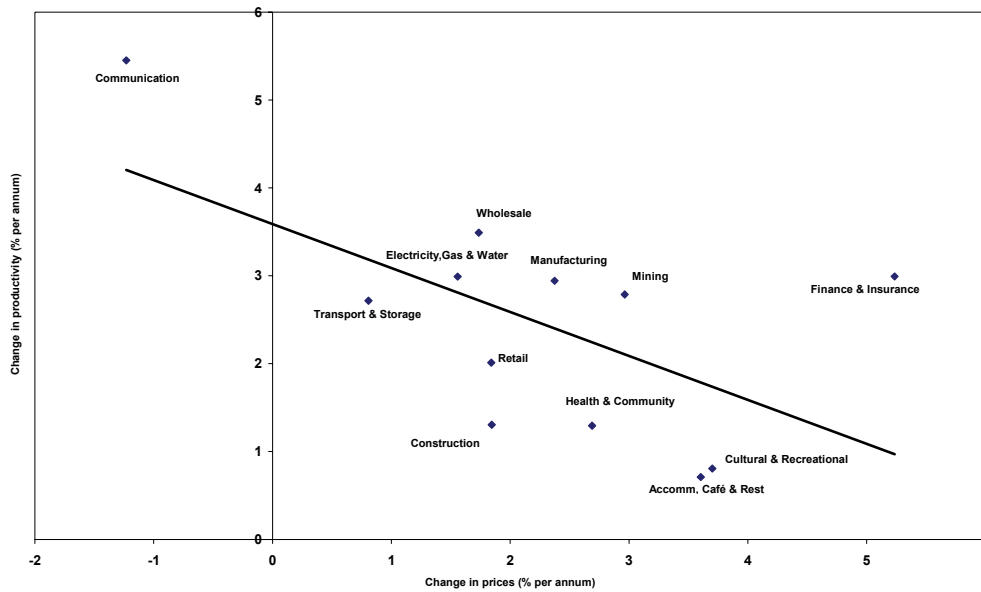
- 8.19 A study of the distribution of productivity gains from the 1990s by Parham et al found that industries with high productivity growth have tended to grant wage increases in line with aggregate wage increases. Moreover, while recording higher profits, the gains in productivity have also been passed onto consumers through lower prices.¹² Indeed the authors found that the inverse relationship between productivity growth and prices was much stronger in the 1990s than in previous periods, due to a stronger competitive environment. This encouraged productivity gains to be passed on through lower prices rather than nominal wage growth or profit taking.
- 8.20 The negative relationship between productivity growth and prices in the period since the introduction of workplace bargaining is displayed in Chart 8.3.

Encouraging future productivity growth

- 8.21 The strong productivity growth achieved during the 1990s can continue. There remain extensive opportunities for improvement in Australia's productivity performance as it has not fully overcome past laggard performance.
- 8.22 Chart 8.4 shows that despite the strong improvement in the 1990s, Australia's productivity level remains toward the bottom third of OECD countries. More specifically, Australia was ranked 15th among OECD countries in GDP per hour worked in 2004 and had a labour productivity level only 80 per cent of that of the USA.
- 8.23 Not only is there the potential for Australia's productivity performance to lift, there are strong imperatives to do so if we are to secure future prosperity. As detailed in the Commonwealth Treasury's Intergenerational Report of 2002-03, the ageing of the population implies that productivity growth has and will increasingly become the most important driver of real GDP growth per capita.

¹² D Parham, P Barnes, P Roberts, S Kennett, *Distribution of the Economic Gains of the 1990s*, Productivity Commission Staff Research Paper, Ausinfo, Canberra, 2000.

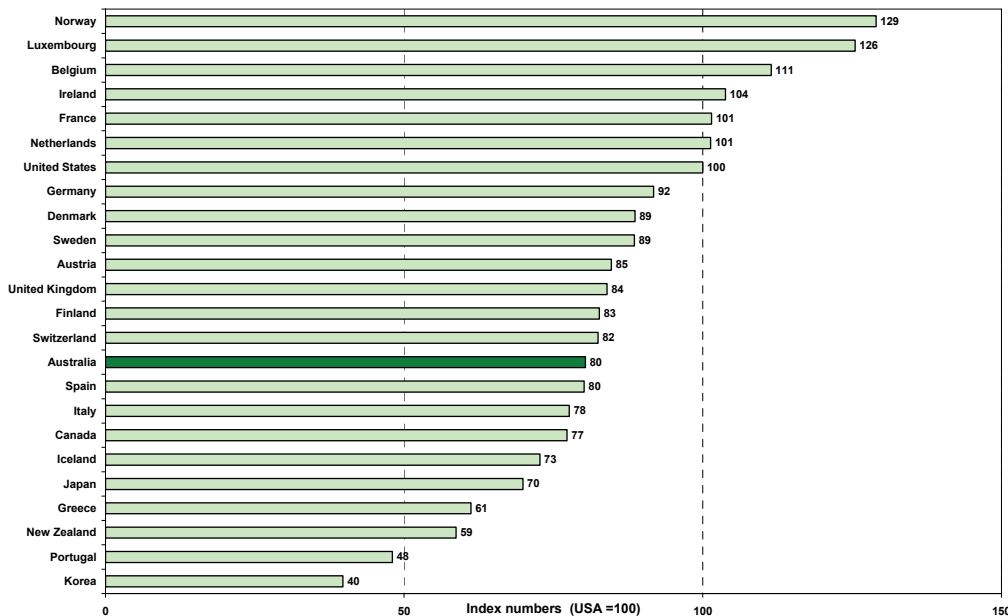
Chart 8.3: Change in productivity and prices by industry, 1990-2005



Source: ABS, Australian System of National Accounts 2004-05 (Cat No 5204.0), Tables 9, 11 and 25.

Note: Average annual industry price changes are estimated as the average annual change in industry gross value added in current prices minus the average annual change in the same measure but in chain volume terms.

Chart 8.4: GDP per hour worked in OECD countries, 2004 (a)



Source: OECD Productivity Database, January 2006 (accessed 30 June 2006).

(a) The 24 High - Income OECD members were used in this graph. Index calculated in 'purchasing power parity' terms.

- 8.24 The Intergenerational Report sets out what has become known as the “3Ps” framework - identifying population, participation and productivity as the key drivers of real GDP growth per capita. More specifically:
- **Population** or the proportion of the population who are of working age;
 - **Participation** or the number of hours actually worked by an average person of working age; and,
 - **Productivity** or the GDP generated by an hour’s work.
- 8.25 Population provides the pool of working age people from which the workforce is drawn. The participation cluster determines how many hours of work are performed. This is affected by the labour force participation rate, unemployment rate and average hours worked by those employed. Productivity determines the volume of goods and services produced by an hour’s work.
- 8.26 The proportion of the population of working age is projected to decline over the longer term as the population ages. This places greater importance on actions to increase participation and productivity to increase real GDP growth per capita.
- 8.27 The Australian Government’s recent Welfare to Work reforms aim at lifting participation in employment. The reforms focus on encouraging those that are currently unemployed, particularly people with a disability, parents, mature age people and the very long-term unemployed into employment.
- 8.28 As discussed in previous chapters, in reviewing and setting minimum wages, the Commission can affect employment levels and therefore has a direct impact on one of the factors that underpins prosperity, that is, the level of unemployment.
- 8.29 Furthermore, the Commission can indirectly affect productivity levels by ensuring its decisions do not discourage the shift to workplace bargaining.
- 8.30 Workplace bargaining provides an opportunity not available through centralised wage setting for workers and employers to agree on workplace practices which best suit their local needs. Both workers and employers can agree on workplace arrangements incorporating improvements in productivity and flexibility which meet personal and business requirements.

Conclusion

- 8.31 Australian productivity growth improved markedly following the widespread adoption of workplace bargaining in the early 1990s. This growth was impressive both from an historical and an international perspective.
- 8.32 Continued productivity growth underpins the future economic prosperity of all Australians. As demonstrated in this chapter, more can be done to improve productivity. There are also challenges facing Australia which can be better addressed through sustained improvements in productivity facilitated by greater workplace bargaining.
- 8.33 The principal object of the WR Act recognises the important role that workplace bargaining plays in contributing to this productivity growth. The Commission can assist the nation in meeting future economic challenges when reviewing minimum wages by considering the impact of its decisions on the incentives to engage in workplace bargaining.

