CEDA: WORKPLACE RELATIONS.

AUGUST 14 2015

The Workplace Relations Inquiry draft report released last week has surprised a number of commentators – from the left and from the right.

The basis of those judgments differed, of course.

But at either end of the spectrum those who thought they knew our ideology have been surprised.

And I'm pretty happy about that.

We don't have an ideology at the Productivity Commission.

We draw on established economic principles and on the evidence available to us to put forward proposed reforms.

And when we deal with policy having significant social aspects – gambling, national disability, aged care – we equally give serious consideration to the social policy rationales for public policy.

We may be accused of having a preference for economic and social principles over the received wisdom of the ages, but that accusation we see more as a test. Our intention is never to be left in a position where it can be fairly said that the PC proposition suggests that great criticism of social science:

> 'it's all very well that this works in practice, but how well does it work in theory?'

When we said, as we did at the outset in the largest set of Issues Papers in the Commission's history, that this inquiry would be comprehensive, but impartial and based on where the evidence leads us, some people took that to be just a bit of PR language.

It wasn't.

And it won't be in the future, either, as we develop the final report.

There's a lesson here for ideologues of all persuasions.

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Workplace relations has long been a deeply politicised piece of public policy.

And political parties acting in defence of their principles is no bad thing.

But if it does not have to be politicised, it should not be.

In my view, it does not have to be, in relation to the draft report.

And that is simply because the failures we have identified are not failures in the principles behind having workplace regulation, where the politics naturally arises; but failures in *the practices* used (or in some notable cases not used) by the parties - employer, employee and administrator.

We observe and document idiosyncrasy, anachronism and misuse of the system, but we find no case – at this juncture – for abolition of any central element of the system.

That is not to say that we would start from here, if we were designing a workplace relations system.

We would not.

The crucial point is that since these are not failures of principle, it does not axiomatically follow that our political leaders would or should avoid the chance to look closely at what the evidence reveals and themselves fail to give serious thought to how to respond to the final report, due in late November.

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Today, I do not propose to list all the reforms we have put forward.

But I will highlight

- some that have received no attention and on which we seek responses;
- some where it will repay a detailed reading of the relevant chapter, as I feel that initial public comment may have misread us; and
- some where the scope of change may have as yet gone unnoticed.

And in support of attempting to solicit submissions for the next phase of this inquiry, let me address them under headings drafted according to a group from whom we would like to hear more.

Not to exclude others from contributing, but chosen where we believe the public understanding of change – without which nothing will move forward - deserves public comment from those most relevant.

And to welcome new ideas provoked by reaction to perceived failings in our draft. Ideas with evidence, for preference.

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First, however, I'd like to describe the way we arrived at our fundamental draft conclusion: that the Workplace Relations system is not dysfunctional.

The primary elements to the Australian system are:

- the centralised Minimum Wage;
- the National Employment Standards;
- the use of industry-specific awards and enterprise-level agreements;
- individual arrangements; and
- the quasi-judicial body that administers much of it, and makes judgments on disputes.

Outside that national system live a significant group of State public sector workers.

And a group of workers whose arrangements owe little to the formal workplace relations system, and on which data is poor. In their case, we looked for evidence of public policy problems but found relatively few (migrant workers is one exception, sham contactors another).

Where we could find no evidence of a public policy problem, such as with people working in the much-heralded digital services of Uber and the like, we did not proceed further. But if a public policy problem exists, show us.

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The core elements of this system involve significant regulation.

We all dislike regulation; but most submissions from most parties called for more, not less.

Flexibility mechanisms allow variation in that regulation, either via statute authorised under enterprise bargaining or Individual Flexibility Agreements; or via common law contracts.

These flexibility arrangements alter arrangements otherwise set in awards, but not the NES or the Minimum Wage.

So from first principles we sought to establish the fundamental basis for regulating, in order to judge its effectiveness.

Our analysis of labour market economics establishes that a fundamental role of labour market regulation is to redress the imbalance between employer and employee.

The reasons for this are not about the character of employers.

They can be observed quite readily: the high costs of switching jobs for individuals; employers often having better information on investment plans and growth opportunities than employees; employers controlling an employee's future employability via references or training opportunities; employers having better knowledge resources (HR, legal) than employees; and the disproportionate size of the risks an employee may take in bargaining hard with an employer.

There are contrary times in the economic cycle, of course, when circumstances favour some employees over employers.

And the ability for employees to organise as unions can also make a difference. But unionisation has fallen steeply in this country, particularly in the private sector.

For all of this, regulation is needed.

Deregulation options, in comparison, may have extreme consequences for whichever party is not ascendant.

Thus regulation should be judged for its ability to offset an excess market power issue as efficiently as possible.

This was the benchmark we used.

We then looked at the alternatives to the current regulated system: both what submitters proposed (and the evidence they used); and what international experience and academic assessment may tell us.

And we assessed the flaws in the current system, the expected benefits of getting from our present system to a desirable alternative, and the transition costs.

Taking in turn the principal elements of the system noted earlier, we identified alternatives to the Minimum Wage.

The evidence is that studies (including our own deep dive, undertaken for this inquiry and covering the most recent data periods – and using both the University of Melbourne HILDA data base and the Department of Employment's RED data base of 2.5 million income support recipients across Australia) could not show that the current Minimum Wage process had delivered *significant* negative employment outcomes. Results were often inconsistent and the breadth of studies was not great.

For those interested, we have a whole Appendix, 38 pages of *summarised* data (and links to further work) devoted to nothing but the research on this topic, from eight empirical Australian studies over the past 15 years.

We looked at overseas studies and though better in quality they were similarly inconsistent.

A recent summary of global evidence from studies of minimum wage impacts on employment by the *The Economist* newspaper puts it succinctly

"….the debate is not settled but the two sides have converged. The debate is now largely between those arguing that there are small negative effects and those who say there are none at all."

We nevertheless looked closely at possible substitutes, as much because the original rationale for the Minimum Wage – Harvester Man – has long been overtaken by shifts in participation rates and family support via the tax and payments system as anything else.

We also note that the Minimum Wage is not well-targeted to the least well-off individuals.

An Earned Income Tax Credit (EITC) is widely used overseas to assist the target group often characterised as the primary focus of current Minimum Wage arrangements. So we examined it.

Despite this it appears – but we still seek evidence to the contrary – that there is no better choice than to improve the current Minimum Wage process by ensuring that its growth does not outstrip the growth in median wages and productivity; and that during downturns, Fair Work Commission analysis should give greater weight to the risks in unemployment.

That is not to say there is no role for an EITC.

But perhaps it will prove to be of more relevance to social policy than to workplace relations.

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We also looked at the National Employment Standards (NES).

In this case, there were no better alternatives around the world, and there was general support from submissions to the Inquiry.

Nevertheless, it was clear that there was some unconcluded business and some poor incentives.

We have recommended reforms in one case, which I will discuss shortly; and failed to find a satisfactory way of addressing the other (long service leave), as the gains from national symmetry seem small compared to the risks. But tell us if you think otherwise.

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And we examined alternatives to awards.

Awards are unique to Australia.

We considered the New Zealand model of dissolving awards, as they did two decades ago.

As we explain in the relevant chapters, there appears to be neither support for that from the business community at large, in the submissions to us; nor is there a case from theory or data to demonstrate the probability that transition cost is likely to be outweighed by clear benefits.

Moreover, awards are not the core of the system they were once.

Although it has taken some time to achieve, awards today are more about the minimum levels of pay or conditions than a process for leveraging wage or condition growth. And yet they also regulate more than pay rates - aspects of superannuation, allowances, hours and rosters, dispute settlement.

They are, in effect, part of the safety net.

Awards cover far fewer workers than in the 1990s, when the choice was made in Australia to go down the path of enterprise bargaining.

Perhaps 19% of employees today are on award rates. That number was 67% in 1990.

They are, however, more widely used when seeking to establish a benchmark for other arrangements – IFAs or first-time Enterprise Bargains for example; and by definition for those on over-award payments.

Eliminating awards is a clear deregulatory option. Yet it was not advocated in most submissions to us, from any quarter.

Nevertheless, we examined its costs and benefits.

Since our fundamental case for regulation is to offset bargaining power, some safeguard for employees affected by such a decision seemed essential.

Consideration of how to achieve this – expansion of the NES, or use perhaps of a 'common' Enterprise Bargain in an industry as a benchmark, are self-defeating changes; and they otherwise have significant risks to pro-competitive, firm-level variations and innovations in workplace arrangements.

And the benefits to employers need also to be validated. Deregulation by abolishing awards means firms that have chosen *not to move* to Enterprise Bargains or other forms of contract over the two decades they have been available would need to do so.

This group of firms is not small and they show up quite clearly in our analysis: they are primarily SMEs.

Such a deregulation option was not sought by these firms.

Their apparent reluctance to move into the enterprise bargaining system should be given weight.

We did that.

A path strewn with far fewer obstacles to flexibility – but with safeguards for employees - lies in our concept for an Enterprise Contract, designed to allow SMEs to develop enterprise level agreements without having to navigate the enterprise bargaining system.

And in case you are wondering why I keep referring to safeguards, we are yet to receive a submission arguing for no safeguard, consequent on policy change.

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In our judgment, a revised award modernisation process can also be used to address impediments to flexibility in work places still inherent in awards.

The reduction from thousands to 122 has not removed all anomalies and anachronisms – some of them very costly to workplace innovation.

The approach we recommend for the FWC to follow is consistent with that we undertook ourselves with regard to swaps of public holiday dates and variations to certain penalty rates.

This new approach by the FWC would give priority to change based on analysis of priority issues – areas of contention, serious anomalies and evidence of shift in community needs. It would use new research and analytical capability, and apply new obligations to select reform targets; and seek public input on them. The new Minimum Standards Division would be a proactive reform entity.

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And we looked at Enterprise Bargains, not just why they are not being used in some areas but also how they are being used.

We found evidence of misuse of some legislative provisions; and where that evidence was strong, we recommend change.

The more, however, that the problem was serious but ultimately one of fine judgment, we leant towards using the judgment of the regulator. Which is another reason why having fewer regulators drawn from the ranks of former officials of either employees or employers will be crucial.

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The discussion above is meant to illustrate issues uncovered in our process that respondents will hopefully take into account when responding to the draft report on the first four elements of the system.

And to obtain clearer advice, should submitters now feel a desire for greater reform. The task for submitters is to think, how can a Minister carry forward my argument. Evidence, fact, data, survey work are not really for the convenience of the Productivity Commission. They provide the foundation to the public debate, without which reform in an area as fraught as this is unlikely to proceed.

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Let me turn to the fifth element of the system.

Long term improvement in the Australian workplace relations system requires change in the nature and performance of the regulator.

I have been asked since the report draft was released what is in it for the Workplace Relations system of tomorrow.

And my answer is a restructured regulator.

The workplace relations system needs above all else a more robust, transparent process and the expertise to apply it comprehensively across the areas it regulates – much as Productivity Commission reports have found for many policy areas with high regulatory content.

It is obvious and yet so often ignored that if there is to be regulation, the regulator should be fit for purpose.

This is a draft report. Our design for change seeks to address the appointment process as well as the capability, to add up to a shift in culture.

If submitters can offer a better choice for how to ensure the regulator is able to undertake cultural shift, we want to hear it.

For now, the best option, drawn from experience in the Australian environment and from consideration of the key tasks dealing with the future, is:

- modernisation of awards addressing specific hot-spots, in the analytical manner I noted a moment ago;
- improvements to the Minimum Wage process, particularly from the perspective of the unemployed; and
- a shift from form to substance in the assessment of unfair dismissals and Enterprise Bargains.

In future, the FWC cannot rely on partisan analysis. Any one party's analysis, no matter how sound, will be automatically marked down *in public debate* due to its source. In future, the FWC should be in the public debate.

Based on history, we will not be going this comprehensive review pathway again for years. The FWC has to be tasked to take on this new role.

We propose the FWC look at this option now, in *the current* modernisation process. It could recruit staff for that purpose, quite quickly.

New Commissioners might also be appointed, with relevant skills.

If action occurs in real time, we could all learn something about the prospects for change.

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For every change we have proposed in this report, we have considered whether a safeguard addressing the market power issue is present; and if not, if and how the revised system should address that issue.

Although it is often presumed to be a one-way street, some safeguards in our report are for employers, related to when they are facing market power.

- Enterprise contract: multiple safeguards; it applies to a class of employees; while designed for new employees, existing employees may join via an IFA but not obliged to do so; there is a NDT (No Disadvantage Test);; complete transparency to the FWO (Fair Work Ombudsman), in a contract model designed for the purpose; and the right to revert to the award (specified in the contract) after 12 months
- Modernisation process: the FWC (Fair Work Commission) will choose the targets, and publish an analysis
- IFAs (Individual Flexibility Arrangements): the NDT applies, and a party can withdraw after 13 weeks if there is no fixed term (or a longer period, but not more than 1 year)
- NDT, not BOOT (Better Off Overall Test): the NDT is better understood in practice by regulators and the parties than the BOOT; in principle, the difference should be minimal.
- Public holiday swap option: it's in 87 awards already and should be in all. To take advantage of it, a vote is required
- Greenfields: strong incentives to complete a negotiation inside 3 months; an obligation for good faith bargaining; and a term for infrastructure projects that matches the life of the project
- Sham contracting: as a safeguard for employees, the test for a breach of the law should be that an employer could not reasonably be expected to know that a contractor arrangement was a sham, rather than had been reckless in so doing

- Contractors – Enterprise Bargains should not be able to influence or deal in any way with the rates paid to contractors or sub-contractors
- Enterprise Bargaining breakdowns – redressing a tactical imbalance, generally against employers, in responding to disputes during negotiations and where practice has deviated from the intent of legislation.

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I said earlier that I would draw out some of the reforms that have had little attention to date. Again, the intention is that submitters might offer us advice in the second phase of the inquiry.

And I use the headings accordingly.

Employers

We put forward quite a large number of reforms to the enterprise bargaining process itself. These covered tactics during industrial disputes, entry rights for unions, appointment of bargaining representatives, and limits on workplace flexibility – eg IFAs and use of contractors – imposed on enterprise bargains.

There has been little attention given to these in public comment. It is almost as if employers expect that of course these will all now be fixed.

Perhaps they will. But if the relative silence we have heard to date is a reflection that these are of minimal gain, we need to hear from you.

There is no reason to persist with what will be black letter law amendments, with all the pain involved for governments in Senate negotiations, if these are not important.

Unions

For the same set of changes, we need to hear from you if the way we have framed these changes is likely to have serious consequences for the imbalance of power between the parties.

The Commission has taken some criticism for its finding that regulation is justified to the extent it offsets high levels of market power held often – but not exclusively - by an employer.

We have sought to maintain balance but if there are deficiencies in our approach to these issues, it is essential to hear them now.

Reforms affecting particular sectors

While it is preferable to have public policy apply uniformly across sectors or industries wherever possible, there are occasions when it may be necessary to provide solutions to local – albeit serious – issues.

Examples in the draft report are:

Secondary boycotts

penalty rate reform beyond the Hospitality, Entertainment, Restaurant, Retailing and Cafe industries.

In the case of secondary boycotts, we suggest (but are looking for more information) that giving the Fair Work Building and Construction entity responsibility to act as the investigating authority in areas it covers as a specialist regulator might be preferable to a nation-wide reform of the relevant parts of the Competition and Consumer Act.

Secondary boycotts as an industrial tactic seem to be a construction industry issue. But we would like to know if that is not correct.

Our draft report on penalty rates emphasises that community expectations have shifted in the case of some consumer services industries since penalties *to deter* Sunday work emerged, nearly a century ago.

And there are quite obvious anomalies between sectors; and for similar activities.

Whereas in other sectors eg police, nurses and related emergency workers, attitudes have not changed. Their penalties were never designed to be a deterrent to work.

In between these groups, there are many other awards. Further analysis would be a matter for the FWC.

We were told in early comments on our penalty rate reform proposal that this would create a two-tier system.

In fact, there are already many more than two tiers to weekend penalty rates.

As a final comment on penalties, nurses regularly work overnight for 15% extra per hour. We show in the report that there are health costs to individuals working regular overnight shifts. Whereas pharmacy assistants gain 100% per hour extra for working on Sundays. The shift back to Saturday rates, an extra 25% or 50% in that industry (it varies), seems quite reasonable if you are prepared to see penalties as compensation for social inconvenience.

Consideration of these issues would of course be undertaken by the Fair Work Commission.

<u>State and Territory Governments</u>

We have two reforms that may affect State Governments:

- abolishing the right in the National Employment Standards for State and Territory governments to impose the cost of new public holidays on to employers; and
- participation in determining the make-up of a panel to recommend future appointments to a restructured Fair Work Commission.

The NES currently specifies 8 public holidays. Additional days off with pay vary between States, from 3 to 6.

The creation of public holidays would still be a function of States and Territories. But our recommendation is that the costs of any additions to the list – currently an automatic cost to

employers - should in future be a matter for negotiation between employer and employee. And similarly with the obligation to pay penalty rates on those days.

This would effectively cap employer obligations at today's levels, unless negotiation determined otherwise.

We are also recommending reforms that aim to alter the skill mix of future Fair Work Commission appointees.

As indicated earlier, this is a crucial change.

Our draft report sets out our expectations: for the FWC to become a high quality forecasting organisation, with resources dedicated to that purpose not unlike the Reserve Bank does for monetary policy.

And for Commissioners who will take that research and utilise it to improve both dispute settlement and the further modernisation of awards.

Participation by the States in the appointment process will ensure political balance: it is rare that all jurisdictions are of the one political complexion.

And although we have been seen as naïve to imagine that the Commonwealth would ever cede any role back to the States, we note that such a system works in appointments to the ACCC.

And that many States have continuing involvement in workplace relations, thus are not altogether lacking in expertise.

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The draft report on Workplace Relations is a meant to be a document on which to base a debate on how to improve the regulatory system in Australia.

The Australia labour market has performed well for the most part in recent times, but it is clear that some aspects of it are weighing down consumer services, hampering innovation, and reducing the credibility of regulator and regulation.

We can improve its performance, lift employment and still protect workplace standards.

The report is not a cure-all for relationships between employers and employees; and it is not going to rescue parties from the consequence of poor negotiating.

But it provides data and relevant policy design for a necessary discussion on how to make a functional system much better.