Reflections on A Century of Arbitration

Keith Hancock

Introduction

I thank the HR Nicholls Society for inviting me to participate in this Conference, which marks the centenary of federal arbitration. The Society's view of arbitration has, from the outset, had an historical perspective. That is implicit in its name, which declares a critical - indeed hostile – assessment of H B Higgins, the second President of the Commonwealth Arbitration Court. Consistent with what I understand to be the purpose of the conference, I have prepared a paper with an historical focus.

Higgins was no intellectual giant; he was vain; and he enjoyed the exercise of authority. Who among us can cast the first stone? He was also a humane man, using the power conferred him to advance the wellbeing, as he saw it, of less privileged members of an unequal society.

But Higgins was part of a broadly based movement for state intervention in the labour market. As early as 1890, Samuel Griffith unsuccessfully tried to persuade the Queensland Parliament to pass a Bill that would declare it to be the duty of the legislature to enforce wages 'sufficient to maintain the labourer and his family in a state of health and reasonable comfort'. Through the 1890s and into the 20th century, efforts were made in all of the Australian parliaments to curb employers' control over the terms of employment. Much of that story can be told in terms of a war between the democratically elected lower houses and upper houses elected through property-based franchises. The mischiefs to be remedied were threefold – terms of employment seen as harsh and exploitative, and often characterised as 'sweating'; inequality in the bargaining relation between employers and workers; and the economic and social disruption caused by strikes and lockouts.

Concern about sweating was powerful, and not confined to Australia. In the United Kingdom, it led to the creation, in 1909, of Trades Boards modelled on the wages

boards of the Australian states. Before this, a civil servant in the Home Office, Ernest Aves, was sent to Australia and New Zealand to observe and report on their wage-fixing systems. He remarked on the wide support for intervention. It had, he said, 'become part of the better conscience . . . to insist on decent industrial conditions, and, if necessary, to pass measures framed to avoid the repetition in a new land of at least this particular form of old-world trouble'. (Aves actually recommended against the creation of regulatory boards in the UK; but he was overruled by Lloyd George and Churchill, and subsequently became the Chairman of the Trade Boards.)

Many sources can be drawn on to demonstrate the problems that gave rise to conciliation and arbitration. Royal Commissions, parliamentary committees, reports of factories inspectors, clergymen and newspaper reports all contributed to the mounting sense that something had to be done. Strikes were an important mischief; but so was the inadequacy of worker protection. Workers needed protection, not only because of harsh terms of employment, but also because of the inequality of workplace power.

For illustration of the latter, I refer to the evidence in the *Harvester* case. Higgins selected H. V. McKay's factory as the primary subject of his inquiry, not because McKay had a bad reputation, but because he was a large employer (with nearly 500 employees), there was a diversity of jobs, and the application was likely to be hotly contested. The principal employer's witness was H. V. McKay's brother, George, who was the factory manager. George made all decisions about hiring, firing, working time and wages. 'In fixing the wages', he said, 'I have endeavoured to get labour at the cheapest price that I honestly could'. The manager of the plough department said that the men 'get small rises from time to time as they are deemed worthy. As Mr. George McKay thinks fit he gives them small rises . . . .' Sometimes he required the men to work overtime, but refused to pay them for it. If work was interrupted by a mechanical failure, the wages were docked for the period of the interruption, though George might extend the working day so that the workers could make up the time. Before the application was made, the wages book contained no classifications of the

workers – just the name and an amount. After it was made, George entered classifications of unbonded apprentice, improver and journeyman to which the more skilled men were allocated, depending upon what they were actually paid. Whatever might be said about the levels of pay, the evidence showed that the workers in the factory were utterly subservient to George McKay. He exercised unilateral power.

Arbitration – An Historical Mistake?

Unless I am mistaken, your Society believes that arbitration was an historical mistake. There are several comments that I would like to make about this. The first is that it is not a meaningful proposition unless you specify the alternative or alternatives and show that it or they were, in some sense, available. Doing nothing was an unlikely choice. It is conceivable, perhaps, that the choice between arbitration courts and wages boards might have been resolved differently. Indeed, by 1920 virtually the whole of Victorian manufacturing industry had come within the coverage of wages board regulation, except where it was overridden by awards of the Commonwealth Court. And in both Victoria and Tasmania, wages boards operated for most of the 20th century, though they generally adopted the major policies of the federal Court. I simply do not know what outcomes would have flowed from an abandonment of regulation by courts in favour of regulation by boards.

A less likely, but not wholly fanciful, alternative was that Australia might have followed the British pattern. The dominant factor in the legislative framework for British industrial relations was the *Trade Disputes Act* of 1906. This conferred on trade unions immunity from actions in tort, sweeping away the panoply of common law actions – for conspiracy, for inducing breaches of contract, for restraint of trade and so on – whereby employers had countered the efforts of unions to promote the interests of their members. It inaugurated the system of industrial relations that came to be known as 'collective *laissez-faire*', leaving to employers, employers' associations and unions the responsibility of managing their own affairs. Within this framework, the British form of collective bargaining took shape. It remained intact until the 1980s, when the Thatcher Government attached conditions to the legal

immunities enjoyed by unions. The 1906 law adjusted the power balance between employers and workers in the workers' favour. This was also a purpose of the Australian measures. The reasons why the two countries adopted different means to a similar end are complex. They include the then-obtaining configurations of politics and a perception in Australia that correction of the unequal power balance required a more active state intervention.

My second point is closely related. Once established, the arbitration system commanded wide, deep and long-enduring support. There is no need to dwell on the fate of the Bruce Government in 1929. Less familiar, perhaps, is the long-held perception of Australian economists that arbitration was a valuable means of economic adjustment.

In 1924, D. B. Copland – the doyen of Australian economics - criticised past policies of the Arbitration Court (for reasons to which I return), saying that 'arbitration has been a costly experiment for Australia', but he added that 'failure to apply a principle soundly should not, as many suppose, warrant the condemnation of that principle'. [1] The Court was central to the measures proposed, almost unanimously, by Australian economists for dealing with the depression. E. O. G. Shann was probably hostile to arbitration, but nevertheless joined in a consensus that gave it a crucial role. In 1933 Copland, giving the Marshall Lectures in Cambridge, referred to the decision of January 1931, reducing wages by ten per cent. 'The first pronouncement on the crisis from a responsible authority', he said, 'was this award of the Arbitration Court. . . . The Court, with its independent position and known sympathy in the past with the demands for as high a standard of living as the country could afford, was well fitted to call attention to the economic position and to the need for general adjustment. . . . All awards were varied in accordance with this decision, and the net effect was to impart to the wage structure of Australia a flexibility that would not have been possible

[1] Copland, D. B. (1924), 'The Economic Situation in Australia, 1918-23'. *Economic Journal,* vol. 34, pp, 33-51, at p. 45.

without the authority of the Court.' [2] Copland contrasted the flexibility of the Australian system with the rigidity of the British.

W. B Reddaway, a British economist who spent two years in Australia, made a similar comment in 1938:

> Is there any advantage in having machinery for fixing the general level of wages, instead of leaving it to emerge from a large number of sectional decisions? The experience of this period surely shows that such a system is very valuable. The employment market in a country such as Australia does not, and never will, bear much resemblance to the text-book version with its perfect competition, equality of opportunity, automatic adjustments, and so on. Without some general system of regulation it is doubtful whether money wages could ever have been reduced sufficiently to preserve the exporter and encourage new manufactures. . . To secure the general fall in costs that was vitally necessary, a general system of regulation was almost indispensable. [3]

In the postwar years, there was much debate among economists about the *content* of wage policy. For example, there was a long-running debate in the 1960s as to whether general wage increases should reflect movements in productivity and prices or productivity alone. But there was little or no disagreement about *having* a wage policy. To my knowledge, this consensus was not breached until the later 1970s, when the Commonwealth Treasury not only criticised the specifics of wage policy but also called into question the benefit of having one at all. John Howard was Treasurer at the time, and I should not be surprised to learn that his antipathy to arbitration was learned from his advisers.

Since the later 1980s the consensus for arbitration has dissipated. The H R Nicholls Society has played its part in this. But there were even more deep-seated causes: the

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[2] Copland, D. B. (1934), *Australia in the World Crisis 1929-33*, CUP, p. 90.

[3] Reddaway, W. B. (1938), 'Australian Wage Policy, 1927-1937', *International Labour Review*, vol. 37, pp. 314-337, at pp. 334-335.

declining strength of unions, which led many employers to see the regulatory system as an obstacle to a reassertion of dominance in industrial relations; a quest by union leaders for a greater influence over wages; the advent of a generation of business leaders educated in management schools and, related to that, the permeation of business by ideas commonly characterised as HRM; the conversion of political leaders, on both sides of politics, to the doctrines that the Treasury had articulated since the 1970s; and an acceptance by many (though not all) professional economists of the ideas of Milton Friedman and F. A. Hayek. These forces are interrelated and I have not tried to rank them in order of importance. What has happened is water under the bridge. Defining options for the future is not part of my charge today, but if it were, I would have to start from where we are, not where we were in 1985.

My third point will occupy most of my remaining time. It entails a speculation about the contribution of arbitration – negative or positive – to the standard of life over the course of the century. To anticipate: my main conclusion will be that, by and large, we simply do not, and cannot, know.

The new province for law and order

I begin by accepting that Higgins's vision of a 'new province for law and order' – surely a worthy one - did not come to pass. Whether Australia's experience of industrial disputation was made better or worse by arbitration than it might have been under some notional alternative, such as collective bargaining of the British type, is a separate question. It could be debated at length, but the outcome would be inconclusive. A case can be made for the view that arbitration shifted emphasis away from protracted stoppages of work, of the kind that is familiar under collective bargaining, towards more frequent occurrence short-term disruptions. This case would be based on international comparisons, which are fraught with difficulties. But I do not pursue the issue today.

The pre-eminent question is whether, as a result of arbitration, people lived better or worse.

Wages and prices

In confronting that question, we need to look at some economic history. To this end, I shall use a few simple charts. Chart 1 shows the growth in average wages, for adult males, and in prices over the course of the century. [4]Wages grew by a multiple of 236 and prices 51-fold.

Obviously, the *pattern* of wage and price movements, though not the magnitude, was similar. Chart 2 (constructed from the same data) compares wage and price changes more directly. Clearly, there is a correlation, but it is loose. The view that makes most sense, I think, is this: Wages are but some of the prices that exist in an economy, and movements of the average price level entail general, but unequal, changes across the set. There were no doubt times when wage movements added impetus to inflation; and possibly some when they served as a brake. But overall, the process is so complex, with so many interdependencies, that attempting to segregate particular prices is a fairly profitless exercise.

Chart 3 extracts from Chart 1 the movement of real wages across the century. It also shows what happens when we allow for the reduction of working hours. Unadjusted for hours, real adult male wages grew by a factor of 4.6; on an hourly basis, the increase was by one of 5.3. As you see, the period 1945-75 was the time of the fastest increase; those thirty years account for 59 per cent of the total increase in real hourly pay.

Productivity growth

Few of us, I think, would dispute that the increase in workers' living standards was overwhelmingly the product of rising productivity. Indeed, it can be regarded as a rough proxy for productivity growth. Productivity growth can be attributed to growth in the capital stock (including human capital), the advance of technology and better

[4] The wage and price series are composites of different indices for different periods. They represent 'best estimates', but should not be considered precise. Further information will be provided on request to the author.

deployment of the available resources, including labour. Perhaps arbitration assisted the process; perhaps it retarded it; it is easy to think of arguments on either side, and none of them can be tested. As a matter of historical fact, the thirty years of fastest growth were a period when the arbitration system operated and was accepted as the dominant form of wage determination. I do not assert a cause-and effect relation. But if we contrast the growth of living standards in the golden age with the dismal performance that followed it, and we seek reasons for the difference, it would seem natural to look for factors that were new or quantitatively different; and decidedly odd to focus on an institutional constant.

Data of productivity in the market sector are available for the years since 1965, and I have used these to construct Chart 4. [5] Year-to-year changes in productivity are quite erratic and we need to resort to some form of smoothing. For Chart 4, I have calculated five-yearly growth rates, expressed as annual equivalents. Labour productivity is measured per hour. The chart shows the so-called 'productivity surge' of the 1990s, which may or may not be running out of steam. The favourable experience of the 1990s is sometimes ascribed to economic deregulation, including the partial deregulation of the labour market. That performance, however, was no better – indeed marginally poorer – than the performance of the 1970s, when, it is said, the economy was choked by regulation – 'sclerotic' is the term sometimes used. I do *not* infer from this that a regulated economy performs better than a deregulated one. For one thing, the differences are not great; for another, there is the experience of the 1980s, which defies easy explanation; and, finally, there are many other factors to be taken into account. I *am* saying, rather, that the evidence simply does not allow us to reach a verdict one way or the other.

Another perspective on productive performance, covering a much longer period and involving different countries, is given by Chart 5. This draws on data compiled by the economic historian, Angus Madison. [6] They refer to 17 countries within the OECD.

[5] ABS Cat. 5204.0 (time series spreadsheet), Table 22.
[6] Maddison, Angus (1995), *Monitoring the World Economy 1820-1992* and (2001), *The World Economy: A Millennial Perspective*, OECD.

The units of measurement on both axes are percentage deviations from the mean. For example, Australia's per capita GDP in 1900 was 42 per cent above the mean, compared with only 1 per cent above in 1998.

On the face of it, Australia's position on Chart 5 suggests a fairly dismal performance. That the UK and New Zealand did worse is not much comfort. But notice something else. The range of deviations that is needed to cover the 1900 data is 130 percentage units; for 1998 it is only 70 and would be only 50 were it not for the United States. In other words, there has been a narrowing of the differences between the 17 countries – a 'convergence to the mean'. The United States stands as a conspicuous exception: its difference from the mean is almost identical in the two years. One – not the only – reason for it is that America, for whatever reason, has accorded a lesser priority to reduced working time than many other countries. Of the other 16 countries, only three – Austria, Denmark and Germany – were further from the mean in 1998 than in 1900. Over the century, a process of catch-up and levelling-down was going on. Japan is the most conspicuous example. A reason for Australia's seemingly indifferent performance, then. was that countries that started behind scratch made up ground.

There is a second reason. The numbers are about per capita GDP, *not* about the productivity of the labour force. A country with fewer non-employed people, all else equal, would have a higher per capita GDP than one with more. In 1900 Australia had a high masculinity ratio and, for that reason, high labour force participation. For a given productivity level, high participation raises per capita output. A convergence of its demographic characteristics toward the norm would of itself tend to erode its advantage in per capita income.

If there remains anything to explain, there are plenty of candidates. A source of the 1900 advantage was the income generated by pasture and agriculture. That advantage was eroded by both the growth of population and the fall in relative prices of wool and most products of agriculture (hence in Australia's terms of trade). For these and other reasons, there was a very large change in the composition of economic activity. Between 1901 and 1998, the share of employment accounted for by agriculture and

mining fell from 33 per cent to 6 per cent. This reduction was taken up by services, whose share grew from 52 to 81 per cent. There is absolutely no reason why Australia would have the superior efficiency in the production of services that primary production enjoyed in 1901.

If you believe that there is still a problem, you might think about the education and apprenticeship systems, taxation, trade policy, saving rates, managerial competence, the selection and execution of public sector investment projects, and the skill and risk aversion of investors. I have probably forgotten quite a few things. Trying to isolate the industrial relations system's effects is truly to search for a needle in a haystack.

Unemployment

I turn to another criterion often invoked in discussion of the arbitration system, namely its effects on unemployment. Chart 6 summarises Australia's experience, using various indicators. [7] There may be problems with the data, but for much of the century the census serves as a benchmark against which the other estimates stack up reasonably well. I have no quarrel with those who say that, for various reasons, measured unemployment understates the true underutilisation of labour. The understatement was probably not constant across the century, and on the broader basis of underutilisation the experience of the last two decades is likely to have been worse than the chart suggests.. But for present purposes the main features of Chart 6 are sufficiently stark.

The earliest spike predates any wide coverage of regulated wages and must have had another source. There *is* an argument that the moderately high unemployment levels of the 1920s were the product of excessive real wages, though some economists at the time saw the main problem to be fitting returned soldiers into jobs of the kind then becoming available. If we go back to Chart 3, we see that there was a very large jump in real wages in 1920-21. The increase, in fact, was 48 per cent: an extraordinary rise that, if anything, challenges those who see unemployment as the product of excessive

real wages to explain why unemployment was not much greater. This increase in real wages was the product of a 24 per cent increase in money wages and a 16 per cent fall in prices. How did it happen? If you attribute it to wage policy, the story is that the tribunals – federal and state – had allowed real wages to fall in the war years and were adjusting money wages upward at just the time that prices were falling. The wartime fall in real wages was overcompensated, for the reduction between 1914 and 1920 was 17 per cent. Wages and prices were badly synchronised. It was this defect of wage policy that Copland criticised in the comment that I quoted earlier, and it seems a just criticism. The one footnote of reservation is that much the same thing happened in the United Kingdom where, with the minor exception of the trade boards industries, wages were unregulated.

The next spike was the depression. We can agree, I trust, that this economic catastrophe was imported, and I shall not dwell on it, except to remind you of Copland's argument – uncontentious at the time. and endorsed by Reddaway – that the Commonwealth Court assisted in the process of adjustment. Nor will we disagree that World War II in 1940-41 pulled down the already reduced unemployment rate to hitherto unknown levels.

Now I want to take a long-term view of Australia's experience between the end of the war and the 1990s, when the centralised wage-fixing system came to an end. Full employment prevailed until 1973 and has not since returned. As with the growth in real wages, there seems to me to be an obligation on critics of the arbitral system to explain the co-existence of full employment with a regulatory system that was in full force.

In the early 1970s, however, there *was* a growth in real wages well in excess of normal productivity growth: between 1970 and 1974, the average annual increase was 6.4 per cent. Consistent with this, there was a rise in the ratio of wages to national income and a corresponding compression of the gross profit share. This was the basis of what

[7] Data sources provided on request.

became known as the ‘real wage overhang’. The term, so far as I can tell, was invented by the Commonwealth Treasury. Another way of making the same point was to say that real unit labour costs were higher than in the 1960s. In numerous Treasury papers, such as the annual Budget Paper 2, the Treasury blamed the real wage overhang for the demise of full employment; and it blamed the Commission for the real wage overhang. Treasury was not alone in putting this view, but it was the most articulate and the most influential advocate of it. It criticised the Commission, particularly, for the indexation system that operated between 1975 and 1981, which it saw as ‘locking in’ the real wage overhang.

Time does not allow me to discuss this argument in depth. If it did, I would canvass issues about the constraints under which the Commission had to work, including both the industrial pressures released by the Gorton Government through its botched attempt to imprison Clarrie O’Shea and the expectations of wage increases unwisely raised by the Labor Government elected in 1973. I would also talk about the problem, recognised by even conservative economists, of unwinding inflationary expectations, which was the Commission’s mission in the indexation period. I would point out that the flight from full employment was by no means confined to Australia, which causes doubt about an explanation that emphasises an institutional factor specific to this country. Finally, I would ask why the elimination of the real wage overhang, which was complete by the late 1980s, did not cause a return to full employment.

Conclusion

I have talked about Australia’s experience, over the course of a century, in respect of productivity growth, inflation and unemployment. I have not talked, for want of time, about the effects of arbitration on relative wages. I have elsewhere disputed the argument that these effects lead to structural flaws in the operation of the labour market, but I do not pursue that today. That apart, a fair-minded assessment of the evidence is that it is hard to attribute much of Australia’s experience to the arbitration system. The economic historian who takes a long view will look elsewhere for the important sources of our achievements and failures. As his or her focus narrows to

sub-periods, such as 1920-22, the early years of the depression and perhaps the period of the Accord, interactions between the regulatory system and economic conditions may suggest themselves; but, even then, the competent historian is alive to the risks of oversimplification and dubious claims of causality.

But neither the record of industrial disputation nor the economic effects of industrial regulation are the only criteria by which it should be judged. I referred, at the beginning of my talk, to the civilising function of arbitration – to the redressing of the inherent imbalance of power at the workplace. In the days of Harvester, the imbalance was evident in sweating and in the workplace subjection of wage-earners, exemplified by George McKay. In modern times, the frontiers of the civilising mission have been low pay, the plight of outworkers, unfair dismissal, employer-imposed variability of working hours, refusal to consult and attempts to deny to workers the support of unions. Unlike the H R Nicholls Society, I think that many workers still need the protection of an independent tribunal. Their need is increased by the declining coverage of the labour force by trade unions.

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Chart 1: Wages and Prices in Australia 1901-2003

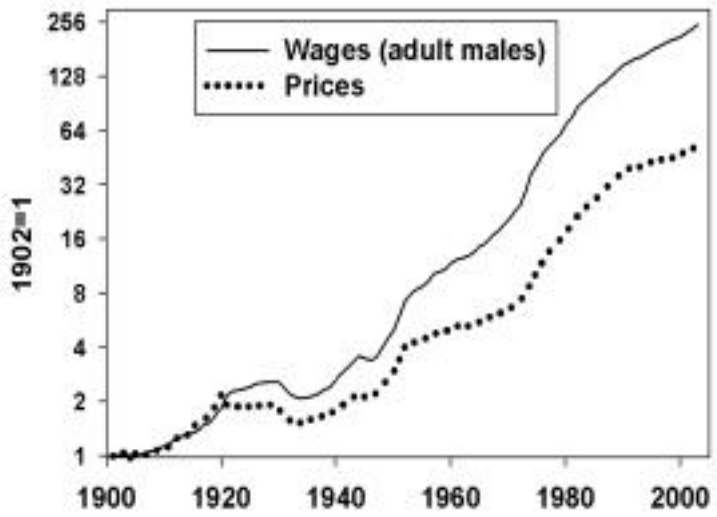

Chart 2: Wages and Price Changes 1901-2003 (% per year)

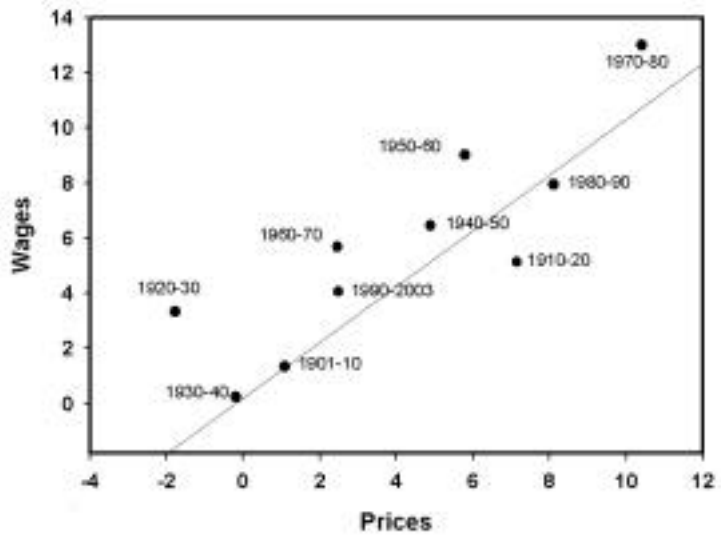

Chart 3: Real Wages of Adult Males in Australia 1901-2003

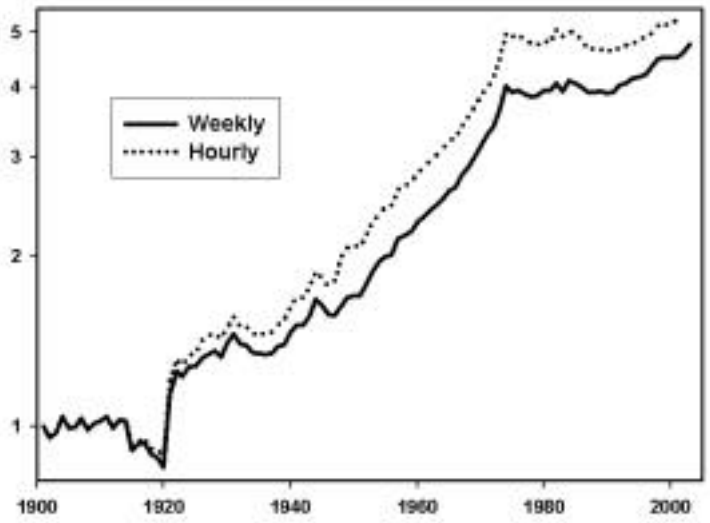

Chart 4: Productivity Growth in Australia 1965-2003

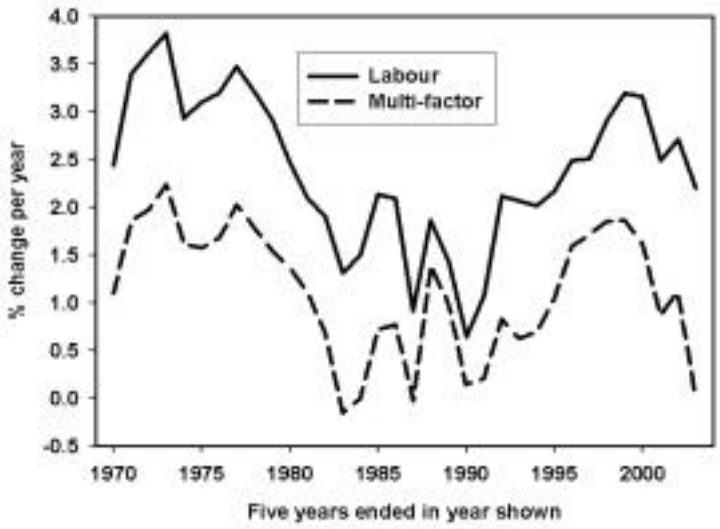

Chart 5: Per Capita Outputs 1900 and 1998

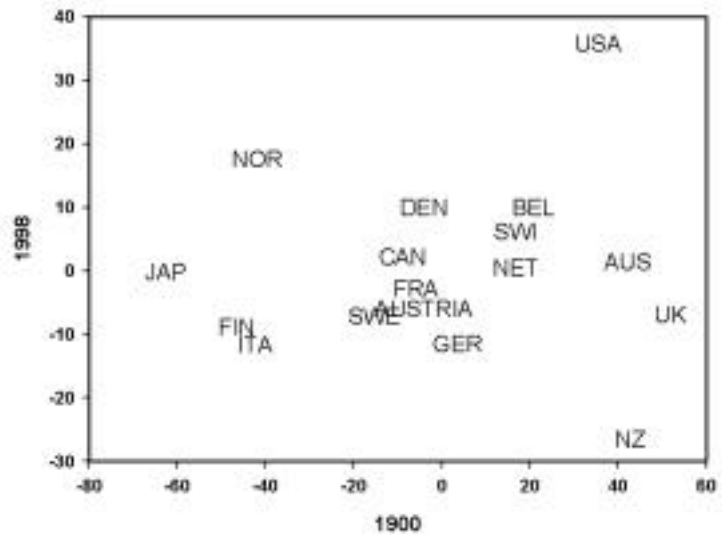

Chart 6: Australian Unemployment 1901-2003