DISCUSSION PAPERS

WAGE POLICY PERSPECTIVES ON THE ACCORD

B.J. Chapman

Discussion Paper No. 139

March 1986

G.P.O. Box 4, Canberra 2601, Australia
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ABSTRACT

Given the recent extension of the Accord, the time is opportune to assess, as far as is possible, what the macroeconomic consequences have been of Australia's first consensual incomes policy. This is one aim of the current paper and it is assisted considerably by placing the Accord in historical context. Judgement of the Accord's success or otherwise is a challenging exercise, in part because the relevant question concerns what outcomes would have been in its absence. Some progress is made by considering recent performance relative both to other periods and to the major OECD countries. The evidence, qualified as it is, seems to suggest that the Accord has contributed favourably. A second goal of the paper is to investigate the validity of recent claims that the Accord has been faltering. For conceptual and measurement reasons it is argued that no compelling evidence exists for such an assessment. Third, the paper examines the challenge to the Accord of devaluation, and the government's tax-wage bargain solution to the dilemma posed by the problem.
1. INTRODUCTION

The Australian prices and incomes Accord was negotiated in 1982 and successfully instituted in 1983 after a period of extraordinary economic adversity. In September 1985 the Australian Council of Trade Unions (ACTU) and the government extended and modified the arrangements for a further two year period. The beginning of 1986 seems, then, an opportune time to examine the measures pertinent to a judgement of the success of the Accord, and to consider briefly recent circumstances that have posed a challenge to its maintenance. These are the goals of the current paper.

Section II examines briefly the economic and political factors that led to the formulation and adoption of Australia’s first consensual incomes policy. A third section describes the performance of the economy since the institution of the Accord. Unambiguously, macroeconomic experience in this time has been favourable relative to previous periods, but more modestly so in a cross-sectional international context. It is argued that assessing the success of the Accord is a challenging exercise, essentially because judgements must be made on a counter-factual basis.

Predictions of the imminent demise of the Accord have been plentiful over its history, and section IV investigates the usual measure of its ineffectiveness, so-called "wage drift". Two points are made: one, that wage drift data do not at this point
reveal consistent non-compliance with the principles of the Accord; and two, that it is not obvious that the existence of substantial wage drift is the relevant variable in this debate, in part, again, for the reason that a counter-factual scenario is necessary.

Perhaps the major challenge for the Accord has been the large devaluation of the Australian dollar during 1985. In part, this has been dealt with through a tax-wage deal designed to reduce wage costs but maintain wage incomes. The factors leading to these arrangements and their implications for policy are highlighted in section V.

It should be admitted at the outset that the paper does not consider in any depth several issues important to a comprehensive understanding of the Accord. The first of these might generally be described as political, and it encompasses (at least) two forms. One is the potential benefits and costs of "corporatism". Some commentators believe that explicit agreements on economic policy between groups are dangerous because they grant power to, and institutionalise, policy-making with some who are unanswerable to voters (Chipman (1985)). Others are more sanguine about such arrangements since they believe these types of agreement lead to favourable macroeconomic outcomes (Schott (1984)). The paper does not, at least directly, touch on this debate.

A second aspect of political economy that could have been afforded more attention concerns the role of the principal political actors in influencing the direction and maintenance of the Accord. It probably has mattered that the opposition coalition has, at various times, been critical of the Accord and the ACTU generally, and that this has facilitated greater cooperation between the unions and the government than would otherwise be the case. Also of interest, but not analysed, is the likelihood that the current arrangements will be renegotiated in 1987, possibly immediately before a Commonwealth election.

A second general area relatively unexamined is that of the "social wage" aspects of the agreement. An important part of the Accord concerns redistribution towards the poorer sectors of the community. Included in the package are policies designed to guarantee universal health care, restructure the tax system, increase social security, decrease non-competitive pricing and provide widespread superannuation. The Accord is thus much more than a contract to decrease inflation and increase growth. However, this paper proceeds on the basis that this is its macroeconomic essence and focuses accordingly on the issues most pertinent to these goals.
II. THE ACCORD IN HISTORICAL CONTEXT

It is not possible to comprehend fully the nature of, and rationale for, the Accord without reference to the economic experience preceding its implementation. In essence the Accord is an attempt to moderate inflationary pressures, in particular those resulting from excessive nominal wage increases. The essential motivation for this approach is to simultaneously allow economic and employment recovery.

The Accord represents the promotion of wages policy to the forefront of macroeconomic management. This change in policy emphasis may be highlighted through a consideration of events in the decade up to 1983.

It is probably fair to conclude that the inflationary experience of 1973-75 contributed significantly to the demise of the Whitlam government. This potential was first recognised after the May 1974 election in which the coalition came close to victory, essentially because of the effectiveness of a campaign based on the allegedly poor record of the Australian Labor Party (ALP) concerning nominal wage increases. In an address to the Premiers in June 1974 Prime Minister Whitlam said

Inflation must be checked, and it must be checked decisively ... In order to help break inflationary expectations, we must now slow the rate of increase in Government spending. Some phasing down or deferment of some expenditure plans must occur.

The change of government in 1975 saw a marked re-orientation of policy. The coalition adopted a strategy known as 'inflation first' in which it was argued that employment and economic growth could not be improved without first substantially decreasing rates of nominal wage increase. There were several arms to the policy, one of which was restrictionist. Part of the justification for small budget deficits and non-accommodating monetary targets was a fear of exacerbating inflationary expectations. This view was made explicit in Budget Statement No. 2, 1981-82 as follows:

At least in the immediate future it is likely that external factors ... will exert a moderating influence on the domestic rate of inflation. What is required is that domestic policies be appropriate to re-inforce those external conditions and prevent a rapid expansion of the economy and an associated burgeoning of wage claims. (p.2)

Restrictionist monetary and fiscal policies were also accompanied by a form of wage policy by the coalition. This amounted to Commonwealth Government submissions to the Arbitration Commission arguing for less than full wage indexation. Partial (and full, in some periods) indexation was experienced from May 1975 to January 1981, when indexation principles were abandoned.

Several observations are pertinent to an assessment of the 1975-83 macroeconomic experience. First, even given the (historically) high rates of unemployment experienced, the Consumer Price Index (CPI) increased by an annual average of 11 per cent, and in no year was the increase less than 7.3 per cent. It is not possible to determine what inflation would have
been with a different policy stance but it was at least believed by the incoming government that the "inflation first" strategy had been unsuccessful in its own terms.

Second, the new government was apparently concerned with the opportunity costs and the income distributional consequences of low employment creation. Thus, not only was "inflation first" apparently difficult to justify in terms of its long-run success, it was also, in the eyes of the Labor government, associated with too high a price.

Moreover, the labour market deteriorated considerably from 1981 to the middle of 1983. In the six months before the successful institution of the Accord, job growth was negative, the (measured) rate of unemployment rose four percentage points, and projections of the rate of growth of investment in plant and equipment were the lowest for 50 years. Presumably a similar accord would have been easy to implement in the early 1930s if, at that time, inflation had generally been perceived to have contributed to the economic malaise.

The origins of the Accord are thus explainable in both political and economic terms. The former because of the view that any government, particularly an ALP government given the 1973-75 experience, must make progress on the inflation front to ensure its longevity, and the latter because of the apparent failure of the alternative strategy. Moreover, a social contract drawn up between the unions and the governments fitted snugly with the new rhetoric of consensus.

The outgoing government assisted in laying the foundations for the Accord. In December 1982 the coalition instituted a wage pause which contributed importantly to decreases in inflation. With the pause in operation at the change in government, the psychological basis for nominal wage restraint had been established, and with it the potential for real wage cuts. As noted above, this potential was considerably heightened by the adverse economic circumstances of the time.

The economic summit of May 1983 resulted in an agreement that there be a return to full wage indexation in September 1983, at which time wage rises commensurate with March and June CPI increases were granted. Further, no changes to awards on the basis of productivity were to be considered before 1985, national wage cases were to be held every six months, and no hours claims were to be heard. The Accord also restricted the opportunity for wage gains on anomalies grounds.

It was hoped that by instituting constraints on the rate of growth of nominal wages, the scene would be set for a multitude of economic benefits. These included increases in economic growth and employment, lower industrial disputes and income redistribution towards the poorer sectors of the community through various social welfare initiatives. Although not so baldly stated, it was also considered important to reduce real
unit labour costs in order to restore profitability.

With these perspectives in place it is now useful to document the evidence so far relevant to a judgement of the effectiveness of the Accord. This is undertaken in section III.

III. INDICATIONS OF THE CONSEQUENCES OF THE ACCORD

In general it is extremely difficult to assess accurately the effects of particular macroeconomic policy stances. There are two basic reasons. First, the question of the influence of policy must be posed in counter-factual terms. That is, experience must be compared with what would have eventuated under alternative approaches. A second, and related, problem is essentially that of simultaneity. In the period since the institution of the Accord many other potentially important variables have changed exogenously. The question thus is the influence of the Accord above and beyond these factors.

Even given these difficulties, it is possible to make some progress in assessment of the Accord. This is attempted in three ways. First, by examining a range of Australian time series data covering both periods of alternative policy approaches and over the time of the Accord. Second, recent Australian experience is documented in the international context. Third, a comparison is undertaken of inflation and real unit labour cost changes in the Accord period with these variables in periods of similar employment growth in post-war Australia. The data allow only superficial insights into the effects of the Accord on economic variables, but this in itself does not constitute a case against their use. The question is one of alternatives.

A principal goal of the Accord is to promote an environment characterised by relatively low inflation in order to enable economic and employment expansion. Thus direct indications of its success will be reflected in movements of these, and other, variables. Some data are presented in Table 1.

<table>
<thead>
<tr>
<th>Year</th>
<th>CPI</th>
<th>Average Weekly Earnings*</th>
<th>Real GDP+</th>
<th>Employment Rate</th>
<th>Unemployment Rate</th>
<th>Real Unit Labour Costs*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>7.9</td>
<td>9.1</td>
<td>3.4</td>
<td>-0.4</td>
<td>6.5</td>
<td>1.0</td>
</tr>
<tr>
<td>1979</td>
<td>6.2</td>
<td>9.2</td>
<td>2.3</td>
<td>1.2</td>
<td>6.1</td>
<td>-1.0</td>
</tr>
<tr>
<td>1980</td>
<td>10.3</td>
<td>11.5</td>
<td>4.2</td>
<td>3.4</td>
<td>6.2</td>
<td>-1.1</td>
</tr>
<tr>
<td>1981</td>
<td>9.0</td>
<td>12.9</td>
<td>4.7</td>
<td>1.7</td>
<td>5.9</td>
<td>1.1</td>
</tr>
<tr>
<td>1982</td>
<td>12.3</td>
<td>10.8</td>
<td>0.3</td>
<td>-0.1</td>
<td>7.0</td>
<td>3.3</td>
</tr>
<tr>
<td>1983</td>
<td>9.3</td>
<td>2.0</td>
<td>1.0</td>
<td>-1.0</td>
<td>10.3</td>
<td>-4.0</td>
</tr>
<tr>
<td>1984</td>
<td>3.5</td>
<td>8.6</td>
<td>6.2</td>
<td>3.6</td>
<td>8.9</td>
<td>-2.5</td>
</tr>
<tr>
<td>1985</td>
<td>7.5</td>
<td>4.9</td>
<td>4.9</td>
<td>4.7</td>
<td>7.0</td>
<td>-3.3</td>
</tr>
</tbody>
</table>

+ Percentage increase from previous year, 3rd quarter.
* Percentage increase from previous year, 2nd quarter.


The data of Table 1 apparently and generally reveal relative economic progress in Australia since August 1983. Price and wage
inflation averaged about 5.5-6.5 per cent from August 1983 compared with about 10 per cent in 1978-83. Further, and most dramatically, rates of growth of real output and employment have increased substantially over the last few years, averaging 5.6 and 4.2 per cent respectively from August 1983, compared to about 2.7 and 0.6 per cent in 1978-83 (although, for the two-year period, 1979-80, growth was high). The recent recovery in these two areas is quite unusual in the last 15 years, an outcome no doubt influenced in part by the extent of decline in the 1981-83 period. Commensurate with these events, the unemployment rate fell significantly from a peak of 10.7 per cent in August 1983.

As well, real unit labour costs have decreased somewhat in recent years, due in part to both wage restraint initiated from the pause and the increases in productivity that have accompanied recovery.

Thus the evidence reflects important improvements in recent Australian economic performance relative to the five years preceding the Accord. To attribute them to the policy change is incautious, however, for several reasons. One is the coincident recovery in 1983 from one of the most severe droughts in Australian history. But while drought recovery was undoubtedly substantial from June to September 1983 (when, in seasonally adjusted terms, gross farm product increased 33 per cent), over the next two years farm output declined 5.5 per cent. For the period of the Accord, then, it is appropriate to describe the influence of rural expansion on overall output growth as, at most, moderate.

A second, and more important, factor was world-wide output recovery and inflation decreases. Given this, it is useful to examine Australian experience in an international context. Indicators of comparative performance are presented in Table 2.

### Table 2

**Recent Australian Economic Experience in International Context**

<table>
<thead>
<tr>
<th></th>
<th>Change in CPI</th>
<th>Change in Wage Rates</th>
<th>Real GDP Growth</th>
<th>Employment Rate</th>
<th>Unemployment Rate</th>
<th>Change in Real Unit Labour Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Average</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1977-83</td>
<td>9.22</td>
<td>9.12</td>
<td>2.62</td>
<td>.58</td>
<td>6.10</td>
<td>0.11</td>
</tr>
<tr>
<td>9 Countries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OECD Annual</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average</td>
<td>8.65</td>
<td>9.40</td>
<td>1.68</td>
<td>.60</td>
<td>5.32</td>
<td>-1.13</td>
</tr>
<tr>
<td>Australia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Average</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1984-85</td>
<td>5.35</td>
<td>5.35</td>
<td>5.55</td>
<td>4.30</td>
<td>6.42</td>
<td>-2.90</td>
</tr>
<tr>
<td>9 Countries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OECD Annual</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average</td>
<td>4.88</td>
<td>5.92</td>
<td>3.68</td>
<td>1.50</td>
<td>7.10</td>
<td>-3.30</td>
</tr>
</tbody>
</table>

**Notes:**
1. The nine OECD countries are USA, Japan, West Germany, Austria, Canada, France, UK, Sweden, and Italy.
2. The OECD figures for employment growth and changes in real unit labour costs exclude Austria and Sweden.
3. Changes in real unit labour costs for the early period refer to 1973-83 as more disaggregated data for the OECD were unavailable.
4. Some definitional differences between the OECD and Australian variables imply difficulties in comparisons of levels but are unlikely to affect comparisons of changes.

**Sources:**
The data of Table 2 reveal that the directions of change in recent Australian economic experience have been shared with the main Organisation for Economic Cooperation and Development (OECD) countries. As such they imply a less sanguine interpretation of the benefits of the Accord than the comparisons of contemporary Australian performance with the immediately preceding period. Notably, in some areas relative improvements have been considerable, but in others this is not the case. Several points should be highlighted.

First, compared to comparable countries, Australian growth in both output and employment has been substantial. Relative to 1977-83 annual real output increased by a factor of about 2.8 in the 1984-85 period, compared to around 2.2 for the main OECD countries. Relative employment expansion has been even more obvious, the data implying greater than a 7-fold expansion for Australia, compared to less than 2-fold growth for the other countries.

Second, while there have been clear decreases in Australian wage and price inflation, these have not been extraordinary from an international perspective. Indeed, without the reduction in the CPI resulting from the exclusion in 1984 of medical services, Australian inflation decreases would have been relatively low. Apparently increases in unemployment rates have also been similar to OECD experience, although the rapid relative burgeoning of Australian employment growth implies that to some extent this is explainable in terms of a comparative increase in the labour force participation rate. Real unit labour cost decreases have been greater for Australia compared to the earlier period.

A third method of assessing macroeconomic performance under the Accord is to compare it with similar instances in employment growth for which reasonable data are available. In the post World War II period economic expansion has been unusually large in 1950-51, 1953-55 and 1963-65. Table 3 presents inflation and real unit labour cost data for these periods and for 1984-85.

**TABLE 3**

<table>
<thead>
<tr>
<th>Period</th>
<th>Annual Increase in Employment</th>
<th>Annual Increase in CPI</th>
<th>Annual Increase in Average Weekly Earnings</th>
<th>Annual Increase in Real Unit Labour Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-51</td>
<td>4.15</td>
<td>17.75</td>
<td>21.00</td>
<td>-2.94</td>
</tr>
<tr>
<td>1953-55</td>
<td>3.82</td>
<td>1.30</td>
<td>5.20</td>
<td>-0.79</td>
</tr>
<tr>
<td>1963-65</td>
<td>4.36</td>
<td>2.35</td>
<td>6.45</td>
<td>-1.67</td>
</tr>
<tr>
<td>1984-85</td>
<td>4.30</td>
<td>5.35</td>
<td>5.35</td>
<td>-2.90</td>
</tr>
</tbody>
</table>

*Note:* The real unit labour cost figure for 1950-51 is an approximation calculated from Pope and Hithers (1985). If anything, in absolute terms it is likely to be too high.

*Sources:* Reserve Bank of Australia (1982), Pope and Hithers (1985) and figures supplied by the Commonwealth Treasury.

The data show that, compared with periods of similar employment growth (excepting the Korean War of 1950-51), the inflationary consequences of expansion were slightly higher in 1984-85, but only in this period were there no increases in real wages. Moreover, real unit labour costs fell most in the Accord period. This is explained by the constancy of real wages since
productivity growth was low in 1984-85, relative to preceding periods of comparable expansion. In part, these favourable outcomes are probably a consequence of the unusually low level of economic activity preceding the Accord. In the post-war period there has been no other recovery starting from a base of over 10 per cent unemployment. This implies, again, that there are limitations in comparative exercises.

The data of all three tables allow insights into the policy debate. Accord supporters can point to the unusual improvement in macroeconomic performance since August 1983. As promised, employment and output growth have been at exceptional levels, and measures of inflation and real unit labour costs have decreased. Moreover, cross-country evidence reflects unambiguously relative expansions in Australian job-creation with no apparent inflationary consequences. In comparison with similar post-war employment expansions real wage and real unit labour costs decreases have been high.

Accord detractors could make several observations. One is that if all economies have moved similarly to Australia, the data of Table 1 are not relevant to the debate. Second, while growth may have been relatively high compared to other countries, inflation and unemployment rate decreases have not been noteworthy, and the rates of both remain high by international standards. Third, it is not possible at this stage to distinguish the effects of the Accord from other influences, in particular the low starting base prior to recovery and the coalition-initiated wages pause (which all preceded the Accord). Lags in the system are complex to determine and thus firm conclusions on the efficacy of particular policy initiatives are necessarily incautious.

The difficulties inherent in directly and confidently relating macroeconomic outcomes to government policy are apparent from the above. There are at least two conceptual problems. The first is that judgements concerning policy effectiveness are necessarily relative assessments. This implies that an evaluation postulates outcomes associated with alternative scenarios, for which data are necessarily not available. For the exercise at hand, one such counter-factual would be collective bargaining under the existing Australian institutional framework. This approximates the 1981-82 experience in which economic experience was unambiguously poor relative to both overseas and other periods in Australian economic history. Such a reference is unfair, however, for the reasons related to the second conceptual problem inherent in policy assessment, outlined below.

Economic variables, including expectations, change continually. In no two periods of time are enough factors sufficiently similar to facilitate confident policy comparison. For example, the following are pertinent in the Accord context. First, the dramatic deterioration of the economy in 1982-83 probably affected the attitudes and expectations of the principal economic agents profoundly. Second, the Accord was preceded by a wage pause which directly influenced some economic outcomes and
may have indirectly impacted upon others. Third, in the Accord period the state of the labour market per se may have resulted in similar wage outcomes with a different government stance.

Even given these caveats and qualifications on judgements of the success or otherwise of the Accord, some conclusions are in order. The most obvious is that, in absolute terms and relative to both previous experience and other OECD countries, the Australian economy has grown substantially since August 1983. As well, inflation has fallen considerably in absolute terms, although not relative to the rest of the world. These data suggest that the case for the Accord is more easily made than is the case against the Accord, at least on short-term macroeconomic grounds. Those arguing the desirability of alternative approaches must come to terms with the major difficulty that the Accord apparently has "the runs on the board", no matter how obvious are the problems associated with directly attributing causality. Moreover, because of the weight given by the major parties to distributional aspects of the agreement, the Accord cannot be judged solely in terms of changes in macroeconomic outcomes.

IV. THE DEMISE OF THE ACCORD

Predictions of the demise of the Accord have been fashionable since, and even before, its inception. Theoretical arguments have focussed on the difficulty of obtaining and maintaining widespread union support of the arrangements. If workers seek and obtain rises above awards, this represents breakdown, and for this reason, the emphasis has been on the notion of "wage drift".

Wage drift is defined as the difference between award wage rates and average ordinary-time weekly earnings. Allegedly, its existence reflects union wage bargaining outside the centralised award system and thus a close look at the evidence is warranted. Two points are developed below: first, that the available data are subject to large quarter-to-quarter swings, so that inference on the basis of a few observations is likely to be misguided; and, second, it is not clear that wage drift, in and of itself, presents sufficient argument for the view that the Accord is ineffectual. Again, a counter-factual is needed.

Both Dawkins and Blandy (1985) and Lloyd (1985) concede initial success for the Accord in terms of constraining wage movements, but argue that recent developments in wage drift are evidence for non-compliance with the principles. Dawkins and Blandy conclude that:

"The evidence suggests then that while the Accord was probably successful in containing labour costs and real wages for a year or so, this success is not being sustained...[continued success] depends in part on the ability of the government to sell wage restraint to the ACTU. This is becoming an increasing problem. (p.45)"

Their data, similar to Lloyd's, are presented and updated in Table 4.
TABLE 4
WAGES AND WAGE DRIFT
(per cent increase over previous quarter)

<table>
<thead>
<tr>
<th>Award Wages</th>
<th>Average Weekly Ordinary-time Earnings</th>
<th>Wage Drift</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>(ii)</td>
<td>(ii)-(i)</td>
</tr>
<tr>
<td>1984 February</td>
<td>2.1</td>
<td>0.0</td>
</tr>
<tr>
<td>May</td>
<td>3.2</td>
<td>0.0</td>
</tr>
<tr>
<td>August</td>
<td>1.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>November</td>
<td>0.0</td>
<td>1.7</td>
</tr>
<tr>
<td>1985 February</td>
<td>0.0</td>
<td>0.7</td>
</tr>
<tr>
<td>May</td>
<td>2.5</td>
<td>1.3</td>
</tr>
<tr>
<td>August</td>
<td>0.0</td>
<td>1.4</td>
</tr>
</tbody>
</table>


The Dawkins and Blandy and Lloyd assessments were both written before the second and third quarter 1985 data became available. But these additional observations make it apparent that no clear trend is obvious in wage drift. The May data reveal large negative drift, attributable in part to the National Wage Case of April 1985 in which wage indexation based on the previous six-month increase in the CPI was granted. Presumably lags in implementation contributed to the drift apparent in the August data. A reasonable conclusion is that these data do not signal, unambiguously, considerable and consistent evidence of drift.

Several issues are noteworthy for those interested in using wage drift data as evidence for the success or otherwise of an incomes policy. First, wage drift does not in itself necessarily represent non-compliance, for the following three reasons. One, while award rate data are standardised for industry and occupational composition, compositional changes in the labour force will affect estimates of average weekly earnings. Thus an increase in the proportion of the work force in more highly paid positions implies, ceteris paribus, the existence of drift even with substantial compliance with awards. Two, about 15-20 per cent of the labour force is not covered by awards and, purely for reasons of increased productivity, may be receiving extra bonus payments or commissions. Three, in a rapidly growing economy some employees are likely to experience faster than usual promotion rates, giving the illusion of non-compliance. Of course, employers may institute faster promotions or reclassify labour in response to employee demands for over-award payments, an action which may justifiably be described as non-compliance. Unfortunately the data are too aggregated to allow meaningful analysis of these factors. Purely on measurement grounds, caution is appropriate.

Second, to repeat a theme of this paper, the issue must be addressed with reference to a counter-factual. The question is, what would the increase in labour costs and their change over time have been under alternative policy scenarios? It is credible, for example, that with wage indexation in the absence of a consensual incomes policy nominal wage growth would have been higher which would have resulted in more adverse consequences for labour costs. It is difficult to believe it could result in
less, although this possibility cannot be completely dismissed. Such agnosticis was even more appropriate for those interested in advocating decentralised collective bargaining in the absence of the Commission, since no evidence of its likely effect is available for Australia.

Third, compliance per se is probably not the fundamental issue vis-a-vis the wage consequences of the Accord. Presumably firms are concerned first and foremost with profits and, thus, with real unit labour costs. The data of Tables 1, 2 and 3 reveal that absolutely, and relative to previous periods, there have been significant decreases in this variable. Concomitantly, the profit share has grown substantially.

In summary, wage drift data tell us little about the efficacy of the Accord in restricting labour costs. They are subject to large quarter-to-quarter swings and conclusions based on few observations have been erroneous. Moreover, the data may not be relevant for several reasons. They change because of factors unrelated to non-compliance; they are at best a misleading indicator of variations in firm’s real unit labour costs since they are not adjusted for changes in productivity; and they tell us nothing about what would have eventuated with a different policy stance. Other data, in particular real unit labour cost changes, have not been consistent with the view that recent events signal the increasing ineffectiveness of government macroeconomic policy. If the Accord has been floundering, the evidence is difficult to find.

V. THE CHALLENGE TO THE ACCORD OF DEVALUATION

The clearest threat to the Accord arose from the large devaluation of the Australian dollar, which began in earnest in November 1984. In the six months following, the dollar declined on a trade weighted basis by nearly 25 per cent. This event posed a serious dilemma for the government.

The essential problem of devaluation for the Accord is its short-term inflationary impact. Under a wages pact which has the maintenance of real incomes as its cornerstone, a one-off increase in the CPI has the potential to be translated into a higher rate of inflation through compensating nominal wage increases. This, then, was the government’s dilemma: not to support full wage indexation could be seen as a reneging on the arrangements and lead to a breakdown of the Accord, but to allow compensatory nominal wage increases implies higher inflation. The political consequences of this latter possibility were probably seen to be substantial given the experience of the preceding ALP government.

The tensions inherent in this challenge became clear in the months leading up to the signing of the extension of the Accord in September 1985. For example, Greg Harrison, assistant national secretary of the Amalgamated Metal Workers’ Union said at the time: “In the eyes of the unions, if there is any discounting of the wage, that is the beginning of the end for centralised
wage fixing." On the other hand, the government was intent upon restricting the inflationary flow-on from the devaluation, which is apparent from statements made in its submission to the September–October 1985 National Wage Case such as: "the depreciation must be supported by policies to contain the general inflationary consequences of the particular price increases unavoidably associated with depreciation." [Commonwealth of Australia (1985) p.90].

The solution to this problem emerged in the form of the tax-wage deal included as a component of the extension of the Accord. [Commonwealth of Australia and ACTU (1985)]. The September 1985 agreement stated, in part, that:

Wage rates shall be fully adjusted in accordance with movements in prices, provided that an amount of 2 per cent shall be offset by a tax cut designed to maintain the real value of the industrial wage.

To this effect the ACTU accepts that the 2 per cent shall be offset in the national wage adjustment expected to occur in April, 1986, provided the cumulative effect of depreciation as measured by statistics is 2 per cent or greater.

... The government agrees to restore the value of the industrial wage by a tax cut from the first of September by reducing personal income tax by an amount equal to the after-tax equivalent to a 2 per cent wage increase.

The notion of a tax-wage tradeoff is not new in Australian debate, and has been used in several instances overseas. The essence of the policy is that it enables a decrease in real labour costs for employers at the same time as it allows the maintenance of after-tax purchasing power for employees. Compared to what might otherwise have eventuated, a tax-wage bargain promotes price restraint and employment expansion, but this is not to say that it is a free lunch.

In a world of perceived short-term budgetary constraints, the Australian tax-wage tradeoff has the potential for transferring the implications of devaluation to reduced government consumption or transfer payments (or to other tax changes). This prognosis assumes that tax receipts are indeed lowered (they may not be if the tradeoff inspires sufficient growth in investment and employment), and that the government does not expand the deficit. Other scenarios are possible, the major point being that the inflationary implications of devaluation are in the first instance transformed into redistribution through the impact on the budget.

The tax-wage tradeoff utilised in the two year extension of the Accord is similar in flavour to the notion of a tax-based incomes policy (TIP). This idea was suggested by the Carter Administration in 1978 as an attempt to deal with inflation in the United States. It was argued that the existence of a wage-price nexus made restrictionist policy an ineffectual and expensive instrument for dealing with inflation, and that the solution lay in legislation offering tax rebates to workers bargaining for less than full compensation for price increases.

A plethora of alleged administrative costs and the potential for substantial budget deficit increases from the tax cuts
persuaded Congress to reject the scheme. Nevertheless, it is useful to examine briefly such schemes to place the Australian innovation in context.

TIPs directed to wage earners take two possible forms: tax penalties for increases above, and tax rebates for increases below, some prescribed norm. The essence of the "real wage insurance" scheme proposed by Arthur Okun (1981) was to offer rewards contingent on the ensuing rate of price inflation. That is, for example, the government might offer tax rebates equivalent to the difference between a wage bargaining norm and the ensuing rate of price inflation. Under this type of arrangement, if the wage norm was 5 per cent, and price inflation turned out to be 7 per cent, the 2 per cent loss in purchasing power would imply a real wage maintenance equivalent tax cut for workers qualifying.

The major potential for contingent TIPs is that, if a sufficiently high proportion of wage earners subscribe to the norm, ensuing price inflation may not exceed it, implying reduced inflation but no tax rebates. This outcome represents a free lunch.

Two major differences exist between the Australian scheme and contingent TIPs. First, because the Australian plan does not depend on ensuing price inflation tax receipt losses are inevitable. A government concerned with minimising uncertainty on budgetary outcomes is more likely to support such a scheme, even though some redistributive implications arise. The second difference is that the tax-wage tradeoff agreed to under the Accord is probably perceived to be a one-off response to the unusual devaluation experience of 1985. Thus the step of using the tax system as a tool for wages policy is unlikely to be taken again in the near future as no obvious attempts have been made to institutionalise the notion.

It may be useful to examine the basis for TIPs as a more integrated macroeconomic policy instrument. If the maintenance of workers' after-tax purchasing power is considered important to the sustaining of incomes policy, tax rewards contingent on wage restraint and the ensuing level of price inflation have the potential for favourable macroeconomic outcomes. That the Accord has demonstrated the flexibility to incorporate some of the advantages of such trade-offs indicates the potential for further innovation.

VI. CONCLUSION

It is important to consider the macroeconomic and political circumstances that led to the successful institution of Australia's first consensual incomes policy, the Accord, in early 1983. The unambiguously adverse economic circumstances of 1981-83 undoubtedly affected the motivations of the principal agents, as did the perceived ineffectiveness of alternative policy. The experience of the previous ALP government, in particular,
experience related to inflation, also contributed to the design
and implementation of the framework.

It is difficult to assess the effects of the Accord
confidently, essentially because comparisons of outcomes on a
counter-factual basis are required. Nevertheless, the available
data make it difficult to argue against the Accord on short-term
macroeconomic grounds. Relative to both 1976-83 in general and
compared to periods of similar employment expansion, the Accord
has apparently delivered considerable benefits to the economy. To
a lesser extent this is true if the basis of judgement is in an
international context, since other OECD countries' 1984-85
experience has also been favourable. As well, the low base from
which recovery began and the pre-Accord wages pause have
independently contributed to recent successes. Thus it is
inaccurate to attribute all the benefits to the Accord, but,
similarly, it takes a questionable act of faith to argue that
circumstances would have been better without it.

Predictions of the demise of the Accord have been frequent,
and empirical analysis of this prospect has centred on measures
of wage drift. However, these data need to be treated warily.
Important measurement problems are inherent in using wage drift
as an indication of wage increases above awards. Further, the
need for caution in interpretation of trends is manifestly clear
given the propensity of the data to exhibit large short-term
fluctuations. So far, there is no convincing evidence of non-
compliance.

Conceptually, a major point relevant to wage drift in the
context of the alleged demise of the Accord is this. The relevant
question is not non-compliance per se, but what outcomes would
have been under different policy scenarios. The data presented on
relative decreases in real unit labour costs imply, again, that
it is not easy so far to establish the case for alternative
arrangements.

The most serious challenge to the Accord arose as a
consequence of the large devaluation of the Australian dollar in
1985. The inflationary implications of this event had the
potential to undermine the Accord since the government wished to
avoid the concomitant nominal wage increases implicit in a wage
indexation pact.

The solution to the government’s dilemma was found through a
tax-wage bargain. Over time workers’ real purchasing power is to
be maintained through tax cuts equivalent to the difference
between price and nominal wage increases. This policy innovation
shares a major benefit of real wage insurance-type TIPS, in
which, relative to what would otherwise have eventuated,
inflation is decreased and employment is expanded. The Australian
version, in effect, transfers the implications of devaluation to
the budget.
Apparently this use of the tax system as an adjunct to wages policy is perceived to be a one-off response to special circumstances as no attempts have been announced to institutionalise it in a contingency context. A case can be made for more serious consideration of this option, at least for those advocating continued innovation in an Accord context. Opponents of present arrangements would be more likely to see benefits in the encouragement of firm-based wage bargaining. On recent empirical grounds their case is less easily made.

FOOTNOTES

1 For analysis of the redistributive implications of the Accord, see Peetz (1985).

2 As referenced in Hughes (1980), p. 86.

3 For an analysis of "inflation first", see Davis and Lewis (1979).

4 In the twenty years preceding the early 1970s the aggregate unemployment rate averaged around 1.5 per cent, and never exceeded 2.8 per cent. The average rate from 1975-83 was about 5.5 per cent.

5 To some extent world price changes probably kept Australian inflation rates higher than they otherwise would have been. This is particularly the case with regard to oil prices in the late 1970s.

6 Estimates of foregone output resulting from high unemployment are to be found in Chapman and Gruen (1984).

7 About one percentage point of this decrease is due to the Medicare effect and is thus not directly attributable to the inflation-moderating effects of the Accord.

8 Increases in participation rates of about 0.5 percentage points over the period of the Accord have undoubtedly decreased the extent of the unemployment rate decline.

9 See Bentley (1981), Gruen (1983) and Withers (1982).

10 Both Dawkins and Blandy, and Lloyd, recognise these issues.

11 As reported in The Age July 26, 1985

12 See, for example, Sheehan and Ironmonger (1973).
REFERENCES


