LIBERAL DEMOCRATS
Western Australia

MINISTERIAL REVIEW OF WA STATE INDUSTRIAL RELATIONS SYSTEM

Submission by the WA branch of the Liberal Democrats

The Liberal Democrats are an Australian political party, registered federally and in a number of States and Territories, including WA. The Western Australian branch of the Liberal Democrats welcomes the opportunity to make this submission to the Ministerial review of the State's industrial relations ("IR") system.

Executive summary

WA's current IR laws tend not to achieve their avowed purpose of protecting vulnerable workers from receiving sub-standard pay and conditions. Rather, the laws have an in-built bias and tend to have the opposite effect. Vulnerable workers tend be less likely to find secure and well-paid employment, and more likely to find themselves unemployed and living off government welfare, than other workers.

The WA Government should fundamentally reform the State's IR system to create a truly free labour market in this State. This would reverse the inherent bias in the current IR system against the economic interests of vulnerable workers. It would do this by giving back to these workers their most effective weapon – the ability to compete on price with higher skilled and more productive workers.

Full deregulation of the WA labour market will not lead to the exploitation of workers. WA's labour market is already highly competitive, and competitive labour markets deter exploitation. The deregulation of the WA labour market will only make it more competitive and less exploitative.

Further, the idea that free labour markets are inherently exploitative is based on a fallacy; that a labour contract is a zero-sum transaction. In fact, a labour contract is a win-win or positive-sum

transaction. So long as it is entered voluntarily on a competitive market, a labour contract cannot by definition be exploitative. For this reason also, full deregulation of WA's labour market will not result in worker exploitation.

Full deregulation of WA's labour market will strongly differentiate it from labour markets in all other States, that are subject to heavy regulation under the Federal system. This should attract capital and labour from other States to WA, with significant flow on benefits for the State's economy.

Full deregulation of the State's labour market is also consistent with and will promote the competitive federalism as intended by the founders of the Constitution. A strong incentive will be created for all other States to liberalise their labour markets or risk losing capital and labour to the West. If other States do follow WA's lead, this would be precisely how competitive federalism was meant to operate, which would be to the benefit of all Australians.

Evidence-based policy

The Liberal Democrats are a political party in the classical liberal or libertarian tradition.

All government policies, to a greater or lesser extent, interfere with the freedom of individual Australians, whether it be in their family, social, community, religious or working lives. As classical liberals, the Liberal Democrats believe that government interference with an Australian's freedom in all spheres of life should be kept to a minimum. We believe that legislation can only be justified by a demonstrated need to protect others from non-consensual harm to their person or justly-acquired property.

When assessing the merits of any proposed government policy the Liberal Democrats do not give any weight to the intentions of the proponents, however worthy or noble they may be. We are interested only in the real-world effects of government policy.

This is just another way of saying that government policy must always be evidence-based; we do not believe it is enough that it is based on good intentions. The Liberal Democrats believe that only a rigorous evidence-based assessment of the effects of government policies can properly elucidate whether an interference with individual freedom is justified and should be enshrined in law.

Importantly, when assessing the effects of a government policy the Liberal Democrats believe legislators should look not merely at the immediate but at the longer effects and trace the consequences of the policy not merely for one group but for all groups.

Protecting vulnerable workers

WA's IR laws restrict the freedom of participants in the market for labour in a variety of ways. These laws have the laudable goal of protecting workers from receiving sub-standard pay and working conditions. A particular object has been to protect the most vulnerable workers in the WA labour market – the young, the inexperienced, the low-skilled, the long-term unemployed, the indigenous, the non-English speaking, recent migrants and the disabled ("vulnerable workers").

When examined statistically, the real-world effects of these laws depart markedly from the intended effect of protecting vulnerable workers from sub-standard wages and conditions. Under WA's current IR system, vulnerable workers tend be less likely to find secure and well-paid employment, and more likely to find themselves unemployed and living off government welfare, than other workers.

The Liberal Democrats believe that the statistical disadvantage of vulnerable workers is contributed to by the structure of current IR laws; in particular the economic incentives they create for participants in the labour market. In other words, we believe WA's current IR laws have an in-built bias against the economic interests of vulnerable workers, the very workers that they are intended to help.

This can be demonstrated by carefully analysing the economic incentives created by the various kinds of IR laws that currently apply in WA.

Minimum employment conditions: The Minimum Conditions of Employment Act 1993 creates a safety net of minimum wages and minimum employment conditions for all employees across the State. The effect of the safety net, however, is that employers are forced to discriminate against vulnerable workers. Why? Where, as will often be the case, a vulnerable worker's productivity is worth less in the market than the safety net, that worker must compete for employment on the same terms as workers whose productivity is worth at least as much as the safety net. The inevitable result is that vulnerable workers are priced out of the labour market and onto the welfare rolls – an effect verified by the unemployment and welfare statistics.

Industry awards: The Industrial Relations Act 1979 creates an arbitration tribunal, the WAIRC, that has power to make awards setting minimum wages and conditions for groups of workers by industry. This process occurs without regard to each individual worker's wishes or situation, or those of their employer. In arbitrating wages and conditions it is literally impossible for the WAIRC to have sufficient knowledge to fairly reflect in a single wage rate or common conditions the value to each and every employer of the output of each and every worker within the relevant group. Inevitably, there will be individual cases where the wages and conditions are awarded by the arbitration tribunal above the market level for that worker's productivity. This will most likely be the case for vulnerable workers whose skills are the least valuable in the market. In those cases, there is an in-built economic disincentive for employers to take on and retain the vulnerable workers. The inevitable effect of awards is that at least some vulnerable workers will lose their job or not be employed in a job they otherwise might have won on a free labour market.

Definition of employee: This review is considering varying the definition of employee under the Industrial Relations Act 1979 "to ensure comprehensive coverage of all employees". This kind of amendment is intended to protect vulnerable workers against being coerced into sham contracting or labour hire arrangements that provide wages and conditions below the legislated or arbitrated minimum. The theory is that by defining contractors and on-hire workers as employees, no worker will fall below the minimum. The theory does not play out in practice, especially for vulnerable workers whose productivity is worth the least in the labour market. Inevitably, there will be cases where vulnerable workers' productivity may not justify the safety net, but will justify lower pay and conditions on offer under a contracting or labour hire arrangement. In those cases the vulnerable worker's job prospects are reduced. A higher rate of unemployment and welfare dependency among vulnerable workers, rather than the intended higher wages and conditions, is the result.

Union privileges: Under the Industrial Relations Act 1979 unions are given legal privileges to represent groups of workers in negotiations and to police and enforce compliance by employers. It is claimed that by granting unions these privileges, unions will counteract the greater bargaining power of employers and raise wages and conditions for all workers across the board. This does not play out in practice. While unions representing highly skilled workers have been able to win better wages and conditions for their members, this has come at the expense of other workers. To see why, consider that unions can only raise wages (the price of labour) by restricting the supply of labour – this is the basic law of demand. To raise their members' wages, therefore, unions representing highly skilled workers typically adopt tactics that restrict labour supply. For example, unions bargain for high award wages and conditions for their employed members; this excludes competition from lower-skilled workers. Another example is unions

bargaining for rigorous licensing and training qualifications; this excludes competition from unlicensed and untrained workers, typically in the vulnerable worker category. There are other examples. The point is that when wages and conditions for one group are raised by union pressure, the net effect – again under the law of demand – is that employers will purchase less labour. And when employers purchase less labour this comes at the expense of a range of other groups in the economy – consumers, the tax collector, the jobless and, importantly for the present example, other workers. Because of the legal privileges granted to unions, therefore, rather than all workers' conditions improving, WA has a "two-speed" union movement in which strong unions get high wages and conditions for their members at the expense of all other workers. This results in fewer job opportunities and lower wages and conditions in particular for vulnerable workers whose unions do not have any means of restricting supply to raise their wages and conditions. Again this is the very opposite of the intended effect of the laws.

Unfair dismissal: The Industrial Relations Act 1979 gives jurisdiction to the WAIRC to hear and determine unfair dismissal claims by employees. Bringing such a claim carries little or no risk for the employee; there is only a nominal filing fee, and if unsuccessful the employee does not have to pay the employer's costs. By contrast, the employer faces considerable costs. There is the direct cost of representation and lost management time. But there are also other indirect costs. For example, dismissals can be found to be unfair for minor procedural slip-ups, even in cases where the employee's conduct would otherwise justify dismissal. Employers have to bear an additional cost of managing their business to the high standard of procedural fairness demanded by the WAIRC. The upshot is that in a marginal hiring decision, particularly for a small business, the potential direct and indirect costs of an unfair dismissal claim may tip the balance against hiring the worker. This disincentive to hiring falls most heavily on vulnerable workers, where their inexperience often makes the decision to hire riskier than a decision to hire a more experienced candidate. The effect is that unfair dismissal laws tend to discourage employment of vulnerable workers; again, the opposite of their intended effect.

Equal pay: This review is considering amendments to the Industrial Relations Act 1979 to confer power on the WAIRC to hear cases and order equal pay for equal work performed by men and women to bring WA's laws into line with Federal laws. These laws do not, however, help women workers achieve higher wages. Why? There will always be some cases where a female employee is less productive than a male performing the same work. This may be for a variety of reasons, although the most common is the woman's choice to take a period out of the workforce to have a family. In such a case an order compelling equal pay for a woman and her more productive male counterpart creates an economic disincentive for the woman to be employed. Importantly, in this example the man is more productive than the woman, so the reason the man is preferred cannot be the employer's prejudice against the woman. Again, it is vulnerable workers who are

female whom equal pay laws are most likely to disadvantage. Of all women workers, vulnerable workers have the lowest skills and more likely to be less productive than their male competitors.

In summary, WA's current IR laws tend not to achieve their avowed purpose of protecting vulnerable workers from receiving sub-standard pay and conditions. Rather, the laws have an in-built bias and tend to have the opposite effect. Vulnerable workers tend be less likely to find secure and well-paid employment, and more likely to find themselves unemployed and living off government welfare, than other workers.

Competition and vulnerable workers

Given the failure of current IR laws to effectively protect vulnerable workers, is there a change to the law that would be more likely to achieve this purpose?

In any market, the seller's main competitive weapon is the ability to compete on price. Where a seller reduces the asking price of a good or service - according to the law of demand - the number of buyers will increase. Sales go up as the asking price goes down. Labour markets are no different. In labour markets, workers are sellers and wages are the price. In the labour market job opportunities go up as the asking wage goes down.

This explains why WA's current IR system increases unemployment amongst vulnerable workers rather than improving their wages and conditions. Current laws deprive them of their greatest competitive weapon – the ability to compete on price. This hobbles the State's most vulnerable workers from competing effectively with other workers; and their job prospects reduce accordingly.

The Liberal Democrats believe that a more reliable and effective protection for vulnerable workers would be provided by the existence of many employers. The employers who protect a worker are those who are looking to hire. Their demand for the worker's services makes it in the self-interest of the worker's current employer to pay the full value of the work. If the current employer does not, someone else may be ready to do so. Competition for their services – that is the worker's real protection.

Of course, competition by other employers is sometimes strong, sometimes weak. There is much friction and ignorance about opportunities. It may be costly for employers to locate desirable employees, and for employees to locate desirable employers. This is an imperfect world, so competition does not provide complete protection. However, competition is the best,

or, what is the same thing, the least bad, protection for the largest number of workers that has yet been found or devised.

The Liberal Democrats believe that the WA's IR laws would better protect vulnerable workers if they were amended to increase the number of employers who are competing for their services. This could be achieved simply by repealing the legislation that creates legal obstacles to vulnerable workers competing on a level playing field with better-off workers, thereby creating a truly free market for labour in this State.

Two acts should, therefore, be repealed: the Minimum Conditions of Employment Act 1993; and the Industrial Relations Act 1979. These repeals would eliminate legislation for minimum employment conditions, industrial awards, unfair dismissal claims and special union privileges; as well as providing workers with the freedom to work as contractors or on-hire workers without restriction of terms. The WAIRC, the Industrial Appeal Court and the Industrial Magistrates Court would also be disestablished by the repeal of the Industrial Relations Act 1979, saving the State Government the considerable cost of administering those institutions under the current system.

In summary, the WA Government should fundamentally reform the State's IR system to create a truly free labour market in this State. This would reverse the inherent bias in the current IR system against the economic interests of vulnerable workers. It would do this by giving back to these workers their most effective weapon – the ability to compete on price with higher skilled and more productive workers.

Free markets and exploitation

If the WA Government was to adopt the Liberal Democrats' policy and establish a truly free market for labour in this State, wouldn't this be worse than the current situation? Wouldn't ruthless employers simply cut the pay and conditions of those currently employed on minimum wages and conditions? How would this help vulnerable workers who are unemployed to get a job? Wouldn't those who were lucky enough to have a job get their pay cut, without any improvement in the job prospects of the unemployed? Wouldn't we have a race to the bottom, with desperate workers scrambling over each other for ever lower paying jobs? Wouldn't the rich just get even richer and the poor get even poorer? Wouldn't we end up with third world working conditions for most of our workforce?

In other words, wouldn't a free labour market simply be a recipe for exploitation of vulnerable workers by ruthless and economically powerful employers?

The answer by most people to this question would be "of course, yes." And it is not doubted that those who hold this view do so sincerely and for the worthy reason that they do not wish to see exploitation of the weak and vulnerable in our society. Even so, the Liberal Democrats believe that when the facts are examined, the view that free labour markets promote exploitation is misconceived for two straightforward reasons.

The first is that effective competition deters exploitation.

It is simply not possible for employers either individually or as a group to consistently pay workers less than they are worth in a highly competitive market. And WA's labour market is already highly competitive. On given day in WA there are vast numbers of employers competing for labour, entrepreneurs establishing new businesses, and new hires by private businesses. Even a "powerful" employer cannot depress labour prices below the value of workers' marginal (incremental) productivity for long because other firms are attracted by the cheaper labour. The new firms hire these workers and thereby put upward pressure on the prices paid to labour until further profit from the initial exploitation of isolated labour disappears. Also, if employer clout depresses wage rates in one location, labour supply will decrease as mobile workers leave, again putting corrective upward pressure on wage rates.

Rather than paving the way for worker exploitation, full deregulation of the labour market will make WA's labour market even more competitive, providing workers with even greater protection from exploitation.

The second reason that the belief that free labour markets are exploitative is wrong is that it based on an economic fallacy; that a labour contract is a zero-sum transaction.

Let us start at square one. "Free market" is a summary term for an array of exchanges that take place in society. Each exchange is undertaken as a voluntary agreement between two people or between groups of people represented by agents. These two individuals (or agents) exchange two economic goods, either tangible commodities or non-tangible services. In the labour market the worker exchanges labour services, in a mutually agreed way, for money wages; here the corporation is represented by a manager (an agent) with the authority to hire.

Both parties undertake the exchange because each expects to gain from it. Also, each will repeat the exchange next time (or refuse to) because his expectation has proved correct or incorrect in the recent past. Trade, or exchange, is engaged in precisely because both parties benefit; if they did not expect to gain, they would not have agreed to the exchange.

This simple reasoning refutes the argument against free trade typical of the "mercantilist" period of 16th to 18th century Europe and classically expounded by the famed 16th century essayist Montaigne. The mercantilists argued that in any trade, one party can benefit only at the expense of the other – that in every transaction there is a winner and a loser, an "exploiter" and an "exploited". We can immediately see the fallacy in this still popular viewpoint: the willingness and ever eagerness to trade means that both parties benefit. In modern game-theory jargon, trade is a win-win situation, a "positive-sum" rather than a "zero-sum" or "negative-sum" game.

Once the zero-sum fallacy is abandoned, it can be seen readily that the exchange of labour on a free market cannot result in exploitation, so long as the exchange is voluntary and the worker has many employers to choose from. Which is precisely what the full deregulation of the labour market will achieve.

In summary, full deregulation of the WA labour market will not lead to the exploitation of workers. WA's labour market is already highly competitive, and competitive labour markets deter exploitation. The deregulation of the WA labour market will only make it more competitive and less exploitative.

Further, the idea that free labour markets are inherently exploitative is based on a fallacy; that a labour contract is a zero-sum transaction. In fact, a labour contract is a win-win or positive-sum transaction, that so long as it is entered voluntarily on a competitive market, cannot by definition be exploitative. For this reason also, full deregulation of WA's labour market will not result in worker exploitation.

Competitive federalism

The Liberal Democrats support competitive federalism as it was intended by the framers of Australia's Constitution. Under competitive federalism, wherever possible, government activities should be decentralised to the State level. We believe this policy generates economic and social benefits through governmental competition, policy experimentation and individual choice. It also removes inefficient bureaucratic duplication of Federal and State agencies.

The Constitution provided for a federally competitive model for IR in Australia. To this end, the Constitution conferred a single and limited power on the Commonwealth. Federal laws could only be made for the conciliation or arbitration of interstate disputes. All other IR powers were reserved to the States whose separate IR systems would be competitive with one another.

This model was almost completely dismantled in the first decade of the 21st century. First, the High Court controversially interpreted the Constitution to allow the Commonwealth to legislate about any and all of the activities of corporations, including IR. Then all States, except WA, referred their residual IR powers to the Commonwealth. By jettisoning competitive federalism in IR, as it has been in most other areas of the economy, the Liberal Democrats believe Australia has kicked a massive own goal.

Only WA resisted the completion of the 21st century Federal takeover of IR, by choosing not to refer its residual IR powers. The residual constituency of WA's IR system is mainly small business employers and employees (sole traders and partnerships), and State public sector employers and employees. Estimates of employee coverage is from one in five (21.7%) to more than one-third (36.2%).

The Liberal Democrats welcome the WA Government's decision not to refer its residual IR powers to the Commonwealth for these participants in WA's economy. The referral of WA's IR powers could have been the final nail in the coffin of competitive federalism in IR in this country. By choosing to retain its IR powers, and conduct this review, the WA Government has provided all Australians with the opportunity for some life to be breathed back into the competitive federalism model, at least in IR.

In this submission the Liberal Democrats have advocated that the WA Government fully deregulate the segment of WA's labour market that remains outside the Federal system. By doing this, WA's IR system could become an effective competitor to the Federal IR system in the market for capital and labour. The Liberal Democrats believe that if WA fully liberalises its labour market, investment capital and labour will be attracted to WA from the other States, fleeing from the restrictive Federal IR system. This would have huge economic benefits to all West Australians.

If this policy is adopted, and is successful in attracting capital and labour from the other states, those other States will be incentivised to follow WA's lead and match WA's IR's reforms or risk losing further capital and labour to the West. The result will be a virtuous circle of more business investment and activity, and more jobs, across the nation. All Australians will be better off. Further, the intentions of the founders of the Constitution will have been given full and proper effect.

Terms of reference

The Liberal Democrats' response to the specific Terms of Reference are set out below.

WAIRC: Paragraphs 1 & 2 of the Terms of Reference concern a review of the structure, jurisdiction and powers of the WAIRC. If the Liberal Democrats WA policy is adopted, the Industrial Relations Act 1979 that establishes the WAIRC will be repealed and so the WAIRC will be disestablished.

Equal pay: Paragraph 3 of the Terms of Reference concerns equal pay laws. Equal pay laws should not be introduced because they do not help women workers achieve higher wages and conditions for the reasons explained earlier in this submission.

Definition of employee: Paragraph 4 of the Terms of Reference concerns extending the definition of "employee". If the Liberal Democrats WA policy is adopted, the Industrial Relations Act 1979 containing the definition will be repealed.

Minimum conditions: Paragraph 5 of the Terms of Reference concerns the updating of minimum conditions of employment. If the Liberal Democrats WA policy is adopted, the Minimum Conditions of Employment Act 1993 containing these conditions will be repealed.

State awards: Paragraph 6 of the Terms of Reference concerns updating State award conditions. If the Liberal Democrats WA policy is adopted, the Industrial Relations Act 1979 that provides for the WAIRC to make awards will be repealed.

Enforcement: Paragraph 7 of the Terms of Reference concerns enforcing WA's labour laws, awards and other instruments. If the Liberal Democrats WA policy is adopted, the legislation that creates the obligations to be enforced will be repealed, so there will be no obligations to enforce.

Local government: Paragraph 8 of the Terms of Reference concerns the terms and conditions of employment of local government employees. Consistent with the Liberal Democrats support of competitive federalism, wherever possible, IR should be regulated at the State level. If local government employees can be covered by the WA State system, they should be.