



OECD Jobs Study Working Papers No. 3

The Impact of Industrial  
Relations Practices  
on Employment  
and Unemployment

**David Marsden**

<https://dx.doi.org/10.1787/855620410587>

**THE OECD JOBS STUDY  
WORKING PAPERS**

**NO.3  
THE IMPACT OF INDUSTRIAL RELATIONS PRACTICES ON EMPLOYMENT AND  
UNEMPLOYMENT**

**by  
David Marsden (1)  
London School of Economics**

**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT**

**Paris 1995**

**020726**

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## **SUMMARY**

This working paper deals with the effects of collective bargaining and other forms of collective employee representation (such as works councils) on employment and unemployment. Collective bargaining is concerned with both substantive issues, such as rates of pay or weeks of notice to be given before lay-off, and procedural matters in which management and employee representatives jointly manage important areas of employee relations thereby contributing to workplace co-operation. Whereas many substantive rules can be said to cause lower levels of employment and enterprise efficiency, procedural rules by reducing transaction costs, improve co-operation and thus, indirectly, help jobs.

The paper starts by examining some substantive rules and the evidence for their effects on employment in OECD countries. It then looks at some of the compensating flexibilities which are introduced by procedural rules. These may be dependent on substantive rules: for example, employment security may be a precondition for flexibility in applying job classifications. Equally, some substantive rules would not be viable without appropriate procedures: for example, industry-wide pay rates cannot function without some flexibility at the enterprise level. However, what may be necessary for institutional reasons may not be sufficient for labour market purposes. The paper looks at forms of flexibility which exist within the current frameworks, and at recent changes introduced by employers and worker representatives to increase adaptation to changing labour and product markets. It concludes with an analysis of some policies which could help mitigate employment effects of current joint regulation practices, and which could help improve enterprise competitiveness.

## **LES EFFETS DES PRATIQUES EN MATIERE DE RELATIONS PROFESSIONNELLES SUR L'EMPLOI ET LE CHÔMAGE**

### **RÉSUMÉ**

Ce document de travail traite des effets des négociations collectives et d'autres formes de représentation collective des salariés (comme les comités d'entreprise) sur l'emploi et le chômage. Les négociations collectives portent à la fois sur des questions de fond, telles les rémunérations ou le nombre de semaines de préavis de licenciement et sur des questions de procédure, domaine dans lequel les représentants du patronat et des salariés gèrent conjointement des aspects importants des relations avec le personnel ce qui renforce la coopération au sein de l'entreprise. Si de nombreuses règles de fond entraînent sans doute une baisse des niveaux d'emploi et nuisent à l'efficacité des entreprises, en revanche les règles de procédure améliorent la coopération en réduisant les coûts de transaction et favorisent ainsi indirectement l'emploi.

L'auteur examine d'abord certaines règles de fond et leurs effets sur l'emploi observés dans les pays de l'OCDE. Il analyse ensuite certaines des flexibilités que les règles de procédure introduisent en contrepartie. Ces flexibilités dépendent parfois de règles de fond : la sécurité de l'emploi, par exemple, peut être une condition préalable à la flexibilité dans la classification des emplois. De même, certaines règles de fond seraient inapplicables en l'absence de procédures appropriées : les taux de rémunération convenus pour l'ensemble d'une branche, par exemple, ne pourront pas être appliqués s'il n'y a pas une certaine souplesse au niveau de l'entreprise. Mais ce qui peut être nécessaire pour des raisons institutionnelles peut ne pas être suffisant pour répondre aux impératifs du marché du travail. Ce document examine les différentes formes de flexibilité qui existent dans les contextes actuels ainsi que les changements introduits récemment par les représentants du patronat et des salariés pour faciliter l'adaptation à l'évolution des marchés du travail et des marchés de produits. Pour conclure, il analyse certaines mesures qui pourraient contribuer à atténuer les effets sur l'emploi de réglementations communes actuelles et à améliorer la compétitivité des entreprises.

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## 1. Introduction

Concern about the effects of industrial relations practices on employment and unemployment has been voiced in many OECD countries. In Europe, it has been associated with the idea of 'Eurosclerosis': that employers' freedom to hire and use labour has become excessively restricted by collective agreements and labour laws. In Australia the influence of central arbitration procedures on firms' ability to adjust to changing markets has been hotly debated, and lies behind some of the recent reforms to promote enterprise bargaining. In Japan, as domestic markets open up and overseas ones are threatened by the high Yen, a number of writers have questioned how much longer Japanese firms can afford to offer employment security to their core workers as a part of the deal with the unions for workplace co-operation.<sup>2</sup> In the United States, the success in boosting employment opportunities for less skilled and lower paid workers has been widely held up as one of the achievements of labour market deregulation.

This working paper deals with those practices associated with collective bargaining and other forms of collective employee representation, such as works councils which, strictly speaking, usually 'co-decide' and participate with management rather than bargain. 'Joint regulation' embraces both collective bargaining and worker participation, and covers both the regulation of pay and benefits, and industrial government<sup>3</sup>, that is, the joint management of employment relations within the enterprise. Although negotiated and legal rules differ in many respects, for the purposes of this paper, they will often be treated as analogous unless the difference has some direct impact on employment outcomes.

Because union strength has declined during the last decade in many countries, and there is growing evidence that many practices associated with joint regulation might be introduced even in a non-union environment, a separate paper is devoted to the impact of employee management practices on unemployment (Jobs Study Working Paper no. 2). This focuses on policies management has been adopting unilaterally rather than through joint channels. The impact of industrial relations, and more generally, 'joint regulation' practices on unemployment is complex and controversial. It has been common to distinguish between 'substantive' and 'procedural' rules, and broadly speaking their effects on employment differ. Substantive rules refer to those specifying particular outcomes, such as the rates of wages to be paid to a particular class of workers, or the number of weeks notice to be given before lay-offs. These have commonly been contrasted with the outcomes that would be expected under a régime of competitive labour markets. Procedural rules relate more to the process of industrial government in which management and employee representatives jointly manage important areas of employee relations and are influential over the process of workplace co-operation. They play an important role in adapting substantive rules, such as those on pay, to the local circumstances of each firm. The impact of procedural rules is not easily analysed within the standard competitive model of labour markets because their main function is that of reducing transaction costs. Thus, whereas many of the substantive rules associated with collective bargaining are deemed to cause lower levels of employment and enterprise efficiency, the procedural rules, and the institutions regulating them, on both the employer and employee side, may improve co-operation, and thus indirectly, help jobs.

This working paper starts by examining some substantive rules and the evidence for their effects on employment in OECD countries. It then looks at some of the compensating flexibilities which are introduced by procedural rules. It will also be argued that some procedural rules are dependent on substantive rules: for example, that employment security may be a precondition for flexibility in applying job classifications. Equally, some substantive rules would not be viable without appropriate procedures: for example, industry-wide pay rates cannot function without some flexibility at the enterprise level. However, what may be necessary for institutional reasons may not be sufficient for labour market purposes. The paper



looks at forms of flexibility which exist within the current frameworks, and at recent changes introduced by employers and worker representatives to increase adaptation to changing labour and product markets. It concludes with an analysis of some policies which could help mitigate employment effects of current joint regulation practices, and which could help improve enterprise competitiveness.

## **2. Bargained pay and work rules and unemployment**

There are strong theoretical reasons for expecting that when collective bargaining raises the cost of employment above the competitive level, it will have an adverse effect upon the distribution of employment and unemployment.<sup>4</sup> First, because the demand for labour depends upon that for the goods and services it produces, bargaining up the pay of a particular category of workers above the competitive level is likely to cause employers to hire less of it. The reaction may not be immediate because it takes time to reorganise production and to invest in alternative methods, but in the long run, a higher price will lead to less of that category being hired. Second, fixing standard rates of pay irrespective of individual performance, or compressing wage differentials both raise the price of less efficient workers within a particular job category, and reduce incentive for the more efficient and the more skilled. The latter may depress the organisation's performance, and thus its sales, and potentially employment. Third, collective bargaining, especially at enterprise level, by giving disproportionate weight to the interests of incumbent workers, may establish hiring and lay-off provisions which reduce job opportunities for unemployed workers. Fourthly, collectively agreed work rules may restrict labour utilisation and slow organisational change, thus causing the firm to be less competitive. Finally, certain kinds of bargaining structure may be more prone to inflation, and thereby force governments to run their economies with higher levels of unemployment than would otherwise be necessary.

### **2.1 Effects of wage structure on employment**

Collective bargaining may affect the distribution and levels of unemployment where it causes wage differentials to deviate from the levels that would prevail in competitive labour markets. Notable examples among these are the union/non-union differential; policies for particular categories of workers, such as the low paid and young workers; and solidarity wage policies.

#### **a) Union/non-union differentials**

Compared with individual bargaining over wages in a competitive labour market, collective bargaining enables a group of workers to negotiate a higher wage, the size of the increase and the amount of employment foregone depending on the sensitivity of employers' demand for labour to changes in its price (its elasticity). If the elasticity is low, a relatively large increase in the price of labour will have only a small effect on jobs so that the union will face a more favourable trade-off between pay and jobs, than if labour demand is highly elastic. Labour demand will be less elastic: if consumers cannot easily switch to other products; if employers cannot easily substitute other categories of labour or capital; if other categories of workers are in a weak bargaining position because they cannot afford to withhold their labour; and, under some conditions, if the pay of the bargaining group represents only a small proportion of the employer's total pay bill. The first of these depends primarily upon the degree of competition in product markets, discussed later. The second, substitution, may be limited by restrictive employment rules. The third raises the possibility of wage gains at the expense of other categories of labour. The fourth, the 'importance of being unimportant', does not always hold [see Hicks (1963)], and is of less relevance to employment levels because of the relatively small numbers of workers directly involved.

The standard analysis of the micro-level employment impact of union bargaining divides a particular labour market into covered and non-covered sections, and traces the effects on each. Raising the wage above the competitive level in the covered section causes employers to reduce the number of jobs on offer, and so displaces workers into the non-covered section, where the increased labour supply will depress wages. The crowding effect in the non-covered section may depress pay levels to the point at which some workers withdraw from the labour force, and employment falls; some may search for longer in the hope of a better paying job, thus causing unemployment to rise; or if the wage cannot fall to the market clearing level, perhaps because of a minimum wage rule, then unemployment will also rise.

Estimating the size of such employment effects requires information on the size of the relevant wage differential and of the demand elasticities. This would give the size of the potential employment displaced from the section covered. Full estimation of unemployment effects would need additionally to take account of the ability of the non-covered section to absorb displaced employment, and the possibility that additional workers would be drawn into the industry or occupation in the hope of gaining employment in the covered part.

Average union wage mark-ups across an economy appear to be fairly modest in many countries, except for the United States. Recent estimates for union members by Blanchflower and Freeman (1992) using a similar range of controls<sup>5</sup> across countries show the typical union wage effect varies between about 5% in Switzerland to about 10% in the UK, and 20% in the United States.<sup>6</sup>

Because union-non-union differentials generally change only slowly over time, one may presume employers have fully adjusted to them, so that their employment effects depend upon the long-run labour demand elasticities, and the degree of coverage. Such labour demand elasticities tend to be fairly low [-0.15 to -0.5, Hamermesh (1986, 1993)], and are lower for adult males than for women and young males. Multiplying these by the wage mark-ups would give an approximate idea of the displacement effect on the covered section: between 3% and 10% in the US, and between 1.5% and 5% in the UK on Blanchflower and Freeman's estimates, but considerably lower in the other countries. The potential unemployment effects in both the US and the UK would however be mitigated by the relatively smaller size of the covered sections in these countries, and the ability of the larger non-covered sections to absorb displaced workers.

However, such national averages are not a reliable guide to bargaining effects because labour demand elasticities vary among occupations, and because different institutional arrangements enable bargaining to be more or less effective. Information on the latter depends on the existence of suitable surveys of institutional arrangements, such as the UK Workplace Industrial Relations Surveys (WIRS). Using the 1980 and 1984 WIRS, Stewart (1987) and (1991) found that, in 1980, the presence of a closed shop enhanced semi-skilled workers' earnings, with a differential of about 5% if there was a post-entry closed shop, and about 10% if a pre-entry one.<sup>7</sup> The effect was slightly smaller for skilled workers, and it appeared to increase slightly between 1980 and 1984. Later work by Metcalf and Stewart (1991), using WIRS 1984 data, found that in plants without a closed shop, union recognition had a statistically significant impact on pay compared with non-union plants only if membership density was above 95%. Then the differential rose to 7-10%. Similarly, the presence of a post-entry closed shop had little effect on pay unless membership density was above 95%. In contrast, the presence of pre-entry closed shop led to a 17-19% differential over workers in non-union plants.

In many OECD countries, collective bargaining at the enterprise level builds upon industry level agreements which set minimum rates of pay for each position in the industry's job classification. British evidence suggests that coverage by an industry agreement adds less to the union mark-up than coverage by

both an industry and an enterprise or plant agreement. The biggest mark-up occurs when workers are covered by an enterprise or local agreement only [Gregory and Thompson (1981)]. Recent evidence for Italy shows that the presence of local (establishment level) agreements and the degree of local union strength raise wage levels [Lucifora (1993)].<sup>8</sup>

Thus, the main employment effects of pay agreements are likely to be concentrated where there are local agreements, and local union membership is strong.

The other limitation on national averages of bargaining mark-ups is that the size of the mark-up may depend upon product market competition. If the firm is a monopolist, its demand for labour is likely to be less elastic than the average for all firms, and the wage gain will be met by sharing product market rents. For the UK, Stewart (1990) found the mark-up attributable to collective bargaining was dependent upon whether the establishment faced a competitive product market: the mark-up was 8-10% where there was significant product market power, and non-existent where there was none.

The dependence of the bargaining mark-up on product market competition and institutional structures raises doubts about the importance of resulting employment effects in the future. Increased competition in many product markets as a result of the globalisation of markets, and the removal of barriers within the European single market, should reduce the level of rents firms could gain from a dominant market position. As regards institutional changes the two institutions in the UK most associated with the mark-up, pre- and post-entry closed shops, have both now been abolished.

#### **b) Sectoral wage agreements**

Unlike the type of bargaining common in the US and the UK, which has been largely focused on the enterprise level, and has attracted most theoretical and econometric work, the commonest form in most European Union countries is that of industry or sectoral agreements providing a framework for subsequent negotiations at plant and enterprise level. These tend to produce higher rates of coverage than in either the US or Britain and so pose rather different problems relating to pay, and to the uniformity they may impose across an industry.

Blanchflower and Freeman's study showed a comparatively small average union pay differential in some of these countries, and so one might, misleadingly, suppose that the employment effect would be small. However, because such agreements generally set minimum rates of pay to apply across a whole industry, the more relevant effect might be on wage dispersions and on different types of firms, illustrated in Chart 1. For there to be some compression of the lower tail of dispersions, the minimum would need to be set above the rate that would prevail in the weakest firms. Although the employers' organisation might seek to satisfy the ability to pay of all of its members, the union would be unlikely to agree to the minima being dictated by the marginal firms. If they did, workers in the most prosperous firms would probably find their ability to negotiate held back too much, and so would have no incentive to remain within the industry union. They might also favour wage compression for organisational reasons (see below: §3.6).

The effects of such agreements on wage dispersions have not been widely studied, but some fragmentary evidence suggests their potential effects. In Sweden, Hibbs (1990) showed the LO union's solidarity wage policy between 1970 and 1980 was one of the chief factors responsible for reducing the dispersion of wages among contract groups, and blue collar workers. However, the Swedish centralised bargaining system was not typical of continental European models in that it fixed the size of the kitty to be distributed at lower levels, often prescribing how it should be distributed between different categories. It did not set minimum wages along the lines of the French, German or Italian models.

In the absence of analyses of the effects of bargained minima one might look at studies of the effects of minimum wages on pay. The French minimum wage (SMIC) is in many ways analogous to an industry minimum in terms of its functioning, [as was the British sectoral minimum wage system under the wages councils (abolished in 1993)]. Bazen and Martin (1991) found that a 1% increase in the real SMIC would raise real youth earnings by 0.4%. Since young workers are closest to the minimum, this would suggest compression of the dispersion. In the UK, Kaufman (1988) found that the minimum had no effect on average male wages in the sector, and could therefore have only had a very small effect on dispersions of their earnings), but for women, a 1% rise would increase their earnings by 0.07% to 0.15%, combining, according to the authors, a reduction in the dispersion and a 'ripple' effect on higher paid women in the sectors. None of this evidence provides a direct test of how far industry agreements compress the lower end of the wage dispersion, but the results are suggestive.

The other aspect of industry agreements is that they usually consist of two elements: how jobs should be classified, and what rates of pay should attach to individual categories. The two are logically related as one cannot fix rates of pay without defining the units to which they are attached. These constrain employers as concerns both work organisation, as the classification system imposes a degree of uniformity across firms, and rates of pay. Such uniformity can be ill-suited to firms using atypical technologies or organisation patterns. IBM's withdrawal from the German metal industry bargaining machinery on the ground that much of its activity had shifted from manufacturing to computer services provides an illustration of these problems.<sup>9</sup>

### **c) Union bargaining and the pay of young and unskilled workers**

During the 1960s and 1970s, unions in many countries followed policies that favoured the pay of low paid workers, including young workers and the unskilled. The reduction of wage dispersions and skill differentials in many countries, as shown in Table 3, affected young and unskilled workers.

Unions supported national incomes policies which favoured larger increases for the low paid out of a desire to ensure new labour market entrants joined their respective unions. During the 1960s tight labour markets meant that employers competed hard to recruit young workers. Nevertheless, with the break in conditions, in some countries youth pay continued on its upward trend, and in others, a ratchet effect meant that it did not fall back to earlier levels. For the UK, evidence of a switch from excess demand to excess supply in youth labour markets at the end of the 1960s was provided by Merilees and Wilson (1979), and Wells (1983) showed that youth rates of pay did not respond for several years after. In France and Italy, collective agreements did not distinguish between youth and adult rates, a practice which did not appear to harm youth entry in the 1950s and 1960s, but which appears to have damaged their access to jobs from the 1970s [Marsden and Ryan (1986 and 1991)].

Raising relative pay for youth and unskilled workers, and sustaining enhanced levels once the market has turned is likely to be particularly risky for these categories. Layard (1982) and Wells (1983) found that demand was more sensitive to relative wages for young workers than for adults, especially male adults. Layard (1982) obtained demand elasticity estimates of -1.3 and -0.3 respectively for young males and females, with -1.6 and -0.4 for adult females and males for manufacturing blue collar workers 1948-77. For the US, work by Freeman and Anderson obtained similar sized demand elasticities for young, and adult males, and for adult women. Hamermesh's (1986) review including other countries supported their results, with somewhat higher estimates for the US.

By skill, Nissim (1984) estimated higher demand elasticities for unskilled than for skilled labour for UK engineering, ranging from -1.1 for skilled, to -2.3 for unskilled workers.<sup>10</sup> Hamermesh (1986) reported that whereas skilled labour generally emerged as a complement to capital, unskilled labour was a substitute. This, combined with a greater likely substitutability between youths and unskilled adults, would make unskilled employment particularly vulnerable to increases in their relative pay that were not demand-related.

There is thus *prima facie* evidence that, in the absence of accompanying policies to raise skill levels, the raising of youth and unskilled relative wages during the 1970s contributed to their employment difficulties.

#### **d) Bargaining and 'rate-for-the-job' rules**

Another source of reduced wage dispersions associated with collective bargaining is the use of 'rate-for-the-job' rules, so that a common rate of pay applies to all workers in a given occupation or category irrespective of individual differences in productivity. Such rules might be deemed to raise the relative cost of employing less efficient workers, and to reduce incentives for the more efficient within the same job categories.

One important reason for the prevalence of such rules is that they are easy to monitor and to enforce. If a collective agreement were to allow management to vary the rate of pay in line with its valuation of a worker's productivity, the union, and its members, would have no easy way of gauging whether the employer was respecting the agreement or not. Since employers are better informed about current and likely future sales, there is an information asymmetry which gives them a strong bargaining advantage over individual workers.

Another important reason for such rules is that in large firms, the administrative cost of establishing individually variable pay is high. Therefore, unless the variability of work demands within a particular job category is great, which it often was not under tightly supervised and tayloristic patterns of work organisation, pay differentiation is unlikely to be economic.

Such rules may limit job openings for less efficient workers as employers are likely to filter them out in the recruitment process. If rate for the job rules are motivated primarily by union policy or by employers' administrative convenience, then it is likely that such workers will be penalised.

Rate for the job rules have proved particularly damaging for youth employment. Several European countries, by insisting on all workers being paid the same rate for the job, have penalised young workers, whose productivity is lower than that of adults. Garonna and Ryan (1986) identified two policies: one of regulated inclusion, under which a special status is created for young workers so that they may be hired at a special trainee or youth rate of pay; and one of exclusion, under which no such discounts apply. The conditions for regulated inclusion are discussed in a later section (§3.5), but exclusion generally arises because adult workers fear substitution by cheap young workers unless there is some way of regulating recourse to them by employers. Garonna and Ryan attribute the small size of youth differentials in Italy and France, as compared with Britain and Germany, to this effect, and hence the lower levels of youth employment there compared with countries where regulated inclusion is practised.

## 2.2 Reduction of incentives

Some policies pursued through collective bargaining may damage employment by reducing incentives. One instance of this is by means of rate for the job rules. Another is by policies to reduce skill or other pay differentials. Both factors have generated a good deal of practical action. One reason for the popularity of 'merit pay', or performance related pay policies is the belief that they enable management to motivate employees to achieve higher standards of performance [Marsden and Richardson (1994)]. The compression of wage differentials, on the other hand, was one factor in the revolt of skilled workers and supervisors against their own unions in Italy in 1980, and a factor in the breakdown of central bargaining in Sweden. The theory of 'efficiency wages' has gone furthest in attempting to explain why employers might seek pay differentiation within job categories, and in particular why they might pay above the competitive market rate for particular skills, especially where jobs demand a high degree of employee discretion so that the quality of work cannot be easily monitored. As a result, employers depend upon how conscientiously workers do their jobs. It is argued that they can ensure higher quality work either by increasing the cost of dismissal to the workers, or by inducing better motivation. According to the first, employers pay above the competitive market clearing rate in order to strengthen the sanction of dismissal. According to the second, by paying more, they induce a feeling of reciprocity among the workers so they feel obliged to work better [see Akerlof and Yellen (1986)].

There have been a number of attempts to apply the theory to wage data [eg. Dell'Aringa and Lucifora (1990), Lang and Leonard (1987)] but they provide at best indirect tests of the potential impact of rate for the job rules, so it is difficult to gain any idea of their possible magnitude.

A major difficulty with the theory, and thus with the feasibility of alternatives to rate for the job rules, except for higher management, is that it is very difficult to measure employee output to the satisfaction of both management and employees. Bishop (1987) cites evidence that the correlation between the ratings of the same employees by different supervisors is quite low. Hence, employee confidence in the fairness of evaluations is likely to be low, and the potential for causing demotivating jealousies among staff is high. Thus employers may be deterred by the risk that the extra productivity gained by motivating high performers may be less than that lost because of conflicts over evaluations. Therefore, for most employees, the arguments about the efficiency loss due to rate for the job rules are finely balanced.

Pay differentials for skill and responsibility are widely held to play an essential part in the functioning of an effective labour market. It is worth distinguishing job movements between firms from those within the same internal labour market. It seems that once workers have entered an occupation, wages play only a small role in reallocating labour among firms and between industries [OECD (1965), Mackay et al. (1971)]. Although workers with occupational skills are somewhat more likely to change firms than those with enterprise specific ones, many employers seek to retain their more skilled labour whatever the type of market to which it is integrated. In contrast studies of new entrants suggest that supply is sensitive to relative starting wages, especially among young males [eg. Zabalza et al. (1979) on UK teachers, and Freeman (1971) on US college trained engineers]. Thus, union policies compressing differentials for skill and responsibility are most likely to affect mobility among the latter category.

As concerns the motivation, and readiness to accept promotion of incumbent workers, the effects of reduced differentials are harder to gauge. If their external mobility is reduced by firm-specific skills and other costs of job changing, internal pay relativities may be more important. Anecdotal evidence suggests some sensitivity. In both Britain and Italy, in the late 1970s, when differentials for skilled and supervisory staff had been compressed, many employers complained that they could not pay their skilled and managerial staff adequately. The revolt of the skilled and supervisory staff at Fiat in October 1980 against the policies

of the main Italian unions which had promoted greater equality was generally seen as a manifestation of the same problem. However, in both countries this evidence remains ambiguous between inadequate levels of relative pay and feelings of unfairness caused by their recent reduction.

How important such questions are may depend in part on the type of management structure adopted. It will be argued below (§3.6) that certain kinds of structure, notably those placing a greater emphasis on co-operation and team work, may require smaller occupational differentials than more hierarchical models.

### **2.3 Hiring and firing restrictions**

In a recent study, Büchtemann (1993) distinguishes between job and employment security at the enterprise level, the former relating to workers' probability of retaining employment in their current job, and the latter, to retaining a job with their current employer.

In practice, most collective agreements which protect workers in the event of lay-offs relate to employment rather than job security. Even then, employment security is usually treated as an objective to be sought rather than a guarantee. Employers are expected to use what measures they can, including retraining and redeployment, before, finally, using permanent lay-offs [Büchtemann (1993), Gennard (1979 and 1986), Yemin (1982)].

Precise estimates of the costs of laying workers off are difficult to ascertain because regulations vary from country to country, and because they may be enforced with varying degrees of severity. Indeed, where lay-offs depend upon agreeing appropriate measures with worker representatives, as is the case in Germany and France, the cost will vary according to the degree of cooperation forthcoming from workforce representatives.

A second consideration is that in many countries, employment security provisions have not been imposed by legislators upon reluctant employers, but have been agreed initially between employer and employee representatives. Such was the case in France where the 1969 iron and steel agreement, and national inter-industry agreement paved the way for subsequent legislation [Reynaud (1969)]. In Germany, the basis of much of the employment security provisions applicable during enterprise rationalisation (consultation, retraining, redeployment, and lay-offs) was established in a wave of industry agreements on rationalisation between 1964 and 1968 [Delamotte (1971)]. These preceded the enhanced powers given to works councils in this domain by the 1972 Works Constitution Act. Hence, the law cannot be considered to be independent of union and employer preferences in this domain.

The agreement of employers to employment security provisions does not preclude possible adverse effects upon employment. First, there may be significant side-effects experienced by other groups (externalities). Secondly, many such agreements were made in the 1960s when employment problems were different. Thirdly, whatever the possible compensating advantages employers may gain, many perceive the provisions as a disincentive to further hiring.

Although agreed provisions on lay-offs may reflect the trade-offs between the objectives of employers and employee representatives, not all parties are equally represented. Typically, large firms and their employees are more influential in employer and worker organisations. Large firms may find it easier to anticipate potential redundancies and to provide employees with advance notice. Because they are engaged in a wider range of activities, they may find it easier to redeploy staff to other activities, than would small

firms. Among employees, more senior, skilled, male workers are frequently better represented in works councils and unions than are young unskilled workers, women, and ethnic minorities [Fürstenberg (1969)].

In fact, allowance is frequently made for such interests in lay-off provisions. In several countries size thresholds exempt the smallest firms, and length of service thresholds often exempt employees with less than two years service. As a result, a great many of the employees laid off receive no compensatory payments, and of those that do, only a very small proportion receive large payouts. Such factors, according to Büchtemann (1993), help to explain the generally small employment effect detected for employment security measures [the one major exception being the study by Lazear (1990)].

However, Flanagan (1993) argues that, in European Union countries, the persistently high levels of unemployment, as compared with Japan and the US, appear to result from greater reluctance among European firms to hire new labour. Hiring rates declined sharply in Europe in 1970s and 1980s [OECD (1986)] and European firms began to adjust to external shocks by varying hours of work more than employment. This, he argues, is tentative evidence that 'insider' interests have come to weigh more heavily than those of 'outsiders' in economic adjustment. The evidence, however, is tentative.

The reluctance to hire is a particularly serious problem, if Flanagan's argument is correct, because it explains the greater concentration of unemployment on a smaller number of individuals, who remain unemployed for a much longer time than in the US. In addition to the human cost, such workers see their skills and future ability to work decay. There is thus a decline in the effective labour force available.

Employment protection measures may also affect the distribution of employment conditions. If the exemptions from employment protection provisions make it cheaper for certain types of firm to hire certain kinds of labour, then the effect may be not to cause lower employment, but rather to encourage a form of segmentation in employment. The emergence of this kind of dualism has been suggested by Atkinson and Meager (1986). However, the radicalism of their predictions, and the extent to which firms were consciously using this model in the UK has been contested strongly by Pollert (1988) and Hakim (1990) using labour force survey and WIRS follow-up data.<sup>11</sup> Nevertheless, the three sets of findings would be consistent with some employers responding in a piecemeal fashion to the increased cost of laying off certain categories of workers. In addition, because employment security provisions in the UK are felt to be among the least stringent in Europe (see below), such tendencies may be less developed there than elsewhere. In Spain and France employers have made widespread use of measures to facilitate hiring on short-term contracts.<sup>12</sup> Often these are followed by hiring on a standard employment contract so they have served as part of the induction and screening process. Since one of the greatest costs in recruitment is that of selecting the wrong person, the advantages of induction contracts to employers should not be underestimated. Special employment contracts for young workers have been widely used indicating their popularity among employers. In countries where standard rates of pay apply to workers of all ages, such measures enable young workers to be hired at more economic rates without threatening the integrity of collective agreements and employers' salary systems.

In European countries, the big wave of employment security agreements and laws occurred between the mid-1960s and the mid-1970s at a time when unemployment was rising, but low by current standards, and employers and unions were keen to deal with problems of technical change and rationalisation of production. The overriding problem then was to persuade workers to accept changes in production organisation which would threaten the future need for their skills (and semi-skills). Thus, employers were paying for greater flexibility and acceptance of change. Once set up, such schemes are difficult to change.



So it is possible that even though employers had agreed to these procedures, they have ceased to be appropriate.

Many European employers, according to a 1989 opinion survey, regard the difficulty and cost of laying people off as a factor reducing their willingness to hire new labour [European Commission (1993)]<sup>13</sup>. There was considerable variation among countries in 1989, with relatively small percentages of employers claiming the costs were restrictive in the UK, and above average percentages in France, Spain, the Netherlands and Italy. More detailed figures available for 1985 showed that one third of industrial employers believed that inadequate flexibility of procedures for hiring and laying off was a 'very important' factor in their not hiring additional labour. Only in Germany, the Netherlands and the UK did more than one third of employers feel it was 'unimportant' [Nerb (1986) 74].

Although these are opinions, and the firms were not asked to specify for which categories of labour these remarks applied, they are given some additional force by the inverse correlation between the EC's index of employment protection and the rate of dismissals, and the positive correlation with use of early retirement. The former indicates that the measures discouraged lay-offs, and the latter that they encouraged substitution of alternative job-reduction measures<sup>14</sup> [European Commission (1993) Ch. 7].

#### **2.4 Labour utilisation and competitiveness**

Collective agreements and unwritten workplace custom can exert a considerable influence on patterns of labour utilisation, and thus favour or hinder productivity growth. In the short-run, such practices may increase employment, as indeed has sometimes been their purpose, but this is only sustainable, in a competitive economy, in the medium term if those concerned accept lower pay. Even this result may not be sustainable in the longer run as new generations of skilled workers find the better pay of other firms more attractive, so that the average quality of the workforce involved gradually declines.

In an economy in which adjustment costs are negligible, such a result may have few repercussions beyond those workers and those firms bound by such practices. However, this is rarely the case, and it can take a considerable time for a national economy to recover from the loss of a major industry which has failed to remain competitive. The catastrophic loss of market share by UK-based automobile firms during the 1970s had far-reaching effects on component suppliers, research and development, not to mention firms which supplied goods and services to car workers.

Thus, one has to consider agreed practices which inhibit the efficient use of labour and organisational change because of their likely indirect effects upon employment and unemployment in the longer term. Labour utilisation in the firm can be considered under two main headings: (i) constraints arising from rules or commitments to using labour in a particular way which lead to under-utilisation of current workforce skills; and (ii) limitations on firms' ability to modernise their human resource management practices.

In a famous study of productivity and unions in the late 1940s, Zweig (1951) warned that it was relatively easy for economists to define 'restrictive labour practices' in terms of lost productivity or increased production cost. However, at the end of his detailed field study of such practices in five major sectors of British industry, he concluded that there was little unanimity among managers in different firms as to whether they were harmful or simply, often, the price to be paid for doing other things effectively. For example, the craft skill demarcations which confine the execution of certain tasks to those who have

completed the appropriate apprenticeship was often seen as a natural consequence of the way vocational training was organised.

There have been many famous cases of monopolistic labour practices which have restricted production, but to rely on such cases runs the risk of reasoning from anecdotes. An alternative approach is to look at the sorts of issues that have arisen in flexibility discussions and negotiations between unions and employers in a number of countries. The efforts employers have been prepared to put into such deals indicate the gains they expect.

Recent examples much discussed in the flexibility negotiations of the 1980s include:

- US: reforming seniority rules and related seniority districts
- UK: reducing craft and other occupational job demarcations
- Many countries: revising out-of-date job grading systems
- France and Germany: easing restrictions on working time arrangements

**a) Seniority rules**

Seniority rules, by the late 1970s, were identified by many US firms as an obstacle to efficient production. For many years, use of seniority rules in lay-offs and in subsequent re-hiring had served a number of useful functions. It enabled the firm to retain more experienced employees, and to minimise its loss of human capital investment during recession. It provided a degree of predictability to employees which reduced the danger that those with the most marketable skills would leave in anticipation of lay-offs. It helped preserve morale because seniority was an easily observable criterion so that management could be seen to be behaving fairly rather than arbitrarily. Finally, as long as production systems were fairly stable, and work organisation based on narrow, routine tasks, applying seniority rules even for some job progression did little harm to productivity. However, such production systems quite suddenly became obsolete in the late 1970s because of changes in product markets and in production technology. In the automobile industry, for example, Japanese producers managed to provide a wider range of models, with a greater variety of accessories, and to change models more quickly and cheaply, so that it became necessary for the US producers to be able to redeploy labour more quickly between jobs, and to broaden the range of tasks undertaken by skilled workers.

Seniority rules became a major obstacle to redeployment for two reasons. First, new production methods broke the continuity of job progression from one job to another. Training as well as experience became necessary. Secondly, seniority rules imply the prior existence of a group or category of workers who can be ranked by seniority, what was commonly called a 'seniority district'. Movement of workers from one district to another would normally disrupt the working of seniority. If it were transferable, then the seniority ranking in the host district is disrupted; if it were not, then workers have no incentive to accept redeployment. Katz (1985) follows the introduction of more flexible arrangements in the US automobile industry and the removal of many seniority rules, as a part of the recovery programme of the major firms in that sector. Kochan, Katz and McKersie (1986) provide similar evidence for a wider range of sectors stressing the transformation of US industrial relations in the process, with a shift in the focus of union action from job control and seniority to acceptance of joint labour-management and 'quality of working life' programmes. Kochan, Katz and Gobeille (1983) provide some evidence that union involvement in QWL programmes across a sample of GM plants had a favourable impact on productivity, at the very least, because it appears to have enabled management to carry out some of the organisational changes it was seeking. McKersie (1990) has argued that many firms have moved away from seniority towards new

concepts of employment security based on more flexible deployment of labour, and broader job grading systems (discussed below: §4.4).

The other feature of seniority rules, brought out by the studies of Gouldner (1954) and Crozier (1964), is that they reduce management's control over job allocations, and so reduce the rewards at the disposal of line management in order to gain workforce co-operation.

There is no systematic evidence on the distribution of seniority rules across OECD countries. Evidence from France, Germany, and the UK suggest that their formalisation into collective agreements in the US was without parallel in other countries. The studies of Crozier (1964), of Sainsaulieu (1965), and of Eyraud (1983) in France suggest that any such rules were informal, and were not recognised by higher levels of management (which they were in the US, hence their inclusion in collective agreements). Evidence from the German steel industry again suggests that seniority rules in job progression were at best informal and confined to small groups, and were not transferable, and probably not recognised by higher management [Bosch and Lichte (1982)]. In the UK, seniority has been one criterion in lay-offs, but its use in job progression less common, if only because other (craft) principles have been used in job regulation [Eyraud et al. (1990)].

#### **b) Craft and job demarcation rules**

Craft and job demarcation rules which limit management's freedom in allocating work have gained most prominence in the UK, and figured prominently among the labour practices targeted by management in the flexibility negotiations of the 1980s [Atkinson and Meager (1984), Marsden and Thompson (1990), MacInnes (1987)]. In their survey of reported flexibility agreements, Marsden and Thompson (1990) found that about half included clauses relating to improving the deployment of labour, with about one third specifically covering skill demarcations.

As with the seniority rules of the US, skill demarcation rules do not necessarily cause loss of productivity. Apart from the risk to capital equipment and to safety when work is undertaken by inappropriately trained workers, under the persistent conditions of skill shortage that have characterised UK labour markets, strict demarcations could ensure better skill utilisation [Prais (1981)]. Nevertheless, during the 1980s, the removal of particular kinds of job demarcation attracted employers. First, the economic crisis faced by a number of major firms gave management the opportunity to gain acceptance for changes which had been delayed during the 1970s. Secondly, as in the United States, manufacturing management faced the same need to adopt more flexible production systems and to raise quality, both of which transformed previously acceptable working practices into obstacles to efficiency. New technology blurred the boundaries between established electrical, mechanical, and hydraulic skills such that rigid skill demarcations led to poor utilisation. Similarly, as competitors made more use of preventive maintenance, teams of skilled maintenance workers able to work flexibly proved more economical than previous practices. Recent work by Richardson and Rubin (1993) on the work practice concessions made in the working time negotiations in the British engineering industry suggests that this kind of change has continued, enabling further productivity improvement in the firms concerned.

Evidence on the existence of such rules outside the UK is fragmentary. Jürgens et al. (1993) reporting an international comparative study of the automobile industry could find no evidence of such practices in Germany, and the US. Nor is there evidence of such practices in Japan [Dore (1973), Aoki (1988)]. In France, Eyraud (1983) reported no evidence of British style demarcations, but d'Iribarne (1988) has argued that French firms may be characterised by a rule of non-interference in each other's work between levels in the firm's hierarchy, and between different functions. For management to interfere in the

work of another group outside times of crisis, he argues, would offend their sense 'honour' by casting doubt on their competence.

**c) Job grading systems**

Job grading systems have been another major area of change of working practices pressed by employers during the 1980s in order to facilitate easier deployment of labour. This was an important part of the workplace level changes in both the United States [eg. Katz (1985), Osterman (1988)], and also in the UK [Marsden and Thompson (1990)]. It has also figured widely in workplace changes in France [Eyraud et al. (1989)], and in Germany [Schudlich (1991)].

Although apparently very technical, job classifications lie at the heart of the employment relation, and in many countries (with Japan as a notable exception), they provide the vital link in the 'wage-work bargain' by enabling each category of jobs within the enterprise to be priced. In most industrial relations systems, there are complex agreements dealing with how workers should be paid when they are temporarily allocated to other work. Should they retain their initial rate of pay even if the new work is less demanding or less skilled? If so, for how long? And so on. Clearly, the finer the detail of the job classification, the more likely it is that even a small change in the work done will require some variation in the rate of pay. In decentralised shop floor bargaining systems, such as that in Britain, it was not uncommon for even minor redeployment, perhaps to another department, to require first negotiation between first line management and either the worker concerned or his or her shop steward. The broader job categories introduced in the US and in the UK have generally sought to give management greater freedom to redeploy labour as changing circumstances demanded.

Similar changes have also been sought by French employers, moving away from job classification systems based on work posts, which made transfer from one post to another, and adaptation to new skills often very difficult. They have sought to move to more flexible systems based on job evaluation (*critères classants*), although often the influence of the old system has remained strong [Lanfranchi (1988), Eyraud et al. (1990)].

**d) Working time arrangements**

Working time arrangements have also been targeted by employers in order to improve the utilisation of labour and other resources. The main concern of employers has been to obtain working time régimes which are better adapted to short-term fluctuations in demand so as to make it easier to deal with unforeseen problems and peak loads and to enable fuller utilisation of expensive capital equipment. This suggests three main aspects of working time: variability in the length of the working day; variability in the pattern of weekly work and of holidays; and changes in the pattern of shift working. At the same time that employers in many countries have wanted to achieve greater flexibility in working time, unions have wanted to negotiate shorter working hours thereby opening up the possibility of a trade-off.

A fixed length for the working day can lead to underutilisation and raise costs in two ways: customer demands do not always arrive predictably, and some jobs may require specific blocks of time so that they can only be fitted into a fixed working day if they are started early on (eg. train drivers' journeys). Overtime working provides some flexibility, albeit at a cost, but in some countries, there are legal or agreed restrictions on the amount of overtime that can be worked in a given period (eg. in France, the law allows no more than an average of 46 hours worked per week over a twelve week period [Lyon-Caen and Pélissier (1988)]).

Employers in both France and Germany have been concerned to get the law and collective agreements to concentrate on fixing limits to working time over longer periods than one week. Annual working time, for example, would give employers the chance to increase weekly hours during peak periods, and then to offset these by shorter hours in off-peak periods. This would also avoid the cost of paying for overtime hours. They have also been interested in altering shift-working patterns and to increase the use of weekend working in order to extend the time during which capital equipment can be run, or particular services provided.

Legal regulation of weekly hours and overtime can be unduly rigid because the general rule cannot be easily adapted to take account of local or changing circumstances. The general rule may be made more flexible by allowing exemptions, for example, to allow for certain services where there are long periods of inactivity during the day, and to adapt conditions to different categories of workers. It is also often possible to obtain approval from a labour inspector for exceptional treatment. However, such adaptation multiplies the number of exceptions and increases the burden on the enforcement agency, and on firms which may not be aware of the law's complexities. For this, and other reasons, successive French governments have sought to increase the role of collective agreements on the ground that they are more capable of adapting to the needs of particular industries while providing an acceptable level of protection to employees. The negotiations have, however, been fraught with difficulty, not least because the unions are often too weak to provide effective control over enterprise negotiations, and so have been reluctant to lose the protection of the law. Nevertheless, during the 1980s, and particularly after the Auroux laws, a large number of agreements were reached at both industry and enterprise level, many of which dealt with aspects of the organisation of working time [Ministère du Travail (1989)]. The employers appear to have used negotiations on the reduction of working time in order to gain concessions for more flexible patterns of utilisation [Boulin and Taddéi (1989)].

In Germany, although the impulse for negotiation on working time has come from the unions' campaign for reduced weekly working hours, the employers have used the negotiations to press for their own changes such that shorter working time for each worker comes at the price of more flexible working time arrangements [Bosch (1990)].

The contents of flexibility and concession agreements are strong evidence of employers' views of practices that impede productivity since they are prepared to pay for the changes. However, there have been few surveys and data are fragmentary. Other evidence of pronounced national differences in the obstacles to flexibility can be found in opinion surveys of employers.

One such survey from the mid-1980s [Elbaum (1987)] showed that French and Belgian firms were more likely to see insufficient flexibility in hiring and lay-offs as a reason for not increasing employment. In contrast, British firms were more likely to see rationalisation and new technology as a reason. Use of temporary workers, and inflexible working time arrangements were also of more concern to Belgian and French, than to British firms.<sup>15</sup>

One systematic comparison of Britain and France highlighted the greater interest of British employers in increased flexibility of job demarcations and labour deployment, and relatively little interest in working time arrangements. This appeared to be due to the greater emphasis on the defence of occupational based jobs supported by occupationally based union organisation in Britain. In contrast, flexibility agreements in France placed much greater emphasis on working time arrangements, and correspondingly less on job control issues. In the absence of strong principles around which to organise workplace job control, unions focused on obtaining general rules likely to attract a broad coalition of support within the enterprise and within the branch. They therefore focused more on general wage increases for all, and general working

time rules, and built their organisation around the defence of these. Hence, when employers came to seek productivity enhancing changes, the sticking points tended to be those where change affected certain practices which were fundamental to the pattern of job regulation: in Britain, skill demarcations, and in France, working time arrangements [Eyraud et al. (1990)].

## **2.5 Bargaining structure, inflation, and unemployment**

High and variable rates of inflation, by shortening time horizons for investment, depress investment and growth [Leigh-Pemberton (1992)], and thus are bad for jobs. Thus, collective bargaining structures which make inflation more likely could be deemed potentially harmful to employment. This is all the more likely as rising inflation is likely to cause governments to adopt restrictive economic policies.

Concern about whether some types of collective bargaining structures are more prone to inflation than others has a long history. Hicks (1955) suggested that the interaction between the claims of different bargaining groups might generate inflation. For example, suppose that, because of skill shortages, skilled workers covered by local bargaining were able to gain a pay increase, whereas those whose pay was fixed by an industry agreement could not. Adjusting the pay of the latter, which would be justified on grounds of scarcity or fairness, might only be possible if the whole structure of pay rates in the industry were jacked up. Thus, Hicks argued, seeking to maintain full employment with this kind of bargaining structure would be inflationary. More recently, Nickell (1990) has argued that a combination of skill shortages and a fragmented bargaining structure in Britain could make it difficult to reduce unemployment without boosting inflation.

Adjustment to economic changes and shocks which imply adaptation of pay levels may also be impeded by fragmented bargaining structures. Under such conditions, no single group might be willing to allow its pay to decline in response to the new conditions out of the fear that it would be the only one so to do. The collective situation resembles that of the 'prisoner's dilemma' in which the expectation or fear of a lack of reciprocity by the other parties discourages any one party from being the first to make concessions, all refuse, and adjustment falls on employment rather than wages. As in the previous example, government attempts to maintain employment translate into inflation.

During inflationary periods, persuading pay bargainers to moderate their claims has encountered similar problems. Aubrey Jones (1973), former head of the National Board for Prices and Incomes, argued that 'wage-wage' inflation had come to dominate as each group fought to avoid being left behind by the others.

The degree of fragmentation of bargaining structures is critical. Extreme fragmentation may leave bargainers with little market power so that agreed rates correspond closely to their competitive levels. However, it becomes more of a problem as groups increase in size and acquire more bargaining power [Crouch (1985)]. A number of writers have argued that such 'prisoner's dilemma' problems are particularly common where bargaining groups are sufficiently large to exert a degree of market power, and to compete with each other for prestige or membership, but in which no one group is sufficiently large to provide stable leadership.

Clearly, such processes can only take effect if employers have the ability to pay which depends partly on monetary policy, and partly on other income recipients, and income for other purposes being squeezed. Tightening monetary policy will restrain inflation by curbing demand, and thus employment, but it may not always be the employment of those with most bargaining power.

### **3. Sources of flexibility in industrial relations systems**

The picture so far is one in which collective bargaining appears to have a generally negative effect upon unemployment as compared with competitive labour markets. Use of bargaining power is likely to distort competitive wage structures and lead to some workers being excluded from jobs they would accept. Restrictive working practices, even if originating in rules set by management, slow productivity growth, and harm the competitiveness of the firms concerned. And as the bargaining structures common in most industrial countries, are neither wholly decentralised nor wholly centralised, they appear to do badly in terms of higher than necessary inflation and unemployment.

Against this rather negative balance sheet, a number of more positive features of collective bargaining must be set before any final conclusions may be drawn for policy. Many of these features are often neglected in the discussion of institutional influences on unemployment. They suggest a number of positive benefits from working through collective bargaining and other forms of employee representation, and by examining some of the less visible forms of flexibility contained within collective institutions and how they have been adapted in recent years, it is possible to identify some areas of reform which could help combat some of their unemployment effects.

#### **3.1 Role of employers in setting up IR practices**

The discussion of bargained rules often proceeds as if they were imposed unilaterally by unions on unwilling employers, and as if rules of a similar nature would not be adopted by employers even in the absence of such pressures. In practice, collective bargaining usually brings together powerful organisations on both sides, each capable of inflicting heavy costs on the other. Therefore, one must consider that a good proportion of the outcomes reflect a compromise between the objectives of employers and worker representatives. Indeed, one of the historic arguments advanced to justify workers' collective action is that it helps to redress the imbalance of power that would otherwise exist in labour markets between firms, especially large ones, and individual workers. Moreover, even in largely non-unionised sectors where collective bargaining has little direct influence, one can often find the same characteristics of inertia in wages and employment with respect to labour market fluctuations. Some of these issues will be dealt with in greater detail in the working paper on management practices, and so will not be considered further here. However, because employment security regulations have attracted so much attention in the discussion of unemployment, and especially, the apparent reluctance of European employers to hire new labour, it is worthwhile delving deeper into the role of employers in this issue.

As illustrated in the earlier discussion of employment security agreements, in several countries, such as France and Germany, collective agreements between employers and unions at both sectoral and national level preceded legislation in this area, and provided a model for the type of provisions to be included. Far from conceding simply to worker demands for greater employment security, the agreements were mainly concerned with promoting organisational change and rationalising production, both of which would have serious employment consequences. In the steel industry, which pioneered such agreements in France, and in other mass production industries, a great many workers had skills that were not easily transferable, and would be rendered obsolete by the changes. The same applied to middle management employees whose skills lay primarily in their previous work experience and their detailed knowledge of their particular organisation and its work norms. With the potential loss of jobs and skill obsolescence, workers' morale could easily collapse, and with it, the ability of the firms to implement their change programmes. Management had also to ensure that once the first wave of changes was complete, the employees remaining would work effectively and willingly.

Because of the likelihood of further changes, management could not just introduce change unilaterally, and expect those workers remaining to work hard simply out of gratitude that they had survived. It was therefore necessary to set up a framework to discuss the implications of change, and agree the measures needed to minimise the cost to employees. In some OECD countries this took the form of ex ante agreements about procedures, while in other, reliance was placed upon customary methods for working out arrangements as the need arose [Gennard (1979)].

It might be objected that such arguments are valid for voluntary but not for legally based employment security rules which set more costly provisions. Nevertheless, in many countries, employment law has been used to set minimum conditions sufficiently low to enable worker representatives and employers to agree locally the arrangements which suit their needs best. The law has often been modeled on existing agreements, particularly as concerns consultation procedures.

### **3.2 Bargaining structures that avoid wage competition**

It was argued earlier that certain kinds of pay bargaining structure were likely to harm employment levels because governments would need to restrain their inflationary tendencies by running the economy below capacity (§2.5). One solution to the problems of competitive pay bargaining, and to the reluctance of bargaining groups to make economically necessary concessions under fragmented bargaining has been to propose greater coordination by means of centralised bargaining.

Blyth (1979), intuitively, and Calmfors and Driffil (1988), more formally, have argued that centralised bargaining systems should be less prone to inflation than more fragmented ones. The Calmfors and Driffil argument rests on the interaction of two opposing processes. As bargaining units increase in size from the plant or enterprise to the central level, their bargaining power increases. However, as the coverage of collective agreements increases, so it becomes harder to escape the negative consequences of individual settlements, and easier to benefit from any sacrifices they might make in the general interest [Olson (1971)]. The latter force serves to moderate unions' use of bargaining power, and enables bargainers to take a longer term and more moderate view.

However, the bargaining power of groups with an intermediate degree of centralisation, is only partly moderated by their limited inclusiveness. Those which aim for non-inflationary increases can find themselves in a classic prisoner's dilemma as they cannot control the behaviour of rival bargaining groups. Individual unions have only limited incentives to pursue moderation, and individual employers have little incentive to resist such claims if facing down a strike will result in loss of market share and possibly only temporary advantage in costs. Hence, economies in which bargaining structures are neither wholly decentralised nor highly centralised can be very vulnerable to wage inflation.

The impact on employment may come through several channels. Vulnerability to spurts of acceleration of inflation may discourage investment or force governments to adopt restrictive macro-economic policies which use unemployment in order to restrain bargaining pressures.

There is some evidence supporting this view. Between the 1970s and 1980s, countries with centralised bargaining systems, and those with highly decentralised ones tended to score better on both inflation and employment [Paloheimo (1990)]. However, the indicators of bargaining structure used are rather subjective and the results hinge on changes in the rankings of countries by degree of centralisation [eg. Soskice (1990)]. Moreover, the influence that central organisations wield or try to wield over bargaining outcomes at lower levels varies over time, as does the degree to which strong union organisations use their power aggressively or cooperatively.



### 3.3 Flexibility within industry agreements

The earlier discussion of industry bargaining (§2.1) focused on its action in compressing wage structures. However, in practice most industry bargaining systems set minimum rates of pay, or some analogous indicator, and leave considerable room for additional negotiation (although not always bargaining) at the enterprise and establishment levels. It might be objected that such flexibility always involves additional payments by employers. There have been occasions when employers have complained that what was agreed at industry level was reopened for additional negotiation at the plant and enterprise level.<sup>16</sup> However, the target for employer organisation negotiators is to obtain a settlement such that the combined outcome of the industry and company level negotiations accords with its members' business plans. Public statements to this effect are rare for the obvious reason that they would then become the minimum target which the union could sell to its members. Nevertheless, in the days of the heyday Swedish centralised system, calculations of expected wage drift from plant and enterprise bargaining were common. Thus, one can expect the likely effect of subsequent discussions over pay to have already been taken into account in deciding what employers can accept at the industry level. Indeed, if that were not the case, many employers would probably resign from their organisations (as occurred with the flight of small and medium-sized firms from the German metal industry employers organisation in 1993 over the wage convergence agreement).

'Articulated bargaining' [Giugni (1965)] might be a less misleading term to describe industry bargaining in which the industry level sets a framework for discussions at the local level in order to adapt the agreement to the conditions of different firms and different localities. The basic principle is that lower levels of negotiation should not contravene what has been already agreed at a higher level. The degree of freedom left to local negotiators can of course vary, depending on how closely the parameters for lower level agreements are set, and how much bargaining room is left by substantive terms agreed at the industry level.

Although there is a lot of institutional information on the scope for industry-level agreements to be adapted to the conditions of individual enterprises, the most telling evidence is to be found in studies of the pay mark-up, or 'wage gap'<sup>17</sup>, determined at enterprise and plant level in Germany, Italy, France, and Sweden.

#### a) Germany

Teschner's (1977) study of works council wage policies in the metal, chemical, textile and tobacco industries found that the wage gap between industry minima and average gross earnings in individual plants varied between 5% and 40%. The size of the gap was correlated with regional unemployment, sector, and the type of payment system in operation. The wage gap was also higher for skilled than unskilled workers with an unweighted mean across plants of 23% as against 17%, suggesting that employers have the scope at enterprise level to adjust skill differentials modestly according to their individual needs.

More recently, Meyer's (1991 a and b) survey of 103 small and medium-sized firms in Niedersachsen and Baden-Württemberg found that 80% of the firms applied a wage agreement. Of these, 15% paid only the rates set in the industry agreement. The others, on average, paid 14% above the industry rate. The main variables associated with this increase were: presence of a works council; number of vacancies; level of training; and (inversely) the percentage of women. Among these small and medium sized firms, there appeared to be little difference in mark-up by size.

These two surveys suggest that economic pressures at the enterprise, notably, recruitment and skill levels, do indeed affect the size of the wage gap, and are evidence of some capacity of pay levels set at the industry level to adapt to local pressures.

#### **b) Italy**

In Italy, the scope for enterprise bargaining and pay supplements unilaterally decided by the employer was greatly squeezed by the indexation system in force from 1977 and by unanticipated inflation [de Luca (1987)]. In 1976, according to employer federation (Federmeccanica) data, the wage gap between gross earnings and the minima set in national industry agreements in the metal industry was 28%, this being the result of local bargaining and employer supplements. It remained steady until after the reforms of 1984, climbing to 43% in 1990 [Asap (1993), Appendice Statistica]. Data for the Lombardy employers [Assolombarda] give similar, but slightly lower estimates of the gap for metal industry employers in the Milan area: up from 26% in 1983 to 37% in 1991.

The agreements of 1983 and 1984 reduced the degree of indexation and Assolombarda data show a decline in the share of pay determined by indexation, from 44% in 1983 to 39% in 1991 [Asap (1993), Appendice Statistica III].

The same sources show a steady increase in the wage gap for the Milan metal industry in 1991, from 15% for unskilled to 23% for the highest skilled, and from 14% for junior clerks to 93% for the highest level of managers still covered by collective agreements [Asap (1993)].

One can only surmise on the scope for adaptation by individual firms as data are not shown at this level. However, de Luca (1987) records quite large differences between industrial sectors. For 1984, about 25% in textiles and clothing, about 45% in chemicals and pharmaceuticals, and about 30% in the metal industry. In addition, the Assolombarda data show that, in 1991, individual premia added 18% to industry minima: ranging from 2% for blue collar workers and 17% for white collars, to about 40% for managers covered by collective agreements. This suggests that employers have a significant margin with which to respond to labour market and motivational needs.

#### **c) France**

In France, the gap between industry rates and enterprise pay levels is often considerable, and has increased in recent years. Eyraud, et al. (1989: p.159 ff.) found that average basic pay in their sample of plants was considerably above the industry agreement minima.<sup>18</sup> In metal industry firms, lower paid manuals were paid 20-60% above the industry minima, about 20% when blue collar workers were in the majority, and up to 60% when white collars were in the majority. Higher paid white collar workers were also well above the industry minima for their grades. So, establishment level factors provide a considerable mark-up, and also alter the structure of pay, particularly for the larger firms and market leaders which made up the bulk of their sample. Interestingly, the wage gap was not uniformly greater for more highly classified workers in the plants studied, suggesting a margin for adapting wage differentials within the enterprise. The authors concluded that industry agreements served as a benchmark for annual pay increases, and a guide for wage structures.

In France, industry agreements also leave individual firms with a good deal of freedom to develop their own policies on other remuneration issues such as fringe benefits. A study by the CERC (1987) identified four distinct types of policy which appeared to be pursued whatever the industry agreement concerned.

- Type 1. Firms where employment is regulated by a set of stable rules; mostly large firms able to develop their own practices in agreement with their unions; they gain freedom from sectoral agreement because they can do what they like provided benefits exceed the branch minima;
- Type 2. Firms with organised flexible management: relative weakness of institutional constraints;
- Type 3. Firms with unorganised flexibility: industry agreements are relatively unrestrictive, and there are no enterprise agreements;
- Type 4. Construction industry: low level of local bargaining activity, low pay, but relatively high fringe benefits financed at sectoral level.

The authors concluded that the diversity of firms' practices within sectors highlighted the relatively weak influence of sectoral agreements on firms' practice in France.

In general many EU countries provide a good deal of flexibility at the enterprise level, increasing with the greater use of additional enterprise level agreements. The main employment problem would seem to lie with the marginal firms and unprofitable sections of industrial bargaining groups discussed in the first part of this paper. Two problems will need to be discussed later: whether there are ways of making industry agreements more responsive to the needs of firms going through a temporary crisis, and whether they can be linked with certain active labour market policies.

#### **d) Sweden**

Sweden has had a different model whereby central bargaining set the aggregate increase in the wage bill for each industrial contract area. This 'wage pot' or 'kitty' could be distributed as local bargainers decided, and its size was usually determined in relation to the growth of the total wage bill [Hibbs (1990)]. At various times, the central agreement also set norms for its distribution, for example, that the lower paid should get special increases. When in force, the solidarity wage policy imposed an equalising effect by specifying how the 'wage pot' or 'kitty' was to be distributed at lower levels.<sup>19</sup> Apart from that period, the model provided a good deal of room for adaptation to local conditions, and has indeed been introduced as a part of the government's strategy to decentralise pay determination in the public sector [Schager (1993)].

#### **e) Japan**

The Japanese case offers an interesting variant in which pay bargaining takes place at the enterprise level between management and enterprise unions. However, the latter are grouped into industry federations which coordinate bargaining strategies among their members. In addition, the national union and employers' confederation coordinate the activities of their constituents at the national level. To assist coordination, and to avoid problems of some groups holding out until after the others have settled in the hope of gaining a better increase, with all the problems this entails for obtaining a first settlement, bargaining is concentrated in a short period in the 'spring offensive' [Dore (1987)].

Additional scope for individual firms to adjust their own pay increases is provided by the annual bonus which can represent the equivalent of several months base salary [Nohara (1992)]. This is decided at company level once its financial results are known, and may also be the subject of bargaining, but outside the spring offensive. According to Hashimoto and Raisian (1988) the average bonus for manufacturing varies roughly in proportion to production (a 10% change in production producing an 11% change in the

bonus) thus affording some variability in employers' labour costs. In 1978, average bonus stood at roughly 20% of total benefits. Although that would give an average margin of variation of only  $\pm 2\%$  of benefit costs, it may provide more scope for variation among firms.

### **3.4 Agreed frameworks and cooperative exchange**

There are three broad arguments concerning positive effects of worker representation on productivity which mitigate some of the efficiency losses discussed earlier. The first concerns the 'union-voice' argument of Freeman and Medoff (1984), the second, an analysis of the reasons for restrictive work practices, and the third, the conditions for 'cooperative exchange' within the enterprise.

#### **a) The union-voice argument**

The union-voice argument stresses the value of the information management obtain when they learn about worker grievances and their likely causes. When acting individually, workers may express their grievances to management ('voice'), they may quit the firm ('exit'), or they may grin and bear it. If they quit, they will probably take with them valuable information about the causes of their discontent, which could be due to too heavy supervision, bad working conditions, badly organised work, and so on. They will also take with them any investment management has made in their skills, and replacing them may prove costly. In addition, the firm's most marketable employees are those most likely to quit. These costs may be avoided if management can discover the cause of discontent, but when employees express their 'voice' individually, they risk being seen as trouble-makers. Moreover, their colleagues, who stand to gain from the improved conditions may prefer to keep their heads down, and 'let Harry do it'. On the other hand, collective representation can protect those expressing grievances on behalf of their colleagues. Thus Freeman and Medoff (1984) argue that unions are necessary to provide 'voice', and that by this means, management can learn about the causes of employee discontent and avoid the resulting costs.

Management has some alternative channels for employee voice at its disposal, for example, surveys of employee opinions, and encouraging first line management to be more active in discovering the causes of employee discontent. Although these can provide valuable information, they are not independent of management. Hence, employees may still fear victimisation, particularly if first line management is also responsible for performance appraisal and merit awards.

The evidence that union representation raises productivity has been extensively reviewed. Data problems are severe. The great majority of studies in the United States indicate a positive effect on productivity, but a negative effect on other variables of company performance, such as profits [Belman (1992), Addison and Hirsch (1989)]. Those in Britain paint a more mixed picture.

#### **b) Restrictive work practices and 'low trust'**

Restrictive work practices are often motivated by defensive rather than monopolistic considerations. Sometimes they are embodied in formal agreements, but more often they are informal customs developing within individual workplaces, and sometimes extending across many firms. Brown's (1973) study of workplace custom in British engineering firms showed that often the sources of customary rules were in fact management decisions and tolerances. In most work environments, informal workplace custom plays an important part in regulating the relations between management and workers because it is almost impossible to make explicit all the tasks workers have to undertake in exchange for their pay. Coase

(1937) argued this was why the employment contract usually contained the presumption that the employer would have the 'right to manage' and to direct what work was to be done subsequently. However, management's authority to detail work exists only within certain limits of what management and workers consider a fair and acceptable exchange. But because the detailed tasks to be undertaken are not specified, the exact limits of management's authority cannot be made precise. In addition, firms have to cope with changing markets and changing demands, some of which cannot easily be forecasted, so management has to be able to vary the demands made of its workers if the firm is to survive.

In such an environment, custom plays a very important part in determining what are the demands management can make, beyond which workers may legitimately refuse additional requests. In some environments, a great deal of workplace custom is regulated by small group bargaining, as was the case in the British engineering firms studied by Brown. In the United States, such customary rules often had to be incorporated into legally binding collective agreements, although the day-to-day interpretation would still rely heavily on informal agreement. In the French firms studied by Bernoux (1972), Crozier (1964) and Sainsaulieu (1988) such custom was more fragile, relying on implicit understandings between supervisors and work groups, which were not recognised by senior management. However, supervisors could not work without them, and so had to connive with their work groups.

If such rules are part of the normal give and take between management and workers in adapting to the changing needs of firms, why should they sometimes become obstacles to change, and why should they be any more restrictive than the terms of any contractual agreement?

One important reason is that workers (or management) come to fear that the other party is seeking covertly to alter the terms of the agreement in their favour. If workers were confident that management would faithfully report the changing value of their output and pay them accordingly, there might be less need to insist on easily monitored 'rate for the job' rules. Equally, if they were confident that the employer would seek to minimise redundancies, and not use lay-offs to get rid of those who have presented grievances, they might insist less on strong seniority rules in lay-offs and in bidding for internal vacancies. Similarly, restrictive job demarcation rules which go beyond the needs of technical competence provide skilled workers with a buffer against employment insecurity.

Monopolistic motives may also be present, but these are often limited by the need for the support of other groups of workers. Brown (1973) stressed that shop stewards' ability to defend work customs that were advantageous to one group depended upon their ability to convince other work groups that they were acceptable. His study cited cases in which shop stewards supported management against the claims of some groups, albeit based on custom, that threatened the good faith of their relationship with management and their ability to sustain the support of other groups. D'Iribarne (1988) similarly stresses that the stability of customary relations of non-interference in each others' work ('honour') he found in French firms depended also upon willingness to moderate claims that threatened other groups.<sup>20</sup> There is less likely to be sympathy and support from other groups for one which defends a customary rule for monopolistic goals than for one which does so to defend its livelihood.

One reason why such rules appear to be less restrictive in German and Japanese firms is that employment relations function at a higher level of trust between workers and their employers, at least for their core workforces. With a high degree of employment security, provided in the German case by widely recognised skills and fairly long job tenures, and in the Japanese one by the implicit understanding of company-based employment and basic income security, many of the defensive measures discussed earlier become unnecessary. Added to that, the methods of workforce representation, based on works councils in Germany and strong enterprise unions in most large Japanese firms, remove the need for workers to organise

their own defensive practices. In both countries also 'rate for the job' rules play a smaller role, job rotation playing an important part in training, and in Japan, the link between seniority and pay and the bonus system outweighs the influence of the current job on pay [Nohara (1992)].

c) **'Cooperative exchange'**

'Cooperative exchange' as a source of greater productivity has come to the fore as a result of research on work organisation in Japanese and German firms. 'Organisational slack' or 'X-inefficiency' is widespread in all organisations, and much of the information needed to reduce this lies with employees at or near the job level. Under the low trust conditions which prevail in many firms, and which are encouraged by tight managerial control, and an insistence on contractual obligations, workers have little incentive to share this information with management. If anything, they have every incentive to use it to make their own jobs easier, and to withhold it from management in case it is used as a reason for reducing their pay or increasing their workloads [Mottez (1966)].

In organisations with stable markets, management may be able to reduce its dependence on such information by dividing jobs into small units along Taylorist lines, and using close control to ensure work of the right quantity and quality is done. But even this form of organisation is vulnerable. Crozier's (1964) study showed how in tightly organised bureaucratic organisations, management is unable to predict and plan for all eventualities, and that unanticipated problems easily create bottle-necks which then provide a basis for small group bargaining power. Drawing on their research on Japanese and east Asian firms, Koike and Inoki (1990) argue that the degree of uncertainty attached to all markets means that job knowledge inevitably eludes management control, making managers heavily dependent upon workers' job knowledge for efficient organisation. Management might respond to this uncertainty by increasing buffer stocks, but this would tend to reduce the organisation's efficiency. In a low trust environment, management is encouraged to reduce workers' scope for discretion, and this generates a vicious circle [Fox (1974)].

Although sharing information could enhance the firm's performance, in a low trust environment, such cooperation is discouraged by the fear, or expectation, that it will not be reciprocated. Sharing information reduces one's own bargaining power and puts one in a position of weakness vis-à-vis the other parties. Workers could lose some of their control over work rhythms, or even their jobs. Management could find itself paying for productivity which never materialises. A prisoner's dilemma problem emerges, and the gains from mutual cooperation remain elusive.

Most of the strategies for cooperation which deal with the parties concerned in isolation prove to be unstable, including those based on 'reputation' and the use of 'tit-for-tat' strategies. Cooperative behaviour early on could, for example, be designed to trick the other party. In 'tit-for-tat' strategies, in which one party keeps withdrawal of cooperation in reserve in order to punish the other party should it not cooperate, the final round of the game is always problematic. As a result, cooperation in every round is problematic.<sup>21</sup>

The main lesson of the 'prisoner's dilemma' model is that it is each party's expectations as to the other's behaviour which are critical. Even if one party wishes to cooperate, but would be worse off if cooperation is not reciprocated and, it is suspected that the other will not reciprocate, then it is logical to refuse cooperation. Given the importance on expectations in building cooperation, then each party needs to fulfil its commitments. Not to do so could be a signal that one's intentions have changed, so that in future cooperation will not be forthcoming. In practice, worker representatives and employers know that economic life is full of uncertainty, and that not all commitments, however well intended, can be met. The problem lies in distinguishing genuine cases of force majeure in which good faith has been kept from those in which faith

has been broken. The latter would signal changed behaviour and therefore alter the expectations of the other party.

If cooperative exchange is to take place, there is a need for guarantees and sanctions from outside. One solution is for employers and workers to form coalitions with others of their own kind with the power to inflict sanctions on individuals for failure to cooperate. To conserve their power, such coalitions need to be able to police the activities of their own members and to evaluate and encourage action in good faith. In addition to sanctions, which may not always be very effective, they can monitor critical information affecting the ability of local parties to fulfil each others' expectations.

Such would seem to be one of the important functions of the information exchanged between German and Japanese employers and their respective worker representatives both at the industry and at enterprise levels. It would also be one of the reasons why German and Japanese unions have not had to rely upon the forms of 'job control' unionism found commonly in the US and the UK, and why field research has found so little evidence of the workshop level restrictive labour practices discussed earlier in this paper.

These three related arguments, of union-voice, eliminating defensive practices, and cooperative exchange suggest important compensating gains for the presence of forms of collective worker representation. However, the gains are likely to be greatest in those firms where cooperation leads to greater productivity and where work involves high levels of skill and reasonable levels of workers' judgement.

#### **d) The problem of 'low trust cooperation'**

One important counter-argument to the above is that management and workforce may decide to 'live and let live', giving the appearance of cooperation because management refrains from anything which would disturb its relationship with the union. Thus, management might tolerate many restrictive labour practices because the cost, in terms of likely conflict, would be too high. Something of this kind appears to have occurred with the failure of the 'Donovan reforms' in Britain and with the increased powers of factory councils in Italy during the 1970s. In both cases, increased powers for workers and their representatives led to a collapse in productivity as the new institutions failed to generate active cooperation.<sup>22</sup> Instead, they led to a rise of worker expectations which could not be met, and to combative rather than cooperative industrial relations. In Sweden too, the additional representational rights obtained by workers during the 1970s were associated with increased militancy rather than increased cooperation [Kjellberg (1992)].

These observations show that the frameworks for cooperative exchange and collective voice are necessary but not sufficient conditions for cooperative relations. The contrast with the German case is revealing. There, pressures for greater powers for shop stewards, and for direct union-enterprise bargaining were strongly resisted by employers who maintained and encouraged the existing system of works councils. This suggests that employers have a key role in the development of cooperative relations. Although they may be supported by an institutional framework which protects against non-cooperative action, the parties have to build their cooperative practice themselves. Employers and worker representatives demonstrate to each other their commitment to cooperation by the amount they are prepared to invest in it, and this encourages further cooperation. In the German case, during the 1970s, management refused to negotiate with shop stewards, which would have undermined their relationship with the works councils, and the unions and works councils generally kept stewards in a subordinate role.

In contrast, in Britain, Italy and Sweden, many of the additional powers came from legislative intervention or were gained against employer opposition. It was therefore difficult for employers to present

their action within the new institutions as the first step in a process of cooperation and so begin to win the trust of workers and their representatives. As a result, many of the new powers were used as a platform for additional gains at the expense of employers rather than as the beginning of a new era of cooperation, as many of the architects of the reforms had hoped.

### **3.5 Cooperative frameworks for youth inclusion**

There is widespread evidence that youth access to jobs is reduced by high levels of youth pay relative to adults. Yet, in some countries, unions and employers are able to agree low youth rates of relative pay whereas in others they are not. Contrasting six European Union countries, Garonna and Ryan (1990) identify two distinct modes of youth employment: exclusion, and regulated inclusion. Given the persistently high levels of young people's unemployment in Europe, the reasons for this merit analysis.

Marsden and Ryan (1986 and 1990) argue that the problem lies in the acceptability or otherwise of special low rates of youth, and particularly trainee, pay relative to adult skilled workers. Young and adult workers have potentially opposed interests because the former, if engaged on low rates of pay, could become substitutes. Ideally, their lower productivity and need for training and experience should be compensated by correspondingly lower rates of pay. However, there is a potential problem that employers will take advantage of the lower pay, but fail to deliver on the training so that young workers become a source of cheap, substitute, labour.<sup>23</sup> Apprenticeship regulations provide one means by which the status of young trainees can be clearly identified, and their training more easily monitored by adult workers and their representatives. Under such circumstances, skilled adult workers are more likely to agree to special apprentice pay rates, and other kinds of wage for age system.

Where induction training is largely informal and on-the-job, the provision of training and useful work experience is harder to monitor. Adult workers have been less willing to accept special trainee and youth rates of pay in this situation, and have been more insistent on rate for the job rules which apply to all workers, whatever their age or training status. Thus, among the countries Marsden and Ryan examined, Belgium, France, and Italy all fell into the latter category with small or non-existent discounts on youth pay and youth exclusion was the rule. In contrast, in Britain and Germany, apprenticeship rules made low youth rates for trainees more acceptable, and thus facilitated greater youth access to employment: a system of regulated inclusion.

Both this and the previous example suggest that the impact of collective bargaining institutions upon employment depends less upon their existence or otherwise, but on what kinds of policy they pursue. Adversarial relations may be compatible with good overall economic performance under decentralised bargaining, and with relatively simple production processes which are less subject to the dysfunctions of tight management control.

### **3.6 Substantive rules underlying cooperation**

There are two main areas in which workplace cooperation may require substantive rules: a degree of employment security may be necessary to ensure cooperation in job flexibility; and the various institutions of workplace cooperation, and cooperative working itself, may call for smaller occupational pay differentials than would be the case under competitive markets.



**a) Employment security and job flexibility**

One of the biggest problems in achieving cooperative exchange is reassuring workers that sharing information with management will not threaten their own jobs. Passing on ideas for more efficient practices, and helping train fellow workers so that they can work more flexibly or undertake some routine maintenance involve the surrender of a measure of individual bargaining power, and may enable the employer to dispense with certain jobs. Workers may take a long term view of such issues if they believe they will still be employed by the firm when the benefits start to accrue.

**b) Cooperative exchange and wage hierarchies**

It has been common to contrast two types of management organisation: in one it exerts central control and plays the role of a specialist coordinator; and in one a greater part of the coordinating activities are undertaken by work teams sharing information, and management, as a specialist coordinator plays a smaller part. Studies of Japanese management indicate that positions of authority are less sharply delineated than in many western firms, and that greater reliance is placed upon coordination through teams [Aoki (1988)]. Comparing British and Japanese software engineers, Lam (1994) has shown that work roles are much more sharply delineated in the UK whereas in Japan overlapping work tasks between jobs, and systematic job rotation leave much more coordination done between work teams rather than through specialist coordinators.

Where firms use specialist coordinators, there are strong arguments for concentrating rewards on those in these key positions [eg. Alchian and Demsetz (1972)]. Substandard performance in these roles is likely to damage the whole organisation.

In contrast, wage differentials may be smaller in an environment of cooperative exchange. With extensive cooperative exchange and information sharing, coordination tasks are less concentrated on key positions, and greater reliance is placed upon consultation and joint coordination. Because less hinges on the decisions of a few critical individuals, there is less reason to tilt the reward structure towards management. Indeed, it may be that team oriented work structures favour greater equality of rewards because of the greater mutual dependence.

There are, therefore, some reasons to expect cooperative exchange to work better with smaller wage differentials between managerial and other employees than with the scale of differentials needed under the control oriented models. Thus, the reduction of wage differentials associated with some kinds of union action discussed in the first section may harm incentives only when there is a control-model of management in operation.

**c) Encompassing bargaining coalitions and wage differentials**

Policies to reduce wage inequalities have been common when unions have been closely involved in general fights against some national emergency, such as the control of inflation, and when they have sought to develop 'encompassing' structures which embrace a large percentage of their potential membership.<sup>24</sup> Examples of such policies can be found in the British and Italian unions supporting their countries' incomes policies in the latter half of the 1970s, and in the long term policies of the unions in Germany, Sweden, and a number of the other countries with 'neo-corporatist' bargaining systems.

The association between wage solidarity policies and strong central coordination in wage bargaining may be explained by the organisational needs of the union groups leading such policies. All

unions, even strongly centralised ones, are, in effect, coalitions of many different groups of workers, some of which would have considerable bargaining power on their own while others are much weaker. The problem facing the union leadership is that of holding the coalition together, knowing break-aways by powerful members are always possible.

The main argument for the beneficial macro-economic impact of centralised or coordinated bargaining by encompassing union and employer organisations is that it is easier for such groups to achieve moderation in the interests of longer term growth than under more decentralised bargaining [Calmfors and Driffil (1988)]. This entails that powerful groups of workers forego their short-term advantage and sacrifice possible wage gains, whereas weaker groups will do relatively better. Managers in prosperous firms might also wish to pay their workers more in order to facilitate organisational change or use of more performance related pay. In the short-run, at least, groups with greater bargaining power have to sacrifice their selfish interest to that of some wider goal. However, such groups are also those which could most easily prosper outside the encompassing union or employer association.

The problem therefore is how to ensure that the coalition holds together. The only bonds would seem to be either long-term self-interest, which may seem very abstract when compared with the immediate and concrete gains from breaking away, or some moral goal. Hence the importance for encompassing unions to have wider goals such as solidarity, greater equality, or social justice. These provide a moral justification for the self-restraint by stronger groups. It is notable that both the British and Italian unions justified their wage equalisation policies in the fight against inflation by the idea that those on higher pay had to help the lower paid who suffered disproportionately from price rises. It is also notable that the Swedish unions promoted greater wage equality as one of the goals of central bargaining [Hibbs (1990)] and that the German unions, although not stressing equality to the same extent, have long stressed the importance of skill and its associated rewards, as something which can be achieved by all workers, rather than individual performance.

Thus it seems likely that neo-corporatist arrangements, whether as a response to a particular emergency, as in Britain and Italy, or whether a long term organisational strategy, as in Sweden (until recently) and Germany, contain an inherent bias towards reducing wage differentials, and as a by-product, reducing individual wage incentives.

#### **4. Recent changes favouring more flexibility**

The processes discussed so far have already generated some response from firms, employers' and workers' organisations, and these may provide clues as to policies whose extension might be encouraged in other firms, industries, or countries.

##### **4.1 Reforms in industry bargaining systems**

Among the biggest problems facing industry bargaining systems in recent years has been that of developing sufficient flexibility at the enterprise and establishment levels without destroying the benefits accruing from a stable system of multi-employer regulation, such as limiting tendencies towards competitive pay bargaining. Adaptation has been needed to give firms more leeway to adapt to increasingly volatile international markets and faster moving competition. It has also been needed to enable management to carry through a number of organisational reforms. These two factors, greater variability in costs, and greater freedom for management to adapt work organisation have been among the key factors behind the recent

movement to greater enterprise autonomy in bargaining in some countries [Katz (1993), Windolf (1989)]. This section examines some examples of attempts to adapt bargaining institutions in this direction, and some of the motives driving them.

**a) Germany: 1993 agreement for 'hardship clauses'**

One of the most significant developments in German industry bargaining in recent years has been the introduction of special 'hardship clauses' in industry agreements to ease the employment consequences of the convergence of wage rates between former East and West Germany.<sup>25</sup> The most famous case was the metal industry agreement of May 1993, but similar clauses have also been negotiated in other industries such as printing, textiles, and clothing [Bispinck R, and WSI-Tarifarchiv (1993)]. The provisions are intended to enable firms facing severe financial difficulties to opt out of the industry agreement for a limited time to enable them to avoid lay-offs and to carry out restructuring.

The hardship agreements are concluded between individual firms and their works councils, and have so far involved such concessions as delayed implementation of the industry pay agreement and possible payment of lump sum compensation to the employees at the end of the period. By December 1993, fifteen such agreements had been reported in the metal industry in Saxony [EIRR (12.1994)].

Although the circumstances of the agreement were exceptional, as were the strains on industry bargaining imposed by reunification, and the resulting employment adjustments, the idea appealed to a number of employers and commentators who stressed the utility for extending the idea to all industry agreements, and across all Germany.<sup>26</sup> In fact, the agreement on hardship clauses is fairly cautious, and incorporates guarantees to maintain the integrity of industry bargaining.

If individual firms and their works councils could unilaterally exempt themselves from the provisions of industry agreements, the latter would very quickly lose their force. Too restrictive a rule would also harm industry bargaining as employers organisations faced increasing discontent from small and medium-sized firms who could not remain in business under the agreements in force, and were therefore leaving the employers' organisation.<sup>27</sup> Equally, union members might question the value of organisations whose policies were pricing them out of jobs. Thus, deciding the conditions under which hardship clauses may be invoked is critical to the survival of industry bargaining. The compromise reached left the decision with the parties to the industry agreement: the industry employers' organisation and the union. Should they fail to reach agreement, there is provision to set up a joint commission, but if that fails to agree, then the industry agreement should be applied.

It remains to be seen whether the new opt out clauses will be effective, either in giving enough flexibility to enable some firms to survive or in halting the erosion of membership of the employers' organisations and of the coverage of industry agreements.

**b) Italy: reform of collective bargaining system**

Industry bargaining in Italy has undergone two major reforms during the past ten years: the first reducing the coverage of the indexation provisions of the Scala Mobile in 1983 and 1984, and the second, involving the final abolition of indexation and the agreement, in July 1993, to establish a new system of articulated bargaining.

The impact of the first change has been to increase the scope for adjusting pay at the enterprise level, and to enable employers to reverse the compression of pay differentials that occurred as a result of flat-rate indexation. The wage gap, discussed earlier, increased as a result of these reforms, and occupational wage differentials were markedly increased [Ministero del Lavoro (1987) Ch. 4].

The agreement reached in July 1993 sought a new constitution for collective bargaining with national level discussions on incomes policy, sectoral agreements setting pay for two years and other issues for four, supported by a system of enterprise or territorial agreements of four year duration. The aim of the sectoral agreement is to set pay within a forum which enables coordination with macroeconomic performance, while leaving room at the enterprise level for pay to reflect changes in productivity, quality, and other elements of company performance. The system should be articulated in the sense that the higher levels set a framework for negotiation at the lower levels. In particular, company level negotiations should be bound by what has been agreed at the sectoral level. At the enterprise level, a form of works council should be established with two thirds of its members directly elected by employees, and one third by union members [Protocollo (1993), EIRR 236 (9. 93)]. Enterprise level representation was agreed in December 1993 [EIRR 241 (2. 1994)] and the first sectoral agreement, in the chemical industry, was concluded in March 1994. Shortly after its formation, the first government of the new, reformed, electoral system reaffirmed its support for the new industrial relations system.

The new system has been developed from an analysis of the ills of the former system. Apart from reducing wage differentials, the former indexation system had also greatly limited the scope for collective bargaining at both sectoral and company level. New initiatives at the sectoral level and change at company level could only be 'funded' by adding to inflation payments. By substituting national level discussions for indexation, it becomes possible for industry-level negotiators to make allowances for likely pay supplements negotiated at enterprise level, and so keep the overall total increase in line with macroeconomic objectives. Reforming workplace representation with a mixture of individual and union-based representation is intended to overcome the declining support for the previous workplace system, and thus to increase the effectiveness of workplace employee negotiators.

### **c) France: growth of enterprise bargaining**

After several government-led attempts to encourage greater depth of collective bargaining during the 1970s, the Auroux laws introduced in 1982 appear to have given a considerable boost to bargaining activity at the enterprise level. In the late 1970s, industry agreements outnumbered enterprise agreements by about two to one. However, by 1986, about the number of enterprise agreements had more than tripled to about 6,000, outnumbering industry agreements by six to one [Eyraud and Silvestre (1991)].

This growth appears to have favoured two developments. First, it is likely to have contributed to the faster growth of average earnings over industry minima after 1986 [Lanfranchi and Afsa (1990)]. Secondly, it appears to have been associated with the increased use of merit increases, which by 1991, affected nearly 60% of employees, and represented about one third of the annual pay increase. According to the Ministry of Labour survey, the most widely used form, that of mixed general and merit increases, has been the subject of enterprise bargaining in the majority of firms applying it [Ministère du Travail (1992)]. In view of the concentration of bargaining and of merit increases in larger firms, it is likely that such negotiations affect a still larger proportion of employees.

#### **d) Sweden: decentralisation of model**

The dismantling of central bargaining in Sweden began in earnest in 1983 with the break-away of the metal industry employers, and was consummated in 1990 when the SAF decided to end central bargaining and confine its activities to coordination of industry bargaining. Steps in a similar direction were taken in the Swedish public sector with the decision to promote local bargaining over central pay fixing with the 1985 reforms designed to promote bargaining at sub-sector and agency level [Schager (1992)].

The decentralisation in Sweden appears to address a number of problems. From the early 1980s, coordination among the key actors was increasingly difficult. The classic model had been dominated by the bargaining partnership between LO, the main private sector blue collar union, and SAF, the private sector employers' association. With strong shared interests in success of the export sector of the economy, and an ability to assume wage leadership, the two organisations had been able to agree pay increases consistent with continued export competitiveness [Martin (1984)]. By 1980, this partnership had lost its dominance over other bargaining parties, notably in the public sector and among white collar workers, and any wish LO had for wage moderation was challenged by more militant demands from the other unions. An era of wage competition set in [Kjellberg (1992)].

Apart from losing confidence in the ability of central bargaining to coordinate effectively, private sector employers found a number of its features increasingly constraining. The wage equalisation policy had squeezed the differentials of skilled blue collar workers, and opened the gap between them and white collar workers, resulting in recruitment and retention difficulties which could only be resolved by agreeing additional payments locally. This added to the strains on the central bargain. Finally, employers needed more autonomy at the local level to develop new production methods and new patterns of work organisation, and found established pay structures too restrictive [Myrdal (1991)].

The decentralisation to industry bargaining would appear to be reflected in the increased differentials among industries in Sweden during the 1980s (although some movement in this direction was also in progress during the 1970s, Table 3). In the public sector, Schager shows that the decentralisation of public sector pay determination coincided with an increase in the dispersion of earnings among public servants from 20% to 28% between 1985 and 1990. Over the same period there was only a small increase in the private sector.

#### **e) Australia: enterprise bargaining**

Australia has traditionally had a relatively centralised system of pay fixing through a system of national and industry awards by its industrial tribunals which set minimum rates of pay. Industry, and often enterprise bargaining, could translate these awards into effective pay, negotiate additional supplements ('overawards'), and deal with other conditions of employment. It has been widely argued that the award system leaves too little room for adjustment to local factors. Even though the minima may follow competitive pay pressures, for which there is conflicting evidence [Niland (1986)], they would do so for a tribunal's whole jurisdiction, irrespective of individual employers' ability to pay. According to Plowman (1986), negotiated overaward payments do not always provide additional flexibility.

Green and Macdonald (1991) cite survey evidence from the 1991 AWIRS<sup>28</sup> supporting the view that the award system had removed responsibility for confronting certain issues from workplace level unions and management. Managers particularly in large workplaces, reported employee related factors such as unions, lack of resources, and government regulations as barriers to change.

Thus, the shift towards enterprise bargaining fostered by the 1991 National Wage Case represents an attempt to give enterprise level bargainers greater scope over pay in order to agree new working practices and new arrangements for workplace representation.

#### **4.2 Changes in wage structures likely to mitigate employment effects**

The reduction of wage differentials is one of the effects of union and government action on pay that is likely to reduce employment, particularly as concerned lower paid and less skilled workers. During the 1970s, in many OECD countries, wage differentials were compressed, often under the influence of such policies. This movement could be seen in most dimensions of wage structures: dispersions, as well as differentials in earnings by skill, industry, and by gender (Table 3).

In contrast, during the 1980s, much of the earlier movement of compression was reversed [Marsden (1990), Katz et al. (1993)]. There has been considerable debate over the causes [for a review see OECD (1993)]. Important among these have been the strong demand for educated labour induced by technical change, increasing faster than supply in the US and the UK [Bound and Johnson (1992), Bean et al. (1990)], and high unemployment, especially among the unskilled [Pencavel (1994)].

However, more important in the present context is whether institutional arrangements have allowed sufficient flexibility for the changes to take place. Exploring these may give some clues as to ways of making bargained and administered wage structures more responsive to labour market pressures.

A number of changes in bargaining arrangements in various countries can be cited as factors enabling changes in wage structures:

*France:* decline of industry bargaining and greater importance assumed by enterprise bargaining during the 1980s; from the mid-1980s, less government support given to SMIC which ceased to boost the relative earnings of low paid workers after about 1984 [Katz et al. (1993)]; severe public sector pay limits from 1982 [Meurs (1992)];

*Germany:* limited government policies to 'deregulate' labour markets and to limit unions' ability to strike [Bosch and Sengenberger (1989)];

*Italy:* reassertion of the 'right to manage' in large enterprises from the late 1970s [Becchi and Negrelli (1986)]; government led negotiation of partial de-indexation in 1983/84 [dell'Aringa and Lucifora (1990)], and its abolition in 1992;

*Netherlands:* decline of industry bargaining and growth of enterprise bargaining during the 1980s [Visser (1990)];

*Sweden:* the breakdown of central pay negotiations from 1983 when the metal industry employers broke away, and their permanent abandonment decided by the employers from 1990; 1985 public sector pay reforms seeking more decentralised pay fixing [Schager (1993)];

*UK:* union concessions in the early 1980s decided against a background of closures, restructuring and heavy job losses; general retreat from industry to single-employer bargaining [Brown and Wadhvani (1990)];

US: union concessions in large unionised plants [Kochan, Katz and McKersie (1986)]; government policy not to update minimum wage with inflation;

Thus, in many OECD countries, there have been changes in institutionally regulated wage structures during the 1980s which would seem to favour employment. The persistently high levels of unemployment in many countries, especially in EU countries, suggest there may be need for further change. However, management's needs within the enterprise, and the need for a stable framework for cooperation may set a limit on how much wages should respond to external movements in labour markets.

### **4.3 Spread of 'merit pay' and individualised increases**

'Merit pay', or performance related pay decided by the employer according to management assessment of an employee's performance, has been spreading fairly rapidly, particularly in Britain, France, and Italy among the West European countries. It has been widely regarded as a new source of flexibility in remuneration systems for employers enabling them to respond better to external labour market pressures, and to use pay in order to motivate staff. It has also been associated with a move away from pay systems and tight supervision developed for repetitive jobs under mass-production to newer forms of effort management [Schudlich (1991)]. For example, among the reasons reported by the Ministry of Labour for firms using individualised pay in 1986 were the need to promote organisational change in an environment constrained by elaborate job and pay classification systems, to reduce absenteeism, and to restore skill differentials.<sup>29</sup> As with a number of other issues discussed in this paper, the effect of merit pay on unemployment is more likely to be indirect, by giving enterprise management more local influence over pay, and more freedom to adapt remuneration systems to meet new management needs.

Survey evidence from France, Italy and the UK, indicates that its use is now quite widespread, but that it accounts for a greater share of total earnings among managerial than among other staff. For other staff, its use has increased, especially among white collar staff, but the percentage of total pay resulting from it has remained limited.

How far the spread of merit pay has contributed to greater pay responsiveness to markets is not clear. It may simply give management more autonomy over pay for the purposes of local enterprise management. It may establish a closer link between individual pay and individual performance, but there are considerable difficulties for management to measure the performance of individual employees accurately (see §2.2 above). It may also enable management to allocate more pay to highly skilled or able employees who might otherwise leave. One indicator of change is the growth of earnings dispersions within occupations which might signal the decline of rate-for-the-job systems. Data available for France, Sweden and the UK show an increase in intra-occupational dispersions during the 1980s. In France, the movement began from the mid-1980s [CERC (1989) 38]. In Sweden the movement began in the early 1980s, and in the UK, from the late 1970s [Marsden (1989)].

### **4.4 Flexibility agreements**

Concession bargaining and flexibility agreements concerned with changes in working practices such as seniority or job demarcations have been primarily associated with 'job control' unionism. As Delamotte observed in his study of productivity agreements of the 1960s, cases where changes in specific working practices are negotiated in exchange for more pay can be distinguished from those where a works

council may have to agree on general issues related to changes in working practices, but dissociated from pay bargaining. Like the earlier wave of productivity agreements, concession and flexibility negotiations have provided a means by which management can gain support for change through collective bargaining.

There is no systematic data source for such agreements, so it is not possible to assess directly how much change takes place outside such agreements, and there has been little evaluation of how far the reported changes were actually delivered, nor of their subsequent effects on productivity.

A number of case studies in the United States reveal a significant role for such agreements in helping to restructure firms and restore their lost competitiveness, notably in the automobile industry [Kochan et al. (1986); Katz (1985)]. In the UK, there was a wave of flexibility agreements in the 1980s, often concluded against a background of severe economic difficulty. Marsden and Thompson (1991) argued that they were genuine agreements (as opposed to unions acquiescing in management decisions), and that there was tentative evidence that they, and related bargained concessions, had contributed to the productivity surge of the early 1980s. Productivity concessions in exchange for pay or other benefits such as shorter hours have continued [Richardson and Rubin (1993)] although it seems that the productivity concessions have been more far-reaching than in the early 1980s.

#### **4.5 Unionism and new management methods**

Finally, an important question is whether existing patterns of employee representation have impeded or facilitated the introduction of new management methods, such as lean production, flexible specialisation, team working, and total quality management. This issue is dealt with in more detail in the working paper on management practices and unemployment, nevertheless, some preliminary considerations are in order. There are two main reasons why a number of writers have argued that these methods are incompatible with current patterns of employee representation: they are often alleged to be based on individualised relations between employees and management; and they involve a greatly increased right to manage which is incompatible with joint regulation.

There is evidence in several countries that unions, workplace representatives, and local management have been able to reach working compromises. The reason is probably the same as that behind the flexibility concessions agreed in Britain and the United States: neither workers nor management have many illusions about the survival of non-competitive firms. In practice, lean production has been widely adopted in Japanese firms that were unionised, and from there spread to North American and European producers. In Italy, the survey reported by Negrelli (1991) showed individual negotiation over aspects of labour deployment and flexibility developing within a framework of collective rules for employee representation and adjustment of the production process. In another survey, on northern Italian firms, Regalia and Ronchi (1989) found that practices such as quality circles and management-employee communication programmes were positively correlated with local union presence, although there had been some conflict over introduction of quality circles. They also reported that they had been widely used for purposes of work reorganisation and increased flexibility. In Germany, in the automobile industry, lean production, team working, and new skill concepts have been dealt with by enterprise management and the works councils, and the metal workers' union, IG Metall, has been active in promoting its own concepts of team working. The main conflict has not been so much over the use of new working methods as over the powers of works councils to oversee such processes as staff appraisal, and whether the emphasis of merit pay should be upon skill, which can be externally measured, or management assessment of an employee's performance [Huber and Lang (1993)].



Such examples can be multiplied (see for example reports on individual firms in EIRR), but they show only that in many firms, management and employee representatives have been able to introduce new concepts of employee management and work organisation by adapting rather than abolishing pre-existing forms of employee representation. There is no necessary contradiction between them, although it would not have been possible to introduce these changes in the face of militant or ideological worker opposition.

Without detailed case studies, it is not possible to evaluate whether the adoption of new methods would have been faster or slower without employee representatives being involved, nor can one establish whether employee-management relations would have been more or less stable afterwards. Management may often be able to introduce changes unilaterally against workforce opposition, but if it cannot maintain a good working relationship subsequently, the hoped for productivity and quality may not be forthcoming.

## **5. Policies to increase adaptability**

At the microeconomic level, the main analytical conclusions to this paper may be summarised by looking at the effects of collective employee representation on three broad groups of workers. For the less skilled, lower paid groups, raising their rates of pay by collective action, in the absence of suitable training policies, is likely to cause greater unemployment. For the highly skilled and educated, reducing pay differentials may reduce incentives to train, and, perhaps more important, to take the risks associated with exercising initiative and responsibility. For the middle groups, those with blue and white collar technical and intermediate professional skills the outcome is less clear. For such workers, both employer and employee often have considerable sunk costs in the employment relationship: detailed knowledge of the employer's business, skills learned on the job, and so on, such that both parties incur considerable costs if the relationship ends. For this group, motivation, and the quality of the exchange between employer and employee is the vital ingredient to good economic performance.

There is a trade-off between policies for these three broad groups. Unskilled and semi-skilled employment may benefit from greater wage flexibility, and flexibility of individual incentives may encourage performance of the managerial group. But encouraging cooperative relations between workers and management, and among workers in the middle group, may militate against both wage flexibility and high managerial incentives. The flexible working and information sharing needed for high productivity and quality among the intermediate group require an environment of cooperative exchange.

Cooperative working may require greater equality of rewards than the right to manage, more market-oriented, model. First, it has been argued (§3.4 above) that cooperation needs a stable framework, and that when this is provided by the parties involved, it relies upon coalitions of interests within encompassing groups. Because the existence of such groups usually entails a loss of individual bargaining power by the strongest groups, some wider moral or ideological purpose is needed to motivate them. In the post-war years, this has mostly been provided by solidarity and egalitarian sentiments. Secondly, cooperative working in the workplace, where people work flexibly within teams implies a less sharp division between tasks of coordination and organisation and those of execution. Where there is a sharp division it makes sense to concentrate rewards on those in the coordinating role because their performance is critical. But when production depends more on sharing information and responsibility, the need for exceptional rewards is weaker. Indeed, it might even harm cooperation.

There is therefore a tension between the policies which favour greater employment opportunities for the unskilled and low paid and incentives on the one hand, and those favouring cooperative exchange on the other. In the short-run, the first might have a swifter impact on employment, but in the longer run,

cooperation could prove more effective by promoting the general level of efficiency of firms, and thus their position in national and international markets. We return to some of these issues in the working paper on management practices.

#### **a) Coordination and the need for a macroeconomic forum**

The main function of central coordination of pay bargaining is to tackle problems that are more difficult to deal with in a more decentralised way. The difficulty of achieving rates of pay increase consistent with full employment when bargaining groups were large but nevertheless fragmented was one such issue. Traxler's (1993) survey suggests that coordination rather than a having central bargain is the most important factor in restraining group pressures. When coordination of the main parties broke down in Sweden, so did central bargaining. Countries with "behind the scenes" coordination, such as Japan and, to a lesser extent, Germany have fared more successfully on inflation and unemployment in recent years than those with central bargains.

Coordination has to work by gaining consent rather than by constraint so the main problem is that of communicating bargaining pressures and economic problems among the parties involved, and of forming a consensus as to which goals are realistic. Coordination in the Japanese case is interesting because the main organisational strength of the unions lies at the company level, and although the industry federations play a key role in coordination of bargaining, they have little in the way of coercive power [Dore (1987)]. In the run-up to the annual 'spring offensive' there is intense consultation sharing information on the problems to be resolved during the period of pay bargaining. In this way, the problems facing individual enterprises can be given as much weight as economy-wide considerations. Thus, the system avoids the fragility which came to characterise central bargaining in Sweden, and which led to its collapse.

Coordination does not require a single institutional structure. In some countries it has worked through central bargaining, but both Germany and Japan have achieved similar outcomes without there being central bargains. Indeed, as Traxler observed, in neither country is coordination institutionalised, being mostly behind the scenes.

There may indeed be considerable advantages to coordination over central bargains as the latter may often become transformed into the minimum level any industry or enterprise level worker representative can accept without losing the confidence of his or her membership. Equally, it is difficult for central bargainers to be too specific about how much is gained centrally, and how much at lower levels without

appearing to the rank and file to sacrifice their interests to those of some abstract notion of the 'wider economy'.

The coordination process can be used to broach a number of other more qualitative issues apart from pay. For example, the encouragement of different kinds of pay innovation, or working time régime or approach to retraining, or lay-offs, or how to deal with the problems of the long-term unemployed could be discussed. These issues might then take more substance at the industry or enterprise level. Issues where individual firms would find it difficult to act in isolation are especially suitable for discussion at the peak level. For example, it is widely argued that firms offering employment security in isolation will be penalised by attracting poor quality workers who stand the greatest risk of being fired [Büchtemann (1993)].

## **b) Industry level pay negotiations**

Industry bargaining provides one means by which national level coordination may be translated into concrete outcomes, but two conditions are needed for this to be successful. First, industry bargainers need to be involved in the coordination process; and secondly, the agreement itself has to leave enough room for there to be effective enterprise level negotiations on local issues. The potency of the competition between rival groups excluded from the peak level negotiations in Sweden between LO and SAF, and their unwillingness to be bound by agreements which represented the needs of the industrial sector illustrate the problems arising in the first case [Kjellberg (1992)]. The pressures for decentralised bargaining highlighted by Katz (1993) and Windolf (1989) arising from the need for enterprise level flexibility underline this.

Industry bargaining generally sets minimum rates of pay for whole industries in a particular region, and usually play an important role in determining annual pay increases. Although the industry bargaining systems discussed in this paper leave considerable room for adjustment at the enterprise level, there being a wide and varying range of wage gaps, this does not always meet the needs of firms which encounter severe employment crises. This is a particular problem for small and medium-sized firms which, although efficiently run, may still face extreme difficulties as a result of the loss of a major order, or an exchange rate shift suddenly wiping out a once profitable market. In such cases, industry minima may be too restrictive, and there is a strong case for the development of 'hardship clauses' to enable the firm to weather the storm. Although it is still early to evaluate the outcome of the German experience, first reports suggest that the guarantees built into the 'hardship clauses' have given flexibility while maintaining the overall integrity of industry agreements which provide a critical element in overall bargaining coordination there.

The other major role that can be played by industry agreements is to provide a framework for negotiations at enterprise and plant level to enable existing work rules to be adapted to the new patterns of management and production organisation. The importance of trust was stressed earlier for there to be cooperative exchange in the workplace. Organisational change can be extremely important to enable firms to respond to the increased competition flowing from the removal of tariff and other trade barriers. Yet a workforce on the defensive could prove a serious obstacle to the efficient introduction of change. If management's goal in reorganising is to innovate and raise efficiency, and not to destroy existing forms of employee representation, then it will be important to be able to signal these intentions. An agreed framework at the industry level, and agreed means of supporting existing representation could provide a strong signal of commitment to working within agreed procedures.

## **c) Enterprise level policies**

Many of the working practices commonly cited as causing inefficiency have been reduced or removed during the 1980s, and the influence of 'rate-for-the-job' pay systems has declined introducing a greater degree of variability according to individual skills and performance. Such practices, however, are never removed once and for all because, as argued above, they are born of workplace custom and workplace conflicts. As a result, the problems of maintaining flexible patterns of work organisation and elements of pay flexibility in the workplace are continuous rather than discrete. Workplace custom does not cease to exist when the rules are changed. Rather, the substantive content of what is accepted as fair and reasonable changes. Therefore, the problem is one of maintaining the atmosphere in which change was agreed, and of maintaining a consensus on the purposes which have to be met. This highlights the importance of maintaining cooperative exchanges.

This does not have to be tied to pay flexibility, but there are a number of areas in which some of the recent developments in pay could help promote cooperation. It was argued earlier that at least one of the

reasons for the widespread acceptance of 'rate for job' pay rules was that in an environment of mutual suspicion, the application of such rules could be easily monitored. Similar factors have lain behind the difficulty of using both merit pay and profit sharing. In a study of the UK tax office merit pay scheme, Marsden and Richardson (1994) found that one of the most important factors which soured general support for the principle of relating pay to performance was distrust of the way management was applying it. In the case of profit related pay, the French government found that the only criterion that was acceptable to the unions was that of declared profits because only this could be effectively monitored [Camerlynck and Lyon-Caen (1982)].

Many production systems have evolved beyond the point at which workers produced a highly standard output with little scope for quality. This change has undermined many of the traditional individual output-based incentives, a point recognised in the debates on payment systems in all the major EU countries [eg. Schudlich (1991), Della Rocca (1990)]. Equally, relating pay to average experience, as is done by length of service payments is unpopular in many administrative-type jobs because of the automaticity of the pay whatever the quality of effort.<sup>30</sup> Indeed, both kinds of system are forms of rate for the job: output based incentives being based often on a form of piece price; and length of service increments corresponding to steps towards the rate for the experienced worker at the top of the scale.

Provided it is linked to a suitable system of performance appraisal, and the job offers enough scope for individual improvement, then 'merit pay' offers a means of encouraging better productivity while at the same time diluting the effect of 'rate for the job' principles. It is a system that has been spreading rapidly in the British public sector, and in France in both public and private sector employment especially in terms of the numbers of workers covered if not in the amounts of money individuals receive [CERC (1989)]. There has as yet been little evaluation of the effectiveness of merit pay in improving workers' motivation. A recent study of tax office staff in the UK suggested that the scheme in force there could indeed be demotivating, but that the main cause of its failure lay in its perceived unfairness [Marsden and Richardson (1994)], and notably in the suspicion that for cost reasons, management had placed a ceiling on good evaluations irrespective of how good individual performance was.

This points to an important feature of 'merit pay' systems, that they are part of a wider wage-effort bargain, and so cannot easily be insulated from pay bargaining. In addition, markets reward individual merit only in so far as it meets customer demands (a question of outputs) whereas individual workers tend to judge their work from the quality of the inputs. The difficulty of measuring performance to the satisfaction of all parties, and the problem of establishing the amounts of money to be used for merit awards indicate the need for joint regulation.

Profit sharing schemes also break away from rate for the job rules, and introduce a modest element of variability into pay in response to the firm's performance. Recent work reviewed by Blinder (1990) and by FitzRoy (1992) indicates that it can indeed improve performance. A frequent theoretical objection is that the impact of any one individual's effort on profits is too small to be noticed, and that there will be tendency towards free riding as those who put in minimum effort will get the same as those who work much harder. This would indeed be a problem if the employment relation were short-term, but because it is still usually long-term (with median job durations of ten or more years), there is ample scope for peer group pressure to limit 'free riding'. Thus, profit sharing can turn to advantage the very continuity of employment relations that makes norms of fairness so powerful.

Productivity bargaining, and flexibility deals are another important category of instruments for use at the enterprise level. Although discredited in Britain in the late 1960s on account of poney deals designed to evade incomes policy restrictions, British management has been much more successful in using them

during the 1980s and 1990s as a vehicle for change. Although it is not customary in most continental European countries to link pay increases to changes in specific working practices there have been other developments. For example, in France, recently, some firms have negotiated pay increases conditional upon attainment of some specified improvement in productivity [Eyraud et al. (1990)]. These examples could well be generalised by means of a frame agreement.

However, 'rate for the job' rules are a product of low trust relations between employers and employees. They have been a powerful principle in collective bargaining because they are easy for workers and their representatives to monitor. Merit pay, profit sharing, and productivity change depend upon a much greater amount of trustworthy information being available from the employer. For that reason, the information needs to be subject to joint control.

#### **d) Training and product market competition**

Training emerges in two important contexts: the problems of the unskilled unemployed, and that of labour market bottlenecks. Policies to foster cooperation among the middle section of the workforce, it was suggested, tend to favour smaller occupational wage differentials and greater equality of rewards, but these are harmful for the jobs of the unskilled. Providing greater opportunities for improving one's own skill levels, and for replacing obsolete skills could ease the policy dilemma in this area.

Bottlenecks in labour supply, it has been argued, pose major problems to fragmented bargaining systems because they distort wage structures between those who can improve their earnings and those whose pay is locked into organisational or bargained pay structures. Recently, Nickell (1990) has stressed this as one of the major obstacles to the UK achieving low inflation and full employment.

Product market competition may have much to contribute to easing any distortions in wage structures arising from collective bargaining. Stewart's (1990) evidence for the UK highlighted the importance of rent sharing in the union mark-up. Thus, increased product market competition could do much to ease some of the employment displacement problems associated with monopolistic pay bargaining.

It could also play an important part in the realm of restrictive practices. Analysing the impact of the employment law reforms of the 1980s in the UK which had done much to reduce the institutional power of trade unions, Brown and Wadhvani (1990) concluded that the most important factor had been the competitive pressures on management to take the initiative in promoting organisational change. In a study of the UK automobile industry's labour adjustments in the early 1980s [Marsden et al. (1985)], the authors also concluded that the depth of the commercial crisis facing the UK-based manufacturers, and the government's announcement that it would not act as employer of last resort had contributed greatly to the reorganisation of labour relations in that industry.

Finally, product market competition may contribute to promoting cooperative exchange because of the pressure on management to tackle sources of organisational slack and to promote information sharing. In so far as these are a source of increased efficiency, they put pressure on management to avoid 'live and let live' environments. They may also put pressure on worker representatives towards greater economic realism as to what can be achieved for their members.

Thus, changes in bargaining structures and industrial relations systems to help employment need to be supported by appropriate labour market and product market policies.

## Notes

1. This paper has been prepared with the financial support of the OECD as a part of the OECD Jobs Study. Thanks are due to Scott Kelly, LSE, for excellent research assistance. The views expressed in this paper are those of the author and do not necessarily represent those of the OECD.
2. For an extremely clear statement of this argument see the survey of Japan in the Economist magazine (9.7.94).
3. Chamberlain and Kuhn (1965).
4. This does not apply in labour markets dominated by a single major employer. Under such conditions of a single buyer, or of a cartel among local employers, the wage could be bargained up to the competitive level with no loss of employment. With the great increase in transport, the classic case of monopsony, that of the company town, is less and less common. Perhaps the most likely cases of monopsony now are those where workers' travel to work range is very limited, for example, by the demands of child-care.
5. These were: experience, schooling, gender, part-time status, marital status, and industry.
6. These results are broadly consistent with those for the US reported by Freeman and Medoff (1984), and Lewis (1986), and for the UK by Gregory and Thompson (1981), Blanchflower and Oswald (1988), and Metcalf (1990).
7. In a post entry closed shop workers are expected to join the union after the employer has hired them. In the pre-entry closed shop, workers have to be members of the appropriate union before they can be hired. All action to enforce a closed shop was made illegal in 1988 and the pre-entry kind itself was made illegal in 1990.
8. The coefficient on membership density was 0.07, and on the presence of an agreement, 0.03, for log earnings.
9. Handelsblatt 3.7.92.
10. The own wage demand elasticities were respectively for skilled, semi-skilled and unskilled engineering workers: -1.06, -1.76, and -2.31. The substitution elasticities were: skilled/semi-skilled, 2.63; skilled/unskilled, 1.68, and semi-skilled/unskilled, 3.75.
11. Part of the discrepancy of findings may result from the use of different kinds of survey. Atkinson and Meager based their conclusions on interview with about 70 commercial organisations with more than 500 employees across a range of sectors. Their questions were qualitative: whether certain practices were in use for at least some categories, and whether they had increased, or the firm was intending to increase their use. The idea that these changes corresponded to a conscious strategy was the authors' own conclusion, and was not supported by Hakim's use of a follow-up to the WIRS survey. Observing business 'strategies' however is not easy, especially if one believes that they tend to emerge from an accumulation of decisions taken as opportunities arise. Thus, if employment security incentives were pushing firms in one particular way, an overall, coherent, picture could emerge from their successive employment policy decisions without there being any explicit grand strategy. Pollert's critique suggests that Atkinson and Meager's model was not accurate as a general description of employment policies of

the majority of firms in the middle 1980s, but it remains possible that they had captured a direction of movement among key firms.

12. Percentage of employees on fixed term contracts in 1991: 32% in Spain, 10-16% in Denmark, Greece, Portugal, and France [Employment in Europe (1993) 181].
13. Employers were asked in 1985 and in 1989 to assess the importance of insufficient flexibility in hiring and shedding labour' as a reason for 'not being able to employ more people' [Employment in Europe (1993) Ch. 7].
14. In some countries, such as France, early retirement has been heavily subsidised by the pension funds, and so has proved a relatively cheap measure for employers, although the costs to the pension funds and from consequent reductions in the labour force are considerable.
15. For more results see: European Economy no. 27 March 1986.
16. Such complaints were common among Italian employers during the 1970s.
17. Defined as the amount by which gross earnings exceed the industry minima as a percentage of the latter.
18. That is: excluding premia such as 13th month, profit-sharing, and length of service bonuses.
19. 1964 saw the first 'low wage pot': a common flat rate increase for every worker; wage drift amounts; flat rate, cost of living adjustments; and low wage adjustment amounts [Hibbs (1990) p.62 ff.].
20. At a more general level, this argument finds some support in game theory. Maynard-Smith (1982) shows that the expectation that one will escalate any conflict that threatens one's own territory (because that is something one cannot afford to lose) produces a stable pattern of behaviour whereas the conventional choice between aggressive ('hawk') and non-aggressive ('dove') strategies does not.
21. This is the 'reverse induction' argument. The 'tit-for-tat' strategy implies one should start by cooperating in the first round, and only refuse cooperation in the round following one in which the other party failed to cooperate. Thus not cooperating is used as a retrospective punishment. However, this sanction does not work for cooperation in the last round of a finite game, so both parties fear the other will not cooperate. Since mutual non-cooperation means that both parties lose the gains from cooperation, the threat of punishment for non-cooperation also loses its effect. Therefore cooperation is also problematic in the penultimate round, and so on, back to the first round [Dasgupta (1988)].
22. The failure of the Donovan reforms to produce the gains in productivity and low inflation that their architects had intended is demonstrated by Metcalf (1989). Batstone (1988) reached similar conclusions reviewing the failure of the reforms to generate the kind of cooperative practices intended, and problems raised by increased expectations. A special issue of *Rassegna Sindacale* (86/87, Sept-Dec. (1980) was devoted to the high expectations generated by the Italian factory councils which they proved unable to meet.
23. Ryan (1989) takes the argument further in the context of public workplace training schemes for young workers.

24. 'Encompassing' groups are those which include a large percentage of the members of a particular group.
25. In 1991, the metal industry employers and union had agreed a staged convergence between the basic wage rates fixed in industry-regional agreements between former East and West Germany by April 1994, and convergence for other benefits over a slightly longer period. Several factors explain why the employers agreed to the convergence. Herr Stümpfe, then president of the metal industry employers, argued that wage convergence could not await productivity convergence because the flight of skilled labour from east to west in search of high pay was slowing productivity convergence (die Zeit, 21.6.1991). It is also likely that the large employers, who could better cope with convergence, were better represented in the employers' association than small employers, hence the discontent of small and medium employers [EIRR 221, (6.1992)], and Pleiten, Pech und Pannen, die Zeit (14.5.93).
26. Mundorf H., in the Handelsblatt 16/17.7.93, and Barbier H, in the Frankfurter Allgemeine Zeitung, 18.5.93, [cited in Bispinck R, and WSI-Tarifarchiv (1993)].
27. On leaving the employers' organisation they would continue to be bound by the agreement until its expiry. Only after would they cease to be bound by agreements reached by the employers' organisation.
28. Australian Workplace Industrial Relations Survey.
29. Bilan de la négociation collective en 1988, Ministère des Affaires Sociales et de l'Emploi, Paris.
30. The Efficiency Unit (Next Steps) reported that 70% of civil servants approved of the idea of rewarding good performance with better pay, and a recent survey of Inland Revenue staff found that 57% thought that performance pay was good in principle [Marsden and Richardson (1991)].



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Table 1. **Union wage effects and bargaining coverage in selected countries**

	Union/ Non-union wage differential	Dispersion of earnings		Union membership density	% of workers covered by collective agreements
	%	Union CV%	Non-union CV%	%	%
United States	22	58	81	16	18
UK	10	53	74	39	47
West Germany	8	43	64	32	90
Austria	7	43	60	46	98
Australia	8	56	65	40	80
Switzerland	4	46	85	27	53

Note: density and coverage rates adjusted for % of workers excluded from collective bargaining (eg. managerial employees in some countries).

Source: Blanchflower and Freeman (1992) Tabs.3 and 4.; density and coverage: OECD *Employment Outlook* (1994), p. 173.

Table 2. **Bargaining systems and coverage in selected countries**

Country	Industry bargaining	Coverage of collective agreements %	Rate of unionisation %	Type of min. wage	Direct state intervention in private pay barg.
Belgium	Yes	45	77	Agreed nat. min.	No
Denmark		83	86	Sectoral agt.	No
France	Yes	80	12	National legal min.	
Germany	Yes	100	40	Sectoral agt.	No
Great Britain		55	46	Abolished 1993/4	No
Greece			25	Agreed nat. min.	
Ireland		57	58	Legal sectoral min.	No
Italy	Yes	100	63	Sectoral agt.	
Luxembourg			50	National legal min.	
Netherlands	Yes	70	30	National legal min.	No
Portugal		58	30	National legal min.	
Spain		61	16	National legal min.	
United States	No			Federal minimum	No

Source: Coverage: CERC 1991, p. 25, unionisation, OECD *Employment Outlook* 1991, EIRR.

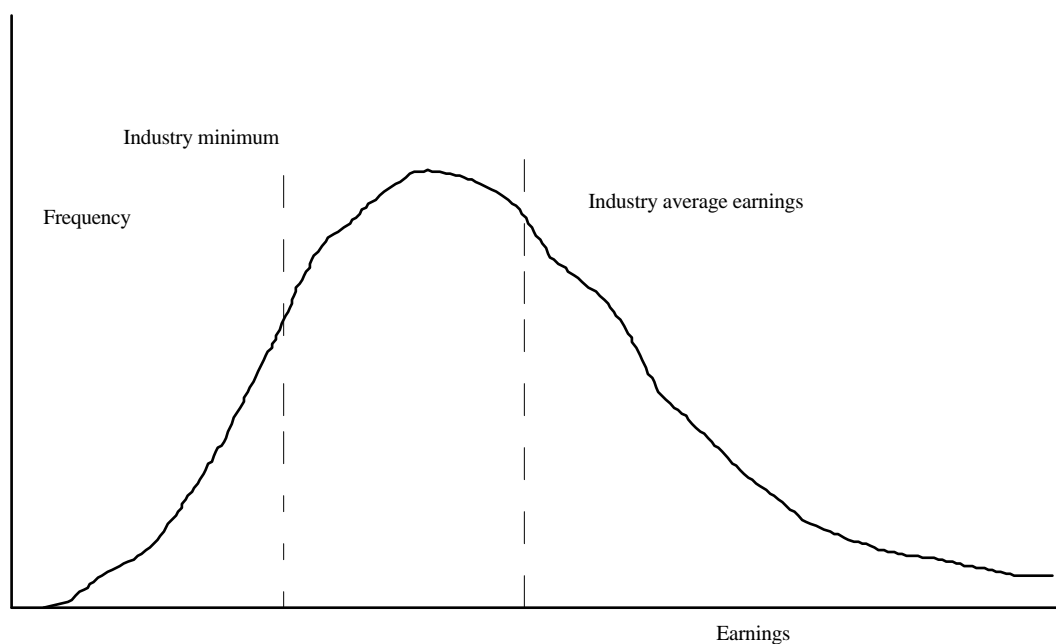
Table 3. **Summary of the main changes in wage structure 1970-1988**

	Dispersions		Occupations		Industries		Male/female	
	1970s	1980s	1970s	1980s	1970s	1980s	1970s	1980s
France	-	+ (84)	-	+ (86)	-	+ (84)	-	-
FR Germany	-	- a)	=	- (<84)	+	+	-	-
Italy	--	+/- a)	--	+ (84)	--	+	-	?
Japan		+ a)		+ a)				
Netherlands	?	++	?	na	?	?	--	-
Sweden	-	+ (83)	-	-	+	+	?	?
United Kingdom	-	++	-	++	--	+	--	+
United States	-	++	+/-	+	+	+	=	-

Key: + indicates increase; - decrease; = not much change; +/- changes in different directions depending on categories; double sign major changes; na: not available. Where the turning points in trends are known to deviate markedly from the turn of the decade, they are indicated.

Sources: Marsden (1990) except: a) OECD *Employment Outlook* (1993), and Katz et al. (1993).

Chart 1. **Illustration of the potential effect of industry minima upon the earnings distribution in a particular industry**



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