

NOTE

THE ACCORD AND PRODUCTIVITY IN THE AUSTRALIAN MANUFACTURING SECTOR

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Productivity enhancement is at the forefront of the current programmes of microeconomic reform and award restructuring. However, the combination of the effects of the Accord, high real interest rates and restrictive demand management policies are constraining labour productivity growth. Technical progress in the Accord period has been largely capital augmenting, a reversal of earlier trends. The implication is that productivity growth is likely to be low in the future despite the emphasis of current supply side policy measures.

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The manufacturing sector is at the forefront of the workplace reforms being instituted under the processes of award restructuring. In part, the rationale for this process is to improve the productivity performance of the manufacturing sector.¹ Currently there is an imperative to lift the productivity performance and international competitiveness of the manufacturing sector. The purpose of this note is to highlight the potential paradox associated with this current emphasis upon microeconomic reform and wage capping: far from generating an acceleration in labour productivity growth, it in fact may hinder the future rate of labour productivity growth in the sector. A similar paradox was emphasised by Skinner with respect to US manufacturing performance: despite elaborate attempts to reduce and rationalize costs (principally labour), many enterprises found that productivity improvements were marginal.² The problem was that longer term productivity enhancing measures associated with scale and age of plant were ignored. Similar dangers are present in Australia given the policy emphasis towards supply side and cost-cutting measures for productivity generation.

The Bureau of Industry Economics summarised a number of studies it had conducted on Australian post war productivity performance in the manufacturing sector.³ There appeared to be a direct connection

between output growth and productivity growth (Verdoorn's law) and the average age of plant. Moreover, the post war experience was one characterised by technical progress being largely labour augmenting. That is, new capital was substituted for labour and the efficiency of the labour force improved. This was accounted for in part by the upward trend in real wages together with the widely held view that new technology and efficiency enhancing processes are largely embodied in new capital.⁴ Not surprisingly, labour productivity growth generally exceeded capital productivity growth and capital-labour ratios increased.

Since 1983, wage determination in the Australian economy has been via the centralized Accord process. Despite periodic reviews to the wage determination principles and procedures, the aim has been to set nominal wage growth within the parameters of prevailing macroeconomic policy objectives. The consequence has been real wage reductions, falls in the real unit labour costs of production, and a fall in labour's share of real value added. These results have not been accidental, but have been the deliberate consequence of setting wages towards volatile external sector constraints and improving the share of value added being distributed towards profits.

Apart from the labour cost and profits consequences of the Accord, two other features stand out in the post 1983 period: the increase in real interest rates and their sustainment at record levels, and in concert the attempts to control and dampen demand growth in lieu of increasing current account deficits. Recent budget statements clearly articulate the need to contain expenditure growth in order to control the burgeoning deficit on the current account.⁵

Table 1

Manufacturing Trends, 1983/4–1988/9: Output, Inputs and Productivity	
	Growth %
Output	22.4
Labour	8.6
Capital	5.7
Labour productivity	13.8
Capital productivity	16.7
Real unit labour costs	– 7.8
Capital-output ratio	– 21.8
Capital-labour ratio	– 2.6

Sources: *Australian National Accounts, 1988/90*, ABS 5211.0 and ABS 5221.0; and *Economic Round-up*, The Treasury, May 1990.

Table 1 details the broad trends in output, labour input, capital stock, real unit labour costs, capital-output and capital-labour ratios, and

various productivity estimates for the manufacturing sector for the period of the Accord.⁶ The data and estimates are subject to theoretical and statistical limitations which are spelled out by Harris and Lattimore.⁷ Nevertheless, using different output or input measures generates similar broad trends over the longer term. The evidence is more unreliable over the short term, such as in year to year growth rates.

In general, capital-labour and capital-output ratios have declined, the growth in capital productivity has exceeded the growth in labour productivity and technical progress has been largely capital augmenting. The average age of the capital stock in Australian manufacturing has increased in the 1980s, continuing a trend which began in the early 1970s.

The EPAC paper on Australian productivity performance indicated that for the 1980s the performance of the manufacturing sector in both labour and total factor productivity had declined relative to the 1970s and relative to other OECD economies.⁸ Estimates conducted by Hughes *et al.*, suggested that the slow-down could be explained by the general slow-down in demand together with the decline in real unit labour costs of production.⁹ That is, reducing labour costs have largely had a negative impact on technical progress.

The explanation takes several forms. First, it could represent simple factor substitution where enterprises have responded to changing factor prices and chosen to employ more labour relative to capital stock in the face of the effects of the Accord together with high real interest rates. Second, given time lags and the uncertainty associated with adjustment, the outcome may represent changes in utilization ratios. Firms are economizing more on capital and more fully utilizing their capital stock; more labour is employed to utilize the stock with greater frequency, on a more continuous basis, etc. The capacity utilization rate for manufacturing reported by the Westpac/Confederation of Australian Industry survey has increased over this period.¹⁰

The implications following from these developments take several interesting forms. First, technical change is becoming capital augmenting, reversing earlier post war trends. Capital is being utilized more efficiently, but labour productivity growth will be impaired by falling capital-labour ratios and an ageing capital stock. Second, sluggish labour productivity growth will place further pressure upon the Accord to generate wage moderation and containment. The critics of the Accord will view moderate labour productivity growth as a clear failure of the Accord, especially its phase of award restructuring.¹¹ Similarly, even greater emphasis will be placed upon the imperative for microeconomic reform to improve labour productivity growth. Third, employment growth can be expected to be sustained for the manufacturing sector as long as demand expands. With lower rates of labour productivity growth, the elasticity of employment with respect to output will increase. The implications for labour productivity growth may be pessimistic, but for employment generation in the sector they are optimistic.

What this suggests is that the current emphasis upon productivity

enhancement through award restructuring and microeconomic reforms are wide of the mark. The Bureau of Industry Economics studies found no association between product market competition and productivity performance.¹² Moreover, microeconomic reforms are aimed at improving static allocative efficiency. The long promised investment boom has not eventuated, despite the improvement in profitability. Indeed, current expectations in the manufacturing sector are quite pessimistic,¹³ indicating that such an investment expansion and significant increase in the capital stock will not take place in the near future. If demand policies remain restrictive, interest rates at high levels, and wages capped, then the clear indication is that capital-output and capital-labour ratios will decline, labour productivity growth will stagnate and technical progress become largely capital augmenting.

Current policies paradoxically can contribute to a future slowdown in manufacturing labour productivity growth. As long as demand growth is contained and real unit labour costs are reduced, the spectre of an ageing capital stock and capital augmenting technical progress will become a longer term feature of the manufacturing sector.

NOTES AND REFERENCES

1. See P. Morris, *Award Restructuring: the Task Ahead*, Australian Government Publishing Service, Canberra, 1989.
2. W. Skinner, 'The productivity paradox', *Harvard Business Review*, 64, 4, 1986, pp. 55-64.
3. Bureau of Industry Economics, *Manufacturing Industry Productivity Growth: Causes, Effects and Implications*, Research Report No. 21, Australian Government Publishing Service, Canberra, 1986.
4. OECD, 'Total factor productivity', *OECD Economic Outlook*, 42, December 1987, pp. 39-48.
5. Budget Statement No. 2, 1989/90, p. 2.51, Australian Government Publishing Service, Canberra.
6. Output: Gross product at 1984/5 prices, manufacturing.
Labour: total person hours of employment, manufacturing.
Capital: average net capital stock, manufacturing.
Productivity: output growth less input growth.
Real unit labour costs: average for the non-farm sector.
7. C. Harris and R. Latimore, *Studies of Productivity Growth and Technical Efficiency in Australian Manufacturing*, Bureau of Industry Economics, Working Paper No. 56, Canberra, 1989.
8. Economic Planning Advisory Council (EPAC), *Productivity in Australia: Results of Recent Studies*, EPAC, paper No. 39, Australian Government Publishing Service, Canberra, 1989.
9. B. Hughes, J. Burgess and W. Dunlop, *Neoclassical Formulation of Productivity Growth in Manufacturing*, Department of Economics, University of Newcastle, Research Report No. 172, 1990.
10. The trends in the Westpac/Confederation of Australian Industry survey are contained in Budget Statement, *ibid.*, p. 2.21.
11. D. Moore 'Industrial relations and the failure of the Accord: what should be done?', *Australian Bulletin of Labour*, June 1989, pp. 153-183.
12. *op. cit.*
13. For evidence of downturn in manufacturing expectations see *Westpac Review*, 37, December 1989, p. 4.