

**IMPACT OF THE TRADE UNIONS ON WAGES AND EMPLOYMENT**

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### **ABSTRACT**

This paper discusses the problematic impact of trade unions on wages, gross domestic product, rent-seeking, company level profits and effects of union activities, power and influence on union densities. While unions have a positive countervailing voice in the work place their influence and status world wide in recent years has been markedly diminishing.

### **INTRODUCTION**

This paper is comprised of three parts. Part I examines in some detail the vexed issue of the role and function of unions in modern industrialised western-style economies, noting that economists generally take a negative view of the effect of unions on wages, GDP, rent-seeking and company level profits. Part II explores the interrelationship between institutional arrangements concerning union activities and wage fixing arrangements, and the power and influence of unions as measured by union density and other indicators And finally, Part III reviews the literature in relation to the impact of decentralised industrial relations regimes, principally enterprise-level bargaining as are been increasingly by Australian and other governments, on the immediate and longer term prospects of unions.

### **PART I: THE EFFECTS OF TRADE UNIONS ON WAGES GDP AND PROFITS**

As a consequence of the industrialization of western-style economies, trade unions and collective bargaining have become the primary instruments by which workers have sought to protect and enhance their wage rates and the terms and



conditions of employment Stevens (1995, p.1990). Trade Unions are now a pervasive component of the institutional framework in labour markets of democratic countries worldwide. The Australian Bureau of Statistics (1985) (cited in Rawson 1986, p.6) defined trade unions as:

... an organisation consisting predominantly of employees, the principal activities of which include the negotiation of rates of pay and conditions of employment for its members.

As Sapsford and Tzannatos (1993, pp.245-265) note, trade unions are complex institutions, and can be analysed from social, economic and political viewpoints. The multifaceted social, political, economic nature and function of trade unions gave rise to the celebrated Ross-Dunlop debate in the 1940s-1950s, which was reducible to a 'disagreement over the relative weights to be attached to ... [their] ... political and economic factors'.

Economists have generally treated trade unions as institutional labour market imperfections analogous to firms with monopoly powers, with a maximising function be it wages, employment, the wage bill, total membership, or more recently, utility. Monopolistic wage increases are viewed as deleterious, inducing both inefficiency and inequality; thus unions' restrictive work practices and other activities (e.g. political lobbying) are viewed as having a net adverse effect on employment, production costs and productivity, investment, firm profits and competitiveness, and hence on economic growth.

Some empirical studies have confirmed this view. In a study of the impact of unions on coal mining in West Virginia USA over 1897-1938, Boal and Pencavel



(1994) found that unionisation of individual mines lifted wages by about 6.5%, reduced operating days by 25%, substantially curtailed managerial authority, had a negligible impact on employment and during the 1930s caused operator profits to fall by about 52%. Not surprisingly, mining companies 'hated the union like God hates sin'. Stevens (1995) estimated the social cost of rent seeking by unions in the US. (the total compensation effect including the union fringe-benefit effect, 1.25 times the wage effect) as 0.5% of GDP, on the basis of a wage gap of 21% for more unionized industries and 16% for those less unionized. There was also a 20% profitability difference between highly and less unionized sectors of highly concentrated industries and an estimated related decline in their stock values of \$45,000 per worker based on a \$4225 annual 'rent' per unionized worker.

In Australia, unionization is estimated to have had a negative impact on GDP of 1%, one-half of which is due to the union wage premium (though this is disputed) which itself has been variously estimated as 7-10% by Mulvey (1986), 17.22% by Christie (1992) but more recently by Miller and Mulvey (1996) as almost negligible once firm size is taken into account. This negative impact may largely comprise internalization of the 'spillover effect' and widespread US-type rent-sharing in larger Australian firms.

The union-wage premium concept remains somewhat problematical however, owing to the nonrandomized selection of unionized workers. In a longitudinal US. study, Card (1996) found that low level-skill workers were positively selected in the union-wage gap and high-skill level workers negatively selected with the two opposing biases roughly cancelling out in the overall workforce.



Blanchflower *et al.* (1996) found strong evidence of rent-sharing in concentrated US. industries. There was a lagged elasticity of wages in relation to profit of 0.08, indicating that one-quarter of the inequality of US. wages in the industries examined was due to the existence of firm rents. Conversely, following deregulation of the US. Airlines industry in 1978 (the demonopolisation of routes etc.) by 1992, flight attendants' and pilots' wages were 39% and 22% lower respectively than if deregulation had not occurred (Cremieux 1996). Similarly, in Australia, following deregulation of the Airline industry, the attempt by airline pilots in 1989 to obtain a 30% wage rise by strike action, led, in a more competitive industry, to their defeat. Wages were contained, less favourable working conditions imposed, and a 25% reduction in employment levels resulted (Norris 1996).

However, trade unions according to Freeman and Medoff (1979, 1984) and others, have a countervailing positive "second face". This comprises a voice-response face at the workplace (as productivity-augmenting transmitters of collective voice) and in the political arena which has a positive effect on the functioning of imperfect economic and social systems provided they do not demand total compensation levels, wages and wage-effect rents, which exceed worker productivity. In two Australian studies, Miller and Mulvey (1991, 1994) estimated that the net effect of union activities was to reduce the probability in the youth labour market of quitting the job by 10%, and in the overall labour market by about 3% - a clear positive economic outcome. An evaluation of the net social merit of unions and collective bargaining, 'entails trying to weigh the relative



importance of the costs and benefits associated with their two faces’ (Stevens 1995, p.191). See below for ‘The Two Views of Trade Unionism’ wages and employment.

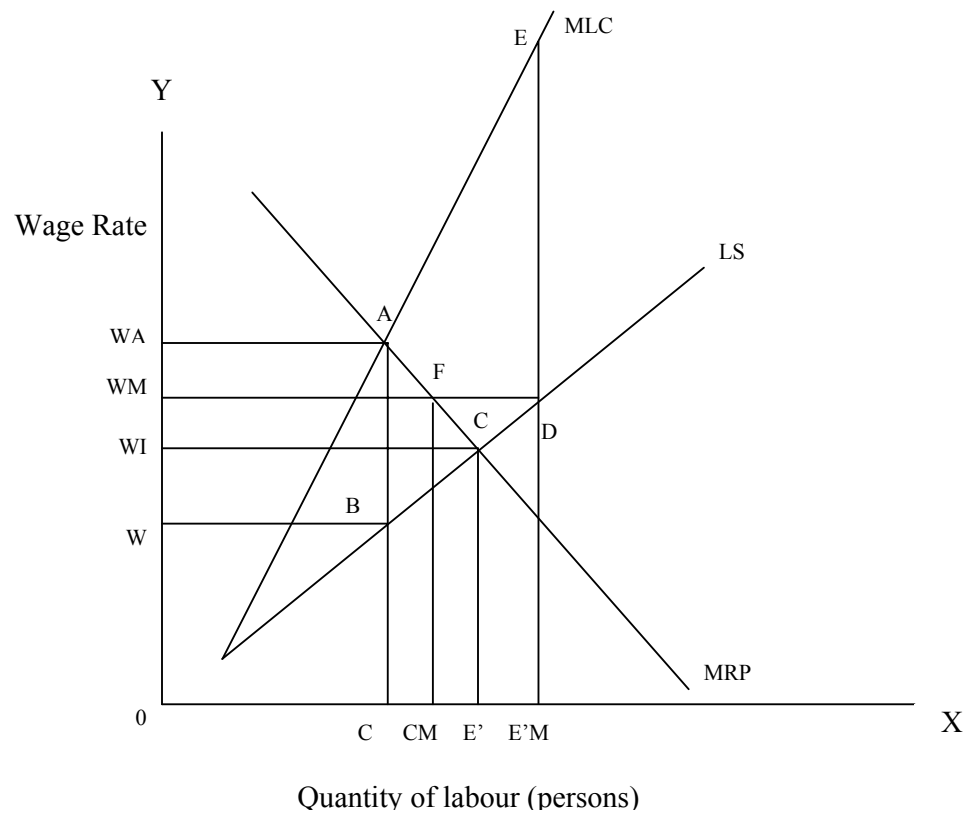
	Unions and Efficiency	Unions and Income Distribution	Unions as Sociopolitical Organisations
Neo/Classical/ Monopoly Suppliers of labour	<ul style="list-style-type: none"> <li>• Unions raise wages above competitive levels</li> <li>• Unions work rules decrease production</li> <li>• Unions lower national output through strikes</li> </ul>	<ul style="list-style-type: none"> <li>• Unions increase income inequality by increasing the wages of highly skilled workers</li> <li>• Unions create horizontal inequality by creating differentials among comparative workers</li> </ul>	<ul style="list-style-type: none"> <li>• Unions ration jobs</li> <li>• Unions fight for their own interests in the political arena</li> <li>• Union monopoly power breeds corrupt and non-democratic elements</li> </ul>
Collective Voice/Institutionalist	<ul style="list-style-type: none"> <li>• Unions improve productivity by reducing quits rate and improving morale and cooperation among workers</li> <li>• They improve communication between workers and management</li> </ul>	<ul style="list-style-type: none"> <li>• Unions reduce inequality among workers by standard late policies</li> <li>• Union rules limit the scope for employers to take arbitrary actions concerning promotion, retrenchment etc</li> </ul>	<ul style="list-style-type: none"> <li>• Unions are political institutions that represent the will of their members</li> <li>• Unions represent the political interest of lower income and disadvantaged persons</li> </ul>

*Table – 1: Two Views of the Trade Union Economists and Unions*  
Source:- Freeman and Medoff (1979 pg 75).

Figure I below shows that if unions set the wage rate at  $w'$ , the labour supply curve facing the monopsonist would be  $w'CL_s$ , maximising profits at C by employing  $e'$  workers at wage  $w'$ . Thus unions are successful in increasing both wages and employment to their perfectly competitive level. However, a union



wage above  $w'$  is achieved at the cost of reducing employment below its perfectly competitive level; though provided the union wage is set below  $w'$ , employment will be still be higher than that in the absence of union action, Sapsford and Tzannatos (1993, pp:263-4).



*Figure 1: Effects of union on wages*  
Source:- Sapsford & Tzannatos (1993, p 161)

Early economic models of unions viewed unions as analogous to the profit-maximising firm, describing the ‘rational union’ as alternately maximising:

- wage income per member, though this was implausible as it implied their seeking high wage rates, forcing most members out of employment;



- members employment, which implied their driving members' wages as low as possible, below what they would obtain without unionisation, suggesting that the union was dispensable; or
- the wage bill of members, the product of members' wage rates and employment, which is maximised at the point where elasticity of union labour demand is equally to unity (1) - see Figure II below - where  $Z$  members are employed at  $W2$  wage.

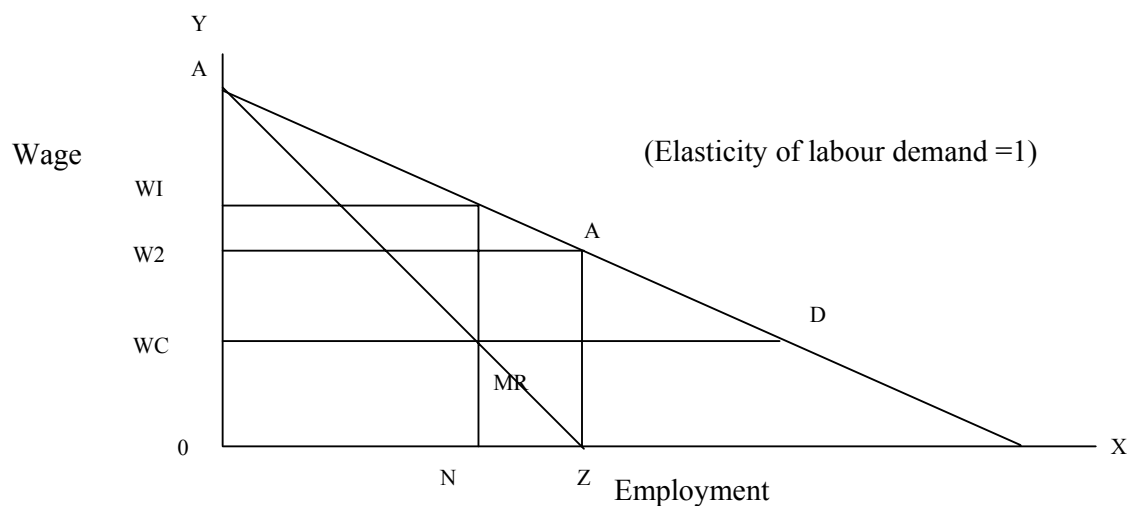
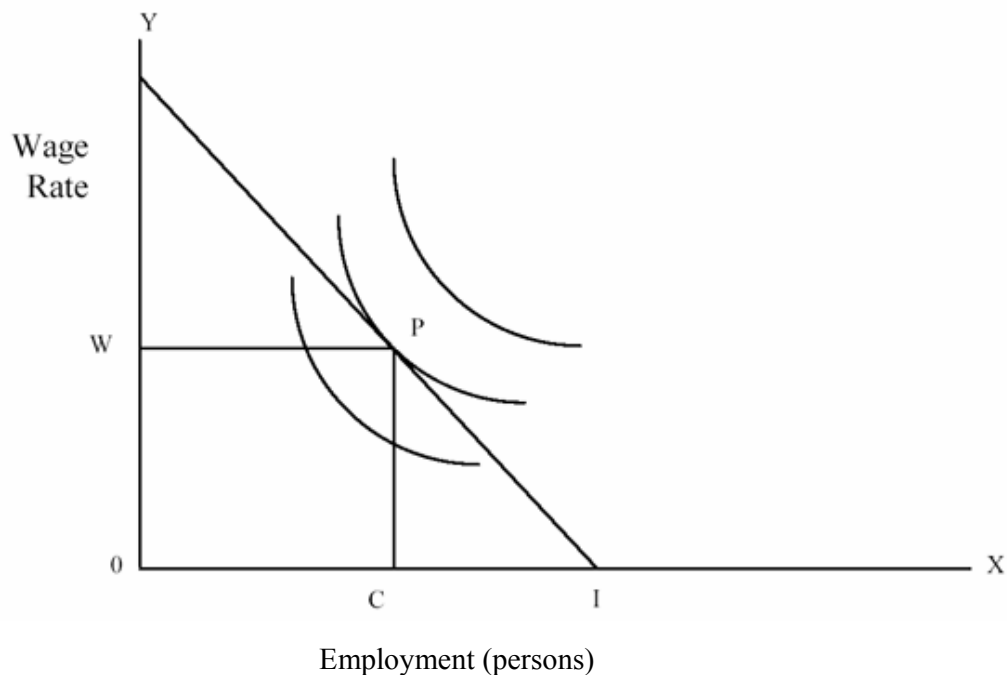


Figure 2: Wage maximizing model  
Source:- Norris (1996 p 136)

However, unions cannot be viewed as monopoly sellers of members' labour services sine they do not incur production costs. Rather, unions act as agents of their members. Accordingly, the Union-Monopoly analogy, sees unions as attempting to maximise *economic rents*, being total payments to members over and above the supply price of labour –  $W_c$ . See Figure II above in which the union sets wages at  $OW1$  and the profit-maximising employment is  $ON$ .



Since the 1980s, the simple maximising models of unions have been abandoned for a utility-maximising model in which unions seek to maximise utility from various combinations of the level of wages and employment of their members. This can be represented on a union-indifference map, which as wages and employment are not perfect substitutes is sharply kinked in favour of the existing wage-employment combination: see Figure III. below.



*Figure 3: Utility maximizing union model*  
Source:- Sapsford and Tzannatos (1993 p 277)

Expressed simply, individuals join unions if the monetary and nonmonetary gains derived from membership, comprising work terms and conditions including grievance procedures and support in case of threatened dismissal or redundancy, exceed the costs, being membership fees, psychic costs, and potentially adverse employer responses (Christie 1992, p.44). In broadly promoting their members interests, unions have four principal objectives:



- improving the conditions of employment, the maximising function noted above and countering the monopsony power of employers;
- organisational security;
- providing direct assistance to members; and
- political or non-industrial objectives, Deery (1983, pp 63-76).

Ascertaining whether unions have been successful in promoting their members' interests is problematical. However, a number of union-success indicators are available including:

- union density over time;
- the union/non-union wage differential and impact on the structure of wages eg. the earnings dispersion across skilled and unskilled workers;
- improving terms and conditions of employment; and
- effect on firm profits, and economic rents etc.

Union density, an important indicator of union power, increased dramatically over the 20th century in most western countries. For example, in the UK union membership increased from 10.6% of the workforce in 1892 to 53.6% in 1980, and in Australia, from 6% in 1900 to a peak of 59% in 1954. In Australia, union density which is always subject to business cycle fluctuations and differential government support (Ng 1987; Bean and Holden 1989), subsequently fell to a low 40% in 1992. About one-half of this decline was due to the impact of structural change on industries, sectors and occupations and the remainder was caused by a diminishing propensity of employees to join unions (Peetz 1990, p.221).



Secondly, unions have achieved substantial improvements in the terms and conditions of employment, utilising their economic and political powers. In Australia, the trade unions were instrumental in the first federal labor government's election in 1904 which in turn saw trade unions being officially recognised, the centralised conciliation and arbitration system established in 1904 and union representation of employees in national wage cases, though their benefits spilled over to non-union members. Since 1904, Australian unions have obtained a steady improvement in real wages and conditions of employment including: standard annual leave, sick pay and long service leave; equal pay for equal work; parental leave; redundancy protection; and superannuation (Alexander and Lewer 1996, pp.53-7).

Through the 1980s a fall in real wage levels estimated at 5-17% accompanied the various Accord agreements reached between the federal Labor government and the ACTU. These agreements promoted restrained wage increases linked to productivity gains and less restrictive work practices as a trade-off for employment creation which favoured unemployed outsiders and thereby the public interest, and gains in the social wage - government transfers and tax expenditures (Peetz 1990, p.221). Trade union ability to provide job security diminishes during the periods of high unemployment, recession, low economic growth and a push towards privatisation and contracting out etc. as occurred in this period, did reduce unions effectiveness in meeting their objectives.



## **PART II: WORLD WIDE PATTERNS OF UNION ACTIVITIES AND STATUS**

Because trade unions are one of many large competing interest groups in most economies and the state broadly reflects the balance of power between such groups, union power, organization and ability to mobilize members in pursuit of their objectives critically depends on the role of the state and employers. As Frenkel (1993, p.17) observes, union power can be assessed,

... with reference to the amount of control exercised by the state and employers in promoting or limiting union autonomy, union structure - which facilitates or impedes organizational cohesion - and the extent of joint regulation involving participation in the determination of procedural and substantive rules affecting employees lives.

Similarly, Freeman (as cited in Keynon and Lewis 1993, p.56) argues that, 'relatively modest differences in the institutions that govern labor relations exert a substantial influence on the evolution of unionism'. Unions can be more or less involved in making key economic decisions with government, and though weak unions can be involved in economic decision-making, 'it is nevertheless more common for the powerful unions to be strong in the labor market, influential in the corridors of the ruling party and involved in economic decision-making' (Frenkel 1993, p.11).

Much of a union's bargaining power over wages depends on its members' 'right to strike'; while the firm's power depends on its legal right to lock-out and/or fire



union members. In the US., union members have the general right to strike at the termination of a binding contract, at which time the union may only negotiate with the employer for a new wage contract if a majority of employees vote for it to represent them. Since 1960, US. employers have taken an increasingly hostile approach to unions, including illegally firing employees for voting for a union. So for reasons including structural change, rising unemployment but especially an increasingly hostile government- employer alliance, union density in the US. has fallen sharply.

Since 1980, under a Conservative government in the UK., a series of laws have been enacted substantially curbing union powers that under the previous Labour Party government had steadily expanded to include extensive unfair dismissal laws (1971) and trade union immunity from civil action (1975). The Conservation government labour law reforms included:

- outlawing secondary boycotts and closed-shop practices;
- requiring unions to operate more democratically, exposing them to civil liability for illegal action;
- providing financial support to government enterprises in order to break public sector strikes; and
- restricting employees rights of redress for unfair dismissal etc.

Freeman and Pellitiers (cited in Kenyon and Lewis 1993, p.520) found that:



... changes in legal regulations are a major determinant of UK [union] density over the long run ... [and that] ... the vast bulk of the observed 1980s decline in union density in the UK is due to the changed legal environment for industrial relations.

Frenkel (1993) was able to identify three main types of union patterns in a study of ten Asia-Pacific countries as at 1990, with the main feature being the nature of state-union relations, which varied according to the relative power of the state: state corporatist; state exclusionary; and state collaborative. Some interesting configurations were observed. For instance, in the state corporatist model applicable in Singapore, unions were strictly controlled by the State but included in decision-making bodies at the micro (firm/industry) level as well as at the macro-level through peak council representation. Union membership was relatively low at 15% though the union-shop principle was permitted in some enterprises, unions were encouraged to concentrate their efforts at the workplace level and most union members were covered by collective bargaining agreements.

Korea and Taiwan provided examples of the state exclusionary pattern in which the state's goals were to exclude and marginalise autonomous unions (Kwon 1997) This was achieved by strong state (carrot and stick) control: manipulating internal union affairs, use of consultative councils to 'integrate' workers at the enterprise level, and election of senior union officials to the party-dominated legislative assembly.



State collaborative unionism, applying in Australia and New Zealand, was distinguished by legislation guaranteeing a major role for unions in the labor market. Here union membership has been encouraged by access to a centralised conciliation and arbitration system, awards with a union-preference clause, enforcement of the 'closed-shop', and being able to push union claims in contravention of binding awards, with relative legal impunity. Unions have also had substantial involvement in state decision making. First, since the early 1900s they have been represented in national wage cases, together with state and federal governments and employer groups. Secondly, when the Hawke Labor government adopted a Scandinavian-type corporatist approach to policy making in 1983 with its National Economic Summit, unions – through their peak council the ACTU - were thereafter intimately involved in the series of Accord documents, which followed, evolving over time, 'from a largely macro-economic wage-fixing process to a much more general policy with a focus on micro-economic problems like the structural efficiency of the award system, restrictive work practices and the like' (Kenyon and Lewis 1993, p.54).

In conclusion, comparisons between countries with respect to differing union/wage fixing arrangements, indicate that,

... unionism tends to do better in terms of members in countries where wage-fixing arrangements are centralised and based on a consensus between peak union, employer and government representatives. (Kenyon and Lewis, 1993, p.56 reporting the research results of Freeman (1989) and his colleagues)



### **PART III: RECENT TRENDS**

Wage flexibility is an essential element in a deregulated, competitive economy. At the macro-level, there should be scope for a decline in real aggregate wages. At the micro-level it means there should be enterprise level bargaining on the basis of changes in labour productivity. Centralised wage fixation is thus an institution of the past. Since 1991 in Australia there has been consensus about the necessity to radically reconfigure the existing system of wage determination.

The Commonwealth government in 1992 stressed the importance of the linkage between microeconomic reform at the individual enterprise level and productivity gains:

Work place bargaining provides clear and direct incentives for the parties to seek out and share the maximum possible productivity gains ... workplace bargaining encourages the parties directly involved to accept responsibility for the industrial relations practices and outcomes.  
(Commonwealth of Australia  
as cited by Rimmer 1994, p.25).

The Industrial Relations Commission (IRC) has encouraged the development of enterprise level bargaining so that wages and conditions can be fixed at a level appropriate to each enterprise, with the result that by 1993 about 25% of federal award system workers were covered by enterprise agreements.



The national wage case decision in October 1991 introduced the enterprise bargaining principle though the ACTU then called for the legislative changes necessary to facilitate enterprise-level negotiations between unions and employers. Within eight months about 100 agreements had been ratified by the IRC covering: work organisation; conditions of employment; the working environment; training; and, the use of capital (Rimmer 1994, p.29). However the introduction of new legislation to speed up the process and saw over 1000 enterprise agreements covering some 35% of employees under federal award (11% of all employees) entered into by June 1993.

The process of enterprise bargaining required employees to communicate and negotiate directly with their employers rather than through union officials and industrial tribunals concerning the terms and conditions of their employment contract, its implementation, monitoring and the resolution of subsequent disputes.

Simply stated, the main impact of enterprise bargaining in Australia and elsewhere (eg. New Zealand) has been, 'to reduce the power and influence of existing Federal and State tribunals, trade unions and employers' associations' (Kriesler 1995, p.155). See Table 2 for the 'pros and cons of enterprise bargaining'.



Supporters Argue	<ul style="list-style-type: none"> <li>• It would replace our existing highly centralized and cumbersome, two tiered award system with agreements which would better reflect the capacity of companies to pay.</li> <li>• Union power and influence will be reduced.</li> <li>• Productivity will rise, as a result of greater recognition of individual differences between employees.</li> <li>• Industrial disputes would be settled more quickly, without the need for outside tribunal and intervention.</li> <li>• Greater cooperation and trust between employers and employees would replace the present “them and us” philosophy.</li> </ul>
Opponents Argue	<ul style="list-style-type: none"> <li>• Wage differential will widen</li> <li>• Working conditions and terms of employment will deteriorate as the influence of unions falls.</li> <li>• Employees will strongly oppose it, leading to a fall in trust and rise in bitterness towards employers.</li> <li>• Employer-funded employee training will be reduced.</li> <li>• Our Federal-system of Industrial Relations will prevent it.</li> </ul>

*Table – 2: The Pros and Cons of Greater Enterprise Bargaining*

Source: P. Kreisler (1995, p. 156)

Fewer than 30% of Australia’s private sector workforce are now union members, 15% of which have been nonfinancial for more than six months. Also a mere 8% of new workforce entrants since the mid-1980s have joined unions. These statistics indicate that union power is now sharply declining. Furthermore, in recent times, job growth has been mostly confined to small employers who have



largely evaded union-sponsored enterprise bargaining endeavours and centralised controls, contracting-out, the self-employed, women and part-time workers less disposed to joining unions. Australia also has the highest job mobility in the advanced world which reduces employees' interest in unions and their activities. Furthermore, unions have failed to sell their services to employees, maintain sufficient contact with them and ensure genuine democratic involvement

The combined effect of reduced union density, power, structural changes which have been occurring in the economy and the reconfigured industrial relations regime is that, as Kreisler (1995, p.156) explains,

... our industrial relations system is becoming very much a half-way house between highly centralised systems on one hand and highly decentralised ones on the other. This appears far from optimal given that the countries which have had the best wage policy outcomes and GDP per capita outcomes over the past decade are those which tend to be at either end of the spectrum.

New Zealand's adoption of a radical mostly decentralised system of industrial relations in which national, occupational and award negotiations have been replaced by collective and individual workplace-level negotiated contracts, has seen union density and power go into a near fatal decline. Just an estimated 50%-60% of employees are now covered by collective or individual workplace level contracts.



Union power has also been reduced by the gradual implementation of reform measures in relation to government business enterprises under the Hilmer et al (1995) and similar initiatives that are causing job losses due to rationalisation and privatization. Also, during the latter years of the Hawke-Keating Labor government, unions were increasingly less influential in relation to its socio-economic policy measures. The 1996, 1999 and 2001 election successes of the Coalition federal government have undoubtedly increased the ongoing decline in the role, power and status of Australian unions perhaps in a manner similar to the UK experience in the 1980s under the conservative Thatcher government. In relation to industrial relations, the Coalition's stated program has been to:

- end unions monopoly right to represent certain classes of employees;
- abolish the present system of compulsory arbitration;
- permit both employees and employers to utilise anyone's services in connection with workplace negotiations;
- encourage employers and employees to enter direct contracts based on worker performance and productivity rather than a 'pay the job approach' to wage fixing; and
- maintain a safety net nationally set safety-wage to protect the rights of lower-paid workers.

The Coalition's broad policy was supported by a 1993 Business Council of Australia

study, which promoted the goal of just one union per workplace with the clear



objective of redistributing power is existing workplaces in favour of employers,  
and  
the creation of USA-type non-union workplaces in 'greenfield sites' (Dabscheck  
1995, p.54).

However, all is not lost for unions in Australia under an increasingly decentralised  
industrial relations regime where government at best provides a neutral legal  
regime  
with respect to their status and activities. In Sloan's view (1992) a more  
decentralised union structure must necessarily emerge which would also enhance  
union representation of its members through more direct contact and higher  
member  
accountability and a better ability to monitor employer conduct. Further, if union-  
type services really became contestible at the individual enterprise level, only the  
most  
efficient, effective employee representative entities would survive. In other words,  
in  
terms of the Ross-Dunlop debate, the successful more decentralised unions,  
largely  
deprived of their political function would focus on their core-business, promoting  
the economic welfare of their clients.



## CONCLUSION

In industrialised western economies, the primary role and function of trade unions has been to advance the economic welfare, expressed in terms of wages and fringe benefits, and working conditions of their members, by collective action at the workplace and political action at the broader societal/governmental level. Unions across the span of the 20th century have successfully advanced their members interests. They have been most successful under supportive centralised wagefixing and arbitration systems. However, their success has in part depended on a supportive or at least benign government. In the last 20 years, union density has sharply dropped across most countries as economic conditions have worsened and changed, and employers as well as governments have either sought to directly curb union activities and their powers, or promoted a more decentralised industrial relations regime stressing workplace level enterprise bargaining as a means of achieving higher productivity and better representation of workers interests in an increasingly competitive global environment .



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