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# Labour Market Adaptability Seminar Papers

NEW ZEALAND  
**Planning  
Council**

*Te Kaunihera Whakakaupapa  
Mo Aotearoa*



# Labour Market Adaptability Seminar Papers

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## LABOUR MARKET FLEXIBILITY

Address to Planning Council Seminar

May 1990

*Flexible - "capable of being bent, admitting to a change  
in figure without breaking."*

In 1986 the Economic Monitoring Group said, "the general sense of an efficient and adaptable labour market is clear enough, but it is much less easy to find a more precise statement of what is desirable."

"An efficient and adaptable labour market" - "one which ensures that people move to jobs (both paid and unpaid?) where they are most productive - and where they have sufficient incentive and means to further increase their productivity whilst doing those jobs?" How do we know when we have achieved such a labour market?

Labour markets do not appear to adjust rapidly. Theories such as human capital, internal and dual labour market, implicit contract, and transaction cost analysis, and efficiency wage all contain partial explanations of why economically rational behaviour by employers and employees at the micro level will lead to disequilibrium in the labour market. But over the longer term, for reasons of macro efficiency and equity, such disequilibrium is clearly undesirable.

In an aggregate sense the desired level of flexibility might be defined as one which, given other appropriate policy, leads, in the medium term, to sustainable full employment whilst maximising growth in real incomes. Unfortunately this attempt at definition raises more questions than answers. First, there may be trade offs between full employment and maximising real income growth. Second, we can only say we have achieved sufficient flexibility, ex post, and that's only if we agree what constituted maximum growth. And if not, we're still left to argue about the cause - insufficient flexibility in the labour market or other inappropriate policy.

Easton (1986) defined aggregate flexibility as "the ability of the labour market to redeploy labour in the face of significant structural change without substantially increasing unemployment." In that sense he said "it could well be argued that New Zealand has a flexible labour market, at least in that period." However, when we add the additional condition, "whilst maximising growth in real incomes", then our achievement of flexibility over that period looks much less certain.

As Easton notes the desirable level of flexibility may change over time depending on the rate of structural

change in the economy and, I might add, the predictability of that change. In addition, the key components of flexibility may differ in different economic conditions - as Savage observes in his case studies in electrical and electronics manufacturing, there is an asymmetry in the labour adjustment behaviour of firms in times of increasing demand compared with times of decreasing demand.

It is probably for these two reasons that across the OECD "increased labour market flexibility" has been seen as a key policy issue in recent years. Rapid structural change - caused by the internationalisation of markets, the growth of the newly industrialising economies, rapid changes in technology and consumer products - all imply a need for higher levels of flexibility. In addition, and associated with structural change, decreasing demand produces a different set of problems for employers than expanding demand. For example, legislation on redundancy payments, which many employers currently argue is a "rigidity" would be less prominent in their analysis of "rigidities" in a time of expansion.

Studies of economy wide flexibility generally seek to examine aspects of such flexibility, and can be grouped into three main areas - quantity adjustments, price (wage) adjustments and quality adjustments.

One set of indicators of quantitative adjustments is provided by labour mobility measures. Labour moving across, within or between firms, across industries, occupations, or regions provides a constant reallocation of resources. There is considerable variation across the OECD in labour turnover rates, but I have not seen any comparative New Zealand data. High labour mobility may assist the process of structural adjustment (fewer layoffs, more attrition); however better developed internal labour markets may also facilitate adjustment with reduced uncertainty for employees and possibly reduced transaction costs for employers.

There are two sets of wage flexibility measures - aggregate wage flexibility and relative wage flexibility. Aggregate wage flexibility, refers to the capacity of average wages (and benefits?) to vary with international competitiveness, labour market conditions and/or to price levels. The Reserve Bank have argued that rising real wages have been a major factor in contributing to the growth of unemployment. Des O'Dea (EMG, 1989) found that real income wages have declined since peaking in the early 80s, but that the real product wage (which measures the real cost of labour to the employer) has increased over the 1985-89 period.

Relative wage flexibility is seen as a means of signalling to workers where their most productive uses are. Various measures of relative wage flexibility have been devised. Measures of variability of wages include variability across industries, regions, occupations and within occupations across industries, including some new variants which Dennis Rose and Ray Harbridge will discuss this afternoon.

The Economic Monitoring Group (1986) concluded that, on the basis of measures of industry wage

dispersion, "in comparison with the OECD there is little ground for thinking that the New Zealand labour market is unusually inflexible." In addition, they found that over the 1975-83 period industry wage dispersion had increased substantially. Updating and extending the earlier work of the EMG, Des O'Dea found "that wages are responsive to changes in industry demand, but that the response is sluggish ... there is some suggestion that the flexibility of response has increased recently."

Another important set of adjustment mechanisms are quality ones. Blandy and Richardson, for example, assert that quality adjustment is a more important source of labour market adjustment than variations in relative pay. I am unable to find any New Zealand studies of aggregate quality adjustment, but clearly the overall education and training culture, both within and outside the workforce, will influence the capacity of the economy to adjust to changing demands for skills.

Brunhes (1988) notes in his work that most previous OECD studies of labour market flexibility have focused on its external forms, changes in the labour market and relations between enterprises and the labour market. In fact the unit of analysis can range from economy wide to regional or sectoral levels and down to the level of an individual enterprise. Brunhes chose to focus on the enterprise level to "investigate the internal forms of labour flexibility, i.e. the way in which enterprises in response to the economic, technological and sociological changes of the 1980s are seeking to introduce greater flexibility into their 'manpower' usage" (p.11).

There is no consensus on any one system of classification, but I like the simplicity and the internal/external distinction of the one Brunhes uses. He distinguishes five different kinds of enterprise flexibility.

Table 1:

Labour Flexibility Within Enterprises	
<i>External numerical flexibility</i>	- "the number of employees is adjusted to needs"
<i>Externalisation</i>	- "part of the firms work is put out to enterprises or individuals who are not bound by employment contracts"
<i>Internal Numerical Flexibility</i>	- "the number of working hours is adjusted in line with needs but the number of workers remains unchanged"
<i>Wage (and wage 'like') Flexibility</i>	- "the ability to adjust wages"
<i>Functional flexibility</i>	- "workers job content is modified according to need". has both short term and long term aspects - from filling in for someone else who is sick to doing maintenance work to retraining for new production process.

(Brunhes, 1988)

This classification is not without its problems; there are points of ambiguity and overlap. Brunhes found wide variation in the country characteristics and trends. In a series of interviews with managers in four countries (the UK, France, Germany and Sweden) Brunhes (1988) found that in all four countries employers sought greater flexibility, but "most of the people interviewed in France and the United Kingdom took 'flexibility' to mean 'fixed term contracts', 'the ability to lay off workers' or 'flexible working hours'. In contrast, in Germany and Sweden multiskills, qualifications and especially training were thought to be as important as, and often even more important than, these considerations ..." (p.16). It is clear that moves towards greater flexibility take different forms in different countries.

In Sweden employers have very little external flexibility; fixed term contracts are rare and not increasing, the only scope for flexibility in working hours is overtime, subcontracting is on the increase but is narrowly restrained by law and redundancy costs are high. On the other hand functional flexibility is widespread; personnel are commonly shifted from one part of an enterprise to another. Such functional flexibility is extensively promoted by government training and retraining as well as by enterprises and unions. Brunhes says "the relative absence of numerical flexibility reflects the community's commitment to ensuring that its members enjoy a certain amount of job security and stability: in a changing economy this is possible only if workers are prepared to change the work they do and thus undergo the training that this entails. Employers are accustomed to thinking along these lines, and are willing to promote training, while the government plays a major role in the organisation and funding of training" (p.20).

In contrast, in the UK, few legal and social constraints stand in the way of a high degree of external numerical flexibility, externalisation and internal numerical flexibility. Redundancy procedures are not very restrictive and there is a high and growing level of temporary and short term jobs, insecure part time work sometimes on irregular hours, contracting out, use of agencies and rapidly increasing self employment, and many moves towards annualised hours or 'flexiyears'. Functional flexibility, by comparison, is low but is gradually increasing. Associated with the low functional flexibility is a low level of investment in training and skills.

Brunhes' comments that, despite differing attitudes towards other aspects of flexibility, in terms of wage flexibility, most enterprises across all four countries were seeking to replace across-the-board pay structures by some form of performance (individual or group) linked system. Mechanisms include bonuses, profit sharing, group and individual bonuses, but in virtually all of them the proportion of income linked to performance is small. Brunhes noted that none of the enterprises regarded wage flexibility as one of the more important parts of their labour flexibility policy - rather it is seen as an important way to motivate employees and improve productivity. Rojot, however, notes that, on the basis of his additional studies, other aspects of wage flexibility are felt to be significant; notably aggregate wage flexibility - the alignment of wage agreements with the growth of the labour force and/or the economy - and relative wage flexibility - the role of wage differentials in mobility between industries and occupations. Negotiations at individual enterprise level have little influence over such aspects of wage flexibility.

What do we know of labour flexibility at the enterprise level in New Zealand? Many of you will know more about this than I, but I'd like to use John Savage's 1989 study as a starter.

John used the following taxonomy for analysing labour adjustment methods:

Table 2

Adjustment Methods (Declining Demand)		
	<u>Savage</u>	<u>Brunhes</u>
Change Inflows/Outflows		
-	reduce recruitment	} 'external numerical'
-	reduce promotion	
-	downgrade 'non wage' employment conditions	
-	tighten entry requirements	
-	tighten dismissals policy	
-	reduce retirement age	
-	reduce promotion	
Change training		
-	change training length or composition	'functional'
Change hours		
-	reduce overtime	'internal numerical'
-	reduce basic hours	
Change jobs		
-	redesign jobs	'functional'
-	transfer workers to maintenance	
-	transfer workers to other products	
Change employment		
-	staff required to take leave	'internal numerical'
-	temporary lay offs	'external numerical'
-	permanent layoffs	
-	attrition	
Change wages		
-	reduce basic wage*	'wage'
-	reduce overtime wage	
-	reduce bonuses, allowances, perks	
'Non Labour' changes		
-	reduce use of subcontractors	'externalisation'
-	other e.g. build stocks, merchandise	

\* relative to award

He asked firms to describe the adjustment methods they would use in cases of a) declining and b) expanding demand over three time periods, "short term" (<1 month), "medium term" (1-6 months) and long term (6 months +). The following table summarises adjustment methods in the declining demand situation.

Table 3

Most Common Long Term Labour Adjustment Mechanisms			
Declining Demand			
Mechanism	% firms who would use	% firms who would not use	Brunhes
permanent layoffs	59	27	external numerical
reduce basic hours	40	50	internal numerical
reduce bonuses, allowances	31	69	wage 'like'
redesign jobs	22	28	functional
reduce basic wage	18	89	wage
reduce recruitment rate	17	0	external numerical
temporary layoffs	18	59	internal numerical
alter product mix	17	33	functional

Amongst the possible range of adjustment methods there were many which most firms would not consider at all, these being downgrading employment conditions (e.g. subsidised cafeteria etc) (100%), reduction of basic wages (81%), reduction of retirement age (79%), reduced promotion (73%), tighten dismissals policy (65%) and using temporary layoffs rather than permanent ones (65%), altering training length (59%), or tightening entry requirement (56%).

John notes that disliked methods are ones that all involve some degree of renegotiation of explicit contract conditions, as well as implicit ones. Reducing relative wages and changing conditions were disliked because they "created friction" and presumably reduced morale and productivity.

The most common adjustment methods in the long term were thus numerical, external, in the form of permanent layoffs, reduced recruitment, temporary layoffs and internal, in the reduction of basic hours,

wage and wage 'like' (reduced bonuses, allowances, reduced wage relative to the award) and functional (altered product mix and redesigning of jobs).

The situation was a little different in the increasing demand situation.

Table 4

Most Common Long Term Labour Adjustment Mechanisms in 23 Firms Expanding Demand			
	% firms who would use	% firms who would not use	Brunhes
Increase bonuses, allowances, perks	43	57	wage 'like'
Increase basic wage	28	61	wage
Increase recruitment rate	23	5	external numerical
Change training length or composition	20	53	functional
redesign jobs	13	47	functional
increase subcontracting	13	19	externalisation

(One of the major expansionary adjustment mechanisms mentioned was more/less mechanisation, not a direct labour adjustment mechanism, although implicitly associated with many of the above.) Comparison of the tables shows asymmetry in behaviour: promotion rates are more likely to be increased than decreased, basic wages are more likely to be increased than decreased, bonuses, allowances and perks are more likely to be increased than decreased, basic hours are more likely to be reduced than increased, increased subcontracting is favoured over reducing it, the product mix is less likely to be altered in expansionary than in contractionary phases. Unsurprisingly, wage and wage 'like' features are more likely to be adjusted upwards than downwards.

Asked about constraints on adjustment the firms noted labour supply constraints to be the most important, followed by award constraints.

Table 5

Adjustment Constraints Considered Important	
	%
Labour supply	78
Explicit award conditions	57
Technical/organisational	52
Government related	48
Implicit understandings	43
Others	13

Finding employees with particular qualifications or skills, or in some cases, "people who are adaptable", was the most commonly reported constraint. Some managers said they would rather operate below capacity than risk hiring "unsuitable workers". In another recent survey Savage, Campbell and Bollard once again found respondents citing the poor quality and attitudes of the workforce and shortages of skilled labour as barriers to the improvement of quality and productivity, but expected these barriers to lessen in the future. Around 13% of all firms thought wage setting practices were a constraint, a similar proportion were concerned about the level of hours worked, and another 13% found general employment conditions, particularly redundancy pay problematic, whilst a further 13% found all three areas constraining (incl. demarcation, long service increments). Twenty five percent of all firms had a major concern with blanket award coverage and compulsory unionism, and around 20% mentioned the ACC levy. Technical and organisational constraints related mostly to small firm size, and the skill specificity of existing workers.

From Savage's small sample of firms we can tentatively conclude that in New Zealand labour adjustment mechanisms in times of declining demand tend to be numerical, particularly external, but also internal, with wage 'like' and functional adjustments being less likely.

What do we know about changes in flexibility at firm level of the 1980s in New Zealand? I'd like to run through briefly, but hope both Mike Clark and Ray Harbridge will be able to add a lot to the picture.

#### *External Numerical Flexibility*

In many awards there is wider scope for employing people on fixed term contracts, on a part time or a casual or job sharing basis. The growth of part time workers is consistent with this. Such employment is

concentrated in the service sector, generally in jobs with low skill and high turnover.

#### *Externalisation*

The practice of subcontracting work to individuals and enterprises has certainly increased, but there is a real absence of hard data in this area. There are various forms - putting work out, on-site subcontracting, hiring temporary staff from agencies, increasing use of self employed workers. It is difficult to generalise about firm behaviour but the growth of the temporary personnel industry, the growth of self employed contractors particularly in forestry, owner drivers; building, the growth of self employment across nearly all sectors in the 1980s and the growing number of small enterprises over the 1986-89 period, all suggest growing externalisation. Subcontractors probably tend more commonly to be highly skilled technical staff, and low skilled ancillary staff.

#### *Internal Numerical Flexibility*

New shift arrangements have been negotiated (e.g. Fortex), but are not common. In some awards 'clock hours' have been extended. Annualised hours agreements are being negotiated e.g. dairy industry, but are not common. I hope Mike Clark will be able to tell us more about the frequency and nature of such changes in his paper.

#### *Wage Flexibility*

As noted earlier, at the workplace level, wage flexibility has more to do with improving employee motivation, skill and productivity than as a means of attaining flexibility. It is often tied in with moves to increase functional flexibility as in the case of NZ Steel and Nissan and Fisher and Paykel.

#### *Functional Flexibility*

Technological change which has often blurred old occupational boundaries e.g. in the printing industry is a main driver of increased functional flexibility. It may involve extending the range of tasks an employee can do (e.g. Nissan) and/or upgrading skills. There are some notable examples of increased functional flexibility e.g. NZ Steel, Toyota, but it is certainly the exception rather than the rule. Functional flexibility may already be high in some areas - it is more likely to be present in small enterprises, and New Zealand is predominately a nation of small enterprises. However, in larger enterprises our still predominantly craft based union system is clearly an impediment to increases in functional flexibility.

#### *Increased Workplace Flexibility: The Options*

Preferred options will depend to a large extent on the nature of the firm. Where skills specific to the firm

have been developed or when more general skills are in short supply preferred adjustment mechanisms will be different than in the case of workers who are easily replaced. To some extent there is a trade off between different kinds of flexibility; achieving functional flexibility depends on a high degree of commitment from the workforce, inconsistent with high turnover rates.

Brunhes' distinguishes between "short term" and "long term" flexibility commenting that there may be a trade off between the two - "it may be that the short term flexibility enjoyed by the British is an indirect impediment to long term flexibility; insecure jobs do not facilitate the acquisition of skills, trained employees can do a large amount of overtime, which dispenses firms from training new workers ..." (p.35).

Lifetime employment, on the other hand, can engender high levels of trust and cooperation between manager and worker, easing the process of change and adjustment in the longer term.

Hill, commenting on trends in Britain, says "it is certainly feasible that some changes occurring in the name of flexibility may not be in the longer term interests of either employers or employees" (p.26).

Having discussed the elements of flexibility from the perspective of the employer I'd like to add some quotes which illustrate how "labour market flexibility" is often viewed from "the other side".

- "The flexible labour market is in fact a labour market rigged to favour the powerful against the many." Peter Harris, then PSA.
- "The specific changes which employers want are of three kinds. First, they want the costs of instability to be borne by workers and the State ... secondly they want to reduce the bargaining power of trade unions, and thirdly to be able to pay lower wages." Peter Brosnan.

Brunhes notes that the kind of flexibility workers seek is the possibility of taking time off for family reasons, for accumulating leave for long weekends etc. The Economist points out that many salaried workers already have flexibility of this kind. Such workers also want a less rigid career path to allow more family time when children are small etc. Some firms e.g. IBM have realised that making such paths available is also less costly for them.

This serves as a reminder that whilst there are power questions in the employer/employee relationship, mutually beneficial changes can be made. But conflict between the aspirations of the groups is inherent.

Finally a quote from one Swedish employer interviewed by Brunhes'



Research.

The Economist, *All in the Corporate Family*, 12 May 1990.

**The dispersion of wage settlements  
in registered collective agreements -  
1984/5 - 1988/9.**

**Raymond Harbridge\***

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