

Policy by Contract

Social pacts in Australia and New Zealand

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Abstract

Governments often make public deals with interest groups, yet the conditions under which these bargains emerge are not well understood. This paper explores these policy contracts in the context of “social pacts”, where governments sign explicit policy agreements with peak level union federations for electoral gain. I develop a theory of pacts and then apply it to an empirical puzzle emerging from events in Australia and New Zealand, 1983-1996. Facing similar macroeconomic crises and with historically similar wage bargaining institutions and levels of union density both elect Labor governments which then make opposite choices: the New Zealand government embarked on a period of radical deregulation, relying on unemployment and monetary policy to discipline wage demands while the Australian Labor Party and Council of Trade Unions signed a formal Accord, enhancing unions’ relevance in wage bargaining and policy making. Relying on original interviews with key policy makers in both countries, I conclude that the organizational relationship between the union peak associations and the Labor parties were the critical differences that made intertemporal political transactions possible (and self-enforcing) in Australia but not in New Zealand.

Keywords: economic policy, wage bargaining, contract theory, social pacts, Australia, New Zealand

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“There would have to be an agreement. The government would rely on the union movement in the same way that the union movement would rely on the government.”—Laurie Carmichael, former Federal Secretary of the Australian Metal Workers’ Union

A government, by definition, possesses full powers of legislation within some territory. Yet it is not uncommon to see senior government ministers meeting publicly with the leaders of powerful interest groups. Sometimes governments even go so far as to make publicly announced policy agreements with non-governmental groups. Why would a government need to sign a special agreement with some subset of the population, especially in democratic settings where the governments derive their powers from the express consent of the governed? What makes these agreements credible? They are not enforceable in a conventional sense; there is no court to arbitrate disputes. In this paper, I explore the conditions under which these bargains emerge. To ground the discussion, I focus on an a subset of agreements known as “social pacts”.

Since the mid 1970s, governments and peak-level labor federations in several countries¹ have been able to jointly formulate national-level policies on wages, working conditions, training regimes, industrial policy, taxation, and government welfare spending. This is all the more remarkable since these agreements occurred in countries not historically enjoying centralized labor movements and bargaining institutions. What’s more, these “social pacts” began emerging at the same time that the neo-corporatist institutional arrangements of northern Europe came under pressure, most notably in Sweden. The academic literature on these pacts, however, is largely a collection of case studies with little to connect one to another besides appearing together in the same edited volumes. There is precious little in the way of general theoretical propositions and even fewer instances of work that considers cases outside the EU15.

¹The most frequently discussed are Finland, Ireland, Italy, the Netherlands, Portugal, Spain and the UK. See, *inter alia*, Fajertag and Pochet (2000); Regini (1995, 2003); Rhodes (2001); Visser (1998)

In this paper, I address some of these shortcomings in the literature by developing a general theoretical model of social pacts working in the tradition of the transactions approach to policy (Dixit, 1996; Spiller and Tommasi, 2003, 2007). As is standard in the theory of repeated games, the model predicts that self-enforcing intertemporal agreements are more easily sustained when discount rates are low, incentives for cooperation are high (or immediate payoffs to one-time deviations are low), and the number of actors is small. A key feature of the game, however, is the commitment potential offered in the initial contracting stage. Whether these commitment enhancing bargains can emerge in equilibrium is driven by the scale of transaction costs in negotiating and delivering policy favors to unions. I then apply the model to an empirical puzzle emerging from events in Australia (pact) and New Zealand (no pact) over the 1983-96 period. In the early 1980s both countries faced nearly identical economic and political crises. In crucial elections, both elect Labor² governments which then make opposite choices: the New Zealand government pursued a radical deregulation strategy, relying on monetary policy and unemployment to discipline wage demands.³ In Australia, the Council of Trade Unions (ACTU) and the Australian Labor Party (ALP) signed a formal Accord in which the unions offered real wage restraint in exchange for increases in the “social wage.” In evaluating the puzzle, I rely on data drawn from original interviews with key government, union, and business leaders in both countries. I conclude that differences in the organizational relationship between the union peak associations and the Labor parties were the critical differences that made intertemporal political transactions possible (and self-enforcing) in Australia but not in New Zealand.

This paper makes several contributions. First, I propose a model that delineates some of the conditions under which an elected government would find it worthwhile to sign and imple-

²Note that the spellings of the Labor parties differ in Australia and New Zealand; The ALP uses the American spelling while the Labour Party in New Zealand uses a British spelling. When referring to the NZLP I will use the British spelling but when referring to both jointly I will stick with American English.

³Observers have described New Zealand’s broad and deep economic reforms of the 1980s-90s as roughly equivalent to an IMF restructuring program. See Evans et al. (1996) for an overview.

ment a policy contract with powerful interest groups even though the government possesses *de jure* power to legislate unilaterally. Second, by exploring these contracts in the context of social pacts, I extend the relevance of social pacts beyond the narrow, technocratic discussions of labor market and incomes policy by connecting them to the larger theoretical concerns of transaction cost politics and contract economics. I explicitly link social pacts to the electoral imperatives facing governments. Third, I present a novel explanation for the empirical puzzle in Australia and New Zealand. Fourth, the contrast between events in Australia and New Zealand demonstrates how negotiated policy implementation achieved a similar (if not superior) current outcome, namely a successfully restructured economy, while imposing a lower social cost during the transition and sharing it more equitably. Finally, I contest Mancur Olson's pessimism about the emergence of strategically meaningful encompassing groups⁴. Instead, I show how the ability of peak associations to act strategically in national-level policy making is a function of their organizational capacities, which are in turn largely determined by the incentives and constraints generated by macropolitical institutions and economic structure.

The paper is organized into five parts. The next section outlines the current lack of structure in the literature on social pacts. Section two sketches the outline of the theoretical model. Section three describes the situations in Australia and New Zealand on the eve of their elections. Section four presents the interview findings and interprets them in light of the model. Section five concludes. The appendix collects the formal discussion of the model and details about the data and interviews.

⁴“Peak associations frequently lack the unity needed to have any great influence on public policy, or even coherent and specific policies.”(Olson, 1982:50)

1 Social pacts

Beginning in the 1980s, observers of European industrial relations systems began commenting on a series of agreements between peak-level union federations and governments (Fajertag and Pochet, 2000, 1997; Regini, 1984, 1986; Teague, 1995; Visser, 1998). These agreements differed substantially in their content, timing, and durability but all were tossed into buckets labeled “social accords” or “concertation”. Typically they embodied some form of exchange in which unions pulled their punches on the wages front or assented to changes in work regulations in exchange for social spending, taxation, or other policies they preferred.

Initially, these events appeared surprising for several reasons. First, pacts began appearing about the same time that corporatist institutions came under pressure, most notably in Sweden. Second, these pacts emerged in countries without historically centralized union movements or strong employer groups: Ireland, Italy, Spain, Portugal, and the Netherlands. Third, these initial agreements came about after the dramatic collapse of the UK Social Contract of the late 1970s, the failure of which ushered the Thatcher government into power.

Unfortunately, the literature has generated no consensus definition of a pact, likely due to each agreement’s many idiosyncratic features. For my purposes, pacts are negotiated policy contracts: a *social pact* is a written, formally articulated agreement in which specific policy domains are identified, policy targets set, and the responsibilities of the signatories enumerated. A pact is time-bound, either explicitly or implicitly.⁵ A pact is signed by at least two of {labor peak association, employer peak association, government/executive, opposition party}. To be considered a pact, the government or prospective government must either be a signatory of the pact *or* the pact must have clauses which require government action *and* the government publicly declares its support for the agreement and its intention to take the required actions.

⁵I.e., pacts either have an expiration date or are known to become void when, for example, the political party in question loses office.

Pacts can, in principle, involve employers at their inception. Since the key provision in most pacts, including that of Australia, is a policy-wages tradeoff, union participation is critical. Employer participation may occur subsequently or not at all. While the timing and degree of employer support plausibly has implications for the duration and effectiveness of social pacts (Baccaro, 2006; Baccaro and Simoni, 2006; Baccaro and Lim, forthcoming), for the sake of simplicity and to make the model more directly applicable to the empirical situation at hand I will only be considering contracts between parties/governments and unions.

Note that pacts as discussed here are distinct from collectively bargained employment contracts, whether private or public sector. While governments (or agencies thereof) routinely act in the role of employer and negotiate contracts with unionized public sector workers, these are narrow in scope and restricted only to a subset of unions. Social pacts, however, are agreements with union peak associations that affect public policy goals while also setting bargaining parameters across the entire economy. In a pact, the government negotiates in its role as policy maker, not as employer.

My definition of a pact implies an obvious necessary condition: there must exist some peak-level association capable of negotiating with a government. Additionally, for a pact to be at all meaningful, unions must play a significant role in determining nominal wages in the economy. I view pacts as a middle point on a continuum with completely decentralized bargaining at one end and stable well-developed corporatist institutions at the other.⁶

Social pacts differ from stable institutionalized bargaining arrangements (at least initially). First, the agreements are time-bound, with definite dates of inception and termination. Second, they are explicit agreements over specific policy domains. Third, they almost always have specific policy targets (inflation levels, wage increases, etc.). Fourth, they must

⁶For an extensive discussion of the nuances of neo-corporatism vs. concertation, see Molina and Rhodes (2002) and Baccaro (2003). See Traxler, Kittel and Blaschke (2001) for a more detailed construction of a wage/price bargaining continuum.

be self-enforcing by construction. Unions typically cannot appeal to organs of government to ensure that the governments' terms of the pact are complied with. Similarly, governments and parties cannot appeal to an impartial observer to force unions to live up to their end of the bargain. Even if such a third party enforcer did exist, it is unlikely that the outcomes of interest are fully observable and could be contracted upon.

From the other side of the continuum, pacts also differ from lobbying and implicit contracts between parties and unions. Unions in even the most decentralized bargaining environments maintain significant political relationships: unions support parties in the expectation that, should the party win power, it will endeavor to enact policies that benefit unions, or at least not hurt them. Both the Dixit and Londregan (1995) framework and the standard Grossman and Helpman (2001) model of lobbying can be viewed as descriptions of these more generic types of party-union relationships. Unlike lobbying and implicit contracts, however, pacts are very *policy-specific* and very *public*. Indeed, pacts are trumpeted loudly within unions and in the press more broadly. While, on some level, pacts might be viewed through the lens of common agency and lobbying, I argue that the public nature of pacts begs for an explanation not captured in these standard models.⁷

The definition above implies several interesting, interrelated theoretical puzzles. First, why would the government negotiate policy with outside actors, especially those not powerful enough to achieve their desired policy outcomes directly? Why not just legislate as it sees fit? Second, how do the social partners settle the distributive conflicts within their own organizations? Third, why do some pacts persist while others collapse? Fourth, why does the content of pacts seem to evolve over time in places where they can be sustained?

Though the literature on pacts has recognized the puzzles (Baccaro, 2000; Harcourt and Wood, 2003; Regini, 1995), and even proffered some generic responses, it tends to be descrip-

⁷It is also worth mentioning that the literature on concertation generally ignores the highly public nature of pacts.

tive of pacts in particular cases lacking the analytic foundations capable of answering these questions or generating statements applicable across cases or to political transactions more generally. There is one common thread running through the case study literature, however: pacts are policy responses to times of perceived “crisis”, often framed as exogenous. Authors have pointed to the oil shocks, “globalization”, and EMS/EMU convergence/accesion criteria as the source of “crisis”.⁸ I take up the issue of crisis more extensively below.

While the focus in this paper is on electoral considerations, I am hardly the first to argue that political concerns matter. Regini (1995) claims that pacts are a way for governments to deflect blame for implementing unpopular policies. Hamann and Kelly (2007) also posit “electoral pressures” as key to understanding pacts in Europe. Adolph (2006:ch.7) presents an extension of the Iversen (1999) model of wage-price bargaining, directly addressing wage-policy trades between unions and governments. In his model, wage restraint-policy bargains are most effective at reducing unemployment when the central bank is an inflation hawk, unions are moderately centralized, and the government is controlled by Left parties. The most significant attempt to date to address pacts in a systematic fashion comes from Bacarro and co-authors (Baccaro, 2006; Baccaro and Simoni, 2006; Baccaro and Lim, forthcoming). In a series of papers, they argue that pacts emerge when the following conditions obtain: “weak” governments⁹ face a “crisis” in a country where the union movement is dominated by a political moderates (i.e., not Communists). Whether pacts are “durable” is determined by whether employers buy in.

The model I describe below shares technical and substantive similarities with both the Adolph and Bacarro arguments. I go further, however. The Adolph model is more concerned with links to central bank policy and unemployment outcomes than in modeling the emergence of pacts. Unlike either, my model provides explicit microfoundations for social

⁸See, *inter alia* Fajertag and Pochet (2000, 1997); Hancké and Rhodes (2005); Hassel (2003); Regini (1995); Rhodes (2001)

⁹They are typically referring to minority coalitions and caretaker governments.

pacts by linking pacts to the electoral incentives of partisan politicians and union leaders. In so doing, I am able to make more specific claims about the effects of partisanship, electoral and legislative institutions, and party-union organizational ties on the emergence and maintenance of pacts.

2 A model of social pacts

Social pacts, as defined above, are intertemporal political exchanges. Deals of this type are fragile. They not only encounter all the obstacles endemic to any intertemporal exchange, i.e., time inconsistency and moral hazard, they also involve outcomes that are observable but potentially not verifiable, vulnerability to random shocks to both the political and economic system and the possibility that the agents making the deal may not be the ones called upon to deliver on its terms and conditions. These attributes are the hallmarks of potentially steep transaction costs. Additionally, there is no possibility of third party enforcement for these transactions. If pacts are to be sustained in equilibrium, they must be self-enforcing. Repeated games are the standard tool for modeling situations of this type. They have been frequently employed for modeling situations of political exchange and contracting (e.g., de Figueiredo and Weingast, 2005; de Figueiredo, 2002; Spiller and Tommasi, 2007).

The model builds on Adolph's extension of Iversen's wage-price bargaining model. Due to space considerations, I only present a sketch of the model and describe the equilibria and key implications. A full formal discussion of the model and derivation of propositions is available at <http://students.washington.edu/jsa5/papers.html>.

2.1 Players

Consider the following game with four strategic players: a set of n equally sized unions, L^i ($i = 1 \dots n$), who choose nominal wage increases for their bargaining areas; an incumbent

party, P , who controls tax and transfer at some cost; a representative citizen, C , who chooses either the incumbent or the challenger in periodic elections;¹⁰ and a monetary authority, M , with control over the inflation rate. For the sake of exposition, I posit an extremely simplified political system. C can be interpreted as the median or decisive voter. Implicit in this formulation is the assumption that there is a solution to the underlying voting game. In the model, I also abstract away from intra-labor movement politics and assume that all unions are equivalent; what matters is how many there are, i.e. the fragmentation of the labor movement.¹¹ I explicitly investigate this (strong) assumption below in discussing the Australian and New Zealand cases.

Each union is assumed to value real wages, employment, and the “social wage”. Specifically, each union’s utility at time t is

$$V_t^{L^i} = S_t + \alpha(w_t^i - \pi_t) - (1 - \alpha)\bar{U}_t U_t^i \quad (1)$$

where π is the inflation rate; w^i is the nominal wage increase set by union i ; U^i is the unemployment rate amongst members of union i and \bar{U} is the average unemployment rate in the economy; $\alpha \in [0, 1]$ is a parameter governing the relative importance of wages and unemployment; and S is the “social wage” or, alternatively, the government policies that benefit unions.

The decisive citizen also cares about wages and unemployment. Her utility at t is given by

$$V_t^C = -\frac{1}{2}\beta\pi_t^2 - \frac{1}{2}(1 - \beta)\bar{U}_t^2 - \tau_t \quad (2)$$

where $\beta \in [0, 1]$ describes her relative aversion to unemployment and τ is a non-negative tax

¹⁰ C is assumed not to be a union member (or at least does not vote as if she were)

¹¹This paper is a component of a larger project, part of which addresses the internal politics of labor federations and their ability to act as unified bargaining agents in extensive detail. For preliminary work in this vein, see Ahlquist (2006).

that can be used to finance the social wage. For simplicity, funding for the social wage enters the citizen's utility function negatively. One way to interpret S , then, is as a transfer from C to L by way of P ; C is buying wage restraint from the unions. Some may object to this formulation of the fiscal effect of the social wage since "social wage" policies are frequently universalist in nature. Nevertheless, even universalist policies are redistributive. τ can be thought of as the additional transfers that the unionized workers are able to extract beyond what the median voter prefers, even if the median voter prefers some positive tax rate based on her position in the income distribution.

The incumbent party cares only about gaining and remaining in office, so its objective function will be induced by the citizen's voting decision rule. The party does control taxation and transfers. Specifically, the party can set τ and S subject to the budget constraint

$$S_t \leq \tau_t - \epsilon \tag{3}$$

where ϵ describes the slippage between the amount of taxes collected and the delivery of transfers to union members. This slippage can take on many interpretations, several of which I discuss below. At the most generic level, ϵ reflects transaction costs in government-union interactions.

The monetary authority is assumed to care about aggregate price levels and unemployment. M chooses the inflation rate to minimize the loss function

$$V_t^M = -\frac{1}{2}\iota(\pi_t)^2 - (1 - \iota)(\bar{U}_t)^2 \tag{4}$$

The parameter ι describes the relative weight the monetary authority places on price stability versus unemployment.

2.2 Economic Assumptions

Rather than posit a full model of the economy, I import Iversen's specification of the labor market and expectations-augmented Phillips curve. Specifically, I assume that unions set nominal wage increases.¹² The effect of nominal wages on prices and unemployment flows through two channels: a relative price effect and an aggregate price effect.¹³ The relative effect for union i is given by cw^i , where $c = 1/n$ is a measure of the centralization of unions. The relative effect for all other unions is given by cw^o . The aggregate effect for i is c^2w^i while for all other unions it is $c(1-c)w^o$. If M were to set inflation below the price increases implied by the nominal wage demands w^i and w^o , there would be an effect on unemployment. These disequilibrium conditions simplify to

$$\Delta U^i = w^i(c^2 - c + 1) + w^o c(1 - c) - \pi \quad (5)$$

$$\Delta \bar{U} = cw^i + (1 - c)w^o - \pi \quad (6)$$

2.3 Sequence of play and information

The game is played in discrete time from $t = 0, \dots, \infty$. The value of ϵ is common knowledge and assumed constant for all periods. At $t = 0$, P and L can bargain over a contract of the form $\langle S'_\infty, w^i_\infty \rangle$, where the subscript denotes an infinite sequence of vectors (S'_t, w^i_t) . I assume that, if possible, P and L reach a Nash bargaining solution in setting contract terms. If a contract is signed, then the contract's existence is announced to C , along with the values $\langle S'_\infty, w^i_\infty \rangle$. C then either appoints P or some challenger as policy maker. If the challenger is selected then $\tau_t = 0 \forall t$ and the L^i set nominal wages accordingly. If P is installed in office, P and L^i implement τ_t , S_t , and w^i_t , which need not be those announced under the

¹²Obviously wage increases are the result of union-employer bargaining. This simplification is equivalent to models in which the union sets the wage rate and the employer sets employment levels, given the union wage.

¹³See Iversen (1999:38-46) for a detailed discussion and derivation of the relative and aggregate effects.

pact. M sets π_t and the stage ends. In subsequent periods, play proceeds identically only there is no possibility for a pact. Since the state of the economy is determined and realized every period, I need only consider contracts that are constant through time at no cost of generality.

2.4 Equilibria

First consider a one-shot version of the game, solvable by backward induction. The last move belongs to M , who sets inflation to minimize its loss. Let $\pi^*(w^i)$ be M 's best response. In the absence of any pact, each union sets its wage to maximize its wage-employment outcome. Denote this wage as $\hat{w}^i = \hat{w}$. Suppose a pact was signed setting $S' > 0, w' < \hat{w}$. Even if this contract makes unions strictly better off than under $V^{L^i}(\hat{w}, S = 0)$, the unions have an incentive to renege on their side of the bargain *ex post* and set $w^i = \hat{w}$. Similarly, P has no incentive to deliver on S' . Any policy announcement by P is therefore non-credible from the perspective of the citizen, so signing a contract has no electoral value; citizens will randomize between voting for and against P .¹⁴ Unions are therefore indifferent between signing pacts and parties are indifferent about offering them. In this (subgame perfect Nash) equilibria neither the social wage nor wage restraint are delivered, even if there is a positive probability that a pact is signed.

2.4.1 The infinitely repeated pacting game

Suppose now that the game is infinitely repeated. Assume each player holds the common discount rate δ . While there are an infinite number of equilibria to any infinitely repeated game, I construct one in which pacts are credible and have electoral payoffs for the party. Specifically, consider the following strategy profile:

¹⁴Note that the infinite repetition of the stage-game equilibrium is also an equilibrium of the infinitely repeated game.

- M sets the inflation rate according to $\pi^*(w^i)$;
- L^i signs and implements a wage restraint pact in every period t provided that 1) P is in office at t ; 2) P has implemented the agreed social wage in every previous period; and 3) All other unions have maintained wage restraint in all previous periods. Otherwise $w_t^i = \hat{w}$.
- P signs and implements a pact in which $\tau = S_t' + \epsilon$ provided that 1) P is in office at t and 2) All unions have maintained wage restraint in all previous periods. Otherwise $\tau_t = S_t = 0$.
- C installs P in office in every period provided that 1) a pact was signed at $t = 0$; 2) P was in office at $t - 1$ or $t = 0$; and 3) Economic performance under the pact has been better in each of the previous periods than what would be expected under the challenger. Otherwise install the challenger.
- P and L^i set w^i and S' according to Nash bargaining.

Let σ denote this strategy profile. Note that σ requires both vertical and horizontal accountability: All unions defect if P fails to deliver or if one of the unions attempts to free ride on the wage restraint of the other $n - 1$. A pact, then, is a way of using elections and electoral accountability to induce more centralized bargaining.

The strategy profile is only an equilibrium under certain conditions. As with all repeated games, the patience of the players is important. Due to the structure of this game, only the unions' discount rates matter; they are the only ones being asked to give up current gains for a stream of future benefits. If the unions are not sufficiently patient, no pact can be credible in equilibrium. I also prove in the formal discussion that there is a maximum level of transaction costs, $\bar{\epsilon}$, above which no amount of wage restraint can be profitably purchased from the unions. What's more, ϵ controls the size of the total possible gains from a pact. As

transaction costs increase a pact becomes less attractive.

Equilibrium in the iterated pacting game: *There exists a Nash equilibrium for the infinitely repeated contracting game under the trigger strategy σ provided that transaction costs are not too high ($\epsilon < \bar{\epsilon}$) and unions have a long enough time horizon ($\delta \geq \delta^*$).*

2.5 Extensions

I briefly consider two extensions of the basic model. The first considers costly monitoring of other players' compliance with the pact and the second introduces uncertainty into the citizen's perception of the party's ability to address important policy issues.

Any trigger strategy relies on the ability of the other players to monitor one another and detect noncompliance. The basic model assumes that monitoring of all parties is essentially costless; all unions will know if any of their brethren defect, as will the incumbent party. This is clearly unrealistic, all the more so as the number of unions increases (c decreases). Suppose that in each period, each union could pay a fee, $\phi > 0$, to know with probability c that at least one of the other unions is free riding, otherwise the wage demands of other unions are undetectable except by observing M 's response. I conjecture that introducing monitoring costs shrinks set of parameter values in which a pact can be sustained. What's more, I would expect pacts to be more difficult to induce where the labor movement is more fragmented.

As a second possible extension, suppose that there are two possible values of ϵ , ϵ^l and ϵ^h with $\epsilon^h > \bar{\epsilon} > \epsilon^l \geq 0$. The citizen is initially uncertain about which type of party she is facing. C clearly prefers that the ϵ^l -type hold office, provided this party is able to strike a bargain with the unions. At $t = 0$ Nature reveals the value of ϵ to P and the L^i .¹⁵ P and L^i can then strike a pact, the Citizen updates her beliefs and votes, policy is implemented

¹⁵That L^i knows P 's type with certainty is not strictly necessary. All that is needed is that L have better information than C . L 's acquisition of this information could occur in a variety of ways. For example, L could learn about P during the process of bargaining over a pact.

and the outcomes realized. Under the same equilibrium conditions as described for the complete information version, pacts can emerge and be self-enforcing in equilibrium. In this equilibrium, however, the pact also serves as a signal of party type to the electorate. By construction, only ϵ^l -types can sign pacts that will be implemented, yielding a separating equilibrium. The self-interested actions of unions serve to inform the electorate.

2.6 Discussion

The simple game described above is meant to highlight two aspects of pacts. From a partisan perspective, pacts are a way to make campaign promises credible. Under the incomplete information extension, pacts also can signal voters that the party is capable of addressing issues the electorate care about. From the union's perspective, the pact is a way of committing to wage restraint.

The model also generates testable hypotheses. The first three follow directly from the constructed equilibrium:

1. Pacts are only possible when transaction costs are sufficiently low
2. Pacts will only occur where unions have long time horizons
3. Unions and governments should show evidence of actually implementing the actions required of them.
4. Union leadership and government should be very concerned with any union deviation from the pact.

This last hypothesis follows from the grim trigger equilibrium I proposed in which each union defects if they observe any other union free riding.

The extensions also have empirical predictions:

5. Voters are uncertain about the ability/willingness of a party to implement their preferred economic policies and should show evidence of revising their beliefs about the party/government that signs a pact.
6. Where pacts are implemented there should be investment in monitoring technology.
7. More fragmented labor movements imply that there is less likelihood of a pact and that monitoring plays a big role if one does occur.

These hypotheses, especially those pertaining to discount rates, belief change, and transaction costs are quite difficult to evaluate in any large- n setting. As a result, I exploit to a detailed comparison of two cases.

3 Australia and New Zealand

I now turn to a paired comparison of events in Australia and New Zealand during the 1980-2000 period to establish that the model captures logic of events as understood by the agents involved. These cases provide an outstanding opportunity to examine the conditions surrounding the emergence of social pacts. They are historically, culturally, and demographically about as similar as any two countries in the world.¹⁶ Both faced quite similar economic and political crises in the early 1980s. They held elections within a year of one another, with the Labor winning in both. The newly elected governments made opposite choices, however. The New Zealand government¹⁷ embarked on a radical neoliberal restructuring program using interest rate policy to control inflation and unemployment to discipline wage demands. A bargain with the unions was never even considered until immediately before the 1990 electoral defeat of the NZLP. In Australia, the ALP and the ACTU signed a formal Accord,

¹⁶This is not to minimize important differences in, for example, indigenous populations, geographic size, or climate, but merely to assert that these differences are not here relevant.

¹⁷1984-1990. Peter Lange was PM for the 1984-9 period. Geoffrey Palmer and Mike Moore succeeded him.

centralizing wage bargaining and imposing wage restraint in exchange for education, health, retirement, and industry policies benefiting unions. The Accord was renegotiated eight separate times and served to implement both a centralized incomes policy and the subsequent transition away from centralized wage setting. For 13 years the Accord functioned as the primary statement of domestic economic policy for the ALP governments.¹⁸

In this section I first briefly describe the economic policies and wage bargaining institutions that existed in Australia and New Zealand for much of the 20th century. I then turn to a depiction of the political and economic crises of the early 1980s.

3.1 Economic policy since the Depression

Australia and New Zealand are far removed from the economic centers of the North Atlantic and have less than 25 million inhabitants between them. At the core of their economies are commodity and agricultural exports. As such, both countries are simultaneously exposed to world markets, as changes in commodity prices produce boom-and-bust cycles familiar to students of developing nations, while also confronting a long-term secular decline in their terms of trade.

From the Depression of the 1930s to the 1980s both pursued economic policies amounting to import substitution: high tariffs on manufactured imports, import licensing requirements, foreign exchange controls, fixed exchange rates, and export incentives for agricultural and mineral commodities. State ownership and control played a particularly large role in New Zealand, where the government took active roles in virtually every sector of the economy and routinely acted to control prices (Evans et al., 1996). In many ways, the economic structures of Australia and New Zealand in 1980 resembled those of resource-exporting developing countries more than those of industrialized nations. Export earnings were almost exclusively derived from resource and agricultural commodities. Manufacturing was inefficient, uncom-

¹⁸The ALP held power from 1983-96. Hawke was PM from 1983-91. Paul Keating took over for 1991-6.

petitive, and concentrated in relatively low-value-added industries like apparel, footwear, and the assembly of consumer durables. Domestic competition was weak, and trade deficits with the rest of the OECD were growing.

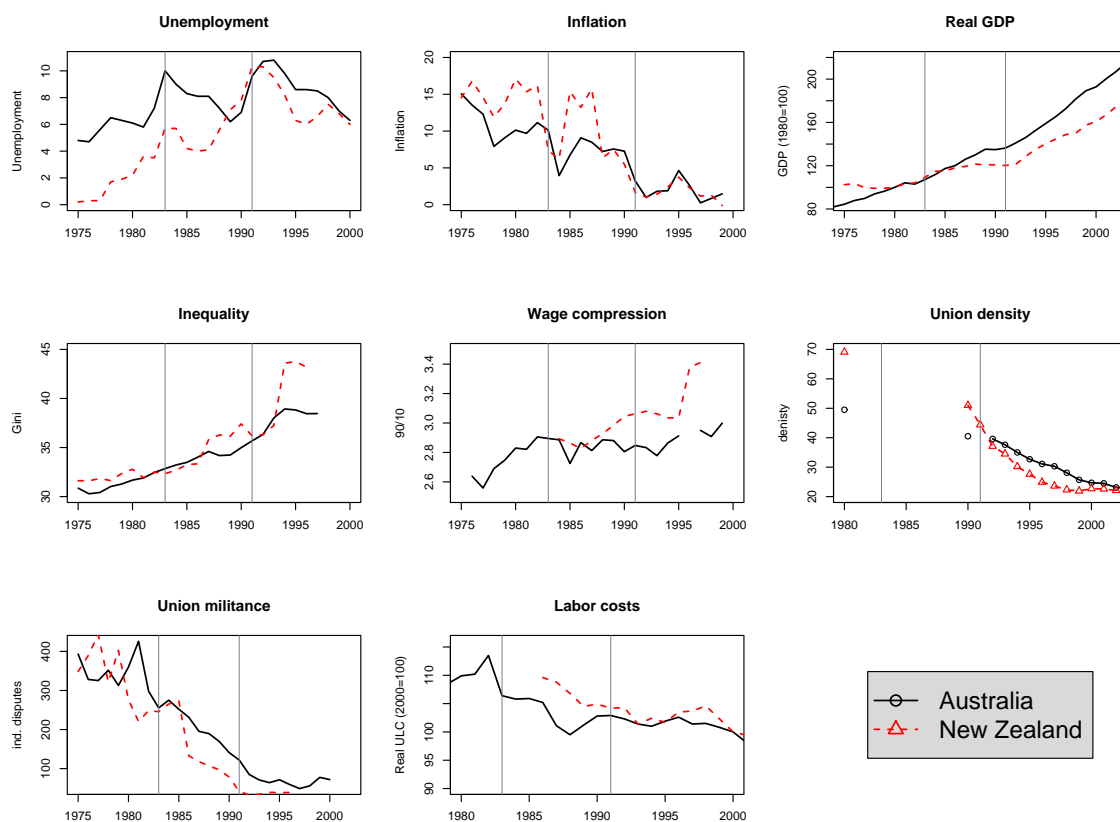
In the period since 1990, developments in both countries have paralleled OECD trends: increased openness to the world economy; increases in service sector employment and declines in manufacturing; decreases in union membership and militance; moderation in welfare spending; and increased inequality. Figure 1 depicts some of these trends. The figure also highlights several differences. First, during the Accord period (between the grey vertical bars), New Zealand's unemployment rate climbed dramatically whereas it decreased in Australia up until the 1990 global recession. Second, New Zealand had much more volatile and generally higher inflation. Third, economic growth has been better in Australia than in New Zealand. Fourth, the growth in inequality has been much slower in Australia than in New Zealand. Last, the decline in union penetration of the labor force has been much less drastic in Australia.

3.2 Unions and wage bargaining in the Antipodes

The laws governing union recognition in both Australia and New Zealand date back to the early part of the 20th century. A key feature of the system is the provision for union registration with government. Once registered, a union becomes the sole bargaining agent for a class of workers, usually defined along skill or occupation lines. Government recognition is crucial as wage bargaining in both countries was organized through a system of arbitration tribunals. Skill- and occupation-based unions enjoy property rights in representational monopolies. The union movements in both countries are extremely fragmented. Many small unions have succeeded in carving out occupational niches.¹⁹ General and industrial unions

¹⁹This fragmentation is even more pronounced in Australia, where industrial relations tribunals and union recognition exist at both the Commonwealth and the state levels. There is a complex interplay between state and federal wage cases and awards.

Figure 1: Comparing Australia and New Zealand



Note: Vertical grey bars represent the Accord period in Australia in which wage movements were centrally negotiated. Data sources are identified in the appendix.

are rare.

There are also some differences in the two countries' wage bargaining systems worth noting up front. First, in New Zealand public and private sector unions had different bargaining systems. Private sector unions had occupational awards (see below) similar to Australia whereas the public sector had "enterprise-level" contracts. Second, the public sector made up a much larger portion of the employment base in New Zealand than in Australia, reinforcing the differences in the wage setting mechanisms (Schwartz, 1994). Third, the government of New Zealand frequently intervened in private sector negotiations and awards in ways that

were constitutionally impossible in Australia. For example, one interview subject described Prime Minister Muldoon’s intervention in the 1978 meat workers strike.²⁰ To end the strike Muldoon offered to supplement the employers’ offer with state funds (James, 2006).

Under the arbitration system, wages and working conditions are set using a combination of three venues. First, there is the formal “award”: a statement of wages, conditions, overtime rates, etc., handed down by special industrial relations tribunals. In the wage cases that culminate in an award, unions, employers, and sometimes governments present cases describing in numbing detail the wage levels that should apply to a particular set of workers. Wage demands are justified on the basis of profitability, productivity changes, and overall price levels. The arbitration tribunals were not economic policy making bodies; they were there to prevent and settle industrial disputes (Isaac, 2006).

Second, there are so-called “over award” payments, in which unions negotiate additional payments above the award rates with specific firms or across industries. Third, unions and firms can elect not to file a wage case at all, preferring to negotiate in the absence of any arbitration.

The relative importance of each of these venues in union and employer negotiating tactics has varied through time and across firms and unions, depending on the stance of the Commission, the relative power of workers, and the state of the economy. Smaller and weaker unions (and employers) tend to seek the benefits and low transaction costs associated with simply implementing the wage decision as handed down. The tribunals, especially in Australia, have also varied in their goals for the scope of their awards. At times the major wage cases were viewed as defining the “basic wage”, i.e., the effective minimum workers would expect to get in different jobs. At other times, the major national wage cases attempted to impose a “total wage”, often with the goal of enforcing wage indexation to inflation. During the latter periods, unions with sufficient industrial power tended to turn to over award

²⁰Muldoon headed the third National Party Government of New Zealand between 1975 and 1984.

payments and non wage-case bargaining.

Over time, relative wages across the economy ossified into a rigid set of “wage relativities.” These relativities—essentially highly organized and legally enabled pattern bargaining—took one or a combination of the major wage awards as a benchmark and then adjusted the others proportionally based on a predefined set of industrial classifications and functions. Bargaining tactics for national wage cases saw the union federation lead with the strongest affiliates, often the metal workers, and then use the gains won in that case to justify wage demands across the economy. Since wage “flow-ons” became nearly automatic, the award system allowed many of the small, weak unions to survive. Gains won by stronger unions were automatically extended to nearly everybody. Wage pressures percolated through the economy rapidly. One Australian contact remarked, “If the metal workers got a raise on Friday, I’d get one on Tuesday, as a professor!” (Gregory, 2006)

This fixed set of wage relativities, immediate flow-ons, and the never-ending wage cases effectively built cost push inflation pressures into the economy. For many years this was not a major problem in either country. Due to comprehensive protectionist policies, industrial producers were able to pass along any wage increases to consumers. The industrial relations tribunals kept wages, inflation, and unemployment more-or-less in sync.

Beginning in the late 1960s, the system began to show signs of strain. When the UK joined the EEC in 1968, both countries lost their privileged competitive position in their largest export market. With the first oil shocks, the arbitration system demonstrated an alarming tendency to generate “wage break outs”. Taking advantage of high commodity prices in the 1972-3 period, strong unions began negotiating outside the arbitration system. Seeking to maintain historical wage relativities, other unions would file competing wage cases, passing wage increases through the entire economy and stimulating yet another series of demands from the stronger unions. In New Zealand this provoked inflation rates above 10% for the 1974-84 period. The National Party government under Muldoon tried a series of

unilateral policies to control inflation and stimulate growth, but was unsuccessful. Finally, Muldoon ordered a general freeze on all prices and incomes in 1982. The freeze lasted nearly two years.

In Australia the Labor government under Whitlam (1972-5, the first since 1949) was confronting the oil shocks and wage pressures just as it was implementing a large increase in public spending. “The oil shock came at worst possible time for the ALP because they were spending big; inflation was up to 17%.” (Willis, 2006) The government rejected calls from the Treasury to reduce spending and increase taxes and instead called for wage restraint on the part of the ACTU. Whitlam proposed a partial wage indexation scheme that would have demanded real wage reductions from higher-wage workers. The government offered the unions no other inducements for their restraint. Bob Hawke—the President of the ACTU and future Prime Minister responsible for the Accord—declared in 1974 that “we will not indulge in a trade-off in wages for some conjectural reduction in inflation...our people will not be sacrificial lambs to the system’s altar.”(Singleton, 1990:33). Ultimately, the Whitlam government was unable to secure union cooperation leading to Whitlam’s dramatic defeat in 1975. Whitlam’s successor, a conservative government under Fraser (1975-83), followed a “fight inflation first” policy in which it attempted to use the Commission to force wage restraint via partial indexation. This policy proved unsuccessful as unions increasingly made demands directly on employers. By 1981, any pretext of wage indexation was jettisoned and another wage break out ensued; the metal workers secured an 18-month agreement providing for a 17% wage increase, a reduction in work hours, and several supplementary allowances (Deery and Plowman, 1991). The agreement flowed on to the rest of the economy immediately. The Fraser government responded by imposing a 12-month wage freeze for all federal workers and asking the Commission to do the same for the private sector. The Commission agreed.

3.3 Crisis and the contracting moment

Entering the 1983-84 period, both Australia and New Zealand were in states of full-fledged crisis. Both were under wage/price restrictions which clearly could not be continued indefinitely. Emergence from the freeze, however, was a *political* problem. Policy makers in both countries were keen to avoid the wage-inflation spiral that had ensued in the wage break outs of the 1972-4 and 1981-2.

Double-digit inflation and wage break outs were but one of a host of problems facing both governments. Unemployment was at historically high levels and expected to grow. GDP growth was negative in Australia and near zero in New Zealand. New Zealand faced an even more precarious situation than Australia, with extremely high debt load and deteriorating credit with international lenders (Evans et al., 1996). Table 1 provides a summary of the situation in both countries at the time of the wage freezes.

There were political crises ensuing as well. In Australia, the Fraser government was proposing legislation to limit union industrial activity. At the same time, there was dramatic upheaval in the ALP; Hawke replaced Hayden as opposition leader less than two months before the scheduled federal election (Singleton, 1990). As yet there was still no plan to lift the wage freeze.

In New Zealand, the political crisis was even more profound. Muldoon's long spell in office had won him many enemies; his management of the economy turned out to be disastrous. In a fit of pique, Muldoon called snap elections for 1984. By this time, the NZLP had become, in the words of one union strategist, "an anti-Muldoon coalition" Harris (2006). A former Treasury economist quipped that "Muldoon went so far that [Labour] was the only game in town." (Wilkinson, 2006) The expected change in government and accompanying devaluation provoked a foreign exchange crisis and prompted the Reserve Bank to halt conversion of the New Zealand dollar the day after the election (Evans et al., 1996).

To sum up, in the early 1980s both Australia and New Zealand faced profound economic

Table 1: The political economies of Australia and New Zealand (1982)

	Australia	New Zealand
Unemployment	7.2	3.5
Inflation	11.1	16.2
% Δ GDP	-1.1	0.8
% Δ GDPpc	-3.0	0.2
Current Acct (%GDP)	-5.0	-7.0
Deficit (%GDP)	2.57	7.45
Gov't Debt (%GDP)	17.3	59.8
Union density	49.5	69.1
GDP/hr worked (\$US)	19.4	19.2
Ind. disputes	298	248
ISI	86.8	76.5
Population (MM)	15.2	3.2
GDPpc (\$US,K)	17.5	16.0
CBI	0.36	0.24
Federalism	Yes	No
Electoral rule	SMD w/pref.	SMD
Legislature	bicameral	unicameral

Note: Union density values are for 1980; ISI is percent of manufacturing production not exported. CBI is central bank independence. For data sources and definitions see the appendix.

problems characterized by double-digit inflation and high and growing unemployment. These problems were, in part, endogenous to the economic structure, wage bargaining institutions, and past policy choices of the two countries. Government action in the form of wage-price freezes had provoked a political-economic crises; there were no immediate plans for how to exit the freezes without exacerbating the economic problems. It was in this situation that elections were held. In Australia, the ACTU and ALP signed a pre-electoral Accord in which unions offered to return to centralized wage setting through the Commission and government offered social and tax policies to compensate. No such deal was considered in New Zealand. Once elected, the NZLP embarked on a rapid and radical reform plan lead

by Treasury minister Roger Douglas.²¹ “Rogernomics”, as the reforms came to be known, included floating the exchange rate, removing compulsory arbitration for wage bargaining, reforming and shrinking the public sector, privatizing the many state-owned enterprises, removing exchange controls, tariffs and export subsidies, and increasing the independence of the central bank, including restricting its mandate to price stability.

4 Interviews

In this section, I investigate the reasons given by key actors for the opposite choices made by the ALP and NZLP governments and interpret them in light of the model from section two. I then examine the structure and dynamics of the Accord with an eye toward understanding its renegotiation and sustainability as well as its eventual collapse.

4.1 Policy responses to crisis

Why did the ALP negotiate and sign the Accord whereas the NZLP felt no need to? The model (and extensions) give three reasons. First, the transaction costs may have been much higher in New Zealand than in Australia. Second, unions in New Zealand discounted the future more heavily than those in Australia. Third, the electorate in Australia was more dubious of the Labor party’s capability to act effectively than in New Zealand. Interview subjects identified all these factors as relevant in making the decisions that they did.

4.1.1 Transaction costs, electoral signalling and party-union linkages

Australia

The ALP and ACTU maintained tight organizational linkages but had an often conflictual relationship. The ALP relies heavily on union contributions for its finances. Unions could

²¹Note that there are two important Douglases (no relation) in New Zealand during this period: Roger Douglas, the Labour Finance Minister 1984-8, and Ken Douglas, President of the NZCTU.

(and did) affiliate directly with the ALP, controlling bloc votes in the precincts. Many prominent union leaders, Bob Hawke chief among them, went on to careers in politics in the ALP. Kerry Schott²² describes the relationship (likely with some hyperbole): “The Australian Labor Party is so embedded in the union movement...If a Labor party had introduced a policy of real wage cuts there would have been riots in the streets...The party would have been just ripped apart.” Additionally, any Australian government wishing to unilaterally interfere with wages and prices needed to alter the constitution. Indeed, a referendum to this effect was floated in 1973 but lost. In 1979, the ALP Conference again debated a proposed referendum to give the government powers to legislate prices and incomes. ALP-affiliated unions were able to block this proposal within the party, making it clear that voluntary union consent would be needed for any incomes policy (Singleton, 1990:115-118). These tight linkages played the dual role of reducing the transaction costs of coming to an agreement with the unions while also increasing the political incentives for creating a pact. What’s more, the size of these transaction costs and the strength of these ties varied through time.

Ever since the Whitlam Labor government’s inability to address the inflation and unemployment problems, conservative governments had hammered Labor as economically irresponsible. Bill Kelty²³ states “I took the view that Labor was in power from ’72-’75 but in the end, lost power with no credibility on the economy. Couldn’t have handled inflation worse if we’d tried,” (Kelty, 2006). The union-party relationship presented an electoral problem. Nevertheless, there were disputes within the ALP on the desirability and likely effectiveness of a wage restraint-policy bargain. “Not everybody in the ALP wanted the Accord,” says Kelty; One of his former assistants adds that “Some in Treasury thought the Accord was flim-flam meant to conceal and ease introduction of other policies, especially the reduction

²²assistant secretary for prices and incomes policy, the division of the employment and industrial relations ministry responsible for monitoring and implementing the wages and prices part of the Accord. I will follow the convention of identifying interview subjects by the positions they help during the timeframe of interest, not by their current positions.

²³the ACTU Secretary and person most responsible for the Accord on the union side.

of tariffs.” Bill Hayden, the ALP leader during the entire post-Whitlam opposition period, was reticent to give the ACTU any formal role in policy making. Willis²⁴ echoes a sentiment expressed by several former ALP and union officials: “Bill Hayden was a barrier. He was concerned about Hawke.” The Accord wasn’t finalized until Hayden was forced out and Hawke took the reigns of the ALP shortly before the election.

After the experience with Whitlam and the patent reticence of Hayden to make specific policy promises in exchange for wage restraint, Hawke’s ascendancy in the ALP proved critical for unions. Hawke was known and well respected in the union movement for his work as the ACTU advocate and then general secretary. Laurie Carmichael²⁵ believed that he could do business with the ALP under Hawke because Hawke understood the unions and knew that the government would have to rely on them. Personal relationships mattered as well: “We [Hawke and Carmichael] could talk to each other and talk bluntly, even when disagreed.”

Coming in to 1983, it was clear that, as in the 1980 election, Labor would be on the defensive about its capability to handle the economy and its relationship with the unions. The ALP looked to the UK for ideas, ironic since the British Social contract had collapsed in 1979, bringing the British Labour government down with it. Willis claimed that the Australians learned from the British experience: “In 1978 I went to the UK to talk about incomes policies. The UK policy failed because Labour got too ambitious with its wage demands. Labour tried to keep wages too low with union agreement, but unions blew out.” Willis’ assessment of the British experience was echoed by several other respondents.

The conservative platform appeared to be more of the direct confrontation with the unions that had characterized the previous Fraser government. Willis, however, saw the ALP-ACTU

²⁴Shadow treasurer during the Fraser years subsequent minister for employment and industrial relations. He is chiefly responsible for formulating and later implementing the Accord from the ALP side.

²⁵Federal secretary of the pivotal Australian Metal Workers’ Union and later Assistant General Secretary of the ACTU under Keltj.

connection as a potential strength that should be exploited: “There was no political interest for conservatives to sign an Accord. Kelty approached Fraser government with a deal and Fraser told them to get lost...The Accord was something the Labor Party generated. There was no compulsion on us. It was credibility for us that we can handle inflation. Which was really basic for us and something the [future] opposition couldn’t claim.” Bill Mansfield²⁶ summarizes the whole process well:

The origin [of the Accord] was really a political and economic issue. Politically it was important for the union movement and the Labor Party for effectively coming out of the wages pause... Being able to produce a consensus, particularly with the union movement, was an important part of a campaign strategy. A political campaign strategy to win an election...Hawke had a reputation among the electorate more generally as a problem-solver and consensus builder.

What about the scope of the Accord? Why were only wages, taxes, and social spending addressed? Clearly there were other issues of concern to unions that were not included. Specifically, during the Accord period, the ALP governments devalued and then floated the currency, drastically reduced tariffs, restructured the public service, and emphasized domestic competition among firms. Willis explains why these other items were not on the Accord agenda: “The exchange rate, tariffs. They had nothing to do with Accord agenda. They were excluded because unions would disagree and had no electoral benefit.” While the ACTU, Kelty in particular, were almost surely informed of these moves, the unions were never *publicly* consulted nor was their consent requested. The Accord’s primary purpose from the government’s perspective was electoral. Michael Keating²⁷ sums up: “There was dialogue [between the government and ACTU] on a significant but limited number of issues.”

²⁶former head of the telecommunications union, former ACTU Assistant Secretary, and later a commissioner on the industrial relations commission

²⁷secretary of the Department of Employment and Industrial Relations during the ALP governments of 1983-96.

In sum, the close relationships, both organizational and personal, between the ACTU and the ALP made the Accord both electorally necessary and practically feasible. Negotiations surrounding a pact failed under Hayden because the ACTU did not trust that Hayden could deliver the promised benefits and Hayden did not believe he could trust the unions to hold to the bargain; transaction costs here were too high. While the model above presents transaction costs as economic, here they were political. After Hawke replaced Hayden, transactions between the party and the unions became much easier. Consistent with the signalling extension, the ALP clearly needed union cooperation to signal credibility. Hawke fit the bill as party leader due to his public reputation as a consensus builder and his strong personal ties to the union movement. The personnel linkages between the ACTU and ALP, with a former ACTU Secretary occupying the Prime Minister's office reinforced the ongoing nature of the union-party relationship. All interview subjects emphasized that the Accord served chiefly as an electoral document.

Australian Voters

The crux of the model is the willingness of the pivotal voter to alter her evaluation of a partisan actor's policy promises based on the existence of a (credible) pact. The signaling variant emphasizes that voters will update their beliefs about the party's type after a pact. There is some evidence that this did in fact occur in Australia.

The most obvious depiction that voters' evaluations changed is the results of the elections themselves. The ALP defeat of the Coalition government in 1983 saw the party increase its seat share in the lower house from 40.8% in 1980 to 60% in 1983. The 1987 election saw that share increase further to 68.8%. Note that this second electoral result occurred immediately after the second renegotiation of the Accord and in the context of an improving economic situation relative to 1982 (see figure 1).

Although I have been unable to find survey data that ask directly about the Accord, there is some survey evidence that appears to corroborate the idea that (at least some)

voters changed their mind based on signals sent during the Accord process. In a 1983 post-election survey (Beed et al., 1983), 58% of respondents claimed that the choice of party leader affected their vote “a great deal” or “somewhat”; recall that Hawke was installed as leader of the ALP shortly before the election. Of the 8.1% of voters in 1983 who reported switching their party vote from the 1980 election, the voters’s perception of party and policy was the most frequently cited reason. In a separate survey administered just after the election (Beed, Centre and McNair, 1983), a plurality (49%) thought that top management of trade unions had gotten worse over the previous decade; a majority of 81% believed that unions had too much power. Nevertheless, 66% reported believing the government does not cooperate enough with the unions. When presented a menu of policy options and asked to choose the three best for combating unemployment, extending the wages freeze (the Coalition’s proffered solution) was among the two least likely to be chosen.²⁸

Polling data from the 1987 election (McAllister and Mughan, 1987) also sheds some light. 62% named ALP leader Hawke as the most likely to get Australia out of its current economic problems. 40.5% believed that government policy would improve the economic situation one year hence compared to 18.5% who believed the opposite. The proportion of respondents claiming that trade unions had too much power declined 10 points to 70.1%.

New Zealand

In New Zealand, there was no need for the NZLP to signal credibility to the electorate; Muldoon had succeeded in completely discrediting the National party on economic issues. This was exacerbated by the fact that Muldoon had courted the Federation of Labour (FoL)²⁹ “[Muldoon] was unable to achieve the political arrangements his policies depended on. He was counting on the leadership of the union movement to use their influence to limit wages

²⁸7.3% named it among their top 3 policy options. The least likely to be chosen was restricting overtime (6.4%). 25% named controlling inflation and 19% chose restricting wage rises.

²⁹The FoL subsequently renamed itself the Council of Trade Unions (NZCTU) after it merged with the public sector federation, the Combined State Unions, in 1987.

growth in exchange for tax concessions. The [FoL] leadership was unwilling to cooperate in this and was unable to as the constituent unions would not surrender their autonomy for setting wages to central authorities. Neither were they interested in contributing to the success of Muldoon's strategy even if they could." (Scott, 2005:63) Others, mentioned above, describe Labour as the only real game in town.

Unions were no great source of power within the NZLP at the time. A former union leader and subsequent aide to a rebel NZLP MP explains:

Unions were not as tightly integrated into the Labour Party. They couldn't veto policies. Numerous unions were outside the party. Affiliation to the national Labour Party was a joke. Anybody could show up as a delegate. What was much more important was to get onto the party Executive. But you're in the Executive as individual members...Unions were not aware of the presence of anti-union folks in the Labour Party. Anti-Muldoon business went along with Labour as well. Labour didn't think they needed the unions (Simpson, 2006).

Another advisor describes the situation in more detail:

While there were crossovers between the Labour Party and the union movement, many key union leaders were not powerful figures in the Labour Party—although some were. The most influential figure in the union movement, Ken Douglas, belonged to another party altogether. Some of the unionists who were most influential in the Labour Party were not important figures in the union movement (Scott, 2005:63).

Compared with Australia, the NZLP had both fewer incentives to negotiate with the unions and faced higher hurdles in coming to an agreement.

Muldoon called snap elections, making for an extremely abbreviated campaign period. There was little in the way of specific policy proposals or extensive debate and little time to

formulate an agreement between unions and the NZLP even if one were considered. Labour did campaign on the basis of an orderly exit from the wage-price freeze. Once elected, however, the first order of business was to address the foreign exchange crisis. The currency was devalued and then floated almost immediately. From there the reforms increased in pace for the next two years. Unions (and others) were “blindsided by the timing of devaluation issues. People were bewildered by the pace and speed of it.” (Conway, 2006) Nevertheless, the FoL approached the Minister of Labour in 1984 about a negotiated exit from the wage-price freeze. The offer was rejected (Harris, 2006). The Lange government (1984-1989) turned to interest rate policies to address inflation. “Treasury advisers rather half-heartedly advised the Government that a brief return to central control of wages was an option. I doubt the idea was taken seriously by the Government. The ministry concluded that deals with the FoL over wage fixing wouldn’t work but neither would a return to controls. The stage was set for a rise in unemployment.” (Scott, 2005:64)

In 1988, Prime Minister Lange unilaterally halted the economic reform package. The stock market crash of 1987 also had a major negative effect on New Zealand, pushing the economy into recession while the budget was still in a precarious position. By this point, the Labour government was staring at the prospect of elections while undertaking unpopular spending cuts in an extremely inhospitable economic climate. Under these conditions, the NZLP began floating ideas about some sort of deal with the newly formed NZCTU. Several interview subjects referred to this offer as an act of desperation. Even union members seemed unimpressed “Unions and government approached one another to get an Accord-style agreement to keep Labour in power for the 1990 election but the [union] membership was uninterested. Members didn’t attend CTU meetings regarding the possible accord.” Though the so-called Growth Agreement was signed, it was only in existence for six weeks. Labour lost the 1990 election in a landslide and the agreement was never implemented.

The evidence presented above shows New Zealand as a negative example supporting both

the notion that pacts are electoral signals. In the 1984 election, the NZLP had no need to signal the electorate about their economic credentials and unions had insufficient influence with the NZLP to make any demands or credibly offer a deal. Once it became clear that the deep and rapid reforms of the 1984-88 period were unpopular and the economy was entering recession, however, a desperate NZLP government suddenly found a taste for a deal with unions. Ironically, in this case the Growth Agreement was not a signal of competence to deal with economic problems but rather a signal that Labour's electoral promises not to continue the reform program were credible ³⁰. The Growth Agreement can be viewed as a belated attempt to tie the hands of a government that was institutionally unconstrained and had backtracked on previous promises.

4.1.2 The players' time horizons

The model shows that agreements can be self enforcing so long as the players do not discount the future too much. Specifically, the unions need to value the future. Interview subjects discussed this subject at length.

Australia

Consistent with both the model and the notion that the Accord served an electoral function for the ALP, political leaders had fairly short initial time horizons, though they did not have a specific end date either. Ralph Willis states "We hoped it would last one period of government and then see how it went. We didn't say we will keep this in place for the next ten years." Schott has a similar evaluation: "What the Australians thought, on the basis of the UK incomes policy, was that they [wage restraint agreements] were very unstable and they never stayed in place for very long. You could hold it for a couple of years and then you'd lose it...You could only hold it together for about two or three years. This was because

³⁰For example, 56% of Kiwis polled in 1990 found they had "no trust" in the Labour party compared to 54% "not sure" about National; a plurality of 42% thought Labour "not capable" to govern. At the time of the election, 56% of voters thought the economy had gotten worse over the prior year and 66% believed that government policy had a negative effect on the economy (Vowels and Aimer, 1990).

you only had wage restraint and nothing else. It was very hard on the unions.”

The Accord proved remarkably durable, largely due to the willingness of the ACTU to renegotiate as conditions changed. The government was seeing benefits from the arrangement as well. Michael Keating says “success bred success and that’s important.” This had the effect of lengthening politicians time horizons: “At any point in time we [the government] wanted it [the Accord] to last.”

On the ACTU side, it is clear that union leaders had much longer-term goals for the Accord. Kelty viewed the Accord as the vehicle that would transform the Australian economy while improving the plight of workers. He had correspondingly long time horizons: “We needed a long period Labor government. At least nine to ten years expected from the Accord.” Carmichael is even more explicit in his goals. “The main influence in my mind was trying to pursue the possibility of something like a Swedish agreement between the political and industrial sections of the movement.” He explicitly stated that he viewed the Accord as the first step on a longer path to a stronger welfare state supported by negotiated wage/price bargaining.

In Australia, ALP time horizons were governed by election cycles, but, as the Accord proved useful and flexible leaders saw no definite end date for the process. Union leaders, for their part, had very long term goals for the Accord, goals which required the ALP remain in office. As such, the time horizons of the two major players coincided.

New Zealand

In New Zealand, there appeared to be a profound mismatch between union and partisan goals. In particular, the newly elected NZLP had very short time frames and foresaw an end date. “The Labour government thought they were going to lose in 1987 anyways so they may as well take the tough decisions now and front them later.” (Wilkinson, 2006) Union leaders, “because of the nearly three years of the wages freeze, were desperate to want to believe that Labour would save them. In my view herein lies much of the subsequent

problem of the trade union movement.” (Douglas, 2005:80) Expectations for the incoming NZLP government were quite high, but nobody possessed time horizons sufficiently long to make a large deal possible. Once the path the Lange government was pursuing under Roger Douglas became clear to unions, the union movement fell in to disarray; private sector unions were unsure of how to respond while public sector unions expressed opposition to the government (Harris, 2006). Neither the will nor the patience required to make an agreement self enforcing appears to have existed on either side.

4.2 Additional considerations

Thus far we have seen that both the scale of transaction costs and the time horizons of the players varied between Australia and New Zealand. But where does this variation come from? I argue that the internal politics of union federations, specifically their ability to come to consensus across both sectors and industries is a key determinant of transaction costs.

4.2.1 Transaction costs and the power of unions federations

When asked why an Accord-like arrangement never emerged in New Zealand, interview subjects in both countries frequently responded with statements similar to the one given by this former NZCTU official: “There was no Accord in New Zealand because the unions are too weak.” (Goulter, 2006) This in spite of higher levels of union density in New Zealand. Ken Douglas—the head of the FoL at the time—gives a more specific evaluation:

Our leadership, my leadership if you like, could not deliver the required union membership support in a coherent and progressive way. The fact that the Labour movement collectively had never seen itself as a cohesive movement of mass action, capable of developing a consensus that was able to be turned into a popular political programme was our Achilles’ heel (Douglas, 2005:83).

Another advisor recalls that “The Federation of Labour did not have the power over the constituent unions that the ACTU had at the time in Australia...Powerful unions here had made it clear to FOL headquarters that the days of [former FoL secretary] Skinner and Muldoon doing deals over wage movements were over for good,” (Scott, 2005:63).

These comments point to an area where transaction costs emerge: the strategic capacity of union federations. Where the federations were able to unify under one roof and come to a consensus, they reduced the costs of making a pact work. But why were there such profound differences between the strategic capacity of the ACTU and the FoL? There are several immediate reasons. First, unions in New Zealand were split between the public and private sector federations and each federation faced different bargaining institutions. The two federations could not come to an agreement on how much support to give the NZLP. In Australia, the ACTU had succeeded in absorbing both the public sector federation in 1979 and the white-collar union federation in 1981. By 1983, the ACTU affiliates represented about 82% of unionized workers in Australia³¹ (Golden, Wallerstein and Lange, 2002). Party-union linkages, as noted above, were much stronger in Australia.

A second reason is less obvious and only uncovered through interviews: New Zealand unions, especially in the private sector, were dependent on government for wage outcomes. They had ceded the capacity for independent action.³² Several subjects reported a situation similar to that described by Peter Harris: “Unions in New Zealand were very schizophrenic. They had the rhetoric of free bargaining but heavy reliance on government patronage.” A former president of the public sector workers union remarked that “Union leaders were bureaucrats who were used to working a system of industrial patronage. They had nothing to do but sit in an office and count the money.” (Simpson, 2006) The industrial relations

³¹Comparable data are not available for New Zealand

³²Indeed, union leaders were so expectant of government munificence that, upon receiving a report in early 1984 detailing Roger Douglas’ policy agenda, “many in the [FoL] Executive, including [then head] Knox, did not want to believe it and openly espoused that it was a fabrication.” (Douglas, 2005:80)

system had freed them from the need to actively organize workers and all but the few strongest did not have to actively bargain. Wage outcomes came from a combination of the industrial strength of a few and government intervention. Thus, when it came time for the NZLP to address pressing problems, the “government believed that the unions had little to offer,” (Harris, 2006).

This state of affair contrasts markedly with the ACTU in Australia. Beginning in the 1960s, the ACTU had begun investing heavily in their research capabilities; in Bob Hawke the ACTU hired its first advocate. Hawke later hired Ralph Willis who notes that “at that time we were the only people in the ACTU with college degrees.” As Hawke progressed through the ranks at the ACTU, this changed dramatically. By 1983, the ACTU had a sophisticated political and research operation under its roof.

The nature of the Australian arbitration system also affected the capacity of the ACTU. “The ACTU had responsibility for the basic wage case so the ACTU had a history of and capability for bargaining. Unions ceded the bargaining power to the ACTU in the 1950s because everybody got the basic wage and had an interest in keeping it as high as it could be. The Commission brought in the total wage case in 1960s which gave everybody the same percentage increase. The ACTU managed that as well.” (Willis, 2006) In addition, the ACTU can use the arbitration system to punish affiliates. If it chooses, it can file statements with the Commission undermining the wage demands of any particular union. I return to this below in the discussion of how the Accord was maintained.

Clearly, then, there were substantial and important differences in the strategic capacities of the peak labor bodies in Australia and New Zealand that affected the likelihood of a social pact’s emergence. The discussion above, however, implies that this variation in strategic capacity is to some degree endogenous to the institutional environment in which the unions and parties operated.

4.2.2 Incentives for union negotiation

Variation in the willingness of union federations to negotiate with governments does not hold much explanatory power in the cases of Australia and New Zealand. Unions were willing to work with government in both cases. The ALP and ACTU had been discussing various ways to address inflation since the sacking of the Whitlam government. The ACTU had even offered to hold discussions with the Fraser government (Singleton, 1990). In 1984 the FoL offered to negotiate an exit to the wage freeze with the newly elected NZLP government. Nevertheless, some attention to the unions' decisions is critical if the argument is to travel outside these two cases.

The model predicts that unions' willingness to forego wage increases will depend on the scale of the social wage offered by the government and the marginal benefit of a wage gain traded against loss of employment and/or increased inflation. If the threat of unemployment is sufficiently great, unions will prefer to moderate wage demands on employers in exchange for a compensating social wage.

Relaxing the assumption of a completely homogenous unions, the incentive to bargain need not be symmetric across unions. In order to maintain wage restraint, the strongest unions, i.e., those best positioned to extract wage increases from their employers, will have to be willing to participate. We should therefore expect the strongest unions to be the linchpins of any social pact. Bill Kelty expressed exactly these sentiments: "It was the industrially strong that led the Accord negotiations, not the industrially weak and not the public sector. People like Carmichael [Federal Secretary of the metal workers] and McDonald [Secretary of the building workers] were key." A former official from the ministry of employment and industrial relations adds "Stronger unions were committed to a more centralized approach...They had seen effects of the Fraser government and unemployment," (Belchamber, 2006).

It was not until unemployment really began to bite the strongest unions that the ACTU

and ALP were able to cobble together a workable Accord. Prior to this period, the ACTU had, for several years, discussed returning to centralized wage negotiation, but only under the auspices of full wage indexation. The metal workers opposition to wage restraint provisions had torpedoed previous ALP attempts at an incomes policy (Singleton, 1990). In 1983, with unemployment exceeding 10% and the prospect of a Labor government, the ACTU began to seriously consider real wage restraint. Michael Keating describes the metal workers' plight: "The metal workers lost bargaining power with the recession and collapse of resource boom. They were willing to go along with recentralization because they were not really giving up much. They couldn't really get much more along." After all, the metal workers had just won a 38-hour work week and huge pay increases in the last round of negotiations. Laurie Carmichael puts a slightly different spin the reasons for his supporting the Accord:

The things we were pursuing were quite fundamental. The concept of the social wage—you couldn't do that industrially...I believed that there were some things that you couldn't possibly achieve by industrial activity alone...we'd proven [in the last wage cases] that you could do certain things industrially but there were some things that you needed political strength to do and that you needed to have a government in office. So we went to the metal workers membership on the basis of going in to the Accord in order to gain those things that we could not gain by industrial strength alone.

When the Accord came before the ACTU, there were some divisions. Carmichael describes the division:

The construction industry, the mining industry, the waterside workers—they opted for pure collective bargaining...They were critical of [those who would negotiate for a social wage]. They condemned it. They expected it to be given politically. They were not prepared to come to an agreement or make a deal or whatever.

The union movement was divided...You had a substantial part of the Left that would support the Accord and all the Right was prepared to support the Accord. And you had this other group which were the Maoists [who argued that] it was a weakness to come to an agreement on social wage issues...You should pursue it by industrial means...So you had an unholy alliance among the Maoists and the male-dominated industrially strong sections of the union movement that reflected the dominance of the mining and construction industry. Now on the other side, those that depended on the social wage like the public servants and teachers, they became allies of mine. Those that had a foot in both fields, the metal workers, had a significant number who could make their way through industrial activity also had a significant number of people who could not make their own way...What right have we got to leave our members for dead who can't fight?...We've got the right to pursue social wage activities that they would benefit from...We could formulate a concept that fitted the Accord as it emerged.

Carmichael's support, as Federal Secretary of the metal workers' union, is widely viewed as pivotal in the ACTU's adoption of the Accord. After he and the secretary of the electrical workers' union came out in favor of the Accord at the 1983 ACTU congress, the anti-Accord delegates were, in Carmichael's words, "flattened".

Unions were generally willing to negotiate with parties in both Australia and New Zealand. Only when the strongest unions' marginal gains from additional wage increases were mitigated by high unemployment and inflation, however, was the ACTU able to effectively enter in to an agreement that would require wage restraint.

4.2.3 Employers

Interview subjects in both countries universally described employers as fragmented, unorganized, and relatively uninvolved in policy making, especially at the early stages. Kelty

describes his take on the employers' role in the Accord era:

The employers' commitment, in personal terms, was strong. But they had nothing to do with it. They weren't driving it. They weren't doing anything. We [the ACTU] were running it. We were giving them wage reductions. They would never get up in an election campaign and say 'this is great'. They never even supported us when we pushed for enterprise bargaining...They were intellectual pissants. Some were really opportunists...Some of the key companies stuck with us, but they never publicly supported the system. Only Alan Jackson got up and said he supported the Accord, but he was run out of the country after the [1996] election.

There was some effort made in Australia to bring employers on board. Hawke convened a tripartite economic summit immediately upon taking office with the idea of garnering support from both labor and business. By that time, however, the Accord had already been ratified by the ACTU. More substantively, the initial monitoring and, in later iterations, superannuation and training programs did require some degree of employer participation. The government foresaw this and actively endeavored to strengthen organized business: "The business sector was really very weak. We had no strong business peak body. [The Government] went out of its way to build up the expertise of the Business Council of Australia, which is now much stronger." (Schott, 2006)

While there was not organized opposition from employers, there was no groundswell of support either.³³ Joe Isaac says that "employers were hostile to the whole idea of the Accord formally. Essentially it was a fear that the ACTU was getting too much access to the government." He further identifies the lack of employer integration as the Accord's key deficiency (Isaac, 2006). Without the support of business, there was little hope that an

³³See, for example, Scott (1987).

Accord could survive a change in government. When the ALP lost the 1996 election, the Accord process ended.

4.3 Holding the Accord together

If it is costly to monitor others' compliance with a pact, then a pact is less likely to emerge and survive. The trigger strategy described for the repeated game requires that L^i and P can in fact monitor one another's compliance. Relaxing the assumption of homogenous agents also suggests that enforcement mechanisms must exist to punish deviators. Exogenous shocks to the economic system or players' discount rates could derail the deal. The Accord also seems likely to have an endogenous effect on the likelihood that it can be sustained over time: as the economic situation improves there is a weaker incentive for workers to remain in the tightly controlled bargaining relationship, potentially requiring further increases in the social wage. Though not modeled explicitly, the flexibility to renegotiate in the face of both the endogenous changes and exogenous shocks must also exist to accommodate the varying interests within the ACTU's union coalition and the ALP's political one. Interview subjects spoke at length about the various mechanisms that held the Accord together and the weaknesses that ultimately brought the Accord down.

4.3.1 Monitoring

Monitoring union wage demands was relatively easy. The arbitration system centralized the reporting of all wage settlements. When claims outside the guidelines were filed, the ACTU and government, specifically the department of employment and industrial relations, would join together and make presentations before the Commission, asking them to make awards in line with the Accord (Schott, 2006). Thus the institutional environment played both a positive and negative role in monitoring. The arbitration system induced a very fragmented union movement but also centralized the reporting of wage settlements.

Monitoring the government is more difficult. An added complication is the fact that the Accord was not directly binding on non-unionized workers in the economy, most notably in the professions. The ACTU was sensitive that its members not be the only ones giving up wage increases; doctors, barristers, and the like should have their fees tied to the Accord guidelines as well. As a result the government sponsored the creation of two consultative, the Economic Planning Advisory Committee (EPAC), under the Treasury, and Australian Council on Prices and Incomes (ACPI) under the department of employment and industrial relations. The latter was directly responsible for monitoring prices and incomes of the professions. The Accord set up a series of bi- and tri-partite bodies for the purpose of monitoring wages and prices across the economy.

4.3.2 Enforcement

In general, union compliance with the Accord guidelines was quite good, particularly in the first years (Schott, 2006). Nevertheless, There were several cases in which certain unions, some not affiliated to the ACTU, clearly attempted to challenge the Accord guidelines.

Probably the most dramatic challenge to the Accord came with the 1989 pilots strike. The Australian Federation of Air Pilots, not an ACTU union, had gone outside the arbitration system to secure a 30% pay increase. Willis states “We could not allow [the pilots] to win. It would have brought down Accord.” In the end, the government went to extreme lengths to break the strike, including importing foreign “scab” pilots and using the air force to fly domestic passenger and freight routes. The ACTU supported the government in its actions. The ACTU had also supported the government in its 1984 deregistration of the Builders Labourers’ Federation. This union had a long history of “standover contracts” where the union would strike at critical moments in construction projects for side payments. Without ACTU support, the deregistration would have caused major national disruptions (Keating, 2006).

4.3.3 Safety valves, creative accounting, and renegotiation

Monitoring and punishment alone would be insufficient to keep the Accord going over time, especially if a major union decided that it was no longer in its interests to go along. Interview subjects cited three major ways that these pressures were accommodated.

First, Schott and Willis mentioned that the government and ACTU approached the Commission to allow some anomalous wage claims to go through, “You basically had to keep everybody in the tent and at the same time have a few little back doors you could let people sneak out of for good reason, like they weren’t getting paid much to begin with.” (Schott, 2006). These “safety valves” were built in to the system so some out-of-line wage increases could go through without flowing on to everybody. “There was sufficient discipline within the Commission especially with the anomalies procedure...The building industry was always a difficult area. Anomalies arising in building by and large didn’t flow outside.” (Isaac, 2006)

Second, negotiators at the highest levels showed extraordinary creativity in generating workable solutions to challenges, particularly in the context of renegotiation. One of the first things to note is that the original (1983) Accord actually did not promise real wage restraint on the part of the unions; it only conceded a return to centralized wage setting and full indexation, based on the CPI. Some real wage reductions were achieved in the first year due to some creative accounting work by the government and ACTU (Schott, 1989). Specifically, health care expenses are a component of the CPI. One of the first social policy initiatives of the new ALP government was the introduction of comprehensive medical insurance program which effectively removed the health care component of the CPI. As a result, wage indexation was approximately 1% lower than would have otherwise occurred. (Belchamber, 2006; Willis, 2006)

In 1984, the building trades union negotiated a supplementary payment package outside the Accord guidelines; this union was too powerful for the ACTU to just reject the contract.

Willis credits Kelty with having the idea to repackage this payment as a form of employer-sponsored superannuation. “Superannuation came about because some of the more Left wanted to rock the Accord boat. We came across super[annuation] by accident.” (Willis, 2006) The union agreed, thereby deferring these payments and keeping money wage demands in line with the Accord. “Health care and superannuation made tradeoffs easier. These trades were not inconsistent with general philosophy of the Left in Australia. You establish a beachhead and you let society catch up.” (Kelty, 2006)

This creative use of superannuation to maintain wage restraint was extended to everyone in the following year. By 1985, Australia was confronting a dramatic decline in the terms of trade and a devaluation of the Australian dollar. The Hawke government approached the ACTU, asking the unions to renegotiate the Accord and accept less than full indexation in order to accommodate the devaluation in the currency and the corresponding increase in prices of imported goods. The ACTU eventually agreed in exchange for superannuation and tax cuts, both to be phased in over time. Several respondents cited the introduction of industry superannuation as one of the most important and enduring achievements of the Accord period. (Kelty, 2006; Schott, 2006; Willis, 2006) This achievement was in no way anticipated at the outset. It came about in the process of maintaining a larger commitment to cooperation built on certain shared interests, namely the ALP’s desire to remain in office and the unions’ belief that an ALP government was its best hope for delivering consistent improvements in living standards during challenging economic times.

All of these specific instances point to the fact that renegotiation of the Accord was not just possible but expected: “We knew the Accord would need to be renegotiated.” (Willis, 2006) The nature of the Accord changed significantly over the years. It was variously used to introduce centralized wage setting, rework wage relativities, transition bargaining back to individual unions, and, ultimately, respond to employers’ demands for more flexibility and productivity incentives by introducing enterprise level bargaining. Kelty knew the central-

ized system was a short-term solution; he had longer-range plans: “If you believe in the internationalization of the Australian economy, a centralized system determined by a protected manufacturing sector does not work. Even to keep a minimum [wage] rates system you had to move progressively to a more devolved system. We wanted to keep an effective national minimum rate and so we had to change the nature of the wages system. It was a fixed wages, fixed exchange rate, high interest rate system. This doesn’t work with lower tariffs, increased productivity, and low inflation.” (Kelty, 2006) Michael Keating recognized this consciously flexible nature of the Accord process: “Kelty and [PM Paul] Keating definitely had a strategy over time. They wanted to wean unions off the most centralized system by enhancing and redistributing productivity gains.” Through the process of renegotiation the overly rigid wage and policy prescriptions that brought down social pacts in places like the UK and Italy were avoided in Australia.

4.3.4 Rank-and-file consent

Several interview respondents identified the very centralized nature of the Accord as one of its major weaknesses. “The Accord finally turned in to a process between Kelty and [Prime Minister Paul] Keating. And that led to the undoing. Instead of it being a real negotiation for an Accord process that would have a long term life it became talks at the top level.” (Carmichael, 2006) The Accord was never taken to a referendum of union *members*, though it was endorsed by ACTU congresses. Several former union officials did report extensive member education and information dissemination campaigns within their unions at the initial stages (Carmichael, 2006; Mansfield, 2006; Simmonds, 2006; Watson, 2006), but there was little mention of ongoing member-leadership dialogue on the Accord.

The centralized nature of the Accord and its heavy reliance on ACTU coordination and Bill Kelty’s relationships with ALP Prime Ministers Hawke and Paul Keating stunted the roles for union leaders and reduced the value of union membership for workers in general.

Willis says that wage “increases seemed to be generated by the ACTU or the government. There was no real job for individual unions. This put downward pressure on membership and participation in unions.” Kelty describes the difficulty in transitioning back to decentralized bargaining: “The greatest problem I had was to get unions out there to bargain. You can easily kill a union movement if their only capacity is to file cases at the national level. They need to bargain and do their own things. We [the ACTU] borrowed the power [from the affiliates] to achieve these objectives. We had less trouble getting the power and more giving it back.” Another ACTU official agrees in describing why the ACTU pushed for a decentralization of bargaining in 1990: “Unions needed to do union things-organize and bargain. They were losing members.”(Belchamber, 2006). He goes on to argue that the centralized nature of the Accord harmed unions’ incentives to organize.

While there were no major rank-and-file revolts against restraining features of the Accord, neither were the rank-and-file directly brought in to the process nor was democratic endorsement used as a way to silence Leftist critics, as Bacarro argues occurred in Italy (Baccaro, 2000, 2002). Australian unions paid a price however. With little direct role for individual unions in the highly centralized period of the Accord and few options for the rank-and-file to express their “voice”, many chose the exit option. Union membership dropped but, as table 1 makes clear, the drop accelerated *after* the return to more decentralized bargaining when many unions struggled to regain their industrial footing.

4.4 Summary

Interviews with twenty one key individuals involved in negotiating and implementing policy in both Australia and New Zealand shed considerable light on the divergent trajectories of the two countries during 1983-96. While unions in both countries were disposed to negotiate with governments during crisis, only in Australia were the electoral incentives sufficient to drive the ALP to negotiate incomes policy and offer substantive compensation for wage re-

straint. Tight party-union linkages bound key decision makers together in long-term personal relationships and career paths thereby reducing transaction costs and making negotiation profitable for both the ACTU and the ALP. The ACTU held extremely long time horizons, making the threat of defection more potent in sustaining the Accord.

The Accord's durability was largely a result of its flexibility. Both the ACTU and the ALP were willing to renegotiate in response to shocks to the system. Consent of the unions was garnered by a combination of the delivery of actual social wage outcomes and the continuing fragility of the Australian economy. Once the unemployment and inflation risks had abated, however, centralized bargaining came under sustained pressure from the strongest unions. The Commission's 1991 award which placed more restrictions on wage rises than either the ACTU or government had asked for spelled the end of centralized wage setting; Kelty used the Accord process to begin the transition to enterprise-level bargaining. Though the Accord continued to exist as a publicly declared policy statement from the ACTU and ALP, it ceased to make serious demands of the unions in terms of wage restraint. When Labor lost the 1996 election, the Accord died as well. Employers had never publicly supported the Accord and the incoming Coalition government had little to gain from allowing unions a say in social policy.

In terms of the model, I find evidence that both the size of transaction costs and the discount rates of the unions help explain the divergent paths of Australia and New Zealand. Interview respondents gave statements consistent with the incomplete information extension of the model; they viewed that Accord as a signal of competence to the electorate. There is also evidence of investment in monitoring and enforcement technologies, something we would expect under a repeated game with costly information acquisition. Finally, available economic and electoral data and the manner and content of the renegotiated Accord supports the notion that the parties did in fact implement their sides of the bargain.

5 Conclusion

In this paper, I have presented a theoretical model of social pacts, building on insights from the transactions approach to public policy. I argued that pacts are, at their core, political bargains in which political parties seek to make credible policy promises to the electorate. Unions enter in to the contract for two main reasons: they are compensated for their sacrifices through public policies they value and, due to economic circumstances, policy options are a more effective path to garner benefits for union members than industrial action. Pacts are sustained through time by the threat of defection by both parties. The ability to sustain the agreement depends on the time horizons of the unions and the slippage between taxation and delivery of the social wage. In the context of pacts, union leaders with strong career and personal connections to political parties have longer time horizons and are more willing to bargain. Unions with strong institutional ties to particular parties lower these transaction costs and make pacts more likely under conditions of crisis for two reasons: due to their close relationship, the public does not view the party alone as capable unless the unions are known to consent to the party's policy and, second, the unions keep the party from offering other policy options less to the unions' liking.

I then turned to the puzzle of the divergent strategies pursued by Labor governments in Australia and New Zealand. Consistent with the model, policy makers in New Zealand chose not to attempt a negotiated wage-policy contract. The NZLP was not suffering from electoral skepticism about its ability to address the country's economic malaise. Unions were not a major force in the NZLP and unions were split into two federations and unable to come to internal consensus. Time horizons for both the NZLP and unions were short. In contrast, the ALP was struggling to establish credibility with voters on its ability to address inflation and unemployment concerns. Union cooperation was essential for making credible policy statements. For an incomes policy to work, union cooperation was needed. High

unemployment, especially in sectors of the economy where unions were industrially strong, induced the ACTU to come to an agreement. Organized employers played a negligible role in negotiating, implementing, or blocking policy both countries. That said, employers never expressed support either; when Labor finally lost office in 1996, the Accord ended as well.

The argument points the way for several areas for further research. First, and most obviously, this paired comparison can hardly be considered definitive. The argument awaits more systematic confrontation with statistical tests. Second, attention needs to be paid to the exact nature of party-union relationships. As the Australia-New Zealand comparison ably demonstrates, all Left-labor parties are not alike. The development of quantitative measures of party-union interpenetration should be a goal here. Third, attention to the careers of union leaders should also be investigated. Though often in unintentional ways, the Accord provided several lucrative career paths for union officials, most notably the management of superannuation funds. How the career concerns of union leaders affect their willingness to commit their unions to certain policy agreements is understudied. The issues identified here point to other cases that could yield further insights. For example, why was there no agreement between unions and the government in Argentina during the 2000-02 crisis?

Finally, while it is not the central purpose of this paper to determine whether Australia's negotiated transition or New Zealand's rapid and deep reform program yielded better current outcomes, a few words on the subject are in order. First, it appears that both Australia and New Zealand have more-or-less successfully restructured their economies. Both countries are now deeply integrated into global trade, investment, currency, and financial networks. Gone are most of the inefficient industries from the pre-1982 ISI period. Service sector employment is the dominant and growing area of employment in both countries. Labor costs have declined. Inflation and unemployment has been brought under control. Both countries used to be among the most strike-prone in the OECD; industrial disputes have dropped off significantly. Labor markets are much more fluid and bargaining is much less

centralized.³⁴

That said, New Zealand has had to pay a much steeper price. Most obviously, inequality has increased dramatically when compared to Australia. Welfare benefits have eroded and training systems have weakened. The NZCTU argues that New Zealand essentially pursued a “low road” strategy to international competitiveness under the 1984-1996 Labour and National governments (Conway, 2002). New Zealanders also paid a steeper price during the transition, facing higher unemployment and more volatile currency and inflation outcomes in the 1986-91 period, reinforcing the idea that monetary policy is a fairly blunt instrument that can impose high social costs in moving from one equilibrium to another. Australia’s negotiated approach appears to have shared the costs of restructuring more equitably across society.

Appendix A: Data and interviews

data

Unemployment Standardized unemployment rate taken from the Comparative Welfare State dataset (Huber et al., 2004), henceforth CWS.

Inflation Price level of consumption taken from the Penn World Tables (Heston, Summers and Aten, 2006), henceforth PWT.

Real GDP Index with 1980 as the base year. GDP data taken from the PWT

Inequality Gini coefficient taken from the UTIP EHII dataset (an update of the Deninger & Squire data) (UTIP Research Group, 2006)

Wage compression The 90/10 ratio taken from the CWS.

Union density Adjusted union density taken from Visser (2006)

Union militance Industrial disputes / labor force taken from CWS.

Labor costs Real unit labor costs index, 2000=100, taken from the ILO’s *Key Indicators of the Labor Market*, henceforth KILM.

GDPpc & population Per capita GDP and population levels both from the PWT.

³⁴For an extended discussion of these changes, see Bray and Walsh (1998).

Current Account Current account balance as %GDP from the World Bank's *World Development Indicators* (2006), henceforth WDI.

Government debt Central government debt from the WDI

GDP/hr. worked GDP per hour worked in 1990 \$US from the KILM

ISI Manufacturing as %GDP - Manufacturing exports as %GDP from WDI

CBI Central bank independence score from Cukierman, Webb and Neyapti (1992)

interview details

Interviews were conducted by the author between September and December 2006. All interviews, save one phone interview, were conducted in person. In Australia interviews took place in Canberra, Melbourne, Sydney, and Tewanin. All New Zealand interviews occurred in Wellington. The goal was *not* to collect a random sample of any larger population (e.g., union members) but rather to identify the universe of individuals who played important roles in formulating and implementing policy *at the time* and interview as many of them as possible. Interview subjects were identified in two ways: first, through mentions in the public record, press, or secondary literature as having a pivotal or noteworthy role and, second, as referrals from already identified interview subjects. Most interviews were done individually though there was one group interview of commissioners on the Australian Industrial Relations Commission and two situations in which the referrer accompanied me on the interview with the referral. Interviews took place at numerous locations, ranging from subjects' homes or offices to cafes and bars. There is an interview protocol, but all were conducted as a structured conversation. Table 2 identifies the interview subjects and their relevant affiliations.

Table 2: Interview Subjects
Relevant Position

Country	Subject	Relevant Position
Australia	Grant Belchamber	wages and policy div., dept. of employment & ind. rel.; ACTU research officer
	Laurie Carmichael	Federal secretary, Australian Metal Workers' Union; Asst. Gen Sec., ACTU
	Bruce Chapman	Liason between PM Keating and ACTU
	Paul Goulter	Head NZ TUC; Dir. ACTU Education & Campaign Centre
	Roy Green	Asst. to Bill Kelty, ACTU
	Bob Gregory	Board member, Reserve Bank of Australia
	Joseph Issac	Commissioner, AIRC ³⁵
	Bill Mansfield	Secretary, Telecommunications Union; ACTU; Commissioner, AIRC
	Michael Keating	Dep. sec. of finance; Sec. of employment & ind. rel.
	Bill Kelty	General Secretary, ACTU
	Kerry Schott	Head of wages and policy div., dept. of employment & ind. rel.
	Jim Simmonds	Commissioner, AIRC
	Chris Warren	Federal secretary, journalists' union
	Ian Watson	Commissioner, AIRC
	Ralph Willis	Min. of employment & ind. rel.; Treasury minister
New Zealand	Peter Conway	President, Distribution Union; Economist, NZCTU
	Arthur Grimes	Economist, Reserve Bank of New Zealand
	Peter Harris	Head of research and policy advocacy, CSU; head of technical services, NZCTU
	Colin James	Journalist
	Tony Simpson	President, CSU; chief of staff for Labour MP
	Jim Anderton	
	Bryce Wilkinson	Treasury economist

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