Ideas About Labour Markets

the Last 100 Years and the Twenty-first Century

JUDITH SLOAN

THE SIR RONALD TROTTER LECTURE

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NEW ZEALAND BUSINESS ROUNDTABLE

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The Sir Ronald Trotter Lecture

SIR RONALD TROTTER was the first chairman of the New Zealand Business Roundtable in its present form, a position he held from 1985 to 1990.

Among his many other roles he has been chief executive and chairman of Fletcher Challenge Limited, chairman of the Steering Committee of the 1984 Economic Summit, a director of the Reserve Bank of New Zealand, chairman of the State-owned Enterprises Advisory Committee, chairman of Telecom Corporation, chairman of the National Interim Provider Board, a chairman or director of several major New Zealand and Australian companies, and chairman of the board of the Museum of New Zealand Te Papa Tongarewa.

He was knighted in 1985 for services to business.

This lecture was instituted in 1995 by the New Zealand Business Roundtable to mark Sir Ronald Trotter's many contributions to public affairs in New Zealand. It is given annually by a distinguished international speaker on a major topic of public policy.

The fifth Sir Ronald Trotter lecture was given by Professor Judith Sloan at the Museum of New Zealand, Te Papa Tongarewa in Wellington on 21 September 1999.

Judith Sloan

JUDITH SLOAN is a professor of Labour Studies at the Flinders University of South Australia. Formerly she was the director of the National Institute of Labour Studies (NILS) in Adelaide where she undertook and supervised a wide-ranging research programme on labour markets and industrial relations issues. She holds a Master of Arts degree in economics from the University of Melbourne and a Master of Science degree in economics from the London School of Economics, and is currently a commissioner of the Productivity Commission, the Australian government's principal microeconomic research agency.

Professor Sloan is a regular radio and television commentator and has been a weekly columnist in the *Australian Financial Review* and *The Australian*.

She has substantial experience on public company boards and is currently a director of Santos Limited, Australia's largest on-shore oil and gas company, and Mayne Nickless Limited, a health care and logistics company, and is chair of SGIC Holdings Limited, one of the leading general insurers in South Australia. Professor Sloan was appointed to the board of the Australian Broadcasting Corporation in August 1999.

Introduction by
Ralph Norris,
chairman,
New Zealand Business Roundtable

AS CHAIRMAN of the New Zealand Business Roundtable it is my great pleasure to welcome you all to this event, and particularly our guest speaker, Professor Judith Sloan.

This is the fifth Sir Ronald Trotter lecture. The series was inaugurated in 1995 to recognise Sir Ron Trotter's role as the Business Roundtable's founding chairman and his many contributions to business and public affairs in New Zealand. We are delighted that Sir Ron and Lady Margaret Trotter have been able to join us this evening.

The purpose of the lecture is to feature an outstanding international speaker on a major topic of public policy. Having been privileged to hear speakers from the United States, Britain and Europe, we are pleased to have a very distinguished Australian with us on this occasion.

Professor Sloan has contributed often to the public debate about labour market, education and training issues in Australia, and she is no stranger to the New Zealand scene. The Business Roundtable has looked to Judith for advice on a number of occasions over the past 10 years, on issues ranging from labour market regulation to industry training and minimum wages.

In 1994, Professor Sloan authored a substantial report for us entitled *Towards Full Employment in New Zealand*, as a contribution to the work of a prime ministerial task force. It remains in my view one of the most

readable and informative accounts you will find on the subject of employment and the problem of unemployment.

The report emphatically rejected the proposition that full employment is a phenomenon of the past and is unlikely to be achieved again, now or in the future. It argued that the causes of unemployment are well understood, and can usually be traced to bad government policies. Key issues are labour market flexibility and welfare incentives.

At the time the report was written, the unemployment rate in New Zealand stood at about 8.5 percent of the labour force. The report argued that New Zealand had put in place the main elements of a framework for restoring full employment, and that provided the framework was maintained and improved, unemployment could be as low as 4 percent by 1998/99. New Zealand's record of getting unemployment down to 6 percent by 1996 and the achievement by the United States of an unemployment rate of just over 4 percent today suggest that this projection was eminently realistic.

But Professor Sloan also warned five years ago that the period ahead would throw up challenges to New Zealand's employment performance, including cyclical downturns in the economy and adverse external shocks, and that no time should be lost in taking steps to make the growth and employment outlook more robust. Unfortunately we failed to heed that warning, with the result that average unemployment rose to 7.7 percent last year and the Maori unemployment rate climbed back to a totally unnecessary 19.5 percent. These rates have only fallen slightly with the current economic recovery.

It is therefore timely to renew our understanding of how labour markets work, and of the nature of the obstacles to a better employment performance. This issue is particularly topical in the year of a general election when political parties are putting forward very different proposals as to how employment relations in this country should be regulated. To assess them, we can only benefit from having the opportunity to review what academic inquiry and practical experience have to teach us so that we can make good choices about policies in

the period ahead. I can think of no one better qualified than Judith Sloan to help us in this task, and I invite her to address us on the topic: 'Ideas about labour markets: the last 100 years and the twenty-first century'.

Ideas About Labour Markets: the Last 100 Years and the Twenty-first Century

THE POWER OF IDEAS should never be underestimated. Good or bad ideas will usually influence public policy – if not in the short run then at least over the long run. That is certainly true in the case of the labour market. Unfortunately, for much of this century, and in many countries, the ideas behind industrial relations laws were more often bad than good. Workers and employers alike suffered under philosophies that fundamentally misunderstood labour markets. For much of this time, New Zealand and Australia had two of the worst industrial relations regimes among western countries. More recently, labour market liberalisation has taken place on both sides of the Tasman. But the old, bad ideas have not disappeared, and are still widely promoted. If further labour market liberalisation is to proceed successfully, we must continue to combat those ideas and expose the fallacies behind them.

Collectivist ideas about labour markets

In the early decades of the twentieth century a variety of socialist and other collectivist ideas gained ground worldwide, and labour markets did not escape this development. In New Zealand, the influence of Fabian socialism can be seen in industrial relations legislation introduced as early as the 1890s. The advent of national awards, in

which all workers with a given job description were covered by centrally determined wages and conditions, set a framework for New Zealand labour relations which remained in essence unchanged until quite recent times. In Britain around the same period, trade unions were given special legal privileges – a mistake that was to detract from the flexibility and productivity of the British economy for most of this century. Even in comparatively laissez-faire America, unions were granted various legal privileges in representing workers. In the countries of continental Europe, there was also a trend towards greater union powers and stronger collective bargaining.

Australia was not immune from this tide of ideas. One of the most influential figures in the history of Australian labour market regulation was Henry Higgins – a wealthy barrister who might today be called a chardonnay socialist. Having made his money, Higgins devoted himself to promoting supposedly advanced social legislation. It was his vote alone that lead to the conciliation and arbitration power being included in the Australian constitution. According to Higgins:

> If a man cannot maintain his enterprise without cutting down the wages which are proper to be paid to his employees … it would be better that he abandon the enterprise.

As president of the Commonwealth Court of Conciliation and Arbitration, Higgins's most famous action was to introduce the basic wage in Australia. This was his 'proper' wage. Higgins evidently saw industrial relations policy as an extension of social welfare, with the onus on an employer to pay a 'proper' wage. But it is highly questionable whether the notion of a 'just' or 'proper' wage has any genuine meaning. Mainstream economics has long been unable to make any sense of the old, medieval notion of a 'just price' – a price supposedly capable of being determined independently of exchange values arrived at in a market. Similarly, merely declaring that employers should pay a just or proper wage does not mean that all outcomes in a labour market will be just or proper.

Language similar to that of Higgins is not hard to find in the contemporary debate on both sides of the Tasman. As recently as 1998, the Australian Centre for Industrial Relations Research and Training stated:

> We must move on to a more positive trajectory that simultaneously promotes fairness and efficiency at work. For too long managers have believed in the fiction that all they do is 'just manage'. The result of this philosophy is that more and more people are 'just managing' to get by. It is time policy promoted a situation in which justice played a greater role in the management of issues at work.

As a rhetorical device, justice language has built-in advantages: few people are likely to come out in favour of 'injustice' in the workplace. Also popular is the language of cooperation and harmony. For instance in 1985 a former vice-chancellor of my university, Keith Hancock, stated:

> [An] effective industrial relations system ... is one concerned with promoting and encouraging harmony and cooperation between the industrial parties while providing mechanisms to resolve the competing interests of employers and workers in an equitable manner.

This was written at a time when some people hoped Australia would abandon its system of compulsory arbitration. But it was not to happen. Hancock's report merely recommended a fine-tuning of the system of conciliation and arbitration. It even wanted greater centralisation, with all authority vested in trade union and employer associations, along with the tribunals. As it happened, the Hancock report was so archaic it was not actioned by the government; it was redundant even before it came out.

Are labour markets special?

The assumption lying behind the views of people such as Hancock and Higgins is that labour markets are special – that they are somehow different from other types of market. This view is widespread in some

Australian universities. But every market is special in its own way. Just because a market has certain distinctive features, this does not automatically mean that the key principles underlying its operation are different from those of other markets. If the law is to treat labour markets differently, justification is needed as to how labour markets are 'special', and why that should matter.

Sometimes it is claimed that labour markets are special because people are involved. "This is not the market for potatoes", runs the argument. "It is all about human beings." But people are involved in all markets, as buyers and sellers in some capacity. Markets are about serving people's various needs. Labour markets are about labour services. They involve people as employees, but also as employers – from the large corporate to the corner dairy owner who hires one person to assist behind the counter. In the absence of an explanation as to why the principles that apply in other markets do not apply in labour markets, the objection that labour markets involve people is empty.

Another candidate for the uniqueness of the labour market is the fact that the demand for labour is a derived demand. Thus consumers do not generally demand labour directly. They demand goods and services, and in so doing indirectly demand the labour that goes into producing those goods and services. But that alone does not make labour special: all other inputs to the production process are also subject to derived demand. When a worker demands a spanner to tighten a screw, that constitutes derived demand. But we do not regard the market for spanners as special. Thus the argument about derived demand is also unconvincing.

A third reason often given for why labour markets are different is the alleged inequality of bargaining power between employers and employees. Here we perhaps come to the heart of the misunderstanding about labour markets. Employers have large resources and are wealthy, it is claimed. Individual employees have few resources, and typically depend for their very survival on holding down a job. Bargaining is inherently unequal. The law needs to assist employees to redress this

inequality through giving unions special powers and providing for collective bargaining structures.

This analysis assumes implicitly that employers and workers are in competition with one another, and indeed Keith Hancock speaks explicitly of competing interests. But this assumption is a fallacy. If it were correct, one would expect to see, for example, the workers of Hong Kong systematically impoverished and downtrodden. After all, they receive no 'help' from their labour law of the type envisaged by people like Hancock, and they operate in one of the freest labour markets in the world. Yet the workers of Hong Kong have experienced an enormous rise in their living standards over the past generation or two, and their incomes are higher today in real terms than those of New Zealand workers.

How markets work

The view that workers and employers are in competition is at odds with the most fundamental feature of all markets. Markets are about voluntary exchange between buyer and seller. The seller possesses a good or service that they are willing to part with. The buyer is prepared to pay for that good or service. In this exchange one can expect gains to be generated for each party. Were it not a case of expected mutual benefit, at least one party would not make the exchange. Rather than competing with one another, buyer and seller are cooperating. Voluntary cooperation for mutual gain underlies the market for potatoes, spanners, television sets, cars, land, and financial services. It also underlies the market for labour services. The greater the scope for making voluntary exchanges, within a framework of law, the greater will be the benefits from trade. The greater the extent to which decisions can be made at a decentralised level, the greater will society be able to take into account the wide spectrum of individual needs and preferences, ranging from the preference on the part of consumers for a certain variety of potato to the desire on the part of a worker for a job with a certain pattern of hours.

Voluntary cooperation for mutual gain characterises labour markets just as much as it characterises any other market. Employers and workers need each other. They are in partnership to produce goods and services, for sale to other firms or to households. The entire production process must be geared to the needs of households, or in the end has no justification. Ultimately every worker is part of a household.

When coming together in voluntary cooperation, both workers and employers gain if they are allowed maximum scope to make contracts that best suit their individual circumstances and desires. There is no inequality of bargaining power in a competitive labour market for essentially the same reason that there is no such inequality between consumers and producers in a competitive market for potatoes or spanners. If consumers are dissatisfied with the price or quality of a product, they can switch to a different supplier. Competition between producers, and the consequent ability of a consumer to shift their custom, constrains the behaviour of even the largest corporate. Similarly with competitive labour markets: if a worker is not satisfied with the wages and conditions in their present job, they can shift to a different employer. Employers are competing amongst themselves to hire and retain good and motivated workers. They need to pay market rates of remuneration. For that reason, any employer has strong incentives to structure the package of wages and conditions they offer to a worker in the most attractive form.

Of course some workers can command higher wages in the market than others. Those with skills in high demand will earn higher rewards than those with comparatively few skills. The terms on which workers and employers trade will depend on the options available to each. Differences in rewards are an inevitable outcome of a competitive labour market. But differences in rewards have been a feature of virtually every society, including communist countries. To the extent that policy-makers wish to reduce income inequalities, experience has shown that this goal is more effectively achieved through a system of taxation and income support than through direct regulation of the labour market.

Trends in labour markets

In earlier times a fixed wage or salary was the predominant means of remunerating employees. This form of payment might have helped obscure in the public mind the partnership nature of the enterprise. It shifted much of the risk on to employers, and may have promoted a paradigm of conflict between two sides. But a fixed wage is only one payment option, and the number of employees on fixed wages is diminishing. There is a labour market trend towards more contingency payment arrangements: employees' remuneration is linked either to the success of the enterprise for which they work or to their own performance. Employers are also using contract workers in greater numbers.

For many people a different type of labour market is emerging. Rather than having a large number of people performing undifferentiated work, jobs tend to be more specialised. A worker is becoming more likely to regard themself as Jo Smith Incorporated than as a wage worker. The increasingly fluid and heterogeneous labour market is a welcome trend, and has evidently been assisted by the revolution in information technology. Information technology workers themselves typify this labour market as much as any group. They generally regard themselves as project workers. Their motivation is to complete a given project rather than simply to be an employee in a given company. On finishing a project they move on. They shift frequently between self-employment and salaried status.

We are thus seeing a much more complex labour market in which some workers are employees, some employers, some self-employed, and some fall into more than one category by holding down multiple jobs. Moreover, people expect to move between these various categories over time in a way that was never the case in the past. It is to be hoped that this will help to erode the old paradigm of employers and employees in conflict.

Another significant development is the worldwide decline in union membership. Between 1985 and 1995, the percentage of wage and salary

workers belonging to a union in New Zealand fell from 54.1 percent to 24.3 percent. In Australia union membership for the same period fell from 45.6 percent to 32.7 percent. This trend is not confined to countries that have liberalised their labour markets. In France, where union membership has never been high, the percentage of workers belonging to a union fell from 14.5 percent to 9.1 percent over the same 10-year period. And in Germany union membership fell from 35.3 percent to 29.1 percent. These figures reflect both the changing nature of the workforce and changing values among workers.

If inequality of bargaining power were a real and universal phenomenon in labour markets, the available empirical evidence would present a puzzle. Why have employers not taken advantage of their superior bargaining position and bid down wage rates constantly over time? Surely wages would be zero, or at least continually falling. But in reality the complete reverse is true. Despite the occasional short-term fall, real wages have risen dramatically since the beginning of the industrial revolution. The claim by Karl Marx that the living standards of the proletariat were falling under capitalism was wrong even at the time he made it.

Moreover, labour market regulation designed to redress inequality of bargaining power and other alleged market failures has a poor record in practice. In Australia the principal objective in setting up the system of compulsory arbitration was to prevent and settle industrial disputes. Yet for many decades Australia had one of the worst records for industrial unrest in the western world. Far from promoting harmony and cooperation, labour law divided workplaces into warring camps. Many strikes were truly pointless. They would have been amusing were they not so damaging, not least in the reputation they gave Australian industry for being an unreliable supplier.

New Zealand was somewhat less susceptible to strikes than Australia. But under its pre-1984 policy framework, with the national award system a key element, New Zealand had the worst record for

productivity growth of any Organisation for Economic Cooperation and Development (OECD) country. In Australia and New Zealand there was an unhealthy dominance both of unions and employer associations. With monopolies on both sides of the labour market, the conflict model came to be institutionalised.

Labour market regulation

The last two decades of the twentieth century have seen economic liberalisation taking place in most countries of the world. But the labour market has generally stood out as a lagging sector in this overall trend. While a few countries have undertaken significant labour market reform, labour law worldwide is still dominated by traditional ideas in which the labour market is seen as special. Moreover, with the general decline of unionisation, new forms of regulating labour markets have gained in popularity. Rather than being viewed as attempting to set the bargaining rules between monopoly employers and monopoly employees, many new regulations now concern themselves directly with some aspect of the employment contract. Former Sir Ronald Trotter lecturer Richard Epstein was not exaggerating when he wrote:

> World-wide, the regulation of labour markets has created a legal edifice of stunning complexity. Protective laws abound on every conceivable aspect of the subject: health, safety, wages, pensions, unionisation, hiring, promotion, dismissal, leave, retirement, discrimination, access and disability. The multiple systems of regulation now in place often work at cross purposes with each other.

Many of these new regulations effectively specify various mandatory elements in employment contracts, either by making a term compulsory or by prohibiting a term. In justification, it is often argued that certain elements in an employment contract are simply good business practice. Thus it is claimed that good employers will naturally want to provide a certain period of paid parental leave for their staff, since they wish to retain the services of female employees who become parents. This

argument confuses good practice for some employers with good practice for all employers. There are many thousands of employers in an economy, each with their own unique circumstances. Many employers may find it good business practice to provide paid parental leave. But in a labour market based on freedom to contract, they are already entitled to do so, without the government becoming involved.

Many other employers will not wish to provide paid parental leave. But to compete effectively in the labour market against employers who do provide that condition of service, these employers may need to compensate workers more highly in some other aspect of their total remuneration package. To the extent that employees, individually or collectively, value paid parental leave highly compared with other contractual terms such as the wage level, a given employer will be more likely to provide that condition, or, in its absence, will be forced to compensate employees in other ways. In other words, voluntary contracting will provide terms that best reflect the preferences of individual workers. For instance, childless or self-employed people, or families where one parent chooses to leave the workforce to become a full-time carer, do not benefit from paid parental leave. Mandating paid parental leave is a cross-subsidy from these groups to other groups. It is a good example of a 'top down' policy inconsistent with the distribution of individual preferences within a population.

In short, centralised prescription of certain contractual terms for all workplaces harms both employers and employees by ignoring differences in circumstances, and by cutting across individual preferences. Promoters of such measures imagine they are implementing progressive social policy – that they are 'helping' workers, and that the costs, if any, can be easily borne by a few rich businesses. But that is to be mistaken about where the costs will lie. Ultimately these costs are not borne by the suppliers of capital. Depending on the precise nature of the markets in question, the costs of a mandatory term will fall in some proportion on workers – through fewer jobs, lower wages and reduced non-wage compensation – and on consumers, through higher prices for goods and

services that are now less efficiently produced. Thus one effect of mandatory paid parental leave will be reduced average wage levels.

In both New Zealand and Australia there is now a statute making it illegal to specify any mandatory retirement age in an employment contract. This law has had a perverse impact in Australian universities, as it has elsewhere. Nobody can be forced to retire, including low-performing academics. The reaction from universities has been predictable. They bribe their 'dead wood' to retire by paying them large sums of money. They do not mind good academics continuing to work on. Thus a policy with the ostensible aim of promoting continued participation in the labour market ends up being a cross-subsidy from good workers to bad workers – hardly the original intention of the legislators.

The minimum wage is a mandatory term with particularly damaging outcomes. Here the cost falls most heavily on one group of workers – those made unemployed as a result of their marginal value to employers being less than the mandated minimum. This group largely comprises unskilled workers; those who are young or otherwise inexperienced in the workforce; and workers who present some special risk to an employer. In other words, those most harmed by the minimum wage are the very workers legislators typically claim they most wish to help. The costs of the minimum wage will also fall on some low-wage employees. Certain employers will react to a minimum wage by cutting back, not on staff numbers, but on various elements of non-wage compensation such as training or working conditions. As always, the mandatory term ends up ensuring that the overall preferences of individual workers are less well reflected in compensation packages.

Considered as social policy, the minimum wage is poorly targeted. Many people who are paid the statutory minimum do not live in poor households. Yet the motivation for a minimum wage presumably reflects concerns about income adequacy. If so, using the tax and transfer system to directly 'top up' low household incomes is much more effective than imposing a statutory minimum wage in employment contracts.

Labour market liberalisation in Australia and New Zealand

Despite the extensive regulation that remains, the last decade has on balance seen labour market liberalisation in both New Zealand and Australia. On both sides of the Tasman dire consequences were widely predicted for the reforms – not only from politicians, but also from commentators in the media and even from many academics. In New Zealand, for instance, Raymond Harbridge of Victoria University of Wellington said the Employment Contracts Act (ECA) would bring 'a proliferation of industrial disputes' and 'the worst excesses of gangster unionism'. Fellow Victoria University academic Pat Walsh expected a 'slide into a major depression'. These were very large claims. Most social outcomes have a great number of causes. Predicting extremely serious consequences from just one statute – no matter how significant – ignores the complexity of our societies.

Nonetheless, similar forecasts were also made in Australia in the context of the Australian labour market reforms. In both countries there were widespread predictions of greater industrial unrest, lower productivity growth, reduced job security, more overworked employees and greater income inequality. In all cases the claims were not borne out by events.

Industrial unrest has fallen in both Australia and New Zealand following liberalisation – in New Zealand's case dramatically so. In 1990, the final calendar year prior to the introduction of ECA, 300 working days were lost per 1000 employees in New Zealand. By 1998 only 11 working days were lost. Strikes are almost extinct in this country. Perhaps that is why the recent industrial action at Ansett New Zealand attracted so much media attention; the Ansett strike was a genuine rarity. In any case, the inconvenience of delayed flights is a reminder to New Zealanders of life before the ECA. In Australia the reduction in lost working days has also been substantial – from 500 per 1000 employees in 1980 to 150 in 1996.

Productivity growth following liberalisation has been very impressive in Australia. Partial labour market reform took place in 1993 under the Labour government, and again in 1996 under the current administration. The big increase in productivity growth in recent years cannot be wholly attributed to labour market liberalisation but a more efficient labour market is clearly an important element. When adjusted for short-run cyclical factors, total factor productivity growth was around 2.4 percent in 1996/97 and 1997/98, compared with a long-run average of 1.2 percent in the years leading up to 1993/94. That constitutes a doubling in annual productivity growth. Though the percentages may seem small, they represent a huge change. Growth in output per head that previously took 13 years now takes only six years.

In New Zealand the statistics on productivity growth are less robust. Some commentators have painted a picture of disappointing productivity growth following the ECA by focusing on labour productivity. But the best productivity measure is total factor productivity. Looking simply at labour productivity ignores substitution between labour and capital that may be occurring. For instance labour productivity might be growing by only 0.5 percent but if capital productivity is growing by 10 percent total factor productivity will be expanding very strongly.

Moreover, in the case of the ECA there was a natural reason why it might always have been expected to lead initially to modest growth in labour productivity. The ECA was introduced at a time of high unemployment in New Zealand. It brought rapid job growth, as a large number of generally low-skilled workers, previously locked out of the workforce, were able to take advantage of more flexible bargaining conditions. The influx of low-productivity employees impacted negatively on average labour productivity growth. But it was the right social trade-off for the government to make – putting people into jobs rightly took priority over growth in real wages. Such a trade-off would be welcome to many in Australia today. And as hoped, total factor productivity growth in New Zealand does appear to have increased

significantly as a result of labour market and other reforms. According to a study by Diewert and Lawrence, total factor productivity growth is now higher in New Zealand than in the United States.

There is little sign of greater job insecurity as a result of the Australasian reforms. In 1975 – admittedly a year in which a recession was ending – 25 percent of the Australian workforce changed jobs. In 1998 the comparable statistic for turnover was 21 percent. Rapid turnover has long been a feature of labour markets in Australia, as elsewhere. Labour markets resemble a swimming pool in which water is flowing in and out at a rapid rate. Moreover, the percentage of workers changing jobs in Australia because of retrenchment was unchanged between 1975 and 1998. Similar comparative statistics are not available for New Zealand but a recent international survey by AC Neilson found that 70 percent of New Zealand workers were happy with their job security. New Zealand workers were in the top half of the table for job security among the 20 countries surveyed.

There is some truth in the claim that people are working longer hours, at least in the case of professional workers. But it does not follow that people actually feel more overworked. In Australia the proportion of workers saying they work 45 hours or more per week increased from 24 percent in 1974 to 28.2 percent in 1999. That measure is probably subject to overstatement bias. More importantly, other survey data suggest that 63 percent of workers who *do* work long hours are happy with those hours.

There is no evidence that labour market liberalisation has widened the gap between rich and poor in the workforce. The increase in earnings inequality has been a worldwide trend over the past decade or two, and is found in countries with both flexible and inflexible labour markets. It appears to be linked mainly to recent technological change favouring skilled labour. In Australia, income inequality began increasing in the mid-seventies, well before labour market liberalisation. In analysing the distribution of incomes, it is generally of greater interest

to look at household income rather than individual income, and household income should be the main target of any policies aimed either at income redistribution or at maintaining income adequacy.

Household incomes in Australia have been growing more equal over the last two decades, as a result of changes to the system of taxation and transfer payments. In New Zealand, household incomes became more unequal in the late 1980s and early 1990s, reflecting the big build-up in unemployment at that time. But as unemployment fell substantially in the wake of the ECA, earnings inequality narrowed. The New Zealand story illustrates nicely the link between unemployment and inequality: when large numbers of people cannot earn a market wage, household incomes will be more unequal. For that reason, measures such as the minimum wage increase earnings inequality.

Weakness of the ECA and new threats

New Zealand's ECA is widely admired legislation, and has attracted considerable international attention. The act was seen as a genuine innovation, in that it takes a contract approach to the labour market. With one unfortunate exception, the mandatory personal grievance provisions, the attachment to the myth of unequal bargaining power is little in evidence. Rather it is assumed that voluntary exchange between buyers and sellers of labour will produce the best outcomes. Workers and employers are free to make individual or collective contracts, and the form of contract is itself a matter for negotiation. The national award structure, compulsory unionism and trade union registration were all discarded by the ECA. The success of the act demonstrates the gains from allowing voluntary exchange between freely contracting parties.

The biggest weaknesses in the ECA are the compulsory personal grievance provisions and the retention of a specialist labour court, especially as unjust dismissal can be grounds for a personal grievance under the legislation. Had the framers of the ECA been fully consistent

in their philosophical approach, any special personal grievance provisions in a contract would themselves have been subject to negotiation between the parties. After all, there are already standard common law remedies for personal grievances. Moreover, allowing a specialist court to handle labour market disputes is always unwise. It encourages judges to see the labour market as 'special', and their job as being to redress unequal bargaining power rather than simply applying the principles of contract law. Many decisions of the New Zealand Employment Court appear to have amply borne out this concern about specialist institutions.

As a result of these developments, dismissing staff in New Zealand, even for perfectly legitimate business reasons, is often seen as having high potential costs. Employers are discouraged from hiring in the first place. Since compulsory personal grievance provisions add to employers' overall expected labour costs, employers react partly by offering lower wages. Not only is employment lower, workers in general do not even gain in job security. Those already employed may become more secure, but only at the expense of other workers becoming unemployed as a result of the greater risks involved in hiring them. Those rendered unemployed are workers who, for various reasons, employers regard as high risk. As a group, they are more vulnerable than the 'insiders' who have become more secure. Yet again a statutory intervention designed to help workers ends up harming the most vulnerable among them.

Despite this major weakness in the ECA, any retreat from the general provisions of the legislation would be very damaging. The trends worldwide are towards more decentralised wage bargaining, declining unionisation, greater individual contracting, and pay linked to enterprise performance. Any attempt to turn back the clock would be like trying to hold back the tide. There are evidently some threats on the immediate horizon. For instance, the Labour Party's industrial relations policy includes some dangerous ideas. Under Labour's policy, only trade unions can be a party to collective contracts; unions can negotiate multi-employer agreements; individual employment contracts

must be consistent with collective contracts; 'good faith' bargaining is required; and the Employment Court has strengthened powers.

This represents a return to many of the old, bad ideas at a time when trends in the labour market are more than ever demonstrating the irrelevance of the old thinking. For instance, Labour wishes to increase greatly the status of unions at a time when union membership worldwide has declined considerably. In New Zealand, fewer than half of all collective contracts today are negotiated by unions. Yet Labour plans to bring back a union monopoly in collective bargaining. When taken with the right of unions to initiate negotiations for multi-employer agreements, this may lead to a de facto return to national awards. These policies will detract from investment and growth. The requirement that individual contracts be consistent with collective contracts is also in line with a drift back to national awards.

The introduction of 'good faith' bargaining would be of particular concern. Like 'justice' or 'proper wages', 'good faith' is one of those terms that may seem unobjectionable, but used in its typical context it is actually harmful where it is not simply meaningless. Australia has fortunately escaped the introduction of any requirement that bargaining in the labour market be conducted in 'good faith'. But in America 'good faith' has caused real problems. For example, if an employer does not increase their first offer in negotiations they are failing to bargain in good faith, according to some court interpretations. In other words, employers cannot make take-it-or-leave-it offers.

This is a very strange development. With normal commercial transactions, nobody argues that the law should require business people to negotiate in 'good faith' by never making take-it-or-leave-it offers. Only the continued allure of the myth of unequal bargaining power explains the requirement for 'good faith' in the context of labour relations. If introduced to New Zealand, good faith bargaining will lead to lengthier and more costly negotiations, increased union involvement, greater judicial intervention, and much more work for lawyers. On top of all this, Labour, if elected, would increase the powers of the

Employment Court. Under such policies, the higher transactions costs associated with employment contracts would further increase unemployment, other things being equal.

Australia went briefly down the path of statutory remedies for personal grievances, and saw a dramatic increase in the number of cases brought for unfair dismissal. Small businesses were the worst affected, which fortunately fed back into the politics of the issue. Both the last Labour government and the current Coalition government moved to limit personal grievance claims. Fees must now be paid before actions can even begin, and there is an upper limit to compensation. In addition, there is a probationary period during which newly hired workers cannot lodge a claim. That is an important restriction, since most disputes occur during the first six or 12 months of an employment relationship; often employment disputes are largely personality clashes.

These remedial measures have combined to reduce greatly personal grievance actions in Australia. Failing the abolition in New Zealand of the Employment Court and the compulsory personal grievance provisions in the ECA, the implementation of similar measures here would substantially limit the damage from the current regime.

The challenge for New Zealand policy-makers is to build on the lessons from the past 100 years about the benefits of voluntary contracting in labour relations. The world is changing in ways that make it even harder to return to the conflict model of the past. As my Flinders University colleague, Mark Wooden, has written:

> [A] return to a highly centralised system for the determination of wages and employment conditions is neither a realistic nor sustainable option. Centralised institutions are inconsistent with both the values of individuals in modern societies and the demands of a global economy.

It would be a great shame if the gains from the Employment Contracts Act 1991 were squandered by the re-introduction of old, failed ideas from the past. Unions might benefit, but the biggest losers would be New Zealand workers.