NEW ZEALAND BUSINESS ROUNDTABLE

Submission on the Employment Relations Law Reform Bill

February 2004

Executive Summary

- This submission on the Employment Relations Law Reform Bill (the bill) is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests.

- The submission provides a high level assessment of the bill and draws out a number of implications of the proposed changes.

- The bill amends a number of areas of the Employment Relations Act (ERA), including the definition of good faith, provisions relating to collective bargaining, the resolution of employment relationship problems and protection of employees when businesses are sold.

- Although the minister of labour has dubbed the bill a 'fine-tuning' of the ERA, the proposed changes are comprehensive and would constitute a significant alteration of the labour relations landscape in New Zealand.

- In our view, the bill represents poor public policy and should be withdrawn. We have several concerns with the proposed changes:

  (i) they lack a sound policy basis. In particular, they do not recognise the realities of the modern labour market and are a step back toward compulsory unionism, compulsory arbitration and national awards;
  (ii) they would significantly worsen the business environment in New Zealand and have an adverse impact on New Zealand's growth prospects and its ability to return to the top half of the OECD income rankings; and
  (iii) the process used to develop the bill has been flawed and has been dominated by the Council of Trade Unions (CTU), with little engagement being sought with business.

- The government has stated that economic growth "remains a top policy priority". The proposed changes to the ERA will do nothing to lift growth and are likely to reduce it. This should be the central consideration of the Committee in addressing the bill.

- Collectively, the proposed changes to the ERA will mean a less flexible workforce, through the promotion of collective bargaining, unionisation and multi-employer collective agreements. They will expand the role of third parties in labour relations and will increase compliance costs.

- The changes represent a further move toward a 'European' model of labour market regulation. This is occurring at the very time that the weaknesses in that model are becoming more obvious in countries such as France, Italy and Germany and commentators are recommending wholesale changes to it.

- There is evidence that strict employment protection policies reduce growth and hamper innovation. The proposed changes are therefore at odds with the government's innovation focus under the Growth and Innovation Framework.

- In its assessment of the bill, we recommend that the committee not get lost in its complex detail. It should instead focus on the 'big picture'. The fundamental question to be asked of the proposed changes to the ERA is whether they will promote a more prosperous New Zealand.

- We support the detailed submissions of Business New Zealand on the clauses of the bill. However, in our view the proposed changes will not promote New Zealand's prosperity. We think the bill should be withdrawn and a fundamental review of the Employment Relations Act and its underlying principles should be undertaken. The review should address weaknesses in the current labour relations legal framework and involve inputs from all interested parties.

1. Introduction

1.1 This submission on the Employment Relations Law Reform Bill (the bill) is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests.

1.2 A national interest perspective requires that account be taken of the interests of many groups, including consumers, employees, the unemployed, employers and investors. The tension is not between the interests of firms and employees, as is often suggested. Trying to establish whether a particular feature of labour law is 'business friendly' or 'worker friendly' is to adopt the wrong criterion. So-called 'worker protection' rules, for example, which raise the costs and risks of employment, typically hurt workers as a group, the unemployed and consumers, rather than employers, at least beyond the short run. If the costs and risks of employing staff go up, firms will have to offset them in one way or another to maintain competitive returns on investment. This is particularly true in today's open capital markets. Thus it is quite superficial to view any provisions in the bill, or their removal, as a 'win' for either workers or employers. The proper national interest criteria to be applied are whether a measure contributes to efficiency (a more productive economy), equity (in relation to all parties, and in particular marginal workers and the unemployed) and individual freedom (a minimum of state interference with people's choices).

1.3 This submission provides a high level assessment of the bill and draws out a number of implications of the proposed changes. It does not provide a detailed clause-by-clause assessment of the bill. For such an assessment, we would commend the comprehensive and detailed submission provided to the committee by Business New Zealand.

1.4 Section 2 outlines the key elements of the bill. Section 3 provides an assessment of the proposed changes included in the bill. Section 4 presents our conclusions and recommendations.

2. Experience with the Employment Relations Act

2.1 It is often argued that the experience with the Employment Relations Act (ERA) has been satisfactory and that a further tightening of employment relations law would not have an adverse impact on the New Zealand

economy. Such a view needs to be questioned for several reasons. Experience under the ERA has not been positive and it may not provide a good indicator of the potential impact of the changes proposed in the bill.

2.2 First, some of the worst provisions in the original ERA were removed as a result of concerns expressed by business and other groups. Some, like the protection afforded to workers involved in the sale or transfer of a business, have now been revived in the bill. Second, the impact of the ERA has been limited by the narrower interpretation of 'good faith' by the courts. This interpretation has been highlighted as the reason for the greater emphasis on good faith in the bill. Third, the focus of bargaining under the ERA remained the enterprise. In contrast, the bill strongly promotes multi-employer bargaining.

2.3 While there was much scare-mongering among unions, academics and politicians at the time the Employment Contracts Act (ECA) was passed, it proved to be groundless. High levels of satisfaction with its operation were reported in surveys. The ECA was a major factor in the growth in employment and the decline in unemployment that characterised the 1990s. It was also a significant contributor to post-1993 productivity growth.

2.4 A recent Treasury report argued that the negative impact of the proposed changes to the ERA would include an increase in uncertainty around statutory obligations and an increase in compliance and employment costs. According to the Treasury, the cumulative impact of the changes to the ERA would be modest. This comment is beside the point.

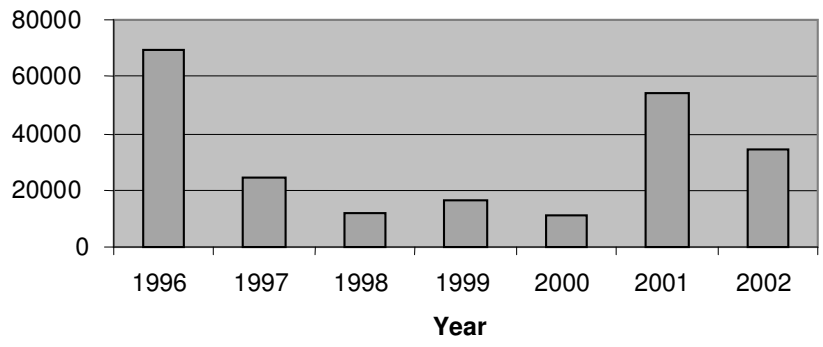
2.5 While the full extent of any impact cannot be known, given the scale of the changes and the scope for interpretation, the key question relating to the bill is whether it moves New Zealand's labour market framework in the right direction or the wrong one. The same question applied to the original ERA and neither the Treasury nor the NZBR saw it as a positive move. No single policy move, by itself, is likely to have a large impact, either positively or negatively, on economic performance. Cumulatively, however, sound or unsound moves make a large difference – it is now well established that the relative quality of policies and institutions is the main determinant of differences in countries' economic performance. Continuous improvement in policy settings, as in business, is essential to maintaining international competitiveness. In our view the bill is a backward move in terms of

improving the environment for growth, and the Treasury report is not in disagreement with this assessment.

2.6 There is no evidence that the ERA has made any contribution toward lifting economic growth, which the government says is its top priority goal. Indeed, the most recent Treasury forecasts suggest a declining trend path for growth in GDP per capita, relative to both current levels and those experienced over the past 10 years. The ERA has also had some adverse labour market impacts, including generating an increase in the number of person-days lost to work stoppages (see Figure 1).

Figure 1

Person-days of Work Lost to Work Stoppages
1996 – 2002
(December Year)



Source: Statistics New Zealand

3. Key elements of the Employment Relations Law Reform Bill

3.1 The bill amends a number of provisions of the ERA, including the definition of good faith, provisions relating to collective bargaining, the resolution of employment relationship problems, and protection of employees when businesses are sold.

3.2 Although the minister of labour has dubbed the bill a 'fine-tuning' of the ERA, the proposed changes are comprehensive and would constitute a significant alteration of the labour relations landscape in New Zealand. That it is more than fine-tuning is evident from the fact that the bill proposes more than 40

changes to the ERA, while the bill and its accompanying explanatory note total more than 100 pages.

3.3 A number of the key elements in the bill are summarised below.[1]

Good faith

3.4 The bill extends the meaning of good faith in employment relationships beyond the common law obligation of 'mutual trust and confidence'. Parties to the employment relationship are required to be active and constructive in establishing and maintaining a productive employment relationship by being responsive, communicative and supportive. The bill specifies that the duty of good faith may require a number of things, including:

- the disclosure to employees of specific information that may affect them; and
- the requirement that the parties should bargain over all issues between them rather than allowing specific matters to impede further bargaining.

3.5 Breaches of good faith are subject to fines. The bill also empowers the Employment Relations Authority to fix the terms and conditions of a collective agreement if there has been a breach of good faith in relation to collective bargaining.

Promotion of collective bargaining

3.6 One of the key aims of the bill is to promote and encourage collective bargaining and settlement. The bill provides strong incentives for parties to enter into collective bargaining and to form collective agreements. It also includes provisions to discourage and penalise the "deliberate undermining and avoidance of collective bargaining". In particular, the bill:

- makes it clear that the process of collective bargaining should result in a collective agreement unless there is a genuine reason not to;
- requires that a union and an employer "continue to bargain" about unresolved matters even though they have come to a standstill or reached a deadlock about a particular matter;

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[1] For a more comprehensive list of the proposed changes included in the bill, see Mills, Jennifer (2003) *Employment: Major overhaul of the Employment Relations Act*, Bell Gully, www.bellgully.com and EMA Northern (2003) *Employment Relations Law Reform Bill*, Employer Bulletin Special Issue, Volume 15, Number 47a, 12 December, www.emadvice.co.nz.

- enables the Employment Relations Authority to provide assistance to the parties in certain circumstances and make non-binding recommendations for the settlement of matters in dispute between them;
- introduces several measures to prevent the undermining of collective bargaining, including classifying several types of behaviour in respect of collective bargaining as being breaches of good faith;
- determines that it is a breach of good faith if employers intentionally seek to undermine a collective agreement by passing on the terms and conditions of a collective agreement to employees on individual agreements;
- extends the definition of the coverage clause to cover the work or type of work done by named employees;
- allows subsequent union and employer parties to join existing collective agreements where the parties to the original agreement have negotiated an enabling provision to allow for this;
- amends the prohibition on preference to allow collective agreements to contain more favourable terms and conditions than individual agreements, thus legitimising special one-off payments to public sector union members;
- requires a first meeting if a multi-employer collective agreement (MECA) is initiated or if bargaining for one continues after a ballot. It is a breach of good faith to fail, without reasonable excuse, to comply with this requirement; and
- strengthens the effect of the '30 day rule' in the ERA, which provides new, non-union employees with the terms and conditions of any collective agreement that covers their work.

Employment relationship problem resolution

3.7 In the area of unjustified dismissals, the bill makes a number of changes, including:

- a change in the test of whether or not a dismissal is justifiable to one "determined on an objective basis" that takes into account whether a dismissal was fair and reasonable;

- introduction of a new remedy of recommendations, which allows the Employment Relations Authority/Court to recommend that an employer take actions to prevent a similar employment relationship problem from occurring where it has found that workplace factors were a significant factor in the grievance; and
- measures aimed at promoting the use of mediation and non-judicial problem resolution services.

Continuity of employment

3.8 The bill provides a two-tiered framework of employment protection in restructuring situations:

- default protective provisions will apply to most employees and employers in the event of a sale, transfer of business or initial contracting out of a business; and
- groups of “vulnerable” employees (ie those in the cleaning, food services and laundry sectors) will be given a higher level of statutory protection. These "vulnerable" employees will be given the right to transfer to their new employer on the same terms and conditions that they enjoy with their current employer.

4. The Employment Relations Law Reform Bill: An assessment

4.1 In our view, the bill represents poor public policy and should be withdrawn. We have several concerns with the proposed changes:

(i) they lack a sound policy basis;
(ii) they will worsen the business environment in New Zealand and will have an adverse impact on New Zealand’s growth prospects, thereby limiting its ability to move into the top half of the OECD income rankings; and
(iii) the process used to develop the bill has been flawed and has been dominated by the Council of Trade Unions (CTU), with little engagement being sought with business.

(i) Lack of a sound policy basis

4.2 The first broad concern with the proposed changes to the ERA is that they lack a sound policy basis. In particular, the changes do not appear to recognise the realities of the current labour market.

4.3 The New Zealand labour market has changed considerably in recent decades, with an increasingly diverse workforce, a significant increase in the labour force participation rate of women and an increasing proportion of the workforce engaged in so-called 'non-standard' work such as part-time work and self-employment.

4.4 The deregulation of the labour market in 1991 through the ECA recognised the changing realities of the labour market. It did so by putting in place a regime under which employees and employers were free to negotiate mutually beneficial employment arrangements, including non-wage benefits such as parental leave, health benefits and holiday entitlements.

4.5 The NZBR strongly supports the continuation of such a system for regulating employment relationships and the right of employees and employers to freely negotiate terms and conditions that suit them. In our view, a flexible and voluntary system of negotiation over the terms and conditions of employment contracts is the best way of recognising the differing circumstances and preferences of employees and firms and ensuring that the labour market is able to evolve to meet the challenges of changing circumstances.

4.6 The bill represents a further and significant move away from the current, relatively deregulated labour relations environment in New Zealand toward a system of:

- compulsory unionism;
- compulsory arbitration; and
- national awards.

4.7 Each of these is discussed briefly in turn.

Promotion of compulsory unionism

4.8 The bill promotes compulsory unionism through the union monopoly on collective agreements and the statutory requirement for employers to bargain. This promotion of compulsory unionism is occurring despite the fact that unions are becoming less relevant in the modern economy and rates of unionisation are dropping both in New Zealand and worldwide. For example, union 'density' (the proportion of potential union members who belong to a union) in New Zealand dropped from 55.7 percent in September 1989 to 21.4 percent in December 1999 and has remained relatively static

since then. In 2002, only 21.7 percent of workers belonged to a union. This number is even smaller in the private sector, with only 12 percent of workers belonging to unions.[2]

4.9 It is clear that one of the key motivations of the ERA changes is to appease unions who are disgruntled at this low ratio and the fact that it has not increased despite the privileges granted to them under the ERA. The law firm Simpson Grierson notes, "Unquestionably, the bill provides a significant boost to the union movement", and Ms Wilson is on record as saying she envisages that union density could rise to around 30 percent.

4.10 It is not at all clear why increasing the number of unionised workers would be a good thing. New Zealand workers – and particularly those in the private sector – have moved on from the 1970s/1980s mindset and have become sophisticated participants in the modern labour market. Most now choose individual contracts. Others judge that collective representation can provide benefits, but that such collectivisation need not be provided by a union. Indeed, under the ECA, many workers used non-union bargaining agents. Workers in the modern economy also recognise that unions can hinder, rather than help the productivity growth on which increases in wages depend and so may, in fact, detract from their well-being.

Promotion of collective bargaining

4.11 The bill aims to boost collective bargaining through a statutory requirement to settle and imposed settlements by the Employment Relations Authority. As noted by law firm Simpson Grierson, "The right of employers to say "no" to a collective agreement is also significantly curtailed." Employees' freedom to choose between individual and collective agreements is equally affected. Individual contracts recognise the diverse needs, interests and performance of firms and employees. There are no sound public policy grounds for trying to tilt the playing field towards collective bargaining.

Promotion of national awards

4.12 The bill represents a move in the direction of national awards. It does this through the imposition of forced MECAs with subsequent party clauses. Any employer who is asked must attend at least one meeting and demonstrate good faith. If no agreement is reached, and the Employment Relations

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[2] May, Robyn *et al* (2003) *Unions and Union Membership in New Zealand: Annual Review for 2002*, Working Paper 1/03, Industrial Relations Centre, Victoria University, Wellington.

Authority decides there is a breach of good faith, such an agreement may be imposed.

4.13 This carries collectivism to new heights. There is nothing wrong with firms in an industry coming together to negotiate a broad agreement, but most don't want to. Most want to deal directly with their own employees, and vice versa. The basis of this provision is transparent. The CTU in its submission on the ERA review made it clear that its ultimate agenda is "a return of the [national] award system."

Monopoly unionism

4.14 The bill's explicit agenda is to restore, through government fiat, privileges that ordinary workers have refused to confer on unions, as exemplified by the ongoing decline in union density since the deregulation of the labour market in 1991.

4.15 One of the benefits claimed by unionists is that they can lift wages through the creation of monopolies, which give them greater bargaining power vis-à-vis employers. Such monopoly pressure can only be exercised by unions if they can restrict the supply of labour. They can do this in one of two ways:

- by making it harder for non-union labour to get jobs at all. The proposed changes to the ERA attempt to do this by making it more difficult for employees to work under an individual contract (ie removal of prohibition on preference, provisions surrounding undermining of collective contracts, etc); and
- by stopping anyone from undercutting the cost of union labour. The proposed changes to the ERA attempt to do this in a number of ways including through the provisions relating to employees involved in the transfer or sale of a business.

4.16 The advent of market reforms such as deregulation, globalisation and the removal of trade restrictions worldwide has meant that the position of unions is tenuous. They are finding it ever more difficult to sustain a monopoly position in the labour market. Efforts to buttress it by legislation will ultimately prove fruitless, but will reduce the flexibility and growth potential of the economy.

False underlying assumptions

4.17 Not only is the bill out of step with modern labour market realities, it is also based on the false premise that labour markets are special; are characterised by unequal bargaining power between employers and employees; and require special regulation to promote unionisation and collective bargaining to offset this inequality.

4.18 The idea of unequal bargaining power is explicitly incorporated in the ERA and proposed amendments. It also underlies other labour market legislation such as the Holidays Act. The notion of unequal bargaining power in the labour market is something that is asserted by the government, but has never been explained or defended. It is refuted by a vast body of law and economics scholarship.

4.19 The idea owes its origins to Marxist economics. Marx saw the world in terms of a class struggle between workers and owners of capital. Employers had the upper hand and would 'exploit' workers. The wages of workers would be driven down to subsistence levels, and they would become "wage slaves".

4.20 Facts soon demonstrated that Marx was wrong. Wages rose strongly even in his lifetime. In the modern era, Hong Kong is a country where unions hardly exist but wage levels are among the highest in the world. The fallacy in the notion of unequal bargaining power is obvious. As University of Chicago legal scholar Richard Epstein has stated:

> If such an inequality did govern the employment relationship, we should expect to see conditions that exist in no labour market. Wages would be driven to zero, for no matter what their previous level, the employer could use his (inexhaustible) bargaining power to reduce them further, until the zero level was reached. Similarly, inequality of bargaining power implies that the employee will be bound for a term while the employer … retains the power to terminate at will. Yet in practice we observe both positive wages and employees with the right to quit at will.[3]

4.21 In competitive labour markets, the reality is that employers compete with one another for workers, and workers compete with one another for jobs. Wages are driven up by productivity increases and competition for scarce labour. At times there may be a buyer's market or a seller's market for particular skills in particular locations. But there is no systematic advantage for one side over another, otherwise wages would never rise, and there is nothing special

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[3] Epstein, Richard (1984) 'In Defense of the Contract at Will', *University of Chicago Law Review*, 51, p 972.

in any relevant economic sense about employment contracts.

4.22 The notion of unequal bargaining power is not supported by theory and evidence. It is even less credible when examined in the context of the current New Zealand labour market, which is characterised by low unemployment, labour shortages in many occupations and regions, as well as a large number of small employers.

4.23 A second misconception that flows from the unequal bargaining power fallacy is that 'take-it-or-leave-it' offers from employers are 'bad'. This belief does not recognise that, as consumers, we face take-it-or-leave-it transactions every time we deal with businesses such as banks or supermarkets. It is the most common form of transaction in the marketplace. It respects property rights and freedom to contract, and is in no way coercive. Neither workers nor consumers are exploited in competitive markets: an employee or consumer who can go elsewhere is very hard to exploit.

(ii) Impact on economic growth

4.24 The government has stated that economic growth "remains a top policy priority".[4] The Speech from the Throne at the opening of the current parliament stated that the government:

> ... sees its most important task as building the conditions for increasing New Zealand's long term sustainable rate of economic growth.

The government has amplified this statement by saying its goal is to see New Zealand attain a level of income per capita in the top half of the member countries of the Organisation for Economic Cooperation and Development (OECD).

4.25 The test of any policy should therefore be whether or not it assists in moving the country toward this laudable and ambitious goal.

4.26 The proposed changes to the ERA fail this test. Indeed, the changes are far more likely to reduce the growth rate of the economy and frustrate the attainment of this goal. As a result, wages will be lower than otherwise and, as a country, we will be less able to afford services such as better schools and better health care.

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[4] Budget Policy Statement 2004, p 2.

4.27 Collectively, the proposed changes to the ERA will mean a less flexible workforce, through their promotion of collective bargaining, unionisation and multi-employer collective agreements. The narrower definition of 'justifiability' in the area of personal grievances will mean it is harder to dismiss workers. The changes will lead to greater uncertainty for employers as new legal interpretations are developed in areas such as personal grievances, 'good faith' and bargaining (eg what constitutes 'undermining' of a collective agreement).

4.28 The new protections afforded to workers in the event of contracting out or the sale or transfer of a business will have a significant impact on the ability of firms, and the economy more generally, to adapt and restructure. They will also reduce the economic value of firms in the sectors covered by the new provisions and the incentive to invest in them.

4.29 The disincentive to invest will apply to a wider set of industries than those identified in the bill. This is because the minister of labour can add to the categories of employees listed in Schedule 1 of the bill. Firms will have far less of an incentive to invest in firms in sectors that could be 'threatened' by such regulation.

4.30 The bill's expansion of the role of 'third parties' such as the Employment Relations Authority and the courts is a move back toward compulsory arbitration. This is detrimental to the effective operation of business given that third parties:

- do not possess either the information or business expertise required to make informed decisions;
- are not well placed to judge what the 'right' outcome should be in particular cases; and
- do not face the consequences of their decisions.

4.31 The increased involvement of third parties could have adverse effects on the behaviour of employers and unions during bargaining or disputes and lead to unproductive strategic behaviour.

4.32 The ERA bill's proposed changes will lead to higher administration and compliance costs for employers. For example:

- the provisions relating to 'undermining' of collective contracts will require employers to negotiate (or at least be seen to be negotiating) separately with each employee working on an individual contract – a time-consuming and potentially wasteful exercise;
- the requirement that employment agreements must contain employment protection provisions will take time and cost to implement. It will also lock firms into a process that may not be appropriate given that employers cannot foresee the circumstances surrounding sales and transfers that will occur in the future.

4.33 Additional compliance and direct costs would come on top of cost increases associated with a series of labour market and other changes that the government has introduced in recent years, including:

- the re-nationalisation of ACC;
- successive large increases in minimum wages, especially for people under 21 years of age;
- the increase in the top income tax rate to 39 percent;
- the introduction of an extra week of holidays and changes to the Holidays Act;
- the introduction of parental benefits; and
- changes to the Health and Safety in Employment Act.

The government has also signalled the possible introduction of a pay equity policy. While the current proposal is that pay equity, if introduced, would apply only to the state sector, it would still have a significant impact on private sector firms which will need to compete for staff with public sector organisations in a distorted labour market.

4.34 Collectively, these changes, along with other anti-growth policies, have adversely affected the operating environment for business in New Zealand. According to Business New Zealand, an average New Zealand company faced additional costs of over $26,000 over the three calendar years 2000-2002.[5] In addition, the Business New Zealand - KPMG Compliance Cost Survey of August 2003 found that:

- the average enterprise spent over 1,300 hours on compliance requirements; and

[5] Business New Zealand (2002) *The Great NZ 7-Day Service Co Ltd*, 25 February, www.businessnz.org.nz.

- respondents' annual compliance burden came to $52,724 per annum ($812 per employee).

4.35 On a per-employee basis, compliance costs were higher for small firms. Nearly 30 percent of compliance costs were employment-related. Nearly all respondents considered that there had been an increase or no change in compliance costs in the last year.[6] The proposed changes to the ERA would exacerbate this trend.

4.36 The proposed changes to the ERA and the wider labour market reforms represent a move toward a 'European' model of labour market regulation. This is occurring at the very time that the weaknesses in that model are becoming more obvious in countries such as France, Italy and Germany and commentators are recommending wholesale changes to the system.[7] Indeed, the German government recently introduced some changes aimed at reducing the unemployment benefit and giving added flexibility for employers to hire and fire workers.[8]

4.37 According to a 2001 study, New Zealand is already at a competitive disadvantage when it comes to labour market institutions such as social welfare and industrial relations arrangements. The study showed that New Zealand was poorly placed in international comparisons of strictness of eligibility criteria for unemployment insurance and suspension of unemployment insurance payments, and only moderately well placed in the late 1990s in terms of strictness of employment protection for regular employment.[9]

4.38 In the Fraser Institute's *Economic Freedom of the World 2003 Annual Report*, New Zealand was placed only 21st in the category of labour market regulations, which measures economic freedom in the areas of minimum wages, hiring and firing practices, the share of the labour force whose wages are set by centralised collective bargaining and the extent to which the

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6 Business New Zealand/KPMG (2003) *Report of the Business New Zealand – KPMG Compliance Cost Survey*, August 2003, pp 4-6.

7 See, for example, Blitz, James (2002) 'Berlusconi's Battle', 15 April, www.ft.com; Sennholz, Hans F (2003) 'The German puzzle', *The Independent*, 2 April 2002; Berthold, Norbert and Rainer Fehn (2003) *Unemployment in Germany: Reasons and Remedies*, Center for Economic Studies and Ifo Institute for Economic Research, Working Paper No 871, Munich; 'Here are the ideas. Now for action?', *The Economist*, 29 June 2002, p 53.

8 Bernstein, Richard (2003) 'Germany's Social Democratic Party Endorses Schroder', *The New York Times*, 2 June, www.nytimes.com. .

9 Eichhorst, W *et al* (2001) *Benchmarking Deutschland: Arbeitsmarkt und Beschaftigung,* Bericht der Arbeitsgruppe Benchmarking und der Bertelsmann Stiftung, Berlin, cited in Berthold, Norbert and Rainer Fehn (2003) *Unemployment in Germany: Reasons and Remedies*, Center for Economic Studies and Ifo Institute for Economic Research, Working Paper No 871, Munich, pp 23-36.

unemployment benefit preserves the incentive to work. New Zealand's ranking compares with that of Hong Kong (2nd), the United States (3rd) and the United Kingdom (5th).[10] Recent and proposed labour market reforms will make the overall ranking of labour market institutions in New Zealand even less favourable.

4.39 An increase in the degree of labour market regulation is likely to have an adverse impact on the rate of economic growth in New Zealand. A recent OECD report examined the impact of policy and institutional settings in both the product and labour markets on productivity and firm dynamics. This work was part of a broader project which aimed to identify the sources of economic growth in OECD countries. The objective of the exercise was to explain the reasons for different growth experiences across the OECD and to identify policies, institutions and other factors that could contribute to enhancing long-term growth prospects.

4.40 Key findings from that work are that:

- strict employment protection legislation, by reducing employment turnover, may in a number of circumstances lead to a lower productivity performance and discourage the entry of firms;
- there is evidence that high hiring and firing costs weaken productivity performance, especially when wages and/or internal training do not offset these higher costs, thereby inducing sub-optimal adjustments of the workforce to technology changes and less incentive to innovate;
- the negative impact of strict employment protection laws on productivity is stronger in countries with an intermediate degree of centralisation/coordination; and
- employment protection regulations mainly affect market access of small and medium-sized firms. [11]

4.41 Recent empirical work in 10 OECD countries shows that countries with low administrative barriers, pro-competition sector-specific regulations and

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[10] Gwartney, James, Robert Lawson and Neil Emerick (2003) *Economic Freedom of the World 2003 Annual Report*, The Fraser Institute, Vancouver, p 14.

[11] Scarpetta, Stefano *et al* (2003) *The Role of Policy and Institutions for Productivity and Firm Dynamics: Evidence from Micro and Industry Data*, Working Paper No 329, OECD, Paris, pp 5-7.

flexible hiring and firing rules typically experienced higher entry rates of small sized firms.[12]

4.42 This evidence is consistent with a World Bank study from the 1980s that found that countries with inflexible labour markets suffered a penalty of 1.4 percentage points in their annual growth rates.

4.43 Overly strict employment protection policies can also have adverse effects on an economy's ability to innovate. This is of concern given that innovation is recognised as one of the most important sources of economic growth. As noted in a recent OECD report:

> … policies that make hiring and firing difficult can increase the cost of implementing innovations, when these require labour downsizing or reorganisation; and policies that favour the bargaining power of insiders can reduce the ability of firms to appropriate innovation rents, especially when post-innovation wage re-negotiation is possible …[13]

4.44 The OECD notes that the effect of entry regulations is particularly important for productivity performance in industries in which technology is evolving rapidly, such as information and communication technology (ICT) industries. Furthermore, the OECD notes that product and labour market policies can also affect the propensity of a country to concentrate production in innovative industries, by, for instance, affecting the pace of resource allocation in the economy.[14]

4.45 The introduction of stricter employment protection policies is therefore working at cross purposes with at least two of the areas that are seen as critical to the government's growth and innovation framework, namely:

- enhancing the innovation system in all areas of the economy; and
- strengthening foundational areas, with priority given to policy initiatives that will promote further increases in sustainable economic growth.[15]

(iii) Flawed policy development process

4.46 A flawed process was followed in the development of the bill. In particular, we are concerned about the short timeline to make submissions on the bill, the extent to which the policy development process has been dominated by

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12 OECD (2002) 'Productivity and Innovation: The Impact of Product and Labour Market Policies', in *OECD Economic Outlook*, Volume 2002/1, No 71, June, p 176.

13 *Ibid*, p 178.

14 *Ibid*, p 176 and p 181.

15 Ministry of Economic Development (2003) Growth *and Innovation Framework: Progress Report 2003*, p 4.

discussions with the Council of Trade Unions, and the fact that there has been little or no engagement with business over what would amount to significant changes to the industrial relations environment in New Zealand.

Short deadline for submissions

4.47 The timeline provided for business organisations to develop a response to the bill has been inadequate. The bill was presented to parliament last December and organisations were given less than three months to respond to the changes – a period that included the run-up to Christmas and the holiday period.

4.48 This is of concern given both the extent and complex nature of the changes to the ERA. The experience with the changes to the Holidays Act suggests that many employers are only now – some months after the passage of the Holidays Bill – coming to grips with their full implications.

4.49 Although employer organisations, including the NZBR, asked for an extension of the deadline for submissions beyond 27 February, none has been granted.

Union domination of the policy development process

4.50 A key concern with the bill is the fact that the policy development process has been dominated by the Council of Trade Unions (CTU), as exemplified by the bill's content.

4.51 As revealed by NZBR research in late January, the CTU presented a shopping list of labour law demands in a December 2002 submission and its views have clearly dominated the development of the bill. There are startling similarities between the CTU submission and the bill. The broad objectives and policy directions of each document are largely consistent, and in key instances the drafting is identical.

4.52 All of the areas of concern outlined in the December 2002 CTU submission are addressed in the bill:

- an expansion of the interpretation of good faith;
- provisions to favour collective bargaining over individual agreements and to encourage multi-employer collective agreements;
- more onerous unjustifiable dismissal provisions;
- moves to eliminate so-called 'free riding' by non-union employees; and

- restrictions on contracting out and the sale of a business.

4.53 Several examples show the degree to which unions' views have been incorporated in the bill.

4.54 The ERA introduced the concept of 'good faith' into employment law. Courts were forced to define that term, and mostly based their judgments on the common law test of mutual trust and confidence. In response to parliamentary question 2132 on 16 February 2000, minister of labour Margaret Wilson said that employment relationships should be based on principles of "mutual trust and confidence". The courts were therefore presumably acting in a way that was consistent with the minister's views at the time. However, this was not strong enough for the CTU and their wish to introduce a higher standard was carried out to the letter. Courts would have an even greater role in determining whether the duty of 'good faith' has been met.

4.55 As noted above, union representation has fallen considerably since the 1980s and has barely recovered under the ERA, with only one worker in five now belonging to a union. The CTU, in its December 2002 submission, sought two changes to further shift the balance away from individual contracts and toward union-negotiated collective contracts:

- it asked for the legislation to clearly state that employers had no need to pass on superior terms and conditions from collective contracts to employees on individual contracts. This exact change was made in the bill; and
- it requested that the legislation state: "an employer cannot pass on the same terms and conditions, or substantially similar terms and conditions agreed as a settlement for a collective agreement … to employees not covered by the collective agreement, without the written agreement of the union or union parties to the collective agreement". In other words, unions should have the power to approve individual contracts.

4.56 In this case, the CTU was given what it asked for, though through a less direct route than the explicit requirement of union 'sign-off'. Instead, an employer breaches the duty of 'good faith' if he or she extends the provisions of a collective agreement to other employees in order to "undermine the collective agreement". Such slippery wording means huge scope for interpretation in individual cases and great uncertainty for

employers. It also means that the only insurance for employers against getting bogged down in legal hassles is getting union sign-off of individual contracts. This would lead to an absurd, almost Orwellian situation where unions hold sway over non-members' contracts.

4.57 Finally, the CTU wanted more 'face-time' with union members, at company expense. It asked that employers be instructed that they could not dock wages of union members who held meetings during work time, and that the legislation state that an employee eligible for education leave would be "an employee who is a member of a union." Policymakers rubber-stamped these two changes.

4.58 Further examples of the considerable overlap between CTU demands and the bill's content are available on the New Zealand Business Roundtable website (http://www.nzbr.org.nz/documents/features/ctu_submission.asp).

4.59 In contrast, the views of business have not been incorporated at all in the bill. Even the modest reform suggestions that were put forward by Business New Zealand at the time of the ERA Review were rejected. These recommendations included:

- that any group of employees, whether or not members of a registered union, should be able to bargain collectively with their employer;
- that the concept of 'good faith' require an employer who does not wish to negotiate a collective agreement to meet with the union to discuss the matter but not to go through the exercise of considering the detail of individual clauses;
- that the formulation of bargaining claims and reporting back on negotiations be done either during one or both of the legislatively provided union meetings (section 26 of the Act) or outside work time to avoid adverse effects on productivity;
- that recognition be given to the fact that the so-called 'balance of power' now frequently lies with employees and that, at the least, a salary bar above which personal grievance and employment agreement provisions do not apply should be reintroduced; and
- that the legislation provide for an effective probationary period when the Act's personal grievance provisions do not apply.

5. Conclusions and recommendations

5.1 In 1999, the OECD argued that the employment relations framework that existed under the ECA was "sound". The ERA, introduced in October 2000, represented a step in the wrong direction for labour relations law in New Zealand. The changes proposed in the bill represent a further move away from the decentralised and flexible labour relations system that existed under the ECA.

5.2 In its most recent report on New Zealand, the OECD expressed a similar view, noting that:

> Although the labour market remains one of the most flexible in the OECD, recent years have seen a clear trend towards greater rigidities and higher labour costs. Further such changes are in the pipeline. Individually the measures have been fairly benign, but cumulatively their impact may be important … social objectives need to be balanced against the benefits of labour market flexibility – namely faster productivity growth and a more stable and resilient economy.[16]

5.3 We agree with the OECD's assessment. The changes proposed in the bill will harm employers, employees and the national interest. They will do nothing to assist the government in meeting its ambitious target of restoring New Zealand to the top half of the OECD in terms of GDP per capita. Indeed, they will have the opposite effect by reducing the economy's ability to adapt to frequently changing market conditions in the world economy.

5.4 This is not to say that the sky will fall if the bill is passed into law. The NZBR did not predict that in its comments on the ERA in 2000 and we are not saying that now. We did not and do not intend to make the kind of exaggerated and nonsensical claims that were made by those who opposed the ECA when it was introduced. However, the evidence suggests that the changes will have an adverse impact on New Zealand's ability to innovate and grow.

5.5 The proposed changes seem unlikely to represent an end point for policy. The December 2002 CTU submission makes it clear that in the CTU's agenda they are but a stepping stone on a path back to the world of national awards, compulsory unionism and compulsory arbitration that existed in the 1970s and 1980s. At the behest of the CTU, the provisions relating to the sale or transfer of a business, which were removed from the Employment Relations Bill in 2000, have returned in modified form in this bill. The

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[16] OECD (2003) *Economic Survey – New Zealand 2003*, Supplement No 3, Paris, December, p 12.

introduction of paid parental leave in 2002 provides further evidence of CTU influence, with the prime minister recently indicating that the government is looking at expanding the scheme.[17] The government has consistently followed the CTU's bidding.

5.6 For the reasons outlined in this submission, we consider that the Employment Relations Law Reform Bill is not in the national interest (as opposed to the interests of the CTU). It does not meet standard public policy criteria of efficiency, equity and individual freedom. We consider that the committee should not get lost in the detail of this complex bill. It should instead focus on the 'big picture'. The fundamental question to be asked of the proposed changes to the ERA is whether they will promote a more prosperous New Zealand. We submit that they do not and that the bill should not proceed. Instead, we submit that a fundamental review of the ERA and its underlying principles should be undertaken. The review should address weaknesses in the current labour relations legal framework and should involve input from all interested parties.

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[17] Clark, Rt Hon Helen (2004) *Prime Minister's Statement to Parliament*, 10 February, www.beehive.govt.nz.