

**Kensington Swan Seminar on  
the Employment Contracts Bill**

**A Better Way of Working**

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**WELLINGTON  
24 APRIL 1991**

## **A BETTER WAY OF WORKING**

John Hyde, a former Liberal party member of the Federal Parliament in Australia, recently told the following story which is relevant to the topic of today's seminar.

"In West Australia", he wrote, "there has recently been a considerable hullabaloo about people feeding dolphins to attract them to beaches where tourists may view them. Rules are now in force to restrict the practice, lest the dolphins become dependent on the handouts and fail to learn how to fend for themselves. Should we not have a similar concern for the human species?"

"Yet, if we were to countenance laws that prevented people from working and we were not to provide the resultant unemployed with an alternative income, then we would commit an injustice equivalent to denying the dolphins access to the fish in the sea without providing the alternative dole of fish."

The Employment Contracts Bill goes a long way to making high levels of employment in New Zealand legal once again. Yesterday the Bill was reported back to the House. Employers and employees can now evaluate its likely final shape and will soon be able to take advantage of the new opportunities it provides to create more jobs and find better ways of working.

With impeccable timing, Dave Morgan and the seafarers did the country an invaluable service in recent days by reminding us what the debate has been all about. When railway workers go on strike in Japan, which is a rare occurrence, they apologise for their actions and try to minimise the inconvenience to the travelling public. Factory workers turn up before work to make their protest, put their placards away at the normal starting time and continue working without loss of wages or production. Japan has one of the OECD's least regulated labour markets. The ferry dispute was a reminder of the economic consequences of a regulated and monopolised system and the habits and attitudes it breeds.

For decades, New Zealand workers were indoctrinated with the belief that 'the union makes us strong' and that copious strike activity raised living standards, just as the Aztecs believed that the rise of the sun depended on copious offerings of living human hearts. The truth is that unionisation as we have known it helped make us poor. Real wages have stagnated since 1960 in New Zealand whereas they have more than doubled in successful economies. In the 1980s non-union wages have risen faster than union wages in the United Kingdom and the United States. The reality is that strong economies and rising living standards are built on continually acquiring and adapting skills, increasing productivity and working hard.

We need to evaluate the new legislation in the context of trends in the international economy and New Zealand's place in it. The old system was part of the institutions and regulations of the set of fortress New Zealand policies that has been swept away by the irresistible pressures of international competition. Globalisation - the mobility of capital, know-how and skills to those locations where the highest returns can be reaped, and the supply of the entire world market from those locations - has increasingly become a reality in world industry. International economic relations are now little different from inter-regional exchange, and notions like a national labour

force, a national capital stock or a national money supply are becoming more and more meaningless.

Henceforth national governments will have to ensure good locational conditions for mobile resources in competition with governments in other countries to avoid a flight of capital, businesses and skilled people. Handouts such as tax incentives and subsidies which can be withdrawn as easily as they are introduced will not be material in this regard; at most they will distort investment patterns rather than influence overall flows. Of far more importance will be factors such as labour organisation (unions, labour laws, work practices) in attracting or repelling mobile capital, high skills and knowhow.

In the past, international forestry firms have looked at the labour relations environment they would face if they invested in New Zealand and walked away. Already one Australian firm to my knowledge is likely to relocate to New Zealand because the new framework is more attractive than the labour situation in Australia. Another may do so if the trans-Tasman shipping problem is also solved.

However, it is not enough for New Zealand simply to dismantle the worst features of our current system. We are a country on the periphery, far from world markets and sources of international capital. If we wish to make New Zealand an attractive place to live, work and do business, the quality of the business environment we need to create, including our labour laws, must be exceptionally high. The government has also set itself demanding economic targets against which policy decisions must be judged. It indicated to the electorate a goal of reducing unemployment by half in its first term. It is also committed to restoring New Zealand's credit rating to a Triple A status. These are the kinds of benchmarks against which the new employment legislation must be evaluated.

The cornerstone and central achievement of the new legislation is its rejection of the century-old conflict-based model of employment relations which holds that employer and employee interests are fundamentally opposed, in favour of a model which recognises that they share a common interest and that employment contracts depend for their existence on making both better off. As its name suggests, the legislation recognises that the best way of promoting high employment and high incomes - the best way of protecting workers - is to base labour law on the principle of freedom of contract. Like other standard economic relationships - for example those between producers and consumers or savers and borrowers - the relationships of employers and employees will be governed largely by the principles of normal contract law.

The legislation rejects the myths about the 'special' nature of labour contracts and alleged 'inequalities' in bargaining power. It rightly recognises that - in the absence of legal obstacles - it is competition for labour services that sets wages and forces them up over time. The fallacy about unequal bargaining power is apparent when it is recognised that major corporates have no more ability to hire workers on inferior terms than the smallest firm in the land. If they offer work at \$9 an hour when the market rate is \$10, other things equal they will get few workers. The essence of bargaining power is the existence of alternatives, which are greatly expanded in the new legislation. This is not to say that in the labour market, as in any other, there are not times of scarce or plentiful supplies which favour sellers or buyers, but the point about properly functioning markets is that they adjust under competition to remove

such imbalances. For this reason currently unemployed workers will be major beneficiaries of the Bill.

Ken Douglas has described the legislation as a return to the 1830s and others have painted a picture of a return to the world of Charles Dickens, sweat shops and chimney sweeps. This vision is absurd; it bears no relationship to modern conditions. Moreover, what readers of Dickens would never appreciate is the unprecedented economic growth and improvement in working conditions that occurred in that period. During the 19th century, the population of Great Britain increased from 11 million to 37 million and per capita wages quadrupled. The establishment of private property, the rule of law, the rapid growth of contract and the decline of regulation - particularly of trade and the labour market - provided the foundation for that spectacular economic success.

A legal audience may be interested in knowing that the great change in Britain which signalled the rapid spread of contracting in the labour market was the repeal of the Statute of Artificers (usually called the Statute of Apprentices) in 1819. As one authority described it, the previous laws:

"... controlled entry into the class of skilled workmen by providing a compulsory seven years' apprenticeship; they reserved the superior trades for the sons of the better off ... they required permission for a workman to transfer from one employer to another ... and they empowered justices to fix wage rates for virtually all classes of workmen."

Britain led the so-called industrial revolution by discovering that there are basically two ways of organising the daily work of the world. The first is to have courts or, more recently, central planning bodies, telling everybody else what to do and how to do it. Examples were pre-industrial revolution Europe and what are, or were, the centrally planned economies.

The other way of organising work is to let everybody make any agreements they desire with one another - that is, to trade freely. A contracting society, in contrast to a regulated society, can use all of the widely dispersed information throughout that society in order to bring about as efficiently as possible the provision of goods and services, the formation of new capital, and the investment of time and resources in new ventures. In order for this sort of market economy to work, we need to have a rule of law, based in our system on property, tort and contract, and an independent bench and bar to administer it.

As is well known, the foundations of Britain's economic prosperity were undermined by trade union laws and other departures from relatively non-interventionist policies implemented from around the turn of century. A major achievement of Mrs Thatcher's government, which is now acknowledged by the British Labour party, was to attack trade union monopoly privileges in a series of Employment Acts. Similar developments are now occurring in Australia. The recent Troubleshooters case which upheld the right of a team to work as independent short term contractors alongside unionised building employees was described by a union leader, in rhetoric with which New Zealanders have become familiar, as representing:

"... the first major breakthrough for the New Right, in its efforts to take the Australian workforce out of the award and arbitration system and into the quagmire of contracting."

As one Australian observer commented:

"Those marvellous words - 'the quagmire of contracting' - cry out for display in large neon lighting. They ... demonstrate the profound contempt of the trade union boss for the ordinary working man and woman."

The Liberal governments that are likely to come into office at both federal and state level in Australia over the next 2 years are likely to go down the same road that New Zealand is taking.

Those who have supported major labour market reform in New Zealand have essentially advocated the creation of a stable, intelligible legal environment in which productivity-enhancing contracts can be written. There is a serious question as to whether any statutory law, other than legislation on employment standards, is needed to create such an environment. The common law has continued to regulate employment contracts in New Zealand; indeed more than half the workforce is outside the ambit of collective bargaining and the 'special' jurisdiction of labour law. The protections of the common law against fraud, coercion, incapacity and duress apply to employment contracting as to other contractual relationships.

Arguably the strongest case for some form of statutory law is that over time labour law has become a special province and judicial precedent has moved it away from its role of protecting and enforcing contracts. On this argument, the task of Parliament is essentially to give fresh guidance to the courts in order to bring employment contracting into line with general contract law so as to limit inappropriate forms of judicial activism while a new understanding and legal culture develops in respect of employment relationships.

The Bill as introduced, and as modified by the Select Committee, goes a considerable distance to doing away with the enormous complexity of past arrangements and performing a basic role of facilitating free trade in labour services. Some of the detailed changes made by the Select Committee will take time to analyse and the implications of some of the Bill's provisions cannot be known with certainty until tested in practice. For these and other reasons it is unlikely that the Bill is the last word in labour relations reform.

The Select Committee is to be commended for making some useful changes to the initial Bill, such as the deletion of the 'new matters' provisions, the provisions affecting the shipping industry and some improvements to transitional arrangements which will facilitate a faster adjustment to the new environment. Where the legislation still falls short is in its unwillingness to entertain a full range of contracting freedoms and the retention of some of the baggage of the former system. The general thrust of the amendments is to reintroduce a degree of prescription and detail which, in general, appears unnecessary, and to eliminate options permitting wider freedoms. Examples of these changes are the removal of clauses 3 and 4 which would have allowed contracts to be made in forms other than those specified in the Bill, some restrictions on bargaining agents and prescriptions on procedures for appointing them, and new provisions on sick leave and parental leave.

Of more significance is the requirement for all contracts, individual and collective, to include provisions for personal grievances. This extends a new form of regulation to the large section of the labour market that has been outside the ambit of collective bargaining. A considerable industry has grown up around personal grievance cases which has arguably not benefited the economy or the workforce at large. As other countries have found, provisions which strengthen job security for some workers inevitably reduce job security for other, more marginal workers. Legal practitioners would not be doing their clients - employers or workers - a favour by encouraging them to provide in their contracts for complex rules or liabilities governing redundancy or termination of contracts. For the employer, these raise the risks and costs of employment, and for the employee they will have the effect of reducing wages or other conditions of the contract. Contracts which provide for termination at will, on notice or on the expiry of a fixed term will be more efficient in many cases. Unless contracts provide otherwise, employers should have the same ability to terminate employment as employees have to quit. The resources of courts are better employed in determining whether contracts are breached rather than in arbitrating on vague notions of fairness arising out of complex rules which invite litigation.

These concerns are heightened by the retention of specialist institutions in the form of the Employment Tribunal and the Employment Court. These pose the risk of maintaining a legal culture which treats employment contracts as different from other contractual relationships. The risk will be increased if existing personnel are simply transferred across to the new institutions. Some of the recent decisions of the Labour Court have shown an astonishing lack of appreciation of commercial and economic realities. Another insight into attitudes in these quarters was the report of the previous government's inquiry into industrial democracy under former Chief Judge Horn, the findings of which were totally at variance with the philosophy behind the new legislation.

Although the government has clearly sought to clip the wings of the court, there remains a danger that former case law will be regarded as having precedent and that new forms of judicial regulation will replace the statutory regulation that the government has been at pains to remove. This is an area which the government and interested parties will no doubt be watching closely and any such developments will need to be nipped in the bud.

The government will also need to address other issues in labour market reform if it wishes to achieve its growth and employment objectives. Some special provisions governing retail employment have not yet been repealed. The trans-Tasman maritime Accord remains in place even though it has now been repudiated by governments (and opposition parties) on both sides of the Tasman. There is a need for the jurisdiction of the Commerce Act to be extended to cover anti-competitive practices in the labour market on the same basis as other markets. Taxpayer funding of the Trade Union Education Authority has no justification in the new environment and the Act supporting it should be repealed.

In respect of employment, the OECD commented in its recent report on the New Zealand economy that:

"As unemployment is of particular concern, attention should be paid to institutional characteristics which impede job creation. Difficult decisions will

have to be taken, involving industrial relations legislation, minimum wage laws, and the levels of and eligibility for social welfare support."

Of these three items, the government has not yet addressed the effects on employment of the present Minimum Wage Act. *The Economist* recently reported that the Trades Union Congress in Britain wants a national minimum wage set at half average earnings, and noted that this would price thousands of workers out of a job. The current minimum wage in New Zealand is set at that level. The government's aim of halving unemployment over the next 2 1/2 years implies a need to create perhaps 100,000 new jobs, allowing for the fact that some discouraged workers would re-enter the workforce if employment conditions improve. This is a rate of job creation far in excess of anything achieved in recent years. It is implausible that it can be attained without ensuring that low-skilled people can be absorbed into the workforce at pay rates that reflect their initial productivity.

However, the task ahead is not only, or even primarily, one for the government to undertake. Employers, unions and workers all face new opportunities and challenges.

Most employers will clearly welcome the new opportunities. In a recent poll, some 70 percent of chief executives of firms of all sizes said their business would benefit from the freedom to negotiate with their workers under the proposed Bill, including - contrary to the findings of the Graham Task Force - 61 percent from the manufacturing sector. The task of employers will be to comprehensively review the needs of their operations, consider the aspects of awards or agreements and work practices they want to change, examine improved forms of individual and collective bargaining and talk with their employees to gain their trust and cooperation in bringing them about. They will also need to recognise that, in a competitive market, notions of wage fixing on the basis of relativities, employers' 'ability to pay' and automatic linkages with productivity gains go out the window. The only relevant criterion for pay fixing is the need to meet the market to retain or recruit staff in the numbers, quality and locations desired.

It is to be hoped that employers are learning that economic factors prevail in the labour market as in any other. It was ironic that the Reserve Bank's questionable involvement with the Growth Agreement last year, ostensibly on the basis of its contribution to wage moderation, recently cost it a higher settlement, according to union comments, than it would otherwise have incurred. The trouble with central planning of this type in the labour market, as in any other market, is that it doesn't work. That lesson has again been demonstrated by recent Polish experience. As one leading economic authority has reported:

"The government boldly abolished regulations over practically all prices, including the exchange rate. Unfortunately, Warsaw made a major mistake by freezing wages. This wage policy had much to do with Poland's subsequent decline in industrial output and with the recent defeat of the government. The Polish reformers apparently forgot that wages, like prices, need to be freely set by market forces in order to allocate efficiently a country's most precious resource, human capital."

This lesson is as relevant to the public sector as to the private sector. Supply and demand factors and rewards for performance must be recognised in public sector

employment contracts if we want an efficient public sector. Accountability should be exercised through budget allocations, not through controls on managerial decisions. There are dangers of forgetting these lessons and drifting back to a system of centralised wage controls.

For their part, unions will need to adapt to retain loyalty and membership. We are likely to see a decline in union membership in line with worldwide trends; even without deregulation, unionism in Australia is expected to fall to around 25 percent of the workforce by the year 2000. Union members will need to decide whether membership remains valuable to them or whether to increase their take home pay by ceasing to pay union fees. The performance of some unions as bargaining agents will be stimulated by competition from people such as private arbitrators, solicitors or industrial advocates. On the other hand, there are some skilled union officials and some very unskilled aspirant advisors and negotiators. As Rob Campbell has observed, "the market will sort these out".

Either the present generation of union leaders or its successors will also need to review its general economic and political thinking if it is to remain relevant. The entire thrust of the Council of Trade Unions' submission on the Bill was to reject the economic directions New Zealand has been belatedly following in recent years in favour of some alternative economic model or 'third way'. Referring to a recent meeting of Eastern European economic reformers, *The Economist* recently reported that:

"Astonishingly, they all more or less agreed on broad policy. No one much disputes the idea that reform will have to involve deregulation, demonopolisation, a tight monetary policy and, above all, fast privatisation. Anyone who so much hints at a 'third way' between communism and capitalism is considered naive; there is simply no more time to try more experiments."

We are still some distance away from reaching such a consensus in New Zealand. As one submission on the Bill pointed out, several generations have been taught at schools and universities the socialist view of the 'class struggle'. It added that for many years Radio New Zealand has played an acknowledged role in union activity by its ready and selective use of FOL, CTU and Victoria University spokespeople heavily biased against employers. In a radio debate only two years ago, CTU member Bill Andersen professed that for him East Germany - a country subsequently revealed as bankrupt and corrupt, and which has now disappeared from the map - was the ideal society. So long as such ideas are still taken seriously we will have difficulty as a community in overcoming our economic problems.

Massey University researchers have recently reported that although New Zealanders desire comfort and prosperity, hard work and competition are not particularly popular. Disturbingly, they found that social engineering tendencies in the education system have devalued hard work, excellence and competition - so much so that many young people hide their abilities. Today in Singapore, which has overtaken New Zealand in the per capita income stakes, factories typically work a three-shift, five or six day week with maintenance carried out during the sixth or seventh day except in continuous processes which work a seven day week. The New Zealand problem was recently summed up by an expatriate manager of a major New Zealand construction group who contrasted New Zealand performance with his home state:

"It costs twice as much, takes twice as long, and the people who build are paid half as much... There's a lot of tradition here : morning tea, afternoon tea - I've never heard of the likes. The practice is not prevalent in the United States. If workers take a break, it's usually taken where they are standing, not by returning to base."

Clearly a further ingredient in restoring our economic performance can be summed up in two four letter words: 'hard work'.

As a debt-ridden and uncompetitive economy, New Zealand is far away from regaining a triple A credit rating. Indeed with the present Moody's review we are at risk of a further downgrading to single A status. This would take many New Zealand corporate borrowers out of the investment grade bracket, reducing their credit lines and increasing their cost of capital. Economic management of the highest quality will be needed to avert a future downgrading, as will a major turnaround in attitudes and work practices.

New Zealand still has a long way to go to get its economy in working order, but the enactment of the Employment Contracts Bill will remove a giant obstacle to progress. The Bureau of Industry Economics in Australia recently estimated that across the whole economy labour reforms of the type contained in the Bill would produce gains each year approaching 1 percentage point of GDP. Applied to New Zealand, such gains would be worth around \$700 million a year or the equivalent of adding a fishing industry or a kiwifruit industry to the economy. Over time they would compound. The stakes for all in capitalising on the new opportunities are clearly very high.