

**H R Nicholls Society Meeting**

**Common Law and Common Sense:  
The Employment Contracts Bill**

**Roger Kerr  
EXECUTIVE DIRECTOR  
NEW ZEALAND BUSINESS ROUNDTABLE**

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## **COMMON LAW AND COMMON SENSE: THE EMPLOYMENT CONTRACTS BILL**

"The property which every man has in his own labour, as it is the original foundation of all other property, so it is the most sacred and inviolable. The patrimony of a poor man lies in the strength and dexterity of his hands; and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour, is a plain violation of this most sacred property. It is a manifest encroachment upon the just liberty both of the workman, and of those who might be disposed to employ him. As it hinders the one from working at what he thinks proper, so it hinders the others from employing whom they think proper."

Adam Smith

### **Introduction**

On 12 March of this year, the Australian government announced a programme for reducing most tariffs to a general rate of 5 per cent by 1996. As one commentator put it: "This was the day that protection died in Australia."

On 1 May next, the government in New Zealand appears set to implement the Employment Contracts Bill. This discards our century-old industrial conciliation and arbitration system and replaces it with a legal regime of free contracting. Property rights and freedom to trade in labour services are being restored.

As is well known, protectionism and labour market regulation have had a symbiotic relationship. Industry was protected from 'unfair competition' from imports in return for accepting that union members had to be protected against 'unfair competition' in the labour market through the award and arbitration system. This twin delusion has taken a fearful toll on the living standards of both our countries.

New Zealand has been dismantling its protection structures and average effective rates of assistance are now comparable to those in Australia. The current government is committed to further reductions, although decisions have yet to be taken. The signals from federal and state opposition parties suggest that labour market deregulation is not far away in Australia. Both countries may be laying the foundations for a turnaround in their relative long run decline.

Australian economic commentary on what has been going on in New Zealand in recent years has taken some curious forms. One school of thought has been blinded with admiration for the structural reforms achieved and has called for similar boldness by Australian Treasurers. Another sees the New Zealand economy as still struggling and puts this down to a misguided 'monetarist' and 'free market' experiment which Australia should avoid like the plague. Both views are wide of the

mark. *The Economist* has generally had the story right, apart from a rather misplaced and passing preoccupation with the sequencing of reforms. As it put it recently, the problem has been that:

"... the Labour government did only part of the job - the easiest part. Three huge areas were neglected: the rigid labour market and its centralised pay-award system, which prevents wages adjusting to market conditions; the lavish welfare state; and the budget deficit."

It is no great puzzle why the benefits to date have not been greater. The reform programme has been unbalanced for prolonged periods and political instability has eroded business confidence.

Nevertheless, much policy reform has been achieved and many gains are apparent. Labour productivity grew at an annual rate of about 5 percent in the manufacturing sector between the end of 1987 and the beginning of 1990, and by 3 percent for the whole economy. Productivity gains in state-owned enterprises and the waterfront have been spectacular. There has been a marked change in the pattern of investment away from protected activities to unprotected ones. The non-wage share of GDP has increased and aggregate business investment rates have remained high. Competitiveness has improved as rising labour productivity and falling real wages have reduced relative labour costs. Large reductions have occurred in inflation, inflation expectations, nominal interest rates and wage expectations.

One of the major downside factors has been a steep rise in unemployment. This is continuing and may top 10 percent of the labour force in the year ahead. However, as the recent OECD survey on New Zealand noted:

"A large part of the increase in unemployment since 1986 reflected a transformation of hidden into open unemployment - and not the loss of profitable jobs. Many lost jobs had been viable only on account of government subsidies or border protection. These policies attracted resources into uncompetitive activities, in many cases reducing the incentives for the acquisition of the management and labour skills necessary for more competitive industries."

The OECD noted that the solutions to high unemployment would require difficult decisions involving industrial relations legislation, minimum wage laws, and the levels of and eligibility criteria for social welfare support.

### **The Labour Market Since 1984**

As the figures for labour productivity show, there have been large changes in the New Zealand labour market since 1984. There has also been a transformation in attitudes and behaviour. Those who have been concerned about labour market developments have not argued that nothing has happened. Their point has been that not enough has been done to reform labour laws and institutions so as help firms adapt to intensified competition and enable workers displaced by restructuring to be reabsorbed in new activities.

In my view there have been two main reasons for the change in the employment relations climate. One is the impact of the general economic policies that have been pursued. A monetary policy aimed firmly at disinflation and policies such as trade liberalisation, deregulation of domestic industries, public sector reforms and privatisation have given firms strong incentives to contain costs, raise productivity and develop closer relations with their employees. This process has been enhanced by the second factor, the commendable refusal by ministers of labour to become embroiled in industrial disputes. The non-interventionist stance adopted by Mr Stan Rodger - 'sideline Stan' as he became known - has been followed by subsequent ministers and has forced parties to confront and resolve their own differences. Ten years ago, mostly at the behest of employers, the first item on the weekly cabinet agenda was the list of current industrial disputes. In recent years, even at times of tense industrial situations on the waterfront or the electricity industry, the imprecations from employers were for the government to keep out.

In contrast to these two powerful influences on the labour relations environment, the contribution of specific changes to labour law has been relatively modest.

Probably the single most important and least noticed change made by the previous government was the introduction of voluntary arbitration. This happened at the same time compulsory unionism was reintroduced, and this 'one step forward, one step back' approach was to characterise the government's term. The abolition of automatic access to third party arbitration by a decision of one party strongly reinforced the disciplines on wage bargainers to find their own solutions. The trade union movement agreed to the decision to scrap compulsory arbitration at the time, but later lamented it as an error and surreptitiously pressed for its restoration, with some success in the final months of the Labour government.

The major attempt by the Labour government to achieve labour market reform was made in 1985-87. The New Zealand equivalent of the Hancock review - as it unhappily turned out - was based on a Green Paper issued in late 1985. Most of the government's expressed intentions were commendable. It wished to encourage a more decentralised and dispersed wage fixing system, to promote new options for bargaining arrangements other than blanket coverage national awards (in particular by allowing unions to opt out of the award system), to allow workers the choice of union representation, to eliminate second tier bargaining by requiring all employees to be covered by a single document and to promote sanctity of contracts. On the other hand, it set its face against contemplating genuine voluntary unionism and sought to promote union amalgamation by increasing the minimum size of unions to 1,000 members, a move that flew in the face of efforts to develop enterprise-focused bargaining structures.

The reformist ministers in the previous government who had come, albeit rather slowly, to appreciate the significance of labour market reform, were thwarted by opposition in the party and the trade union movement. Despite claims to the contrary, the Labour Relations Act of 1987 largely amounted to tinkering with the existing system. Subsequent initiatives in the labour area saw a continuation of the 'one step forward, one step back' pattern. On the positive side, the government implemented a State Sector Act, in the face of fierce resistance from public sector unions, which went further towards dismantling the centralised system and introducing greater flexibility. It also abolished the special legislation governing waterfront employment relations, which has led to one of the major success stories in

New Zealand microeconomic reform, and it deregulated shop trading hours. On the other hand we endured a futile inquiry into industrial democracy and a two year debate on proposals to legislate for so-called 'employment equity'. The bankruptcy of these was convincingly exposed in the debate, allowing the new government to repeal the employment equity legislation as one of its first moves. In March 1990, recognising that its attempts at bargaining reform in the Labour Relations Act were insufficient, the Labour government decided to give employers a right to opt out of awards, but this too was so circumscribed as to be totally ineffectual. At the same time, it reintroduced a form of compulsory arbitration. In a final twist, the government reverted to centralism in September 1990 with a so-called 'Growth Agreement' with the trade union movement, the central feature of which was an undertaking to confine wage adjustments to 2 percent.

Throughout this period, developments in industry were characterised by a mix of the encouraging moves towards workplace cooperation and more productive work arrangements that I referred to and 'business as usual' as far as the pattern of award rounds and the institutional machinery was concerned. A major event in the transition from centralised wage fixing to 'free' bargaining was the irresponsible wage push by unions in 1985/86, which led to an increase in average weekly earnings of 17.4 percent in 1986. This was the single most important setback in the economic reform programme, resulting in the disappearance of thousands of union members' jobs and a loss of competitiveness from which the economy is still struggling to recover. However, the lesson was quickly learned. Increases in average weekly earnings in the two succeeding years were around 7-8 per cent, in 1989 and 1990 about 4-5 percent, and are currently running at 2-3 percent. With inflation coming down to similar levels and continuing productivity improvements, a platform for achieving genuine competitive advantage is being created.

As far as policy is concerned, the overriding lesson of the period is that piecemeal reforms to labour law produce disappointing results. The architects of the Labour Relations Act, including the Department of Labour which has been a principal defender of the old system, argued that the removal of a few 'keystones' and the provision of opportunities to opt out of awards were all that was needed to allow desirable change. This has proven to be a recipe for reform at a snail's pace and for a growing gap between employment displacement and absorption. It is clear that wide freedoms need to be created to overcome inertia and the power of vested interests to resist change. The new government has recognised this in bringing down the Employment Contracts Bill.

### **The Employment Contracts Bill**

From the mid-1980s, New Zealand employer organisations, government agencies other than the Department of Labour, the OECD and IMF, independent commentators and the National party in opposition pressed the case for much more comprehensive labour market reform. Public opinion surveys also showed large majorities - of the order of 70 - 80 percent, including among trade union members - in favour of voluntary unionism, worker choice of representation, and giving employers and employees the freedom to deal directly with one another. The present government made labour relations reform a central element of its election campaign and assumed office with a clear mandate for change.

The cornerstone of the Employment Contracts Bill is a rejection of the century old conflict-based model of employment relations which holds that employee and employer 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. Myths about the 'special' nature of labour contracts and 'unequal' bargaining power have also been discarded. As its name suggests, the Bill 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.

Some of the most significant provisions of the Bill are as follows:

- compulsory unionism is abolished and replaced with freedom of association;
- unions will become incorporated societies with no special rights (the term trade union does not appear in the Bill, which speaks of employer and employee organisations);
- unions lose the exclusive right to collectively bargain on behalf of workers - they may negotiate themselves or use the services of any bargaining agent;
- awards and agreements disappear and are replaced with employment contracts;
- subsequent party provisions - the mechanism by which awards were given blanket coverage, even to parties who had no role in their negotiation - disappear and employment contracts will only apply to those persons who actually contract to be bound by them;
- terms and conditions of employment will be governed by contractual principles, either under individual or collective employment contracts;
- the elimination of union registration provisions removes the basis for demarcation disputes;
- no specific provisions are made for redundancy and the Labour Court loses the power to determine redundancy compensation where the parties cannot agree;
- a strike or lockout will be lawful except where there is a collective employment contract in force that relates to the striking employees; and
- appeals from decisions of mediators or other appointed persons to the Labour Court can only be made on questions of law (not fact).

At this stage personal grievance procedures are retained in their present form with some modifications:

- there will no longer be any requirement that workers be covered by unions before they can use the procedures;

- the right to use the personal grievance procedures will be dependent upon whether the person is covered by a collective employment contract or has a personal grievance procedure in his/her individual employment contract;
- reinstatement will no longer be the primary remedy;
- 'procedural unfairness' in the manner of the dismissal will no longer render the dismissal unjustified if the employer had substantive justification ('good cause') for dismissal.

The Mediation Service and Labour Court are to be retained, but there will no longer be any requirement to use mediators from the Mediation Service to chair disputes. The parties may agree to have any other person (such as an arbitrator, solicitor or industrial advocate) mediate the dispute. The government has indicated that it has yet to take final decisions on these institutions and on personal grievances.

### **Evaluation of the Bill**

In its original submission in response to the Green Paper in 1986, our organisation wrote:

"Labour and industrial relations law in New Zealand has gradually isolated labour market contracting arrangements from common law and common sense. The current myriad pieces of labour law are not only a mystery to the outsider; even practitioners find it a maze. The arcane body of rules inhibits beneficial contracts, and what is required in its place is a minimum set of laws necessary to allow the negotiation of agreements subject to enforcement by the parties and their appointed arbitrators. Complex and often unenforceable labour laws mean uncertainty, which reduces incentives for investment, risk-taking and hiring of new labour.

The common law rules allowing freedom of association and freedom to enter into mutually beneficial arrangements (contracts) for employment that should exist in principle have been replaced in practice by a set of obligations and constraints which preclude more productive employment. Incomes of both workers and enterprises are reduced by the incapacity to adapt awards to local and individual conditions. Employers' offers are less than they could be owing to the insecurity and non-enforceability of awards. The parties to awards have few incentives to design their own arrangements to enforce agreements they have freely entered into... What the government must do is create a stable, non-distortionary and intelligible legal environment in which employment and productivity-enhancing contracts can be written."

A serious question arises as to whether any statutory law - other than legislation on employment standards - is needed to reflect these principles. 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. The civil courts have remained involved in employment matters. The main argument for some form of statutory law which we found

compelling was that over time labour law had become a special province and judicial precedent had moved it away from its role of protecting and enforcing contracts. In New Zealand circumstances at least, there seemed a need for Parliament to give fresh guidance to the courts in order to bring employment contracting into line with general contract law. This would limit if not prevent inappropriate forms of judicial activism while a new understanding and legal culture developed in respect of employment relationships.

This analysis points to the case for a relatively brief and simple statute with the essential purpose of facilitating free trade in labour services. The Bill certainly goes a long way to doing away with the enormous complexity of past arrangements. Where it currently 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. There are a number of significant inconsistencies in this regard which could undermine both efficiency and equity objectives in the labour market.

- The Bill is effectively a 'right to work' law in that it disallows the right to make union or non-union membership a condition of a contract. While there may be a transitional argument for outlawing contracts which require union membership because of past attitudes and behaviour associated with closed shops, there are no obvious grounds for concern about allowing non-membership of a union to be a condition of an employment contract and full contracting freedom should be allowable in the longer run.
- Compulsory grievance procedures are retained in respect of collective contracts and there is a risk that they will be extended to individual contracts. Legislated redundancy and dismissal rules raise the costs and risks of employment and have been an important factor in the poor unemployment record of several European countries. There are no grounds for disallowing 'at will' or 'on notice' contracts and any alternative terms should be a matter for voluntary negotiation in employment contracts.
- Compulsory disputes settlement procedures are similarly retained for collective contracts. Again these should be a matter for voluntary contracting or, as a second-best option, should be legislated only as a standard form model for parties to avail themselves of should they so choose.
- The specialist Labour Court is retained, which poses a serious risk of perpetuating attitudes and a legal culture which have no place in the new regime. Since 1987 the Goddard court has greatly extended its reach. Employers and politicians alike have looked askance at the intrusions it has made into redundancy and dismissal cases in total disregard of commercial realities. While it will no doubt have its wings clipped, there is a strong case, supported by some of New Zealand's leading industrial lawyers, for its total abolition. The civil courts have the expertise and capacity to handle contractual disputes, which should greatly reduce in number.
- The provisions on strikes and lockouts fall somewhat short of reducing these issues to a simple determination of whether action has been taken in breach of a contract or whether trade has been interfered with unlawfully.

These inconsistencies are not fatal flaws in the Bill but they would undermine its effectiveness. With its difficult economic and employment situation, New Zealand can ill afford politically expedient compromises. A significant number of more or less technical problems have also been identified and it is hoped that these will be remedied. Other criticisms that have been made by its supporters have less validity. Among some employers there is an apparent 'fear of freedom' and a belief that some of the props and crutches of the old system are needed to prevent 'instability' in bargaining. The basic response to these criticisms is that employers need to get close to their staff to sort out any such problems and that managers should do what they are employed to do, namely manage.

### **Reactions to the Bill**

The Bill was introduced by the government as part of an economic package in December 1990 which also included reforms to social welfare benefits. Market reactions have been favourable, with a welcome slide in interest rates over the last few months.

The introduction of the Bill has already given an impetus to bargaining reform. Recent negotiations in the accommodation and hotel industries have seen an end to penal rates, the introduction of youth rates and more freedom to use casual staff. These concessions would have been considered sacrilege by the union movement even 12 months ago. Other developments of this sort look set to follow.

There has been overwhelming support among employers for the Bill. Two briefing sessions in Auckland were attended by a total of 2,000 employers. According to the Director General of the Employers Federation:

"The response is outstanding. Never before have we had such numbers. Without exception the meetings are giving massive support to the new bargaining arrangements and the new cooperative era of labour relations."

The initial reaction of the unions was muted, if not stunned. In submissions to the Select Committee considering the Bill, some unions have accepted its inevitability and concentrated on issues of detail. The capacity of the union movement to oppose the Bill has been weakened by the extent to which the intellectual argument in favour of reform has been won in recent years, the majority support for key changes shown in public opinion surveys and the government's electoral mandate. Lacking other bases for opposition, the unions have more recently resorted to old-fashioned rhetoric and protests in an attempt to influence political opinion. The arguments have been incoherent, with marxist slogans about 'wage slavery' conflicting with claims that wages will 'blow out' without the discipline of union restraint. There have been the usual threats of industrial anarchy and a disregard for the interests of others, with Combined Trade Unions president, Ken Douglas, saying the union response was to hold on to what they had and "somebody else would have to go to the slaughter". Most commentators seem to think that such crude tactics are unlikely to impress the government, which has put forward the case for the Bill in an articulate and principled way.

The news media have concentrated on opposition to the Bill. They have given prominence to the views of unions and other critics and have seized on the natural

variations of opinion among employers on technical aspects of the Bill to suggest major differences of opinion that do not exist. Criticism has also come from industrial relations reporters, academics and lawyers. As in Australia, all these are groups whose professional 'expertise' in the old system stands to become largely redundant.

The Labour opposition initially declined to give a commitment to repeal the Bill. Under pressure, it has now said it will do so.

### **Implications for New Zealand - and Australia?**

The Select Committee is currently deliberating on the Bill and it is expected to be reported back to the House within the next week or so. The government has indicated that it is unlikely to be significantly changed, but hopes are held that some of the inconsistencies identified in it will be improved and technical deficiencies remedied.

The enactment of the Bill on 1 May or shortly thereafter will not usher in radical overnight changes in labour practices. Rather than being a quantum leap into the unknown, the Bill will facilitate an extension and acceleration of a process of decentralisation of employment relations and adoption of productivity-improving working methods that goes back several years. It will also put pressure on uncompetitive wage structures that have been maintained by monopoly union power and allow 'outsiders' - particularly the low-skilled, women, part time workers and ethnic groups - who have been marginalised by the rigidities of the previous system to compete more effectively for jobs.

The Bill does not mark the end of necessary labour market reform in New Zealand. As the OECD has noted, statutory minimum wages in New Zealand have been increased to an exceptionally high level by international standards and are precluding low-skilled workers from gaining employment. Antiquated employment arrangements in the shipping industry need to be overhauled. Some special provisions governing retail employment need to be 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 goods and factor markets. More generally the new freedom to negotiate employment contracts tailored to the needs of firms and employees will open the way for policy reforms in areas such as training, accident insurance and occupational health and safety.

Advocates of labour market reform in Australia can perhaps take some heart and draw some lessons from New Zealand experience.

One is that sound intellectual arguments and evidence win hearts and minds in the long run, not least among workers. It is hard to sustain arguments about exploitation and anarchy when even partial deregulation on the waterfront has led to fewer disruptions than ever before, higher not lower wages, massive increases in productivity and lower costs. Labour relations policies are not a matter of political debate in successful countries. I would be surprised if they are a source of contention in New Zealand in a few years' time.

Secondly, I believe there is little prospect that deregulation will lead to the kind of wages 'blow-out' much feared in Australia. Most workers are realists. They understand the relationship between profits and jobs, and the new system will bring this relationship into sharper focus. A few years ago a former Employers Federation leader accused me of "wanting to let the gorillas out of the cage" for advocating a move from centralised wage controls to free bargaining. He under-estimated the intelligence of most workers - and, for that matter, unionists. Provided monetary policy is set against inflation and product markets are competitive, there is no reason why deregulated labour markets in Australia and New Zealand should exhibit more of an inflationary bias than those of, say, Switzerland and Japan. Talk in Australia of the need for a 'wages policy' as a separate arm of economic policy has always struck me as curious. Why should governments regulate the price of labour any more than the price of wool? It is government action in fooling around with markets that is more likely to produce explosions - or implisions - in the case of either labour or wool.

Thirdly, New Zealand experience gives some cause for confidence that the business community can be encouraged to give its full backing to labour market reform. Having worked through the issues at a fundamental level 5 years ago, there has never been any debate within the Business Roundtable about the need for comprehensive reform or the shape it should take. Other employer groups in New Zealand have moved to similar positions. In the short term, some businesses gain from controls and accords, and some fear the consequences of change. But all lose in the long run from the inefficiency of centrally planned labour markets.

Finally, I believe the achievement of the Employment Contracts Bill owes something to a willingness by its advocates to argue from first principles and to reject tactically expedient formulations and compromises. It is perhaps noteworthy that the argument for labour market reform in New Zealand has not been advanced under the banner of 'enterprise bargaining' that has been fairly widely adopted in Australia. Although in a freer environment the traffic will certainly flow from broad occupational and industry awards to a more decentralised level, there is no economic principle which states that the right locus of bargaining is the enterprise. In some cases it may be smaller units within the enterprise, including individuals; in others it may be larger ones. The only economic principle that stands up to scrutiny is the principle of freedom to contract.

New Zealand's economic difficulties will not end with the passage of the Employment Contracts Bill, but a giant obstacle to progress will have been removed. In relation to Australia, the Bureau of Industry Economics recently concluded that:

"With returns to labour accounting for some two-thirds of GDP, it is not surprising that reforms in the labour market seem to offer the greatest potential benefits among the different microeconomic reforms currently under consideration. Across the whole economy labour reforms alone might produce gains approaching 1 percentage point a year of GDP."

Potential gains in New Zealand might well be of the same order.

The debate about protection reform in Australia began in the early 1970s, and in New Zealand about 10 years later. It will be near the turn of the century before the damage protectionist policies has done to our economies has been repaired. The

debate about labour market reform began in earnest in the 1980s and is now in its final stages in New Zealand, and I suspect in Australia as well. They have been wasted years for both countries. New Zealand still has a long way to go to get its economy into working order. But on 1 May or shortly thereafter one more breakthrough seems likely to be made.