

**'Moving Forward' Conference on the Employment Contracts Act
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**Deregulation of the New Zealand
Labour Market:
Things Done and Left Undone**

**Charles Baird
CALIFORNIA STATE UNIVERSITY, HAYWARD
UNITED STATES**

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DEREGULATION OF THE NEW ZEALAND LABOUR MARKET: THINGS DONE AND LEFT UNDONE

In Praise of the ECA

I think that May 15 ought henceforth to be officially designated as Freedom of Labour Day in New Zealand. The Employment Contracts Act 1991 (ECA) is a bold, giant step toward the worthy goal of restoring freedom of contract to New Zealand labour markets. It has totally abolished compulsory unionism and obliterated the special privileges that unions have unjustifiably enjoyed in New Zealand since 1894. In no other advanced country in the world, and certainly not in the United States, has the legislature been willing to challenge the hegemony of trade unions to such an extent.

This is all the more remarkable because before the ECA compulsory unionism reigned supreme in New Zealand. New Zealand was far worse than the United States. Now the tables are turned. In comparison with New Zealand, the United States is in the dark ages of corporatism. Let me briefly explain how bad things are in labour relations law in the United States.

While most collective bargaining in the United States has been done at the enterprise level, forced union representation and forced union membership are quite common. Moreover, bargaining is compulsory. There is a duty to bargain in good faith. The statute that regulates labour relations in the United States is the National Labor Relations Act, as amended (NLRA).

If a majority of employees in an enterprise vote to be represented by a union, that union becomes the exclusive bargaining agent of all employees who were eligible to vote. A union certified by majority vote represents those who voted for it, those who voted against it, and those who didn't vote. Individual American workers are *not* free to designate representatives of their own choosing.

In contrast, under the ECA New Zealand workers are free *individually* to select their own representatives. Section 1(c) of the ECA declares that a purpose of the Act is:

To enable *each* employee to choose either - (i) To negotiate an individual employment contract with his or her employer; or (ii) To be bound by a collective employment contract to which his or her employer is a party (emphasis added).

New Zealand workers can choose to represent themselves or to be represented by an agent. Furthermore the agent does not have to be a labour union. Unions represent only those workers who individually choose them as representatives. There is no forced representation.

In the United States workers can be forced to join (or at least pay dues to) unions that have been certified by majority vote. The First Amendment to the United States Constitution forbids the government to abridge the freedom of association of any individual. Yet, with the blessing of the United States Supreme Court, Congress has given unions the right to force workers to join, or at least pay tribute to, them as a condition for those workers to keep their jobs. In 1947 a too timid United States Congress amended the NLRA to permit individual states to ban forced membership

and forced dues within their jurisdictions. Twenty-one states, the so-called right to work states, have done so.

In 1991 the New Zealand parliament was *not* too timid to eliminate forced membership and forced dues altogether. Section 6 of the ECA guarantees that membership is totally voluntary.

In the United States employers are forced to bargain in good faith with certified unions on a long list of mandatory subjects of bargaining. Case law has defined good faith bargaining as being willing to make concessions. If employers do not make sufficient concessions to prove that they are bargaining in good faith, they can be found guilty of an unfair labour practice and forced to accept the union's terms.

In every other area of the law, in order for contracts to be valid they must have been entered into freely by all of the parties involved. Parties are not forced to bargain: they must choose to bargain. Contracts that are the result of coerced bargaining are not enforceable. But in American labour relations law *all* collective bargaining contracts are coerced and enforceable. All United States collective bargaining contracts are based on involuntary exchange. Congress has not dared even to make timid changes in this area.

The 1991 New Zealand parliament was bold enough to abolish completely forced bargaining. *However, there is a danger that it may be reimposed by judicial interpretation.*

Section 1 (d) of the ECA states that it is a purpose of the Act to make bargaining voluntary. Sections 18 - 20 do exactly that. The word "may" is used repeatedly. The words "shall" and "must" do not appear in this connection save to say that collective contracts "shall be in writing". In *Adams v Alliance Textiles (New Zealand) Ltd* [1992], first the Employment Court and later the Court of Appeal declared that the ECA has no explicit provision for mandatory good faith bargaining and that no court should try to "import" such an obligation into the Act. So far, so good. *But* section 12 (2) of the ECA says:

Where any employee or employer has authorised a person, group, or organisation to represent the employee or employer in negotiations for an employment contract, the employee or employer with whom the negotiations are being undertaken shall ... recognise the authority of that person, group, or organisation to represent the employee or employer in those negotiations.

This means that if a worker designates a union to represent him or her in negotiations for an employment contract with an employer, that employer cannot refuse *to recognise* the union for that purpose. However, an employer can refuse *to bargain* with the union. That is, if the employer chooses to bargain for the labour services of the employee, bargaining must be done through the union. The employer cannot bargain with the employee directly, but the firm can refuse to bargain with the union.

Nevertheless, there is a danger that the difference between mandatory recognition of a bargaining agent and mandatory bargaining with a bargaining agent is too subtle to prevent the judicial importation of a United States-style duty to bargain in good faith into the ECA. Indeed, in a recent *Employment Law Bulletin* article entitled "The Renaissance of the Duty to Bargain in Good Faith" the author argues that section 12 should be used in that way. She even goes so far as to say that in *NZ Medical*

Laboratory Workers [1994] the Employment Court found that the employer's conduct "amounted to a breach of the mutual duty to bargain in good faith."

The Employment Court is not the only source of possible recidivism on this point. In the September 1995 issue of *Work*, the Labour Party made clear that it advocates a return to mandatory good faith bargaining.

The benefits of abolishing forced representation, forced membership and forced bargaining are many. For example, unions lose control over the supply of labour. Labour markets become contestable so the actual scarcity values of different sorts of labour services can be discovered. Both employees and employers can be more flexible in adapting to changes in market conditions.

All these are important to an economist, but they pale in comparison with the fact that when force is abolished, when all interactions in the labour market are on the basis of voluntary exchange, the property rights of each individual worker and employer are respected. Specifically, workers own their own labour services. They, or agents they individually choose, are the only ones entitled to make offers to sell those services in labour markets. Forced union representation and/or membership confers on unions a property right to the labour services of workers who are subjected to that force. It is simply legalised theft.

So much for the things done. There are things that remain undone, for the ECA has some deficiencies.

The principal deficiency of the ECA: unjustifiable dismissal

I have just completed a study for the New Zealand Business Roundtable on the issue of mandatory unjustifiable dismissal restrictions in employment contracts. Section 26(a) of the ECA states that all employment contracts must include an effective personal grievance settlement process. Section 27(a) explicitly includes unjustifiable dismissal as a personal grievance. Section 147 proscribes contracting out of the provisions of the ECA. Taken together, these features of the ECA completely abolish the at-will employment doctrine in New Zealand.

Under the common law of employment contracts, in the absence of an agreement between an employer and an employee to the contrary, either party could terminate the employment relationship at-will. That is, an employee could quit a job at any time and for any reason or for no reason. Similarly, an employer could dismiss an employee at any time and for any reason or for no reason.

In the United States this at-will employment doctrine had been in effect since the 1840s. It was not unusual for actual employment contracts to have a notice provision of one to four weeks, but no law mandated such a provision. Beginning in the mid 1970s and continuing throughout the 1980s, more and more state courts and legislatures imposed unjustifiable dismissal restrictions on employment relationships.

Prior to 1970 most employment in New Zealand, including employment covered by collective bargaining contracts, was at-will unless there were explicit contractual agreements to the contrary. At-will was imported into New Zealand in 1909 as the result of the ruling that year in a British case called *Addis v Gramophone Co*. In 1970 parliament amended the Industrial Conciliation and Arbitration Act 1894 to give "wrongful termination" protections to unionised at-will employees. However, New Zealand courts interpreted "wrongful termination" to mean dismissal that was

contrary to the explicit terms of a contract or without sufficient notice. These restrictions were always understood to be implied by the *Addis* decision, so parliament's attempt to overrule *Addis* for unionised workers failed. In 1973 parliament tried again. This time it protected unionised workers from "unjustifiable dismissal", and made very clear that dismissals hitherto permitted under *Addis* could be challenged if they were not "fair".

That is, courts were told to do more than examine the legality and explicit terms of employment contracts. On the basis of what in New Zealand is called the "implied term of mutual trust and confidence", and what in the United States is called the "covenant of good faith and fair dealing", courts were instructed to inquire into the *justice* of employers' decisions to terminate employment relationships. Formulations like "implied term of mutual trust and confidence" and "covenant of good faith and fair dealing" are simply lawyer-talk designed to allow judges to substitute their own views on employment relationships for the views of the individual parties involved.

From 1973 to 1991, only collective bargaining contracts included mandatory unjustifiable dismissal restrictions. In 1991 parliament had a choice between three alternatives. It could restore all employment relationships to an at-will basis, continue to limit mandatory unjustifiable dismissal restrictions to collective contracts, or impose at-will restrictions on all employment relationships. In the event, parliament chose the third and worst option.

The usual explanation of why parliament chose to impose universal unjustifiable dismissal restrictions was that it is necessary to set minimum standards. Prior to the ECA, unions, it is asserted, protected their workers from unjustifiable dismissal. Since the ECA significantly reduced the power of unions, that protection had to be afforded by regulation at the individual level. But this argument overlooks the principle that individual employees and employers know best what contractual arrangements suit their unique circumstances of time and place. In an unfettered labour market there will be a wide variety of contractual arrangements. No regulator can possibly know enough to design a one-size-fits-all substitute.

F A Hayek, the 1974 Nobel Laureate, taught us that the knowledge that is relevant to the efficient allocation of resources and the coordination of economic activities exists nowhere in its entirety. Rather, it is widely dispersed, frequently changing, almost always subjective, and often tacit. Each person has some bits of the relevant knowledge - the bits pertaining to him or her and a few bits pertaining to some people with whom the person is familiar - but no one, and no government agency, can have all of the relevant knowledge. Hayek called this the principle of the division of knowledge. He used it to demonstrate the futility of central economic planning and formulating one-size-fits-all regulations, even if they are called 'minimum codes', for any part of an economy. Too bad Hayek is not required reading in the Labour Party.

The predictable effects of the imposition of unjustifiable dismissal restrictions, which I elaborate in my NZBR study, include less efficiency in the management and deployment of labour resources, higher information costs in labour markets, the founding of fewer start-up firms and the expansion of fewer existing firms, fewer employment opportunities in general, the hiring of fewer high risk employees, diminished opportunities for entry level work and on-the-job training, decreased productivity of many already-hired workers, lower real compensation paid to workers, and increased inequality in the distribution of income.

The remedy is clear. In keeping with the overall spirit of the ECA, freedom of contract ought to be restored on the issue of unjustifiable dismissals. New Zealand should return to the at-will presumption in all employment relationships. Individual employers and employees who, for their own purposes, choose to contract out of at-will should be free to do so. The principle of the division of knowledge implies that a multitude of different contractual arrangements will emerge. The only characteristic that we know they will all share is that they are voluntary.

Other deficiencies of the ECA

There are three other deficiencies that I want to consider. Next to unjustifiable dismissal restrictions, the second worst sin of commission in the ECA is that it grants jurisdiction over labour disputes to a specialist court, the Employment Court, which is a direct descendant of the old Labour Court which adjudicated labour disputes under the old regime of special privileges for unions. A major purpose of the ECA was to bring labour disputes under the same common law principles as most other disputes. It was a huge blunder for parliament to think that judges from the old Labour Court would be philosophically and temperamentally able to treat labour like other markets. All their experience was based on treating labour as special.

In the event, the Employment Court has demonstrated its inability to break away from its old habits. Last year the Business Roundtable and the Employers Federation published a paper by Colin Howard on the interpretive gymnastics of the Employment Court. This year the NZBR will publish a study by Bernard Robertson on the relative merits of specialist and generalist courts. I highly recommend both studies.

The other minimum code included in the ECA is found in section 14 which grants unions that have been selected as worker representatives a right of access to the private property of employers without the consent of those employers. This can only be understood as a remnant of the age of special privileges for unions. Section 14 states that designated representatives may "enter those premises at any reasonable time when employees are employed to work on the premises" for the purpose of discussions with the employees they represent regarding negotiations for their employment contracts. If this seems reasonable, it is only because we are all used to thinking of labour representation as a special case. But it isn't. Suppose an employee has hired an attorney as a representative in some civil litigation, either involving the person's employer or not. We wouldn't think it proper for the attorney to be granted access to the employer's property against the employer's will to discuss that litigation. The attorney and his client can very well agree to meet at some place and time that does not interfere with the client's job. So too can a designated labour representative and his client. Why should parliament want to defend the employer's property rights in the case of an attorney and abrogate the employer's property rights in the case of a labour representative?

But worse than that, the ECA left untouched three particularly troublesome minimum codes that are contained in other legislation - legally mandated holidays, OSH regulations and, worst of all, legal minimum wages. These are its sins of omission.

Mandated holidays, in the form of minimum vacation periods, mandated family leave and the like, amount to an assertion by regulators (i) that they know better than individual workers and employers what holiday policy should be, and (ii) that a uniform holiday policy, imposed by central planners, is correct for all workers and all employers notwithstanding the local circumstances of time and place. Hayek's

principle of the division of knowledge gives the lie to both assertions. It is not difficult to imagine circumstances under which both workers and their employers would be better off *as they see it* if they were free to make trade-offs between holiday time and wages and salaries. There is no reason to think that voluntary exchange would result in a uniform holiday policy for all workers within a firm, much less that it would result in a uniform holiday policy among firms. True, workers complement each other within a firm, and firms are often in complementary relationships with each other, but the individuals involved understand those relationships better than any central planner. They, not the central planners, have the clearest perceptions of the relevant costs and benefits.

The insistence on a centrally planned uniform holiday policy for an entire country can only be understood as a paternalistic fear that, left to their own devices, workers have insufficient bargaining power to get a 'fair' holiday policy. But the idea that labour has an automatic bargaining power disadvantage is a myth. Moreover, American data on conditions in labour markets in the nineteenth century strongly suggest that it was always a myth. In the end, only the individuals involved themselves can adequately judge whether a holiday policy is 'fair'. I can think of no government official in the United States or anywhere else to whom I am willing to delegate the authority to determine what is 'fair' for me. Any government official who tries to do so is guilty of what Hayek called the fatal conceit.

With regard to OSH regulations, New Zealand is clearly better off than the United States. The Health and Safety in Employment Act 1992 at least moved away from design standards and toward performance standards in OSH regulations. In the United States we still try to centrally plan safe workplace environments and force all employers to adopt the central plan. In New Zealand you let employers figure out their own designs for workplace safety. However, section 6 of the Act instructs employers to take "all practicable steps" to provide a safe working environment. Does this mean do all that is technically possible regardless of cost? Some court decisions (e.g. the *Ansett* case) suggest that employers are not free to employ cost-benefit analysis in designing workplace safety.

The economically correct way for the government to address OSH issues is to promote worker and employer awareness of risks. With that knowledge, workers and employers can work out their own solutions. For example, some workers may be willing to incur a high risk on the job in exchange for an increased compensation that is less than the cost to the employer of eliminating the risk. Such contracts should not be forbidden. To do so is to substitute the judgment of planners for the judgment of the people directly involved - another instance of the fatal conceit.

Judges and juries in injury cases do not, of course, look at the problem in this way. They are blinded by what Richard Epstein calls the "*ex post* syndrome". In any particular case involving an accident that has already happened, there is a sympathetic 'victim' and a deep pocket employer. Compassion toward the victim seems appropriate. What such judges and juries forget, however, is that their decision in the extant case will send signals to other workers and employers that it is futile to negotiate contracts that are, *ex ante*, mutually beneficial. The entire market process is thereby impaired.

Perhaps the most important concept in economics is that demand curves - for apples, books, cars and labour - are always downward-sloping. This logically follows from the common sense proposition that, other things being equal, buyers prefer to pay lower prices rather than higher prices for any product or service. Given income,

tastes, preferences and perceptions of the nature of the product, buyers plan to buy less at a high price than they do at a low price. Yet, here and in the United States, there are people (sorry, I mean politicians) such as Steve Maharey, the Labour Party's would-be labour minister, and Robert Reich, the incumbent Secretary of Labor in the Clinton administration, who claim that increases (they usually say modest increases) in the wage that must be paid to low-skilled workers will increase the numbers of jobs that employers will offer to such workers. They are saying that higher wage costs make employers want to increase the amount of labour hired. This is akin to saying that water runs up hill.

Furthermore, Mr Maharey has proposed a 46 percent increase in the youth minimum wage and a 14 percent increase in the adult minimum wage. These are hardly modest increases. More importantly, they show that Mr Maharey really does believe in downward-sloping demand curves.

Both Mr Maharey and Mr Reich base their claims that increases in the legal minimum wage will expand employment on a thoroughly discredited study done in 1994 by David Card and Alan Krueger of hiring policies in fast food restaurants in New Jersey (which increased its minimum wage) compared with Pennsylvania (which did not). Card and Krueger based their study on telephone interviews of self-identified managers at the fast food restaurants. When David Neumark and William Wascher examined the actual payroll records of these fast food restaurants, they found the reverse of what Card and Krueger claimed to find. They found, as economists for as long as such studies have been done have found, that increases in the legal minimum wage cause disemployment. And the disemployment falls on the least able, the least skilled and the least experienced - the people at the bottom of the economic ladder. It is perhaps important to recognise that at the time the Card-Krueger study was undertaken, Mr Krueger was a member of Secretary Reich's staff in the Department of Labor.

Milton Friedman accurately summed up the minimum wage issue in the *Wall Street Journal* on 29 April 1996 with these words:

Raising by law the price of any commodity or service will reduce the quantity that purchasers of that commodity or service wish to purchase, whether the item in question is gasoline or wheat or milk or labor. The only issue is by how much.

A higher minimum wage would therefore mean that fewer people would be employed. Fewer people will produce less than more people, so the basic cost of a higher minimum wage would be smaller total output. Some people would benefit - those current minimum wage workers who are retained at the higher minimum wage. Some people would lose - those current minimum wage workers who become unemployed.

It is difficult for me to see how this kind of redistribution of income among low income workers compensates for the loss in total output.

In conclusion

I conclude that the ECA is almost a model for the rest of the world. While I would gladly take the ECA as it is in exchange for America's NLRA, more needs to be done to restore full freedom of contract to New Zealand labour markets. You are 80

percent of the way there, but the 20 percent that remains to be done is still a game worth the candle.