Karori Rotary Club

The ECA: Almost a Model for the World

Charles Baird
CALIFORNIA STATE UNIVERSITY, HAYWARD
UNITED STATES

WELLINGTON
19 MARCH 1996

THE ECA: ALMOST A MODEL FOR THE WORLD

From the perspective of an American free-market economist, New Zealanders deserve hearty congratulations for the 1991 Employment Contracts Act (ECA). Without doubt, New Zealand now has one of the least regulated labour markets in the world. Compared with New Zealand, the United States is stuck in the dark ages of corporatism. I have spent most of the last 20 years advocating the deregulation of American labour relations. While my pleas and those of several like-minded American labour economists have gone unheeded in the United States, in New Zealand the advocates of essentially the same agenda have succeeded in getting most of their principles written into law. The Tenth Commandment proscribes envy, but I am envious.

But the ECA is not perfect. It could be improved. My plan in this address is first to praise the ECA by comparing it favourably to American labour relations law and then to explain what I regard as its three main shortcomings and to suggest remedies for them. There are other labour market regulations in New Zealand that should be repealed or modified - e.g. legal mýnimum wages and mandated paid holidays - but I shall not discuss them here.

In praise of the ECA

The main statute regulating labour relations in the United States is the National Labor Relations Act (NLRA). When it comes to labour relations ýn the United States, there is no such thing as equal protection of the law. There are three particularly egregious features of US labour law - exclusive representation, union security and mandatory good faith bargaining. Notwithstanding the interpretive gymnastics of the Employment Court, the ECA was written to protect New Zealand workers from each of these injustices.

Exclusive representation

The NLRA promises to protect American workers' right to representation "of their own choosing". In fact it does no such thing. Each worker is forced to accept the representation services of a union that receives a majority of the votes cast in a certification election. No individual can designate a representative of his or her own choosing unless the one designated is also designated by a majority of fellow workers. A union certified by majority vote is the exclusive bargaining agent of all the workers eligýble to vote. It represents those who voted for it, those who voted against it, and those who did not vote. It is a winner-take-all process that is defended on the grounds that it is 'democratic'. But unions are not governments. Therefore, forcing individuals to submit to the will of the majority is a violation of each individuals' freedom of association. In the private (i.e. non-governmental) sphere of human action the appropriate decision rule is individual choice. People may voluntarily associate with private organisations that are run democratically, and if they do not like what a majority decides, they can leave the association without suffering any penalty. In the United States the only way a worker can escape the representation services of an unwanted union is to lose his or her job.

Under New Zealand's Labour Relations Act 1987 matters were much worse. In covered occupations there was not even a vote on whether to be represented by a union. The government simply forced all covered workers into unions. Given the way politicians usually act, I would have expected that any reform of the Labour Relations Act on this point would be timid. For example, American exclusive representation might have been seen as a politically possible compromýse. But, to its great credit, New Zealand's parliament went further. It enacted the ECA, section 1(c) of which declares that it is a purpose of the Act:

> To enable *each* employee to choose either – (i) To negotiate an indivýdual 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).

Unlike American workers, New Zealand workers really may designate representatives of their own choosing. They can choose to represent themselves or to be represented by an agent. The agent can be "another person, group, or organisation" (section 10); it does not have to be a labour union.

Union security

The NRLA permits certified unions and the employers with whom they bargain to include union security clauses in their collective bargaining agreements. Such clauses force all the workers to join the certified unions (union shops) or pay dues to the certified unions (agency shops). This coercion is justified on the basis of an alleged 'free rider' problem. Since, under exclusive representation, a certified union must represent all the workers on the job whether they are members or not, without a union security clause some workers could get the benefits of union representation without paying their fair share of the union's costs of providing representation services. Such workers, it is said, would be 'free riding' on the backs of union members who do pay dues. This free rider argument is spurious. If unions represented only their voluntary members there could be no free riders. American unions fought long and hard to get the privilege of exclusive representation, and now they use that privilege as an excuse for forced membership and forced dues. If they want security against free riders, American unions should advocate amending the NLRA to substitute members-only bargaining for exclusive representation.

In 1947 a too timid US Congess amended the NRLA to permit ýndividual states to ban union security within their jurisdictions. Twenty-one states, the 'right to work' states, have done so. Under New Zealand's Labour Relations Act 1987 all covered workers were forced to be union members and pay union dues. In 1991 New Zealand's parliament was not too timid to eliminate forced membership and forced dues altogether. Section 6, the voluntary membership section of the ECA, states:

> Nothing in any contract or in any other arrangement between persons shall require any person – (a) To become or remain a member of any employees organisation; or (b) To cease to be a member of any employees organisation; or (c) Not to become a member of any employees organisation.

Inasmuch as before the ECA all covered workers were forced to be members, there was never any provision in New Zealand labour relations law for forcing non-members to pay dues. (The one exception up to 1987 was a worker who avoided union membership under a narrow 'conscientious objection' clause but had to pay the equivalent of union dues to the Department of Labour.) The ECA made no such provision. A too timid parliament might have enacted agency shops as a compromise with the unions, but the 1991 parliament had a clearer view of the principles of individual freedom and justice.

Mandatory good faith bargaining

The NLRA forces employers to bargain in good faith with certified unions on a long list of mandatory subjects of bargaining. Notwithstanding that the NLRA explicitly states that employers do not have to make concessions to unions in bargaining, case law has defined good faith bargaining as being willing to compromise. For example, in one case General Electric Co. was determined to be acting against the law when its representative presented the union with a take-it-or-leave-it offer. GE had polled its workers to discover what contract terms they wanted and then it offered those terms to the workers. The court admonished GE for dealing with its union through the workers rather than dealing with its workers through the union, and forced GE to cease and desist from take-it-or-leave-it bargaining.

This is is a very good example of the apartheid of labour relations law in the United States. In every other area of the law, in order for contacts to be valid they must have been entered into freely by all of the parties involved. Parties must not be forced to bargain; they must choose to bargain. Contracts that are the result of coerced bargaining are not enforceable. But in labour relations law *all* collective bargaining contracts are coerced and enforceable. Congress has not dared even to make timid changes in this area.

There was forced good faith bargaining in New Zealand under the Labour Relations Act 1987, but the 1991 parliament was bold enough to abolish this injustice completely. Sections 19 - 20 of the ECA make it clear that parliament intended to permit, not coerce, collective bargaining. 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 (NZ) Ltd* [1992], first the Employment Court and then 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. However, more recent decisions have indicated that at least the Employment Court is moving in the direction of trying to resurrect mandatory good faith bargaining. For example, in *NZ Medical Laboratory Workers Union v Capital Coast Health Ltd* [1994], the Employment Court found a breach of the mutual duty to bargain "in good faith". The Court of Appeal later reversed the Employment Court in this case.

Some deficiencies of the ECA

As Penelope J Brook has said, the ECA is "an incomplete revolution". In my view there are three deficiencies that should be remedied: (i) incomplete freedom of association; (ii) the composition and jurisdiction of the Employment Court; and (iii) mandated unjustifiable dismissal employment contracts.

Incomplete freedom of association

Section 7 of the ECA states that:

> Nothing in any contract or in any other arrangement between persons shall confer on any person, by reason of that person's membership or non-membership of any employees organisation – (a) Any preference in obtaining or retaining employment; or (b) Any preference in relation to terms or conditions of employment (including conditions relating to redundancy) or fringe benefits or opportunities for training, promotion, or transfer.

Superficially, this may seem to be a reasonable non-discrimination rule, but it makes union-free and union-only employments illegal. In this respect the ECA mimics the American NLRA.

Section 6 of the ECA correctly makes membership in all employee organisations voluntary. So long as voluntary membership is assured, there is no reason to prevent an employer from agreeing with a union to hire only union members. Similarly, there is no reason to prevent an employer from hiring only non-unýon workers. In both cases it is a question of freedom of contract.

Suppose I own an apartment building with a large garden. Under the principle of freedom of contract I may enter into an agreement with a firm that sells gardening services that, for the life of the contract, I will buy my gardening services exclusively from that firm. A union can be correctly thought of as a firm that sells the labour services of its voluntary members. Why should an employer be forbidden to enter into a contract with a union (firm) by which the employer will, for the life of the contract, purchase labour services exclusively from that union? If it is all right for me, as an owner of an apartment building, to enter into an exclusive purchase contract with a gardenýng firm, it must also be all right for me, as an employer, to enter an exclusive labour purchase contract with a union.

Similarly, when an employer chooses to operate on a union-free basis he or she merely tells the job applicants that employment contracts will be made only with individual workers who are willing to abstain from union membership and activities for the duration of the contract. That is exactly the same as telling job applicants that individual employment contracts include a stipulation that each worker will get, say, two weeks of paid vacation each year. As long as the prospective employees are free to accept or reject the employer's offer and make counter offers, there is no reason to proscribe either type of employer offer. If the employer and a prospective employee come to mutually agreeable terms, they have a contract. If they don't agree, they don't have a contract. That is what freedom of contract is all about.

Incidentally, it is not just employers who may want to operate on a union-free basis. In America in the early twentieth century there were many examples of employees

requesting that their employers have employment contracts that prohibited union membership. These employees sought protection from union organisýng activities.

Specialist v generalist courts

Parts I and II of the ECA were written by parliament in order to deregulate the labour market so that it would once again be governed by the common law of property, contract and tort. The twentieth century is a long, sad story of attempts by governments all over the Western world to set labour markets apart from standard rules of law and economics. For example, in 1914 the US Congress enacted the Clayton Antitrust Act, section 6 of which proclaims, "That the labour of a human being is not a commodity or article of commerce". With no more excuse than that lame proclamation, the authors of the Act proceeded to exempt unions from all antitrust laws. Of course human labour is a commodity or article of commerce. Humans themselves are not, but the labour services they perform using their mental and physical capacities most certainly are. There are sellers of labour services (workers and would-be workers), and there are buyers of labour services (employers and would-be employers). Correspondingly, there is a supply, a demand and a price (wage or salary) for every kind of labour. ln short there is a labour market for every kind of labour service. And those labour markets are no different from markets for cars, apples, computers, furniture, etc. Ordinary economic analysis applies to every market. Ordinary common law of property, contract and tort ought to apply to every market.

The ECA is the biggest step taken by any country toward legal equality for labour relations, but that step is in danger of being at least partially nullified by the consequences of Part VI of the Act which gives the main responsibility for interpretation and enforcement to a specialist court, the Employment Court. If labour relations law is supposed to be just like ordinary law, why did parliament take labour relations away from the jurisdiction of ordinary courts and give it to a court that is a direct descendant of the Labour Court under the Labour Relations Act 1987? Under section 188 of the Act the personnel of the Labour Court became the initial personnel of the Employment Court. With one exception, they still are. This was a huge mistake, for those judges were already dedicated to treating labour relations in a unique way. They were perhaps the least well qualified to launch a new era of legal equality for labour relations.

In a forthcoming paper written for the New Zealand Business Roundtable, Bernard Robertson explains the problem in these words:

> Specialist Courts are created when some interest group does not believe that equal application of the laws by judges applying the traditional canons of statutory interpretation and the traditional values of the common law will result in decisions that pursue their own ideology and interests.

When a matter is removed from the jurisdiction of an ordinary court it becomes political. Indeed, that is often why a specialist court is set up. An interest group doesn't like the way ordinary courts decide all issues. It employs a politician to lead an attempt in the legislature to get the issue out of the hands of 'old fashioned' judges and into the hands of 'progressive' specialists. In other words the specialist judges are

often selected on the basis of the likelihood that they will carry out the political intentions of the politicians that created the specialist court. Under the ECA, the holdovers from the Labour Court on the Employment Court have tenure until age 72. Thus although a new philosophy is regnant, the dead hand of 'progressive' specialists will be felt for some time to come.

The wrongs of unjustifiable dismissal

Now we come to what I consider the most serious fault of the ECA. Section 26(a) states that all employment contracts must ýnclude 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. Actually, in this regard the ECA makes matters worse than they were under the Labour Relations Act of 1987. Prior to 1991 it was still possible for individual, non-union workers to be employed on an at-will basis. The original version of the ECA imposed the unjustifiable dismýssal doctrine only on collective contracts. In the version that became law, unjustifiable dismissal was imposed on *all* employment contracts.

- The at-will doctrine and its exceptions

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 has been in effect since the 1840s. It was not unusual for actual employment contracts to have a notice provision for one to four weeks, but no law mandated such a provision. During the 1960s in the United States the at-will doctrine was modified by Title VII of the Civil Rights Act of 1964 which barred employers from dismissing employees on the basis of race, religion and gender. Employees, however, were still free to quit their jobs for any reason at all or for no reason. They still are.

The civil rights exceptions to at-will employment proved to be the camel's nose under the tent. Beginning in the late 1970s and continuing strongly through the 1980s, state courts began to impose other exceptions to the at-will doctrine. These exceptions fell into three categories: (i) public policy; (ii) implied contracts; and (iii) a covenant of good faith and fair dealing.

The public policy exception (with which I don't disagree) says that an employee cannot be dismissed for refusing to violate a statute or for exercising a right that is guaranteed by statute. For example, in those states where courts have declared this exception, an employee cannot be fired for serving on a jury or for refusing to falsify records.

The implied contract exception has been imposed by courts whose judges find that, although there is no explicit contractual agreement between an employee and an employer that spells out exceptions to the standard at-will contract, such exceptions

are implied by statements in employee manuals, as well as oral and written statements by supervisors to the effect that if employees keep up their good work they will have a safe job. There have been instances of judges finding that a compliment to an employee by a supervisor implies an employment contract that says dismissal can only be for good cause.

The implied covenant of good faith and fair dealing is the most open-ended of all. This is lawyer-talk which permits a judge to impose just about any substantive and procedural requirements he or she wishes on just about any employment relationship. What's worse, sometimes allegations of breach of good faith and fair dealing are heard in tort rather than contract. The remedy in contract is the award of economic compensatory damages. Remedies in tort also include compensation for subjective harms (e.g. hurt feelings) and explicit punitive damages.

- **Costs and consequences**

Clearly, the intent of Parts I and II of the ECA is to ensure that all employment contracts are voluntary exchange contracts. All parties are free to choose whether to employ representatives and, if so, what kind of representatives. All parties are free to choose whether to bargain with any other person or group or their representatives. And all parties are free to choose whether or not to affiliate with a union. If it were not for sections 26(a), 27(a) and 147 of the ECA, all parties would be free to choose whether to bargain with others over the at-will versus unjustifiable dismissal issue. Some employers may be willing to afford unjustifiable dismissal protections to employees in order, for example, to get those employees to be willing to acquire firm-specific skills. Some employees may be willing to forgo the job security of unjustifiable dismissal in exchange for higher pay or other perquisites. In a voluntary exchange setting there would be a wide variety of job security arrangements in employment contracts - some with a lot, some with none. Whatever is mutually acceptable to the contracting parties would emerge. This is just another illustration of the fertility of freedom.

Under the at-will employment doctrine, employers had absolute flexibility over the quantity, skill-composition and deployment of employees. Employers could compliment employees without worrying that doing so granted the employee a property right to a job. Employers could write employee manuals that explained employee responsibilities without fear that an employee who went by the book, but who did not fit into planned changes in technology, location, product-mix and marketing strategies, could not be replaced by someone who did. Employers were willing to hire high-risk employees - e.g. young, inexperienced, or unskilled people who had bad luck at other jobs, and people who needed retraining to re-enter the labour force. This gave these high-risk employees opportunities to improve their skills and to prove their abilities.

Under the unjustifiable dismissal doctrine, every person becomes next to impossible to fire without going through the costs and perils of litigation. Thus, employers are going to be slow to hire when they want to expand and slow to fire when they want to contract. They will not be able to manage their work forces efficiently. Some prospective entrepreneurs, seeing the litigation and liability perils of hiring, firing, laying off, promoting, demoting, deploying and redeploying workers, may simply opt

not to go into business; or, if they are already in, they may decide not to expand. Existing employers will increasingly rely on independent contractors, temps, and part-time workers. In brief, from an employer's perspective unjustifiable dismissal restrictions amount to a tax on the hiring of labour.

Supply and demand analysis of the labour market reveals that workers will, through lower wages and loss of employment opportunities, bear some portion of any unjustifiable dismissal tax imposed on employers. Moreover, workers will tend to bear more of the unjustifiable dismissal tax when demand elasticity is large and when supply elasticity is small than they would with small demand elasticities and large supply elasticities. Who are the workers whose labour demand elasticities are large? Precisely those whom it is easiest to replace with technology - the least skilled, least experienced, least able workers. Who are the workers whose labour supply elasticities are small? Precisely those who have very few employment alternatives - the least skilled, least experienced, least able workers. The unjustifiable dismissal tax discriminates against such workers. As a result, in addition to lowering wages and reducing employment, unjustifiable dismissal makes the distribution of income less equal than it would otherwise be.

In conclusion

While its strengths far outweigh its weaknesses, the ECA can be improved. In keeping with the freedom of contract spirit of the ECA, both union-free and union-only employment, based on voluntary bargaining, ought to be permitted. The Employment Court should be abolished and jurisdiction over employment contracts should be placed where jurisdiction over other contracts is placed - in the High Court. Finally, unjustifiable dismissal also ought to be a matter settled by freedom of contract. If individual employees and employers agree to include unjustifiable dismissal clauses in their contracts, so be it. Similarly, if they agree on employment at-will, so be it. While the common law presumption is that, in the absence of an explicit agreement to the contrary, employment is at-will, perhaps it would be wise for all employment contracts to address the issue explicitly. If exceptions to at-will are recognised in an employment contract, the exceptions should be spelled out. Finally, courts should be forbidden to overrule these and any other terms of voluntary exchange employment contracts.