New Zealand's Employment Contracts Act: An Incomplete Revolution

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New Zealand's new Employment Contracts Act abolishes much of the apparatus of the old centralised wage-fixing system. ***Penelope Brook****, Senior Associate in the Investment Banking Division of CS First Boston NZ Limited, argues that although the Act represents substantial progress in labour market reform, it retains significant barriers to the realisation of the full benefits of a free contracting regime for employers and employees.*

New Zealand's new Employment Contracts Act came into force on 15 May 1991. It replaces the former Labour Relations Act of 1987, which had perpetuated a regime of labour law dating back to the Industrial Conciliation and Arbitration Act of 1894. This regime had translated the collectivism of the English Fabian Socialists into a rigid, adversarial and centralised system in which compulsory union membership and predominantly craft and occupational unions with exclusive rights of coverage made for a high degree of monopoly power in the labour market. It depended for its functioning and continuing rationale on undermining cooperation, limiting opportunity, and carefully balancing privileges defended by increasingly elaborate, obfuscating rhetoric. It could have been aptly described by Geoffrey Walker's commentary on current labour law in Australia:

> This is a region where the law is binding on the weak but not on the strong, where the law exalts rather than discourages conflict and confrontation, where the decision of a tribunal does not settle a dispute but merely provides something else to dispute about, where the person most affected by the decision has no necessary right to be heard and where freedom under the law is treated almost as a superstition. (Walker, 1989)

The Employment Contracts Act makes a substantial but incomplete break from this regime. It replaces a system based on a view of employment relationships as inherently adversarial and exploitative with a system based on the view that employment relationships are a matter of mutual benefit to employers and workers, and are for this reason fundamentally cooperative. The most notable effect of this change is the rejection of extensive statutory protection of union rights and privileges aimed at making unions strong enough to counter the alleged 'bargaining power' of employers, in favour of a model that concentrates on the contract between employers and employees, with the role of unions in the contracting process left to the discretion of employees.

In this article I assess how successfully the new Act creates a sound and sustainable basis for free association and contracting in the labour market. I sketch the appropriate objectives for a labour market reform policy, and evaluate the Employment Contracts Act in the light of these criteria. I then discuss the extent of change necessary to tackle some of the key deficiencies of the Act. My concluding remarks include comments on the relevance of the New Zealand experience for the debate on labour market reform in Australia.

The Appropriate Objectives of a Labour Law Reform Process

General agreement is likely about the sorts of results that we would want from employment relationships: at a macro level, high and improving incomes and high employment; and, at a micro level, harmonious work relationships, a sense of fairness, and self-esteem on the part of workers. The focus of debate is rather the sort of law that will achieve these ends.

For the last 95 years, the dominant Australasian approach has been to mandate bargaining arrangements and contractual terms that conform to some centralised notion of what is desirable. This has presented considerable practical problems, rooted in the sheer inability of highly centralised bargaining and condition-setting to garner and mobilise dispersed information about workers' and companies' needs, preferences and circumstances, and in the vulnerability of centralised, politicised systems to rent-seeking abuses. A 'negative' approach to labour market reform would therefore seek to remove the structures that have deprived the parties to employment relationships of the power to determine those relationships: that is, to eliminate:

- statutory protection, or mandating, of particular bargaining structures and processes (such as provisions facilitating compulsory unionism, union registration provisions, blanket coverage provisions, and restrictions on minimum union size);
- government intervention to set minimum wages and other work conditions (such as comparable worth legislation, and provisions on hours and holidays); and

- activism on the part of the courts to similar ends (such as activist interpretations of the law on dismissals and redundancies).

From a 'positive' perspective, the concern will be to develop a legal regime that facilitates contracts of mutual advantage to the workers and employers who enter into them, by protecting self-ownership, avoiding legal barriers to entry in labour markets, and ensuring that freely negotiated contracts can be enforced. Here the well-being of workers is promoted by the maximisation of the opportunities available to them through relatively unfettered labour markets. Their protection rests not on mandated minima and representation 'rights', but rather on:

- competition between employers for workers (and between workers for jobs);
- freedom of choice with regard to any collective bargaining arrangements;
- the protections of the common law (including contract-law constraints on the use of duress, fraud or misrepresentation, or advantage being taken of incompetence; and tort-law constraints on induced breaches of contract); and
- antitrust or trade-practices constraints on the exploitative use of genuine market power.

Questions may be raised as to why, if the crucial legal protections for free and productive contracting are to be found in the common law, any special labour statute is needed. For New Zealand, with its history of extensive and intensive intervention in employment relationships, the answer is twofold. First, an explicit but simple statute, enunciating the applicability of basic contract and tort law to employment contracts, can give employers and workers a clear guide to the new basis for their relationships with one other. Second, a statute that explicitly places employment contracts in this domain and denies the relevance of precedents built up under the interventionist labour legislation of the last 95 years will limit the ability of the courts to perpetuate some of the excesses of the previous regime.

How the Employment Contracts Act Measures Up

The new Act is largely designed to enable free contracting between employers and employees, and freedom of association by workers in collective associations. It is intended to 'promote an efficient labour market' through freedom of association and freedom of choice as to the negotiation and application of employment contracts.

The progress made by the Act is perhaps most evident in the institutions it abolishes. Previous provisions for compulsory union membership, union registration and blanket coverage provisions and minimum union size rules are all eliminated. Awards and agreements disappear and are replaced with employment contracts; and the determination of redundancy provisions becomes the prerogative of the parties affected by them. Workers are freed to choose to negotiate for themselves or to use the services of any bargaining agent. Strikes and lockouts are made unlawful during the term of any collective contract, as well as over issues relating to freedom of association, personal grievances and disputes over the interpretation, application or operation of employment contracts.

The results can be expected to be particularly salutary for those workers who have, in the past, been either poorly represented by their unions or excluded from the workforce altogether (disproportionately, women, ethnic minorities, regional workers and the low-skilled).

In the light of such progress, it may seem churlish to point to the new legislation's defects. These defects are, however, all the more noticeable given how much the Act gets right. They also present potentially significant barriers to the realisation of the full benefits of a free contracting regime for workers and employers. Further, for others looking to the New Zealand legislation as a model for reform, they provide some warning of the dangers of a reform process that is not at all its stages based on a clear understanding of the strengths of, and legal prerequisites for, freedom of contract in the labour market.

All the 'defects' discussed here constrain freedom of contract in a manner intended to afford workers with protections against the dangers of full exposure to the market, but with the real effect of restricting opportunities. They include:

- a definition of freedom of association that effectively proscribes union and non-union shops;
- the mandatory inclusion of minimum personal-grievance and dispute-resolution procedures in all contracts, both individual and collective;
- an excessively complex (and in some ways heavy-handed) approach to strikes;
- the retention of specialist institutions;
- the retention of laws instituting minimum wages and other conditions of employment; and
- continued differentiation of the regimes for state and private sector employment.

Freedom of Association

The Act places primary emphasis not on freedom of contract as such, but rather on freedom of association (although a substantial degree of freedom of contract can be inferred from a number of the Act's provisions). Freedom of association is so defined as to preclude employers from either requiring or forbidding membership of an employees' association as a condition of employment contracts or exerting 'undue influence' on employees with regard to membership of such organisations. In other words, the Act proscribes both union shops and non-union shops.

At issue here is how employees' freedom to asso-

ciate as they find beneficial, and employees' and employers' freedom to enter those contracts (and only those contracts) that they think will be beneficial, can be made to work together. As an example of the sort of problem that could arise, consider the situation of an employer who believes it would be in the interest of the shareholders in his or her company for all employees to be retained on individually-negotiated contracts, without the involvement of any bargaining agent or employee organisation. This could prove difficult, if not impossible, under the present Act. So, too, could the realisation of an employer's preference that, say, all of his or her employees be covered by a company union. In effect, the so-called 'freedom of association' provisions are sufficiently strong to cut across the freedom of employers to decide what kinds of workers they wish to employ.

As for the use of 'duress' to achieve either a union or a non-union shop, the operative notion is that of 'economic duress'. In contrast, duress of the kind with which the common law of contract has traditionally been concerned, and which should ideally be the focus of labour legislation, occurs where one party to a contract is compelled by the other to make a choice between two things that the first party owns. (The classic example is the footpad demanding: 'your money or your life!'.) What the Act does, instead, is attach to freedom of association a 'right' to be employed not in general, but by a particular employer, regardless of that employer's preferences about the affiliations of his or her workers. In other words, it confers on workers a 'right' to be employed wherever they choose — for any worker to compel any employer to employ him or her on the worker's terms — without conferring on employers (on behalf of their shareholders) a corresponding 'right' or freedom to employ whomsoever they choose.

Put this way, it becomes clear that, even if there were very few, if any, situations in which employers and employees would together elect to work within a union or a non-union shop, rather greater issues are at stake in the denial of this freedom. If employers are deemed unable to place constraints or requirements on union membership in the contracts that they offer workers, it is a small step to similarly constrain any other contractual term, so that the whole principle of freedom of contract is placed in question.

Mandatory Personal Grievance and Disputes Provisions

In its first incarnation the Employment Contracts Bill by and large upheld the principle of freedom of contract in the case of individual contracts, while specifying what were effectively minimum personal grievance and disputes provisions for collective contracts. In the Act as finally implemented, these provisions were tightened and extended to all contracts, at the same time as the Act's overall coverage provisions were tightened to prevent contracting out of its jurisdiction. The result is that the large proportion of the workforce (probably over half) who were previously not covered by union-negotiated awards and agreements now face new restrictions on the conduct of their relationships with one other. The intention, presumably, was to extend a perceived protection to all workers. It is a 'protection', however, that is likely to come at some cost.

In the case of the mandated personal grievance provisions, a key element is the effective abolition of 'at-will' contracts, that is, of the common-law rule that, unless the parties to an employment contract decide otherwise, either will be able to terminate the relationship at will (for a detailed exposition of the value of the 'at-will' rule, see Epstein, 1984). Instead, the Act institutes for **all** contracts the notion that any dismissal may be tested for its 'justness' and that, in the event that it is found to be 'unjust', compensation can be ordered not only for lost income but also for hurt feelings, humiliation and the like. (The common law *Rule in Addis*, which has for some decades precluded compensation for hurt feelings and humiliation in unjust dismissal cases, is thereby overturned.)

The focus on freedom of contract in the New Zealand debate is at odds with the concern with facilitating enterprise bargaining that has dominated the labour market reform debate in Australia.

Mandating a degree of decentralisation from occupational or industrial awards to enterprise agreements does not, in itself, remove the tyranny of legislation over employers and workers alike.

The general point to be made with regard to both the personal grievance and disputes provisions is that workers and employers involved in long-term relationships with each other have strong incentives to think about how they will handle matters if their relationship goes bad. The more heavily they have invested in a relationship, or the more scarce the opportunities and skills involved are, the more likely it is that they will agree, for example, on some form of personal griev-

ance procedure of their own. On the other hand, there will be situations in which the best protection for the worker and the employer involved will be the freedom to break off the relationship and look elsewhere for contractual partners. A contract providing a formal grievance procedure has no *a priori* moral or economic advantage over a contract in which an employer may fire, and a worker quit, 'at will', or over any intermediate option. Instead, the desirability of any particular option will depend on the circumstances and preferences of the parties involved.

This issue has often been muddied by the fact that, while it is generally accepted that in the absence of contractual provisions to the contrary an employee may leave at will, and without his or her employer contesting the reasons, there is an unwillingness to allow a corresponding freedom to employers. The costs of arbitrarily limiting this freedom can, however, be considerable. Making termination of a contract unnecessarily difficult or costly increases the costs of employing workers in the first place, and so reduces overall employment (a point that is borne out by evidence across OECD countries). These costs are borne disproportionately by inexperienced workers and workers who do not conform to traditional stereotypes for their occupation, as employers will be less willing to employ 'unknown quantities' if it is difficult to terminate relationships that do not work out.

Strikes

An effective response to contractual breaches can be embraced by two principles:

- that parties to a contract are free to include in that contract provisions for labour or employment to be withdrawn under certain agreed eventualities; and
- that breach of a promise to perform or provide work is a breach of contract, and an action that interferes with the freedom of other parties to fulfil their contractual obligations is a tortious act.

The first principle means that employers and workers are free to include 'rights' to withdraw labour or employment in their contracts, which can then be activated without the contract being breached. Such provisions may well be rare, but they should not be precluded as a means of dealing with disagreements. The second means that where a contract is breached, or a breach is induced by a third party, there is ready access to the courts.

In contrast, the Act includes strike and lockout provisions premised on constrained 'rights' to strike and lockout on the part of workers and employers respectively. It attempts to distinguish legal from illegal 'strikes' and 'lockouts' according to whether or not they fall within the term of a collective agreement and according to the issue that generates the action. It also imposes differential restrictions on strike action in what are deemed to be 'essential' industries, and defines withdrawals of labour in the context of concerns about safety (which under common law would ordinarily not constitute contractual breaches) as legal 'strikes'.

While the likely costs of this approach are difficult to quantify, their sources can be identified. First, there are likely to be higher costs to defining the legality of and dealing with strike action. Second, there are likely to be less tangible, but nonetheless important, costs stemming from a continuing perception of employment contracts as somehow different from other commercial contracts, in that they are modified by *a priori* 'rights' with regard to contractual breaches.

Specialist Institutions

Rather than placing legal disputes relating to employment contracts in the jurisdiction of the civil court system, the Act constitutes a new Employment Tribunal (responsible for adjudication and mediation) and Employment Court (which replaces the former Labour Court). The maintenance of separate institutions with jurisdiction over employment contracts creates a strong risk that a legal culture based around the former legislation will be retained, at the expense of the principled implementation of the new legislation. This risk is increased by the provision in the Act for the personnel from the Labour Court, who had proved particularly adept at innovative interpretations of dismissal and redundancy law, to be transferred directly to the Employment Court.

Minimum Conditions

While the Act effectively removes the previous power of registered unions to establish minimum wages and conditions across the occupations they covered, it leaves intact a body of minimum-wage law, occupational-safety law, and law on hours, holiday provisions, parental leave and the like. In this sense, freedom of contract as promoted by the Act remains constrained by a binding floor on employment costs, and workers and employers remain to some extent constrained in their ability to depart from traditional norms for hours, leave arrangements and the like.

The retention of this body of law has potentially serious implications for the ability of the new legislation to generate increases in employment. The minimum wage in particular has in recent years sat at around 50 per cent of the average wage, which is high by both historical and international standards, and is likely to constitute a real barrier to the employment of the unskilled and workers in relatively depressed regions.

State Sector Employment

Before the passage of the Act, the innovations in state sector employment legislation had facilitated a degree of decentralisation and flexibility in contract negotiation that compared favourably with what could be achieved under the Labour Relations Act. The Employ-

ment Contracts Act reverses this situation, leaving some state sector employees subject, for example, to bureaucratic wage-fixing regimes, and retaining a role for the State Services Commission in shaping employment contracts. The latter role is also increasingly inconsistent with evolving authority and accountability structures within government departments, and with the extensive scope for competition between state and private sector employers for workers.

The Scope for Further Reform

The Labour Relations Act that preceded the Employment Contracts Act was essentially a centralist-collectivist response to preoccupations with perceived inequalities of bargaining power and inevitable conflict in employment relations. The central emphasis in the previous regime on establishing strong, state-protected unions with which to counter the power of inherently exploitative employers meant that no amount of streamlining could produce legislation capable of supporting freely negotiated, cooperative employment contracts. (Indeed, the Labour Relations Act itself was the product of tentative, and largely unprincipled, streamlining.) Instead, a revolutionary approach to legislative reform was required.

In contrast, the criticisms raised in this article could be satisfactorily addressed within the general framework now provided by the Employment Contracts Act; each may be seen as a matter of detail (if, in some cases, particularly significant detail).

Key elements in such a process would include rewriting (or simply deleting) the freedom of association provisions, deleting the personal grievance and disputes provisions, replacing the strike and lockout provisions with a simple enunciation of the applicability of tort law, replacing the provision for a specialist Employment Court with a statement of the jurisdiction of the civil courts over employment contracts, and extending the full jurisdiction of the Act to state sector employees. Complementary moves would involve the repeal of the minimum-wage law and other laws establishing minimum conditions, and amendment of the Commerce Act to extend the coverage of antitrust law to the labour market. None of these moves would be at odds with the central emphasis of the Act on facilitating employer and worker autonomy in negotiating the terms of their relationships with one other.

The resulting legislation would be relatively brief. Indeed, a number of organisations that attempted to draft 'ideal' freedom of contract legislation during the debate on the Employment Contracts Bill found it possible to do so in only a few pages. Such brevity and simplicity has its own attractions; a law that is clear and simple is far more accessible to the average worker and employer than the monolithic statutes that have become the norm in labour law in Australia and New Zealand.

Concluding Comments

The New Zealand reform affords some important lessons about the general preconditions necessary for a successful outcome. It also provides some potentially useful insights into the labour market reform that has been conducted in Australia in recent years.

Perhaps the main lesson to be learned from the New Zealand reforms is that it is possible to argue successfully from first principles, rejecting compromises that may appear 'politically' or tactically expedient. Both the advocates of reform and some of the politicians actually involved in the reform process exhibited a willingness to think through the basic questions of what employment relationships are actually about, and what sort of law might best promote their benefits and moderate their abuses. It is notable that the Act falls short in areas where arguments about the 'true' basis of bargaining power, and the nature and strengths of freedom of contract, appear to have been poorly understood by those with ultimate responsibility for its drafting. What seems to have happened, in particular, is that the general advantages of freedom of contract have been accepted, but the potency of free contracting as a protection for the very weakest of workers has not been so well understood.

The focus on freedom of contract in the New Zealand debate is at odds with the concern with facilitating enterprise bargaining that has dominated the labour market reform debate in Australia. While it is likely that a regime based on freedom of contract will produce a relatively high proportion of enterprise and workplace arrangements (if of varying formality), there is no guarantee that these arrangements would be best for, and chosen by, all workers and employers. In some cases, both will see greater benefits in individualised arrangements. In others, broader occupational or industry arrangements could conceivably remain the best way of at once meeting employers' and workers' preferences and minimising their contracting costs. Mandating a degree of decentralisation from occupational or industrial awards to enterprise agreements does not, in itself, remove the tyranny of legislation over employers and workers alike. A more fundamental focus on making freedom of contract work is not only more principled than a focus on enterprise bargaining; it also makes more practical sense.

References

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